

Economics Group

Special Commentary

Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277
Charlie Dougherty, Economist
charles.dougherty@wellsfargo.com • (704) 410-6542

Housing Chartbook: June 2020

The housing market will be at the forefront of the recovery

While home sales have been one of the early bright spots in the fledgling economic recovery, efforts to contain the coronavirus crisis have impacted the housing market. Sales and housing starts plummeted in March and April, when many parts of the country implemented stay-at-home orders and nonessential businesses temporarily shut their doors. Home showings were banned in many areas during April, triggering a plunge in existing home sales. The collapse in sales and starts occurred during an abrupt pullback in broader economic activity. We estimate real GDP declined at nearly a 40% annual rate during the second quarter. That said, if May's surprise 2.5 million improvement in payrolls is any indication, the downturn has already found a bottom and a modest recovery is likely now underway. We anticipate a bounce-back in growth in the second half of the year as businesses and individuals adapt to operating with social distancing and working remotely. Progress on therapeutics and vaccine development should also help restore confidence, and economic activity will gradually pick up as more restrictions are eased.

Housing is clearly one of the economy's bright spots. Mortgage applications for the purchase of a home, which are a reliable leading indicator of new and existing home sales, have steadily risen since bottoming in early April and are now up 18.1% compared to last year. While existing sales weakened substantially during May, new home sales surged over 16%. New homes are much more conducive to virtual showings, which makes social distancing less of an issue.

Housing is clearly one of the economy's bright spots

The buoyancy in new home sales is also evident in builder confidence. The NAHB Housing Market Index surged 21 points in June to 58, as builders reported an increase in buyer traffic along with higher sentiment regarding the sales environment, both current and over the next six months. More projects also appear to be moving forward. Over half of the 422,200 residential construction jobs that were lost in April were added back in May, which strongly suggests builders were swift to incorporate additional safety measures and that single-family and multifamily building has quickly resumed.

Figure 1

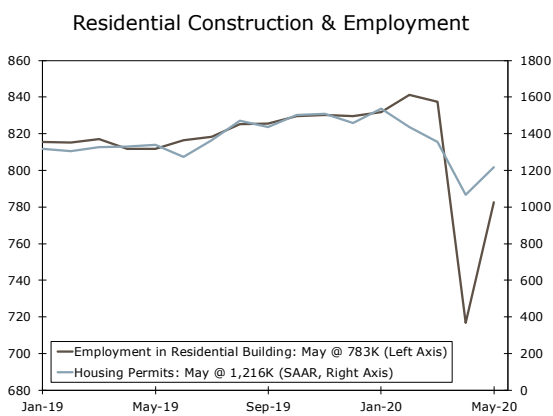
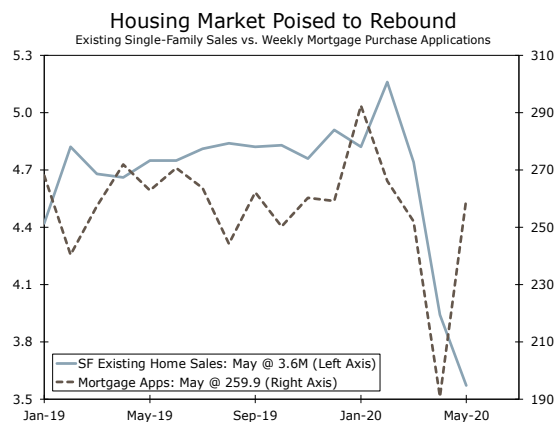


Figure 2



Source: U.S. Departments of Labor & Commerce, NAR, MBA and Wells Fargo Securities



The bulk of payroll losses have been among workers who tend to be younger and more likely to rent.

Housing: A Potential Cyclical Accelerant

Underpinning the more positive trend recently have been several tailwinds which will continue to support the housing market in the short term. Mortgage rates remain low (3.3% in June) and should remain so for the foreseeable future, which should incentivize more renters to become homeowners and induce higher turnover from those looking to upsize or downsize. The Fed has indicated the federal funds rate should remain near zero until at least 2022. Even then, mortgage rates should be 4% or less. Demographics will also remain favorable, as a tidal wave of Millennials are approaching an age which often brings major life events, such as marriage and having children, which tend to lead to buying a home. The job losses seen over the course of the past few months has brought unemployment rates higher across every age cohort. The bulk of payroll losses, however, have been concentrated in hourly workers, primarily in the hospitality and retail sectors, who tend to be younger and more likely to rent.

The apparent resiliency of the housing market recently should also provide other areas of the economy with a much needed boost. Residential fixed investment (housing starts, manufactured housing, home improvement spending and brokers commissions) only comprise about 3.5% of overall GDP. That number rises to over 15%, however, when including consumption spending on housing services such as tenant rents and utilities. But even that underestimates the true economic impact. Home sales drives demand for other ancillary services such as mortgages, insurance, legal services, inspections and interior designers, as well as for durable goods spending on furniture, household appliances, and home furnishings. A rebound in home sales should also support home prices, which have moderated considerably in a handful of the nation's largest metropolitan areas.

While the housing market will not be entirely unscathed from the coronavirus crisis, home sales and new home construction are one of the first green shoots from the fledgling economic recovery. The surprisingly robust 2.5 million May rise in nonfarm payrolls suggests that at least the first part of the economic recovery may come sooner and be much stronger than had been expected. The road to a full recovery, however, remains a long one. More than 22 million jobs were lost in March and April. Fundamentally, demand for housing rides on the back of employment conditions. Structural trends which predate the pandemic are also likely to remain in place, namely a lingering shortfall of affordable homes for sale. Regulatory constraints make it difficult to build affordable housing in many parts of the country, so supply constraints will likely persist. The residual effects of the pandemic will likely alter the type and location of homes rented and sold. Usable square footage to accommodate remote work has become more important. There may also be an increased preference for less dense markets that can more easily accommodate social distancing. The move away from areas with high tax burdens will also likely accelerate. We have updated our forecasts for both new and existing home sales and now expect a 8.2% drop in total sales this year. New home sales are expected to decline 2.5%, while sales of existing homes are expected to fall 9.0%. Housing starts should fall 6.2%, with a 3.1% drop in single-family and a 13% fall in multifamily starts.

We now expect a 8.2% drop in total home sales this year.

Figure 3

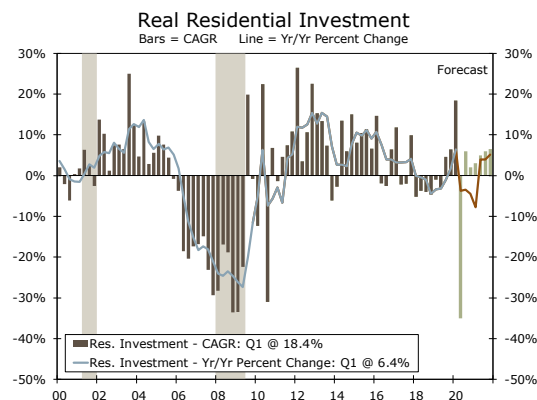
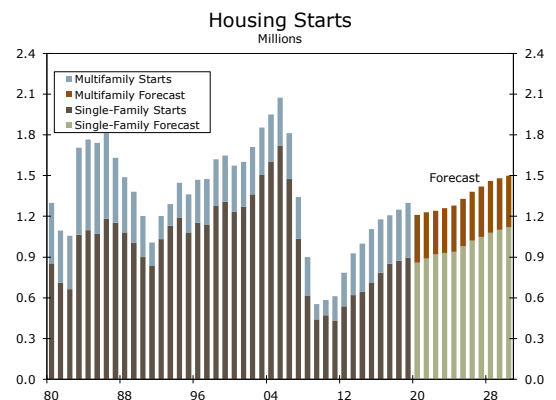


