

Economic Indicator — June 20, 2024

Residential Construction Pulls Back in May

Broad Based Weakness Highlights the Headwinds from Elevated Interest Rates

Summary

New Home Construction Slumps to the Slowest Pace in Four Years

Nearly pulling back all of April's sequential gain, total housing starts fell 5.5% in May to 1.277 million units—the slowest annualized pace in four years. Weakness was broad based as both single and multifamily starts fell on the month. The forward-looking permit activity was also soft, suggesting builders have become less optimistic about prospective demand given persistent inflation and the higher-for-longer interest rate environment.

We anticipate interest rates to remain elevated in the near term, though project two Fed rate cuts in the second half of the year—September and December—that, if realized, would likely lead to a gradual lowering of mortgage rates and support new construction. The scarcity of existing homes on the market should benefit new construction, though affordability remains a substantial challenge for many homebuyers, particularly those purchasing for the first time. Housing demand is expected to remain reasonably firm reflecting the still-healthy labor market and supportive demographic trends. Sustained higher mortgage rates, alongside elevated construction financing costs and a dearth of buildable lots and chronic labor shortages, continue to weigh on home builders' view about the outlook as evidenced by the second straight drop in the NAHB Housing Market Index in June.

Economist(s)

Sam Bullard

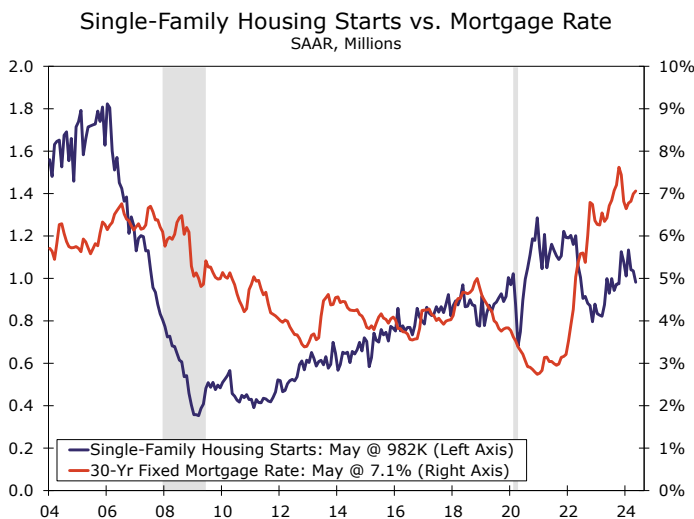
Senior Economist | Wells Fargo Economics
Sam.Bullard@wellsfargo.com | 704-410-3280

Patrick Barley

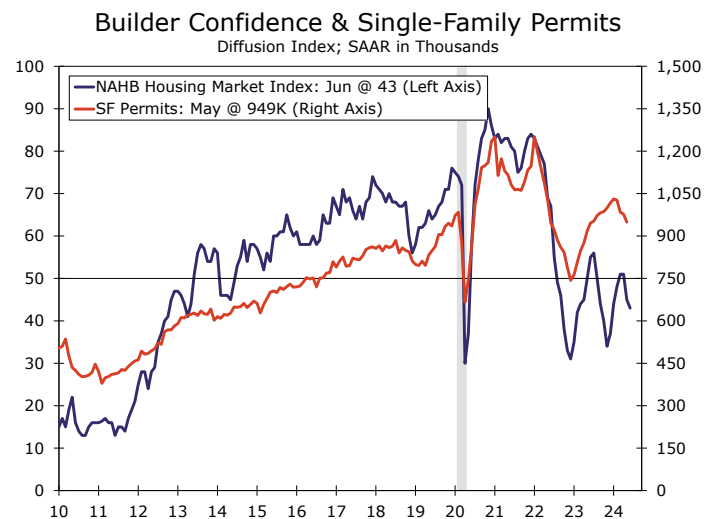
Economic Analyst | Wells Fargo Economics
Patrick.Barley@wellsfargo.com | 704-410-1232

Mortgage Rates Stifle Single-Family Construction

- Single-family starts dropped 5.5% in May, the third sequential slip. The 982K-unit pace is the slowest pace of construction since October 2023, the same month that mortgage rates peaked at 7.8%.
- High prevailing mortgage rates remain the millstone around the single-family market's neck. The average 30-year fixed rate reported by Freddie Mac averaged 7% in both April and May and is on course for a three-peat in June.
- Worsening home builder sentiment and a slip in single-family permits presage further slowdown in single-family construction. Single-family permits fell 2.9% over the month to a 949K-unit pace. Permits have fallen for four consecutive months as builders seem to be reassessing their construction plans in the face of worsening affordability conditions.
- To that point, the NAHB Housing Market Index (HMI) fell a further two points in June to 43, the lowest reading since December 2023. Home builders have stepped up their usage of price cuts and incentives to rope in buyers, but high mortgage rates and elevated financing costs continue to feed into overall builder pessimism.
- A dearth of supply in the resale market should continue to encourage new development to some degree. In April, nearly one-third of all homes for sale were new builds, more than double the pre-pandemic average of 13%.



