



26 September 2014



SENT TO LSU AGCENTER/LOUISIANA FOREST PRODUCTS DEVELOPMENT CENTER - FOREST SECTOR / FORESTY PRODUCTS INTEREST GROUP

To all:

Another disappointing set of housing numbers. OK, things are improving, but the pace is agonizingly slow. The FED is still propping up the economy with low interest rates, but the major beneficiaries are Wall street, and not main street. Jobs remain elusive for many, particularly young people - those who buy starter homes. Europe is in serious trouble, potentially facing deflation pressures; China is slowing; and the USA has some serious problems too. I hate to keep mentioning debt, but sooner or later, we will need to address entitlement programs - currently, they take 60% of federal tax revenue (50% or spending - we borrow the difference); and if we don't make changes, they will gobble up 80% of tax revenue within 20 years. Of course, the government won't let that happen - changes will be necessary and most of us will be losers. All this to say, there are serious headwinds to any economic recovery, and housing will be impacted. I haven't mentioned the international problems - terrorism; Ukraine; Middle east - - -

We have lots of problems, but, I have confidence our leaders will somehow, make the right decisions. It is going to be tough to achieve 3% GDP growth on a sustainable basis over the next several years - housing will continue to have problems, but, things are improving slowly. Sooner or later, we will need to redirect the economy to more investment for the future, and less current consumption. Otherwise, we're going to have a tough time fixing existing problems.

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Housing comments – September , 2014

- *August was another weak month for housing*
- Housing getting better, but multi family is the driver so far – rental demand is strong!! **Single family sales of new homes remains weak!!!**
- Housing's issues - slowing world economy; weak job market; sluggish income growth; tight credit environment continues
- *Main problem continues to be the job market. Unemployment rate keeps coming down, but often this is due to people leaving the workforce. It is taking longer to find a job (employers are getting pickier); labor force participation rate keeps falling (will lead to labor shortages in the future); and many jobs (30%) are temporary with low pay, no benefits, etc. There is no short term fix to this problem. It will take a coordinated effort to address education issues; taxes; smarter health care solutions; and whether or not we (USA) are willing to invest in the future. To do so, we have to postpone some consumption (spending) for now, and invest more in R&D; infrastructure; education;* **This is going to be made more difficult due to the huge debt the country has accumulated from years of deficit spending (22 years out of past 24 were deficits) – and the growing needs of 75 million retiring baby boomers – severe strain on social programs like SSI and Medicare/Medicaid. Already, Medicare/Medicaid, plus SSI take 60% of today's federal tax receipts.**

A continuation of this scenario will negatively impact housing demand and wood product markets for some time – but, it's fixable – we just need to get our collective acts together

Here are some good references from NAHB on Impact Of Housing on the Economy

Gives you some appreciation why housing is so important to the Economy, and why one can't move forward without the other!!!!

- (1) Impact of Homebuilding and Remodeling on the U.S. Economy (May 2014, Paul Emrath)
- (2) Housing's contribution to GDP (NAHB staff)

(http://www.nahb.org/reference_list.aspx?sectionID=784)

Housing, Economy, and wood products

Here is another good article on housing's impact on the economy – why the economy is having problems moving forward.

NYT (<http://www.nytimes.com/2014/04/27/upshot/the-housing-market-is-still-holding-back-the-economy-heres-why.html?ref=business&r=1>)

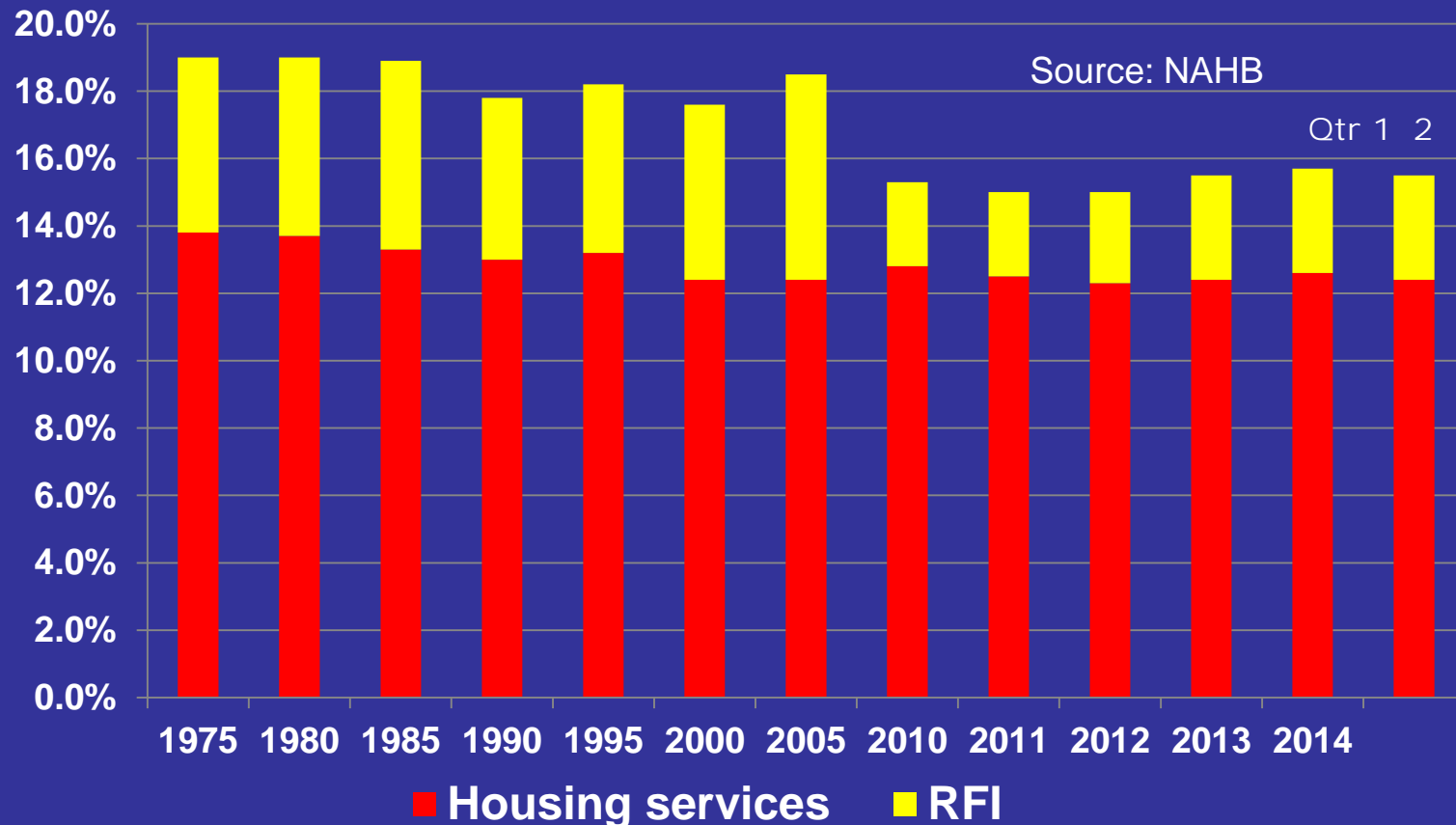
Here is the dilemma – housing contributes about 4% directly to GDP and another 12 – 15% indirectly, for a total of 16 – 19%. The key to housing's recovery is good paying jobs with benefits. That means we need a stronger economy. But, with housing and related activities contributing only 15% to GDP, that won't happen. The old “chicken and egg” dilemma. What is the solution? I've read that U.S. businesses have about 2 trillion Dollars stashed on their balance sheets (**much of it offshore**). If they were to invest that in plant, equipment, job training, technology, R&D, Etc., that would create jobs and some momentum for the economy. What is holding them back? Uncertainty is key reason (**and the corporate tax code**). We need “Washington” to provide leadership in where the country is headed and how to get there – we need to remove some of the uncertainty. And, they need to convince businesses (and the public) that their vision (to fix the economy) is realistic and they have a viable strategy for achievement. A tall order and I know I have oversimplified things. But, the current mix of politicians in Washington can't agree on A unified strategy to move the country forward. Consequently, housing, the economy, and hence, the wood products industry, will continue to “underachieve”.

Also, many corporate chieftains don't see the demand for their products/services. Lack Of demand doesn't encourage an investment in additional plant/equipment, or new Hiring for that matter. We still have excess plant capacity.. Thorny problems!!

Housing's contribution to GDP (%) – historically, it is almost 20% of the economy when you include housing services and fixed investment, but today it is down to 15%. In reality, it is even more important when you include purchased furniture, landscaping, general maintenance, etc. key reason why the economic recovery remains muted

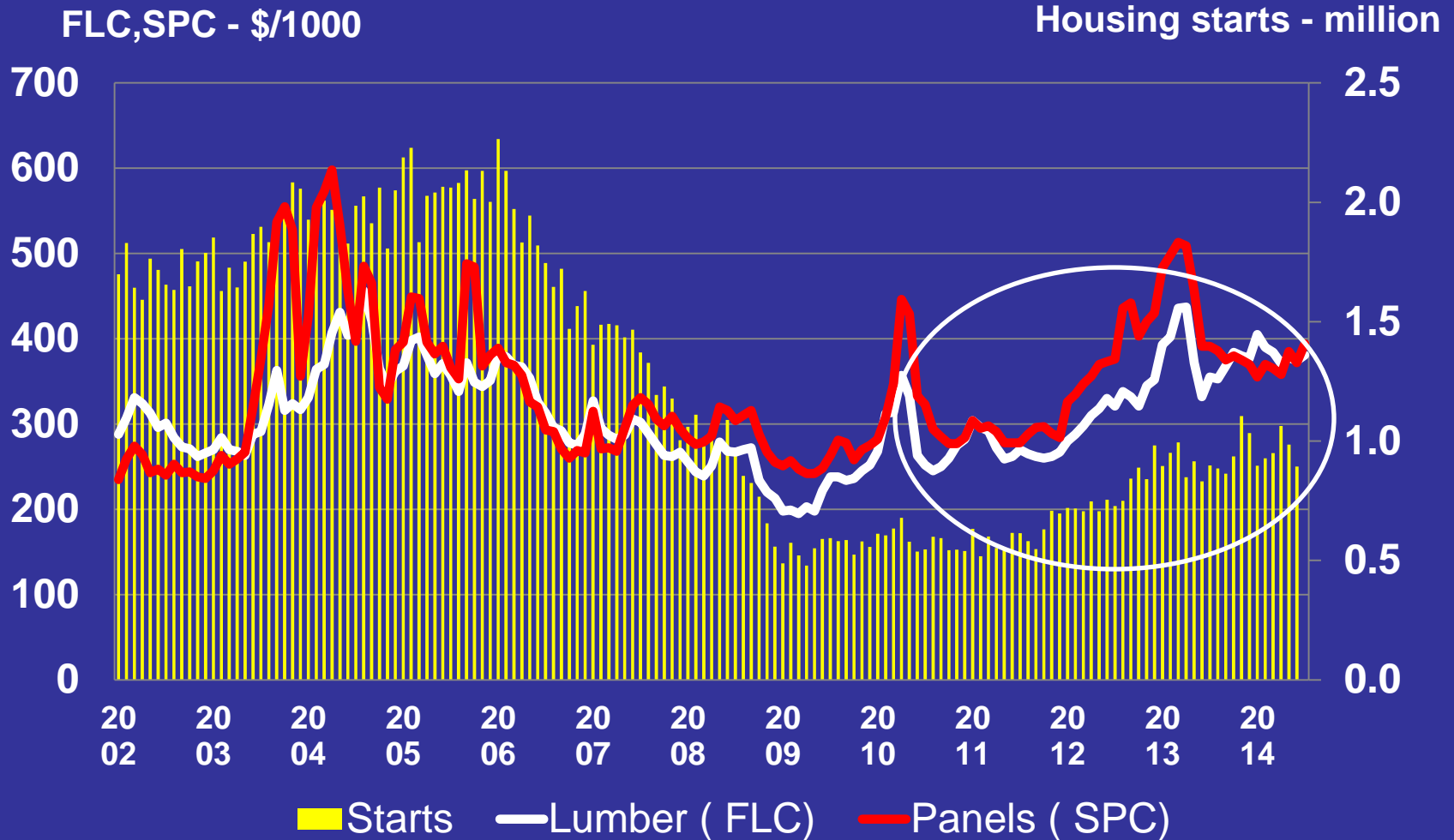
Housing services = gross rents paid by renters (include utilities) + owner's imputed rent (how much It would cost to rent owner occupied homes) + utility payments

RFI (residential investment) = construction of new SF and multifamily structures, remodeling, manufactured homes , plus broker's fees



Housing starts and wood product prices – Economics 101

75% of structural wood products go to housing (new construction plus remodeling)
50% or more of hardwoods go to housing related activities.

