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According to the Case-Shiller National Home Price Index, the value of homes increased by 10.4% in 2020, surged by 18.8% in 2021, surpassing the record annual growth rate of 14.5% set in the mid-2000s. For the first three months of 2022, home prices continued to climb, rising 23.3% on an annualized basis. The strength of the U.S. housing market has been driven by record low inventory levels, record low mortgage rates, and the desire to move during the pandemic. Prior to the COVID outbreak the median price for a new and existing home was $331,000 and $270,000 and now it is $450,000 and $391,000.

However, the recent increase in mortgage rates should take some steam out of the housing market. Since the beginning of the year, the average 30-year fixed mortgage rate increased from 3.25% to a recent 5.45%, and climbing. If a borrower took out a $400,000 mortgage at 3.25%, they would owe $1,741 a month. At a 5.45% rate, that payment increases to $2,259 per month. For a family that earns the median income of $68,000, it would currently spend almost 40% of its income to make a mortgage payment, compared to 31% at the end of last year. The result is a decline in housing affordability. This decline in affordability showed up in the most recent University of Michigan consumer survey, pointing to waning demand as we head into the second half of 2022   The number of those thinking now is a good time to buy dropped to historic lows, while those thinking it is a good time to sell hit historic highs. This gap suggests that buyers may regain some control over the market.

While a stronger labor market may seem as an offset to declining affordability, the pace of wage growth has not kept up with home prices. Over the past 2 years, home prices increased by 37% while wages rose by just 12%. This gap was a problem well before 2020 and the beginning of the pandemic. This gap, between wages and home prices may seem similar to the 2006 housing bubble. Unlike that housing crisis, the fundamentals in the housing market are very different today. Excessive leverage, looser underwriting standards, and financial speculation were some of the factors then. Recent price surges were due to historically low interest rates, low inventory levels, and a shift in demand due to the pandemic. We may not see home prices drop outright, but there could be a significant deceleration from current growth rates, especially if inventory levels increase.

At the beginning of the year, the inventory of existing homes was 1.6 months at average sales rates, a record low. This has moved up slightly as in April, it had reached 2.2 months. The inventory of new homes has risen sharply, with a 9-month supply of new homes, well above a balanced market and is consistent with a price decline. As new home sales represent only 10% of the market, the national average home price index will be driven by the inventory of existing homes.

However, it is important to understand that national numbers do not reflect the variation in home prices changes across the country, since not all regions had the same growth rates. Price adjustments will vary across the U.S. as some markets may be extremely overvalued, while others are not.