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Weekly Relative Value

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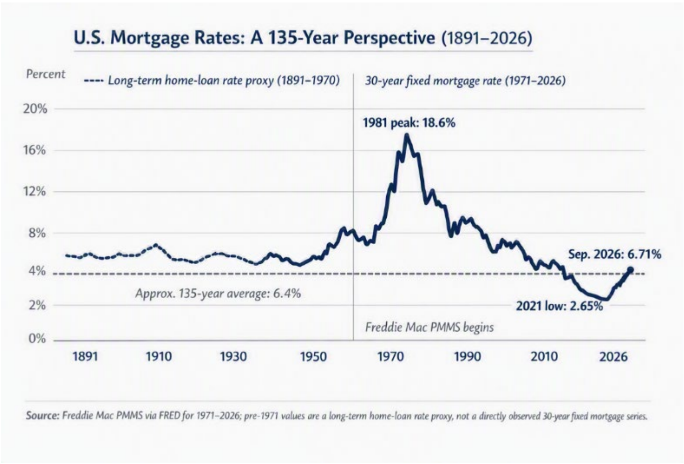
The Great Housing Reset: Prices, Demographics and a Market Out of Balance

Lots of people in real estate continually complain about "how high mortgage rates are." However, these complaints are rooted in how unsustainably low rates were from 2009 to 2021. Without this period, no one would be thinking of a 6.5% mortgage rate as a "problem." You can see that current rates are right at the long-term 136-year average.



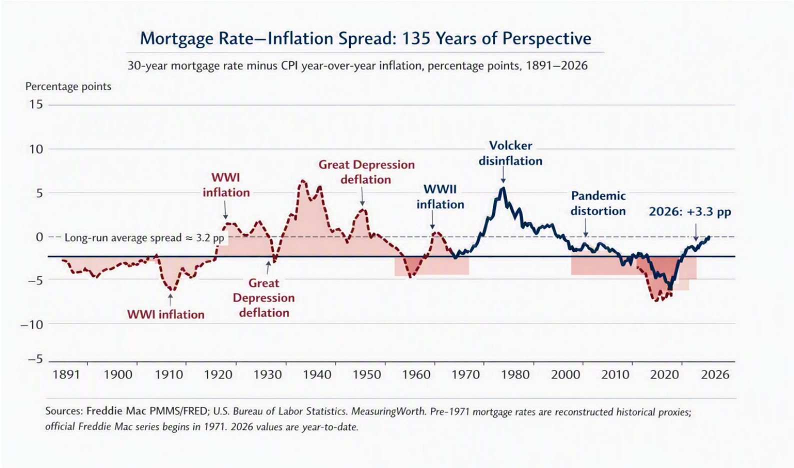
Inflation explains the extremes**.** During the inflation shock of the late 1970s and early 1980s, the 30-year fixed mortgage rate reached roughly 18%. That episode illustrated a basic relationship: higher inflation produces higher interest rates, while lower inflation permits lower rates. Pretty normal.

Relative to inflation today, mortgage rates are close to the historical norm.

- **Mortgage rate:** 6.7%
- **Estimated August CPI inflation:** 3.1% year over year
- **Mortgage rate-inflation spread:** 3.6%

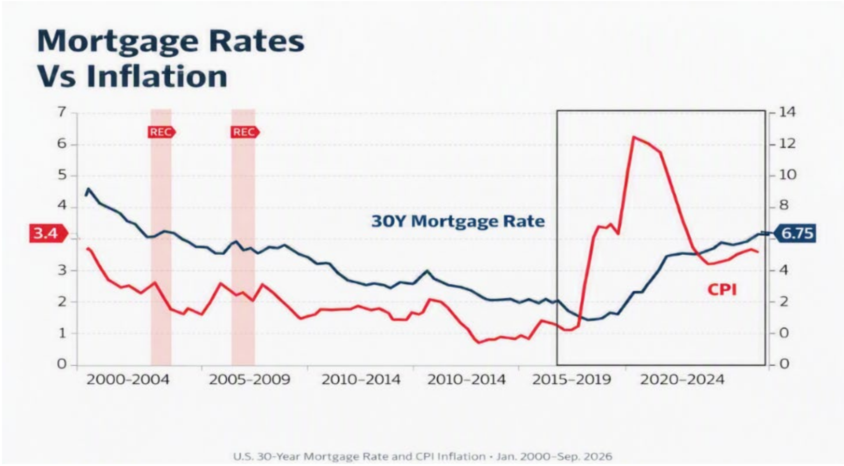
As shown below, a spread of this size has been common over the past eight decades. With inflation near 3%, mortgage rates in the mid- to high-6% range are not historically unusual.

