Foreign buying of treasuries helped keep interest rates lower than they ordinarily would be in economic recovery, allowing buyers to bid home prices up to ever higher levels.

Housing Gets Even Less Affordable

Continued From Page D1

gap has been widening," says Barbara Ryan, an associate director at the FDIC.

To be sure, housing prices could continue to climb, thanks in part to interest rates that are still at historically low levels. In addition, how much impact declining affordability will have depends in part on whether it's offset by shifting demographics and by rising employment—which creates rising incomes—says David Berson, chief economist of **Fannie Mae**. Another factor: what happens to demand from investors who tend to focus more on total return than on their monthly payments.

As affordability has declined, many borrowers have increased their buying power by shifting to adjustable-rate loans and interest-only mortgages, which allow borrowers to pay interest and no principal in the loan's early years. More recently, many have embraced option ARMs, which give borrowers multiple payment choices. Borrowers who elect to make the minimum payment can see their loan balance rise, which is known as "negative amortization."

"We postponed the inevitable with these interest-onlies and negative-amortization" loans, says David Lereah, chief economist of the National Association of Realtors. "But you can't sustain double-digit price appreciation and keep homes affordable."

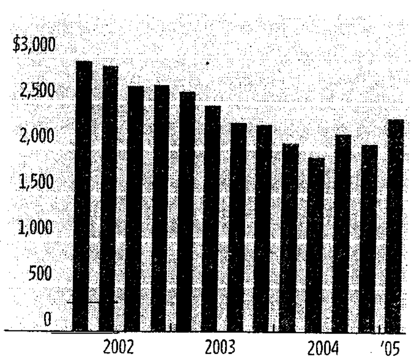
So far, the steady upward appreciation in prices hasn't had much of an impact on home sales. The NAR yesterday boosted its forecast of existing-home sales to show a rise of 2.8% to 6.97 million this year, setting another record.

In California, where affordability is a big problem, more-affordable areas are

PRICES MAXED OUT

Mortgage Payments Hit the Wall

Mortgages aimed at boosting affordability are starting to lose their punch. Below is the average initial payment on new mortgages taken out to buy homes.*



*Data for jumbo mortgages, currently loans above $359,650

Source: Bear Stearns Cos.

The Least-Affordable Housing Markets

Here are some of the nation's least-affordable markets, based on how much of a median-priced house can be bought by someone earning the median income in that market.

METRO AREA	4Q 2004	1Q 2005
Merced, Calif.	29.0%	27.6%
Visalia, Calif.	37.1	35.4
Santa Cruz, Calif.	41.1	38.7
San Diego	50.9	48.4
Los Angeles	51.7	49.4
Salinas, Calif.	51.7	50.1
Santa Ana, Calif.	54.5	52.5
Santa Barbara, Calif.	56.5	53.9
Santa Rosa, Calif.	56.5	54.3
Redding, Calif.	55.8	54.5
San Francisco	57.4	55.9
Napa, Calif.	61.1	58.9
Honolulu	62.2	60.1
San Jose, Calif.	64.9	62.6
Chico, Calif.	65.7	62.9
New York	65.8	64.3
Oakland, Calif.	68.3	66.0
Miami	69.8	66.2
Riverside, Calif.	75.2	70.5
West Palm Beach, Fla.	78.4	73.1

Notes: This affordability index measures the percentage of the median-priced existing home that can be purchased by a

seeing bigger price gains. Home-price growth in San Diego and Orange County, two of California's least affordable markets, has dropped to the single digits, according to the California Association of Realtors, while prices have climbed more than 20% in less expensive areas, such as Riverside-San Bernardino.

Overall, just 16% of households in California can afford the median-priced home, according to the California Association of Realtors, the lowest level since 1989, when the average rate on a 30-year fixed-rate mortgage was 10.33%. Rates on 30-year fixed-rate loans currently average just 5.81%, according to HSH Associates in Pompton Plains, N.J.

Until recently, innovative mortgage products have made it easy for home buyers to buy ever more expensive homes while taking less out of their pockets. Monthly payments on jumbo loans have risen only once since 2002, according to the Bear Stearns study. That climb came when rates jumped in the third quarter of 2004 and was quickly reversed thanks largely to the surging popularity of option ARMs. Option ARMs and interest-only loans have accounted for 65% to 70% of jumbo-mortgage originations in recent months, according to UBS AG.

The new data suggest "the housing market could cool under its own weight," says Mark Zandi, chief economist of Economy.com.

The advantages of shifting from a fixed-rate mortgage to an ARM or other affordability products have been declining as the Federal Reserve has boosted short-term interest rates and the yield curve has flattened, narrowing the gap between short- and long-term interest rates. Rates on ARMs that are fixed for the first year currently average 4.7%, according to HSH Associates. That's the highest level since July 2002, and just 1.11 percentage points lower than the rate on a 30-year fixed-rate mortgage. As recently as May 2004, borrowers could cut the rate on their loan by 2.41 percentage points by opting for a one-year ARM instead of a 30-year fixed-rate mortgage.

The initial teaser period for some mortgage rates can be as brief as a month.

Higher short-term rates are also reducing the attractiveness of option ARMs. Once the initial teaser period—which can be as brief as a month—ends, rates on these loans can jump to 5.5% or more, not much lower than the rate on a traditional 30-year fixed-rate mortgage. Credit-rating services recently set tougher standards for option ARMs because of fears that borrowers who hold these loans will default at a higher rate. That, says Dale Westhoff, a senior managing director at Bear Stearns, "ultimately makes it more expensive to originate these kinds of loans."

A handful of lenders have tried coupling option ARMs with 40-year mortgages, but coming up with additional ways to reduce monthly payments is likely to be difficult. Standard & Poor's Corp. says some proposed mortgage programs it's been asked to evaluate recently are aimed at fixing the low payment for a longer period. Others try to manage the sharp increase in payments a borrower can face when the interest-only period ends or the option ARM resets, so that the mortgage balance is paid off during the remaining term. With some lenders offering rock-bottom teaser rates, "I don't know how much lower you can get" when it comes to reducing the initial monthly payment, says Standard & Poor's associate director Brian Grow.

