A Service Of
STATEWIDE TITLE
Special 1st Edition
The Statewide Economic Newsletter

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4TH QUARTER 2007 ECONOMIC$ FORECAST

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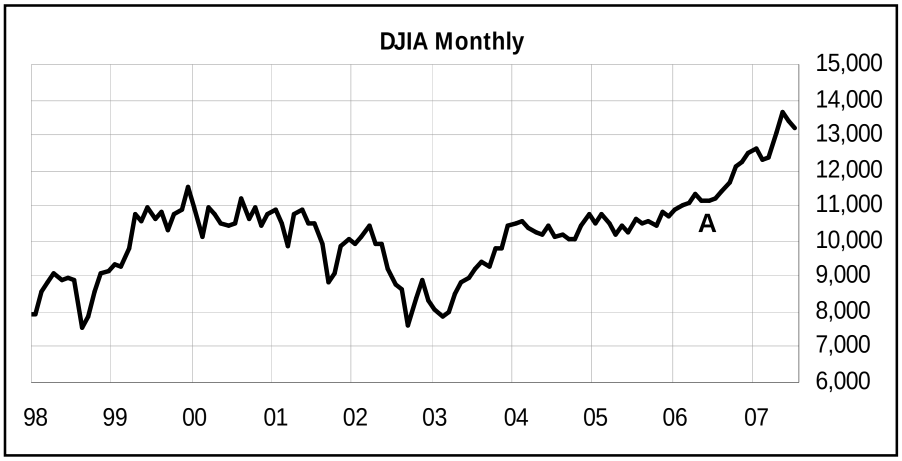
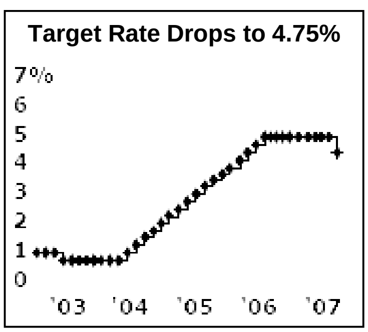
Ever since the days of the Oracle of Delphi, people have wanted to be able to predict future events with a knowing certainty. In economics there is no such thing, but there are a number of indicators that economists keep an eye on. There are over 200 such indicators I monitor from the U.S. Bureau of Economic Analysis. And while that large number can be difficult to digest in a short period of time, following too many indicators creates confusion as many often contradict other indicators. But like most economists, I do have my favorites that I go to on a regular basis. One of the things I follow is market chart patterns.



Although past trends are not necessarily indicative of future behavior, there are certain chart patterns that give us some idea as to what may occur in the future, provided certain factors hold constant (*ceteris paribus*). Awhile back in a talk I was giving, I pointed to a pattern that had formed on the Dow Jones Industrial Average's monthly stock index chart. The pattern I was speaking of is known as a "cup and handle" pattern, and at point "A" on the chart, the market had fallen into a consolidation period. I noted to the group that based on this pattern unless some unforeseen factors occurred, the market was poised to make a run. And it did. At the time the DOW was just over 12,000 and it subsequently ran as high as 14,121 for a gain of approximately 16% in a few short months time. There are many such patterns we look at in charts. Another pattern I noted in that talk was observing floors and ceilings or areas of hard support and resistance. At that time oil was banging on an area of hard resistance known as a ceiling. If it failed to penetrate the ceiling then we could expect the price to bounce back or retract. In the following months that was exactly what happened as the price of oil retreated in the markets, and the price of gasoline fell from just over $3.00 a gallon to around $2.60 or 14%.

