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## Tracking the Housing Market

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The U.S. residential real estate market is now experiencing its second recovery since its 2006 top and the 2008 global financial crisis. At the moment, consumers, market participants and policy makers are pondering two vital questions:

- Has the housing market bottomed?
- How sustainable is the recent upswing?

To answer these questions, we track the total market value of owner-occupied real estate from the Federal Reserve and privately-owned housing starts from the Census Bureau.

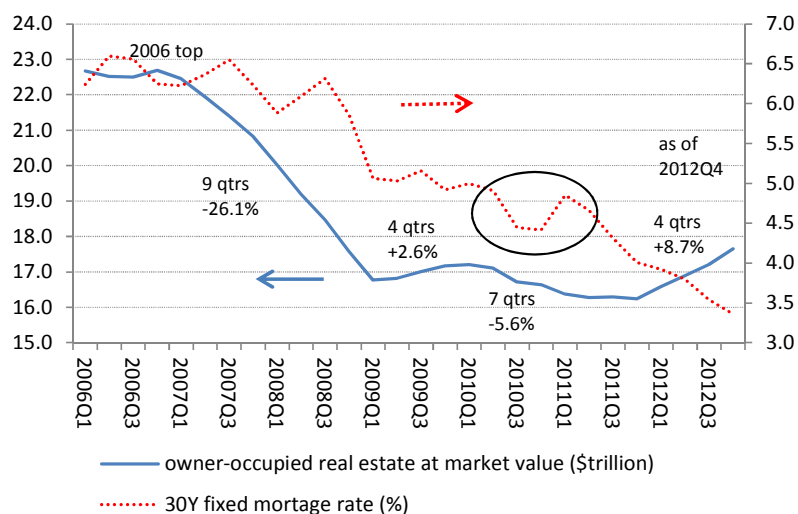
From our perspective, several conclusions resonate:

- The present recovery is the second rebound in the housing market since the crisis.
- While the current recovery in housing is likely extending, an untimely rise in mortgage rates and a weak economy are key downside risks to the recovery.
- The total value of real estate reached a low of three standard deviations below its long run trend at the bottom of the housing market. Values still remain well below two standard deviations.
- Housing starts are half their normal historical average. So there is plenty of room for improvement.
- The recovery is uneven regionally. The west is in the lead and the northeast lags.

### A Second Recovery Attempt

As measured by the total market value of owner-occupied real estate, the U.S. housing market topped in Q4 of 2006. It crashed 26.1% over the next two years before finding a temporary bottom in Q1 of 2009.

**Figure 1. A Second Recovery Attempt**



Source: Federal Reserve (Flow of funds account of the United States), Freddie Mac, and Center for Financial Stability Inc.



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The first recovery was short lived and relatively weak, lasting one year from 2009Q2 to 2010Q1 and measuring 2.6% in market value. The housing market rolled over with a decline of 5.6% to a fresh low by the end of 2011. Figure 1 shows that in the face of an already waning recovery, an unintended increase in mortgage rates (and treasury yields) in response to the Fed's QE2 program may have tipped the housing market into another prolonged slide. Economic growth had also slowed somewhat for much of 2011. It had taken many quarters of meaningful decline in mortgage rates before the housing market found its latest bottom in Q4 of 2011.

The second recovery began in Q1 of 2012. This upswing, up 8.7% in total market value as of its fourth quarter (2012Q4), is likely extending in 2013.

The ongoing recovery is encouraging. It has now exceeded the unsuccessful 2009-2010 recovery in duration by at least a calendar quarter and in market value by more than twofold.

