

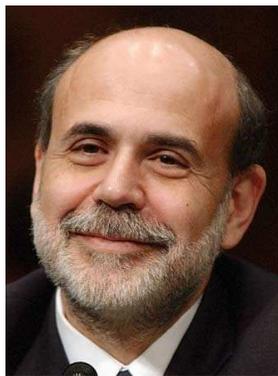
## Some thoughts on housing and the economy

Paul Willen, Federal Reserve Bank of Boston

New England Consumer Advisory Group  
November 14, 2011

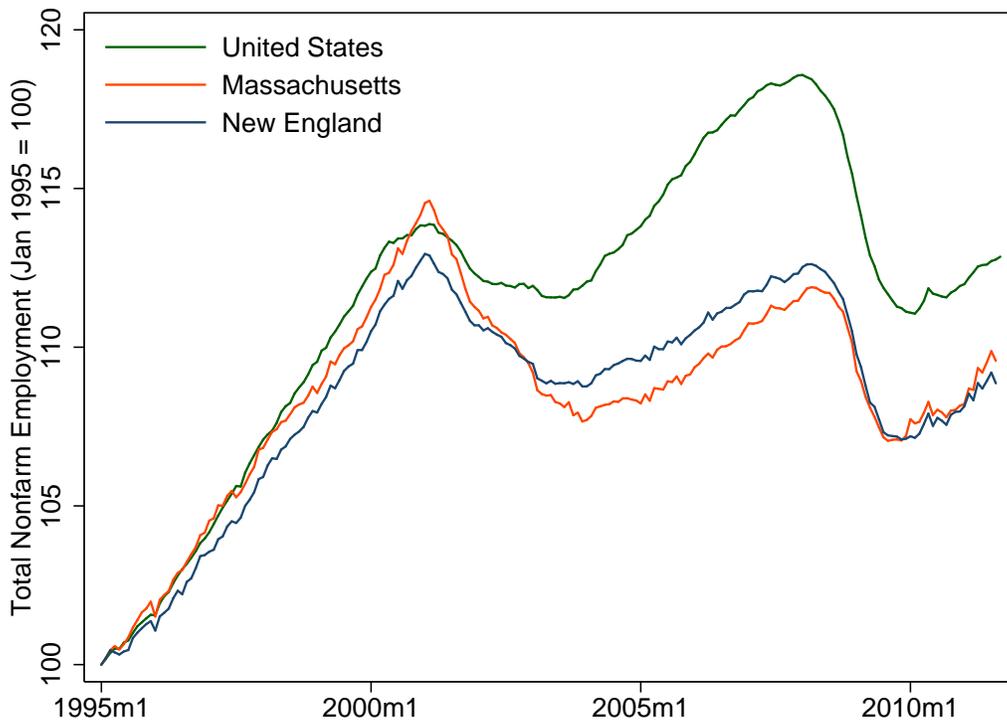
## Disclaimer

- I am speaking today as a researcher and as a concerned citizen
- not as a representative of:
  - The Boston Fed
  - or the Federal Reserve System

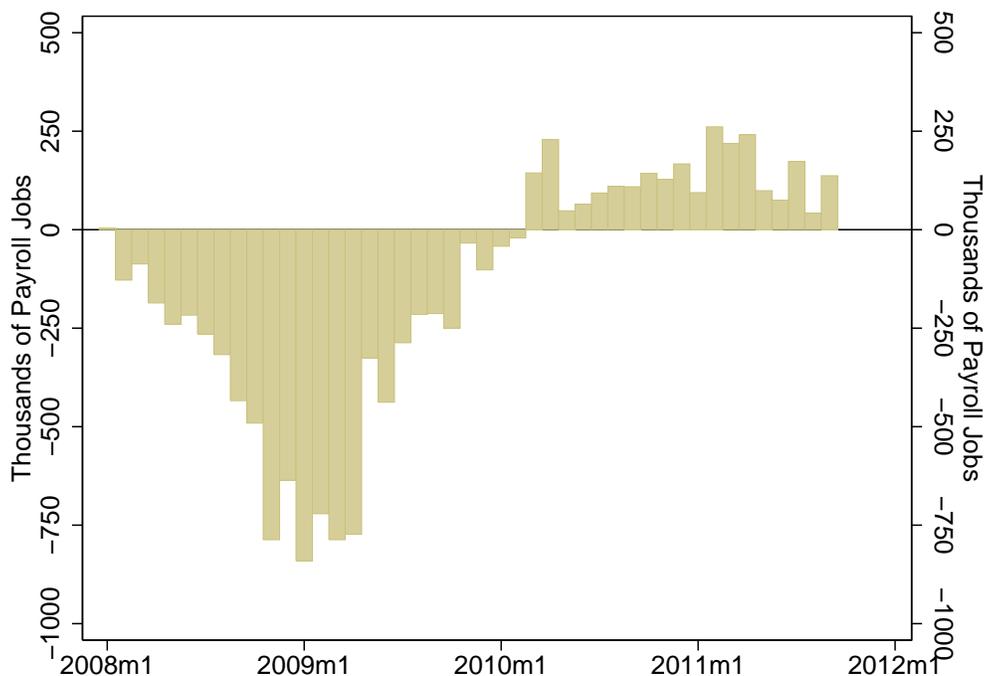


- When I say “we”, I don’t mean Ben and me.

