

## MEICAP Results Pertaining to Housing Prices

House prices are affected by a number of factors including interest rates, inflation, repayment options (like interest only) and mortgage qualification guidelines. The largest influence comes from interest rates as that determines the monthly payment for any given mortgage size. Thankfully, the MEICAP model is best able to predict interest rate activity as detailed on the Interest Rate tab and we have made every effort to incorporate the other factors to arrive at meaningful projections for housing prices.

The graph presented at the right displays the model's ability to mirror actual price fluctuations over the past 40 years and it has done an admirable job although actual results preempted model results by about 5 years between 1975 and 1987. This was due primarily to the fact that interest rates remained lower than the model expected during the late 70s, inflating house prices.

The lower than expected interest rates were driven by a lagging unease about the stock market following an extended period of stagnant earnings growth. The stock market performed poorly during the late 60s and early 70s and it took a while for investors to regain confidence in the rising earnings taking place in the late 70s.

Depleted investment capital from years of Baby Boomer negative savings met increasing consumption in the early 80s and interest rates spiked and severely dampened the economy, resulting in the recession of 1981 and 1982. Baby Boomer housing demand continued to climb, keeping financial markets strained but early Baby Boomer savings began filling the shortfall and rates started retreating in the mid 80s.

Interest rates have continued to retreat as the pool of investment capital grew, here and around the world. Wealth has been generated faster during the past 25 years than any other time in history and that growing pool of investment capital lowers borrowing costs for everybody. The trend reached its zenith in 2003 when rates hit record-breaking 46-year lows.

The housing market received another big boost in the early 2000s since the stock market crash and dot.com meltdown scared investors away from the stock market and the surge in bond market funds accelerated interest rate declines as a result. Other investors put their savings into their homes and the increased demand fueled an aggressive appreciation in values between 2002 and 2005.

Unfortunately, with Baby Boomers starting to retire and the echo Baby Boomers clearly in their negative savings period, the pool of investment capital is starting to shrink and interest rates are rising as a result. House values have gone up so far that affordability issues limit new demand and rising interest rates threaten existing owners. These trends are not strong enough to cause a "crash" but softness in the housing sector is expected for the coming 15 years.