

## No Home Price “Collapse”

Many of you may have recently seen a chart circulating on the internet suggesting a nationwide collapse in home prices is on the way, that we are in the “biggest bubble in history,” the collapse is “inevitable and nothing can stop it.” The claim is that since home prices adjusted for general price inflation are even higher than they were in the previous bubble that peaked nearly twenty years ago, the coming crash “will be even worse.”

Just to refresh our recollections, the bursting of the last bubble led to a massive decline in home prices, with the national Case-Shiller home price index down 27% in the five years ending in early 2012. An even larger decline today could be devastating for the US economy.

But we don’t think this is going to happen.

First, it’s important to recognize that one of the reasons housing is so unaffordable is that we have a set of government policies that boost home prices while reducing after-tax incomes. These include state and local regulations that stifle home construction, government-sponsored enterprises that artificially boost mortgage lending while not boosting housing supply, and a fiscal spending and tax system that leaves potential homeowners with less ability to accumulate a down-payment or meet monthly income requirements. When government at all levels spends more than 35% of GDP and the overall cost of government – including regulations, for example – is roughly 50% of GDP, there is less left over for what workers actually want versus what the government wants us to have.

Second, the same analyst now making apocalyptic warnings about the housing market did so in June 2019, since which home prices are up 57% overall or 7.6% per year, while the overall consumer price index was up 3.9% per year.

Third, there is a key difference between the bubble twenty years ago and the current environment. We had massive overbuilding in the prior bubble, with housing starts averaging 1.9 million per year in 2002-06, versus an average of 1.5 million in the past five years.

To see the importance of housing supply, imagine a hypothetical world in which the government decided to ban all new housing construction. What would we expect to happen to home prices relative to the general consumer price index? Obviously, home prices would go way up due to limited supply. Home prices would also be higher relative to wages.

Clearly, this would be bad policy; we would never want the government to ban home building. But if it did so the rise in home prices relative to overall prices and wages would not be a “bubble,” it’s what the remaining market forces would require: higher home prices to reflect housing scarcity unless and until the government ended the idiotic ban on home building.

In a way, that’s what has happened, but not as extreme. Government has limited homebuilding through environmental rules, zoning, and “affordability” concerns (the latter of which end up making home less affordable!). And so homes are scarcer than they should be and home prices have gone up relative to the price of other goods and services. In addition, with so much land unavailable for development, a larger population means higher prices, as well.

One issue to take note of in the housing market is that strict immigration enforcement so far this year is probably putting modest downward pressure on prices. Case-Shiller home prices were down 0.7% in August versus January. Yes, strict enforcement should lift the cost of building new homes as the labor supply gets tighter. But it also makes more rental units available for natives and legal immigrants, which should put downward pressure on rents and let potential home buyers wait longer before they buy. In turn, that means downward pressure on the price of existing homes.

None of this is to say all is well with the US economy. The stock market looks priced for perfection and is underestimating recession risk. But a housing collapse is highly unlikely and a collapse even greater than the last one even more so.

| Date/Time (CST) | U.S. Economic Data             | Consensus | First Trust  | Actual | Previous |
|-----------------|--------------------------------|-----------|--------------|--------|----------|
| 11-25 / 7:30 am | Retail Sales – Sep             | +0.4%     | <b>+0.5%</b> |        | +0.6%    |
| 7:30 am         | Retail Sales Ex-Auto – Sep     | +0.3%     | <b>+0.2%</b> |        | +0.7%    |
| 7:30 am         | PPI – Sep                      | +0.3%     | <b>+0.2%</b> |        | -0.1%    |
| 7:30 am         | “Core” PPI – Sep               | +0.2%     | <b>+0.1%</b> |        | -0.1%    |
| 9:00 am         | Business Inventories – Aug     | 0.0%      | <b>0.0%</b>  |        | +0.2%    |
| 11/26 – 7:30 am | Initial Claims – Nov 22        | 225K      | <b>222K</b>  |        | 220K     |
| 7:30 am         | Durable Goods – Sep            | +0.5%     | <b>NA</b>    |        | +2.9%    |
| 7:30 am         | Durable Goods (Ex-Trans) – Sep | +0.2%     | <b>+0.3%</b> |        | +0.3%    |
| 8:45 am         | Chicago PMI – Nov              | 43.8      | <b>43.3</b>  |        | 43.8     |