

After the binge, the hangover. We know that housing market bubbles during the late 1980s left many countries with a housing hangover. House prices tumbled and new homebuilding was unusually weak throughout the industrial world during the early 1990s.

How bad a housing hangover do we face? In 1995, spending on residential investment (which includes new homebuilding and home improvements) accounted for 6 per cent of economic activity in this country. That figure is close to the average in the euro area.

By 2002, residential investment had grown to roughly 10 per cent of GNP. That was well above the share in other advanced economies, but could be justified by our unusual demographic dynamics. In fact, some analysts consider 10 per cent to be this country's sustainable level of housing investment over the medium term.

Then all hell broke loose. The European Central Bank slashed its one-size-fits-all interest rate, inflating the housing bubble here. Soaring house prices made homebuilding extremely profitable and residential investment swelled to 17 per cent of GNP in 2006.

Using the 10 per cent figure as the medium-term norm, my back-of-the-envelope calculation suggests that the rate of investment in housing since 2002 has generated an excess stock of housing equivalent to about 25 percent of GNP. In other words, we've €40 billion worth more houses than we currently need. This is consistent with Census 2006 that showed there were more than 250,000 vacant dwellings in the country that year.

Analysts expect residential investment to slump to about 5 per cent of the economy next year. The estimates above suggest that homebuilding would have to remain at depressed levels for five years to work off the surplus. Builders may be sleeping off the hangover for a lot longer than they think.