

Housing and the UK Economy



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Housing and Economic Activity

- Asset prices have grown in importance
- Millions of jobs linked directly or indirectly to the property / construction sectors
- Strong household wealth effects on
 - Consumer borrowing and demand
 - Living standards of pensioners
 - Incentives to save
- Changes in house prices and activity have huge effects on the allocation of scarce resources in the UK economy

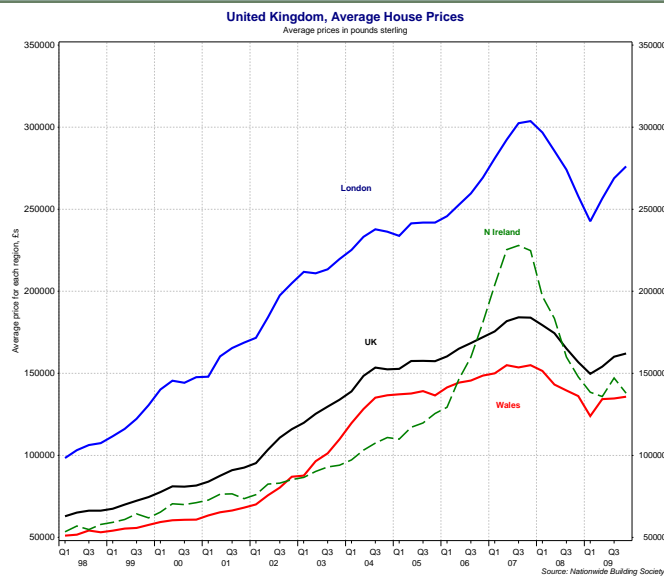
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Background

- Over 70 per cent of homes are owner-occupied
- Last ten years has seen a surge in buy-to-let investments (property as a speculative investment)
- Mortgage is perhaps our biggest financial commitment
- Construction accounts for approx 7% of GDP
- Housing-related spending is perhaps 15% of AD
- Strong multiplier and accelerator effects when the property sector is expanding – but these can go into reverse
- UK housing market is more vulnerable than others to price volatility and the risk of property bubbles
 - (i) Majority of loans are on floating (variable) interest rates
 - (ii) Low price elasticity of supply of new housing

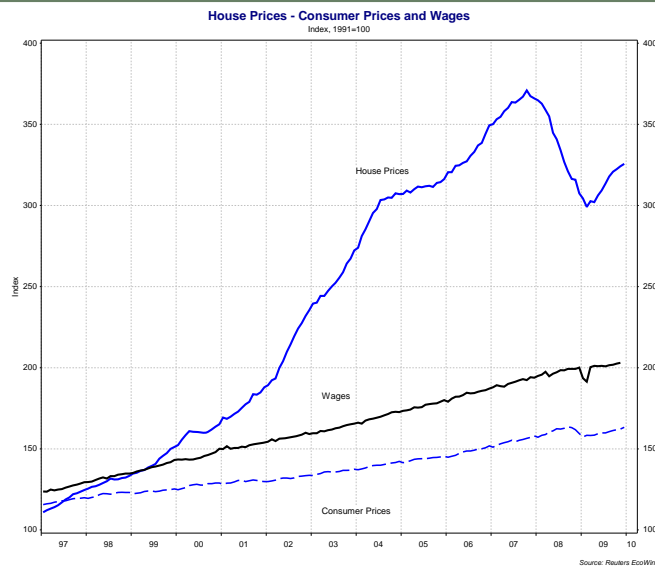
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A recession of sorts but now recovering



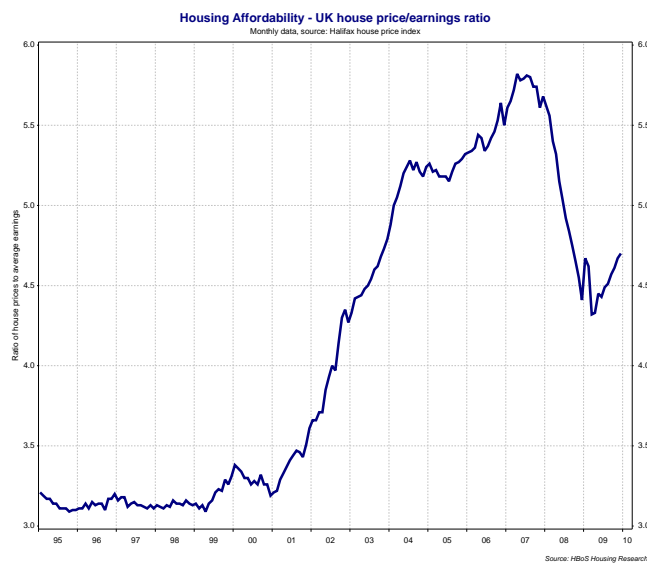
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Real house prices



