Rebounds and Reversals: Construction and the Fed

Declining interest rates through the first half of 2019 bolstered housing demand. After a period of somewhat elevated inventories of newly built single-family homes, market conditions are now supporting a rebound in home building. The NAHB/Wells Fargo Housing Market Index has posted consistent gains, and is registering a positive reading of 68 — the highest since last fall.

Consequently, the rate of single-family permits has increased since April, and single-family housing starts have expanded since May. August’s annual rate of single-family starts (919,000) was the second highest since the Great Recession. Nonetheless, due to the declines at the start of the year, total single-family starts remain 2.7% lower on a year-to-date basis, and are on pace to close out the year below the 2018 totals.

As the rest of the economy grapples with slowing prospects, the Federal Reserve continued its gradual pivot to a more dovish policy stance, reducing the Federal Funds rate by 25 basis points in September. This action reverses half of the interest rate tightening it undertook in 2018, which is an admission by the Fed that the prior policy path was too aggressive and threatened an economic downturn.

While the policy reversal is positive for home building, there are signs that short-term credit market conditions are under additional stress, requiring further action by the Fed to ensure liquidity. This is not a cause of immediate concern for the overall economy, but short-term interest rates will be closely monitored in the months ahead. For example, while mortgage interest rates declined over much of 2019, interest rates on builder and land developer loans have remained somewhat elevated.

Overall, current economic conditions are consistent with NAHB’s forecast of slowing growth over the next few quarters. During this period, job growth will continue but trend lower, although income gains will be a positive factor for housing demand. The Fed’s ongoing dovish position will support this slow growth economy over the near term.

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