Goldman Sachs | Economics Research

22 October 2023 | 10:09PM EDT

US Economics Analyst

Higher for Longer and the 2024 Housing Outlook (Walker)

- While the sharpest declines in housing activity and prices are now long behind us, the recent jump in mortgage rates and the prospect that they are likely to remain elevated for the foreseeable future present headwinds to the economy's most interest rate sensitive sector. In this week's *Analyst*, we summarize our outlook for the housing market for the rest of this year and 2024.
- Sustained higher mortgage rates will have their most pronounced impact in 2024 on housing turnover. Nearly all mortgage borrowers have interest rates below current market rates, almost 90% have rates 2pp below, and over 60% have rates 4pp below, strongly disincentivizing them from moving. As a result, we expect the fewest annual existing home sales since the early 1990s at 3.8mn.
- Limited available housing supply has kept homebuilding resilient to higher interest rates: despite 3½pp higher mortgage rates today, housing starts were 5% above 2019 levels in September. While vacancy rates remain at historic lows, we expect housing starts to decline by 4% to 1.34mn in 2024, reflecting sharply fewer multifamily starts. The backlog of multifamily units already under construction has grown 56% since 2020, and the pipeline for new projects has already begun to narrow.
- The almost 1pp rise in mortgage rates since the summer has already pushed monthly housing activity lower, and we expect those slides to continue into early next year. We expect quarterly annualized residential fixed investment growth to swing from +2% in 2023Q3 to -7% in 2023Q4 and -4% in 2024Q1, before rebounding later in 2024 for roughly flat annual growth (Q4/Q4 basis, vs. -3% in 2023).
- We estimate that home prices have increased 4.2% so far this year but are likely to fall 0.8% through December for a +3.4% year-over-year increase (Case-Shiller measure). We expect only modest home price growth of +1.3% in 2024, as supply remains tight but high rates weigh on affordability.
- Continued oncoming multifamily supply should allow rent inflation to normalize further even as starts slow, and we expect the PCE measure to return to just above pre-pandemic levels by late 2024. PCE shelter inflation has already slowed from a peak monthly rate of +0.79% to +0.54% in the September PCE report (GS forecast), and we expect it to slow to +0.42% by December 2023 and +0.31% by December 2024, implying a decline in the year-on-year rate to 4.1%.

Jan Hatzius
+1(212)902-0394 | jan.hatzius@gs.com
Goldman Sachs & Co. LLC

Alec Phillips
+1(202)637-3746 | alec.phillips@gs.com
Goldman Sachs & Co. LLC

David Mericle
+1(212)357-2619 |
david.mericle@gs.com
Goldman Sachs & Co. LLC

Spencer Hill, CFA
+1(212)357-7621 | spencer.hill@gs.com
Goldman Sachs & Co. LLC

Ronnie Walker
+1(917)343-4543 |
ronnie.walker@gs.com
Goldman Sachs & Co. LLC

Tim Krupa
+1(202)637-3771 | tim.krupa@gs.com
Goldman Sachs & Co. LLC

Manuel Abecasis
+1(212)902-8357 |
manuel.abecasis@gs.com
Goldman Sachs & Co. LLC

Higher for Longer and the 2024 Housing Outlook

After the one-two punch of skyrocketing mortgage rates and normalizing pandemic-fueled demand led to the sharpest slowdown in the US housing market since the 2008 financial crisis, most national-level metrics of housing activity stabilized in 2023, home prices rebounded, and residential fixed investment is set to increase by 2% annualized in Q3.

While the sharpest declines in housing activity and prices are now long behind us, the recent jump in mortgage rates and prospect that they could remain elevated for the foreseeable future present headwinds to the economy's most interest rate sensitive sector. In this week's *Analyst*, we summarize our key forecasts for the housing market for the rest of this year and 2024.

