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Another Housing Bubble

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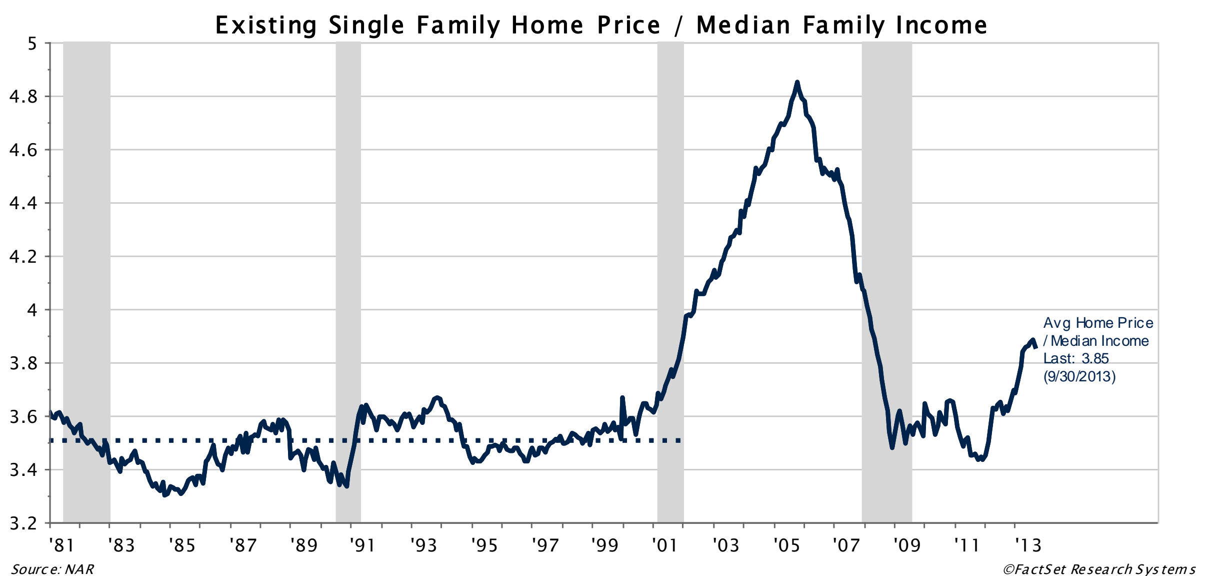
*** QE Is Driving Home Prices Back Into Bubble Territory**

*** Housing Starts and Construction Remain in the Basement**

*** A Worrisome Return to Price Distortion, Not Fundamental Recovery**

Suspicious eyes have long focused on the unintended consequences of Quantitative Easing. But one such consequence is going largely unnoticed. Home prices have once again advanced considerably faster than incomes, and in the last several months have broken out of their historical band. The last time this happened regulators and politicians ignored the warnings, asserting a "new paradigm" supporting home ownership as interest rates and down payments declined to then record lows.

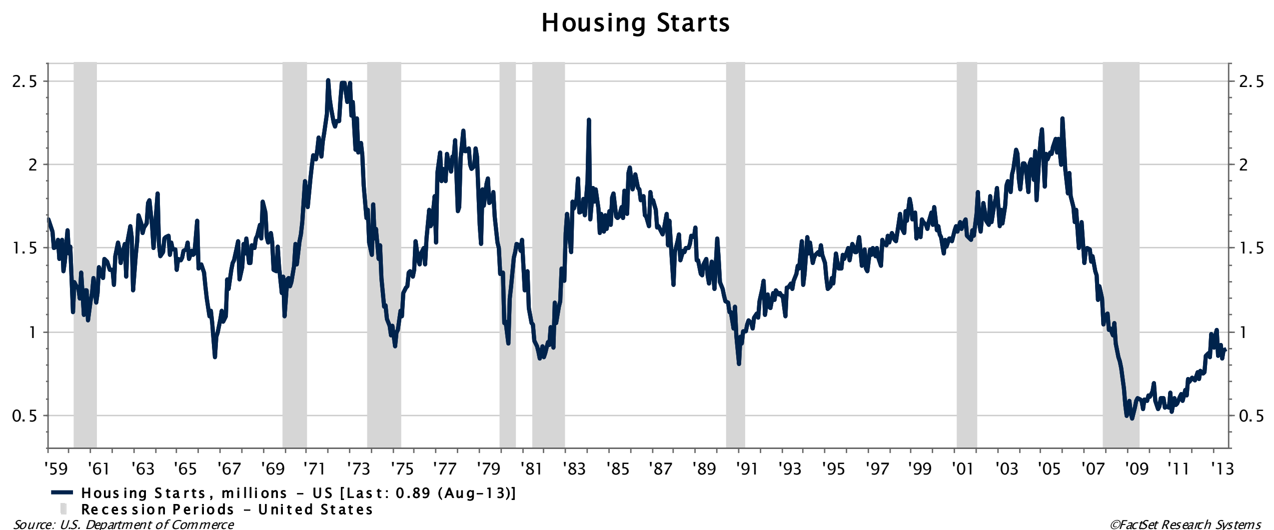
QE has undeniably kept mortgage rates below where they would normally be, presumably to stimulate the housing industry and its many adjunct components. Instead of fundamental stimulation, this policy has primarily and artificially elevated home prices. Tapering or withdrawal of QE would almost certainly cause home prices to fall again. The updated exhibit below clearly shows we are once again well outside the 3.4 to 3.6 historical ratio of price to family income, putting us almost one third of the way back to the catastrophic 2005 peak in this ratio.



