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MACROECONOMIC MOVES AND MORTGAGE MARKET ANALYSIS

Job Data and Ukraine (Week ending Mar. 7, 2014)

It was a volatile week in mortgage markets. Early in the week,

rapidly changing conditions in Ukraine caused a great deal of movement in mortgage rates, but there was little net impact. Later in the week, stronger than expected labor market data was negative for mortgage rates, and rates ended the week higher.

Against a consensus forecast of 140K, the economy added 175K jobs in February, and the figures for the prior two months were revised a little higher. This took place, according to the Bureau of Labor Statistics, despite the largest weather related disruption since 1996. The Unemployment Rate unexpectedly rose from 6.6% to 6.7%, but this was due to an increase in the number of people that entered the labor force. The solid jobs report exceeded expectations nearly across the board. Since stronger economic growth raises future inflationary pressures, this was unfavorable news for mortgage rates.

After Russia moved troops into Ukraine, the threat of an escalating conflict caused a "flight to safety" in financial markets on Monday. This involved a shift by investors to relatively safer assets, resulting in a large decline in stocks and significant improvement in bonds, including mortgage-backed securities (MBS). A complete reversal took place on Tuesday, however, after the Russian President said that Russia would not use military force in Ukraine.

Ukraine and China
(Week ending Mar. 14, 2014)

Tensions in Ukraine flared up again this week, causing investors to shift assets from stocks to the relative safety of bonds. Weaker than expected economic data in China also favored bonds over stocks, while the US economic data was roughly neutral. As a result mortgage rates ended the week lower.

The most significant US economic report released this week, Retail Sales, contained some good news and some bad news.

On the positive side, the results for February were stronger than expected. Unfortunately, the figures for January were revised lower. Overall, this left the data over the two-month period a little weaker than expected. Given the offsetting effects of the solid headline number and the downward revisions, combined with weather related distortions, the report caused no change in the economic outlook and had little impact on mortgage rates.

There was a lot of talk in the mortgage industry this week about a proposal out of the Senate Banking Committee that would replace Fannie Mae and Freddie Mac. Together, Fannie and Freddie purchase or insure the majority of fixed-rate mortgages, so any changes to their structure would have enormous implications for mortgage lending. In the proposal, a new government entity would take over many of the functions of Fannie and Freddie, while some of the default risk would be shifted to private insurers. Both political parties support a reduction in the risk to taxpayers, but beyond that opinions vary widely about the appropriate role of government in the housing market. As a result, this proposal is viewed as a starting point for a long political debate, and the implementation of major reform of Fannie and Freddie is projected by most experts to be many years away.

Yellen Surprises Investors (Week ending Mar. 21, 2014)

A short comment by Fed Chair Janet Yellen caught investors off guard on Wednesday, and the reaction was not good for mortgage rates. In addition, a reduction in tensions in Ukraine caused investors to return to riskier assets, hurting safer assets such as mortgage-backed securities (MBS). As a result, mortgage rates ended the week higher.

As widely expected, the Fed scaled back its bond purchases by $10 billion to $55 billion per month. According to Yellen, if the Fed's economic outlook does not change significantly, the bond purchases are expected to end in the fall of this year. Fed officials have long maintained that they expect that the fed funds rate, the Fed's primary tool for monetary stimulus, will remain near zero for a "considerable period" of time following the end of the Fed's bond purchases. The big surprise came during Yellen's first press conference as Fed Chair, when she defined the meaning of a "considerable period" as about six months. This would place the first fed funds rate hike in the spring of next year. Before Yellen's comments, the market consensus was for the first rate hike to take place near the end of next year. While mortgage rates are not directly tied to the fed funds rate, the economic strength implied by the expected timing of the first fed funds rate hike was unfavorable for bonds of all maturities.

The housing reports released this week revealed that conditions in February were little changed from January. February Existing Home Sales decreased slightly from January. Total inventory of existing homes available for sale rose 6% to a 5.2-month supply. February Housing Starts declined slightly, while Building Permits increased 8%. The March NAHB Housing Index showed that home builder confidence increased slightly. It is widely believed that housing activity over the last couple of months has been depressed by the unusually severe winter weather, which means the pent up demand could be a positive in coming months.