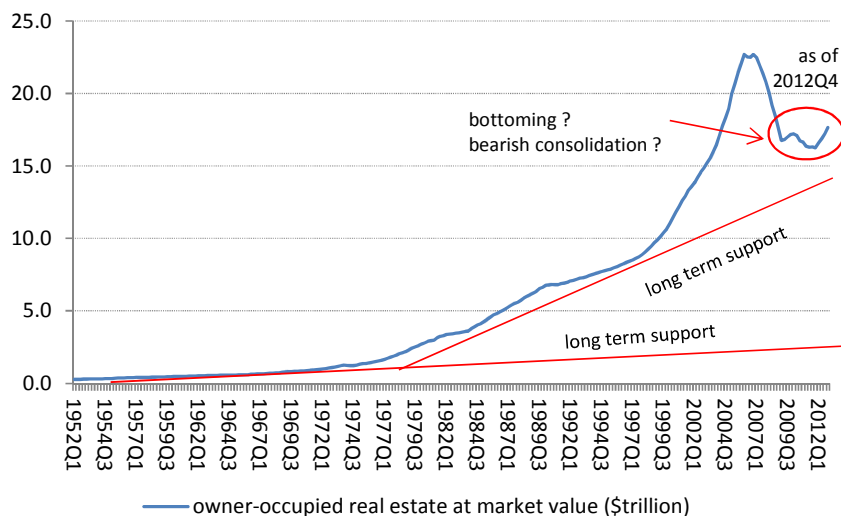
At the same time, there's much loss to recover and the trajectory of the recovery is still within the realm of a countertrend rebound. The recovery in 2012 represents just 22% and 15% of the total loss in market value to the 2011 low and the 2009 low, respectively.

Our analysis suggests that an untimely rise in mortgage rates and a weak economy are key downside risks to the recovery. If downside risks should materialize, these two episodes of recovery would likely be interpreted as a sideways consolidation in technical terms or essentially a stabilization at present levels.

### Long Term Trends

From a long term perspective, whether recent stabilization represents a nascent bull market or only a bearish consolidation remains to be seen (Figure 2).

**Figure 2. Long Term Profile**



Source: Federal Reserve (Flow of funds account of the United States) and Center for Financial Stability Inc.

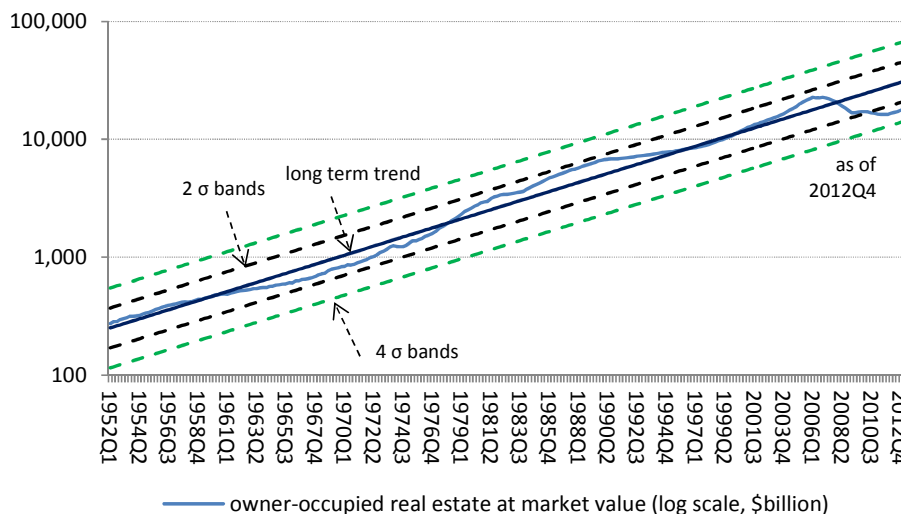


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On a log scale, recent low in total market value nearly reached a three standard deviation decline with respect to the long term trend (Figure 3).

**Figure 3. Long Term Trend**



Source: Federal Reserve (Flow of funds account of the United States) and Center for Financial Stability Inc.

Relatively attractive valuation, low mortgage rates and a growing economy are supportive. However, they do not necessarily preclude another dip. Valuations are attractive if one assumes the long term trend continues and the market will not overshoot further to the downside. Low mortgage rates and a slowly growing economy have been present for some time. But responses by the housing sector have been unimpressive so far.

### Housing Starts

We track readings of privately-owned housing starts from the Census Bureau to shed light on housing activities. We calculate trailing 12-month total of non-seasonally adjusted starts to avoid potential distortions.

By this measure, housing starts have just recovered to half of their long term historical average. Furthermore, recovery has been uneven geographically, especially for single family units.