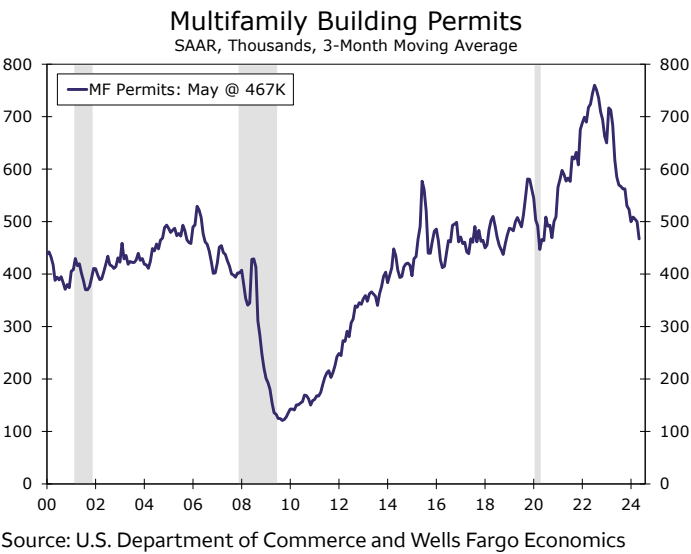
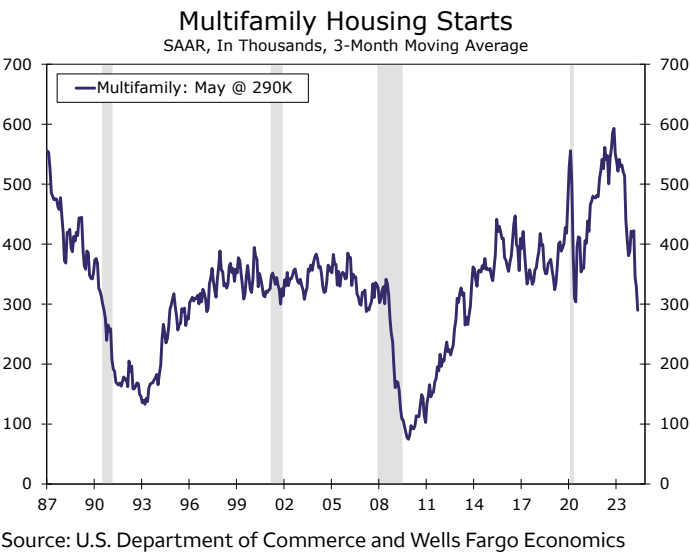
Source: U.S. Department of Commerce, Freddie Mac and Wells Fargo Economics



Source: U.S. Department of Commerce, NAHB and Wells Fargo Economics

Multifamily Remains Vexed by Higher Rates, Weakening Fundamentals

- Adverse single-family affordability has helped boost multifamily demand, but multifamily development remains on the downswing as robust incoming supply and high interest rates have prompted developers to hold off on starting new projects.
- To that effect, multifamily permits fell 5.6% in May to a 437K-unit pace, the lowest level since April 2020. Multifamily starts, which are more volatile month-to-month, fell 6.6% to a 295K-unit pace.
- The long downdraft in apartment construction is more apparent when looking at the annual growth numbers. Multifamily starts are running nearly 50% below their year-ago pace, and permits are down 29% over the year.
- We expect multifamily construction will likely weaken further in the back half of this year. Longer term, better balance in the apartment market, lower financing costs and easier access to credit should help multifamily development rebound.



Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Bank, N.A. ("WFBNA"). This report is not a product of Wells Fargo Global Research and the information contained in this report is not financial research. This report should not be copied, distributed, published or reproduced, in whole or in part. WFBNA distributes this report directly and through affiliates including, but not limited to, Wells Fargo Securities, LLC, Wells Fargo & Company, Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., and Wells Fargo Securities Canada, Ltd. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. WFBNA is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

This publication has been prepared for informational purposes only and is not intended as a recommendation, offer or solicitation with respect to the purchase or sale of any security or other financial product, nor does it constitute professional advice. The information in this report has been obtained or derived from sources believed by WFBNA to be reliable, but has not been independently verified by WFBNA, may not be current, and WFBNA has no obligation to provide any updates or changes. All price references and market forecasts are as of the date of the report or such earlier date as may be indicated for a particular price or forecast. The views and opinions expressed in this report are those of its named author(s) or, where no author is indicated, the Economics Group; such views and opinions are not necessarily those of WFBNA and may differ from the views and opinions of other departments or divisions of WFBNA and its affiliates. WFBNA is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this report, neither WFBNA nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this report, and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. WFBNA is a separate legal entity and distinct from affiliated banks, and is a wholly-owned subsidiary of Wells Fargo & Company. © 2024 Wells Fargo Bank, N.A.

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority ("FCA"). For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 (the "Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Act for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EFTA, this report is distributed by WFSIL. For recipients in the EU, it is distributed by Wells Fargo Securities Europe S.A. ("WFSE"). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in MiFID2. This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE