The Kiplinger Letter

FORECASTS FOR EXECUTIVES AND INVESTORS

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Dear Client: Washington, Feb. 10, 2017

HOUSING FORECASTS		
	2017	**2016**
Single-family starts	865,000	783,000
Multifamily starts	390,000	385,000
New-home sales	635,000	561,000
Existing-home sales	5.60 mil.	5.44 mil.
Year-end 30-year mortgage rate	4.6%	4.3%
Year-end price change	Up 5.0%	Up 5.6%

This year's housing market in one word: Tight. Inventories of existing homes for sale will keep shrinking relative to the demand for them. Builders will struggle to put up enough new houses.

Expect prices to keep rising at a steady clip and sellers to have the upper hand over buyers.

HOUSING

The typical home's value will climb by 5% across the U.S. as a whole in 2017... down slightly from 2016's 5.6% gain but still notable, given the significant run-up since the housing bust.

Starter homes will appreciate even faster because of strong demand from first-time buyers and a dearth of houses at the low end of the market.

For pricier places...those over $500,000... Slower gains. Inventories are healthier at the higher end of the market in most metro areas.

Most of 2016's hot markets will stay hot. Or heat up even more. Many Western cities where extremely tight supplies have pushed up prices can expect continued gains in 2017. Among them: Sacramento, Calif. Spokane, Wash. Boise, Idaho. Also, Dallas. Other booming metro areas...San Francisco, Denver and Portland, Ore... will slow down a bit, simply because prices there have increased so much, so quickly.

Some previously sleepy housing markets will be waking up. In the Northeast: R.I., N.H., Pa., N.J. and upstate N.Y. Inventories of homes for sale have plunged, particularly in cities such as Buffalo, N.Y. Faster price increases won't be far behind.

In the Midwest: Cincinnati and Louisville, Ky. Much of Ind., Minn. and Wis.

In the South: Baton Rouge, La. Memphis, Knoxville and Chattanooga, Tenn. Savannah, Ga. Winston-Salem, N.C. Birmingham and Huntsville, Ala. Jacksonville, Fla. The trend is similar all over: Declining supply because of fewer homeowners selling.

Home builders will do what they can to satisfy demand. But they are limited by tight credit, a lack of workers and...most crucially...the scarcity of buildable lots. Cash-strapped local governments are increasingly forcing builders to cover the cost of infrastructure for any new developments: Roads, sewers, schools, libraries, etc. Such fees add $12,000 to the cost of the average new home. In Calif.: $27,000.

Look for new homes to shrink in size this year as construction firms scramble to put up more starter homes for first-time buyers...a bid for the lower-priced market.

The features that buyers prize most in new homes today: Walk-in closets for master bedrooms, energy-saving windows, great rooms and laundry rooms.

One big concern for builders: Surging lumber costs. Framing-lumber prices jumped by 18% last year on fears of possible tariffs on Canadian timber products, now that a U.S.-Canada trade deal has expired. Similar gains are on tap this year.

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FINANCE Rising mortgage rates in coming months will slow refinancing activity and likely put a dent in the number of overall mortgage loan originations. Lenders will increase the number of loans going to home buyers, whose ranks will be propelled by further gains in jobs, wages and new household formations. But the hike in such loans won't be enough to offset the decline in refinancing loans.

Higher rates have more of an impact on refinancing than on purchasing. Why? Buying a home involves a variety of economic factors. Refinancing, however, depends primarily on whether the gap between a homeowner's mortgage rate and the going rate is large enough to be worth the paperwork and fees involved.

U.S. ECONOMY Manufacturing, construction and other firms will bolster investments in equipment and facilities this year after spending relatively little in the past two years. Look for capital spending to rise 3%-4%, after a flat 2016.

Several developments point to a bright future for business outlays: A continuing upward trend in corporate profits, rising confidence in the economy, the promise of corporate tax reform and an easing of regulations on businesses. Also helping are firmer oil prices and President Trump's call to spend $1 trillion on roads and other infrastructure, which has contractors champing at the bit.

