

Economics Group

Special Commentary

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Housing Chartbook: September 2018

Still Having Trouble Exiting the Soft Patch

Housing remains in a soft patch, with sales, new home construction and, more recently, home prices all moderating from their already meek trajectory. The loss of momentum since this spring is notable because it has come at a time when overall growth has strengthened. The housing market appears to be struggling with a number of cyclical and secular challenges. Stronger growth has bolstered demand for new and existing homes, particularly those priced around the median home price or less. Inventories of homes at these price points remain exceptionally lean, however, which has allowed prices to rise much faster than incomes and their historic norms in many markets. At the upper end, demand for homes has clearly weakened, as rapid price gains over the past few years coupled with rising mortgage rates over the past year have significantly reduced affordability. The new tax law, which limits the amount of mortgage interest that can be deducted and puts limits on deductions for state and local taxes, also appears to be sapping demand in higher-end markets, particularly in the Northeast and along the West Coast. In addition, a stronger dollar and slower growth abroad have reduced foreign demand for U.S. homes.

At this point in the business cycle, housing is unlikely to make a major breakout to the upside. The Federal Reserve is in the midst of raising short-term interest rates to a neutral level, which is likely at least a full percentage point higher than they are today. Mortgage rates will not likely rise as much but should still increase by at least a half a percentage point over the next year. Higher interest rates are already beginning to bite, with sales at the upper end weakening across much of the country. Higher-priced homes are remaining on the market longer than they used to, and inventories are rising, prompting many sellers to reduce their asking prices.

Demand for more modestly priced homes, which we define as homes priced 20% over the median or less, remains fairly strong. Half of the existing homes sold in August were on the market for less than a month. Moreover, inventories of more modestly priced homes remain exceptionally tight across much of the country. But even here, rising mortgage rates are making an impact. Tales of bidding wars have subsided and now appear to be relegated to just a handful of submarkets.

Housing remains in a soft patch, and a major breakout to the upside at this point in the business cycle is unlikely.

Figure 1

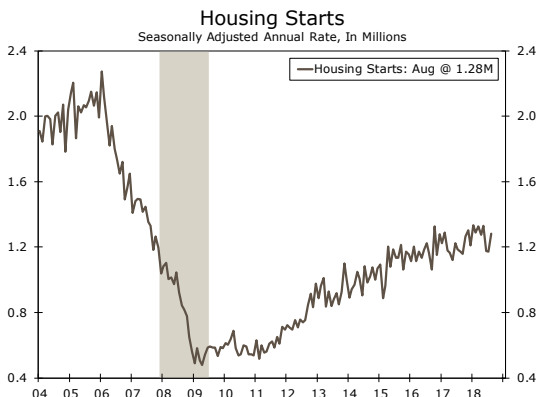
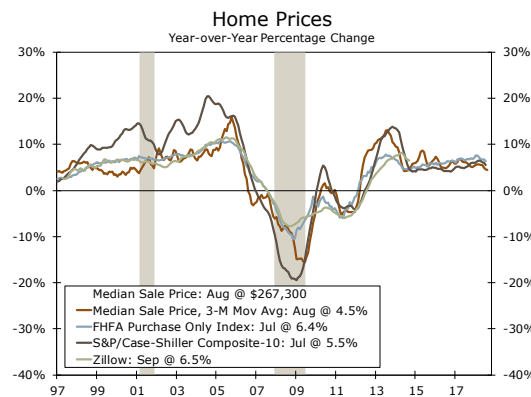


Figure 2



Source: U.S. Department of Commerce, NAR, FHFA, Zillow, S&P and Wells Fargo Securities



Rising home prices have pulled housing affordability lower over the past couple of years.

From a cyclical standpoint it is hard to see how the housing market will gain much momentum. While job growth remains strong and consumer confidence has soared, rising home prices have pulled housing affordability lower over the past couple of years. As a result, prospective buyers have pulled back, opting to either remain in their current homes or continue to rent. Rising mortgage rates will intensify this trend, as potential buyers do not have as many options to deal with reduced affordability as they have had in the past. In prior cycles, buyers would migrate toward less expensive homes or opt for adjustable-rate mortgages to bolster their purchasing power. Neither strategy offers much relief today, however, as there are even fewer homes to choose from at lower price points and adjustable-rate mortgages do not offer enough savings from fixed rates to justify the interest rate risk a borrower would take. Adjustable-rate mortgages accounted for just 6.5% of originations this past month, which is close to the average of the past eight years.

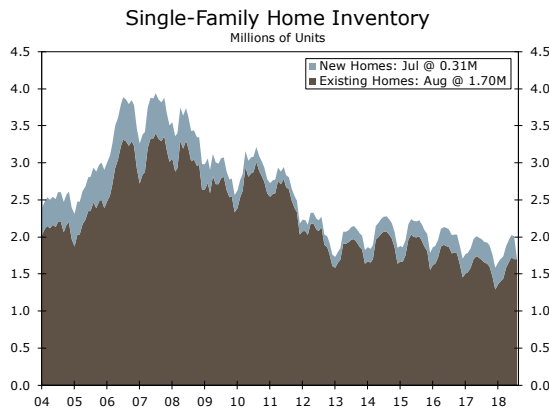
Overall existing home sales are expected to drop 1.0% drop in 2018. The decline is not all that surprising given that there have been 4.6% fewer homes for sale through the first eight months of 2018 than during the first eight months of 2017. While inventories were down 4.6%, sales have fallen just 1.5%, which means that homes are still selling relatively quickly. The inventory situation has been improving. After falling year-over-year for 39 consecutive months, inventories were unchanged in July and 2.7% higher on a year-over-year basis in August. Inventories of single-family homes are up 3.0%, while inventories of condos and co-ops are up 1.4%. Even with the gains, inventories are considerably lower than they were three years ago and well below their long-term norms. Tight inventories will likely keep a tight rein on home sales going forward, but with inventories now rising, home sales should rise too.

Rising construction costs have made it tougher for builders to profitably deliver homes at lower price points.

We still expect new home construction to be stronger during the coming year, although the magnitude of that improvement is slightly less than we expected earlier. Inventories of new homes have been rising in recent months, with most of the gain in homes not yet started. Much of the new lot supply has been in areas targeted for entry level homebuyers. We may see a bit of a rebound in homebuilding in coming months. Lumber prices have fallen from the highs hit earlier this summer, which may allow builders to restart projects put on hold earlier this year. The number of permitted but not started homes has increased substantially in recent months. A rebound in starts would likely send the seasonally adjusted numbers sharply higher, as starts typically decline late each year and were already poised to fall less than usual due to the slower pace maintained this summer.

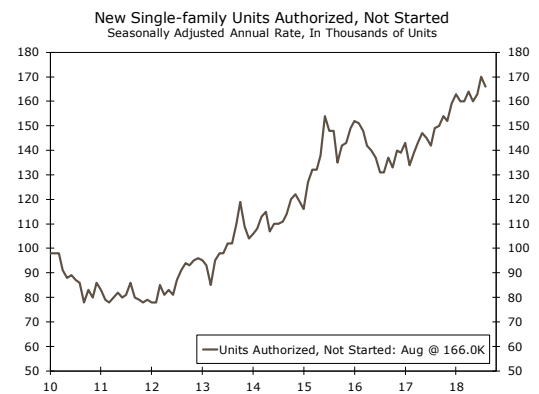
Our forecast has been extended and we see the business cycle continuing through 2020. Our GDP forecast is on the high side of consensus estimates for 2019 and 2020, which is why our home sales and new home construction forecast are also a bit stronger. The underlying fundamentals for housing remain positive, with stronger job and income growth boosting household formation. The supply issues plaguing the housing market and the delay in home buying by Millennials are not likely to change materially, however, which will continue to temper the improvement.

