

# THE ECONOMIC OUTLOOK GROUP



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## ECONOMIC TALKING POINTS

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### **Housing Starts Inches Higher in March, But Prepare For A Real Breakout!**

The modest increase in new housing starts during March is a statistical widow, one that by itself can mislead you into thinking this industry is still ailing. Probe deeper into the latest release, however, and you find the seeds of a stronger recovery this spring.

We predicted days ago that last month's housing starts would be disappointing. The anemic 2% increase lifted new construction to a 926,000 annual rate, the second lowest since last June. Single-family homes didn't fare much better, with starts up 4.4% to a still unimpressive 618,000 rate. (Single-family starts last year rose to 648,000)

Now for the good news. To get a fuller picture on the outlook for home building, these are not the sole metrics to look at. We have urged clients to focus instead on three other data points --- and view them within the context of the recent harsh winter weather.

First of all, builders tend not break new ground if adverse weather conditions prevented them from completing construction on previous homes. Given the harsh seasonal conditions the past few months, workers are still busy catching up on structures that fell behind schedule. So the initial metric we look at in the this release is the number of homes "currently under construction."

Not surprisingly this backlog has swelled in March to 842,000, the most in seven years! (Chart 1) It therefore stands to reason that the corollary, the number of homes actually

completed fell, which it did. Completions dropped 3.9% last month, to an 823,000 annual rate, fewest since last June. (Chart 2.)

Chart 1

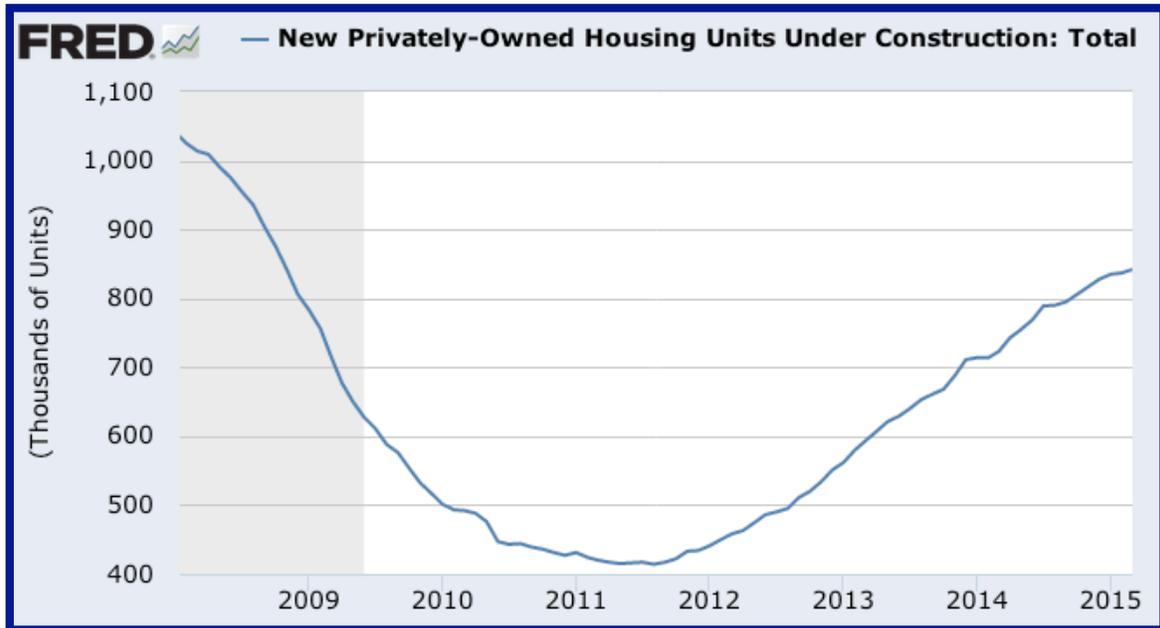
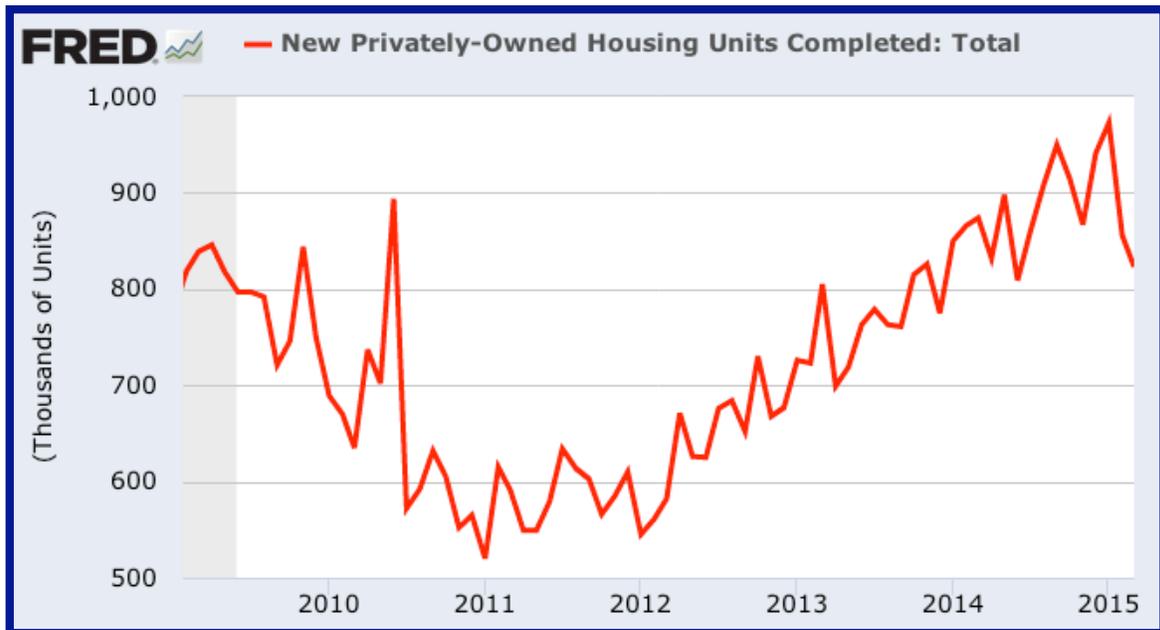


Chart 2.



Thus, the softness in starts during March is perfectly understandable in view of the challenges to complete construction on earlier homes due to the winter. But this weakness represents just a temporary slowdown starts.

How do we know that?

Let's look at the relationship between actual housing starts and permits filed for future construction. In essence, the ratio of these two sheds light on how far behind builders are in their plans for construction. So long as the ratio of permits to starts remains above 1.00, it suggests faster construction activity in the coming months. In February and March, this ratio climbed to 1.21 and 1.12, respectively, while in milder months of December and January, it slipped below 1.00. Put in other terms, the ratio of permits to starts in February and March tells us that plans to break new ground have been rising faster than actual starts. This lag serves as leading indicator, one that is signaling an acceleration in new home construction in the months ahead.

Fortifying this projection was yesterday's release on confidence among home builders. According to the National Association of Home Builders, member sentiment jumped four points, to 56; that is already 10 points above the level of April 2014. One favorite subcomponent we track is customer traffic into builder show rooms, which gauges buyer interest. It also jumped four points this month to 41, and again reflects much more activity than last April when the traffic index stood at 31.

Together, these metrics tell us housing construction activity is about to gain fresh momentum. It is being supported by the scarcity of new and existing homes on the market, stronger job and income gains, and a relaxation in mortgage rules to allow first time buyers to qualify for a loan. We are therefore quite bullish on the home building industry.

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