Monthly Market Monitor

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MMM 04-08

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Market Comments

U.S. interest rates remained volatile as credit and inflation fears caused wide swings in rates. The London Interbank Offering Rates (Libor) came under considerable upward pressure due to an investigation by the British Bankers Association on the possible understatement of borrowing costs by panelists who are polled to determine official daily Libor fixings. Since March 31, 2008 six-month Libor climbed approximately 40 basis points to 3.02 percent[1] [see Chart 1]. The increase in this widely used index for bank funding could result in a jump in borrowing costs and higher resets for ARMs indexed to Libor.

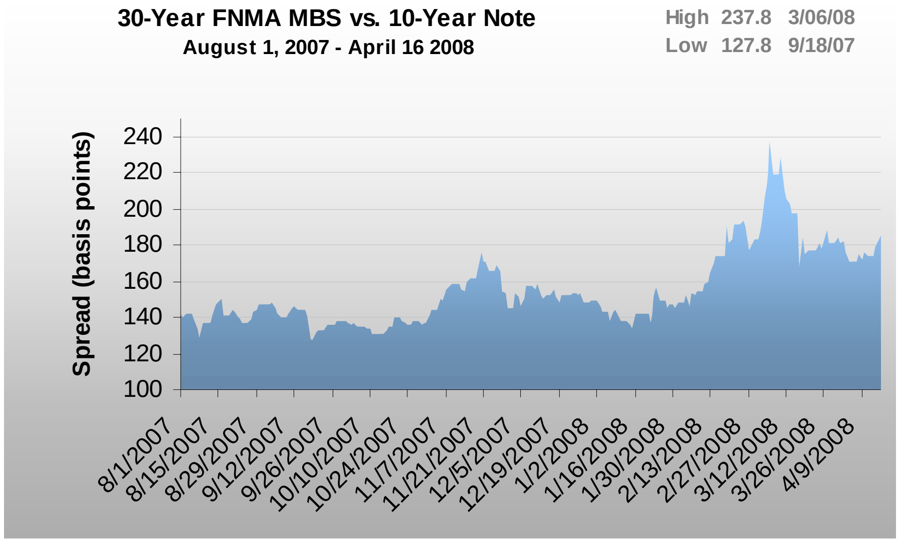
Yields across the Treasury curve rose with most of the upward pressure on the short end where yields jumped from 44 – 60 basis points. Rising inflation expectations and a relative calm in the credit markets allowed Treasury yields to rise; however, swap spreads remained wider than year ago averages. The spread on mortgage backed securities relative to 10-year Treasury yields also recovered; with some narrowing in spreads the past month, but still significantly wider than the year ago average [see Chart 2, on page 2]. Liquidity improved somewhat in the mortgage securities market. Steps by the Federal Reserve to allow financial institutions to borrow directly from the Central bank through the Term Auction Facility, the Term Securities Lending Facility and the Primary Dealer Credit Facility served to supplement the availability of funding by accepting mortgage-related securities as collateral. While these lending facilities have a finite life, they do offer another source of funding during a period of lower demand for mortgage securities.

Current Interest Rates (Chart 1)

	4/22/2008 Yield	12/31/2007 Yield	bp change
Short Term			
Federal Funds Target	2.25%	4.25%	-200
Prime Rate	5.25%	7.25%	-200
Libor (1-mo.)	2.90%	4.60%	-170
Libor (3-mo.)	2.92%	4.70%	-178
Libor (6-mo.)	3.02%	4.60%	-158
3-mo. T-bill	1.27%	3.24%	-197
6-mo. T-bill	1.63%	3.39%	-176
2yr. T-note	2.20%	3.05%	-85
Longer-term			
5yr. T-note	2.95%	3.44%	-49
10yr. T-note	3.71%	4.02%	-31
30yr. Bond	4.46%	4.45%	1

[1] Bloomberg, L.P. April 21, 2008; 11:35 am EDT.

(CHART 2)



SOURCE: BLOOMBERG L.P.

Despite the efforts of the Federal Reserve, the private-label securities market, where many of the troubled loans are housed, remained shuttered. Of the approximately $1.0 trillion of subprime private-label mortgage-backed securities (PMBS) issued in 2005, 2006 and through the third quarter 2007, the peak period in originations, 12 percent, or $127 billion in securities experienced a rating downgrade by Standard and Poor's and an additional 7 percent remained on CreditWatch negative.[2] The subprime PMBS downgrades, account for 50 percent of S&P's negative ratings actions on mortgage securities since 2005. The poor performance of these securities resulted in a broken market as new issue activity has ground to a halt in 2008.

