Written by **Bob Adelmann** on June 16, 2014

Chinese Economist at IMF Warns of Global Housing Bubble

The false assumption that regulators can be safely counted upon to steer economies — local, national, or global — to full employment with minimal inflation while avoiding booms and busts was exposed in the latest yelp from the deputy managing director of the International Monetary Fund (IMF), Zhu Min. In Chinese, his name means "people rule" or "democracy," but his ideology is firmly rooted in the Keynesian fallacy that economies can be successfully managed by experts without assistance or input from the common folk.

In announcing that the IMF has launched a new website, Global Housing Watch, Zhu delights in thinking that the world's economy can be driven by looking through the rear view mirror. He said,

> Housing prices are inching up….
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> In fact, our research indicates that boom-bust patterns preceded more than two-thirds of the recent 50 systemic banking crises [experienced around the world]….
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> We need to guard against another unsustainable boom.

Through a series of charts and graphs — one the tools of hubris-infected Keynesians — Zhu concludes that another bubble is brewing: "33 out of 52 countries in our Global House Price Index showed increases in house prices," some of them unnerving. For example, Zhu's own China has seen housing prices gain nearly 10 percent in just the last year, placing it fourth behind New Zealand, Hong Kong, and the Philippines. The United States, Israel, Australia, Switzerland, and Germany aren't far behind, either, registering gains in the high single digits.

And when other ratios are calculated, such as affordability compared to rents and incomes, the numbers are equally concerning. In explaining why he's nervous, he sounds sensible:

> Theory asserts that house prices, rents and incomes should move in tandem over the long run. If house prices and rents get way out of line, people would switch between buying and renting, eventually bringing the two in adjustment. Similarly, in the long run, the price of houses cannot stray too far from people's ability to afford them.

In a free, unfettered, unregulated housing market, of course, Zhu is exactly right. But as Ronald Reagan famously said, "Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

Zhu is a graduate of that school. Born and raised in China, Zhu attended Fudan University, where he obtained his BA in economics in 1982. That university, founded in 1905, was subverted into a Keynesian transmission belt when the People's Republic of China took over the country in 1952, modelling itself after the Soviet educational system.

After graduating from Fudan, Zhu gained a master's degree in public administration from Princeton and a Ph.D. in economics from Johns Hopkins University. Prior to his work at the IMF, Zhu held various positions at the Bank of China, serving, as his own bio boasts, in "internal control [and] compliance." No free market training there.

And his analysis of the international housing bubble that appears ready to burst shows it. What's needed is more regulation and interference in the operation of the market than already exists, says Zhu, who suggested putting limits on loan-to-value ratios that banks and mortgage companies can offer, along with higher debt-to-income ratios required by borrowers. Additional capital requirements on the lenders themselves were also recommended. And then, of course, there's monetary policy "which involves the central bank [of each country] raising interest rates … to cool off the housing sector."

Min admits, however, that these strategies may have limited impact or usefulness partly because the "policy toolkit" used by managers is still being developed:

> The task [of regulating the global housing market] is difficult for a couple of reasons. First, assessing when house prices are out of line with economic fundamentals is as much art as science. Second, the policy toolkit to manage housing cycles is still under construction.

In this remarkable admission by one of the IMF's brightest and best minds, does Zhu think perhaps he might have done better getting a degree in the arts? One thing is sure, however, and that is that leaving the housing market alone, to let buyers, sellers, borrowers, and lenders sort things out by themselves is not one of the Keynesian tools in his toolkit:

> The tools for containing housing booms are still being developed. The evidence on their effectiveness is only just [now] starting to accumulate. The interactions of various policy tools can be complex. But all this should not be an excuse for inaction.…
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> [Instead] we need to move from "benign neglect" to an "all of the above" approach when it comes to policy choices.

Back in May, the *Financial Times* saw the bubble approaching, with some 11 countries in its own analysis rising by double digits over the last 12 months. Even housing price increases in Germany, said the *Times*, are "prompting concern, with the Bundesbank warning that valuations are as much as 25 percent too high in [some] big cities." It went on to examine housing prices in Britain, Israel, and New Zealand, each of which is seeing prices way above "norms."

The *Times* also expressed concern that the IMF's "toolkit" might not have enough clout to quash the latent bubble:

> Economists at organizations including the Bank for International Settlements question whether, on their own, macroprudential regulation can stop a boom once it is going full throttle. It is easier [for lenders and borrowers] to find a way around tougher regulation that to dodge higher official interest rates.

It is clear that there is an international housing bubble forming. It is equally clear that the so-called "policy toolkit" still under construction by the best and the brightest among the regulators will do little to dampen that latent bubble from expanding and then imploding once again. It's the inevitable boom and bust cycle as explained by Austrian economist Frank Shostak: "Fractional reserve banking (creation of money out of "thin air") is actually instrumental in creating the dilution of real wealth formation and boom-bust cycles."

Georg Wilhelm Friedrich Hegel said it plainly: "The only thing we learn from history is that we learn nothing from history." It's too bad that Min didn't major in art or history. He might then do better in steering the global economy away from the next global housing bust by allowing it to operate without interference from experts such as himself.

Photo of IMF Deputy Managing Director Zhu Min: AP Images

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