# Employment Levels: Total Nonfarm Payrolls



# Recent Private-Sector Employment Growth

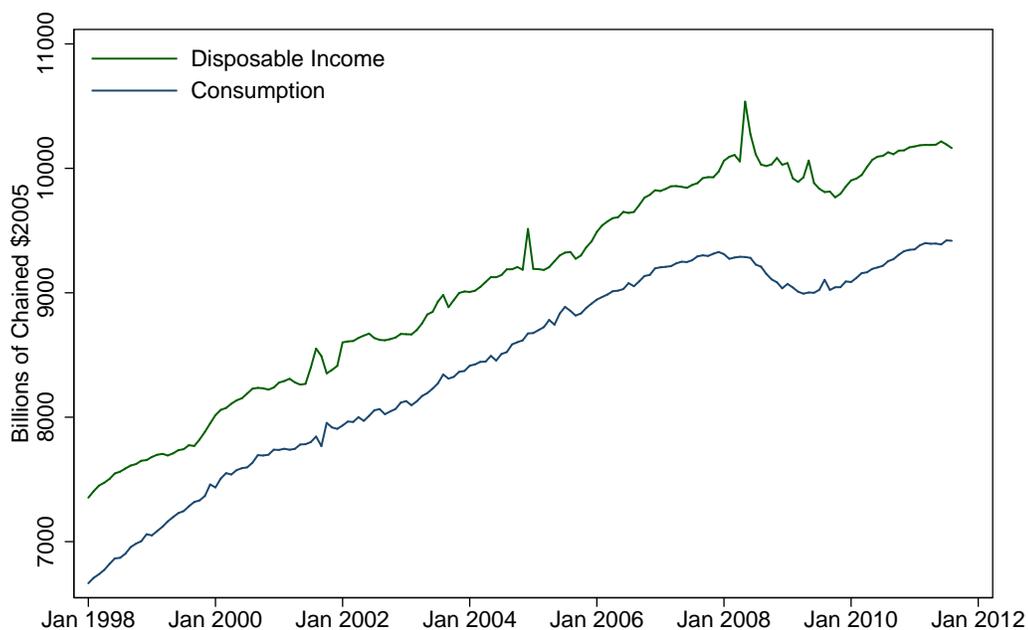


Sources: Bureau of Labor Statistics (Establishment Survey).

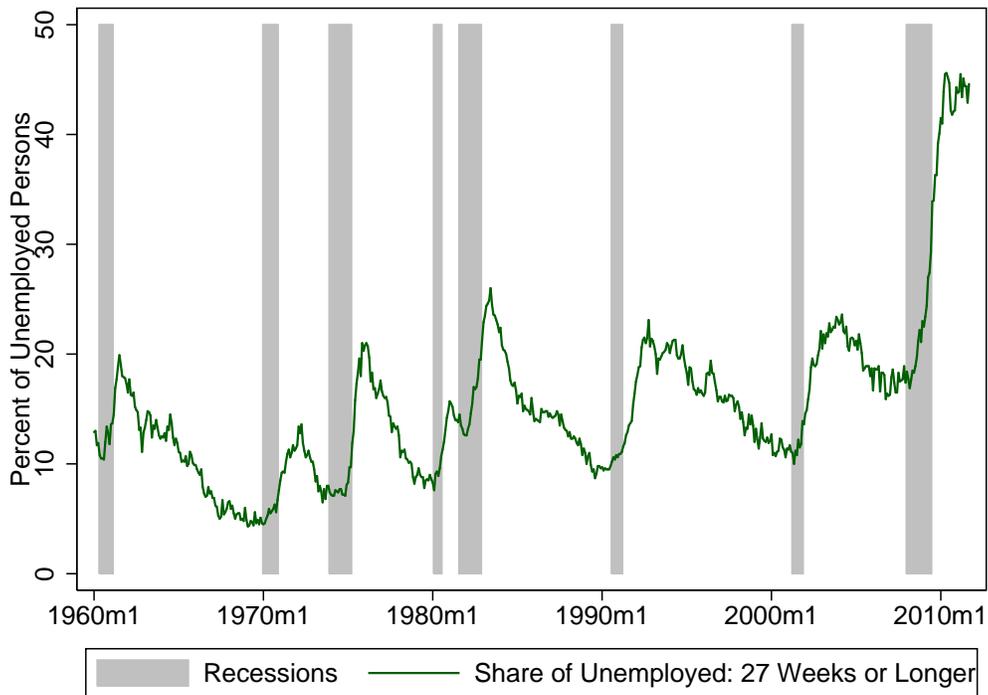
## Why is the recovery so slow? Some possibilities

- **De-leveraging:** Lack of aggregate demand as firms and consumers rebuild balance sheets?
- **Labor markets:** Unemployed don't have the right skills or are "locked" into underwater mortgages?
- **International:** Firms wary of future health-care or tax liabilities?
- **Housing:** "We can't have a recovery with housing."