Exhibit 1: GS Housing Forecasts

Housing Forecasts												
	Annual Average				2023				2024			
Indicator	2022	2023	2024	2025	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real Residential Fixed Investment (QoQ ar)	**-17.4**	*-3.1*	*0.2*	*3.2*	**-5.3**	**-2.2**	*2.3*	*-7*	*-4*	*1*	*2*	*2*
Housing Starts (Thous. SAAR)	**1,551**	*1,388*	*1,335*	*1,430*	**1,385**	**1,450**	**1,359**	*1,358*	*1,335*	*1,325*	*1,325*	*1,355*
Existing Home Sales (Thous. SAAR)	**5,081**	*4,093*	*3,838*	*4,244*	**4,327**	**4,250**	**4,023**	*3,773*	*3,740*	*3,796*	*3,863*	*3,952*
New Home Sales (Thous. SAAR)	**637**	*680*	*723*	*771*	**638**	**691**	*700*	*690*	*708*	*708*	*728*	*747*
Homeowner Vacancy Rate (%)	**0.8**	*0.8*	*1.0*	*1.1*	**0.8**	**0.7**	*0.8*	*0.8*	*0.9*	*0.9*	*1.0*	*1.0*
Case-Shiller Home Price Index (QoQ ar)*	**5.7**	*3.4*	*1.3*	*3.8*	**-1.0**	**6.9**	*7.8*	*0.5*	*-2.6*	*1.1*	*1.7*	*2.3*
Primary Mortgage Rate (%, EOP)**	**6.4**	*7.1*	*6.8*	*6.3*	**6.3**	**6.7**	**7.3**	*7.1*	*7.3*	*7.2*	*7.1*	*6.8*

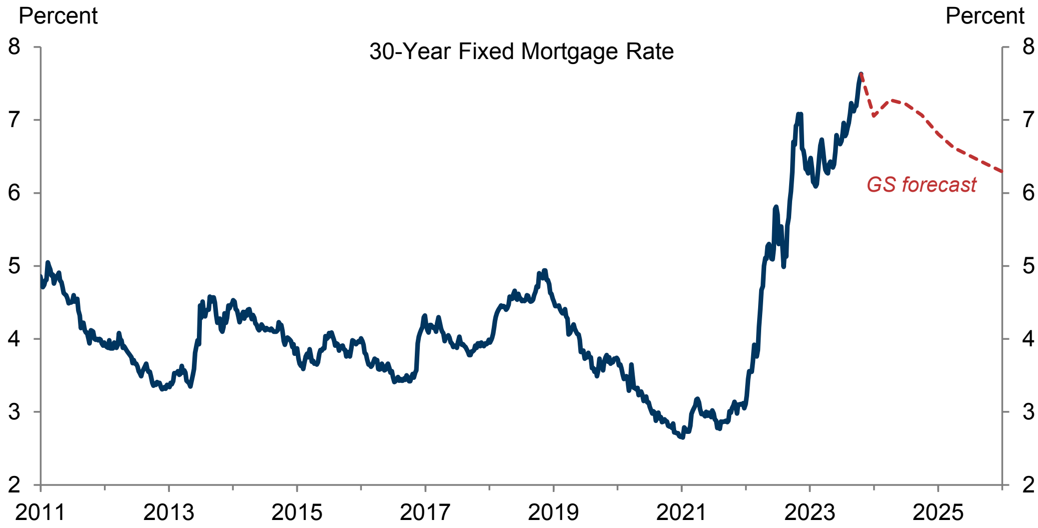
Note: Published figures in bold. Red, italicized numbers denote GS forecasts.
* Annual values are the seasonally adjusted year-over-year rates for December.
** Annual values are EOP.

Source: Department of Labor, S&P Global, Freddie Mac, Goldman Sachs Global Investment Research

Sustained Higher Rates Will Weigh on Housing Turnover

Interest rates have risen across the curve in recent months, and especially so at the long end. Exhibit 2 shows that mortgage rates have increased by almost 2pp since their trough in early 2023, with about half of the increase coming since the summer. Our strategists expect mortgage rates to remain elevated for the foreseeable future, dipping to just under 7% by the end of next year.

Exhibit 2: Mortgage Rates Have Jumped Above 7½% and Are Likely to Remain Elevated



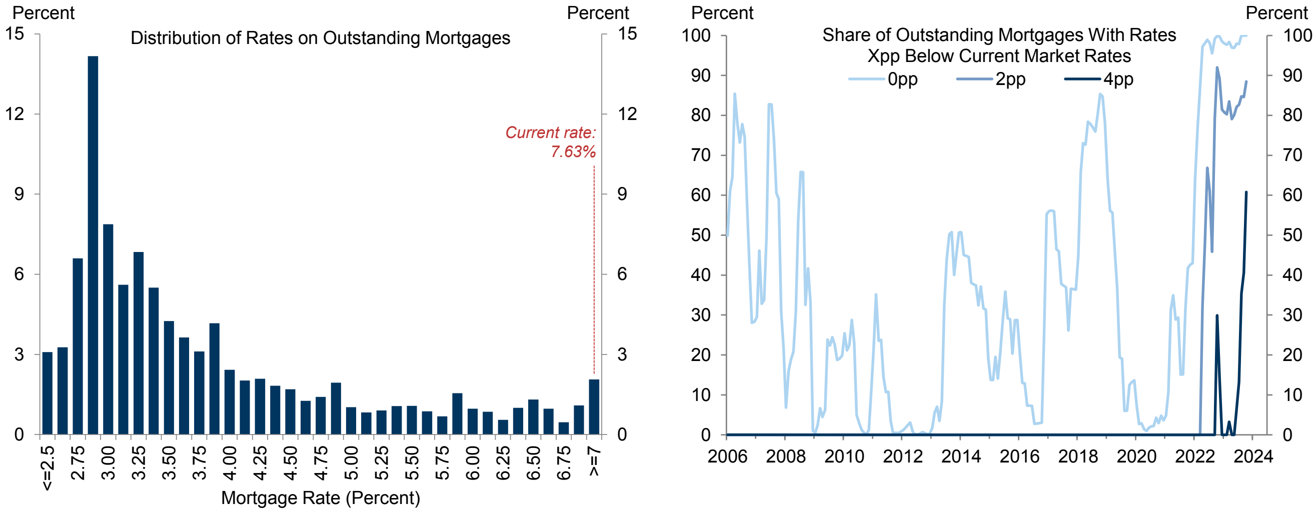
Source: Freddie Mac, Goldman Sachs Global Investment Research

