



Think twice about strange places

50-60% Rise in global grain prices over the last 12 months. Let them eat cake!

property

Alan Ahearne



You need to know the area and to be aware that prices tend to rise, and fall, at the same time across countries before buying foreign property

IN DAVID McWilliams's documentary series *In Search of the Pope's Children* broadcast by RTE last year, Dublin developer Harry Crosbie remarked, "I wouldn't buy in Donnybrook, because it's not an area I know."

I was reminded of his comment last week as I waded through the property supplements of various newspapers. What I found striking was the huge number of foreign properties for sale, many of which are being peddled as investment opportunities. From Boston to Berlin and from Bucharest to Bangkok, the ads tell us that we can make bucketloads of cash from investing in residential and commercial property abroad.

The difficulty I have in evaluating these "opportunities" is that, well . . . these places are not areas I know.

I could blindly accept the analysis in the promotional material, but I'm sure you'll understand if I prefer to crunch the numbers myself. And what I do know about the relationship between property markets across countries and about recent devel-

opments in the global economy would make me wary of investing in property in some of these countries.

For starters, I know that property cycles tend to occur around the same time across countries.

That fact may seem odd, because property is a non-traded good. You might have thought that domestic factors largely determined swings in property markets. Idiosyncratic shocks to individual countries do play a role.

But the close association between property prices across countries suggests that global factors, such as changes in interest rates or business cycles, are important determinants of property cycles.

Over the past four decades, there have been four major episodes of simultaneous property price booms across advanced economies — 1973-74, 1978-79, 1986-89, and 1997-to date.

Each of the first three of these episodes was followed by a period in which a large number of countries experienced property price declines. Interestingly, even countries that did not experience prop-

erty booms suffered price declines when global property markets soured.

It is also worth noting that the most recent boom episode stands out in the sense that a historically high number of countries have experienced abnormally rapid rises in property prices since 1997. If these prices follow the same patterns as before, prices in a large number of countries are likely to decline at some point in the not-too-distant future.

In some countries, prices have already turned south. House prices, for example, are falling in Germany and the United States — and, of course, in Ireland. Why should we think that, this time around, prices in other countries will not follow suit?

It is true that the global interest rate cycle may have peaked. Interest rates are falling in the United States, and both the ECB and Bank of England may have lost their appetite for further hikes.

In a typical housing boom and bust, however, interest rates peak about one year after the peak in house prices. Real (that is, inflation-adjusted) house prices continue to fall

for nearly four years, even though interest rates come down sharply after they peak.

It seems that when a bubble bursts, it can't be reinflated. A new bubble can inflate to take its place, but that takes time.

The other thing I know is that some of these economies are deeply troubled. And poor economic performance is usually associated with dim prospects for property gains. Italy and Portugal are economic basket cases. Both fought China for market share in textiles, clothing and footwear — and China won.

Portugal enjoyed a construction boom around the time of entry into EMU in 1999, as interest rates dropped. But the honeymoon was short-lived. The IMF's most recent report on the country talks of a "lengthy period of adjustment" to sort out the resulting mess. I don't know about you, but I don't like the sound of that!

I also know that German commercial property is feeling the ill-effects of the credit crunch. The *Financial Times* recently reported Goldman

