Housing

Shelter is an essential part of well-being, and owner-occupied residential housing provides shelter for many. The value of one's personal residence often is the greatest source of individual wealth. Housing investment and expenses are significant factors in the overall economy. The securitization of mortgage financing is an important sector of the capital markets. The spectacular collapse of the housing market was the primary cause of the Great Recession. The pandemic prompted an increase in housing demand that triggered both investment activity and housing inflation. A review of trends in housing can provide perspective for economic activity and investing ahead.

PERSPECTIVE

Housing is a component of economic activity through both investment and ongoing expenditures. Chart I shows trends in each over time. Residential investment as a percentage of GDP has drifted lower for decades. The level of activity has varied widely. The sharp decline in the Great Recession is notable. The subsequent uptrend experienced a pandemic-induced spike soon followed by a pullback once again. Housing expenditure as a percentage of total personal expenditures has drifted lower as well but remains a large component. The abnormal increase during the pandemic was short-lived.

Among the outcomes of the Great Recession was much greater attention given to housing affordability. Indeed, a contributing factor in the preceding speculative housing bubble was the seeming indifference to the factors used in its determination. Table I provides a recent year-over-year comparison of these factors and the aggregate impact on overall affordability. While home prices increased sharply during the pandemic, the rate of increase has slowed considerably. Well known is the central-bank induced increase in interest rates last year. The result was a doubling in fixed mortgage rates. Consequently, monthly principal and interest payments increased almost 50% while median income gains trailed well behind. The result was a material decline in affordability.

The trend in the Housing Affordability Index before, during and after the pandemic is shown in Chart II. This index is maintained by the National Association of Realtors. *A value of 100 means that a family with median income has exactly enough income to qualify for a mortgage on a median-priced home. An index above 100 signifies that a family earning the median income has more than enough income to qualify for a mortgage loan on a median-priced home, assuming a 20 percent down payment.* The combination of higher home prices and rising mortgage rates brought the index to and below the affordability level. Price increases have been curtailed by the forces of demand and supply. However, further mortgage rate increases cannot be dismissed.

INVESTMENT IMPLICATIONS

Investors continue to assess the likelihood that inflation can be tamed without a material slowdown in economic activity let alone a recession. The Federal Reserve's primary tool for slowing inflation is higher interest rates. The good news for investors at this time is higher yields on money market and bond investments. The less good news for home buyers is higher mortgage rates and lower housing affordability. The slowdown in housing activity is being watched closely as a forewarning of slowing elsewhere. Stock markets are watching closely.

CHART I

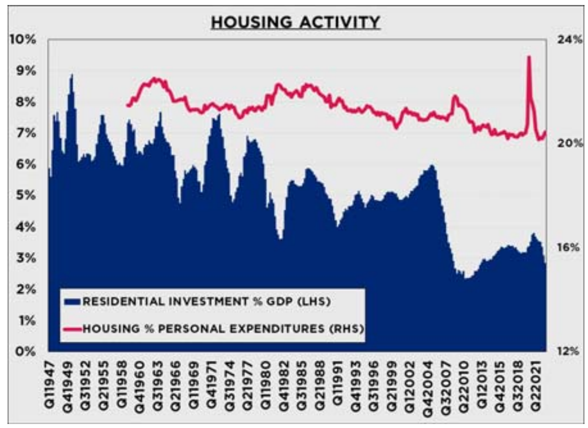

TABLE I

HOUSING AFFORDABILITY FACTORS

	December 2022	December 2021	% Change
Home Price	$372,700	$365,300	2%
Mortgage Rate	6.44%	3.15%	104%
Monthly P&I	$1,873	$1,256	49%
Median Income	$90,984	$85,701	6%
Affordability Index	101.2	142.2	-29%

CHART II