For <u>The Times</u>
Andrew Oswald, Professor of Economics, Warwick University
January 11, 2004

Housing, Again

A year ago I argued in this newspaper, and on television and radio, that we should expect a housing crash between 2003 and late 2005. Although it is too early to be sure, the honest thing to say is that currently I look wrong. Justifiably, some people, including your Letters Page correspondents, are cross with me.

Should I really throw off my gloomy mantle and invest in property? No. Unfortunately, most of the chat and statistical information about the UK's housing market is still produced by building societies. Yet they, of course, have a direct interest in high house prices. It is not good for the public that we are short on independent commentators about the market for homes.

Forecasting the future is a fraught business. But my view is that academic economists should get out into the world and say what they think -- even though, of course, they are sometimes going to be wrong as well as right. Very few do so, though, I suspect they find it too frightening. That, however, leaves newspapers and TV to be dominated by folk with a vested interested in seeing high house prices, high share prices, and so on. If we had more researchers who spoke up about the historical patterns in markets, my hunch is that we would see smaller swings up and down, and that that would be good for the country.

But more importantly, I think that although I may look wrong now, in fact the fundamentals of the housing market look worse than a year ago. Most of the indicators of an overheated housing market have become more extreme.

If you draw a graph of the real price of homes since the 1970s, you trace out a jagged cycle. Unfortunately, as in 1988, which was just before the crash of that period, the UK looks like it is at the top of a wave in the cycle. The ratio of house prices to average incomes, which in the past has never let us down as a warning indicator, is as high as, or even higher than, before the last crash. This continues to be worrying, because the history of markets is that, like a piece of stretched elastic, they eventually snap back and hurt the unwary.

Current discussions have a tone reminiscent of the period before the most recent stock market crash. Then, prices were also miles above the historical trend; again there was talk of a new era; again many scoffed at pessimists and argued that low interest rates had eradicated the chance of any giant fall in prices. A bit later, shares almost halved in value.

Actually the strategy I recommended in 2003 would have done people well. I argued that for those with the flexibility to do so, it was sensible to sell houses and, if you had the courage, to put the proceeds into shares. My forecasting of the price of homes has been poor for parts of the UK (I thought average prices would peak around the middle of 2003 and actually they have risen a few per cent since then). But those adopting my suggestions could have been richer by now. The stock market as measured by the FTSE 100 is up by nearly a third since the middle of last year; selling homes and buying shares would have worked. Siphoning all of your assets into the stock market would have been an extreme gamble, admittedly, but even putting a moderate slice of the value of one’s house sale into shares would have left most people well ahead of keeping their money in property.

My kinds of forecasts about the national housing market have so far been incorrect. But for how long?