



21 May 2015



SENT TO LSU AGCENTER/LOUISIANA FOREST PRODUCTS DEVELOPMENT CENTER - FOREST SECTOR / FORESTY PRODUCTS INTEREST GROUP

(As always, Thank you Al)

To all;

Attached is latest note. April starts were up considerably, so lets hope things may be getting better. This is the spring building season!

Still lots of problems facing housing - credit issues; jobs; economy; strong dollar hurting exports; etc. I still think debt in the USA, and the rest of the world is going to cause serious problems going forward. Many countries are defacing their currencies (quantitative easing, etc.) to promote growth, but incurring huge amounts of debt in the process. And, to date, this strategy has had only limited success. The debt problem isn't just with federal governments, but many state governments in USA , along with consumer debt in USA, Canada (per capita debt in Canada exceeds USA), China, Europe,.... The big problem with debt is repayment - where the money comes from to pay off the debt - and the programs that are sacrificed in the process. I've said this several times before - debt is OK if you are investing for your future (building infrastructure, R&D, health care, education,). But, sadly, much of the debt today is for consumption.

All this to say, interesting times ahead, but I believe we will get our collective acts together, and address the various problems. Housing's future (and wood products) depend on a strong economy.

Al Schuler

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Housing comments – May , 2015 - great month this time!!!

- *March starts increased 20% (to 1.135million, annual rate) from previous month, with single family coming in at 0.733 million(SAAR) – a major improvement from previous month, and, 9.2% above last year.*
- *Multi family continues to be the driver (35% of total) – rental prices still increasing – single family sales remain weak and this has big impact on wood product prices. This trend will probably continue for some time.*
- *Economic issues - slowing world economy(China GDP slowest in past 6 years); sub par domestic job market; sluggish income growth; continuing tight domestic credit environment .*
- *Main problem (short term) continues to be the job market. Unemployment rate keeps coming down, but good jobs remain scarce, and many people are working two or more jobs to make ends meet.*

Longer term – makeup of U.S. economy is changing and this is impacting spending patterns and housing choices – shrinking middle class as top and bottom income earners grow.

- ***In addition, there are growing concerns that the job market is undergoing long term – structural – changes. Automation is reducing job prospects for the middle class while creating jobs for the highly skilled and less skilled sectors . End result is stagnating family incomes that could translate to lower total housing demand with more emphasis on multi family/rental demand. E.g., higher paying jobs with benefits in the goods producing sector employs 13.9% of the workforce - use to be 25 – 30% in the 1970's. Lower paying service sector now 71% - use to be 50%.***

Housing inventory – short supply is driving up prices!

One more issue impacting housing – with starts remaining weak, we will see a continuing shortage of inventory, and that means higher prices. Many Builders just don't see enough traffic supporting an increase in starts. In the Resale market, many people can't list their homes due to foreclosure issues, Underwater mortgages, Job problems, credit issues, etc. Current inventory is 4.6 months for new homes and 4.7 months for existing homes – six months supply is considered a 'healthy market'

Another good article on current housing situation re: dilemma for 1st time Buyers. Limited choices; higher prices; weak income growth; weak New home construction; --- short supply drives prices higher putting more 1st time buyers out of the market. **I've said this before – return of 1st time Buyers is needed before housing returns to “normal”!**

(<http://finance.yahoo.com/news/first-time-buyers-face-hurdles-101147166.html>)

Existing home inventory – short supply drives prices higher

Months supply, single family



Still Rising

Analyzing economic factors and including suburbs, Local Market Monitor forecasts 2%-9% growth in home prices in these 10 markets.

Richest Markets	Avg. Home Price (Thous.)	12 Mos. Growth Forecast
San Francisco	\$859	5%
Los Angeles	433	8
San Diego	400	2
New York	392	5
Washington	356	5
Cheapest Markets		
Detroit	\$116	6%
Cleveland	149	5
Las Vegas	179	8
Tampa	184	7
Atlanta	190	9

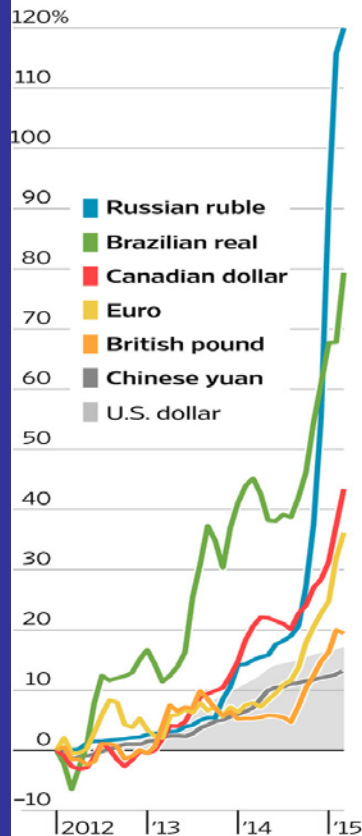
Source: Local Market Monitor

Another headwind – stronger dollar crimping demand in markets Popular with foreigners

Relative Real Estate

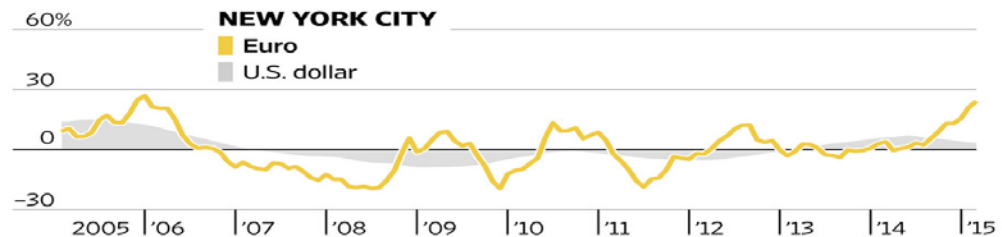
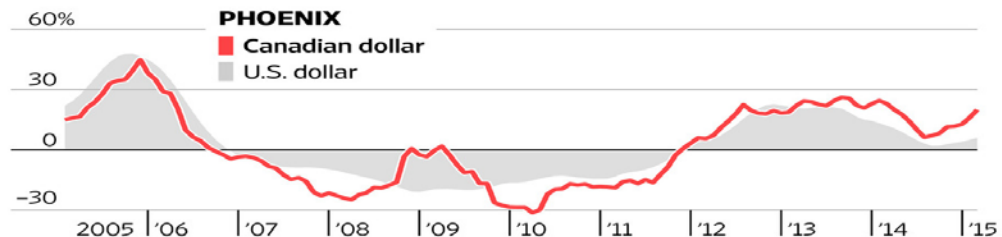
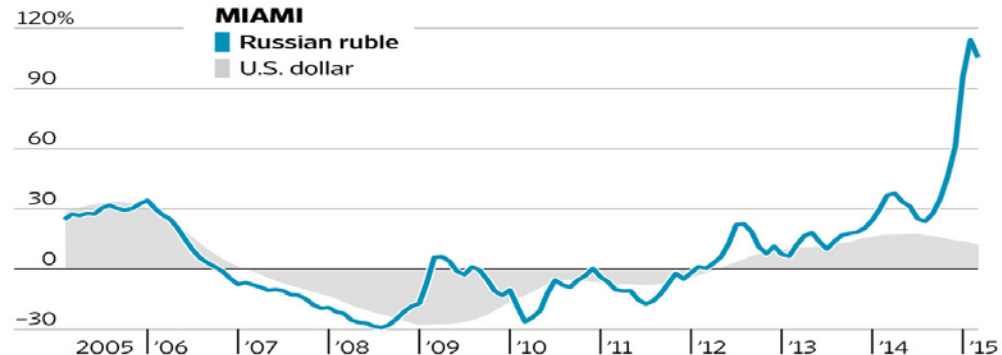
The dollar's increase against many other currencies has made U.S. real estate more expensive for foreign investors. The change is particularly important in markets with a high concentration of foreign buyers, such as Phoenix and Miami.

U.S. median home price, change from 2011, as denominated in select currencies



Source: Zillow

Metro-area median home price, change from a year earlier



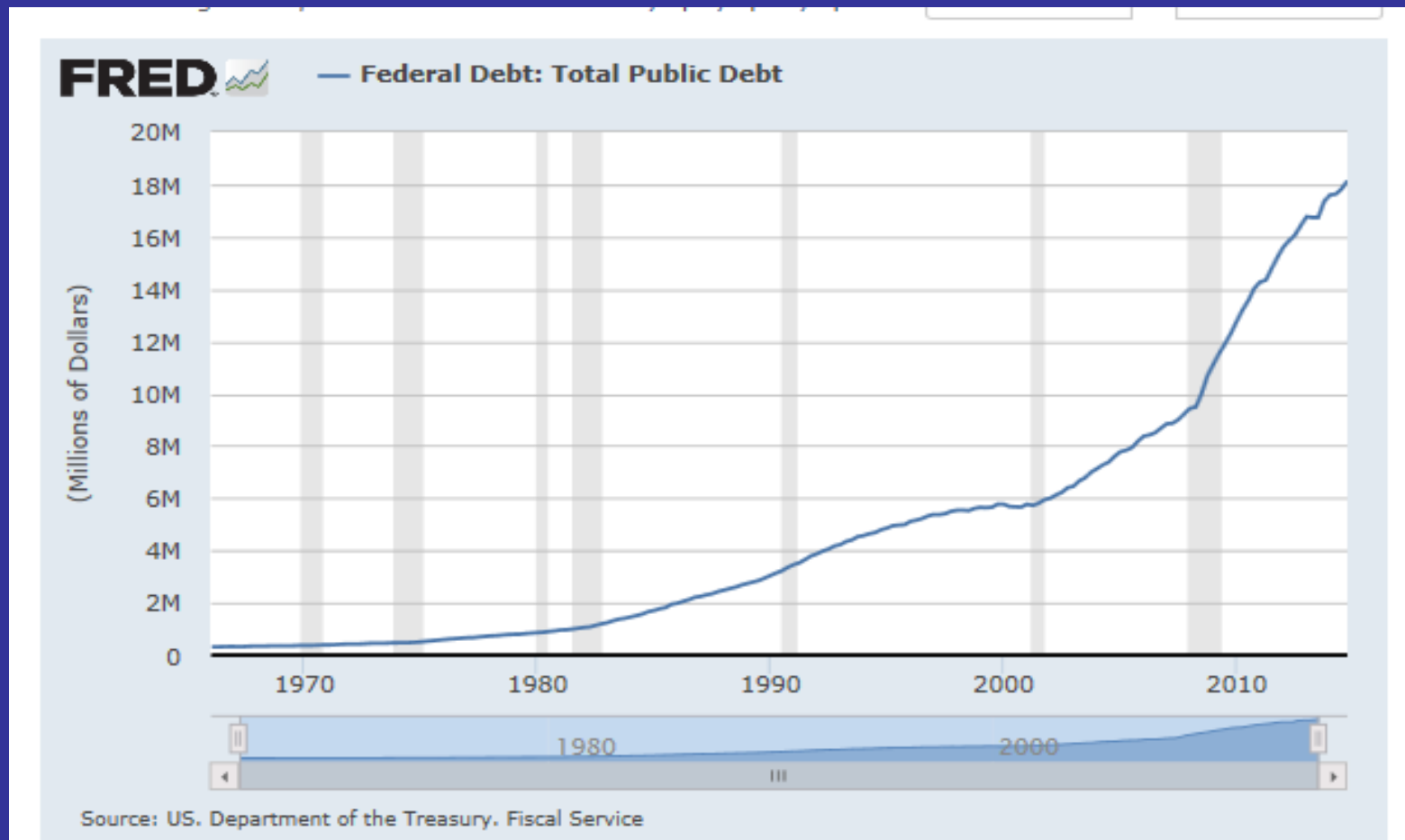
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Debt issues – much of world is in debt (lots of debt)
As they try to revive stagnating economies

Rule of thumb – when debt exceed 90% of GDP, it becomes almost Impossible to recover as carrying costs, austerity programs, etc. severely damage the economy's ability to grow And function . Greece is latest example. So far, we're fortunate that the world still has faith in the U.S. dollar, and continues to fund our Spending habits.



USA --Total Public Debt has tripled in past 15 years



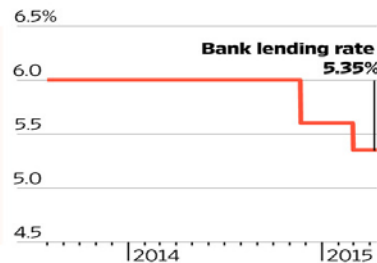
Again – printing money and issuing debt isn't the answer
– weak demand is the main problem

Asia's Debt Trap

Interest rates have come down across Asia...

Interest rates

CHINA



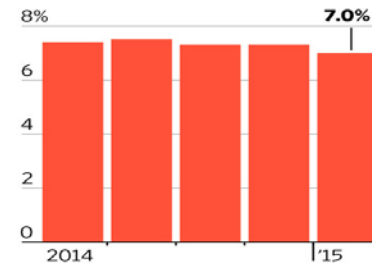
...but demand and consumer prices have remained low...

