# INSIGHT & PERSPECTIVE

## *U.S. Housing Decelerating*

***August 27, 2018***

***The sustained rise in U.S. home prices has put a dent in home affordability. Meanwhile, recent existing home sales data has been sluggish.***

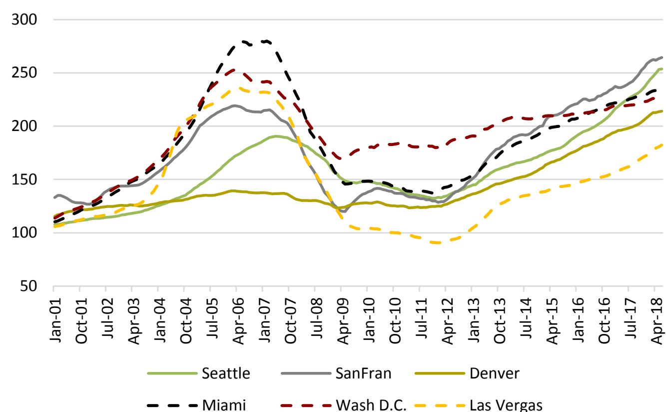
***Is the U.S. housing market beginning to recalibrate?***

***At approximately 15%-20% of the U.S. economy, housing will likely have an effect on how economists view GDP in the coming quarters.***

### Existing Home Activity Slowing; Affordability In Question

After enjoying a long post-crisis recovery, it appears the U.S. housing market is slowing down as higher home prices and higher mortgage rates chip away at affordability. In line with rising mortgage rates through much of 2018, the pace of home price gains has slowed since February and existing home sales figures have turned lower. Lately, more media reports have surfaced indicating buyers have begun to balk at steep price tags in the most high-demand metro areas. In some metros such Seattle, San Francisco and Denver, data indicates prices have moved well-above those in the housing heyday of the mid 2000's. Many of these regions are heavily influenced by growth in technology-related businesses. Other metros like Miami, D.C. and Las Vegas have still not reached their previous price highs; yet values have been on a steady recovery. While still not at its historical worst, home buyer affordability has deteriorated to lows last seen in 2008. The absolute bottom in affordability occurred in 2006 (See Figure 3). In relation to the deteriorating affordability, home inventory levels seemingly bottomed in December 2017 and have been on a slight rise since; indicating demand may be beginning to wane.

**Figure 1: S&P CoreLogic Cash Shiller Home Price Indices By Key Metro Area**
Source: S&P / Case Shiller




### New Home Activity Trends Unbroken

While the market for existing homes appears to be adjusting, new home activity data remains rather robust (Figure 2) as building permits, new home sales, and housing starts continue to be on the rise.

The post-crisis fall in new home activity was perhaps more severe versus existing homes,  and the recovery has been more gradual. New homes sales and housing starts are only approximately 50% of what they were at the previous housing peak.

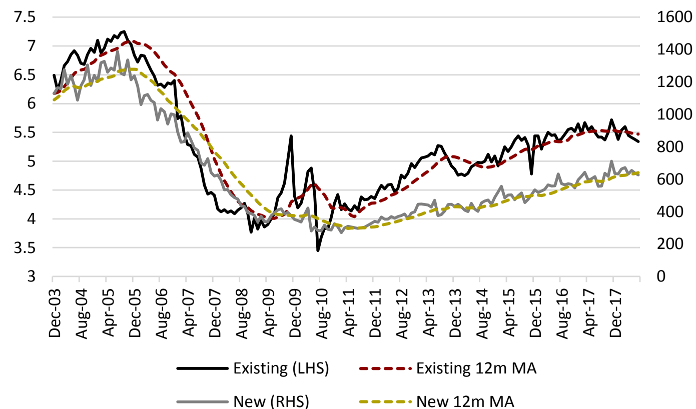
**Figure 2: U.S. Existing and New Home Sales**

Existing sales in millions of units (LHS); New sales in thousands of units (RHS)

12m MA = 12-month moving average

Source: National Association of Realtors; U.S. Census Bureau

***The trajectory of existing home sales has begun to weaken, while new home sales trends still remain rather strong.***




### Home Affordability Nearing Pre-Crisis Lows

Since 2012, the recovery in home prices has been a steady drag on home affordability; pushing the Home Affordability Index below its long-term average of 150.49 (Figure 3).  While the home price recovery has been good news economically, the sustained rise (back to pre-crisis levels) has begun to weigh on demand.  Over the last six years, buyers have had the benefit of low mortgage rates to aid home purchase buying power.  Now that mortgage rates and home prices have moved up in tandem, it has begun to take some of the steam out of the housing market.

