

Economics Group

Special Commentary

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Housing Chartbook: March 2019

Lower Mortgage Rates Have Firmed Up Housing Activity

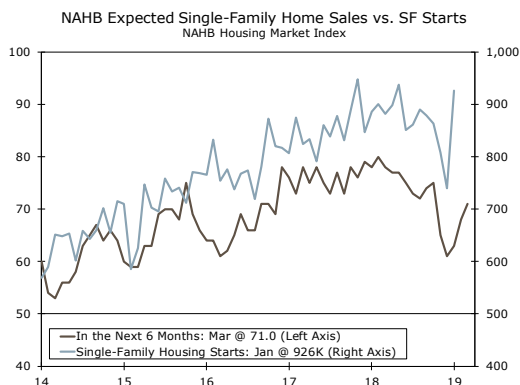
Momentum in the housing sector has shifted from steadily deteriorating late last year to improving modestly early this year. The Fed’s policy pivot and the resulting turnaround in financial conditions are primarily responsible for this shift, which has so far been limited to an increase in prospective buyer traffic and rise in mortgage applications for those looking to purchase a home. Data on sales and new home construction have been mixed at best so far this year, as well as difficult to interpret given delays resulting from the government shutdown, substantial revisions to previously reported data and significant swings in weather conditions. Demographics are also becoming more favorable, as Millennials age up and come ever closer to reaching major life milestones, such as establishing careers, marrying, having children and buying their first home.

Momentum in the housing sector has improved modestly this year.

The shift in momentum comes at a good time. The slide in new home construction that began last March was gaining momentum toward the end of last year, and builder optimism collapsed during the final months of 2018. With mortgage rates now a half percentage point lower than they were in December, demand has perked up somewhat and builder optimism has improved. Forecasts for home sales and new home construction have also been ratcheted up. Our own forecast has changed relatively little. We see home sales and new home construction as poised to reverse the trend seen this past year, when economic growth strengthened and housing weakened. This year, overall growth is expected to slow and home sales and new home construction should improve modestly.

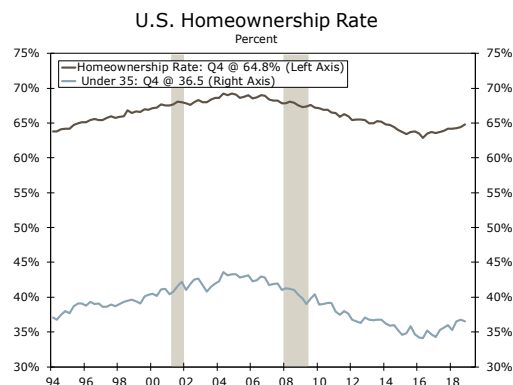
Demographics are slowly shifting back toward homeownership. The oldest cohort of Millennials will turn 38 this year, which is an age at which, historically, homeownership tends to increase. The seasonally adjusted homeownership rate rose 0.2 percentage point to 64.6% in the fourth quarter of 2018, continuing its steady improvement since bottoming in the second quarter of 2016. Some of the greatest improvement has come among the younger cohorts, where homeownership declined substantially during the Great Recession. The improvement in homeownership coincides with an acceleration in overall economic growth, as real GDP growth ramped up to a 3% pace from a 2% pace and the unemployment rate fall below 4%. Even with more favorable economic and demographic trends, the rise in homeownership remains relatively modest and we expect it to remain so.

Figure 1



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

Figure 2



Together we'll go far



**Millennials
 will likely
 remain
 renters for
 longer.**

There is More to Millennials than Simply the Numbers

While the rising number of Millennials reaching their late thirties is encouraging, homeownership is still likely to lag prior generations. A larger proportion of Millennials are non-white and non-native born, two groups among which homeownership has historically been lower. Millennials also may desire to become homeowners later than prior generations. Moreover, Millennial women are graduating college in much larger numbers than Millennial men, and many of these women are putting off marriage and having children. College-educated Millennials are more likely to settle in urban areas, where creative industries are clustering. This is where the bulk of luxury and lifestyle apartments have been developed this past decade. Residents of these communities appear loath to give up the amenities that come with this lifestyle, including convenient access to work, entertainment and transit, on-site pet care and a network of like-minded people. The upshot is Millennials will likely remain renters for longer, which means the rising numbers reaching their late thirties will be more like a steady breeze than a stiff tailwind to homeownership.

Where Millennials buy their first homes may also be different than prior generations, which largely strived for a big house in the suburbs. While many will, we believe a larger proportion will continue to choose to live closer to the central business district or urbanizing suburbs that offer many of the amenities they have become accustomed to while living in their upscale apartment communities. One of the reasons prior generations sought out the suburbs was to seek out better schools for their children and to live near people that were more like themselves. Given the delay in reaching prior milestones, Millennials are likely to have fewer children but more choices when it comes to sending their children to school, including magnets, charters and private schools. Moreover, Millennials are more like the people in urban areas than those in traditional suburban subdivisions.

With a larger proportion of Millennials choosing to remain close to the center cities, housing affordability and clashes over gentrification are likely to remain challenging for years to come. The redevelopment of urban areas offers many societal benefits, including the more efficient use of infrastructure and mass transit, as well as revitalized businesses and entertainment venues that provide job opportunities to parts of cities where they had been lacking. Increased demand for urban housing will also put added pressure on developers and political leaders to come up with affordable housing options. Opportunity zones might provide a catalyst to bring more affordable housing to the market. Townhomes are likely to become increasingly popular, as they are easier to develop in the tight confines of urban areas and less costly to build and maintain.

**Our forecast
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Our forecast for housing remains modestly positive. While mortgage rates have come down and home price appreciation has moderated, we see only a modest improvement in home sales and new home construction over the next couple of years. We look for new home sales to rise 2.9% in 2019 and look for single-family starts to rise 2.8%. Home prices should continue to moderate, as builders continue to focus on more modestly priced homes in less expensive parts of the country. Prices for new homes are expected to rise just 1.2% this year, while prices for existing homes should rise 4.5%.

Figure 3

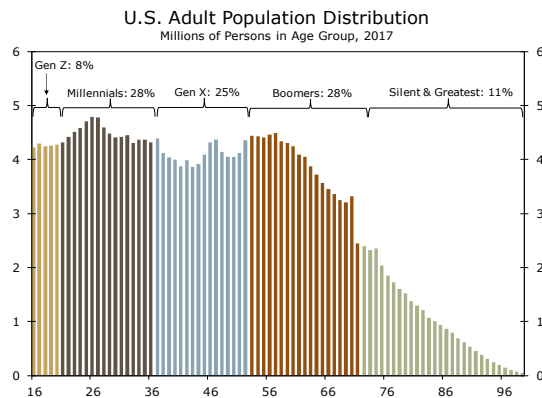
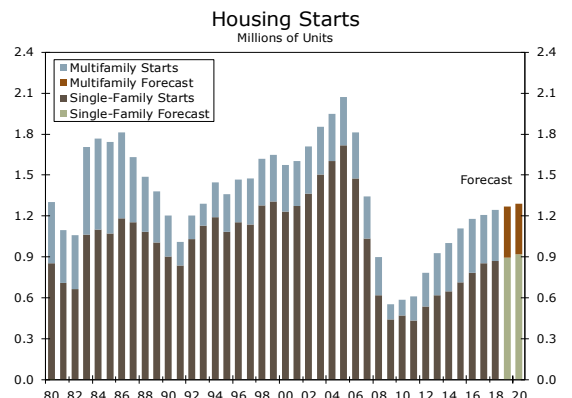


