



## MORNING BRIEFING

September 23, 2020

### The Economic Consequences of De-Urbanization

Check out the accompanying [chart collection](#).

(1) The roof is rockin'. (2) Housing boom offsetting lots of busts. (3) Existing home sales are hot, especially for homes with room for an office, and a swimming pool to boot. (4) Millennials are suddenly, finally buying homes en masse. (5) 32% rebound in Q3 real GDP? (6) Inventories of existing and new home sales are historically low. (7) Residential construction plus home improvements exceed nonresidential construction, as well as public construction. (8) Housing-related economic activity should more than offset weak recovery in pandemic-challenged industries. (9) A win-win for distressed home sellers and real estate investors.

**US Economy I: Home Rush.** “This Joint Is Jumping” is a happy [tune](#) from the 1949 musical comedy film by the same name. It could be the theme song for the housing market of 2020, and perhaps beyond. It is our view that the US housing boom stimulated by the pandemic may very well more than offset the pandemic-related bust in many other industries. The viral pandemic has resulted in a pandemic of de-urbanization. It has caused lots of city dwellers to move to suburban and rural homes. Large homes that were sitting on the market for months prior to the pandemic are getting snapped up, sometimes sight unseen or with only a virtual tour of the property. Houses with room for one or two offices for working and studying from home are in demand. So are ones with nice backyards and swimming pools for the kids.

As you know, Debbie and I always try to back up our theories with hard data. The question is whether the data can confirm that the strength in housing-related economic activity is sufficient to more than offset the weakness in industries that may remain depressed or fail to recover fully from the lockdown recession. Let's have a look:

(1) *Existing home sales on fire.* Yesterday, we learned that existing home sales rose to 6.0 million units (saar) during August, the highest pace since May 2006 ([Fig. 1](#)). The pace of single-family existing home sales rose to 5.37 million units (saar), the highest since April 2006. The number of single-family homes available for sale was only 1.27 million units, near recent record lows ([Fig. 2](#)). The months' supply of single-family homes sank to a new record low of 2.8 during August.

Sales are likely to remain strong since the Pending Home Sales Index compiled by the National Association of Realtors (NAR) jumped from a record low of 69 during April to 122 during July, the highest since October 2005 ([Fig. 3](#)). Existing home sales are counted when they are closed rather than when they go to contract.

(2) *Soaring home prices.* Booming demand combined with a shortage of supply are causing the prices of single-family existing homes to soar. The median price rose 11.7% y/y during August to a record \$315,000, while the average rose 9.1% to a record \$345,700 ([Fig. 4](#) and [Fig. 5](#)).

(3) *Snapping up big existing homes.* The NAR reported that properties typically remained on the market for 22 days in August, down from 31 days in August 2019. Sixty-nine percent of homes sold in August 2020 were on the market for less than a month. First-time buyers were responsible for 33% of sales in August, up from 31% in August 2019. For three straight months, home sales have climbed in every region compared to the previous month. Median home prices in each of the four major regions rose at double-digit rates from levels one year ago.

The NAR [reported](#) huge increases in sales of bigger, more expensive homes. Here are the y/y percentage changes during August by price range in sales: \$0-100k (-20.5%), \$100-250k (-8.9), \$250-500k (14.2), \$500-750k (28.2), \$750k-1m (34.5), and \$1m+ (44.0). The steadily northward progression of the y/y changes in sales as the sale price ranges go up is incredible.

(4) *Millennials turning into homebuyers.* There's more and more anecdotal evidence that all those Millennials who've been renting apartments in urban areas are responding to the pandemic by buying houses in the burbs. Undoubtedly, many of them are the first-time buyers in the NAR data. Millennials were born between 1981 and 1996. That would make them 24-39 years old this year. Homeownership rates for the under-35 age group rose to 40.6% during Q2, the highest since Q3-2008, while the rate for the 35- to 44-year-old cohort rose to 64.3%, the highest since Q1-2011 ([Fig. 6](#)).

**US Economy II: Under (Residential) Construction.** On Monday, Debbie and I reviewed the latest new home sales and construction data. Needless to say, that segment of the housing market is also booming. Consider the following:

(1) *Starts may just be starting to jump.* Multi-family housing starts completely recovered from the Great Financial Crisis (GFC) by 2013 as demand for rental apartments boomed. Single-family housing starts also have recovered since the GFC but remain around their lows during the five homebuilding cycles prior to the GFC ([Fig. 7](#)). Single-family housing completions too are back only to previous troughs prior to the GFC ([Fig. 8](#)).

