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The missed opportunity to use home equity to stimulate the U.S. economy

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Introduction

One can describe the accumulation of wealth in home equity as a benefit to the homeowners. However, in practice the release process of such equity into cash is hindered by the fact that a joint ownership of a home by a lending institution and a household turns the equity stake into a debt obligation. If a household attempts to withdraw some cash from their home equity stake, the banking system turns such equity into a new debt obligation. This is -economically speaking- a worst-case scenario for households. When households reduce their shareholdings in companies, in government debt titles or by withdrawing money from their own bank savings, the conversion into cash does not turn itself into a new debt obligation. The result of these latter economic actions "only" reduces their accumulated savings levels.

In the U.S., the level of home equity reached $25.3 trillion by the end of the third quarter 2021 according to the statistics from the Federal Reserve. With an estimated nominal GDP for the U.S. of $23.2 trillion for 2021, this single savings category of $25.3 trillion has now exceeded the total U.S. GDP level, a remarkable economic development! For the E.U., the European Central Bank has published a study in 2020 called "Household Wealth and Consumption in the Euro Area". A rough estimate of net housing stock values in the E.U. showed a net worth in housing stock of Euro 45 trillion or in U.S. dollars $40.3 trillion in 2019. The World Bank estimated the EU GDP at U.S. $15.27 trillion for 2020. The European Central Bank, just like the Fed in the U.S., has helped governments to spend more than their tax receipts with the help of Quantitative Easing exercises.

What, in economic terms, seems essential is that Central Banks and their governments take steps to put home equity levels on an equal footing with other forms of accumulated savings. For most countries involved, the level of savings incorporated in home equity represents by far the largest savings category.

Why and how this can be done for the U.S. is explained in this paper.

1. Economic growth. employment levels and home equity in the U.S.

A comparison can be made about the changes in the U.S. GDP[1] and in Home Equity levels[2]

The next overview shows the variations in relation to the U.S. GDP at the time.

GDP Q1 2000 $10.470 trillion	Home Equity Q1 2000 $7.125 trillion	Ratio 68.05%
GDP Q4 2005 $13.324 trillion	Home Equity Q4 2005 $14.375 trillion	Ratio 107.88%
GDP Q4 2012 $16.420 trillion	Home Equity Q4 2012 $8.277 trillion	Ratio 50.41%
GDP Q3 2021 $23.202 trillion	Home Equity Q3 2021 $25.315 trillion	Ratio 109.11%

The remarkable feature from these macro-economic data is that they show the huge fluctuations in home equity levels as compared to the GDP levels over time.

There are several possible reasons which may explain these fluctuations.

The first one is linked to the availability of credit: the supply side of funds. The Great Recession happened because of an oversupply of funds on terms which exceeded the capacity of many households to service and repay their loans. The recovery period for different groups of households was very uneven as will be set out later.

A second reason is linked to unemployment levels. One has only to follow the statistics of the Federal Reserve[3], which show that in October 2006 a high level of employment was reached with 6.727 million unemployed. The unemployment number increased to 15.219 million by November 2009 and did only return to a 6.700 million unemployment level by October 2017.

A third reason may be the interest rate applied. This may influence the own equity level a homeowner can afford in order to purchase a home or stay in one and a fourth reason may be a change in the level of new housing starts.

1 U.S. Bureau of Economic Analysis, Gross Domestic Product [GDP], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/GDP, January 10, 2022.

2 Board of Governors of the Federal Reserve System (US), Households; Owners' Equity in Real Estate, Level [OEHRENWBSHNO], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/OEHRENWBSHNO, January 10, 2022.

3 https://fred.stlouisfed.org/series/UNEMPLOY/

Home equity levels reflect the net wealth of households linked to the value of their homes. What these data do not show is how a household can use such savings on a temporary basis without having to rely on financial institutions to turn such savings into cash. The other option and often not a suitable one, is to move from the existing home to a cheaper one to free up some liquidity.

An interesting study by the Federal Reserve[4], shows that the recovery from the Great Recession was quite uneven for various groups of households. The poorer 60 % of households had the greatest difficulty and thereby took the longest time period to recover.

