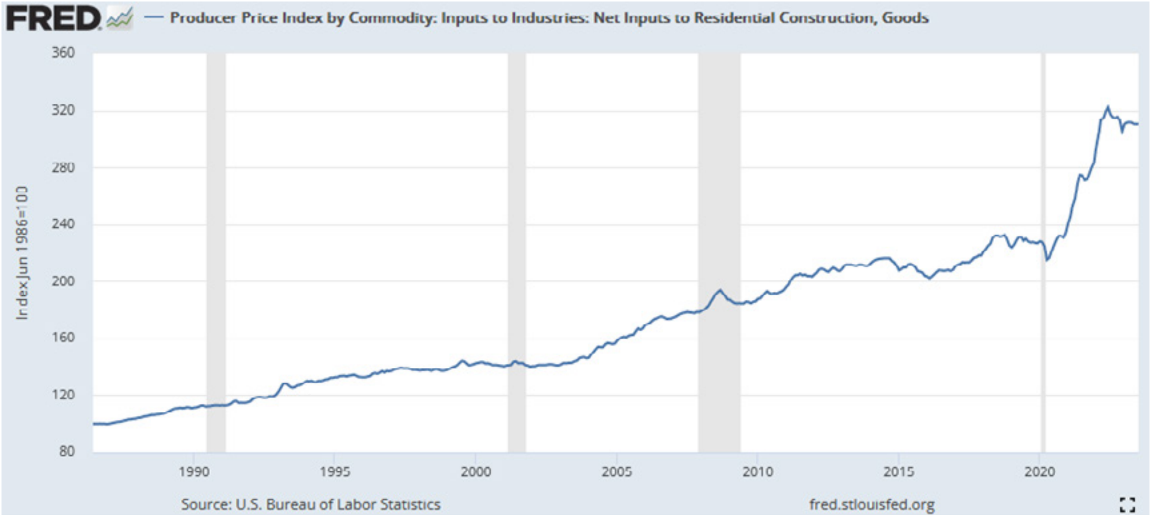
August 23, 2023

Building Costs

Here's an interesting chart that reveals something about both inflation and housing. The line is the Producer Price Index category covering goods used in home construction. It was rising gradually for decades, then turned sharply higher in 2021.



Source: [David Sommers]

These costs rose about 50% from 2020 through the June 2022 peak and are holding on to most of that increase.

This helps explain why home prices went crazy, and also illustrates why inflation is so terrible. Even if prices stabilize, the fact that they're now flat *at a much higher level* means inflation is continuing to make things (home construction material, in this case) more expensive.

Prices could fall again, of course. The index would have to decline about 30% to get back to that inflection point. Not impossible, but hard to imagine without a broader deflationary trend. Unless that happens, home construction will remain costly.

Affordable Housing

This table is an interesting comparison of housing affordability in some major developed countries. The left section shows the percentage of average disposable income needed to make payments on an average-priced home at current mortgage rates. In the US this is presently 23%. It averaged around 14% in the 10 years before COVID and was as high as 26% before the 2008 crisis. The other countries are mostly higher, meaning homes are/were less affordable there.

	Housing affordability index (% disposable income)			Adjustment required to return to pre-Covid average affordability		
	Latest	Pre-Covid 10Y Average	Pre-GFC peak	House prices (%)	Income (%)	Mortgage rates (ppts)
U.S.	23	14	26	-41	69	-4.3
Germany	34	21	30	-36	60	-3.4
NZ	56	35	56	-35	59	-4.2
Canada	38	25	29	-33	55	-3.5
U.K.	31	21	35	-33	50	-3.5
Australia	45	32	44	-25	41	-2.8
Japan	32	25	25	-23	26	-1.7
Sweden	27	20	29	-19	25	-1.7
Korea	39	35	--	-11	22	-1.0

