CSFI

C E N T R E F O R T H E S T U D Y O F F I N A N C I A L I N N O V A T I O N

5 DERBY STREET
LONDON W1J 7AB

TEL: 020 7493 0173
FAX: 020 7493 0190

The UK mortgage market in 2008: A round-table discussion with John Wriglesworth, Mark Boleat and Chris Gentle held on Wednesday, January 23, 2008 at Watermen's Hall, 18 St-Mary-at-Hill, London, EC3R 8EF, from 12:30-2:15pm.

All financial crises need to be put into context and the first speaker did that for the current housing downturn. The crash of the early 1990s does contain similarities with the present – phenomenal growth in house prices, mortgage lending and personal debt and an influx of specialist and US-backed lenders. But during 1988 mortgage rates rose from 7% to 13% and the Government gave a six-month warning of the end of double mortgage tax relief. As the second speaker put it: "People rushed to buy homes on mortgages they couldn't afford with partners they couldn't stand." Transactions rose from 1.4m a year to 2 million. It all ended in tears – 2 million unemployed, mortgages rates at 15% and 2 million in negative enquiry (where their mortgage exceeded their property value). Despite the carnage, house prices only fell 13% in nominal terms between 1990 and 1995. The ratio of house prices to income (HPI) fell from five to three.

Fast-forward to today and the average HPI is 5.7. The first speaker said it was not a good guide as it compared a stock with a flow and took no account of falls in interest rates. Without the credit crunch he believed house price would have petered out, finding a new plateau without the need for falls in transactions or prices. The credit crunch hit confidence. Firstly investors failed to distinguish between the US and UK markets and shut off funding indiscriminately. Secondly footage of queues at Northern Rock triggered a crisis in confidence. Transactions volumes fell 25% with one agent reporting a 90% fall. Whether prices fall depends on confidence. If it returns to the funding market there is no reason why demand will not return. If confidence does not return, then new lending will be constrained, confidence, house prices and consumer spending will fall, which in turn will put the UK in a recessionary environment. Were prices to fall he anticipated a 10% decline. Even then repossessions were unlikely to soar as there was no sign of a rise in unemployment that will force people to sell.

The second speaker reached further back in history to the 1970s when prices fell in post-inflation terms by 45% between 1973 and 1977 while mortgage rates hit 17%. Pain was felt by homeowners, developers and insurers. Compared with that, the current situation looks like a "bog standard downturn in a cyclical market". Securitisation was never needed in the UK thanks to the network of nationwide banks. As Joseph Stiglitz said recently: "If you could find enough fools to take bad mortgages, you had every incentive to lend as much as you could. What is remarkable is how many fools (including banks with supposedly good risk management systems) there were." The speaker agreed a 10-20% price fall was possible but would be confined to asking prices and therefore relatively meaningless. Arrears would not rise sharply; valuers would be sued; lawyers would make money. He did not see a shortage of mortgage finance. Specialist lenders would disappear and traditional lenders compete for market share. Margins will rise but rates will fall as interest rates fall.

The third speaker said the funding gap – the difference between deposits and loans – combined with the drying up of wholesale markets was a cause for concern. However housing was a culturally popular investment in the UK. There might be a structural change in the mortgage market as lenders react to the slowdown by being more aggressive in back office efficiencies. The issue will be to provide good service in a poor marketplace. He doubted there would be much innovation given that innovation in the form of securitisation had got the market into its current position.

One member from the lending industry agreed there would be no rise in repossessions without a rise in unemployment but also thought prices would fall 10%. He wondered whether that would be such a bad thing given that a 10% would take the market back to where it was a year ago and ease affordability problems. Another member said a major difference between the US and UK was that housebuilding continually fell short of demand, underpinning prices. One member speculated the Government would hike stamp duty to take advantage of falling interest rates but the panel doubted that. The speakers also doubted the UK would go into recession.

Others thought the panel was too sanguine. One said that as many as 3 million people were vulnerable to rising mortgage rates as they came off fixed rates, particularly among the UK's subprime sector. He said lenders and brokers had been guilty of significant mis-selling and forecast repossessions would hit 1994 levels. Another warned that if wholesale financing continued to dry up, lenders would have to raise mortgage rates that would trigger a fall in volumes and house prices that lead to recession. The panel, however stuck to its view that the UK should not need to brace itself for a US-style crash.