THE STATE OF THE NATION

This is the second of my multi-part series on the macroeconomics of political and social issues that weigh heavily on our “State of the Union”.

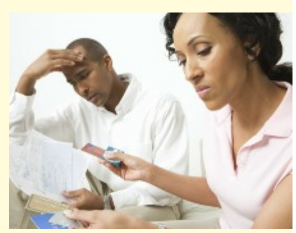
JOBS

Seventy-three months have now passed since The Great Recession began. Officially, that recession ended in the middle of 2009, but nobody would argue that we’ve had anything like a full recovery. Official unemployment remains at 6.7percent, with 10.3 million people looking for work, including roughly 3.45 million who have been doing so for at least half a year and it would be much higher if so many people hadn’t dropped out of the labor force. Long-term unemployment — the number of people who have been out of work for six months or more — is four times what it was before the recession.

The time is long overdue that we start worrying about the right things—namely, the plight of the jobless and the immense continuing waste from a depressed economy. Aside from the Federal Reserve, it seems at times, it’s as if nobody in Washington considers high unemployment a problem. The latest affront to the unemployed is Congress’ decision to curtail the unemployment benefits of those who have been unemployed more than 26 weeks because people aren’t trying hard enough to find jobs, and that extended benefits are part of the reason for that lack of effort—this, from a Congress that that chooses antagonism over accomplishment.

Obviously things would be better but for the fiscal policy out of Washington. Spending cuts, take money from an economy that still needs some stimulus, and is getting it only through the expansionary monetary policy of the Federal Reserve. Reduced government spending has detracted from growth in eleven of thirteen past quarters. That period roughly coincides with the time that Mr. Obama and Congressional Republicans have shared governance since Republicans took control of the House in 2011, promising an immediate $100 billion in spending cuts.

So this seems like a good time to offer a sort of refresher on the nature of our economic woes, and why this remains a very bad time for spending cuts. Let’s start with what may be the most crucial thing to understand: the economy is not like an individual family. Families earn what they can, and spend as much as they think prudent; spending and earning opportunities are two different things. In the economy as a whole, however, income and spending are interdependent: my spending is your income, and your spending is my income. If both of us slash spending at the same time, both of our incomes will fall too.



And that’s what happened after the financial crisis of 2008. Families struggled to cope with the debt they had run up during the housing bubble: Many people suddenly cut spending, either because they chose to or because their creditors forced them to. Businesses were reluctant to invest given the weakness of consumer demand. Under these conditions, government cutbacks simply swelled the ranks of the unemployed—and as family incomes fell, so did consumer spending, compounding the damage. The result was a plunge in incomes that also caused a plunge in employment, creating the recession-like environment that persists to this day.

Why did spending plunge? Mainly because of a burst housing bubble and an overhang of private-sector debt— but people talk too much about what went wrong during the boom years and not enough about what we should be doing now. For no matter how lurid the excesses of the past, there’s no good reason that we should pay for them with year after year of mass unemployment.

So what could we do to reduce unemployment? The answer is that this is still a time for above-normal government spending, to sustain the economy until the private sector is willing to spend again. We should invest in rebuilding our infrastructure (bridges, roads, and other public works projects), retraining people for higher-skilled jobs and investing in research and new technologies. The crucial point is that under current conditions, the government is not, repeat not, in competition with the private sector. Government spending doesn't divert resources away from private uses; it puts unemployed resources to work. Government borrowing doesn't crowd out private investment; it mobilizes funds that would otherwise go unused. While public debt can pose problems, it doesn't make the nation poorer, because the vast majority of it is money we owe to ourselves.

Now, just to be clear, this is not a case for more government spending and larger budget deficits under all circumstances—and the claim that liberals always want bigger deficits is just false. For the economy isn't always like this—in fact, situations like the one we're in are fairly rare. By all means let's try to reduce deficits and bring down government indebtedness once normal conditions return and the economy is no longer depressed. But right now we're still dealing with the aftermath of a once-in-three-generations financial crisis. This is not the time for austerity.

