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HOUSING MARKET PERSPECTIVES

On the Level with Bill Emmons

Could Housing Markets Face Another "Taper Tantrum" Moment?

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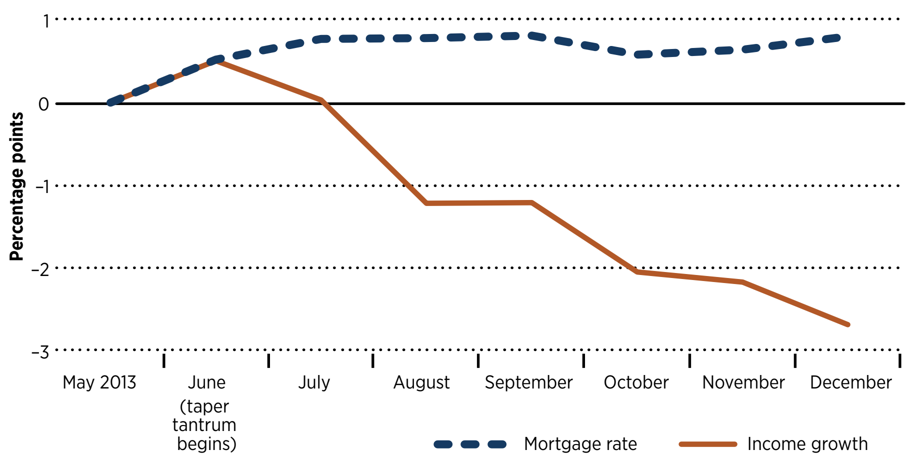
FIGURE 1

Change in 30-Year Mortgage Rate and Household Income Growth Rate



SOURCES: Wall Street Journal, Bureau of Economic Analysis

NOTE: Mortgage rate is the monthly average of daily rates for 30-year fixed-rate mortgages. Income is the three-month moving average of inflation-adjusted per-capita disposable personal income. The figure shows cumulative changes since May 2013 in the level of the mortgage rate and cumulative change in the year-over-year growth rate of income in percentage points.

During the summer of 2013, rising mortgage rates associated with the so-called "taper tantrum" started to pressure the housing markets. While housing starts, home sales and house prices generally grew more slowly or declined through the end of 2013, this did not lead to a full-fledged housing downturn or a significant economic slump.

While still historically low, mortgage rates have been on the rise again in recent months. However, at least so far, they are rising at a somewhat slower pace than they did in the second half of 2013. On the other hand, household income growth has dropped in recent months. In addition, house prices and rents, having increased strongly for several years, now appear more vulnerable to a correction than they did in 2013. Will housing markets weaken in 2017 as they did during the taper tantrum of 2013, and will the economy escape relatively unharmed again this time?

The Taper Tantrum of 2013 and the Housing Market Slowdown

Comments by former Federal Reserve Chairman Ben Bernanke in June 2013 about the potential for tighter monetary policy in the near future triggered a sharp increase in long-term interest rates, including fixed-rate mortgages. This became known as the "taper tantrum." Figure 1 shows an almost one percentage point increase in the 30-year fixed mortgage rate between May and September of 2013. At the same time, household income growth was slowing (i.e., was growing at successively slower rates from one month to the next). This combination suggests that financial markets may have reacted more to Bernanke's comments than to signs of a strengthening economy. The result was a financial shock to housing and other interest-rate sensitive parts of the economy.

Several housing market indicators reacted strongly to this rise in mortgage rates. Figure 2 shows that housing starts, home sales and mortgage applications—which include both home purchase and refinancing transactions—slowed sharply through the end of that year. By October, the year-over-year growth rate of housing starts had declined 30 percentage points from May. By December, home sales growth was about 15 percentage points lower than before the taper tantrum. The growth rate of mortgage applications had declined by almost 60 percentage points by the end of the year.

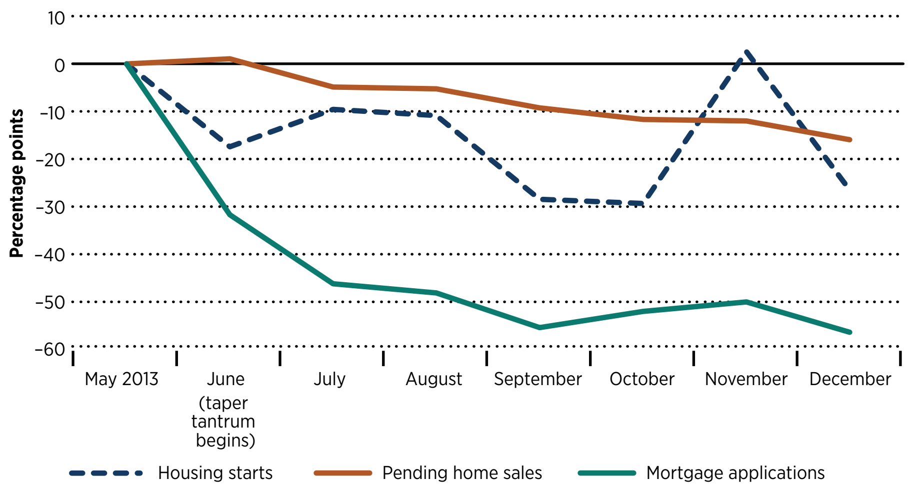
House prices and the month-to-month cost of shelter—including both the rent paid by apartment dwellers and a measure of "implicit rent" that represents the cost of owning and occupying one's own house, termed "owners' equivalent rent"—also seemed to react modestly to higher mortgage rates. Figure 3 shows that, relative to price trends that were in place in May of 2013, both house prices and the cost of shelter rose a bit more slowly for a brief period. House prices also rose more slowly.

