Housing Watch

Turbulence but no crash

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SAAR: Seasonally adjusted annual rate

CPI: Consumer Price Index

No crash, but potential turbulence ahead

As we head into the final quarter of 2023, we review the recent developments in the housing market. The 30-year fixed mortgage rate topped 7.3% last week to the highest level in 23 years, crunching affordability (Exhibit 1). The "lock-in" effect continues, with homeowners reluctant to sell their homes in the current environment, leading to divergence in the new and existing home markets. Near-record low supply of existing homes (Exhibit 2) has spurred the building of new homes. Indeed, new home sales have held up despite a meaningful drop in August (-8.7% m/m), which was likely due to the hurricane impact on the West and South. Meanwhile, existing home sales were down 0.7% m/m (-15.3% y/y) to 4.04mn saar in August (Exhibit 3).

Floor beneath prices

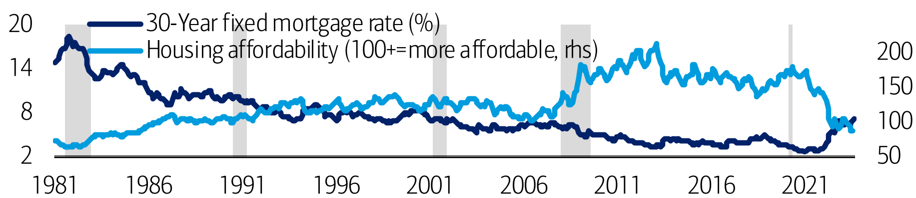
With rates likely staying higher for longer, we are cautious of potential turbulence ahead. Existing homes inventory is likely to remain squeezed going into next year, holding up the floor beneath home prices. In July, home prices increased again, by 0.7% m/m (1.0% y/y). Builder confidence has fallen for two consecutive months, which could impact housing starts, and homeownership may continue to be a challenge in the near term. On the bright side, some sales activity should be supported by millennials reaching the prime home-buying age, and single-family building permits have steadily held up. This can help the housing market retain some of its momentum without falling apart.

1980 vs. 2023: Déjà vu?

Looking back at previous housing recessions, we think the 1980s are a better analogy for today's market than the 2008 housing crash. Leading up to 1980, y/y CPI inflation soared by nearly 10pp to 14.8%. The Fed responded by rapidly hiking rates, which doubled mortgage rates to 18.6% by 1981 and subsequently the housing market took a hit (Exhibit 4). Noticeably, demographics were favorable back then, with baby boomers having entered the prime home buying age. This is similar to millennials today.

A key question is how elastic demand is to rising mortgage rates. While to a degree home sales can be supported by activity from this prime age group, persistently high mortgage rates should make the decision of purchasing a home more challenging in the near term. Indeed, favorable demographics were not enough to hold up the market in the 1980s and will likely not be enough to stimulate the market this time around.

Exhibit 1: Mortgage rate and housing affordability
Mortgage rates have surged recently and affordability is nearing historic lows



Source: Federal Home Loan Mortgage Corporation, National Association of Realtors
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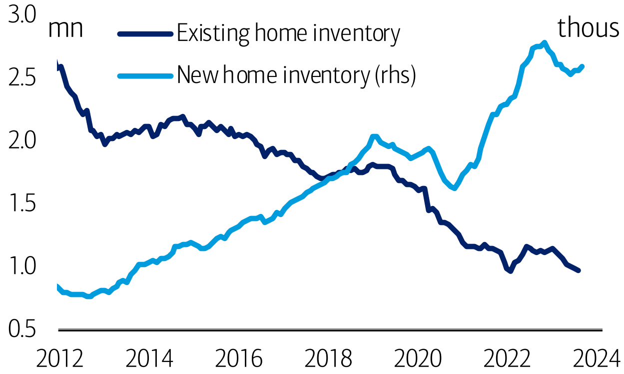
Exhibit 2: New and existing home inventory (saar)
Inventory of the two markets have diverged



Source: National Association of Realtors, Census Bureau, BofA Global Research
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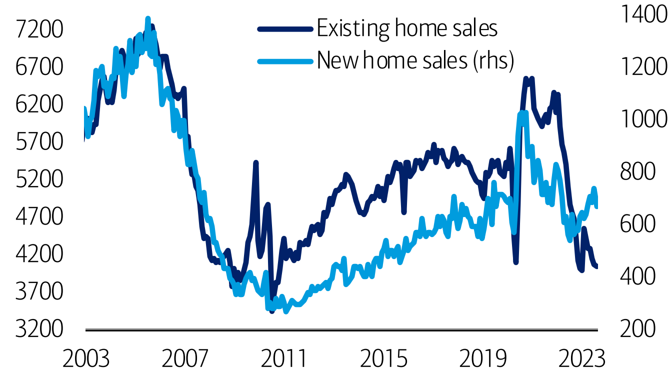
Exhibit 3: New and existing home sales (thous, saar)
Existing home sales continue to struggle while new home sales have held up