THIS WEEK



Much of today's frustration with mortgage rates reflects the unusual period from 2009 through 2021, when rates stayed below 4.5%. The pandemic years were the true outlier. Federal Reserve quantitative easing and exceptionally low interest rates kept borrowing costs artificially low and the spread between mortgage rates and inflation fell to about -4.4 percentage points, meaning inflation was running well above mortgage rates. That boosted housing demand and helped push home prices sharply higher.

Outside of that window, rates in the 5% to 7% range were common, and today's rate is close to the long-term average.



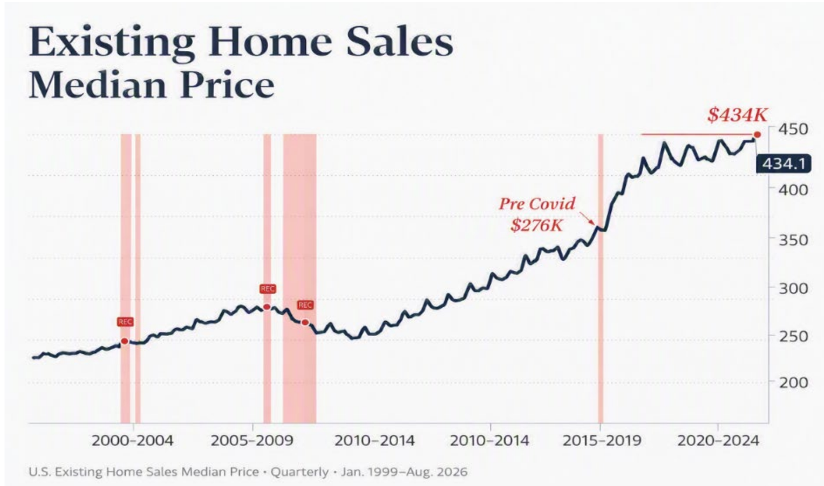
Rates have now returned to more normal pre-2009 levels, but the adjustment happened quickly. They feel high because borrowers and sellers became accustomed to an era that had little historical precedent.

Bottom line: Mortgage rates near 6.5% are close to their long-term average and are not the main cause of today's housing affordability crisis.

If mortgage rates are not the main problem, the next question is obvious: why is housing still so unaffordable? The answer lies in home prices, which have risen far faster than household incomes.

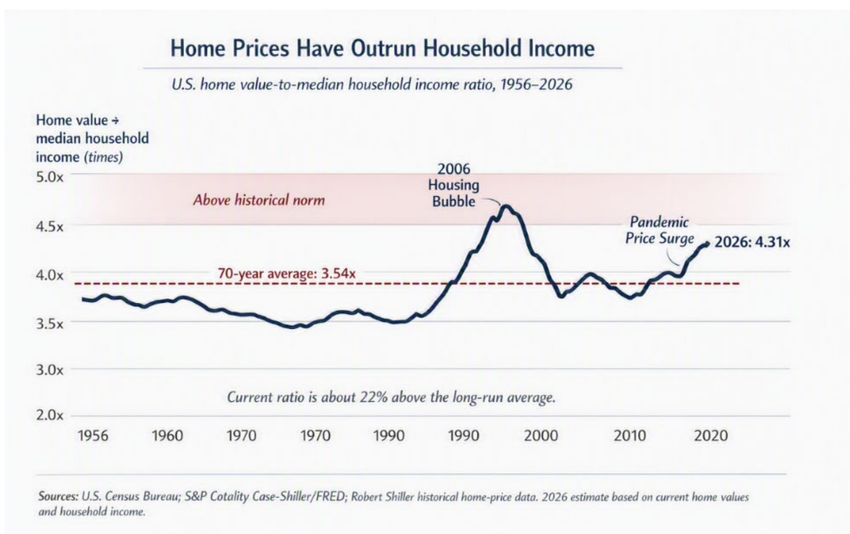
AFFORDABILITY

Since the pandemic, the median home price has soared by approximately 60% to $434,000.



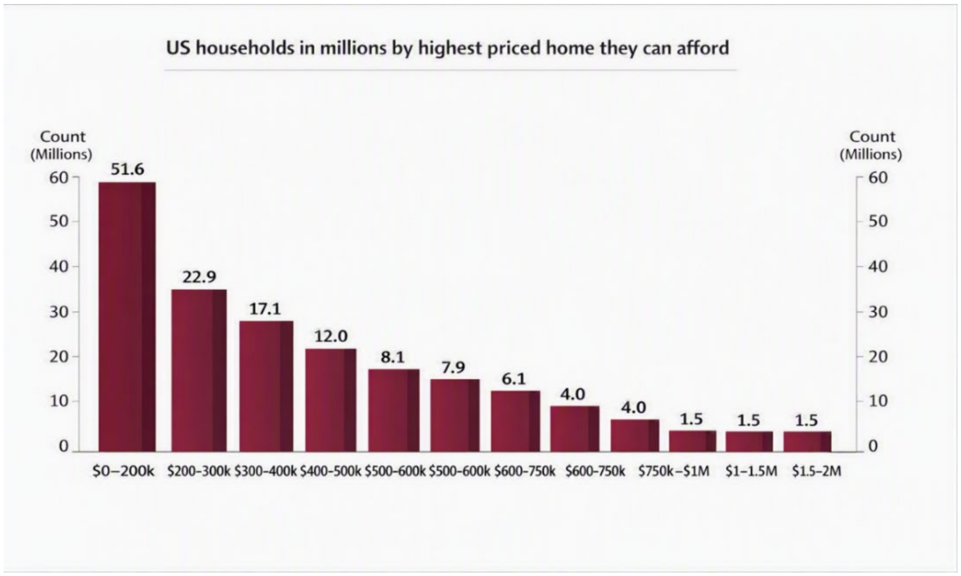
At the same time, income has fallen far behind. Home prices relative to income remain far above historical norms, which is pricing buyers out and suppressing both demand and sales.

