Monthly Market Monitor

August 28, 2008

MMM 08-08

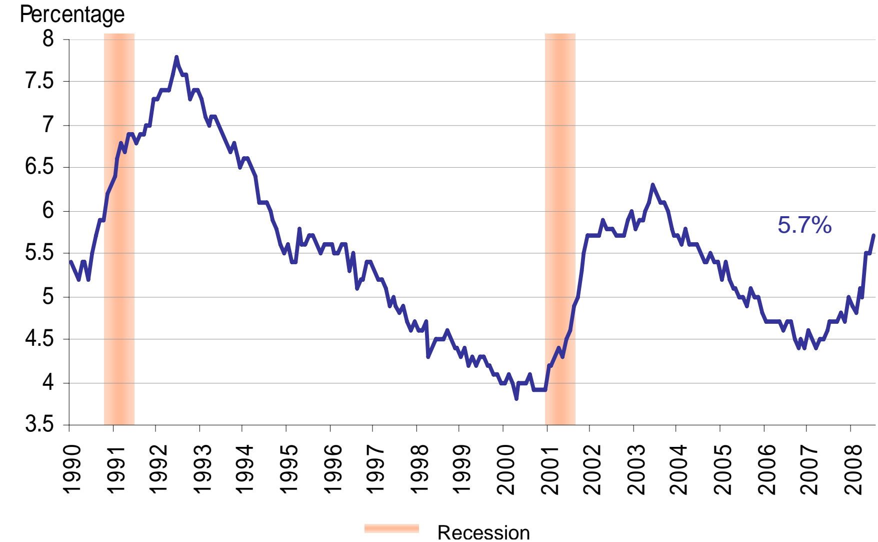
Sharon L. Stark, 202.906.6567
Barbara F. Buckley 202.906.6286
Office of the Senior Deputy Director

Economic Comment

The thrift industry received little relief as economic growth remains sluggish in the midst of the housing downturn. The economic weakness in the U.S. is amplified by rising unemployment and slow income growth. The home price correction is ongoing along with a steep decline in home construction, to alleviate the inventory overhang. These two forces will help to reduce a bulging stockpile of approximately 2.2 million homes available for sale[1] at the end of the third quarter compared to a normalized inventory of 1.25 million homes. Nonetheless, there is no rapid fix for the excesses that exist in the economy, resulting in a protracted decline in overall activity in the coming months and continued constraint on thrifts' abilities to lend and borrow funds.

The U.S. unemployment rate has more than doubled in the past twelve months to 5.7 percent as of July (Chart 1); the result of nearly half a million job cuts since the beginning of this year and more people out of work for longer periods of time. The rising number of part-time workers also illustrates the stress in the labor markets. Job losses have been most significant among construction and manufacturing companies and most recently, among professional service providers. Industries, such as finance, real estate, accounting, and temporary help providers have shed jobs this year; an indication of the second round effects of a faltering housing market.

Unemployment Rate, as of July 2008 (Chart 1)



Source: Bureau of Labor Statistics

[1] Census Bureau, Second Quarter 2008.

