1970s: The Case of the Missing Homes

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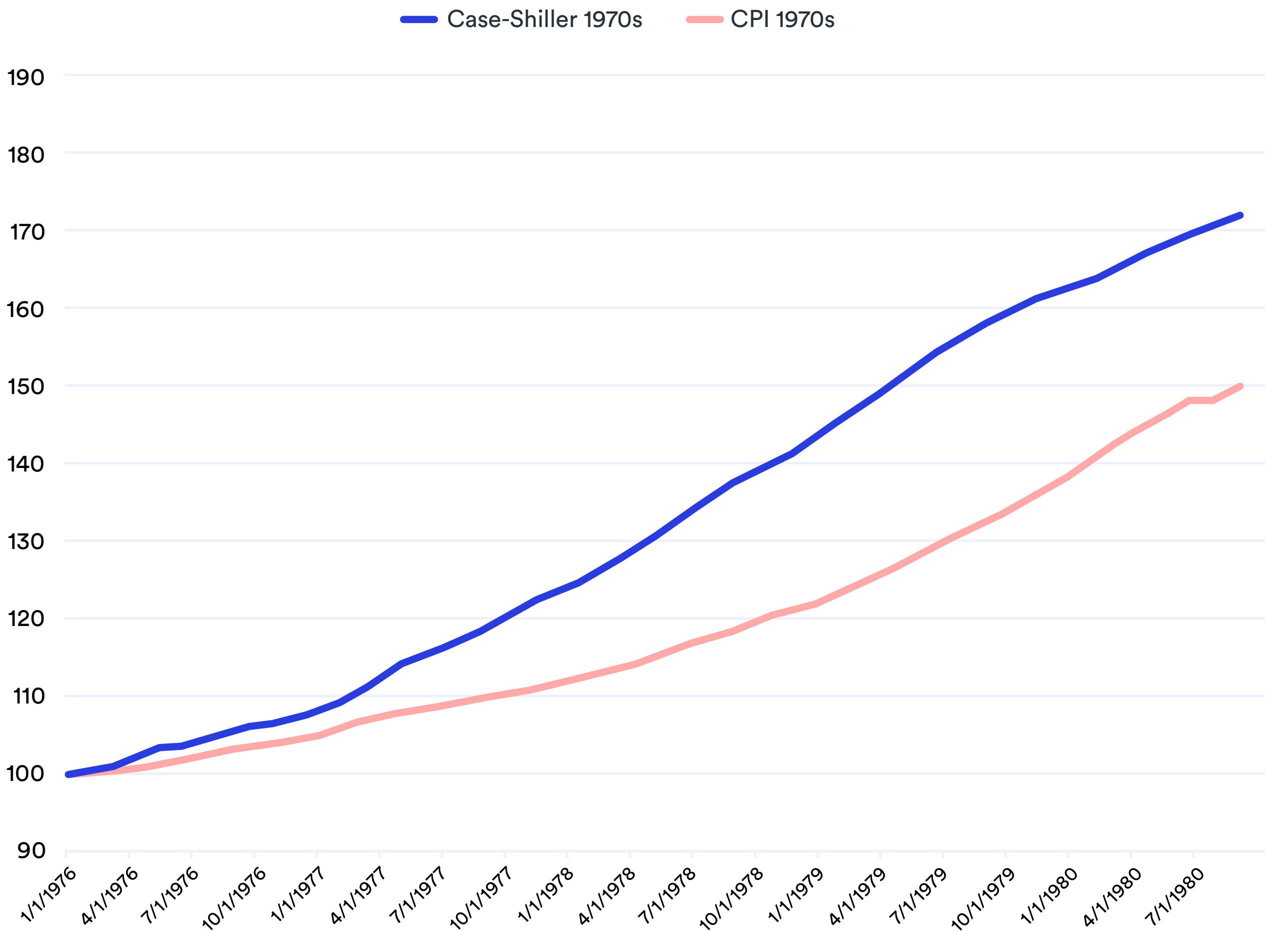
Introduction

There is only one other period in the modern U.S. economy that closely mirrors that which we are currently experiencing: the 1970s. The 1970s were a period of stubbornly high inflation where the Fed raised rates at a historic pace in order to tame runaway prices. One of the most important financial lessons from this period was that despite rising mortgage rates which put pressure on housing demand, home price appreciation (HPA) outstripped inflation and outperformed other asset classes[1], such as equities. In fact, mortgage rates on their own are a fairly poor indicator[2] of the housing market over a medium horizon.

