Lecture 1

The Great Recession & Economic Geography
The Great Recession

I.  • Housing Bubble
II.  Financial Frenzy
III. Global Instability
IV. US Weakness
I. The Housing Bubble

A. Boom & Bust
B. Geography of the Boom
C. E.T., Go Home!
D. Mortgage Madness
Housing prices

Total value of assessed property in California (Scale in trillions)

'09-'10: $4.4 trillion

Source: State Board of Equalization
Los Angeles Times

S&P/Case-Shiller Index (1987-2007)

San Francisco Index (SFXR)
U.S. Composite Index (CSXIR)

© SocketSite.com
Home sales

- Peaked in 2006
The crash

Mortgage foreclosures

Home foreclosures are up sharply in California as many borrowers struggle to make higher payments on adjustable-rate mortgages.

Number of foreclosures statewide, quarterly data

- 3rd quarter 1996: 15,418
- 1st quarter 2008: 47,171
- 1st quarter 2007: 11,033

San Diego Monthly Defaults/Foreclosures

Source: foreclosureforum.com, sddt.com

Bank fire sales & low prices
I. The Housing Bubble

A. Boom & Bust
B. Geography of the Boom
C. E.T., Go Home!
D. Mortgage Madness
California: pivot of the boom & bust
Home prices in 20 metropolitan areas fell 15.9 percent in the last year. Prices plummeted 23.7 percent in the San Francisco region.

Sources: Standard & Poor’s / Case-Shiller
High-flying Bay Area

Housing Price Index as Percent of 1979 Price


The numbers say it all

- $106,000
  - The amount the median price for a single-family house jumped in the past 12 months
- $74,124
  - The typical Bay Area household's earnings
- $36,000
  - The amount the median price for a single-family house increased from February to March

Median price of existing single-family houses

Source: Standard 

From: Wenzel / Berstein
Ripe for foreclosure

And this doesn’t show Central Valley!
I. The Housing Bubble

A. Boom & Bust
B. Geography of the Boom
C. E.T., Go Home!
D. Mortgage Madness
Why was Inland California hit so hard?

- E.T. - the extra-terrestrials
  - Seeking dream home
  - Go deep in debt to buy
  - Stagnant wages
    - See part IV

- Escaping high prices
  - Rich bid up prices in city
  - Link to growing inequality
    - See lecture 18
Unaffordable housing

California Real Estate Gone Wacky

To determine the state of housing markets, economists use the ratio: House Price: Annual Income. A 6:1 ratio per county equates that the median price of a home is six times more than the median income. In average housing markets the price-to-income ratio rarely exceeds 3:1. Between 2000 and 2004, the median household income in California increased 10%. In the same period, the median price of homes increased 184%.

In 2000 only two counties in California had a price to income ratio greater than 6:1: San Francisco and Marin counties. Coastal real-estate consistently had higher ratios than inland real-estate. Nevada County was the sole inland county that had a ratio above 6:1.

Housing Affordability

To individually assess housing affordability it is helpful to have an idea of down payment and a mortgage interest rate. Banks and lenders assume that you should spend 28% of your annual or monthly income to pay the mortgage debt.

2004

After four years of home price inflation the ratio for many counties dramatically increased. In the coastal counties, ratios went from an average of 5:1 to 8:1. In 2004 some counties had homes selling at 8 times the median household income.

Ratio:

Median Home Price: Median Household Income

- no data
- 2:1
- 4:1
- 6:1
- 8:1

Source: U.S. Census Bureau, American Fact Finder, DJJnews.com, RAND California, Rima Beals

Ever fewer can afford a house in Bay Area

You’ll need to earn at least $124,000, study calculates

By Kelly Zito
Chronicle Staff Writer

The yawning gap between incomes and Bay Area housing costs is pushing home ownership out of reach for all but the older and most affluent, according to a new report.

Even though last year’s falling mortgage rates helped some Bay Area residents purchase homes, they did not increase low-income home buying, the report says.

“It’s no longer just a poor person’s problem,” said Erin Riches, senior policy analyst at the California Budget Project, a Sacramento advocacy group for low- and middle-income people. “You have more and more middle-income people who are devoting higher and higher amounts of their incomes to housing.”

The group’s 27-page report, which analyzed state and federal data on income, rents and home prices, found that, overall, paychecks in California are not keeping pace with housing costs — a theme echoed in several other recent economic studies by business and government entities.