ECONOMIC CONDITIONS

U.S. economic conditions remained in a slump, led by a protracted contraction in residential investment followed by the recent downturn in employment. GDP growth in the fourth quarter 2007 (most recent available data), showed a 0.6 percent output rate compared to 4.9 percent in the previous quarter. Positive contributions from gains in personal consumption (1.58 percent), net exports (1.02%) and spending for services (1.18 percent) were partially offset by the pullback in housing (-1.25 percent) and inventory stockpiles (-1.79 percent).[3]

Payrolls

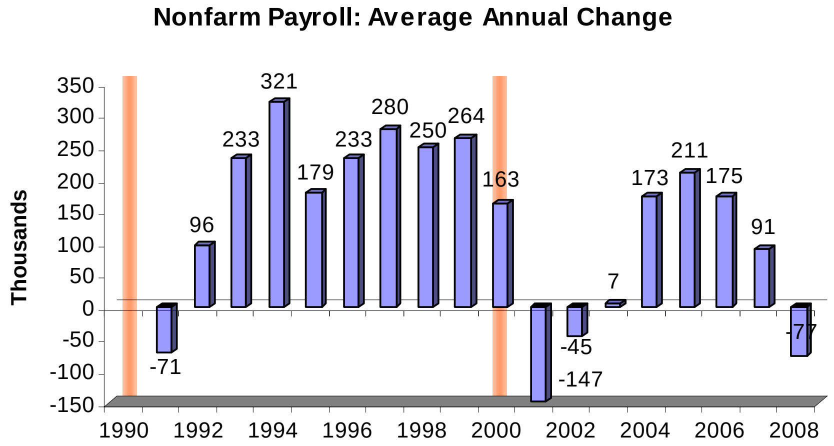
U.S. employment conditions deteriorated in the first quarter of this year. According to the Bureau of Labor Statistics, the unemployment rate rose to 5.1 percent in March and nonfarm payroll employment fell by 80,000. In the past three months, U.S. payrolls have shed 232,000 jobs, led by losses in manufacturing, construction, and employment services [see Chart 3, on page 3]. The jump in the unemployment rate to the highest level since September 2005 was driven by a 434,000 increase in the number of unemployed persons in March. The tally for the past year was quite discouraging with 1.1 million more people unemployed resulting in a 0.7 percent ascent in the unemployment rate.

The March drop in payrolls was the third consecutive monthly decline, and the first time this trend emerged since 2003. Manufacturing employment was off by 48,000 the past month, and is down by 310,000 over the past twelve months. The March decline may have been overstated due to a strike by an auto parts manufacturer, which led to plant shutdowns. Absent the strike, the trend in factory job losses is discouraging as motor vehicle and parts companies have lost

[2] Standard & Poor's Transaction Study: Structured Finance Rating Transition and Default Update as of April 4, 2008.

[3] Percentages represent the percentage contribution/subtraction for overall GDP growth for the quarter.

NONFARM PAYROLL AS OF MARCH 2008 (CHART 3)



SOURCE: BUREAU OF LABOR STATISTICS, MARCH 2008

an average of 6,000 jobs per month from February of last year to February 2008.

Construction jobs for both residential and commercial properties continued to fall, resulting in a loss of 394,000 jobs since the peak employment period in September 2006. Specialty trade contractors were especially hit hard in March, as 42,000 jobs were shed during the month. Clearly the contraction in home sales hurt employment among contractors, in addition to the decline in home prices, which may discourage homeowners from embarking on home improvement projects.

Employment in professional and business services contracted, with 35,000 jobs lost in March. Most of the declines were in the employment services component, specifically temporary help, which accounted for roughly half of the job cuts in this industry. Since the hiring peak in 2006, employment services lost 210,000 jobs, yet another sign of a pullback in business investment this year.

