



Australian School of Business

Never Stand Still

Australian School of Business

Economics

# Financial Crisis and Property Price Indexes

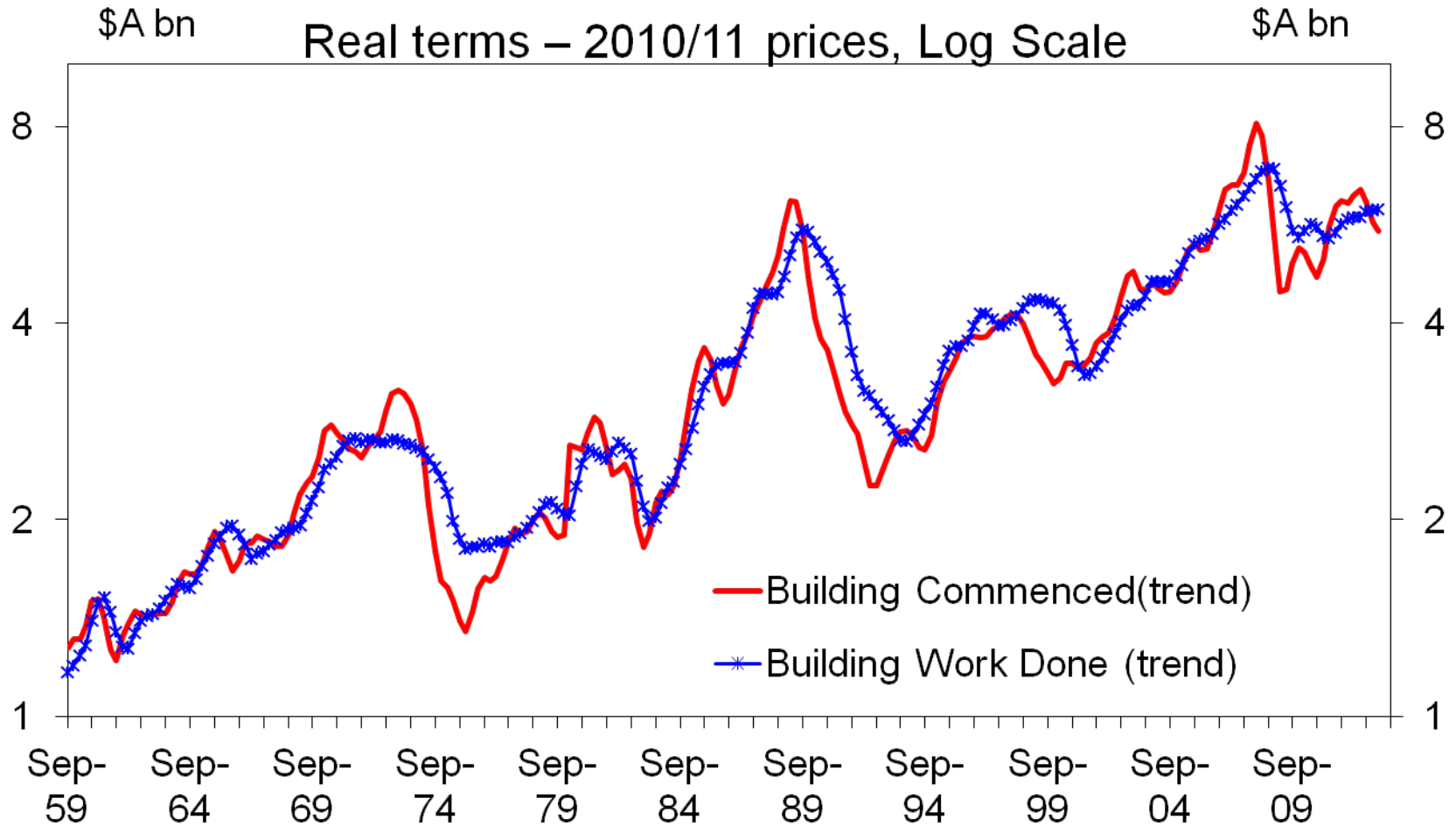
Comments by  
**Kevin J. Fox**

Reitaku University  
October 2013

