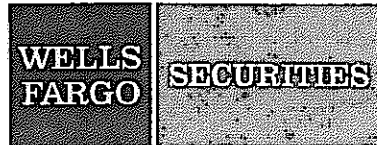


August 17, 2010



Economics Group

Special Commentary

*Blog
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Housing Data Wrap-Up: August 2010

Home Sales and New Home Construction Face a Tough Second Half

We have slightly reduced our forecast for home sales and new home construction to incorporate more recent data. While the changes are relatively minor, the significance is that we needed to lower our numbers even further. Our housing outlook has consistently ranked among the lowest of regularly published forecasts. Our lack of optimism for the housing sector has been driven primarily by the lack of improvement in the labor market. Potential homebuyers are also being held back by more stringent mortgage underwriting and more conservative appraisals, neither of which is likely to improve until the oversupply of housing is reduced. If all of this sounds circuitous, that is because it is; and this is one reason why the recovery process in the housing market is so slow and agonizing.

The second half of the year is likely to see some trying times for realtors and homebuilders. The homebuyer tax credit program likely pulled a larger portion of sales into the first half of the year, boosting sales and helping support home prices. Once the tax credit ended, demand quickly eroded. Mortgage applications for the purchase of a home plunged 44 percent between late April and early July, leading to an immediate slump in new home sales during May. Sales rebounded slightly during June, but builders reported extremely slow buyer traffic in both July and early August. Sales of existing homes have held up somewhat better, but should slide a bit further in coming months.

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According to the National Association of Realtors, first-time buyers accounted for 46 percent of home sales during May and 43 percent in June. Now that the tax credit has expired, we expect the share of first-time buyers to slip back to historical norms or even slightly below. We also look for the share of distressed transactions, which had been running at about 30 percent of all sales in May and June, to increase. The larger proportion of distressed sales will likely cause housing prices to decline during the second half of the year, giving back much of the gains that occurred over the past year. Florida, Georgia and Arizona appear particularly vulnerable, due to the high level of mortgage delinquencies and high proportion of home mortgages that are underwater.

Table 1

August 2010 Housing Data

	Release	Consensus	Actual	Prior	Revised	Next Release
NAHB Sentiment Index	August	15	13	14		Sep-20
Housing Starts, Thousands of Units	July	560K	546K	549K	537K	Sep-21
Housing Permits	July	580K	565K	586K	583K	Sep-21
Existing Home Sales, Millions of Homes	June	5.10M	5.37M	5.66M	-	Aug-24
Percent Change	June	-9.9%	-5.1%	-2.2%	-	Aug-24
New Home Sales, Thousands of Units	June	310K	330K	300K	267K	Aug-25
Percent Change	June	3.3%	23.6%	-32.7%	-36.7%	Aug-25
S&P Case/Shiller Composite-20	May	0.2%	0.47%	0.44%	0.61%	Aug-31

Source: Bloomberg LP, National Association of Realtors and U.S. Department of Commerce and Wells Fargo Securities, LLC

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While the second half of the year will likely be challenging, we do not think it will change the timetable for the housing recovery. Tax credits could not last indefinitely, and we were bound to see a payback when they eventually ended. The underlying fundamentals for the housing market are slowly but surely improving. Affordability has improved significantly, and home prices have returned to historic norms relative to after-tax income. Mortgage applications for the purchase of a home have actually picked up slightly over the past few weeks, hinting that a post-tax credit bottom may not be too far off. Recent declines in mortgage rates should also attract some new buyers to the market, although buyers will not come back in a major way until they feel more confident about their employment and income prospects.

