Harry’s Take

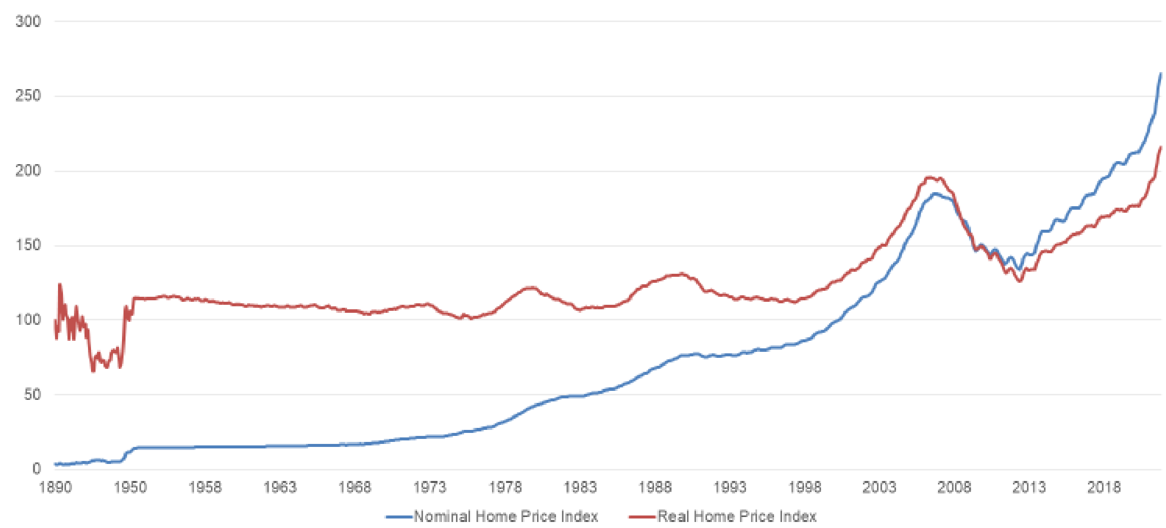
November 30, 2021

Second Real Estate Bubble Is More Extreme Than First and About To Crash

I keep reading articles saying that this real estate bubble is not like the first one, mainly because now we don’t have all of these “no doc” and “no down” loans. That to me just says we won’t have defaults to trigger the downturn at first. In the 2008 financial crisis, housing peaked in early 2006 ahead of it and helped trigger the downturn with the subprime mortgage defaults.

The primary issue to me is always simpler: How overvalued is real estate? And it is more overvalued than it was in 2006 at the last top, from my view. I have to remind people that real estate does not bubble as often or to such extremes as stocks. This has all occurred since 2000, when after the crash of the first tech bubble, speculation suddenly switched to housing in a still highly accommodative monetary environment of zero and negative real rates.

Home Prices Now 46% Above 2000 Peak, 11% Adjusted for Inflation



Source: http://www.econ.yale.edu/~shiller/data.htm

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Note in this chart the red line for real home prices adjusted for inflation. Between 1890 and 2000, home prices stayed mostly in the 100–120 index range. They did what they were supposed to, correlating with the cost of living and construction, not amplifying economic gains like stocks. With super low rates and more-accommodative lending, we had the first bubble into early 2006. Then, prices collapsed 34%, more than in the Great Depression, when they were down only 26%. Home prices were not as overvalued into 1929, as home loans were not accommodative: 50% down with a 5-year balloon payment.

Home prices took into 2012 to bottom, much longer than stocks. Then, we saw the second bubble (into now), but home prices have finally start to slow in their ascent, signaling a likely downturn again. And, of course, you know I see a major downturn into 2022–2023, which definitely will trigger another real estate crash.

So, what's the downside this time, in a time when the experts see less? More, of course. The clearest and natural support for home prices would be to fall back to the 2012 lows. That would dictate a crash of about 48%, vs. 34% last time. I have been forecasting a crash of 45%–50% for many years. Why?

Homes now are 46% higher in nominal prices (blue line) and 11% higher in real prices…

So, am I dying to buy real estate from 2023 forward in this final crash? Not really. I would wait until then to buy, but my new tag line for real estate in the aging societies of most developed countries is this: “Real estate will never be the same.”

I expect real estate to return to correlating over time with inflation, and that inflation will be more in the 0%–2% range in the next boom from 2024 into 2037 or so. So, I don’t see most people getting rich just sitting on real estate as they did in the last few decades, that’s all!

Harry

Got a question or comment? You can reach us at info@hsdent.com.