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Commentary on the economic situation

Repeating the same mistakes

The policies of 1979 have been abandoned

The recent Mansion House speech and Autumn Statement confirm that the Government has completely rejected the ideas behind its macroeconomic policies in 1979. At its start the Thatcher Government repudiated short- term demand management, based on macroeconomic forecasts, because that approach had failed in the 1960s and 1970s. Instead it favoured stable, but gradually declining, growth of broad money over the medium term. The thinking was that this nominal anchor would deliver stable growth of demand and output with falling inflation. Essential to the system was a floating exchange rate, because this would prevent inconsistencies between a fixed exchange rate and the money supply target.

This whole structure, which was imposed on the Treasury by Mrs. Thatcher's ministers, has now disappeared. Mr. Lamont reads the speeches his civil servants write for him and accepts their short-term forecasts as the best assessment of the future that he can find. The Treasury machine has taken over, while the Conservative Party has no distinctive macroeconomic policies worth mentioning. As in the 1960s and 1970s the Chancellor's decisions are subject to two main influences, forecasts of the short-term outlook for the economy (which are usually wrong) and sharp fluctuations in the exchange rate (which are always unforeseen). These influences are often contradictory and policy is a muddle most of the time.

Once again, the Government is under-estimating the significance of the housing market and monetary growth

The Chancellor's next embarrassment will be the failure of the economy to recover in early 1992. According to *The Times* (11th November), Mr. Lamont is now defining recovery as above-trend growth and in effect committing the Government to achieve it. His civil servants have told him that the slow growth of broad money and depressed housing market will not prevent "recovery" in this sense. He clearly believes them. Has he forgotten that the same civil servants were telling one of his predecessors in 1987 and 1988 that rapid growth of broad money and a bouyant housing market would not be followed by rising inflation? The Treasury was wrong about the scale and persistence of the boom then, and it will be wrong about the scale and persistence of the recession in 1991 and 1992. Apparently his key advisers are claiming similarities between the upturn in 1981 and 1982, and the situation today. But there is one crucial difference between then and now. In the early 1980s a tremendous surge in mortgage lending was under way, because everyone wanted to get onto the housing ladder. By contrast, as we argue in the accompanying paper, the house price declines of the last two years have knocked the housing ladder down and removed this vital source of stimulus.

Professor Tim Congdon — 12th November, 1991

Summary of paper on

'The housing ladder has fallen down'

Purpose of the paper One of the most remarkable features of the economy in 1991 has been the failure of mortgage credit to respond to lower interest rates. The purpose of the *Review* is to consider why the demand for mortgages has been so weak and to assess the wider macroeconomic ramifications.

Main points

* **The last 20 years have seen three extreme housing booms, in the early 1970s (associated with the "Barber boom"), in 1978 and early 1979 (the "Healey boomlet"), and in 1986-88 (the "Lawson boom"). In each of these booms the net gains, after interest costs and tax relief, to a highly-borrowed home-owner have been substantial.**

* **The realization that these gains were available encouraged people to borrow heavily, which stimulated the excessive monetary growth and rising inflation of the late 1980s. Since late 1989 the Government has kept interest rates high in order to dampen the housing market.**

* **Falling house prices since late 1989 have made all home-owners worse-off, but the impact has been particularly severe on the first-time buyers of the Lawson boom. Hundreds of thousands of home-owners have seen the value of the deposits on their homes wiped out.**

* **If house prices had continued to rise since mid-1989, the first-time buyers of the Lawson boom would now be potential second-time buyers. But, because this group cannot put up the deposit for a larger house, they cannot move. Without second-time buyers, there are no third-time buyers; without third-time buyers, there are no fourth-time buyers; and so on. This is the sense in which "the housing ladder has fallen down".**

* **Without further significant cuts in interest rates, the plight of the housing market will constrain wider macroeconomic recovery in 1992 and 1993.**

This paper was written by Professor Tim Congdon.

