

Past, Present, and Future of the U.S. Housing Finance System:

June 9, 2010

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Cleveland Federal Reserve

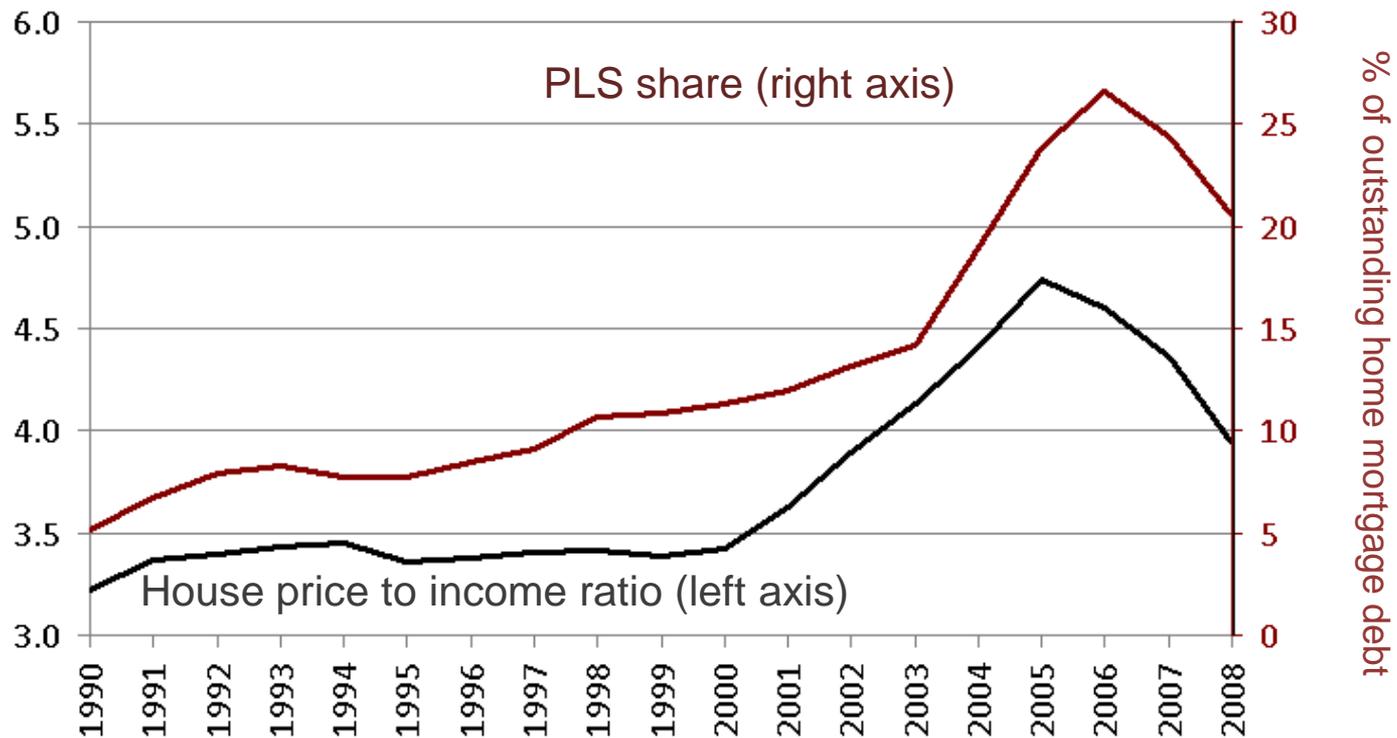
Goals of the System

- Liquidity
- Stability
- Affordability

It was deviation from these principles, rather than adherence to them, that led to the financial crisis!