Table 1: Wealth concentration and leverage in 2007

	Bottom 30 (0-30)	**Middle 30 (31-60)**	**Next 30 (61-90)**	**Top 10 (91-100)**
Share of wealth in...				
...housing	45%	41%	33%	15%
...stocks	11%	15%	21%	24%
...other	44%	44%	46%	61%
Share of homeowners with mortgage LTV over 80 percent	13%	22%	16%	6%

[4] https://www.federalreserve.gov/econres/notes/feds-notes/asset-ownership-and-the-uneven-recovery-from-the-great-recession-20180913.htm

Table 2: Homeownership rates and decomposition of increase in renter share

	Bottom 30 (0-30)	Middle 30 (31-60)	Next 30 (61-90)	Top 10 (91-100)
Share of families that are homeowners...				
...in 2007	41%	71%	89%	91%
...in 2016	33%	59%	81%	92%
Change in renter share 2007-2016*...	7%	12%	8%	0%
...previously owned a home	-1%	3%	3%	0%
...never owned a home	9%	9%	5%	0%

Between 2007 and 2016 21.319 million homes and thereby homeowners experienced foreclosure proceedings[5]. In total, it is estimated that there were just over 135 million homes in 2016, which means that in about one out of every six homes, and thereby the homeowners, were confronted with foreclosure proceedings. It is highly likely that most of these homes were owned by the bottom 60% of families/homeowners.

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2. The possible scenarios for future actions.

The fundamental change that took place in September 2008 was the start-up of a program of Quantitative Easing by the Federal Reserve. Its balance sheet on September 1, 2008, was $905 billion. On January 3, 2022, the Fed's balance sheet reached a total of $8.765 trillion. Over the same period the U.S. Government debt increased from $8.85 trillion in Q1 2007 to $28.43 trillion by 2021 Q3[6]. Both the QE injections in buying up mostly Treasuries' and more recently buying up long term mortgage bonds helped to make liquidity available to the U.S. government and to the holders of such long-term mortgage bonds. However, a further increase in both QE and in U.S. government debt levels might not be the most desirable manner of adjusting to the current economic situation.

Against a background of rising prices of prime commodities, oil and gas included, it was reported that Jamie Dimon, the Chief Executive of JPMorgan, stated that there is a very good chance that the Fed may (have to) raise interest rates four or more times this year. Such increase in borrowing costs will affect nearly all households but will hit the ones from the bottom 60% the most.

[5] https://en.wikipedia.org/wiki/Timeline_of_the_United_States_housing_bubble
[6] https://fred.stlouisfed.org/series/GFDEBTN/

The difference between the bottom 60% of households and the top 40% is that the latter usually have a wider range of financial options to overcome increased expenditure pressures, while the lower income households did and still do have very limited options. The lower income groups mostly rely on their employment income as their principal source of cash.

The Federal Reserve and the U.S. Government are both constrained in helping households more than what they have done already. The Fed, in order to combat increasing inflation levels, might have to increase interest rates as the Chief Executive of JP Morgan already predicted. Such increases will affect borrowing costs for the company sector and for households. Prices on all kind of household necessities may rise. Households, from the bottom 60% by income level, will feel the squeeze the most; being it from outstanding mortgage loans, car loans, student loans, and pension savings. A substantial increase in prices is coming from overseas, in rising oil and gas prices, shipping costs and in other commodities.

One can only conclude that more of the same: i.e., further increases in QE and/or an even higher level of U.S. government debt could easily run into problems. The real problem is that both such actions depend on an improving economic growth scenario in order to reduce outstanding government debts and rescue the Fed from further increases in QE. Such optimistic scenario is unlikely to occur in the short run.

3 An optimistic scenario.

The key lessons from the Great Recession were demonstrated through the adjustment periods for the bottom 60% of households; the time period that these groups needed in order to recover from their losses. For many in this group, this adjustment period took more than 10 years.

In addition, the U.S. unemployment statistics[7] also show the time period that it took to recover from the Great Recession. In October 2006 the unemployment rate stood at 4.4%, The first time it was equal to that level was by March 2017: again, a recovery period of over 10 years! Of course, economic growth is needed, and government spending helps an economy to grow, but the vital statistic is linked to how fast households can recover from a recession. The level of unemployment is thereby a better guide to what happens in a Western economy rather than the rate of economic growth. For the U.S., in economic terms, it matters most how fast the lower 60% of households can and do recover. These households depend nearly totally on income levels out of employment.

This brings one to the accumulated values in home equity, which currently stands at $25.315 trillion in the U.S. This is a savings pot which is now larger than the total U.S.2021 GDP output. The opportunity exists to use such savings in a manner that stimulate economic growth, increases employment levels without creating an additional obligation by the U.S. government to borrow more. In my past papers this was called: Quantitative Easing Home Equity; or in an abbreviated term QEHE.

