



Business Investment Dwarfs Housing

Since 2008, the market punditry has focused on housing, housing and housing. Business news channels have housing experts who report on every housing number as if it were the golden key to all economic activity. People say “we can’t have a recovery without housing.” Conventional wisdom has an obsession with housing.

We find this somewhat understandable. Housing was the crisis. Housing is important. Building homes creates jobs, houses represent personal wealth, mortgages are typically the largest single debt of individuals. We get it.

At the same time we think all this focus on housing is misplaced...at least when it comes to analyzing the economy. Business investment is much more important and the economy has recovered even though housing has been in the doldrums for a long time.

Home building was just 2.2% of GDP in 2011 and houses do not create future wealth. Business investment in equipment and software was 7.4% of GDP in 2011 and this investment is what drives productivity and profits. Business investment creates wealth; houses are where we put wealth.

Investment Is Booming

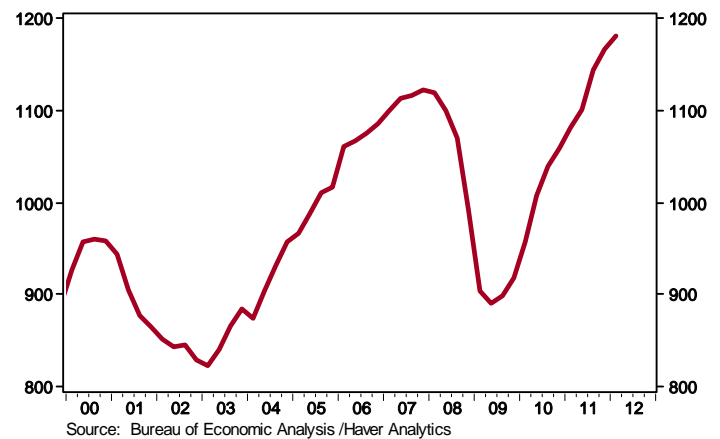
Businesses invest in three different things – structures, inventory and “equipment and software.” Business structures, like housing, were overbuilt and have yet to recover. Business inventories plummeted by about \$200 billion in 2008 and 2009, and have recovered most of that, but not all. But business investment in equipment and software has boomed. In fact, it’s at an all-time record high in both nominal and real terms.

Business investment in equipment and software, fell from \$1.12 trillion at an annual rate in Q4-2007 to \$890.5 billion in Q2-2009, a drop of 22%. But then, after mark-to-market accounting rules were fixed, businesses turned on the investment engines in a big way. Investment has increased at a 10.8% annual rate since then, up 11 consecutive quarters and now stands at \$1.18 trillion. Businesses have invested \$2.3 trillion in the past two years.

During those same two years, investment in housing has been just \$690 billion. In other words, if you want to understand why the economy has grown, look at business investment in equipment and software, not housing. In fact, anyone who focused too much on housing would have remained much more bearish about the economy than they should have.

Business investment, in the cloud, smartphones, tablets, new machinery, drilling and fracking equipment, railcars, drugs, and telecommunications raises productivity and lifts profitability. This is what creates growth. And that’s what the conventional wisdom missed in recent years.

Private Nonresidential Investment: Equipment & Software
SAAR, Bil.\$



Private Residential Investment
SAAR, Bil.\$