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There has also been some progress made at reducing the oversupply of housing. The number of completed homes for sale has dropped back to its pre-housing boom level. The months' supply of new and existing homes for sale remains elevated, however, reflecting the recent slump in sales and addition of new supply from foreclosures. New home inventories currently make up a 7.6-months' supply at the current sales pace, while there is an 8.7-months' supply of existing homes. The absolute level of new home inventories is back near historical lows, however, which means construction will snap back nicely once a sustained recovery in home sales is in place. In contrast, the absolute level of existing homes remains well above its long-term norm and the months' supply figure will likely spike once sales fall off their recent stronger tax credit induced pace. Concerns about the oversupply of housing will continue to put pressure on appraisers to remain conservative in the valuations. Homebuilders will also continue to struggle to raise capital, which will help further reduce new home inventories.

Demand for homes is expected to remain soft through the remainder of 2010. The latest NAHB/Wells Fargo Home Builders Survey fell 1.0 point in August to 13, which is the lowest level since March 2009. Expectations for both present and future sales decreased during the month and prospective buyer traffic remains exceptionally low. The South and West, which is where the bulk of new home construction activity took place during the boom, have seen the greatest fall off in buyer activity, with builders reporting traffic has returned to pre-tax credit levels.

The dearth of buyer traffic this summer and increase in existing home inventories should pull homebuilding sharply lower over the summer months. Our GDP forecast projects residential investment to slide at a 16.0 percent annual rate in the third quarter, following a 27.8 percent increase in the second quarter. Following this summer's drop, sales and new construction are expected to increase modestly this fall, although most of the improvement will merely be statistical. Both sales and homebuilding typically decline in the fall and since they are already low, they can not decline as much as they normally would. As a result, the seasonally adjusted figures should post a modest increase. A genuine recovery in sales and new home construction will not likely take place until early next year, when job growth should be modestly stronger. We do not expect housing starts to rise back above the 1.0 million unit level on a sustained basis until 2012.

Figure 1

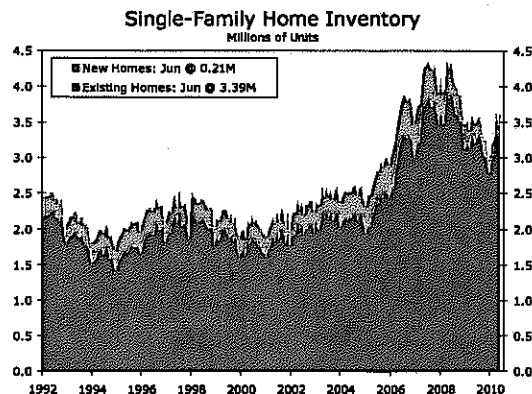
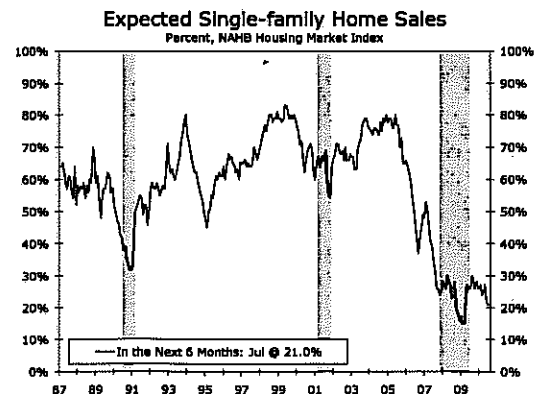


Figure 2



Source: National Association of Realtors, U.S. Department of Commerce, NAHB and Wells Fargo Securities, LLC

