DOW JONES

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Report on Business Column

**Don't count on next housing bust being a localized event**

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WASHINGTON -- Here are a few sobering thoughts to ponder as you gaze out over the economic landscape of the New Year: Housing busts, like booms, are typically global in nature. They almost always bring on recessions or significant economic slumps. In most cases, busts occur after a rise in short-term interest rates. And, finally, every major banking crisis to hit the developing world since the Second World War has coincided with a housing market collapse.

That, at least, is what a review of the best available economic research on housing markets suggests, according to **Marco Terrones**, an economist at the International Monetary Fund in Washington.

It's tempting to think of housing weakness as a local threat that might hit, say, Toronto and Vancouver, but not Calgary, or Boston and New York, but not Atlanta.

Instead, Mr. Terrones argues that the eventual fall of the housing market will almost certainly be a globe-spanning event. What starts in Shanghai could soon take down Saskatoon.

“Just as the current upswing in housing prices has largely been a global phenomenon, any downturn is likely to be highly synchronized across countries, with corresponding implications for the world economy,” Mr. Terrones warns in the latest IMF Research Bulletin.

Canada and the United States are far from alone in experiencing a runup in real estate prices. Indeed, that's not even where the largest gains have occurred. Housing prices are up more than 60 per cent (after inflation) since 1997 in Australia, Ireland, the Netherlands, Spain, Sweden and Britain.

There are ample clues that these kinds of gains are unsustainable.

In many countries, buying a house has never been less affordable and renting is now often much cheaper than owning.

Based on his own research, Mr. Terrones and IMF colleague Chris Otrok have concluded that global factors are far more influential on local housing markets than previously believed. They argue that housing prices typically move in sync across geographical boundaries, ebbing and flowing with global movements of interest rates and economic activity.

There is also evidence that consumer behaviour has become increasingly tied to house prices. Across industrialized countries, every dollar increase in real estate prices produces an average 5-cent rise in consumption. And vice versa, one presumes.

Like a jolt of strong coffee the morning after a rough night, all this research helps explain why so many economists have a sense of foreboding about the coming year — in spite of some generally positive economic signs. Growth is robust in Canada, the United States and elsewhere. Stocks also entered the year on an upswing and retailers reported strong holiday sales.

Housing jitters could keep Ben Bernanke up at night after he succeeds Alan Greenspan as chairman of the U.S. Federal Reserve Board on Feb 1.

What does he do if the U.S. housing market melts?

Back in 2001, at least, Mr. Bernanke had an unequivocal answer. Writing in the prestigious American Economic Review, Mr. Bernanke, then an economics professor at Columbia University, argued that central bankers should pretty much ignore asset price movements — unless those prices are a precursor of inflation.

As Fed chairman, the temptation for Mr. Bernanke to soften that hard line could become intense, particularly if any part of the banking system is threatened by falling house prices and mortgage defaults.

But like everything to do with housing, it's no longer just a U.S., or North American, story. It's a global saga, over which the Fed has less and less control.

One of the lingering frustrations of Mr. Greenspan's tenure is that his campaign to push up short-term interest rates has had such minimal impact on longer-term rates. It is Mr. Greenspan's "conundrum."

Part of the answer is that the Fed is no longer in complete control of U.S. credit markets. Low interest in the United States and elsewhere hinges increasingly on the continued willingness of foreigners, including the Chinese central bank, to invest their trade surpluses in U.S. stocks and bonds.

In recent days, the U.S. dollar has taken a beating, in part because foreign investors figure the Fed is nearly done raising rates. A sharply lower dollar would make U.S. assets less attractive, forcing all that capital to search for better rates elsewhere and leaving mortgage markets high and dry.

Brace yourself. The consequences of globalization could hit home in 2006.

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