Figure 4



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

National Housing Outlook

	2013	2014	2015	2016	2017	2018	2019	Forecast	
								2020	2021
Real GDP, Percent Change	1.8	2.5	2.9	1.6	2.4	2.9	2.3	-5.8	3.3
Residential Investment, Percent Change	12.4	3.8	10.2	6.5	3.5	-1.5	-1.5	-1.3	1.1
Nonfarm Payroll Change (Avg. Monthly)	192	250	227	195	176	193	178	-703	240
Unemployment Rate	7.4	6.2	5.3	4.9	4.3	3.9	3.7	8.7	6.4
Home Construction									
Total Housing Starts, in Thousands	924.9	1,003.3	1,111.9	1,173.7	1,202.9	1,250.0	1,289.9	1,210.0	1,230.0
Single-Family Starts, in Thousands	617.7	647.8	714.6	781.5	848.9	875.7	887.7	860.0	890.0
Multifamily Starts, in Thousands	307.2	355.5	397.3	392.2	354.0	374.3	402.2	350.0	340.0
Home Sales									
New & Existing Home Sales, in Thousands	5,516.0	5,374.0	5,755.0	6,013.0	6,124.0	5,960.0	6,026.0	5,530.0	6,055.0
New Home Sales, Single-Family, in Thousands	429.0	439.0	501.0	561.0	613.0	617.0	682.0	665.0	690.0
Total Existing Home Sales, in Thousands	5,087.0	4,935.0	5,254.0	5,452.0	5,511.0	5,343.0	5,344.0	4,865.0	5,365.0
Existing Single-Family Home Sales, in Thousands	4,484.0	4,344.0	4,646.0	4,838.0	4,892.0	4,742.0	4,765.0	4,300.0	4,790.0
Existing Condominium & Co-op, in Thousands	603.0	591.0	608.0	614.0	619.0	601.0	579.0	565.0	575.0
Manufactured Homes									
Total Shipments, in Thousands	60.2	64.3	70.5	81.1	92.9	96.6	94.6	88.5	90.4
Percent Change	9.7	6.8	9.7	15.0	14.5	3.9	-2.0	-6.5	2.1
Home Prices									
Median New Home, \$ Thousands	268.9	288.5	294.2	307.8	323.1	326.4	321.5	325.0	330.3
Percent Change	9.7	7.3	2.0	4.6	5.0	1.0	-1.5	1.1	1.6
Median Existing Home, \$ Thousands	197.1	208.3	222.4	233.8	247.2	259.3	271.9	273.0	277.6
Percent Change	11.5	5.7	6.8	5.1	5.7	4.9	4.9	0.4	1.7
FHFA Purchase Only Index, Percent Change	7.0	5.0	5.3	5.8	6.4	6.5	5.3	3.6	3.9
S&P Case-Shiller C-10 Home Price Index, Percent Change	11.7	7.9	4.6	4.5	5.3	5.4	2.0	0.7	0.8
Interest Rates - Annual Averages									
Federal Funds Target Rate	0.25	0.25	0.27	0.52	1.13	1.96	2.25	0.25	0.25
Prime Rate	3.25	3.25	3.27	3.52	4.13	4.96	5.25	3.25	3.25
10-Year Treasury Note	2.35	2.54	2.14	1.84	2.33	2.91	2.14	0.95	1.36
Conventional 30-Year Fixed Rate, Commitment Rate	3.98	4.17	3.85	3.65	3.99	4.54	3.94	3.09	3.08

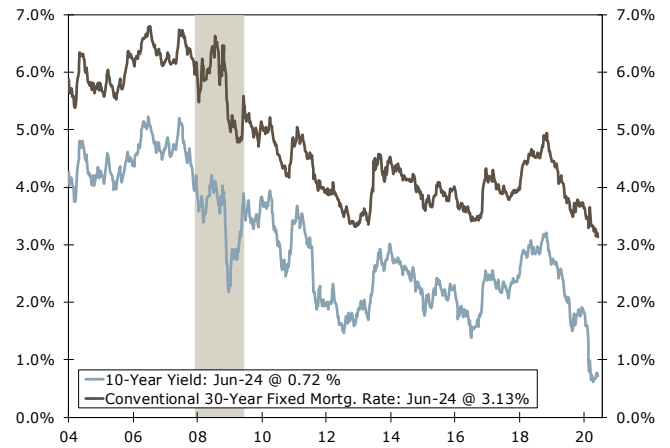
Forecast as of: June 24, 2020

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

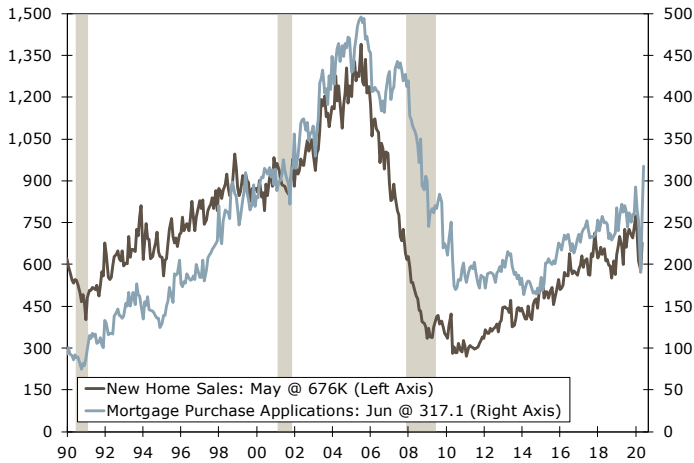
Mortgages

- The mortgage market seized up as the economic ramifications of COVID-19 became clear. Massive Fed purchases of mortgage-backed securities (MBS)—more than \$600 billion since March 16—have helped ease conditions. With added liquidity, agency MBS spreads have retraced much of their surge.
- According to the Mortgage Bankers Association, 4.2 million borrowers, representing 8.4% of all mortgage loans, are now in forbearance.
- Widespread forbearance eases the financial strain on households but might stress some mortgage servicers. Regulatory agencies are struggling to keep up.
- Despite the turbulence, mortgage rates are near record lows and applications for the purchase of a home are up 18.1% over the past year.

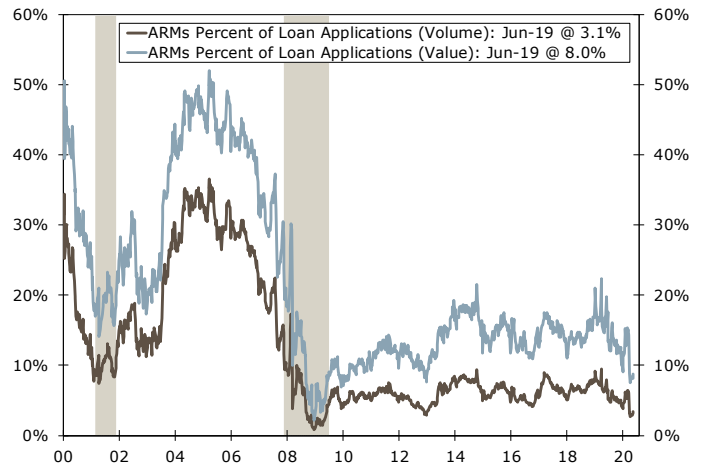
Conventional Mortgage Rate vs. 10-Year Treasury Yield



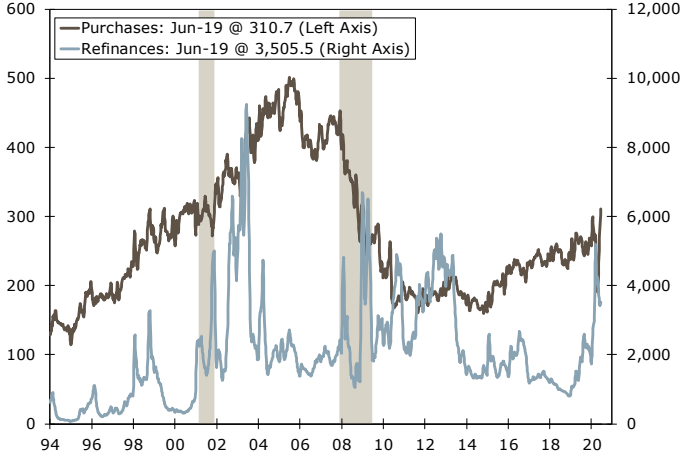
New Home Sales vs. Mortgage Purchase Applications
 SAAR, Thousands; Index 1990=100



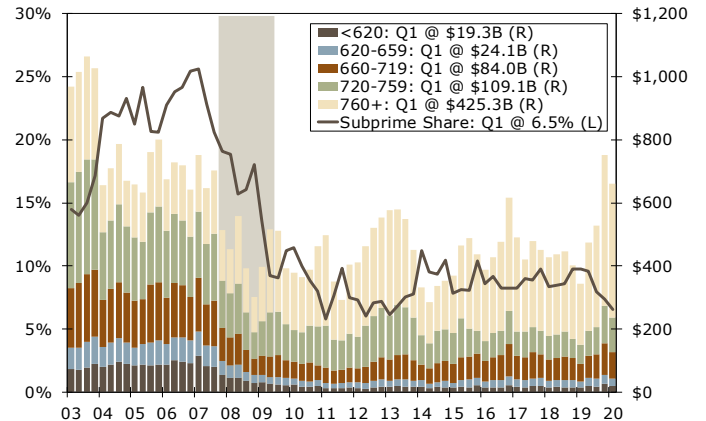
Adjustable Rate Mortgage Applications



Mortgage Applications
 Index 1990=100, 4-Week Moving Average



Mortgage Origination by Credit Score
 Billions of Dollars

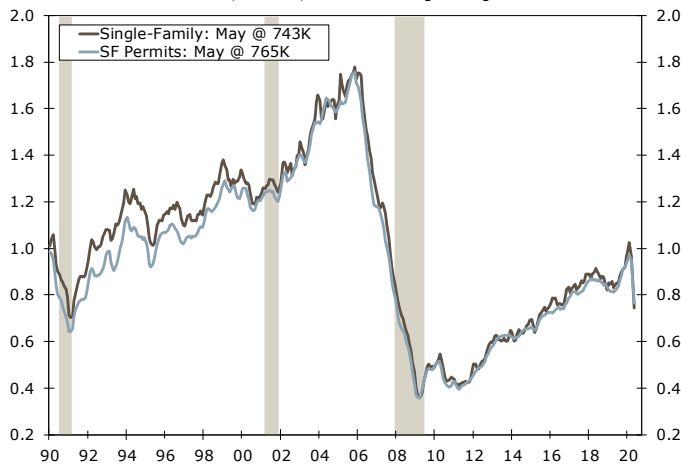


Source: MBA, FHLMC, Federal Reserve System, U.S. Dept. of Commerce and Wells Fargo Securities

