

# Housing Bubble III Seminar

March 12, 2008

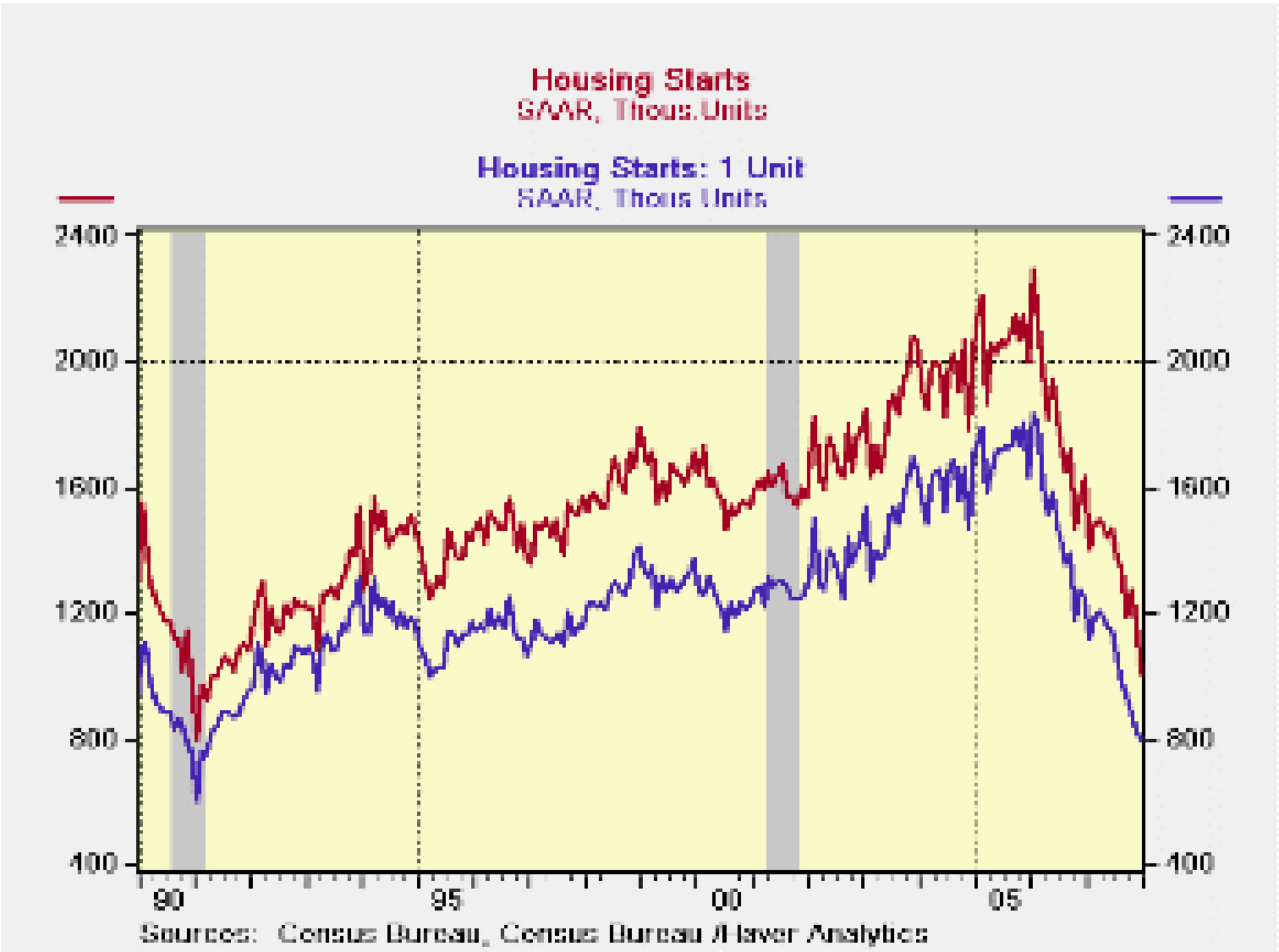
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# The Housing Bust is not occurring in isolation

- The US economy is being simultaneously hit by four major negative shocks
- Falling home prices and reduced construction activity are impacting consumption and residential construction
- A major credit crunch and a vicious de-leveraging process are sharply curtailing credit availability
- Falling equity and non-government debt prices are further destroying household wealth
- International oil prices at over US\$100 a barrel are at record highs

# The Housing Bust is in Full Swing

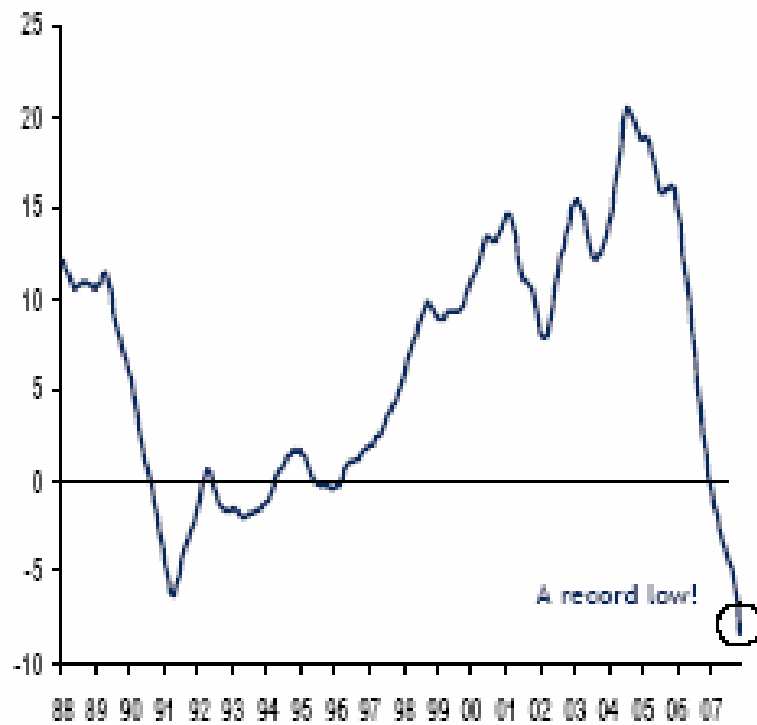
- Residential construction contracted by over 20 percent in 2007, thereby directly subtracting more than 1 percentage point from GDP
- Housing prices at the national level fell by around 10 percent, thereby wiping out around U.S. \$2 trillion from household wealth
- Estimated losses to the financial system from sub-prime mortgage lending have steadily risen to U.S. \$400 billion
- Foreclosures have leapt to an annual rate of around 1.5 million, while the rate of home ownership has started to decline



