

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

When you're lost in the darkness look for the pod
Specifically the prestige TV podcast on the ringer podcast network where we're breaking down
every new episode of HBO's the last of us
On Sunday nights grab your battery and join Van Lathen and Charles Holmes for an instant reaction
to the latest episode
Then head back to the QZ on Tuesdays for a deep dive with Joanna Robinson and Mallory Rubin from
character arcs to video game adaptation
Choices story themes to needle drops will parse every inch of this cordyceps coated universe
Watch out for mouth tendrils and follow along and Spotify or wherever you get your podcast
Today the recession versus reality
As most people know the US economy is in a recession
Last fall three-quarters of voters told CNN that the US was in a recession a
Bloomberg economic model said the odds of a recession by the fall of 2023 was
100%
These numbers are a little bit strange because
We are not in a recession
We're actually not even close
The unemployment rate today is lower than any month since the 1960s
Real disposable income is growing the economy is expanding consumer spending is strong even
housing seems to be rebounding
So why is everybody not just normal people but professional economists to so
Convinced by so obsessed with this idea that we are either in or at the precipice of a recession
I
have two theories
The first theory is what I've called the everything is terrible, but I'm fine philosophy
if you ask Americans about how the broader economy is going or
Whether American schools have gotten to political or whether America is on the right track or
whether they trust the media
capital T capital M the media when you ask about the states of things broadly
People tend to give really depressed answers
Everything is terrible the economy. Oh, it's in a recession media can't trust a thing. They say schools.
They're a mess America dumpster fire
But if you ask the specifics
The answers tend to change how
Are your finances? Oh, they're okay. How's your favorite podcast or news outlet? Oh, it's great
It tells me the media is terrible by the way, but it's great in September Gallup released an education
survey that asked two questions
How's us education broadly only 45% said they were satisfied a calamity
Schools in disarray, but then they asked how's your oldest child's education and
82% of Americans said they were satisfied
Everything is terrible, but I'm fine
The second theory is what I've called the yo-yo economy
The news media tends to judge the economy

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

I would say based on a rolling average of everything that's happened in the last six months
It is perfectly backward-looking and as a result. They missed the fact that the economy just keeps
doing these yo-yos
Furniture inflation goes up, but then it crashes used car inflation surges
But then it crashes saving rates tech stocks Bitcoin crypto
Everything is a yo-yo these days up and down and when the world is on a string like this
You cannot evaluate the economy by memorizing the conditions of the last six months and just
repeating them ad nauseam
You're gonna get stuff wrong
So for example, look at housing two years ago 2021 the US housing market was flaming scorching
red-hot
Last year the market collapsed
Construction down home purchases down home prices down mortgage applications. Everything
went down and fast
And if you do what most media analysts do you memorize that narrative?
And you just parrot it for a few months and that works really really well until things change and
things are changing
The rest of this episode is about the fact that things are changing fast
The housing flash freeze is over. The comeback might be right here right now
Today's guest is Bloomberg writer Connor Sen
We talk about five signs the housing market is set for a major comeback in 2023 and
How a housing turnaround will change the narrative about inflation the recession and so much more
I'm Derek Thompson. This is plain English
Music
Connor Sen welcome back to the podcast
Derek, thanks for having me
So last year you came on the show during what felt like peak recession fears in
2022 we had had consecutive quarters of negative GDP growth people were losing their minds about
the imminence of the
Inevitability of a recession and I wanted to zag and I brought you on to help me zag to predict that
actually
It was not inevitable and it was not imminent that we were going to have a recession
You explained all the reasons why you thought a recession was not forthcoming and at least for the
year of 2022 up till now
You were right
So now I want to do another pod
Because the housing market seems to be rebounding the housing market which was crashing
crashing crashing throughout 2022
Seems like it may have hit the bottom and the bottom just might be a trampoline because some of
these numbers are going up much faster than I anticipated
So I texted you I said do you think you could summarize our potential housing rebound in like five
numbers and 30 minutes later
I had five numbers in my inbox