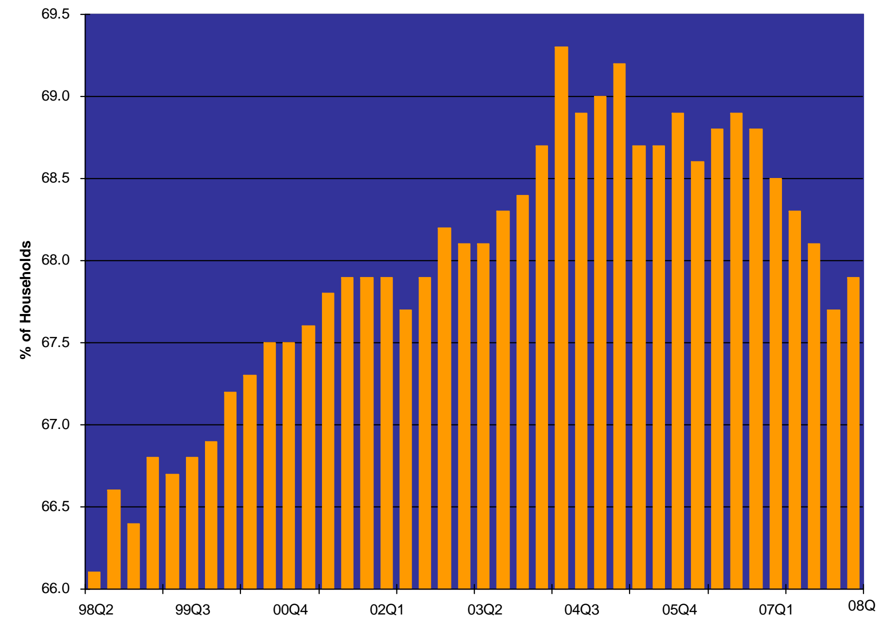
EROSION IN HOUSING ACTIVITY

Housing activity has contracted on all fronts with construction, sales, and prices on a protracted decline over the past six to twelve months. Residential mortgage originations were down approximately 26 percent from a year ago in the second quarter to $589 billion according to an estimate by National Mortgage News. The second quarter volume did outpace that of the first quarter of 2008 and the last three months of 2007 which tend to be slower periods for lending. In contrast, the Federal Housing Administration (FHA) single family loan business rose considerably in recent months. The FHA insured 351,140 mortgages in the second quarter, a 48 percent increase from the first three months of the year.

The contraction in housing activity has resulted in a decline in the homeownership rate which soared to a high of 69.3 percent in the second quarter of 2004 (Chart 2). A combination of a strong economy, income growth, and readily available financing led to the highest homeownership rate in this country's history, from a decade long average of 66.2. In recent months, the ownership rate has moderated and currently stands at 67.9 percent.

New home construction is down 31.7 percent from a year ago as builders struggle to trim inventories. Total production fell below 1 million annualized units in July 2008 for the first time in a decade. Builders have reduced starts of single family homes by 43 percent from a year ago June, to just 647,000 annualized units, the lowest level since 1991. Meanwhile, construction of multi-family units continues to rise, climbing 40.8 percent the past twelve months. Applications for building permits did increase in June of this year, perhaps a sign that we are nearing an end to the housing slump.

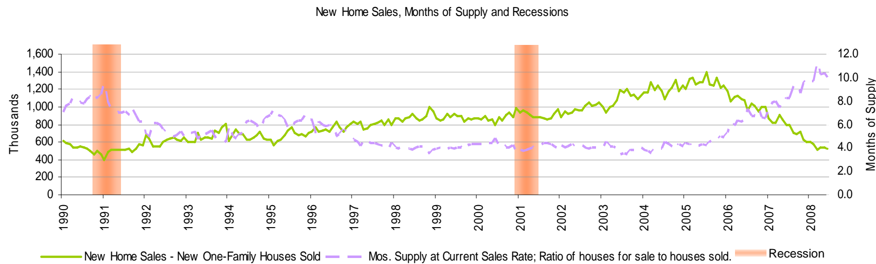
HOMEOWNERSHIP RATE, AS OF Q108 (CHART 2)



SOURCE: U.S. CENSUS BUREAU

Home builders continue to offer incentives to sell new homes; only to be somewhat offset by tight lending conditions. Financing for potential homebuyers in need of non-conforming terms is difficult to obtain and rising mortgage rates reduce the number of borrowers that qualify for loans. New home sales volume has fallen to 530,000 annualized units, a 33.2 percent decline from June of 2007 (Chart 3). Somewhat discouraging is the drop in sales despite a decline in the median home price. For the first time in 5 years, the median home price is below $200,000 at $196,300. Although builders have halted construction of new homes, the slow pace of sales has resulted in 10 months worth of inventory or 426,000 units for sale. This is an improvement over the recent peak of 11.2 months posted in March 2008, but is far from a more normalized level of six months and suggests builders must continue to cut prices to increase demand.

NEW HOMES SALES FALLING, AS OF JUNE 2008 (CHART 3)



SOURCE: U.S. CENSUS BUREAU

There are over 2.2 million vacant homes for sale in the U.S., or 1.8 percent of total housing stock.[2] This is nearly double the historic average level of available homes. Home resales have been especially slow as sellers have less options to incite potential buyers and financing remains difficult for all but the most prime borrower. The inventory of existing homes stands at roughly 11.1 months, a result of slow sales and a rising number of foreclosures, which is quickly adding to the balance of housing stock in the U.S. In addition, the number of condominium conversions in the past twelve months has contributed to the glut of unsold homes.

Homeowners have received some relief as mortgage rates have remained relatively low in the past year and mortgage servicers have worked diligently to help borrowers avoid foreclosure. According to reports from Hope Now, servicers developed workout plans for 522,000 loans in the second quarter; in addition to the 482,000 completed in the first three months of 2008.[3] Loan modifications accounted for 42.2 percent of the workouts, with the remaining comprised of new repayment plans.

