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News release

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Mortgages and housing in the near and long term - speech by David Miles

In a speech to the Home Builders Federation, David Miles - External Member of the Monetary Policy Committee - considers how persistent the observed fall in UK housing market activity might be, and the potential implications for house builders, mortgage funding and the MPC.

David Miles begins by explaining that it is typical for long lived assets, such as property, to be adversely affected by economic downturns. But, he says, "...the impact on the housing and mortgage markets over the past few years has been greater than is usual even in a bad recession.... And that is because this recession started with the near collapse of the banking system." This leads him to ask whether the observed decline in activity is part of a "...painful transition from a position where the cost and availability of mortgage debt was unsustainable...", or whether we are stuck in a "...bad equilibrium of low confidence, low willingness to lend which is unwarranted by the risks, and impaired ability to buy".

He believes the available evidence is more consistent with the first hypothesis. He notes that for several years prior to 2007, "Both the average spread on new mortgage lending and the variability in spreads across different types of mortgage looked unsustainable". But that situation appears to be unwinding, with the spread over the cost of bank funds appearing to have moved back above the pre-2000 average and there now being "...substantial differentials between interest rates on mortgages with different risk characteristics". He also reports that the availability of mortgages with very high loan-to-value ratios has fallen sharply. On that point, he suggests: "It probably never made sense for there to be 100% mortgages."

David Miles goes on to discuss the potential implications of moving back to a world where the cost and availability of mortgages are more sustainable. He sets out some simple calculations based on a stylised model of the world to explain that the need for larger deposits would be expected to cause a temporary but sharp fall in the number of first time buyers - increasing their average age and reducing the owner occupation rate - and lead to many fewer housing market transactions; results which are broadly consistent with reported data. In due course, however, his model suggests that housing activity should pick up. Even so, the transition path to the new equilibrium is likely to be uncertain and potentially subject to overshooting. That could create difficulties for both builders looking to plan new construction and for the MPC, which will "...need to re-calibrate the link between Bank Rate and the cost of debt to finance house purchase".

David Miles concludes by considering whether there could also be a permanent change to the way mortgages are funded. He notes that the issuance of Residential Mortgage Backed Securities (RMBS) has collapsed since 2007 and says "...there are reasons to question... whether the type of RMBS that were issued are a natural funding vehicle for UK mortgages." That, he suggests, is because the principal buyers of RMBS often wanted short duration, non-sterling denominated assets. He says: "A more natural source of funds... might be from institutions who want long-term, sterling assets - for example pension funds and insurance companies." Adding: "Market forces can be expected to work to bridge gaps between potential suppliers and potential demanders of products and this may work in the mortgage market now to cause an evolution in the type of mortgages so that the nature of the funding and the essential nature of the debt it allows to be created are better matched."

Key Resources

Mortgages and housing in the near and long term – Full speech