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

So we're gonna go through these five numbers absolutely ideal situation of the guests doing the host's work for him by the way
Before we get to the numbers
Catch us up right the pandemic housing market in 2020 and 2021
I think most people remember it was absolutely insane
It was so hot and suddenly it all hit a wall in 2022
What happened so we saw mortgage rates go from 3% at the beginning of 2022 to 5% by April to 6% by August to 7% by October and that process really just took buyers out of the market
they they pulled back in April May and they really really pulled back in September October and 2022 was a large respects the market trying to figure out what to do with that because you had lots of home buyers who are sorry homeowners
Who had gotten these pandemic 3% mortgages and they said fine. We'll just say no problem
And a lot of maybe would-be sellers said we would rather rent out or just not sell than transact in this market
At the same time that a lot of buyers either couldn't or wouldn't
Transact in the market so it became kind of a standoff for the rest of the year and the question heading into January was
Okay, Q4 is slow mortgage rates are high
What are things going to look like after the holidays when people come back and
Assess market conditions and what we've seen is a really explosion in demand over the past five or six weeks
It's so crazy to think like how
Insane the housing market was in 2020 and 2021 and then just how quickly it totally froze up
It's like, you know, there's viral videos where they're in like Antarctica or like northern Minnesota during a polar vortex
And they take a pot of boiling water and they throw the boiling water into the air and it crystallizes suddenly into ice and snow
Like I maybe you've seen those like viral videos. This was basically the housing market for the last three years
Like you it went from uncomfortably scalding to the point where I'm writing takes like a month after month saying
I think housing can't get any hotter
No, now I think housing can't get any hotter and the Fed starts raising rates mortgage rates go up fashion
They've gone up in decades and it just instantly instantly becomes ice cold building
Confidence declines every month new home sales fall practically every month between January 22 and October 22 and that leads
Us to this rebound where we might go from ice cold to hot again
So the first number that I want to bring up that explains the US housing market today is 6% the average 30 year mortgage rate is has now fallen to 6% from 7%
Which is where it was in the last quarter of 2022
What's going on with rates right now and why is this maybe the most important story to begin with

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

when explaining the housing market?

Yeah, so the question really in 2022 heading into 23 was what level of mortgage rates?

We'll get the market back into balance and we can argue about what balance looks like whether it's flat home prices or a

pickup and transactions

but when rates at seven it was just like okay, this is clearly a level that has frozen the market and

And some people said 5% was the level that would sort of unfreeze the market because that's what it was in spring before things

Sort of slowed down

Tall brothers luxury home builder actually said that they thought 6% was the level that would be workable for people

And that's sort of what I thought it would be because you've seen home prices have come down a little bit a little more in markets

Like boys Ian Phoenix that were overheated

but nationally they're down about two three percent from the highs and then

Incomes that kept growing because jobs were really strong and I think to some extent the sticker shock of

Going from seven to six all of a sudden made it seem like this isn't so bad

And there's also been some changes in terms of this notion of mortgage rate buy-downs that both home builders and home sellers have employed where

It's not quite what we saw during the peak of the home buying frenzy in the mid-2000s

But they might give you 2% off your mortgage rate for the first year 1% off for the second year

You still have to qualify for the eventual higher rate

But it's a way to for home buyers to sort of swallow the the sort of affordability challenges for at least for a couple years

Can you help me understand this divergence between

The federal funds rate that the Federal Reserve controls and mortgages because last year

We saw mortgage interest rates go up pretty much in tandem with the Fed raising its interest rate

But the Fed is still raising rates even if it's by less 25 basis points in the last announcement

But the mortgage rate is actually falling

Why are we seeing that divergence?

