



Economic Insights: Conversations with the Dallas Fed

April 12, 2011

America's Housing Market: What's Required for a Sustainable Recovery?



When Will Housing Stabilize and Support the Recovery?

John V. Duca

Vice President & Senior Policy Advisor

Federal Reserve Bank of Dallas*

and Adjunct Professor, Southern Methodist University

Anthony Murphy

Senior Research Economist and Policy Advisor

Federal Reserve Bank of Dallas*

* The views expressed are those of the speakers and should not necessarily be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System.



Introduction

- An anemic recovery after the Great Recession
- Aside from hurting the financial system, the subprime boom and bust notably affected construction and consumption

Bottom line: housing shifted economy's momentum

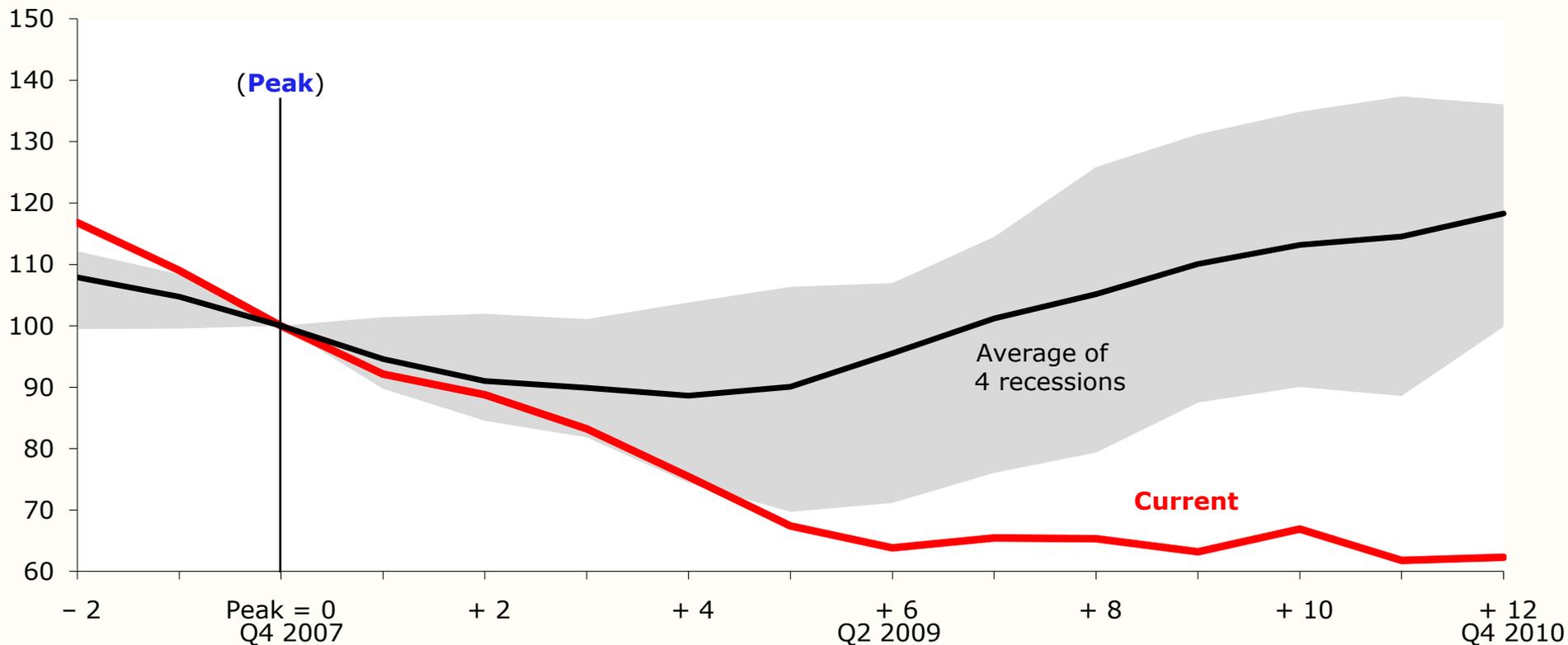
- from big plus in mid 2000s
- to big negative in 2007-2009
- to small negative in 2010, small plus in 2011?

An important momentum shift!



Real construction well below normal in this recovery

Real Private Residential Investment
(Peak=100)

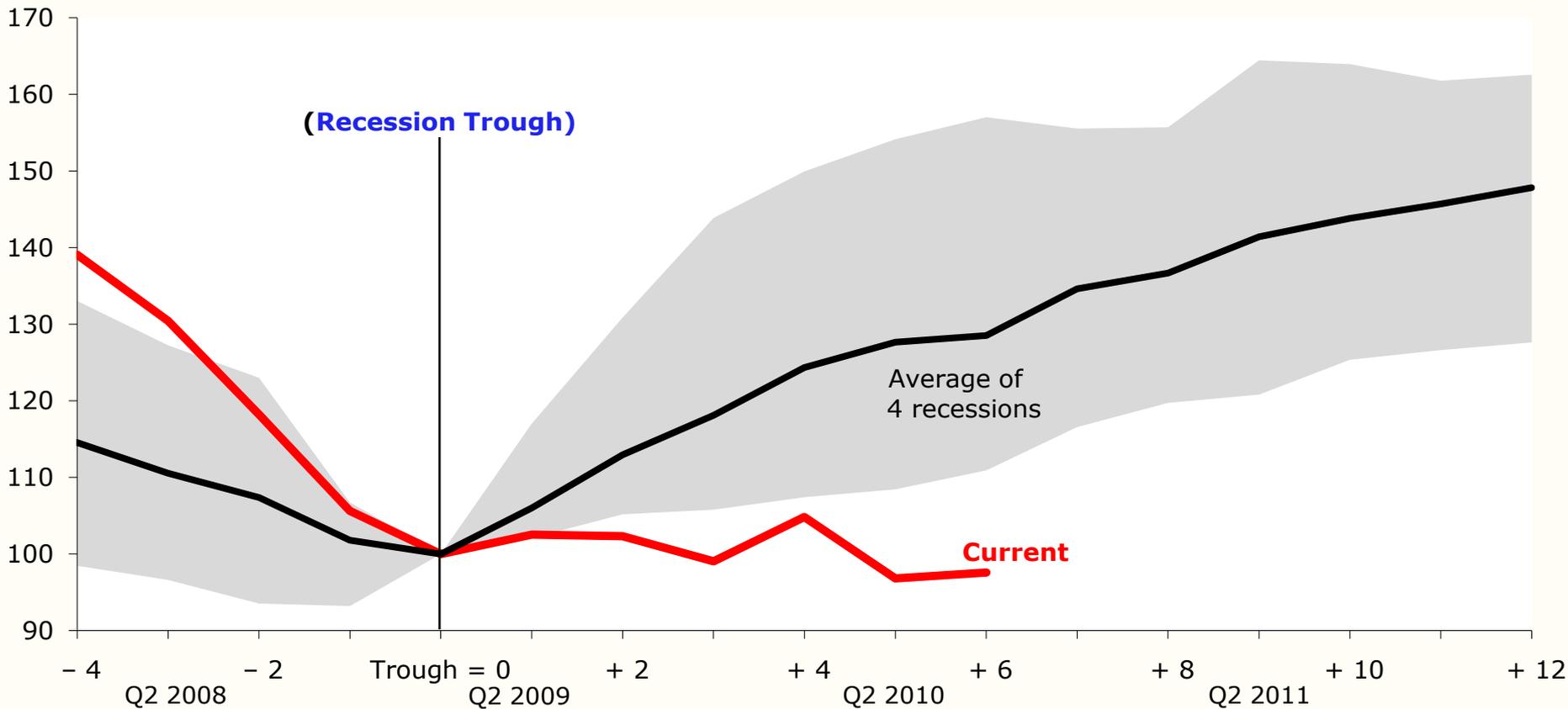


NOTE: Grey area indicates range of previous 4 recessions (1973-74, 81-82, 90-91, and 2001); excludes the very short 1980 recession.



Real construction well below normal in this recovery

Real Private Residential Investment
(Recession trough=100)



Note: Grey area indicates range of previous 4 recessions (1973-74, 81-82, 90-91, and 2001); excludes the very short 1980 recession.



Outline

- Key drivers of housing
- Housing construction
- House prices
- Regional dimensions



Key drivers of housing

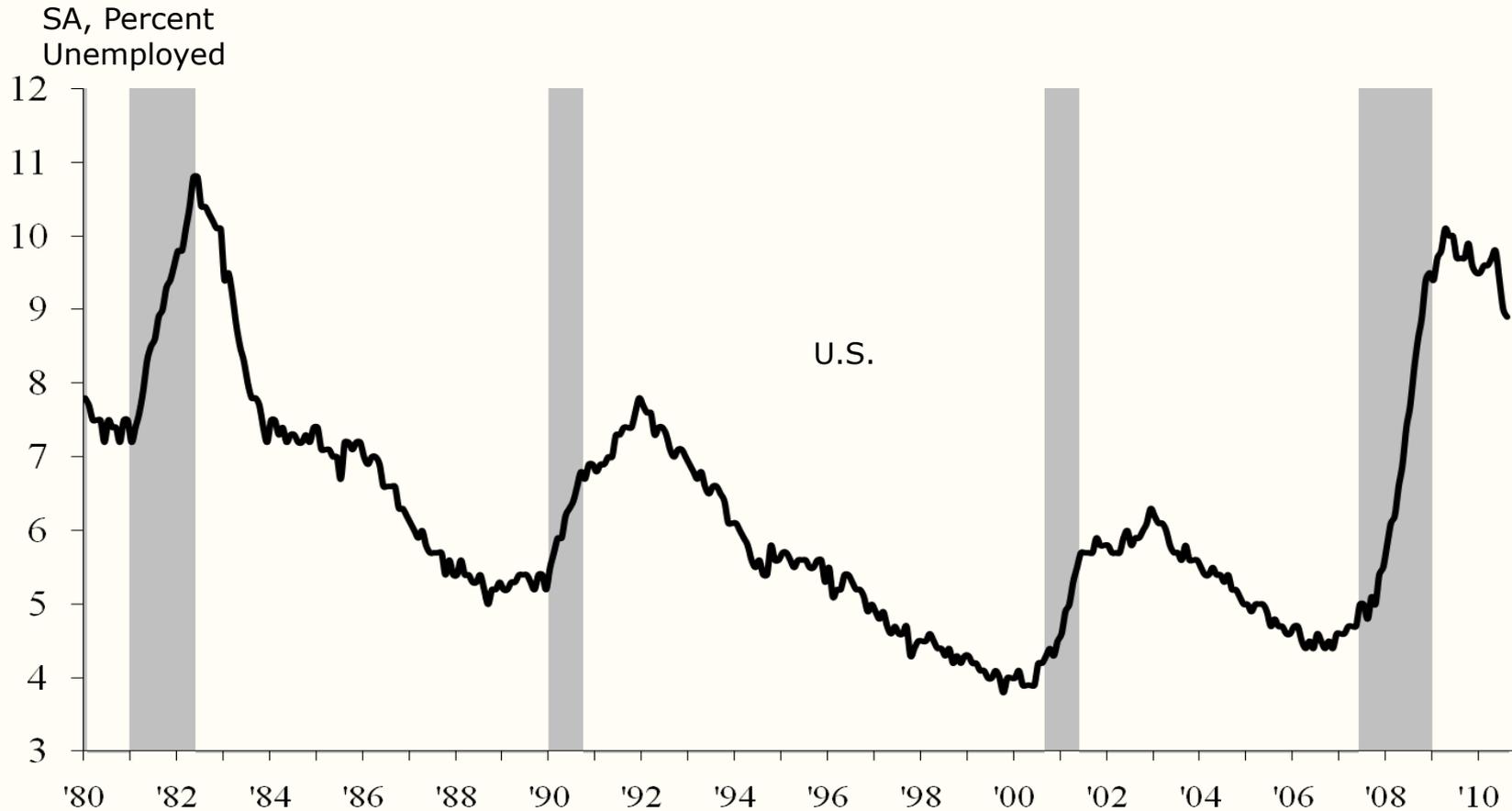
Demand:

- Income or unemployment
- Interest rates and recent capital gains/losses
- Credit Standards (noninterest terms of mortgages)

Easy standards (low down-payments) a main driver of house prices during recent boom and bust



Largest jump in unemployment since the 1930s



Source: Bureau of Labor Statistics and author's calculations.



