MORNING BRIEFING
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All About Housing

Check out the accompanying chart collection.

Executive Summary: The US housing market is undergoing a reversal of fortune. The scorching hot market conditions of six months ago have reversed, as 40% home appreciation over the past two years plus soaring mortgage rates have priced homeownership beyond many Americans' grasp. The resultant greater demand for rental units has spurred high rent inflation. Additionally, the pool of would-be homebuyers has shrunk, more deals are falling apart before closing, motivated sellers have begun dropping listing prices, and builders are slashing prices. … Today, we look at all things housing, including how recent demographic and domestic migration trends have affected market conditions and at how market conditions are affecting homebuilders.

US Housing I: From Boom To Caboom? The pandemic-induced housing boom is over. Would-be homebuyers no longer are lining up out the door for open houses and jumping into bidding wars within hours of first listing. In fact, one of the ugliest charts on the block right now shows the index for traffic of prospective buyers of new homes. It has plunged from 71 at the start of this year to 37 during July (*Fig. 1*). Just as ugly is the chart showing the sharp declines so far this year in the Housing Market Index (for new homes) and the Pending Home Sales Index (for existing homes) (*Fig. 2*).

Until recently, a shortage of housing inventory held back strong sales volume and caused home prices to soar. Now inventory-to-sales ratios are rising, as declining affordability is depressing sales volume from the demand side. Contracts are being canceled mid-deal because buyers who hadn't locked in their mortgage rates can't afford the monthly mortgage payments that are so much higher than they expected to pay when they first started looking for a house. Buyers also are wary of purchasing a home that could now depreciate in value. Sellers looking to get out while prices are still elevated and before interest rates rise further have started lowering their listing prices.

Nevertheless, Melissa and I don't expect a housing crash the likes of the Great Financial Crisis (GFC) saw, even though national measures of home prices are likely to fall in coming months. That's because demand for housing is likely to remain elevated due to the demographic trends discussed below and because mortgage lending standards were tighter in recent years than the historically lax standards that prevailed in the years before the GFC. Consider the following:

(1) *Sales decrease as inventories increase.* Total existing home sales (including single-family homes and condominiums) plunged 21% since January to 5.1 million units (saar) during June, the slowest pace since June 2020 (*Fig. 3*). New home sales peaked at 1.04 million units (saar) during August 2020 and fell 43% to 590,000 units in June of this year (*Fig. 4*).

The recent weakness in sales largely reflects the surge in mortgage rates since the start of the year combined with the jump in home prices since the end of the lockdown recession in 2020. The inventory-to-sales ratios of both existing and new homes are rising as sales fall.

During June, there were 1.26 million existing homes for sales, well below the record high of 4.04 million during July 2007 (*Fig. 5*). As a result of this year's sales drop, the month's supply of existing homes on the market rose from a record low of 1.6 months during January to 3.0 months during June. During the GFC, readings above 10 months were the new abnormal.

A similar analysis shows that new homes for sale rose 16% from 394,000 units in January to 457,000 units in June, the highest inventory of such housing since spring 2008 (*Fig. 6*). The months' supply rose from a record low of 3.3 months during August 2020 to 9.3 months in June, the highest since May 2010.

(2) *Pending deals come undone.* Pending existing home sales data for June will be out this morning. The National Association of Realtors' (NAR) Pending Home Sales Index ticked up in May but still was about as low as it was in March 2020, when the Covid lockdowns started (*Fig. 7*).

The index tends to be a leading indicator for existing home sales. But a wave of cancelations suggests that sales could be weaker than the index suggests. The share of sales agreements on existing homes canceled in June was about 15% of all homes under contract, according to a July 11 *report* from Redfin. That was the most deals undone since early 2020, when the residential real estate market essentially froze during the lockdown.

(3) *Rising rates & prices leaving buyers out in the cold.* Mortgage applications for new purchases fell dramatically by 25% ytd through July 15 (*Fig. 8*). Over the same period, the 30-year mortgage rate shot up from 3.30% to nearly 6.00%.

Remarkably, over the past 24 months through June, the median existing home price is up 42.1% (*Fig. 9*). Over the 24 months ending May, the median new home price was up 40.2%

(*Fig. 10*). But yesterday, we learned that this price plunged 9.5% m/m during June. So the median price increase over the past 24 months through June is now 18.0%.

Altogether, housing has become much less affordable in recent months. Through May, the NAR's Housing Affordability Index based on a 30-year fixed rate mortgage dropped to the lowest seen since July 2006 (*Fig. 11*).

