US housing slump deepens

Barry Grey
18 August 2010

New data released this week shows that the US housing market remains mired in a slump, belying the Obama administration's claims that its policies are producing an economic recovery.

On Tuesday, the Commerce Department reported that single-family housing starts in July fell to their lowest rate since May, 2009, the deepest point of the recession that followed the September, 2008 financial panic. Housing starts fell 4.2 percent, the fourth straight monthly decline.

In addition, the issuance of housing permits, an indicator of future starts, fell 3.1 percent to a 14-month low.

The *Wall Street Journal* quoted Joshua Shapiro, chief economist at the consultancy MRF Inc., as saying, "Financial distress on the part of many households, ongoing labor market weakness, and vicious competition from an enormous overhang of existing homes all point to a very tough slog for homebuilders in the months and quarters ahead."

The bleak Commerce Department report followed Monday's release of a National Association of Home Builders survey showing that its confidence index fell unexpectedly from 14 in July to 13 this month. The homebuilders' confidence measure has now declined for three months running. This month's level was the lowest since March of 2009.

The US housing market is caving as a result of persistent high unemployment and a resulting fall in income and consumer demand, combined with the impact of soaring foreclosure rates, which result in a large backlog of properties for sale at sharply reduced prices.

The downward trend followed the termination earlier this year of Federal Reserve purchases of hundreds of billions of dollars in mortgage-backed securities from the government-run mortgage finance giants Fannie Mae and Freddie Mac. The Obama administration and the Fed were counting on the private market to sustain a housing recovery under conditions of accelerated growth. That has not materialized.

Another factor in the housing slump is the April 30 expiration of a tax credit for home buyers. Even though mortgage rates are at historic lows, around 4.5 percent, workers are either unable or wary of investing in a house under conditions of mass unemployment and falling wages. In addition, banks have tightened credit terms.

Richard Dugas, the chief executive of PulteGroup, Inc., the biggest US homebuilder, was quoted by the *Financial Times* as saying, "The fall-off in demand has been well documented, and in truth has likely exceeded just about all expectations. Right now, the industry's biggest issue is a lack of buyers."

The Obama administration has rejected any government public works program to create jobs and refused to provide serious relief for the millions of long-term unemployed. In recent months, it and the Democratic leadership of Congress have dropped even their minimal stimulus proposals in response to pressure from Wall Street to move toward deficit reduction and keep unemployment high as a means of driving down wages.

The growing social distress, reflected in record bank seizures of foreclosed homes and mortgage delinquencies, is further impacting the housing market. This week, Deutsche Bank published a report showing that the rate of serious mortgage payment delinquency in the average US congressional district has soared to 9.4 percent as compared to 3.3 percent at the time of the 2008 election. Serious delinquency is defined as being more than three months behind in payments.

The rate of serious delinquency is more than 20 percent in 23 congressional districts, including 13 in Florida, six in California and two in Nevada.

The housing slump is helping to fuel a general decline in confidence in the US economy and fears of a "double dip" recession in America and internationally. This is reflected in a flight by investors to the relative safety of US Treasuries, pushing down the interest on these bonds. Ten-year Treasury note yields dropped nine basis points on Monday to 2.60 percent, the lowest level since the height of the crisis in March of 2009.

On Tuesday, the Obama administration held a housing finance summit at the Treasury Department, bringing together federal officials, Wall Street CEOs and economists to discuss reform of Fannie Mae and Freddie Mac. The meeting was something of a concession to Republicans who have denounced the financial regulatory overhaul passed in July for leaving the two government-owned mortgage finance companies untouched.

Behind the Republican criticisms stand major Wall Street banks that want to see the activities of Fannie Mae and Freddie Mac curtailed so that they can grab a larger share of the potentially lucrative mortgage market. When the financial crisis erupted in the late summer of 2008, the federal government took control of Fannie Mae and Freddie Mac, using some $150 billion in public funds to prevent the two firms from collapsing. Since then, the Obama administration has upped the cap on public subsidies to the mortgage finance firms to $400 billion.

Fannie Mae and Freddie Mac now account for more than 90 percent of all home mortgages in the US. They purchase mortgages from private banks and lenders, bundle them into mortgage-backed securities, and sell the securities to investors. However, the private market for these securities has virtually collapsed.

While bankers want the government-owned mortgage finance firms to be downgraded and eventually eliminated, they made it clear at Tuesday's summit that they want the government guarantee on new mortgages to be maintained.

At the Tuesday meeting, Bill Gross, the founder and manager of Pacific Investment Management Co. (PIMCO), the biggest bond fund in the US, called for an aggressive government program to boost the housing market and stimulate consumer demand. He proposed that the government enable all homeowners with Fannie Mae- or Freddie Mac-backed mortgages who are paying more than 1 percent above the current rate to refinance at the lower interest level, saying this would pump $50 billion to $60 billion into the economy.

The PIMCO billionaire warned, "The American economy is approaching a cul-de-sac of stimulus, both monetarily and fiscally, which will slow it to a snail's pace incapable of providing sufficient job growth going forward. Unemployment rates will approach and remain at double digits unless a positive fiscal stimulus is provided in the next six months."

Gross speaks for certain sections of the financial elite, and his proposal is considered anathema by others whose holdings of mortgage debt would decline in value were it carried out.

Treasury Secretary Timothy Geithner, who presided over the conference, ignored Gross' proposal and put forward a policy more in line with the interests of the major Wall Street banks. "We will not support returning Fannie and Freddie to the role they played before conservatorship," he said, "where they fought to take market share from private competitors while enjoying the privilege of government support."

Treasury officials subsequently said they had no plans to enact a refinancing plan along the lines of that proposed by Gross.

While the financial markets are nervous over the implications of the slowdown in US economic growth, they are quite happy with the boom in corporate profits resulting from brutal cuts in jobs and labor costs. US corporate profits for the second quarter of 2010 are running more than 45 percent higher than a year ago, even though sales are up only 9 percent.

The Dow rose by 104 points Tuesday despite the dismal housing numbers on the strength of positive profit reports from Home Depot and Wal-Mart. Home Depot profits beat analysts' estimates even though sales failed to meet expectations.

Wal-Mart's second quarter profits increased 3.6 percent entirely on the basis of cost cutting. Reflecting the impact of the jobs crisis on Wal-Mart's largely working-class clientele, the company reported that revenue at its US stores open at least a year fell 1.4 percent, far more than had been forecast. It was the fifth straight quarterly drop in US store revenues.