Figure 3



Source: U.S. Dept. of Commerce, NAR, Bloomberg LP and Wells Fargo Securities

Figure 4



National Housing Outlook

											Forecast	
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020		
Real GDP, Percent Change	1.6	2.2	1.8	2.5	2.9	1.6	2.2	2.9	2.8	2.2		
Residential Investment, Percent Change	-0.1	13.0	12.4	3.9	10.1	6.5	3.3	0.9	4.0	3.5		
Nonfarm Payroll Change (Avg. Monthly)	174	179	192	250	226	195	182	199	165	120		
Unemployment Rate	8.9	8.1	7.4	6.2	5.3	4.9	4.4	3.9	3.6	3.3		
Home Construction												
Total Housing Starts, in Thousands	608.8	780.6	924.9	1,003.3	1,111.8	1,173.7	1,202.9	1,295.0	1,375.0	1,425.0		
Single-Family Starts, in Thousands	430.5	535.3	617.7	647.9	714.5	781.5	848.9	925.0	1000.0	1055.0		
Multifamily Starts, in Thousands	178.3	245.3	307.2	355.4	397.3	392.2	354.0	370.0	375.0	370.0		
Home Sales												
New Home Sales, Single-Family, in Thousands	305.0	369.0	429.0	437.0	501.0	561.0	613.0	660.0	700.0	740.0		
Total Existing Home Sales, in Thousands	4,260.0	4,660.0	5,090.0	4,940.0	5,250.0	5,450.0	5,510.0	5,454.0	5,525.0	5,570.0		
Existing Single-Family Home Sales, in Thousands	3,787.0	4,128.0	4,484.0	4,344.0	4,646.0	4,838.0	4,892.0	4,843.0	4,910.0	4,952.0		
Existing Condominium & Co-op, in Thousands	477.0	528.0	603.0	591.0	608.0	614.0	619.0	611.0	615.0	618.0		
Home Prices												
Median New Home, \$ Thousands	227.2	245.2	268.9	288.5	294.2	307.8	323.1	337.4	350.2	363.2		
Percent Change	4.8	7.9	9.7	7.3	2.0	4.6	5.0	4.4	3.8	3.7		
Median Existing Home, \$ Thousands	166.1	176.8	197.1	208.3	222.4	233.8	247.2	261.5	275.5	289.1		
Percent Change	-3.7	6.4	11.5	5.7	6.8	5.1	5.7	5.8	5.4	5.0		
FHFA Purchase Only Index, Percent Change	-4.2	2.9	7.1	5.1	5.4	6.0	6.7	6.6	6.0	5.6		
S&P Case-Shiller C-10 Home Price Index, Percent Change	-3.5	0.3	11.7	7.9	4.6	4.5	5.3	5.8	5.3	4.9		
Interest Rates - Annual Averages												
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.27	0.52	1.13	2.13	3.06	3.19		
Prime Rate	3.25	3.25	3.25	3.25	3.27	3.52	4.13	5.13	6.06	6.19		
10-Year Treasury Note	2.78	1.80	2.35	2.54	2.14	1.84	2.33	2.95	3.49	3.51		
Conventional 30-Year Fixed Rate, Commitment Rate	4.46	3.66	3.98	4.17	3.85	3.65	3.99	4.60	5.09	5.11		

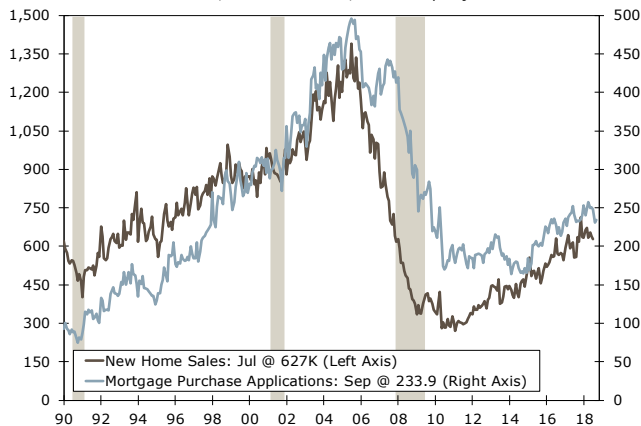
Forecast as of: September 25, 2018

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, FRB, FHFA, FHLMC, National Association of Realtors, S&P, Wells Fargo Securities

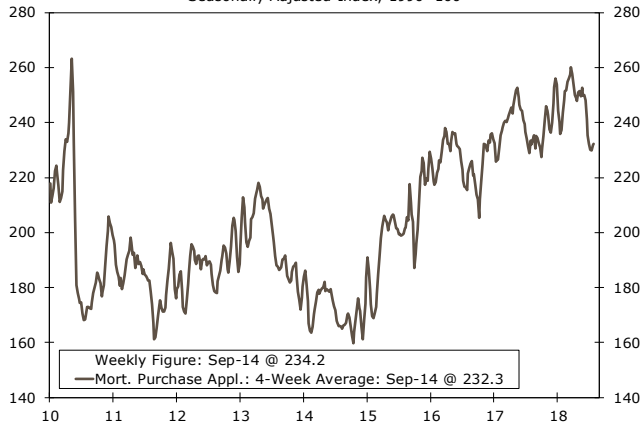
Mortgages

- Mortgage rates have followed Treasury yields higher, with the contract rate for a 30-year fixed rate mortgage climbing to 4.65% in mid-September. Rising rates are likely deterring home buying, as purchase applications have fallen 6.6% over the past three months. Refi applications have fallen 39.1% year-over-year, as fewer homeowners can achieve meaningful savings by refinancing at today's interest rates.
- With home buying cooling, price appreciation is also moderating. With less purchasing power, buyers are shifting to lower priced homes, leading to price cuts at the upper middle and upper end of the market.
- Mortgage originations rose 2.2% in Q2 and are up 3.8% from last year. Originations to buyers with low credit scores rose the most, contributing to the slight uptick in the subprime share to 8.5%.

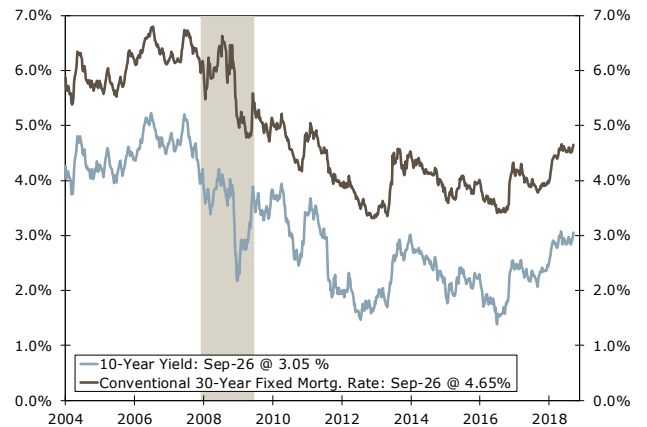
New Home Sales vs. Mortgage Purchase Applications
Thousands, Index 1990=100; Seasonally Adjusted



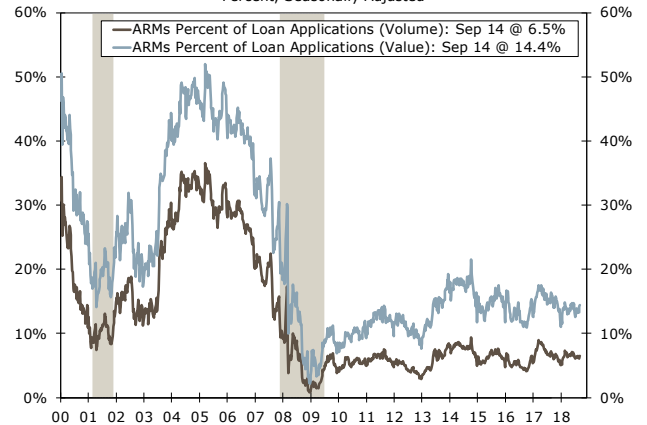
Mortgage Applications for Purchase Index
Seasonally Adjusted Index, 1990=100



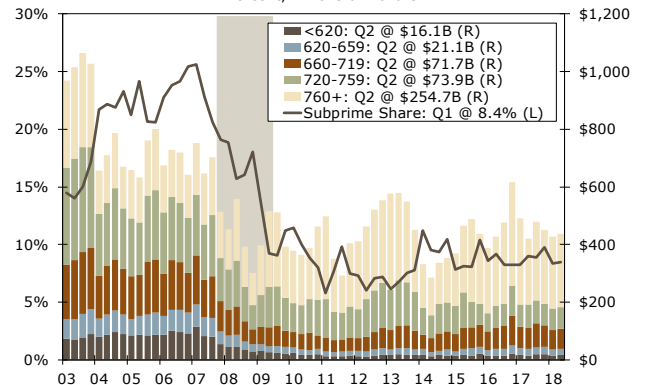
Conventional Mortgage Rate vs. 10-Year Treasury Yield
Percent



