- Vicious cycle of falling prices and weaker demand:
  - Housing Prices: Declining trend again since the second half of 2010.
    - Looking by major cities, a housing bubble can be seen in some cities, but the housing price decline is occurring nationally. There are balance sheet adjustment pressures throughout the U.S. (Fig. 47)
  - The fall in housing prices reduces housing repurchases and home loan refinancing. It also decreases household real assets, which increases the household debt burden. This reduces housing demand, and housing starts and sales are weak. Weak sales and flow of repossessed properties into the market are resulting in large numbers for sale, and pressure for further price declines.
- Another thing making repurchases difficult is financial institutions' strict lending stance (Fig. 48) and the high percent of negative equity loans (when the housing loan balance is larger than that home's current value). (Fig. 49)
  - Negative equity is an incentive for "strategic default," where the borrower can repay the loan, but loses his home with the aim of abandoning the repayment obligation. (Fig. 50)
- There were insufficient results from the Home Affordable Refinance Program (HARP), etc. A HARP improvement policy was announced in October 2011, but it is uncertain whether it will produce results.

Fig. 47 Housing Prices & Characteristics, by Major City

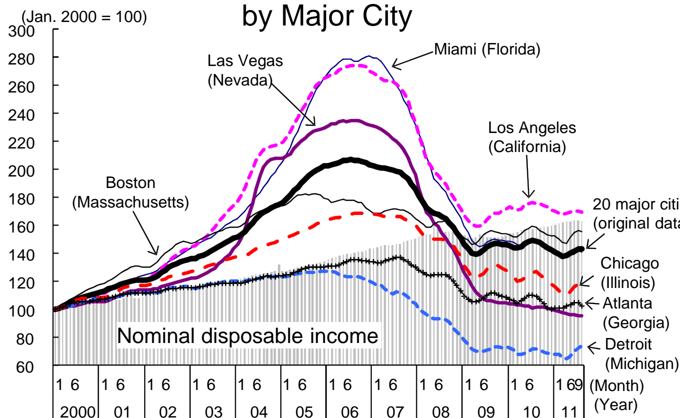
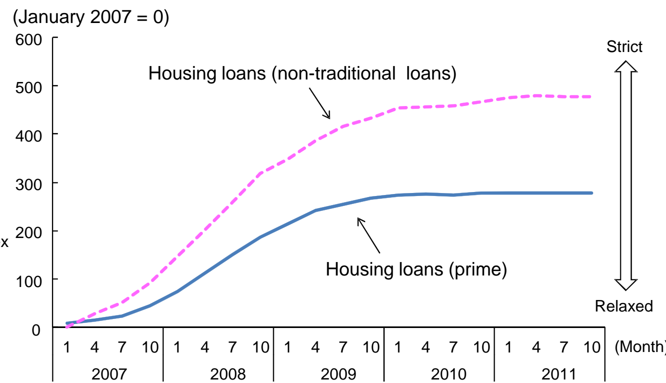


Fig. 48 Lending Stance for Housing Loans



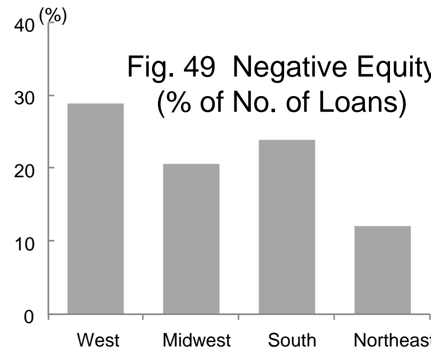
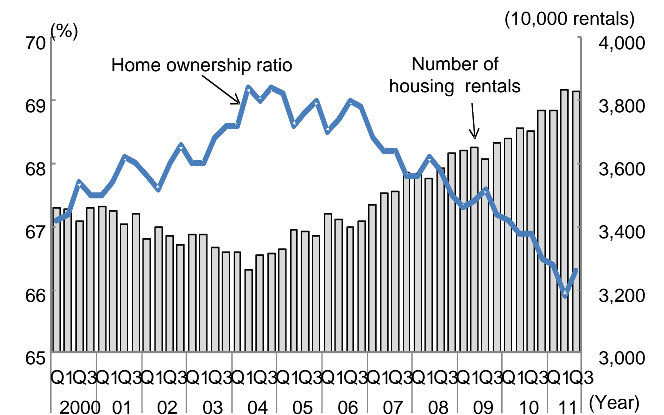