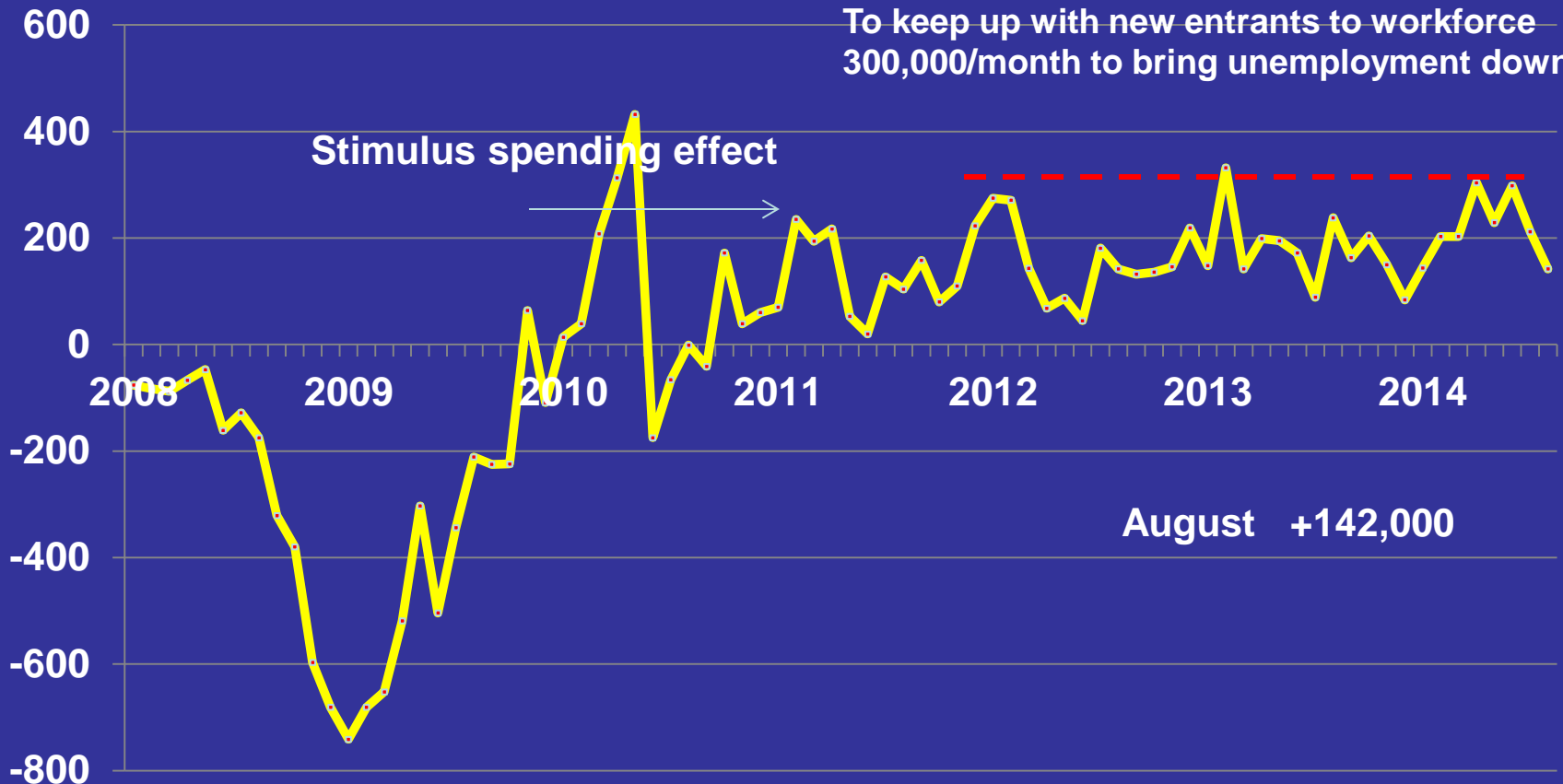


Sources: Prices – Random Lengths (<http://www.randomlengths.com/>); starts (Bureau of Census (<http://www.census.gov/construction/nrc/>))

**Employment situation - our biggest problem - it's getting better, but the jobs recovery remains weak by past standards, and many jobs (e.g., temporary ones)
Don't include health care or retirement benefits – those kinds of jobs don't encourage people to buy houses**

Net change in non farm payrolls – monthly, thousands

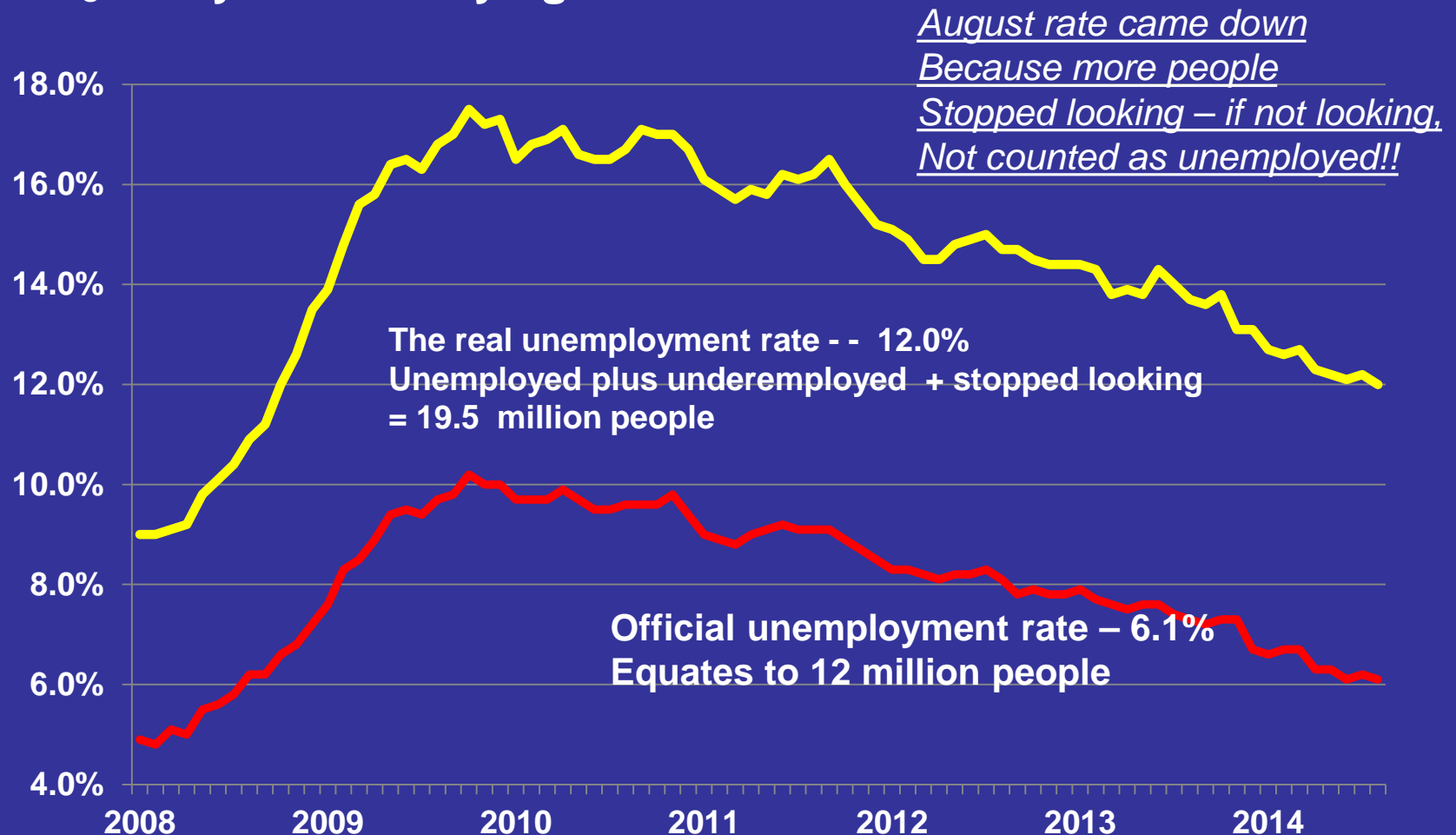
**We need 100,000 – 150,000 net new jobs/month
To keep up with new entrants to workforce
300,000/month to bring unemployment down**



Source: U.S. BLS (www.bls.gov)

Unemployment keeps coming down – but, the quality of many jobs being created is not so good

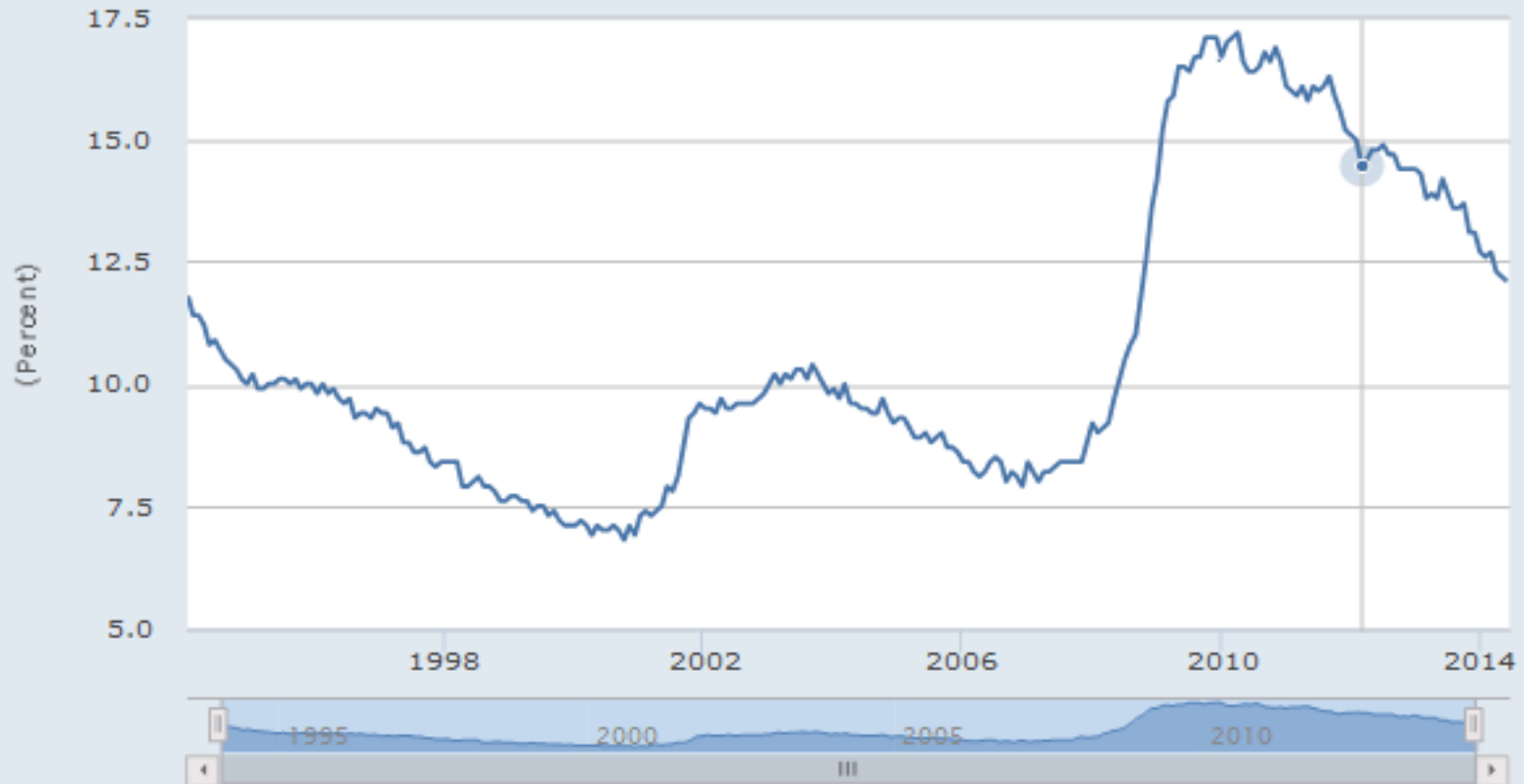
**There are about 20 million people either unemployed, underemployed, or stopped looking – they are not buying houses



Jobs - - Still the main problem with 12% of work force
Either unemployed,(10M) underemployed (7.3M), marginally attached
(2.3M) === about 20 million

