



The Financial Crisis: What Happened?

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The challenges started with home loans called "subprime mortgages".

A "mortgage" is a loan to a borrower so that he or she can purchase a house or similar property.

A "subprime mortgage" is a loan to a borrower who has not established a good record of paying back debts (a poor "credit history").

Today, we can look back and see that people taking on subprime mortgages may not have been able to afford them, may not have understood them, may have been misled or simply may not have been honest.

When a bad loan is made, someone will lose money.

What happened?

Thousands of people borrowed money to purchase homes. Many of these borrowers did not have a good "credit history" (the report card on how you pay your bills) and could only get loans called "subprime" mortgages.

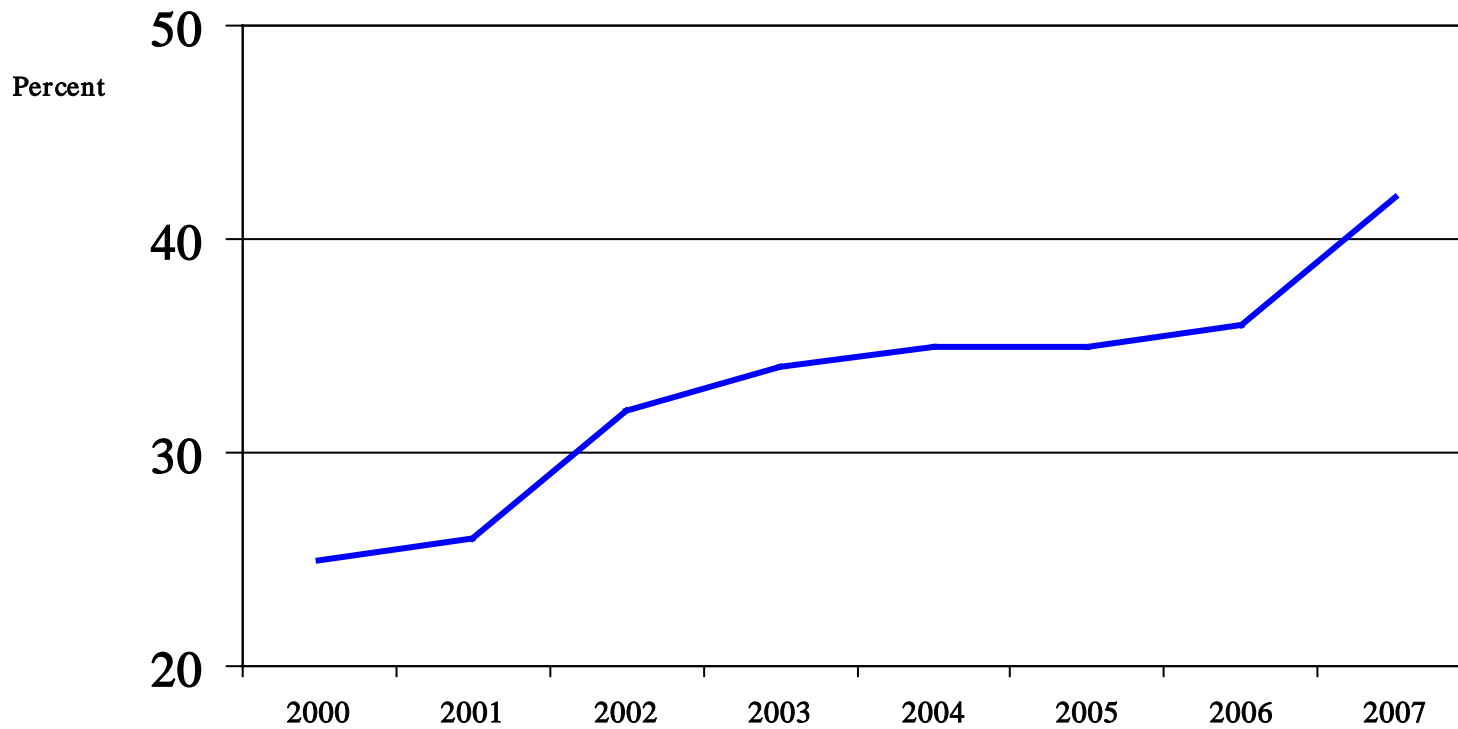
These loans would have been hard to repay in the best of circumstances:

- Some borrowers did not have the income to repay the mortgage
- Some borrowers took on the responsibility for a mortgage (debt) that was very large as compared to the value of the home
- The interest rate on many of the loans could change and increase rapidly. Not everyone understood what this meant.
- Many times, the borrower used the mortgage as a means of getting cash for other purposes.
- Many times, salespeople (brokers) pushed borrowers to take on the loans that the borrower did not fully understand.

The paperwork was often incomplete.



Subprime Mortgages with Incomplete Documentation

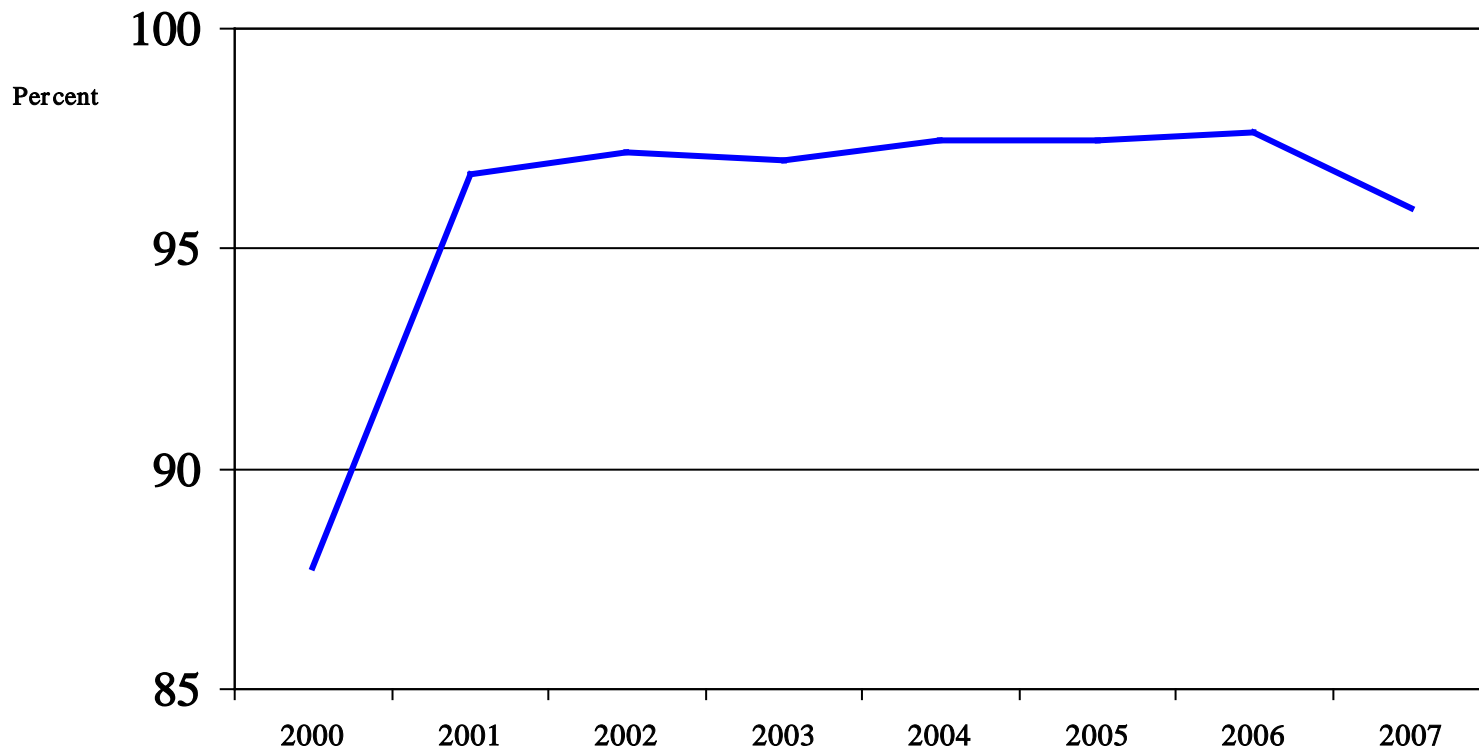


Source: Loan Performance Corp.

The borrower put little of his/her own money into the home purchase (a "down payment").



