Cross-Border Investment in the US Mortgage Market

IUHF World Congress

June 26, 2017

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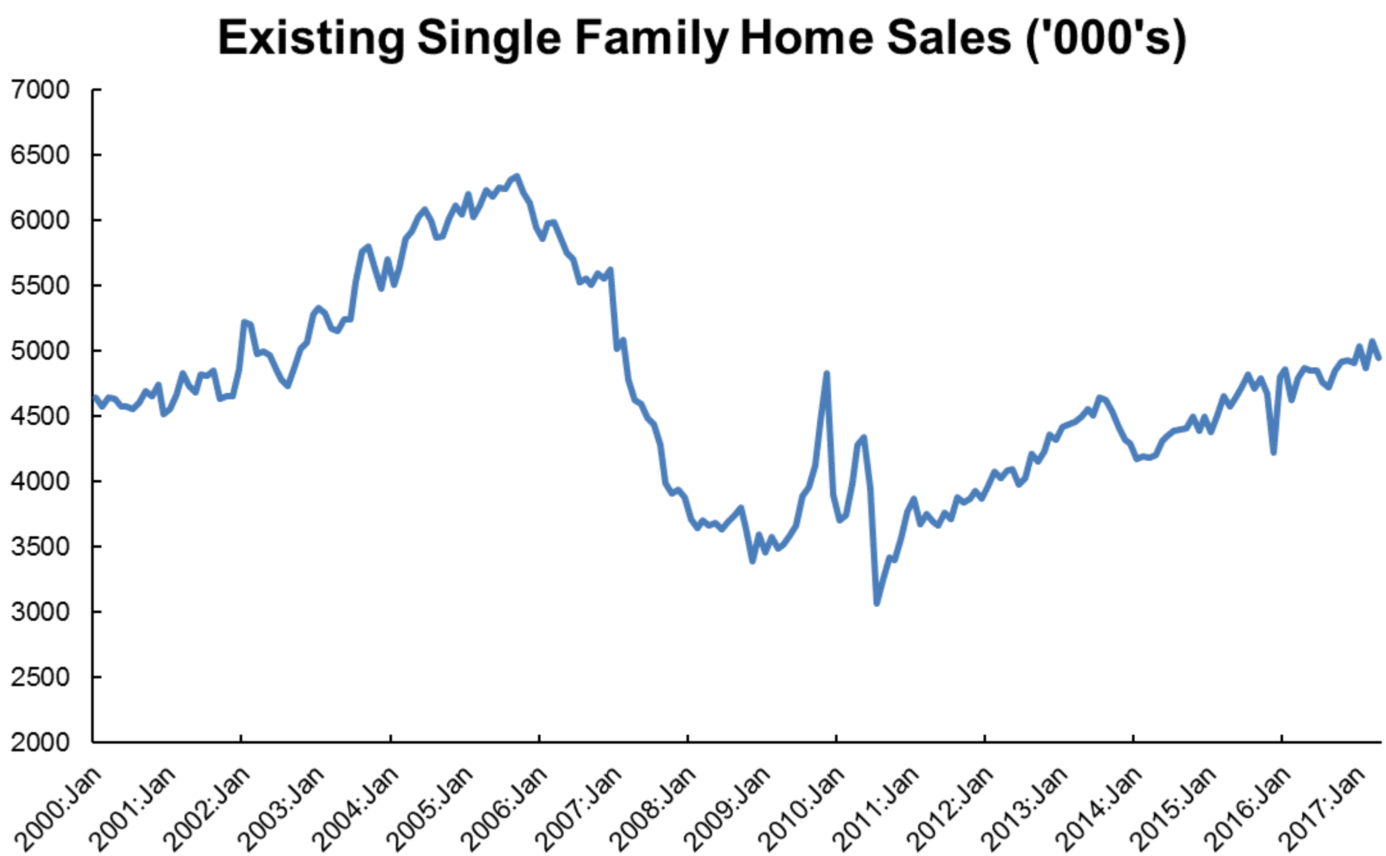
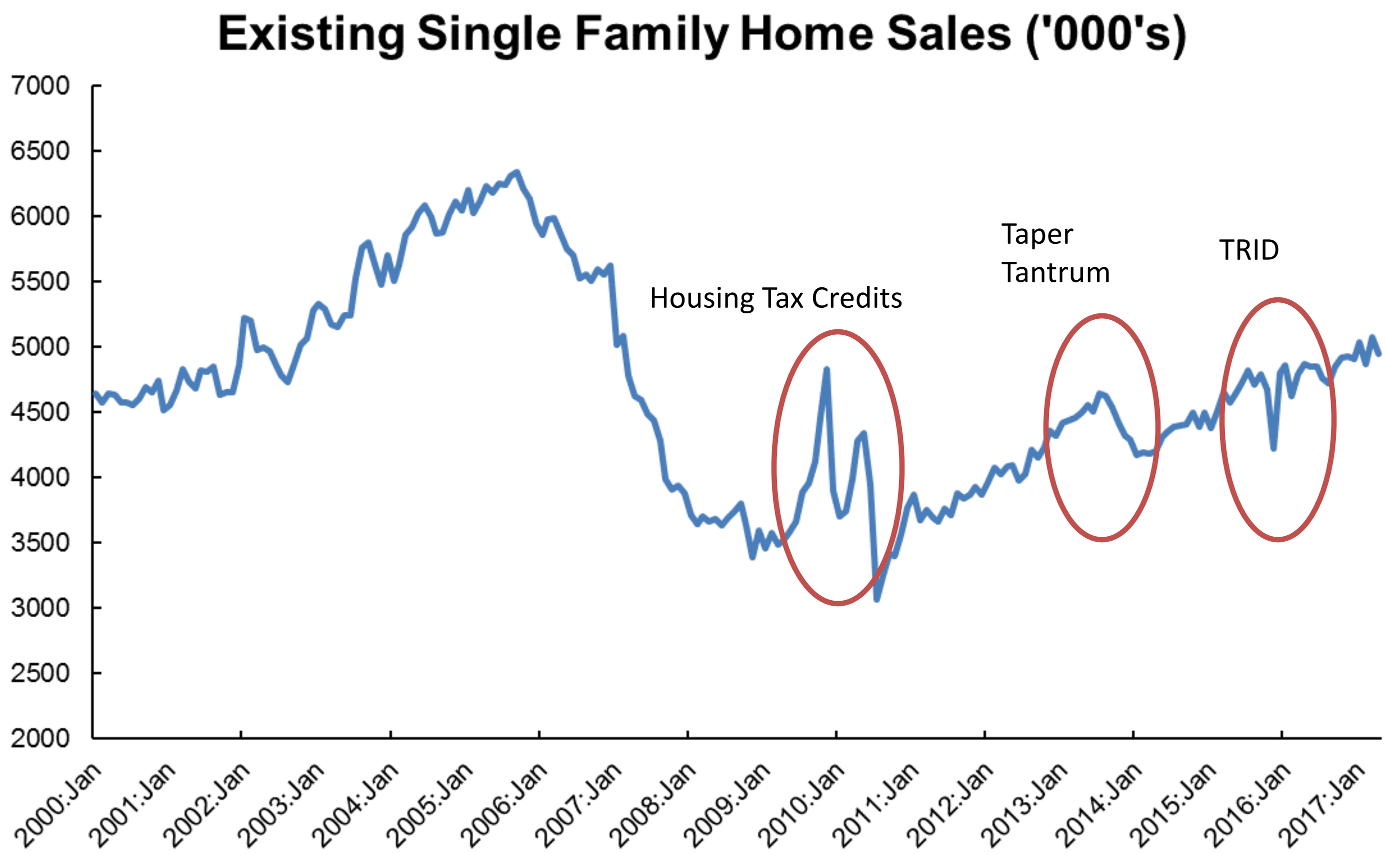
The US housing market has experienced a modest, choppy recovery since the crash



