THE PROSPECTS FOR U.S. RESIDENTIAL REAL ESTATE AND THE ECONOMY

Prof. Stijn Van Nieuwerburgh

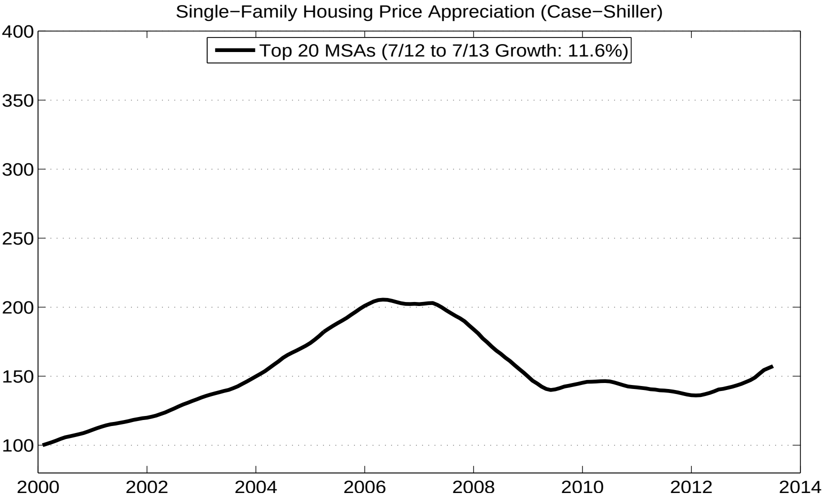
Director Center for Real Estate Finance Research NYU Stern

October 18, 2013

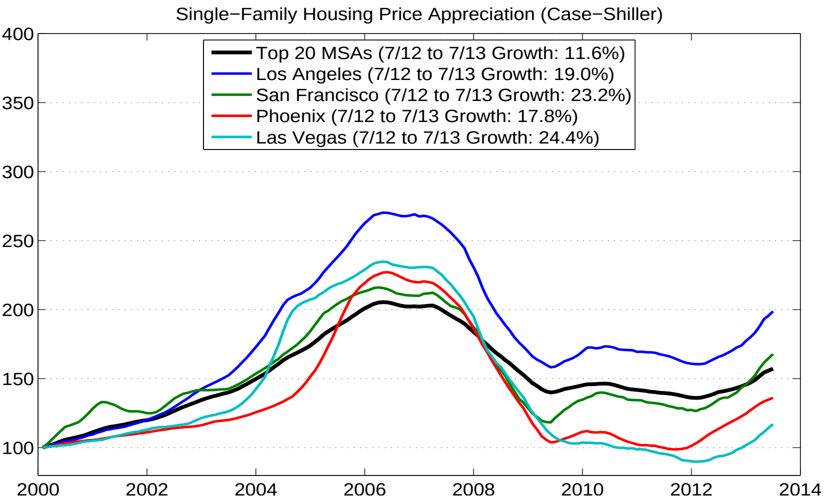
Consensus View on Broader Economy

- Modest but improving economic growth in 2014
- QE tapering begins early 2014, ends toward end of 2014; short-term interest rates raised in 2015
- Modest increases in long-term bond yields as economy strengthens
- Outlook for equities positive
- Some economic damage from political/fiscal uncertainty

