US Housing: The 'V' we need to see

The US economy is re-opening and there are encouraging signs in many sectors, but none more so than housing. Record low borrowing costs and rising optimism suggest a vigorous recovery that can help kickstart growth in other parts of the economy

Source: Shutterstock

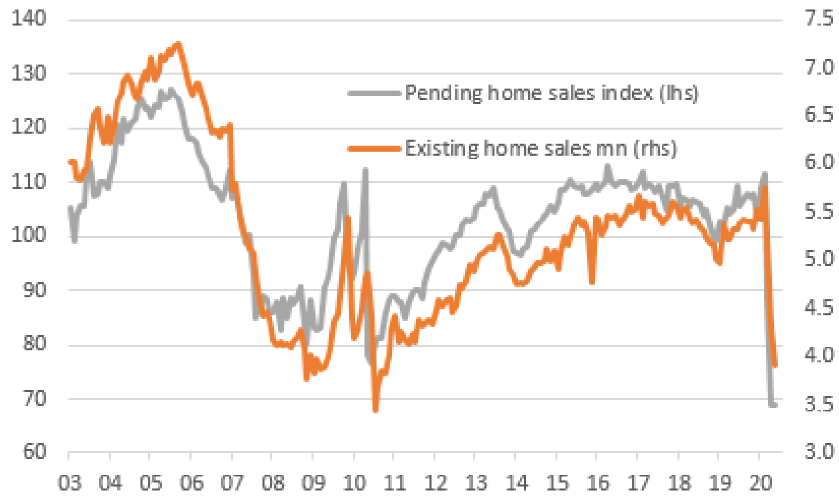
Housing went from feast to famine...

The housing market had been in good shape at the beginning of the year as record employment, rising wage growth and falling mortgage rates finally prompted a decent pick-up in transactions. This triggered a major rebound in construction activity with residential investment the one bright spot of the 1Q 2020 GDP report, recording annualized growth of 18.5%.

However, the Covid-19 pandemic sent optimism in the sector crashing lower. Mortgage applications plunged in the wake of the lockdown measures with transactions pulled as fear griped the market. For first time buyers, deposits that were invested in equities were hit hard and a general sense of panic over health, wealth and jobs made even seasoned buyers anxious.

Existing home sales fell 32% between February and May, taking them towards the lows experience in the global financial crisis of an annualized 3.9 million. New home sales proved to be a little more resilient, falling 25% between January and April. Meanwhile, housing starts - a measure of construction activity - fell 42% between January and April, giving a clear indication that residential investment will be a major drag on economic activity in 2Q20.

Home sales collapsed as pandemic fears hit



Source: Macrobond, ING

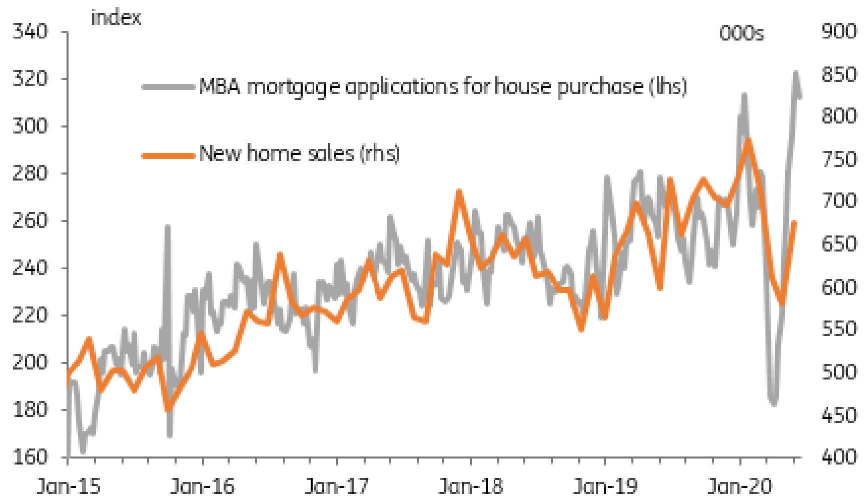
But clear signs of a "V"

However, the news is already turning for the better with lead indicators pointing to a vigorous recovery in housing activity, potentially to levels not seen in years. Chief amongst them is the fact that mortgage applications for a home purchase rose for nine consecutive weeks, taking them to an 11-year high. Admittedly, they slipped back last week, but remain 18% higher than at the same point last year.

At face value this is remarkable given the scale of joblessness in the economy and the ongoing uncertainty relating to the path of Covid-19. One explanation is that the average home buyer in the US is 47 years old, as reported by the National Association of Realtors. The more affluent, slightly older workers have been less impacted by job losses than younger workers employed on lower wages in retail and hospitality, who would be far less likely to be in the market for a house in any case.

The rebound in equities may have calmed nervousness about making a potential purchase of a new primary home or vacation home. Meanwhile aggressive Federal Reserve action has eased financial market tensions with credit continuing to flow and mortgage rates and debt payments as a proportion of disposable income falling to new lows.

