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Housing Market Update

Economic Commentary **July 3, 2025**

SUMMARY

Persistent high mortgage rates have been a major headwind for the housing market during the 2025 spring selling season. According to the latest data, the seasonally adjusted annualized rate (SAAR) of single-family housing starts for May was 924,000 units, flat with April, but down from 1.1 million units in February and the lowest since July 2024. YTD, for the first five months of the year, single-family housing starts are down 7.1%. Single-family permits have likewise receded steadily since February to 898,000 units in May, the lowest since April 2023.

New home sales have been stable but May's estimate of 623,000 (the seasonally adjusted annual rate or SAAR) was 12.9% below the post-Covid 19 average of 715,000. May's new home sales declined from April's surprisingly strong SAAR estimate of 722,000 units. YTD through May, new home sales are down 2.9%.

Despite the moderate declines in housing production and sales, homebuilder sentiment is gloomy. The NAHB/Wells Fargo Housing Market Index (HMI) was 32 in June, below the neutral level of 50 and thus signaling a contraction. June's HMI was the lowest since December 2022 and the third lowest reading since 2012. The Index's three components – current market sentiment, 6-month sales expectations and buyer traffic - all declined.

A key driver of builder malaise, as noted above, has been continuing high mortgage rates. The average rate on the 30-year mortgage, according to Freddie Mac, has ranged mostly between 6.50% and 7.00% for the past three years. As of June 26, the average rate for a 30-year fixed rate mortgage was 6.77%, according to Freddie Mac. The spread between the 30-year mortgage rate and 10-year Treasury yield is about 250 bp, down from 300 bp seen soon after the Fed began raising interest rates in March 2022, but well above the long-term historical spread of 175 bp. The higher spread provides some compensation to mortgage originators for lower origination volumes and also a greater cushion against Treasury interest rate volatility. It suggests the potential for a decline in mortgage rates of as much as 75 bp (to around 6.00%) with no change in Treasury yields, should market conditions return to "normal," perhaps if the uncertainty surrounding the economic and geopolitical outlooks subsides.

Mortgage rates have more than doubled from pre-2022 levels, raising the monthly mortgage payment on a $400,000 home with a 10% downpayment by 35%, according to my calculations. Yet, house prices continue to grind higher. Even so, the pace of the annualized increase in house prices has slowed from the peak of 19.0% in 2021, to zero so far in 2025, according to Case-Shiller. Median and average new home prices are up by 1.5% YTD (through May), reversing the declines recorded in 2023 and 2024. Median and average existing home prices have also continued to rise, but the rate of increase has slowed slightly in 2025 to 3.7% (from 4.7% in 2024) and to 4.8% (from 6.0%), respectively.

With the sharp drop in affordability, it is surprising that house prices have not fallen sharply. According to Case Shiller, national house prices have risen 140% since the 2008 financial crisis, far outpacing the CPI, which is up 45% over that same time frame. The durability of price increases could reflect the momentum that had developed after the COVID-related surge in housing demand. Nevertheless, upward price momentum has slowed considerably, which could reverse in the months ahead.

One leading indicator of potential house price declines is the build-up of existing and new home inventories in recent months. Existing home inventory has risen 35% from 1.14 million at year-end 2024 to 1.54 million in May and is up 20.3% YOY. The number of months of supply has risen from 3.2 to 4.6 over that period and is now the highest since July 2016. Likewise, new home inventories have been climbing since the onset of the pandemic. In May, they were estimated to be 507,000 units, up 3.7% from year-end 2024 and up 8.3% YOY. The months' supply of new homes was estimated to be 9.8 in May, the highest since mid 2022 (which back then was caused by a sharp but short-lived decline in sales). Before 2022, months' supply was not been that high since 2009, in the immediate aftermath of the Great Financial Crisis.

Treasury Secretary Bessent has alluded to the possibility of declining house prices (and rents) recently, rejecting concerns about rising inflation from tariffs. He suggested that declines in owners equivalent rent (OER) , a component of the CPI, would help to offset any temporary increases in inflation from tariffs.

