GSE Activity Report

Thursday, August, 10, 2023

9th Inning Results

Summary

FHFA today released the results of the ninth stress test it's run on Fannie and Freddie since Dodd-Frank demanded this in 2010. Using pretty much the same flawed models as the Fed, FHFA finds Fannie and Freddie pretty much as they are even under acute stress.

Impact

As with the Fed's CCAR stress test, FHFA's assumes lower-for-longer interest rates (i.e., zero for the three-month Treasury in 3Q/23 and throughout the test) and subdued inflation (i.e., 1.25% now rising to 1.5% in nine quarters). The yield-curve is also said to steepen through the scenario. FHFA's scenarios for house-price declines and that for multifamily are a bit more severe than the Fed's.

Thus, as with banks, what we know for GSEs from this test is hard to know other than that the real severely-adverse world will look nothing like the severely-adverse scenario. Under it, the GSEs sort of hold their own.

Without their allowance for Deferred Tax Assets (DTA), both Enterprises reported comprehensive income in the severely adverse scenario. Key drivers were portfolio growth and house price appreciation in 2022, partially offset by a more severe house price decline in the 2023 planning horizon. Without DTA, the GSEs' capital goes negative, with Fannie's CET1 hitting -$87.5 billion; Freddie's CET1 is -$53 billion.

With their DTA allowances in the severely adverse scenario, both Enterprises experienced comprehensive losses of $8.4 billion. Fannie still stands reasonably firm, with a net worth of $52.5 billion; Freddie scores $36.4 billion. Fannie's 2Q net worth (DTA included) is $69 billion; Freddie's 2Q net worth (DTA included) is $42 billion. Fannie's CET1 remains unchanged, while Freddie's is slightly better off at -$50.4 billion.

Outlook

What does any of this mean in higher-for-longer with inflationary pressure affecting a raft of assumptions leading up the net worth conclusions? Not much even if Fannie and Freddie were paying dividends rather than attempting to retain earnings for privatization somewhere over the rainbow. Fannie's real-world 2Q adjusted total risk-based capital shortfall is -$248 billion, while its leverage tier one capital shortfall is -$201 billion. Freddie provides a risk-based capital shortfall of -$161 billion and leverage tier one capital shortfall of -$141 billion. So, what's a stress test matter?

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