In spite of lower rates and policy initiatives, borrowers are dealing with some strong headwinds. Credit is less readily available than in previous economic cycles. In addition to an overall decline in home mortgage originations, the availability of high loan-to-value (LTV) loans (LTV of 90 percent or more) has fallen dramatically in the past twelve months. These tighter lending standards somewhat mitigate the impact of policy initiatives enacted to stabilize the housing market.

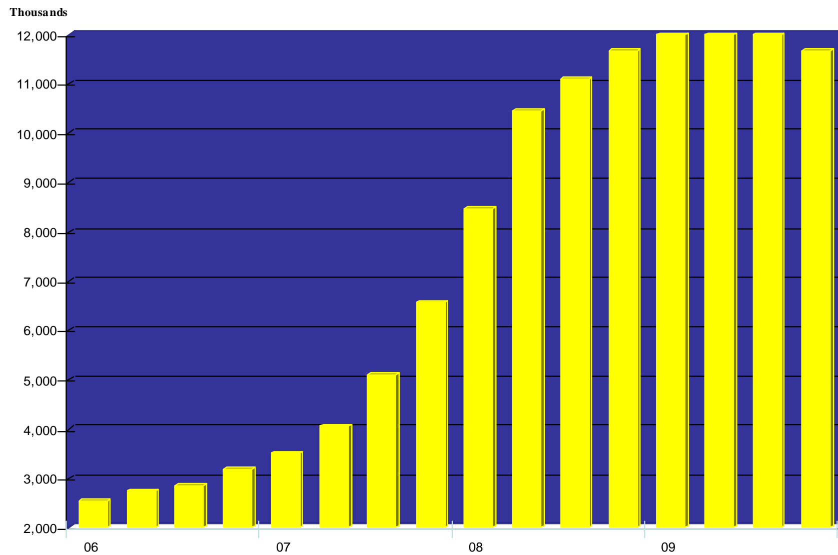
Another challenge for homeowners is the increasing amount of negative equity in homes. Approximately 8 million homeowners are underwater, or 10 percent of the single family inventory of homes (Chart 4). Delinquencies and foreclosures continue to rise as job losses, stagnant income growth, and deteriorating household balance sheets make it difficult for borrowers to make timely monthly payments. Analysts at Moody Economy.com estimate a rising number of homeowners with negative equity through 2009.

---

[2] Moody's Economy.com
[3] Inside Mortgage Finance, August 1, 2008.

RISE IN NEGATIVE EQUITY, AS OF 4Q09E (CHART 4)

NUMBER OF UNDERWATER HOMEOWNERS



SOURCE: EQUIFAX, MOODY'S ECONOMY.COM

It is this confluence of events that exerts persistent pressure on home prices. According to the most recent S&P/Case-Shiller home price index, home values across the nation fell by an average of 15.76 percent over the past twelve months (Chart 5). Cities that experienced the fastest rate of price appreciation, now lead the downturn in prices, with Las Vegas and Miami reporting the largest price declines. A monthly comparison of prices shows six cities; Denver, Charlotte, Boston, Minneapolis, Dallas, and Atlanta with price gains. While one month does not make a trend, the positive price movement is encouraging. Affordability issues still plague cities such as Los Angeles, San Francisco and Washington, D.C. where prices are likely to continue to fall in the coming quarter.

S&P/CASE-SHILLER HOME PRICE INDICES, AS OF MAY 2008 (CHART 5)