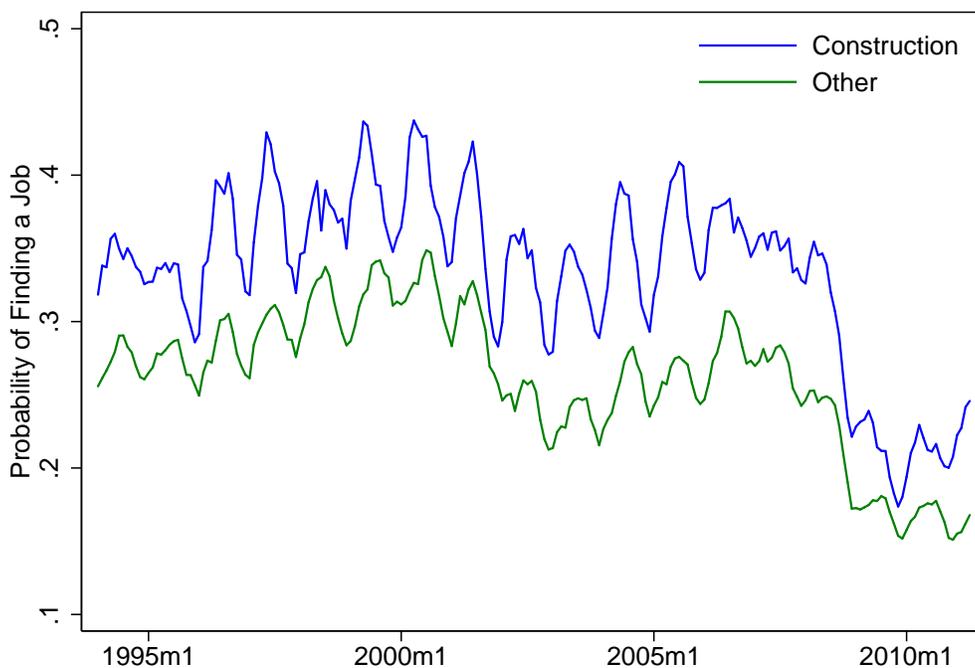
## De-leveraging: Increase in Saving



# Labor: Long-Term Unemployment

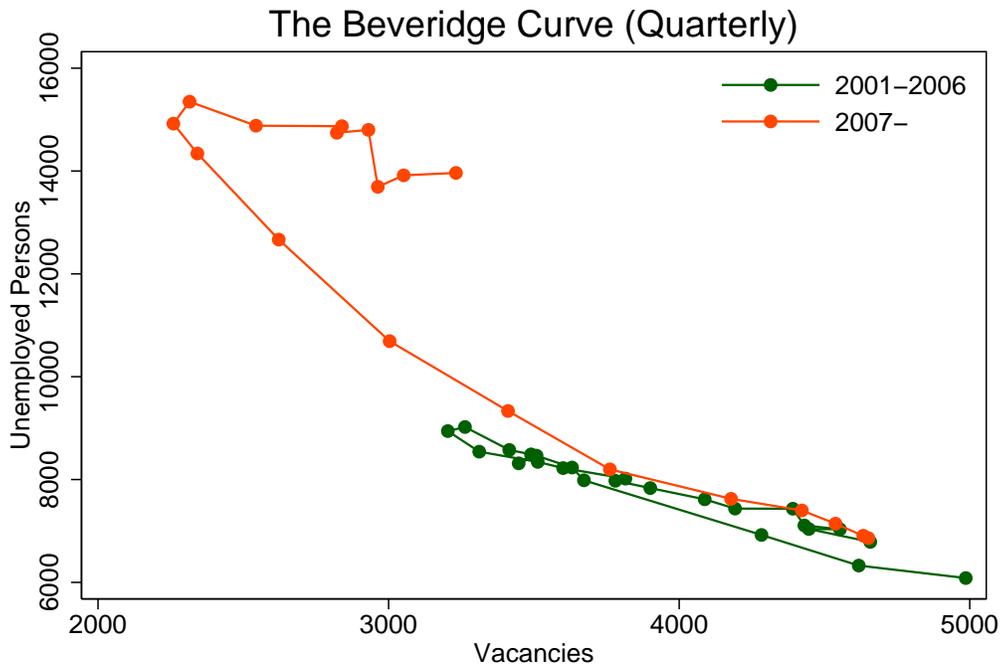


# Labor: Job-Finding Rates by