Mortgage rates alone not enough to drive latest housing cycle

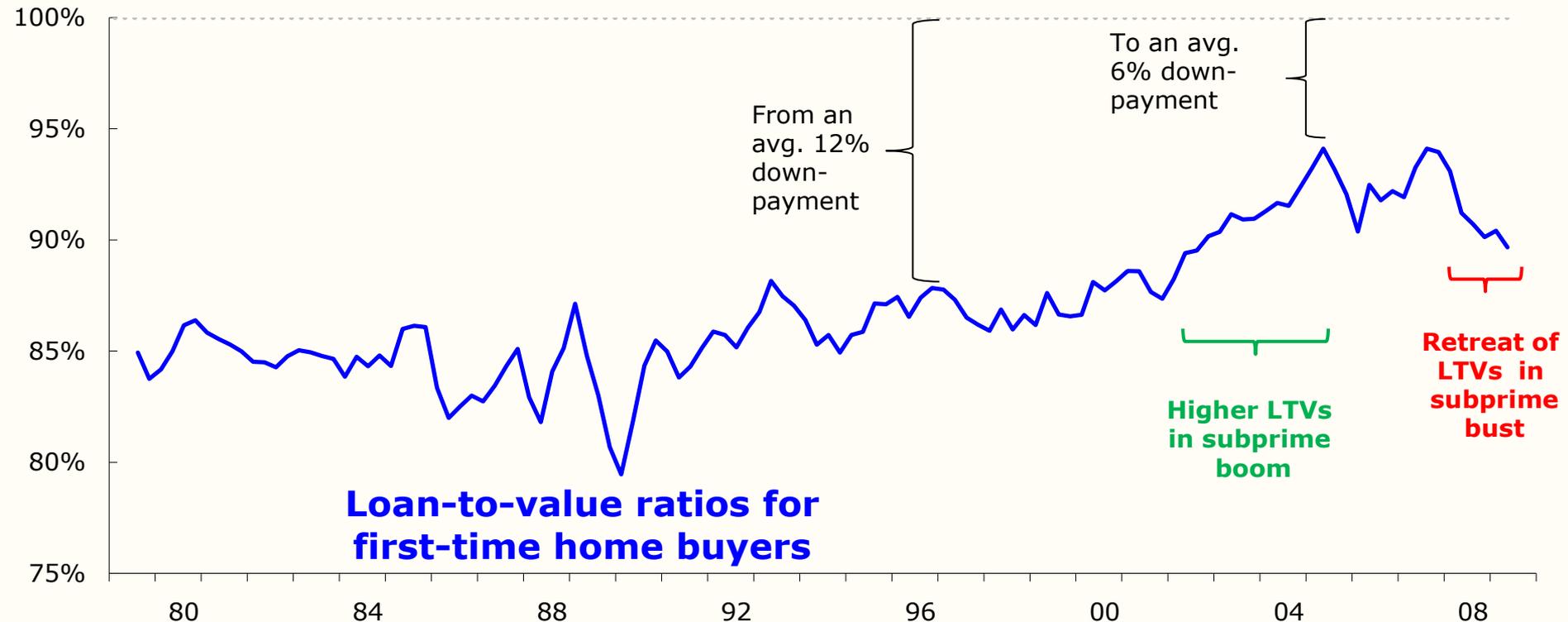


Sources: Freddie Mac, Bankrate, Federal Reserve, and Duca, DiMartino, and Renier, <<http://dallasfed.org/research/eclett/2009/el0902.pdf>>



Loan-to-value ratios swing during subprime boom and bust

Percent of home purchase price



Source: "Shifting Credit Standards and the Boom and Bust in U.S. House Prices," John V. Duca, John Muellbauer, and Anthony Murphy, Dec. 2010.



Key drivers of housing

- Demand:
 - Income or jobs
 - Interest rates and recent capital gains/losses
 - Credit Standards (noninterest terms of mortgages)
- Supply (stock of housing and foreclosure sales):
 - Stock of housing higher from construction boom so vacancy rate higher
 - Foreclosure sales compound excess supply
- **Swings in credit drove boom-bust in house prices**

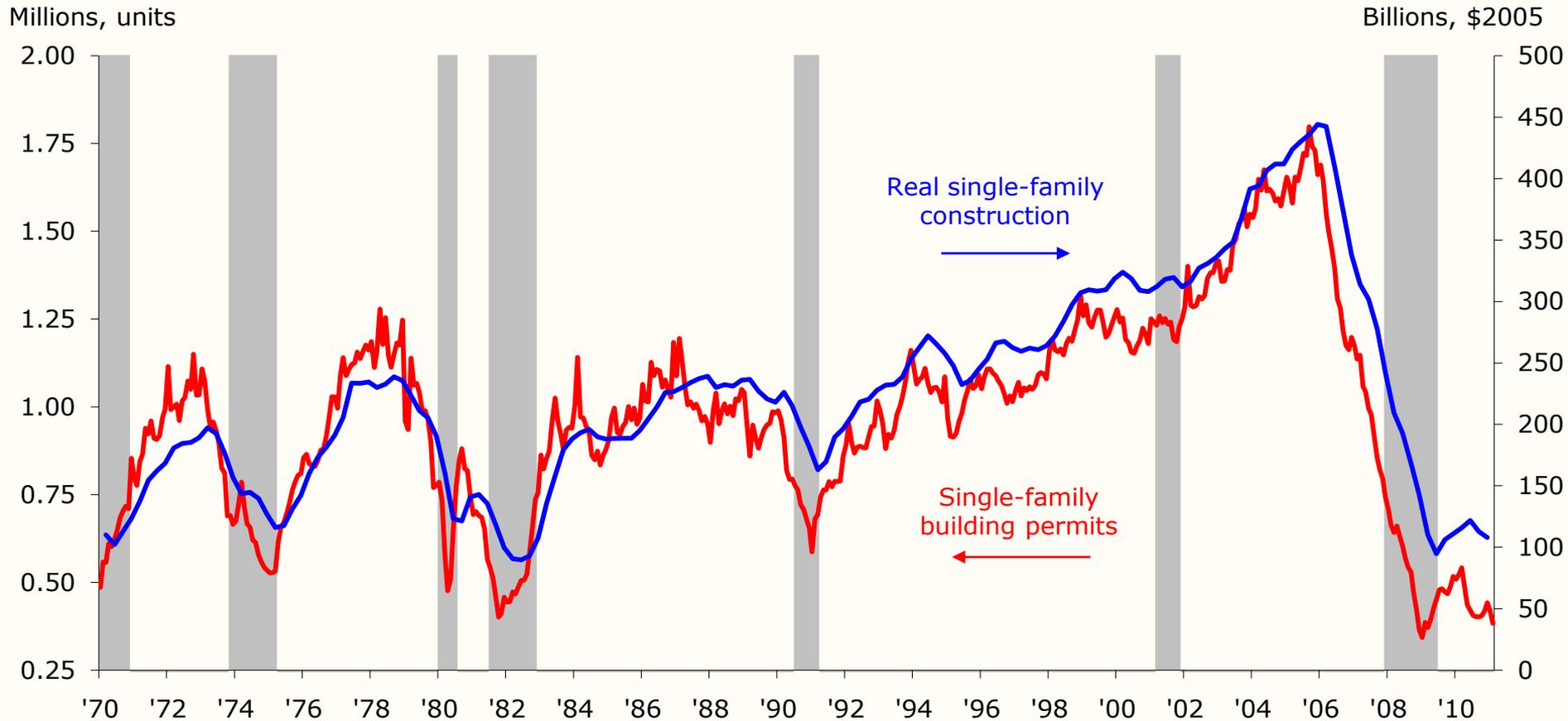


Housing construction

- Overbuilding during the boom
- Unusually low construction during the bust
- False dawn from home-buyer tax credit
- Housing construction finally turning up?
Not yet....



Housing permits bottom, and after a lag, so does home construction

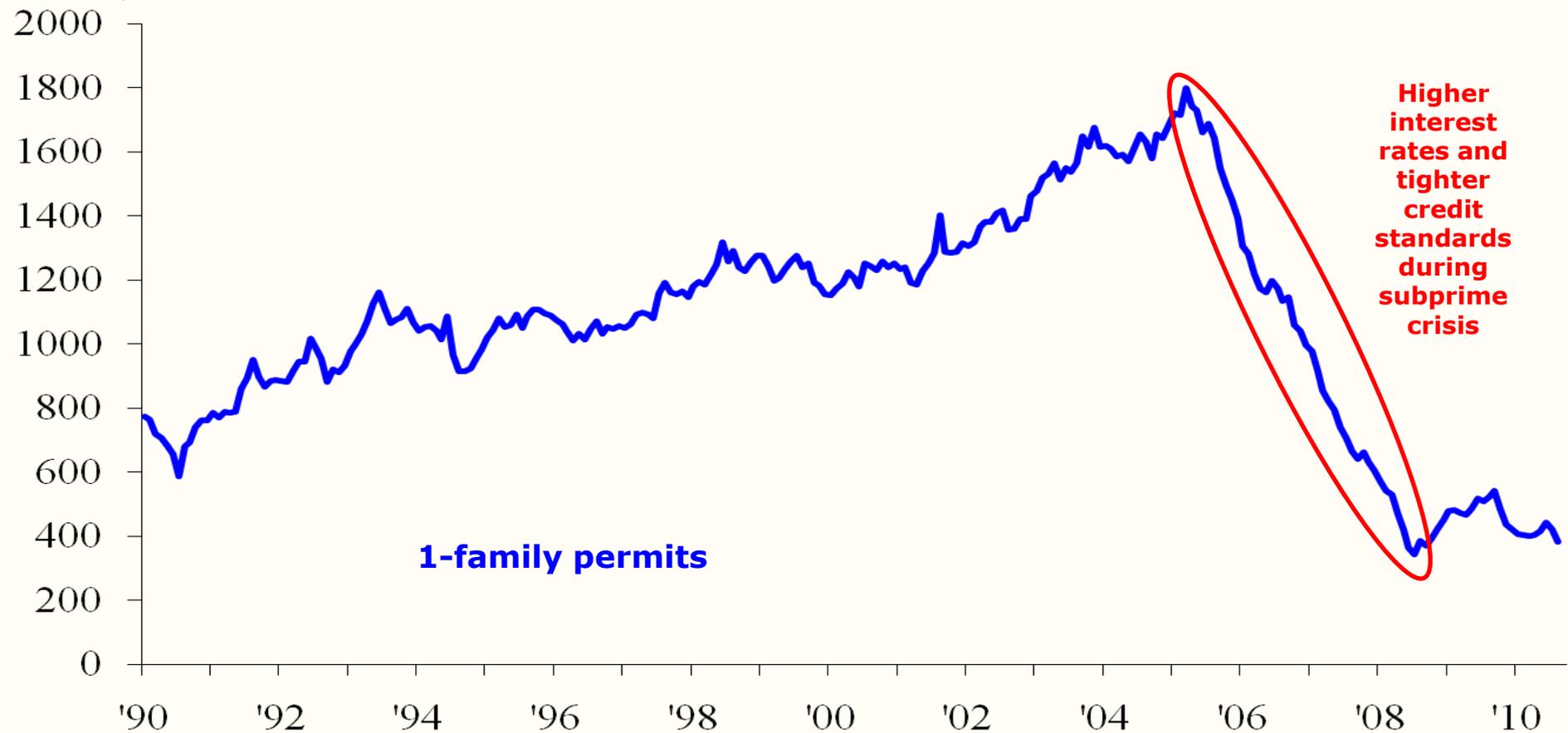


Source: Bureau of Economic Analysis, U.S. Census and author's calculations.



Home building falls after interest rates rise in 2005 and credit standards tighten

