Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist
Thomas Demas, Managing Director

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# Housing Bubble Bunkum

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**David Gitlitz**

**If we've seen the best cast of the bubbleists, there's little to fear.**

From all the **"housing bubble"** hand-wringing issuing from financial media and so-called expert opinion, one is left with the impression that the only thing worse than housing prices continuing to rise too fast is that they might stop rising. Economist **John Makin**, who has carved out a career niche as a **Cassandra** warning of economic threats that rarely materialize, devoted more than 1,300 words to that supposed menace with an op-ed last week in the ***Wall Street Journal***. According to Makin, whose views are solidly within the establishment consensus, the bubble wouldn't even have to end in falling prices to do significant economic damage. "A mere leveling of housing prices…would be sufficient to remove the boost from housing that is worth about 1 percentage point of growth," Makin wrote.

How does he know that rising **home values** have accounted for that much of overall **GDP growth**, which has amounted to 3.6% in **real** terms (5.9% **nominal**) over the past year? Well, he doesn't actually say, beyond asserting that "rising real estate values have contributed massively to household wealth," which he presumably assumes has provided the requisite support to **"the consumer.**" But for that one percent contribution to hold up, the net gain in **residential real estate wealth** over the past year, about $1.4 trillion, would have had to translate into some $120 billion in **nominal spending growth**. By standard estimates, however, the **"wealth effect"** on **consumer outlays** amounts to no more than 5% of the change in **net worth**. Makin's estimate, then, likely is off by nearly half. Moreover, while obviously significant, the boost in real estate values has accounted for less than 40% of the total $3.7 trillion gain in household net worth. Housing prices, in other words, have hardly been the singular prop to **consumption growth** portrayed by Makin and others.

The housing bubble alarmists also tie themselves up in contradictions over the **interest rate** outlook. Historically, the biggest housing price busts have come when **monetary policy** moves to aggressively **tighten** in response to **inflationary** surges, including during the late 1970s and the early and late 1980s. To avoid that eventuality, the bubbleists ought to view **the Fed's** current **"measured" rate normalization** program in a positive light. In fact, to the extent the Fed is successful quelling incipient inflationary impulses and avoiding a significant price-level breakout, it should also reduce the appeal of **tangible assets** such as real estate relative to **intangibles**, including **equities**. That would seem to be a prescription for avoiding the bubbleists worst-case fears. Instead, though, they warn, as Makin did last week, that central bank **rate hikes** have "already quelled the housing boom in the U.K., Australia and New Zealand." Again, according to this view, it seems that the greatest danger implied by the housing boom is that it will one day end.

Meanwhile, there are several little-noted indicators in the current setting that contra-indicate residential real estate being in an irrational bubble, sure to pop with ugly consequences. For one thing, **median new home prices** fell more than 7% last month and are down 4% in the past year. **Existing home prices**, it's true, are up some 14%, but it's unlikely such a disparity would be seen in a true bubble. That also goes for **lumber** prices, which have fallen considerably in the past year.

**Bottom Line:** The inconsistencies and flaws in the case being made by housing bubble alarmists indicates to us that the economic risks currently arising from the residential real estate market are not particularly worrisome. We see the greatest risk to that outlook in the chance that the Fed would fall too far behind the curve, allowing a sizeable inflation breakout that would require an aggressive policy response. TM