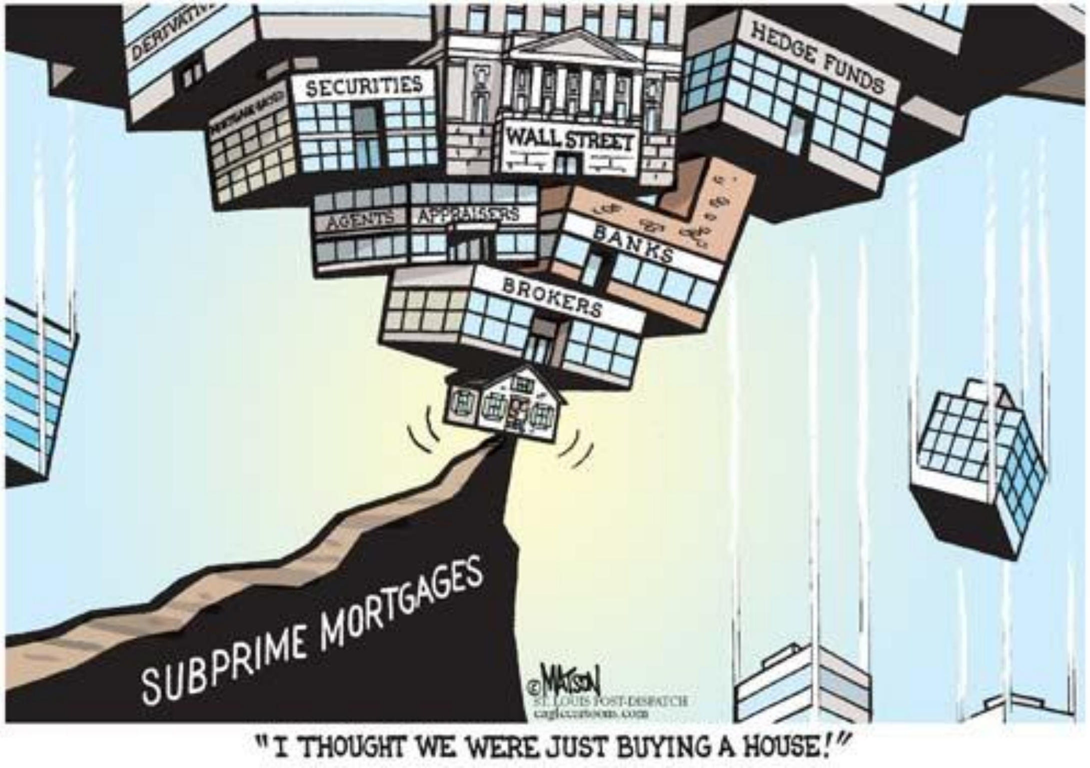
LSE

Centre for the Study of Globalisation and Regionalisation

Housing Markets and the Global Financial Crisis

Herman Schwartz
Mat Watson
André Broome
Len Seabrooke



US Power Rising

1. Absence of constraint

equals: US global financial arbitrage / $ recycling

- The US escaped the usual constraints, '91-05
  - Over-consumed (from 65% to 70% of GDP)
  - Overinvested at home (GFCF from 14% => 19%)
  - Overinvested overseas ($7 trillion gross)
- And made money doing this! ☺
  - At the cost of rising net foreign debt… ☹

