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PERSPECTIVE

New administration to steward over the next recession

By Jonathan Michaels

In a week's time we will have a new leader of the free world, and with it a new era of policy, diplomacy and economy will usher in. The last eight years have laid witness to certain economic growth, pulling our country from near-certain ruin to stable financial health. While the recovery may not have been as bristling as some would have preferred, we are far removed from the days of 10 percent unemployment and eye-popping foreclosures.

With a change in administration, a natural question arises about what type of economy our president will oversee. Seven years of straight economic growth should be worrisome to all, as recessions like to loom in the corner, repeating themselves with frightening regularity. From 1945 to 2008, periods of economic expansion have averaged some 57 months, putting our seven-year recovery squarely at the outer edges of a recessionary cycle.

Superficially, recessions are difficult to understand. As the population grows, so does the need for goods and services, which increases national output, or GDP. The increased economic activity causes businesses to employ more people, giving rise to increased household income. More money to spend only pushes the needle further into economic health, begging the question of why would it ever stop.

The trouble comes in when markets become oversaturated with goods and services, as profiteers rush to capitalize on the increased demand. Consumers can only buy so many new refrigerators, televisions and cars, and when the desire for consumption fills, demand falls. In an effort to remain profitable, employers begin to reduce salaries and lay off workers, and downward the economy begins to go.

It is no surprise then that there have been 49 recessions in our country's history, returning every few years with unwelcomed certainty. Academically, a recession is defined as two consecutive quarters of negative GDP. The National Bureau of Economic Research — the largest economic research team in the U.S., an organization formally charged with announcing the start of a recession — puts a finer point on the discussion. The NBER defines a recession as: "A significant decline in economic activity spread across the economy, lasting more than two quarters which is 6 months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."

The nation's GDP for the second quarter of 2016 was a stagnated 1.4 percent. While this is far from a negative growth rate, GDP has been on a general decline since mid-2014, when output stood at a high of 5 percent. While not necessarily indicative of what will happen this go-around, it is interesting to note that in the second quarter of 2008 GDP had fallen to 2 percent, before plummeting to negative 8.2 percent later that year.

Equally interesting is consumer behavior in the housing market. The Composite Home Price Index shows that single-family home prices have steadily increased since the end of the last recession, reaching 2005 price levels, and just a tick below the 2006 peak. What is concerning, however, is that the home ownership rate (the percentage of homes that are occupied by the owner) has fallen dramatically to 63 percent, the lowest since the Index began tracking the data in 1965. By way of comparison, in 2006 nearly 70 percent of all U.S. homes were owner-occupied.

Also relevant to the housing market discussion are new home mortgage applications, which were down 6.9 percent in October. Housing starts (the number of new residential construction projects started) also slowed considerably in the third quarter of the year. With housing prices at 2005 levels, and consumer home ownership at an all-time low, it would not be a surprise to see a cooling of the market — particularly when GDP is on the downturn. Stated another way, now is not the time to buy.

Perhaps the biggest worrier of them all is the Consumer Price Index, the price paid by consumers for a basket of goods and services. As of September 2016, the Index measured 241 points — the absolute highest since the start of the Index in 1950 — meaning that we are now paying more for goods and services than at any time since the end of the second World War.

The average price of a new car today is $33,560, an average that has risen year-over-year for generations. In 2016 dollars, a new car in 1980 — the year Ronald Regan took office — cost an average of $21,413, or about 35 percent less than today. Perhaps as a result of increased prices, consumers are holding on to their new car purchases for a record 11.5 years.

In 2009, U.S. auto sales plummeted to 10.4 million, down from 16.4 million in 2006. The industry has come roaring back, hitting a seasonally adjusted annual rate of 17.8 million units this year. Yet, indicators suggest that this number may also begin to cool. Many automakers have experienced a decrease in sales from 2015, leading to large built-up inventories. This year BMW is down 5.2 percent; Ford is down 8.1 percent.

Car dealership profitability appears to be echoing this trend. On average, dealership profitability is down 2.9 percent from the same time period in 2015, and with most dealers carrying higher than normal inventory levels, further profit erosion will likely occur. Decreased profitability is reflected in a slowing of dealership acquisitions. Public company acquisitions of domestic dealerships fell from $1.5 billion in 2014 to $775 million in 2015, a downward trend that continues into 2016. Blue sky multiples are down as well, meaning that dealerships are worth less today, and owners will have a more difficult time trying to sell.

Sadly, the time has come for an economic chill. Too many indicators suggest that the recovery has moved on, and that the nation will soon experience a constricted economy. Fortunately, downturns typically mirror the expansions they follow, and if true, the next recession should be about as mild as the recovery recently experienced. The U.S. is still the undisputed economic leader, making up 29 percent of the world's economy; the time has just come for consumers to retreat, businesses to shutter, and the new regime to steward over it all.

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