Source: Bloomberg, Haver, Corelogic, MLS, Morgan Stanley Research

Source: Lance Lambert

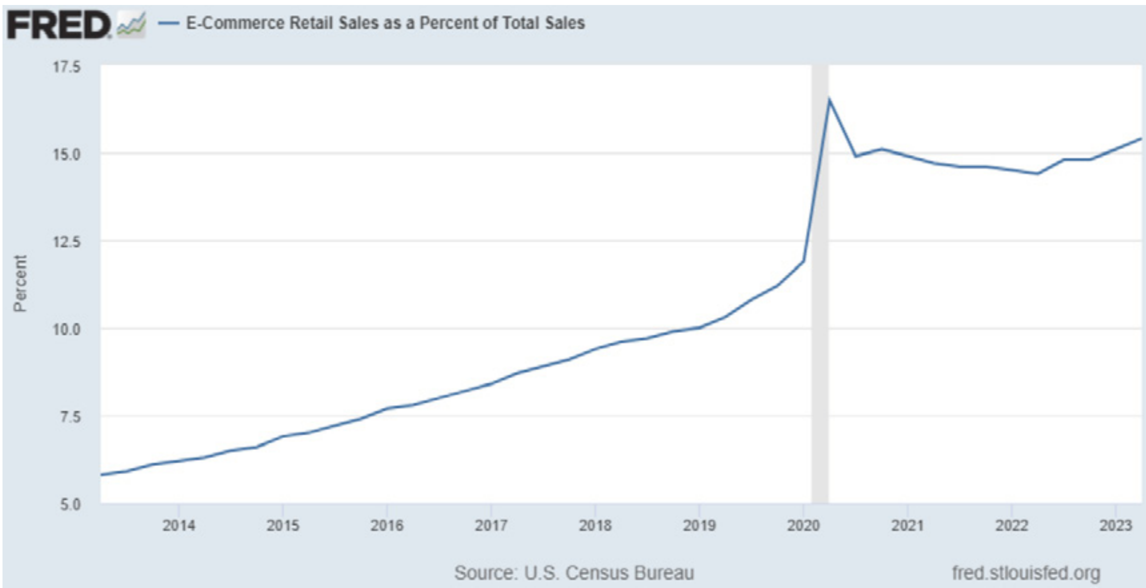
The right section is enlightening, too. It shows the change needed to make homes as affordable as they were in the pre-COVID period. In the US, this would require home prices to drop 41% or incomes to rise 69% or mortgage rates to fall 4.3 percentage points. A combination of smaller changes might work, too, but a scenario in which home prices fall while incomes go up is hard to imagine.

The conclusion seems to be that the 2010s were a uniquely golden opportunity to buy a home, and even more so for those who refinanced to lower fixed rates in 2020-2021.

Small (but Permanent) Change

We knew back in 2020 the pandemic was going to change the economy in important and likely permanent ways. Here's a good example.

The line shows e-commerce sales as a percentage of total retail sales. You can see it shot higher as COVID discouraged consumers from visiting physical stores. More important, e-commerce sales are holding on to most of that increased market share.



