

## theirview

## Housing and financial stability

**In the event of a steep decline in housing prices, it is the shadow banking sector that takes the hit**

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**H**ousing is a financial asset. Unlike financial securities, it has a direct utility value, like gold and other commodities. As such, housing can be a barometer of asset bubbles, and also of financial repression as savings flee financial securities when real interest rates turn negative. Housing markets are therefore central to financial stability.

As fixed assets, houses were traditionally considered non-tradable internationally. The proximate trigger for the greatest global financial crisis since the Great Depression of the 1930s however lay in the housing sector. A house in Arizona, US, can now be financed by a municipality in Western Australia. As claims on ownership become eminently tradable, housing markets increasingly raise issues of global financial stability.

The few long-term house price indices that are available, such as those for the US, Canada, Australia and Norway, indicate that real house prices were quite stable from the time the series begin in the 19th century right up to the 1970s, when they started rising and becoming very volatile. They rose dramatically from the end of the last decade of the 20th century to peak just before the onset of the global financial crisis.

Who or what is to blame for housing bubbles? There are five prime suspects: international capital flows deriving from global imbalances, easy monetary and regulatory policies that lower yields and encourage risky credit, fiscal policies that promote house ownership, and the shift from the gold standard to fiat currency.

What are the takeaways for developing countries in general, and for India in particular?

First, house prices have risen sharply in urban India in recent

years, the near-term tapering notwithstanding. The National Housing Bank (NHB) RESIDEX shows that residential housing prices in the National Capital Region have doubled since 2007. They rose even more steeply in Pune and Mumbai. They increased 3.5 times in Chennai. The moot point is whether the urban housing boom is a response to a real demand-supply imbalance, or whether it is a speculative bubble, driven by excessive liquidity, large capital inflows, financial repression on account of low real interest rates, and a booming informal or black economy. What is a bubble? One way of looking at this is to compare rental incomes from investment in housing (2% currently) with the cost of prime borrowers (in excess of 10%). Investment in housing can only be repaid through capital appreciation. This was the original sin of the US subprime housing crisis. When housing prices declined, the financial edifice came crashing down. Second, affordable housing is a bigger issue in developing countries because of lower median incomes and rapid urbanization on the one hand, and the steep rise in urban housing prices on the other. Low income households are vulnerable to being priced out of the market. The middle and upper classes have access to financial markets, while economically weaker sections are mostly financially excluded. There is under-investment in the latter and over-investment in the former.

Third, what should be the policy response to address this imbalance? Lowering regulatory standards to enable the economically weaker sections to access housing finance could result in a US-type subprime that can threaten financial stability and entail taxpayer-funded bailouts. The latter are also

**REAL US HOME PRICE INDEX (1890-2014)**



AHMED RAZA KHAN/MINT

likely on equity considerations. Is it therefore more desirable to provide direct fiscal support, through tax breaks and/or subsidies? The poor need access to shelter, which could be effectively done through income transfers for rentals till such time as they accumulate savings to own a house, when ownership could be transferred at subsidized prices, as in Singapore.

Fourth, monetary policy seems too blunt an instrument for promoting financial inclusion. Low interest rates can endanger macroeconomic and financial stability by fuelling asset bubbles, as in advanced economies. The Federal Reserve's purchase of housing mortgages on an epic scale in the wake of the crisis as part of its quantitative and credit easing policies to support housing markets may be spawning new bubbles and eventual taxpayer-funded bailouts as the US housing sector is now virtually nationalized. On the other hand, if monetary policy is used to target asset bubbles it may deflate business cycles prematurely. This famously led Alan Greenspan, former chairman of the Federal Reserve, to argue that central banks should not call asset bubbles but simply clean up after they burst. The global financial crisis showed just how costly the

clean-up can be. The debate over monetary policy targeting asset bubbles currently centres on finding new instruments, such as macro-prudential policies adopted by India in the run up to the global financial crisis. The jury is still out on this, however, especially since some pro-cyclical features of the Basel II framework, such as market-to-market, have been retained in Basel III.

