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CAPITAL

By DAVID WESSEL



The Fed Starts to Show Concern At Signs of a Bubble in Housing

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In the debate over whether the housing market is a bubble about to burst, the crowd that argues it isn't has been able to cite reassuring utterances by Federal Reserve officials. But there are proliferating signs that the housing market is looking a bit frothy. And now the U.S. central bank is beginning to worry more about it.

It isn't only that housing prices keep rising faster than almost anything else, up 10% on average nationally in 2004, according to the U.S. Office of Federal Housing Enterprise Oversight, and up 25% or more in the hottest markets in California, Florida and Nevada.

It isn't only that the clever mortgage industry keeps coming up with new ways to lend people money to buy houses that involve ever-more leverage and little -- or sometimes no -- down payment.

It's that more people are buying second and even third homes, expecting that prices will continue to rise so they can sell the houses quickly at a profit -- and that is drawing the Fed's attention. The National Association of Realtors says its surveys find that 23% of all homes purchased in 2004 were for investment, and a further 13% were vacation homes. It's as if Americans got tired of the stock market, and decided to look elsewhere to try to lose money.

For a long time, Federal Reserve Chairman Alan Greenspan dismissed suggestions that the U.S. was in the early stages of a housing bubble. He talked about the extraordinary demand for houses among hard-working

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immigrants. He emphasized that housing, unlike stocks, is a local market, so it's almost impossible to have a national housing bubble. He explained that it's hard to speculate in a house that you own because to sell it you have to move out.

But there has been a little more concern creeping into his commentary in the past few months. "We do have characteristics of bubbles in certain areas, but not, as best I can judge, nationwide," he told a House committee in February. Mr. Greenspan speaks to the Economic Club of New York at lunchtime tomorrow. If housing comes up in his remarks or if he is questioned on the subject by one of the prominent economists there, look for the Fed chairman to mention -- as Fed Governor Donald Kohn did recently -- the upturn in people buying vacation homes, second homes or other homes on the risky bet that housing prices will continue to rise as they have lately.

Mr. Greenspan hasn't yet hit the "irrational exuberance" gong, the phrase he used to warn about the stock market in December 1996. The Fed and other bank regulators, however, this week warned banks to take more care with home-equity loans, noting that such loans are "subject to increased risk if interest rates rise and home values decline." (Did you say decline? Gulp.) Even a slowing of the pace of increase in housing prices probably would dent consumer spending, which, for the past couple of years, has been helped by Americans tapping their home equity.

Other Fed officials have begun to express some anxiety. In a speech last month, Mr. Kohn said, "A couple of years ago I was fairly

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ON THE WEB

For more on the Realtors survey, www.realtor.org/PublicAffairsWeb.nsf/Pages/SecongHomeMktSurges05?OpenDocument

For Mr. Kohn's speech, www.federalreserve.gov/boarddocs/speeches/2005/20050422/default.htm

ABOUT DAVID WESSEL

David Wessel, 50 years old, The Wall Street Journal's deputy Washington bureau chief, writes Capital, a weekly look at the economy and the forces shaping living standards around the world. He also appears frequently on CNBC.

David has been with The Wall Street Journal since 1984, first in the Boston bureau and then the Washington bureau, where he was chief economics correspondent. During 1999 and 2000, he was the newspaper's Berlin bureau chief. He also has worked for the Boston Globe and at the Hartford (Conn.) Courant and Middletown (Conn.) Press. He has shared two Pulitzer prizes, one for a Boston Globe series on race in the workplace in Boston and the other for Wall Street Journal stories on the corporate scandals of 2002.

He is the co-author, with fellow Journal reporter Bob Davis, of "Prosperity: The Coming 20-Year Boom and What It Means to You" (Random House/Times Books, 1998), which argued that the next 20 years will be better for the American middle class than the previous 20 years.

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Houses Afire

Percentage change in house prices, year-to-year.



confident that the rise in real-estate prices primarily reflected low interest rates, good growth in disposable income and favorable demographics." Mr. Kohn was a longtime adviser to Mr. Greenspan before his

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appointment to
the Fed board.

No longer. "Prices have gone up far enough since then relative to interest rates, rents and incomes to raise questions; recent reports from professionals in the housing market suggest an increasing volume of transactions by investors, who...may be expecting the recent trend of price increases to continue," Mr. Kohn said.

A surge in the number of people buying houses as a speculative investment is the contemporary equivalent of the story about Joseph P. Kennedy, father of the late president. According to the tale, he sold his stocks a week before the 1929 crash because he heard a shoeshine boy named Billy touting U.S. Steel and RCA. When the shoeshine boy starts giving you tips, he is supposed to have said, it's time to get out of the market.

The Fed, which contributed to the housing boom by keeping short-term interest rates so low for so long -- and encouraging the bond market to do the same with the long-term rates that determine mortgage rates -- doesn't expect a collapse of housing prices or an economic calamity. Mr. Kohn's worst case is "an erosion of real house prices" -- translation: an increase in house prices that falls short of the overall inflation rate -- "rather than a sudden crash."

Americans who have owned their homes for the past few years have a lot of equity in their homes: \$9.62 trillion worth at the end of last year, up 13% from a year earlier, according to the Fed's tally. Even if house prices fall a bit, homeowners still will have significant equity -- except for those who have hocked nearly all the increase in home values with frequent refinancing or large home-equity loans.

But if house prices stop climbing, it won't be pleasant. Americans will feel poorer -- and they'll spend less as a result.

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