

Estate agents had it easy during the boom years. Houses practically sold themselves as frenzied buyers snapped up properties regardless of price, quality, or location. But the easy times ended last spring when the housing market seized up and sales transactions have plummeted. Estate agents have toiled desperately since to match buyers with sellers, but to no avail. The market is frozen. And with the traditional autumn selling season about to kick off tomorrow, the prospects for a quick thaw look dim.

The collapse in sales is a classic symptom of the early stages of a housing bust. The problem in the market at present is that sellers are from Mars and buyers are from Venus. Sellers still think that their homes will sell for an amount close to what similar houses sold for last year. They think that if they offer a small discount, their properties will shift within a few months.

Buyers see it differently. Increases in mortgage interest rates over the past 18 months have significantly reduced the amount they can borrow. Many buyers simply can't afford to pay the sky-high prices that sellers are looking for. To be sure, the European Central Bank may pause this week in response to the ongoing turmoil in global credit markets. If the credit crisis proves to be short-lived and contained, however, as many economists think it will, then the ECB will resume hiking rates soon. In any event, the ECB is not likely to cut rates in the foreseeable future, so houses will remain unaffordable for many buyers.

Some argue that rising incomes will eventually improve affordability, even if house prices and interest rates don't drop. They have a point. The problem, though, is that wage growth is going to have to moderate significantly from the roughly 6 per cent pace recorded last year if our economy is to regain international competitiveness. That means that it is going to take a long time for incomes to catch up to house prices. Meanwhile, the glut of homes for sale is growing alarmingly.

And that gives buyers the upper hand. Anecdotes suggest that buyers are putting in low-ball bids on homes for 25 to 30 per cent below asking price. Many buyers aren't even bothering to make offers at all, having chosen instead to wait in the expectation that selling prices will tumble over the next year.

How will the standoff end? The most likely answer is, in tears for sellers. At least that is what we can expect if other countries' experiences of property cycles are any guide. When transactions dried up in April, estate agents blamed the drought on uncertainty over stamp duty, on the general election, on the April showers, and on anything else they could dream up. But now the list of things to blame is blank. Over the next few months, the stock of unsold houses will grow, and sellers will eventually recognise that the only way to flog a home in post-bubble Ireland is to slash the price.

The resulting shake-out in housing won't be pretty. Many buy-to-let investors will drop like flies. And that's probably no bad thing. You see, there used to be a time, before the bubble inflated, when most property investors were professionals. Buying and managing rental property was a full-time job. Investors were to housing what doctors are to

healthcare—experienced experts. But then the butcher, the baker and the candlestick maker joined in. It didn't matter that the properties these amateur investors purchased were grossly overpriced because they expected prices to keep rising. They had little expertise in property, just a blind faith in a simple strategy that for many years brought success. They bid up the price of houses to ludicrous levels, spoiling the market for genuine buyers looking for homes.

These investors overpowered the market. According to data from the Central Bank and Financial Services Authority of Ireland, outstanding residential mortgage loans more than doubled from €5 billion in December 2003 to €15 billion in June 2007. Incredibly, investors accounted for no less than one-third of the increase. Mortgage lending to investors jumped nearly 50 per cent each year between 2004 and 2006. By June of this year, one-quarter of all mortgages were held by investors.

The building industry has also become distorted. Many small-time builders fancied themselves as big-time developers. They borrowed tens of millions of euros from banks and built—and in some cases are still building--scores of houses that nobody wants to buy. The interest payments on these loans are enormous. And now the banks are sticking the boot in. The banks are nervous and want their money back. Many developers will soon be forced to cut and run. Asking prices on new homes will have to be slashed.

So it's clear what's needed to unwind the bust in the market. Sellers and developers will have to drop their prices. The market will have to repair. And those who made easy money from property during the boom will have to start working again for a living.

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