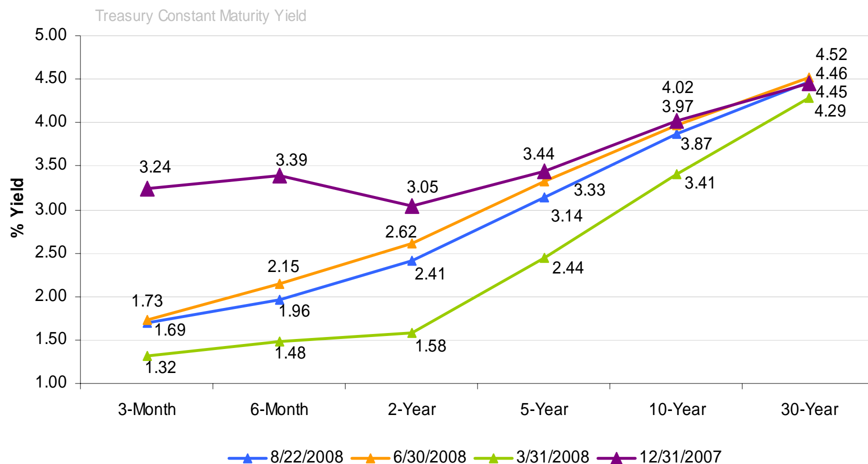
	May 2008	Year/Year %Change	Month/Month %Change
West			
Denver	129.72	-4.84	0.96
Las Vegas	161.04	-28.36	-2.92
Los Angeles	198.59	-24.55	-1.94
Phoenix - AZ	157.32	-26.47	-2.49
Portland - OR	175.53	-5.23	0.38
San Diego	178.03	-23.20	-1.41
San Francisco	162.70	-22.85	-1.17
Seattle - WA	178.67	-6.30	-0.50
Midwest			
Dallas - TX	121.61	-3.08	1.00
Minneapolis - MN	140.12	-14.77	0.67
Central			
Chicago	150.03	-9.45	-0.27
Cleveland - OH	108.88	-8.00	-0.61
Detroit - MI	92.61	-17.23	-1.26
Northeast			
Boston	160.35	-6.20	1.05
New York	193.88	-7.79	-0.03
Southeast			
Atlanta - GA	124.41	-7.86	0.18
Charlotte - NC	133.16	-0.19	1.02
Miami	193.19	-28.32	-3.61
Tampa - FL	177.14	-20.19	-0.76
Washington, DC	199.23	-15.36	-0.98
Composite	181.48	-16.86	-0.91
Composite-20	168.54	-15.76	-0.77

SOURCE: STANDARD & POOR'S AND FISERV

RISING RATES

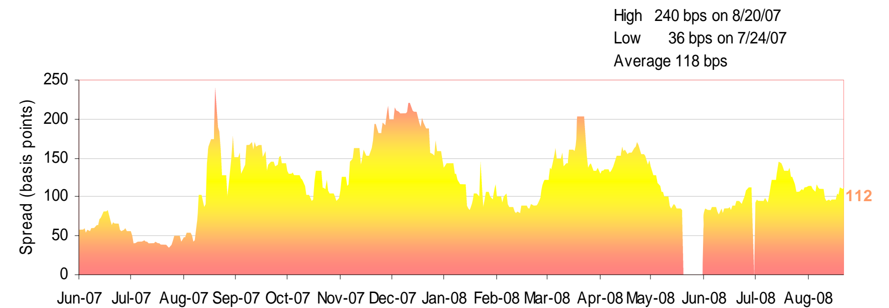
The level of interest rates has shifted significantly in the short end of the yield curve as a result of aggressive easing of monetary policy by the Federal Reserve Board. Since the beginning of 2008, short term rates have fallen by 143 basis points (bps)[4], while long term rates have barely changed (Chart 6). The steepening is a result of rising inflation pressure, which tends to push long term rates higher as investors require a premium for longer maturities. In addition to the inflation concerns are credit fears associated with financial institutions with exposure to the mortgage market. As expected, this encompasses the majority of depositories which have experienced difficulty in obtaining efficient funding in recent months. The widening spread between LIBOR and Treasury bill yields illustrates tight credit conditions with the current spreads considerably wider than the normalized 36 bps (Chart 7). An increase in funding rates for financial institutions eventually translates into higher borrowing rates for homebuyers, a transition that appears to be in progress.

TREASURY YIELD CURVES, AS OF AUGUST 22, 2008(CHART 6)



SOURCE: BLOOMBERG, L.P.

3-MONTH LIBOR VS. 3-MONTH T-BILL, AS OF AUGUST 22, 2008 (CHART 7)



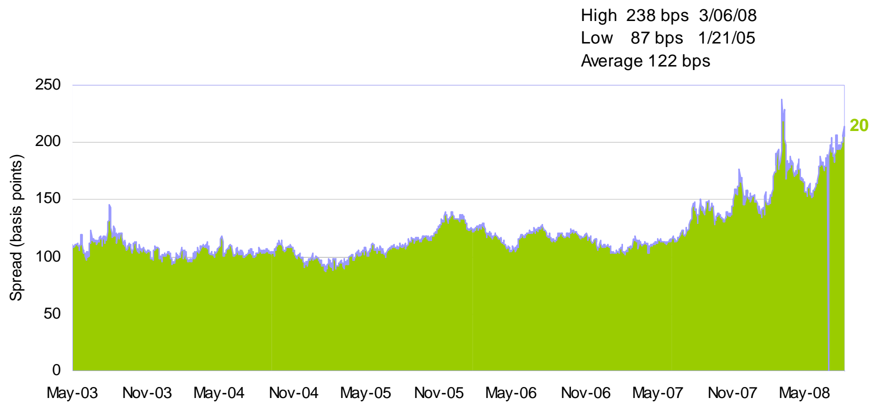
SOURCE: BLOOMBERG, L.P.

