

# Macroeconomic Conditions and Home Valuations

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The views expressed are my own and not those of the Federal Reserve Board or other members of its staff.

In setting a price for a home (vacant or otherwise), it is important to take both current and expected future macroeconomic conditions into account:

- Buyers may be planning to resell in the future
- Sellers must be induced to give up the option of being able to sell in the future.

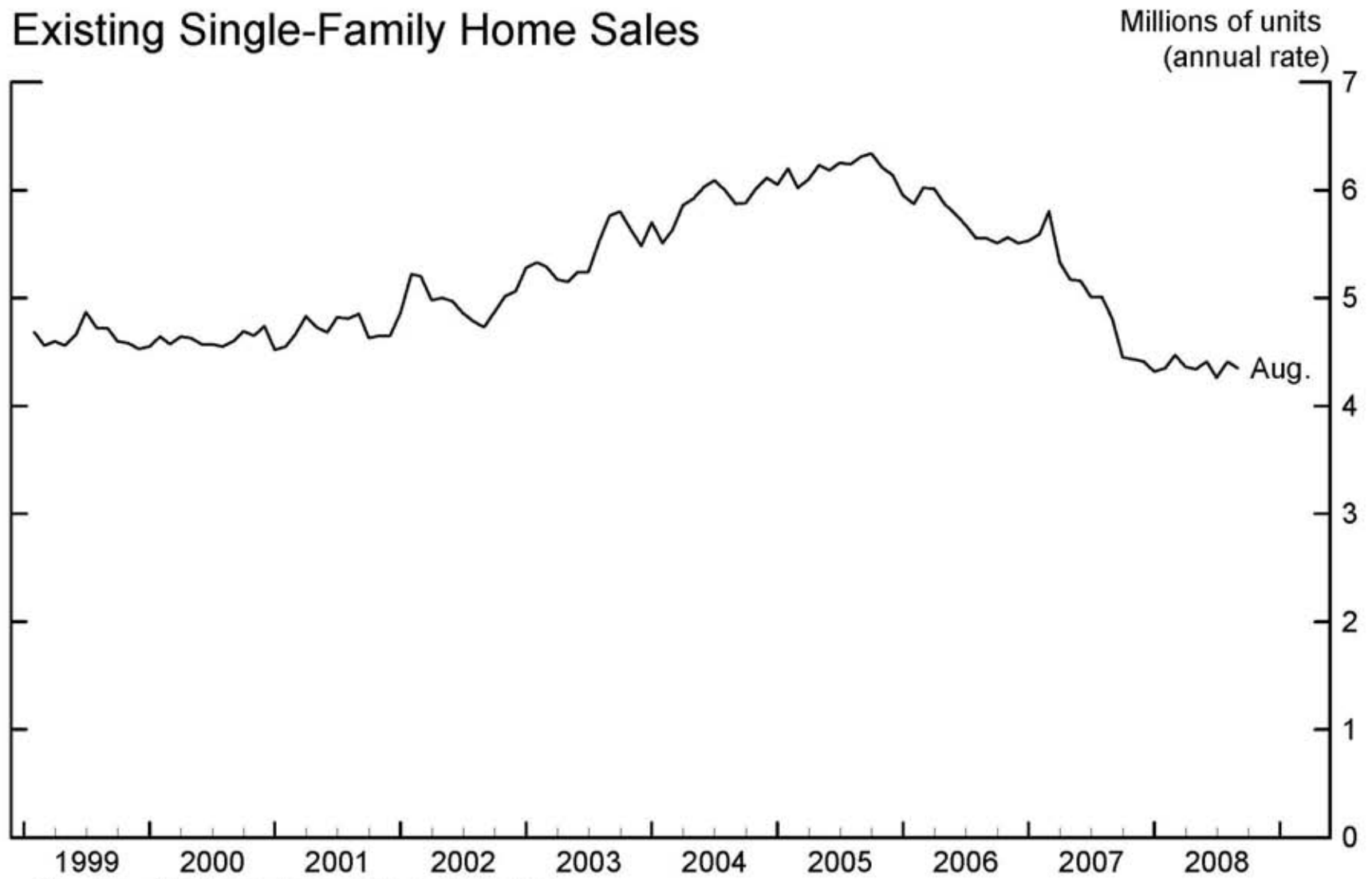
Of course conditions will vary across regional markets. But this cycle has common themes that are affecting most communities.

Supply/demand imbalances have driven housing activity way down from its peak, with scant signs of bottoming out and no signs of an upturn.

