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Peak for Housing Said to Be Near

Slowing price increases in California may cause a recession by 2007, UCLA economists say.

By Bill Sing
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California's housing boom appears to be peaking, and the resultant slowdown is expected to produce "weak growth" in the state's economy during the next two years and a possible recession by the end of 2007.

That's the view of economists at the UCLA Anderson Forecast, which plans to release its widely watched quarterly outlook this morning.

"There are some signs that the housing party is ending," said Christopher Thornberg, senior economist at the UCLA group and author of its California forecast.

Thornberg points to an almost doubling of homes on the market in the last six months, a flattening of sales activity and the increasing reliance on high-risk mortgages by buyers to acquire today's expensive homes. Property in California, he said, is now overvalued between 40% and 45%.

"The forecast for California is mediocre at best; at worst we are liable to dip into another recession," Thornberg said, putting the odds of a recession by the end of 2007 at "at least 50% if not more."

Thornberg said that a peaking housing market doesn't necessarily mean prices will plunge. Prices could continue to rise, but at a much slower rate. That's already started to happen in previously hot markets such as San Diego and the Bay Area, he said.

The latest UCLA outlook is slightly more downbeat than its previous report in June "because I think we're at the peak" of housing, Thornberg said. UCLA economists have long warned that a decline was coming and could end badly, but this is their strongest suggestion yet that the top may finally be at hand.

Although UCLA forecasters have consistently been more pessimistic about the housing boom

and California's economy than many other analysts, their views are notable because they were among the first economists to predict the 2001 recession and to identify the current housing boom as a bubble.

UCLA economists have said signs of housing speculation were emerging as early as 2002 -- and since then the median California home price has risen 71%, from \$266,000 to \$456,000.

Because the state's job growth and consumer spending have been supported by rising home prices, any flattening of real estate values would cut into overall hiring and prompt consumers to rein in their pocketbooks, the UCLA forecast said. Job creation in other sectors is not strong enough to fully offset declines in housing-related fields such as construction, the state's fastest-growing job sector, the report said.

"When consumers realize they can no longer expect that appreciation bonus to subsidize their consumption habits, they will very likely pull back on spending," Thornberg said.

Other analysts agree that the state's dependence on housing has added risks to its economy. Although he didn't specifically cite California, Federal Reserve Chairman Alan Greenspan on Monday again warned of potential declines in home prices.

But other analysts don't necessarily agree that the real estate boom is over yet, or that job growth will cool anytime soon.

Keitaro Matsuda, senior economist at Union Bank of California in San Francisco, said the California housing market "still has a lot of momentum" thanks to strong demand supported by rising job growth and consumer incomes. Employment growth in the service sector is gaining strength, he said, and could help offset any slowdown in real estate-related employment.

Even Hurricane Katrina might help the state's housing market, said Steve Cochrane, regional economist at Economy.com in West Chester, Pa. By slowing the national economy, the storm could keep mortgage rates low, he said.

"That could give the housing market in California another year of life before it slows down," Cochrane said. He noted that the state's housing market started to slow last fall, then got a second wind this year.

For its part, the California Assn. of Realtors said in its latest forecast last week that home-price appreciation in the state would moderate in 2006, rising a mere 10% after four years of hefty gains.

Typically, it takes 12 to 18 months before a slowdown in housing dampens the overall economy, UCLA's Thornberg said. The UCLA forecast calls for the state's job growth -- the best indicator of expansion -- to slow from 1.6% this year to 1.2% in 2006 and 0.8% in 2007.

Residential building permits, meanwhile, will slow from 211,000 units this year to 189,200 next year and 176,500 by 2007, UCLA predicted.