ECONOMIC UPDATE

REGIONS

November 26, 2019

October New Home Sales: Strong, Just Not Quite That Strong . . .

› New home sales <u>fell</u> to an annual rate of 733,000 units in October from September's (revised) sales rate of 738,000 units

› Months supply of inventory stands at 5.3 months; the median new home sale price was <u>down</u> by 3.5 percent year-on-year

New home sales fell to an annualized rate of 733,000 units in October, better than our above-consensus forecast of 718,000 units. The slight decline in the sales rate in October, however, follows a sizable upward revision to the September sales rate, now reported to be 738,000 units rather than the 707,000-unit sales rate initially reported. While new home sales were strong in October, they weren't quite as strong as the headline, i.e., seasonally adjusted and annualized, sales number implies. On a not seasonally adjusted basis, there were 57,000 new home sales in October, matching our forecast. That our forecast of unadjusted sales was exactly on the mark but our forecast of the "headline" sales number fell short of the mark reflects the Census Bureau using a larger seasonal adjustment factor than our forecast anticipated. All of which is simply yet another illustration of a point we routinely make, which is that when it comes to the data on new residential construction and sales in any given month, the trends in the raw data are much more than the headline number.

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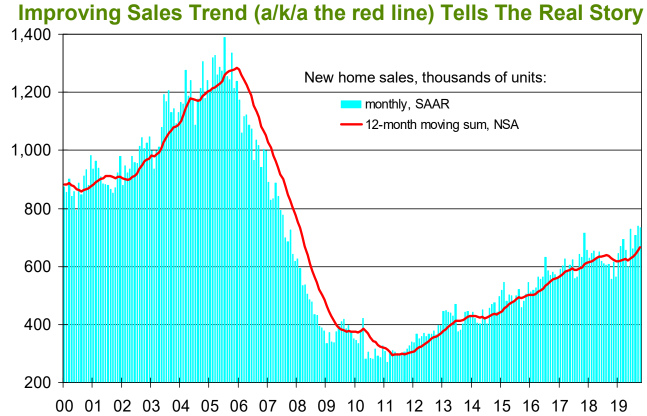
Improving Sales Trend (a/k/a the red line) Tells The Real Story



We think the running 12-month total of not seasonally adjusted sales is the best gauge of the trend rate of new home sales and, as can clearly be seen in our top chart, the trend sales rate has rebounded smartly from the affordability shock of late-2018 that carried into early 2019. As of October, the not seasonally adjusted data show 667,000 new home sales over the past 12 months. Not only is the running 12-month total comfortably above where it was prior to the affordability shock, but it now stands at its highest point since April 2008, when it was beating a hasty retreat from the unsustainable highs set prior to the 2007-09 recession. We have argued that the trend sales rate would be rising at a faster pace were it not for supply side constraints – labor shortages, shortages of buildable lots, and regulatory impediments, to name a few – that are acting as a drag on the pace of construction of new single family homes. As we noted in our weekly *Economic Preview*, applications for purchase mortgage loans have been notably strong over recent months, reflecting buyers attempting to jump on low mortgage interest rates, while builder confidence remains elevated, which we think helps support our contention that sales could be rising faster than they are. Either way, builders are sitting on backlogs of unfilled orders, as indicated by the elevated share of sales accounted for by units on which construction has not yet started. At the same time, what we refer to as "physical inventories" of new homes for sale, i.e., units either completed or in some stage of construction, fell sequentially in October and are down on an over-the-year basis (note – some refer to this measure as "spec" inventories, as the units are being built before they are sold). As we look at the inventory picture as a whole, it supports our view that there is further upside room for single family housing starts over coming months, which makes us comfortable in our call that residential investment will be a steady, even if modest, support for top-line GDP growth over coming quarters.

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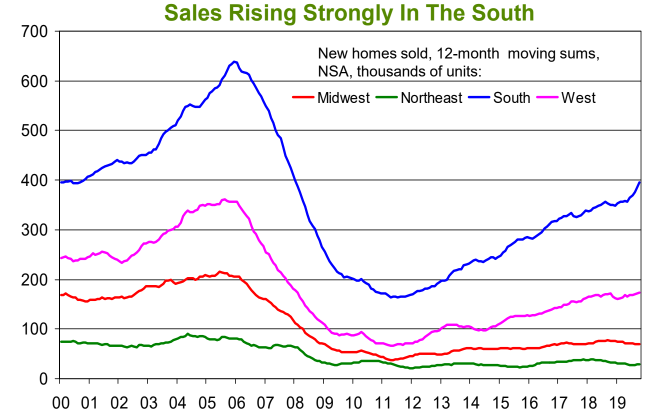
Sales Rising Strongly In The South



If there is one thing to quibble over in the new home sales data, it is that the strength in sales is concentrated in the South and, though to a lesser degree, West regions, while the Midwest and Northeast regions continue to lag. On a year-to-date basis, not seasonally adjusted sales are up 9.35 percent for the U.S. as a whole, with sales in the South region up 15.44 percent and sales in the West region up 8.39 percent. Conversely, year-to-date sales are down by 8.96 percent in the Midwest region and down by 10.71 percent in the Northeast region. Though historically the South and West regions have combined to account for the lion's share of new home sales, at 85.30 percent of year-to-date 2019 sales, the concentration in the South and West regions is more pronounced than is typical.

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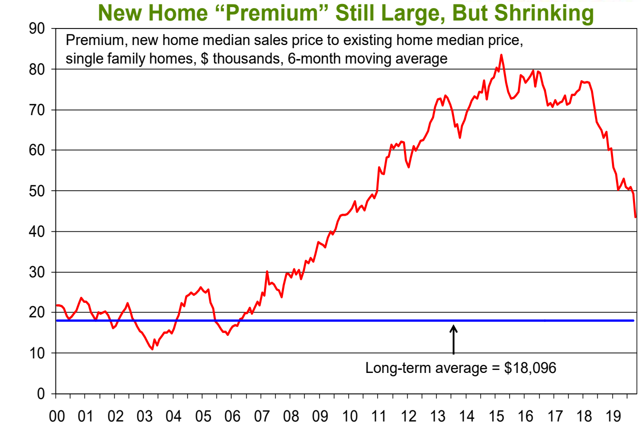
New Home "Premium" Still Large, But Shrinking



The median new home sales price has been drifting lower over the past several months, which is a reflection of the shifting mix of sales across price ranges. This has contributed to a narrowing of the new home premium. At the same time, however, supply constraints are supporting rapid growth in the median existing home sales price, which is clearly helping narrow the new home premium. To the extent builders focus on the lower price points, the new home premium will narrow further, but will likely remain above its long-term average. That said, builders can clearly profit by targeting those buyers who are being shut out of the existing homes market, which will be a support for new home sales in the months ahead.

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