(4) *Tighter lending standards.* Fortunately, mortgage lending standards have been tightened significantly since the GFC. During Q1-2022, the percent of mortgages delinquent by 90 days or more remained at a record low of 0.5% (*Fig. 12*). The similar delinquency rate for home equity loans was 0.8%. Both were well below the delinquency rates on auto loans (4.0%), student loans (4.7%), and credit cards (8.4%).

US Housing II: Homebuilders Getting Squeezed. Q2's real GDP will be released tomorrow. According to the Atlanta Fed's *GDPNow* tracking model, it is likely to show a small decline of 1.6% (saar) led by a large 10.1% drop in residential investment, which is highly correlated with both total housing starts and housing completions (*Fig. 13* and *Fig. 14*). Consider the following:

(1) *Starts mixed by type.* Single-family housing starts can be volatile, but June's 8.1% drop to 982,000 units (saar) appeared to be a clear weakening of the post-pandemic uptrend in homebuilders' breaking ground (*Fig. 15*). Single-family permits, a leading indicator for starts, fell 7.7% in June to 970,000 units (saar) (*Fig. 16*).

Multi-family starts and permits increased, however. Likely that reflects builders' recognition of the demand for more affordable units for purchase and for rent, as buyers are priced out of the single-family market.

(2) *Homebuilders' margins at record high.* While new home prices have risen significantly, the increase isn't all going into homebuilders' margins; much is going to the increased costs of building materials and labor. Global supply-chain disruptions and shortages of building materials along with generally rising prices in the US have led to higher costs to build.

The PPI for final demand in construction rose 19.2% y/y during June (*Fig. 17*). Homebuilders have gotten a bit of a reprieve in the price of lumber but still may be working to offset the skyrocketing cost of lumber that occurred just a few months ago.

Nevertheless, the forward profit margin of the S&P 500 Homebuilding industry has increased significantly from 8.9% at the start of 2020, just before the pandemic, to a record high of 15.1% recently (*Fig. 18*). However, both forward revenues and forward earnings seem to have peaked in recent weeks. (See our *S&P 500 Industry Briefing: Homebuilding*.) June's drop in the median new home prices suggests that the industry's profit margin may be about to head south quickly.

US Housing III: Millennials Forming Households. Leading up to the pandemic, the number of households surged; then during the pandemic, it fell as many extended families moved in together to share costs and commiserate during the lockdowns. Following the pandemic, household growth again is on the rise, albeit more slowly than before (*Fig. 19*).

Prior to the pandemic, many Millennials started purchasing their first homes. But as affordability has become a real challenge for many of them recently, the number of rental households increased from Q3-2021 through Q1-2022, while the number of owner-occupier ones decreased (*Fig. 20*). These developments are likely to boost multi-family housing starts, while depressing single-family housing starts.

Harvard's Joint Center for Housing's recently released "*The State of the Nation's Housing Report 2022*" included an interesting section on demographics. Here are a couple of excerpts from the report's *fact sheet*:

(1) "Household growth has been strong during the pandemic, increasing by 3.2 million between Q1 2020 and Q1 2022. This has been driven in part by the large millennial generation aging into prime years of household formation. The peak of the millennial generation (born 1985–2004) was age 31 in 2021. As a result, there were 46 million adults aged 25–34 in 2021, a record-high number for the age group most likely to form households."

(2) "The aging of the baby boom generation is resulting in a meteoric rise in the number of older adult households. The peak of the baby boom generation (born 1946–1964) was age 59 in 2021, and the oldest members of the generation were age 75. The number of householders age 65 and over rose by 10.0 million from 2011 to 2021 and is projected to rise by 1.1 million annually until 2028. This growth in older households will result in a more pressing need for accessible and affordable housing as well as supportive services to meet the changing needs of this demographic."

US Housing IV: Urban Exodus. Many owner-occupier households have skirted the housing affordability hurdle by moving to cheaper areas. The remote work trend, outlasting the pandemic, has provided workers with the flexibility to live in more affordable areas as well as save time and money on commutes. As a result, mass migration has occurred from urban areas into more rural less expensive ones.

The Harvard housing report observed: “Though overall residential mobility continues to decline, pre-pandemic trends in migration away from large urban areas continued during the pandemic. In total, the core counties of large metro areas lost 1.2 million people to domestic migration last year, while suburban counties of these large metros gained 428,000 people from domestic moves. Counties in small- and medium-sized metros added a net total of 539,000 migrants, and rural nonmetropolitan counties gained 235,000 people from net domestic migration last year—reversing a decade-long trend in net domestic outflows.”

