

The Puget Sound ECONOMIC FORECASTER

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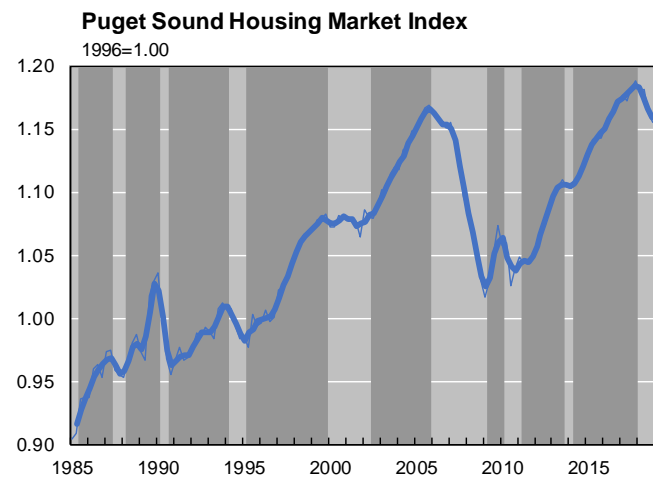
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Housing Market Index

The housing market index fell again with data from Q4 2018, down -2.1 percent from a year prior and marking a full year of declines. Most of this downturn occurred in Q3 and Q4.

The component indexes, demand and supply, both contributed to this overall decline. With supply increasing significantly – year-over-year inventory was just shy of doubling– and demand declining due to a generally slowing economy, the housing market experienced a definitive correction in 2018.



Seattle's housing market has been making headlines as of late, but the region's story is far more nuanced. One such dimension is price; home prices have fallen significantly in Seattle, but this has more to do with demand spreading to the fringes of the region. In fact, regional home prices increased 5.9 percent year-over-year. Zillow reports confirm that price activity is still rising in Snohomish and Pierce counties, especially out in the more suburban and rural areas where cheap housing is still available, if far from the downtown core where jobs tend to be.

Supply and demand tend to be lagging indicators though, and changes in the affordability index may signal what the future holds. Affordability declined -3.8 percent from Q4 2017 to Q4 2018, but actually increased a marginal amount quarter-to-quarter at the end of 2018. With recent reports of Seattle home prices increasing, the correction period may be shifting. Historically, regional home prices have only fallen significantly in large recessions. Without a downturn of such magnitude – which is not forecasted – it is reasonable and in line with the forecast to think that demand will pick up again, although affordability remains a concern. Housing in the affordable and mid-range markets has already picked up the pace region-wide.

