



31 October 2014



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

To all,

Attached is latest note. Things are getting better, but very slowly. Multi-family continues to remain strong as renting remains in favor for many middle income people. This will probably continue until the job market gets stronger. Still too many part time jobs with little or no benefits; little or no inflation adjusted income growth; and a slowing world economy. I know this sounds discouraging, but it's not too bad considering the many problems facing the world economy. Terrorism; Ebola, Ukraine; ISIS; All said and done, the US economy is doing well considering the many headwinds.

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Richard P. Vlosky, Ph.D.
Director Louisiana Forest Products Development Center
Crosby Land & Resources Endowed Professor of Forest Sector Business Development
Room 227, School of Renewable Natural Resources
Louisiana State University
Baton Rouge, LA 70803
Phone (office): (225) 578-4527
Fax: (225) 578-4251
Mobile Phone: (225) 223-1931



Housing comments – October , 2014

- *September was decent month for housing – up 18% Year over year*
- 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 domestic job market; sluggish income growth; tight credit environment continues – Europe is in a recession, and facing disinflation with growing deflation concerns.
- *Main problem (short term) 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.*
- **Another problem, longer term, is the aging population – I've included a few slides suggesting that the solution is Immigration reform. Without it, we're going to see serious labor shortages (skilled labor particularly), and enormous problems with entitlement programs like SSI and Medicare . If we don't deal with these issues, (and better debt management) housing won't come close to returning to the “good old days”!!!!!!**
- **My best guess re: housing is that it will be 2016 or later before we get back to 1.5 million starts. Don't expect too much from the Congress or the Administration over the next two years. More gridlock and less concerted effort to solve serious problems facing the country . Lots of politicking, but no problem solving.**
- **RE: the economy and interest rates – I believe the FED will keep interest rates low for some time (another two years??). Why – the economy is being propped up by monetary policy, and there is little evidence it can move forward without the stimulus. I hope I'm wrong, but I don't think so.**

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!!!!

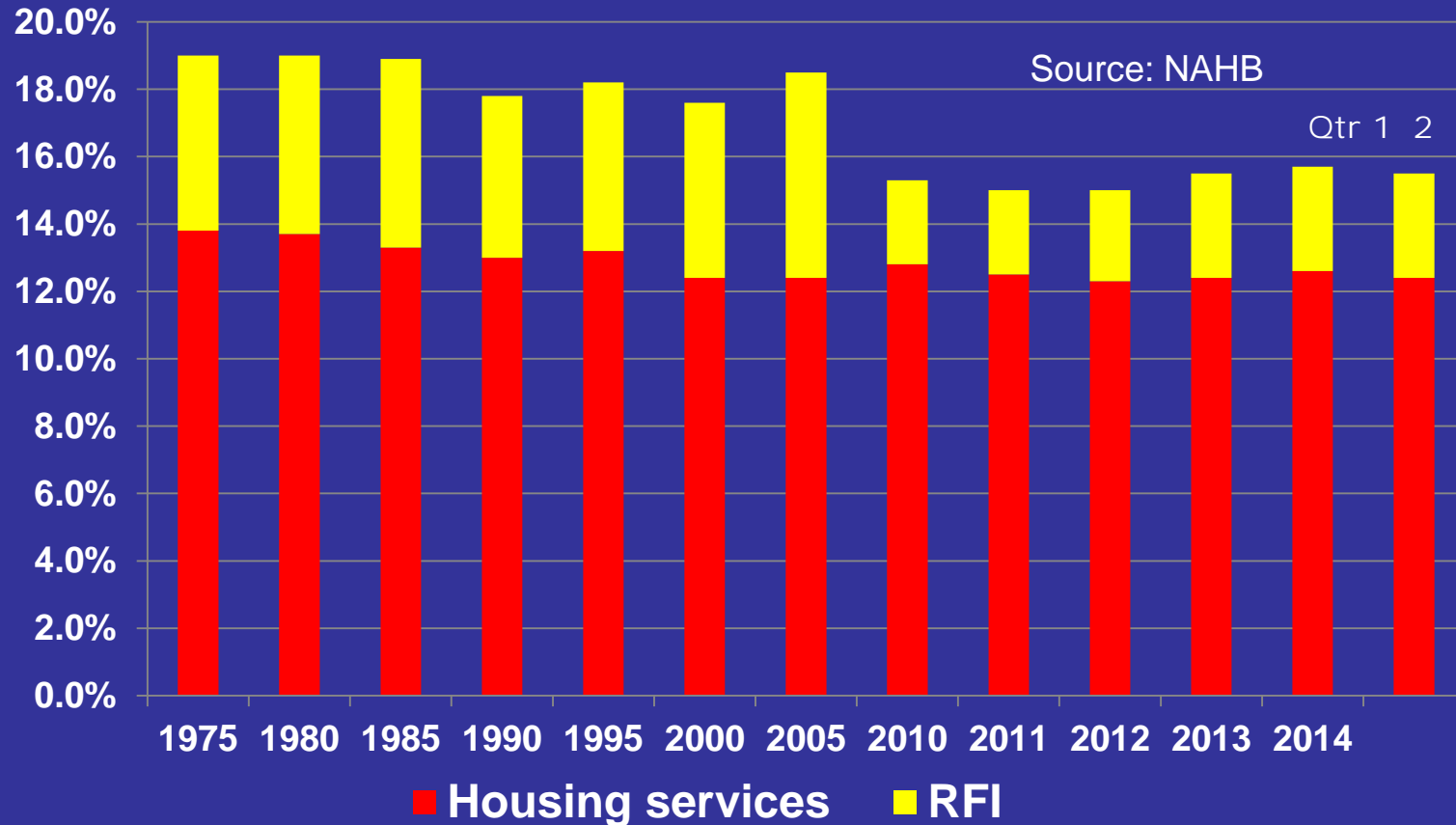
- (1) Impact of Homebuilding and Remodeling on the U.S. Economy (May 2014, Paul Emrath)
- (2) Housing's contribution to GDP (NAHB staff)

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

Housing'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

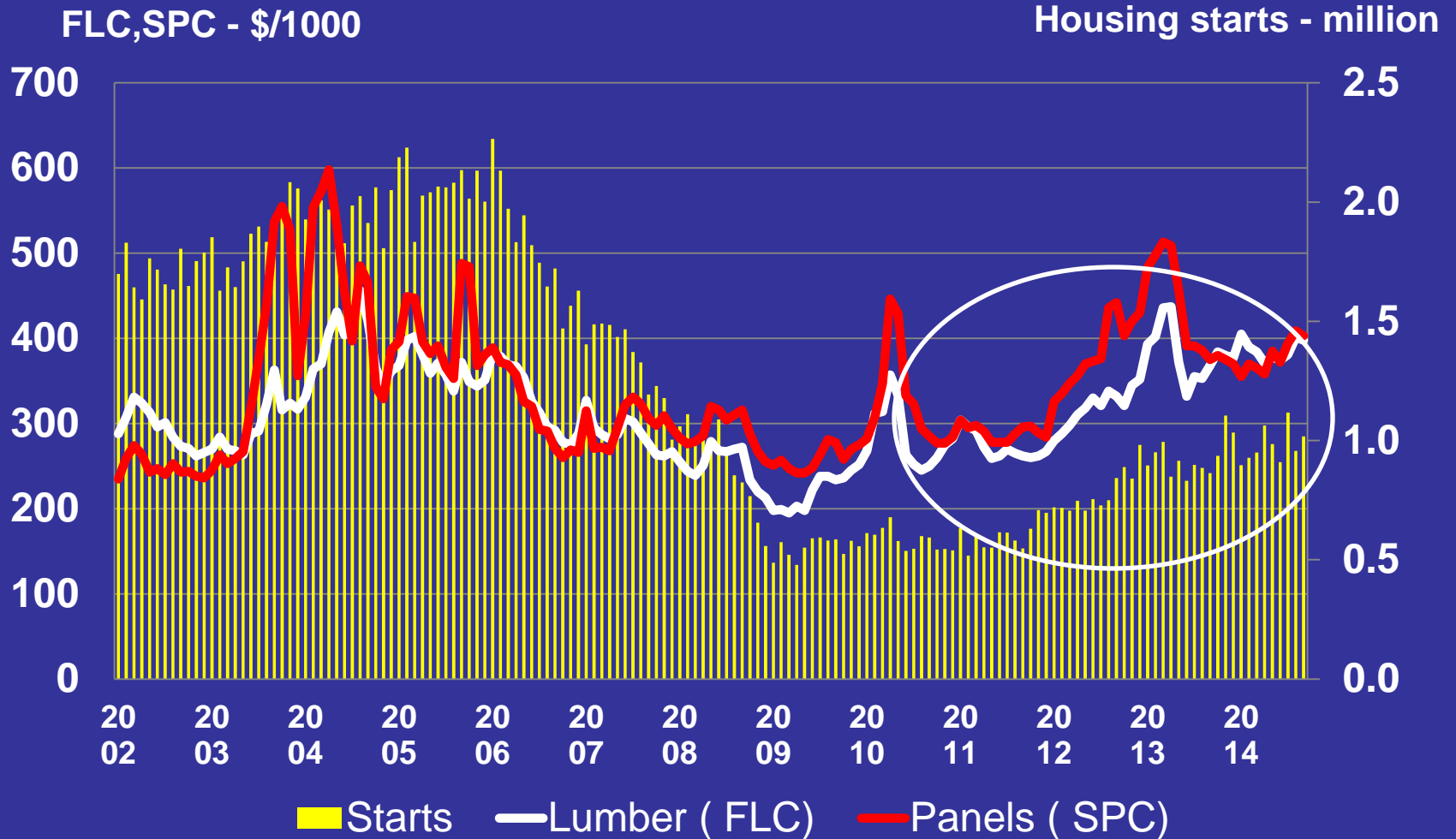
75% of structural wood products go to housing (new construction plus remodeling)

50% or more of hardwoods go to housing related activities. By the way, main reason wood

Prices have gone up is better demand/supply balance – reduced production !!!!! Key

To being profitable is lowering your costs. Being a price taker in commodity markets,

lower costs is best Strategy!!!!!!!

