



MONTHLY MARKET MONITOR

THURSDAY, JUNE 5, 2008

MMM 05-08

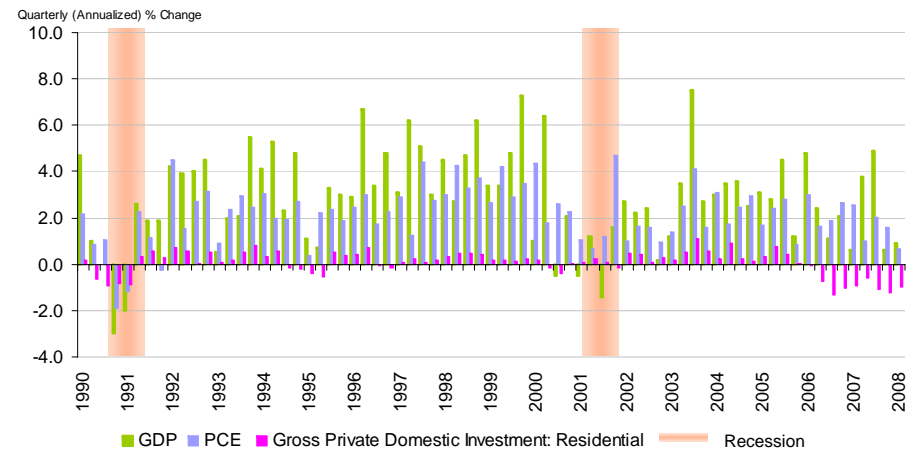
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ECONOMIC COMMENT

The U.S. economy remains in a slump as illustrated by the second consecutive quarter of sub-par GDP growth. First quarter GDP advanced a mere 0.9 percent, slightly higher than the fourth quarter pace and up 2.5 percent from a year ago. Output was boosted by a surge in inventories, which added 0.21 percent to the growth rate, and net export gains, which contributed an additional 0.80 percent. Offsetting the positive factors to GDP is the persistent contraction in residential investment (-25.5 percent) and a 2.5 percent decline in business spending. These two components subtracted 1.17 percent and 0.30 percent, respectively, to first quarter GDP. The most influential component of U.S. growth is personal consumption expenditures (PCE), which advanced at a 1.0 percent pace, nearly half its pace from the previous year. In previous periods of economic stress, (Chart 1) the protracted downturn in housing was followed by an attendant decline in consumer spending and eventual contraction in overall growth. While we are not suggesting that this is likely to occur in the current environment, the headwinds that consumers face increase the possibility for an economic decline.

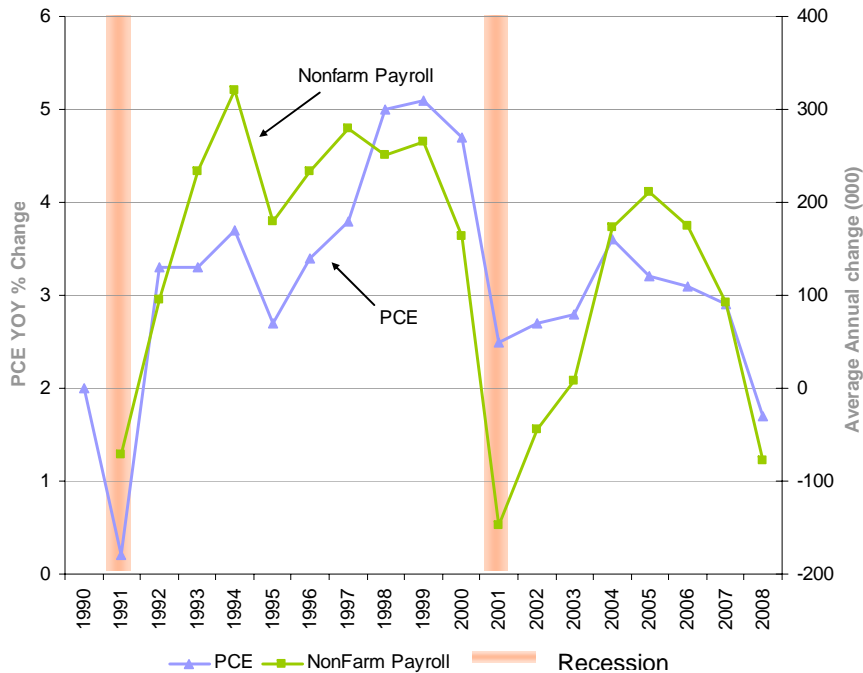
CONTRIBUTIONS TO GDP, AS OF 1Q 2008 (CHART 1)



SOURCE: BUREAU OF ECONOMIC ANALYSIS

Job growth has eluded the U.S. in 2008. Payrolls have shrunk by an average of 65,000 jobs per month in the first four months of the year. The greatest job losses have occurred in the sectors of manufacturing, construction and retail, industries largely influenced by housing conditions. In contrast, the aging U.S. population continues to fuel job gains in health care, and increases in new households require more professionals in the education industry. The importance of job growth to the consumer is illustrated in Chart 2 below. The impact of jobs on consumer spending is significant, with both jobs and spending increasing as the country moved out of recession in 1991 and 1992 and slowing in tandem since the beginning of 2008.

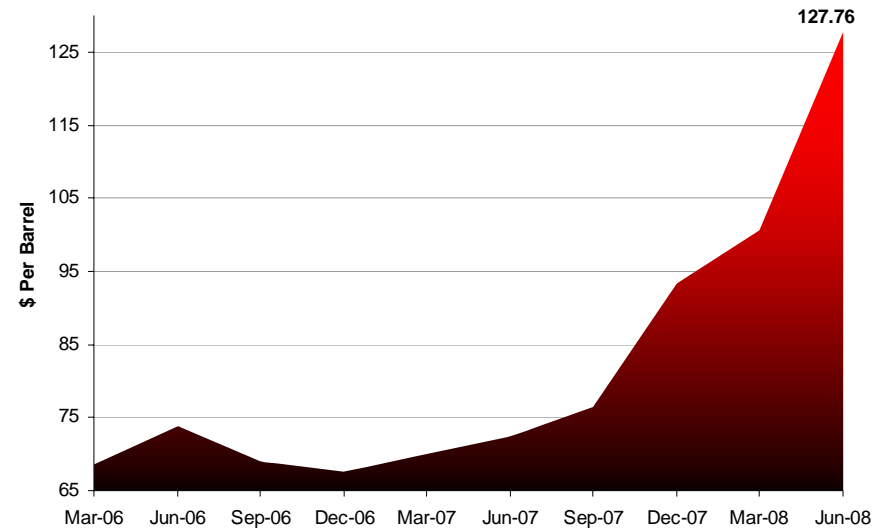
(CHART 2)



SOURCE: BUREAU OF LABOR STATISTICS & BUREAU OF ECONOMIC ANALYSIS

Inflation has reared its ugly head in the form of soaring energy and food prices. While the core consumer price index growth rate stands at roughly 2.3 percent, the overall index advanced 3.9 percent in March and has remained significantly higher than the core rate for the last six months. Historically, when this difference remains in place for a protracted period, the overall index tends to prevail as an indicator of inflation’s impact on consumption. In response, the Federal Open Market Committee may adjust monetary policy and in the current environment, may leave the target Fed funds rate unchanged and shift its focus to rising inflation fears in the near term. Clearly the heightened press attention affects consumer behavior, as daily news reports of soaring gasoline prices and public transportation fuel surcharges blanket print and broadcast media. The chart below illustrates the rapid and prolonged rise in oil prices, which has translated into \$4.00+ per gallon gasoline prices (Chart 3). After paying higher heating bills over the winter, U.S. households must now fund rising costs to drive cars, fly and ride public transportation. Inflation is another obstacle that could diminish consumption in the coming months.

WTI CRUDE OIL FUTURE, AS OF JUNE 2, 2008 (CHART 3)



SOURCE: BLOOMBERG L.P.

HOUSING CONDITIONS

Generally, indicators of housing activity suggest that residential investment will remain a drag on GDP growth. Homes sales remain in a slump in the U.S. with existing home sales, which comprise 85 percent of single-family home sales, falling 17.5 percent the 12 months ended in April 2008. The inventory of homes available for sale rose to a 10.7 month supply, the highest level since June 1985.¹ The result of the inventory overhang is a considerable pullback in new home construction, with the number of housing starts near a 17-year low and off 30.6 percent the past six months.² Building of multifamily units rose in the month of April, but single-family construction fell for the twelfth consecutive month. It would be premature to draw any conclusions from the April data, because multifamily data tends to be volatile.

Home prices continued their descent as measured by both the S&P/Case-Shiller home price indices and the Office of Federal Housing Enterprise Oversight (OFHEO). The Case-Shiller 20-city home price index experienced a 14.3 percent decline in March 2008 to 172.16, led by Las Vegas, Miami and Phoenix, where investor buying was most prevalent. (Chart 4)³ Cities with low affordability, such as San Francisco and San Diego, also experienced 20+ percent declines in their indices, while the indices of economically stressed cities, such as Cleveland and Detroit, fell further. Only one city, Charlotte, showed an increase in the price index, which stands at 132 percent of its base of 100 recorded in 2001.

¹ National Association of Realtors.

² U.S. Census Bureau.

³ A reading of 172.16 suggests prices are 72.16 percent higher than where they stood in 2001, when the base of 100 was established. The S&P/Case-Shiller index measures price changes of single-family homes only based on arms-length transactions.

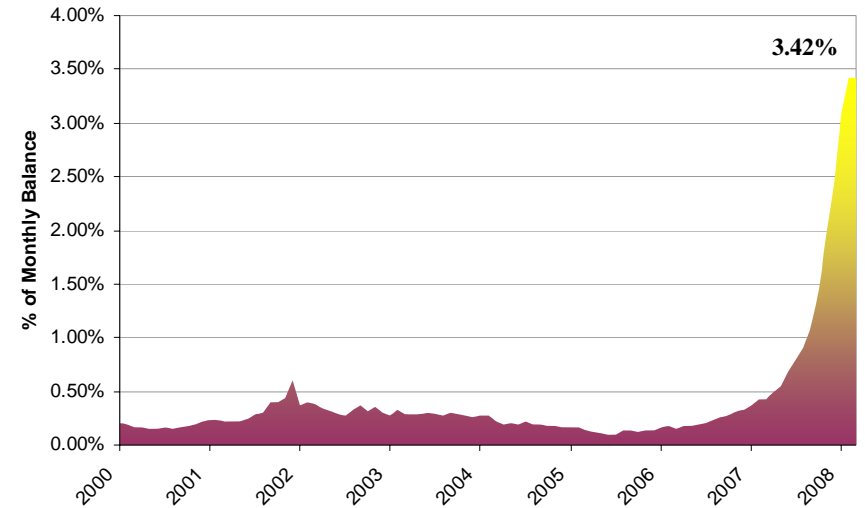
(CHART 4)

	March 2008	Year/Year %Change	Month/Month %Change
West			
Denver	127.43	-5.04	-0.05
Las Vegas	169.31	-25.92	-4.44
Los Angeles	207.11	-21.72	-3.59
Phoenix - AZ	166.97	-23.01	-3.33
Portland - OR	174.39	-4.03	-1.05
San Diego	185.44	-20.51	-2.57
San Francisco	168.38	-20.23	-3.53
Seattle - WA	178.29	-4.37	-0.87
Midwest			
Dallas - TX	119.08	-3.29	1.16
Minneapolis - MN	142.24	-14.10	-2.53
Central			
Chicago	150.35	-9.99	-1.94
Cleveland - OH	106.42	-9.51	-0.37
Detroit - MI	95.57	-17.93	-2.09
Northeast			
Boston	158.54	-5.93	-1.10
New York	198.46	-6.62	-1.01
Southeast			
Atlanta - GA	124.61	-6.46	-0.97
Charlotte - NC	131.52	0.83	0.23
Miami	208.88	-24.56	-4.51
Tampa - FL	182.26	-19.56	-3.36
Washington, DC	202.34	-14.68	-2.27
Composite	186.06	-15.30	-2.37
Composite-20	172.16	-14.36	-2.15

The OFHEO purchase-only house price index, which measures changes in the prices of homes financed by conforming loans, fell by 1.7 percent in the first quarter of the year. The drop is the largest quarterly decline on record and leaves the year-over-year change at -3.1 percent. OFHEO reported the largest price declines for the 12 months ended March 2008 in Merced, CA (-24.68 percent), Stockton, CA (-21.51 percent), Modesto, CA (-20.96 percent) and Naples-Marco Island, FL (-18.67 percent). California and Florida cities comprised 19 of the 20 positions among the cities with the highest price declines. Metropolitan areas that experienced the greatest home price appreciation over the same period include Houma-Bayou Cane-Thibodaux, LA (+11.22 percent), Grand Junction, CO (+9.08 percent), Wenatchee, WA (+8.02 percent), and Austin-Round Rock, TX (+7.74 percent.) Quarterly price changes reflect a continued decline in home prices across the country, with California and Nevada showing the most significant depreciation in the first three months of this year.

The delinquency and foreclosure data for residential mortgage loans were mixed the past two months. It is encouraging to see a deceleration in the growth in delinquencies of fixed-rate and adjustable-rate mortgages, as well as in those loans to subprime, Alt-A and prime borrowers. (Charts 6, 8, 10-12). Nonetheless, two months do not make a trend and it is premature to conclude that delinquencies have stabilized. Borrowers with option ARMs still face headwinds from loan recasts due to negative amortization triggers. As shown in Chart 5, 90+ day delinquencies among option ARMs are rising steadily from a year ago and currently stand at approximately 3.4 percent of outstanding loan balances. The late payment rate is similar to that of prime borrowers, so the levels are not alarming, but the rate of delinquencies has more than tripled from a year ago.