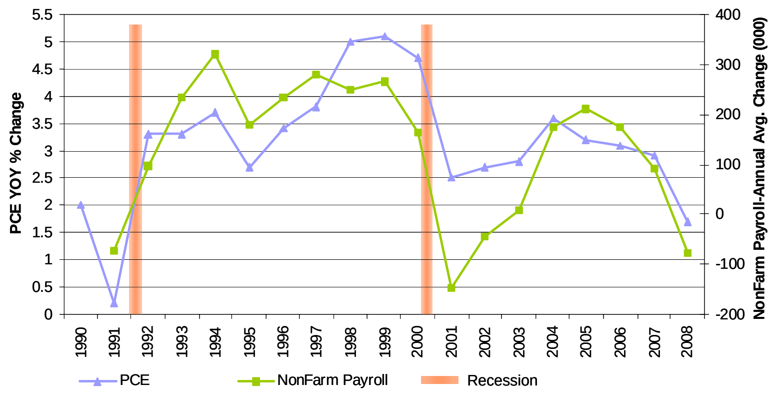
After shedding more than 100,000 jobs in the past year, mortgage lending related entities cut just 700 positions from January to February of 2008.[4] According the Bureau of Labor Statistics, a total of 364,100 people were employed in the mortgage lending industry in February of this year with 112,700 working as mortgage and non-mortgage loan brokers and 251,400 employed in “real estate credit.”

Consumer Spending

The downturn in employment conditions may have contributed to the deceleration in personal spending growth. Real personal consumption expenditures (PCE) growth slowed to a 1.7 percent pace in the first quarter of the year. The deceleration is considerable in light of the 2.2 and 3.3 percent pace recorded in 2007 and 2006 [see Chart 4, on page 4]. Vehicle sales volume was just 15.3 million annualized units in the first quarter for the year, compared with 16.1 million units the prior year[5]. Reports of slower sales among retailers of household products and home improvement centers also reinforced the notion that consumers are reining in their spending. The erosion in home equity also translated into potentially fewer purchases by consumers. According to analysis completed by Mark Zandi, of Economy.com, for every $1 decline in home equity, consumers reduce spending by roughly 7 cents. Given a 15 percent drop in home prices and a $3 trillion drop in housing wealth, personal consumption expenditures (PCE) may be reduced by 2.0 percent in 2008, resulting in a 1.5 percent decrease in GDP growth.[6]

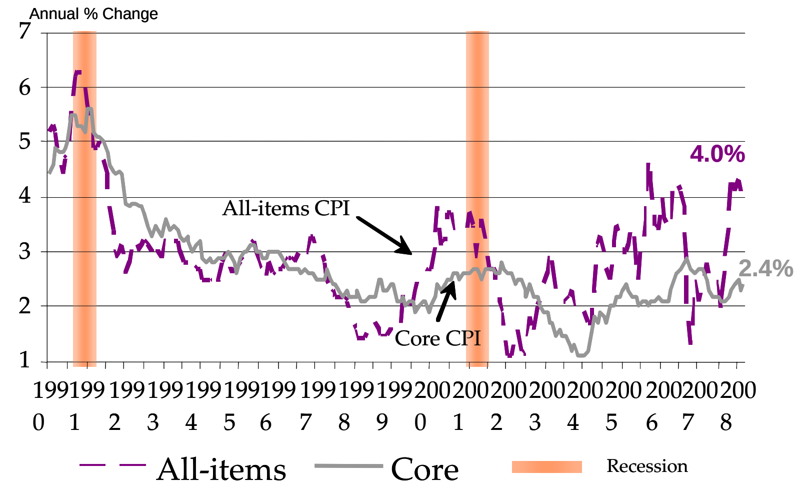
[4] “Employment Edges Lower,” MortgageDaily.com, April 4, 2008.
[5] Zandi, Mark, “U.S. Macro Outlook: No Help Wanted,” Economy.com April 7, 2008.
[6] Ibid.

NONFARM PAYROLL VS. PCE GROWTH AS OF FEBRUARY 2008 (CHART 4)



SOURCE: BUREAU OF LABOR STATISTICS

CPI AS OF FEBRUARY 2008 (CHART 5)



SOURCE: BUREAU OF LABOR STATISTICS

Inflation
Inflation pressures appear to be eroding the growth in real disposable income, which advanced at a 1.3 percent pace, assuming an annualized core inflation rate of 2.0 percent[7]. Core inflation advanced at a 2.4 percent pace from a year ago March 2008 [see Chart 5], but remained on the low end of price increases in the last year. One could argue that inflation is not a significant barrier to GDP growth or monetary easing; however, the protracted gains in fuel prices, food costs, and import prices may subsequently lead to further cutbacks in future consumer and business spending.

Housing
Home resales remained 23.8 percent below the 6.60 million unit level in February of 2007, according to the National Association of Realtors (NAR). Sales of existing single-family, town homes, condominiums and co-ops rose 2.9 percent (annualized) in February of 2008[8], as the median sales price fell 8.2 percent from a year earlier [see Chart 6].