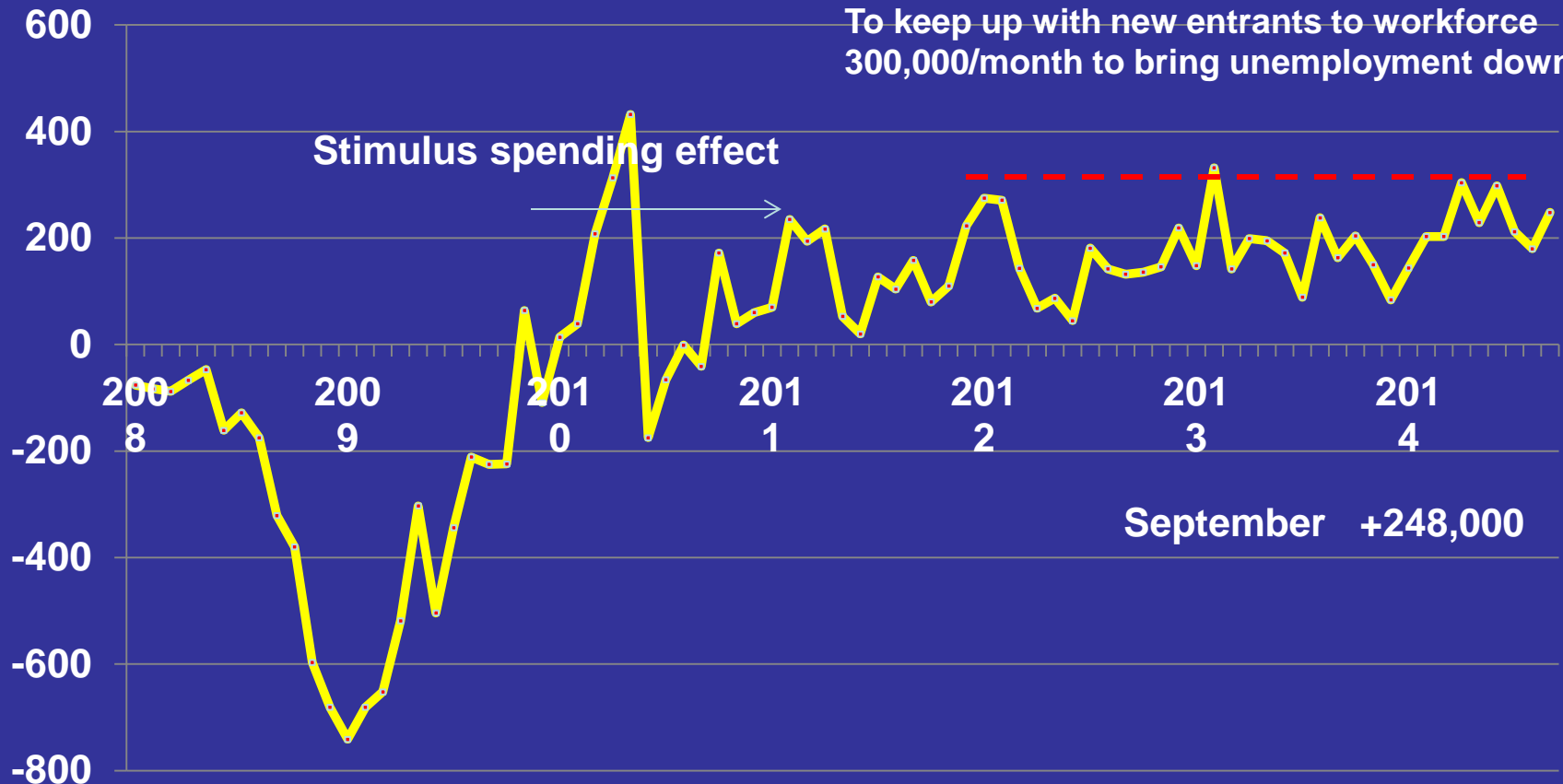


Sources: Prices – Random Lengths (<http://www.randomlengths.com/>); starts (Bureau of Census (<http://www.census.gov/construction/nrc/>)

**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**

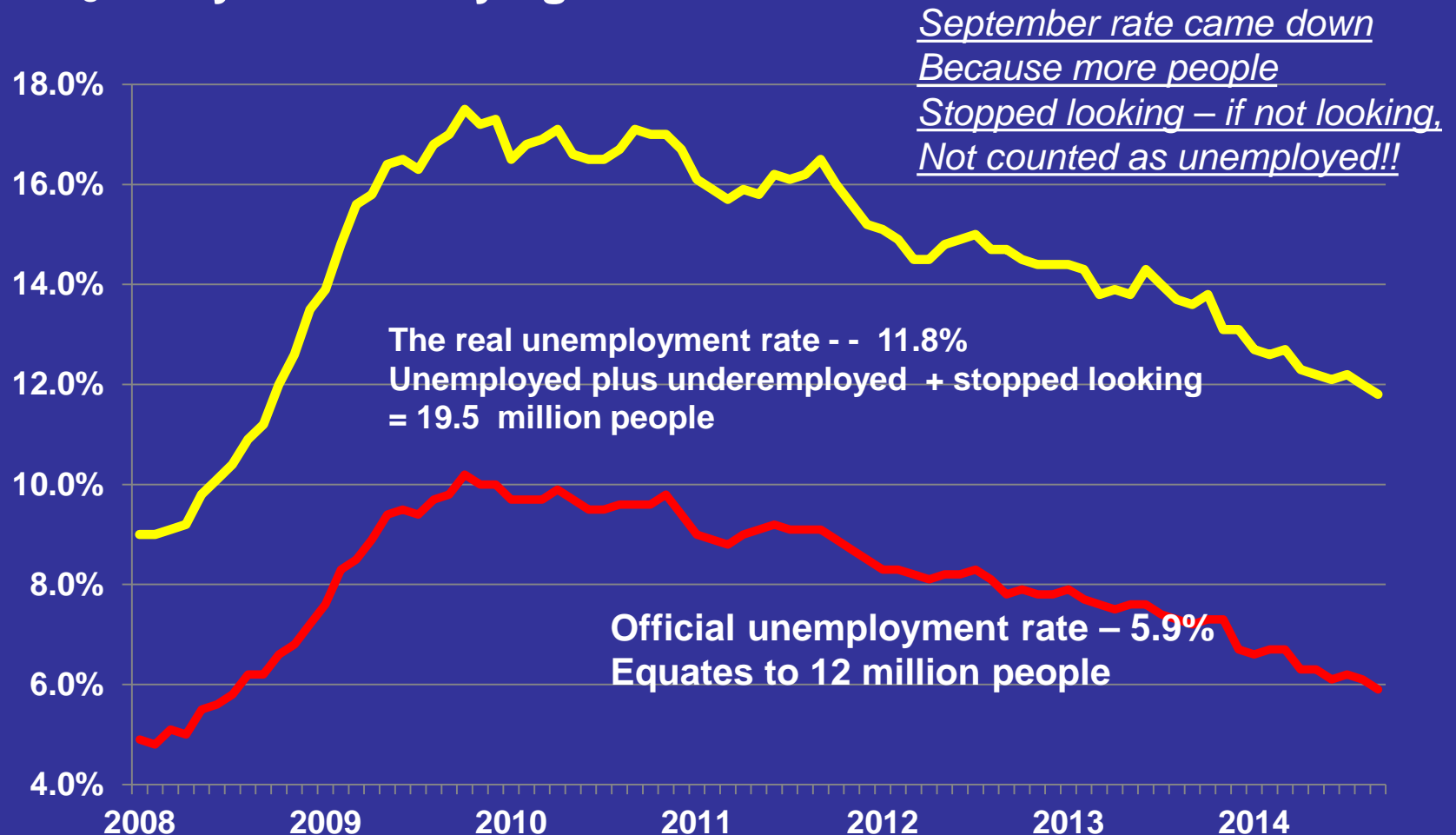


September +248,000

Unemployment rate keeps coming down – but, for wrong reasons

1. Many jobs are temporary with few benefits; 2. many have left the work force (and are no longer counted as unemployed)

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



Latest employment situation showed unemployment dropping to 5.9%,
 But, this is misleading. Slide below compares December 2007
 (the last “normal year”) with today’s numbers. E.g. look at the 1st line ---
**Total net jobs created in past 7 years Was a meager 300,000, not nearly enough to absorb
 the 8 million or so adults that entered the labor force over that time period. Key reason
 The rate has come down is because many have left the labor force, not due to job creation!!!!**

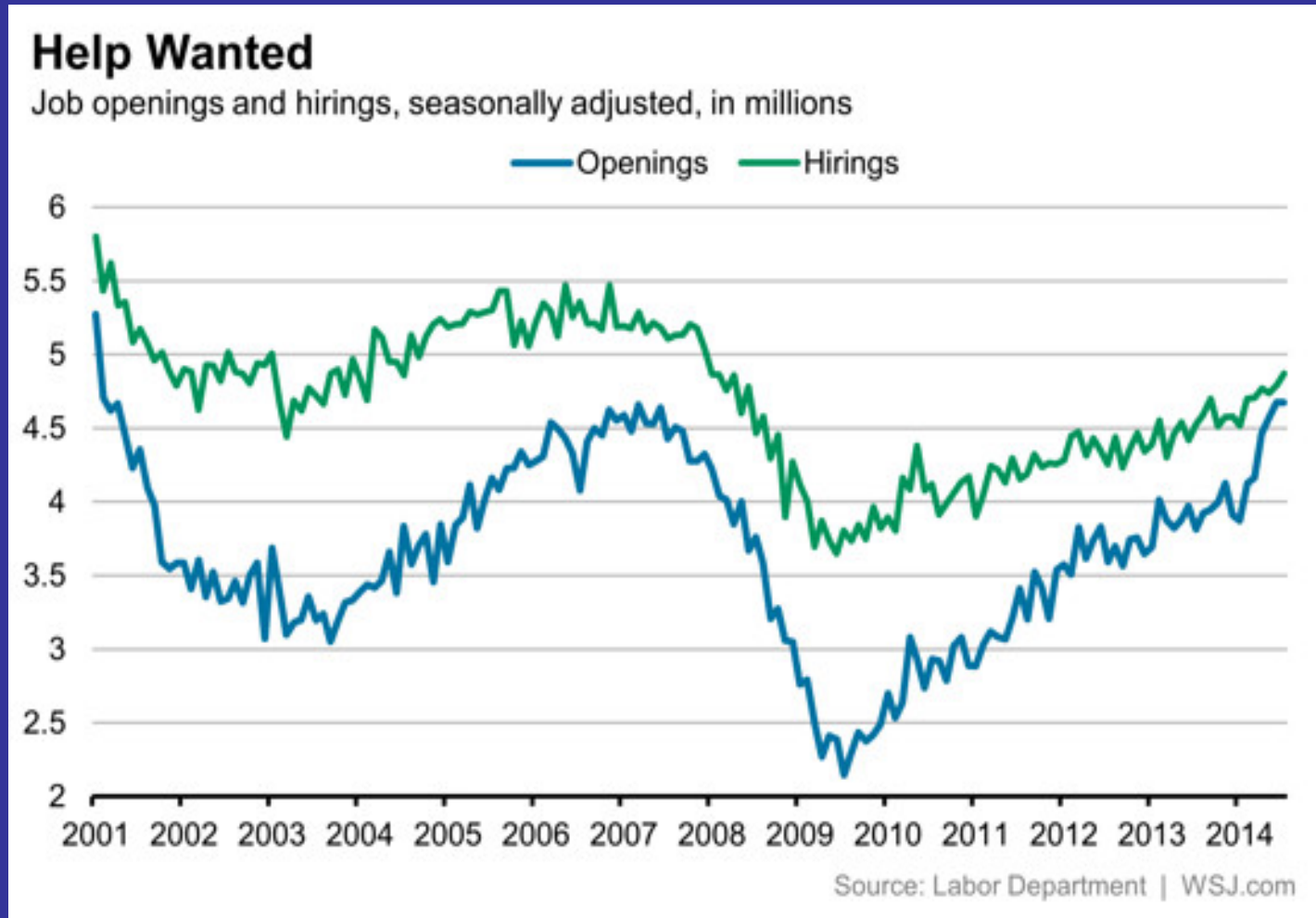
	Dec. 2007	Now	Change
Total number of jobs	146.3 million	146.6 million	300,000
Total number of unemployed	7.6 million	9.3 million	1.7 million
Unemployment rate	5.0%	5.9%	0.9 percentage points
U-6 unemployment rate (unemployed + underemployed)	8.8%	11.8%	3 points
Average hourly earnings, adjusted for inflation, 2014 dollars	\$24.33	\$24.53	20 cents
Employed part-time for economic reasons	4.6 million	7.1 million	2.5 million
Employed part-time for economic reasons, pctg. of the labor force	3.0%	4.6%	1.6 points
Labor force participation rate	66.0%	62.7%	-3.3 points

Another problem with today's economy – yes, unemployment rate is now below 6%, but income growth is missing. E.g., inflation Adjusted income today is the same as it was twenty years ago. I.e., There has been no improvement in median family income over the Past two decades. That's why many people believe we are still in a recession, and consumer confidence remains weak. **Just a reminder, consumer spending is 70% of the economy, and without real Income growth, spending can't grow very fast.**