Source: National Association of Realtors, Haver Analytics

The volatile path is punctuated by various policy measures

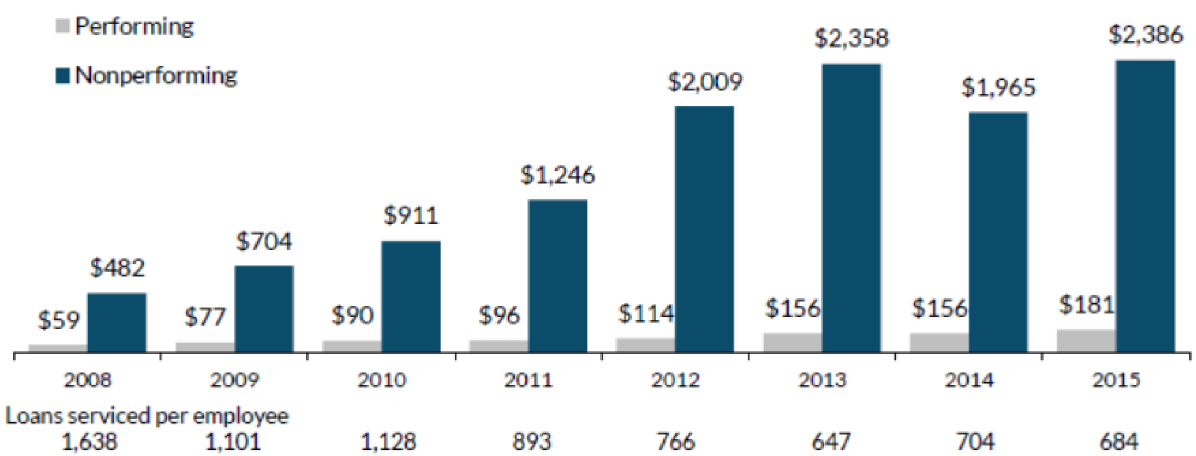


Source: National Association of Realtors, Haver Analytics

The slow trend rate of growth reflects the dampening impact of derisking on one hand…

- GSE G-fees raised by 25 basis points to about 60 bp
- CFPB TRID, adding complexity and costs to servicing
- Legacy impact of Reps and Warrants on bank risk appetite
- CCAR – stress tests make difficult to fully utilize the entire "credit box"

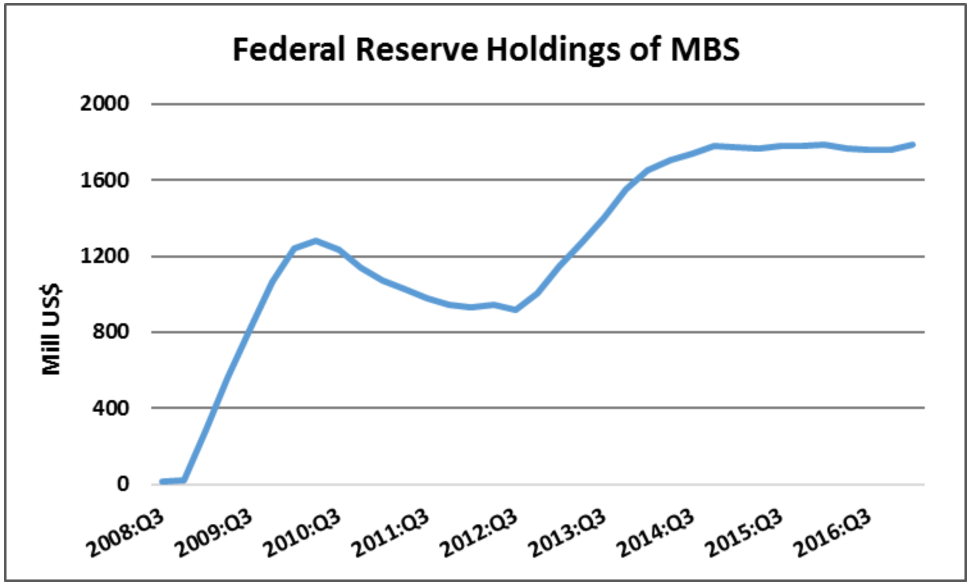
Servicing Costs per Loan Are Way Up, Productivity Is Down



