ECONOMIC UPDATE

REGIONS

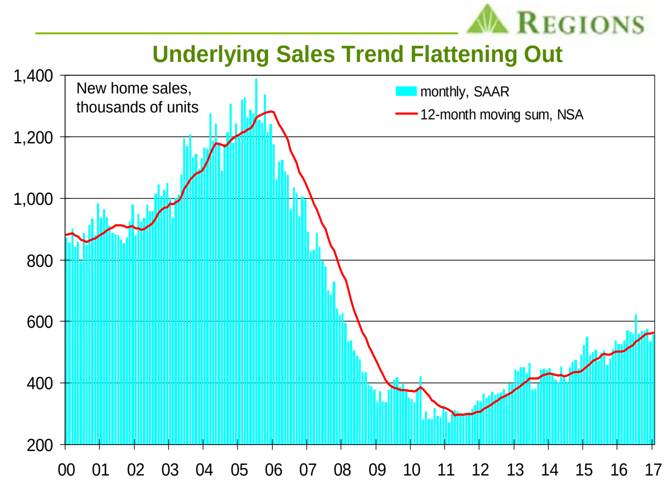
February 24, 2017

January New Home Sales: Underlying Sales Trend Flattening Out

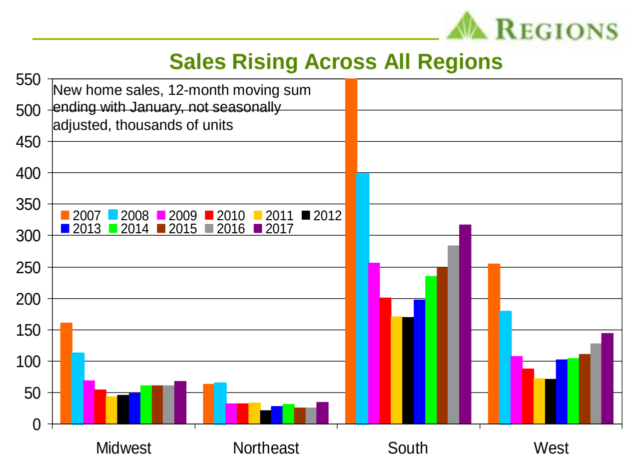
- New home sales rose to an annual rate of 555,000 units in January from December's revised sales rate of 535,000 units.
- Months supply of inventory stands at 5.7 months; the median new home sale price rose by 7.5 percent on a year-over-year basis.

New home sales rose to an annualized sales rate of 555,000 units in January, well shy of the consensus forecast of 571,000 units and even further below our forecast of 593,000 units. Prior estimates for sales over the October through December period were revised down by a net 27,000 units. The new homes market continues to be plagued by low inventories while higher-end sales continue to drive overall sales. We have been consistent in our forecast that 2017 would not bring much relief on the supply front, but at the same time we have expected the mix of sales to shift more towards the middle and lower price ranges, a call that we are now questioning.

On a not seasonally adjusted basis, there were 41,000 new homes sold in January, just under our forecast of 44,000 sales – this miss of 3.000 units in unadjusted sales translates into our miss of 38,000 units on the seasonally adjusted annualized headline number. This January saw the highest January sales tally since 2008, and the 41,000 sales put the 12-month moving sum of not seasonally adjusted sales, which we see as the truest gauge of underlying sales trends at 562,000 units. This is the highest such total since August 2008, but what is concerning is that over the past few months this trend rate of sales has flattened out, as can be seen in the red line in the top chart. While for some time now limited growth in supply has acted as a drag on the pace of new home sales, the flattening out of the underlying sales rate corresponds with the post-election increase in mortgage interest rates. While mortgage rates did tick down a few basis points in January relative to December, rates are nonetheless well above their pre-election levels.

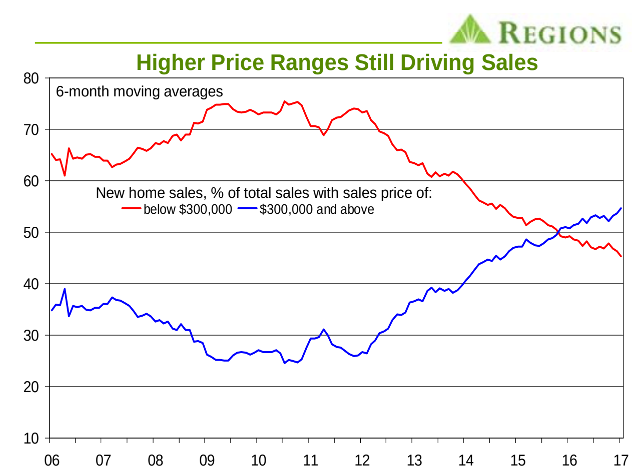


We and other analysts have argued higher mortgage rates won't choke off housing market activity as long as they come in conjunction with firmer income growth. Continued improvement in labor market conditions has yet to result in meaningful and sustained acceleration in wage growth, with wage and salary earnings easily the largest component of personal income, and while reductions in individual income tax rates would mean faster growth in disposable personal income, any such reduction in tax burdens is still some way off in the future. In other words, the higher mortgage rates have been with us for a few months now but faster income growth has yet to materialize to a meaningful degree. As such, it is possible that these higher mortgage rates are impeding home sales.



While faster income growth could cushion the blow of higher mortgage interest rates, that still leaves ongoing inventory constraints as a drag on sales. Inventories of what we refer to as "physical" homes for sale, or, sales of units either under construction or already completed, stood at 212,000 units in January. While well off the cyclical low, this number has not budged over the past four months. One consequence of these lean inventories is that units on which construction has not yet started continue to account for an elevated share of total new home sales, and this means that single family housing starts should hold up over coming months despite higher mortgage interest rates as builders work to clear backlogs. Shortages of lots, labor, and, to a lesser extent, materials in the midst of steady growth in demand have contributed to these backlogs.

Another trend we've been highlighting is the share of new home sales accounted for by homes priced at or above $300,000 – in January this share stood at 56.1 percent and over the past 18 months has averaged 53 percent. New home sales have been atypically skewed towards the higher end of the price scale, which has simply reflected how supply constrained builders were responding to underlying demand and credit conditions. It also reflects what in many markets have been steep increases in entitlement costs which tend to be passed along to buyers in the form of higher sale prices.



We have for some time been constructive on the demand side of the housing market. Higher mortgage interest rates leave us a bit less so, but our main concerns remain on the supply side of the market. As such, at this point our best bet remains a slow but steady increase in new home sales in 2017.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com