ECONOMIC UPDATE

REGIONS

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December Existing Home Sales: Limited Room To The Upside From Here

- Existing home sales fell to an annualized rate of 5.490 million units in December from November's (revised) sales rate of 5.650 million units.
- Months supply of inventory stands at 3.6 months; the median existing home sale price rose by 4.0 percent on a year-over-year basis.

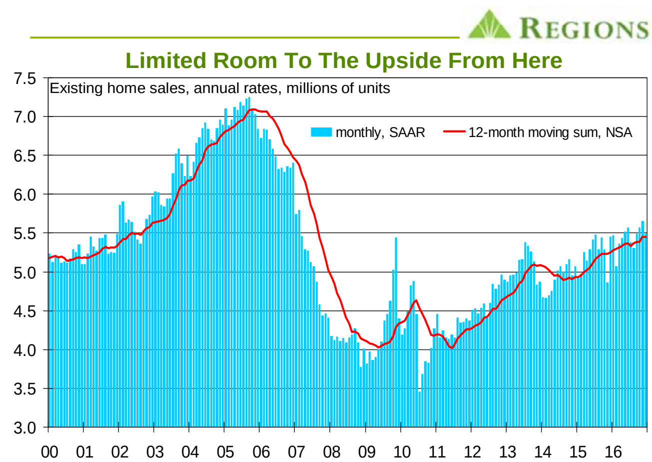
Existing home sales fell to an annual rate of 5.490 million units in December from an upwardly revised sales rate of 5.650 million units in November. December sales came in below the consensus forecast of 5.530 million units and our forecast of 5.580 million units. While it may seem tempting to pin December's decline in sales on the post-election jump in mortgage interest rates, that is not the main culprit. Keep in mind existing home sales are booked at closing, so December closings mostly reflect sales contracts signed prior to the bump in mortgage rates. Instead, lean inventories not only remain a drag on sales but over the past few months have become an even bigger drag. The combination of these lean inventories and higher mortgage interest rates (which will become more apparent in the data beginning with January) lead us to question how much upside there is for existing home sales in 2017.

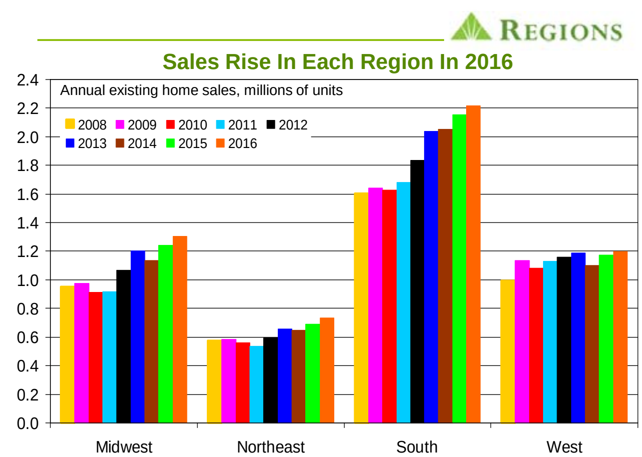
There were 437,000 existing homes sold in December on a not seasonally adjusted basis, a bit below our forecast of 446,000 sales. This left not seasonally adjusted sales just 0.2 percent higher on a year-over-year basis for the U.S. as a whole. For all of 2016, there were 5.452 million existing homes sold, up 3.8 percent from the 5.254 million sales in 2015. The Northeast posted a 6.1 percent increase in sales in 2016, with sales in the Midwest up 5.2 percent, sales in the South up 3.1 percent, and sales in the West up 2.1 percent.

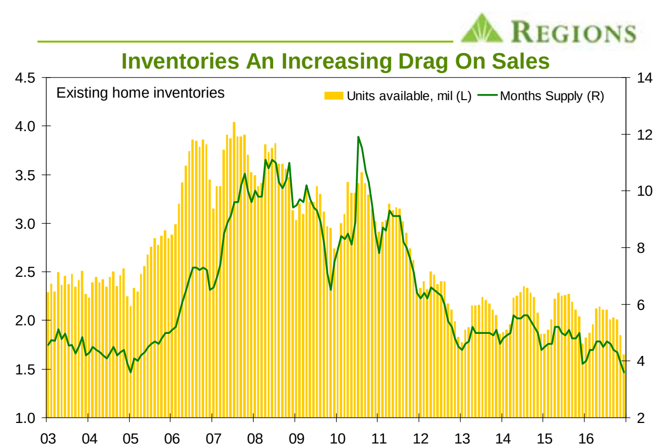
The flattening trend in sales, seen with the red line in the top chart, is largely a function of inventory constraints that have become more binding over the past several months. Listings fell 10.8 percent in December, which is in line with historical patterns for the month (the NAR's inventory data are not seasonally adjusted), but listings were down 6.3 percent year-on-year, the 19th consecutive month in which listings were down year-on-year. At 1.650 million units, the level of listings in December is the lowest in the life of the current data series, which dates back to 1999. The months supply metric slipped to 3.6 months in December, the lowest since January 2005, which was pretty much the height of the frenzied pre-recession "housing boom" but recall that at that time sales were running at over a 7-million unit annualized rate.

The inventory data illustrate a point we have been making for some time, i.e., that despite solid demand side fundamentals there was cause for concern on the supply side of the market. We have argued these concerns would only intensify, and the December data don't argue otherwise. Lean inventories have helped fuel robust house price appreciation, which is better seen in the various repeat-sales price indices than the more commonly cited median price metric, but notably low mortgage interest rates had acted as a buffer between higher prices and affordability. As mortgage rates push higher, that buffer will become thinner and thinner. The post-election bump in mortgage rates is not sufficient to freeze home sales, but it likely will become more pronounced in 2017. This will hit hard on the lower ends of the price scale, particularly for prospective first-time buyers. To be sure, continued job and income growth will help blunt the impact of higher mortgage rates, but only up to a point, particularly given how robust price appreciation has been. Moreover, we've argued that anyone who has purchased a home or refinanced a mortgage at a low rate could feel "locked in" by that mortgage rate and thus be unwilling to move if it means taking on a higher interest rate on a new mortgage loan, which would further limit for-sale inventories. We've also noted the rise of single family REITs over recent years helps account for an above-normal share of renter occupied single family housing units, thereby further limiting inventories of existing homes for sale, and this constraint won't lift soon.

We continue to believe demand remains healthy, but the impact of higher mortgage rates should not be discounted. As such, given ongoing supply constraints, it is reasonable to question how much upside there is for existing home sales in 2017.







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