

JAN. EXISTING HOME SALES DROP LIKELY A BLIP, RUSH TO LOCK IN LOW RATES TO BOOST

**U.S. existing home sales declined 3.2% in January to 5.38mn annualized, well below expectations, likely reflecting delayed contract closings due to inclement weather and the ongoing shortage of for-sale homes. Sales were down in all regions (Chart 1)*

**The pending home sales index (counts sales at initial contract signing) that leads existing sales by one-two months increased October through December, pointing to a likely rebound in sales in the next report (Chart 2)*

Mortgage interest rates have settled around 4.30%, 60 basis points above 2017 lows, but remain very low historically and should not derail the housing market recovery. Given that existing home sales are counted at contract closings, the impact of the run-up in rates in January is unlikely **to have affected January's final sales*

January's decline in existing home sales was temporary and is not the beginning of a slide in housing activity. The supply of homes continues to constrain sales, and bad weather delayed closings. Our hunch is the recent rise in interest rates was not a significant factor explaining the temporary weakness.

The months' supply of existing homes – ratio of existing homes available for sale to sales rate – remained near its historical lows, at 3.4 in January, reflecting the chronic shortage of home inventories (Chart 3). This suggests that an acceleration in new residential construction is needed to satisfy the very robust demand for housing and points to a slower pace of growth in existing home sales relative to new housing starts.

Continued solid job growth and the low unemployment rate, rising incomes, favorable demographics, high household net worth, and the chronic shortage of for-sale homes will ensure that housing, which is at a much earlier stage of its recovery than other sectors, continues on an upward trend. The path up will be rocky with interest rate, supply, and weather roadblocks along the way.

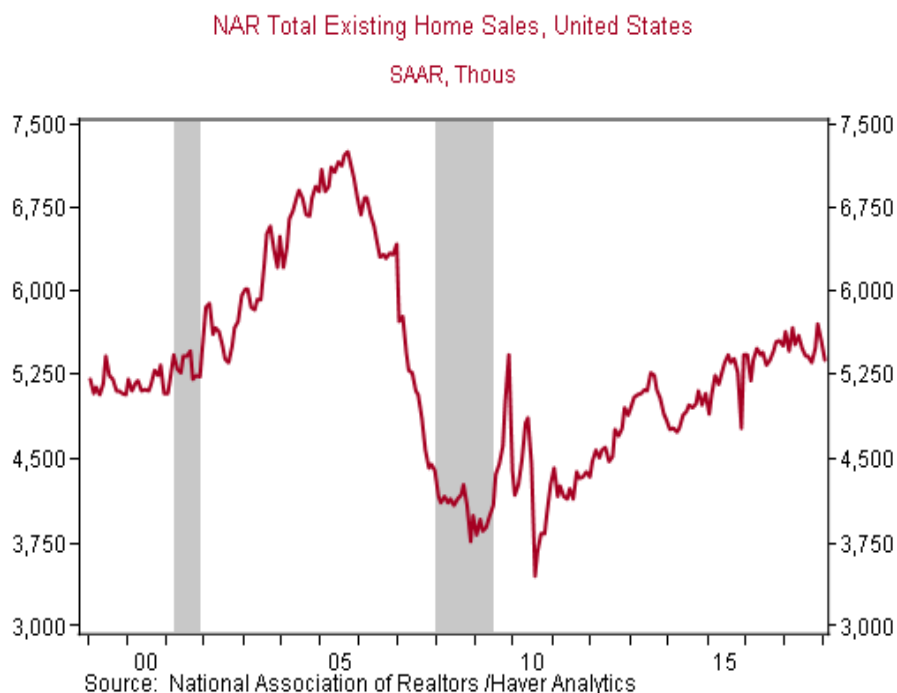
The sharp 100 basis point rise in interest rates beginning in May 2013 — the so-called “**Taper Tantrum**”— provides an interesting benchmark for the expected pattern of home sales. Initially, existing home sales surged as buyers rushed to lock in mortgages in fear of further rate increases. Existing home sales then remained depressed in subsequent months, with sales eventually recovering as consumers adjusted to the new rate environment (Chart 4). **The University of Michigan's consumer sentiment survey** suggests that a similar response is currently under way, as a relatively high share of consumers view current home buying conditions as good because of rising interest rates (Chart 5).

The Mortgage Bankers Association's weekly mortgage loan applications for purchase volume index has reflected the rush to lock in rates, climbing to relatively elevated levels through early February, before falling sharply in the latest week.

The higher rates may keep some potential homebuyers on the sidelines, but we expect that, as long as mortgage interest rates remain below 5%, the housing market recovery will be sustained. Based on the **National Association of Realtors' Housing Affordability Index** — which currently suggests that buying conditions are very favorable — we estimate that interest rates would have to climb well above 5% to prevent a normal household from qualifying to purchase a median priced home (Chart 6).

