Jerry Howard:

Welcome to Housing Development. I'm Jerry Howard.

Jim Tobin:

I'm Jim Tobin. Well Happy New Year and a belated Merry Christmas.

Jerry Howard:

Same to you and your family, Jim. I trust you had a great time. My family and I went to Vermont as is our tradition, where the kids continued to demonstrate that they are in fact on the athletic upswing while I may not be. They ski rings around me to the point where I think I've about put my skis away for the last time. My dad always told me, "If at first you don't succeed, try again. Then if you don't succeed, give it up. There's no sense in making a damn fool out of yourself." So I think I've reached that point.

Jim Tobin:

Yeah. That's why I remember my dad telling me, "Remember, if you can't be an athlete, be an athletic supporter." Glad you had a great Christmas break. Well deserved. I know you and I both received a lot of calls from our members over the break about supply chain issues. I know we're looking forward to having our guests on today to talk economics of not only the supply chain, but of the housing market moving forward.

Jerry Howard:

Yeah. The politics of the supply chain are getting more and more frustrating for you, I know, and for me as well. The fact that the lumber industry barely increased their production this past year is appalling, and to me is evidence of people who are more concerned about their own individual greed than the good of the nation. We've really got to get something done on that. We're going to have, I think, make a big splash on the supply chain issue when we get to the IBS.

Jim Tobin:

Yeah. Agreed. Again, it's the number one issue. Supply chain is obviously a major factor. Doors, windows, appliances, building materials, but lumber, once again, we're seeing a almost unconscionable increase in lumber prices especially when housing demand hasn't waned at all this year. It seems like the lumber industry would match our demand in order to meet supply.

Jerry Howard:

You know, if it weren't so sad, it would be laughable that the president this week said in reference to the production of meat in the United States that capitalism without competition is exploitation. I wonder if he's looked at the lumber markets anytime recently. It's just, he pays attention to the areas that he wants to and seems not to in the other areas. We've got to force the president and the Congress to understand that we are, and Rob can tell us, 15, 12, whatever it is, percent of GDP. And if we aren't working, nobody's working. They need to pay attention.

Jim Tobin:

Yeah. Agreed. Agreed. Yeah. I like a steak just as much as the next guy, but we've got to be looking at bigger sectors than, than just beef production.

Jerry Howard:

Well, Jim let's turn to our guest, a man who we both know by reputation, although he's rarely around in the office because he travels so much. So a good opportunity to reconnect ourselves with our friend and colleague, the Traveling Wilbury of NAHB, Dr. Rob Dietz. Rob, welcome.

Dr. Rob Dietz:

Thank you very much. It's good to join you guys today.

Jim Tobin:

Hey Rob. There is a certain Jeff Lynne quality about you, I believe.

Jim Tobin:

Not George Harrison or, or Dylan, but definitely a Jeff Lynn quality.

Dr. Rob Dietz:

That's right. The orchestra. Yeah.

Jerry Howard:

Well, Rob, obviously we're starting a new year. There have been some interesting developments aside from the Omicron virus that have impacted the economy. Why don't you start off by just telling our listeners your overall forecast for the economy as a whole and then for housing?

Dr. Rob Dietz:

I think if we look back at 2021, we had a fairly solid year in terms of economic growth, some significant headwinds that we can discuss. But economic growth for last year, probably coming in when final data are tallied, a 5.7% growth rate. Our expectation is that we will continue to see growth in 2022, that growth is going to slow. So we're looking at just around a 4% GDP growth rate next year. So the challenge I think here in 2022 is going to be the factor that builders have faced for quite a while, which is rising inflation pressures. Certainly we've seen it in lumber. We've seen it in other kinds of building material pricing. In terms of the overall aggregates and looking at the inflation data last year, the core PCE measure, this is the federal Reserve's preferred measure of inflation, it's kind of like CPI, was up four and a half percent. And that was ahead of the Fed's forecast.

Dr. Rob Dietz:

Our forecast for 2022 is that that measure is going to be at about 3% rate. This is going to slow somewhat, but it's above the Fed's 2% target. Now, what does that mean? It means that the Fed's going to have to tighten monetary policy. The expectation is that for 2022, we're going to see three fed rate hikes. So about a 75 basis point increase in the federal funds rate and probably three more in 2023. And we're already beginning to see the impacts of that on the bond markets. The 10-year treasury rate is now above 1.7%. We saw Freddie Mac data just today that indicates that the average 30-year fixed rate mortgage is right around 3.2%. That's the highest rate in about 20 months. Obviously historically low interest rates have helped housing demand over the last year, year and a half.

Dr. Rob Dietz:

Our forecast is that we expect the 30-year fixed rate mortgage to continue to rise and likely begin to approach about 3.9% by the end of the year. On the demand side, we're going to face rising rates. Then of course, as you all have discussed and NAHB is working on, we've got a lot of supply side challenges, the top one being building materials and the ongoing skilled labor shortage.

Jerry Howard:

What does that mean, Rob? What's your prediction for overall economic growth?