OPTION ARM – 90+ DAYS DELINQUENT – MARCH 2008 (CHART 5)



SOURCE: LOAN PERFORMANCE

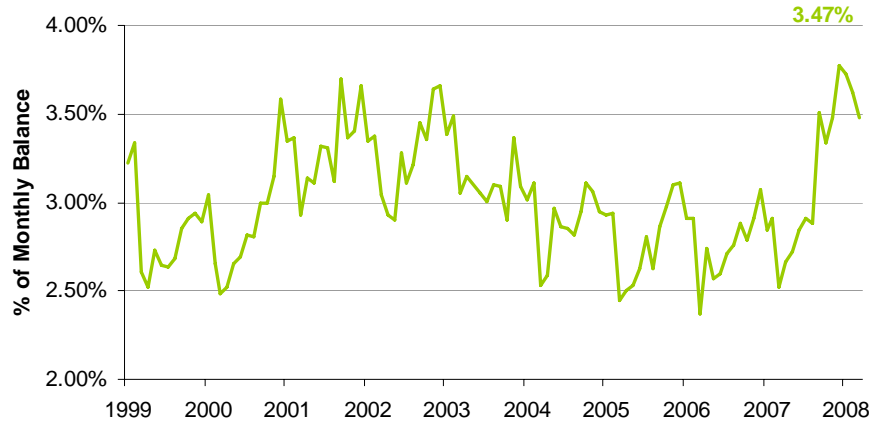
In contrast to the delinquency experience, foreclosures of loans have risen in both loan types and in each borrower category. (See charts 7, 9, 13-15) The foreclosure rate among all outstanding loans in the Loan Performance servicer database is 1.48 percent as of March 2008, roughly 0.12 percent higher than during the previous month. As expected, subprime borrowers showed the greatest percentage of foreclosures at 10.48 percent, followed by Alt-A mortgage holders at 4.51 percent. Prime borrowers' foreclosure incidence remains below 1.0 percent.

News about the housing market is sobering and reinforces the notion of a protracted decline in residential investment. The large inventory of unsold homes and tight credit conditions may force home prices lower, further reducing homeowners' equity and potentially constraining consumer spending in the coming quarters.



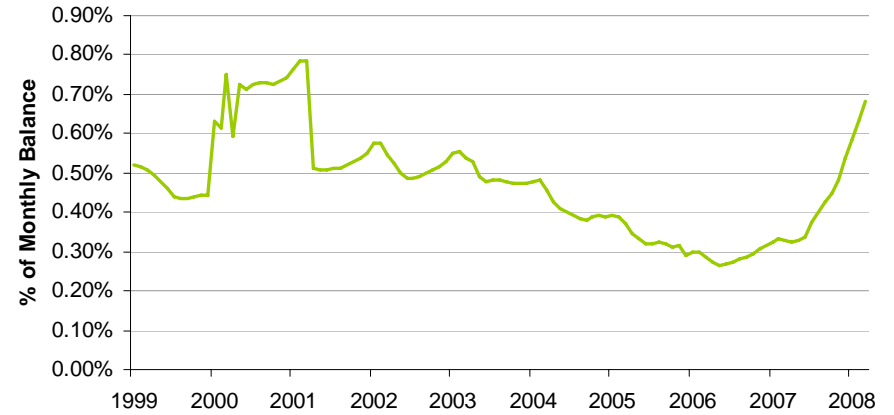
NATIONAL DELINQUENCY & FORECLOSURE RATES: FIXED & ARM LOANS (CHART 6)

