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Housing Bubble Bloodbath

By Mike Whitney

“The crash of the housing bubble will not be pretty. Millions of people stand to lose their homes and life savings. However, it was inevitable. The bubble created a fantasy world that could not continue. At the peak of the bubble, 160,000 people a week were buying a home, most at bubble inflated prices. The longer the bubble persists, the larger the group of people who paid way too much for their home. While it is not good that so many dreams had to be ruined, the number will be even larger if the bubble deflates slowly. So I make no apologies about hoping for the hasty demise of the bubble.” **Dean Baker, “Slow Motion Train Wreck” The American Prospect, Aug 2, 2006**

“No question about it, the housing downturn is here now, and it’s big.” **Jim Hamilton “New Home Sales continue to Fall”, Econbrowser Aug 25, 2006**

01/13/06 "Information Clearing House" -- - I wonder if Alan Greenspan takes a copy of the business page along with him on the chair-lift at the Aspen, so he can read about the plummeting housing market before swooshing down the well-groomed bunny-slopes at his favorite ski resort. After all, no one played a larger role in inflating (what the “Economist” called) the “biggest equity bubble in history” than the retired Fed-master. His low interest-rate bonanza triggered a stampede of speculation in the real estate market sending prices through the stratosphere and setting the stage for the biggest economic bust in American history.

The whole catastrophe was cooked up Sir Alan and his coterie of brandy-drooling

elites at the Federal Reserve.

Thanks, guys.

Greenspan has undoubtedly taken note of the sudden spike in foreclosures which have set off alarm bells from Wall Street to the American heartland. The effects of his “cheap money” policies are finally sending tremors through America’s fragile economic landscape. In September, 2006 the US Foreclosure Market Report released a statement that over 112,000 homes had entered some stage of foreclosure “a 63% increase from September 2005!?! September was the second straight month in which more than 110,000 new foreclosure filings were reported nationwide, evidence that the spike in August was not just a one-month anomaly.”

No, it is not a “one-month anomaly” and it is bound to get considerably worse as \$1 trillion of ARMs (Adjustable Rate Mortgages) reset in 2007. The rising foreclosure numbers are the result of rising monthly payments on the new-fangled loans which have low introductory interest rates, but can unexpectedly double after a two or three year period.

Imagine mortgage payments that suddenly jump from \$1,300 per month to more than \$2,000 on a \$129,000 house. That’s what many people will be facing in 2007 when their loans reset and they are suddenly forced out of their homes and onto the streets.

The housing bubble is actually an extension of the stock market bubble; Greenspan’s earlier swindle which cost American investors \$7 trillion in retirement and life-savings. Both equity balloons can be attributed to the shabby and exploitative monetary policies of the Federal Reserve. By expanding credit and money supply via low interest rates, the Fed has kept the economy whirring along creating the impression of prosperity when it’s all just smoke and mirrors. America’s opulence is built on a mountain of debt that’s piled a mile high. Regrettably, that mountain is about to cascade-down on the American people sometime in 2007-2008. There’ll be no escaping the fallout from the \$4.5 trillion dollars of new mortgage debt that’s built up in the last 7 years. By the end of 2007 we should be able to identify many of the painful trends that accompany a deep recession; prices of homes will steeply decline, GDP will fall, and Greenspan’s mighty Temple of Debt will crash to earth.

Don’t believe me?

The New York Times reported last week that “about 2.2 million borrowers that took out sub-prime loans from 1998 to 2006 are likely to lose their homes”. That translates into about 10 million people! But that, of course, is just the beginning of the bloodbath. The real fun begins when the whole, ugly ball-o-corruption starts to

unwind and we get an insider's-view of a system that is rotten to the marrow. The housing industry is saturated with fraud; the banks, the mortgage lenders, the Fed and the homeowners themselves have all played a major role in this sordid confidence game.

Consider this, for example:

In 2006 the Mortgage Brokers Association for Responsible Lending (MBARL) said that "Liar's Loans" (those based on what you TELL the bank you are earning, rather than what you are REALLY earning) "shot up to an estimated 62% of mortgage originations... A recent sampling of 100 stated income loans by an auditing firm in Virginia (based on IRS records) found that 90% of the income statements were exaggerated by 5% or more, WHILE ALMOST 60% OF THE STATED AMOUNTS WERE EXAGGERATED BY MORE THAN 50%"!?! (Dan Dorfman New York Sun)

Are you kidding me? A majority of loan applicants are grossly exaggerating their income and the banks are handing out hundreds of thousands of dollars WITHOUT EVEN CROSS-CHECKING IRS STATEMENTS?

