Bone's Loans

BANES CAPITAL GROUP

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When I was younger (like, say, 35) I was always impressed with economists' ability to predict changes in items such as existing home sales. As I set about learning the ways of the prognosticator over the past 15 years, I've realized one overarching fact about economists in those 'earlier' days and that is this: They had better toys than me.

The technology boom and the democratization of data has led to charts such as the ones below, courtesy of Thompson Reuters Eikon. In the chart entitled "US Housing Summary" below, we can see Existing Home Sales has had four consecutive monthly declines for the first time since late 2013. If you recall, late 2013 was the first significant updraft in 10-year UST yields since the credit crisis. Higher rates couldn't hold into 2014, and the average 30-year mortgage rate resumed its fall, and home sales began another extended period of impressive gains.

Unfortunately, it doesn't appear falling Treasury rates will bail out home sales, and consequently home prices, this time. While home price indices are still on the rise, and the median price of a home in the U.S. is at an all-time high ($269,600 as of July 31), I think it's pretty safe to make the same prognostication I'm hearing in the wider media that we can most likely expect a non-seasonally adjusted drop in U.S. home prices for the first real time since late 2012.

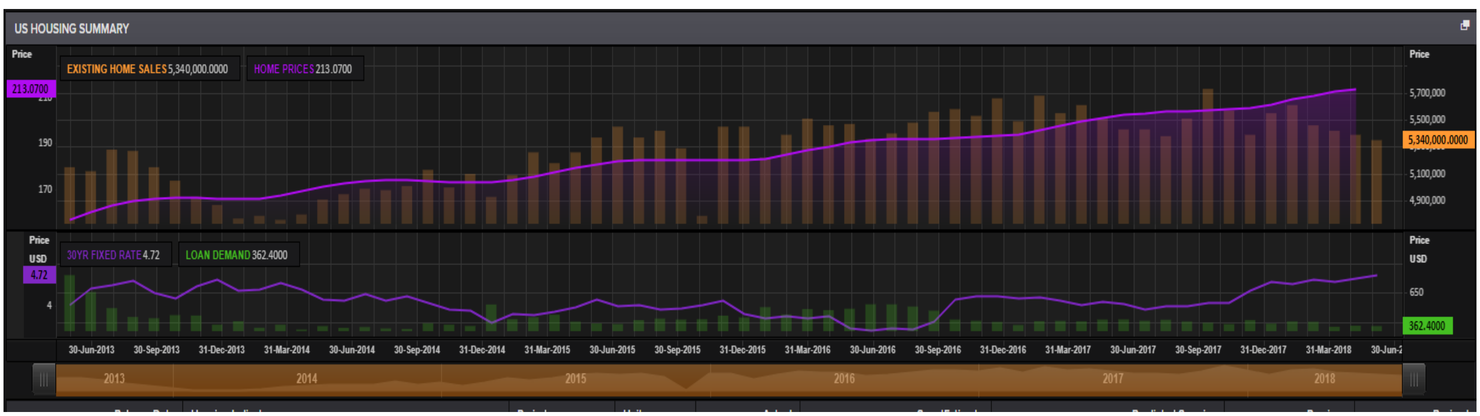
But is this a good thing? The country is certainly having home affordability issues, so a median home price drop could certainly put more good people in homes at the margin, but in my humble opinion the affordability issue is a much larger and systemic issue not easily solved by a cyclical break in home prices. I'll let the good people at the Urban Institute and others debate that one, and I'll move on to the second concern brought about by falling home prices: "How negatively will this affect the broader economy?"

