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the market value of the house had increased to $450,000. The bank will allow me to borrow 80% of the value of the house or $360,000; I owed $200,000 so I could borrow another $160,000 as a home equity loan. I did this, borrowing $100,000, which I used to buy a car ($40,000) and to make the down payment on a summer home that cost $300,000 (I paid $60,000 in cash and borrowed the rest). Now, I owed $540,000 altogether, and by purchasing a second house I added to demand in the housing sector. That was what upper-middle class Americans were doing.

The financial institutions had a lot of funds to lend. The intermediation set up a system to get funds to the banks that were actually making the loans to home buyers and developers who were building new housing. Interest rates were low, so everyone wanted a house or a second house. This drove the expansion of the American economy. Everyone is happy -- foreign investors, foreign central banks, American financial institutions, and the American public.

Of course, it was overdone on the boundaries, and loans were made to households that could not afford to repay. Much crooked activity took place. Respectable banks left this to brokers who made the doubted loans for them. Many lower-middle class Americans got in too deep and soon faced problems making the payments for their homes. But many also managed to own a house for the first time and felt proud to be property owners.

Everything is going up, house prices, demand for housing, building new houses, lending, and profits for financial institutions. The access to home equity lending enabled Americans to buy cars, send their kids to increasingly expensive colleges, take vacations, buy large screen television sets, etc etc.

The student loans for college worked much the same way. Improved financing increased the demand for college education; colleges raised their prices in the face of demand increases. Students borrowed more money. The financial institutions bundled the student loans and refinanced these. The US government provided some guarantees for some of these loans. Great -- more people went to colleges, colleges made a lot of money and built better facilities or raised their professors' salaries. Students borrowed more money to get educated, believing that when they graduated they would make a lot of money to pay off the loans.

Through such factors, lending rose and rose, and American households became more and more in debt. Life was good. The rising values of homes reduced the risk to the lenders, provided a cushion for old age for home owners or a ready source of financing through home equity for education, vacations or whatever you wanted. The rest of the world worked hard making things, sent money to the US, the US financial institutions spread this money around so that the stuff the rest of the world was making could be sold to the Americans.

Everyone is happy. The Chinese business community is making good money; the Chinese household is able to save, the Chinese economy is growing fast in response to the high level of demands. Central banks send their money to the US, and in doing so keep their currency depreciated so that they are competitive in selling in the US. The head spins at the beauty of the system. But all depended on the continued borrowing by American households.

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Of course, intelligent people could see that this could not last. Housing prices were unrealistic when compared to the earning power of the owners of the houses. Only continued increases in housing prices could sustain this wonder.

Consequences of the Collapse of the Bubble

In 2007, this paradise began to crumble, and we are now in the middle of the unwinding and collapse of the structure that has been built. Several things happened more or less in conjunction: The mortgage market in the United States had built in increases in interest rates, suddenly increasing the