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**Daily Economic Comment**

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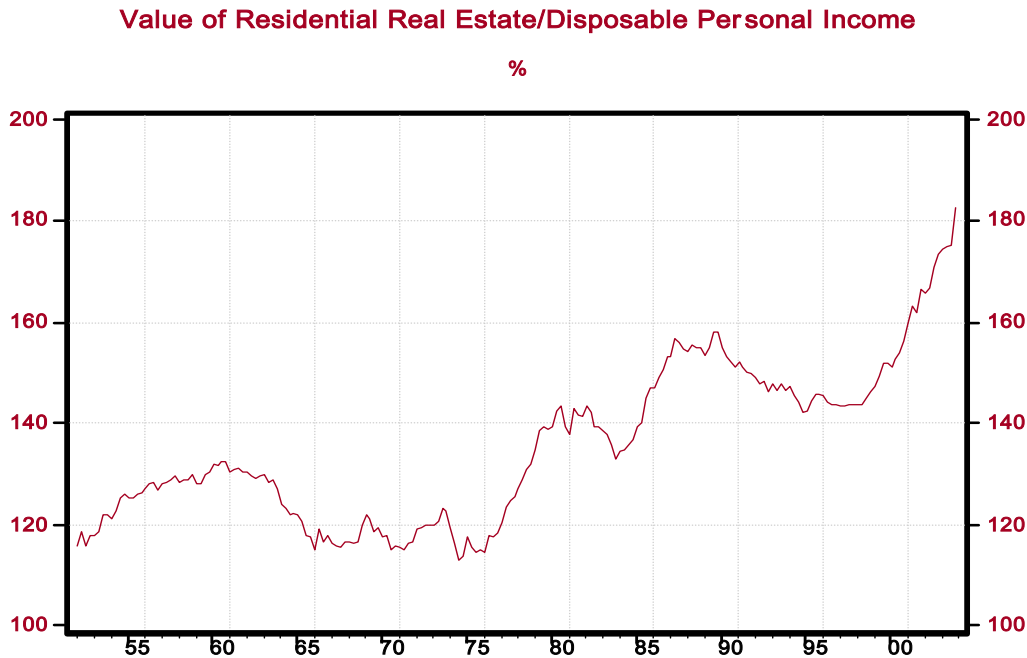
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### **Bad Combo for New Housing – Demand Down and Supply Up**

It was reported today that April new home sales plunged 11.8% from March's record sales pace. At 1.093 million units annualized, April's sales rate was the lowest since May 2003. To blame the sharp drop in April new home sales primarily on the rise in mortgage interest rates seems a bit farfetched inasmuch as the 30-year fixed rate increased only 60 basis points from the end of March to the end of April. But in the second half of this year, new home demand will fundamentally suffer as mortgage rates continue to climb. After all, given the sharp increase in the value of residential real estate relative to disposable personal income (see Chart 1), it has been the exceptionally low mortgage rates that have kept home purchases affordable.

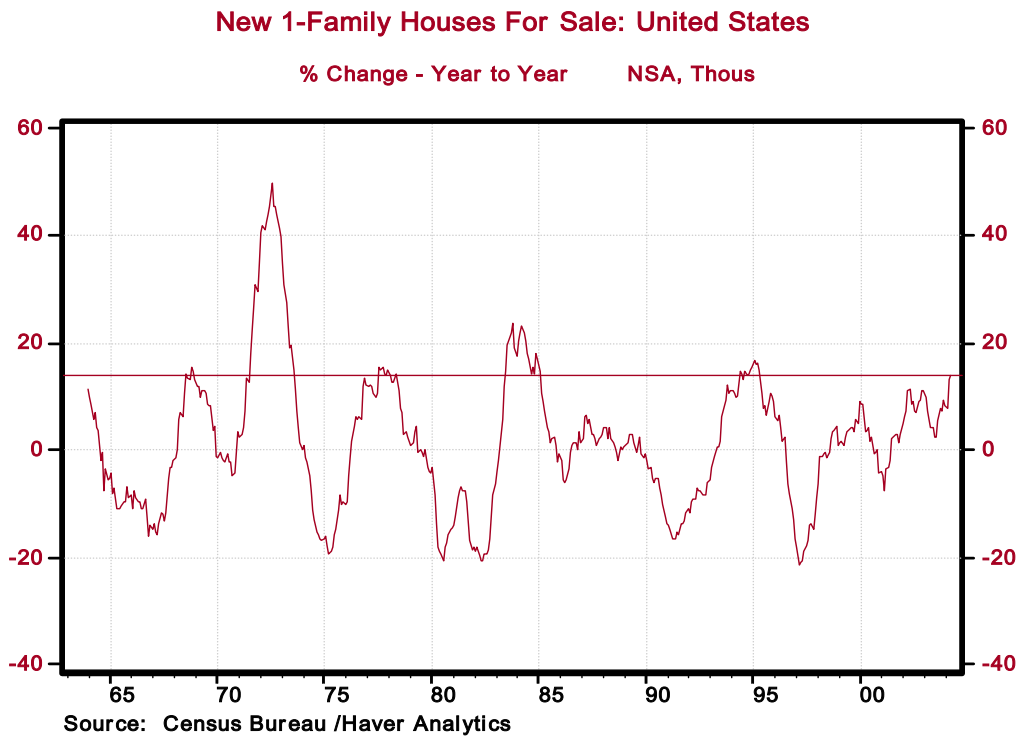
Chart 1



As demand for new homes is beginning to wane, the supply of them is starting to grow relatively rapidly. In the 12 months ended April, new homes *for sale* are up 13.86% -- the fastest growth since May 1995 (see Chart 2). As demand slackens more in the second half of the year, so, too, will home building. New jobs in the construction sector have accounted for 18% of the total 1.148 million additional payroll employees in the past 12 months. Currently, contractors won't even return your call inquiring about a room addition. Come next fall, they will be making cold calls to you.

The information herein is based on sources which The Northern Trust Company believes to be reliable, but we cannot warrant its accuracy or completeness. Such information is subject to change and is not intended to influence your investment decisions.

Chart 2



### **April Durable Goods Data – Stronger Than They Appear**

After healthy monthly gains of 3.9% and 5.7% in February and March, respectively, new orders for durable goods retreated by 2.9% in April. No matter how you sliced it or diced it – with defense, ex-defense; with civilian aircraft, ex-civilian aircraft – new orders were down. And although total shipments of durable goods fell 0.8% in April after March's 4.3% increase, shipments of nondefense capital goods ex-aircraft continued to move ahead by 0.7% vs. 3.5% in March. More importantly, these shipments are off to a good arithmetic start for the second quarter. If shipments of nondefense capital goods ex aircraft were to remain at the April level in May and June, then annualized second quarter growth would come in at 10.2% -- not all that slower than the first quarter's growth of 11.9%.

### **PPI Hunan Style**

The Chinese PPI inflation remains hot. In the 12 months ended April it was up 5.0% compared with increases of 3.9% and 3.5% in March and February, respectively. One way or another, Chinese aggregate demand has to moderate. A stronger currency might help. If other policies cool off the Chinese economy, then there will be less upward pressure on the yuan. Less upward pressure on the yuan would imply less of a need for the Chinese monetary authorities to buy U.S. dollars with freshly-printed yuan. Uh oh – there would go one of the principal sponsors of the greenback and principal underwriters of U.S. debt. As Asian economies in general begin to overheat early next year, the dollar could hit an air pocket as Asian central banks withdraw their support.

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