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By Lawrence Yun, *Senior Research Forecaster*

The subprime loan market is certainly making news. The delinquency rate on subprime loans soared to 14.3% as of the fourth quarter of 2006 and the 2007 figures are likely to be measurably higher still. Just two years ago, the subprime delinquency rate was at a cyclical low of 10%. While that still sounds high, it is a level expected by lenders who take on the risk of lending to borrowers with credit history problems. The foreclosure rate which lags behind delinquency trends will inevitably rise further from its already high of 4.5% for these risky loans. Wall Street, which had been eager to fund these loans at high interest rates, has now begun to close the money tap.

So what will be the impact from the subprime market fallout? Consider, the subprime loans comprised about 13% of the overall mortgage market, and 20% of mortgage originations since 2005 (though there are divergent figures depending upon the source). The recent overall rise in default rates is primarily associated with the subprime loans rather than with the predominant prime loans. The delinquency rate on prime loans was only 2.8% by comparison with the foreclosure rate running at 0.5%. Both delinquencies and foreclosures for prime loans have been steady with very little movement. Therefore, a 14.3% delinquency on 13% of the loan market means subprime problems are impacting close to 2% of all loans. Factor in the fact that one-third of all homeowners own their home free-and-clear, the subprime problems are associated with about 1.4% of all homes. History says that less than half of these homes with delinquent mortgage payments ever move into actual foreclosure. So roughly speaking, 0.7% of all homes will at most run into eventual foreclosure from recent meltdown in the subprime sector.

In addition, unlike past housing recessions of early 1980s or early 1990s when the country was losing jobs, the current housing recession is associated with job gains - two million in the past 12 months. So there will likely be quick purchases of foreclosed homes that reach the market. Very painful for those losing their homes. But that problem looks to be isolated without spreading significantly to the overall housing market.

The recent subprime problems will dent home prices. Nationally, prices are projected to fall 1% in 2007, before picking up in 2008. As for the regional impact, the top five states with the highest prevalence of subprime borrowing were California, Rhode Island, Michigan, Nevada, and Illinois, and so these markets will face higher risk. By contrast, those states with little exposure to subprime loans are North Dakota, South Dakota, Vermont, Alaska, and Montana.

Locally, Phoenix added 89,000 jobs in the past 12 months. That is a huge help in lining potential homebuyers. But fall in sales is reflecting that many are renting. As such rents have been climbing fast. Very soon, the squeezed renters will begin to search for a home purchase. Best guess is for home sales to show a year-over-year growth by the fourth quarter. The momentum will strengthen in 2008. Prices will also show respectable rise in 2008. The market just needs to pass through the subprime loan implosion in 2007.