FIGURE 1

Seventies Inflationary Boom



1. Tubbs, Michael. Breaking Into the 60/40 Portfolio with Residential Real Estate. 2023. https://contentimages.o-prod.unison.com/images/im/60_40_Portfolio.pdf
2. O'Hara, Matt & Michael Tubbs. Home Price Appreciation, Interest Rates, and Inflation. 2022. https://assets.ctfassets.net/a26d66afjkk1/443DQG1FVxceitJ0lViWvi/798832cb5092e5d96d630b26e6b4f32d/Home_Prices__Interest_Rates__and_Inflation.pdf

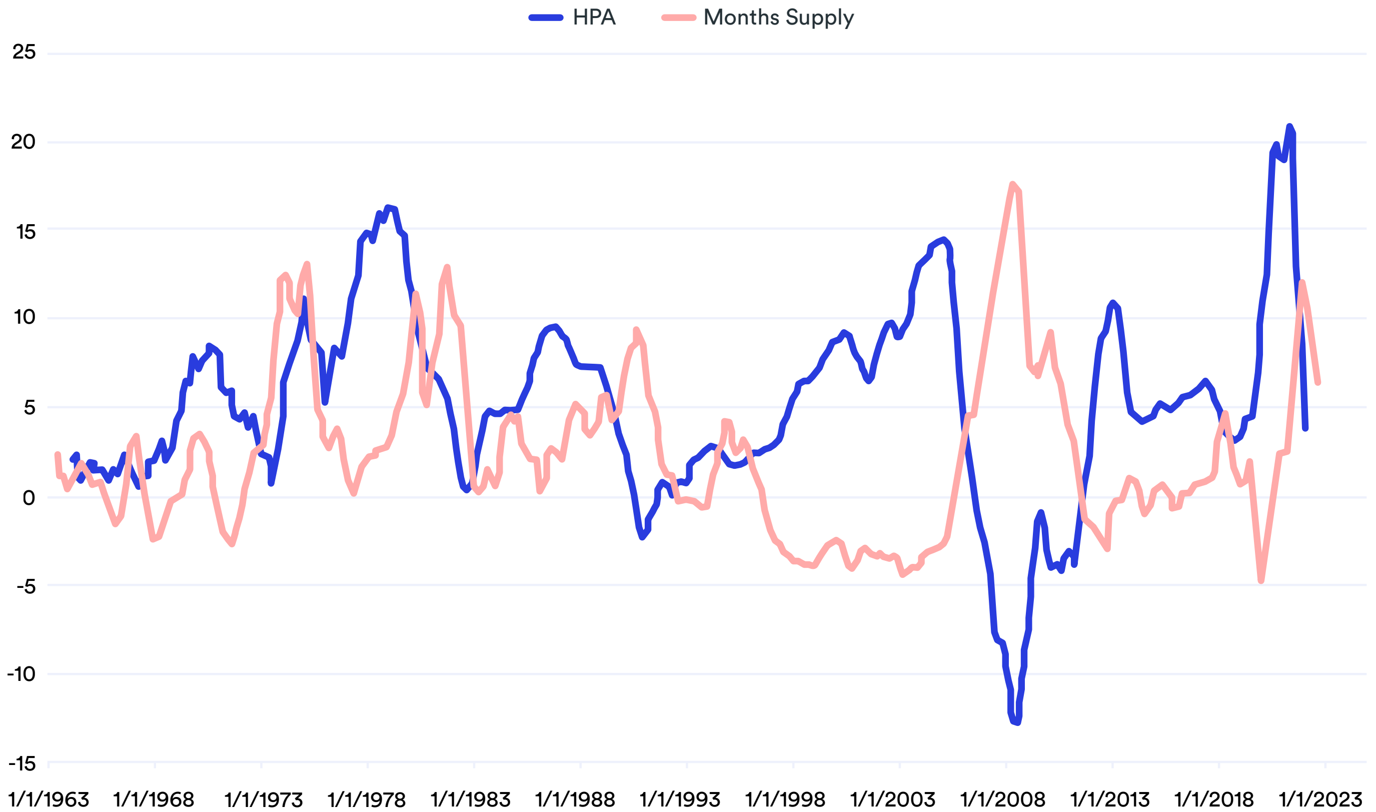
In Unison's view, the predominant factor which enabled home prices to perform so well amidst high economic uncertainty, was the supply imbalance the U.S. was experiencing at that time. Enumerating the housing stock on its own is not a useful indicator of the degree to which the market is constrained, or an accurate reflection of housing supply relative to demand. We need to construct slightly more intricate measures to gauge the tightness of supply. One such is the month's supply of new homes (the ratio of new homes for sale over transactions), which has incredible predictive power when it comes to home prices; we must also consider key historical periods in the housing market.