We expect sustained higher rates to have the most pronounced impact in 2024 on housing turnover. Exhibit 3 shows that nearly all mortgage borrowers have interest rates below current market rates, and that almost 90% have rates more than 2pp below and over 60% have rates more than 4pp below.[1] The combination of mortgage borrowers refinancing at low rates en masse either last cycle or early in the pandemic and the high current level of mortgage rates has created a significant implicit financial cost for a substantial share of households that otherwise might consider moving, as buying a new home would require them to prepay their current mortgage and take out a new mortgage at a significantly higher rate. We expect this "lock-in" effect to push existing home sales even lower in the coming months and to limit any rebound next year: we expect existing home sales to decline to 3.8mn in 2024, the lowest level since the early 1990s.

While a more moderate pace of existing home sales will weigh sharply on the *gross* supply of available homes, it should have limited implications for *net* housing supply and the longstanding nationwide housing shortage, as (in many cases) households are simply switching between housing units (i.e. no housing units are being created or destroyed). However, turnover does have meaningful implications for GDP, as fewer existing homes sales will weigh on residential fixed investment via reduced brokers' commissions (which hold a 17% weight in RFI).

[1] The right panel of Exhibit 3 shows that it has been historically unusual for a large share of outstanding mortgages to be more moderately below current market rates, a byproduct of the long-term decline in interest rates. A recent academic study highlighted that the large share of households with mortgage rates well below market rates could dampen the stimulative effect of future rate cuts. See David Berger et al., "Mortgage prepayment and path-dependent effects of monetary policy," 2021.

Exhibit 3: Essentially All Borrowers Have Mortgage Rates Well Below Current Market Rates, and Even a Sharp Decline in Mortgage Rates Would Leave a Historically Large Share of Homeowners With a Financial Disincentive to Move