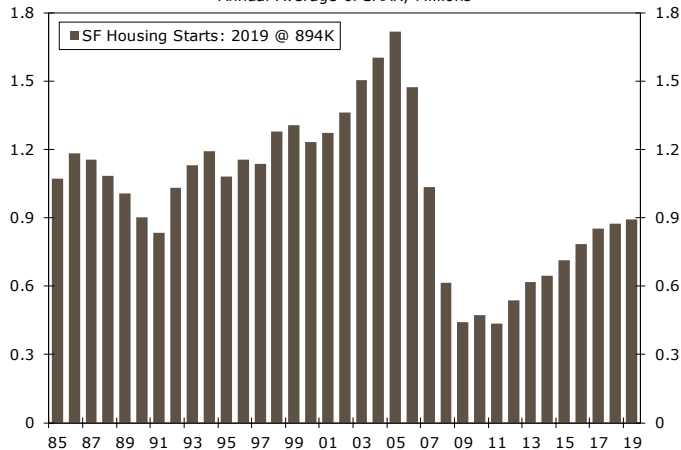
Single-Family Construction

- Cumulative single-family starts through May 2020 are running just 2.4% below their year-ago pace. Single-family permits through May, however, are running 1.8% *ahead* of their year ago pace. Single-family construction has been less affected by lockdown orders. After declining sharply in April, residential building added 65,600 jobs in May, while specialty contractors added 160,400 jobs.
- The strong start will not prevent single-family starts from falling this year. Even after rebounding slightly, the NAHB/Wells Fargo Homebuilders survey still shows prospective buyer traffic well below the levels seen earlier this year. Several homebuilders have noted an uptick in contract cancelations, which is to be expected given the sudden spike in unemployment and heightened uncertainty about the economy.

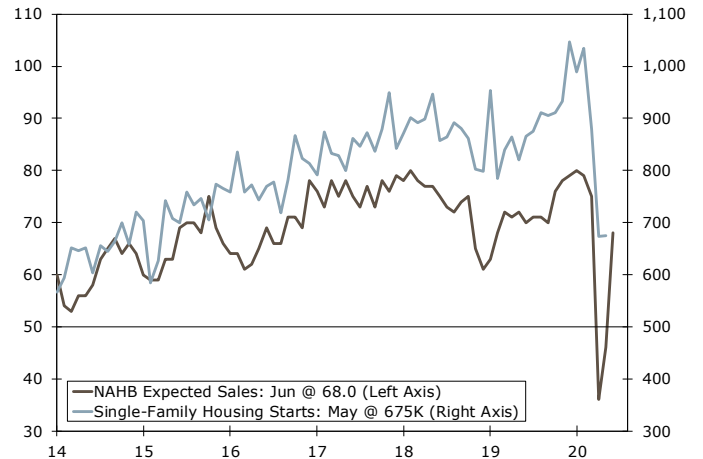
Single-Family Housing Starts vs. Building Permits
SAAR, Millions, 3-Month Moving Average



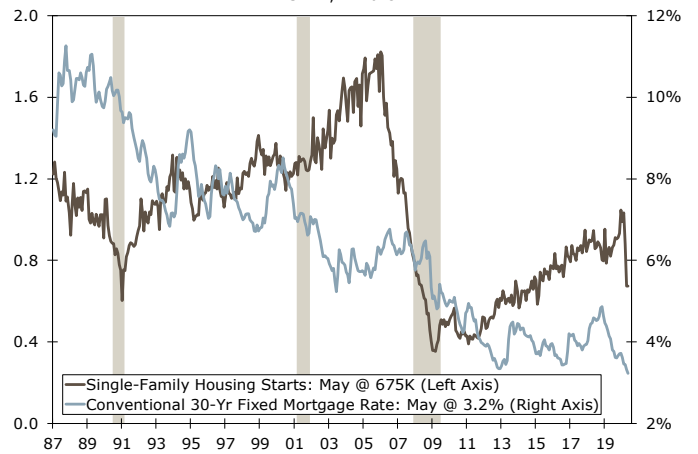
Single-Family Housing Starts
Annual Average of SAAR, Millions



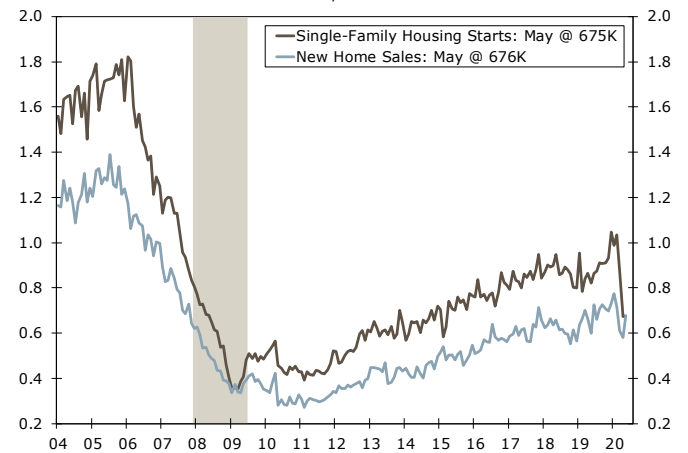
NAHB Expected Single-Family Home Sales vs. SF Starts
Index; SAAR, Thousands



Single-Family Housing Starts vs. Mortgage Rate
SAAR, Millions



Single-family Housing Starts vs. New Home Sales
SAAR, Millions

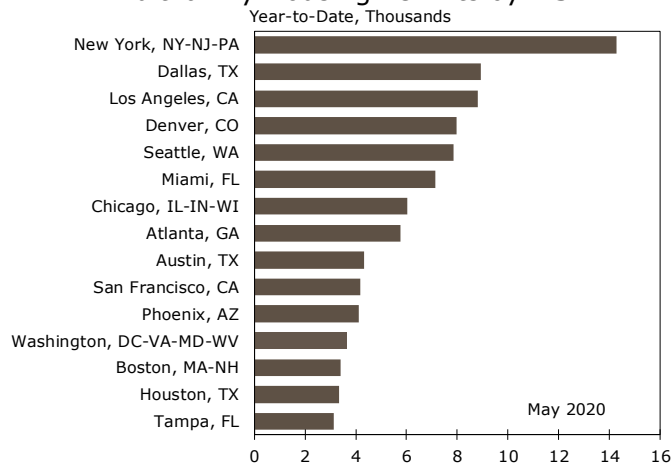


Source: U.S. Department of Commerce, National Association of Home Builders and Wells Fargo Securities

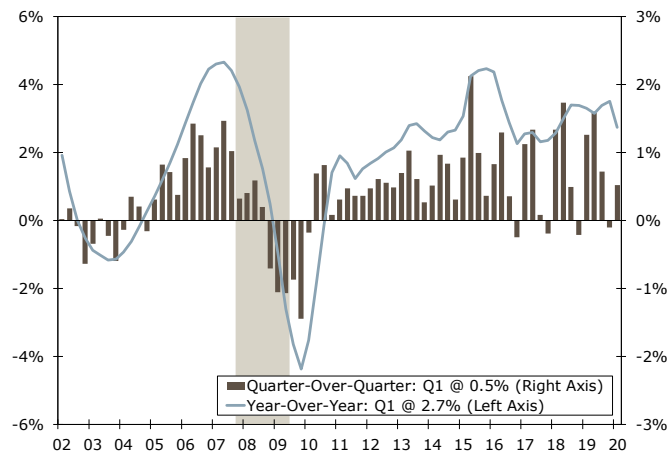
Multi-family Construction

- While overall vacancy rates remained historically low throughout much of this cycle, the sudden spike in unemployment has led to a jump in missed rent payments. Moreover, a surge in multi-family construction—the overwhelming majority of which is rental apartments—will lead to an avalanche of new supply later this year and in early 2021, amidst what looks to be soft demand.
- Multi-family starts rose 15% in May, following three months of sharp declines. There were roughly 670,000 multifamily units under construction during May and unfortunately the bulk of this supply is likely to come on line at a time that the unemployment rate is relatively high and absorption is likely to be somewhat slower than recent years.

