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Housing Market Stuck in a Rut

By Megan McArdle

Felix Salmon ponders what it means when the housing market is not clearing:

> The number is so low that it looks like a statistical aberration: let's hope it is. Because if it isn't, the news is gruesome. It means that despite record-low mortgage rates, people aren't able to buy houses: essentially all the benefit from those low rates is going to people who already own their homes and are taking the opportunity to refinance.
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> The news also means that there's a big gap between buyers and sellers: the market isn't clearing. Sellers are convinced that their homes are worth lots of money, or will rise in price if they just hold out a bit longer; buyers are happily renting, waiting for prices to come down. And entrepreneurial types, whom one would expect to arbitrage the two by buying houses with super-cheap mortgages and renting them out at a profit, don't seem to have found those opportunities yet.

Arnold Kling adds:

> Old consensus: we need Freddie and Fannie in order to make housing "affordable."
>
> New consensus: we need them in order to "prevent further house price delicnes," in other words, to make housing less affordable.
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> I have to question this consensus. It reminds me of the consensus that "We should someday deregulate oil prices, but not now" that prevailed in the late 1970's. President Reagan rejected that consensus, ripped off the Band-aid of oil price controls as soon as he took office, and the consensus now is that he was right to do so. I have been arguing since early in this crisis that we need a similar approach in housing.
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> Markets achieve a spontaneous order. The opposite of order is disorder. Price controls in the oil market created disorder, to the point where fights broke out in lines at gas stations.

I'd be happier about Frannie if we could engineer a slow transition to a free market. Instead, the government is now guaranteeing about 90% of mortgages. The government's plan to deal with this problem: make the banks pay for their guarantees. This doesn't seem to make a great deal of sense. After all, what is the appropriate cost of the guarantee? Why, it's the amount that the guarantee is reducing the cost of the mortgage. Since the banks would then charge this amount to the homeowners, the net effect should be zero.

Now, maybe you think that the liquidity guarantee will prevent "runs" on the housing market and thus, like the FDIC, generate more value than it consumes. But I'm having a hard time seeing how this model is applicable. Indeed, the problem in the housing market seems to be that homeowners are not rushing to sell.

Or maybe you think that the regulation that goes along with guarantees will help. But you can have the regulation without the guarantees, and both the regulation and the fees will tend to weaken over time as not only developers and banks, but also homeowners and community groups, lobby for cheap government cash. Most government insurance programs seem to spend most of their time flirting with insolvency.

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http://www.theatlantic.com/business/archive/2010/08/housing-market-stuck-in-a-rut/61969/