



# Where do we go from here?

2009 Texas economic and housing outlook.

by Mark Dotzour and James P. Gaines

As 2009 dawns, a national/global recession is well underway that is already more severe and probably longer-lasting than the past several ones. The federal government has dedicated almost \$1.5 trillion to stimulate the economy or to bail out specific companies or industries—including housing and home foreclosures—but so far, there is little evidence of any significant improvement. And the new administration is untested and unknown. The current down cycle appears more like the 1980-

1981 recession in terms of overall severity, length, and its effect on wealth for our country.

## Traveling a bumpy road

Last year was tumultuous not only for the U.S. economy but most especially for the housing market. New and existing homes sales and prices declined radically, especially in the dozen or so states that dominated the national reporting. Fortunately, the Texas economy and housing market performed far better, particularly in terms of job growth and home-price stability.

The economic recession and turmoil in the financial and capital markets coupled with falling oil and gas prices suggest that 2009 will be a difficult year for Texas and the rest of the country. Most of the major

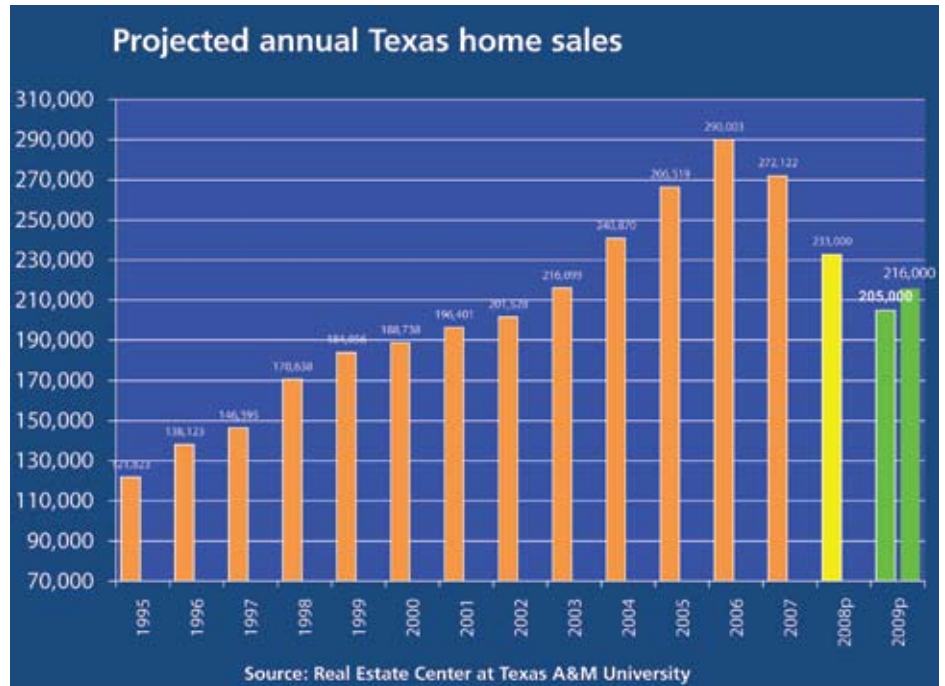
economic and financial factors affecting the supply of and demand for housing have turned negative for the coming year. How far down the market may go and how long it takes to recover remain uncertain. Projecting the Texas residential market for 2009 with the current level of financial and economic disarray is challenging. The unprecedented level and unknown consequences of government intervention in the economy make economic prognostications virtually impossible.

### The power of negative thinking

A key, immeasurable force is the increasingly negative outlook of people and businesses about the coming year. The highly publicized financial-market problems and falling economy have created uncertainty among buyers, sellers, business people, lenders, builders, and other housing-market participants. When people are unsure and take a wait-and-see attitude, the results are easy to project: nothing happens. Uncertainty and negativism at the national level remain pervasive, and some of these attitudes are creeping into Texas.

### At least we're still in Texas

Texas may not be able to defy the national downward trend but should still outperform the rest of the country in some key aspects. The recent growth and prosperity in Texas have been attributable to the economic expansion created by the energy industry and the diversification of the state's economy into other fast-growing areas, such as healthcare. The pace of job formation in the state during the past several years has



Numbers for 2008 and 2009 are projections, with a high and low range for 2009 based on a projected drop-off in home sales of 10%-15%.

been outstanding, but that rate is likely to decelerate significantly in 2009.

By the end of 2008, the price of West Texas Intermediate Crude had fallen more than 66% from its peak and continues to decline. Natural gas prices have followed the same pattern. The high-powered job growth in Texas fueled by record high crude oil and natural gas prices, the extraordinary levels of residential and nonresidential construction throughout the state, and the general economic boom in Texas peaked in 2006 and 2007, and the outlook for the next year or so is not as favorable.

### What's the outlook for home sales?

While Texas avoided the housing-price bubble during the 2003-2007 boom that affected so much of the rest of the country, there was a "bubble" in sales-transaction volume, as buyers took advantage of the low interest rates with easy credit and underwriting. Total reported 2008 home sales in Texas were roughly 233,000, down about 15% from 2007 and slightly less than the 2004 total. Sales in 2009 could fall another 10% to 15% to between 216,000 and 205,000 units, which is approximately equal to 2002-2003 levels. The lower projected figure reflects a 29% decline in total sales from the 2006 peak. The precipitous fall in sales volume primarily reflects the severe tightening in the mortgage market as well as uncertainty about the economy. Graphically, it looks like the stair-step increases in annual sales experienced between 2002 and 2006 are being mirrored downward (see the chart above).