Inflation, change from a year earlier

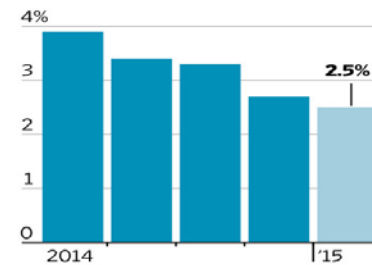
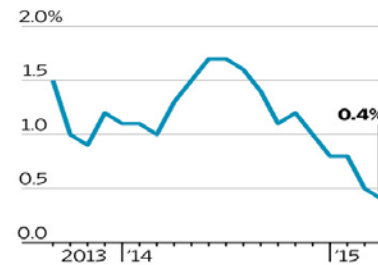
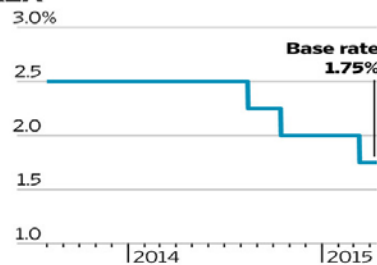


...and growth has continued to slow across the region

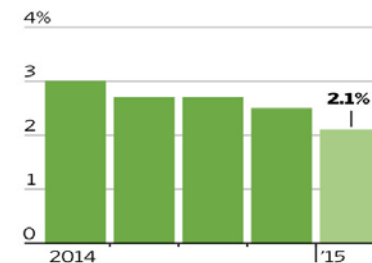
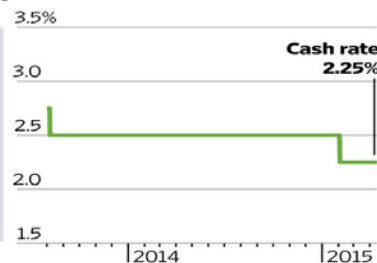
GDP, change from a year earlier



SOUTH KOREA



AUSTRALIA



Sources: CEIC; Deutsche Bank (Australian inflation for 1Q 2015); TD Securities (Forecast for Australian gross domestic product for 1Q 2015); WSJ poll of seven economists (South Korea GDP forecast for 1Q 2015)

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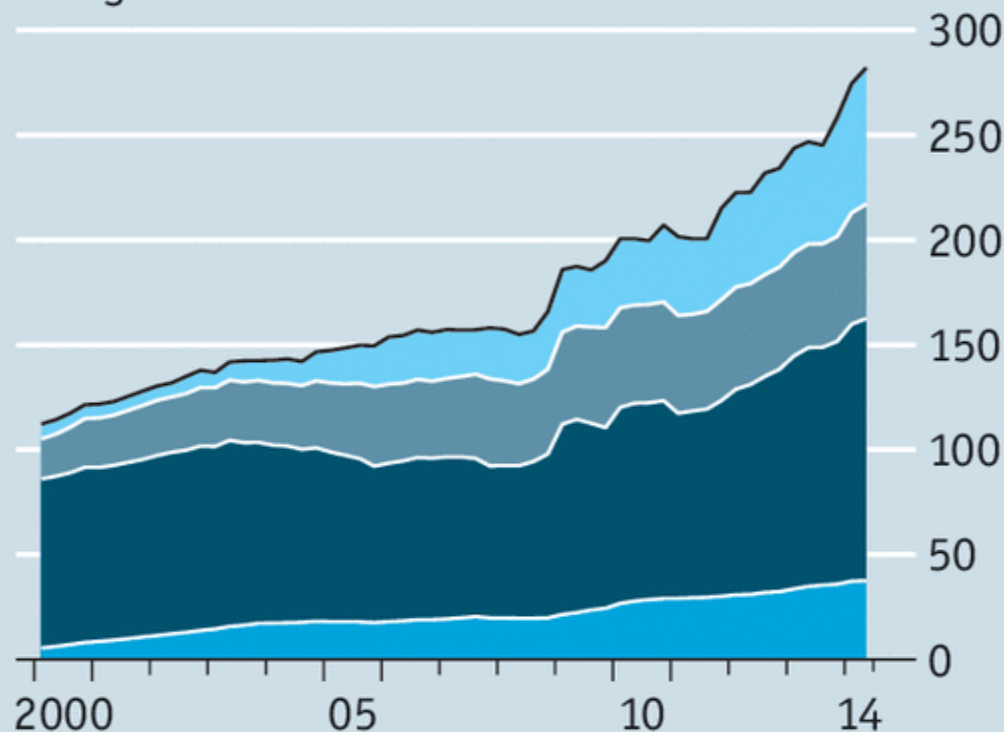
Lots of debt in China

Redder China

2

Chinese debt, % of GDP, from:

households non-financial corporate
government financial sector



Source: McKinsey

Economist.com

China's economy – slowing down

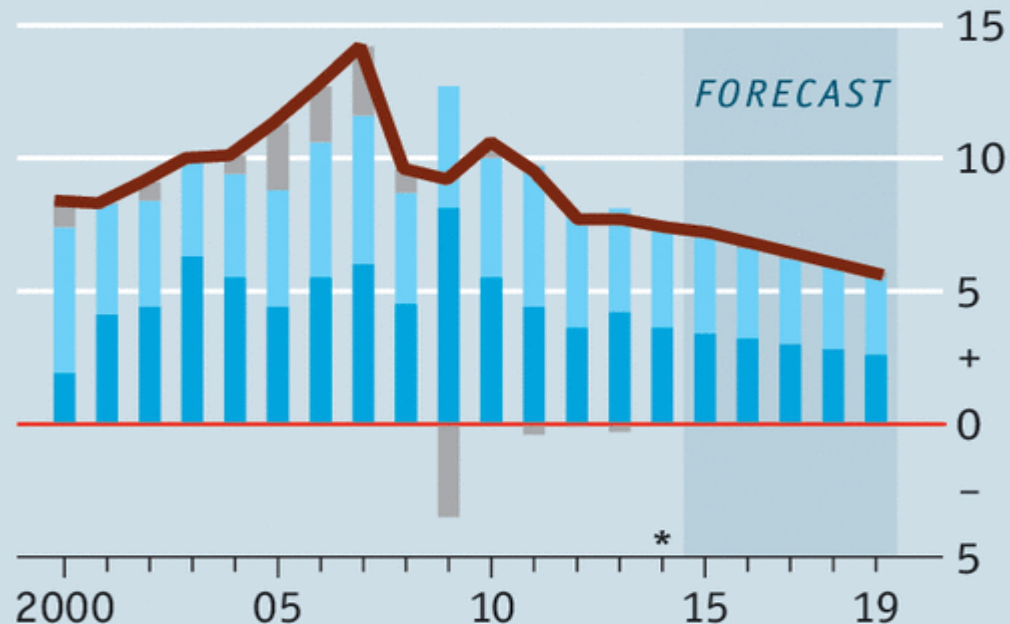
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The shape of things to come

Contribution to China's GDP growth

Percentage points, from:

■ investment ■ consumption ■ net exports
— GDP, % increase on a year earlier



Sources: Haver Analytics;
Economist Intelligence Unit

*Estimate

Economist.com

“Low inflation world” is symptom of weak demand as noted by recent WSJ article – this could be a structural /long term problem

One solution --- technology that spawns new industries that fulfill Demands not currently met by existing products – weak demand is the problem

The problem is primarily due to excess capacity relative to demand - WSJ

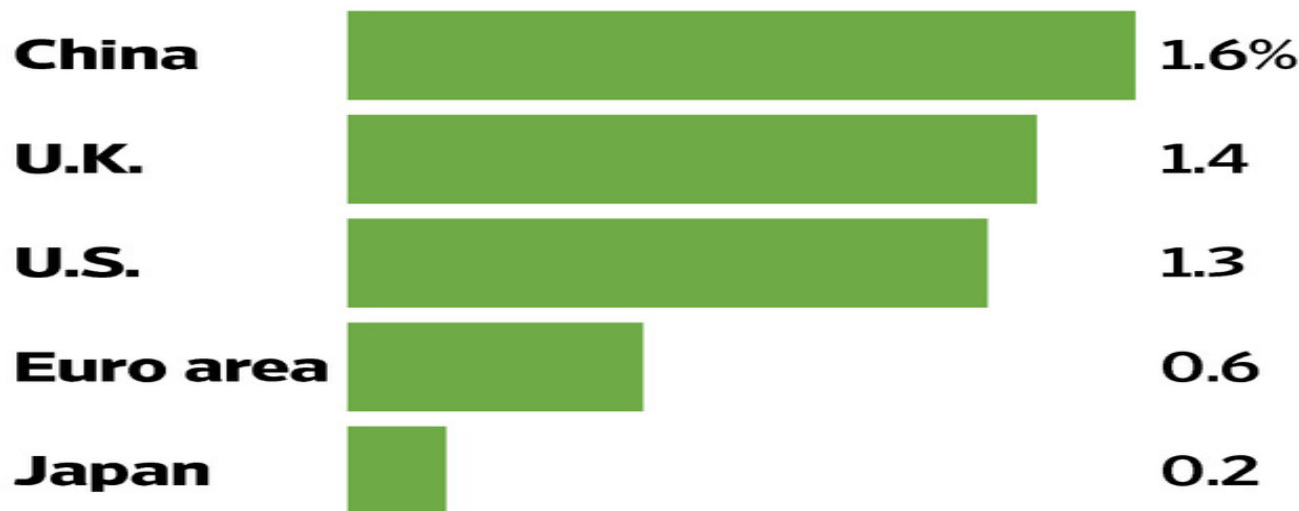
The answer to weak growth isn't currency devaluation – it's growing/creating demand for products, services, etc. That means investment, product development – this requires research, infrastructure spending , tax reform, better education. This is a structural problem that will take years/decades to remedy, and unfavorable demographics in Europe, Japan, and the USA are going to make this more challenging. The world needs new industries based on new products – this creates needed demand and jobs. “Necessity is the mother of invention”. Find the needs that aren't being met by existing products.

E.g., New technology and innovations create new products/services desired by consumers and demand for such products will create jobs, income, ... E.g., Apple products do this all the time. Other examples include new medical devices/products; computing innovations; 3D printing .. Prior examples include the jet engine; cotton gin; model T Ford; MMM's numerous innovations; the telephone; ---- each invention spawned new industries creating jobs to produce desired products – new technology could help us solve the demand problem, but we need to do the research to develop new technology, and we need a supportive government and tax system that can help create an environment that encourages innovation, risk taking, etc.

Low inflation on this scale is a symptom of weak demand – printing money won't solve the problem – like “pushing on a string” – solution is new products, new Industries – this requires R&D; infrastructure investment; better education;... And, a government supporting a business environment that encourages risk Taking, innovation, (tax and regulatory reform would be good start)

Target Practice

Core prices for five economies, change from a year earlier



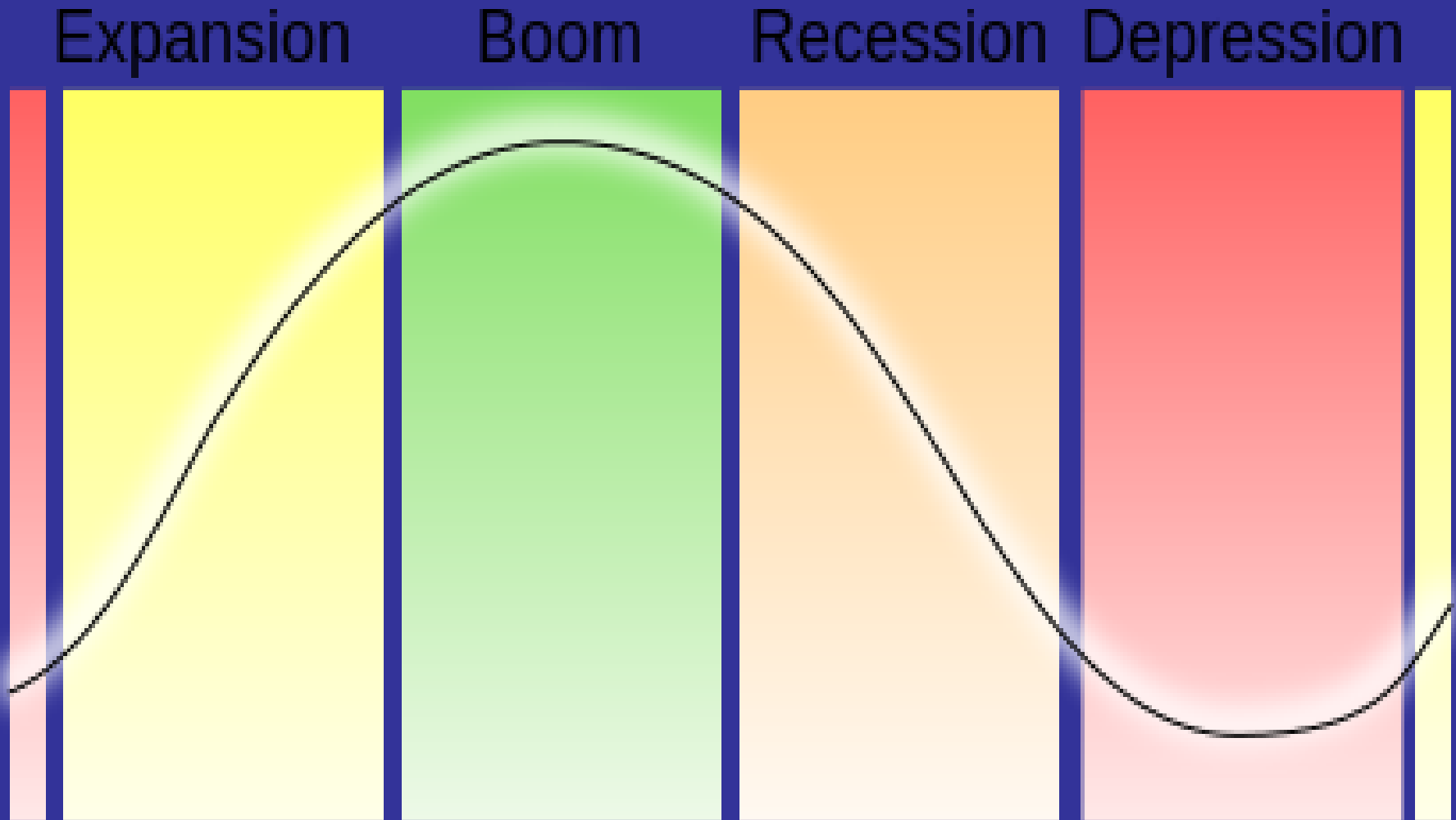
Note: For most recently reported month.
Japan figure excludes sales-tax effect.

