Help for a Sustainable Recovery

by Lawrence Yun, *NAR Chief Economist*

While we listen to the animated discussions surrounding the health care debate, war strategies, flu vaccines and Nobel Peace Prizes, the federal budget deficit continues to rise. There is certainly no delight in watching the budget deficit soar. The $1.4 trillion deficit in the 2009 fiscal year to September is the highest ever in U.S. history – both in sheer dollar figures as well as the highest since the Second World War if measured in relation to the overall economic pie. It's a huge burden to future generations.

Why should we be concerned? Because continuing high budget deficits could easily cause interest rates to rise much sooner – and possibly quite sharply. Yes, there will be arguments about what federal programs work and which ones just bleed money. But Washington needs to come out with a credible plan to reduce the deficit over time.

Meanwhile, price correction – and over-correction – have wreaked havoc on the broader economy. Wall Street balance sheets were bleeding heavily before the big help from the $700 billion TARP funding. Property owners felt it, too: foreclosures spiked, strategic defaults rose among financially capable but underwater homeowners, and appraisals became messier. Most importantly in terms of economic impact, the bulk of American families have experienced a major hit to their wealth accumulation — by more than $4 trillion in the past three years. The economy will have a difficult time gaining firm footing without government life support if home values continue to fall.

One area where federal taxpayer dollars have been effectively utilized is that first-time homebuyer tax credit. The key to any future sustainable economic recovery lies in home values stabilizing or, better yet, a return to a historical home price appreciation rate of 3 to 5 percent each year. The bubble prices crash landed, but all the excesses have already been removed. In fact, one could legitimately argue that home values have overshot downward. Price-to-income ratio is now below the historical average. The monthly mortgage payment for a middle income person buying a middle priced home is well below its historical norm.

A review of the latest data strongly suggests that the homebuyer tax credit has had its intended impact of significantly stimulating home sales. From about 4.5 million annualized home sales pace in the few months prior to the stimulus, sales have jumped to 5.1 million in recent months. That is a change of 600,000 additional existing-home sales. New home sales have risen from the mid 300,000 to low 400,000 range over the similar period. The rise in sales has been concentrated in the lower-priced home segment largely because first-time buyers are looking to stay, rightly, well within their budget.

Housing inventories, while still higher than desired levels, have been trimmed. The latest 8-month supply of existing-home inventory is much better than the double-digit figures of last year. Home values have likewise moved in an "improving" direction. Broadly speaking, they are down from one year ago, but the declines have been less steep in recent months compared to the pre-stimulus times. The median existing-home price as of August was down 12.5 percent compared to a nearly 20 percent decline early in the year. In short, sales have risen and home prices are on the verge of stabilizing.

But the housing stimulus package is set to expire. A settlement, and not the contract signing to buy, must occur by the end of November. Some first-time buyers who are signing contracts to buy in October just may make the deadline. It would be pity if the housing market which is just on the cusp of a self-sustaining recovery rolls downhill again. That could happen if potential buyers step back and inventory returns to an upward climb. Falling home values – independent of whether it is overcorrecting or not – will bring back all the associated collateral damage.

A much happier scenario would be that the buying momentum continues for few additional quarters so that inventory falls back down to the normal 5 to 7 months, a level consistent with home value stabilization. Once that is accomplished, the consumer “fear factor” of waiting and waiting for a lower price later will no longer be part of the home buying decision. We will have reached a point of housing market self-sustainability. Consumer confidence will be lifted. The wealth impact of consumers opening up wallets for general consumer goods will steadily turn positive. Thus, the broader economy also gets set for a sustainable recovery without needing further stimulus dollars.

For that happy scenario to play out, a time extension on the home buyer tax credit is critically needed. At a cost of about $10 billion (if extended through the middle of next year), the housing market will likely have recovered nicely with the broader economy on track for a solid robust expansion. That $10 billion price tag is rather modest compared to the $700 billion in TARP funding and $800 billion of the broader economic stimulus package that was passed early in the year (with debate still raging over the effectiveness of that broad spending bill). Moreover, the cost of $10 billion is a static measure that does not take into account job creations and increased tax revenue from rising economic activity. Actually, if we take into consideration all of the economic dynamic responses, the homebuyer tax credit can be argued as a net positive revenue generator for the federal government.

There is nothing like economic growth to dent budget deficits. If the economy was already at full capacity, the housing stimulus would simply be moving dollars from one sector of the economy to another. But as is fully visible out in the streets, we are nowhere near full capacity. Factory capacity utilization was 69.6 percent in August, compared to an 80 percent rate that should be the case in normal economic times. On the job market front, the country is facing a double-digit unemployment rate rather than the healthy 5 or 6 percent unemployment rate. Therefore, there is a plenty of room for growth for a win-win situation for the housing market and other sectors of the economy.

