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May New Home Sales: Further Improvement In New Home Sales

- > New home sales rose to an annual rate of 546,000 units in May from April's (revised) sales pace of 534,000 units.
- > Months supply of inventory stands at 4.5 months; the median new home sale price fell by 1.0 percent on a year-over-year basis.

New home sales rose to an annualized rate of 546,000 units in May, ahead of expectations and up from an upwardly revised sales rate of 534,000 units in April (prior estimates for both February and March were revised higher). May's sales rate marks the fastest monthly sales rate since February 2008. At the same time, however, inventories of new homes for sale remain notably lean, with the month supply metric falling to 4.5 months, the lowest since June 2013.

It is worth noting mortgage interest rates rose appreciably in May, so part of the increase in new home sales, which are booked at contract signing, could reflect prospective buyers who had been sitting on the fence hurriedly jumping off, perhaps with some enticement from builders (who no doubt were in full compliance with OSHA fence jumping safety standards), to avoid even higher rates. In our write-up of the May existing home sales report we expressed concern as to the impact of rising mortgage interest rates on home sales, and it will be interesting to watch new home sales in the month ahead as they will give a more timely read of any adverse impact of higher mortgage rates than will existing home sales, which are booked at closing.

As we routinely point out the data on new residential construction and home sales are best viewed in the context of the underlying trends in the not seasonally adjusted data. Especially new home sales, which is one of the most inherently volatile data series out there and one subject to a sampling error so large so as to render the headline number irrelevant. Our preferred means of viewing the new home sales data is to take the 12-month moving sum of the raw (i.e., not seasonally adjusted data), which shows the underlying trend beneath the month-to-month gyrations in the headline sales numbers. Over the past 12 months the raw data show 482,000 new homes have been sold, the highest running 12-month total since late 2008. On this basis, the message in the May new home sales report is the same as it has been for the past several months – steady albeit slow improvement. To help illustrate this point the middle chart shows the not seasonally adjusted sales data, note in both April and May the raw data show 51,000 new home sales making these the strongest months since August 2007. Thus far in 2015 sales in each month topped sales in the same month a year ago, which was not the case in 2014.

As is the case with existing home sales, inventory constraints are likely acting as a brake on the pace of new home sales. It is, however, worth noting inventory constraints are less binding with new home sales, as new home sales can occur when the unit is completed, when it is under construction, or even before construction has started. Hence, with inventories of "physical" homes for sale (i.e., either completed or under construction) up from historical lows but only marginally so, sales of homes on which construction has not yet started continue to account for an outsized share of all new home sales – 35.3 percent in May. This is a clear signal that inventories are tight. While there is every reason to expect inventories to rise over coming months, there is little reason to expect inventories to rise at anything resembling a rapid pace. The bottom chart shows completions of single family units intended for sale in each of the four broad Census regions (recall over 30 percent of single family starts are not placed on the market for sale). We present the data in comparison to the average seen over the 2000-2002 period, which we refer to as the last "normal" years seen in the housing market. So, even forgetting about the excesses seen during the pre-recession years, the pace of new single family construction is nowhere near anything that could be considered normal. Still, to some extent, what builders are missing out on in volume they are making up for in margins, as sales of homes priced at or above \$300,000 continue to account for an atypically high share of all new home sales.

We have from day one said the journey back to normal housing market conditions will be a slow one and, the better headline number notwithstanding, the May report on new home sales does nothing to change our view.

