



Top Of the Business Cycle

April 12, 2005

A variety of factors indicate that today is the top of this business cycle.

First, oil prices are very high, and they are predicted to remain at or above \$45 per barrel for the balance of this year. As a result, gasoline prices are probably going to remain over \$2 per gallon this year. These high oil prices are the equivalent of a 1 percent tax on gross domestic product. They are damaging the ability of consumers to support the economy, and consumer demand represents approximately two-thirds of GDP growth. Without growing consumer demand, the economy will slow substantially. In addition, high oil prices are crimping business profits and denting the desire of businesses to hire more labor. This is part of the reason why the March jobs report was so disappointing. With high oil prices I am afraid the April report will also be weaker than expected.

Second, the federal reserve has embarked on a tightening program, promising to raise rates at each meeting until the federal funds rate reaches at least 4.5 percent. We are now at a funds rate of 2.75 percent, so we have a long way to go. With the promise of higher short-term rates, the ten-year bond rate has finally started to move upward as well. This is important for the overall outlook and is particularly important for central Florida's economy. Mortgage rates are priced off the ten-year Treasury bond rate. With a higher bond rate, mortgage rates have also begun to move higher. The average fixed rate thirty-year mortgage is now about 6 percent, up substantially from its lows. I expect that fixed rate thirty-year mortgages will be priced at 7 percent or higher by this time next year. Higher interest rates will spell slower housing sales across the U.S. and slower population growth across Florida.

Third, housing markets are at speculative highs today in Florida and even here in central Florida. Investors have placed large bets that real estate prices and demand will continue to increase from today's inflated levels. With rising interest rates and a slowing national economy, this is not likely to happen. When investor

expectations are not met, there will be substantial losses and reduced demand. The resulting readjustment will not be smooth.

It is just these three factors that were prominent in the last recession, except that instead of over speculation in the stock market today we have over speculation in residential real estate. Unfortunately then, as now, the results will be a much weaker economy going forward.

This is Hank Fishkind for 90.7 FM, WMFE News.

<http://www.fishkind.com>