Figure 4



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

National Housing Outlook

	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	2.4	2.2
Residential Investment, Percent Change	-0.1	13.0	12.4	3.9	10.1	6.5	3.3	-0.2	-1.3	1.5
Nonfarm Payroll Change (Avg. Monthly)	173	181	192	251	227	193	179	223	165	120
Unemployment Rate	8.9	8.1	7.4	6.2	5.3	4.9	4.4	3.9	3.7	3.5
Home Construction										
Total Housing Starts, in Thousands	608.8	780.6	924.9	1,003.3	1,111.9	1,173.7	1,202.9	1,242.4	1,270.0	1,290.0
Single-Family Starts, in Thousands	430.5	535.3	617.7	647.8	714.6	781.5	848.9	870.5	895.0	920.0
Multifamily Starts, in Thousands	178.3	245.3	307.2	355.5	397.3	392.2	354.0	371.9	375.0	370.0
Home Sales										
New Home Sales, Single-Family, in Thousands	305.0	369.0	429.0	439.0	501.0	561.0	613.0	628.0	645.0	660.0
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	5,340.0	5,490.0	5,540.0
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	4,742.0	4,880.0	4,940.0
Existing Condominium & Co-op, in Thousands	477.0	528.0	603.0	591.0	608.0	614.0	619.0	601.0	610.0	600.0
Manufactured Homes										
Total Shipments, in Thousands	51.6	54.9	60.2	64.3	70.5	81.1	92.9	96.6	102.3	108.5
Percent Change	3.1	6.3	9.7	6.8	9.7	15.0	14.5	3.9	6.0	6.0
Home Prices										
Median New Home, \$ Thousands	227.2	245.2	268.9	288.5	294.2	307.8	323.1	324.8	328.8	333.4
Percent Change	4.8	7.9	9.7	7.3	2.0	4.6	5.0	0.5	1.2	1.4
Median Existing Home, \$ Thousands	166.1	176.8	197.1	208.3	222.4	233.8	247.2	259.3	271.2	283.4
Percent Change	-3.7	6.4	11.5	5.7	6.8	5.1	5.7	4.9	4.6	4.5
FHFA Purchase Only Index, Percent Change	-4.2	2.9	7.1	5.1	5.3	6.0	6.6	6.6	5.0	4.4
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	5.4	4.5	4.2
Interest Rates - Annual Averages										
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.27	0.52	1.13	1.96	2.63	2.69
Prime Rate	3.25	3.25	3.25	3.25	3.27	3.52	4.13	4.96	5.63	5.69
10-Year Treasury Note	2.78	1.80	2.35	2.54	2.14	1.84	2.33	2.91	2.98	3.05
Conventional 30-Year Fixed Rate, Commitment Rate	4.46	3.66	3.98	4.17	3.85	3.65	3.99	4.54	4.58	4.65

Forecast as of: March 18, 2019

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

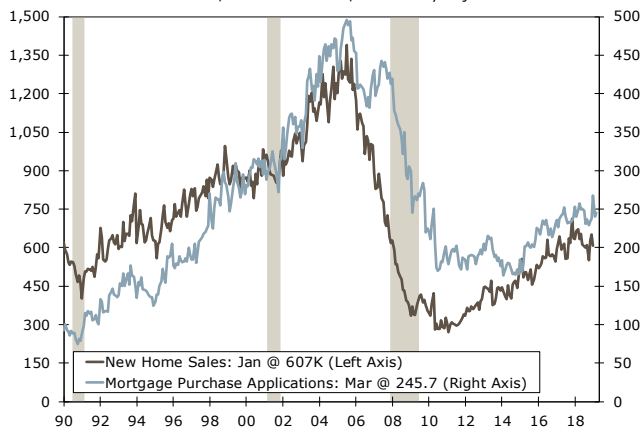
Mortgages

- Slower global economic growth and the Fed's monetary policy pivot have pulled Treasury yields lower in recent weeks. Mortgage rates are now around half a percentage point lower since December.
- Lower financing costs should bolster affordability, which has been one of the greatest impediments to home sales this past year. The past few weeks show buyers are coming back, with purchase applications recovering most of the year-end drop.
- Mortgage purchase applications have largely bounced back since the start of the year, although the weekly data remain volatile and applications are up only modestly year-over-year.
- Refinancing volumes have responded less to the drop in rates and are 4% below their year-ago level.

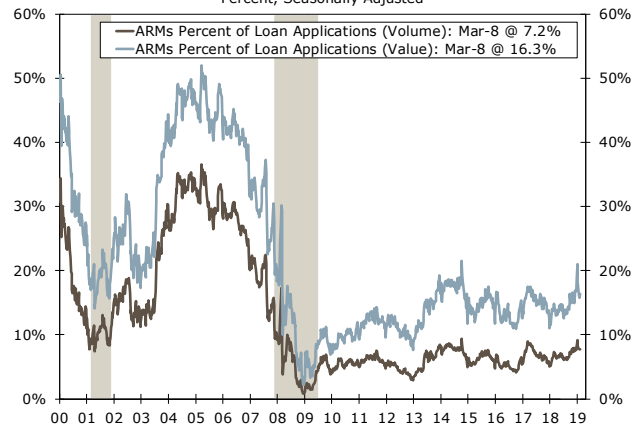
Conventional Mortgage Rate vs. 10-Year Treasury Yield
 Percent



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

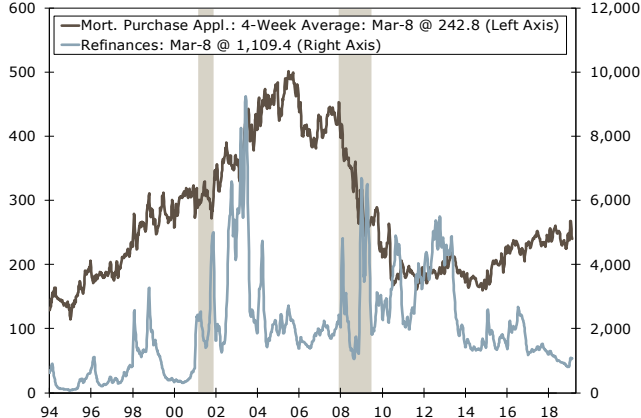


Mortgage Applications
 Percent, Seasonally Adjusted

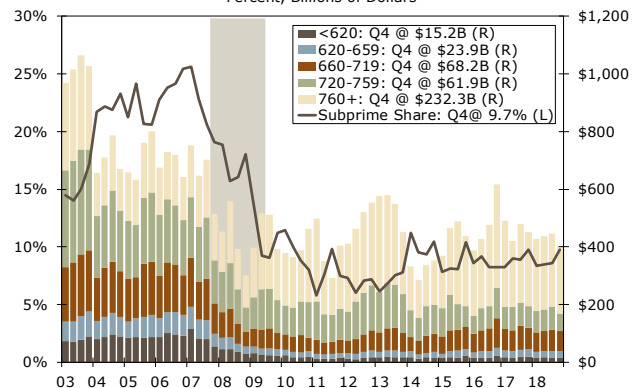


Mortgage Applications

Seasonally Adjusted Index (1990=100); 4-Week Moving Average



Mortgage Origination by Credit Score
 Percent, Billions of Dollars

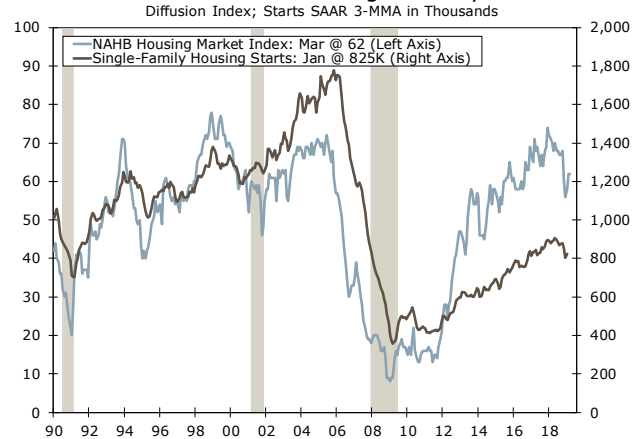


Source: MBA, FHLMC, Federal Reserve System, U.S. Dept. of Commerce and Wells Fargo Securities

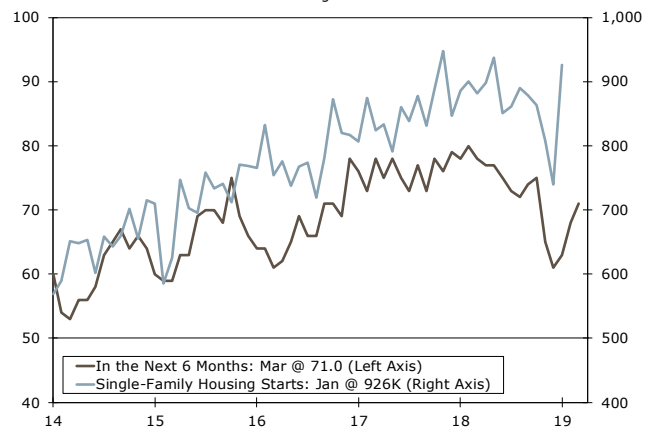
Single-Family Construction

- Single-family starts surged 25.1% in January, following three consecutive monthly declines toward the end of 2018. Winter months' data are notoriously volatile and we suspect January's increase was aided by milder and drier than usual weather. The February employment data suggest starts declined as more typical winter weather returned.
- The resurgence in single-family starts matches up well with the most recent data from the NAHB. The overshoot in starts is also evident.
- Single-family permits are less impacted by swings in the weather and have fallen in 3 of the past 4 months. Single-family starts are primed for a big drop in February, as permits have averaged 833,000 over the past 3 months, which is 10% below January starts.