For instance, an income of about $124,000 was needed to purchase a median-priced $560,240 home in the Bay Area in 2003. That’s $47,400 higher than the $76,600 median house-
St. Regis penthouse on sale for $70 million

James Temple, Chronicle Staff Writer
Thursday, August 28, 2008

Real estate mogul Victor MacFarlane has placed his huge St. Regis penthouse on the sales block for $70 million, a figure that would obliterate the previous record price tag for a San Francisco residence.

If there's a buyer, that is.

The asking price for the completed condo, the interior of which is still under construction, works out to $3,500 for each of the roughly 20,000 square feet. MacFarlane bought the property, originally three unfinished units on the top two floors, for about $30 million in late 2005. At the time, it was the highest total ever paid for a condo property - if you consider it a single purchase - and nearly the largest amount ever spent on a San Francisco home.
Low-end market most volatile

Low-priced homes led plunge

Home values across the San Francisco metropolitan area have plummeted 17.2 percent from a year ago and 25 percent from their peak in May 2006, according to the Standard & Poor’s/Case-Shiller index. Despite this, prices are still up nearly 75 percent from January 2000.

Low-priced homes – those priced under $513,218 – appreciated the most during the boom, but sank faster amid the bust. High-priced homes – those above $756,420 – didn’t increase as quickly, but have largely retained their value.

Standard & Poor’s / Case-Shiller index

Source: Standard & Poor’s / Case-Schiller
I. The Housing Bubble

A. The Price Bust
B. Geography of the Bust
C. E.T., Go Home!
D. •Mortgage Madness
Sub-primal scream

- Subprime mortgages
  - No income check
  - No down-payment
  - Beyond means to pay

- ARMs
  - Adjustable Rate Mortgages
  - Payments rise suddenly

- Recession feedback
  - People lose jobs, can’t pay
Mad Men

• The mortgage mongers
  • Local banks pushing mortgages

• California in the lead
  • 55% of subprimes
Why did lenders go mad?

- Secondary Mortgage market
  - Huge increase since 1980
  - Pumps in money from investors
  - Takes risk off lender
The Great Recession

I. Housing Bubble
II. Financial Frenzy
III. Global Instability
IV. US Weakness
II. Financial Frenzy

A. Capitalizing on Finance
B. After-Stocks of 2000s
C. Subprime Slime
D. Don’t Bank On It
Finance in command

FIGURE 2.1
The Rise of Financial Services and the Decline of Manufacturing


<table>
<thead>
<tr>
<th>Year</th>
<th>Manufacturing</th>
<th>Financial services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>29.3%</td>
<td>10.9%</td>
</tr>
<tr>
<td>1960</td>
<td>26.9%</td>
<td>13.6%</td>
</tr>
<tr>
<td>1970</td>
<td>23.8%</td>
<td>14.0%</td>
</tr>
<tr>
<td>1980</td>
<td>20.8%</td>
<td>15.0%</td>
</tr>
<tr>
<td>1990</td>
<td>16.3%</td>
<td>18.0%</td>
</tr>
<tr>
<td>2000</td>
<td>14.5%</td>
<td>19.7%</td>
</tr>
<tr>
<td>2003</td>
<td>12.7%</td>
<td>20.5%</td>
</tr>
<tr>
<td>2004</td>
<td>12.1%</td>
<td>20.6%</td>
</tr>
<tr>
<td>2003</td>
<td>12.0%</td>
<td>20.4%</td>
</tr>
</tbody>
</table>


Source: Ray Dalio, Bridgewater Associates.

Boom Times in Finance
The industry's portion of compensation and profits in the United States.

PAY The financial industry's share of all wages and salaries.

PROFITS The financial industry's share of all corporate profits.

Source: Moody's Economy.com

US financials as a percentage of market cap
Source: SG Equity Research
New & Exotic finance

- Rising Stock Markets
- Derivatives
- Hedge Funds
- Private Equity

- See lecture 14
II. Financial Frenzy

A. Capitalizing on Finance
B. • After-Stocks of 2000s
C. Subprime Slime
D. Don’t Bank On It
Cleaning up the last bubble
Interest Rates fall

- Fed lowers rates to keep economy from collapsing
- Mortgages get cheaper
- Housing bubble launched
Loose money moves...