The economic case for austerity—for slashing government spending even in the face of a weak economy—has been solidly repudiated both at home and abroad by real world evidence. Claims that spending cuts would actually boost employment by promoting confidence have fallen apart. Claims that there is some kind of red line of debt that countries dare not cross, have turned out to rest on fuzzy and to some extent just plain erroneous math. Predictions of a fiscal crisis keep not coming true, while predictions of disaster from harsh austerity policies have proved all too accurate.

Now is as good a time as any to refute some of the other canards regarding stimulus programs, like they never go away. Ending stimulus has never been a problem—in fact, the historical record shows that it almost always ends too soon. In the United States, government spending programs designed to boost the economy are in fact rare—F.D.R.'s New Deal and President Obama's much smaller Recovery Act are the only big examples. And neither program became permanent—in fact, both were curtailed much too soon. F.D.R. cut back sharply in 1937, plunging America back into recession; the Recovery Act had its peak effect in 2010, and has since faded away, a fade that has been a major reason for our slow recovery. In America, we have a pretty good record for behaving in a fiscally responsible fashion, with one exception—namely, the fiscal irresponsibility that prevails when, and only when, hard-line conservatives are in power.

Keynesian economics says not just that you should run deficits in bad times and pay them down in good times. And it's silly to imagine that this will happen, right? Wrong. The key measure you want to look at is the ratio of debt to G.D.P., which measures the government's fiscal position better than a simple dollar number.

And if you look at United States history since World War II, you find that of the 10 presidents who preceded Barack Obama, seven left office with a debt ratio lower than when they came in. Who were the three exceptions? Ronald Reagan and the two George Bushes. So debt increases that didn't arise either from war or from extraordinary financial crisis are entirely associated with hard-line conservative governments.

And there's a reason for that association: U.S. conservatives have long followed a strategy of "starving the beast," slashing taxes so as to deprive the government of the revenue it needs to pay for popular programs. Yet, these same hard-line conservatives declare that we must not run deficits in times of economic crisis. Why? Because, they say, politicians won't do the right thing and pay down the debt in good times. And, irony of ironies, who are these irresponsible politicians they're talking about? Why, themselves.

Incidentally, foreign experience follows the same pattern. You often hear Japan described as a country that has pursued never-ending fiscal stimulus. In reality, it has engaged in stop-go policies, increasing spending when the economy is weak, then pulling back at the first sign of recovery (and thereby pushing itself back into recession). So the whole notion of permanent stimulus is fantasy posing as hardheaded realism.

The president has fought unsuccessfully to combine deficit reduction, including spending cuts and tax increases, with spending increases and targeted tax cuts for job-creation initiatives in areas like infrastructure, manufacturing, research and education, a formula closer to what the economists propose. But Republicans have insisted on spending cuts alone and smaller government as the key to economic growth. The results, Mr. Obama has taken to saying, are "self-inflicted wounds."

Those wounds have translated into millions of human tragedies—homes lost, careers destroyed, young people who can't get their lives started. And while many people have pleaded all along for policies that put job creation front and center. Their pleas have, however, been drowned out by the voices of conventional prudence. We can't spend more money on jobs, say these voices, because that would mean more debt. We can't even hire unemployed workers and put idle savings to work building roads, tunnels, schools. Never mind the short run, we have to think about the future!

But the cuts have done huge short-term economic damage. If you look at the areas that sustained major cuts they were in education, infrastructure, research and conservation. Public investment fell sharply—so sharply that many observers refer to it as a "collapse"—as state and local governments canceled transportation projects and deferred maintenance. Researchers, like those at the National Institute of Health, also took large cuts. And there was a major cut in spending on land and water conservation. In sum, the cuts mainly involved investing in the future. So, we aren't just looking at short-term harm, we're also looking at a long-term degradation of our prospects, reinforced by the corrosive effects of sustained high unemployment.

The bitter irony, then, is that it turns out that by failing to address unemployment, we have, in fact, been sacrificing the future, too. What passes these days for sound policy is in fact a form of economic self-mutilation, which will cripple America for many years to come. The ugly truth is that by tolerating high unemployment we have inflicted huge damage on our long-run prospects.