FRED

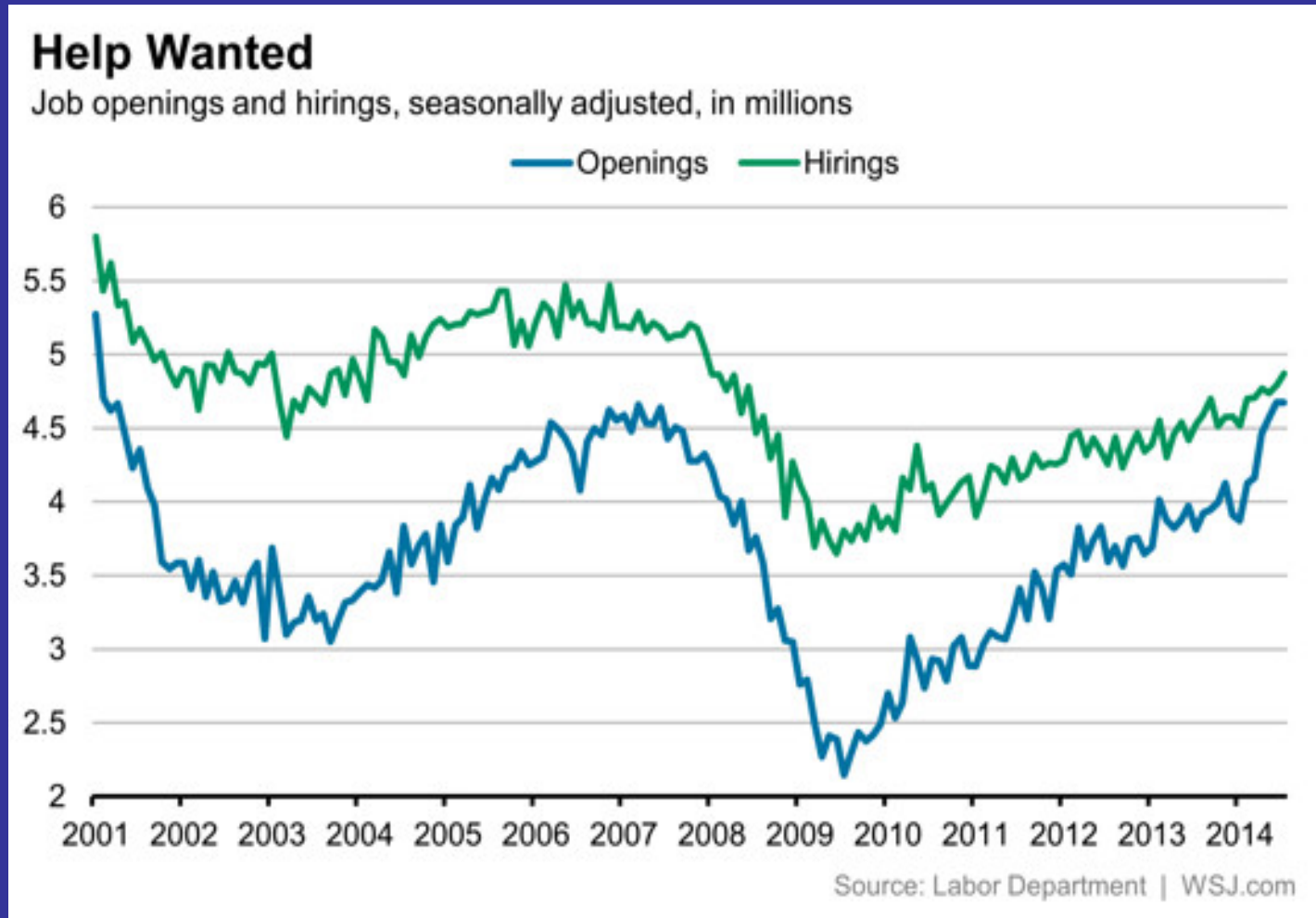
— Total unemployed, plus all marginally attached workers plus total employed part time for economic reasons



Source: U.S. Department of Labor: Bureau of Labor Statistics

Shaded areas indicate US recessions - 2014 research.stlouisfed.org

But, the labor market is improving, and we should be Thankful for that.



Another sign things are getting better

Hiring Headcount

Unemployed workers per job opening, seasonally adjusted



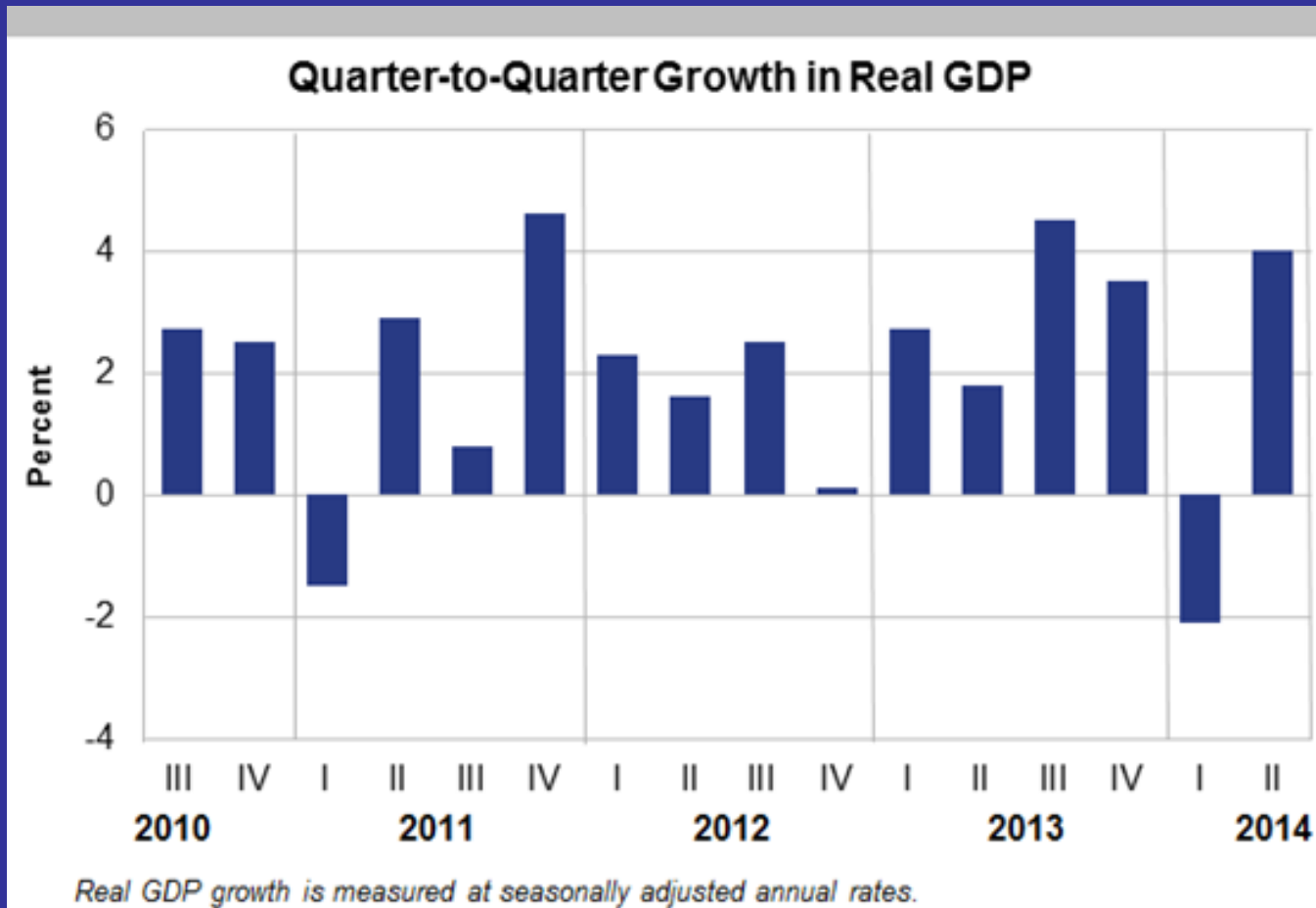
Source: Labor Department | WSJ.com

Labor force participation rate is shrinking – this is not good!!

we will see more labor shortages in the future????



Economic growth of 4.0% – 2nd qtr 2014 – good bounce from -2.9%
In 1st Qtr – will it continue through rest of 2014>>>>
GDP for 2013 was 1.9% - nothing to write home about



Economic and Housing Outlook – downward revisions from July outlook – looks like 2016 is best bet for turnaround????

	NAR		NAHB		
	2014	2015	2014	2015	2016
GDP	1.6%	2.8%			
Housing starts(000)	1041	1290	986	1244	1541
Single (SF)	656	863	643	875	1173
Multi (MF)	385	428	343	369	368
Resales (000)	4982	5344	4251	4524	4663
SF Sales	440	603	441	597	839

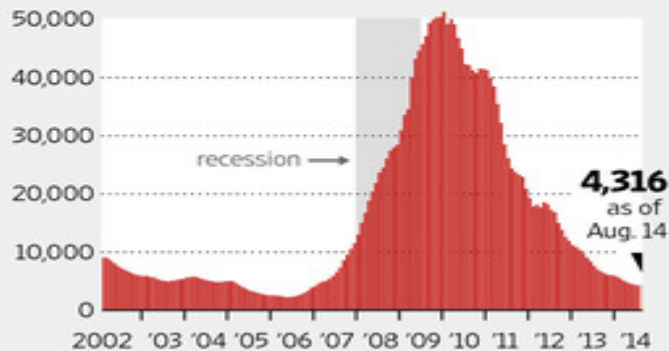
Source: NAR (<http://www.realtor.org/research-and-statistics>)

Many markets are slowing down – Phoenix is good example of city hurt by housing Collapse, then quick rebound until recently . Problem in many cities is lack of Traditional buyers with “bargain hunters” disappearing as prices increase.

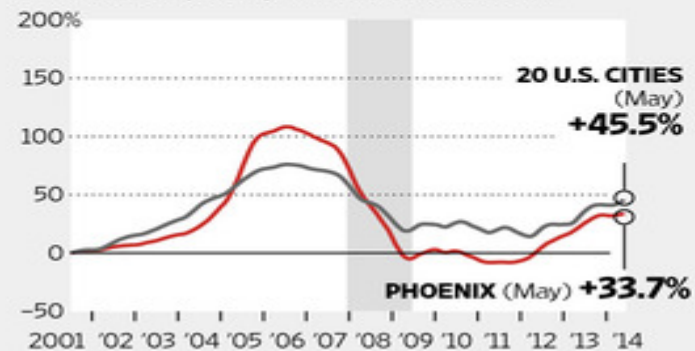
Return to Normal

As foreclosures in Phoenix have plunged since the crash, prices have risen...

Pending foreclosures in Phoenix



Change in Case-Shiller's Phoenix home-price index and its 20-city composite since June 2001

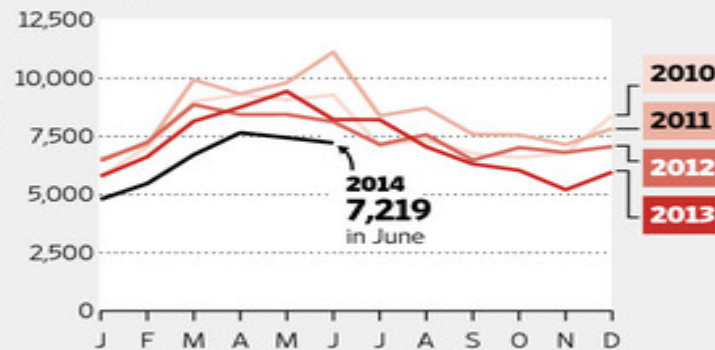


...drawing more sellers to market, though sales are lower than recent years amid questions of affordability.

Change in monthly inventory of previously owned homes listed for sale since June 2001



Monthly sales of previously owned homes in Phoenix, sorted by year



Source: Mike Orr, W.P. Carey School of Business, Arizona State University (Arizona inventory and pending foreclosures); S&P Dow Jones Indices (prices); National Association of Realtors (U.S. inventory); Arizona Regional Multiple Listing Service (sales by month) The Wall Street Journal

Recent Housing statistics

Background:

Markets are getting better – maybe????

Have we turned the corner? – Probably, but

The climb back will remain muted

Until we see economic growth of 3% or

More for an extended period of time!!!

Starts are finally turning the corner, but growth is painfully slow – Multi family remains strong!!

