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Home prices may see 3-year fall: M. Stanley

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NEW YORK (Reuters) - There is a "substantial" risk that U.S. home prices will slide for the next three years or more, in a downturn that could be unlike anything seen before on a national level, Morgan Stanley said on Thursday in a report.

Price levels of the RPX Index, a derivative index based on home prices in 25 U.S. metropolitan residential property markets, indicate an expectation that prices will decline for the next three years, with a recovery likely to occur between three and four years from now, Morgan Stanley said.

"The property derivatives market seems to be suggesting that we are in a very different environment, on the heels of market events that could force a housing recession like none ever imagined or experienced," Morgan Stanley analysts said.

"The fundamental argument for going long housing is that history has never seen such extended periods of house price declines," Morgan Stanley said. "We think that such arguments have limited credibility because of limited periods of data and over-reliance on analysis using national level data."

While home price declines for three years or longer have not occurred in recent years on a national level, regional data demonstrates that unusual price increases often lead to sustained corrections, the report said.

Morgan Stanley used data from the Office of Federal Housing Enterprise Oversight going back to 1979, which show that home prices did not post yearly declines on a national basis between 1979 and 2006.

"It is the lack of historical downturns which investors are using to argue that things could not be as bad as the market implies," Morgan Stanley said.

Data from individual metropolitan areas, however, show that regional housing downturns occurred in around 11 percent of the years analyzed, and the average negative streak lasted 1.5 years, the bank said. In 53 episodes of downturns in local markets, seven lasted for three years or more, "which does not appear to be such a small frequency to us," Morgan Stanley said.

Higher-than-normal price increases over three-year periods have historically resulted in price declines in metropolitan areas. In 23 of the 25 metropolitan areas in the index, returns in 2006 were slowing compared with 2004 to 2005, and "this may also be an indication of a pronounced downturn," the report said.

"We believe that the regional behaviors of the past can serve as guides on a larger scale," Morgan Stanley said.

"There is always a chance that things can change quickly, but given the tremendous overhang of subprime pressures, risk of recession, and the higher cross-regional correlations, we think the probability of a three-plus-year downturn is substantial," the bank said.

(Reporting by Karen Brettell; editing by Leslie Adler)
