Housing, the Economy, and Wood Products Markets -- today and thoughts about tomorrow

Al Schuler (aschuler@fs.fed.us)
USDA Forest Service
Remaining Competitive in Hardwood Components Production
WERC Workshop

April 20, 2009.
Wood Product Markets
Macro View
Softwood Markets – 70% to housing

2008 U.S. Softwood Lumber Demand
41 BBF

- Industrial 28%
- New Residential 29%
- R&A 36%
- NR 5%
- Export 2%

2008 U.S. Structural Panels
26.4 BSF(3/8)

- Industrial 28%
- New Residential* 38%
- R&A 26%
- NR 6%
- Export 3.5%

*New Residential incl. SF, MF, and Mobile Homes

Lumber and Panel Prices Follow Housing
lumber demand down 55% ; prices down 60%
U.S. Hardwood Lumber Consumption Trends

Source: Bill Luppold, USDA FS

* flooring, millwork, trusses, cabinets, & fabricated wood members

Residential markets are now 2.5 times the size of furniture markets

Source: Bill Luppold, USDA FS
Housing and Hardwood Product Markets – strong linkages

Changes over most recent time periods

Source: HMR Executive, March 2009
There was an article in the St. Petersburg Times Newspaper on Sunday.

The Business Section asked readers for ideas on "How Would You Fix the Economy?"

Here is the BEST idea submitted thus far:

Dear Mr. President:

Patriotic Retirement:

There's about 40 million people over 50 in the workforce. Pay them $1 million a piece severance with three stipulations:

1) They leave their jobs. Forty million job openings - Unemployment fixed.

2) They buy NEW American cars. Forty million cars ordered - Auto Industry fixed.

3) They either buy a house or pay off their mortgage - Housing Crisis fixed.

Source: St. Petersburg (FL) Times, March 29th
Housing Issues
Today’s Economic Crisis – A Chronology

1. Housing Collapse – easy credit, unrealistic expectations, weak regulation, greed, exotic financial instruments – As house prices reached unsustainable levels and mortgage rates increased, foreclosures increased and house prices tumbled. The credit crunch began as banks began a “deleveraging” process – and stopped lending.

2. The financial crisis that started with the mortgage market, spread to commercial real estate and credit cards as the entire financial system was freezing up.

3. This caused job losses in construction, and other industries, especially ones that rely on credit for business – autos and other big ticket items, etc.

4. Job losses escalate - - enter the recession.

Solution - - Stabilize housing markets by addressing foreclosure problem
Many are at fault for this colossal mess
Everybody can’t afford a home –
Home ownership is not the “Holy Grail” – downside is lower Mobility, too much investment in non performing assets ...

Source: U.S. Census – (www.census.gov/hhes/www/housing/hvs/hvs.html)
Using our homes as “piggy banks” left many homeowners Vulnerable!!

*Contributes to rising foreclosures, delinquencies and abandoned homes.
Single Family Housing starts

Thousand units, SAAR

Down 81% from peak

Source: U.S. Census
Housing Rebound – How to Spot One

- **Inventory** – six months supply is “typical” and time on market is about 90 days (www.nahb.com, www.nar.com)
- **Sales** – look at year over year growth to eliminate seasonality impact (www.nahb.com)
- **Rate of price decline** – is it slowing? (www.nar.com)
- **House price to rent ratio** – buying becomes more attractive when the P/R ratio is 15 or lower (www.nar.com).
- **Housing affordability** – when a significant percentage of households can afford to buy homes, sales will rise. The “Housing Opportunity Index” is calculated by NAHB for 220 metro areas (www.nahb.org).
- **Rate of foreclosures** – if it is falling, that is a good sign. Realty - Trac (www.realtytrac.com) and MBA (www.mba.com) track foreclosures.

Basic math tells us that prices and incomes must trend together.

Income and Price set to Index of: 1990 = 100

Sustainable relationship

Correction

Sources: NAHB & NAR – Home prices; U.S. Dept HUD – family income

- New home price
- Existing home price
- Median Family Incomes
Ratio of Median home prices to median family income

Coming back to “normal”

Source: Income – HUD; prices – NAR and Census
Housing Affordability
Getting better

HOI - % of homes sold that would be affordable to a family with a median income

65% are affordable
Only 40% affordable

Source: NAHB
Case Shiller National Home Price Index*

Prices are down 26.5% from the peak (Qtr 1 2006)
many analysts expect 10% to 15% further drops

* Existing homes
Price Rise
Not realistic
House Price to Rent Ratios Improving

Source: Economagic time series (http://www.economagic.com)
Home Inventory

Months supply single family

Foreclosures are the problem

Source: U.S. Census Bureau, New Residential Sales, CB06, Table 1.
Housing is Regional !!!!!

