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## Be Warned: Mr. Bubble's Worried Again

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ABBY JOSEPH COHEN, the [Goldman Sachs](#) strategist then making a name for herself as Wall Street's optimist in chief, sat directly to Alan Greenspan's right. One chair away was Robert J. Shiller, a largely unknown Yale economist.

As they ate lunch in a stately dining room at the Federal Reserve that day in December 1996, Mr. Shiller argued that the stock market had risen to irrational levels. In a soft, Midwestern-tinged voice, he asked Mr. Greenspan, the Fed chairman, when the last time was that somebody in his job had warned the public that the stock market had become a bubble.

Mr. Greenspan listened without giving his opinion, and Mr. Shiller went home assuming that he had been farther away from Mr. Greenspan than Ms. Cohen in more ways than one. Three days later, however, driving his son to school in the family Volvo, Mr. Shiller heard on the radio that stocks were plunging because Mr. Greenspan had asked in a speech whether "irrational exuberance" was infecting the markets.

"I may have just started a worldwide stock-market crash," the professor told his wife, Virginia, who accused him of delusions of grandeur.

Today, nine years after his lunch with Mr. Greenspan and five years after the markets finally did crash, Mr. Shiller is sounding the same warning for real estate that he did for stocks. In speeches, in television and radio interviews and in a second edition of his prophetic 2000 book, "Irrational Exuberance," he is arguing that the housing craze is another bubble destined to end badly, just as every other real-estate boom on record has.

These, in short, are his second 15 minutes of gloom. He predicts that prices could fall 40 percent in inflation-adjusted terms over the next generation and that the end of the bubble will probably cause a recession at some point.

Despite being a boyish-looking 59-year-old academic economist with a halting speaking manner, he has become the bugaboo of the multibillion-dollar real-estate industry. Its executives, like many Wall Street economists, say that low interest rates and a growing population will keep house prices rising, even if future increases are smaller than recent ones. On Monday, the National Association of Realtors reported that the median home price climbed to \$208,500 in the second quarter, up 14 percent from a year earlier.

"Shiller is predicting the mountain goes into the sea," Robert I. Toll, the chief executive of Toll Brothers, a home builder, said in a recent interview, without having been asked about the economist. "He's selling himself."

To Mr. Shiller, though, it is a question of history, not salesmanship. Most people have never looked at decades and decades of home prices, because such data have been almost impossible to find. Stock-market charts often go back almost a century. Housing charts typically start sometime in the distant decade of the 1970's.

But Mr. Shiller has unearthed some rare historical housing data for other countries. Using old classified advertisements, he was then able to fashion a chart for the United States that goes back to the 19th century.

It all points to an unavoidable truth, he says. Every housing boom of the last few centuries has been followed by decades in which home values fell relative to inflation. Over the long term, the portion of income that families spend on their shelter stays about the same.

Builders become more efficient, as they are doing today. Places that were once sleepy hinterlands, like the counties south of San Francisco or a patch of desert in southern Nevada, turn into bustling centers that take pressure off prices elsewhere. Even now, the United States remains a mostly empty nation.

"This is the biggest boom we've ever had," said Mr. Shiller, who bought into the boom himself in 2002, with a vacation home near one of Connecticut's Thimble Islands. "So a very plausible scenario is that home-price increases continue for a couple more years, and then we might have a recession and they continue down into negative territory and languish for a decade.

"It doesn't even attract that much attention," he continued. "There will be many people thinking it was a soft landing even though prices may have gone down in real terms by 40 percent."

MR. SHILLER begins his story 400 years ago, in the country that helped invent the idea of a bubble. In 1585, workers in Amsterdam began to dig a canal through the city. It became known as the Herengracht, or gentlemen's canal, for the fashionable row houses that soon sprang up on its banks. Merchants moved into many of them, and the canal remains one of the city's finest addresses today.

In recent years, a Dutch economist named Piet M. A. Eichholtz heard about a book from the 1970's that traced the Herengracht's history, including records of every sale. But his efforts to track down a copy failed - until he was browsing through a secondhand bookstore in Amsterdam almost a decade ago, not long after Mr. Shiller's lunch with Mr. Greenspan, and stumbled across one.

It had all the details Mr. Eichholtz wanted.

To translate the sales into an index of prices over the years, Mr. Eichholtz turned to a method invented by Mr. Shiller and a colleague. The United States government uses the same process for

its best-known measure of house prices, which is published every quarter by the Office of Federal Housing Enterprise Oversight, the chief regulator of [Fannie Mae](#) and [Freddie Mac](#).