So two reasons for that one is that mortgage rates tend to be benchmarked more to 10 year treasury rates rather than the overnight Fed funds

Rate that the Fed change raises and lowers every month

And that's just because a mortgage pays down over time the average amount of time people spend in a home tends to be about seven years

So that's just sort of the part of the curve where mortgage rates sit and because

Markets anticipate that the Fed will be done raising interest rates sometime this spring

They immediately went from okay, if we know where we think the Fed will top out rates

we can start to project when they might cut rates and

It's debatable whether or not too many cuts have been priced

But a fair number of cuts have been priced in 2024 which then lowers this 10-year rate

Which then lowers mortgage rates and the other part that goes into mortgage rates is a risk spread

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

between mortgage rates and treasury rates

And that's a function of volatility and sort of complex financial stuff

But as sort of financial markets have settled down over the past few months that spread has started compressing as well

Which is led to lower mortgage rates

So you're saying it's conceivable that in the next few months even as the Federal Reserve continues to raise rates by say 25 basis points every

Few months we might still see 30-year mortgage rates hold steady at 6% or maybe even decline a bit
It's possible they could decline maybe up to another half percent just because the mortgage spread again

The difference between mortgage rates and treasury rates is about 50 to 75 basis points higher than historically has been

And so it's possible that spread could compress as people get more comfortable with the conditions on the ground

The second number is 500,000 and here we're talking about national housing inventory

If you've heard me talk about housing in any other podcast on this show

You know that inventory is one of the numbers that I'm always looking at so last year in 2022 National housing inventory the number of houses sitting on the market fell to a record low of 250,000 it doubled in about six months

From the beginning of the year to the end of the year peaking just shy of 600,000 and now it's falling again houses are getting scarcer on the market which could put pressure on

Prices so this is all these are all figures from Alta's research kind of why is

Inventory such a critical stat for us to focus on and what is this number telling us?

Right so inventory is really how many homes are for sale and it sort of gets you to the point of what would make a home

Price go down and it's typically more people trying to sell than people ready to buy and if there just aren't that many homes for sale

It's hard for prices to go down, especially at a time when demand might be coming back

And what's really interesting about this decline in inventory in 2022 again?

We're already in the mid-February and we're still making lows that we haven't seen since last June is that if there aren't enough

Existing homes to buy that makes home builders potentially more interested in building new homes to sort of fill that gap and

That home building sort of impulse leads to construction and jobs and sort of pushes a lot of the GDP type measures of economic activity

Yeah, I think for people who are who are listening and sort of getting confused about sort of the the relationship between inventory and

And home prices just basically think of it as pressure right that lower inventory puts pressure on housing prices to go up

Because if there's fewer houses on the market plus more buyers that means that you know

It that there's naturally that less up that that smaller supply is going to force prices up

And that's what we seem to be seeing right now one of my favorite housing analysts Bill McBride

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

says that we tend to see two bottoms in

In the real estate market

We see a bottom in housing activity and then we see a bottom in housing prices

So, you know, if you look at

The at at inventory start to change direction, right?

It was rising rising rising throughout 22 and now it seems to be falling again

That might just predict that prices are going to do the opposite inflection point that they have been falling for a while

But they might come back up the third number that I want to throw at you or that you initially threw at me is

2014 the year 2014

So last October

New home sales were lower than almost any month in the last ten years

It was one of the worst months for new home sales that we've seen basically this century if you exclude the great the

Global financial crisis. So that's a situation where the boiled water was well and truly frozen in January for this year

We do not have official numbers yet

But according to some projections from private sector companies new home sales in January are supposed to be higher than any non

COVID month since at least

2014 so new home sales could really trampoline from these

Decade lows. What are you seeing in terms the prospects for new home sales?

So it's it's difficult because right now so much of the volatility month-to-month in housing activity has been due to changes in mortgage rates

So if mortgage rates surge back to 8%

That would freeze the market again

But if they fell back to five and a half percent

We might have a booming market and so when we're trying to project where are things going to go?