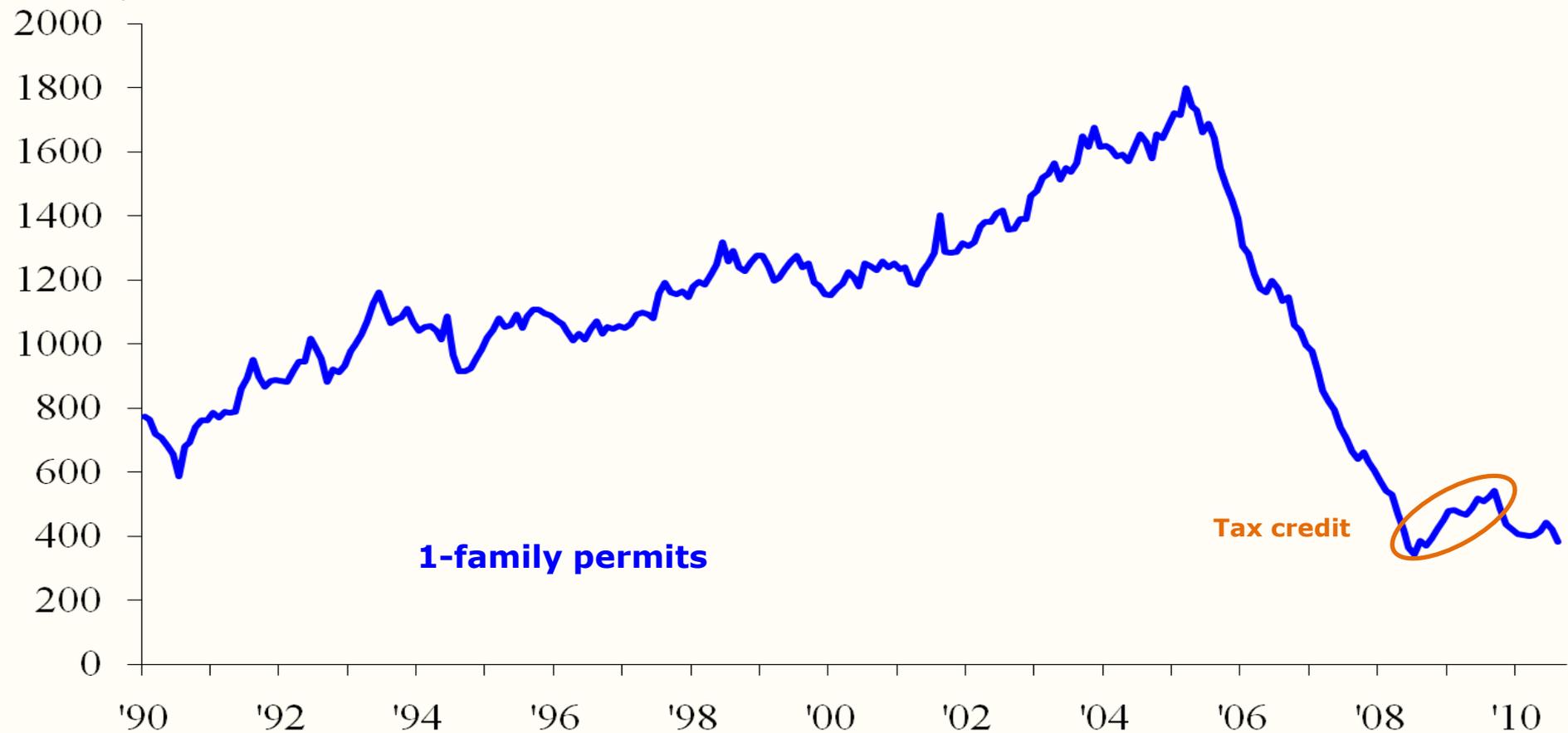
SAAR, thousands





...then temporarily boosted by home buyer tax credits

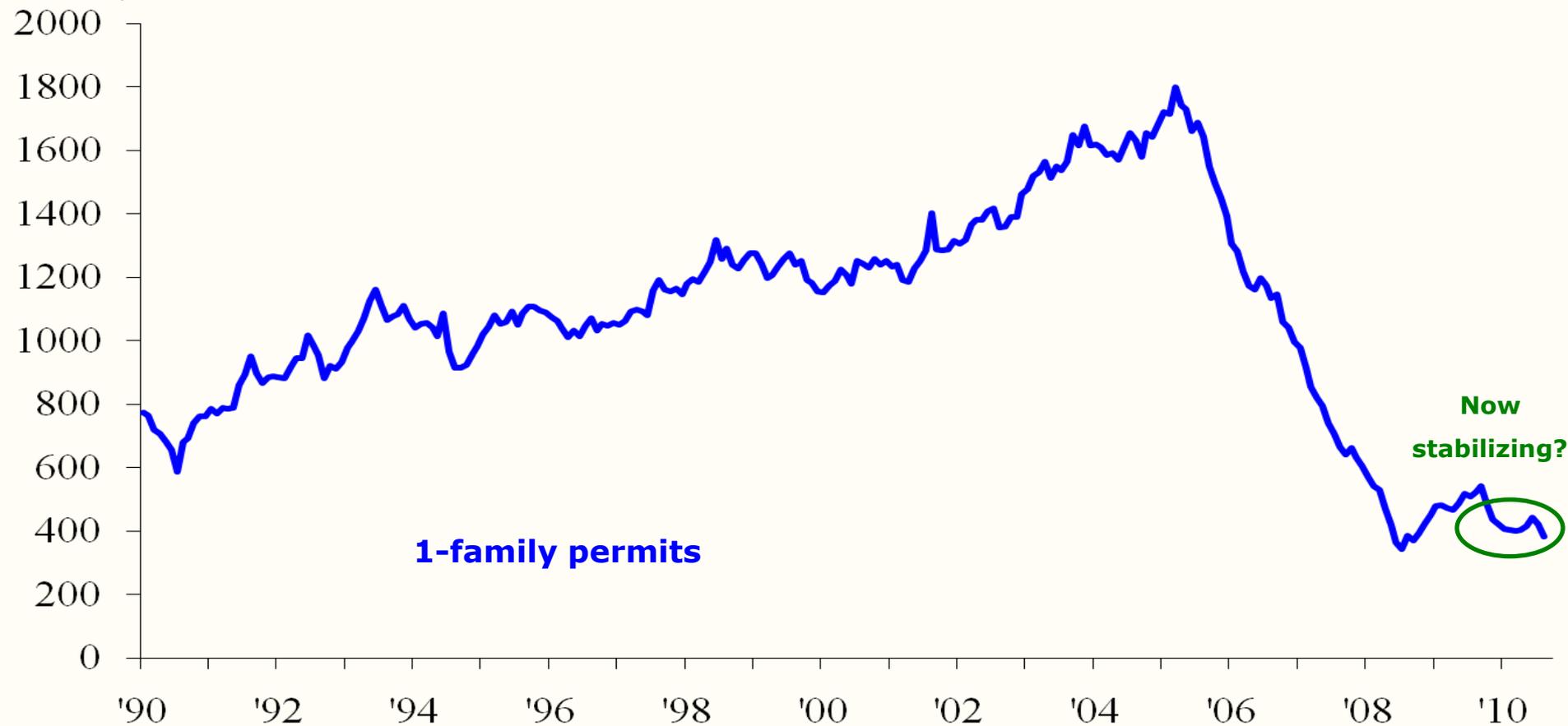
SAAR, thousands





...now on a slow path to recovery

SAAR, thousands





How much excess supply of houses needs to be worked off and for how long?

■ **On the Downside:**

- Vacancy rate: excess supply worked off in 1 year at current building pace
- Five million deeply underwater mortgages: possibly more excess supply

■ **On the Upside:**

- Job growth outside “sand states” points to some building in growth states
- Household formation likely to recover with revival of job growth

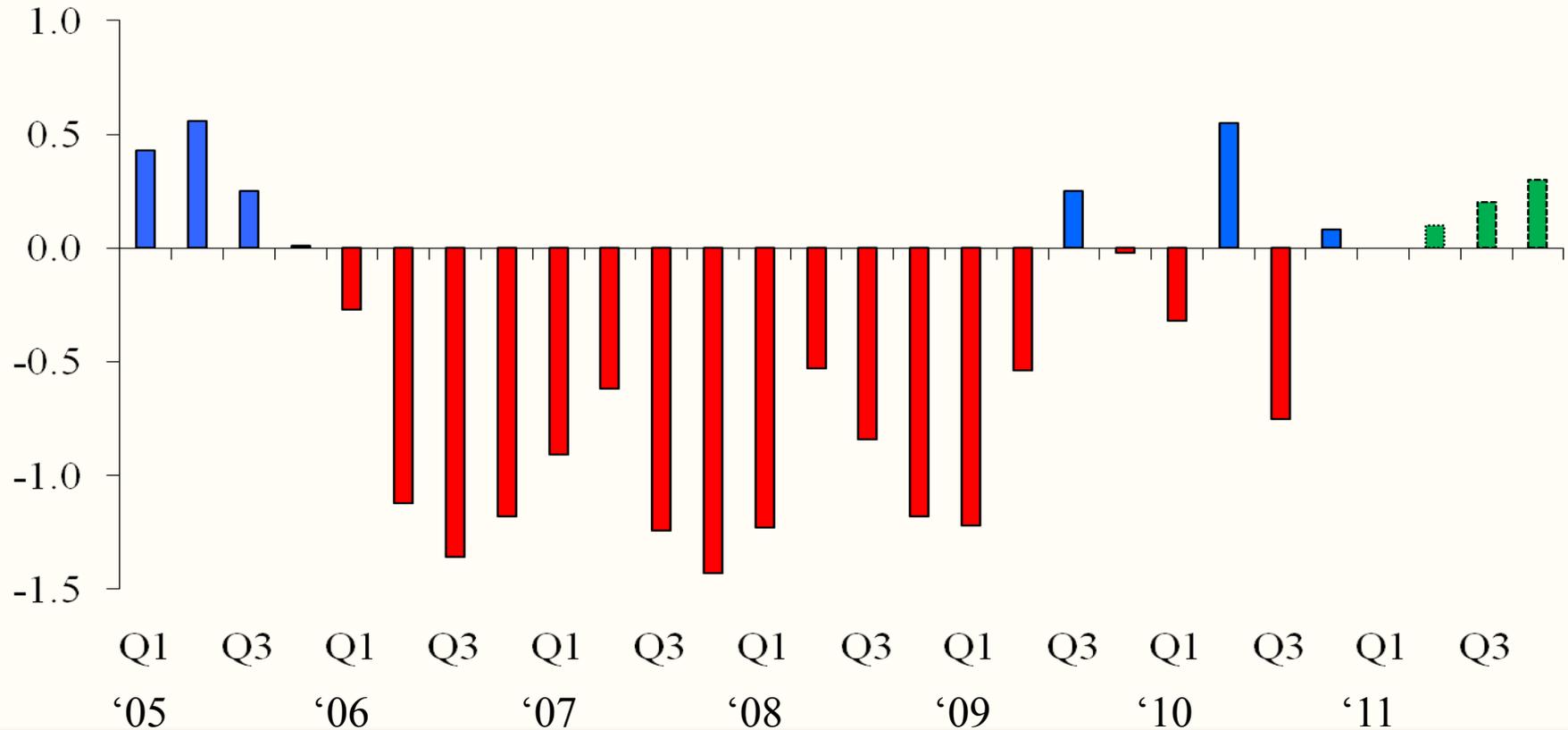
■ **Consensus Outlook: Slow Improvement**

- Home building rises from 400,000 to 500,000 or so one-family units by late 2011/early 2012
- Return to “normal” 1,100,000 annual pace in 2014 or 2015?



Homebuilding contribution to GDP growth likely to turn up modestly

Contribution to GDP growth,
% pts.





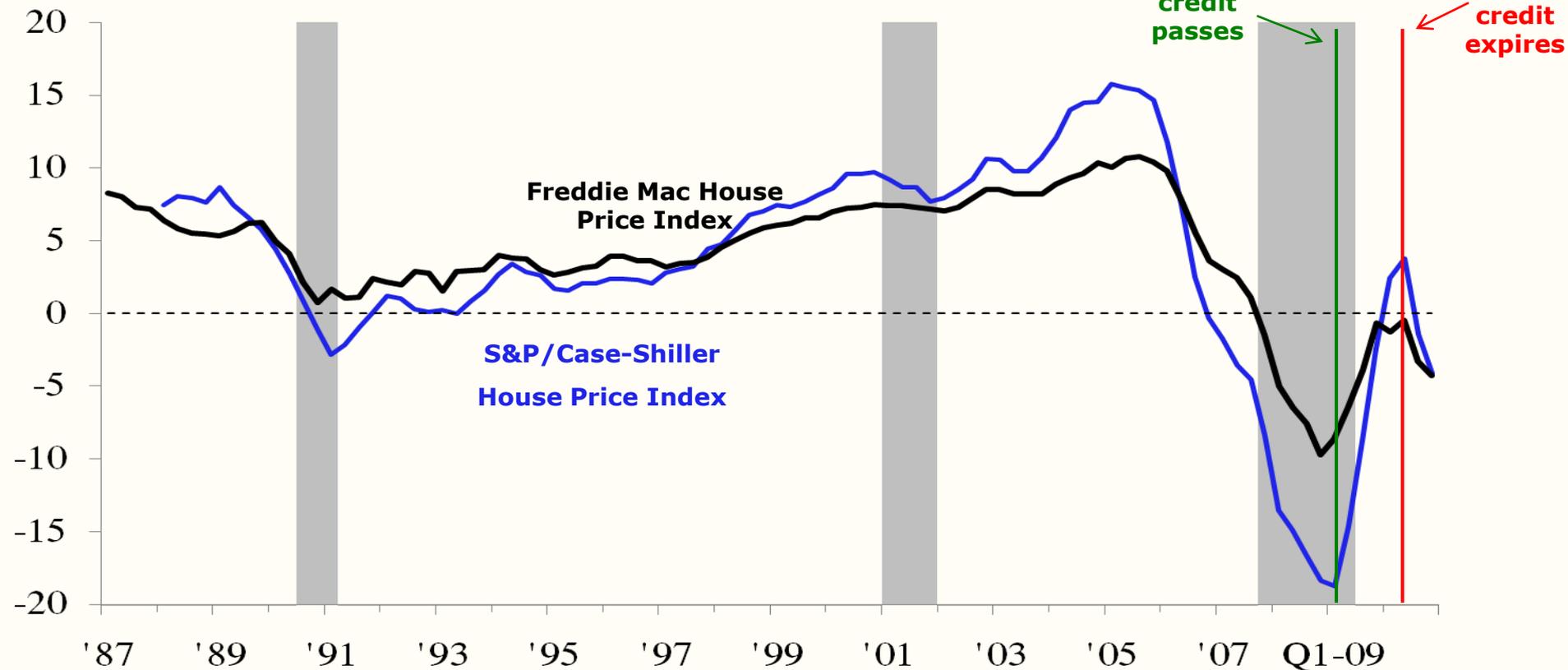
House prices

- Tax credit broke downward spiral in house prices
- House prices resume falling after tax credit expires
- Our model predicts house prices likely to:
 - Bottom in late 2011, after falling about 6% since 2010 Q3
 - Recover somewhat better with stronger income
 - Recover somewhat slower if tighter credit
- Price-to-rent data and model give similar outlook