## Backstory:

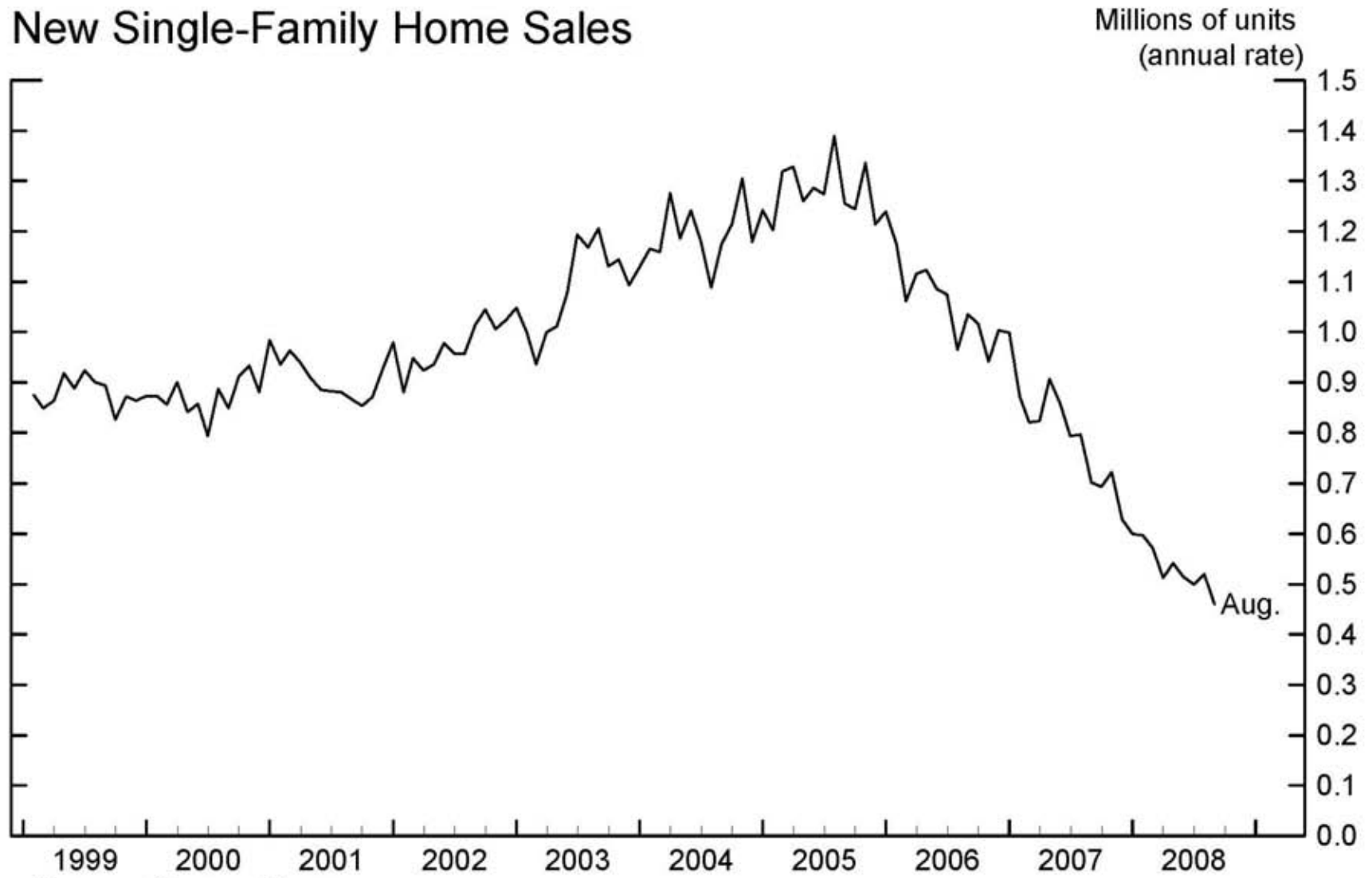
- Broad access to mortgage credit (fueled in part by poor underwriting), low interest rates, and other factors led to a boom in construction in the early to mid-2000s.
- Demand has contracted sharply as the economy has slowed and credit conditions have tightened.

# Existing Single-Family Home Sales



Source. National Association of Realtors.