Below is a figure displaying the month's supply[3] of new homes and HPA. When HPA was beginning to take off during the mid-to-late 1970s, the month's supply of new homes contracted rather quickly. This was certainly spurred by higher mortgage rates which locked many individuals into the homes they already had, similar to the position many find themselves in today. Heavy microeconomic pressure is applied to HPA when there are few homes on the market, but a large number of people want to transact. Conversely, leading into the housing crash of 2008, the month's supply of new homes shot up quite rapidly. It wasn't until the balance of transactions and listings leveled out that HPA began to turn around.

3. U.S. Census Bureau and U.S. Department of Housing and Urban Development, Monthly Supply of New Houses in the United States [MSACSR], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/MSACSR, November 6, 2023.

FIGURE 2

Tighter Supply During High HPA



While this period was one of considerably high HPA, as we have described, real returns were likewise strong. This begs the question: how well does an indicator like the month's supply perform in predicting real returns in house prices? The answer: quite well, actually! Moreover, it exhibits similar performance with both nominal and real returns–meaning it's a robust measure of HPA regardless of the macroeconomic environment. Below you can see two figures, both of which list HPA one year ahead on the y-axis and the month's supply of new homes on the x-axis. The difference between the figures is that the first showcases nominal prices, while in the second, HPA is deflated by the CPI.[4] The lower the supply (to the left), the higher HPA tends to be in the future, and the higher the month's supply (to the right), the lower the HPA. There was a structural shift in higher nominal HPA during the 1970s, but after accounting for inflation, we can see that real home prices were closely aligned with the historical relationship between the month's supply of new homes. Similar figures with interest rates would show a flat relationship between HPA and interest rates, indicating no predictive power over HPA.

4. U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items in U.S. City Average [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPIAUCSL, November 6, 2023.

