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Housing supply remains low, even as demand falls

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Demand for housing has fallen drastically since the start of 2022 with high prices and rising mortgage rates pushing many prospective buyers out of the market. However, home prices have continued to grow. A shortage of existing homes, slow growth of new construction and discouraged new home builders threatens to keep price growth elevated.

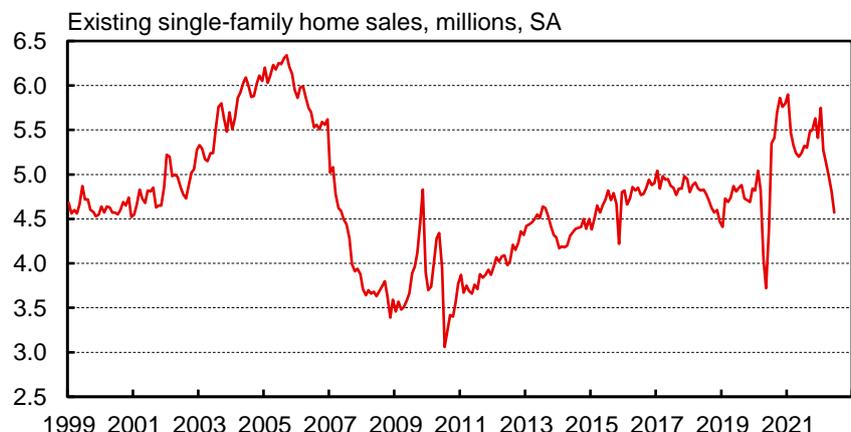
Housing demand continues to fall in 2022

Demand for single-family housing reached record highs during the pandemic, as many office workers began working remotely and mortgage lending rates fell to historic lows. Sales of existing single-family homes peaked in January 2021; a 17 percent growth compared to the pre-pandemic level (February 2020), according to the National Association of Realtors.

Homebuilder confidence in the market for newly built single-family homes peaked in November 2020, with the NAHB/Wells Fargo Housing Market Index (HMI) growing nearly 22 percent compared to the pre-pandemic level (February 2020). The index reflects market conditions and sales of present and future single-family homes.

The supply of available homes for sale and new construction could need keep up with the drastic and sudden rise in demand, resulting in rising listing prices and subsequent housing inflation. Home price have reached an all-time high in 2022 with the median sales price of existing homes having grown an average of 2.5 percent a month in the first half of 2022, up 13.3 percent year-over-year in June 2022. The shelter component of the Consumer Price Index (CPI), largely weighted by owners' equivalent rent, is up 5.6 percent year-over-year in June 2022.

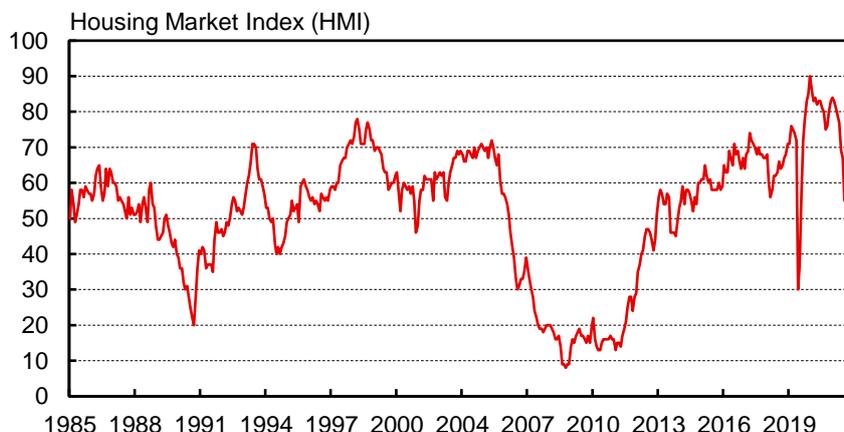
SALES OF EXISTING HOMES CONTINUE TO FALL FROM PANDEMIC PEAKS



Source: National Association of Realtors, MUFG Bank Research Office

To slow price growth, the Federal Reserve raised the benchmark overnight interest rate in March 2022 for the first time since 2018 and began reducing its securities holdings, including Mortgage-Backed Securities (MBS) in June 2022. As a result, the average 30-year fixed rate mortgage reached five percent in April 2022 for the first time since 2009 and has remained above it as of July 2022.

