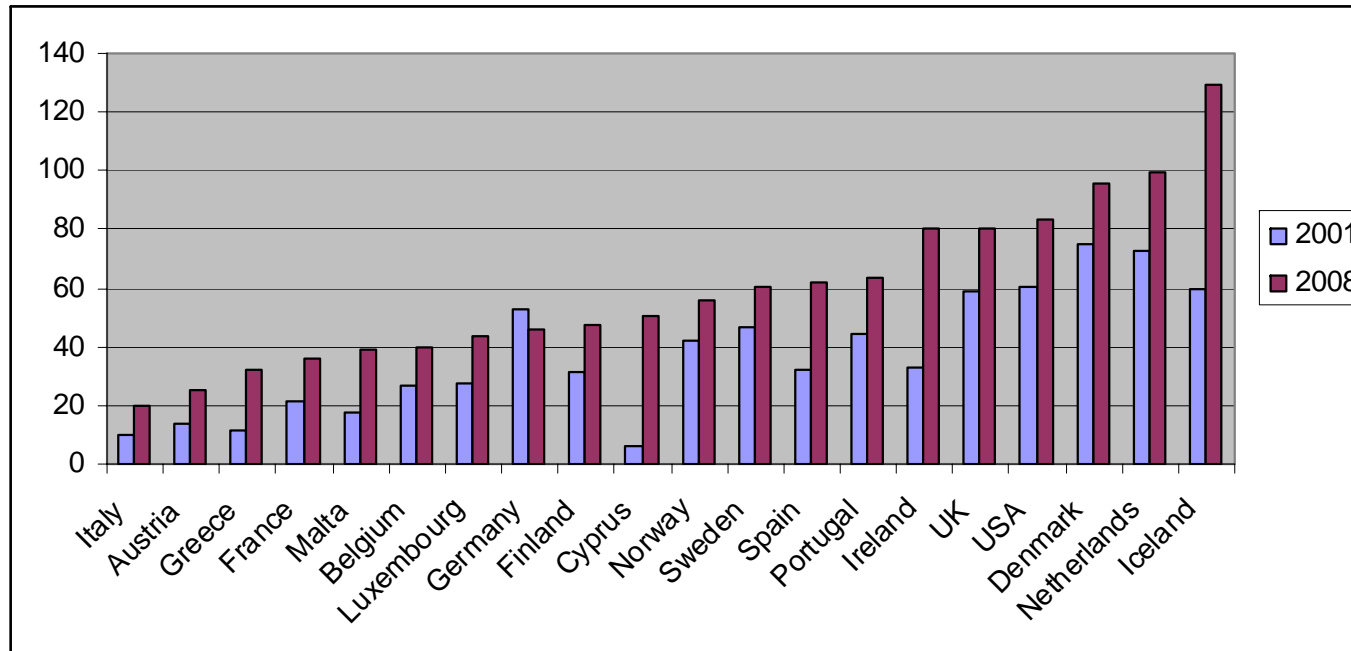


# The UK Economy, Housing & the Credit Crunch: Past, Present & the Future

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# The Build Up of Debt

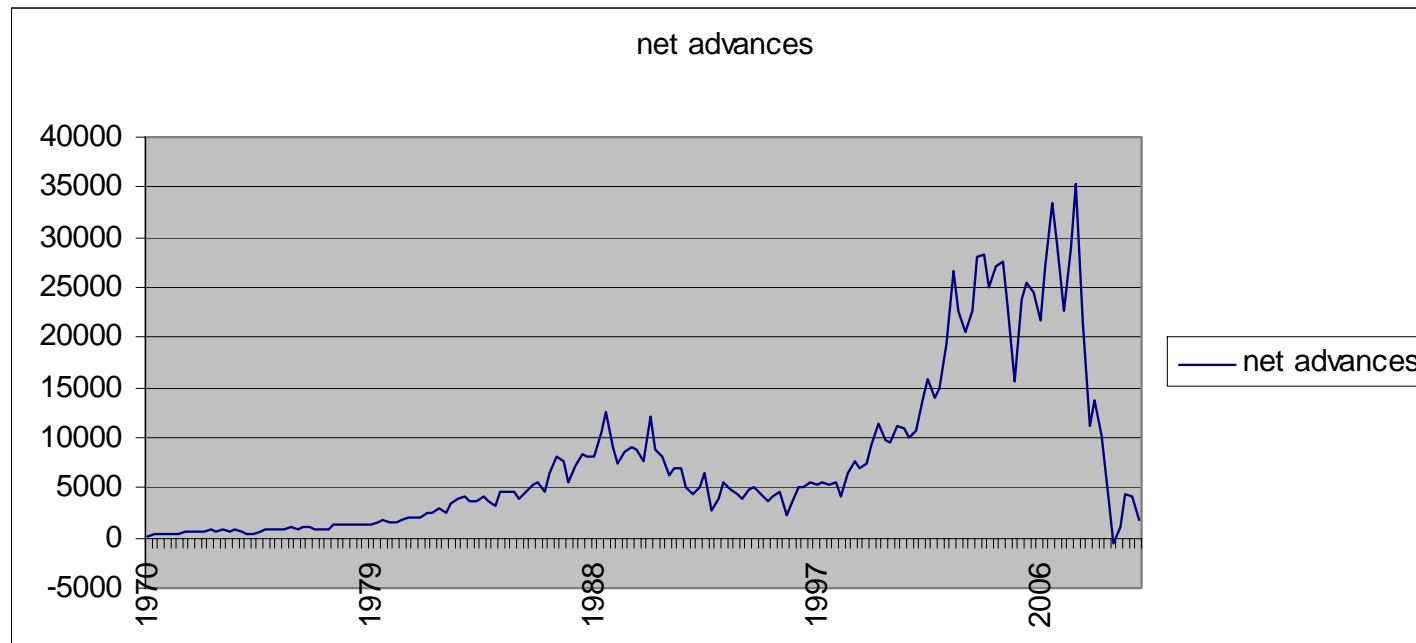


**Figure 1. Mortgage Debt/GDP 2001 and 2008**  
Source. European Mortgage Federation

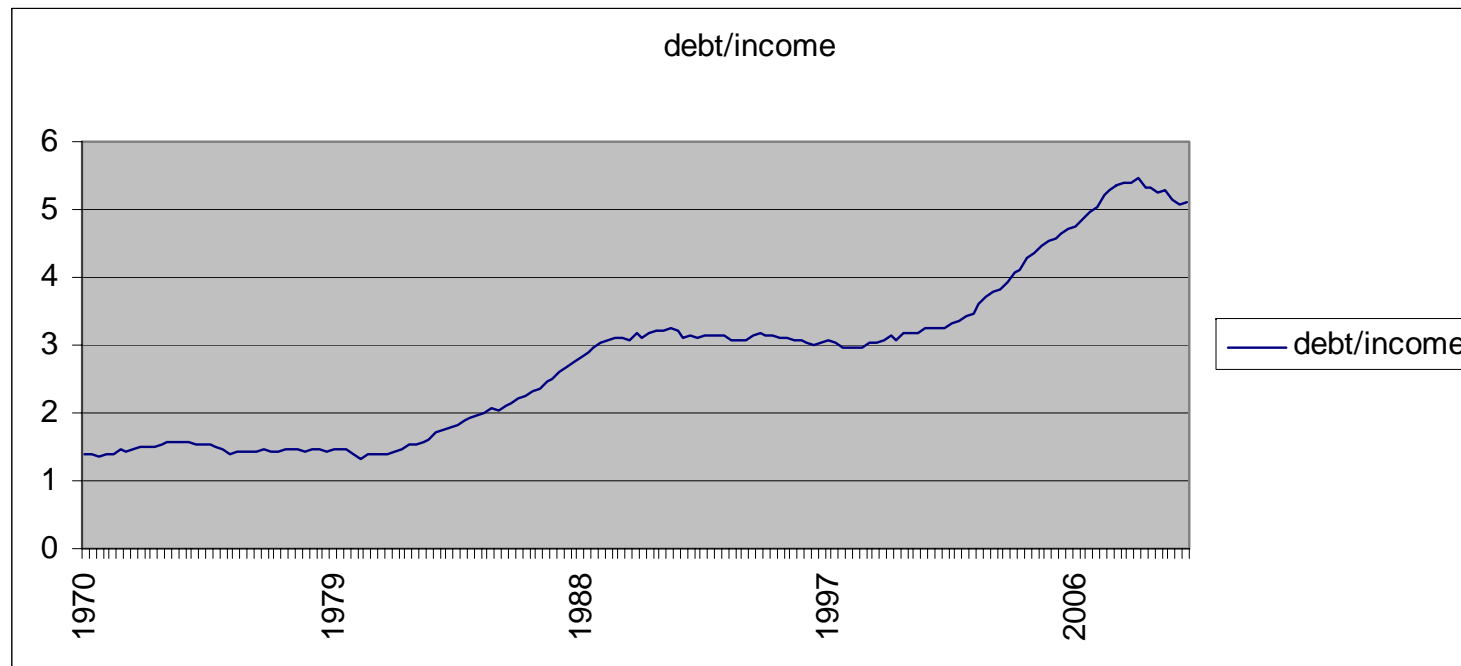
# Some Basics

- **The build up of mortgage debt has been common to many countries (although the debt levels are considerably different).**
- **The rise took place despite the fact that historically the structure of mortgage institutions was very different.**
- **Securitisation arose in the 1930s because of a particular a set of institutional characteristics in the US.**
- **The standard view was that this was the most efficient model & other countries should adopt it (lower costs and greater liquidity – countries with savings surpluses finance those with shortages).**
- **Countries such as UK adopted it during mid/late 90s because of a perceived lack of funds from retail sources (low household savings rates). But ...**

