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May Residential Construction: Single Family Segment Fares Better Than Expected

- Total housing starts fell to an annualized rate of 1.549 million units; total housing permits fell to an annualized rate of 1.695 million units
- Single family starts fell to 1.051 million units and single family permits fell to 1.048 million units (seasonally adjusted annualized rates)
- Multi-family starts fell to 498,000 units and multi-family permits fell to 647,000 units (seasonally adjusted annualized rates)

Total housing starts fell to an annual rate of 1.549 million units in May, well below our well-below-consensus forecast of 1.611 million units, while total housing permits fell to an annual rate of 1.695 million units, above our forecast of 1.656 million units but far below the consensus forecast of 1.778 million units. The declines in housing starts and permits seem to fit snugly into the narrative that higher mortgage rates are crushing the housing market, at least for those who go no further than the headline numbers. As our regular readers know, however, we pay virtually no attention to the seasonally adjusted and annualized data on residential construction and home sales, and instead focus on the not seasonally adjusted data. Additionally, we also pay attention to the mix of construction activity between the single family and multi-family segments of the market. In that sense, the May data are better than we expected, as the unadjusted data show both single family permits and starts topped our forecasts while multi-family permits and starts fell short of our forecasts. To be sure, single family construction and sales are feeling the weight of higher mortgage rates, but demand hasn't suddenly dried up and the market remains undersupplied. And while one can never draw meaningful conclusions from one month of data, particularly in the highly volatile multi-family segment of the housing market, it could be that the combination of a massive backlog of under construction units, higher interest rates, and expectations of a slowing labor market are causing some to re-think the extent to which additional multi-family development makes sense.

The not seasonally adjusted data show total starts of 138,300 units in May, below our forecast of 145,700 units but, as noted above, this miss reflects multi-family starts falling well short of our forecast. There were 93,600 single family units started in May, topping our forecast of 91,600 units. At the same time, prior estimates of single family starts in March and April were revised higher, with the data now showing a two-month total of 207,500 starts. As we've noted, single family starts shot higher in March and April as mortgage interest rates were beginning to rise, which to some extent reflected a push to beat even higher rates

down the line, and we expected the May data to bring some payback. While this seems to have been the case, one thing we thought would stem the decline in single family starts is that builders are still sitting on significant backlogs of unfilled orders. It is worth noting that, aside from the burst in March and April, May's total of single family starts is the highest monthly total since last August.

On a not seasonally adjusted basis, there were 148,900 housing units permitted in May, topping our forecast of 146,300 units. As with starts, however, single family permits topped our forecast while multi-family permits fell short of our forecast. There were 95,000 single family permits issued in May, down from the rate-induced spikes in March and April but aside from these two months the highest monthly total since last June. That single family permits and starts held up as well as they did in May will be lost on those not making it further than the headline (i.e., seasonally adjusted and annualized) numbers, but is to us worth noting. To be sure, the hurdles are now higher, with mortgage rates pushing over six percent, and while we expect single family activity to fall over coming months, there is still considerable underlying demand for single family home purchases in a market that for over a decade now has been chronically undersupplied. Higher mortgage rates will narrow that divide, but they will not eliminate it.

Both single family and multi-family completions rose in May, with the highest monthly total of multi-family completions since last July. At the same time, however, backlogs of under construction units grew further in both the single family and multi-family segments. As of May, there were a total of 1.670 million housing units under construction, second to only August 1973 as the highest total on record. Additionally, there were a total of 287,600 housing units which had been permitted but not yet started, of which 157,600 were single family units. Though the data on construction pipelines tend to be overlooked, the reality is that supply chain challenges remain a drag on completions. As such, these backlogs will keep builders busy for some time to come even as current demand eases due to higher mortgage rates and a slowing economy.