While 30-year fixed mortgage rates are lower than historical averages, the recent rise to an average 6.52 percent[5] suggests higher rates in the future. Concerns about future losses in the mortgage backed securities markets have pushed spreads toward the widest levels in a year. The spread between 30-year FNMA passthroughs and the Treasury 10-year note breached the 200 bps mark again in recent days, still below the peak 238 bps reached in March of this year, but indicative that all is still not well in the mortgage market. Investor uncertainty regarding the financial health of Fannie Mae and Freddie Mac coupled with continued speculation of some remedial action by the Treasury Department has cast a pall over this market. The share prices of the two entities have fallen more than 90 percent this year and their ability to raise capital is constrained. The impact on thrift industry is felt most by those originating home mortgages and those that own GSE debt. The ability of the GSEs to purchase loans may be constrained due to capital levels, while the prices for preferred shares and debentures are dampened by questions regarding the financial condition of the company and any potential action the Treasury department may take to stabilize the two entities.

[4] Represented by the yield on the six month Treasury bill.

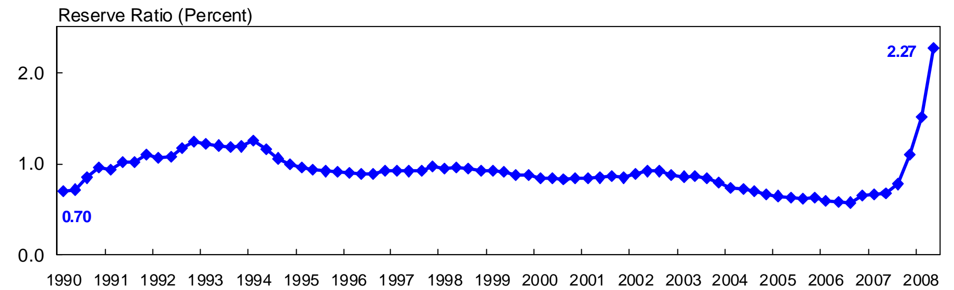
[5] Freddie Mac Weekly survey of Mortgage Rates, July 31, 2008.

30-YEAR FNMA VS. 10-YEAR NOTE, AS OF AUGUST 22, 2008 (CHART 8)



SOURCE: BLOOMBERG, L.P.

RESERVE COVERAGE RATIO, AS OF JUNE 2008 (CHART 9)



SOURCE: RESERVE RATIO = ALLL TO TOTAL LOANS AND LEASES.
OFFICE OF THRIFT SUPERVISION / AUGUST 2008

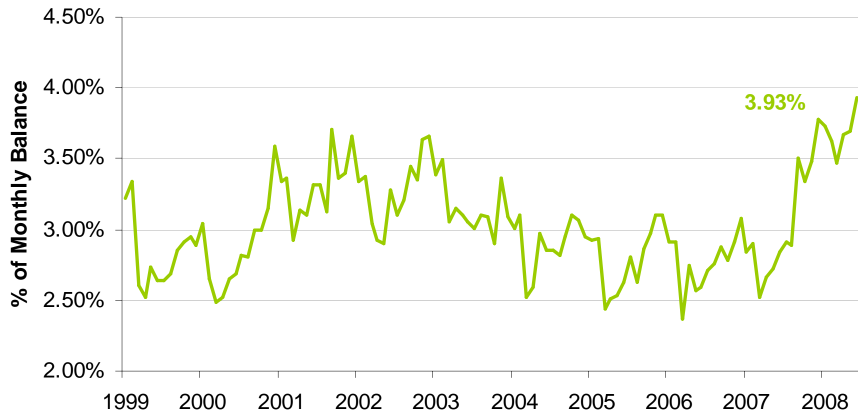
CONCLUSION

What does this mean for the thrift industry? Clearly earnings will be challenged in the coming months and provisions for loan losses are likely to increase providing a cushion against future charge offs. As of the second quarter of 2008, OTS supervised thrifts added a record $14.0 billion to loan loss provisions, putting the industry's loan loss reserve ratio[6] at a historic high of 2.27 percent. The additional provisions and recognition of losses resulted in a reported $5.3 billion loss by OTS-supervised institutions in the second quarter, resulting in a negative 1.41 return on assets for the quarter. Efforts to stave off avoidable foreclosures are moving forward with full force as institutions work to improve asset quality and shore up capital levels in anticipation of still challenging times ahead.