## Most Intense House Price Deflation In Over A Decade

Case Shiller Home Price Index (year/year % change)

Composite of 10 Metro Areas



Composite of 20 Metro Areas



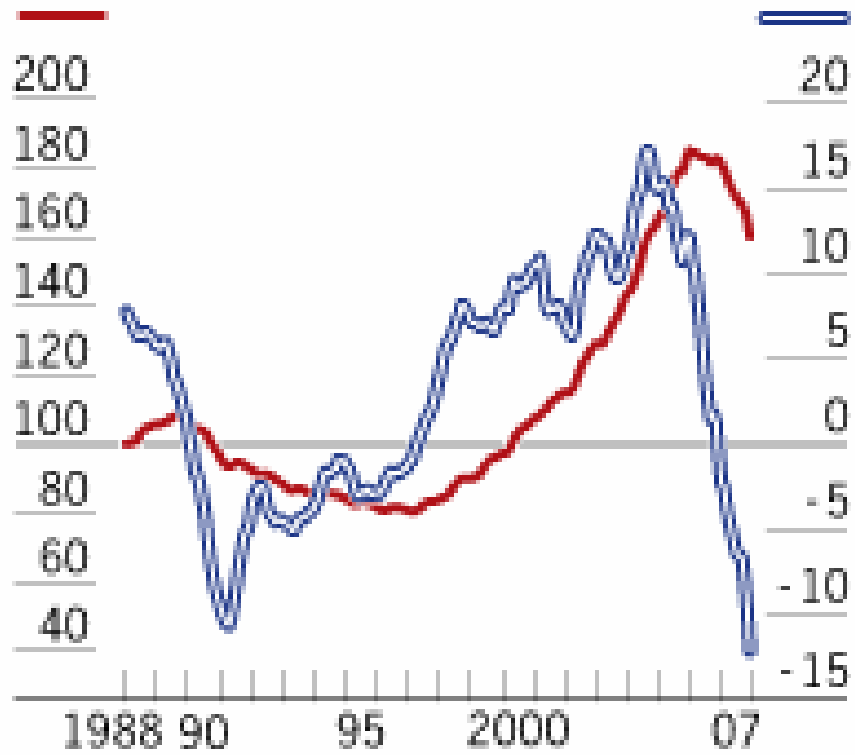
Source: S&P, MacroMarkets LLC, Merrill Lynch

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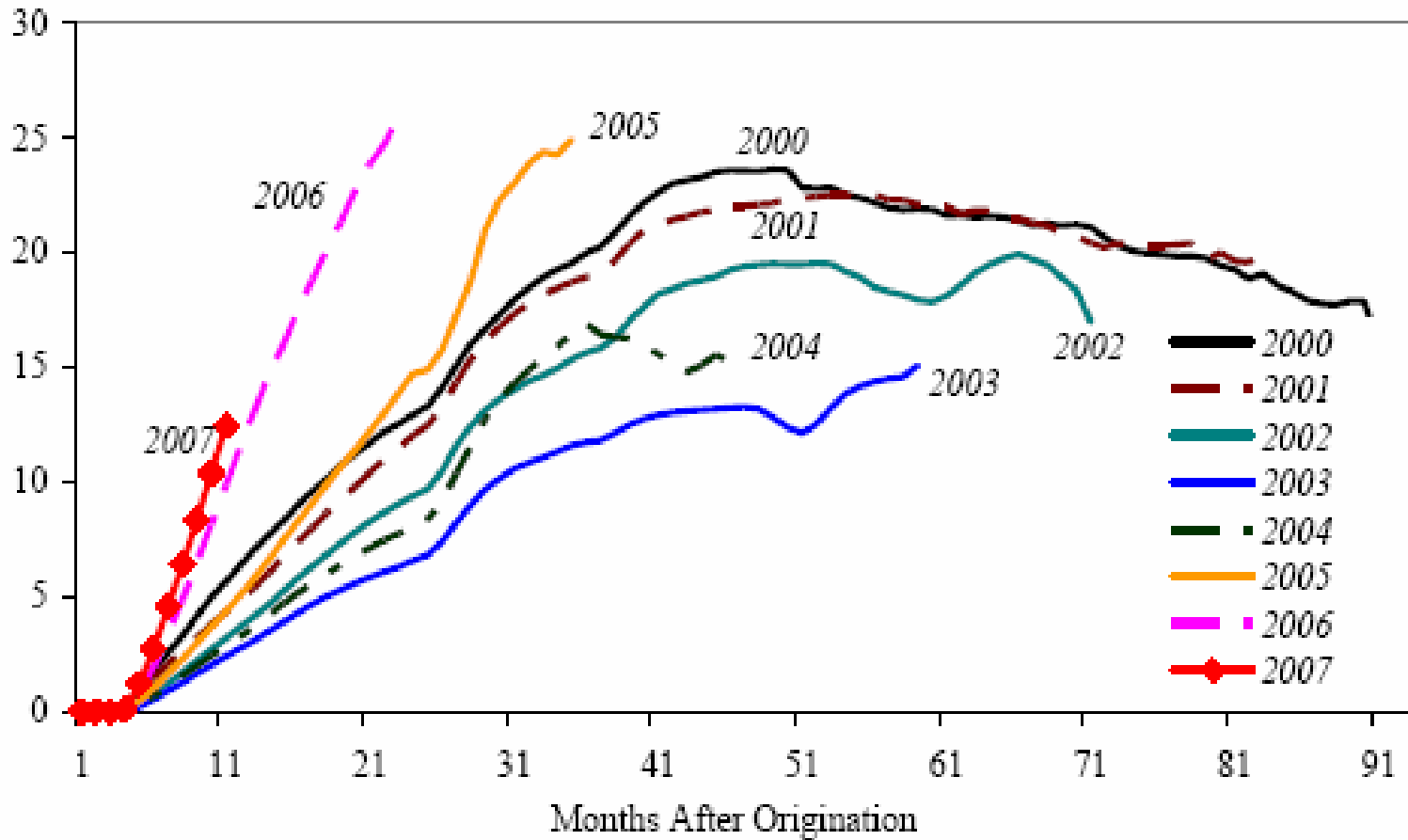
## US real house prices

