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Real-estate bubble?

Commentary: U.S. won't go the way of Japan, Hong Kong

By Paul Erdman, CBS.MarketWatch.com
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SAN FRANCISCO (CBS.MW) -- Housing starts plunged 11 percent last month, and suddenly everybody seems to be wondering whether there is a real-estate bubble in the United States, whether this is the first sign that it is about to collapse, and what would be the consequences for the economy in general and the stock market in particular.

Make no mistake: In terms of its potential impact on our economic well-being, this issue ranks right up there with whether there is war or peace in the Mideast. The development of housing bubbles is a recurrent phenomenon in the capitalist system. In recent times, we have seen some dandies, with Japan and Hong Kong earning the gold and silver medals. What happened in the wake of those nations' bubbles gives us good reason to worry.Troubled Tokyo

In Japan, a real-estate bubble grew to astounding proportions before it began to collapse in 1991. Since then, real-estate prices there have sunk for 11 -- yes, eleven -- years in a row. Despite that, there are, as yet, no indications that the end is in sight, or even that the rate of decline is abating.

Residential land prices in Japan fell another 12 percent during the past year and are off 31 percent from three years ago. This is a classic example of what happens when a national economy sinks into deflation after the bursting of asset bubbles -- in this case, both a stock-market bubble and a real-estate bubble: Sinking stock prices and sinking real-estate prices continue to re-enforce each other. The process results in an economy -- in Japan's case, one that was thought to be invincible -- sinking into a dreary and seemingly never-ending deflationary spiral.The case of Hong Kong

Hong Kong provides another example of a real-estate bubble that has collapsed in spectacular fashion and undermined what many thought was also an invincible economy. Residential-real-estate prices have declined 65 percent from their peak in 1997, the year the former British colony was ceded to Beijing.

During this same period, unemployment has risen to 7.6 percent. The Hong Kong government, which is renowned for its hands-off policy where the private sector is concerned but which also owns most of the land in Hong Kong, has suspended all further real-estate auctions. The hope is that now that new supply has been cut off, boththe slide in real-estate prices and the economy can be reversed.The U.K. finds itself in exactly the opposite position. There, during the past 12 months, residential real estate has increased in value by 30 percent. Even though that country's economy could use a boost in the form of lower interest rates, the Bank of England's monetary policy committee voted 7-2 in its November meeting to hold interest rates steady as a result of concern that a rate cute would only contribute to "the housing-market frenzy."

So where does the U.S. stand? Well, to begin with, there is definitely no housing-market frenzy here. Nor are their signs of an imminent collapse of housing prices, even at the very high end of the pricing scale.

L.A. story

It is California that leads the way -- both up and down. I recently spent a couple of days with the top guns in real estate in Los Angeles -- the agents who drive their clients to those $10 million homes up for sale in Beverly Hills, Brentwood and Malibu in their Rolls Royces. They remember all too well what happened in the first half of the 1990s, when the housing markets in their towns collapsed. Yet one gets no sense of any panic there today -- not even fear and loathing. Price softness, yes. But no one sees any price decline exceeding 10 percent next year.

True, properties are beginning to move more slowly. Inventories are increasing somewhat. But nobody anticipates a rerun of the early 1990s, when a real-estate downturn accompanied and contributed to a major swoon in the overall economy of Southern California.

The same is true in the Bay Area of Northern California, despite the deep trouble that Silicon Valley still finds itself in. Throughout California, prices in the midrange and at the low end of the market remain firm and turnover brisk. Foreclosures are up, but not by much.

The Fed monitors the housing market just as closely as does the Bank of England. Fear of contributing to a housing bubble has not deterred it from cutting interest rates 12 times in a row. As Alan Greenspan has said repeatedly in recent months, there is no real-estate bubble in the United States. See related story on the mathematical case for home ownership.

Yet the misguided deflationists among us would have you believe that not only does one exist, but when it pops we will go the same route Japan went more than a decade ago, when its twin bubbles collapsed and then fed on each other in a downward deflationary spiral.

Right now, they are wrong on all counts. The stock market, instead of plunging ever further, has made a truly remarkable recovery in the past six weeks. The housing market is cooling, but in a gradual and orderly manner. And, contrary to what some have been telling us, prices are increasing at all levels, including the wholesale level, though at a very moderate pace. Even war against Iraq has now been put on hold.So as we approach Thanksgiving week, we Americans have good reason to be content with the current state of the country. We can even be increasingly optimistic about the future -- and about the value of our homes.

Economist and author Paul Erdman is a CBS.MarketWatch.com columnist.