It's really a function of mortgage rates and since mortgage rates have hit 6% in recent weeks and

Sort of people who wanted to buy a home last year, but maybe we're scared or had affordability issues have decided to come back to the market in

January we're seeing this huge rebound in sales. So it almost makes you have to think about

Does the data tell you enough about where things are going or do you have to think about the fact that there are buyers out there who

want to buy homes who maybe are just responding to mortgage rates and

Predictions about where home prices will go over the next few months and enter in the market or exit it based on shifts in those in that thinking

So the sum of everything that we've said so far

We've seen that mortgage interest rates have started to come down a little bit that seems to be spurring more new home buys

More new home buys means that inventory is going down and as inventory goes down

We should expect housing prices to go back up

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

You put all that together and it's starting to sound like the housing market, which really entered a dead zone in 2022 is getting hotter

This is all looking at the demand side though

And so now I think we should bring in the supply side and the third number that I should be the fourth number that I have for you is

40% since October of last year and October really seems to have been kind of the bottom of this housing market since October of last year

DR Horton and Lenard the two largest publicly traded home builders are up 40%

40% stock appreciation in the last five months in the last five months for these two large home builders

What are you looking at when you look at DR Horton and Lenard?

So the question for home building stocks in 2022

Wasn't just what are sales likely going to be in the future

It was well home prices fall so much that these large inventories of land and houses under construction that they have will turn into losses

Because they were marked on their balance sheet at a certain price level certain valuation

But if home prices were to fall 30% that could be off significantly and then the stocks could crash and

What's happened is that you know, we're now in February and so we got through those really tough months

They continue to sell homes. They continue to report earnings

And now they've cleared that backlog to some extent and now they have lower mortgage rates and higher demand

It seemingly this year to work with so they sort of benefit from the concern of

Lower home prices isn't what it was and now there's also the prospect of much better demand this year and maybe in 2024 as well

Which has really shifted the thinking of what the prospects for the home building industry look like over the next 12 or 18 months

What about the cost of inputs? That was a huge problem in 2022 especially early 2022

There were all these fears that the input cost for all of these houses was gonna skyrocket

Which is gonna make it really unappealing for these builders to build homes because the cost is gonna gonna rise

Commensurately have we seen those costs come down a little bit for things like lumber and plastics?

We have and they've talked about the fact that lumber prices of have

Because of that that cost I saw one estimate that for a certain sized townhome

But the decline in the cost of lumber would mean a seventy thousand dollar savings for a builder on the cost side

That's how much the drop in lumber had an impact of and then to the extent that sort of sort of trades and construction and labor

That loosens up and it's no longer as pandemic crazy as it has been

There's the prospect of cost cuts there as well

So you could see stabilizing home prices while their costs come down

Which all that would flow through into higher profit margins down the road. Yeah, this gets into

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

what I've called the yo-yo economy
I feel like there's a lot of economic analysts not you and
Hopefully not me but definitely a lot of economic analysts who for whatever reason
tend to anchor
Their analysis of the economy to whatever was happening six months ago
And if that's your mode of economic analysis, you are well and truly effed in
In terms of trying to understand this economy because everything keeps changing over six months
intervals
So for example, you saw in just the category of something like, you know durable goods use car
inflation when absolutely berserk
And then it came down and it was negative durable goods inflation when absolutely berserk stuff like
furniture
I think people remember maybe like a year ago. It was so unbelievably expensive to buy new
furniture the
Overseas shipping costs from Shanghai were skyrocketing
But those came all the way back down computer costs semiconductors had this boom and bust cycle
We saw it in terms of savings rates. We saw it in terms of
Tech employment, you know with the with the hiring going on in Silicon Valley
And we might be seeing it in housing and it it just goes to show that like you you can't
Hold on to or embrace an economic narrative and just stick with it for six months without
Continuing to check that narrative against emerging numbers because we really are just in an
unbelievably bizarre economic period
Where things just keep going up and down back and forth penduluming all the time
And I think to your point on housing
We look at gross domestic product GDP and how in the past in the last two quarters of 2022
It grew about 3%
Which to some extent was an offset of what happened in the first half of the year
Which was very weak but housing detracted over 1% each quarter from GDP because we saw
housing starts fall
Fewer home sales all that flowed through into the lower GDP
And if we start to see that housing is now inflecting higher and it's gonna start adding to GDP
Going from like a minus one on GDP to say plus half percent is like increasing trend GDP by a
percent and a half
and at a time when
Forecasters are looking for only a half percent of GDP growth in 2023
You can see it clear quickly how sort of much much higher growth might be in this year than people
thought coming into the year
It's such a good point
And you're getting a little bit ahead of where I wanted you to go because I'm gonna ask about
recessional
Recession implications of all this analysis in just a second
But it's such a good point that I think and not enough people are
Staring closely at just how significant this housing rebound is not just for sellers not just for buyers