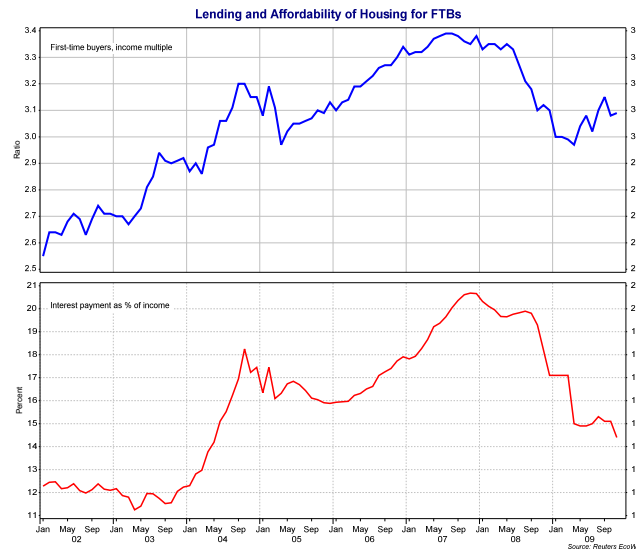
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Affordability is key to driving demand



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Can first time buyers get into the market?



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Rampant house price inflation increased the wealth of millions of home-owners

Housing stock worth £4 trillion

The value of the UK's private housing stock rose by an estimated 9% in 2007 to reach £4 trillion, says the Halifax.

This figure has more than tripled over the last decade, rising by 208% from £1.3 trillion recorded in 1997.

In contrast, the headline rate of inflation (RPI) has increased by 31% over the same period.

Despite fears about slowing UK property prices, the bank says the housing stock is worth more than three times the country's outstanding mortgage debt.



The value of residential property in the south east has grown by 192% over the last decade.

At the start of 2008 the UK housing stock was given a total value of £4,314 billion. This is equivalent to 62 per cent of the nation's wealth,

- Positive real house price inflation for over a decade
- Brought capital gains for many home-owners
- Many traded up to more expensive properties
- Or they remortgaged and unlocked some housing equity
- But the housing boom also created much more mortgage debt

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But with higher prices came higher debt

Net worth

- = value of financial assets
- - value of financial liabilities (e.g. mortgage and credit card debts)
- Re-mortgaging a property and releasing the equity adds to your liabilities

Mortgage arrears up 31% in 2008

The number of mortgage accounts in arrears has shot up by 31% in the past year, according to figures from the Financial Services Authority (FSA).

At the end of 2008 there were 377,000 accounts in arrears by 1.5% or more of their loan balance, roughly equivalent to arrears of at least three months.

It means borrowers in trouble currently hold 3.4% of all mortgage loans, with their loans worth just over £40bn.



The FSA says mortgage arrears have increased steadily since early 2007

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Root causes of the housing boom

- Demand side factors:
 - Easy availability of mortgage finance (often 100% LTV ratios)
 - Expectations of future house price appreciation
 - High level of consumer confidence
 - Speculative demand e.g. from buy-to-let investors
 - Impact of overseas investors and large-scale inward migration
- Supply-side factors:
 - Low price elasticity of supply of new house-building
 - High price of building land
 - Rising wages and other construction costs

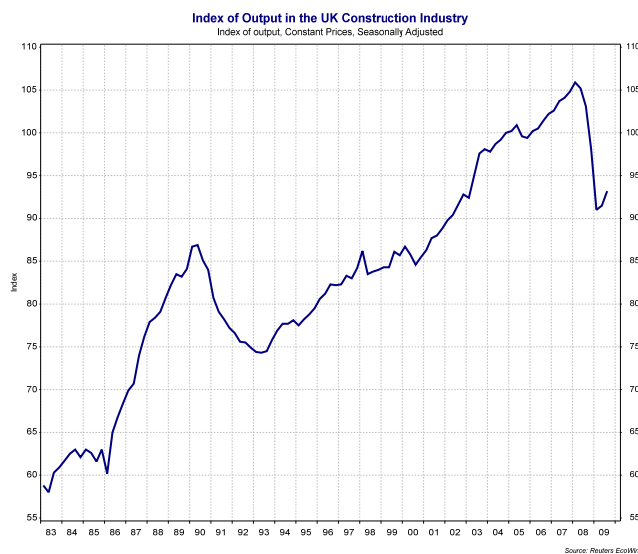
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Who gained from the property boom?