Industry



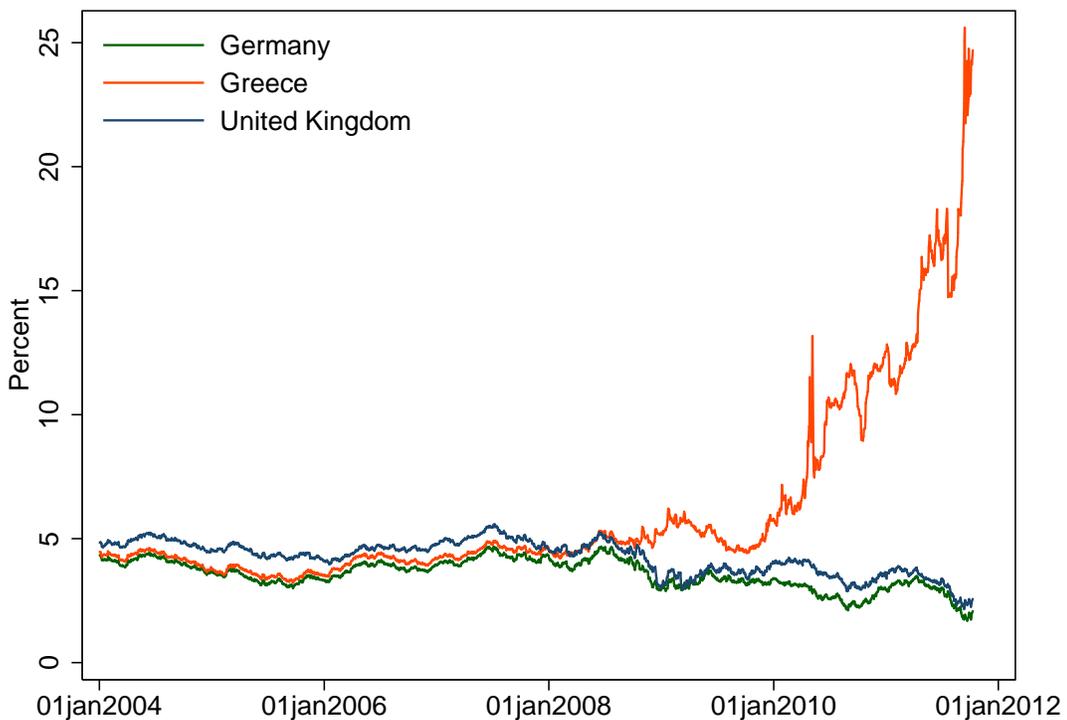
Note: Five-month moving averages.

# Labor: Mismatch

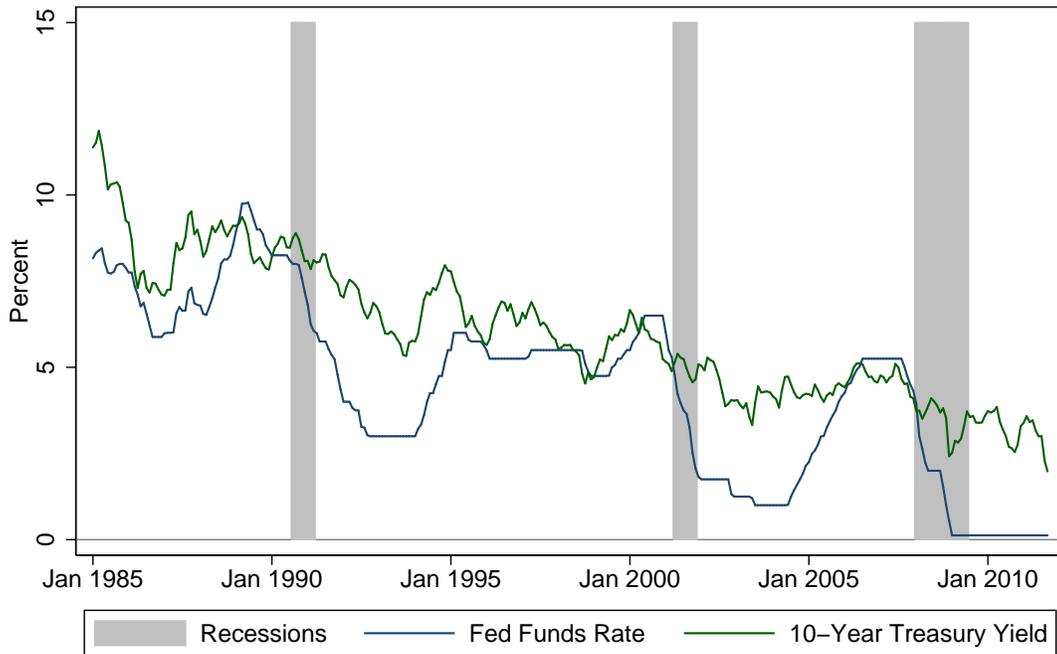


Note: JOLTS data current through September.