Single family starts, Thousand units, SAAR



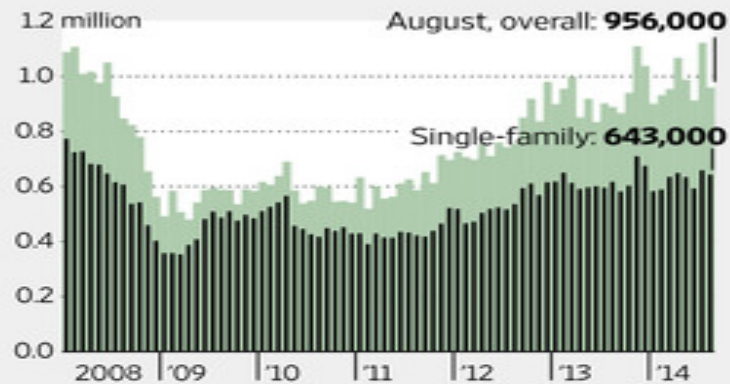
Source: Census (<http://www.census.gov/const/www/newresconstindex.html>)

Things are improving, but to be honest, we're only back to where we were in 2008. And, the driver has been multi family – I'm not too impressed with this "recovery", But, at least we're "building some momentum"

Building Momentum

Housing starts fell sharply in August, but single-family construction remains steady and both housing starts and permits remain above their levels at the same time last year...

Housing starts, seasonally adjusted annual rate

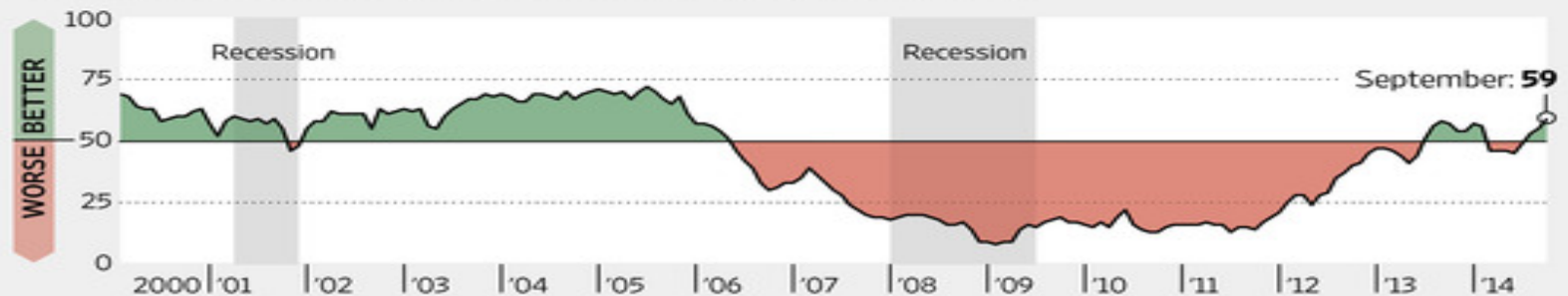


Change from previous year in seasonally adjusted annual rate, three-month moving average



...and builder confidence is as high as it's been since the end of the last housing boom.

Home builder outlook for the market for newly built, single-family homes



Sources: Commerce Department (starts and permits); National Association of Home Builders

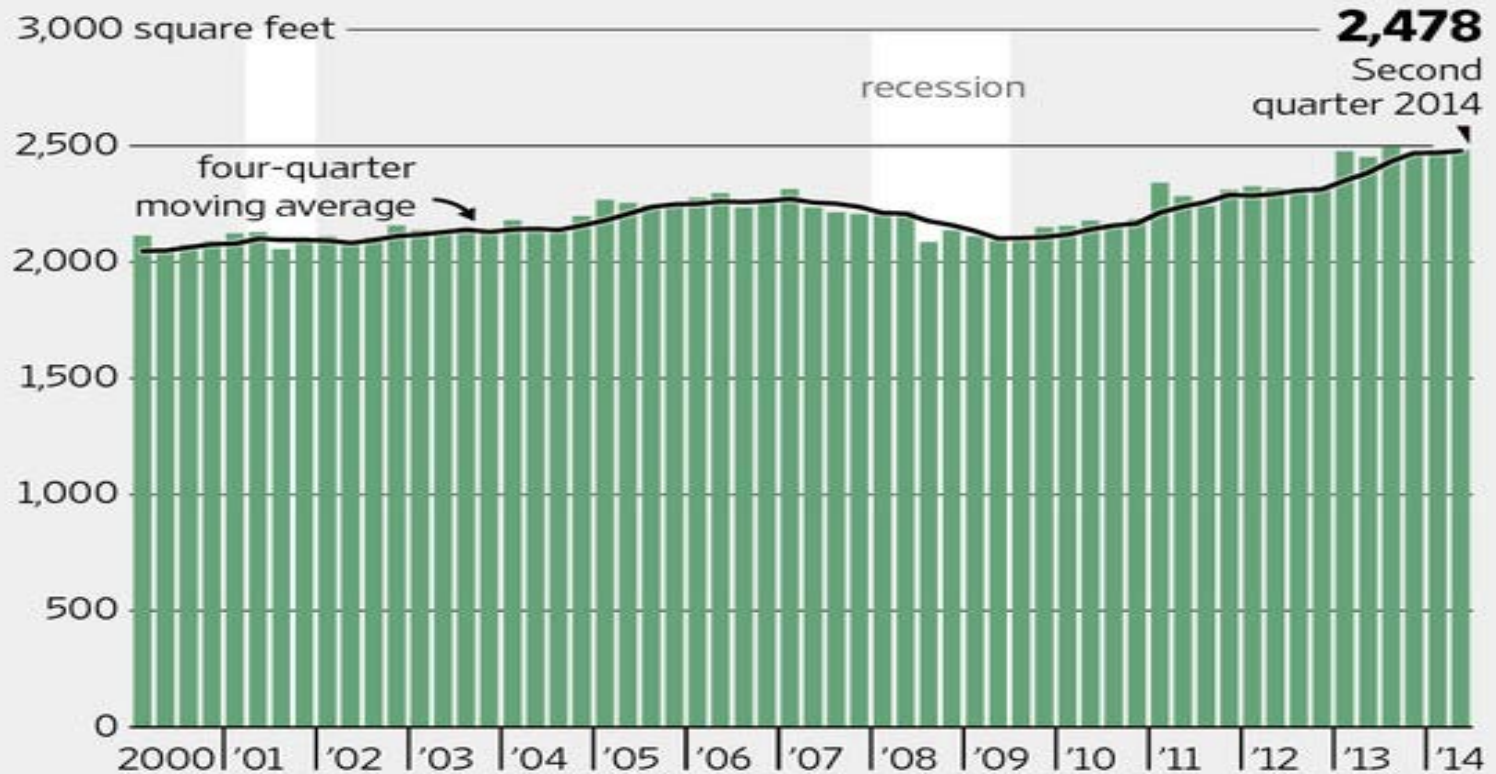
The Wall Street Journal

Another indication that 1st time buyers are absent from this market - -
"Dominated by better heeled , move - up buyers with capital and credit
To buy larger homes" - Kris Hudson, WSJ

(http://online.wsj.com/news/article_email/u-s-home-size-levels-off-for-now-at-least-1408476927-IMyQJAxMTA0MDIwMDEyNDAYWJ)

Big Footprints

Median square footage of newly built U.S. single-family homes



Source: Commerce Department via Moody's Analytics

The Wall Street Journal

Multi family continues to strengthen

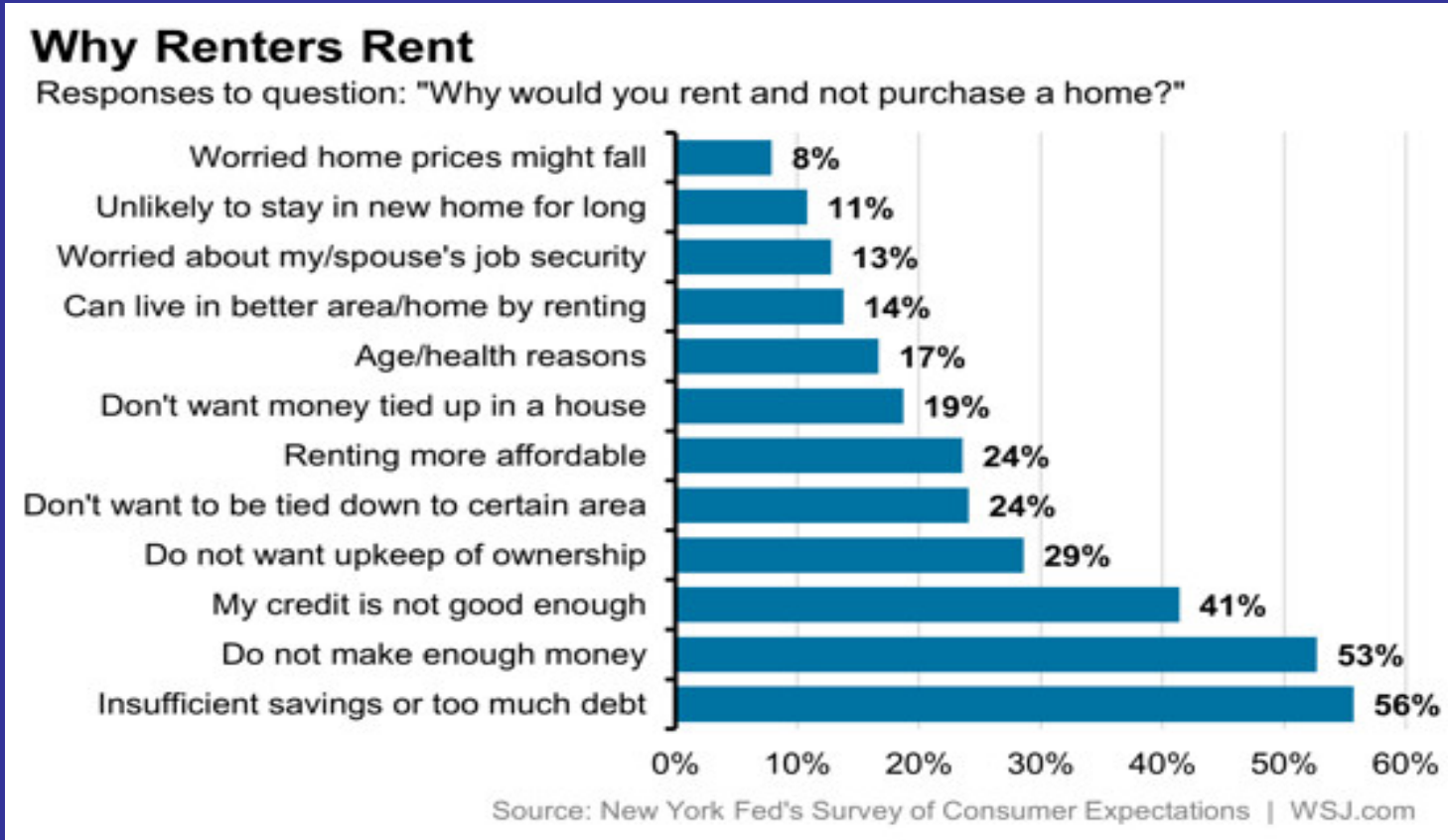
Shared Spaces

Structures with five or more units that began construction over the preceding 12-month period, not seasonally adjusted, in thousands



Source: Commerce Department | WSJ.com

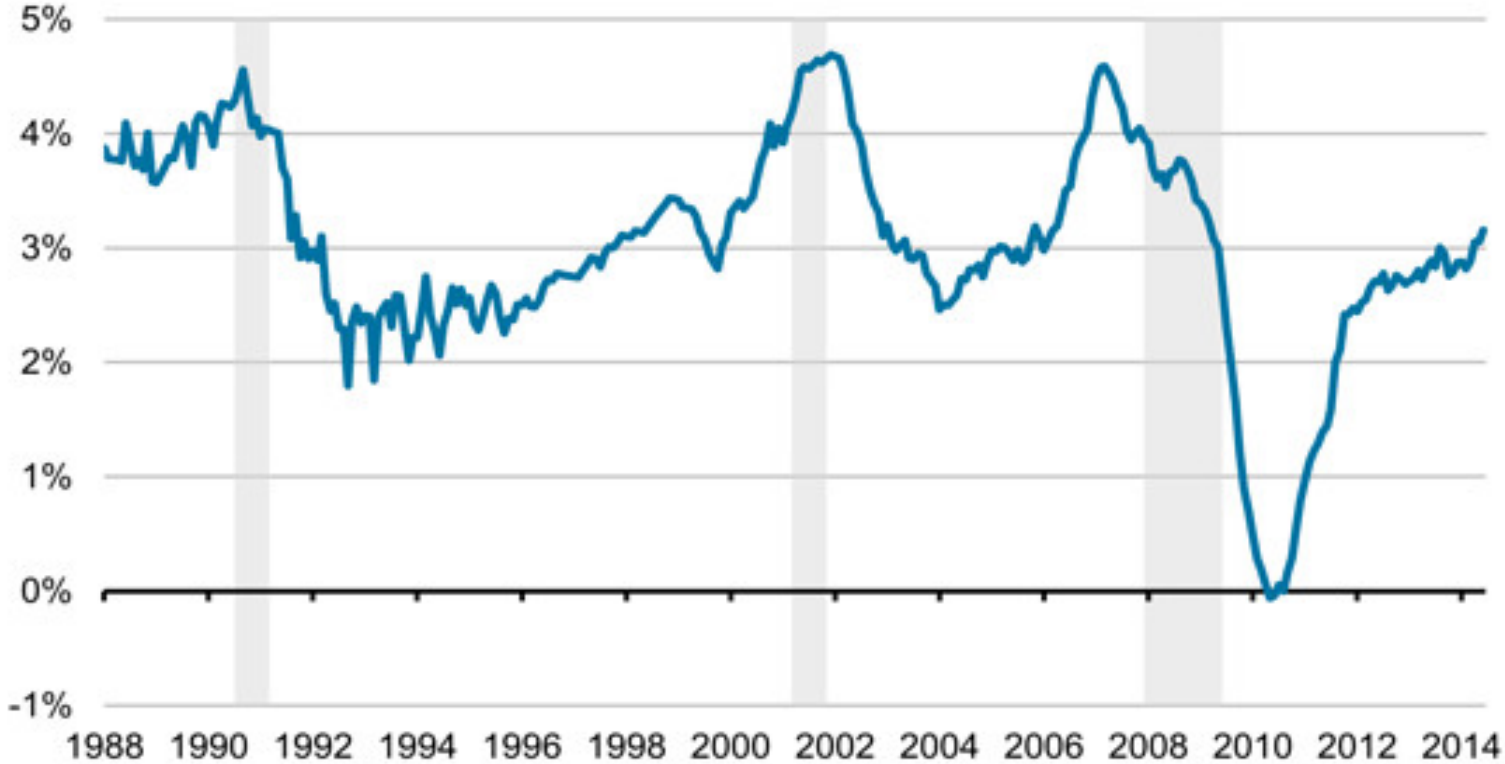
Renting is popular because many can't afford to buy - -
It's that simple?? Again, JOBS, JOBS