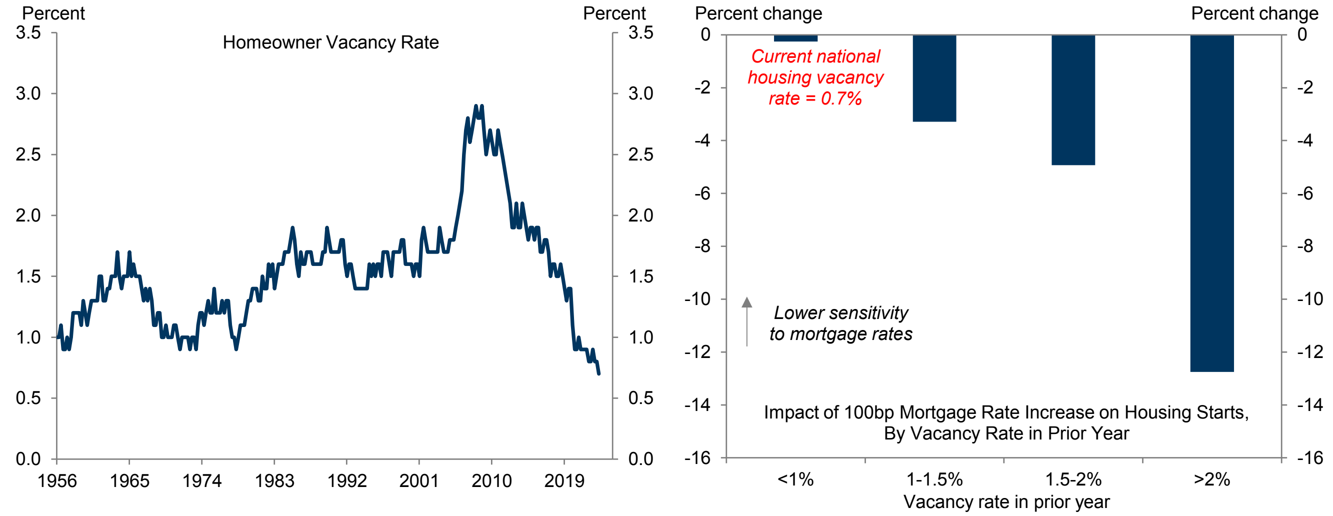


Source: eMBS, Goldman Sachs Global Investment Research

Dueling Forces for Homebuilding: Lack of Supply and Strong Income Growth vs. Construction Backlogs and Poor Affordability

Early last year, we argued that extreme tightness in the housing market would dampen the hit to housing activity from higher interest rates. Our analysis, summarized in Exhibit 4, suggested that when the homeowner vacancy rate is low—as it was then and still is today—the sensitivity of housing starts to mortgage rates is sharply reduced. Because financing costs are a small share of construction costs, homebuilders likely normally slow construction when interest rates increase in anticipation of weaker demand. However, when housing markets are tight, like they are today, lack of supply appears to be the constraint for potential homeowners—not their lack of financial wherewithal—and homebuilders can keep building because they should have little fear that homes will sit unsold after completion.

Exhibit 4: Housing Activity Is Less Sensitive to Higher Mortgage Rates When Housing Markets Are Tight, Which Helps to Explain the Limited Impact of Sharply Higher Rates This Cycle

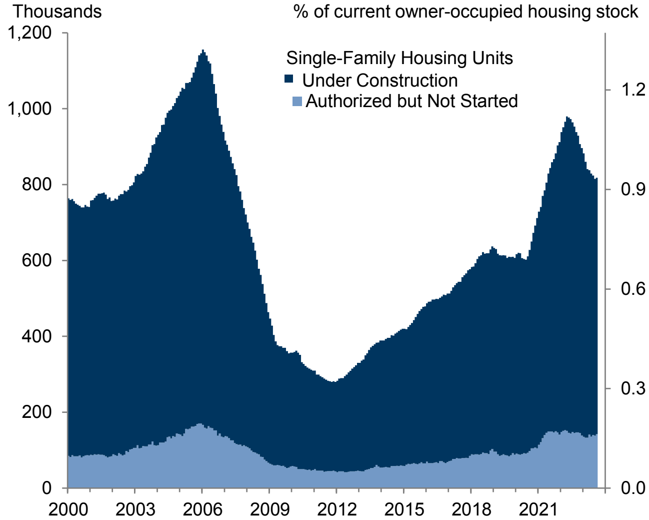


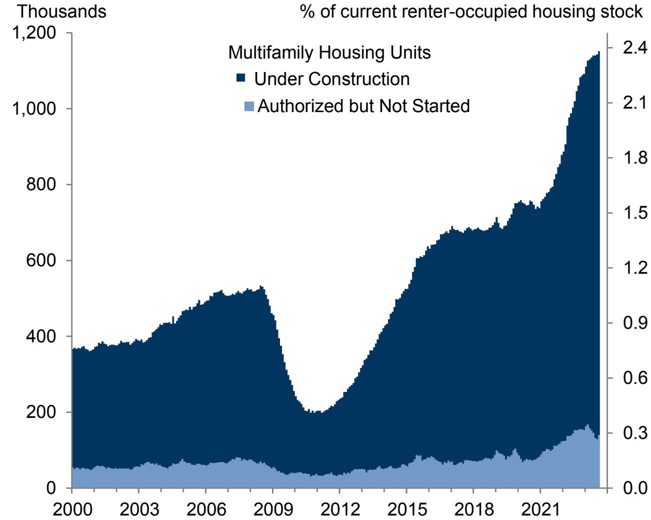
Source: Department of Commerce, Goldman Sachs Global Investment Research

While homebuilding did decline in 2022, the limited available housing supply did indeed reduce the impact of higher interest rates: despite 3½pp higher mortgage rates today, housing starts in September were 5% above 2019 levels. Nonetheless, we expect housing starts to slow by 4% to 1.34mn in 2024. Our forecast reflects roughly unchanged single-family starts (at 1.0mn) and sharply fewer multifamily starts, which we expect to total less than 350k, the lowest level since 2013.

