

Home Sales Continue to Contract

Overview:

Recent data have continued to support a notion that, if the economy is already in a recession, it should be a mild and short one. Manufacturing activity has so far fared much better than during the 2001 recession, supported by strong exports. Initial jobless claims have trended higher but have remained below the 400,000 trend seen in the 2001 recession. There are two exceptions: home sales and consumer confidence, whose performances have been comparable to more severe recessions in the early 1980s.

Both total existing and new home sales fell in March. Since their peak in September 2005, single-family existing home sales have declined about 31 percent. Compared to peak-to-trough declines in six economic recessions since existing single-family home sale data collection began in 1968, the decline in the current cycle was the third largest, following the 1980 recession (40 percent drop) and the 1981-82 recession (45 percent drop).

New home sales have performed much worse than existing homes. The decline to date from the peak in July 2005 of 62 percent is already the largest on record since the inception of the series in 1963, surpassing the 58 percent drop in the 1980 recession.

The University of Michigan's Consumer Sentiment Index for April was the lowest since March 1982 -- more than a point below its lowest level during the 1990 recession and was well below its lows during the 2001 recession. The forthcoming tax rebates should help lift confidence. Rising gasoline prices may temper the impact on spending as they act as a tax increase on consumers. In addition, according to the survey, only one-third of consumers said they planned to use the rebate on spending; most intended to use it to repay debt and add to their savings.

Interest Rates:

Treasury yields rose steadily this week despite bearish housing data. Fed funds futures pared down expectations for a rate cut next Wednesday. The odds of a 25-basis point cut in the fed funds rate declined to about 70 percent, down from 100 percent in the previous week. The yield on the 10-year Treasury note rose to 3.88 percent by mid-Friday afternoon -- eleven basis points higher than the closing rate on the previous Friday.

Housing and Mortgage Indicators:

Total existing home sales fell 2.0 percent in March to a seasonally-adjusted annualized rate of 4.93 million, as the drop in single-family home sales outweighed the increase in condo sales. Single-family home sales fell 2.7 percent, completely reversing the increase in February. Condo sales rose 3.6 percent, following a 3.7 percent increase in February and an 8.2 percent drop in January.

Sales of single-family homes during the first quarter of this year were down 20.0 percent from those during the same period last year. Condo sales have performed worse, with year-to-date condo sales 28.7 percent lower than those last year. Since their peak in September 2005, single-family existing home sales have declined about 32 percent -- surpassing the peak-to-trough drop of about 30 percent seen in the 1990-91 recession.

Even with a drop in home sales for the month, sales' performance improved considerably for the quarter as a whole. The decline in the first quarter -- at 3.7 percent annualized rate -- moderated significantly from the drop of at least 25 percent in each of the previous three quarters.

Existing home sales rose in two regions: 2.3 percent in the Northeast and 2.2 percent in the West. Sales dropped 6.5 percent in the Midwest and 3.5 percent in the South.

New homes sales decreased 8.5 percent in March to a seasonally-adjusted annualized pace of 526,000 -- following a 5.3 percent drop in February (previously reported as a 1.8 percent drop). The March pace is the slowest since September 1991.

Sales of new homes during the first quarter of this year were down 33.6 percent from those during the same period last year. Sales have declined about 62 percent since their peak in July 2005.

On a regional basis, sales of new single-family homes fell in all four regions of the economy, with the Northeast posting a 19.4 percent drop, followed by 12.9 percent in the West, 12.5 percent in the Midwest, and 4.6 percent in the South.

The number of homes available for sale dropped 1.1 percent to 468,000. This is the 12th consecutive month of decline to the lowest level since July 2005. The steady decline in inventory reflects considerable cutbacks in single-family homebuilding.

A small drop in inventory but a huge decline in sales pace pushed up the months' supply or the inventory-sales ratio to 9.8 months in March -- the highest reading since September 1981.

Another indicator of sluggish housing demand is a sharp increase of the length of time on the market. The median number of months on the market picked up sharply this year, rising to 7.5 months in March -- the largest since February 1992. The median number of months on the market averaged 5.7 months last year.

The median price for new homes fell 13.3 percent in March from a year ago -- the fourth year-over-year decline in the past five months and the largest decline since July 1970.

The Office of Federal Housing Enterprise Oversight (OFHEO) Purchase-only House Price Index (HPI) increased 0.6 percent in February from January -- the first monthly increase in eight months. From a year ago, the purchase-only index fell 2.4 percent, slightly moderating from a year-over-year drop of 2.7 percent in January. Since peaking in April 2007, the monthly purchase-only index has declined 3.1 percent.

The OFHEO index portrays a more optimistic picture of home prices than other measures of home prices. It is based on data from Fannie Mae and Freddie Mac. Thus the index includes only conventional conforming loans, largely excluding high-priced homes, especially in areas of the country where home prices have weakened considerably over the past year. The OFHEO data also include relatively fewer subprime loans and adjustable rate mortgage loans, which have performed relatively worse over the past year.

Economic Indicators:

Durable goods orders declined 0.3 percent in March, following a 0.9 percent drop in February. This was the third consecutive monthly decline. For the first quarter, new orders fell at an 8.5 percent annualized rate, accelerating from a 5.9 percent drop in the fourth quarter. Excluding transportation, new orders rose a healthy 1.5 percent.

Nondefense capital goods orders excluding aircraft -- a proxy for future business investment -- were unchanged in March, after declining in January and February. Shipments for nondefense capital goods excluding aircraft -- the proxy for equipment and software spending used in the calculation of economic growth in the current quarter -- rose 1.2 percent following two consecutive monthly declines. On a quarterly basis, inflation adjusted shipments of non-defense capital goods excluding aircraft declined at an annual rate of 3.2 percent in the first quarter, compared with a 3.6 percent increase in fourth quarter of 2007.

One troubling sign in the report was that inventories of durable goods jumped 1.1 percent -- the biggest this year -- and shipments fell. The inventory-to-shipments ratio rose to 1.56 months, the highest since November 2001. That indicates companies will need to pare production in coming months.

The University of Michigan's Consumer Sentiment Index declined 6.9 points to 62.6 in April from the March. The index measuring consumers' assessment of current conditions declined 7.2 points to 77. The expectations component declined 6.8 points to 53.3.

With rising food and energy prices, consumers reported they expect inflation of 4.8 percent a year from now -- an increase from 4.3 percent reported in March. Their expectations for five years from now rose more modestly to 3.2 percent from 2.9 percent.

Next week:

Tuesday — The Case-Shiller Home Price Index for February and the conference Board Consumer Confidence Index for April;

Wednesday — The advance estimate of the first quarter gross domestic product; the employment cost index for the first quarter; and the conclusion of a 2-day Federal Open Market Committee meeting;

Thursday — March personal income and personal consumption expenditures; March consumption spending; and the Institute for Supply Management (ISM) manufacturing survey for April; and

Friday — April employment report and March factory orders.

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