DM HOUSING: LOTS OF MONITORING, NO REAL BRAKES

Suttle Economics Notes #162

- DM house price inflation was rapid into 2021, especially in Australia, Canada and Sweden
- High prices are stimulating activity, although supply responses take time
- The inventory of homes for sale remains low, notably in North America, pushing up prices
- Financial factors will not act as a brake; it would help if the Fed stopped buying MBS

Chart 1
DM house prices
%m/m; sa for US and UK; nsa for others

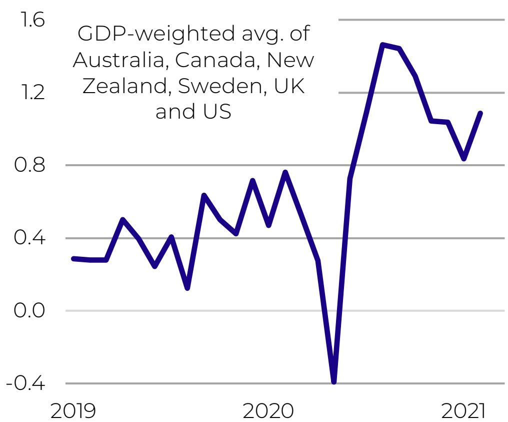
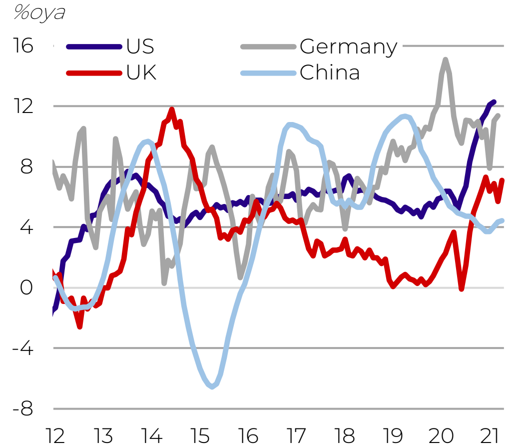


Chart 2
Major economies: house prices
%oya



Housing sector indicators across a broad array of DM economies have remained very strong into the early months of 2021. This is not a great surprise.[1] DM central bank monetary policy remains extraordinarily easy. Housing is the most interest and credit sensitive sector in any economy. Its response to stimulative monetary policies in the early quarters of the last expansion was dulled by the damage done by the bursting of the global housing bubble in 2008 and the resulting caution from all sides in the housing market. Early in this recovery, the response is proving to be far more vigorous. This is in part because of the pent-up demands from the anemic nature of the last one. In addition, C-19 has, so far, had a significant effect on the pattern of consumer spending, reducing the demand for services and thus freeing up more disposable income for outlays on housing.

The much-asked question is whether (and when) housing is riding for a fall. Financial factors do not seem likely to act as much of a brake any time soon. Lending conditions will remain very supportive and policy makers have both a limited willingness and ability to impose macroprudential measures sufficient to temper demand suddenly. The excesses of the last housing expansion in many countries have led to far more cautious behavior in this boom, making it less likely that housing will weaken because of a financial panic (a problem elsewhere might channel flows *towards* housing, as in the early 2000s). This makes it all the more likely that it will be diminishing affordability (high prices relative to incomes) that will eventually choke off the boom.

House price gains accelerate into 2021

DM house prices have continued to rise at a rapid clip in the early months of 2021. My 6 country (GDP-weighted) aggregate measure was up an average 1%m/m, in November through February (Chart 1). The

[1] My last note on DM housing was *What can stop surging DM housing prices?* Suttle Economics Notes #145, November 29th, 2020. The answer provided in the note was not much, in the short-run.

Chart 3
Smaller DM economies: house prices
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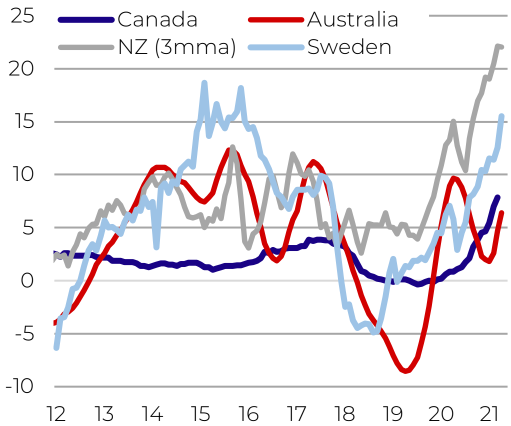