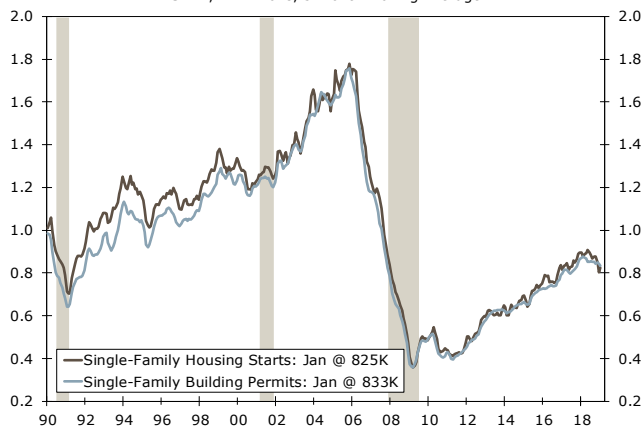
Builder Confidence & Single-Family Starts



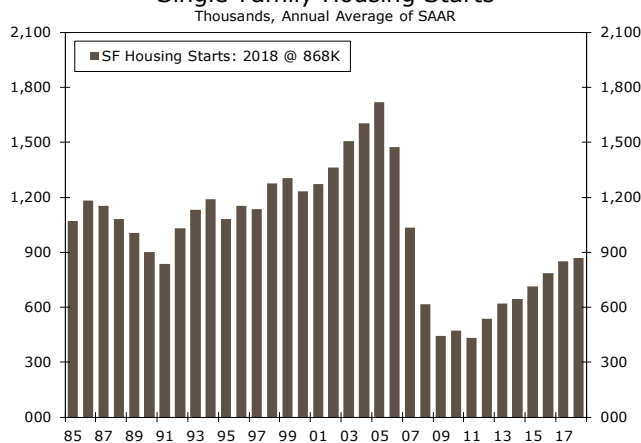
NAHB Expected Single-Family Home Sales vs. SF Starts



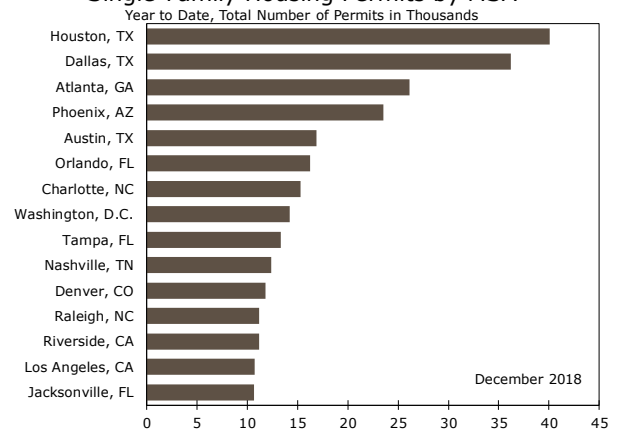
Single-Family Housing Starts vs. Building Permits



Single-Family Housing Starts



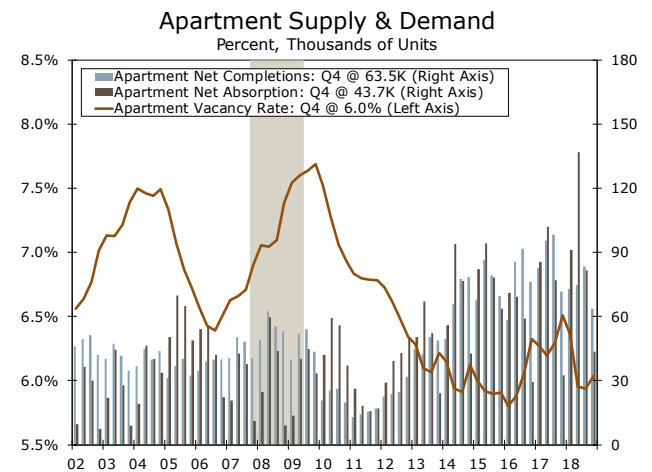
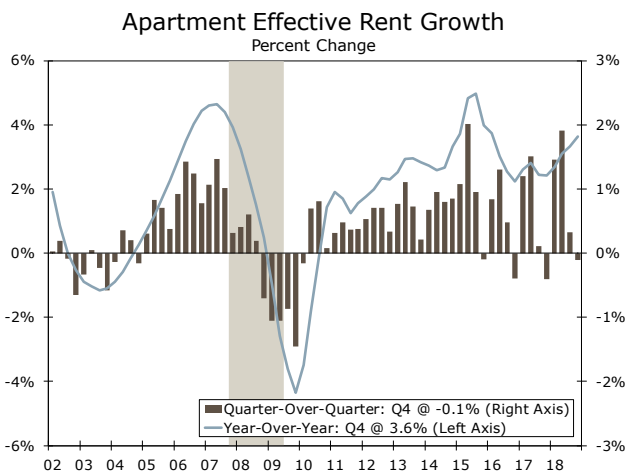
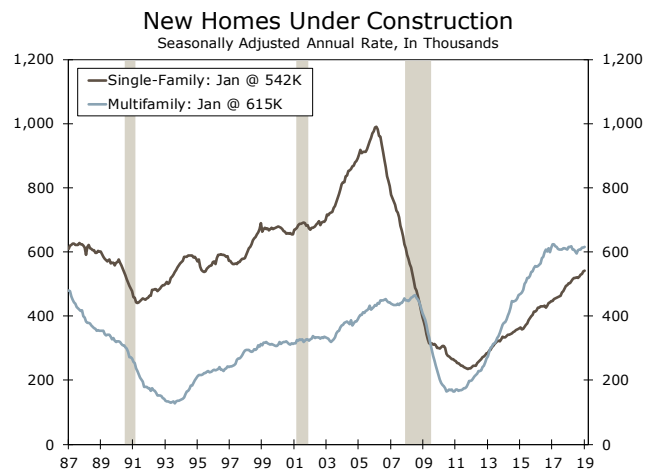
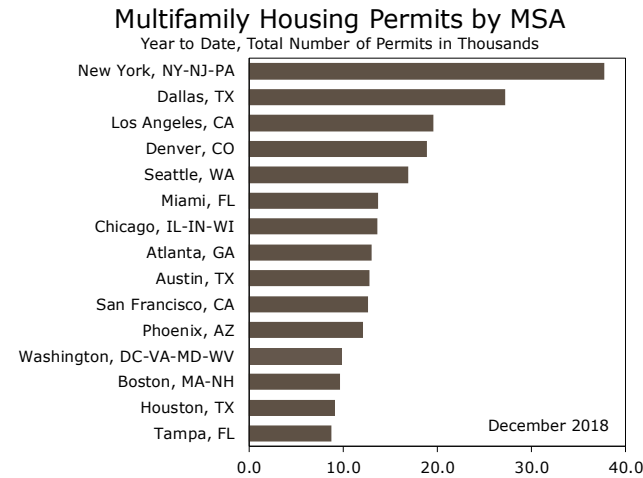
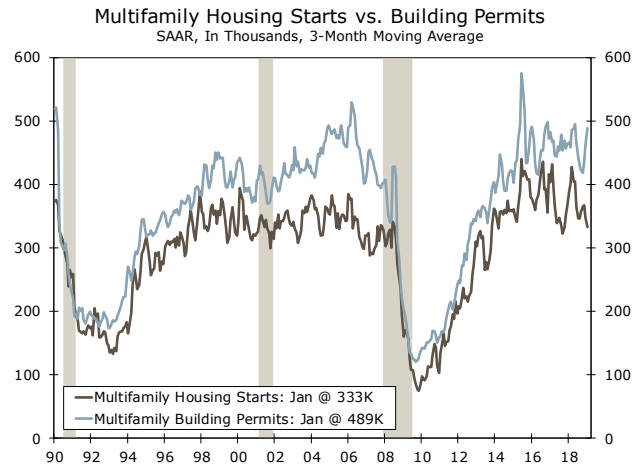
Single-Family Housing Permits by MSA