Home prices soften after the home buyer tax credit expires

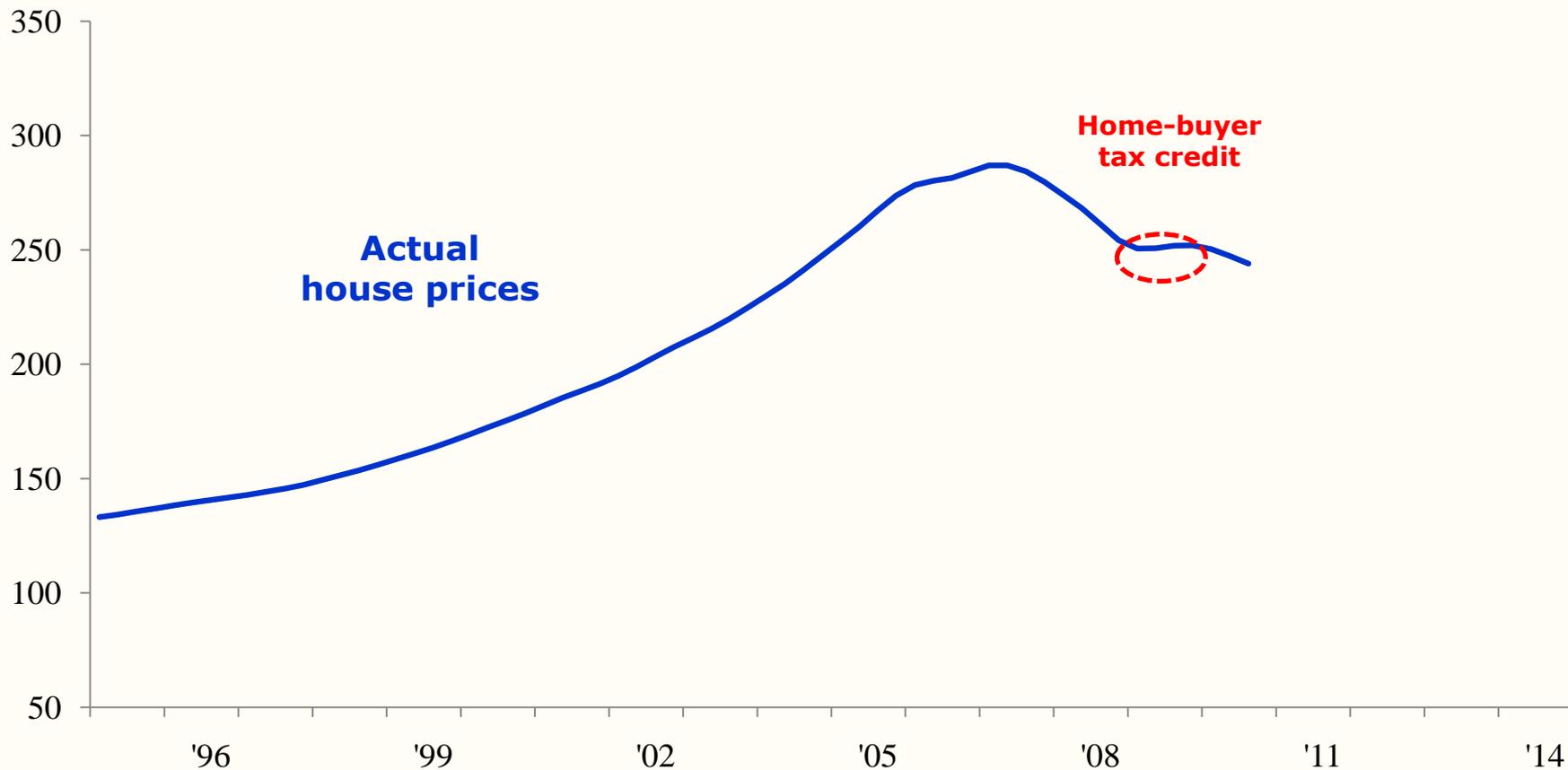
Percent, yr/yr





Home-buyer tax credit interrupts house price correction

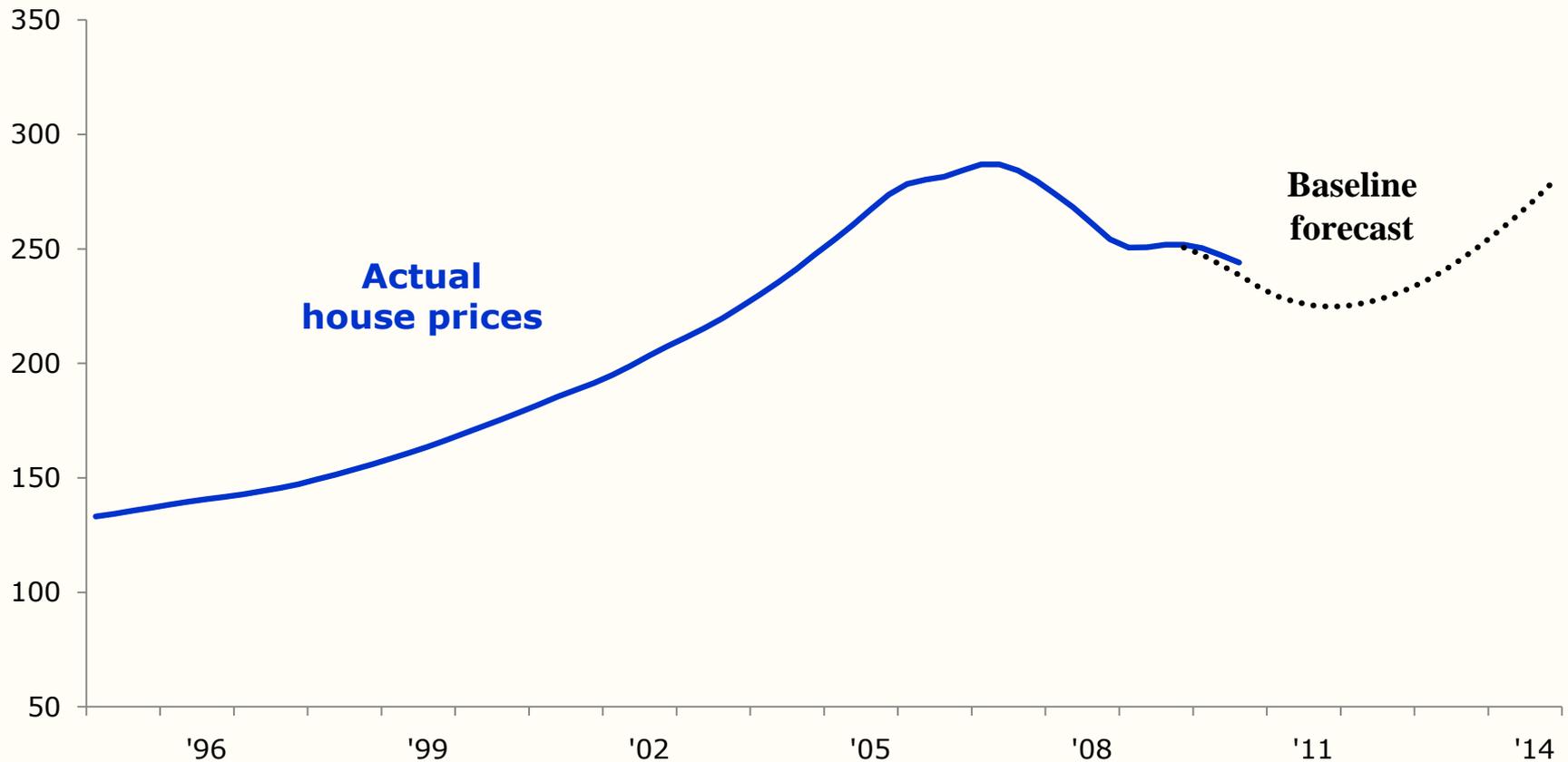
Index, 1987q1= 100





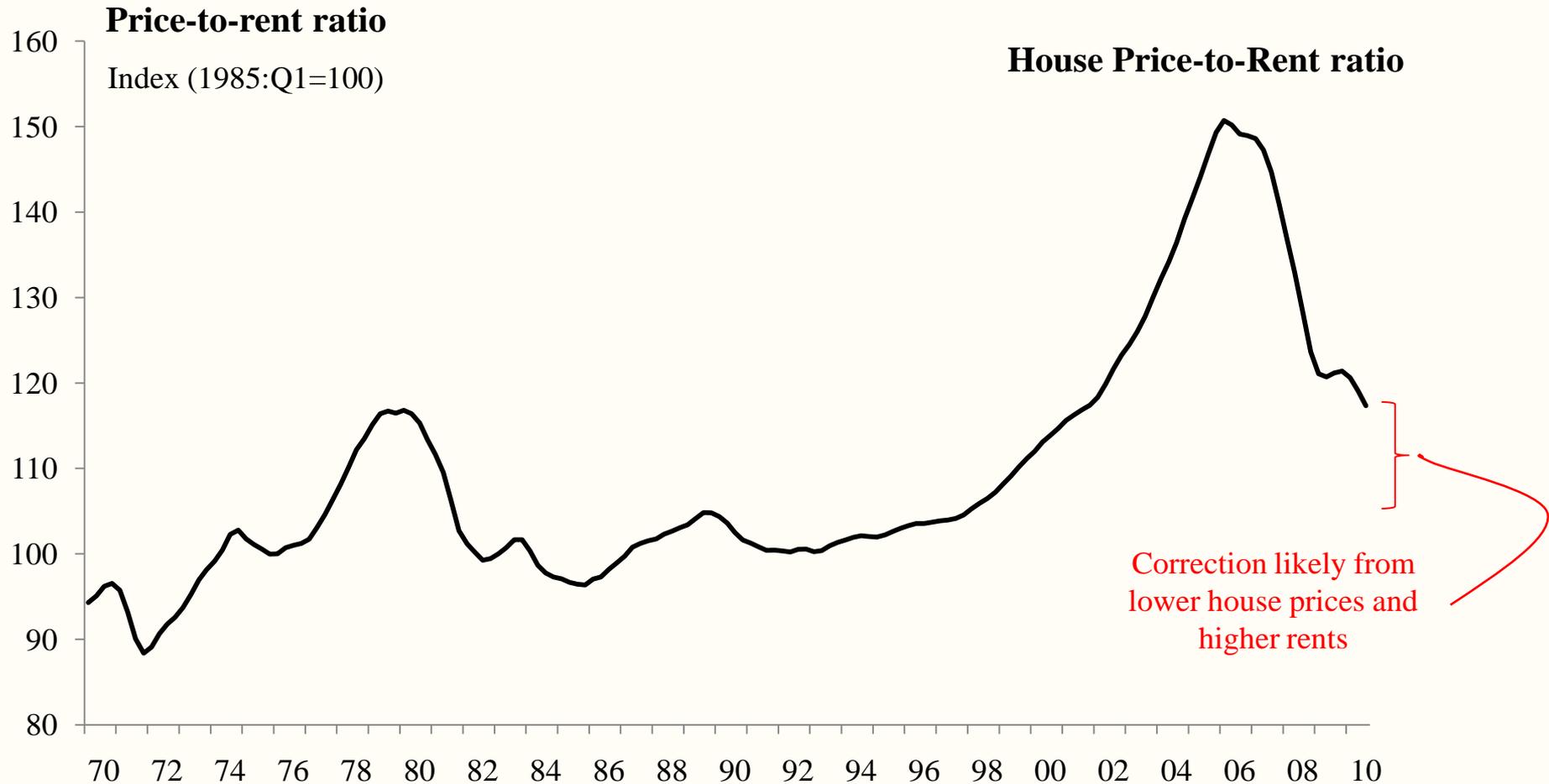
House prices likely to soften 5-6% more, bottoming out in late 2011