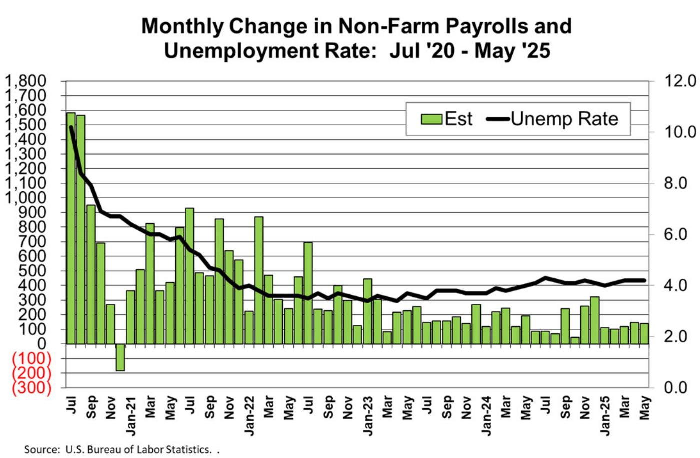
The Fed is under pressure to reduce its target Fed Funds rate, which could lead to declines across the Treasury yield curve. According to my calculations, the annualized three -month rate of headline and core CPI inflation declined to 1.0% and 1.7%, respectively in May and the annualized 3-Month average rate (A3MoAvg) rate of headline and core PCE inflation dropped to 1.1% and 1.7%, respectively. While such benign readings could be temporary, the primary drivers of inflation, including especially energy costs, seem to be cooling. Headline and core A3MoAvg readings for the CPI and PCE are below the Fed's target of 2%. If the economy was chugging along at a solid pace, the Fed would have a stronger argument for holding off. However, employment growth is slowing, continued unemployment claims are rising, the housing market is under pressure and much of the rest of the economy facing a slowdown precipitated by uncertainty raised by the potential impact of tariffs. If it aims to remain true to its dual mandate, the Fed should acknowledge both the progress on inflation and the risks of a more consequential slowdown in the economy by taking a first step – cutting the Fed Funds target by 25 bp – and continuing to monitor inflation trends and economic conditions closely.

The CME Group's Fed Watch indicator (derived from Fed Funds futures prices) currently assesses the probability of a 25 bp rate cut at the FOMC's upcoming July 30 meeting at only 23%. However, it sees a 72% chance of a 25 bp rate cut and 21% chance of a 50 bp rate cut by its Sept. 17 meeting. By December, the Fed Funds futures see an 8.5% probability of a 25 bp cut (from the current range of 425-450 bp), a 35% chance of 50 bp of cumulative cuts, a 45% chance of 75 bp of cuts and a 10.7% chance of 100 bp of cuts. Thus, by December, the Fed Funds futures are apparently anticipating a significant slowdown in the economy.

That could lead to a potential combination of house price declines and mortgage rate cuts, which could at least put a floor under the housing market and set the stage for a potential rebound.

ECONOMY

- The Philly Fed's 25Q2 Survey of Professional Forecasters anticipates 2025 real GDP growth of 1.4%, down a full percentage point from the previous report. Real GDP fell 0.5% in 25Q1, primarily because of a surge in imports ahead of the expected increase in tariffs. The Forecasters expect GDP growth to be 1.5% in 25Q2, but then ease to 0.9% in 25Q3 before recovering slightly to 1.4% in 25Q4. These estimates are down from expectations of 2.0% growth in each of the remaining 2025 quarters from the previous survey. For 2026, the Survey shows a slight pick-up in growth to 1.6% and then to 2.2% growth in 2027, which is the current long-term expected growth rate of the U.S. economy.
- Industrial production was down 0.2% in May (from April) and up 0.6% YOY. 0.1% increases in manufacturing and mining were more than offset by a 2.9% drop in utilities. Capacity utilization was down 0.3% to 77.4% and has been trending lower since 2022. The ISM Purchasing Managers Index was 49.0 in June, below the neutral level of 50, but up slightly from 48.5 in May. The PMI has been below 50 for ten of the past 12 months. The industrial sector has been surprisingly resilient in the face of increases in interest rates and the concerns over tariffs, but orders and backlogs are contracting at a faster pace, which could lead to an acceleration of the decline in industrial production in future months.
- Job growth has been slowing. The establishment survey showed an increase of 139,000 in May, according to the Bureau of Labor Statistics, down slightly from 147,000 in April. The household survey, which has been surprisingly volatile and, with a major revision, more difficult to interpret, had a decline of 696,000 in employment in May, compared with April's 461,000 increase. Despite that volatility, the unemployment rate has been surprisingly stable at 4.2% for the past three months.
- Seasonally adjusted weekly unemployment claims have eased slightly since reaching a two year peak in May, but continued claims have risen to a three year high. Job cuts, as measured by the Challenger report, were 93,816 in May, down 11% from April, but up 47% YOY. The main driver of job cuts has shifted from DOGE to other sectors of the economy. The report attributed the cuts to the combined effect of tariffs, funding cuts, declining consumer spending and overall pessimism.
- Consensus expectations anticipate a further slowing in payroll employment gains to 110,000 in June and the unemployment rate to remain at 4.2%. The ADP private sector jobs report showed a surprising decline of 33,000 jobs in June, the first decline since early 2023.



