



MORTGAGE MATTERS...

Keeping you updated on the market!

For the week of

June 28, 2010

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Keeping
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on market
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MARKET RECAP

The housing market is playing out close to what we had anticipated post-April 30, so we weren't surprised to hear that existing-home sales slipped in May, posting a 2.2 percent drop to an annualized adjusted rate of 5.66 million units. The consensus opinion called for sales to increase to 6.07 million units, due to an anticipated push to close by June 30, so the unexpected slip was disappointing. The good news was that the median sales price, at \$179,600, remains 2.7 percent above last year's median price, while inventory tightened to an 8.3-month supply.

The slip in existing-home sales was nowhere near as disappointing as the tumble in new-home sales, which hit their lowest level since 1963. Whereas the consensus expected sales to post at an annualized rate of 470,000 units for May, the market was only able to deliver a 300,000-unit rate. To get a perspective on just how far new-home sales have dropped, only five years ago new homes were selling at a 1.39-million annualized rate. There was one notable positive in the new-home data – inventory tightened to an 8.5-month supply.

The disappointing data on home sales has rekindled talk of a double-dip recession. Many pundits were expecting existing-home sales to improve until July, after which the full impact of the tax-credit expirations would be felt. We've stated in past editions that we expect housing sales to behave similarly to automobile sales when they underwent a similar stimulus. In other words, we expect to see a precipitous sales drop (which we are seeing) followed by stabilizing and increasing sales.

Other market watchers are less sanguine. Employment worries have been the gut reaction to the lackluster demand for new homes. Construction will certainly suffer if fewer new homes are being built, so goes the extrapolative train of thought. Keep in mind, though, that renovations on foreclosures and short sales will pick up some of that slack. The more pressing issue, in our opinion, is draining the inventory of existing homes before building more new ones, which appears to be occurring. After all, when you want to drain a tub, you don't keep adding water.

Sales aren't the only housing-market variable hitting lows. Mortgage rates continue to hold, and at times exceed, historical lows, and could continue to do so into the near future. The Federal Reserve noted that inflation is “likely to be subdued for some time.” The Fed also said that “prices of energy and other commodities have declined somewhat in recent months, and underlying inflation has trended lower.” But a few dissenting voices note that the low-rate pledge might fuel another asset-price bubble. Experience has taught us that dissenting voices are worth listening to.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
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Personal Income & Outlays (May)	Mon, June 28, 8:30 am, et	Income: 0.4% (Increase) Outlays: 0.2% (Increase)	Important. Spending is expected to ease on renewed economic concerns.
S&P Case/Shiller Home Price Index (April)	Tues, June 29, 9:00 am, et	3.4% (Increase)	Moderately Important. April's prices will likely be skewed by the push to exploit federal tax credits.
Consumer Confidence (June)	Tues, June 29, 10:00 am, et	62.9 Index	Moderately Important. Confidence is easing, but remains healthy.
Mortgage Applications	Wed, June 30, 7:00 am, et	None	Important. Low rates alone are no longer stimulating lending activity.
Construction Spending (May)	Thurs, July 1, 10:00 am, et	0.5% (Decrease)	Important. The drop in new-home construction will hurt overall spending.
Pending Home Sales Index (May)	Thurs, July 1, 10:00 am, et	99.8 Index	Important. Sales will decline after the April surge.
Employment Situation (June)	Fri, July 2, 8:30 am, et	Unemployment Rate: 9.7% Jobs: 70,000 (Decrease)	Very Important. Deviations from the consensus opinion will impact interest rates.

The Costs are Outweighing the Benefits

We've stated that the benefits of low interest rates have run their course. We hold to our contrary opinion that low rates are actually hindering more than helping markets these days. Consider the mortgage market: Even though mortgage rates are dwelling in the basement, fewer people are applying for mortgages. The MBA reported that purchase activity declined 1.2 percent to the second-lowest level since 1997 last week, while refinancing activity slid 7.3 percent from its May 2009 highs.

The Federal Reserve's low-rate policy is hardly inspiring confidence. "Rates must be low because the economy is circling the drain," so the man-on-the-street rationale goes. It's the wrong message to send, because promoting risk aversion also means promoting inertia. Risk-averse markets are simply less willing to engage in riskier, but worthwhile, economic activity.

This risk-averse sentiment is readily reflected in the capital markets, where the relatively non-productive assets of gold and Treasury securities continue to be the investments of choice. That's unfortunate, because we'd all be better off if there were more investment in the very productive (though riskier) assets of home purchases and renovation and mortgage lending.

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