# New Single-Family Home Sales

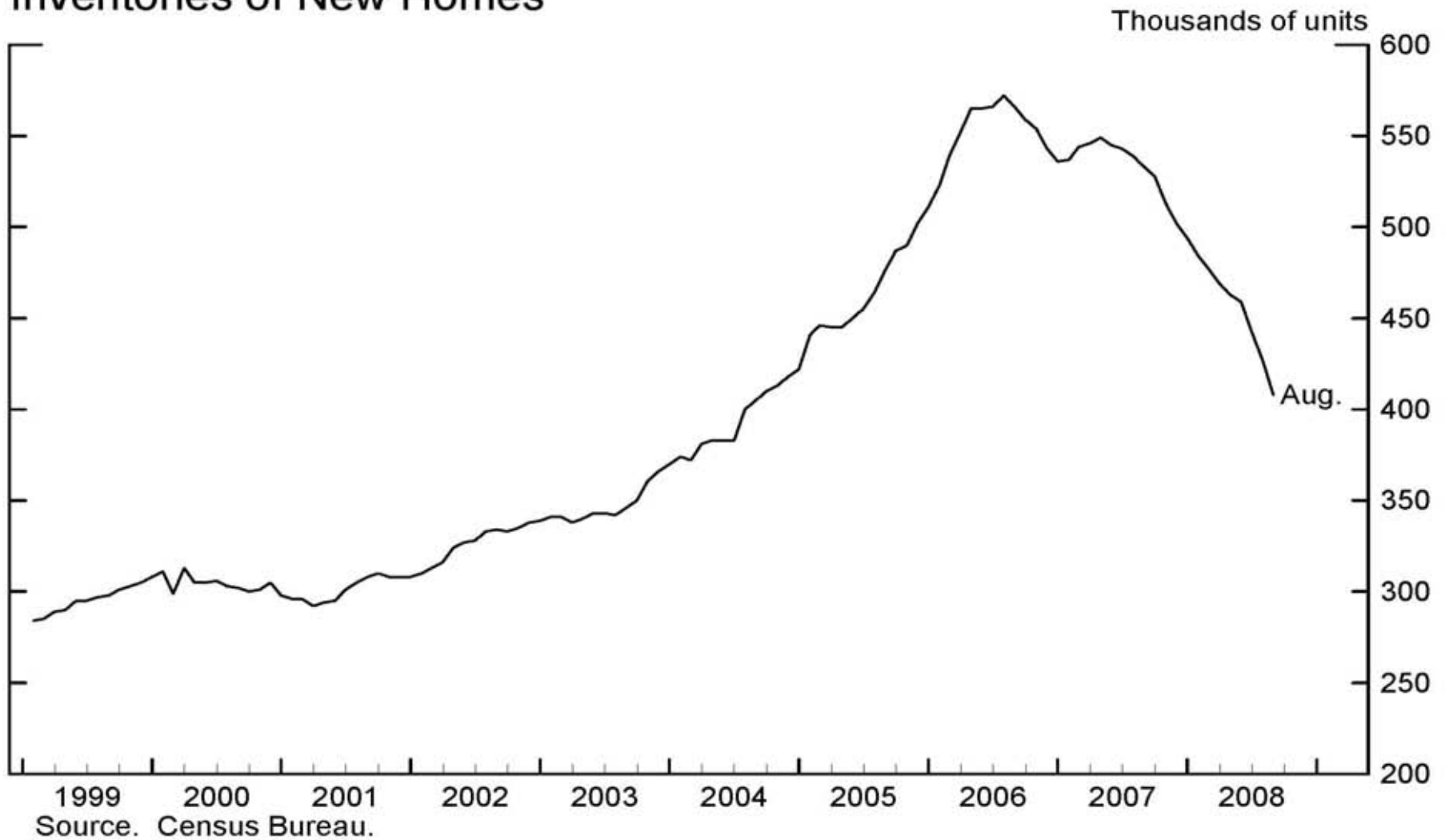


Source. Census Bureau.