Chart 4
Nation-urban home inflation spread
%-points; national rate less urban rate (%oya)

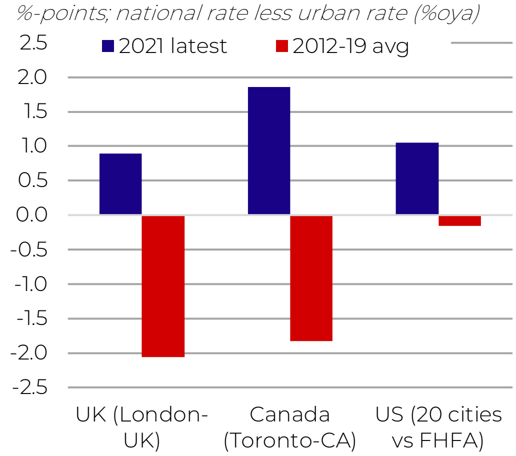
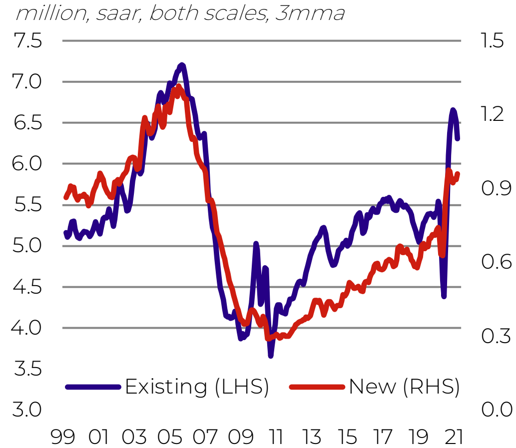


Chart 5
US home sales
million, saar, both scales, 3mma



US FHFA and Case-Shiller are available only through February. Timelier measures computed by "big data" realtors (e.g. Zillow) suggest that US house price inflation has continued at a monthly rate of 1% into the spring selling season. Among the larger economies, the acceleration in annual price gains since the middle of 2020 has been most notable in the US and UK (Chart 2). UK price gains look to have accelerated most recently (March through May) judging from data provided by the realtor indices and a national survey of surveyors.

House price inflation has remained most eye-catching among smaller DM economies, especially New Zealand and Sweden (Chart 3). There has been a widespread acceleration into 2021, including in Australia, where prices had remained weak through September. In the year to April, the Australian Corelogic median urban house price index was up 6.4%oya; in the 6m through April, however, it was up 19¼%, at an annual rate (ar). Over the same time frame, Sweden's HOX price index was up 19.4%, ar.

The other feature of recent DM price gains has been their uniformity across regions within countries. Previous phases of strong national price gains have been led by surges in urban areas. This time around, urban price gains have often lagged behind those in the economy as a whole (Chart 4). This is presumably partly a reflection of the reduced attractiveness of urban living since the outbreak of C-19. Price gains across US regions have been far more uniform in this price surge than in the last one, in 2005. Then, the standard deviation of annual price gains across the 9 regions was 5.6% (e.g., price gains in East North Central averaged 3.7% while gains in the Pacific were 20.4%). In the 12m through February 2021, the standard deviation of annual regional price gains was just 1.2% (the range spread was 7.3% in the West South Central to 10.9% in the Mountain region).

Shortages will stimulate activity

The dynamic of higher prices has been driven by a surge in demand for home purchase in response to falling interest rates. In the United States, home sales (both new and existing) initially fell in the early months of the C-19 crisis but have since recovered to be at their highest since 2006 (Chart 6). A similar pattern has developed in Canada. Existing monthly home sales in March touched 70k; the trend since 2013 had been a remarkably stable 40k (there was a brief slump below 20k in April 2020).