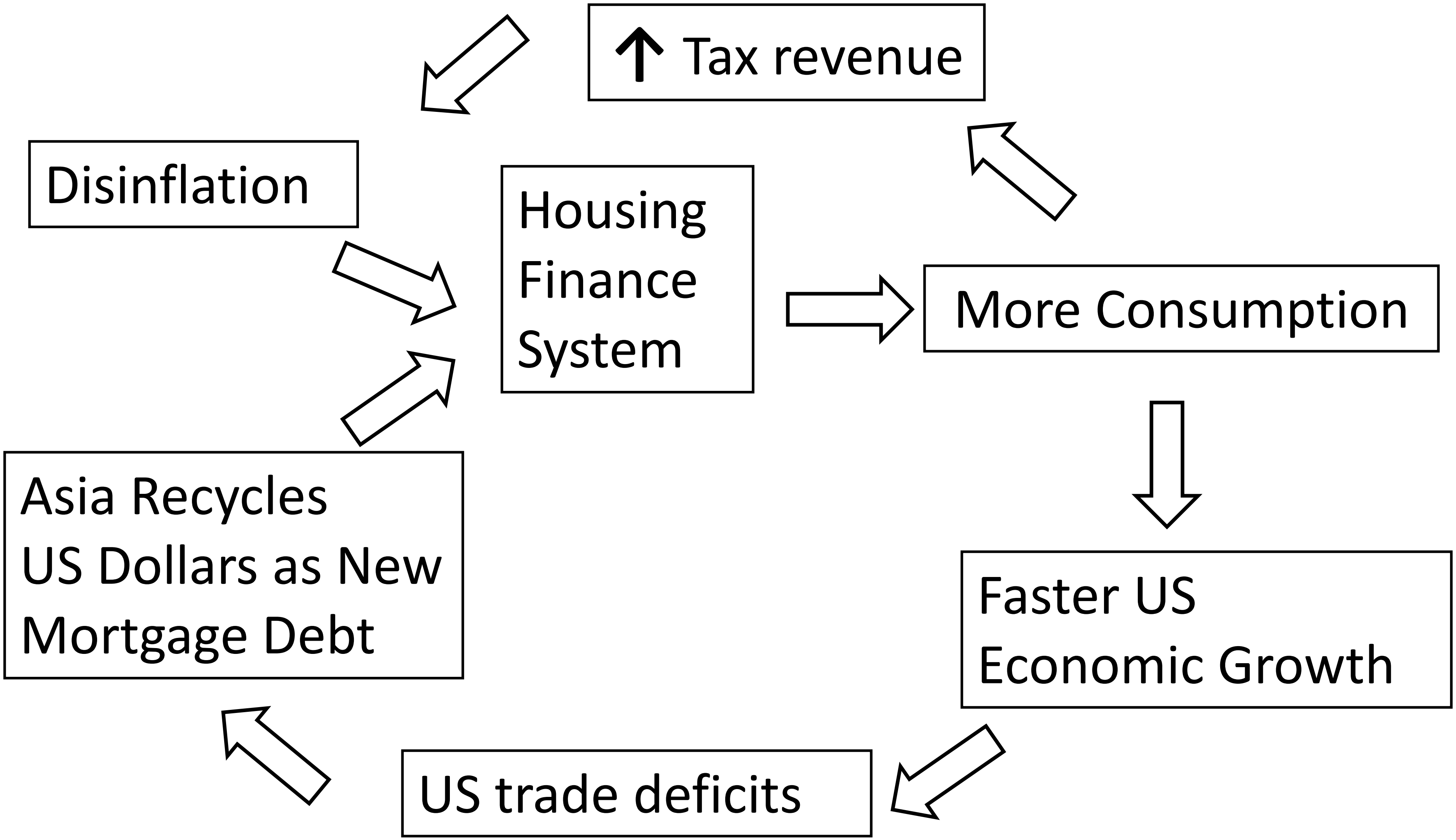
US Power Rising

1. Absence of constraint
2. Control over production chains
   - US owned share of MSCI from 10% => 24%
     vs. Foreign Share of US from 5% => 9.7%
   - US MNCs' share of GWP up 40% => 7.8%
   - Ratio of USDIA to FDIUS, 1995-2004
     - Assets ratio from 1.32 => 1.5
     - Value added ratio from 1.4 => 1.6
     - Turnover ratio from 1.1 => 1.4

US Power Rising

1. Absence of constraint
2. Control over production chains
3. Differential growth
   - *"market share"* not absolute growth
   - US share of OECD GDP up 4.2 % points to 42.7%, 1991-2005 (vs fall from 46.6% [1950] => 37.8% [1982])
   - US share of world GDP stable at 20% despite rapid growth in China, India, etc

The 1990-2000s US growth cycle



Housing finance

- High rates of homeownership +
- High levels of mortgage debt to GDP +
- Easy refinance of mortgage debt and home equity withdrawal +
- Securitization of mortgages

= “US style housing market”

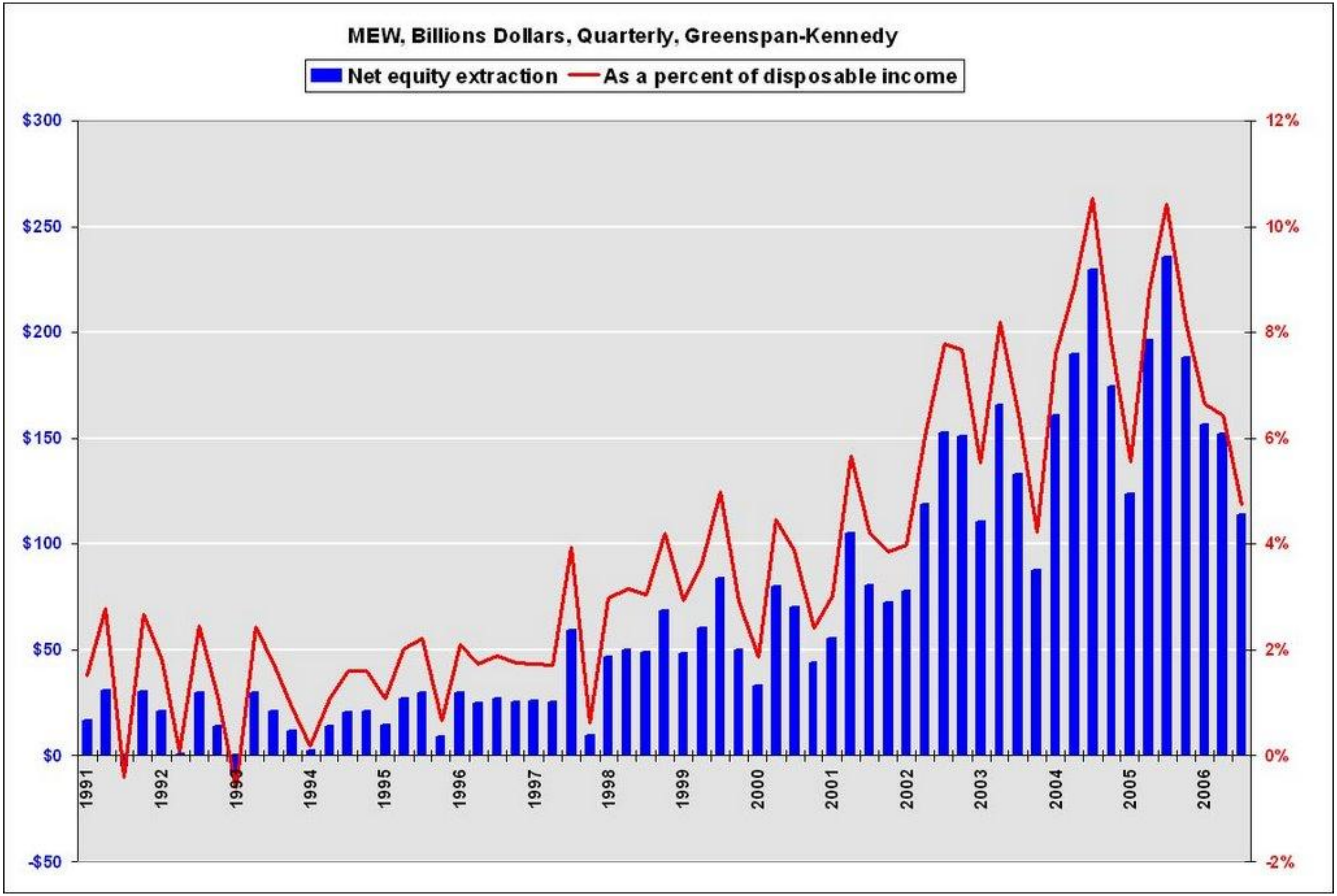
can create (or destroy) lots of aggregate demand

