Housing Prices Have Fallen More than During the Great Depression

How Much Lower Will They Go?

By Washington's Blog
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I noted in January that the housing slump is worse than during the Great Depression.

The Wall Street Journal noted Tuesday:

> The folks at Capital Economics write in with this gloomy tidbit: "The further fall in house prices in the first quarter means that, on the Case-Shiller index, prices have now fallen by more than they did during the Great Depression."
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> By their calculations, prices are now down 33% from their 2006 peak, compared with the 31% decline during the Depression.

The Independent agreed on Wednesday:

> The ailing US housing market passed a grim milestone in the first quarter of this year, posting a further deterioration that means the fall in house prices is now greater than that suffered during the Great Depression.
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> The brief recovery in prices in 2009, spurred by government aid to first-time buyers, has now been entirely snuffed out, and the average American home now costs 33 per cent less than it did at the peak of the housing bubble in 2007. The peak-to-trough fall in house prices in the 1930s Depression was 31 per cent – and prices took 19 years to recover after that downturn.

How Bad Could It Get?

The above-quoted Wall Street Journal also notes:

> The remarkable thing about this downturn is that even though prices have fallen by more than in the Great Depression, the bottom has yet to be reached. We think that prices will fall by at least a further 3% this year, and perhaps even further next year.

I pointed out in December:

> [Nouriel] Roubini said that the United States "real estate market, for sure, is

> double dipping", and and predicted that banks could face another $1 trillion in housing-related losses.
>
> Now Zillow is forecasting that U.S. home values are poised to drop by more than $1.7 trillion this year.

In a real worst-case scenario, how far could housing decline?

Dean Baker argued in January 2010:

> Real [i.e. inflation-adjusted] house prices are still 15-20 percent above long-term trend.

In March of this year, Gary Shilling predicted that housing would decline another 20%, and wouldn't recover for 4-5 years.

I reported last year:

> The co-creator of the leading house price index – Robert Shiller – says that he is worried housing prices could decline for another five years. He noted that Japan saw land prices decline for 15 consecutive years up to 2006.
>
> Indeed, it is possible that housing prices may never return to their peak bubble levels. See this, this and this.

I noted in 2008:

> In the greatest financial crash of all time – the crash of the 1340s in Italy … real estate prices fell by 50 percent by 1349 in Florence when boom became bust.

So Shilling's prediction is within the realm of historical events: it is already worse than the Great Depression, it could get as bad as the worst depression of all time … 1349 Florence.

Moreover, while the 1349 was limited to one city-state, the current crash is more or less global. I pointed out in 2008:

> The [current] bubble was not confined to the U.S. There was a worldwide

bubble in real estate.

Indeed, the Economist magazine wrote in 2005 that the worldwide boom in residential real estate prices in this decade was “the biggest bubble in history”. The Economist noted that – at that time – the total value of residential property in developed countries rose by more than $30 trillion, to $70 trillion, over the past five years – an increase equal to the combined GDPs of those nations.

Housing bubbles are now bursting in China, France, Spain, Ireland, the United Kingdom, Eastern Europe, and many other regions.

Why Is This Happening … And What Can We Do to Fix It?

Government economic policy that does nothing meaningful to tackle unemployment and the failure to prosecute mortgage fraud are largely responsible for the slump in housing.

Until those policies are reversed, housing could keep declining for a long time.

As I explained last year, the government’s entire policy regarding housing is counter-productive in the long run:

> When housing crashed in 2007 and 2008, the government had two choices. It could have:
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> > (1) Tried to artificially prop up housing prices;
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> > or
> >
> > (2) Created sustainable jobs, broken up the big banks so that they stop driving our economy into a ditch, and restored honesty and trustworthiness to the economy and the financial system. All this would have meant that the economy would recover, and people would have enough money to afford to buy a new house. (See this).
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> The government opted to try to prop up prices.
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> Indeed, as I have repeatedly pointed out, the government’s entire strategy has been to try to artificially prop up the prices of all types of assets.
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> For example, I noted in March:
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> > The leading monetary economist told the Wall Street Journal that this was not a liquidity crisis, but an insolvency crisis. She said that Bernanke is fighting the last war, and is taking the wrong approach. Nobel economist Paul Krugman and leading economist James Galbraith agree. They say that the government’s attempts to prop up the price of toxic assets no one wants is not helpful.
> >
> > The Bank for International Settlements – often described as a central bank for central banks (BIS) – slammed the easy credit policy of the Fed and other central banks, the failure to regulate the shadow banking system, “the use of gimmicks and

palliatives", and said that anything other than (1) letting asset prices fall to their true market value, (2) increasing savings rates, and (3) forcing companies to write off bad debts "will only make things worse".