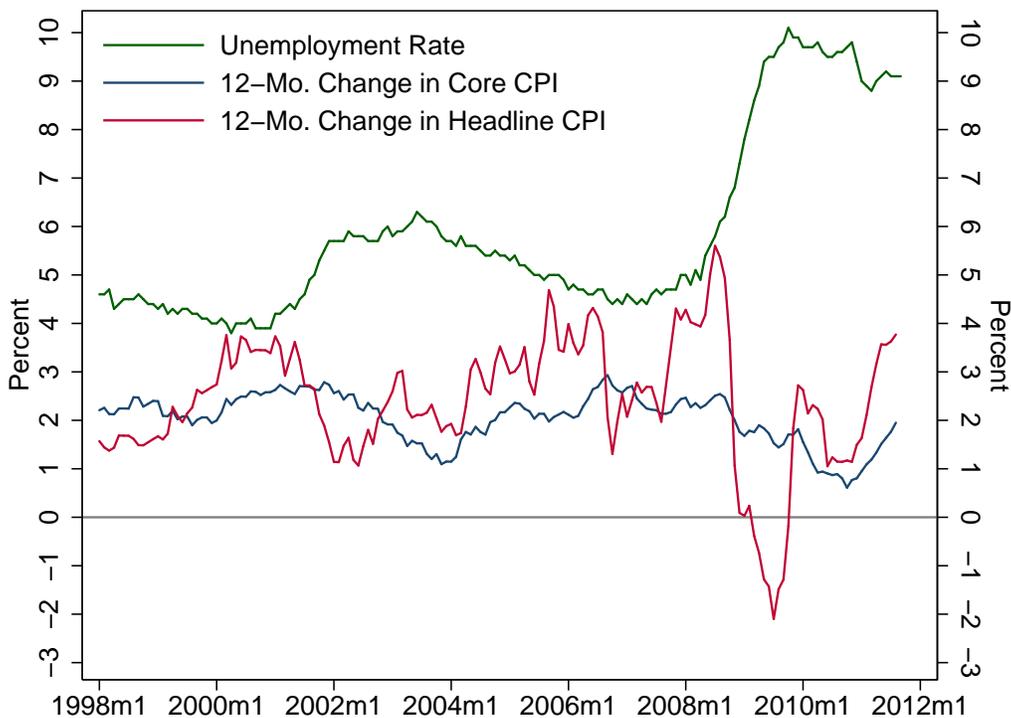
# International: Problems in Europe



# Federal Funds Rate and 10-Year Treasury Yield



# Unemployment and Inflation



## Negative equity: This time is NOT different

- Early on in the crisis, we argued that most people with negative equity did not default in the last cycle.
- People said, “This time is different.”
  - 53,823 borrowers with  $LTV > 120\%$  in Q4, 1991
  - Over next two years, 2837 (5.2%) lost their homes.
- People said that this time was was different.
  - MA had a mild recession (Not true, unemployment rate was 9.5 percent)
  - “Walking away” was just not done back then.
- Now we have data for this crisis.
  - 72,934 borrowers with  $LTV > 120\%$  in Q4, 2007.
  - Over next two years, 3402 (4.6%) lost their homes.
- Most borrowers with negative equity will stick it out.