Total Mortgage Debt/House Value

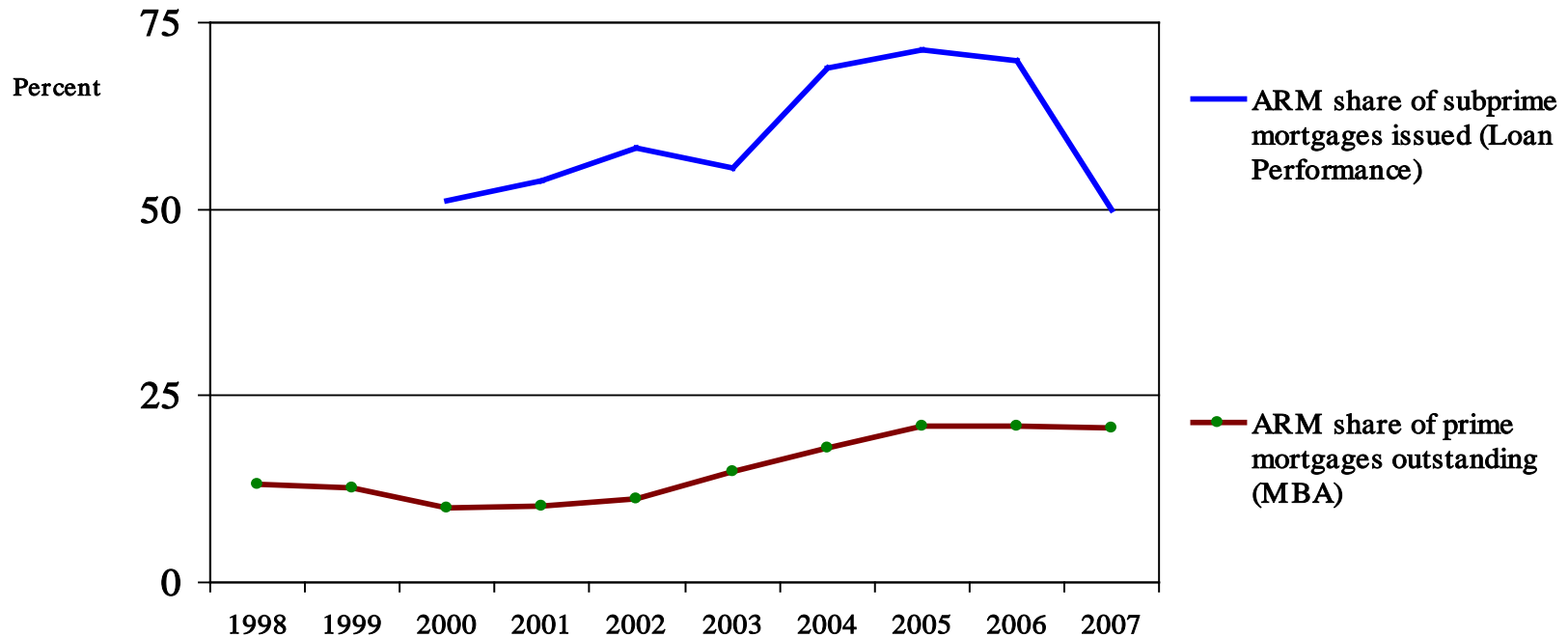


Source: Loan Performance Corp.

On many loans, the interest rate could change and go higher.



Share of Mortgages with Adjustable Rates

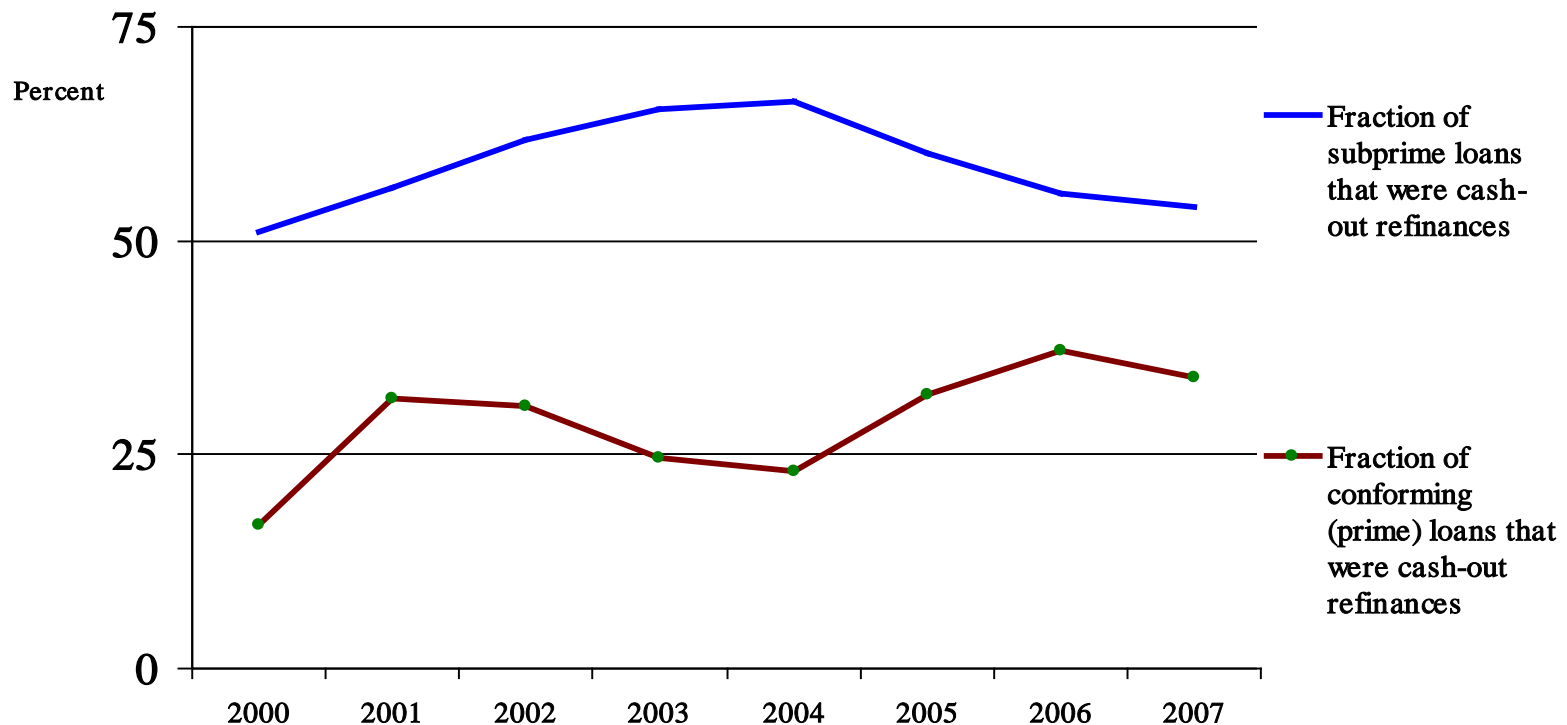


Sources: Mortgage Bankers Association, Loan Performance Corp.

Many borrowers used their mortgage for cash to spend immediately or to pay other bills.



Share of Mortgages That Were Cash-Out Refinances

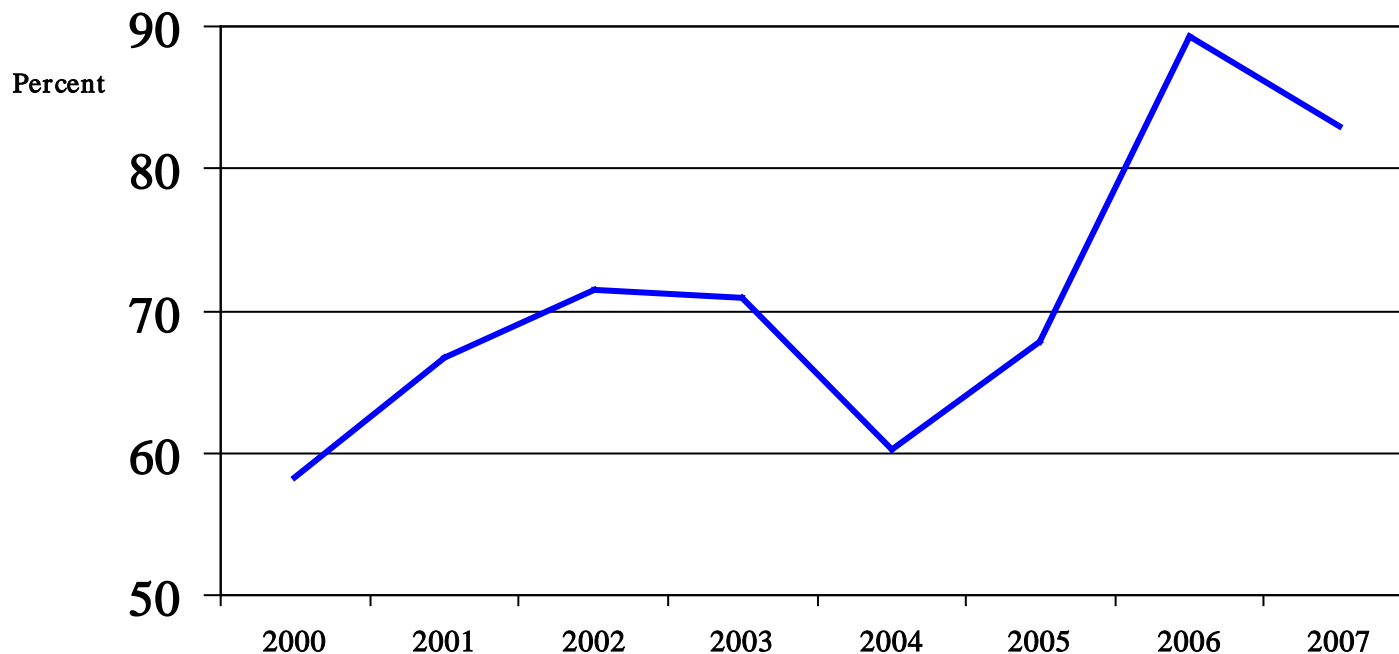


Source: Loan Performance Corp, Freddie Mac.

