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## March New Home Sales: Underlying Trend Shows Sales Flattening Out

- > New home sales fell to an annual rate of 511,000 units in March from February's revised sales rate of 519,000 units.
- > Months supply of inventory stands at 5.8 months; the median new home sale price fell by 1.8 percent on a year-over-year basis.

New home sales fell to an annualized rate of 511,000 units in March, below the consensus estimate, though prior estimates for the prior three months were revised slightly higher. Sales were unchanged in the Northeast, up in the Midwest and South regions, but down sharply in the West region in March. Inventories rose modestly and the months supply metric rose to 5.8 percent, which would suggest the new home market is roughly in balance, though we'd take issue with that assessment. Though down 1.8 percent year-on-year, the median new home sales price remains significantly higher than its existing home counterpart, and that gap will likely narrow only slowly.

Now that we've fulfilled our duty of relaying the seasonally adjusted annualized rate headline numbers, we can get to the task of discussing the data in our preferred manner. Not seasonally adjusted (or annualized) sales rose to 48,000 units in March, matching April 2015 as the strongest month for new home sales since May 2008. We had forecast unadjusted sales of 46,000 units in March but were off to a larger degree on our forecast for headline sales (488,000) since the decline in the seasonal adjustment factor was smaller than we had anticipated. Be that as it may, the 12-month moving sum of not seasonally adjusted sales, which we consider to be the most relevant gauge of underlying trends in sales, stands at 503,000 units as of March. This can be seen in one of two ways – it is the highest 12-month total for new home sales since November 2008, but at the same time the 12-month total has been pretty much stuck over the past four months, never below 501,000 or above 503,000, implying the underlying trend rate of sales is flattening out.

Our view is that this flattening out in the trend rate of sales has more to do with the supply side than the demand side of the market, contrary to the story being told by the months supply metric. Typically a months supply of 6.0 months indicates a balance between supply and demand so, at 5.8 months in March, this metric suggests the new home market is roughly in balance. But, if one looks at the inventory of what we refer to as "physical" new homes for sale, i.e., the number of units either completed or at some stage of construction, they are nowhere near levels that would be considered normal, as can be seen in our bottom chart. We have for some time been pointing to what has been an elevated share of new home sales accounted for by units on which construction has not yet been started – 35.4 percent in March. This is a reflection of an undersupplied market. Builders continue to point to constraints on lots (in part due to what has become a much more cumbersome entitlement process), labor, and materials as holding down supply, constraints which have shown some signs of easing but continue to throttle development.

Another factor we've pointed to as acting as a brake on the pace of growth in sales is what has been an increased emphasis on the higher price points. Starting back in 2012 sales of homes priced at or above \$300,000 began to account for an increasing share of total new home sales and that share has since risen steadily, settling at slightly above 50 percent over the last several months of 2015. As we put it, builders have been making up for in margin what they have been lacking in volume. It should also be noted that many of the homes sold in the early phases of this recovery had been built, or at least started, in 2006-08, when there was far more activity on the lower end of the price spectrum. Recall that when sales fell off the table builders got caught out having started on a considerable number of spec homes, and that for almost four years completions ran well ahead of starts and sales. Once that backlog was cleared, builders of course built fewer spec homes and what they were building were higher priced homes, which has largely continued. We have questioned how much more support there is on the high end of the market and in March these higher priced homes accounted for just 43.8 percent of sales.

We still expect steady but slow growth in new home sales over the remainder of this year, but will note sales could surprise us to the upside if builders put more emphasis on the lower price points. This, however, would happen only gradually, if at all.

