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Housing Starts Fell Sharply in July

Lower Mortgage Rates Not Yet Boosting the Residential Sector

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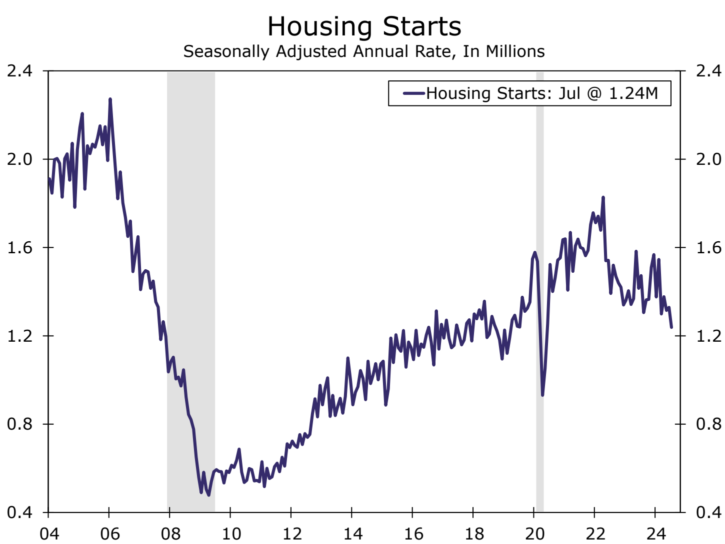
Summary

Rate Environment Still a Headwind for Residential

Residential construction continues to downshift under the pressure of high interest rates. Total housing starts fell 6.8% during July, a sharper than expected decline driven entirely by yet another pull-back in single-family starts. After out-performing over the past few years, single-family construction is now turning lower amid softening conditions in the new home market.

By contrast, multifamily starts improved for the second consecutive month in July. However, multifamily permits declined and gave back much of June's large gain, which suggests that multifamily development remains weak despite firming apartment market conditions and prospects for lower financing costs in the near future.

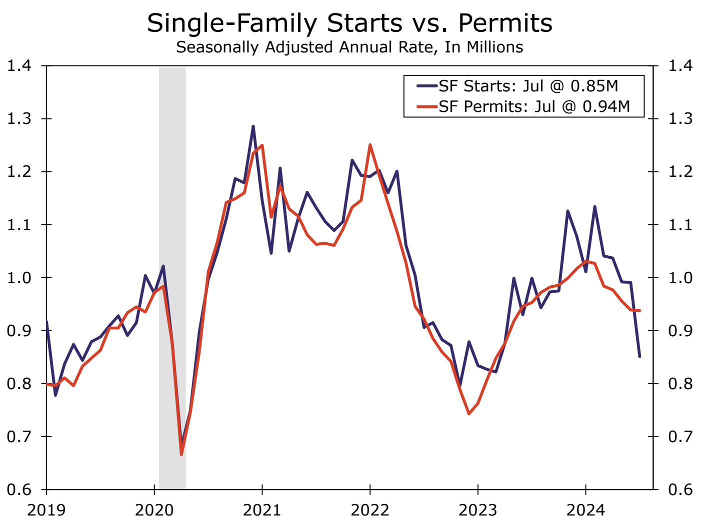
All told, the residential sector has yet to respond to lower mortgage rates, which have moved down in recent weeks amid increased expectations for rate cuts from the Federal Reserve. On top of the decline in new construction, mortgage applications for purchase have remained tepid in recent weeks. What's more, the NAHB Housing Market Index once again fell during August. Less restrictive monetary policy should eventually provide a lift, but the lethargic response so far is a reminder that a more challenging macroeconomic backdrop is likely adding to the headwinds posed by high interest rates.



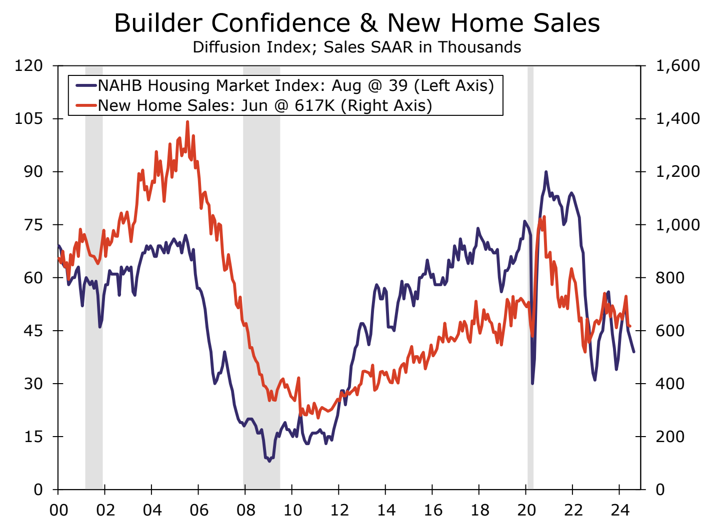
Source: U.S. Department of Commerce and Wells Fargo Economics