Single-Family House Price Appreciation: 2000-2013

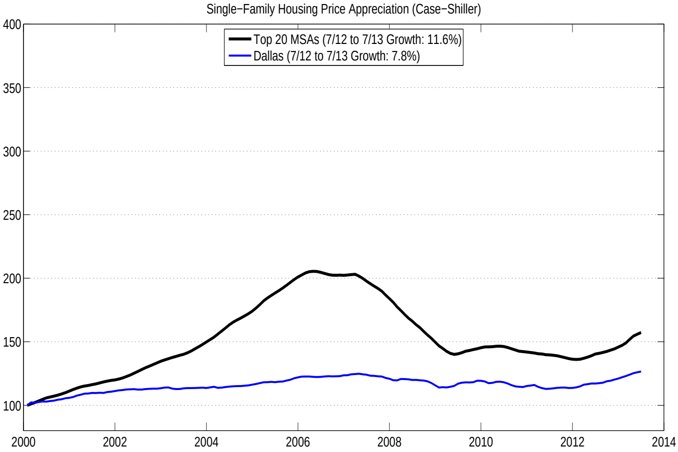


Single-Family House Price Appreciation: 2000-2013

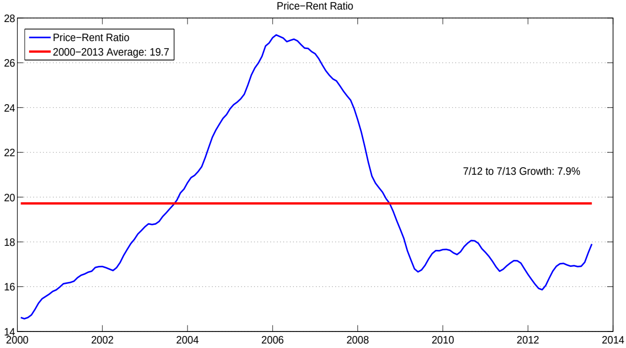


NYU STERN
CENTER FOR REAL ESTATE FINANCE RESEARCH

Single-Family House Price Appreciation: 2000-2013

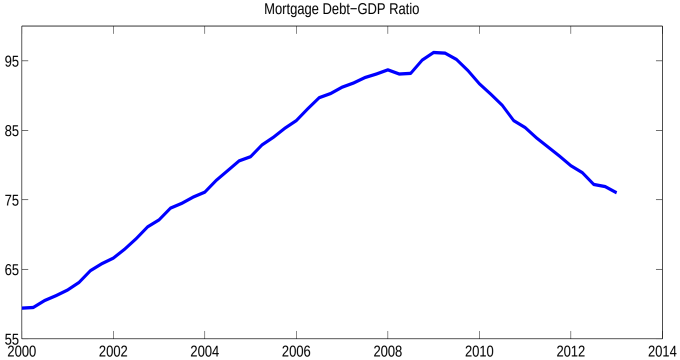


Shiller's Bubble



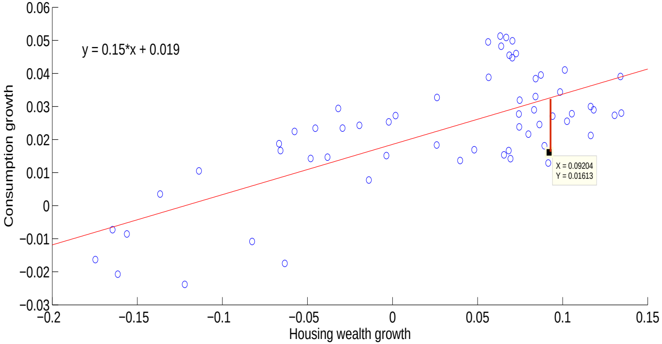
- Over longer periods, price-rent close to, but below average
- Survey evidence on HPA expectations modest

Leveraging and De-leveraging



- Mortgage debt down $1.25tn and 20% relative GDP
- Boom: consumption stimulated by home equity extraction; increase in housing wealth stimulated entrepreneurship
- Bust: consumption curtailed by paying off debt, foreclosure, lower collateral values

Housing Wealth - Consumption growth Nexus



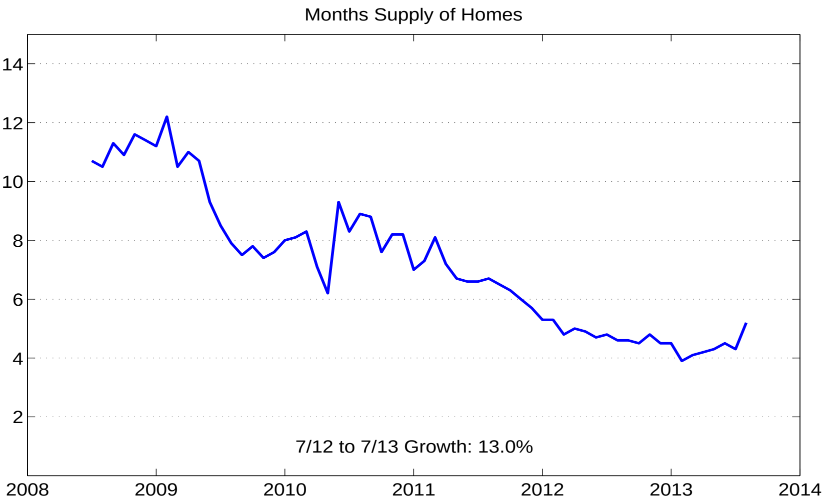
- Slope is 0.15 over 1998-2013 period, implying 3.3% consumption growth; **half** of current 1.6% value
- Shortfall estimated over 1953-2013 period bigger still
- Deleveraging, fiscal austerity, political uncertainty conspire to impair transmission of housing wealth gains to real economy

