Economic Indicator — June 20, 2024

Residential Construction Pulls Back in May

Broad Based Weakness Highlights the Headwinds from Elevated Interest Rates

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Summary

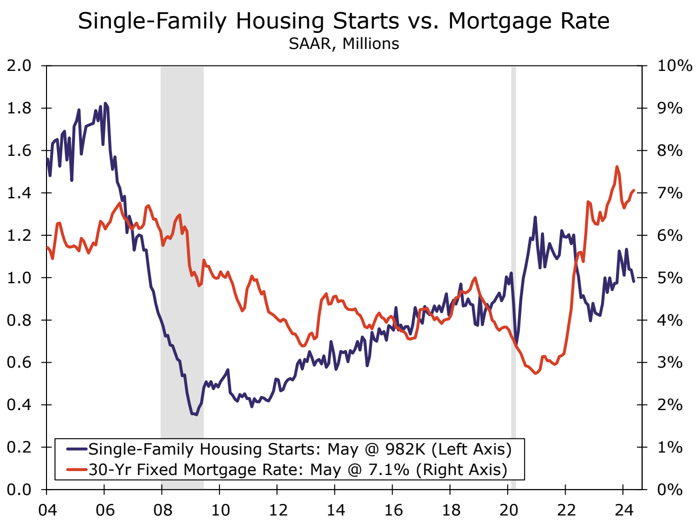
New Home Construction Slumps to the Slowest Pace in Four Years

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.

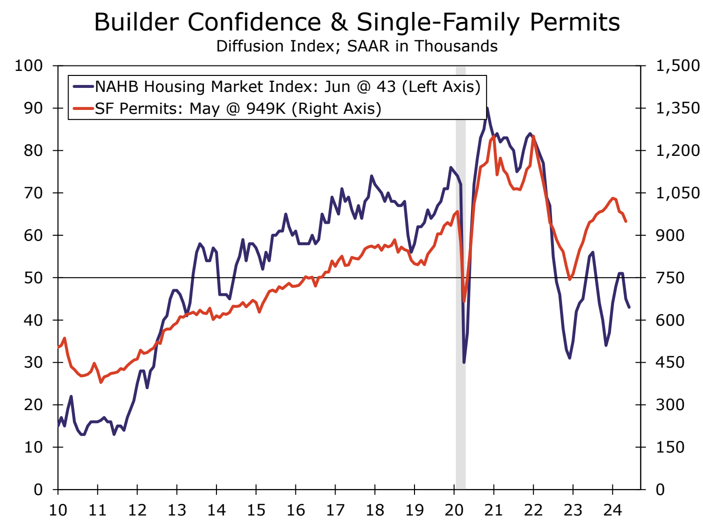
We anticipate interest rates to remain elevated in the near term, though project two Fed rate cuts in the second half of the year—September and December—that, if realized, would likely lead to a gradual lowering of mortgage rates and support new construction. The scarcity of existing homes on the market 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.

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%.



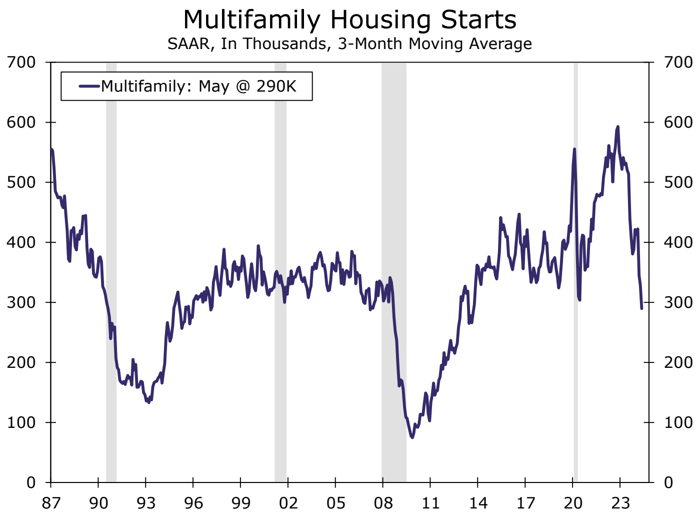
Source: U.S. Department of Commerce, Freddie Mac and Wells Fargo Economics



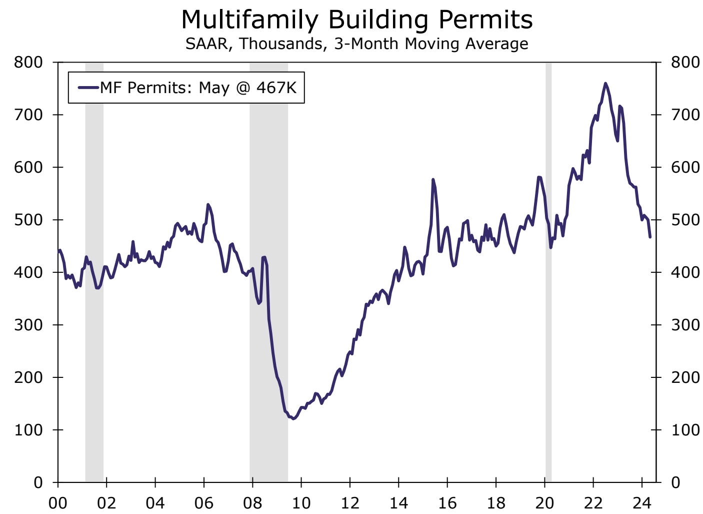
Source: U.S. Department of Commerce, NAHB and Wells Fargo Economics

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.



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



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

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