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March New Home Sales: Is March's Strong Sales Pace Sustainable?

- > New home sales rose to an annual rate of 621,000 units in March from February's revised sales rate of 587,000 units.
- > Months supply of inventory stands at 5.2 months; the median new home sale price rose by 1.2 percent on a year-over-year basis.

New home sales rose to an annualized sales rate of 621,000 units in March, well ahead of the consensus forecast of 585,000 units but slightly below our forecast of 624,000 units. Prior estimates for December-February were revised higher by a net 43,000 units. March's sales rate stands just below the 622,000 unit rate seen last July as the highest monthly sales rate since January 2008. The true strength of March new home sales, however, is best seen in the raw, i.e., neither seasonally adjusted nor annualized, data. The raw data show 58,000 new homes sold in March, matching our forecast and marking the best month for new home sales since August 2007. But, as with sales of existing homes, a strong March leaves us wondering whether sales have simply been pulled forward from subsequent months or whether the underlying sales rate is ramping up. In both cases, lean inventories make us think it is more the former than the latter, but coming months will bring our answer.

As we routinely note, we have little use for the seasonally adjusted annualized housing market data, instead preferring to focus on trends in the not seasonally adjusted data. Indeed, as we noted in our weekly *Economic Preview*, one reason expectations for March new home sales were so low is that many analysts focused on the sizeable decline in single family housing starts in March, as reported in the seasonally adjusted annualized data. The raw data, however, showed surprising strength in single family permits, starts, and completions, which we expected would carry over into new home sales, as proved to be the case. March's 58,000 sales and revisions to the past few months leave the running 12-month total of not seasonally adjusted sales at 576,000 units, the highest since July 2008.

Still, despite strong sales in March there are still concerns on the supply side of the market. As seen in our middle chart, the number of "physical" homes for sale, i.e., sales of units either under construction or already completed, remains well below historical norms and indeed has fallen in each of the past three months (note our calculation is based on the not seasonally adjusted data). While well off the cyclical trough, we think further increases in physical inventories will come at only a halting pace, meaning limited inventories will continue to weigh on new home sales. As we have noted in our write-ups of the data, lean inventories are also acting as a material drag on sales of existing homes, but one key difference is that new homes can be sold prior to construction having been started. Sales of such units accounted for one-third of all new home sales in March, and this share has been notably elevated for some time now. These early sales, however, will help ensure single family housing starts remain firm over coming months as builders work to clear backlogs.

New home sales remain skewed towards the higher ranges of the price distribution, a trend we have been highlighting for some time now. In March, 55.2 percent of all new home sales were accounted for by units priced at or above \$300,000 and such sales have accounted for over half of all new homes sales over the past two years. This has simply reflected how builders constrained by shortages of labor and buildable lots responded 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; potential tariffs on imported lumber will only add to costs being passed along to buyers. As seen in our bottom chart, the new home "premium," i.e., the differential between the median sales prices of new and existing homes, remains significantly above longer-term norms. In the earlier phases of this cycle, the wider differential was driven more by weakness in existing home prices but over the past few years it has been driven more by builders having targeted the higher price ranges. That the gap has narrowed a bit over the past several months is mainly a reflection of what has been a faster pace of price appreciation for existing homes.

We have for some time been constructive on the demand side of the housing market but less so 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, a strong March notwithstanding.

