



House price now matters more than numbers sold

- **US home sales eased for second month in March**
- **But house prices continue to rise**
- **This will underpin strengthening household spending**

US housing markets weakened slightly in February and March. Total home sales eased in both months, dropping from a three-year high of 5.385 million units (annualised rate) in January, to 5.337 million in March. Housing starts admittedly jumped to 1.036 million in March (the first number above one million since 2008) but building permits, which are more of a leading indicator than starts, have broadly speaking been flat in the 900-910 thousand range since last November.

Housing has had a good run over the past 18 months. Total sales have risen by double-digit rates on a twelve-month basis (March was still up 10.9% from a year earlier) and have only stalled in the last few months. The supply of unsold homes is low by historic standards: 4.4 months for new homes, compared with a long-run average of 6.1 months; and 4.9 months for existing homes, with a long-run average of 5.2 months. Some of the weakness over the last winter months may be due to unusually bad weather, in which case there could well be something of a rebound in the summer.

However, there is one housing market series which continues to develop well, namely house prices. This is important for two reasons. First, because house prices tend to have a stronger impact on household spending than equity prices. The historical relationship has tended to be that households increase their spending by 4 cents for every dollar that share prices rise; but by 8 cents for every dollar of higher house prices. Second, because rising house prices – and equity prices – are one likely reason why the employee payroll tax increase (or rather, reversal) in January has not had much of an impact on household spending. Moreover, because most people are not necessarily selling their homes in order to be influenced by what they hear and perceive about house values, house price developments are arguably for the moment more important than the actual number of home sales.

There are a number of different measures of US house prices. The Case-Shiller index and the Federal Housing Finance Agency (FHFA) index both measure sales of the same house. The drawback is that they are published with one month's lag and, with the Case-Shiller index, the geographical coverage is limited. By contrast, the National Association of Realtors index for new home sales and the Census Bureau's index for existing home sales are slightly more up to date, are broken down by median and average prices, and go back much further (to 1968 for existing homes, to 1975 for new homes).

This Comment looks at the median price of existing homes. For the sake of giving complete information, however, it should be noted that the Case-Shiller 20 cities index rose by 1% in January and by 8.1% from a year earlier, the highest number since June 2006. The FHFA index – published today – rose by 0.7% in February (the fifth month the rise was at or above ½% per month) and was up 7.1% from a year earlier, again the highest rise since June 2006.

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For existing homes – published yesterday – the median price rose by 2.3% in March and was up 14.5% from a year earlier. On a three-month moving average, the 12-month change has been in the double digits since last December. Nominal house prices have risen 17% from their lowest level (July 2011) and are now 18% below their peak (October 2005).

Perhaps more importantly, real house prices – the median price of an existing home, deflated by the CPI – are at their highest in four years.

US real house prices - nominal median price for existing homes, deflated by CPI



There is clearly still a long way to go to reach the peaks of the housing bubble – in fact, that may never happen. However, house prices have recaptured the levels at which the housing boom began; and strong US demographics should ensure continued momentum. Moreover, as the time approaches when the Fed will cease its quantitative easing and in due course begin to raise interest rates, households that are currently reluctant to commit are likely to want to lock into current interest rates before it is too late. These developments should therefore continue to underpin strengthening household spending over the course of the year and into 2014.

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