The housing ladder has fallen down

An analysis of the depressed housing market and its macroeconomic significance

Financial advantages of home ownership now much weaker

The housing ladder has been a familiar landmark on the British financial scene for many years. People have taken it for granted that borrowing to buy a house is a good financial decision and that the more borrowing they do the better. This assumption goes far to explain the seemingly irrepressible personal sector loan demand of the last 20 years and, in particular, the bouyancy of the demand for mortgage finance. But in the middle of 1989 the financial environment changed radically. Since then the arithmetic of housing finance has been very unfavourable for borrowers. With house prices falling and more homes being repossessed by lenders today than ever before, many hundreds of thousands of households regret that they were tempted into home ownership a few years ago. The purpose of this paper is to argue that recent experiences have been so traumatic that it will significantly dampen the demand for mortgage finance in the 1990s.

A full understanding of the present *malaise* in the housing market may be helped by a discussion of developments in the 1970s and 1980s. The widespread enthusiasm for house purchase needs to be explained, because it was this enthusiasm that led to the borrowing excesses of the late 1980s. As we shall see, the tax system was undoubtedly an important influence, but it was not the only one.

Mortgage finance has always been volatile

Mortgage finance has always been volatile. A sense of perspective on recent problems may come from looking at the 1930s, which saw a remarkable boom in housing. The building societies' net mortgage advances soared from £82.1m. in 1932 to £124.6m. in 1934 and £140.3m. in 1936. There were also fluctuations in the 1950s and 1960s, but their importance to the economy as a whole was less than today. A much higher proportion of the housing stock was in public ownership and privately-rented (where it was subject to rent controls), while virtually all forms of credit were restricted in some way or another by the Bank of England. Moreover, house price changes were much steadier than in the 1960s and 1970s. According to figures prepared by the Building Societies Association, the average rate of house price increase between 1956 and 1970 was 6.2%, with the smallest increase 0.9% (in 1959) and the largest 10.3% (in 1965). It needs to be strongly emphasized that, in this 14-year period, nominal house prices never fell. House price increases were also consistently above the post-tax mortgage rate and higher than the pre-tax mortgage rate in most years.

The first extreme housing boom, in the early 1970s

The first extreme housing boom was in the early 1970s, following the Competition and Credit Control reforms of September 1971. The price of the average house increased by 18.1% in 1971, 37.4% in 1972 and 32.1% in 1973. In effect, house prices doubled in three years. Moreover, with the mortgage rate under 10% for most of the period, the gains to anyone who had borrowed to buy a house at the end of 1970 were enormous. The net wealth effect for the personal sector as a whole was less because inflation and rising interest rates had a devastating effect on holders of gilt-edged securities and National Savings. The early 1970s saw a drastic redistribution of wealth from holders of financial assets to home-owners in a very short period of time. In most countries similar redistributions have occurred only after wars or major political disturbance.