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David Rosenberg [former chief economist for Merrill Lynch] writes:

> Our advice to the Obama team would be to create and nurture a fiscal backdrop that tackles this jobs crisis with some permanent solutions rather than recurring populist short-term fiscal goodies that are only inducing households to add to their burdensome debt loads with no long-term multiplier impacts. The problem is not that we have an insufficient number of vehicles on the road or homes on the market; the problem is that we have insufficient labour demand.

Indeed, as I pointed out in April, unemployment is so bad that 1.2 million households have "disappeared", as people move out of their own houses and move in with friends or family.

BIS wrote in 2007:

> Should governments feel it necessary to take direct actions to alleviate debt burdens, it is crucial that they understand one thing beforehand. If asset prices are unrealistically high, they must fall. If savings rates are unrealistically low, they must rise. If debts cannot be serviced, they must be written off.

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Baker said last November that the government hasn't really helped homeowners, but has really been helping out the big banks instead:

> The big talk in Washington these days is "helping homeowners". Unfortunately, what passes for help to homeowners in the capitol might look more like handing out money to banks anywhere else.
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> So, who benefits from "helping homeowners" in this story? Naturally the big beneficiaries are the banks. If the government pays for a mortgage modification where the homeowner is still paying more for the mortgage than they would for rent, then the bank gets a big gift from the government, but the homeowner is still coming out behind.
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> ***
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> There are simple, low-cost ways to help homeowners who were victims of the housing bubble and lending sharks…. But this would mean hurting the banks rather than giving them taxpayer

> dollars, and we still don't talk about hurting banks in Washington DC.

Similarly, Zack Carter wrote yesterday:

> The Treasury Dept.'s mortgage relief program isn't just failing, it's actively funneling money from homeowners to bankers, and Treasury likes it that way.
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> Economics whiz Steve Waldman [writes]:
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>> The program was successful in the sense that it kept the patient alive until it had begun to heal. And the patient of this metaphor was not a struggling homeowner, but the financial system, a.k.a. the banks. Policymakers openly judged HAMP to be a qualified success because it helped banks muddle through what might have been a fatal shock. I believe these policymakers conflate, in full sincerity, incumbent financial institutions with "the system," "the economy," and "ordinary Americans."

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Instead of fixing the real problems with our economy or genuinely helping struggling homeowners, the government has made everything worse by trying to artificially prop up asset prices in a way that only helps the big banks.

And as banking analyst Chris Whalen wrote last month:

> An aggressive combination of reflation by the Fed and restructuring of the housing and banking sectors is the way to restore US economic growth, but you won't hear about restructuring large banks from adherents of the neo-[i.e. faux] Keynsian faith.
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> Instead of embracing a permanent state of inflation, as has been the case in the US since the 1970s, we need to deflate the bubble and start again. It is not too late for President Obama and Congress to restructure the US financial system, fix the housing market and create the conditions for true economic growth.

Lest you think I am unfairly criticizing Keynesian economics, I pointed out last year:

> "Deficit doves" – i.e. Keynesians like Paul Krugman – say that unless we spend much more on stimulus, we'll slide into a depression. And yet the government isn't spending money on the types of stimulus that will have the most bang for the buck … let alone rebuilding America's manufacturing base. See this, this and this. [Indeed, as Steve Keen demonstrated last year, it is the

> American citizen who needs stimulus, not the big banks.]
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> Today, however, Bernanke … and the rest of the boys haven't fixed any of the major structural defects in the economy. So even if Keynesianism were the answer, it cannot work without the implementation of structural reforms to the financial system.
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> A little extra water in the plumbing can't fix pipes that have been corroded and are thoroughly rotten. The government hasn't even tried to replace the leaking sections of pipe in our economy.

In truth and in fact, the government's policies are not only not working to stem the rising tide of unemployment, they are making it worse.

Forget the whole "Keynesian" versus "deficit hawk" debate. The real debate is between good and bad policy.

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