(2) *Snapping up new homes.* During July, new single-family home sales rose to nearly match single-family completions for the first time on record, which goes back to 1968! The inventories of new homes for sale relative to new homes sold fell to previous record lows during July and is likely to make new lows in coming months ([Fig. 9](#)).

(3) *Residential construction has room to grow.* The Census Bureau's monthly data on construction put in place show that spending on residential construction and home improvements combined totaled \$546.6 billion during July ([Fig. 10](#) and [Fig. 11](#)). That sum has exceeded the sum of nonresidential and public construction spending for the past few years. It could easily match its record high of \$678.6 billion during February 2006 in coming months, in our opinion.

Arguably, the outlook for nonresidential construction spending is grim if de-urbanization depresses the demand for offices, hotels, and retail spaces in cities even after the pandemic is over. Public construction spending, on the other hand, may get a boost after the presidential election no matter who wins. Residential construction and home improvements together are likely to continue to climb in record-high territory, more than offsetting the likely weakness in commercial construction.

**US Economy III: A Recovery with Booms & Busts.** The lockdown recession was unprecedented. It lasted only two months, March and April. It was followed by a V-shaped recovery from May through August. Real GDP fell 5.0% during Q1 because March depressed the results and fell 31.7% during Q2 because April clobbered the results. On September 17, the Atlanta Fed [GDPNow](#) model was tracking Q3 at a remarkable 32.0% rate. That's an unprecedented rebound from the unprecedented recession. Debbie and I are still projecting 25% for Q3, then 5% for Q4. We believe that there remains enough fiscal stimulus from the CARES Act and plenty of monetary stimulus to keep the economy growing through year-end.

However, there is mounting concern that the fiscal stimulus from the CARES Act, which was enacted on March 27, is petering out and that a second round is unlikely until after the

November 3 election. Our optimism about the sustainability of the recovery even without a second round of fiscal support is partly based on our upbeat outlook for the housing market, which is certainly getting a boost from record-low mortgage rates thanks to the Fed's ZIRP4ever. Let's have a closer look at how the housing-related sector of our economy compares to the services industries that are struggling most to recover from the lockdown recession:

(1) *Housing-related industries add up to lots of economic activity.* Again, the sum of residential construction and home improvements was \$546.6 billion (saar) during July. Retail sales of building materials and garden equipment soared to new highs in recent months, totaling \$447.1 billion (saar) during August. But we aren't going to use this series for comparison purposes because much of it is included in the residential investment component of GDP, so doing so might double-count the construction data.

Instead, let's add personal consumption expenditures in current dollars on furniture and furnishings and on household appliances ([Fig. 12](#)). That rose to a record \$315.8 billion (saar) during July. Now let's add residential construction, home improvement construction, spending on furniture and furnishings, and spending on household appliances ([Fig. 13](#)). That totaled \$862.4 billion during July.

(2) *Pandemic-challenged services continue to struggle.* Among the industries that are most likely to face a challenging recovery are the ones covered by the following categories of personal consumption expenditures (followed by their July saar levels): air transportation (\$62.7 billion), hotels & motels (53.9 billion), amusement parks, camp grounds & related recreation (32.9 billion), admission to special spectator amusements (3.3 billion), and gambling (109.3 billion). Altogether, they peaked at a record \$549.9 billion during December, and plunged 87.0% through April ([Fig. 14](#)). Collectively, they've rebounded 267.6% through July. Personal consumption expenditures on food services peaked at a record \$863.8 billion during January and plunged 47.6% during the subsequent three months. It is up 62.0% since then through July to \$733.4 billion.

**US Financial Accounts: Home Run.** The Fed's [Financial Accounts of the United States](#) has been updated with Q2 data. It shows that following the Great Financial Crisis (GFC), the value of real estate held by households bottomed at \$17.9 trillion during Q1-2012, a 26% drop from the then-record high during Q4-2006 ([Fig. 15](#)). There has been a remarkable 72% rebound since the most recent trough to a record \$30.8 trillion.

The level of total home mortgages outstanding barely increased over this period. As a result, owners' equity rose \$12.0 trillion to a record \$20.2 trillion during Q2 since bottoming during Q1-2012. Collectively, homeowners now own 65.6% of their homes, up from a post-GFC low of 45.8% during Q1-2012 ([Fig. 16](#)).

This equity is a potential shock absorber for millions of Americans who are house-rich but cash-poor as a result of the pandemic. A September 18 [article](#) in *The Wall Street Journal* on this subject observed: "Even if there isn't a surge in repossessed homes to buy cheaply off the courthouse steps—which led to the emergence of Wall Street's landlords during the foreclosure crisis a decade ago—there is likely to be a lot of forced sales and new renters."