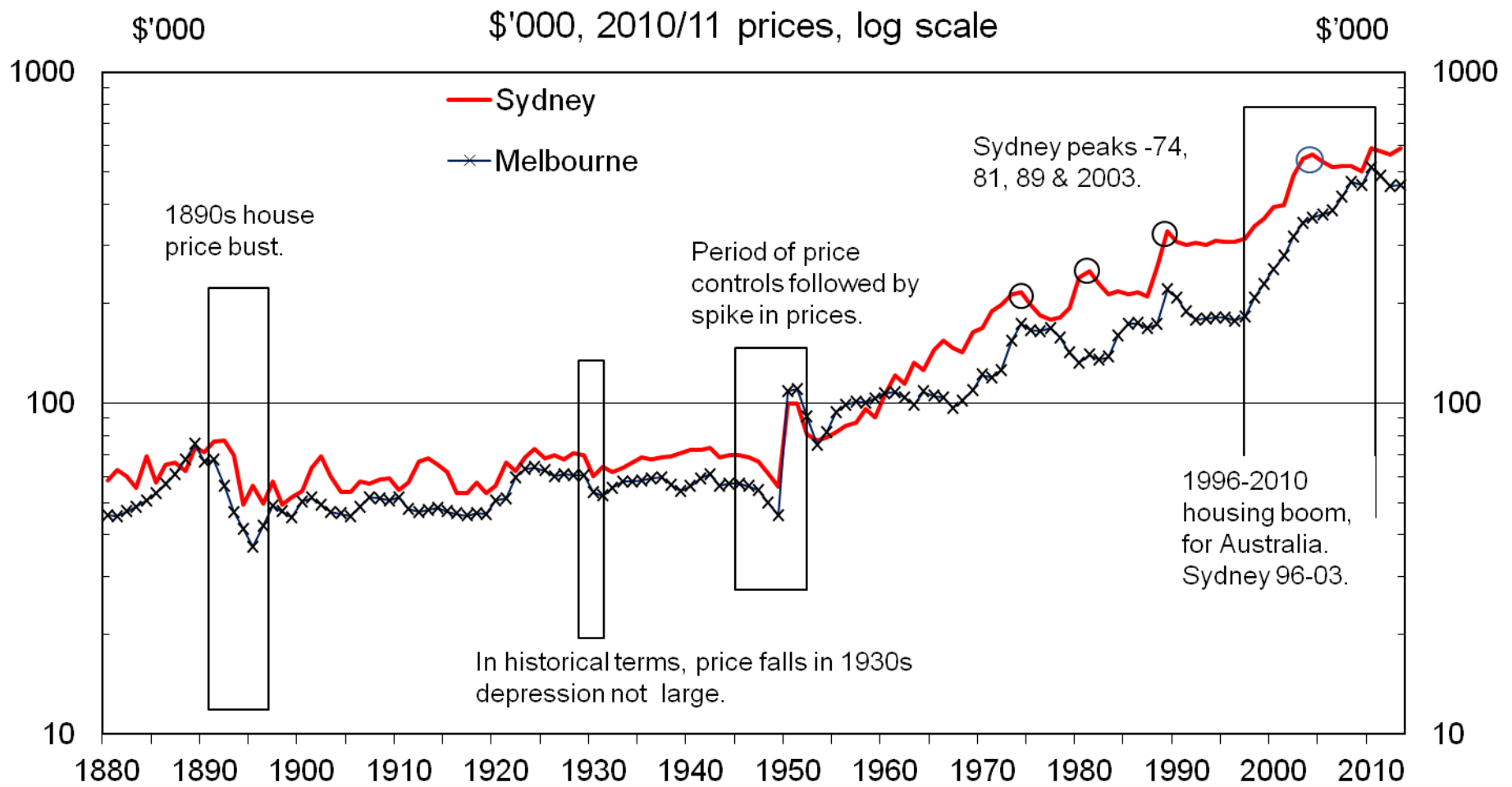
# Overview

1. Strong link between financial crises and property markets.
2. Price indexes key in understanding market conditions.
3. Following slides draw on work of my colleagues, Nigel Stapledon and Iqbal Syed.