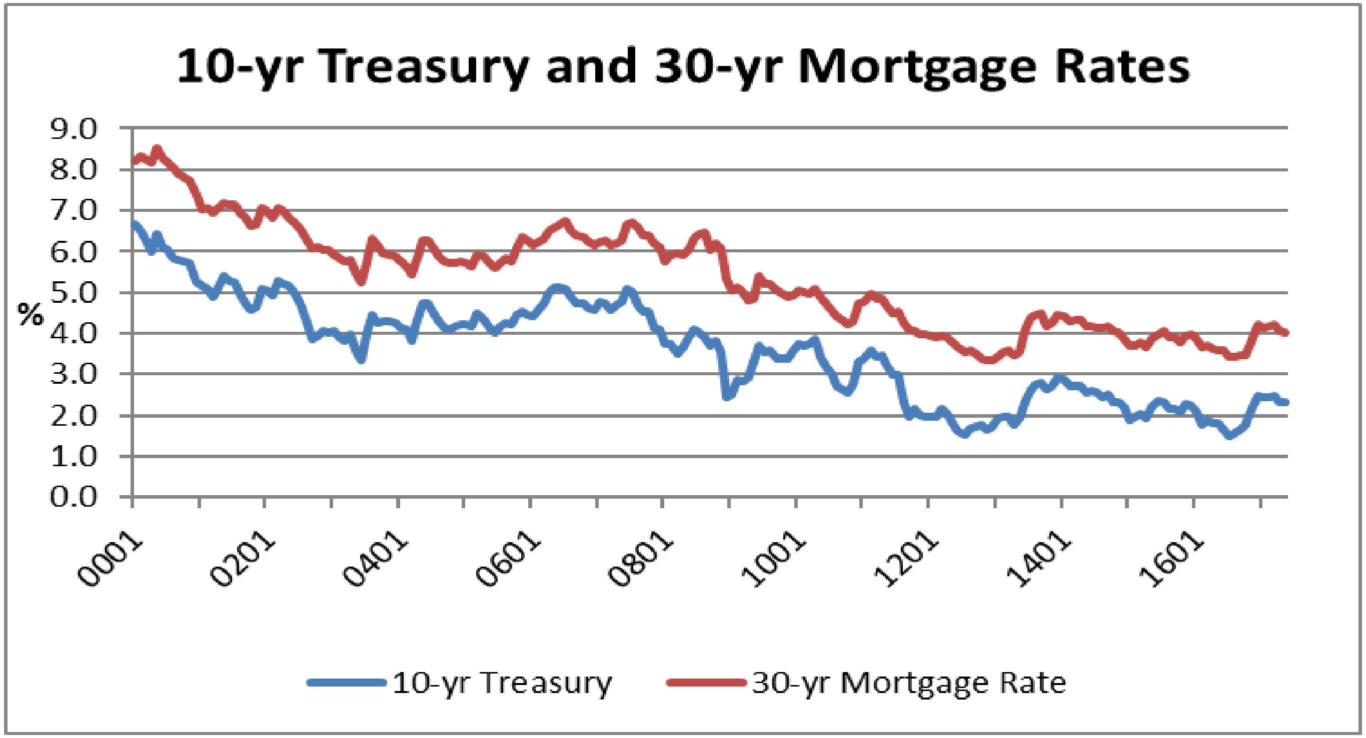
Source: Mortgage Bankers Association.

