

# The Final Demise of A Speculative Housing Bubble

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(September 16, 2009)

*The speculative mania in housing has been extended by massive Federal Reserve and government intervention; the government now owns or guarantees 2/3 of U.S. mortgages.*

**While speculative bubbles may pop in terms of sales and valuations, the psychology that underpinned the mania lives on for some time--especially if government extends the speculation with massive interventions.**

**I sincerely doubt the average American understands the full measure of Federal intervention to prop up the U.S. housing market.** The numbers casually dropped (with little context, of course--this is pure MSM "coverage," after all) in the *Wall Street Journal* report [No Easy Exit for Government as Housing Market's Savior](#) (WSJ.com) are truly mind-boggling:

*To keep funds flowing to the housing market, the government bailed out Fannie Mae and Freddie Mac last year and now effectively owns the mortgage finance giants and their combined \$5.4 trillion in loan portfolios. To keep mortgage rates low, the Federal Reserve is on track to purchase nearly \$1.5 trillion in debt issued or guaranteed by the government's various mortgage arms and another \$300 billion in Treasuries, which set the benchmark for home lending.*

**What the reporters fail to mention is the value of all U.S. mortgages is about \$10 trillion-- meaning the U.S. government now guarantees over half of all mortgages just with Fannie and Freddie.**

But wait--it gets worse--much worse:

*Since the beginning of the year, the Fed has purchased \$836 billion of mortgage backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae, the federal body that securitizes FHA loans. The purchases have helped push down interest rates on mortgages guaranteed by the firms from nearly 6.5% last October to 5.25% today, according to HSH Associates, which tracks the mortgage market.*

*The Fed is likely to decide to carry on buying until it reaches the \$1.25 trillion target it set in March, and then taper off gradually.*

**So the Fed is buying \$1.2 trillion in toxic, doomed mortgages, fully 12% of the entire mortgage market of the U.S., just this year alone.** And why would the Fed print all that nice new money and exchange it for toxic mortgages worth a mere fraction of their original value? **To clear the sludge off Fannie and Freddie and Ginnie's books, so they can underwrite trillions more in questionable mortgages.**

This is an astonishing level of government intervention to prop up a housing market which remains highly speculative.

But the Fed and the Federal government are not just buying up stupendous amounts of toxic mortgages with taxpayer funds (or freshly printed money): the government is also guaranteeing **fully 80% of all new mortgages via FHA.**

*Teri Gifford, who runs a mortgage brokerage serving Kentucky and Ohio, says 95% of her business involves getting clients loans backed by the FHA.*

According to my esteemed colleague Karl Denninger of the [Market Ticker](#), "The FHA portfolio has doubled over the last two years, with 2.6 million loans added (of a total of 5.18 million.)"

For context: there are about 50 million outstanding mortgages in the U.S., of which about 4 million have been foreclosed or are in foreclosure. **This means that Fannie and Freddie "own" some 25 million mortgages (50%) and FHA "owns" 5 million (an additional 10%).** Add in VA (Veterans Administration-backed mortgages) and Ginnie Mae-backed mortgages, and it turns out the **Federal Government owns or guarantees two-thirds of all the mortgages in America.**

Uh, remind me again what "capitalism" and "free markets" stand for, as it seems the nation has completely forgotten the terms' meaning.

**Simply put: "socialism" is bad except when it guarantees my mortgage and let's me buy a house for 3.5% down, and also gives me \$8,000 in "free money" to use for the down.** Golly gee, it turns out socialism isn't half bad... I only feel sorry for the poor dumb suckers who are foolishly saving up actual hard-earned cash to accumulate a 20% down payment.

But since those engaging in "free market capitalism" in the private banking sector are only 5% of home mortgages, I guess we can just write them off as outliers.

**All this "government backing speculative housing" is real nice except for the fact all the money is borrowed or created out of thin air.** Our "leadership" seems to believe that you can prop up a \$10 trillion dollar housing market with \$7 trillion in "free money" with no consequences.

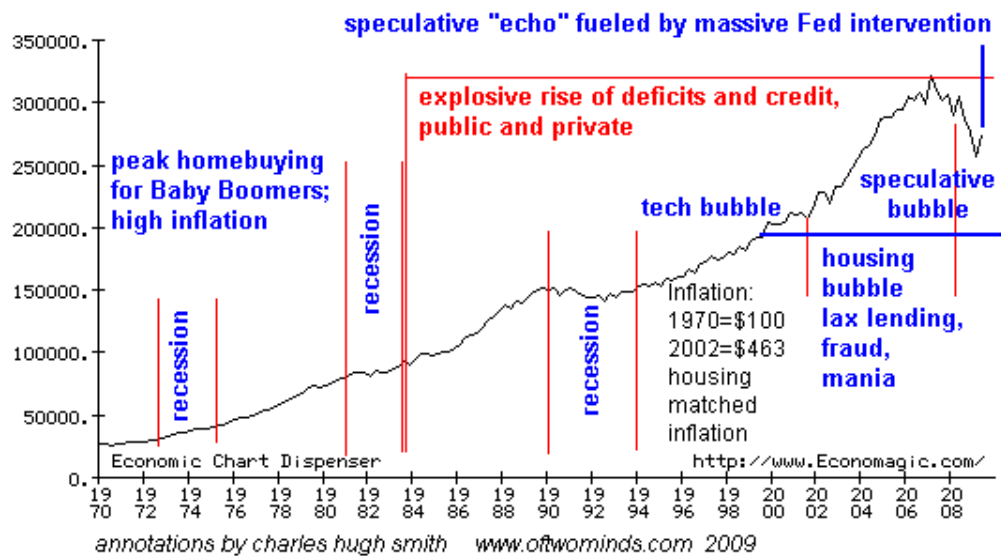
Perhaps there are already consequences which are as yet beyond the control of the Fed. According to the sources listed by Mr. Denninger, total delinquencies and foreclosures in the FHA loan portfolio have reached 21.43%--so one in five of all the FHA loans the government is guaranteeing to stem the housing bust have already soured.

