Research Department
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# Up from the Depths?

This spring several hopeful signs have pointed to an end of the housing industry's protracted decline. But the recovery (if it comes) would begin from an abnormally low level of activity—less than a 1.0-million annual rate of starts in the January-April period. In fact, even if starts increase 50 percent by year-end, as many observers predict, the average for the year would still fall 8 percent below the modest 1974 total of 1.3 million units. A recovery should not be constrained by a lack of mortgage funds, as it was last year, but it would be hampered by the large overhang of unsold and uncompleted units, and by a continuing rise in home prices.

The good omens include April's substantial upturn in permit activity, as well as the early-year upsurge in savings inflows into thrift institutions. Another straw in the wind is the March rise in new-home sales, which preceded the introduction of the tax credit on such sales.

**Easy money, high costs**
Compared with the tight-money situation of a year ago, 1975 should be a year of readily available and relatively cheap mortgage money. (Still, the situation is not all that favorable in comparison with several earlier years.) The net inflow into thrift institutions should reach about $40 billion, over double last year's very modest gain. Savings-and-loan institutions will probably garner about 90 percent of that inflow. The S&L's loanable funds probably will be augmented by a large amount of loan repayments, but these will be used in part to make substantial repayments of debt to the Federal Home Loan Banks, and also to rebuild liquidity reserves. This still might leave the S&L's with about $45 billion for the financing of new loans, or roughly enough to finance about 1.5 million units (new and existing) at current prices and lending terms.

The continued rise in construction costs and home prices may act as a depressant on home sales, although the rise should be more moderate than in the past several years. Many families have been priced out of the market in the past decade, especially since about 1967. In the ensuing period, prices of new single-family homes have increased almost 70 percent, outpacing a 55-percent rise in median family incomes. (In early 1975, the median new-home price exceeded $38,000). At today's prices and lending terms, monthly home payments approximate $225—about double the 1967 average.

Lumber prices are lower now than they were a year ago, but the market recently has firmed considerably, thereby contributing to a 10-percent rise in construction-material costs just within the past half-year. New labor contracts meanwhile call for wage increases of 10 percent or so, despite jobless rates in the construction


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trades that run twice as high as those recorded elsewhere. Further increases in home prices thus may be expected, and for awhile at least, they might continue to outpace the rise in family incomes.

**Tax credits and inventory**
With home prices still high and with unsold housing covering the landscape, Congress has provided a lubricant in the form of the special tax credit (up to $2,000) on the purchase of new homes. Even before the credit went into effect, sales of new single-family homes rose 12 percent in March to a 449,000-unit annual rate. Recent reports suggest that the tax credit has been successful in moving more of the unsold inventory and—despite some industry doubts—optimistic homebuilders claim that it could boost the sales rate to as high as 700,000 units in a few months' time.

Congress is now preparing to inject an additional stimulus into the market, in a form of subsidized 6-percent mortgages on home purchases or, optionally, flat $1,000 grants for downpayments. (The latter would not be available to those who take advantage of the $2,000 tax credit.) The bill has been approved by House-Senate conferees, but it may be vetoed by the President because of its high $300-400 million annual pricetag.

In any case, builders are unlikely to increase their activity very substantially until sales pick up some more and the existing inventory declines. Thus, unlike last year, the major constraint on the market is not the lack of mortgage funds but rather the continuing overhang of unsold units (completed and uncompleted)—generally estimated at about 650,000 units early this spring. In the single-family market, the inventory totals about 390,000 units—12 percent below the year-ago figure, but still equal to a 10 months' supply at recent sales rates. In fact, the present inventory is 70 percent higher than the inventory at the start of the last housing upturn in 1970.

With the sharp decline in starts, the number of units under construction (both single- and multi-family) has fallen about 27 percent below a year ago, to about 1.1 million units. (But that is still about 30 percent more than the number under construction at the start of the 1970 upturn.) The imbalance is concentrated in Florida and other Southern states, which account for almost half of the total units in the national pipeline.