Index, 1987q1= 100





House price-to-rent data and model also suggest prices near the bottom





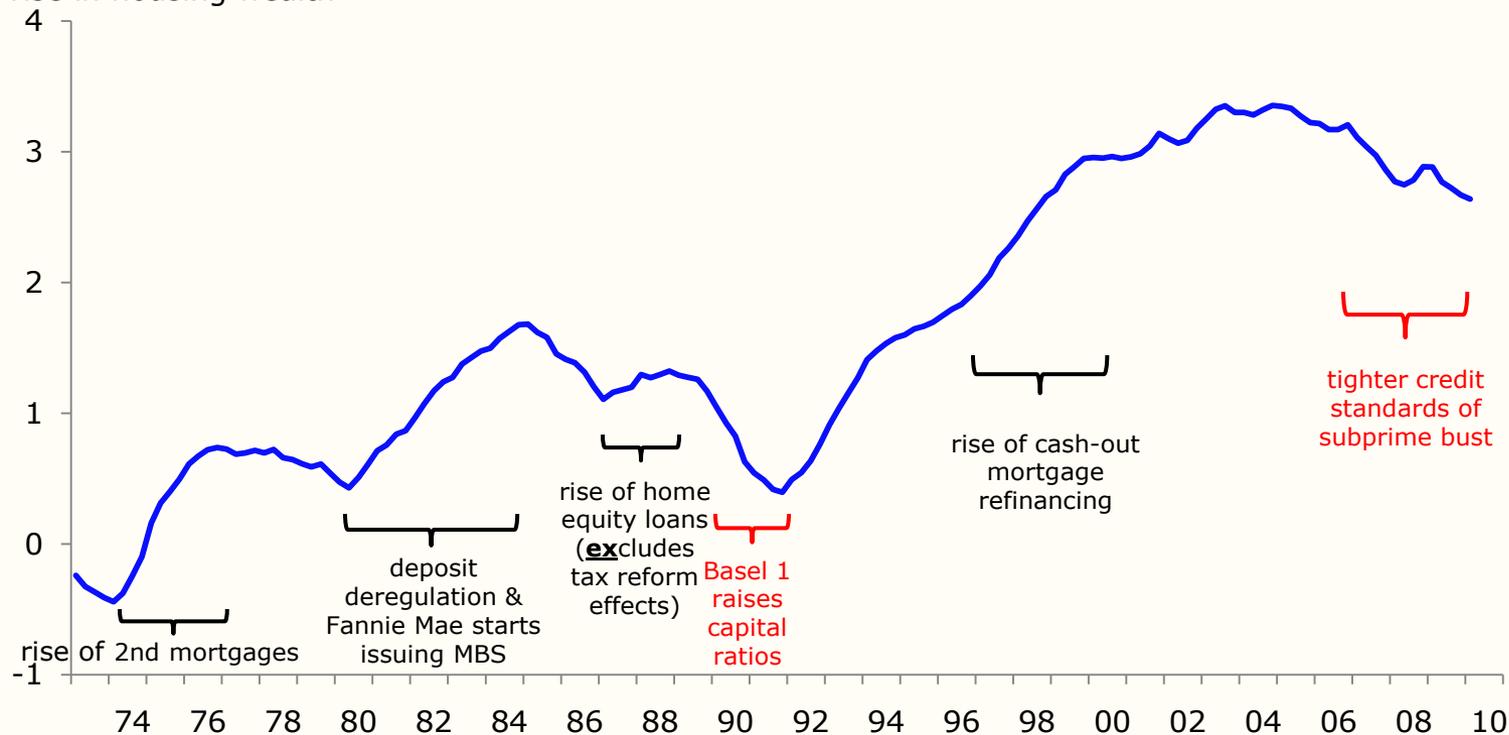
House prices: wealth effects on consumption

- Ability to borrow from housing wealth big impact on housing “wealth” effects on consumption
- Combination of higher housing liquidity and house prices had large effect on consumption in the 2000s
- Small negative “wealth” effect in 2011, likely to turn positive in 2012 as house prices begin to rise



Housing wealth impact on consumption doubles in late-1990s, recedes during the subprime bust

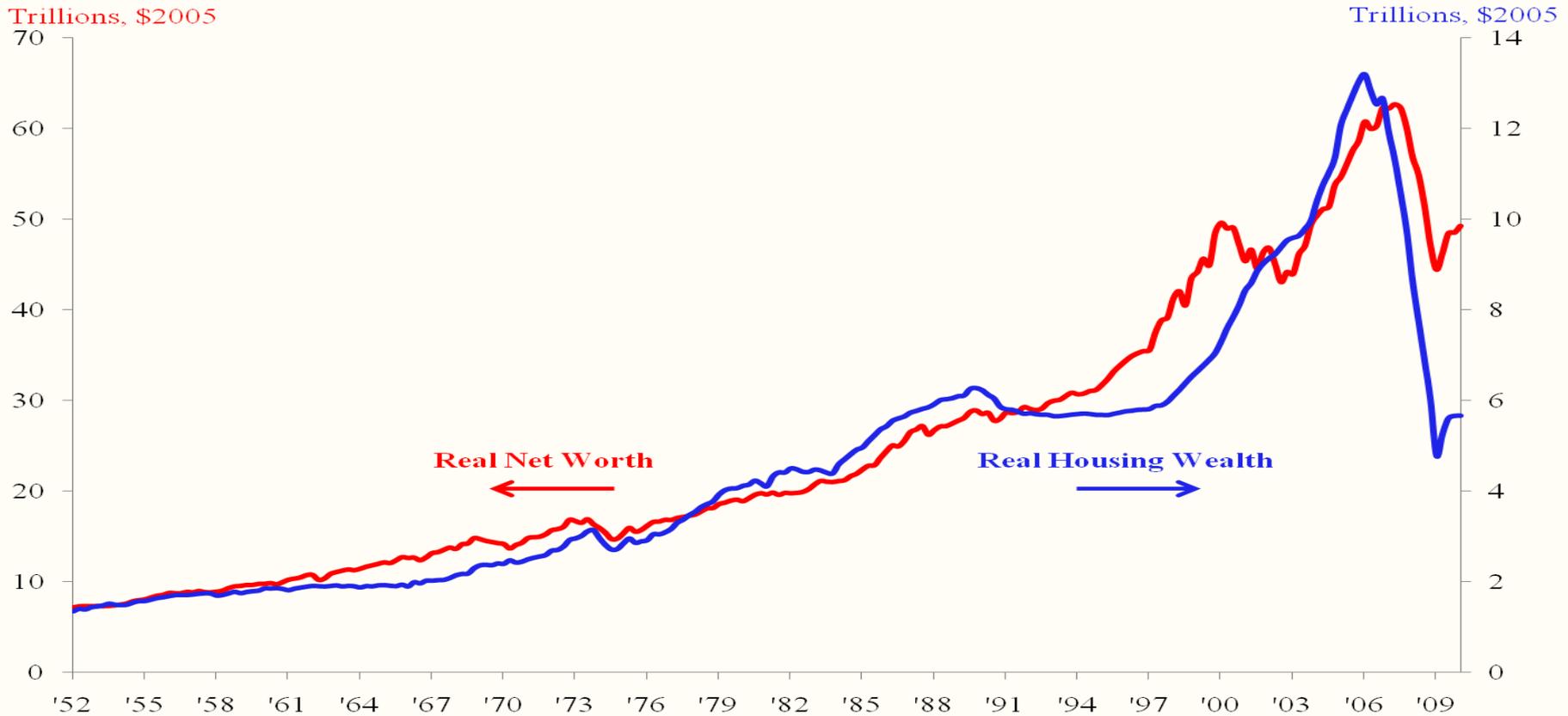
\$ Impact per year of \$100 rise in housing wealth



Source: "How Financial Innovations and Accelerators Drive U.S. Consumption Booms and Busts," J. Duca, J. Muellbauer, and A. Murphy, Feb. 2011.



Total and housing wealth stabilize after plunging

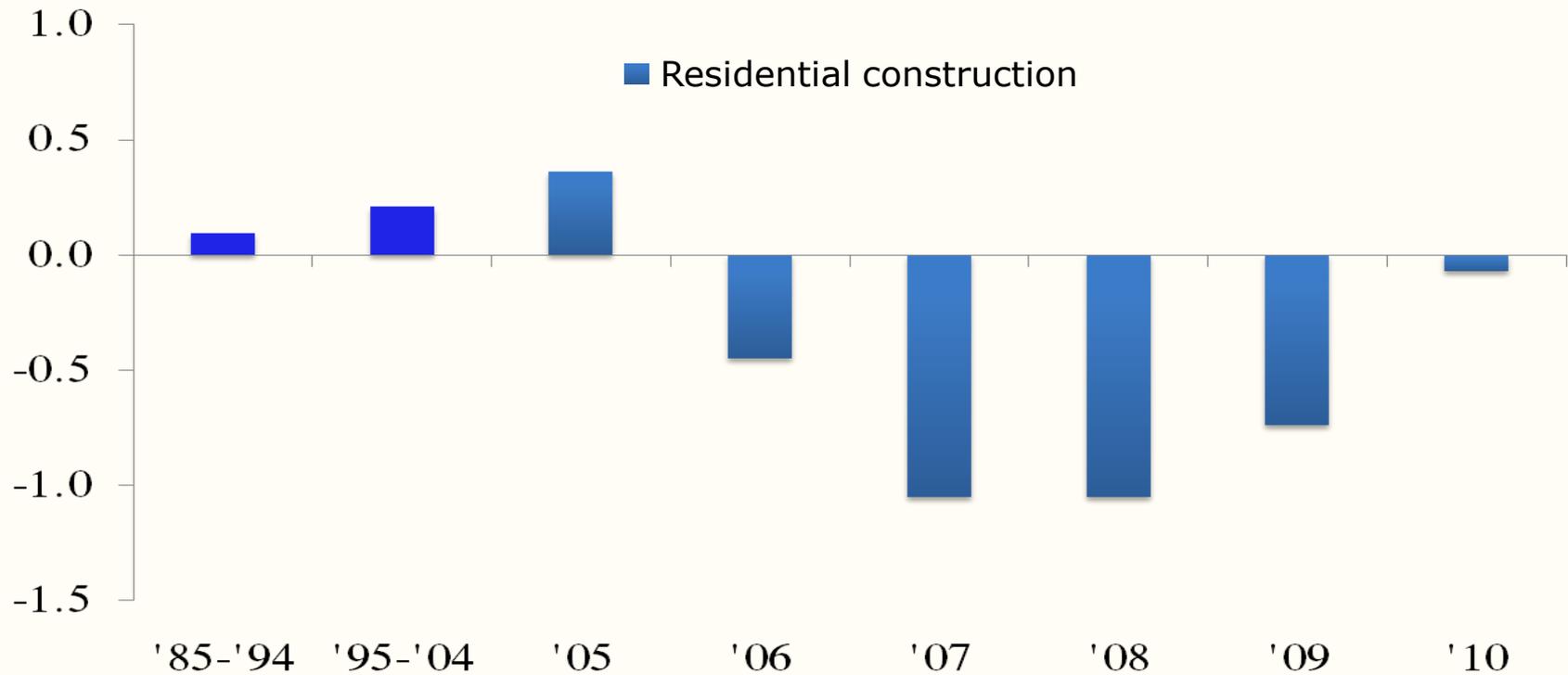


Source: Bureau of Economic Analysis, U.S. Census and author's calculations.



GDP contributions of housing effects on construction and consumption

Contribution to GDP growth,
% pts.

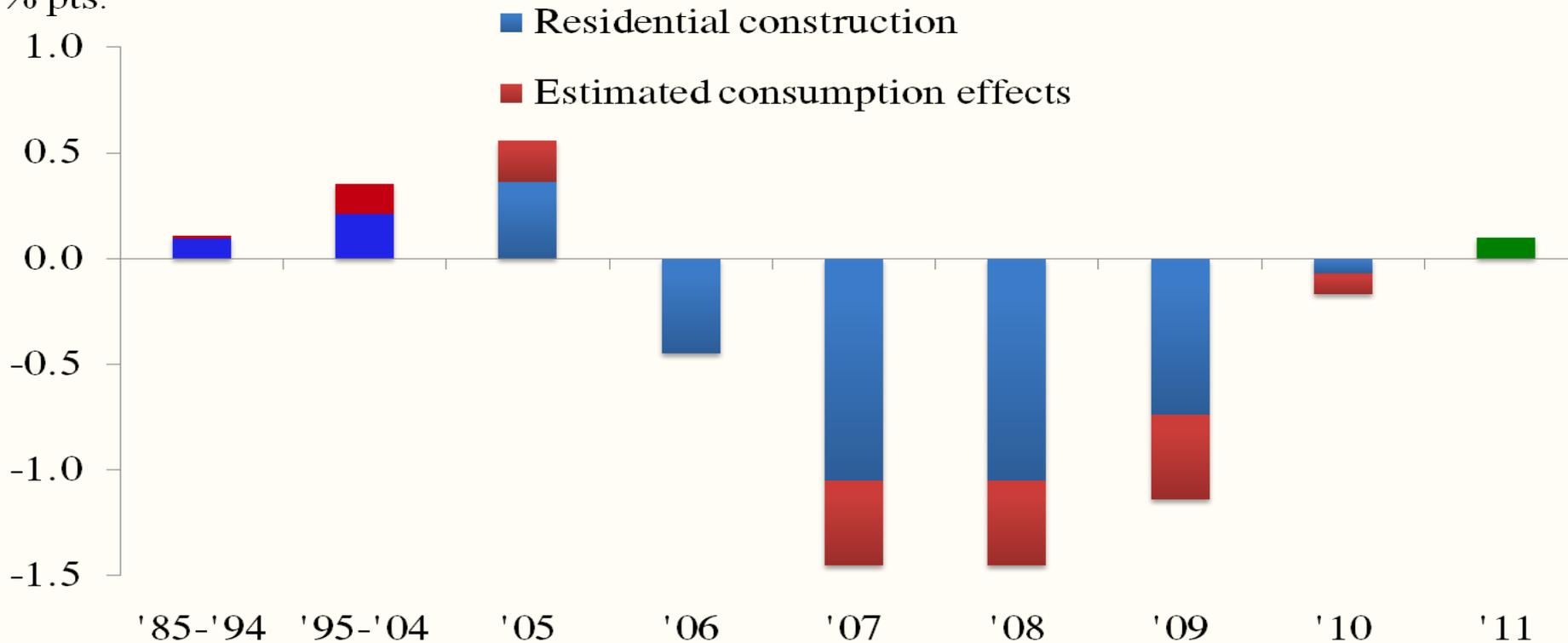


Percentage point contributions to GDP Growth. Estimated housing wealth effects net out an assumed 30% import share of an induced effect on consumer spending.



