U.S. Housing Update

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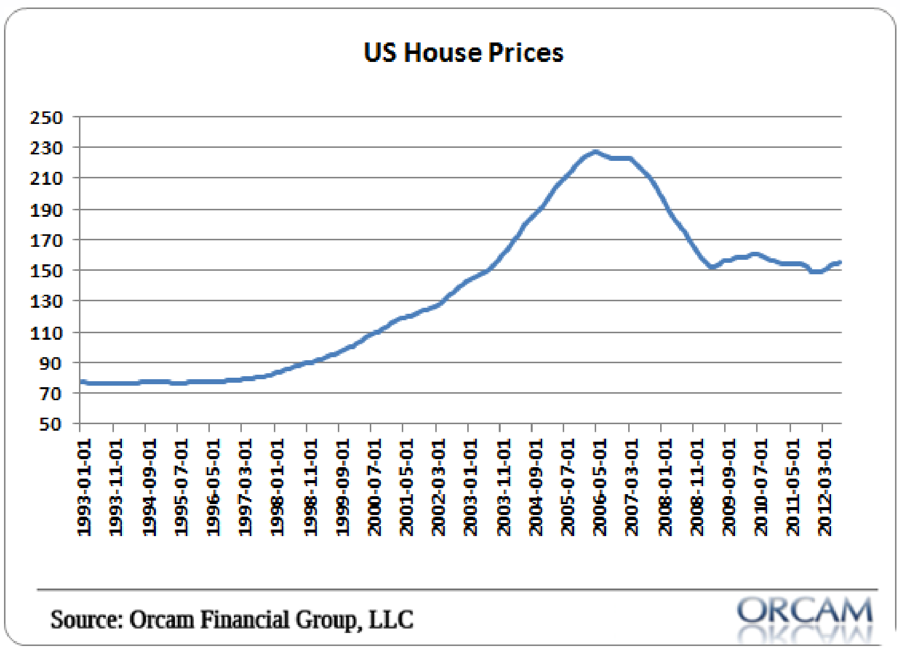
This morning's Case Shiller Housing Data brings the housing market to the forefront. The housing market was the epicenter of the crisis and remains a key piece in the balance sheet recession equation. After all, 73% of all consumer debt is mortgage related debt so when housing collapsed the consumer balance sheet was suddenly turned upside down. Understanding the direction of the US economy requires an understanding of US housing in the current environment.

"Bubbles don't turn into v-shaped recoveries…."

Where is housing now?

This morning's housing data showed a slight uptick in house prices. The 10 and 20 city composites were up 1.3% and 2.0% in August (year over year). That's good news. Overall, house prices appear to have stabilized. If we look at a few price metrics we can also see stabilizing signs.

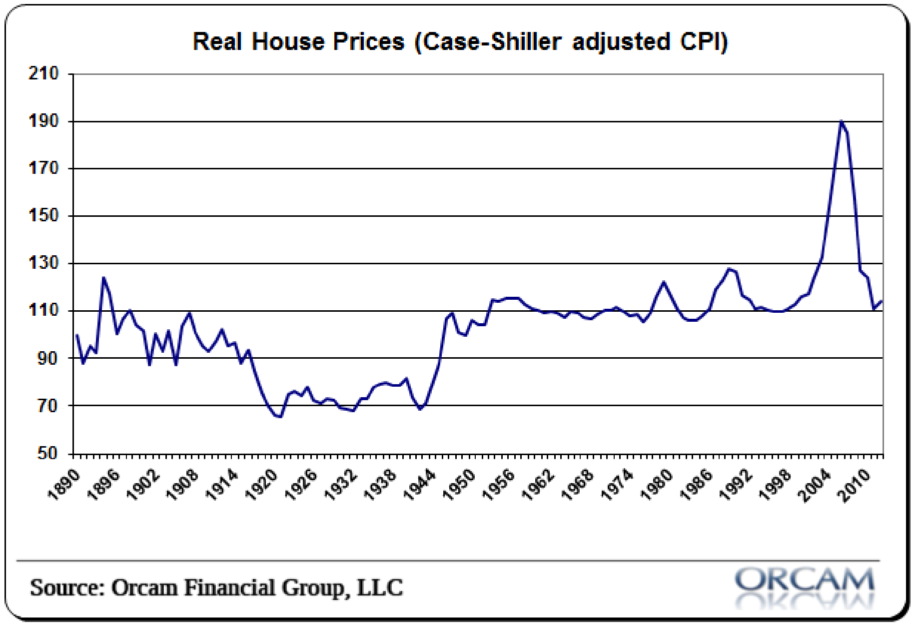


(Figure 1—Case Shiller 20 Index)