Case-Shiller 10-city composite, deflated by CPI

Annual % change



**Subprime 60-Day Delinquencies by Mortgage Vintage Year**  
*(In percent of original balance)*



Sources: Merrill Lynch; and LoanPerformance.

# An Adverse Feedback Loop

- Declining home prices and a housing-induced credit crunch have tipped the economy into recession.
- The impending recession further weakens housing demand.
- The recession also aggravates the credit crunch.
- Falling home prices and a more pronounced credit crunch tips the economy further into recession.

# Excess Supply in the Housing Market

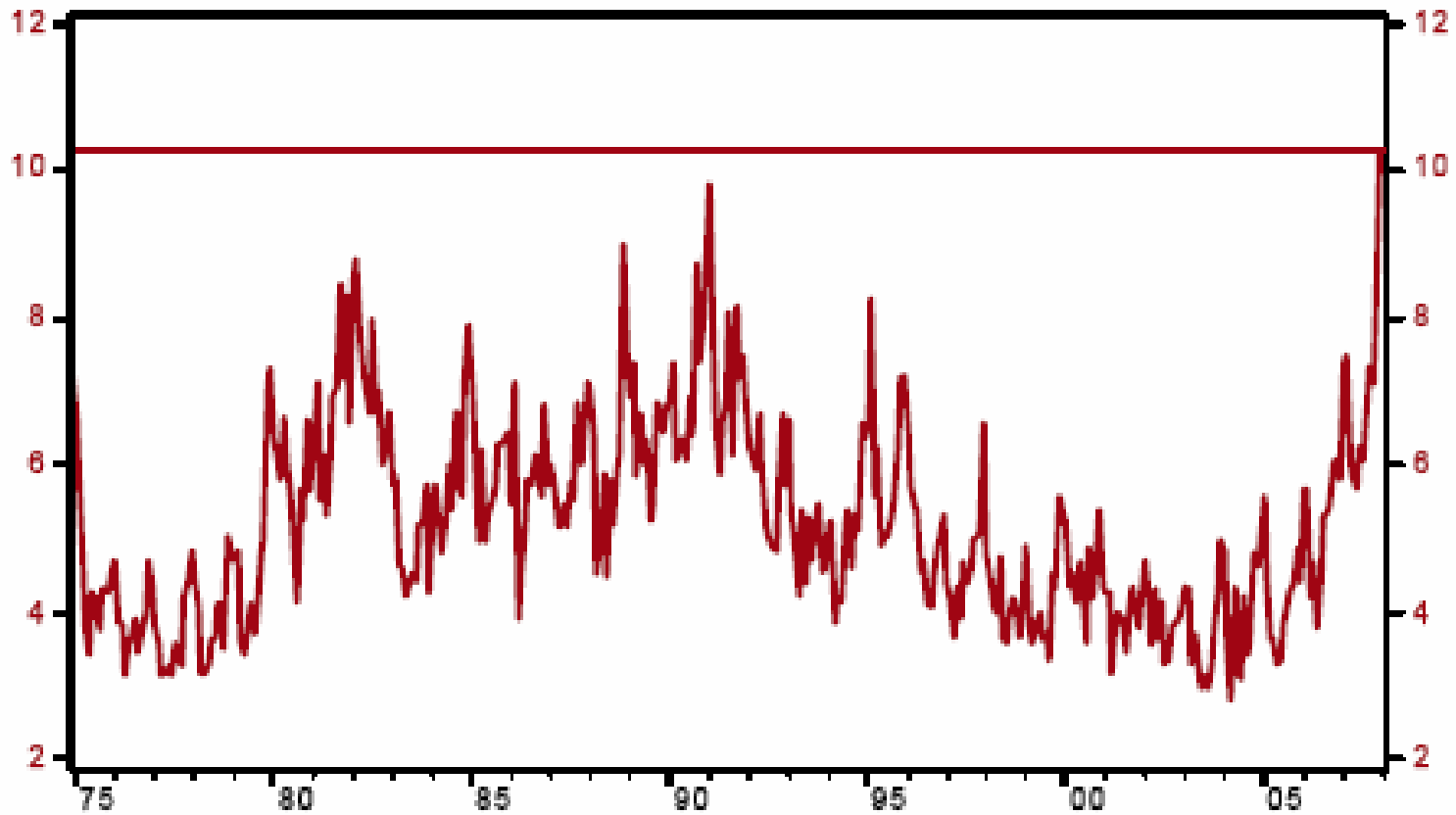
- Vacancy rate are at historic highs
- Unsold inventories have swollen to 5 million units or 10 months' supply
- Affordability index remains inflated suggesting a further 15-20 percent decline in home prices.