Rental prices keep increasing as demand outstrips supply
Rental construction strength will continue????

Climbing Back

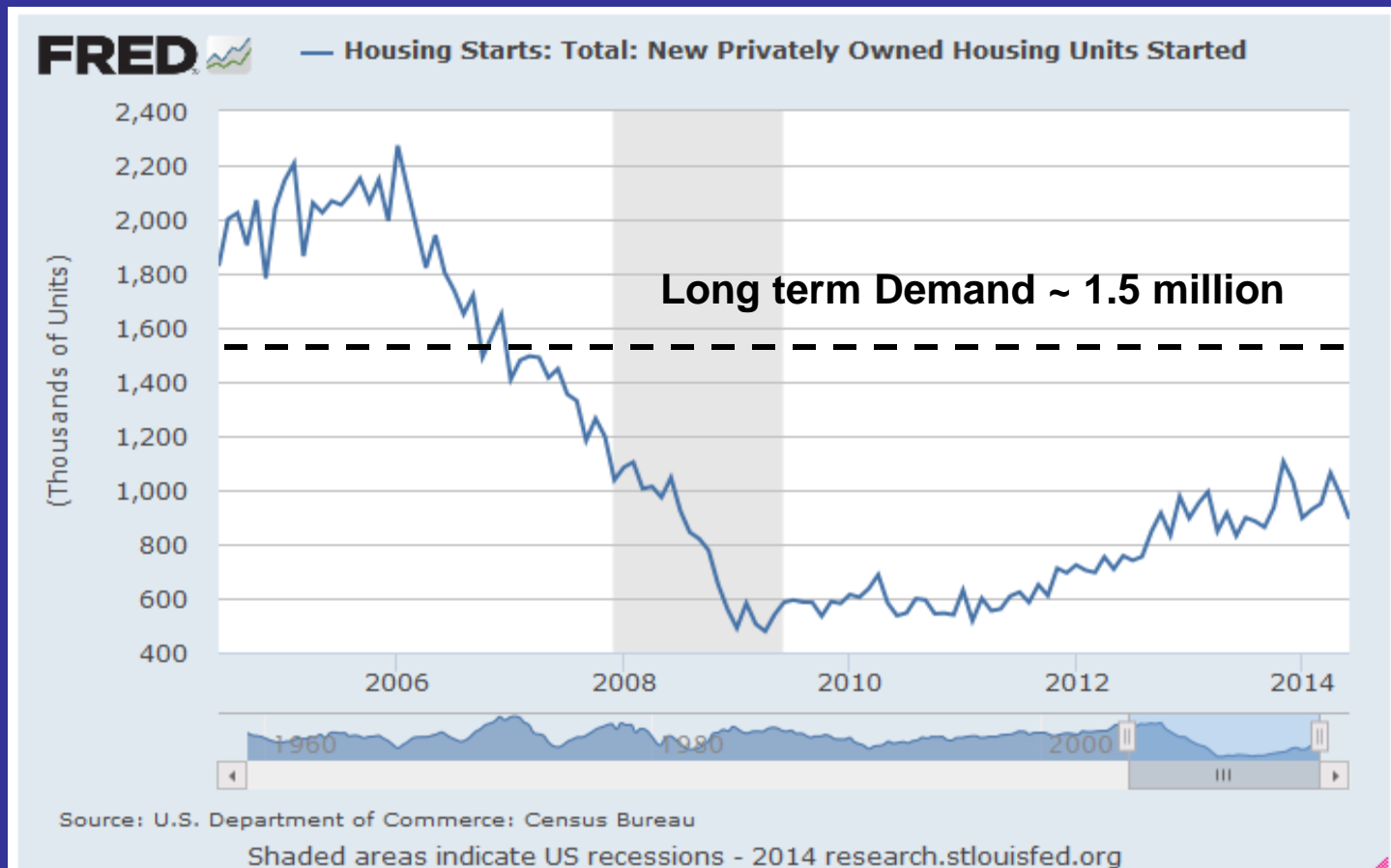
Consumer price index, rent of primary residence, change from year earlier



Source: Labor Department | WSJ.com

Long term shelter demand is estimated to be about 1.5 million annually
Based on demographics (65%), replacement demand(25%), and speculative demand including 2nd homes.(10%)

(to date, the main drivers have been speculators/investors and people paying cash:
E.g., in 1st qtr investors were 17% of existing home sales while cash sales were 43% of total purchases)

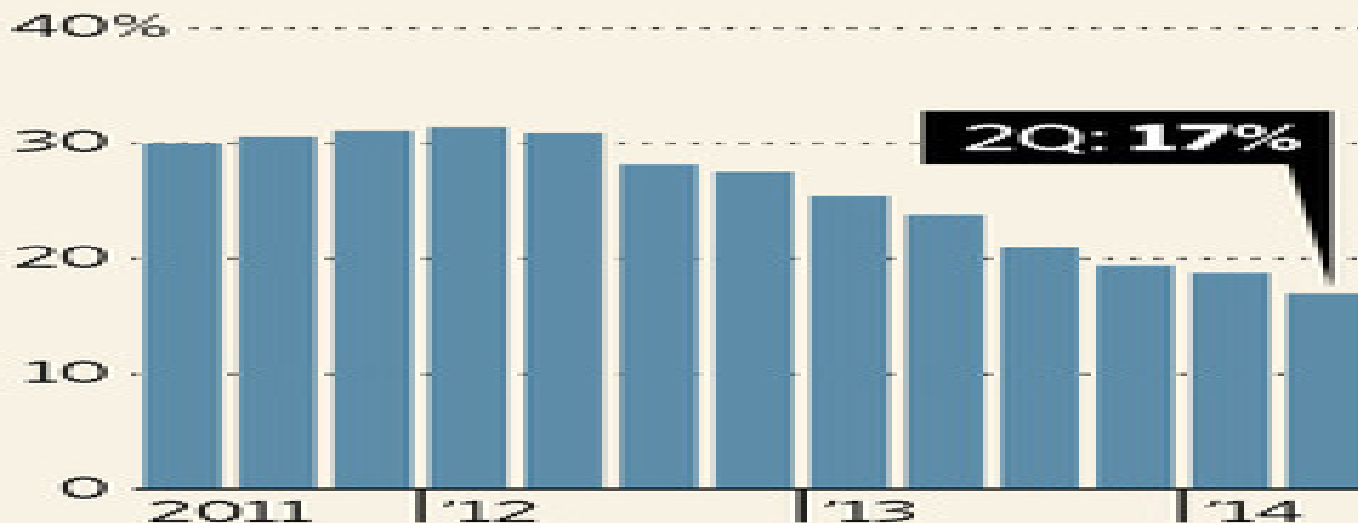


Some good news –

Fewer underwater homes means more homes on the market,
And this drives prices down –A GOOD THING – also facilitates
moving to better Paying jobs (i.e., difficult to move when you're underwater)

Getting Above Water

Fewer borrowers owe more than their homes are worth. Percentage of homes underwater in the U.S.

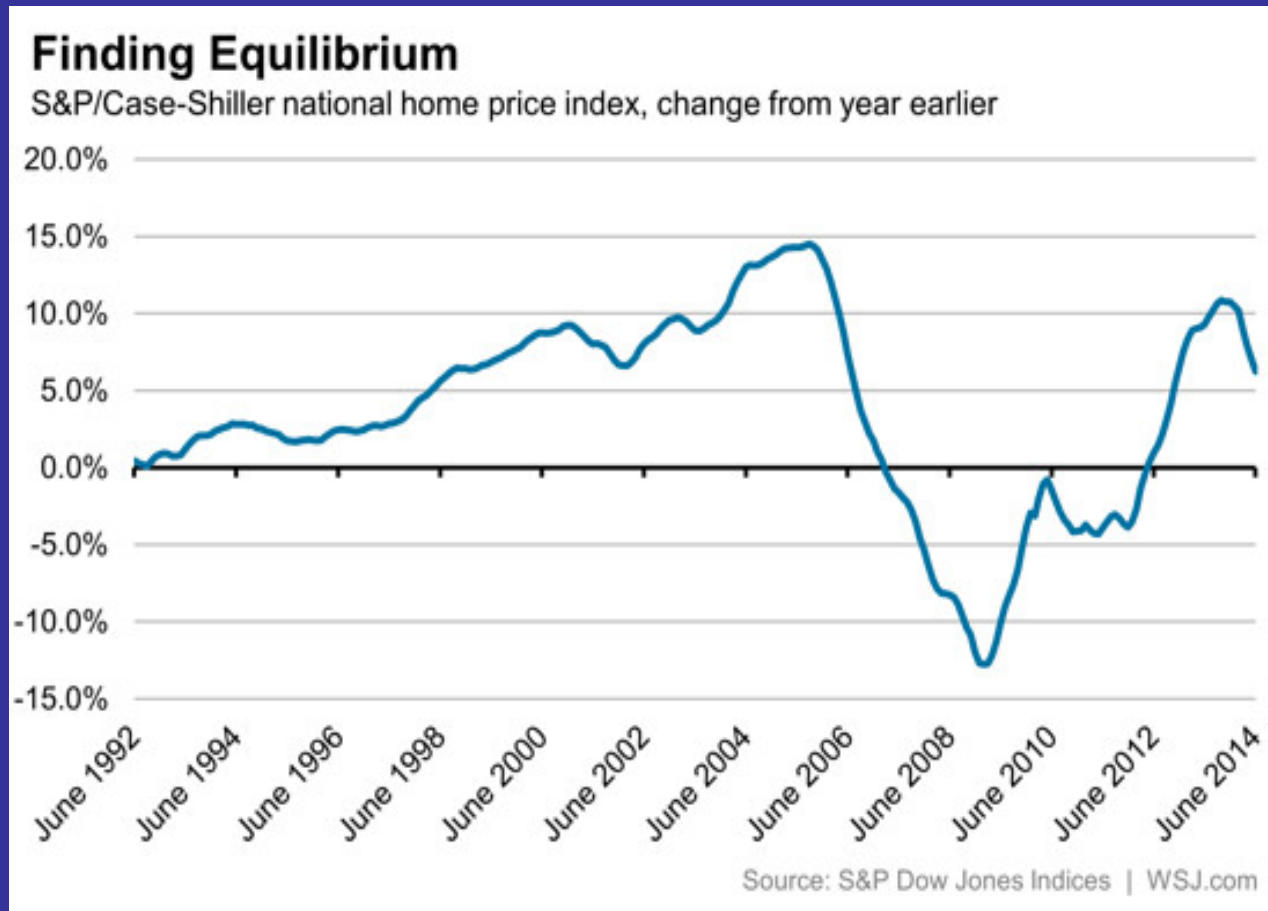


Note: Includes only homes that have a mortgage. Based on estimated home values.

