DUCENTA SQUARED
ASSET MANAGEMENT

Monthly Fixed Income Insight

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US housing market faces a perfect storm

The US housing market has historically been a key driver of the business cycle providing investment, employment, and consumption to the economy. Excluding the easy lending standards during the 2000s, which distorted the cyclicality of the property sector, the housing market has traditionally been a leading indicator for the overall economy. The US housing market, which is facing a perfect storm of rising financing costs, weakening demand, and increased supply, is already in a recession and we expect the overall economy to follow suit in the first half of 2023.

Housing demand falling off a cliff

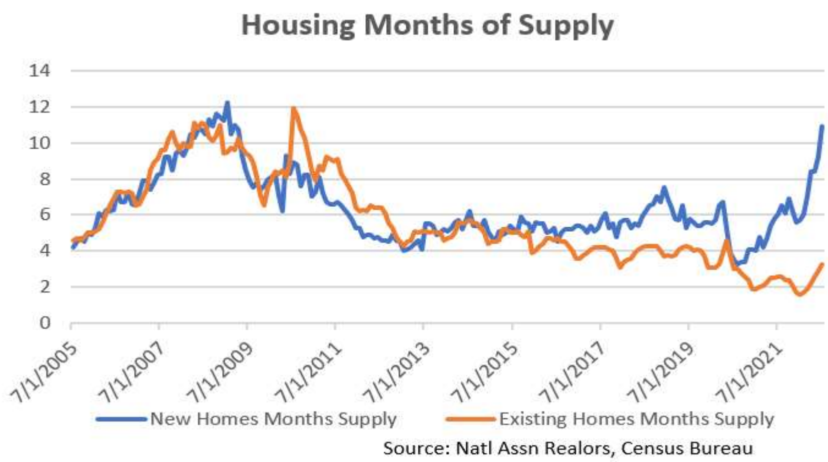
The fiscal and monetary policy stimulus in support of the economic collapse following the pandemic fueled a boom in the housing market. The “good times” for the housing market appear to be over as existing home sales and new home sales in July 2022 declined 20% and 30%, respectively, on a year-over-year basis. Pending home sales declined 23% year-over-year in the same period and applications for purchase mortgages are down 29% year-to-date. With mortgage rates above 6% for the first time since December of 2008 and housing affordability down 43% from the peak in March of 2021, we expect the decline in mortgage activity to accelerate from here.

Source: Natl Assn Realors, Census Bureau

Source: FHLMC

Housing supply is growing

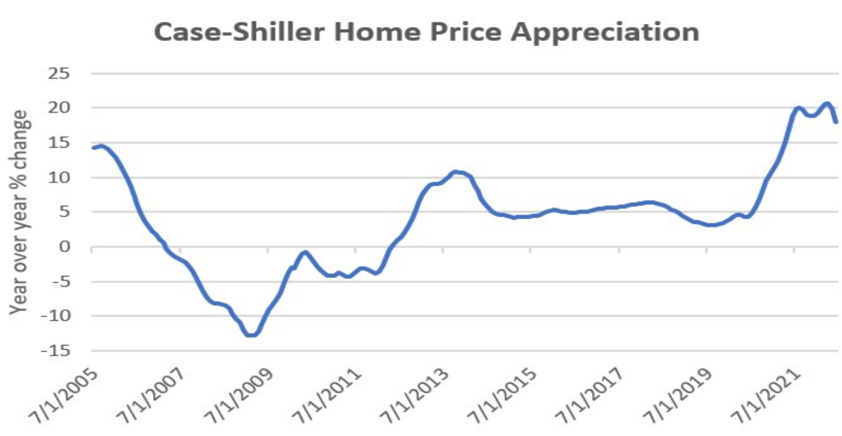
Inventory levels for both new and existing homes are increasing. The graph below highlights the combined effect of falling sales volumes and rising inventory levels on the months’ supply in the housing market. New home months’ supply reached an all-time low of 3.3 months in August of 2020 and in July of this year rose to a 13-year high of 10.9. Part of the increase in the months’ supply of new homes is attributable to the dramatic decline in sales, but inventories have also moved higher from a low point of 284,000 new homes in August of 2020 to 464,000 in July of 2022. We expect inventory levels to continue to increase but at a slower pace, given the negative sentiment expressed by the National Association of Home Builders Index which fell for the eighth consecutive month in August.



Home prices are the last shoe to drop

From the S&P CoreLogic Case-Shiller Home Price Index (the "Case-Shiller Index"), home prices are up an astounding 43% since the start of the pandemic in March of 2020. With deteriorating demand and rising supply, home price growth has started to slow. In June, the Case-Shiller Index declined on an annual basis from 19.9% to 18% which represented the largest monthly decline since the inception of the index in 1987. The hot property markets in the west, such as Los Angeles, San Francisco, Denver, and Seattle, recorded negative month-over-month prices in June. Given the supply and demand imbalance and deteriorating affordability, we see prices slowing sharply over the coming quarters with a risk of outright declines in home prices. We expect home price appreciation to fall from the current 18% to around 5% for 2022 and see prices flat in 2023 with a risk for modest declines.

Despite our negative outlook on the current housing market, we do not expect a repeat of the 2008-2009 housing induced economic collapse. The structural differences between the financial crisis housing market and the current one are significant. Post-great financial crisis regulatory reforms to the mortgage lending market have reduced both leverage and speculation in housing, and as such, we do not see outsized downside risk to the broad economy.



Past performance is no guarantee of future results.

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