An echo on the line
Global market capitalisation, $trn

Source: Thomson Datastream

FIGURE 7.1
The Internet Bubble and the Housing Bubble: A Comparison, November 2007

II. Financial Frenzy

A. Capitalizing on Finance
B. After-Stocks of 2000s
C. Subprime Slime
D. Don’t Bank On It
Housing Market Turns Sour

According to the S&P/Case-Shiller index, which uses January 2000 prices to establish a base value of 100, June prices for the San Francisco area were 159.83 percent of the base level, down from a peak of 218.37 percent, and in a 20-city index, prices in June were 167.69 percent of the base value, down from a peak of 206.52 percent.

San Francisco metro area defined as five counties:
Alameda, Contra Costa, Marin, San Francisco and San Mateo.

May '06: 218.37
July '06: 208.52

20-city composite: 167.69
San Francisco metro area: 159.83

John Blanchard / The Chronicle
Toxic debt

- Underwater mortgages
  - Foreclosures
  - Where did the slime ooze to?
- Repackaging mortgages
  - CDOs
  - Tranches
- Where’s the joker?
- Subprimes & ARMs were junk bonds of our time
  - High risk, reward & hype
Goodbye to All That

- Down go the investment banks
  - Bear Stearns
  - Lehman Bros.
  - Merrill Lynch
  - Goldman & Morgan barely survive

- Pivotal players in repackaging slime
US Treasury rescue for Fannie Mae and Freddie Mac

Treasury secretary looks at $15 billion cash injection for crisis-hit mortgage lenders

US Treasury Secretary, Hank Paulson (right)

Iain Dey and Dominic Rushe

US TREASURY secretary Hank Paulson is working on plans to inject up to $15 billion (£7.5 billion) of capital into Fannie Mae and Freddie Mac to stem the crisis at America’s biggest mortgage firms.

The two companies lost almost half their market value last week as rumours of a government bail-out swept the stock markets, hammering share prices around the world.

Together, the two stockholder-owned, government-sponsored companies own or guarantee almost half of America’s $12 trillion home-loan market and are vital to the functioning of the housing market.
II. Financial Frenzy

A. Capitalizing on Finance
B. After-Stocks of 2000s
C. Subprime Slime
D. •Don’t Bank On It
Taking It To the Bank

- Banks stuck with bad paper
- Off-loaded junk came back to haunt
- SIVs and other brilliant ideas
Subprime, CDO Bank Losses May Exceed $265 Billion (Update5)
By Jody Shenn and David Mildenberg

Jan. 31 (Bloomberg) -- Losses from securities linked to subprime mortgages may exceed $265 billion as regional U.S. banks, credit unions and overseas financial institutions write down the value of their holdings, according to Standard & Poor's.

S&P cut or put on review yesterday the ratings on $534 billion of bonds and collateralized debt obligations, many of which were rated as high as AAA. The action was the broadest by the New York-based firm in response to rising delinquencies among borrowers with poor credit. Moody's Investors Service and Fitch Ratings today said that they're also toughening assessments of the securities as home prices fall and the economy weakens.

While banks and securities firms such as Citigroup Inc. and Merrill Lynch & Co. accounted for most of the $90 billion in writedowns to date, S&P said the next wave may descend on regional U.S. banks, Asian banks and some large European banks. The ratings actions may create a "ripple impact" that further reduces debt prices, S&P said.

Yesterday, Washington Mutual, the nation's largest thrift, reported another loss; this time $3.3 billion, or $6.58 a share and more than three times the firm's Q1 loss. On the other coast, Wachovia, the nation's fourth largest bank by total deposits, posted a second quarter loss of $8.9 billion and slashed its dividend from 37.5 cents to a measly 5 cents per share. Like WaMu, which recently eliminated over 3000 jobs related to its tanking mortgage business, Wachovia announced plans to cut 6500 jobs in its ailing home loan division and cancel over 4000 open positions.
Too Fast & Furious

California leads the way down…. 