Despite these vast potential benefits to the economy from extending the homebuyer tax credit, valid questions should nonetheless be asked. Is there any pent-up demand remaining? Will the tax credit just go to the people who would have bought a home anyway and thereby will simply pocket the $8,000 check? Well, the following table shows a compelling case for tapping the financially healthy renter population.

In 2000, before the housing market boom, there were 11.5 million renter households who had the necessary income to buy a median priced home at prevailing market conditions. Today, the pool of renters who can buy a median priced home is over 16 million. Just nudging even a small share – say 5 percent – of these financially healthy renters into buying via a tax credit check will mean 800,000 additional home sales. That number is sufficiently meaningful to get the inventory down to the level of home value stabilization. The housing market will then be on the path to a self-sustaining recovery.

After what we have been through this decade, it would be quite nice to observe a return of a “boring” housing market with annual price growth of a steady and normal 3 to 5 percent - without any of the fits, frenzy, and panic. A faster and firmer recovery can happen if the tax credit is opened up to more buyers by making it apply to *any buyers* – just just first-timers – and by raising the income limit for qualification. It would also contribute to healthy economic activity – a sustained recovery – and thus help to put a dent in the deficit. In short – it’s a win/win. NAR is working hard to get that homebuyer tax credit extended. You can help – by calling, writing or emailing your Congressional representatives. It’s good for home buyers, it’s good for REALTORS®, and it’s good for the U.S. economy.

This table reflects data available through July 3rd of 2009.

Monthly Indicator	Recent Statistics	Likely Direction Over the Next Six Months	Forecast
Existing Home Sales slipped 2.7% in August to a seasonally adjusted annual rate of 5.10 million units – 3.4% above their sales level in August of 2008. The national median sales price for an existing home was $177,700. The inventory of existing homes available for sale at the end of August fell to 3.62 million units – an 8.5-month supply at the current sales pace.	Aug 09 5,100 Jul 09 5,240 Aug 08 4,930	↑	The strength of recovery depends on tax credit extension
New Home Sales rose slightly in August, posting a seasonally adjusted annual rate of 429,000 units – 0.7% ahead of July's revised rate of 426,000. New home inventory continued to decline to a 7.3 month supply at the current sales rate. That is down 3.9% from the previous month and more than 34% off its year-ago level.	Aug 09 429 July 09 426 Aug 08 444	↑	To rise from rock bottom levels
Housing Starts also posted a small increase in August, registering 598,000 units – up 1.5% from July's level of 589,000. Despite the rise in August, starts were still 29.6% below their level a year ago. Building permits – generally a reliable indicator of future starts – posted a seasonally adjusted annual rate of 579,000 – 2.7% above July's level.	Aug 09 598 July 09 589 Aug 08 849	↑	A long way to go until full recovery but still trending up
Housing Affordability continued at very healthy levels. NAR's Housing Affordability Index (HAI) posted a reading of 159.1 in August – up from July's reading of 155.5 and significantly higher than the 125.8 reading in August of 2008.	Aug 09 159.1 July 09 155.5 Aug 08 125.8	↔	No meaningful changes to income, home value, or mortgage rates
Mortgage Rates remain at historic lows. The average rate on a 30-year fixed mortgage loan was 5.42% in June. While an increase from May's average rate of 4.86%, it is well below the 6.32% average in June of 2008. As the economy begins to turn the corner, look for mortgage rates to inch upward although remaining well below 6% for the foreseeable future.	Sept 09 5.06% Aug 09 5.19% Sept 08 6.04%	↑	Slowly inching higher
Employment The economy shed 263,000 jobs in September – a larger number than anticipated and a sign that despite other encouraging figures on the economy, the job market remains a drag on a more robust economic recovery. The unemployment rate rose to 9.8% – its highest level since June of 1983.	June 09 -263 May 09 -201 12-month total: -5,843	↑	Finally to get a net gain in few months after more than 7 million job cuts
Economic Growth The U.S. economy showed some improvement in the 2nd quarter of this year. Real GDP growth registered -0.7% – a significant increase from the -6.4% figure in the 1st quarter Going forward, GDP growth should turn positive in the 3rd quarter, but consumer spending activity may be tempered by the still-worrisome job market.	2009:II -0.7% 2009:I -6.4% 2008:II -1.5%	↑	Production recovery intact

Notes: All rate are seasonally adjusted. New home sales, existing home sales, and housing starts are shown in thousands. Employment growth is shown as month-to-month change in thousands. Inflation is shown as the month-to-month change in the Consumer Price Index. Sources: NAR, Bureau of the Census, Bureau of Labor Statistics, Freddie Mac, and the Mortgage Bankers Association