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Why Are Home Sales Plummeting in America? Huge Waves of Foreclosures Coming down the Pike

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Why are home sales plummeting?

On the surface, it is because the government's tax-credit for first-time home buyers lapsed in April. It takes a couple of months lag-time between buyer purchase decisions and the actual close of escrow, and so the expiration of the tax-credit is just now hammering the market.

And there is a huge backlog of housing stock.

And sellers are holding out hope that they can get close to peak prices for their homes, while buyers believe that prices will fall further – and so are waiting until prices decline further.

But there is a more fundamental reason that home sales are plummeting.

Specifically, when housing crashed in 2007 and 2008, the government had two choices. It could have:

> (1) Tried to artificially prop up housing prices;
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> or
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> (2) Created sustainable jobs, broken up the big banks so that they stop driving our economy into a ditch, and restored honesty and trustworthiness to the economy and the financial system. All this would have meant that the economy would recover, and people would have enough money to afford to buy a new house. (See this).

The government opted to try to prop up prices.

Indeed, as I have repeatedly pointed out, the government's entire strategy has been to try to artificially prop up the prices of all types of assets.

For example, I noted in March:

> The leading monetary economist told the Wall Street Journal that this was not a liquidity crisis, but an insolvency crisis. She said that Bernanke is fighting the last war, and is taking the wrong approach. Nobel economist Paul Krugman and

leading economist James Galbraith agree. They say that the government's attempts to prop up the price of toxic assets no one wants is not helpful.

The Bank for International Settlements – often described as a central bank for central banks (BIS) – slammed the easy credit policy of the Fed and other central banks, the failure to regulate the shadow banking system, "the use of gimmicks and palliatives", and said that anything other than (1) letting asset prices fall to their true market value, (2) increasing savings rates, and (3) forcing companies to write off bad debts "will only make things worse".

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David Rosenberg [former chief economist for Merrill Lynch] writes:

> Our advice to the Obama team would be to create and nurture a fiscal backdrop that tackles this jobs crisis with some permanent solutions rather than recurring populist short-term fiscal goodies that are only inducing households to add to their burdensome debt loads with no long-term multiplier impacts. The problem is not that we have an insufficient number of vehicles on the road or homes on the market; the problem is that we have insufficient labour demand.

Indeed, as I pointed out in April, unemployment is so bad that 1.2 million households have "disappeared", as people move out of their own houses and move in with friends or family.

BIS wrote in 2007:

> Should governments feel it necessary to take direct actions to alleviate debt burdens, it is crucial that they understand one thing beforehand. If asset prices are unrealistically high, they must fall. If savings rates are unrealistically low, they must rise. If debts cannot be serviced, they must be written off.

I pointed out in March 2009:

> Paul Krugman wrote a couple of weeks ago:
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> > The truth is that the Bernanke-Geithner plan — the plan the administration keeps floating, in slightly different versions — isn't going to fly ….
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> Why won't it fly?
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> One reason is that economic psychologists tells us that consumer psychology has shifted for many years to come, and Americans are hunkering down and not buying anything other than the bare necessities. The Fed can try to play the part of all of the actors in the economy, but it won't work.
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> Today, Edward Harrison's must-read post explains provides additional reasons why the Geithner-Summers-Bernanke plan to prop up asset prices cannot succeed (if you don't read the whole post, at least read the following excerpts):
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> > The U.S. government's efforts point in [only one direction]:

> Increase asset prices. If the assets on the balance sheets of banks are falling, then why not buy them at higher prices and stop the bloodletting? This is the purpose of the TALF, Obama's mortgage relief program and the original purpose of the TARP.
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> There is only one direction the government is headed: increase asset prices (or, at least keep them from falling). Read White House Economic Advisor Larry Summers' recent prepared remarks to see what I mean. (Summers on How to Deal With a 'Rarer Kind of Recession' – WSJ) ….
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> These plans are not going to work
> As aggressive as this campaign by the U.S. government is, it will have limited effectiveness because the extent of the writedowns of assets already on the books is going to be too massive. …

And Ryan Grim reported in April 2009:

