GSE Activity Report

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The Big Squeeze

Summary

Reinforcing the sharp turn-around in housing markets evident since the Fed surprised markets with its first 75 bps hike, a new working paper from the San Francisco Fed provides the first hard evidence of how monetary-policy shocks in the U.S. hit listing prices hard and fast. The study's approach is data-based, but theoretical; today's markets suggests it's also prescient.

Impact

Using high-frequency data from 2001 to 2019 in the CoreLogic Multiple Listing Service dataset along with high-frequency measures of monetary policy shocks, a one-standard-deviation contractionary monetary policy surprise expected in future interest rates due to forward guidance or asset purchases is found to lower list prices by 0.2 to 0.3 percent within just two weeks – equivalent to the better-accepted effect on stock prices. Interestingly, quantitative tightening has the largest impact on listing prices, a phenomenon that we surmise without back-up evidence in the paper may be due to market expectations of the impact of significant reductions in Fed purchases of agency MBS. This is in sharp contrast to the slow impact evidence in sales prices in contractionary shocks or the overall impact of fed-funds rate changes.

One reason for the link between QT and listing-price declines may lie in another finding of this study: a similar surprise shock to future rates also increases thirty-year mortgage interest rates, hiking them by four basis points within a month. An exogeneous one percentage-point rate hike lowers list prices by about three percent in one month. Interestingly, this result does not vary based on local housing supply controlling for income or bank-branch density (a factor we would also have expected to prove irrelevant unlike the others). However, areas with lower incomes or house values are most responsive to monetary-policy contraction.

Outlook

The study is significant to strategic planning in light of the Fed's newfound conviction to do what it takes to tackle inflation. It has long been an axiom of economic thinking and therefore of mortgage-market planning that policy surprises hit house prices with multi-year lags. However, prior studies were based on sale prices where a significant lag is likely due to contractual commitments which, in the years in which most research was conducted, could take several months to clear. Listings are likely a more sensitive indicator of actual market trends, proving an early warning signal of the broader contractionary trends already clearly evident in financial-asset prices. However, given the continuing decrease in the time between a list and sales contract as well as that between contract and closing, sales-price data going forward are likely also to become considerably more dynamic in response to monetary-policy shifts.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com