August 09, 2018

Economics Group

Special Commentary

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Housing Remains in the Slow Lane

Supply Shortages and Affordability Concerns Continue to Weigh on Home Sales

The recent acceleration in overall economic growth has done precious little to promote a stronger housing recovery. Home sales, new home construction and outlays for renovations and repairs were collectively a net drag on overall growth during the first half of the year, even as real GDP growth ramped up to a 4.1 percent pace during the second quarter. The disconnect between a strengthening economy and struggling housing sector has been a common theme throughout this expansion and, unfortunately, is a theme that is likely to continue.

The most recent housing data are perplexing. After falling in April, May and June, sales of existing homes through the first half of 2018 are running 2.2 percent below the same period last year, despite stronger job and income growth. One reason for the shortfall is the lack of homes on the market. The inventory of existing homes available for sale fell on a year-to-year basis for 36 consecutive months, before eking out a miniscule gain in June. Even if June marks a turning point, inventories still remain near historic lows, particularly in parts of the country where economic growth has been the strongest. New home construction has picked up but is not providing much relief. Higher prices for lumber and other building materials are making it difficult for builders to ramp up construction, which has kept inventories of newly built homes unusually lean.

With fewer homes for sale, prices have been driven much higher, particularly in parts of the country where population, employment and incomes have been growing rapidly. Nationwide, home prices have been rising at least twice as fast as incomes for the past four years. As a result, housing affordability has taken a hit and far fewer consumers feel now is a good time to buy a home. The Fannie Mae Home Purchase Sentiment Index fell 4.2 points in July and is now slightly below its year-ago level. Fannie Mae's survey is consistent with data from the University of Michigan, which have shown a persistent slide in the share of consumers that feel now is a good time to buy a home.

Figure 1

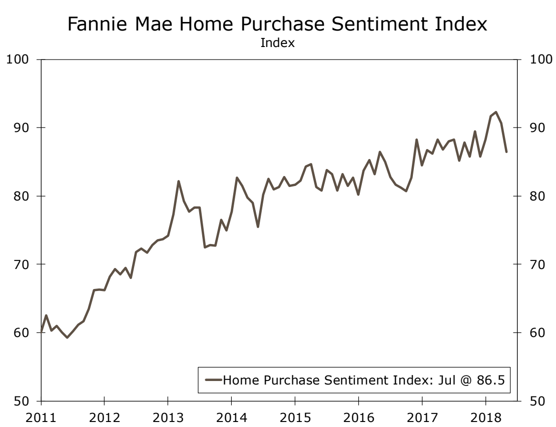
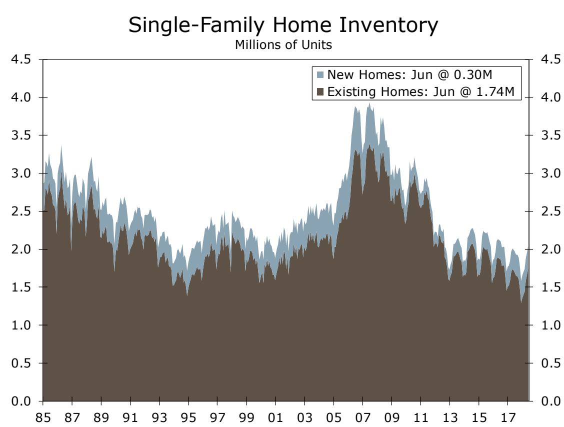


Figure 2



Source: Fannie Mae, National Association of Realtors and Wells Fargo Securities

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Scaling Back Expectations Even Further

The magnitude of the slide in the proportion of consumers stating now is a good time to buy a home has rarely been seen outside of a recession and is difficult to reconcile with the broadening economic recovery. One explanation for the split is that much of the economy's strength has been concentrated in a relative handful of markets, mostly in the West and South. Western markets have disproportionately benefitted from the tech boom and many of the most tech-intensive markets, including San Jose, San Francisco, Seattle and Denver, consistently possess the leanest inventories and post some of the largest gains in home prices. Conditions have been somewhat better in the South, where new construction has helped bolster supply. Inventories are lean in most of the region's major markets, however, and several typically affordable markets like Dallas, Atlanta, Nashville and Raleigh are now seeing home prices rise even faster than they did during the bubble years.

Price appreciation in the Northeast and Midwest has generally been less dramatic, aside from Boston and New York City. The former is benefitting from the tech boom, while the latter has benefitted from the renewed interest in living in large cities. Inventories are still fairly lean in most major metropolitan areas but homes are taking longer to sell in many mid-sized markets and price appreciation in those markets is much slower or even nonexistent. Slower price appreciation in the Northeast and Midwest relative to the South and West is one of the reasons net migration has slowed as much as it has, and more of those that do relocate from the Northeast and Midwest are renting for longer because they are having difficulty selling their current home.

While conditions should still improve, sales and new home construction should rise less than previously projected. Sales of existing homes are actually expected to decline 1.4 percent this year, which will still mark an improvement from the current pace, on track for a 2.2 percent decline. New home sales should fare considerably better, rising 9.8 percent. This is much less than we had previously thought and partly reflects the impact of higher prices for lumber and other building materials, as well as the continued difficulty builders are having finding the workers they need.

