First Trust
Monday Morning OUTLOOK
March 25th, 2013
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Housing Recovery Still Young

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Into early 2012, conventional wisdom argued that the odds of a robust housing recovery were lower than the odds of New Mexico and Georgetown losing to Harvard and Florida GC.

Remember…a "shadow inventory" and "deleveraging" would keep housing depressed for years? But, hey, who cares about conventional wisdom? Home building, home prices, and home sales are all rising nicely.

From mid-2009 to mid-2011, housing starts hovered a little below 600,000 at an annual rate, venturing higher only after tax credits of up to $8,000 were passed out. Now that government has quit trying so hard, housing starts have jumped to 900,000.

Home prices are up no matter what index you follow. The FHFA index, which tracks homes financed by conforming mortgages, is up 6.5% from a year ago. The Case-Shiller index, which tracks all purchases in the 20 largest metro areas, is up 6.8%. CoreLogic shows prices up 9.7%; Radar Logic shows prices up 13.3%.

Home sales are also up. Existing home sales are up 10% versus a year ago while new home sales are up 29%.

Some are still befuddled by all the improvement. Their theory is that the housing market cannot get better if the US still has too many homes. This theory makes some superficial sense, but doesn't hold up under closer examination.

If a company with long lead times finds itself with an excess inventory – like the housing market discovered in 2006 – it will cut production to eliminate that excess. But once inventories start falling fast enough and for long enough, the company can increase production secure in the knowledge that inventories will keep falling even if it's not as fast as before.

Meanwhile, in order to help clear out the excess inventory, prices fall. But prices bottom well before the excess inventory is gone. Discounts shrink as the inventory gets smaller and smaller and by the time the market has returned to normal, prices have also come completely back as well.

We believe the housing recovery has much further to go. Given population growth and "scrappage" (replacements due to fires, floods, hurricanes, or voluntary knock-downs), housing starts should get back up to about 1.5 million per year, which would be an increase of more than 60% from the most recent pace. We expect this to happen before the end of 2015.

Home prices should keep rising as well. Relative to rents and replacement costs, housing is about 10% below fair value. Meanwhile, loose monetary policy means rents and construction costs themselves should accelerate over the next few years.

Sales should go up as well. Assuming sales relative to population size returns to 2001 levels (which was before the excesses of the housing boom) the annual sales pace should be almost 6 million existing homes and 1 million new homes. The current annualized pace of 5 million existing homes and 430,000 new homes, respectively, means that there is still plenty of room for growth.

In this environment, the last thing we should be worried about is a stronger economy that leads to higher mortgage rates. Higher rates would show more demand for credit, which means more housing activity, not less. And in an atmosphere where potential buyers are confident their home will appreciate they will be more aggressive about buying than if rates were lower, but they expected stagnant or declining prices.

None of this means housing is back to normal. It's still got a long way to go, but it appears to be solidly on its way. We expect more big gains ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-26 / 7:30 am	Durable Goods – Feb	+3.9%	**+4.5%**		-4.9%
7:30 am	Durable Goods (Ex-Trans) – Feb	+0.5%	**+0.7%**		+2.3%
9:00 am	Consumer Confidence – Mar	67.5	**64.7**		69.6
9:00 am	New Home Sales - Feb	0.420 Mil	**0.415 Mil**		0.437 Mil
3-28 / 7:30 am	Initial Claims Mar 23	340K	**339K**		336K
7:30 am	Q4 GDP Final Report	+0.5%	**+0.7%**		+0.1%
7:30 am	Q4 GDP Chain Price Index	0.9%	**0.9%**		0.9%
8:45 am	Chicago PMI – Mar	56.5	**57.9**		56.8
3-29 / 7:30 am	Personal Income – Feb	+0.9%	**+1.5%**		-3.6%
7:30 am	Personal Spending – Feb	+0.6%	**+0.5%**		+0.2%
8:55 am	U. Mich Consumer Sentiment- Mar	72.7	**72.0**		71.8