Recently, one of our accounts asked a great question: Is the mass exodus out of the more expensive areas reflected in the latest housing inflation data?

Our answer: Based on the following resources, population size by geographic location is factored into the Consumer Price Index (CPI) for owner-occupied and tenant rent. However, the sample size is constant for a period. The latest data reflect the 2018 geographic CPI pricing areas (based on the 2010 Census population size). So, no, the CPI for rent would not factor in the exodus from more expensive geographies to cheaper ones (by way of weighting the cheaper ones more).

That means that if the geographies were reweighted against the population, it’s possible that the CPI would be lower. But keep in mind that the “cheaper” regions have experienced rental increases following increased housing demand. Also, the fact that the Bureau of Labor Statistics collects “existing” rent information (as opposed to the prices for new listings) for the CPI makes it a lagging indicator, which more than likely means that CPI for rent currently is vastly understated. (See *BLS Handbook of Methods* and this NBER *working paper* by economist Larry Summers et al.)

Calendars

US: Wed: Durable Goods Orders Total, Core, Ex Defense, and Nondefense Capital Goods Ex Autos -0.3%/0.3%/-0.5%/0.2%; Wholesale & Retail Inventories; Goods Trade Balance; Pending Home Sales -1.5%; MBA Mortgage Applications; Crude Oil Inventories; Gasoline Production; Fed Interest Rate Decision 2.50%; FOMC Statement. **Thurs:** Real GDP & GDP

Price Deflator 0.5%/7.9%; Core PCED 4.4%; Initial & Continuous Jobless Claims 253k/1.375m; Kansas City Manufacturing Index; Natural Gas Storage. (Bloomberg estimates)

Global: **Wed:** Germany Gfk Consumer Climate -29; France Consumer Confidence 80; Italy Consumer & Business Confidence 96/108; Japan Leading & Coincident Indicators. **Thurs:** Eurozone Economic Sentiment 102.0; Germany CPI 0.6%m/m/7.4%y/y; France PPI; Spain Retail Sales 1.3%; Spain Unemployment Rate 13.0%; Japan Industrial Production 3.7%; Japan Retail Sales 2.8% y/y; Japan Unemployment Rate 2.5%. (Bloomberg estimates)

Strategy Indicators

S&P 500 Q2 Earnings Season Monitor (*link*): With nearly 27% of S&P 500 companies finished reporting revenues and earnings for Q2-2021, the revenue and earnings surprises are well below their recent trends. Revenues are beating the consensus forecast by 1.6%, and earnings have exceeded estimates by 4.5%. At the same point during the Q1 season, revenues were 2.5% above forecast and earnings beat by 9.5%. For the 134 companies that have reported Q2 earnings through mid-day Tuesday, the aggregate y/y revenue and earnings growth rates has slowed from their readings from Q2-2021 to Q1-2022. Collectively, they have a y/y revenue gain of 8.0% and an earnings decline of 2.6%. Just 70% of the Q2 reporters so far has reported a positive revenue surprise, and 76% have beaten earnings forecasts. Markedly fewer companies have reported positive y/y earnings growth in Q2 (58%) than positive y/y revenue growth (81%). These figures are bound to change as more Q2-2022 results are reported in the coming weeks. While we expect y/y growth rates to remain positive in Q2, we think revenue and earnings surprises will moderate q/q due to the slowing economy, rising inventories, and higher costs.

US Economic Indicators

New Home Sales (*link*): New home sales (counted at the signing of a contract) in June resumed their decline after a surprise to the upside during May. Sales contracted for the fifth time this year, tumbling 8.1% in June and 29.7% ytd to 590,000 units (saar)—the lowest since April 2020. Of the 590,000 homes sold in June, only 155,000 units were completed, while 184,000 units were not yet started and 251,000 units were under construction.

Meanwhile, there were 457,000 units for sale at the end of June (the most since spring 2008), with only 41,000 units completed and 110,000 units not started; 306,000 units were under construction. At the current sales pace, it would take 9.3 months to run through the supply of new homes—the highest since May 2010. Meanwhile, homebuilders' confidence is plummeting, dropping a near-record 12 points in July and 28 points ytd to 55—the lowest since May 2020. July's 12-point drop is the biggest on record excluding April 2020's Covid-related 42-point plunge. All components were hit hard this month, with current sales (-12 points to 64), future sales (-11 to 50) and traffic of prospective buyers (-11 to 37) all posting double-digit declines, to their lowest readings since June 2020 for current sales and since May 2020 for the future sales and traffic components.