EXISTING HOME SALES AS OF FEBRUARY 2008 (CHART 6)

SOURCE: REALTOR.ORG

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[7] Bureau of Economic Analysis, February Core personal consumption expenditure deflator (PCE deflator).
[8] All percentages related to existing home sales volume are seasonally adjusted.

As expected, sales were especially depressed in high costs areas of the U.S. According to Lawrence Yun, chief economist at the NAR, the improvement in existing home sales is partially driven by the downward adjustment in home prices. The inventory of available homes for sale was also trimmed in February by 3.0 percent to 4.03 million units or a 9.6 month supply at the current sales pace. By category, single-family home sales rose by 2.8 percent to 4.47 million units in February, but were 22.9 percent below the pace last year. Prices are 8.7 percent lower. Condominium and co-op sales also improved by 3.7 percent, but remained 29.7 percent below the rate from a year ago. The decline in condo prices persisted with the median price falling by 4.9 percent compared to February 2007.

The U.S. Department of Housing and Urban Development (HUD) and the U.S. Census Bureau reported a 1.8 percent decline in new home sales during the month of February 2008, a 29.8 decline from a year ago. Total units sold were 590,000 (annualized), and the average sales price was $296,400. Supply of new homes available for sales stood at 471,000 (annualized), which represented roughly 9.8 months of supply at the current sales rate. This was the largest level of housing stock in the U.S. since the last housing correction in the 1990s and a far cry from the five to six months of supply in a balanced housing market. The data is not encouraging, but is quite volatile, as new sales are recorded at the time the sales contract is signed, versus existing home sales which are recorded at the time the sale is closed. Pipeline pressures from homes under construction may only add to housing stockpiles and exert further downward pressure on home prices.

As noted previously, the unprecedented velocity of home price depreciation continued. Both the S&P/Case-Shiller and Office of Federal Housing Enterprise Oversight (OFHEO) home price indices showed continued deterioration in home prices. The monthly Case-Shiller Composite-20 house price index fell by 10.71 percent annually. As expected, the cities of Miami (-19.33%), Las Vegas (-19.29%), Phoenix (-18.23%), and San Diego (-16.74%) lead the yearly declines. On a monthly basis, the depreciation was greatest in Las Vegas (-5.10%) and Phoenix (-4.05%) [see Chart 7]. The OFHEO monthly index of purchased homes showed an annual decline of 2.97 percent in home prices, with the greatest deterioration in the Pacific region (-9.39%) followed by the New England region (-4.31%) at a distant second. The persistent decline in home values and increasing number of job losses are expected to lead to increasing loan foreclosures. With prices down 10.0 percent from their peak in 2006, approximately 9 million homeowners, or 10.3 percent of single family homes, are

CASE-SCHILLER HPI-BY OTS REGION AS OF JANUARY 2008 (CHART 7)

	JANUARY 2008	JANUARY 2007	YEAR/YEAR % CHANGE
WEST			
DENVER, CO	128.98	135.86	-5.06
LAS VEGAS, NV	186.05	230.52	-19.29
LOS ANGELES, CA	224.41	268.68	-16.48
PHOENIX, AZ	180.06	220.20	-18.23
PORTLAND, OR	178.81	179.79	-0.55
SAN DIEGO, CA	197.45	237.16	-16.74
SAN FRANCISCO, CA	183.81	211.78	-13.21
SEATTLE, WA	181.62	183.92	-1.25
MIDWEST			
DALLAS, TX	118.56	122.62	-3.31
MINNEAPOLIS, MN	151.16	167.97	-10.01
CENTRAL			
CHICAGO, IL	156.47	167.52	-6.60
CLEVELAND, OH	108.49	118.61	-8.53
DETROIT, MI	100.17	117.96	-15.08
NORTHEAST			
BOSTON, MA	162.59	168.29	-3.39
NEW YORK, NY	200.49	212.81	-5.79
SOUTHEAST			
ATLANTA, GA	127.08	133.45	-4.77
CHARLOTTE, NC	131.70	129.43	1.75
MIAMI, FL	225.40	279.42	-19.33
TAMPA, FL	194.64	228.86	-14.95
WASHINGTON, DC	212.83	238.84	-10.89
COMPOSITE	196.06	221.32	-11.41
COMPOSITE-20	180.65	202.32	-10.71

expected to have no or negative equity in their homes.[9] If home prices fall an additional 10% from today, an estimated 12 million homeowners will be underwater. The impact of falling home prices on foreclosure experience could indeed be substantial.

