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United States Equity Markets

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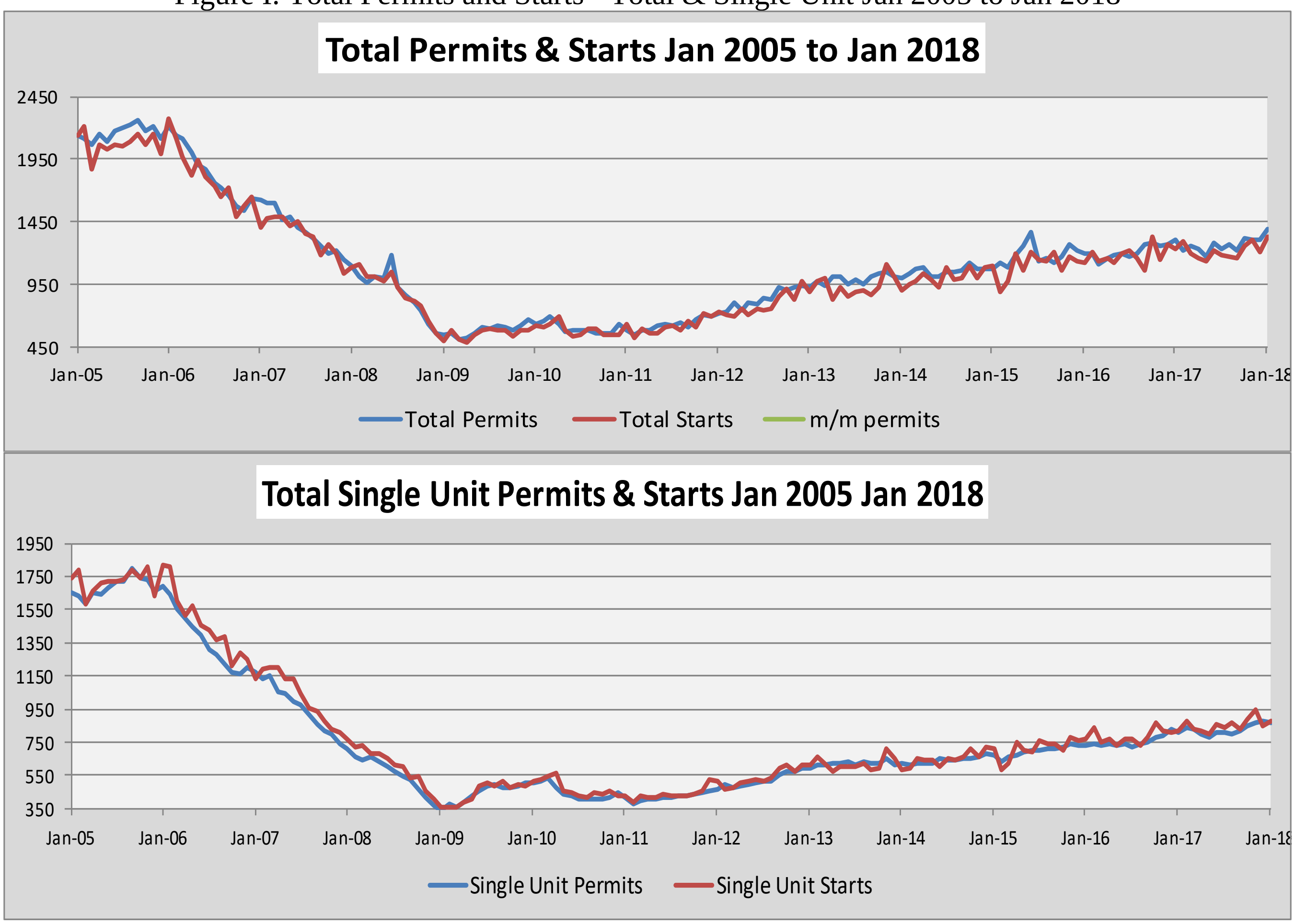
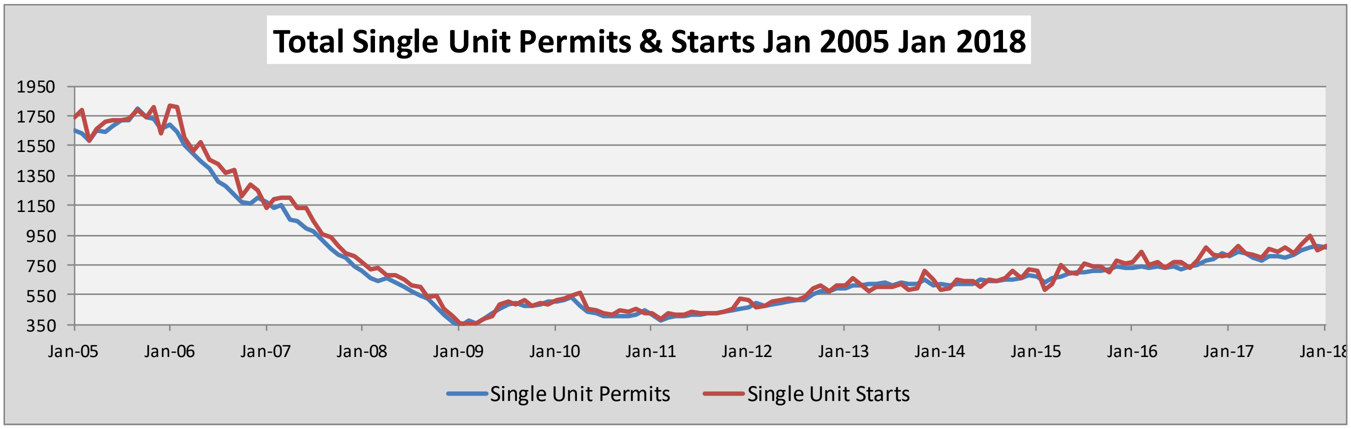
Housing data excellent permits up 7.4% starts up 9.7% - Bank lending improving slightly - Higher rates may not derail housing – permit report contradicts terrible retail sales building materials report

