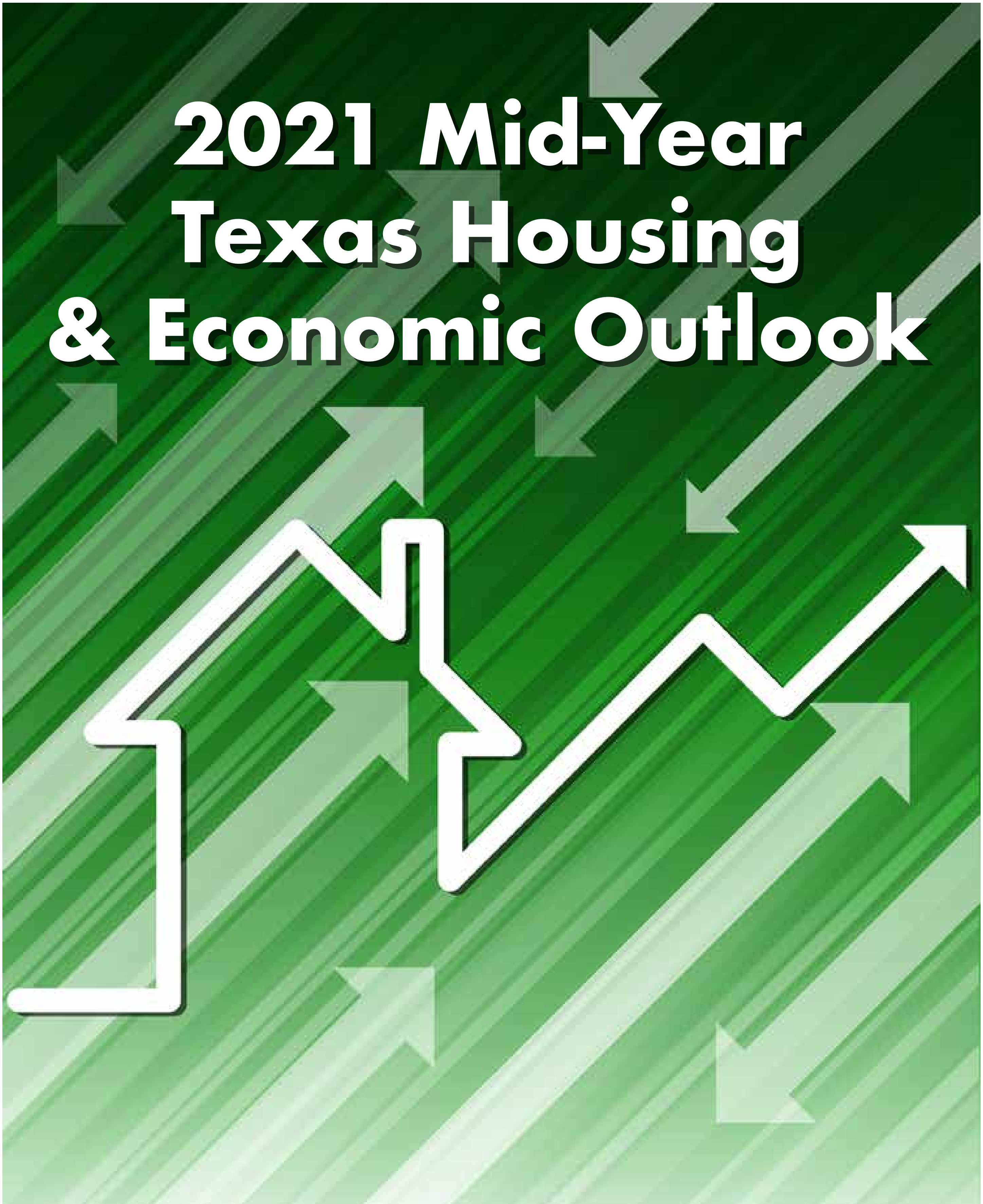
2021 Mid-Year Texas Housing & Economic Outlook



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The economic recovery continues due to increasing COVID-19 vaccination rates that have allowed the reopening of the economy. Based on the most current data from the Texas Department of State Health Services, 52.3 percent of the state's population is fully vaccinated[1]. Unfortunately, after months of decline in COVID-19 cases, the number of new cases has increased because of the number of people not yet vaccinated and the emergence of the Delta variant, which has shown to be more contagious. This has increased uncertainty surrounding the end of the pandemic. Until the virus is beaten, a full recovery cannot be secured.

Growth prospects for the Texas economy have improved for 2021 because of the economy's reopening and, to some extent, the uptick in the oil industry. The strong recovery has caused supply-chain bottlenecks, putting upward pressure on prices and raising inflation concerns. Whether inflationary pressures are transitory is uncertain because of unknowns about whether the economy is fundamentally different coming out of the pandemic and the uncharted territory of recovering from a health crisis.