…offset by extraordinary measures designed to keep mortgage costs low

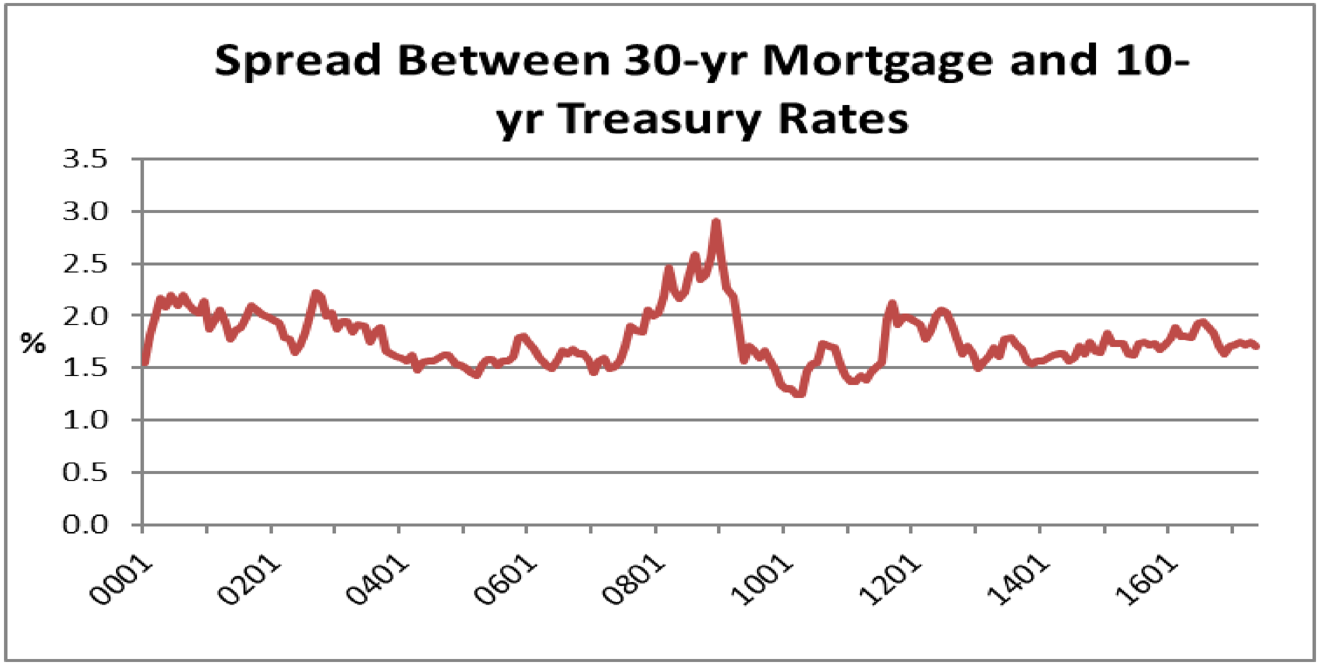
- Federal Reserve “zero rate policy” for seven years 2008-2015
- FHA lowers MIP by 25 bps 2015
- QE – The Fed now owns over 30% of MBS outstanding



