Spatial Economics Research Centre

Monday, 7 November 2011

The Beginnings of the US Housing Boom

Posted by Dr Christian Hilber, SERC and LSE

Joe Gyourko, (from the Wharton School) gave a great SERC seminar on Friday. The NBER paper - An Anatomy of the Beginning of the Housing Boom US Neighbourhoods and Metropolitan Areas - attempts to figure out when the boom began in different US cities and neighbourhoods and whether any fundamentals were moving in the 'right direction' to help explain timing and magnitudes.

The research provides pretty convincing evidence -- using some amazing data -- that housing markets are 'local' (i.e., metro area) phenomena and are a large extent driven by income as the main fundamental on the demand side and by regulatory and physical/geographical constraints on the supply side. Supply constrained cities boomed earlier and the research explains pretty convincingly that strong income growth occurred at the same time and offers a plausible explanation of house price booms in those cities. This is essentially 'Economics 101'. Even more interesting, however, are the places that experienced substantial house price booms that were not explained by high income growth and tight supply; those in places such as Las Vegas or Phoenix. In these places Joe finds no evidence of the boom coinciding with a positive income shock nor is supply very tight. One further thing we know from Joe's paper: The housing booms (or bubbles) in Las Vegas and Phoenix emerged much later and both the boom phase and the bust phase were very steep. So how can these phenomena be explained?

As Joe was careful to emphasize; the paper he presented does not provide an answer and at this point we can only speculate (although he is promisin much more research to come). One plausible explanation to me is the following: Irrational exuberance needs some sort of 'convincing story' to emerge Strong house price growth in places such as SF, NYC, Boston, LA etc. – that were supply constrained and at had good fundamentals – coupled with th extremely low interest rates created the "story" that the house price boom was being driven by historically low interest rates (or other changes in the economy). People started believing in this story. I would imagine that there may have been some spatial contagion effect. This is at least what the 'spa history' of the US boom suggests – and is consistent with some maps on timing that Joe showed during his seminar. Essentially the belief in ever growing house prices may have spread from places such as SF and LA to places such as LV or Phoenix, even though the fundamentals in those place apart from the interest rates - were extremely different. Now, in the places where it is easy to build (e.g., in Las Vegas or Phoenix) developers started to build like crazy. In places such as SF or NYC perhaps irrational exuberance started to contribute to the price increases originally driven by fundamenta But how can prices increase at all in LV or Phoenix if supply is elastic? Perhaps the explanation is that supply is only very elastic in the long-run but no in the very short run; this is due to various planning, development and construction lags. So in the very short run if price growth expectations are (too) high this may encourage developers to add a lot of new housing stock. This pushes up house prices in the short-run but once supply adjusts in the medium and long-term prices come back to the pre-boom levels or may even fall below those. Because overbuilding can easily happen in LV or Phoen but not in Los Angeles or SF, this can explain why the house price levels in SF and LA are still significantly higher than before the boom started, where this is not the case in LV and Phoenix. The downward adjustment was much steeper in LV and Phoenix.

Again, Joe's research doesn't yet prove any of this – so this is only informed speculation on my behalf. But SERC research shows that elements of this story – e.g. that planning constraints and physical/geographical constraints in conjunction with strong income growth explain the strong increase in pric – are certainly consistent with UK data. There are likely other explanations and the above may be too simplistic to explain everything. After all, on our Real Estate masters we spend several lectures on the fundamentals of housing markets and house price dynamics and there are numerous factors tha contribute. Still the above may be a rough explanation of the fascinating picture Joe painted about the timing of the boom across different US metro areas.

Posted by Prof Henry G. Overman on Monday, November 07, 2011

No comments:

Post a Comment

Newer Post Home Older Po

Subscribe to: Post Comments (Atom)