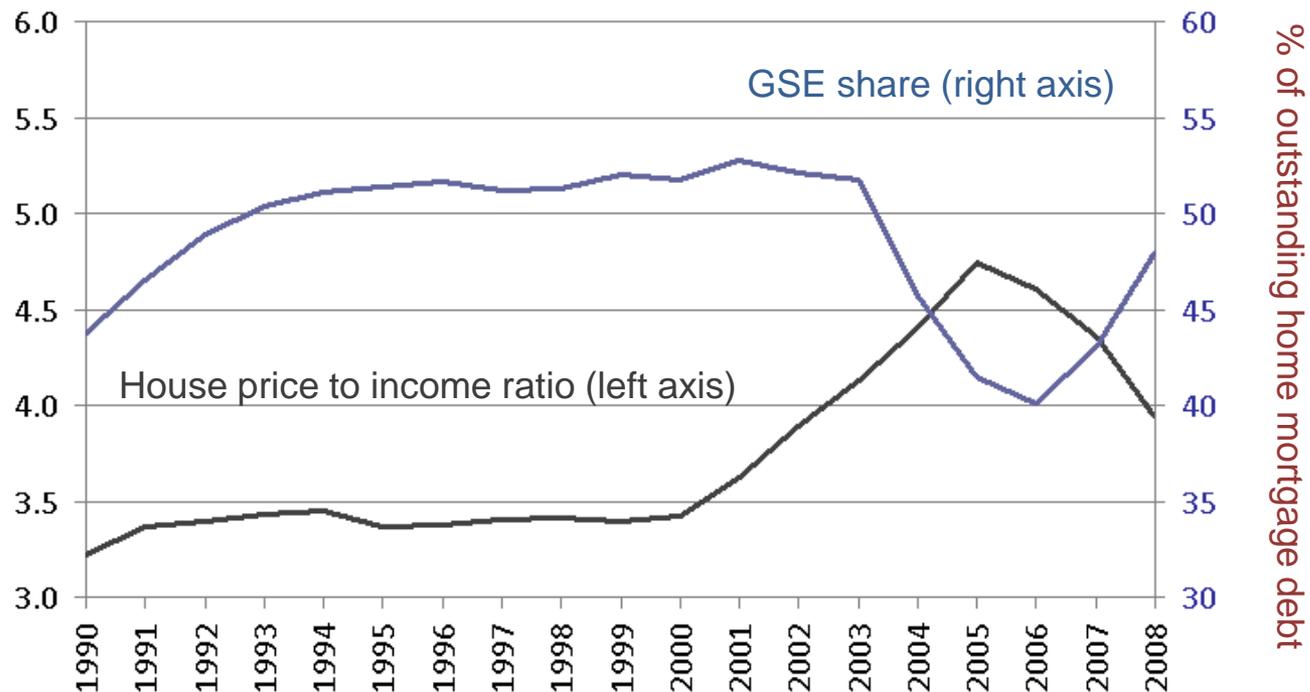
Private-Label MBS Grew With House Price Appreciation

- Uneven regulatory playing field caused capital to flow to unregulated PLS markets.
- Unsustainable, poorly underwritten loans in PLS pipeline amplified a massive housing bubble.