The fundamental backdrop for single-family starts is stronger than that for multifamily from both a demand and a supply perspective. On the demand side, we expect next year's robust income growth to be skewed toward higher-income households, which disproportionately reside in owner-occupied housing (87% of households in the top income quintile live in owner-occupied housing vs. 45% in the bottom). On the supply side, the homeowner vacancy rate—the relevant vacancy rate for single-family housing—has continued to decline over the last few years and now sits at the lowest level on record. In contrast, the rental vacancy rate—the relevant rate for multifamily housing—has already begun to rebound, though remains at historically low levels. Additionally, as Exhibit 5 shows, while a substantial portion of the backlog of single-family homes under construction has already been cleared, the backlog of multifamily units already under construction has continued to grow (+56% since 2020) and now totals almost 2½% of the existing renter-occupied housing stock. We expect multifamily developers to focus to clearing that large backlog before breaking new ground. And indeed, the pipeline for new projects has continued to narrow amid recession concerns and poor absorption rates, with multifamily permits down 15% vs. their 2023H1 average.

Exhibit 5: While a Substantial Portion of the Backlog of Single-Family Homes Under Construction Has Already Been Cleared, the Backlog of Multifamily Units Under Construction Has Continued to Grow



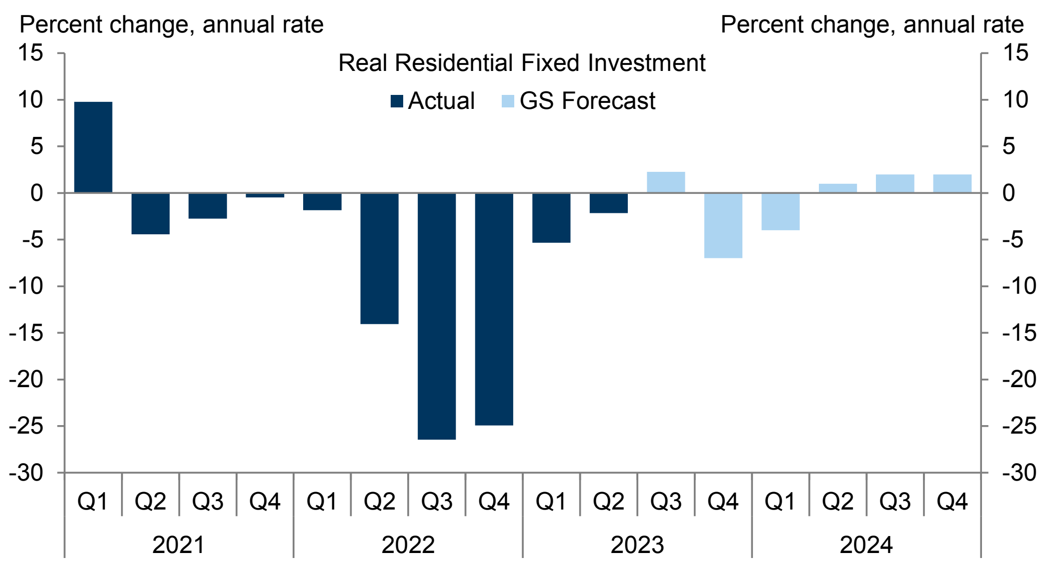


Source: Department of Commerce, Goldman Sachs Global Investment Research

Sharply Lower Residential Fixed Investment Growth in 2023Q4 and 2024Q1; Roughly Flat Growth on Net Next Year

The almost 1pp rise in mortgage rates since the summer has already pushed monthly housing activity lower. Putting that together with the above pieces, we expect quarterly annualized residential fixed investment growth to swing from +2% in 2023Q3 to -7% in 2023Q4 and -4% in 2024Q1, before rebounding later in 2024 as the negative impulse from higher rates fades for roughly flat annual growth (Q4/Q4 basis, vs. -3% in 2023).

Exhibit 6: We Expect Residential Fixed Investment Growth of -7% Annualized in Q4 and -4% in Q1