Source: Central banks and government statistical agencies

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Bloomberg News

If Economic Cycle Theorists Are Correct, "2015 To 2020 Will Be Pure Hell For The United States" – Michael Synder's article referring to Kondratiev cycle/wave
Explanation of current economic problems in USA and much of rest of world



Another article in WSJ - Ben Bernanke versus Larry Summers

(<http://www.wsj.com/articles/on-secular-stagnation-ben-bernankes-theory-meets-larry-summerss-evidence-1428460593?KEYWORDS=theory+meets+evidence+in+rate+debate>)

Tries to explain why economic growth has been so slow in recent years. Discussion Between Ben Bernanke and Larry Summers centers around real interest rates (nominal rate minus inflation) – when they are low for an extended time (4- 5 years), it indicates something is wrong with the economy. I.e., when demand for money is low, this keeps interest rates low. Summers argues that it is the result of weak investment because companies see little need to expand Plant capacities because demand is lacking, or existing capacities are sufficient to produce What is demanded today. Similar to previous argument that inflation is low because we have excess supply/not enough Demand. Bernanke counters that low rates are due to a combination of Cyclical Factors – recent financial mess; international issues such as global savings glut as China and Other countries with large trade surpluses saved more than they invested and exported The rest to the U.S. (i.e., they bought our Treasury bills, etc.). Bernanke argues that “The shortfall in U.S. growth wasn’t due to a shortage of investment, but the fact that imports were displacing domestic production”. He also suggests that slower growing Labor force and slow productivity growth is keeping interest rates low.

Both explanations are plausible with lots of supporting evidence. The beauty of being an Economist is that sometimes (many times)we don’t know the real answer until much later when even more evidence/data is available. However, if Bernanke and other central bankers are wrong, then we are delaying the implementation of a better strategy to Correct today’s weak demand problem. For what it is worth, I’m in Larry Summers camp – Weak growth is the result of chronic weak demand. We have too much capacity to produce Existing products – what we need is new technology to produce/develop new products.

Another good article addressing state of the world economy

Too much of everything, from commodities, labor,
And capital. Causing serious challenge to policy
Makers around the world.

E.g., Fall of Soviet Union and rise of China added more than 1 billion workers to the world's labor force; aging population in Europe, USA, are saving more adding to supply of capital and keeping interest rates low; oversupply of Commodities around the world pushes prices lower;

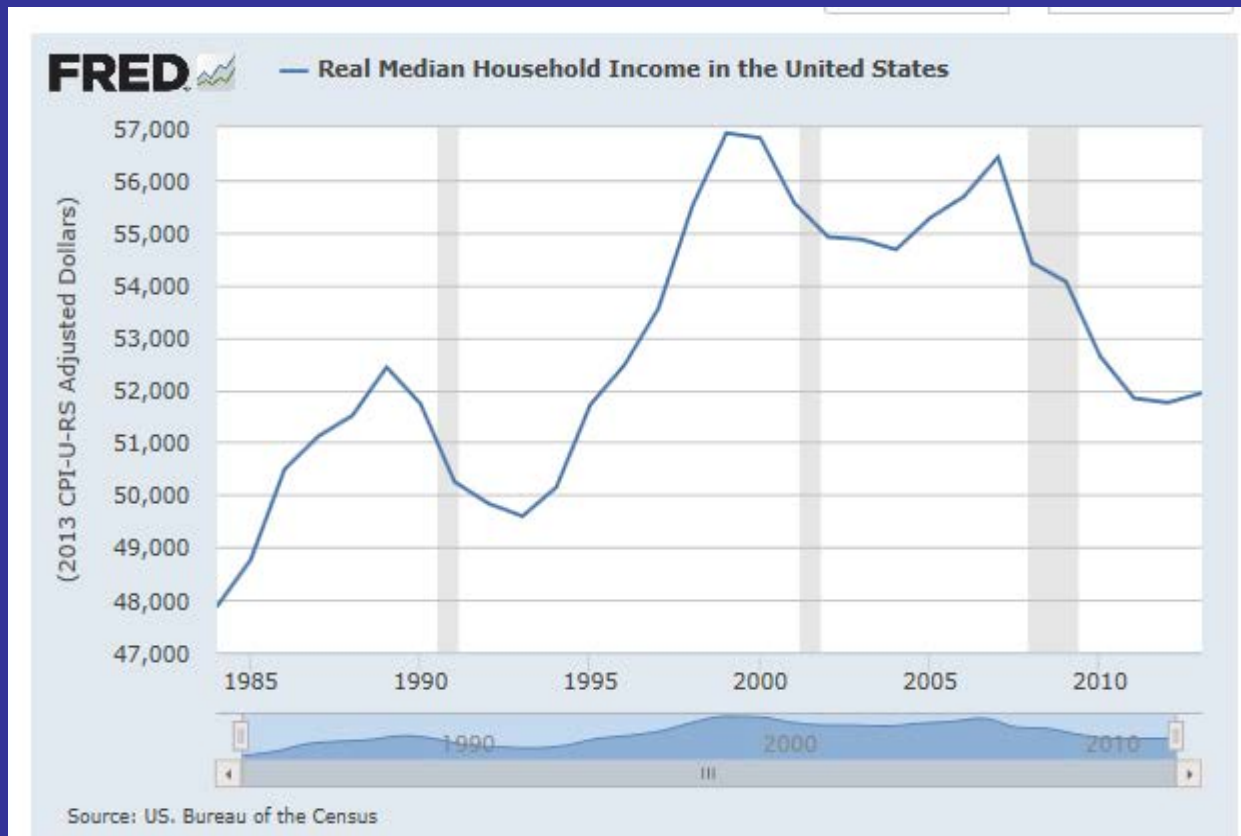
Major deflation risk!!!!!! Again, weak demand or too much supply is the problem

Source: (<http://www.wsj.com/articles/global-glut-challenges-policy-makers-1429867807>)

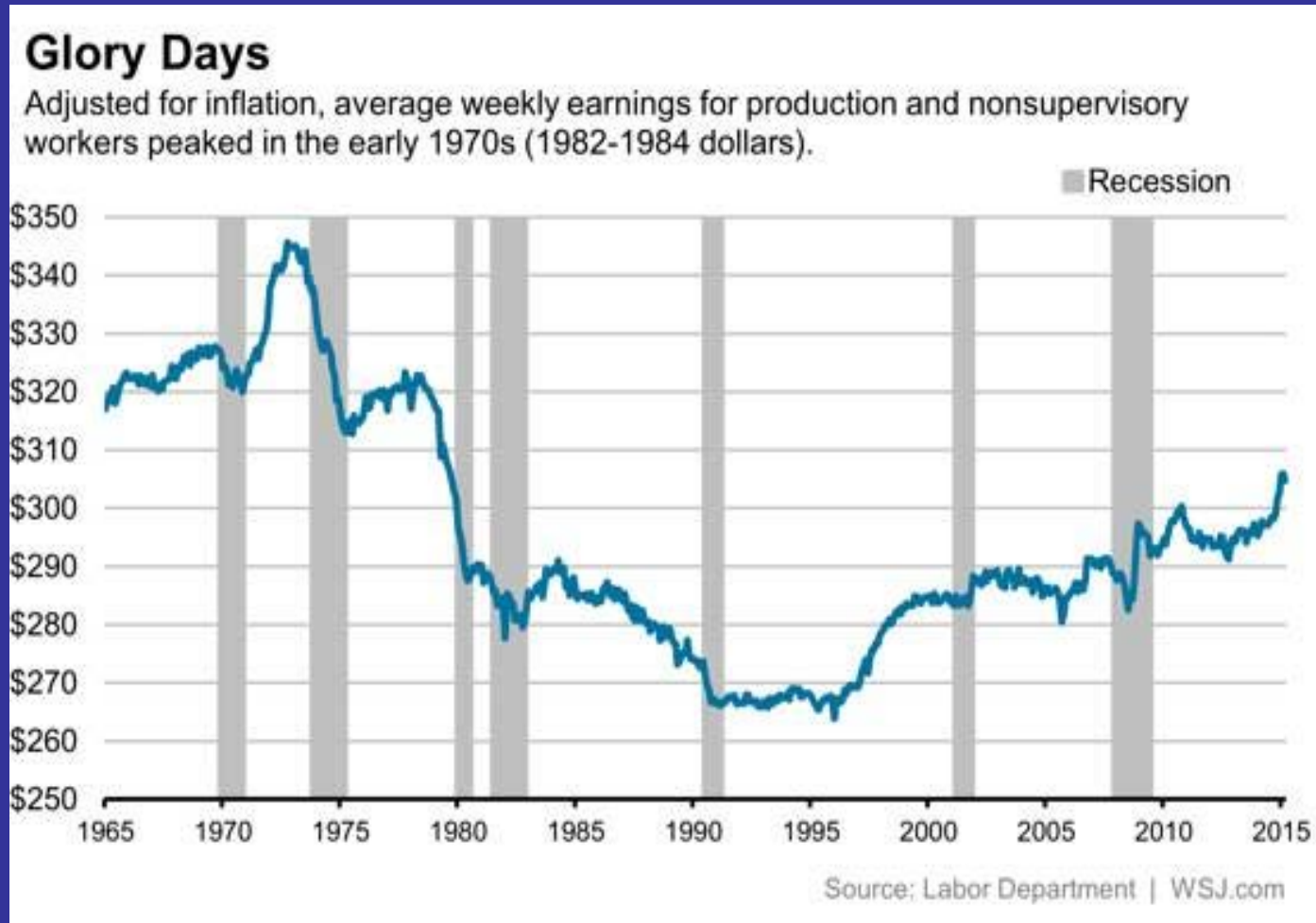
Following are a few slides showing what is happening
To household incomes and wages over past decades

1st, just a reminder what has happened to incomes over the past twenty years ---

real incomes have been shrinking for the past 20 years



Major source of income is wages – they are off considerably from the 1970's.
One reason weekly earnings are down is that Average workweek has shrunk
from 39 hours to 34 over the past 40 years
(see next slide)



Counting Down

Average weekly hours of production and nonsupervisory workers

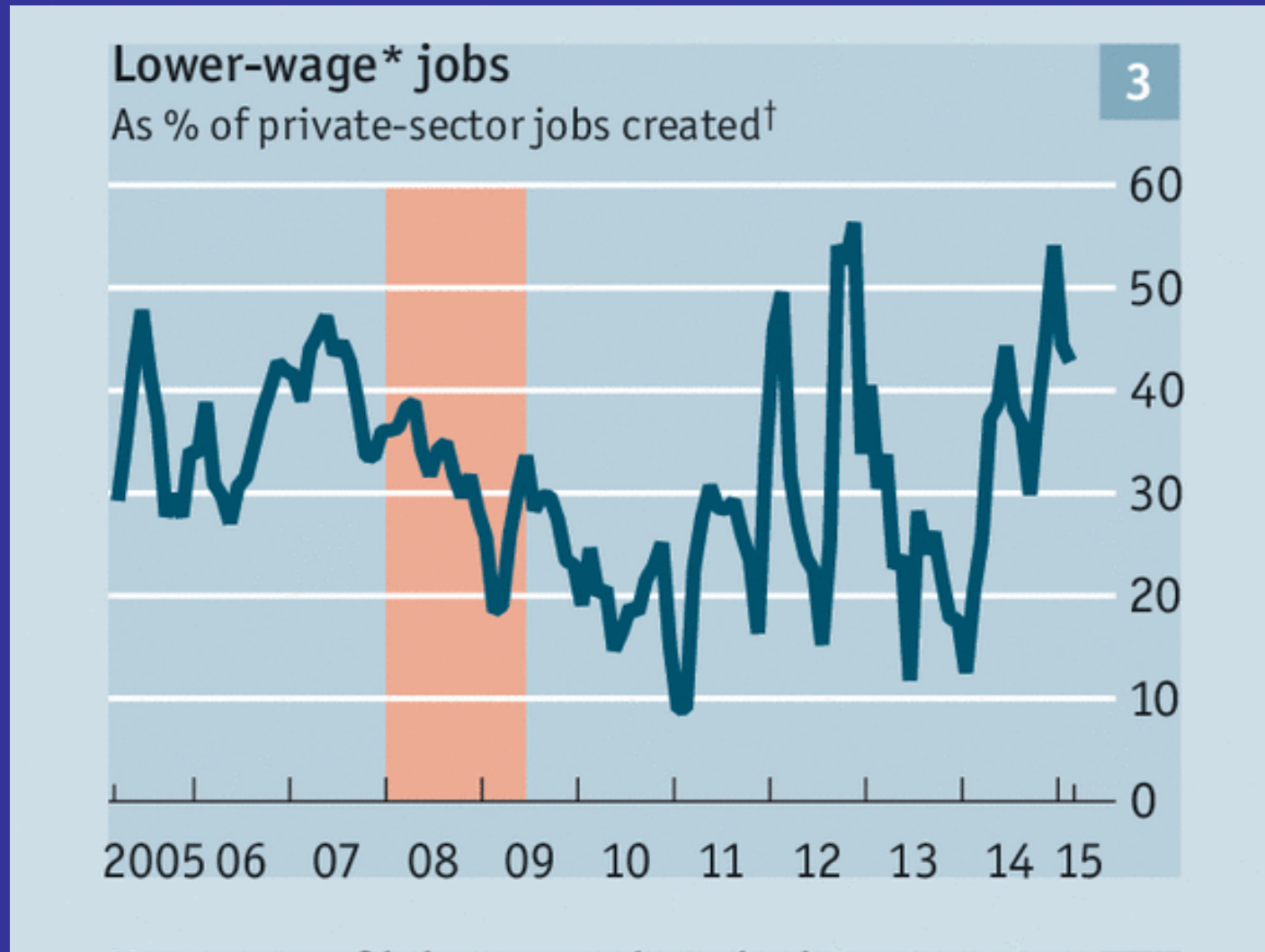


Source: Labor Department | WSJ.com

Looking at hourly wages, things aren't so bad. However, working fewer hours is OK if you're taking home more money – you're not going to do that with lower skilled jobs which is where the U.S. is headed.