## Economic and Housing Market Outlook: May 2007

	2006				2007				2008		ANNUAL			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	2005	2006	2007	2008
<b>U.S. Economy</b>														
<i>Annual Growth Rate</i>														
Real GDP	5.6	2.6	2.0	2.5	2.0	2.1	2.8	3.1	2.9	2.9	3.2	3.3	2.3	2.9
Nonfarm Payroll Employment	2.2	1.5	1.6	1.5	1.5	1.3	1.4	1.3	1.2	1.3	1.7	1.9	1.5	1.3
Consumer Prices	1.9	5.0	3.1	-2.1	3.1	3.2	2.3	2.6	2.4	2.7	3.4	3.2	2.1	2.6
Real Disposable Income	4.6	-1.5	3.2	5.3	4.5	0.4	3.2	3.1	3.6	2.9	1.2	2.6	3.1	3.0
Consumer Confidence	106	107	104	107	110	108	108	108	109	110	100	106	109	109
<i>Percent</i>														
Unemployment Rate	4.7	4.7	4.7	4.5	4.5	4.6	4.7	4.7	4.7	4.7	5.1	4.6	4.6	4.7
<i>Interest Rates, Percent</i>														
Fed Funds Rate	4.5	4.9	5.3	5.2	5.3	5.3	5.3	5.3	5.0	4.8	3.2	5.0	5.3	4.9
3-Month T-Bill Rate	4.4	4.7	4.9	4.9	5.0	5.0	5.0	4.9	4.7	4.5	3.1	4.7	5.0	4.6
Prime Rate	7.4	7.9	8.3	8.2	8.3	8.3	8.3	8.3	8.0	7.8	6.2	8.0	8.3	7.9
Corporate Aaa Bond Yield	5.4	5.9	5.7	5.4	5.4	5.6	5.7	5.8	5.8	5.8	5.2	5.6	5.6	5.8
10-Year Government Bond	4.6	5.1	4.9	4.6	4.7	4.8	4.9	5.0	5.0	4.9	4.3	4.8	4.9	4.9
30-Year Government Bond	4.6	5.1	5.0	4.7	4.8	4.9	5.0	5.1	5.1	5.1	4.6	4.9	4.9	5.0
<i>Mortgage Rates, percent</i>														
30-Year Fixed Rate	6.2	6.6	6.6	6.3	6.2	6.4	6.5	6.6	6.6	6.5	5.9	6.4	6.4	6.6
1-Year Adjustable	5.3	5.6	5.7	5.5	5.5	5.5	5.5	5.4	5.3	5.2	4.5	5.5	5.5	5.2
<b>National Housing Indicators</b>														
<i>Thousands</i>														
Existing Single-Family Sales	6,863	6,627	6,287	6,263	6,506	6,223	6,274	6,351	6,604	6,534	7,076	6,478	6,338	6,520
New Single-Family Sales	1,111	1,100	1,001	1,040	888	913	903	913	911	948	1,283	1,053	904	935
Housing Starts	2,123	1,873	1,714	1,559	1,464	1,460	1,466	1,491	1,489	1,540	2,068	1,801	1,470	1,546
Single-Family Units	1,747	1,530	1,401	1,234	1,157	1,133	1,125	1,138	1,136	1,182	1,716	1,465	1,138	1,186
Multifamily Units	376	343	313	324	307	327	341	353	353	358	352	336	332	359
Residential Construction*	619	601	570	540	515	501	496	499	503	511	608	582	503	516
<i>Percent Change -- Year Ago</i>														
Existing Single-Family Sales	-2.1	-7.2	-12.4	-10.1	-5.2	-6.1	-0.2	1.4	1.5	5.0	4.4	-8.5	-2.2	2.9
New Single-Family Sales	-11.5	-14.3	-22.8	-18.8	-20.0	-17.0	-9.8	-12.2	2.5	3.8	6.7	-17.9	-14.1	3.4
Housing Starts	2.6	-9.3	-18.4	-24.3	-31.0	-22.0	-14.5	-4.3	1.7	5.5	5.8	-12.9	-18.4	5.1
Single-Family Units	2.6	-10.4	-19.8	-28.2	-33.8	-25.9	-19.7	-7.8	-1.8	4.3	6.5	-14.6	-22.3	4.2
Multifamily Units	2.9	-3.8	-11.3	-5.1	-18.3	-4.7	8.9	9.0	15.0	9.5	2.1	-4.5	-1.1	8.2
Residential Construction	6.1	-1.5	-8.1	-12.8	-16.8	-16.5	-13.0	-7.6	-2.3	1.8	8.6	-4.2	-13.6	2.7
<b>National Home Prices</b>														
<i>Thousands of Dollars</i>														
Existing Home Prices	216.9	226.8	225.0	219.3	211.7	222.9	224.4	220.1	213.4	225.2	219.6	221.9	220.3	223.8
New Home Prices	244.8	246.1	236.2	243.9	243.1	245.6	236.9	246.1	246.0	249.6	240.9	245.3	246.2	251.1
<i>Percent Change -- Year Ago</i>														
Existing Home Prices	8.6	2.9	-1.1	-2.7	-2.4	-1.7	-0.3	0.4	0.8	1.0	12.4	1.0	-0.7	1.6
New Home Prices	6.5	6.9	-0.1	1.6	-0.7	-0.2	0.3	0.9	1.2	1.6	9.0	1.8	0.4	2.0
<b>Local Region</b>														
Payroll Jobs (in thousands)	1857.0	1883.9	1890.4	1946.9	1944.6	1968.7	1967.9	2024.8	2022.4	2053.3	1787.7	1894.6	1976.5	2063.5
Home Sales	18531	21398	17733	16160	15215	18787	16634	16451	15641	19426	103725	73822	67087	71045
Home Prices (in thousand \$)	334.4	341.9	329.5	333.9	341.9	345.0	329.5	335.6	346.0	354.0	300.3	335.3	338.2	348.8
<i>Percent Change -- Year Ago</i>														
Jobs	6.8%	5.9%	5.7%	5.5%	4.7%	4.5%	4.1%	4.0%	4.0%	4.3%	6.2%	6.0%	4.3%	4.4%
Home Sales	-22.4%	-27.8%	-37.7%	-25.7%	-17.9%	-12.2%	-6.2%	1.8%	2.8%	3.4%	7.1%	-28.8%	-9.1%	5.9%
Home Prices	28.6%	13.8%	4.4%	3.0%	2.2%	0.9%	0.0%	0.5%	1.2%	2.6%	35.1%	11.7%	0.9%	3.1%

Quarterly figures are seasonally adjusted annual rates.