### What about home prices?

Real Estate Center research completed several years ago has shown that the most reliable indicator of future price trends in residential houses in Texas is the "months of inventory of unsold homes." The metric is easy to calculate

and easy to understand. If you have six homes on the market and sell an average of one home per month, then there are six months of inventory in the local market. Our research has indicated that about six and a half months of inventory is a “balanced market,” where prices are likely to continue to increase at a moderate pace. Currently, Texas has about six and a half months of inventory. That’s why prices of Texas homes continued to increase in 2008, while prices at the national level have been falling. Nationally, there is between 10 and 11 months of inventory.

The chart on this page shows how the months’ supply of inventory has oscillated over the past two decades. In the early 1990s, the months’ inventory was at an elevated level of 10. This number declined consistently through the 1990s and dropped below five months for several years. The Texas market has been below the six-and-a-half-months level for most of the 21st century.

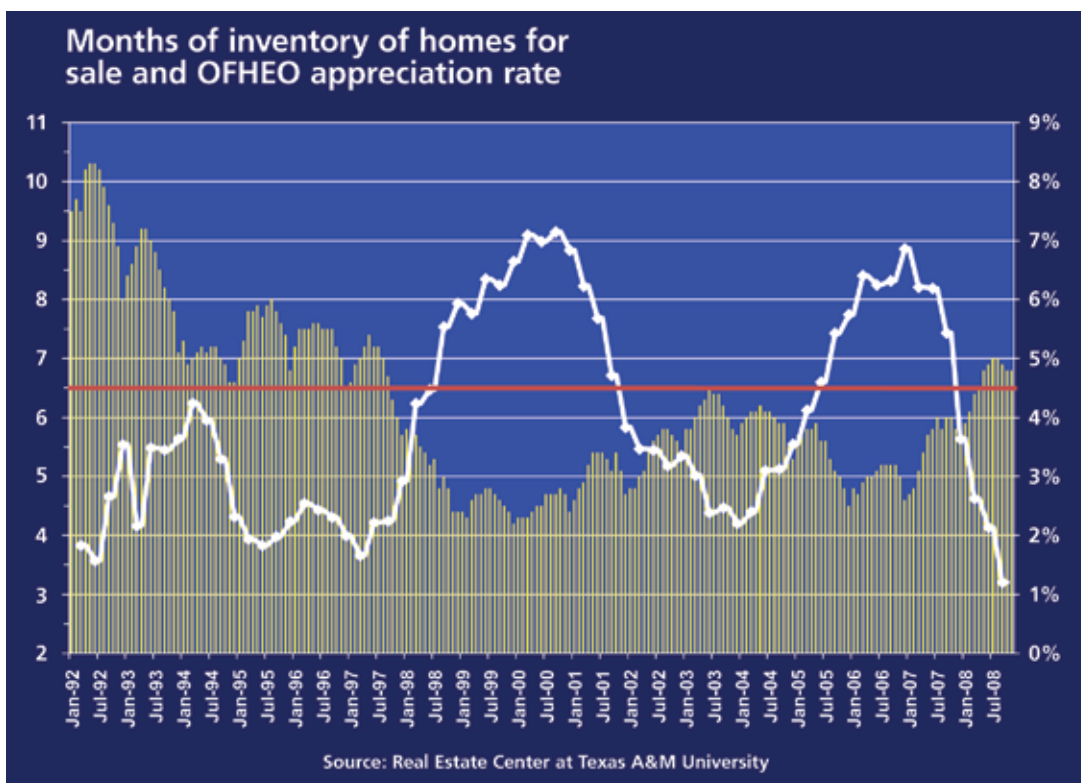
The chart also shows the annual rate of appreciation in the Texas housing market as measured by the Office of Federal Housing Enterprise Oversight. The OFHEO data indicate that price appreciation has never fallen below zero in the last 16 years. Even when the month’s supply of houses rose to 10 months in 1992, prices still went up about 2% per year. When inventory levels get below six and a half months, prices start to escalate much more rapidly. Current inventory levels are similar to those experienced in the 1994 to 1997 period. Notice that prices continued to increase between 2%-3% per year during that time.

What will happen to prices of Texas homes in 2009? The past data would indicate that homes should continue to increase in price, albeit at a very modest rate. The only reason that prices could fall in 2009 in Texas would

be that a pervasive fear of the uncertain future would cause people who would normally buy a house in 2009 to continue with a wait-and-see attitude.

As we go into the new year, keep in mind that thousands of homes will be sold in Texas in 2009. Mortgage rates are likely to drop this year to the lowest levels of our lives, creating a once-in-a-lifetime opportunity for people to make a move. Is there a risk that home prices could fall? Of course. But for Texans planning to buy a home that they want to live in for the long-term, this could be the best buying opportunity of the decade. ★

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The yellow vertical bars show months’ inventory for each month since 1992; the white line displays the OFHEO appreciation rate.