



MORTGAGE MATTERS...

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Keeping you updated on the market!
For the week of

April 12, 2010

MARKET RECAP

As the federal tax credits for home buying near the April 30 expiration, consumers are taking notice. The National Association of Realtors reported that its pending home sales index climbed 8.2% to 97.6 in February. The surge is similar to the one seen in October prior to the November 30 end date for the original homebuyer's tax credit.

Will there be a third surge somewhere down the line? That's difficult to say, but the lobbying is on. NAR lead economist Lawrence Yun commented last week that another surge is needed to stabilize prices and reduce inventory, suggesting that extending the credits again wouldn't be the worst thing the federal government could do for housing.

We remain unconvinced. We think the credits have run their course, so any extension would have a marginal benefit at best. That's okay, though, because the market is close to taking over. According to a recent Fannie Mae survey, two out of three Americans think it's a good time to buy a home – a percentage that matches responses in a similar survey in 2003 – while 31% believe it's a very good time to buy. Seventy percent of the respondents said that buying a home continues to be one of the safest investments. To put that in context, 74% ranked a bank account as a safe investment while only 17% viewed the stock market as safe. Real estate remains the investment of choice.

Americans might be viewing mortgage rates less favorably than housing opportunities. The era of record-low rates is winding down. The average rate on a 30-year fixed-rate loan has jumped from about 5% to more than 5.3% in the past week. There's a silver lining to the increase: sellers might find a more eager market, because many buyers will want to complete their purchases and lock in still-decent rates before they go higher.

This leads us to the most-frequently asked question: are rates *really* going higher? After all, recent minutes from the Federal Reserve's latest meeting state that it was committed to keeping rates low for an “extended period.” We think the Fed is

fighting a losing battle. Even though most economists consider inflation to be of relatively little threat at the moment, they acknowledge things can change quickly. More important, an increasing number of credit-market participants are expecting a quick change.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
International Trade (February)	Tues, April 13, 8:30 am, et	\$38.8 Billion (Deficit)	Moderately Important. The expected increase in the deficit should have little impact on dollar value or interest rates.
Import Prices (March)	Tues, April 13, 8:30 am, et	0.9% (Increase)	Important. A strengthening dollar is helping to hold prices in check.
Mortgage Applications	Wed, April 14, 7:00 am, et	None	Important. Purchase activity should rise through month's end.
Consumer Price Index (March)	Wed, April 14, 8:30 am, et	All Goods: 0.1% (Increase) Core: 0.1% (Increase)	Important. Consumer-driven inflation remains benign, though more economists expect increasing inflationary pressure.
Retail Sales (March)	Wed, April 14, 8:30 am, et	0.8% (Increase)	Important. The upward trend in sales suggests growing consumer confidence.
Industrial Production (March)	Thurs, April 15, 9:15 am, et	0.5% (Increase)	Important. Rising industrial production increases the likelihood of producer-induced inflation.

Housing Market Index (April)	Thurs, April 15, 1:00 pm, et	16 Index	Important. Homebuilders continue to struggle with excessive inventory.
Housing Starts (March)	Fri, April 16, 8:30 am, et	610,000 (Annualized)	Important. Starts are volatile, but recent data suggest a rising trend.

A Historical Money Perspective

The potential for a burst of money creation is yet another arrow for our higher-rate quiver. The Federal Reserve controls the monetary base – currency and coin and deposits at the Federal Reserve bank. From this base, banks generate loans, which produce new money. In fact, it can be new money produced at a rate many times over the Fed's base amount. (Banks are required to hold only 10% of deposits in reserve).

The concern today is that the Fed has increased the monetary base too much, giving banks the ability to create too much money. When the economy picks up, so the argument goes, banks will quickly put these funds to use, producing a surge of inflation and a concomitant surge in interest rates.

We don't think it's quite that ominous, but we still think inflation is likely nonetheless. We just think it will be inflation at the historical annual rate of around 3%. The return to historical norms means mortgage rates are destined to rise. Thirty-year fixed-rate mortgages have historically been priced 1.75% to 2.0% above the 10-year Treasury note, now yielding 3.85%, which translates into 5.75% loans.

We all crave a return to normalcy, to be sure. In the meantime, we think it's worthwhile for borrowers to lock in today's still abnormally low rates.



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