How so? Our seemingly endless slump has done long-term damage through multiple channels. The long-term unemployed eventually come to be seen as unemployable; business investment lags thanks to weak sales; new businesses don't get started; and existing businesses skimp on research and development. Economic weakness has already reduced America's economic potential by around 7 percent, which means that it makes us poorer to the tune of more than $1 trillion a year. And we're not talking about just one year's losses; we're talking about long-term damage: $1 trillion a year for multiple years. The evidence is overwhelming that by failing to respond effectively to mass unemployment—by not even making unemployment a major policy priority—we've done ourselves immense long-term damage.

Is there any chance of reversing this damage? The Fed researchers are pessimistic, and, once again, they're probably right. America will probably spend decades paying for the mistaken priorities of the past few years. It's really a terrible story: a tale of self-inflicted harm, made all the worse because it was done in the name of responsibility. And the damage continues as we speak.

> "When it comes to our budget, we should not be stuck in a stale debate from two years ago or three years ago. A relentlessly growing deficit of opportunity is a bigger threat to our future than our rapidly shrinking fiscal deficit." –Obama

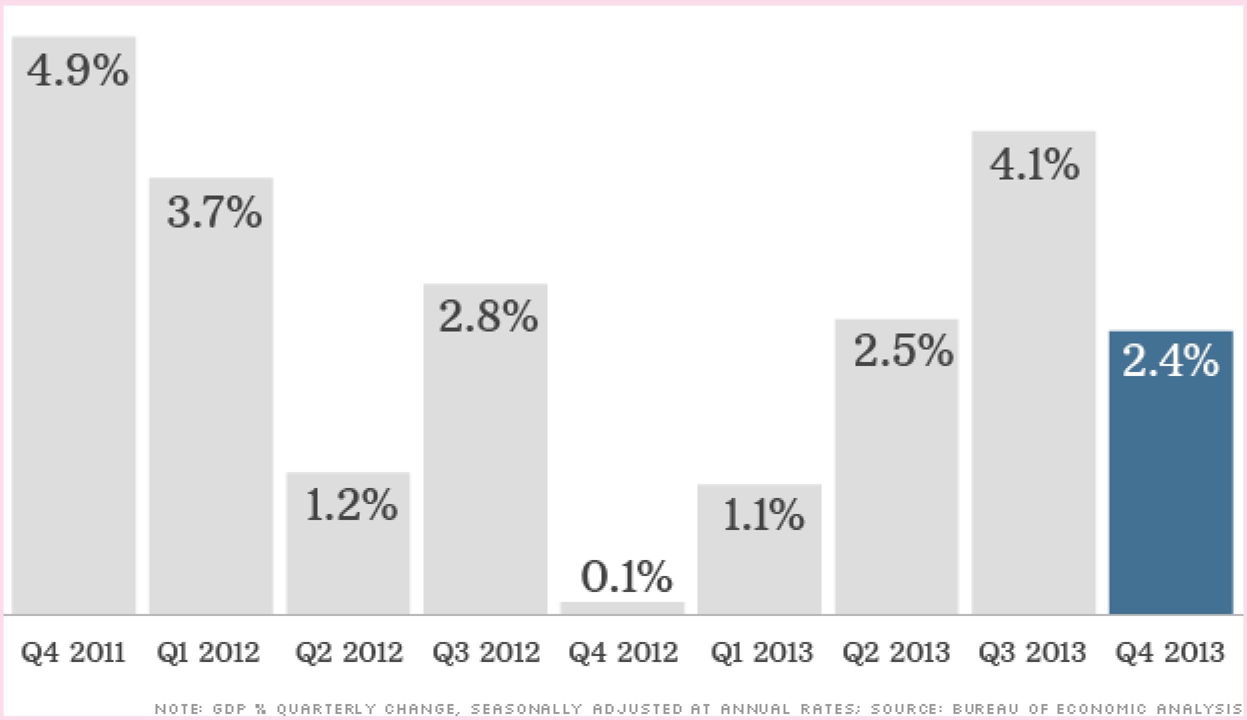
The president was right and the Federal Open Market Committee, which sets policy for the central bank, echoed as much when it stated that "Fiscal policy is restraining economic growth," reiterating public comments that Ben S. Bernanke, the Fed chairman, has made for months. He noted that the economy was much stronger than Europe's largely because the United States initially opted for stimulus measures and allowed deficits to increase when the recession and financial crisis hit five years ago. European governments pursued austerity policies to cut their debts, further stalling economic activity and in turn inflating deficits. The evidence has been in for some time, both at home and abroad: Deficit reduction is and has been a drag on economic recovery.