Mortgage Applications
Percent, Seasonally Adjusted



Mortgage Origination by Credit Score
Percent, Billions of Dollars

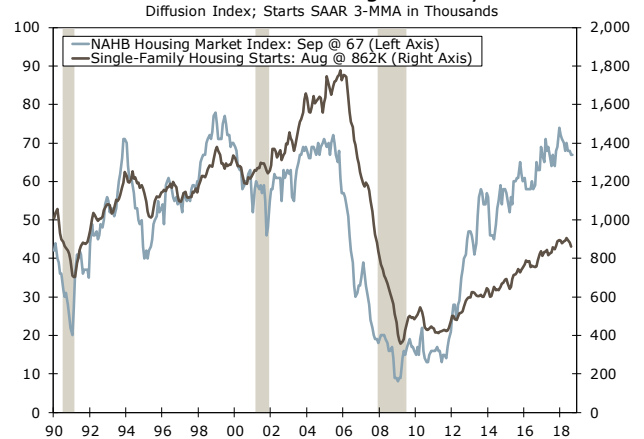


Source: MBA, FHLMC, Federal Reserve Board, U.S. Dept. of Commerce, FRBNY and Wells Fargo Securities

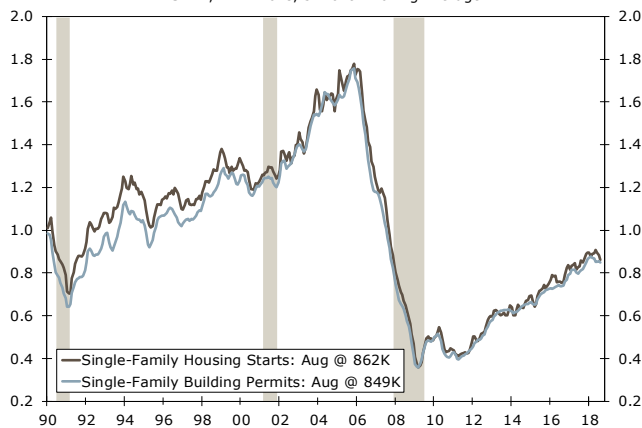
Single-Family Construction

- Single-family starts rose 1.9% in August to an 876,000-unit annual rate but remain well below the pace seen earlier this year. Single-family permits fell 6.1% in August and are now running 6.4% below starts, suggesting starts may weaken in coming months. Despite this moderation, builder confidence remains elevated, particularly in the South and West, which account for the overwhelming majority of single-family construction.
- Single-family completions were up 11.6% nationwide despite wet weather in the South, and the region's underlying momentum remains strong.
- Higher building material prices and the continued scarcity of labor appear to have caused builders to postpone some projects.

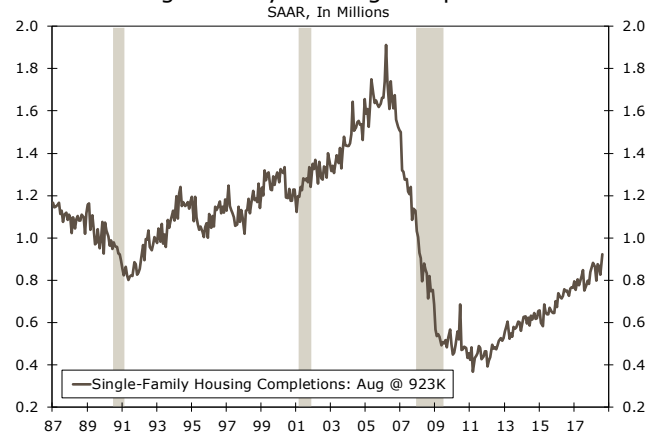
Builder Confidence & Single-Family Starts



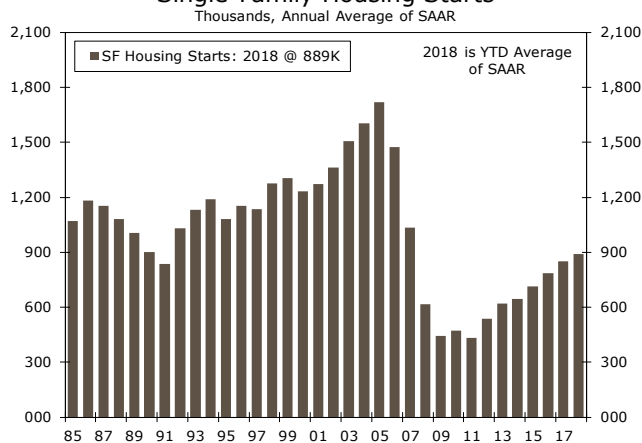
Single-Family Housing Starts vs. Building Permits



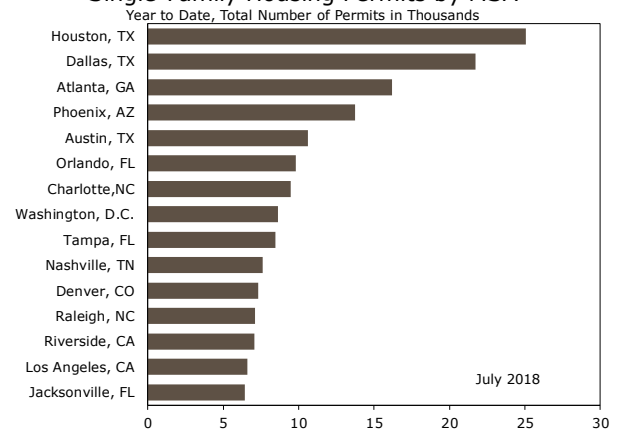
Single-Family Housing Completions



Single-Family Housing Starts



Single-Family Housing Permits by MSA

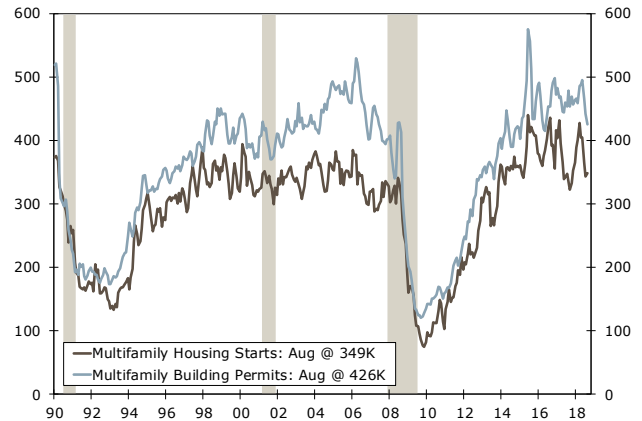


Source: U.S. Department of Commerce, National Association of Home Builders and Wells Fargo Securities

Multifamily Construction

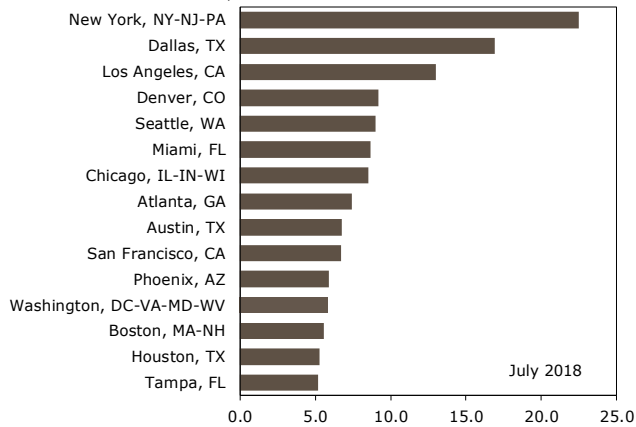
- Multifamily housing starts surged 29.3% in August, following declines during the prior two months. Permits declined 4.9%, however, marking their fifth consecutive drop. One a year-to-date basis, starts are running 8.5% ahead of last year, while permits are down 0.8%. Despite the gap, however, permits are still running over 16% ahead of starts on a year-to-date basis, which should give starts a boost later this year.
- This slowdown in permitting likely reflects rising vacancy rates in many of the markets where construction has been the strongest this decade. Rising building material costs and higher subcontractor costs are also likely causing many developers to delay some projects.

