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February New Home Sales: Fading Sales Still More About Supply Than Demand

- > New home sales fell to an annual rate of 772,000 units in February from January's (revised) sales rate of 788,000 units
- > Months supply of inventory stands at 6.3 months; the median new home sale price rose by 10.7 percent year-on-year

Total new home sales fell to an annualized rate of 772,000 units in February, between our forecast of 757,000 units and the consensus forecast of 801,000 units, with modest upward revisions to prior estimates of sales over the prior three months. On a not seasonally adjusted basis, there were 65,000 new home sales in February, matching our forecast and up slightly from 64,000 sales in January. As we noted in our weekly *Economic Preview*, however, February is typically a seasonally strong month for new home sales, with an average February increase of 13.4 percent over the 2000-2020 period. As such, the seasonal factor used to derive the estimate of the headline (i.e., seasonally adjusted and annualized) sales number is geared up for an increase much larger than the 1.6 percent increase seen this February, hence the middling headline sales number. The relevant question, of course, is why sales this year underperformed February norms. While higher mortgage interest rates may have taken some of the steam out of demand for new home purchases, we'd argue that supply-side constraints remain the biggest drag on sales. That builders are facing constraints on materials and labor supply is not a new story, but materials constraints have become even more binding over recent months, leading many builders to lower the voluntary sales caps they've had in place since mid-2021. That order backlogs continue to grow, on both ends of the supply pipeline, is a sign that higher mortgage rates have not choked off demand. To be sure, the higher mortgage rates go, the more of a threat posed to demand, but the reality is that it will take some time before builders make a dent in current order backlogs.

As noted above, the not seasonally adjusted data show sales of 65,000 units in February, bringing the running 12-month total of not seasonally adjusted sales, which we consider the best gauge of the underlying sales trend, down to 753,000 units. As illustrated in our top chart, this is the lowest 12-month total since August 2020, and February marks the ninth straight monthly decline. Given the strength of new home sales last spring and the extent to which new construction is impaired this spring, the running 12-month total of sales will fall even lower. As we often note, new home sales can be booked at any stage of construction, i.e., prior to construction having been started, while construction is underway, and after the unit has been completed. For a time, sales of units on which construction had not been started were accounting for an elevated share of total new home sales, but this became less and less feasible for builders as supply-side conditions became more challenging. In addition to losing control over delivery times, these pre-construction sales were exposing builders to an increasing degree of price risk, given the extent to which materials costs were rising.

Builders have responded by starting homes but not releasing them for sale until construction is well underway. This affords them some, though to be sure far from complete, control over delivery times and passes price risk over to the buyer. One way this shift shows up in the data is the rising share of sales accounted for by units under construction, which has been hovering around 50 percent over the past several months. Additionally, under construction units have been accounting for roughly two-thirds of new homes for sale, well above normal, as the share of new homes for sale accounted for by completed units hovers near all-time lows. As we've noted over recent months, we think this shift in sales tactics has led some to mistakenly conclude there has been considerable progress on the supply side of the market. The increase in under construction units has indeed led to an increase in spec inventories, or, inventories of completed and under construction units. But, we've referred to this as "spec lite" construction, as builders are taking on very little carry risk and are indeed passing price risk along to buyers. That these under construction units continue to sell quickly is a sign that demand continues to hold up – many builder communities boast long waiting lists – even with higher mortgage rates. If that changes, builders can quickly cut back on "spec" starts.

As indicated in our bottom chart, builders are still able to pass higher costs along to buyers. While the median new home sales price was up 10.7 percent year-on-year in February, we think it merits mention that the average new home sales price hit \$511,000 in February, the highest on record. At some point, something has to give, and in this case there will likely be some give on both the supply side and the demand side of the market. When that will happen, however, is anyone's guess.