Mortgage rates are near historic lows



The spread between mortgage costs and Treasury yields is near pre-crisis levels



Source: FRBNY

The relative stability in the mortgage spread reflects two offsetting trends

Upward pressure from higher G-fees and servicing costs

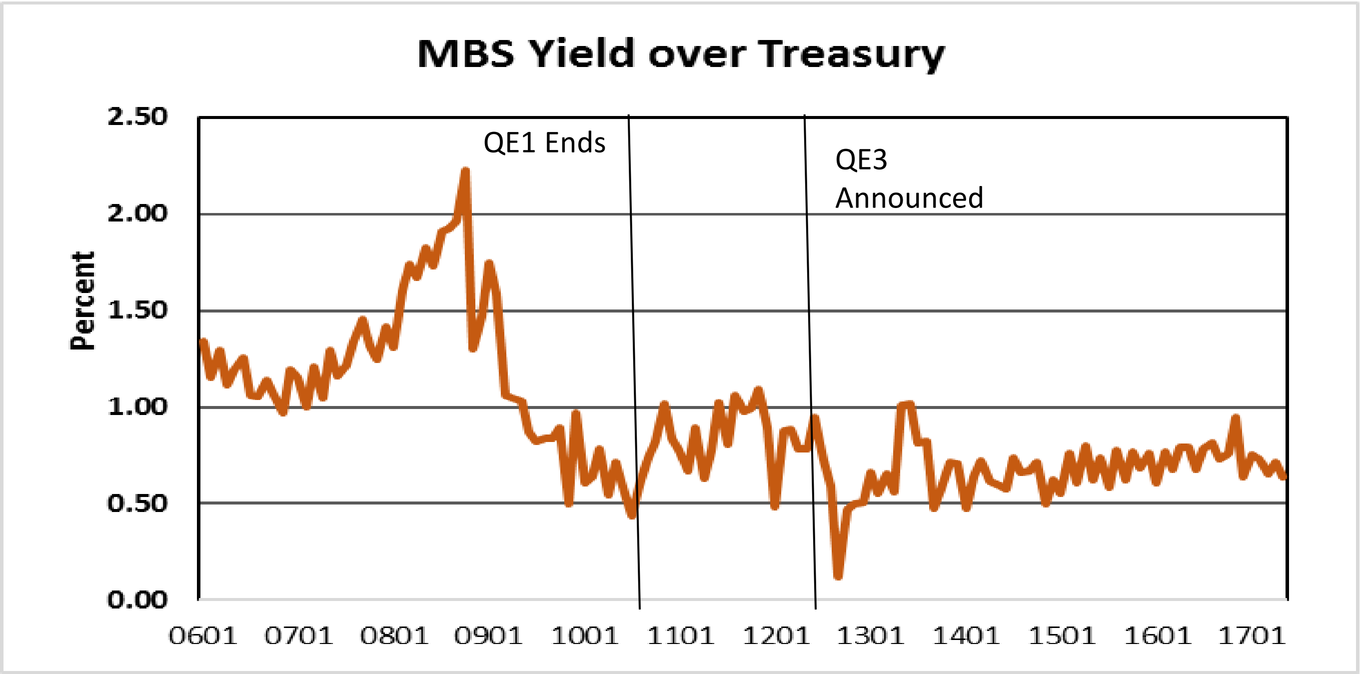
Downward pressure from QE and low market volatility

Change from 2007 = +60 bps

Change from 2007 = -75 bps

Source: Author’s calculations

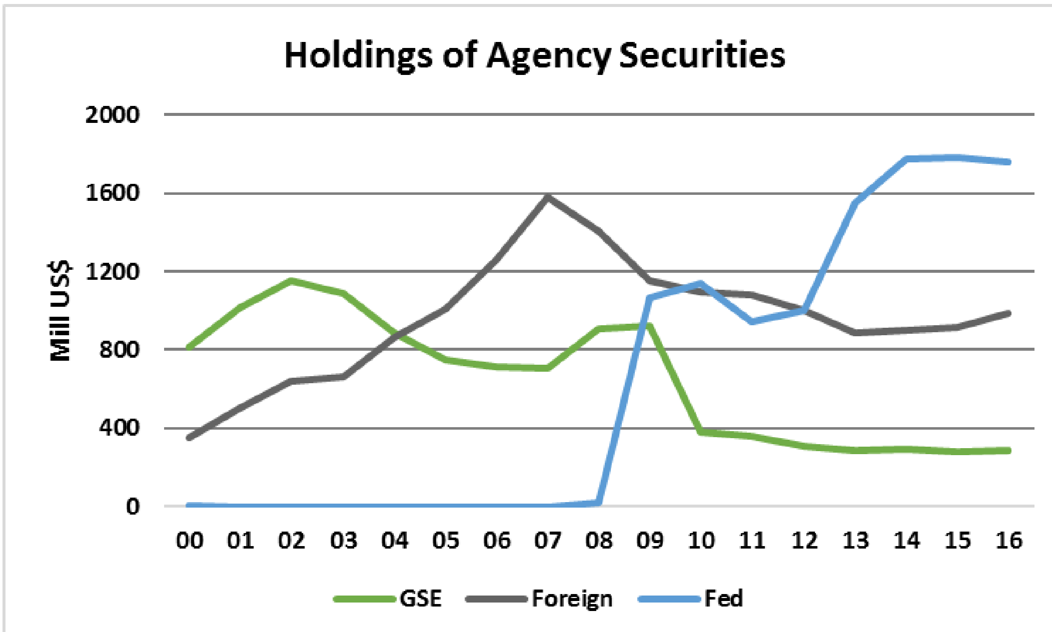
The excess return investors earn over Treasuries is historically very low



