# The mortgage crisis in the u.s. essay

Design

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s. Metrics defined and used : Foreclosure , Sub-prime lending , Mortgage rates, House sales, House prices, Housing starts Recent trends have shown unprecedented levels of foreclosure rates of the U. S. homes which have been linked to an unprecedented mortgage crisis which could lead to a recession of the U. S.

economy. This essay looks at several parameters for defining this mortgage crisis, and their overall effect on the U. S.

economy. I ForeclosureForeclosures are defined as processes of legal action usually started when borrowers fall 90 days behind on their mortgage repayments, of which nearly 40% of mortgages end up in liquidation. As shown in Figure 1, foreclosures have been steadily going up since 2006, with American families losing their homes. A total of 268, 532, or nearly 0. 58 % 0f American homes were foreclosed in 2006, and the number shot up in 2007 to 405, 000, which crossed the 1% mark nationwide. ( Christie, 2008). As Figure 1 shows, the rate seems to be accelerating, and many economists believe could last well into 2009, and even longer. The most significant aspect of this phenomenon is that most forclosures have affected the sub-prime mortgage market.

The sub-prime mortgage and lending are terms which are discussed below. II Sub-prime mortgage and lending The mortgage crisis in the U. S. is largely due to sub-prime lending (Figure 1), which means that huge amounts of loans had been given out in previous years to people with poor credit scores without any proper assessments of their ability to repay. In many instances it is suspected that , people obtained mortgages through fraudulent means, with lenders and borrowers breaking rules. (CNN Money, 2008).

Most of this lending started on a large scale in 2003 when mortgage rates (discussed below) fell to their historic low. Banks could borrow additional money easily from private lenders through the mortgage bond market, apart from the Freddie Mac. The housing market bubble seen in the U. S. in recent years followed the explosive growth in 2004 and 2005 of sub-prime mortgages, which were lent to numerous ‘ sub-prime’ buyers who otherwise would not have qualified for mortgage lending. By comparison, the traditional ‘ prime’ mortgage holders (with proper credit history and ability to repay) have not shown a worsening trend. Figure 1. Foreclosure start rates in the prime vs sub-prime sectors.

(Source : U. S. Government Accountability Office, www. gao. gov) III Mortgage Rates Mortgage rates refer to the rates of interest that mortgage holders pay every year upon their remaining mortgage. There are three mortgage rates of interest to us to explain the current crisis, fixed rate, short-term rates and introductory rates (explained below). Fixed rates refer to an agreed rate which would remain fixed for a specified period of time.

All mortgage rates fell to a historic low in 2003, prompting many buyers who previously could not afford mortgages to buy houses for the first time. However it must be remembered that although fixed rate mortgage rates still remain low at present( around 5. 5 – 6 %), sub-prime borrowers in many instances have had to pay much higher rates of interest because of the typical poor credit history. In face of a worsening credit situation, although base mortgage prices are likely to remain low, the number of sub prime defaulters (and foreclosures) are likely to go up much higher. Figure 2 summarizes the situation with relation to the relevant interest rates. Figure 2. Typical U.

S. 30-year fixed mortgage rates between 2004-2007, compared to 1-year adjustable mortgage rates, and federal fund rates. (Source : US Census Bureau) With mortgage rates at its lowest in 2003-5, a lot of the sub-prime mortgages that were sold had especially low introductory ‘ teaser’ rates for the first two years. ‘ Teaser rates’ were basically introduced to entice more first-time buyers to take up mortgages.

Economists however were worried about the housing bubble because its continuance was dependant on the sub-prime owners’ ability to continue paying. The short-term adjustable mortgage rates (just lending money for 1 year that allowed low introductory rates) were reset to 5. 5 % from a low of about 4% in 2006, as shown in Figure 2, compared to the somewhat modest rise in the National 30-year fixed mortgage rates (that meant that the mortgage was to be repaid over 30 years, and a fixed rate of interest applied).

