

Box 1

THE IMPACT OF US HOUSING SUPPORT INITIATIVES ON RECENT HOUSING MARKET DEVELOPMENTS

The US housing market, which was at the epicentre of the US and global financial crisis and economic downturn, has been showing signs of stabilisation since 2009. However, this appears to reflect, at least partly, the outcome of various housing support initiatives. Now that some of the support measures have been withdrawn, there is a risk that the observed improvements could prove to have been short-lived, as suggested by the weakness in recent housing market indicators. The purpose of this box is to report on the observed positive impact of such measures on the US housing market and to highlight potential sources of renewed weakness emerging in

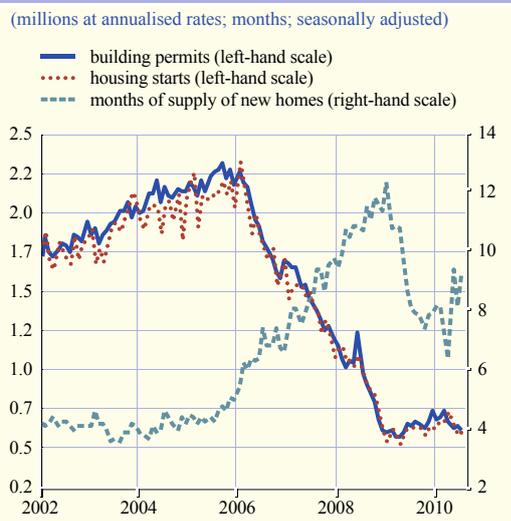


the absence of policy support. This is an important element in gauging the sustainability of the recovery in the US housing market and therefore the US economic outlook.

The US housing market has witnessed unprecedented distressed conditions since the crisis started. Housing starts decreased from more than 2 million units in 2005 to only 554,000 in 2009 (see Chart A), while foreclosures soared from 780,000 to about 3 million during the same period. House prices, as measured by the Case-Shiller Index, declined by more than 30% from their peak in 2006. More recently, though, some signs of improvement in the US housing market began to emerge. First, house prices started to stabilise as the annual change of the Case-Shiller Index returned to positive territory in early 2010. In addition, improved affordability due to previous house price declines, together with public support for new homebuyers introduced during the recession, supported demand and helped existing home sales to rebound in late 2009 to their highest level in almost three years (see Chart B). Progress has also been made in reducing the excess supply of new homes available for sale which, nevertheless, still remains elevated relative to the current rate of monthly sales.

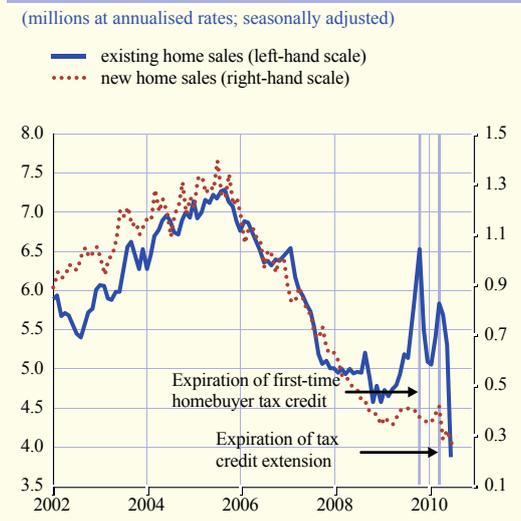
These improvements were partly driven by a number of government support initiatives, as federal support for the housing market expanded significantly during the crisis. A first set of measures consisted of mortgage modification programmes – such as the Home Affordable Modification Programme (HAMP) – which aimed to help distressed borrowers by making monthly mortgage payments more affordable. One effect of such modifications has been to slow the pace at which delinquencies turn into foreclosures and these, in turn, increase the supply of distressed properties on the market. Since such properties are usually sold at a significant discount, mortgage modification programmes might have contained, or at least delayed, the downward pressure on house prices related to foreclosures. Nevertheless, the positive impact could prove temporary, as many of the modified mortgages tend ultimately to redefault: it has been reported that more than half of all modifications become seriously delinquent one

Chart A US housing market developments



Source: US Census Bureau.

Chart B US home sales



Sources: National Association of Realtors and US Census Bureau.

year following conversion.¹ Even though recent vintages of mortgage modifications appear to be more successful, partly owing to increased focus on writing down principal on outstanding loans, renewed pressure from rising foreclosures cannot be excluded, as roughly one quarter of US homeowners have outstanding mortgages that exceed the value of their homes.

