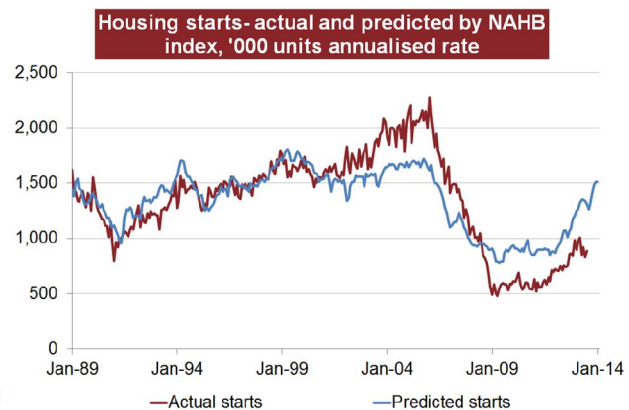
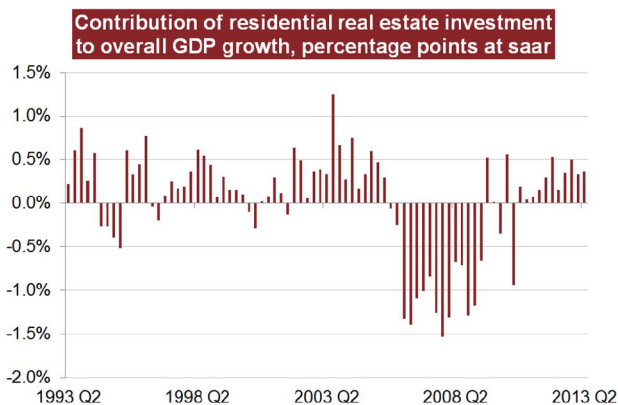


## Not the end of the US housing recovery

- **Recent US housing market data is slightly off**
- **But underlying numbers are still good**
- **Housing market activity paused in Q3 (possibly in Q4) but will recover in 2014**

Mortgage rates are rising; mortgage applications are falling. The NAHB housing market index stalled in September; and housing starts and building permits were down in August. An observer would be justified in thinking that the housing recovery – which has provided about one-seventh of US output growth over the past two years is coming to an end.

Justified – but wrong. It certainly seems that housing will have contributed less to growth in Q3 than over the past two or three quarters – but these were unusually strong, not just by post-crisis but even by historic standards. In fact, over the past five years, the contribution of housing to GDP growth (a quarterly annualised 0.3 percentage points, with overall average growth of 2.2%) has been close to what was achieved during the early 2000s housing boom (0.4 percentage point contribution to average growth of 2.5%). However, the number of homes built has only recovered from a low of 478,000 units (annualised rate) in April 2009 to around 900,000 in 2013. To put this into perspective, in previous housing market busts, absolute bottoms for housing starts and building permits tended to be between 800,000 and 900,000 units. So we have barely risen to previous troughs – and the US population is now 20 million larger than it was in 2006.



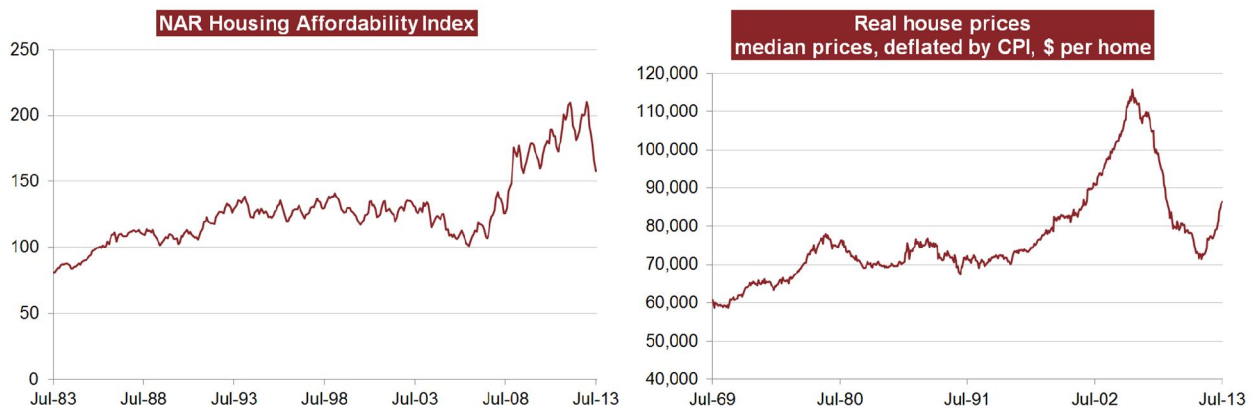
Meanwhile, the NAHB index may have stalled in September; but the August and September numbers are the highest since the housing bubble burst in late 2005. There is a good relationship between this index and housing starts (although the index tends to underestimate starts in a boom and overestimate in a bust). The latest NAHB numbers therefore forecast continued strong housing starts.

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Obviously, this is all tied up with the Fed's decision on how to wind down (or not) its quantitative easing. There are concerns that higher bond yields could choke off the housing market recovery; and 30-year mortgage rates have risen by around 100bps over the past six months in tandem with bond yields. But, bear in mind that this has also been a period of extremely high home sales, with July registering a total of 5,784,000 units, the highest since July 2007.

Moreover, although higher interest rates have made housing more expensive, this too must be seen in a perspective; the National Association of Realtor's Housing Affordability Index is still below its long-term average; as well as below its ten-year average. (A reading of 100 means that a family on median income just qualifies for a mortgage on a median-priced house. A higher reading means houses are more affordable and *vice versa*.) By historic standards, US houses are still relatively cheap. For all the price rises we have seen in recent years, real house prices (median prices for existing homes, deflated by the CPI) are still more than 25% lower than their peak in October 2005.



In addition, past experience shows that when households are concerned about higher interest rates, they do not immediately stop buying houses. While there may be a pause while they attempt to gauge where rates will go, there is then usually also a move to lock in current interest rates before they rise even further. Also, the supply of homes for sale, both existing and new, is well below its long-term average (new homes for sale are 5.2 months, existing are 5.1; the long-term average is 6.1 months for new and 7.3 months for existing).

All this being said, the double-digit growth in residential investment that we have seen over six of the past seven quarters is unlikely to continue. It does seem that there was a housing market pause in Q3, possibly to be extended into Q4. But that is just what it will be – a pause. There is still substantial pent-up demand for housing in the US; housing is still affordable and will continue to contribute to growth in 2014.

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