CHMURAECONOMICS&ANALYTICS

House Appropriations Annual Retreat: Economic Update

November 13, 2007

CHMURAECONOMICS&ANALYTICS

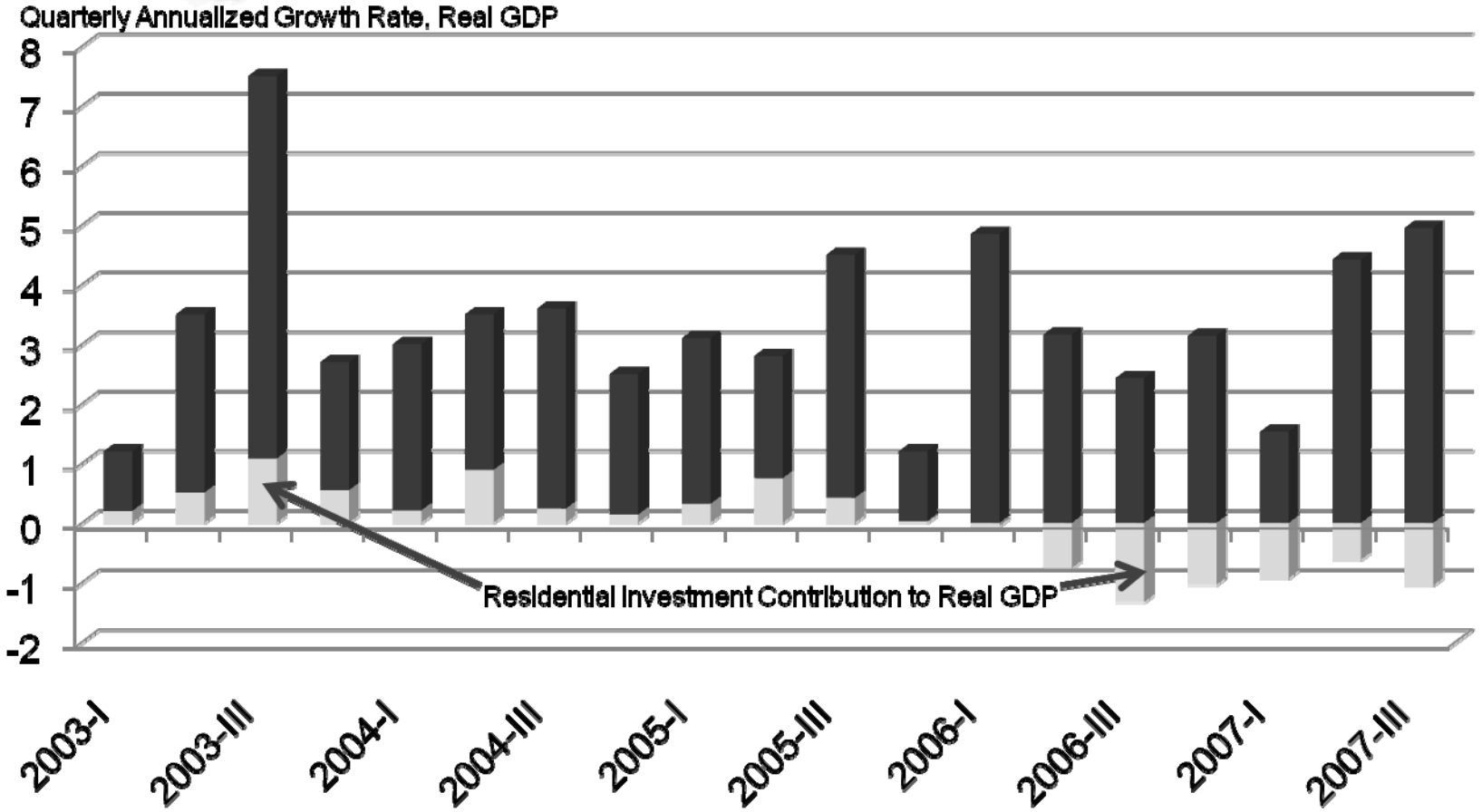
Overview

- Housing and subprime mortgage issues lead to greater uncertainty around national growth
  - Lack of home price appreciation = less consumer spending
  - Sub-prime mortgage issues = tighter bank lending
  - No recession but little room left for Fed to ease
  - Slowdown is MAINLY in housing-related industries
- Virginia ranked 13th in the nation
  - Housing market in RELATIVELY good shape
  - Home prices not negative (yet)
  - Overall economy growing

Impact of Housing on U.S. Economy

- Reduction in real GDP from decline in housing investment
- Increases in home equity propelled consumer spending…when will that support end?
- Subprime mortgage's with ARMs – 450,000 per qtr through end of 2008 reset
- Bank credit crunch?

Residential Building Impact on Real GDP



Lack of Home Price Appreciation is Slowing Consumer Spending

- 2004 Joint Center for Housing Studies, Harvard University: housing wealth effect
  - Consumer spend 5.5¢ of every $1.00 of housing wealth increase
  - Spending occurs over a little more than a year
  - Wealth from stock market takes several years to filter into consumer spending
- Estimated total value of owner-occupied homes in US; Increased based on HPI
- **2006 Q2 PEAK** in housing wealth impact on economy
  - About $1.69 trillion increased home wealth spent over 4 qtrs; 18% of $9.34 trillion annualized consumer spending 2006 Q2
  - 2006 home price appreciation 10.2% yoy
- **2007 Q1** home price appreciation 4.3% yoy **= $1.3 trillion** increased home wealth spent over 4 quarters
- **2007 Q3 $390 billion** increased home wealth with home prices going flat (0.5% of $8,305.3 billion consumer spending)

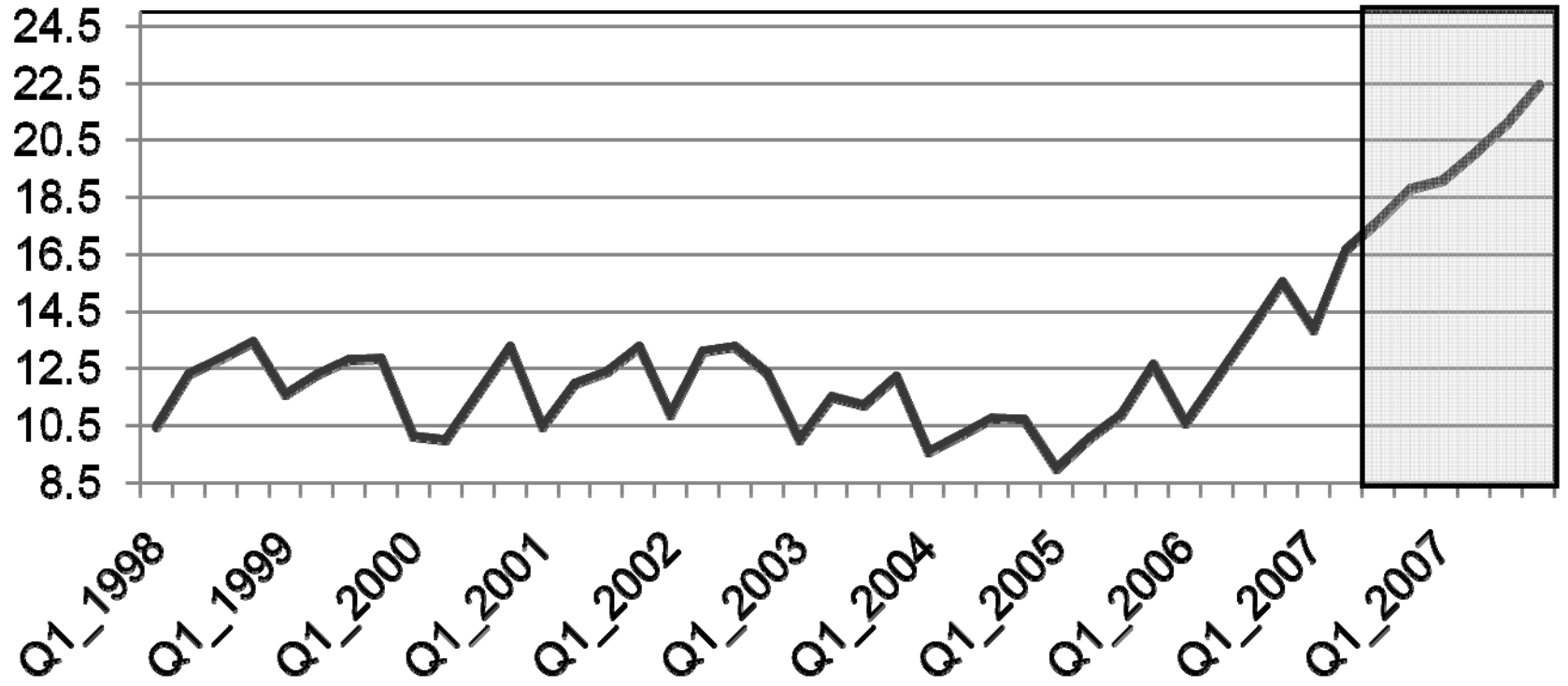
Subprime and Foreclosures

- 2000 quarter 1
  - Subprime accounts for 0.7% of all mortgages
  - Subprime accounts for 3.3% of all foreclosures
- 2001 quarter 1
  - Subprime accounts for 1% of all mortgages
  - Subprime accounts for 5.7% of all foreclosures
- 2007 quarter 2
  - Subprime accounts for < 7% of all mortgages
  - Subprime accounts for 38% of all foreclosures
- 450,000 resetting subprime ARMS each qtr through 2008 qtr 4. Assume all go Past Due…Worst Case Scenario
- 2008 quarter 4
  - Subprime accounts for < 5% of all mortgages
  - Subprime accounts for 52% of all foreclosures

Source of historical data: Mortgage Bankers Assoc.; Chmura created forecast.

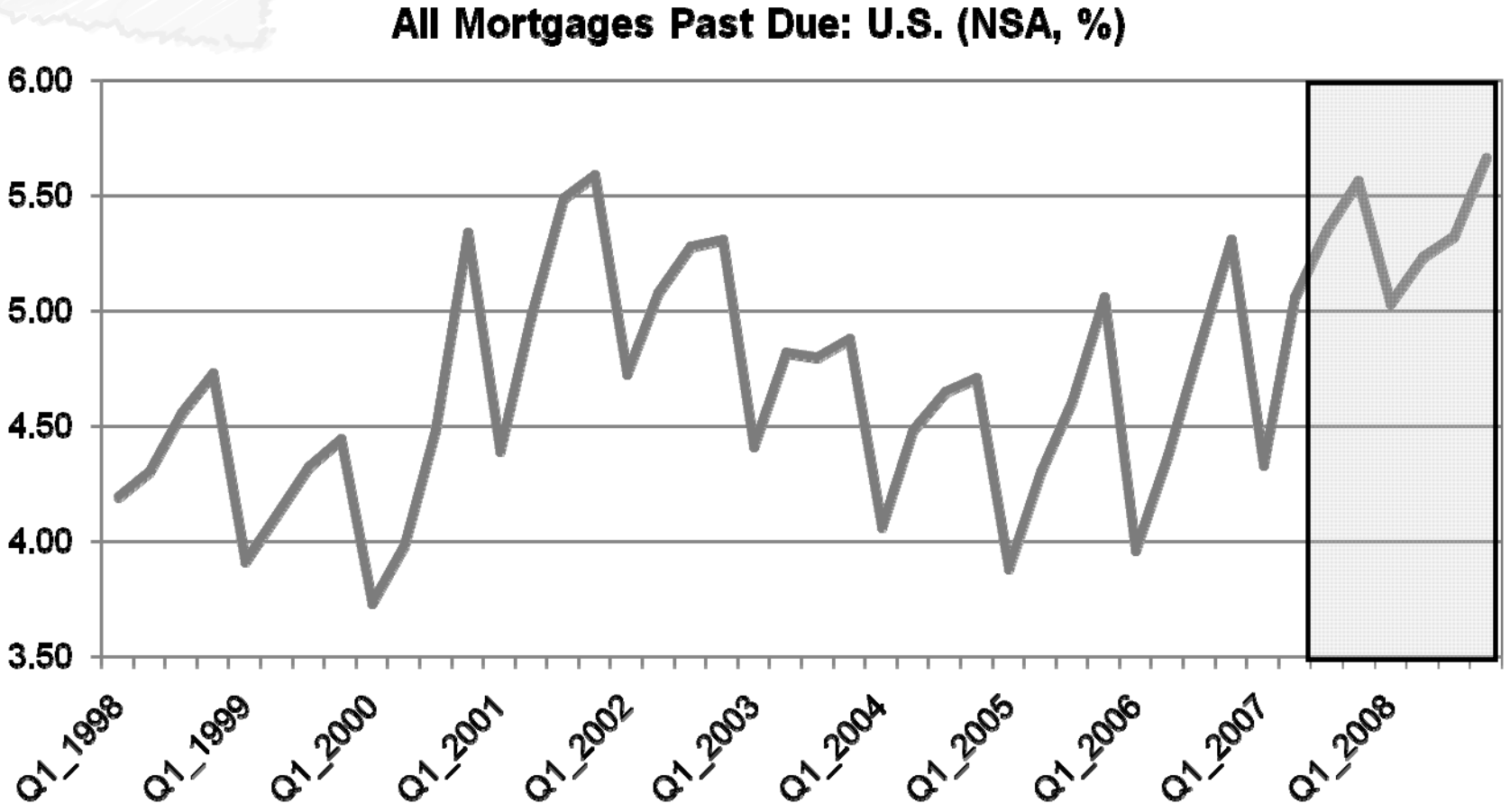
Assume 450,000 Resetting Subprime ARMS Go Past Due

Conventional Subprime ARM Mortgages: Total Past Due*: U.S. (NSA, %)



*Past due is 30, 60, and 90 days old.
Source of historical data: Mortgage Bankers Assoc.; Chmura created forecast.