E 35

Journal Link: *Determine how much house you can afford with the Mortgage Tools, at* **RealEstateJournal.com**

As home prices rose, riskier mortgage volume exploded

The Trillion-Dollar Bet

Homeowners Take Risks in a Bid for Lower Mortgage Payments

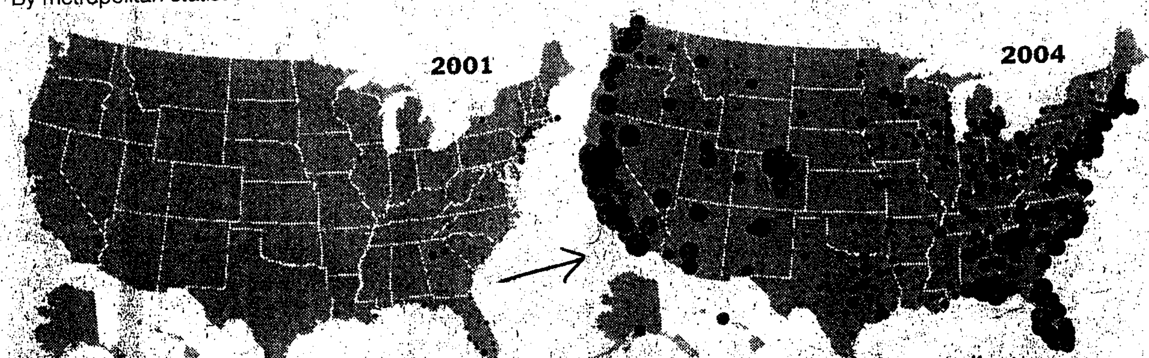
6-16-05

Risking Affordability

As home prices continue to rise across the country, home buyers are turning to riskier adjustable-rate mortgages to help buy homes that they would not otherwise be able to afford.

Circles on the maps are sized by the percentage of home loans greater than $360,000 that are interest-only loans. Does not include refinancing. By metropolitan statistical area.

PERCENTAGE OF LOANS 10% 40% 70%



EXPLOSION IN RISKIER "INTEREST ONLY" LOANS

	BASICS	PROS	CONS
Fixed Rate	Usually 15- or 30-year terms. Borrower makes fixed monthly payments on principal and interest.	Payment amounts are guaranteed and inflation effectively reduces them over time; borrower builds up equity gradually.	Borrowers who plan to move fairly quickly will have paid more with a fixed-rate loan.
Hybrid adjustable-rate mortgage	The mortgage rate is fixed for a period of time, usually 3 to 10 years, and then is reset based on market rates.	Initial mortgage rate is lower than on fixed-rate mortgages.	If rates go up when rate resets, borrower could be hit with much higher monthly payments.
Interest-only adjustable-rate mortgage	Rates may be fixed or adjustable. Borrower pays only interest for a certain number of years, after which borrower pays principal plus interest. Borrower can pay off principal at any time without penalty.	Initial payments are much lower than they would be if borrower were also paying principal. Good for people who expect big increases in income.	The spike in payments could be onerous. If home prices fall, a borrower could build up no equity despite years of interest payments.
Pay option adjustable-rate mortgage	Typically an adjustable-rate mortgage where the rate adjusts monthly. Each month, borrower has the option of four different payments, one based on an artificially low rate like 1.25%, one interest-only on that month's rate, one principal plus interest on a 30-year schedule and one principal plus interest on a 15-year schedule.	Initial payments can be extremely low. Good for people with variable income who want flexibility.	If borrower makes only minimum payments, the size of the debt will actually grow. After five years, borrowers must pay principal plus interest on a 30-year schedule, which could mean sharply increased monthly payments.

Source: LoanPerformance

E29

The New York Times

Mr. Appelbaum said, "It doesn

AMERICAN DEBT LEVELS INCREASE

Fed Reserve Study finds:

CHRIS LESTER
Assistant Managing Editor/Business

This will make you see red

Here are a few fresh takes on debt, a topic sure to get this Scotsman's kilt in a bunch, particularly as interest rates trend higher.

We'll start on the home front.

Every few years, the **Federal Reserve Board** conducts a comprehensive survey on the financial state of American households. The Fed's "Survey of Consumer Finances" for 2004 recently came out, and it unleashed a blur of interesting numbers.

Here are just a few trends:

Household Income falls (infl. Adj.)

■ Average inflation-adjusted household income declined 2.3 percent during the 2001-2004 period. In the previous three-year period, average household income had jumped 17.3 percent.

Household Gains tied To housing

■ Despite the income slippage, average household net worth increased 6.3 percent during the 2001-2004 period. That gain was down from 28.7 percent during the previous three-year period.

■ Families made most of their net worth gains on real estate. The average value of primary residences increased 28.1 percent during the 2001-2004 period.

Few families are saving

■ Fewer families are saving money. The proportion of families that say they are saving money declined 3.1 percentage points in the recent 2001-2004 survey, to 56.1 percent.

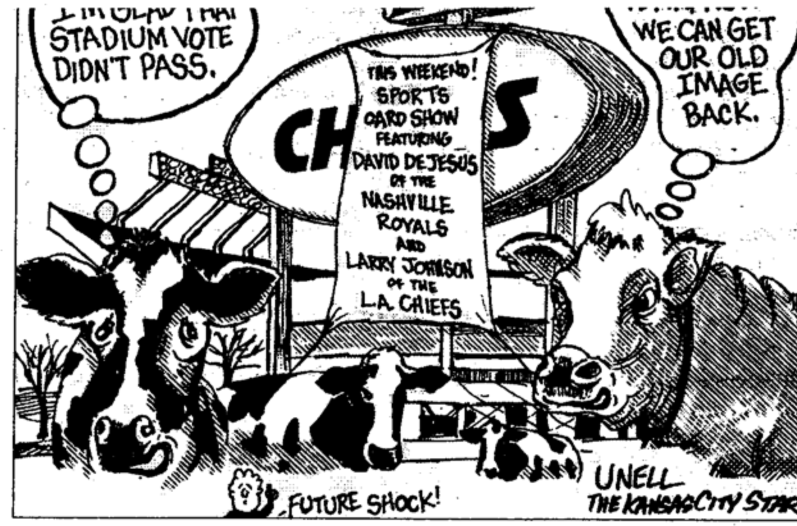
More families Deep in debt

■ More families are in debt, and deeper in debt. The proportion of families in debt climbed 1.3 percentage points, to 76.4 percent. The overall debt load of those families that are borrowing jumped 33.9 percent from 2001 to 2004.