What would it take to reverse these trends? For one thing, in the near term, do no harm. Austerity, including sequestration, is the economic version of medieval leeching. Until just recently, the Federal Reserve has continued to apply high doses of monetary stimulus, which supported low interest rates, which in turn led to an improving housing market. But it can't do it alone, and Congress is counteracting such tailwinds with fiscal headwinds. Congress needs to shift its focus on jobs and get people back to work.

ECONOMY JUST MUDDLING ALONG

The U.S. economy grew at a 2.4% annual pace in the fourth quarter, marking a slowdown primarily driven by cuts in government spending. The economy merely muddled along at the end of the year, but economists call it "impressive" given the federal spending cuts and the government shutdown in October.

Overall, economic growth was not quite as strong at the end of 2013 as originally thought, according to revised data released by the Commerce Department on Friday. Gross domestic product -- the broadest measure of economic activity -- grew at a 2.4% annual pace in the fourth quarter, revised down from 3.2% originally reported last month.



The number fell short of economists' expectations and is disappointing after faster 4.1% growth in the prior quarter. A decline in federal spending was the largest drag on growth, subtracting a full percentage point from GDP. (If government spending had merely remained the same, the economy would have grown at a 3.4% pace.) Given that drag, overall economic growth is "still impressive," Paul Ashworth, chief U.S. economist for Capital Economics said. Weakness in the housing sector also weighed on the economy. Investment in residential real estate slowed for the first time in three years, according to the report.

As usual, the U.S. economy is still driven primarily by consumer spending, which picked up slightly in the fourth quarter. International trade was also a large driver of economic growth, as exports grew at a faster clip than imports from other countries. Business investment contributed to growth, albeit at a slower pace than in the previous quarter.

DEFICIT CONTINUES TO DROP SHARPLY - CBO

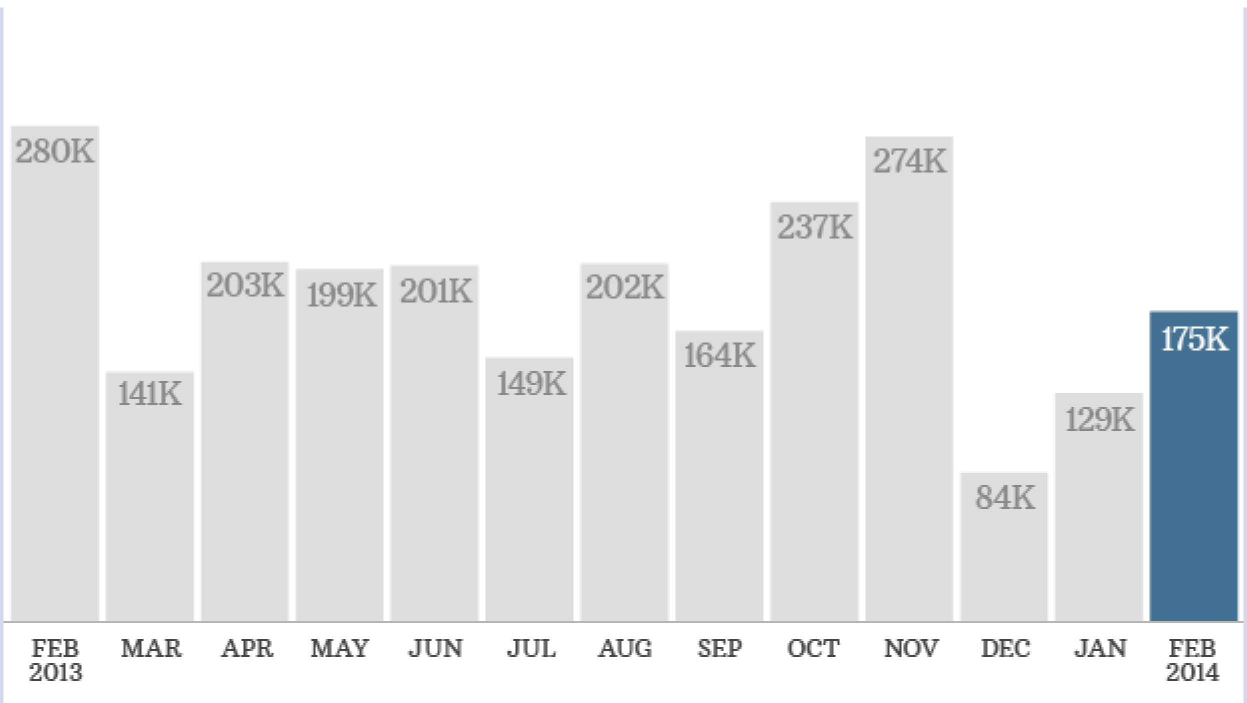
The age of trillion-dollar deficits is well over. For now. Thanks to a recovering economy, spending restraint and higher tax receipts, the Congressional Budget Office (CBO) now projects the deficit for 2014 will be $514 billion, or 3% of the size of the U.S. economy. As a share of gross domestic product, that represents a nearly 27% drop from last year, and marks the smallest deficit since 2007. In its latest budget and economic outlook, the CBO also projected that the 2015 deficit would reach a low for the coming decade, at $478 billion, or 2.6% of GDP, and then stay below 3% for a couple of years after that.