Lower skilled jobs Becoming a problem – no easy solution



Source: (<http://www.economist.com/news/finance-and-economics/21648022-unless-wages-grow-americas-economic-blip-could-become-trend-careful-now>)

OK – I know I harp on about the “income inequality issue” as a problem, but To be fair, high income earners pay more than 80% of the income taxes in the USA, The source of over 50% of federal revenue . In the rest of the world, the Income taxes provide 33% of federal revenue while a consumption tax provides another 33% . The consumption tax/value added tax is more regressive (higher burden on lower income people) , so, maybe our system isn’t so bad?

Who’s Paying What?

How income and federal income taxes were distributed in 2014.

Groups of taxpayers by income	Income range	Share of total U.S. income	Share of total income tax
Bottom fifth	\$0 to \$24,200	4.5	-2.2%
	\$24,200 to \$47,300	9.3	-1.0
Middle fifth	\$47,300 to \$79,500	14.8	5.9
	\$79,500 to \$134,300	20.0%	13.4
Top fifth	Above \$134,300	51.3	83.9

Note: Total estimated U.S. income for 2014 is \$13.7 trillion. Total estimated U.S. individual income tax for 2014 is \$1.26 trillion. Income figures are higher than those shown on tax returns, as they include untaxed income due to employer-provided health coverage, municipal-bond interest, retirement plans and other items. Each quintile contains about 65 million people.

Source: Tax Policy Center

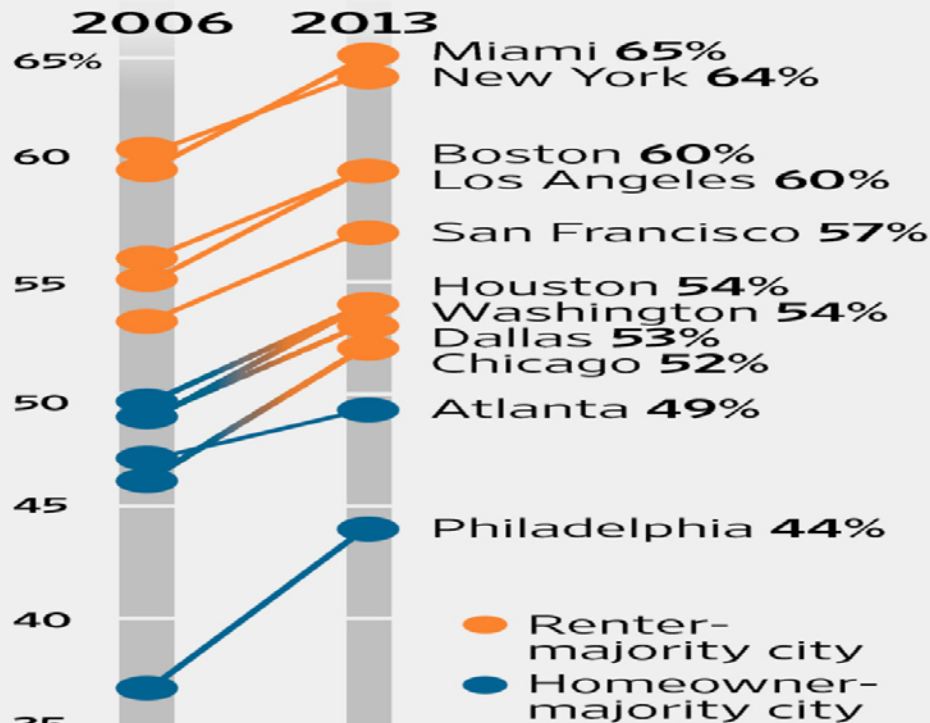
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Rental demand keeps increasing – I think this trend will continue
For another few years at least

Urban Trend

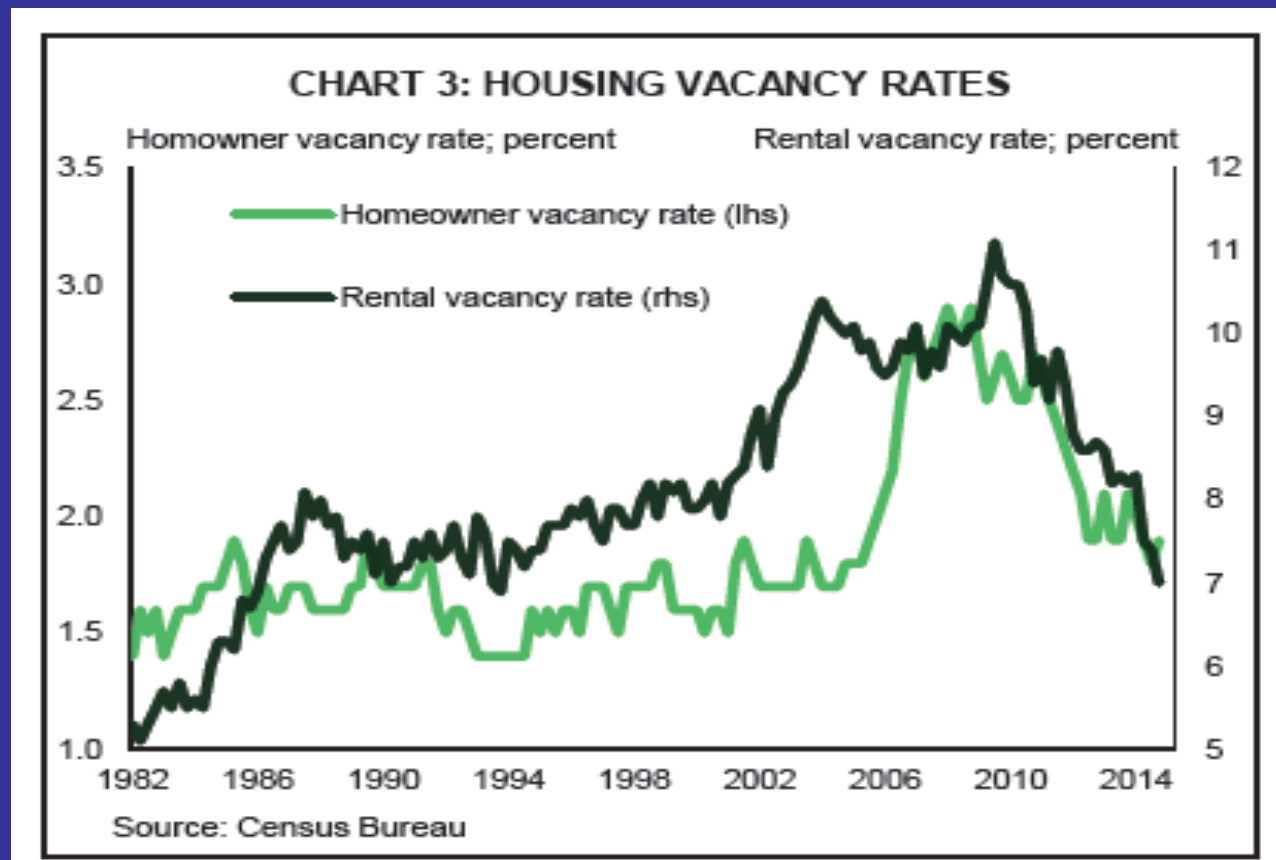
Nine cities of the 11 largest metros have more renters than homeowners.

Share of population in rental housing

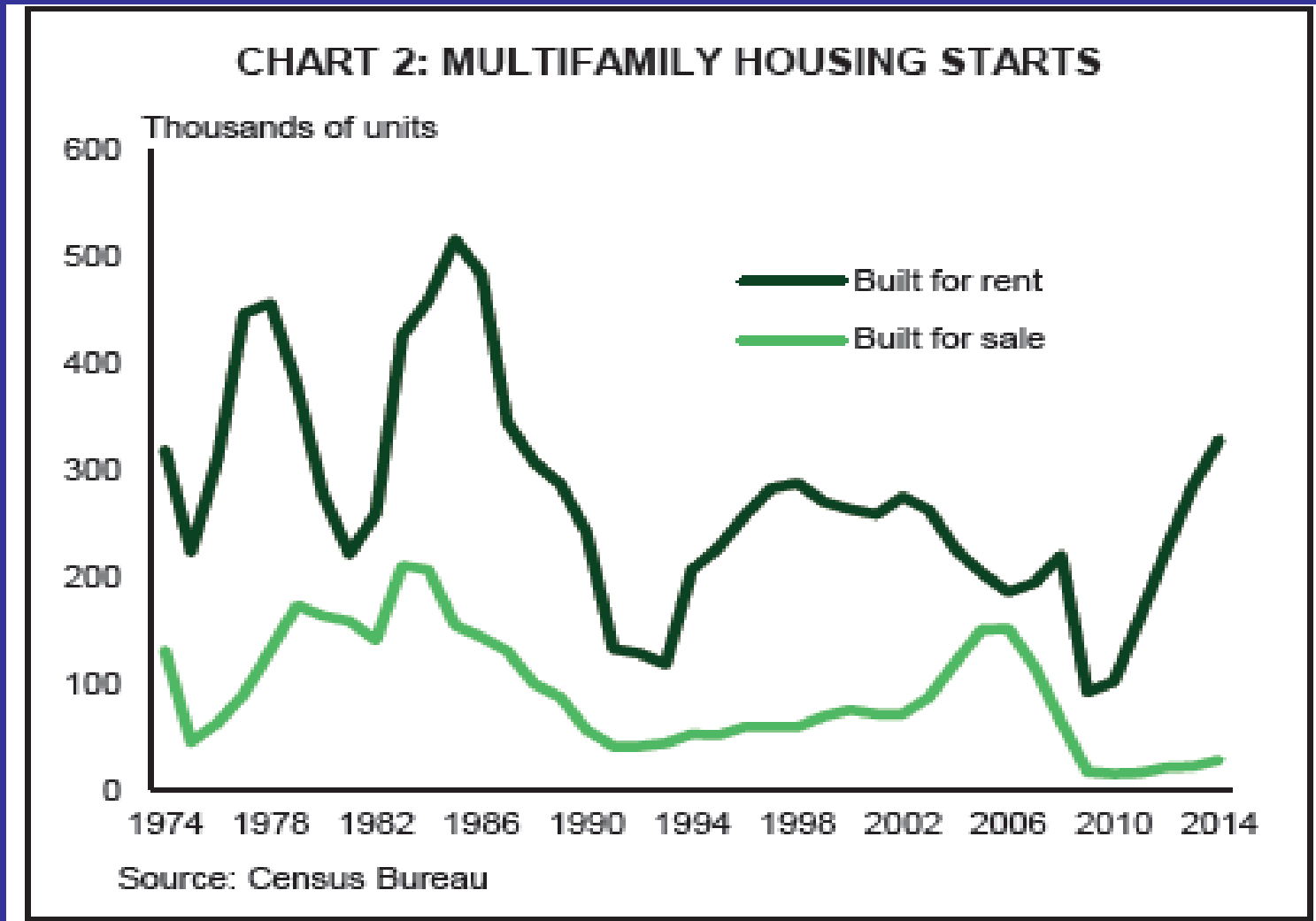


Source: Census Bureau via NYU's Furman Center for Real Estate and Urban Policy
The Wall Street Journal

Falling rental vacancy rates will drive rental prices higher
And this will drive multi family construction – Economics 101

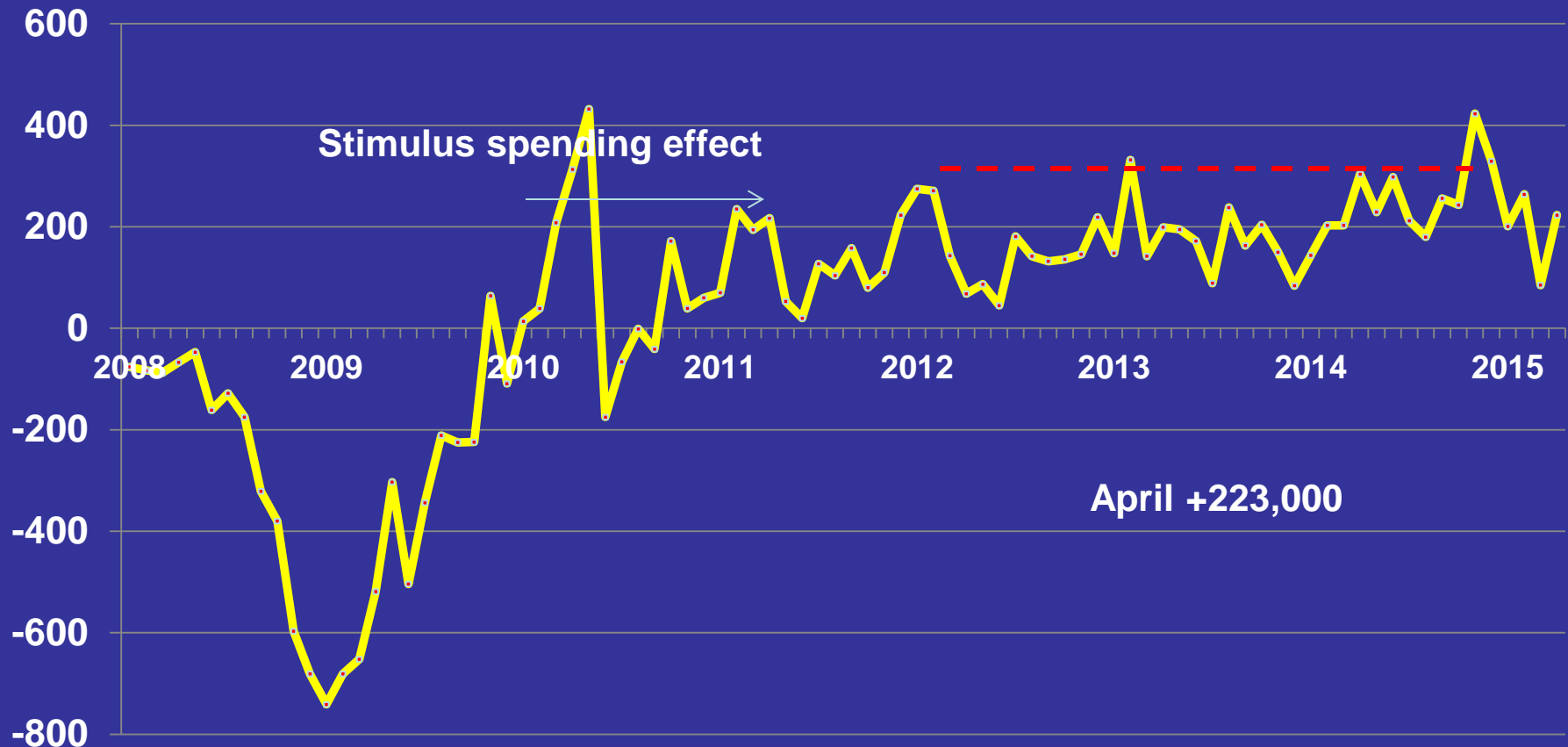


The bulk of multi family housing are rental units



Employment situation - our biggest problem - it was getting better, but 2015 Had been a bumner until April when 223,000 jobs were created

