

Are Houses Homely?

September 1, 2003

We talked of it last week, but we cannot warn you enough about the impending housing bubble implosion. We obviously do not know when the bell will ring telling us that it's all over. It has lasted much longer than we expected, but then we all know that markets over-do both on the upside and the downside. There are, however, several indications that things may be coming to a close. For example, some of Freddie Mac's securities have just been downgraded. Their president has resigned, and now even Fannie Mae is being looked at very closely. These Government Sponsored Entities (GSE's) are heavily leveraged and, in our opinion, much too aggressive in their business practices.

Previously owned home sales in July set a record. Why? Because the increase in mortgage rates caused a stampede to buy that house before rates went up even more. This is a classic signal of an over-bought asset. Housing inflation begets disinflation, which in turn can result in deflation. We expect the coming price decline to be in the neighborhood of 25-30%.

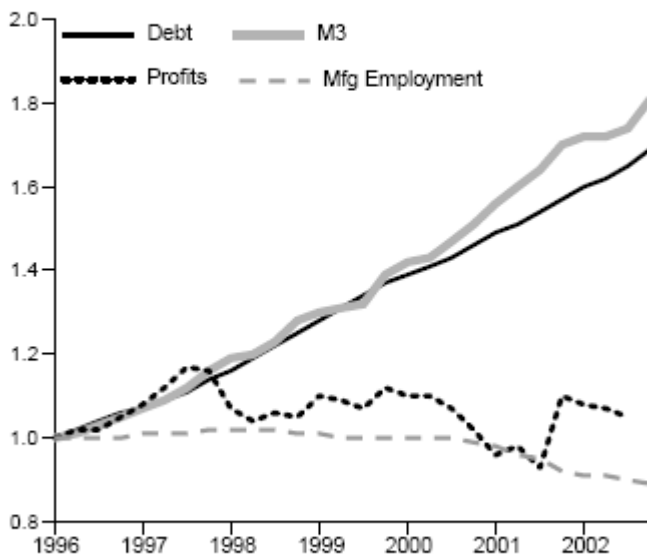
The announcement of relatively good economic news continues to spook government traders into believing that aggregate inflation levels are sure to rise. By their actions they will prevent the very thing they fear the most – an expanding economy, which they believe causes inflation. Economic growth, under the present circumstances, will not lead to sustainable inflation. This simply means that by these traders acting the way they do, will cause the final nail to be hammered in the economic coffin.

These actions will cause a slow recovery to be no recovery at all, if they continue acting in this manner. It does appear that they will. The lessons of the late 1970's, which were learned much too late, needs to be forgotten. But you know it's not all bad for us. Their miscalculations create our opportunities.

Please think about the following chart and we shall address it next week. It may be the best explanation of what is going on in this economy we have seen.

The U.S. Economy's Collapse Function Since 1996

(Indexed to 1st Quarter 1996 = 1.00)



Sources: Federal Reserve; U.S. Dept. of Commerce; U.S. Dept. of Labor; EIR.