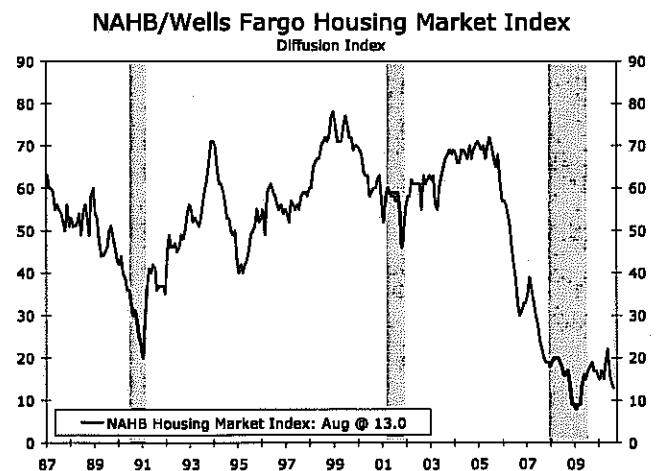
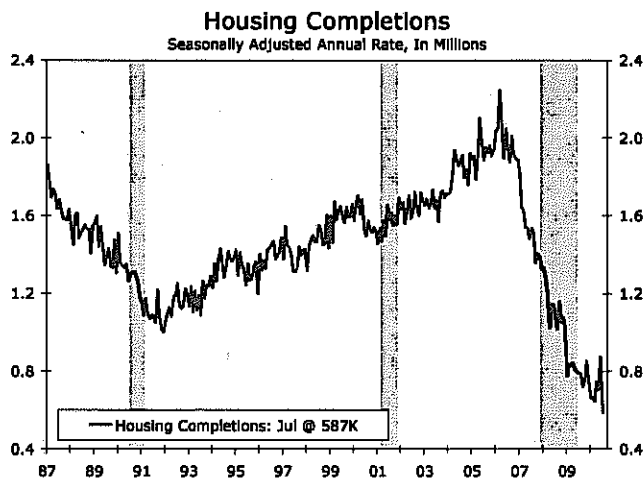
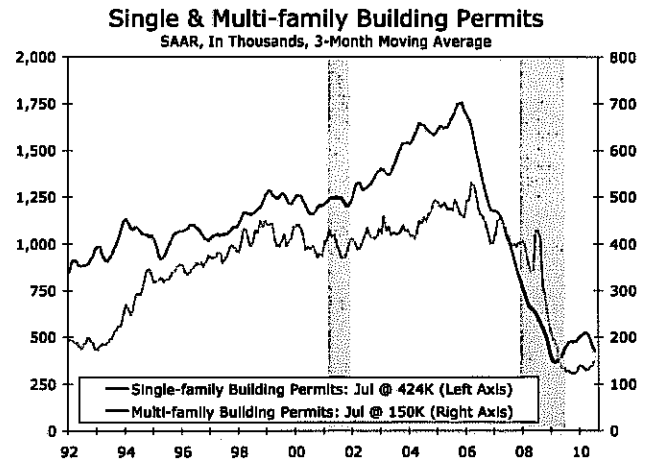
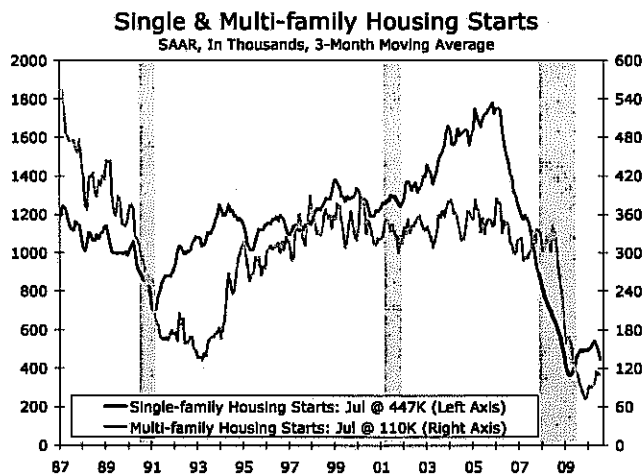
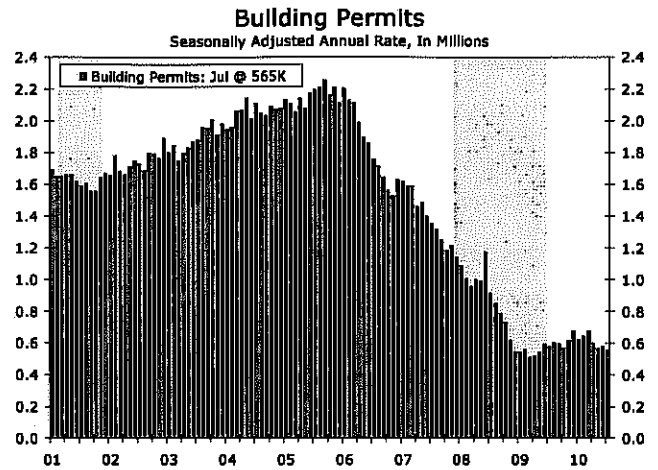
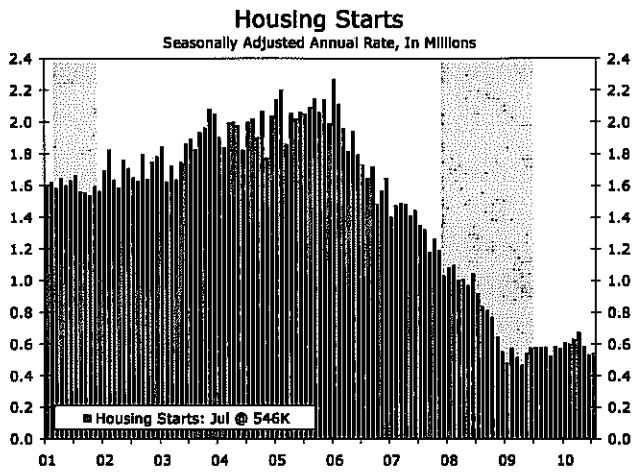
National Housing Outlook

