

MARKET INDICATORS				
		This Week	Last Week	Last Year
MBA 30 Yr FRM	↔	4.94%	4.94%	4.99%
10 Yr T	↑	3.69%	3.66%	2.88%
Fed Funds	↔	.00%-.25%	.00%-.25%	.00%-.25%
Refi Index*	↓	2860	2894	4473
Purch Index*	↓	212	221	257
S&P 500	↑	1076	1066	827

*seasonally adjusted

RATES

Rates Mixed: 10-Year Treasury Yield Higher -- Mortgage Rate Flat

"...bond prices should remain under pressure in the near-term but it is time to watch the radar for clearing skies and a buying opportunity."

William O'Donnell, RBS, 02.18.10

- 10Y T yield higher in current week -- to 3.8% mid-week with more investors selling this week (stock market up, Fed discount rate hike, housing starts increase) -- (supply↑, price↓, yield↑)
- Last week 10Y T yield averaged 3.69% after holding at 3.66% for the previous three weeks
- In the short-term 10Y T yield expected to hold between 3.6%-4.0%
- Next week, numerous releases (see upcoming events) along with Bernanke's semi-annual monetary policy report to Congress complicate making a more solid prediction

"The Fed can talk all day about how the discount rate hike is technical and not a policy move, but the market sees it as a shot across the bow."

Chris Rupkey, Chief Financial Economist, Bank of Tokyo-Mitsubishi, 02.18.10

- Despite Fed-spoken reassurances that Fed funds rate would remain low for an extended period of time, Fed funds futures initial reaction was to increase the odds of a Sept. Fed funds rate hike to 70% shortly after the discount rate hike was announced (up from 54% the previous day)
- Prior to the discount rate hike, most economists weren't predicting a Fed funds rate hike until 2011
- The eventual increase in Fed funds rate is more likely to lift short-term Treasury yields rather than long-term Treasury bond yields that more directly impact mortgage rates

"I don't predict interest rates ... mortgage rates are affected by a number of things, not just housing finance, they are affected by things in macroeconomy, including Treasury rates."

Edward DeMarco, Acting Director, Federal Housing Finance Agency ("FHFA"), quoted on MarketWatch, 02.18.10

Mortgage Rate Held at 4.94% -- All Application Indices Down Slightly

- 30Yr FRM held at 4.94% for second straight week -- 3bp increase in 10Y T yield (3.69%) offset tighter spread (125bp)

- Spread between 123bp - 136bp for past nine weeks averaging 131bp (as high as 164bp; averaging 149bp in previous nine-week period)
- Total market application index fell 2% to 601 -- above 600 for three consecutive weeks after averaging 540 (Jan.) and 597 (Dec.)
- Total purchase app index dropped 4% to 212 from 221 and 238 in previous two weeks
 - Conv'l purchase app index sank 5% to 195 ... first reading below 200 since Christmas week -- lowest weekly reading since Aug. '95 (when 30Yr FRM was 7.85%)
 - Gov't purchase app index dipped 3% to 237 -- falling from 260 two weeks ago and 244 last week
- Total and conv'l refi app indexes were down 1% vs. prior week to 2860 and 2781, respectively; gov't refi index slipped 2% to 3309 -- above 3k for the past three weeks (averaged 2582 in Jan. '10)
- Conv'l refi share remained at 75% for second consecutive week (matching last month's average)
- Refi share of gov't apps fell one point to 48% this week -- averaged 47% in both Dec. & Jan.
- Share of conv'l ARM apps held at 9% for third straight week -- averaged 8% in both Jan. and Dec. based on dollar amount
- Based on number of loans, 5% of conv'l apps were ARMs - consistent with levels over the past three months

"We've reached the point of burnout ... most of the people who can refinance today have done so already."