# Homeowner Vacancy Rate



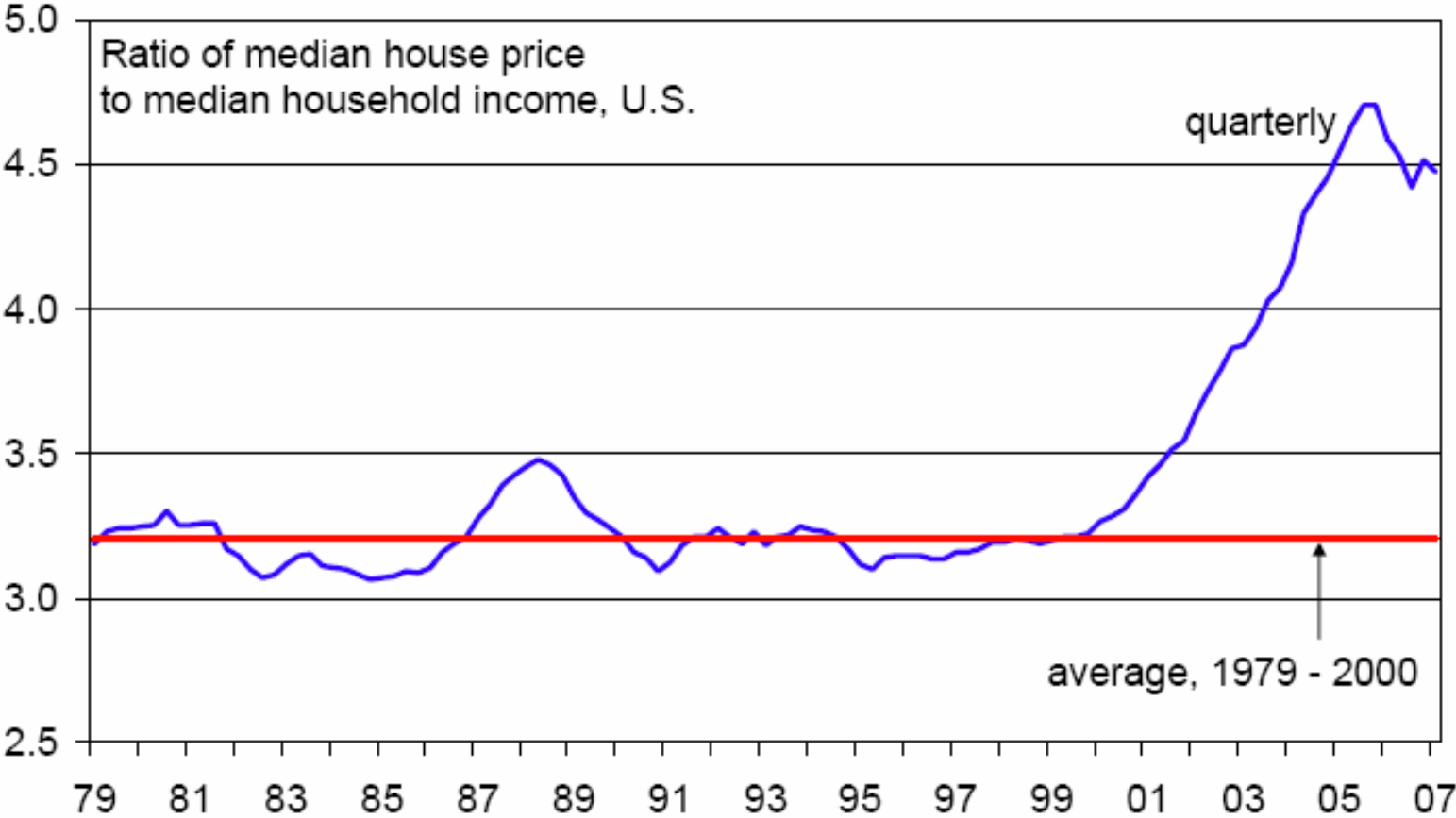
## Inventory-sales for completed product pierces 10 months' supply

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Source: Haver Analytics, Merrill Lynch