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

Multifamily Construction

- Multifamily starts rose 2.4% in January following a 25.4% plunge in December. While the data are notoriously volatile, starts are now running well below permits, suggesting we will see a rebound in multi-family starts in coming months.
- Demand for multifamily units remains strong, thanks to strong demand for apartments in large and rapidly growing job markets around the country. The onslaught of new supply continues to raise concerns about overbuilding, but demand has also consistently beat expectations.
- The apartment vacancy rate was just 6% in Q4, which is fairly low for this period of the business cycle. Rents have moderated in recent months but remain up solidly year-over-year.

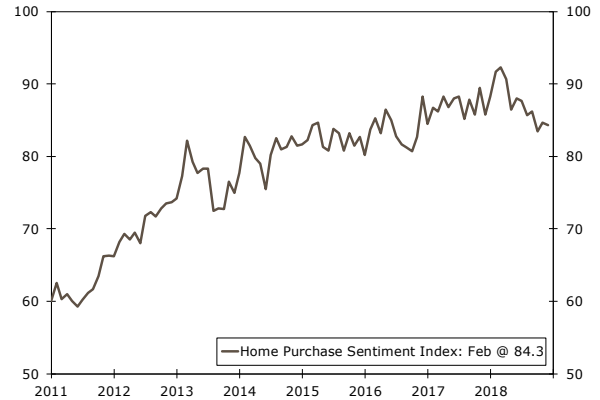


Source: U.S. Department of Commerce, CoStar, Inc. and Wells Fargo Securities

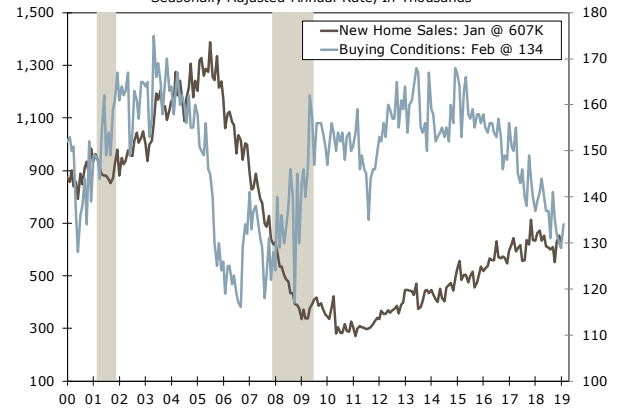
Buying Conditions

- The long slide in buyer sentiment appears to have leveled off, as mortgage rates declined and housing prices moderated. There is still a scarcity of affordable homes available for sale, which is keeping many potential buyers on the sidelines.
- The long running slide in the University of Michigan measure of buying conditions accurately presaged the decline in housing activity. The index is showing signs of stabilizing in recent months but has shown little sign of turning around.
- Various measures of buyer sentiment suggest expectations should not be raised too aggressively for the spring selling season. Lower interest rates and moderating home prices will help shore up housing demand but are unlikely to ignite a strong rebound in sales and new home construction.

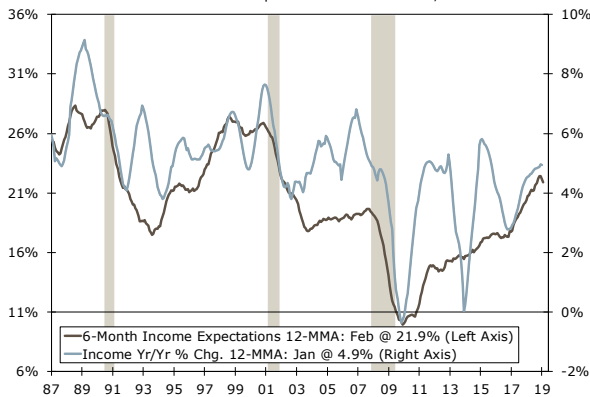
Fannie Mae Home Purchase Sentiment Index



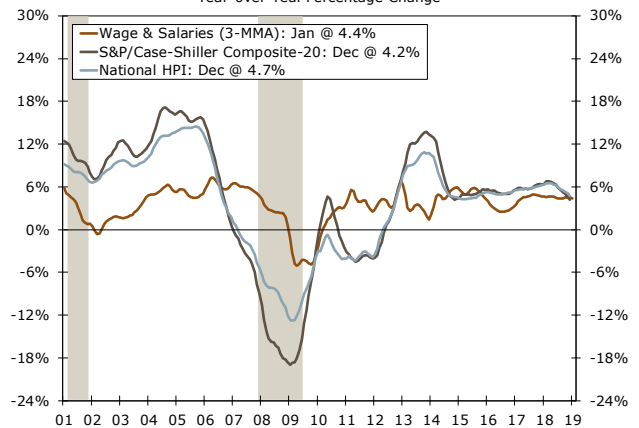
New Home Sales vs. Buying Conditions



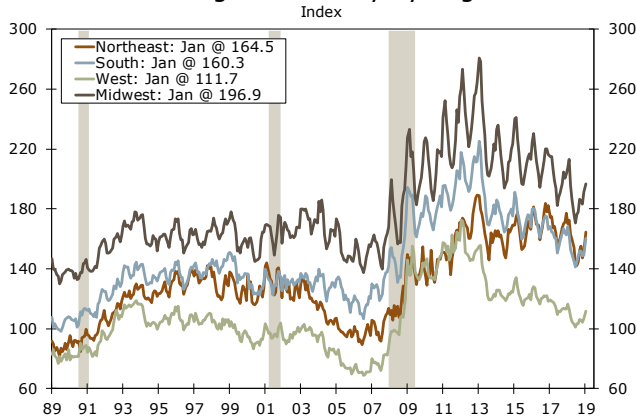
Consumer Confidence vs. Disposable Income



Home Prices vs. Wages and Salaries



Housing Affordability by Region

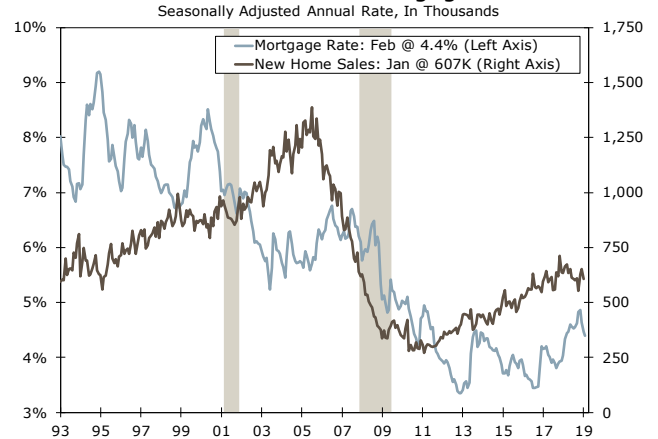


Source: University of Michigan, National Association of Realtors, The Conference Board, S&P, Fannie Mae, U.S. Dept. of Commerce and Wells Fargo Securities

