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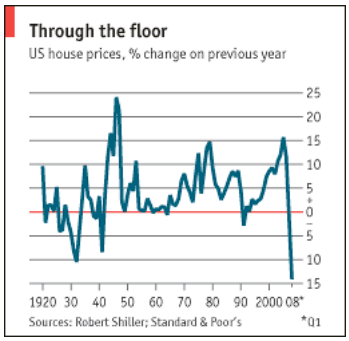
The housing market

Dropping a brick

May 29th 2008
From *The Economist* print edition

House prices are falling even faster than during the Great Depression



"A DESTABILISING contraction in nationwide house prices does not seem the most probable outcome...nominal house prices in the aggregate have rarely fallen and certainly not by very much." Alan Greenspan's soothing, if rather verbose, words on America's housing market in 2005 rank high on history's list of infamous predictions. But to be fair, most American economists shared his view that it was highly unlikely that average nationwide home prices would drop. That was the sort of thing that happened only during a deep depression, like the 1930s.

Unfortunately, new figures this week reveal that house prices have already fallen by more over the past 12 months than in any year during the Great Depression. The S&P/Case-Shiller national index fell by 14.1% in the year to the first quarter. Admittedly, other property indices show smaller drops, but most economists now favour this measure. The index goes back only 20 years, but Robert Shiller, an economist at Yale University and co-inventor of the index, has compiled a version that stretches back more than a century. This shows that the latest fall in nominal prices is already much bigger than the 10.5% drop in 1932, at the worst point of the Depression.

And things are even worse than they look. In the deflationary 1930s, America's general price level was falling, so in real terms home prices declined much less than they did nominally. Today inflation is running at a brisk pace, so property prices have fallen by a staggering 18% in real terms over the past year. In nominal terms, the average home is now worth 16% less than at the peak in 2006, and the large overhang of unsold houses suggests that prices have further to fall. If so, this housing bust could well see a bigger cumulative fall in prices than the 26% real drop over the five years to 1933. Most people would call that a pretty destabilising contraction.

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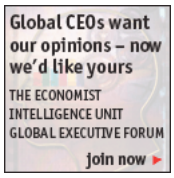

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