ODDO BHF
CORPORATES & MARKETS

Economy

Focus US
N° 2021 - 17

US: this is not a real estate bubble

Thursday 29 April 2021

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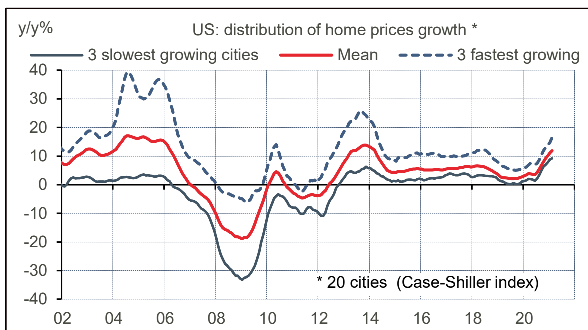
The price of US housing is 12% higher than a year ago on a national average. The acceleration concerns the entire country. Such vigour had not been observed since the mid-2000s, right in a middle a credit bubble. At that time, the price boom was based on excessive indebtedness facilitated by securitising mortgage loans, especially in the subprime segment. At first glance, there is nothing similar today. The strength of housing demand has both specific (pandemic) and fundamental (demographic) causes, which are reinforced by low borrowing rates. Sensitivity to interest rates is a risk factor.

The week's focus

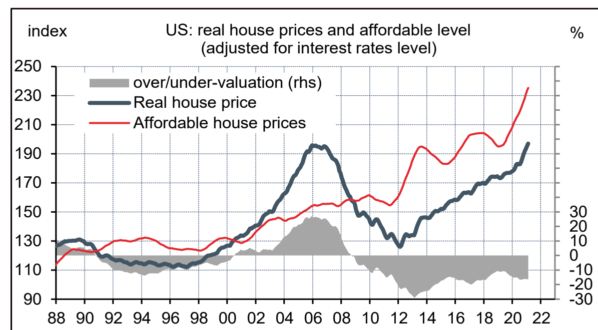
After rising at an average annual clip of 5% as of 2015, house prices have accelerated sharply in the last year. The pace has more than doubled on a national average. The average real price (i.e. deflated by the inflation rate) has returned to the peak reached in 2006. We all know what happened next. Apart from this similarity in house price levels, the present situation and the housing bubble of 15 years ago have little in common. Three differences in particular should be highlighted.

- **The geographic distribution of prices.** In the mid-2000s, there were very large disparities from one place to another. In some metropolitan areas, house prices rose by almost 40% per year between 2004 and 2006 (Los Angeles, Phoenix, Miami, Las Vegas), while in other areas house prices were moving in line with inflation, i.e. they were stable in real terms. In the current period, the home price increase is certainly not uniform between states, but it does show a great deal of homogeneity (chart lhs). As such, it can be assumed that the increase reflects economic and social factors rather than speculation (chart lhs).
- **The interest rate effect** After the 2001 recession, borrowing rates had fallen but not the extent that could explain the acceleration in prices in the following years. The cause was the easing of lending standards (subprime securitisation). Prices were deviating from their fundamental value, which can be estimated by adjusting them for changes in income, inflation and changes in borrowing rates. The deviation of the real price from this adjusted level gives an overvaluation of 25% in 2005-2006, whereas today the deviation would be negative by about 15% (chart rhs). The price at which the median household can access real estate has increased thanks to the rise in disposable income (which was accentuated during the pandemic recession) and thanks to the fall in borrowing rates (3.0% in 2020 vs 5.9% in 2005).
- **The household balance sheet.** The bubble burst when the burden of real-estate debt became unsustainable for households. At its peak in mid-2006, it represented over 70% of GDP. In Q4 2020, the ratio was just 51%.