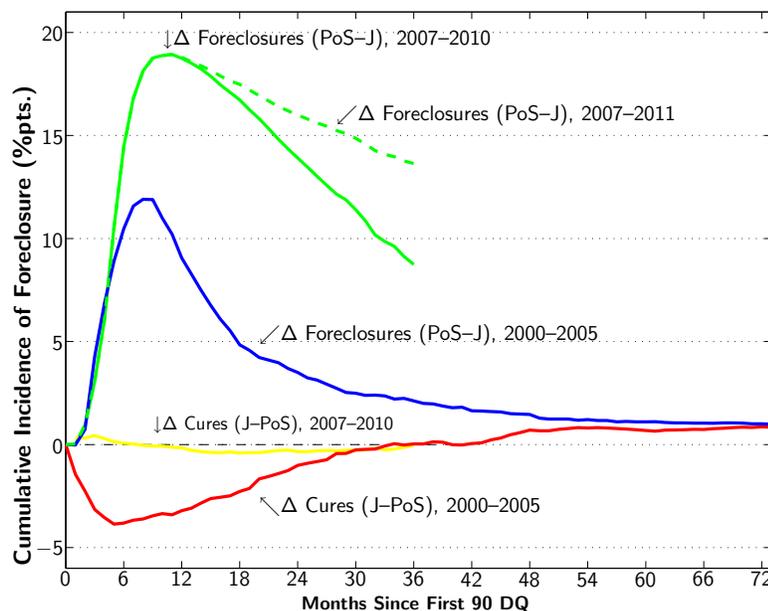
## Legal Issues

- Recently, lots of issues raised about sloppy foreclosure procedures:
  - Title transfer: Servicer not authorized to carry out foreclosure.
  - Robosigning: Servicer employee not authorized to sign affidavits.
  - Poor controls.
- These are serious issues
- Interagency Review (OTS, OCC, FDIC, Federal Reserve)
- The reviews found:
  - “critical weaknesses in servicers’ foreclosure governance processes...” (p. 5)
  - “foreclosure document preparation processes...” (p. 5)
  - “oversight and monitoring of third-party vendors, including foreclosure attorneys.” (p. 5)

- But it's not clear that any of this really hurts borrowers. Review found that:
  - "...borrowers subject to foreclosure in the reviewed files were seriously delinquent on their loans." (p. 6)
  - "...servicers possessed original notes and mortgages and, therefore, had sufficient documentation available to demonstrate authority to foreclose." (p. 6)
  - "servicers generally attempted to contact distressed borrowers prior to initiating the foreclosure process to pursue loss-mitigation alternatives, including loan modifications." (p. 6)
  - "... some – but not widespread – errors between actual fees charged and what the servicers internal records indicated, with servicers undercharging fees as frequently as overcharging them." (p. 9)
- If anything, sloppy procedures result in delays that allow borrowers to stay in homes longer!
- In fact, BofA paying billions to investors for foreclosing *too slowly*.

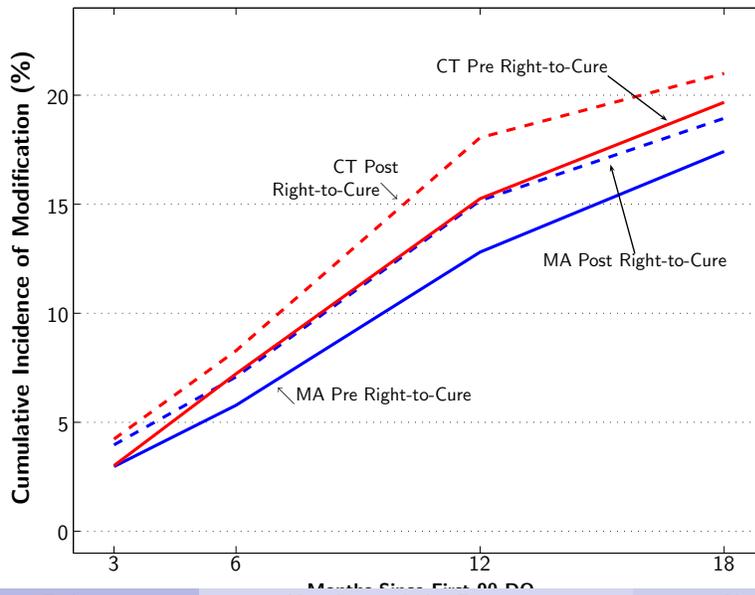
## Borrower protection only delays the inevitable

- In power-of-sale states, lender forecloses without court.
- In judicial states, borrower guaranteed a "day in court."



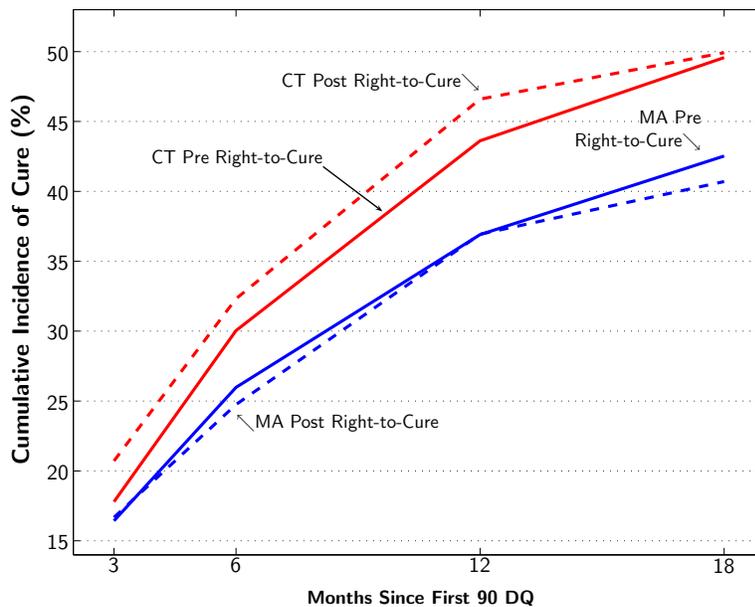
## Right-to-cure law similarly ineffective

- Mass. Right to cure law gives borrowers 90 days to work with lender.
- Compared borrowers eligible for the law with ineligible borrowers.



