BANK OF ENGLAND

# News release

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## Mortgages, housing and monetary policy - what lies ahead? - speech by David Miles

In a speech delivered to the Northern Housing Consortium, David Miles – External Member of the Monetary Policy Committee – discusses how the financial crisis has transformed the UK housing and mortgage markets. First-time buyers now need to postpone their purchases in order to save for a larger deposit and in the future may increasingly look at alternative schemes for financing house purchases with more outside equity. He predicts that this need for equity will lower the rate of owner-occupation. In the short-term this creates transitional problems – particularly for house builders – and recent government policies have been designed to counter them. But in the longer-term a lower rate of owner-occupation, and a bigger rental sector, need not be a negative outcome – it could help to offset tax distortions that work against renting and stabilise the housing and mortgage markets, and ultimately the wider economy. Monetary policy might need to be re-calibrated but would not be less effective.

David Miles begins by showing how the UK housing market is going through “an extraordinary period of readjustment”: the volume of house transactions has halved since mid-2007 and the average level of real house prices has declined by 20% since the September 2007 peak – the same time as Northern Rock’s demise. He notes that new house building has fallen by more than half and the net flow of mortgage lending has collapsed to almost zero. “It is not surprising that the recession and the financial stresses have had a huge impact on the housing market. The disposable income of the majority of households has fallen; uncertainty about future levels of incomes has increased sharply. Uncertainty pushes down on the value of long-lived assets, and few assets are as long-lived as houses”, he says.

Banks and building societies now require house purchases to be financed with more equity. The most obvious source of equity is from buyers themselves. For many people, it is only by postponing their purchase that they can accumulate the larger deposits banks and building societies demand. Consequently, the average age at which people buy their first home will rise and the share of owner occupied houses will fall.

But this is not the only source of equity available to buyers. Miles considers several alternative forms of outside equity-like funding, including shared ownership schemes and equity loans. With some of these schemes the buyer retains total ownership of the property but the repayments on the outside funding is linked to the value of the house. In principle there could be a wide range of loan contracts which permit home-owners to decide how much house price risk they want to take on.

Outside equity can bridge some of the gap between mortgage loans and the deposits from first-time home buyers, and also bring risk-sharing benefits. Nonetheless the rate of owner-occupation in the UK is likely to fall. But although that creates transition problems, in the longer-term it need not be negative. Indeed a lower rate of owner-occupation, and a larger rental sector, can generate some benefits. For example, it offsets the distortions created by the tax system which discourage renting. In the UK, capital gains tax is not levied on owner-occupied housing, but it is levied on capital gains from rented property; landlords also pay tax on rental income. The current tax regime favours owner-occupation over renting.

It is possible – though far from inevitable – that if owner-occupation and mortgage debt is lower changes in Bank Rate will have a smaller effect on the economy. And changes in house prices will have less impact on the economy when leverage in the housing market is lower. But the economy would probably become more stable. That would make the task of setting monetary policy easier.

**Key Resources**

**Mortgages, housing and monetary policy - what lies ahead? - speech by David Miles – Full speech**