- Personal income declined 0.42% in May, the first decline in two years. Compensation of employees, including wages and salaries continued to rise at a 5%+ pace. The declines came mostly from proprietor's income, rental income and personal current transfer receipts. Disposable personal income declined 0.55% in May, while personal consumption expenditures eased by 0.14%. As a result, the personal savings rate declined from 4.9% to 4.5%

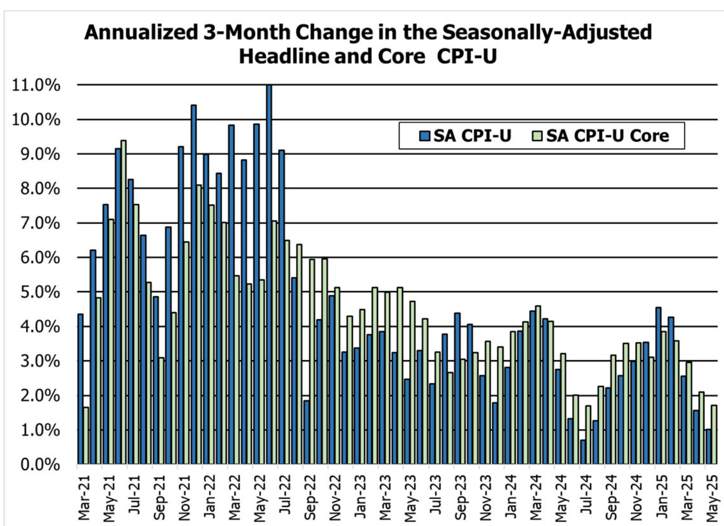
- The Conference Board's measure of consumer confidence fell 4.6 points in June to 93.0. The measure has declined from its most recent peak of 112.8, as economic and geopolitical developments have unfolded. Consumers' assessments of present conditions dropped 6.4 points to 129.1; while the expectations component fell 4.6 points to 69.0. Consumers are more confused about the outlooks for business conditions, jobs and their incomes six months from now. Their expectations of the likelihood of recession ticked higher to 69%.

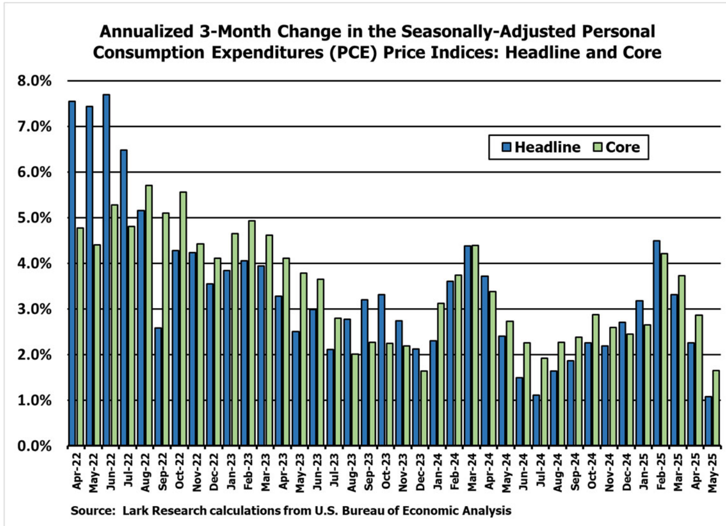
INFLATION

- Headline CPI rose 0.21% in May, down from 0.31% in April. On an A3MoAvg basis, it rose 3.0%, down from 4.0% in April. Core CPI, which excludes food and energy, rose 0.21% in May compared with 0.27% in April. On an A3MoAvg basis, core CPI increased 2.8%, down from 3.7% in April.

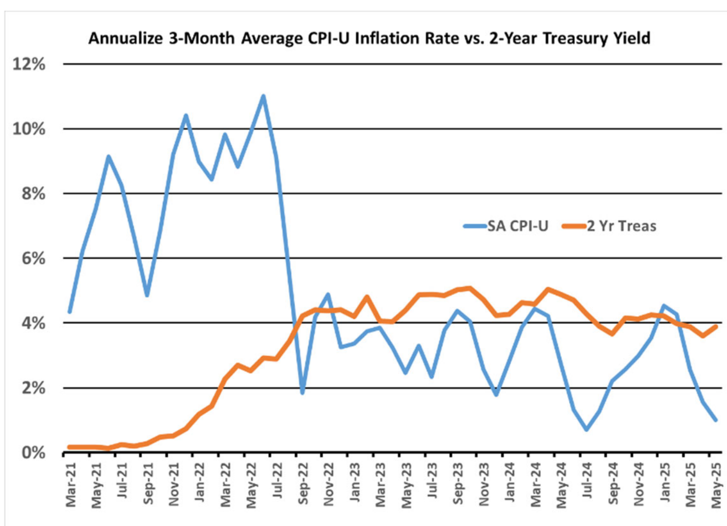
  The SAAR of headline and core CPI on an A3MoAvg basis is depicted in the chart below. It shows that headline CPI decreased from 1.50% in April to 1.01% in May; while core CPI declined from 2.1% in April to 1.71% in May.

