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The Bottom Line
Relevant Insights for the Savvy Investor

JUNE 2022

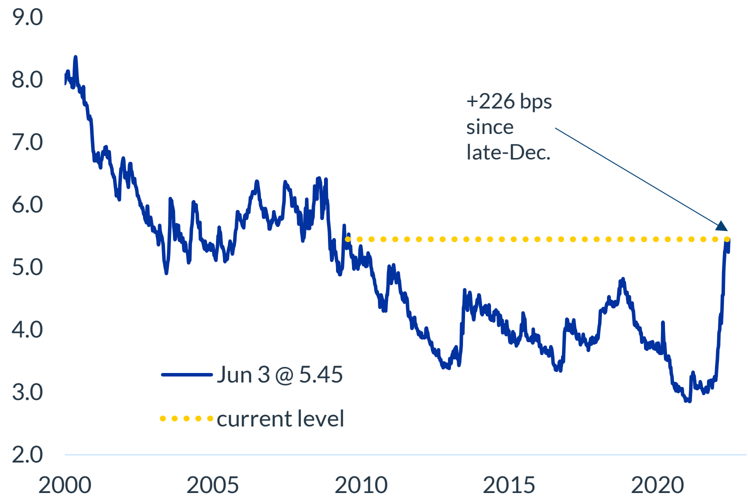
The Housing Market is Taking it on the Chin

The housing market has peaked. Since mid-December, when the Fed announced a speeding up of the pace of reducing the size of their bond portfolio, longer-term interest rates have moved up significantly.

The 30-year fixed-rate mortgage rate has had the most notable change, as it has jumped an eye-popping 2.26 percentage points (chart 1). Usually, changes in monetary policy take time to affect the economy, but this time, the Fed is going at it with both barrels. They are raising the federal funds rate, which is pushing up short-term interest rates, and they are reducing the size of their bond portfolio, which is putting upward pressure on the longer-term interest rates.

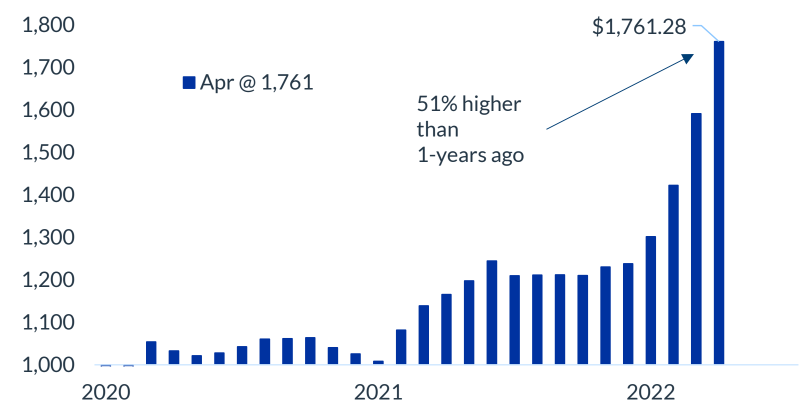
The jump in mortgage rates has pushed up the cost of a monthly mortgage payment. That payment is now 51% higher than it was this time last year for a median-priced home (chart 2). That has already reduced some of the white-hot demand for housing. The pace of home sales began to decline last year, when prices began moving up, but sales have

CHART 1: Mortgage Rates
%, 30-yr Fixed Rate



Source: Bankrate.com, June 2022.

CHART 2: Monthly Mortgage Payment - Median Existing Home
$, 30-year fixed rate mortgage, 80% financing



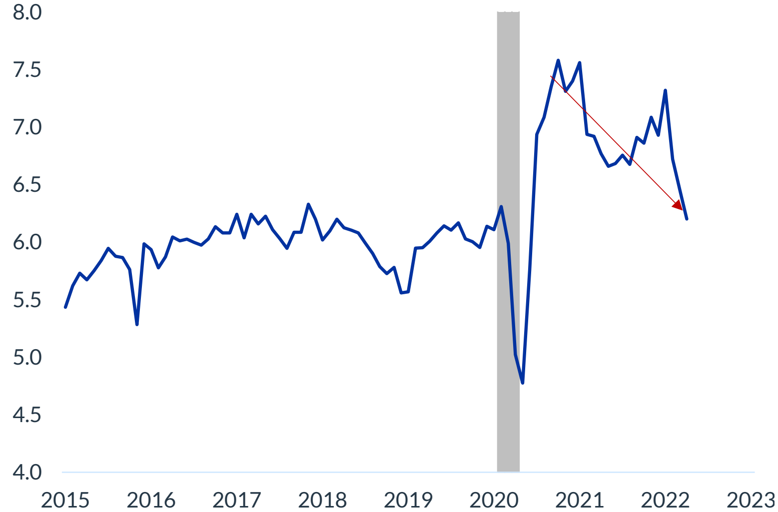
Source: National Association of Realtors, Bankrate.com April 2022.

declined at a more rapid pace since mortgage rates started to move up; they are down 15% since January (chart 3). This will probably not have much of an impact on home prices in the near term since there is so much pent-up demand. But the pace of price increases will likely taper off as the year progresses. This, of course, will help take some pressure off inflation.

