{ INFLATED ASSETS }

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Is the surge in UK house prices yet another bubble? If so, when will it pop?

Alan Greenspan, former chairman of the US Federal Reserve, famously observed that it is impossible to identify an asset bubble until after it has popped. Central banks should therefore focus on dealing with their consequences, rather than attempting to prevent them.

It's fair to say that this view was comprehensively discredited by experience in the Greenspan years, which saw two of the biggest asset bubbles in history – first the stock market and technology bubbles of the mid- to late-1990s, and then the credit and housing bubbles of the noughties.

It might be argued that the second of these bubbles was, in part, caused by Greenspan's response to the unwinding of the preceding stock market bubble. Fearing a repeat of the Great Crash of 1929, he cut interest rates aggressively and flooded the system with liquidity. The shock to demand caused by 9/11 and the subsequent invasion of Afghanistan and Iraq caused him to further open up the monetary sluices, prompting an explosion in credit and a runaway housing market, not just in the US, but in much of Europe and beyond.

The question, therefore, arises of whether the unprecedented monetary accommodation of the past five years, which was unarguably a very necessary response to the financial crisis, has by the by begun to inflate fresh asset bubbles, which are already incubating renewed crises for the future. Are we not just repeating the mistakes of the Greenspan years?

Negative real interest rates, which many advanced economies have had over the past five years, are almost by definition bound to result in 'yield compression' and asset bubbles.

We see this at its most evident in the indiscriminate craze for emerging market assets, or at least we did observe it. Federal Reserve tapering has since caused the whole process to go into reverse, with all the destabilising consequences associated with a collapsing asset bubble.

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But bubbles have also reappeared in some advanced economies, most obviously the UK housing market. This is not an affliction that has so far affected other European economies.

Despite tentative signs of revival, the housing markets in both Spain and Ireland, which experienced even bigger bubbles than the UK in the run-up to the crisis, remain deeply depressed.

The difference is instructive. In Britain, we've seen a series of public policy initiatives to get the housing market going again – this is the belief that if house prices are rising, people will feel wealthier and therefore spend more, supporting economic growth.

It worked – perhaps a little too well. Mortgage approvals surged 42% in January, and year-on-year house price inflation is virtually back in double digits. Price-to-income ratios are not quite back to where they were at the previous peak, but they are again way ahead of the long-run average.

Is this a bubble, and if so, how dangerous is it? Britain's historic housing problem is as much one of deficient supply as excessive, speculative demand. The UK simply doesn't build enough affordable housing in the places where people want to live and work.

Very low interest rates have, meanwhile, encouraged people to pay more than they can perhaps afford. If rates were to return to anything like pre-crisis 'normality', many homeowners would struggle.

The next stage would use the Bank of England's new, so-called 'macroprudential' toolkit. By increasing the capital requirements on mortgage lending, the bank could make mortgages more expensive without directly raising interest rates.

Will this be enough? It's worth a try, but personally, I doubt it. In the end, the only thing guaranteed to take the heat out of a rising housing market is higher interest rates. Unfortunately, the rest of the economy may not be ready for such a tightening, the dilemma that has repeatedly confronted central bankers in the face of fast-rising asset prices.

Clamp down on renewed, bubble-like conditions in the housing market, and you may well end up pole-axing the rest of the economy as well.

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