Amy Crews Cutts, Deputy Chief Economist, Freddie Mac, quoted in The Washington Post, 02.14.10

- Freddie recently lowered their 30Yr FRM estimates to 5.0% in 1Q10 (down 10bp from Jan.'s forecast) with the remaining quarters in '10 down 30bp to 5.2% (2Q), 5.5% (3Q) and 5.7% by 4Q10
- Lower 30Yr FRM due to both lower 10Y T yield (3.6% in 1Q10) rising to 4.2% by 4Q10 and tighter spreads which are now expected to hold at 140bp in 1H 2010 and 150bp in second half of the year
- Freddie's '10 origination forecast was lowered to \$1.60T from prior month's \$1.75T prediction with a 50/50 split between purchase and refi originations ('11 originations \$1.7T, 30% refi share)
- Home price declines taper off throughout '10 then flatten or rise in '11
- Unemployment rate predicted to hold at 10.0% through 2Q10 then fall to 9.5% by 4Q10 (to average 9.0% in 2011)
- GDP 3.5% in 1H 2010 -- dipping to 3.3% in second half of the year
- Total home sales up 15% in '10 vs. '09, to 5.70MM then increase to 6.20MM in '11 a 9% VPY increase

"Mortgage rates are expected to rise because the Federal Reserve plans to stop buying mortgage-backed securities by the end of March. For the last year, the Fed has been buying more than four-fifths of newly issued mortgage bonds. When the central bank stops buying them, private investors will have to step in. By most indications, investors are more risk averse than the Fed when it comes to mortgages. To compensate for the perceived risk of new mortgages, investors might demand substantially higher interest rates."

Holden Lewis, bankrate, 02.18.10

Fed's continued support for Fannie and Freddie is contributing to tighter spreads between 30Yr FRM and 10Y T yield. Fed is also continuing to purchase MBS (\$11B net in each of the past two weeks) which is keeping mortgage rates down (with seven weeks to go before the 3/31/10 deadline Fed has room to purchase an additional \$55B MBS to reach their \$1.25T commitment). Since the Fed has clearly communicated their intentions to the markets, there

may be just a slight upward adjustment to mortgage rates (via wider spread) after the March 31 deadline -- although others suggest rates will rise 50bp as soon as the Fed ends their program. These are unprecedented times which result in varying predictions on what will occur next quarter ...

- "I do believe that private investors, whether domestic or international, will be stepping in [to purchase MBS]." Edward DeMarco, Acting Director, Federal Housing Finance Agency ("FHFA"), quoted in *American Banker*, 02.19.10
- "It's difficult to know exactly what will be sufficient to entice private investors back in." Michael Fratantoni, Director of single-family research and economics, Mortgage Bankers Association, quoted on *bankrate* 02.18.10

Rates Sources: Federal Reserve, Moody's Economy.com, MBA, Freddie Mac, bankrate, RBS

ECONOMY

Inflation Tame in January

"Pricing power is likely to be contained by ample slack."

Maury N. Harris, *Economist*, UBS, 02.18.10

- Consumer Price Index ("CPI"), a measure of average change in prices of household goods and services, rose 0.2% in Jan. ... predicted to rise to 0.3% ... increasing at a 0.2% monthly pace since Sept. '09
 - Energy prices soared 2.8% largely fueled by 4.9% increase in gas prices
 - Food prices grew 0.2% in Jan. vs. Nov.'s and Dec.'s 0.1% increases
- Core CPI, excluding food and energy, (0.1%) was expected to hold at Dec.'s 0.1% ... first decline in core CPI since Dec. '82
 - Drop in core CPI due to 0.5% decline in shelter costs driven by the (2.1%) reading in 'lodging away from home' category
- In the past twelve months, CPI has increased 2.6% (food down 0.4%, energy prices up 19.1%)
- More closely watched core CPI is up 1.6% in the past twelve months

"Given the massive amount of slack in the U.S. economy, this first decline in core prices in over a quarter century is probably not the last. ... While credit markets have improved sufficiently for the Fed to unwind its emergency lending support, the benign inflation picture suggests no reason to tighten policy rates for an 'extended period'."

Sal Guatieri, *Economist*, BMO Capital Markets, quoted on *MarketWatch*, 02.19.10

- Producer Price Index ("PPI"), a measure of average change in domestic producers of goods and services prices, increased 1.4% ... above expected 0.8% gain and Jan.'s 0.4%
 - Energy prices up 5.1% vs. 0.7% in Dec.
 - Food prices grew 0.4% -- down from Dec.'s 0.7% rise (food prices more volatile in PPI than in CPI)
- Core PPI, excluding food and energy, was up 0.3% vs. predicted 0.1% and 0.0% in Jan.
- PPI tends to jump in Jan. as pricing power is tested -- remaining months of the year tend to be less volatile
- Annual adjustments are reflected in Jan. CPI and PPI releases

Tame inflation reports are supportive of Fed funds remaining at a low rate and also helps sustain demand for long-term bonds (demand↑, price↑, yield↓) which influence mortgage

rates.