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 – very SAD



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

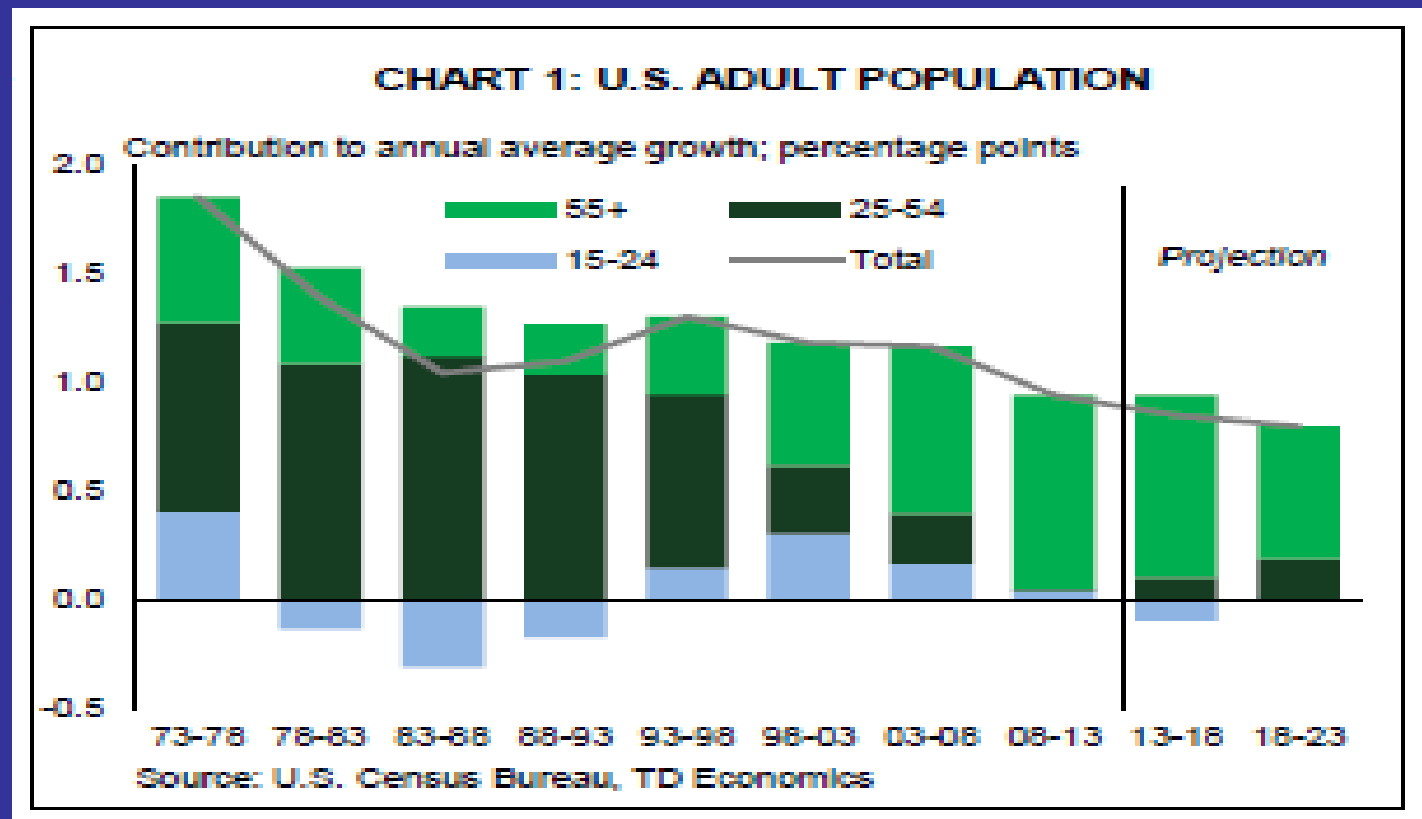
But, Labor force participation rate is shrinking – this is not good!!

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

% of civilian adult population , that are working



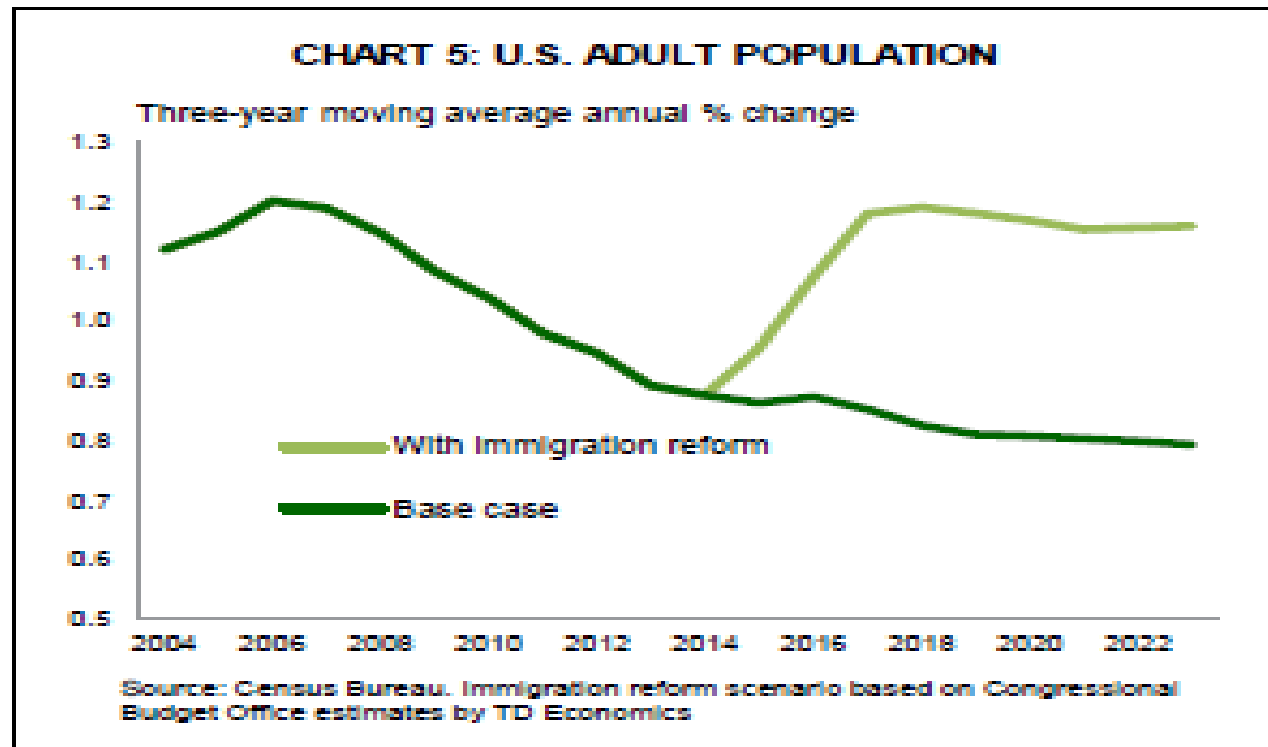
Projections show an aging population with the bulk of population growth in the 55+ age group – this suggests that labor shortages are going to be a very serious problem in the future!!!! (and, by the way, a serious Challenge for SSI and Medicare)



The solution – immigration reform!!!

Here is excellent article from TD bank on how to “recharge the U.S. labor market” :

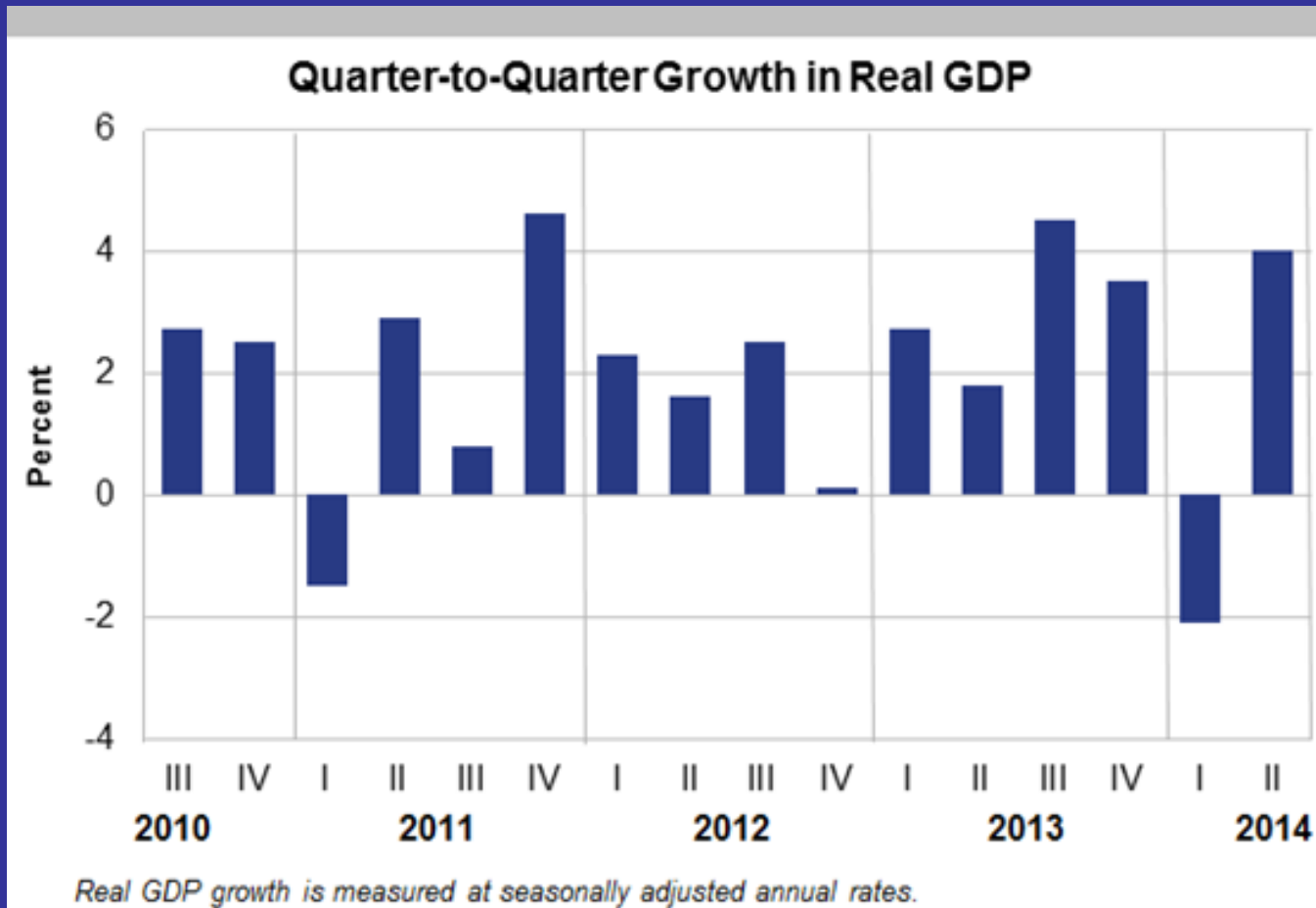
(http://www.td.com/document/PDF/economics/special/Recharging_the_US_Labor_Market.pdf)



Slowing population and labor force growth is a reality across America

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 August outlook – looks like 2016 is best bet for turnaround????

