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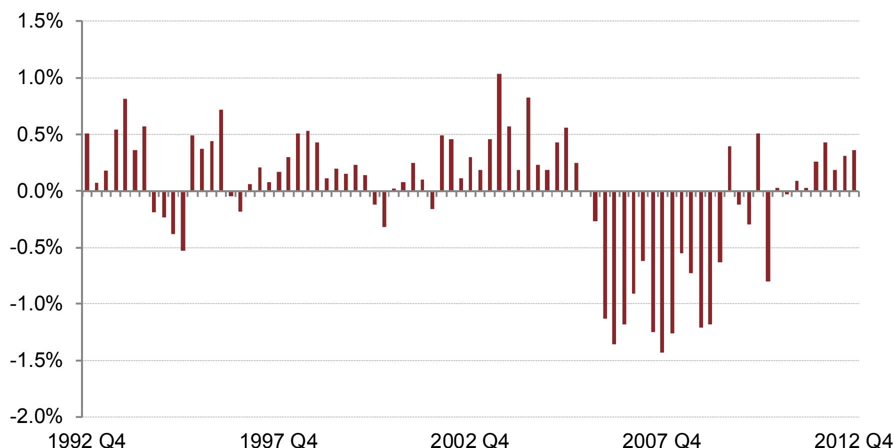
US housing strength – still a long way to go

Housing market to be solid, not spectacular

US sales of new homes were considerably stronger than expected in January, rising to 437,000 units (annualised rate), the highest number since July 2008. Housing data have been up and down over the past few months. Starts slipped in January after rising to a 4½-year high in December; but building permits, which have a longer lead than starts, continued to rise, reaching *their* highest level over the same period (since June 2008). Sales of existing homes are down from a recent peak in November, but total home sales have been above 5 million units for six months, the longest such stretch since H2 2007. (I remember when total home sales first decisively broke through the 5 million barrier in 1996. That was a clear sign of housing boom to come and firm recovery from the bust of the early 1990s.)

Housing should continue to provide a boost to US economic activity in 2013, underpinned by continued low interest rates as well as by the fact that household deleveraging (as mentioned in previous comments) has proceeded to a stage where household debt broadly speaking is bearable and households are beginning to take on at least short-term debt again. In fact, over the past year, the average contribution of housing to overall GDP growth has been 0.3% per quarter (annualised rate), almost exactly the same (the difference begins in the second decimal, which really is meaningless in these comparisons) as in the five years leading up to the end of the housing boom in Q4 2005. However, to some extent, this is due to the weak starting point.

Contribution of residential real estate investment to overall GDP growth, percentage points at saar



In spite of recent housing strength, it is salutary to recall where the US housing market is in absolute terms, not just relative to bubble peaks, but also relative to previous busts. Total sales peaked at 8.5

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million units in July 2005. At their lowest point, sales were 57% down from the peak, roughly the same as in the late 1970s bust when home sales fell 55% from peak (April 1978) to trough (April 1982). However, 7½ years later, much of that fall had been recaptured and total home sales were 20% below peak. Currently, after a similar period, we are still 40% below peak. At just under 1 million units, housing starts and building permits have moved back above the troughs of previous housing busts – but not by much, as these tended to be in the 700-800 thousand units rate.

But in some ways the most relevant metric may be prices. There are a plethora of US house price indices: the currently best known is the Case-Shiller index, but there is also the Federal Housing Finance Administration index (which tracks the sale price of the same house. Both of these published December data today, both showing the strongest 12-month rise in house prices since the summer of 2006. There is also the National Association of Realtors index which tracks the prices of existing homes; and the Census Bureau index for prices of new homes. The longest stretch of data is NAR series for sales of existing homes, which is therefore the one used here.

The chart shows that real house prices, in spite of record-high affordability (not just because house prices were low, of course) have barely recovered. January real house prices are up 12% from the trough of October 2011; but they are still down 31% from the peak reached in October 2005.Where they are now is essentially where they had fallen to by April 2009; which, in turn, is roughly speaking where they were in late 1998.

This is important for two reasons. First, because it means that there are presumably still a large number of households with or near negative equity. Even though house prices are rising, it is likely to take a long time before they have fully recaptured lost ground. In fact, it may never happen. (The time to reach pre-bust real house price peaks has lengthened in each housing bubble. On current trends, it might happen by late 2016; but that is in a way a meaningless number.)

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Second and related to the first point, US households are taking on short-term debt, but they remain wary of taking on more long-term debt. Hence, it is unlikely that we will see the same kind of debt-fuelled price rises that we saw in the early 2000s. Over the very long run, house prices should keep pace with inflation with some impact from issues like demographics, regulation and population density. This fits in with the price series used here, which shows real house prices in January 2013 37% higher than in January 1968, an annual rise of 0.1%. Going forward, it seems likely that housing market developments will be solid, but not spectacular, not just in 2013, but further out as well. That's actually not so bad.

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P.S. Following last week's comment on the impossibility of enforcing fiscal discipline, it looks as if the EA Fiscal Compact already is unravelling, with France in the lead, but not alone in wanting easier terms or prolonged adjustment periods.

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