LECTURE 20
FINANCIAL FRENZY & BUBBLE ECONOMICS

Dysfunctional Finance
FINANCIAL FRENZY

I. The Logic of Bubbles

II. Play it Again, Sam

III. Into the Great Recession
I. THE LOGIC OF BUBBLES

A. •Capitalist Cycles
B. Financial Follies
C. When Bubbles Burst
BUSINESS CYCLES

- Revisiting the basic business cycle (Lec. 4)
- Underlying movements of the ‘real’ economy
- Finance is implicated in all cycles
  - Does not always run amok
CYCLES WITH CREDIT

• Upswing
  • Good profit & prospects » investment surge (I)
  • Hiring, wages & consumer spending (C)
  • Taxes & govt. spending (G)
  • Multiplier effects
  • Profits & prospects reinforced

• Credit expansion (bank lending)
  • Business investment & commercial credit
  • Household purchases (houses & cars)
  • Payments come in, more lending
  • Money supply grows, interest rates may drop
I. THE LOGIC OF BUBBLES

A. Capitalist Cycles
B. • Financial Follies
C. When Bubbles Burst
FINANCE STEPS OUT

- Easy credit
  - Everyone borrows extra & spends – inflates demand
  - Economy heats up faster – good times

- Shift into finance
  - Savings pile up in banks – more credit
  - Surpluses invested in securities

- Financial assets on the rise
  - Prices go up, draw in more funds
  - Asset bubble – self-reinforcing
  - Wealth effect – everyone feels richer

- Good times bandwagon rolls
FINANCIAL FORCING

- Financiers play an active role in bubbles
  - Promote financial investments
    - Transaction fees
    - New financial instruments
    - Credit for financial speculation
    - Compete for business
  - Jump on asset bandwagons & drive
    - Promote ideology of quick riches
    - Show the way (bonuses, insider trading)
    - Weaken govt regulation
BUT WHY BIG BUBBLES?

- Financial bubbles don’t happen with every business cycle
  - Need longer term forcing of finance

- Two theories
  - Finance in command
    - Financialization corrupts the system
    - Deregulation & forgetting
      - Kevin Phillips, Bad Money, George Stiglitz, Freefall
  - Stagnation of real economy
    - Slowdown in accumulation
    - Shift of capital into finance & quick fix

  Robert Brenner, Giovanni Arrighi, The Long 20th Century
FIGURE 2.1
The Rise of Financial Services and the Decline of Manufacturing

Manufacturing and Financial Services:

<table>
<thead>
<tr>
<th>Year</th>
<th>Manufacturing</th>
<th>Financial services</th>
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<tbody>
<tr>
<td>1950</td>
<td>29.3%</td>
<td>10.9%</td>
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<tr>
<td>1960</td>
<td>26.9%</td>
<td>13.6%</td>
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<td>23.8%</td>
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<td>16.3%</td>
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<td>2000</td>
<td>14.5%</td>
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<tr>
<td>2003</td>
<td>12.7%</td>
<td>20.5%</td>
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<tr>
<td>2004</td>
<td>12.1%</td>
<td>20.6%</td>
</tr>
<tr>
<td>2005</td>
<td>12.0%</td>
<td>20.4%</td>
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</table>


Source: Ray Dalio, Bridgewater Associates.
I. THE LOGIC OF BUBBLES

A. Capitalist Cycles
B. Financial Follies
C. •When Bubbles Burst
FINANCIAL MELTDOWNS

- Post-bubble depressions are the worst
  - E.g., 1870s, 1930s, 2010s, Japan 1990s

- Finance seizes up
  - Credit hard to get
  - Assets decline – reverse wealth effect
  - Industry reluctant to invest
  - Consumers cut back (pay off debt)

Ken Rogoff & Carmen Reinhart, *This Time It’s Different*
II. PLAY IT AGAIN, SAM

A. •Tulips, Tracks & Trouble
B. Bank Blowups, 70s & 80s
C. Security Bubbles, 1990s
LONG HISTORY OF BUBBLES

- From the dawn of capitalism
- Tulip Mania
  - 1630s Holland
- South Sea bubble
  - 1720s Britain
- Europe 1873
American Bubbles 19th Century