Mortgage “brokers” wanted to make a commission and may not have cared if the loan could be repaid.



Share of Subprime Mortgages Issued through Broker or Wholesale Channels

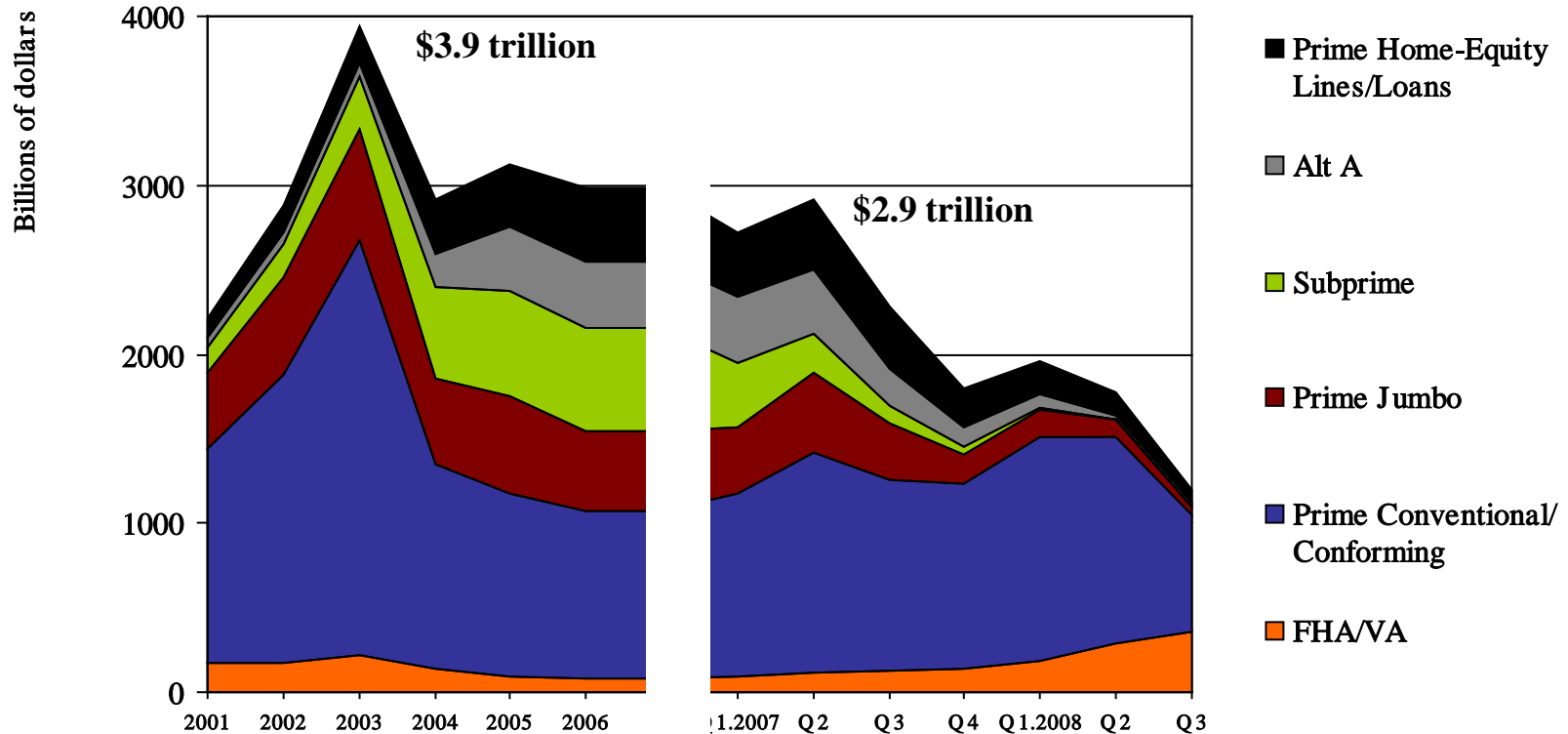


Source: Loan Performance Corp.



Easy money from investors across the world meant that more and more subprime mortgages were financed.

US Mortgage Originations

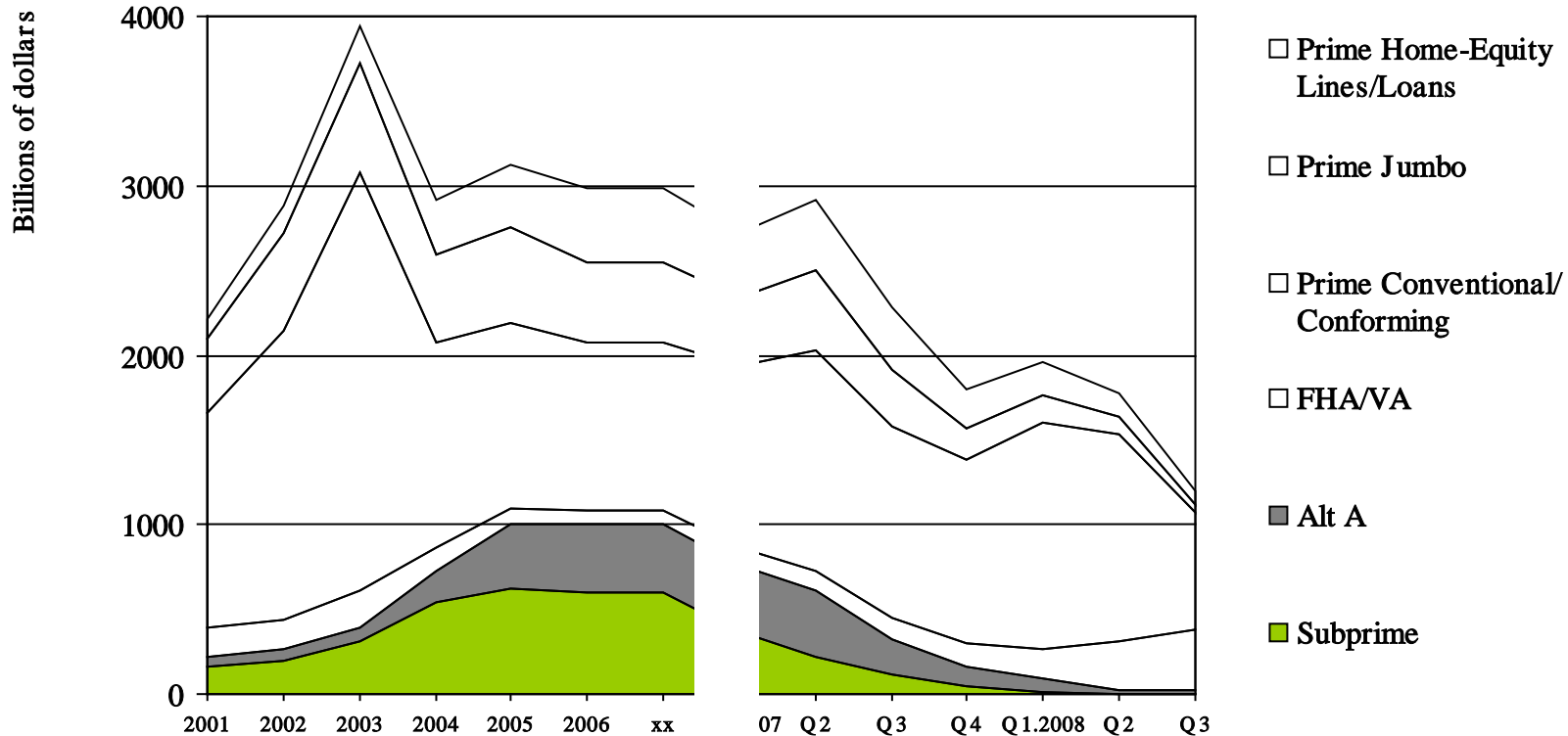


Quarterly figures for 2001 through 2008 expressed at an annual rate.
Source: *Inside Mortgage Finance*, Sept. 5, 2008; Q3.2008 estimate based on *IMF* update of Oct. 31, 2008.



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Quarterly figures for 2007 2008 expressed at an annual rate.
Source: *Inside Mortgage Finance*, Sept. 5, 2008; Q3.2008 estimate based on *IMF* update of Oct. 31, 2008.

These “nontraditional” mortgage loans were taken by investment companies and transformed into securities.

What is a security?

- A security is created when many individual assets are pooled together and sold to investors in the financial markets.
- The income from the assets making up the security produces cash for the investor.
- Investors may sell the securities to other investors.

Subprime mortgages were typically transformed into “mortgage-backed securities”

- Sometimes, the mortgages were broken into pieces and packaged with other similar mortgage pieces. These were called “collateralized mortgage obligations.”
- And sometimes, other assets or enhancements were added to the collateralized mortgage obligation to create a “collateralized debt obligation.”