Two Key Questions

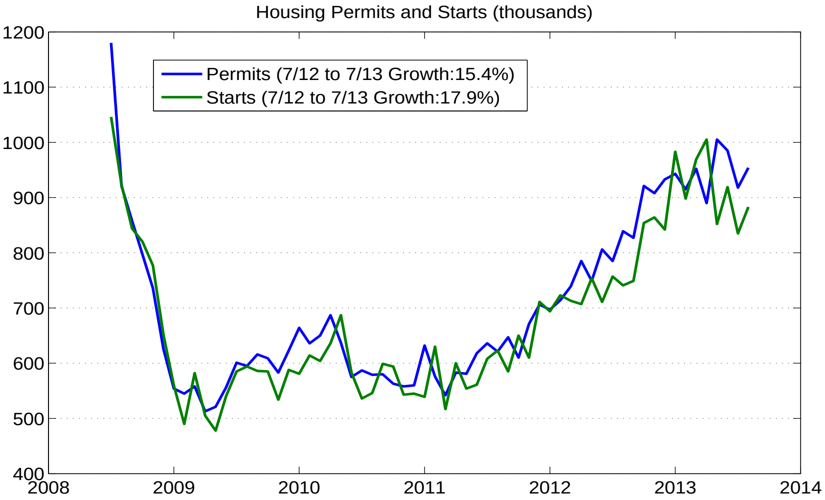
1. How much further can we expect house prices and housing wealth to increase?
2. How much of that increase will make its way into consumption growth?

