

Serious warning against interest only loans

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The mix of decreasing house prices, variable and interest only loans is poisonous for many real estate owners, and it is just getting worse by the day, interest rates are climbing an economist warns.

Danish economist, who predicted the financial crisis: Interest only loans is a catastrophe.

At the age of 27 he was convinced that the so called sub prime loans in the US would develop into a ticking bomb under the global economy. Together with a heavily booming housing market would develop into a ticking bomb under the global economy. Together with a booming housing market in the Western world the risky loans would lead the entire world into a severe economic crisis he wrote in this Masters Thesis at the University of Copenhagen. A year later the bubble busted in the American housing market, and a year later the great credit crisis became reality.

Now it is the Danish market for interest only and variable loans he warns against. Home owners with these risky loans can end up in serious problems in the moment when the economic stimulus package start working. At that specific time inflation will start increasing.

"If that happens, it will with very high probability lead to interest rate increases in most European countries, including Denmark, because the European Central Bank has declared an intention to keep a target inflation rate. Therefore it is very risky, that we are now seeing an increase in the use of interest only loans. Those were the exact loans, that in the period 2003 to 2006 made real estate prices go crazy and led the Danes to increase their debt way too much," says MS in Economics Jens Kjaer Soerensen in an interview with DJOEF-magazine.

Half the owners of real estate in Denmark don't pay down on their mortgages, and in the first quarter of 2009 alone more than 80% of all new loans were variable loans, because they are now historic cheap in comparison to fixed loans.

Unhealthy political interference

That the new loan types is the main responsible for the sky rocking house prices is not something all economists agree in. None the less most support Jens Kjaer Soerensen's viewpoint that, politicians made a mistake in the autumn of 2008 influencing the mortgage market, which resulted in a lower short term interest rate. A hand was held underneath all the home owners, who had taken a risk by betting on a variable loan. At the exact same time as the price should be paid the risk was taken away from them.

That is a very unhealthy signal to send – both to home owners and to the banks and mortgage institutions – who are lending out money, Jens Kjaer Soerensen says.

"When politicians interfere in the market to prevent an increase in the short term interest rate, as we saw in October, then you can imagine how the market adopts and creates an expectancy about that the more home owner who uses interest only loans, the higher the probability that the government will step in if home owners at a later stage will enter trouble," says Jens Kjaer Soerensen to DJOEF-magazine.

After his Masters Thesis named: "The Dynamics of House Prices - International Evidence" from the Spring of 2006 about a coming financial crisis because of the busted housing bubble, Jens Kjaer Soerensen got a job as an investment banker in a bank. Together with his former professor - Jakob Broechner Madsen, who also during several years have warned about unhealthy mechanisms on the housing market – he held seminars about a decade with way too much credit in the whole world and that house prices in the long run would not increase more than the general salary and price increases. But during the booming housing market there didn't seem to be "demand" for that viewpoint, as Jens Kjaer Soerensen expresses it to DJOEF-magazine.

Jens Kjaer Soerensen has now moved to California, where he is a CFO of the start-up company named Earthlite, which sell an energy management system that can reduce the energy consumption by up to 60%. The credit critical professor Jakob Broechner Madsen is today a professor at a University in Australia.

Read more about Jens Kjaer Soerensen's viewpoints: www.jensks.com