Countrywide

IndyMac

WaMu (CA S&Ls)

Wachovia (World Savings)
Stocks dive

- $27 trillion lost worldwide
- Panic of 2008
- Into the Great Recession
The Great Recession

I. Housing Bubble
II. Financial Frenzy
III. Global Instability
IV. US Weakness
III. Global Instability

A. The Turning Point
B. 1980s
C. 1990s
D. 2000s
Postwar ‘golden age’ (1945-1970)

- US profits & investment high
  - US exports capital
  - Small downturns
    - Late 1940s, late 1950s

- Europe & Japan in ruins after WW2
  - German & Japanese miracles
Global glut

- US + Japan & Germany
  - Global trade glut by mid-1960s
  - Profit falls in US > 1965

- *Oil was not the cause of crisis*
  - Price spike of 1973
  - War, Arab boycott, & OPEC
  - 1% reduction in GDP
1970s

• US devalues dollar
  • Nixon 1971

• US staggers through decade
  • Inflation
  • Weaker growth

• Japan & Germany revive smartly
Long slowdown

• **Turning point of 1970**
  • End of Golden Age, start of Neoliberal Age
    • See lecture 6 & Harvey
    • Vs. Amsden & Phillips

• **Performance falls by half**
  • 1945-70 vs. 1970-95
  • Three indices
    • Profit & investment rate
    • Productivity growth
    • Wage growth

Robert Brenner, *The Economics of Global Turbulence*
Return of the Repressed

- The 10-year ‘Juglar’ cycle is back

- Trough-to-trough
  - 1973-1982
  - 1983-1992
  - 1993-2002
  - 2003-2010?
Financial froth

- 1970s
  - International debt bubble
- 1980s
  - S&L& stock bubbles
- 1990s
  - Stock bubble
- 2000s
  - Mortgage bubble
III. Global Instability

A. The Turning Point
B. 1980s
C. 1990s
D. 2000s
Recession of 1980s

- Deep decline, 1979-82

- Deindustrialization
  - Midwest leveled
  - Unemployment > 10%

- Benefits for capital
  - Reduces capital stock
  - Reduces wages & unions

![United States - Unemployment Rates (1950 - 2005)]
US revival?

- Corporate restructuring
  - Plant closures
  - Bankruptcies

- Productivity and profits start to rise
  - Stock run-up begins

- Japan challenge
  - Plaza Accord, 1986
  - Dollar falls, Yen rises
  - Stops Japanese inroads
Japan Hits the Wall

- Crash of 1989
  - Stocks
  - Real Estate
  - Bad loans

Sources: Standard & Poor’s; Japan Real Estate Institute, via Japan Ministry of Internal Affairs and Communications; Bloomberg
III. Global Instability

A. The Turning Point
B. 1980s
C. 1990s
D. 2000s
Japan struggles through 90s
Europe sluggish

- German stagnation > 1990
- EU Austerity > Maastricht (1993)
East Asian boom & crisis

- New industrializers
  - See lecture 3

- Japanese capital switch

- Blows up in 1996-97
US triumphalism

- Rapid growth, 1994-99
  - Profits up
  - Investment boom, 1993-96
  - Productivity growth

- New Economy
  - Tech fantasy & internet

- ‘Great American Jobs Machine’
  - Unemployment finally falls
  - Wages rise (at the end)
US Tech & Stock Bubble, 1997-2001

- Easy money
- The Fed (low interest)
- Borrow to play
- Buy-Backs (25%)
- Foreigners (25%)
- Wealth effect
Where Was the New Economy?

California Tops Italy As 6th-Largest Economy in World

California economy surpasses France

LOS ANGELES - Forget those occasional contests in which a California Cabernet beats out a French Bordeaux. Here is a real blow to the chauvinism of the nation that invented the word. La Belle France has been bumped from fifth place among the world's economies by the Republic of California.

A shaky euro, a strong dollar and California's booming $1.3 trillion economy combined last year to push the nation's most populous state past France's $1.25 trillion economy and within striking distance of Britain, which is the world's fourth-largest economic power, at $1.42 trillion, according to a new analysis by the Los Angeles Economic Development Corp., a business group.

"It's hilarious because no country has tried harder to make itself important than France, and no place has worked harder than California to screw itself up," said Joel Kotkin, an economist and senior fellow at Pepperdine University in nearby Malibu. "So I think it's a great week.

The study was based on California's employment and personal income data from last year, and on data from the Organization for Economic Cooperation and Development in Paris, using current exchange rates. It ranked the U.S. economy No. 1, followed by those of Japan and Germany.

"We got a phone call from the French media, a little bit huffy," said Jack Kyser, chief economist for the Economic Development Corp. "We're benefiting from a very strong dollar, but also spectacular economic growth.

Yo-Jung Chen, the vice consul general, and press attaché at the French consulate in Los Angeles, was philosophical.