Furthermore, the article notes: "People behind on their payments aren't being kicked out of their houses yet because of federal and local restrictions on foreclosure enacted during the pandemic. Many with federally guaranteed mortgages have entered forbearance, which allows them to skip payments for up to a year without penalty and make them up later." According to the Mortgage Bankers Association, about 3.5 million home loans were in forbearance in early September. Many more borrowers are behind on their payments but not in forbearance programs with their lenders.

Rental companies formed after the GFC to scoop up cheap houses are now raising billions in rent-backed bonds. They are house-hunting to scoop up homes from distressed sellers. In some cases, they are letting the sellers stay as renters. In other words, the market has fashioned a win-win situation for the buyers and sellers.

## CALENDARS

**US:** **Wed:** M-PMI & NM-PMI Flash Estimates 53.1/54.7, MBA Mortgage Applications, EIA Crude Oil Inventories, Powell, Mester, Quarles, Evans. **Thurs:** New Home Sales 890k, Initial & Continuous Job Claims 843k/12.339m, Kansas City Manufacturing Index, EIA Natural Gas Inventories, Powell, Williams, Evans. (DailyFX estimates)

**Global:** **Wed:** Eurozone, Germany, and France C-PMI Flash Estimates 51.7/54.1/51.9, Eurozone, Germany, and France M-PMI Flash Estimates 51.9/52.5/50.5, Eurozone, Germany, and France NM-PMI Flash Estimates 50.5/53.0/51.5, UK C-PMI, M-PMI, and NM-PMI Flash Estimates 56.3/54.1/56.0, Germany Gfk Consumer Confidence -1, Spain GDP -18.5%q/q/-

22.1%/y/y, Kuroda. **Thurs:** Ifo Business Climate, Current Conditions, and Expectations 93.8/89.5/98.0, France Business Confidence 95, ECB Economic Bulletin, ECB General Council Meeting, Wuermeling, Bailey. (DailyFX estimates)

## STRATEGY INDICATORS

**S&P 500 Sectors Net Earnings Revisions** ([link](#)): The S&P 500's NERI improved in September for a fourth straight month and was positive for a second month following 13 straight negative readings. All 11 sectors also improved for a fourth month in a row, and most were positive and at their highest levels since mid-2018. The S&P 500's NERI rose to a 30-month high of 13.6% from 9.5% and is up from an 11-year low of -37.4% in May. That compares to a tax-cut-induced record high of 22.1% in March 2018. NERI improved m/m in September for all 11 sectors for a fourth month; that compares to all 11 worsening on a m/m basis from March to May. During September, NERI was positive for 10 sectors, the most since September 2018, which compares to negative NERI readings for all 11 sectors from April to July. Utilities turned positive m/m, which means Real Estate now has the worst track record, with 10 months of negative NERI. Here are the sectors' September NERIs compared with their August readings: Industrials (30-month high of 18.9% in September, up from 14.4% in August), Consumer Staples (18.2 [30-month high], 14.4), Health Care (16.7 [30-month high], 13.5), Energy (15.7 [26-month high], 14.0), Information Technology (15.2 [27-month high], 9.4), S&P 500 (13.5 [29-month high], 9.5), Consumer Discretionary (13.8 [30-month high], 6.8), Communication Services (13.1 [23-month high], 10.9), Materials (12.6 [27-month high], 8.3), Financials (7.9 [26-month high], 6.5), Utilities (2.7 [20-month high], -0.4), and Real Estate (-6.5 [seven-month high], -10.9).

**S&P 500 Sectors Earnings, Revenues, Valuation & Margins** ([link](#)): Last week saw consensus forward revenues rise w/w for ten of the 11 S&P 500 sectors and forward earnings for nine. Real Estate had both measures fall, while Financials posted a drop in its forward earnings. Due to the sharp decrease in forward earnings this year, forward P/E ratios for nearly all sectors now are back above their recent record or cyclical highs prior to the bear market. Tech and Utilities are the only sectors now expected to have improved profit margins in 2020, whereas back in early March eight sectors were expected to see margins improve y/y. During 2019, just two sectors' margins improved y/y: Financials and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since 2018, it has moved lower for nearly all the sectors. In the latest week, the forward profit margin moved higher for Industrials and Materials. Here's how the sectors rank



based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (14.3, down from 19.2), Utilities (14.2, record high), Real Estate (13.4, down from 17.0), Communication Services (13.6, down from 15.4), S&P 500 (10.9, down from 12.4), Health Care (10.5, down from 11.2), Materials (9.7, down from 11.6), Industrials (8.2, down from its record high of 10.5% in mid-December), Consumer Staples (7.3, down from 7.7), Consumer Discretionary (5.9, down from 8.3), and Energy (2.2, down from 8.0).

