ECONOMIC UPDATE

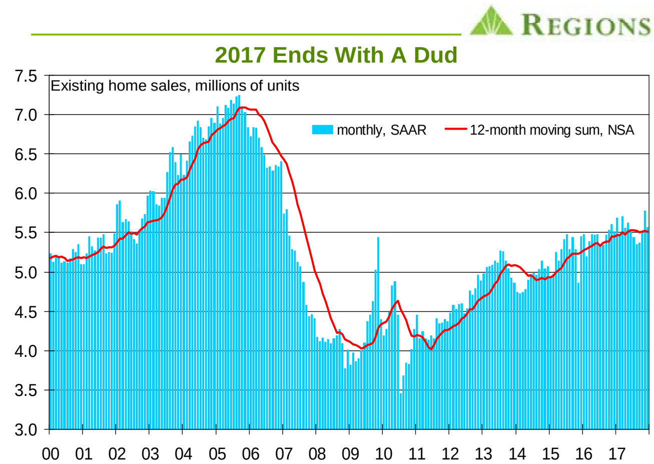
REGIONS

January 24, 2018

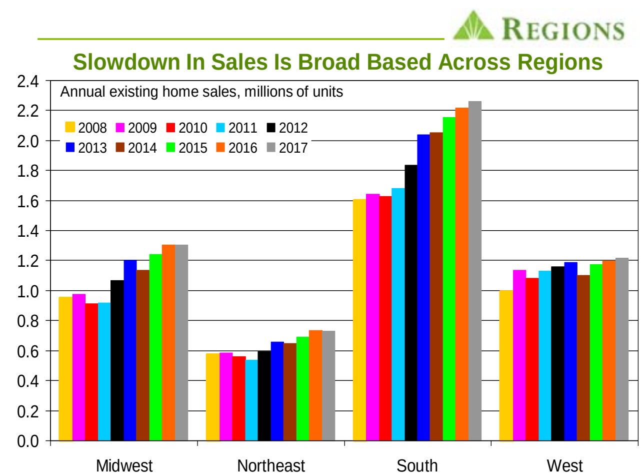
December Existing Home Sales: 2017 Ends With A Dud

- Existing home sales fell to an annualized rate of 5.570 million units in December from November's revised sales rate of 5.780 million units.
- Months supply of inventory stands at 3.2 months; the median existing home sale price rose by 5.8 percent on a year-over-year basis.

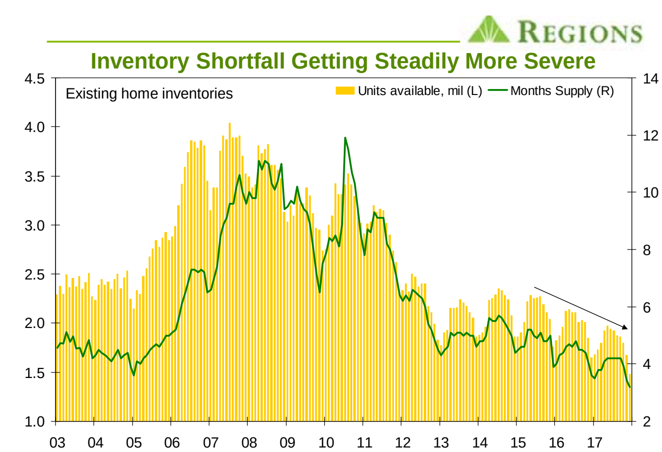
There are no villas for rent in Tuscany and there are no homes for sale in the U.S. Okay, maybe not, but it sure seems that way, at least the part about there being no homes for sale. Existing home sales slipped to an annualized rate of 5.570 million units in December, well below consensus and even further below our forecast of a sales rate of 5.790 million units. The headline sales number, however, doesn't even begin to do justice to how barren the existing homes market has become, as that headline sales number is largely thanks to a friendly seasonal adjustment factor that makes sales look better than is the case. To better appreciate market conditions, take a look at the not seasonally adjusted data, which show sales down year-on-year and the lowest level of existing homes for sale in the life of the data. At the same time, lean inventories continue to fuel robust house price appreciation which, along with what figure to be higher interest rates as 2018 wears on, threaten to erode affordability and thus put a crack in what up until now has remained solid demand.



Our forecast of not seasonally adjusted sales of 458,000 units proved far too ambitious. We adjusted our forecast up on the possibility that closings of higher priced homes, mainly in the Northeast and West regions, would be pulled into December to beat the less generous mortgage interest deduction beginning in 2018 resulting from the recently enacted tax bill. From what we can see in the data, the shares of sales in the higher price ranges didn't change much in December, so the upward adjustment to our forecast proved to be the wrong call. We were not, however, laboring under any such illusions when it came to the underlying supply dynamics. As we noted in our weekly *Economic Preview*, our forecast anticipated inventories would touch an all-time low in December, and while that proved to be the case even we didn't have listings falling as much as they did. The 1.480 million units is so far below the next-lowest level (1.650 million) that it hardly seems like we're talking about the same data series. This pushed the months supply metric down to 3.2 months, also the lowest on record. We've pointed to inventories, or the lack thereof, of both new and existing homes for sale as the main housing market story line to follow in 2018, and while inventories of existing homes will almost surely bounce from December's low, we don't expect any meaningful degree of relief on the supply side this year.



Not seasonally adjusted sales rose in the South region but fell in each of the other three broad regions in December. For 2017 as a whole, the not seasonally adjusted data show total sales of 5.511 million units which, while the best year for existing home sales since 2006, reflects only a 1.1 percent increase from 2016 sales. Sales fell in the Midwest and Northeast regions in 2017 while notching only modest gains in the South (up 1.9 percent) and West (up 1.8 percent) regions. The slowdown in sales has been broad based across all regions, which simply points to inventory constraints being similarly broad based.



As we've previously discussed, the rise of single family REITs in the wake of the housing market bust has been a significant, even if underappreciated, drag on existing home sales, as single family homes now account for a significantly greater share of the occupied rental housing stock than has been the case in the past. With rapid rent growth providing steady cash flows and robust price appreciation generating capital gains, these single family REITs are enjoying the best of both worlds and there is little reason to think they will begin to dispose of their stocks of single family homes any time soon. One concern we have in 2018 is that if mortgage rates do rise as we anticipate, an increasingly growing number of homeowners who have either originated or refinanced a mortgage at historically low mortgage interest rates will have increasingly less incentive to move, thus further restricting the number of homes traded. Prospective first-time buyers will be the group most adversely impacted by limited inventories and waning affordability.

Our concerns about the housing market have thus far been limited to the supply side of the market. That is beginning to change with both prices and mortgage interest rates threatening to erode affordability, thus acting as an additional drag on sales in 2018.

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