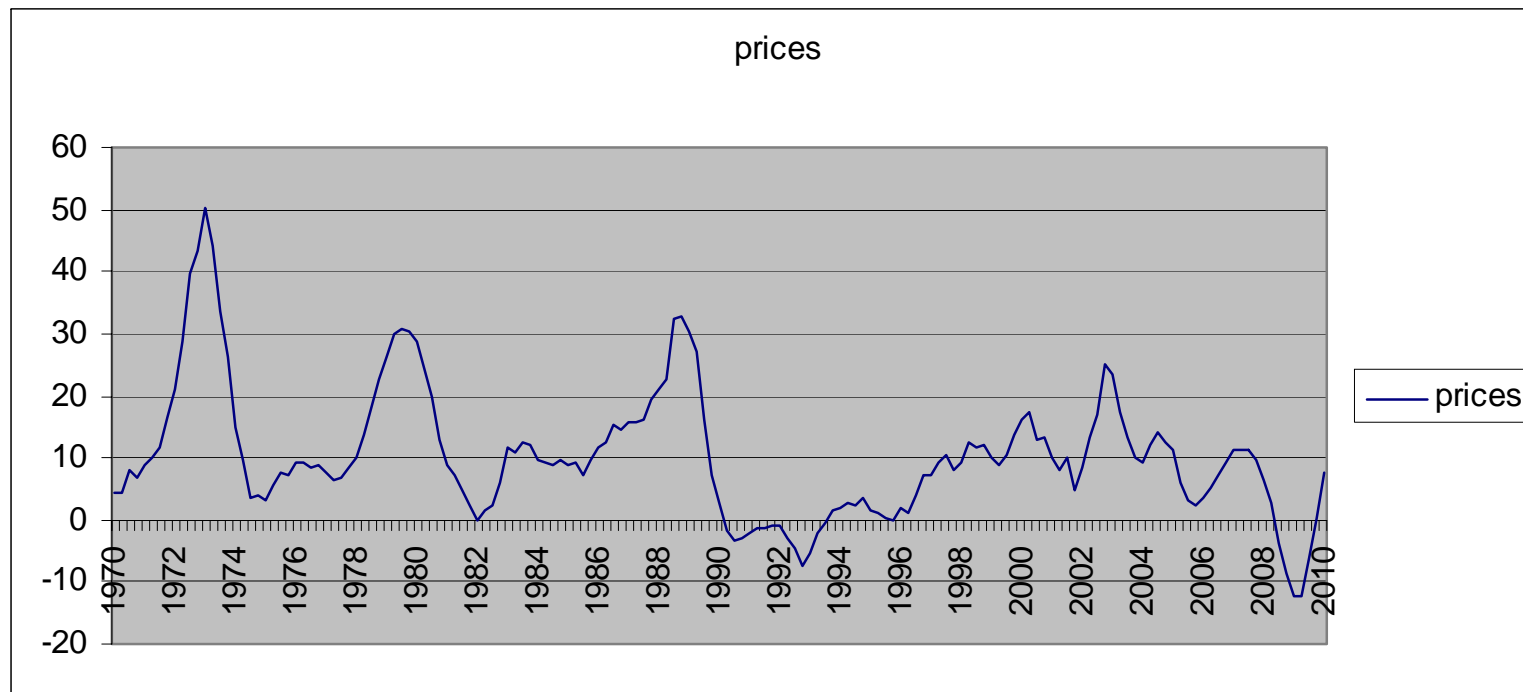
# Mortgage Net Advances



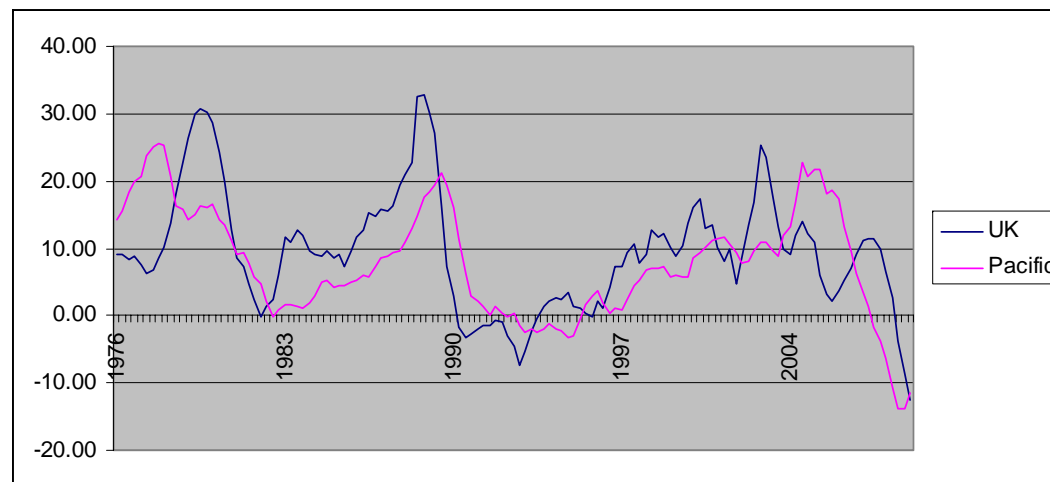
