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The Nation

They Cried Wolf. They Were Right.

By [VIKAS BAJAJ](#)

IN May of 2004, Dean Baker, an economist in Washington who had been warning about excesses in the housing market, sold his two-bedroom condo after concluding that the market had lost its moorings from reality.

In a way, he was two years too early. Had he waited until May 2006 when home prices in the Washington area peaked, his home would likely have appreciated by roughly 38 percent from its 2004 value, according to an index that tracks home prices in the metropolitan region.

The case of Mr. Baker, who now happily rents a similar condominium a few blocks away, serves as a useful illustration about the perils of calling and timing financial bubbles. It may be easy to spot an out-of-control market, as Mr. Baker and others did, but quite another to predict when one has truly gotten out of hand.

In a replay of the years before the tech-stock bubble burst in 2000, housing market skeptics have spent much of this decade being tarred as the boys who cried wolf. Their predictions were proved wrong year after year as people continued to bid up the price of condos in Miami and new houses in suburban Phoenix.

Academics and economists like Mr. Baker came across as gloomy sourpusses who did not want Americans to have fun and grow rich by flipping second homes on the New Jersey or Florida coasts.

“The naysayers simply look silly at the end of the bubble,” said Mark Zandi, chief economist for Moody’s [Economy.com](#) who was among the experts raising questions about the underpinnings of the housing boom. “They are completely discounted and discredited because they have been saying things are askew for a year or two. It’s when the naysayers’ views have been completely discarded and discredited that the bubble inflates to its apex.”

Mr. Baker said he knew he would never be able to call the top of the real estate market precisely, either as a home seller or an economist. He noted that he was also too early in calling the tech bubble in 1997. “Sure it could go somewhat higher,” he said of the real estate market. But, he added, “I felt the need to

talk about it, and do anything I could to bring attention to it.”

Some in the real estate industry say the early cries of bubble should be called to account on the grounds of intellectual fairness. If the boosters have to acknowledge they were wrong when they provided justifications for prices that were, well, unjustifiable, then the doubters should also own up to the fact that they were too negative, too early.

“Even the people that were talking about booms busting, my goodness they were talking about it in 2001 and 2002,” said David Lereah, the former chief economist with the [National Association of Realtors](#). “And they were wrong for four years and they only became right at the end of 2004.” He and his former employer had been criticized for the optimistic forecasts they made during the boom.

Economists, even the famous ones, mostly see the to and fro between the housing bulls and bears as an academic debate. Their influence over markets and the behavior of consumers, they say, was and is at best marginal.

Robert J. Shiller, the Yale economist whose book “Irrational Exuberance” became required reading for bubble watchers, has said that there is a long tradition of naysaying in the face of soaring markets to little effect.

Newspapers during the boom in the 1990s and in the early years of this decade expressed warnings about the housing market, along with more upbeat sentiments. But the critical voices often did not register above the din of the frenzied market.

“You got some of us sitting there in a distance saying that this is a bubble, we don’t know when its going to end,” said Christopher F. Thornberg, an independent economist who is based in Los Angeles. “And then you have mortgage brokers and real estate agents who are much closer to the buyer who are whispering in their ear that, well, yeah, there are some markets that are out of line but not this neighborhood.”

Almost everyone would agree that of far greater import to the timing and performance of bubbles are interest rates and the availability of credit. Both are set by the market, but regulators at the Federal Reserve exert significant influence over them. The main discussion now, with the benefit of hindsight, is whether the central bank should have taken a more muscular approach in regulating mortgage lending and raised interest rates sooner. (After the tech bubble burst, the Fed cut its benchmark rate sharply and left it at 1 percent from the summer of 2003 to the summer of 2004.)

In recent interviews, [Alan Greenspan](#), the former Fed chairman, has argued he did not realize the extent of reckless lending practices in 2005 and 2006. He also defended the central bank’s decision to keep short-term interest rates low early in this decade to avert the risk of deflation.

Last week, the Fed cut rates sharply to ease conditions in the credit market, kindling some fears of

inflation.

“We have had two bubbles in the last 10 years,” noted Allen L. Sinai, the president and chief economist at Decision Economics, a consulting firm based in New York. “The only way I would say it won’t happen — and this is arguable — is for the central bank to do something about it before it gets too far, and right now the central bank’s religion is not to interfere.”

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