

• FEBRUARY 23, 2010

Housing Looks to Avoid Worst-Case Scenario

By KELLY EVANS

The floor beneath home prices might be wobbly, but it is unlikely to collapse.

December's average home prices in 10 major cities are expected to be flat to slightly down when Standard & Poor's releases its Case-Shiller home-price index Tuesday. Seasonal weakness and a lull in activity following the original November expiration of the government's \$8,000 home-buyer tax credit, since extended, are seen as possible factors.

A decline would mark the first monthly drop since May, which might seem worrisome given widespread concern that a "double dip" in home prices could short-circuit the country's nascent recovery. Yet such an event is looking less likely.

For one, the roughly 32% drop in home prices from their 2006 peak through spring 2009 has helped bring prices more in line with their historical relationship to both rents and income, said Alan Levenson, chief economist at T. Rowe Price.

Home prices have risen about 5% from their April 2009 trough and still look to be about 5% undervalued compared with households' after-tax personal income, said Mr. Levenson. They were about 45% to 50% overvalued by the same measure during the boom.

Meanwhile, the foreclosure pipeline could be gradually thinning. The share of mortgages 30 days delinquent or more declined in the fourth quarter. The percentage entering foreclosure dipped as well, the Mortgage Bankers Association said last week.

Even if home prices do weaken further amid fading government support for the housing market, it doesn't necessarily spell disaster.

When Federal Reserve officials devised their "stress tests" of banks last May, they anticipated that by the fourth quarter of 2009 home prices would be down 14% from the prior year, followed by a drop of 4% in 2010. Their worst-case scenario was even grimmer, with prices falling 22% in 2009 and 7% this year. However, Tuesday's Case-Shiller figures are expected to show that prices wound up dropping only 4% to 5% in 2009, and forecasters said they could hold roughly steady this year.

That, said Nomura Securities economist Zach Pandl, would mean "the banking system is in better health than feared."

Write to Kelly Evans at kelly.evans@wsj.com