First Trust
Monday Morning OUTLOOK
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Housing – An Emotional Ride

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Wow, that was faster than a short-track sprint, or, a luge run. In the blink of an eye, conventional wisdom says the US housing recovery has gone from non-existent, to a new-bubble, and now back to a full-scale meltdown.

We don't believe any of this. Since the Panic of 2008, emotion seems to rule the day when it comes to economics and economic journalism. With housing, it's even worse because roughly 2/3rd's of Americans own a home – a key part of the so-called "American Dream." The house is a big part of retirement assets, it was at the center of the financial crisis, and it was slow to begin recovery.

Casual (but concerned) observers of housing see things out of the corner of their eye. So, when housing starts dropped 16% and existing home sales fell 5.1% in January alone, and this was what the bubble-types were saying would happen, pessimism ramped up quickly. New home sales data arrive Wednesday, and they will be down as well.

But this is no bubble bursting; it's the impact of the Polar Vortex. Weather in both December and January was unusually harsh and home construction and sales are down. Back in 1994, the last time a January experienced cold like 2014, housing starts fell 17% and new home sales dropped 24%.

Some analysts are claiming it must be higher interest rates that are taking a toll. But, the US had a housing bubble during 2003-07, when 30-year mortgage rates averaged 6.1%. Today those same 30-year rates are 4.4%. Adjusted for inflation, real mortgage rates are actually a little bit lower today than they were back in 2003-07.

The housing affordability index – a combination of home prices, borrowing costs and median family incomes – shows that a median family can more easily afford a mortgage now than at any time from 1971 through 2008.

Some are arguing that banks' credit standards are too tight to continue the housing recovery. But the New York Federal Reserve Bank recently reported that total mortgage debt increased $152 billion in the fourth quarter of 2013, the largest increase for any quarter since 2007. This suggests banks are getting looser with lending standards, not tighter.

The bottom line is that our outlook for housing hasn't changed. After weather patterns return to normal, housing starts will pop up sharply and will eventually rise to about a 1.5 million annual rate by late 2015. New home sales will also rise about 15 – 20% per year for the next several years, eventually getting back up to a 900,000 annual rate. (There's a large gap between housing starts and new home sales mainly because: (1) new home sales don't include multi-family units, like apartments, and (2) as with knockdowns, many new homes are built on land already owned by the future occupant, and don't count in the new home sales data.)

Existing home sales, which were falling even before the weather turned brutal, are not going to turn around as sharply, but for a couple of benign reasons. First, inventories are unusually low, limiting selection for potential buyers. Second, existing home sales are not that far below where they should be. Typically, about 4.5% of housing units get sold each year, which would be about 6 million homes in today's market. Even at January's beaten-down level, existing homes were sold at a 4.6 million annual rate, only 23% below the norm. Perhaps more importantly, while home construction feeds right into GDP, existing home sales barely affect GDP at all.

None of this is to say that the trend recovery in housing is going to be a straight line. It hasn't been so far and won't be in the future. But that recovery as well as the broader improvements in the economy have much further to go. Bears and pessimists, who have predicted another recession for the past five years, are going to have to look harder, and a heck of a lot longer, before they finally get what they want.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-25 / 9:00 am	Consumer Confidence – Feb	80.0	**80.2**		80.7
2-26 / 9:00 am	New Home Sales – Jan	0.400 Mil	**0.396 Mil**		0.414 Mil
2-27 / 7:30 am	Initial Claims – Feb 22	335K	**335K**		336K
7:30 am	Durable Goods – Jan	-1.5%	**-2.7%**		-4.2%
7:30 am	Durable Goods (Ex-Trans) – Jan	-0.2%	**-0.5%**		-1.3%
2-28 / 7:30 am	Q4 GDP Second Report	2.5%	**2.4%**		3.2%
7:30 am	Q4 GDP Chain Price Index	1.3%	**1.4%**		1.3%
8:45 am	Chicago PMI – Feb	56.4	**58.0**		59.6
8:55 am	U. Mich Consumer Sentiment- Feb	81.2	**81.2**		81.2