Some necessary after thoughts about a bubble that was not

A real estate bubble continues to be the consensus reason for the financial crisis the US recently endured and which was later exported to other countries via globalized financial markets. Was there a bubble to justify an incoming depression supposedly comparable only to that one of 1929? Definitely not. If that was the case, how could the US and the world enter into such a panic that made it fall into a short term recession until the picture got clearer? The role of authorities and leading private counterparts was essential and sad to say, they failed miserably. They should have known better that if they insisted, even without base, that the worse was to come, then the risks of having a self induced poor outcome would come into reality. Let us just thank the Federal Reserve and later followers for they did indeed fought a perilous and extreme ensuing illiquidity with whatever means they had. Had it not been that case, we would be now in real trouble.

The following facts are useful and not to be easily forgotten:

1. Between January 1988 and June 2006 peak, real estate prices in the US annually grew approximately 2.4% in inflation adjusted terms[1]. On the other hand, between January 1988 and October 2007 peak, the Dow Jones Index had approximately a 7% annual growth in real terms.
2. From peak to through, US real estate prices fell around 33% in nominal terms (from June 2006 to April 2009), whereas the Dow Jones Index fell almost 54%, also in nominal terms (from around 14.000 level in October 2007 to 6.500 level in March 2009).
3. From respective peaks to present time, both real estate and Dow Jones indexes are down around 28% in nominal terms.

If anything, the bubble pointed into assets different to real estate ones – as of today, the guilty party -, even considering shorter periods between 2000 and peak months in 2006 - 2007.

Furthermore, an updated analysis into the US mortgage market raises a different picture too:

1. At the end of 2008, US mortgages amounted to a US$ 14.600 billion stock whereas at present they are close to a US$ 14.200 billion one[2].
2. Delinquency rates are today near 9.4%[3] or almost double its average rate from January 1979.
3. If we assume an economic loss of 30% over these delinquent loans, the owners of these mortgages would face a little over US$ 400 billion loss, but the unexpected portion for which no reserves would have been previously put aside might then be half of it – given a historic average close to a 5% delinquency rate in mortgages-.
4. In other words, the unexpected portion would be equivalent to 10 BP´s Deep Water fiascos, distributed along three years.

[1] See S&P / Case Shiller US National Home Price Index and CPI All Urban Consumers
[2] US Federal Reserve, Flow of Funds June 10th, 2010
[3] Mortgage Bankers Association, all mortgages (residential and commercial), non seasonally adjusted.

Are then to be found US$ trillions in mortgage related losses in the US$ 14.500 billion aggregate economy? Certainly not. What we have witnessed, however, is a huge wealth redistribution under volatile and illiquid conditions which has sometimes been wrongly confused with an aggregate loss. Some gained and some others lost but the economic cost for the economy as a whole might be essentially circumscribed to investments being done earlier than necessary.

Back then from June 2006 to mid 2008 the US economy was receiving a shock, a manageable one, where prices were adjusting. If 30% was the right figure to correct for them, and not even a lower one which was most probably the case, that was it. What is incredible is how this price correction turned during the second half of 2008 into a huge shock, panic and "bubble" related but irresponsibly baseless indeed. Under these circumstances, higher than prudent debt to equity ratios in the financial sector were only to meet an abrupt end.

In short, the bubble was no bubble at all, the mortgage loss was unashamedly exaggerated and our leading private and public authorities did a lousy job to be sure, panicking after misreading facts. When the dreaded deeds were in place, monetary expansion was the solution and expansionary fiscal measures were not.

The above description was also visible by mid 2008. By that time real estate prices had already fallen by 25% from their peak and mortgage delinquencies were getting over 6.3%. What hindsight gives us is how poorly private and public authorities took decisions, how unfit they were for the tasks ahead.

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September 10th, 2010

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