

Housing Market Disaster Worsens

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The brief moment of hope that housing had hit a bottom and that both the rate of home sales and prices would improve is slipping away. The pressures that will push prices down, by another 20% in some markets, are rising interest rates and an unemployment rate that will almost certainly go over 10% and stay there for several quarters.

The new Reuters/University of Michigan survey [reports that](#) the value of homes when adjusted for inflation will drop for at least another half a decade based on current conditions. The survey also raises the concern that consumer spending cannot resume to any normal level while people believe that the value of what is in many cases their largest asset continues to fall.

Home prices may actually increase on an absolute basis and could begin rising very rapidly if inflation begins to increase as the economy comes out of the recession. A number of economists see inflation as the next large challenge that the Fed faces. They see the vast ocean of cash that central banks have pumped into the global markets as a natural start to rising prices due to too much capital chasing too few goods. Worldwide production levels are low and it may take them several quarters of demand to get some industries back "online."

The 1973 to 1975 recession was severe, although not as severe as the current one. As the economy emerged from the downturn, inflation was in the double digits and in 1981 Treasury bond yields topped 15%. Oil prices were an important contributor to the increase. Crude has doubled since the beginning of this year, even in the face of a poor economy, and shows some signs of rising higher.

Home prices could start to move up by 10% a year again, but, if so, that will almost certainly be accompanied by interest rates that are moving up at about the same pace. The housing price disaster might disappear but it will not be in a way that will increase demand. Owning a house that appreciates in price does not have much attraction when it is tethered to a 12% fixed mortgage rate.

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