ABOUT

Real Estate Research provided analysis of topical research and current issues in the fields of housing and real estate economics. Authors for the blog included the Atlanta Fed's Jessica Dill, Kristopher Gerardi, Carl Hudson, and analysts, as well as the Boston Fed's Christopher Foote and Paul Willen.

In December 2020, content from *Real Estate Research* became part of *Policy Hub*. Future articles will be released in *Policy Hub: Macroblog*.

Disclaimer

Email Me

Subscribe by E-mail

Subscribe by RSS

Other Fed Websites

Comment Standards:
Comments are moderated and will not appear until the moderator has approved them.

Please submit appropriate comments. Inappropriate comments include content that is abusive, harassing, or threatening; obscene, vulgar, or profane; an attack of a personal nature; or overtly political.

In addition, no off-topic remarks or spam is permitted.

March 5, 2014

Government Involvement in Residential Mortgage Markets

With the federal funds rate effectively at the zero lower bound, the Federal Reserve has used unconventional forms of monetary policy. Specifically, the central bank has issued forward guidance about the policy path and purchased large amounts of U.S. Treasury bonds and agency mortgage-backed securities (MBS) in an effort to lower long-term interest rates. In the case of agency MBS purchases, a goal was to stimulate the housing market by lowering mortgage rates. Two papers presented at the recent Atlanta Fed/University of North Carolina—Charlotte conference, "Government Involvement in Residential Mortgage Markets," examine the extent to which the Federal Reserve has been successful.

Unanticipated announcements of new large-scale asset purchase programs (LSAPs), or changes in these programs, should have an immediate impact on interest rates under the assumption that the total stock of purchases is what matters. On the other hand, the flow of purchases may independently influence markets through portfolio rebalancing—that is, investors reacting to the removal of duration and convexity from the market—and liquidity effects—that is, ease of reselling assets in the future. Diana Hancock and Wayne Passmore conduct an empirical analysis of the differing effects of the LSAPs in their paper, "How the Federal Reserve's Large-Scale Asset Purchases Influence MBS Yields and Mortgage Rates." Using weekly data from July 2000 to June 2013, the authors estimate a model of MBS yields that controls for market expectations about future interest rates and find that the Federal Reserve's market share of MBSs and Treasuries are negatively related to MBS yields. Under their model, the Fed's holdings of MBSs has lowered MBS yields by 54 basis points and the Treasury holdings have pushed down the MBS yields another 70 basis points. This finding is consistent with portfolio rebalancing and liquidity effects being important determinants of MBS yields.

The finding is important because it suggests that agency MBS yields and mortgage rates will rise when the Federal Reserve reduces its MBS purchases—even if the Fed successfully signals that it intends to keep rates low for an extended time. On the margin, this could serve to dampen housing market activity, including refinancing. Since the beginning of the third phase of quantitative easing (QE3), the Fed's MBS market share has grown from around 17 percent to nearly 24 percent. Given the estimate that each percentage point increase in market share pushes MBS yields down by 2.3 basis points, reducing the Fed's MBS market share back to a pre-QE3 level would push MBS yields up by around 16 basis points, which is unlikely to be economically meaningful.

While the cost of mortgage refinancing is borne by MBS investors, most of the policy attention is placed on the benefit to borrowers through an increase in their disposable income. In cases where borrowers are underwater and having difficulty making mortgage payments, refinancing can ease borrowers' financial distress. In "The Effect of Mortgage Payment Reduction on Default: Evidence from the Home Affordable Refinance Program," Jun Zhu, Jared Janowiak, Lu Ji, Kadiri Karamon, and Douglas McManus estimate that during the 2009 to 2012 period, a 10 percent reduction in monthly mortgage payments for participants in Freddie Mac's Home Affordable Refinance Program (HARP) resulted in a 12 percent reduction in the monthly default hazard for 30-year fixed rate conventional-conforming mortgages. This likely helped slow the flow of mortgages entering the foreclosure pipeline and gave neighborhoods time to stabilize.

Government involvement in residential mortgage markets takes many forms (see the conference website for papers that examine other forms of intervention). Taken together, the papers discussed here provide evidence that the Federal Reserve's LSAPs and Freddie Mac's HARP did put downward pressure on longer-term interest rates and facilitated refinancing activity that helped to support housing and mortgage markets. The tapering of the MBS LSAPs should

REAL ESTATE RESEARCH SEARCH

Search

RECENT POSTS

Assessing the Size and Spread of Vulnerable Renter Households in the Southeast
What's Being Done to Help Renters during the Pandemic?
An Update on Forbearance Trends
Examining the Effects of COVID-19 on the Southeast Housing Market
Southeast Housing Market and COVID-19
Update on Lot Availability and Construction Lending
Tax Reform's Effect on Low-Income Housing
Housing Headwinds
Where Is the Housing Sector Headed?
Did Harvey Influence the Housing Market?

CATEGORIES

Affordable housing goals
Credit conditions
Expansion of mortgage credit
Federal Housing Authority
Financial crisis
Foreclosure contagion
Foreclosure laws
Governmentsponsored enterprises
GSE
Homebuyer tax credit
Homeownership
House price indexes
Household formations
Housing boom
Housing crisis
Housing demand
Housing prices
Income segregation
Individual Development Account
Loan modifications
Monetary policy
Mortgage crisis
Mortgage default
Mortgage interest tax deduction
Mortgage supply
Multifamily housing
Negative equity
Positive demand shock
Positive externalities
Rental homes
Securitization
Subprime MBS
Subprime mortgages
Supply elasticity
Uncategorized
Upward mobility
Urban growth

not be a cause for concern. The Fed's strong forward guidance combined with the slow, judicious pace of the taper imply that stagnation of the housing market is unlikely.

By Carl Hudson, Director, Center for Real Estate Analytics in the Atlanta Fed's research department, and

March 5, 2014 in Governmentsponsored enterprises, Loan modifications, Monetary policy | Permalink