	NAR		NAHB		
	2014	2015	2014	2015	2016
GDP	2.1%	2.9%			
Housing starts(000)	1015	1283	1001	1239	1544
Single (SF)	649	860	643	875	1173
Multi (MF)	366	423	352	364	370
Resales* (000)	4938	5316	4340	4645	4695
SF Sales	459	613	446	597	839

*NAR resales include condos whereas NAHB excluded condos

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



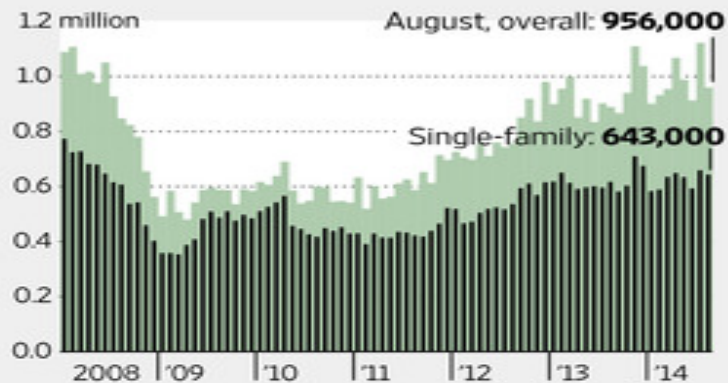
Source: Census (<http://www.census.gov/const/www/newresconstindex.html>)

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

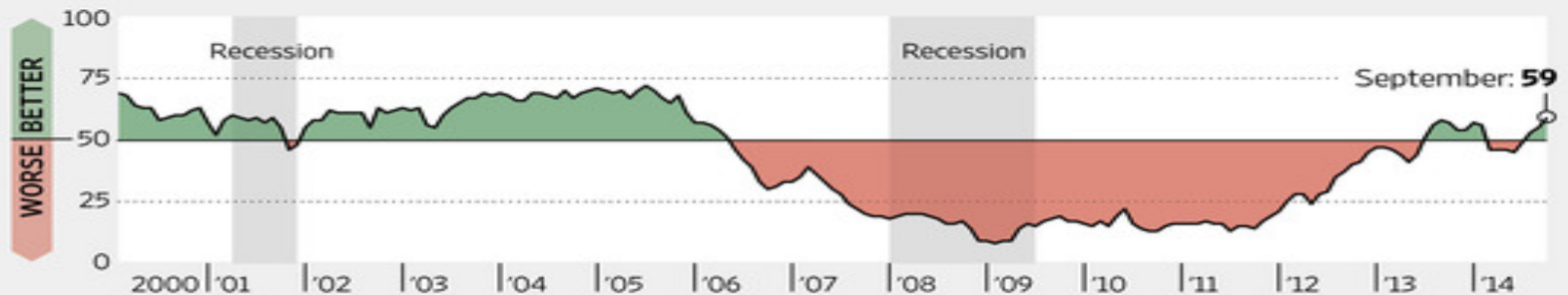


Change from previous year in seasonally adjusted annual rate, three-month moving average



...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

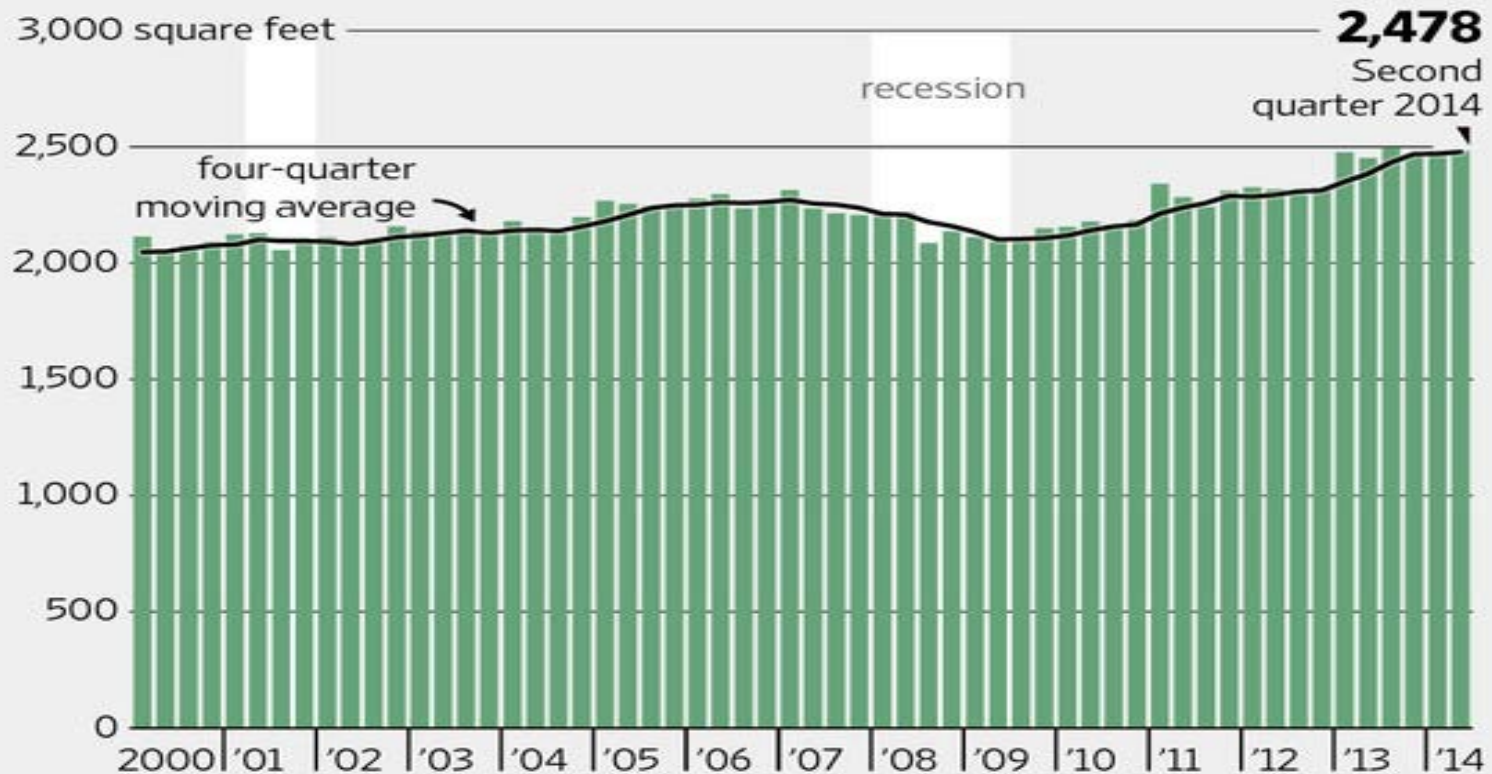
The Wall Street Journal

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



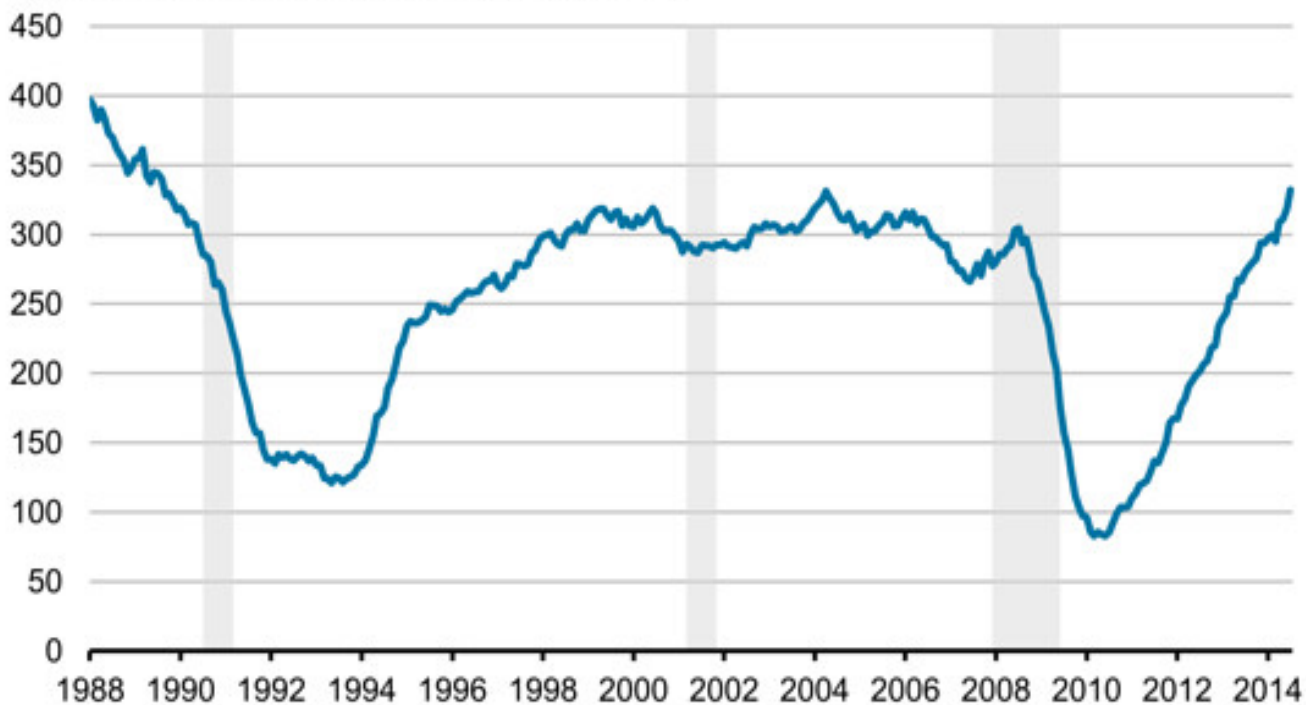
Source: Commerce Department via Moody's Analytics

The Wall Street Journal

Multi family continues to strengthen – this trend is Expected to continue as mortgage applications for New single family homes continues to fall according to the Mortgage Bankers association