# Affordability Went Bust During The Housing Boom



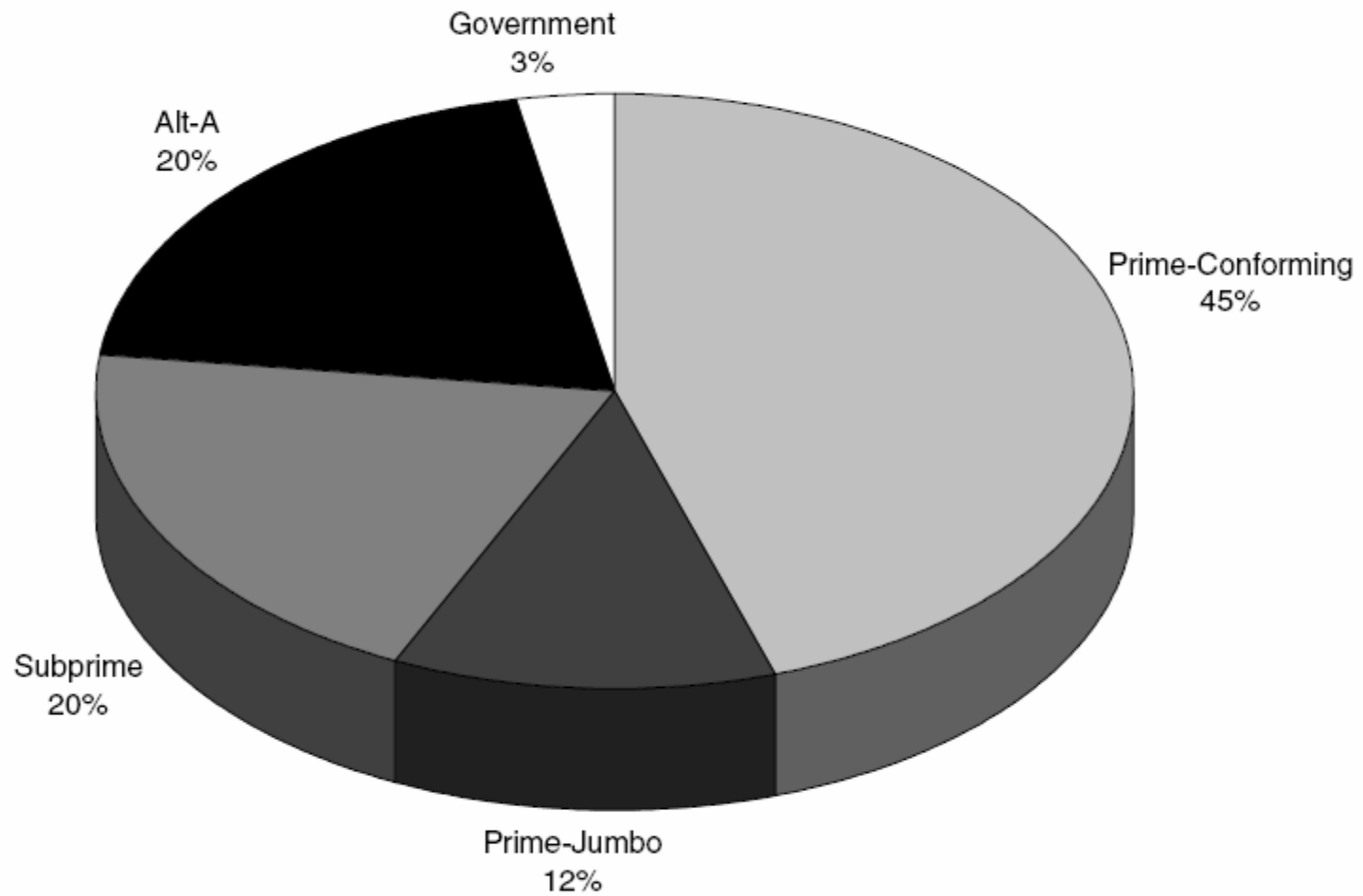
## Housing Demand Will Continue to Contract in 2008

- Many sub-prime and Alt-A lenders, who provided 40 percent of all mortgage loans in 2006, are no longer in business.
- Mortgage lending standards have tightened dramatically.
- Adjustable rate mortgages will continue to reset at a high rate.
- Foreclosures are set to ratchet up as more homeowners have negative equity in their homes.

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Estimated Purchase Dollar Originations, 2006

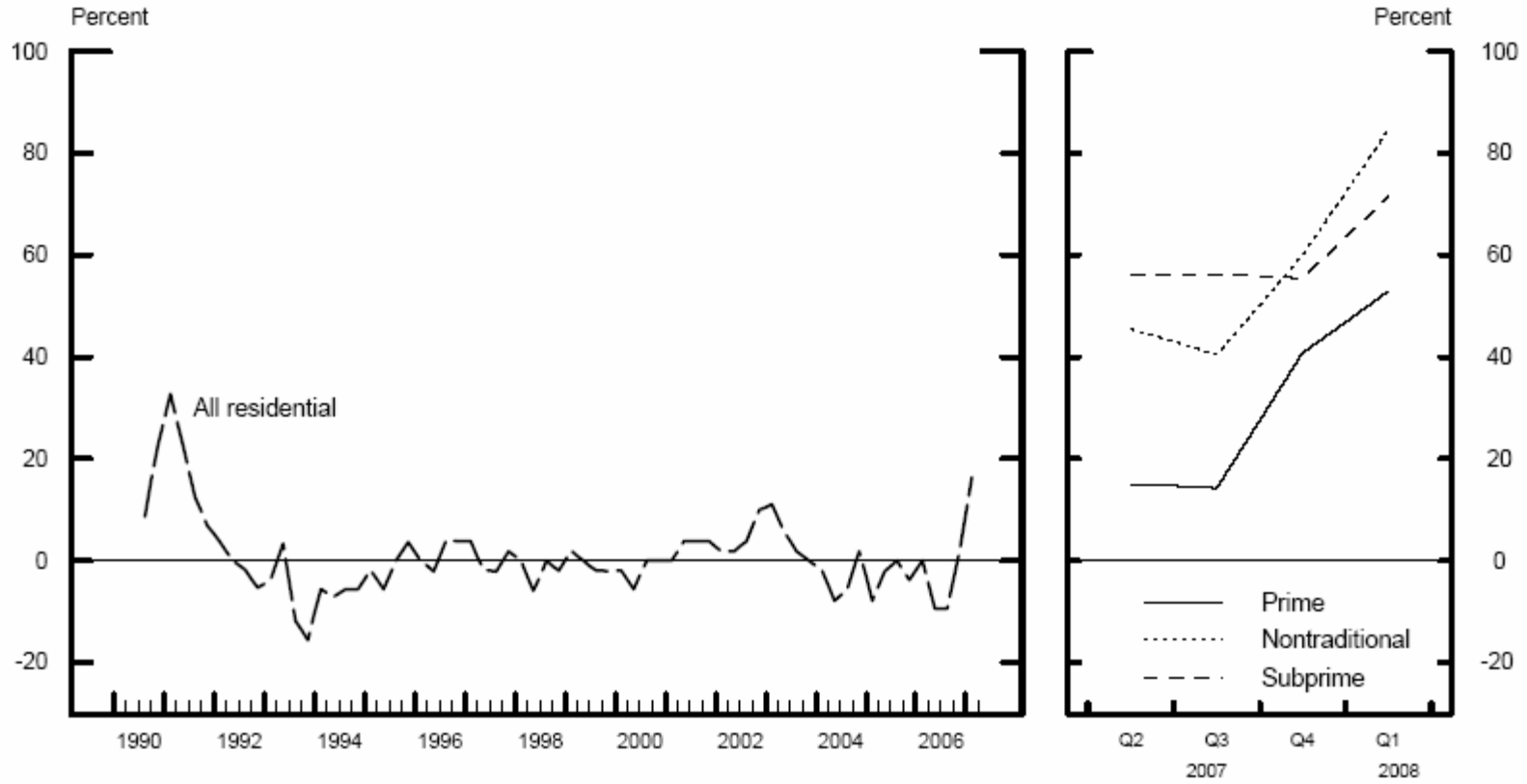
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Source: Inside Mortgage Finance, MBA, LEHC, Credit Suisse U.S. Mortgage Strategy, Credit Suisse analysis.