Housing wealth

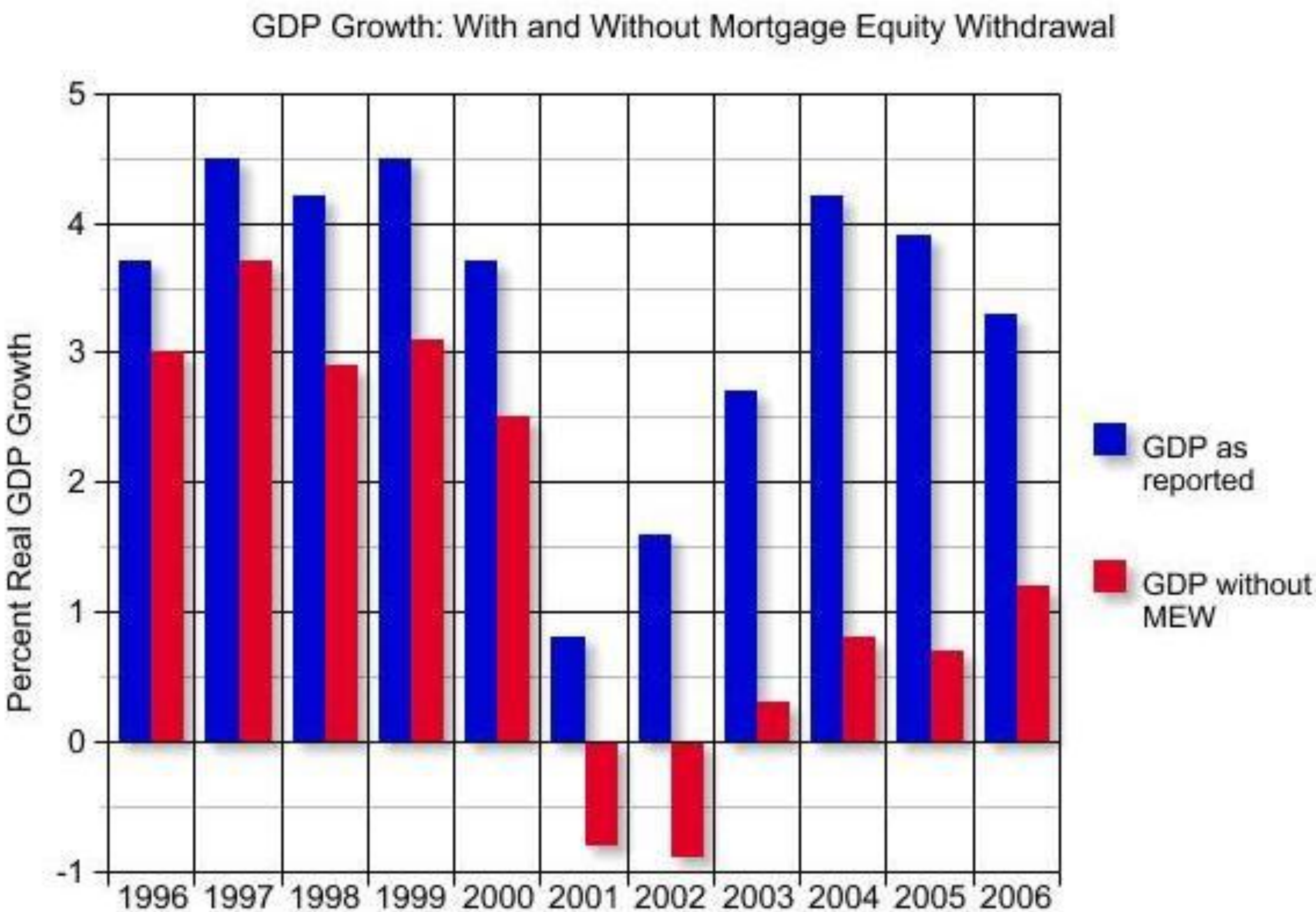
- New homeowners buying between 1999 and 2005 saw an increase in median net wealth from $11,100 to $88,000, mostly in home equity
- Incumbent households' median net wealth nearly doubled from about $152,400 to $289,000
- People spent this money,

  powering economy

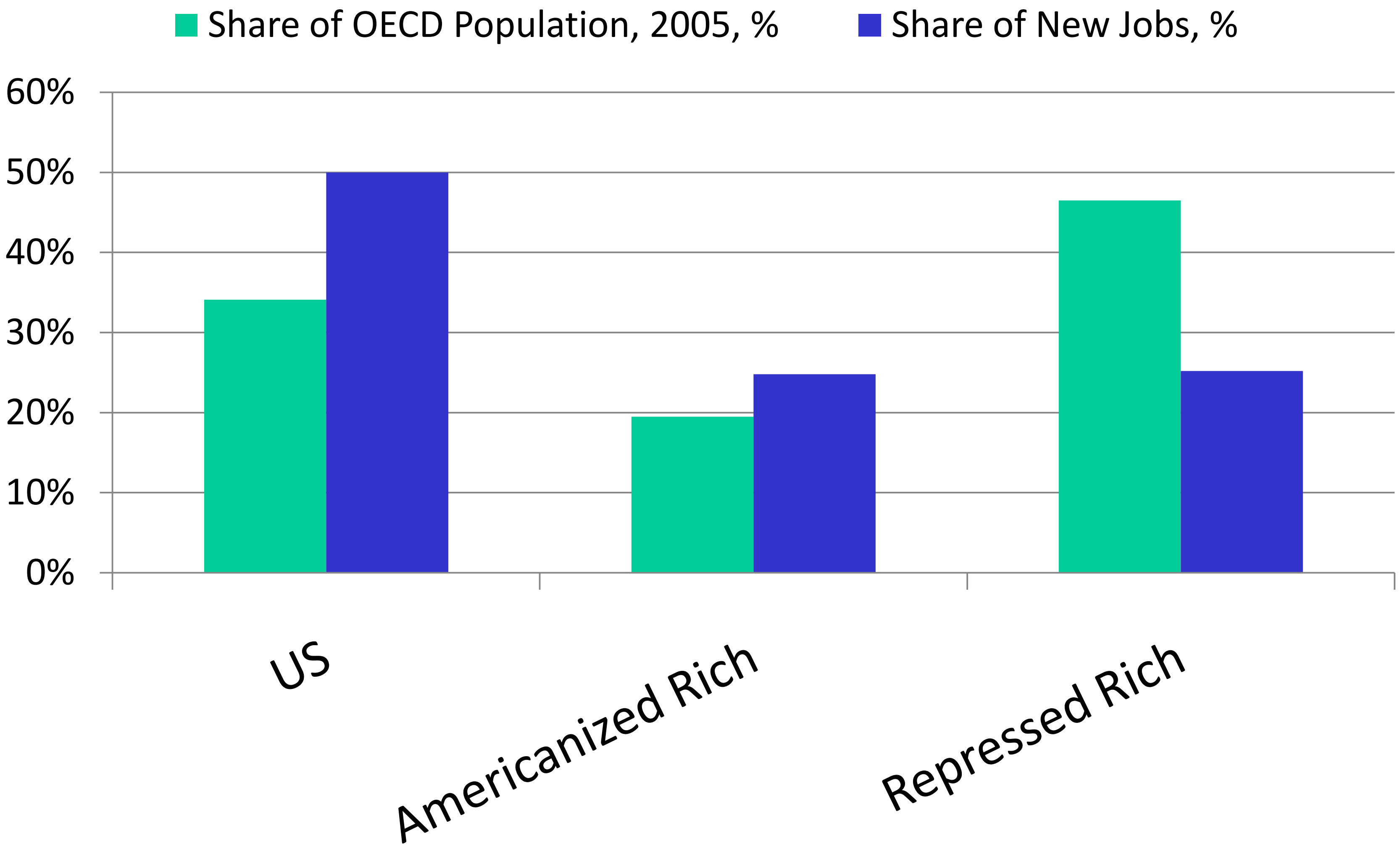
MEW as % DPI (Greenspan)



