

HOUSING: NORMAN IN WONDERLAND

NORMAN LAMONT, Britain's chancellor of the exchequer, told the House of Commons on December 12, 1990: "There is reason to think that the recession will be relatively shallow and short-lived." In his New Year's message, published by *The Financial Times* a few weeks later on January 2, 1991, Lamont comforted the public with this assurance: "There is certainly no question of a slump or of the economy going into free fall." Britain has since suffered seven quarters of continuous recession, with GDP down 4% on the peak reached in spring 1990.

So who is kidding whom? That question has disturbed editorial writers at the right-wing *Daily Telegraph*, which is spotlighting the debilitated state of the construction industry, which has suffered what the true-blue newspaper called "the longest and deepest recession since the Great Depression of the 1930s."

The facts, which Treasury analysts are not allowed to use to colour the conclusions in speeches by government spokesmen, make grim reading.

* The government is paying over £1 billion a year towards the mortgages of people who are out of work.

* Shelter, the housing charity, reports that 144 houses a day were repossessed in the January-March period. And because they have fallen behind in their mortgage repayments, 290,000 families are now at risk of losing the roofs over their heads.

THE GLOBAL STORY is similar. People reduced consumption as they watched their wealth deteriorate around them. Stable house prices are crucial to prosperity - vital for families that have to plan their spending over a 20-year period. When prices collapse, as they have done in the past three or four years - illustrated by the data produced by the Bank for International Settlement (see graph) - the gameplan changes.

In Britain, for example, the real price of houses has fallen 23% since the price peak in 1989. People are restoring their net balances by cutting back on spending until incomes rise to levels sufficient to meet their needs. Meanwhile, the manufacturing and retail sectors are suffering.

Where - when - will it all end? In Britain, with the election safely out of the way, all pretence at knowing the answers have now gone out of the window. Mr Lamont has found a new trick:

instead of looking into the future through the sharp end of his looking glass, he has reversed his instrument - to derive comfort from hindsight! By looking backwards, the future looks rosy! Mr Lamont has leaped three years into the future to discover that "In two or three years' time, I believe people will look back and see that it was now, during this critical period, that the right decisions were taken."

This may not give employees or investors anything to take to the bank, but the UK government is on-course for the "success" now being enjoyed by the French government, which claims one of the industrial world's lowest inflation rates and

an unemployment rate of nearly 10%. But the dangers of this strategy are now worrying the gnomes of Zurich. The Switzerland-based BIS recently warned, in its annual report: "Real estate price deflation...might be considered to be a new phenomenon in the postwar economic history of the industrial countries....If not contained, it could not only have further repercussions on financial institutions in the countries concerned but also affect the prospects for full economic recovery."

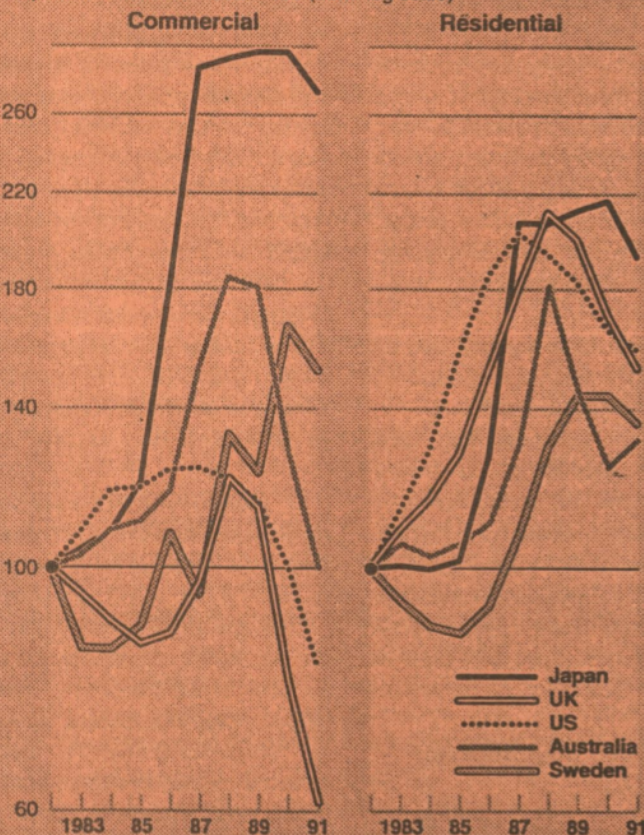
In other words: if people cut consumption in line with the downward spiral of the value of their homes, banks might go bust.

But this is not a new event in postwar history. It happened after the land speculation that began in the late 1960s, which generated a boom that led to the bust of 1974. House prices turned south, but high levels of inflation disguised the effect - though not the impact on the labour market. Result: because the official response was inappropriate, and because there was no world war-type rescue operation, the industrial countries suffered protracted levels of high unemployment.

Investors trying to maximise their returns should expect a similar outcome in the 1990s. Reconstruction in the ex-Soviet economies will not materialise in time to save many jobs; and there are no political programmes to enliven the economies of the west. Which adds up to more deflation, and stalemate until it suits the domestic needs of the German and Japanese economies; then the financial lifeblood will start to coarce through the global arteries, once again, leading to the beginnings of recovery in about 18 months from now.

Property prices

Adjusted for inflation 1982 = 100 (semi-log scale)



Source: BIS annual report