**Plus and minus**

All things considered, the industry is now making progress in reducing its inventory, and basic demand factors also suggest that the stage is set for recovery. The rate of housing starts in late 1974 and early 1975, for example, was only about one-half the estimated underlying demand indicated by prospective household formation and replacement rates. Indeed, the strong demographic base of the market, with the continued rise in the marriageable-age population, could yet give a strong lift to housing activity later in the decade.

Yet even with a relatively ample supply of mortgage funds, demand factors probably will not support an early return to the 2-million plus levels of homebuilding of 1970-73—or a sustained realization of the Congressionally-ordained national housing goal of 2.6 million annual units (including mobiles). Even with annual household formations of about 1.6 million—far above the level of the 1960's—and with allowance for normal vacancies, such a rate would imply an annual replacement demand of about 700,000 units as the result of demolitions, conversions, fire losses, and other factors. However, demolitions in the last few years apparently have been only about half as large as they were in the 1960's, when urban-renewal programs were in full swing. Consequently, replacement demand could be weaker than earlier expected.

Moreover, mobile homes should continue to account for a significant portion of future housing demand. Sales of mobiles plummeted 40 percent last year to about 330,000 units, but they should pick up again as credit becomes more available and as the cost of alternative housing continues to rise. The sharp rise in outlays for major additions and alterations—double the 1970 pace last year—also suggests that increasing numbers of families will not follow the traditional route of "moving up" by purchasing newer, larger, and more expensive homes. Thus, despite definite recovery signs, the market for new homes in the late 1970's could be somewhat weaker than predicted several years ago.

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## BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

| Selected Assets and Liabilities Large Commercial Banks | Amount Outstanding 5/07/75 | Change from 4/30/75 | Change from year ago Dollar | Change from year ago Percent |
|---|---|---|---|---|
| Loans (gross, adjusted) and investments* | 85,383 | + 367 | + 2,364 | + 2.85 |
| Loans (gross, adjusted)—total | 65,058 | + 146 | + 814 | + 1.27 |
| Security loans | 1,259 | + 126 | + 80 | + 6.79 |
| Commercial and industrial | 24,019 | – 95 | + 700 | + 3.00 |
| Real estate | 19,515 | – 5 | + 492 | + 2.59 |
| Consumer instalment | 9,826 | + 4 | + 560 | + 6.04 |
| U.S. Treasury securities | 7,901 | + 218 | + 2,322 | + 41.62 |
| Other securities | 12,424 | + 3 | – 772 | – 5.85 |
| Deposits (less cash items)—total* | 84,263 | – 66 | + 5,300 | + 6.71 |
| Demand deposits (adjusted) | 23,010 | + 425 | + 830 | + 3.74 |
| U.S. Government deposits | 436 | – 533 | – 603 | – 58.04 |
| Time deposits—total* | 59,491 | + 68 | + 4,892 | + 8.96 |
| States and political subdivisions | 7,584 | + 71 | + 227 | + 3.08 |
| Savings deposits | 19,514 | + 102 | + 1,588 | + 8.86 |
| Other time deposits‡ | 28,889 | – 104 | + 2,136 | + 7.98 |
| Large negotiable CD's | 15,465 | – 172 | + 1,699 | + 12.34 |

| Weekly Averages of Daily Figures | Week ended 5/07/75 | Week ended 4/30/75 | Comparable year-ago period |
|---|---|---|---|
| **Member Bank Reserve Position** | | | |
| Excess Reserves | 66 | 54 | 45 |
| Borrowings | 0 | 3 | 195 |
| Net free (+) / Net borrowed (–) | + 66 | + 51 | – 150 |
| **Federal Funds—Seven Large Banks** | | | |
| Interbank Federal fund transactions | | | |
| Net purchases (+) / Net sales (–) | + 1,626 | + 502 | + 886 |
| Transactions of U.S. security dealers | | | |
| Net loans (+) / Net borrowings (–) | + 641 | + 279 | + 308 |

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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