- **Current home value-to-income ratio:** 4.31 times
- **70-year average:** 3.54 times
- **Implied overvaluation:** about 22%

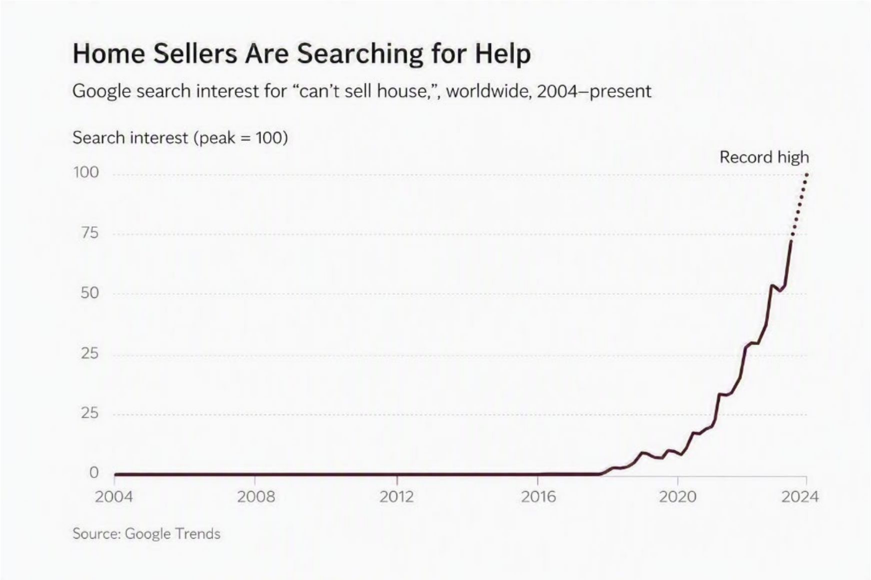


Only one other period in U.S. history has seen home prices reach a comparable multiple of income: 2006. The bubble and lack of affordability did not last long. As we all know, prices crashed shortly thereafter, restoring the home price/income to normal levels (3.5 times). The key constraint on housing is therefore not a historically abnormal mortgage rate; it is a price structure that remains disconnected from what buyers earn.

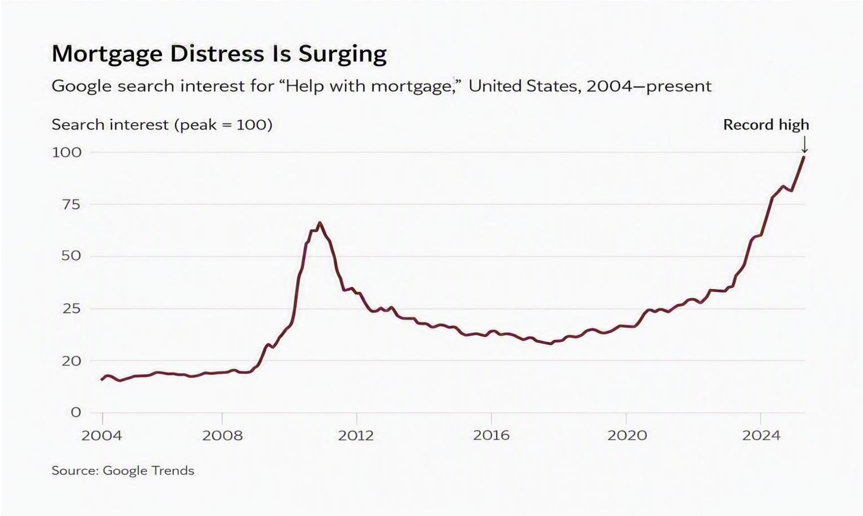
As shown below, currently 75% of U.S. households can only afford a home priced below $300,000, well under the current median sales price of $434,000.



Meanwhile, Google searches for “can’t sell house” just hit an all-time high. Above 2008.