Fig. 49 Negative Equity (% of No. of Loans)

Fig. 50 Homeowning Ratio & No. of Rentals



- Federal Government:
  - Many of the series of economic stimulation policies based on the American Recovery and Reinvestment Act (ARRA) have ended, so federal government expenditures peaked in mid-2010, and are in a declining trend. (Fig. 51)
  - Large scale economic stimulation policies created a much worse fiscal situation. The FY2011 fiscal deficit was the largest in history, and the claims outstanding also historically high. (Fig. 52)
- State and Local Governments:
  - Due to worse local economies, in order to respond to revenue shortages, broad cuts in expenditures have been implemented. Government expenditures are in a declining trend. (Fig. 53)
  - Most of the federal government’s support based on ARRA ended in FY2011. FY2012 is expected to see greater deficits than in FY2011. (Fig. 54)
  - Contractionary fiscal policy is placing downward pressure on local economies, by layoffs of government staff, etc. Worse local economies reduce tax revenues, for further contractionary fiscal policies, which may also result in a vicious circle.

Fig. 51 Federal Government Expenditures as % of GDP

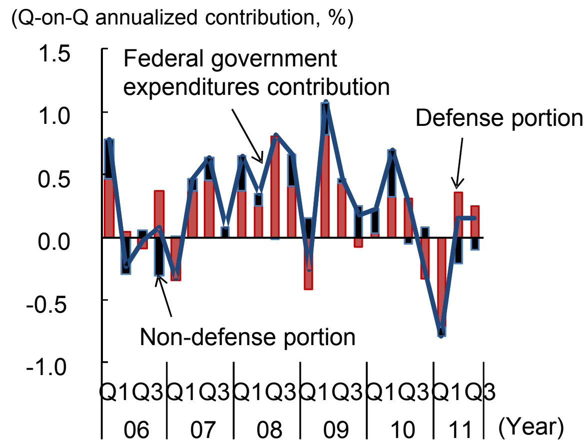


Fig. 53 State & Local Government Expenditures as % of GDP

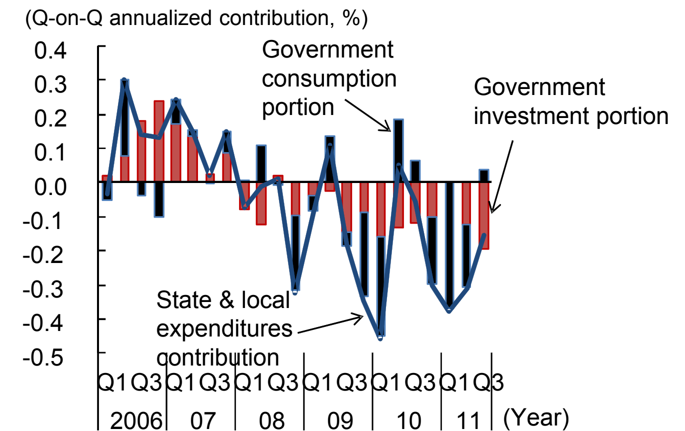


Fig. 52 Fiscal Balance & Claims Outstanding

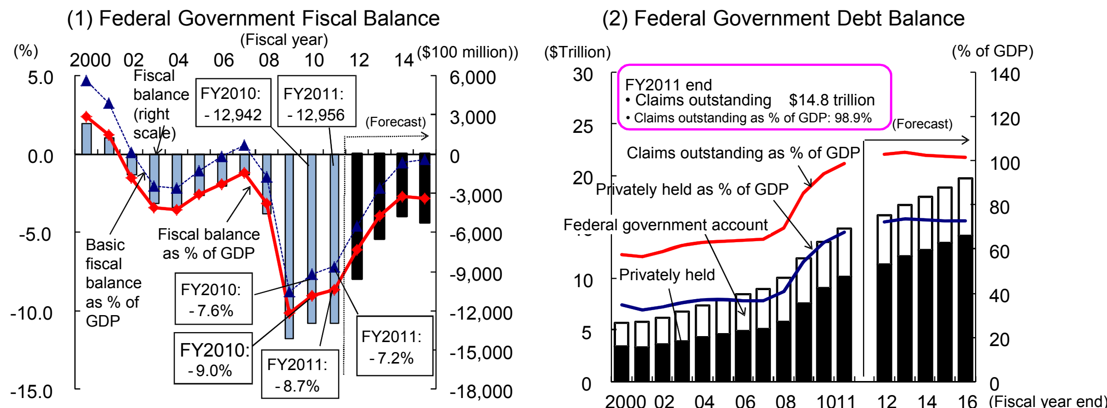
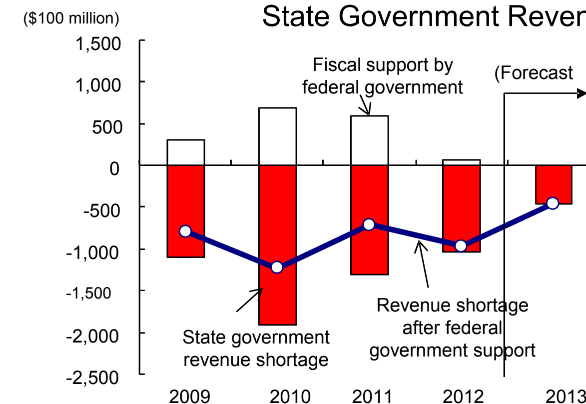


Fig. 54 Fiscal Support by Federal Government, and State Government Revenue Deficit