[7] https://fred.stlouisfed.org/series/UNRATE/

3.1 The why question.

With over $25 trillion locked up in home equity, many U.S. households are asset rich, but the bottom 60% of households are also often cash poor.

If demand levels start to slow down or even drop due to increases in prices and in borrowing costs, an economy is in trouble. This means many households will be getting in trouble. Trouble means that these households can no longer afford the same expenditure patterns as they had in the past. The top 40% of households usually have sufficient additional financial resources to cope with such changes in prices and in interest rates. However, as history has shown, the recovery rate for the bottom 60% took over 10 years in order to get back to the 2007 situation.

The real economic question could be: Why can a system not be implemented that helps some or most of the 60% of households that are asset rich but cash poor? With the benefit of hindsight, if Quantitative Easing had not been directed to buying up government debt titles, would an alternative system not have done a better job? Better in this way would have been to use households home equity as the lever to create more jobs and higher levels of disposable income. Such program could have as a target to temporarily reduce households' own equity in their properties.

A temporary program can be devised that would get cash in the hands of some or most of the 60% lower income households at a 0% interest rate. The Fed rather than keeping buying long dated mortgage bonds, which it has done over the last year as it expanded its mortgage bond portfolio from $576 billion to $2.615 trillion[8] could decide to help households directly or indirectly with the help of, for instance, Fannie Mae, Freddy Mac and/or Ginny Mae. Currently, the Fed's portfolio of mortgage bonds makes up nearly 30% of all QE outstanding already.

Why would such a course of action be recommendable?

The first point to make is that it is important to underline the unique role that the Fed plays in the economic affairs of the U.S. and in the welfare of the U.S. population. Its aims are not profit oriented but are linked to macroeconomic management. It can have a median term view about how the economy should or could develop.

Who, in the U.S., needs the help most? It is not the top 40% of households by income and wealth levels as the above statistics from the Fed did already show. It is therefore the bottom 60% of households.

What do they need? When interest rates are increasing, the banking and financial sector will generally follow, and the costs of borrowing will generally go up for all households and companies. At the same time, prices of all type of goods and services will go up. As stated

[8] https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm

already, the bottom 60% of households by income and assets have the lowest absorption capacity to overcome such price rises in goods, services and interest rates. The great number of foreclosures during the Great Recession blocked the U.S. economy to achieve a rapid improvement in employment levels and in disposable incomes.

What might be considered is to use a different approach for the bottom 60% of households.

3.2 The How Question

The aim of a financial support system is to help some or most of the bottom 60% of households as soon as possible. Why soon? With rising inflation levels, the purchasing power of the lower income households will quite quickly come under threat, basically because they have assets (homes) that cannot easily be turned into cash, even for a small share of their asset value.

Helping these households on a temporary basis to obtain some of the money locked up in their properties will help these households to continue to maintain their spending levels at the higher shop prices. Such action will help employment levels to stay on a more acceptable plateau. Such help could be made available to homeowner's occupiers only and not to landlords as the latter group should be in the housing market for the long run.

The Fed or with the Fed's help, another U.S. government agency can become a co-shareholder in the equity stake of a home owned by the homeowner occupier. It would no longer be turning home equity savings into debts, at great costs to the households involved. By the way, repossessions are, economically speaking, the fastest manner to lower the general level of house prices and the level of new housing starts as history has shown. Just to refresh the memory: according to the statistics from the Fed[9], the median house price in the U.S. was $257,400 in Q1 2007. By Q1 2009 the median house price had dropped to $208,400; a drop of 23.6%. It took to Q1 2013 before median house prices were restored to the level of Q1 2007 when they reached $258,400. In the meantime, were too many households affected by the lack of cash and by the forced sales of their home"?

The real "why" question was and is: were in hindsight too many households in the bottom 60% of income and wealth left to their own devices, without a recognition that forced sales made them and many others indirectly, only poorer? It could have been so different.

How to improve matters for the future?

The first element in the jigsaw puzzle is to recognize that the past adjustment method of relying on the private banking sector was suboptimal. Once the mortgage debt payments stopped, a solution could only be achieved which forced households to accept the terms of these financial institutions. The banks have profit motives and in a declining housing market, they are highly unlikely to offer terms that will cause them losses. The past adjustment method created a guaranteed loss for the households; for some on paper only, for others a

[9]https://fred.stlouisfed.org/series/MSPUS

stark reality. The forced sales of homes as a side effect of the Great Recession created substantial losses for all homeowners, but especially for the group of households that were cash poor, made worse by the rapid increase in unemployment levels.

