

### Economic Environment

#### What Can We Expect with Housing in 2002 & Beyond? by Al Schuler

##### NEAR TERM

The immediate impact of the September 11 terrorist attacks was to push an already weak economy into recession. The manufacturing sector had already been in recession since August 2000. However, consumer spending, which represents two thirds of the economy, remained relatively healthy thanks to continuing strength in consumer confidence supported by a still healthy employment picture and ten Fed rate cuts [to date]. Housing was relatively strong, although it was also starting to lose some momentum.

The big question is what to expect in 2002? One way to look at the future, post-September 11, is to consider two scenarios. Scenario "A" assumes that terrorist attacks of the magnitude of September 11 are a one-time event, and that world leaders are successful in their efforts to combat or at least contain terrorism. In this scenario, the most probable outcome is a short, mild recession in the U.S. (Many other countries, like Japan, several Southeast Asian countries and several South American countries are already in a recession, while countries like Europe and Canada are slowing significantly.) The consensus is for mild contraction in the second half of 2001, with unemployment reaching six percent next year. In this scenario, housing should hold up relatively well, pull back some in the last half of 2001, then follow the economy upward in 2002 (Figure 1). The nice thing about housing demand is that it always returns to trend, so the anticipated pull-back in late 2001 will be made up when the economy recovers.

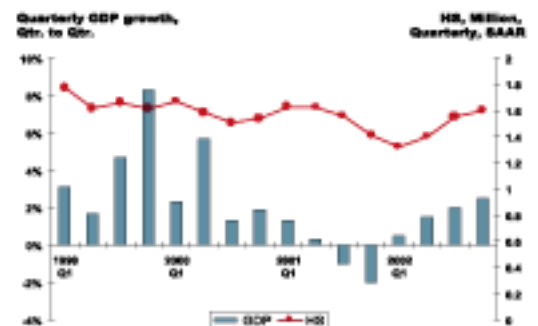
##### Will the economy recover from September 11?

Following is a summary of Peter Lynch's Wall Street Journal article entitled, "What's Next." The U.S. has experienced nine recessions in the past 50 years, and we've had nine recoveries. There are five compelling reasons why this recession will not get out of control:

- Government spending acts as a buffer, and the major current surplus will ensure continued spending.
- The housing market has created \$2 trillion in additional equity for homeowners in the past three years, which offsets much of the losses from the current economic downturn.
- The banking system is in good shape.
- We have unemployment buffers such as dual income families, a still strong service sector to compensate for the much smaller, but weaker manufacturing

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##### Quarterly GDP\* and Housing Outlook\*\* Terrorist Attack Turns Weak Growth into Mild Recession



\*Consensus (NAHL, NAFL, NAHE, Conference Board, WSJ, Morgan Stanley)  
\*\* Forecast: NAHS (Sept. 28, 2001)

FIGURE 1: QUARTERLY GDP AND HOUSING OUTLOOK

sector, and unemployment insurance.

- Lower interest rates (ten Fed rate cuts this year, and possibly more to come) will keep consumers spending and eventually encourage more business investment.

The bottom line is that the economy will recover, but we're not sure that it will return to the growth rates of the late 90's.

Scenario "B" is highly improbable, but possible, hence it deserves mention. In this scenario, high profile terrorist attacks continue in the U.S. and throughout the world. This forces the U.S. and much of the rest of the world into a "war-time economy" in which all economic sectors contract except the Federal Government. In this scenario, GDP doesn't matter and housing starts pull back significantly. The October 22 Business Week article, "What's at Stake," discusses how terrorism threatens the global economy. The gist of the article is that globalization (world trade and GDP growth) will become slower and costlier if the fight against terrorism is protracted.

## LONGER TERM HOUSING OUTLOOK—2003 & BEYOND

**Housing Demand:** In contrast to the one above, this is a "good news" story. It seems that the U.S. Census population estimates, which are done between the actual decennial (annual ten-year) counts, underestimated population growth by about 7 million people in the 90's. Most of the "undercount" is attributable to an underestimate of net immigration (this is professional immigration where immigrants have the financial means to buy houses and does not include illegal immigration). To understand the significance of this "revelation" to estimates of future housing demand the three major components of trend/sustainable demand (Figure 2) have to be examined. Of the three, the size and distribution of the population determine household formations, which normally account for about 70 percent of demand. The more difficult component to estimate is net immigration levels. Demand also depends on vacancy levels (e.g. unsold inventory, vacant homes and second homes), and net removals (homes that are demolished each year).

Household formations is the category most affected by the population undercount. In essence, annual household formations during the 90's, as determined by the Census were 1.35 million, or about 200,000 per year higher than previously thought. During the late 90's, when annual housing demand exceeded 1.8 million, the demographers explained that it was not sustainable because trend demand, (defined in this article to be the total of the three categories in Figure 2) was approximately 1.65 million. We were "borrowing from the future." In light of these new Census numbers, that was simply not true.