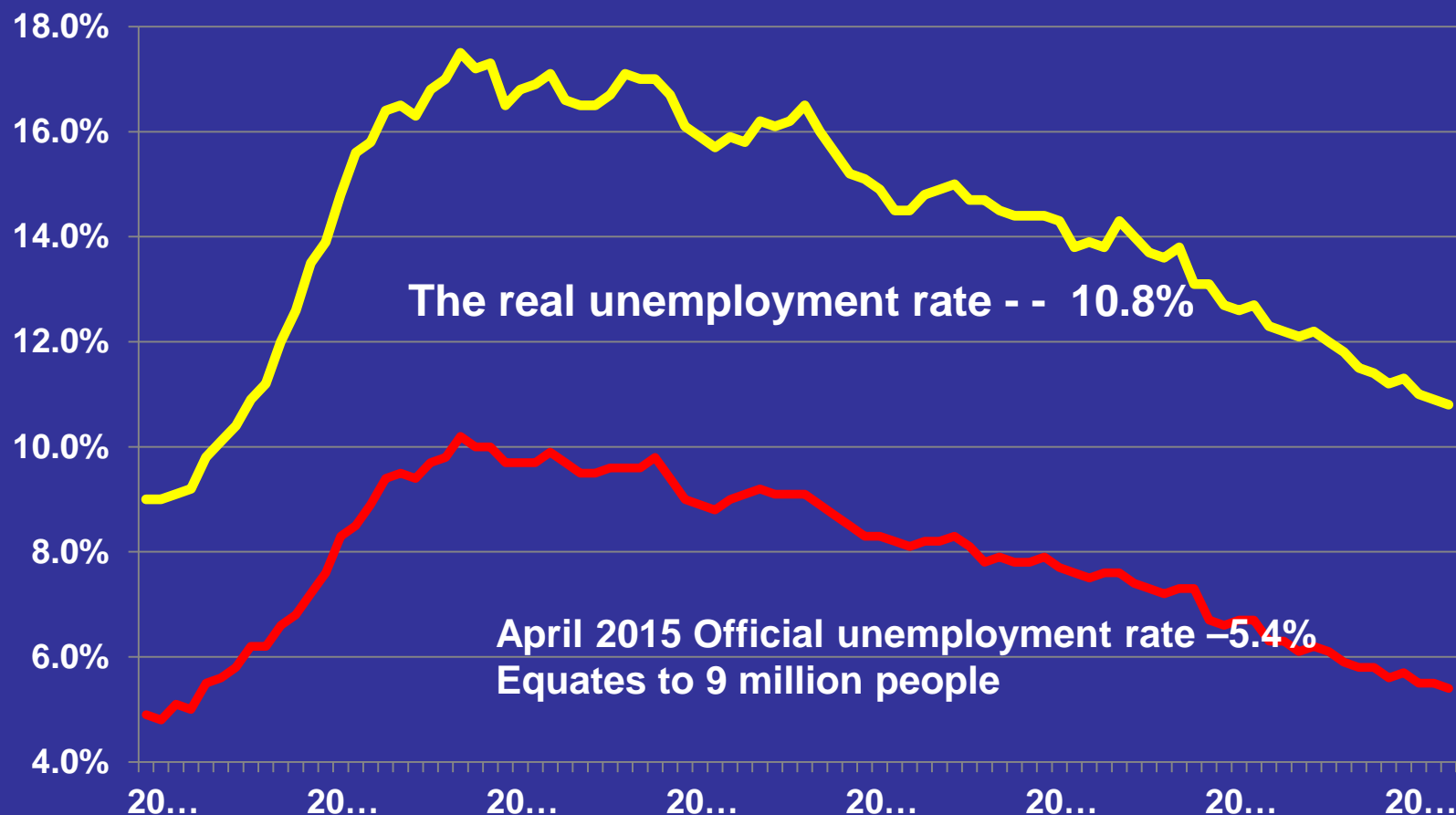
Net change in non farm payrolls – monthly, thousands



Source: U.S. BLS (www.bls.gov)

Unemployment rate keeps coming down – but, nearly 7 million remain “underemployed” – working part time, but want full time jobs

There are about 18 million people either unemployed, underemployed, or stopped looking – **But, it is getting better!!!

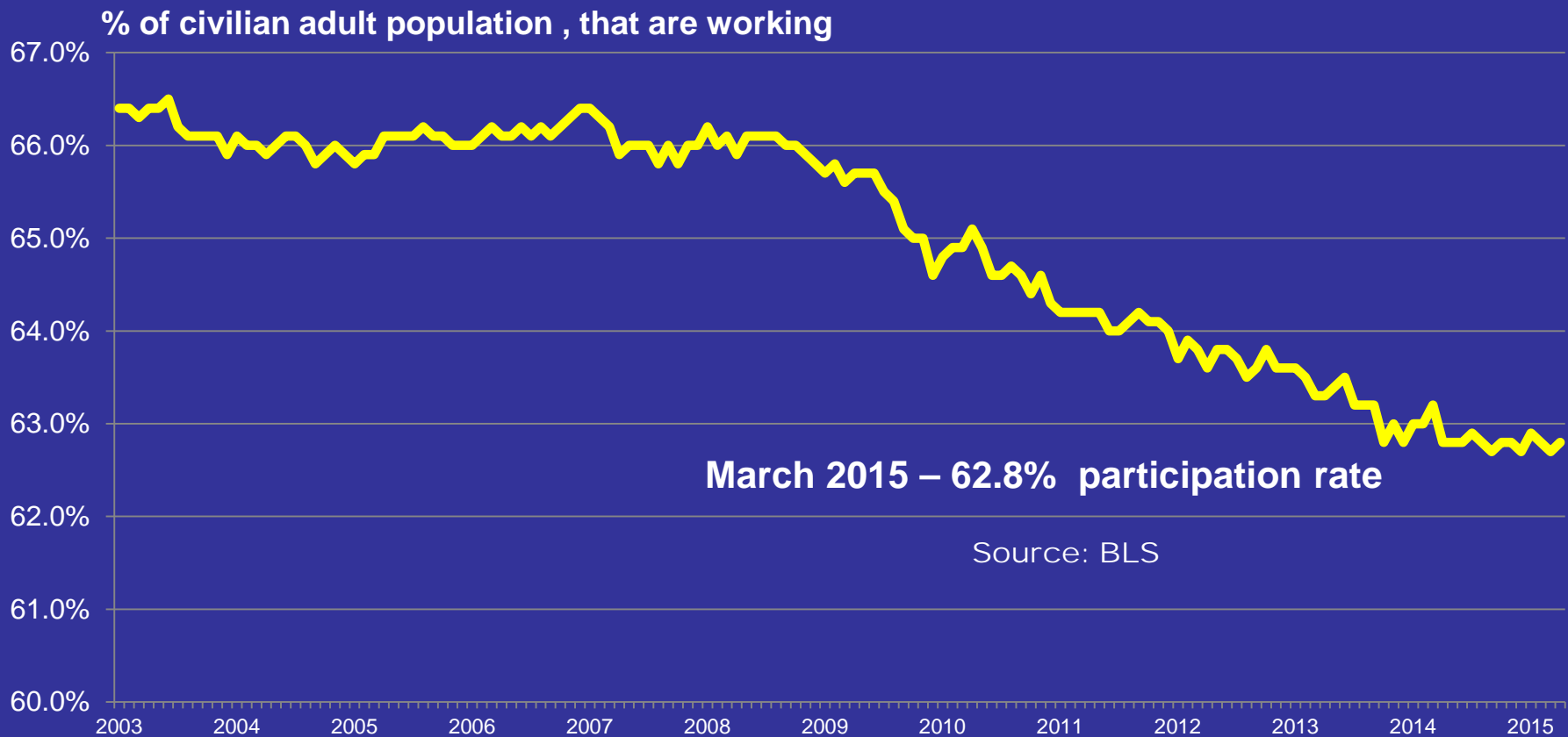


Yes, unemployment rate is now below 6%, but income growth is missing (yes, it is starting to pick up, but very slowly). E.g., inflation Adjusted income today is the same as it was twenty years ago. I.e., There has been no improvement in median family income over the Past two decades. That's why many people believe we are still in a recession, and consumer confidence remains relatively weak.

Just a reminder -----

consumer spending is 70% of the economy, and without real income growth, spending can't grow very fast!!

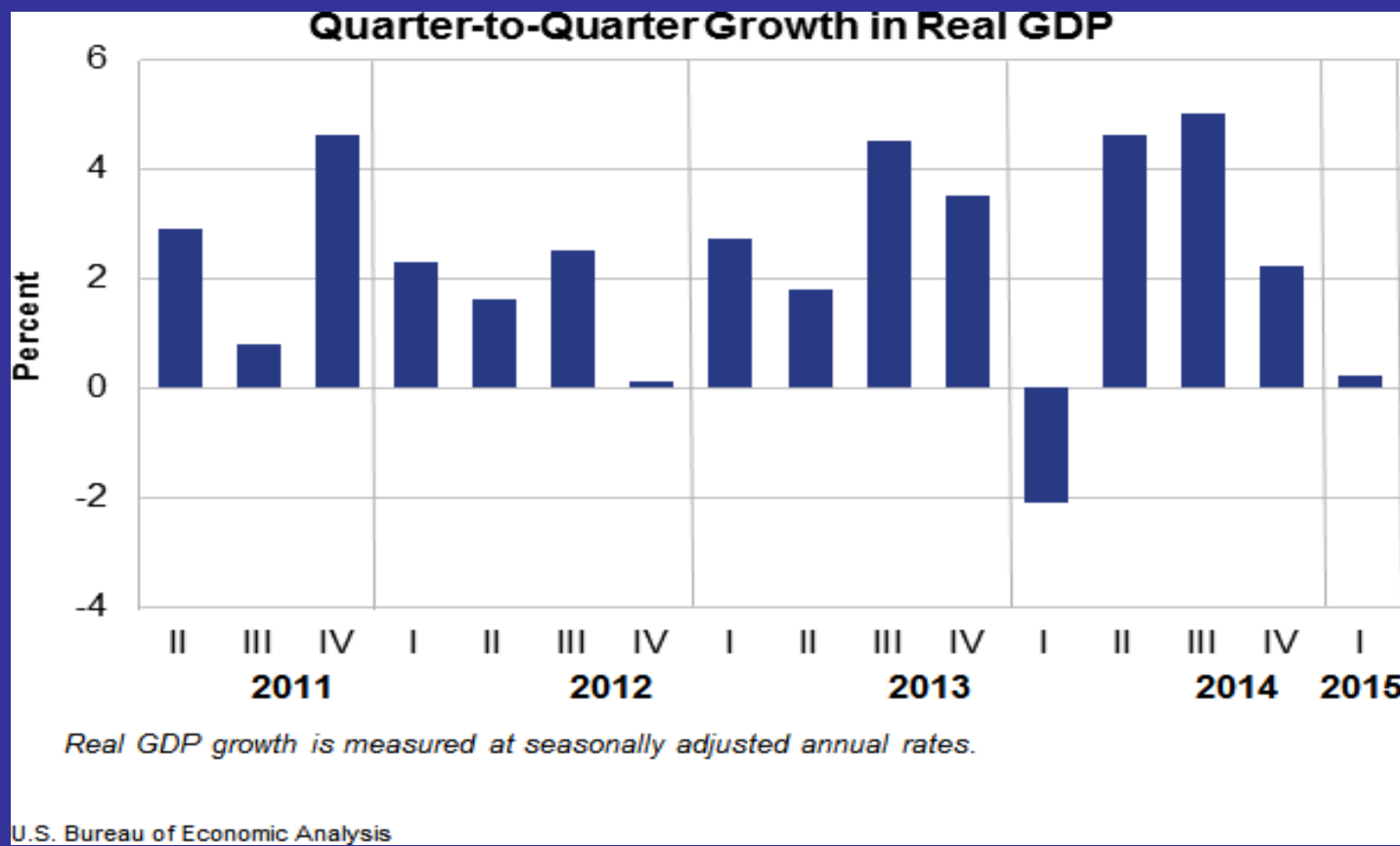
Labor force participation rate is shrinking – demographics is probably the main reason – we'll see skilled labor shortages increase over the next decade - we're already seeing construction related shortages with brick layers, masons, electricians, plumbers, etc. Solution – Revamp our education system (a 4 year degree isn't for everyone – 2 year Community colleges, vocational schools, are better fit for many) and we could do a better job with immigration policies too.



