

“But when it comes to calculating traditional output gaps, there is no notion of a bubble. If part or most of the fall in output was a collapsed bubble, then today’s output gap would be smaller than it appears.” This would mean that inflation risks in the medium term are higher than otherwise thought.

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- **October 1, 2009.** Article. ["Is the Rate of Homeownership Nearing a Bottom?"](#) Federal Reserve Bank of St. Louis *The Regional Economist*, October 2009.

President's Message: Is the Rate of Homeownership Nearing a Bottom?

The housing crisis has been central to our current recession. An economist at the Federal Reserve Bank of St. Louis, Carlos Garriga, has devoted much of his research to understanding the intricacies of mortgage markets and loan choices.

What insight might his research bring to the current environment? To begin,

he has examined the evolution of homeownership rates and their connection with mortgage market innovations. For about a quarter of a century, the homeownership rate hovered around 64 percent. In 1966, it was at 63.5 percent. Twenty-seven years later, in 1993, it had barely budged to 63.8 percent. However, over the past 15 years, a significant change occurred, largely the result of government policy and innovations in mortgage markets.

Politicians pushed to increase the home-ownership rate on the premise that home-owners are more likely to maintain their property than a renter would. And, of course, almost every version of the American dream includes a house with a white picket fence.

In the early 1990s, the Federal Housing Administration (FHA) started to offer mortgage products with low down payments. Prior to this, most mortgage lenders required a 20 percent down payment on all new loans. The rationale for the down payment was to ensure that the home had enough equity to ward off foreclosure if home prices were to fall substantially. To qualify for a low down payment, homeowners had to buy lenders mortgage insurance or private mortgage insurance.

In the late 1990s, conventional lending became more sophisticated. To avoid mortgage insurance, lenders offered a second loan (at a higher interest rate) for a portion of the remaining loan amount. The advantage of the combo, or piggyback, loan was that borrowers could increase their leverage at a lower cost since mortgage interest payments could be deducted on their income tax, whereas mortgage insurance premiums were not deductible until 2007. The homeownership rate increased from 63.8 percent in early 1994 to 68 percent in 2002.

Over the following three years, the rate increased to 69.2 percent, in the heart of the housing boom. Over this period, subprime lending took off and additional mortgage products were introduced and became popular. These included zero down-payment loans, interest-only adjustable-rate mortgages (ARMs) and payment-option ARMs.

The last loan type allowed borrowers flexible monthly repayment strategies,

including full amortization of principal with either zero or even negative amortization.

The bottom soon fell out. Since the end of 2006, nationwide home prices have fallen by as much as 30 percent. The homeownership rate has been steadily declining, too, since then. Through the second quarter of 2009, it was down 1.5 percentage points, to 67.4 percent. This decline reflects a rebalancing: Just as we saw the homeownership rate increase by a little over one percentage point as new mortgage products were introduced, we now see those buyers exiting the market as that equity disappears.

Assuming they could just "refinance later," they found themselves unable to make payments as prices tanked. Additionally, as Carlos recently discussed in the St. Louis Fed's National Economic Trends publication, refinancing denials started to increase well before the peak of the housing boom, suggesting that lenders were uncomfortable with the values being assessed to homes. publication, refinancing denials started to increase well before the peak of the housing boom, suggesting that lenders were uncomfortable with the values being assessed to homes.

[[1]](<https://www.stlouisfed.org#endnotes>)

These borrowers obtained financing through risky tools. If all borrowers who could obtain financing through standard financing options (i.e., not zero down-payment loans, interest-only loans, etc.) had already entered the homeownership arena, they would have already been captured within the 2002 rate of 68 percent.

The homeownership rate is now down below the 2002 level; it has remained at roughly 67.5 percent for three quarters (Q4 2008 through Q2 2009). Although further data are needed, this suggests the decline might now have bottomed out, provided the economic environment doesn't pull down otherwise well-positioned homeowners.

A natural question is to wonder whether the severity of the price decline will force additional homeowners out. During the 27 years that the homeownership rate hovered around 64 percent, there were many price fluctuations and yet no change in the ownership rate. The difference is that

virtually no homebuyer was highly leveraged; almost all buyers had already paid at least 20 percent of the purchase price of their home. Hence, even as prices fell, homeowners were able to "ride out" the storm. Examining homeownership rates is one small but interesting piece of the puzzle. Government policy helped buoy the home-ownership rate to historic highs, and risky lending practices pushed it even higher. Time will tell where the new equilibrium rate will settle, but signs point to a near end in the decline.

Endnotes

1. Garriga, Carlos. "Lending Standards in Mortgage Markets." *National Economic Trends*, May 2009, p. 1. See, May 2009, p. 1. See [\[http://research.stlouisfed.org/publications/net/20090501\]](http://research.stlouisfed.org/publications/net/20090501)(<http://research.stlouisfed.org/publications/net/20090501/cover.pdf>) . [[

[/cover.pdf/cover.pdf](#) [back to text](<https://www.stlouisfed.org#1##1>)]]

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- **September 25, 2009.** Presentation. "[Monetary Policy Feedback Rules at the Zero Lower Bound.](#)" ([jamesbullardsnbzurichsept25finalpdf](#)) *Financial Markets, Liquidity and Monetary Policy* Swiss National Bank Research Conference Zurich, Switzerland. [Press Release](#) | [Related news articles](#).

St. Louis Fed's Bullard Calls for the Development of Quantitative Rules for U.S. Monetary Policy That Could Be Implemented in the Current Environment

ZURICH, Switzerland —

Bullard addressed the “Financial Markets, Liquidity, and Monetary Policy” research conference that was organized by the Swiss National Bank.

Bullard's presentation, "Monetary Policy Feedback Rules at the Zero Lower Bound," is available on the Bank's [web site](<https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/jamesbullardsnbzurichsept25final.pdf>) ..

"The Federal Reserve needs to avoid falling into a low nominal interest rate trap," a prolonged environment of low nominal interest rates and possible deflation, Bullard said. The Fed also "needs to be able to communicate to the private sector how it intends to react to shocks in the future."

Prior to December 2008, the Fed communicated its monetary policy via adjustments in interest rates. But with nominal interest rates currently near zero, the likely path of the Fed's monetary policy is unclear to financial markets, causing additional uncertainty.

"We have spent 20 years refining ideas about interest rate rules and optimal monetary policy," Bullard said. "We should now consider quantitative rules because we are at the zero bound, and may remain there for some time depending on how the economy performs."

Bullard noted that while the FOMC had announced its intention to buy up to \$1.75 trillion in asset-backed securities by the first quarter of 2010, "there has been little indication of how or whether these amounts might be adjusted given incoming information on economic performance."

"It is also unclear whether this policy is consistent with price stability," he added. "Unclear policy creates uncertainty in financial markets."

"The key issue is how to think about the asset purchase program," Bullard said, adding that the inflationary impact of unwinding the asset purchase program hinges on the financial markets' expectations of future policy.

Bullard said that an optimal asset purchase program would:

- be contingent on the state of the economy;
- use a Taylor-type rule that could communicate how purchases would be adjusted as additional information on the economy becomes available;
- help communicate to markets how the purchase program is consistent