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Economic Watch

U.S.

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Economic Analysis
U.S.

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Residential foreclosures: trend and economic impact

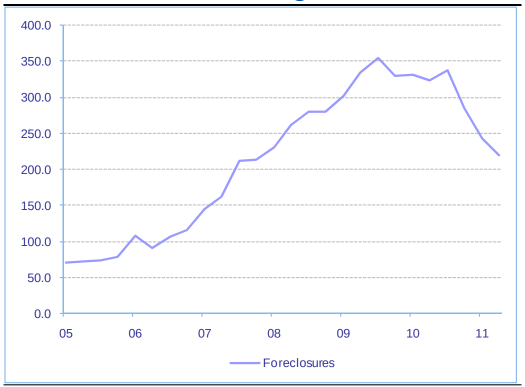
- **In mid-2011, the "shadow housing inventory" amounted to a total of 3.5 million units**
- **This excess supply could have an accumulated negative impact of 1.4 points on GDP growth between 2011 and 2014**

Since the fall of 2010, the number of homes that have begun a foreclosure process has gradually dropped to just over 222,000 units in June 2011, 40% below the high of March 2010, according to data from RealtyTrac. Figures from the Mortgage Bankers Association (MBA) point to the same trend and indicate that the amount of the mortgages that started on the foreclosure process in the first quarter of 2011 was equivalent to 1.03% of all residential mortgages. This figure is nearly 0.45 percentage points below the high of June 2009.

This slowdown suggests that the effects of the residential and mortgage crisis that began in 2006 have started to ease. However, this does not mean that the negative impacts of this crisis on the economy in general, and on the housing market in particular, will disappear in the short term.

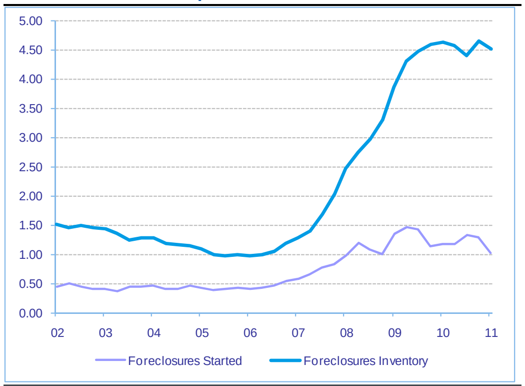
In fact, the high level of current foreclosures, which still represent 4.5% of the residential portfolio, and the probable new defaults over the coming quarters, suggest that the negative effects of this situation will continue both for households and economic activity in general. One of the features of the present sluggish economic recovery is the negative contribution of residential investment to GDP growth, whereas it was among the driving forces behind the three previous recoveries

Chart 1
Residential foreclosure fillings, thousands



Source: RealtyTrack

Chart 2
Foreclosures started and foreclosures inventory, as % of residential portfolio



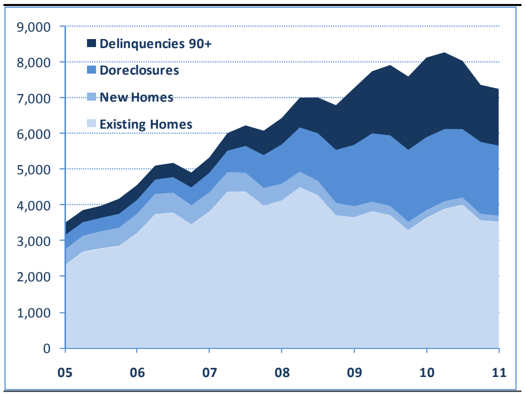
Source: Mortgage Banks Association

The high volume of foreclosure proceedings currently underway and the potential increase in such proceedings resulting from persistently high mortgage delinquency levels, suggests that there is a shadow housing inventory which will have a direct impact on the prices of residential homes and the number of new home starts. Indirectly, its effect will be passed on to household consumption through real-estate wealth, and to residential investment.

An initial estimate of the shadow housing inventory indicates that it could number around 3.5 million units in June 2011: 1.95 million units of foreclosures and 1.55 million defaults. These figures, together with the number of homes currently on sale, will amount to a supply of homes of around 7.5 million units, nearly three times the figure at the end of the recession of 2001.

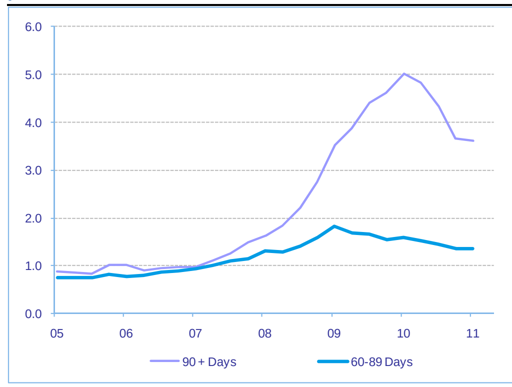
However, the excess supply has been moderating since 2010 and current data suggest that the trend will continue over the coming years, given the slight increase in sales and the downward trend in foreclosures and mortgage defaults.

Chart 3
Housing on sale and "shadow inventory", thousands of units



Source: Census, NAR, MBA and Federal Reserve

Chart 4
Residential delinquency, as % of residential portfolio



Source: MBA

Residential prices are reacting in two ways: in the case of foreclosed homes they are adjusting fast, while the rest are stabilizing.