### **S&P 500 Sectors Forward Revenues and Earnings Recovery from Covid-19 Trough**

[\(link\)](#): The S&P 500's forward revenues and earnings, as well as its implied forward profit margin, bottomed at cyclical lows on May 28 after 14 weeks of Covid-19 declines. Since then, S&P 500 forward revenues has risen 4.3%, forward earnings has gained 11.1%, and the forward profit margin has risen 0.6pt to 10.9%. The S&P 500 and nine of its 11 sectors have posted new highs during the last three weeks in either their forward revenues, earnings, or profit margin. The exceptions: Energy's revenues; Utilities' revenues and earnings; and Real Estate's revenues, earnings, and profit margin. Real Estate's earnings and margin made a new low again in the latest week. Here's how the sectors rank by their changes in forward revenues and forward earnings since May 28: Consumer Discretionary (forward revenues up 7.4%, forward earnings up 35.0%), Information Technology (5.2, 7.4), Industrials (5.0, 16.8), Financials (4.9, 11.1), Communication Services (4.6, 6.9), Materials (4.3, 14.8), S&P 500 (4.3, 11.1), Health Care (3.4, 8.9), Energy (3.1, 300.1), Consumer Staples (2.2, 4.2), Real Estate (0.2, -5.3), and Utilities (-1.9, 0.3).

## **US ECONOMIC INDICATORS**

**Existing Home Sales** [\(link\)](#): "Housing demand is robust but supply is not, and this imbalance will inevitably harm affordability and hinder ownership opportunities. To assure broad gains in homeownership, more new homes need to be constructed," notes Lawrence Yun, NAR's chief economist. Existing home sales advanced for the third month in August (to 4.2% above its pre-pandemic level), though the pace slowed last month after posting back-to-back record gains in June and July. Existing home sales—tabulated when a purchase closes—climbed 2.4% in August and 53.5% during the three months ending August, to 6.00mu (saar), the highest level since 2006. Sales had plunged 32.1% during the three months through May to 3.91mu (saar)—which was the lowest sales pace since October 2010. Both single- (+50.4% to 5.37mu, saar) and multi-family (+85.3 to 630,000 units) sales posted sharp gains over the three months through August, after plunging 30.8% and 43.3%, respectively, during the three months

through May. Sales are up sharply in all regions over the past three months—with sales in all regions now above year-ago levels: West (73.6% & 9.7% y/y), Northeast (57.5 & 5.7), South (50.3 & 13.0), and Midwest (42.4 & 9.3). Total inventory at the end of August was 1.49 million units, 18.6% below a year ago—with unsold inventory back down at its record low of 3.0 months' supply, pushing home prices higher.

**Regional M-PMIs** ([link](#)): Three Fed districts now have reported on manufacturing activity for September (New York, Philadelphia, and Richmond) and show the manufacturing sector expanded at its fastest pace since October 2018. The composite index climbed to 17.7 this month from 13.0 last month; it was at a record low of -62.9 in April. Activity in the Richmond (to 21.0 from 18.0) region was the best since September 2018, while New York's (to 17.0 from 3.7) was back near July's 17.2—which was the first positive reading since February; growth in the Philadelphia (15.0 from 17.2) region slowed for the fourth month, though remained at an elevated rate. (The Richmond, New York, and Philadelphia measures were at record lows of -54.0, -78.2 and -56.6, respectively, in April.) Meanwhile, September's new orders (to 19.9 from 10.8) measure expanded at nearly double the pace of August, as billings in the Richmond (27.0 from 15.0) region accelerated at its fastest rate since fall 2018, while Philadelphia's (25.5 from 19.0) expanded at the fastest pace since before the pandemic; New York's (7.1 from -1.7) swung from contraction to expansion. (The Richmond, Philadelphia and New York measures were at record lows of -62.0, -70.9 and -66.3, respectively, in April.) In the meantime, employment at factories continues to improve, turning positive in July (5.8) for the first time since hitting bottom in April (-41.3)—expanding to an eight-month high of 13.8 this month. Richmond (to 23.0 from 17.0) and Philadelphia (to 15.7 from 9.0) manufacturers both hired at a faster pace this month, while New York's (2.6 from 2.4) remained just north of the breakeven point between contraction and expansion. (The Richmond, Philadelphia and New York measures were at record lows of -22.0, -46.7 and -55.3, respectively, in April.)

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