ECONOMIC UPDATE

REGIONS

February 24, 2021

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January New Home Sales: Solid Start To 2021, But Will It Last?

- New home sales <u>rose</u> to an annual rate of 0.923 million units in January from December's (revised) sales rate of 0.885 million units
- Months supply of inventory stands at 4.0 months; the median new home sale price <u>rose</u> by 5.3 percent year-on-year

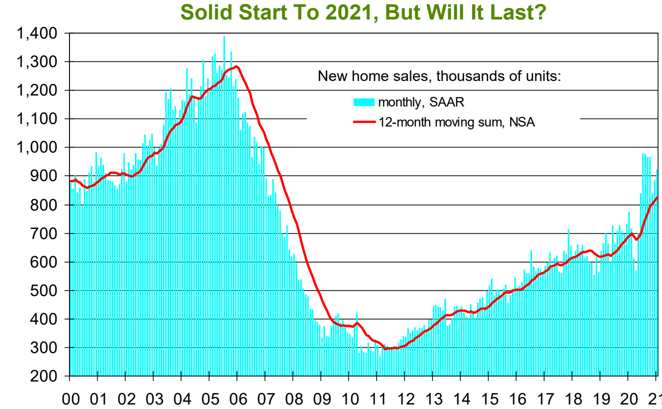
Total new home sales rose to an annualized rate of 923,000 units in January, easily ahead of what we and the consensus expected, while prior estimates of sales from October through December were revised higher. Inventories of new homes for sale remain notably lean, with the months supply metric falling to 4.0 months in January, while the median new home sales price rose 5.3 percent year-on-year. Builders are facing growing backlogs of unfilled orders, meaning that they will stay busy in the months ahead even if demand starts to taper off. With mortgage rates on the way higher amid a run of robust price appreciation, it is fair to wonder whether demand will begin to soften due to diminished affordability, and there are some indications that has already begun to happen. It is, at least in our view, too soon to draw any definitive conclusions, and doing so will take longer given that the February data will be skewed by the harsh winter weather that has impacted much of the U.S., so the true test may not come until the spring sales season is in full swing.

On a not seasonally adjusted basis, there were 70,000 new home sales in January, well ahead of our forecast of 62,000 sales. Our miss, however, was entirely accounted for by the South region, where the 42,000 sales topped our forecast while sales in the Midwest, Northeast, and West regions matched our forecast. January sales in the South region outperformed single family permits, starts, and completions, so it will be worth watching to see whether either data set is revised with next month's releases. As of January, the running 12-month total of not seasonally adjusted new home sales, which we see as the most reliable indicator of underlying sales trends, stands at 826,000 units, the highest such total since October 2007.

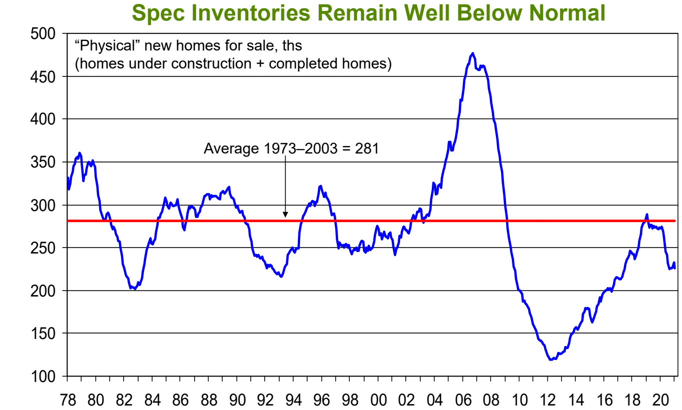
After having trended lower for more than two years, spec inventories surprisingly ticked higher in December, and ahead of the January data we wondered whether that increase would be sustained. It was not, with spec inventories turning back down in January. At the same time, the share of sales accounted for by units on which construction had not yet started remains elevated. The January report on new residential construction showed a further increase in the backlog of units that have been permitted but not yet started. In other words, all signs point to builders struggling to keep pace with demand. One implication of this backlog is that, even should demand begin to taper off, it will take builders some time to work through these order backlogs, making for a more gradual transition to a slower pace of construction as opposed to there being an abrupt drop-off in construction.

As noted above, there are reasons to wonder whether demand has indeed begun to taper off. One indicator we watch closely is the Mortgage Bankers Association's weekly report on new applications for purchase mortgage loans. Activity dropped sharply in the week ending February 19, with the seasonally adjusted index falling to a nine-month low. This print, however, should be discounted given the impact of the harsh winter weather. That said, the index had already turned lower prior to the MBA's latest weekly observation – the last data point shown in the chart to the side is the February average, which was 5.5 percent below the January average. With applications for purchase mortgage loans leading sales, this is clearly worth watching in the weeks ahead even allowing for the most recent week's data being somewhat distorted. Another telling sign in the MBA's data is that in the week ending February 19, the average loan size of purchase mortgage loan applications was $418,000, which is 20.2 percent than the average loan size in the same week of 2020. This goes right to our point about affordability becoming a concern – while the MBA data cover purchases of both new and existing homes, the point remains the same. Home prices have been rising at a very rapid clip over the past several months, and while low mortgage interest rates acted as a buffer against diminished affordability for much of that time, our point has been that the higher prices went, the thinner that buffer would become even without a change in mortgage interest rates. We've also argued that, with prices having risen so much, affordability would be more sensitive to a given change in interest rates than has been the case in the past. So, while we're not saying that the cycle is about to turn, it is clearly time to at least allow for that possibility given that we're only at the beginning of the increase in mortgage rates.

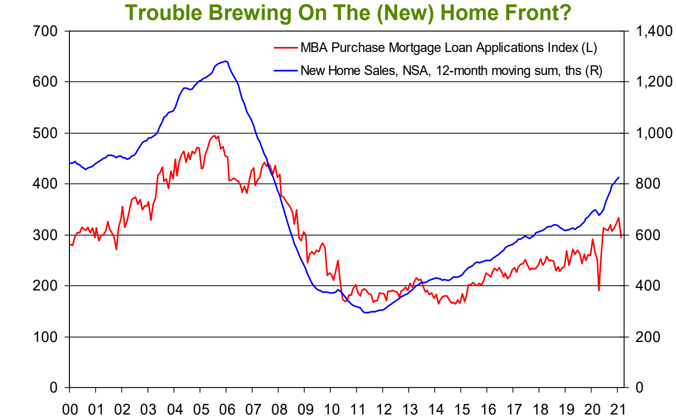
Solid Start To 2021, But Will It Last?



Spec Inventories Remain Well Below Normal



Trouble Brewing On The (New) Home Front?



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