

This is a printer friendly version of an article from [www.heraldtribune.com](http://www.heraldtribune.com)  
To print this article open the file menu and choose Print.

Article published Dec 28, 2006

**BUSINESS**

## Real pain from real estate

*Most experts agree the housing market is due for a correction, but could it cause a recession?*

By STEPHEN FRATER

[stephen.frater@heraldtribune.com](mailto:stephen.frater@heraldtribune.com)

The housing industry has been held out in the past two years as the economic landing gear stabilizing the nation for a soft landing.

But now with its fortunes so changed, many are asking whether the spongy real estate market will drag the economy into recession.

Even the Federal Reserve's "Beige Book" report -- a document published eight times a year that gathers anecdotal information about economic conditions around the nation -- has a fairly grim assessment of the housing market, analysts say.

Of those postulating the possibilities of a housing-driven recession, Paul Kasriel, Northern Trust's chief economist, is among the more pessimistic.

He thinks that because housing played such an important role in keeping the economy chugging during the last two years, if it is responsible for a recession, that downturn could be particularly severe.

Kasriel refers to a fairly simple formula: take the dollar value of new and existing single-family homes in 2005 and divide it by the nation's gross domestic product, the total of all goods and services produced in one year. That gives you a ratio of 16.3 percent.

"That's off the scale," Kasriel said. "The ratio has never been that high. The median is 8.4 percent and the previous high, of less than 12 percent, was in the late 1970s."

Real estate prices have been dropping faster than ever before. The National Association of Realtors said last month that the median price in October for existing homes fell to \$221,000 nationally, down a steep 3.5 percent from October 2005.

"That's the largest decline on record since 1968, and the speed of the decline has been breathtaking," Kasriel said. "It's just like a straight line down."

The median is the price at which half the houses sold for more, half for less.

But the very people who compile those statistics and analyze them think that the chances of a recession are fairly slim. They say that the housing market already is showing some signs of renewed vigor.

On Wednesday, a report on new home sales seemed to back them up. The Commerce Department said sales of new single-family homes rose 3.4 percent last month to a seasonally adjusted annual rate of 1.047 million units. The median price of a new home sold last month rose to \$251,700, up 3.2 percent from the October level and 5.8 percent higher than a year ago.



AP ARCHIVE PHOTO / MARK LENNIHAN

A house in Chappaqua, N.Y. has a "For Sale by Owner" sign Friday, July 21, 2006.

The report on existing home sales for November, considered to be a more reliable indicator of the real estate market, will be released today.

Lawrence Yun, an economist with the National Association of Realtors, says economists like Kasriel and Dean Baker, who just issued a report titled "Recession Looms for the U.S. Economy in 2007" for the Center for Economic Policy Research, are off the mark. Baker especially, says Yun, "has been pessimistic about the housing sector for about four years now."

While Yun concedes that housing prices in certain areas, including Southwest Florida, "have gotten ahead of themselves, we don't see the sector tipping the economy into recession."

Yun notes mortgage rates are "back to one-year lows, which should stimulate buying." He also points out that job and population growth in Southwest Florida as factors mitigating against a deleterious impact. He expects to see renewed home buying in future months.

"It's psychology, people are waiting to see when the bottom is coming," Yun said. "Due to dropping rates and dropping prices, it's only a matter of time."

### **Cash flow tightens**

Baker, whose Washington, D.C.-based center admittedly leans to the liberal side, thinks there is a strong potential for a downward-spiraling housing market to drag the nation into recession.

With housing markets in historic decline, prices falling in many areas, anemic new home construction, a weakened mortgage industry and only a few areas showing strong demand for owner-occupied housing, things could get worse before they get better, said Baker, who is the center's co-director.

Baker's report says that Florida has been the hardest hit market in the South, experiencing the biggest price declines -- with condominiums bearing the brunt. Weak market conditions are expected to persist for as long as another six months.

"We've had an unprecedented run-up in home prices, on the order of 30 percent in recent years," said Baker, who fully expects the real estate market to give that gain back. He says it's the result of the same kind of "irrational exuberance" that former Federal Reserve Chairman Alan Greenspan cited with the stock market during the heady days of the late 1990s.

Consumers have pulled out an enormous amount of equity from their homes and spent it. That has been a serious boost during the past few years because such a huge portion of the economy is driven by consumer spending, Baker said.

"About \$800 billion in equity was taken out of the housing sector by consumers in 2005. This year I expect it'll be about \$500 billion, and in 2007 it'll be between \$200 (billion) and \$300 billion," he predicted.

As housing-related cash dries up, so does the overall economy. Baker terms it "a significant drop" in economic liquidity.

"If we go into recession, it'll be because of housing."

Robert Reich, a former Clinton administration Cabinet member and a professor at the University of California at Berkeley, has been warning all year about a general slowdown caused by the waning housing market.

The two biggest sectors of the economy in terms of their impact on jobs and suppliers are the housing and automobile industry.

"Both these sectors are in deep trouble right now," Reich said. "Detroit is awash in unsold inventories. The housing bubble is bursting. If more job losses result, as I expect they will, the problems of these two sectors will spread throughout the economy because consumers won't have the dollars they need to buy everything the economy is producing."

Although rates are now still low, "they could easily spike upward again," Reich said, adding that Federal Reserve chairman Ben Bernanke and his policymakers should be seriously considering a rate cut. "That Bernanke and company are still muttering about inflation is itself very worrying."

### **Wall Street's reaction**

A correction in the U.S. real estate market is under way, says a recent report from UBS, one of the world's largest financial firms.

That observation was confirmed by the Office of Federal Housing Enterprise Oversight, which noted a "national deceleration in house prices."

That agency's House Price Index shows the rate of appreciation falling in seven of nine U.S. Census districts. OFHEO Director James B. Lockhart said that U.S. house prices are growing at less than 1 percent during the third quarter, providing "more evidence that the long-forecasted national deceleration in house prices is occurring."

"We do not expect the U.S. economy to pick up again until the fourth quarter of 2007, when the combined effect of interest-rate cuts and a gradual turnaround in the construction cycle should take hold," UBS said in a recent report.

"A weakening housing market could heavily dent the sentiment of U.S. consumers, who, through their domestic spending and their abundant imports, had been stimulating the U.S. and the global economy," the report states.

Kasriel, the Northern Trust economist, notes that short-term interest rates are higher than long-term interest rates. That is known as an inverted yield curve in financial circles, and is a historically accurate indicator of economic downturns.

In this case, the Fed Funds rate, the overnight rate the Federal Reserve charges commercial banks for borrowing money, is 5.25 percent, while 10-year Treasury bills are trading at about 4.5 percent.

"That indicates a slowdown in the economy," Kasriel said. "If the spread gets larger it would be a reliable indicator of recession."

The Federal Reserve's nightmare scenario is that the correction in the housing market could turn out to be more severe and widespread. But despite bearish indicators, the central bank seems to be betting that housing will not trigger a recession.

Most parties, including the NAR, agree that new home construction will likely continue to drop as it struggles for balance between supply and demand.

That process already is well under way in Southwest Florida as builders cut back their expansion plans and

shed workers. Some smaller builders have already failed.

The Urban Land Institute's "Emerging Trends In Real Estate 2007," a survey of 600 real estate industry experts, says that 2007 will remain troublesome for the housing market as prices continue to soften in the search for a balance.

Next year "won't be a stand-out for the housing sector. Odds favor pricing declines or, at best, stagnant markets," the institute said.

---

Staff writer Michael Braga contributed to this report, which contains information from The Associated Press.

---