

# More headaches ahead for the housing industry?

## Some see slide ending soon, but many see more trouble looming

By Kathleen M. Howley  
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BOSTON — The worst may be yet to come for the U.S. housing market, according to many economists who have been watching the extended slide.

The jump in 30-year mortgage rates by half a percentage point to 6.69 percent in the past six weeks is putting a crimp on borrowers with the best credit, just as a crackdown in subprime lending standards limits the pool of qualified buyers.

**The national median home price is poised for its first annual decline since the Great Depression, and the supply of unsold homes is at a record 4.2 million, the National Association of Realtors reported.**

"We're talking about a two- to three-year downturn that will take a whole host of characters with it, from job creation to consumer confidence," said Mark Kiesel, executive vice president of Pacific Investment Management Co., which manages \$668 billion in bond funds. "Eventually, it will take the stock market and corporate profit."

Confidence among U.S. homebuilders fell in June to the lowest since February 1991, according to the National Association of Home Builders/Wells Fargo index released this week. Housing starts declined in May for the first time in four months, the Commerce Department reported. New-home sales will decline 33 percent from 2005's peak to the end of this year, according to the Realtors' group, exceeding the 25 percent three-year drop in 1991 that helped spark a recession.

"It's not just a housing recession anymore; it looks more and more like an economic recession," said Nouriel Roubini, a Clinton administration Treasury Department director and economic adviser who now runs Roubini Global Economics in New York.

**The picture looks considerably different in Central Texas, where the home market is solid and prices continue to rise. But many other cities are seeing sharp drop in home sales.**

There are some important dissenters to the gloomy outlook school of thought.

Treasury Secretary Henry Paulson acknowledged last week that the housing downturn "has been a drag on the economy." But he added: "I do believe that we are at or near the bottom."

And Bank of America Corp. chief executive Kenneth Lewis declared that the housing slump is almost over.

"The drag stops in the next few months," Lewis said.

"We do not see a recession. Because that drag stops, you'll see the economy begin to pick up in the third and fourth quarters."

But the pain is real and widespread.

Homebuilding stocks are down 20 percent this year after falling 20 percent in 2006, according to the Standard & Poor's Supercomposite Homebuilding Index of 16 companies.

Before last year, the index had gained six fold in five years.

"There isn't a recovery about to happen," said Ara Hovnanian, chief executive of home builder Hovnanian Enterprises Inc. The company's share price has fallen 38 percent in the past year.

Goldman Sachs Group Inc., the world's biggest securities firm, and Bear Stearns Cos., the largest underwriter of mortgage-backed securities, blamed rising foreclosures for their falling profits.

David Viniar, Goldman's chief financial officer, said the troubles in the subprime mortgage market have yet to be fully felt by the investment banks, insurance companies, pension funds and asset-management firms that hold mortgage-backed securities.

Subprime mortgages, given to people with bad or limited credit histories, account for about \$800 billion of that market.

"I continue to believe that we haven't seen the bottom in the subprime market," Viniar said in a June 14 conference call. "There will be more pain felt by people as that works through the system."

Rising mortgage rates are prolonging the pain for the housing industry and for buyers.

**The average U.S. rate for a 30-year fixed mortgage was 6.69 percent last week, up from 6.15 percent at the beginning of May, according to Freddie Mac.**

**The recent increase in mortgage rates is the biggest spike since 2004. The change means buyers can afford 8 percent less house than they could five weeks ago, said Kiesel of PIMCO.**

Most economists don't expect rates to fall anytime soon, which means no relief for homebuyers.

The yield on the 10-year Treasury note, a benchmark for mortgage rates, is at 5.14 percent, up almost a half-percent since the beginning of the year.

Higher mortgage rates make it harder for people to qualify for loans, or to buy as much house as they would like. And with lenders tightening their standards, many buyers will be priced out of the market, economists say.

Roubini predicts the decline in home sales will last at least another 12 months, reducing the median house price by 5 percent this year and next. That would take home prices back to 2004, when the national median was \$195,200.

The primary cause of the 1990 to 1991 recession was a real estate boom and bust similar to the past seven years, Roubinis said.

He put the chance of a recession this year at 50-50, above former Fed chief Greenspan's 33 percent estimate.

"There is no doubt there is a slowdown going on in the U.S.," Greenspan said at a conference last month. "We are clearly having troubles in the capital investment area, as well as potentially in the consumption area and obviously housing being a significant drag."

Neal Soss, chief economist at Credit Suisse Holdings USA Inc., says that home sales won't increase in any sustained way until 2008, though the stumble probably won't cause a recession because the housing market hasn't reduced consumer spending.

"Here we are, a year and a half into the housing slowdown, and retail sales are off the chart," Soss said. The economy expanded at a 1.9 percent pace in the first quarter, compared with a year earlier, the smallest gain since the 1.8 percent rate in the second quarter of 2003, "but it hasn't collapsed, and I don't think it will," he said.

**Courtesy of JB Goodwin**