  The increase in shelter costs, a component of CPI, has eased from a recent peak of 4.8% in March to 4.2% in April and then to 4.0% in May, on an A3MoAvg basis. However, the annualized increase in shelter costs had moderated to a low of 3.0% in November. On average, over the past year, shelter has accounted for 84% of the increase in monthly CPI.





- The seasonally adjusted GDP personal consumption expenditures (PCE) deflator, the Fed's preferred measure of inflation, increased at an average 3-month annualized rate of 1.08% in May, down from 2.25% in April, its third consecutive monthly decline. Excluding food and energy, the PCE deflator rose at a 1.65% annualized 3-month rate in May, down from 2.86% in April. Both the headline and core rates are now below the Fed's 2.0% target.
- In his recent remarks before Congress and in recent speeches, Fed Chairman Jerome Powell emphasized that the unemployment rate remains low and the labor market is at or near full employment. He noted that although inflation has come down, it remains somewhat above the Fed's 2% target (apparently referencing the YOY figures, which incorporate less current inflation trends). The Fed remains attentive to the risks to both sides of its dual mandate and will review the incoming data in making decisions about the Fed Funds target rate.

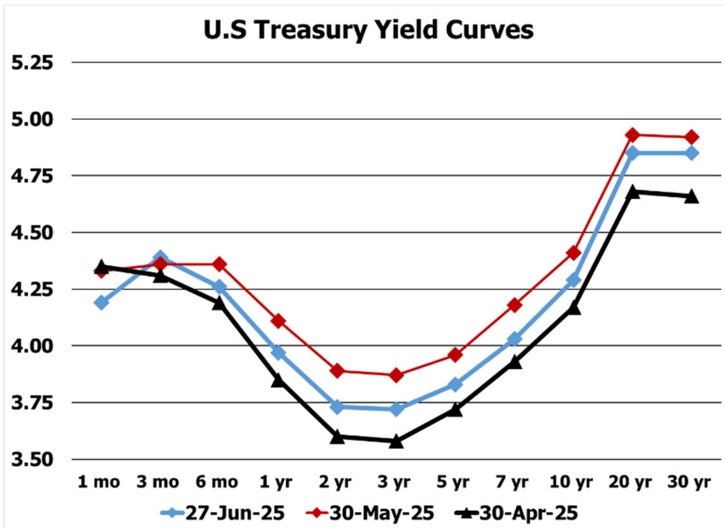


- The CME's Fed Watch tool, which is based upon futures prices, currently assigns a 23% probability to a 25 bp decrease in the target Fed Funds rate (to 4.00%-4.25%) at the July 30 FOMC meeting. However, it sees a 72% chance of a 25 bp rate cut and a 21% chance of a 50 bp rate cut at its Sept. 17 meeting. By December, it sees almost no chance that the

Fed Funds target will remain at its current level, but instead anticipates cumulative cuts totaling as much as 100 bp, with a 35% chance of 50 bp of cuts, a 45% chance of 75 bp of cuts. This implies that a slowdown in the economy will be evident by then.

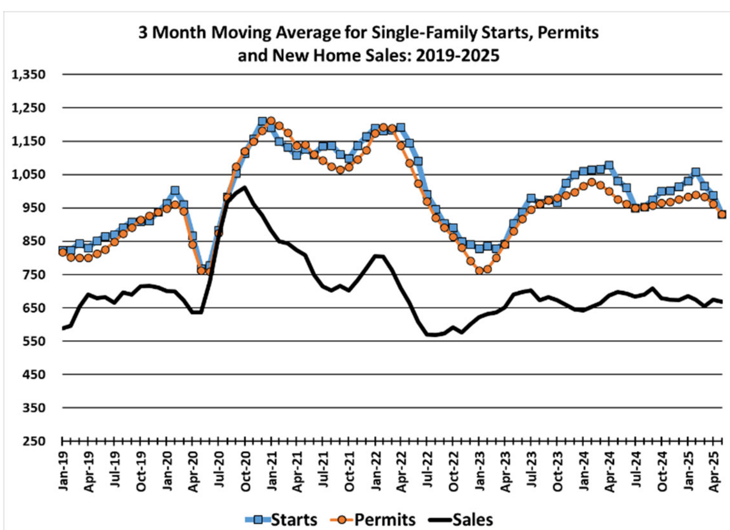
INTEREST RATES

- The yield curve shifted lower across most maturities in June, increasing its sag (vs. the May yield curve) across the intermediate maturities. The sag suggests that shorter term rates will drop over the next 2-3 years, probably in response to a slowing economy. It was greatest during the month of April when the market sold off; but lessened when the tariffs were paused in May. Intermediate yields have declined in June, despite the stock market's rally.