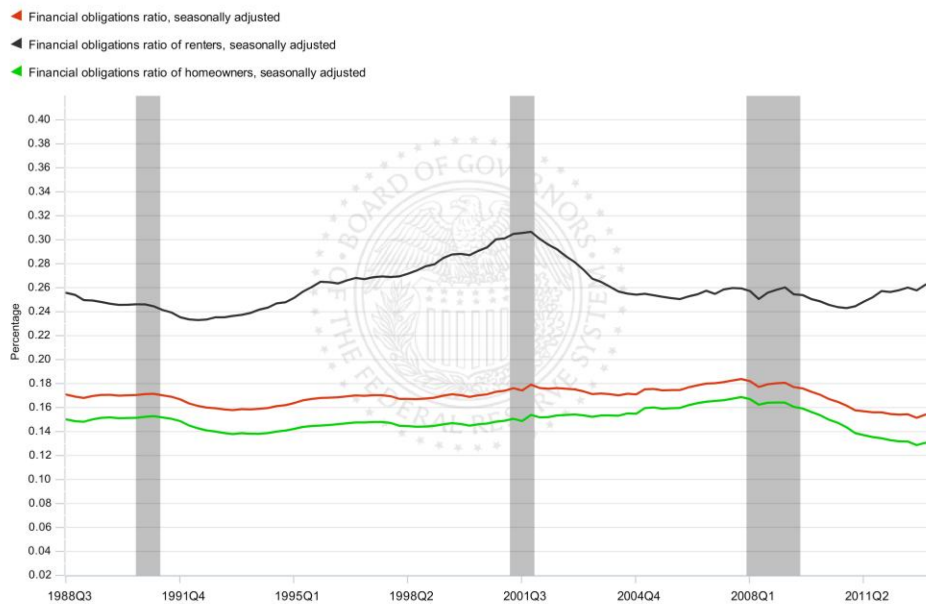
Remarkably, the newly-created Financial Stability Oversight Council, specifically created by the Dodd-Frank Act to identify and address such risks, has been silent. Meanwhile, record punitive fines have been extracted from the financial sector based on obsessive, rear-view mirror revisionist history, along with enormous regulatory restrictions for the mortgage market. However, no such thoughtul review of history has been made of the damage directly caused by decades of multiple, artificial subsidies of home ownership.

It should be clear by now that we would have had no Great Recession and the year-later financial crisis had home prices not massively outstripped family incomes. Without a meaningful recovery in jobs and incomes, higher home prices now will, at best, temporarily reduce negative equity in existing mortgages at the expense of new homebuyers. It is hard to believe this unintended but perverse cycle of price subsidy is repeating without FSOC notice and action.

The intended revitialization of housing has done little to restore construction activity. Housing starts have indeed rebounded by nearly 80% from their record low but have failed to surpass their five low points since the 1950s! Worse, they are gradually receding again. The exact same thing can be said for new home sales.



With mortgage rates successfully restrained by QE manipulation, the Financial Obligation Ratio for homeowners has plummeted to new lows while the FOR for renters continues to climb. QE addiciton has deepened, leaving homeowners ill-prepared for any eventual reversal in longer term interest rates.



There will be many arguments that the price-to-income ratio is not that relevant considering the prevailing and exceptionally favorable affordability environment. These are the same defensive arguments employed by regulators and Congress a decade ago, as prices began their annual, double-digit escalation.

Perhaps this partly explains why regulators have elevated stress testing over traditional determinants for capital adequacy, including increasing distance from Basel III. We note that a 20% home price collapse over the next 18 months is prominently included in the next CCAR (Comprehensive Capital Analysis & Review).

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