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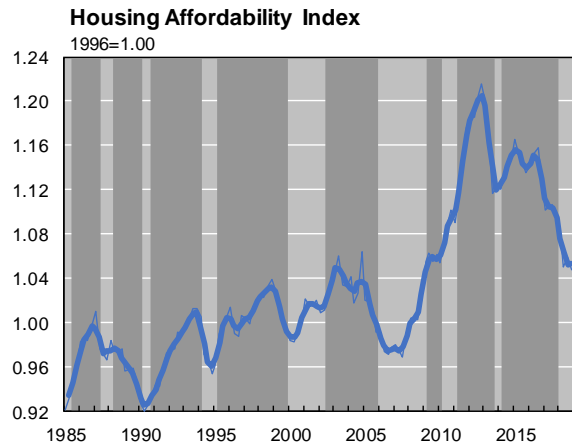
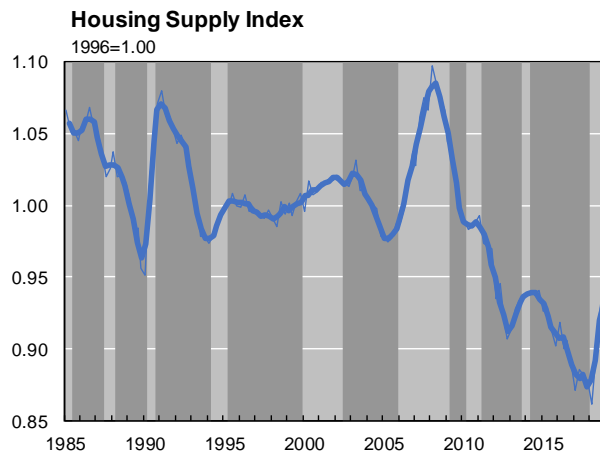
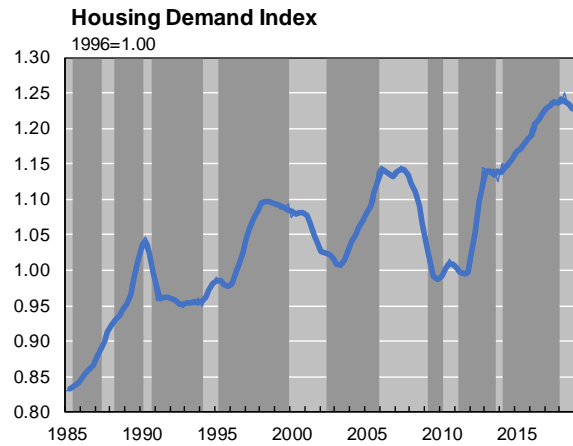
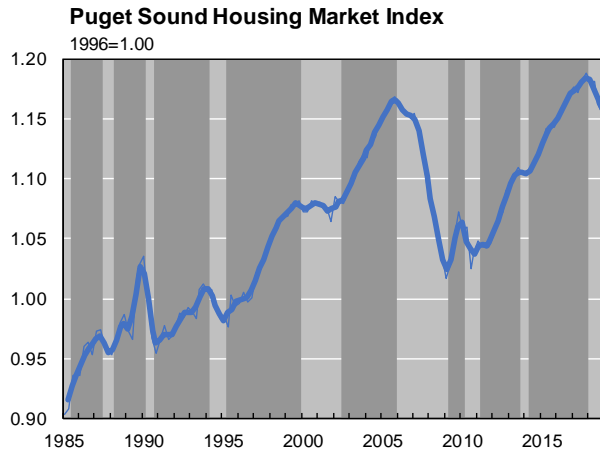
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The Puget Sound Housing Market Index

Seasonally Adjusted and Annualized

	2017.4	2018.1	2018.2	2018.3	2018.4	Annualized Percent Change	
						Over Last Quarter	Over Last Four Quarters
Housing Market Index (1996=1.0)	1.184	1.183	1.175	1.166	1.159	-2.5	-2.1
Unsmoothed index (1996=1.0)	1.188	1.181	1.181	1.162	1.155	-2.4	-2.7
Closed home sales (units)	74,889	70,018	69,997	64,109	61,892	-13.8	-17.4
Housing inventory-closed home sales ratio	1.0	0.9	1.3	1.6	2.0	93.9	109.8
Average closed sales price (\$)	542,670	547,139	582,248	567,807	574,823	4.9	5.9
Consumer price index (1982-84 = 1.0)	2.653	2.680	2.714	2.716	2.730	2.1	2.9
Housing Demand Index (1996=1.0)	1.235	1.241	1.238	1.234	1.227	-2.5	-0.7
Unsmoothed index (1996=1.0)	1.239	1.234	1.250	1.230	1.224	-1.9	-1.2
Employment (thous.)	2105.9	2124.3	2132.7	2144.2	2160.4	3.0	2.6
Unemployment rate ¹ (%)	4.1	4.1	3.9	3.8	3.9	0.1	-0.2
Household formation (number)	23,234	24,769	22,470	21,741	21,827	1.6	-6.1
Average closed sales price (\$)	542,670	547,139	582,248	567,807	574,823	4.9	5.9
Mortgage rate ¹ (%)	3.92	4.27	4.54	4.57	4.78	0.21	0.86
Housing Supply Index (1996=1.0)	0.874	0.879	0.893	0.920	0.932	5.3	6.6
Unsmoothed index (1996=1.0)	0.878	0.862	0.896	0.920	0.944	10.0	7.4
Housing inventory (units)	6,051	5,366	7,460	8,802	10,494	76.9	73.4
New housing construction (units)	28,769	26,619	25,279	28,668	30,096	19.9	4.6
Housing Affordability Index (1996 =1.0)	1.095	1.076	1.063	1.053	1.054	0.3	-3.8
Unsmoothed index (1996=1.0)	1.099	1.080	1.051	1.059	1.048	-4.1	-4.6
Average closed sales price (\$)	542,670	547,139	582,248	567,807	574,823	4.9	5.9
Household income (\$)	165,177	167,648	169,074	171,458	173,580	5.0	5.1
Mortgage rate ¹ (%)	3.92	4.27	4.54	4.57	4.78	0.21	0.86

¹Percent change calculated as simple change in variable.