# Total Private Non-residential Building Work 1959-2013

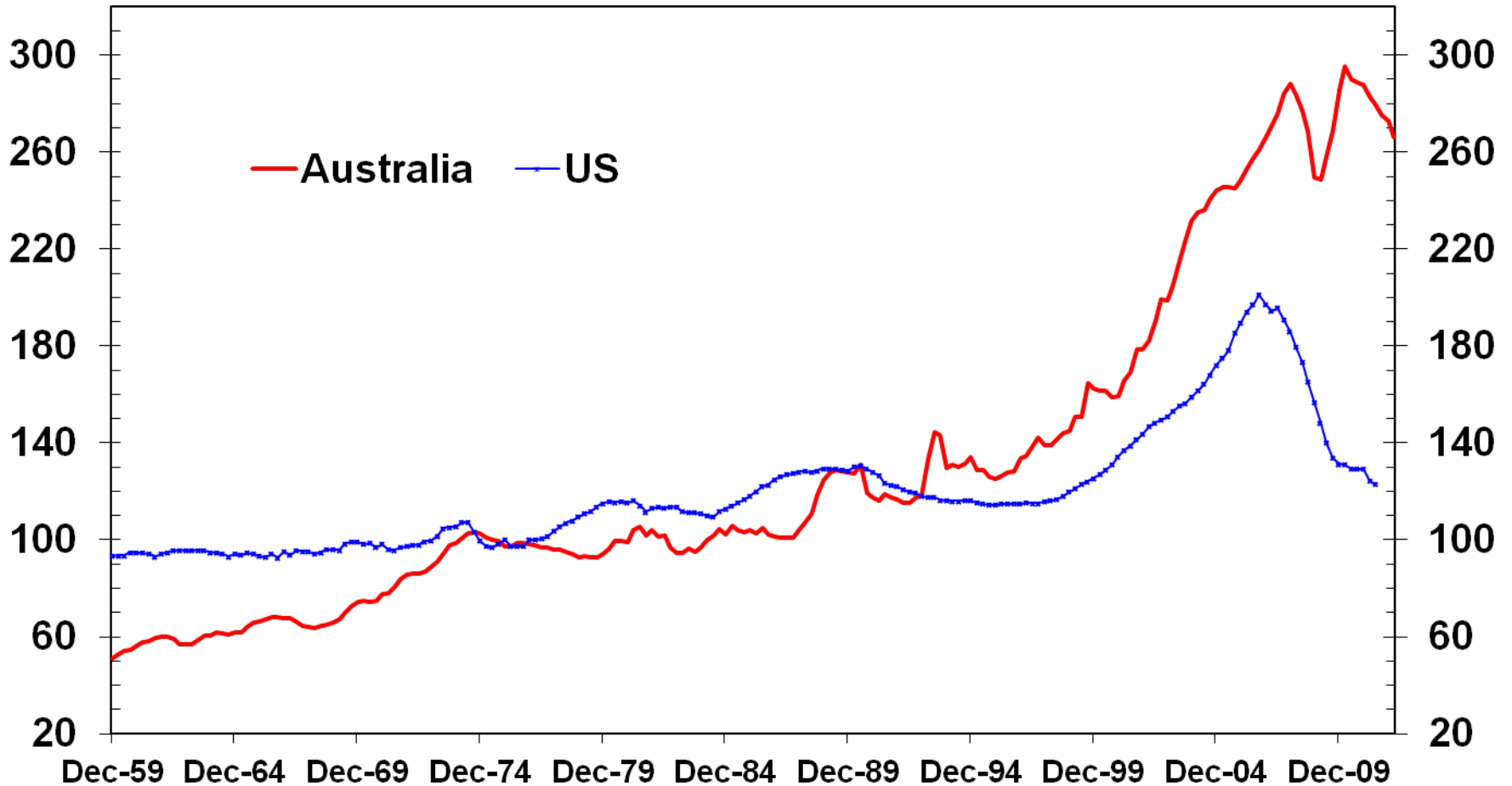


# Sydney and Melbourne median house price series, 1880-2013



# Australian and US Indexes of Real House Prices 1959-2012

Index at June 1975 = 100



# Ed Leamer and the US Business Cycle

Observed that housing led recession 8/10 times

- Housing plays above its weight
- Business investment tended to lag housing
  - not saying business investment does not play a role but because it lags housing, housing is the one to watch
- Policymakers should target housing cycle

# Ed Leamer and the US Business Cycle

Two recessions not preceded by downturn in housing

- 1953 end of Korean War recession
- 2000 IT bubble

Evidence for other countries less convincing

- domestic focus of US economy vs. external influences affecting business cycle
- e.g. Australia

