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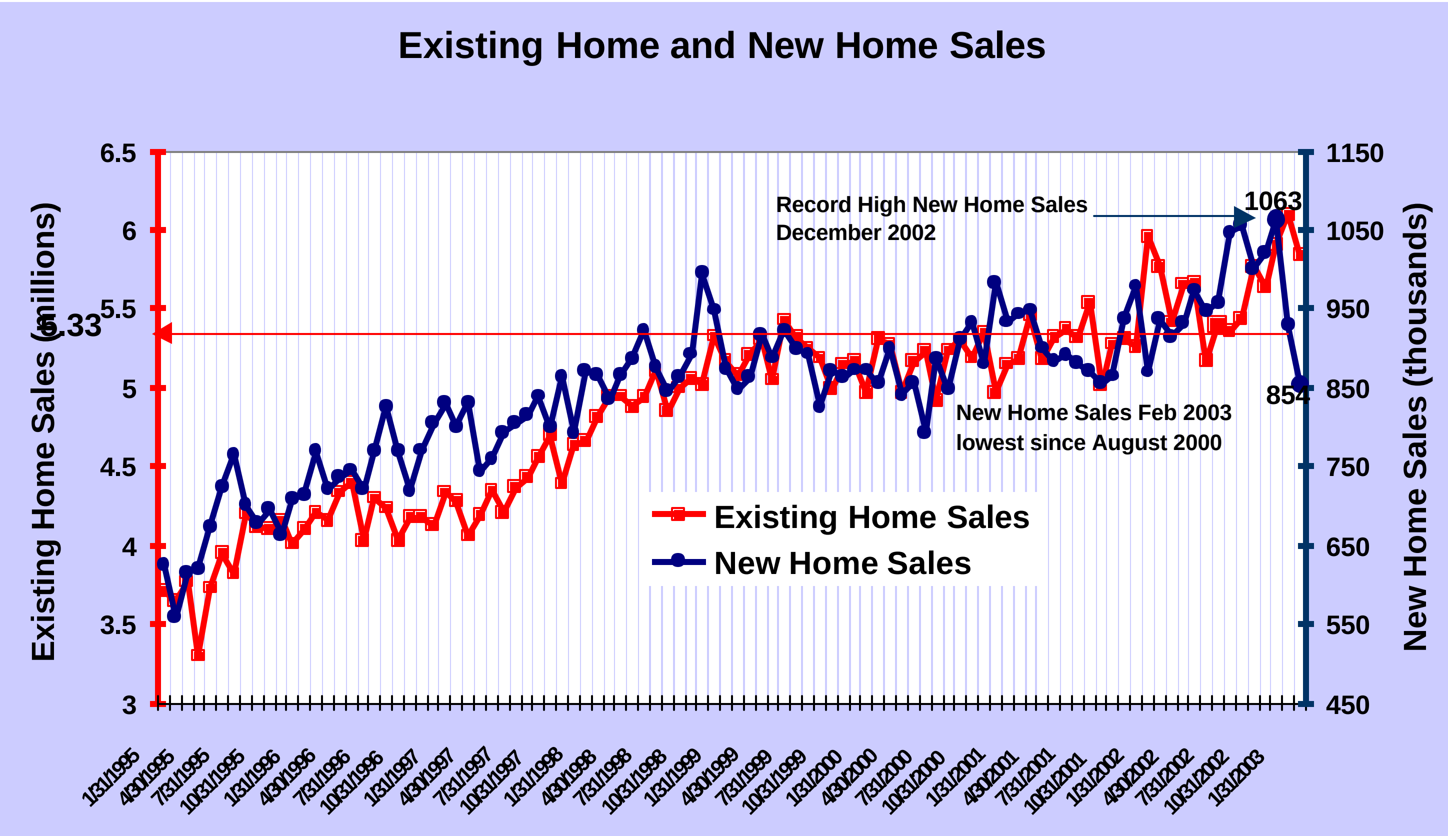
## New Home Sales Fall to Lowest Level Since August 2002




**Actual Data Points:** GDP over this business cycle has been substantially impacted by housing activity and the level of home sales, along with interest rates, drives housing starts. In an environment of high uncertainty, consumers should be expected to truncate the horizons over which they have sufficient certainty to enable them to take on their most important asset acquisition, a new home. The environment since the beginning of this year has been immersed in the fog of geopolitical disturbances. It is not surprising, therefore, that some impact is now being felt in the housing market. Both existing and new home sales fell in February, but the drop in new home sales (to levels of late summer 2000) has been much more significant. The peak in New Home Sales occurred in December 2002, when it was not so clear how the problems with Iraq would play out. Since then, economic uncertainty has increased and at 854,000, the drop since January amounts to nearly 20%. Since "changes" in expenditure drive GDP growth, going forward, this is a highly negative sign. Along with the Durable Goods numbers this morning, prospects for GDP growth in QII 2003 seem to be highly suspect. "It ain't over 'til it's over," Professor Berra once said, but this has to be taken as a worrisome sign that the recovery from the 2000/2001 recession has been aborted.