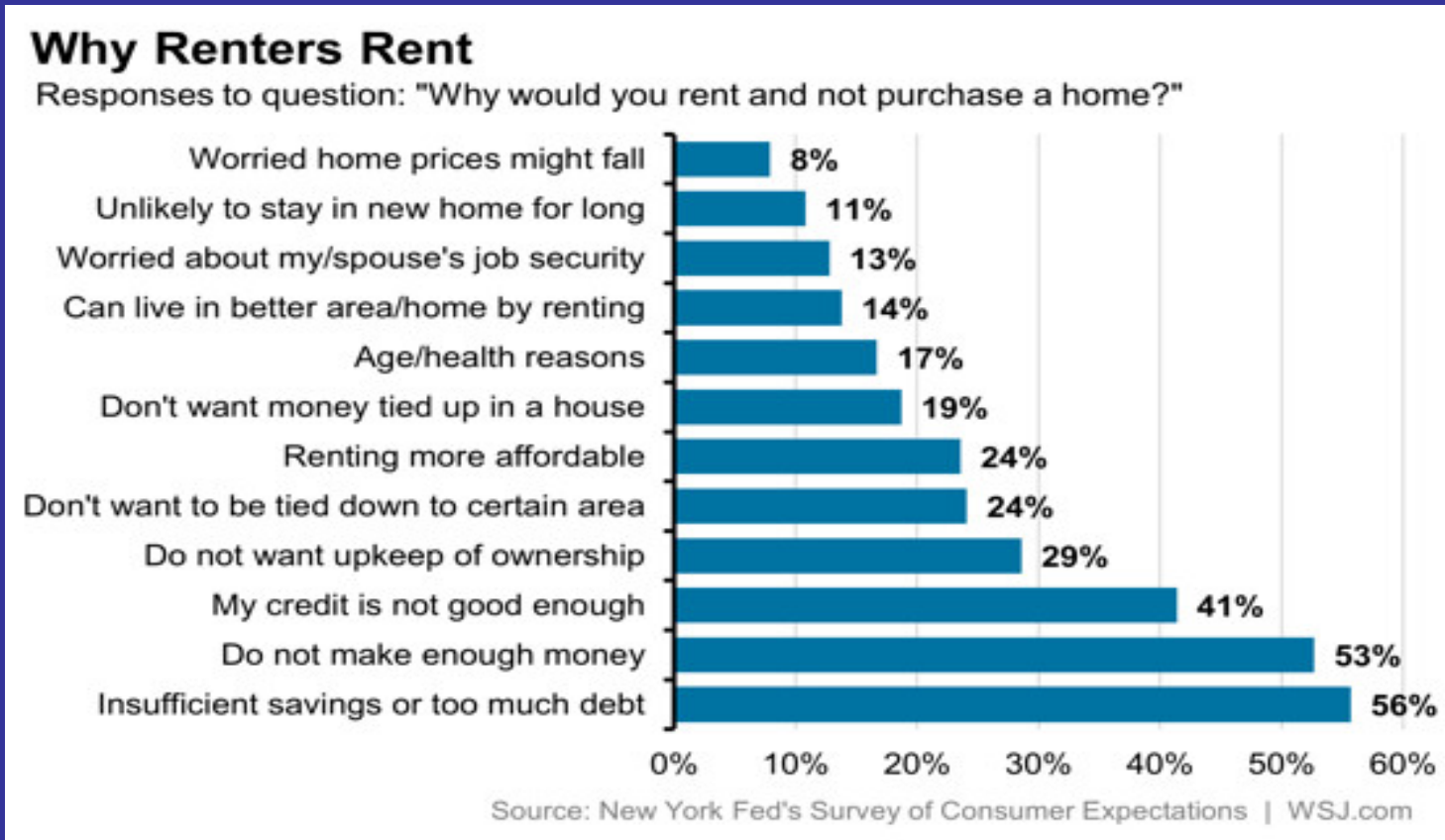
Shared Spaces

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

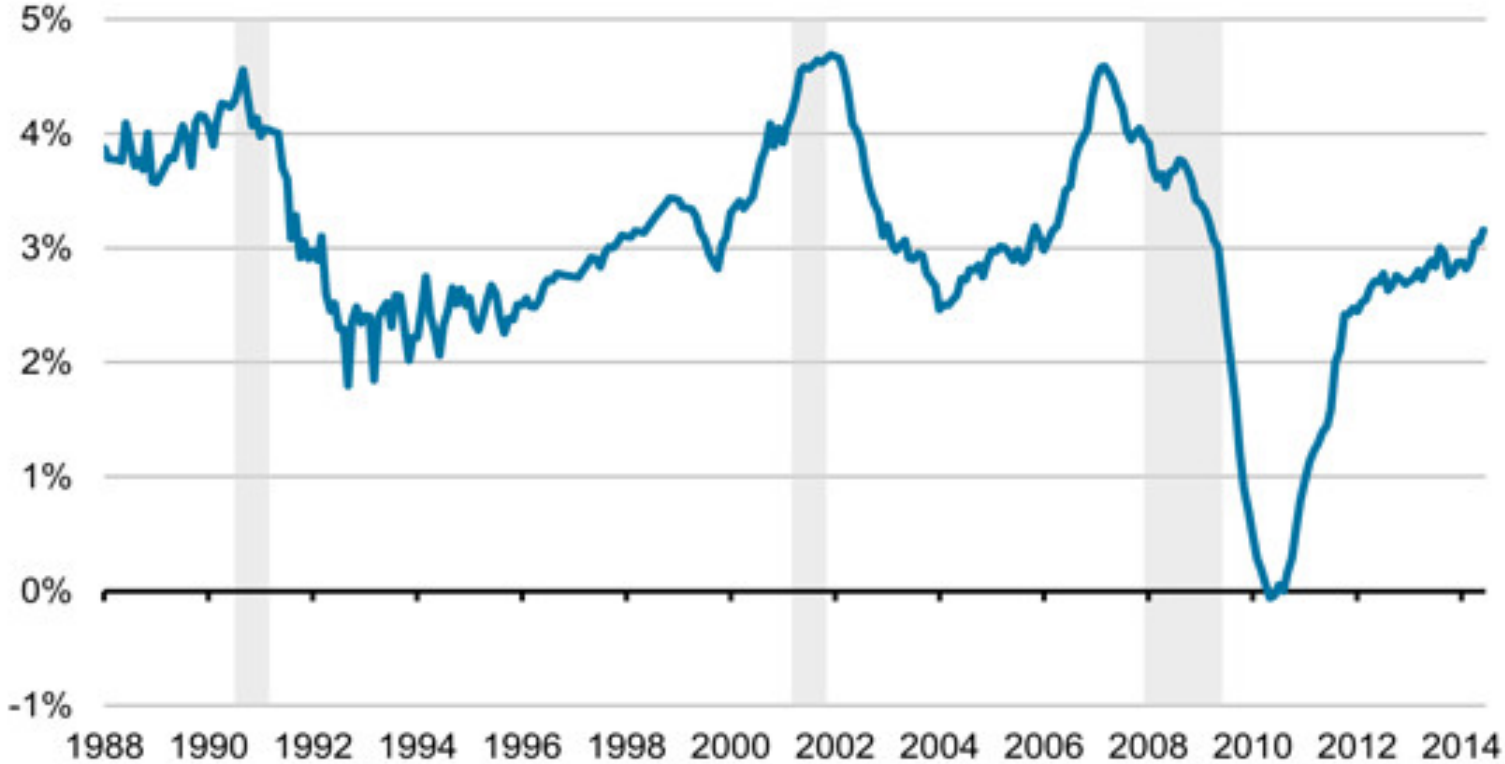
Renting is popular because many can't afford to buy - -
It's that simple?? Again, JOBS, JOBS



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)

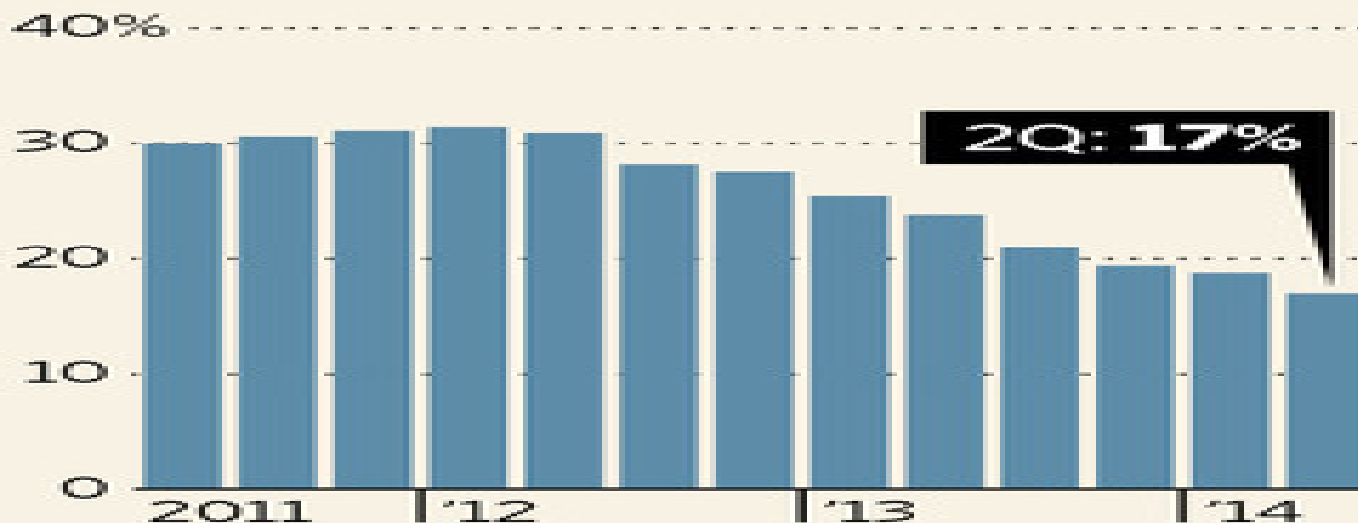


Some good news –

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.

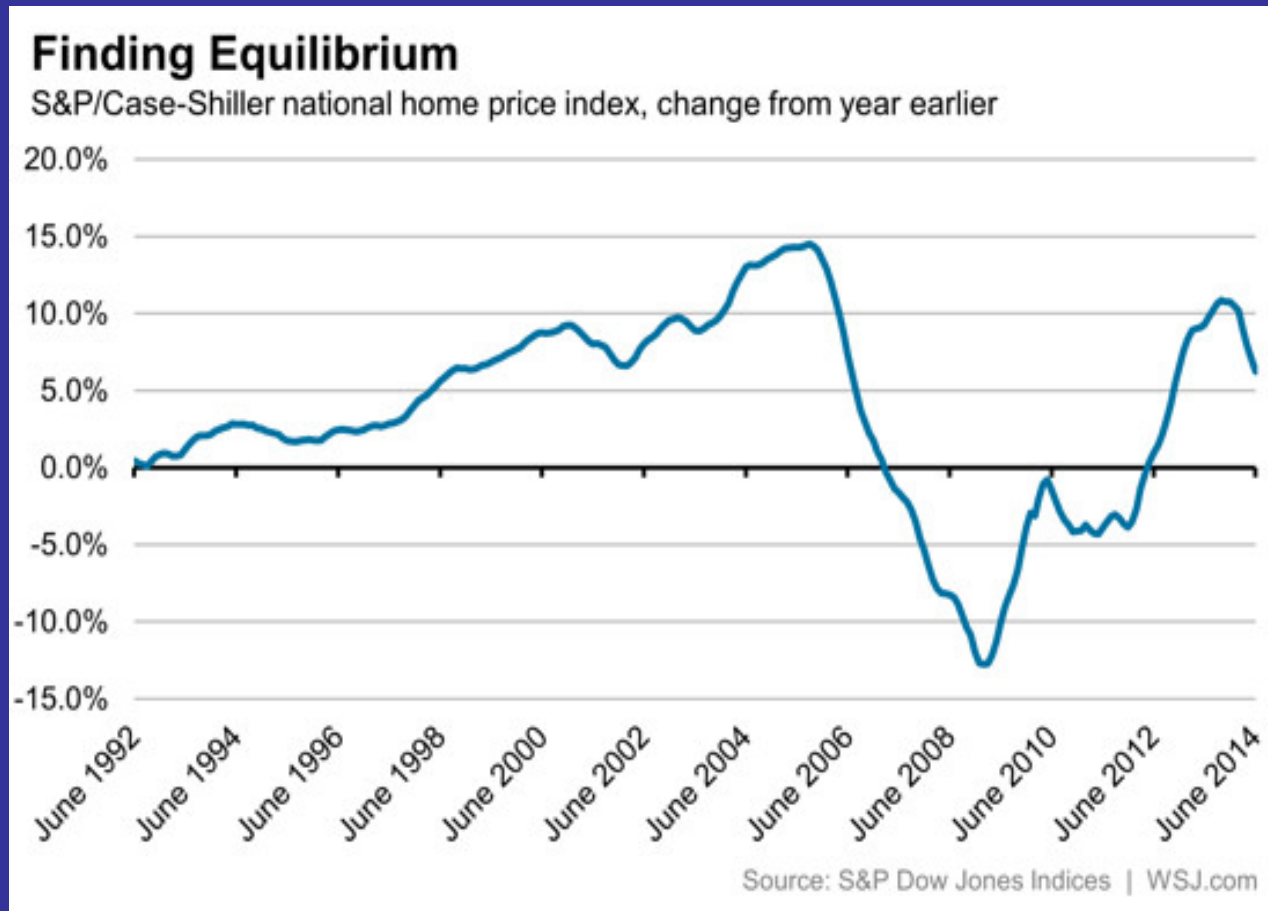


Note: Includes only homes that have a mortgage. Based on estimated home values.