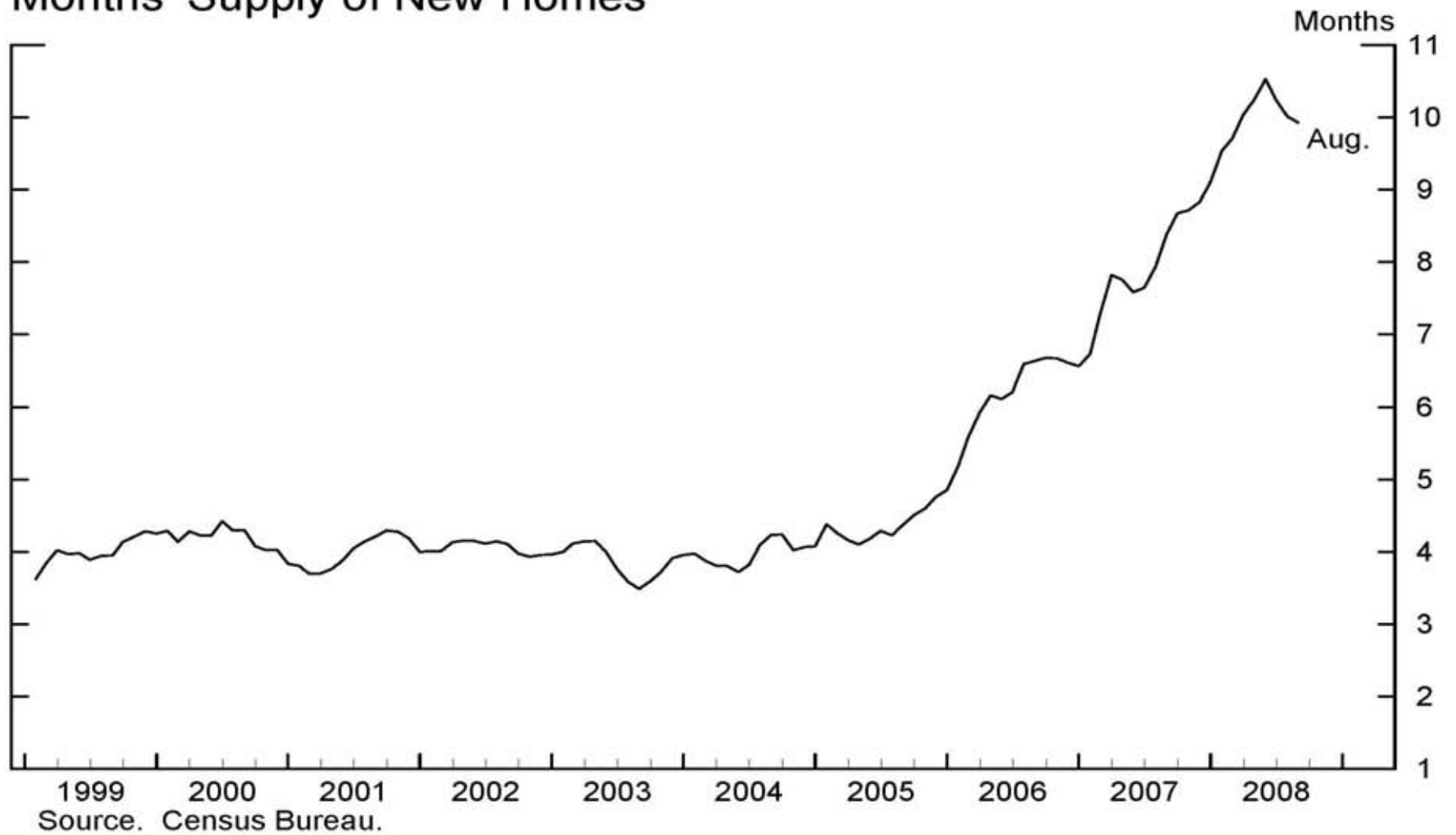
# Single-Family Housing Starts



# Inventories of New Homes



## Months' Supply of New Homes





Similar to real activity, house prices have seen a boom and bust, both nationally and in most parts of the country.

# Prices of Existing Homes

Percent change from year earlier



Source. OFHEO, S&P/Case-Shiller.