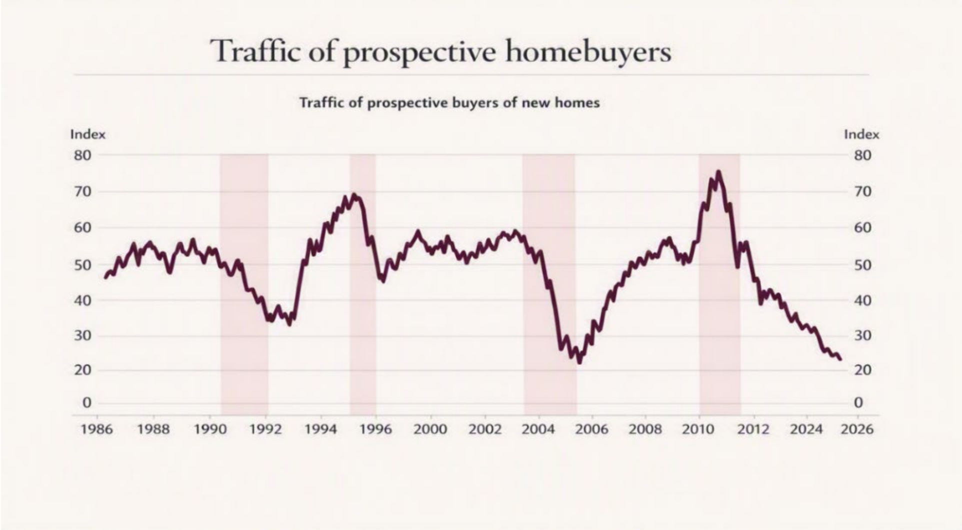


Google searches for “help with mortgage” are back at 2009 levels.



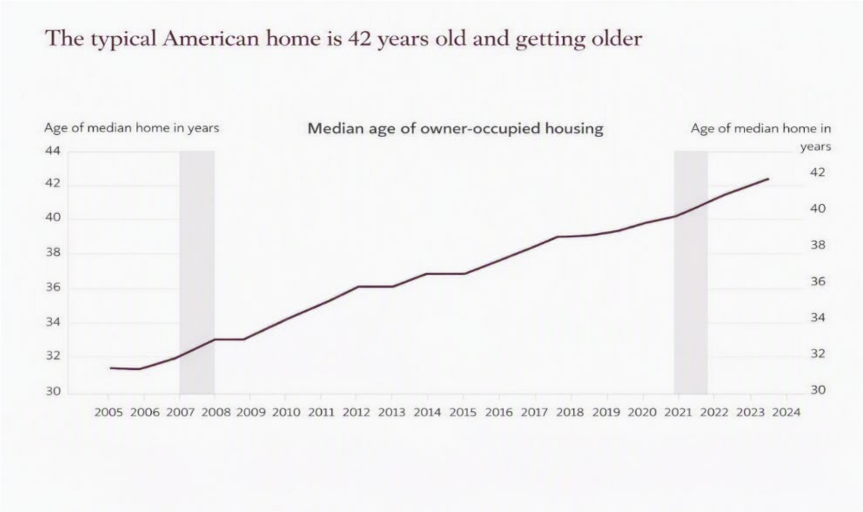
Sellers can't sell and owners can't pay.

Mortgage rates at 6.7% combined with a median home price of $434,000 are holding down traffic of prospective homebuyers. The share of first-time homebuyers is at the lowest level in decades. The pandemic boom has fully reversed. After surging to a record high of 75 in 2021, homebuyer traffic collapsed as home prices and mortgage rates climbed.



Source: NAHB

Buyers may want homes, but elevated prices and borrowing costs have pushed many properties outside their price point. And as a result, the typical American home is now 42 years old, up from 30 in 2008.



Source: NAHB

NO SHORTAGE OF HOMES

There have been many analysts saying that inventory, or lack thereof, is the problem. Well, don't look now, but U.S. housing inventory is almost back to its pre-pandemic level.

August 2019 supply: 1.24 million listings
August 2026 supply: 1.14 million listings

National inventory is now within roughly 8% of its pre-pandemic level. If the current trend continues, supply could move above 2019 levels next year, a threshold already crossed in parts of the South and West.

Eighteen states now have more inventory than they did before the pandemic. In other words, more than one-third of the country may be moving from shortage toward excess supply.

States leading the supply surge:

1. **Washington:** +51%
2. **Tennessee:** +46%
3. **Colorado:** +36%
4. **Arizona:** +32%
5. **Utah:** +31%
6. **Texas:** +30%

States where a genuine shortage remains:

1. **West Virginia:** -46%
2. **Rhode Island:** -48%
3. **Vermont:** -48%
4. **New Jersey:** -53%
5. **Illinois:** -62%
6. **Connecticut:** -70%

In many markets, the problem is no longer a lack of homes for sale. There are homes available; buyers simply cannot afford them.

The housing downturn is increasingly concentrated in the Southern and Mountain West markets that experienced the largest pandemic-era booms.