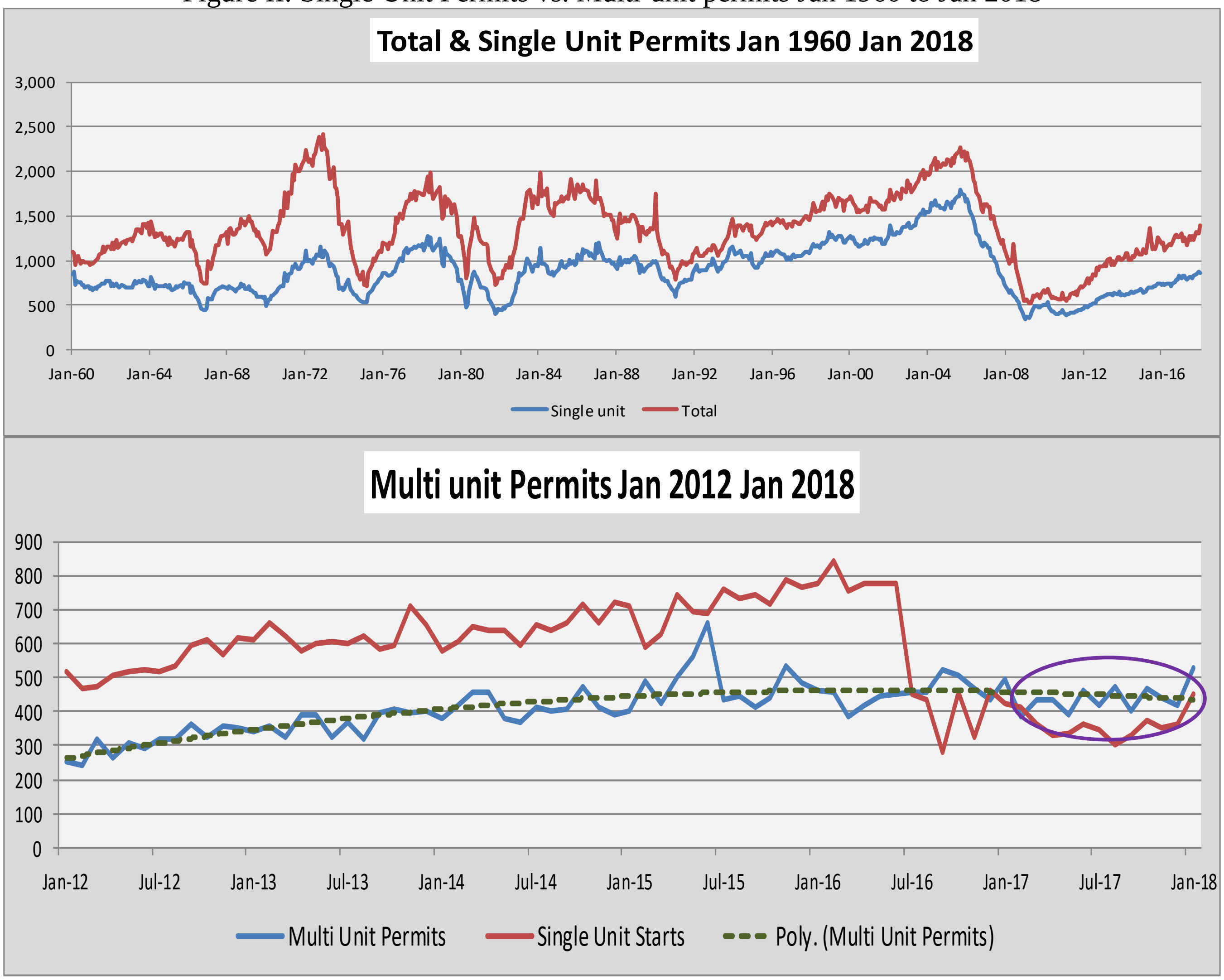
Figure I: Total Permits and Starts - Total & Single Unit Jan 2005 to Jan 2018