But then the downward trajectory ends. Deficits will again top $1 trillion starting in 2022, and be at or above 4% of GDP, according to the CBO. The reason? Revenue will keep pace with economic growth, but spending will exceed it. "Spending is boosted by the aging of the population, the expansion of federal subsidies for health insurance, rising health care costs per beneficiary, and mounting interest costs on federal debt," the CBO said. All other federal spending except that on entitlements and interest, meanwhile, is projected to reach its lowest point as a percentage of GDP since 1940.

Overall, the CBO expects $7.9 trillion to be added to the nation's cumulative public debt over the next decade. That's $1 trillion higher than CBO's projection last May, in part because of changes in the agency's economic forecast—specifically lower projections for real economic growth. In any case, the debt is now expected to grow from roughly 74% of GDP this year to 79% by 2024. Historically, that's a high level. In 2007, total public debt was just 35%.

For policymakers, the sharp drop in deficits for the next few years relieves pressure on them to address entitlement and tax reform. Indeed, there is little appetite left in Washington for the so-called grand bargain. Treasury Secretary Jack Lew observed, "We have a little time to deal with the long term."

HIRING SURPRISINGLY STRONGER IN FEBRUARY



The job market picked up more than expected in February, led by strong hiring in professional and business services. The U.S. economy added 175,000 jobs last month, marking an improvement from January and topping economists' expectations. Meanwhile, the unemployment rate ticked up to 6.7%, from 6.6% the prior month as more Americans joined the labor force.

Economists had been expecting a weaker jobs number due to colder than usual weather throughout much of the country in February. Ice and snow can postpone hiring if businesses close, or even cause a decline in outdoor jobs, like construction. That didn't happen though. Instead, hiring picked up across many sectors. Construction added 15,000 jobs, restaurants and bars added 20,100 jobs and education and health services added 33,000 jobs. By far, the strongest hiring came from professional and business services industries, which include accountants, architects and technology workers. This sector alone added 79,000 jobs last month.

Wages are up: Average earnings ticked up 9 cents, to $24.31 an hour in February. It may not sound like much, but it was the largest monthly wage gain in more than two years. “Rather than gains in equities providing impetus for the wealthy to spend, stronger wage growth will help boost spending across all income groups," said Ellen Zentner, senior U.S. economist for Morgan Stanley. "This will be a key underpinning for consumer spending and economic growth this year."