Assume 450,000 Resetting Subprime ARMS Go Past Due



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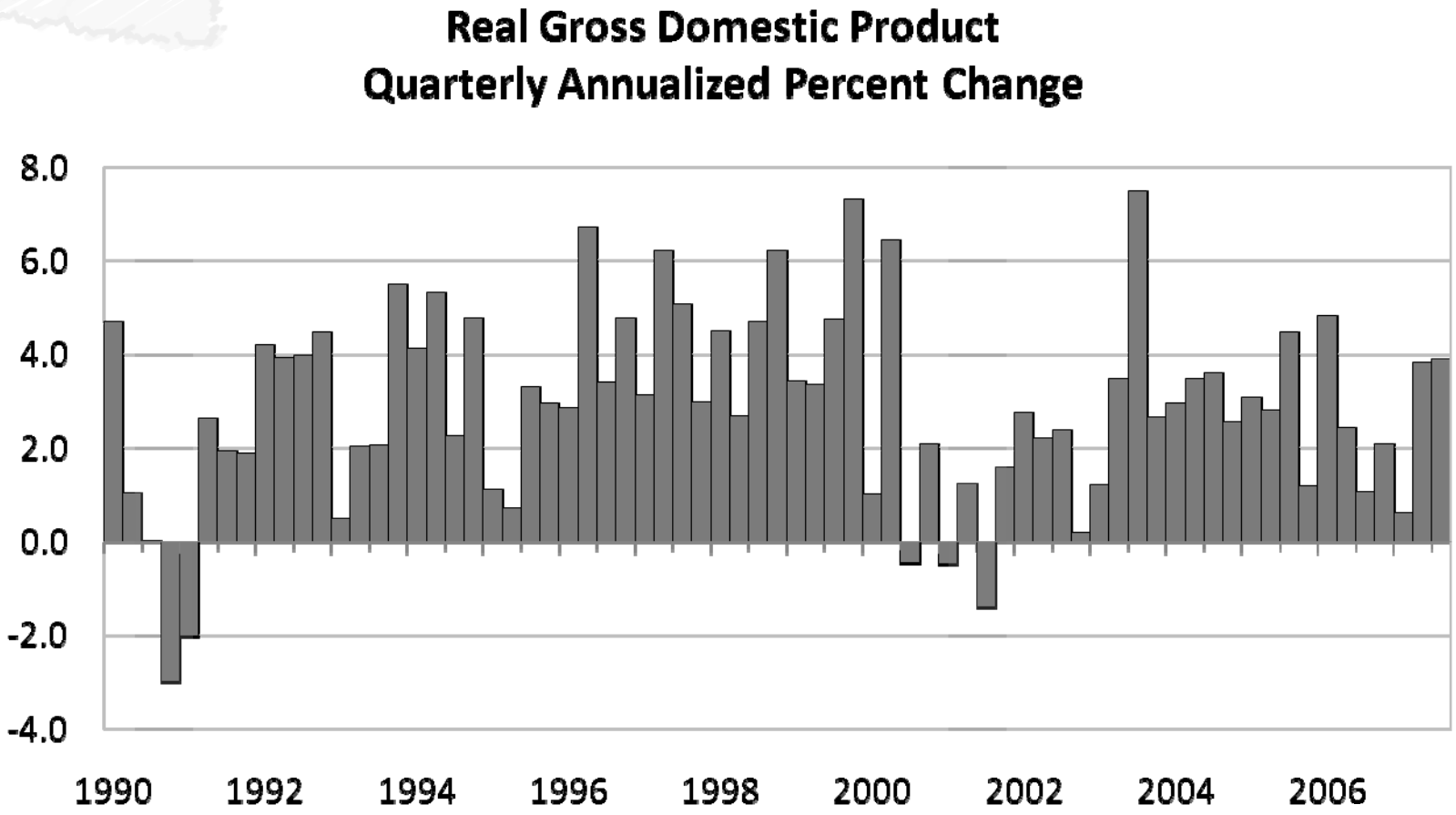
Source of historical data: Mortgage Bankers Assoc.; Chmura created forecast.

Credit Crunch? Recent Fed Comments

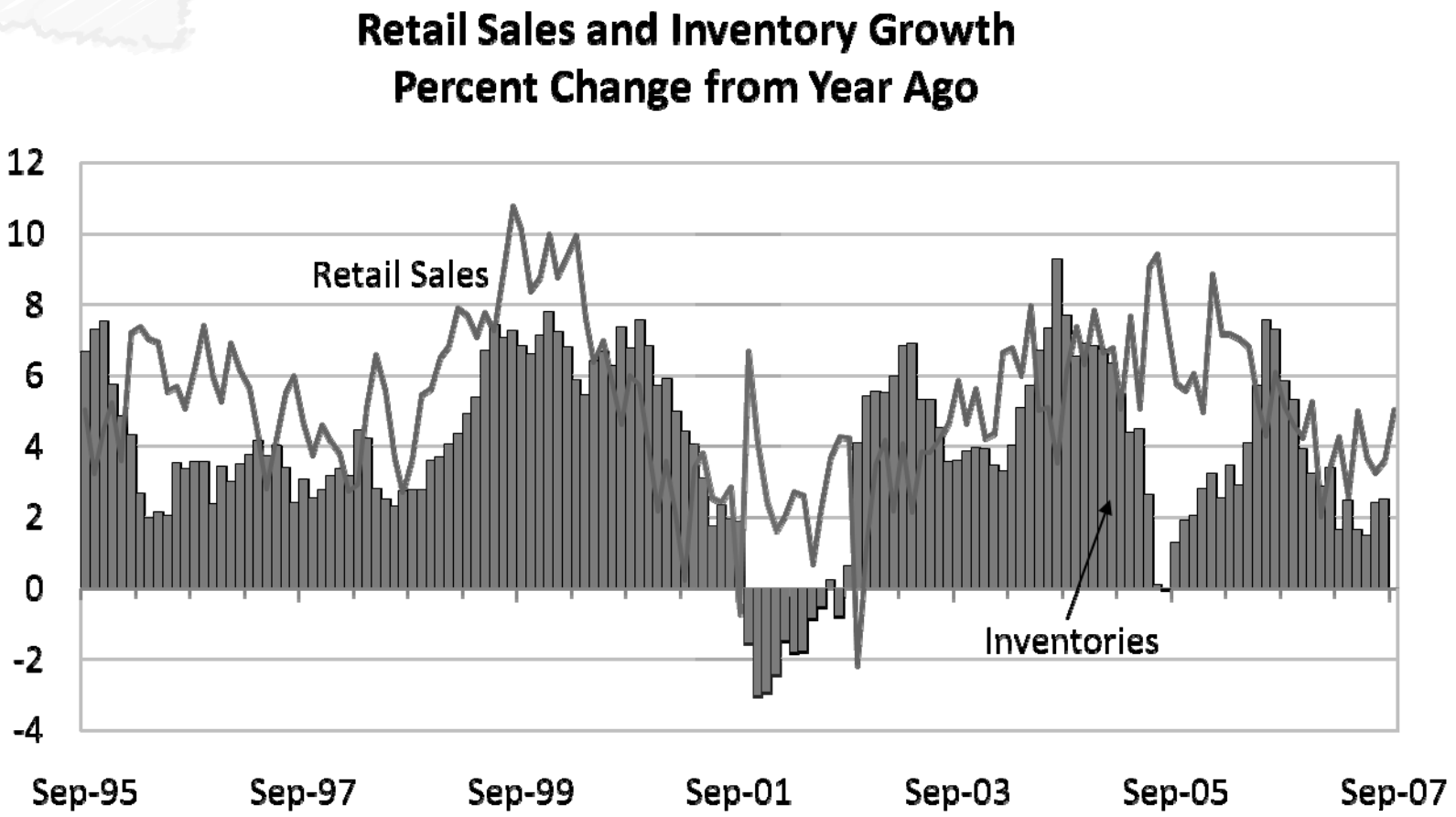
- David Kohn, Oct. 5, 2007
  - '..credit availability is likely to be a little tighter than before…'
  - '…we would not have eased policy if the outlook for inflation had not been favorable.'
  - '…you should view these forecasts even more skeptically than usual.'
- Chairman Bernanke, Nov. 8, 2007
  - "He said the Fed's policy committee sees growth slowing "noticeably" in the current quarter and remaining "sluggish during the first part of next year" but "then strengthening as the effects of tighter credit and the housing correction began to wane." (WSJ, 11/9/07)

Real GDP Almost Stalled in 1st Qtr; Near 4% in 2nd and 3rd Quarters



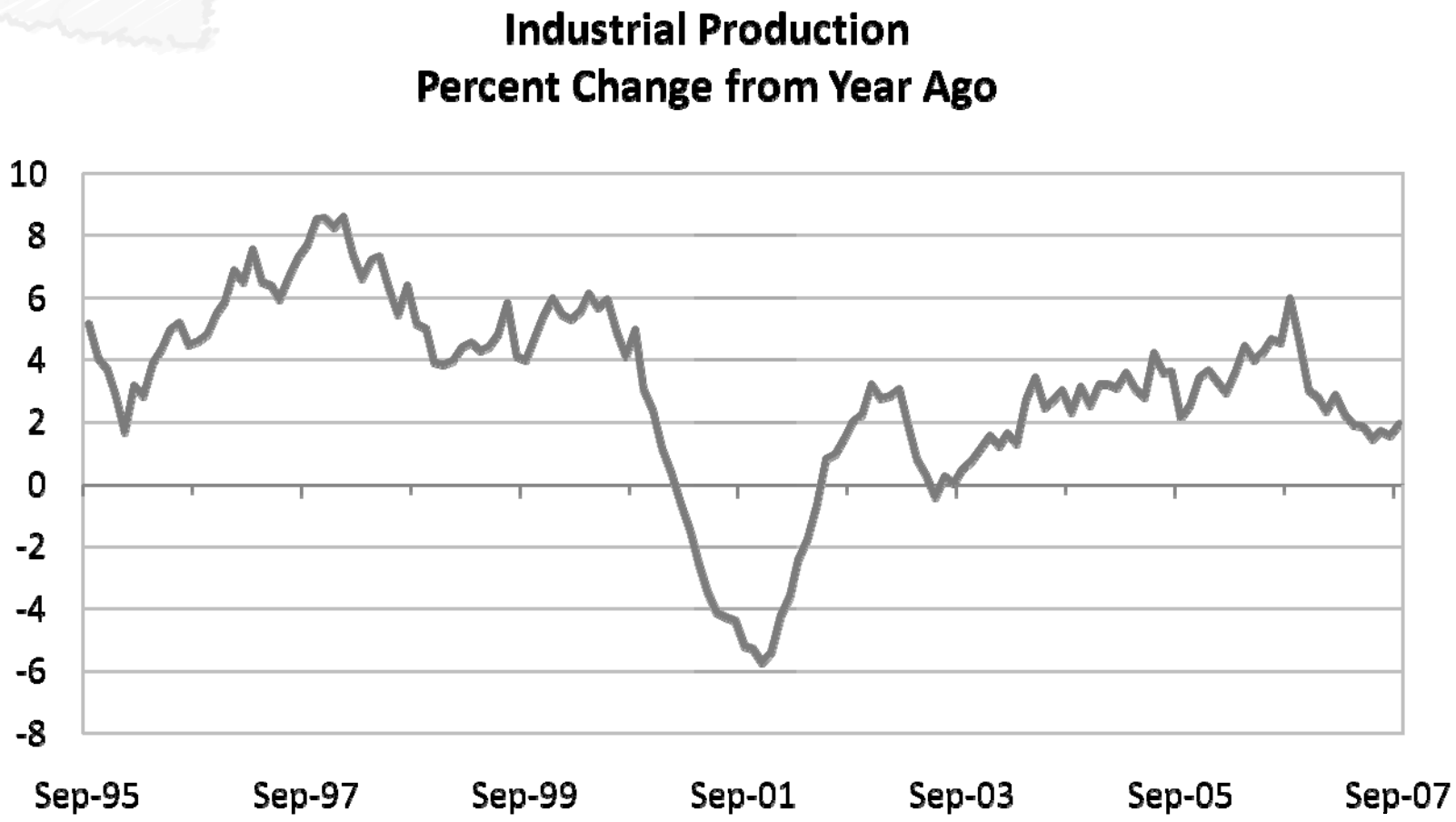
Data through 3rd Quarter 2007.
Recessions are shaded.

