

What's in store for 2008? The Grinches point to the housing overhang, the global credit crunch, faltering economic growth and rising unemployment--factors that portend an *annus horribilis* ahead for the property market.

But other commentators are more optimistic. They bring good tidings of a projected bottoming out during the second half of next year, followed by a recovery in 2009.

Their confidence seems to rest largely on expected cuts in interest rates. Alas, such optimism is groundless.

For starters, financial markets are not pricing in any reductions in rates by the European Central Bank next year. The recent jump in euro-area inflation to well above the ECB's target looks set to stymie monetary easing for the foreseeable future.

Second, even if the ECB were to cut its policy rate, banks would pass on to homebuyers only some of the reduced wholesale cost of borrowing. Lenders would probably use the opportunity to rebuild margins that have been squeezed by the credit crunch.

Third, international experience tells us that housing downcycles typically last for five years, despite interest rate cuts. In fact, unless the ECB slashes rates very sharply (which is highly unlikely), borrowing costs will be higher here than during the typical housing bust. If anything, we should expect our downturn to be more severe than the average bust.

Fourth, the ECB's current policy rate of four percent is not usually high. Four percent is a reasonable expectation for the long-term average. Any reductions below this rate would therefore be temporary. Potential homebuyers would be wary of future increases.

Those encouraging buyers to borrow if rates dip are inviting people to repeat the same mistake as in 2004 and 2005. Haven't we learnt anything?