

United States

By Dwight Jaffee and Sean Wilkoff, University of California, Berkeley

Macroeconomic overview

During 2009, the United States (US) continued in its deepest recession since the Great Depression. Most macroeconomic indicators reached the worst levels seen in the past decade. Real GDP growth rate became negative reaching -2.4%. The unemployment rate increased dramatically to 9.3%, over double the unemployment rate seen a decade ago. The inflation rate dropped slightly, with fears of deflation and inflation equally balanced. Interest rates continued to drop, reaching their lowest values for the past 25 years. Experts continue to disagree whether the official end of the recession can be dated in late 2009. Although GDP growth turned positive at the end of 2009 and continued into 2010, concern for a double-dip recession remained evident. This concern was reinforced by the very slow improvement in the employment rate. Job growth has begun, but additions to the labour force have so far matched the new job opportunities, allowing little improvement in the unemployment rate. Further concerns arose in mid-2010 as the Gulf of Mexico oil spill remained unchecked and the European sovereign debt crisis remained unsolved.

Housing and mortgage markets

The housing market in 2009 continued to decline. Housing starts fell to little more than half of 2008 levels, while housing completions dropped by about 30%. Permits issued dropped only slightly less than housing starts. New homes sales continued their decline since 2005. The total housing stock increased slightly. Overall, a recovery in housing construction activity appears only as a future hope, probably beyond 2010.

On a more positive note, existing home sales saw their first increase since 2005. The existing home sales levels were lower than 2007, but higher than 2008. House prices continued their decline, dropping below levels not seen since 2003 and 2004. However, gross residential lending, buoyed by refinancing and existing home sales, increased for the first time since 2005. Much of the refinancing and home sales activity benefited from a variety of government programmes during 2009, including US Government mortgage guarantees provided through the Federal Housing Administration (FHA) and the GSEs (Government-Sponsored Enterprises, Fannie Mae and Freddie Mac, operating under a government conservator). It is unclear whether these programs will continue, and if they are discontinued whether the lending activity has sufficient momentum to continue on its own. Mortgage delinquency and foreclosure rates continue to rise. Total mortgage delinquency rates (more than 30 days delinquent) were 5.8% at year-end 2007, 7.9% at year-end 2008, and ended 2009 at 9.5%. Foreclosure rates were 2% at year-end 2007, 3.3% at year-end 2008, and ended 2009 at 4.6%. Of course, delinquency and foreclosure rates on subprime mortgages were even higher, ending 2009 with a delinquency rate of 25.3% and a foreclosure rate of 15.6%.

Government programmes to modify mortgages, and therefore avoid delinquency and foreclosure, continue to be active, but it remains uncertain if they will achieve their goal. One concern is that these programs may simply push foreclosure activity to the future. For this reason, it is unclear whether delinquency and foreclosure conditions in 2010 will show improvement or not.

Mortgage rates declined in 2009 to 5.04%, down from 6.04% in 2008 and 6.34% in 2007. Other mortgage contract terms generally showed trends toward better underwriting standards. In particular, LTV ratios declined from their 2007 levels, reaching levels almost on par with 2006 levels. The average LTV ratio reached 76.9% in 2008, the LTV ratio for newly built homes was slightly lower (76.2%) and the previously occupied home LTV ratio reached 77%.

Funding

The securitisation market in 2009 issued a larger amount of MBS than in 2008 a sign that the securitisation market is providing funding. However, the vast majority of these MBS are backed by Fannie Mae and Freddie Mac, with very little private market underwriting. Concerning covered bonds, agency debt issued by the GSEs declined for the first time since 2005. The private market segment of the United States covered bond market remains small with Bank of America and JP Morgan having issued the only two covered bonds by domestic banks.

Significant financial reform legislation is likely to be passed during 2010, since extensive reform legislation is pending before the US Congress as of mid-2010. Most of the reforms are directed at bank activity, including stronger capital requirements, restrictions on derivative and other high-risk activities, and cost-sharing within the industry for future bailouts. Major mortgage market reform, however, is not included in the pending financial reform legislation. The reason is that the two GSEs, operating under the government conservatorship, represent the core of the government's current program for stabilising the housing and mortgage markets. It is thus considered too soon and too dangerous to carry out major mortgage market reform during 2010.

Eventually, of course, the future form of the US mortgage market, including the future role for Fannie Mae and Freddie Mac, will reach the policy reform agenda perhaps in 2011. There is already wide-spread agreement that the public-private hybrid format for Fannie Mae and Freddie Mac has failed. Simply put, the firms maximised their private value by taking on extensive interest rate and credit risks, leaving US taxpayers to pay the price when those investments failed, an amount already approaching USD 200 billion. Since the two GSEs are unlikely to play a substantive role on the future US mortgage market, the major policy question is how to reorganise the US mortgage market without them:

- 1) Is the private sector able to replace the close to 50% of the US mortgage market that was previously supported by the GSEs?
- 2) Can private mortgage insurance expand to help the markets carry on efficiently without the GSEs?
- 3) Will the absence of the GSEs require a greater and continuing direct role for the U.S. government in the mortgage market?
- 4) If there is to be a greater government role, what form should that take? For example, would it include an expanded role for the already existing FHA and GNMA programs?
- 5) Should other fundamental changes be considered for the US mortgage market? For example, should recourse to borrower assets be expanded as it is currently in most European countries?

	EU27, 2009	USA, 2009	USA, 2008
GDP growth (%)	-4.2	-2.4	0.4
Unemployment rate (%)	8.9	9.3	5.8
Inflation (%)	1.0	-0.8	4.4
% owner occupied	68.2	67.2	67.5
Residential Mortgage Loans as % GDP	51.9	81.4	86.2
Residential Mortgage Loans per capita, EUR thousand	12.37	26.04	29.08
Total value of residential loans, EUR million	6,125,727	7,994,457	8,850,770
Annual % house price growth	-6.8	-12.4	-9.5
Typical mortgage rate (euro area), %	2.71	5.04 ⁵⁸	6.04
Outstanding Covered Bonds as % outstanding residential lending	23.2	0.1	0.2

Notes:

- Typical mortgage rate in the euro area refers to the APRC (Source: ECB)
- EU owner occupation rate for the EU27 average derived from EMF calculations based on latest available data.

USA=2009

Source: EMF, Eurostat, ECB, Federal Reserve, Bureau of Economic Analysis, US Bureau of Census



⁵⁸ Conventional 30-year mortgage rate on a new mortgage loan