# Ed Leamer and the US Business Cycle

## Intuition

- lumpy asset (major investment) = natural tendency to be cyclical
- also sensitive to income and interest rates (endogenous to cycle)
- BUT non-residential construction and equipment investment also share these characteristics

## Leamer focus on ‘timing’

- housing moves down first
- less lumpy/shorter building time than say office building, reacts earlier



# Observations on Australia

Housing cycles less successful ‘predictor’ of recessions  
– property in aggregate bigger story

1970s

– property + near financial crisis (saved by high inflation)

1989

– commercial property dominant story in financial crisis  
– this was similar to 1890s when Australia had its first serious financial crisis

“Global Financial Crisis”

– despite housing price boom, by good luck (timing, resources boom), missed a US-style fall.

# Rent Also Important

In equilibrium:

$$\text{Rent} = \text{Price} \times \text{User Cost}$$

$$\text{Or: User Cost} = \text{Rent}/\text{Price}$$

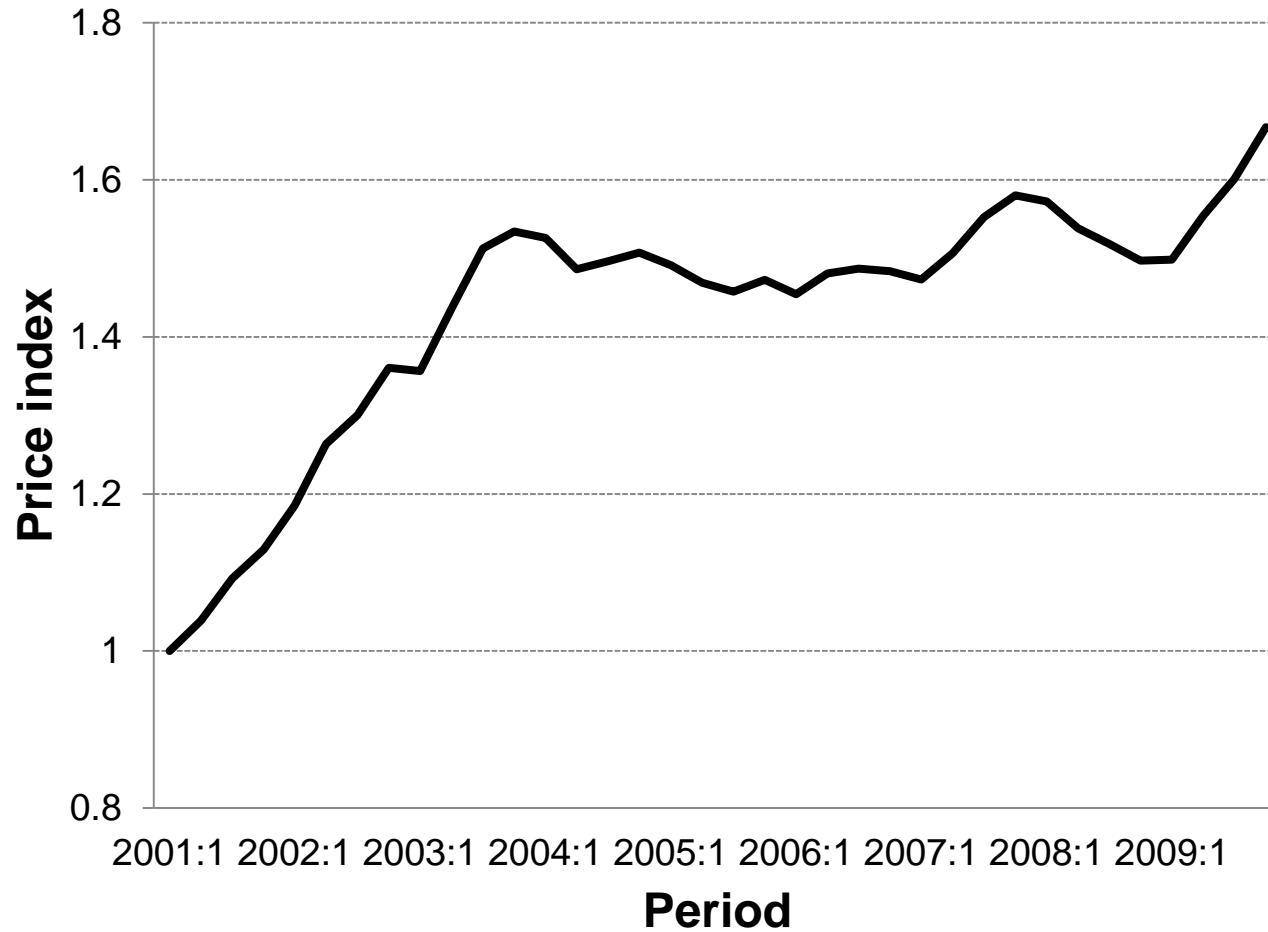
$$\text{Or: } 1/\text{User Cost} = \text{Price}/\text{Rent}$$