Admittedly, that's a truncated summary of a 38-page report packed with numbers, charts and analysis. You can read the whole thing at **federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf**.

But, in general, it portrays many

See LESTER, D-11



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New bankruptcy rules

By MARK SHAIKEN
Guest Columnist

COMMENTARY

On Oct. 17, 2005, life under the new bankruptcy code began. One of the most important changes made by the new law is restrictions placed on the role bankruptcy judges will be permitted to play in Chapter 11 reorganizations.

Business bankruptcy cases are a delicate balance of rights and protections given to debtors, power and leverage given to creditors, and discretion given to bankruptcy judges to oversee the process. With such a balance, the parties in the case have been given the incentive to resolve their differences through business solutions.

Without appearing to give much thought to the effect on this delicate balance, Congress enacted a number of changes prohibiting bankruptcy judges from exercising discretion, such as the discretion to extend deadlines, and by doing so may have changed the balance dramatically.

Here are some examples:

■ **Plan filing deadlines:** In the past, judges had the power to extend the time within which Chapter 11 debtors could exclusively file a plan of reorganization.

The new law limits the judge's discretion to extend the exclusive plan filing deadlines to 18 months. As a result, Chapter 11 businesses will have to move through the bankruptcy process more quickly, and parties may be encouraged to "hold out" for the expiration of the deadlines, rather than attempt to resolve differences.

E6

The judge cannot determine in which cases the balance of debtor and creditor rights should be maintained to encourage resolution of differences. And in large, complicated business cases, 18 months may not be a sufficient period of time for the business to stabilize and a business plan to emerge.

■ **Real estate lease decisions:** Similarly, when a business commences a bankruptcy case, it previously had a short 60-day period to decide which real property leases to keep or terminate. Landlords typically waited the debtor to make the

Housing Bubble popped in early 2006…

CNNMoney.com

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CALIF

California home sales drop 24% in January

Decline reflects rising mortgage interest rates and weakening consumer confidence.

University of Phoenix Online
ASSOCIATES DEGREE
BACHELORS DEGREES
• Bachelor of Science in

February 28, 2006: 7:26 PM EST

SAN FRANCISCO (Reuters) - California's housing market is slowing as analysts had predicted, underscored by a slump in home sales in January, according to the California Association of Realtors.

boston.com

THIS STORY HAS BEEN FORMATTED FOR EASY PRINTING

The Boston Globe

MASSACHUSETTS

Mass. home sales plummet 21%

January prices also slip but condo deals climb

By Chris Reidy, Globe Staff | March 1, 2006

The number of single-family homes sold statewide fell 21 percent in January, the largest year-to-year decrease in monthly home sales since April 1995, and another sign that the once red-hot local real estate market is cooling, the Massachusetts Association of Realtors reported yesterday.

Based on the supply of homes for sale, up sharply from a year ago, the real estate market favored the buyer in January.

This is a printer friendly version of an article from **www.heraldtribune.com**
To print this article open the file menu and choose Print.

Article published Mar 1, 2006

FLORIDA

48% home sales drop leads state

One theory: Many well-off sellers await the 'right offer'

By Stephen Frater and Michael Pollick
STAFF WRITERS

E5

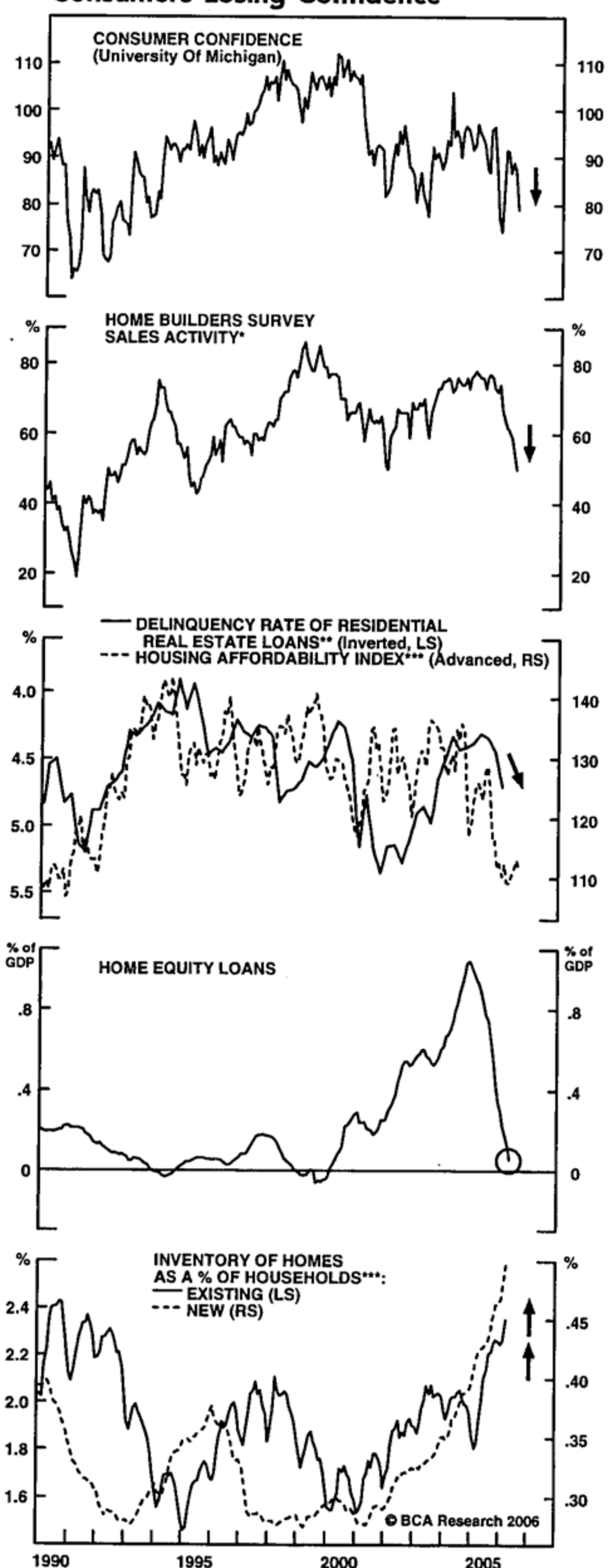
The high season peaked in mid-February but so far there is little evidence of a long-awaited and often-predicted real estate recovery.

