BANK OF ENGLAND

Press Office
Threadneedle Street
London EC2R 8AH
T 020 7601 4411
F 020 7601 5460
press@bankofengland.co.uk
www.bankofengland.co.uk

News release

29 April 2002

Property and the Economy – Speech by David Clementi

In a speech today at the international dinner of the Chartered Surveyors' Livery Company, David Clementi, Deputy Governor at the Bank of England, discusses the importance of the property market for monetary and financial stability, two of the Bank's Core Purposes.

Mr Clementi notes that the divergent trends in house prices and commercial rents "mirror the current imbalances in the UK economy, on which the MPC has had a good deal to say in its minutes. The buoyancy of the housing market is closely associated with the strength of domestic demand; while the relative weakness of the commercial market mirrors the retrenchment in the scale of the operations of multinational companies in the UK, as well as the effects of the slowdown in global demand on internationally-exposed UK companies. As with all imbalances, this situation will eventually have to be resolved. But this need not necessarily involve a sharp correction in residential property prices. The MPC's central projection for activity and inflation has been consistent with a more gradual cooling in residential demand, and some recovery in the commercial sector on the back of an improvement in the international economic environment."

Commenting on the implications for monetary policy, Mr Clementi says "there are some who believe that the MPC should act now to contain what they perceive to be a dangerous 'bubble' in house prices. I am not convinced by this view, for two reasons.

"First, while residential house price inflation has caused some concern, and can clearly not be sustained forever at current rates, the evidence for a bubble is not conclusive. By their very nature, bubbles are hard for policy makers to identify, particularly at the time. I do take some comfort however from the fact that the ratio of house prices to households' post-tax earnings is still well below the levels seen in the late 1980s. Of course, multiples are rather higher in London and the South East - but it is the MPC's job to set interest rates for the country as a whole, not for particular regions or sectors.

"The second point is that our mandate is to target RPIX inflation, not house prices. House prices are by no means irrelevant to aggregate inflation - there are many important links through consumers' spending and saving decisions … and the MPC studies the latest evidence on this at its monthly meetings. But inflation is affected by a whole raft of other factors as well, and these also need to be taken into account in our overall policy judgment. Even if the property market gets out of line, monetary policy adjustment is appropriate only to the extent that property developments risk the inflation target not being met.

"On balance, my view is that the current state of the housing market does not, taken on its own, raise undue concerns for the inflation outlook. But we need to - and will - stay alert to developments in the data. And both we, and the markets, need to recognise that the build up in debt creates heightened downside risks. Though debt service burdens do not appear to be excessive at current interest rates, higher borrowing makes the household sector more vulnerable to unexpected falls in income or increases in interest rates. Perhaps financial innovation and greater macroeconomic stability have raised the sustainable level of debt - but we do not know this for sure, and it is the job of central bankers to remain cautious."

Key Resources

Property and the Economy – Full speech
http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2002/speech170.pdf