It's mind-boggling!

The question is, how many of these "liars" will be unable to meet their mortgage obligations when the bill comes due in 2007-2008? And, how will their (myriad) defaults affect housing prices for everyone else?

Another indication of hanky-panky appeared in the back-pages of the New York Times last week under the appropriate title "A Phantom Rebound in the Housing Market" by Daniel Gross. The article points out that while the Commerce Dept was celebrating the latest rise in new home sales (in Nov) the reality was quite different. In fact, the government is overstating sales "by up to 20%". The Commerce Dept failed to subtract the thousands of people who signed contracts but "simply walked away from their deposits when they realized they couldn't flip the houses for a quick profit."

Ooops! So the government is falsifying the figures to make things look better than they really are?

You bet. And, most of the high-end home builders like Toll Bros are reporting cancellations in the neighborhood of 37%!

The Times adds that, "Mr. Zandi of Economy.com estimates that the differential is even greater. 'Given the rise in cancellation rates, it suggests that between 150,000 and 200,000 home sales are being counted that actually did not occur.'"

“Did not occur”! So, the government is beefing up their stats with an extra 200,000 homes a month!?!

Gadzooks!

Okay, so the homeowners are lying on their loans, and the government is lying about the sales (and inventory) figures; is that it?

No. In an earlier article (The Fed’s role in the Housing Crash of ’07) we already covered how the banks are loaning out as much money as possible through all kinds of “untested” Mickey Mouse mortgages so that unqualified borrowers can get-on-board the housing gold rush. These are the ARMs; the “no-down payment, “interest-only” loans which Business Week magazine called “the riskiest and most complicated home loan product ever created”. Many of these ARMs are timed to explode sometime in the next 2 years and the aftershocks from the defaults are expected to be felt throughout the economy.

Of course, the banks never would have exposed themselves to such extraordinary risk if they weren’t able to bundle-up these dubious loans and ship them off to Wall Street. Fund managers have been more than eager to take this “collateralized debt” and use it in the booming hedge fund industry. No one really knows what will happen to the stock market when foreclosures begin to skyrocket and the banks and hedge funds are unable to recoup their losses. But a major “correction” (meltdown) is certainly not out of the question.

Once again, all of these problems originated at the Federal Reserve where interest rate manipulation and the loosey-goosey approach to money supply have created the potential for an economic firestorm.

Bubble, bubble; toil and trouble

So, what can we expect when interest rates tighten up and the market begins to slump.

Well, first off, according to the Wall Street Journal, lenders will get “more cautious in initiating new loans and have been setting aside more reserves for potential loan losses.” The banks are battening down the hatches and preparing for the worst. This just confirms that the real hurricane hasn’t even touched down yet and that America’s over-leveraged consumers should try to straighten out their financial affairs as swiftly as possible. (Get out of debt, pronto!)

A USB study indicates that a “high percentage of borrowers with delinquent, defaulted and foreclosed loans have second mortgages. These borrowers are so overburdened by the added debt that **THEY HAVE TROUBLE MAKING THE PAYMENTS ON THEIR FIRST MORTGAGES.** This is an ominous development

since 34% of all mortgages in 2006 were second mortgages.”

In other words, it's not simply people in the sub-prime market who are feeling the pinch. Millions of Americans either have loans that will reset at significantly higher monthly rates (which they won't be able to pay) or they are completely maxxed-out financially after draining every last farthing out of their home equity. In fact, falling prices have decreased the amount of money that homeowners are able to take out of their home equity. (Equity withdrawals decreased by 70% in the last year alone!) That means that there is \$525 billion less fueling the overall economy (GDP). As housing prices steadily decline, we can expect that America's growth will shrink accordingly.

The American consumer is hobbled by debt and has no way to increase his revenue as long as wages remain stagnant. Additionally, US households are now showing negative savings. (minus .2%) When the home equity “punch bowl” dries up, it'll be hard times for the average over-leveraged American consumer. He'll have nothing left for his buying sprees but the plastic in his wallet. (Credit card debt is soaring)

It'll be tough on the banks and Wall Street, too. After all, over 50% of all mortgages since 2003 have been these shaky, non-conventional loans which have ignored the standard criteria for loaning money (20% down payment, fixed interest rate, sufficient collateral and earnings) Now they'll have to “pay the piper” and accept the dismal aftereffects of their profligate lending.