GDP contributions of housing effects on construction and consumption

Contribution to GDP growth,
% pts.



Percentage point contributions to GDP Growth. Estimated housing wealth effects net out an assumed 30% import share of an induced effect on consumer spending.

Forecast

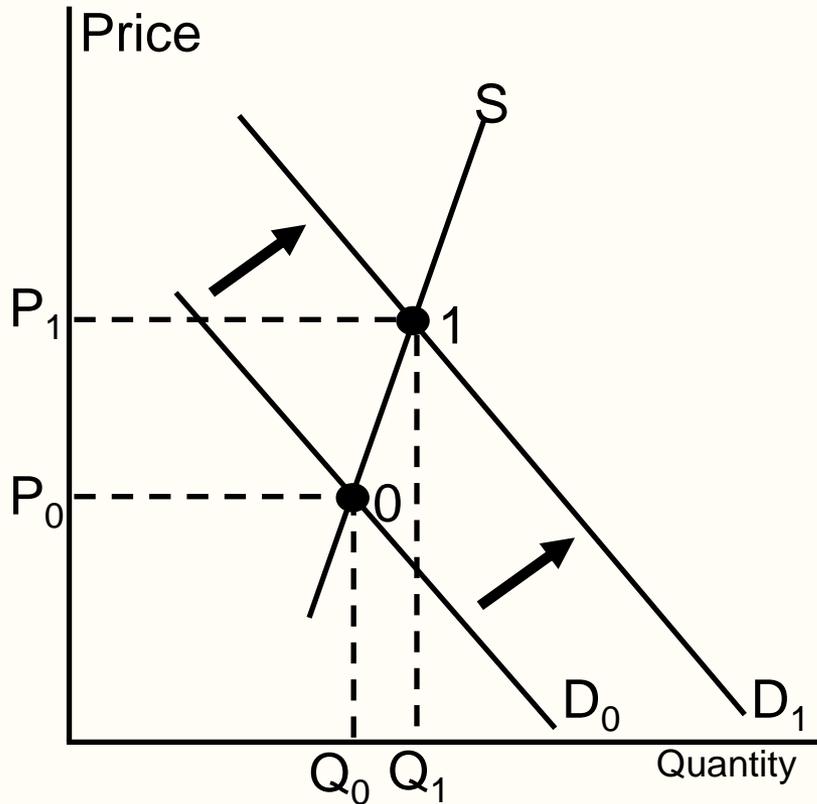


Regional variation in house prices during the boom and bust

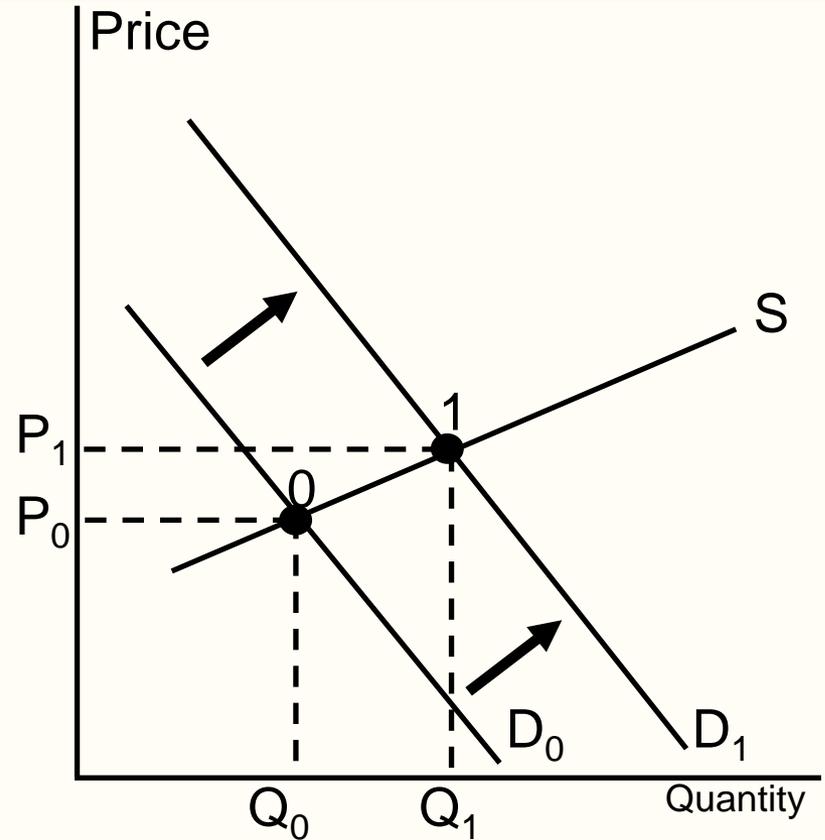
- Supply *ins*ensitive areas: housing demand mainly affects house prices, less effect on construction
- Supply sensitive areas: housing demand mainly affects construction, with smaller house price swings
- States where borrower liability limited to the house (no deficiency) saw faster price correction
- TX consumer spending steadier owing to limited home equity borrowing and more stable house prices



Supply sensitivity affects response of house prices to higher demand in the boom



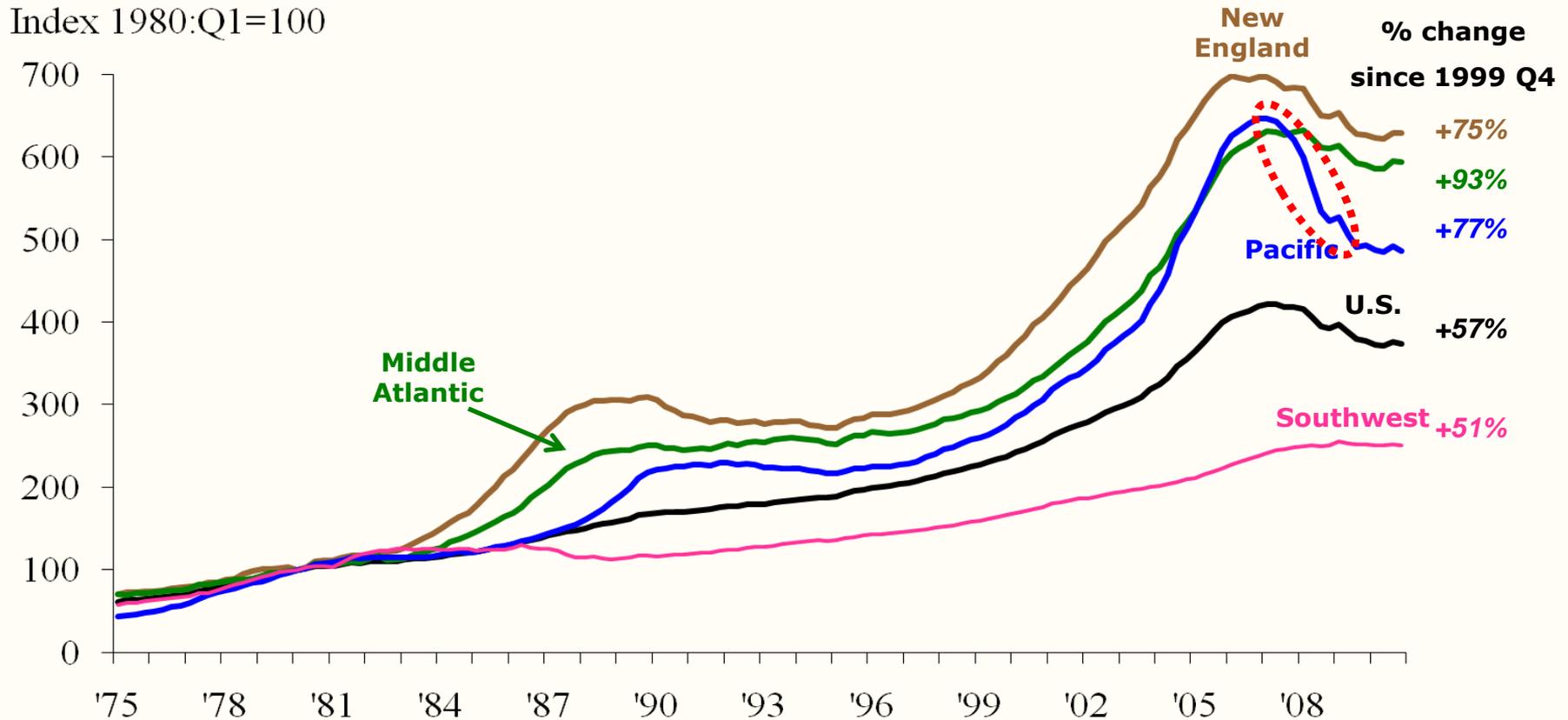
Supply Insensitive
(Northeast, Pacific)



Supply Sensitive
(South ex. Florida)



Bigger swings in house prices in coastal (supply insensitive) regions





Housing affordability recovers in some coastal areas due to price declines....

	Affordability			Home Price Change 2006-2010	Serious Mortgage Delinquency Feb 2011
	1999 Q4	2006 Q4	2010 Q3		
U.S.	64%	42%	72%	-11%	7.6%
LA	43%	2%	40%	-29%	9.1%
New York	55%	5%	23%	-11%	8.3%
San Fran.	11%	8%	28%	-16%	3.2%
Miami	59%	10%	70%	-41%	25.7%
Atlanta	73%	68%	81%	-12%	7.7%
Austin	56%	58%	74%	+10%	3.8%
Dallas	64%	62%	71%	+6%	5.6%
Houston	66%	56%	73%	+11%	3.3%

Source: National Association of Home Builders and Wells Fargo, housing opportunity index and Freddie Mac repeat home price index (refi's included). Percent of homes sold that are affordable to families earning the median income of that area, putting 10% down, using a 30-year conventional mortgage, and having mortgage payments no higher than 28% of income.



Number of months to sell listed existing homes more stable in TX than U.S.

	Dec 2002	Dec 2008	Dec 2010
U.S.	4.9	11.0	9.5
Texas	5.4	6.2	7.2
Austin	5.7	5.4	5.6
Dallas	5.5	5.7	6.4
El Paso	6.3	11.2	6.7
Houston	5.4	5.8	7.4
San Antonio	5.2	7.6	7.6

Sources: National Association of Realtors and Real Estate Center at Texas A&M University. Data include multifamily units (condos) and are not seasonally adjusted.



Likely outlook: momentum shift

- Homebuilding: hit bottom in late 2010:
 - Slow pick-up emerging, returning to normal in 2014
 - Earlier up-turn in supply sensitive, pro-growth states (e.g., Texas)
- House prices: sag until mid to late 2011 then recovering
 - Moderately down in weak labor markets / (most) supply insensitive areas
 - May be turning up where laws allow homeowners to “walk away”
- Net housing effects on growth: momentum shift
 - Switch from negative to neutral in 2011 and positive in 2012
 - Housing likely to add to growth in TX in 2011
 - Housing will contribute more to growth over time



Background Slides



'Underwater' Mortgages

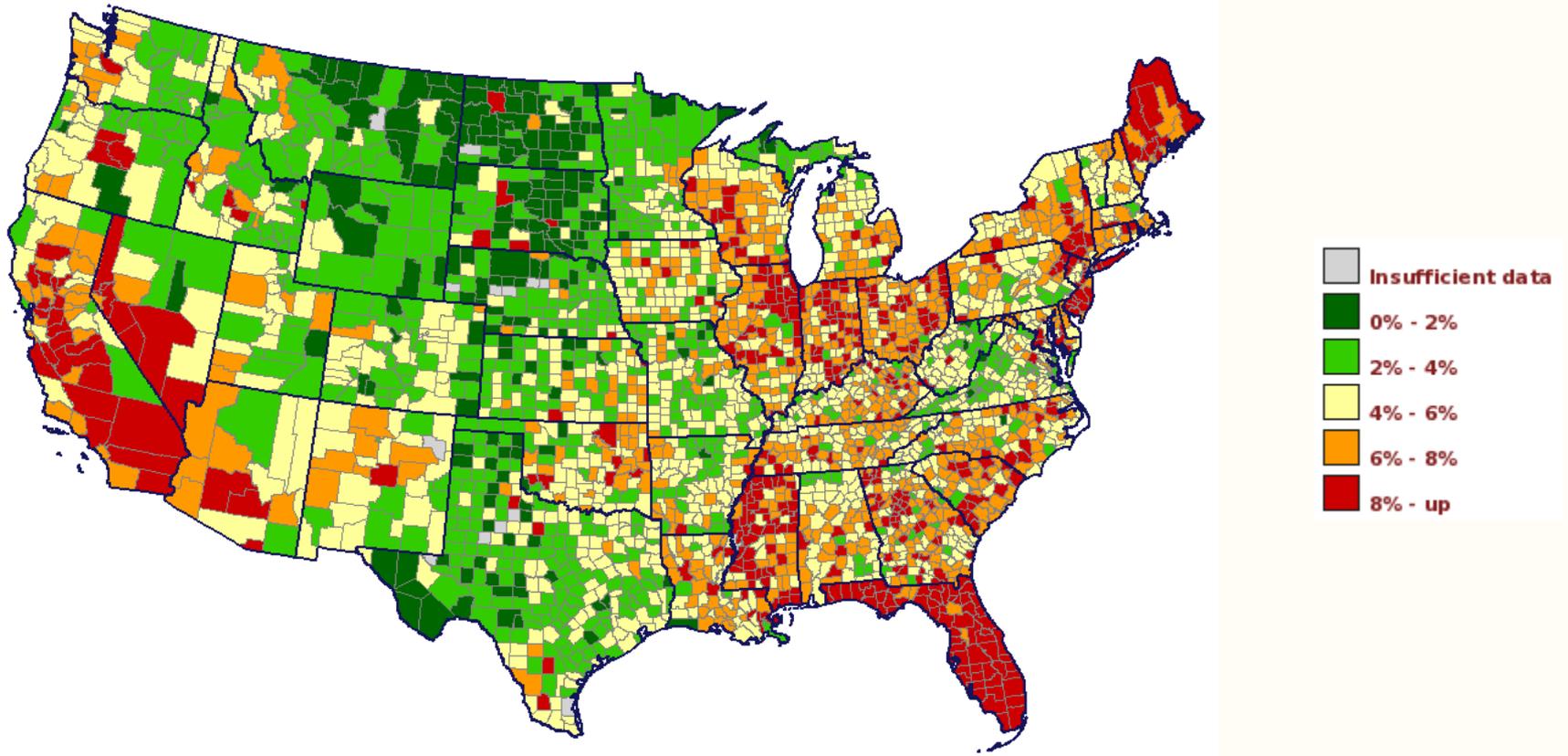
Negative Equity	Share of First Mortgages	Share of Homeowners	Millions of Homeowners
0% to 5%	4%	2.6%	1.9m
5% to 10%	3%	1.9%	1.4m
10% to 25%	6%	3.9%	2.9m
25% Plus (Serious)	10%	6.5%	4.8m
All	23%	14.8%	11.1m

