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LATEST U.S. ECONOMIC OUTLOOK

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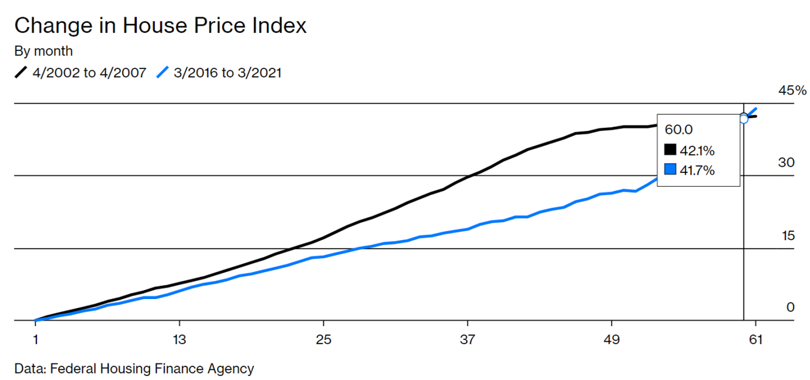
U.S. Economic Outlook Report
June 24, 2021: Is the U.S. in a housing bubble?

Prevedere Chief Economist, Andrew Duguay, provides a personal view on topical economic issues

Home prices are rising at a pace similar to the previous housing crisis in 2008, but is a crash imminent? In this report, I look at key leading indicators, such as home prices and supply, to answer that question. By comparing the current housing market to the last, we can glean some clues to determine whether or not the U.S. housing bubble is about to burst.

Classic Crash Culprits

On the surface, there are some of the classic culprits of the previous housing crisis appearing. The Federal Reserve's push for ultra-low, long-term interest rates alongside direct subsidization of the housing mortgage industry has driven mortgage payments down but subsequently drove housing prices up. Bidding wars and high demand have ensued, creating a feeling that this is just not sustainable. According to Redfin, Median Home Prices shot up more than 26% in May. The pace of increase in home prices is nearly identical to the previous housing bubble, rising 42% in 5 years.



However, this housing market is very different from the one 15 years ago, and there is a low probability of the market imploding on itself like it did in 2007-2009.

Bubble Prevention Factors

The first key difference is supply. If the previous housing bubble was a good example of an oversupplied market, today's housing market is a good example of an undersupplied market. According to the U.S. Census Bureau, available inventory has been at record lows throughout the pandemic and has only crept back up to five months of supply. In 2006, before the housing crisis, the supply of inventory was at seven months and rising rapidly as Housing Starts had exceeded two million a year in the two years prior. Yet, in 2020, there were only 1.4 million houses built.

One of the main reasons the U.S. is not likely to see a bubble is that we couldn't even build as many speculative houses if we wanted. After the last housing crisis, nearly half a million workers left the residential construction industry, and many have not returned.

Today there are 150,000 fewer workers in the residential building industry than in 2006, despite the U.S. having 33 million more people to house today than 15 years ago.

The other bubble prevention component is on the financial side. A significant compounding factor in a housing bubble is the creditworthiness of those receiving mortgages for increasingly expensive homes. Credit standards fall dramatically in the run-up to the previous housing crisis. However, mortgage lending standards by most accounts are staying tight and conservative today, thanks in part due to additional regulation and industry standards after the last crisis.

Another key part is the types of loans available--while 60% of mortgages were adjustable-rate in 2006, only 0.1% of all mortgages issued today allow for interest rate adjustments. This helps prevent future financial strain for existing borrowers, as interest rates are likely to go up (probably even sooner than the Fed is leading on) as inflation picks up steam and puts pressure on monetary policy to be less accommodating. Previously this compounded financial problems for consumers, as new mortgage applicants plus existing mortgage owners got hit with higher payments. However, now rising interest rates will only impact the select few that are applying for new mortgages. Rising rates may start to suppress rising housing costs, but that alone is not a bad thing and will not cause systemic malaise as it did 15 years ago.

Conclusion

At Prevedere, we are confident that residential construction has many opportunities in the next few years, as all the demand signals are there for the U.S. to reverse from a decade of underbuilding on housing. Construction material costs are rising, but there is more than enough market to support the pass-through of higher input costs due to increasing new-home valuations from a builder's perspective.

Our outlook is more optimistic than the Wall Street Journal Economist Consensus on New Housing Starts in 2021 and 2022. For those worried about this being a repeat of the last housing bubble, the evidence suggests today's market is very different, and there is a low probability that this ends in a crash.