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### August New Home Sales: A Welcome Break, Nothing More If Even That

- > New home sales rose to an annual rate of 685,000 units in August from July's (revised) sales rate of 532,000 units
- > Months supply of inventory stands at 8.1 months; the median new home sale price rose by 8.0 percent year-on-year

Under the heading of "if something seems too good to be true it probably is," total new home sales rose to an annualized rate of 685,000 units in August, much stronger than either we (574,000) or the consensus (500,000) expected. On a not seasonally adjusted basis, there were 55,000 new homes sold in August, besting our forecast of 47,000 sales, reflecting a 27.9 percent increase from the 43,000 sales in July. Recall that mortgage interest rates dipped in August, and many builders reported that buyers were quick to respond. With new home sales booked at the signing of the sales contract, that would help account for the strength in new home sales seen in the unadjusted data. At the same time, August has historically been a slow month for new home sales; over the 2000-2021 period, the average August decline in new home sales was 4.1 percent. With the seasonal adjustment factors geared for a decline in sales, the 27.9 percent increase in unadjusted sales this August was magnified by seasonal adjustment, helping account for the lofty headline sales number. Of more importance, whether the strength in August new home sales is genuine or the product of favorable seasonal adjustment and the inherent volatility in the Census data, don't expect it to last. Any relief brought by the dip in mortgage interest rates in August is but a distant memory given the extent to which mortgage interest rates have risen over recent weeks.

As noted above, the not seasonally adjusted data show 55,000 new home sales in August. Our miss on our forecast of unadjusted sales is entirely due to the South region, where the 37,000 sales were more than we anticipated. On a year-to-date basis through August, there have been 469,000 new home sales in 2022, down 14.3 percent from the same period in 2021. Year-to-date sales are down 25.9 percent in the Northeast, 25.4 percent in the Midwest, 16.5 percent in the West, and 10.6 percent in the South.

At August's sales pace, the supply of new homes for sale is equivalent to 8.1 months of sales. Spec inventories of new homes for sale (units either completed or under construction) were down slightly in August but were nonetheless 26.8 percent higher year-on-year. As we have discussed over the past several months, a shift in tactics amongst builders in mid-2021 – starting units but not releasing them for sale until construction was well underway – resulted in a sharp increase in spec inventories (in the form of units under construction) when sales began to decline. While builders have been more aggressive with incentives to help move these units, it is interesting that the increase in sales in August came from units already completed and units on which construction had not yet started, with sales of under construction units falling. We will note that the data on the composition of sales and inventories by stage of construction is prone to sizable revision, but as the data now stand under construction units now account for over two-thirds of all new homes for sale, with the share of for-sale units accounted for by completed homes rising to 10.3 percent in August after having hit an all-time low of 7.7 percent in June.

It should be noted that the new home sales figure reported by the Census Bureau is a gross sales number, not a net sales number. In other words, the Census data do not account for cancellations. Once a new home goes under contract, regardless of the stage of construction at which it does so, that unit is booked as a new home sale. Invariably, some portion of sales contracts are ultimately cancelled, but builders have reported that cancellations have risen significantly of late. For instance, in times of rapidly rising mortgage interest rates, someone who signed a sales contract before having their mortgage rate locked may find that, when they are quoted a rate, they may be either unable or unwilling to go ahead with the purchase given what their monthly mortgage payment would be. As such, given the recent jump in cancellations, the Census Bureau data are overstating new home sales. To be sure, as market conditions improve and previously cancelled sales turn into actual sales, the Census Bureau data do not pick this up, as they only register the original sale, meaning that new home sales will be understated. Over time, cancellations are a wash in the data, but at present new home sales are being overstated. It could be that, given the extent to which mortgage rates have risen to date, cancellations will begin to tail off, barring a significant weakening in labor market conditions. That said, higher rates will mean fewer sales contracts being signed so, either way, builders will be facing further declines in sales in the months ahead.

