
From: Sam Suznevich
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MORTGAGE MATTERS...

• Keeping up-to-date on market fluctuations allows you to bring greater value to your clients.

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Keeping you updated on the market!
For the week of

January 11, 2010

MARKET RECAP

The first full week of the new year wasn't one of the more encouraging weeks. It began with a dour report on pending home sales, which tumbled 16% in November raising concerns among many economists that the housing recovery could be poised for a relapse.

The most repeated explanation for the drop in pending sales was that October's numbers were buoyed as buyers rushed in to take advantage of the federal tax credit before its initial expiration on November 30. Of course, we now know that the credit has been extended through April and expanded to include a \$6,500 incentive for some buyers who already own a home.

The good news is the November report did not account for the new-and-improved federal tax credit. So after we work through November's bout of housing dyspepsi we will likely see sales rates gradually pick up and home inventories gradually decline.

That is, if employment – the most important variable in any recovery – improves. The news is not as encouraging as we would have liked. Friday's employment report showed the official unemployment rate held steady at 10% for December, though employers shed an unexpectedly high 85,000 jobs.

The first question that pops to mind is, "How can the unemployment rate hold steady if job losses increased?" Once people stop looking for jobs, they are no longer counted among the unemployed, which is why there is a supplemental employment report. When discouraged workers and part-time workers who would prefer full-time jobs are included, the "underemployment" rate in December rose to 17.3% from November's 17.2%.

December's employment numbers have led a few pundits to believe the job situation will not improve much in 2010. We think it is too soon to consider throwing in the towel. It's worth noting that the Federal Reserve still thinks the economy is improving, saying in the minutes of its last meeting of the Fed governors that “ economic growth was strengthening in the fourth quarter, that firms were reducing payrolls at a less rapid pace, and that downside risks to the outlook for economic growth had diminished a bit further.”

It is not a ringing endorsement of the economy, to be sure, but it is an endorsement.

| Economic Indicator | Release Date and Time | Consensus Estimate | Analysis |
|----------------------------------|-----------------------------|-------------------------------------------------------|--------------------------------------------------------------------------------------------------------|
| International Trade (November) | Tues, Jan. 12, 8:30 am, et | \$34.3 Billion (Deficit) | Moderately Important. The energy-driven deficit will have little impact on equity and lending markets. |
| Mortgage Applications | Wed, Jan. 13, 7:00 am, et | None | Important. Refinance and purchase applications have stalled on recent economic concerns. |
| Retail Sales (December) | Thurs, Jan. 14, 8:30 am, et | 0.3% (Increase) | Important. Increasing retail sales suggest consumers are becoming more optimistic. |
| Import Prices (December) | Thurs, Jan. 14, 8:30 am, et | 0.1% (Increase) | Important. Import prices are under control, but the pressure for rising prices is increasing. |
| Consumer Price Index (December) | Fri, Jan. 15, 8:30 am, et | All Goods: 0.1% (Increase) Core: 0.2% (Increase) | Very Important. Any signs of impending inflation will move interest rates higher. |
| Industrial Production (December) | Fri, Jan. 15, 9:15 am, et | 0.4% (Increase) | Important. Improving conditions in manufacturing are foreshadowing a pick up in economic activity. |

The Big Overhang

The Federal Reserve is on lenders' minds these days, and for good reason: They are concerned how the Fed's plan to wind down purchases of mortgage-backed securities will influence the lending market.

Over the past year, the Fed has bought \$1.25 trillion of mortgage-backed securities to ease lending markets and keep longer-term rates low. The program has succeeded on that front by pushing mortgage rates below 5% to levels unseen since the early 1950s. The big fear now is that when the Fed stops purchasing

these mortgage-backed securities (and that is the plan for late March) mortgage rates will start rising and the housing market will start back peddling.

We think the fears over a rate-induced reversal are overdone. Lower rates have done their job, but they have done about all they can do. We've argued in past editions that a rising interest-rate environment wouldn't be the worst thing to happen, because it would motivate people to act, particularly if rising rates are accompanied with rising economic activity and rising employment levels – both of which we still see as likely for 2010.

When the economy does officially improve, all the goodies we have become accustomed to will go away as well. However, that is not bad either. Sound markets are reflective of their ability to stand on their own two feet. At this point, just about everybody would like to see the mortgage and housing markets do just that.

In the meantime, mortgages rates and home prices remain very attractive. We just cannot say for how long. With the proposed changes in FHA lending standards, likely additional mortgage-market oversight, April's impending expiration of the federal home buyer's tax credit, and the Fed backing out of the mortgage securities market, the deals we see today might not be so attractive a few months down the road.



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