Fixed: 30, 60 & 90+ Days Delinquent 1999 - March 2008



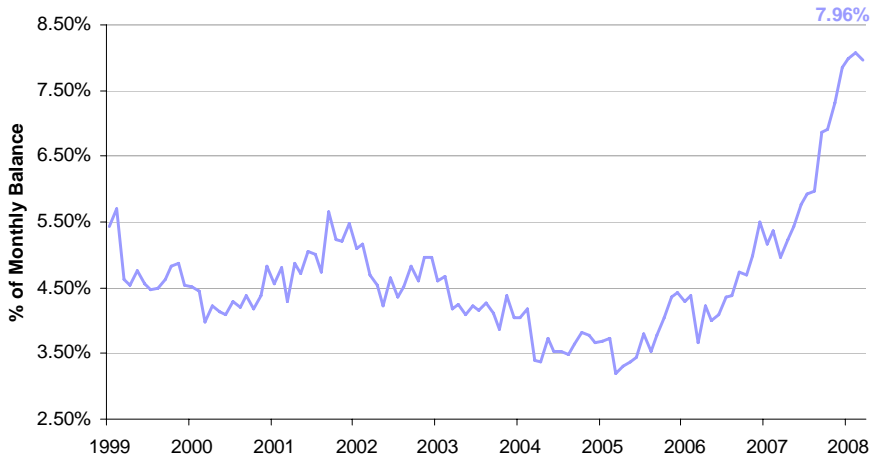
(CHART 7)

Fixed: Foreclosure 1999 - March 2008



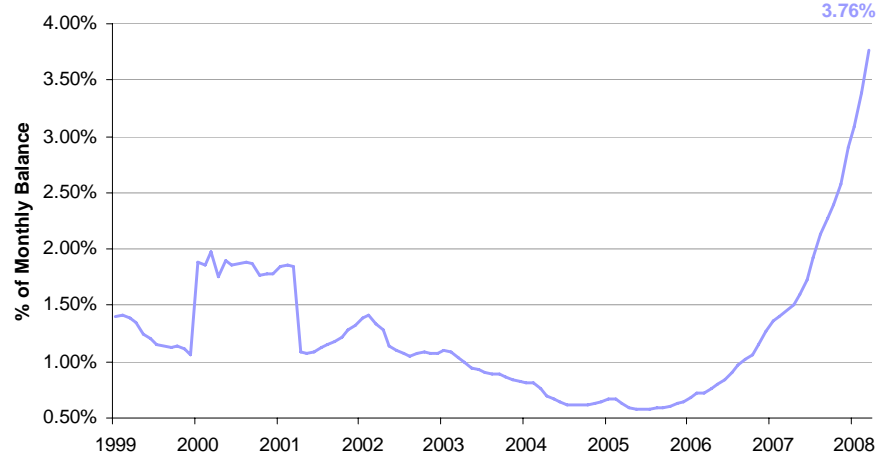
(CHART 8)

ARM: 30, 60 & 90+ Days Delinquent 1999 - March 2008



(CHART 9)

ARM: Foreclosure 1999 - March 2008

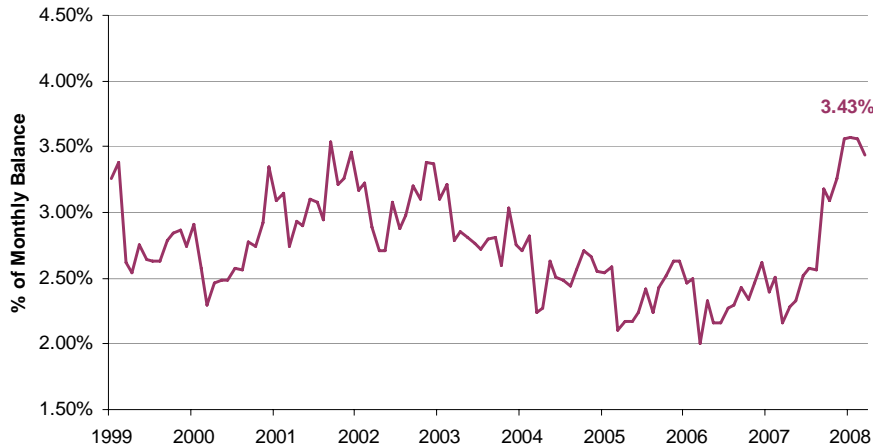


SOURCE: CHARTS 5-15 LOANPERFORMANCE, A SUBSIDIARY OF FIRST AMERICAN REAL ESTATE SOLUTIONS



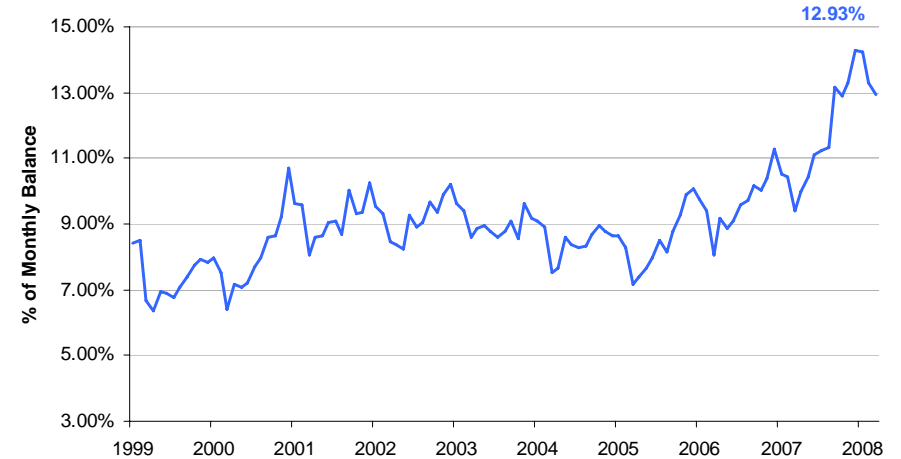
NATIONAL DELINQUENCY RATES: PRIME, ALT-A & SUBPRIME LOANS
(CHART 10)