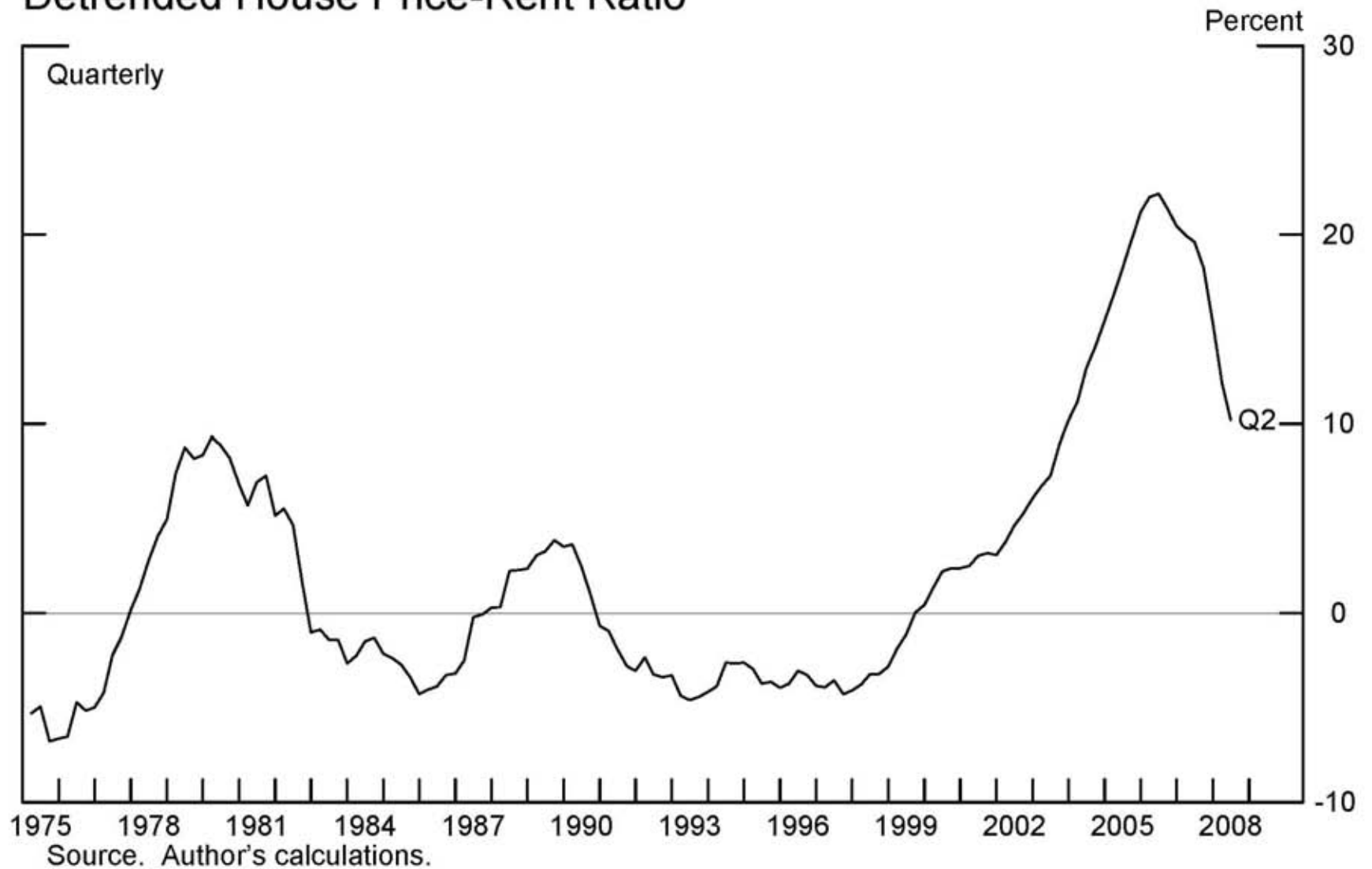
## Regional OFHEO Repeat-Transaction House Prices Indexes (Nominal July/July Growth Rates)

	US	Pacific	Mtn.	West North Central	West South Central	East North Central	East South Central	N.E.	Middle Atl.	South Atl.
2005	9.6	16.0	13.3	7.8	5.9	4.2	6.1	8.6	12.2	13.4
2006	5.9	10.7	10.6	3.2	7.3	2.1	7.2	0.2	5.1	6.1
2007	1.9	1.4	5.2	1.2	5.3	-1.3	3.9	-1.1	2.6	2.5
2008	-5.3	-17.6	-4.7	-1.9	0.6	-3.9	-1.2	-4.7	-3.5	-5.2

A framework used by economists to assess overvaluation: look at house prices relative to rents.

- Adaptation of methods used to study stock market.
- Long-run relationship more robust than the relationship between house prices and other “fundamentals” (Gallin).
- Limitations: data, model imprecise at high frequencies, other factors bear on relationship (and, of course, more about market than individual properties).