## Cure rates the same

- Cure rates
- Were the same before and after the law.



# Forecasting house prices

- Beware of house price forecasts.



# Adaptive expectations

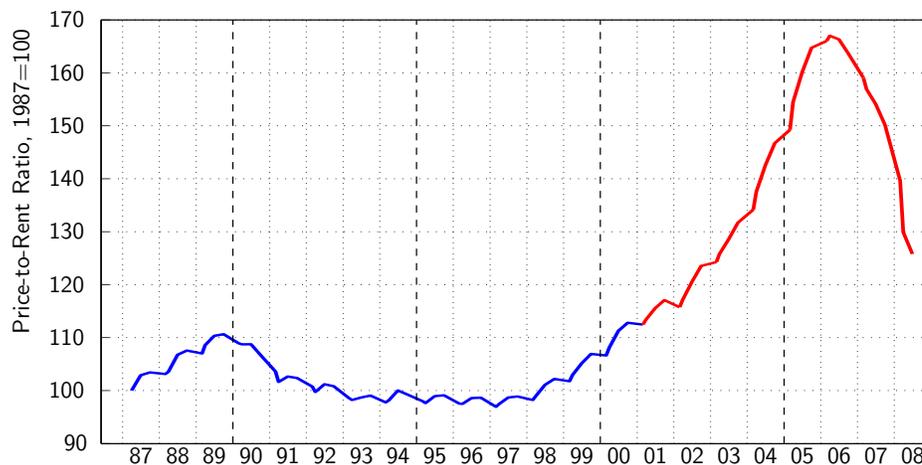
- JPMorgan “HPA Update”

Date of	Data from	Title
12/8/06	10/06	“More widespread declines with early stabilization signs”
1/10/07	11/06	“Continuing declines with stronger stabilization signs”
2/6/07	12/06	“Tentative stabilization in HPA”
3/12/07	1/07	“Continued stabilization in HPA”
9/20/07	7/07	“Near bottom on HPA”
11/2/07	9/07	“UGLY! Double digit declines in August and September”

- JP Morgan, May 16, 2008.: “We expect another 15% drop in home prices over the next 12 months.”

## The Price-Rent Ratio over time

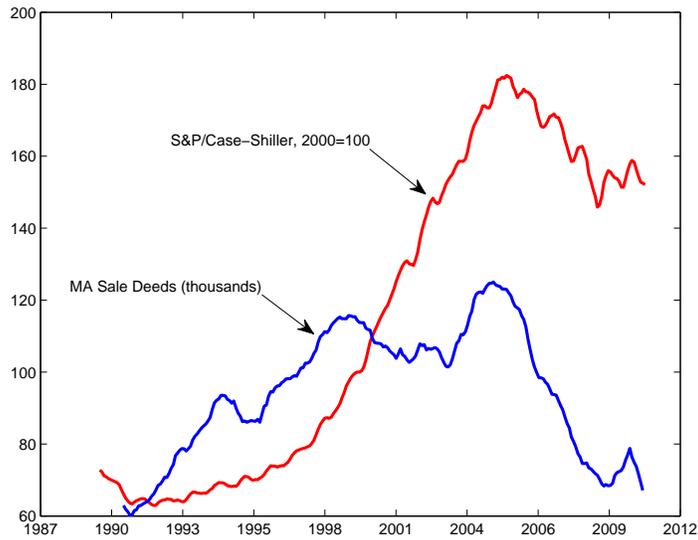
- Case-Shiller 20-city composite index
- BLS Rent index



