

DAILY GLOBAL
COMMENTARY

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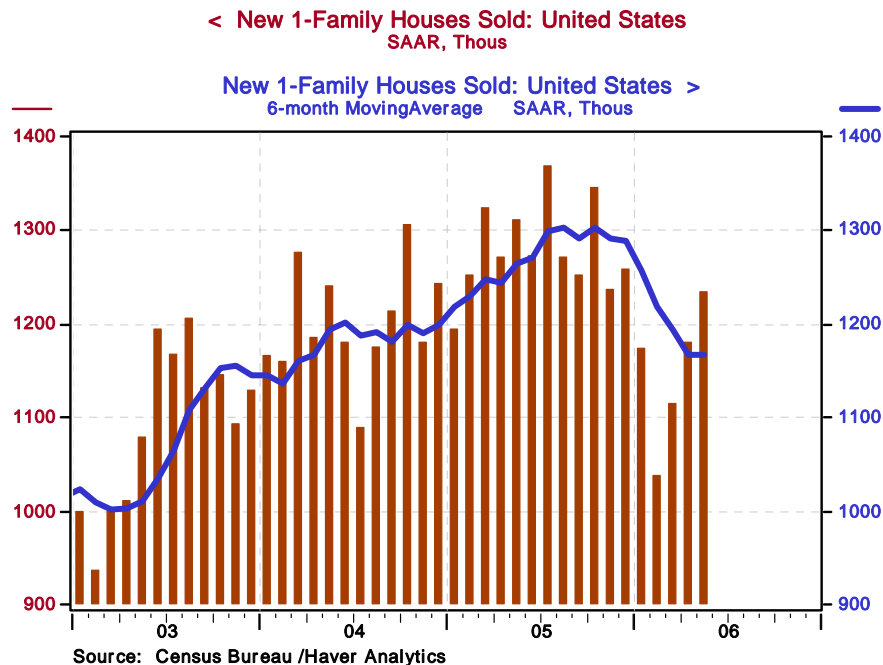
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New Home Sales: Today's Report Is At Odds With Other Housing Market Information

June 26, 2006

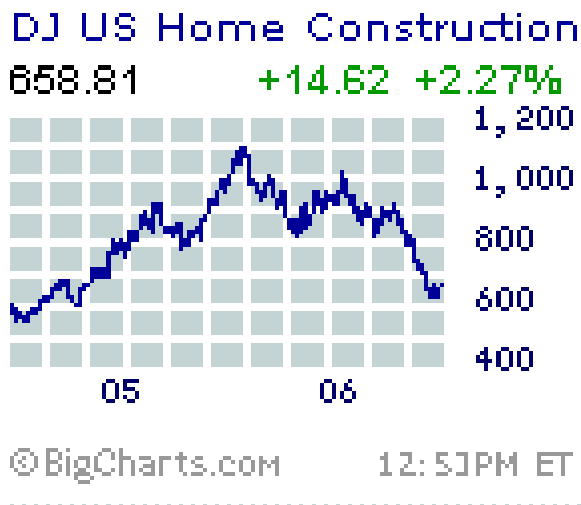
Sales of new homes increased 4.6% to an annual rate of 1.234 million units in May. The headline reading is contrary to expectations of a decline in sales of new single-family homes. On a 6-month moving average basis (see chart 1), sales of new single-family homes appear to have stabilized at a lower level after maintaining a strong momentum in much of 2005. There are reasons to believe that today's report probably presents an exaggerated picture of the strength in home sales when viewed in isolation.

Chart 1



Let us look at all the reasons why the implied strength in sales of new single-family homes during May is questionable. (1) The Housing Market Index of the National Association of Home Builders dropped to 42.0 in June, the lowest since April 1995. (2) Home builders such as KB Homes, Pulte Homes, and Toll Brothers, have slashed earnings forecasts and reported a drop in orders. KB Homes announced layoffs of about 7.0% of its workforce. Job layoffs adding up to of about 6,300 have been announced at housing market related firms such as Washington Mutual and Ameritrust. (3) Last week, the Dow Jones Home Construction Index for the U.S. was off 43.0% from its high in July 2005. (4) Housing Affordability Index is at the lowest level since July 1995, which is hardly supportive of increasing home sales. (5) The cost of a 30-year fixed rate mortgage has risen to 6.71%, the highest since June 2002.