Consumer Confidence (*link*): Consumer confidence in July sank to its lowest level since February 2021, with the present situation component accounting for virtually all of this month's decline. The Consumer Confidence Index dropped for the second successive month and the fifth time this year, to 95.7 in July, down 12.9 points the over past three months and 19.5 points ytd. The index's expectations component declined for the sixth time this year, plunging 30.1 points ytd to 65.3—the lowest level since March 2013—though was little changed this month. The report notes recession risks persist, with July's reading well below 80.0. Meanwhile, the present situation component, which had been in a relative flat trend, has dropped 12.5 points the past four months to a 15-month low of 141.3—with roughly half the decline occurring this month. "Concerns about inflation—rising gas and food prices, in particular—continued to weigh on consumers," according to the report. In July, consumers' appraisal of current business conditions were less favorable, with the percentage of consumers saying business conditions are good (to 17.0% from 19.5%) falling and the percentage saying conditions are bad (24.0% from 22.8%) rising. Consumers' assessment of the labor market also deteriorated, with the percentage saying jobs are plentiful (50.1 from 51.5) down and the percentage saying jobs are hard to get (12.3 from 11.6) up—with the former the lowest in over a year. Meanwhile, consumers were mixed about the outlook for short-term business conditions, with the percentage expecting them to improve (14.0 from 14.6) and worsen (27.2 from 29.7) both moved lower. The pattern was the same for the short-term labor market, with the percentage expecting more jobs to be available (15.7 from 15.9) moving slightly lower, as did the percentage anticipating fewer jobs (21.4% from 22.2%). Meanwhile, consumers were pessimistic about their short-term financial prospects, as those expecting incomes to increase (14.7 from 16.1) fell while the percentage expecting incomes to decrease (15.7 from 15.3) edged higher. Lynn Franco, senior director of economic indicators at The Conference Board, noted: "Looking ahead, inflation and additional rate hikes are likely to continue posing strong headwinds for consumer spending and economic growth over the next six months."

Regional M-PMIs (***link***): Four Fed districts (New York, Philadelphia, Dallas, and Richmond) now have reported on manufacturing activity for July and show the manufacturing sector fell deeper into contractionary territory. The composite index improved a bit, though remained in negative territory for the third month, climbing to -6.0 in July after falling from 12.6 in April to -7.8 in June. Activity in the New York (to 11.1 from -1.2) region swung from negative to positive this month, while the Richmond (0.0 from -9.0) region returned to the break-even level after contracting for two months. Meanwhile, activity in both the Philadelphia (-12.3 from -3.3) and Dallas (-22.6 from -17.7) factories dropped further into contractionary territory. Orders (-9.5 from -8.6) this month contracted at a sharper rate as billings in the Philadelphia (to -24.8 from -12.4) region contracted at double June's rate, while Dallas' (-9.2 from -7.3) were slightly more negative. Meanwhile, orders growth in the Richmond (-10.0 from -20.0) area fell at half June's pace, while New York's (6.2 from 5.3) held at a steady pace. Employment (15.8 from 19.6) slowed a bit but continued its strong readings, with a solid pace of hirings by factories in the Philadelphia (19.4 from 28.1), New York (18.0 from 19.0), and Dallas (17.9 from 15.2) regions, while Richmond (8.0 from 16.0) hired at half last month's pace.

Regional Prices Paid & Received Measures (***link***): We now have prices-paid and -received data for July from the New York, Philadelphia, Richmond, and Dallas regions, and all are showing a noticeable easing of inflationary pressures. (Note: The New York, Philadelphia, and Dallas measures are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures.) The prices-paid measure in the New York region slowed to 64.3, the lowest since last February, down from April's record-high 86.4, while Philadelphia's gauge eased for the third month to an 18-month low of 52.2 from April's cyclical high of 84.6—which wasn't far from its record high of 91.1 in the mid-1970s. Dallas saw its prices-paid measure sink to a 20-month low of 38.4 this month, slowing sharply from November's record-high 83.3. Prices-paid in the Richmond region eased for the second month to 124.9 from May's record-high 150.1. Turning to prices-received, New York's measure eased for the fourth month this month, from a record-high 56.1 in March to a 16-month low of 31.3, while Philadelphia's is at 30.3, down from October's cyclical high of 62.9. Dallas' eased to a 17-month low of 29.3 from its record-high 50.9 in October. Meanwhile, Richmond's eased to 89.2 from last month's record high of 103.1.

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