

# [Irrational exuberance](https://assignbuster.com/irrational-exuberance/)

Exuberance and the Housing Bubble An investment in real estate is widely regarded as one of the best investments one can make. The notion that home prices will always rise is as strong as it is incorrect and in the early 2000’s this line of speculative thought led to a level of irrational exuberance that threatened to topple the U. S. economy and its financial system. After the dot. om bubble burst and the subsequent 70% drop in the NASDAQ, investors both professional and amateur clamored for a safe harbor for their investments. Real estate had a long standing perception of being a relatively risk free investment and appeared to be a suitable alternative. With the new influx of investment dollars hitting the real estate market the prices of homes soon began to increase. Also as a result of the dot. com crash the Fed began cutting its short term interest rate from 6. % down to 1% in an attempt to overcome the 2000-2001 recession. With easy access to cheap money, rising home values and reliable public information being made widely available by our media outlets, the American public would soon begin to display herd behavior in an attempt to cash in on the latest financial gold mine. Stories of quick money made from flipping houses seen in the news buoyed individual and investor confidence which quickly paved the way for overconfidence.

Investors overconfidence in the housing market raised their tolerance for risk; meanwhile, the rising profits and asset prices led to speculative behavior where economic decisions were increasingly based upon bravery and less upon sound economic and financial principles. Historically, regional real estate bubbles have not been an uncommon occurrence; however, the scope, size, and longevity of the national bubble that existed between 2000 to 2007 had never before been witnessed in the American real estate market. It was argued that the existence and subsequent results of such a bubble were not even thought possible.

Alan Greenspan once compared the housing boom to a glass of champagne. Mr. Greenspan reasoned that real estate did not have one giant bubble but rather many tiny bubbles each popping as they rose too high and then being replaced by countless others, much like a glass of champagne. Consistent with this line of thinking was the Federal Reserve’s inaction and lack of involvement with lending institutions in regards to its broad authority over deceptive lending practices granted by the Home Owner Equity Protection Act.

In 2007 as the ascent in home prices continued to outpace the rise in income, the market simply had too many people with too little money owning too many homes. The industry that had built itself on optimistic speculation was beginning to collapse on itself as the numbers of foreclosures were starting to mount and people and institutions were beginning to realize they had spread themselves too thin. In February of 2007 twenty five subprime lenders had declared bankruptcy marking the beginning of the subprime mortgage crises and the ending of the housing boom.

As the investment mania was coming to an end the bubble burst and people began to lose faith. New investments were exposed as disappointments and projects were halted, postponed or cancelled and the same contagion that fueled the bubble in the first place began to propel the market downward. In the end it was people’s expectations of perpetual capital gains that fueled the mania and investors’ irrational exuberance led them to believe that rates would never rise and home value’s would never fall.