Consumers are Still Spending
No Inventory Imbalances



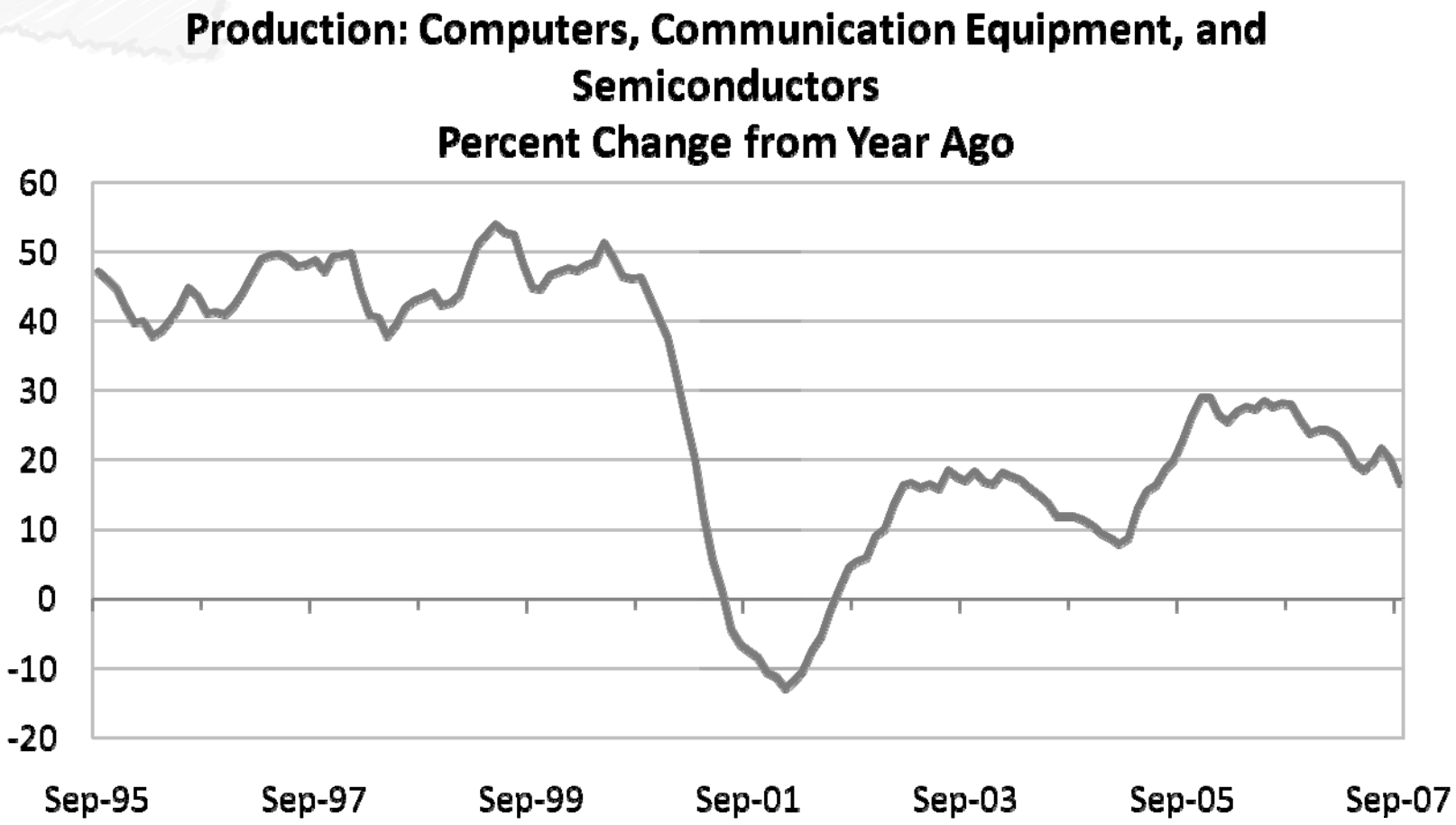
Data through September 2007.

Industrial Production Slowed But Still Growing



Data through September 2007.

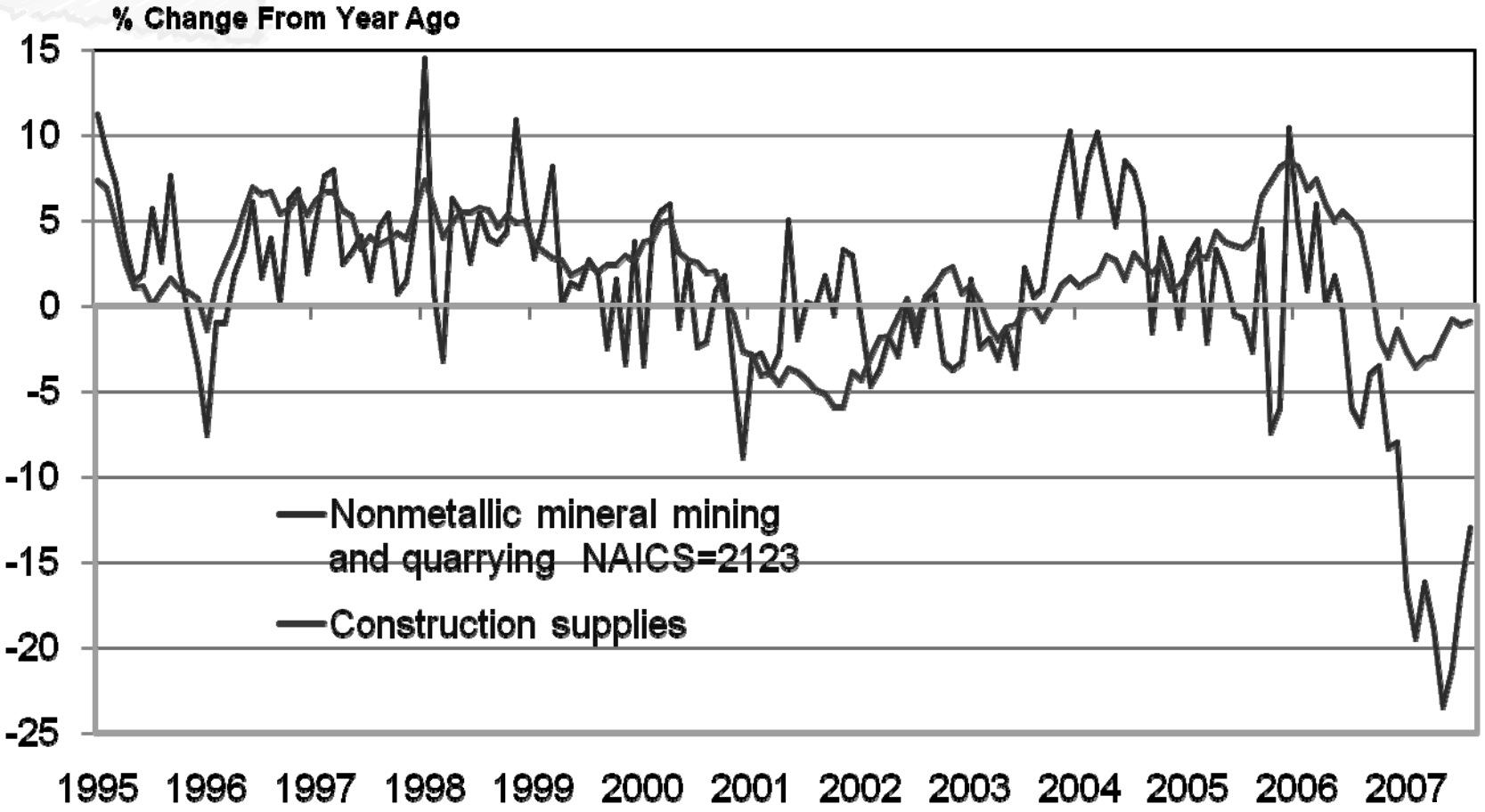
IT Output Still Near 20%



Data through September 2007.

Slowdown is Mainly Housing-Related

(Production for Housing Materials is Off)



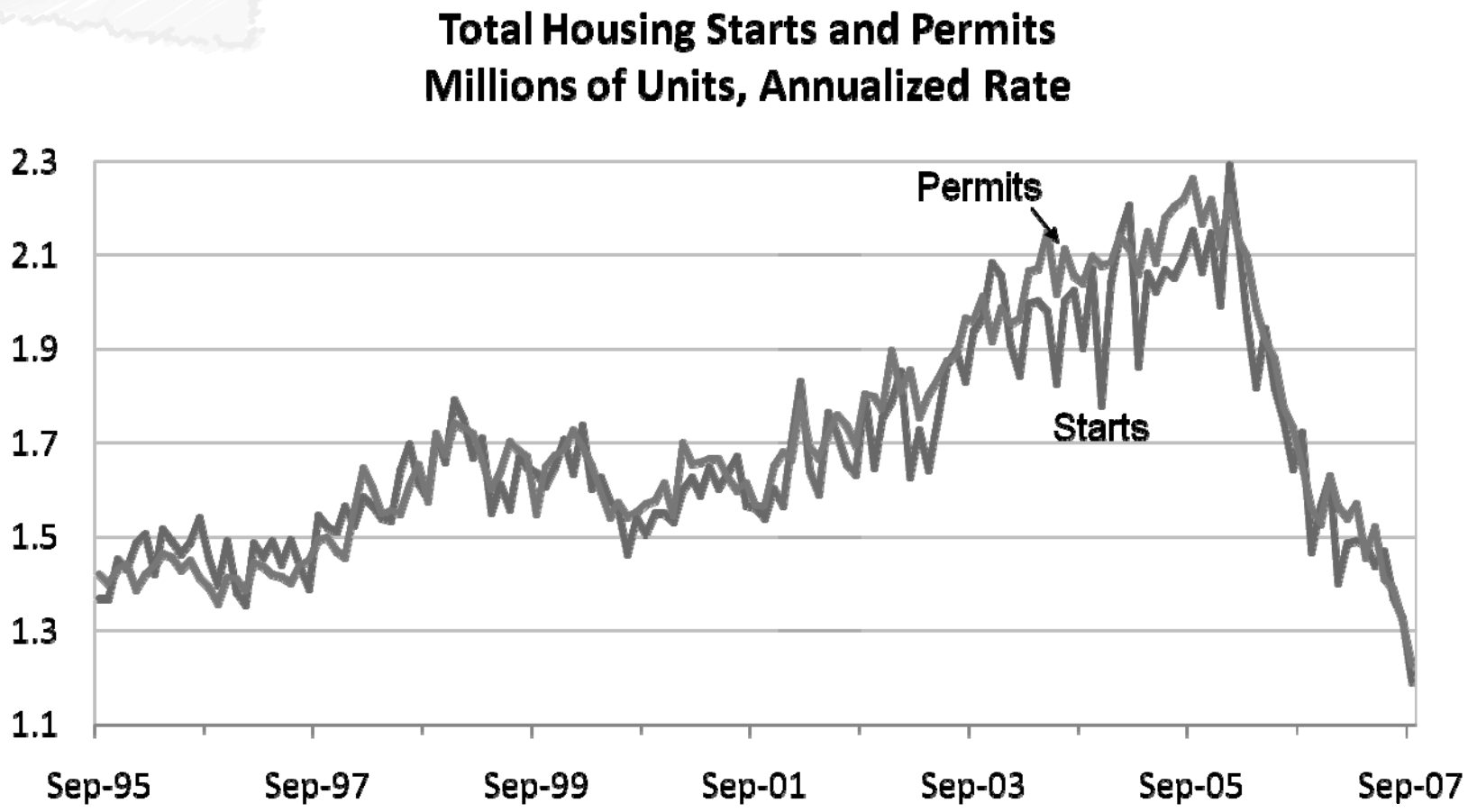
Data through August 2007.

U.S. Employment Off in Housing-Related Industries

(Selected Industries, June – October 2007)

Total nonfarm	**448,000**
Construction	**-64,000**
Residential building	-26,000
Nonres trade contractors	24,000
Manufacturing	**-87,000**
Wood products	-9,000
Furniture and related products	-7,000
Retail trade	**-32,000**
Furniture stores	1,000
Electronics and applicance stores	-10,000
Bldg material and garden supply stores	-33,000
Financial activities	**-8,000**
Credit intermediation and related activities	-32,000
Depository institutions	16,000
Real estate	6,000
Professional business services	**144,000**
Education and health services	**192,000**
Leisure and hospitality	**141,000**

Housing Sector is in Recession (12-Year Low, Down 19% From Year Ago)



Data through September 2007.

National Forecast

	2006-2007 Actual				2007-2008 Forecast			
	Qtr 4	Qtr 1	Qtr 2	Qtr 3*	Qtr 4	Qtr 1	Qtr 2	Qtr 3
Quarterly Annualized Rates								
Real Gross Domestic Product	2.1	0.6	3.8	3.9	2.4	2.4	2.7	2.6
Consumptions Expenditures	3.9	3.7	1.4	3.0	1.8	2.2	3.0	2.8
Residential Investment	-17.2	-16.3	-11.9	-20.1	-10.0	-3.5	-0.3	4.2
Nonresidential Investment	-1.4	2.1	11.0	8.0	1.8	2.3	2.8	2.2
Equipment and Software	-4.9	0.3	4.7	5.9	2.2	2.3	2.3	2.0
Government Expenditure	3.5	-0.5	4.1	3.7	3.4	-1.1	-0.3	2.2
Net Exports, Goods & Services	-597.6	-612.4	-574.1	-546.4	-524.5	-497.5	-486.0	-477.9
(Billions of 2000 Dollars)								
Percentage Change from a Year Ago (%)								
Consumer Price Index	2.0	2.4	2.6	2.4	2.8	2.8	2.7	2.6
Yields (%)								
Federal Funds Rate	5.2	5.3	5.3	5.1	4.6	4.5	4.5	4.5
Prime Rate	8.2	8.3	8.3	5.1	7.6	7.5	7.5	7.5
10-Year Treasury	4.6	4.7	4.8	4.7	4.5	4.7	4.7	4.9
30-Year Conventional Mortgage	6.2	6.2	6.4	6.6	6.4	6.3	6.4	6.6

Source: Chmura Economics & Analytics

Note: Yields reported for the average of the quarter

Fed's Preference? Recession or Accelerating Inflation?