Of the $11.136 trillion in mortgage loans outstanding, approximately $1.1 trillion or 10.2% of the market were subprime loans. Most recent data for February 2008 showed 21.47 percent of subprime borrowers were delinquent compared to 13.97 percent one year ago.[10] Foreclosure data suggested an increasing number of homeowners are losing their homes, as the rate of foreclosure on all mortgage loans nearly doubled in the past year and for subprime loans, rose to 9.54 percent from 3.90 percent in the twelve months ended in February 2008 [see Chart 8].

Conclusion

The financial markets remained on alert for future credit losses and trading disruptions as participants adjusted to a new method of risk assessment. The repricing of credit risk will require a few more quarters as price discovery is thin and transparency with regard to valuation methods is lacking. In the meantime, the spillover from the problems in the housing market into the consumer and business sector will continue. A fair profit cushion among U.S. corporations and judicious staffing levels may soften the blow to business investment, but the consumer is not likely to fare as well. Given that consumer spending comprises roughly two-thirds of the pace of GDP; the subtraction from the U.S. output rate could anchor the growth rate at current levels for the next quarter.

TOTAL BALANCES FOR EACH REGION AS OF FEBRUARY 2008 (CHART 8)

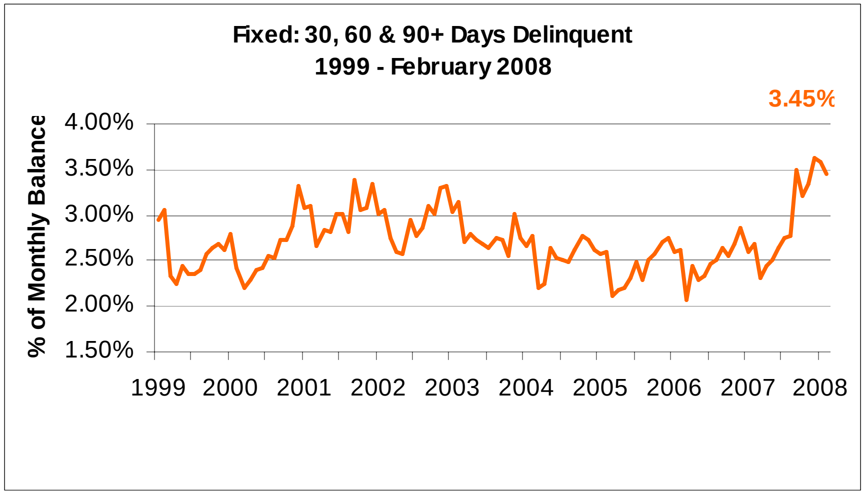
	Feb-08	Feb-07	bp change
National			
Fixed			
DQ	3.45%	2.69%	76
FC	0.62%	0.32%	30
ARM			
DQ	7.61%	5.34%	227
FC	3.14%	1.39%	175
Prime			
DQ	3.43%	2.36%	107
FC	0.74%	0.29%	45
Alt-A			
DQ	12.53%	9.78%	275
FC	3.97%	2.07%	190
SubPrime			
DQ	21.47%	13.97%	750
FC	9.54%	3.90%	564

Source: Loan Performance
Delinquency (DQ) and Foreclosure (FC) as a percent of active loan dollar balances.

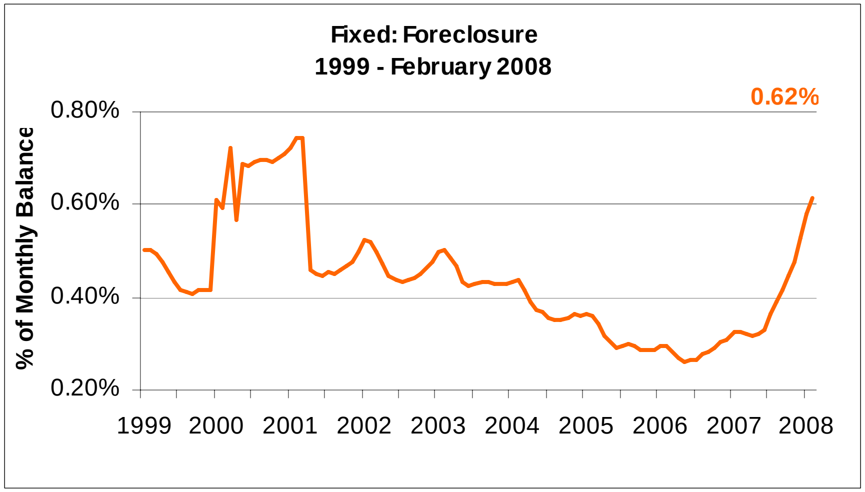
[9] Zandi, Mark; Jaffee, Richard; Melser, Daniel, "Home Appreciation Mortgage Plan," March 2008.
[10] LoanPerformance.