	Actual			Forecast	
	2007	2008	2009	2010	2011
Real GDP, percent change	1.9	0.0	-2.6	2.8	2.1
Nonfarm Employment, percent change	1.1	-0.6	-4.3	-0.6	0.7
Unemployment Rate	4.6	5.8	9.3	9.7	9.6
Home Construction					
Total Housing Starts, in thousands	1341.8	900.0	554.3	588.9	809.2
Single-Family Starts, in thousands	1035.8	616.3	442.3	488.9	679.2
Multi-Family Starts, in thousands	306.1	283.7	112.0	100.0	130.0
Home Sales					
New Home Sales, Single-Family, in thousands	768.7	482.2	373.9	370.0	496.5
Total Existing Home Sales, in thousands	5674.7	4892.0	5157.9	4981.0	5678.0
Existing Single-Family Home Sales, in thousands	4959.2	4337.5	4566.7	4358.4	4939.9
Existing Condominium & Townhouse Sales, in thousands	715.5	554.5	591.3	622.6	738.1
Home Prices					
Median New Home, \$ Thousands	243.7	230.4	214.5	205.4	211.2
Percent Change	0.3	-5.5	-6.9	-4.2	2.8
Median Existing Home, \$ Thousands	215.5	195.8	172.5	170.2	173.0
Percent Change	-2.9	-9.2	-11.9	-1.4	1.7
FHFA (OFHEO) Home Price Index, Percent Change	1.8	-3.0	-4.0	-1.3	1.4
Case-Shiller C-10 Home Price Index, Percent Change	-4.4	-16.7	-12.9	-2.0	1.6
Interest Rates - Annual Averages					
Prime Rate	8.05	5.08	3.25	3.25	3.40
Ten-Year Treasury Note	4.63	3.66	3.26	3.17	3.32
Conventional 30-Year Fixed Rate, Commitment Rate	6.34	6.04	5.04	4.72	4.92
One-Year ARM, Effective Rate, Commitment Rate	5.56	5.18	4.71	4.00	4.20

