



Fannie Mae Forecasts Home Price Growth, Existing Sales

Like most recent economic forecasts, that one from Fannie Mae's Economic and Strategic Research (ESR) group for July continues to project a pull-back in recent inflation numbers. This time there seems to be a little hedging, but there is little of that in the housing portion of the report.

According to the Federal Housing Finance Agency (FHFA) Purchase-Only Index, **house prices rose 15.7 percent** in April from a year prior, **the fastest annual growth rate since the beginning of the index in 1991**. Consequently, the company significantly upgraded its quarterly house price forecast, projecting that the FHFA index will increase by 14.8 percent in 2021, up from the prior forecast of 8.0 percent. Given the combination of affordability constraints weighing on demand and an end to what may be the pulling forward of many purchases over the last year by first-time home buyers, **price growth in 2022 is expected to decelerate but still register a gain of 5.4 percent**.

A lack of listings continues to hold back home sales, and as expected, existing home sales slipped 0.9 percent in May to an annualized pace of 5.80 million. Even with the pullback in sales, the supply of homes for sale at the current sales pace was only 2.5 months, an historic low for the month of May. A modest uptick in new home listings in recent weeks has brought them to a level similar to the same time in 2019, but sales are 7 percent higher than then.

Pending home sales, which lead closings by about 30 to 45 days on average, jumped 8.0 percent in May **which would normally suggest a significant increase in existing sales in June**. But the ESR group says they believe the increase partially reflects a recoupling of the index's typical relationship with existing sales which had deviated somewhat in recent months. They expect further near-term slowdown in the pace of sales. The economists slightly downgraded the forecast for second and third quarter total home sales because of a weaker short-term outlook for new home sales, largely due to continued supply constraints affecting homebuilders. This was partially offset by a modest upward revision to second quarter existing home sales. Total sales for 2021 are now expected to increase by 3.8 percent rather than the 4.2 percent predicted last month.



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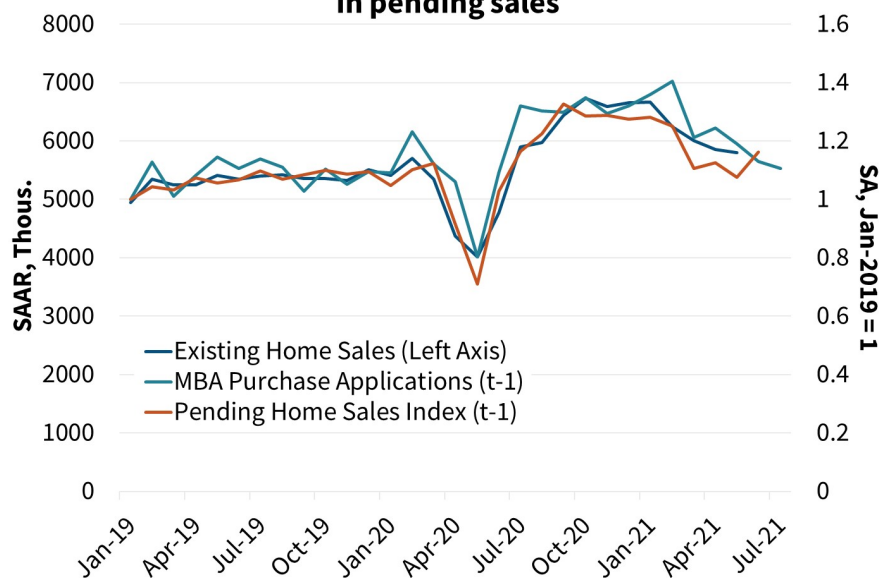
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Existing home sales may not follow jump in pending sales



Homebuilders continue to face supply constraints, limiting the pace of sales. The company says many anecdotal accounts have builders no longer accepting orders or limiting them until supply chain disruptions and material prices ease, and they're able to catch up with existing backlogs. Consistent with this dynamic, new home sales fell 5.9 percent in May. In contrast, single-family housing starts rose 4.2 percent over the month, but this followed a 16.0 percent plunge in April. However, with lumber prices now falling sharply from their recent peak (futures prices are down 57 percent as of July 12 from the peak in May), and an expectation that supply chain disruptions and labor shortages will ease moving forward, **the forecast is for single-family housing starts and sales to rebound as the year progresses.** An increase in the number of new homes for sale should also contribute to move-up homebuyers placing their existing homes on the market, putting some downward pressure on surging prices.

