Northern Trust

DAILY ECONOMIC COMMENTARY

Setting Up for Jackson Hole

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I was once favored with an invitation to the Federal Reserve's annual retreat in Jackson Hole, Wyoming. It was an amazing experience; the participant list was a Who's Who of global economic policy makers. I called my mother to brag, but all she wanted to talk about was the mischief that she and my father had gotten into while honeymooning in the area some fifty years earlier. Too much information.

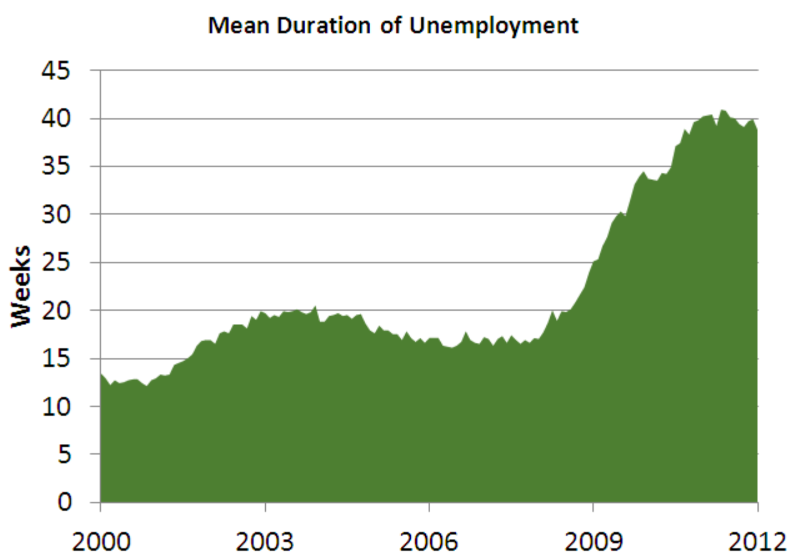
It was the late summer of 2007, and the conference centered on the developing trouble in the housing market. Chairman Bernanke took to the podium and gave a speech which acknowledged the contagion which was spreading from housing finance to other markets, and described the impact of this advancing duress on economic activity. Two weeks later, the FOMC cut the target Federal funds rate by 50 basis points as it began its effort to combat a growing crisis.

Comments offered at Jackson Hole often presage monetary policy. So the anticipation is building for this year's edition, which begins a week from Friday. The Chairman's observations will be offered five years to the day after that pivotal 2007 address.

Over the past week, we've gotten a preview of issues which may find their way into Mr. Bernanke's prepared text. Among the most prominent is the degree to which our lingering high level of unemployment is due to structural factors or cyclical factors.

Structural factors generally refer to a mismatch of skills between jobs lost and jobs available. An example in the current landscape would be licensed carpenters, facing an extended correction in construction, who would need extensive retraining to change fields. Some see evidence of structural unemployment in the very long average duration of unemployment:

Chart 1



If, in fact, a large fraction of current joblessness is structural, then the pool of hirable labor is smaller and the slack in the labor market is lower than the unemployment rate might suggest. This, in turn, would imply that we are closer to expanding at full potential, and that pushing for faster growth risks inflation.

By contrast, a view that unemployment is largely a product of weak economic activity (cyclical) would suggest that inflation risk is not a major concern and that pushing for faster growth is needed to address the elevated rate of joblessness.

You can see the reflection of this debate in the minutes from the last FOMC meeting. "A number of participants expressed the view that structural changes in the labor market were not sufficient to explain the high level of unemployment," while "another participant" advanced the notion of skills mismatches creating a lot of structural unemployment. The text seems to suggest a plurality of voters favoring the cyclical interpretation.

Over the past week, speeches and research from the Federal Reserve have touched on this topic. A paper from the Federal Reserve Bank of New York suggests that structural unemployment is limited, while Atlanta Fed President Lockhart questioned why such large apparent resource slack hasn't placed more downward pressure on inflation. The lines between the two camps are being clearly drawn.

While the FOMC did not approve QE III in August, the minutes reflect a membership very open to that possibility. (The discussion seemed somewhat more negative on the possibility of cutting the interest rate on excess reserves, or IOER.)

Acting on this orientation will very much depend on the data to be received between now and the FOMC meeting on September 12, chief among them the employment report for August. But Chairman Bernanke's analysis of the current situation in his Jackson Hole address may also be very influential. And so while it is not easy to focus on economic presentations amid such breathtaking surroundings, those assembled (and those following at some distance) will be hanging on every word.

July Existing Homes Sales – Small Positive Developments

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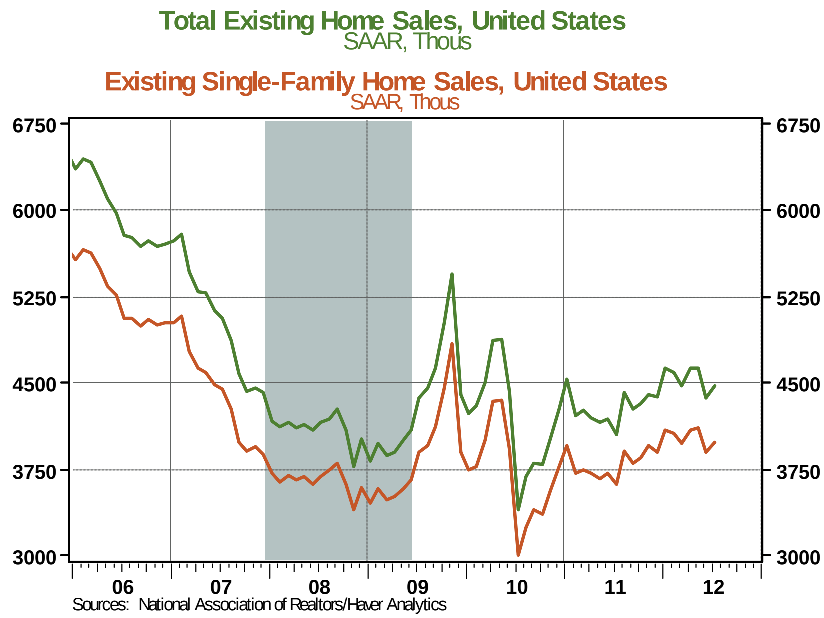
Sales of all existing homes increased 2.2% to an annual rate of 4.47 million homes in July. The small gain is noteworthy given that it follows a 5.4% drop in June and a steady reading in May. But, the level is still short of the high seen in January 2012 (4.63 million homes). Purchases of single-family homes advanced 2.1% to annual rate of 3.98 million homes.