"Since California is a big trading partner for France, we congratulate it," Chen said. "We believe this situation is mostly due to the exchange rate, and that the economy in Europe and in France is quite strong." And, he added, "We still believe we produce the best wine in the world.

Value of Chronicle 500 Firms Nearly Triples to $3.5 Trillion

Bay Area benefits from hot IPOs, unprecedented rise of stock market

By Peter Sinton

Capitalizing on a wild bull market and an insatiable appetite for initial public offerings, the top 500 publicly traded companies in the Bay Area turned in an incredible performance in the past year. The market value of this year's Chronicle 500 mushroomed to nearly $3.5 trillion — almost triple the $1.3 trillion as combined value of last year's top 500 companies. That far outpaced the performance of the tech-dominated Nasdaq index, which didn't quite double during the same period, and the Dow Jones industrial average, which rose a modest 6 percent.

For readers who have a hard time relating to trillions, $3.5 trillion is almost double the proposed federal budget for next year.

In compiling the list of 500 most valuable public companies this year, companies needed a market value (shares outstanding times share price) of at least $75.5 million. A year ago, the No. 500 ranked company was worth just $23 million.

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III. Global Instability

A. The Turning Point
B. 1980s
C. 1990s
D. 2000s
The collapse of 2000-2002

- Stock fall begins Spring 2000
  - Nasdaq falls by half
  - NOT caused by 9/11

- Stocks go down for 3 years
  - One of longest declines ever
  - $7 trillion vaporized!
Tech implosion

**Global Crossing sold for $250 million**

Global Crossing Ltd., once worth more than $50 billion, agreed Friday to sell a majority share in the company for $250 million, giving a company controlled by Hong Kong billionaire Li Ka-Shing the world’s largest fiber-optic network and leaving banks and other creditors with a tiny fraction of the $12.4 billion they are owed.

The price underscores the steep devaluation of telecommunications assets as conditions in the industry have worsened. It also marks the beginning of the Shing’s Hutchison Wampoa Ltd. and partner Singapore Technologies Telemedia were offering $750 million for a 79 percent stake in a restructured Global Crossing. Creditors rejected that offer.

The new bid, backed by creditors and approved by a New York bankruptcy judge, gives the company $250 million in cash and gives its banks $300 million in cash along with a 6 percent stake in the company. Other creditors would split an equity stake of 32 percent and $25 million in new debt.

**Qwest to write down $34.8 billion in assets**

Telecom company says it’s deducting $531 million of revenue for 2000, 2001

Analysts said the reductions are aggressive but not surprising given similar markdowns by competitors like WorldCom. As for the $531 million in statement of revenue from capacity sales, Qwest had specifically warned investors in early September that such an action was possible.

For all the changes, Qwest’s effort to sort out its accounting troubles is far from over. KPMG, the auditing brought in to replace Arthur Andersen after the Securities and Exchange Commission began questioning Qwest’s accounting earlier this year, is many months from completing its review.

Qwest also continues to labor under the cloud of possible charges resulting from continuing investigations by the SEC and the Justice Department. The investigations and the unsettled bank’s holding up Qwest’s efforts to begin selling long-distance service in its home territory.
Fed jumps in

Fed Reduces Short-Term Rates to Lowest Level Since 1961

By LOUIS UCHITELLE

WASHINGTON, Nov. 6 - Struggling to reverse the slide in the American economy, the Federal Reserve cut its key short-term interest rate today for the fifth time this year, aggressively pushing it down to a level not seen since early in the presidency of John F. Kennedy.

The Fed's policy makers, gathered here for one of their periodic meetings, would cut interest rates again. The only question was by how much.

The choice to cut by half a percentage point rather than a quarter point - lowering the rate to 2 percent - reflected what some analysts described as a determination on the part of the Fed to start the economy growing again in case another recession was already under way.

"They see an economy clearly in recession, and they decided that it makes sense to act aggressively now to get things going as quickly as possible," said Peter Hooper, chief economist for Deutsche Bank North America. "We are out of the woods yet in this war on recession."

The Fed, in a brief statement, said that it had lowered rates once again because "weighed uncertainties and concerns about a deterioration in business conditions both here and abroad are dampening economic activity."

Some analysts described the reference to deterioration abroad as an attempt to encourage the European Central Bank and the Bank of England to also cut rates when they meet on Thursday. Both have been reluctant to act as strongly as the Fed to counter a potential global recession.