MEW vs GDP, 1996-2006



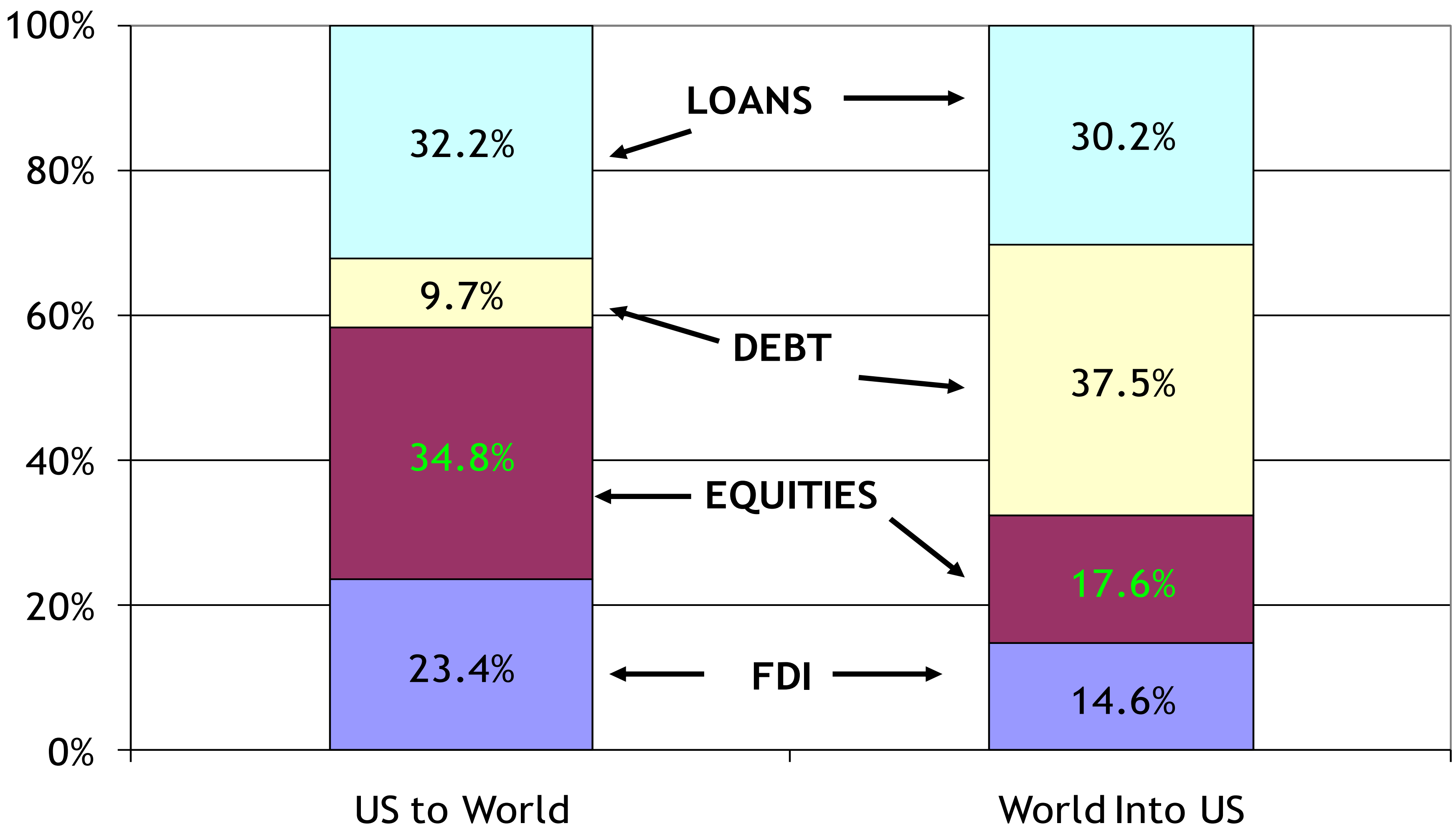
Employment gains, 1991-2005



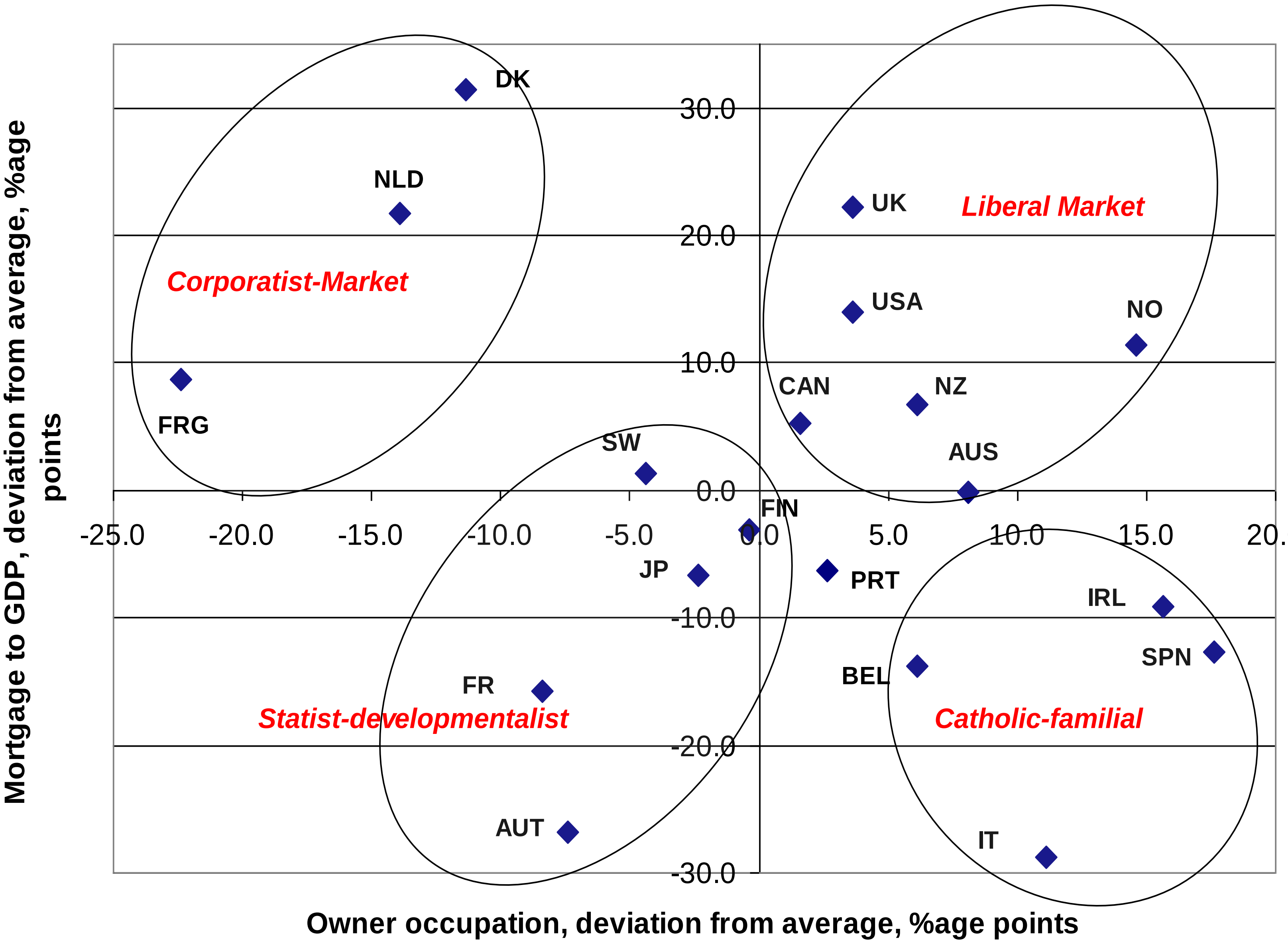
Differential growth (adjusted)

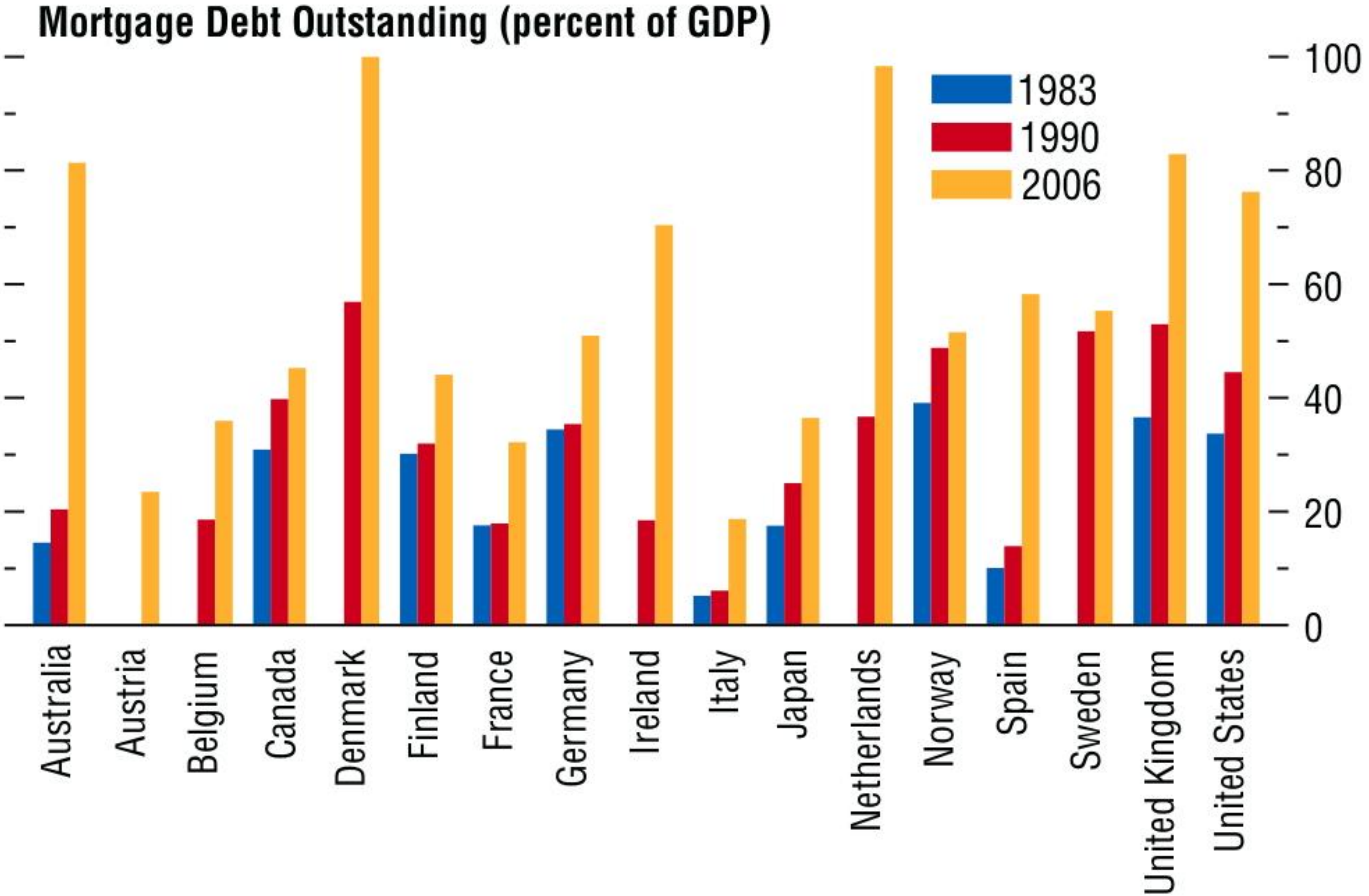
Population adjusted % change, 1991-2005	USA	OECD Ave.	FRG	Japan
GDP (real, local currency)	33.5	28.1	17.3	13.3
# of Employed	1.8	3.0	-2.9	-2.7
# of Unemployed	-24.8	6.8	91.5	109.7
GFCF	79.9	48.2	2.7	-13.5
GFCF Metals/Mach	159.8	100.1	19.0	22.8