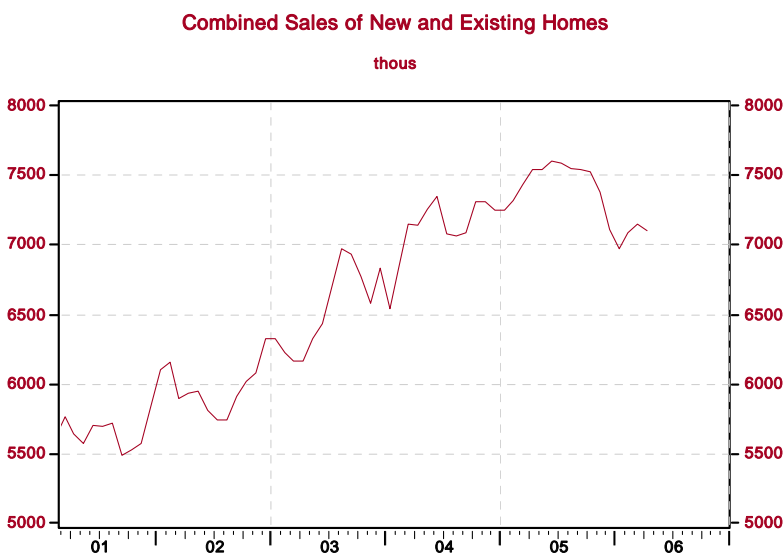
Chart 2



Source: www.marketwatch.com , John Spence, June 22, 2006

These grim housing market numbers are not supportive of growth in home sales. New homes make up roughly 20.0% of the total sales of new and existing homes. The existing home sales report for May will be published tomorrow. Combined sales of new and existing homes are down 6.6% from the peak established in June 2005. Sales of single-family existing homes have dropped in six out of the last seven months.

Chart 3



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These are details of the May report on new home sales. On a regional basis, sales of new homes increased in the Midwest (+2.7%), South (+6.0%) and West (+5.3%) but dropped in the Northeast. The median price of a new single family home rose 3.1% from a year ago to \$235,300 in May but fell 4.3% from a month ago. The inventory of unsold new homes fell to a 5.5-month supply in April from 5.8-month reading in April.

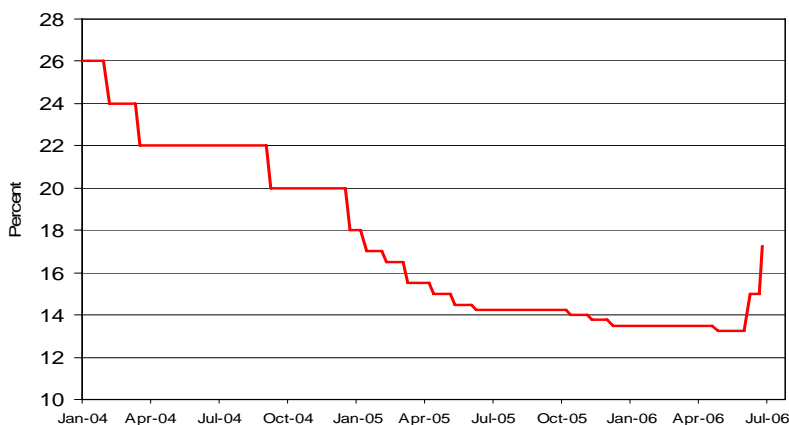
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Turkey: Panic or Prudence?

Another weekend, another “emergency meeting” from the Central Bank of Turkey (CBT). As we noted earlier this month (See Daily Global Commentary, June 6: [“Central Bank Of Turkey Will Need to Hike Interest Rates Tomorrow”](#)), the CBT is rapidly running out of time to establish its inflation fighting credentials. It seems that, after a few years of regularly pruning its policy rates to match easing inflation, the bank is scrambling to remember how to fight rising prices. With political concerns threatening to further destabilize the markets, the CBT has little leeway left.