Prime: 30, 60 & 90+ Days Delinquent
1999 - March 2008



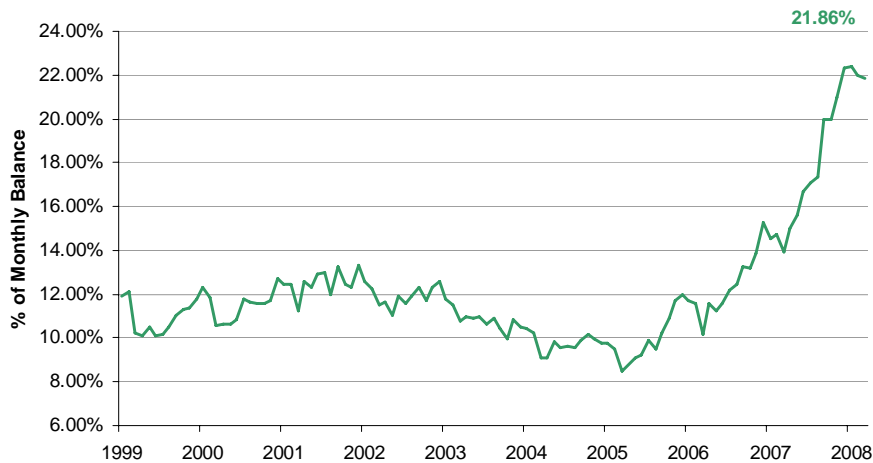
(CHART 11)

Alt A: 30, 60 & 90+ Days Delinquent
1999 - March 2008



(CHART 12)

Subprime: 30, 60 & 90+ Days Delinquent
1999 - March 2008



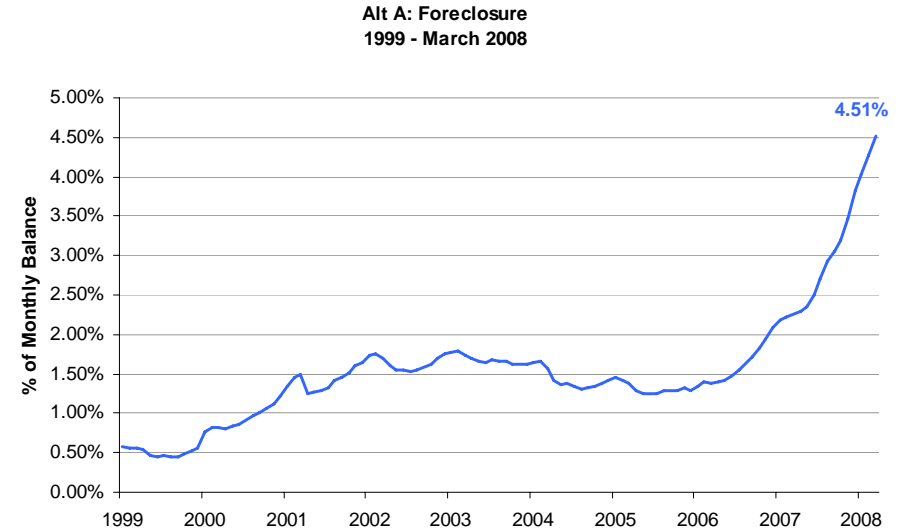
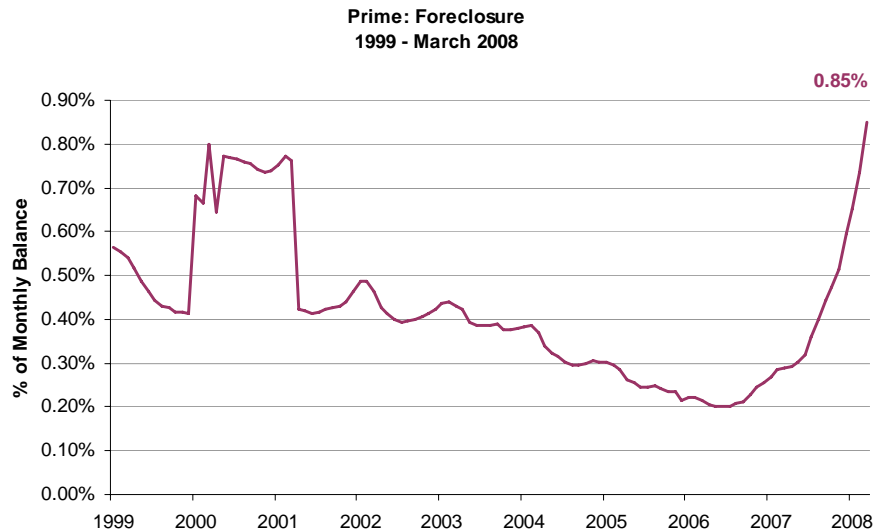
SOURCE: CHARTS 5-15 LOANPERFORMANCE, A SUBSIDIARY OF FIRST AMERICAN REAL ESTATE SOLUTIONS

