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D.C. hangs on as global haven for real estate

Expert Opinion

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By now, most people are aware of the inflation scare. Rising worldwide prices of steel, soybeans, lumber, energy and seemingly just about any other commodity have put a damper on otherwise impressive economic news.

Concurrently, the fear of inflation has investors concerned about interest-rate hikes. How this bigger, worldwide economic picture will affect Washington's real estate market is precisely the topic to explore.

World commodity prices are rising in large part due to the economic expansion and productivity of China and India, two of the most rapidly growing economies in the world.

China's economy, which ranks fifth, weighs in at about $1.3 trillion (just behind California). At an annual growth rate of 10 percent, China's economy has the potential of doubling in size in seven years, reaching $2.5 trillion by 2011.

To put this matter into perspective, the U.S. economy in 2003 will reach $10.5 trillion.

As China and other emerging economies become "industrialized" — ironically, thanks in part to the free market system America is resented for — their demand for raw materials and energy is having an inflationary effect on commodity prices while simultaneously lifting Latin America, an exporter of commodities and raw materials, out of a four-year recession.

It's no secret the world is becoming a single globalized economy.

This painful transitional period is bound to produce a few hiccups that will challenge America's ability to set economic policy for sustainable growth, not just at home but globally. We are now close to one-third of the world's economy.

There is simply no room for knee-jerk policy reactions, as some politicians seem to be preaching.

For right or wrong, globalization, despite its alleged disruptive social effects, has been heartily adopted by industrializing nations and emerging economies embracing free-market policies to solve development issues.

Along with this global expansion and the attendant pressures on prices, the job market in this country is gaining steam.

Consequently, the United States now faces inflationary pressures from two sides: commodity prices and rising labor costs. In the past, the Federal Reserve has tamed inflation by adjusting interest rates.

By the same token, the historically low interest rates we have been experiencing will be a thing of the past as the Fed gradually moves rates up to manage inflation.

Rates need to rise to achieve two important objectives:

- Attract record levels of foreign investment to cover our deficits;
- Stabilize the deteriorating dollar now that America has won the competitiveness battle against Europe by allowing the dollar to devalue by 30 percent against the Euro.

Higher interest rates will produce a corrective action in the real estate market, particularly in high-leveraged markets where part of demand has been driven by speculation. However, as investment money always seeks out returns, real estate will continue being the bellwether.

In a market such as Washington, where demographics and job growth-driven demand have been solid forces behind rising prices, price strength should continue.

As the preferred destination for international real estate investment, Washington is poised to move into one of the top spots in the country and perhaps the world as a real estate investment destination and thus avoid severe price corrections as rates rise.

Indeed, this forecast was touted at a recent real estate conference, where expert after expert recommended the continuation of investment in real estate, even in light of or because of the aforementioned conditions.

The real estate market most likely will continue being the safest investment strategy as the industry establishes a sustainable equilibrium, even with gradual interest-rate increases and a slower pace of growth in appreciation.

And so in Washington, the city that generates the most political rhetoric in the world, the real estate market can expect to surf through this election year without being swallowed up by the government's power struggles.

Perhaps it's time to think of the election year in terms of the cicada attack we are currently experiencing: harmless but difficult to ignore.

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