## Detrended House Price-Rent Ratio



# The Sheer Volume of Foreclosures is Also Damping House Prices

## Foreclosures Initiated (Thousands)

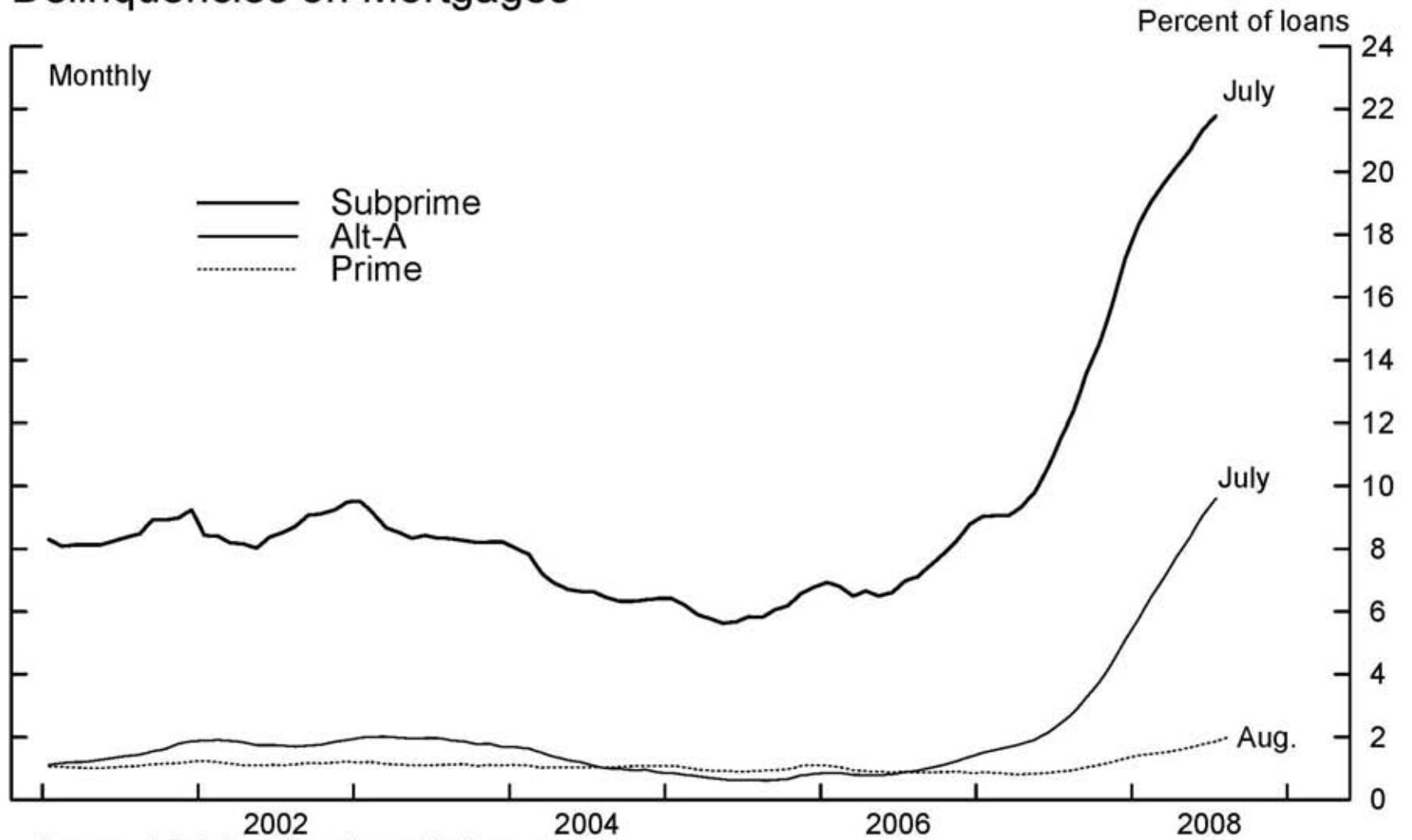
	Subprime	Prime	Total
2006	535	321	1005
2007	854	552	1558
<b>2008:H1</b>	<b>591</b>	<b>520</b>	<b>1204</b>

- Servicers overwhelmed => fewer workouts
- Spillovers to prices of neighboring homes (Schuetz, Been, and Ellen, 2008)

# Moreover, foreclosures are headed higher

- Delinquency rates
- Interest rate resets
- Limited refinancing opportunities
- Soft economy