NYU STERN
CENTER FOR REAL ESTATE FINANCE RESEARCH

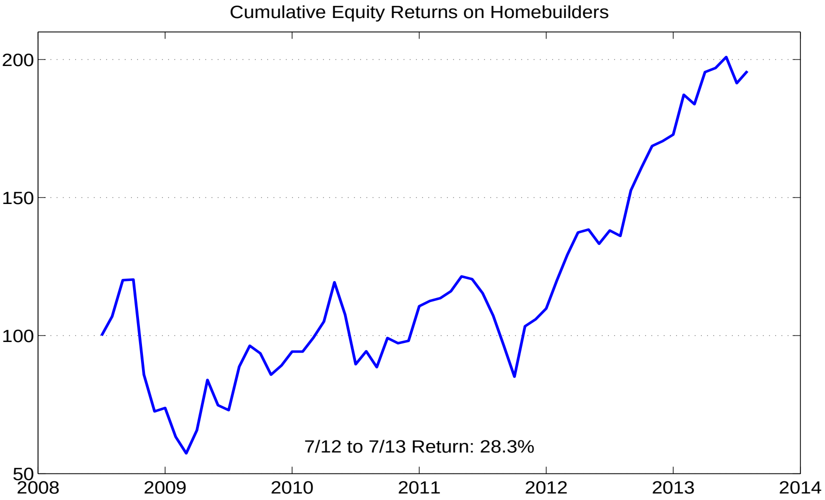
Fundamentals: Short Supply



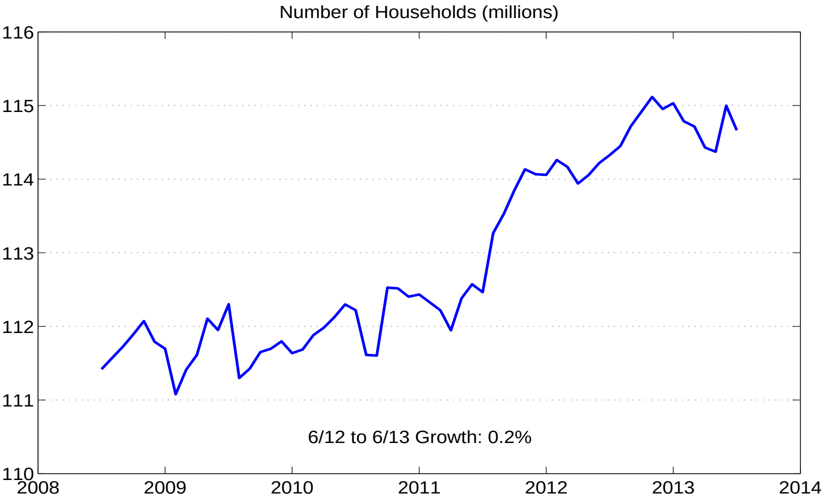
Fundamentals: Short Supply



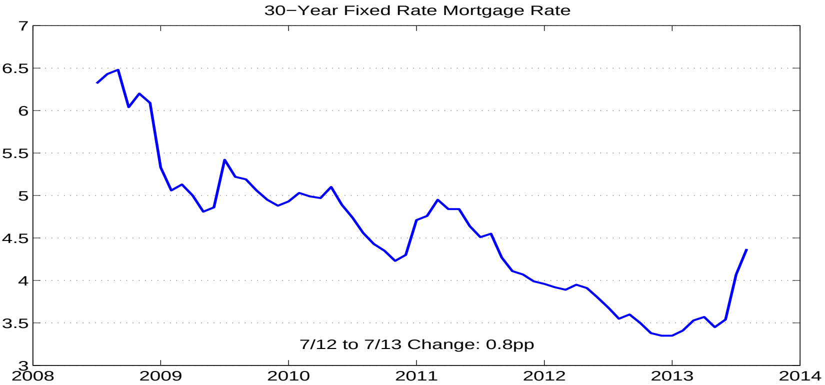
Fundamentals: Short Supply



Fundamentals: Household Formation

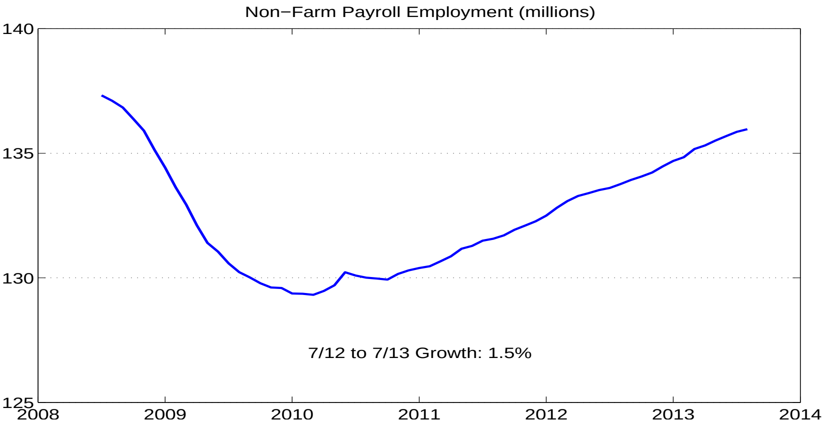


Fundamentals: Housing Affordability

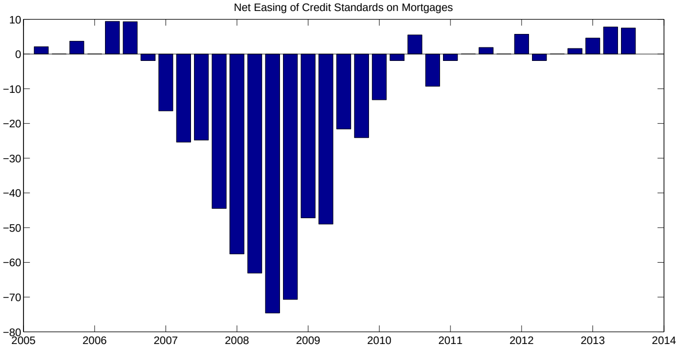


- Housing affordability: 100 in June 2006, 210 in January 2013, 156 in August 2013
- But, houses more affordable than during 1996-2005 period

