

Housing Market – Nov 21 2006

Housing: The riddle of rates and prices

NEW YORK – Nov. 21, 2006 – Conflicting data this week showed that the housing market, like a bull in the ring, is wounded yet still powerful. It takes an experienced toreador to discern whether the beast will succumb to the knife or come charging back. The course it takes may hinge on which matters more to buyers: falling interest rates [a big positive] or fear of falling prices [a big negative].

For now, at least, housing construction is clearly in a localized recession. The freshest evidence came on Nov. 17 from the Census Bureau, which announced that starts on construction of single-family homes plunged 14.6 percent in October, to the lowest level since July 2000. On top of that, permits fell 6.3 percent, to the lowest level since December 1997, indicating that construction could dip even further in the months ahead.

But that's not the end of the story. Buyers could still save the housing market, depending on how they react to current economic conditions. Mortgage rates, after rising at the beginning of this year, have dipped in recent months, from a peak of 6.80 percent on average for a 30-year fixed loan in July to 6.24 percent last month, according to Freddie Mac. There's also speculation that the Federal Reserve could cut rates in the months ahead, if inflation is under control and the economy flags.

Divided Economists

If buyers take heart from the decline in mortgage rates and step up to buy, the backlog of unsold homes could shrink quickly – especially with the production of new homes having abruptly fallen. That would put the market back on sound footing within a few months. On the other hand, if potential customers decide that an investment in housing is “dead money” because home prices are going to flatten or decline for an extended period, then no jiggering of interest rates is going to encourage them to part with their down payments.

Economists are sharply divided over the prospects for housing because they disagree over how potential buyers will react. Ian Shepherdson, chief North American economist of High-Frequency Economics in Valhalla, N.Y., is a bear on housing because he thinks the prospect of further price declines, or at least a lull, will scare away buyers. During the boom, he says, people were effectively being paid to buy homes because the annual appreciation they got was greater than the interest on their loans. That is no longer true.

But economists who are more bullish say buyers don't seem to be frightened despite the flood of bad publicity about housing. They point to the recent resilience of demand. For example, the Mortgage Bankers Assn. announced on Nov. 15 that its seasonally adjusted index of mortgages to purchase homes rose 2.7 percent in the week ended Nov. 10, to its highest level since July. The biggest factor: lower mortgage rates. Rates for 30-year fixed mortgages fell to 6.15 percent, their lowest since this past January.

Waiting for the Recovery

And people are putting those mortgage loans to work: Sales of both new and existing homes are up from their summer lows. "We're probably seeing the turn. We're starting fewer homes even though we're continuing to sell them," says Michael Englund of Action Economics.

The housing slump is far from over, but the conditions for an eventual recovery are in place: Builders are sharply cutting back, and buyers are cautiously continuing to buy. That means the backlog of unsold homes should begin to diminish. The welcome decline in mortgage rates may seem small compared to the reversal in price trends, from soaring to sinking. But it appears enough to put at least some people back in a buying mood.

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