# Economic Research

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## *Taking a Peek at the US Housing Market*

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# US Economy | Taking a Peek at the US Housing Market

## Key takeaways

- Amid increasing optimism over the prospects of economic recovery in the US, we think it is worthwhile to look at the source of the recent slump – the housing market – which, to a large extent, is showing promising signs of recovery.

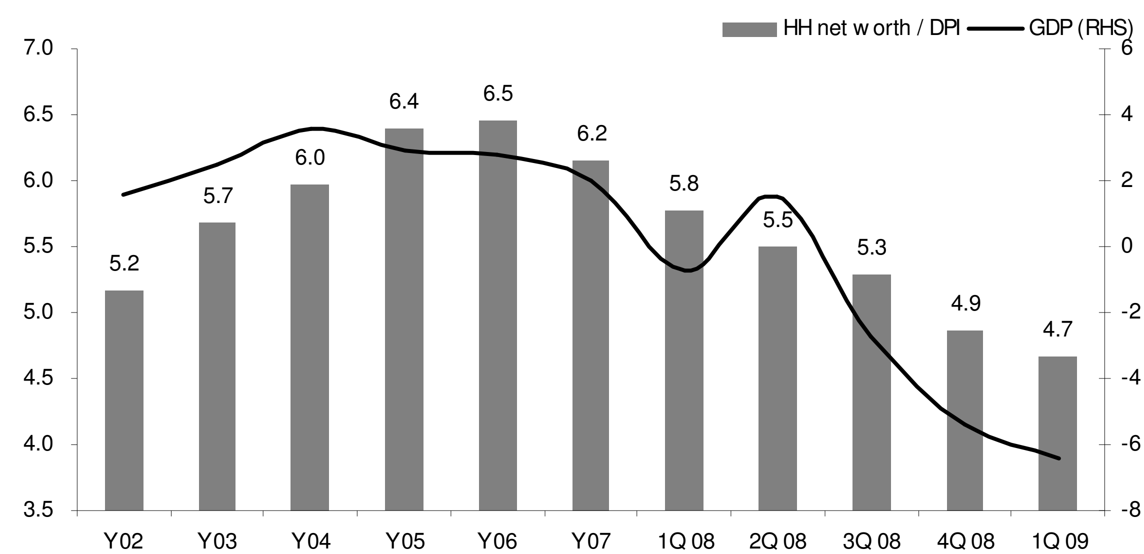
- The importance of real estate assets can be seen from the fact that it still accounted for a sizeable 73.8% of total household tangible assets in 1Q2009, despite a slow decline since 2005. This indicates that the health of the US housing market is crucial to households as it is a significant source of wealth creation. Hence, a rejuvenated housing sector is needed to repair household balance sheets. However, further increase in mortgage rates could impede recovery in the housing market.

- The sequential trend of recent month-on-month (m-o-m) changes shows new home sales (NH) and existing home sales (EH) were up by 11.0% and 3.6% respectively in June, leading to a decline in housing stock.

- Nonetheless, as home prices remain at depressed levels, there is unlikely to be any wealth effect generated from the housing sector at this juncture. This also means housing sales will not provide a much needed boost to American consumers, which partly explains the 1.2% decline in personal consumption expenditure (PCE) in 2Q2009.

- Rising long-term bond yields that have pushed up mortgage rates could hamper the recovery of housing sector. In addition, high delinquency rates in the real estate segment will continue to curb bank lending, making the recovery of the economy slower than anticipated.