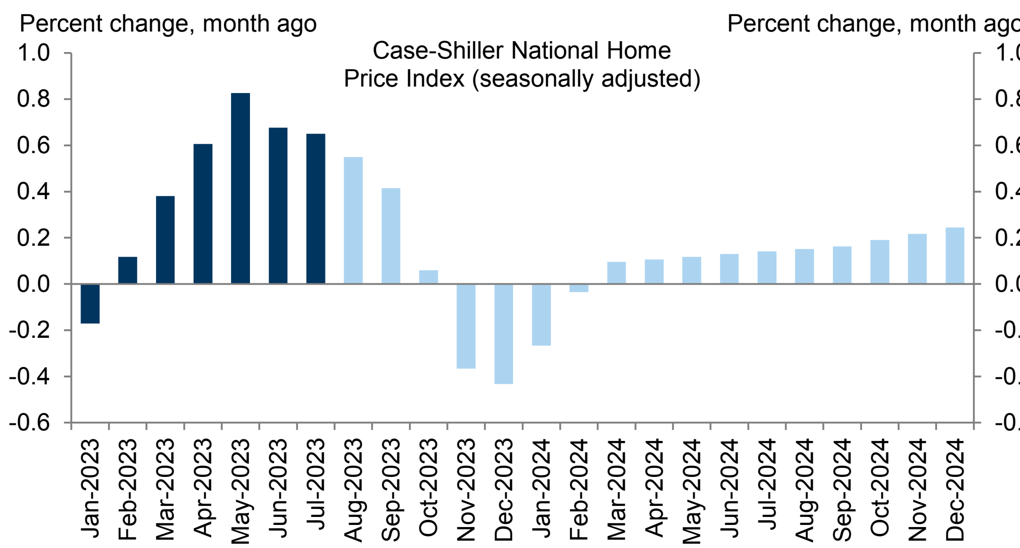


Source: Department of Commerce, Goldman Sachs Global Investment Research

Home Prices Likely to Decline This Winter Before Rebounding Only Modestly in 2024

Exhibit 7 shows the projections of our housing model that jointly considers supply, demand, affordability, and home prices under the environment outlined above. The model suggests that home prices are likely to continue increasing rapidly for the next couple of monthly readings—owing in part to the Case-Shiller home price index's delayed release time and three-month moving average design mean—before slowing sharply and turning negative into year-end. Thereafter, our model projects a rebound to below-trend home price growth (Dec. 2024 year-over-year: +1.3%) as rates decline modestly but remain at elevated levels.

Exhibit 7: We Expect Home Prices to Decline Later This Year Before Rebounding in 2024



Source: S&P Global, Goldman Sachs Global Investment Research

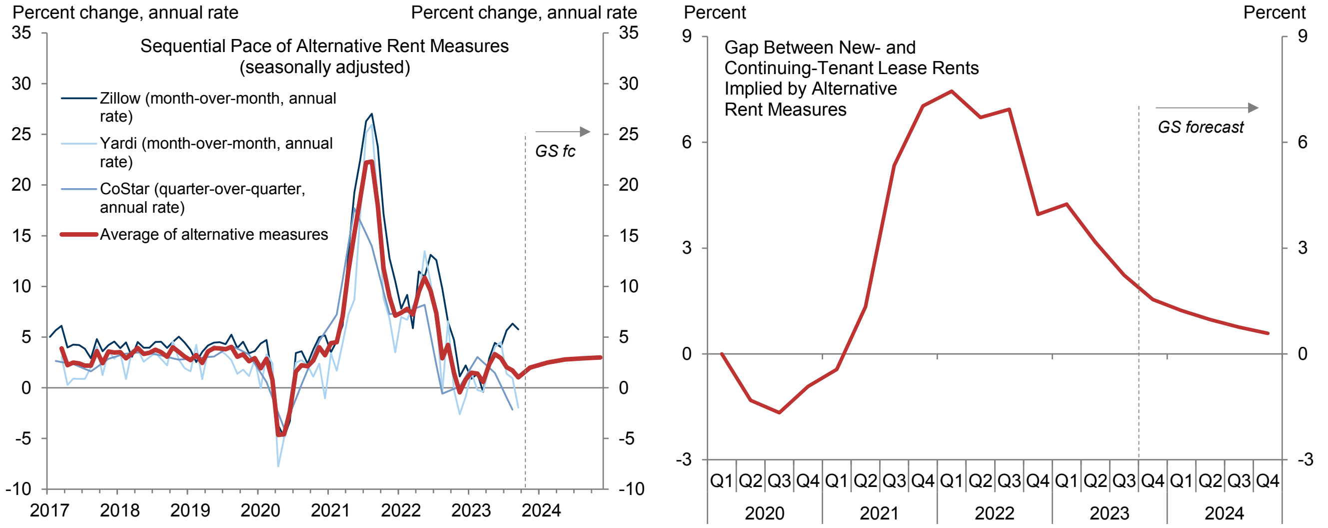
Shelter Inflation Will Slow to Just Above Pre-Pandemic Levels by Late 2024

Should we worry that fewer multifamily housing starts could slow the normalization in rent inflation? We think not. Even though multifamily starts are likely to decline, completions are likely to continue running near their multi-decade high pace, which should help clear the construction backlog and contribute to a modest increase in the rental vacancy rate.

