First Trust
Monday Morning OUTLOOK

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No Recipe for Weak Housing

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Something strange happened after last Friday's jobs report - the yield on the 10-year Treasury Note fell, finishing Friday at 2.95%, down four basis points from Thursday's close. To us, this makes no sense. If anything, it serves to reinforce our view that the bond market is making a big mistake.

Yes, we realize that July nonfarm payrolls (at +157,000) were lighter than the consensus expected 193,000. But, as we wrote in our Data Watch, May and June were revised upward by a total of 59,000. In other words, July payrolls were 216,000 higher than the Labor Department estimated in June. If we assume these new workers make the average weekly wage, that equals $10.5 billion more in annualized earnings for American workers (216,000 x $933.23 x 52) – in just one month!

Meanwhile, civilian employment (an alternative measure of jobs that includes small-business start-ups) rose 389,000 in July, helping push the jobless rate down to 3.9%. Even more impressive, the U-6 unemployment rate - what some people refer to as the "true" rate, which includes discouraged and marginally-attached workers as well as and those with part-time jobs who say they want full-time work - fell to 7.5%, the lowest reading since 2001.

The Hispanic unemployment rate dropped to 4.5% in July, the lowest on record dating back to the early 1970s. At 6.6%, the black jobless rate was not at a record low, however, these figures are volatile from month to month and have averaged 6.9% in the past year, the lowest 12-month average on record. Notably, the unemployment rate among those age 25+ who never finished high school is 5.1%, also the lowest on record dating back to the early 1990s. You sensing a trend?

Put it all together and we see plenty of reasons to be optimistic about economic growth in the third quarter. It's early, but right now we're tracking 4.5% real GDP growth in Q3, which would boost the year-over-year increase to 3.3%. Some analysts tried to discount the growth in the second quarter because of a surge in exports, but we think the more important quirk in Q2 was that companies reduced inventories at the fastest pace since 2009. A return to a more normal pace of inventory accumulation means a large boost to growth in Q3, more than offsetting any impact from trade.

The conventional wisdom just can't wrap their collective heads around the idea that tax cuts and deregulation are truly boosting underlying growth. And, like much of the previous nine years, keep looking for a reason to be bearish about the economy. This time they think housing will collapse. After all, housing starts fell in June, so did new home sales, and existing home sales have fallen for three straight months.

That said, it's too early to rule out that this is simply statistical noise. These figures will go through some quite substantial revisions in the months and even years ahead. The softness could be completely revised away.

And remember, home building is still below fundamental levels, based on population growth and scrappage. The US has about 138 million housing units, so annual population growth of 0.7% per year suggests we need to build about 950,000 new housing units per year (0.7% of 138 million). Add to that homes replaced due to scrappage (voluntary knock-downs, fires, floods, hurricanes, tornadoes) and the 1.25 million housing starts of the past year simply isn't enough.

Finally, while higher mortgage rates would pose a problem for homebuyers if everything else were unchanged, that's not the case. Mortgage rates have moved higher because of faster anticipated economic growth. In that environment, mortgage rates should be higher, and home-buying should move higher as well. An economy with 3% real GDP growth and a jobless rate below 4% is going to create more buyers than the Plow Horse economy that prevailed from mid-2009 through the start of 2017.

In spite of our optimism, one of the things we know for sure about the next couple of years is that, from time to time, one part of the economy (or more) will lag others. We expect the pouting pundits to use that weakness to predict doom and gloom. We can't prove they will be wrong, just like we can't "prove" the sun will come up tomorrow. But, for the past nine years we've disagreed with the pessimism, and we still do. The economy - and housing - will continue to grow.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-7 / 2:00 pm	Consumer Credit– May	$15.0 Bil	**$14.2 Bil**		$24.6 Bil
8-9 / 7:30 am	Initial Claims – July 8	220K	**216K**		218K
7:30 am	PPI – Jun	+0.2%	**+0.3%**		+0.3%
7:30 am	"Core" PPI – Jun	+0.2%	**+0.2%**		+0.3%
8-10 / 7:30 am	CPI – Jun	+0.2%	**+0.2%**		+0.1%
7:30 am	"Core" CPI – Jun	+0.2%	**+0.2%**		+0.2%