NATIONAL DELINQUENCY & FORECLOSURE RATES: FIXED & ARM LOANS

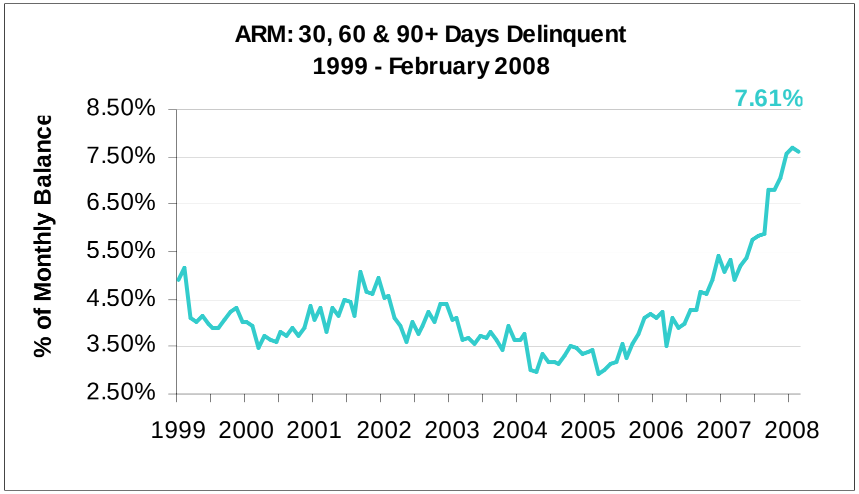
(CHART 9)



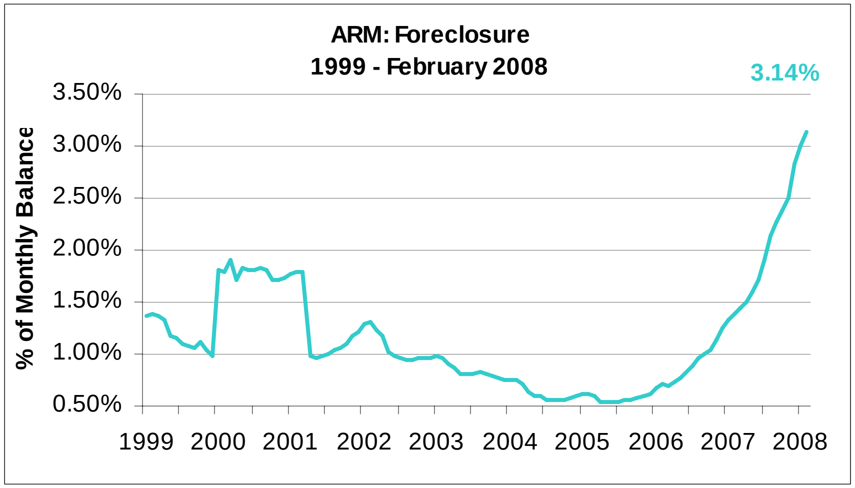
(CHART 10)



(CHART 11)



(CHART 12)



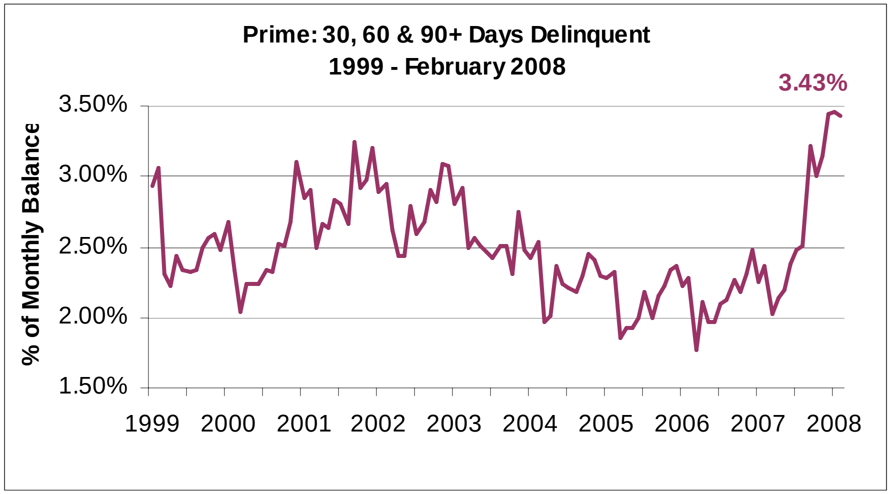
SOURCE: CHARTS 9-18 LOANPERFORMANCE, A SUBSIDIARY OF FIRST AMERICAN REAL ESTATE SOLUTIONS