Finally, Indian housing markets are a mix of shadow and regulated banking finance. Registered housing prices grossly understate the market price. This makes it difficult to compile robust indices. The data from Bank for International Settlements (BIS), Haver Analytics, and Scotiabank used by the International Monetary Fund to develop a new housing price index for emerging markets give very contradictory trends. This mix also results in a conundrum. In the event of a steep decline in housing prices it is the shadow banking sector that takes the hit. It is the shock absorber that shields regulated banking sector from instability, with non-performing assets in the housing sector much lower than in other sectors.

Comments are welcome at [theirview@livemint.com](mailto:theirview@livemint.com)

## bookview

## From the Czarist rubble, an autocrat rises

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**R**eaders plunging into Stephen Kotkin's "Stalin: Paradoxes of Power" expecting a detailed dissection of the cobbler's son who evolved into the monster called Stalin may be disappointed to find that, as a boy called Iosif Dzhugashvili, he plays a relatively minor role in early chapters. The narrative focuses largely on the disintegration of czarist Russia. What we do learn about the life of Soso, as Stalin's family referred to him, is served up as a relatively acceptable childhood given the time and place, denouncing the popular Freudian analyses that spot early evidence of a psychopath.

But "Stalin" is far more than the story of the man. Kotkin's stunningly ambitious project is nothing less than to write an exhaustive history of Russia and the world around it, from the collapse of the czarist empire through the end of World War II. The first volume

ends in 1928 on the eve of the savage collectivization of Russia's peasant agriculture, with fascism rising to the west.

It becomes immediately clear that Kotkin, a professor of history at Princeton, has done prodigious research, not only among the troves of scholarly works about Stalin but also in the archives that have become accessible since the collapse of the Soviet Union. More important, he is not shy about assailing what he regards as false interpretations by other historians. His Stalin is not a disciple who deviates from Lenin; he is Lenin's true disciple, in pitiless class warfare, in the inability to compromise, and, above all, in unshakable ideological conviction.

There is little equivocation in Kotkin's judgments. Scholars who argue collectivization was necessary to force Russian peasants into a modern state are "dead wrong." The conclusion by the British historian E. H. Carr that Stalin was a product of circumstances, and not the other way around, is "utterly, eternally wrong." On the contrary, it is



**STALIN** STEPHEN KOTKIN

**Stalin: Paradoxes of Power, 1878-1928**

Stephen Kotkin  
Penguin Press

one of Kotkin's major theses that Stalin "reveals how, on extremely rare occasions, a single individual's decisions can radically transform an entire country's political and socioeconomic structures, with global repercussions." Kotkin's involvement in his subject is so intense that at times he leaps from his historian's perch right into the fray.

A work of this scope, ambition and intensity is bound to attract challenge, debate and criticism. I would have wished more attention to the role of culture and religion in the fall of the Russian empire and the rise of Soviet power. What was striking throughout the book were the many troubling echoes with Russia today. Kotkin argues convincingly that Stalin was that rare individual whose decisions radically changed history, and his next volume, on collectivization, promises to further develop the thesis.

"The Russian Revolution—against the tyranny, corruption, and, not least, incompetence of czarism—sparked soaring hopes for a new world of abun-

dance, social justice and peace," Kotkin writes. "But all that was precluded by the Bolsheviks, who unwittingly yet relentlessly reproduced the pathologies and predations of the old regime state in new forms." Is that not what is happening today, after the soaring hopes raised by the collapse of the Bolshevik state? Of course, President Vladimir V. Putin is not even a pale shadow of Stalin, and today's Russia is a far cry from Stalin's totalitarian state, but then the young Dzhugashvili gave no sign that he would become Stalin, just as Putin showed no early evidence of what he would evolve into.

This reader, for one, still hopes for more evidence that Stalin was indeed singular, a historical malignancy, and not a product of circumstances. It is a testament to Kotkin's skill that even after almost a thousand pages, one wants more.

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