GSE Activity Report

Wednesday, January 31, 2024

Would a Trump Victory Set the GSEs Free?

Summary

Common-stock investors clearly think so, but they're a notably speculative lot and more than likely wrong. In this report, we lay out why we think the limbo in which the GSEs have languished since 2008 is now a permanent quasi-vegetative state.

Impact

We are in no way suggesting that failing substantively to redesign Fannie and Freddie is a good thing – quite the contrary. While there is widespread disagreement on what can best be done with them, virtually everyone across the range of the political spectrum wants something done. The problem now as before is that no one agrees on what can best be done and doing pretty much anything forces hard decisions no Administration to date nor any Congress has been willing and able to undertake.

To be sure, meaningful changes around the margin are certain if Donald Trump wins a second term, but we do not think these will be any more fundamentally structural than the changes wrought by Mark Calabria and Treasury until they laid out a course of structural redesign about a week before Mr. Biden's inauguration. Before that, the Trump team looked at the GSEs only from time to time and then only to undo a bit of what the Obama Administration had done during its episodic fits of doing something about the GSEs along with promising big plans to do a lot more.

The reason for policy paralysis is not just political dysfunction, manifest though it always seems to be. Rather, it's that doing something structurally different with Fannie and Freddie has significant dislocation for borrowers, mortgage bankers, credit enhancers, and – depending on what's done – the federal budget. Continuing conservatorship is thus a cocoon of insulation for interested parties who agree on little beyond the need for change if GSE changes are to their immediate liking.

Given this pessimistic prognosis, are there key differences between Biden II and Trump II, assuming there is no crisis forcing reluctant hands and Congress continues incapable? First to what Mr. Trump might do since that's the topic de jour:

- FHFA will get a new director who won't be anywhere near as interested in what the agency now calls "equitable housing finance," dismantling much of what's been done in recent years at least when it comes the spouting rhetoric that portrays the agency as newly anti-"woke."
- GSE powers to engage in new products and special-purpose credit programs will be rolled back and affordable-housing goals loosened, although this will take time and could be laid aside if other issues garner immediate attention in coming years.

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- The new director is likely to retain the current capital-regulatory regime in part because dismantling it would be Herculean and mostly because a Trump FHFA will want the GSEs even better capitalized than a Biden FHFA in order to make reprivatization a more plausible option. Still, the 2021 Trump I plan did not contemplate an end to the conservatorship and why Trump II would take this on given all the other things it's got to do is thoroughly uncertain.

Outlook

A far greater obstacle to ending the conservatorships is that reprivatization would rip the effective guarantee from the GSEs that has been in place since the 2008 wake-up call showed the fragility of the old implicit guarantee. Key statutory benefits such as exemptions from the more stringent QM, the willingness of the Fed and global central banks to hold MBS, and the favorable treatment under bank capital rules would all come to an end.

The newly-privatized entities would have some advantages over banks, most notably lighter-tough capital, resolution, and liquidity rules. But this same flexibility would give investors and foreign governments a good case of the willies. The Trump team would need to be very bloody-minded to take all these chances.

It would also have to be willing to take the significant political risk of higher-cost mortgage loans. As a recent FRB-Philadelphia study showed, restricting GSE purchases of investor mortgages gave banks more to do but at greater borrower cost and reduced credit availability. This is not a particularly systemic macroeconomic and political problem when it comes to investor loans; quite another when it comes to home mortgages.

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