US: house prices by city



US: house prices adjusted for inflation and interest rates



Sources: Thomson Reuters, ODDO BHF Securities

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- According to preliminary Markit surveys, the confidence of purchasing managers strengthened further in **April**. PMIs reached new records, at 60.6 points in the manufacturing sector and 63.1 in services. The acceleration signal from such levels should not be minimised but it also should not be forgotten that the pandemic pushed PMIs to extremes levels, on the downside in 2020 and the upside in 2021. PMIs overshoot because they are constructed as diffusion indices. They measure a gap between positive and negative opinions on production, employment, orders and prices. For normal variations in the economic cycle, there is a fairly stable linear relation between PMI levels and GDP growth. With the shock stemming from the pandemic, the relation became non-linear for a while, making it trickier to interpret PMI levels and changes. Last year, in the cycle trough, the fall in GDP was stronger than the PMIs suggested. This year, it might be the other way round.
- In **April**, for the second month in a row the Conference Board consumer confidence index surged, gaining 12.7 pts after 18.7 pts in March. It is still slightly below the pre-pandemic level. Labour market conditions (the difference between plentiful and hard to get jobs) showed an unprecedented improvement over one month.
- Even though real-estate indicators remain dynamic (see page 1), a normalisation is starting to emerge. Year-on-year, price rises continued to accelerate in **February** (+12% for the nationwide S&P/Case-Shiller index) but the quarterly pace has slowed slightly since the end of 2020. This is in line with data for home sales, which have moderated somewhat.
- Unsurprisingly given the direction of sentiment in industry, durable goods orders continued to rise in **March** (+0.5% m-o-m). Excluding volatile elements such as defence and aircraft, the increase is even stronger (+0.9% m-o-m, +11.6% y-o-y), a robust signal for the investment cycle.

Monetary and fiscal policy

- The two main parameters of the monetary policy stance were not modified at the FOMC meeting on **27-28 April**. The FOMC voted unanimously to keep the federal funds rate in a range of 0-0.25%, and monthly asset purchases were extended at a pace of $ 120bn per month. The press release notes the strengthening of activity and employment, as well as an increase in inflation, resulting in large part from temporary factors. At the press conference, Jerome Powell said that more time was needed before the economy makes “substantial progress” towards the dual goals of full employment and price stability. To avoid any ambiguity concerning his intentions, the Fed chair said, or rather repeated, that it is not time to start talking about tapering asset purchases (last week’s Focus US: "*The tapering sequence*"). The next FOMC meeting is scheduled for **16 June**. At that date, we will have had the monthly employment reports for April and May (likely to be very solid) and CPI inflation for May will be known (in our view this will be the peak, somewhere between 3.5% and 4% y-o-y). It is possible that the Fed might then start to pivot in its communication regarding asset purchases. A complete change in the guidance on asset purchases is more likely at the end of the summer in our view.On **28 April**, Joe Biden addressed Congress following the first 100 days of his presidency. He outlined his *American Families Plan*, focused on education and childcare with an announced price tag of $ 1.8 trillion over ten years. On the revenue side, the plan includes an increase in the marginal rate of tax on high earners from 37% to 39.6% and seeks to bring the top rate of taxation on income from capital into line with this level (versus 20% today).

The week ahead

- The schedule for economic data should be dominated by the report of the Bureau of Labor Statistics (BLS) on the labour market (**5 May**). New jobless claims recently posted a further decline to below 600k over four weeks, suggesting that the employment growth has increased. In March, new job creations came to 916k, of which one-third in the leisure and hospitality sector. The easing of travel restrictions and the reopening of businesses should once again result in a strong rebound. Unemployment is expected to be under 6%. In February 2020, the level of payrolls was 5% higher than today, equivalent to 8.4m jobs, while the unemployment rate stood at 3.5%. The other key figures will be the ISM and PMI indices for the manufacturing (**3 May**) and services sectors (**5 May**).