- Canal boom – 1830s (1839)
  - State bonds & Brits
  - First great industrial & land boom

- RR & Mine Bubble – 1870s (1873)
  - NY, Philly RR & SF mining stocks
  - Post-Civil War overexpansion

- RR & corp. bubble -1880s (1893)
  - RR stocks (NYSE)
  - Industrial overexpansion
AMERICAN BUBBLES – 20TH CENTURY

- 1920s bubble (1929)
  - NYSE stock exchange
  - Florida land & L.A. oil

- 1970s bubble (1973)
  - Real estate & banks
II. PLAY IT AGAIN, SAM

A. Tulips, Tracks & Trouble
B. • Bank Blowups, 70s & 80s
C. Security Bubbles, 1990s
BANK BUBBLE OF 1970S

- Bank crisis of early 1970s
  - Real estate bubble bursts
- Petro-dollar influx
- Inflation & low real interest

» wild lending spree
  - Domestic
  - International
BANK CRISIS OF 1980S

- Fed squeezes inflation
- Paul Volcker & interest rate rise (to 9%)
- Global crisis
- National defaults
- US Farm defaults
S & L COLLAPSE

- Deregulation c. 1980
  - End of S&L limits
  - Real estate & CDs

- S&L collapse of 1986-93
  - $300 billion vaporized
  - US rescue (RFC)
  - S&Ls sold off
JAPANESE BANK BUBBLE

- Mad lending of 1980s
- Crisis hits 1989
- Stock & real estate bubbles

**Walking dead’ will drive Japanese bank into state hands**

Charlotte Denny in Tokyo and Jonathan Watts

Renewed worries about the health of Japan’s troubled financial system dragged shares in Tokyo to a 13-year low last week, after the country’s most senior business leader suggested the government might be forced to nationalise insolvent banks.

Trading curbs were imposed on the two weakest of the four main banks, UFJ Holdings and Mizuho Holdings, after the warning by the chairman of the Japan Business Federation, Hiroshi Okuda. Investors dumped the shares fearing they could lose billions of dollars if the government takes over the banks.

The Japanese government will be forced to nationalise at least one of the country’s four biggest banks by the end of the year, to prevent the crisis in the financial sector tipping the country back into recession, a senior business leader warned.

Tougher solvency standards advocated by the financial affairs minister, Heizo Takenaka, will push several main lenders into bankruptcy, Mr Okuda said. “Of the four major banks, two are very solid, but the other two are fragile. I believe that most probably in December (bankruptcy) may be seen,” he said.

A decade of lending to unprofitable companies has saddled Japan’s banks with worthless loans estimated at more than 33 trillion yen ($430bn), around 40% of GDP. Mr Takenaka has promised to clean up the bad loans, but his scheme has come under fire from politicians and bank managers, who fear it may lead to bankruptcies and job losses that could undermine the nascent recovery.

Quarterly output figures released by the government last week suggest that growth is already faltering. Japan’s economy expanded by 0.3% from July to September, down from 1% in the previous three months.

For the first time in a year, the government lowered its assessment of the economy as weak overseas markets hit exporters and inflation of 1.2% created bad loans faster than banks are able to write them off. With the slide of the Nikkei stock index to its lowest level in 19 years, the stock portfolios held by banks are now worth about a fifth of the value they held 12 years ago.

Faced by this combination of rising liabilities and declining assets, investors are abandoning Mizuho Holdings — the world’s biggest bank — and UFJ, another of the big four institutions, driving their share prices down.

The bad loans saga has dragged on for years despite a series of government rescue schemes each touted as the solution to the crisis. Banks have continued lending to dodgy customers, foisting on them the idea that if they cut off funding the companies would collapse, adding to the true extent of the finance sector’s worthless lending.

Mr Takenaka’s reforms are expected to lead to the collapse of many of these so-called non-performing loans. Last week Mr Okuda said that the failure of some of the largest firms among the walking dead would be a sign of the government was serious about reform.