Role of Fannie and Freddie

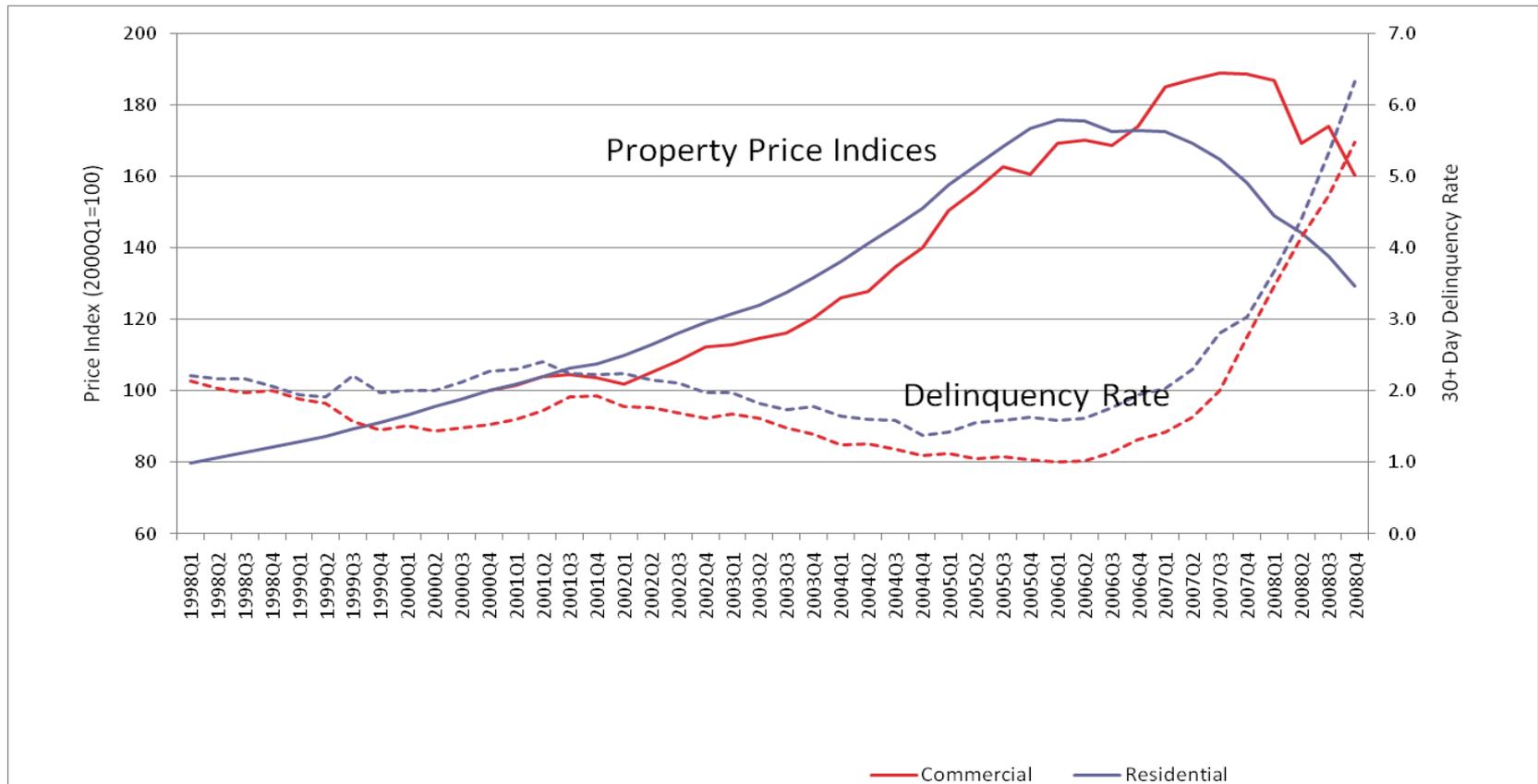
- Meanwhile, the GSEs market share dropped dramatically, just as the bubble was forming.
- GSEs accounted for less than half of MBS issuance and less than 30% of originations in 2005 and 2006.



Notes: Price-to-Income Ratio defined as median sales prices of single-family, condo or co-op divided by median household income; Federal Government includes federal government, government-sponsored enterprises, and agency- and government-sponsored enterprises-backed mortgage pools
Sources: Federal Reserve Flow of Funds; Current Population Survey; National Association of Realtors