In fact, the Sarasota-Bradenton market had the dubious distinction of being the Florida market with the biggest decline in sales during January: a precipitous 48 percent drop when compared with the same month a year ago -- more than double the state's 19 percent decline.

The Charlotte County-North Port market saw its sales drop 18 percent during the same time frame, the Florida Association of Realtors reported Tuesday.

Housing glut reaches levels of the late '80's collapse:

CHART 11
Consumers Losing Confidence



*SOURCE: NATIONAL ASSOCIATION OF HOME BUILDERS
**SOURCE: MORTGAGE BANKERS ASSOCIATION
***SOURCE: NATIONAL ASSOCIATION OF REALTORS

The combination of deteriorating housing activity and worries about energy (and the effect this is having on electricity rates) is eating into consumer sentiment. The preliminary University of Michigan poll of consumer confidence showed a sharp drop in May (top panel, **Chart 11**). Consumption growth has slowed in fits and starts since January, but not yet by enough to confirm that a period of trend or below-trend growth is underway. However, such an outcome looms in the coming months.

The boom in energy and commodity prices started the inflation scare back in late 2004. However, prices further down the supply chain failed to ignite. Finished goods producers have had great difficulty increasing selling prices because retailers face strong resistance from consumers. In fact, the PPI report last week showed that the core finished goods inflation rate has been drifting mildly lower. The same pattern is true for core CPI goods prices.

The sharp rise in gold prices in recent months has heightened inflation worries. Memories of the 1970s – when energy and gold prices soared in tandem as the dollar sank – have revived. However, the link between gold and inflation is tenuous at best. The "relationship" between gold prices and headline and/or core inflation that prevailed in the 1970s has long since broken down (**Chart 12**). In fact, the few times CPI has rebounded since the mid-1980s have not coincided with, or been led by, bull markets in gold prices (shown as the shaded areas in **Chart 12**). Soaring gold prices do not herald a revival in global inflation, but are part of the commodity stampede and reflect growing anti-dollar sentiment.

E12

incredible surplus of new construction!

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NOTE increase since March (2 months ago)

Mr Bernanke is counting on a "soft-landing" for the housing boom, the central pillar of the US consumer economy.

It provided $600bn of spending last year from home equity withdrawals - ie, from ever-bigger mortgages entailing ever-more debt.

This rosy assumption is looking shakier by the day. The inventory of unsold new houses is now at the highest level in a decade, rising by 1m properties to 4m over the last year.

The Philadelphia index of US construction equities has crashed 23.3pc since early May, pointing to an immediate wave of lay-offs.

Some 32pc of the 4.22m jobs created by the US economy since the expansion began in 2001 have been in the housing sector, more than four times the usual ratio, according to a study by Merrill Lynch. HSBC warns that US property has already tipped into a downturn, with the likelihood of outright price declines in the overheated markets of the East and West coast.

Ian Morris, the bank's chief US economist, said the combined cost of mortgage payments and house insurance for new buyers in California takes up 70pc of pre-tax income.

"Affordability is now worse than in 1981 when mortgage rates were 16pc. This is pretty scary stuff," he said, predicting a property slump lasting four to five years.

The Federal Reserve's blunder was to hold interest rates at almost free-money levels of 1pc until the summer of 2004, yet blowing fresh asset bubbles at home and abroad, and stealing prosperity from the future by pushing spending to the reckless level of 107pc of GDP.

The time for tough love was then, not now, sixteen rate rises later - with delayed effects only just starting to exact their toll. If Ben Bernanke had guts, he would now be holding the ground he staked out to Congress in April, explaining patiently that inflation lags the cycle. Are the bond markets telling us he has failed his first test of nerves?

more ECRI press quotes

Unusually high percentage of the American workforce is tied to housing… 32% of jobs, 4X the normal level.

Inventories of unsold homes reach the highest levels in a decade.

ABOUT ECRI

In the Press

European growth outlook is improving...

Euro Zone Inflation Pressures Up

06/02/2006

LONDON, June 2 (Reuters) - Inflation pressure struck a 5-1/2 year high in Europe in April and is steadily becoming a fact of life in Japan after many years when deflation was the problem, the ECRI institute said on Friday.

Increasing inflation in Germany and France pushed underlying price pressures in the euro zone to 5-1/2 year highs, an index from the Economic Cycle Research Institute showed.

In supply glut, notice huge apartment/ condo overhang

OFF THE CHARTS

Floyd Norris

Many Homes Are on The Market And Sales Numbers Are Declining

WHEN the American economy fell into recession five years ago, it was the strength of the housing market that kept the downturn short and mild. Home sales kept rising throughout the downturn, and then took off when the recession began.

But now home sales are falling and the number of unsold homes is at the highest level ever. Housing starts are starting to fall, but remain at a high level by historical standards. If sales do not pick up this summer, when sales are usually seasonally strong, it could be a sign that prices are going to come under pressure and lead to a much larger decline in housing starts.

The accompanying charts show year-over-year changes in sales of existing single-family homes and apartments, using six-month moving averages to smooth out monthly fluctuations. The latest figures show sales of single-family homes down 4.4 percent, the largest dip since 1995, and apartment sales off 6.6 percent. Statistics on apartment sales are only available back to 1999, but that is the worst showing in that period.

Meanwhile, the number of existing single-family homes on the market is up 33 percent year-over-year, measured the same way. Figures from the National Association of Realtors, going back to 1983, show no comparable increase in homes for sale. The number of condominiums and cooperative apartments for sale is up 61 percent.

