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REVIEW & OUTLOOK | AUGUST 25, 2010

The Housing Mirage

Homeowner subsidies have only delayed the day of reckoning.

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Yesterday's news that sales of existing homes fell a record 27% in July did not trigger the end of civilization. Instead, while stocks generally declined on the news, shares of home building companies rallied on the chance that this market has finally found a bottom.

We make no predictions on whether the expected rebound in August or autumn sales will come to pass, after more than four years of a declining market and numerous federal programs delaying the inevitable correction. The trigger for yesterday's decline was the expiration of the \$8,000 first-time home buyer tax credit, a political gimmick that altered the timing of some sales, provided a larger tax benefit to many people who were going to buy anyway, and did nothing to change the fundamental supply and demand for housing.

In helping to postpone an inevitable real estate reckoning, while temporarily creating a mirage of a recovering market, the tax credit followed in the distinguished footsteps of George W. Bush's Hope Now, Barney Frank's Hope for Homeowners, and Barack Obama's Home Affordable Modification Program (HAMP), among many other policy lowlights.

If a housing recovery is finally upon us, it will be no thanks to Washington's serial interventions, nor to the home builders who have cheered so vigorously for them. Together with the Realtors and mortgage bankers, the home builders form a lobbying army of the Potomac. The mission is to secure ever higher federal subsidies for housing. The strategy is to convince politicians of both parties that a robust economic recovery can only occur if residential real estate is booming again. This is false.

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Plunge in Home Sales Stokes Economy Fears

With the exception of temporary bubbles caused by reckless monetary policy, rising home prices are merely a symptom of a vibrant economy, not a cause. The true cause of economic growth and higher living

standards is rising productivity, which occurs when societies wisely invest in many things, such as new technologies and new ways of doing business. Housing is just one of those things. Setting as a goal the maintenance of high levels of investment in housing has obvious political appeal, but it's junk economics for a nation that wants to innovate and grow.

If housing prices continue to decline, there are other practical reasons why Washington should resist the urge to launch another program intended to build a floor under the market or to keep people in homes they never could afford. Andy LaPerriere of ISI Group notes that when people suggested in 2005 or 2006 that housing subsidies should be reduced, opponents would warn that such moves might cause a steep decline in prices, knock out a significant contributor to GDP growth and even threaten financial firms that had recklessly wagered too much on real estate. All of this happened anyway.

Today, despite the array of federal programs, prices have declined almost 30% from their peak, the banks had their crisis, and, without a real estate bubble, housing is no longer a

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driver of GDP growth. The game of taking cash out of a refinancing during a bubble market is over, so housing is not likely to drive consumer spending.



Associated Press

There's also the little matter of the various homeowner rescues failing completely on their own terms. Seven million households are still behind on their payments or in foreclosure. Mr. Obama's HAMP was advertised as a way to help three or four million homeowners avoid foreclosure by modifying their mortgages, but HAMP has resulted in fewer than half a million permanent modifications and is now treading water. Recently, more people have been kicked out of the program than have

received permanent modifications, as potential beneficiaries struggle to provide required documentation. Re-default rates on modified mortgages remain appallingly high.

The government has been pretending that troubled borrowers, even if they have numerous debts beyond the mortgage, can become reliable borrowers by tweaking the home loan. Washington also participates in spreading the fiction that recovery depends on keeping people in homes they can't afford.

What people really need are jobs, and what the economy needs to create those jobs is for Washington to stop force-feeding investment to politically favored goals and let investors find the most productive uses for their money.

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