Mortgage approvals suggests good times ahead

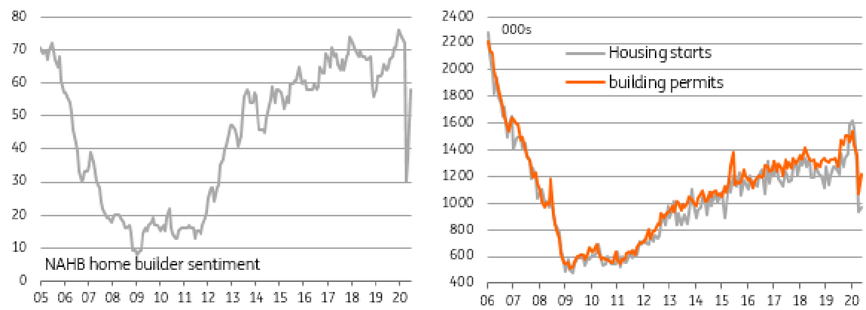


Source: Macrobond, ING

The surge in mortgage applications has already triggered a 16.6% bounce in new home sales in May. Both new home sales and pending home sales are recorded at the point buyers sign the contracts – which is obviously right at the beginning of the transaction process. Even so, the performance of new home sales (newly built properties) was much stronger than pending home sales and likely reflects developers/home builders being better able to leverage technology in their pitches, such as doing virtual tours of properties.

This is borne out by the fact that home builder sentiment, as measured by the National Association of Home Buyers has rebounded sharply and suggests that housing starts and building permits, which rose 4.3% and 14.4% respectively in May, will post further strong gains in coming months. This is good news for construction activity and employment in the sector.

Home builder optimism points to improving construction



Source: Macrobond, ING

The pending sales figures reflects contract signings for homes that are already in existence and given the lockdowns, realtors were unable to physically get to the homes to show prospective buyers around and were likely less able to set up virtual tours of properties. Given the re-opening the situation has eased in much of the United States so we are expecting to see a huge 25%+ increase in May pending home sales – published next Monday.

Such an outcome would suggest the worst is over for existing home sales, the data for which is collected at the very end of the process as the transaction is closed/completed. We expect to see a small rise in June given the time it takes to close a sale, but anticipate much stronger numbers in July.

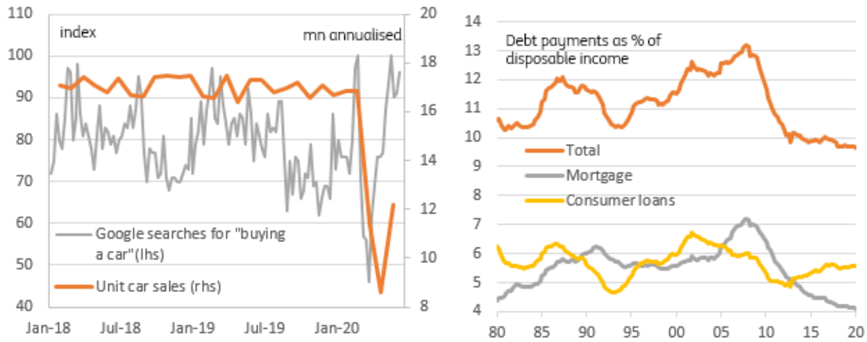
The housing market kick-starts the recovery process

All in all, the outlook for housing transactions, construction activity and employment in the sector is looking much better than what looked possible just a couple of months ago. Housing transactions are also strongly correlated to retail sales – as people move to a new home they typically also spend money on new furniture and home furnishings, garden equipment and building supplies such as a new paint job and a bit of home improvement.

With the Fed signaling monetary policy will remain extremely accommodative for a prolonged period and credit conditions looking in decent shape, favourable financing conditions should continue. With the economy now adding jobs and mortgage debt payments as a proportion of disposable incomes at historic lows the fundamentals appear fairly sound.

This should provide a decent platform for the housing market and associated sectors with the same story helping to fuel demand for other big-ticket items. Indeed, auto sales look as though they should also get back to pre-Covid 19 levels quickly based on google search data for "buying a car".

Car sales on the rise as debt payments fall



Source: Federal Reserve, ING, Bloomberg

But there are still risks...

That's not to say that there aren't risks of a setback. Where we think caution is warranted centers on the fact that while the economy is adding jobs, around 20% of the workforce continue to claim unemployment benefits. This is above the 13.3% "official" unemployment rate published by the Bureau for Labour Statistics. Under the current rules you do not actively have to be searching for work to claim benefits, however to classify as "officially" unemployed you do need to be job hunting.

With the US$600 per week unemployment benefit boost ending on 31 July and little sign of an agreement to extend it there is the potential that many households that have experienced job losses could feel significant financial pain. Should this result in rising mortgage delinquencies and defaults this could derail the recovery phase with forced sales boosting supply and depressing prices.

In this regard, the average age of a first-time buyer is 33 and any economic uncertainty and potential fear over employment prospects mean that this first part of a housing market transaction chain remains the weakest link.

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