

The Mortgage Corner

MORE WEAKNESS IN BUILDERS CONFIDENCE?

Builders' confidence remained at a 15-year low for the second consecutive month. Is this a sign of further deterioration in housing construction, or that the market is stabilizing. The Federal Reserve's first pause in rate hikes may help the housing market to stabilize.

Reacting to what they perceive as increasing consumer uncertainty regarding the market for new single-family homes, builders tempered their views on current and expected sales activity in the Wells Fargo/National Association of Home Builders Housing Market Index (HMI) for August, released today. The HMI declined seven points to 32, its lowest level since February of 1991. This was the seventh consecutive month in which builder confidence, as measured by the index, has fallen.

The index peaked at 72 in June 2005 and has fallen since then. This is the fastest decline in its 21-year history, according to CBS Marketwatch, and is a good predictor of housing starts.

"Two big factors are coloring builders' perceptions of the market right now – rising sales cancellations and substantial growth in inventories of both new and existing homes," said NAHB Chief Economist David Seiders. "These factors are largely the result of an increasing number of potential buyers adopting a 'wait-and-see' attitude because of uncertainty about where the housing market is headed, and record-high energy costs also appear to be weighing on housing demand. We're also seeing an anticipated withdrawal of investors/speculators from the market, following a major influx in 2004-2005."

Housing starts, which will be reported Wednesday, have fallen about 18 percent since its January peak. New home sales are down 17 percent from last July's peak.

Derived from a monthly survey that NAHB has been conducting for 21 years, the NAHB/Wells Fargo HMI gauges builder perceptions of current single-family homes and sales expectations for the next six months as "good," "fair" or "poor." The survey also asks builders to rate traffic of prospective buyers as either "high to very high," "average" or "low to very low." Scores for each component are then used to calculate a seasonally adjusted index where any number over 50 indicates that more builders view sales conditions as good than poor.

All three component indexes declined in August. The component gauging current single-family home sales fell seven points to 36, while the component gauging sales expectations in the next six months and the component gauging traffic of prospective buyers both fell six points, to 40 and 21, respectively.

Regionally, the HMI recorded a three-point decline to 34 in the Northeast, a five-point decline to 15 in the Midwest, a nine-point decline to 41 in the South and a 10-point decline to 42 in the West.

"It's important to recognize that home sales and housing production are subsiding from record levels a year ago, and those levels clearly were unsustainable," noted Seiders. "We expect the erosion in market activity to continue through most of this year

before stabilizing in 2007.” Seiders also noted that, historically, builder sentiment tends to contract by a greater margin than actual sales and production activity.

What will cause it to stabilize? The Federal Reserve’s August 8 pause after 17 consecutive rate hikes may signal a downward trend in interest rates. A major reason for the decline in housing construction and new home sales has been rising interest rates. This is while longer-term bond markets have been falling for months, with the 10-year Treasury bond yield at 4.93 percent at this writing, keeping fixed mortgage rates from rising. Short-term rates hover around the overnight fed funds rate of 5.25 percent, while the Prime Rate remained at 8.25 percent.

“On the bright side for consumers, the economy continues to be in fundamentally good shape, mortgage rates remain near historic lows, house price gains are decelerating, and builders are offering substantial buyer incentives to keep their inventories down. Such favorable market conditions certainly are reason for optimism among those in the market to buy new homes,” Seiders said.

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