- *"The Federal Reserve sets the nation's monetary policy to promote the objectives of **maximum employment, stable prices, and moderate long-term interest rates**. The challenge for policy makers is that tensions among the goals can arise in the short run and that information about the economy becomes available only with a lag and may be imperfect."*
- *The Federal Reserve has supervisory and regulatory authority over a wide range of financial institutions and activities. It works with other federal and state supervisory authorities to **ensure the safety and soundness of financial institutions….***
- August 17 action was sector-specific (liquidity in financial markets)
- September 18 action acknowledged spillover to the broader economy
- Recession worries?

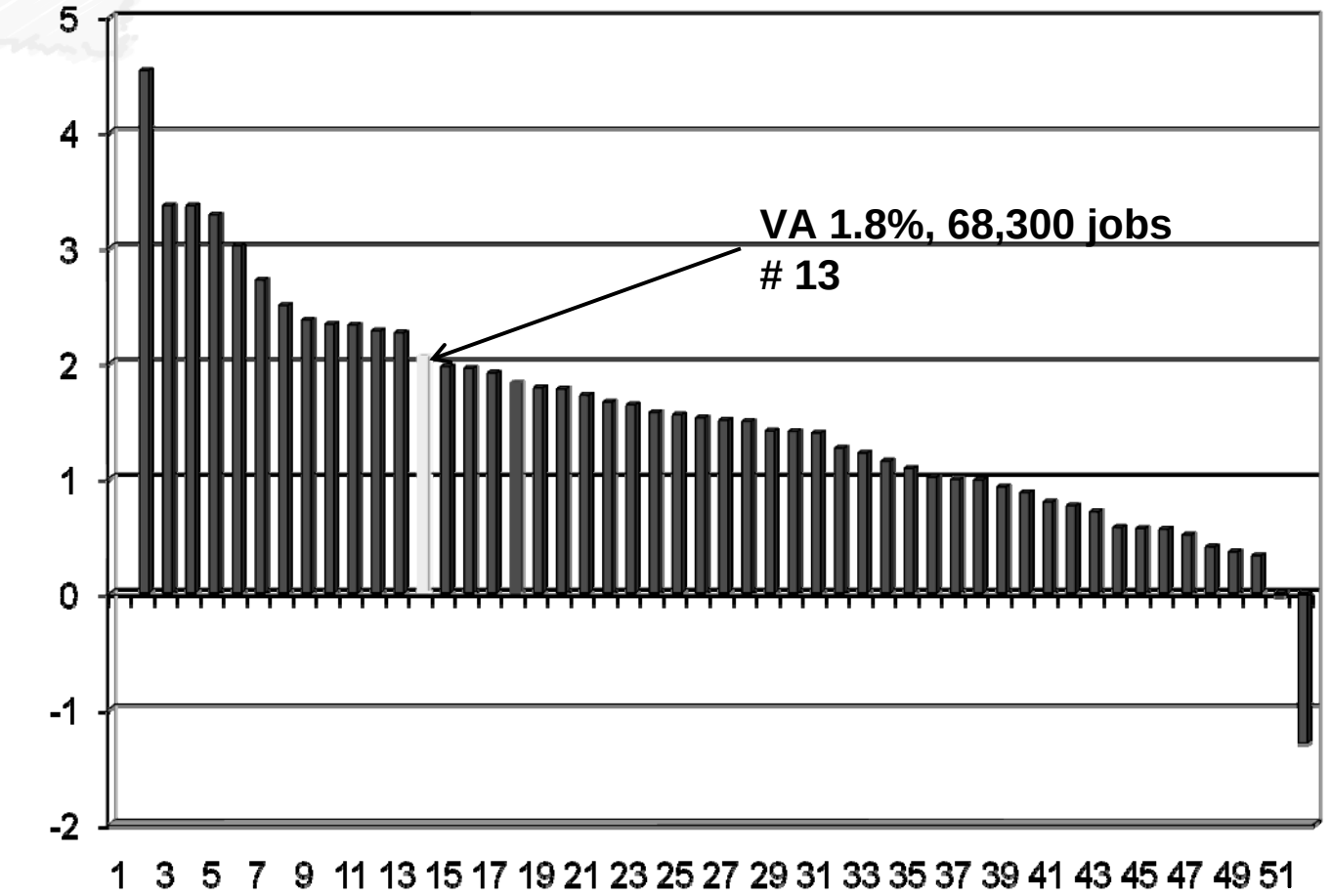
Will the Fed Ease Further?

- Today's data suggest they don't need to
  - Economy is growing
  - But how will the consumer react?
- Inflation is at the top end of the Fed 'comfort zone' (argues against easing)
  - Weaker dollar causes higher import prices
  - Oil prices
- Interest rates are close to neutral

Virginia Compares Favorably to Other States

- Employment
- Home price appreciation
- Mortgage delinquency rates
- Residential real estate foreclosures
- But real estate is still in recession
  - Permits
  - Inventory and sales

State Rankings, Employment Year-over-Year September 2007



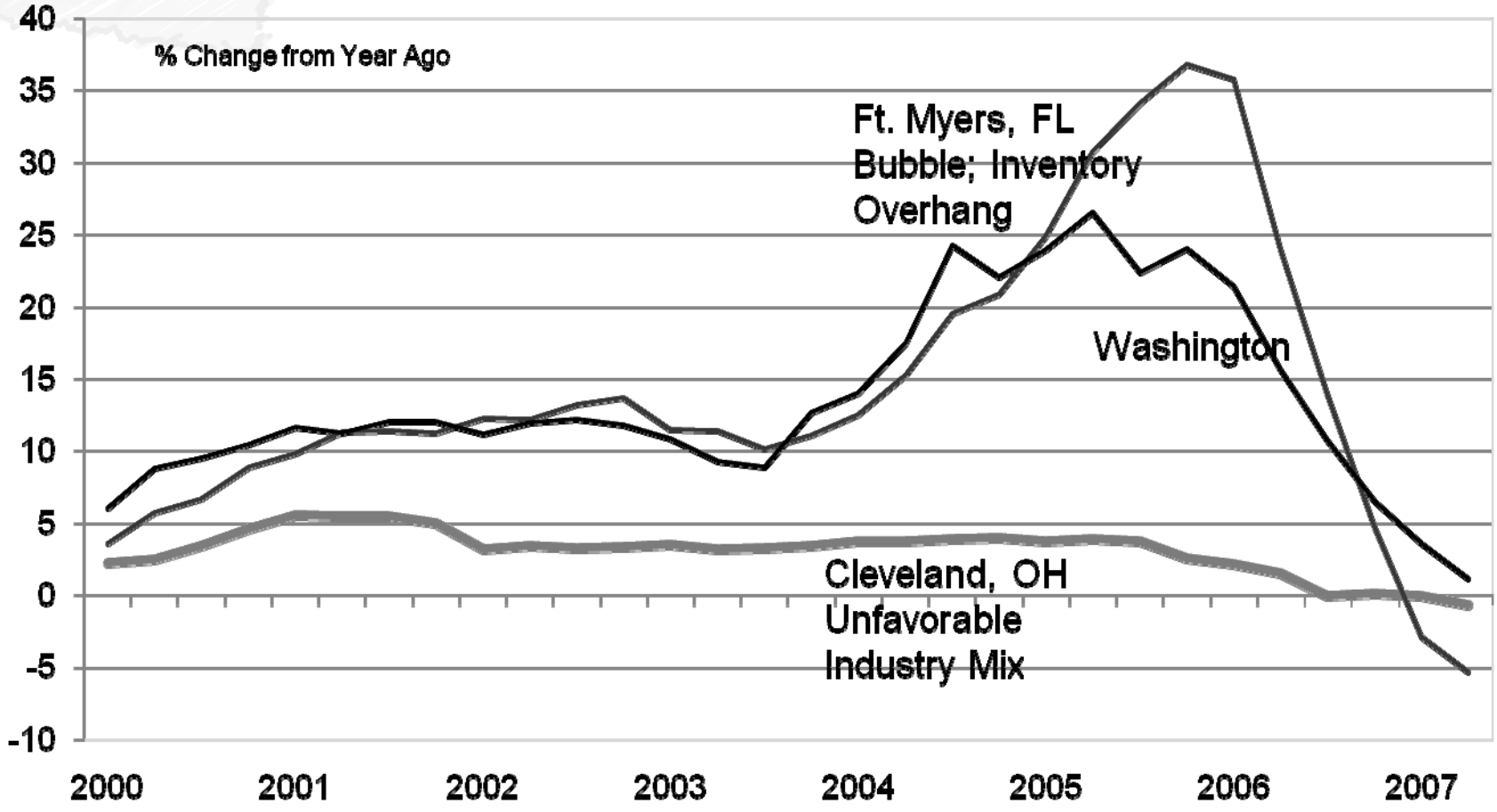
Utah +4.4%

Wyoming +3.3%

Ohio 0.01%

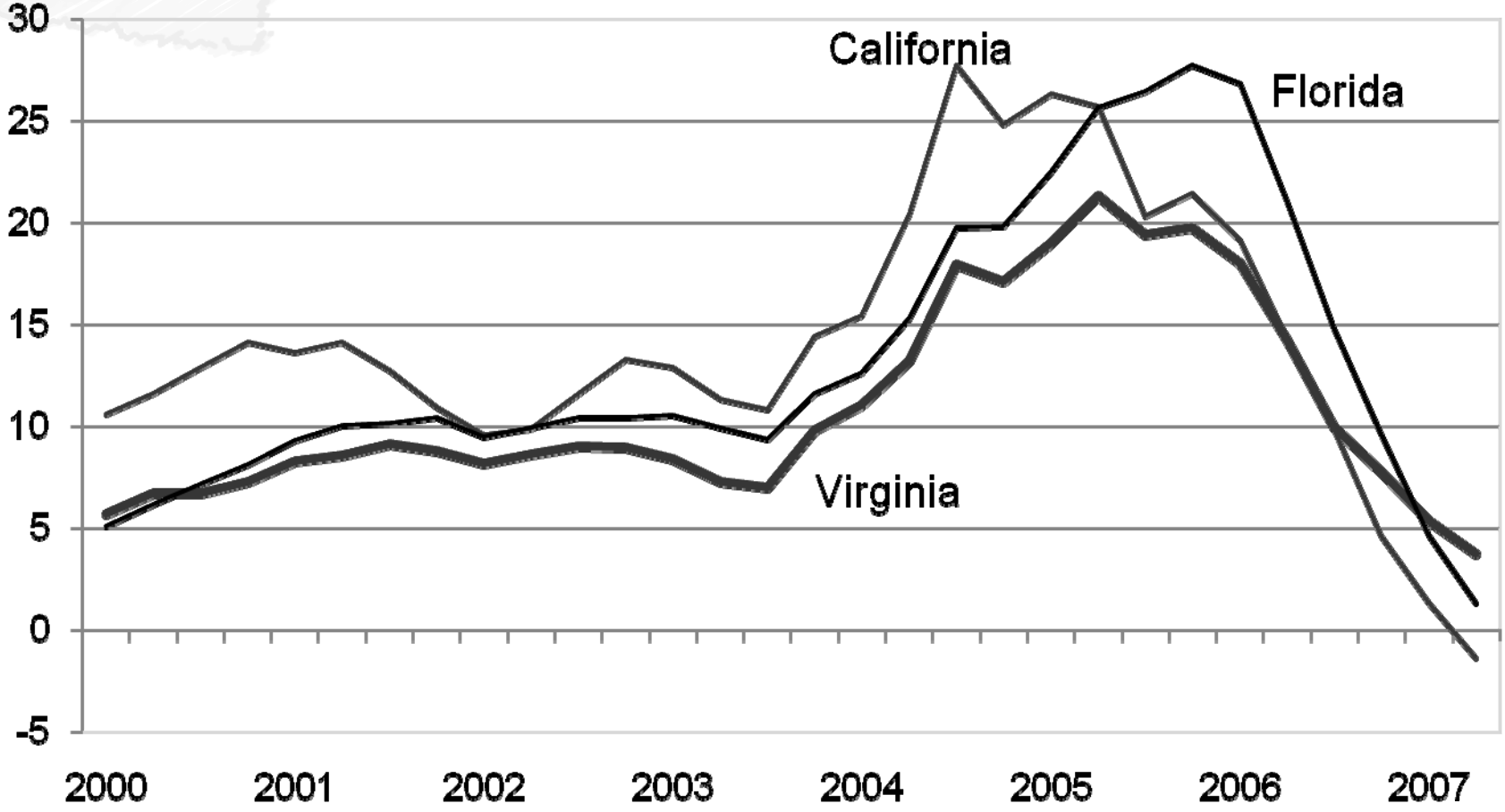
Michigan -1.5%

Home Price Appreciation (Metropolitan Areas)



Source: Office of Federal Housing Enterprise Oversight
Data through 2nd quarter 2007.