Multifamily Housing Starts vs. Building Permits
SAAR, In Thousands, 3-Month Moving Average



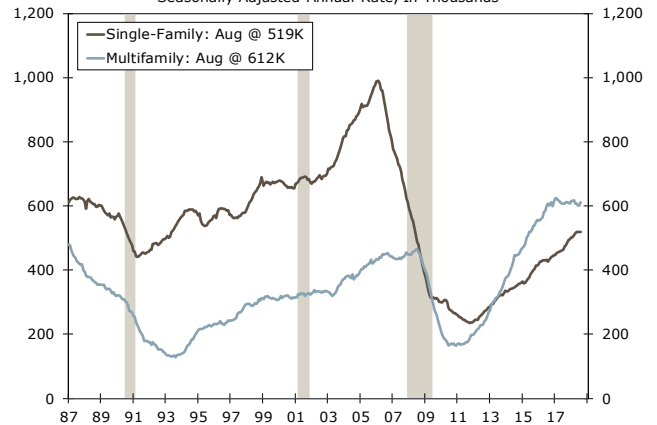
Multifamily Housing Permits by MSA

Year to Date, Total Number of Permits in Thousands



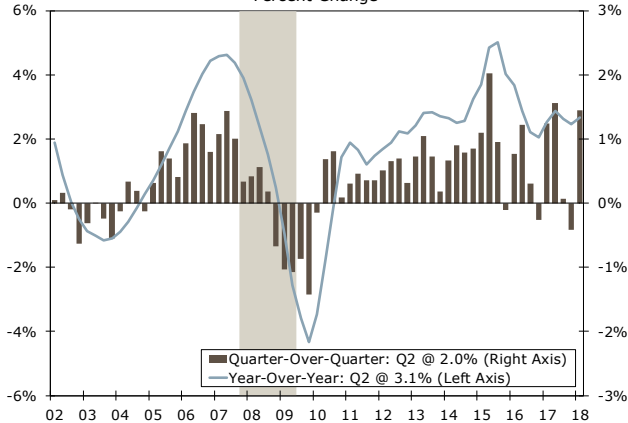
New Homes Under Construction

Seasonally Adjusted Annual Rate, In Thousands



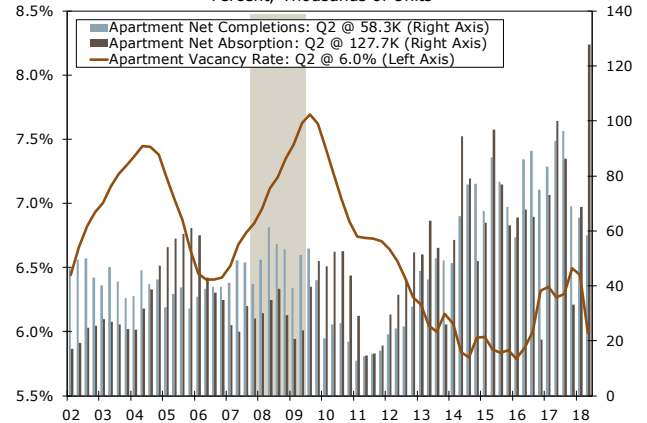
Apartment Effective Rent Growth

Percent Change



Apartment Supply & Demand

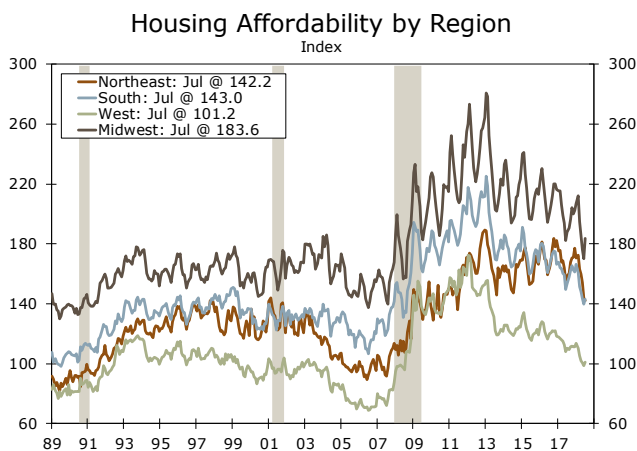
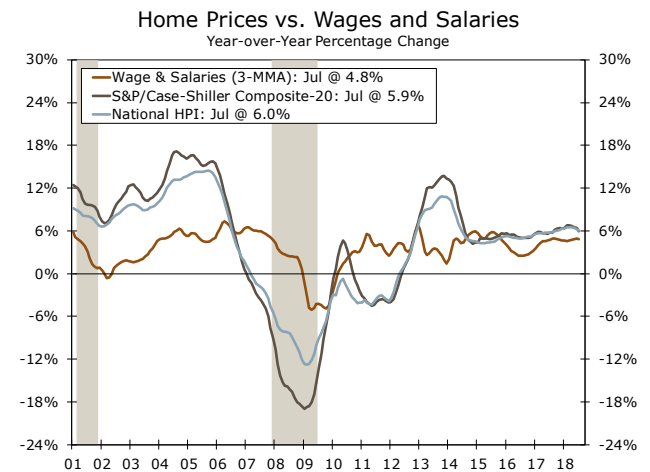
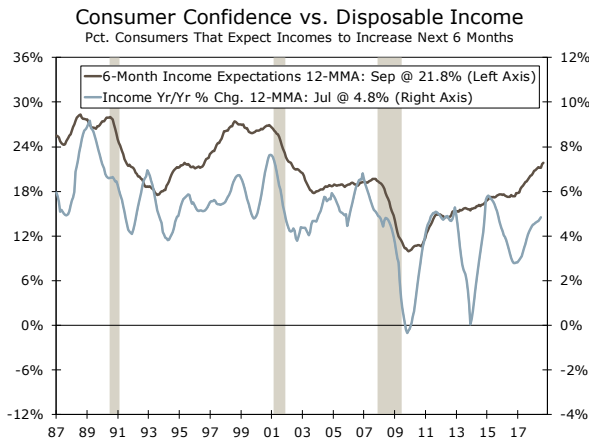
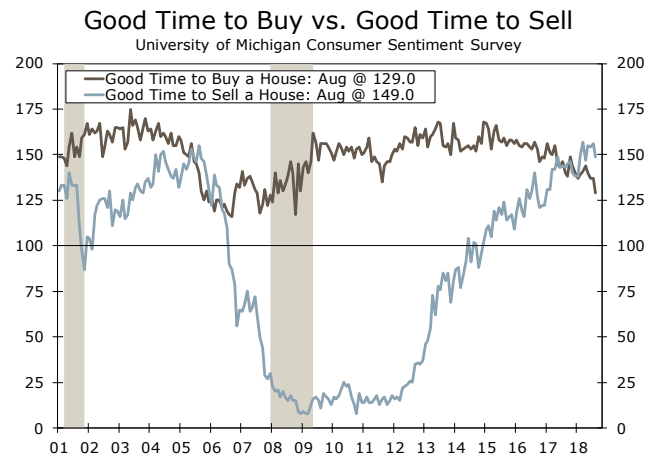
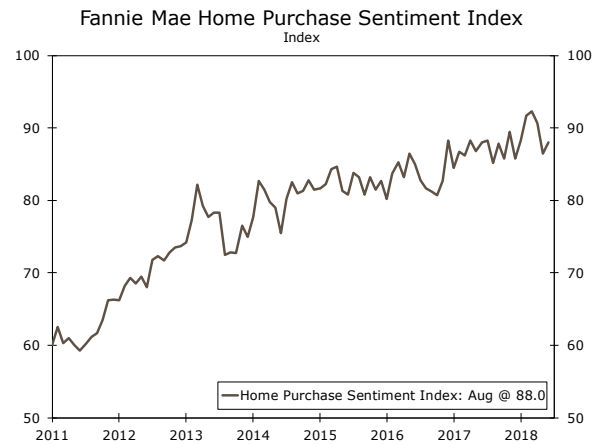
Percent, Thousands of Units



Source: U.S. Department of Commerce, CoSTAR and Wells Fargo Securities

Buying Conditions

- Buying conditions have deteriorated, as rising mortgage rates and declining affordability have kept many potential home buyers on the sidelines. The Fannie Mae Home Purchase Sentiment Index has fallen 4.3 points since its cycle high in May. The net proportion saying it is a good time to buy has fallen to 21%, the lowest level since August of last year.
- The proportion of consumers stating now is a good time to buy a home in the University of Michigan Consumer Sentiment Survey has seen an even more pronounced drop and is now at a post-recession low.
- Lean inventories are playing a big role in consumers' indecision, with many homeowners opting to remain in their current home because they fear they will not be able to find a suitable home to buy.

