First Trust
Monday Morning OUTLOOK
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Housing Recovery Still Young

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The turnaround in the housing market is perhaps the brightest spot in an otherwise tepid economic recovery.

Home sales, home building, and even home prices are all headed up. In the past twelve months, sales of existing homes are up 9% while sales of new homes are up 25%. Housing starts are up 29%. The two most prominent home price measures, Case-Shiller and FHFA, are both up at about a 7% annual rate in the past six months.

This is not a dead cat bounce. As we pointed out almost a year ago, the US was at an upward inflection point where fundamentals would help propel the housing market into a recovery. (click here to view last year's piece). Now, we think the stage is set for more advances over the next few years.

The number of existing homes for sale is down to the same level as 2003-04. Meanwhile, the US population has grown 8% and the homeownership rate is lower. In other words, with so many potential buyers and relatively few homes, we now have a *shortage* of homes on the MLS. The market for new homes is even more extreme, with fewer new homes for sale than at any time since at least the early 1960s

Although the total stock of housing – all rentals, vacancies, and owner-occupied homes combined – still looks lofty, we would not be surprised at all to find the Census Bureau revising these figures over the next few years as we find out many homes have to be substantially refurbished before they can be lived in, with problems like missing copper pipes and untended leaks, because they've been vacant too long.

On a national average basis, homes are still screaming "buy." We track the price-to-rent ratio for homes based on data from the Federal Reserve and Commerce Department. In the past 30 years, home prices have averaged 15.8 times annual rent. Now, they're only 13.6 times rent, or roughly 14% below the norm. The same thing happens when we compare home prices to replacement cost, where the ratio is about 16% below the average of the past 30 years. Given loose monetary policy, we expect both rents and construction costs to move up noticeably in the next several years. So, to get back to more normal ratios means home prices will have to go up even faster.

And despite the rise in home building in the past year, expect at least another few years of gains. To keep up with population growth and "scrappage" rates, builders should start about 1.5 million homes per year. This includes both owner-occupied and rental properties. (For scrappage, think fires, floods, hurricanes, tornadoes, plus voluntary knockdowns.)

Lately builders have been starting homes at about a 750,000 annual rate, only half of what's needed. That makes sense if they still want to cut inventories. But they're not going to do that forever. In a few years they'll realize they can stop cutting inventories and the pace of construction that makes this possible is 1.5 million units per year. That may seem like a steep climb from here, but we can get there in three years if housing starts grow at a 26% annual rate, slightly slower than over the past year! No wonder the NAHB index, which measures homebuilder confidence, has rebounded so sharply, from 14 last September to 37 in August.

Notice how the housing recovery is happening well after previous rounds of homebuyer tax credits and when the theoretical support from quantitative easing was supposed to be falling. Instead, what we have is a free-market recovery when government support has been going away. If the politicians just stay out of the way, it will be a powerful force for a broader economic recovery and many more jobs in the next few years.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-25 / 9:00 am	Consumer Confidence – Sep	63.2	**66.5**		60.6
9-26 / 9:00 am	New Home Sales – Aug	0.380 Mil	**0.375 Mil**		0.372 Mil
9-27 / 7:30 am	Durable Goods – Aug	-5.0%	**-5.9%**		+4.1%
7:30 am	Durable Goods (Ex-Trans) - Aug	+0.3%	**-0.2%**		+0.7%
7:30 am	Q2 GDP Final	1.7%	**1.5%**		1.7%
7:30 am	Q2 GDP Chain Price Index	1.6%	**1.6%**		1.6%
7:30 am	Initial Claims – Sep 22	375K	**378K**		382K
9-28 / 7:30 am	Personal Income – Aug	+0.2%	**+0.3%**		+0.3%
7:30 am	Personal Spending – Aug	+0.5%	**+0.5%**		+0.4%
8:45 am	Chicago PMI –Sep	53.0	**50.2**		53.0
8:55 am	U. Mich Consumer Sentiment - Sep	79.0	**79.0**		79.2