Source: Zillow

The Wall Street Journal

Indeed, Price increases are slowing as recent Case Shiller Data indicates



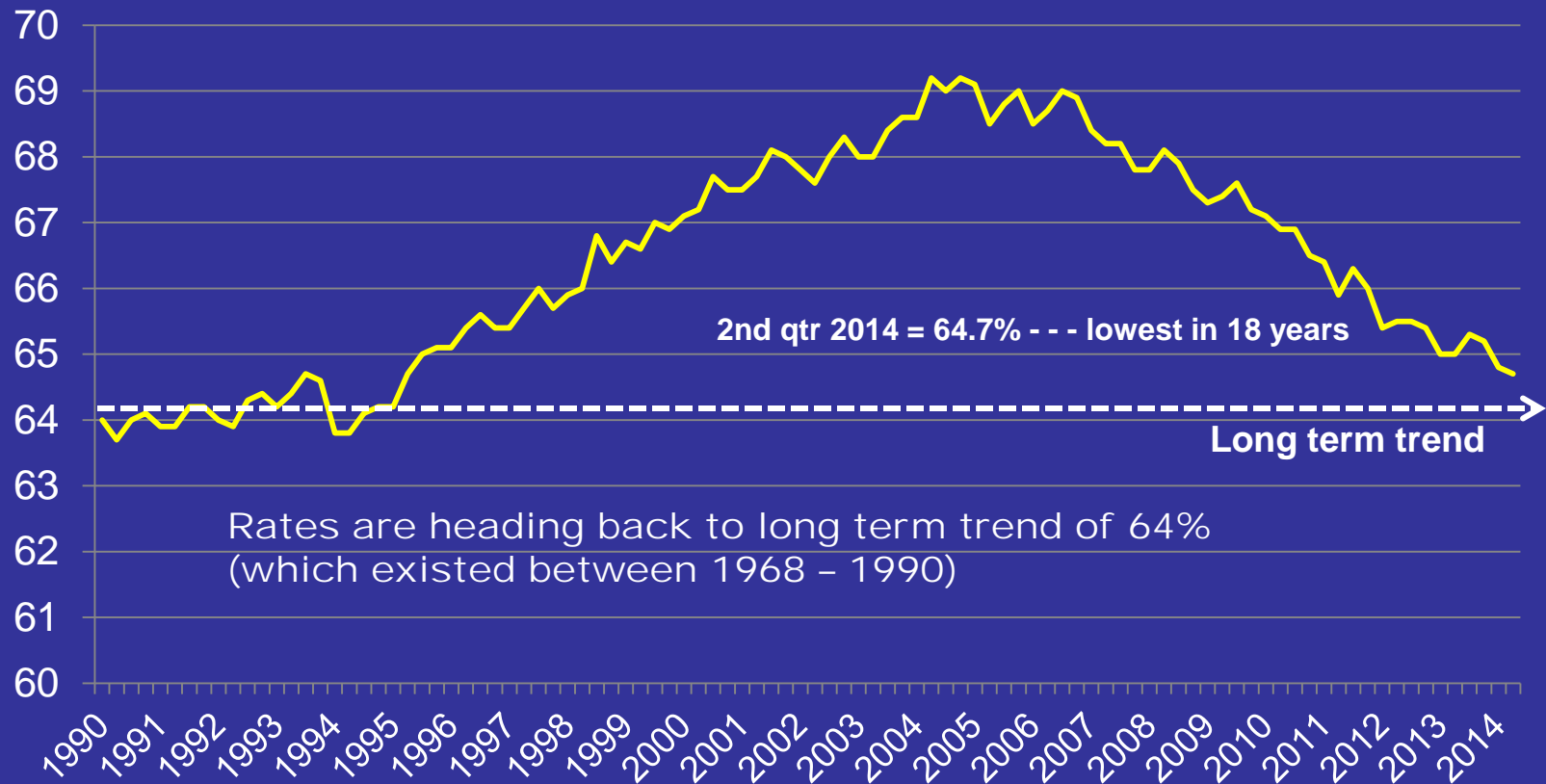
Impact of weak household formations - -

homeownership rates have been falling for the past seven

Years - when the economy gets back to normal,

Will people go back to single family or will we see more renting?
There will be impacts on wood products demand

Home Ownership(%)



Source: Census (<https://www.census.gov/housing/hvs/data/q413ind.html>)

Despite low mortgage rates, people are having problems
Buying a house because their real incomes have been shrinking
For the past 20 years – this is a structural problem (long term)
And not cyclical --- no quick fixes to this problem – Also, 15%
Of population live at or below the poverty level (\$24000 family of 4) –
i.e., 45 million Americans - Canada’s entire population plus 12 million - SAD



Real household incomes changed little in past 30 years

However, the same Census report show that incomes for 15-24 year olds increased 10.5% in the Past year – this is good news for housing because these are 1st time buyers who have been absent in recent years!!!!!!

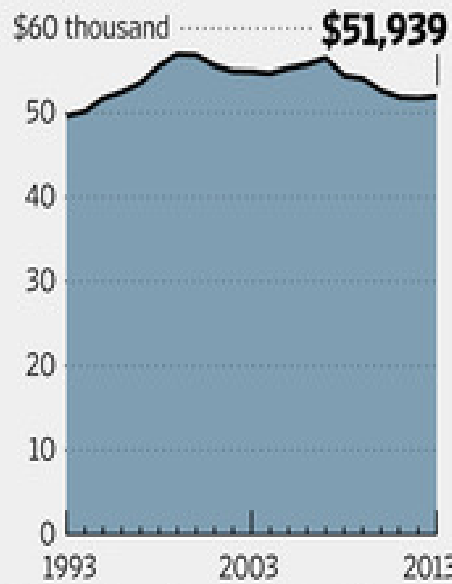
Source: WSJ (<http://online.wsj.com/articles/income-data-show-a-lost-generation-finding-its-bearings-heard-on-the-street-1410892047>)

Income Statement

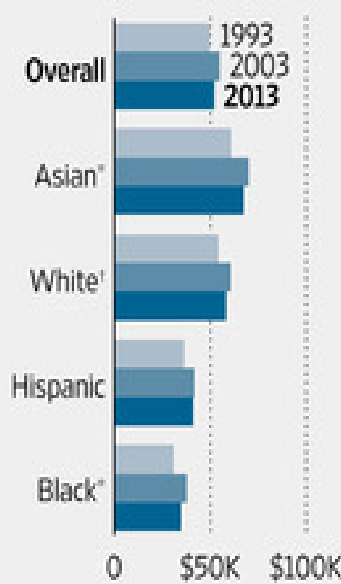
Income ticked up for the first time since the recession, but it remains far from its peak.

U.S. median household income, adjusted for inflation

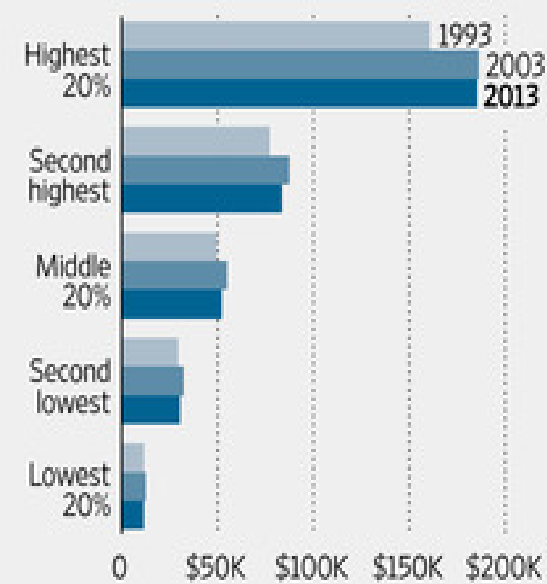
OVERALL



BY RACE, in thousands



BY INCOME QUINTILE, in thousands



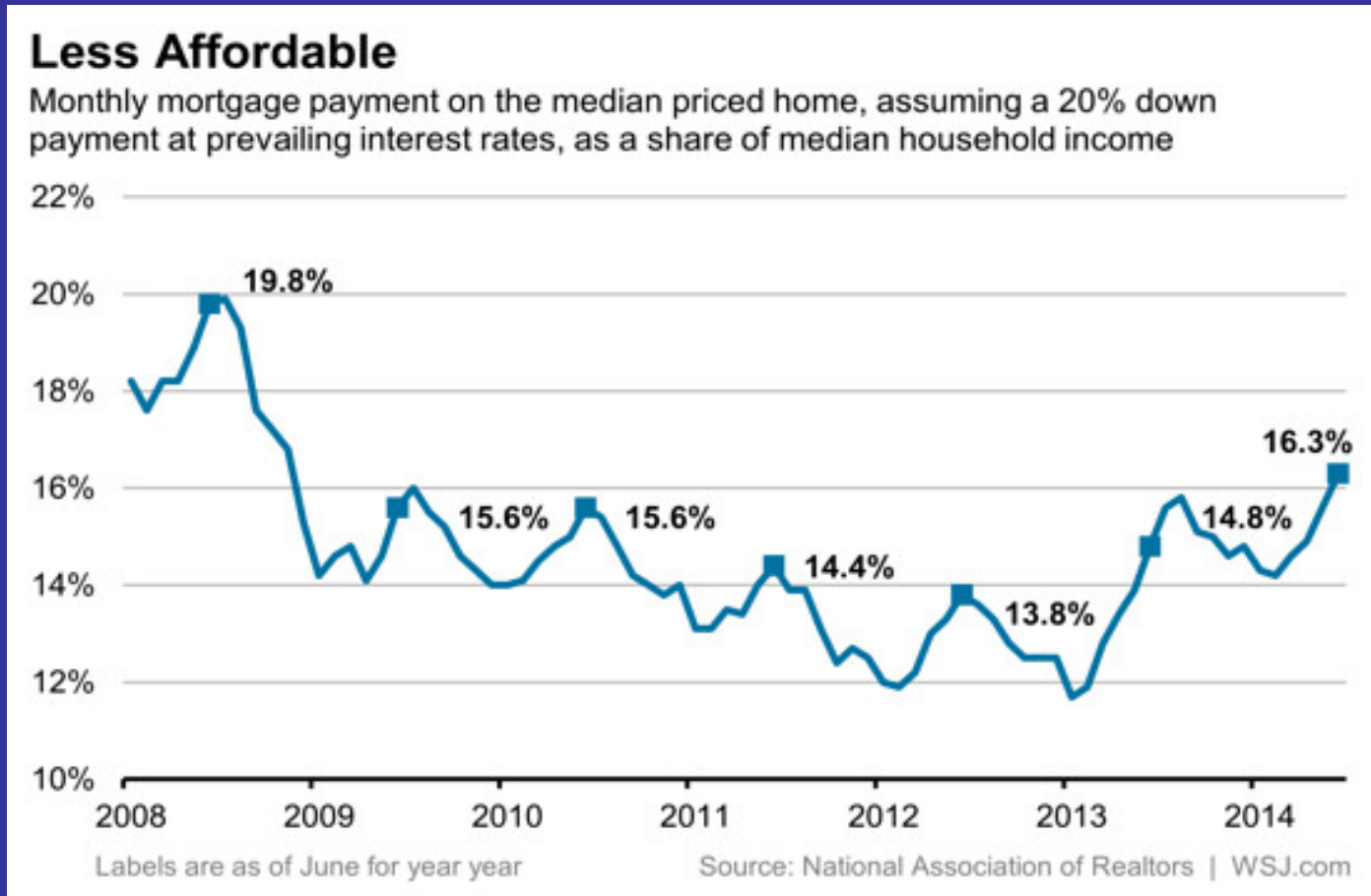
*Alone or in combination with any other race †non-Hispanic Source: Census Bureau

The Wall Street Journal

Source: WSJ (<http://online.wsj.com/articles/u-s-incomes-edge-higher-as-sluggish-recovery-persists-1410878730>)

Another drag on the housing recovery – decreasing affordability

(it's actually worse – many people can't afford the 20% down payment, can't Qualify for a loan with tighter credit restrictions, - - we need lots of better Paying jobs to get housing back on its feet)



Real incomes are shrinking – why??