The U.S. “spread the risk”

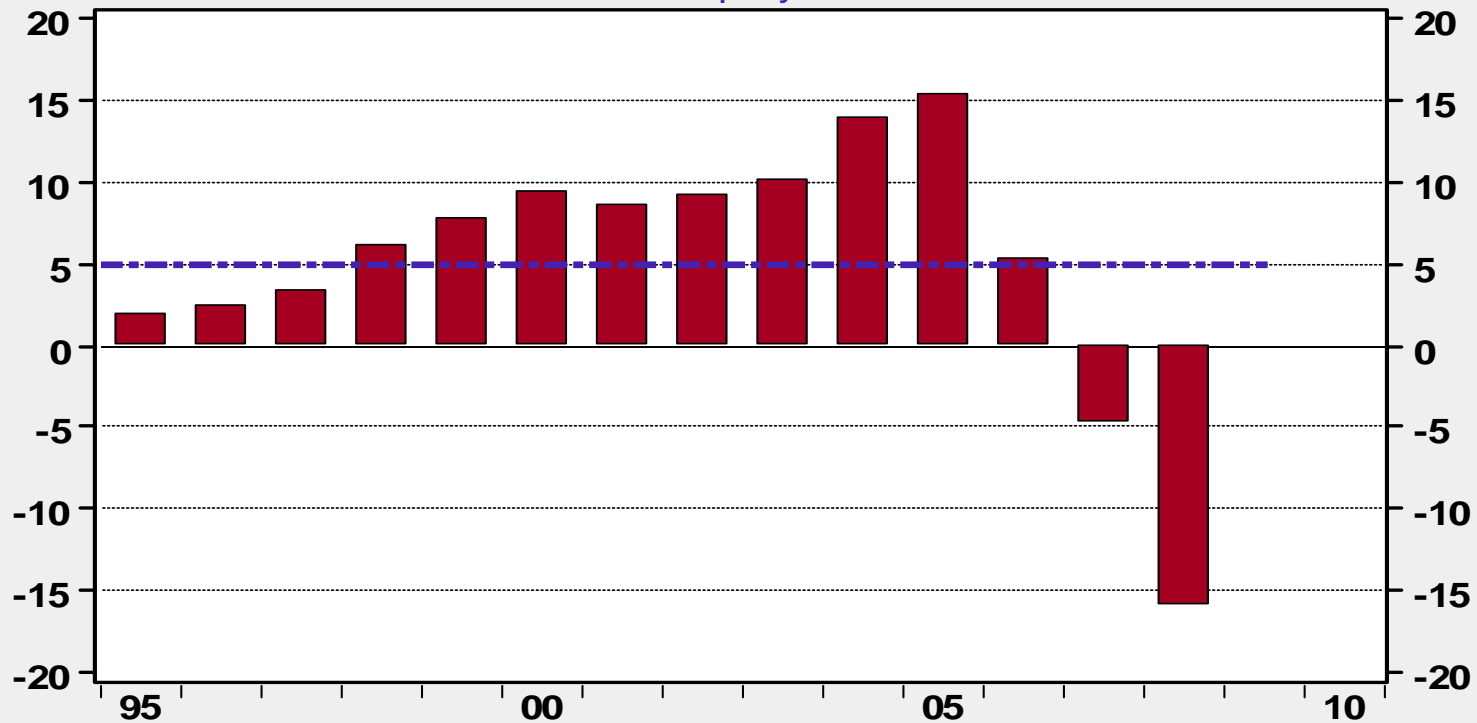
- The securities were sold to investors around the world.

Easy credit contributed to a boom in house prices.



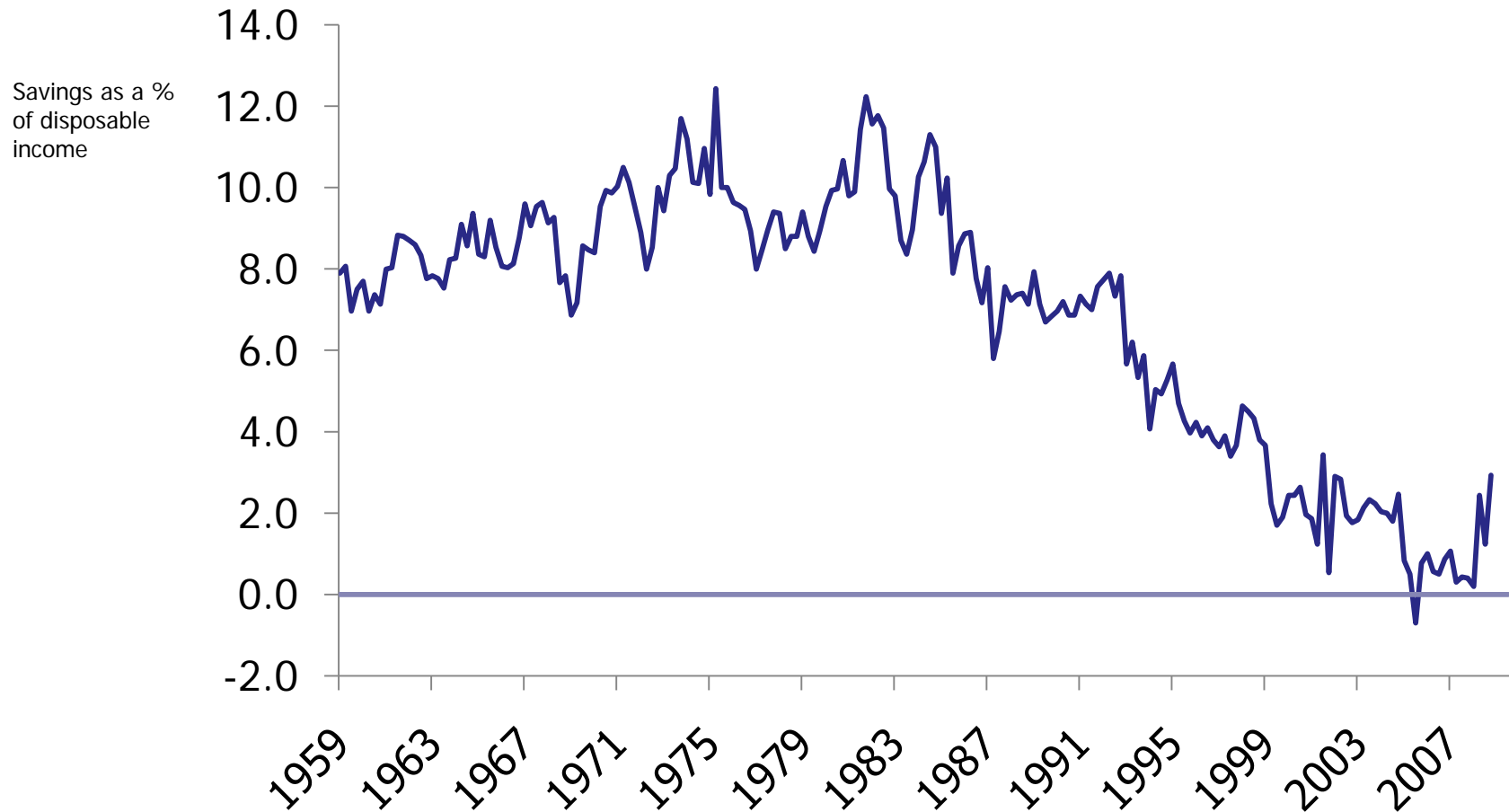
US House-Price Appreciation: S&P/Case-Shiller Home-Price Index
Percent per year

