

Frozen in Time?

For some reason, I enjoy the look of cars and trucks from the 1950s. Styles varied among makes. No one confused a Ford with a Chevy or a Dodge with a Studebaker.

Fidel Castro was in the news the other day. It is hard to believe that it has been 50 years since his communist coup in Cuba. As I read the article I was struck by the age of the vehicles in the accompanying photos. All of the cars and trucks were from the 1950s, yet the photos were taken in 2009! It looked like things were frozen in time.

Speaking of frozen, the US economy is operating at unsustainably low levels, especially in auto sales and home building. According the Census Bureau, there are about 130 million homes in the US. Housing starts in December 2008 amounted to an annualized number of 550,000. Put in context, at the current pace of housing starts, it would take 236 years to replace all homes in the US.

Homes are normally built at a pace that would replace the existing inventory of houses every 75 years. Assuming we get back to the normal "replacement rate" of 75 years, then housing starts will have to go up to an annualized rate of 1.75 million. This represents a dramatic climb from the current 550,000 pace.

Why are housing starts so low? The answer in part rests with the enormous inventory that must be sold off. Until this happens, the current low pace of starts is exactly what must occur for the housing market to get back to normal. It is helpful to understand what "normal" should look like. We can then know when we get there and we can also understand how far we have to go.

Auto sales in December 2008 came in at an annualized rate of 10.3 million. Figures from the Federal Highway Administration show that about 240 million cars and light trucks travel US roads. So, at December's sales pace it would take 23.4 years to replace these cars and trucks. Normally, the replacement rate for auto sales is about 13 years. During the last big recession of 1981-82, the auto sales replacement rate rose to just 16.3 years. (Of course, the replacement rate for cars and trucks in Cuba is essentially zero since virtually no new vehicles have been sold there since the 1950s.)

What is the story behind these numbers? I do not believe the US economy will ever resemble Cuba. Although auto sales might not return to a replacement rate of 13 years, there is no doubt sales (and manufacturing) will increase. Housing, in turn, will also recover from its present lows. More building, more qualified buyers, more sales, more money flowing, etc.

The economy is destined to get better. This does not mean we are on the verge of an immediate boom. What the numbers do say however, is that we are already at, or very close to the economic bottom.

Spring is in the air, the weather is getting warmer and the economy is beginning to thaw. Now, if we could just get a nice Cuban cigar...

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