***Median home prices, median income, and mortgage rates are components of the Homebuyer Affordability Index (Figure 3).***

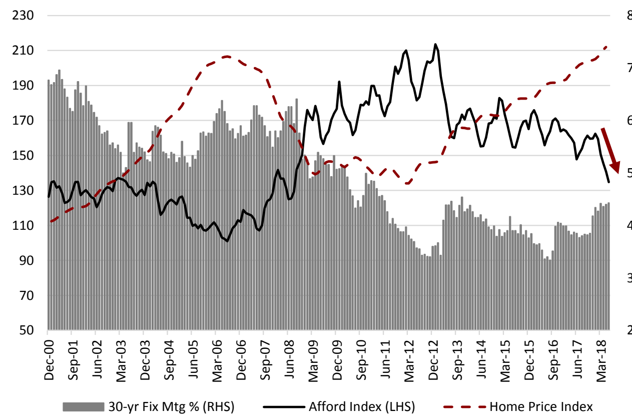
While home prices present a clear negative relationship to affordability, the sustainable impact of mortgage rates since 2000 has been more imprecise.  However, rapid and material increases in mortgage rates have helped to cause an immediate degradation in affordability (Figure 3).  We witnessed this in 2013 and the subsequent rise in interest rates thereafter .  Most recently, the latest rise in mortgage rates has caused affordability to move sharply lower.  The current combined impact of rates and prices is the culprit in pushing affordability back near pre-crisis lows, a condition that may be cause for some economic concern.

Meanwhile, tight home inventory has helped push up home prices for an extended period and contributed to the lack of affordability.  However, after reaching new multi-year lows, inventory may be showing early signs of correcting (Figure 4).  The potential emerging inventory correction, combined with pressures in affordability, and a bias to higher mortgage

rates may contribute to a further ease in existing home sales. This development raises the likelihood of an eventual ease in the pace of home price appreciation overall. This is why some concern over the trajectory of the housing market has come up in the recent financial press.

***Home prices and affordability have historically trended in opposite directions. The impact of mortgage rates, however, is less precise.***

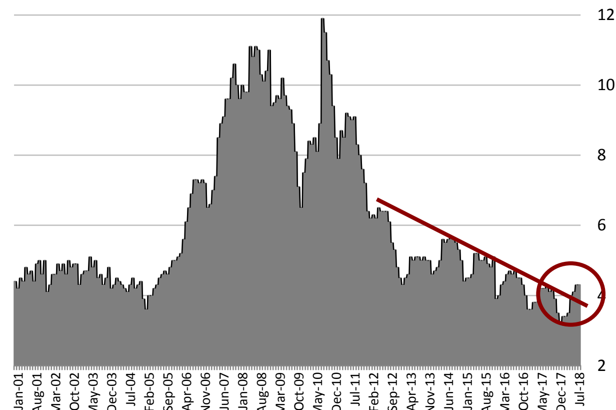
**Figure 3: Affordability Index, National Home Price Index & Mortgage Rates**
Source: S&P / Case Shiller,=; Bankrate.com; National Association of Realtors




***Inventory levels have broken the trend pattern of lower highs and lower lows. The potential for a firm reversal in the prevailing trend is something we are watching closely.***

***In our view, a firm reversal could put some pressure on the recent home price trajectory (see dashed line in Figure 3).***

**Figure 4: Months Supply of U.S. Home Inventory**
Source: National Association of Realtors




## Something To Watch

In our view, current housing conditions are removed from the excesses of the mid-2000s. However, a directional change in home prices and housing should be important to economists and investors. Real Estate and related industries account for approximately 15% to 20% of the U.S. economy, and sentiment in the space goes a long way in effecting how consumers and investors feel about underlying economics. To further the point, ongoing signs of deceleration in housing and/or an outright

downturn should be expected to negatively effect U.S. GDP forecasts in the out quarters. As part of our work, we will maintain our watch of these and other U.S. housing developments and their potential effects on the market and the economy.

### Questions?

Please contact us should you need further detail on this analysis and/or our general market view. We will be glad to have a discussion as to how these and other circumstances may effect your asset allocation or portfolio strategy.

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**MAGNUS FINANCIAL GROUP LLC**
280 Park Avenue, 25th Floor West,

New York, NY 10017

800-339-1367

www.MagnusFinancial.com