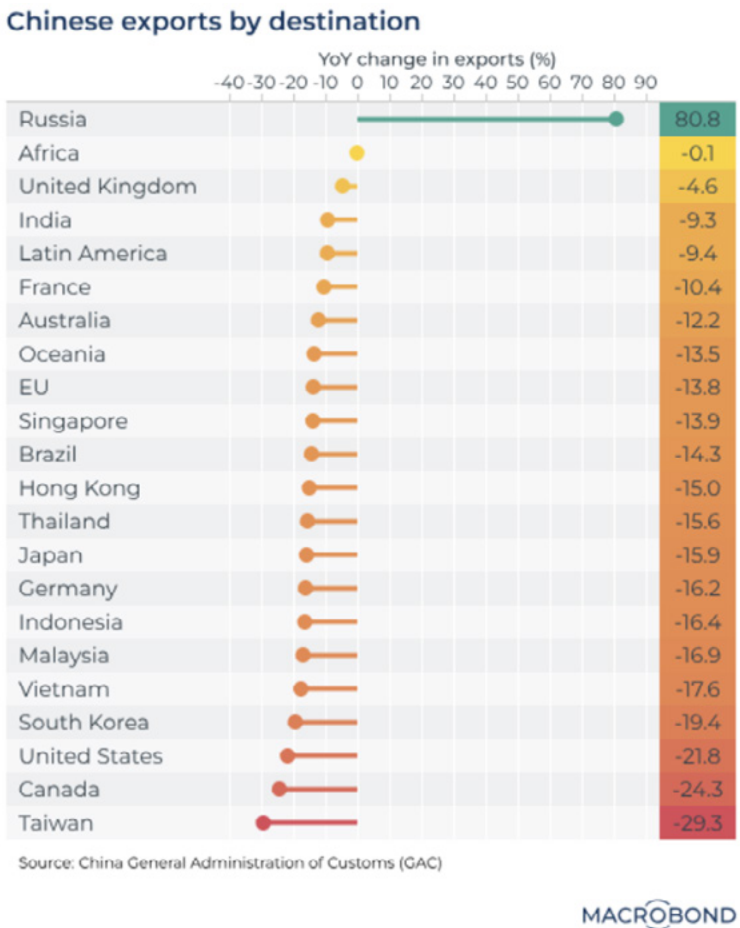
Source: St. Louis Fed

So it looks like COVID-related changes worked to the benefit of e-commerce companies and encouraged other retailers to expand their online businesses. That's an important change but look also at the vertical axis. The e-commerce share went from around 12% to 15%. Or, looking from the other side, bricks-and-mortar retail sales dropped from 88% to 85%.

These are significant changes—enough to make a big difference for some retailers—but the vast majority of retail sales happened in stores before COVID and still happen in stores now. Sometimes the surprise is how *little* changed.

Chinese Exports

Last week we shared a chart highlighting China's declining share of US imports. A related question is where are China's still-substantial exports going? And more important, what are its growth markets? This chart shows the year-over-year percentage change in Chinese exports to various countries and regions.



Source: [*Markets & Mayhem*]

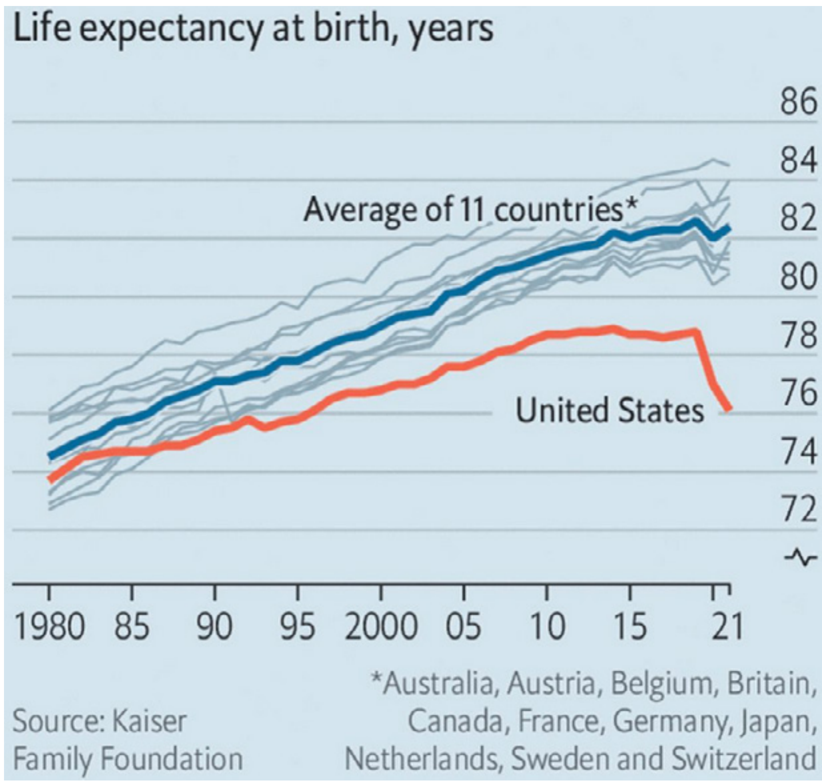
If the last year is any indication, China's only positively-trending trade relationship is with Russia, to which exports surged almost 81%. Everywhere else on the list declined.