Share of Four Basic Instruments in Total Outward Investment by Region (%, 2006)

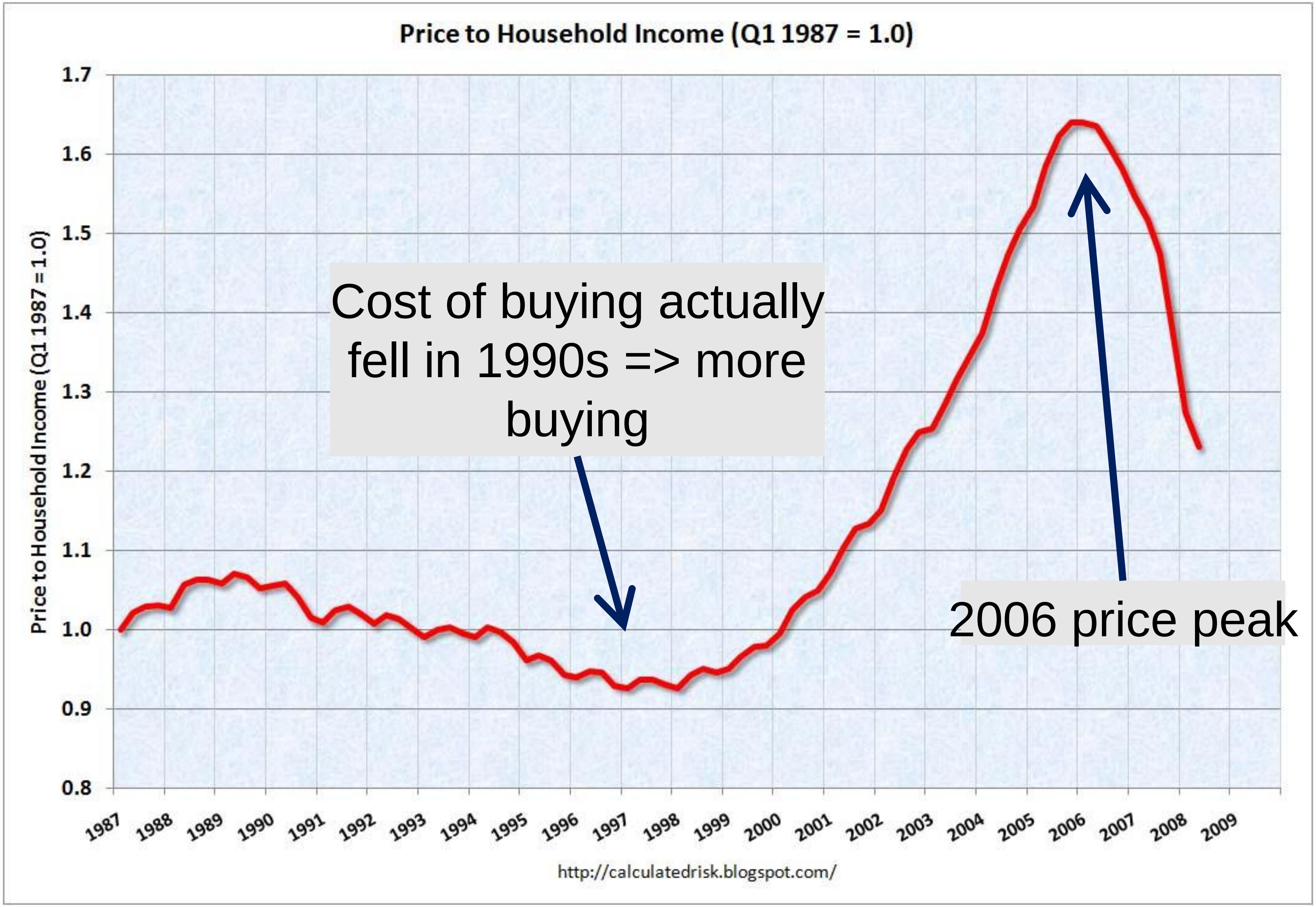


Four types of housing regimes defined by relative deviation from the average OECD levels of mortgage debt to GDP and owner-occupation prevailing 1992 to 2002 (in percentage points)