Source: Zillow

The Wall Street Journal

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



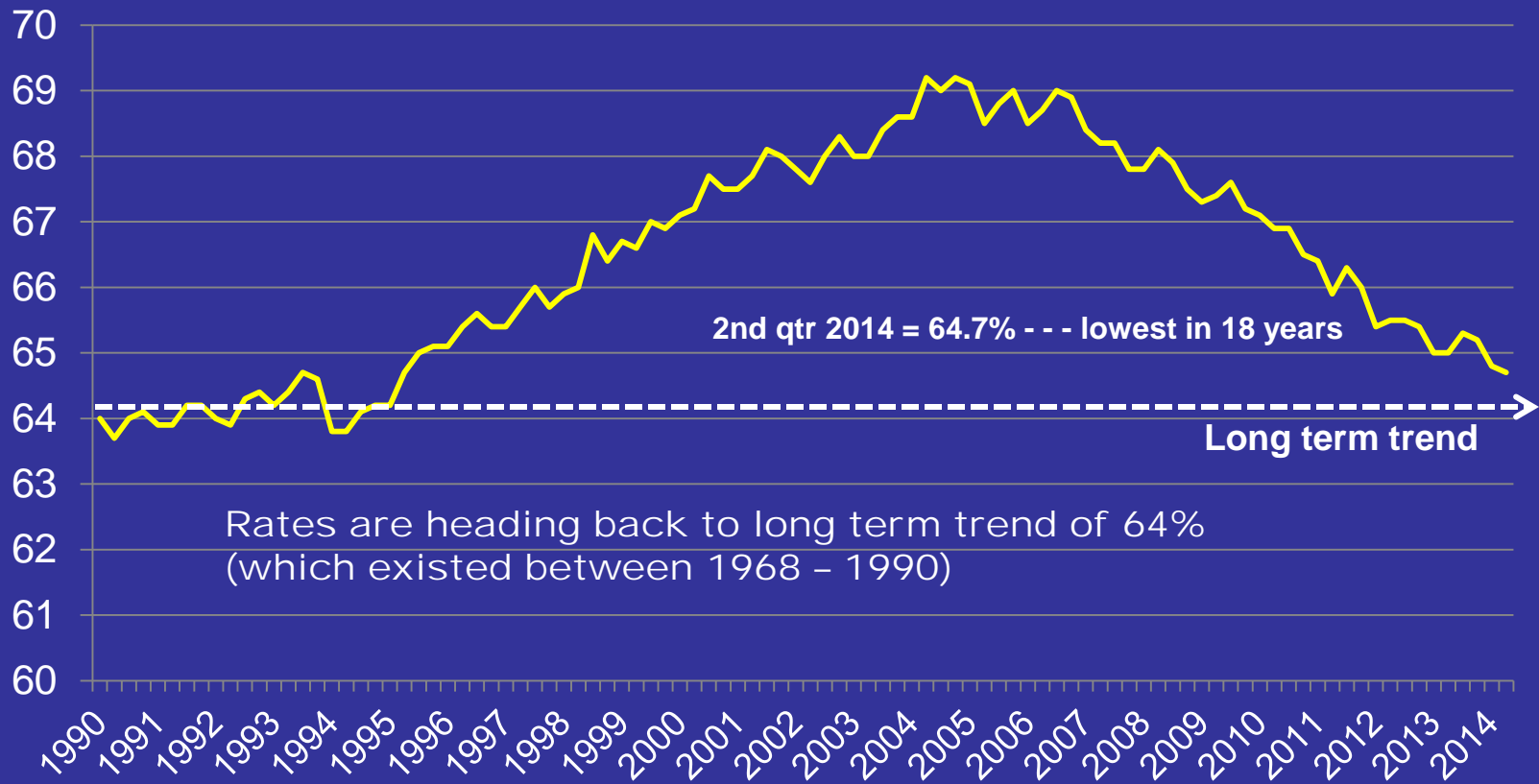
Impact of weak household formations - -

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



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

Real household incomes changed little in past 20 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!!!!!!

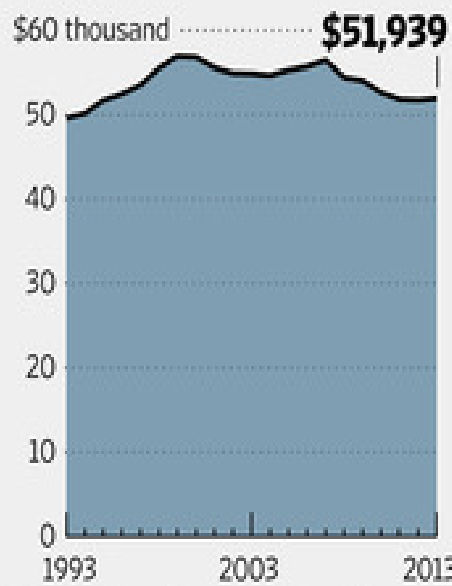
Source: WSJ (<http://online.wsj.com/articles/income-data-show-a-lost-generation-finding-its-bearings-heard-on-the-street-1410892047>)

Income Statement

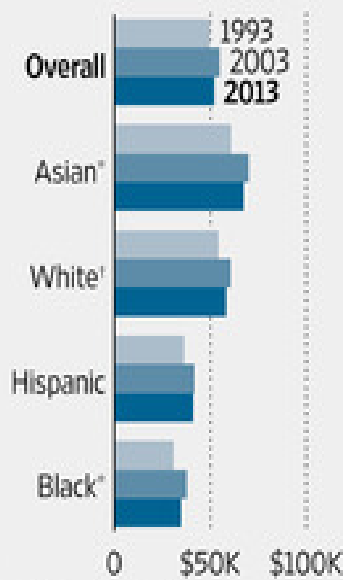
Income ticked up for the first time since the recession, but it remains far from its peak.

U.S. median household income, adjusted for inflation

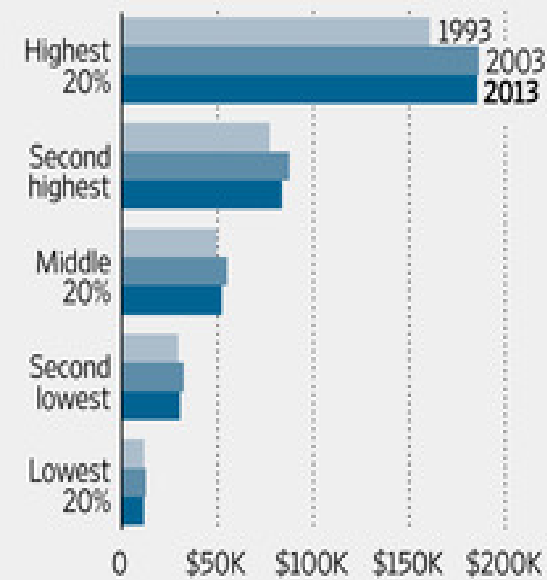
OVERALL



BY RACE, in thousands



BY INCOME QUINTILE, in thousands



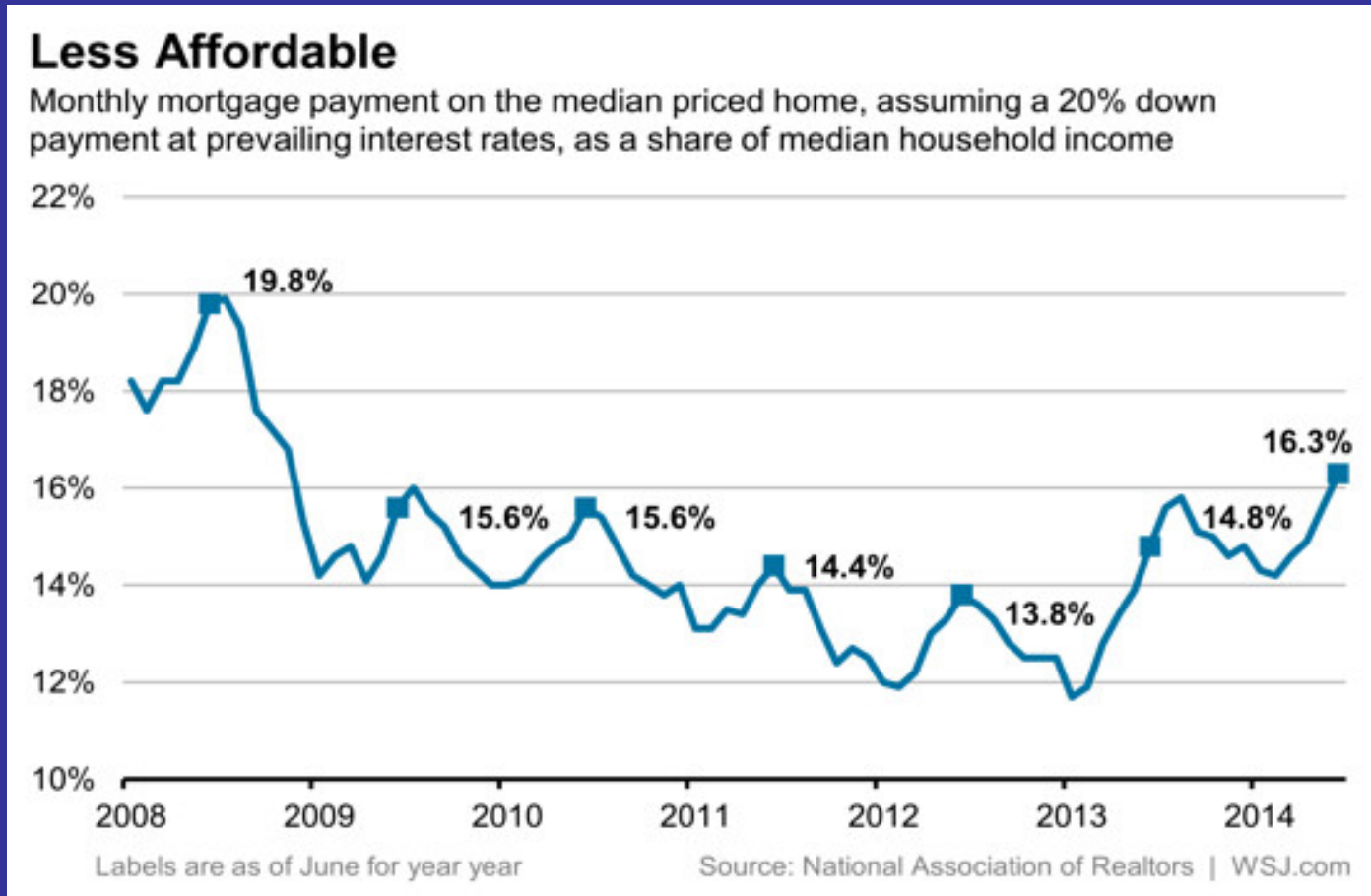
*Alone or in combination with any other race †non-Hispanic Source: Census Bureau

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??

