

Project: Union Leader Submission / Impact of Inflation on Housing Market
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Higher inflation ahead? Not all bad for homeowners.

Like any economic prediction, forecasting the course of inflation is a dicey proposition. Even so, many economists agree we may be entering a period of rising inflation that could dampen the sputtering recovery.

Consider: According to the U.S. Bureau of Labor Statistics, since it began tracking inflation in 1913, the annual rate has averaged about 3.4 percent. At that pace, consumer prices double every 20 years.

Over the past decade, though—from 2001 to 2010—inflation averaged just 2.4 percent. So far this year, the annual inflation rate has climbed steadily every month, from 1.6 percent in January to 3.6 percent in July.

Though runaway inflation seems unlikely, it may be prudent to anticipate that a continuation of the current trend could take us to 4 percent or beyond. What would higher inflation mean for the residential real estate market? The outlook is mixed:

Mortgage rates rise. When inflation takes off, it can translate into higher mortgage rates quickly. That hasn't happened yet—rates remain exceptionally reasonable.

But with inflation ramping up, historically low mortgage rates may not be around much longer. First-time homebuyers or homeowners looking to refinance should pull the trigger now—or risk regretting their inaction later.

Home prices trend higher. For homeowners who bought when the market was healthier, rising inflation and home prices will help to restore their equity. For first-time buyers, however, a high-inflation environment can price them out of the market and chip away at the value of the money they've saved for a down payment—all the more reason to move quickly.

Fixed-rate mortgages look better than variable-rate loans. Fixed-rate mortgage holders benefit from higher inflation because they pay their loans back with devalued dollars. As inflation rises, their monthly payment stays the same, but the value of those dollars decreases. Homeowners with variable-rate mortgages, however, will see their interest rate increase with inflation, leading to larger payments.

The rent vs. buy decision becomes easier. Inflation increases housing costs for renters because landlords keep raising the rent to keep up with changing market conditions. Homeowners who choose a fixed-rate mortgage, however, can freeze the bulk of their monthly payment. Property taxes and insurance will still rise with inflation, but principal and interest won't.

Fixed-rate payments become more affordable. Wages generally increase with inflation, so a fixed-rate mortgage should consume a smaller percentage of take-home pay over the years and become progressively more affordable.

Paying points becomes a more attractive option. Homebuyers often look no further than the monthly payment to evaluate affordability. If inflation sends mortgage rates higher, many prospective buyers might decide that a larger payment no longer fits into their budget. In this case, it might be wise to buy the rate back down by paying points at closing.

Is higher inflation on the way? Probably. Is that awful news for homeowners and those who hope to join their ranks? Not necessarily. A mortgage professional can evaluate your situation and recommend a sensible strategy for managing inflation risk.

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