Home Price Appreciation by State



Source: Office of Federal Housing Enterprise Oversight
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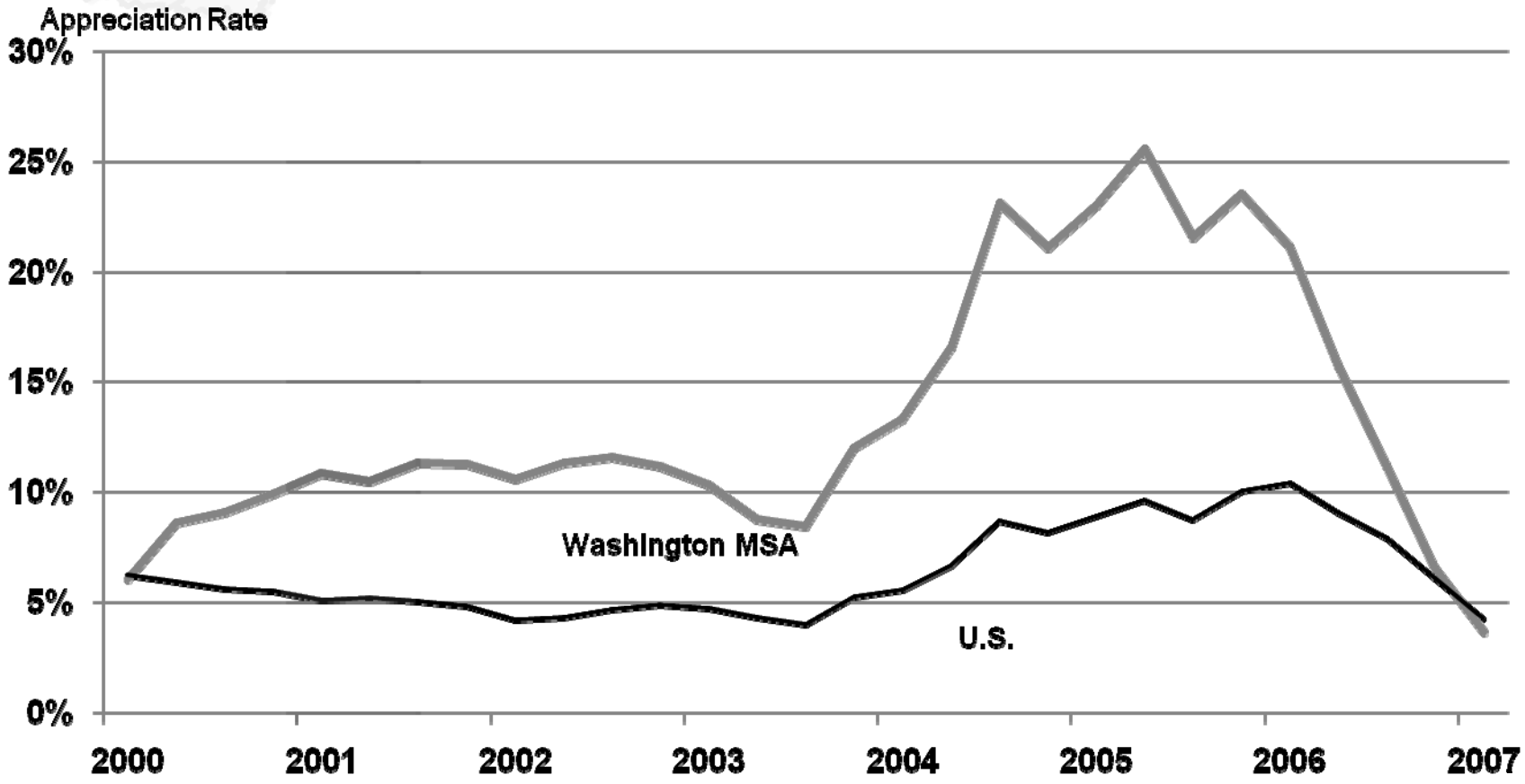
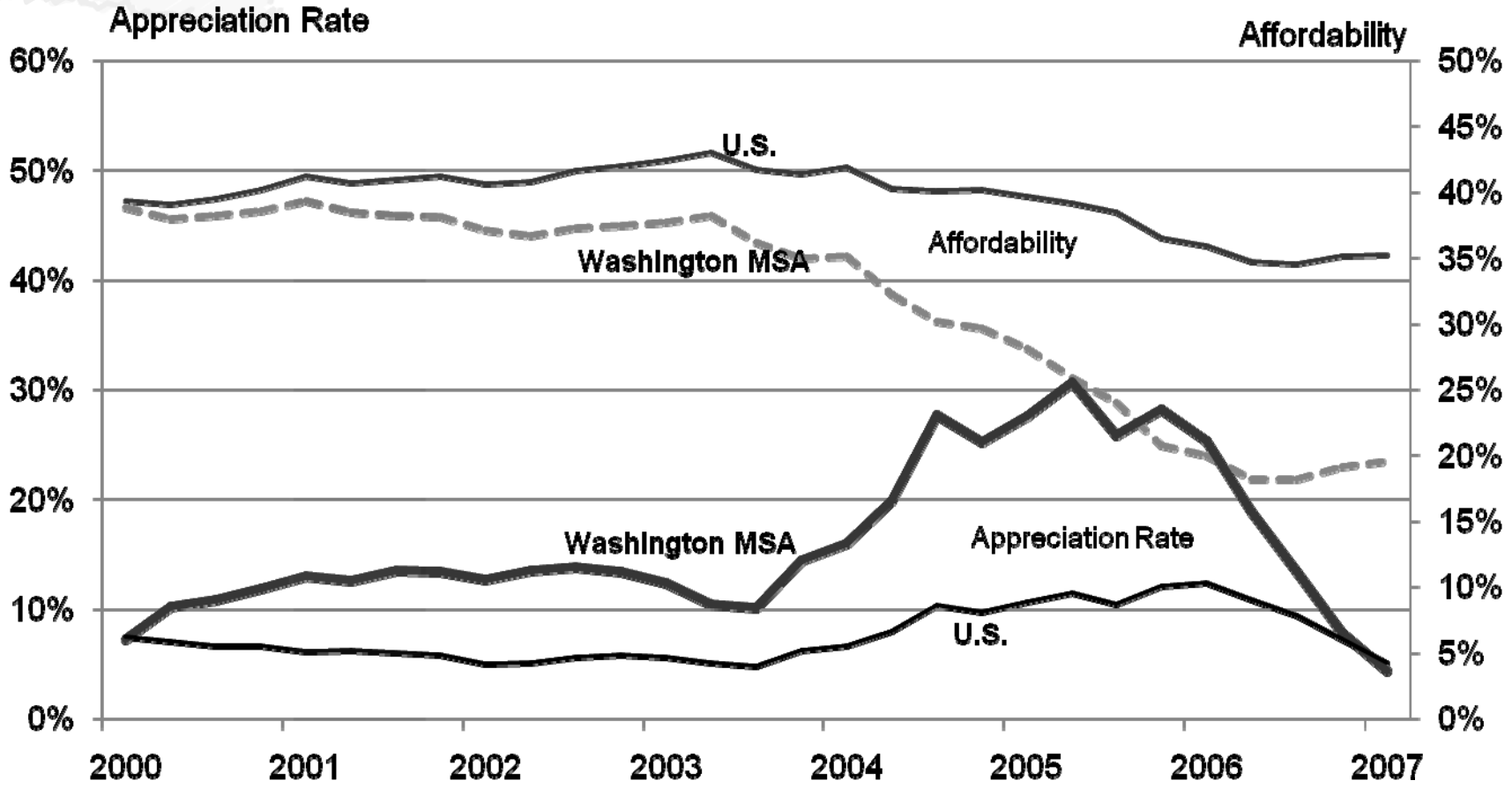
Home Prices Have Risen



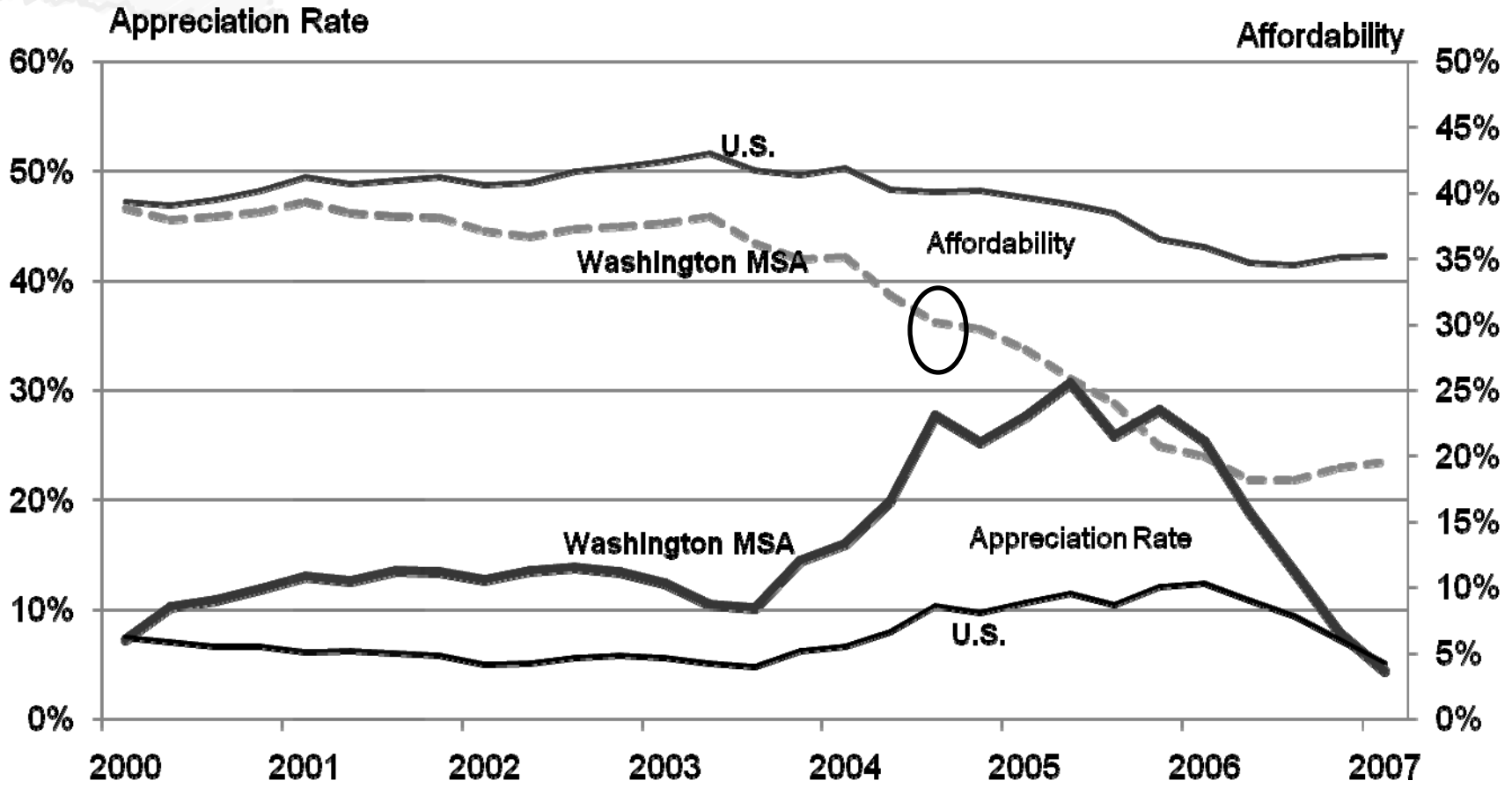
Data through 2nd Quarter 2007.
Source: Chmura Economics & Analytics, Office of Federal Housing Enterprise Oversight

…Making Homes Less Affordable



Data through 2nd Quarter 2007. Affordability is % of Households that can afford a median-priced home.
Source: Chmura Economics & Analytics, Office of Federal Housing Enterprise Oversight

When will Washington MSA See Affordability at 36% Again?



