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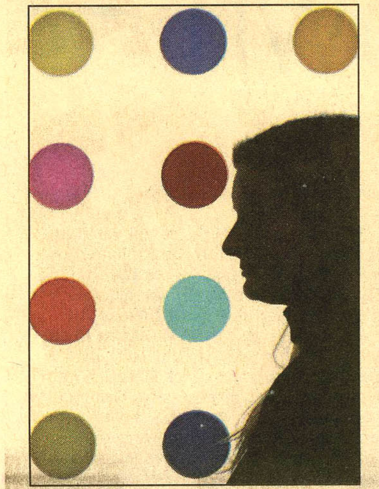
How to tell a bubble from fizz

Contemporary art prices are booming. **James Goodwin** looks at the role of supply, demand and property prices

Making you dizzy: would this piece by Swiss artist Ugo Rondinone hold its value over the years? David Gray/Reuters

It is said that people buy contemporary art when they are confident about their society and economic future – and reminders of the past when they are not. So how do they feel now?

Judging by Sotheby's contemporary art (post-1945) evening sale in New York this month, pretty good. With the buzz of a late 1980s dealing room and an undertone of 1960s idealism, the auction was delivered to a younger and probably wealthier audience than before. In just over an hour, the auctioneer Tobias Meyer steered 52 carefully selected lots to new heights of artistic fame and fortune. And Christie's contemporary sales last week were similarly spectacular. In May they reached $128m, breaking the last record of $98.3m for an overall sale of contemporary art, set at the height of the contemporary art boom in 1989.



Hirst auctioned by Sotheby's Getty Images

According to the Art Market Research company, the present upturn, which has accelerated in the past 2-3 years, follows an almost unbroken pattern since 1996 of rising prices for the top 25 per cent of contemporary art, outpacing nearly all sectors of the art market. In some cases, the price of works by living artists has doubled in the past five years. For the first time last year, prices for living artists exceeding £1m breached 10 per cent of all art works sold at auction.

Many factors affecting the contemporary art market today are similar to those of the 1950s and 60s in Paris, New York and London. The pattern, though, provides a salutary lesson for present day investors. In France after the war, prices for contemporary art rose gradually, accelerated towards 1954-56 and levelled off in 1960-62. Then they fell, especially for the most innovative works. By 1967, some were sold at auction for a tenth of their gallery price.

So why is the market so healthy now? During the 1985-90 art boom, prices were driven to their highest real price level. Supply started to dry up, with some art going into museums. Then demand fell. Only now are some of those works leaking back into the market, notably the Badminton cabinet being auctioned at Christie's Important European Furniture sale this December, after an absence of 14 years. Last time, it fetched $15.2m.

Yet, according to a recent survey by ARTnews, the majority of leading collectors worldwide still favour contemporary art over modern and impressionist art by ratios of two and four to one. This flies in the face of the laws of supply and demand. When you think about it, there could be an almost unlimited supply of contemporary art.

As competition in the art market is based on perceived aesthetic value, sellers compete for the recognition of opinion formers. Tactics include the use of scandal, such as the Royal Academy's *Sensation* exhibition in 1997. But there are other ways.

Once you have established your market, the problem for the artist and dealer becomes: what to produce and how much of it. The choice is between a broader market and higher prices. For instance, Sara Mortarotti of the Milan-based art index company, Gabrius, quoted the example of an up-and-coming Japanese artist whose prices had fallen in line with the increased number of lots sold. To overcome this, dealers developed tactics such as storing paintings acquired at lower prices and buying back those in circulation.

In an unprecedented move for a living artist, Damien Hirst was reported in The Art Newspaper last January to be buying his own early works. Dealers often sign an exclusive contract with an artist to obtain a monopoly over production. In the late 1950s, Leo Castelli, who was the key figure in the US market's development, attracted new artists by paying them a monthly stipend in exchange for a contract.

But there is one vital caveat for anyone investing in the contemporary art market: it is simply much more vulnerable to changes in the value of other investments than older works. The antique market has a certain guarantee from history while most contemporary art can simply disappear.

A recent academic study regarded property – not the stock market – as the main driver of world art prices during the last boom, specifically Japanese land prices. This means that a collapse of international property prices could be the trigger for the next downturn. The IMF warned in its World Economic Outlook that rising interest rates could halt growth in housing markets in Australia, Ireland, Spain and the UK. It may already be happening, with some reports from Australia saying that house-price falls in the first half of the year coincided with lower prices for modern and contemporary art. The good times may be coming to an end.