The national story is shifting from too few homes to too many homes at prices buyers cannot — or will not — pay.

Bottom line: Mortgage rates are not the main cause of today's housing affordability crisis. The current rate of about 6.5% is nearly the same as the 136-year average of 6.4%.

Rates are also much lower than they were in the 1970s, 1980s and 1990s, when mortgages often carried rates near 10%.

The real problem is home prices.

Home prices have risen much faster than inflation and household incomes. That has pushed many buyers out of the market and helped create four years of weak housing demand.

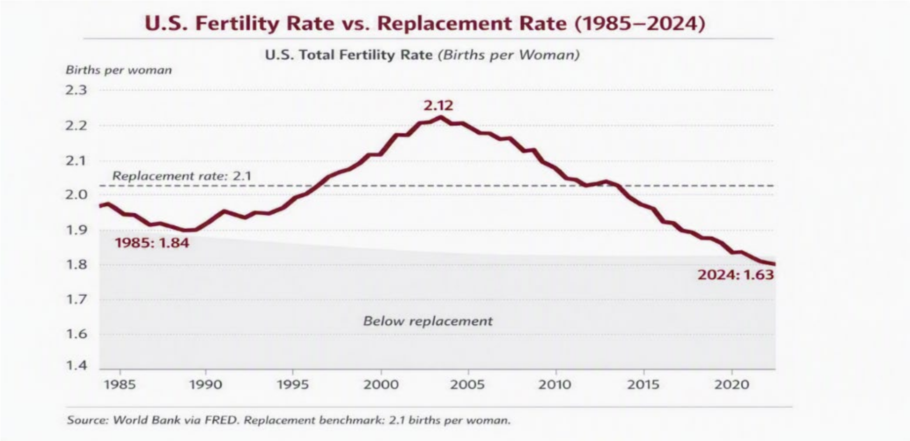
Lower the home price and affordability will return.

DEMOGRAPHICS ARE DESTINY

In January 2024, the CBO projected U.S. deaths would overtake births in 2040. In just one year of new data, the CBO now expects deaths to overtake the births in 2033, seven years earlier than expected last year.

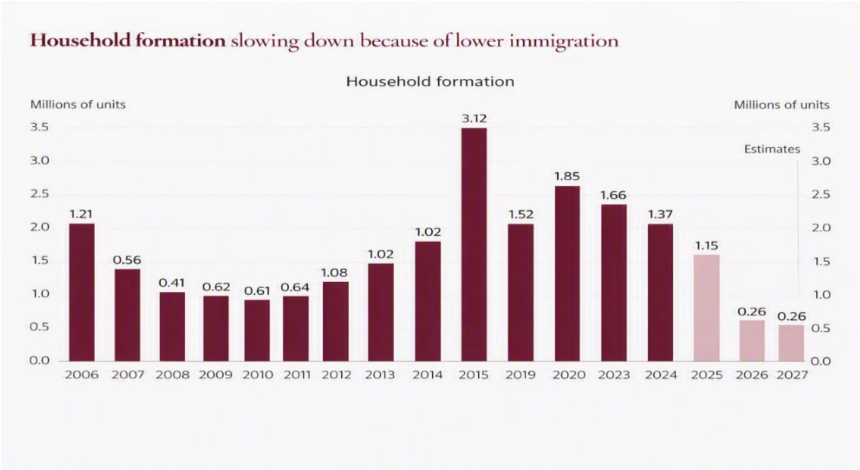
The fertility rate is 1.6. Replacement is 2.1, and it hasn't been above that since 2007.

17 states already record more deaths than births. Through most of the 2010s that number was four.



The CBO's own words: without immigration, the U.S. population starts shrinking in 2033. Projected growth over the next 30 years is 0.2% a year. From 1975 to 2024, it was 0.9%. That's the part people miss.

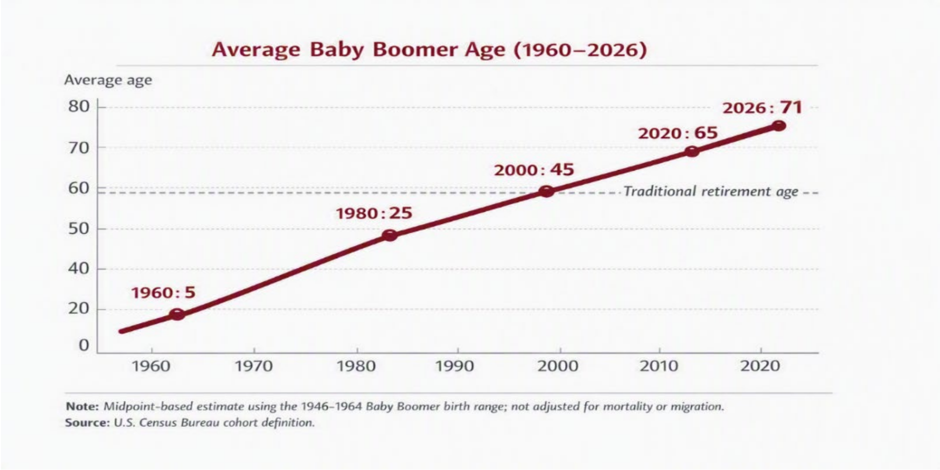
Household formation has slowed sharply as immigration has declined, removing a key source of underlying housing demand.