NOTE: DATA USES ACTIVE LOAN DOLLAR BALANCES ON A MONTHLY BASIS; ALT A IS DEFINED AS ORIGINAL CREDIT SCORE 620-659 AND LTV AT ORIGINATION > 80%.

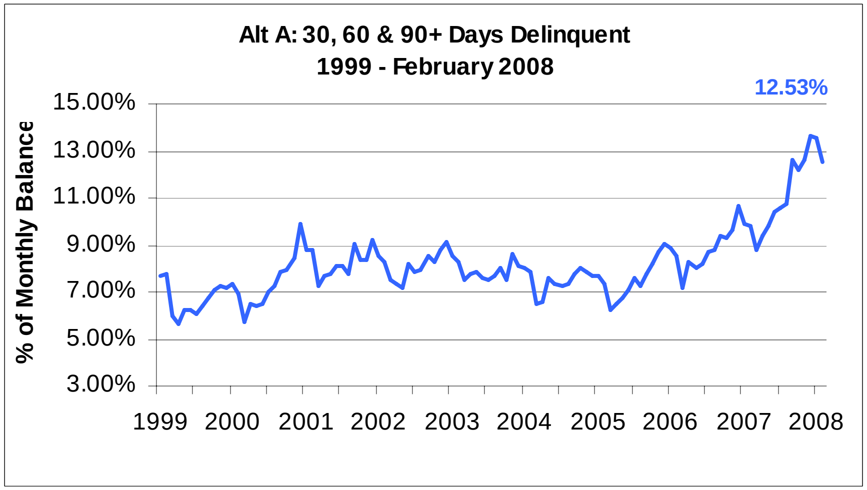
ALL VARIATIONS OF DOCUMENTATION ARE INCLUDED. DATA FOLLOWS THE MBA DEFINITION OF DELINQUENCY.

NATIONAL DELINQUENCY RATES: PRIME, ALT-A & SUBPRIME LOANS

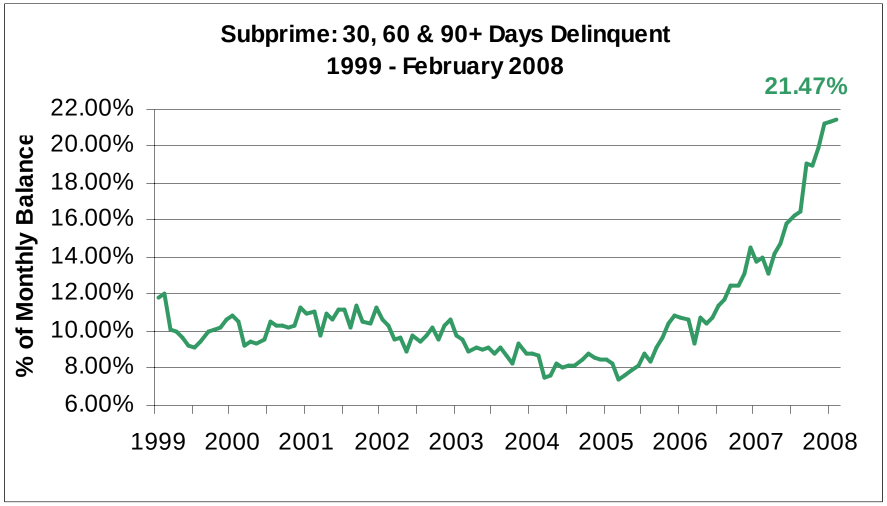
(CHART 13)



(CHART 14)



(CHART 15)