Will Housing Markets Follow the Same Pattern in 2017?

Virtually all long-term interest rates increased in late 2016 and early 2017. Market commentators point to the outcome of the November 2016 election and a widely held view that fiscal policy changes may occur in 2017, raising economic growth or inflation, at least temporarily. At the same time, monetary policy is becoming more restrictive, which also could lift longer-term interest rates. At its March 2017 meeting, the Federal Open Market Committee raised its federal funds rate target by 0.25 percent to a range of 0.75 percent to

FIGURE 2

Change in Year-Over-Year Growth Rates

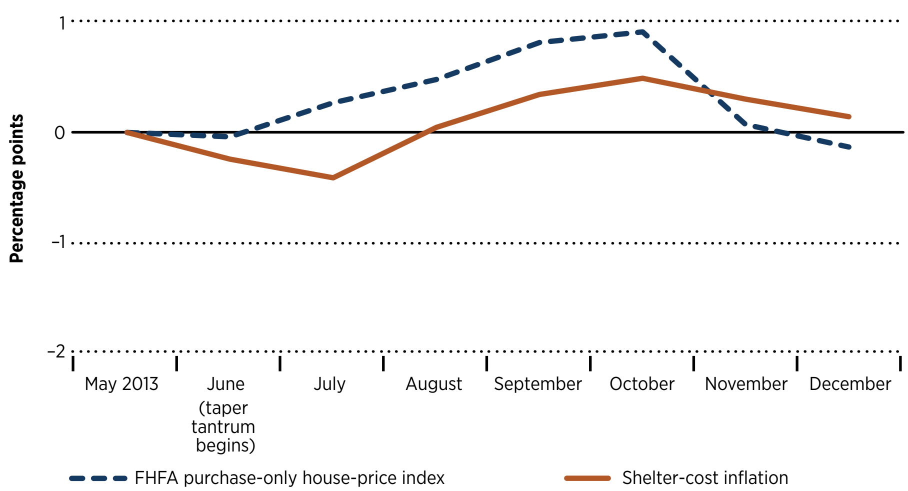


SOURCES: Census Bureau, National Association of Realtors, Mortgage Bankers Association.

NOTE: All series are seasonally adjusted. Housing starts and pending home sales are annualized number of housing units. Mortgage applications include both home-purchase and refinance transactions; the applications index equals 100 in the week ending Mar. 16, 1990. The figure shows cumulative changes in the year-over-year growth rates of each series in percentage points.

FIGURE 3

Change in Excess Housing Inflation Rates



SOURCES: Federal Housing Finance Agency, Bureau of Labor Statistics.

NOTE: All series are seasonally adjusted. Excess FHFA inflation is calculated by subtracting the year-over-year growth rate of the all-items consumer price index (CPI) from the year-over-year growth rate of the FHFA purchase-only house-price index. Excess shelter inflation is calculated by subtracting the year-over-year growth rate of the all-items CPI from the year-over-year growth rate of the CPI shelter index. The figure shows cumulative changes since May 2013 in year-over-year growth rates of each measure in percentage points.

1 percent, with the potential for future gradual increases this year if the economy performs in line with the FOMC's forecasts.

Figure 4 shows that mortgage rates have increased by more than one half of one percent through the first four post-election months, somewhat less than during the taper tantrum. As in 2013, a weakening trend in household income suggests that higher mortgage rates likely have more to do with anticipated policy changes than tangible signs of a stronger economy.

The growth rates of housing starts and home sales have declined in recent months, according to Figure 5. Mortgage applications have also slowed. These recent changes are similar to those seen during the taper tantrum.