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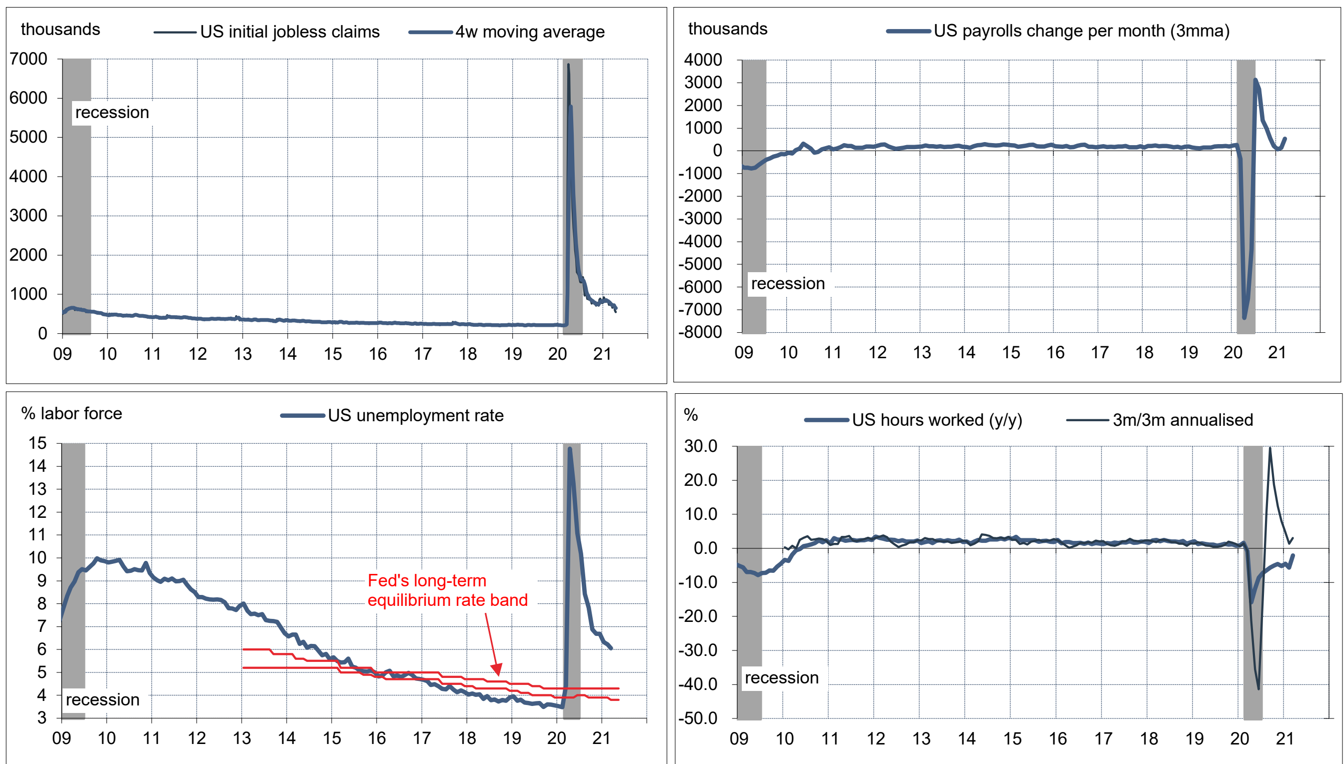
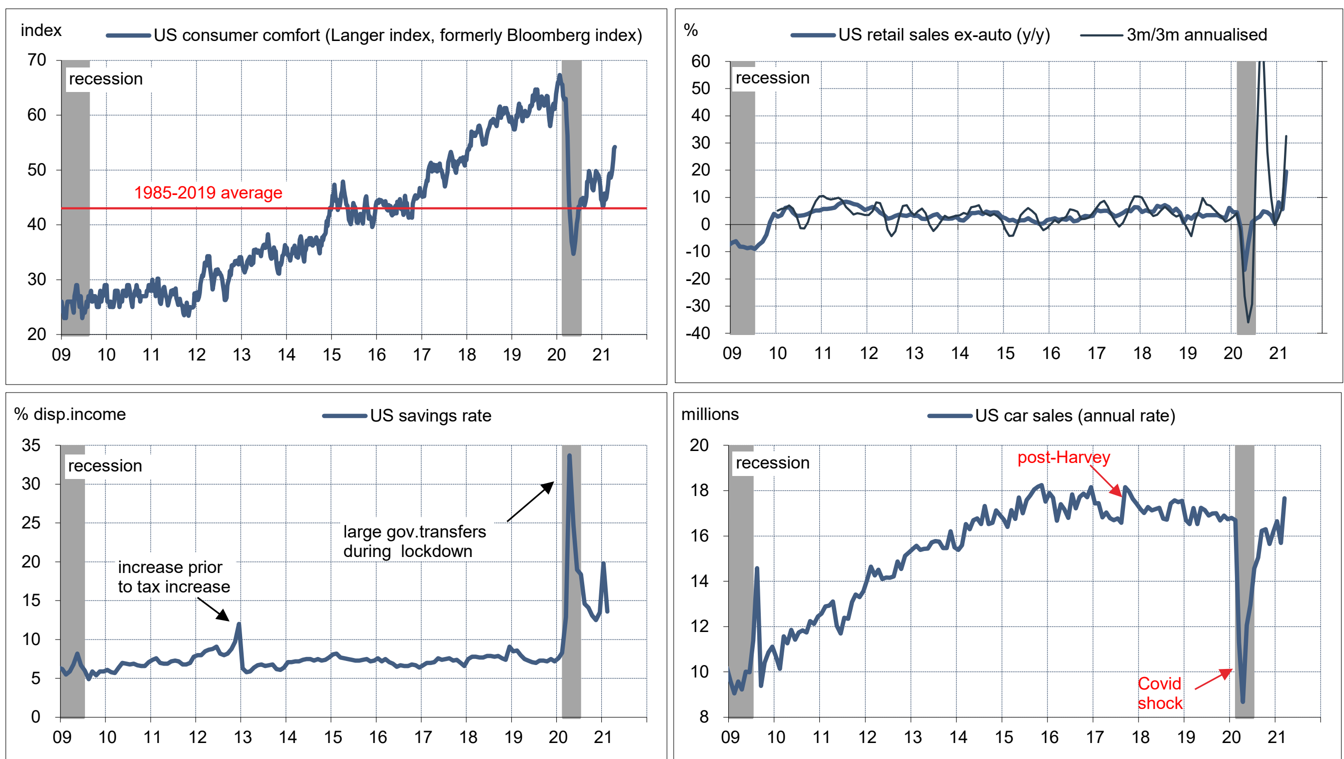
Appendix 1 - Labour market