Mr Okuda referred to the “fragility” of two of the leading banks without identifying them. Analysts have been wary about the health of UFJ and Mizuho, who have built up portfolios of worthless loans during Japan’s 10-year-long economic slump.
STOCKS ALSO RISE

- Bubble of 1980s
  - 1986 – 500 point fall in one day
  - Computer trading malfunction

- Bonfire of the vanities
  - Master of the universe
    - Gordon Gekko
  - ‘Greed is Good’
    - Ivan Boesky, Wall Street trader of 1980s, later indicted for insider trading
II. PLAY IT AGAIN, SAM

A. Tulips, Tracks & Trouble
B. Bank Blowups, 70s & 80s
C. Security Bubbles, 1990s
INTERNATIONAL PORTFOLIO BUBBLES

- Britain & Sweden, 1992
  - Banks & currency
- Mexico, 1994
  - Peso Crisis
- Asian Crisis, 1996-97
  - Thai state bonds, etc.
- Russia, 1998
  - Stock collapse
- Argentina, 2001
  - Meltdown of peso & 3 presidents
1990s US Stock Bubble

- Focused on high tech & internet
- NASDAQ > NYSE
WALL STREET SCANDALS

Former hedge fund broker pleads guilty

Stewart convicted
Founder of homemaking empire faces prison time

The Fastows plead guilty
Andrew Fastow and his wife, Lea, leave the federal courthouse in Houston after both accepted plea bargains in exchange for pleading guilty in the corporate scandal. See story on Page B3.

Enmeshed in scandal
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
Chronicle Senior Writer

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 combined value of last year's top 500 companies. That far outpaced the performance of the technology-heavy 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, that No. 500 ranked company was worth just $9.2 million.

Bay Area companies' stock values soar - 3x vs NASDAQ 2x in 1999
Cisco Goes To #1

Cisco Passes Microsoft In Worth
San Jose firm is now world's most valuable

Business

Silicon Valley's Cisco Systems surpassed Seattle's Microsoft as the most valuable company in the world, a landmark shift that highlights the explosive growth of the Internet as well as concerns that Microsoft could be headed or even tumbling in the aftermath of its legal troubles.

San Jose, Calif.'s Cisco, the largest manufacturer of Internet networking equipment, finished trading on Tuesday, yielding a market value of $185 billion, compared with $132 billion for Microsoft, which has been the planet's most valuable company since the now-defunct network of companies with a combined market value of $135 billion.

Cisco's stock has more than tripled over the past year, compared with a 17 percent rise for Microsoft. In 1996, Cisco was the 17th most valuable of the world's largest 20 companies, according to PEG.

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Cisco, ranked ninth in the world at the end of 1995, is now the world's most valuable firm, according to a report by PEG, a research firm that追踪了世界上最大的20家公司的价值。 Cisco的市值在过去一年中增长了三倍以上，超过了微软17%的增长。1996年，思科是全球20家最大的公司中的第17家，而如今它已经成为全球市值最高的公司。

Company Now Most Valuable Firm in World

ON THE COMPANIES STACK UP

<table>
<thead>
<tr>
<th>Cisco</th>
<th>Microsoft</th>
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</thead>
<tbody>
<tr>
<td>$4.5 billion</td>
<td>$6.2 billion</td>
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Cisco, the dominant player in the Internet networking market, has surpassed Microsoft as the world's most valuable company. The move highlights the explosive growth of the Internet and raises concerns about Microsoft's future, as the company battles legal challenges.

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FLOOD OF VENTURE CAPITAL TO BAY AREA

• Nearly $30 billion in 1999
Bay Area led pack of IPOs in 1999

124 companies went public, raising $11 billion, about one-sixth U.S. total.

By Vincent Hin

In 1999, Wall Street gave a shot-out to Internet and technology companies that the way of a day when $2.5 billion in public offerings nationwide raised $1.4 billion. Of that total, about $1 billion went to Bay Area companies.

AIG Technologies Inc., a testing and measurement equipment business spun off from computing chores, the Internet storage equipment vendor, the Internet storage equipment vendor, and the Internet storage equipment vendor, joined the Nasdaq stock market on Oct. 26, 1999. AIG was then followed by dozens of other Internet companies, including Telstra, Verisign, and Earthlink.

Business service companies, such as Los Angeles-based CompuServe Inc., which also runs on-site services, were among the top brokerages. By mid-November, the Internet storage equipment vendor, a stock market leader since going public last year, "is without a viable business model," said Michael Metz, a partner of the Internet storage equipment vendor.

