HaMMR Digest

Stay current with economic and mortgage market trends.

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Weekly Wrap — As Good as It Gets?

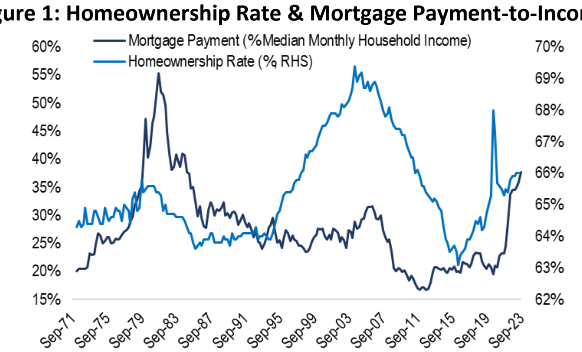
- Consumers throw caution to the wind as retail sales surged in September, capping a solid Q3.
- The economy was firing on all cylinders in Q3, but a slowdown is on the way, in part due to the housing sector.
- Existing home sales have languished under the weight of higher rates, but inventory has started to rise.

Incoming data has reflected an economy that was not only resilient, but also accelerating in Q3. Case in point, retail sales surprised again to the upside in September with a 0.7% m/m surge (cons. 0.3%). In fact, consumer spending was up an annualized 6.4% in Q3, the fastest pace since 4Q17 excluding the recovery from the pandemic. With households on firm financial footing, it will require much more stress in the labor market to drive consumption sustainably lower. The manufacturing sector also continued to find its footing in Q3 after several quarters of weakness: September manufacturing production rose 0.4% (cons. 0.3%) with the bulk of growth coming from durable goods. Tentative uptrends in purchasing manager indexes (PMIs) and freight volumes also point to the shift in momentum. However, further acceleration is unlikely given elevated interest rates, firms' inclination to hold lean inventories until demand proves more durable and the ongoing auto strike, which becomes a bigger drag on Q4 production every day it continues.

While it is tempting to extrapolate recent data releases forward, risks remain skewed to the downside. We continue to expect a meaningful deceleration in Q4 with negative headlines building as highlighted in "Potential Tempest Ahead." The good news for the Fed is that buoyant economic momentum means they can patiently observe how the economy unfolds with U.S. Treasury yields ascending to multi-decade highs. Even with all of the risks we have outlined for Q4, the momentum at the start of the quarter should be more than enough to record a solid quarter of growth. We see far greater risks building for the first half of 2024, particularly after the recent jump in longer-term interest rates.

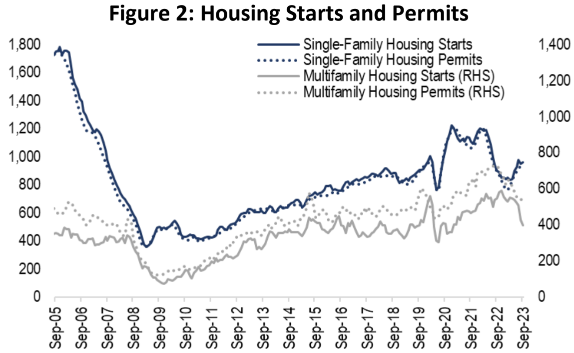
One of the most rate-sensitive sectors is a key risk to monitor and has already started to feel the heat: housing. Existing home sales sank -2.0% m/m (cons. -3.7%) in September, which extended a multi-month downtrend and pulled the pace of sales -1% below the January 2023 cycle low and to the slowest pace since 2011. A persistently tight inventory of existing homes for sale has limited the downside for home prices, but the tides are turning. Inventory climbed higher in September for a third straight month, up a seasonally adjusted (sa) 3.4% m/m and a notable acceleration from the 1.6% combined build in July and August. With mortgage rates now pushing near 8%, affordability will become a greater drag on demand and inventory could normalize more quickly. Even with positive demographics and a sturdy labor market, affordability constraints will increasingly price out more buyers and temper the recent rebound in the homeownership rate (Figure 1).