Bottom line: U.S. population growth is slowing as fertility remains below replacement and immigration declines. Fewer new households mean weaker long-term housing demand, while an aging population adds more homes to the market. Demographics move slowly, until the effects become impossible to ignore.

HOUSING AND DEMOGRAPHICS

A major housing headwind is about to hit. And that's the Baby Boomer exodus from the U.S. housing market.
In the next decade, the share of U.S. population above 75 will skyrocket. The Baby Boomer owners who have fueled the housing market over the last 20 years will turn into sellers as they age out.



And Gen X, the next generation in line to buy up those homes, won't be able to absorb it as they are 20% smaller in population than the Baby Boomers.

The result is that by 2037, there will be more 75+ aged Americans than 55-64 aged Americans, which will be a first in modern U.S. history. This will lead to lower homebuyer demand, more supply and lower prices in retirement destinations, especially across Florida and Arizona.

Bottom line: U.S. population growth is slowing as fertility remains below replacement and immigration declines. Fewer new households mean weaker long-term housing demand, while an aging population adds more homes to the market. Again, demographics move slowly, until the effects become impossible to ignore.

A SHOCKER!

The August jobs report was much stronger than expected. Employers added 162,000 jobs, nearly three times the consensus estimate of 55,000. The previous two months were also revised by a combined 55,000 jobs. July, originally reported as a loss of 23,000 jobs, was revised to a gain of 21,000.

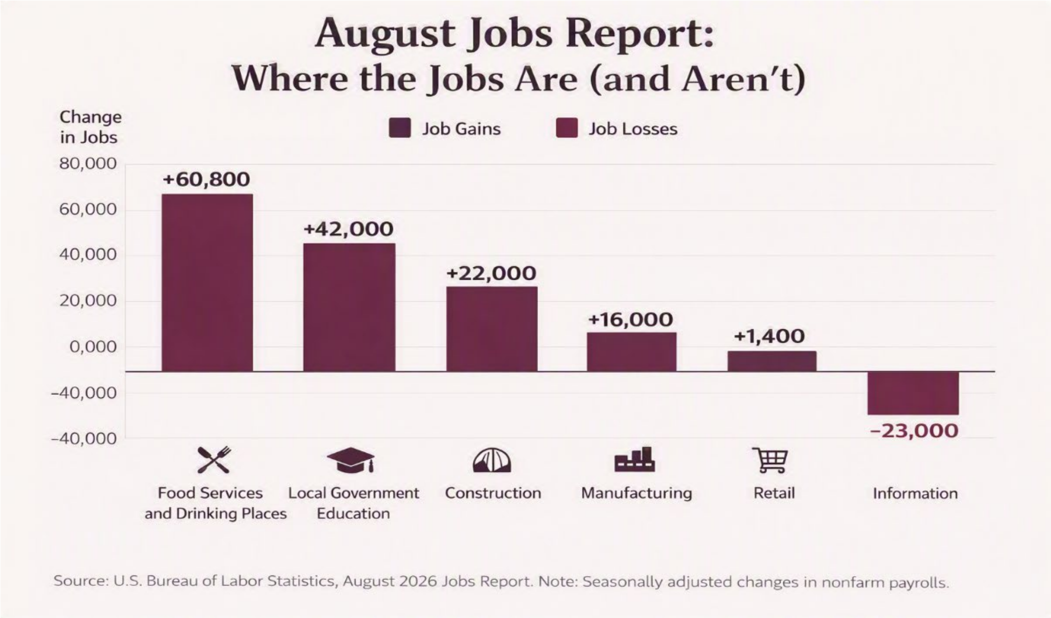
On the surface, the report looked solid. The average workweek increased to 34.4 hours from 34.3, pushing total hours worked up 0.3%-one of the strongest monthly gains this year.

More people entered the labor force, with participation rising to 61.6% from 61.4%. Even so, the unemployment rate held at 4.1%.

The broader U-6 unemployment rate, which includes discouraged workers and people working part time because they cannot find full-time jobs, fell to 7.7% from 7.9%. That suggests the labor market tightened, although slowing wage growth tells a less convincing story. Real wages remain below year-ago levels after inflation.

The headline also hides an important shift in the kinds of jobs being created. Information lost 23,000 jobs, and unemployment in finance has nearly doubled over the past year. At the same time, more hiring is occurring in lower-paying areas such as restaurants and schools.