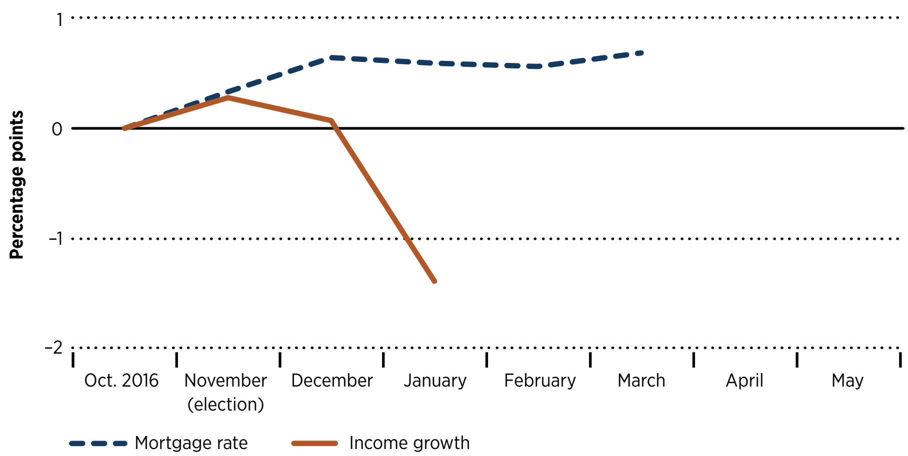
In one respect, housing markets may be more vulnerable to higher mortgage rates now than they were in 2013. House prices and apartment rents have increased strongly in recent years, rising faster than household incomes in some parts of the country.[1] Figure 6 shows house prices, as well as the cost of shelter, appear to have slowed noticeably relative to their recent trends. Compared to overall inflation, housing-related measures of price pressures have decreased recently much more than they did during the taper tantrum.

Cautious Housing Outlook is Warranted

Mortgage rates have increased less since the November election than they did during the taper tantrum. However, the housing recovery is at a more advanced stage now and may be more vulnerable to a correction. The strength of the overall economy also is unclear, as some forecasts of first-quarter GDP growth have recently declined below one percent.[2] Whether

FIGURE 4

Change in 30-Year Mortgage Rate and Household Income Growth Rate



SOURCES: Wall Street Journal, Bureau of Economic Analysis

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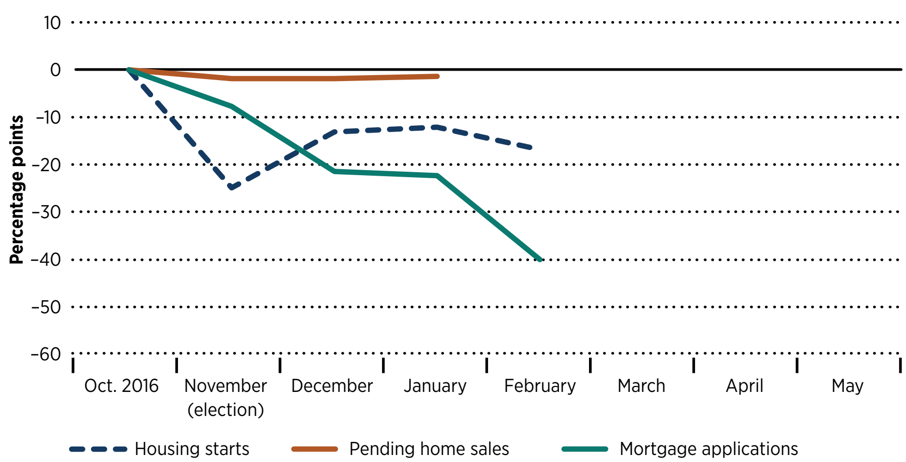
FIGURE 5

Change in Year-over-Year Growth Rates



SOURCES: Census Bureau, National Association of Realtors, Mortgage Bankers Association.

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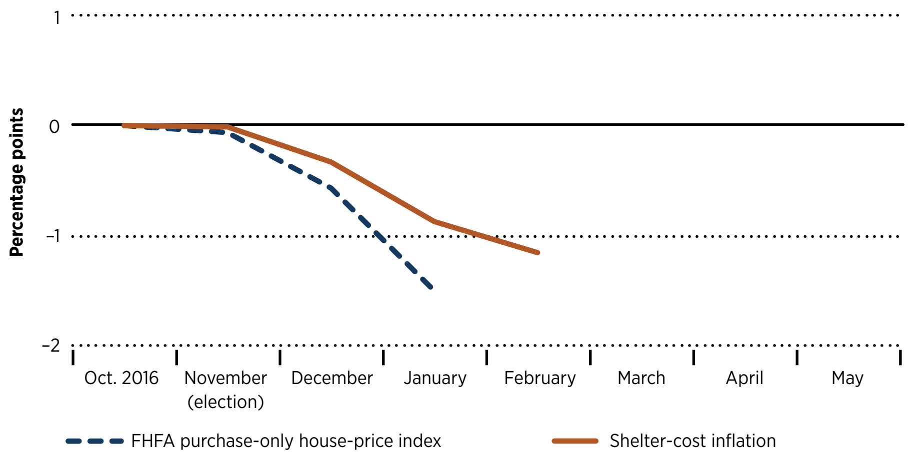
higher mortgage rates will cause housing markets to falter in 2017 is still an open question. ■

ENDNOTES

1 See On the Level, Issue 2.
2 See daily updates of the Federal Reserve Bank of Atlanta's GDPNow forecast.

FIGURE 6

Change in Excess Housing Inflation Rates



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