Fannie Mae and Freddie Mac reported larger-than-expected 4Q07 net losses, largely reflecting on-going weakness in the housing sector and the deterioration in prime mortgage credit. Despite these larger-than-expected net losses, market participants do not expect Fannie or Freddie to resort to additional capital raising activity since they both maintain adequate levels of surplus capital. The earnings news was largely overshadowed by OFHEO’s announced removal of Fannie and Freddie’s portfolio growth caps which will allow the GSEs to resume their purchases of mortgage-related securities. As such, conditions in the MBS market, which have been strained in recent weeks, improved modestly. However, OFHEO’s 30 percent capital surcharge requirement still remains a major binding constraint to portfolio growth. Although credit losses and additional provisioning thus far have largely been a reflection of a deterioration in prime mortgage credit, internal FRBNY analysis suggests that a sharper decline in the housing environment could result in large, cumulative losses from Fannie and Freddie’s subprime and Alt-A exposures.
For additional information, please see the following report by Warren Hrung, Michael Holscher, Eric Stein and Wendy Wong:

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