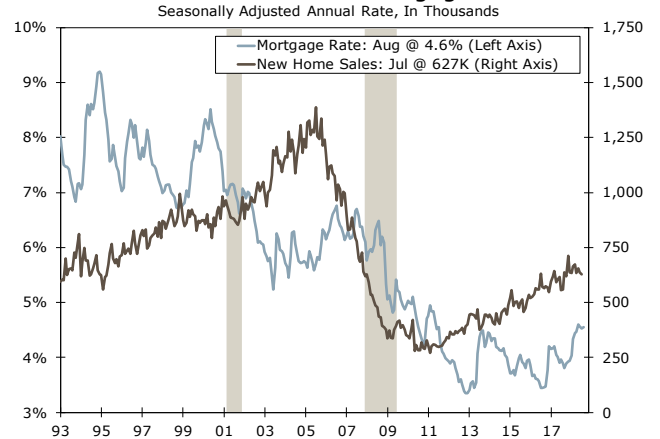


Source: University of Michigan, National Association of Realtors, The Conference Board, S&P, Fannie Mae, U.S. Dept. of Commerce and Wells Fargo Securities

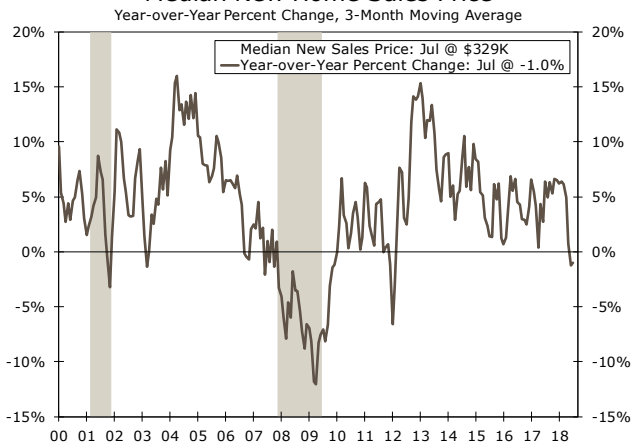
New Home Sales

- New home sales remain disappointing. Sales fell 1.7% in July after a 2.4% drop in June. While summer storms in the Northeast may have exaggerated the extent of the slowing, sales have had trouble gaining momentum in most regions.
- Tax law changes limiting deductions may be limiting sales in certain markets, particularly the Northeast. Foreign demand has also moderated, which is impacting sales in the West and parts of the South.
- The soft new home sales figures are a sharp contrast to the still high levels of builder confidence. Buyer traffic remains solid but there are still too few affordably priced homes for entry level buyers to choose from. Townhomes are also selling more slowly, likely reflecting high construction costs.

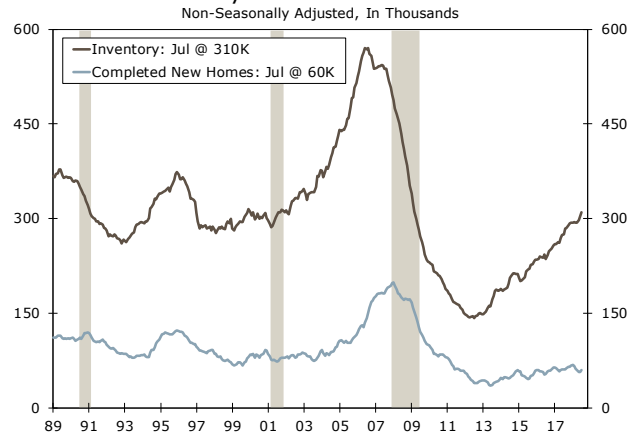
New Home Sales vs. Mortgage Rates



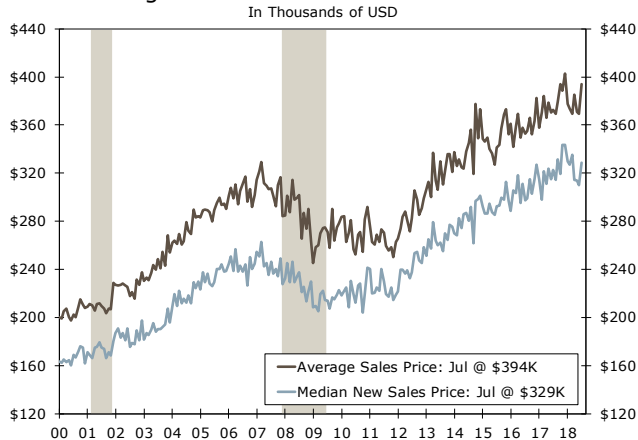
Median New Home Sales Price



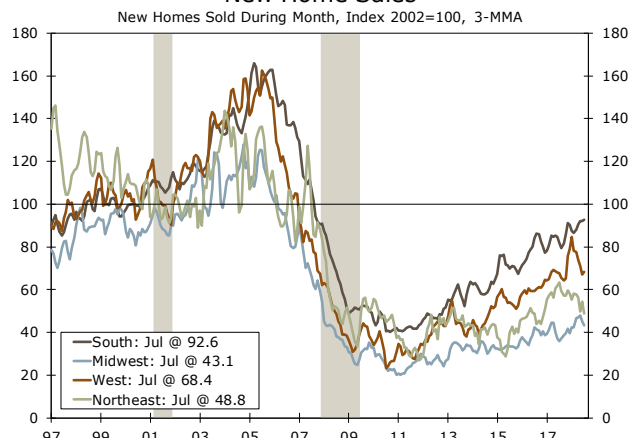
Inventory of New Homes for Sale



Average and Median New Home Sale Price



New Home Sales

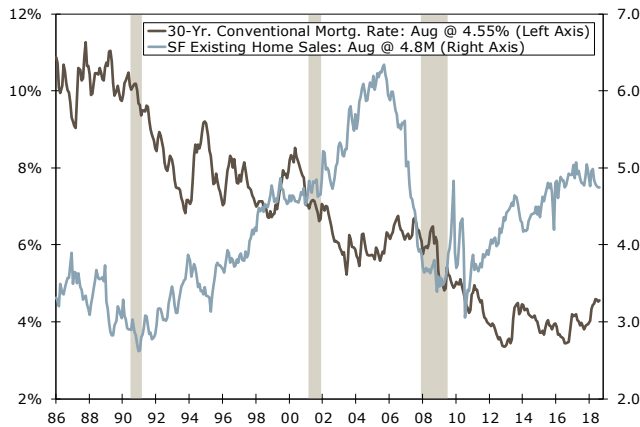


Source: U.S. Department of Commerce, FHLMC and Wells Fargo Securities

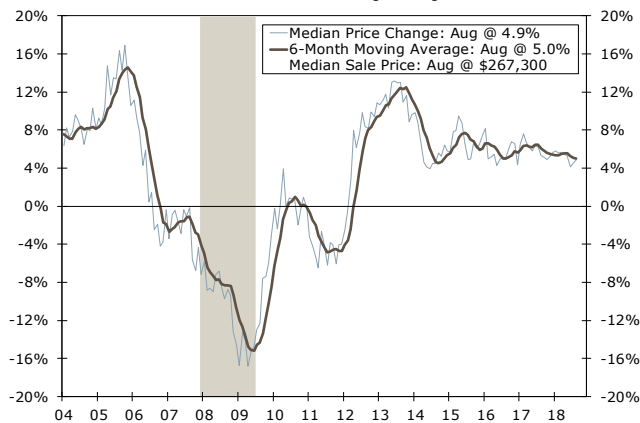
Existing Home Sales

- Sales of existing homes continue to struggle with both supply and demand issues. Sales were unchanged in August, following four consecutive monthly declines. Despite what appears to be flagging demand, homes priced around the median are selling quickly, with 52% of the homes sold in August on the market for a month or less.
- While demand is strong for homes prices around the median or less, it has weakened at higher price points. Rapid price gains in much of the West and parts of the South have priced out many potential buyers, which is leading to some outright price declines. The new tax law and a pullback in foreign buying are also braking higher-end demand.
- Existing home sales will likely drop slightly for 2018 as a whole but should rebound modestly next year.

