

Exposed Fannie

The Federal National Mortgage Corporation, commonly known as Fannie Mae, is the nerve center of the massive US mortgage industry.

During the past 2 years, there had been evidence building of massive accounting fraud at Fannie Mae, reminiscent of the Enron scandal. Now, the company has announced an indefinite delay in filing its 2004 financial report and the cat is clearly out of the bag.

This cat has sharp claws and is ready to pounce on the massive housing industry, as Fannie Mae will be forced to retrench its business operations, resulting in less liquidity available for new mortgages. This no doubt will have the Government bailout teams scrambling to rescue Fannie Mae with public funds.

Meanwhile, the housing market is in nosebleed territory. According to the National Association of Realtors, 2004 was a record year for home purchases, yet a staggering 36% of these purchases consisted of vacation homes or second homes for investment purposes. The largest beneficiaries of this buying frenzy have been the coastal areas, where prices have outperformed. Suffice it to say that when everyone piles into an investment sector all at once, the easy money was made a long time ago and there is a bloodletting ahead. The decline and fall of Fannie Mae is a clear warning sign that should be heeded by homeowners and real estate investors.

If the Fannie Mae situation wasn't troubling enough, the Asians possess a real estate wrecking ball of their own. With their vast US Dollar earnings from trade surpluses, Asian governments have been the principal buyers of newly-issued US Government debt. By the simple law of supply and demand, the willingness of the Asians to buy and hold massive quantities of US Treasury bonds keeps interest rates low. For now, the Asians have a clear motive in keeping our interest rates low. The less the US consumer pays out in interest, the more that is available for the purchase of Asian goods. This keeps Asian factories humming and their people in steady jobs.

Now imagine what happens if the Asian appetite for US Treasury bonds starts to wane. In order for interest rates to remain stable, reduced demand would have to be met with reduced supply. However, it is a stretch to think that the US Government can reduce its borrowing needs anytime soon. The important point is this...there will come a time when the Asians no longer will be content to add to their existing hoard of US Treasuries, whereby interest rates will rise and real estate will become less affordable across the board, sparking a decline in prices.

Clearly, the Asian governments, most notably Japan and China, constitute a major wild card for US real estate prices as they now heavily influence our interest rates. Recently, I noted that France has become the first country to issue 50-year government bonds, with the UK and Germany likely to follow. It would not surprise me in the least to see the introduction of 50-year mortgages as politicians look for ways to support real estate

prices in a rising interest rate environment and at the same time lower the financial burden for increasingly cash-strapped consumers, particularly the aging baby boomers.

March 31, 2005