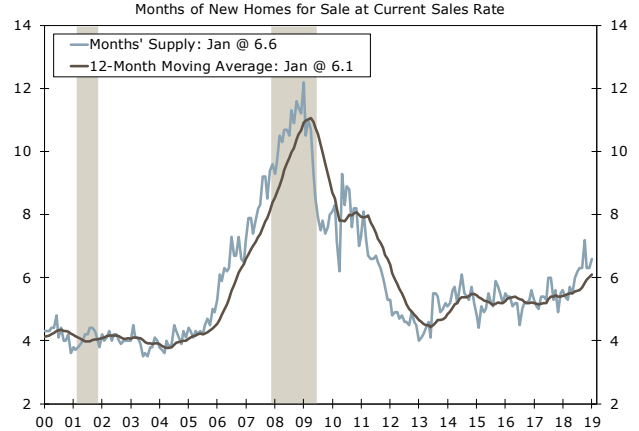
New Home Sales

- New home sales fell 6.9% in January but data for the last three months of 2018 were revised higher, which took some of the sting out of that disappointing headline. The revisions appear to be more technical than real, however, with the seasonally adjusted pace for the final three months of the year bolstered by 21,000 after just a 6,000-unit upward revision to actual sales, most of which were in the South.
- With sales moderating, inventories of new homes have increased in recent months, which has led to some discounting in parts of the country. Builders currently have 336,000 homes for sale, which equates to a 6.6 months' supply.
- The median price of a new home has fallen 3.8% over the past year, reflecting a shift away from higher priced homes.

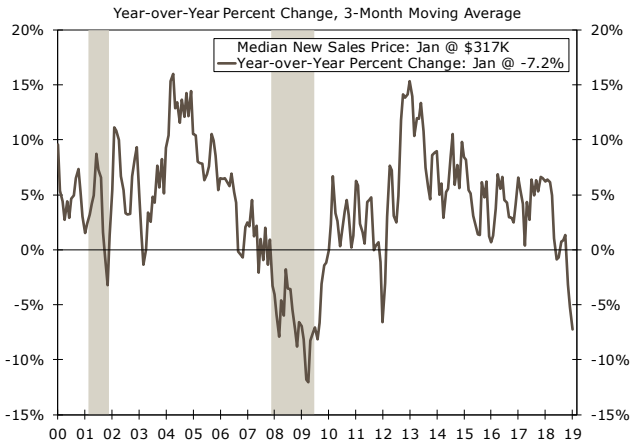
New Home Sales vs. Mortgage Rates



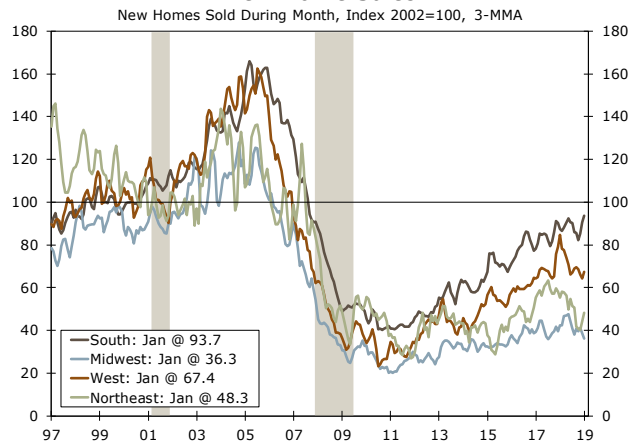
Inventory of New Homes for Sale



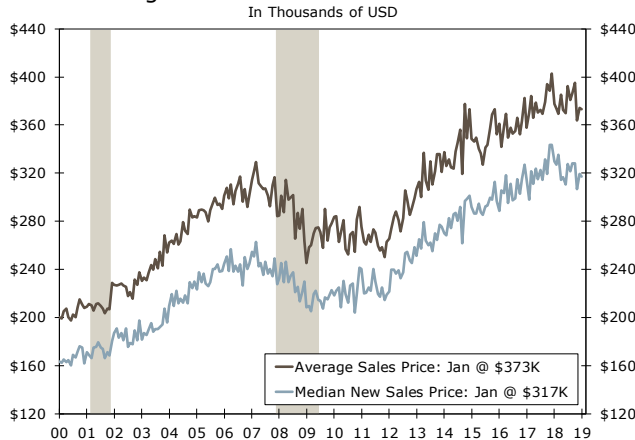
Median New Home Sales Price



New Home Sales



Average and Median New Home Sale Price

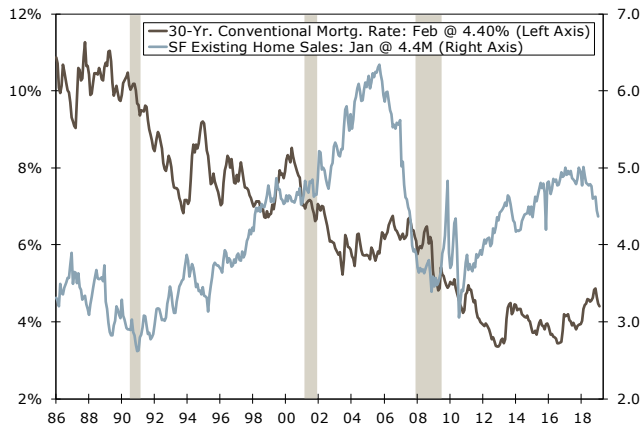


Source: U.S. Department of Commerce, Freddie Mac, FHLMC and Wells Fargo Securities

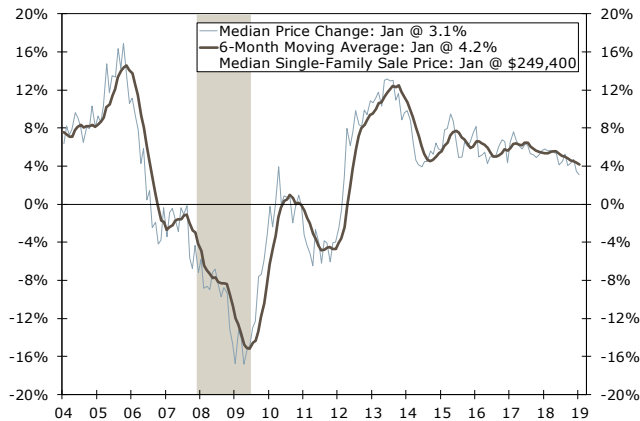
Existing Home Sales

- Existing home sales fell for the third consecutive month in January, falling 1.2% to a 4.94 million-unit pace. Sales are down 8.5% year-over-year.
- Overall sales fell in every region except for the Northeast. The supply-constrained West, where affordability challenges are the greatest, saw the largest decline and dropped 2.9% during the month.
- The recent softness in resales reflects deteriorating affordability during much of last year. Existing home sales measure closings, which reflect purchase contracts from 1 to 2 months earlier, when mortgage rates were higher and stock prices were tumbling.
- Inventories remain low historically but have risen for six consecutive months, ceding more power to negotiate prices to buyers. Consequently, the median price rise in January was the slowest pace since 2012.

