

Credit losses from mortgage crisis could hit \$400B

Contributed by Sam Stamper
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NEW YORK — Total credit losses from the mortgage meltdown could total nearly \$400 billion, with about half that amount being borne by U.S. financial institutions, according to new research released Friday. The overall economic impact in the housing market could be much greater, however, as financial institutions — finding their capital depleted — pull back from lending, resulting in a contraction of nearly \$2 trillion in balance sheets. The new figures are much higher than preliminary forecasts by the Federal Reserve and others, last year, of about \$150 billion in direct impact. The new research finds lending to households, businesses and other entities would decline by about \$900 billion as a result of the mortgage meltdown. Goldman Sachs economist Jan Hatzius and others presented the findings to the U.S. Monetary Policy Forum sponsored by Brandeis University and the University of Chicago.

More broadly, the mortgage market troubles — rising foreclosures, problems with mortgage-backed bonds and other securities — could cut U.S. economic growth by 1 to 1.5 percentage points over four quarters, the research says. That figure does not take into account additional impact from the decline in the housing market, including declining home construction and sales of related items. "Feedback from the financial market turmoil to the real economy could be substantial," the paper says. The gross domestic product, the broadest measure of goods and services produced in the country, barely eked out a 0.6% rate of growth in the fourth quarter of 2007 and grew by 2.2% for all of last year. Federal Reserve Gov. Frederick Mishkin, in commenting on the research, noted that the \$400 billion in lost credit represents less than 2% of the outstanding \$22 trillion in U.S. equities. He questioned how it would have such a large negative effect on the domestic economy. "After all, a 2% decline in stock market prices sometimes happens on a daily basis and yet leads to hardly a ripple in the U.S. economy," said Mishkin. According to the research, the credit losses have such a large potential impact because they are borne by highly leveraged financial institutions, primarily banks. Banks must reduce their lending to restore their balance sheets, which then leads to a substantial decline in overall activity. Boston Federal Reserve Bank President Eric Rosengren suggested that the findings were highly dependent on how far home prices ultimately fall, and whether U.S. unemployment rises. The authors looked at around a 15% drop in prices.