80-Year Historical Annual Average: 5 Percent
Percent per year



Sources: S&P, Fiserv, and MacroMarkets LLC, Haver Analytics

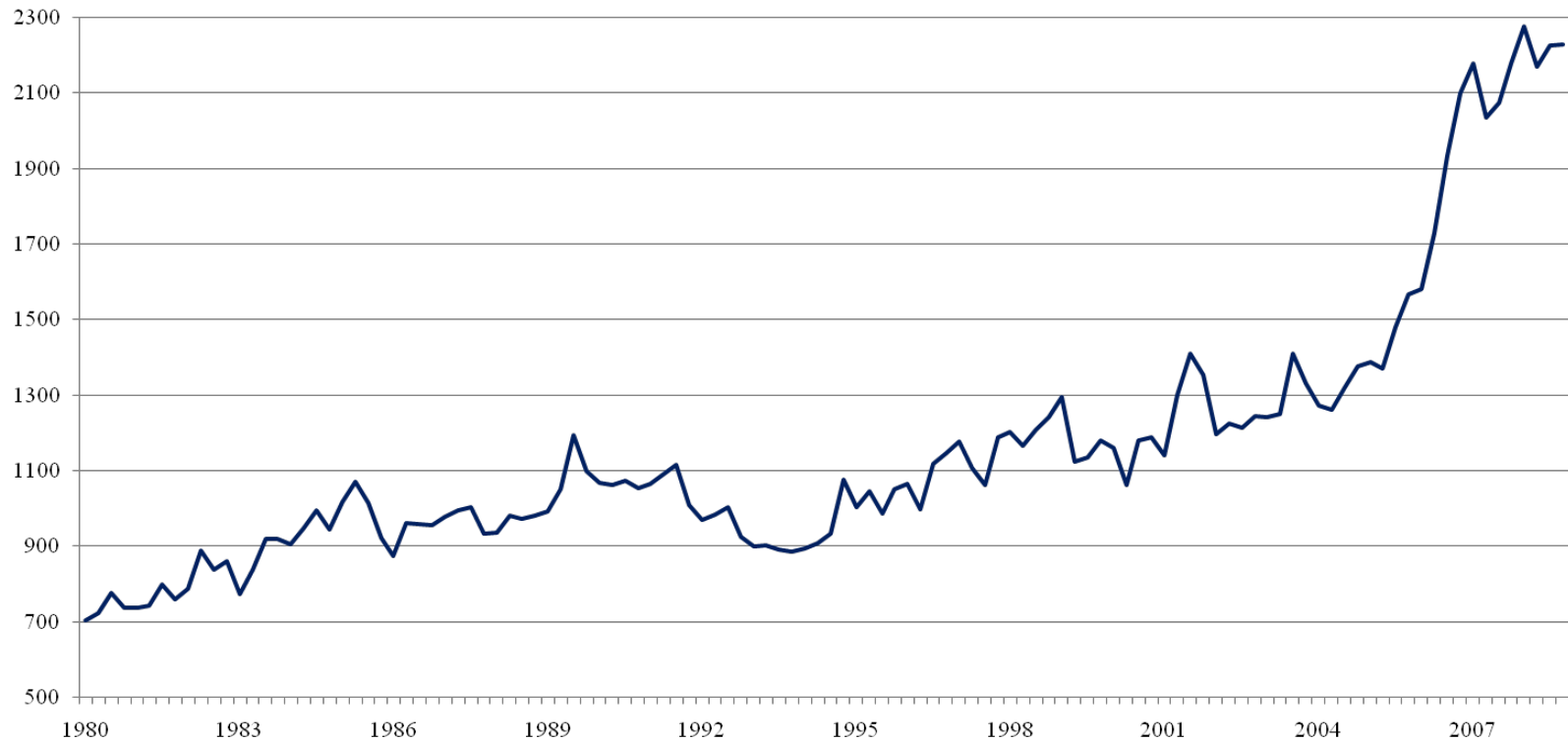
It became the norm to spend – and not save.



**This bad situation was made worse because
There were more homes for sale than buyers.**



Total US Vacant Housing Units: Year Round For Sale Only



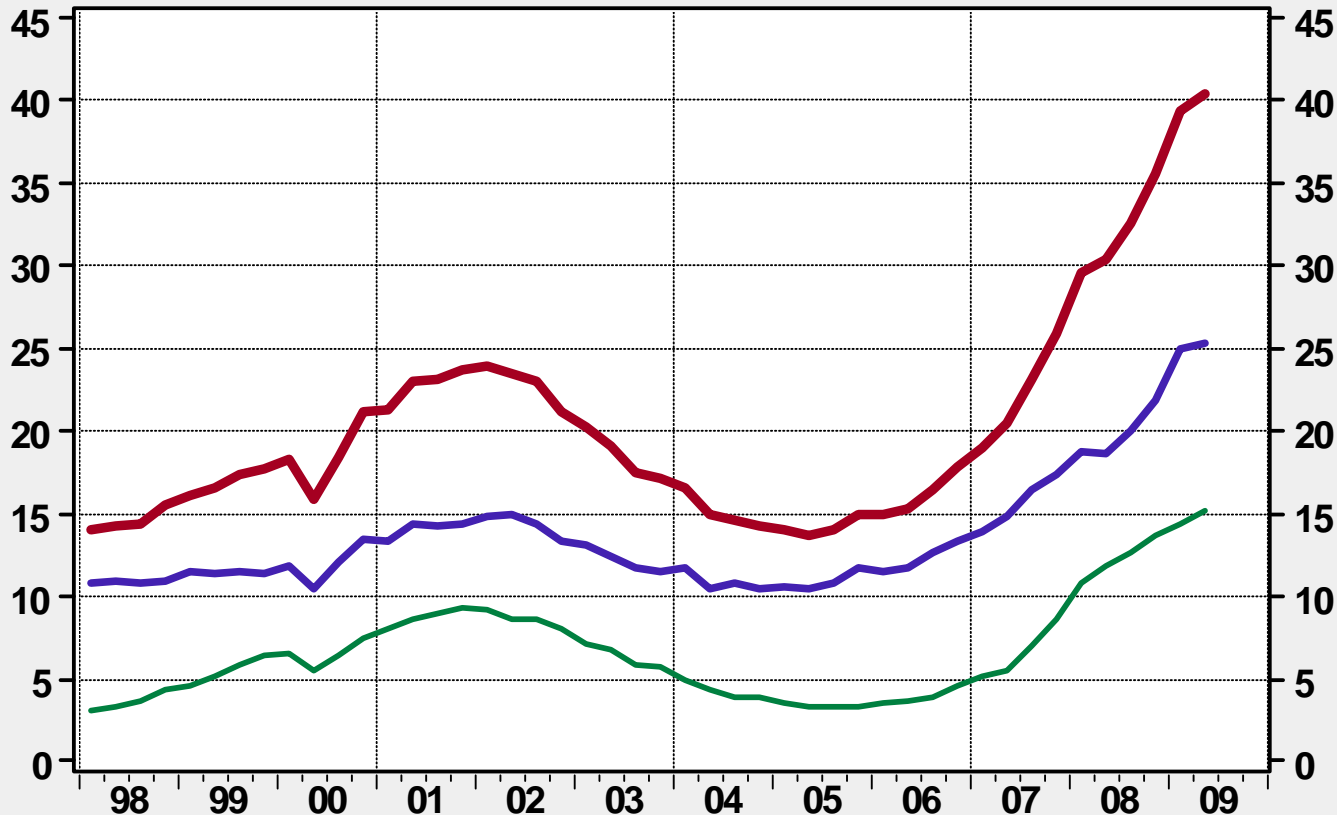


Because of too much supply and less demand,
housing prices began to fall.

Geographic Area	Peak to Present Decline	When the Market Peaked
Boston	18.41	November 2005
Chicago	26.76	February 2007
Denver	11.11	March 2006
Los Angeles	40.92	April 2006
Las Vegas	51.85	April 2006
Miami	47.82	December 2006
New York City	20.87	May 2006
San Diego	42.21	March 2006
San Francisco	45.57	March 2006
Washington, D.C.	33.25	March 2006

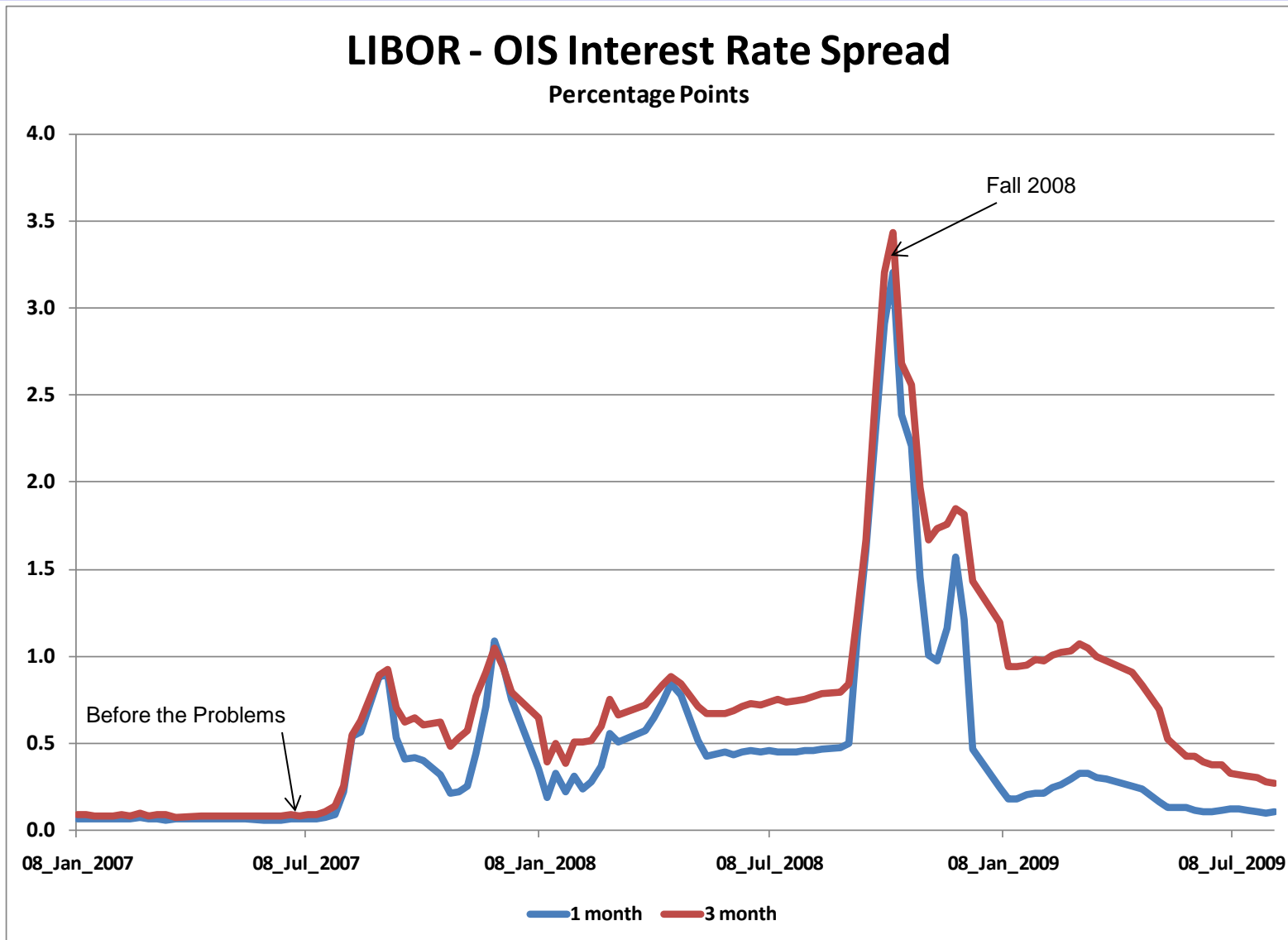
The volume of "bad" mortgages grew.