- Homeowners who bought early in the cycle
- Construction companies
- Mortgage lenders
- Government and local councils (higher tax take)
- Industries supplying the construction sector
- Household goods and furnishings
- Estate agents, lettings agencies and other service industries linked to property

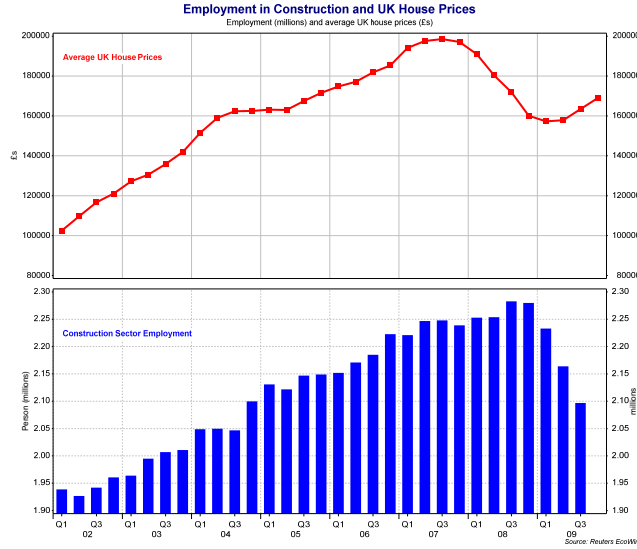
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Construction output is highly cyclical



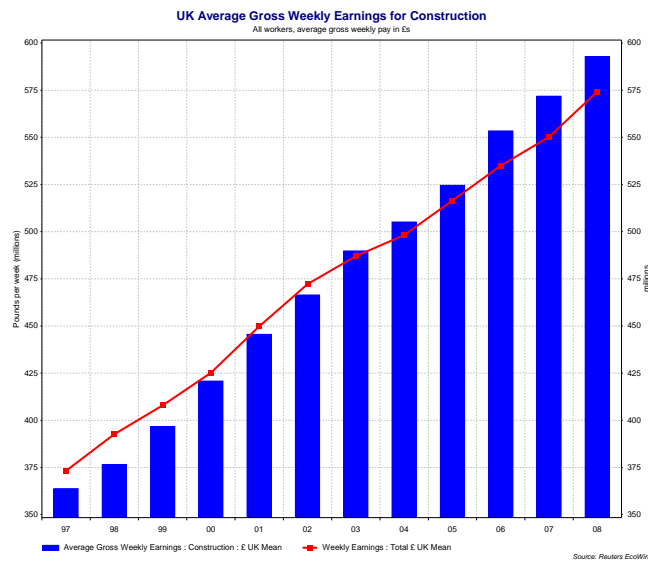
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Creating more jobs in a boom but over 200,000 jobs gone since the downturn



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And wages and earnings rose too



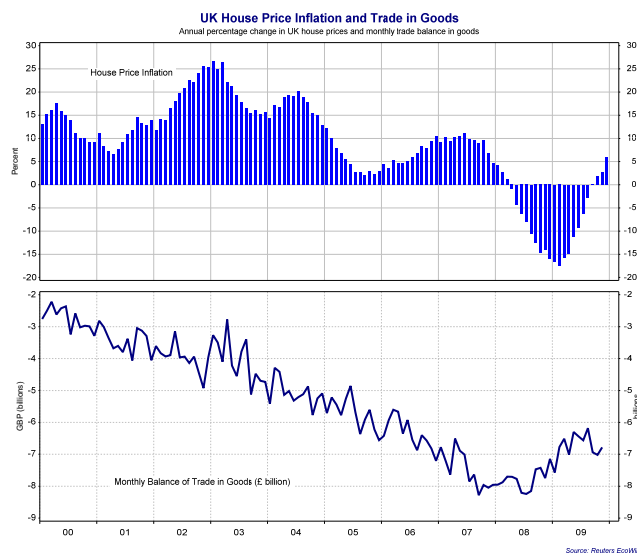
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Wider macroeconomic effects of a property upturn

- A fall in the household savings ratio
- Mortgage equity withdrawal boosted consumption
- Contributed to fast growth of AD
- But also to a widening trade deficit – as higher spending increased the demand for imports
- Consumer price inflation remained low until 2008
- Huge rise in personal sector debt – much of it **secured** on the rising property market

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Property and the UK trade deficit