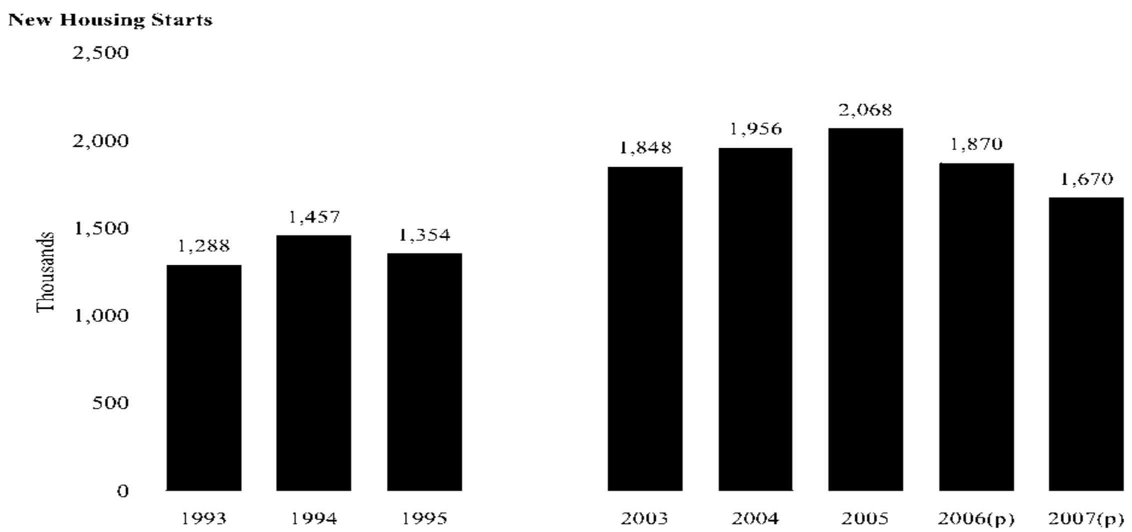


Besides trying to divine future economic events from charts, economists also analyze fundamental data. Some recent fundamental data bears consideration. For example, oil has recently hit an all-time high of $83 a barrel; the dollar has declined such that it is now on parity with the Canadian dollar for the first time since the early 1970's; and the Federal Reserve has cut the federal funds rate by a half point recently and the discount rate (the rate at which banks borrow money) by a half point the middle of August. These factors taken individually and collectively should all be considered as matters which contribute to inflationary pressure. A declining dollar only serves to make goods imported more expensive; higher oil prices raise the cost of consumer goods as oil factors into several areas of a product's pricing, from transportation costs, to heating and cooling costs to plastics. Cutting the federal funds rate, which will affect consumer interest rates, increases the buying power of the consumer and, therefore, increases inflationary pressure.

(continued on reverse)

Other areas that bear watching where fundamental data is concerned is the increased number of delinquencies and foreclosures that can be expected in the sub-prime and adjustable-rate mortgage market as borrowers face interest-rate resets, a large number of which will be coming due this October. Many economists are predicting that these elements, combined with a slump in the housing market along with weaker consumer spending, signals an oncoming recession. However, the recent rate cut should prop up the adjustable mortgage market at least for the short term spurring a new wave of refinances. The six-million-dollar question is how long the Federal Reserve can keep interest rates this low or continue to cut rates in light of the inflationary pressures referenced above. The Federal Funds rate had remained at 5.25% since June 2006, but with the recent half point cut, it has dropped down to 4.75%. This is an attractive position both on the demand-and-supply side of the equation and should serve to soothe concerns in the long term bond market, which is where long term fixed mortgage rates are set.

For the past decade our economy has enjoyed a period of healthy GDP growth, increasing productivity that in turn resulted in an unprecedented era of disinflation. Part of these gains has been achieved by lowering labor costs by transferring our manufacturing capacity offshore. However, import prices from these low-cost venues have risen significantly this year for the first time ever placing doubt on how much longer our economy is going to be able to rely upon the overseas wage pool to hold down production costs. Accordingly, real GDP growth is forecast to slow from 2.9% in 2006 to 1.9% in 2007 before recovering to 2.5% in 2008.



Source: Census Bureau, http://www.census.gov/const/www/quarterly_starts_completions.pdf

The chart above shows the current plight of the national housing market. In the national home market, builders began work on the fewest homes in twelve years in August, translating into 2.6 percent decline in new housing starts. Sales of existing homes are down as well. But should we in North Carolina be concerned over the woes in the national housing market? North Carolina has seen its longest real estate boom ever in its history. Housing sales are still active. Although sales declined last year, values increased so that the total worth of our real estate market remained roughly the same. Our state is also benefiting from a national growth trend, gaining many new residents from colder climates. In fact, in the past two censuses we have gained new congressional seats. Population growth is expected to last into the next decade and the state may see its population nearly double by 2015. All this growth translates into continued demand for sales of existing homes as well as new homes. Even the fallout from the increasing number of foreclosures will translate into opportunity as those homes will be added to the available inventory to satisfy increasing housing demand. Additionally, as long as the Federal Reserve can hold interest rates to a reasonable rate, we will continue to enjoy credit availability for creditworthy borrowers; refinances will remain healthy as variable rate mortgages are reset; sales should continue to hold stable; and as long as people continue to move into our state, demand for housing will continue to increase.