"Extreme arguments counting on labor slack on the one hand or high levels of bank reserves on the other to cause a price collapse or a hyper inflation ignore offsetting factors that suggest relatively stable prices."

Steven C. Wieting, Citi, 02.19.10

Economy Sources: Bureau of Labor Statistics, MarketWatch, UBS

HOUSING

Builder Confidence Rose In February -- Outlook Less Than Rosy

"Several limiting factors are still weighing down builder expectations ... Credit remains tight for construction projects, foreclosures remain high and priced-to-move distressed property sales are pulling down comparative values."

David Crowe, Chief Economist, National Association of Home Builders, 02.16.10

- The Housing Market Index ("HMI") - a measure of builders' confidence in the housing market - rose two points in Feb. to 17
- HMI has been holding with +/-2pts of 17 since May '09 -- up from single-digits Nov. '08 through March '09
- Increase in Feb. driven by improved future and present indices while prospective buyers traffic index held at 12
- Regionally, indices were mixed: two point improvements in the Midwest (lowest region with a reading of 13) and South (19) and one point declines in West (14) and Northeast (19)
- HMI is a weighted average of three diffusion indices: present, future (six months out) and prospective buyers traffic with each builder (no matter the size) given equal weight
- Reading over 50, which hasn't occurred since Apr. '06 would imply builder's perception of good sales outweighs those viewing conditions as bad

Higher Housing Starts in January Exceeded Expectations

"Housing starts have stopped plunging but have yet to show a sustained uptrend."

Greg Robb, Senior Reporter, MarketWatch, 02.17.10

- Housing starts climbed 2.8% in Jan. to a 591,000 annual pace -- slightly better than consensus 580,000 and above Dec.'s 575,000 pace
 - Multi-family starts increased 9.2% in Jan. ... higher monthly volatility in this sector than in single-family starts
- Single-family housing starts rose to 484,000 -- up 1.5% from Dec. and 35.6% higher than Jan. '09
 - More than half of the single-family housing starts were in the South region despite the 0.4% decline in Jan. to 257,000
 - Midwest region also saw a 5.1% drop to 75,000 in Jan.
 - Single-family housing starts rose 15.9% in the Northeast -- yet remain lowest in the nation at 51,000
 - Starts were up 5.2% in West to 101,000
 - Single-family housing starts were higher than year-ago levels across all the regions
- Despite low demand for new homes and a plethora of existing homes available for sale, some of the larger builders seem to be adding inventory in preparation for potential buyers looking to take advantage of the tax incentive.

- New home sales will be covered in next week's Microscope -- they are expected to fall to 325,000 from Dec.'s 342,000 (inventory was flat at 234,000 Nov.-Dec. while months' supply rose 1.3mos to 10.2mos in Dec.)

"Builders remain pessimistic, but are nonetheless ramping up production."

Brian Bethune and Nigel Gault, Economists, IHS Global Insight, 02.16.10

- Total housing permits were down 4.9% to 621,000 -- just below expectations after Dec.'s 14-month high 653,000
 - Permit issuance 16.9% above year-ago levels
- Single-family housing permits were up 0.5% to 507,000 -- below consensus estimate of 590,000
- Regionally, single-family permits were mixed:
 - South up 2.3% to 270,000
 - West rose 0.9% to 110,000
 - Midwest posted a 3.8% decline to 75,000
 - 3.7% drop in Northeast to 52,000
- Building permits, a less volatile early indicator of housing starts activity, may also be up in anticipation of increased single-family home buying activity ahead of the April 30th tax expiration

"It is a matter of time before the tax credit drives starts to new highs."

Ian Shepherdson, Chief U.S. Economist, High Frequency Economics, quoted on MarketWatch, 01.17.10

Housing Sources: U.S. Census Bureau, Moody's Economy.com, NAHB, IHS Global Insight

UPCOMING EVENTS

Consumer Confidence (Feb.)	2/23
New Home Sales (Jan.)	2/24
Durable Goods Orders (Jan.)	2/25
GDP (4Q09 - 2 of 3)	2/26
Existing Home Sales (Jan.)	2/26