MARKET CONDITIONS FOR SINGLE-FAMILY HOUSING HAS DETERIORATED



Source: NAHB/Wells Fargo, MUFG Bank Research Office

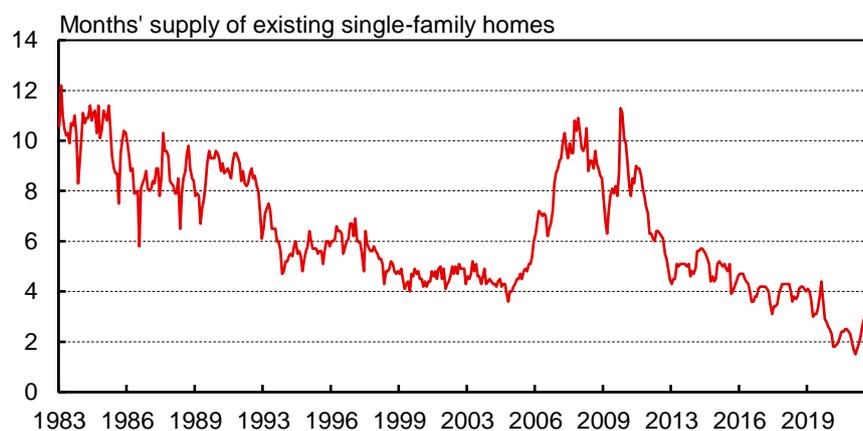
Demand has since fallen considerably, reflected in both overall market conditions and existing single-family home sales. The NAHB/Wells Fargo HMI has fallen 34 percent overall from March to July 2022. All components of the index, including present sales, sales in the next 6 months and traffic of prospective buyers of single-family homes, are all down. Additionally, existing single-family home sales from the National Association of Realtors are down 21 percent since the beginning of the year.

Falling demand will improve the supply/demand imbalance in the housing market and help slow price growth, but widespread housing shortages threaten to keep prices and price growth relatively high.

Low housing supply will maintain upward price pressures

The supply of available homes is hovering around historic lows. The months' supply of existing single-family homes has trended downward for decades, referring to the number of months it would take for the current inventory of homes on the market to sell given the current rate at which they are being sold. A declining months' supply indicates an imbalance in the housing market where demand is growing faster than supply.

INVENTORY OF SINGLE-FAMILY HOMES IS HOVERING NEAR HISTORIC LOWS



Source: National Association of Realtors, MUFG Bank Research Office

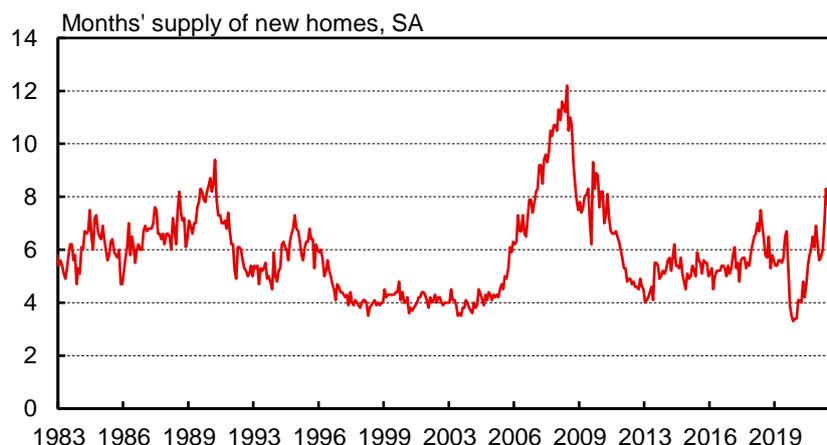
The months' supply of existing homes has been growing since the start of 2022, but the level is still relatively low. Moderate home appreciation is expected in a "healthy" housing market where there are five or six months of supply. As of June 2022, supply is near 3 months.

The significant reduction in housing demand in 2022 has potentially flattened the months' supply, but longer-term trends will prevent the rate of homes entering the market from growing faster than the rate at which they are sold. The millennial generation of adults are reaching the prime age for home buying which will keep demand relatively high and older Americans are staying in their current homes longer, keeping existing home supply lower.

New home construction has been entering the market, but not at a rate that would significantly impact decades of compounding housing shortages. The months' supply of new homes presents a "healthier" housing market where supply is closer to six months, but new homes only comprise 10 percent of the overall housing market and there is not a positive long-term trend of new housing supply. A consistent growth in supply of new homes that outpaces demand would be needed to alleviate housing shortages in the coming years and moderate price growth of homes.

The supply of new homes has been growing since the end of 2020 and has surpassed the pre-pandemic level, but growth is likely to slow. Presently deteriorating housing demand from high prices and rising mortgage rates reduces the short-term outlook for builders, impacting new construction and preventing a significant number of new homes from entering the market.

