

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

## Market Comment

Can we hit the reset button? We are being factitious, of course, but 2010 has not exactly gotten off to a rousing start. Last week's data releases only added to the perception that we are stumbling into the new year.

After three months of increases, sales of existing homes fell 16.7% to a seasonally adjusted annual rate of 5.45 million in December. Not only did the decrease in sales surprise most analysts, it was the biggest monthly decrease on records that date to back 1968, according to the NAR.

The subsequent release on new-home sales offered little solace. Sales fell 7.6% in December to a seasonally adjusted annual rate of 342,000, meaning the annual sales pace dropped to levels last seen in the first half of 2009 – an epoch most of us would like to relegate permanently to the past.

However, it might not be as bad as all that. Weather was a significant factor in the sales decline. National Oceanic and Atmospheric Administration data showed that December temperatures were three degrees below normal and that it was the

11th-wettest December on record. Bad weather, it is believed, drove many potential buyers to the sidelines.

Some market commentators fingered the first-time home-buyer's tax credit as well, noting that it caused a surge in sales in mid-2009, but left the market shaky by year's end. They have a point. As we saw with the cash-for-clunkers program, federal tax credits tend to pull demand into the incentive period without increasing aggregate demand. Credits might be successful in stanching a downward spiral but they often fail to create sustained and growing demand.

The good news is that whether demand is growing or not, prices are stabilizing. In the existing home market, median home prices rose 1.5% to \$178,300 in December, while inventories fell more than 6%.

In the new-home market, the median sales price rose 5.2% to \$221,300 in December, posting the biggest gain in seven months. Moreover, the news on inventories suggests the increase will likely stick. There were an estimated 231,000 new homes for sale at the end of December, down from 235,000 in November, leaving supply at levels last seen in 1971.

Economic Indicator	Release Date and	Consensus Estimate	Analysis
Personal Income & Outlays	Mon, Feb. 1, 8:30 am, et	Income: 0.3% (Increase)	Moderately Important. Recent increases in both income and outlays underlie improving economic growth.
Construction Spending (December)	Mon, Feb. 1, 10:00 am, et	0.5% (Decrease)	Important. The data will reflect recent cutbacks in residential construction.
Pending Home Sales (December)	Tues, Feb. 2, 10:00 am, et	97.1 Index	Important. Sales are expected to stabilize after November's precipitous drop.
Mortgage Applications	Wed, Feb. 3, 7:00 am, et	None	Important. Refinances continue to slow, as lower rates have run their course.
Productivity & Costs (4 <sup>th</sup> Quarter 2009)	Thurs, Feb. 4, 8:30 am, et	Productivity: 0.5% (Increase)	Important. Increased productivity will keep employee-induced inflation under control.
Employment Situation (January)	Fri, Feb. 5, 8:30 am, et	Unemployment Rate: 10.1%	Very Important. A palpable improvement in the unemployment rate could push interest rates higher.
Consumer Credit (December)	Fri, Feb. 5, 3:00 pm, et	\$8 Billion (Decrease)	Moderately Important. Tighter credit-card standards are lowering overall credit demand.

## Rates Revisited

Mortgage rates dropped again (though only marginally) for a fourth-consecutive week, even though we continue to warn they will rise. We, along with many others, have laid out the most obvious reason: The Federal Reserve's stated plan to cease buying mortgage-backed securities by the end of March.

For months, the consensus (and we have been part of it) in the mortgage industry has been that mortgage rates will rise. Now, a minority opinion is forming that believes rates are unlikely to rise when the Fed withdraws from the mortgage-securities market. Their reason: the Fed has been signaling its intentions for months, so why haven't rates risen in anticipation?

There is no easy answer, but a logical one is that mortgage rates are influenced by numerous variables, in addition to the

Fed's securities purchases: supply and demand for loanable funds, underwriting standards, monetary policy, time preferences, employment, consumer confidence, and the state of the economy are just a few. In other words, we think rates will rise not only because of changes in Federal Reserve policy but because of changes in the aforementioned ancillary variables as well.

Moreover, speaking of ancillary variables, the economy expanded in the fourth quarter of 2009 at the fastest pace – 5.7% annualized – in six years, far exceeding most economists' expectations. Such growth can only be sustained for so long before employment picks up. As we have stated in the past, employment is the number one variable in sustaining a housing recovery.



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