August 29, 2022

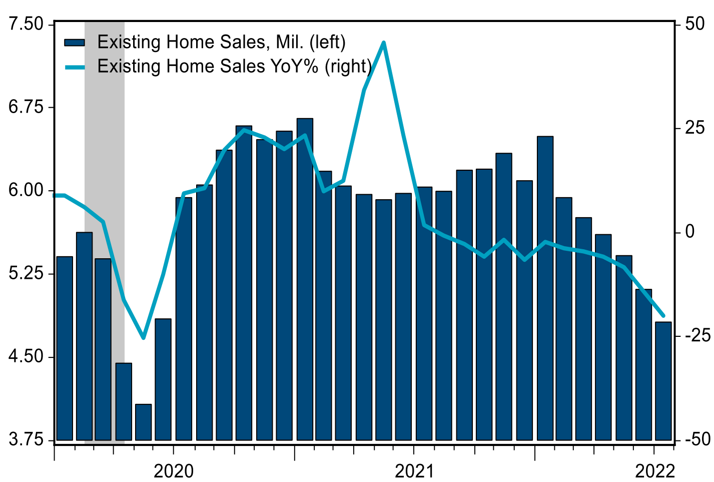
Recession, in Housing?

Economic INSIGHT

With back-to-back quarters of negative growth, the U.S. economy is arguably falling into – or further into – recession. But even as demand and production slow, prices remain elevated. The U.S. housing market, in particular, is facing a similar scenario. Home sales are sluggish, yet prices are extremely elevated. While some measures of housing activity – and the broader economy – are signaling a significant downturn, and the possibility of even a recession, others indicate there are still opportunities in the market.

HOME SALES SLUGGISH

Existing home sales fell 5.9% in July, and a whopping 20.2% from this time last year. Sales have fallen 26% from the recent January 2022 peak of 6.49M to a 4.81M unit pace. This marks the sixth consecutive month of decline and the slowest pace since May 2020.



Source: National Association of Realtors/Haver Analytics

Meanwhile, inventories, or the months' supply of available homes for purchase, continues to rise. From an all-time low of 1.6 months in January, the number of available homes has since risen 106%, reaching 3.3 months in July and the highest level since June 2020.

But while demand is relatively lower, at least from peak levels, and supply is relatively higher, at least from extremely reduced levels, there remains a sizable gap between the

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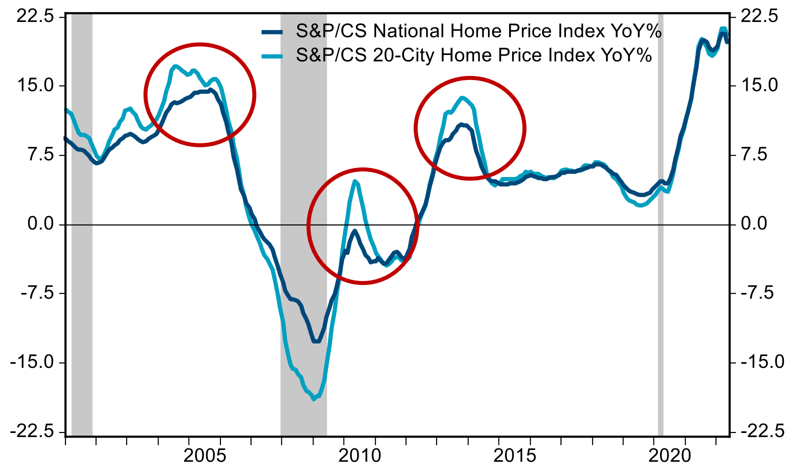
two. In other words, despite some movement towards equilibrium, demand continues to outpace the still-tight levels of inventory, maintaining upward pressure on prices.

PRICES STILL ELEVATED

According to the latest monthly report from the National Association of Realtors, home prices are still "too-high." The median price for a previously owned home rose nearly 11% from this time last year, reaching over $400k. While down slightly from the prior month's record level of $413.8k, prices are still historically elevated across the country.

In fact, much of the price growth experienced in the last two years has been significantly more widespread than in past housing market cycles, reaching outside of the traditional downtown urban markets. Rather than limited to the typical "hot" areas such as downtown Los Angeles or New York City, price growth – double-digit price growth – was extended to once-quiet housing markets like Boise and Tampa as workers relocated in search of more space – often to accommodate at-home learning or the new home office – or lower housing costs. The result was soaring home values in nearly every corner of the market.



Source: Standard & Poor's/Haver Analytics

According to the S&P Case-Shiller 20 City Home Price Index, prices rose to a peak of 21.2% in the largest 20 metropolitan areas and 20.6% nationally. By contrast, in 2013, the 20-city index far outpaced the national market by three percentage points with an even larger gap of more than five percentage points in 2010.

As of May, while prices remain elevated on a historical basis, cost pressures have slowed somewhat, dropping to 20.5% (20-city) and 19.8% (national).

MARKET OUTLOOK

Negative real income growth, rising prices, elevated borrowing costs, limited access to labor, particularly skilled labor, as well as lingering shortages for parts and materials are among the plethora of factors broadly weighing on housing. But while some would-be home buyers are being squeezed out by rising prices, declining borrowing costs are

GLOSSARY

YoY – Year over Year

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providing a welcome incentive fueling, or at least supporting demand. At the same time, some sellers are increasingly anxious to sell in a still "hot market," suggesting more balanced conditions may continue to develop on the horizon.

According to Freddie Mac, after rising to a peak of 6% in early June, the fixed rate on a 30-year mortgage has retreated back to 5.13% as of August 18, offering a welcome boost to buying power and affordability for potential home owners. Additionally, while still relatively expensive, some sellers are cutting list prices, as expectations are being reevaluated amid a rapidly cooling market and additional construction, particularly for apartments and condos, is likely to offer some additional – medium-term – relief to soaring costs.

Going forward, the U.S. housing market will expectedly continue a downward trend as the underlying strength of the economy is intentionally reduced by a more aggressive monetary policy pathway. That being said, the buildup in the housing market appears to be less of a bubble-like scenario and more a reflection of a structural adjustment to preferences as Americans relocated around the country during and in the immediate aftermath of the Covid-19 crisis. Thus, coupled with a significantly higher quality of credit this time around, while housing has clearly transformed from a tailwind to a headwind for the economy, as seen in the past, there doesn't appear to be anywhere near the conditions that would indicate a systemic meltdown looming around the corner.

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