Figure 1: Homeownership Rate & Mortgage Payment-to-Income



Sources: Census Bureau, Freddie Mac, NAR, Arch MI

Figure 2: Housing Starts and Permits



Souces: Census Bureau, Arch MI

Home builders have been able to capture an increasingly larger share of demand for homes with attractive incentives, particularly rate buydowns. But those incentives become less attractive to buyers and more expensive to builders as rates have marched higher. The souring mood of homebuilders was reflected in the latest National Association of Home Builders (NAHB) Housing Market Index, which fell further in October to 40 (cons. 44). Accordingly, housing starts are likely to cool in the months ahead, despite the September rebound for single-family starts (Figure 2). Housing demand will remain depressed and turn into a headwind for the broader economy again unless interest rates head sustainably lower in short order. The Fed still has a window to achieve the soft landing they have long hoped for, but it is rapidly closing as financial conditions have tightened rapidly.

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Recent Data Releases

Key economic and housing data releases over the prior week:

Date	Indicator	Period	Actual	Consensus	Revised	Prior	Note
10/17/23	Advance Retail Sales m/m	Sep	0.7%	0.3%	0.8%	0.6%	sa
10/17/23	Retail Sales Control Group m/m	Sep	0.6%	0.1%	0.2%	0.1%	sa
10/17/23	Industrial Production m/m	Sep	0.3%	0.0%	0.0%	0.4%	sa
10/17/23	Capacity Utilization	Sep	79.7%	79.6%	79.5%	79.7%	sa
10/17/23	Business Inventories m/m	Aug	0.4%	0.3%	0.1%	0.0%	sa
10/17/23	NAHB Housing Market Index	Oct	40	44	44	45	index, sa
10/18/23	MBA Mortgage Applications	10/13/23	-6.9%	--	--	0.6%	w/w, sa
10/18/23	Building Permits	Sep	1,473	1,453	1,541	1,543	k, saar
10/18/23	Building Permits m/m	Sep	-4.4%	-5.7%	6.8%	6.9%	sa
10/18/23	Housing Starts	Sep	1,358	1,383	1,269	1,283	k, saar
10/18/23	Housing Starts m/m	Sep	7.0%	7.8%	-12.5%	-11.3%	sa
10/19/23	Initial Jobless Claims	10/14/23	198	210	211	209	k, sa
10/19/23	Continuing Claims	10/7/23	1,734	1,706	1,705	1,702	k, sa
10/19/23	Philadelphia Fed Business Outlook	Oct	-9.0	-7.0	--	-13.5	index, sa
10/19/23	Existing Home Sales	Sep	3,960	3,890	--	4,040	k, saar
10/19/23	Existing Home Sales m/m	Sep	-2.0%	-3.7%	--	-0.7%	sa
10/19/23	Conference Board Leading Index	Sep	-0.7%	-0.4%	-0.5%	-0.4%	m/m, sa

Sources: Bloomberg Consensus Survey of Economists, Arch Global Economics

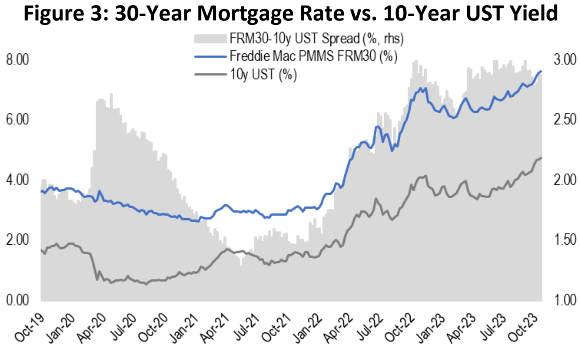
Green = beat expectations; **Red** = worse than expectations; (compared vs. prior if no consensus estimates available)