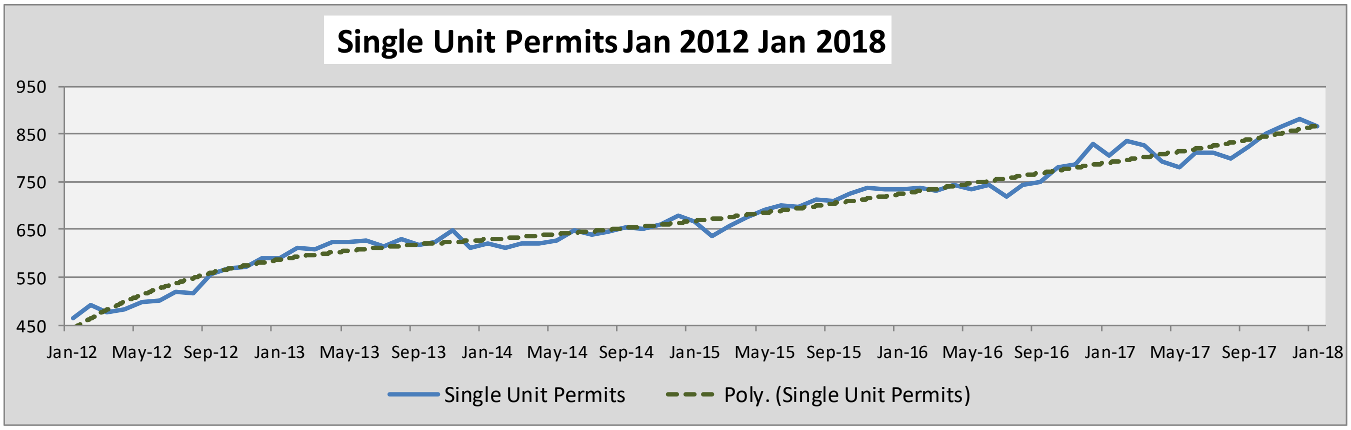




Source: Department of Commerce, SISR

Figure II: Single Unit Permits vs. Multi-unit permits Jan 1960 to Jan 2018





Source: Department of Commerce, SISR

Key Points

- This morning the Department of Commerce reported on **Permits & Starts** for Jan 2018, and the headline data was much stronger than expected with: permits up 7.4% m/m and up 7.4% y/y. Starts were also strong at up 9.7% and now up 7.3% y/y.
- The central question from this report is where will interest rate go in 2018 and 2019 and how will it affect the housing sector.
- The retail sales report from earlier this week was terrible with respect to building materials where building materials turned out to be the worst sector m/m on the entire retail sales report.
- This report was completely in conflict with the building material sales data

Interest Rate outlook for 2018 to 2019

Since the beginning of the year 2018 interest rates have been up about 40 basis points and the central question is will these higher rates slow the housing sector. Historically unless rates get way ahead of income growth, the higher rates should not derail the housing sector. Since the recent spike in rates we have argued that the markets will initially