\* Billion dollars

Source: Forecast produced using Macroeconomic Advisers quarterly model of the U.S. economy.

Assumptions and simulations by Dr. Lawrence Yun.

# Economic Monitor

This table reflects data available through April 6, 2007.

Monthly Indicator	Recent Statistics	Likely Direction Over the Next Six Months	Forecast
<b>Existing Home Sales</b> increased by 3.9% in February to 6.69 million seasonally adjusted annualized units. Resales were unchanged in the West region, but rose in the Northeast, Midwest and South. The inventory of existing homes available or sale rose 5.9% to a 6.7 months supply at the current sales pace.	Feb 07 6,690 Jan 07 6,440 Feb 06 6,940	↓	Subprime lending woes drag down sales
<b>New Home Sales</b> fell by 3.9% in February to 848,000 seasonally adjusted annualized units. The decline follows January's sharp drop and is the lowest level of new home sales since mid-2000. The inventory of unsold new homes was at an 8.1 month supply, unchanged from January.	Feb 07 848 Jan 07 882 Feb 06 1,038	↔	Sales have come down fast and will remain weak for the remainder of the year
<b>Housing Starts</b> posted a 9% gain in February, with 1.525 million seasonally adjusted annualized units. The strong gain was somewhat surprising, given February's weather in most of the country. With weaker new home sales doing little to significantly decrease inventory, builders are holding back on construction.	Jan 07 1,525 Feb 07 1,399 Jan 06 2,132	↓	Builders are mindful of needing to not over supply the market
<b>Housing Affordability</b> NAR's housing affordability index decreased modestly in February to 114.9. The decline was due primarily to higher mortgage rates in February compared to those in January. Still, the index shows that a family earning the median income has slightly more than enough income to qualify for a loan on a median-priced home.	Jan 07 114.9 Feb 07 116.0 Jan 06 111.1	↑	Wage growth of 4% has been the highest in nearly a decade
<b>Purchase Applications</b> The Mortgage Bankers Association's mortgage purchase applications index inched upward in March to 405.3 – back above the 400 mark after dipping below it in February. While the index figure does not portend any real acceleration in housing demand, it does suggest that the housing market is stabilizing.	Mar 07 405.3 Feb 07 397.0 Mar 06 407.6	↑	No solid pick up in mortgage applications until 2008
<b>Employment</b> Payroll employment rose by 180,000 in March. February's job gain figure was revised upward by 32,000. Both commercial and residential contractor employment rose. Jobs in credit intermediation outside of banks (i.e., principally mortgage lending) fell by 2,900 in March – no doubt part of the subprime mortgage lending fallout.	Mar 07 180 Feb 07 113 Mar 06 175	↓	Job gains will be positive but weakened to about 150,000 per month for the balance of the year
<b>Mortgage Rates</b> declined in March, averaging 6.16% for the month. That is the lowest level so far this year. Lower rates are good news for the housing market, as they help spark home sales activity in those areas where housing activity has significantly cooled. Never the less, rates are expected to rise later this year as the economy improves.	Mar 07 6.16 Feb 07 6.29 Mar 06 6.32	↔	Modestly higher by the year's end
<b>Inflation</b> The Consumer Price Index (CPI) rose 0.4% in February. The core index – minus food and energy – advanced 0.2%. The cost for food was a major contributor to the overall CPI, with the food index rising 0.8 percent in February, following a 0.7 percent increase in January, likely due to weather extremes in the fruit and vegetable growing regions.	Feb 07 0.4% Jan 07 0.2% Feb 06 0.1%	↓	Slower economic growth will dampen inflationary pressure over time

Notes: All rates are seasonally adjusted. New home sales, existing home sales, and housing starts are shown in thousands. Employment growth is shown as month-to-month change in thousands. Inflation is shown as the month-to-month change in the Consumer Price Index. Sources: NAR, Bureau of the Census, Bureau of Labor Statistics, Freddie Mac, and the Mortgage Bankers Association