The second element in the jigsaw puzzle is to study the adjustment period. If, for arguments sake, it was assumed that households could have applied to a state-owned organization that would turn some of their home equity into cash at a 0% interest rate, what would have been the result?

A first point to be made is linked to the risk structure of the mortgage outstanding. One cannot and should not help households that have less than 10% in home equity. On the other hand, those households that have lost their jobs or are in jobs on lower pay scales, need the cash most. In a recession period there are many of such households in the bottom 60%. This group is the group that needs the cash injection most in order to sustain their daily expenditure levels.

If a system could be implemented that helps such households to have partial access to their home equity savings at a 0% interest rate, it would avoid most of the negative elements linked with increasing existing government debt levels. The latter represents a claim on future incomes of nearly all households and companies. It would also avoid the need for further Quantitative Easing as it has been practised up too now.

4. Some conclusions

The loss in home equity in the U.S. between Q4 2005 and Q4 2012 represented a loss to households of practically 43% of the total value of the U.S. housing stock over these years. Over the same period the unemployment rate increased from 5% in October 2005 to double that at 10% by October 2009 and only to reach 7.8% by October 2012, still well above the 5% of October 2005. The main aim of this paper was and is to seek an alternative pattern of adjustments, as such losses in home values and simultaneously in jobs do not represent a very attractive and economically intelligent adjustment process.

The two main tools used to combat the Great Recession, i.e., Quantitative Easing and additional U.S. government debt financing over and above its tax revenues have led to an outstanding level of QE of $8.87 trillion according to the latest data (was QE $905 billion per September 2008) and a total U.S. government debt level of $28.427 trillion for the 3rd quarter 2021 as compared to $8.170 trillion for Q4 2005.

Both the Fed’s and the U.S. government use of funding sources have multiplied strongly and of course have helped to bring about an economic recovery. With a GDP of $23.2 trillion as per the third quarter 2021, one may wonder for how long such debt-based rather than asset value-based expansion can be continued? The bright point in the situation is that currently homeowners collectively have a networth of $25.315 trillion in home values.

The U.S. is in a fortunate position in that its housing stock has a current networth of over $25 trillion.

The past adjustment process from the Great Recession made households suffer the losses of on average 43% in home equity levels. Such process had two main drawbacks. Firstly, it allowed and gave priority to the financial sector in arranging work-out solutions. These work-out solutions allowed financial institutions to set the standards, which rarely led to losses for them apart from for a few “gambling” banks.

The proposed solution in this paper is based on helping some or most of the households within the bottom 60% of income and wealth and help them turn some of their home equity into cash at a 0% interest rate. The $25 trillion of home equity should be considered as a collective savings reserve, equal to money in a bank, with the difference that the “Bank” will be the Federal Reserve or its representatives.

From the studies as quoted in tables 1 and 2, the top 40% of households do not need support, but many households in the bottom 60% do. This has become an urgent matter as price inflation, both from overseas sources and from domestic ones are starting to emerge. The Fed is also predicted to raise interest rates, which is nice for households that have cash surpluses, but a nightmare for those that do not, like many in the bottom 60% of households.

At the current QE and government debt levels, an extended and drawn-out adjustment period with the prospect of a severe drop in home values, once again, will lead to increased poverty levels, unless some cash is made available to these households. This can be done on basis of 0% interest rate in exchange for a share in the home equity: QE HOME EQUITY (QEHE).

Such cash helps households to pay their bills and such system allows them to pay principal amounts over the mortgage only. The reward for the U.S. government is threefold: 1. It avoids a repeat of the long-drawn-out recession that happened after 2007. 2. It keeps households in work, rather than getting unemployed. 3 It preserves most of the home equity levels, rather than creating a substantial loss in home equity for all households. 4. The decisions about what to do and when remains totally with the Board of Governors of the Federal Reserve.

A system that provides the cash on basis of home equity savings can be set up with the help of Fannie May, Freddy Max and Ginny May. Online applications would be a logical communication method. The Fed may take it upon itself to explain the benefits of such deals to the banking sector involved. It was indicated that households with 10% or less of home equity might be excluded from applying.

Under the current threats to economic growth, a rapid system implementation would be helpful.

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