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Home Price Appreciation Will Slow in 2005

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Over the last few years home prices have appreciated strongly in the nation, in Florida, and here in central Florida. For example, the average price for a new home sold in Orange County was \$246,000 in November, which was 7 percent more than last year. The average price paid for an existing home was \$219,000 for a gain of 15.6 percent over last year. Each of the other counties in the Orlando MSA enjoyed similar appreciation. For instance, existing home prices jumped a whopping 28 percent in Osceola County and 19 percent in Lake.

When home prices increase, owners are wealthier. Since the biggest asset most families have is their home, these increases in values and in wealth are very important economically. When people are wealthier they tend to be more optimistic and they tend to spend more. The economic growth we have enjoyed recently is due in part to this wealth effect translating into increases in consumption and in investment by households.

In large part the boom in housing markets was the result of very low mortgage interest rates. Low mortgage rates stimulated people to buy houses; renters converted to owners; owners traded up to bigger homes. Demand rose and so did prices. This period of rapid price appreciation is now ending. The main reason is that interest rates are no longer falling. If rates simply remain the same, housing markets will cool. The incremental demand triggered by falling rates dissipates when rates stabilize. That is the point in the cycle we are in now.

Across the state and here in central Florida the volume of new home sales and resales actually peaked in May and has not regained its prior peak. Since rates have stabilized, the demand for homes is no longer expanding – it's strong, but there is no further upward momentum. This will soon translate into a slowing of price appreciation. Furthermore, the federal reserve has begun increasing interest rates and has announced that it will continue to do so until the federal funds rate is between 4 and 5 percent. Thus, short-term rates will increase at

least 2 full percentage points this year. This will translate into higher mortgage rates as well.

This translation is not 1-for-1. Instead, mortgage rates will rise more slowly, say by about 1 percent. But rise they will, and this will further slow the appreciation of housing prices. Nevertheless, for most folks their home is their largest and most important asset. And I believe that homes will hold their values. However, the strong gains in pricing are over for the balance of this business cycle.

This is Hank Fishkind for 90.7 FM, WMFE News.

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