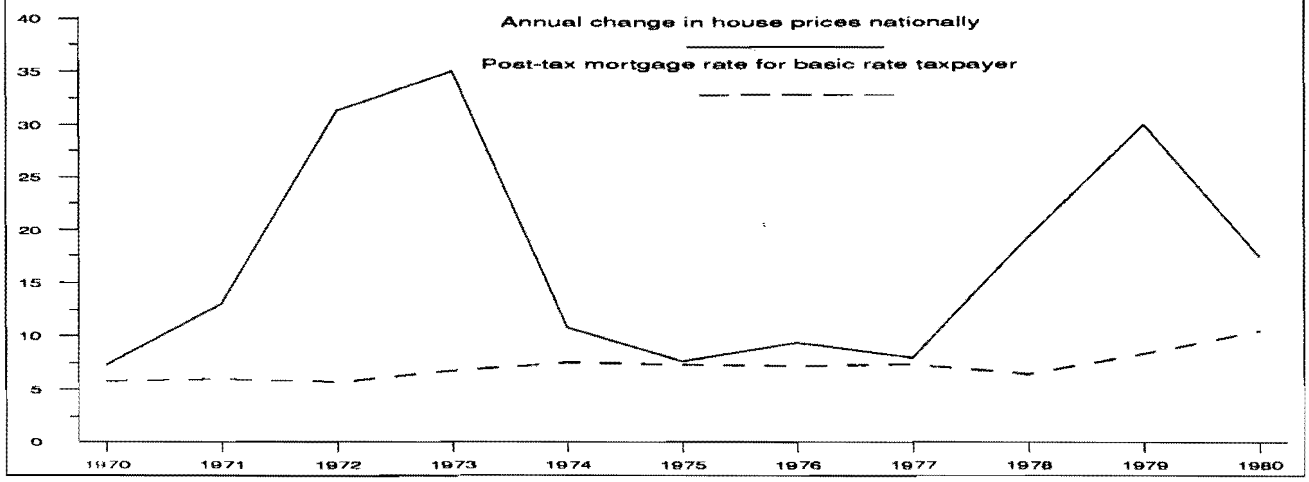
The second extreme housing boom, in the late 1970s

During the boom of the early 1970s the interest on all mortgage borrowing (whether for first, second, third or whatever homes) was deductible from taxable income, while capital gains on private residences were free from capital gains tax. In 1974 Mr. Denis Healey, the Chancellor of the Exchequer in the newly-elected Labour Government, restricted mortgage interest relief to a £25,000 mortgage on the first residence. This limit on mortgage interest relief was not relevant to most borrowers, because the average house price in 1974 was £11,300. Since the other underlying advantages of home-ownership remained, Mr. Healey's changes did not diminish most people's wish to be home-owners rather than tenants. When short-term interest rates fell to very low levels in late 1977 (with Minimum Lending Rate briefly at 5%), another surge in mortgage lending began. In 1978 the average house price increased by 17.1%, in 1979 by 29.1% and in 1980 by 15.5%. In three years it went up by about 75%, again far ahead of the interest rate on borrowed money.

Returns from mortgage borrowing greater in the 1970s than in the 1980s

Although the 1980s tend to be regarded as the heyday of the cult of home equity, the 1970s in fact gave much better returns from housing. In the ten years to 1980 the average rate of increase in house prices was almost 17% a year, whereas the average mortgage rate was a touch above 10% and the post-tax mortgage rate was roughly 6% - 7%. (The standard rate of income tax in the late 1970s was 35% or above.) If income is measured inclusive of capital gain,

Chart 1 House prices and post-tax mortgage rate in the 1970s



anyone who borrowed to buy a house was receiving, in a typical year, a tax-free supplement to income equal to 10% of his outstanding mortgage. At the same time holders of such financial assets as bank deposits, building society deposits and National Savings were suffering heavy erosion of their wealth because of inflation. The gross interest rate on deposits was almost continually lower than the inflation rate, yet it was still subject to tax at rates (for most people) of 35% or more.

The tax benefits of maximizing debt

The most vivid demonstration of the financial benefits of mortgage indebtness was provided by people (archetypal "yuppies") who tried always to maximize their borrowings. The obvious way of maximizing debt was for them to make frequent moves up the housing ladder as their incomes rose with inflation, real growth and their own career promotion. If mortgage debt could be kept always at about three to three-and-a-half times income, the tax- free supplement averaged roughly a third of income every year. The precondition for enjoying this gain was to have enough money for the first deposit, in order to start on the housing ladder. After a few years of capital gain, the typical "yuppie" had equity in his first property which was two or three times the original deposit. He then used his equity to put up a larger deposit on his second home. After another few more years, he had equity which was two or three times the second deposit, and seven, eight or nine times the original deposit. He then put up a yet larger deposit on his third home. And so on. As long as house prices were rising in nominal terms, and mortgage debt was easy to service (because of moderate interest rates and tax relief), the financial logic of home-ownership was compelling.

