

US: HIGHER RATES LIKELY TO HURT HOUSING IN FIRST HALF OF 2017

**Despite declines in sales of new and existing homes in December, residential fixed investment likely rebounded in Q4 after falling in the prior two quarters*

**This strong rebound may be somewhat short-lived due to the approximate 60bp jump in US mortgage interest rates since the US elections*

**Pick up in wage growth and a stronger economy should counter the negative impact from higher rates in the medium term*

Despite declines in sales of new and existing homes in December, residential fixed investment likely rebounded in Q4 after falling in the prior two quarters (see [“US GDP: 2016 at 2% again, step up likely in 2017-18”](#), January 26, 2017). However, this strong rebound may be somewhat short-lived due to the approximate 60bp jump in US mortgage interest rates since the US elections, leaving housing as one of the few sectors not likely to get a significant boost from the impending economic regime change (see Chart 2).

The expected reaction of households to higher interest rates is not straightforward. We may actually see persons, who are able to, rush to lock in rates at current levels in fears of any further increases. Indeed, the University of Michigan Consumer sentiment survey showed a surge in the share of persons who said it is a good time to buy homes in advance of rising interest rates (see Chart 3). Also, mortgage applications for home purchases have been elevated since the election. Therefore, a short-term surge in activity is possible.

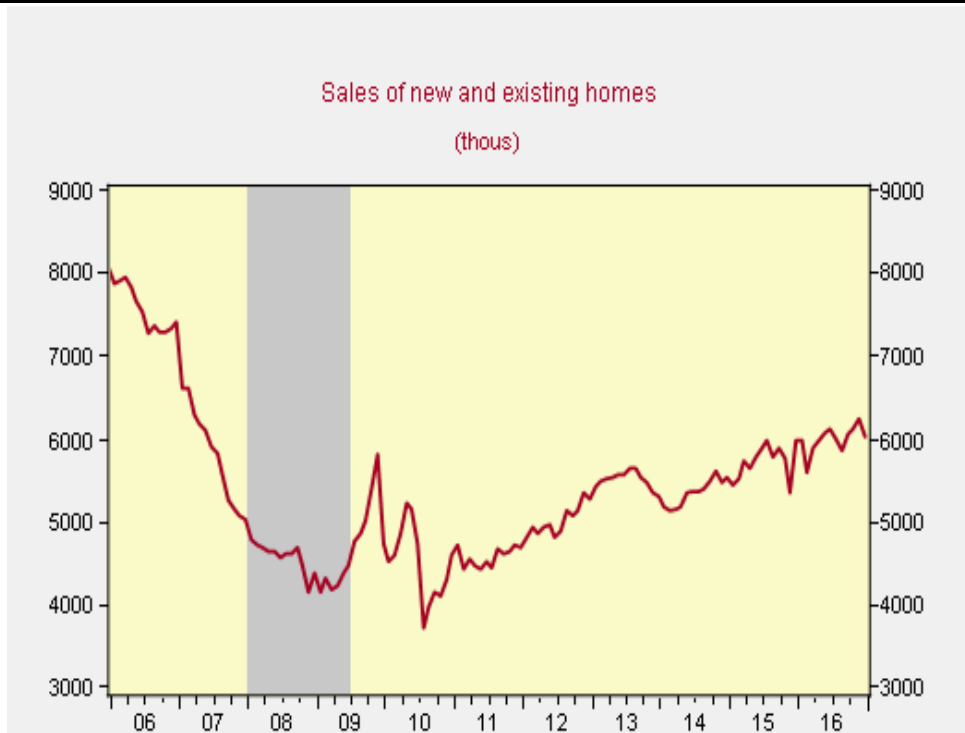
However, as the 2013 “taper tantrum” experience showed, sustained higher level of rates could depress activity eventually (see [“US October Existing Home Sales Strong But Higher Rates Poses Downside Risks”](#), November 22, 2016). Consider a person interested in purchasing a house at the median sales price of an existing home, \$232,200, the recent jump in rates would translate into roughly a \$65 increase in monthly mortgage payments, adding up to \$780 a year – a considerable amount of money for some potential buyers. Indeed, the drop in homes sales in December could already be reflecting the impact from higher rates.

Taken together, the magnitude of any slowdown in housing may not be large or persistent - mortgage interest rates are still historically low, households are in better shape than they were in 2013 and key housing metrics of sales and construction are still well below their pre-recession peak – there is plenty room for improvement.

A pick up in wage growth and stronger economy should counter the negative impact from higher rates in the medium term. Moreover, homebuilders have become much more optimistic about the business environment since the elections which will hopefully encourage them to ramp up construction of more affordable homes – the share of new homes built that are affordable, are pretty low, limiting options for first time home buyers (see Chart 4).

