



# Popular Economics

*Promoting the Popular Understanding of Economics*

## **Popular Economics Weekly**

*Week of January 14, 2008*

### **Housing's Future**

December's inflation figures are both good and bad news. Wholesale (PPI) and retail (CPI) inflation were up 6.2 percent and 4.1 percent, respectively, in 2007 though they showed little change in December. The higher inflation was mainly because of soaring energy prices, with CPI retail energy prices rose a huge 17.4 percent, followed by transportation and medical care in 2007.

It was good news because it showed that 2007 had a booming economy (rising prices mean rising demand), and bad news because it has hurt consumers' pocket books, while inflation fears have kept the Federal Reserve from reducing short-term interest rates faster. In fact, economic growth in 2007 is on course to equal 2006 Gross Domestic Product growth of 2.8 percent, even if fourth quarter '07 drops to 2 percent from Q3's 4.9 percent growth rate.

It seems that Chairman Bernanke in his latest remarks, at least, has got the message that the Fed should move faster in reducing interest rates, if it wants to slow the rate of mortgage defaults and give 2008 a boost.

Only such an action can spell relief to the mortgage and real estate industries. Even the underlying interest rates on prime credit Option ARMs now exceed 7.5 percent, due to the LIBOR, MTA, and COFI ARM indexes in use.

Relief does seem to be on the way with a reduction in fixed interest rates. The conforming 30-year fixed rate is now down to 5.25 percent with an approximate 1-point origination fee, and some jumbo products have edged into the 5 percent range. That is close to its 40-year low last reached in 2004, for those who remember.

This has spurred a surge in mortgage applications, with the Mortgage Bankers Association reporting an application increase of 32 percent and 28 percent, respectively, over the first 2 weeks in January. Its Conventional Loan Purchase Index increased 10.5 percent while the Government Purchase Index (largely FHA) jumped 17.6 percent in the week ending January 11.

The greater purchase activity is a sign that lower interest rates may be spurring higher home sales. On an unadjusted basis, the MBA's Purchase Index actually increased 45.2 percent over that time.

Inflation moderated in December, as both the PPI and CPI core rates increased just 0.2 percent, in part because consumer spending has slowed significantly. December's retail sales were the main culprit, falling for the first time in 6 months. But sales were up 4.2 percent for all of 2007, slightly ahead of inflation.

So inflation isn't to be feared if it means an economy that is growing along with inflation. The lower interest rates we are seeing this year should mean better growth and inflation.

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