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The economic shock hitting the housing market continues to grow—but where it'll take us remains uncertain

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The inflationary period that took off during the '70s was eventually quelled by the Federal Reserve. But it wasn't painless—just ask homebuyers of the '80s. To tackle inflation, the central bank went through a multiyear phase of jacking up interest rates. The Fed did rein in inflation, but only after high interest rates sent the economy into recession twice in the early '80s and pushed mortgage rates over 18% in 1981.

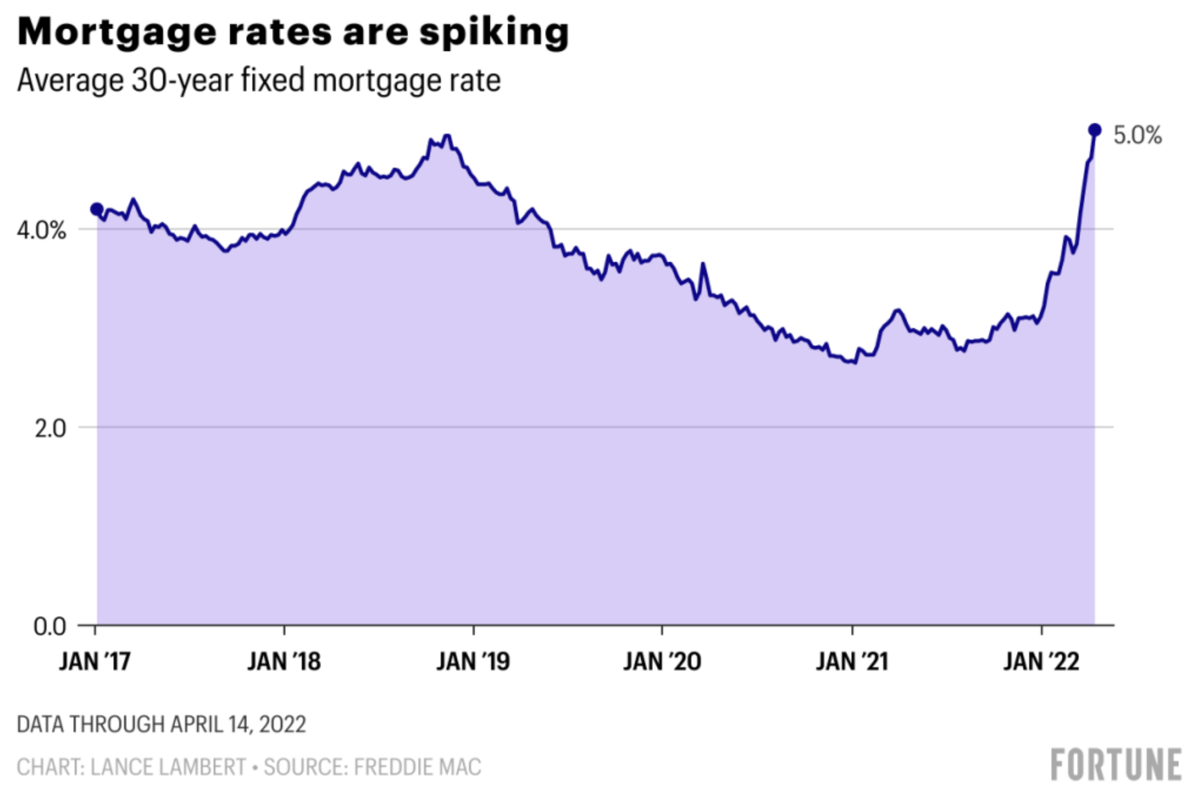
Fast-forward to today, when the Federal Reserve is once again pressuring interest rates higher as it works to tackle our ongoing inflation problem. It's hitting home shoppers particularly hard: Over the past four months, the average 30-year fixed mortgage rate has shot up from 3.11% in December to 5% as of last week. If a borrower took out a $400,000 mortgage at a 3.11% rate, they would owe $1,710 per month. At a 5% rate, that payment shoots up to $2,147 per month.

That swift move up in mortgage rates amounts to an economic shock hitting the housing market. The question now is what will it do to red-hot home prices?

"When mortgage rates are where they are today, homeownership becomes unattainable for certain households. Some people just won't be able to qualify for the home they want to purchase," Devyn Bachman, vice president of research at John Burns Real Estate Consulting, tells *Fortune*. Indeed, as mortgage rates rise, not only does it price out some homebuyers, but it also causes others to lose their mortgage eligibility (which requires meeting lenders' strict debt-to-income ratios).

So far, spiking mortgage rates—which are expected to post another uptick this week—haven't done much to rein in the housing market. Sure, there are signs the housing market is softening. However, it's only by a tad: We're still amid a historically tight—and competitive—housing market in which the lack of inventory leaves buyers with little choice but to bid up home prices.

"I would say for sure we have seen softness in the data, but nothing too dramatic yet," Logan Mohtashami, lead analyst at HousingWire, tells *Fortune*. Now that mortgage rates are over 5%, he says, additional softening is likely on the way.



When will softening come? Bachman thinks it might come this summer. Historically, the housing market chills out a bit as buyers and sellers alike go on summer vacations. There's another reason why real softening might not come until summer: There are so many buyers trying to get into the market that even if some back off, others will be ready to take their place, Bachman says. That "logjam" could delay any mortgage rate–spurred cooling.

"We know the system is logjammed, but we don't know how far back the logjam goes," Bachman says. "In my opinion, it will take a couple months for all this to shake out."

HousingWire's Mohtashami thinks it would be good for the broader economy if spiking mortgage rates cause the housing market to cool down a bit. Over the past year, U.S. home prices have soared 19.2%. That's simply unsustainable. In fact, Black Knight, a mortgage technology and data provider, finds the typical U.S. household would now have to spend 31% of its income to make a mortgage payment on the average-price home. That's the highest level since 2007.

"It's too many people chasing too few homes. We desperately need a breather," Mohtashami tells *Fortune*.

If soaring mortgage rates do rein in the rate of home price appreciation, it would likely be welcomed by the Federal Reserve. After all, the unprecedented run on home prices during the pandemic remains a major driver of inflation.

But keep in mind cooling or deceleration in the housing market doesn't mean home prices will fall. In fact, every major real estate firm with a publicly available outlook, including the Mortgage Bankers Association and CoreLogic, still forecast home prices to rise over the coming 12 months.

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