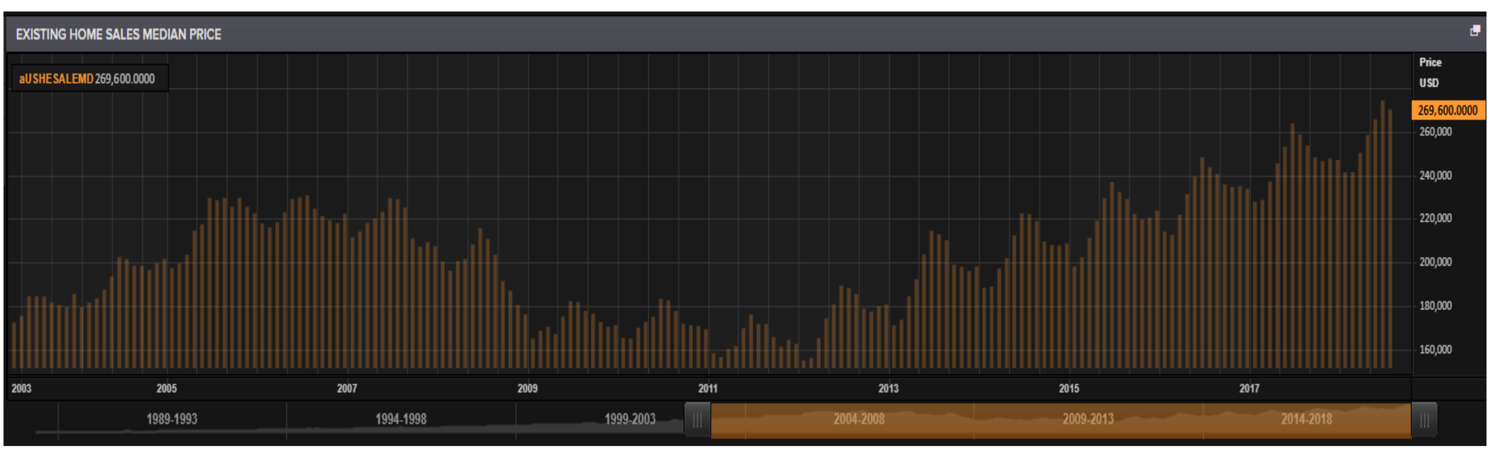
This is an interesting one, not only because it will become very personal for a lot of folks, but because this brings into question the intent of the Fed and will be a great test of the foundation of the housing market rebound post-crisis. Is the Fed hoping for a correction in home prices to solve (or at least assist) in the affordability issue? Are they hoping for a 'soft landing' in home prices? The Fed's intent is about to be tested over the next few months. There has been very little blowback from the latest round of Fed Fund rate increases, primarily because the consumer wealth accumulated during the most recent (record) run up in the stock market hasn't yet suffered. The general public's pocketbook hasn't yet been hit. However, the coming drop in home prices will be every bit as painful as a drop in 401k values, and will cause the first round of consumer grumbling this particular Fed has had to endure. And this time, unlike late 2013, lower rates won't quickly reverse course to buoy home prices and quieten the grumbling.

While consumer grumbling will be painful for the Fed, I'm sure they're prepared for it to some degree. You don't take away the punchbowl at the party without expecting some to be unhappy. But will a break in home prices cause ripples throughout the rest of the economy? The answer has to be yes, but how much? The housing market foundation is much stronger this time around. We don't have, for example, durable goods outpacing historical gains solely on the expectation of home price gains as we did in 2007-2008. in other words, call girls in Miami aren't ordering five dishwashers for their five rental homes they expect to flip for a profit in 3 months.

In my opinion it will be a great first test for our housing economy since the great recession, and I'm not of the opinion the ripple effect will be widespread and nasty. As a matter of fact, a cyclical break in home prices now could potentially let off a significant amount of steam that would set up another sustained run up in home prices over the next ten or so years. That’s a good thing, unless you're trying to buy your first home ... and you're in San Francisco ... and you don't fit into the mold of any of the current housing subsidies ... and you don't have a rich uncle.

But what do I know? We should ask the economists who, I'm sure, still have better toys than me.





Courtesy: Thompson Reuters Eikon

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