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Economic Depression in America: Housing's Double Dip

By Mike Whitney
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The housing market is now in full retreat. This week, the Commerce Department reported that sales of new homes plunged nearly 17 percent in February to a 250,000 annual pace. That's a record low. At the same time, the median price fell 8.9 percent from February of last year. The news comes on the heels of Monday's equally-dismal report that showed existing home sales dropped 9.6 percent in February. These are Depression era stats and builders know it which is why they're unloading homes as cheaply as possible. It's been 5 years since housing prices peaked in July 2006, and the market is still nowhere near the bottom. In fact, the rate of decline is accelerating. This is shaping up to be the worst spring in history.

If you want to know where the housing market is headed, keep an eye on inventory. That's the whole ball of wax. When inventory balloons, prices go down. At present, inventory is rising (8.9 month's supply) which means that prices have further to fall. But these figures don't include the vast shadow inventory that the banks are holding off-market. Many analysts think there could be another 5 to 6 years of inventory stacked up on bank's balance sheets. The Wall Street Journal's Mark Whitehouse takes an even grimmer view. He thinks the backlog could be in the vicinity of 9 years. Here's a clip from his article in the WSJ:

"Banks' vast pile of foreclosed homes doesn't appear to be diminishing. That's a troubling sign for the future of the housing market.

Back in April, this column tallied up all the foreclosed homes sitting in banks' inventory, as well as the "shadow" inventory of homes in the foreclosure process or on which owners had missed at least two mortgage payments. At the time, we reported that at the current rate of sales, it would take 103 months to unload it all.

Over the past six months, that number has actually risen. Banks managed to pare down the shadow inventory, but largely by taking possession of foreclosed homes. As of September, they owned nearly 994,000 foreclosed homes, up 21% from a year earlier. The shadow inventory stood at 5.2 million homes, down 7% from a year earlier. Grand total: 107 months of inventory.

The numbers aren't exactly comparable to the April analysis, as the providers of data have changed. The inventory data now come from RealtyTrac, the shadow inventory data from LPS Applied Analytics, and the sales data from Core Logic. But no matter how you slice it, the housing market faces almost nine years of foreclosure hangover.....

The mountain of foreclosed homes casts a long shadow." ("Number of the Week: 107

Months to Clear Banks' Housing Backlog", Mark Whitehouse, Wall Street Journal)

If this glut of homes was suddenly dumped onto the market, prices would go into freefall and the banks would be swallowed up by the red ink. That would force the Fed would to initiate another bailout. (which Bernanke definitely does not want) So the banks are releasing homes in dribs and drabs while concealing the number of non-performing loans they're holding from shareholders. It's all a giant coverup.

This is from Bloomberg:

"The number of homes in foreclosure rose to a record 2.2 million in January, according to Lender Processing Services Inc. in Jacksonville, Florida. About 23 percent of homeowners with mortgages had negative equity in the fourth quarter, meaning their home-loan balances were higher than the value of their properties, CoreLogic Inc. said in a March 8 report."

Prices are falling, home equity is drying up, foreclosures are at record highs, and the incentive to "walk away" and let the bank take the mortgage-loss has never been greater. All of the mortgage modification programs have been a total failure. The Fed purchased $1.7 trillion of garbage mortgage-backed securities (MBS) from the banks, but hasn't lifted a finger to help homeowners. All of the pain from the $8 trillion housing bubble has all been shunted onto the backs of ordinary working people.

Present policy continues the same pattern of relentless class warfare. Since Bernanke announced his bond purchasing program (QE2) in November, the Fed has bought $440 billion of US Treasuries notes from the banks. This has pushed equities up nearly 15 percent which (according to the Fed's flow of funds report) makes it look like consumers are rebounding from the deep losses they experienced during the financial crisis. But the figures are misleading. The wealthiest 5 percent of Americans control more than half of all the nation's financial assets whereas the bottom 50 percent have almost none. So the uptick in stocks doesn't improve their situation nearly as much as a boost in home values. When housing prices go up, homeowners are more apt to spend which increases economic activity and stimulates growth. The New York Fed just released a working paper last week which showed that "Between 2000 and 2007, consumer borrowing added an annual average of about $330 billion to the cash they could spend; by 2009, consumers were diverting $150 billion away from potential spending in order to reduce the debts they had built up. This represents a remarkable $480 billion reversal in cash flow in just two years." (NY Fed)

So housing prices are critical to getting the economy back on track. But in a time when all the gains in productivity are upwardly-transferred to management, workers are more dependent than ever on rising asset values in order to increase their consumption. That's why consumer spending will stay flat until housing prices go up.

Obama's unwillingness to seriously address the housing crisis has extended the period of household deleveraging and added to economic sluggishness. He needs to force the banks to negotiate cramdowns (principle reduction) and keep more people in their homes. That's Job#1. Then he needs to boost fiscal stimulus to lower unemployment and increase demand for housing. The Fed's quantitative easing (QE2) can't fix this problem. It can buoy stocks and lower long-term interest rates, but it can't create jobs, patch household balance sheets, or stabilize housing prices. This week's plunging new home sales proves that Bernanke's strategy is a flop. It's time to move on to Plan B.

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