

## Rate Hikes Won't Kill Housing

**Brian S. Wesbury** – Chief Economist  
**Robert Stein, CFA** – Dep. Chief Economist  
**Strider Elas** – Economist

Home building plummeted in February, which made perfect sense; this February was the coldest for the most Americans since 1979. What no one expected was that new home sales would soar. Bad winter weather usually doesn't hurt new home sales as much as it hurts housing starts, but it typically has an impact. This time, though, new homes sales spiked 7.8%, hitting the highest level in seven years.

The new home sales report confirms what we've been saying for the past few years: the housing recovery still has much further to go. It won't be in a straight line, the monthly reports are volatile, but expect more home building and sales in the year ahead than in the past twelve months.

Most importantly, the upward trends will continue even as the Federal Reserve starts to raise rates. In theory, higher rates should dampen housing activity. But this version of "chalkboard economics" ignores too much other information.

First, based on population growth and scragginess (knockdowns, fires, floods, hurricanes, tornadoes...etc.), we're headed to about 1.5 million housing starts per year by 2016-17, about 50% higher than in 2014. Second, job growth has picked up. Payrolls look ready to rise about 3.5 million in the next year, the best since the 1990s. Third, wage growth is picking up. Average weekly earnings are up 2.6% in the past year, versus a gain of 1.8% in the prior year.

Fourth, home prices are likely to continue upward, but not as quickly. When home prices finally bottomed in 2011, they were undervalued relative to the level of rents. Meanwhile, home building was slow, limiting supply. As a result, home prices rebounded rapidly in the early stages of the recovery. The national Case-Shiller index increased at an 8.6% annual rate in 2012-13. But prices rose a slower 4.6% last year. And now that home prices are fairly valued relative to rents and construction is up, prices may rise even more slowly.

Last, potential homebuyers are not only interested in mortgage rates, they're also affected by how fast rents are rising. For example, a tenant looking forward to rent increases of 4% per year will buy a home faster than someone who foresees 2% rent hikes.

For that reason, it's important to compare mortgage rates to the growth in rents. In the past twenty years, the conventional 30-year fixed mortgage rate has averaged about 3 percentage points higher than the growth rate of rents. Now, that gap is almost zero. So, unless mortgage rates suddenly skyrocket, expect continued growth in rents to gradually make homeownership more attractive again.

The housing recovery is not bullet-proof and one day will come to an end. But given general economic improvement and rent growth, that day is not yet on the horizon.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-30 / 7:30 am	Personal Income – Feb	+0.3%	<b>+0.3%</b>	<b>+0.4%</b>	+0.3%
7:30 am	Personal Spending – Feb	+0.2%	<b>+0.3%</b>	<b>+0.1%</b>	-0.2%
3-31 / 8:45 am	Chicago PMI – Mar	51.8	<b>50.2</b>		45.8
9:00 am	Consumer Confidence – Mar	96.4	<b>96.7</b>		96.4
4-1 / 9:00 am	ISM Index – Mar	52.5	<b>52.2</b>		52.9
9:00 am	Construction Spending – Feb	-0.1%	<b>+0.1%</b>		-1.1%
afternoon	Total Car/Truck Sales – Mar	16.9 Mil	<b>16.9 Mil</b>		16.2 Mil
afternoon	Domestic Car/Truck Sales - Mar	13.5 Mil	<b>13.5 Mil</b>		12.9 Mil
4-2 / 7:30 am	Initial Claims - Mar 28	285K	<b>290K</b>		282K
7:30 am	Int'l Trade Balance – Feb	-\$41.4 Bil	<b>-\$41.2 Bil</b>		-\$41.8 Bil
9:00 am	Factory Orders – Feb	-0.4%	<b>0.0%</b>		-0.2%
4-3 / 7:30 am	Non-Farm Payrolls - Mar	246K	<b>241K</b>		295K
7:30 am	Private Payrolls – Mar	240K	<b>233K</b>		288K
7:30 am	Manufacturing Payrolls – Mar	10K	<b>8K</b>		8K
7:30 am	Unemployment Rate – Mar	5.5%	<b>5.5%</b>		5.5%
7:30 am	Average Hourly Earnings – Mar	+0.2%	<b>+0.2%</b>		+0.1%
7:30 am	Average Weekly Hours – Mar	34.6	<b>34.6</b>		34.6