Fraction of Subprime Mortgages Delinquent or in Foreclosure (%)
 Of Which: Fraction 30+ Days Past Due (%)
 And: Fraction in Foreclosure (%)



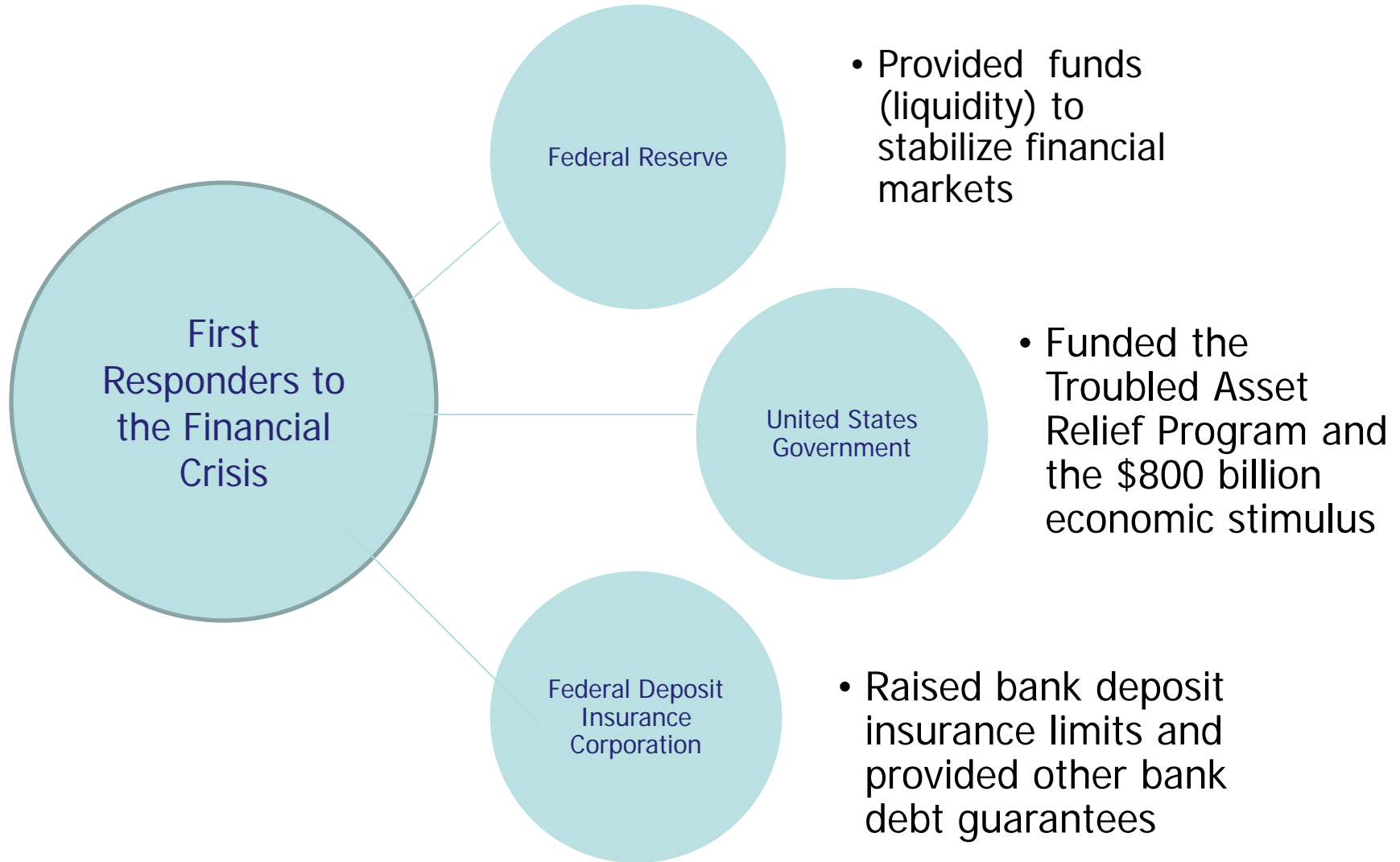
Source: Haver Analytics

The country faced a financial crisis.





The Federal Reserve, the U.S. Government, and the Federal Deposit Insurance Corporation all responded.



The Federal Reserve provided funds to keep financial markets functioning. That's our job.



The Federal Reserve's Federal Open Market Committee has substantially reduced interest rates.

As early as August 2007, the Fed began expanding the terms of its lending programs to banks and has introduced several new programs.

The Fed introduced several lending programs to certain nonbank organizations, using a provision in the Federal Reserve Act that has not been used since the 1930s.

Congress responded with the Troubled Asset Relief Program and an Economic Stimulus.



Legislation was enacted– The Emergency Economic Stabilization Act of 2008. The legislation contained provisions for a “Troubled Asset Relief Program” or “TARP”.

Congress passed an \$800 billion economic stimulus program.



The Federal Deposit Insurance Corporation responded with higher levels of insurance.

Federal Deposit Insurance coverage increased to \$250,000 per owner through December 31, 2013 (Beginning May 2008)

Banks also had the option to pay a fee to participate in two other temporary programs beginning November 2008 and ending on December 31, 2009:

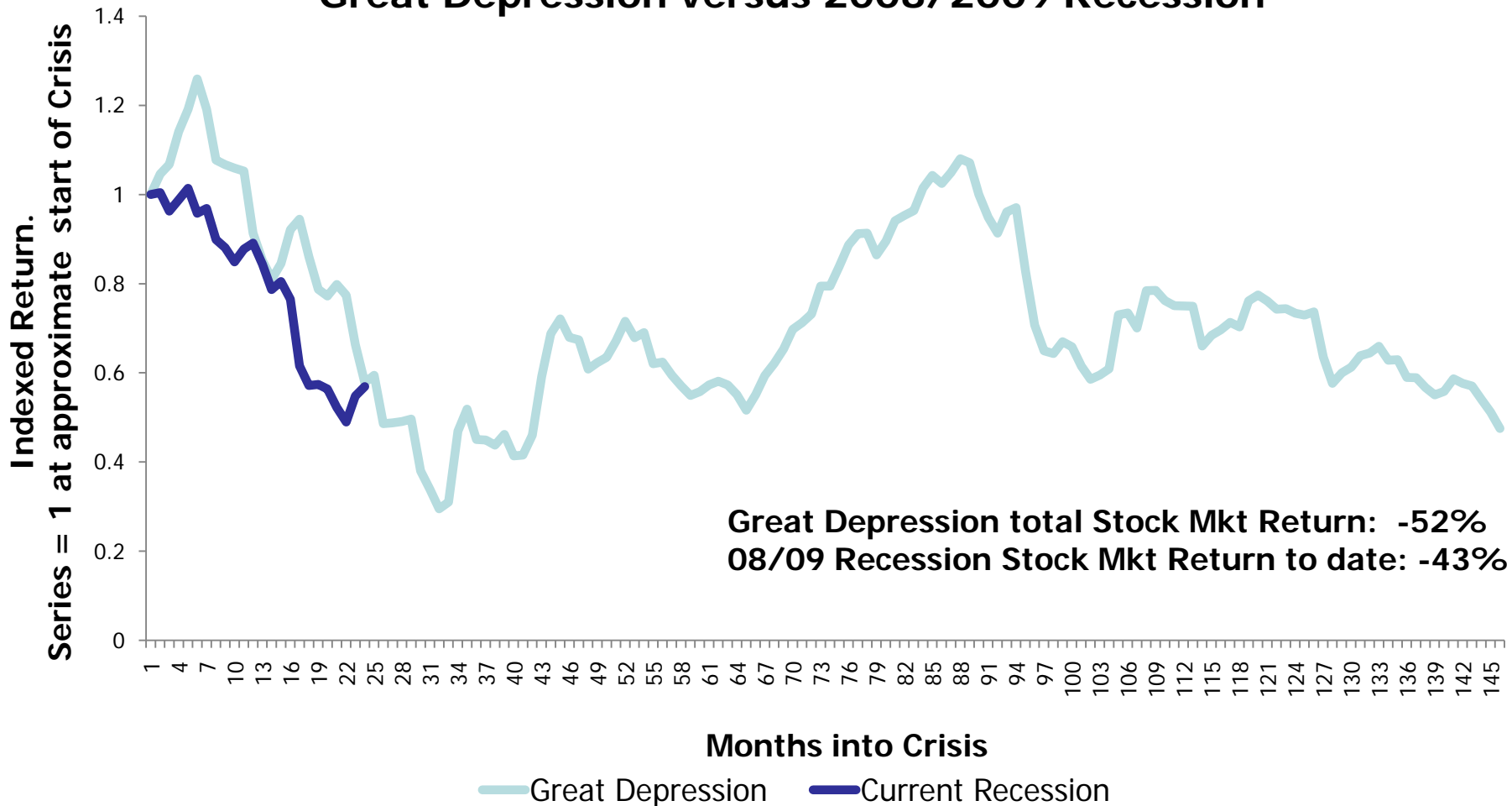
- Full insurance of noninterest demand accounts in excess of \$250,000 (program may be extended for six months)
- Guarantee of certain newly-issued senior unsecured debt of banking organizations

Separate from the FDIC program, the Treasury temporarily guaranteed participating money market mutual funds until September 19, 2009

Is the current crisis as bad as the Great Depression?



