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Housing boom due to global intergration says Greenspan

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Published: October 9 2006 20:18 | Last updated: October 9 2006 20:18

The great boom in US house prices that abruptly petered out in recent months was caused by increased global integration, not loose monetary policy, Alan Greenspan, the former chairman of the Federal Reserve, has claimed.

“I don’t think that the boom came from a 1 per cent Fed funds rate or from the Fed’s easing. It came from the collapse of the Berlin Wall,” Mr Greenspan told a private audience in Canada on Friday.

The former Fed chairman said the collapse of Communism in eastern Europe and the shift towards more market-based economies in China and other parts of the developing world brought “billions of cheap labourers onto the scene”.

This, he said, “brought disinflation and lowered inflation risk premiums and long-term interest rates, creating a decline in real interest rates and equity-risk premiums.”

In consequence, “the real market value of assets increased faster than GDP”.

Mr Greenspan said the system “ran out of steam as no one could afford houses any more.” But he said the worst of the housing correction may already be over.

Asked why he had not tried to raise interest rates to dampen down the technology bubble in the stock market in the late 1990s, the former Fed chairman said “we tried that in 1994/1995 and failed.”

Mr Greenspan said the tightening cycle from 1994 to 1995 was “highly disruptive” but failed to rein in stock prices.

“We didn’t diffuse the bubble, we made it worse,” he said. “The stock market was flat during the tightening period and when the tightening ended in 1995 the stock market took off.”

“We learned that the Fed could not incrementally diffuse a bubble,” he said.

Mr Greenspan said he realised that “unless we tightened aggressively enough to hurt the economy and profitability the market bubble wouldn’t diffuse. Rates would have had to go up 10 to 12 percentage points to break the back of the stock market, which would destroy the economy.”

The former Fed chairman also talked about developments in the energy market, highlighting the absence of spare capacity as a major source of volatility in prices.

“Excess capacity is not there any more,” he said. “Therefore if anything goes wrong on the supply side, prices can jump.”

He added “there is also a significant terrorist premium, and prices were also bid up by financial speculation.”

Mr Greenspan defended the role of hedge funds, which he said “did us a great favour in buying oil contracts.”

He said “hedge funds now have the inventory they need, so the bids are disappearing, and prices are now falling,” even though “global demand for oil has not slowed much.”

But he was critical of the oil industry, remarking “another problem is that the huge amounts of cash flowing into national oil companies are not being used for exploration.”

Mr Greenspan said there is not enough refining capacity, and cast doubt over whether ethanol derived from corn could ever adequately substitute for US consumption of petroleum products.

The former Fed chief said global warming was “real, evident and a given.” He described the Kyoto accord as “naïve” but praised the European Union carbon trading system.

He said he was unconcerned about conslidation in the banking industry, arguing that “new institutions will spring up to meet local and community needs.”