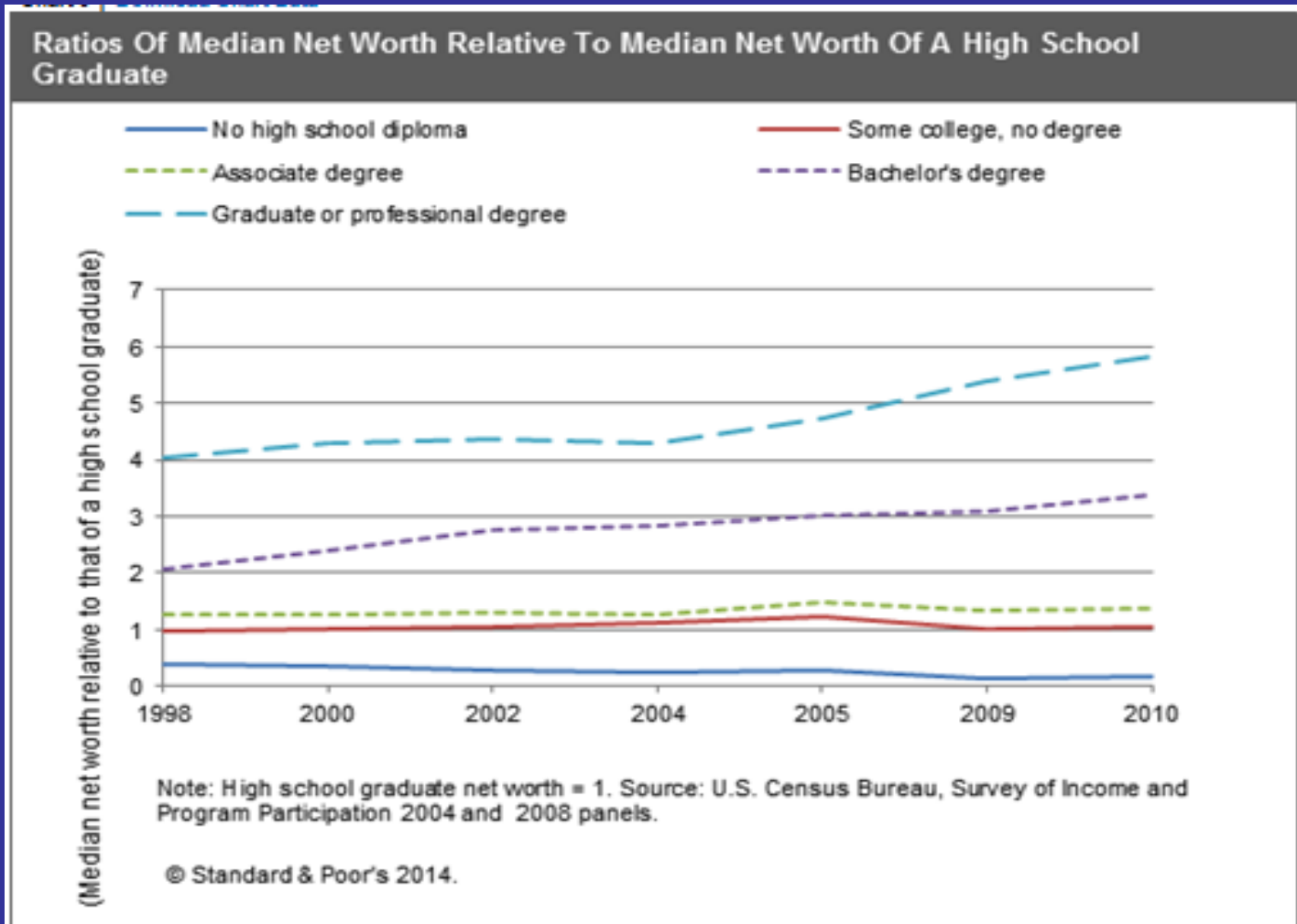
OK – we have discussed this before, but maybe it is time to Revisit the issue of education – how it impacts standard of Living, the economy, and demand for housing (and wood products)
PS. – a good friend pointed out that this isn't the only problem facing the Economy – agreed – I'm hoping to point out a few other structural Issues in future housing notes.

The next few slides are from a recent study by Standard and Poor's, A reputable organization in my opinion. The title of the report " How Increasing Income Inequality is dampening U.S. economic growth, And Possible ways to change the tide".

(https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1351366&SctArtId=255732&from=CM&nsl_code=LIME&sourceObjectId=8741033&sourceRevId=1&fee_ind=N&exp_date=20240804-19:41:13)

Education pays - a no brainer!!

(study by Standard and Poor's – a reputable organization)



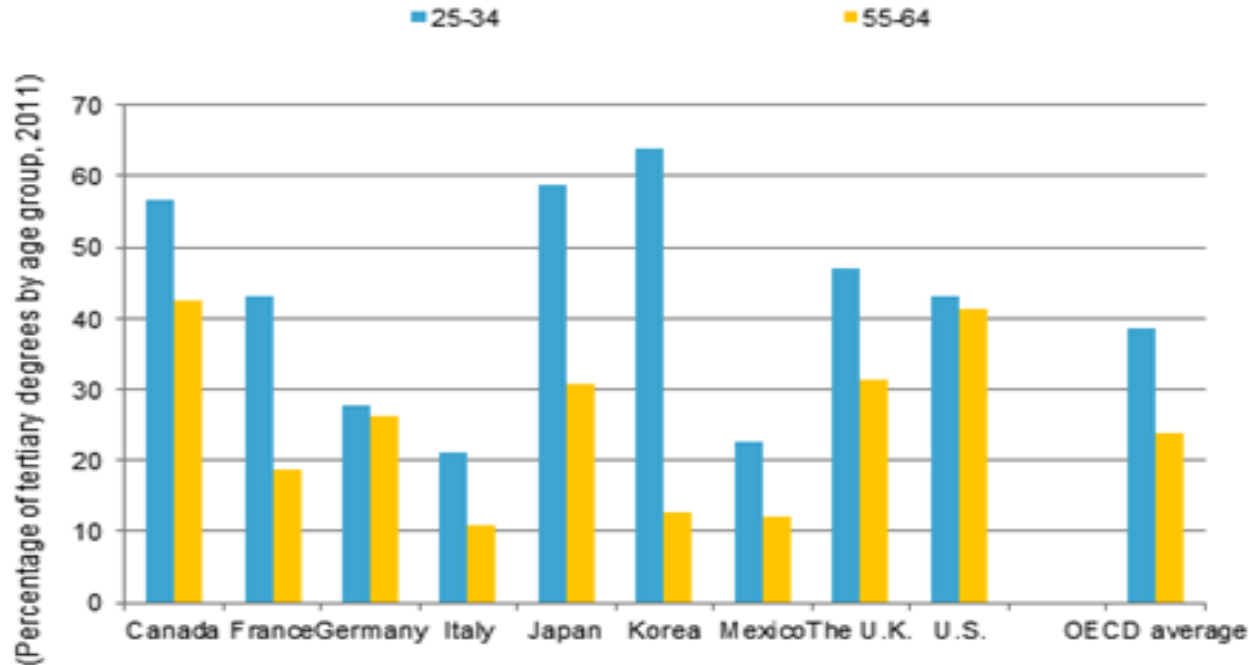
Source: Standard and Poors

(https://www.globalcreditportal.com/ratingsdirect/renderArticle.do?articleId=1351366&SctArtId=255732&from=CM&nsi_code=LIME&sourceObjectId=8741033&sourceRevId=1&fee_ind=N&exp_date=20240804-19:41:13)

If education pays, why is U.S. slipping behind????

Chart shows percentage of college degrees by age group - -
Note the difference between young and old . e.g., in most
Countries, young people are better educated, but in U.S. , there is little difference
I don't know about you, but I would feel a lot better if the next generation was better
Educated than their parents.

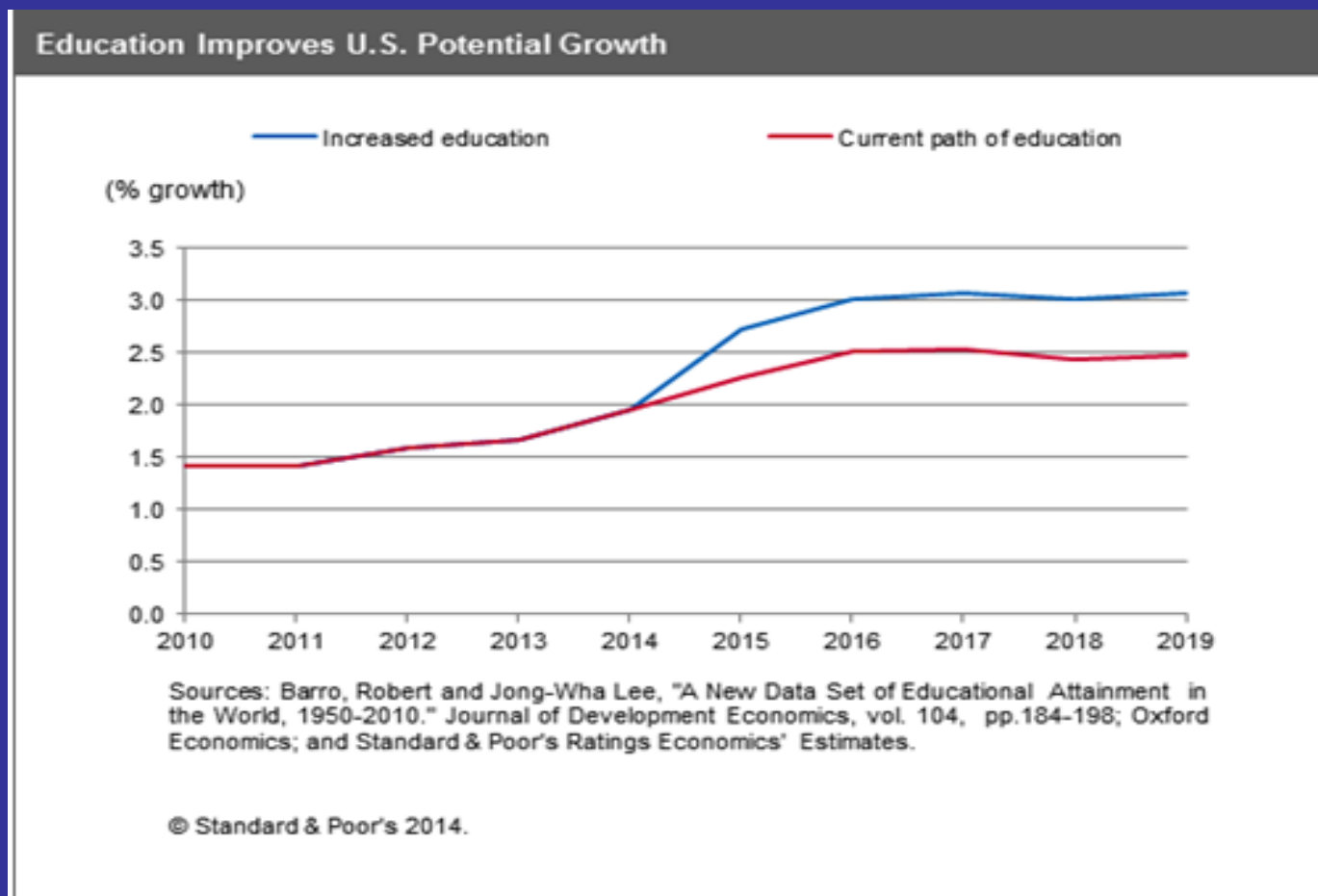
U.S. Education Is Slipping Behind



Source: The Organisation for Economic Co-operation and Development (OECD), "Education At A Glance 2013."

© Standard & Poor's 2014.

Education can improve our economy – again, why are we Falling behind????



PS. A colleague suggested that better education alone won't
Fix the economy – I agree – we have additional structural problems

What's the problem and How do we solve it??