"I hope this is a short-term correction for some of the excesses of last year," said Chris Chen, a partner of the Internet storage equipment vendor, who says it's still on the Internet.

Investors are finally beginning to realize that there are strong and weak tech companies. This year, the number of IPOs was down from 560 in 1998 to 127 in 2000, with 11 debuts made in the first four months of this year, compared with 15 in the same period in 1999.

Marketing engineer Steve Cole uses some of Copper Mountain's technology at the firm's Palo Alto headquarters.

Top-performing IPOs

Companies ranked by stock price appreciation between the company's initial offering date and late 1999.

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Industry</th>
<th>Stock Price</th>
<th>% Change</th>
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<tbody>
<tr>
<td>Google Inc.</td>
<td>Technology</td>
<td>$88.00</td>
<td>656%</td>
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<tr>
<td>Amazon.com</td>
<td>Retail</td>
<td>$150.00</td>
<td>1500%</td>
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<tr>
<td>eBay Inc.</td>
<td>Internet</td>
<td>$23.00</td>
<td>500%</td>
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Biggest IPOs in 1999

The five companies ranked by dollar amount of initial public offering.

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Industry</th>
<th>Dollar Amount</th>
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</thead>
<tbody>
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<td>Google Inc.</td>
<td>Technology</td>
<td>$1.1 billion</td>
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<td>Amazon.com</td>
<td>Retail</td>
<td>$610 million</td>
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<tr>
<td>eBay Inc.</td>
<td>Internet</td>
<td>$300 million</td>
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<tr>
<td>Yahoo! Inc.</td>
<td>Internet</td>
<td>$175 million</td>
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<tr>
<td>Amazon.com</td>
<td>Internet</td>
<td>$150 million</td>
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Bay Area Bears the Brunt

By Kelly Zito
Chronicle Staff Writer

Three interest rate cuts in as many months couldn't stop a bear market from shredding Bay Area stocks in the first quarter.

For the three months ended yesterday, share prices of firms with headquarters in the Bay Area swooned 19.6 percent, mirroring perceptions drops in the Dow and Nasdaq indices, according to a report by San Francisco's Davis Staggs Investment Management.

On a weighted basis — which takes the companies' market caps into account — local stocks suffered 21.4 percent.

The Dow Jones

Bay Area Stocks Watch

Franklin Calif. 250 Growth Index

The 250 largest publicly traded companies with headquarters or major operations in California. The index is equally weighted, meaning each company represents 0.4 percent of the total index. The index was set at 250 on Dec. 31, 1990.

May 12: 2.325.95
Percent change: 7.15%

Franklin Bay Area 100 Index

The 100 largest publicly traded companies in the 415, 408, 510, 650, 925 and 707 area codes. The index is equally weighted, meaning each company represents 1 percent of the total index. The report is based upon an index value of 100 as of Dec. 31, 1990.

May 12: 1,394.05
Percent change: 8.96%
Bay Area Firms Lose $2 Trillion Out Of $4.5 Trillion Lost In 2000-01

Tech firms' $2 trillion paper loss

By Michael Liedtke
Associated Press

Hard times in high-tech are turning Silicon Valley from a financial Shangri-La to a land of lost fortunes.

Since the technology-driven Nasdaq stock index peaked on March 10, 2000, Northern California's 100 largest publicly held technology companies have lost about two-thirds of their combined market value, wiping out $2 trillion in shareholder wealth, an Associated Press analysis shows.

The region's three largest tech bellwethers — Cisco Systems Inc. of San Jose, Intel Corp. of Santa Clara and Oracle Corp. of Redwood City — accounted for $686 billion of the staggering pain.

Stock value of big Silicon Valley firms shrinks by two-thirds

By loss From Page D1

Per losses.

While virtually all publicly held companies around the country have been stung by the stock market's plunge during the past 17 months, Silicon Valley is ground zero.