The most striking aspect of the US housing market is the lack of inventory of both new and existing homes for sale (Chart 6). The US National Association of Realtor (NAR) data show that there were just 1.07 million homes on the market in March, down from a peak of 4 million in July 2007 (and 3.5 million in

Chart 6
US: home inventory and affordability
index *months of sales*

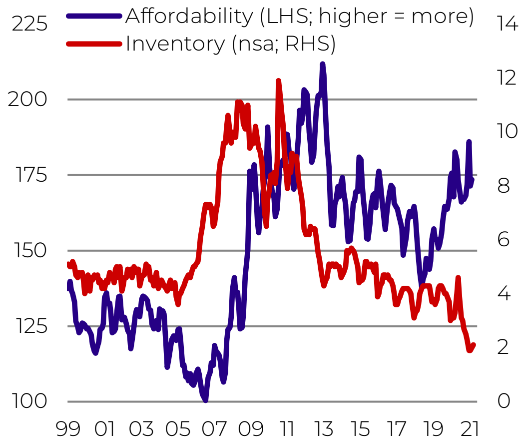


Chart 7
DM: housing growth contribution
% points of quarterly GDP growth, saar

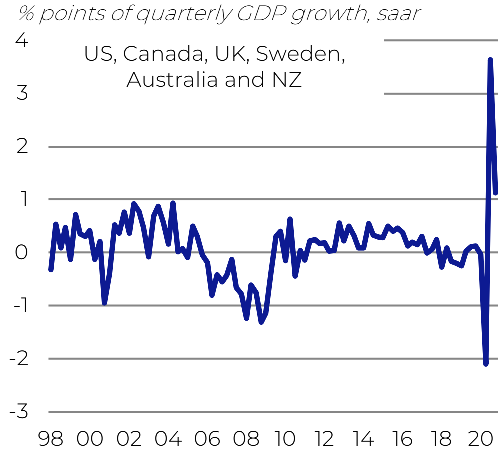
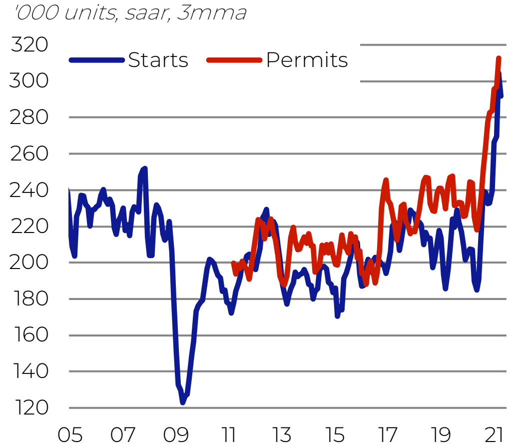


Chart 8
Canada: housing indicators
'000 units, saar, 3mma



August 2010). In 2021Q1, there was the lowest absolute stock of houses for sale on record. As a result, something of a buying frenzy has developed, with housing being sold at substantial mark-ups relative to asking after sitting on the market for a very short-period, often on an "as is" basis (i.e. with no inspections). NAR data show that the median home was on the market for 19 days in February 2021, down from an average of 100 days in February 2012. The inventory of cheaper houses is particularly scarce in the United States, having fallen by about one-third in the (national) price range up to $250k in the past year. By contrast, the inventory of homes with a list price of $750k or more has been roughly stable.

Housing already made a substantial contribution to DM growth in 2020H2 (Chart 7). The lift in 20Q3 reflected the resumption of activity after stoppages in 20Q2. Those two quarters are best averaged for a net gain of about ¾% of GDP per quarter; 20Q4 was just over 1%q/q, saar. 21Q1 looks to be on track for about ½%-point growth contribution.

Housing activity indicators have risen significantly in some of the smaller DM economies in recent months, which is consistent with the strong price signals seen there. The rise in permit applications and housing starts in Canada since the middle of 2020 is particularly noteworthy (Chart 8). Approvals (the equivalent of permits) have also been rising sharply in New Zealand and, most recently, in Australia (Chart 9).

The Australian housing sector has been on a roller coaster in recent years. The upswing through 2017 was fueled by strong speculative demand, including from Chinese buyers (the same had been true, to a lesser extent of New Zealand and Canada). The ending of this speculative wave was followed by a two year slump which was arrested, in part, by RBA easing in 2019. The recovery from mid-2019 was derailed for a while by C-19 problems, although now seems to be back on track, despite a lack of Chinese buyers.

Financial stability concerns: lots of monitoring

The buoyancy of housing markets (rising house prices and low rates encouraging activity and borrowing) is beginning to raise financial stability concerns at some central banks. In their April statements, both the Bank of Canada and Reserve Bank of Australia promised to "monitor" housing sector risks.

Housing related lending in the major DM economies has been far more subdued than in the mid-2000s, when housing markets were last overheating (Chart 10). US mortgage lending was up a modest 4.6%oya in 2021Q1. Growth in both Australia and Canada was about 4%oya.