MORTGAGE PURCHASE APPLICATION ACTIVITY DECLINED AS RATES REMAINED ELEVATED

Ever-higher rates weighed more heavily on mortgage application activity. The MBA Weekly Applications Survey showed the average contract rate for a conventional 30-year fixed-rate mortgage rose 3bps to 7.7% during the week ending Oct. 13 while the average FHA contract mortgage rate declined -4bps to 7.36%, resulting in a -7bps contraction in the spread between the FHA and conventional rate to -0.34%. Meanwhile, the average contract rate for a jumbo 30-year fixed-rate mortgage declined -14bps to 7.56%, resulting in a -17bps contraction in the jumbo-conventional spread to -0.14%.

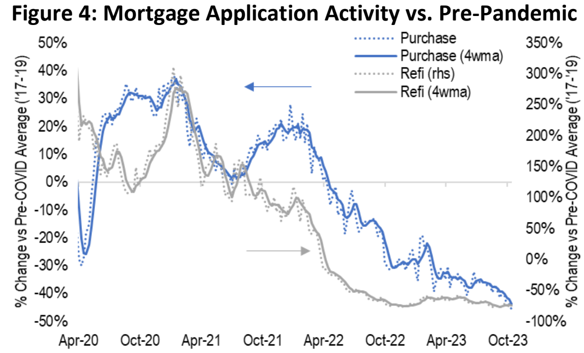
Freddie Mac's more recent Primary Mortgage Market Survey (PMMS) for the week ending Oct. 18 indicated that the FRM30 climbed 6bps w/w to 7.63% (Figure 3) as the yield on the benchmark 10-year U.S. Treasury (UST) climbed 6bps to an average of 4.76% over the same period. Accordingly, the spread between the PMMS FRM30 and the 10-year UST was unchanged at 2.87%, about 115bps wider than its typical non-stressed level prior to the pandemic and still close to the recent peak just above 300bps. We expect rate volatility and mortgage spreads to remain wide until more clarity is gained around the path of inflation and monetary policy, which is not likely to occur until early next year.

Figure 3: 30-Year Mortgage Rate vs. 10-Year UST Yield



Sources: Freddie Mac Primary Mortgage Market Survey, Federal Reserve Board, Arch MI

Figure 4: Mortgage Application Activity vs. Pre-Pandemic



Sources: Mortgage Bankers Association, Arch MI

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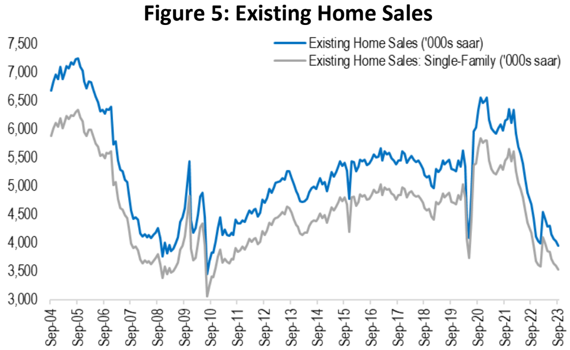
Alongside the continued rise in mortgage rates, mortgage application activity declined -6.9% w/w (sa), leaving the index down -18% year over year and down -62% compared with pre-pandemic levels (i.e., the average of the same week in 2017, 2018 and 2019). The weekly decline was driven primarily by a -9.9% (sa) decline in refinancing applications, which remained down -12% y/y and -78% below the pre-pandemic level (Figure 4). Purchase applications declined -5.6% w/w (sa) and were down -21% y/y and -46% relative to pre-pandemic levels.