Source: FRBNY, Bloomberg

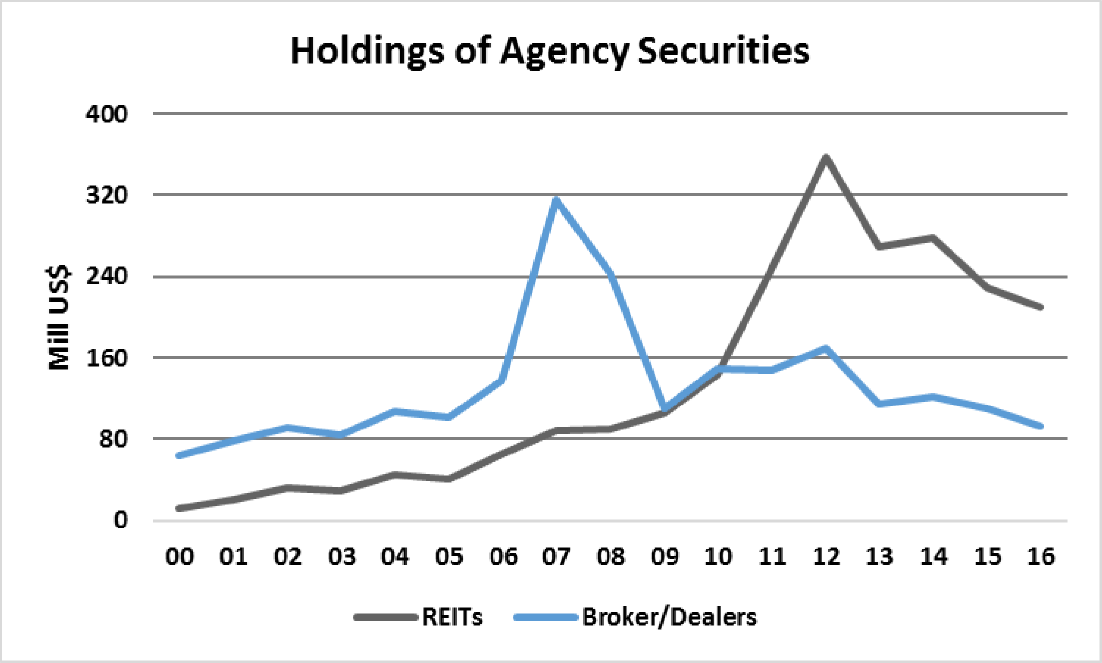
The Fed will soon start to shrink its MBS holdings – who will buy?

Fed purchases occurred facing headwinds of selling by the GSE's and foreign investors