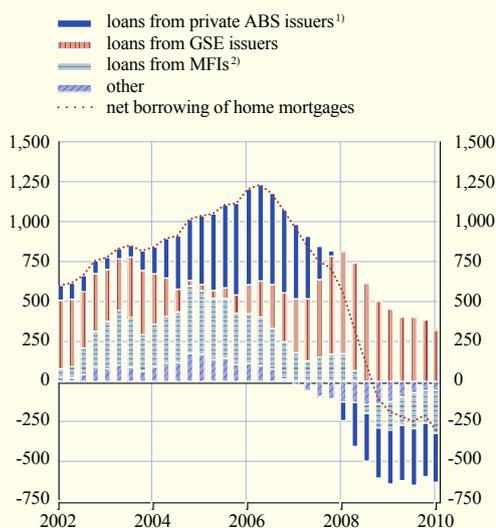
The homebuyer tax credit has been another housing support initiative. The measure was introduced as part of the 2009 stimulus package and consisted of a tax credit offered to first-time homebuyers. The programme appears to have played an important role in boosting existing home sales in the second half of 2009, with home resales jumping by almost 30% between August 2009 and November 2009 (the original expiration date of the programme, see Chart B). Home sales subsequently strengthened again in March and April 2010, which coincided with a second deadline following the extension of the tax credit until April 2010. However, one concern associated with the homebuyer tax credit is that the corresponding rebound in sales merely represented demand brought forward from the future, pointing to further weaknesses in the housing market following its expiration. This appears to be supported by available indicators which show renewed declines in home sales immediately after the expiration of the tax credit.

Finally, initiatives have been introduced to support the US mortgage market in order to help improve the availability and cost of credit to homeowners. One such initiative related to the large-scale (USD 1.4 trillion) purchases of debt of government-sponsored enterprises (GSEs) and GSE-guaranteed mortgage-backed securities (MBSs) on behalf of the Federal Reserve System, implemented between January 2009 and March 2010. The purchases appear to have contributed to a marked decline in mortgage rates. The interest rate on 30-year conforming mortgages declined by more than 1 percentage point to around 5% in November 2008, following the initial announcement of the programme, and remained at lower levels thereafter despite the end of the programme in March 2010. This resulted in improved housing affordability, with the US Housing Affordability Index remaining well above its long-term average as of mid-2010.

Public sector support remains crucial for the US mortgage market. In part, this has been driven by a dramatic change in the sources of US mortgage funding over recent years. While the supply of credit through private asset-backed security issuers (ABSs) dried up with the collapse of private-label mortgage securitisation during the financial crisis, the gap has only partially been replaced by way of mortgage originations financed through the GSEs Fannie Mae and Freddie Mac (see Chart C). Consequently, GSEs have been

Chart C Net borrowing of home mortgages in the United States

(four-quarter cumulated transactions in USD billions)



Source: Federal Reserve Board.

1) Loans from private asset-backed security issuers.

2) Loans from commercial banks, savings institutions and credit unions.

¹ See the report entitled "OCC and OTC Mortgage Metrics Report, First Quarter 2010", published in June 2010 by the Office of Comptroller of the Currency and Office of Thrift Supervision, Washington D.C.

the only source of net positive mortgage financing since 2008, which, however, did not prevent an overall decline in net mortgage borrowing.

GSEs have been pivotal in sustaining demand for mortgages and thus housing affordability. In September 2008, in view of their deteriorating solvency situation, Fannie Mae and Freddie Mac were placed under government conservatorship, whereby the Treasury provided a capital injection for each institution. To further ensure their solvency, in December 2009, the US Treasury extended its original support scheme to allow for unlimited capital infusions over the next three years, thus permitting any cumulative reduction in net worth over this period to be accommodated. Even though this may have facilitated the modification of mortgages serviced for the two agencies and eased investors' concerns about the solvency of the two institutions, the enhanced federal support for these GSEs ultimately added to the rising fiscal costs. Going forward, support for the mortgage market through GSEs is likely to be subject to limits. This is not only because of the added burden on the US fiscal position, but also because of the caps imposed on their portfolio growth, which put a limit on GSEs' capacity for purchasing new mortgages.

To conclude, much of the stabilisation in the US housing market since 2009 appears to reflect various housing policy initiatives. As some of the home support measures have now been withdrawn, the observed improvements may prove to be only temporary, and the renewed weakness in housing developments as of late may weigh on the economic outlook.