The picture is consistent with demand for homes suddenly drying up, while sellers are reluctant to cut prices. Such a standoff could end with buyers returning, but it could also end with prices starting to slip, or with a lot of homes being pulled off the market.

New homes make up a much smaller part of the market, and are not shown in the charts. But those figures show even more rapid increases in inventory and larger declines in sales.

The sales outlook appears to be falling most rapidly in the Western states, where sales of existing single-family homes are running at 13 percent below levels a year ago. A couple of years ago, the West was showing the most rapid gains in sales.

The Realtors do not break down inventory by region, so it is not clear from their data where the unsold homes and apartments are located. But sales of existing apartments are weakest in the South and West, which could be an indication of growing inventories in the largest states in the two regions, Florida and California.

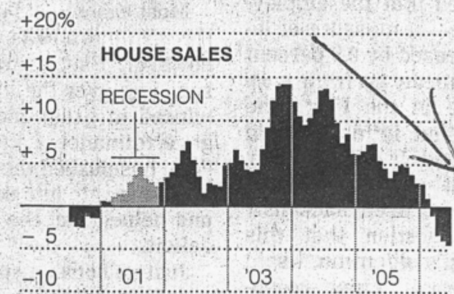
To be sure, over the 12 months through June more than 6 million single-family existing homes and 1.2 million new homes were sold. Only a few years ago, both of those figures would have been records, and the declines are coming from high levels. It is conceivable that the market will stabilize at levels that look weak only when compared to last year's extraordinary numbers.

But with sales weakening and the number of available homes rising, those who warned of a housing bubble must be wondering if their fears are finally becoming reality.

TimesSelect: Meet **Floyd Norris** at nytimes.com/norris.

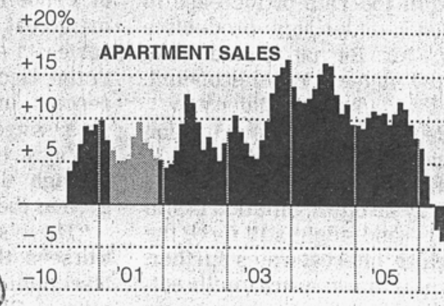
As Home Sales Slip . . .

Change in sales for first six months of 2006 from the same period of 2005



Year-over-year change in six-month moving average of sales of existing single-family homes

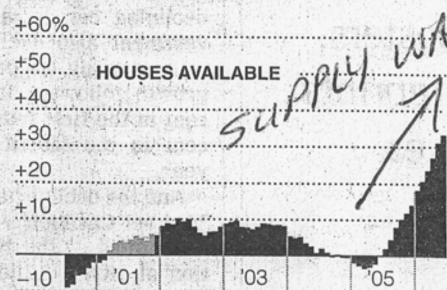
DEMAND DOWN



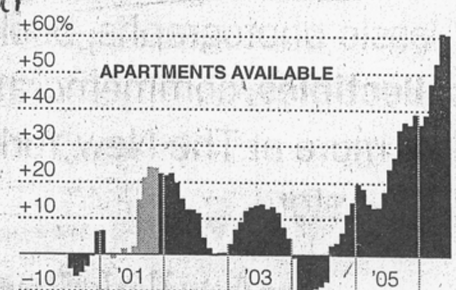
Year-over-year change in six-month moving average of sales of existing condominium and co-op apartments

. . . Many More Are Offered

SUPPLY WAY UP



Year-over-year change in six-month moving average of number of existing single-family homes on market and unsold



Year-over-year change in six-month moving average of number of existing condominiums and co-op apartments on market and unsold

Source: National Association of Realtors via Haver Analytics

The New York Times

6

HOPEFUL: Sales may rebound, but starts still uneven…

Home Sales Bode Well for Big Picture

Second Consecutive Rise Points to Limited Fallout From Market Slump in 2007

12-22-06

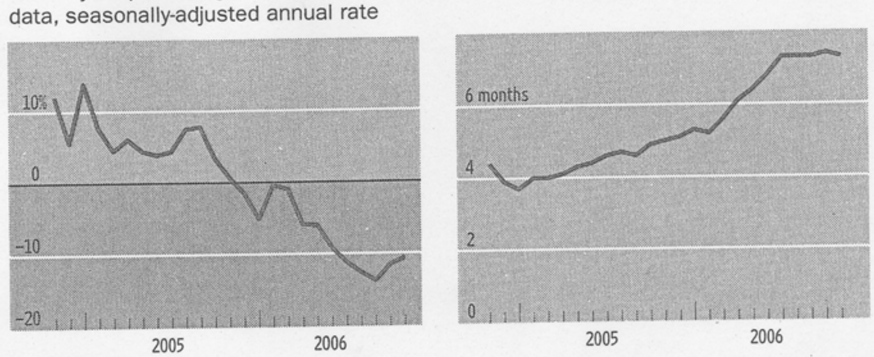
By CHRISTOPHER CONKEY

Well Stocked

The drop in sales has leveled off, but there are still many houses on the market

Existing-home sales
Year-to-year percentage change: monthly data, seasonally-adjusted annual rate

Housing inventory
Months supply at the current sales pace



Source: National Association of Realtors

WASHINGTON—Sales of existing homes rose for the second consecutive month in November, a sign of rebounding demand that suggests the economic fallout from the housing market's slump will be limited next year.

The National Association of Realtors said sales of existing homes last month increased 0.6% from October to an annual rate of 6.28 million units, down 10.7% from a year earlier. Spurred by lower interest rates and home prices, sales have now increased in back-to-back months for the first time in more than a year.

Together with a recent upturn in the rate of new-home sales, the modest rise in existing-home sales indicates that home-buying activity may be stabilizing after a yearlong downturn.

"The change was small, but the results were encouraging nonetheless because they suggested activity is beginning to form a bottom" said Michael Moran, chief economist at Daiwa Securities America Inc.

If the housing slump is indeed bottoming out and starts to reverse itself in the months ahead, it would gradually lift a great weight off the broader economy. Housing-related industries have been shedding thousands of jobs in recent months, and builders have been forced to scale back construction to match waning demand. That has been a major factor behind the slowing economy this year, and many economists say growth—now running at an inflation-adjusted annual rate of about 2.0%—won't fully bounce back until the housing correction has run its course.

