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Asset Allocation
Chart of the Month

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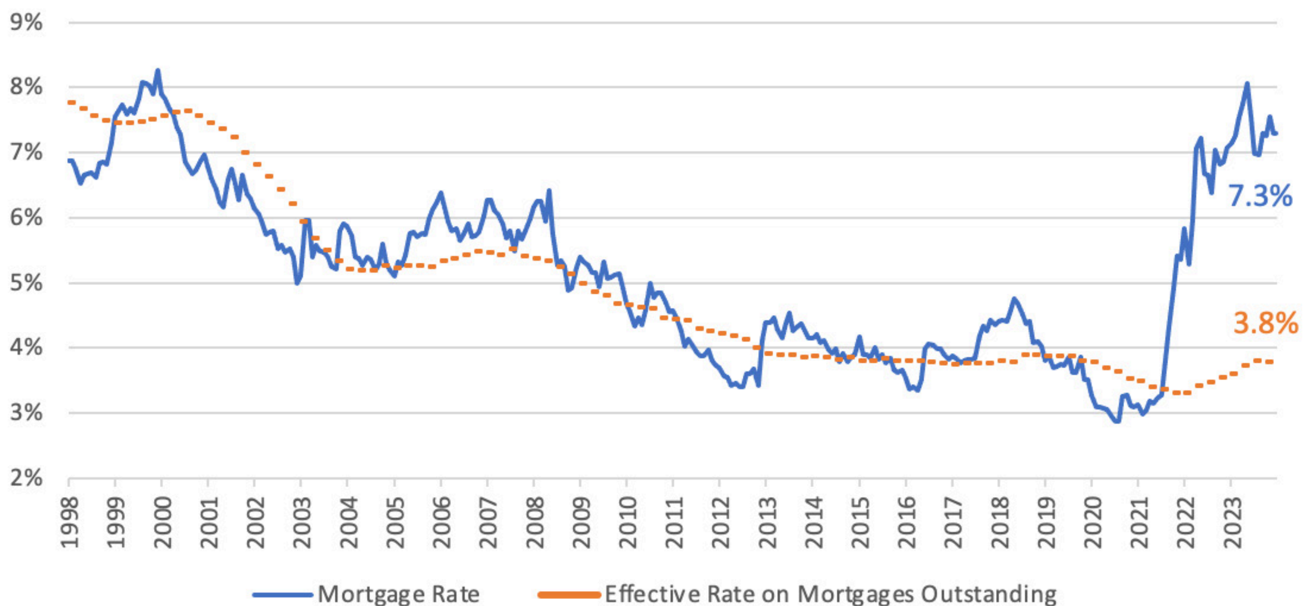
Cabin Fever

- Housing is one of the most interest rate sensitive sectors in the economy. Yet the unique aspects of this cycle have created challenges for the Federal Reserve in its effort to slow the economy and tame inflation.
- In theory, higher interest rates should reduce demand for housing by increasing the cost of ownership. While it's true that single-family housing starts have decreased due to higher interest rates, we haven't seen a corresponding drop in home prices.
- Typically, home prices decline following monetary tightening. However, this cycle is different. Since the Fed began raising interest rates in February 2022, the median new home price has increased by 10%, existing home prices have risen 8%, while consumer prices have increased just 6%. Not only are home prices higher, but they are also rising faster than overall inflation.
- Higher mortgage rates have indeed lowered housing demand. New mortgage applications are at their lowest levels since 1995. However, the supply of homes has decreased even more, with existing home inventory near record lows.
- High interest rates have created a "locked-in effect" where homeowners either do not want to move or cannot afford to move due to high mortgage rates. An extended period of low interest rates, followed by the rapid rate hikes by the Fed, has created a significant gap between new mortgage rates and the effective rate on existing mortgages. Homeowners are locked in, while potential homeowners are locked out.
- We believe it will take years for supply and demand conditions to normalize. In the meantime, pent-up demand for housing is growing. Even if rate cuts release some supply, we expect demand to meet it, keeping upward pressure on home prices.

Mortgage Rate Gap



Source: Bloomberg. The mortgage rate is based on the Bankrate.com national average with monthly data since 1998 through the latest reading on June 19, 2024. The effective rate is based on data from the BEA with quarterly readings through the 1st quarter of 2024.

Word About Risk

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