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Editorial

Mr. Bubble

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Alan Greenspan keeps saying that it's unclear why home mortgage rates have remained so low. After all, the Federal Reserve chairman has been doing all the things people in his position normally do to push rates up - warning about "bubbles" in the housing market, assuring the business community that the economy is basically strong and tripling the Fed's overnight lending rate, to 3 percent.

Perhaps we can help solve the mystery.

Persistently low mortgage rates are symptomatic of an economy that is not doing as well as Mr. Greenspan suggests. Mortgage rates are linked to Treasury bond yields, which are unusually low. And depressed bond yields are generally the market's way of saying that the economic outlook is worrisome.

In his Congressional testimony last Thursday, Mr. Greenspan called that notion "less persuasive" than other explanations, but it looks pretty persuasive to us. By keeping rates so low for so long, the Fed not only helped to inflate housing prices, but also made it easy for homeowners to borrow against those inflated values.

The ability to get cheap loans against some, or even all, of one's home equity - in addition to credit cards, auto loans and other forms of borrowing - has increasingly replaced savings from income as the source of consumers' spending money.

At the same time, tax cuts have sent the federal budget deep into the red, setting the stage for slower growth. Already, the combination of paltry personal savings and government deficits has driven the national savings rate to near zero.

That means there is virtually no domestic pool of money from which to make investments and pay obligations, so business and government must borrow from abroad: an astounding sum approaching $1 trillion is projected for 2005 alone. That puts the economy at risk, in part, because lending by foreigners currently puts downward pressure on United States interest rates, further inflating the bubble.

The challenge now is how to deflate the housing bubble slowly without a dangerous collapse. It is hard to see how the Fed could raise its own rates enough to deflate the housing bubble without painfully squeezing heavily indebted Americans. And since bubbles are fun while they last, Congress and the administration are unlikely to change their profligate ways as long as the bubble is expanding.

That "what, me worry?" behavior increases the chances that the bubble's deflation, when it comes, will be severe, because a government already in hock cannot easily turn on the money spigot to ease a downturn. So it's hard to imagine how the housing bubble might deflate in a way that spared millions of Americans from serious financial distress. Still, a big step in the right direction would be for Congress to revert to disciplined budgeting in which tax cuts and spending increases are fully paid for, even if that means defying President Bush.

Meanwhile, it is hard to take Mr. Greenspan's reassuring talk about the economy seriously when there's so much evidence to the contrary.

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