The banks should have spotted this disaster a mile away. Instead, they decided to improvise on mortgages so they could keep the money flowing and maximize profits. Now, there's not a life boat big enough on Planet Earth to bail us out.

Glub, glub.

Once again, we need to remind ourselves that the housing boom was not created by market forces, but by cheap money pumped into the system (via the “creative financing” rip-off) by our friends at the Federal Reserve. They are responsible for this whole bloody boondoggle.

When the Fed cut short-term interest rates from 6.5% to 1% in 2001, they knew that they were simply leaping from one equity-bubble to another. In the next 5 years, total mortgage debt increased by a whopping 82% and total real estate value nearly doubled to \$21 trillion dollars.

These are huge numbers and, of course, the Fed knew exactly where the money was going, just as they knew what the outcome would be in the long term. The effects of low interest rates and increases to the money supply are like the

immutable laws of science. In this case, they act like gravity pulling the whole battered US economy into a bottomless black hole. It was entirely predictable.

So, what happens now?

What can we expect from the architects of this colossal rip-off in the next year or two?

Well, the Fed, the US Treasury and the Bush administration--the real axis of evil--would like to forestall the inevitable recession-depression until they carry out their forthcoming attack on Iran. That's why Bush is sending another carrier group to the Gulf as well as a squadron of F-16s to Turkey. (It also explains why the US forces seized 5 Iranian hostages in Irbil, Iraq yesterday) The US is clamping down on transactions with Iran's main banks ("unilateral sanctions") and has coerced the Saudis into "discounting their top-line sweet crude by \$1.75 to US customers" (Jim Willie "Golden Jackass.com") to put additional pressure on Iranian oil exports. As Willie says, "This is the real story behind the falling (Gas) prices, not the silly (East Coast) weather".

Uncle Sam is gearing up for another Middle East dust-up in Iran and the lower gas prices are (temporarily) averting a US recession.

The longer term prospects, however, are not so rosy. The "sunny Jim" reports in the media about a "soft landing" will have no effect on the impending housing collapse or on America's downward economic spiral; the numbers are simply too enormous. By spring 2007, the Fed will have to lower rates to stop the hemorrhaging and to avoid a full-blown depression. When that happens, the last wobbly bit of scaffolding that's propping up the greenback will be kicked-out and the dollar will slip into oblivion.

As long as the Fed keeps rates fixed, the pressure on housing will continue to intensify; pushing prices lower and inventories higher. GDP and home equity will continue to shrivel.

It's all bleak, bleak, bleak.

I'll leave you with a final comment from Michael Hudson's "The New Road to Serfdom: an Illustrated Guide to the Coming Real Estate Collapse" (Harpers May 2006) Hudson, who may well be the foremost authority on the housing bubble says:

"Although home ownership may be a wise choice for many people, this particular real estate bubble has been carefully engineered to lure homebuyers into circumstances detrimental to their own best interests. The bait is easy money. The trap is a modern equivalent to peonage; a lifetime spent working to pay off debt on an asset of rapidly dwindling value. Most everyone involved in the real estate

bubble thus far has made at least a few dollars. But that is about to change. The bubble will burst, and when it does, the people who thought they'd be living the easy life of a landlord will soon find that what they really signed up for was the hard servitude of debt serfdom... America holds record mortgage debt in a declining housing market. Even that might first seem okay—we can just weather the storm in our nice new houses. And in fact things will be okay for homeowners who bought long ago and have seen the price of their homes double and then double again. But for more recent homeowners, who bought at the top and now face decades of payments on houses that soon will be worth less than they paid for them, serious trouble is brewing. And they are not an insignificant bunch. The problem for recent homeowners is not just that prices are falling; it's that prices are falling even as the buyer's total mortgage remains the same or even increases. Eventually, the price of the house will fall below what the homeowners owe, a state that economists call negative equity. They can't sell—the declining market price won't cover what they owe the bank—but they still have to make those (often growing) monthly payments. Their only “choice” is to cut back spending in other areas or lose the house—and everything they paid for in it—in foreclosure. Free markets are based on choice. But more and more homeowners are discovering that what they got for their money is fewer and fewer choices. A real estate boom that began with the promise of “economic freedom” will almost certainly end with a growing number of workers locked into a lifetime of debt servitude that absorbs every spare penny.”

It can't be stated more succinctly than that.

Thanks, Michael Hudson, for your insightful analysis, but it may be too late.

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