



The Northern Trust Company
Economic Research Department
Positive Economic Commentary

"The economics of what is, rather than what you might like it to be."

50 South LaSalle Street, Chicago, Illinois 60675

Web Page -- <http://www.northerntrust.com> (See Economic Research)

Paul Kasriel (312)-444-4145

Fax (312)-444-4132

June 4, 2004

Housing: It's Different This Time (As It Was For Stocks In 1999)

Below are four charts pertaining to the value of owner-occupied residential real estate. The last period plotted is 2003:Q4. In all cases but one, the last data point is a post-WWII record high. The one exception is mortgage debt as a percentage of the market value of residential real estate, which was at a record high in 2003:Q3. At the end of 1999, similar statistics related to the U.S. stock market were at post-WWII highs. Those who thought that U.S. equity prices at the close of 1999 were significantly overvalued were dismissed with: "You don't understand. It's different this time." Asset price bubbles deflate when the "gas" flowing into them – central bank credit – gets restricted. As we enter a period when the Fed will start to restrict the growth in the credit it provides the U.S. financial system, it will be interesting to see if it really is different this time for the housing market or if it is a bubble just as the stock market was back in 1999.

Chart 1

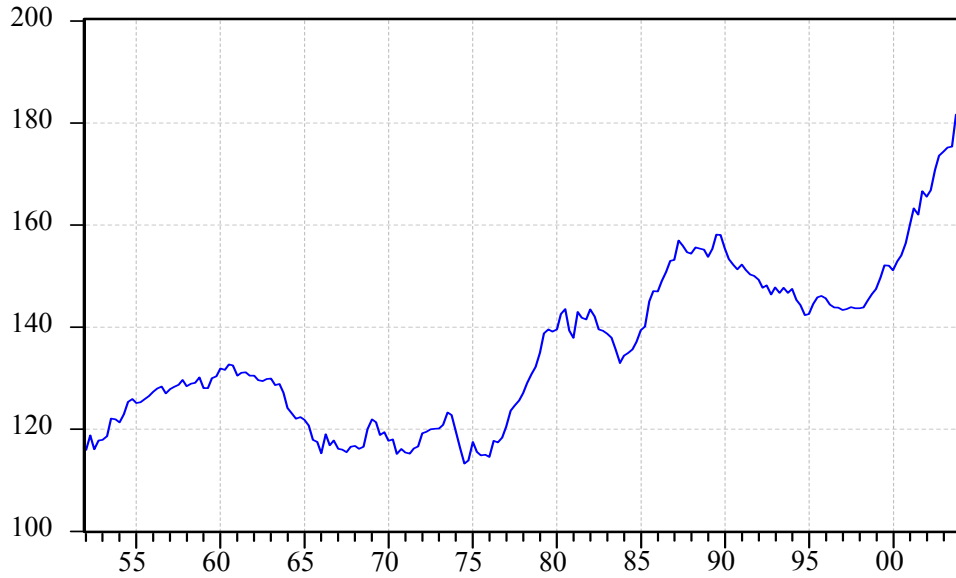
P/E Ratio for Owner-Occupied Residential Real Estate

Mkt. Value of Res. Real Estate / Imputed Rental Services on Res. Real Estate



Chart 2

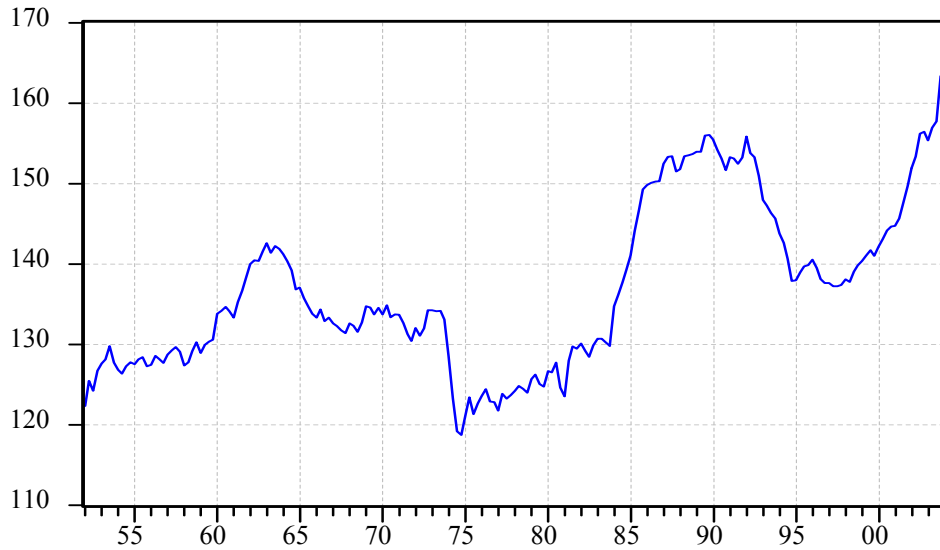
Market Value of Owner-Occupied Residential Real Estate / DPI*
%



