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May Existing Home Sales: Steady Improvement But An Uncertain Path Ahead

- Existing home sales rose to an annualized rate of 5.350 million units in May from April's sales rate of 5.090 million units.
- Months supply of inventory stands at 5.1 months; the median existing home sale price rose by 7.9 percent on a year-over-year basis.

Existing home sales rose to an annualized rate of 5.350 million units in May, the highest monthly sales rate since July 2013, with sales rising in each of the four broad geographic regions. The median existing home sales price rose 7.9 percent, year-over-year, sustaining what over the past four months has been a notable acceleration in the pace of house price appreciation. In our weekly *Economic Preview* we noted the faster pace of price appreciation may help draw out more prospective sellers and help relax what have been lean levels of inventory. To some extent, this appears to be the case, as inventories posted an atypically large increase for the month of May but nonetheless the months supply metric dipped to 5.1 months thanks to May's heady sales rate. This will be a key factor to watch over coming months – the extent to which relaxing inventory constraints help cool down the pace of price appreciation which, with mortgage rates likely to drift higher over coming months, will be critical in sustaining sales in many markets.

As our regular readers are by now aware, we are always somewhat skeptical of the housing data – permits, starts, and sales – expressed in terms of seasonally adjusted annualized rates, and our preference is to look at 12-month moving sums of the raw (i.e., unadjusted) data to gauge the underlying trends. The top chart highlights the difference between the annualized headline number and the 12-month moving sum of unadjusted sales. So, while the adjusted May headline number overstates the improvement in sales, the unadjusted data show 5.049 million existing home sales over the past twelve months, a figure last seen in late 2007 (barring late 2013, when active investors were snapping up distressed properties).

Another under-the-headline trend we have been highlighting for the past several months is the diminished share of distress sales. In May, distress sales accounted for 10 percent of overall sales, below May 2014 and well below the cyclical peak. Doing some back of the envelope calculations yields a 10 percent year-on-year increase in nondistress sales in May, sustaining a trend that began back in 2014 even as the adjusted headline sales number was drifting lower. But, one factor we do not quite have a handle on is the fate of what, despite a considerable paring down, remains a well above-average inventory of distress. It would figure that sturdier price appreciation would draw some of this inventory back on the market, but whether or to what degree that happens remains an open question.

It does, however, seem clear that for some time now lean inventories have been acting as a drag on sales. Inventories of existing homes for sale were up 3.2 percent in May which may not seem too large of an increase but May is a month in which inventories typically show little change (the NAR's inventory data are not seasonally adjusted). That said, the months supply metric remains consistent with an undersupplied market which, as noted above, has helped fuel faster price appreciation. If mortgage interest rates do indeed rise over coming months, the combination of higher prices and higher interest rates could pose too high of a hurdle for first time buyers. Since the end of the downturn, the share of homes sold to first time buyers has been well below typical levels. In May, first time buyers accounted for 32 percent of total existing home sales, still below normal but higher than for some time. But, it will remain to be seen whether or not price appreciation holds at its current pace and, if so, whether or not this prices prospective first time buyers out of the market, particularly given our expectations for mortgage rates.

There are many cross currents below the headline existing home sales numbers. Improving job and income growth have supported steady, if not stellar, growth in demand. Still, yet to be resolved questions on inventories, price appreciation, and mortgage interest rates make for an uncertain path going forward.

