US Housing And Government Action

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In setting out their election platforms, both Democrats and Republicans want to address housing affordability, which has become a hot-button issue for US voters. Two and half years of tight monetary policy has left potential homebuyers unable to afford a new property and persuaded potential sellers that they should sit tight and keep enjoying cheap finance locked in years ago.

The issue has begun to have macroeconomic effects, with US housing permits and building starts for July hitting a post-2020 trough, while new home sales for June fell to the lowest level since last November. Investors, for their part, have looked through this soft patch and bid homebuilder stocks higher on the basis that anticipated interest rate cuts will gin up fresh demand. The issue that all participants in this gummed-up part of the US economy must consider is how impending government action may change the equation.

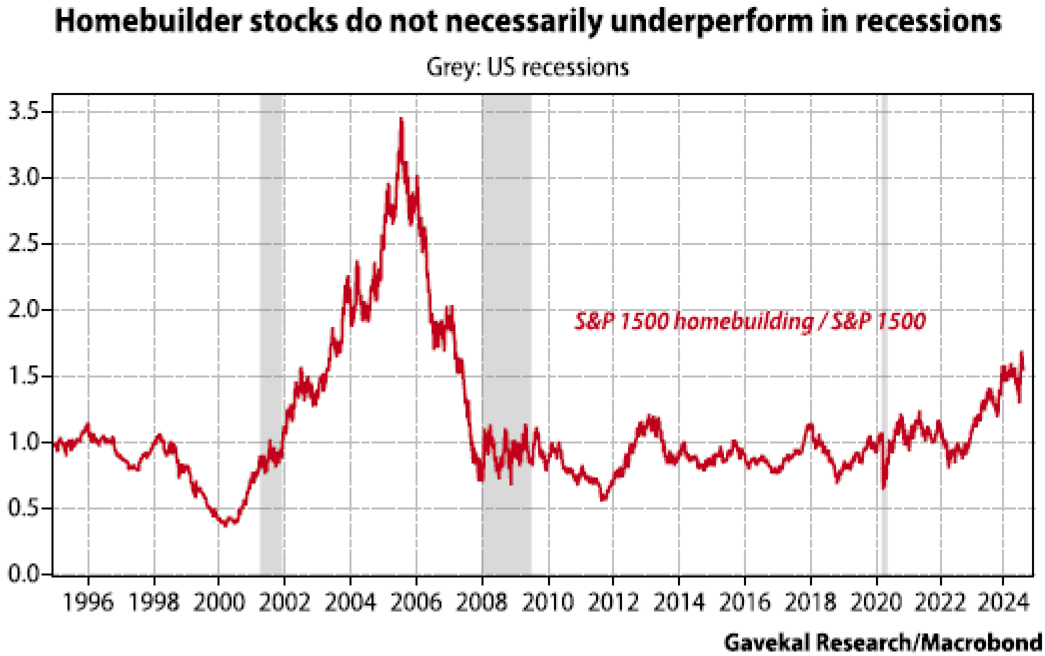
Both Donald Trump and Kamala Harris want to tackle housing affordability, with Trump mainly focusing on the problem of high mortgage rates, while Harris has outlined a more detailed plan that includes tax credits for first-time buyers and help with down payments. Harris also wants to give builders tax incentives to construct affordable rental housing and starter homes for first time buyers, with the aim of adding 3 million units in four years. This apparent political focus on offering housing support suggests that, one way or another, the US government will become more friendly to private homebuilders.

The US housing market should benefit from interest rate cuts, which are likely to begin in September given a softening of inflation. Lower oil prices will both help contain inflation and weigh on the pricing of breakeven inflation rates. These factors should depress mortgage rates and support housing demand. In addition, elevated building material inventories at wholesalers and a possible clearance for Freddie Mac to buy second mortgages should aid the sector and support homebuilder equities.

There are, however, two possible kinks to this generally rosy outlook for the US homebuilding sector.

1) As mortgage rates fall, some previously “trapped” existing homes may be released onto the market. The sharp rise in new mortgage rates relative to very low rates that homeowners secured before 2022 caused owners who may otherwise have looked to move, to simply sit tight. This effect crimped supply in the used home segment and pushed buyers into the new-build market, which has been good news for homebuilders over the last two years. Hence, a looming decline in US mortgage rates is likely to spur more supply of existing homes and create a reverse effect, where the market for new properties becomes relatively less attractive.

2) A US recession would dent housing demand. This is not my base case, but the possibility cannot be ruled out, especially given July's softer than-expected payroll report. Such anoutcome would assuredly hit homebuilder stocks hard, as falling household incomes will weighon housing demand. At the same time, a US recession is likely to result in lower mortgage rates,which will improve future demand for property. In past recessions, it should be noted that UShomebuilder stocks have not decisively underperformed the broader market.



All things considered, US homebuilder stocks should keep outperforming the broad market due to the likely support that the sector will get from the US government and the prospect of lower mortgage rates. The two drags mentioned above could, however, result in that relative performance component suffering higher volatility than would be usually expected.

As housing affordability becomes a central focus in the upcoming elections, the broader U.S. economy could see significant effects. While the possibility of lower interest rates and increased governmental initiatives may uplift the housing market and homebuilder stocks, some risks might dampen this outlook. The influx of previously "trapped" homes and the chance of an economic downturn could create challenges and increase market volatility. Even so, with policymakers likely to support housing, the sector remains an attractive area for investors—albeit one that may face some turbulence.

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