### **Half of what it used to be**

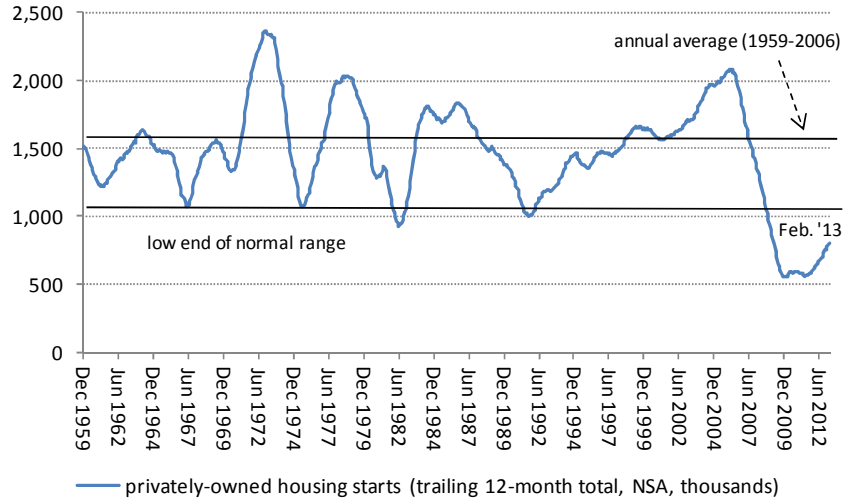
Housing starts remain well below the lower-end of their normal historical range (Figure 4). Total housing starts reached 806 thousand units for the 12-month period ending February 2013. The average for years between 1959 and 2006 has been 1.551 million units. By this measure, current levels of starts are about half of their normal long term historical average. For the two episodes of recovery discussed above, housing starts have only increased 36% from 574 thousand units to 781 thousand units over the initial 12 months.



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**Figure 4. Housing Starts**

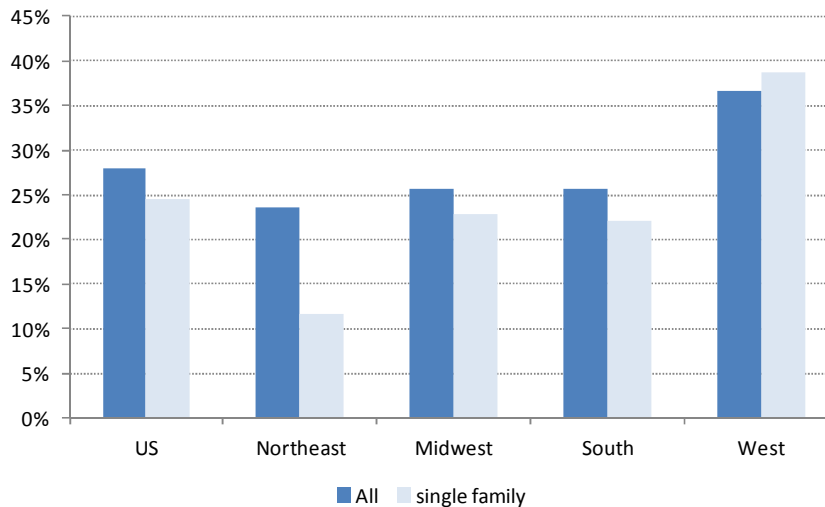


Source: Census Bureau and Center for Financial Stability Inc.

## Uneven rebound

The recovery in housing starts is also uneven geographically. Figure 5 presents the ratio of total housing starts during the 12-month period ending February 2013 and those during the 12-month period ending February 2012. It is obvious that the national rebound is mainly driven by the west.

**Figure 5. Housing Starts Growth  
1Y ending Feb'13 vs. 1Y ending Feb'12**



Source: Census Bureau and Center for Financial Stability Inc.

The disparity in single family starts is even greater. The northeast region has been notably lagging. This region represents 17.5% of the U.S. population and has top populous states such as New York, Pennsylvania, New Jersey and Massachusetts. During the 12-month period ending February 2013 and that ending February 2012, single family starts rose 12% in the northeast vs. 24% for all of U.S.



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