The Affordable Mortgage Depression

Government policies were designed to increase homeownership. Affordable Mortgages, created to realize this goal, were responsible for the Housing Bubble and distorted the economy. The unwinding of these distortions will result in a Global Depression.

Obama's Stimulus Bridge To Nowhere

I was recently asked why so many state and local governments are in such dire fiscal situations.

The answer to this question is fundamental to understanding both the Housing Bubble and why Stimulus Spending never had a chance of resolving the present economic downturn.

The decade long Housing Bubble was not restricted to homebuilders, mortgage brokers, real estate speculators and investment bankers. The phenomenon was an economy-wide economic distortion.

Consumer spending, which accounts for 70% of economic activity, increased dramatically driven by:

- Leveraged housing equity gains
- The wealth effect of rapidly rising asset prices
- The ability to monetize and spend paper equity gains
- Unemployment rates as low as 3.8% in 2000 and 4.4% in 2006 and 2007
- A steadily declining national savings rate which briefly turned negative
- The rapid increase in housing and consumer debt
- A rising stock market which both benefited from and contributed to the factors above

Economic activity was above Keynesian Full Employment Equilibrium for the better part of a decade due to the dynamic impact of debt-driven, unsustainable, housing price appreciation.

State and local governments benefited directly from this economy-wide bubble as tax revenues soared.

- Rising property values increased property taxes
- Incremental employees and income contributed to higher tax receipts
- Each construction project, house sale and new business formed generated revenue for local governments

Government entities nationwide enthusiastically spent all of this extraordinary windfall. Even worse, most committed themselves to greater spending in the future under the assumption that unsustainable, leverage-driven growth would continue into perpetuity.

When the bubble collapsed so did tax revenues. Given the peculiarities of property taxes, many state governments will continue to see revenues decline for years to come.

A Historical Perspective on Depressions

The Great Depression was a liquidity crisis made worse by Government intervention. The Affordable Mortgage Depression is a crisis of solvency. Bizarrely the federal Government has responded to the downturn by increasing liquidity and massively expanding the nation's debt burden. Policy makers have again made the situation worse and longer-lived, while failing to resolve the fundamental problem of overvalued assets and excessive leverage.

The sad truth has always been that housing prices are going to return to levels supportable by market conditions and economic fundamentals. No amount of incremental Government spending or debt can prevent this market imperative from happening eventually. Excessive leverage will be rationalized and the process is going to be painful.

Stimulus Supporters Don't Understand the Downturn, Fail to Appreciate that it is Far from Over and Have Ignored What Will Happen After Unsustainable Spending Expires

Anyone who argues that Stimulus Spending or a Keynesian response to the downturn has worked lacks perspective. The crisis is far from over, so how may a determination of efficacy yet be made? At minimum, the full implications of the strategy have yet to become known. Trillions in new deficits still need to be serviced and repaid. The effect of a growing debt burden must be factored into any analysis of the policy's effectiveness.

We do know that unemployment hasn't improved and is roughly 3% above levels purported to justify the ongoing massive budget deficit.

Why a Keynesian Response Was Never Going to Work

The economy, driven by an asset and debt bubble, was operating well above Full Employment Equilibrium for the better part of a decade. The ensuing crash did not push the economy below its sustainable productive capacity, nor has it yet to return housing prices to pre-bubble levels.

Deficit spending has maintained GDP at an unsupportable level at a cost of trillions of dollars in debt. Keynesian stimulus is supposed to be a temporary bridge during which the economy reabsorbs slack capacity. The Government's stimulus is a bridge to nowhere which has delayed necessary adjustments consistent with less-levered economic activity. Even as robust, deficit-driven GDP figures have obscured reality, undistorted economic fundamentals have continued to erode.

The economy careens off the end of "the stimulus bridge to nowhere" later this year.

Delaying the Inevitable

The Stimulus Bill allocated vast sums of money to prop up bloated state and local governments. Necessary employment cuts, which should have been made in 2008 and 2009, have been delayed for two years at extraordinary expense.

When the money runs out those cuts will occur nationally in large numbers. Not only has the Stimulus Bill not delivered on promised employment claims, it has delayed a needed resolution to structural economic problems.

Fading stimulus spending, state and local government layoffs and a reversal in Census hiring will result in higher unemployment, likely overwhelming any private sector, fundamental recover. Bleak unemployment trends, a downturn in GDP, combined with the plodding cause of the crisis, falling housing prices, will illustrate in short-order to even the most obtuse that there was never an economic recovery; only the narrative of one created at a cost of trillions in wasted dollars, all to no productive end.

A more detailed analysis "Why Keynes Is Irrelevant"

An excerpt from The Affordable Mortgage Depression Manifesto: The Case for a Depression (October 2008) responding to an argument that the larger relative size of government today will be economically beneficial relative to that which existed during The Great Depression.

"The relative size of the federal, state and local governments compared to the 1930s is perceived to be a steadying force on the economy. In 1929 the federal government constituted 3% of GDP compared to approximately 20% today.

On the surface this argument makes sense until one considers that each government entity will be negatively impacted by declining real estate values, a decline in real estate transactions, declining consumer spending, declining business activity, declining tax receipts and rising unemployment. Many state and local government entities will be required to cut back spending precipitously. We have already begun to see states and municipalities run into budget or financing difficulties.

...

How much money the federal government will be able to borrow and spend is a matter of debate. In order to provide incremental stimulus to the economy, the federal government must first overcome the numerous state and local spending cutbacks. Even if the federal government could meaningfully impact the economy with stimulus projects, I note that similar projects during the 1930s had no meaningful impact on extricating the economy from the Great Depression."

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