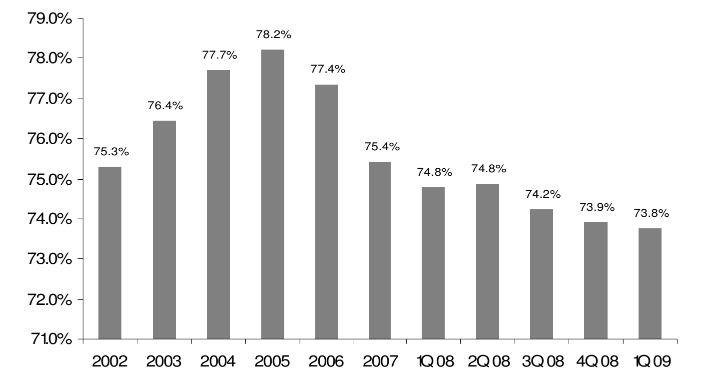
### US household net worth and GDP are moving in tandem




*Source: US Federal Reserve & Bureau of Economic Analysis (BEA)*

# Why the housing sector is critical to US economy…

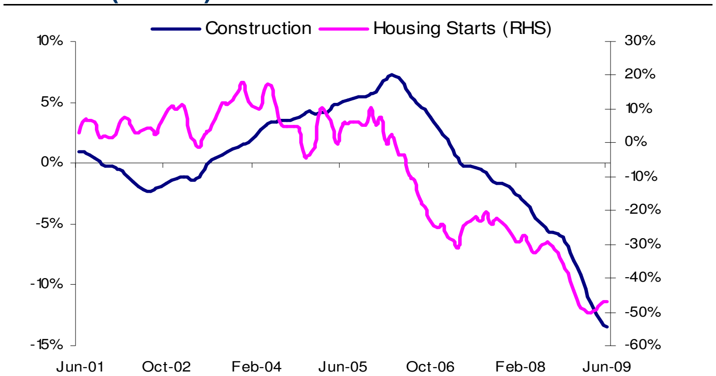
## Chart 1: Real estate % of total tangible assets




*Source: US Federal Reserve*

- Based on the US flow of funds account, real estate still accounted for a hefty 73.8% of total household tangible assets in 1Q2009 despite declining from its peak in 2005.
- The sub-prime mortgage crisis has clearly had a significant effect on household balance sheets by shrinking its worth, leading to a slump in consumer spending in 2Q2009.
- It is critical for the real estate sector to recover before consumer spending can improve. Thus far, efforts to boost the sector through the Making Home Affordable (MHA) program and the US$8k tax credit for first time buyers have been fruitful.

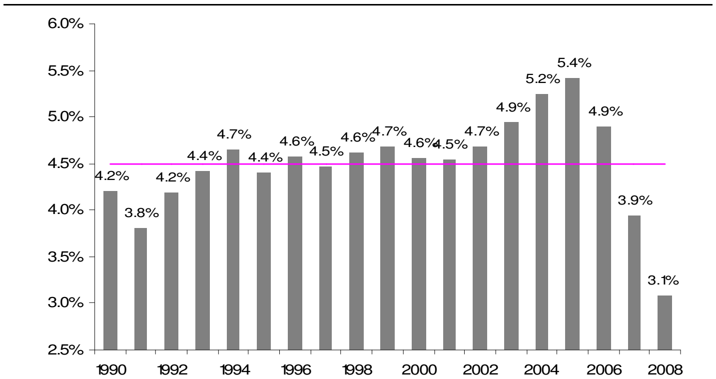
## Chart 2: Construction workers & housing starts YoY% (3mma)




*Source: Bloomberg*

- There is a strong link between the number of workers engaged in construction activities and US housing starts with a correlation of close to 70% and an R-squared of 50%.
- This correlation may explain the weak spending pattern during the collapse of sub-prime mortgage financing as construction workers were among the first to be retrenched.
- The US government's fiscal stimulus measures will likely help to stem further losses in construction jobs as more infrastructure projects are rolled out.