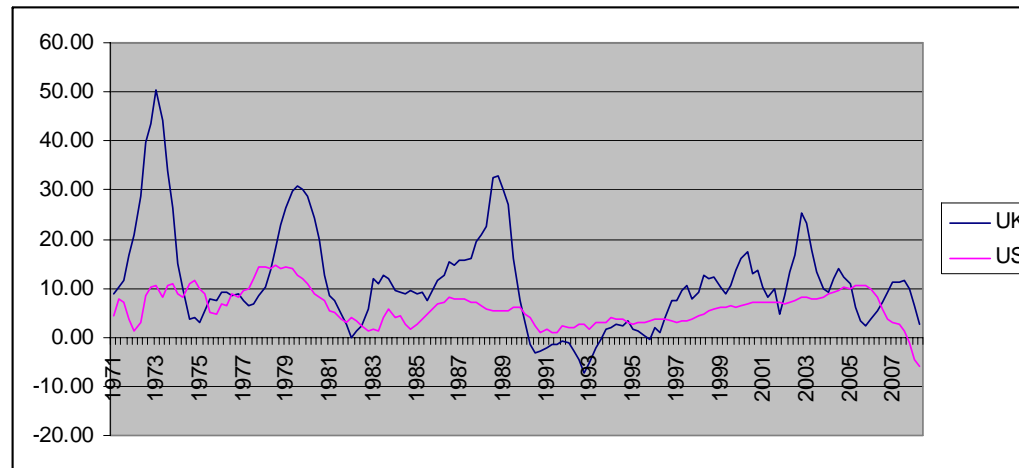
# Mortgage Debt / Income



