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Global Housing Markets Continue to Climb

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SEI Fixed Income Portfolio Management (FIPM) manages fixed-income strategies for SEI's Managed Account Solutions.

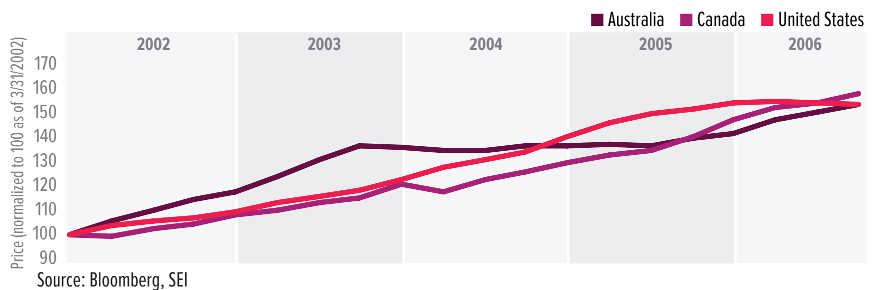
Snapshot

- Prior to the financial crisis, housing markets in the U.S., Canada and Australia followed similar price trajectories, consistently reaching record levels.
- While the U.S. market began a five-year price decline in 2006, a similar downward move never materialized in Canada and Australia.
- In fact, prices have continued to rise almost unimpeded since the Great Recession, sparking current debate about the sustainability of prices in both markets.

The "Great Recession" that began in December 2007 led to the global financial crisis which began the following year. While there was a multitude of root causes, a key factor was the U.S. housing market. Historically low mortgage rates and relaxed lending standards helped create a housing bubble in the U.S. and its popping crippled the world's financial system and necessitated U.S. taxpayer-financed bailouts to rescue.

Prior to the financial crisis, housing markets in the U.S., Canada and Australia followed similar price trajectories, consistently reaching record levels (Exhibit 1).

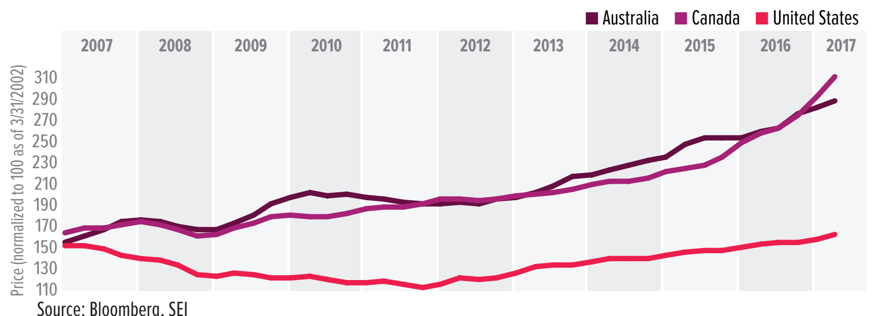
Exhibit 1: Home Prices (2002-2007)



Source: Bloomberg, SEI

The ensuing housing collapse in the U.S. saw home prices fall almost 30% from their pre-crisis highs. But while the U.S. market began its five-year decline in 2006, a similar downward spiral never materialized in Canada and Australia (Exhibit 2). In fact, prices have continued to rise almost unimpeded since the Great Recession, sparking current debate about the sustainability of prices in both markets.

Exhibit 2: Home Prices (2007-2017)



Source: Bloomberg, SEI

The fallout from the U.S. housing collapse was widespread. Financial markets were turbulent, gross domestic product (GDP) plummeted and unemployment soared. Peak to trough, U.S. GDP slid 3.4% in 2009, on top of a 7.7% annualized drop in the fourth quarter of 2008. A 14.7% fall in construction spending coincided with the downturn and held back GDP expansion until consistent month-over-month growth resumed in early 2011. In addition, construction spending didn't eclipse its nominal 2008 levels until 2015.

