HOUSING BUBBLE CONCERNS PERSIST - BUT THIS IS NO 2008

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(15Nov2022) … While many have become reluctant to deny the existence of housing bubbles given widespread monthly price declines and the experience during the Great Recession, it is unlikely that the economy is setting up for another rendition experienced in 2008-09.

HOME PRICE DECLINES … Home prices are generally down from their peaks, as reflected by record equity depletion during the third quarter, but in most cases they're still up year-over-year. Median home prices fell 0.98% in August from a month earlier, following a 1.05% drop in July. The two periods mark the largest monthly declines since January 2009. But they're also generally elevated compared to where they were pre-pandemic. That leaves borrowers in many areas with enough of a cushion in home value to continue incentivizing loan repayment. But there's still room for some of these markets to fall.

But while there remains downward pressure on the housing market, it is less severe than that seen in the infamous 2008-09 downturn. It is doubtful that we will see the same level of delinquencies and defaults and we're not seeing a lot of oversupply, like we did in 2008, so the fundamentals today are a little bit stronger. The biggest challenges are affordability and how we resolve it moving forward.

HOUSING DEMAND AND FORMATION … While household formation has been driving excessive demand in recent years, affordability constraints have grown with the rise of mortgage rates. The market has reached a point where people are starting to make different decisions where household formations are concerned. However, the market is likely to avoid the kind of oversupply seen in 2008, which resulted from excessive lending without proper consideration of ability-to-repay, in part because the rise in mortgage rates is naturally curtailing the availability of existing homes as demand falls.

HOUSING AFFORDABIILITY … Compared to a year ago, housing affordability fell to its lowest level since 1989 as monthly mortgage payment climbed 44% and median family income rose by 3%. The income required to afford a mortgage, or the qualifying income, is the income needed so that mortgage payments on a 30-year fixed mortgage loan with a 20% down payment account for 25% of family income. A mortgage is affordable if the mortgage payment (principal and interest) amounts to 25% or less of the family's income.

Housing affordability had double-digit declines from a year ago in all four regions. The South had the biggest decline of 31.0%. The Midwest and West both experienced a weakening in price growth of 27.7%. The Northeast had the smallest dip of 23.3%.

MARKET INCENTIVES … Most mortgages today have rates that are less than 5%, so people are disincentivized to put their house on the market to sell. So at the same time we have rates go up and a contraction in demand, we also have a limitation on supply. How this all shakes out will likely play a big role in what happens next to housing. The bigger question is, will we see a significant contraction in home prices? And the answer depends on the difference between supply and demand.

Regionally, limitations on housing demand and equity could reverse some price gains that occurred because people from states with higher values, like in the Northeast, could sell homes to live in less expensive regions, such as the Southeast. If someone doesn't have the cash, they have less incentive to move. So now prices have to adjust back to the local buyers and that remains the biggest challenge for home prices.

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