Although this rate reset curbed the massive sub prime lending, it meant that many sub-prime borrowers were now faced with extremely high repayments after their first two years were over, and defaulted mortgage payments became widespread. Foreclosures soon followed and the pace gradually accelerated over 2006-7. In 2007, the final blow was dealt by the drying up of credit to re-finance many of these foreclosed homes (1), as lenders realized that mortgages had become high risk investment portfolios for themselves.; IV House sales With so many foreclosures and tightening credit, house sales (both new homes that were being sold as well as existing ones) began to plummet as from 2006, as shown in Figure 3. House sales figures, refer to the total number of houses sold, either across the USA or in certain states or districts, although in this paper, we mean national sales figures. They can be of two main types – new houses and existing houses. They are a good indicator of the health of the national economy.

Figure 3. Sharp Drop in home sales and Housing starts (2006-7).; New house sales were hit harder than existing home sales, reflecting the fact that there significantly less first-time buyers as well as those families who wanted to move to newer properties.; V Housing Starts Housing starts refer to the number of new residential housing units that were started to be constructed during a said period. It is an important index of construction activity, and a leading indicator of the nation's economy.

An increasing inventory of unsold homes leads to a slow down in new home construction, also known as housing starts, mentioned above. From 2005 to 2007, as shown in Figure 3, the number of new house starts has more than halved. The effect that this has on the national economy is substantial : millions of those employed in real estate, construction and other industries related to these activities have had job losses, a feature that is often seen in recessions. It has been predicted that the slowdown in housing starts will continue at least till the end of 2008. (Yun, 2007). VI House Prices Average prices for houses reflects the demand for houses in the housing market, and are usually categorized into two types – existing house prices, based on evaluation of realtors, and home sales prices, which refer to the resale value of houses. Falling house prices reflect a down turn in the number of buyers more than sellers, often seen in situations where getting mortgages or re-mortgage financing become more difficult. In the current situation, it is most likely that the ' housing bubble' is bursting, as the number of sub-prime mortgages led to a wide-spread expectation of a continued boom in the property market.

The supply of extra homes has led to an oversupply, which is driving the lowering of house prices. House prices have had sharp declines recently – as shown in Figure 4, which depicts the year-over-year changes in house prices shows that there has been a sharp decline of nearly 18 % between 2005 and end 2007. Again, this decline is likely to continue as the sub-prime crisis deepens. Figure 4.

House prices The overall impact of the above on the U. S. economy The impact of this crisis on the U. S. economy as a whole is substantial. As a result of the profound economic effects of the foreclosure crisis will have in 2008, U. S. GDP will be $166 billion lower as a result of a depressed real estate , construction and employment markets.

Both of these factors have already started producing lower incomes across the country, and a reduced demand for consumer goods and services. (USA Today, 2008) As a result, there will be 524, 000 fewer jobs created across the U. S. in 2008.

(Christie, 2008). Rising home prices in 2003-5 had fueled the growth in consumer spending exceeding the growth of gains in real income, as with more equity in their homes, consumers habitually spent more too. With declining house prices, consumer spending will inevitably go down. In 2008, growth in consumer spending could slow down to 2. 0%, well below a 3.

1% gain in incomes. Automobile sales, (estimated at 15. 7 million units) down by almost a million than in 2006, will have their worst year since 1998. (Christie , 2008).

All is not gloom and doom however. Federal, state, and local governments as well as banks and mortgage lenders have quickly realized the dangers of the reckless sub prime lending situation. But this mortgage crisis is not going to bring the U.

S. economy to a halt. Indeed, job growth in 2008 is expected to be around 0. 85% and GDP growth to be around 1. 9%. In 2009, those figures are projected by most economists to be 1. 2% and 2. 9%, respectively.

(Christie , 2008) The negative economic impacts could also be significantly reduced if mortgage holders and loan providers could re-negotiate on newer payment terms with those families who can pay their mortgage, but were forced to foreclose due sharp escalations in payments. Such actions could avoid any further negative effects on local housing markets and on the national broader economy. And the other silver lining on the horizon is the fact that the monetary policy makers would have learned their lesson about ‘ lending responsibly’. References Christie, L (2008) Foreclosures up 75% in 2007. In CNN Money.

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