

From: US GIO <[REDACTED]>

To: Undisclosed recipients;

Subject: J.P. Morgan Macro Skinny: US housing market emerging from the shadows

Date: Fri, 21 Sep 2012 14:48:43 +0000

Attachments: 2012-09-21_Housing_market_emerging_from_the_shadows.pdf

Inline-Images: image005.png; image008.png; image009.png; image010.png; image011.png; image012.png; image013.png; image001.png; image014.png; image003.jpg; image002.png

Macro Skinny

J.P.Morgan

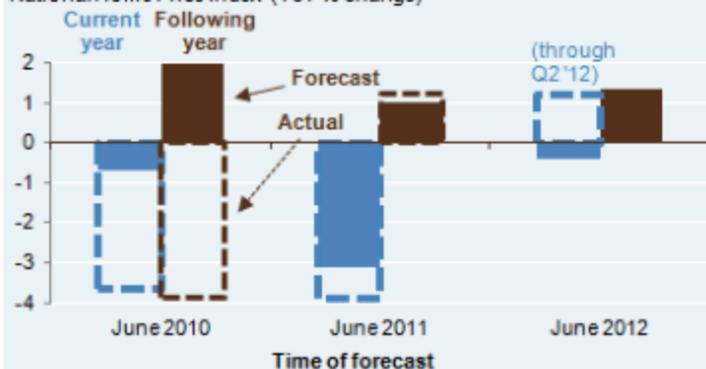
September 21, 2012

US housing market emerging from the shadows

1. The housing market is turning the corner. The housing market bottom that has been forecast over the past several years has failed to materialize. This has been especially true for home prices, which have consistently been projected to rise “next year” (left chart). The recent spate of housing data has been stronger than expected: prices have turned positive; new construction is picking up; and sales of new and existing homes are rising.¹ Although residential investment has not been the engine of economic recovery it usually is, housing has made a meaningful shift to boosting GDP growth, rather than dragging it down (right chart).

After years of overshooting, forecasts are now undershooting...

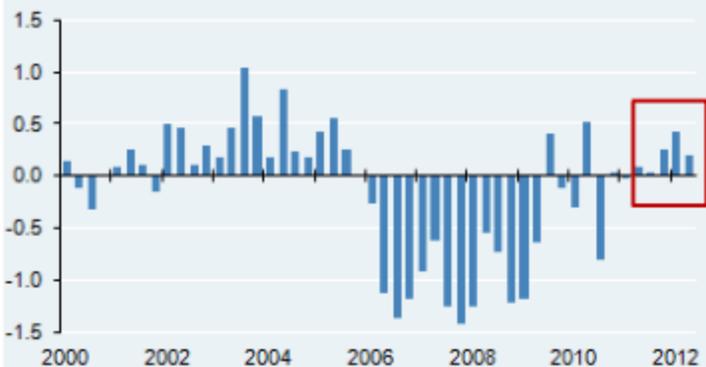
Economists and real estate experts' projections of the S&P Case-Shiller National Home Price Index (YoY % change)



Source: Pultenomics, Morgan Private Bank.

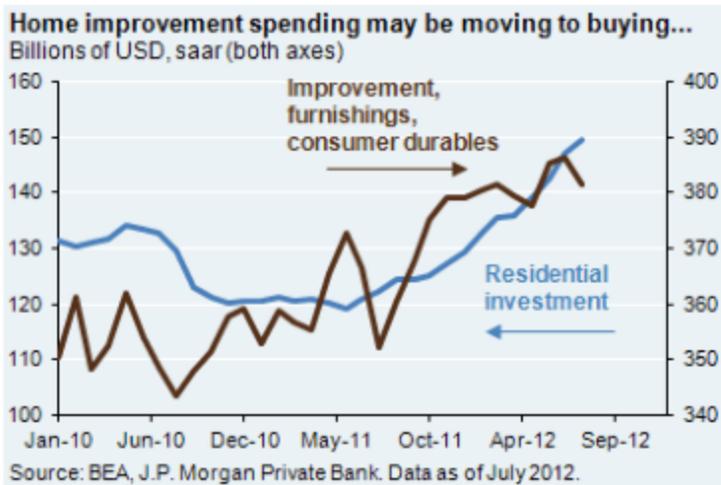
...and housing is becoming a boost instead of a drag

