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Housing Market Searches For Silver Lining

By Sean Minogue

A looming shadow has cast itself over the U.S. housing market for the past two years and market turmoil has disseminated throughout the world as the US teeters on the brink of recession. Underlying falsehoods and gross misconducts by banks and Wall Street have been exposed through the severity of the subprime mortgage crisis and financial markets have yet to recuperate. Credit quality has diminished and banks continue to retreat as investors and analysts struggle to identify a faithful future for market stability.

Although these issues have been identified, a positive financial forecast is not yet plausible. According to the International Monetary Fund (IMF), house prices continue to fall, while foreclosures and delinquencies are on the rise. In turn, credit quality has diminished, even for those individuals and families with previously good credit. The crisis has dissolved the reliability of major mortgage lenders Fannie Mae and Freddie Mac and an end to the instability remains elusive.

“Stemming the decline in the U.S. housing market is necessary for market stabilization as this would help both households and financial institutions to recover,” the IMF stated in its latest Global Financial Stability report. “At the moment, a bottom for the housing market is not visible.”

However, the IMF, as well as other analysts, has identified positive reinforcements that will give the market a slight nudge in the right direction. Government sponsored enterprises have come to the aid of Fannie Mae and Freddie Mac, as well as initiated legislation to support troubled housing markets. On July 30, President Bush signed a housing bill into law, which is designed to give mortgage assistance for approximately 400,000 citizens facing foreclosure. The bill will provide $300 billion in federal support to refinance mortgages and aid mortgage lenders. These efforts are anticipated to arouse areas of the housing market, but will not reconcile the market’s volatility. Several analysts believe the bill is merely a foothold that would temporarily sustain the mortgage market. Ultimately, a permanent solution must be fulfilled in order to complete a full recovery.

Nevertheless, government bodies and banks are wielding new techniques in an attempt to discover that ultimate solution, and no one is more emphatic about change than Treasury Secretary Henry Paulson. Paulson spearheaded the efforts to sustain mortgage lenders Fannie Mae and Freddie Mac, and has recently proposed an alternative for mortgage-backed securities. His alternative strategy uses covered bonds as a form of mortgage financing. The failure of mortgage-backed securities caused the recent collapse in the housing market and covered bonds are expected to be a promising new alternative.

“I believe covered bonds have the potential to increase mortgage financing, improve underwriting standards, and strengthen U.S. financial institutions by providing a new funding source that will diversify their overall portfolio,” Paulson said.

Covered bonds have been used in Europe for years as a successful security for mortgage lenders. Four of the US’s leading banks—Bank of America, Citigroup, JPMorgan Chase and Wells Fargo—have already adopted the proposal and assumed covered bonds as a mortgage strategy.

“We applaud these banks for their leadership and for recognizing an opportunity to help increase mortgage funding availability and strengthen our financial system,” said Paulson. “We are at the early stages of what should be a promising path, where the nascent U.S. covered bond market can grow and provide a new source of mortgage financing.”

However, Paulson’s proposal remains a “quick-fix” to market instability. Investors are reluctant to buy bonds that are not government supported, including Paulson’s covered bonds. The market is not suitable for an automatic transition to covered bonds. Investors will keep a scrutinizing eye on the nation’s four largest banks and their impending results.

Critics and cynics will continue to analyze and critique government action, but there is no simple remedy for the market situation.

The question remains, how will the market change its course? There is no definitive answer, but many seem to agree that a financial upswing is not in the foreseeable future. In the meantime, we should expect continued volatility before stability. Financial markets will continue to lag due to weakened credit conditions, mortgage setbacks, and high energy prices. However, there has been a push in the right direction as these issues have been addressed and efforts are being made to restore our markets.

Treasurer Paulson stressed the importance of government backing in Fannie Mae and Freddie Mac and the housing bill as significant measures toward restoration.

“This period of market stress has revealed broader financial regulatory issues, and we are working to address these on a number of fronts as I have described. We remain focused and vigilant. I am confident that we will work through current challenges and Americans will benefit from an economy that emerges stronger and better poised for robust growth,” he said.

While there is hope for the future, recent legislation has only provided short-term support for the housing crisis and the market must prepare itself for strenuous times ahead.

“There are no simple or quick remedies for this,” said Paulson, “Until the housing market stabilizes further we should expect some continued stresses in our financial markets.”

Critics and cynics will continue to analyze and critique government action, but there is no simple remedy for the market situation. As vexing as it may seem, the markets have to bear the hardships ahead, while piecemeal efforts stimulate advancement for the future.