Chapter 2, Section 2. U.S. Economy ~ Fiscal Rebuilding Turmoil ~

- **Debt Ceiling:**
  - The claims outstanding was forecast to reach its legal ceiling in early August 2011, but discussions between Democrats and Republicans were unsuccessful, and U.S. debt default was a concern (Figures 55 & 56). Finally, the Budget Control Act of 2011 was passed on August 2, the deadline for reaching the ceiling. This legislated raising the debt ceiling and cutting the fiscal deficit (Fig. 57). However, S&P lowered its U.S. federal government debt rating for the first time in history, and financial and capital markets were roiled.
- **Lack of Progress on the American Jobs Act:**
  - In September 2011, in response to worsening employment conditions, President Obama proposed a $447 billion employment bill. But it has not progressed due to conflict between the Democrats and Republicans over fiscal revenues, etc.
- **Breakdown of Fiscal Deficit Reduction Discussions by the Super Committee:**
  - Due to conflict between the Democrats and Republicans, discussions broke down on November 21. It was decided to launch mandatory expenditure reductions based on the Budget Control Act of 2011 (from 2013 to 2021, uniform reductions of $1.2 trillion of expenses). Along with $0.9 trillion of expenditure cuts decided on first, it was decided to proceed to cut a total of $2.1 trillion of expenditures over the next 10 years. (Fig. 58)

Fig. 55 US Government Bonds CDS

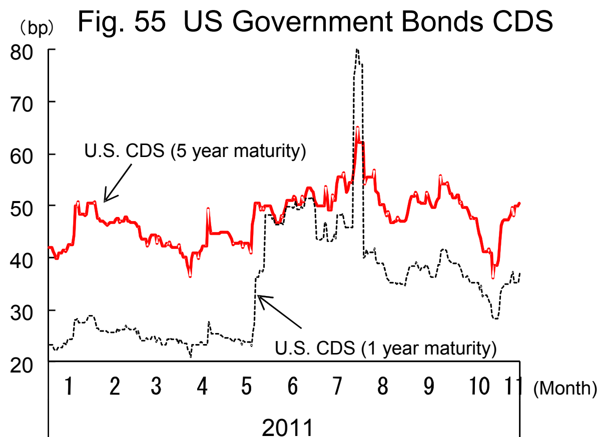


Fig. 57 Budget Control Act of 2011 - Outline

1. Debt Ceiling

Raise debt ceiling by at least $2.1 billion, in 2 stages.