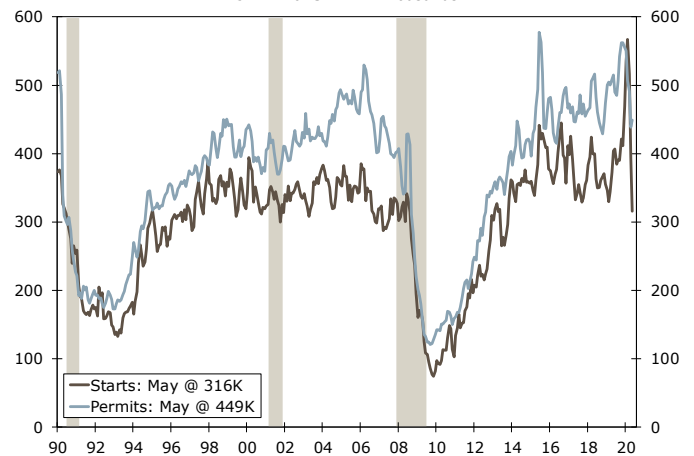
Multifamily Housing Permits by MSA



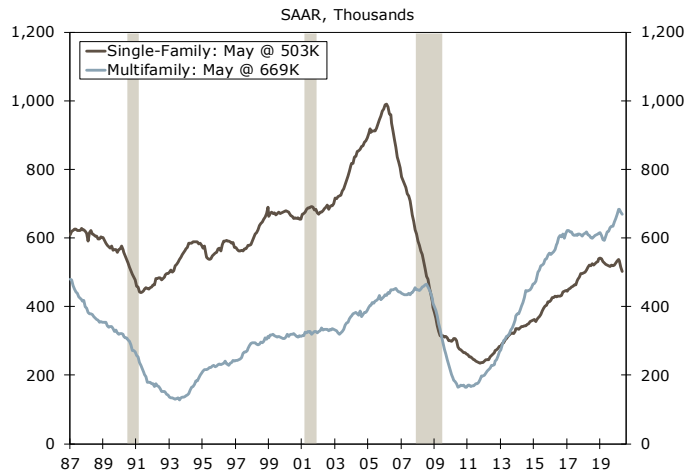
Apartment Effective Rent Growth



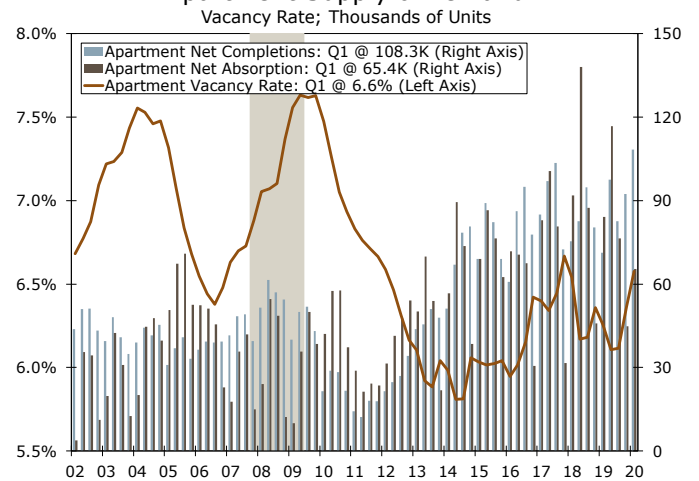
Multifamily Housing Starts vs. Building Permits



New Homes Under Construction



Apartment Supply & Demand

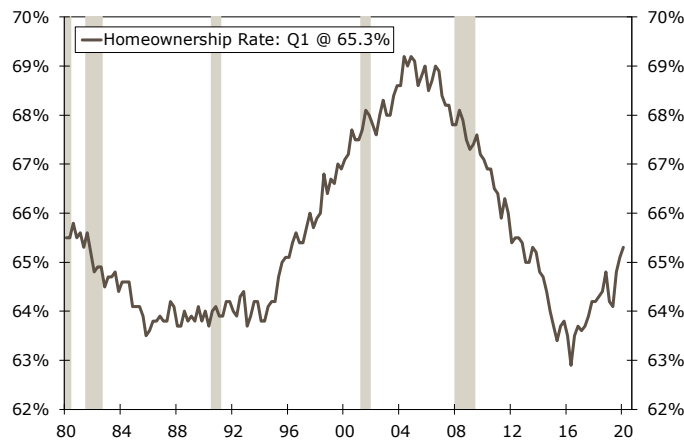


Source: U.S. Department of Commerce, CoStar, Inc. and Wells Fargo Securities

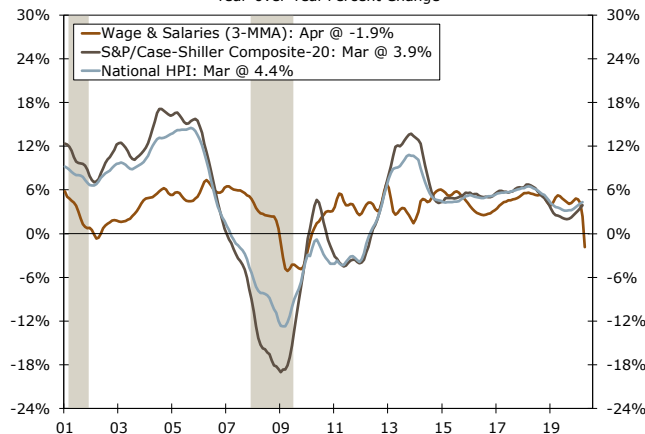
Buying Conditions

- The University of Michigan's *Good Time to Buy a Home* index plunged 28 points in April to the lowest level since 1984 as 30 million Americans filed for unemployment insurance. The index then rebounded 14 points in May.
- The initial hit to employment disproportionately affected renters, but we suspect job insecurity is now hitting a broader swath of the population. As hiring freezes and pay cuts become more widespread, the pool of prospective homebuyers will shrink further.
- Buying a home is a long-term decision and some, particularly Baby Boomers seeking retirement havens, may be looking past current hurdles. Expectations of future conditions fell much less than assessments of the present, suggesting a good deal of optimism regarding the shape of the recovery.

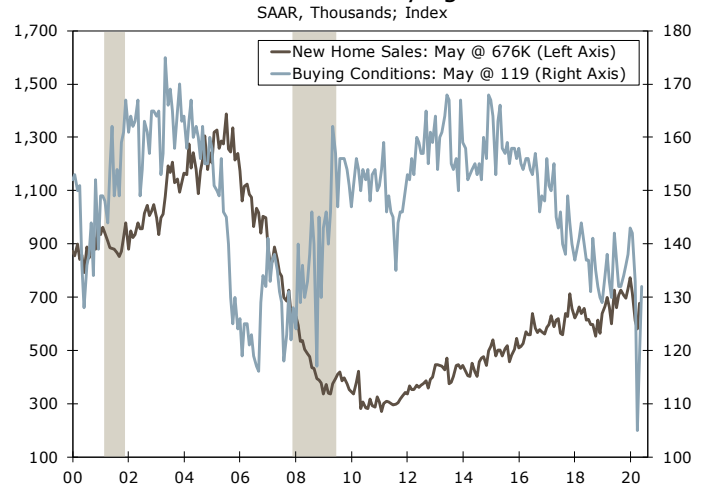
U.S. Homeownership Rate



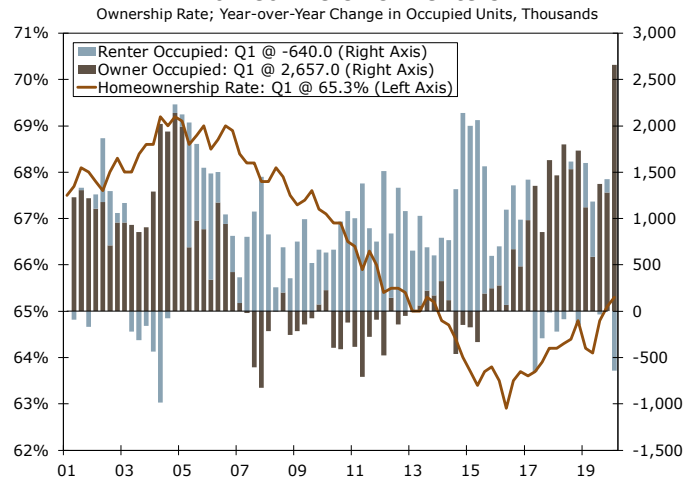
Home Prices vs. Wages and Salaries
Year-over-Year Percent Change



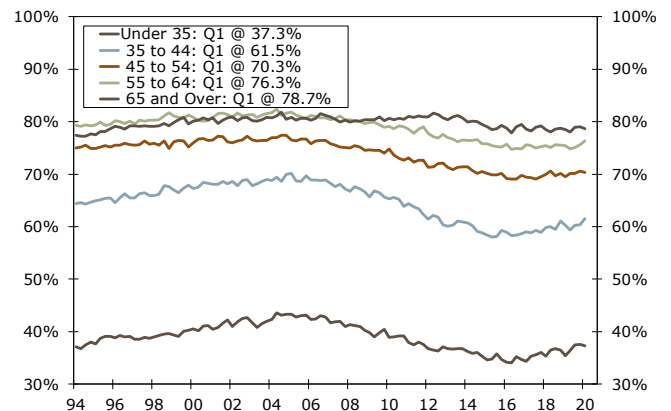
New Home Sales vs. Buying Conditions



Homeowners vs. Renters



Homeownership Rate by Age

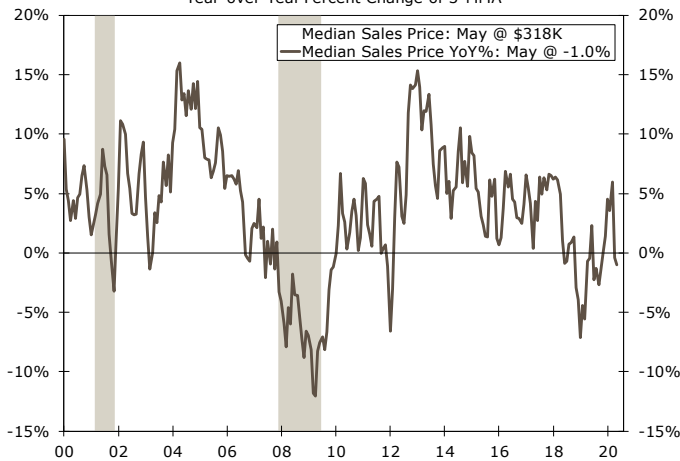


Source: University of Michigan, National Association of Realtors, The Conference Board, S&P, Fannie Mae, U.S. Dept. of Commerce and Wells Fargo Securities

