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A lost decade?

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Like most clichés, “an Englishman’s home is his castle” contains the grain of an important truth. For most people, the family home represents the largest financial asset and therefore the largest store of wealth they will ever own.

Arguably the British fetish for property owning is one reason for Britain’s relative industrial decline; we have a vast amount of money tied up in unproductive, stationary, bricks and mortar. Nevertheless, this intergenerational transfer of wealth has occurred and whilst everyone has sympathy for young people trying to “get on the ladder,” few, if any, want to see house prices fall.

This issue is interesting and important because whilst all eyes are on Brexit and the unholy mess our elected representatives have got themselves and us into, there are longer term and powerful economic forces at play which have a direct impact on living standards, wealth, opportunity and retirement security.

When we analyse the data, two British themes jump out:

Firstly, the decline in real wages. The median real wage in Britain is lower today than it was in 2008. In other words, the threat of a “lost decade” has actually been realised.

Secondly, the principal source of wealth creation for most people[1], house price inflation, has moved to a much lower rate of appreciation than experienced before and, in this decade, house price appreciation has frequently been negative.

In the period 1997-2007 (using Nationwide data) the average annual rate of house price growth was 12%. In late 2002/early 2003, house price inflation was running at some 25%. Contrast this with period 2007-2017 where the average rate of house price growth has been 1.59% per annum. House prices fell by 15% in 2009 and the maximum rate of annual house price appreciation since 2007 was 11% in 2014.

Currently, the rate of annual UK house price inflation has dropped to 2.1% (year ended 31/5/2017).

It is the combination of incomes that are too low coupled to supply bottlenecks in housing production that keeps prices high for incumbents whilst declining house price inflation makes the real cost of housing too high for new entrants.

What is even more interesting is that there is a well-known negative correlation between interest rates and house prices. From 1997 to 2003 interest rates declined from 7.5% to 3.5%. Right now interest rates are standing at 0.25%. The Bank of England, even if it wanted to, cannot stimulate the housing market to supplement low real wage growth with high house price inflation.

For the next decade our legislators will be utterly tied up with Europe. That’s what we mean when we say Brexit is simply a distraction from much more urgent business.

[1] Outside London which until recently has been something of a special case. But even here, recent reports point to a sharp deceleration in house price appreciation.

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