As we have argued for the last year, the outlook for the official measures of shelter inflation in the CPI and PCE reports depends crucially on the gap between rents for new and continuing tenants, which grew sharply in 2021 and 2022. The left panel of Exhibit 8 shows that alternative measures of new-lease rent growth have slowed from an average annualized pace of +9% in 2021-2022 to +2% so far this year. Our model of new-lease rent growth projects a 3% annualized increase over the next couple of years, slightly below the pre-pandemic rate but above the recent pace. While the rental vacancy rate is likely to rise because of strong completions, a strong labor market and the recent rebound in immigration are likely to support demand.

The right panel of Exhibit 8 shows that the slower pace of new-lease rent growth has allowed continuing-lease rents to catch up, shrinking the gap between new- and continuing-lease rents from a peak of 7½% in 2022Q1 to 2¼% in 2023Q3.

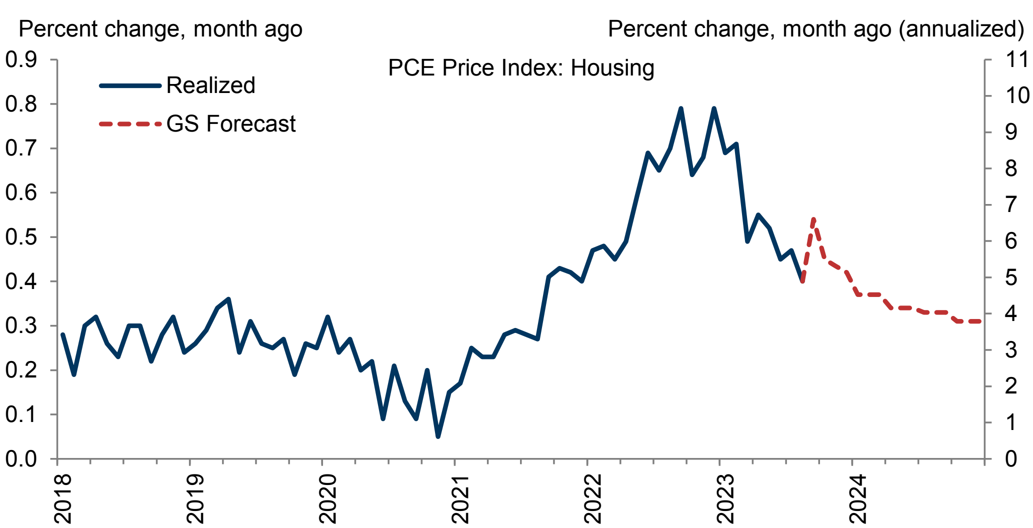
Exhibit 8: New-Tenant Lease Rent Growth Has Averaged +2% on a Sequential Annualized Basis This Year (vs. +9% in 2021-2022); We Estimate That There Is Still a 2¼% Gap Between New- and Continuing-Lease Rents



Source: Costar, Zillow, Yardi, Goldman Sachs Global Investment Research

Official shelter inflation has already slowed from a peak monthly rate of +0.79% to +0.54% in the upcoming September PCE report (GS mapping). We expect shelter inflation to slow to +0.42% by December 2023 and +0.31% by December 2024, implying a decline in the year-on-year rate to 4.1%, as the gap between new- and continuing-lease rents closes further.

Exhibit 9: We Expect PCE Shelter Inflation to Fall From a Monthly Pace of +0.54% in September to +0.42% by E2023 and +0.31% by E2024



Source: Department of Commerce, Goldman Sachs Global Investment Research

Ronnie Walker

The US Economic and Financial Outlook

THE US ECONOMIC AND FINANCIAL OUTLOOK
(% change on previous period, annualized, except where noted)