The payroll report counts every job equally, but replacing a $120,000 career with a $35,000 service job is not the same thing for household income or spending power.



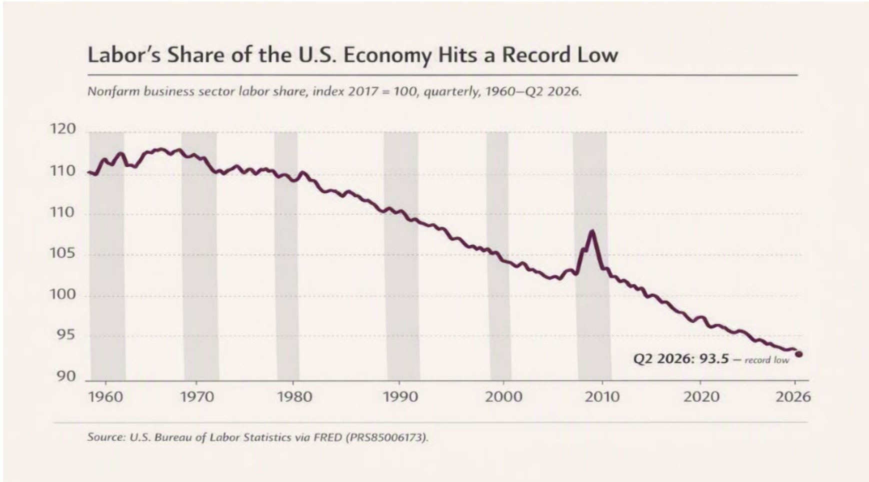
The household survey was even stronger. It showed employment jumping by 569,000, reversing much of the weakness from April through July. Full-time employment rose by 735,000, while the number of people working part-time for economic reasons fell by 414,000.

Those are impressive figures, but this survey is highly volatile from month to month. Moreover, one has to wonder how messed up the household phone survey is due to response rates from illegal immigrants. Are illegal immigrants answering these surveys? If not, then other individuals are overweighted.

The establishment data is also suspect. Are minority firms or firms dependent on immigrants answering these surveys? I think not, and if not, then survey responses from firms dependent on immigrants are overweight, boosting the numbers.

There is no easy way to dismiss the report, but it looks out of step with other labor-market evidence. ADP, JOLTS and the Beige Book all pointed to softer conditions. The Beige Book said employment rose only "very slightly" overall, with five Federal Reserve districts reporting no change. That is difficult to reconcile with a 162,000 payroll gain and a 569,000 surge in the household survey.

One data point can be noisy, misleading and inevitably revised. In any case, today's labor data is unlikely to reveal the sort of wage pressures that could trigger a second inflation wave. Labor's share of the U.S. economy fell to a record low in the second quarter, hardly evidence that workers feel empowered to demand inflation-busting raises despite the ongoing affordability squeeze. This is NOT 2022.



Bottom line: The August jobs report was undeniably strong, but it may be an outlier. It supports the Fed's upbeat view of the labor market and raises the odds of a rate hike, yet the next inflation reports will be decisive. If CPI and PPI come in above expectations, policymakers will have more reason to tighten. If inflation remains mild, the case for raising rates into an otherwise softening economy will be much harder to defend.

TRUMP'S RATE CUT RANT

"Great jobs number just announced, breaking all estimates (except mine!) by double and triple – And you haven't seen anything yet! EMPLOYERS ADDED 162,000 JOB IN AUGUST. Lower the interest rates because the U.S.A. is a much stronger credit than it was just a short time ago! A STRONG COUNTRY MEANS A LOWER INTEREST RATE – IT'S A BETTER CREDIT…Very simple! ***We should have the LOWEST RATE of any country in the World, like "the old days."*** *Without the United States agreeing to allow them their big surpluses, and we could stop that immediately, they would no longer be considered financially ELITE!* ***LOWER THE RATE OR I'LL STOP TRADING WITH COUNTRIES WITH WHICH WE HAVE A DEFICIT,*** *which the U.S. Supreme Court, in its ridiculous and very costly Tariff decision, strongly acknowledged "the President" has an absolute right to do. IT'S BETTER THAN TARIFFS! The Fed Board, with its great new leader, must get smart – BE PATRIOTS for a change.* ***High interest rates put the U.S.A. at a very unfair disadvantage, and I won't allow that to happen!"*** *— President Donald J. Trump, September 4, 2026, Truth Social*

With all due respect to the office of the President, you really cannot make this stuff up.

Trump claims the U.S. should have the lowest interest rates in the world, like "the old days." But in the old days, the U.S. was a creditor nation, had balanced budgets, a smaller federal government, trade surpluses, a low national debt, high savings and was on the gold standard. None of those apply today.

Trump threatened that if the Fed doesn't lower interest rates, he'll cut off all trade with countries that run trade surpluses with the U.S. He claims that's better than tariffs. This would crash the U.S. economy, as a shortage of goods would send prices and unemployment soaring.