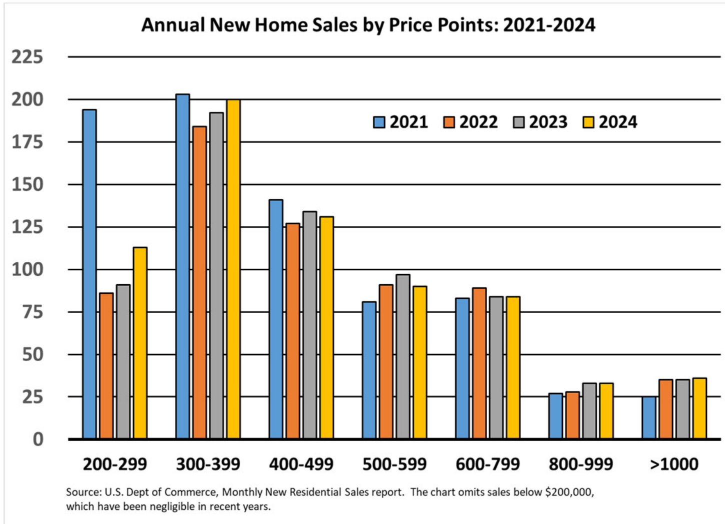


HOUSING MARKET

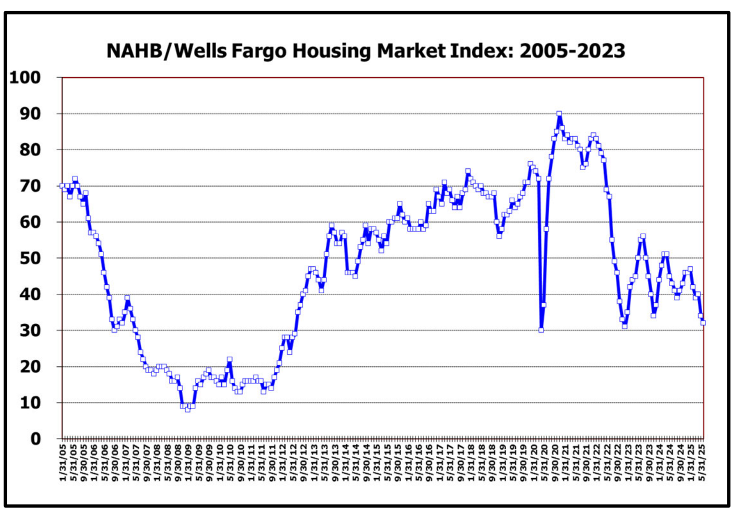
- The 3-month moving averages of SAAR single-family starts and permits bottomed in 2023 and rebounded until early 2024. They have held steady since, but turned down recently.
- The three month moving average of SAAR new home sales bottomed in mid-2022; but after a modest recovery, they too have been rangebound. Although drifting lower recently, the stability of new home sales is surprising, given anecdotal evidence of market softness.



- Total sales of new homes were 771,000 in 2021, 641,000 in 2022, 666,000 in 2023 and 690,000 in 2024. The 16.8% decline from 2021 to 2022 occurred in houses priced below $500,000, with a 55.7% drop in houses priced from $200,000 to $299,000. The declines in lower-priced home sales was only partially offset by increases in house above $500,000.



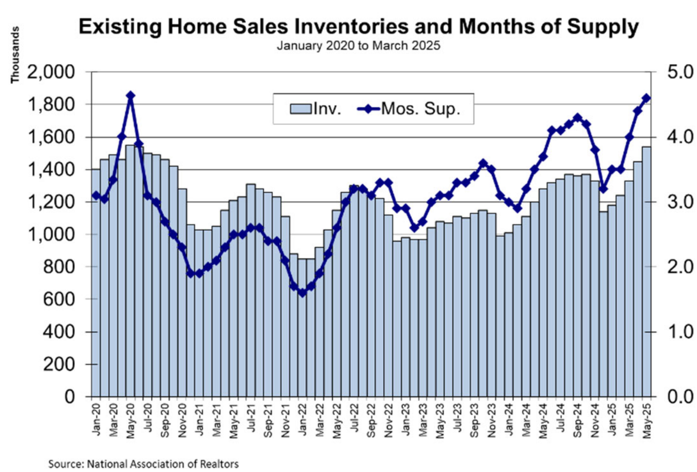
- YTD, through May 2025, new home sales are down 2.9%. A modest increase in sales in the $200,000-$299,000 price range has been more than offset by declines in the $300,000-$399,000, $400,000-$499,000 and $800,000-$899,000 price ranges.
- The SAAR of new home sales fell 13.7% to 623,000 in May from 722,000 in April and was down 6.3% YOY. Unit sales plunged 50% in the $300,000-$399,900, with declines across most other price cohorts. (Sales increased only slightly in the under $300,000 and $600,000-$799,900 price ranges.)
- The median price of a new home increased 3.7% to $426,600 in May from April and was up 3.0% YOY. The average sales price rose 2.2% to $522,200 and was up 4.6% YOY. Apples-to-apples comparisons are impossible with these measures. From the rest of the data, including the breakdown by price points discussed above, most of the increase is probably due to a mix shift toward higher priced homes.