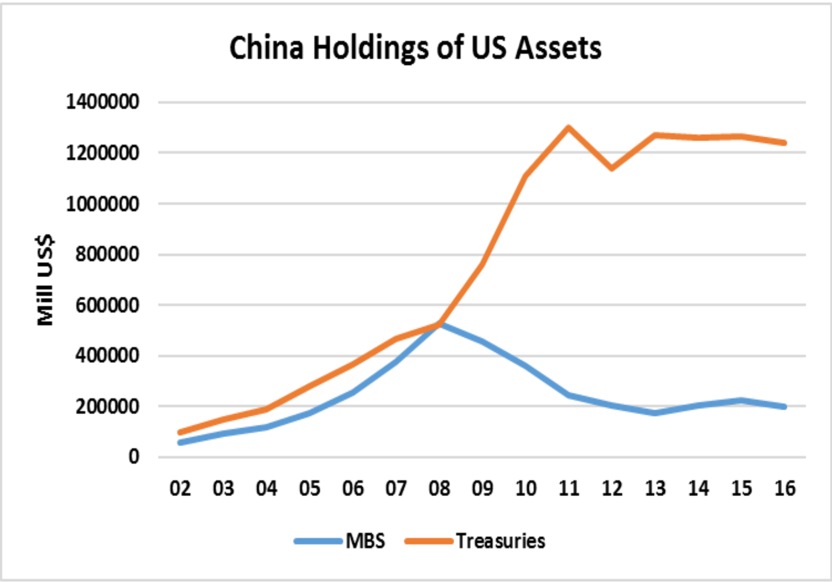
Source: Federal Reserve

The mortgage risk profile is mixed



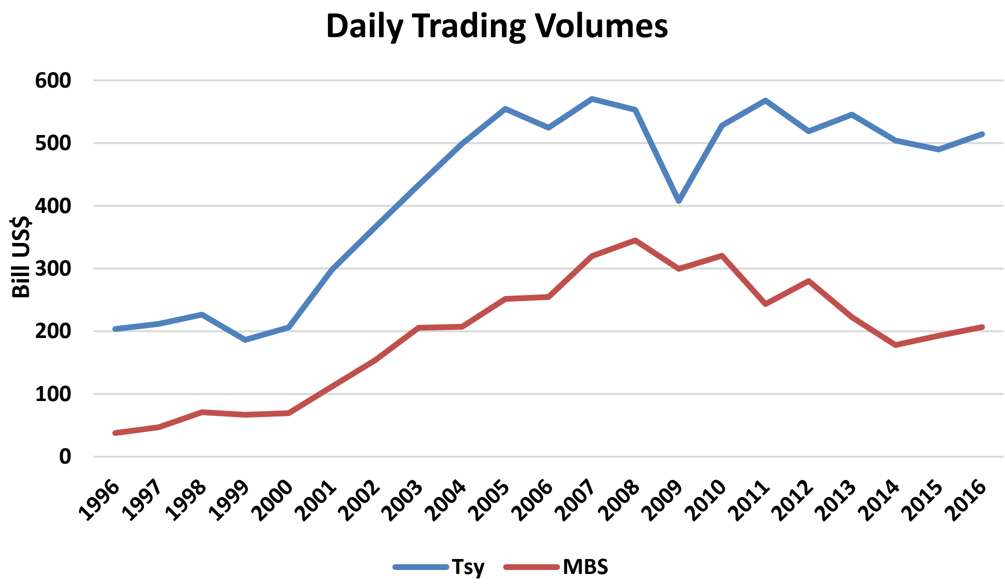
Source: Federal Reserve

Focus on China



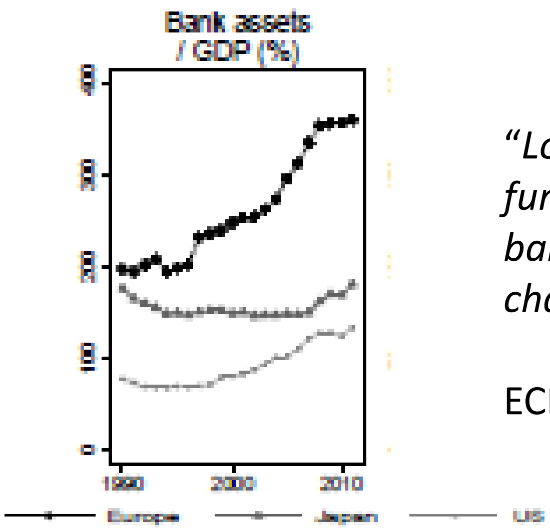
Source: US Treasury, People’s Bank of China

Ending on an upbeat note: The MBS market remains very liquid



Diversification of lending channels

Langfield and Pagano[1] at the ECB find that reliance on bank-financed systems tends to lead to higher levels of systemic risk and lower economic growth, particularly during times of large drops in asset prices, largely because of the leveraged nature of the banking system.



"Looking at our past experience, the absence of an alternative funding channel increased overall economic risk – because the bank lending channel got clogged. Better to have a plurality of channels financing the real economy than to rely on just one."

ECB President Draghi, European Parliament November 2014

[1] Sam Langfield and Marco Pagano, "Bank bias in Europe: effects on systemic risk and growth", ECB Working Paper No 1797, May 2015

The pendulum starts to swing back

- As the US economy has recovered, the Fed has hiked rates and indicated its intention to shrink its balance sheet.
- The Treasury department has issued a 150 page report on regulatory relief for the banking sector.
- Fannie Mae has announced it is raising the debt limit (DTI) cap on mortgages they will insure to 50% from 45%

Prospects for comprehensive GSE reform remain highly uncertain.

Questions?