Appendix 2 - Consumer



Sources: Thomson Reuters, Bloomberg, ODDO BHF Securities

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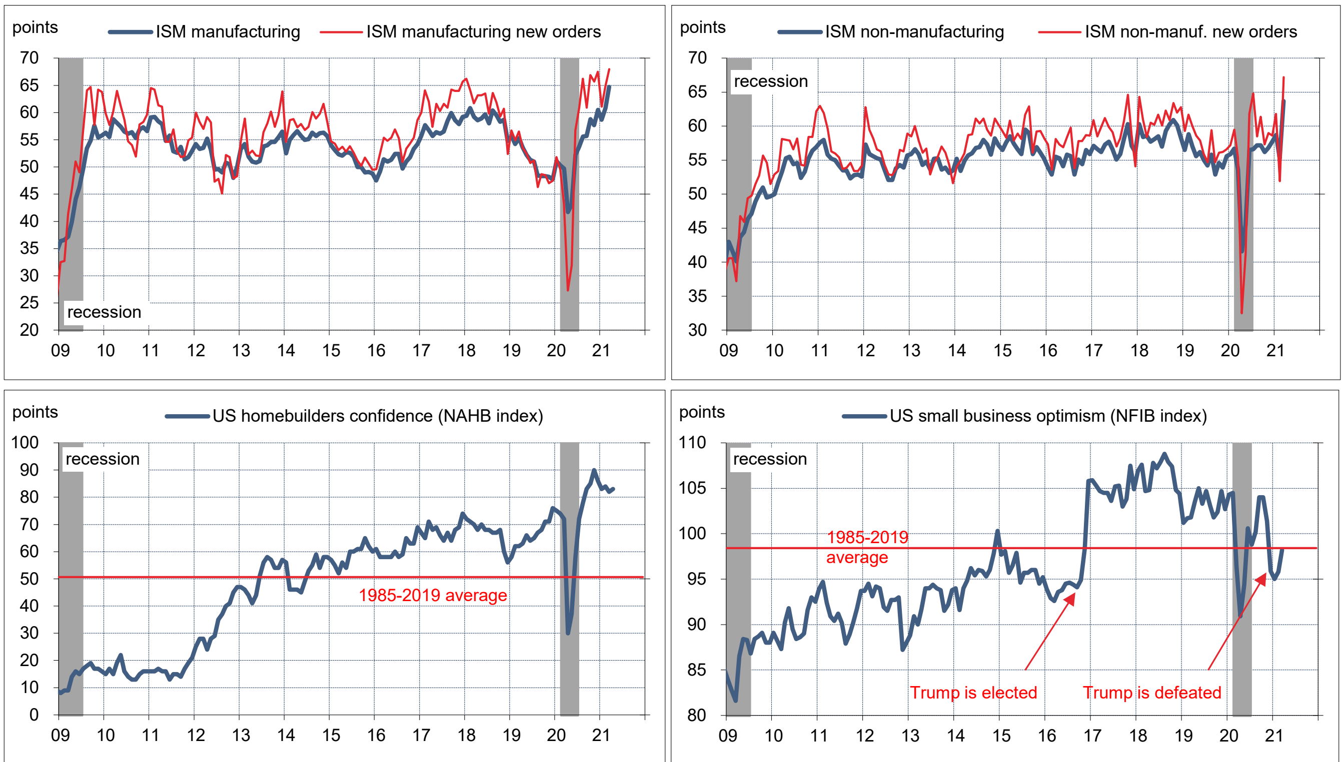
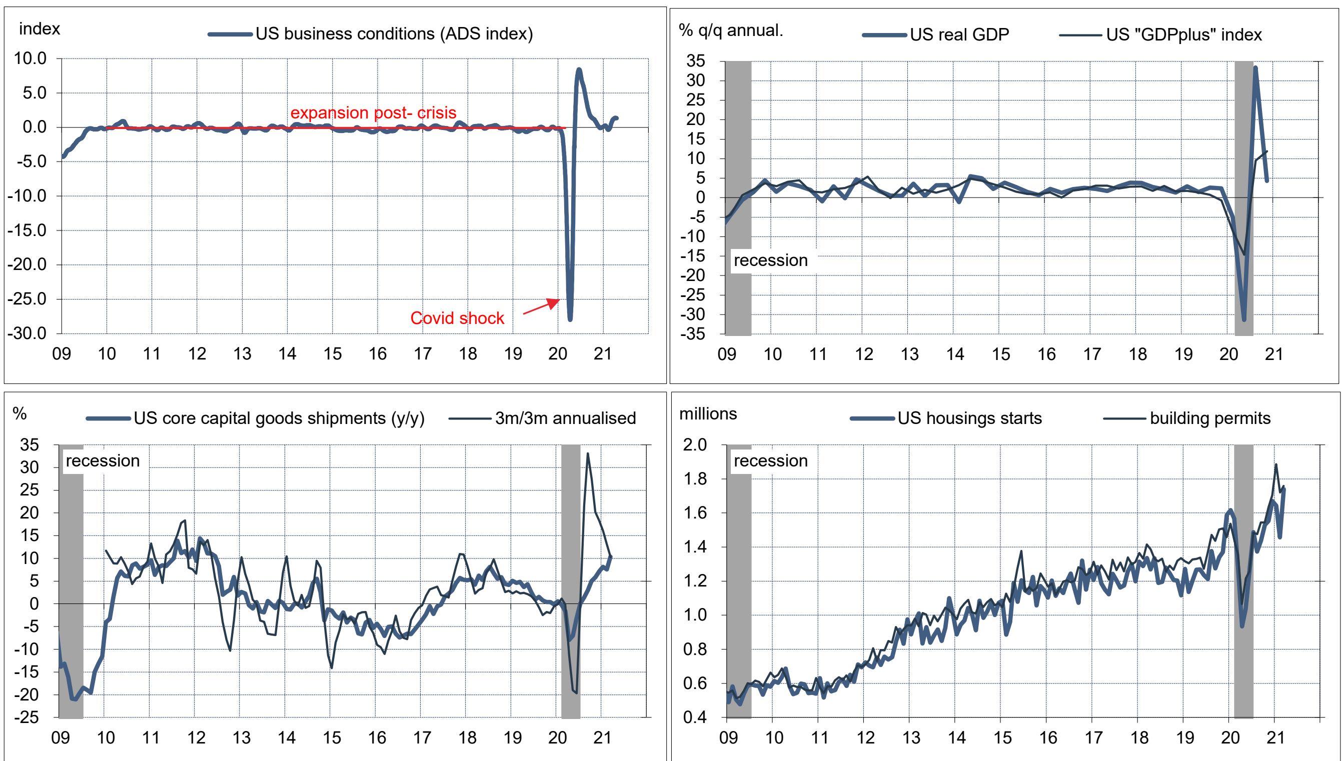
Appendix 3 - Business climate