Economic growth of 0.2% – 1st Qtr 2015 – may delay FED rate increase

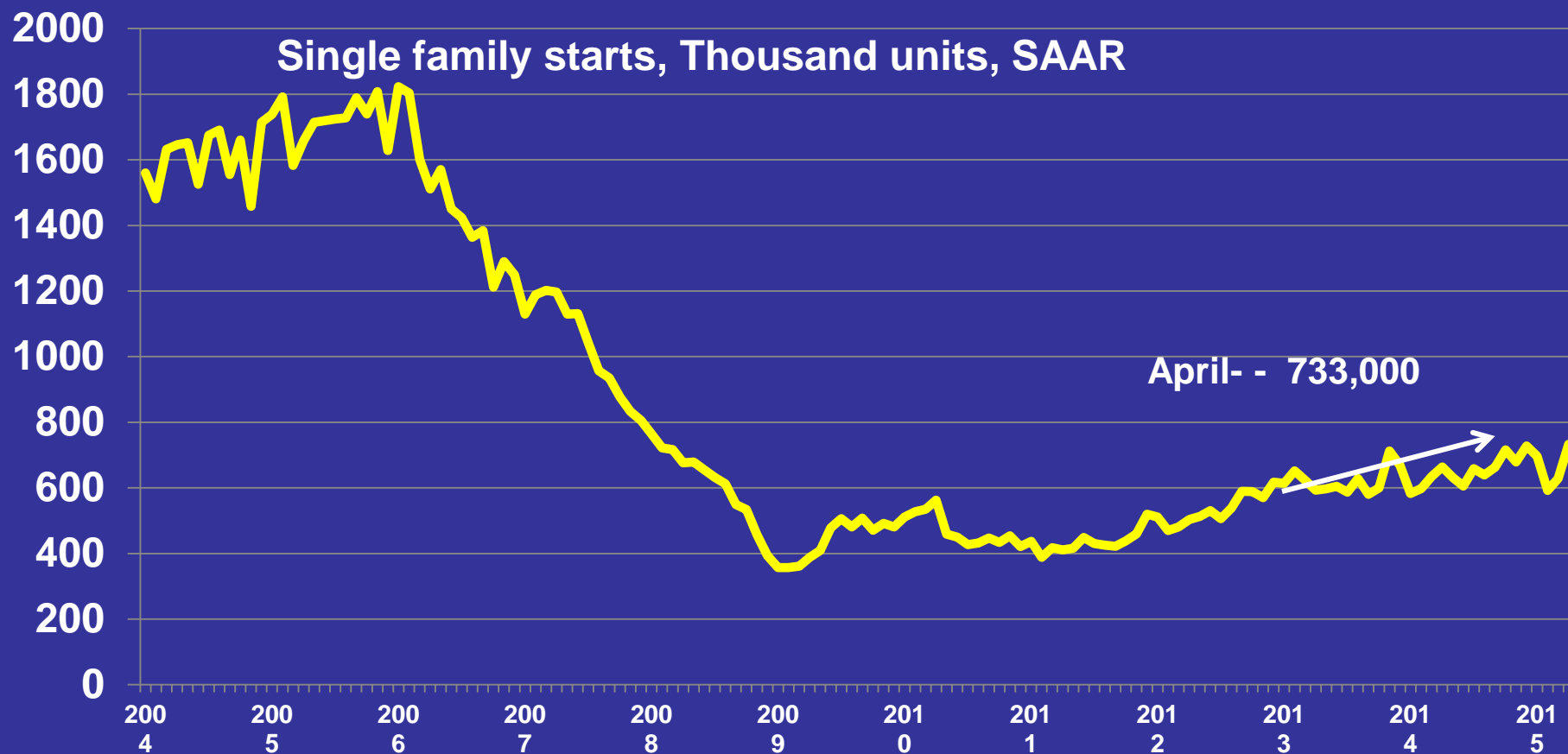
Weather; strong dollar; lower energy prices hurt oil producing states; ...

- (1) Slowing world economy (European recession; weaker China growth)
- (2) Stronger dollar will reduce exports and increase imports – negative impact on manufacturing jobs which is key to income growth in USA
- (3) Political stalemate, terrorism, currency wars, growing national debt, ...



Recent Housing statistics

Starts are inching forward – I'm concerned that the Feds will 'grease the wheels" again – e.g., Fannie and Freddie, FHA --- lowering down payment requirements and premiums on mortgage insurance, I guess they forgot what happened in 2008????



Source: Census (<http://www.census.gov/const/www/newresconstindex.html>)

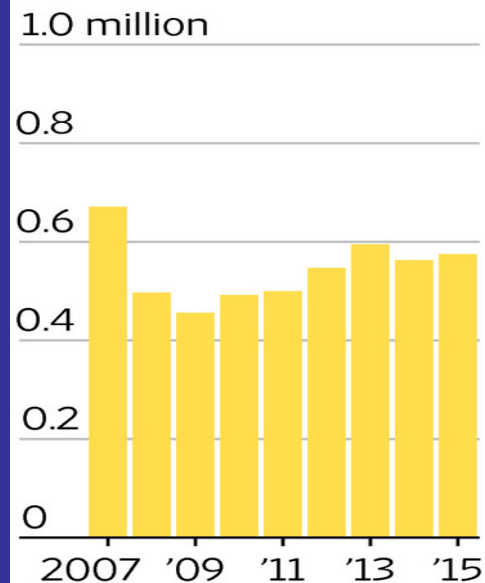
Hopefully, things will improve this year – as the article indicates, Housing is doing best in places where the job market is healthiest. As always, jobs are the key metric to watch, and, a further reminder that Housing is a regional market.

Green Shoots

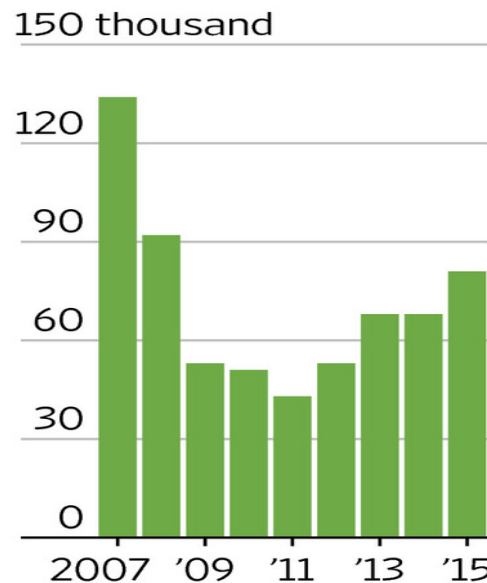
Home sales are up across the board for the first two months of 2015, compared to 2014's weaker start.

Housing market status through February of each year

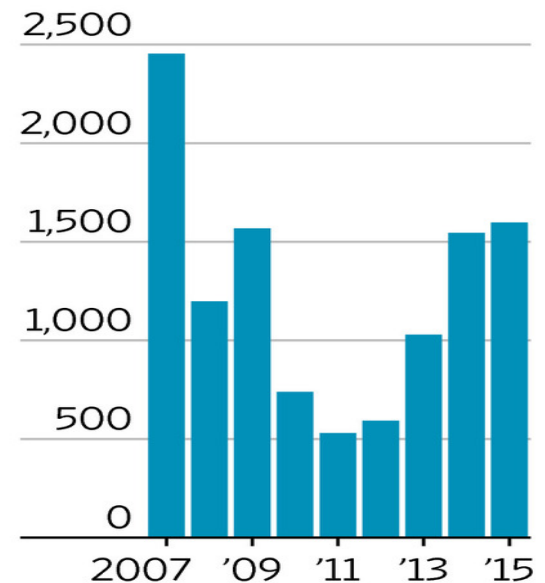
U.S. sales of existing single-family homes



U.S. sales of new single-family homes



Housing permits issued in Jacksonville, Fla.

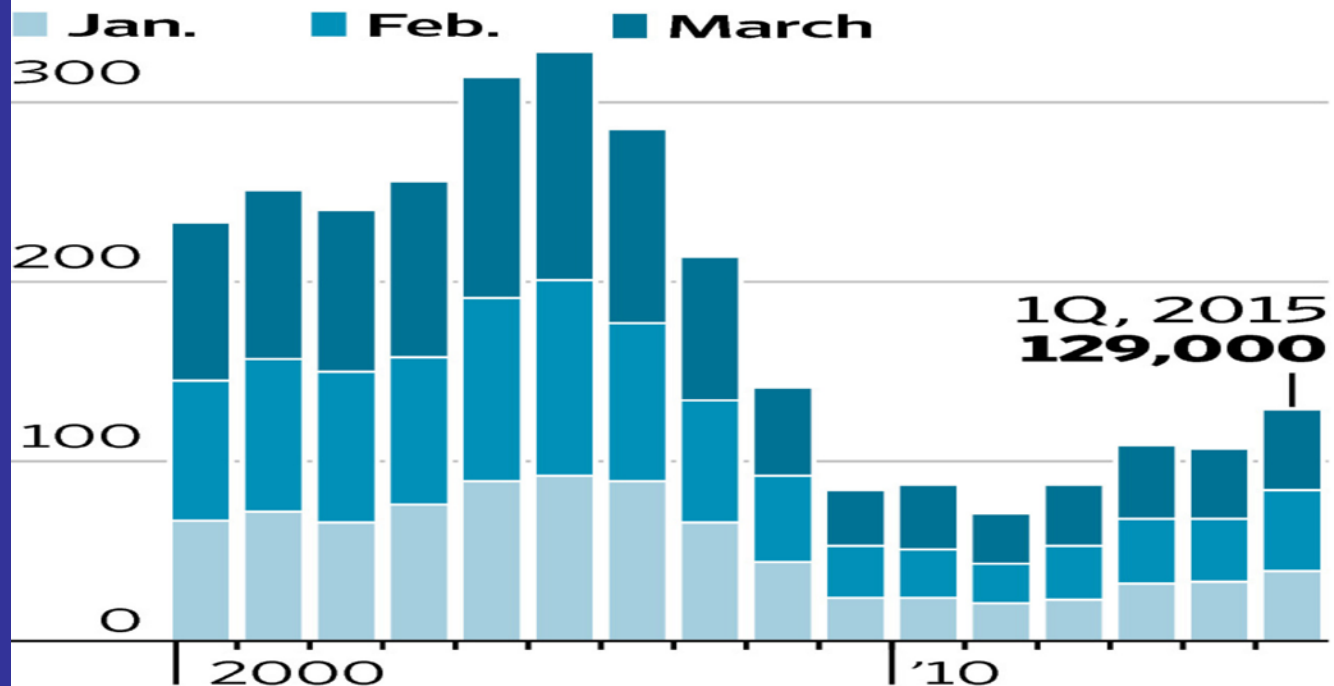


Sources: National Association of Realtors (existing); Commerce Department (new; Jacksonville, Fla.)

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Spring Forward

New single-family homes sold in the first quarter of each year, in thousands of units