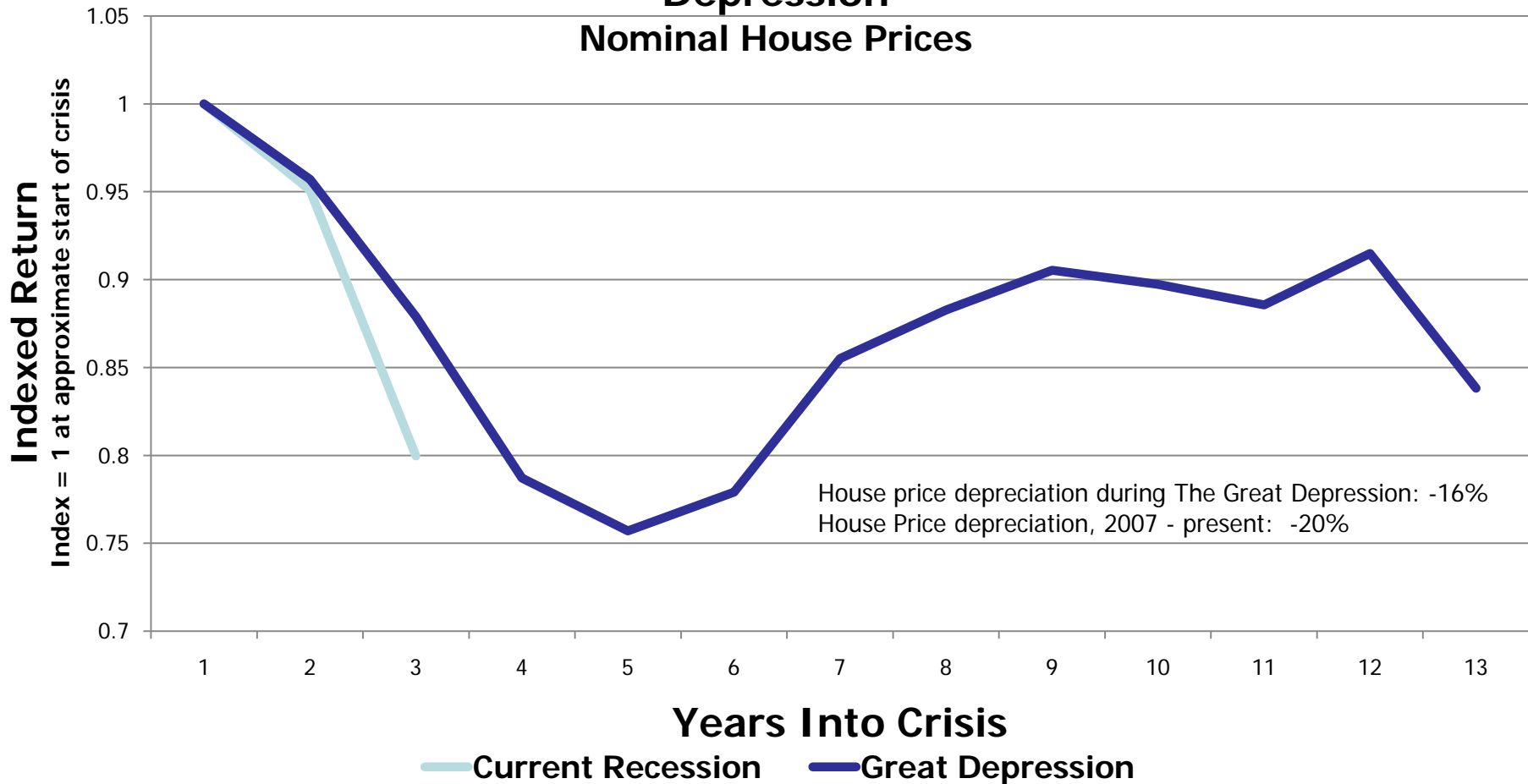
S&P 500 Great Depression versus 2008/2009 Recession



Is the current crisis as bad as the Great Depression?



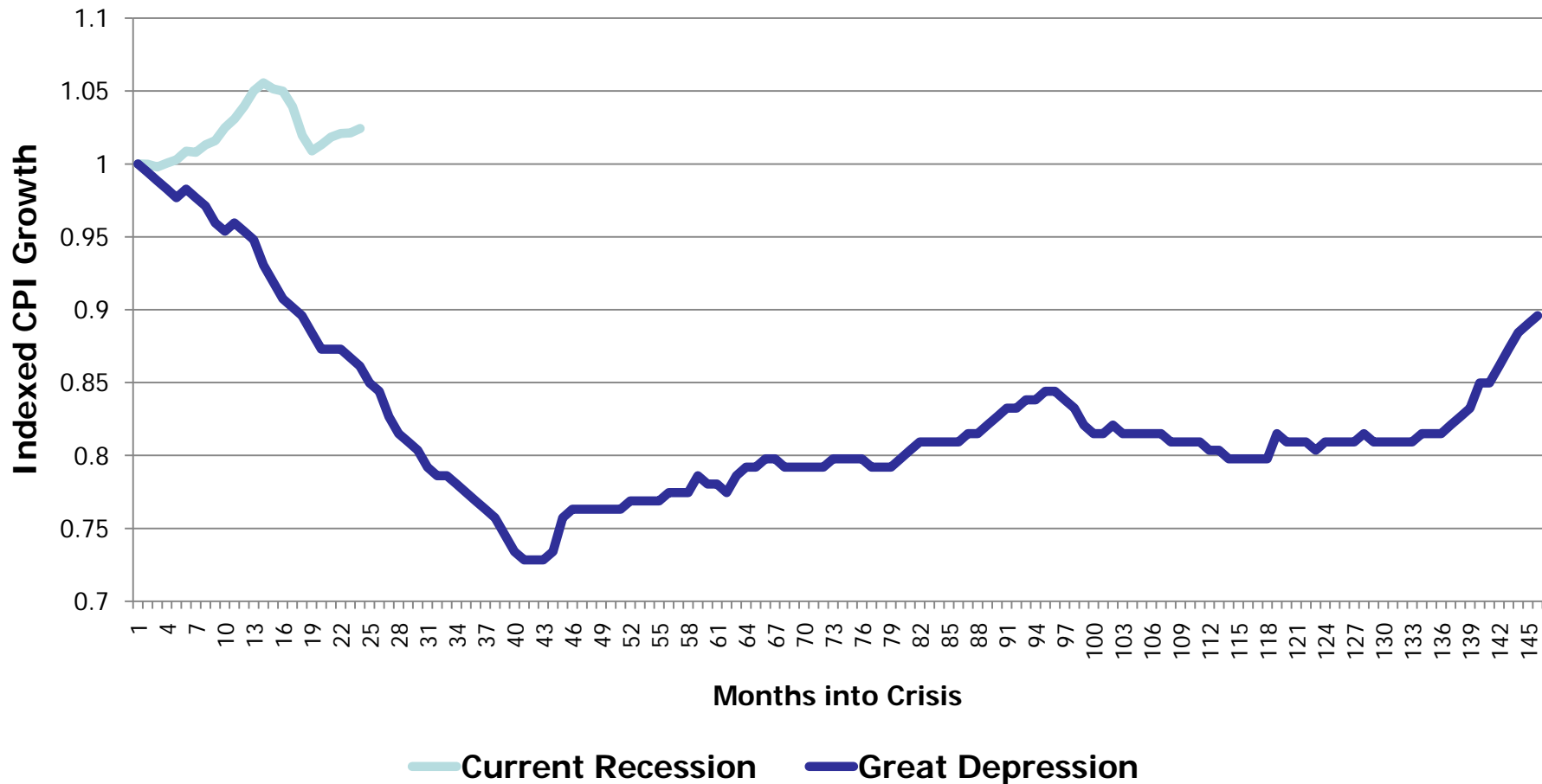
House Prices In Current Recession Steeper than Great Depression