believe that the long rates will likely go higher caused by the large expected deficits, but within several months it likely will succumb to currency influences and a blowing out of the current account deficit, causing a repeat of the 2003 to 2007 Greenspan conundrum and the Bernanke global saving glut phenomena. We have recently argued that the saving glut phenomenon may outweigh the high debt to high interest rate effect, and that by year end interest rate will be close to 2.6% basically where they were last month, prior to the correction.

Bank Lending Stabilizing & possibly improving slightly

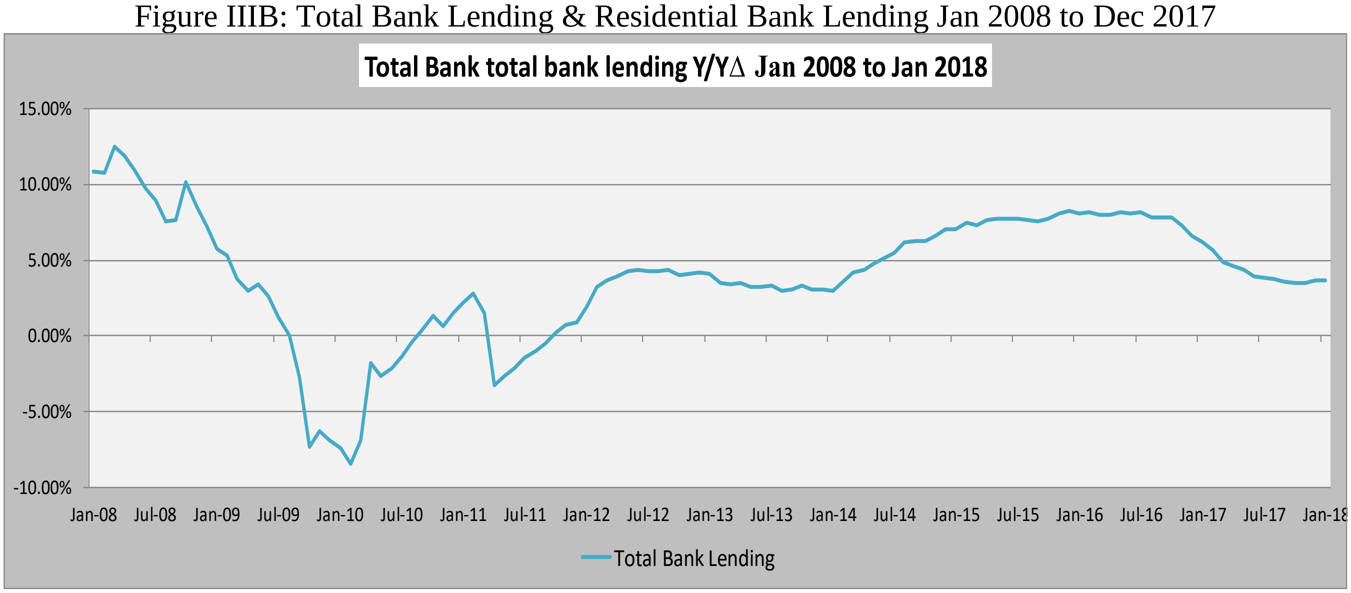
For the past year we have been highlighting that y/y bank lending percentage change rates have been declining. All through 2017 these rates of annual change have been falling to very low level of growth, especially C&I loans down to less than 1% y/y growth, now at 1.2%. Total residential loans are now growing at 4.1% up from the low of 3.6% in October 2017. Total lending has also improved a bit from 3.5% in October to 3.7% currently. Over the past couple of months bank lending has stabilized somewhat and is no longer declining. This is a very positive indicator even though interest rates are currently higher.