Of course, it is far from certain that the housing slump is over. Inventories of unsold homes remained large in November, with a 7.3-month supply on the market at current sales rates, according to NAR data, up from a five-month supply a year earlier. That suggests builders will continue to cut production until supply is better aligned with demand. In the meantime, large inventories will continue to put downward pressure on prices.

Last month's median home price—the price at which half of homes sold for more and half sold for less—was down 3.1% from a year earlier. November was the fourth month in a row that median home prices were down from a year earlier. NAR President Pat Vredevoogd Combs described current conditions as a "window for buyers" to re-enter the market.

Additional support for a rebound is coming from the competitive labor market, which is producing solid wage gains and lifting consumer sentiment. Yesterday, the Conference Board, a private research group in New York, said its gauge of consumer confidence rose to 109 in December from 105.3 in November.

As with the recent data on housing, which generated more relief than enthusiasm among economists, the improved sentiment reading was due more to a moderation in pessimism than any surge in optimism. Indeed, the proportion of those surveyed who said economic conditions are "good" fell slightly to 27.2% this month from 27.5% in November, but that was more than offset by a sharper decline—to 14.6% from 16.2% in November—in the number who said the climate is "bad."

More than anything, the data suggest the nation's economy will be able to maintain its current pace of slow-to-moderate growth as the housing imbalance is corrected. "There's nothing signaling a severe downturn or a severe upturn," said Lynn Franco, who oversees the Conference Board survey.

Meanwhile, the number of people filing initial claims for unemployment benefits rose slightly, to 317,000 last week from 316,000 the week before. The figures point to steady job growth.

Jan. 18 (Bloomberg) -- The U.S. economy is rebounding from last year's slowdown without stoking inflation, government reports on housing, consumer prices and jobs showed today.

Home starts unexpectedly climbed 4.5 percent last month from November, the Commerce Department said in Washington.

Construction of single-family homes fell 4.1 percent last month to a 1.23 million rate, today's report showed. Work on multifamily homes, such as townhouses and apartment buildings, surged 42 percent to an annual rate of 412,000.

Regional Differences

The increase in starts was led by a 26 percent jump in the Northeast. Construction in the West rose 12 percent and increased 1.8 percent in the Midwest. Starts dropped 2 percent in the South.

Dec. Starts are up based on 42% surge in apartments and a 26% jump in very overbuilt Northeast.

Economy has survived housing bubbles without recession, but only when Fed accommodates. [Similar to stocks & declining EPS growth!

Bottom Line: Within a neutral overall allocation to MBS, we recommend investors favor long duration and less negatively convexity sectors: 30-year fixed, and discount securities. Long reset hybrid ARMs are also attractive.

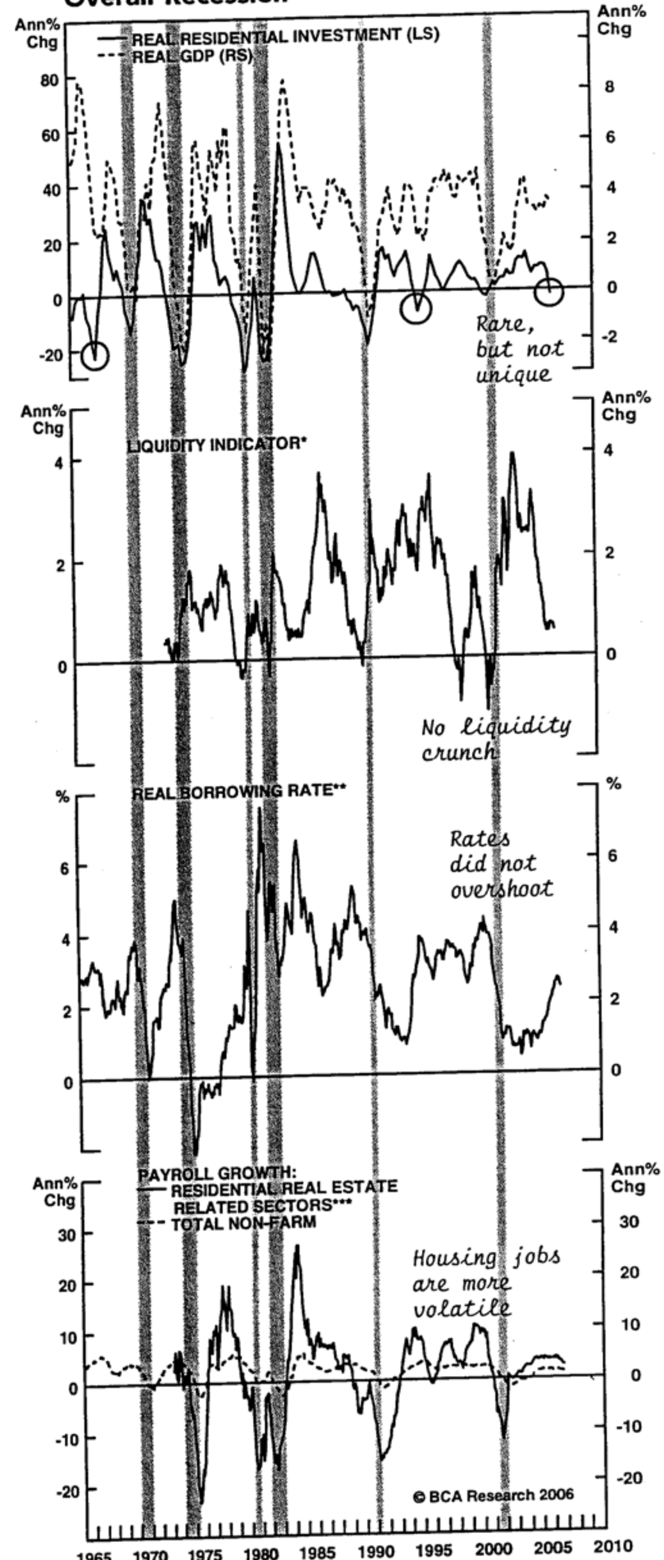
ECONOMY AND INFLATION

The economy continues to grow at a decent pace, probably only slightly below its long-run potential, but fears of a deeper and/or lasting slowdown are building in view of some of the ugly housing data. The key question is: can the economy avoid a recession if housing slumps?

