GSE Activity Report

Thursday, October 1, 2020

Something Else to Worry About

Summary

A troubling new IMF staff paper looks at U.S. housing policy since COVID to uncover some worrisome aggregate and distributional effects. Among these is a sharp build-up in systemic risk due to house-price appreciation and a likely hike in already-grievous wealth inequality related to home ownership.

Analysis

Using 2017-2020 zip code-level, mortgage-market, census, and other data and nonparametric estimations, aggregate findings include:

- After a temporary slowdown in March and April, the median growth rate of the median house price per square foot (PSQFT) bounced right back and then sharply exceeded pre-pandemic levels. Some zip codes experienced YOY growth of over 30% in each month since March. Indeed, these data – but not others in this paper regarding pricing -- may be lower than actual rises for single-family homes if condo prices were excluded. Realtor data did not permit this even though condo prices are doing far less well in some areas than single-family in the wake of the pandemic. Still, overall house-price acceleration is faster than in any four-month period prior to 2007. After the significant interest-rate cut in November 2002, it took about eight months for the house price growth rate to increase steadily; after the interest rate cut in March of this year, it took one month.
- Housing demand has risen at an extraordinary rate since April – median views per property in a typical zip code rose by 99 percent in July 2020 and 121 percent in August 2020. These are astounding numbers and worth notice but a caution: many of these searches are likely not done by purchasers, but by those looking for comps to assess how much equity they might be able to cash out. However, the study doesn't seek to differentiate search purposes, likely because current data make that impossible.
- Lower mortgage rates likely combined with other Fed COVID interventions (e.g., agency paper purchases) clearly account for the sharp increase in housing demand growth even though "fear of missing out" and/or other fundamental changes in household behavior may also account for at least some of them.

Key distributional findings include:

- Increases in housing prices are greatest at the lower-to-middle end of the market as

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determined by zip-code demographics. Even disregarding growth in the very low-income segment, YOY house-price growth rate goes from about 15% in zip-codes with $25,000 median household incomes to zero for those above $225,000 medians, increasing again for very rich zip codes. There is in fact a U-shaped distribution for housing demand.

- A possible explanation for higher prices in lower-income neighborhoods is that lower rates reduce DTI mortgage barriers; if so, this increases financial-stability risk due to greater household leverage. Fear-of-missing-out drivers might explain the very-rich demand uptake, but low rates combined with this phenomenon increases overall price acceleration. Again, this creates stability risk, this time due to the asset-price bubble phenomenon.
- An alternative explanation for high demand in lower-income areas is that higher-income people are fleeing urban areas and thus driving up demand in lower-income zips, but data do not bear this out – house-price, demand, and supply increases are broad-based. This might seem to be equalizing if it were not for the fact that most lower-income households are still unable to access the housing market due to affordability problems that were crushing even before rapid post-pandemic price acceleration. The study posits in the absence of other data that lower-income zip code demand is sparked by gentrification.

Outlook

Noting the need for more data to prove causality, the IMF paper nonetheless concludes that its results argue for pairing major central-bank rate and market interventions with macroprudential policies (e.g., LTV or DTI limits) to reduce systemic risk. As we have noted before, these macroprudential solutions are challenging in the U.S. because the Fed has no power over the GSEs or the nonbanks supplying them with mortgages. Top-down secondary-market standards aimed at equalizing purchases without increasing risk will be a top priority in 2021 regardless of who wins the election if the trends spotted here for the first time continue into early next year. If instability follows these data, then policy solutions will be still more urgent.

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