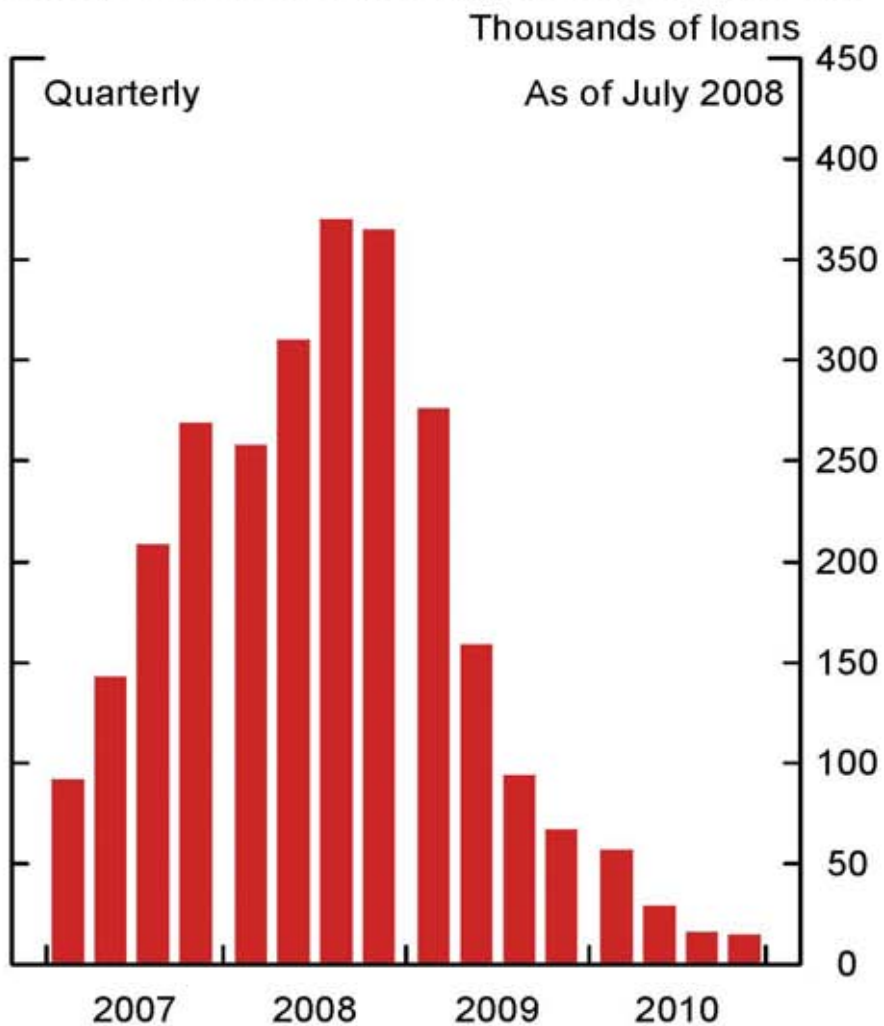
# Delinquencies on Mortgages



Source. First American LoanPerformance.