EXISTING HOME SALES SLOWED FURTHER BELOW COVID-19 TROUGH

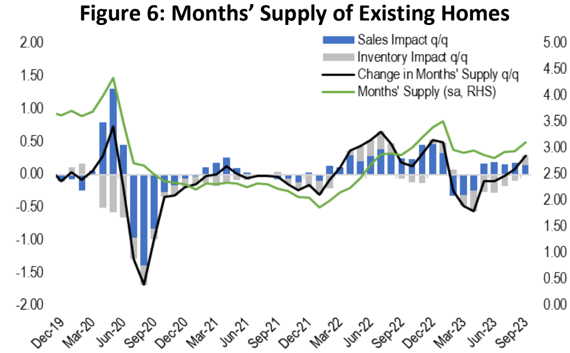
Existing home sales inched down -2.0% m/m (cons. -3.7%) in September to a seasonally adjusted annual rate of 3,960k. This was the slowest sales pace since 2010 (Figure 5) as affordability remained a significant headwind. The decline in the pace of sales from the February 2023 peak has thus far been only -13% compared to the -57% decline last year. However, given the typical timeline from an accepted offer to close (i.e., roughly two months), cooler September sales only reflected the impact of mortgage rates moving up to the low-7% range from the February 2023 low of roughly 6%. As the prevailing 30-year fixed-rate mortgage has since surged closer to 8%, we expect further downside ahead for sales.

Figure 5: Existing Home Sales



Sources: NAR, Arch MI

Figure 6: Months' Supply of Existing Homes



Sources: NAR, Arch MI

Inventory climbed higher for a third straight month in September, up a seasonally adjusted 3.4% m/m and a notable acceleration from the 1.6% combined build in July and August. However, supply conditions remained tight as inventory was -40% below its 2019 level, whereas the pace of sales was only down -26% over the same period. The slower pace of home sales and the recent uptick in inventory has lifted months' supply to 3.1 from 2.8 in March (Figure 6). The seasonally adjusted median sale price of an existing single-family home declined -0.5% m/m but was still up 2.4% y/y to $398k, although it is important to note that this figure is not adjusted for the quality, size or geography of homes sold.

HOUSING STARTS BOUNCED BACK IN SEPTEMBER

Total September housing starts rebounded by 7.0% m/m (cons. 7.8%) to a seasonally adjusted annual rate of 1,358k (cons. 1,383k) albeit not enough to offset the -11.3% decline in the prior month. After a -5.6% m/m downtick in August, single-family starts rose 3.2% m/m and remain up 20% from November's cycle trough. Multifamily starts, which are far more volatile, soared 18% in September to 395k saar (seasonally adjusted annual rate); however, that does not alter the downtrend that has been in place for months as builders focus on working through a near-record level of multifamily units already under construction. We hold a more positive outlook for single-family construction due to low resale inventory and positive demographics. We expect multifamily construction activity to continue to trend slower given the elevated pipeline of multifamily units that are slated for delivery over the coming years. However, our generally positive outlook for the single-family segment does not mean smooth sailing for new home sales. Builder confidence pulled back for the third consecutive month after seven months of gains, falling 4pts m/m to 40 (cons. 44) in October (Figure 7). All three index sub-components fell on the month, largely due to the impact of higher rates on buyer affordability and financing costs for new development. That said, all index components remain above the recent troughs of 4Q22, a similar period of rapidly rising mortgage rates.

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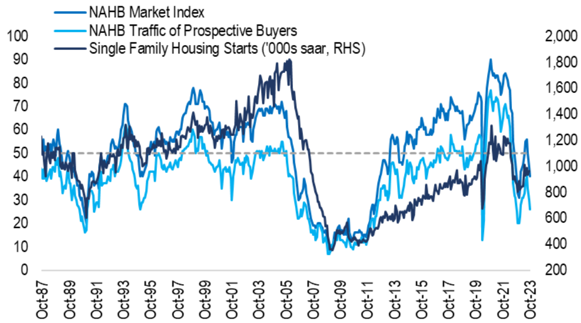
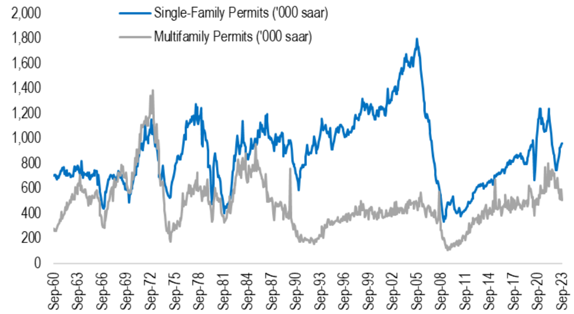
Figure 7: NAHB Housing Index and Housing Starts



