ECONOMIC UPDATE

REGIONS

November 22, 2016

October Existing Home Sales: Excuse Us If We're Less Than Impressed

- Existing home sales rose to an annualized rate of 5.600 million units in October from September's (revised) sales rate of 5.490 million units.
- Months supply of inventory stands at 4.3 months; the median existing home sale price rose by 6.0 percent on a year-over-year basis.

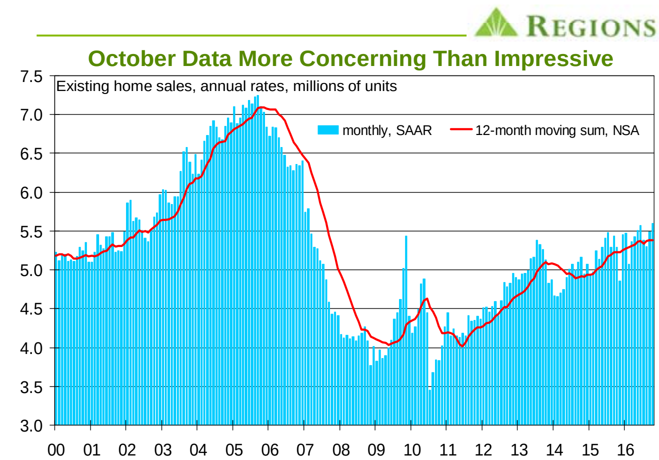
Wow, where is McKayla Maroney when you really need her. Existing home sales rose to 5.600 million units in October, the highest monthly sales rate since February 2007 and easily ahead of the consensus forecast of 5.430 million units and our forecast of 5.480 million units. Yet, as we go through the details of the October report we fell somewhat less than impressed and, indeed, we find the data more concerning than impressive. The October headline sales number has more to do with an overly friendly seasonal adjustment factor than it does about underlying momentum in the housing market. Moreover, with inventories already a material drag on sales and the impact of higher mortgage rates yet to be apparent in the home sales data, we feel plenty of cause for concern even if that doesn't fit with the general reaction to today's report.

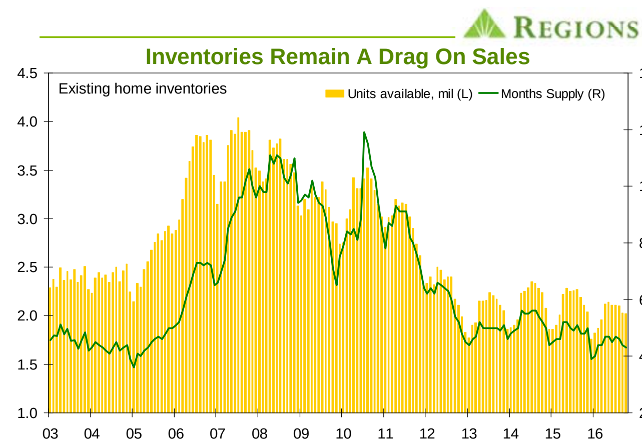
Beneath the headline sales number lurks a fairly pedestrian number on not seasonally adjusted sales. There were 442,000 existing homes sold on a not seasonally adjusted basis in October, well below our forecast of 472,000 units. This reflects a year-over-year increase of just 0.5 percent, in stark contrast to the 5.9 percent increase in sales on a seasonally adjusted annualized basis, i.e. the headline sales number. How you reconcile our too-high forecast on raw sales and our too-low forecast on headline sales is the seasonal adjustment factor. which we underestimated, and badly, for October. This of course illustrates why we repeatedly emphasize the not seasonally adjusted data, specifically the 12-month moving sum, as the relevant gauge of underlying sales trends. Over the past 12 months there have been 5.385 million existing homes sold but, as seen in the top chart, this number has been little changed over recent months.

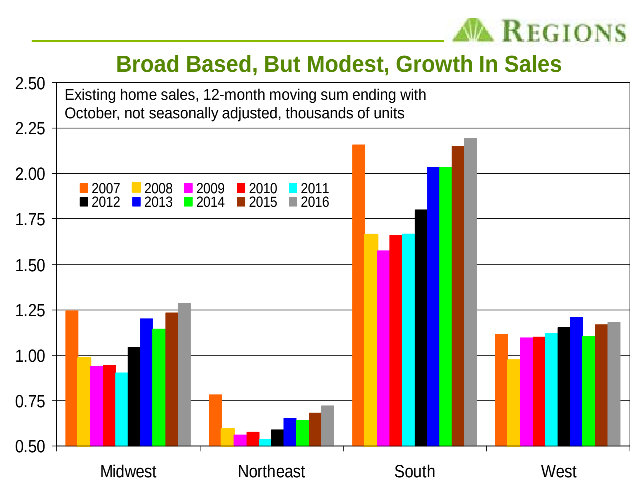
This points to what has for some time been the most binding constraint on existing home sales – lack of inventory. Listings fell between September and October, which is not uncommon (the NAR inventory data are not seasonally adjusted) but what is, or should be, concerning is that October is the 17th consecutive month in which listings have fallen on a year-over-year basis. The median time on market for homes sold in October was 41 days, up nominally from recent months but well below the 57-day median for homes sold last October. The months supply metric stands at 4.3 months as of October, which is significantly lower than what we would see in a normal market.

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. There is nothing in the October data to suggest those supply side concerns are set to fade away, and we would argue they could get even worse going forward. Limited 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 have been acting as a buffer between higher prices and affordability. As mortgage rates push higher, that buffer will become thinner and thinner. The roughly 50-basis point increase in rates on 30-year fixed rate mortgages seen over recent weeks won't choke off demand entirely, but it will hit hard on the lower ends of the price scale, particularly for prospective first-time buyers. The question becomes how much higher rates will climb in the months ahead. It is true that continued job and income growth will help support demand, but there is still cause for concern. Specifically, one side effect is 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.

Beneath the headline October sales number we see cause for concern. We believe demand remains fairly 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 more upside there is for existing home sales.







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