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Economic Corner

Housing & the Economy in the Aftermath of the September 11 Attacks On America by David F. Seiders, Chief Economist, National Association of Home Builders

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For updates to this report, visit www.nahb.com/facts.

Information received during the past week (including labor market data for September) is consistent with our earlier estimate of a small decline in real Gross Domestic Product in the third quarter. Furthermore, downward momentum during the third quarter supports our forecast of a somewhat larger economic contraction in the fourth quarter. This two-quarter setback most likely will qualify as an official economic recession, although this recession should be quite mild by historical standards.

The housing sector was losing some momentum during the third quarter, and there has been some further weakening in the aftermath of the September 11 attacks. Although a telephone poll of builders taken roughly a week after the attacks showed that home sales had held up well and that contract cancellations had not shifted up (although traffic was off) preliminary results of a large mail survey conducted at the end of September show some weakening of home buyer demand as well as greater caution on the part of builders. A falloff in sales was reported by about half of the builders, lower buyer traffic was reported by nearly three-fourths, and nearly 30 percent of survey respondents said their cancellation rate had increased to some degree since September 11. We also found that speculative building is being monitored more carefully by most builders and eliminated by some. Furthermore, half of the builders buying lots on options have extended their contracts to buy more time.

On the positive side, the policy response in Washington has gotten even stronger and financial market conditions have improved to some degree. As we expected, the Federal Reserve cut short-term interest rates by half a percentage point on October 2, following the half-point cut on September 17, bringing the federal funds and discount rates to the lowest levels since the Kennedy Administration (the fed funds rate is now 2.5 percent and the bank prime is 5.5). Longer-term rates also have fallen, including home mortgage rates. The 30-year fixed-rate mortgage averaged 6.64 percent this week, 25 basis points below the level just before the attacks; the 15-year mortgage was down to 6.11 percent; and the one-year adjustable-rate loan was available at 5.34 percent—compared with 5.64 percent before the attacks. The Fed’s actions also helped to bring some semblance of stability to the stock market this week, although the markets continued to operate well below the pre-attack levels.

The initial fiscal policy response to the September 11 attacks was quick and forceful and, as expected, there's more on the way. President Bush has just called for as much as $75 billion in new tax cuts and new federal spending, on top of the recent tax bill that's still being implemented and the $80 billion in extra spending and loan guarantees that's been put in place since September 11. While the composition of the package to be hammered out on Capitol Hill is not yet known, Congress has little choice but to go along with the President's parameters on overall size.

Everything considered, NAHB's forecasts of September 28 still serve as a useful baseline for the near future. [Go to www.nahb.com/news/seiderscommentary.htm for previous reports.] These forecasts show a falloff in housing starts to 1.41 million units in the fourth quarter (13 percent below our pre-attack forecast), following more modest slippage in the third quarter. The fourth quarter is highly vulnerable, despite all the economic policy stimulus, and builders may need to take some special steps to maintain sales. The auto companies have found success with financing incentives, and builders should consider such steps. Temporary mortgage-rate buydowns (e.g., 2-1 buydown for the first two years of the loan) have proven effective in the past, and some high-production builders already have rolled out this device.

The prospects for housing and the economy in 2002 still looks quite good, barring further terrorist attacks or lack of success on the military front. Indeed, the economic takeoff promises to be quick and strong enough to put some upward pressure on market interest rates and cause the Fed to reverse course by the second quarter of next year, if not before. Stay tuned!

> For additional statistics and economic information, visit the "Economic News" section of WTCA's web site. Be sure to check out our recommended economic news links as well.

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