## Chart 3: Residential investment % of GDP

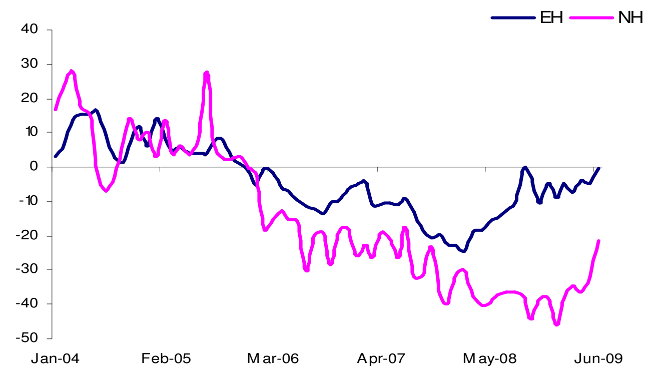



*Source: US Federal Reserve*

- The share of residential investment to GDP has declined significantly to 3.1% in 2008, compared with its long-term average of 4.5%, following the burst of the housing bubble.
- The latest numbers in 2Q2009 still show a contraction in residential investment, albeit at a slower pace of -29.3% compared with -38.2% registered in 1Q2009, the largest decline since 2Q1980 (-55.9%).
- Given this, there is a need for the accommodative monetary policy stance to be maintained for a longer period to promote residential investment.

# Sales improved but prices remain low…

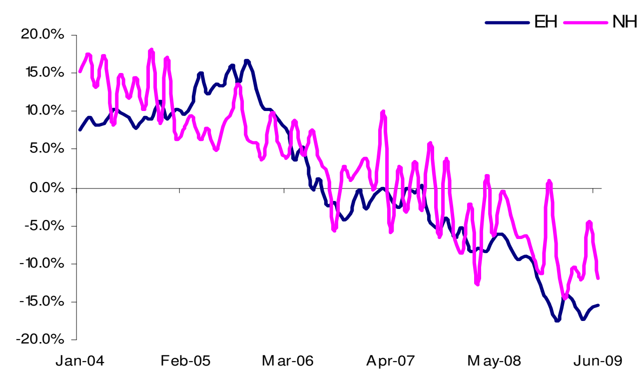
### Chart 4: Home sales in Y-o-Y%




*Source: Bloomberg*

- Home sales have improved in recent months with the sequential trend showing positive growth for both existing home sales (EH) as well as new home sales (NH).
- Including single-family, townhomes, condominiums and co-ops, EH sales increased 3.6% m-o-m to a seasonally adjusted annual rate of 4.89 million units in June from 1.3% in the preceding month.
- On a more positive note, NH sales rose substantially by 11.0% in June from 2.4% and 1.8% expansion in the preceding two months. However, on a y-o-y basis, home sales are still contracting, but at a slower pace than in the last two months.

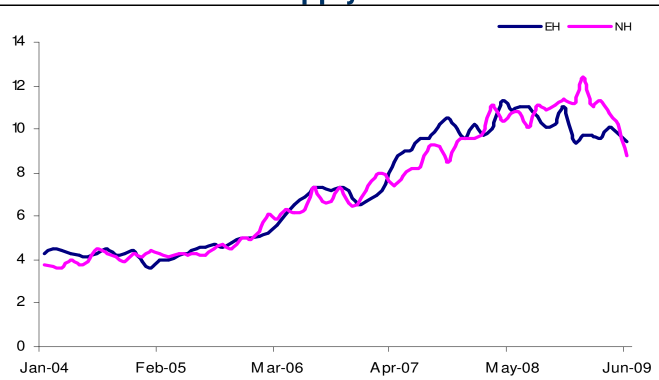
### Chart 5: Median price Y-o-Y%




*Source: Bloomberg*

- While higher sales were recorded, prices remained at depressed levels, contracting at a double digit pace.
- As a result, any positive wealth effect for consumers is unlikely to be generated from the housing sector at this juncture.
- The combination of higher sales and lower prices may have been due to forced selling by banks as a result of the increasing foreclosure proceedings.

