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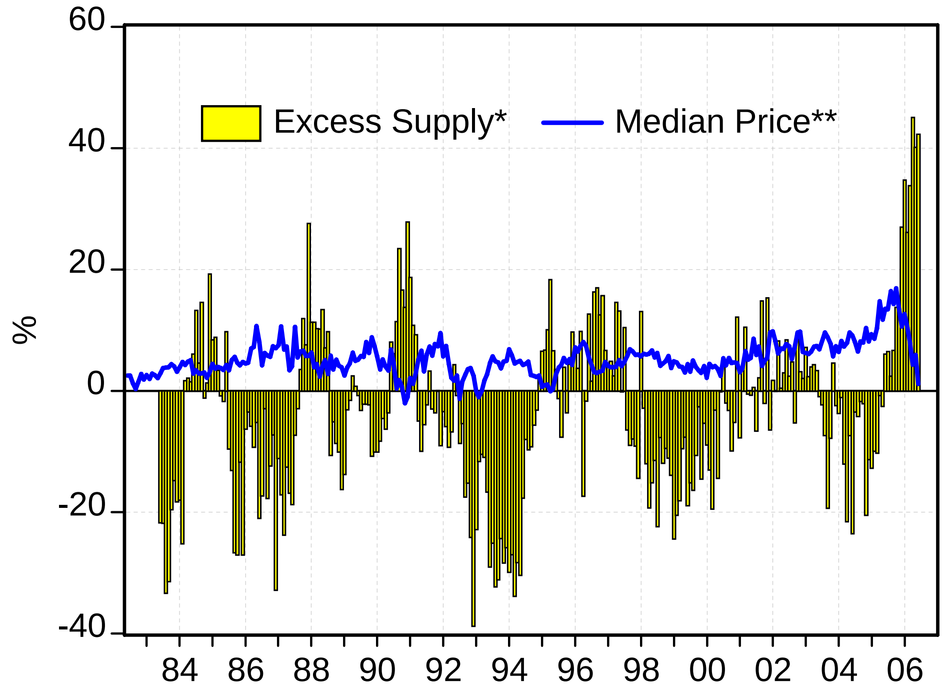
Econ 101 Applied to Existing Homes

July 25, 2006

Econ 101 tells us that when supply exceeds demand *ex ante*, the price will weaken. The existing home market exemplifies this tenet. In June, existing single-family homes *for sale* were *up* 35.7% vs. year-ago. Existing single-family homes actually *sold* were *down* 6.5% vs. year ago. So, the June year-over-year "excess" supply of existing single-family homes was 42.2% (35.7 minus -6.5), just off a record high excess supply of 45.1% set back in April (see Chart 1). Back in June 2005, the excess supply of existing single-family homes was only 6%. And back in June 2005, the year-over-year change in the median price of an existing single-family home was 13.5%. As the supply of homes for sale has grown relative to the demand for them, the rate of price appreciation has slowed to only 1.1% in June 2006. Chart 2 shows comparable data for existing condos/coops. In June 2005, the excess supply of condos was about 40%, on its way up to 74% in June 2006. In June 2005, the median price of an existing condo was up 13.9% year-over-year. In June 2006, the median condo price had *fallen* 2.1%.

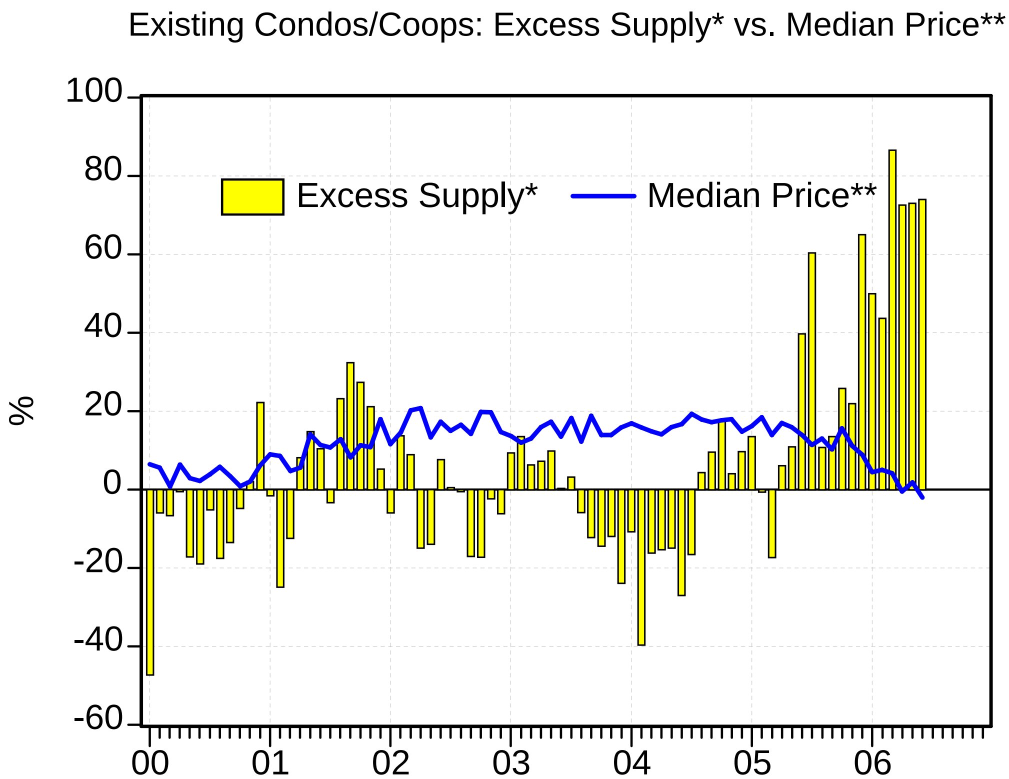
Chart 1

Existing Single-Family Homes: Excess Supply* vs. Median Price**



* y/y % chg. in homes for sale minus y/y % chg. sold
** y/y % chg. in median price

Chart 2



* y/y % chg. in condos/coops for sale minus y/y % chg. sold
** y/y % chg. in median price

In the months ahead, Econ 101 predicts that the prices of existing dwellings will continue to soften. This will serve to reduce the excess supply as some not-so-serious sellers take their homes off the market and as those sellers who have to sell acquiesce to the reality of lower prices. The knock-on effects of all this will be subdued consumer discretionary spending as those "home ATMs" are not refilling as rapidly as before. Another factor that will curtail consumer discretionary spending is slower income growth in housing-related industries as employment and sales commissions moderate further. I said it last week and I will say it again – the residential real estate sector has entered a recession. Whether the economy as a whole enters a recession early next year depends on how severe the housing recession gets. Further Fed interest rate increases can only increase the depth of the current housing recession and geometrically increase the odds of an economy-wide recession.