Forecast as of: August 17, 2010

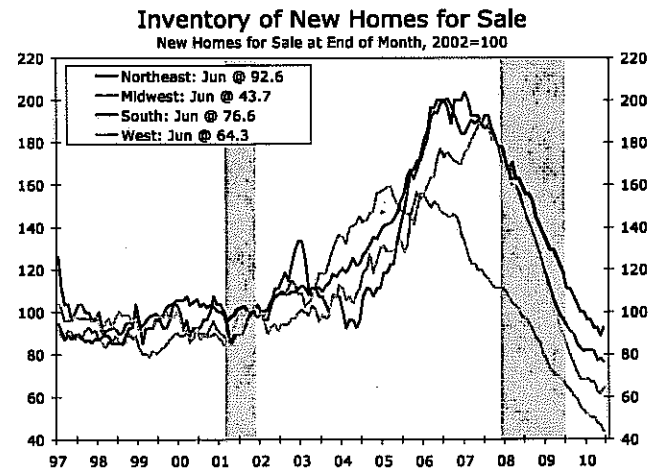
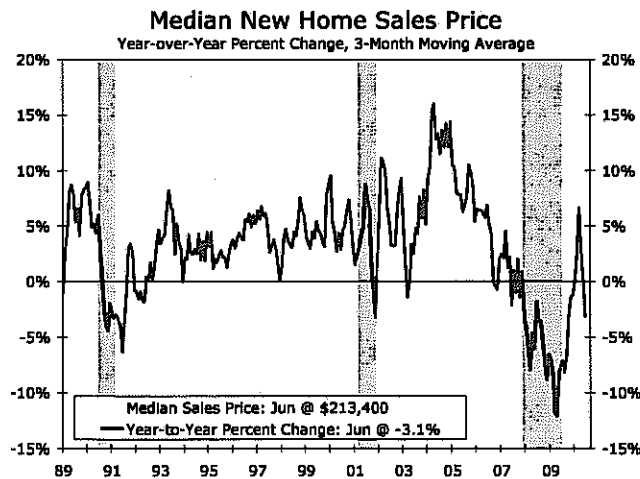
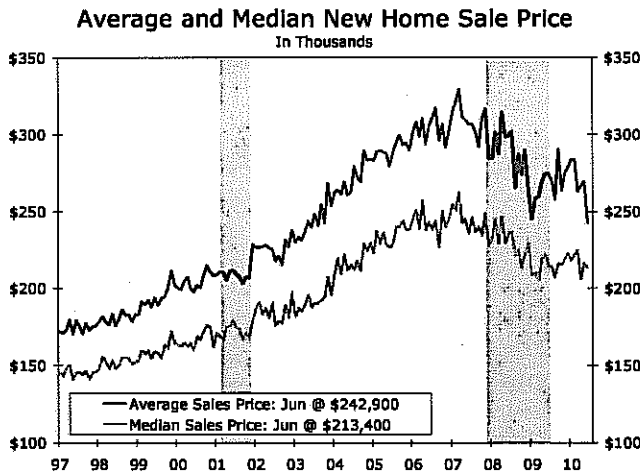
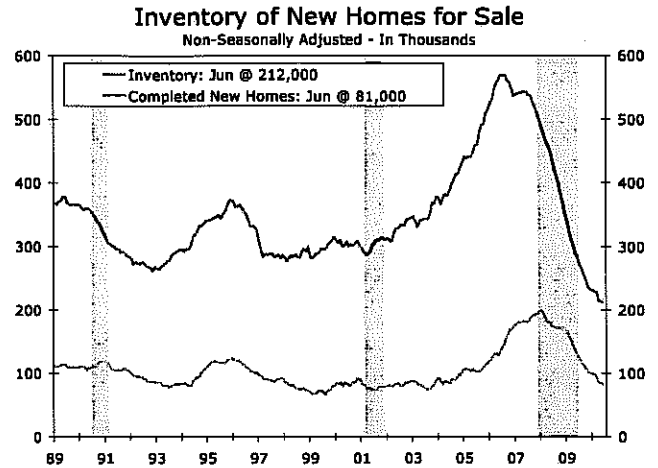
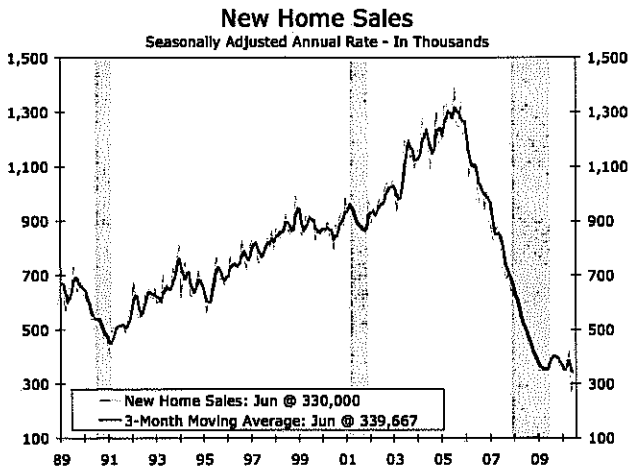
Source: Federal Reserve Board, FHFA, MBA, NAR, S&P Corp, U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities, LLC