Credit Bubble Not Merely in Residential Real Estate

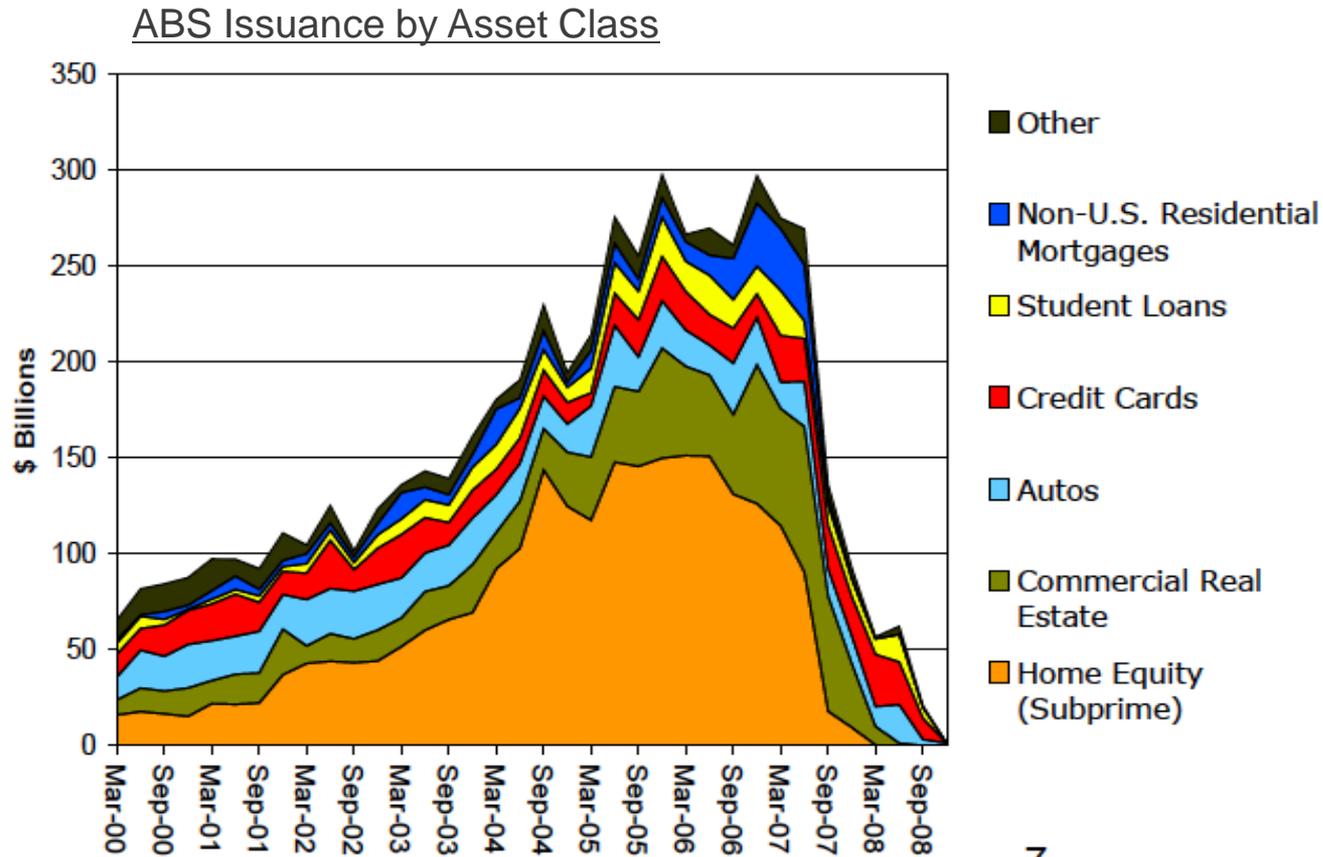
- We see the same bubble-bust pattern in Commercial Real Estate...