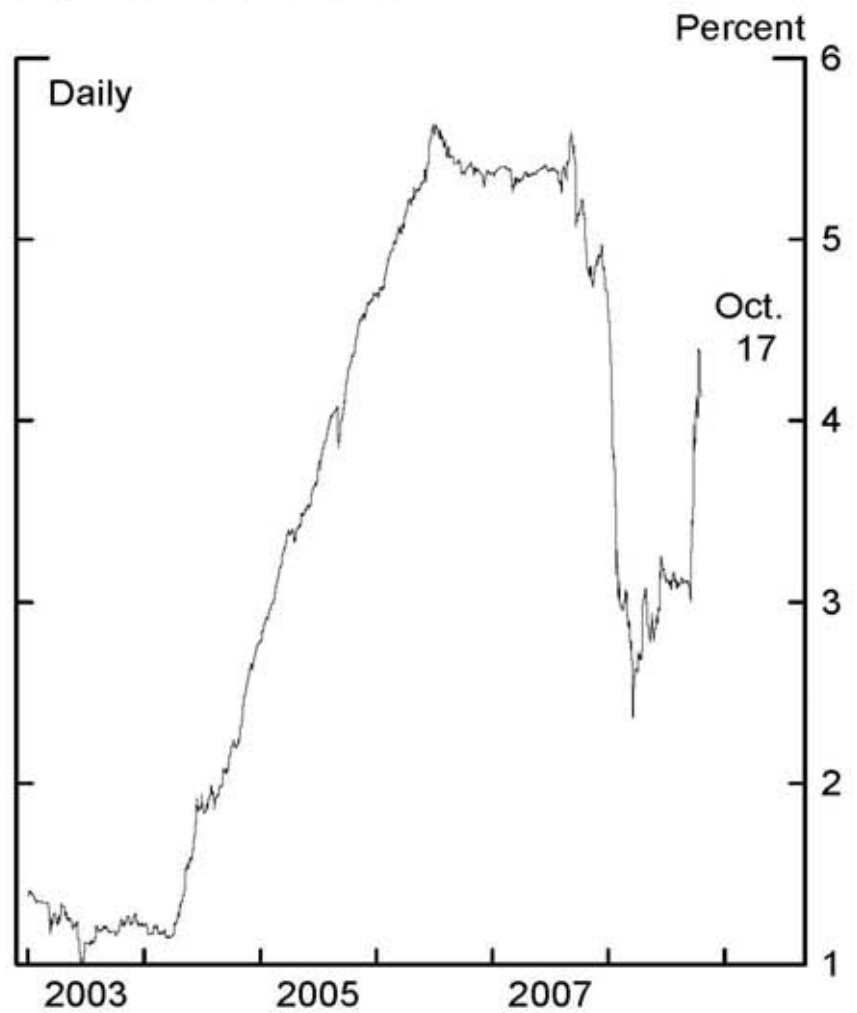


## Subprime First Mortgage Rate Resets

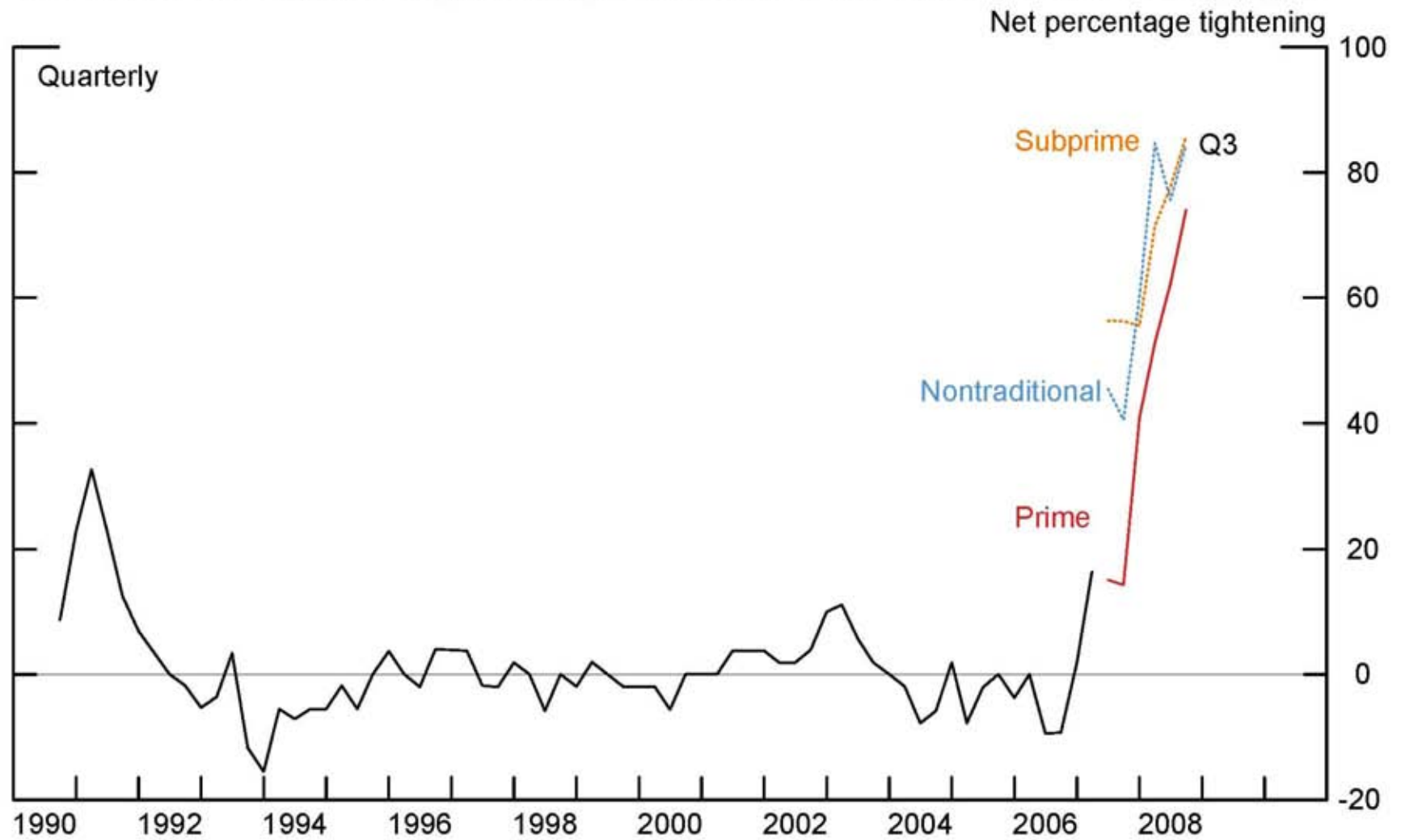


Source. Staff calculations from LoanPerformance

## Six-Month LIBOR



# Commercial Banks Tightening Standards for Residential Mortgages



Source. Senior Loan Officer Opinion Survey.

## Soft Economic Fundamentals

- WSJ survey of economic forecasters shows that 89 percent expect the economy to enter recession in next 12 months, up from 60 percent in September.
- Prices from the Intrade Prediction Market imply a 55% change of the economy entering a recession this year, up from about 15% a month ago.

# Summary

- Valuations need to be forward-looking.
- Supply/demand conditions suggest continued weakness in housing activity.
- All indications are that prices in most areas of the U.S. are not likely to turn up in the near future.