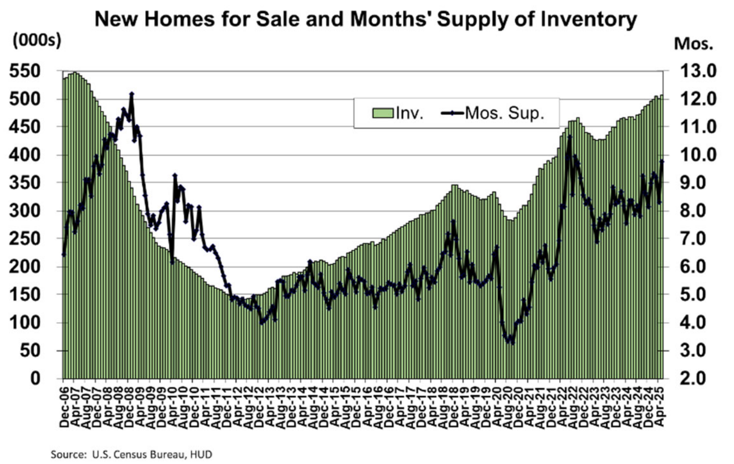
- The NAHB/Wells Fargo Housing Market Index (HMI) came in at 32 in June, below the neutral level of 50 and thus signaling a fairly sharp contraction. June's HMI was the lowest since December 2022 and the third lowest reading since 2012. The Index's three components all declined in June, with current market sentiment dropping two points to 35, expected sales six months out dropping two points to 40 and current buyer traffic also dropping two points to 21.
- Existing home sales were estimated at an SAAR of 4.03 million units in May, up 0.8% from April, but down 0.7% YOY. The three-month moving average of 4.02 million units declined 2.0% from April. The month-to-month increase was probably helped by higher inventories, which were up 6.2% in May from April and the highest since January 2020.
- The median sales price of existing homes rose 1.3% to $422,800 in May from April and by the same percentage YOY. The average price was up 2.0% to $566,500 month-to-month and also up by the same percentage YOY.
- Fannie Mae's Home Purchase Sentiment Index (HPSI) increased by 4.3 points to 73.5 in May. 74% of respondents say that now is a bad time to buy. That is down from the peak of 86% recorded a year ago. Only 26% said that now was a good time to buy; but that is up from the low of 14%. On average, respondents by a wide margin now expect home prices to rise but are evenly split on their mortgage rate expectations. The Index had been rising steadily since it bottomed at 56.7 in October 2022. However, it slid steadily from its most recent peak of 75.0 in November 2024, and the slide gathered momentum in February and March before bottoming in April and rebounding in May.

MONTHS' SALES.

- Inventories of both existing and new homes have been on the rise. Existing home inventories increased 6.2% to 1.54 million in May from April and were up 20.3% from 1.28 million a year ago. Months' supply of sales for existing homes has increased from 3.5 in May 2024 to 4.6 in May 2025, the highest since July 2016.



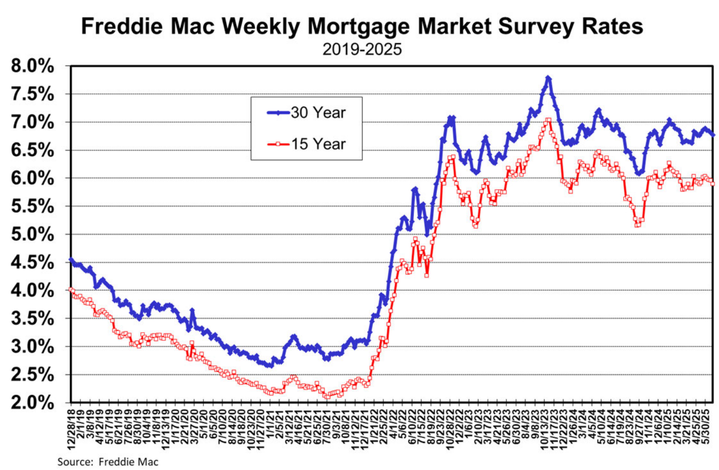
- New homes for sale increased to 507,000 in May from 500,000 in April and were up 8.1% from 469,000 in May 2024. The corresponding months' supply rose to 9.8 in May from 8.3 in April and 8.5 in May 2024. Without a meaningful pick-up in sales, it seems likely that builders will soon cut back on production.