Interest Rates

Even in the presence of higher inflation rates, interest rates are expected to continue at low levels because of well-anchored long-run inflation expectations and the Federal Reserve's current monetary policy. Still, interest rates are projected to rise slowly, first due to:

- a slowdown in large-scale asset purchases by the Fed that include Mortgage-Backed Securities and U.S. Treasuries by the end of the year, and
- a change in overall monetary policy as the need for this type of economic stimulus becomes unwarranted in an environment of strong economic growth accompanied by a full recovery of the jobs lost due to the pandemic and inflationary pressures.

Second, the Fed allowing inflation to be above 2 percent for some time would cause interest rates, including mortgage rates, to increase in the latter part of the year and possibly next year. The period of historically low mortgage rates that existed during the pandemic is probably over. These low rates fueled strong housing demand and contributed to significant home price increases.

It's still not clear how different the economy will be coming out of the pandemic as some changes become permanent. It is possible some structural forces prevalent before the pandemic will no longer hold after it ends. Because this recession was caused by a health catastrophe, the recovery path will probably be different than previous recessions.

Single-Family Housing

For the rest of 2021, the housing market will continue to be characterized by strong demand with low inventories accompanied by strong price growth. Inventories of homes priced less than $300,000 will be especially

[1]Data up to July 28, 2021. Source: Texas Department of Health Services

low, affecting sales in that price range. Inventories should improve in the coming months as listings seem to have reached a trough and are rising, easing some of the price pressures. Given the steep increase in home prices during the year, some households probably found themselves priced out of the market.

Even with shortages of labor, appliances, and lumber and other construction materials driving up new-home prices, new-home construction should register strong positive growth in 2021. The supply bottlenecks faced by homebuilders are anticipated to be resolved in the latter part of this year or next year.

New-home construction is projected to grow in 2022 as the pandemic housing market frenzy dissipates and the market stabilizes toward a more sustainable long-run path. However, growth will be at a slower rate than the previous two years, which registered double-digit increases in permits and starts. Housing permits recorded an average growth rate of 22.7 percent the past two years, well above the historical average of 5.9 percent from 1991 to 2020. Such a record-breaking pace of homebuilding is difficult to sustain for long periods in an ever-changing economic landscape.

Economic growth and demographic trends, such as aging millennials and out-of-state migration, will help drive Texas housing demand in the remainder of 2021 and into 2022.

Estimated State, MSA Single-Family Housing Forecast

	2020 (%)	2021 (%)	2022 (%)	2023 (%)	1991-2020 (%)
Texas					
Housing permits	22.9	22.5	5.4	4.2	5.9
Sales	10.5	5.5	4.0	4.1	4.8
Price per square foot	6.9	16.0	5.0	4.0	4.8
Austin					
Housing permits	19.4	20.8	5.2	4.8	11.5
Sales	9.4	4.8	4.5	4.2	6.3
Price per square foot	8.3	31.4	5.2	4.6	6.3
DFW					
Housing permits	25.2	22.5	5.3	5.7	5.2
Sales	9.6	2.6	3.5	4.1	5.1
Price per square foot	6.3	17.0	4.6	4.2	4.6
Houston					
Housing permits	22.2	12.8	6.3	6.5	6.1
Sales	10.9	7.4	3.3	4.5	4.2
Price per square foot	5.0	13.3	5.0	3.7	5.2
San Antonio					
Housing permits	19.9	27.9	5.0	5.3	8.5
Sales	12.3	6.1	3.9	4.0	7.0
Price per square foot	7.0	12.8	4.7	3.9	4.7

Note: Estimated with May/June 2021 data. Annual numbers represent the 12-month total for single-family sales and housing permits and the average for the price per square foot of the seasonally adjusted data. Price per square foot is nominally estimated from the previous year's average.

Sources: U.S. Census Bureau and Texas Real Estate Research Center at Texas A&M University

The Fed's current monetary policy and well-anchored long-run inflation expectations are expected to keep mortgage rates relatively low through the end of the year. However, they should increase somewhat in the coming months as the Fed tapers its asset purchases and if inflation runs consistently above 2 percent annually. Low mortgages have helped offset rising home prices and have played an important role in the housing market's strong performance during 2020-21. Mortgage rates may increase somewhat, but they are not expected to become a major headwind for housing demand.

For 2022, expect the supply of homes for sale to increase and housing demand to remain relatively strong. This will help balance the market and slow home-price growth. Mortgage rates could be somewhat higher in 2022 than 2021 because of changes in the Fed's monetary policy and because of inflationary pressures. If 2021's high price growth is added to rising mortgage rates, demand should weaken in 2022. Affordability will continue to be an issue for buyers looking to purchase starter homes less than $300,000. In some regions, it will worsen as sharp increases in land, labor, and material costs make it difficult to build homes at that price range profitably.

Delinquencies and foreclosures will probably increase once forbearance ends in the fall of 2021. Both have been kept low due to government policies, but they are no longer seen as major issues facing the housing market because of the recovery in the labor market and government transfers benefiting households that in the past couldn't make their mortgage payments on time. Also, given the lack of homes available for sale, the market could absorb an increased number of homes in delinquency or foreclosure. These homes could possibly be sold with a gain even before they enter into foreclosure.

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