It should be emphasized that rapid inflation and the tax aspect contributed significantly to the gains. The value of tax relief on mortgage interest was obviously greater the higher the level of nominal interest rates. But high nominal interest rates reflected high inflation, including high house price inflation, and the capital gains resulting from house prices increases were free from capital gains tax. The housing market therefore resembled a casino in which the odds were heavily weighted in favour of the punters (i.e., the heavily-indebted yuppies). They enjoyed tax relief on the interest payments on their mortgage liabilities, but did not have to pay tax on the matching inflation gains on their housing assets. This imbalance between the tax treatment of liabilities and assets, combined with the scope for gearing-up by constantly keeping the mortgage at the maximum level, was crucial to the bet.

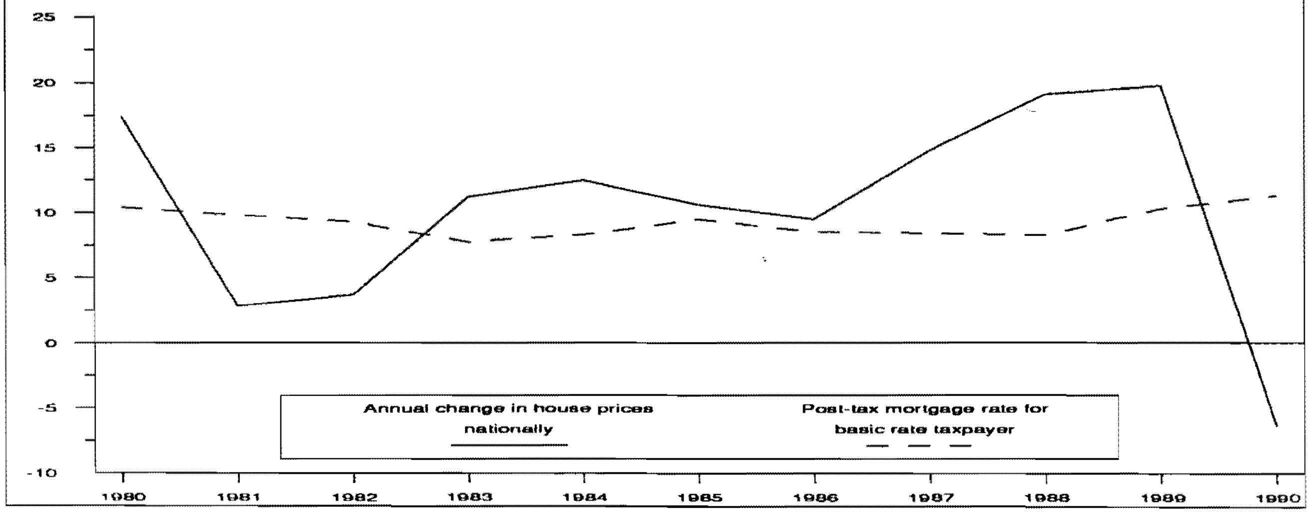
Yuppies' gains at the expense of deposit-holders in the 1970s

Many people remember these years, and their upward progression on the housing ladder, with great affection. Many modest fortunes were made by the mostly pleasurable activity of buying larger flats or houses, with the genuine intention of living in them, as soon as they became affordable. The 1970s were nevertheless not a period of rapid overall economic growth. Of course, if the wealth of the nation as a whole was not progressing, the yuppies' gains had to be offset by other groups' losses. These losses were incurred by holders of financial assets, with the holders of deposits suffering most consistently. By the time that the Thatcher Government was elected in 1979, there was a strong aversion to saving in the form of deposits and financial advisers routinely told their clients to maximize debt, particularly mortgage debt.

