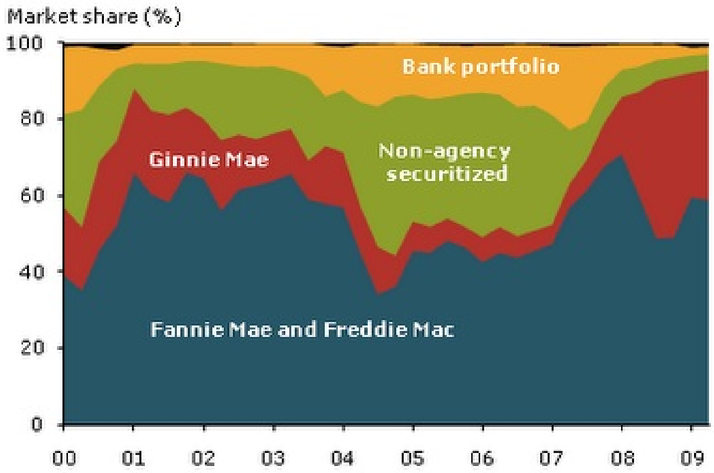
Fed Economist: "It Will Be Difficult for the Housing Market to Return to Normal"

Tuesday, October 27, 2009

The government, for all practical purposes, now controls the entire housing mortgage market.

A senior economist at the San Francisco Federal Reserve Bank, John Krainer, said in a report that that government sponsored enterprise intermediation of mortgage lending will make it difficult for the housing market to "return to normal."

Krainer said that GSEs such as Fannie Mae, Freddie Mac and Ginnie Mae now guarantee over 80% of originations, while non-agency mortgage securitization and loans have pretty much dried up.



Krainer wrote that the banking institution share of mortgage assets declined from 75 percent in the 1970s to 35 percent in 2008 due to the expansion of GSEs.

He added that the expansion of the GSEs has had a great impact on the type of borrowers receiving loans. Pointing to data in late 2006, at the end of the housing boom, Krainer said that about 20 percent of all mortgage originations were made up of subprime loans, and that by 2008, the subprime share was "effectively zero." This then yo-yo'd. The bankers moved out of this market, but the GSE's stepped in.

"Since then, increased FHA lending-identified here by Ginnie Mae's share-has revived this segment of the market," he added. "After plummeting in early 2008, the share of borrowers with FICO credit scores lower than 660 has returned to just higher than 20%, the same share as when subprime securitization peaked in 2006."

However, the collapse of nonconforming loan originations has had a particularly strong impact on the higher end of the market. The share of jumbo mortgages was nearly 9% at the peak in 2006. By the end of 2008, jumbo loans accounted for just 3% of new originations. Meanwhile, in another big shift, option ARMs made up about 6% of originations in the fourth quarter of 2006. By year-end 2008, option ARMs had vanished from the data set

Krainer concludes:

Mortgage originations have slowed considerably over the past two years. According to Federal Reserve flow of funds data, household net borrowing backed by home mortgages has fallen every quarter since the beginning of 2006, and is now negative for the first time since the 1970s. It is difficult to disentangle the role played by declining demand for mortgages from the declining supply of credit. Lender surveys, such as the Federal Reserve Senior Loan Officer Opinion Survey, have consistently reported that borrower demand has declined over the course of the recession. Credit supply *problems, however, still appear to be a major problem affecting the housing market. With the vast majority of current mortgage lending now intermediated in some form by the GSEs, it will be difficult for the housing market to return to normal.*

Bottom line: I am not sure what Krainer considers as normal, but the Fed isn't printing money, which obviously cuts into the supply side of credit. Plus banks are too spooked to be lending what funds they do have, especially when the Fed is paying them interest to simply keep their reserves, risk-free, with the Fed. Further, with a continued high demand told hold cash, no one is rushing out to buy a home. Keep an eye on the household net borrowing backed by home mortgages, the overall housing market won't strengthen in earnest until that number does.

http://www.economicpolicyjournal.com/2009/10/fed-economist-it-will-be-difficult-for.html