There are only two periods since 1960 when housing and economic recessions did not occur in tandem. In both of these periods (1967 and 1995), residential investment contracted, yet real GDP growth stayed positive (**Chart 10**). Importantly, during both of these episodes, liquidity conditions remained supportive, as real borrowing rates never moved into restrictive territory. A similar picture exists today. Real residential investment has already started to contract, yet annual real GDP growth is in the 2-3% area. The fall in residential real estate will be a sizable drag on the economy, via lower consumption growth and investment. However, a full-blown recession should be avoided because the monetary backdrop will not become restrictive and bond yields have recently melted. Importantly, monetary policy has the latitude to ease if growth stays sluggish. Also, non-residential construction is booming, capital spending orders are holding up and net exports should become supportive as import growth slows.

Unlike previous recessions, non-housing hiring plans are proving resilient and are unlikely to buckle, courtesy of a healthy corporate sector. Certainly, housing-related employment is set to suffer a serious blow. Employment in the real

CHART 10
Housing Slump, But No Overall Recession



*FED ASSETS AND FOREIGN CENTRAL BANK GOVERNMENT SECURITY PURCHASES HELD BY THE FED RELATIVE TO NOMINAL GDP
**AVERAGE OF REAL FED FUNDS RATE AND REAL 10-YEAR TREASURY YIELD
***INCLUDES RESIDENTIAL BUILDING, RESIDENTIAL SPECIALTY TRADE CONTRACTORS, REAL ESTATE SERVICES
NOTE: SHADED FOR NBER DESIGNATED RECESSIONS

7

BCA, OCT 2, 2006

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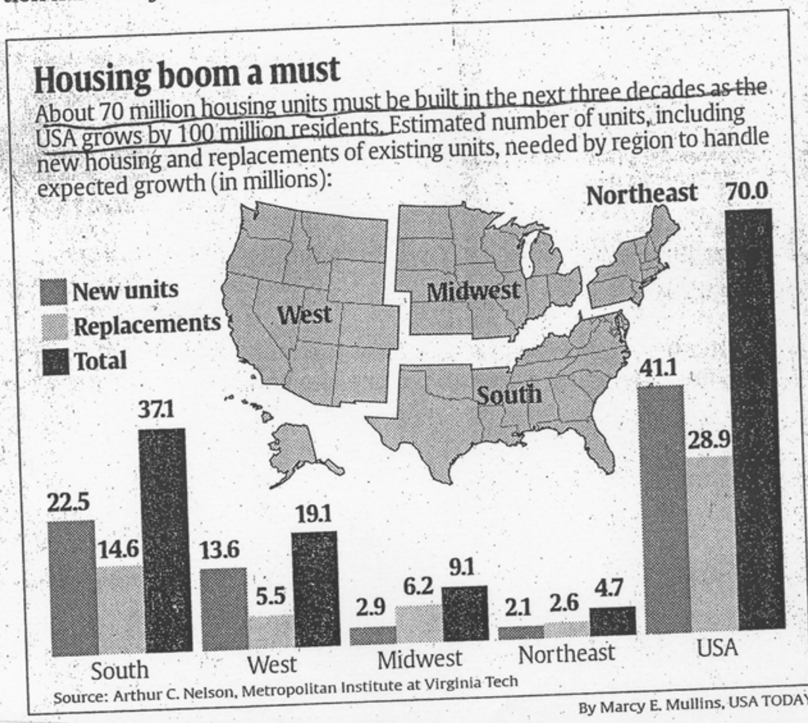
Longer-term bright spots: 70 Million more units needed as US population grows by 100 Million persons in 30 years. Meanwhile, Housing Price Futures may have bottomed…

"LONGER TERM" SURPLUS HOUSING WILL BE ABSORBED."

Microcosm of U.S. growth: A painting crew works at a construction site in north Charlotte. The city's po tion has nearly doubled since 1980 to about 611,000. It's projected to reach almost 1 million by 2030.

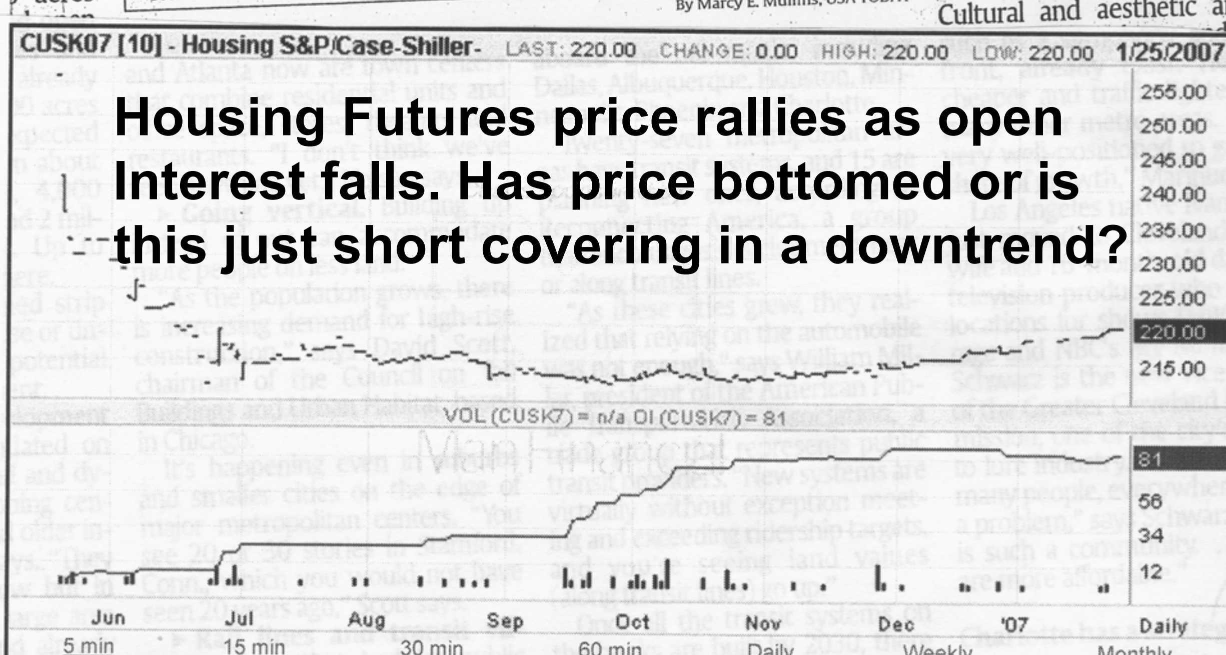


"Right now, there are 6 million households that live in half a mile of stations," says ley Poticha, president of R necting America. "The demai housing near transit is goi grow to over 16 million. That' number."

