

## Trough is Near

### Current Housing and Mortgage Market Activities:

#### Single-family starts stabilize:

Home building activity resumed its drop in March on multifamily weakness. Following a modest increase in February, which was the first increase in nine months, single-family starts were flat in March. While this appeared unremarkable, it was the first two-month period without a drop in two years. Single-family starts have declined in 20 of the past 24 months.

Through the first quarter of this year, single-family starts were 51.7 percent lower than those in the first quarter of 2008. While the decline in total housing starts in the first quarter was sizable, it moderated from the fourth quarter.

#### Sales stabilize at low levels while inventory improves:

Total existing home sales posted a small drop in March, while new home sales were relatively flat during the month. According to the Beige Book prepared for the April 28-29 Federal Open Market Committee meeting, Federal Reserve Bank districts noted that there were some signs that housing market conditions may be stabilizing.

The months' supply for existing single-family home sales is moving sideways in the first three months of the year, hovering around 9.7 months to 9.8 months, down from the 12.0 months peak in November 2008.

For new homes, the months' supply fell to 10.7 months in March, declining in three of the last four months and down from its recent peak of 12.5 months in January 2009.

#### Home price declines ease:

Most measures of existing home prices continued to decline but the pace of decline has slowed. The median price for total existing homes fell 12.4 percent in February from a year ago, compared with a 14.1 percent drop in February. The median price for new homes fell 12.2 percent in March from a year ago, slowing from a 14.9 percent drop in the prior month.

The Federal Housing Finance Administration (FHFA) purchase-only House Price Index—a measure of home prices using a repeat sales transaction methodology—showed that prices increased in February for the second consecutive month. The year-over-year decline was 6.5 percent in February, slowing from a 6.9 percent drop in January and a record decline of 9.1 percent in November.

#### Mortgage rates holds relatively steady despite rising Treasury yields:

The 10-year Treasury yield—the benchmark for fixed mortgage rates—has moved higher since mid-March, when the Federal Reserve introduced the program to purchase \$300 billion of Treasury securities and to increase its purchases of agency mortgage-backed securities and debt. As of this writing, the Fed has purchased

about one-third of the total commitment level of Treasury securities. The 10-year yield rose to 3.29 percent on May 8 compared with the yield of 2.51 percent on the day of the Fed announcement. The rate fell to around 3.10 percent by mid-May. The upward trend of Treasury yields appears to be in response to signs of improving economic conditions and a potentially very large increase in the supply of Treasuries in the pipeline due to the substantial increases in projected budget deficits.

Despite the sharp increase in Treasury yields, conforming fixed mortgage rates have increased only slightly as mortgage spreads have dramatically narrowed. As noted in the Economic Commentary, the spread between the 10-year and conforming mortgage yields has narrowed to about 160-170 basis points from nearly 300 basis points at the end of 2008.

### **Housing and Mortgage Market Projections:**

For the near term, leading indicators of home building activity were mixed. Single-family permits—a leading indicator for single-family housing activity—fell 7.4 percent in March, partially reversing the 16.1 percent increase in the prior month. The February jump, which was the biggest since July 1980 and the first increase in ten months, had offered some hope that single-family starts were close to the bottom.

Another leading indicator of housing activity showed that home builders' sentiment improved considerably in April, albeit from a near record low level. The National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index posted the biggest jump in five years, led by a 10-point increase in the index gauging sales expectations for the next six months. Builders also saw some improvement in current sales conditions and traffic of prospective buyers.

Despite mixed results in leading indicators of single-family starts, we expect that single-family homebuilding activity will bottom in the current quarter after plummeting by about 80 percent from their peak in January 2006. Given the elevated months' supply of new homes, a rapid improvement in the second quarter is unlikely.

We continue to expect mortgage rates to remain low, with 30-year fixed mortgage rates hovering around 4.9 percent for most of this year before rising modestly next year as the economy recovers but growth is expected to remain sub-par for most of the year.

Our forecast of home sales remains close to the April forecast. We project that existing home sales will rebound somewhat in the second quarter from a very low level in the first quarter, supported by distressed sales, but will remain considerably below long-run average levels. A considerable number of foreclosed properties in the pipeline will continue to compete with sales of new homes as they are put on the market. New home sales should bottom in the current quarter and post modest increases through the rest of the year.

Home prices, which are a lagging indicator, should continue to drop through all of this year before recovering modestly in 2010. Given the rising share of sales of foreclosure sales reported by NAR, we increased the share of cash sales in our housing model. As a result, we projected a more pronounced decline in purchase

originations in the May forecast than in the April forecast, especially for the near-term.

On the refinancing side, given the industry's capacity constraints, we lowered our projections of refinance originations in the second and the third quarters and increased them in the fourth quarter. Essentially, the refinance boom is being extended over a longer time period, with a lower peak level of activity, as volume is taking longer to work through the pipeline. This presents some downside risks to our forecast as the projected increase in refinance originations will not materialize if rates move higher later in the year.

In addition, we pared down our projection of refinance originations for all of 2009 because some of the projected increase in refinance originations from the Homeowner Affordability and Stability Plan (those loans where a mortgage insurance policy already existed) will be treated as loan modifications rather than new mortgage originations.

Below are our projections for this year and next:

- Total existing home sales for 2009 should see another drop of about 2.5 percent to about 4.8 million units. Sales will pick up about ten percent in 2010.
- New home sales will decline about 32 percent in 2009 from 2008 to 328,000 units before rising about 17 percent in 2010.
- Median home prices for new and existing homes are expected to continue their decline this year, falling about nine percent. Prices should stabilize at the end of the year and post a slight increase in 2010.
- Purchase originations should post another 13 percent drop to \$742 billion and should pick up about 25 percent in 2010, as both new and existing home sales increase and home prices stabilize.
- Refinance originations should surge by about 145 percent to \$1.87 trillion in 2009—the first increase in four years. Refinance activity will drop about 36 percent in 2010 as mortgage rates rise amid economic recovery.
- Total mortgage production will be up about 62 percent to \$2.62 trillion this year from an estimated \$1.62 trillion in 2008. Total originations should see a 19 percent decline in 2010 to \$2.13 trillion as a drop in refinance originations outweighs an increase in purchase originations.