2018 Outlook

Residential Construction: R&R and New Residential

Residential R&R Market Outlook: Backdrop Remains Solid, We Expect Another Strong Year With Growth Above LT Trend at ~5%

In our *2017 one-stop Outlook* we forecasted that the R&R market would grow at 4-5%. According to the *Joint Center for Housing Studies (JCHS) of Harvard University's Leading Indicator of Remodeling Activity (LIRA)*, the R&R market is projected to end 4Q17 at $315bn, an increase of about 6.3% y/y, slightly ahead of our estimate. LTM at 3Q17 was +6.4% and we doubt there will be any surprises in 4Q17 once it is trued-up with actual data. Based on the LIRA's more robust construction methodology we think this is a better proxy for residential R&R activity relative to the *Home Improvement* series published by the U.S. Census Bureau and calculated by taking total residential spending less new construction spending to derive R&R spending. In its latest release the JCHS estimates that R&R market growth will accelerate in 2018 (from 6.4% in 4Q17) to 7.7% in 3Q18 on a rolling 12 month basis. We tend to agree with JCHS's assessment that the R&R market is likely to see another strong year above its longer-term growth rate average of 4% (2000 – present). Therefore, we are estimating growth of about 5% for R&R overall. Furthermore, we think with the recent storms (Hurricane Harvey and Irma) will be additive in 2018 to the overall market, another underlying force which could drive outperformance versus 2017. Investors should keep an eye on some of the recent tax reform legislation making its way through Congress and how that could impact housing, in general. We briefly discuss the issue in our residential new construction outlook below. During DB's 2017 Building Conference (held 12/7/17), *DB's Building Product Team (Nishu Sood, Tim Daley, and Spencer Kaufman)* presented a series of correlation statistics during their presentation titled *State of the U.S. Construction industry* for various drivers as they relate to home improvement spending (replicated below), correlation coefficients and lags. The full presentation by the team can be found via this link: 2017 Building Conference: State of the US Construction Markets.

Figure 1: Drivers Of Home improvement Spending

Driver	Correlation Coefficient	Correlation Lag
GDP	0.8422	1Q
House Price Index	0.8184	1Q
Leading Economic Index	0.7325	1Q
Remodeling Permits	0.7885	4Q
Housing Starts	0.7436	4Q
Existing Home Sales	0.7478	5Q

Source: Deutsche Bank, Harvard JCHS

What we find encouraging is that many the above indicators remain positive and are likely to accelerate into 2018. For example, according to *Bloomberg*, GDP continues to accelerate with 2017 expected to be +2.2% y/y (from 1.5% y/y in 2016) followed by +2.5% y/y in 2018. Housing starts (at a four quarter lag) should accelerate into 2018 +6% y/y, versus 2017. Also an important driver is housing prices, which, if one looks at the *S&P CoreLogic Case-Schiller U.S. National Home Price Index*, is now reading 196, about 6% higher than the prior cycle peak in 2006.