Since the financing cost plays heavily into the monthly cost of a mortgage, this is the first step in slowing the pace of economic demand, based on the Fed reducing stimulus. But housing (residential investment) makes up a small share of the economy, just 3.5%. But as housing goes, the rest of the economy will follow. Lumber prices have crashed from the pandemic-induced demand (chart 4), and furniture and appliance prices should follow.

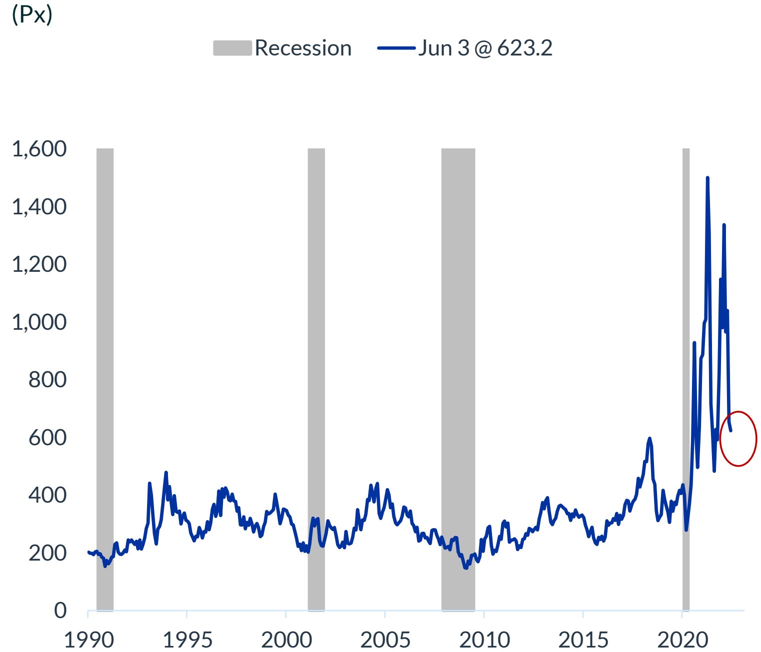
A decline in demand for other goods is expected. The reduction will be enhanced by consumers moving away from goods toward services like travel as the pandemic moves toward an endemic. CNR continues to believe the pace of overall consumption will slow, not contract, which would cause a recession. The strength of household and corporate balance sheets should keep the risk of a recession at bay.

CHART 3: New & Existing Home Sales
units, millions, seasonally adjusted annual rate



Source: National Association of Realtors, US Census Bureau, April 2022.

CHART 4: Lumber: Random Length Futures
(Px)



Source: Chicago Mercantile Exchange, June 2022

Market Trends

Equity markets continue to correct with investors increasingly worried about the risk of recession as the Fed's fight against inflation gets more difficult. Although the risk-to-reward ratio for equities has now improved, with valuations adjusted lower, broader fundamentals still sound, and sentiment reflecting a more bearish outlook, in the near term, it will likely require greater clarity on the path of inflation before markets find a durable bottom.

LABOR

Payroll growth remains robust, but the pace of change is slowing, partially in response to the Fed raising interest rates.[1]

THE FED

The Fed is highly focused on combating inflation; it plans on raising short-term rates by 50 bps in June, and again in July.[2]

HOUSING

Higher mortgage rates are slowing down the red-hot housing market, with existing home sales falling in the past three months.[3]

CONSUMER SPENDING

Spending is shifting toward goods from services as the economy moves back toward pre-pandemic trends.[4]

INFLATION

Inflation unexpectedly hit a new 40-year high in May, reaching 8.6% y-o-y., driven by a surge in gasoline, food and rent prices.[1]

OIL

Gasoline prices are near all-time highs due to high oil prices and reduced capacity at refineries.[1]

Sources

1. Bureau of Labor Statistics
2. Federal Reserve
3. National Association of Realtors
4. Bureau of Economic Analysis

Index Definitions

CPI: The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

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