**“...a house price bubble occurs when homeowners have unreasonably high expectations about future capital gains, leading them to perceive their user cost to be lower than it actually is and thus pay “too much” to purchase a house today.”**

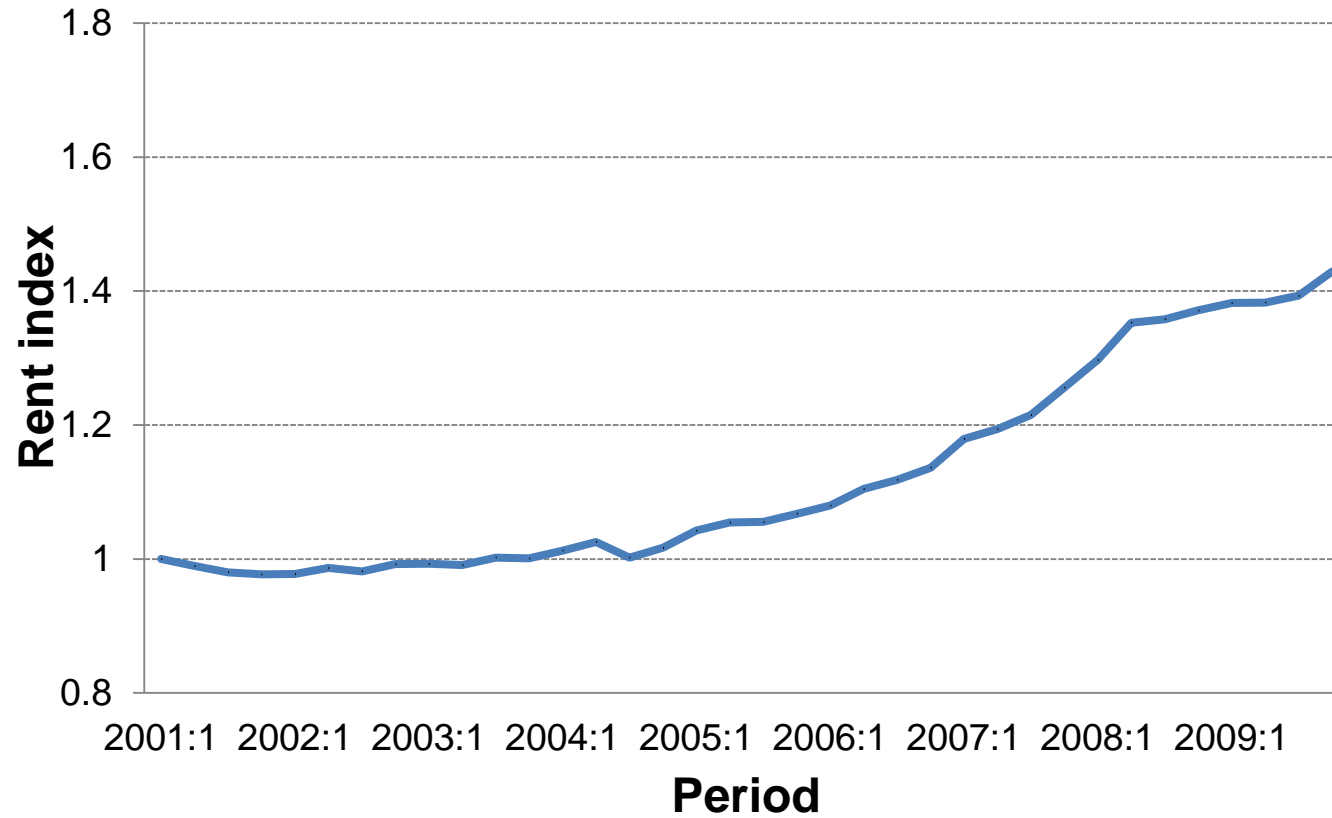
Himmelberg, Mayer and Sinai, 2005

Syed and Hill (2012), “Hedonic Price-Rent Ratios, User Cost, and Departures from Equilibrium in the Housing Market”