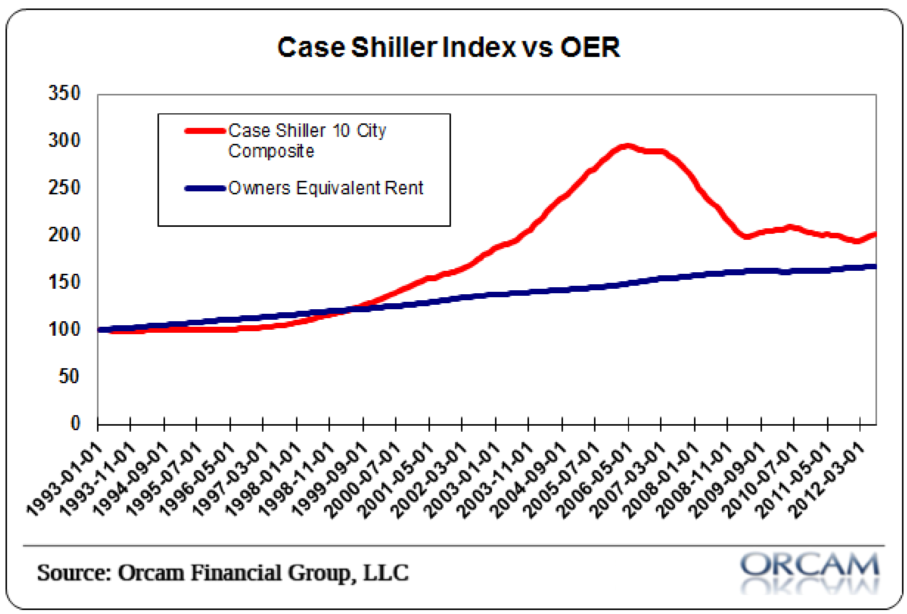
Figure 2 (on the next page) shows the real house price index. This is the famous Robert Shiller chart that keyed me off to the housing bubble in 2005/2006. As you can see, it has adjusted considerably and is now at levels that are much more consistent with sustainable price trends. In fact, the index has come back to its 70 year average rate of about 110 (currently at 114).

Figure 3 shows the house price index compared to the cost of renting as calculated by the Bureau of Labor Statistics and their Owners Equivalent Rent index. Prices are still slightly overvalued by this metric, but have come down substantially.

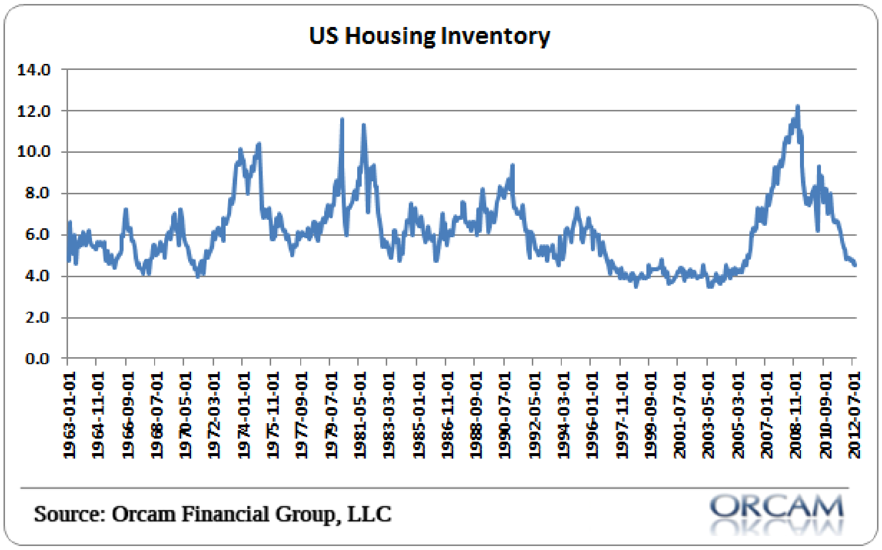
The final figure on page three shows US housing inventories. At the end of the day, the US housing bubble was a supply shock. Too much building was met with not enough demand and when the dam burst it crashed the US economy. As the inventory chart clearly shows, this trend has completely reversed and inventories are now extremely low at just 4.5 months worth of inventory.



(Figure 2—Inflation Adjust Prices)



(Figure 3—House prices versus rent)



(Figure 4—US Housing Inventory)

Housing is the key asset in the US econsumer's balance sheet. So this stabilization is a positive sign. But we would be very surprised if house prices were to make a v-shaped recovery here. The tendency after a bubble is for prices to remain stagnant for many years. We don't think this environment is terribly different than most past bubble environments. So, while we're no longer housing bears we're not big housing bulls.

In short, this stabilization is a good sign that the balance sheet recession in the USA is healing. But we would not be speculating on US housing at this juncture. Rather, we approach the current market from the perspective, that, if you're willing to live in a home for 5 years+ then this is a fine time to be considering a home purchase. If however, you're speculating on US housing, we believe you're engaging in a far more risky transaction and one where the risk/reward is still unfavorable.

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