When 'winner' loses all in the housing market

In a new book, Fred Harrison argues a personal but worrying economic prognosis for homeowners

by Fred Harrison
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House hunters are searching for bargains this weekend. But price discounts offered by anxious sellers will not save today's buyers from walking into the negative equity trap.

The market is set to recover after the election, when Britain will lurch into what I call the 'Winner's Curse' phase of the property cycle. This is when people make the biggest upward errors in their calculation of what a property is worth to secure the house of their dreams.

Tony Blair has already had a taste of what is looming for thousands of property speculators. He and his wife have bought a west London pad for £3.6 million, a multiple of six times their joint earnings, and are having difficulty finding a tenant to pick up the cost of their mortgage.

But the Blairs' travails will not be on the minds of many Easter house hunters, who, beguiled by the huge capital gains achieved since New Labour came to power, will convince themselves that they are safe in Gordon Brown's hands.

I forecast that the multiple of house prices to incomes will reach a record 6.5 as borrowers are enticed by the generous lending policies of banks and building societies. This is not the message promoted by New Labour. Blair is building his re-election strategy around Brown's claim that he has unpicked the patterns of history.

Brown promotes his record as historically unique. I contest this on his own grounds. He identifies volatile house prices as the primary agent for instability: 'Most stop-go problems that Britain has suffered in the last 50 years have been led or influenced by the more highly cyclical, and often more volatile, nature of our housing market.'

Under Brown's chancellorship, house prices have hit record levels since 1997. First-time buyers were squeezed out of the market two years ago, replaced by middle-income earners, who pursued the pension prospects from buy-to-let properties. But many of them are being squeezed by the rise in interest rates to 4.75 per cent.

Bank of England governor Mervyn King claims that nobody knows what will happen to the housing market. I disagree. While Brown appealed to 200 years of evidence to dramatise his record of macro-management, I have searched 400 years of economic history for the common links to booms and busts. History points to a classic bust. Both the commercial and residential property markets will continue to rise until the turn of 2007 into 2008, after which Britain will slide into a savage recession in 2010.

In 1983, I used the trends in residential land values to forecast a recession in 1992. I was correct. The Lawson boom/bust echoed the Barber boom/bust of 1972-74. Nigel Lawson believed that he, too, was tough enough to end the stop/go swings. But he ignored the one leading indicator that would have signalled trouble ahead: the price of land soared above house prices.

Brown failed to take measures against another land boom. He wants us to believe that his decision to make the Bank of England independent was a turning point in economic policy. But the US Federal Reserve has been independent for the best part of a century and presided over one boom/bust after another.

So how did Britain avoid the recession of 2001 which caused grief in the US and Europe? Brown pulled off his Houdini trick by standing Keynes on his head. Instead of the government pump-priming the economy - which would have meant raising taxes or increasing the national debt - he allowed the house market to bubble. Encouraged by low interest rates, people went on a spending spree. They reduced savings and extracted equity from their homes to fuel a consumption boom, offsetting the industrial sector's recession.

The result was household debt that today exceeds £1 trillion. The financial trap that now looms will be camouflaged for a time by the recovery of house prices. Brown's Budget promise to subsidise the mortgages of struggling low-income buyers will give an upward twist to prices, as will John Prescott's town-building plans.

It is too late for Brown to forestall the crash. In fact, the Treasury will make things worse with its plan for a new tax that will help to bump up land prices.

Brown believes that high house prices are due to the drop in the output of new homes. He commissioned Kate Barker, a member of the Bank of England's Monetary Policy Committee, to investigate ways to increase the supply. The Treasury is now strongly tipped to favour a tax on land values, levied when builders apply for planning permission. That revenue from land speculation is supposed to help pay for the roads and schools needed by Prescott's 'sustainable communities' east of London. But a tax on land levied at the point of development is self-defeating. Owners would withdraw from the market and wait for a Tory government to abolish the levy.

Barker insists a development land tax 'is certainly still on the Treasury's radar screen'. I expect that the tax will be introduced to pay for infrastructure, delivering an added upward twist to land values just as prices are pushed into the Winner's Curse zone.

In Boom Bust, I trace land values over four centuries. They move in 18-year cycles, identifying a clear pattern of turning points in the economy. Embedded in this process is a 14-year house-building cycle, terminating in feverish land speculation. During the last two years of the construction cycle people recklessly expose themselves to the Winner's Curse.

In the land market, a rise in demand cannot result in an offsetting increase in supply in places where people want to live and work. So prices are driven to dizzying heights by speculators, who outbid each other with offers for tracts that cannot yield an economic return. The market stalls and the house of cards comes crashing down.

The timetable is dictated by a financial mechanism, at the heart of which is the rate of interest on mortgages. From 1714, this was pegged by the markets at 5 per cent. Today, the MPC is contemplating raising its rate of 4.75 per cent in response to inflationary pressures. The return of the rate to 5 per cent will mark the final phase of the property cycle. Many house buyers who think they are about to pull off great deals this Easter will pay a heavy price in the recession of 2010.

Capital's housing market 'to suffer'

by Matthew Magee
The Herald
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Scotland's homeowners will face the first experience of negative equity in a house price crash due in 2008, according to an author who claims to have studied house price data for the past 300 years.
The market will continue to soar before collapsing and prompting a recession which will turn into a global depression by 2010, argued Fred Harrison, author of Boom Bust, a study of the UK housing market.
"For the first time Scotland is going to see a serious case of negative equity. Edinburgh in particular will suffer very badly with the kind of problem England had back in 1992 and in 1975" said Harrison. "By the end of the decade Britain will be in a deep depression."
Harrison's theory flies in the face of data


300-year study of housing market points to recession followed by depression

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