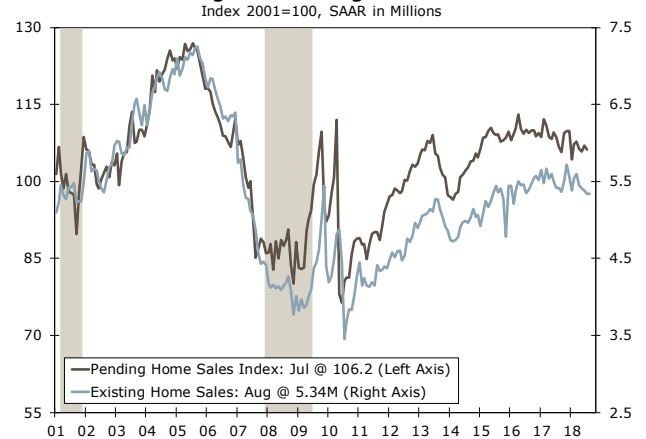
Mortgage Rate vs. Existing Single-Family Home Sales
Percent, SAAR in Millions



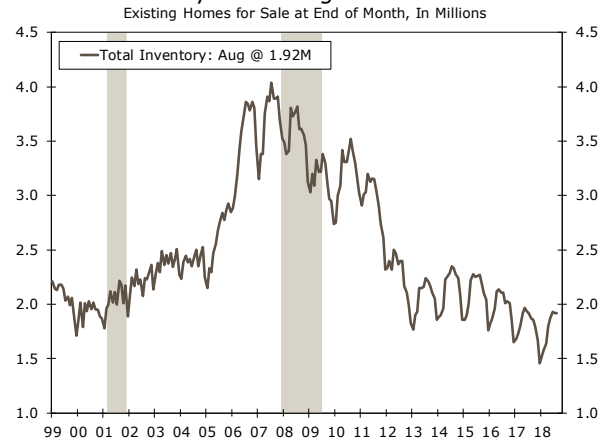
Median Single-Family Existing Home Price
Year-over-Year Percentage Change



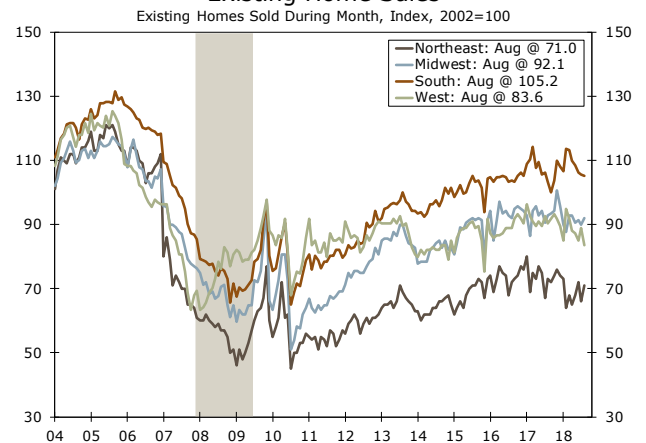
Pending vs. Existing Home Sales



Inventory of Existing Homes for Sale



Existing Home Sales

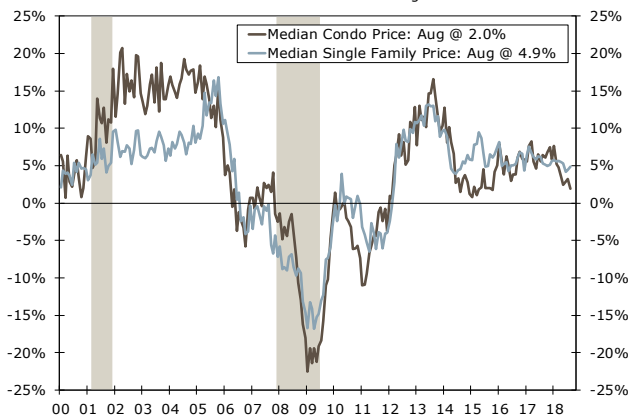


Source: National Association of Realtors, FHLMC and Wells Fargo Securities

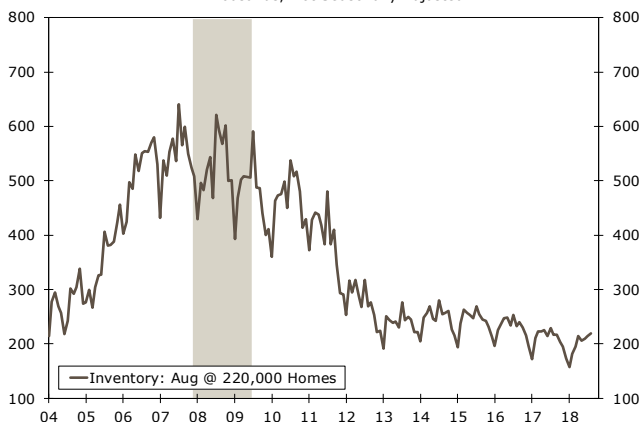
Condos and Co-Ops

- The condo market has suffered from many of the same issues restraining the single-family market. New development has been extremely slow this recovery, and low inventory levels have limited sales. Compared to a year ago, condo sales dropped 4.8% in August. Sales declined in the Northeast and West and were flat in the Midwest and South.
- Condo prices have also cooled recently following a fairly strong appreciation in 2017. The median price rose 2.0% year-over-year in August to \$244,500.
- New York's condo market appears to be going through a rough patch. Sales plunged in June compared with a year earlier. Condo price appreciation also slowed to a crawl, registering just a 2.0% increase over the past year.

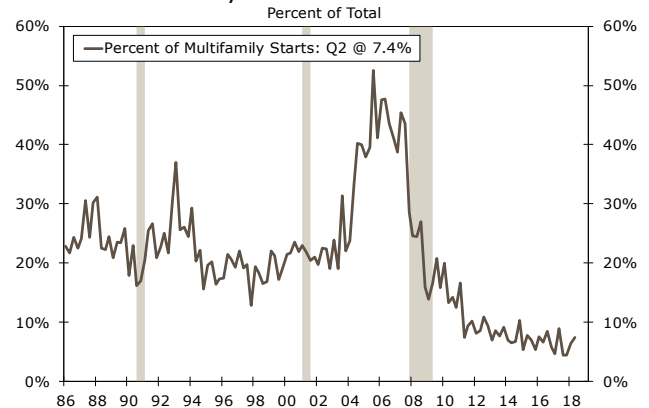
Median Condo & Single Family Home Price
Year-over-Year Percent Change



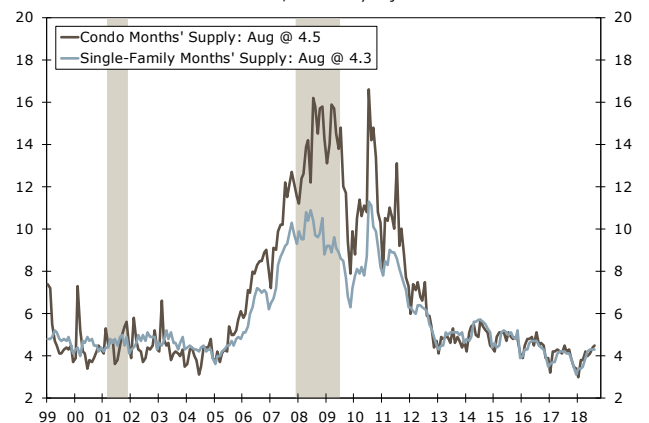
Condo Inventory
In Thousands, Not Seasonally Adjusted