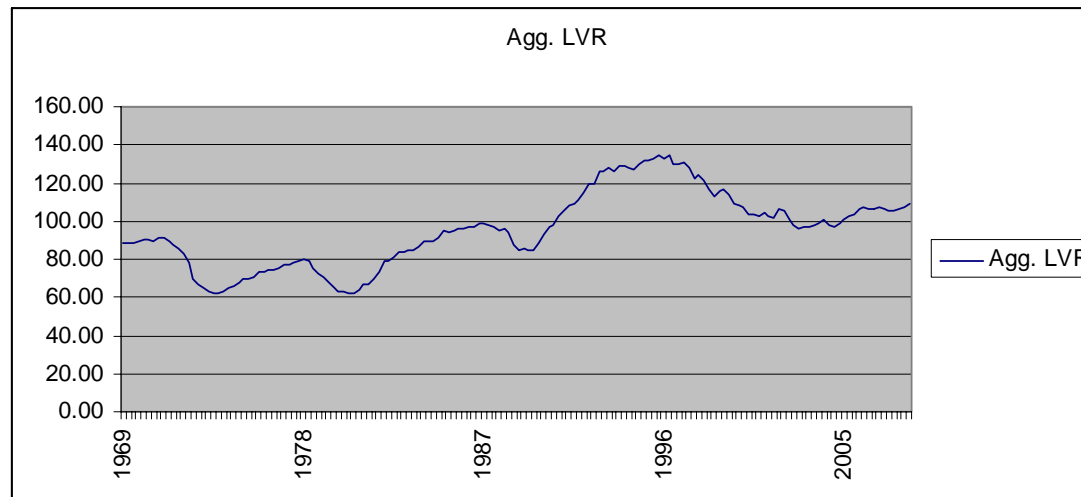
# UK House Prices (annual % change)