Manufacturers are poised to rebuild inventories after significant cutbacks in light of weak commodity prices and slumping exports. Though commodity prices are still relatively low and the export outlook is still uncertain, firms are shifting into higher gear in anticipation of stronger demand ahead for a variety of goods. Among them: Steel, industrial, construction, oil field and metalworking equipment.

The buildup of manufacturers' inventories bodes well for GDP growth, switching manufacturing from being a drag on economic expansion to a contributor.

As the economy continues to gain steam this year and next...

The White House and the Federal Reserve are sure to butt heads over how quickly interest rates need to rise to keep the economic expansion from overheating as the Trump administration implements its stimulus spending. Even without the infrastructure spending program, the economy is on track to achieve full employment and to meet the central bank's 2% inflation target. Besides the spending, the Fed also cites "considerable uncertainty" about the impact of tax reform and cuts in red tape to ease the regulatory burden on businesses.

The Fed frets that economic growth may accelerate beyond expectations, possibly necessitating a speeded-up schedule of interest rate hikes next year.

For now, two quarter-point increases in short-term rates are in the cards, the first in June and the second dependent on the effect of coming policy changes. Though Trump criticized the Fed while campaigning last year for keeping rates low for an extended period following the recession, the White House's tune may change when the Fed turns to tamping down price increases through higher interest rates.

GLOBAL BUSINESS India's anticorruption plan to nix high-value banknotes comes with a cost, namely a slight slowdown this year for its recently torrid GDP growth. India pulled a whopping 86% of its currency out of circulation last November (all of its 500- and 1,000-rupee notes) in a bid to crack down on undeclared income.

Holders of big bills have to exchange them for smaller, newly issued notes, which the government believes to be easier to keep track of for tax purposes. India's economy is strongly cash-based...about 90% of all transactions are in cash.

Despite the move's hit to its economy, India will still eclipse all other nations in economic growth this year, with an expected GDP expansion exceeding 7%.

Another plus for India as it undertakes reform: China's economy is slowing, which has investors increasingly looking to India as the world's top engine of growth.

CITIES Mayors of some of the biggest U.S. cities will take on President Trump over his travel ban on refugees and immigrants, as well as other policies. It's the latest sign of trouble in a relationship that started to erode during 2016, when Trump bashed cities...many, hotbeds of liberalism...and focused his appeal on conservative, rural parts of the country. The deterioration has continued in the months since the election and reached a new low after he took office. He pledges to stop the "American carnage" in cities, including drug epidemics, and claims many cities are incubators for soaring rates of crime and poverty.

The last straw: Trump's call to end federal funding for sanctuary cities, part of his push to crack down on illegal immigration. Enforce U.S. laws that control immigration, he said, or lose billions for everything from cops and schools to health care and infrastructure fixes. Uncle Sam is a key source of funding as cities wrestle with pension shortfalls and other budget problems.

Look for New York, Chicago, San Francisco and others to lead the fight. Their views that Trump's moves are unconstitutional will be tested in court.

CONGRESS Trump's bid to end a ban on partisan politics by tax-exempt churches? It faces an uphill climb in the Senate, where the GOP majority needs help from at least eight Democrats to clear procedural roadblocks. That's a big reach, even if Republicans focus on Democrats who are running for another term in 2018 in states that Trump won last year. Trump vowed to "totally destroy" the ban, which allows the IRS to drop the tax-exempt status of churches that engage in politics.

Backers of Trump's proposal say the prohibition unfairly censors churches. Removing the restriction would give churches and pastors significant political clout.

Foes say keeping it in place will help ensure separation of church and state.

One more thing for congressional Republicans to spar over: Earmarks... funding for pet projects of lawmakers that used to be tucked into spending bills. They've been on ice since 2011, but many GOPers are quietly trying to restore them.

Fiscal conservatives in the party will push to keep the spending ban in place, saying that restoring earmarks would send the wrong message while Trump is trying to "drain the swamp." Earmarks added $16 billion to the budget in fiscal year 2010.

They'll also push back against extra spending that Trump is calling for.

And they'll oppose raising the federal debt ceiling. They'll lose that battle.