Appendix 4 - Conditions of economic activity



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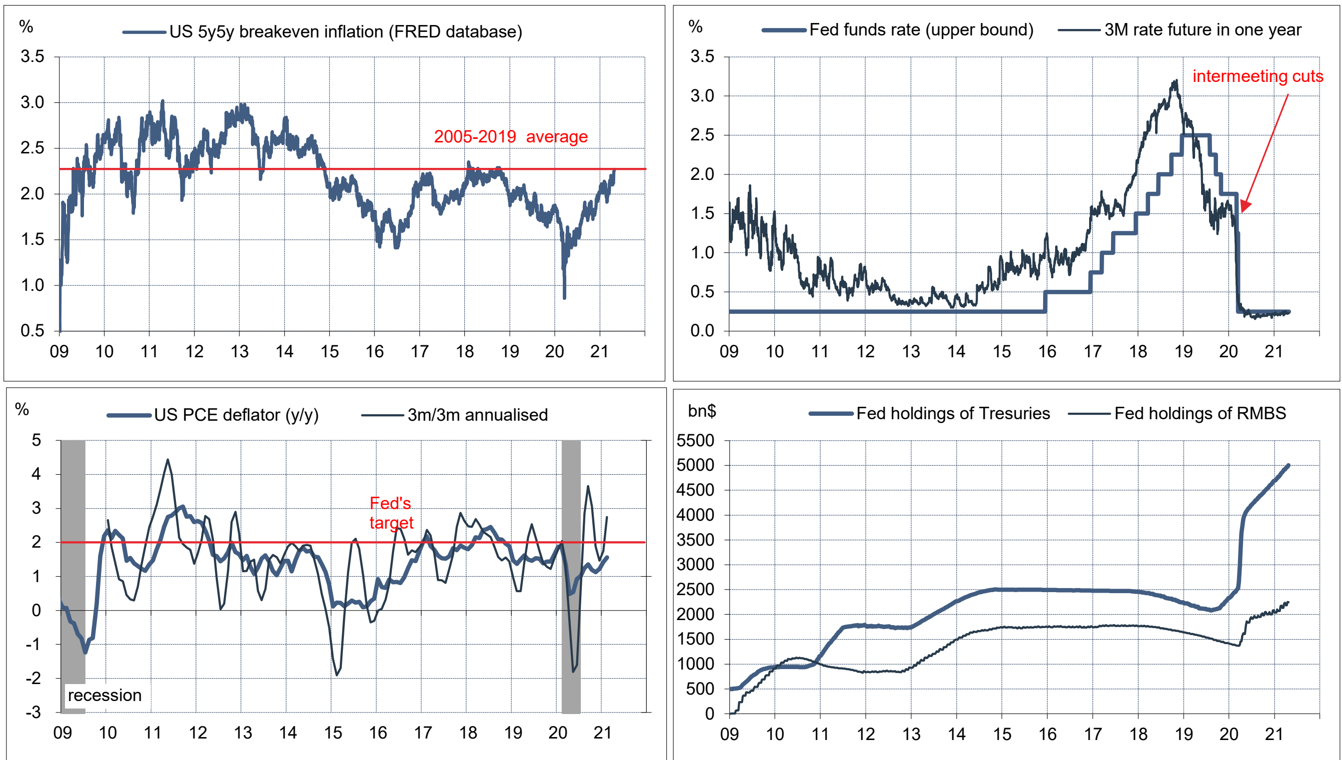
Appendix 5 - Inflation and monetary policy



Appendix 6 - Financial markets

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