GROWING SUPPLY OF NEW HOMES WILL LIKELY SLOW FURTHER BUILDING



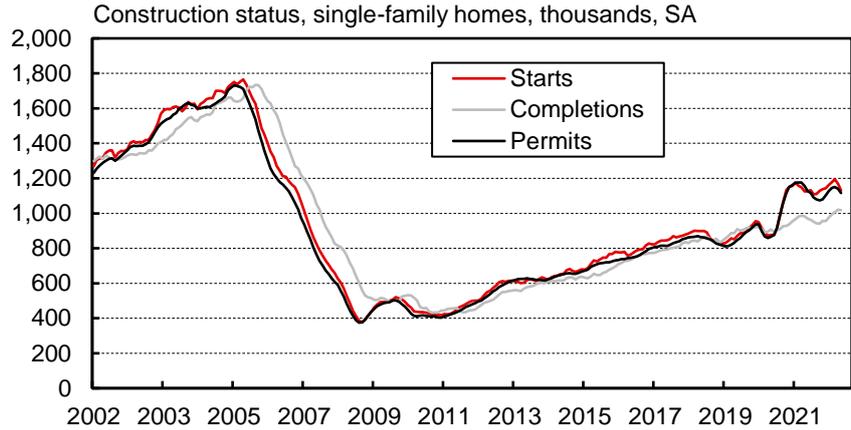
Source: US Census Bureau, MUFG Bank Research Office

New homes have not been built quick enough

Home builders have responded to high levels of demand during the pandemic, but new homes could not be completed quick enough. New housing starts and permits issued for new construction of single-family homes have risen drastically in 2021. New housing starts and permits grew an average of 21 percent and 22 percent year-over-year in 2021, respectively. Completions, however, only grew an average of 6 percent year-over-year during that same period.

Labor and supply shortages likely impacted the rate at which new homes could be built, contributing to the disconnect between permits, starts, and completions – series that historically are closely aligned. This disconnect likely prevented an oversupply of new housing from forming as current demand subsides and short-term outlook for builders deteriorates, a situation that is bad for potential buyers and a market facing housing shortages.

NEW HOUSING STARTS AND PERMITS HAVE OUTPACED COMPLETIONS



Note: 6-month moving average

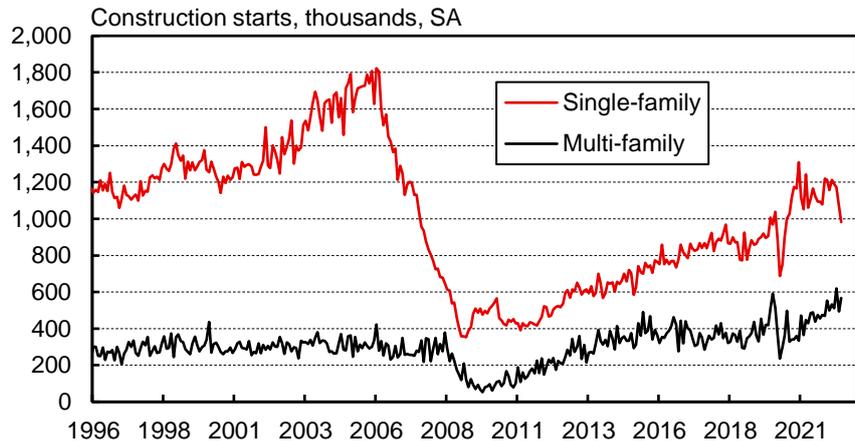
Source: US Census Bureau, MUFG Bank Research Office

Single-family homes have not recovered from the financial crisis

Construction of single-family homes have not fully recovered since before the 2008 financial crisis. In 2006, new construction starts for single-family homes reached 1.8 million. During the COVID-19 pandemic, new construction starts peaked at 1.3 million and have declined down to less than 1 million. The drastic impact of the housing bubble burst and tightening mortgage standards in response to the 2008 recession have likely permanently altered the housing market and exacerbated looming housing shortages.

Construction starts of multi-family homes (i.e. rental units), however, have exceeded the pre-financial crisis level. Builders have accelerated construction of multi-family units as prospective home buyers that no longer qualified for new mortgage loans entered the rental market.

UNLIKE SINGLE-FAMILY HOMES, MULTI-FAMILY STARTS HAVE RECOVERED



Source: US Census Bureau, MUFG Bank Research Office

Demand for housing has fallen sharply from pandemic highs which will likely ease the supply/demand imbalance and lower price growth for housing. Though, systemic housing shortages will persist, keeping price growth relatively high by historical standards. New residential construction has made progress in adding to housing supply but has been unable to produce output quick enough. Worse, a poor outlook for builders from reduced demand will slow new housing construction, further contributing to overall housing shortages. We can expect growth in house prices to slow, but a halt to price growth or falling price is unlikely in the near future.

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