FOREIGN AFFAIRS Trump's White House will test many foreign relationships, not just those in the headlines...Mexico, China and nations with big Muslim populations. The list includes Europe, especially Germany in a bitterly divided European Union. Plus longtime U.S. friends Turkey and the Philippines. Leaders of both countries back Trump generally. But cracks in those relationships are starting to show.

On the other hand, Trump's hard line on Iran will please Saudi Arabia, a key ally in the Middle East that is counting on U.S. support to help control ISIS.

DIGITAL DIVIDE Uncle Sam is poised to spend billions to boost broadband in rural areas. But expect hot debate over which projects get a slice of the federal money pie. Projects will include updating copper wires to fiber and installing many antennas.

Both parties want to include broadband in an infrastructure spending bill that is likely to clear Congress later this year. Broadband's share...about $20 billion... would take up just a sliver of the $1-trillion cost, mostly for roads, bridges and rails.

Federal regulators have plans of their own to help bridge the digital divide. New Federal Communications Comm. Chairman Ajit Pai favors slashing red tape to spur web competition and choice, while cutting spending that he sees as unneeded.

TECH

Next-generation broadcast TV is about to make waves. Progress will pick up this year for new tech that marries over-the-air TV signals with the web and boasts 4K video quality, targeted ads and high-end audio. Rollout starts in 2018 and strong uptake could net broadcasters billions of dollars in increased ad sales.

Expect broadcasters to make a lot more noise about the pending transition, which won't be mandated by Uncle Sam, unlike the analog-to-digital switch in 2009. The plan is to generate buzz among consumers and TV sellers to speed up adoption.

Uncle Sam wants to make it easier for factories to install wireless gear to lower costs and boost productivity by eliminating a slew of cables and cords. Federal researchers recently tested three factories...a machine shop, an auto factory and a steam generation plant...to create guidelines for a variety of factory settings. Many firms have been slow to use wireless due to reliability and security concerns.

Cutting a tangle of cords will pave the way for future "smart" factories, where mobile robots can roam safely and sensors can hoover up troves of data. Wireless use will accelerate...good news for vendors such as Cisco, Siemens and SAP.

AUTOS

Is another diesel scandal brewing...this time for Fiat Chrysler Automobiles? Not necessarily. While there are echoes of Volkswagen's emissions scandal, many of the facts are different. Only about 100,000 FCA SUVs and pickup trucks are accused of violating EPA emissions standards, compared with 600,000 VWs. And while VW admitted wrongdoing, FCA is disputing the Obama-era charges.

A simple software upgrade might be enough to bring cars into compliance. Still, it's too soon to know exactly what happened. If cheating and a cover-up did occur, the legal and reputational hit would be huge. VW's scandal cost it $20 billion.

Meanwhile, the outlook for diesel technology is still bright. Other carmakers want to fill the void left by VW and use diesel to meet future fuel economy standards.

VISAS

The minimum salary may be lifted for skilled workers with H-1B visas under changes being mulled by the Trump administration. Trump's goal would be to protect American workers, who he says lose their jobs to visa holders willing to work for less money. The wage minimums would likely vary by region.

Any changes would not impact this year's lottery for 85,000 H-1B visas. There are 65,000 visas allotted plus 20,000 for workers with master's degrees or higher.

Employers should file petitions by March 31 if they want visas for 2018. Petitions are accepted until April 7, but a lottery is held if the quota is reached within the first five business days. Petitions are sure to surpass last year's 236,000.

TRAVEL

Business travel is already taking a hit from the administration's travel ban. And the impact goes beyond the seven nations listed in the executive order. A recent survey found that about 30% of companies will reduce business travel in the near future. Cancellations have already hit $185 million in lost business. The top reason? Uncertainty over which workers will be allowed to enter the U.S.

Leisure travelers are rethinking vacation plans, too, worried about a rise in anti-American sentiment. Bookings have fallen steeply for some travel agencies.

Yours very truly,

Knight Kiplinger

Feb. 10, 2017 THE KIPLINGER WASHINGTON EDITORS

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