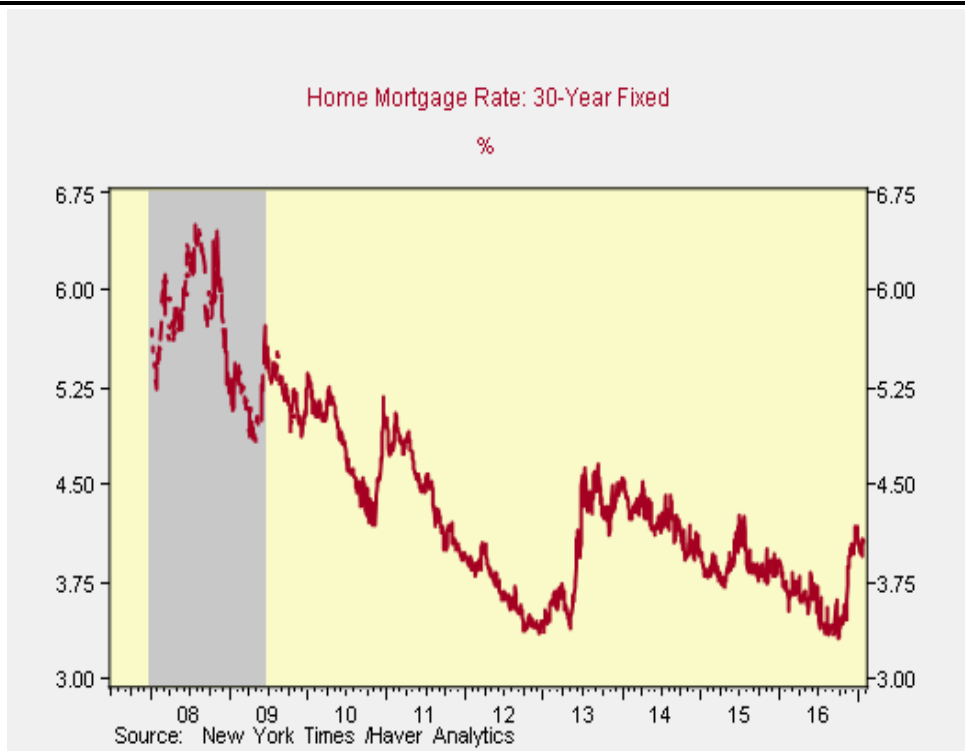
26 January 2017

Chart 1: Sales of New and Existing Homes



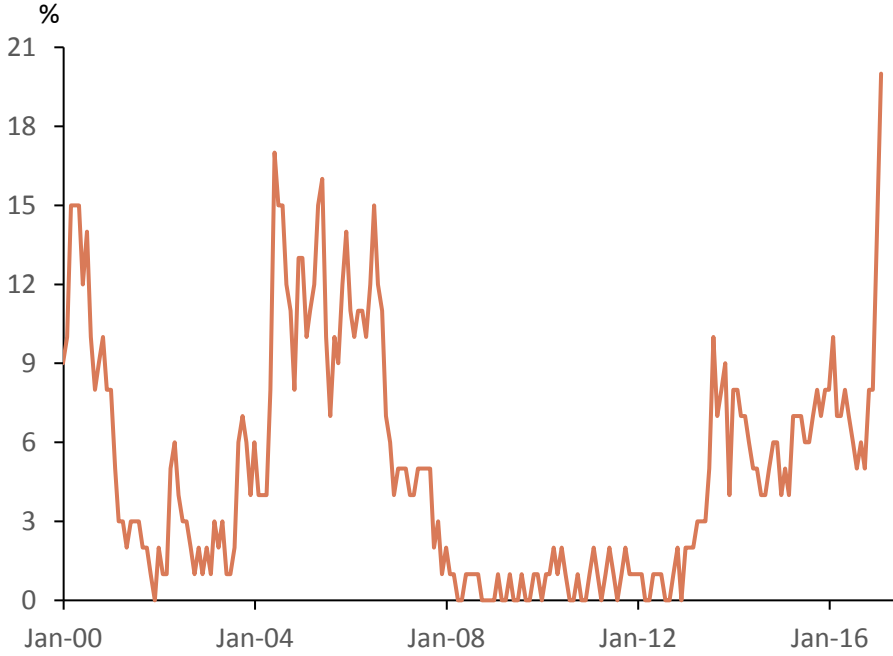
Source: Monthly data. Source: National Association of Realtors, Census Bureau and Haver Analytics

Chart 2: 30yr Fixed Mortgage Rate



Source: Daily data. Source: New York Times and Haver Analytics

Chart 3: Share of Consumers Saying it is a Good Time to Buy a House Because Borrowing in Advance of Rising Rates



Source: Monthly data. Source: University of Michigan and Berenberg Capital Markets

Chart 4: Share of New Homes Sold under \$300,000



Source: Monthly data. Source: Census Bureau and Haver Analytics

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