surveys of consumers UNIVERSITY OF MICHIGAN

Monitoring trends for over 70 years

Subject: Fundamental Changes in the Housing Market October 19, 2018

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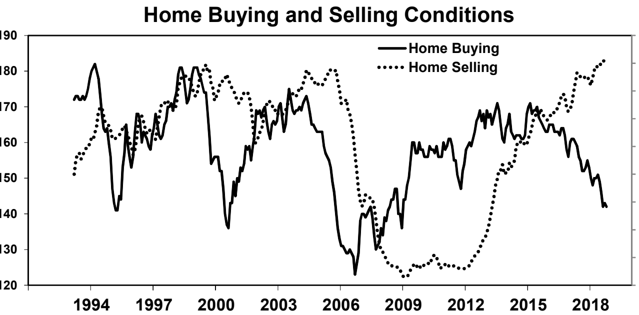
This note documents two significant changes in the housing market: home ownership no longer represents a good investment choice, and the economic conditions affecting home selling and home buying no longer change in unison. When a homeowner decides to sell their current home to purchase another home, they must take into consideration market conditions that affect both selling and buying conditions. As shown in the chart, home buying conditions have increasingly diverged from home selling conditions over the past few decade (the data represent homeowners only). Home selling conditions remained at record lows from 2008 to 2012, while buying conditions improved. Since 2015, in contrast, home buying conditions have progressively worsened while selling conditions improved. Unfortunately, the question on home selling conditions was only added to the surveys in late 1992. Home prices rose more consistently in prior decades, acting to greatly diminish cyclical variations in housing prices. Moreover, it was the absence of declines in housing prices that promoted the notion that homes were "the best investment" a consumer could make. Conventional economic theory holds that expectations about future changes in home prices and mortgage rates should not differ depending on whether a consumer is buying or selling a home. Behavioral economics suggests that homeowners judge the price of the home they currently own differently than the price of the home they are interested in buying. This implies that the impact of declining home prices would have a greater impact on consumers' willingness to sell their current home than to purchase another home. Indeed, the data suggest that falling home prices have little positive impact on home buying.



After asking about their overall evaluations of home buying and selling conditions, consumers were asked to explain why they held those views. As shown in the charts below, trends in consumers' unaided references to mortgage rates closely mirror the overall trends in home buying conditions. Similarly, spontaneous references to home prices closely mirror the overall trends in home selling conditions. Moreover, the data suggest that the primary factor related to sluggish home sales in the current expansion has been due to the divergences between consumer perceptions of credit conditions and their evaluations of home prices. Shifting from slowly sinking home sales to a quicker descent is likely to involve declines in home prices as mortgage rates increase. Rather than signaling greater future sales, declines in home prices will again erode home selling conditions and signal lower future home sales. Current forecasts of a slow decline in home sales ignore the associated impact on home selling conditions and the importance of loss aversion in the context of the largest asset owned by most consumers.

Perhaps even more interesting is the gap between record numbers of consumers who favorably mention home selling prices and the very small nominal gains people anticipate in the value of their own home. In the 3rd quarter of 2018, all homeowners anticipated annual gains of 2.7% in the value of their homes over the next five years. The expected annual inflation rate of 2.5% over the next five years meant that the median inflation-adjusted rate of appreciation for the next five years was just 0.2% per year. While these estimates are more positive than what they anticipated in the past several years, the rebound has been so small so as to eliminate a real financial return on housing investments. Even among those who reported the highest expected appreciation rates, those rates were only barely above the inflation rate they anticipated. Of all the regions, residents of the West expected their home to outdistance the expected inflation rate over the next five year, but it amounted to an inflation adjusted annual gain of just 1.5%. Southern residents expected an inflation adjusted annual gain of just 0.4%; other regions anticipated a loss of 0.7% per year. Stripped of its investment characteristics, housing has become a commodity, and home ownership has become less of a stepping stone toward financial security and more of an anchor on labor mobility.