Weather still holding back hiring: But weather still had some impact on the job market in February. About 6.9 million full-time workers said their hours were temporarily reduced due to "bad weather"—the highest level in any February on record since the government started tracking the data in 1977.   Prior to December, the economy had been adding an average of 205,000 jobs each month. Economists are hoping job growth will return to that level in the spring.

Still not recovered: The U.S. economy lost 8.7 million jobs amid the financial crisis, and as of February, only 8 million jobs had been recovered. Once factoring in population growth, economists still estimate it will take years to get back to pre-recession health in the job market, when the unemployment rate was between 4% and 5%.

Meanwhile, long-term unemployment remains high. As of February, 3.8 million Americans were unemployed for six months or more. The so-called underemployment rate—technically known as the U-6—was 12.6%. That includes the unemployed, plus part-time workers who want to work full time, and people who want a job but haven't searched for one in the last four weeks.

WINTER HITS THE HOUSING RECOVERY

The mercury wasn’t the only thing that was dropping in colder parts of the nation. Cold weather hurt home prices in January, as a closely watched measure of housing values posted its third straight monthly decline. The S&P/Case-Shiller index of prices in 20 major markets dipped 0.1%. "The housing recovery may have taken a breather due to the cold weather," said David Blitzer, chairman of the index committee at S&P Dow Jones Indices.

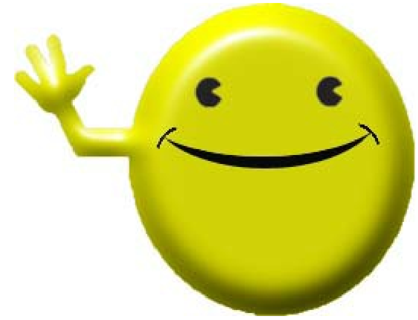
Five cities bucked the trend and saw price gains of 0.4% or more, and all of them--Las Vegas, Miami, **San Diego**, San Francisco and Tampa—are in warm-weather states. Four of the five cities that posted the sharpest drop in prices were cities hit hard by the cold weather—Chicago, Detroit, Minneapolis and Boston. Seattle prices also saw a significant drop.

Home prices are still bouncing back from the bust. On a year-over-year basis, prices gained 13.2% nationally. But gains are slowing; January's annual rise is the lowest 12-month gain posted since August. The high point of the current recovery, the 13.7% increase in November, was generally seen as unsustainable by housing experts.

Home values over the last year have been helped by a drop in foreclosures, a decline in the unemployment rate and a relatively tight supply of homes available for sale in the face of pent-up demand from buyers. But beyond the cold weather, prices are facing a headwind of higher mortgage rates. Rates are up from a year ago, when they hit a record low.

The Census Department reported that the pace of new home sales in February fell 3% from January, and also dipped below year-ago levels. January's estimate was also revised lower. The Northeast suffered by far the biggest decline in new home sales, falling more than 30% from to both January and year-earlier levels, indicating that they were also hurt by the bad weather.

RATE SUMMARY



As the stock market rose this month, mortgage rates worsened slightly.

***Conforming programs—an 1/8th to 1/4th higher ↑**
***Jumbos—no change**
***Governments—only a few programs worsened by an 1/8th ↑**

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO: www.mortgagestraighttalk.com The rate sheets are updated every Friday.

BEST BETS THIS MONTH

***Conforming 15yr. fixed @ 3.125%**
***Conforming 5/1 ARM @ 2.750%**
***High Balance Conforming 30 Yr. fixed @ 4.125%**
***High Balance Conforming 15 Yr. fixed @ 3.250%**
***Jumbo 5/1 ARM @ 2.875%**
***FHA Conforming 15 Yr. fixed @ 2.875%**
***FHA Conforming 30 Yr. fixed @ 3.625%**

I ALSO DO:

- **COMMERCIAL LOANS (more than 4 units)**
- **"HARD MONEY" LOANS**
- **REVERSE MORTGAGES**
- **FOREIGN NATIONALS**
- **DELAYED FINANCING**

MORTGAGE MIRTH

MORTY'S MAILBAG

There were no letters in the mailbag this month.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to be identified as a "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is morty@mortgagestraightTalk.com