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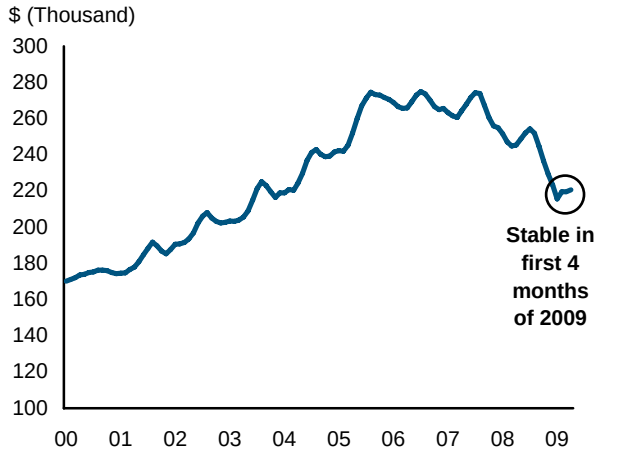
US Economic and Investment Perspectives

Have US Housing Prices Hit Bottom?

Ever since the US housing market collapsed, economists have watched for signs that the worst is over for the sector at the epicenter of the global economic recession. This year, average house prices for existing homes have remained stable (**Display 1**), despite rising foreclosures and relatively high levels of inventory.

Display 1: House Prices Show Signs of Stability

Average Prices for Existing Homes (3-month moving average)



Source: National Association of Realtors and Haver Analytics

It is still too soon to classify four months of improvement as a sustainable trend. Nevertheless, the recent stability appears to defy conventional wisdom, which expects house prices to decline by at least 10% to 15% this year. Is it possible that the downward pressure from foreclosures and inventories has already been fully absorbed in the market?

Measuring house prices is an imperfect science: very few houses are exactly alike, location has a big effect on valuations and prices can be distorted over time by major improvements and renovations or general aging and deterioration.

Many analysts favor the S&P/Case-Shiller (CS) house price series, which declined 6% in the first three months of 2009. In our view, this series suffers from limited geographic coverage, with no presence at all in 13 states and only limited coverage in 17 others. In addition, the CS series is value-weighted, which means that it places more weight on higher-priced homes than lower-priced ones. As a result, it often differs from other unit-weighted indicators and tends to overstate price trends in rising and falling markets.

Our preferred measure is the average price series in the monthly report on existing home sales. Although this indicator is not flawless, we believe that it is more accurate because it is based on all transactions (not just repeat sales), includes every type of mortgage and covers all 50 states.

The Foreclosure Effect

Of course, it is too early to predict that average prices will continue to remain stable on a monthly basis in the coming quarters. Housing sales and prices cycles are not linear, and the average price each month is greatly influenced by volume as well as the regional mix of sales. Indeed, even as housing prices nationwide appear close to bottoming, prices may continue to decline in metropolitan areas with relatively high inventory and large numbers of foreclosed homes on the market and more to come. Clearly, the pattern of house prices from city to city and state to state will be very uneven.

House prices are capable of stabilizing nationwide even as specific regions still struggle with fallout from the subprime foreclosures because the worst-affected areas are highly concentrated. Four states—California, Florida, Arizona and Nevada—accounted for 46% of foreclosures during the first quarter, according to the Mortgage Bankers

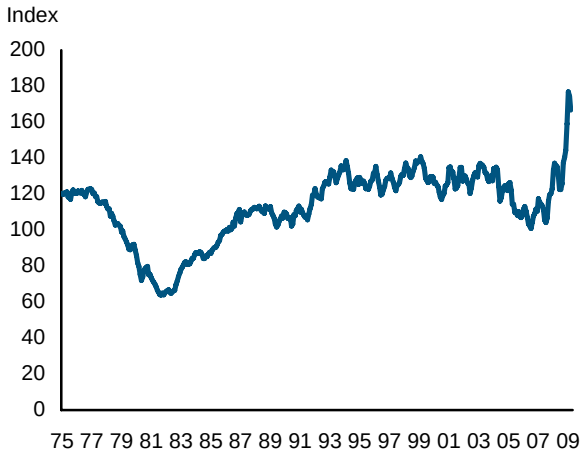
Association. Yet the populations of these states only account for 21% of the US total.

Nationwide, the influence of foreclosures on house prices may be waning. Although the number of foreclosed homes on the US housing market represents less than 5% of the nationwide stock, in recent months these homes have accounted for about a third, or more, of monthly sales totals. This implies that average prices for homes sold are being dragged down by an unusually large number of distressed sales. Yet even with this higher than normal number of foreclosed sales, nationwide prices have not declined since January.

What would it take for prices to fall further? In our view, this would require an increase in sales of foreclosed homes as a percentage of total sales, triggered by a jump in the absolute number of foreclosed homes on the market, or a decline in the overall monthly sales pace.

We estimate that monthly sales are currently running at about to two to three times the monthly rate of foreclosures. Given the huge discount on sales of foreclosed homes relative to other housing transactions, this ratio must be maintained in order to keep house prices relatively stable. In our view, growing momentum for homebuyers, due to tax credits for first-time buyers and record affordability (**Display 2**), is strong enough to sustain the current selling pace. This would outweigh the effect of a large number of foreclosed homes still on the market and help contribute to a further stabilization of house prices in the months to come.

Display 2: Housing Is Now Much More Affordable
Housing Affordability



Source: National Association of Realtors and Haver Analytics

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