### Housing Demand Immigration supports stronger demographics in this decade

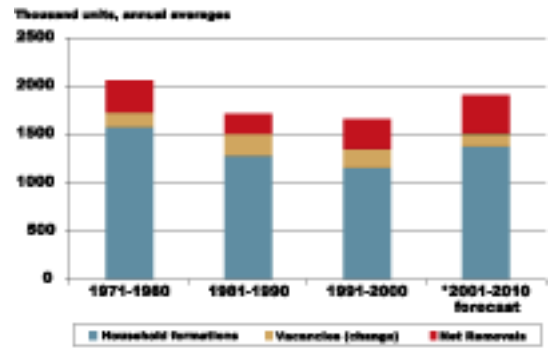


FIGURE 2: HOUSING DEMAND

### Housing Supply Demographics Drive SF and MF Higher in Next Decade!!!

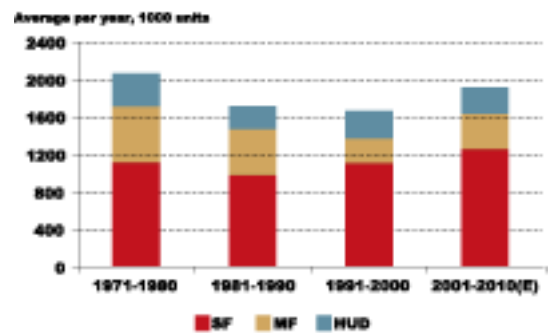


FIGURE 3: HOUSING SUPPLY

**One note of caution:** During the past four years, net immigration accounted for about 25 percent of housing demand, while 34 percent of workforce growth over the decade was attributable to immigration. If the events of September 11 result in sustained lower levels of future net immigration, either from tighter restrictions, or from the diminished “allure of the U. S.,” future housing demand will suffer and labor costs will escalate even faster.

**Housing Supply:** The Census changes also have an impact on the type of shelter that will be in demand because it affects the distribution of the population. People in different age groups have different shelter preferences and differing abilities to act on these preferences. Before the Census numbers became available, most demographers, using population estimates, painted a portrait of America as “graying baby boomers” with fewer young people and many more people on Social Security. The actual Census numbers suggest that immigration has actually, “Smoothed out the differences in the age distribution implied by historical pattern of births and deaths” (Carliner 2001). Carliner goes on to suggest that the market for starter homes and multi-family rental housing has more demographic support than previously thought. This will support stronger demand for trade-up homes as we move through this decade (Figure 3). Furthermore, the Census tells us that there are actually more people in the 35-55 age bracket (baby boomers) than was previously thought. This suggests that remodeling demand, as well as demand for second homes should remain strong.

## IMPLICATIONS FOR WTCA MEMBERS

If there is a downside to this good news it is that these upgraded estimates of housing demand will mean extra pressure on markets for labor and materials over the next decade. We will still face a labor shortage, particularly in the area of skilled labor, because the Census confirmed that the number of people in the 25-34 age group (the construction worker age group) actually fell by 7.6 percent during the 90's. Before the Census, the thought was that the drop would be closer to 13 percent. So, the labor shortage will not be as acute as previously thought, but housing demand will be stronger. The net result will be continuing pressure on labor and building material supplies.

The building construction industry, along with others in the manufacturing sector, is responding to globalization and growing domestic competitive pressures by embracing industrialization trends. Just In Time (JIT) supply and design for manufacture and assembly (automation/mass customization) are being implemented to reduce production costs and improve productivity. We will see a modest increase in factory built housing including “mobile” and modular. The real story though, will be the much heavier use of wood, steel and concrete engineered components and systems for the wall, roof and floor in stick-built construction. Stick-built/site-built technology, which now accounts for about 75 percent of housing, will remain the preferred system, but there will be increasing rates of material substitution. To participate in these trends, make sure you are “in sync” with your customers! Work with them to ensure that you become the supplier of products and systems to enhance their competitive position in the marketplace.

economic information/opinions contained in this article are not necessarily those of the USDA Forest Service. Dr. Schuler can be reached at 304/431-2727 or [aschuler@fs.fed.us](mailto:aschuler@fs.fed.us). His economic information can also be found at [www.woodtruss.com](http://www.woodtruss.com).

**WORKS CITED:**

M. Carliner, NAHB's Housing Economics, May 2001

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## Economic Q & A

The staff of SBC Magazine asked Michael Carliner, NAHB Vice President specializing in economics, for an economic forecast for 2002. Following are his answers to questions about the future of the housing market, the September 11 attacks, technology, labor issues and much more. His responses are very candid and provide a great deal of insight into the future of our industry.