Data through 2nd Quarter 2007.
Source: Chmura Economics & Analytics, Office of Federal Housing Enterprise Oversight

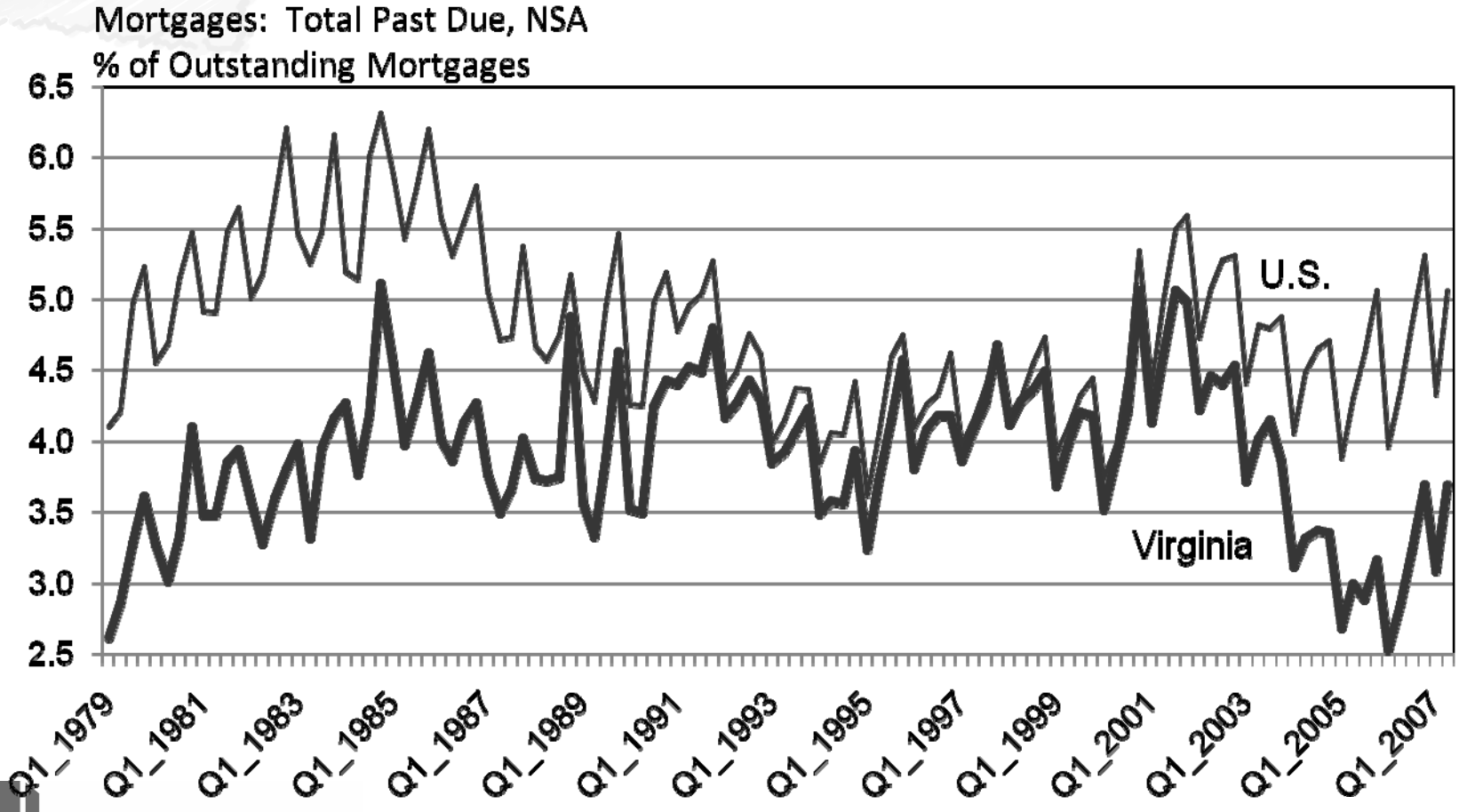
% of Households that Can Afford Median Priced Home, 2007 Quarter 2

	Affordability*
Danville	54.3%
Lynchburg	48.0%
Richmond	43.7%
Blacksburg	42.4%
Roanoke	42.6%
Harrisonburg	42.3%
Hampton Roads	38.0%
Winchester	38.2%
Charlottesville	28.1%
Washington MSA	23.5%
United States	41.9%

Source: Chmura Economics & Analytics

Delinquencies for All Mortgages

Subprime, FHA, VA; Fixed, Adjustable



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Investing in communities

Data through 2nd quarter 2007.
Past due includes 30, 60 , 90 days.

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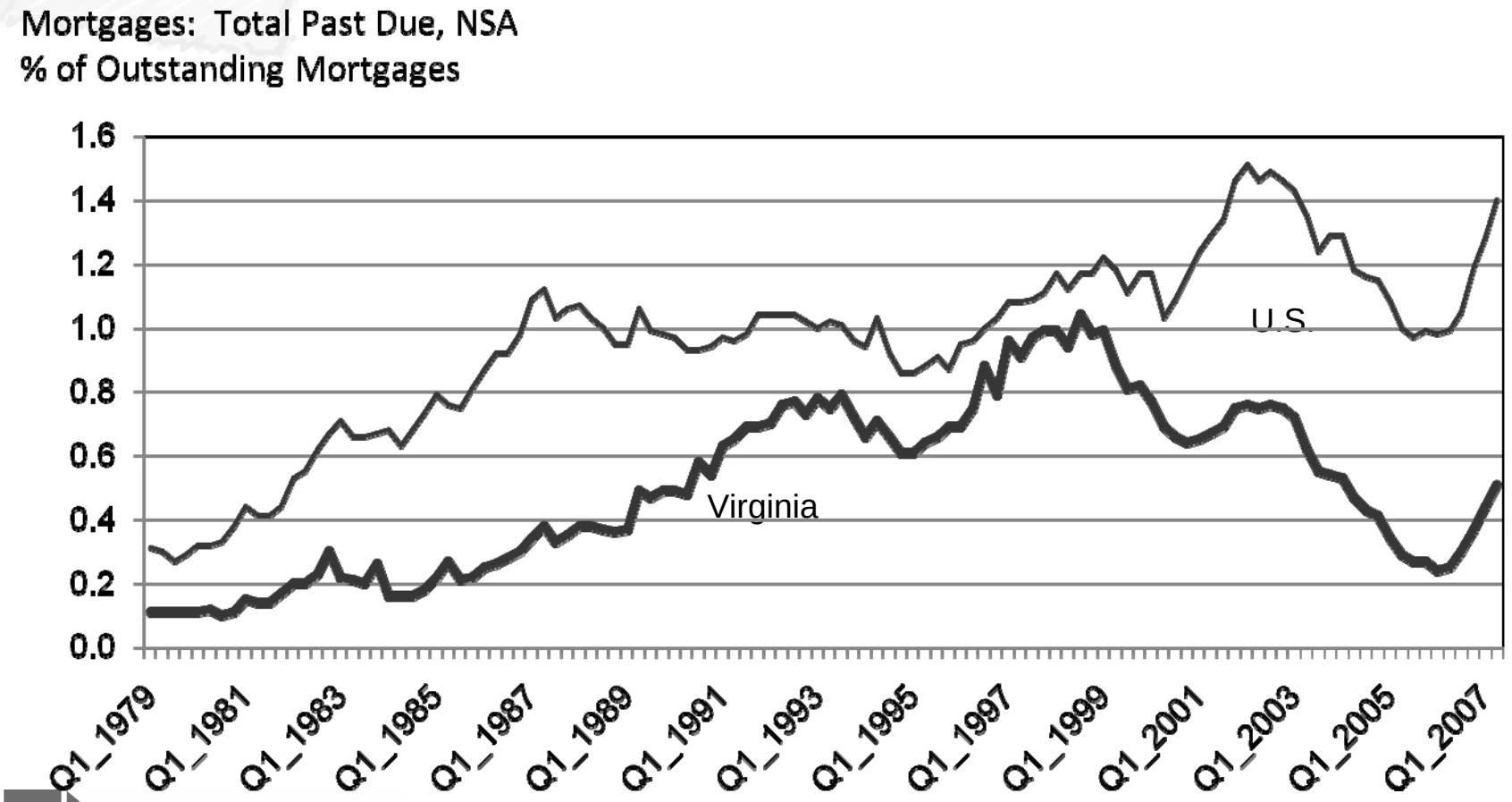
Mortgage Foreclosure Inventory

Subprime, FHA, VA; Fixed, Adjustable



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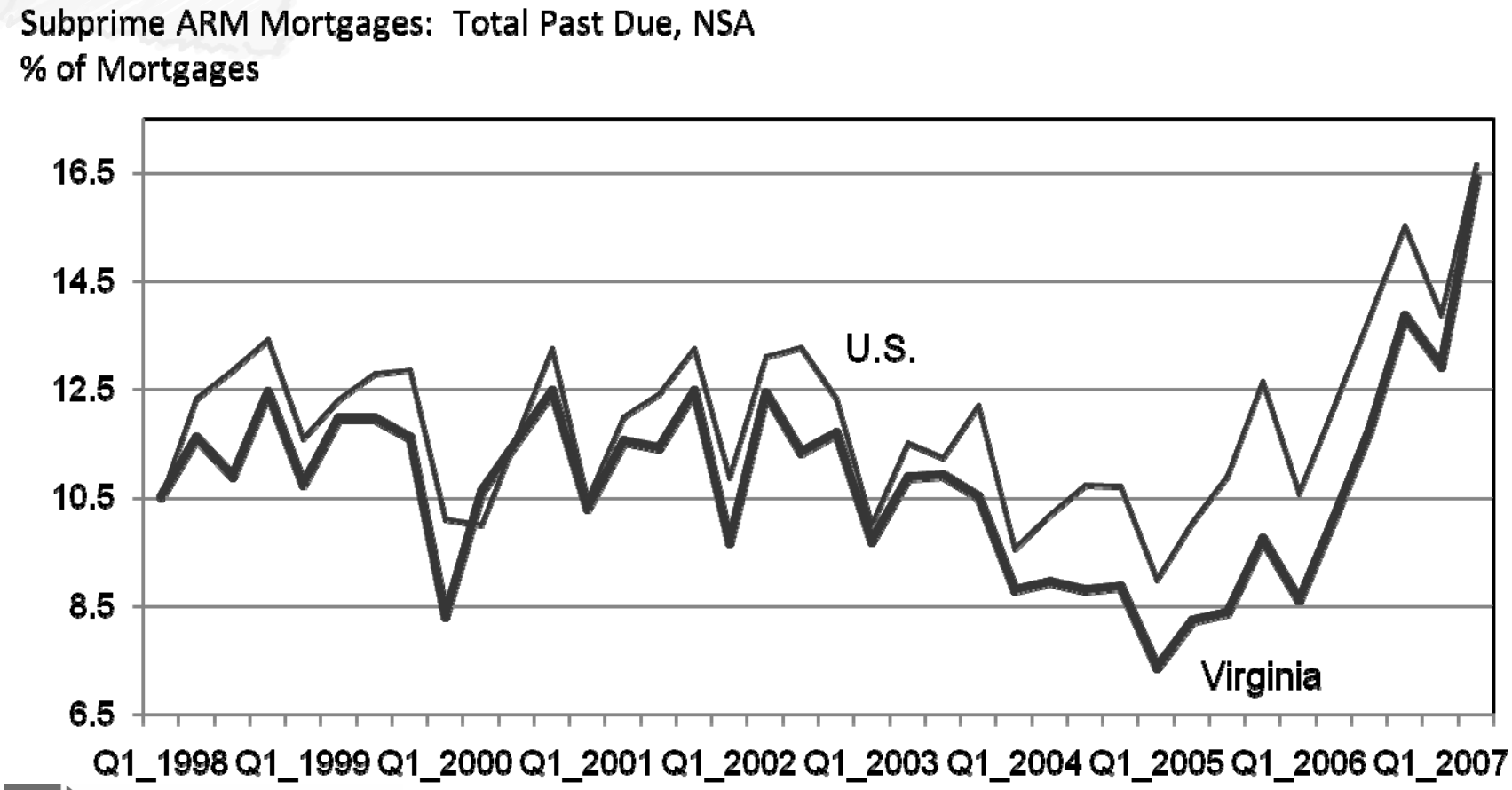
Subprime ARM Mortgages Past Due



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Data through 2nd quarter 2007.
Past due includes 30, 60 , 90 days.