	2021	2022	2023 (f)	2024 (f)	2025 (f)	2026 (f)	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4
OUTPUT AND SPENDING														
Real GDP	5.8	1.9	2.3	2.0	1.9	1.9	2.2	2.1	4.6	0.7	1.9	1.9	1.9	1.9
Real GDP (annual=Q4/Q4, quarterly=yoy)	5.4	0.7	2.4	1.9	1.9	1.9	1.7	2.4	2.9	2.4	2.3	2.3	1.6	1.9
Consumer Expenditures	8.4	2.5	2.2	2.0	1.9	1.9	3.8	0.8	4.0	1.2	1.9	1.9	1.9	1.9
Residential Fixed Investment	10.7	-9.0	-11.6	-1.7	2.6	3.2	-5.3	-2.2	2.3	-7.0	-4.0	1.0	2.0	2.0
Business Fixed Investment	5.9	5.2	4.4	3.6	3.7	3.6	5.7	7.4	0.7	3.5	3.5	4.1	3.8	3.8
Structures	-3.2	-2.1	10.9	2.4	2.8	3.0	30.3	16.1	-1.8	2.0	2.0	2.0	2.5	2.5
Equipment	6.4	5.2	0.9	4.7	3.4	3.0	-4.1	7.7	1.0	6.0	5.0	5.0	4.0	4.0
Intellectual Property Products	10.4	9.1	4.3	3.2	4.5	4.5	3.8	2.7	2.0	2.0	3.0	4.5	4.5	4.5
Federal Government	1.4	-2.8	3.3	0.3	0.0	0.0	5.2	1.1	1.5	-0.6	0.6	0.0	0.0	0.0
State & Local Government	-1.3	0.2	3.3	0.8	0.9	1.0	4.6	4.7	2.5	0.0	0.0	0.1	0.9	0.9
Net Exports ($bn, '17)	-934	-1,051	-903	-909	-931	-936	-935	-928	-868	-880	-893	-903	-914	-927
Inventory Investment ($bn, '17)	13	128	21	45	60	60	27	15	27	15	30	40	50	60
Industrial Production, Mfg.	4.9	2.7	-0.4	2.2	3.3	3.3	-0.3	0.3	0.0	1.4	2.7	3.2	3.2	3.3
HOUSING MARKET														
Housing Starts (units, thous)	1,606	1,551	1,388	1,335	1,430	1,458	1,385	1,450	1,359	1,358	1,335	1,325	1,325	1,355
New Home Sales (units, thous)	769	637	680	723	771	781	638	691	700	690	708	708	728	747
Existing Home Sales (units, thous)	6,128	5,081	4,093	3,838	4,244	4,372	4,327	4,250	4,023	3,773	3,740	3,796	3,863	3,952
Case-Shiller Home Prices (%yoy)*	19.0	7.5	3.5	0.6	3.8	4.9	2.3	-0.2	2.2	3.5	3.1	1.6	0.2	0.6
INFLATION (% ch, yr/yr)														
Consumer Price Index (CPI)**	7.2	6.4	3.4	2.9	2.3	2.4	5.8	4.1	3.6	3.3	3.2	3.2	3.0	2.9
Core CPI **	5.5	5.7	3.9	2.9	2.5	2.5	5.6	5.2	4.4	4.0	3.7	3.3	3.2	3.0
Core PCE** †	5.2	4.9	3.3	2.4	2.2	2.1	4.8	4.6	4.0	3.4	2.9	2.6	2.6	2.5
LABOR MARKET														
Unemployment Rate (%)^	3.9	3.5	3.6	3.6	3.6	3.6	3.5	3.6	3.8	3.6	3.6	3.6	3.6	3.6
U6 Underemployment Rate (%)^	7.3	6.5	6.7	6.6	6.6	6.6	6.7	6.9	7.0	6.7	6.6	6.6	6.6	6.6
Payrolls (thous, monthly rate)	606	399	230	103	80	75	312	201	266	142	112	100	100	100
Employment-Population Ratio (%)^	59.5	60.1	60.5	60.4	60.2	60.0	60.4	60.3	60.4	60.5	60.5	60.5	60.4	60.4
Labor Force Participation Rate (%)^	62.0	62.3	62.8	62.6	62.4	62.4	62.6	62.6	62.8	62.8	62.7	62.7	62.7	62.6
Average Hourly Earnings (%yoy)	4.2	5.3	4.3	3.9	3.6	3.6	4.5	4.4	4.2	4.1	4.1	4.0	3.8	3.7
GOVERNMENT FINANCE														
Federal Budget (FY, $bn)	-2,775	-1,375	-1,700	-1,700	-1,900	-1,900	--	--	--	--	--	--	--	--
FINANCIAL INDICATORS														
FF Target Range (Bottom-Top, %)^	0-0.25	4.25-4.5	5.25-5.5	5-5.25	4-4.25	3-3.25	4.75-5	5-5.25	5.25-5.5	5.25-5.5	5.25-5.5	5.25-5.5	5.25-5.5	5-5.25
10-Year Treasury Note^	1.52	3.88	4.30	4.30	4.25	4.25	3.48	3.81	4.59	4.30	4.60	4.60	4.50	4.30
Euro (€/$)^	1.13	1.07	1.06	1.15	1.15	1.15	1.09	1.09	1.06	1.06	1.09	1.11	1.12	1.15
Yen ($/¥)^	115	132	150	135	135	135	133	144	149	150	153	153	151	135

* Weighted average of metro-level HPIs for 381 metro cities where the weights are dollar values of housing stock reported in the American Community Survey. Annual numbers are Q4/Q4.
** Annual inflation numbers are December year-on-year values. Quarterly values are Q4/Q4.
† PCE = Personal consumption expenditures. ^ Denotes end of period.
Note: Published figures in bold.

Source: Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Ronnie Walker, Tim Krupa and Manuel Abecasis, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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