Source: USA Today April 10 –
(http://www.usatoday.com/money/economy/housing/2009-04-09-vacanthomes_N.htm)
At year end, 12% of homeowners were delinquent or in foreclosure – 5.4 million homeowners. (MBA, March 2009)

Source: MBA, Dennis Couchon, USA Today, Dec 12 2008
Adjustable Mortgage Resets
To date, problems came from subprime mortgages (FICA <620) Over next 4 years, Alt “A” (no doc loans) and option adjustable mortgage (no DP, interest only), resets exceed the subprime problem by 50% or $500 billion
## Forecast of Experts
### 2009 Housing Starts (thousands)

<table>
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<tr>
<th></th>
<th>Single Family</th>
<th>Multifamily</th>
<th>Total</th>
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<tbody>
<tr>
<td>Fannie Mae</td>
<td>317</td>
<td>128</td>
<td>445</td>
</tr>
<tr>
<td>NAHB</td>
<td>360</td>
<td>130</td>
<td>490</td>
</tr>
<tr>
<td>MBA</td>
<td>324</td>
<td>139</td>
<td>463</td>
</tr>
<tr>
<td>NAR</td>
<td>338</td>
<td>211</td>
<td>549</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>334</strong></td>
<td><strong>152</strong></td>
<td><strong>486</strong></td>
</tr>
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NAHB’s Latest Forecast

77% drop from 2005 peak to 2009 bottom
Modest recovery starting in 2010? Most analysts don’t expect to get back to 1.5 million until 2102?

Source: NAHB, March 20, 2009
Long Term Housing Demand Drivers
Longer term outlook looks good

Million per year

Vacancy demand – 2nd homes, speculation building
Removals – net loss from existing inventory of housing stock

1991-2000
2008-2012
2013-2017

Demographics
Vacancy demand
Net Removals

Source: NAHB, June 2008
Remodeling Market
pulling back with economy, but not nearly as bad as new construction

Four qtr moving totals, Billion $

Down 17% from peak to qtr 4, 2008
Could fall another 12% in 2009

Source: Harvard joint center for housing studies
Long Term, Remodeling becoming increasingly important & is the key market for hardwood products

Source: Harvard JCHS 2007
Construction Spending Trends
Feb 08 – Feb 09

$Billion, annual rate

Private Non Res (- 0.2%)

Private Residential (- 30%)

Public + 3.4%

Source: U.S. Census, C30 (http://www.census.gov/const/C30/)
The Economy

- Consumer spending ~ 2/3rd’s of economy
- Economic driver of U.S economy in past two decades
- Not any more –
  - Consumer debt at record highs
    - Employment losses are devastating confidence
    - Savings rate starting to inch up
- Rapidly growing government deficits - inflation and higher interest rates
- Next 2 - 3 years will be very challenging – after that, what happens?
Starting to see glimmers of hope
Sign of the times
Cumulative Net change in Non Farm Payrolls
4.86 million in past 15 months
2.05 million in past 3 months –
unemployment at 8.5% - highest in 25 years
Source: U.S. BLS (www.bls.gov)
Consumer Confidence
Key to future consumption (and investment and lending)

Index: 1985 = 100

Feb 09 = 25.0
Lowest on record

Source: Conference Board (http://www.conference-board.org/economics/ConsumerConfidence.cfm)
Household Debt* to Personal Disposable Income

* Home mortgage plus consumer credit

Source: Federal Reserve, Flow of Funds Account Table D3, F10
Contribution to percent change in GDP by consumer spending

Real Annualized percent change, month over month

Source: BEA
Government pumping Trillions into the economy to get consumer spending again – **there are consequences**

**U.S. GDP Shares – 2008 Qtr 4**

$14.2$ Trillion

Source: BEA ([http://bea.gov/national/nipaweb](http://bea.gov/national/nipaweb))
Forecasts from The CBO (Mar 20, 2009) are for $9.3 trillion deficits over 2010 – 2019 with Obama’s budget.
Total debt = $11 trillion ($6 trillion held by public)
Interest on the Debt is $412 billion in 2008
3rd highest budget item behind defense & transfer payments
Debt is "financed" by inflation, higher interest rates, Higher taxes, and probably fewer services?
Printing Money = Inflation
Biggest loser is the taxpayer?
Particularly, future taxpayers
Government ownership – pros and cons
## Economic Outlook

Over the next 12 – 18 months, Consumer spending and business investment will be weak With the government the only one spending

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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</thead>
<tbody>
<tr>
<td>GDP</td>
<td>2.0</td>
<td>1.1</td>
<td>-2.6</td>
<td>1.6</td>
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<tr>
<td>CPI (total)</td>
<td>2.9</td>
<td>3.8</td>
<td>-1.0</td>
<td>1.9</td>
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<tr>
<td>Unemployment</td>
<td>4.6</td>
<td>5.8</td>
<td>8.8</td>
<td>9.6</td>
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<tr>
<td>Discouraged</td>
<td></td>
<td></td>
<td>16%</td>
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<td>workers, marginally employed, part time for economic reasons</td>
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Source: M. Zandi (Economy.com) - April 9, 2009
• Bottom line – need to fix the foreclosure problem 1st
• That will improve the bank’s capital ratios
• That will unthaw the credit markets
• Then, consumers will spend, investors will invest, and banks will lend
• The economy will take care of itself after that
• Housing will correct (eventually – when inventories return to normal levels)
• Time line for turning the corner (my guess) - housing to bottom this year, but recovery will be slow – economy will pick up late 2009 – employment will be last