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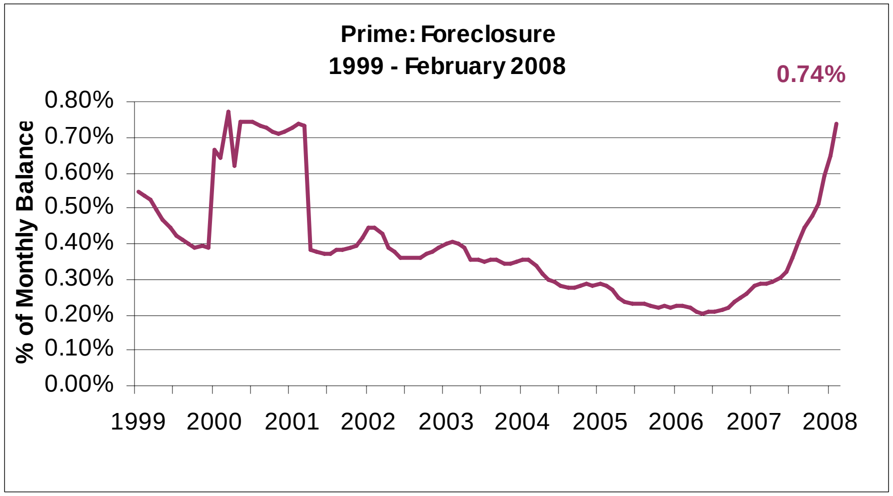
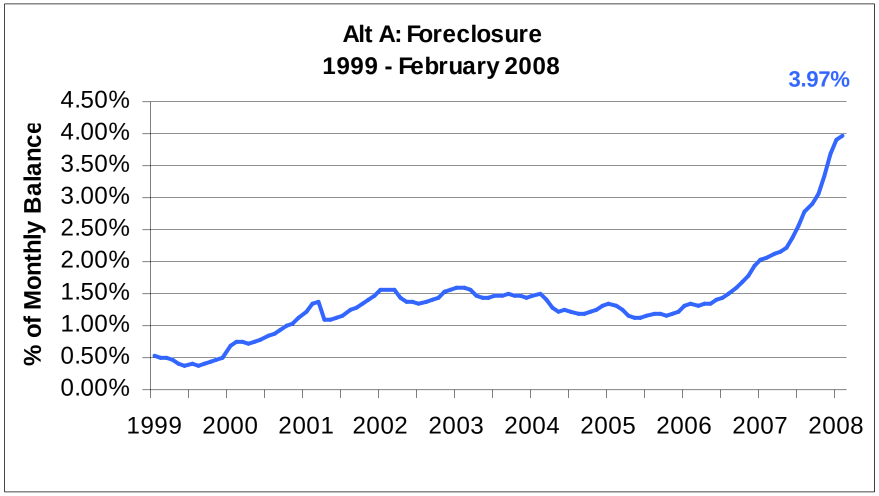
NATIONAL FORECLOSURE RATES: PRIME, ALT-A & SUBPRIME LOANS

(CHART 16)



(CHART 17)



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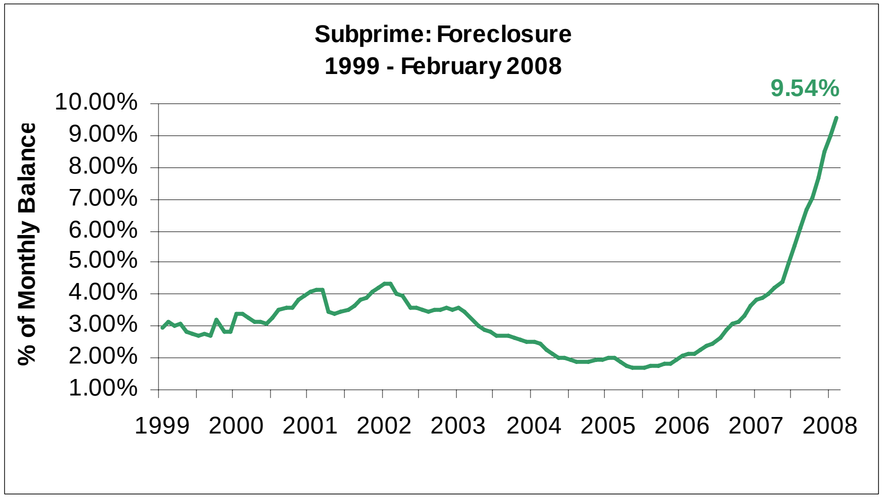

SOURCE: CHARTS 9-18 LOANPERFORMANCE, A SUBSIDIARY OF FIRST AMERICAN REAL ESTATE SOLUTIONS

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