The painful memory of the housing-linked credit problems in both the United States and parts of

Chart 9
Australia and NZ: housing approvals
'000 units, sa, last 3m average, both scales

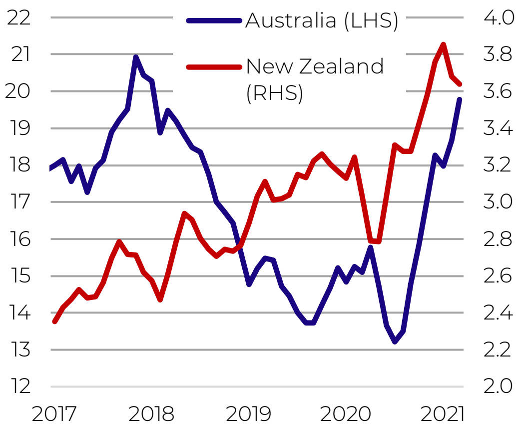


Chart 10
DM mortgage lending growth
%oya; adjusted for series breaks

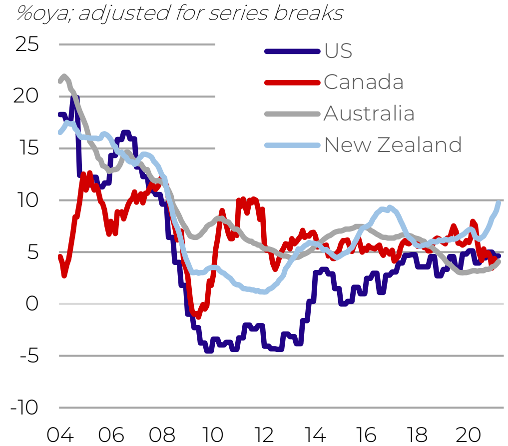
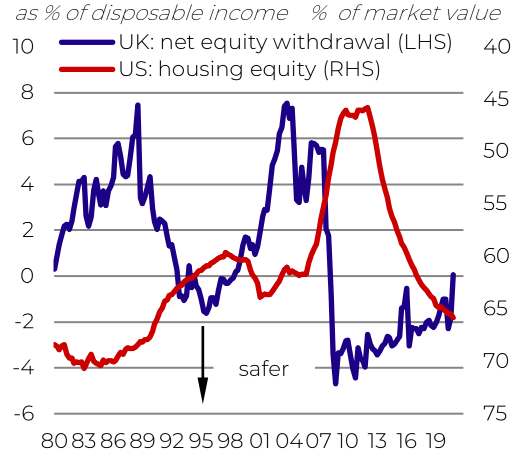


Chart 11
UK and US housing equity
as % of disposable income *% of market value*



Europe (the UK, Ireland, Iceland and Spain) has led to far more caution this time around. The DM regulatory framework is far tougher, requiring that both financial intermediaries and end borrowers maintain higher equity ratios. In the United States, the share of mortgage originations for borrowers with a FICO credit score of less than 720 was just 13.7% in 2021Q1, versus 48% in 2007Q1.

In the last housing boom, mortgage borrowers were able to run high leverage, in part through consistent equity withdrawal as home prices rose. In the current one, the combination of regulation and behavioral change has led to much more responsible behavior. The equity share in US housing was 65.9% in 2020Q4, its highest since September 1990 (Chart 11). Likewise, UK households were building housing equity between 2008 and 2020, although the latest uptick in mortgage borrowing may have ended this deleveraging. UK mortgage borrowing surged in March. The UK housing market is being buoyed up by a transactions tax (stamp duty) holiday that is currently scheduled to be phased out through Q3.

Mortgage growth and house price inflation have been most rapid in New Zealand. There has recently been some tension between the government and RBNZ over how to factor housing into policy-making. For now, the focus is on macroprudential measures (reduced loan-to-value ratios) to rein in risker lending, especially to property investors. In my view, there is a risk that some of the restrictive measures taken will dampen the growth of housing supply, while demand remains supported by low rates.

The Fed may also be skewing the housing market through its QE policy, which involves it buying $40 billions of residential mortgage backed securities each month. In the past year, household mortgage debt has risen by $450 billion, so the Fed is currently buying more than total net new issuance. In a world where the mortgage market was dysfunctional (2009-13) this approach made sense. Now, it is hard to rationalize, in my view. I think this makes it highly likely that MBS purchases will be wound down first as the Fed tapers its asset purchases, likely later in 2020.

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