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

But also for anyone looking at whether the US is gonna enter a recession before we get to a full analysis of the implications of the housing market on
The possibility of a recession. Let's hit the last number that you threw at me number number five is 45
45 this is a prediction number rather than a factual figure and I'm gonna let you set this one up
tell us about the monthly
sentiment survey of home builders put out by the NAHB and
Why 45 is an important number for us to look at?
So this is a monthly survey of home builders where
You can respond anywhere between zero and a hundred where zero is the housing market is completely dead a hundred is things are on fire
And it's never been hotter and 50 represents neither growth nor contraction and this index had fallen
Significantly from the pandemic highs in 2022
Where by December it hit 35 which is sort of pretty deep contraction and close to where it was at the pandemic lows in March and April of 2020
And then in January we saw a very small rebound of 37
But that was really when people just started to see because the surveys probably people were Responding to it in the early part of the month
And so we really hadn't seen the full impact of how strong housing demand was at that point and we get this number
Wednesday this week and
Sort of to set up how quickly this could shift during this yo-yo pandemic economy between May 2020 and June 2020
So right when the housing market started taking off that index went from 37
Which is pretty strong contraction to 58 which is sort of modest expansion in a single month
And I think we could be seeing a sort of more modest version of that this this month where
We go from 35 or 37 in January to a much much higher number
I I think maybe more like 45, but if it went into expansion territory wouldn't totally shock me
Just because we have seen that they give a swing so far in 2023
What would it mean for
Now let's move into the possibilities of recession. I'm interested in you explain it to me what this really would mean for the general economy
because as
we talked about last year once again, you have a ton of
Economists and banks that are predicting a recession in 2023
I think at one point I saw the Wall Street Journal report that nearly a hundred percent of
Major bank analysts projected a recession in the next year and a half
That number I think has fallen a little bit
but if everything that we're talking about
Really comes to play out if the buyers come back into the market as mortgage rates stabilized around six or even five-ish percent as
Homebuilding picks up and only among places like in our but also among all sorts of private

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

Home construction companies around the country and we start to see Residential investment pick up. That's a huge part of the economy. It seems like our Are the odds of a recession? Have to come down if we start to see that home builder number go from the 30s to the 40s the 50s Yeah, I mean the fact that the housing market turned on a dime and slowed as much as it did in the latter part of 2022 And we didn't even see trend economic growth let alone below trend or recession For that to go from sort of a pretty deep contraction to growth in a very short period of time would suggest that Not only will we avoid recession, but we could be talking about Re-acceleration and overheating by the middle of this year Which unfortunately would say maybe six percent mortgage rates are too low and the Fed would need to somehow engineer them higher To prevent the kind of inflation that people are worried about right now All right so this is really where I wanted to get to because and I want to try to Set this up in a way that doesn't utterly confuse listeners, but the Federal Reserve is walking on a wire and On the one hand Obviously it doesn't want to raise rates so quickly and so dramatically that it plunges the US economy into an unwarranted recession but that's not Happening right now unemployment is at the lowest rate that it's been I think since 1969 the labor market is pretty hot and if housing comes back the combination of a relatively tight labor market and a growing housing sector Could mean that even as the Federal Reserve is trying to bring inflation down from seven to six to five to four to in the threes or twos it might sort of hit a Floor around say four percent Which I think most people the Federal Reserve are going to consider too high to not continue to raise rates So let me put the question to you this way Do you think there's a possibility that? That the housing market bounces back so convincingly that by the second half of this year Like even some people that consider themselves somewhat dovish will be saying I think the Federal Reserve needs to keep raising rates by point two five or even point five percent That that is my concern and as much as we're talking about a rebound in the housing market right now Since the jobs report that was so strong about a week and a half ago Mortgage rates have shot up quickly and it could reverse we'll see what happens with the data this week