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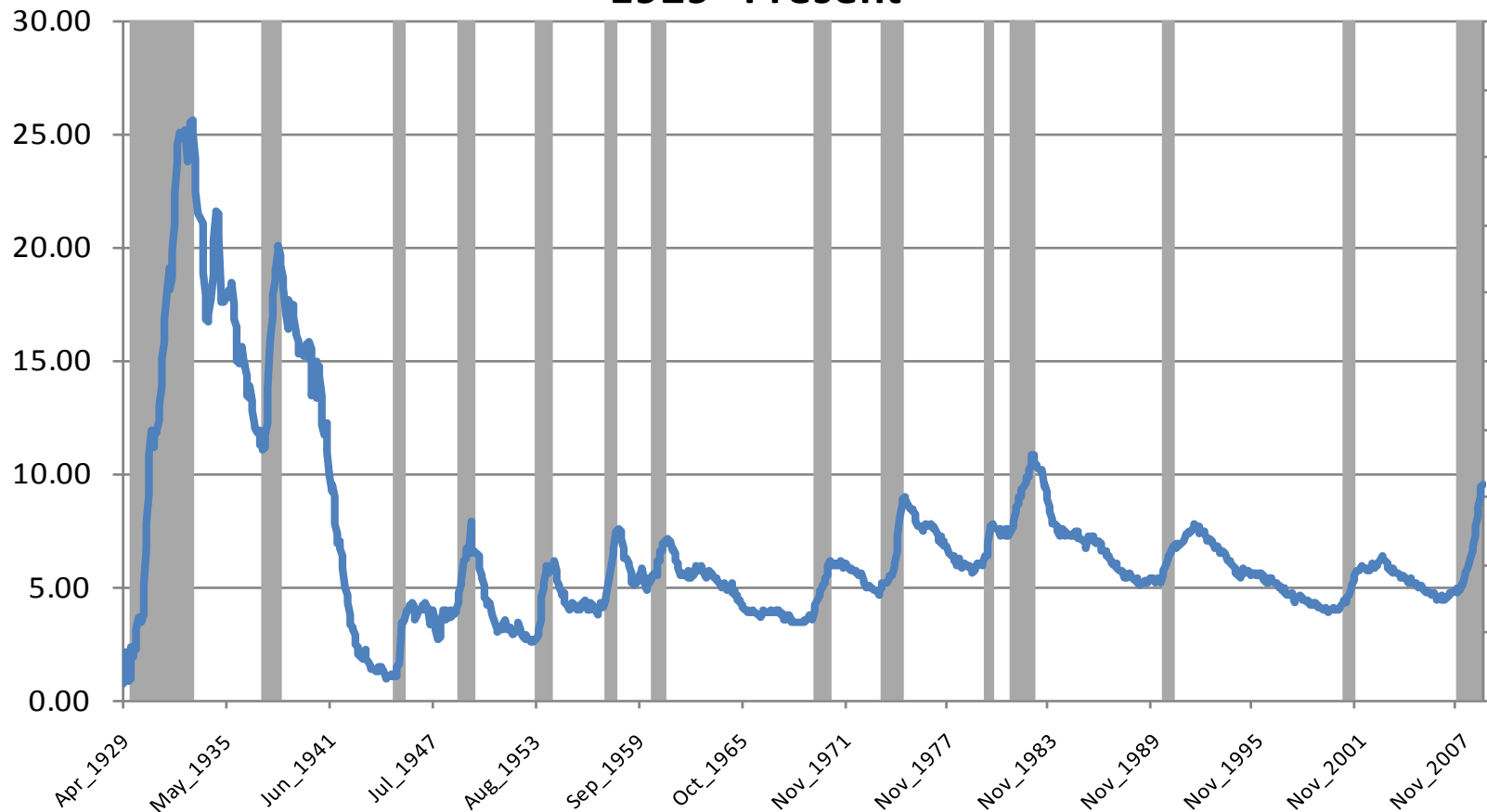
Inflation: Great Depression versus Current Recession



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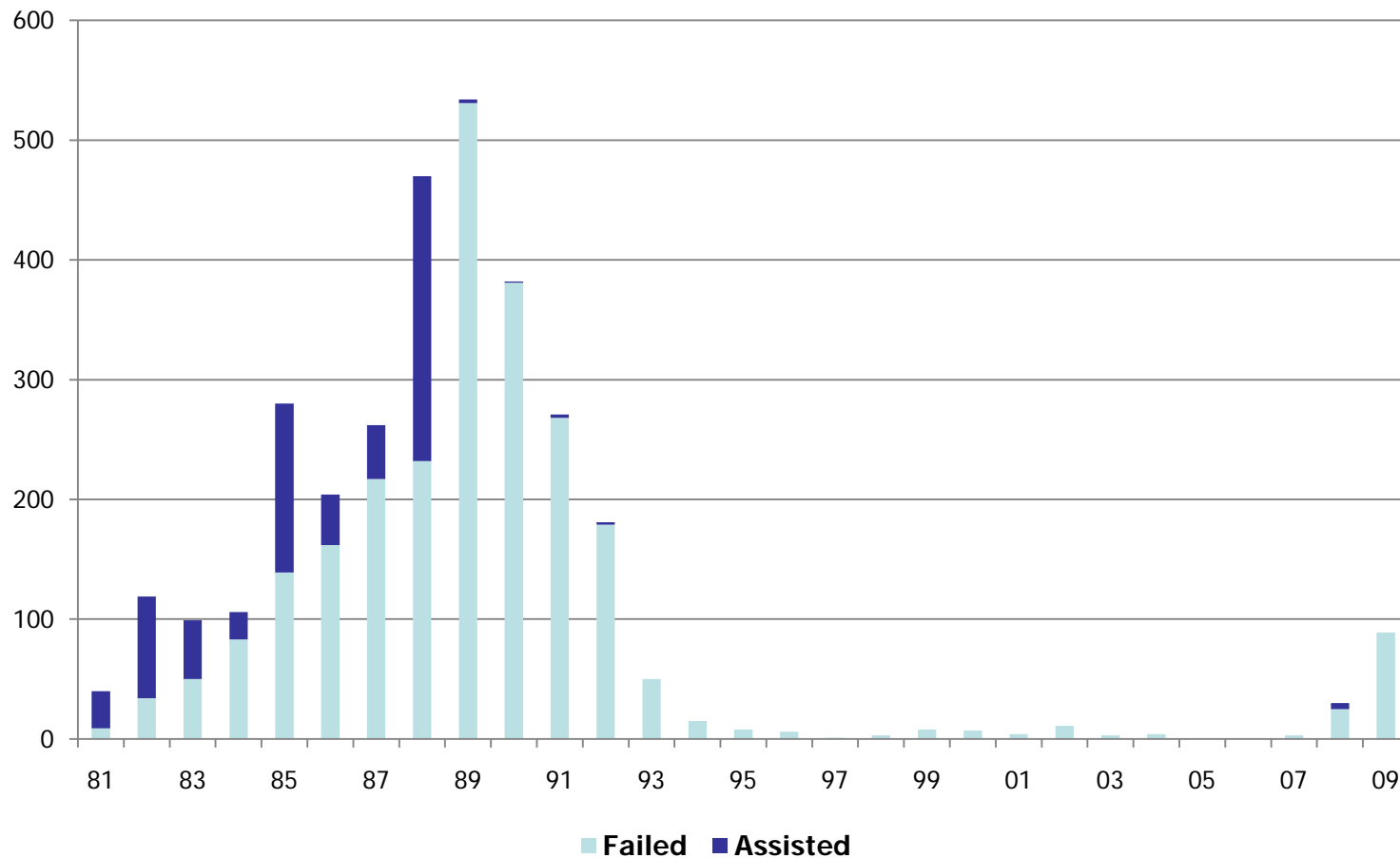
Historical Unemployment Rates 1929 - Present



Gray bars indicate recessions

Bank failures will continue to grow for awhile.

Bank Failures and Assists by Year



Source: FDIC website

We must all be responsible.



Use debt wisely. A manageable amount of debt for an investment is good; borrowing to pay bills is unwise.

Never take on debt that you are not confident that you can pay even if something unexpected goes wrong for a while. Be especially sure that you can pay your credit card debt. It is expensive, and the failure to pay can cause you great problems later.

If something sounds too good to be true, it is. Look harder and ask for help in understanding why.

Save, save, save. It is the best investment you can make in yourself.

Interesting resource.

<http://www.newyorkfed.org/mortgagemaps/>

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Dynamic Maps of Nonprime Mortgage Conditions in the United States

Current 6 Mo. Change

Zip Code: Go Show Cities Show Roads Report: August 2008

Loan Type: Subprime Alt-A

- Loans per 1000 housing units
- In foreclosure per 1000 housing
- REOs per 1000 housing units
- Share ARMs
- Share current
- Share 90+ days delinquent
- Share in foreclosure
- Median combined LTV
- Share low FICO & high LTV
- Share low or no documentation
- Share ARMs resetting in 12 mos.
- Share late payment last 12 mos.

Print Map

index.html Trusted sites

Interested in credit card delinquency maps? Visit:
<http://data.newyorkfed.org/creditconditionsmap/>