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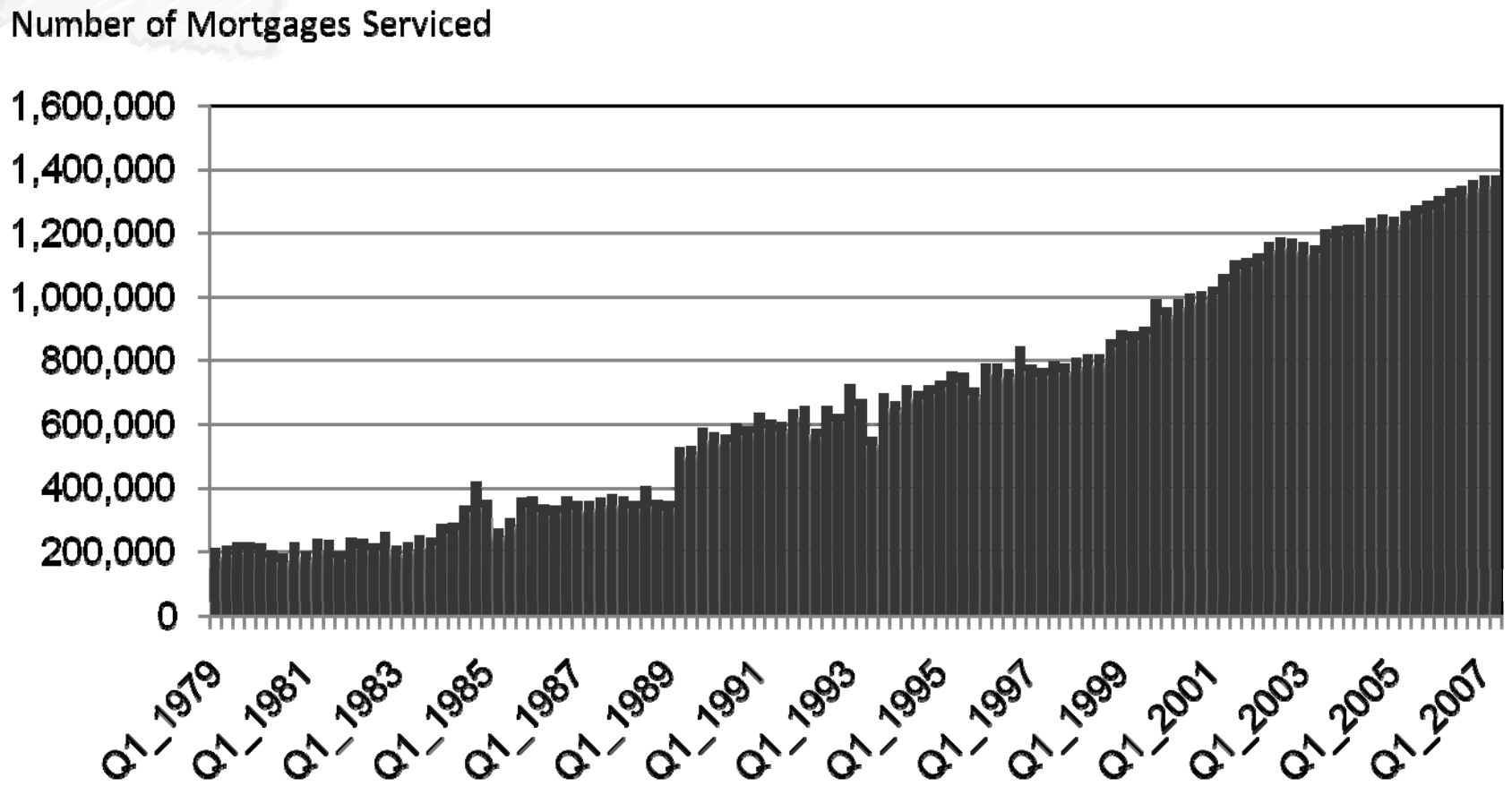
Number of Mortgages Serviced in Virginia



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Data through 2nd quarter 2007.

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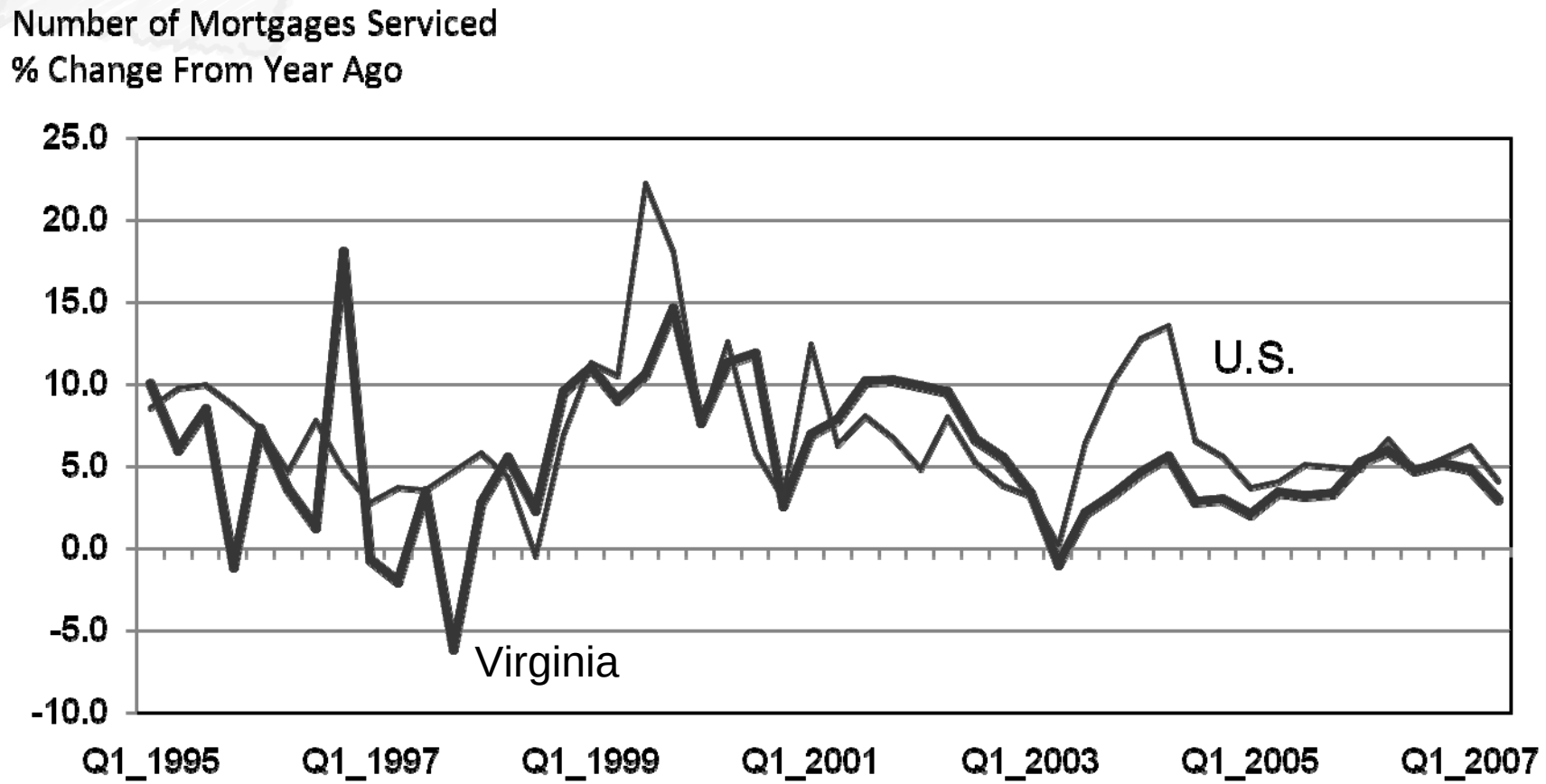
Mortgages Continued to Grow in 2nd Quarter



MORTGAGE BANKERS ASSOCIATION
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Data through 2nd quarter 2007.

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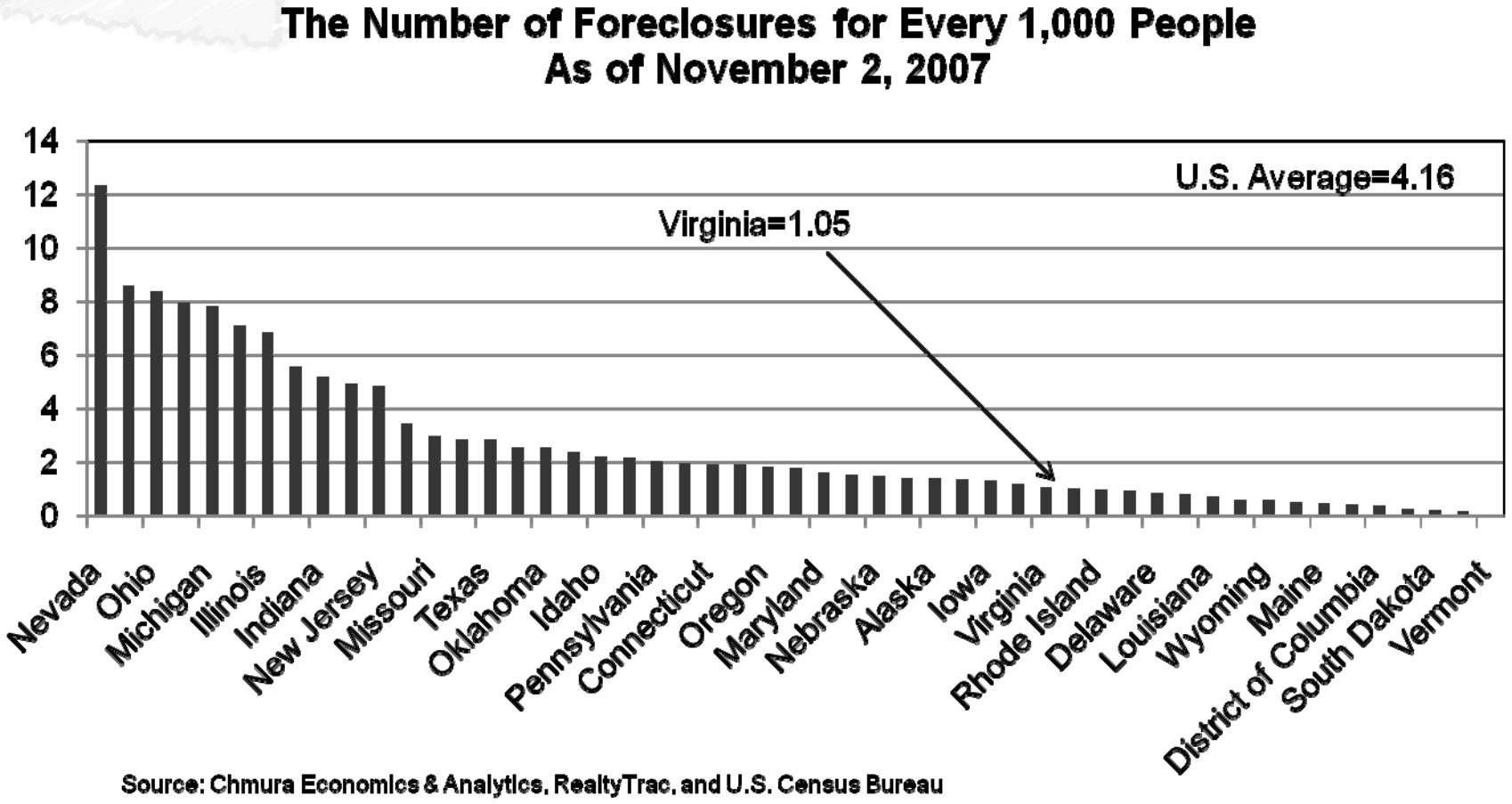
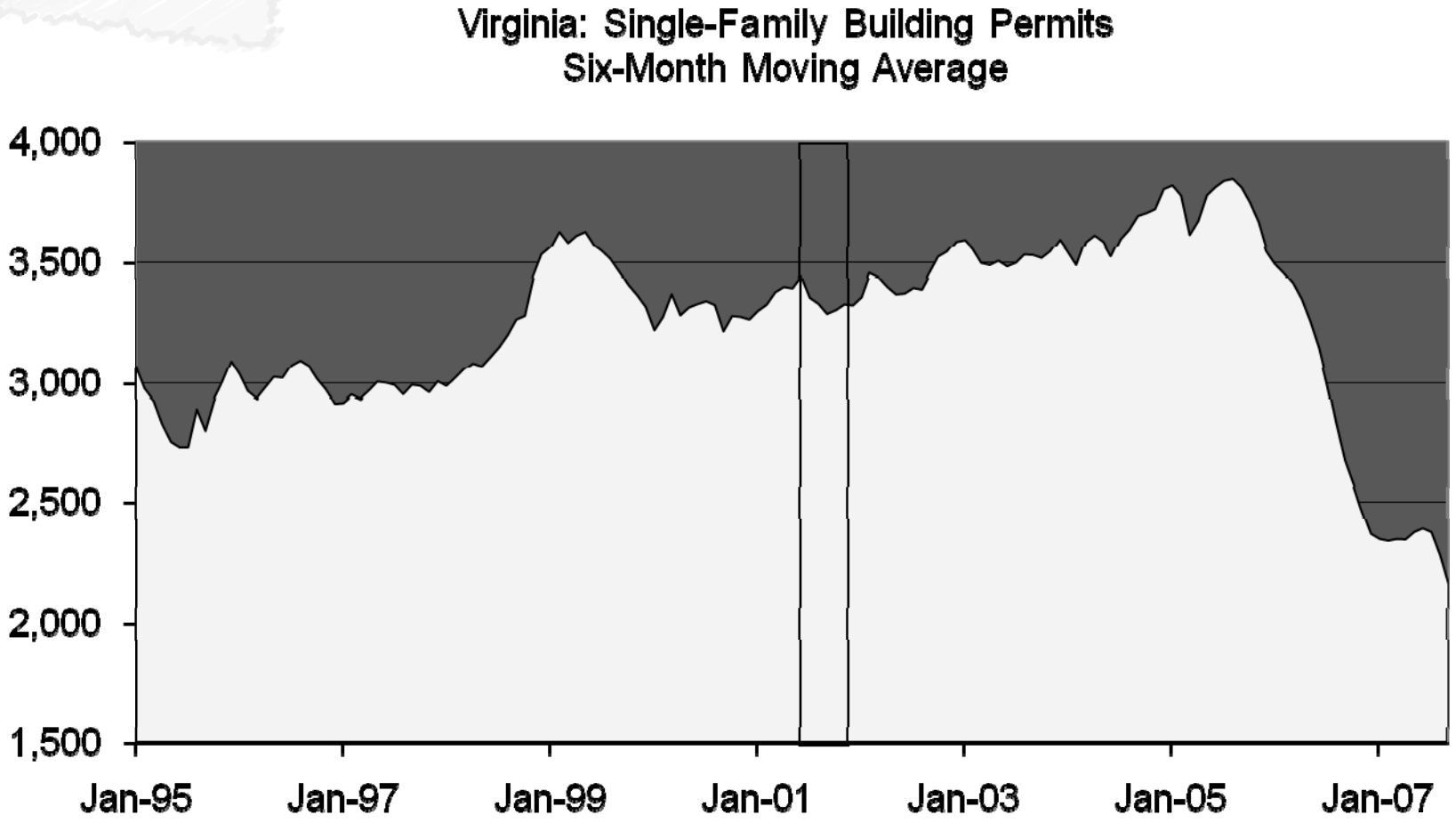
Virginia Ranks 23 in Number of Foreclosures; 35th Based on Per Capita