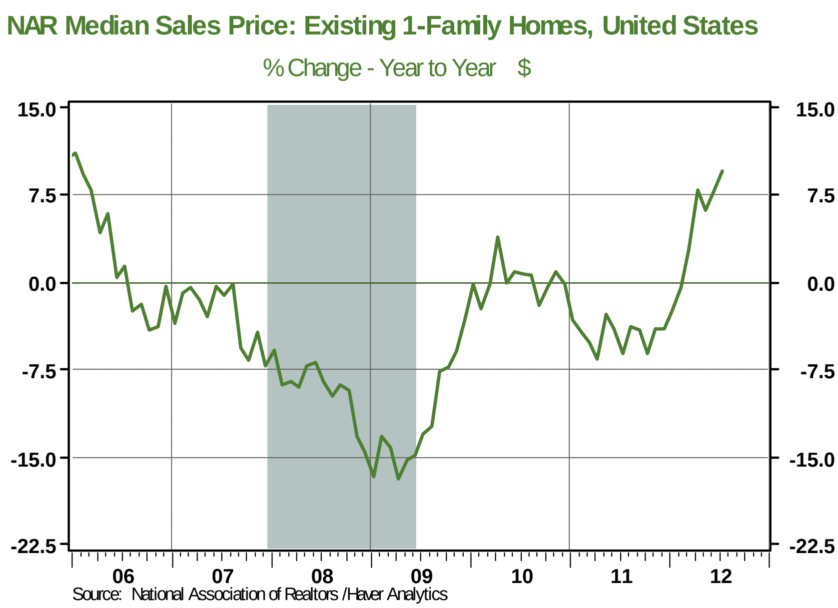
Regionally, sales of existing homes advanced in the Northeast, Midwest, and South but were unchanged in the West. The current level of existing single-family home sales reflects a 17.4% increase from the low seen in November 2008 (3.39 million), with the large part of the increase recorded in the past year. To this extent, there is an improvement in sales of existing single-family homes.

Chart 2



The median price of an existing single-family home increased 9.6% from a year ago to $188,100 (down a tad from the prior month's quote of $189,600). This is the fifth consecutive monthly increase of the median price of an existing single-family; a similar event was last seen in 2006.

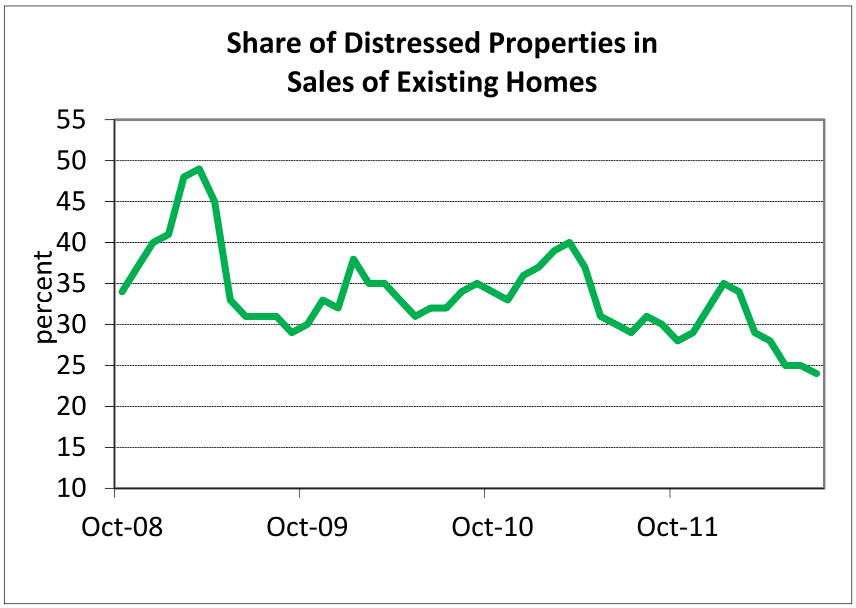
Chart 3



Inventories of unsold existing homes fell to a 6.1-month supply mark in July, the lowest since the crisis commenced.

According to the National Association of Realtors, distressed properties (foreclosures and short sales) made up 24% of sales of existing homes in July, down from 25% in the May-June period and 29% in July 2011. It is also important to note that the July mark is the lowest since October 2008.

Chart 4



Pulling all the highlights of the July existing homes sales data together, it is reasonable to conclude that the housing sector is mending and moving ahead in the desired direction, although the numbers are not robust yet. Given the low mortgage rate environment, less stringent mortgage underwriting standards and a more robust pace of hiring are factors that could give an additional lift to homes sales.