The beauty of the method is that it does a better job of capturing the experience of homeowners than a simple average of house prices does. That average can rise when a bunch of new McMansions get built, even if existing houses have become no more valuable. The Shiller index, by following the same set of houses over many years, tracks the actual financial return that houses produce for their owners.

On the Herengracht, those returns have often been fantastic for 25 or even 50 years at a time. Home prices soared in the first half of the 17th century, around the time of the tulip mania. But they came crashing down in the 1670's, when the prime minister was killed, and partially eaten, by a mob of angry Dutch, and the country nearly disintegrated. Prices lagged inflation during the Napoleonic wars but surged after William became king in 1814 and the country industrialized.

Again and again, the cycle repeats itself. But there is essentially no long-term trend, beyond a general rise in house prices that roughly matches gains in peoples' incomes. As Amsterdam became a global city and its population exploded, demand for homes increased - but so, too, did supply.

PRICES have hardly become more stable over the last 400 years; in fact, they've jumped up and down more in the 20th century than they did during the 18th and 19th. Only the 17th century, that time of cannibalized prime ministers, was more volatile.

"A whole lot of the price increases you see in houses is imaginary, because it's just inflation," said Mr. Eichholtz, a professor at Maastricht University. "People say, 'I have a house. It protects me against the economic imbalances or misfortunes of the country.' The big lesson is that real estate does not give you the protection that people think it does."

A history of Norwegian house prices that Mr. Shiller has found shows the same pattern. As does his index of American house prices, until the blastoff of the last decade. In chart form, it looks eerily similar to the stock chart from his 2000 book.

But this is actually a happy story in many ways. Over the long course of history, families have not been forced to devote an ever-larger chunk of their money to the roof over their heads. They instead can afford better health care, new technologies and - as Mr. Shiller pointed out during lunch this month at a steakhouse in midtown Manhattan - leisurely restaurant meals.

Still, history is easy to forget during times like these. Mr. Shiller says that a steady shift toward freer markets around the world has caused people to think much more about the importance of what they own. The best description, he said, comes from President Bush, who often talks of "an ownership society." (Mr. Shiller has tried, without success, to find out who in the White House had coined the phrase.)

When his undergraduates were reading through old newspapers, they found that stories about house prices were once confined to the back pages of business sections. Today, real estate often seems to be topic A in the national conversation.

Many people have made huge profits from selling homes, and many more have paper profits. When people get together with friends, they want to find a subject that makes others happy, Mr. Shiller says, and real estate fits the bill, just as stocks did in the 1990's.

"It's very much like studying a disease epidemic. It's a contagion," Mr. Shiller said. "When it goes in an up direction, it's very impressive. But it can also work in the down direction."

This psychological approach has been at the core of his work for years. In the 1970's, when his wife was studying psychology, he would soak up the discussions that she and her fellow graduate students had over dinner at the Shillers' house in Delaware. A decade ago, his beliefs about herd behavior led him to his lunchtime conversation with Mr. Greenspan.

Mr. Shiller takes no credit for the phrase "irrational exuberance." He does not remember using it during the conversation. He recently searched through his daily diary, which he keeps on a computer, from the early 1990's and found only one phrase that was at all similar. In 1991, he used "overexuberant" to describe an exercise that had left him feeling sore.

His good friend, Jeremy J. Siegel, an economist at the University of Pennsylvania, stumbled upon a 1959 quotation from Fortune magazine in which Mr. Greenspan discussed "over-exuberance" in the financial community. The phrase is probably his. He may even have to dust it off again soon. He recently called some local markets "frothy" but emphasized that there was no national bubble.

Even so, Mr. Shiller has little company for his radical notion that house prices could fall by 40 percent. Many economists say that interest rates are low enough and demand for housing in big urban areas is high enough to keep from prices from falling very far. Mr. Shiller himself confesses to some doubt.

"I don't have any certainty," he said. "I have a lot of humility" about any prediction.

"We do have a shortage of land in the prestige areas, and so there is a potential for them to go up," he added. "But I just know that the trend over the last century has been for new prestige areas to appear."

If he is right, the Herengracht also looks due for one of its occasional corrections. Prices there have doubled, even accounting for inflation, over the last decade or so. It almost seems like they might never fall again.