

# House Prices are still overvalued

## Predicts a big decrease in House Prices

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The Danish Economist Jens Kjaer Sorensen's prediction about the global financial and credit crisis was right. He now predicts price decreases in house prices.

In his Masters Thesis in Economics from University of Copenhagen in 2006, Jens Kjaer Sorensen who was a student, that the international housing markets was a bubble – and that a credit crisis would lead to a price decrease and financial turbulence.

Two years later he can conclude that he was right in his predictions, which was given at a time when only few well-established economists said the same.

Sorensen, who works as an equity trader in a greater Nordic bank, now predicts that Europe is in front of an even greater correction than the one in the US.

- Especially Denmark will be hit hard, since the growth in construction have been booming, the banking sector is fragmented and the amount of debt in real estate is high relative to GDP, says Sorensen to E24.

20 percent down in Denmark

He believes that house prices in Denmark will have to fall by 40% in real terms from the top in 2006. This prediction states that house prices will have to decrease by additional 20% before the bottom has been reached.

- Denmark is one of the countries in Europe, which is hit the hardest. Three banks have already been hit by the credit crisis and there is a strong downwards pressure on house prices, says Sorensen.

In Norway he believes that prices will decrease by 30% from top to bottom. House prices will have to decrease by additional 26%.

This is a much more negative prediction than most economists in Norway dares to say. Professor Ola Grytten from Norwegian School of Economics and Business Administration (NHH) predicted a year ago that house prices were overvalued by 30%.

Oil is the safety net

According to the professor it doesn't necessarily mean that the market will have to decrease by that much, but he is certain that prices will have to go down substantially in autumn and spring of next year.

From the top in August last year prices on existing houses in Norway has decreased by 4%, but the price on apartments have decreased by 5.3%, according to Norwegian Real Estate Sector (NEF) statistics. Even the sector itself believes that autumn will be tough, but continue to hope that the market will stabilize next year.

Sorensen underlines that even though he is negative about the housing market that the Norwegian economy, including credit and housing market is stronger than the Danish.

- Norway is in a much safer position due to its oil, which will function as a safety net, and at the same time Norwegians are not as much in debt as the Danes, says Sorensen.

Fragmented market

He believes that one of the biggest reasons for the struggling credit market in Denmark is due to the fact that Denmark has a highly fragmented banking sector, which has risk exposure towards small regions. He believes that it is necessary that a consolidation in the banking sector is needed to ensure that more banks are not going bankrupt.

- People have borrowed too much money and over consumed, mainly due to the new aggressive loan types. If people can not afford their payments on the loans banks are in trouble, he says.

He underlines that the subprime-loans in the US are far more aggressive than the loan types we have seen in Europe.

- But the housing bubble is bigger in Europe than in the US. We have better structures for loans, but the credit market is being hit hard from abroad and we will have to adjust our expectation to lower house prices, Sorensen says.

### Overpriced house prices

In his Masters Thesis Sorensen analyzed 23 housing bubbles, which has burst throughout time – and concluded in 2006 that a greater real estate and credit crisis was on its way.

A clear point was that the connection between the housing market and the development in the financial markets. The main conclusion in Sorensen's thesis was that real house prices relative to fundamental economic parameters are constant in the long run.

When the real estate market is above its fundamental value then house prices will at some point follow the tendency and adjust downwards, he writes in his thesis. Sorensen believes that in two years from now house prices in Denmark and Norway will still be overpriced and that the bottom will not have been reached.

Sorensen also predicted that Denmark faced an economic recession. That is the case now. Denmark has unofficially experienced two consecutive quarters with negative economic growth.