

Chapter 6

Economic Context of the Real Estate Bubble Crack: Case of a Border Region – Extremadura

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ABSTRACT

The crisis that shook the global financial institutions in 2007/08 revealed the weaknesses and irrationalities of a system that led millions of people, without compatible returns, to the category of “owners” of their home. During the previous decade, the absurd growth of supply in parallel with the progressive increase in real estate value, made housing “the hen of the golden eggs” of the regional and national economy: banks earn with a credit and families with the valuation of homes. This chapter examines the economic context in the crack of the real estate bubble and analyzes as a practical case the incidents of this crisis at international level in the border region of Extremadura.

ANALYSIS OF THE INTERNATIONAL ECONOMY 2007-2008

During 2007 the economy of the planet enjoyed a remarkable development, around 5%. Although, in the last quarter of the year, global economic growth began a

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moderation phase as a result of permanent financial turbulence. The uneasiness of the financial markets comes from the sector of high-risk or subprime mortgages in the United States, and as a result of the deficit balances in the banks' balance sheets intensified and began to influence the stock markets of the entire planet.

In this new context, at the beginning of this year, the IMF reduced the global growth forecasts for the entire year of 2008 to 4.5%. Production in the United States slowed considerably in the last months of 2007 and this trend has continued throughout 2008, with the slowdown in domestic consumption, the stagnation of corporate profits and the worsening dollar price. Likewise, the economy of the European Union lost the inertia of recent years and most macroeconomic indicators began to fall, as well as the more domestic ones that expressed a lack of confidence on the part of businessmen and consumers.

Japan slowly recovers from the housing sector crisis of the 1990s and increases the confidence of its economy because its banks are in a stronger situation than the Americans or Europeans, even so their economy has not just seen the light at the end of the tunnel. Meanwhile, emerging countries, despite their reduction in the pace of their exports, continue to grow above 4%, especially in the cases of China, India and Brazil, while Russia will grow to 3%. These economies have benefited from strong domestic demand and the high price of the raw materials they export (food and energy), although the financial chaos situation is reaching them and this will force them to reduce their economic projections.

Global inflation increased throughout 2008 in both advanced and emerging market economies due to the rising prices of raw materials and energy. The rise in food prices, in particular corn, soybeans and wheat, has been produced due to the pressures generated by the increase in the use of corn and other food products for the production of biofuels, the rise in demand of emerging market countries, not forgetting the inability of supplies due to adverse weather conditions in some countries such as Australia where drought reduced wheat production by 60%.

For its part, the relevant growth in demand has kept the prices of oil and other products such as metals at high levels. Until now, the world economy has been able to absorb the sustained escalation of oil prices during the last five years without suffering a significant impact. The supply in the world oil markets remains low. Despite OPEC's capacity has expanded, the reaction of the global supply has been slow in the face of a demand for oil products that has continued to grow, especially in the fast-growing emerging market countries, joining with all this shortage of capacity of refining. However, as of the month of June where the historical maximum was reached on the price of oil (147 dollars per barrel), it experienced a brutal fall, until being in the present month of December 2008, at 35 dollars per neighbourhood, the lowest price since 2004.

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