

ECONOMIC UPDATE



REGIONS

March 23, 2017

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February New Home Sales: Solid Headline Masks Flattening Trend

- > New home sales rose to an annual rate of 592,000 units in February from January's revised sales rate of 558,000 units.
- > Months supply of inventory stands at 5.4 months; the median new home sale price fell by 4.9 percent on a year-over-year basis.

New home sales rose to an annualized sales rate of 592,000 units in February, easily topping the consensus forecast of 564,000 units and our forecast of 554,000 units. New home sales have thus far withstood higher mortgage interest rates but low inventories remain a drag on sales. February saw a shift in the mix of sales across price ranges, though given the volatile nature of the new home sales data it is far too soon to know if this marks a lasting reversal of the trend towards higher priced homes. February's shift is reflected in the decline in the median sales price that leaves it down 4.9 percent year-on-year.

The raw data show not seasonally adjusted sales of 49,000 units in February, ahead of our forecast of 45,000 units. Our miss is entirely due to our having underestimated sales in the West region – we had thought sales would be held down by the heavy rains that plagued part of the region for considerable portions of January and February, but this was not the case with new home sales as it has been with housing starts. The 49,000 sales in February reflects a 19.5 percent increase from January, which is a bit stronger than normal – over the 1990-2016 period the average increase in unadjusted sales between January and February was 14.8 percent. This leaves the 12-month moving sum of not seasonally adjusted sales, our preferred gauge of the underlying trend rate, at 566,000 units, the highest since July 2008. Still, as can be seen in the red line in our top chart, that trend rate of sales has flattened out over recent months and, as is apparent in our middle chart, that flattening trend sales rate has been seen across each of the four broad Census regions.

The number of "physical" homes for sale, i.e., sales of units either under construction or already completed, has also been stuck over the past five months, at 213,000 units. While well off the cyclical low, this is nonetheless far below the historical average and we do not anticipate much of an increase over coming months, meaning limited inventories will continue to weigh on new home sales. As we have noted in our write-ups of the data, lean inventories are also acting as a material drag on sales of existing homes, but one key difference is that new homes can be sold prior to construction having been started. Sales of such units accounted for 30 percent of all February new home sales, still a bit elevated but down from shares seen earlier in this cycle. At the same time, sales of units already under construction have accounted for a higher share of new home sales over recent months, indicating builders are confident enough to do at least a bit more spec building.

One trend we've been highlighting for more than two years now is that new home sales have been atypically skewed towards the higher end of the price scale, which has simply reflected how builders constrained by shortages of labor and buildable lots were responding to underlying demand and credit conditions. It also reflects what in many markets have been steep increases in entitlement costs, which tend to be passed along to buyers in the form of higher sale prices. In February, however, units priced at or above \$300,000 accounted for 49 percent of all new home sales, still higher than normal but the first time this share has fallen below 50 percent since last May.

Again, it is too soon to know if this marks the start of a lasting turn in the trend towards builders concentrating on the higher end of the price scale and, as seen in our bottom chart, the new home "premium," i.e., the differential between the median sales prices of new and existing homes, remains significantly above longer-term norms. In the earlier phases of this cycle, the wider differential was driven more by weakness in existing home prices but over the past few years it has been driven more by builders having targeted the higher price ranges. That the gap has narrowed a bit over the past several months is mainly a reflection of what has been a faster pace of price appreciation for existing homes.

We have for some time been constructive on the demand side of the housing market. Higher mortgage interest rates leave us a bit less so, but our main concerns remain on the supply side of the market. As such, at this point our best bet remains a slow but steady increase in new home sales in 2017.