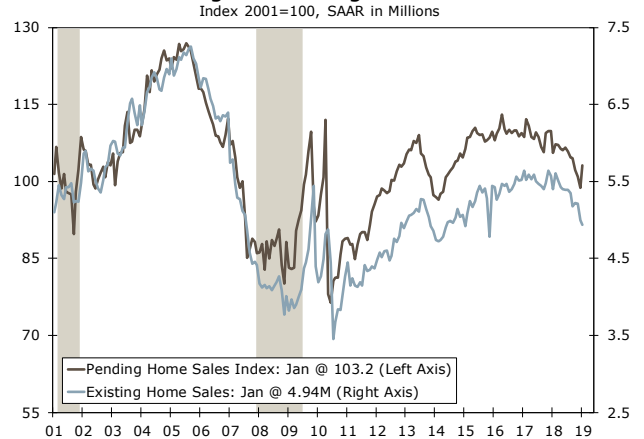
Mortgage Rate vs. Existing Single-Family Home Sales
 Percent, SAAR In Millions



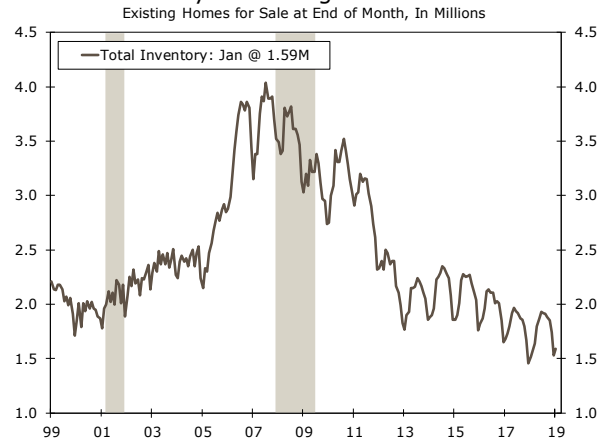
Median Single-Family Existing Home Price
 Year-over-Year Percentage Change



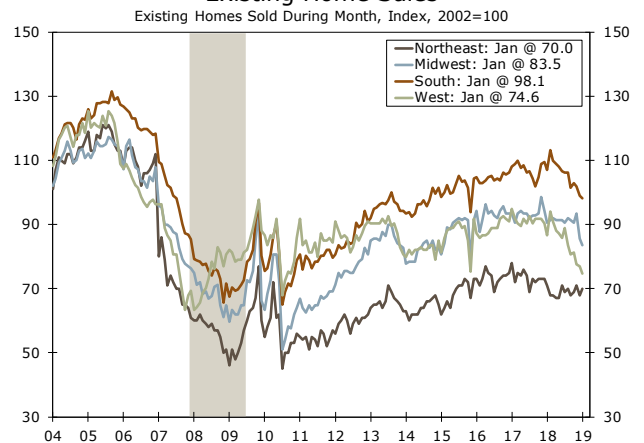
Pending vs. Existing Home Sales



Inventory of Existing Homes for Sale



Existing Home Sales

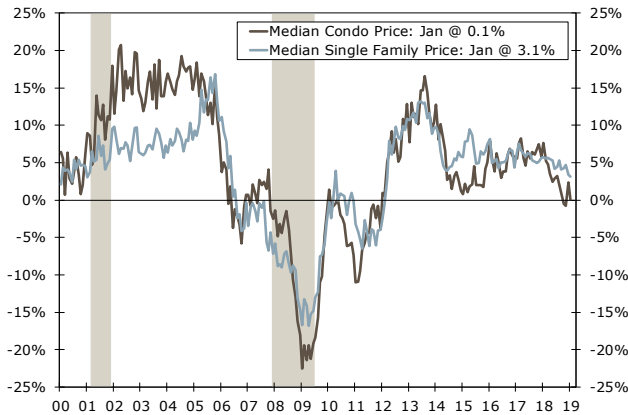


Source: National Association of Realtors, FHLMC and Wells Fargo Securities

Condos and Co-Ops

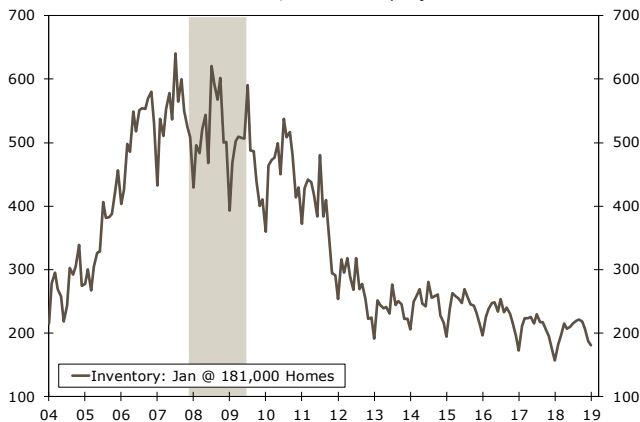
- Higher mortgage rates clearly had a negative impact on condo and co-op sales in 2018. Sales fell sharply in November and December and ended the year 4% below 2017 levels. As rates have come down, sales took a step in the right direction rising 3.6% in January to a 570,000-unit pace. While sales were flat in the West and Midwest, the Northeast and South posted gains of 9.1% and 4.0%, respectively.
- With demand cooling condo prices have softened considerably as owners have lowered prices to entice potential buyers. The year-over-year gain in condo prices has slowed to 0.1% from 7.6% a year ago.
- Sales declined in most major condo markets in 2018, with double-digit declines in Los Angeles, San Francisco, New York and Chicago—all areas where changes to the tax law likely deterred some buyers.