▶ **Ready-made cities.** D Washington and St. Louis su ed hundreds of thousands residents in 1950 than they day. Dozens of cities acros country are well past their h but still have all their streets, power lines and water supp place. If only people would re

Cleveland had a populat about 915,000 in 1950. To has less than half that — 452,

"We have a unique oppor here," says Joseph Mari president and CEO of the town Cleveland Alliance, whi vocates investment dowr Cultural and aesthetic ame



Housing Futures price rallies as open Interest falls. Has price bottomed or is this just short covering in a downtrend?

Housing boom will not end in a crash, says Harvard

6-13-06

By Christopher Swann in Washington

Bricks and mortar: 'Houses will revert to being something to live in rather than money makers', according to the head of Harvard University's housing studies centre

Markets seldom disappoint both bulls and bears for long. But over the coming years the US housing market looks likely to do just that, according to a study by Harvard University.

After the slump of the early 1990s and the surge of the past five years, the housing market might prove an anti-climax to all concerned. The long period of stagnation forecast by the survey would disappoint home-owners who expect big price rises but also those who missed the boat and have been hoping for a crash.

"Although housing prices are stretched, it is hard to see the catalyst for a crisis in the market," says Nicolas Retsinas, director of the Joint Center for Housing Studies at Harvard. "The overvaluation looks pretty well balanced by longer term supports for house prices, so we may just see a few years with little action. Houses will revert to being something to live in rather than money makers."

The study begins with some sobering observations about the record run in the US housing market. Over the past five years house prices have outstripped income growth more than sixfold – the median home now costs more than four times median household income in 49 out of 145 metropolitan areas in the US, a record. In 14 metropolitan areas, the median house is now worth more than six times median income.

Last year saw the average house price shoot up 9.4 per cent – the biggest rise in the average house price since records started more than 40 years ago.

Financial strains on US home-owners have been mounting. The number of Americans devoting more than half of their incomes to housing climbed by 1.9m to 15.6m in the three years to 2004.

To bridge the gap between sluggish earnings growth and speedy house price growth, ever more Americans have been tempted by riskier flexible-rate mortgage products. More than a third of loans last year were at adjustable rates and may rebound on their holders if interest rates continue to climb.

Even more reckless buyers, about 10 per cent last year, opted for payment-option mortgages – which do not require full payment of the interest costs.

So why will non-home-owners be deprived of the crash they have been waiting for?

The strongest underlying support for the market comes from accelerating household formation. Demand is being driven not only by population growth but by household fragmentation, as couples divorce or children leave home.

Immigration has been a still stronger force – over the past decade 12.6m new households were formed in the US. Over the next 10 years the pace of household formation will accelerate to 14.6m, according to the Joint Center for Housing Studies.

"Even if America decided to close the borders now, we would still see the lagged effects of previous waves of immigration," said Mr Retsinas. "Many of those that came to America earlier are only now in a position to buy property. As it is, we don't believe there will be any slowdown in immigration."

The Harvard study also argues that there are fewer points of vulnerability than during previous housing market downturns.

The macroeconomic outlook for the US is uncertain but no mainstream economists are predicting the kind of surge in unemployment or leap in interest rates that would prick the housing bubble. In spite of the shift towards flexible rate mortgages, 75 per cent of mortgage holders have 30-year fixed rate loans and are therefore largely invulnerable to rising rates. A third of households own their homes outright.

Nor are many likely to suffer from negative equity should rising interest rates or unemployment drive up defaults – about 94 per cent of home-owners have equity of more than 10 per cent.

Over-development has also been less of a problem than in the past, the study says. Price declines associated with episodes of big job losses alone average 4.5 per cent, while those occurring around periods of over-building alone average 8.3 per cent, it says.

Not everyone concurs, however. Many economists say national figures are deceptive, since they obscure pockets of extreme over-valuation in property prices and greater vulnerability to rising rates. Other analysts ...

evidence of overbuilding
recent years. Resident
investment has risen to 6
cent of gross domestic pr
uct – its highest level in
years and much higher th
the average of 4.75 per ce

The Harvard study c
cedes that even a slow
housing market could tak
heavy toll on growth,
Americans become less a
to use their houses as A
machines and less empl
ment is created by hor
building.

Provided the slowdown
gradual, as Harvard expe
this could help rebalance
US economy, reduc
demand for imports and
stemming the growth of

E16

Long-term positive view: 14 million new households in 10 years

JAN - JUNE 2007:
WHICH WAY HOUSING ?

	BEST CASE	CURRENT	FURTHER SOFTENING	WORST CASE
RECOVERY:	Strong, back to 2.0mm+ Units/Yr.	Maintain around 1.5 - 1.6+mm units	Starts drop slightly to 1.3 - 1.5mm range	Starts collapse to <1.3mm Units/Yr
ODDS:	1%	25%	50%	25%
PROS:		Fed accomodative If starts hold up, jobs likely hold up Strongest season (Spring) is ahead	Inventories still too high Starts are uneven with too many unneeded multi-family units Banks tighten standards	Housing-related job meltdown cannot be ruled out at this pt. Huge inventories may cut further new starts
CONS:	Sub-Prime mortgage loans won't return Buyers are skeptical	Current mix is too heavy on multi-family Negative job creation may still come	Prices may be starting to level off	Fed: mildly accommodative