Figure IIIA: Bank Lending Table Y/YΔ Jan 2015 to Dec 2017

Total Bank Lending by Subgroup Y/YΔ					
Date	Total Bank Lending	Total Real Estate loans	Residential Real Estate Loans	Commercial Real estate Loans	Commercial & Industrial Loans
Jan-15	7.34%	3.02%	1.03%	7.12%	12.63%
Feb-15	8.00%	3.19%	1.34%	7.12%	12.78%
Mar-15	7.71%	3.51%	1.71%	7.42%	11.42%
Apr-15	7.87%	4.07%	2.04%	8.44%	11.98%
May-15	8.04%	3.91%	1.95%	8.20%	11.46%
Jun-15	7.75%	3.96%	1.98%	8.29%	11.56%
Jul-15	7.60%	3.97%	1.93%	8.46%	11.81%
Aug-15	7.72%	4.20%	2.05%	8.89%	11.18%
Sep-15	7.56%	4.32%	2.08%	9.13%	10.80%
Oct-15	7.60%	4.68%	2.41%	9.65%	10.46%
Nov-15	7.97%	5.15%	3.09%	10.09%	11.07%
Dec-15	7.92%	5.89%	4.59%	10.23%	10.87%
Jan-16	7.89%	6.43%	4.77%	11.24%	9.67%
Feb-16	8.06%	6.53%	4.94%	11.30%	10.07%
Mar-16	7.83%	6.26%	4.83%	10.79%	10.34%
Apr-16	7.68%	6.46%	4.83%	11.23%	10.67%
May-16	7.95%	6.92%	5.55%	11.53%	10.49%
Jun-16	7.95%	6.99%	5.51%	11.63%	9.66%
Jul-16	7.97%	7.24%	6.15%	11.51%	9.58%
Aug-16	7.84%	7.37%	6.54%	11.38%	8.53%
Sep-16	7.92%	7.39%	6.83%	11.15%	8.98%
Oct-16	7.69%	7.55%	7.32%	11.09%	9.03%
Nov-16	7.13%	6.88%	6.06%	10.90%	8.15%
Dec-16	6.47%	6.41%	5.87%	10.15%	7.30%
Jan-17	5.69%	6.25%	5.78%	9.86%	6.58%
Feb-17	4.94%	5.68%	4.96%	9.42%	5.22%
Mar-17	4.84%	5.28%	4.24%	9.17%	3.12%
Apr-17	4.64%	5.22%	4.23%	9.00%	2.71%
May-17	4.34%	4.93%	3.96%	8.59%	2.17%
Jun-17	3.96%	4.64%	3.84%	8.07%	2.14%
Jul-17	3.83%	4.47%	3.78%	7.72%	1.84%
Aug-17	3.78%	4.13%	3.44%	7.31%	2.31%
Sep-17	3.57%	3.81%	3.46%	6.54%	1.93%
Oct-17	3.51%	3.78%	3.61%	6.28%	1.26%
Nov-17	3.48%	3.71%	3.67%	6.04%	0.88%
Dec-17	3.65%	3.73%	3.83%	5.83%	1.11%
Jan-17	3.67%	3.60%	4.08%	5.32%	1.21%

