ECONOMIC & REAL ESTATE TRENDS[SM]

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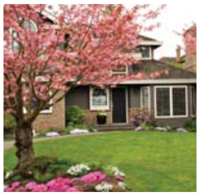

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What Will Cause Housing to Finally Rebound?

In every recession for which we have data, going back to 1960-61 for single-family housing starts and 1969-70 for new and existing home sales, housing activity has turned upward before the end of the economic downturn. Conversely, job market indicators (payroll employment and the unemployment rate) have never improved before a recession's end, and usually have not improved until some months after the beginning of the next expansion. As a result, in past recessions the housing market has always rebounded before the job market. But will the same relationship hold in the current downturn?

Many commentators have said recently that the housing market won't begin to recover until the job market expands again. While that may be the case this time, it has not been the historical pattern in any of the recessions for which data exist. Table 1 shows the relationship between the end of economic downturns and when

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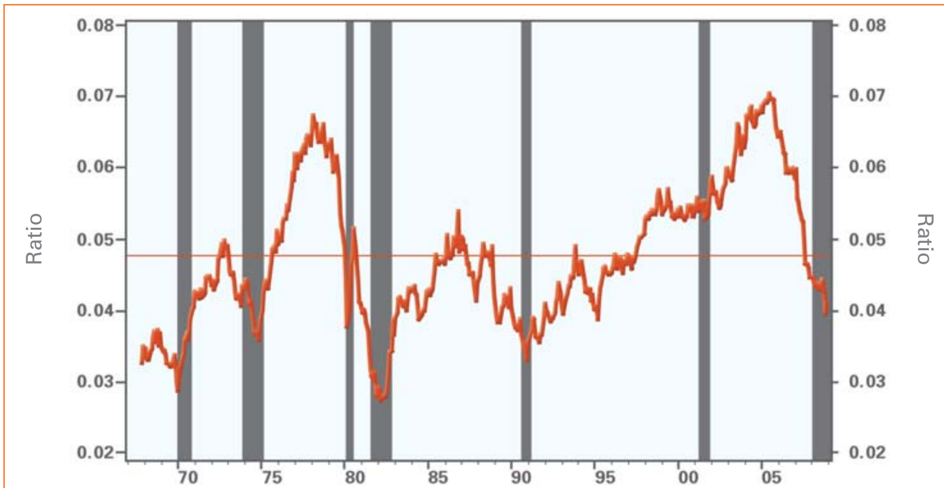
FIGURE 1: HOW FAR WILL HOME SALES DECLINE? (Total Single-Family Sales Relative to Households)



Source: National Association of Realtors/Census Bureau/Haver Analytics

Housing Rebound

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the bottom is reached for the most commonly used measures of the job and housing markets: nonfarm payroll employment, the unemployment rate, existing single-family home sales, new home sales, and single-family housing starts. A figure denoted with a plus sign means that the trough in that measure occurred after the end of the recession – with the number signifying the number of months past the economic trough. A minus sign denotes a bottom before the end of the recession. In every case, each of the housing-related measures bottomed before the end of the recession, with single-family existing sales averaging four months, new sales eight months, and single-family starts seven months. Job-related data, on the other hand, at best are contemporaneous with the end of an economic downturn, but more often lag the economic trough. Moreover, in each of the past two recessions, the national unemployment rate didn't peak until more than a year after the recession ended.

If the housing market usually turns around before the job market, what are the causes of the rebound in housing activity? Most analysts view two factors as helping to lead the housing market recovery: affordability and demographics. For the former, a combination of lower mortgage rates and faster income than home price growth lead to an increase in affordability and thus in home sales. For the latter, a period in which new housing supply falls short of household formations creates increasing amounts of pent-up demand. Together, these two factors allow the housing market to rebound before the job market does.

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TABLE 1: RECESSION ENDS: WHAT LEADS AND WHAT LAGS? (Months)

Recession	Unemployment Rate	Payroll Employment	Existing Home Sales (1-Family)	New Home Sales	Housing Starts (1-Family)
April 1960-February 1961	+3	0	–	–	-2
December 1969-November 1970	+9	0	-8	-12	-10
November 1973-March 1975	+2	+3	-2	-2	-1
January 1980-July 1980	0	+1	-2	-3	-4
July 1981-November 1982	+1	+1	-6	-14	-13
July 1990-March 1991	+15	+2	-3	-2	-2
March 2001-November 2001	+13	+21	-2	-17	-16
Average	+6	+4	-4	-8	-7

Housing Rebound

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What do these causal factors of housing recovery tell us about the prospects for a rebound in the current environment? The news appears to be mixed. Positively, according to the National Association of Realtor's composite housing affordability index, affordability has risen to all-time highs. Moreover, the increase in affordability over the past year is at a record level. Negatively, the demographic news is not as good. Even though homebuilders have cut back significantly on new construction, household growth has fallen by even more. According to the Census Bureau's March 2008 annual estimate, which is an estimate for the full year 2007, the increase in households was only 772,000. This is well below the increase in the supply of housing units in 2007 of 1.45 million – or even the 987,000 unit increase for 2008. A large portion of the difference between the number of new households and the increase in the number of new housing units is a jump in the number of vacant units. Moreover, even this low estimate of the number of new households may be too large – as it implies an unrealistically large jump in the number of net removals from the housing stock (down by more than 1 million units). There is some good demographic news, however.

As shown in Figure 1, the ratio of total home sales to households dropped below its long-term average in September 2007. Of course, it was well above the average in the 2003-6 period, so it has a long way to go before the excesses of that period have been worked off. Monthly data on household growth over 2008 is more upbeat, showing an annual increase of 1.103 million households – but this estimate may also overstate the magnitude of the gain.

The significant overhang of unsold homes along with the steep economic decline suggests that the housing bottom is not likely to be early in this cycle. Demographics should continue to improve slowly, while affordability is expected to stay at record levels, and together these factors will ultimately boost home sales. If, as we project, the recession ends around the beginning of the fourth quarter, then home sales should bottom sometime in the third quarter. Housing starts, on the other hand, may lag in this cycle because of the still high inventory-sales ratio for housing. ◆