The Fed's policy makers reduced the so-called federal funds rate, the interest rate that financial institutions charge each other for overnight loans. That lending rate, in turn, influences the borrowing costs for everything from home equity loans to credit card bills.

"They seem to be making an explicit effort to help both the housing market and the consumer loan market," said Stephen Stanley, chief economist for RBS Securities Inc.

Mortgage rates, which respond closely to long-term borrowing costs set by traders in the government bond market, are less affected by the Fed's actions.

With little fear of reviving inflation, the Fed's overriding goal this year has been to encourage people and business to borrow and spend more. But in a weakening economy suffering from layoffs, eaten capacity and dwindling consumer confidence, the Fed has been only partly successful. With the future uncertain, businesses have curbed their investments despite the cheap credit and Americans have become more cautious spenders.

Back to the Future

The effective federal funds rate is at its lowest point since the Kennedy Administration.

% Year-over-Year

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Easy credit triggers housing boom

Refinancing boom pumps wads of cash into economy

By Edwin McDowell
New York Times

NEW YORK — As home values have soared in recent years and interest rates have fallen to their lowest levels in decades, record numbers of homeowners have refinanced their mortgages.

While homeowners refinance to reduce their monthly payments or shorten the terms of their mortgages, many also cash out part of their equity.

In the past two years, more than 15 million mortgages were refinanced, according to the Mortgage Bankers Association. The refinancing amounted to nearly half of the $2.5 trillion of all mortgage debt outstanding.

The amount of equity taken out by homeowners nationwide who refinanced amounted to about $84 billion in 2001 and $90 billion in 2002, according to Frank Nothaft, chief economist for Freddie Mac, the mortgage loan buyer.

In 2000, only $20 billion in equity was taken out.

Home equity for all families across the United States grew by about $500 billion last year, Nothaft said. This heady rise in home values coincided with exceptionally attractive interest rates.

In recent weeks, fixed-rate 30-year mortgages, for instance, have fallen to 40-year lows of less than 6 percent, and certain adjustable mortgages have fallen below 4 percent.

A Freddie Mac analysis for 2002 indicated that the average refinanced mortgage had an interest rate about 1¼ percentage points lower than the original mortgage.

This pairing of growth in home value and reduction in mortgage rates effectively pumped more than $274 billion into the economy in 2001 and 2002, accounting for 20 percent of the real growth in the nation’s gross domestic product during that time, according to a recent study of mortgage refinancing.

For individual homeowners, the combination of reduced interest rates can mean a lot of enjoyment and savings.
The Great Recession

I. Housing Bubble
II. Financial Frenzy
III. Global Instability
IV. •US Weakness
IV. US Weakness

A. Torpid 2000s
B. Great Recession
C. Bailout!
D. Global Shift?
Torpid 2000s

- Short-cycle, 2003-07
  - Poorest of all recent cycles

- Weak upswing
  - GDP 2.8%
    - 1.6% without housing
  - No capital formation
    - Manuf. K shrinks!
Going nowhere fast

- What recovery?
  - No net job growth
  - No wage growth

- Family income flat
  - Peaked in 2000, then falling
  - Limits of doubling up?

- Profit from workers’ hides
  - Profit share in manufacturing rose from 20.5% in 2003 to a postwar high of 28% in 2008

- No wonder they can’t afford homes!
Debt rattle

- Financing a recovery
  - "The US recovery is the best money can buy"
    - Ken Rogoff, IMF

- Dance of debt
  - Mortgages & refis = 25% of household consumption
Housing: the only good news

• Housing and related industries account for about 23% of U.S. economy, including everything from copper pipes to kitchen cabinets.
  - according to the Joint Center for Housing Studies at Harvard University in Cambridge, Massachusetts.

• The five-year boom in real estate, 2001-06, contributed almost half the economy's growth since 2001.
  - according to Merrill Lynch & Co. (quoted in The Economist)
IV. US Weakness

A. Torpid 2000s

B. • Great Recession

C. Bailout!

D. Global Shift?
Indicators off the cliff

- Manufacturing’s worse fall since 1980s
Retirement accounts losing trillions - so far

Julie Hirschfeld Davis, Associated Press
Wednesday, October 8, 2008

(10-08) 04:00 PDT Washington - ---

Americans' retirement plans have lost as much as $2 trillion in the past 15 months - about 20 percent of their value - Congress' top budget analyst estimated Tuesday as lawmakers began investigating how turmoil in the financial industry is whittling away workers' nest eggs.
IV. US Weakness

A. Torpid 2000s
B. Great Recession
C. •Bailout!
D. Global Shift?
Our Saviors

• Henry Paulson, Secretary of Treasury, former CEO of Goldman Sachs
  "In 2005, [at] Goldman [he] securitized $68 billion in residential mortgages and $23 billion in ‘other assets’ primarily related to CDOs."
  (Mother Jones, August, 2008).