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



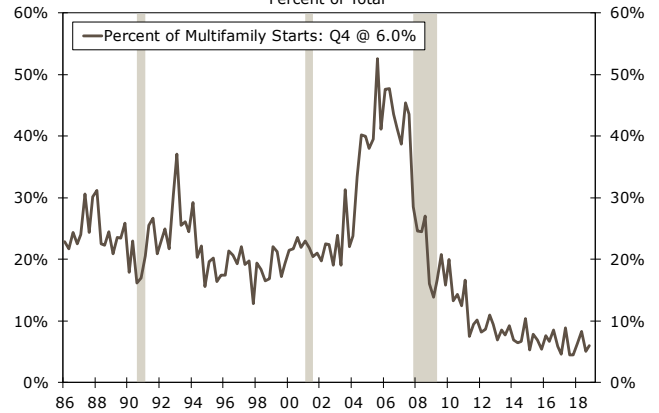
Condo Inventory

In Thousands, Not Seasonally Adjusted



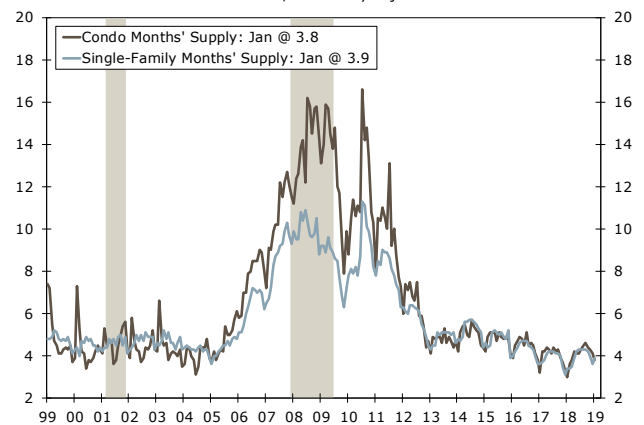
Multifamily Starts Intended for Sale

Percent of Total



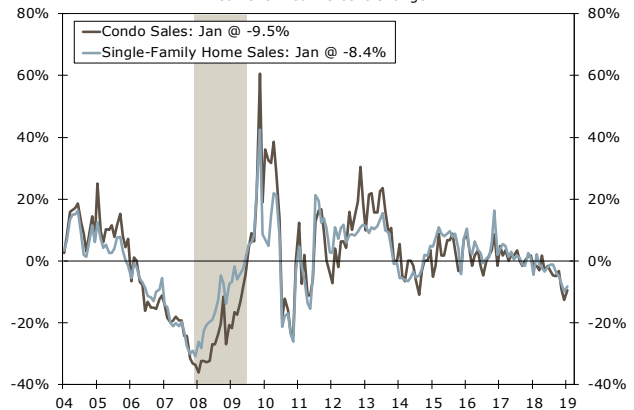
Existing Home Supply

In Months, Seasonally Adjusted



Single-Family Home Sales & Condo Sales

Year-over-Year Percent Change

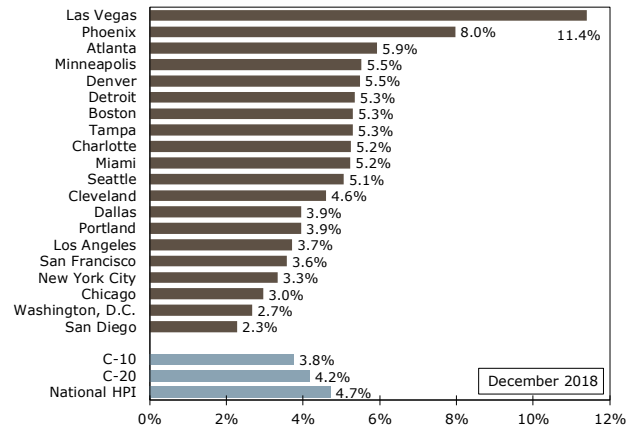


Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities

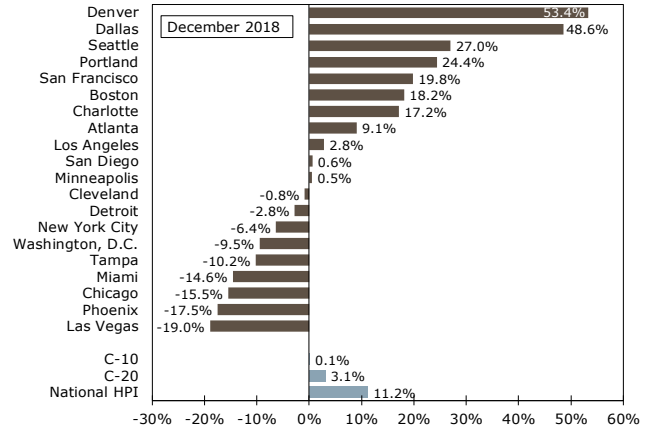
Home Prices

- Against a backdrop of slower sales and shifting demand towards entry level housing—which tends to be smaller in size—home prices are moderating. Homes are staying on the market longer, which is giving buyers more negotiating power. The median existing home value rose just 2.8% year-over-year in January, the slowest pace since 2011. Builders have also offered steep discounts on new homes in order to clear rising inventories. The median price of a new home has fallen 3.8% over the past year. The \$12,400 drop reflects a shift away from higher priced homes.
- The S&P CoreLogic 20-City index rose 4.2% year-over-year in December, its slowest rise in four years. Many West Coast markets have seen price increases cool recently. Price gains have accelerated in the Southeast, notably in Atlanta and Miami.

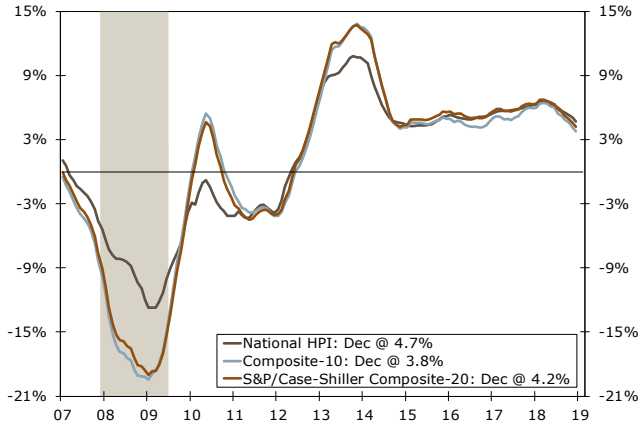
S&P CoreLogic Case-Shiller Home Prices
 Year-over-Year Percent Change, NSA



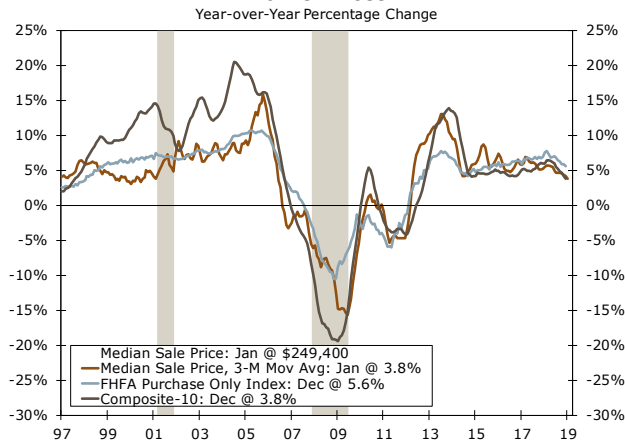
S&P CoreLogic Case-Shiller Home Prices
 Percent Change from Previous Peak, NSA



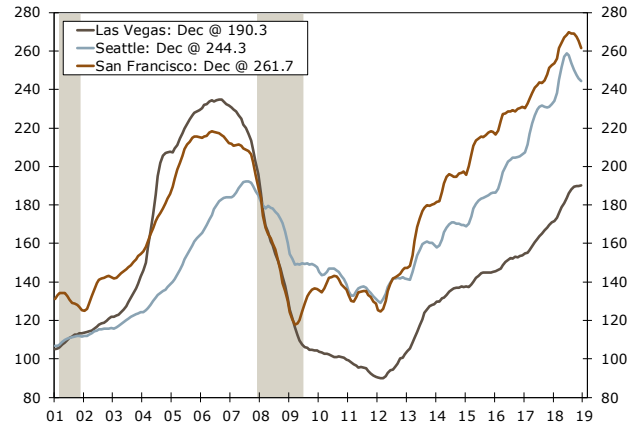
S&P CoreLogic Case-Shiller Home Price Index
 Year-over-Year Percentage Change



Home Prices
 Year-over-Year Percentage Change



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

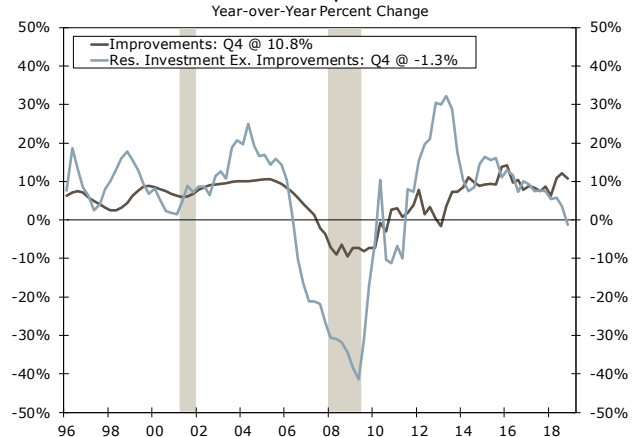


Source: National Association of Realtors, U.S. Dept. of Commerce, S&P, FHFA and Wells Fargo Securities

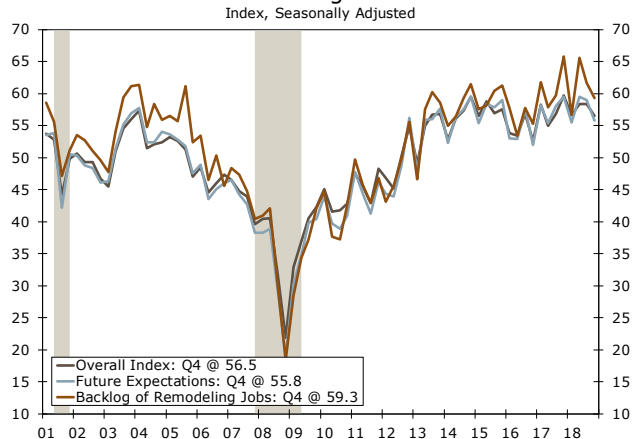
Renovation and Remodeling

- Improvement spending was a bright spot in 2018 amid a dismal year for overall residential fixed investment. Slower sales translated to more residents staying put and undergoing remodeling projects. Residential investment fell 3.5% in Q4. Spending on improvements, however, rose 9.2%. Outlays were boosted by hurricanes that hit parts of the Southeast, as well as the devastating wildfires that hit parts of California towards the end of the year.
- Alongside rising home prices and record levels of home equity, the cash out share of new refinances exceeded 40% and reached a 14-year high in 2018. The level of refinancing remains exceptionally low, however. Given slower home price appreciation amid slower sales, the JCHS projects remodeling spending to be somewhat lighter in 2019, rising 5.1%.