(1) Raise by $0.9 billion

(2) Raise by $1.2 to $1.5 billion, under resolutions based on proposals by the Super Committee

2. Fiscal Deficit Cuts

- Cut expenditures by $917 billion over the next 10 years
- Establish nonpartisan committee from upper and lower houses. Propose $1.5 trillion of fiscal deficit cuts, including tax and benefit reforms. Resolutions by end of this year.
- If a total $1.2 billion of fiscal deficit cuts cannot be decided on, expenditures will be uniformly cut by at least $1.2 trillion from 2013 to 2021.
  - Cuts are applied 50/50 to defense expenses and non-defense expenses. However, these exclude social security benefits, Medicaid, Medicare (benefit portion), unemployment benefits, programs for low income people, etc. (For payments to medical service providers of Medicare, establish ceiling and make cuts)

Fig. 56 U.S. Bond Yields

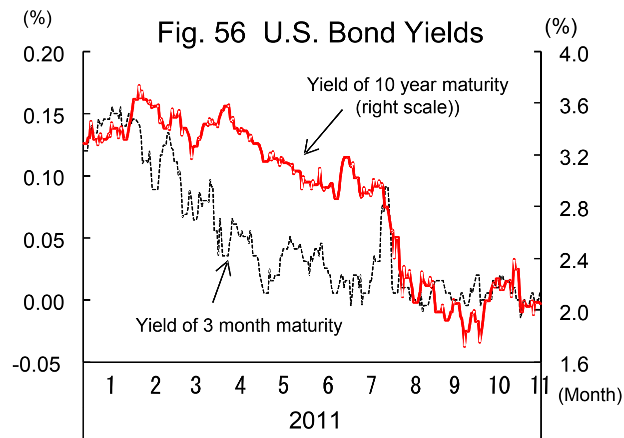
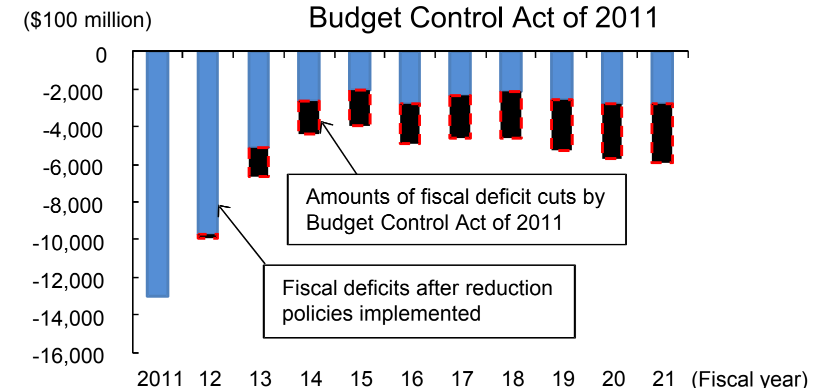


Fig. 58 Fiscal Deficit Reduction Effects of Budget Control Act of 2011



- Inflation: Deflation concerns were pointed out in monetary policy there was continually high inflation in 2011.
- Monetary Policy: From exit strategy discussions, changed to exceptional easing policy (Figures 59 & 60)
  - Medium and long term government bond purchases (Quantitative Easing 2 - QE2) began in November 2010, and were completed as planned in June 2011. A road to normalization was being sought.
  - In July and August, amidst a stronger slowdown trend in the U.S. Economy, the August FOMC stated "…likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013." This clarified the time axis for the federal funds rate.
  - Moreover, the September FOMC decided on a "Maturity Extension Program" (So-called "Operation Twist." By June 2012, purchase $400 billion of long maturity government bonds, and simultaneously sell short maturity government bonds), and reinvestment in the principle redemption portions of MBS, etc.
    - Chairman Bernanke stated his opinion that QE2 reduced long term interest rates by roughly 10 to 30bp, and Operation Twist is forecast to reduce long term interest rates by roughly 20bp. Attention is focused on the effects of Operation Twist. (Fig. 61)