FIGURE 3

Nominal Home Price Appreciation in the 1970s

FIGURE 4

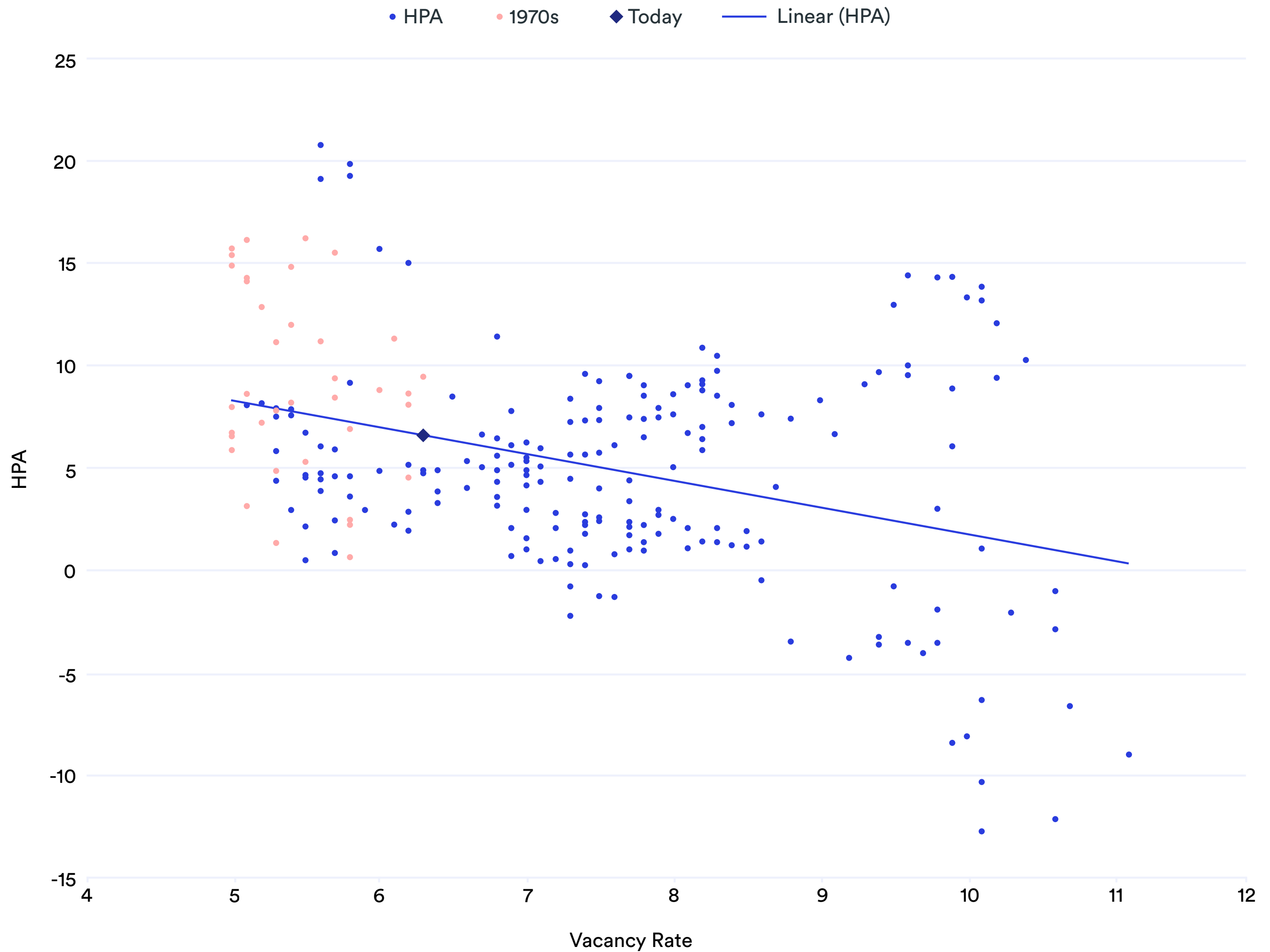
Strong Real Home Price Appreciation Due to Lower Supply

Another lens through which to examine the supply and demand imbalance is that of vacancies.[5] The lower the vacancy rate, the more willing homeowners and renters are to use spaces that might not typically be occupied; in the opposite direction, if the market is flooded with too many homes and cannot satiate demand, the vacancy rate creeps up. Below is a figure with the vacancy rate on the x-axis and HPA on the y-axis. You can indeed see this negative relationship between vacancy rates and HPA, as the lower the vacancy rate (further to the left) the higher the HPA, and the higher the vacancy rate (to the right), the lower the HPA. The 1970s are highlighted in pink, and they represent one of the lowest vacancy rates in U.S. history. The extremely limited supply indicated by vacancies is one of the key reasons HPA outpaced inflation during this time frame and provided robust returns.

5. U.S. Census Bureau, Rental Vacancy Rate in the United States [RRVRUSQ156N], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RRVRUSQ156N, November 6, 2023.

FIGURE 5

TBD



Historically speaking, the 1970s most closely mirror the current economic conditions in the United States. At that time, high economic growth was followed by sluggishness, as the Fed was trying to bring down runaway prices. Many asset classes suffered with so much looming economic uncertainty, but house prices outperformed inflation and other assets. So, what does this mean for the current housing market?