**1. Do you think that the economic slowdown at the end of 2001, because of the September 11 attacks, will affect the housing industry in 2002 or has the effect already diminished?**

The September 11 attacks have had direct effects on homebuyer and builder confidence, and are likely to have indirect effects to the extent that they mean weaker overall economic growth, less spending by consumers and businesses, and weaker labor markets. If it were only the direct effects that mattered, the impact would perhaps dissipate quickly, but we believe that there will be indirect impacts extending into next year. One reason why housing will weather the storm more easily than in past cycles is that the inventories of new homes for sale are low. The economy was already slowing down before September 11, so all of the weakness is not due to the attacks. We believe that by next spring, the positive effects of lower interest rates and increased Federal spending will lead to a fairly strong rebound for the economy and for housing. In housing, what is lost today raises future potential. Most of the demand lost over the next six months will be regained by the end of 2002.

**2. Will a slower economy affect the trend toward technology in home construction? If so, how?**

The slower economy could mean less investment in new technology by building materials companies. The slowdown shouldn't decrease builders' interest in new products, although the labor supply won't be as tight, so the incentive to use new technology to address labor shortages will not be as great in the near term.

**3. Do you foresee any supply side issues for the residential construction industry in 2002?**

Supply side issues are unlikely to be as prominent, with less activity and with new capacity in several key supplier industries.

**4. Will there be any kind of shift in the type of residential construction (e.g. More starter homes or larger homes? Fewer new homes in 2002?)**

Generally, when the housing market softens, it is the high end of the market that contracts most. We are already seeing some evidence of that. The total number of new homes in 2002 is likely, however, to be roughly equal to the number in 2001, with a strong second half of 2002 offsetting weakness in late 2001 and early 2002.

**5. Do you believe that a change in the number of immigrants coming to this country will affect housing starts in the next year? For years after?**

It is hard to predict the effect of September 11 on immigration, but that could be the most important influence on housing in both the short- and long-term. U.S. immigration policy and the stringency of enforcement will probably be significant. Moreover, fewer people may try to come here, and many of those already here may leave. There could be a significant effect both on housing demand and on the availability of construction labor.

**6. How will the component industry specifically (e.g. wood trusses, wall panels, I-joists, LVL, glulam, steel trusses, etc.) be affected by slower economy?**

If housing slips, the component industry will certainly be affected. Also, since lumber prices tend to be more sensitive to demand than component prices, some builders may shift from components to on-site fabrication from raw lumber.

**7. What do you see as the short-term prospects for the component industry? What do you see as the long-term prospects?**

In the short term, some of the motivation for using components—less need for skilled labor, builders' difficulty meeting schedules, etc.—may decrease, slowing the adoption of components. In the long term, the advantages of components will remain and should result in a continued growth in market share.

**8. What will the economy's effect be on the labor market?**

Not only will there be (slightly) less labor demand from home building, but the overall labor market will soften, so competition from other industries for skilled labor will be weaker. We expect the unemployment rate to approach six percent. Many of the labor problems facing builders are long-term, however, and still need to be addressed.

**9. Will the economy impact product selection? (e.g. substitute products in lieu of more traditional products)**

There has been a regional shift away from areas that depend heavily on manufacturing industries for employment (in the Midwest, Carolinas, etc.) and that has some implications for the mix of housing designs and materials demanded. High-end luxury product demand may be weaker,

although demand for such products for remodeling may partly compensate.

**10. What are the prospects for steel components in the residential market and the commercial market? Where does the greatest potential for steel lie?**

Steel has not really taken off in residential construction, with use mostly confined to interior walls in homes with nonwood (e.g., masonry) exterior walls, or areas with especially bad problems with termites. That could change if there is enough progress on tools and fasteners to make steel construction easier.

**11. Please define wood industry marketing wins/mistakes.**

While environmental concerns are not the primary motivation for homebuyers, the story that wood is a renewable resource and that wood use is not necessarily anti-environment needs to be told better. Wood resistance to earthquakes, fires, etc., should be explained, particularly if people become more fearful as a result of recent events. Reaching the consuming public with this message is valuable. Builders have a good understanding of the virtues of engineered wood products and components, and manufacturers can build on that strength.

**12. Which industry, wood or steel, best supports its customers and their associations?**

The wood industry is viewed as fairly arrogant and nonresponsive by builders and other customers. The steel and concrete people certainly appear to be more concerned about customer needs and feedback. The EWP companies have put forth a better effort to provide support and react to needs than traditional wood products. But wood, and lumber, is still the dominant choice in residential construction, and the wood products companies are recognized as key partners in a wide range of common interests.

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