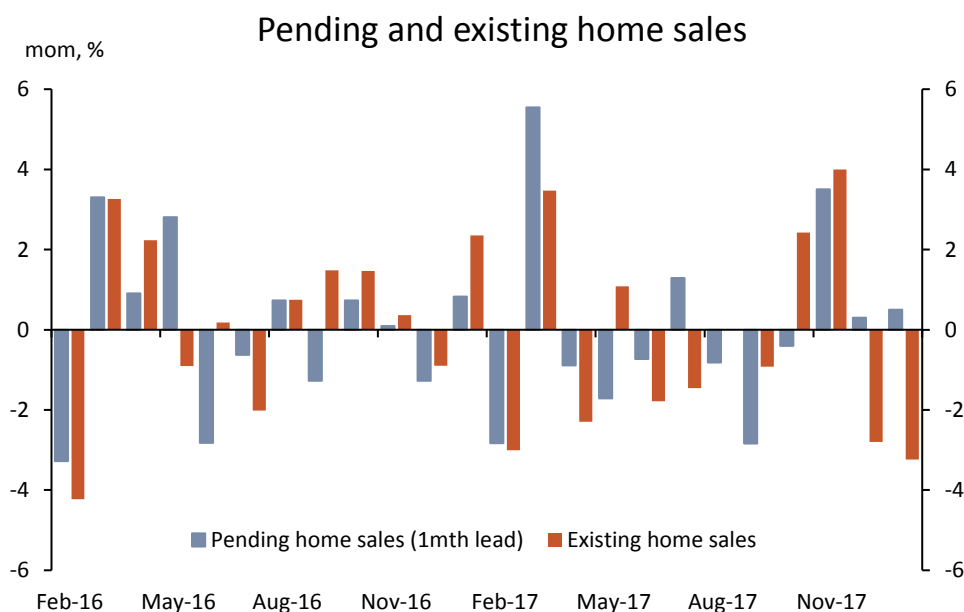
21 February 2018

Chart 1: US Existing Home Sales



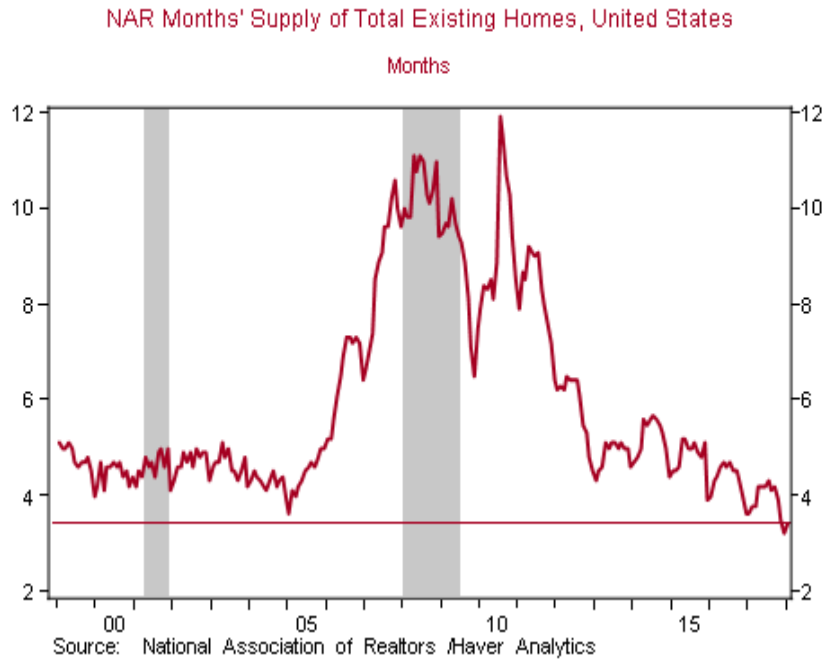
Source: Monthly data. Source: National Association of Realtors and Haver Analytics

Chart 2: Pending and existing home sales



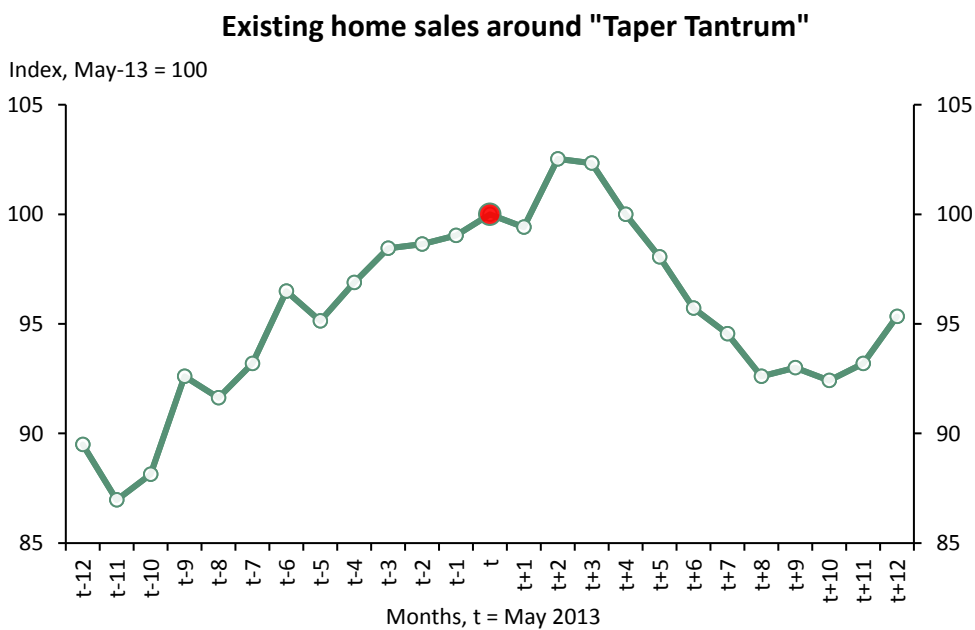
Source: Monthly data. Source: National Association of Realtors and Berenberg Capital Markets