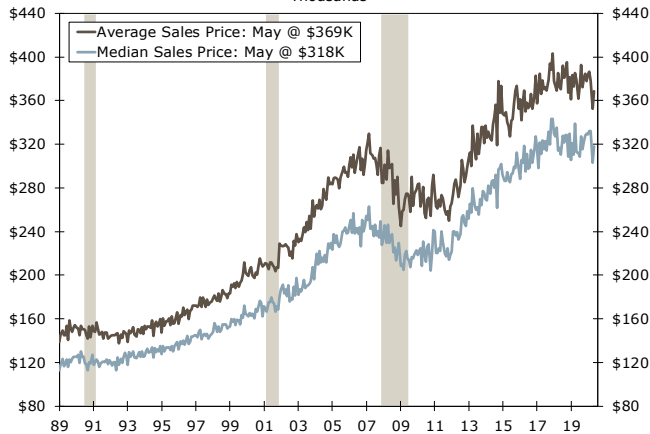
New Home Sales

- New home sales have held up much better than resale as there are fewer overall restrictions on showings. New sales surged in May, rising 16.6% to a 676,000-unit pace. Year-to-date, sales through May are up 1.9% compared to last year. Sales should continue to be sturdy this summer as buying conditions remain favorable.
- The South and West account for the lion share of recent gains, which reflects the migration to more affordable markets.
- Tight inventories should continue to keep builders busy. There were just 312,000 new homes for sale at the end of the May, down 6.6% from a year ago. Months' supply at the current sales pace also fell to 5.6 from 6.7. The median new home price rose to \$317,900, a 1.7% yearly gain.

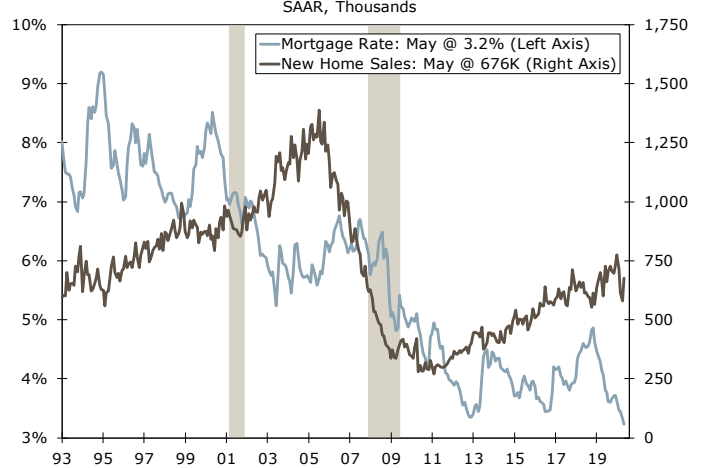
Median New Home Sales Price
Year-over-Year Percent Change of 3-MMA



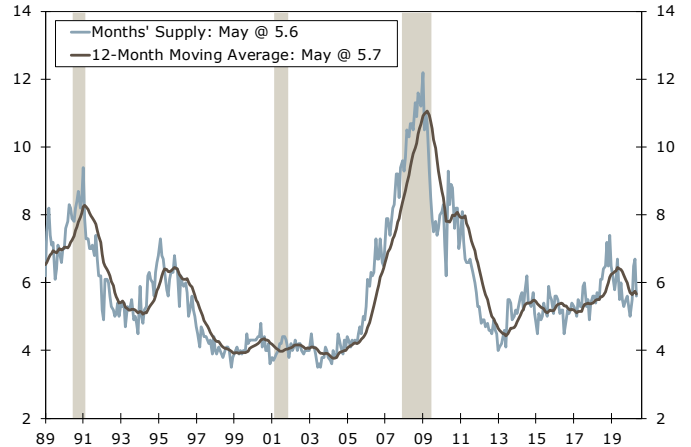
New Home Sale Price
Thousands



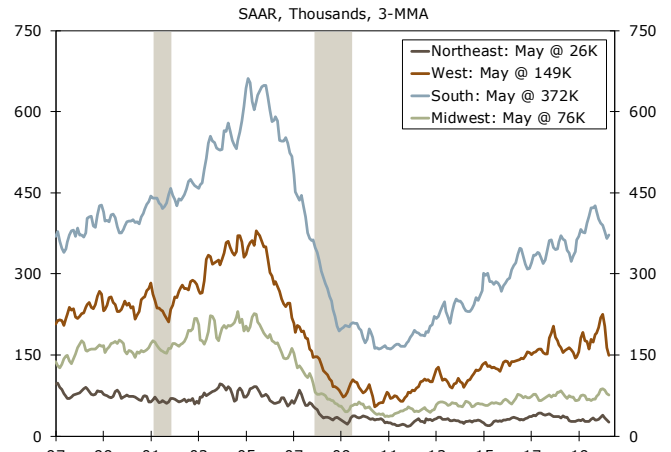
New Home Sales vs. Mortgage Rates



Inventory of New Homes for Sale
Months of New Homes for Sale at Current Sales Rate



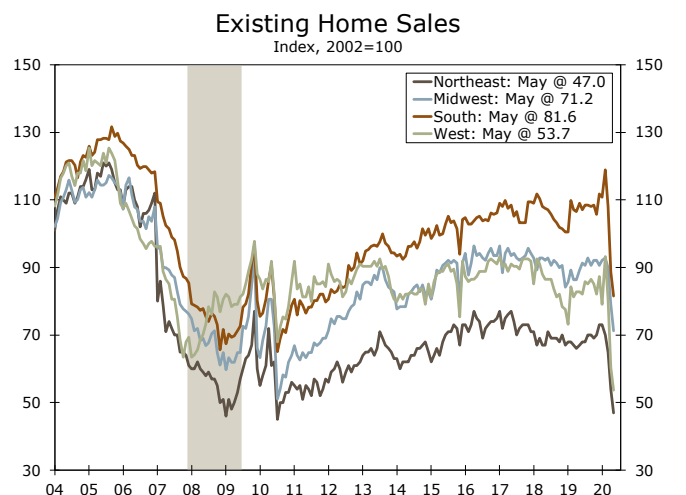
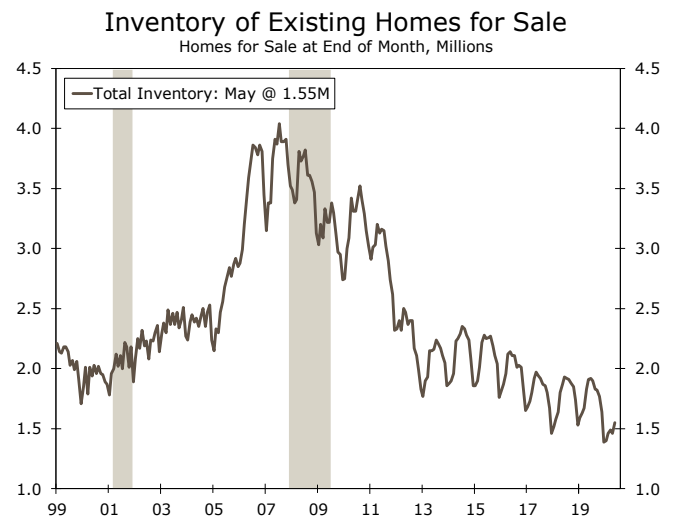
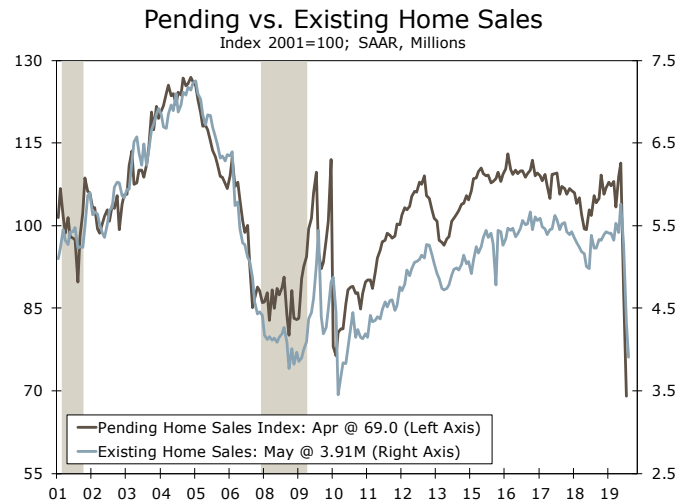
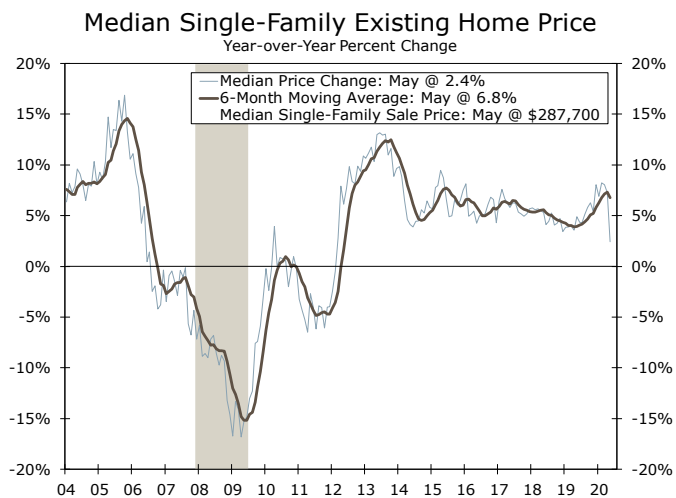
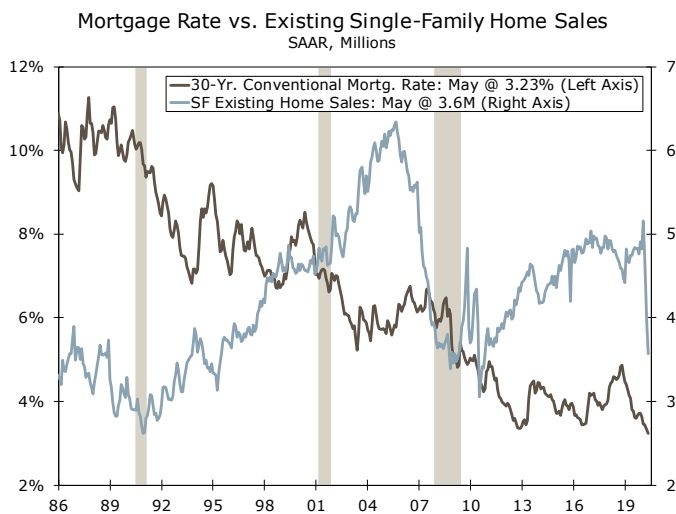
New Home Sales