The recession of 1980 and 1981 made only a start in altering these attitudes. For the first time in the post-war period interest rates rose to a level at which home-buyers were disadvantaged if they had borrowed to finance their purchase. Following the rise in MLR to 17% on 16th November 1979, interest rates stayed in the early 1980s at a level just about appropriate to an economy with strong memories, and continuing expectations, of double-digit inflation. Building societies' mortgage rate averaged 14.9% in 1980, 14.0% in 1981 and 13.3% in 1982. With the national average of house prices rising by only 0.8% in 1981 and 3.3% in 1982, many people who had borrowed to buy a house during 1980 had done poorly. However, it should be noted that, once again, house prices had not fallen in nominal terms.

The recession of 1980 and 1981 had a surprisingly weak effect on people's expectations about interest rates and house prices. The happy memories of the 1970s overshadowed the cyclical setback. Moreover, any dampening of expectations about house price inflation seemed to be offset by financial liberalisation, as the banks entered the mortgage market in an active way in 1981 and 1982. Net mortgage advances boomed in these years despite apparently high borrowing rates and subdued house price increases. When the building societies' mortgage rate came down to average 11.0% in 1983, house price inflation rose to 11.9%. But a renewed tightening of monetary policy restrained the housing market once more, and in 1984 and 1985 house prices increased by 7.8% and 7.7% respectively. In summary, the early 1980s was a period of moderate and fairly stable house price inflation, just as it was a period of moderate and fairly stable monetary growth.

Chart 2 House prices and post-tax mortgage rate in the 1980s



The third extreme housing boom, in the late 1980s

The third extreme housing boom began in 1986, a few years after the liberalisation of housing finance had been completed. Net mortgage advances soared from £19.1b. in 1985 to £40.0b. in 1988. The flood of mortgage credit pushed up the average house price by 14.8% in 1986, 15.8% in 1987 and 22.5% in 1988, to give a total appreciation in the three years of over 60%. There was also a marked disparity in house price movements between regions. Between 1985 and 1988 house prices rose by 89% in East Anglia, and 87% in Greater London and the South-East, whereas in Northern Ireland they went up by only 18%, in Scotland by 22% and in the Northern region by 32%. (These figures, and other regional data quoted elsewhere in this paper, relate to average house prices at the mortgage completion stage. They are taken from the Council of Mortgage Lenders' publication *Housing Finance*.)

Looked at from the perspective of late 1988, there had been a long record in London and the South-East of house price gains above the mortgage rate. Although the 1980s had not been as good as the 1970s they had still been rewarding. The compound rate of increase of house prices in London had been 14.3% and in the South East 13.7% from 1980 to 1988. Over the same period the building societies' mortgage rate averaged 12.3%. So there was a gap of 1% - 2% a year between house price inflation and the pre- tax mortgage rate. In addition, tax relief on mortgage interest remained relevant for most home-buyers. Indeed, it became crucial to the calculation. It had the effect of reducing true interest costs by a further 25% or more, depending on the marginal tax rate of the individual and the year in question. Assuming that most people in London and the South-East during the early and mid-1980s still had mortgages under £30,000 and that they were paying income tax, mortage interest relief was giving them anually a gain equal to about 3% of the value of the mortgage. Overall the untaxed capital gain achieved each year by indebted home-owners in the South of England was 4% - 5% of the value of the mortgage.

In the South the financial advantages of mortgage borrowing remained compelling in the 1980s

It continued to make sense to maximize borrowings. A yuppie keeping his mortgage consistently at three times his income was receiving a tax-free capital gain (from house price appreciation above the post-tax interest cost) equal to 12% - 15% of income. This was less than the fabulous supplement of a third of income achieved in the 1970s, but it was still a handsome return. Moreover, the yuppie had to do nothing to capture this gain, except live in the largest house he could afford. No wonder many young and early-middle-aged people enthused, with Mrs. Thatcher, about the benefits of property-owning democracy. By the late 1980s the prevailing political rhetoric was that borrowing to buy a house was not only financially advantageous, but also politically virtuous. In theory it gave people the sense of social responsibility associated with the possession of property.

