# Fed Ends MBS Intervention

The Federal Reserve ended its largest intervention in the housing market on April 1, ceasing its purchase of Mortgage-Backed Securities (MBS) that began in September of 2008 in order to keep the housing market from imploding.

According to the *New York Times*, the program succeeded in keeping "mortgage interest rates at near-record lows and slowing the nationwide decline in home prices." Professor Susan Wachter at the Wharton School explained: "We were in a deflationary spiral, causing mortgages to go underwater, more foreclosures and a further decline in housing prices. The potential maelstrom of destruction was out there, bringing down not only the housing market but the overall economy. That's what [this program] stopped." She added that this Fed program was "the single most important move to stabilize the economy and to prevent a debacle."

Wachter's statements reveal many errors in her thinking, but especially her belief in interventionism as a cure for the inevitable effects of previous inflationary policies. The housing market did not cause the economic recession, as many have pointed out elsewhere. Instead, it was the political and economic intervention in the years before the Great Recession that set the stage. When the bubble burst, prices tried to move back to more normal levels, but were delayed in doing so by such programs as this one by the Fed.

Lawrence Yun, lead economist for the National Association of Realtors, said that the private market for MBS has now recovered sufficiently for the Fed's intervention to cease "without a hiccup." He said, "Just as the Fed is stepping out, private investors appear to be stepping in. As long as there are buyers…for mortgages, [ending the Fed program] should have no impact on consumers."

And so, where are those buyers? According to Michael Fratantoni, VP for single-family research at the Mortgage Bankers Association, "Homes sales are running at quite a slow pace, and we haven't seen much of a spring buying season yet, so there haven't been a lot of mortgages originated."

Part of the reason the Fed's exit from this massive support program has been so muted is that buyers, when one can find them, are paying cash. Exotic mortgages, such as NINJA loans (no income, no job, no assets), have disappeared. Tightened lending requirements, a huge and increasing avalanche of foreclosures, sellers eager to get whatever they can out of their homes as soon as they can, and the beginning of investors tip-toeing their way back into the market have pushed up cash sales to nearly three times what they were just a few years ago.

The National Association of Realtors said that in March almost 30 percent of all homes were purchased with cash. A spokesman for the NAR, Walter Moloney said, “We’ve had this huge pendulum swing — from liar loans, no-doc loans and no-income loans — to no loans at all.” Miami, Florida, real estate agent Peter Zalewski (whose company is named, appropriately enough, Condo Vultures Realty) said that “Nine out of 10 deals we do are all cash. It’s virtually the only way to get a deal done in south Florida, especially if the property is a condo.” Zalewski thinks cash buyers are coming into the market now “because they’re confident it’s the bottom.”

Gary North predicted on his members website in early March that if investors didn’t show up, interest rates would rise. He said that banks have little interest in making long-term loans when they can loan their reserves back to the Fed and make a profit on the spread without any risk at all. And North said that if investors do come back into the market to buy mortgage paper, “we will know that they have learned nothing since 2007.” In another article for his members, North said that the avalanche of foreclosures in accelerating.

This article reviewed the coming avalanche using a chart provided by Agora Financial that was just updated by Credit Suisse through the end of March. Taken together, the resets of Option ARMs and Alt-A mortgages are going to push up foreclosures and drive down prices further. At a recent Building Industry Association conference, the Bank of America, which currently forecloses on 7,500 homes every month nationally, “will increase that number to 45,000 homes per month” by the end of the year. That is a 600 percent increase in foreclosures, by one bank, and even at that higher rate, it will take BofA more than two years to reduce their backlog.

Other attempts to “stabilize” the housing market, such as HAMP (discussed here) will just continue to get in the way of the inevitable decline in housing prices that must take place to remove the effects of the enormous bubble created initially by the Fed and Congress. There are many more sellers than buyers, financing isn’t available, and those few who are buying for cash are flippinghouses via “the greater fool” strategy. Until the market clears, there is no reason for interest rates to rise, and certainly little interest in new construction. The Fed’s “support” for the market is finally seen for what it was all along:  a mirage, and an impediment to the inevitable correction.