Countries we could not trade with:

- Mexico
- Canada

- Japan
- Taiwan
- Germany
- China
- South Korea
- Vietnam
- Italy
- France

Mexico and Canada are our two largest trading partners. China is third.

We could not trade with most of the world, and the U.S. economy would collapse instantly.

Second, the threat is illogical. The trade deficit countries are not the ones that set U.S. interest rate policy. It's like saying if Susie won't eat her beets, then I will kill Joe's dog.

Third, the Fed is independent. Trump cannot force the Fed to do anything. And these threats make it more likely that the Fed will not bend to Trump's wishes.

Finally, this may also push the Fed in the opposite direction, and it certainly won't do anything good (in terms of anything Trump wants).

Bottom Line: President Trump argues that the U.S. should have the world's lowest interest rates and threatens to halt trade with countries running surpluses with America if the Fed does not cut. This threat is economically destructive and disconnected from monetary policy as it could trigger shortages, inflation, unemployment and retaliation while accomplishing nothing because foreign trading partners do not set U.S. rates. Also, the Federal Reserve is independent — and that political pressure may make officials less willing, not more willing, to cut.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

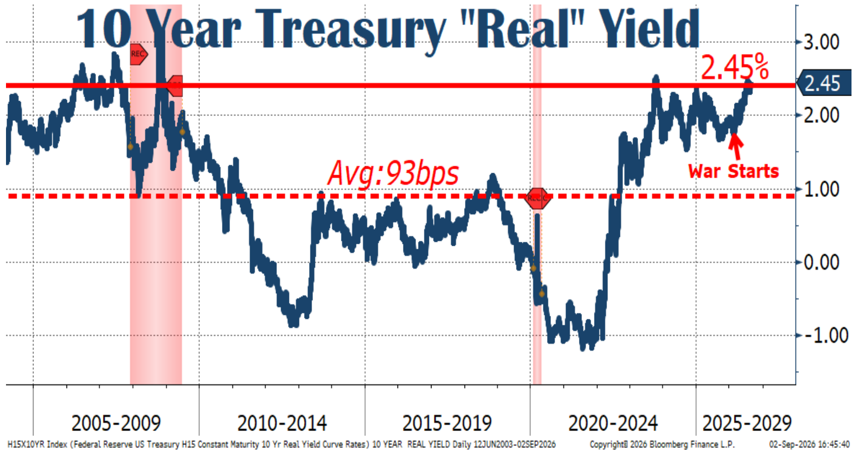
As we move towards a hotly anticipated Fed meeting September 15-16, we will see one last pair of crucial data releases in a short post-Labor Day week: PPI on Thursday and CPI on Friday, both for August. Markets have moved toward a September rate hike in recent days (up to a 60% chance), but a benign CPI print would certainly give the doves more ammo.

The consensus expects headline CPI at +0.4% month over month and +3.4% year over year, but only +0.2% month over month and +2.4% year over year for core. Despite Kevin Warsh's odd focus on headline over core at Jackson Hole, it is core inflation that the FOMC majority will focus on, as month-to-month headline inflation has been distorted by the volatility in energy prices. Core inflation was 0% in June and +0.2% month over month in July. If it comes in for August as the consensus expects, that puts the three-month annualized trend for core inflation at just +1.6%.

Can a single payroll report justify a hike if the recent trend in core inflation is that far under +2.0%?

For PPI, the expectation is +0.4% month over month and +5.2% year over year, accelerating from July's +4.7% year over year. But the PPI components to watch most are the ones that feed directly into the core PCE deflator: health care, airfares and financial services.

Meanwhile, the Treasury market cannot find any love. The 10-year Treasury yield hovered near 4.79% after hitting multi-year highs. The inflation-adjusted “real yield” reached 2.45%, which is more than double the long-term average of 93 basis points.



At the front end, the five-year Treasury real yield is now 2.19%.

Real Treasury yields matter because they show the return investors earn after accounting for inflation. Higher real yields make borrowing more expensive for households and businesses. Higher real rates can slow housing, business investment, hiring and consumer spending. Finally, they reveal how restrictive Fed policy is. A high positive real yield suggests monetary policy is tight, even if nominal rates do not look unusual.

Bottom line: The Fed sits on a knife's edge heading into this week’s meeting. The shocking August payroll number looks like an outlier, and this week's CPI and PPI data will seal the deal one way or another.

Regardless of what the Fed does bonds still offer an attractive risk/reward tradeoff at these levels. Inflation looks less durable than advertised, the economy looks weaker than markets want to admit, and the Fed risks tightening into a slowdown driven more by supply shocks, oil headlines and speculative excess than by genuine demand-led inflation.

Stay patient, stay liquid and use today’s unusually hated bond market to add duration selectively before the Fed and the data force the market to rethink the path of policy.

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For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at **tom.slefinger@alloyacorp.org** or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.