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%.

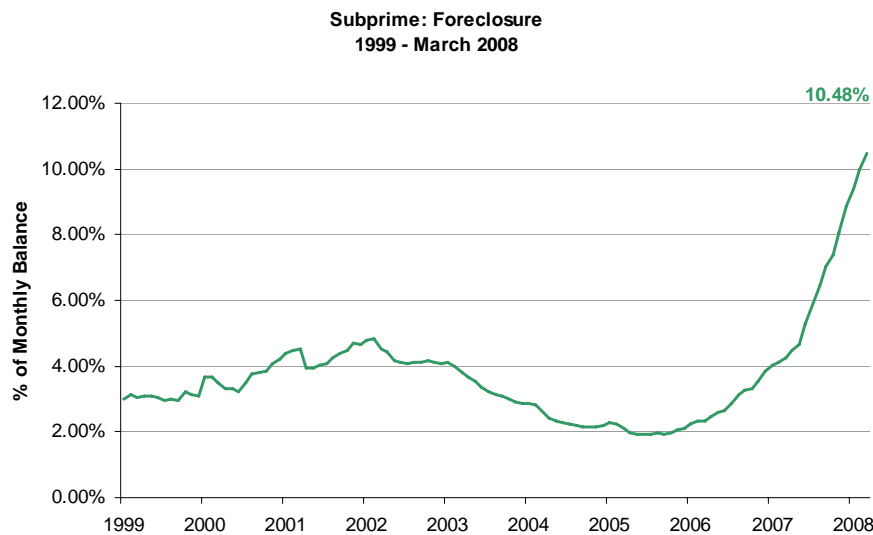
ALL VARIATIONS OF DOCUMENTATION ARE INCLUDED. DATA FOLLOWS THE MBA DEFINITION OF DELINQUENCY.

**NATIONAL FORECLOSURE RATES: PRIME, ALT-A & SUBPRIME LOANS
(CHART 13)**

(CHART 14)



(CHART 15)



SOURCE: CHARTS 5-15 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%.

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MARKET TRENDS

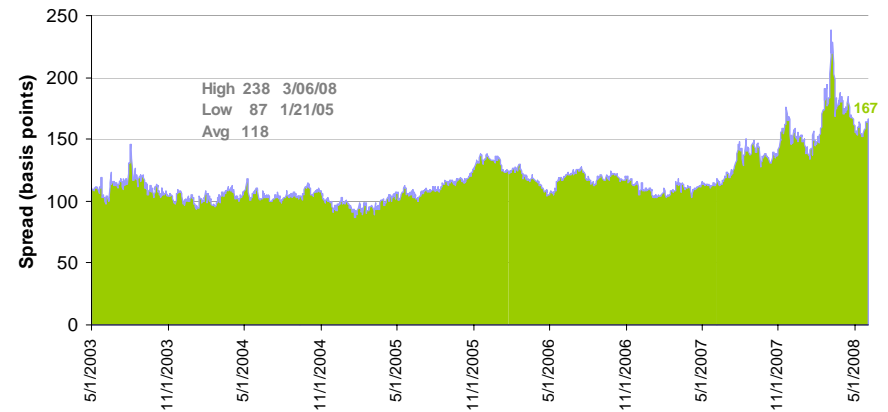
The mortgage-backed securities (MBS) market has enjoyed some relief in spread widening, due in part to the significant change in available supply. After a painful 2007, issuance of non-agency securities has come to a virtual stop, as agencies have reclaimed their position as the dominant issuer. In 2003, agency securities comprised approximately 78 percent of market share in the MBS market.⁴ This quickly declined to a low of 45 percent in 2005 and 2006 as the housing boom ensued and private label securitizations became more prevalent. As of the first quarter 2008, agency MBS market share has climbed to 94 percent of gross new issuance and is on track to mirror the gross issuance of \$555 billion in 2007.