Chart 3: **Months'** supply of homes on the market



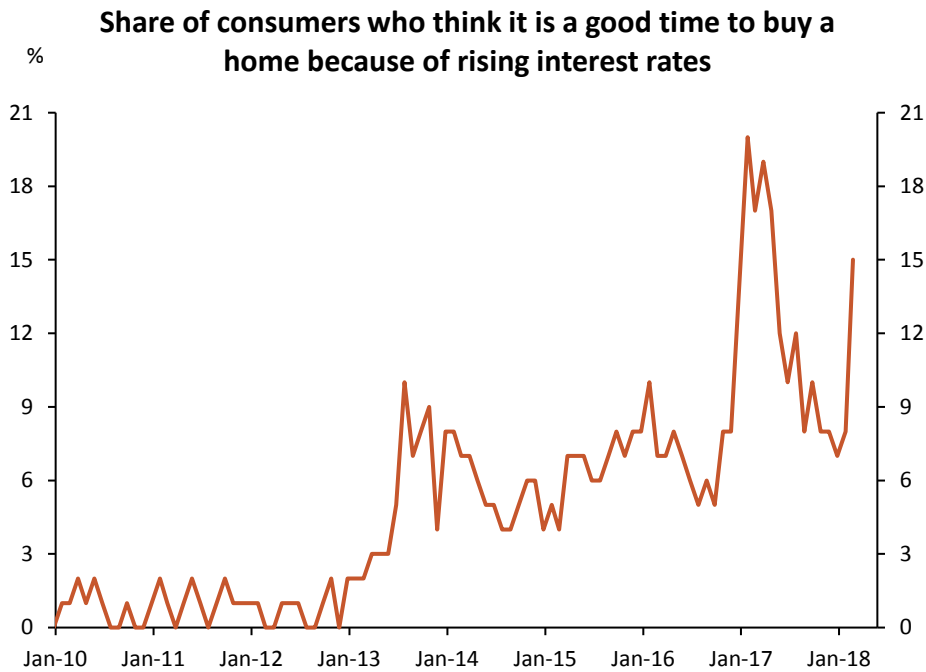
Source: Monthly data. Source: National Association of Realtors and Haver Analytics

Chart 4: Existing home sales around "Taper Tantrum"



Source: Monthly data. Source: National Association of Realtors and Berenberg Capital Markets

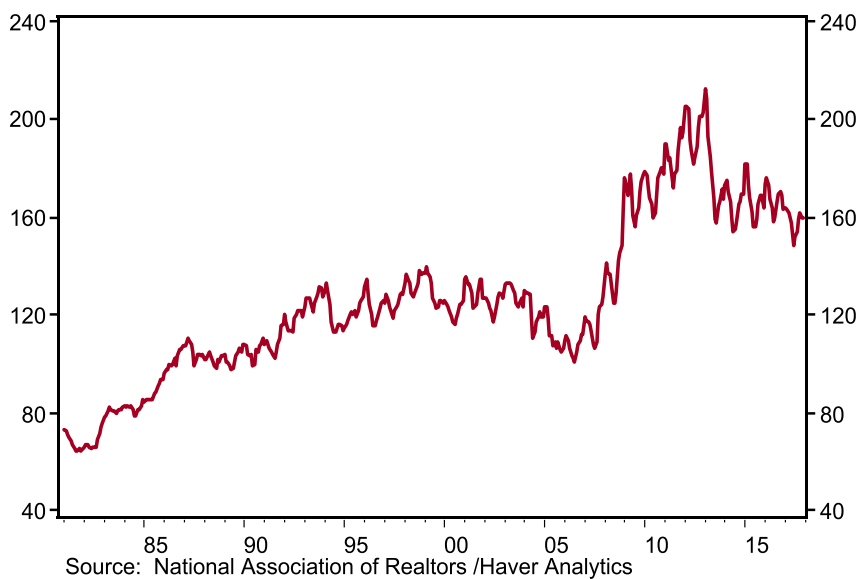
Chart 5: Share of consumers who think it is a good time to buy a home because of rising interest rates



Source: Monthly data. Source: University of Michigan, Bloomberg and Berenberg Capital Markets

Chart 6: Housing Affordability Index

NAR Housing Affordability Index: Fixed Rate Mortgages, United States



Source: Monthly data. Source: National Association of Realtors and Haver Analytics

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