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

But they've shot up from six to six and a half percent
So we can already be seeing the market start to respond to this and saying
Well, the housing market is responding this well to six percent mortgage rates
This thing needs to cool off more to accomplish the Fed's inflation goal
And we could be saying maybe seven percent mortgage rates are what we need to prevent
This sort of economic overheating which is really tough for people like you and me where we want to see our friends be able to buy homes and
Nobody wants to see a housing market like last year
But it's this weird situation where maybe to fix the inflation goal in the short term
We have to just keep crushing the housing market. What do we even call this or what would how do we situate this?
Outcome in terms of the vocabulary that people use about hard landings versus soft landings
So to refresh people who who aren't familiar with this this
Arcane economic glossary
Hard landing is the idea that the Federal Reserve in trying to land the inflation rate from seven percent to two percent
Crash lands the economy because we get a recession on our way down to two and as a result
It's hard on the American people on the other hand people have talked about hoping for a soft landing
That is we glide the plane down from seven six five four
We glide it down to say two point five or three percent and everyone basically says alright Jerome Powell has done his job
What would it mean for the Federal Reserve to essentially bring inflation down to like let's say four percent
We're talking about like let's say it's core inflation down to like four or that were high three percent
But the housing market takes off and as result pushes up residential prices enough that inflation starts to creep up again
The Federal Reserve has to keep raising rates. I mean what kind of what would we refer to this outcome as?
So I've heard people talk refer to it as a no landing scenario
And that's sort of probably a temporary state of affairs because to the extent the Fed believes that that's where we are
they are going to respond more forcefully I believe anyway and
You know, we'll have to shift maybe sort of repeat a more mild version of what we saw last year where we have this overheating economy
And they realize maybe five percent interest rates wasn't high enough
And they're sort of now trying to calibrate things a little bit higher
Not the sort of massive rate hike cycle we saw last year
but it turns out that maybe six or six and a half percent rates gets them to where they want to be and
We're just going through, you know, the next level of this yo-yo economy as we figure out
What actually gets us to the kind of balance that the Fed is looking for right? It's almost like, you know

[Transcript] Plain English with Derek Thompson / Why Everybody Is Wrong About a Recession and Housing's Great Comeback

In in flipping it from hard landing versus soft landing, you know speaking about housing
It's like we want to avoid a hard takeoff, right? We want a soft takeoff
We want housing to try to find some way to
Stabilize at a slightly higher equilibrium, right? Maybe NIH be around like, you know, 48 to 52
Maybe we have, you know an increase in new home prices, but things don't go berserk
But we want this kind of soft takeoff in housing that will allow that housing component of inflation to stay low
Even as all these other elements of inflation whether it's, you know services or durable goods also stay low so we can be brought down into the threes, right?
Yeah, the way I'm thinking about is I think stable growth is okay to the Fed because you could say as supply chains and things work out
Things will just sort of work themselves out declining growth is certainly good from an inflation standpoint
Accelerating growth is probably the thing that can't tolerate if we really do have the unemployment at its lowest level since the 60s
And then growth is surging higher. It's hard to see how we're gonna have 2% inflation in that world
So we really just need to get from you know, maybe it's just that the housing market was ice cold
Now we're warming up and then we'll stabilize at some point this spring and we can all relieve a sigh of relief
But right now the acceleration that I think we've been getting this year is probably not the kind of thing that we can sustain or that the Fed would tolerate
It really is the weirdest economy
I mean every number that goes up goes down six months later every number that goes down goes up six months later
So I guess what we should probably do is just
Wait to see the direction of housing for the next six months
Then bring you on sometime in the fall to follow up on your predictions kind of send from Bloomberg. Thank you very very much
Thank you for listening Plain English is produced by Devon Manzi if you like the show
Please go to Apple podcast or Spotify give us a five-star rating leave a review and don't forget to check out our tiktok
Et Plain English underscore that's Et Plain English underscore on tiktok
You