

Against house price growth



Nationwide house price data

Source: VOA/Nationwide Building Society

This can be seen clearly by comparing growth in various asset classes over the past ten years. House prices have risen 187%, according to the Halifax, against the rise in the FTSE All-Share index of just 57%. As for wages, over the past decade they have barely kept pace with inflation. But land prices have taken off on an exponential trajectory, rising 371% since 1996.

This is far from the first time this has happened. The main graph above shows a similar jump in land prices leading up to 1989 – and then a collapse in the value of that land after house prices peaked in early 1990. This resulted in the recession of the early 1990s, which hit its bottom in 1992. Historically, the cycle involves 14 years of stable or rising property prices followed by four years of recession – and so far, this is precisely what has happened this time around. After the last crash, house prices began to stabilise around 1993, which suggests 2007 will be the final growth year for this cycle,

with a crash beginning in 2008, leading to a recession that reaches its bottom in 2010 – 18 years after the last slump. And nothing has changed to suggest we are about to depart from the trend of history. In fact, the only major difference is one that spells even worse news for the global economy – business cycles across the world have now synchronised, and so have the property cycles.

Just look at what is happening in the US. The recent drop in the construction of new houses was the biggest fall in nearly 16 years. Prices are weakening, and consumers are borrowing themselves deeper into debt. But commercial property remains resilient, so it seems likely that real estate will help to bolster the economy for at least another 12 months.

Marry the trends in the UK and USA with similar trends in other property hot spots, stretching from Ireland and Spain all the way to Australia, and we begin to glimpse why I expect to see a property-led global depression by 2010.

Can we break the cycle?

Why do we repeatedly see this cycle of boom and bust? The trouble is that Government economic models focus too much on wages and profits, and they deliberately ignore the fact that rising land prices periodically squeeze wages and profits to the point where the labour and capital markets have to contract (see the illustration below). So forecasters end up being shocked when output drops below the Treasury's rosy growth path.

That's why experts were shocked when the sharp increase in land values during the Barber boom of the early 1970s was followed by the recession of 1973/1974. Similarly, the squeeze of the late 1980s (the Lawson boom) was followed by the

bust of 1992. And the Brown boom will be followed by the decline into 2010.

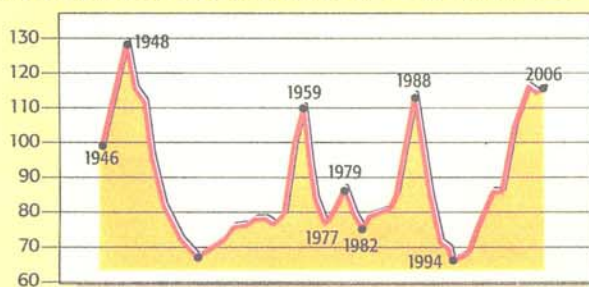
It's too late to prevent the downturn in the latest cycle. And the only way to break the ongoing cycle of boom and bust is through a fundamental reform of the tax system, moving towards taxation on rents paid to landowners, rather than wages and savings income. This would encourage people to invest more and work harder, rather than focusing on ways to avoid paying tax on their income and savings. It would also mean that as the economy grows, and the value of land rises, so would the money collected by the Treasury to spend on public services.

Meanwhile, in terms of what investors should do, it's easy to say glibly that people shouldn't buy property, and it certainly isn't a good time to be thinking about becoming an amateur landlord. But if you do intend to buy a home to live in, it's more important now than ever before that you are aware of the potential risks involved and that you have a cushion in the form of a deposit and affordable monthly repayments.

The people who suffer the most will be those who overstretch themselves now, such as naive first-time buyers taking out interest-only mortgages with no deposit. I believe prices could fall by as much as 20% in real terms – but it's important to remember that the property market varies from one location and property segment to the next. The buy-to-let sector – especially in the regional cities such as Leeds and Liverpool – will be severely hit, with prices dropping by as much as 40% from their current selling prices.

*Fred Harrison's Ricardo's Law: House Prices and the Great Tax Clawback Scam, is published by Shephard-Walwyn (£18.95). Buy from the MoneyWeek bookshop at www.moneyweek.com*

House prices: disposable incomes ratio in the UK



Source: The Business

How land costs squeeze wages and profits