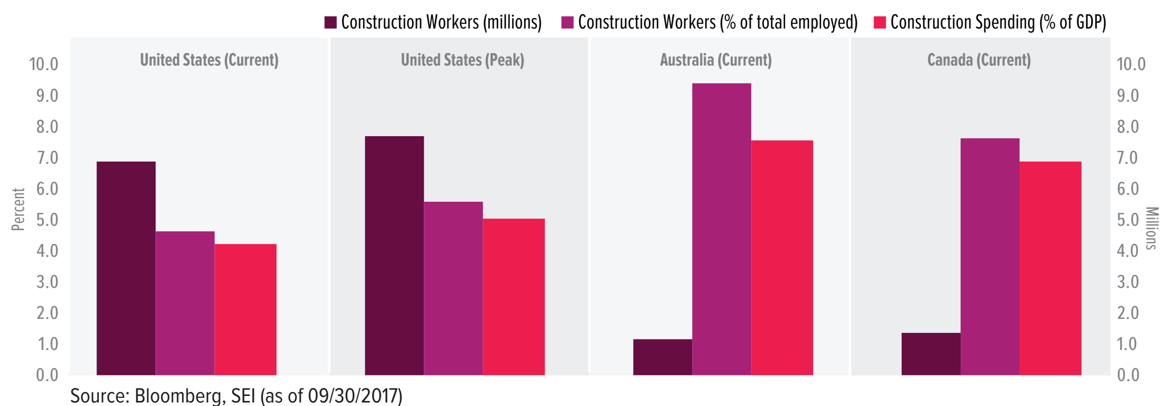
Construction Component Remains Relevant

Pre-crisis U.S. construction spending topped out at 5.1% of U.S. GDP in the second quarter of 2006. It bottomed in 2011, declining to 3.5% of GDP in the first three quarters. Similarly, construction employment peaked at 5.7% of total employed workers in early 2006 but had fallen to 4.2% by the beginning of 2011. The total number of construction workers dropped from 7.7 million to 5.4 million, a decline of nearly 30%. The current statistics show construction workers at 6.9 million, 4.7% of employed individuals, still short of prior highs.

In Australia, the August 2017 data indicated 1.2 million people working in construction, about 9.5% of the employed population and nearly 4% higher than the U.S. peak. From 1990 until August 2017, construction workers made up an average of 8.1% of workers but didn't consistently hit over 8% until 2003. Additionally, construction currently contributes 7.6% of Australian GDP, about 50% higher than the U.S. peak (Exhibit 3).

Canada's construction industry also remains outsized relative to its history and the peak levels in the U.S. Canada's 1.4 million construction workers account for 7.7% of all employed. Prior to recession in the early 1990s, which saw limited house price declines, construction workers peaked at 6.3% of all employed. The fourth quarter of 1993 saw a bottom in the number employed in construction at 672,000, just 5.2% of the total employed. Construction spending now sits at 6.9% of GDP, not as high as Australia's 7.6%, but again, comfortably above the U.S. peak.

Exhibit 3: Construction—an Important Building Block



Source: Bloomberg, SEI (as of 09/30/2017)

The construction sector has propelled GDP expansion in both Australia and Canada for several years, and an industry slowdown could create large headwinds to their economic growth. Also to consider are other real-estate industry occupations, like brokers and mortgage bankers, which have experienced similar growth through this cycle. In addition, the impact could be more severe than prior downturns due to the steady growth of the industry since prior recessions.

Amid the housing bust and the Great Recession, the U.S. had its weakest economy since the Great Depression. As unemployment touched a high of 10%, Congress implemented a massive stimulus package and the Federal Reserve employed unprecedented easing of monetary policy.

Central Bank Support

We have witnessed global coordinated support from central banks since the Great Recession. The efforts by the banks to prop up the world economies supported stability and growth. The U.S. central bank has begun to unwind its stimulus, while the European Central Bank (ECB) and Bank of Japan (BoJ) continue to feed the economy a little longer. The ECB will begin to remove accommodation and taper its bond buying in January. At this point, there is no sign that the BoJ has plans to unwind or restrict efforts to support its economy.

With that said, if a housing correction or economic slowdown materializes in Australia or Canada, we may see a second wave of support for accommodation by the respective central banks. Markets are currently pricing in a 0% probability that the Bank of Canada or Bank of Australia will lower interest rates in the next year. Although history is not a perfect guide for future activity, we know that markets, economies and sentiment can change quickly. If there is supporting data for negative sentiment, it would not take long for the central banks to step in and provide the necessary stimulus to keep their economies afloat.

Our View

While the sound underwriting practices, the current status of loan portfolios and low interest rates indicate stable markets in Australia and Canada, we do not turn a blind eye to the robust price appreciation. In addition, other factors cause us some concern, including the prevalence of interest-only loans and variable-rate loans, as well as sizeable portfolios of investment property loans.

SEI Fixed Income Portfolio Management may hold Australian and Canadian bank bonds for various SEI investment vehicles. We continue to monitor and assess the Australian and Canadian housing markets and banks for any weakness that may develop.

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice and is intended for educational purposes only.

There are risks involved with investing, including loss of principal. Diversification may not protect against market risk. Bonds and bond funds will decrease in value as interest rates rise.

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