

TITLE: Crash Course

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House prices in Oxfordshire will drop for sure within the next three years, according to a group of Oxford University academics working at the department of economics, who have made the housing market their speciality.

Figures released this week from the Land Registry showed that prices in Oxford have shrugged off interest rate increases and rocketed by a staggering 13 per cent in the past three months. However, Oxford dons Gavin Cameron and John Muellbauer - who run a website called HousingOutlook with Anthony Murphy, an academic from University College, Dublin - reckon that we are witnessing a classic economic bubble, with prices reaching ever closer to bursting point.

Professor Muellbauer said: "A fall in prices will inevitably come within the next three years." He added: "And the sooner it starts the better from the point of view of the pain caused. At the moment people are rushing to buy and thinking only of short-term affordability. Misinformation and myopia reigns. It's awful."

Housing Outlook sums up the situation bluntly by saying: "Following on from Tony Dye's comments reported in the press on April 13, 2004, a great deal of attention is now focused on whether prices are sustainable at these levels.

"It is our view that they are not."

Tony Dye, of Dye Asset Management, was the economist who predicted the collapse of the stock market in 2001 - and was proved right. Now he is predicting that UK house prices could fall by 30 per cent over the next five years. People ignore him at their peril.

In answer to critics who pooh-pooh doom-mongering ideas with a shrug and a comment that everyone was saying the same thing last year, the stock reply is: just because the market has continued to overrun does not make it safer. Quite the opposite. The pressure towards an eventual bursting of the bubble becomes even greater.

The prick to burst the bubble could be rising interest rates in USA, which could force them up here too.

The Oxford dons' closely argued points are given further credence by yet another Oxford academic, Andrew Farlow, who has produced two papers - "A Critical Assessment" and "UK House Prices: Bubbles and Buyers" - and believes that the lack of supply in the

market, and the low rate of building new homes, could only account for a 0.5 per cent annual increase.

Dr. Cameron said the high price levels of today were not underpinned by economic realities.

He said: "People are caught between a fear of being left behind and a fear of overstretching themselves. At the moment the former is winning, but that will change as interest rates increase."

He added that psychological factors such as regret at not investing earlier, or even jealousy of others, played a part in sustaining the market.

Housing Outlook compares the present boom with that of the late 1980s, which culminated in prices collapsing by 25 per cent in the south-east and 20 per cent in Oxford. It notes that the average price-to-earnings ratio now is close to its 1989 peak.

It adds: "While affordability (in terms of the ratio of mortgage payments to income) remains at reasonable levels, many households are vulnerable to the increases in base rates that are expected this year. Furthermore, the continued lack of interest among first-time buyers suggests prices have become rather detached from their underpinnings.

But is Oxford a special case, sitting in its green belt and with its ever increasing population of students from home and abroad? Certainly, it has a higher proportion of buy-to-let properties than most other towns - a market now worth nationally some £39bn, up from £2bn in 1998, according to the Association of Rental Letting Agents.

Dr. Cameron said: "The buy-to-let factor is highly volatile and could possibly be particularly vulnerable. At the moment, some prices are so high that they do not produce good enough returns.

"For instance, I see that asking prices at Morrell's Lion Brewery are £300,000 but that flats rent for £1,300 a month. Not enough.

All the same, Professor Muellbauer believes that owners of buy-to-let properties who see their properties as long-term, income-producing investments and are not too "geared" (i.e. have not borrowed too much) may fare better than some would-be first time buyers who are likely to become their tenants.

He said: "When prices begin to fall, potential first-time buyers will be scared off buying and will become renters. But some buy-to-let landlords will be squeezed too."

All in all, the consensus is that the situation is similar to the dotcome bubble on the stock market. It talked itself up and then collapsed.

And the good news for those of us who enjoy a frisson of the feel-good factor whenever we read of rising house prices? According to Professor Muellbauer, the collapse this time round will be less severe than that of the 1990s because the economy is fundamentally on a sounder footing.

The Oxford academics note the wise words of Mervyn King, Governor of the Bank of England, when asked by the Treasury select committee in March 2004 for a headline to summarise the correct attitude to consumer debt: "Think before you borrow, says boring banker."