Residential investment contribution to real GDP growth, %-point

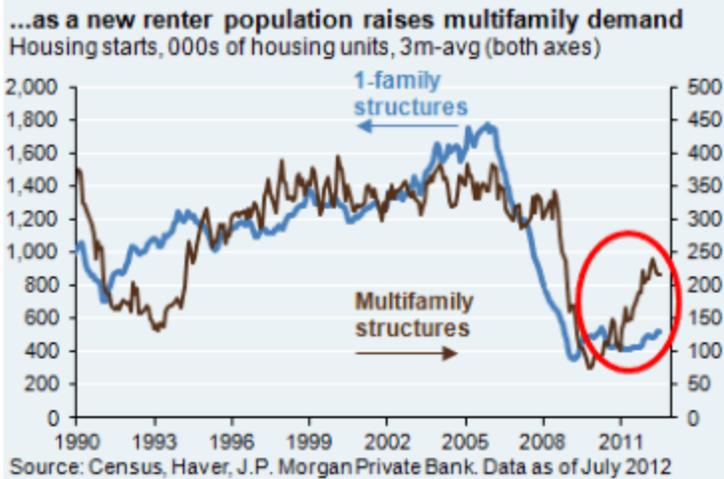
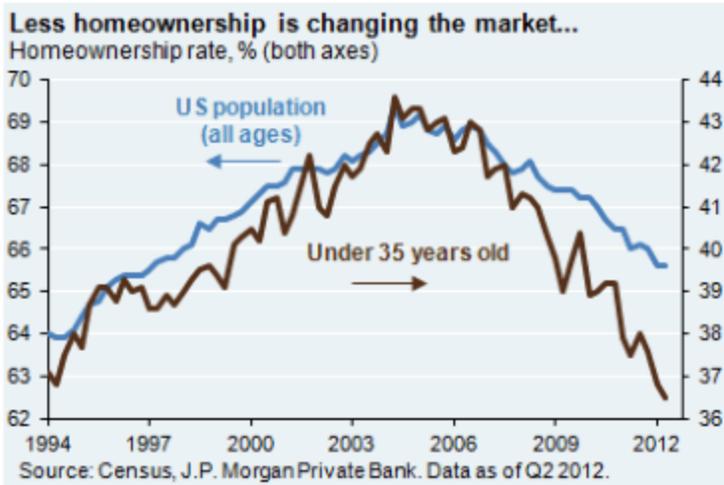


Source: BEA, J.P. Morgan Private Bank. Data as of Q2 2012.

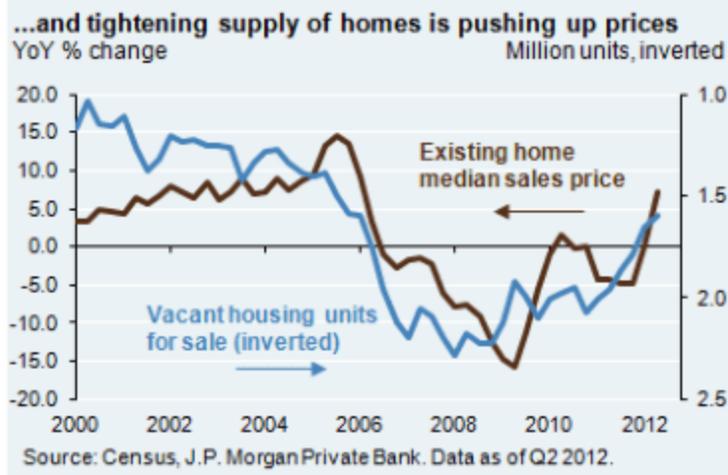
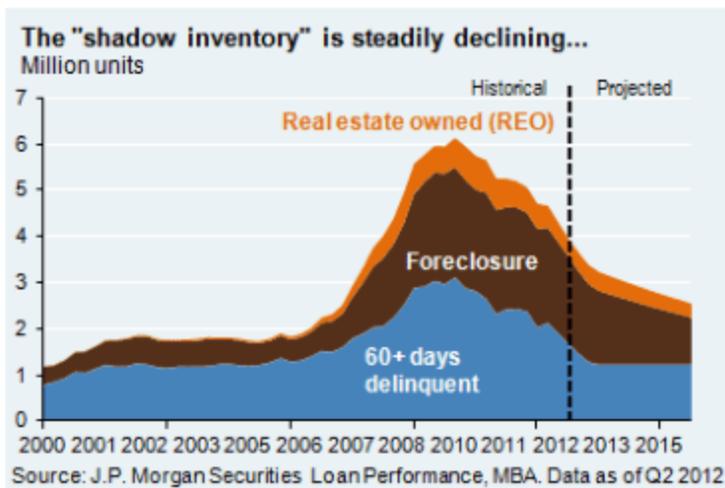
2. From home improvement to housing construction. After saving a significant amount of cash in the first years of the crisis, households have been spending some of that cash on home improvements since.² Recently, we have seen an encouraging transition—spending on home improvement gave way to new home investments. The impressive normalization in homebuilders' expectations of future sales suggests further upside in new home construction and sales in the short term (right chart).³



3. The housing market is transforming. The housing bust has led to a drop in homeownership, particularly for young adults (left chart) who cannot afford to buy homes and choose to either rent or live with their parents. The former is why multifamily construction has outpaced single-family construction (right chart). The latter explains why the formation of millions of new households has been postponed, although surely future homebuyers are accumulating cash in the meantime.⁴ As employment conditions gradually improve, young adults will begin to live on their own and enter the housing market as a key source of demand.