Housing starts are forecast to be 17.7 percent higher than in 2020, up from a 17.2 percent gain previously, due to an upgrade to multifamily starts which moved up 2.4 percent in May to an annualized pace of 474,000 units.

The 10-year Treasury rate closed at 1.45 percent at the end of June after beginning the month at 1.62 percent and was at 1.41 percent as the report went to press. It is not entirely certain what has caused this softness in rates, but a combination of technical factors, including the U.S. Treasury drawing down existing cash balances (limiting new issuance) and investors needing to cover short positions, are said to have contributed to it. Part of the movement is also likely attributable to concerns over the impact on global growth from the spread of the COVID-19 Delta variant.

Coinciding with the pullback in the Treasury rate, the 30-year mortgage rate dipped below 3.0 percent once again. The ESR group now expects it to average 3.1 percent in Q4, down from 3.2 percent in the prior forecast. They have also upgraded the forecast for mortgage origination volumes. Purchase mortgage originations were increased by \$22 billion to \$1.8 trillion for 2021 and \$76 billion to around \$2.0 trillion for 2022. Refinance volume is projected at \$2.4 trillion this year, a \$78 billion increase from last month's forecast and around 1.3 trillion in 2022, a \$102 billion gain.

The economists downgraded their 2021 GDP forecast (Q4/Q4) by one-tenth point to 7.0 percent with an offsetting uptick in 2022's expected growth rate to 2.8 percent. However, those numbers mask more meaningful changes as to the time and sources of growth. Recent consumer spending and housing construction data as well as federal spending projections from the Congressional Budget Office (CBO), led to a move of a larger share of this year's growth to the second half. The Q2 expectation has been revised down accordingly to 8.1 percent from 10.1 percent and the Q3 and Q4 forecasts have been increased. There is also a significant deceleration in consumer spending moving forward. GDP growth will be increasingly driven by inventory restocking and a shift toward spending on services rather than on goods.

The report adjusts the path of inflation, but the authors expect broader inflationary pressures to partially offset many of the transitory factors that have been in play. They forecast the Consumer Price Index (CPI) to remain around an annual 5 percent at the end of 2021 with deceleration expected to follow. It will, however, remain elevated through the end of 2022, with the CPI expected to end the year near 3 percent.

Downside risks to the forecast are COVID-19 developments, supply chain disruptions and inflation. As countries in the Asia-Pacific region, distancing restrictions have been reinstated. This could weigh on global demand and increase supply disruptions. The forecast for the second half of the year assumes easing supply restrictions and a loosening of labor markets. Additionally, while continued inflation is expected, the company sees the bulk of current drivers being transitory. However, even temporary price increases can affect consumer and firm psychology and if inflationary expectations rise further, a wage-price spiral could potentially develop. If this occurs, a jump in longer-term interest rates is possible, **along with earlier or more aggressive pace of Fed tightening**. This would likely drag on growth and negatively impact home sales, prices, and construction, as well as mortgage originations. Because of the uncertainty, there have not been any potential infrastructure or fiscal legislation built into the outlook.

As to the transitory nature of this inflation, the June CPI showed an 0.9 percent month-over-month increase as did the core CPI. This was the third consecutive "hot" inflationary print, leaving the annual topline and core inflation rates at 5.4 percent and 4.5 percent, respectively. The former was the fastest since the oil price surge in 2008, while the latter was the swiftest gain in prices since 1991.

As was the case in the prior two months, the bulk of the increase was due to the ongoing supply chain-driven auto price surge, as well as from "reopening" segments such as air travel, hotels, and food away from home. Subtracting these components, the monthly CPI rose by a significant, though much more subdued, 0.4 percent. While some of the "reopening" industries are likely to continue to experience upward pricing pressure, the surge in auto prices may have already begun to subside. Additionally, the CPI measure overshot its recent relationship to the wholesale price index, suggesting some outsized pullback may occur in the July CPI reading. Therefore, the group says it thinks June may mark the peak of the recent inflation surge, with a leveling of auto prices helping to hold down further gains. As these factors fade, however, others may emerge such as wage gains and the CPI measure of homeownership housing costs.