Single-Family in a Slumber

- After out-performing over the past few years, single-family construction is now turning lower amid softening conditions in the new home market. Single-family starts plunged 14.1% during July, the fifth straight drop and the sharpest decline so far this year.
- Single-family permits also pulled back, but the decline was much more modest. Permits registered a 938K-unit pace in July, just 0.1% lower than the 939K-unit pace in June.
- Lower interest rates should eventually provide a lift, however the recent slowdown in new home sales, higher inventory levels and dimming macroeconomic backdrop suggests further weakness lies ahead in the near term.
- The recent drop in 30-year mortgage rates, which currently stand at 6.6% according to Mortgage News Daily, has yet to boost housing activity. Although refinancing activity has picked-up notably, on balance, mortgage applications for purchase retreated during July and rose only modestly during the first two weeks of August.
- The NAHB Housing Market Index provides additional evidence that buyers have yet to be moved by lower mortgage rates. The headline index declined to 39 in August, a two-point monthly drop that was driven by commensurate declines in present sales and prospective buyer traffic. Builders are still holding out hope that a dip in mortgage rates will eventually boost demand. The "future sales" component rose for the second straight month August.



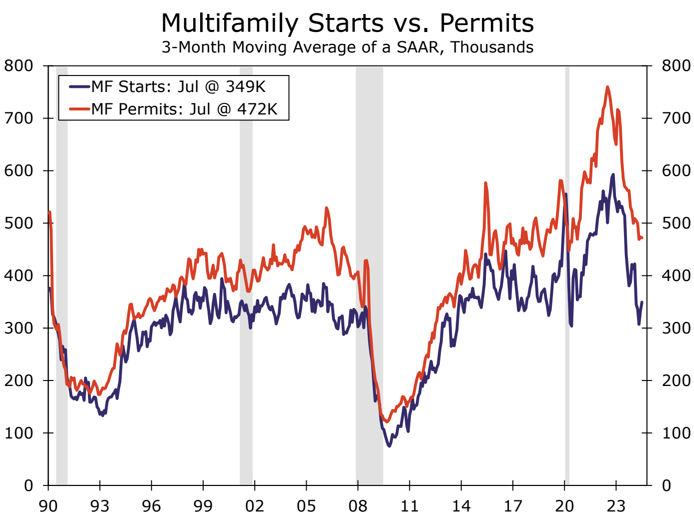
Source: U.S. Department of Commerce and Wells Fargo Economics



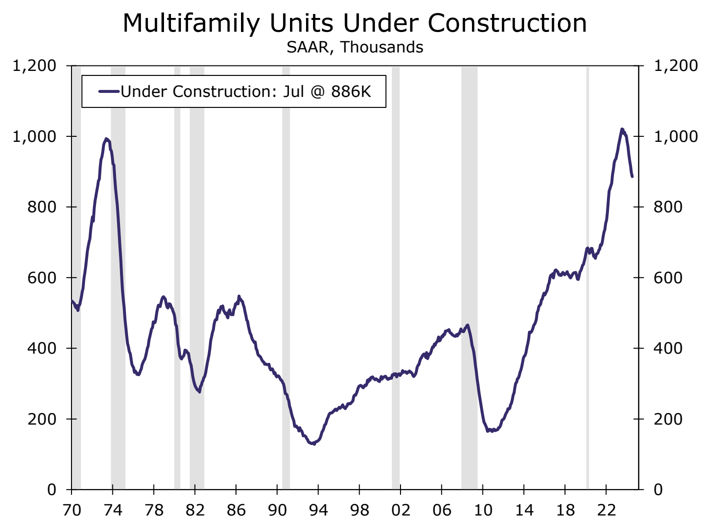
Source: NAHB, U.S. Department of Commerce and Wells Fargo Economics

Multifamily Still Finding Secure Footing

- Multifamily starts jumped 14.5% in July, the second straight monthly improvement. Multifamily development remains weak, however, with the pace of starts down 18.4% on a year-to-year basis. Furthermore, a decline in multifamily permits cuts against the upturn in starts and indicates a still-sluggish pace of development.
- The thinning project pipeline and uptick in project completions this year has allowed the count of units currently under construction to decline in recent months. Multifamily units under construction fell to 886K in July, down 13.2% from the cycle high of just over 1 million units reached last year.
- Less restrictive monetary policy should also bring about a turn in multifamily construction. Apartment market conditions have firmed recently, and decreased financing costs and better credit access should help more projects get started. That noted, modestly improved homebuyer affordability on account of reduced mortgage rates could cut into rental demand.
- All told, the residential sector has yet to respond to lower mortgage rates, which have moved down in recent weeks amid increased expectations for rate cuts from the Federal Reserve. Decreased borrowing costs should eventually provide a lift, but the lethargic response so far is a reminder that a more challenging macroeconomic backdrop is likely adding to the headwinds created by high interest rates.



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



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

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