

Keep a close eye on land prices. The price of land will tell us a lot about what will happen to house prices over the next few years. If land prices plunge, developers will be able to purchase sites and profitably sell newly built houses in two or three years' time at prices markedly below current levels. Prices for existing homes will also have to fall to stay in kilter with prices for new units.

Such declines may be on the cards. The recently released review of the construction industry prepared by DKM Economic Consultants for the Department of the Environment estimates that land prices will decline 6 per cent in 2007 from a year earlier.

According to DKM, the cost of land under the average new house this year is about €78,000. That same house sells for around €310,000. What's striking about DKM's estimates is that land prices surged an eye-popping 20 per cent in both 2005 and 2006. Other building costs, including materials and wages, registered more moderate increases of around 7 per cent.

The relationship between land prices and house prices also explains why housing busts typically take several years to play out fully. New houses coming on stream over the next year or two will be built on sky-high priced land. Because of the glut in housing, they will be sold at a discount. That'll put a squeeze on profit margins. Some developers will suffer large losses. Adjustment won't be complete until all losses have been realised.

In John B. Keane's play *The Field*, Bull McCabe famously said, "He's alright. Let him be. He learnt the lesson of the land." New bitter lessons will soon be learned.

*Alan Ahearne lectures in economics at the Cairnes School of Business and Public Policy at NUI Galway.*