

Economic Indicator — July 26, 2021

New Home Sales Were Surprisingly Sluggish in June

Summary

Softer Home Sales, But Not As Weak As They Appear

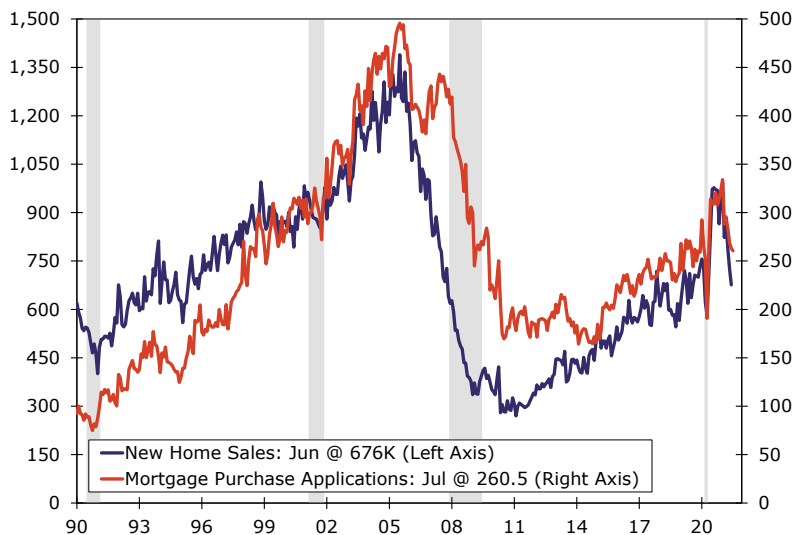
We had a sense that new home sales would disappoint in June and were expecting a number well below the 800,000-unit annual rate consensus. The actual print was even lower, with new home sales dropping 6.6% in June to a 676,000-unit pace, and sales were revised down by a cumulative 90,000 units during the prior three months. Since peaking at a 993,000-unit annual rate in January, new home sales have lost considerable momentum. The drop in sales reflects sticker shock on the part of buyers, some shifting in buyers' attention toward services spending and a high degree of restraint on the part of home builders. The latter is the most important. Many home builders are limiting sales in new communities due to ongoing supply shortages of building materials, HVAC equipment and appliances. The impact of these sales caps are exacerbated by the seasonal adjustment process. Supply chain woes are not only the underlying thread behind the home sales shortfall but are also likely chipping away a few percentage points from economic growth elsewhere.

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New Home Sales vs. Mortgage Purchase Applications
 SAAR, Thousands; Index 1990=100



Source: U.S. Department of Commerce, Mortgage Bankers Association and Wells Fargo Securities

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Home Sales Come in Well Below Expectations

We had a sense that new home sales would disappoint in June and were expecting a number well below the 800,000-unit annual rate consensus. The actual print was even lower, with new home sales dropping 6.6% in June to a 676,000-unit annual rate, and sales revised down by cumulative 90,000 units during the prior three months. Since peaking at 993,000-unit annual rate in January, new home sales have lost considerable momentum. The downward revision will likely lead to some downward revisions to Q2 GDP, as home sales drive spending for a wide variety of goods and services, ranging from home furnishings to pest control.

While there have already been a number of calls projecting that housing has peaked for the cycle, we do not see the recent pullback in sales as all that dire. There are at least three issues currently restraining new home sales. Home prices skyrocketed late last year, triggering some hesitancy on the part of buyers. The hesitancy came at a time when there were a growing list of distractions, as many consumers have increased spending on travel and leisure. Finally, home builders have been limiting sales at new home communities because they are having a tough time securing the materials, workers and appliances needed to build a new home. The important point is that home builders are still selling virtually everything they build. Inventories of completed homes, while they have increased slightly, remain near an all-time low.

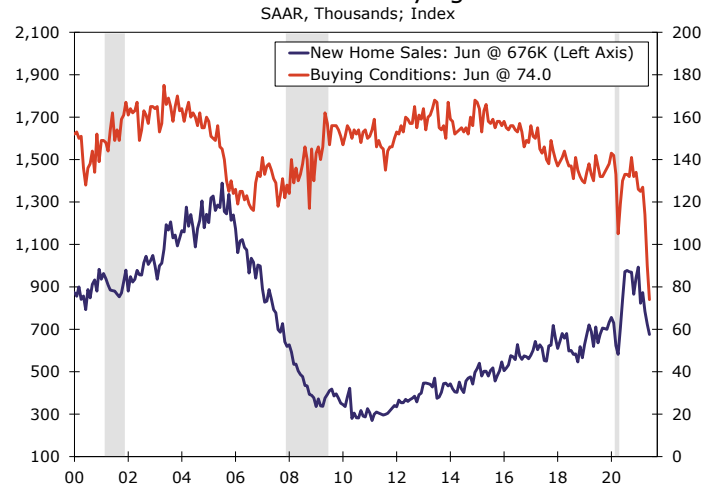
Demand For New Homes Remains Strong at the Upper End

There have been plenty of signs that new home sales were coming under pressure. Consumer confidence surveys had reported a record decline in the proportion of households that felt now was a good time to buy a home, and the proportion of consumers stating they planned to buy a home has been trending lower since the start of the year.