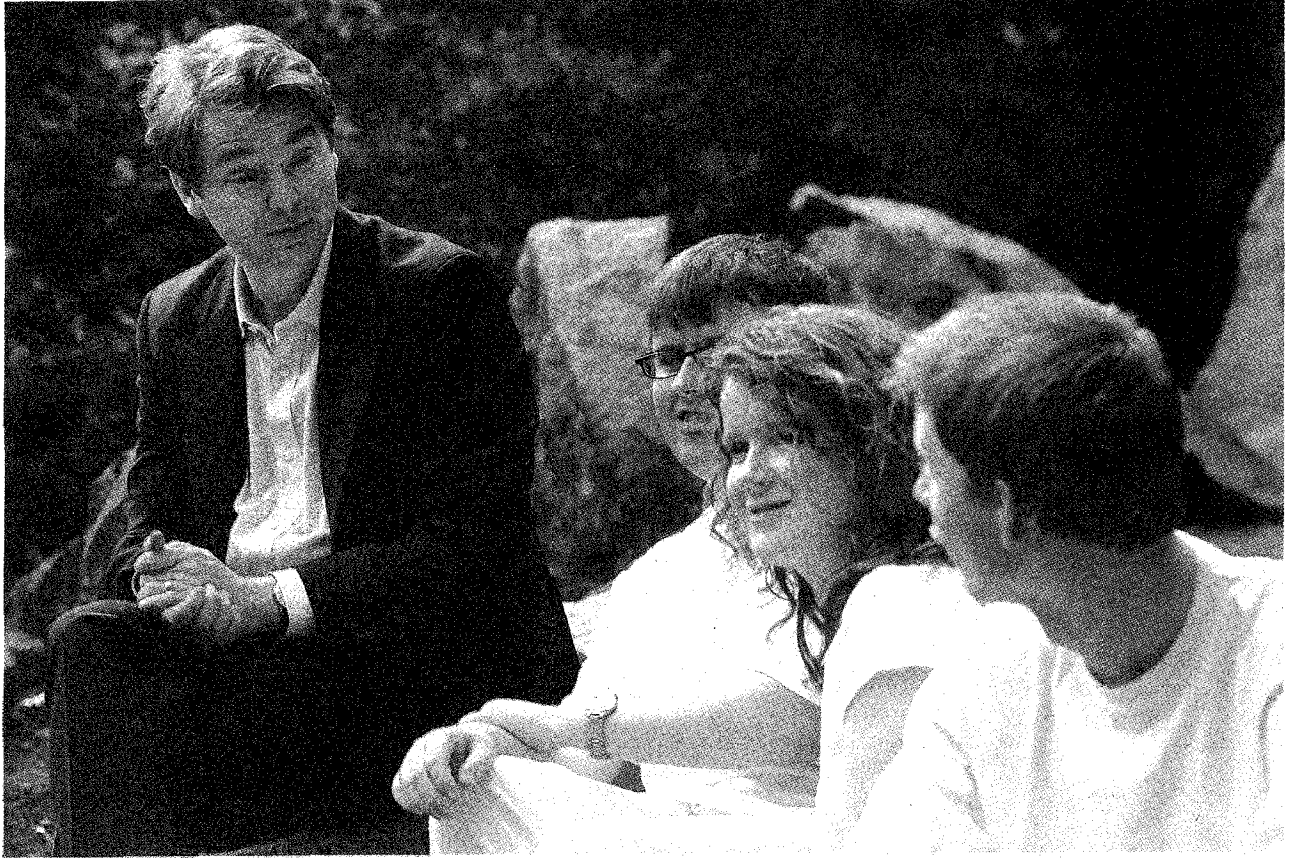
Sachs dished out a cool €2.7bn in May for a commercial property in Frankfurt. But they have not been able to flog off parts of the property, as had been planned. Here's a question: What do foreigners think they know about investing in Frankfurt that the locals don't?

And I know that several large Spanish property developers have also fallen victim to the credit crunch. Many estate agents in Spain are reportedly going out of business, as demand for housing on the Mediterranean coast has dropped in the past two years.

None of this is to imply that investing in foreign properties is necessarily a mistake. But I think you need to know the area. After all, you don't want to get ripped off!

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Publication: Sunday Independent Business
Date: Sunday, September 30, 2007
Page: 2
Extract: 3 of 3
Circulation: 287.750
Author: Alan Ahearne
Headline: Think twice about strange places



DOWN WITH THE KIDS: David McWilliams with some of what must surely now be properly termed the pope's grandchildren