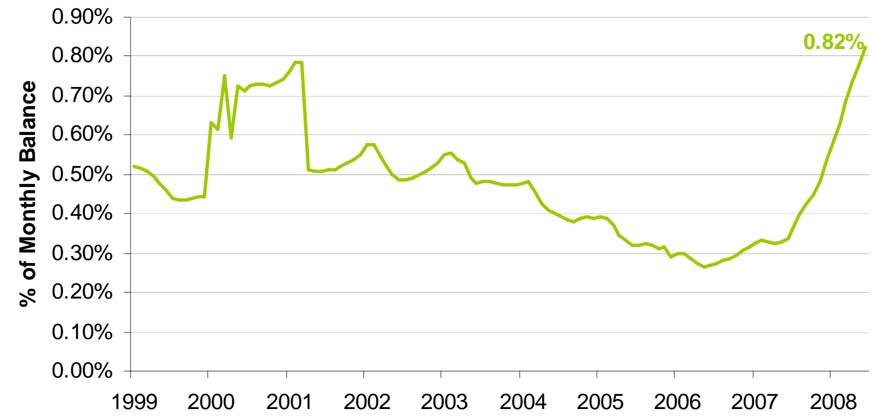
[6] Reserve ratio measures the ratio of allowance for total loans and leases to the balance of all loans and leases.

National Delinquency & Foreclosure Rates: Fixed & ARM Loans

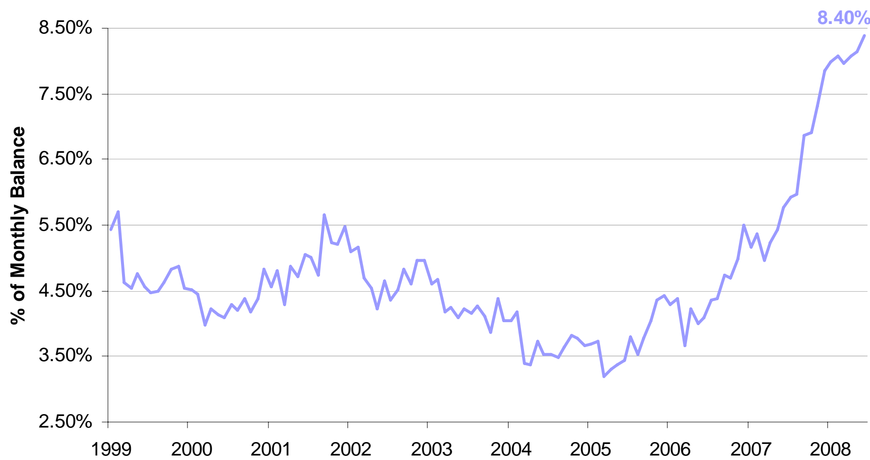
(Chart 10)



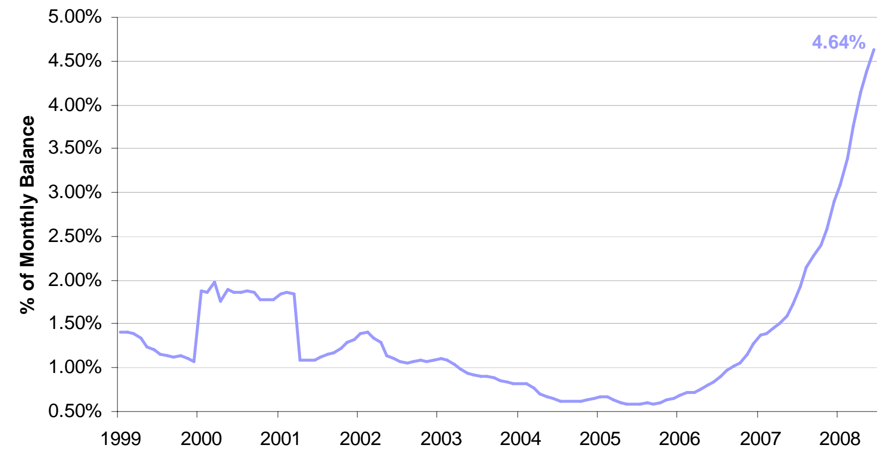
(Chart 11)



(Chart 12)

