GSE Activity Report

Monday, August 7, 2017

Calling Uncle Sam

Summary

This year's stress test results for Fannie and Freddie reach the same conclusion as prior tests: the GSEs won't crash absent a truly horrific scenario, but any crash will cost the Treasury dearly in the absence of capital cushions. Taxpayers, though, are not at still more risk since these huge draws remain within the scope of Treasury's current commitment. Recall that the largest U.S. banks passed a similar version of this test earlier this year but only because they now hold huge risk-based and leverage capital reserves. What's surprising isn't that Fannie and Freddie are likely to survive and cost Treasury dearly if they don't, but rather why Fannie and Freddie fare so differently under comparable scenarios.

Impact

Once again Freddie starts the stress period with pre-provision net revenue that is slightly higher than Fannie's and projects a dividend payment to Treasury during the stress period. Fannie projects no dividends with no explanation given for this discrepancy. While Fannie's provision for credit losses is larger than Freddie's – no surprise given their volume differences – Fannie has slightly improved its credit loss projection versus last year's run. This year, Fannie's losses of $35.3 billion are 70% greater than Freddie's $20.6 billion. Last year Fannie's losses were 75% greater than Freddie's.

This year, the hit to Fannie's revenue on mark-to-market valuations and trading securities/counterparty risk is again far less than that to Freddie's revenues. In fact, Fannie posts a slight mark-to-market gain and a smallish market shock impact, making the combined reduction to its net revenue only $2 billion versus a hit to Freddie's revenues of almost $12 billion.

Under this year's stress test, both GSEs still post pre-tax losses which are less than last year's results. Freddie posts a loss of $15.3 billion versus last year's loss of $22.5 billion while Fannie's loss of $21.3 billion this year is far better than its $33.9 billion loss reported for last year's stress test.

Federal Financial Analytics, Inc.
1140 Nineteenth Street, N.W., Washington, D.C. 20036
Phone (202) 589-0880 Fax: (202) 589-0423
E-mail: info@fedfin.com www.fedfin.com

© 2017 Federal Financial Analytics. All Rights Reserved.

Also, for both GSEs, credit losses as a percentage of their average portfolio balances are way down from last year's stress test. As a result, both GSEs' draws on the Treasury under this year's stress test are lower than last year's results – regardless of the treatment of deferred taxes. Whereas last year the combined GSEs would have projected Treasury draws of $49 billion to $126 billion; this year, their combined draws would range from $35 billion to $100 billion.

Outlook

What do we now know? Nothing new – the GSEs are wards of the state that pose big risks if anything goes wrong.

Federal Financial Analytics, Inc.
1140 Nineteenth Street, N.W., Washington, D.C. 20036
Phone (202) 589-0880 Fax: (202) 589-0423
E-mail : info@fedfin.com www.fedfin.com

© 2017 Federal Financial Analytics. All Rights Reserved.