Sources: NAHB, Census Bureau, Arch MI

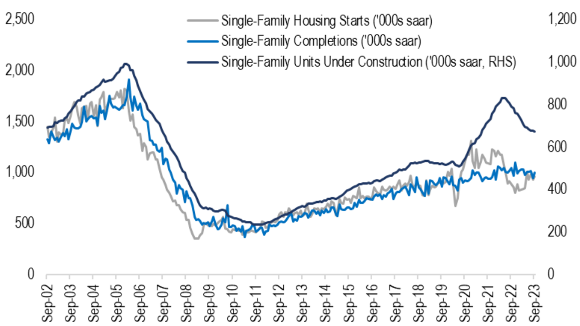
Figure 8: Housing Permits by Type



Sources: US Census Bureau, Arch MI

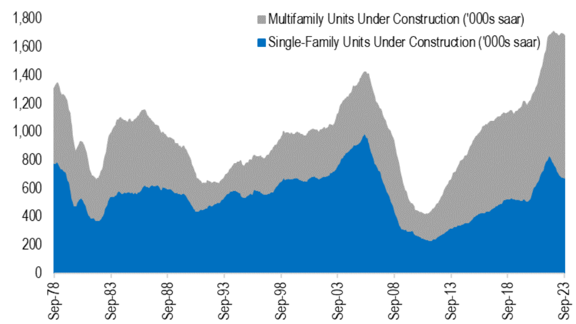
Positively, single-family permits rose for the eighth month in a row, increasing 1.8% m/m, but remained down -22% from last January's peak (Figure 8). Multifamily permits fell -14% m/m, dragging the pace of multifamily permitting -30% below its year-ago level. Total completions rose 6.6% m/m with the year-over-year measure up 1.0% amid pronounced strength in the multifamily segment — up 10% m/m compared to single-family completions up only 5%. After a year's long stretch, the gap between single-family starts and completions has essentially closed (Figure 9). Improving supply chains and easing labor market conditions have allowed builders to start chipping away at the elevated count of 1,676k units under construction (Figure 10). Single-family units under construction have been declining for over a year and were down -15% y/y to 674k in September in stark contrast to the 11% y/y increase to 1,002k in the multifamily segment.