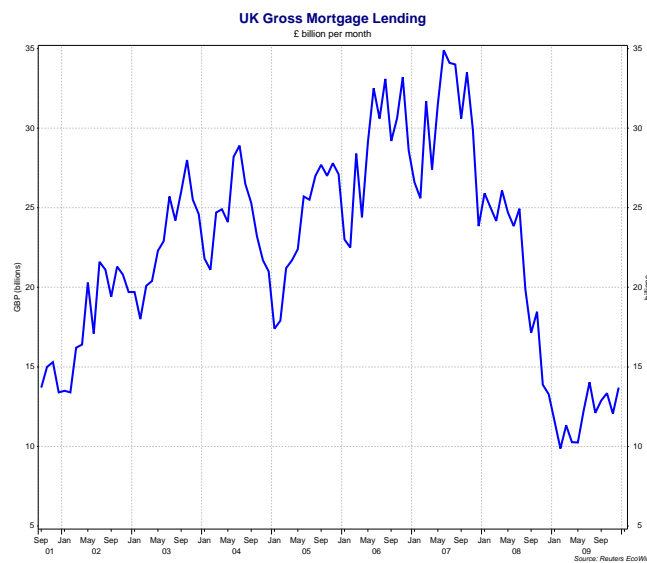
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It couldn't last – the housing bubble bursts

- Sub-prime crisis in the USA spread elsewhere
 - Collapse of Northern Rock
 - Lehman Bros bankruptcy in September 2008
- The supply of mortgage finance started to dry up
 - Mortgage interest rates moved higher
 - Many mortgage lenders withdrew from the market
 - Fall in loan to valuation ratios – higher deposits needed
- Important – change in market expectations and sentiment among buyers and sellers
- House prices started to decline – the beginning of a bear market in property – the bursting of the bubble
- Property becomes very hard to sell when the market turns down

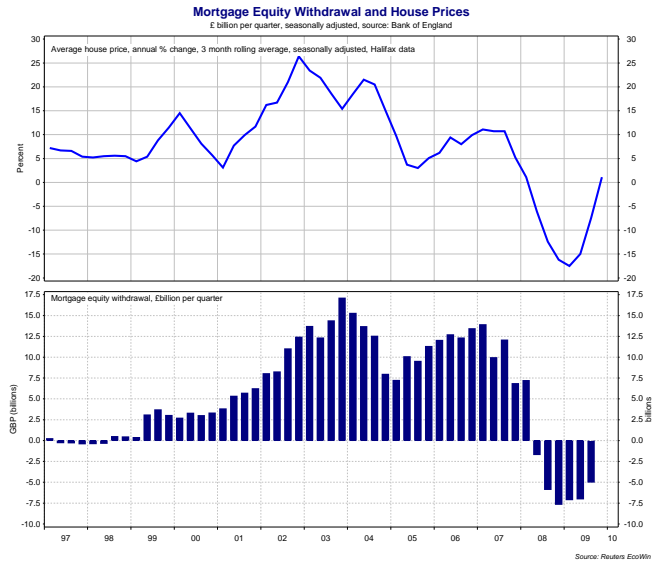
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Oxygen of housing finance was cut off



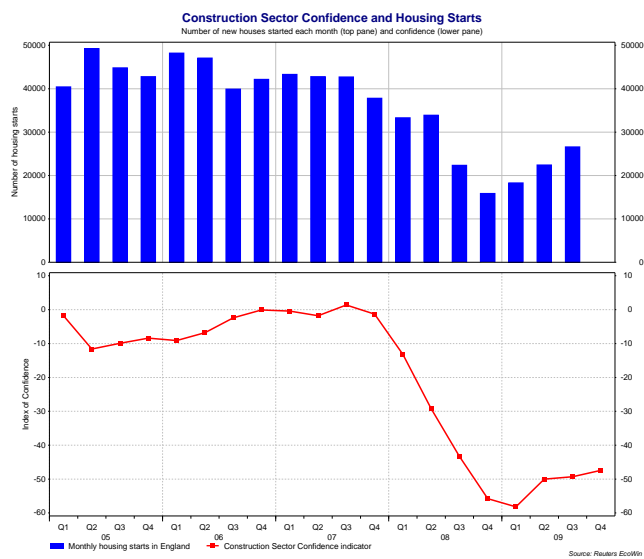
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Housing equity withdrawal has collapsed for now



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New house building has contracted



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Housing has become less of an investment

- For many housing became a refuge from the pensions crisis
- But now
 - (1) Falling prices (sustained property price deflation)
 - (2) Rising cost of home maintenance (often overlooked by property investors)
 - (3) Problems in re-financing a mortgage when 2 and 5 year deals come to an end
- Estimated that nearly 1/3rd of property owners may experience **negative equity**
- **Large rise in demand for social housing** – pressure on local councils

'Millions facing negative equity'

Nearly four million homeowners are in, or close to, negative equity as the property market stutters, according to research group GfK NOP.