Fundamentals: Improving Labor Market



Fundamentals: Easing of Credit Standards



- Fraction of banks easing credit standards on mortgages exceeds that tightening standards for last 4 quarters

Prediction for Housing Wealth Changes

- Using these fundamental factors as historical drivers of housing wealth changes, a linear regression model predicts a 7.5% increase in real housing wealth between 2013.Q3 and 2014.Q2
- Biggest contributors to predicted increase: housing supply (0.8%) and easing of credit standards (1.1%)
- We predict 8.7% real house price growth (Case Shiller) with same model over same period, and a 7.5% increase in the price-rent ratio

Two Key Questions

1. How much further can we expect house prices and housing wealth to increase?
2. How much of that increase will make its way into consumption growth?

NYU STERN
CENTER FOR REAL ESTATE FINANCE RESEARCH

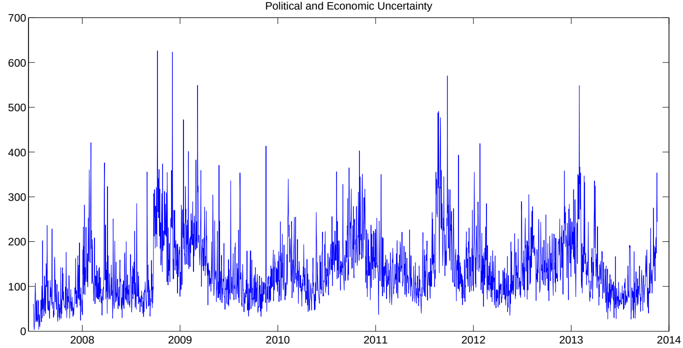
Transmission Mechanism

- Households newly into positive equity territory with increasing house prices
- Nearing end of deleveraging phase
- Reduced uncertainty/improved consumer confidence
- If relationship between housing wealth and consumption growth normalizes, the 7.5% gain in housing wealth would lead to 3.0% increase in real consumption next year, best quarter since 2006

Downside Risks

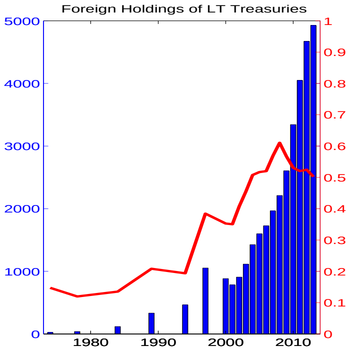
1. Fiscal austerity and political uncertainty
2. Rise in inflationary expectations and interest rates if investors lose confidence in Fed's ability to unwind
3. Large shock to investor confidence and/or banks' balance sheets (e.g. Europe)
4. Tighter underwriting standards if housing finance reform goes off the rails
5. Structural shift in attitudes toward mortgage debt and home ownership

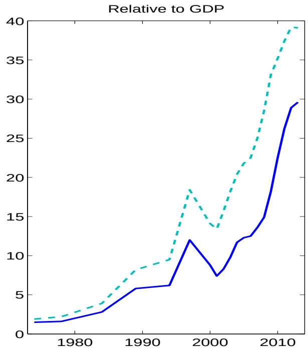
Economic Policy Uncertainty



- Political uncertainty cycles are bad for business and consumer confidence; lowers growth
- May have done permanent damage to U.S. position as world's reserve currency

Foreign Holdings of U.S. Treasuries





- Exceeds $5tn in June 2013; increasing as fraction of size of U.S. economy, but declining relative to amount outstanding
- Nearly 50% of foreign holdings are 3 yrs or less maturity
- Large welfare losses from even modest reduction in foreign holdings

Downside Risks

1. Fiscal austerity and political uncertainty
2. Large shock to investor confidence and/or banks' balance sheets (e.g. Europe)
3. Rise in inflationary expectations and interest rates if investors lose confidence in Fed's ability to unwind its $3.7tn portfolio
4. Tighter underwriting standards if housing finance reform goes off the rails
5. Structural shift in attitudes toward mortgage debt and home ownership

NYU STERN
CENTER FOR REAL ESTATE FINANCE RESEARCH