This destruction of housing equity is playing havoc with consumers' ability to spend freely:

Mortgage problems are walloping Americans' credit scores (LA Times)

Let's look at a chart of housing prices 1970 to 2009 to get an understanding of the speculative bubble which is being propped up by the government:

### US: Average Price of Houses 1970-2009



First, note that up until the housing bubble lift-off in 2002, housing more or less tracked inflation. According to the BLS (which typically understates inflation), inflation jacked prices up almost 5-fold from 1970 to 2002 (\$100 in 1970 = \$463 in 2002).

If the speculative bubble in housing credit and fraud hadn't been enabled by lax regulation and lax lending standards, fraudulent credit ratings, etc. etc. (please read this heavily sourced entry for full details: [Subprime mortgage crisis](#) Wikipedia) or if Federal intervention hadn't propped the market up, then housing values would be around their 1998-2000 levels.

Instead of falling to what might be considered "healthy" or "normative" values, this extraordinary manipulation via a flood of low-cost liquidity and the purchasing of highly toxic mortgages from government-mortgage entities has extended the speculative mania which created enormous imbalances in the U.S. economy.

As I have noted before, speculative bubbles typically have an "echo bubble" spike. Thus the Nasdaq Tech market fell from 5,000 to 3,000 in 2000, but then recovered to 4,000 briefly before its final descent to 1,000.

But how much of a speculative fever would still be present if the Federal government and Fed weren't dumping trillions of dollars into the housing market to keep the speculative bubble alive at literally any price?

Now is a good time to review the context of the housing market and its precarious state. Here are a few of the facts which I have sourced elsewhere in the past, and which you can source via the dozens of links in the above Wikipedia article.

**\$5 trillion was extracted from home equity during the bubble.** That propped up the "consumer spending" on which the world depends. That's gone.

**Consumer debt is \$14.5 trillion, or 134% of disposable personal income.** Much of which, it should be noted, is devoted to debt service. Translation: consumer is tapped out.

**9.6% of mortgages in the U.S. are in default.** 50 million mortgages = 5 million in default.

**Home equity has fallen from \$13 trillion in 2006 to \$8 trillion today.** Home equity is now less than mortgage debt, and highly vulnerable to further reductions in valuation. Mortgages + equity = \$18 trillion. A further 20% decline in home prices would be \$-3.6 trillion, dropping home equity of the entire nation to less than \$5 trillion.

**About 25 million homes are owned free and clear.** That remains the one bit of light in this darkening picture. Not everyone mortgaged their home to the hilt and

squandered the proceeds.

**40% of the home sales in 2005-6 were openly speculative.** Add in fraud, lies and half-truths (Uh sure, I'm gonna live here as my primary residence, heh), and you get 50% of all sales in the bubble years were entirely speculative.

**There are some 18 million empty dwellings in the U.S. right now.** Maybe 4 million qualify as true "second homes" for the upper classes; the rest are, well, just empty.

**Fannie and Freddie floated \$5.4 trillion in mortgages off of assets of \$114 billion.** So leverage of 50-to-1 is just normal business practice now. Or could that have had something to do with their demise?

**Guess what FHA's leverage is: 50-to-1.** Yes, FHA's "reserve" is 2% of its portfolio--and losses are driving that toward zero.

**U.S. households have lost \$5 trillion in home equity, \$2 trillion in retirement accounts and \$8 trillion in the stock market.** Depending on how you add it all up, that comes to a loss of about a third of all household wealth in the past few years.

**Do ya reckon that's good news for a consumer economy?** No wonder the Fed and the Federal government are so desperate to prop up the deflating speculative bubble of the U.S. housing market. A 30% decline in home values--more or less a return to pre-bubble prices in many markets--would mean **total home equity of the U.S.A. would be effectively zero.**

But when you borrow and leverage to the hilt, then that's what happens when asset prices fall from speculative bubble heights: equity falls to zero or negative equity.

Can the Federal government print enough money to buy the entire U.S. mortgage market? I suppose it can; but to believe it can do so without any consequences--that's another story.

<http://www.oftwominds.com/blogsept09/speculative-housing09-09.html>