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OXFORD'S RISING STAR PREDICTS A CRASH, WHILE OTHER ECONOMISTS SEE A 'SLOW STRANGULATION'

**BYLINE:** PHILIP THORNTON ECONOMICS CORRESPONDENT

**BODY:**

WHEN SEVERAL hundred investment bankers, fund managers and asset managers devote a whole morning to a conference on the UK housing market, it is a sure sign the City is getting distinctly worried.

The financiers packed out the venue where the chief economists from the Halifax bank, the estate agents FPD Savills and the analysts Capital Economics as well as a rising star from Oxford University were unveiling their forecasts.

They ranged from an optimistic prediction of a gentle slowdown to annual growth of about 4 per cent all the way to a doomsday scenario of a 40 per cent slump in prices.

Roger Bootle, the head of Capital Economics, hit the nail on the head. "All these people are here not primarily because of their interest in the housing market," he told the audience. "They are interested in the economy overall and I think they are dead right to have focused on this subject.

"If my view of the housing market is wrong then my view on interest rates falling to 3 per cent will be wrong."

The recent strength of the housing market and the levels of debt households have taken on to participate in it is giving UK policymakers headaches.

Such is its significance that in March the International Monetary Fund, which normally worries itself with issues such as the Argentina crisis, weighed in with a warning that Britain faced the threat of a slump triggered by the bursting of a "housing market bubble".

Until the sharp fall in the sterling exchange rate, the debate over the housing market was seen as the crux of a split within the Bank of England's Monetary Policy Committee.

Two of its nine members voted against February's controversial cut in interest rates because of fears it would stimulate borrowing to levels that eventually trigger a deflationary slump.

Mr Bootle, who is forecasting a price crash of between 15 and 20 per cent over the next three years, said the wider economic damage would be severe. "If household wealth were to fall 15 per cent in the current depressed equity price conditions, that will have a large impact on consumer confidence and spending patterns," he told the Credit Suisse First Boston conference.

While few economists would argue with that scenario, the real divergence is over whether such a fall will happen at all.

While Mr Bootle and other analysts believe a fall is inevitable, the mortgage lenders and the estate agents - perhaps unsurprisingly - believe the UK is on track for a gentle slowdown.

The dividing line between the two camps rests on two key issues - what is the best measure for the true value of housing and what would the trigger be that would start the crash?

Martin Ellis, the chief economist at Halifax, the UK's largest residential mortgage lender, said there were several factors that explained the recent strength of house prices and continued sustainability of the housing market.

Mr Ellis said the recent rises could be explained by the fall in unemployment and interest rates that made current mortgage deals affordable. On top of that there was an "acute" shortage of property for sale, historic low levels of new housebuilding and a rising number of households needing homes.

"The fundamentals are very good and I don't think there's a significant prospect of big rises in unemployment and interest rates," he said. "I think the market is very well underpinned. The fundamental factors that caused the crash of the late 1980s are not in place."

Mr Ellis said prices would rise 9 per cent this year as areas of the North and Midlands enjoyed a boom, offsetting the slowdown in the South. But growth in 2004 would be much slower as the slowdown spread out.

Richard Donnell, head of research at Savills, said he expected the market to suffer "slow strangulation" rather than a crash. He said the one-off shift in prices that the environment of low interest rates and inflation had delivered in the form of greater affordability had run its course.

"I think there will be a real squeeze on incomes going forward," he said. "We have big rises in council tax and national insurance and taxes will only go one way in the future. The pensions issue will also be a pressure on incomes."

Mr Donnell echoed the Halifax forecast of 10 per cent growth this year and 4 per cent in 2004, as falls at the top of end of the market are partly offset by gains at the bottom end.

But he warned: "This growth has become increasingly fragile because the people driving the growth are those with the least assets and any future shock would have a disproportionate impact."

While this might seem gloomy, it appeared veritably optimistic set aside Mr Bootle's outlook. "The overall message is clear - houses are now so overvalued that a prolonged period of falling house prices is on the cards," Mr Donnell said.

"You would not even need an obvious trigger for the housing market to slow. All it would take is for households to be unwilling to pay the price asked for housing."

Andrew Farlow, a tutor in economics at Oriel College, Oxford, who specialises in asset bubbles, said economic fundamentals simply did not justify the recent price surge.

"Consumers should hold housing at a high price if they think that when they sell it someone else will be prepared to hold it at a high price, and that person will only be prepared to hold it if they believe someone yet further in the future will be prepared to hold it at a high price and so on," he said.

Mr Farlow said that in a low-inflation environment the real impact of a fall in prices would be much more obvious, which might in turn lead to an over-reaction. Pressed on how much he said: "I would say 20 to 40 per cent."

He said house-price bubbles were the hardest to correct as buyers and lenders were both sucked into the bubble mentality of chasing the rising prices while, on the other hand, it was hard to arbitrage the market.

The two camps also clashed over the role of the financial industry in a crash. Mr Ellis said the banks had learnt a harsh lesson from the 1980s when they were too eager to repossess homes.

But Mr Farlow warned price bubbles made banks' finances look overly healthy in the same way that they gave consumers an illusion of wealth.

One asset manager said after the conference: "I was more convinced by Martin Ellis's arguments than Roger Bootle's. I think it can all be summed up by saying that unless there are forced sales there won't be a crash. And why should there be forced sales?"

The City audience largely agreed. When it was put to a vote, the vast majority predicted that house prices three years from Monday would be between 10 per cent lower and 10 per cent higher than the current level, with the second largest group looking for growth above 10 per cent and the smallest group forecasting a full crash of more than 10 per cent.

"The bulls have it," came a cry from the audience.

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