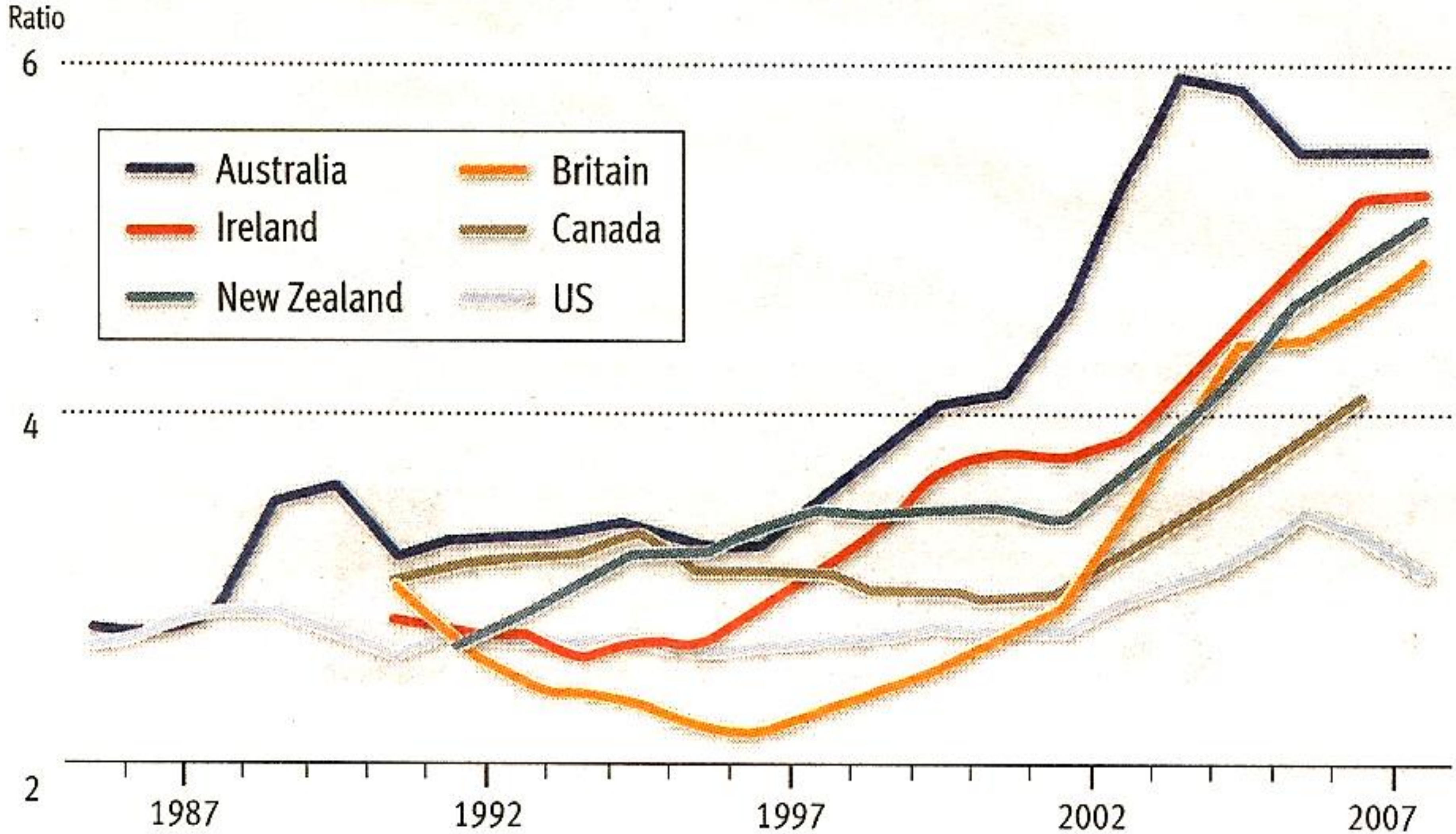



Mortgage Debt Outstanding (percent of GDP)
1983
1990
2006
100
80
60
40
20
0
Australia
Austria
Belgium
Canada
Denmark
Finland
France
Germany
Ireland
Italy
Japan
Netherlands
Norway
Spain
Sweden
United Kingdom
United States

Ratio of US Housing Prices to Income – the fundamental issue



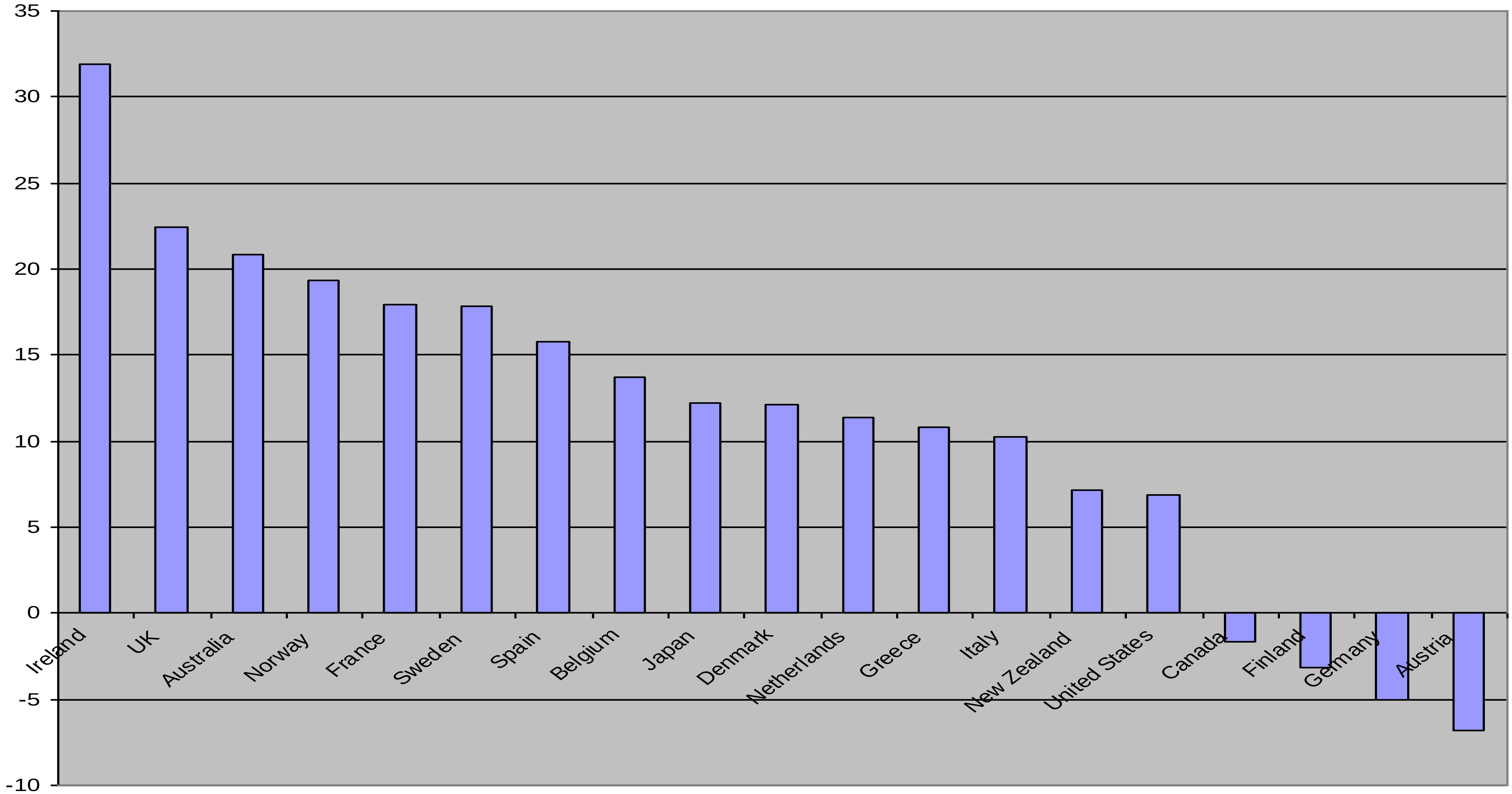
House price-to-income ratios*



* Various combinations of median and mean measures of house prices and incomes used depending on availability

