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Bernanke allays subprime fears as Beazer faces probe

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By Julie Haviv

NEW YORK (Reuters) - Testimony by the two top U.S. economic officials Wednesday raised fresh concerns in financial markets about the deteriorating housing market, despite their view that subprime mortgage problems are "contained."

The practices of lenders in the $1 trillion subprime sector have drawn scrutiny from regulators and law enforcement officials who believe some borrowers have been fraudulently induced to take on more debt than they can handle.

While most of the activity has involved civil actions, the No. 6 home builder in the country, Beazer Homes USA Inc., said it has received a request for documents from federal prosecutors in a probe relating to its mortgage business, sending its shares down as much as 11.8 percent.

The builder specializes in lower-priced homes, the sector of the market where subprime lending has been most prevalent. The FBI said it was looking at "a potential fraud investigation" into Beazer.

The financial markets' worst fear has been that problems with subprimes -- loans aimed at borrowers with weak credit -- will spill into the overall housing sector and push the slowing economy into reverse.

Federal Reserve Chairman Ben Bernanke said in testimony to Congress that the impact of the problem has been "moderate" in the big picture, and U.S. Treasury Secretary Henry Paulson said the problem "appears to be contained."

Paulson, testifying before a House Appropriations subcommittee, said the Treasury was monitoring housing market developments closely but was encouraged by signs that the housing downturn was at or near a bottom.

"This is a complicated issue, but from the standpoint of the overall economy, my bottom line is we're watching it closely but it appears to be contained," he told the panel's financial services and general government subcommittee.

However, the Treasury chief said he had "grave concern" for the many Americans who will be adversely affected by the resetting of adjustable rate subprime mortgages.

Bernanke said he the tighter credit conditions taking over in the subprime market are desirable because they will counter excessively lax vetting of applicants.

Fears that the subprime market could drag down all U.S. home builders punished the entire sector, with the Dow Jones U.S. Home Construction index off about 20 percent since the beginning of February. The index was off 3.3 percent Wednesday, with big declines by Standard Pacific Corp., off 5 percent, and Centex Corp., down 4.3 percent. Beazer led with losses of about 10 percent.

The Dow Jones industrial average, meanwhile, was down nearly 90 points by late afternoon, largely on concerns over a weaker economy and disappointment that the Fed chairman did not do much to encourage hopes for lower interest rates.

In a sign of deepening problems at one of the biggest subprime lenders, New Century Financial Corp., said it had voluntarily terminated its relationship with Freddie Mac and that "several" of its own lenders plan to sell loans that had backed $17.4 billion of credit lines.

The Irvine, California,-based company also said it has entered agreements with regulators in Idaho, Iowa, Michigan and Wyoming to stop lending, following similar agreements with or orders from several other states.

The developments may move New Century closer to bankruptcy, an outcome many analysts already expect.

BERNANKE BRUSHES OFF SPILLOVER

While Bernanke saw no signs of a contagion, he told Congress that housing was the principal source of a slowdown in economic growth that began last spring.

Bernanke's comments suggest the central bank will continue to keep a watchful eye on the housing market and will pay particular attention to the key spring housing market.

Borrowers are increasingly avoiding adjustable-rate home loans. The latest data from the Mortgage Bankers Association showed applications for fixed-rate mortgages are up 30 percent year-over-year while applications for adjustable-rate mortgages are down by 18 percent.

(Additional Reporting by Gilbert Le Gras, Caroline Valetkevitch) (Editing by Richard Satran)