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How strong is US housing?

Recent activity is welcome, but beware exaggerated optimism

Over the past year, residential investment has contributed approximately one-third to overall US GDP growth (on average 0.6 percentage points of a 2.3% total, although the number fluctuates substantially from quarter to quarter). Recent strong housing starts data – housing starts totalled 872,000 units (annualised rate) in September, the highest number since July 2008 and Q3 housing starts as a whole were up 6.8% from Q2 – imply that when the advance GDP release for Q3 is published on Friday, we will see another strong contribution from housing. Add in healthy sales data – the total number of houses sold edged above 5 million units (annualised rate) in August for the first time in 27 months and remained there in September in spite of slightly weaker sales of existing homes – and signs of rising prices, and it is perhaps not surprising that we are seeing comments hailing the recovery of the housing market. Reports greeting today's strong rise in new home sales for September are part of this chorus.

Housing market strength is doubly important. First, of course, because anything that boosts the US economy is welcome. Second, because since the recession was very much due to the bursting of a housing bubble, housing was never going to be the first sign of recovery, as it traditionally tended to be. Rather, a recovery in the housing market would be a sign that the economy as a whole had recovered. Moreover, where the pattern from previous housing cycles over the past forty years is that the recovery – defined as real house prices returning to their pre-bust peak – has lengthened in each cycle, this recovery would have broken the trend and come faster.

That, too, would be good news. But it seems improbable that a recession induced by too much household debt – and more household debt than in previous recessions – would end more swiftly than in the past.

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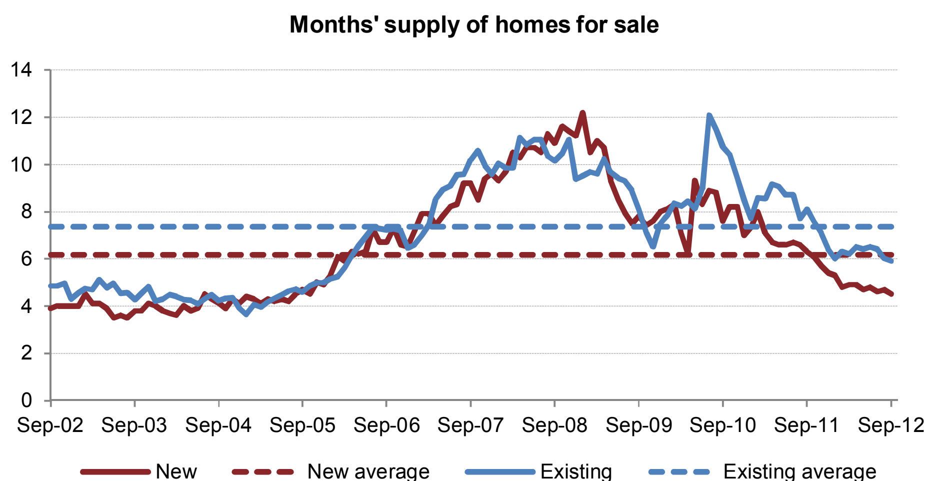
Taking on board today's strong new home sales data, this Comment aims at giving a somewhat longer perspective to the strength of the housing recovery. On housing starts, we need to keep in mind that even after the strong showing of the last year or so, housing starts remain *lower* than the troughs reached in three of the past four housing busts. The exception is 1990/91, when the low was 798,000 starts in January 1991. In addition, in the recent cycle, housing starts bottomed out at 478,000 in April 2009. We are now 41 months later and housing starts have risen by 80%. By contrast, in two of the three previous housing cycles, 41 months after the trough, housing starts had much more than doubled; and even in the early 1990s, the rise 41 months after the lowest point was more than 90%.

In spite of the recent surge, residential investment is only up 11.5% from the bottom reached in Q3 2010 and Q1 2011. By Q2 2012, residential investment made up 2.6% of US GDP, down from a peak of 6.2% in 2005 and compared with an average over the past fifteen years of 4.6%. So there is clearly a long way to go before housing recovers its past strength and role as a driver of US growth. To put it differently: if the amount of residential investment doubled over the next four quarters, it would contribute 2.7% to US GDP growth, that is to say 0.6% per quarter. That would be most welcome – but considering that the fastest four-quarter growth in residential investment was 54% (year to Q3 1982) a doubling of housing investment over a year when it still looks as if there will be at least some impact on growth from the fiscal cliff, however ultimately resolved (and worse if not) looks highly unlikely.

It should also be pointed out that recent bank data show the growth of real estate loans weakening again after some strength over the summer.

If all this is intended to dampen housing sector optimism, there are also reasons to be more cheerful. A key factor is that not only are home sales on the whole on an upward trend, but the supply of unsold homes- both new and existing – is now well below its long-term average. Any continued rise in demand should therefore quickly translate into new production.



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Perhaps more importantly, rising prices mean that more households will find themselves back above water. Although it is unclear how strong the wealth effect is in the current situation (ie, how much rising housing prices will stimulate further spending) but having positive equity should at least have the effect of moderating the deleveraging imperative.

Overall, the housing recovery should continue to support US output growth in 2013, ensuring that activity remains stronger than in most other advanced economies. As noted above, this – like so much else regarding the US – is subject to how, if at all, American politicians manage to deal with the fiscal cliff. But unlike previous recoveries, housing will not be the driver of recovery and the housing market has a long way to go before it reaches the activity rates seen in the early 2000s (let alone the mid-2000s boom years). A continued contribution of around 0.3-0.4 percentage points per quarter would be a good result; to expect more on a sustained basis would be foolhardy.

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