Source: Moody's/REAL Commercial Property Price Index; S&P/Case-Shiller National U.S. Home Price Index; Federal Reserve statistical release

Credit Bubble Not Merely in Residential Real Estate

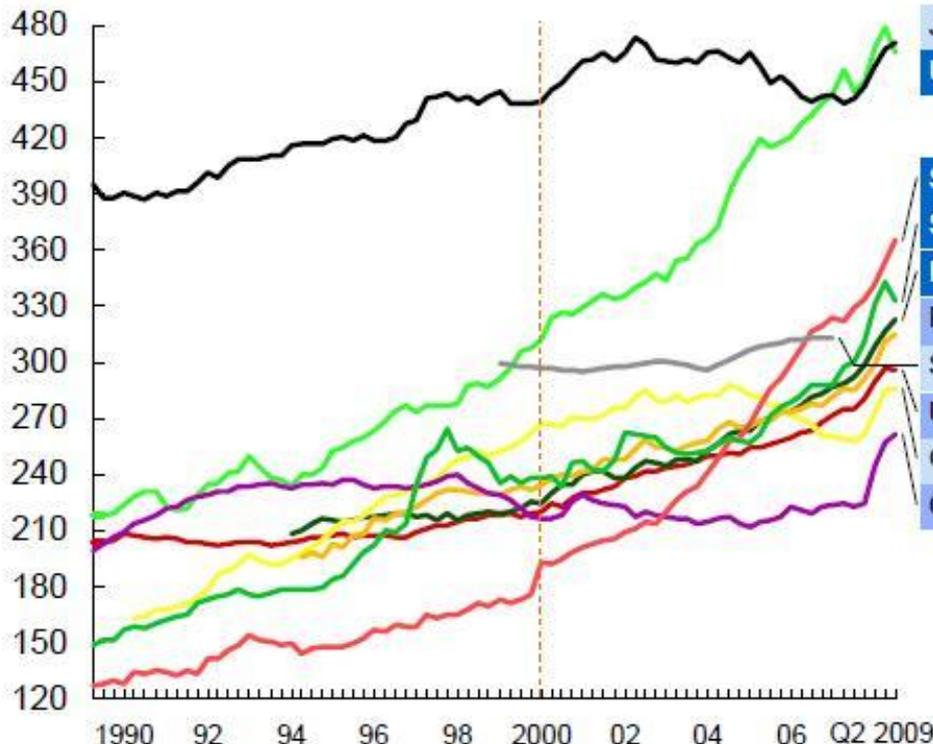
- ...And in other credit markets such as credit cards, auto loans, etc.



Source: Adam Ashcraft (FRBNY), Discussion of "Do Global Banks Spread Global Imbalances," available at <http://imf.org/external/np/res/seminars/2009/arc/pdf/ashcraft1.pdf>.

Debt grew in most mature economies

Domestic private and public sector debt¹ by country
% of GDP



■ Rapid growth
■ Moderate growth
■ Slow/negative growth

	CAGR ² , %		Change, p.p. 2000-08
	1990-00	2000-08	
Japan	1.2	0.5	19
UK ³	3.3	5.2	157
Spain	4.1	7.4	150
S. Korea	4.3	4.2	93
France	1.2	3.9	83
Italy	2.9	3.1	64
Switzerland	N/A	0.8	17
US	0.6	3.5	70
Germany	5.6	0.3	7
Canada	0.3	1.5	28

1 "Debt" is defined as all credit market borrowing including loans and fixed-income securities.

2 Compound annual growth rate. Where data are unavailable, the longest possible period is used.

3 Even after removing foreign lending by UK banks, UK debt/GDP remains higher than every country except Japan.

SOURCE: "Debt and deleveraging: A global credit bubble and its economic consequences." McKinsey Global Institute, January 2010

Returning to the Goals of the System

- Liquidity
 - Countercyclical liquidity
 - Broad and consistent credit to underserved communities
 - Rental housing
- Stability
 - Level regulation of all mortgage lending channels
 - Origination level regulation
- Affordability
 - Affordable long-term, fixed-rate prepayable mortgages
 - Risk should lay with more sophisticated parties (investors and intermediaries) better able to bear it, rather than with relatively unsophisticated borrowers
 - Targeted affordability, including low down payment loans