Fig. 59 Policy Interest Rates & Non-traditional Monetary Policy

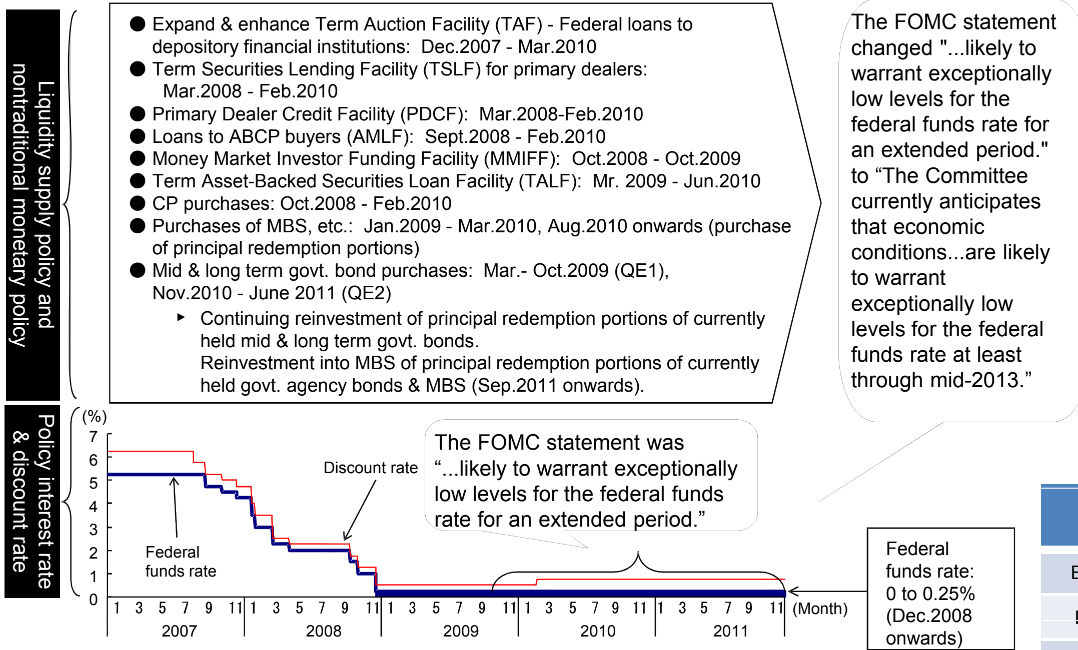


Fig. 60 Fed Balance Sheet

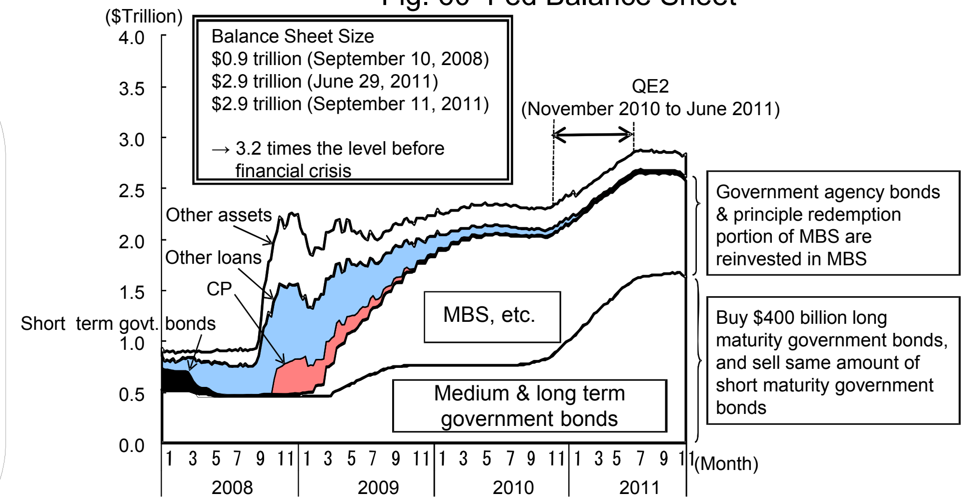


Fig. 61 Operation Twist & QE2 - Comparison

	QE2	Maturity Extension Program (Operation Twist)	(Reference) Operation Twist implemented in past
Execution period	11/2010 – 6/2011 (8 months)	10/2010 – 6/2012 (9 months planned)	February – April 1961
Execution scale	$600 billion ($75 billion / month)	$400 billion ($45 billion / month)	$8.8 billion
% of nominal GDP	4.1%	2.7%	1.6%
% of outstanding U.S. bond balance	7.0%	4.2%	0.5%
Expected effects (statement by Chairman Bernanke)	Long term interest rate reduced by 0.1% to 0.3% = FF rate reduced by 0.4% to 1.2%	Long term interest rate reduced by 0.2% = FF rate reduced by 0.5%	–
Expected effects		Long term interest rate	Long term interest rate reduced by