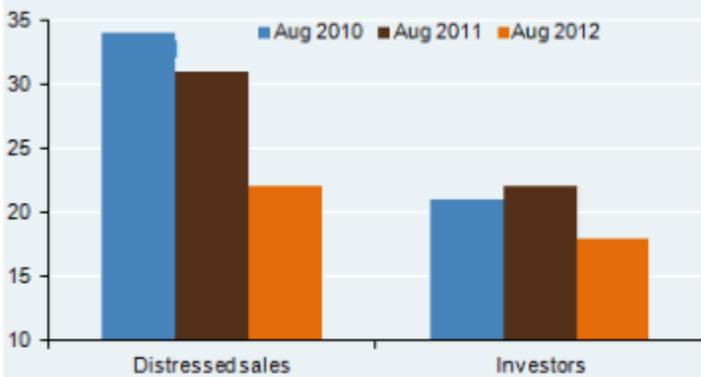


4. Inventories are falling. The stock of vacant homes that are “ready for sale” has fallen sharply in recent quarters, but some analysts argue that the so-called “shadow inventory” will further weigh on the housing market, leading to another dip in prices. First, the shadow inventory has declined meaningfully (left chart). Second, fewer vacant homes and rising prices suggest that shadow inventory will continue to be absorbed and is unlikely to curb the budding recovery (right chart). Indeed, we expect tightening supply to be supportive of home prices and construction activity going forward.



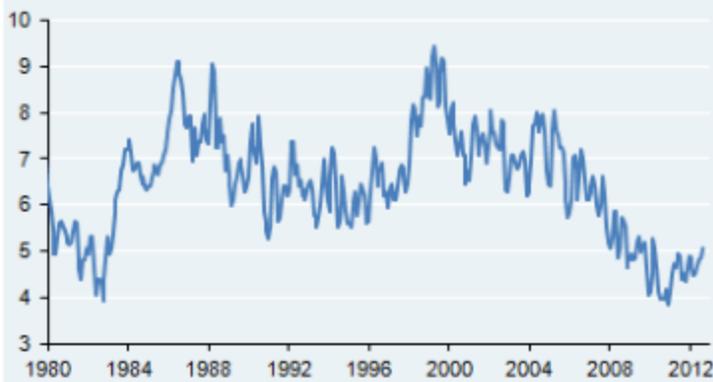
5. The foundation of the housing market is now set. However, similar to every other aspect of this recovery, we expect growth to be slower than we are used to. The run-up in house prices during the mid-2000s accelerated economic activity: we received a double bonus from construction and consumers' ability to extract home equity for spending.⁵ Now, however, this equity extraction channel is blocked, and house prices would have to rise meaningfully to re-open it. We do not expect this to happen anytime soon. A decreasing share of distressed properties is a boost for house prices, and the falling share of investors indicates further normalization (left chart). So, too, does the rising share of households planning to buy (right chart). A housing recovery driven by fundamentals instead of "irrational exuberance" is likely to be mild, but with broad-based indicators pointing in the right direction, the risk of this being another "false start" is very low.⁶

Stock of home and types of buyers are normalizing...
 % of existing home sales



Source: NAR, J.P. Morgan Private Bank.

...as households are increasingly willing to buy homes
 % of consumers planning to buy a home within six months, 3mma



Source: Conference Board. Data as of August 2012.

Michael Vaknin
 Chief Economist, J.P. Morgan Private Bank

Jeff Greenberg
 Associate Economist, J.P. Morgan Private Bank

Paul Eitelman
 Associate Economist, J.P. Morgan Private Bank

¹ The S&P/Case-Shiller (repeat sales) home price index has risen year-on-year. Although the median existing home sales price has risen more than 10%, median new home sales prices are down slightly year-on-year (-2.6% as of July). The value of residential construction put in place is up 17.6% year-on-year (as of July). July new home sales were 25% (372,000, saar) higher than a year prior. August existing home sales were 9.3% greater than a year prior (4.82 million, saar).

² Since 2008, households have significantly cut back on housing investment and consumption spending, implying \$1.3trn of cash savings a year (12% of disposable income).

³ New home sales this July were 25% higher than a year ago, albeit at annualize rate of 371,000 sales the pace is well below the historical average (667,000). Similarly, a national survey of homebuilders reached its highest level in more than 5 years, although still more homebuilders consider the market “poor” than “good.”

⁴ Economists at the Cleveland Fed recently estimated that there has been a shortfall of 2.6 million households (based on data through 2011).

⁵ Home equity extraction has been negative, i.e. implying injection of capital, since 2008.

⁶ The phrase was popularized by Alan Greenspan’s 1996 description of the dot-com boom and stock valuations, and the concept dates back to Charles Mackay, Extraordinary Popular Delusions and the Madness of Crowds (1852).

Acronyms:

BEA – Bureau of Economic Analysis

MBA – Mortgage Bankers Association

NAHB – National Association of Home Builders
SAAR – Seasonally-Adjusted Annualized Rate

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