The figure is based on a survey with 60,000 UK householders and is by far the bleakest assessment of the effect of the slump in house prices.

The report suggested that young people who took out mortgages at the peak of the market were most affected.

Others in the industry regarded the figure as "extreme".

Other estimates have suggested two million fewer were at risk.

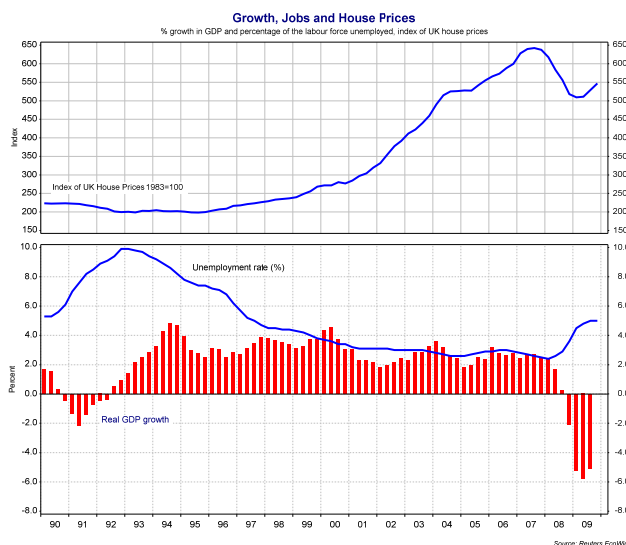
Negative equity is generally only a significant issue for homeowners if they need to move.



The figure is much higher than other negative equity estimates

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Property, GDP and Unemployment



Bear markets in housing usually last between 3 and 5 years

Is the rebound in prices a sign that property will buck this pattern?

Or will prices fall back further in 2010?

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Upsides of the property slump (1)

- Improvement in housing affordability
 - Greater geographical mobility of labour for younger people
 - Improve affordability for people living in rural areas
 - Will require people to save for deposits
- Reduction in property-fuelled consumption
 - Greater sense of balance in the economy
 - The credit-fuelled illusion is over
 - Improvement in the UK trade deficit

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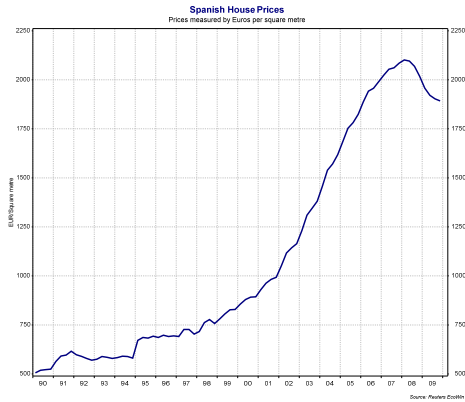
Upsides of the property slump (2)

- Fewer estate agents and their like
 - Releases people into more productive occupations and sectors
- More sober assessment of risks and returns of home-ownership
- Greater focus now on expanding the improving the stock of social housing (extra government spending as a stimulus to the economy)
- Cheaper commercial property provides opportunities for entrepreneurs

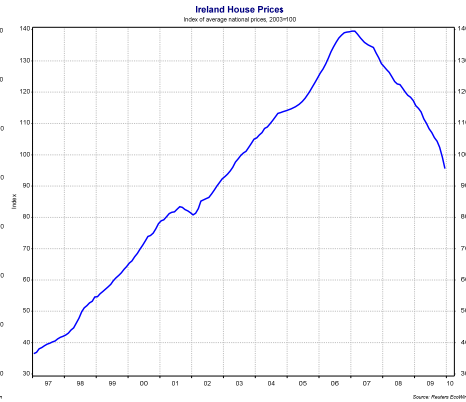
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Deep property recessions in Europe too!

Spain



Ireland



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Concluding thoughts

- Property bubble from 1995-2007 was a key factor creating macroeconomic imbalances
 - Falling savings ratio / excessive leverage of homebuyers
 - Widening trade deficit
- Millions of property owners have suffered from **inflation-illusion** – now they suffer **collateral losses**
- Debt deflation in property market will be a major **constraint** on demand/economic growth in the recovery years
- But will it lead to an opening up of land for new housing supply?
- House prices now rising but not because of macroeconomic fundamentals

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