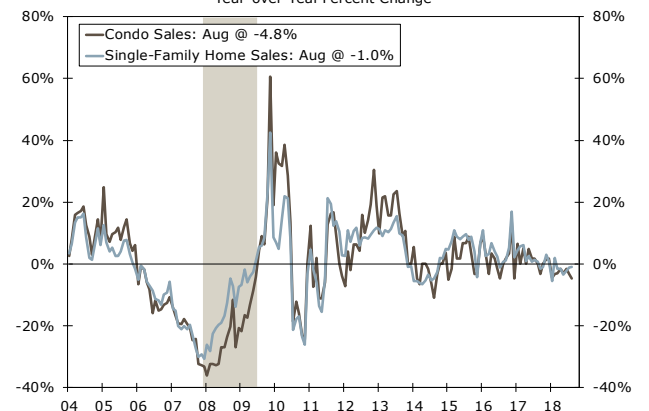
Multifamily Starts Intended for Sale



Existing Home Supply
In Months, Seasonally Adjusted



Single-Family Home Sales & Condo Sales
Year-over-Year Percent Change

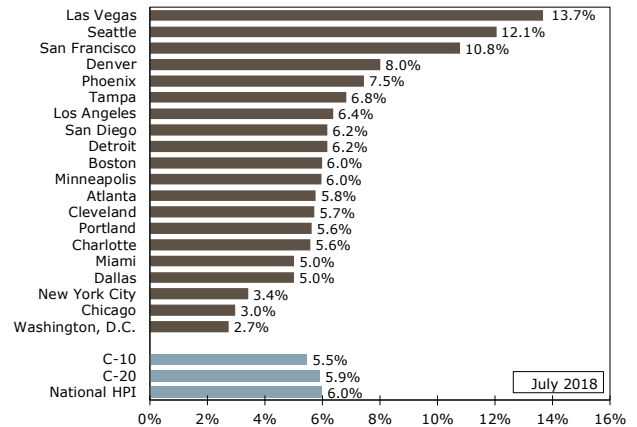


Source: U.S. Department of Commerce and Wells Fargo Securities

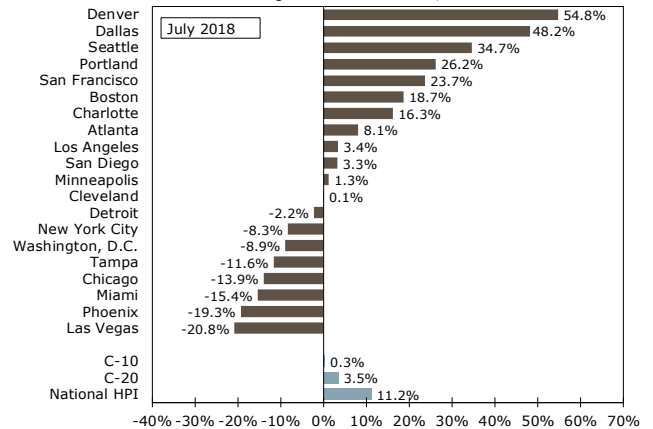
Home Prices

- While home prices continue to rise, the pace is moderating. The S&P Case-Shiller 20-City Home Price Index (HPI) rose just 0.1% in July. The increase was slightly less than expected, although residual seasonality may be understating conditions. On a year-over-year basis, the national HPI is up by a still robust 5.9%.
- While prices have rebounded across much of the nation, several metro areas in the Midwest and Northeast remain below prior peak levels. Metro areas in the states most impacted by the housing bust, such as Tampa, Miami and Phoenix, have also not yet returned to prior peak levels. Las Vegas unseated Seattle as the city with the fastest year-over-year rise in home values, reflecting strengthening economic conditions in that market.

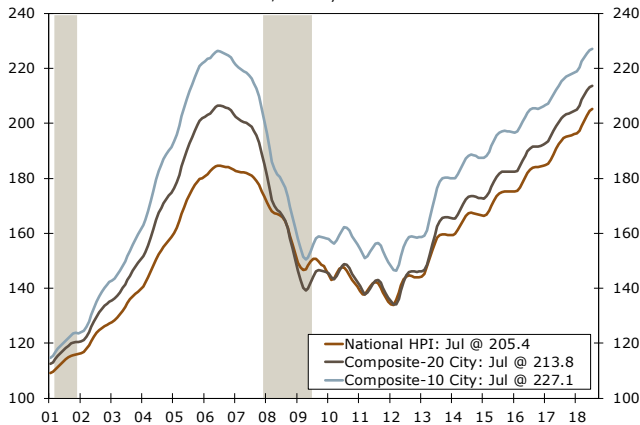
S&P CoreLogic Case-Shiller Home Prices
Year-over-Year Percent Change, NSA



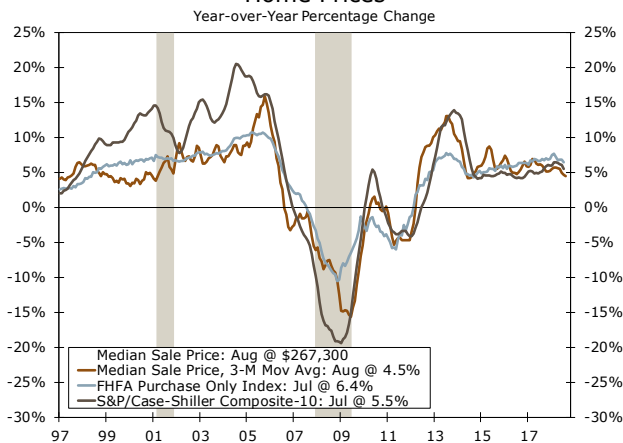
S&P CoreLogic Case-Shiller Home Prices
Percent Change from Previous Peak, NSA



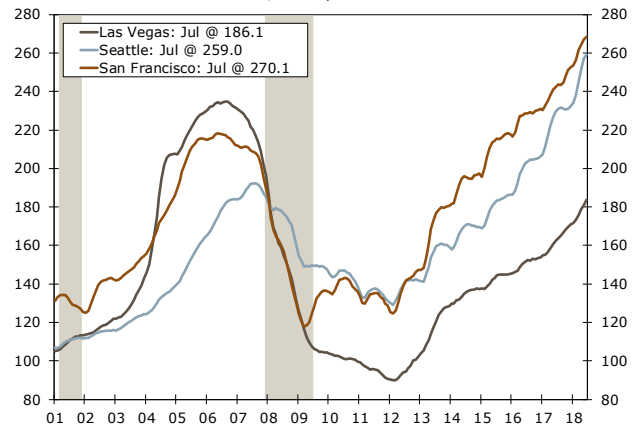
S&P CoreLogic CS Home Price Index
Index, January 2000=100



Home Prices



S&P CoreLogic Case-Shiller Home Price Index
Index, January 2000=100

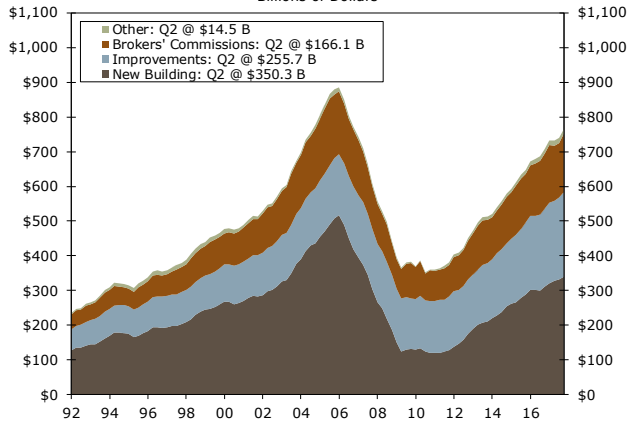


Source: National Association of Realtors, U.S. Dept. of Commerce, S&P, FHFA and Wells Fargo Securities

Renovation and Remodeling

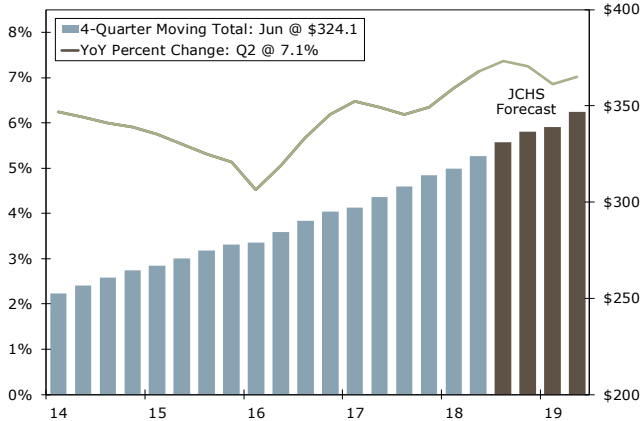
- Renovations and remodeling outlays rose at a 7.0% year-over-year pace in Q2. July construction spending data also showed renovation and repairs spending climbing 10.0% from the prior year.
- While sales of existing homes have slowed this year, home values continue to appreciate, giving owners the confidence to undertake larger projects. Homeowner tenure has also trended higher, which should continue to support renovation spending. The JCHS Leading Indicator of Remodeling Activity projects spending growth to exceed 7.0% in 2018.
- Sales at home improvement centers have slowed over the past three months but should rebound in September, as preparations ahead of Hurricane Florence boosted spending across parts of the South.