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

Existing Home Sales

- COVID-19 hit the housing market at the height of the spring selling season. Existing home sales fell 17.8% in April and 9.7% in May. Large declines were expected, as social distancing and stay-at-home orders prevented showings and contract closings.
- Widespread restrictions to contain the spread of the pandemic have been challenging for both buyers and sellers. Virtual tours and digital signings have been useful stop-gap measures, but they were clearly not enough to avoid a sharp pullback in buying activity and new listings.
- Looking ahead, purchase mortgage applications have steadily risen since mid-April, an encouraging sign that home buying activity is set to rebound over the summer. Still, we expect sales to show a 9.0% decline in 2020, before bouncing back in 2021.

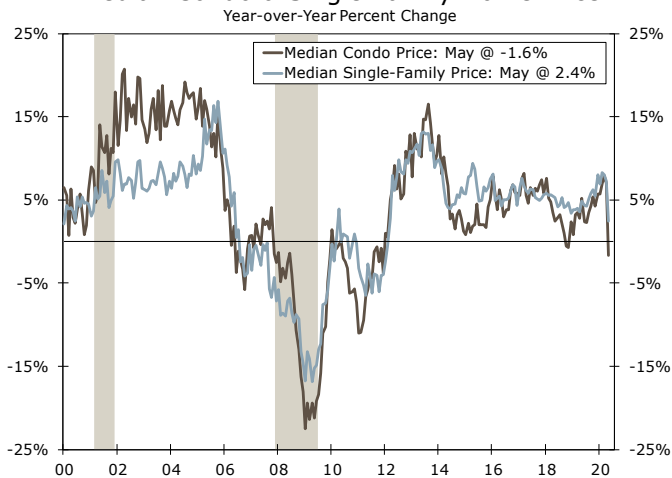


Source: National Association of Realtors, Freddie Mac and Wells Fargo Securities

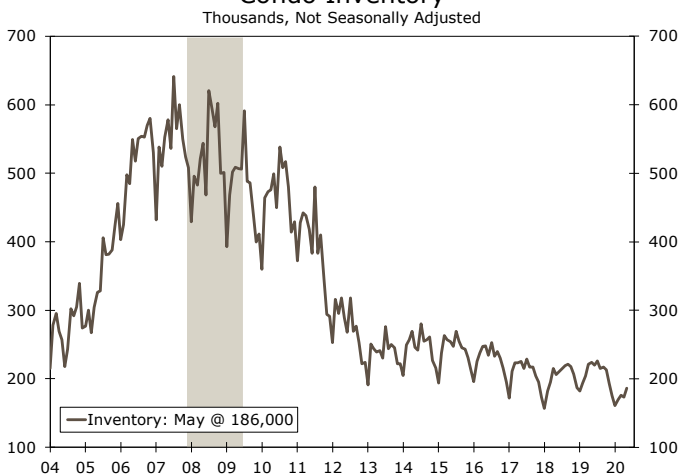
Condos and Co-Ops

- Condo sales tumbled 26% in April and 13% in May. The drop was not unexpected, as many of the largest condo markets, including New York City, Miami, Seattle and San Francisco, have been hit hard by COVID-19. Sales have now fallen to the lowest level since data first began being collected.
- Gateway cities with some of the deepest condo markets are more exposed to the spread of the virus due to their high global connectivity, density and reliance on mass transit. Early survey evidence suggests some city residents are rethinking the benefits of city living—although we think such readings should be interpreted cautiously right now.
- Predicting long-term shifts is difficult, but greater buyer hesitation in the next few months seems likely. Sales will likely weaken further and prices will fall.

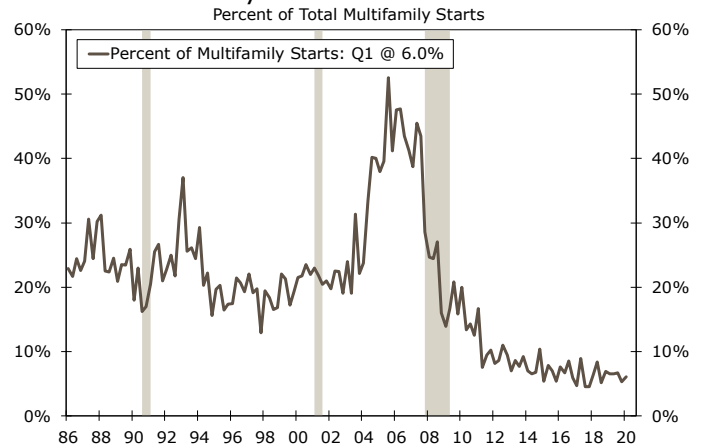
Median Condo & Single-Family Home Price



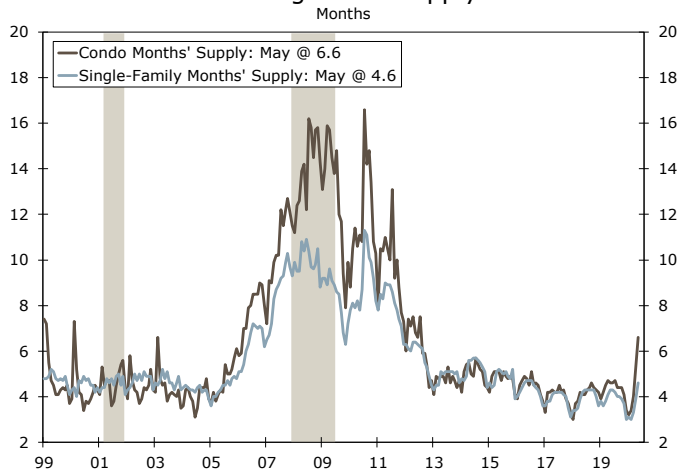
Condo Inventory



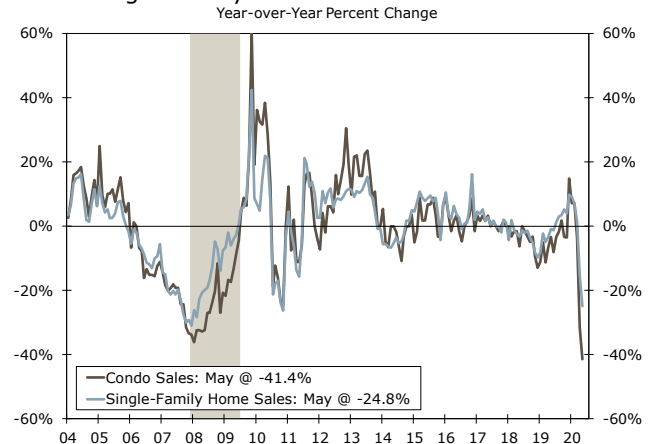
Multifamily Starts Intended for Sale



Existing Home Supply



Single-Family Home Sales & Condo Sales

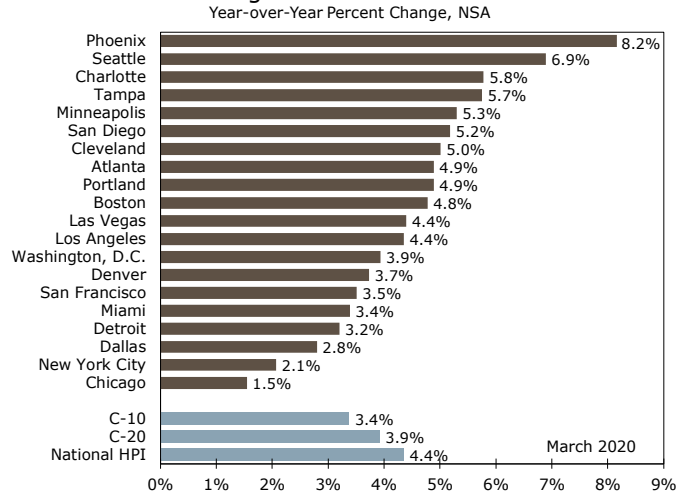


Source: U.S. Department of Commerce, National Association of Realtors and Wells Fargo Securities