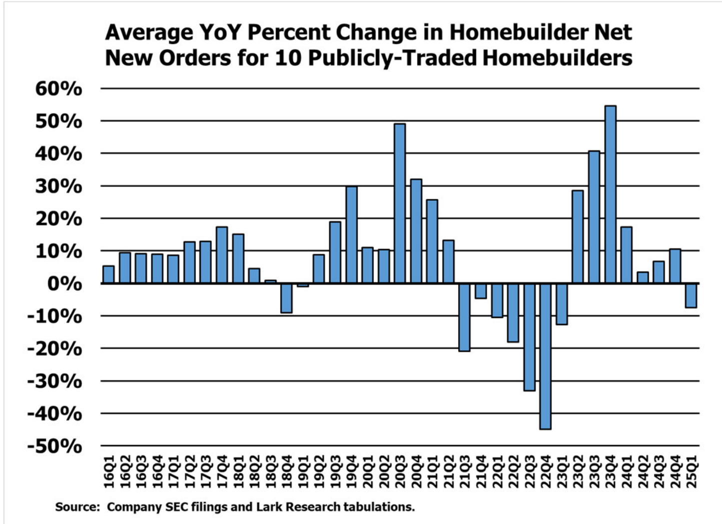
- If months' supply remains high (or goes higher), it is increasingly likely that house prices will begin to decline.

MORTGAGE RATES

- The average rate for a 30-year mortgage has been mostly rangebound between 6.50% and 7.00% since shortly after the Fed began raising the target Fed Funds rate in March 2022. The yield spread between the 30-year mortgage and the 10-year Treasury has also remained elevated throughout most of that period. It rose from its long-standing average of 175 bp to peak levels around 300 bp by mid-2022. Since 2023, however, it has eased to its current levels around 240 bp, mostly because Treasury yields have risen. The increase in spread has probably been driven by market participants demanding a greater cushion against interest rate volatility and a wider spread to compensate for declines in origination volumes. With the 10-year currently around 4.30%, a return to historical average spreads would bring mortgage rates down closer to 6.00%. Mortgage rates appear to be the key to the outlook for the housing market in the coming months.



BUILDER UNIT SALES



- The ten homebuilders in my coverage universe reported an average YOY decline in new orders of 7.4% in 25Q1, a reversal from the 17.4% increase recorded in 24Q1. Preliminary readings on 25Q2 (from KBH and LEN) show mixed results, with KBH reporting a 13.4% drop in unit sales over the prior year, but LEN reporting a 5.8% increase.
- The chart above shows the average YOY percent change in net new orders. It is a little tough to fathom because of the volatility from 2022 to 2024. In short, builders suffered large decreases in new orders in 2022 due to the initial rise in mortgage rates, so comparisons were much easier in 2023. The rebound produced big percentage increases in 2023, but in terms of units, orders were still below totals recorded in 2021.
- The average 7.4% decline in 25Q1 net orders reported by the builders was worse than the 3.3% decline in national new home sales, as estimated by the Commerce Department.
- KBH lowered its fiscal 2025 sales guidance because of persistent affordability challenges in the face of high mortgage rates, low consumer confidence and macroeconomic and geopolitical uncertainty. In FY25Q2, its monthly absorption pace was 4.5 order per community, down from 5.5 in FY24Q2. It is focusing on optimizing its assets to generate the highest possible returns, balancing the pace of sales and production with price community-by-community. It also aims to speed up build times and reduce direct costs. KBH has lowered its base prices to emphasize the value, minimizing the use of sales incentives. Early on in this housing downturn, it increased the number of speculative starts to capture more quick move-in buyers. As existing home inventories rise, the company aims to return its spec start percentage to normal and increase its build-to-order mix, which should help preserve margins.

- LEN's strategy in this challenging economic environment has been to drive volume and growth while matching production and sales pace. This has required reducing prices to address the affordability challenges so that it can maximize sales and deliveries to avoid building excess inventory. Its commitment to its even flow production model has enabled it to adjust its cost structure and overhead to align with current market conditions. Management believes that this will position the company to rebuild margins if market conditions remain soft and expand them when housing begins to recover.

According to Lennar, the housing market has softened further due to persistent high mortgage rates and declining consumer confidence. The cost to deliver homes has also risen, due to restrictive land permitting and rising labor and materials costs (e.g. lumber). Across the industry, higher costs have hindered the pricing adjustments necessary to sustain unit sales.