The first lesson is to look past the high interest and rate hikes as a reason house prices will fall. Rather, we should look to fundamental aspects that will constrain the market. As compared to 2008, the month's supply of homes has pulled back in reaction to the rate hikes. As interest rates rose, like in the 1970s, this discouraged many from selling their homes because they were/are already locked into advantageous financing. Moreover, the current vacancy is 6.3% (the large blue diamond), well below the historical average and closer to the rates we saw in the 1970s–consistent with above-average HPA. The U.S. is facing an extremely constrained housing supply as production is not keeping pace with population growth. These measures of the housing supply better reflect the short- and long-term challenges the U.S. is facing, and how HPA can prove to be a robust asset class just as it was in the 1970s.

About Unison

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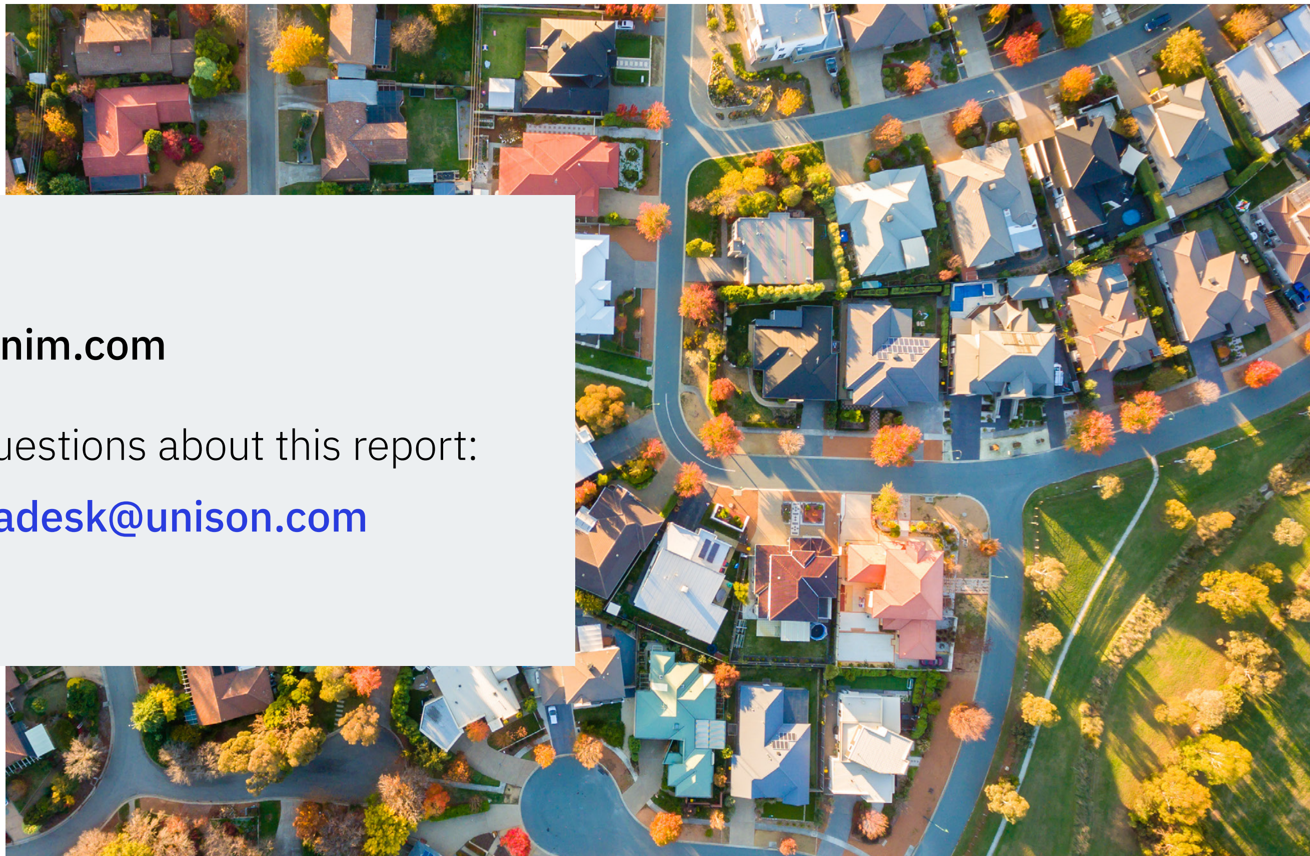

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