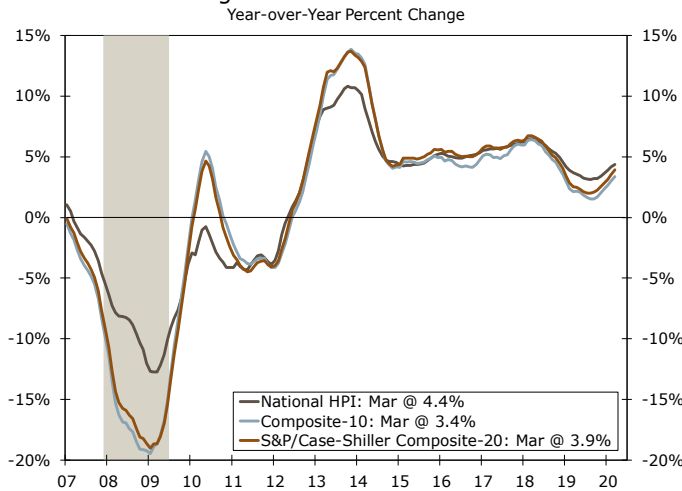
Home Prices

- Home prices may not fall as much as expected, although this may be partially due to the lack of transactions. Many have simply shelved buying plans for at least the next few months, meaning those who have to sell may be forced to take a steep discount.
- Nationwide, we expect price appreciation to cool considerably alongside slower home sales. The median price on an existing home rose 2.3% year-over-year in May. We believe median price appreciation will continue to slow and average just 0.4% growth for the year and 1.7% in 2021.
- Faster population in-flows may allow prices to hold up better in less dense and more affordable areas in the Southeast, Inner West and Texas Triangle.

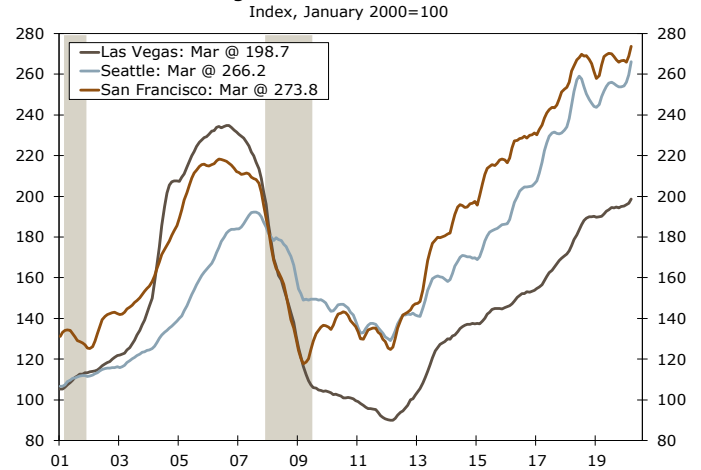
S&P CoreLogic Case-Shiller Home Prices



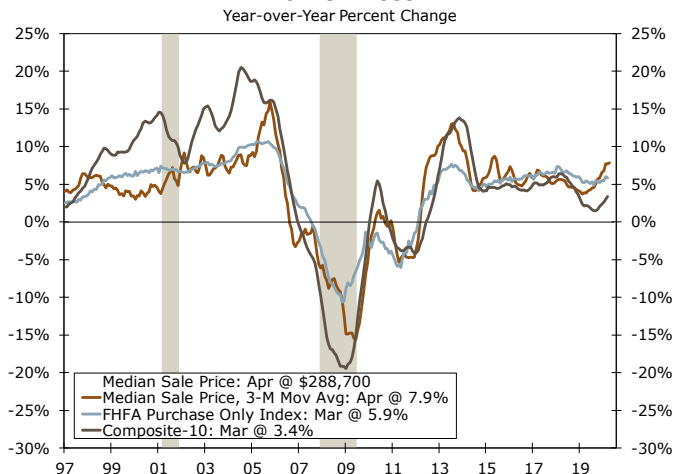
S&P CoreLogic Case-Shiller Home Price Index



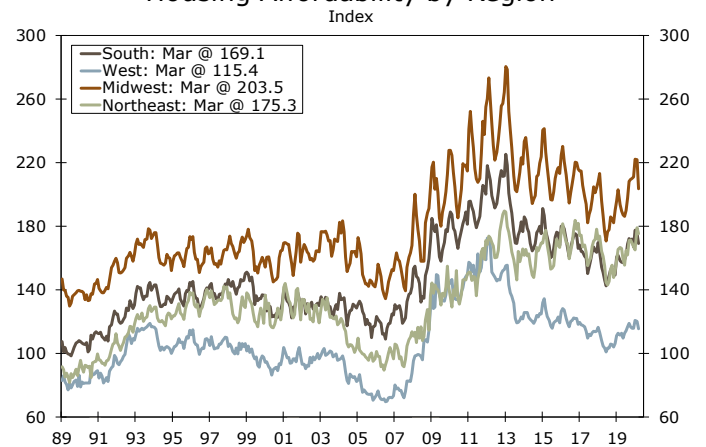
S&P CoreLogic Case-Shiller Home Price Index



Home Prices



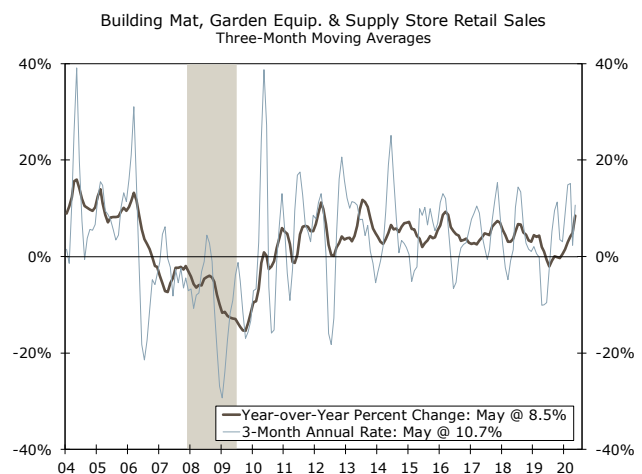
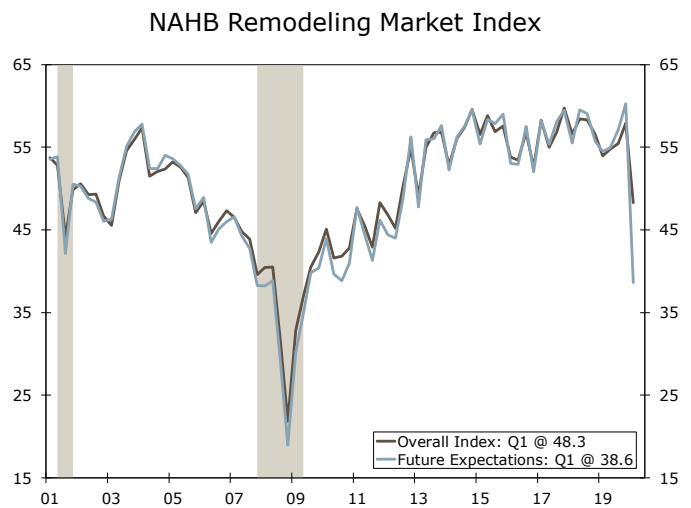
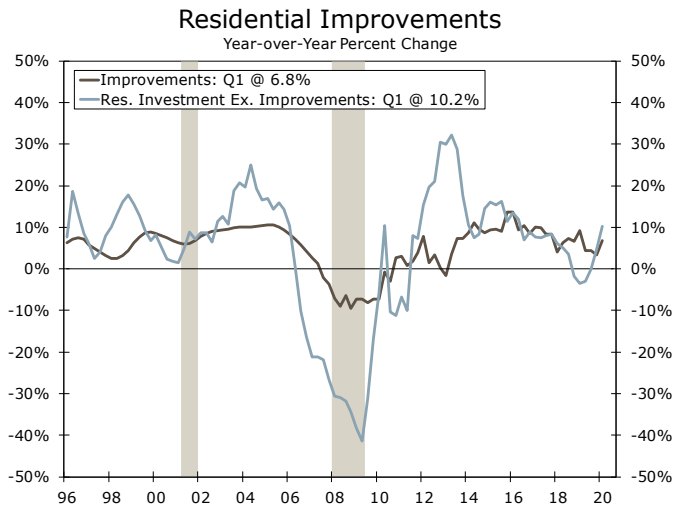
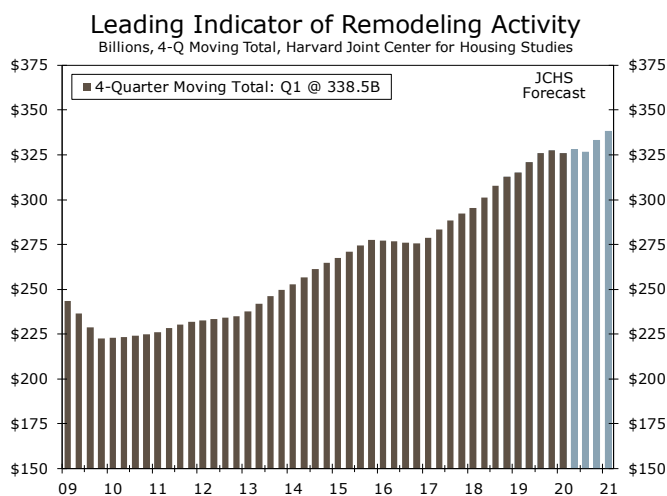
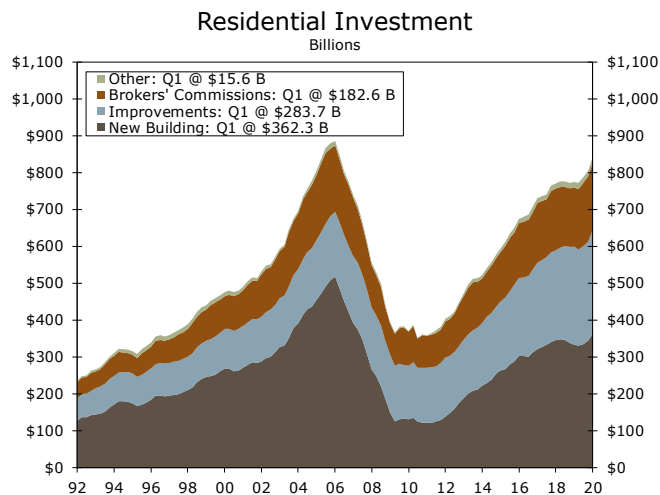
Housing Affordability by Region