**Housing Starts and Mean Reversion:** Focusing on Housing Starts, there is a natural question as to what underlying 'trend' could be in place? A proper analysis would build from a microanalysis of Housing Start data that presumably would relate to income changes, interest rates, alternative asset opportunities, and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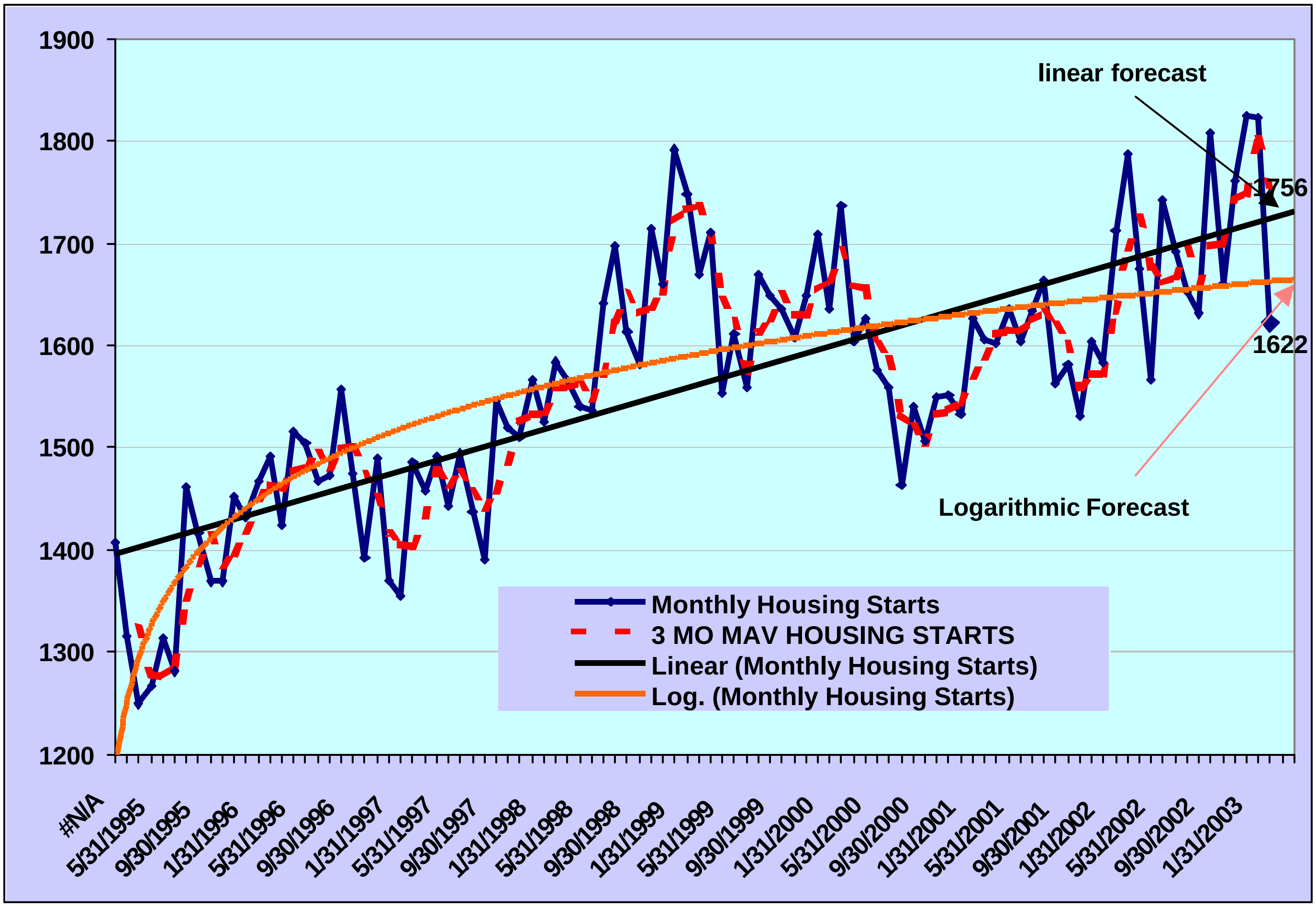
955 Mt. Moro Road, Villanova, PA 19085. tel (610) 527 5368 fax (610) 527 5068



Website www.ecomentary.com. Contact: munkb@ecomentary.com

demographics. We cannot hope to do that kind of analysis in a timely way and have asked a simpler question. Namely, how do the current data fall with regard to a simple linear or logarithmic trend, using a three-month moving average of the underlying Starts data? If linear or logarithmic changes are plotted, we see that the period of 'abnormally low' interest rates have brought Starts data well above their 'trends.' While interest rate




changes began in January 2001, the impact on mortgage financing and the encouragement of new homebuyers is a gradual process. The impact of a downturn in economic activity in the second half of 2000 is readily apparent, as are the likely effects of interest rate reductions in the spring of 2001. That latter trend took housing starts well above their linear and logarithmic trends in 2002. Our current concern is that the "juice" supplied by low mortgage costs is encountering the mean reverting tendencies that underlie many principal consumption patterns. Fundamentally, demographics and income growth must drive new home acquisition. Clearly income growth has slowed and the lack of job growth will eventually slow the upside push coming from demographic pressures. Low interest rates change the intertemporal pattern of durable goods acquisition by accelerating purchases that might not have occurred until later months or years. The issue that may be now arising is that acceleration begins to slow down. Over a longer run period of time, trends can count.