Having hiked its overnight borrowing rate from 13.25% to 15.00% at an emergency meeting on June 7, the CBT surprised the markets by reiterating its commitment to price stability at its regularly scheduled policy meeting last week (June 20), but holding its fire on the interest rate front. Then came a renewed drop in the lira on Friday (June 23), and another emergency meeting that resulted in a 225bp rate hike (taking the o/n borrowing rate up to 17.25%).

Interbank Overnight Rate

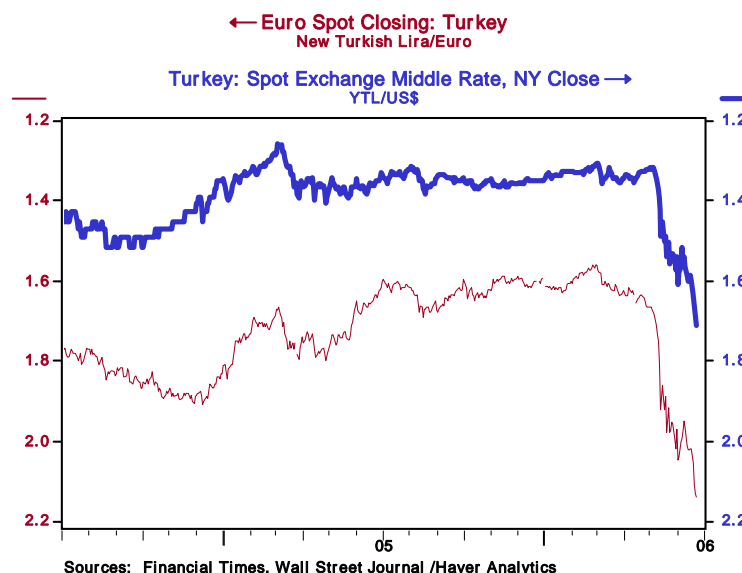


In addition to stepping up the size of its rate hike, the bank has also stepped up its rhetoric and its forex market interventions. In the week after the June 7 tightening the CBT did indulge in some desultory dollar sales, but its actions were perceived as too little, too late. The lira touched 1.7650/US\$ in after-hours trade last Friday, just off its all-time low of 1.77/US\$ (reached in March 2003).

CBT Governor Yilmaz announced today that “you should not be surprised to see a central bank which is more active in matters of foreign exchange and interest rates from now on.”

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This morning, the bank announced the start of dollar sales auctions, and also carried out direct market intervention to support the lira.



The onus for stabilizing Turkey's markets does not rest just with the CBT. Shifting global interest rate expectations and a rise in investor nerves about emerging markets in general, are leading to a closer awareness of political developments in markets such as Turkey. In the face of concerns about looming elections, Islamist-secularist tensions, and an ongoing row with the European Union, PM Erdogan's government sounds far too complacent, reiterating in recent days that the lira's fall reflects global developments and will soon pass.

While there are plenty of macro-economic reasons for anxiety about Turkey's stability, it is the political concerns that risk turning anxiety into an outright crisis. Turkey is under pressure from the EU to open its ports and airports to traffic from EU-member Cyprus by year-end. Erdogan is sticking to the line that the EU must first lift trade restrictions on Turkish Cypriots in breakaway northern Cyprus. The PM has said he would rather risk the suspension of Turkey's own EU entry talks than yield over Cyprus (a highly sensitive issue for Turkish nationalists). According to media reports, the first draft of the EU report on Turkey's accession talks criticizes the Erdogan government for a lack of progress on various reforms, and for its stance on relations with the divided island. Unless the government starts to sound more conciliatory, the publication of the progress report in October will seriously set back the talks.

With the presidential election due in May 2007, political issues are not about to fade away. In fact, if the lira keeps sliding and the CBT keeps hiking, Erdogan may find it hard to ignore calls for an early parliamentary election (the next vote does not have to be held until November 2007) – which would further exacerbate market unease.

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