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Economics

United States, Britain: Housing Bubbles Doomed

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The U.S. housing bubble is showing notable signs of stress. The housing market has been propped up by several years of super-low interest rates, but since interest rates began to rise in April, households have made a significant retrenchment in financing and refinancing of home purchases. Such a retrenchment normally is the first phase of a serious housing bubble crash.

Simultaneously, the housing bubble in Great Britain—built upon the same leverage—is every bit as dangerously overblown and virulent as that in the United States, proportionate to that nation's population. Bank of England Governor Mervyn King, on June 14, labeled home prices in Britain as "well above what most people would regard as sustainable in the longer term." His remarks shook the British financial markets (see coverage on page 68).

The double housing bubbles in the United States and Britain represent one of the most infamously vulnerable sections of the bankrupt world financial system: They are built on piles of leverage; they intersect the world's hundreds-of-trillions-dollar derivatives market; and they are an instrument, whereby consumers refinance their overpriced homes for cash borrowing for consumer spending, which they have no reasonable means to pay back.

It is lawful that the housing bubbles exist in the United States and Great Britain of pro-Iraq war synarchist allies Dick Cheney and Tony Blair. The oligarchical financiers who run the synarchist crowd, used the Iraq War as the lever to put into operation a pre-emptive nuclear war policy, whose intent is to impose upon a blackmailed world a new imperial order based on their rule. Now the paired housing bubbles of these two countries, because of rising interest rates, are threatening to burst, which would detonate the decayed world financial system, and bring down Cheney and Blair.

End of Greenspan's Low Interest Rates

On June 17, the Bureau of Labor Statistics of the U.S. Department of Labor released the Producer Price Index, showing an 0.8% increase for the month. A rising price index portends portends rising interest rates, which would fracture the protective wall that Federal Reserve Board chairman Alan Greenspan had erected around the housing bubble.

The U.S. housing bubble has relied on extremely low interest rates, plentiful mortgage credit—a condition engineered by Fed chairman Greenspan's manipulation of the U.S. financial markets—and the ability of mortgage lenders who make mortgage loans to sell off the mortgages they have made to Fannie Mae and Freddie Mac, and receive cash from Fannie and Freddie with which they can make more new mortgage loans, repeatedly.

In May of 2000, inside the United States, the interest rate on a 30-year conventional, fixed-rate home mortgage was 8.52%. By the end of 2000, the 30-year mortgage rate still hovered around 8.00%. Greenspan, working with the secondary housing agencies Fannie Mae and Freddie Mac, had built a swelling housing bubble since the mid-1980s. But in order to hold up the speculative world financial system, Greenspan had to "print a wall of money" and lower interest rates. However, this gave him the exceptional opportunity to push the housing bubble into a frenzied mode, which would become the overriding financial-economic prop preventing the U.S. economy from collapsing over the next four years. This raised the *average price* of a new home in America to one-quarter of a million dollars in the first quarter of 2004.

In late 2000, Greenspan started cutting the Federal funds rate, the rate at which banks trade overnight money among themselves, and which the Federal Reserve controls through injecting or withdrawing funds from the banking system. The Federal funds rate functions as a floor under all U.S. interest rates. Starting November 2000, when the Federal funds rate stood at 6.50%, Greenspan instituted a series of 11 rate cuts, which brought the rate down to 1.25% in November, 2002. Then, for good measure, he lowered the Federal funds rate to 1.00% in July, 2003, its lowest level in 45 years. The 30 year fixed-rate mortgage interest rate accordingly plunged to 5.23% by June, 2003.

However, the unavoidable consequence of Greenspan's wild printing of money, was the initiation of a Weimar-style hyperinflationary process, a process whose principles are explained by Lyndon LaRouche's Triple Curve collapse function (see *Economics: At the End of A Delusion,* LaRouche in 2004, April 2002). For years, the Bureau of Labor Statistics has lied about the inflation rate, but in May, even though the BLS considerably massaged the numbers downward, it could not obscure the immensity of the underlying inflationary process. Keep in mind that the real inflation rate is far higher than the BLS was forced to admit. The BLS reported that the Producer Price Index rose 0.8% in May. The PPI represents the wholesale price at which businesses sell goods to one another. The PPI rose 5% in the 12 months that ended May 31, the fastest such rise since December, 1990. Were the PPI rate of May annualized, then it would constitute a 9.6% inflation rate.

Food and energy prices rose, respectively, by 1.6% and 1.5% in May, which are annual rates of 19.2% and 18%. This led the PPI upwards.