Some of this relates to the Ukraine situation and global inflation. But it does appear many countries are finding other sources for the goods they once bought from China. That's probably not a good trend for Beijing.

American Exceptionalism

The latest life expectancy data shows the average American can expect to die six years sooner than the average resident of Australia, Canada, Japan, and eight top European countries. That figure worsened due to COVID, but the US was in last place even before the pandemic.

What does this mean economically? That's a harder question. Older people boost consumption but in large numbers can consume more than the younger labor force can produce, causing inflation and debt. This may be a bigger problem in those longer-lived countries.



Source: Science Is Strategic

Thanks for reading *CLIPS THAT MATTER*. We hope you enjoyed it. We welcome feedback and suggestions at oms@mauldineconomics.com.

Best regards,

John & Patrick

Use of this content, the Mauldin Economics website, and related sites and applications is provided under the Mauldin Economics Terms & Conditions of Use.

Unauthorized Disclosure Prohibited

The information provided in this publication is private, privileged, and confidential information, licensed for your sole individual use as a subscriber. Mauldin Economics reserves all rights to the content of this publication and related materials. Forwarding, copying, disseminating, or distributing this report in whole or in part, including substantial quotation of any portion the publication or any release of specific investment recommendations, is strictly prohibited.

Participation in such activity is grounds for immediate termination of all subscriptions of registered subscribers deemed to be involved at Mauldin Economics' sole discretion, may violate the copyright laws of the United States, and may subject the violator to legal prosecution. Mauldin Economics reserves the right to monitor the use of this publication without disclosure by any electronic means it deems necessary and may change those means without notice at any time. If you have received this publication and are not the intended subscriber, please contact service@MauldinEconomics.com.

Disclaimers

The Mauldin Economics website, *Yield Shark, Thoughts from the Frontline, Outside the Box, Over My Shoulder, Transformational Technology Alert*, *Biotech Millionaire, Rational Bear, The 10th Man, The Weekly Profit, Connecting The Dots, Stray Reflections*, *Street Freak*, *ETF 20/20*, *Macro Growth & Income Alert, In the Money,* and *Mauldin Economics VIP* are published by Mauldin Economics, LLC. Information contained in such publications is obtained from sources believed to be reliable, but its accuracy cannot be guaranteed. The information contained in such publications is not intended to constitute individual investment advice and is not designed to meet your personal financial situation. The opinions expressed in such publications are those of the publisher and are subject to change without notice. The information in such publications may become outdated and there is no obligation to update any such information. You are advised to discuss with your financial advisers your investment options and whether any investment is suitable for your specific needs prior to making any investments.

John Mauldin, Mauldin Economics, LLC and other entities in which he has an interest, employees, officers, family, and associates may from time to time have positions in the securities or commodities covered in these publications or web site. Corporate policies are in effect that attempt to avoid potential conflicts of interest and resolve conflicts of interest that do arise in a timely fashion.

Mauldin Economics, LLC reserves the right to cancel any subscription at any time, and if it does so it will promptly refund to the subscriber the amount of the subscription payment previously received relating to the remaining subscription period. Cancellation of a subscription may result from any unauthorized use or reproduction or rebroadcast of any Mauldin Economics publication or website, any infringement or misappropriation of Mauldin Economics, LLC's proprietary rights, or any other reason determined in the sole discretion of Mauldin Economics, LLC.

Affiliate Notice

Mauldin Economics has affiliate agreements in place that may include fee sharing. If you have a website or newsletter and would like to be considered for inclusion in the Mauldin Economics affiliate program, please email affiliates@mauldineconomics.com Likewise, from time to time Mauldin Economics may engage in affiliate programs offered by other companies, though corporate policy firmly dictates that such agreements will have no influence on any product or service recommendations, nor alter the pricing that would otherwise be available in absence of such an agreement. As always, it is important that you do your own due diligence before transacting any business with any firm, for any product or service.