Source: ABS; BEA; BIS; CLG; CSO; OECD; ONS; RBNZ; REIA; Statistics Canada; Statistics NZ; Thomson Financial

Economies at risk – where housing growth is not explained by economic growth



Source: IMF Staff calculations, World Economic Outlook, April and October 2008

Fundamental drivers of house prices are modelled as: the lagged ratio of house prices to disposable incomes, growth in disposable income per capita, short-term interest rates, long-term interest rates, credit growth, and changes in equity prices and working-age population

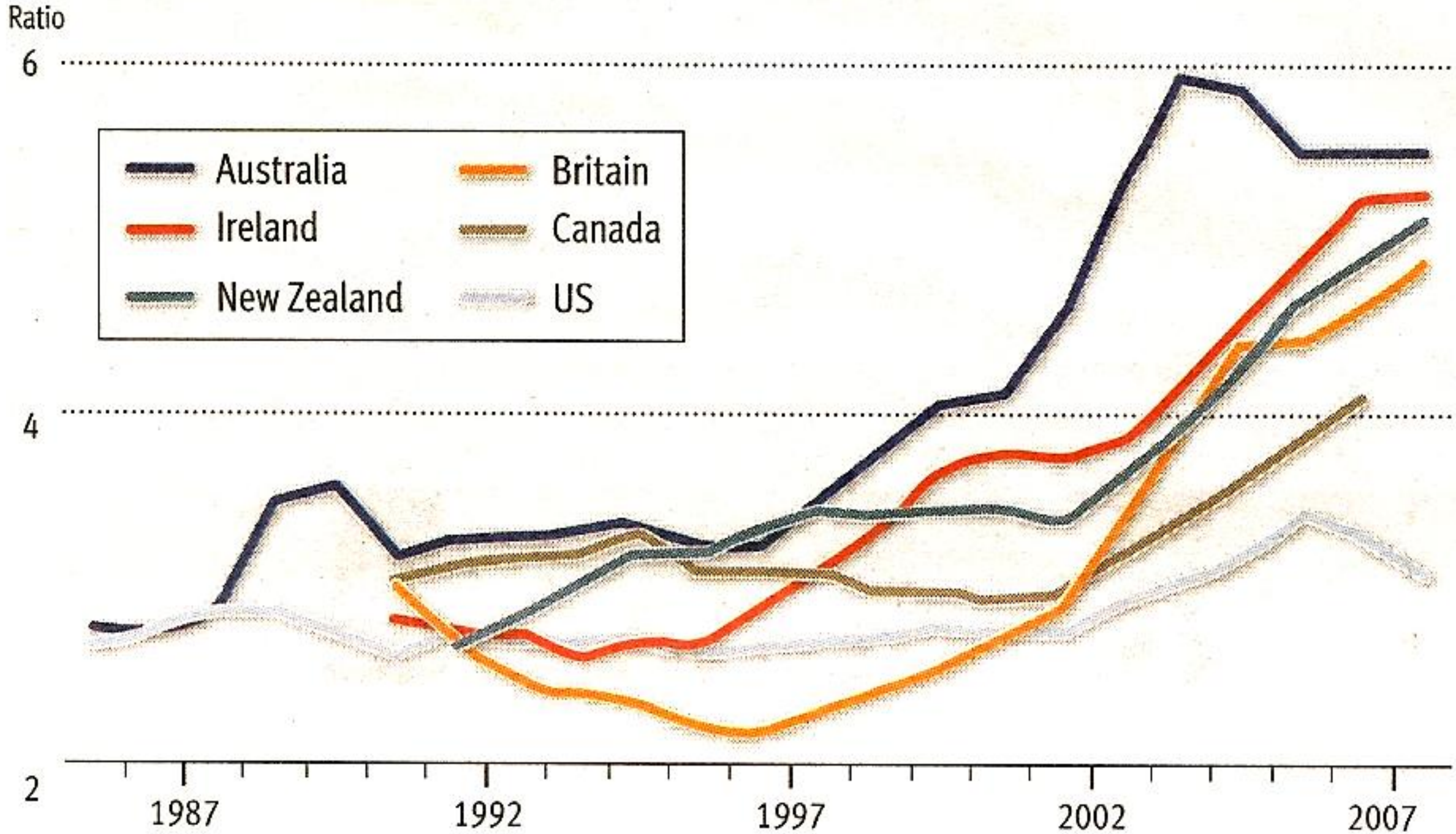
Political Time Horizons, Property Booms, and Financial Liberalisation

	Short	**Long**
Public	*Politicians*	*Regulators*
Private	*Banks*	*Homeowners & Citizens*

Changing Housing Markets in Australia and Denmark

- Taxation is a national concern
- Financial deregulation and reregulation is transnational
- Groups fight for credit access within and between generations

House price-to-income ratios*



* **Various combinations of median and mean measures of house prices and incomes used depending on availability**

Source: ABS; BEA; BIS; CLG; CSO; OECD; ONS; RBNZ; REIA; Statistics Canada; Statistics NZ; Thomson Financial

Changing Housing Markets in New Zealand

- Financial liberalization during the 1980s and 1990s aimed to produce an 'asset-based society'
- But reforms created a generational split between housing market 'insiders' and 'outsiders'
- The rate of home ownership fell from 74% in 1991 to 67% in 2006, and is predicted to fall below 62% by 2016
- Home ownership in the 25-44 age group declined by 44% between 1991 and 2001

Changing Housing Markets in New Zealand

- In the recent property boom policymakers faced a monetary 'catch 22':
  - Interest rates were raised in an attempt to ease the property bubble
  - But borrowers' preference for fixed-term interest rates created a time lag
  - Higher interest rates attracted more foreign capital and pushed up the value of the NZ$
  - This fuelled consumption, inflation, and a worsening trade deficit
- The impact of the global financial crisis has impeded the impact of interest rate cuts, and constrained the scope for further fiscal stimulus

Questions?