

US HOUSING MARKET UPDATE

1st Feb. 2016

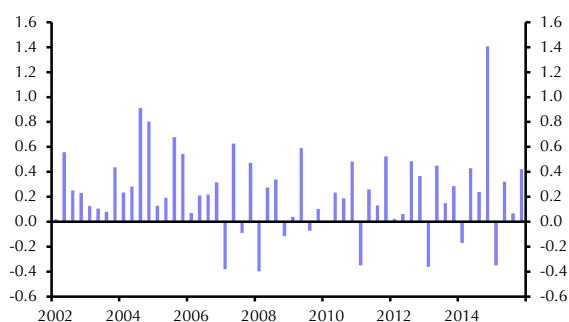


Has household formation stalled?

- The sharp slowdown in household formation in the final quarter of 2015 reflected base effects, and is not a cause for concern. In any event, even though a lack of available homes will act as a constraint on the creation of households, underlying demand from Americans wishing to set up on their own will hold up. That will give homebuilders the confidence to increase production, as well as put upwards pressure on house prices.
- At first glance, the latest figures on household formation based on the Housing Vacancies and Homeownership survey (HVS) made for depressing reading. Household formation in the final quarter of 2015 increased by just 462,000 compared to the same quarter last year, the lowest year-on-year gain since the second quarter of 2010. So has household formation stalled?
- The first point to note is that the low annual rate of household formation growth in Q4 2015 largely reflects base effects. Estimates of household numbers are very volatile, and the small year-on-year gain is due to a surge in formation at the end of 2014. Indeed, the 1.41m gain seen during that quarter was the largest since 1981. **The latest quarter-on-quarter rise of 422,000 is not historically low – it is above the average gain in the final quarter of the year seen over 1990 to 2013 of 343,000.** (See Chart 1.)
- A steady rise in household numbers was to be expected. After all, there are a number of factors currently supporting household creation. The share of 18-34 year olds living with their parents is currently very high – 31.5% did so in 2015, compared to a share of around 27.5% prior to the financial crisis. Many of those will be itching to move out of the parental home and form their own households. The improvement in the labour market will help some of them to do so – after all it is hard to strike out on your own if you do not have a job. And banks are gradually loosening their lending criteria, giving more Americans the opportunity to buy a home.
- However, while we expect a steady rise in the number of people wishing to form households, those ambitions will be held in check to some extent by a lack of homes on the market. A new household can either rent or buy. If looking to buy, aspiring households will find the months' supply of homes on the market close to the level that preceded the financial crisis. And if looking to rent, they will find vacancy rates at record lows. (See Chart 2.)
- These arguments can get rather circular – household formation is needed to sustain housing demand, but a lack of homes can weigh on the formation of those households. **But the key point to note is that if a slowdown in household formation is due to a lack of homes on the market, rather than an unwillingness/inability of people to strike out on their own, that shouldn't impact on builders willingness to up production.** It also means house prices will continue to come under upwards pressure. **In other words, while household formation is likely be steady rather than rapid over the next couple of years, that is not a reason to believe that the recovery in homebuilding is set to tail off.**

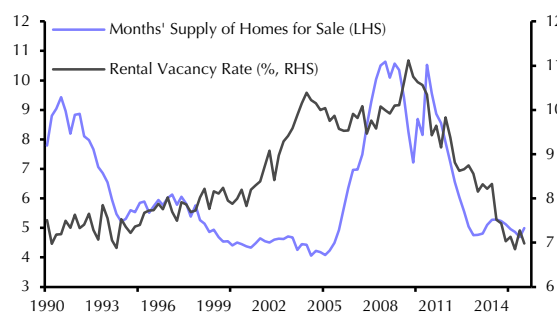
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Chart 1: Household Formation (000s Per Quarter, NSA)



Source – Census Bureau

Chart 2: Months' Supply of Homes for Sale and Rental Vacancy Rate



Sources – Census Bureau, NAR