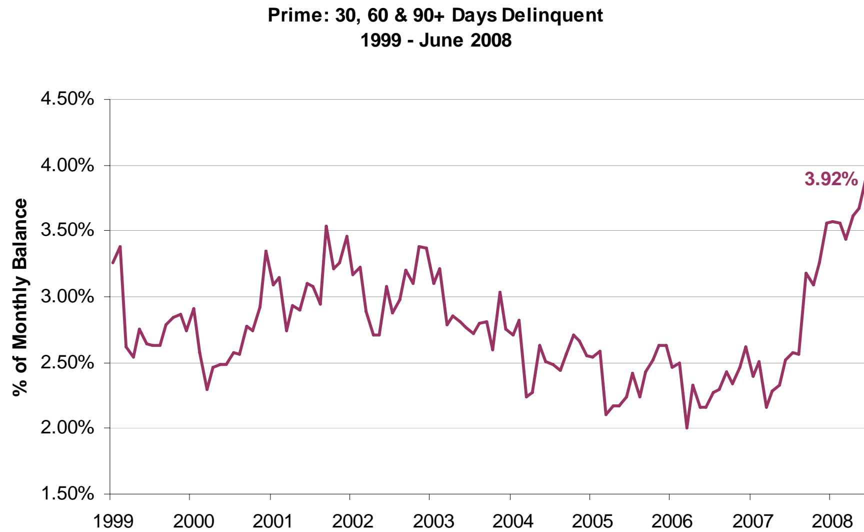


(Chart 13)

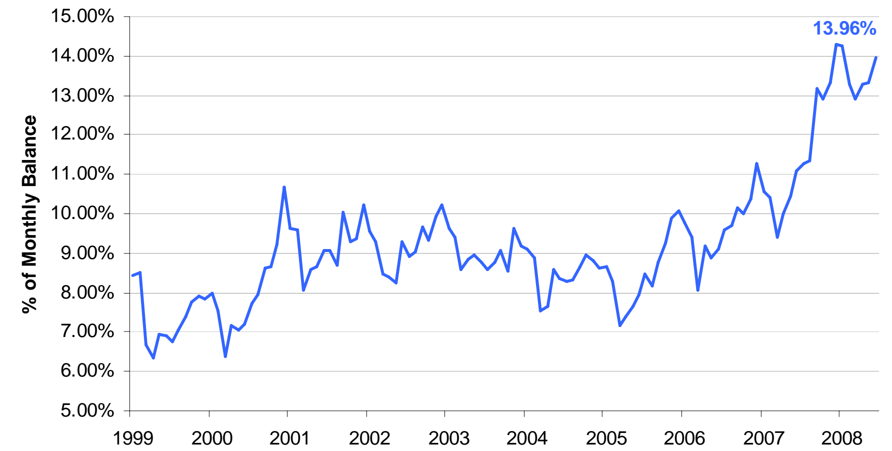


NATIONAL DELINQUENCY RATES: PRIME, ALT-A & SUBPRIME LOANS

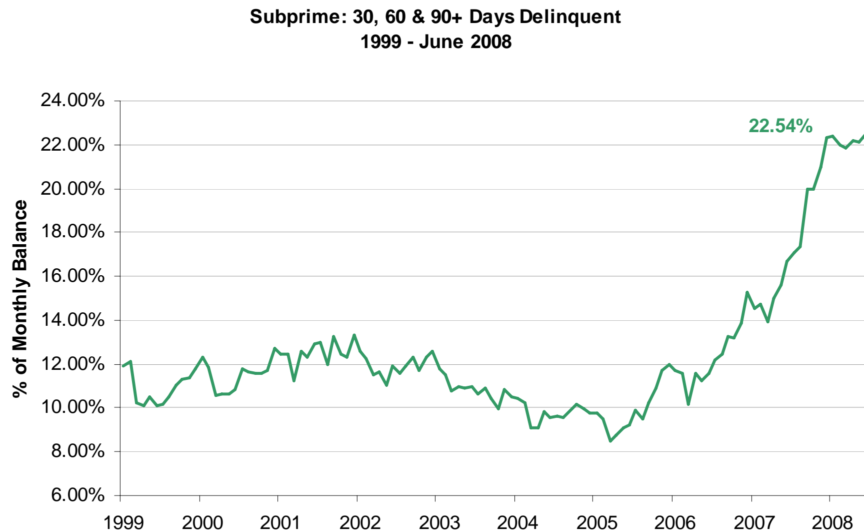
(CHART 14)



(CHART 15)



(CHART 16)