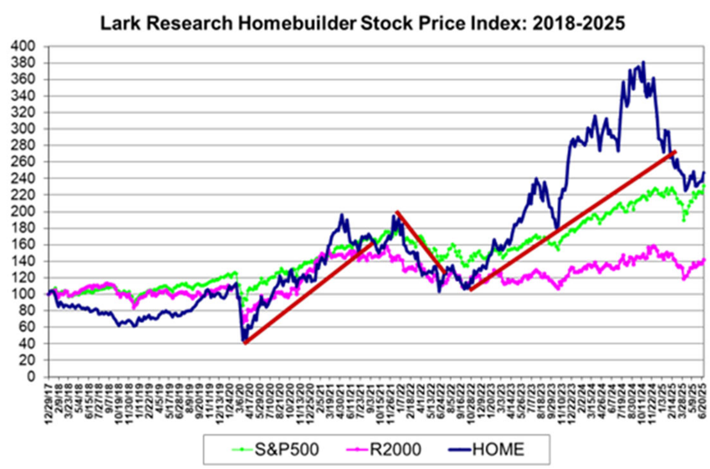
In FY25Q2. LEN's new order units rose 5.8% YOY to 22,460, but its average selling price fell 11.9% to $381,800. Its average order price has fallen more or less steadily over the past three years from a peak of $511,400 in May 2022.

In the quarter, homebuilding revenues declined 6.4% to $7.8 billion, as a 2.0% increase in unit deliveries offset by an 8.5% drop in average delivery price. Homebuilding operating earnings fell 45.7% to $728.2 million, as operating margin fell 670 bp from 16.0% to 9.3%.

Despite these challenges, the company sees continuing strong potential demand from consumers for housing, as millennials move into their peak home buying years. It believes that it is well positioned to adjust to changing market conditions.

HOMEBUILDER STOCK PRICE PERFORMANCE

- After a correction in 2022 that began when the Fed started raising interest rates, my index of 10 publicly traded homebuilders rallied for two years (Sept. 30, 2022 to Oct. 18, 2024), that saw the group surge 258%, outperforming the annualized gains of 64% for the S&P 500 and 37% for the Russell 2000. Since Oct. 2024 (through June 30), the Index has fallen 35%, compared with the S&P 500's 5.3% gain and the Russell 2000's 4.5% decline.



- YTD, through June 30, my index of 10 publicly traded homebuilding stocks has fallen 13.7%, underperforming the 5.0% increase in the S&P 500 and the 3.2% decline in the Russell 2000.
- The Lark Research Homebuilder Index is an equal-weighted measure of the share price performance of 10 publicly traded builders. It therefore gives greater weight to smaller capitalization builders, like BZH, HOV and MHO, for example, which have seen mid-teens to low-20s percentage share price drops so far this year. Thus, my index has underperformed the more broadly based and higher capitalization weighted ETFs in the sector, like XHB, which is down 5.2% YTD, and ITB, which is down 8.9% YTD (through June 30). (Both XHB and ITB include non-homebuilders, such as home retailers, building materials and product suppliers.)

- With this latest rally, these 10 homebuilding stocks are now trading at more than ten times forward earnings, cheap to the broader market, but in line with their historical averages. Consensus estimates are anticipating average earnings declines nearly 25% in 2025, with a projected average increase of 8% in 2026.
- The stocks are trading at 1.7 times equity book value per share on average, close to the average of 1.6 times recorded during the previous peaks in their valuations in 2021. Upside price potential will therefore probably require an improved earnings outlook.

HOUSING FORECAST

- With slowing growth in the economy expected over the next 18 months, and year-to-date decline in new home sales. I currently expect that new home sales will decrease 2.0% in 2025. I also anticipate that single-family housing starts will be down 6.7% for the year.

Table 1

Selected Economic and Housing Market Statistics: 2021-2025F

	2021	2022	2023	2024	2025
Nominal GDP ($B)	23,681	26,007	27,721	29,185	30,352
% Change	10.9%	9.8%	6.6%	5.3%	4.0%
Real GDP ($B of chained 2012 $)	21,495	22,035	22,671	23,305	23,631
% Change	6.1%	2.5%	2.9%	2.8%	1.4%
Existing home sales (000s)	6,120	5,030	4,090	4,060	4,019
% Change	8.5%	-17.8%	-18.7%	-0.7%	-1.0%
New home sales (000s)	821	771	666	686	672
% Change	20.4%	-6.1%	-13.6%	3.0%	-2.0%
Total (000s)	6,941	5,801	4,756	4,746	4,692
% Change	9.8%	-16.4%	-18.0%	-0.2%	-1.1%
Under construction	770	759	676	641	605
SF housing starts	1,127	1,005	948	1,013	945
% Change	13.8%	-10.8%	-5.7%	6.9%	-6.7%
UC / SF starts	0.68	0.76	0.71	0.63	0.64
UC / new home sales	0.94	0.98	1.02	0.93	0.90
House prices					
Existing median ($)	347,100	386,400	389,300	407,600	411,700
% Change	17.0%	11.3%	0.8%	4.7%	1.0%
New median ($)	397,100	455,800	428,600	420,300	424,500
% Change	17.9%	14.8%	-6.0%	-1.9%	1.0%
Case-Shiller National NSA ($)	278,640	294,270	310,980	323,360	329,800
% Change	18.9%	5.6%	5.7%	4.0%	2.0%

Sources: Census Bureau, BEA, S&P, NAR and Lark Research estimates.

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