

The route out of the crisis

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Denmark should be visionary and invite to an international conference about how we secure a well regulated and stable mortgage system, today's writer thinks.



"If Denmark doesn't regulate or create a more solid foundation for the future, we will constantly experience an economy, which through the housing market will generate a 'boom-bust'-economy", writes Jens Kjaer Soerensen.

Times are changing

In the heart of capitalism, USA, it has been realized that the enormous deregulation has been the main force in the creation of the global recession that we are experiencing today.

The former FED Chairman and promoter of the free market Alan Greenspan has acknowledged during a congress hearing in October 2008 was a tough historic admittance, which has given hangovers in the financial sector all over the world.

The chairman of the American congress panel of oversight, Elizabeth Warren, recently summarized the American economic development since the formation of the United States of America in 1792.

She explained that up to the Great Depression the economy was constantly running through a so called '*boom-bust*'-economy, which is an economy based on an artificial (and often politically created) *boom in a specific* sector, which ends in an inevitable *bust*.

International deregulation

After the Great Depression a regulatory safety net was implemented, which through 50 years secured a much more stable economic development (with only very limited financial companies in bankruptcy).

Since the Reagan-years the safety net has continuously been pulled apart – which has regenerated the 'boom-bust'-economy. A development, which is confirmed by The Financial Deregulation Index, which show, that the economy today is way more deregulated than ever before.

The latest international deregulation caused as known a historic loan financed super boom, which came to the surface through a credit expansion without historic comparison and caused huge house and asset price bubbles – both in the US and in Denmark.

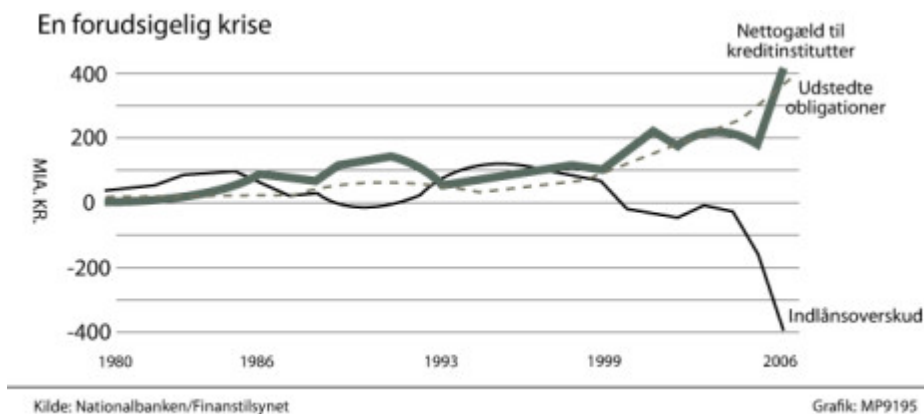
The driving force behind the deregulation in Denmark was led by a combination of EU-initiatives, lobby from the financial sector and was implemented by changing governments.

The latest of which was exemplified by former minister of Economy and business Bendt Bendtsens when he implemented the interest only loans in 2003 and the SDO-law in 2007.

EU wanted a new harmonic international mortgage market, which was inspired by the American. The financial innovations gave a number of new products with a different risk profile, than you had seen previously.

Negative net surplus

The demand for products as variable and interest only loans has been enormous in Denmark. With help from Basel II the banks increased their risk exposure substantially, which is best illustrated by the financial sectors current net surplus.



The figure illustrates, that the net surplus went from being positive to be very negative and the development is especially influenced by the years for implementation of variable loans in 1997 and thereafter in particular the implementation of interest only loans in 2003.

Such a development should have made the alarms ring. Nonetheless the National Bank of Denmark did not warn about a loan financed house price bubble and a potential crisis.

Even though USA has been through a period of acknowledgement the Ministry of Economics and Business does still not believe that the enormous deregulation, which through the credit expansion created the housing bubble.

This conclusion is best emphasized by an analysis published in October 2008. In this analysis the Ministry can't explain 70% of the house price increases from 2003q4 to 2007q4.

Curiosity about the Danish model

In the US, where 80% of new loans are fixed, the interest for the traditional Danish mortgage model has increased. Lately an analysis published by the American Enterprise Institute for Public Policy Research in April 2009.

The interest for the Danish model is not new. The financial guru George Soros has long been promoting the Danish model, which according to him has been the most stable mortgage model since its creation in 1795.

If we politically recognize the problem, it will become possible to get closer to the solution, and we can use this opportunity to act as a visionary leader– for instance by inviting to an international financial conference focusing on the creation of a healthy and stable international mortgage system.

Alternatively the initiatives will come from EU, USA or Basel III, which sooner or later will dictate the regulation from outside. In the EU France and Germany has already attempted to put tighter regulation on the program. This partly because they are forced, since the economic foundation in the EU due to the crisis is threatened, because many of the member countries would experience great difficulties in passing the stability- and growth pact.

Safety in the house

If Denmark do not choose to regulate or create a more solid foundation for the future, we will constantly experience an economy, which through the housing market will generate a 'boom-bust'-economy. The house is the asset in which you easiest can obtain security for leverage being used during an upturn.

The existence of both variable and interest only loans can be the foundation of a dangerous speculation cocktail, when the demand for real estate during an upturn increases it will increase exponentially, and the supply of homes will not be able to adjust.

The housing market will in the future be extremely sensitive towards changes in the interest rate. When the National Bank of Denmark solely is focusing on pegging against the Euro, the Danish housing market is put under administration of the monetary policies of ECB.

Here inflation is the key economic parameter for determination of interest rates. Since the inflation measure is including rent and not house prices we can not expect, that ECB will pay particular focus on the Danish home owner and bring them assistance when needed.

Short-sighted the interest rate will remain low in Europe, but the US will be likely to come first out of the crisis, since it was here the crisis initiated.

The American housing bubble was further on smaller than the European– and the US has stimulated the economy most. A US on its way out of the crisis would create an upwards pressure on resources and interest rates.

This will spread and be highly problematic for Europe and the Danish home owner.