# ECONOMIC UPDATE

REGIONS

January 25, 2018

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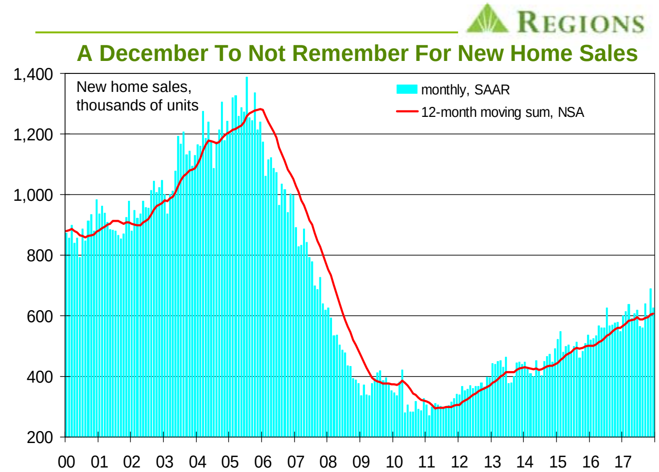
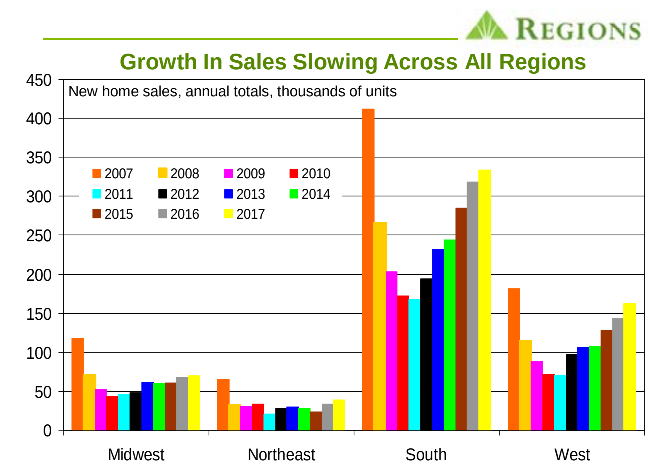
## December New Home Sales: A December To Not Remember

- New home sales <u>fell</u> to an annual rate of 625,000 units in December from November's revised sales rate of 689,000 units.
- Months supply of inventory stands at 5.7 months; the median new home sale price <u>rose</u> by 2.6 percent on a year-over-year basis.

New home sales fell to an annualized rate of 625,000 units in December, far short of the consensus forecast (676,000) and not even in the same time zone as our forecast (706,000). At the same time, November sales were marked down significantly, now reported as 689,000 units rather than the 733,000 units (annualized rates) initially reported, and October sales were also revised sharply lower. Still, as we noted in our write-up of December existing home sales, even the surprisingly low seasonally adjusted annualized headline new home sales number fails to put the state of the new homes market in proper context, as a very generous seasonal adjustment factor makes the headline sales number look better than it should. As is the case with existing homes, inventories of new homes remain notably lean and this continues to act as a constraint on sales. While we expect a bit more relief on the supply side of the new homes market in 2018 than we do for the existing homes market, inventories will continue to run well below historical norms and thus weigh on sales.

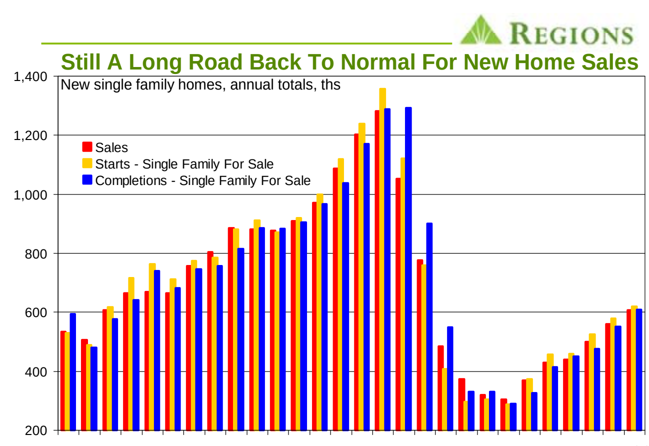



On a not seasonally adjusted basis, new home sales came in at 43,000 units in December, shy of our forecast of 50,000 units. As with existing home sales, we had nudged our forecast higher in anticipation of higher priced sales being booked ahead of the less generous mortgage interest deduction beginning in 2018, and there was a better case to make for this with new home sales – unlike existing home sales, which are booked at closing, new home sales are booked at contract signing. In both cases, however, this basically amounted to us attempting to quantify the noise we anticipated would be in the December data, which is pretty much a rookie mistake made by people who've been at this many years. In any event, our December forecast was by no means a turn in our outlook for home sales, either existing or new, and we continue to maintain that inventories, or the lack thereof, will be the main story in the housing market in 2018.




The 43,000 sales in December put total sales for 2017 as a whole at 608,000 units, an 8.4 percent increase from 2016 sales. For 2017 as a whole, sales were up by 2.9 percent in the Midwest, up by 14.7 percent in the Northeast, up 5.0 percent in the South, and 13.3 percent in the West region. Still, it is worth noting that the pace of growth in sales slowed in each of the four broad Census regions in 2017. To some extent this is to be expected as sales begin to normalize after coming off the depths to which new home sales had sunk following the housing market bust, but we think there are more ominous factors in play here, specifically, that lean inventories are acting as a brake on the pace of growth in sales.

Though some are keen to point out that 2017 was the best year for new home sales since 2007, that's not really all that impressive given the state of the housing market in the intervening years. Our bottom chart shows that while, yes, new home sales have steadily improved, it's taken a long time to get back to where sales were in . . . 1992 (annual sales of 608,000 units). In other words, even if for the obvious reasons, you throw out the 2003-2012 period, the new homes market cannot yet be considered as being anywhere near normal. Builders continue to contend with shortages of buildable lots, shortages of labor, rising costs for materials, and what in many markets are more cumbersome and more costly entitlement processes. As such, while the annual percentage changes in starts, completions, and sales seem impressive, they are still coming off of relatively low bases.




Still, builders are running full steam, and sales of units on which construction has not yet started continue to account for an atypically high share of total new home sales. But, It remains to be seen how higher end sales will hold up, particularly with higher mortgage interest rates and a less friendly mortgage interest deduction – over 55 percent of all sales in 2017 were of homes priced at or above $300,000, easily the highest on record.

Amidst solid job and income growth, our concerns with the housing market have been squarely on the supply side, not the demand side, of the market. This is still the case, but affordability seems likely to be an increasingly worrisome issue as 2018 plays out.

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