The entity that has experienced the greatest surge in activity is Ginnie Mae. These securities are primarily backed by single-family loans, which are individually insured by either the Federal Housing Administration or the Veterans Administration. During the period from 2003 through 2005, net issuance of Ginnie Mae MBS was mostly negative month over month. As the subprime and Alt-A markets deteriorated in 2007, Ginnie Mae issuance rose to approximately 5 percent of net agency issuance and spiked to 24 and 25 percent respectively, in March and April of 2008.⁵ The surge in Ginnie Mae supply is likely a result of an increase in refinancings of ARMs and/or Alt-A loans and loan modifications into FHA loans.

Liquidity in the MBS market is improving, although it remains far from the norms. As illustrated in Chart 17, spreads have narrowed to roughly 167 basis point spread (bps) from a high of 238 bps in March 2008. At 167 bps over the yield on the 10-year Treasury note, MBS spreads on 30-year passthroughs are still roughly 49 bps above the average spread of the past five years.⁶ Liquidity conditions in private label MBS remain challenged due to the high level of delinquencies in the underlying collateral and potential losses on current positions. The absence of the capital markets as a source of funding and rising interest rates in response to higher inflation pressure

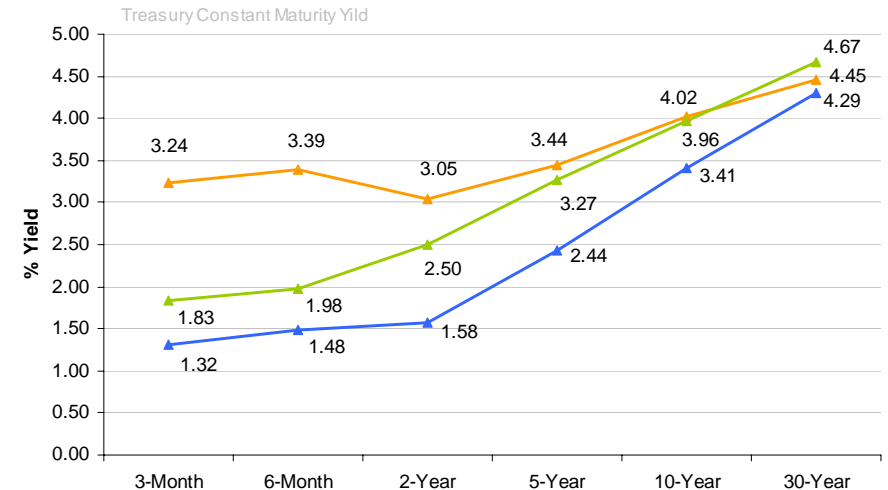
continue to hamper the availability of credit to potential homebuyers and to those who seek relief from unaffordable mortgage payments.

30- YEAR FNMA MBS vs. 10-YEAR NOTE, AS OF JUNE 3, 2008 (CHART 16)



Source: Bloomberg, L.P.

HISTORICAL YIELD CURVE, AS OF JUNE 3, 2008 (CHART 17)



Source: Bloomberg, L.P.

3/31/2008 12/31/2007 6/2/2008

⁴ Fannie Mae, Freddie Mac, Ginnie Mae.

⁵ FHA

⁶ Bloomberg L.P. June 3, 2008.



CONCLUSION

Eroding home equity and rising prices for gasoline and food, coupled with job losses, pose significant headwinds for U.S. economic growth. Although consumer spending continues to grow, it is questionable that households will be able to maintain current buying habits. Recent announcements by car makers of slower motor vehicle sales and production cuts are ominous signs of a continued deceleration in spending. The credit markets appear to have ended the celebration of aggressive rate cuts by the Federal Reserve Board and have shifted their focus to inflation, while keeping an eye on potential credit losses as the deterioration in mortgage loan performance persists. Interest rates continue to rise in response to the possible end to monetary easing and accelerating inflation. On a positive note, the mortgage securities market experienced some reduction in the log jam of bulging inventories. Yield spreads on agency securities stabilized in the last month, although they are not near “normal” levels yet. It is too soon to say all is well and we are at the end of a vicious downturn in the credit cycle; however, the past month suggests there may be fewer incidents of severe crises in the coming months.

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