# Housing Trends: Prices (UK & US)



# Aggregate Loan to Value

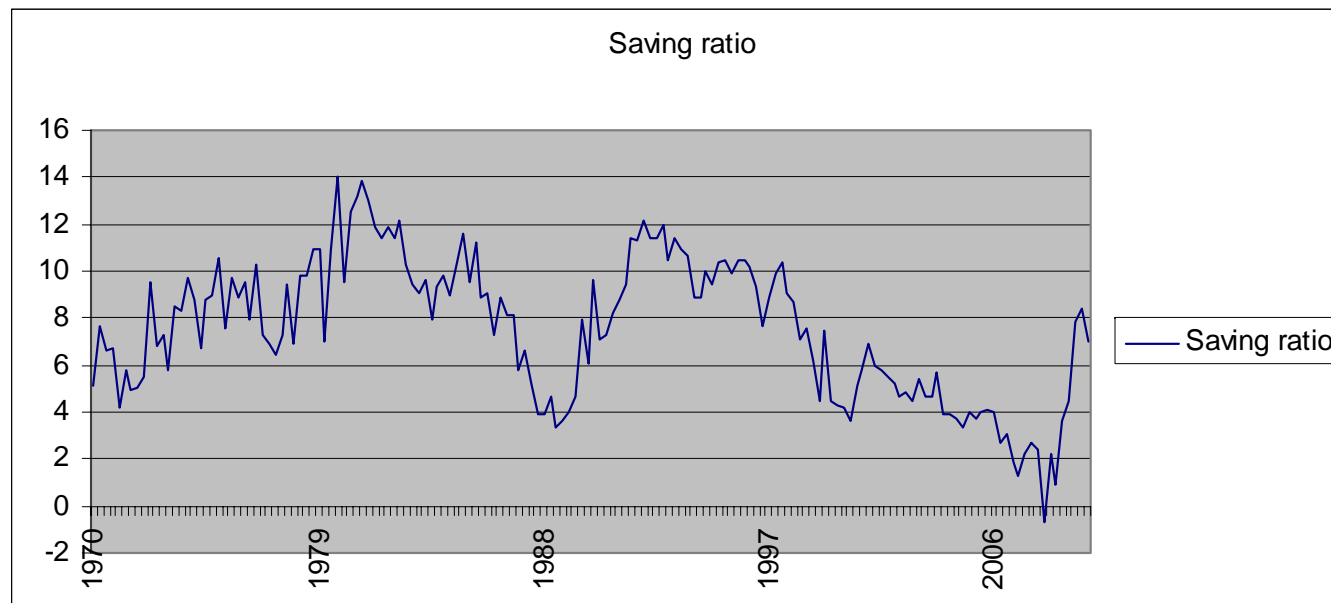


**Ratio of Mortgages Outstanding to the Market Value of the Housing Stock (2002=100)**

Source. Bank of England data base and own calculations



# Household Savings Ratio



# Points (1)

- Despite the collapse in the *flow* of net advances, little effect on the *stock* of debt → ratcheting of debt, due to indivisibility of housing → hard to deleverage a mortgage debt contract.
- Mortgage debt (as % of income 4X higher than in 70s). Perhaps the key indicator of future risk. Countries with high indebtedness are more likely to experience price falls.
- Growth in advances since 1999 due to securitisation, as household savings ratio fell.

## Points (2)

- GDP fell by approximately 5% in 2009, but median forecast for 2009 made at end of 2008 was -1.5%. (do we really believe Treasury is worse than anyone else?).
- But fall in house prices from peak in 2007 Q3 to 2009 Q2 was only 13%.
- So outturn for the economy (in terms of growth) was much worse than expected, but outturn in prices has been much better.
- This either calls into question the nature of some house price models (or the forecasters), or suggests there are further price falls to come.

## Points (3)

- **Price changes in the UK historically have been similar to the US Pacific states – common factor planning?**
- **The growth in debt has not led to an increase in home-ownership. Home-ownership rates have fallen from 70.9% in 2003 to 67.7% in 2009. Key factor has been the increase in the required deposit. FTBs faced a shortage of funds (rise in the average deposit even before the credit crunch).**
- **The main beneficiaries were: (i) existing owners trading up or buying second homes (ii) investors in buy-to-let markets (iii) households extracting equity.**

# Issues for the future (1)

- **Funding shortages could easily continue:**
  1. **Continuing low savings ratios?**
  2. **Securitisation may not return to former levels – higher capital requirements.**
  3. **Possible controls on lending to high risk groups – tighter product regulation by FSA.**
  4. **Ending of Special Liquidity and Government Guarantee Schemes for wholesale markets.**

## Issues for the future (2)

- **New government policy favours the localisation of housing decisions. This is likely to reduce already weak housing supply.**
  1. No local authority has individual incentive to increase housing supply, since population flows offset any affordability improvements, particularly in southern England.
  2. New policies to restrict new residential building in existing gardens. Since these are currently classed as Brownfield sites a significant % of new building takes place on such sites.

# Mortgage Market Restrictions?

- **Possible restrictions on LTIs and LTVs have been suggested. This reduces risk and improves affordability. Also reduces volatility of geared returns.**
- **But there are problems:**
  - (i) Controls were not effective in the 70s**
  - (ii) The burden falls disproportionately on FTBs, although they are not the cause of the underlying problem. This arises from high demands from existing owners).**
  - (iii) There are macroeconomic consequences from controls, efficiency losses? Greater housing/consumption volatility.**

# Alternatives to credit controls

- **Basic problem is increasing demands for housing by existing owners and FTBs pay the price – as income rises, owners increase demand for housing services, second homes for investment and leisure purposes.**
- **Can taxation play a greater role? Capital gains, council tax etc. These do not seem to be on the agenda at the moment.**