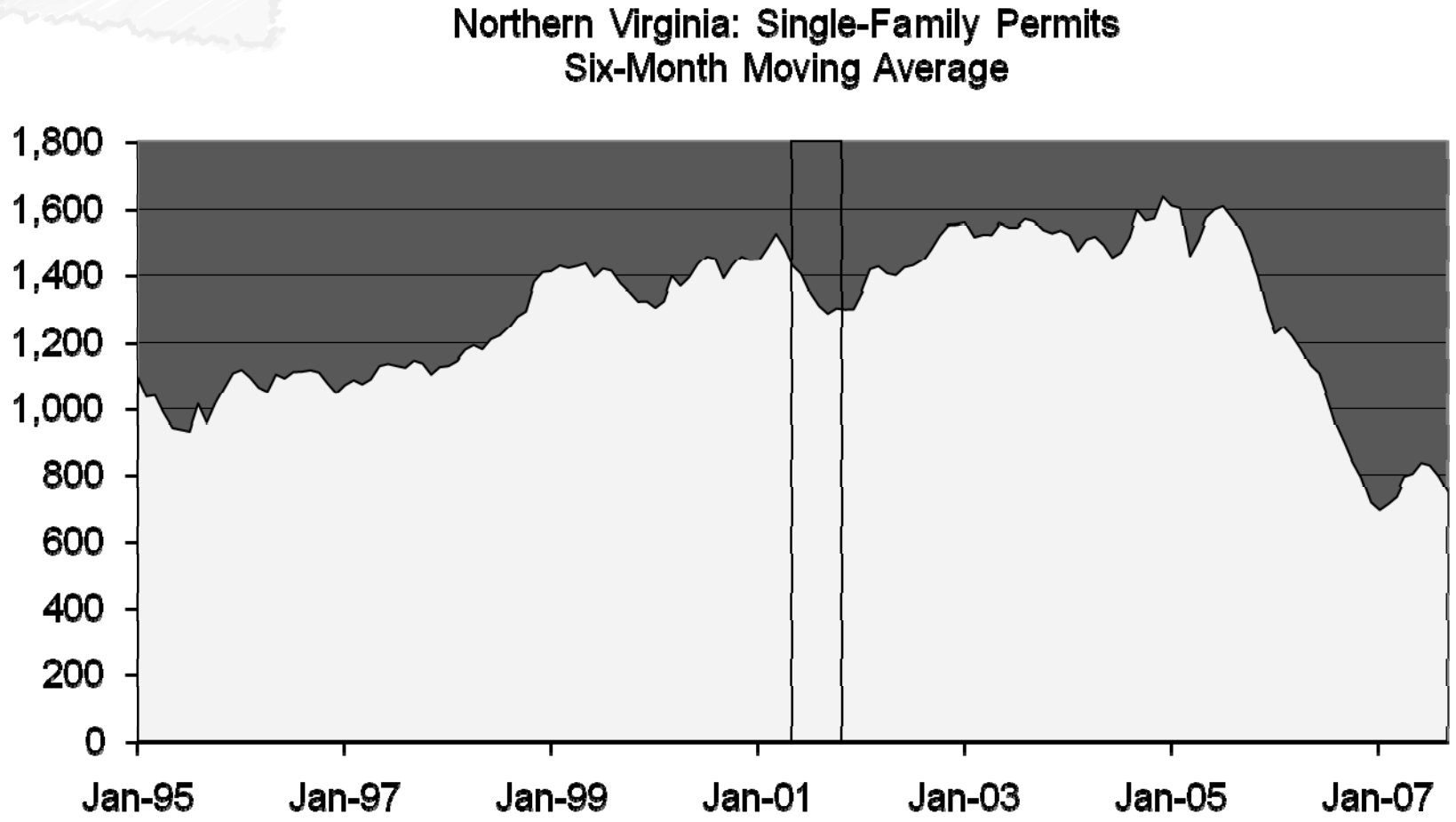


Housing Permits Off 43% From Peak



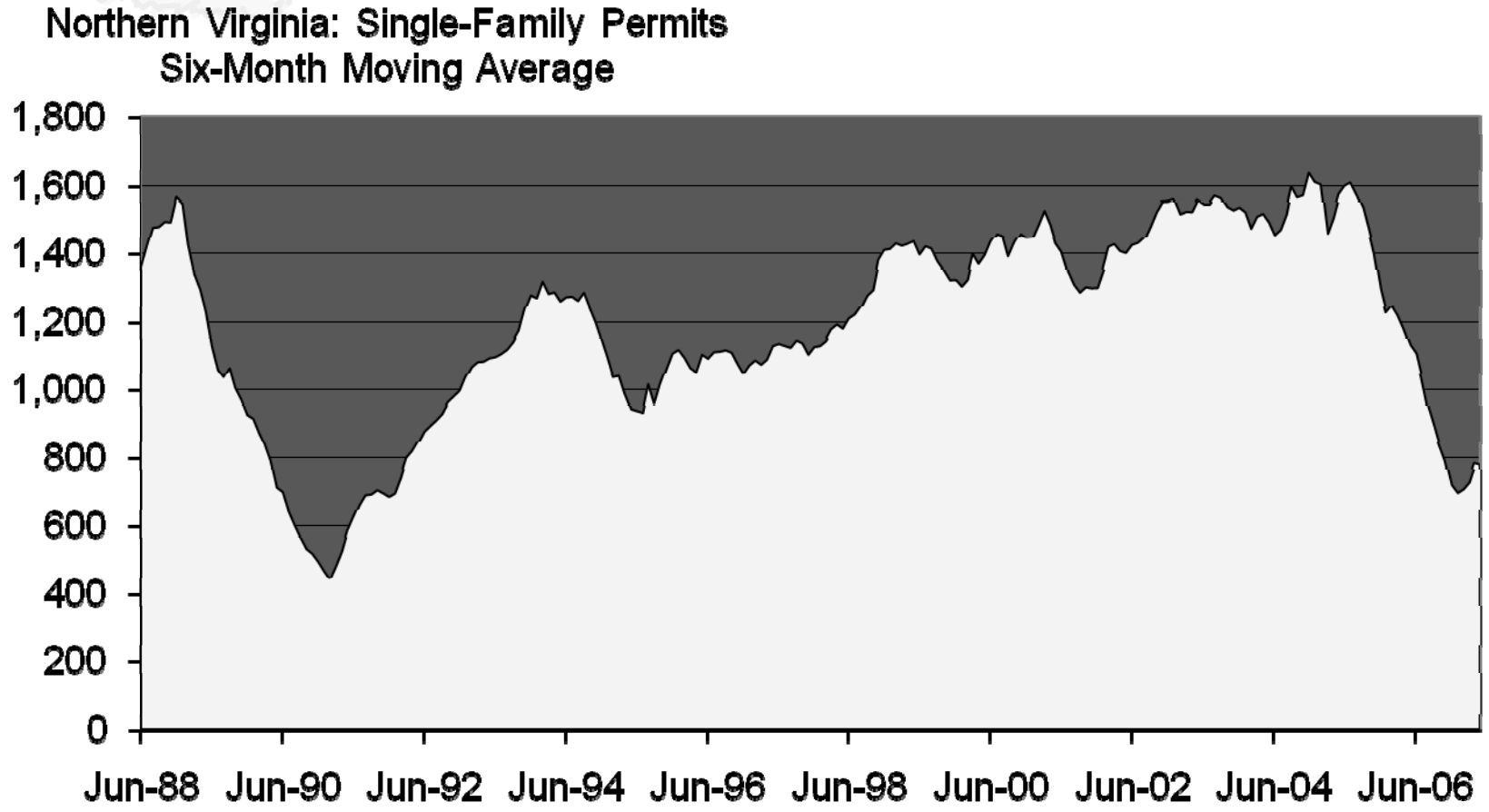
Data through September 2007.
Source: Chmura Economics & Analytics, U.S. Census.

NVA Housing Activity; Off 54% From Peak



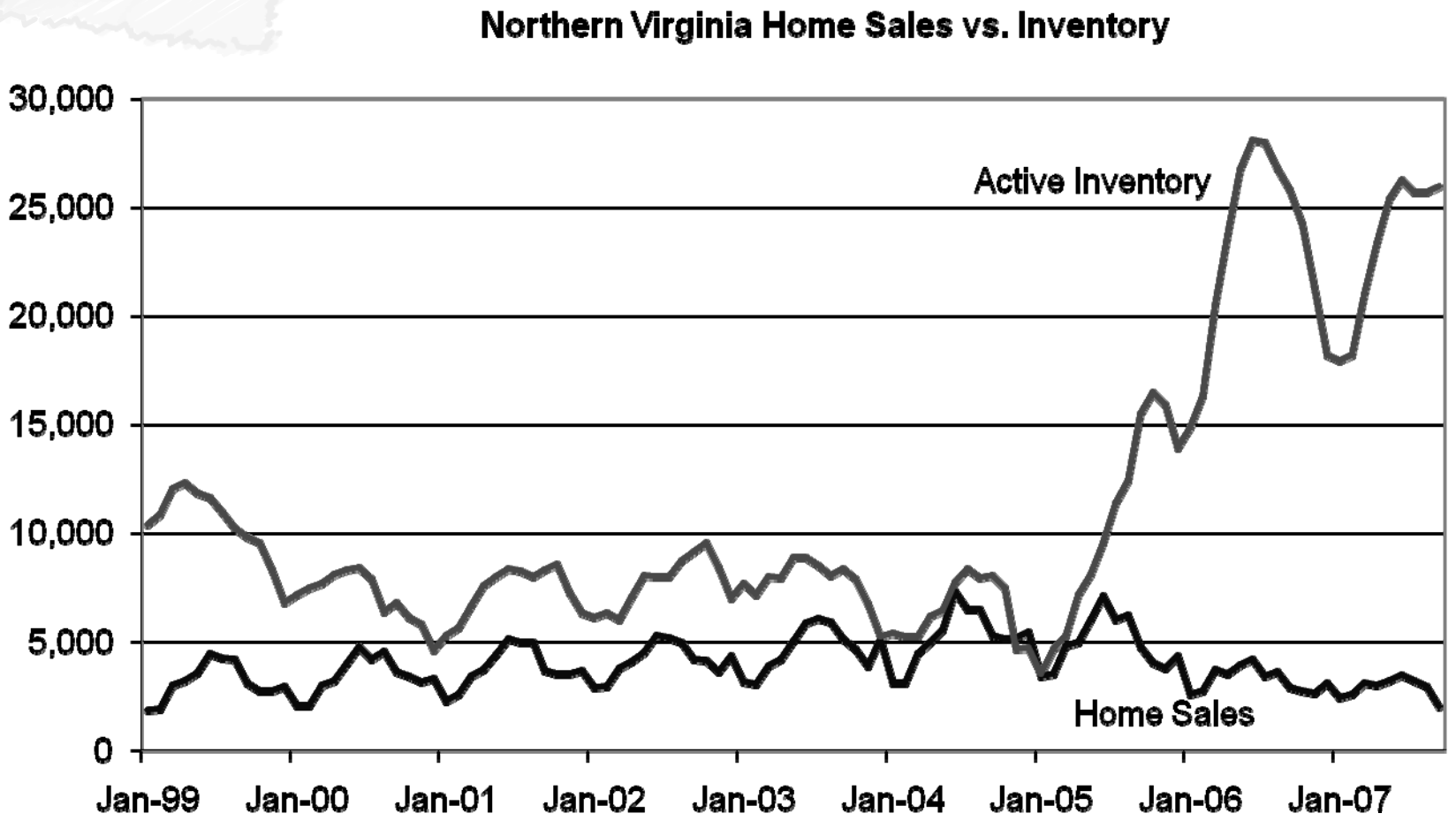
Data through September 2007.
Source: Chmura Economics & Analytics, U.S. Census.

Permits Fell 72% in the Early 1990s



Data through May 2007.
Source: Chmura Economics & Analytics, U.S. Census.

Imbalances Still Exist… 13.8 Month Supply of Homes Based on Sales



Source: MLS
Data through September 2007.

Conclusions

- U.S. growth remains sluggish early in 2008
- No further Fed eases…inflation is concern
- Non-housing sectors continue to fuel growth…no recession
- Virginia fares better than nation in real estate
  - Favorable industry mix
  - Diversity
  - Proximity to nation's capital
- Residential real estate is in recession
  - Building starts to pick up mid-2008
    - Housing prices stagnant; fall in some areas/affordability improves
    - Employment /population gains provide demand for housing