Residential Investment
Billions of Dollars



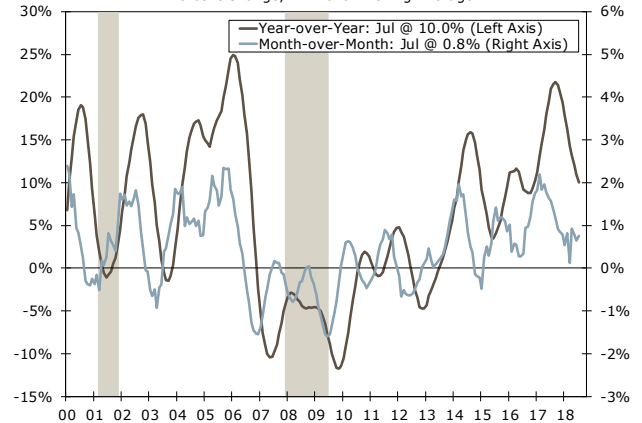
Leading Indicator of Remodeling Activity

In Billions, 4-Q Moving Total, Harvard Joint Center for Housing Studies



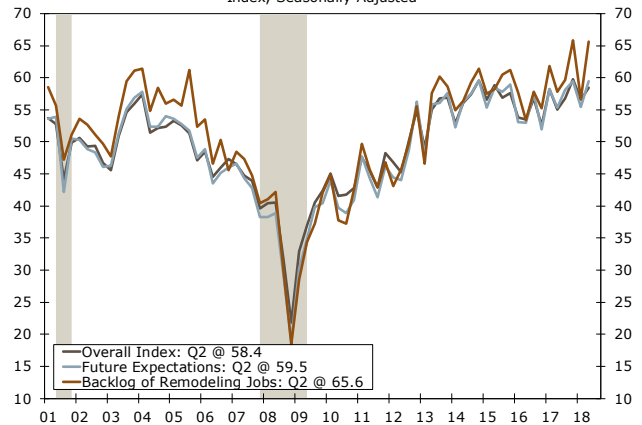
Private Residential Improvements

Percent Change, 12-Month Moving Average



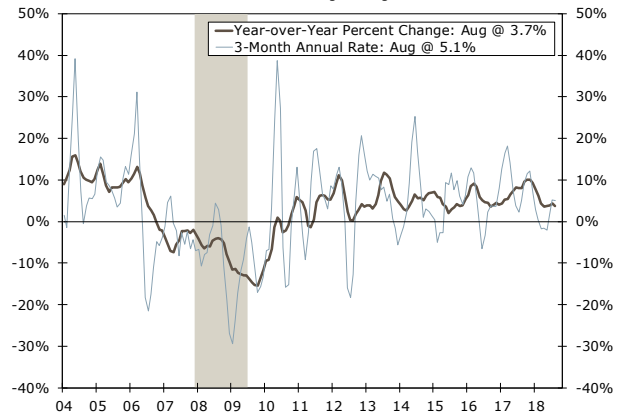
NAHB Remodeling Market Index

Index, Seasonally Adjusted



Building Material, Garden Equip. & Supply Stores

3-Month Moving Average

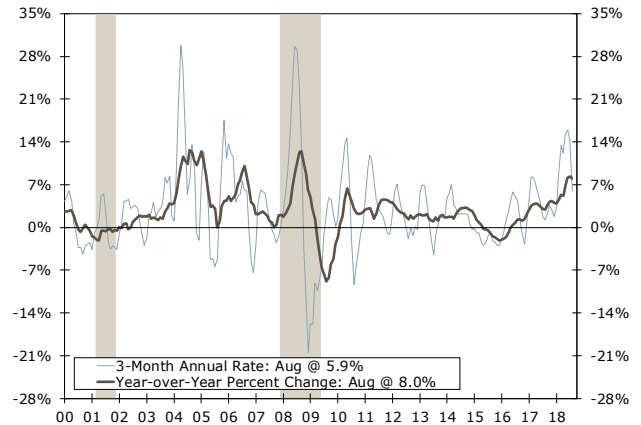


Source: Harvard Joint Center for Housing Studies, U.S. Dept. of Commerce, NAHB and Wells Fargo Securities

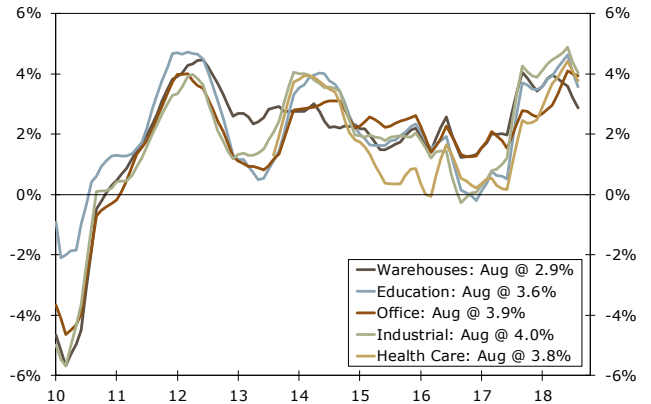
Construction Costs

- Input costs for the construction industry continue to climb higher. Prices for construction materials continued to surge in August, increasing 8.0% on a year-over-year basis. Transportation costs have also been rising amid a shortage of truck drivers. Higher costs are causing new projects to be postponed as they no longer pencil out.
- The continued shortage of skilled labor has also boosted wages of construction workers. In Q2, the Employment Cost Index for construction rose 3.2% compared to a year ago.
- Prices for several key homebuilding materials continued to rise in August, especially for softwood lumber. Sustained cost pressures may be causing builders to hold off on new starts until later in the year when prices are expected to ease.

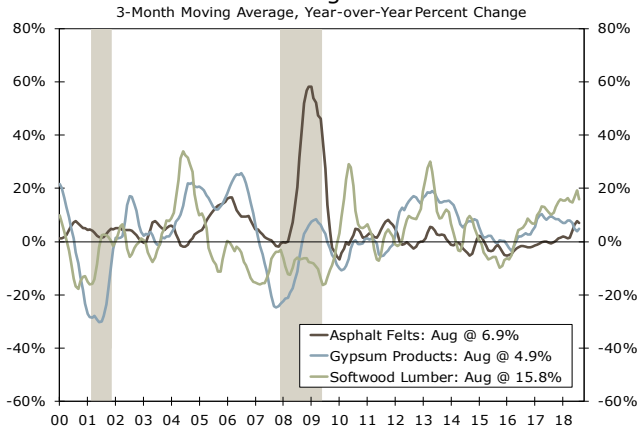
Construction Materials Producer Price Index



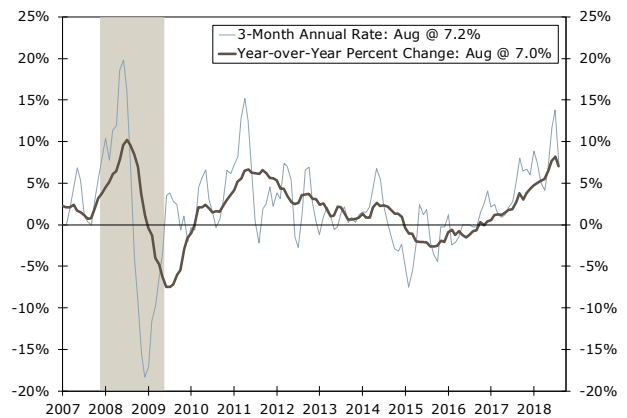
Final Demand PPI: New Building Construction
3-Month Moving Average, Year-over-Year Percent Change



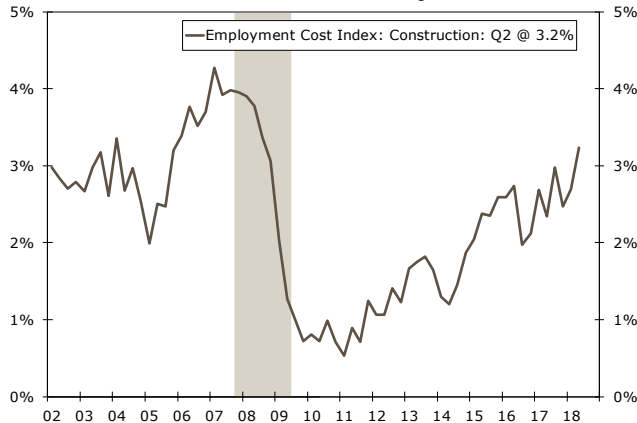
PPI: Building Products



Producer Price Index for Truck Transport



Employment Cost Index: Construction
Year-Over-Year Percent Change



Source: U.S. Department of Labor and Wells Fargo Securities

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