Sources: Negative equity reflects all liens on a home (not just the first lien). Column 2 from estimates by Ken Rosen, Fisher Real Estate Center, University of California, Berkeley. Other columns based on authors' calculations from Moody's.com.



Seriously Delinquent First Lien Mortgages

Feb 2011 · LPS Data





Restructured Loans: Helpful Balm or Ticking Bomb?

Kory Killgo
Financial Industry Analyst
Federal Reserve Bank of Dallas*

* The views expressed are those of the speakers and should not necessarily be attributed to the Federal Reserve Bank of Dallas or the Federal Reserve System.



Restructured Loans

- Loans in which a lender makes a repayment concession to a borrower
- Driven by a change in borrower's condition
- Not a restructuring if similar borrower would receive same terms on a brand new loan
- Expected to be prudent and infrequent

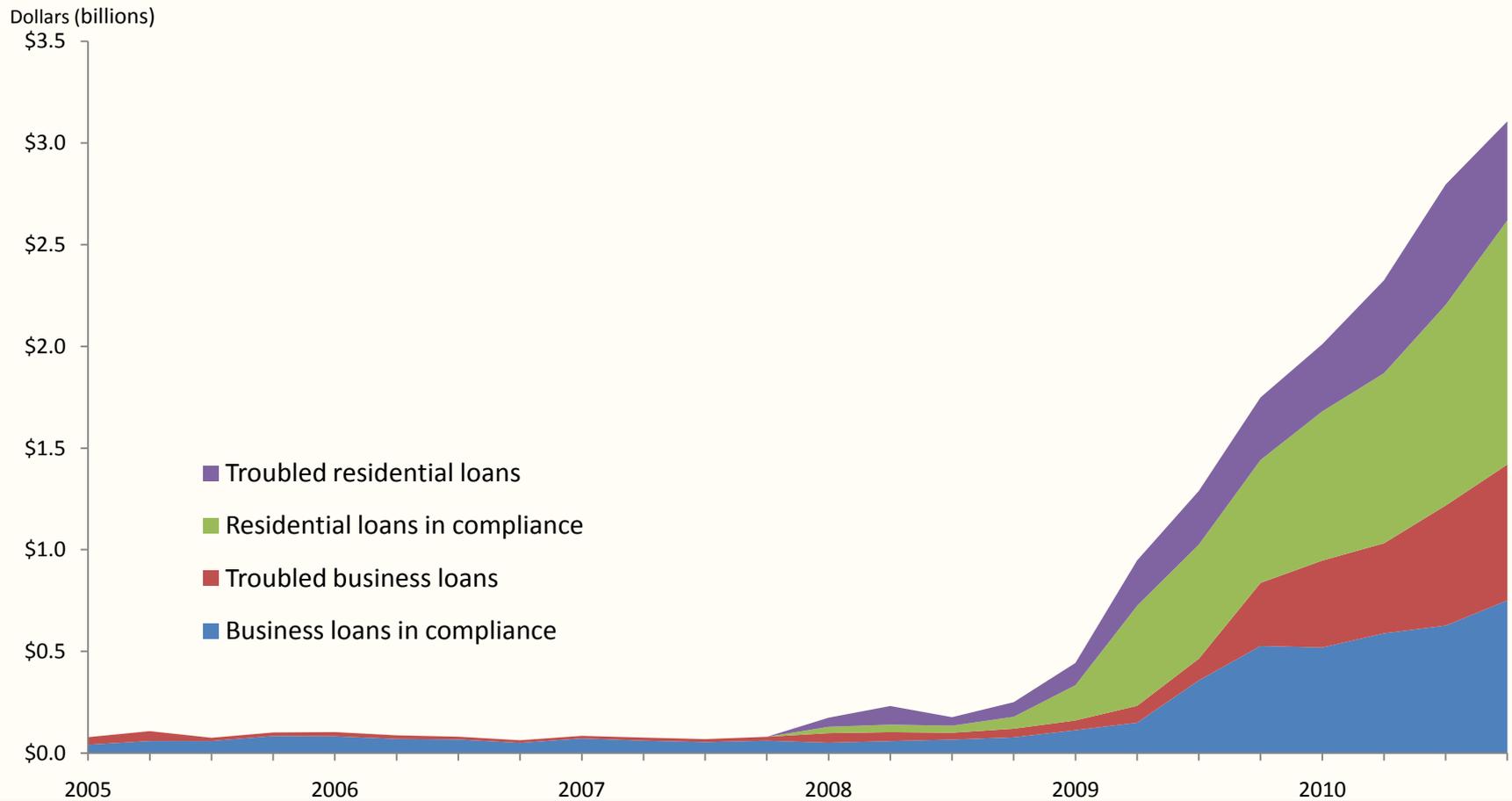


Restructured Loans: Helpful Balm or Ticking Bomb?

- Does restructuring just delay the inevitable?
 - Difficult to say at the macro level
- What we can evaluate
 - Volume of restructured loans
 - How widespread they are
 - Historical context