Housing Starts



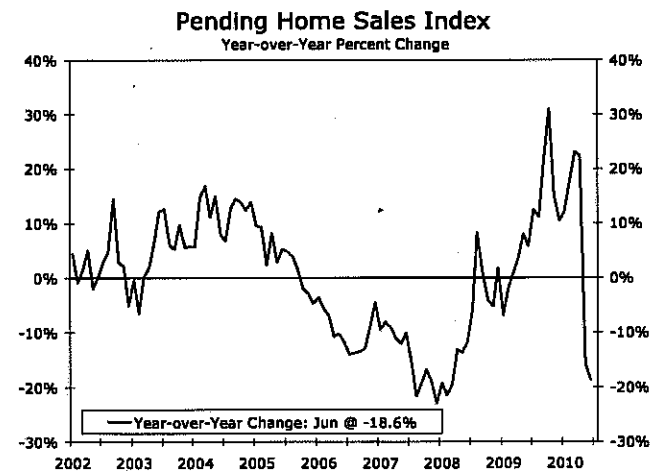
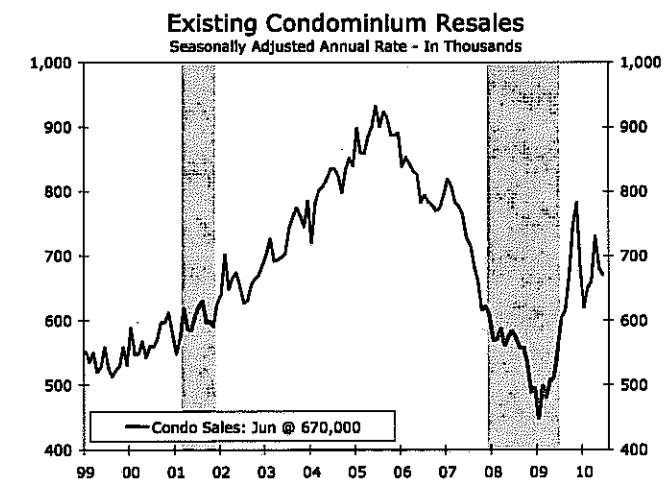
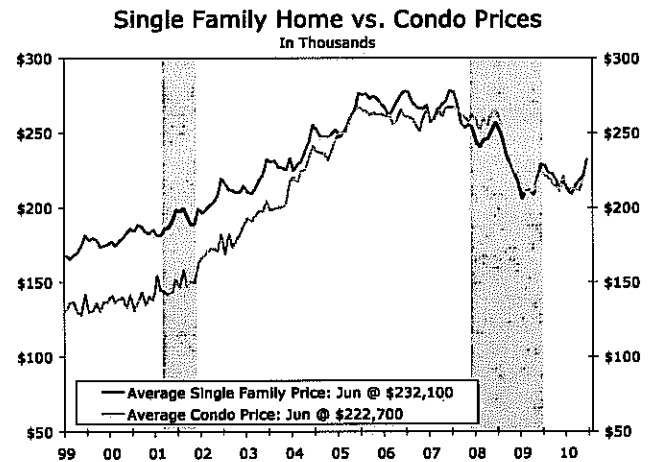
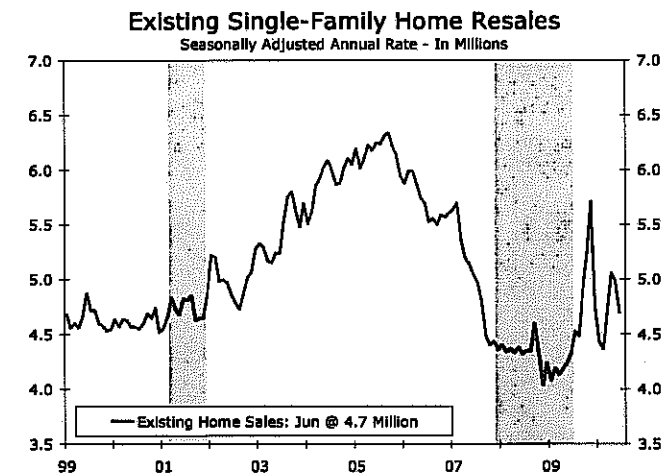
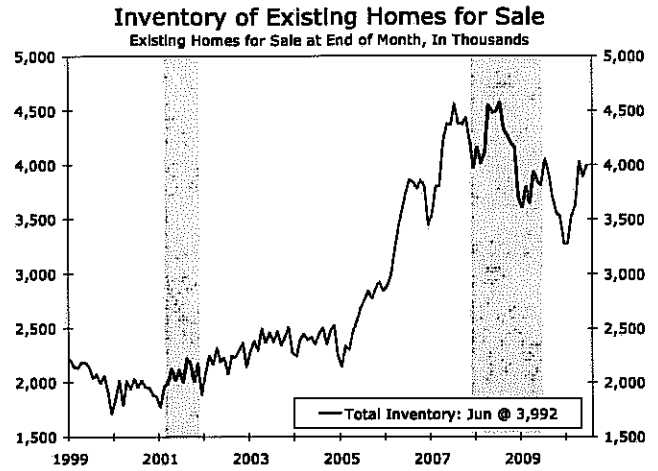
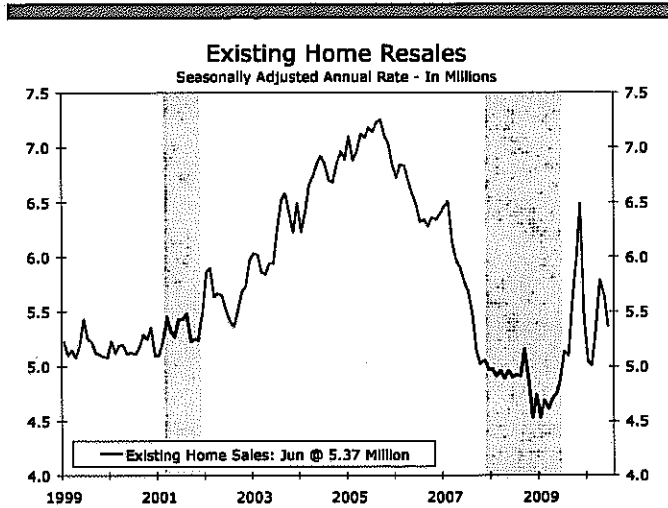
Source: NAHB, U.S. Department of Commerce and Wells Fargo Securities, LLC

New Home Sales



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Existing Home Sales



Source: National Association of Realtors
and Wells Fargo Securities, LLC