*DPI = disposable personal income

Chart 3

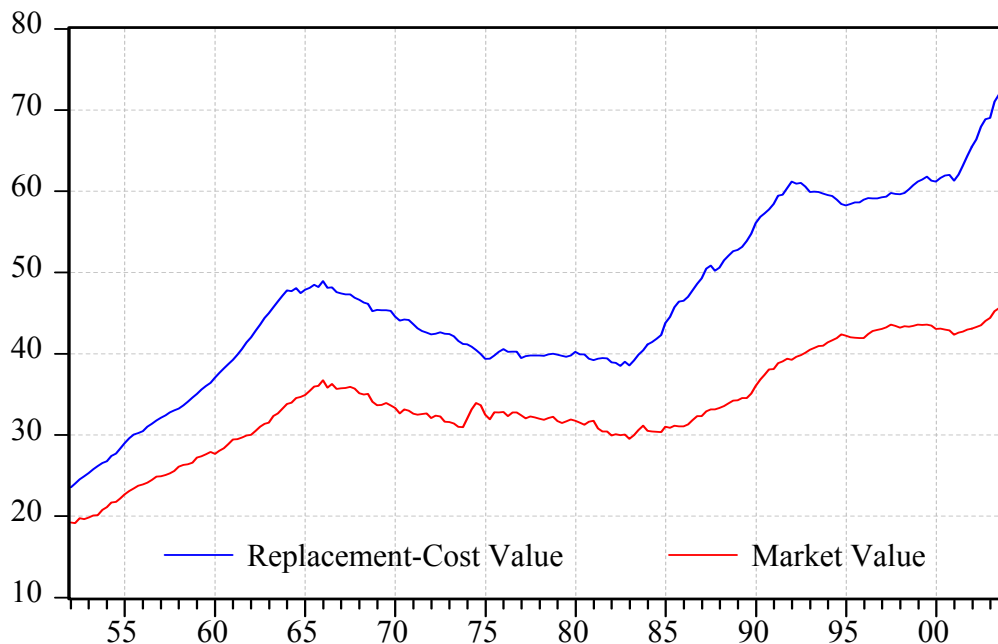
Owner-Occupied Residential Real Estate: Market Value / Replacement Value
%



The information herein is based on sources which The Northern Trust Company believes to be reliable, but we cannot warrant its accuracy or completeness. Such information is subject to change and is not intended to influence your investment decisions.

Chart 4

Owner-Occupied Residential Real Estate Leverage*
%



*Leverage = mortgage debt divided by value of real estate

If I were a creditor, I would be more concerned about the loan amount compared to the replacement cost of the house rather than the market price. I recall back in the late 1990s, when corporations were taking on large amounts of debt, the cognoscenti told creditors not to worry because debt levels relative to the *market* value of corporations were falling. When corporate equities went into a swoon starting in 2000, corporate defaults shot up because debt levels relative to the *replacement* value of corporations were highly elevated. But I'm sure it will be different this time for housing. We had better hope so inasmuch as U.S. commercial banks have a record 60% of their earning assets in mortgage-related obligations.

Paul L. Kasriel, Director of Economic Research (plk1@ntrs.com)

The information herein is based on sources which The Northern Trust Company believes to be reliable, but we cannot warrant its accuracy or completeness. Such information is subject to change and is not intended to influence your investment decisions.