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

Renovation and Remodeling

- Retail sales at building material stores were quite strong in May, rising 10.8% over the year. Even during April's historic drop at most other kinds of retail stores, sales at building material stores held firm.
- Refinancing activity also remains elevated, with mortgage rates setting new all-time lows. Home price appreciation will likely slow, but we do not expect homes to lose value, on average, which will still allow owners to tap into equity for renovation activity.
- That said, uncertain economic conditions will likely cause some homeowners to reassess the need for larger renovation projects. The Harvard JCHS Leading Indicator of Remodeling Activity projects spending on improvements and repairs to decline 1.2% to \$322 billion by early next year.

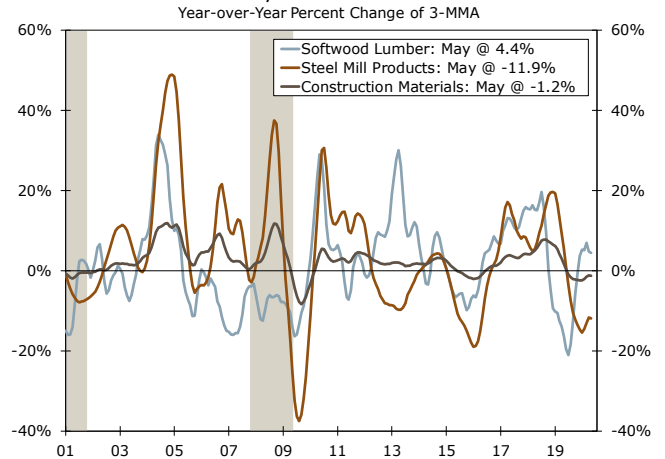


Source: Harvard Joint Center for Housing Studies, U.S. Dept. of Commerce, NAHB and Wells Fargo Securities

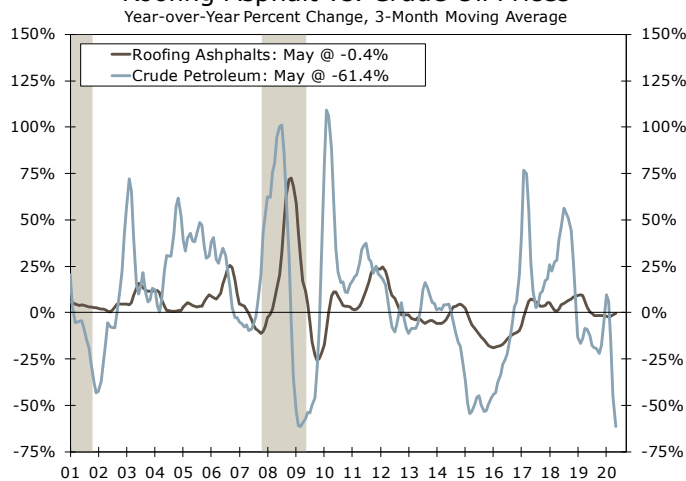
Construction Costs

- The coronavirus crisis is a demand shock, meaning a decline in construction outlays and, by extension, lower demand for building materials, will lead to slower price growth, if not outright declines.
- Similarly, labor cost pressures will likely ease as economic uncertainty leads to fewer projects over the short-term and deepens the pool of construction workers.
- Global energy demand has been sapped, which has led to a marked decline in oil and gas prices. Materials derived from energy sources, such as asphalt and plastics, will likely be pulled lower as well.
- Concerns about supply chain reshoring have roared back. Building materials sourced from high-risk areas will likely see supply chains reoriented.

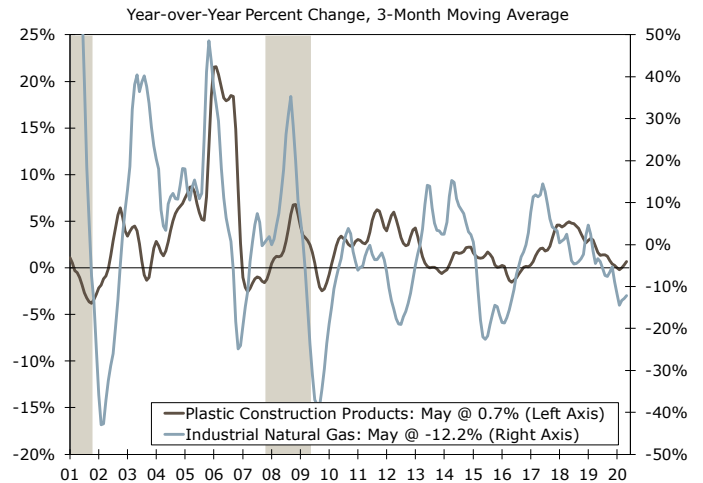
Construction, Lumber & Steel Prices



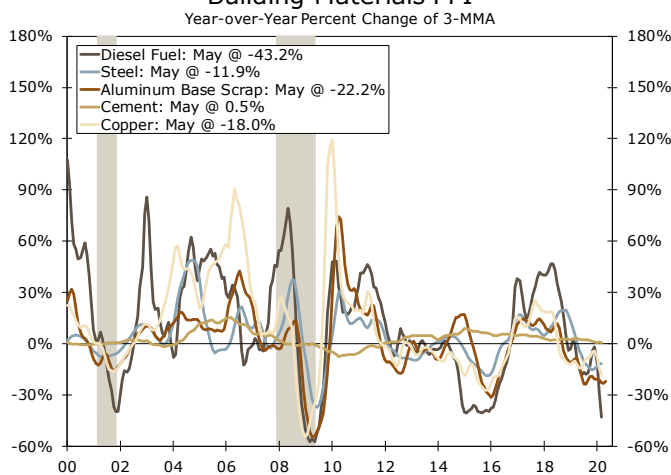
Roofing Asphalt vs. Crude Oil Prices



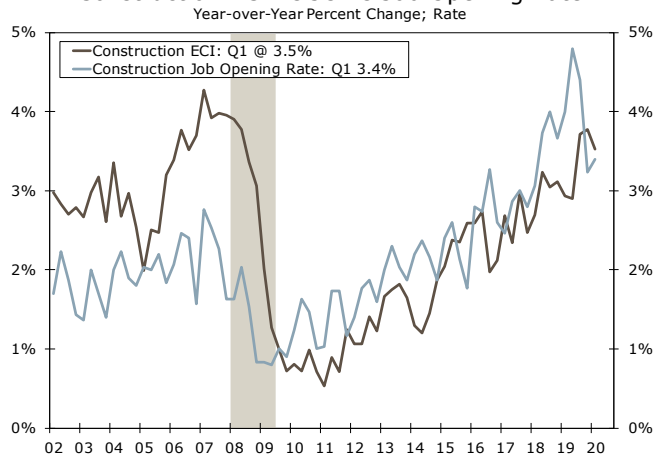
Plastic Constr. Products vs. Natural Gas Prices



Building Materials PPI



Construction ECI vs JOLTs Job Opening Rate



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

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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