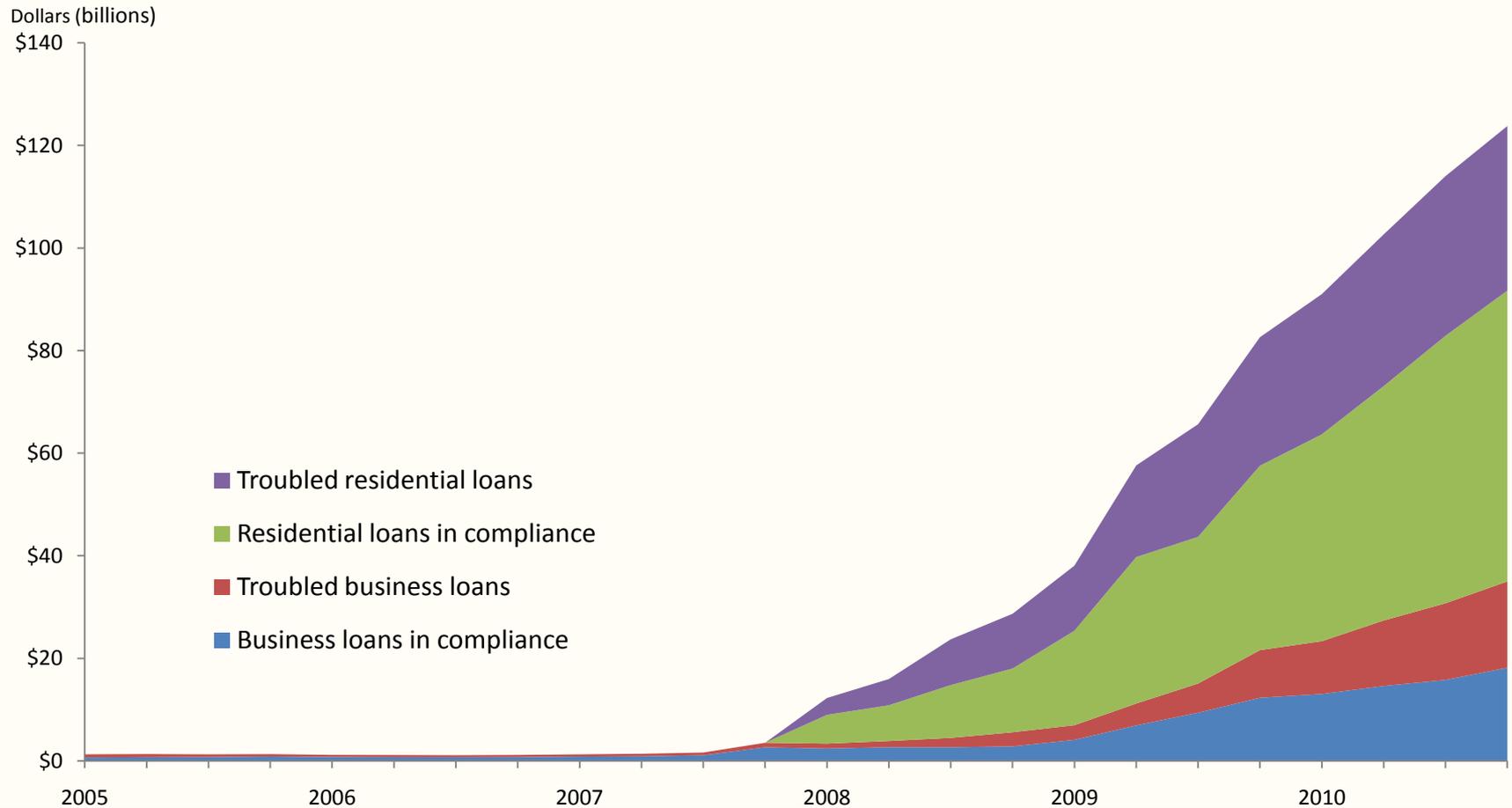


Growth In Restructured Loans In the 11th District



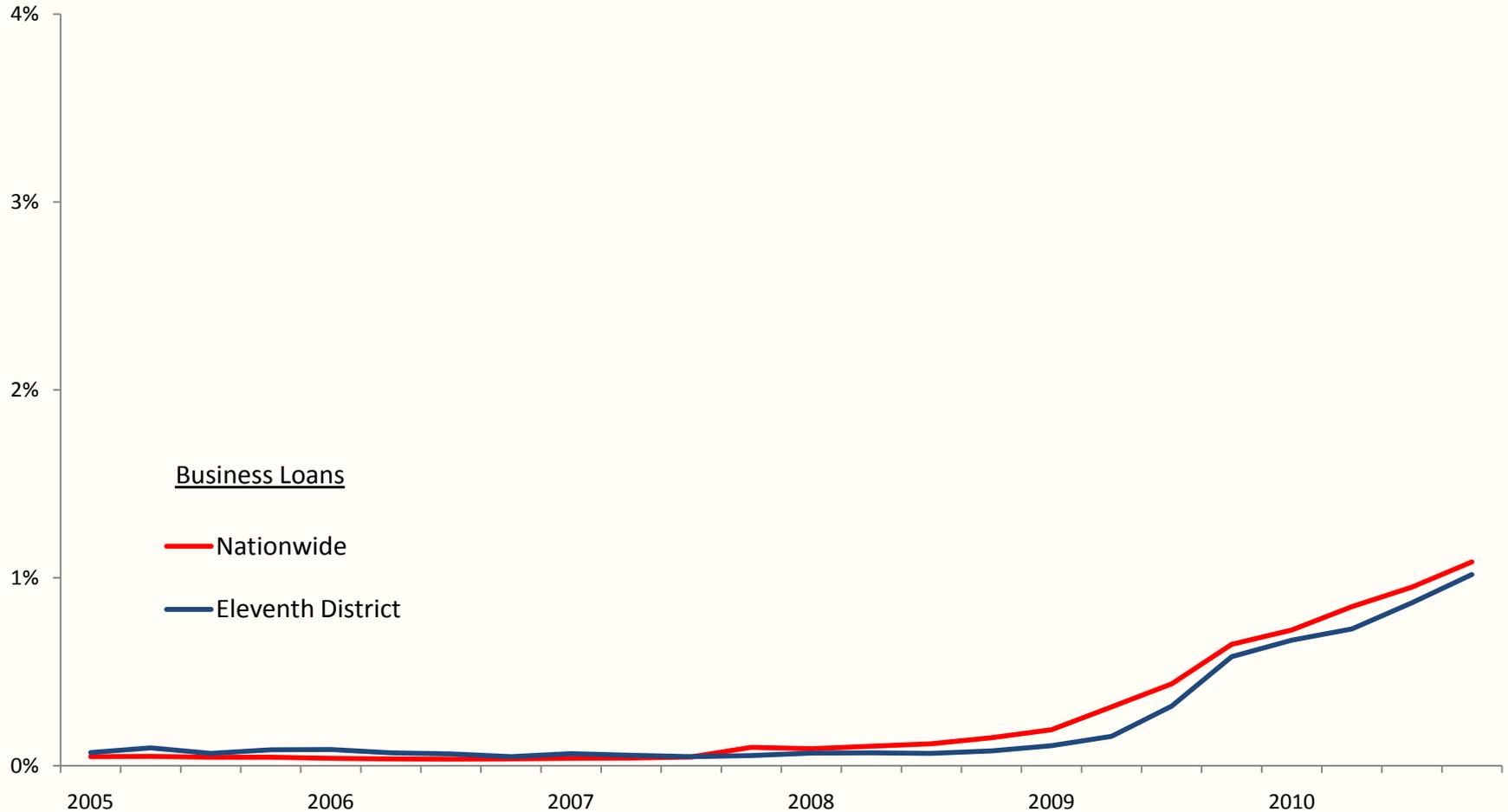


Growth In Restructured Loans Nationwide



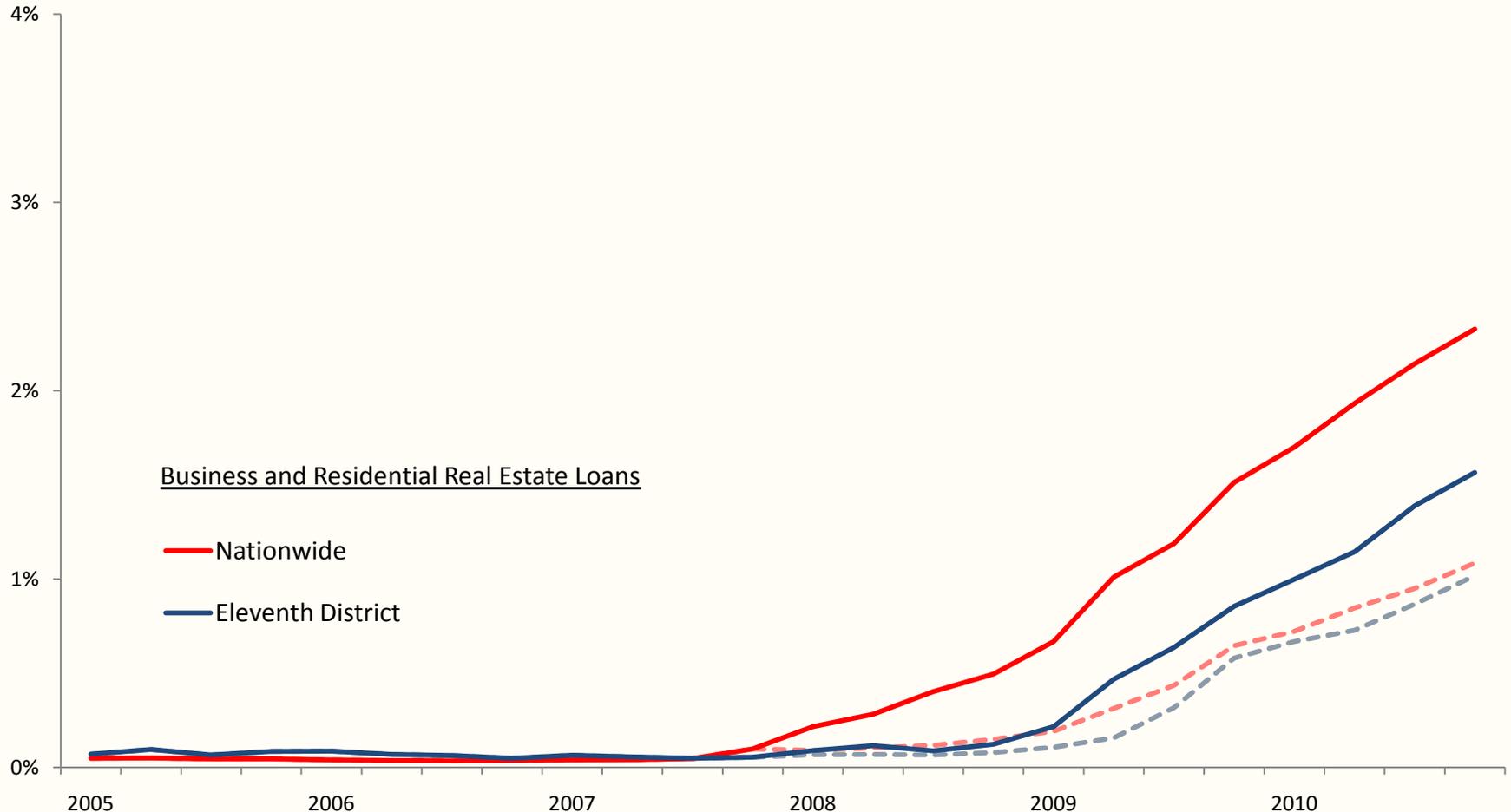


Restructured Loans Relative To Total Loans



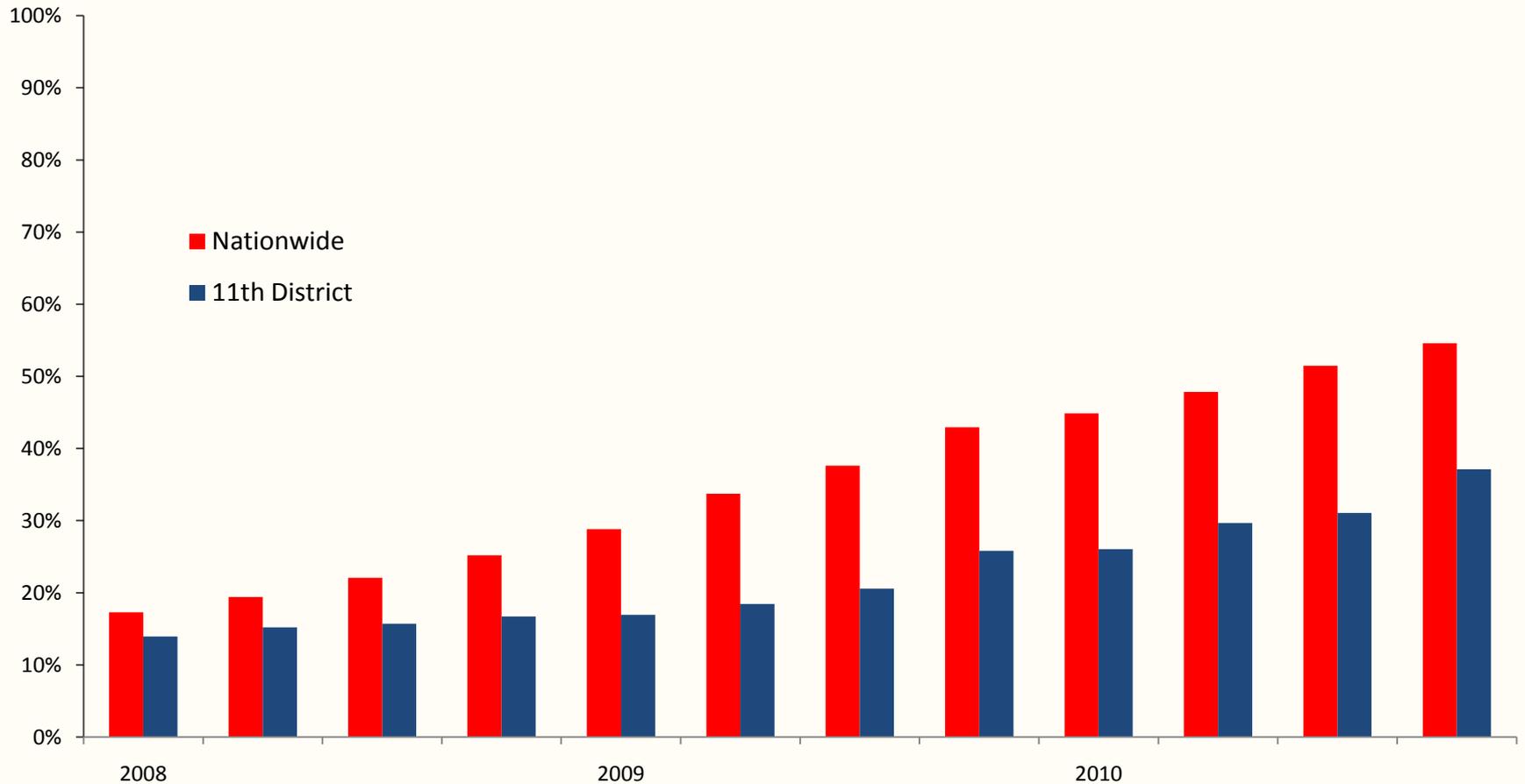


Restructured Loans Relative To Total Loans



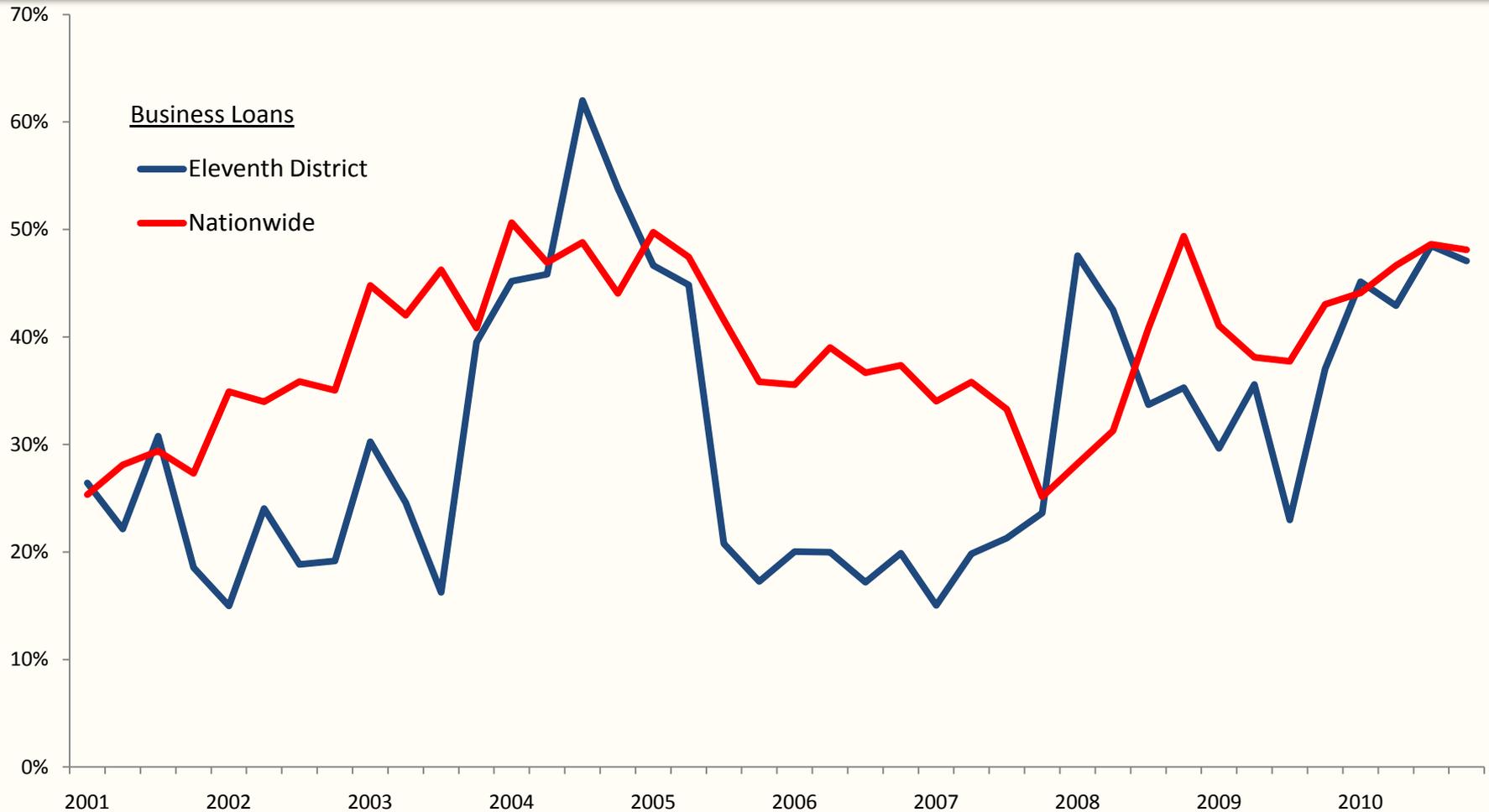


About One Third of District Banks Carry Restructured Loans





Restructured Loan Delinquency Rates





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