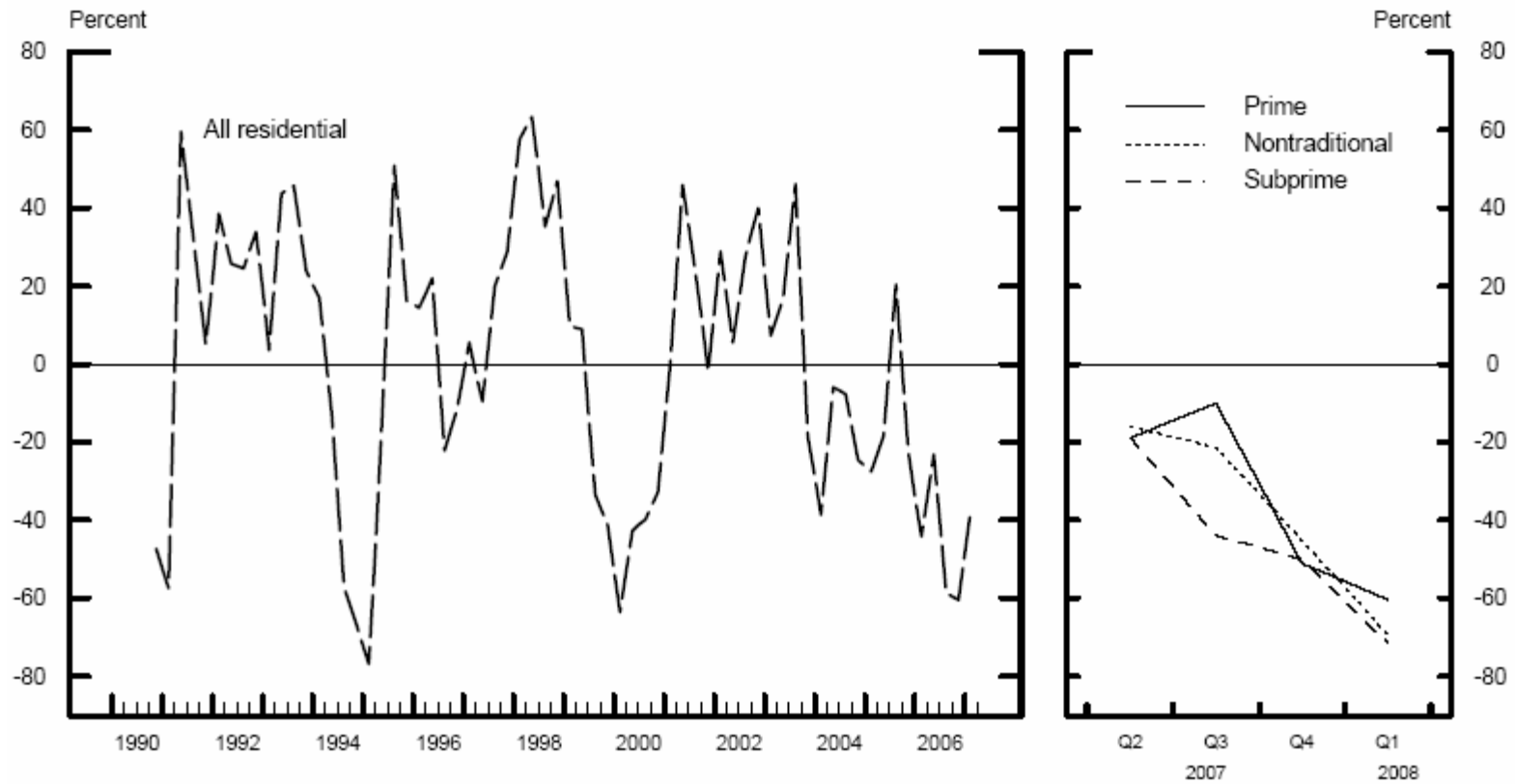
### Net Percentage of Domestic Respondents Tightening Standards for Residential Mortgage Loans



Note. For data starting in 2007:Q2, changes in standards for prime, nontraditional, and subprime mortgage loans are reported separately.

