

count deficit. The current account would be forced to zero by a combination of more exports and fewer imports. For exports to rise substantially, the dollar would have to depreciate significantly in the exchange markets with the obvious consequences on domestic price inflation. For imports to fall sharply, the U.S. would have to suffer a cut in income. This is what usually happens in countries that have to correct a current account deficit: unpleasant but necessary consequences. The U.S. has had current account deficits for almost 20 years. It may continue to have them for several more, but not forever. Sooner or later the adjustment will have to be made. Capital flows are notoriously fickle; when they move they do it fast, without pre-announcements. In sum, the above adjustment scenario is one of the possible risks of the forecast: perhaps a low probability event, but certainly not zero.

Housing Outlook

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Existing single-family home sales fell along with consensus expectations in September. Record levels of home sales are virtually assured for 1999, with the pace expected to ease only slightly next year, according to the National Association of Realtors. While volume is now 10 percent below June's record, sales remain strong, as they have all year. Mortgage rates pulled back slightly in September from their August high. The dramatic increase in borrowing costs seems to finally be having an effect on the red-hot housing market.

Both average and median prices fell as excess demand for housing fell. Builders have been rapidly catching up with declining demand. Consumer confidence continues to buoy the market, but the impact of higher interest rates and bearish financial markets is taking hold.

Sales are expected to fall again in October as mortgage rates are pushed up by the prospect of Fed tightening and the weakening dollar. Moderation in the volatile residential construction industry could remove one of the most serious inflationary threats. A slowdown in home price appreciation would force consumers to spend within their means, as they can no longer count on rapid gains in real or financial

asset prices.

The combination of rapid price appreciation and increased mortgage rates has been cutting into housing demand. Potential home shoppers can no longer assume double-digit asset price gains and low mortgage rates. This is exactly what the Fed intended when it began tightening policy this summer. As there is little besides consumer confidence maintaining high levels of home sales, further Fed tightening could quickly shrink the housing market.

While sales remain at a high level, price appreciation has stalled, except on the West Coast. The stock market's September struggles are especially impacting demand for high-end homes. With housing supply increasing faster than demand, rapid and broad-based price appreciation is unlikely. Consumers remain confident, but simply can no longer afford as much house as they could a few months ago.

The Fed's efforts are having an impact. The most immediate casualty has been the mortgage refinancing market. Refinancings, which soared to a record \$800 billion last year, are currently running at a \$200 billion annual pace and are sure to weaken further with fixed mortgage rates now near 8%. The refinancing boom was one of the catalysts for the recent consumer spending binge, as homeowners lowered their mortgage payments and many took cash out of their homes by increasing their mortgage balance.

The housing market will also soon begin to feel the impact of higher rates. The market has largely shrugged off the higher rates as fence sitters have recently surged into the market in an effort to buy before mortgage rates move even higher. This activity will wane in coming weeks, however.

Housing starts for 1999 as a whole will probably total 1.66 million units, up about 2 percent from last year's historically high figure. Housing starts were down in three out of four regions of the country, with the largest decline – 25.7 percent – occurring in the Northeast. With mortgage rates back up to the 8 percent range, builders are seeing fewer current home sales and are less optimistic about sales in the near future. Housing starts are expected to slip to 1.56 million in 2000.

Existing-home sales are expected to total 5.20 million this year, which will be a 4.8 percent increase over the record 4.96 million sales in 1998. New-home sales are likely to match last year's record of 890,000, then ease to about 831,000 in the year 2000. The median-price of an existing home for 1999 is projected to be \$132,700, up 3.7 percent from 1998. At the same time, the median new-home price is expected to be \$158,500 for 1999, up 4.3 percent from last year. The median existing-home price is expected to rise only 1.4 percent to \$134,500 in the year 2000.

While rising interest rates made U.S. housing slightly less affordable in the second quarter, Kokomo, Ind., made national news by reclaiming its standing as the country's most affordable housing market for the eighth time in the past two and a half years, according to the Housing Opportunity Index (HOI) produced by the National Association of Home Builders (NAHB).

The HOI is a quarterly measure of the percentage of homes sold that a family earning the median income can afford to buy. The HOI ranks 184 metro areas on the basis of recorded home prices. The nationwide score was 67.0. What this means is that families earning the median U.S. household income of \$47,800 could afford to buy 67 percent of homes sold nationwide in the second quarter. That's down from the record high HOI of 69.6 in the first quarter, but still an exceptionally good reading on an historic basis. The national HOI has been above 67.0 in just four quarterly periods since the beginning of 1992.

Higher interest rates on mortgages are a significant factor in the recent decline. The interest rate used in second quarter HOI calculations, representing

a national weighted average of adjustable and fixed-rate loans, was 7.10 percent-up one and a half basis points from the previous quarter. The median price of homes sold also rose in the second quarter, to \$138,000 from \$134,000 in the previous three months.

For the eighth time in the past 10 quarters, Kokomo, Ind., was the most affordable individual market covered by the HOI. In the consistently affordable Kokomo housing market, families earning the local median annual income of \$53,500 could afford to buy 93.5 percent of the homes sold there where the median home sale price is \$90,000.

The most consistently affordable region in the new HOI rankings was the Midwest, where 13 markets made the "25 Most Affordable Metro Areas" list. The South had eight markets in the top 25, while the Northeast had three and the West had just one. The Housing Opportunity Index is based on the median family income, interest rates, and the price distributions of homes sold for each market in a particular quarter of a year.