

Housing Market Monitor

Little Evidence of Upward Trend in Housing

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By Dean Baker

The Mortgage Applications Index shows no notable uptick in sales.

While sales and construction have likely hit bottom for this downturn, there is little reason to believe that the housing market is on a sustained upward path. The Mortgage Bankers Association (MBA) mortgage applications index for purchase mortgages remains at very low levels, albeit about 8 percent above the trough hit last winter. Most importantly, there is no clear upward trend in this measure. With applications preceding sales by close to a month, this means that there is no evidence of a serious uptick in sales coming in September.

There are two immediate reasons for expecting a decline in sales in the near future. First, the new homebuyers tax credit is scheduled to expire at the end of November. While there is still time for buyers to get in the market and close a sale before the expiration of the credit, this window is closing. Congress may vote to extend the credit beyond November, but sales are likely to fall off regardless. If the credit is extended, there will be less urgency to close on a house in the near future.

The other drag on sales is the upward drift of interest rates. The MBA data showed a jump in the average 30-year mortgage from 5.17 percent to 5.38 percent last week. This jump was undoubtedly an aberration, but there can be little doubt that the general trend for mortgage interest rates will be upward. While it may be useful for the Fed to continue to make large purchases of mortgage backed securities and Treasury bonds, it is unlikely to do so. This will remove an important force keeping mortgage rates down.

With an enormous over-supply of housing in most markets, it is difficult to see how real house prices will not continue to fall. The Census Department's data on vacancy rates by metropolitan area drives home the suspicion that declining vacancy rates on ownership units is associated with their conversion to rental units.

For example, in Los Angeles the vacancy rate on ownership units fell by 0.5 percentage points between the second quarter of 2008 and the second quarter of 2009. However, the vacancy rate on rental units rose by 2.1 percentage points. In Miami, the vacancy rate on ownership units fell 1.2 percentage points, while the vacancy rate on rental units increased 3.9 percentage points. In Chicago, the ownership vacancy rate fell by 0.8 percentage points, while it rose by 2.2 percentage points for rental units.

In San Francisco, the vacancy rate of ownership units fell by 1.3 percentage points, while it rose for rental units by 1.2 percentage points. (It is important to note that in most areas, ownership units outnumber rental units by close to 2 to 1.)

Of course this relationship did not hold everywhere. In the New York metropolitan area the vacancy rate for ownership units increased by 0.7 percentage points, while the vacancy rate for rental units increased by 0.6 percentage points. It seems unlikely that the New York market will not experience substantial further price declines. It did see a very large run-up during the bubble, albeit not as much as the most inflated markets.

Washington, D.C. saw declines in the vacancy rates for both ownership and rental units over the last year, with the rate for ownership units falling by 0.3 percentage points and the vacancy rate for rental units falling by 1.5 percentage points. Both rates are now very close to the national average, so this does not suggest a shortage of housing in the Washington area.

The fundamentals of the housing market all indicate that real house prices should continue to decline for some time into the future. The period of free fall is likely over, but there is no way to absorb such a large oversupply of housing without a further decline in real prices. (Some of the real price decline may come through inflation.) The modest price rise shown in the May Case-Shiller index was almost certainly an aberration. (Actually, prices declined modestly in the seasonally adjusted index.) The increase in buying attributable to the homebuyers tax credit may also be temporarily boosting prices, but the general direction will almost certainly be down.

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