FITCH WIRE

Fitch Ratings Cuts U.S. Housing Sector Forecasts on Higher Rates; Lower Confidence

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Fitch Ratings-Chicago/New York-16 March 2023: Fitch Ratings has sharply lowered its expectations for several key performance indicators (KPIs) for the U.S. housing sector in 2023 due to greater than expected mortgage rate volatility and our expectations for benchmark U.S. interest rates to remain "higher-for-longer" as detailed in our latest Global Economic Outlook (GEO). Our revised 2024 forecast shows modest year-over-year (yoy) improvements compared to 2023 for most KPIs. However, the absolute activity levels implied are lower than our prior 2024 expectations, and will be comparable to 2017-2018 levels.

Fitch U.S. Housing Forecasts

North America (YoY Change)	2022	New 2023F	Prior 2023F	New 2024F	Prior 2024F
Housing Starts	-2.9%	-20.0%	-11.9%	-1.3%	-2.0%
Single-Family Housing Starts	-10.9%	-20.0%	-13.0%	3.4%	-5.0%
New Home Sales	-16.8%	-7.1%	-7.0%	2.7%	0.0%
Existing Home Sales	-17.9%	-15.0%	-9.0%	3.6%	-2.0%

F - Forecast.
Source: Fitch Ratings

Housing starts were better sequentially in the month of February as homebuilder confidence improved for the third straight month. Total housing starts grew 9.8% sequentially while single-family starts increased 1.1% vs. January. Lower mortgage rates led to an uptick in homebuyer traffic and sales in January and the early part of February. However, the subsequent increase in mortgage rate levels and volatility will likely weaken homebuyer demand and builder sentiment, pressuring starts during the balance of the year.

We expect homebuilders in our coverage to report 2023 median revenue declines of 16%-18%, driven by reduced home deliveries and slightly lower home prices, offset in part by higher community count. We project most builders' EBITDA margins to fall 700 bps-800 bps this year as lower operating leverage and higher incentives are only partially offset by lower costs for certain building products like lumber. MDC Holdings, Inc. (BBB-/Stable) is expected to report meaningfully lower revenues and more severe margin compression than its peers given very weak new order activity during 2H22.

In 2024, our ratings case forecasts generally provide for mid-single digit revenue declines and 200 bps of further EBITDA margin compression as housing activity remains weak during 1H24. Most homebuilders currently have adequate rating headroom but this cushion is expected to shrink given our forecast of meaningful revenue and margin declines in the next 18-24 months. Rating actions will be driven by company-specific operating performance as well as capital allocation strategies and liquidity cushions, given considerable uncertainty in intermediate term demand.

Mortgage rates have been volatile so far this year. The average 30-year fixed mortgage rate

fell to 6.09% in early February from 6.48% at the start of the year. However, rates have since reverted higher and were back to 6.73% as of March 9 before declining to 6.6% as of March 16. Consumers continue to show meaningful sensitivity to mortgage rates given their impact on affordability, as evidenced by declines in mortgage applications when rates exceed the mid-6% level.

Our latest GEO published on March 10, 2023 assumes interest rates stay higher for longer, with Federal Funds rate at 5.5% at YE 2023 and 4% at YE 2024. We forecast the yield curve to remain inverted during 2023 and to flatten in 2024, with 10-year yields at YE forecast to settle at 4.5% and 4%, respectively.

The spread between 30-year mortgage rates and 10-year treasuries has recently been about 250 bps-300 bps vs the historical average of about 175 bps. This suggests 30-year mortgage rates will likely sustain above the mid-6% range through at least 2023, assuming spreads remain historically wide and are unlikely to dip below 6% until 2024 at the earliest, absent spread compression below historical averages.

Consumer trends remain mixed, but generally more negative than positive, further supporting our more cautious housing sector expectations. Consumer confidence has dipped for two straight months and Fitch's expectations of higher unemployment rates through 2024 and the recent bank failures do not bode well for consumer confidence. However, recent employment trends have exceeded our expectations, leading Fitch to forecast lower unemployment rates in 2023 compared to our December GEO.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

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