Source: National Association of Realtors, Census Bureau, BofA Global Research
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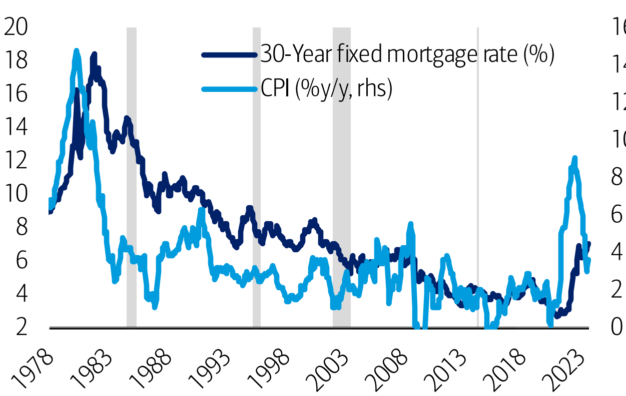
Then and now

Home prices surged by over 16% y/y in early 1979, before plummeting to 0.5% y/y growth by 1982 (Exhibit 5), and existing home sales fell 54% from peak to trough. Post-pandemic, home prices skyrocketed to nearly 21% y/y growth, before flattening out at 0% y/y in June, and existing home sales have fallen nearly 40%.

A more noticeable difference between the early 80s and today is the mortgage debt to disposable personal income ratio. At its peak, the ratio did not exceed 45% in 1980. Today, the ratio is closer to 65% (Exhibit 6). At first blush this difference may seem concerning, but one explanation is that the speed of home price growth has exceeded income growth over the years. Household balance sheets are in very good shape at the moment, and leverage does not appear to be a major concern.

Exhibit 4: CPI inflation and mortgage rates
Today and 1980s both experienced sky-high inflation and mortgage rates



Source: FHLMC, BLS, BofA Global Research
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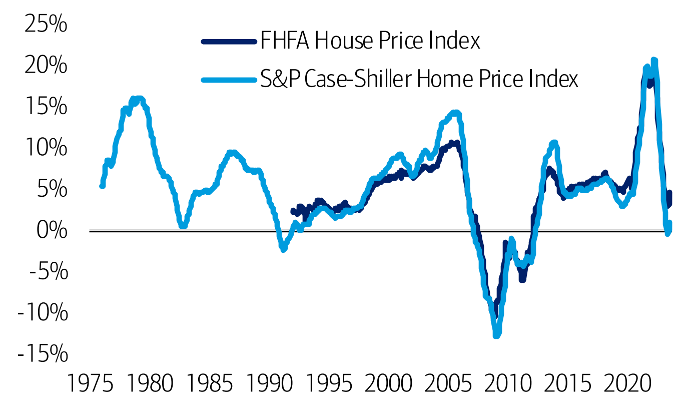
Exhibit 5: National home price growth (%y/y, NSA)
Year-over-year home price growth has recently picked up



Source: Federal Housing Finance Agency, S&P Case Shiller
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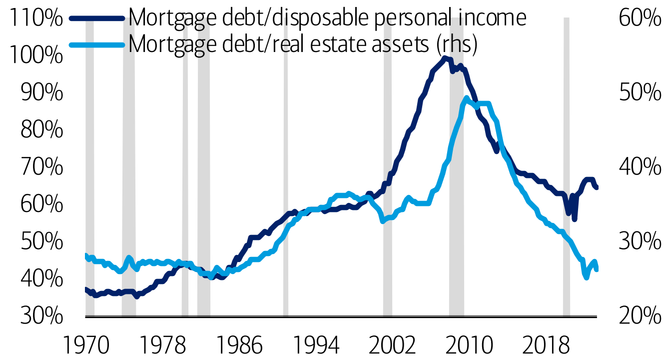
No crash in sight, but potential turbulence ahead

One key theme that we reiterate is that we do not expect another housing crash like 2008. The current market does not show noticeable signs of excess development and household leverage is much less of a concern today. Household mortgage debt was 65% of disposable income in 2Q 23, compared to a peak of 100% at the start of the financial crisis (Exhibit 6). The ratio of mortgage debt to real estate assets (i.e., loan-to-value) was 27% in 2Q 23, significantly lower than 2010.