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The bankers around Greenspan have been quick to attempt to dismiss the May producer price increases, alleging that this represents only a one-month spike. But while energy and food producer prices continue to soar, they are far from the only goods registering major price increases on the producer level. The June 14 *Washington Post* conducted a survey of construction producer prices in the Washington DC/Maryland/Northern Virginia area, over the past 6-12 months. For some goods, it reported the 6 month inflation rate: wire mesh, up 53%; drywall, up 25%; metal studs, up 150%; for other items, it reported the one year inflation rate: steel, up 21%; cement, up 10%, plywood, up 167%. These numbers had not been massaged by the BLS, and represent more clearly what is happening with price inflation.

These prices on the producer level eventually will be passed onto consumers, and show up in the Consumer Price Index, which rose by 0.6% in May.

With producer price inflation raging, Fed chairman Greenspan will undoubtedly raise interest rates at the upcoming Federal Open Market Committee meeting June 29-30, where such matters are considered. A Federal funds rate increase of 0.25% by Greenspan had been anticipated. However, Dana Saporta of Stone and McCarthy Research Associates, told the June 18 *Washington Post* that Greenspan may have to increase interest rates an additional half a percentage point at the next scheduled FOMC meeting in August, for a combined 0.75% increase over two and one-half months.

Already, the interest rate on a 30-year U.S. mortgage is hovering at 6.30%, up a full percentage point from its 5.23% level of June of last year. Part of this increase was in anticipation that Greenspan would raise rates. But were Greenspan to make increases as sharp as 0.75% this Summer, then 30-year mortgage rates could fly up to 7% or above. 7% is considered to be the threshold for danger. This would rupture the Greenspan low-interest regime that systematically fostered the housing bubble.

Financing Cut Back

Consider the astounding fall in U.S. home financing, just on the basis of the already-recorded increase in mortgage interest rates, *even before Greenspan takes the step of officially raising interest rates, which will send all rates higher.*

The Mortgage Bankers Association (MBA) reports that for the week ending June 11, its measure of mortgage financing—the Market Composite Index of home financing—stood at a level of 601, a stunning 65.2% fall from its peak level in June, 2003. Further, for the week ending June 11, the MBA's Refinancing Index stood at a level of 1479, an 85.1% plunge from the level of its peak in June, 2003.

Although the June, 2003 levels constitute recent peaks for home financing and refinancing, the unmistakable trend is for households to bail out of home financing. But without home financings, the volume of homes that can be sold will be greatly reduced. Without home refinancings, households cannot borrow against the inflated value of their homes, and use some of the extracted cash to pay off other debts and buy consumer goods. This has been a mainstay of consumer spending. The absurd volume of home financing and refinancing represents a massive danger currently; but remove them, and the plug is pulled on the U.S. economy.

A Decline in Home Prices?

On June 1, the Office of Federal Housing Enterprise Oversight (OFHEO) issued its quarterly Home Price Index report, which tracks its indices of home prices for the nation, all states, and major cities. The report had some news of home price increases.

Embedded within the OFHEO report, is some so-called "good news," but also some ominous news. For the United States as a whole, the average home price increased 7.7% between the first quarter of 2003 and the first quarter of 2004. OFHEO pointed out that 12 states (including California, Florida, New York, New Jersey, Massachusetts, Virginia, and Maryland), plus the District of Columbia experienced steep home price increases of approximately 50% or more during the past 5 years. So much for the alleged good news, which is, more accurately, the growth of the bubble.

But the OFHEO report also reports that, "for the first quarter of 2004, six states—Vermont, Alaska, North Dakota, South Dakota, Iowa, and Nebraska—experienced negative quarterly [home price] growth, compared with no states in the fourth quarter of 2003." This is only for one quarter, and these are not the hottest states for real estate; nonetheless, this may represent a first significant chink in the armor of the housing market. It could spread to other states.

Combine falling home prices with rising interest rates, and reduced home financing and refinancing, and the housing bubble is toast. The consequences of that implosion, intersecting the derivatives market, will have international consequences. The value of U.S. housing market paper outstanding is more than $13 trillion.

Britain's Bubble Problems.

Already, the Bank of England has carried out four 0.25% interest rate increases to bring its base rate up to 4.5%, and there is widespread discussion that the rate will be raised to 5% before the year is out. BOE Governor Mervyn King's June 14 statement that British home prices are not sustainable, shook up the financial markets, and in a limited way, acknowledged the problem. But while King and Greenspan make different public statements, both they and their respective central banks have indicated that they hope for a miraculous soft landing for their twin housing bubbles. That is a fantasy wish; such highly-leveraged, immense housing bubbles will experience a hard landing. Synarchists Cheney and Blair must prepare to experience their very brief last days in office.