(you have seen this movie before, but let's take another look)

We consume too much and don't invest enough in our future - - -
Most of our competitors consume 60% or less of their economy – yet,
We consume 70% or more. We need to consume less and invest more
In education, infrastructure, R&D,

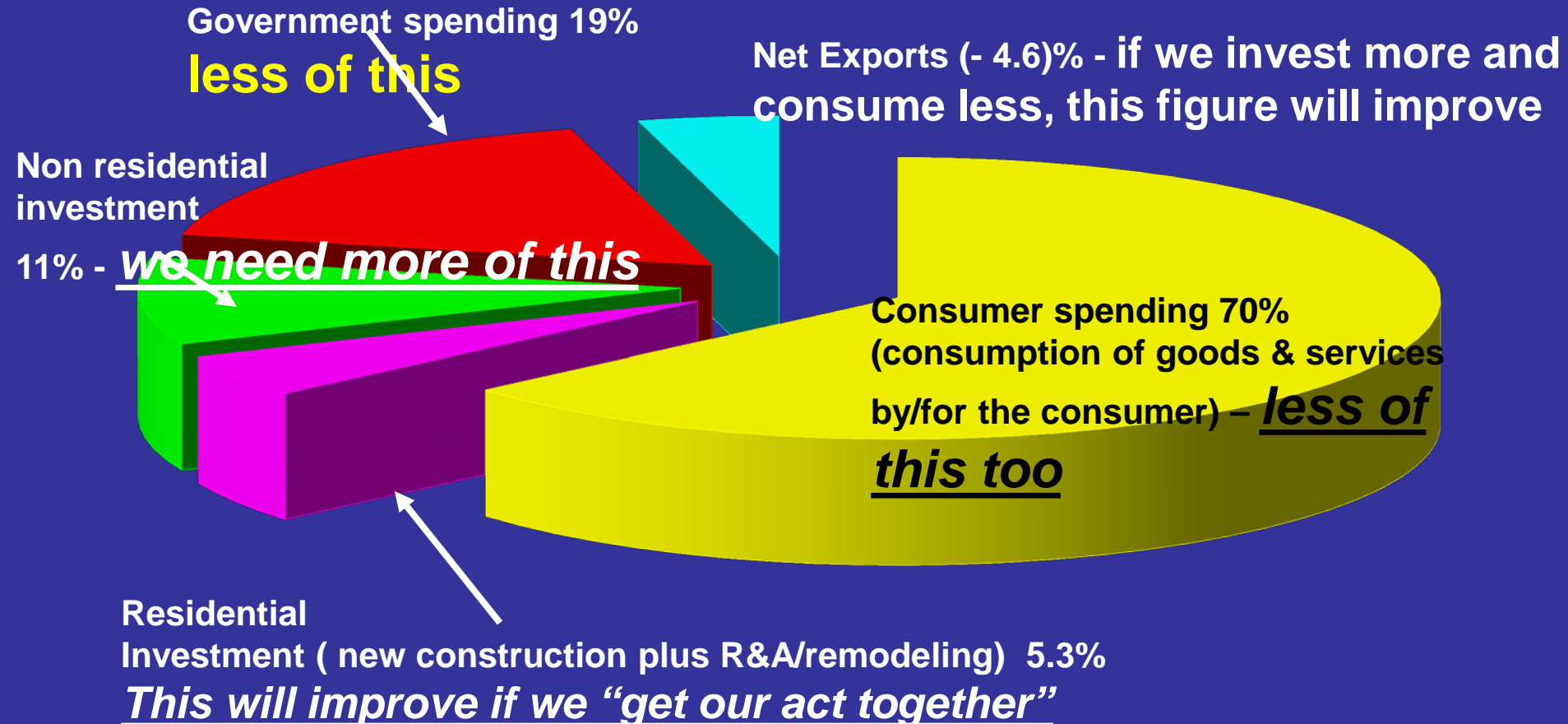
This is a legitimate strategy for improving our economy, and promoting
More demand for housing, and wood products.

I know this is an oversimplification – but, one strategy
Is we need to change the tax laws to favor investment and discourage
consumption (at least until we regain our global competitiveness). And,
The government needs to be involved. By
the way, this is what we did following WWII – after the war was over, the
GI Bill encouraged soldiers to get an education, and other laws were enacted to
Encourage America to invest in its future (e.g., Eisenhower knew the importance
Of investing in a world class interstate highway system).

Bottom line – if we don't invest in our future, we won't have one!!!!!!!!!!

U.S. Economy 2000 – 2010

this type of economy not sustainable – insufficient investment in infrastructure, R&D, education makes us less competitive and this leads to reduced standard of living and less housing demand



U.S. Economy 2013 - - GDP as % of Economy = 68.5%

China consumes <40%; Russia < 50%; Europe <60%

Government spending 19%

less of this

Net Exports (- 3.0)% - if we invest more and consume less, this figure will improve

Non residential investment

12.2% - ***we need more of this***

Consumer spending 68.5%
(consumption of goods & services by/for the consumer) - **less of this too**

Residential Investment (new construction plus R&A/remodeling) 3.0%

This will improve if we "get our act together"

Source: BEA (<http://bea.gov/national/nipaweb>)

New home Sales - - This is key statistic to watch – new single family sales drive wood product demand more than any other housing number – This market remains very weak and will probably continue that way until the Job market strengthens (good jobs that is!!!!!!)

☆ New One Family Houses Sold: United States

2014-07: **412** Thousands (+ see more)

Monthly, Seasonally Adjusted Annual Rate, HSN1F, Updated: 2014-08-25 9:06 AM CDT

Click and drag in the plot area or select dates: 1yr | 5yr | 10yr | Max

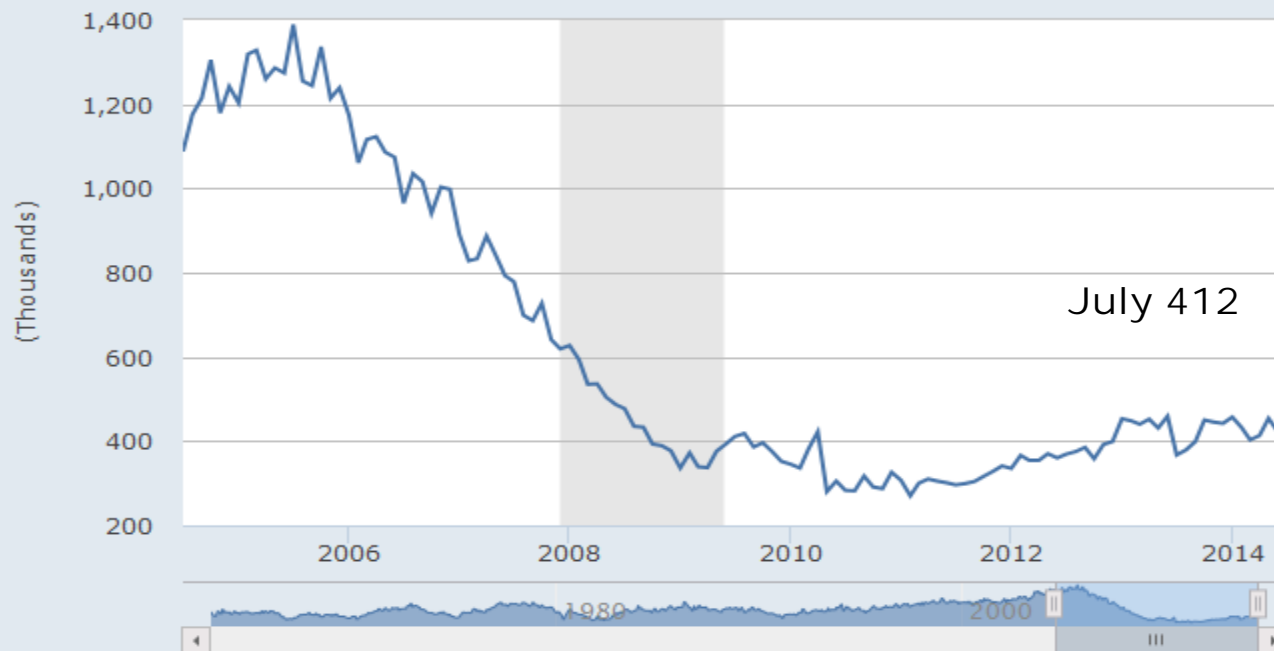
2004-07-01

to

2014-07-01

FRED

— New One Family Houses Sold: United States



Source: U.S. Department of Commerce: Census Bureau

Resale market – In July, more than 29% were cash sales, including foreign buyers and investors – not sustainable scenario – that said, inventories are growing and the market continues to improve with distressed sales continuing to fall

Single family (incl condos), Monthly, Thousand units, SAAR



Source: NAR (<http://www.realtor.org/research>)

Some conclusions – housing continues to improve albeit slowly
Most forecasters now suggesting that 2016 will be “breakout year”??

Short term:

- (1) Economy will muddle along until 2016 - i.e., **2015 still below trend**
- (2) This is still not a healthy housing market - 1st time buyers are absent and household formations are off 50% from trend – furthermore, many of sales are cash, many foreign buyers, etc. I.e., **NOT SUSTAINABLE**
- (3) The key to a recovery in housing is the return of 1st time buyers, traditionally about 40- 45% of the market. Current market skewed to cash buyers and investors. 1st time buyers are mostly young people, but they can't find jobs.
- (4) Political discourse will continue to slow a truly strong economic and housing recovery.

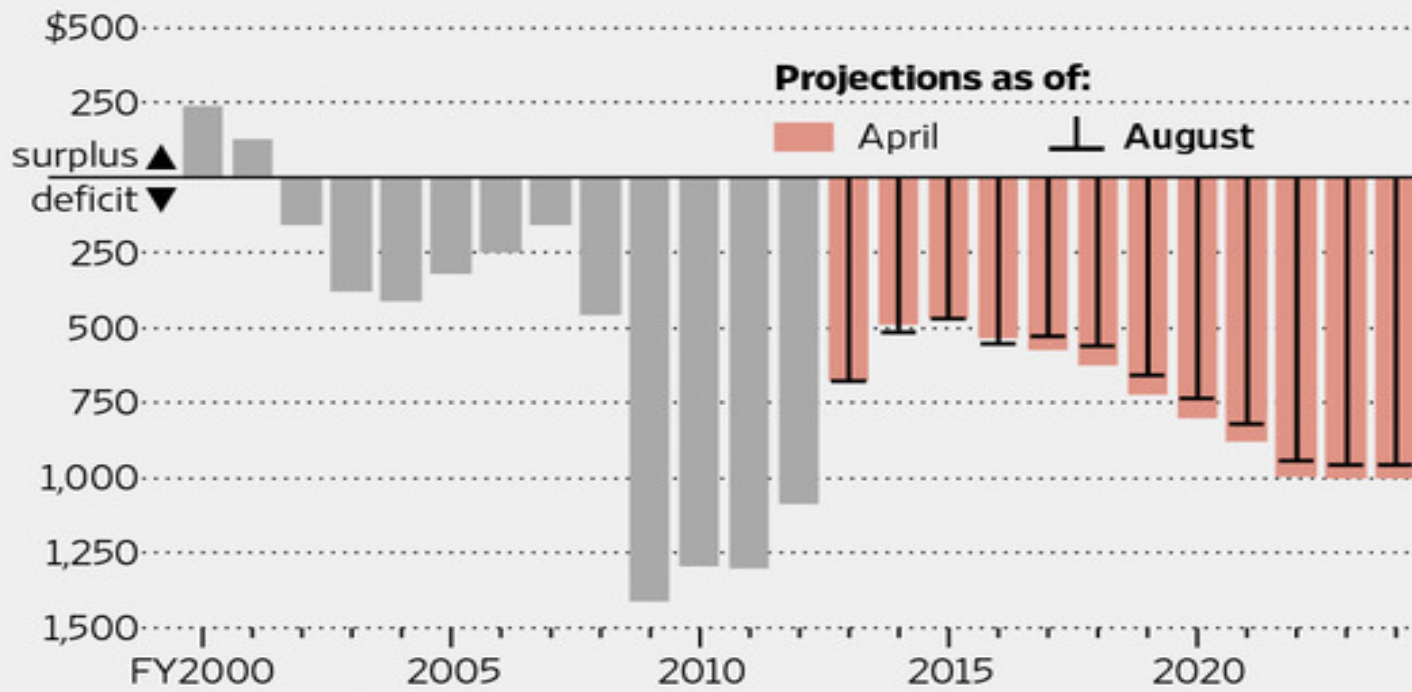
Longer term:

- (1) Housing demand will hinge partly on the footprint of the Federal government – will they continue to promote housing to the degree they have in the past? Yes, the economy is important, but the politicians know how to “grease the wheels”
- (2) Labor participation rate keeps falling – this suggests that there will be future labor shortages. Furthermore, tax revenue will be impacted as more people collect from growing number of government programs while fewer people pay taxes. Look for changes in tax code; consumption tax??; social security; Medicare/Medicaid;
- (3) How will USA deal with aging demographics; crumbling infrastructure; out of control public debt; and, generally, decreasing global competitiveness!!!! My thought – revamp the tax system to Discourage consumption (bring it in line with other countries); and invest more in our future!!! Otherwise, we will continue to “underperform”, and housing and wood products will suffer. This will take a long term commitment from the country, politicians, voters, The U.S. consumption rate (% of GDP) is about 70% while our competitors , it is 60% or lower. Invest for the future – sounds simple, but requires some thinking that prevailed in this country following WWII. **And, we have to get Medicare/Medicaid, and SSI on a sustainable basis (see next slide for information on federal debt because this makes debt reduction critical)**
- (4) LEADERSHIP IS important – politicians need to work on long term solutions – And, more Americans need to get involved in the voting process – non presidential turnout is less than 40%. If you don't vote, don't complain about the outcome or resulting poor or lack of legislation.

Smaller shortfall, but still lots of red ink – if this were a company, It would be bankrupt – Current tax receipts are \$2.976 trillion, spending is \$3.53 trillion. Medicare, Medicaid, plus SSI spending = \$1.75 trillion, or 60% Of the tax revenues. (50% of spending). This needs to change or SSI plus Medicare/Medicaid will gobble up 80% of the federal budget within 20 years

Smaller Projected Shortfall

Federal budget surplus/deficit, in billions



Note: Fiscal year ends Sept. 30.

Source: Congressional Budget Office

The Wall Street Journal