The Housing Market Index

The housing market index is a quarterly measure of residential real estate activity in the Puget Sound region (King, Pierce, Snohomish, and Kitsap counties). The index is composed of three indicators: the number of closed home sales, the ratio of the average closed sales price to the Seattle consumer price index (i.e., the relative or real average closed sales price), and the average time on the market (the ratio of total active listings to closed home sales).

The composite index, which has a value of 1.00 in 1996, is designed to rise or fall as the housing market improves or deteriorates. An increase in home sales, a decrease in the time on the market, or an increase in the closed sales price relative to the consumer price index, all else being equal, leads to a rise in the index.

Conceptually, the housing market index can be interpreted as the real-dollar volume of home sales (the constant-dollar revenue earned from residential real estate activity) adjusted for time on the market (the effort it takes to sell homes). However, like other composite indexes, such as the Puget Sound Index of Leading Economic Indicators, the purpose of the housing market index is to indicate the directional change in residential real estate activity. The housing market index should not be viewed as indicating the levels of activity. Thus, a 10 percent drop in the index means that housing market activity has declined, though not by 10 percent.

The Housing Demand, Supply, and Affordability Indexes

The housing market index is supported by three other composite indexes: the housing demand index, the housing supply index, and the housing affordability index. Whereas the housing market index portrays current conditions in the residential real estate market, the supporting indexes help to explain the market's performance.

The housing demand index is composed of four variables: regional employment, the unemployment rate, new households, and speculative demand (the home price appreciation rate relative to the mortgage rate). The last variable represents certain kinds of speculative behavior (e.g., home-flipping and sub-prime mortgage lending) that sometimes affect home sales and prices. The housing supply index has two components: new housing construction (housing permits lagged four quarters) and the inventory of homes for sale. The housing affordability index incorporates three variables: average closed sales price, average household income, and the mortgage rate. This index is based on a measure of affordability published in *The Puget Sound Economic Forecaster*.

Construction of Indexes

Construction of the composite indexes follows standard procedures (*Survey of Current Business*, November 1987, U.S. Bureau of Economic Analysis). The method entails calculating, standardizing, and combining quarter-to-quarter changes for each component of the composite index. Data to construct the housing market index and its supporting indexes come from two sources: the Northwest Multiple Listing Service monthly reports on residential real estate activity and the economic data base of *The Puget Sound Economic Forecaster*, which is a compilation of information from various government sources (e.g., Washington Employment Security Department and the U.S. Bureau of the Census).

ECONOMIC FORECASTERwww.economicforecaster.com**Interpretation of Indexes**

An upward movement in the housing market index indicates improvement in the residential real estate market, as measured by home sales, time on the market, and the ratio of the average closed sales price to the consumer price index. Such a change is usually associated with an increase in the demand for housing or an increase in the affordability of homes, which are represented by rises in their respective indexes. On the other hand, an increase in the supply of housing, depicted by a rise in the housing supply index, is often indicative of a weakening housing market.

Movements of the housing market index can be explained by changes in the supporting indexes. Although the housing market index and the housing demand index are composed of different variables, they tend to move together over time, implying that conditions in the residential real estate market (i.e., home sales and time on the market) are largely determined by economic and demographic factors (i.e., employment growth, the unemployment rate, and the formation of new households).

A good example of this relationship was the surge in home-buying that accompanied the Boeing expansion and the high-tech boom of the late 1990s. There are other occasions, however, when the housing market is subject to cross-currents. For example, in spite of a rising demand for housing in 1994, a decrease in the affordability of homes stemming from a jump in the mortgage rate led to a downturn in home sales.