Source: Federal Reserve Board

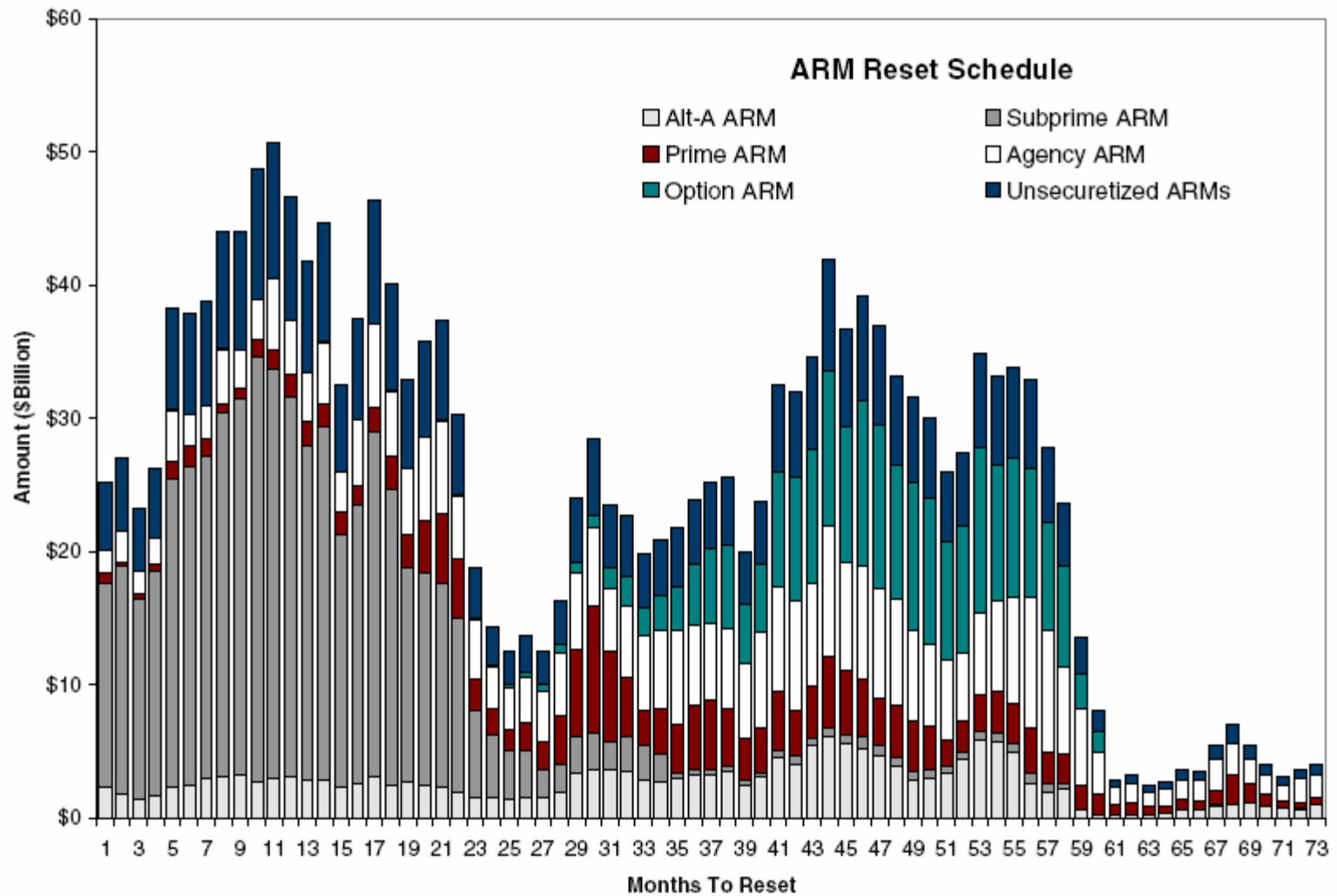
### Net Percentage of Domestic Respondents Reporting Stronger Demand for Residential Mortgage Loans



Note. For data starting in 2007:Q2, changes in demand for prime, nontraditional, and subprime mortgage loans are reported separately.

Source: Federal Reserve Board

## Adjustable Rate Mortgage Reset Schedule



Note: Data as of January 2007.

Source: Credit Suisse Fixed Income U.S. Mortgage Strategy.

# No Stabilization in Housing Market in 2008

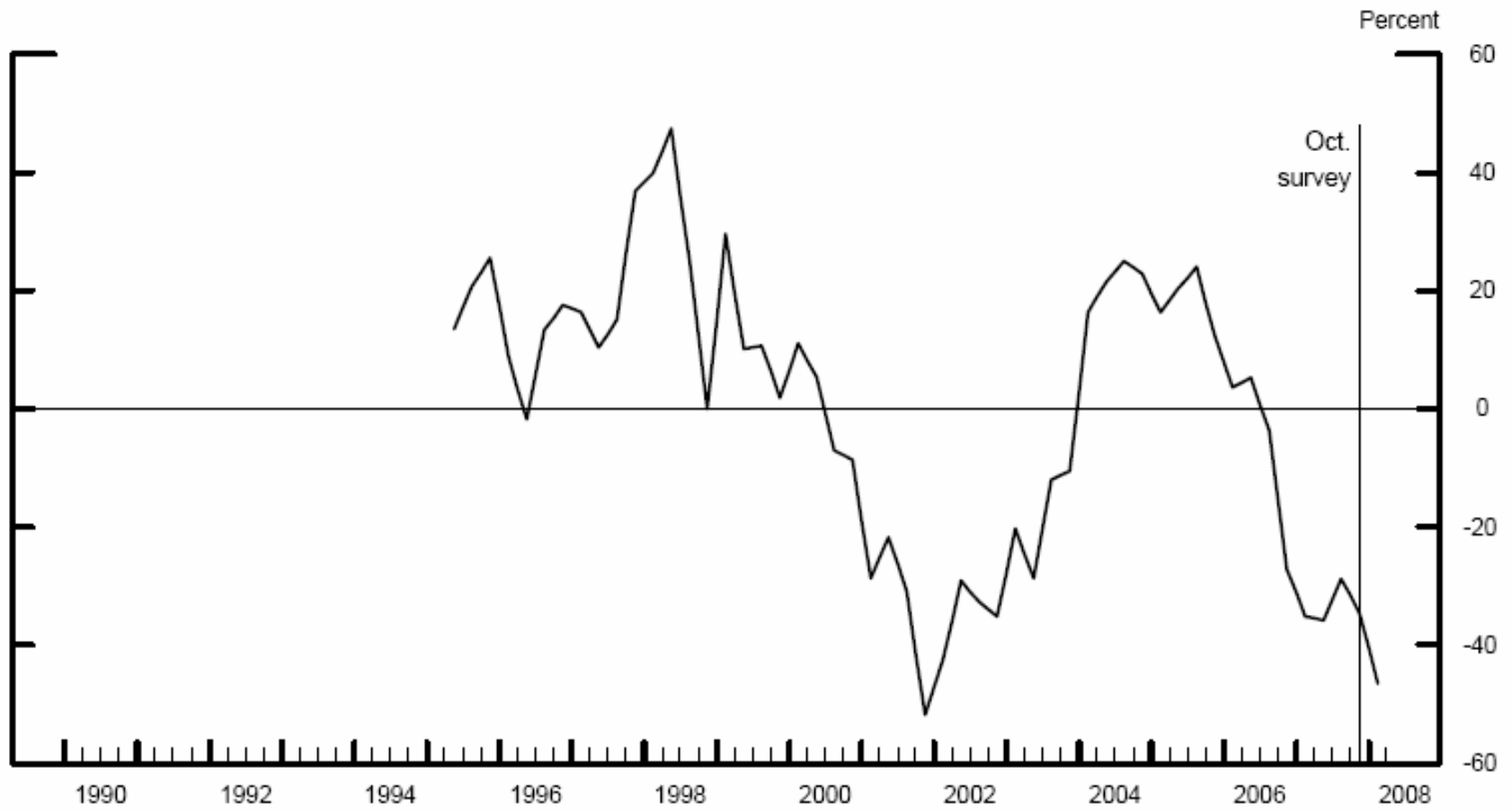
- Housing starts and activity will continue to plumb new lows
- Home prices will fall by a further 10-15 percent in 2008.
- Cumulative Bank losses from mortgage lending will rise to around \$400 billion
- Commercial real estate market will contract in 2008 and add to construction sector job losses.