Dr. Rob Dietz:

So for the overall economy, about a 4% growth rate for 2022. We think the unemployment rate is going to continue to decline. That's in the plus column in terms of the economic outlook. In fact, we're likely to see about a 3.4% unemployment rate by the end 2022. That would take us back to those really low unemployment rates that we saw at the end of the Trump administration. The federal reserve does want to get there.

Dr. Rob Dietz:

What does that all mean then for housing? Higher interest rates, lower unemployment, solid GDP growth, the expectation is a slight gain for single-family starts. We think an overall level of single-family starts is going to be above 1.1 million that will help reduce some of that housing deficit, not a lot, but some of it. There will be an ongoing tight inventory in the resale market that will continue to support the demand for new construction. We're seeing declining vacancy rates and higher rents in the rental market. That's going to support ongoing growth in the single-family, built-for-rent construction sector, as well as the multi-family sector. In fact, our expectation is that we will see greater than 6% growth in the multi-family industry. And that will likely take us to multi-family starts for 2022, approaching almost a half million for the year.

Jim Tobin:

Rob, going back to the labor market. A lot have been said during COVID about "the Great Resignation." And I think there's the reading that just came out at the beginning of January was something over four million people had changed jobs. Some of the highest reading ever, over 4 million people. Restaurants and movie theaters continue to struggle. They're talking about more pandemic relief potentially for some industries. I know that employment and workforce development's a long term drag on housing. You've been talking about that for years. What is the mechanism that gets us back to these kind of pre-pandemic, almost what and technically full employment looks like, what are the factors that get us there over this year that you see?

Dr. Rob Dietz:

I think we need to be thinking about short run, which is this year, and then as well as long run. So in the short run, it's getting back to normal. It's learning to live with the virus. We've got to keep the schools open, for example. That will help support the labor force participation rate, bring more people into the industry looking for jobs. But, the challenge is a big one. We think we need to add about 740,000 construction workers a year. That's to account for both industry growth, and then in a larger sense retirements from the industry, because we know we've got an aging workforce. Ultimately it's going to require efforts by local associations, state associations, NAHB, HBI, other players in the industry to kind of recruit people into the sector.

Dr. Rob Dietz:

And then from the economics, it's about wage growth in the sector that will attract workers, but that wage growth can only occur when we get productivity gains. So when we're thinking about 2022 and 2023, I think the next two years are really going to see an uptick in productivity in the sector. In other words, these are going to be years of housing innovation, whether it's at IBS or local shows, I think you're going to begin to see products and techniques that will highlight the ability to increase home productivity in the home building and remodeling sectors. And that will be a way that out of the skilled labor shortage.

Jerry Howard:

Rob, I think you hit the nail right on the head with that. I mean, nature abhors a vacuum. There's a vacuum in the labor market that it just hasn't been filled. Despite the best efforts of NAHB and our local associations, along with HBI, there is still a major problem. Immigration could help solve it, but the real key, as you say, is technology. You point out that the next couple years are going to give entrepreneurs a real chance to bring technology into the housing sector. Ironically, or maybe not so ironically, but to that end, the IBS has created the new product zone where we're encouraging young startup companies with technology that'll increase construction productivity to come to the show and show off their product and get them into the mainstream market. I think that's really the key to getting out of this. I completely agree with you, but I want to switch for a second. Everything that you've said, to me, just keeps adding straw to the camels back after straw to the camels back on the issue of affordability that is getting worse and worse and nothing you're telling me makes me feel any better.

Dr. Rob Dietz:

Yeah. Unfortunately, I think that's going to be the big headwind in the housing sector. We're going to see declining housing affordability. When we track it on a quarterly basis through the NAHB Wells Fargo Housing Opportunity Index, that index is currently a level of 57, basically means about 57% of new and existing home sales are affordable for a family right in the middle of the income distribution. That's the lowest reading we've seen in just about a decade. Unfortunately, the expectation with higher construction costs pushing up prices, and rents, as well as higher interest rates, that affordability metric is likely to continue to decline because we're not expecting above-trend income growth, which would be the factor that would offset that.

Dr. Rob Dietz:

So from a policy perspective, thinking about what we all do here in Washington DC, we need to be focusing on fighting inflation and reducing costs. Of course in the housing industry, we know the reduction in costs is about trying to find ways to bring down the price of lumber, increasing the supply of appliances and other kinds of building materials, making sure the transportation network that delivers those supplies to work sites across the country is operating efficiently. Those are the most efficient ways to both fight inflation and protect housing affordability.

Jim Tobin:

Hey, Rob, talk to us a little bit about, you mentioned interest rates. The Fed's are going to start moving interest rates up to combat inflation. You thought maybe we get the mortgage rates about 4% by the end of the year. Talk about, as an industry that is interest rate sensitive, talk about what you see, whether or not... Does that tend to pool the market? Is that going? We saw that in, what, three years ago now, over that summer rate increase. Really froze the recovery in housing for a couple of quarters. Tell me what you think 4% interest rates look like and where we go from there.