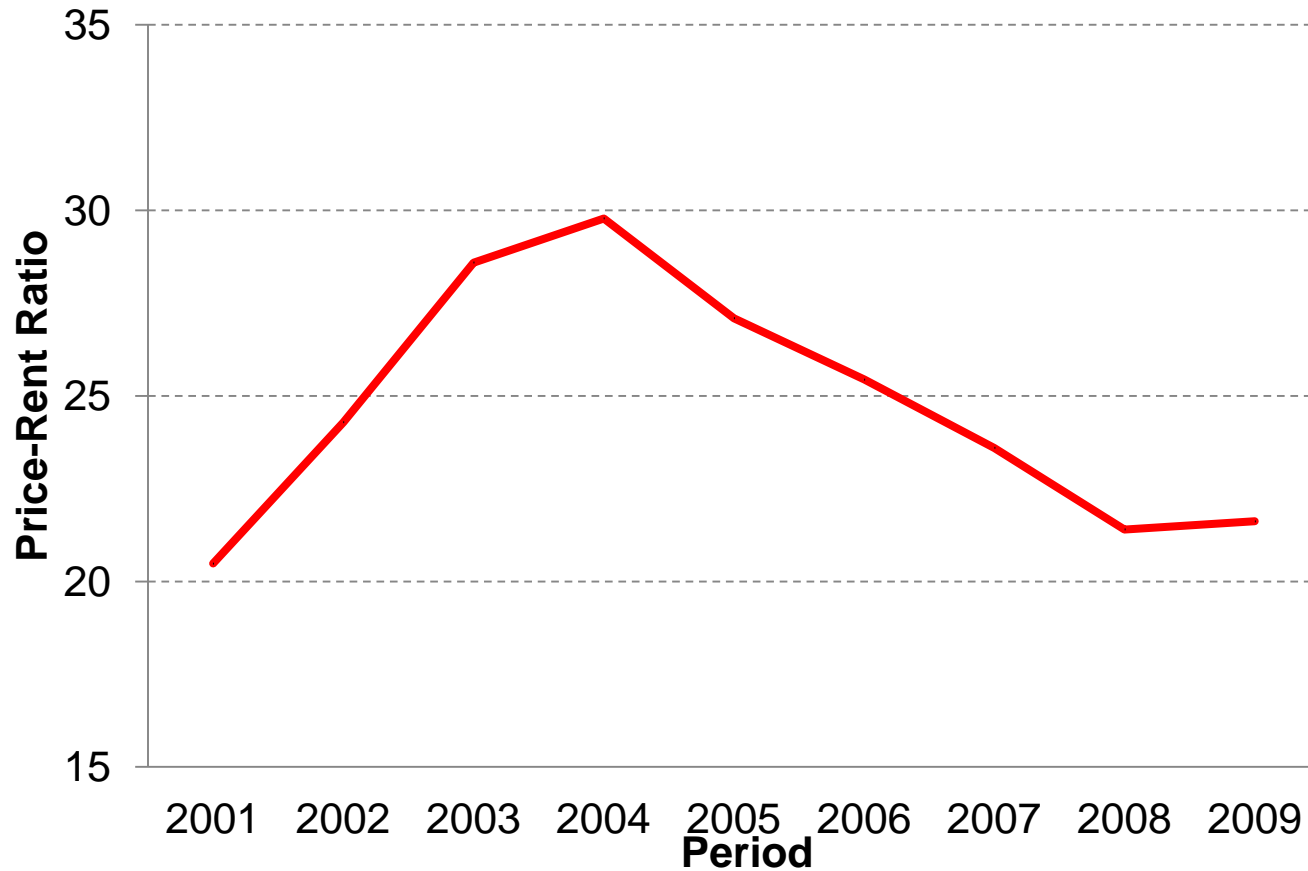
## Hedonic Price Index, Sydney



## Hedonic Rent Index, Sydney



## Hedonic Price-Rent Ratios, Sydney



# Conclusions

Understanding property markets important for policy.

Work presented here on price indexes is extremely valuable in improving the quality of information used for policy formulation.