• Obama’s retreads
  • Robert Rubin, former head of Citibank & advisor to Clinton
  • Larry Summers, former Asst. Secretary of Treasury
  • Both great advocates of de-regulation in 1990s
Socializing Sh*t

- Bank Rescue
  - $700 billion bailout
  - $2-7 trillion in Fed obligations
Peanuts to the people

- No aid to foreclosed homeowners

Bailout includes no bankruptcy aid for homeowners

The Wall Street rescue deal does not include a provision allowing judges to revise loans on primary residences.

By Tom Hamburger, Los Angeles Times Staff Writer  
September 29, 2008

WASHINGTON -- As congressional negotiators labored over the giant financial bailout plan last week, business leaders saw little to applaud in more than a few of the ideas under discussion, including one that proposed changing the nation's bankruptcy laws to make it easier for homeowners to downsize troubled home mortgages.

On Sunday, when the head-butting ended and the dust cleared, a well-funded coalition of banking and mortgage industry lobbyists had reason to celebrate. The final bill included no changes in federal bankruptcy laws.

Dear American:

I need to ask you to support an urgent secret business relationship with a transfer of funds of great magnitude.

I am Ministry of the Treasury of the Republic of America. My country has had crisis that has caused the need for large transfer of funds of 800 billion dollars US. If you would assist me in this transfer, it would be most profitable to you.

I am working with Mr. Phil Gram, lobbyist for UBS, who will be my replacement as Ministry of the Treasury in January. As a Senator, you may know him as the leader of the American banking deregulation movement in the 1990s. This transaction is 100% safe.

This is a matter of great urgency. We need a blank check. We need the funds as quickly as possible. We cannot directly transfer these funds in the names of our close friends because we are constantly under surveillance. My family lawyer advised me that I should look for a reliable and trustworthy person who will act as a next of kin so the funds can be transferred.

Please reply with all of your bank account, IRA and college fund account numbers and those of your children and grandchildren to wallstreetbailout@treasury.gov so that we may transfer your commission for this transaction. After I receive that information, I will respond with detailed information about safeguards that will be used to protect the funds.

Yours Faithfully,  
Minister of Treasury Paulson
IV. US Weakness

A. Torpid 2000s
B. Great Recession
C. Bailout!
D. Global Shift?
Declining position of US

- Massive trade deficit
  - Imports > exports
    - See lecture 6

- We consume, but we don’t produce enough
Deeper in debt

- Long term rise in debt
  - Low US savings rate
  - The world's consumer
- Borrowing to stay afloat
  - Massive payments deficit
  - China & Japan buy into US
    - ~$700 billion each

TOTAL CREDIT MARKET DEBT (ALL SECTORS) AS % OF U.S. GDP

FEDERAL DEBT HELD BY FOREIGN & INTERNATIONAL INVESTORS (FDHBFIN)
Source: U.S. Department of the Treasury, Financial Management Service

Shaded areas indicate recessions as determined by the NBER.
2007 Federal Reserve Bank of St. Louis: research.stlouisfed.org
Maybe Our Time is Up?

- American Daydream of last 30 years
  - Living in a fantasy world of debt & speculation
  - No need to make things
    - See lecture 9
  - Fight wars everywhere
    - See lecture 7

- Historic shifts to new centers of growth
  - Phillips big on this
  - Giovanni Arrighi
  - F. Braudel
California - Sputtering Engine of Growth

Worst plunge in state revenue since World War II dictates cutbacks

On the chopping block

- Governor’s proposed budget eliminates $23 billion from the state’s $100 billion budget, the largest cuts in history.
- Most educators predict the state’s public school system will suffer.

Figure 1
Budget’s Underlying Revenue Growth to Be Modest

Percentage Change in Revenues and Transfers

- Excludes transfers between the General Fund and the Budget Stabilization Account. Adjusted revenues do not include economic recovery bond proceeds, energy loans, and the administration’s proposal to accrue $2 billion of 2009-10 revenues into 2008-09.