Opinion: Housing market isn’t rational

By Robert J. Shiller, New York Times

Home prices have been climbing. They have risen 27 percent nationally since 2012, even more in places like San Francisco. But why worry? If you accept the efficient markets theory — and believe that real estate is an efficient market — then these prices are based on “new information,” even if you don’t know what that information is.

The problem with this kind of thinking is that the efficient markets theory is at best a half-truth, as a voluminous literature on market anomalies shows. What’s more, even that half-truth is grounded mainly in the stock market, which attracts professional investors who sometimes do make the market behave efficiently.

The housing market is another matter. It is far less rational than even the often irrational stock market, for a couple of important reasons. First, most investors find it difficult to understand how housing supply responds to changes in demand. Only a small minority of people think carefully about such things. Second, it is very hard for the minority of smart-money investors who do understand such matters to bet against bubble-level prices in real estate markets. In housing, the smart money has relatively little voice.

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