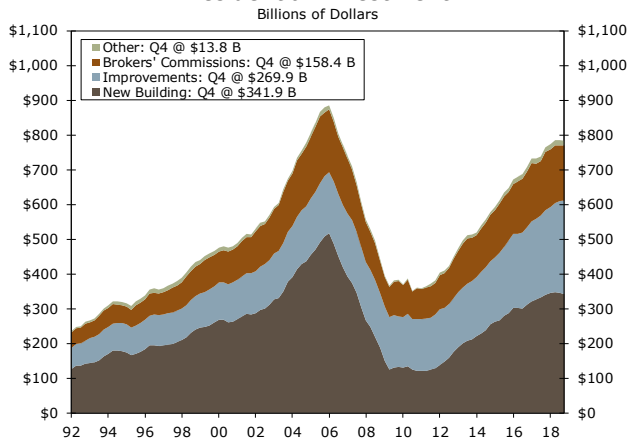
Residential Improvements



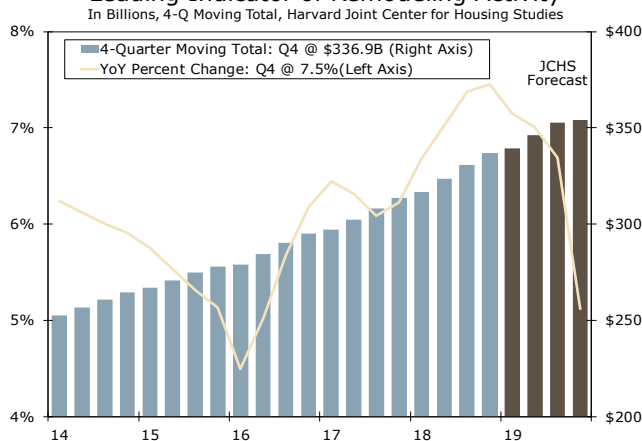
NAHB Remodeling Market Index



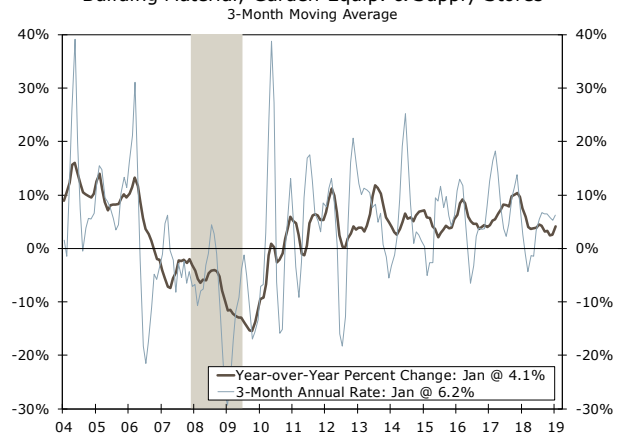
Residential Investment



Leading Indicator of Remodeling Activity



Building Material, Garden Equip. & Supply Stores

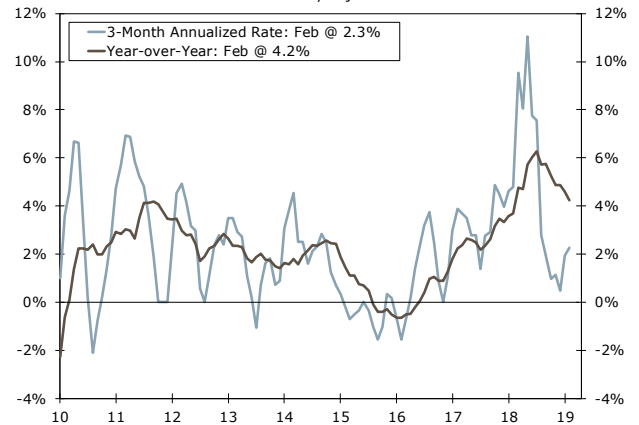


Source: Harvard Joint Center for Housing Studies, U.S. Dept. of Commerce, NAHB and Wells Fargo Securities

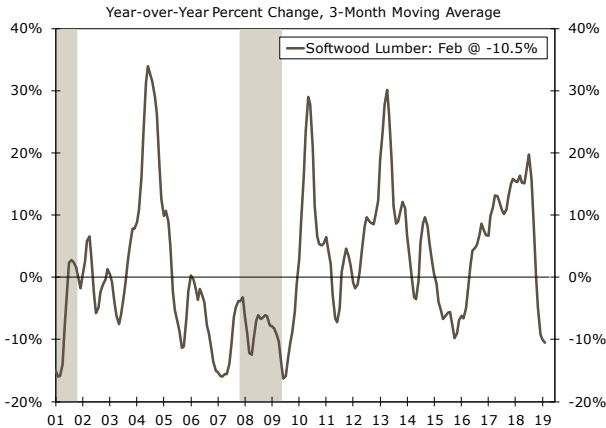
Construction Costs

- Rising labor costs, fueled by a shortage of skilled workers, remain a formidable headwind for builders and developers. The year-over-year change in the Employment Cost Index for construction workers breached 3.0% in Q4, the first time that has occurred since the recession. The number of construction job openings increased to 302,000 in January, which brings it back toward the cycle high hit last summer.
- Material costs have eased recently. After a tariff-induced 8.9% surge mid-2018, structural steel prices have eased, as global economic growth slowed and domestic output increased. Lower oil prices should also ease prices for asphalt-based products. Lumber, gypsum and copper prices have also pulled back. Material prices tend to be seasonal, however, and we expect prices to firm as demand picks up this spring.

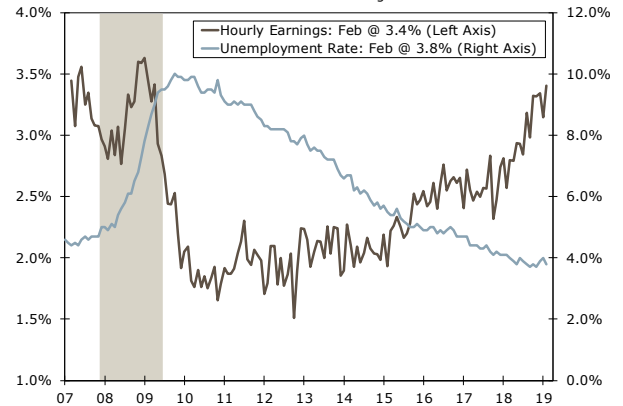
PPI: Materials & Components for Construction
 Seasonally Adjusted



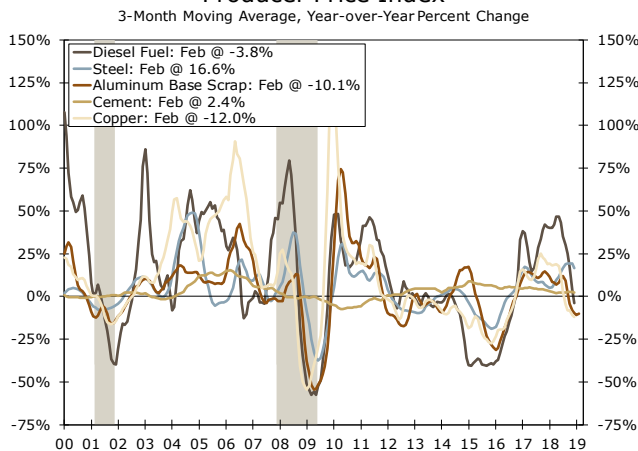
Softwood Lumber Prices



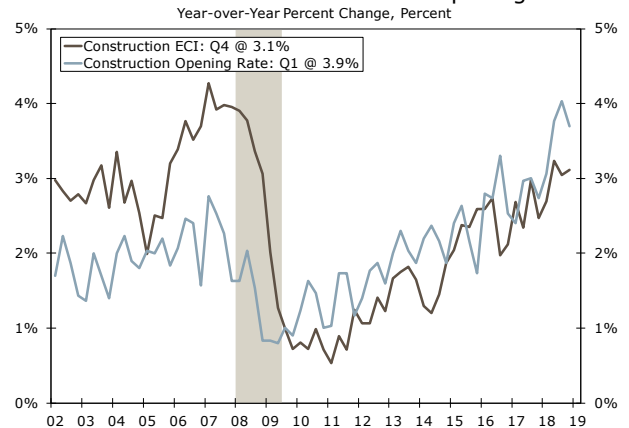
Average Hourly Earnings and Unemployment
 Year-over-Year Percent Change of AHE



Producer Price Index



Construction ECI vs JOLTs Job Openings



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

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