Figure 9: Housing Completions



Sources: US Census Bureau, Arch MI

Figure 10: Housing Units under Construction

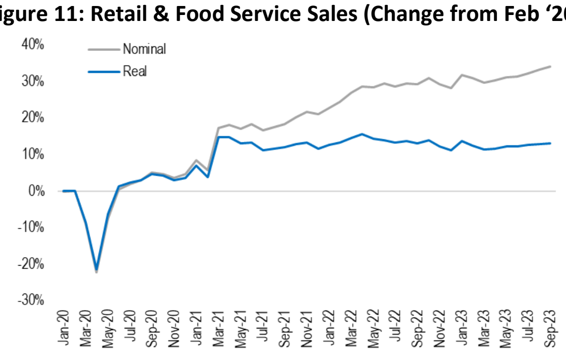


Sources: US Census Bureau, Arch MI

CONSUMERS CAN'T STOP, WON'T STOP SPENDING

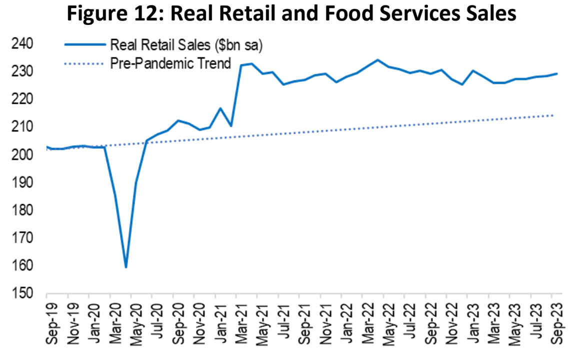
September retail and food services sales rose to 0.7% m/m (cons. 0.3%) following a 0.8% gain in August that was revised up by 20bps. The bumper retail sales report showed broad-based strength led by autos (1.0%), online sales (1.1%) and restaurants (0.9%). Gasoline sales rose at a slower pace of 0.9% compared to the near-7% rise in August as prices at the pump cooled. Conversely, sporting goods and electronics/appliances (-0.8%), building materials (-0.2%) and apparel stores (-0.8%) contracted.

Figure 11: Retail & Food Service Sales (Change from Feb '20)



Sources: Census Bureau, Arch MI

Figure 12: Real Retail and Food Services Sales



Sources: Census Bureau, Arch MI

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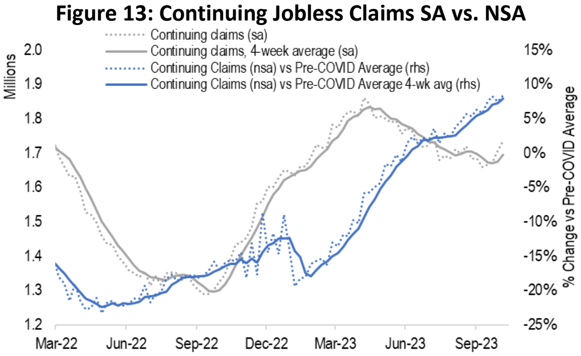
Retail sales, excluding autos, rose 0.6% m/m while the important control group (excluding food, autos, gasoline and building materials), which feeds directly into the GDP report, also rose by 0.6% (cons. 0.1%) on top of upward revisions to the prior two months. The strong September print lifted Q3 annualized control group sales to 6.4% during a period when core goods prices were generally declining. Adjusted for inflation, headline retail sales rose 0.3% m/m (Figure 11), accelerating from the 0.2% rise in August. Real control group sales have performed slightly better, up 0.7% in September after a modest 0.1% gain in August, suggesting consumers have not been spooked into a more precautionary stance, at least not on a consistent basis. In fact, real retail sales remained 13% above February 2020 levels and 8% above the pre-COVID-19 trend (Figure 12).

CONTINUING CLAIMS TRENDING HIGHER

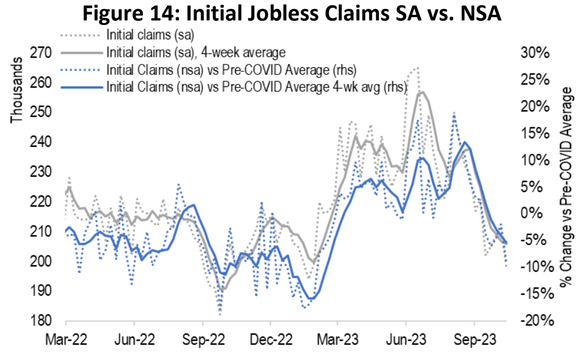
The trend in initial jobless claims remains lower, while continuing claims continued rising relative to the pre-COVID-19 norm. This continues to suggest there has not been an increase in layoffs, but those who are unemployed are finding it more challenging to secure a new job. Altogether, the labor market appears to still be undergoing a normalization process from the pandemic shock. The gradual increase in continuing claims to modestly above pre-COVID-19 norms is consistent with our view that unemployment will gradually normalize higher as well, assuming the Fed dials back appropriately next year. Additionally, due to issues with the new seasonal adjustment factors, we expect seasonally adjusted continuing claims to continue trending higher over the remainder of the year, ultimately surpassing 2m, even if the economy doesn't deteriorate. We expect the labor market to normalize further, so we see upside risk to the 2m figure.

