

The Housing Slump and Price of Gasoline – Correction or Bust?

by Gary D. Halbert

Short of another major terror attack in the US, the current slump in the housing market represents the greatest near-term threat to the economy. The question is whether the slump is stabilizing or if we are in a full-blown housing bust. Home prices nationally skyrocketed by an average of 111% from 1995 until this summer when prices began to peak, so it should not be a shock that we are seeing a correction. But will it continue? Let's look at the latest numbers.

The good news is, new home sales rose 4.1% in August (better than expected), and the median sales price for new homes nationally remained firm at \$237,000. The bad news is, for the 12 months ended August, new home sales were down 17.4%. The unsold inventory of new homes rose to a 6.6-month supply in August. The drop in sales and the increase in inventory have led to a decline in new home construction, as you would expect. Housing starts nationally were down 3.5% in August and are down 19.8% year-over-year.

Sales of existing homes fell 0.5% in August (less than expected), and existing home sales are down 12.6% year-over-year. However, the National Association of Realtors (NAR) announced on Monday that "pending sales" of existing homes rose a surprising 4.3% in August. Pending sales include homes that are under contract for sale but have not closed yet.

The NAR believes that the increase in new home sales and pending sales of existing homes in August are signs that the slump in home sales is leveling out. That remains to be seen, of course. Last week, the NAR reported that the median sales price for existing homes nationally declined by 1.7% in August to \$225,700. This was the first monthly drop in the median sales price since 1995. The NAR also reported that the inventory of all unsold homes (new and existing) rose to a 7.5-month supply in August, the highest since 1993.

With such a large inventory of unsold homes on the market, many analysts predict that home prices will have to fall further before they bottom. This will almost certainly be true in the softer markets around the country. On the other hand, mortgage interest rates are falling once more, and this is one reason that new home sales and pending sales rebounded in August.

In most areas of the country, home prices have not fallen significantly. As noted above, the median price for existing homes nationally fell 1.7% in August for the first time in 11 years. On a regional basis, the NAR reports that median home prices were down from their peak by only 1.1% in the Midwest, 2.6% in the South and 3.9% in the Northeast, and yet prices in the West were actually up 0.3% on balance in August. **So in most areas of the country, home values have held up quite well, especially given the significant slowdown in home sales.**

Perhaps the best example is California where existing home sales in August suffered the biggest year-over-year drop in nearly 25 years. California sales of existing homes plunged 30.1% in August from the same month last year according to the California Association of Realtors. That was the steepest year-over-year decline since August 1982

when sales tumbled 30.4%. Yet despite the plunge in sales, the California median sales price for existing homes still managed to rise 1.6% in August to \$576,360.

So home prices nationally have held up remarkably well given the sharp decline in sales. But depending on where you live, the figures quoted above may sound far too optimistic since there are certain markets where home prices have declined considerably more than the national averages. The question of whether this is a housing correction or a housing bust may well depend on where you live and whether or not you have to sell your home in the next few months.

At the end of the day, the question of a housing correction versus a housing bust will be decided by the economy. Many forecasters are convinced we are going into a recession just ahead, and therefore they believe that the housing market is headed for a bust. If you believe we are headed into a serious recession, then I think you would be justified in believing that a housing bust will follow.

As you know, it has been my view (and that of The Bank Credit Analyst) that a recession is not the most likely scenario. Likewise, a full-blown housing bust is also not the most likely scenario in my opinion. Yet even though I do not expect a major bust in housing, I do believe that the downward cycle has further to go. It will take months to work down the large unsold inventory of homes, and this suggests that sale prices, on average, will weaken somewhat more, especially in those areas that are already seeing lower prices. But I do not see a bust.

One final point. As noted above, a lot of forecasters are bearish on the economy and therefore the housing market. This includes dozens of investment newsletter editors, hundreds of E-Letter writers, Internet bloggers and wannabe economic gurus. Some have even gone so far as to recommend that you sell your home and rent until this downward cycle is over.

For the record, I have never recommended that readers sell their primary residence and look to repurchase at lower prices, and I do not recommend it today. I have seen far too many cases where people were convinced to sell their homes by the gloom-and-doom crowd that always believes a recession is upon us, only to see home values continue upward over the years. My advice is no different today unless you have a good reason, don't sell your primary residence. If we don't have a recession, home prices could well be higher a year or two from now.

President Bush Manipulates Gasoline Prices?

According to a new Gallup poll, 42% of respondents said they believe the Bush administration controls the price of gasoline. Specifically, 42% of those surveyed said they believe the Bush administration “*deliberately manipulated the price of gasoline*” so that prices would fall significantly going into the November midterm elections. While 53% of respondents did not believe the Bush administration controls the price of oil, I was shocked to see that 42% believe President Bush can manipulate the price of gas. That is ridiculous!

Interestingly, almost two-thirds of those who said they believe President Bush manipulated gas prices lower were registered Democrats, according to Gallup. Somehow, that doesn't surprise me!

For the record, the prices of crude oil and gasoline in the US are set daily at the New York Mercantile Exchange where oil and gasoline futures are traded. This is the ultimate open-outcry free market where prices are set by supply and demand and buyers and sellers of all types. President Bush does not control or manipulate the future markets. One of the main reasons oil and gasoline prices went so high earlier this year was the predictions by many climatologists and meteorologists that the 2006 hurricane season would be one of the worst ever. As you know, hurricanes in the Gulf of Mexico almost always send oil, and therefore gasoline, soaring higher. So hedge funds and speculators loaded up on oil and gas futures, and this was a big contributing factor that sent prices to new record highs by the middle of the year.

But guess what – we’ve had no major hurricanes hit the US or cause any supply disruptions in the Gulf this year, and hurricane season is drawing to a close. Plus, with gasoline prices above \$3 per gallon, people figured out ways to cut back, including curtailing summer travel plans in many cases. As a result, inventories of oil and gasoline started to rise.

Hedge funds and speculators (large and small) have been liquidating their long positions with abandon, and this has driven prices much lower than just about anyone had expected. Thus, it has been unprecedented speculation in the energy futures markets that contributed to oil and gasoline prices soaring higher than they otherwise should have in the first half of the year, and now sharply lower as these speculators have to liquidate their long positions. It remains to be seen how low oil and gas futures will go. **The point is, the Bush administration had nothing to do with it**, but the media is all too happy to convince people otherwise.

By the way, you may not have noticed but the stock prices of the large insurers have gone through the roof recently. After being hammered in the first half of the year largely due to the ominous hurricane warnings, insurers like Allstate and Chubb are now seeing their share prices at new highs. With no hurricanes, there were no multi-billion dollar damage claims as had been anticipated. In fact, Allstate’s shares recently hit the highest price in the company’s history. **But then, President Bush must be manipulating that market as well!** Yeah, right!!

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