## House price Declines Implied by Case-Shiller Future Contracts

<b>CUMULATIVE % CHANGE IN HOME PRICES, NOVEMBER-NOVEMBER</b>				
<b>CITY</b>	<b>2007-2008</b>	<b>2007-2009</b>	<b>2007-2010</b>	<b>2007-2011</b>
<b>Boston</b>	-10.4%	-11.6%	-12.1%	-12.1%
<b>Chicago</b>	-7.6%	-7.7%	-7.8%	-5.6%
<b>Denver</b>	-13.2%	-13.3%	-15.9%	-13.9%
<b>Las Vegas</b>	-21.2%	-25.6%	-15.0%	-24.6%
<b>Los Angeles</b>	-22.9%	-27.2%	-16.4%	-12.5%
<b>Miami</b>	-21.6%	-25.3%	-26.8%	-24.0%
<b>New York</b>	-7.0%	-11.1%	-14.1%	-14.2%
<b>San Diego</b>	-23.7%	-16.1%	-14.7%	-16.1%
<b>San Francisco</b>	-19.6%	-15.0%	-21.1%	-24.4%
<b>Washington, DC</b>	-10.7%	-11.4%	-12.9%	-14.6%

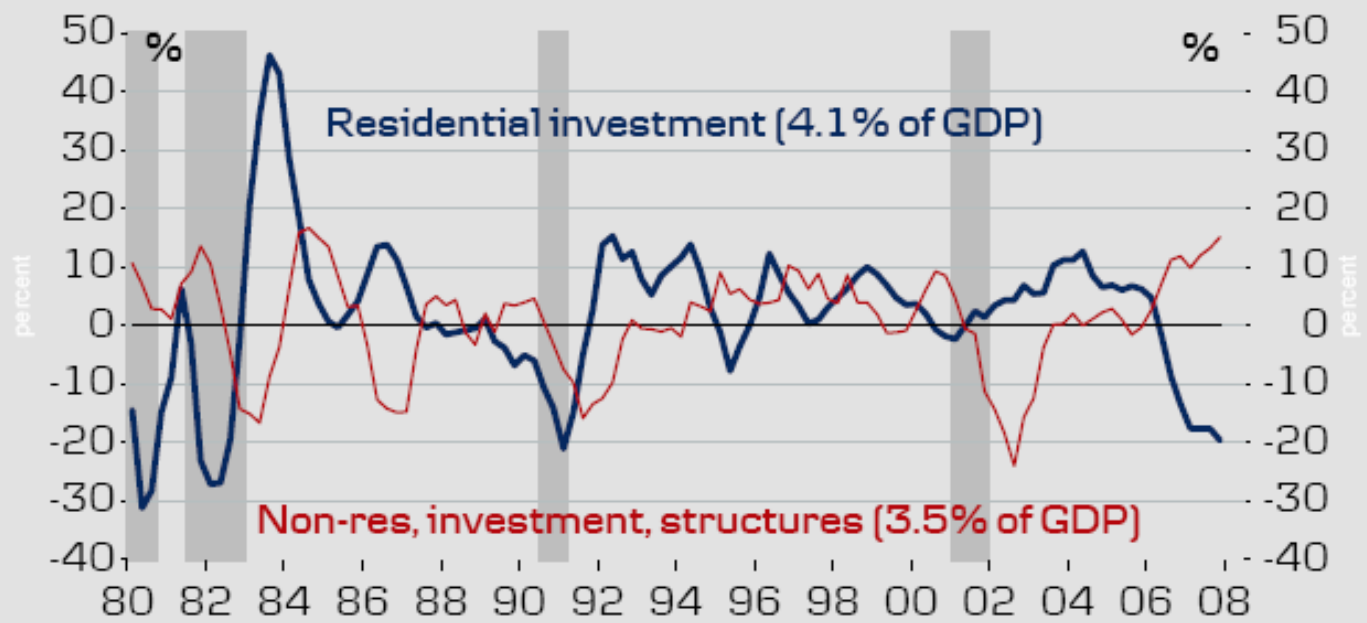
Data as of December 12, 2007. Note that these contracts cover prices with a two-month lag, and that they average prices over three months, so the November 2007 contract actually covers prices from July-September 2007.

Net Percentage of Domestic Respondents Reporting Stronger Demand for Commercial Real Estate Loans



Source: Federal Reserve Board

## Residential and non-residential construction spending



# Policy Inaction is Not an Option

- Further aggressive interest rate cuts are needed
- A second and more targeted fiscal stimulus package is required
- It is not too early to draw up Plan B to provide support to the housing market and the financial sector.