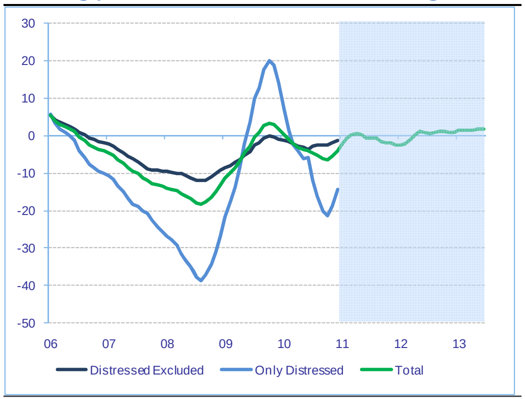
Figures for June 2011 have once more highlighted the housing price trend observed throughout 2010 and the start of 2011: while prices of foreclosed homes have adjusted strongly, those of homes that have not been foreclosed have stabilized. In fact, in mid-June 2011, prices of foreclosed homes had fallen by nearly 15.0% in year-on-year terms, while those of other homes had dropped by barely 1.1%.

The potential entry onto the market of new homes in foreclosure proceedings suggests that this trend will continue into the second half of 2011 and extend throughout 2012, and possibly even 2013. In this environment, it is to be expected that there will be no significant price revaluations in the non-foreclosed home market, while in the case of foreclosed properties the price corrections could continue to the end of 2012.

Our current forecasts indicate that on average there will be no housing price increases until the end of 2012 or the start of 2013. What is more, given the weakness of the economic recovery, the increases expected in 2013 will be below the level of inflation.

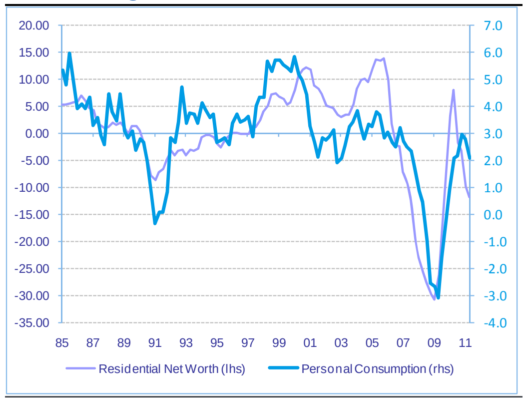
The decline in residential prices, together with the fall in the number of homeowners, is leading to a significant drop in household real-estate wealth, which could affect household consumption in the medium and long term. In past recessions, one of the factors associated with the fall in household consumption has been the loss of real-estate wealth. In fact, the elasticity of consumption to real-estate wealth is around 5.0-6.0%, which implies that for each point of real-estate wealth lost, consumption will fall by 0.05 points. A fall in consumption of this order would have a negative impact of around 0.20 basis points in GDP growth. The current trend indicates that the net residential wealth of households could fall by around 5%, which would lead to a fall of one percentage point in the contribution of household consumption to GDP growth over the 2011-2014 period.

Chart 5
Housing prices and forecast, YoY % change



Source: CoreLogic and BBVA Research

Chart 6
Residential net worth and personal consumption, YoY % change, $ constant 2005



Source: BEA, Federal Reserve and BBVA Research

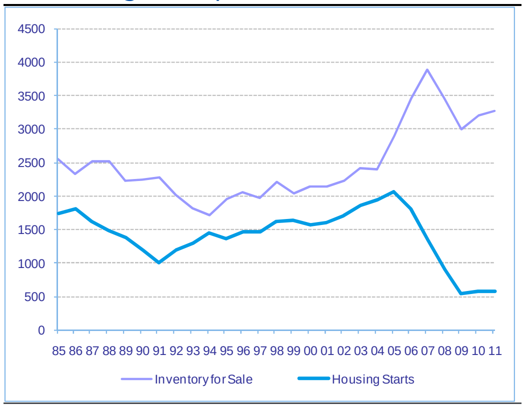
Housing starts will take three years to get off the ground; excess supply easily covers net demand, new household formation and stock replacement

Weak residential demand combined with the high volume of homes for sale means new housing starts have remained at all-time lows since the start of 2009: between 1970 and 2008, housing starts numbered around 1.6 million units per year on average; since 2009, this average figure has been reduced to under 0.6 million.

Our forecasts indicate that the rate of construction of new homes in the second half of 2011 and 2012 will remain at similar levels of around 600,000 per year. In 2013 and 2014 we expect a slight improvement, but it will not be until after 2015 that housing starts will be over one million units per year on average, once the current excess supply has been absorbed, including both homes on the market and the shadow housing inventory.

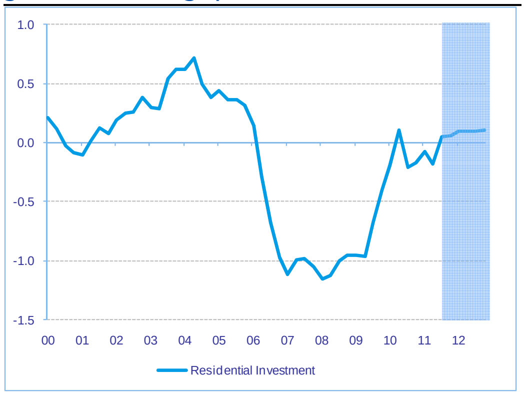
Although the slight increase in housing construction expected in the coming years will have a positive effect on GDP, its contribution to growth will be very limited. The slight increase in residential investment in 2012 and 2013 will only contribute 0.1 percentage points to GDP growth. In previous economic recoveries, the contribution of residential investment to growth in the first two years was 1.3 percentage points in the 1970s, 1.0 point in the 1980s and 0.5 point in the 1990s. In the current recovery, the contribution has been negative (-0.1) and we do not expect it to be slightly positive (0.1) until the third year. The negative effect of lower residential investment on GDP growth can be estimated at about 0.4 pp between 2011 and 2013.

Chart 7
Housing on sale and housing started, thousands of units. Single family



Source: NAR and Census

Chart 8
Residential investment contribution to GDP growth. Percentage points



Source: BEA and BBVA Research