Figure 13: Continuing Jobless Claims SA vs. NSA



Source: U.S. Department of Labor, Arch MI

Figure 14: Initial Jobless Claims SA vs. NSA



Source: U.S. Department of Labor, Arch MI

Continuing claims jumped further to a seasonally adjusted 1,734k from 1,705k the week before. This is a sharp kink higher after steady declines over the past six months (Figure 13). This also lifted the four-week average up to 1,694k from 1,675k. However, the non-seasonally adjusted (nsa) continuing claims data continued to gradually trend higher vs. its typical pre-COVID-19 path as it has for most of this year. The four-week average of non-seasonally adjusted continuing claims moved up to 7.9% above its pre-COVID-19 average (i.e., 2017 to 2019) from 7.2% the week before and up from -6% below six months ago. Meanwhile, initial jobless claims declined by -13k to a seasonally adjusted 198k (cons. 210k) during the week ending Oct. 14, moving the four-week average down to 206k from 207k (Figure 14). The four-week average of 64 initial claims moved down to -5.4% below its pre-COVID-19 average from -4.1% the week before and up from -9% below six months ago.

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The Week Ahead

UPCOMING DATA RELEASES

Key economic and housing data releases for the coming week:

Date	Indicator	Period	Consensus	Prior	Note
10/24/23	S&P Global US Manufacturing PMI	Oct P	49.4	49.8	index, sa
10/24/23	S&P Global US Services PMI	Oct P	49.9	50.1	index, sa
10/24/23	S&P Global US Composite PMI	Oct P	50.0	50.2	index, sa
10/25/23	MBA Mortgage Applications	10/20/23	--	-6.9%	w/w, sa
10/25/23	New Home Sales	Sep	682	675	k, saar
10/25/23	New Home Sales m/m	Sep	1.0%	-8.7%	sa
10/26/23	GDP Annualized q/q	3Q A	4.3%	2.1%	saar
10/26/23	Personal Consumption q/q	3Q A	4.0%	0.8%	saar
10/26/23	Durable Goods Orders	Sep P	1.5%	0.1%	m/m, sa
10/26/23	Core PCE Deflator q/q	3Q A	2.5%	3.7%	saar
10/26/23	Cap Goods Orders Nondef Ex Air	Sep P	0.0%	0.9%	m/m, sa
10/26/23	Initial Jobless Claims	10/21/23	208	198	k, sa
10/26/23	Continuing Claims	10/14/23	1,738	1,734	k, sa
10/26/23	Pending Home Sales m/m	Sep	-1.6%	-7.1%	sa
10/27/23	Personal Income	Sep	0.4%	0.4%	m/m, sa
10/27/23	Personal Spending	Sep	0.5%	0.4%	m/m, sa
10/27/23	Real Personal Spending	Sep	0.3%	0.1%	m/m, sa
10/27/23	PCE Inflation m/m	Sep	0.3%	0.4%	sa
10/27/23	PCE Inflation y/y	Sep	3.4%	3.5%	nsa
10/27/23	PCE Core Inflation (ex Food and Energy) m/m	Sep	0.3%	0.1%	sa
10/27/23	PCE Core Inflation (ex Food and Energy) y/y	Sep	3.7%	3.9%	nsa
10/27/23	U. of Mich. Sentiment	Oct F	63.0	63.0	index, nsa
10/27/23	U. of Mich. 1 Yr Inflation	Oct F	3.8%	3.8%	nsa
10/27/23	U. of Mich. 5-10 Yr Inflation	Oct F	--	3.0%	nsa

Sources: Bloomberg Consensus Survey of Economists, Arch Global Economics

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