ECONOMIC UPDATE

REGIONS

August 23, 2016

July New Home Sales: New Home Sales Smash Expectations

- New home sales <u>rose</u> to an annual rate of 654,000 units in July from June's revised sales rate of 582,000 units.
- Months supply of inventory stands at 4.3 months; the median new home sale price <u>fell</u> by 0.5 percent on a year-over-year basis.

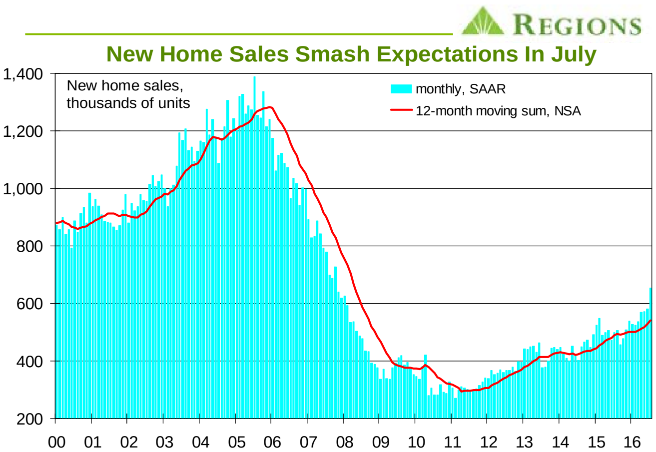
In what turned out to be the forecasting equivalent of Katie Ledecky against the field, new home sales smashed expectations in July. The annual sales rate rose to 654,000 units, easily ahead of the consensus estimate of 580,000 units and the fastest monthly sales rate since October 2007. This despite what remain lean inventories of new homes for sale, with the months supply metric slipping to 4.3 months. Not seasonally adjusted sales came in at 57,000 units, also the best since October 2007 and easily beating our forecast of 50,000 units. This leaves the running 12-month total of new home sales, which we view as the most reliable gauge of underlying trends, at 541,000 units, the highest such total since September 2008. Unlike Katie Ledecky, however, with whom what you saw was exactly what you got, the headline number on the July new home sales report overstates the degree of improvement in new home sales. That said, the underlying trend rate of sales has picked up over the past few months and it will be the supply side of the market, not the demand side, that governs the rate of improvement going forward.

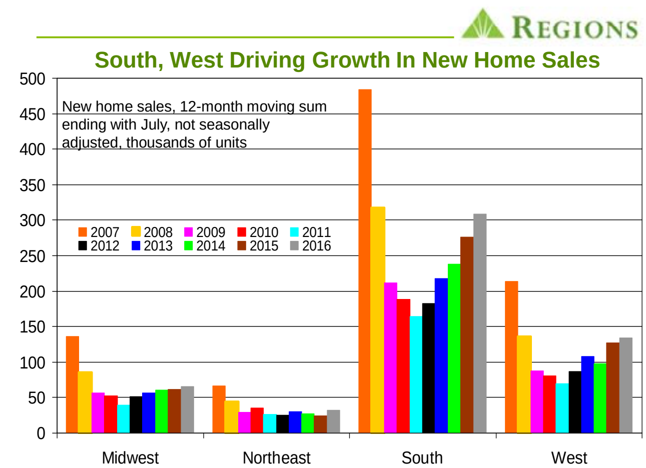
Whether you look at the seasonally adjusted annualized data or the raw data, the South region accounted for the entire increase in new home sales in July. On a not seasonally adjusted basis, total sales amongst the Midwest, Northeast, and West regions fell slightly in July, which is not atypical as unadjusted sales normally fall in the month of July, In the South region, however, unadjusted sales jumped to 35,000 units, the best single month since July 2007. This put the running 12-month total at 308,000 units for the South region, a level last seen in mid-2008. As seen in the middle chart, sales in the South and, to a lesser degree, West regions have been the primary drivers of the improvement in total new home sales, with little change in the Midwest and Northeast regions.

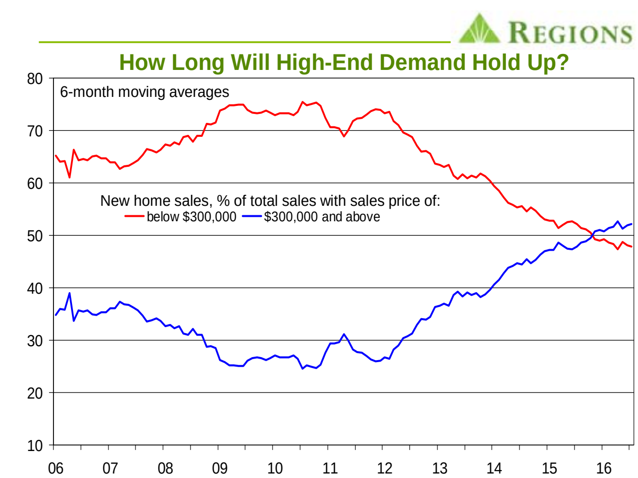
It may seem contradictory that despite the best single month for sales since October 2007 we continue to characterize inventories as lean but the months supply metric, at 4.3 months, tells us differently. Moreover, in July there were 194,000 "physical" new homes for sale, i.e., units either fully completed or under construction, a number that is not only far below the historical average but that has also fallen over recent months. Keep in mind that new home sales can be booked before construction on the unit has been started. We have regularly pointed out units on which construction has not yet started have for some time been accounting for an atypically high share of total new home sales. At better than 30 percent, this was again the case in July while, in contrast, completed units accounted for just 29.8 percent of all sales. This is a number that harkens back to the height of the market frenzy in late 2005/early 2006, when builders were selling them faster than they could build them. To some extent, that is the case today, though at a much, much lower sales rate. At present, builders are contending with shortages of lots and labor and a much lengthier and costly entitlement process. Our view has for some time been that these supply constraints have been the biggest impediment to a faster underlying rate of new home sales, and this will remain the case.

Another trend we've been highlighting is the share of new home sales accounted for by homes priced at or above $300,000. Our bottom chart shows the six-month moving average of this split (which we show to get around the volatility in the monthly data), and July marks the ninth consecutive month in which the six-month moving average has been over 50 percent. One implication of less speculative construction is that builders have been catering to more specific demand and, at least thus far, there has been sufficient demand on the higher end of the market to allow builders to make up for in higher margins what they are missing out on due to lower sales volume. We do, however continue to wonder how much longer this trend will hold up.

Yes, the headline number on the July new home sales report is impressive. The underlying details, however, particularly the inventory details, should temper expectations that July's sales pace will be sustained despite what we expect to remain healthy demand.







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