## Foreclosure Overhang

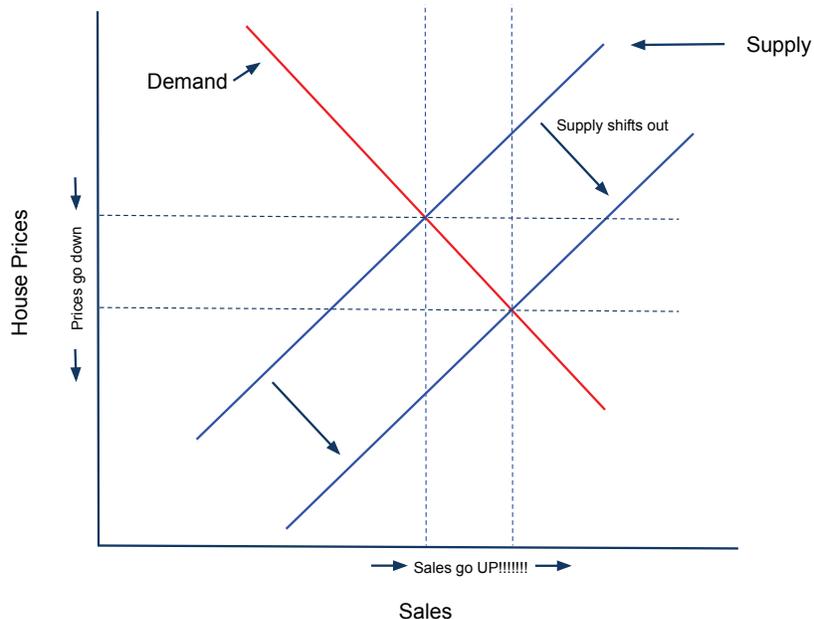
- Many have worried that foreclosures drive down prices.
  - Add supply to market
  - Law of supply and demand and all that.
- But the data suggests that
  - Insufficient demand is what driving down prices and causing foreclosures.
  - Foreclosures aren't driving prices down.
- Why?
- Supply and demand! Falling prices can reflect
  - Falling demand
  - Increasing supply
- The problem is low demand
  - In a "normal" year, MA buyers absorb 40K more properties than are selling right now.

# Sales and house prices in MA, 1990-2011



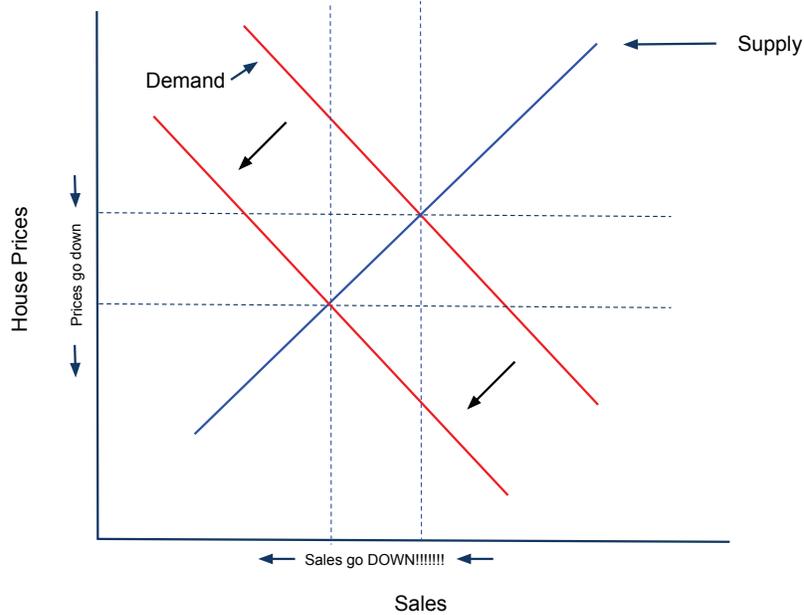
# Effect of an increase in supply

- An increase in supply drives prices down
- But sales go up!

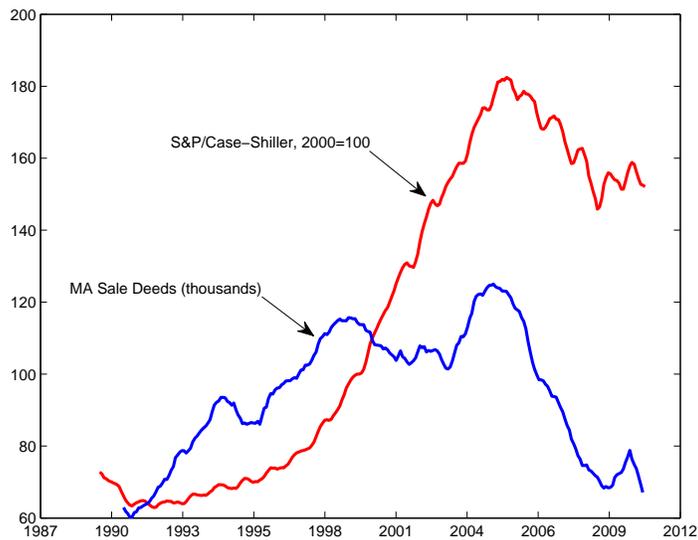


# Effect of a shift in demand

- A reduction in demand drives prices down
- But sales go down!



# Sales and house prices in MA, 1990-2011



## Economists suck at forecasting house prices

- Most house price variation over time is unforecastable.
  - Economists
  - Practitioners.
- Consensus did not anticipate:
  - Boom in the late 90s-00s
  - Bust in 2006-2010.
- In 2006, some argued that low interest rates explained why house prices were so high.
  - Interest rates are much, much *lower* now.
- If simple “supply and demand” models were useful, we wouldn’t be in this mess.
- Good news: Economists are predicting falling house prices.
  - So it’s time to buy!

## The slide you’ve all been waiting for...

- The end.