The Wilshire 5000 index — one of the broadest measures of the overall stock market — has shed $4.43 trillion in shareholder wealth, a 26 percent decline since it reached its peak on March 24, 2000, according to Wilshire Associates.
AND ANOTHER 1/2 TRILLION IN 2002

The Chronicle 200

Top firms lose $409 billion in market capitalization

Intel sheds nearly half its value but still tops Chronicle 200 list
TOTAL LOSS

- Bay Area companies lose 75% of stock value, 2000-2002

- Bay Area companies lose $2.63 trillion of $7 trillion in US -- over 1/3 of total
III. INTO THE GREAT RECESSION

A. The Housing Bubble
B. Mortgage Madness
C. Rubble of the Bubble
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!
HOUSING BUBBLE

- Price surge
  - Low interest & Fed

- Mortgage pushers
  - Subprime slime
  - Refi’s

- Mortgage gushers
  - Secondary thoughts
  - New instruments
  - Promo & leverage

[A History of Home Values chart]

[Annual Increase Household Mortgage Debt chart]


http://calculatedrisk.blogspot.com/
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 (CSXR)

© SocketSite.com
HOME SALES

- Peaked in 2006

![Chart: New Single-Family Home Sales and Inventories](source: Census Bureau)
CONSUMER CREDIT BINGE

- Pump up the volume

### HELL TO PAY?
Consumer credit as a percentage of personal income has never been so high

Source: Commerce Dept.; Federal Reserve

### Household Debt per Person
Grandfather Economic Reports
http://mwhodges.home.att.net/
data: Fed Reserve

- $38,756 per person

<table>
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<th>Year</th>
<th>Debt per Person</th>
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<td>2002</td>
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<tr>
<td>2003</td>
<td>$38,756</td>
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Source: Commerce Dept.; Federal Reserve
UNAFFORDABLE HOUSING

California Real Estate Gone Wacky

To determine the state of housing markets, economists use the ratio: Home Price: Annual Income. A 6:1 ratio per county signifies 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 10.6%. In the same period, the median price of homes increased 18.4%.

2000

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 3:1.

Housing Affordability

To individually assess housing affordability it is helpful to have an idea of a 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.

Ratio:
Median Home Price: Median Household Income

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.

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 homeownership 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.
RIPE FOR FORECLOSURE

And this doesn’t show Central Valley!
WHY WAS INLAND CALIFORNIA HIT SO HARD?

- E.T. - the extra-terrestrials
  - Seeking dream home
  - Go deep in debt to buy
  - Stagnant wages
- Escaping high prices
  - Rich bid up prices in city
  - Link to growing inequality
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 2006

- No wonder they can't afford homes!
Housing Sours

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 2007: 11,033

Source: DataQuick Information Systems, Los Angeles Times

San Diego Monthly Defaults/Foreclosures

Source: foreclosureforum.com, sddt.com

Bank fire sales & low prices
CALIFORNIA: PIVOT OF THE BOOM & BUST
HARD-HIT METROS

U.S. home price freefall
Home price declines
In June from a year ago

San Francisco metro area -23.7%
Los Angeles -25.3%
Las Vegas -28.6%
Phoenix -27.9%
San Diego -24.2%
Denver -4.7%
Minneapolis -13.9%
Chicago -9.5%
Detroit -16.3%
Cleveland -7.3%
Washington -15.7%
New York -7.3%
Boston -5.2%
Charlotte -1.0%
Tampa -20.1%
Miami -28.3%

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
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.

Source: Standard & Poor’s / Case-Schiller

The Chronicle
III. INTO THE GREAT RECESSION

A. The Housing Bubble
B. •Mortgage Madness
C. Rubble of the Bubble
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

INTEREST RATES FALL

- Fed lowers rates to keep economy from collapsing
- Mortgages get cheaper
- Housing bubble takes off
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
BEHIND THE LENDERS

- Secondary Mortgage market
  - Huge increase since 1980
  - Pumps in money from investors
  - Takes risk off lender
III. INTO THE GREAT RECESSION

A. The Housing Bubble
B. Mortgage Madness
C. • Rubble of the Bubble
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
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.

Bad Banks, Bad Banks; Whatcha Gonna Do When They Come For You?

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.
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.
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
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
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
SHIFT TO GOVT DEBT

U.S. debt burden: public and private

Percentage of GDP

Total | Business | Government* | Household | Financial sector

Trillions of $