US housing market: Constructive, for now

More solid figures from the US housing market in 1Q. So far, higher mortgage rates and the adverse effects of tax reform don't seem to have put much of a dent in the market

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Sales slowing as headwinds grow

Another decent set of data on the US housing market suggests buyers are so far coping with higher mortgage rates and the effect of tax reform. Existing home sales rose by 1.1% month-on-month and new home sales jumped by 4%, both beating expectations. Pending home sales, an indicator of sales for the next couple of months, rose by a more modest 0.4% MoM, a touch below expectations, suggesting some dampening in the outlook for 2Q.

Despite the increase in March relative to February, sales of existing homes were below the level seen in March of last year. There are two key reasons for the flattening out of sales levels:

1. There simply aren't enough homes on the market. Inventory levels are near all-time lows and properties spent on average 30 days on the market last month, down from 34 days in March last year. This makes it difficult for sales volumes to rise further.
2. Affordability is stretched, with prices continuing to rise at a pace well above wage growth. The FHFA national house price index rose by 7.2% in February and looks set to increase

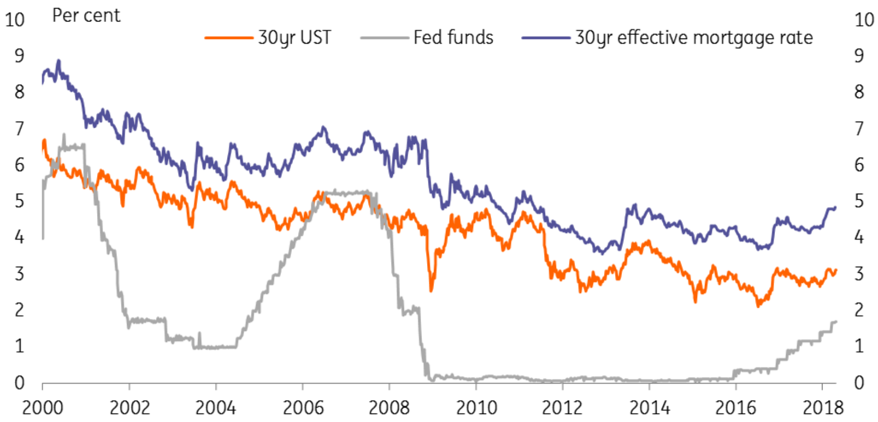
further. At the same time, mortgage rates are rising. Effective rates are nearing 5%, a level not seen since 2011. But mortgage demand appears to be holding up well. That's probably in part down to the strong economy and confidence. But it is also likely that buyers are well aware that rates are set to increase further from here as the Fed stands ready to hike again, so there is a clear incentive to get a mortgage locked in now before rates go up more.

But construction is picking up

The good news for prospective buyers is that house construction is picking up. New starts rose to 1.319m in March and new permits to 1.354m, both around 10% higher than a year ago. Estimates for the previous months were revised up as well, pointing to stronger momentum in the construction sector. This means residential investment looks likely to make a significant contribution to US growth this year, and should eventually make it a bit easier to find a home to buy in the US.

One factor that doesn't appear to be having as much of a negative impact as feared is the tax changes Congress passed in December. The reforms to the US tax code have reduced the tax benefits of homeownership, in particular for high-priced homes. But sales in the $750,000+ segment of the market rose by 15% in March according to the NAR, suggesting buyers at the high-end part of the market are shrugging off the tax impact, at least for now.

US mortgage rates rising as Fed tightens policy



Source: Macrobond

Overall, we remain pretty optimistic about the US housing market in the near term. A strong economy and rising house prices go hand in hand, with increasing construction activity supporting growth momentum. But there is an inherent tension between rising house prices and higher interest rates. Eventually, affordability will be squeezed to the point that price growth moderates and construction slows. We aren't there yet, and may not be for some time. But the pinch point is getting closer.