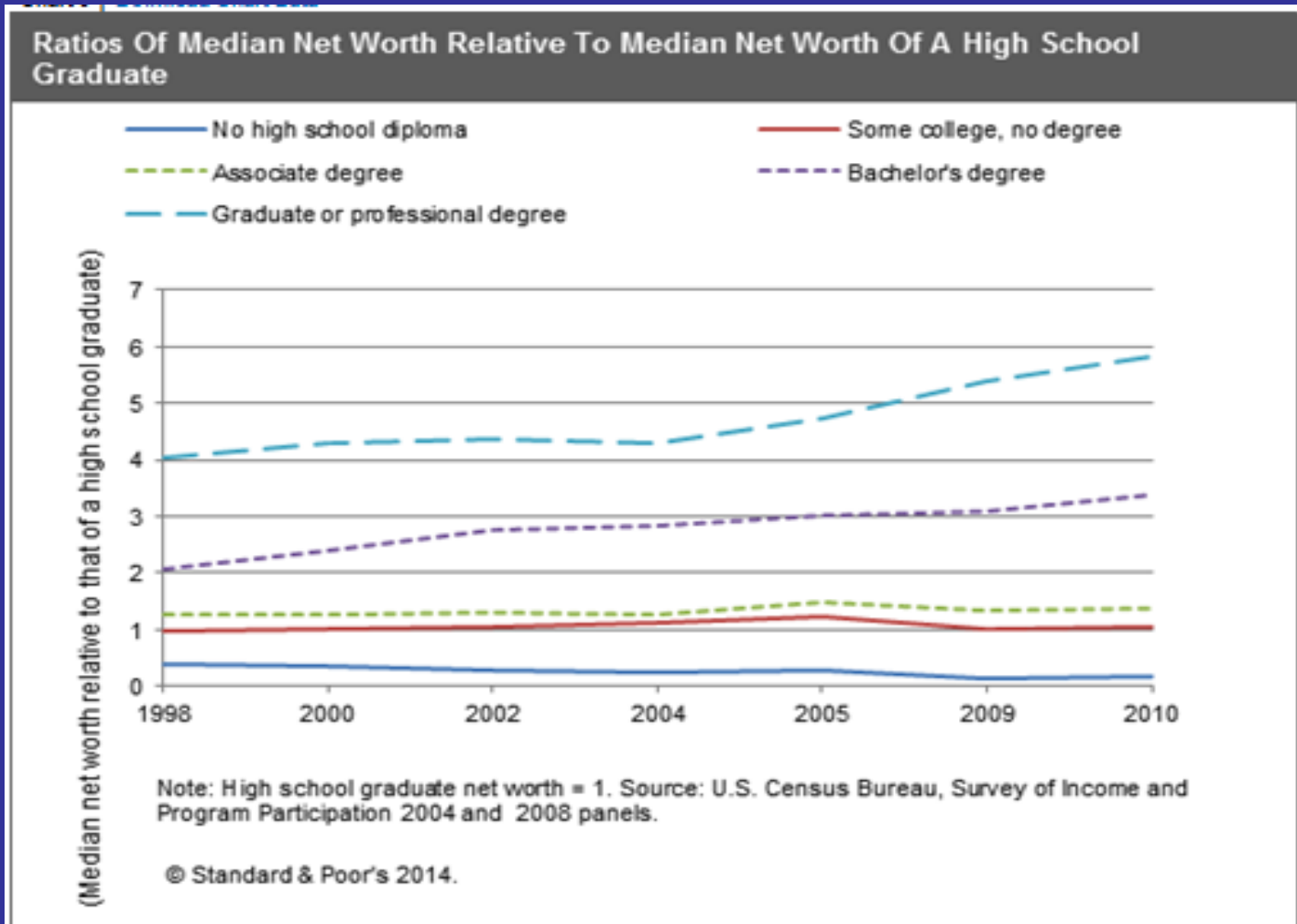
OK – we have discussed this before, but maybe it is time to Revisit the issue of education – how it impacts standard of Living, the economy, and demand for housing (and wood products)
PS. – a good friend pointed out that this isn't the only problem facing the Economy – agreed – I'm hoping to point out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

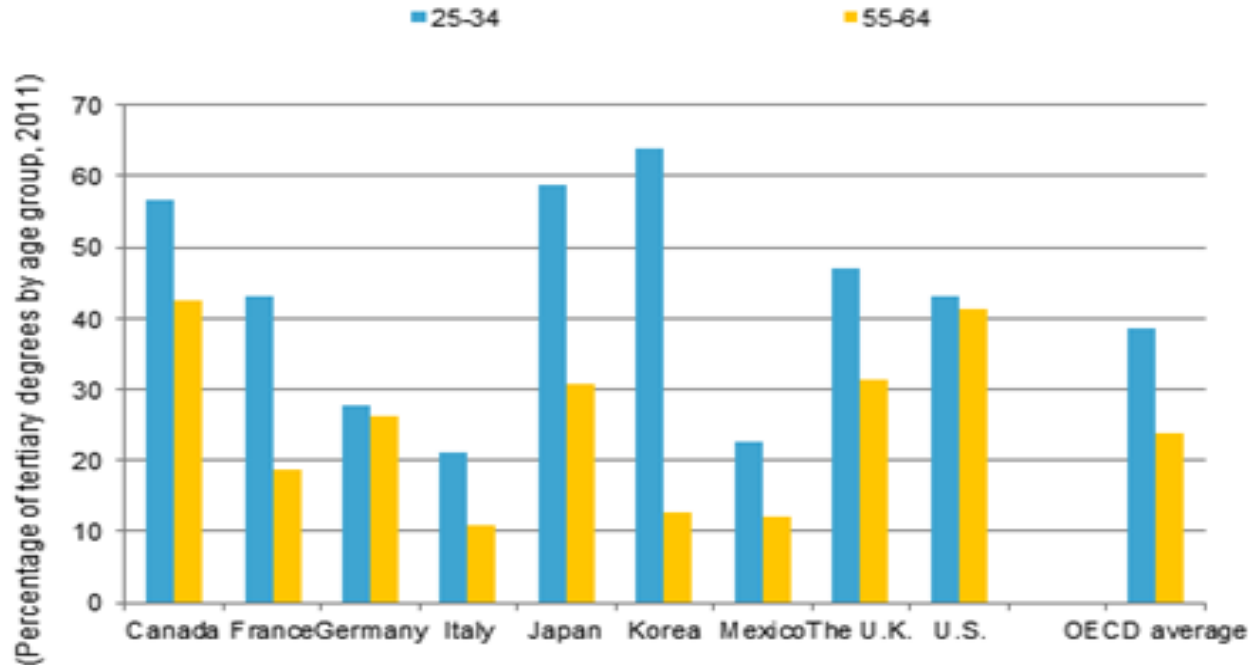
Note the difference between young and old . e.g., in most

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.

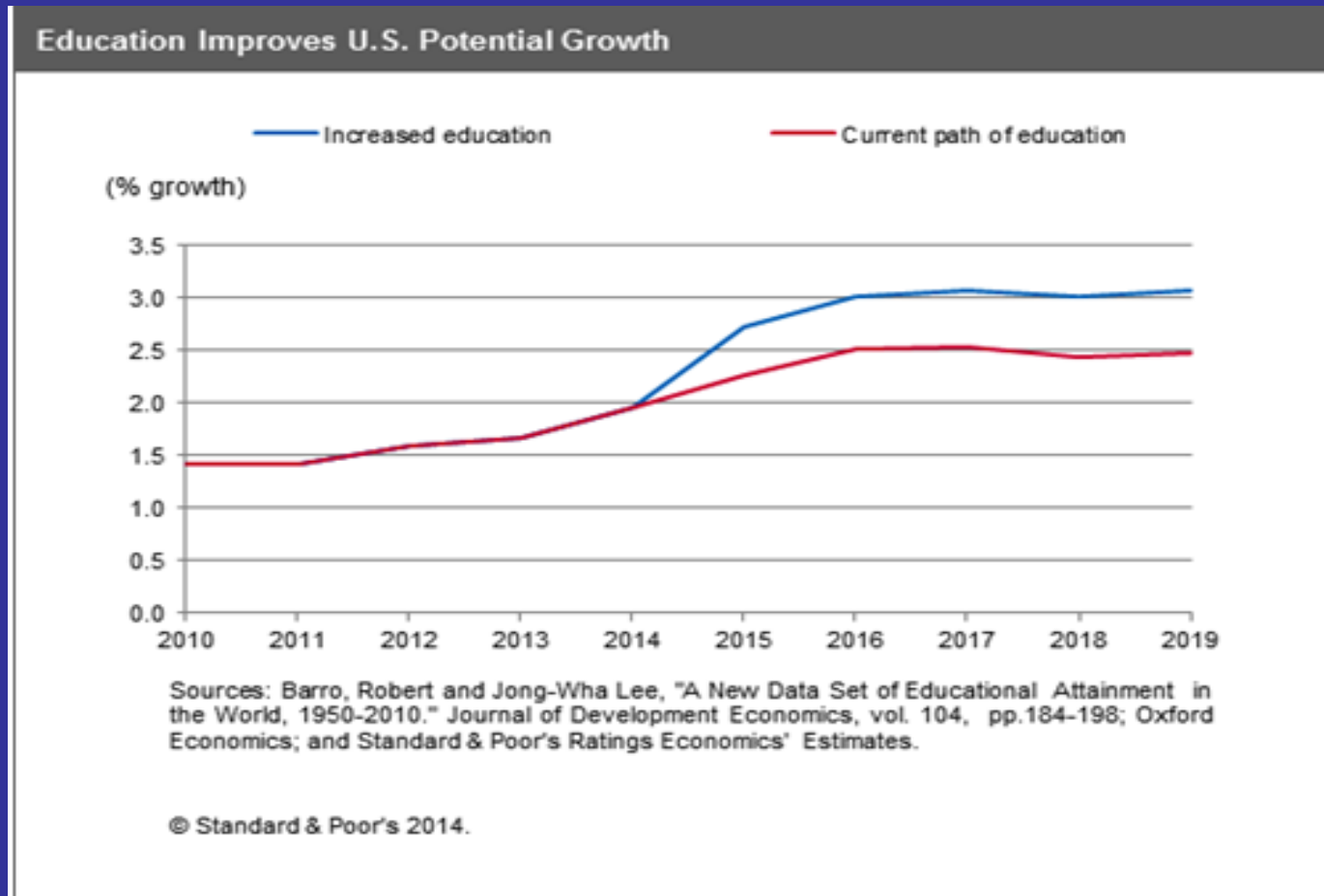
U.S. Education Is Slipping Behind



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,

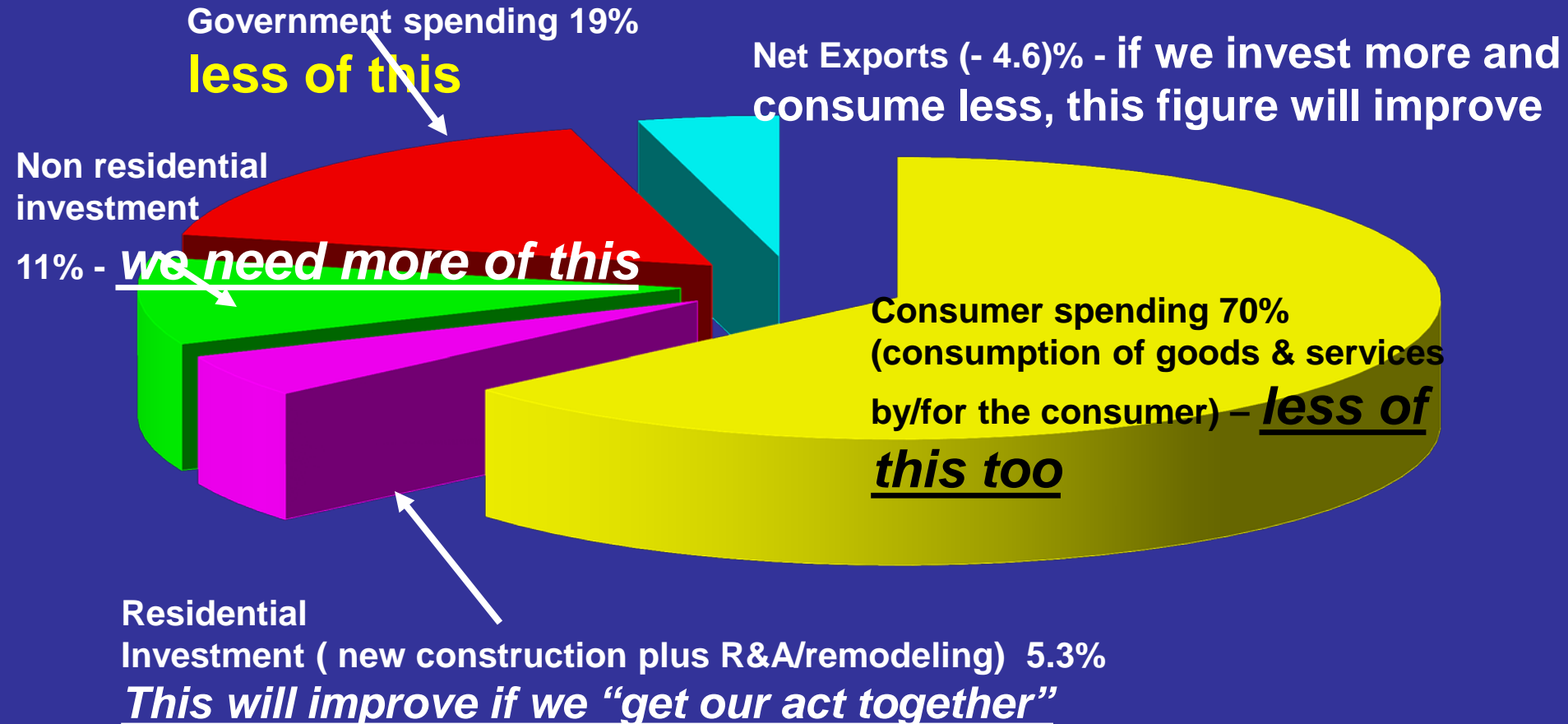
This is a legitimate strategy for improving our economy, and promoting
More demand for housing, and wood products.