> Critics of Geithner, including Nobel Prize winning economist Paul Krugman, insist that the real problem is an asset collapse that led to a crisis of solvency in the banking system. In other words, Krugman argues that home values have come back to Earth, while Geithner hopes to solve the problem by pushing home values back to where they were. The conflict is a serious one because it dictates what response is appropriate.
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> At a closed-door meeting with House Democrats on Monday night, according two members of Congress who were in the meeting, Geithner repeated that he believed the problem with the financial system was a lack of liquidity and that if he could get credit flowing again, the problem would right itself. Key to this analysis is the question of whether one thinks the rise of housing prices was an artificial bubble or if the collapse is reversible and we can return to those highs. Policymakers have resisted labeling it as a bubble. [head of the president's Council of Economic Advisers Christina] Romer, on Monday, came close, referring to a "run-up in housing prices that sure looks like a bubble."…
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> If the crisis is understood as one of liquidity, then the appropriate response is to continue injecting capital into the banking system and fiscal stimulus into the general economy until asset prices return toward previous highs. Japanese policymakers initially understood their crisis to be one of liquidity and injected hundreds of billions during the 1990s, to little effect. But if the problem is something different — a solvency crisis brought on by essentially permanent asset-price declines — then the policy response needed is different.

So were housing prices in a bubble or not? And – if so – have housing prices now come back to earth?

Well, as liberal PhD economist Dean Baker points out:

> Real [i.e. inflation-adjusted] house prices are still 15-20 percent above long-term trend.

In other words, housing was in a bubble, and still has a ways to go before it is back to normal.

As the Wall Street Journal wrote in January:

> Housing economist Dean Baker, the co-director of the Center for Economic and Policy Research, laid out his case at a risk conference last week for why we still have a housing bubble. Adjusted for inflation, home prices are still 15-20% higher than they were in the mid-1990s. "There's no plausible fundamental explanation for that," he says.
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> Why? Simple, he says: Economic fundamentals are all going in the other direction. Rental apartment vacancies are reaching record highs. Many segments of the housing market are still oversupplied. And the core demographic in the country—the baby boomers—are reaching the age where they're more likely to downsize, buying less house in the years to come.
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> Far from some rosy estimates that housing is going through a temporary, once in a lifetime downturn, and that once the market bottoms, homes will again appreciate well beyond the rate of inflation, Mr. Baker argues that home prices are far more likely to increase annually at the rate of inflation, at best.
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> "If anything, I expect housing to be weaker than normal rather than stronger over the next decade," he says. "People who say this is a temporary story, there's no real reason to believe anything like that."
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> The recent burst of good housing news has been fueled by government stimulus, including the tax credit, low mortgage rates and easy financing from the Federal Housing Administration. Mr. Baker, who had been a skeptic of the tax credit, concedes that it has worked. So, too, he says, has the FHA effectively supplied credit to goose sales.
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> But that's likely for the worse, he argues, taking the opposite view of policymakers at the FHA.
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> "As a matter of policy I can't see that we want people to buy a house in 2009 that's 10-20% higher than it would sell for in 2011," he says. "In so far as the FHA was encouraging people to buy homes in bubble markets that were not deflated, that's not good for the FHA and you didn't help the homeowner. We didn't do those people a favor."

Indeed, Baker said last November that the government's hasn't really helped homeowners, but has really been helping out the big banks instead:

> The big talk in Washington these days is "helping homeowners". Unfortunately, what passes for help to homeowners in the capitol might look more like handing out money to banks anywhere else.
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> So, who benefits from "helping homeowners" in this story? Naturally the big beneficiaries are the banks. If the government pays for a mortgage modification where the homeowner is still paying more for the mortgage than they would for rent, then the bank gets a big gift from the government, but the homeowner is still coming out behind.
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> There are simple, low-cost ways to help homeowners who were victims of the housing bubble and lending sharks…. But this would mean hurting the banks rather than giving them taxpayer dollars, and we still don't talk about hurting banks in Washington DC.

Similarly, Zack Carter wrote yesterday:

> The Treasury Dept.'s mortgage relief program isn't just failing, it's actively funneling money from homeowners to bankers, and Treasury likes it that way.
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> Economics whiz Steve Waldman [writes]:
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>> The program was successful in the sense that it kept the patient alive until it had begun to heal. And the patient of this metaphor was not a struggling homeowner, but the financial system, a.k.a. the banks. Policymakers openly judged HAMP to be a qualified success because it helped banks muddle through what might have been a fatal shock. I believe these policymakers conflate, in full sincerity, incumbent financial institutions with "the system," "the economy," and "ordinary Americans."

The bottom line is that home sales are plummeting because housing was in a bubble. While most assuming that Americans are being more frugal and deleveraging – so that we will soon "get thorough this" and home sales will finally bottom – that assumption might not be true.

And there are huge waves of foreclosures coming down the pike. See this, this and this.

Indeed, it is possible that housing prices may never return to their peak bubble levels. See this, this and this.

Instead of fixing the real problems with our economy or genuinely helping struggling homeowners, the government has made everything worse by trying to artificially prop up asset prices in a way that only helps the big banks.

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