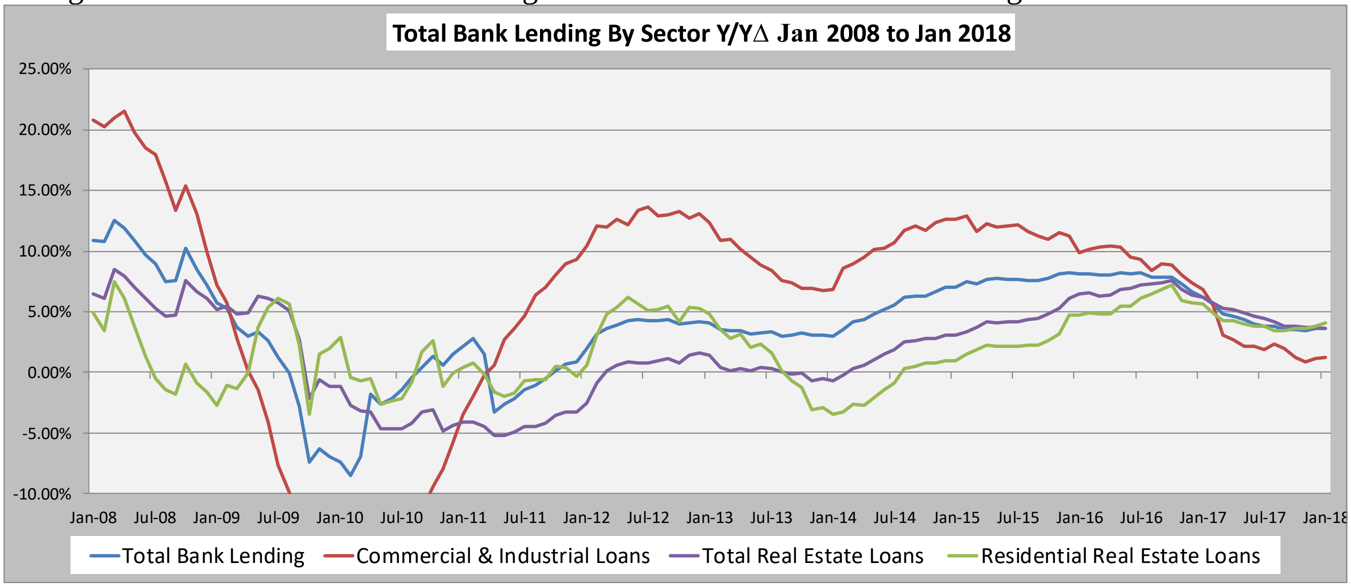
Source: Federal Reserve, SISR

Figure IIIB: Total Bank Lending & Residential Bank Lending Jan 2008 to Dec 2017



Source: Federal Reserve, SISR

Figure IIIC: Total Real Estate Lending - Commercial & Residential Lending Jan 2008 to Dec 2017



Source: Federal Reserve, SISR

Since the recession, the Fed had been helping the housing and auto sectors, by keeping interest rates near zero. By keeping rates low the Fed had been able to stimulate growth in the residential lending space as well as the auto sector. Since October 2016 the y/y rate of lending growth has essentially stalled, but in the last few months despite slightly higher rates, bank lending has been improving. The key issue going forward is what effect higher interest rates will have on the housing sector and will the conventional expectation of higher government debt lead to higher interest rates or will our argument following the global saving glut argument from 2003 to 2007 mitigate this increase in rates.

Summary

The Central question going forward, will be: will higher interest rate slow down the housing sector and will rates rise because of higher government debt: or will the global saving glut phenomenon again mitigate the expected rise in rates, Greenspan's conundrum? Earlier this week the retail sales report was terrible for auto's and building materials both interest rate sensitive sectors. This building permit report was much better and contradicted that retail sales report. Essentially, we more time before we could say definitively, how much higher interest rates will impact the housing sector.

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Price Chart:

A price chart, with changes of ratings and price targets in prior periods, is included above, for all securities covered in this report.

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