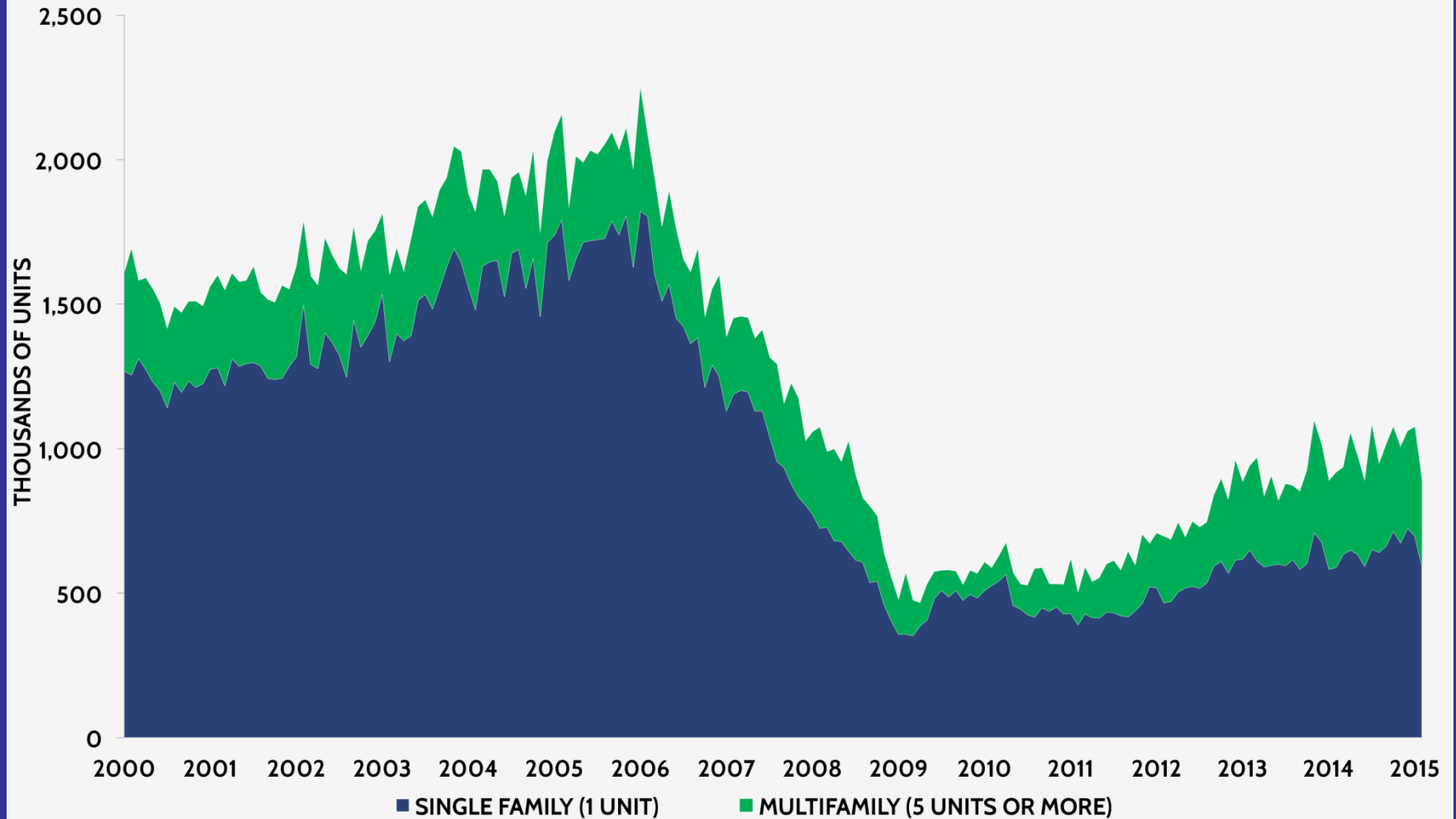
Note: Not seasonally adjusted

Source: Census Bureau

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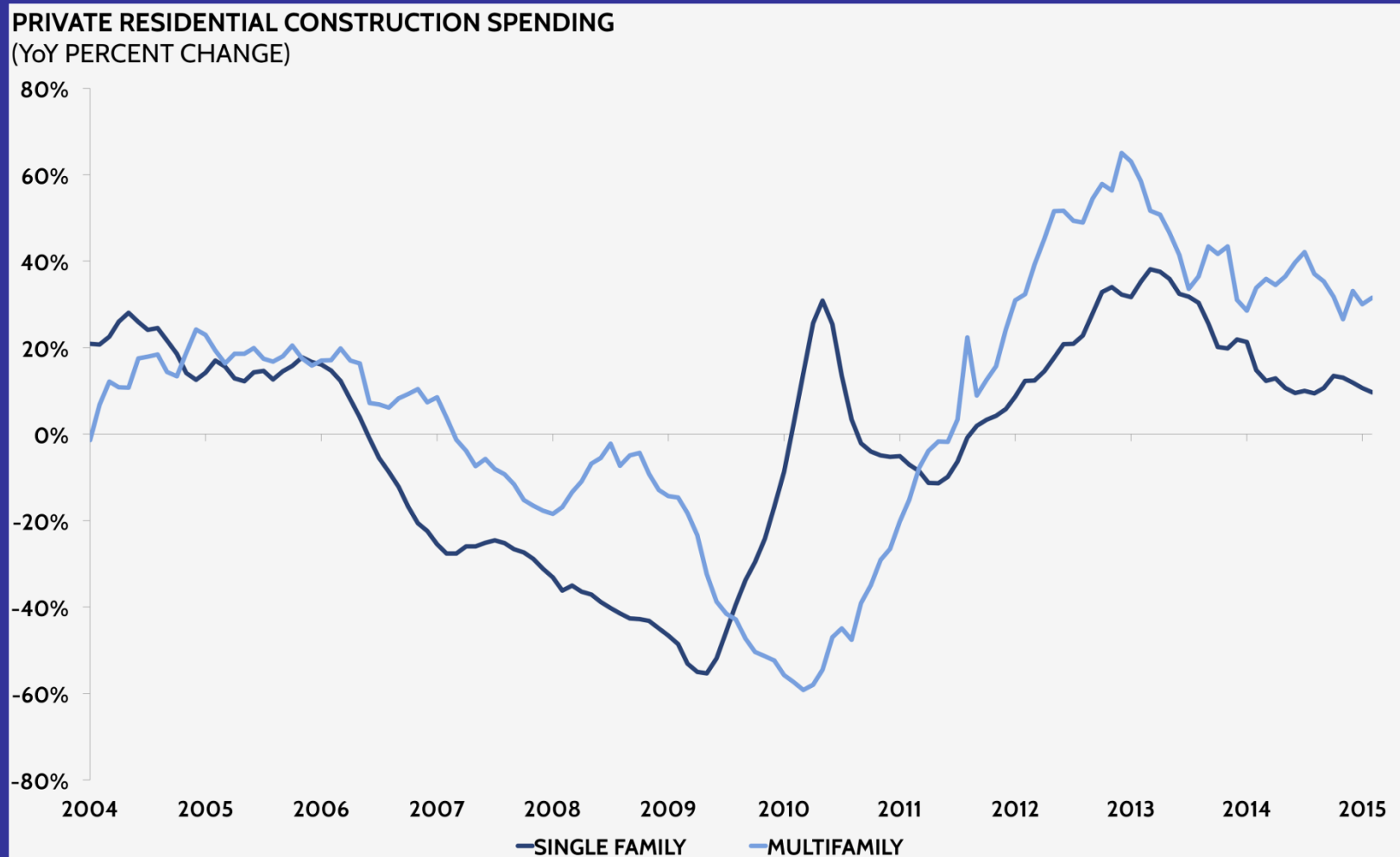
Things are improving

HOUSING STARTS
(SEASONALLY ADJUSTED)



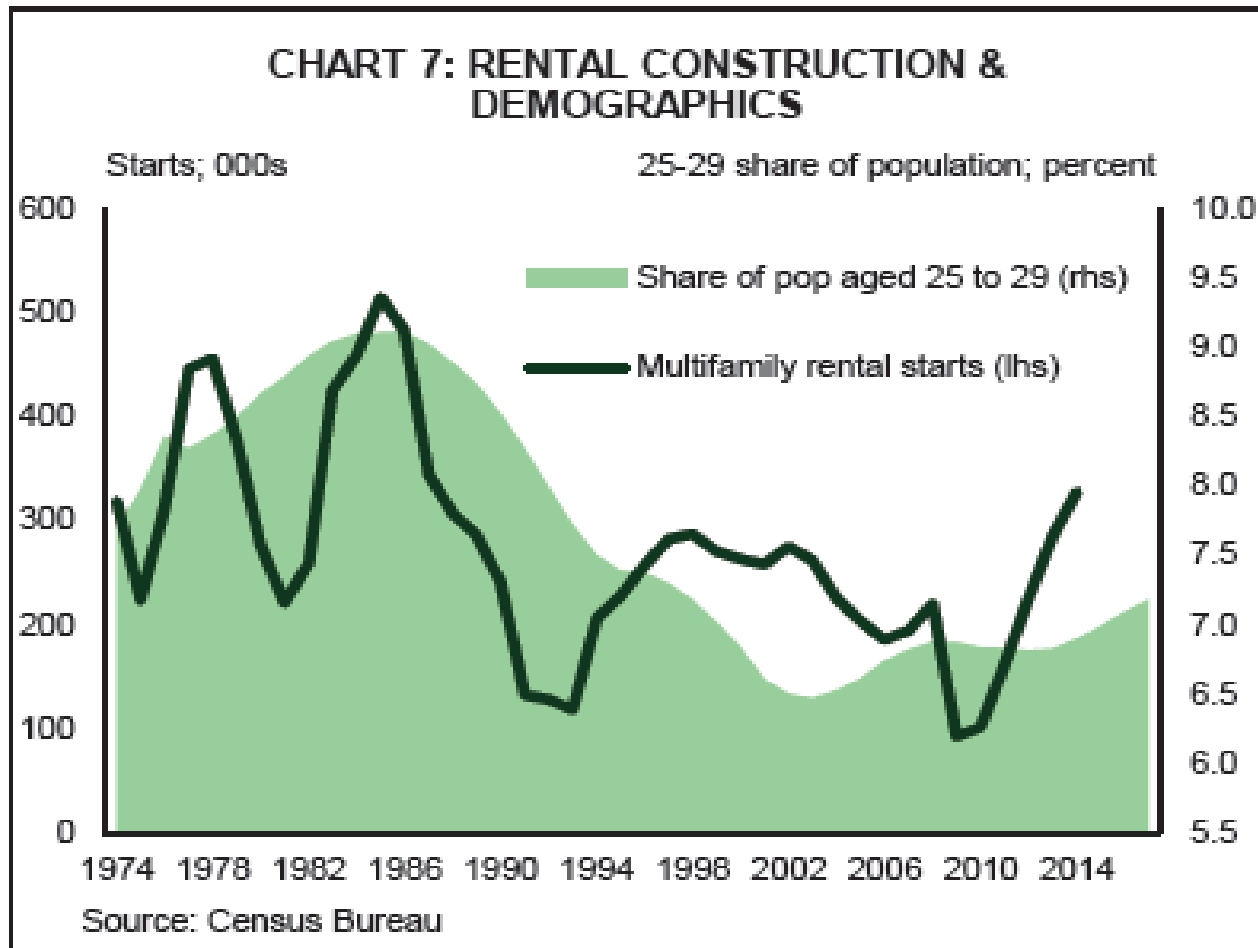
Source: (<http://americanactionforum.org/housing-chartbook>)

But, Spending on MF increasing much faster than SF

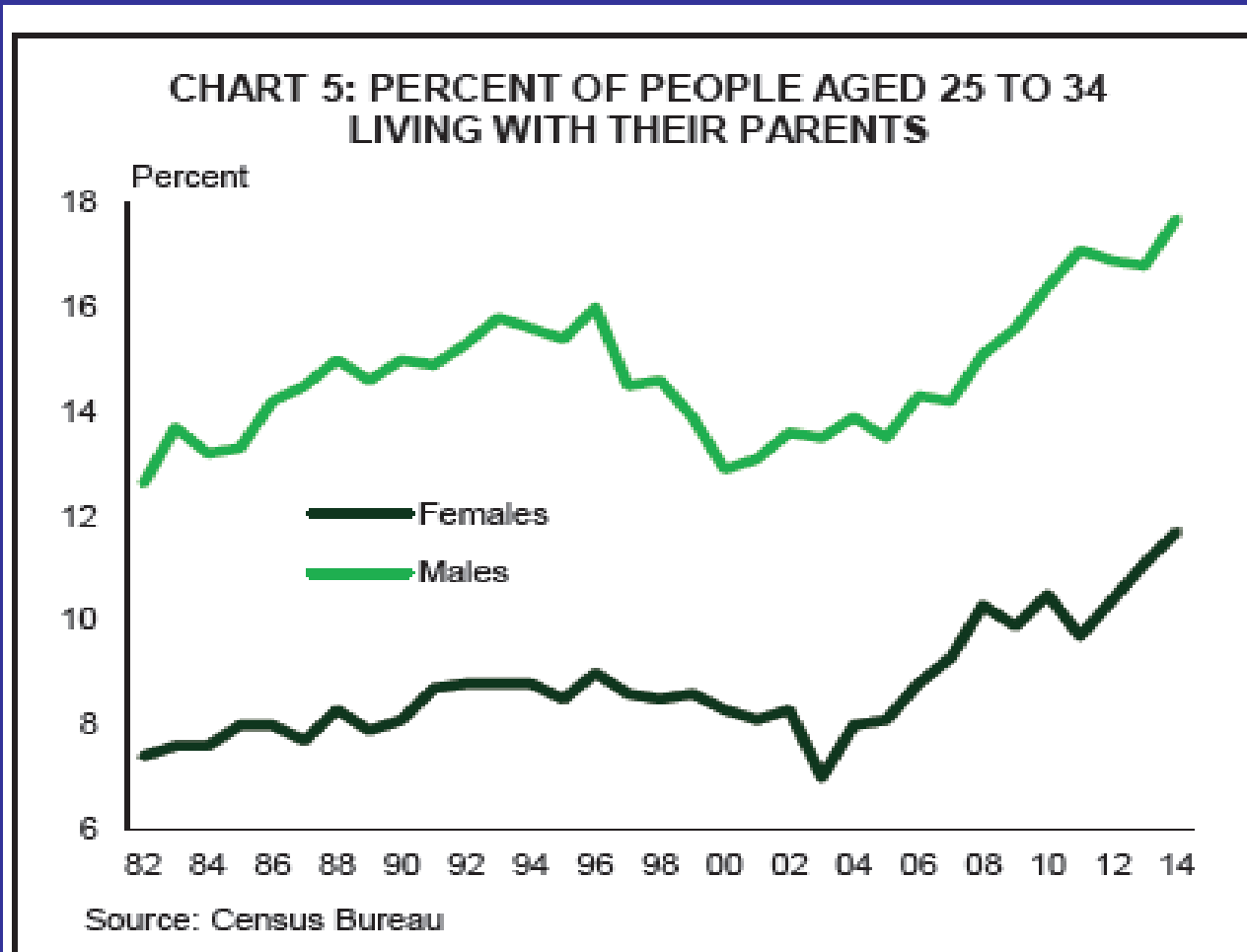


Source: (<http://americanactionforum.org/housing-chartbook>)

