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Federal Reserve Bank *of* Atlanta

MACROBLOG

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What's behind Housing's June Swoon?

The housing market appears to have endured a particularly cruel month in June. Fairly good numbers on existing home sales provided some antidote to a second consecutive monthly decline in housing starts and a sharp decline in new home sales. But that palliative is less comforting than it might otherwise be given the fact that existing sales were still 2.3 percent below the June 2013 rate, and budding optimism diminished further with this week's unexpected drop off in the pace of pending home sales.

In her recent remarks before the Senate Committee on Banking, Housing, and Urban Affairs and before the House Committee on Financial Services, Federal Reserve Chair Janet Yellen took particular note of ongoing weakness in residential real estate:

> The housing sector, however, has shown little recent progress. While this sector has recovered notably from its earlier trough, housing activity leveled off in the wake of last year's increase in mortgage rates, and readings this year have, overall, continued to be disappointing.

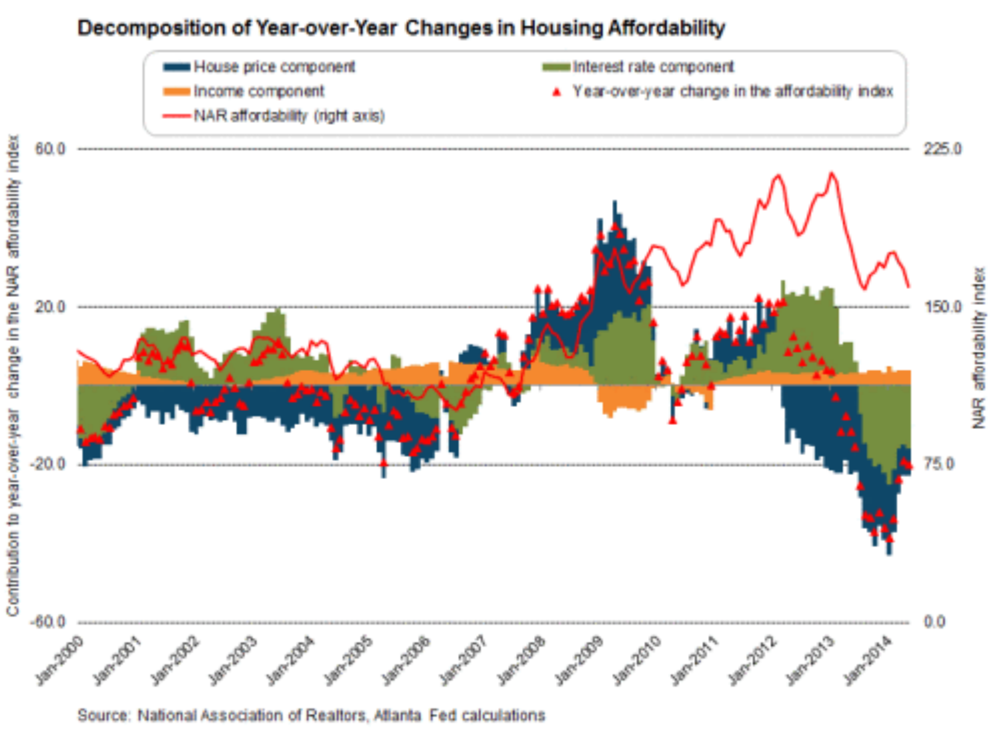
The statement following the conclusion of this week's meeting of the Federal Open Market Committee provided an exclamation point to Chair Yellen's commentary:

> Information received since the Federal Open Market Committee met in June indicates that ... recovery in the housing sector remains slow.

The housing market was a bright spot in the economy from early 2012 to mid-2013, and there's no shortage of conjecture on why it has morphed into a source of concern. Reasonable hypotheses include reduced affordability brought on by higher mortgage rates and real estate prices, tighter lending conditions and ongoing balance sheet issues for households (think student debt), and supply constraints associated with rising construction costs and lot availability (at least in the most desirable locations, as examples here and here discuss).

In a March post in the Atlanta Fed's *SouthPoint*, affordability issues—specifically, interest rates and prices—constituted two of the top three explanations given by our broker and builder contacts in the Southeast for recent slower growth in the housing market. Earlier, we had examined the affordability issue in an Atlanta Fed *Real Estate Research* post. In it, we decomposed the affordability index that the National Association of Realtors (NAR) produces each month. We used our decomposition to show that the rebound in housing prices in 2012 served as a huge drag on affordability and, after six years of contributing to affordability, mortgage interest rates became a drag in mid-2013.

How—and why—has the affordability index changed since we last checked? The chart below provides an update through May 2014 (the latest date for which we have the data necessary for our decomposition):



(enlarge)

On a year-over-year basis, affordability has fallen as a result of rising prices and last summer's uptick in interest rates. Still, affordability remains high by precrisis standards. And given that we have recently passed the anniversary of the first "taper talk," the impact of the interest rate component should fade if rates remain stable and thus become similar to, if not below, year-ago levels. Likewise, house price growth has decelerated and will continue to be less of a drag on affordability as measured by NAR.

It may be fair to attribute some of the recent softness in housing to affordability. But in light of the still relatively high readings of our index, it seems likely that the main culprits are one or more of the other factors discussed above.

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