### Chart 6: Months of supply

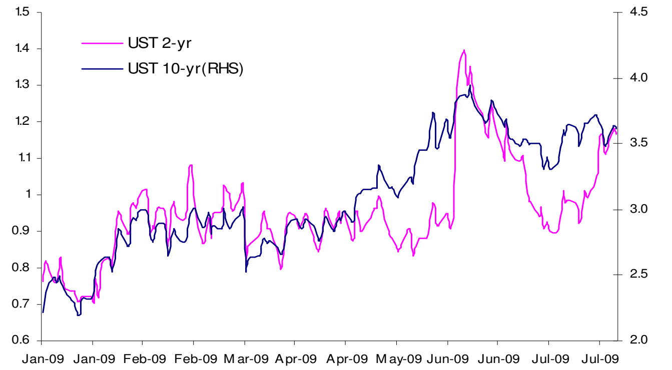



*Source: Bloomberg*

- Housing inventory is depleting due to higher sales in both the EH and NH segments.
- The supply of EH stood at 9.4 months in June, down from a high of 11 months in November 2008, while the supply for NH dropped to 8.8 months from 12.4 in January this year.
- Reduced inventory will likely result in higher housing starts as demand starts to pick up in the medium term. The latest reading showed that starts have improved by 3.6% in June to 582,000 units.

# Rising yields could lead to a slower recovery…

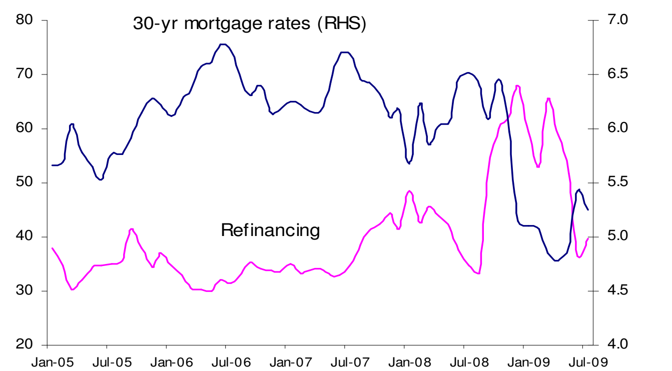
## Chart 7: Rising US Treasury yields….




*Source: Bloomberg*

- Bond yields are rising reflecting investors' concern about US government finances given the sizeable fiscal stimulus package which requires huge borrowings.
- Rising bond yields can lead to a "crowding-out effect", which in turn impedes investment growth as costs of borrowings become increasingly expensive.
- Rising bond yields also signal expectations of higher inflation among investors. Should this turn out to be the case, then the accommodative monetary stance will need to be adjusted accordingly.

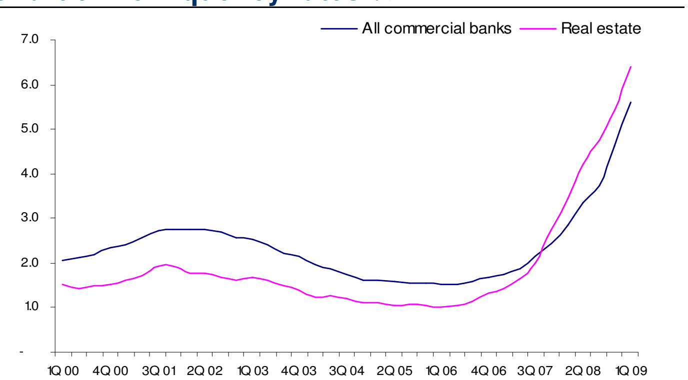
## Chart 8: ….mortgage rates too




*Source: Bloomberg*

- The 30-year mortgage rates are also on the rise, raising fears that home mortgage refinancing activities will stall.
- Mortgage rates have gone up by 40 bps to 5.25% at the end of July after reaching a low in March this year, making mortgage financing increasingly expensive.
- This could herald a slow recovery in the housing market as buyers' repayment capacity has been severely dented by weak income as well as unstable labour market conditions due to the high unemployment rate.

## Chart 9: Delinquency rates %




*Source: US Federal Reserve*

- Due to high delinquency rates, banks are increasingly saddled with bad loans. In 1Q2009, the delinquency rate for all commercial banks rose to 5.6% compared with 4.6% in the preceding quarter.
- In the same vein, the high delinquency rate for real estate loans also suggests that home owners are still facing difficulties in meeting their repayments on time.
- Given this, banks are likely to remain cautious in lending despite signs of an economic recovery. Should the "green shoots" story fade, banks will likely trim back on their lending activities.