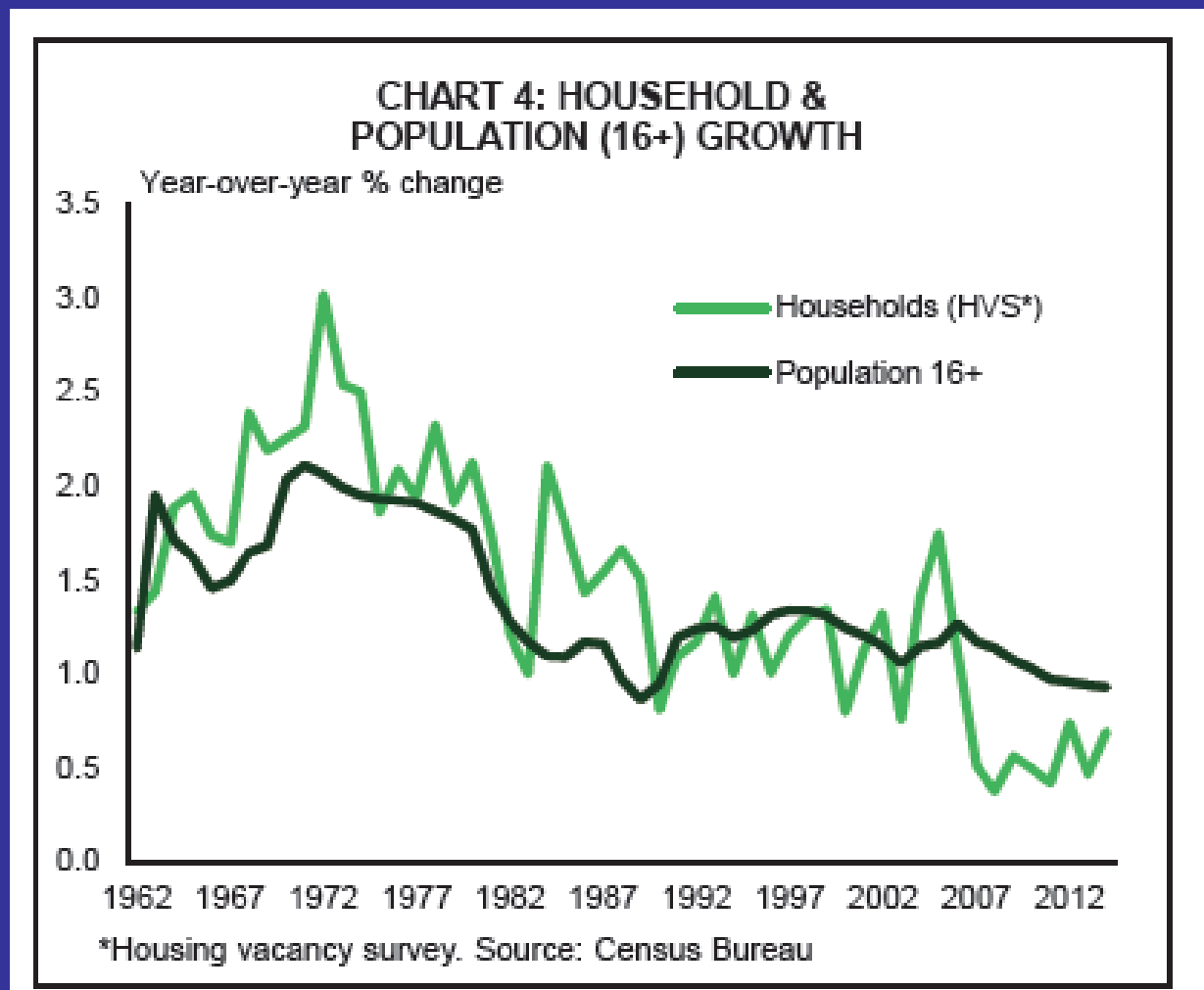
Many young people can't find good jobs – so, they rent instead of Buying a house



Many children still living with parents thus slowing Household formations



Slower rate of household formation will constrain single family housing Starts



Impact of weak household formations - -

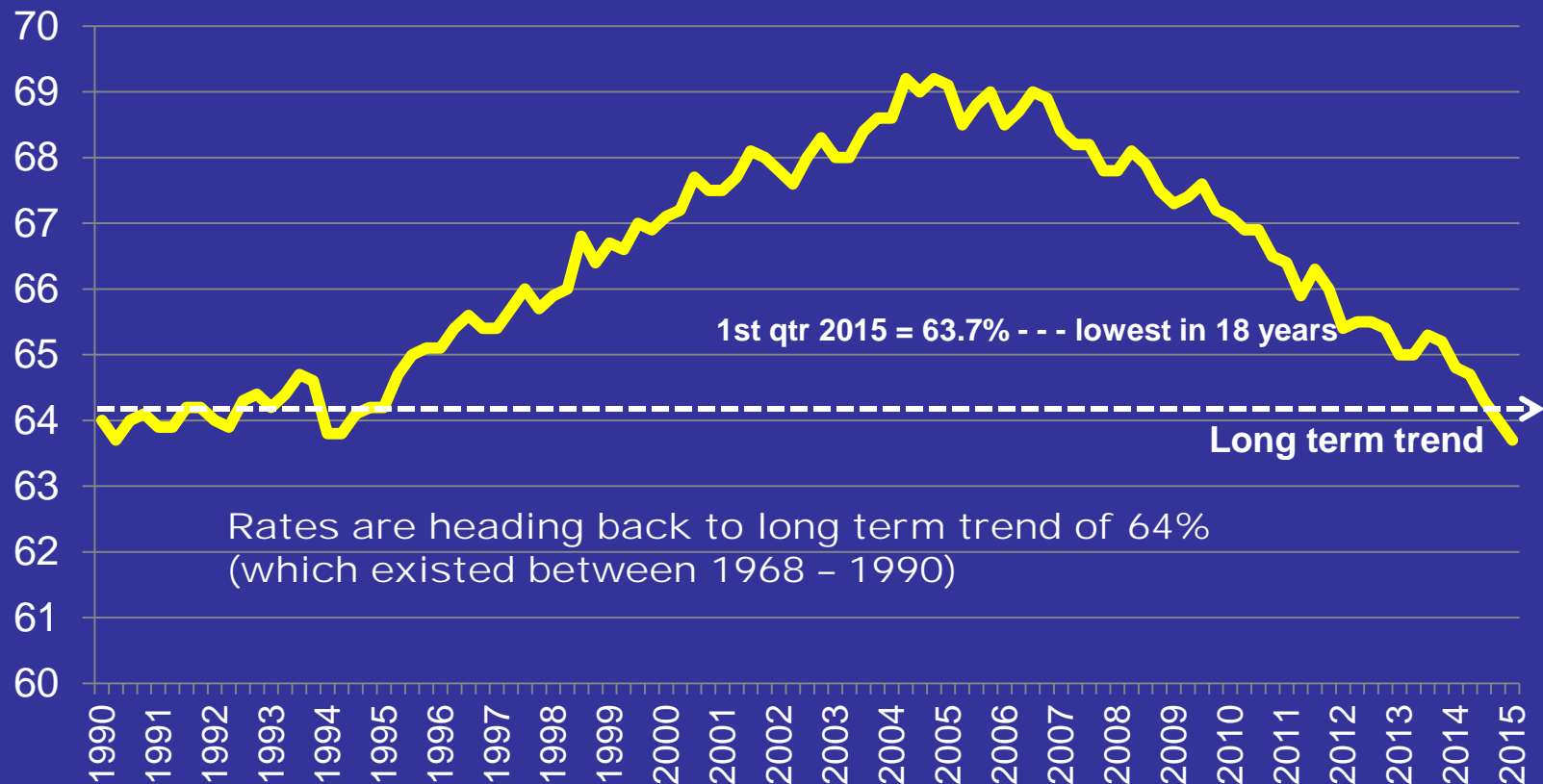
homeownership rates have been falling for the past ten

Years - when the economy gets back to normal,

Will people return to single family or will we see more renting?

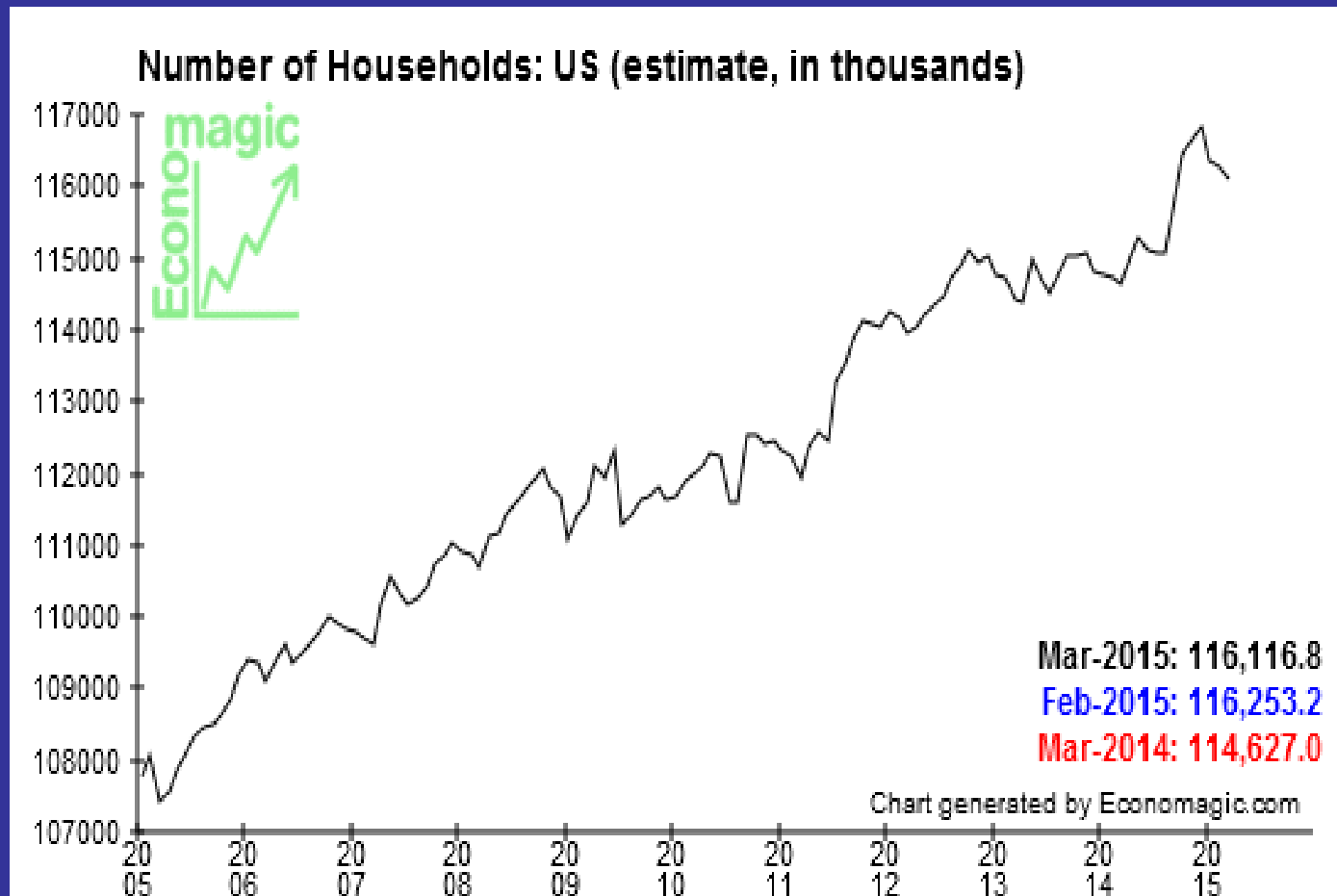
There will be impacts on wood products demand

Home Ownership(%)



Source: Census (<https://www.census.gov/housing/hvs/data/q413ind.html>)

However, number of households keeps increasing - this is a good sign as Number of households represent renters plus homeowners – even Though renters have been increasing faster than owners in past several Years, eventually many of these renters become owners - so, maybe a “light At the end of the tunnel”???



New Single Family Home sales are the key statistic to watch – Sales drive housing starts – this drives demand for wood products!!!

11.4% below revised February rate, but
Almost 20% above March last year



Source: Census (<http://www.census.gov/const/www/newressalesindex.html>)

Resale market continues to improve, but still heavy to cash sales with 1st time buyers still below trend (traditionally they represent about 40 – 45% of market, but today they are at 30%). Another problem today is tight Supply , currently at 4.7 months. Healthy market is about 6 months supply. This Is driving up prices, currently up 6.2% YOY

Single family (incl condos), Monthly, Thousand units, SAAR



Source: NAR (<http://www.realtor.org/research>)

Some conclusions – housing continues to improve albeit slowly

- (1) Economy will continue to improve -- **2015 growth expected to be about 2.5% - however, looks like the "disconnect between the economy and housing will continue ("two tiered economy"???)**
- (2) Still not a healthy housing market - 1st time buyers are absent and household formations are off 50% from trend – furthermore, many of sales are cash, many foreign buyers, etc. I.e., **NOT SUSTAINABLE**
- (3) The key to a recovery in housing is the return of 1st time buyers, traditionally about 40- 45% of the market. Current market skewed to cash buyers and investors. 1st time buyers are mostly young people, **but they can't find good jobs.**
- (4) Political discourse will continue to slow a truly strong economic and housing recovery – too much uncertainty re: Affordable Care Act/Obama care; immigration reform; interest rates Uncertainty will slow job creation, private sector investment. E.g., capital spending lagging in this recovery

Longer term:

- (1) *makeup of U.S. economy is changing and this is impacting spending patterns and housing choices.***
- (2) *There are growing concerns that the job market is undergoing long term – structural – changes. Automation seems to be reducing job prospects for the middle class while creating jobs for the highly skilled and less skilled sectors . End result is stagnating family incomes that could translate to lower total housing demand with more emphasis on multi family/rental demand.***
- (3) *Currency devaluations seem to be the preferred solution to “low inflation” concerns central banks in Europe and Japan are following the U.S. with quantitative easing/printing money, in order to spur demand by weakening their currencies. Good article in WSJ suggesting that the “low inflation world” is really a symptom of too much capacity relative to demand, and the solution isn’t currency devaluation. Better solution may be developing technology to produce products that fulfill market place demands not being met by existing products***

- (5) Growing problem in world economy is that USA is only major economy doing relatively well. Europe in slow growth; China slowing from previous highs (but still good); And we now have more countries devaluing their currencies to promote exports /economy. This will impact the U.S. recovery as a higher U.S. dollar dampens exports and weakens key manufacturing sector.
- (6) One more comment on housing – usually, housing leads an economic recovery (after recessions) – but, this time it is not happening. A stronger economy will be needed to get the housing market back on track. That's hard to accomplish because housing is almost 20% of the economy (direct investment plus services, etc.).