Some of the pullback reflects higher new home prices, but a bigger problem is the lack of lower priced homes available for sale. One way of seeing this is to look at the split between the rise in the median price of a new home, which rose 6.1% over the past year to \$361,800, and the average price of new home, which jumped 12.1% over the past year to \$428,700. The larger rise in the average home price reflects the growing share of new home sales occurring at higher price points and the smaller share of sales occurring at lower price points. New homes priced \$500,000 or more have risen to 28% of new home sales from just 15% last June, while homes priced below \$300,000 have fallen to just 29% of new home sales, down from 39% a year ago.

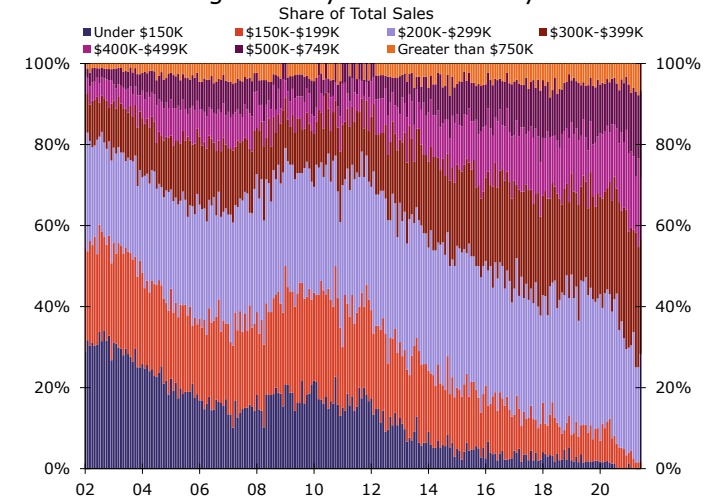
Sales at the upper end are being driven by the affordability migration away from higher cost housing markets on the West Coast and Northeast to lower cost areas in the Mountain West and South. The influx is also triggering an affordability migration in those receiving markets, sending buyers to outlying areas and secondary markets, where the large national builders tend to have a smaller presence.

New Home Sales vs. Buying Conditions



Source: U.S. Department of Commerce, The Conference Board and Wells Fargo Securities

New Single-Family Homes Sold by Price



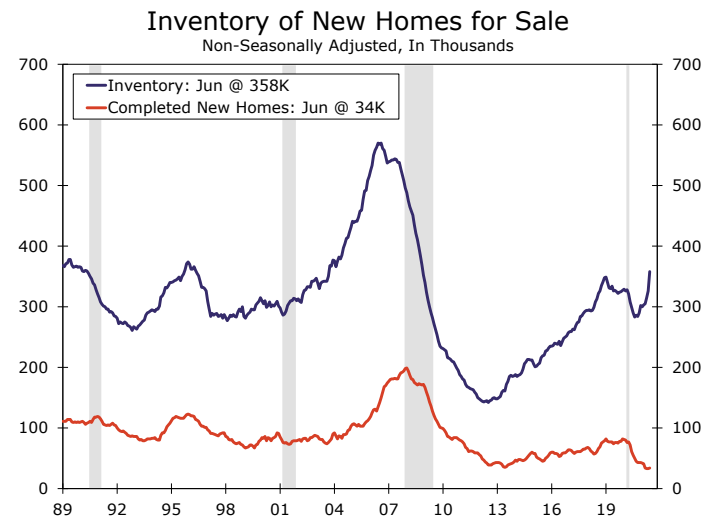
Source: U.S. Department of Commerce and Wells Fargo Securities

Home Builders Are Still Selling Nearly Everything They Build

One of the items highlighted in this morning's weaker new home sales report was that the inventory of new homes available for sale jumped to 6.3 months. On the surface, this would signal that home builders might need to slow construction because they had too many unsold homes. That does not appear to be the problem, however. Builders have already slowed new construction, due to the ongoing challenges in securing lots, building materials, labor and appliances. These challenges have made it difficult to estimate costs and price new homes. As a result, many builders have been limiting sales.

The actual number of new homes available for sale has been increasing. On a seasonally-adjusted basis, the number of homes available for sales rose by 23,000 homes at the end of June to 353,000. By comparison, there were just 301,000 new homes available for sale last June. Most of the increase in inventories has come from homes where construction has not yet started (+48,000) and homes that are under construction (+33,000). The inventory of completed homes has fallen by 29,000 over the past year and remains near all-time lows.

We expect supply chain woes to gradually subside during the second half of 2021 and look for sales and new home construction to rebound modestly from their current levels. We also are looking for new home prices to moderate, as lower lumber prices allow builders to boost construction of more modestly priced homes, primarily in the South and Southwest.



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

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