US Housing At A Key Juncture

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The US housing market is humming along nicely, with both construction and sales doing well. New-build prices have stabilized and those of existing homes continue to rise. Such resilience in the face of a long monetary tightening cycle has surprised plenty of commentators, including myself, but it is clear that positive effects from housing are benefiting the broader economy.

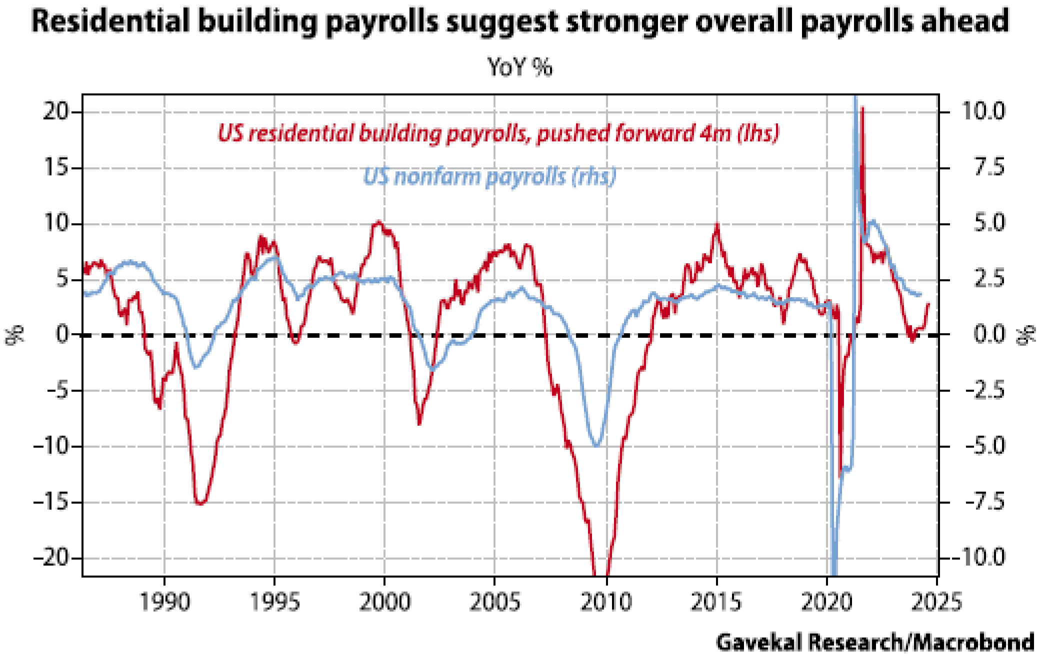
In early 2022, things looked very different, for as mortgage rates rose, US housing became unaffordable compared with incomes and rents. As a result, the issuance of permits to build new homes fell from an annualized 1.92mn in December 2021 to 1.35mn in January 2023. Moreover, the sales of all types of homes tumbled from 7.04mn to 4.72mn in this period.

Building activity began to pick up in January 2023, while sales volumes have started to rise in recent times. The likes of Neel Kashkari, president Of the Federal Reserve Bank of Minneapolis, have expressed surprise at this resilience and advanced explanations such as low housing inventories, increased immigration and the sector having a higher neutral rate of interest than once thought. It is still possible that mortgage rates rise further should inflationary pressure persist, and knock the market back. Yet there are three reasons to think that a stronger housing market presages a stronger US economy ahead:

1) New homeowners usually buy furniture and appliances to fill their abode, which adds to general demand. Therefore, US housing permit issuance and sales tend to lead consumer spending on durable goods by six to nine months. As housing permit issuance has been rebounding since January 2023 and sales have been on the up since November 2023, this support for durable goods orders is either already kicking in, or will soon do so.

2) Higher home prices boost households’ net worth, which can spur them to spend more of their income; i.e. the wealth effect. Measured in years of consumption, US households’ net worth has been rising since early 2023, partly due to higher home prices. As a result, the personal savings rate in the US has been falling, which supports consumption. Rising house prices also allow individuals to take out larger home equity loans, which can be spent on goods and services. This effect will get a further boost if Freddie Mac’s proposal to offer a new product packaging up closed-end second mortgages is approved. It would cause lenders to provide even more home equity loans.

3) A strong housing market means more hard-hatted construction workers being hired, which will strengthen the overall US labor market. While there is little direct relationship between residential building payrolls and employment in other industries, the US housing market is typically one of the economy’s most interest rate-sensitive areas (although last year it defied the gravity of high interest rates). Therefore, employment in the sector tends to lead the rest of the economy.



Overall, if home construction, sales and prices continue to rise, US economic growth will assuredly get supported. Conversely, if housing activity begins to roll over, it will act as a drag on growth. The point is that housing is a key swing factor for the US economy and it is poised in such a way that investors need to pay especially close attention to its progress.

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