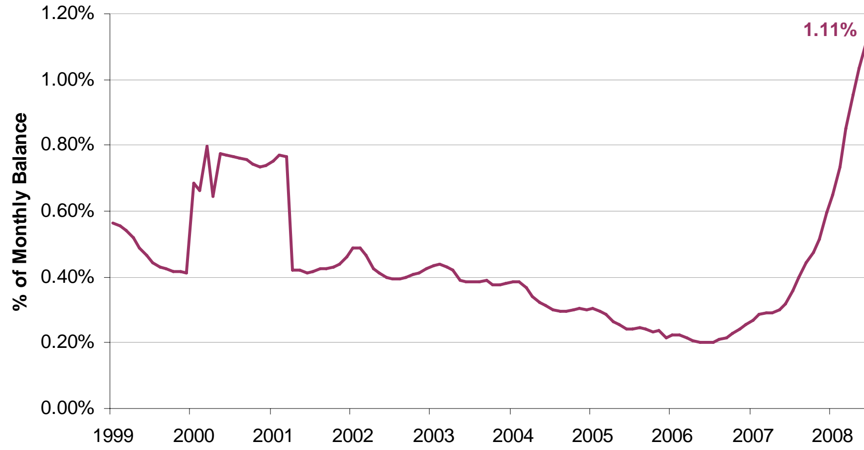
SOURCE: CHARTS 10-19 LOAN PERFORMANCE, A SUBSIDIARY OF FIRST AMERICAN REAL ESTATE SOLUTIONS

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%.

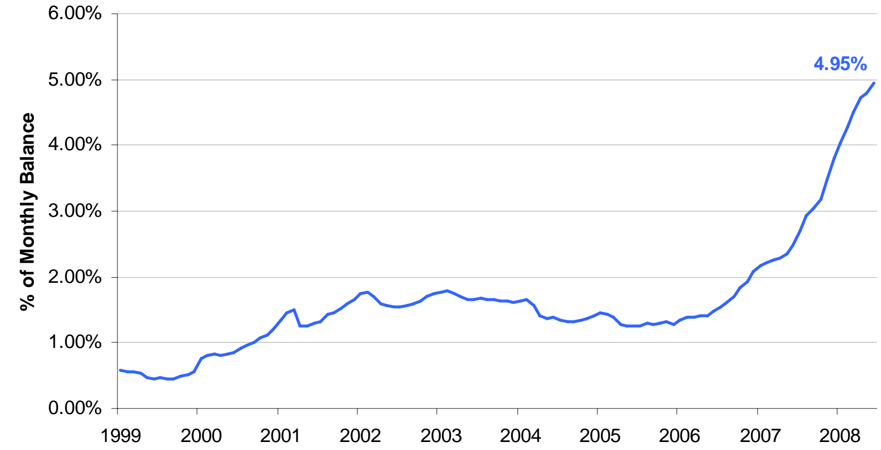
ALL VARIATIONS OF DOCUMENTATION ARE INCLUDED. DATA FOLLOWS THE MBA DEFINITION OF DELINQUENCY.

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

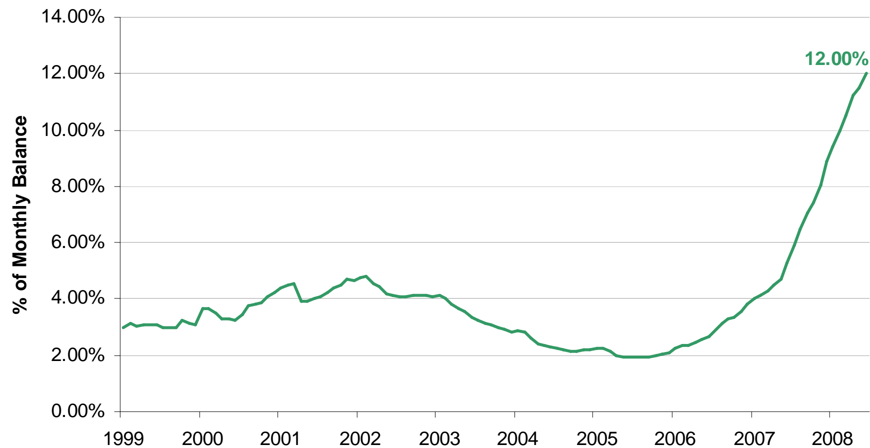
(CHART 17)



(CHART 18)



(CHART 19)



SOURCE: CHARTS 10-19 LOAN PERFORMANCE, 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.

The information contained herein has been prepared from sources believed to be reliable but is not guaranteed by the Office of Thrift Supervision or the Department of the Treasury and is not a complete summary or statement of all available data. The information analysis and opinions expressed herein are subject to change without notice.