The drop in existing home sales is a big reason why residential investment is as weak as it is. Residential investment accounts for 3.9 percent of GDP and reflects the value added by new home construction, residential improvements and the sale of existing homes. Since existing homes were built some time ago, only the commissions on the sale of existing homes are included in residential investment and GDP. But since existing sales are more than eight times larger than new sales, these commissions are fairly sizeable and account for roughly 21 percent of residential investment.

New home construction should strengthen later this year. Building material prices have begun to ease somewhat and typically decline during the summer and fall, which should allow builders to restart some of those stalled projects. We have trimmed our forecast for housing starts to just a 7.7 percent gain this year and have lowered our estimate for 2019 to a 6.2 percent gain.

Figure 3

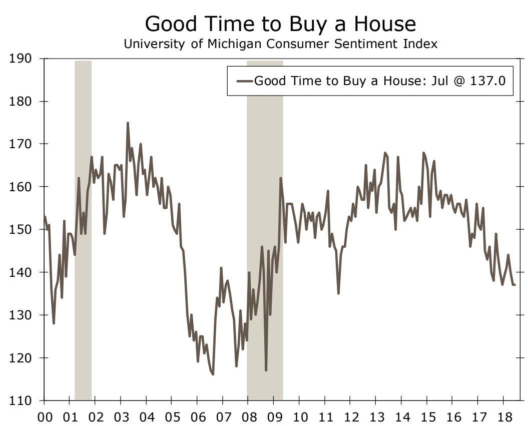
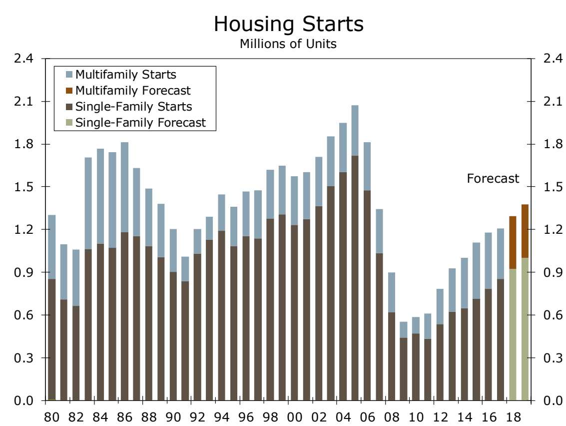


Figure 4



Source: University of Michigan, U.S. Department of Commerce and Wells Fargo Securities

National Housing Outlook

								Forecast	
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Real GDP, Percent Change	1.6	2.2	1.7	2.6	2.9	1.5	2.3	2.9	3.0
Residential Investment, Percent Change	0.5	13.5	11.9	3.5	10.2	5.5	1.8	0.9	3.7
Nonfarm Payroll Change (Avg. Monthly)	174	179	192	250	226	195	182	202	165
Unemployment Rate	8.9	8.1	7.4	6.2	5.3	4.9	4.4	3.9	3.6
Home Construction									
Total Housing Starts, in Thousands	608.8	780.6	924.9	1,003.3	1,111.8	1,173.7	1,202.9	1,295.0	1,375.0
Single-Family Starts, in Thousands	430.5	535.3	617.7	647.9	714.5	781.5	848.9	925.0	1000.0
Multifamily Starts, in Thousands	178.3	245.3	307.2	355.4	397.3	392.2	354.0	370.0	375.0
Home Sales									
New Home Sales, Single-Family, in Thousands	305.0	369.0	429.0	437.0	501.0	561.0	613.0	673.0	720.0
Total Existing Home Sales, in Thousands	4,260.0	4,660.0	5,090.0	4,940.0	5,250.0	5,450.0	5,510.0	5,431.5	5,530.0
Existing Single-Family Home Sales, in Thousands	3,787.0	4,128.0	4,484.0	4,344.0	4,646.0	4,838.0	4,892.0	4,823.5	4,910.0
Existing Condominium & Co-op, in Thousands	477.0	528.0	603.0	591.0	608.0	614.0	619.0	608.0	620.0
Home Prices									
Median New Home, $ Thousands	227.2	245.2	268.9	288.5	294.2	307.8	323.1	337.4	349.5
Percent Change	4.8	7.9	9.7	7.3	2.0	4.6	5.0	4.4	3.6
Median Existing Home, $ Thousands	166.1	176.8	197.1	208.3	222.4	233.8	247.2	261.5	275.9
Percent Change	-3.7	6.4	11.5	5.7	6.8	5.1	5.7	5.8	5.5
FHFA Purchase Only Index, Percent Change	-4.2	3.0	7.2	5.1	5.4	6.0	6.7	6.5	6.1
S&P Case-Shiller C-10 Home Price Index, Percent Change	-3.5	0.3	11.7	7.9	4.6	4.5	5.3	6.0	5.7
Interest Rates - Annual Averages									
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.27	0.52	1.13	2.13	2.75
Prime Rate	3.25	3.25	3.25	3.25	3.27	3.52	4.13	5.13	5.75
10-Year Treasury Note	2.78	1.80	2.35	2.54	2.14	1.84	2.33	2.96	3.48
Conventional 30-Year Fixed Rate, Commitment Rate	4.46	3.66	3.98	4.17	3.85	3.65	3.99	4.62	5.08

Forecast as of: August 8, 2018

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, FRB, FHFA, FHLMC, National Association of Realtors, S&P, Wells Fargo Securities

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