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!!!!!!!!!!

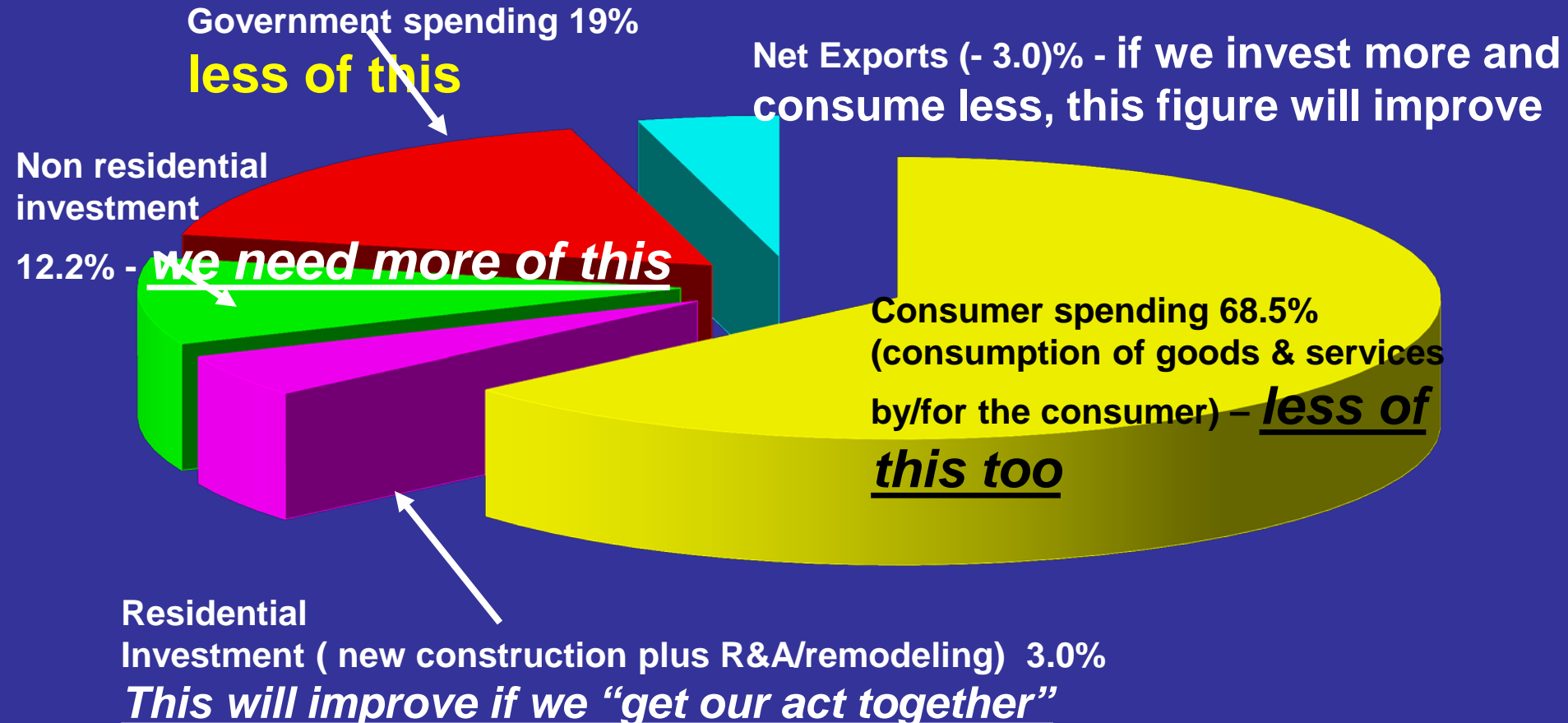
U.S. Economy 2000 – 2010

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



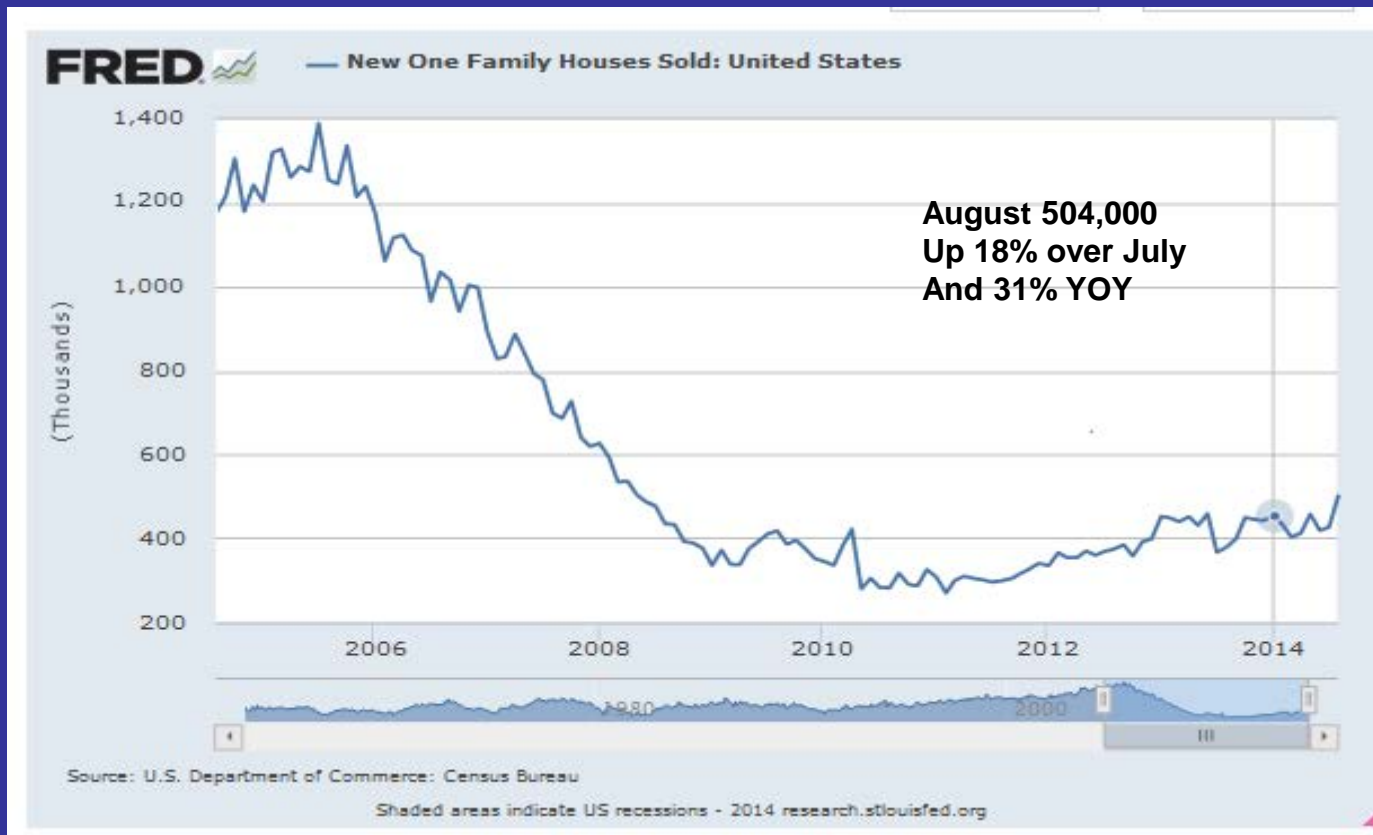
U.S. Economy 2013 - - GDP as % of Economy = 68.5%

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



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 – August numbers were good – maybe things are turning the corner???



But, Resale market remains heavy to cash sales, many of whom Are investors. Need more 1st time buyers to get sustainable (and healthy) recovery

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.

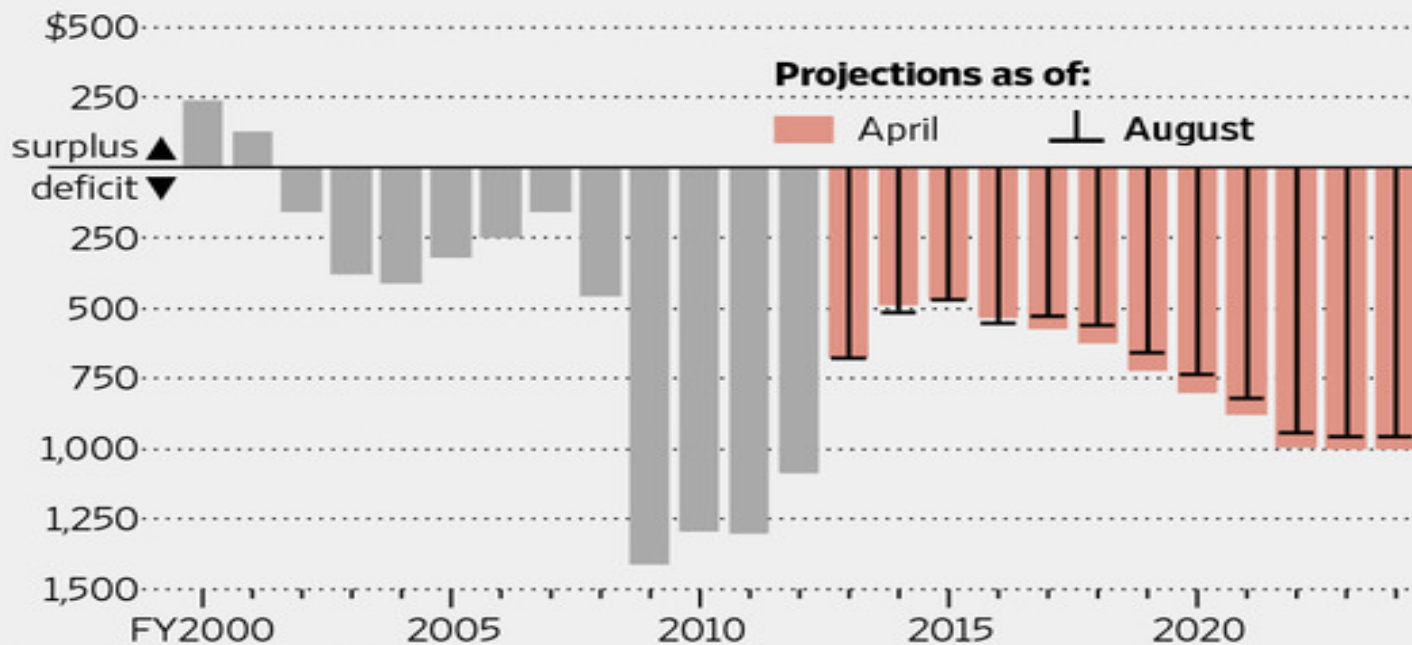
Longer term:

- (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 – mid term 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 federal tax receipts are \$2.976 trillion, spending is \$3.53 trillion (we borrow the difference). 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. Of course, this won't happen – government will cut spending on R&D, education, health care, Medicare, SSI, Medicaid, to balance the budget. Yes, this is being cynical, but unfortunately realistic.

Smaller Projected Shortfall

Federal budget surplus/deficit, in billions



Note: Fiscal year ends Sept. 30.

Source: Congressional Budget Office

The Wall Street Journal