How consumer behaviour sways the housing market- and the economy

Too many individuals underestimate the risks associated with buying a house and many people believe that house prices never fall. Here's why that's a problem

Why consumer behaviour matters

If you want to know how the housing market really works, start with the consumer.

The decisions we make about housing-whether to rent, buy or stay at home with mum and dad- not only affect our quality of life, they affect house prices, too. This matters because changes in prices – in either direction – can play a critical role in the way economies develop and can affect the stability of the entire financial system. It is widely believed that the US housing market played a key role in the global financial crisis of 2008 (though this view is disputed by some. See the VoxEU column by Laurence Kotlikoff).

As such, developments in the property market are followed closely by international organisations such as the International Monetary Fund.

Attitudes to housing

The Fund's Global Housing Watch website and associated newsletter analyse housing markets across the world to gain a better understanding of boom-bust cycles, which they say have preceded more than two-thirds of the last 50 systemic banking crises. The research does not reflect the official view of the IMF but it does provide background information.

In its latest newsletter, the IMF looked at consumer attitudes to housing based on information gathered over six years from the ING International Survey on homes and mortgages. We talked to them about our findings in the section titled: “Understanding behaviour of home buyers across countries”.

In the interview, we highlight the tendency for individuals to underestimate the risks associated with buying a house. A noticeable minority in all 15 countries surveyed agree with the statement, “house prices never fall." Further, agreement with the statement increases as house prices actually increase, despite there being noticeable falls in previous years.

Answers to other questions indicate that many believe buying a house is a good financial investment and that purchasing is a sign of success. The combination of these beliefs suggests that, too often, the risks of buying property are trivialised or underrated.

At the personal level, buying even a few years before house prices peak and possibly fall can leave people in financial distress. At a macroeconomic level, a belief that house prices never – or even are unlikely – to fall can contribute to unjustified rises in house prices and damage financial stability.

The complete picture

At a time when Professor Robert Shiller is noting with concern that house prices in the US have risen at the third-fastest rate in history over the past several years, and there are signs of peaking house prices in countries such as Australia and the UK, the latest IMF Global Housing Watch newsletter is more topical than usual.

Many things affect house prices - demographics, the availability of credit and government policy all play a role. But macroeconomic and market factors do not present the whole story. Consumer attitudes are crucial. Without a better understanding of how people make the decision to rent, buy or stay or stay with friends and family, we cannot fully understand housing markets.