Dr. Rob Dietz:

I think that's right. So if you're thinking about as a builder, your prior business experience, think back to 2018. Think back to 2013. In 2013, we had the taper tantrum. That was when the Federal Reserve pulled back purchases of bonds and the bond market went crazy. We saw a quick jump of about 80 basis points and interest rates. 2018 is probably the better simulation here. And as you mentioned, that was when the Federal Reserve increased rates. As we discussed at the time, they were moving too quickly and they had to pull back in 2019, some of that tightening. But nonetheless, if you want to look at how your business fares in a rate tightening environment, take a look at that second half of 2018. That's when mortgage interest rates approached 5%. And as you mentioned, our forecast has mortgage interest rates approaching 4% by the end of the year.

Dr. Rob Dietz:

We think that's roughly a comparable rise because of the fact that home prices right now are 20 to 30% higher. So for that marginal buyer, that first-time perspective buyer, while 4% rate doesn't sound like a lot compared to the early '90s, or let alone the early '80s. For that buyer today and given today's home prices, it really is enough to push out some of the housing demand. The good news is housing demand remains fairly strong. The demographics are in our favor and the inventory of resale homes. In other words, the existing home inventory is less than a three month supply. It's historically low. So the only alternative really is new construction, but there is that kind of push and pull with respect to housing affordability. And I'm afraid that in 2022, we are going to see some of these younger, higher loan, the value buyers priced out of the market. Again, it just reemphasizes the importance of working on policy items that try to find ways to prevent higher construction costs.

Jim Tobin:

Yeah. You know, Rob, maybe one last question. Crystal ball the supply chain. That's the one thing that we all heard from our members over the Christmas break about the supply chain concerns. It's stretched. It's windows, it's doors, it's appliances, all the lumber, obviously those prices are creeping up. Any relief in sight? Do you think the supply chain eases somewhat over this year or does it ease a lot over the year?

Dr. Rob Dietz:

Well, we still have prices going up. So as kind of an aggregate measure of that, the producer price index, which is the business side measure of inflation. In 2021, we think the PPI will be up an incredible 13%. Within that index, of course you have prices of commodities that move a lot faster than that, including lumber. Our forecast for 2022 is that the growth rate will ease, but it'll still be at a 6% rate, which is orders of magnitude higher than what we've seen years prior. So some easing, but you know, it's going to take a lot of policy work on some of these individual items. Whether it's port activities in terms of unloading products faster, making sure there's enough truck drivers and trucking regulations are in place so that industry can operate, and then within lumber, let's not put taxes, that is tariffs, on the lumber market. That's just taxing ourselves. It's increasing the cost of soft wood lumber and it's contributing to inflation through higher rents and higher home prices.

Jim Tobin:

Well, that's, I guess, that's not as bad news, I guess maybe that's not the way to say it.

Jerry Howard:

Rob, what's your... Before we let you go, your last piece of advice to builders as they get ready to go full bore into the new year, how do you advise them to conduct their business?

Dr. Rob Dietz:

I think the readings and builder sentiment are strong to builders across the country are fairly confident about the sector. I think you need to be so somewhat cautious about those higher interest rates. Particularly if you serve a market segment that has a lot of younger home buyers, because it's those kind of buyers. When they see interest rates move from today's 3.2 to closer to 4% and a 30-year fixed-rate mortgage, who may say, "You know what, my monthly payment is now too high and I'm going to pull back my demand, maybe rent a little bit longer." So if you're in the entry-level space, there's a lot of demographic potential for growth, but you want to be in a market where you can control your construction cost. You're not going to face a lot of high regulatory costs.

Dr. Rob Dietz:

And you got to be aware that those buyers are going to be a little more mobile, a little more sensitive to higher interest rates. Overall, I think we got to keep the big picture in mind. We continue to face a housing deficit of at least a million homes in the United States. A multi-family market is going to be strong because vacancy rates continue to fall. In fact, in our forecast, the strongest market we've got is the remodeling sector. Remodeling is going to be up more than 6% here in 2022, we've got an aging housing stock, there's growth and tear down construction, and just about every kind of buyer and renter is looking for more space. So watch your construction costs, be careful with those younger buyers and renters, and of course be active in your local state associations to make sure your voice is heard on all the policy issues that we've discussed today.

Jerry Howard:

And let me add, come to IBS where you'll hear all the latest and greatest, not only building products and materials, but the education sessions will help you be able to compete with your fellow builders on an even playing field. So thanks again, Rob, we're really pleased to have you with us and really proud of the work that you and your team are doing on behalf of our members.

Jim Tobin:

Thanks, Rob.

Dr. Rob Dietz:

Thanks. Thanks guys.

Jerry Howard:

Hey, congratulations. We are no longer a floating entity. I know from our brethren in the blog and in the podcast universe, getting sponsored is certainly a sign of acceptance. I'm very proud that we now have a sponsor. Wells Fargo, which as an organization, not only does so much for our builders in the field, but for NAHB is one our stalwarts in terms of being there for us. And we welcome them to the sponsorship of this podcast, thank them for everything they do, and encourage our listeners to seriously consider

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Jim Tobin:

I hope to see you all at IBS.