

Research Department
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Housing: How Far Down?

Practically every economist will tell you that the phenomenal housing boom of the 1971-73 period has come to an end, and that a substantial downturn can be expected over the next several quarters as a result of tightening financial and cost constraints. Few will yet agree, however, as to how steep the projected downturn is likely to be.

The National Association of Homebuilders expects a "very drastic" decline in private housing starts, to a 1.5-million annual rate by the opening quarter of 1974—down about 37 percent from the high plateau of about 2.4 million units reached in late 1972 and early 1973. That forecast may be overly pessimistic, however, because it seems to suggest either that basic demand is much weaker than most observers believe, or that Federal housing agencies will provide comparatively less support to the market than they did during the 1969-70 slump.

Given a more conservative reading of these factors, we could envision a decline to about a 1.7-million annual rate, with the trough being reached around mid-1974 rather than earlier. In value terms, the decline likely would be much less, in view of a continued (but hopefully decelerating) rise in construction costs and a steady increase in outlays for alterations and non-housekeeping construction (motels

and hotels). For 1974 as a whole, total residential spending could fall about 8 percent below the peak of \$58.7 billion expected this year, yet remain close to the previous peak recorded last year.

Slower demand

The continued high level of household formations—a consequence of the baby boom of the post-World War II period—should support a relatively high rate of homebuilding for most of this decade. Nonetheless, the recent record level of homebuilding, taking into account the large number of units presently under construction, has probably outpaced the basic level of demand for the time being. Thus, an adjustment is considered likely, completely apart from the current tightening of the mortgage market.

At the present time, over 1.7 million units are under construction—about 17 percent more than a year ago. About three out of five of these units consist of multiples—the segment of the market most susceptible to imbalances, because of the long lead times involved in the planning and construction process. The high level of units under construction in part reflects a lag of completions relative to starts, as a consequence of materials shortages and various construction delays. This lag has helped limit upward pressure on vacancy rates up to now, but as more and more of

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these units come to completion, vacancy rates could rise swiftly, and thereby induce contractors to slash building activity.

Slower sales

The pace of home sales meanwhile has slowed appreciably, and as a result, the inventory of unsold single-family homes (completed and uncompleted) has jumped 25 percent over the past year to 440,000 units. This higher inventory represents an eight months' supply of housing at current sales rates. Since a slowdown in both sales and home starts preceded the sharp run-up in mortgage rates which occurred after midyear, the inventory bulge must instead reflect some decrease in basic demand as well as growing buyer resistance to rapidly rising home prices.

The upsurge in home costs has shown distressingly few signs of easing in recent quarters. During the April-June period, new home prices averaged 22 percent above the year-ago level, reflecting continued increases in construction

wage rates, generally rising materials prices and soaring land costs. Labor and materials costs could moderate during the current downturn, as has already happened in the case of lumber, but the land boom might well continue unabated for some time to come.

Poor man's housing

With large numbers of potential buyers being priced out of the single-family housing market, an increasingly large share of the market will probably be supplied by a product which doesn't even show up in the housing statistics—mobile homes. (Dollar spending for mobile homes is classified, along with autos, in the consumer durable-goods category.) Mobiles sold at a 650,000-unit annual rate during the first half of 1973, some 14 percent above 1972's pace, and sales could rise to the 700,000 level in 1974 as more and more buyers switch to this cheaper-priced housing. Already, mobiles account for almost 90 percent of all single-family units (homes plus mobiles) selling for \$20,000 and less.

Another factor affecting the low-priced end of the market is the projected decline in Federal subsidies. In the first half of this year, 72,000 units of subsidized housing were started—32 percent less than in the comparable period of a year ago. In 1974, subsidized starts are

likely to fall very sharply, unless the Administration lifts its moratorium on new commitments or actively implements its still-undisclosed new program to assist low-income housing.

Mortgage tightness

The general expectation of a substantial decline in home construction is of course closely tied to the expectation of continued tightness in the mortgage market. In recent months, the market has experienced a substantial rise in mortgage borrowing costs, reflecting the overall rise in market interest rates and the sharp slowdown in savings inflows into depository institutions. Savings-and-loan associations experienced a \$15-billion inflow during the first seven months of 1973, as against a \$20-billion inflow in the comparable period of 1972.

After holding fairly steady at about 7¾ percent in 1972 and early this year, the average yield on conventional new-home mortgages reached 8½ percent in August and 9 percent early in September. Not surprisingly, in this situation, housing starts in the June-July period were roughly 15 percent below the rate prevailing six months earlier, at an annual rate, and were expected to continue falling. (Over the longer run, interest rates do not tell the whole story; the level of rates has risen substantially over the past decade, but so too has the

level of housing activity.)

To what extent will Federal agency intervention in the market cushion the housing decline? Agency support should be very large—perhaps every bit as important as it was in the 1969-70 downturn. In that earlier period, agency intervention in the form of secondary-market mortgage purchases and Home Loan Bank advances to the S&L's financed roughly 40 percent of net residential lending. With support of this type, net lending by the S&L's actually increased in both 1969 and 1970.

Another key question concerns the extent to which inflationary expectations have induced a higher rate of construction and sales than would otherwise be supported by basic demand. If this has in fact been the case—if recent levels of homebuilding and homebuying have indeed borrowed substantially from the future—then the expected housing recovery in the second half of 1974 could be weaker (and later) than the underlying trend would appear to suggest.

Verle Johnston

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 9/5/73	Change from 8/29/73	Change from year ago	
			Dollar	Percent
Loans adjusted and investments *	74,635	+ 226	+ 9,225	+ 14.10
Loans adjusted—total*	57,651	+ 64	+ 9,365	+ 19.39
Securities Loans	1,122	- 165	- 1,456	- 56.48
Commercial and industrial	20,217	- 33	+ 3,517	+ 21.06
Real estate	17,236	+ 85	+ 3,049	+ 21.49
Consumer instalment	8,607	+ 24	+ 1,341	+ 18.46
U.S. Treasury securities	5,193	+ 150	- 807	- 13.45
Other securities	11,791	+ 12	+ 667	+ 6.00
Deposits (less cash items)—total*	72,731	+ 622	+ 9,183	+ 14.45
Demand deposits adjusted	21,443	+ 299	+ 1,114	+ 5.48
U.S. Government deposits	245	- 137	- 205	- 45.56
Time deposits—total*	49,609	+ 79	+ 8,242	+ 19.92
Savings	17,426	- 33	- 804	- 4.41
Other time I.P.C.	23,377	+ 44	+ 7,169	+ 44.23
State and political subdivisions (Large negotiable CD's)	5,911 12,235	+ 80 - 103	+ 839 + 6,627	+ 16.54 + 118.17
Weekly Averages of Daily Figures	Week ended 9/5/73	Week ended 8/29/73	Comparable year-ago period	
Member Bank Reserve Position				
Excess reserves	27	56		110
Borrowings	225	295		61
Net free (+) / Net borrowed (-)	- 198	- 238		+ 49
Federal Funds—Seven Large Banks				
Interbank Federal funds transactions				
Net purchases (+) / Net sales (-)	- 534	- 527		- 332
Transactions: U.S. securities dealers				
Net loans (+) / Net borrowings (-)	+ 27	+ 124		- 257

*Includes items not shown separately.