Transcript: Is the U.S. Housing Market Slowdown Cause for Alarm?

After a long period of strength, the U.S. housing market has recently shown signs of softening, with price gains slowing noticeably.

With memories of the key role that the housing market played in the global financial crisis of 2008 to 2009 still fresh, the recent slowdown has attracted the interest of the financial press and investors.

Our analysts have identified three key underlying factors, which make us believe that the current housing slowdown is unlikely to be severe or pose a systemic risk to the economy or markets.

One major factor is that since 2015, “housing formations” have significantly started to trend toward owning rather than renting. This trend was very strong in 2018, and there doesn’t appear to be a reason for it to reverse in the near term.

The second major factor is that households don’t appear to be as overextended financially. The household debt-to-income ratio stood well below its historical average in 2018. This is in stark contrast to the run-up to the housing crisis, when the debt-to-income ratio climbed rapidly above the historical average around 2004 and peaked in 2008.

Another factor is the limited impact of the Federal Reserve’s rate increases. Mortgage rates are still meaningfully lower than historical averages. We think that the Fed is now much closer to the end of its tightening cycle than the beginning, and a potential pause in Fed rate hikes in the first part of 2019 should help keep affordability intact.

Overall, we believe that the current housing softness is a natural symptom of the Fed’s monetary policy normalization that should be limited in duration and depth as long as the Fed does not make unexpected moves to further tighten policy.

Mortgage backed securities backed by non-qualified mortgage loans are specifically favored by our analysts at this point in the cycle. While these securities are backed by loans that do not meet traditional underwriting standards, and are a higher risk credit than agency MBS, we feel their structures offer meaningful credit support. Aside from their high-quality nature, they offer attractive yields and tend to be less sensitive to changes in interest rates.