Exhibit 6: Mortgage debt as a share of disposable income and share of real estate assets

Households have deleveraged their mortgage debt since the last crash



Source: BofA Global Research, Federal Reserve Board

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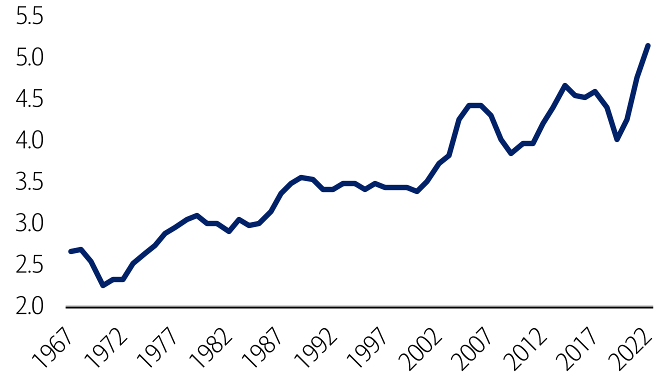
Exhibit 7: Single family home price to household income ratio

In 2022, the median sales price of new single-family homes was over five times the median household income



Source: Census, BofA Global Research

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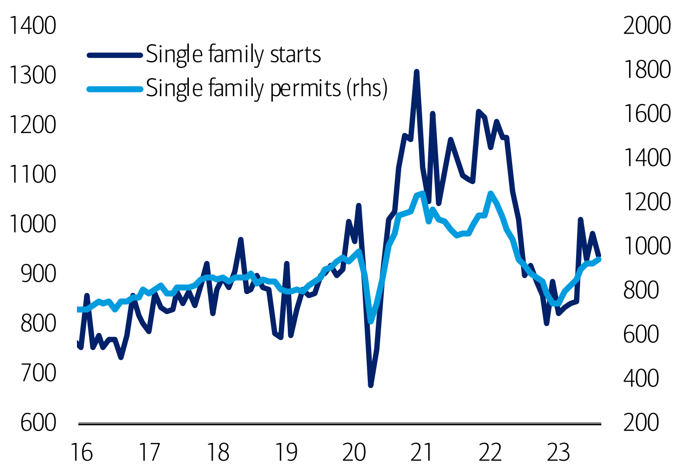
Nevertheless, we remain cautious of potential turbulence ahead. The existing homes market remains squeezed with limited inventories, and although buyers have the option to turn to the new homes market, high mortgage rates and low affordability won't make it an easy task. Furthermore, home price growth has meaningfully exceeded income growth since the start of the pandemic. In 2022, the median sales price of new single-family homes was over five times median household income (Exhibit 7).

Looking ahead, limited inventories, high prices, and labor shortages can be headwinds for some time, but the good news is that single family permits have held up for the past several months. This should support residential investment going forward: recall that the single-family sector is a bigger driver of GDP growth than the multi-family sector (Exhibit 8). Affordability is likely to improve as the Fed cuts rates. At that stage, we should see a more stable and healthy housing market. Until then, hang tight, it may be a bumpy ride.

Exhibit 8: Single family housing starts and permits (thous, saar)

Single family permits continue its upward trend



Source: Census, BofA Global Research

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Exhibit 9: August housing data

Overall housing data came in weaker in August

Latest data (saar, thous)	Aug-'23	Jul-'23	Jun-'23	May-'23	Apr-'23	Mar-'23
Housing starts	1283	1447	1418	1583	1348	1380
% m/m	-11.3%	2.0%	-10.4%	17.4%	-2.3%	-3.9%
Single-family	941	983	930	1012	847	843
Multifamily	342	464	488	571	501	537
Permits	1541	1443	1441	1496	1417	1437
% m/m	6.8%	0.1%	-3.7%	5.6%	-1.4%	-3.0%
Single-family	948	930	924	902	856	829
Multifamily	593	513	517	594	561	608
New home sales	675	739	684	710	679	640
% m/m	-8.7%	8.0%	-3.7%	4.6%	6.1%	2.4%
Existing home sales	4040	4070	4160	4300	4290	4430
% m/m	-0.7%	-2.2%	-3.3%	0.2%	-3.2%	-2.6%
Single-family	3600	3650	3720	3850	3860	3990
Condos/co-ops	440	420	440	450	430	440
Home price growth (%y/y)	N/A	0.96%	-0.03%	-0.39%	-0.12%	0.73%
30-yr mortgage rate (%)	7.07%	6.84%	6.71%	6.43%	6.34%	6.54%

Source: Haver Analytics, BofA Global Research

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August housing data recap

During the month of August, overall housing data came in weaker (Exhibit 9). New home sales dropped 8.7% m/m (5.8% y/y) to 675k saar, with drops seen in all of the regions (Midwest: -17.2%, South: -7.5%, -9.4%), besides the Northeast (6.7%). Housing starts plunged in August (-11.3% m/m, -14.8% y/y), led by multifamily starts (-26.3% m/m) while single family starts also fell 4.3% m/m. Some of the weakness in the August data can be explained by the hurricane impact. On the bright side, building permits have held up (6.8% m/m) with single family permits also up 1.9% m/m. Meanwhile, existing home sales continue to trickle lower, falling 0.7% m/m (-15.3% y/y) to 4.04mn saar. Subsequently, the median sales price of existing homes has held up at $407k, up 3.9% y/y. Crunched inventories of existing homes are keeping home prices high, with the S&P CoreLogic Home Price Index showing a 0.96% y/y increase as of July.

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