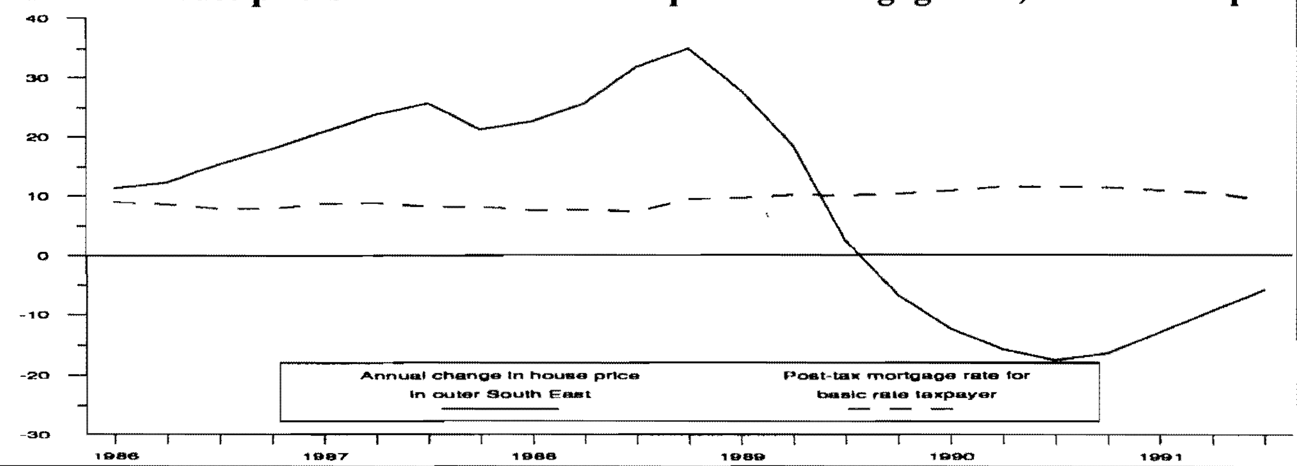
With the Government's apparently strong commitment to home ownership, people moved house as often as possible. By frequent moves they could maximize their mortgage debt. (It is also worth mentioning that second mortgages became much more common in this environment.) The number of house moves in England and Wales (measured by the stamp duty particulars delivered to the Stamp Office) rose from about 1 1/4m. in 1981 to 1,990,000 in 1988. The housing ladder remained very much as it had been in the 1970s. Someone would put up the deposit for his first house, accumulate the deposit for his second house from the increase in house prices, put up the larger deposit for his second house and move, accumulate the deposit for the third house from the further increase in house prices, put up the yet larger deposit for the third house and move, and so on. Turnover in the housing market was lubricated by the continual house price gains, the tax advantages and the deeply-embedded expectation that both features of the housing market would persist into the indefinite future.

But the housing ladder was unstable because of impact on inflation

But the housing ladder was unstable. By 1989 Treasury ministers realized that it had fostered a dangerous pattern of expectations. In an economy where everyone believes that mortgage debt is a Good Thing mortgage debt is liable to grow explosively, generating a larger inflation problem. The Government decided that the house price boom had to be stopped and the British public had somehow to be weaned off its appetite for mortgage debt. It became an explicit objective of monetary policy to cool down the housing market. The official attempt to overturn the housing ladder had two main elements - a sharp rise in interest rates, which was in any case justified by general macroeconomic conditions, and the reduction of the tax benefits of home ownership.

Base rates were raised from 7 1/2% in May 1988 to 15% in October 1989. The effect on the housing market came through rapidly. Although there are several house price indices and they have often given conflicting messages in recent years, a very clear turning-point can be idenitified in mid-1989. From then onwards house prices in the South of England have been falling. In contrast to all previous experience in the post-war period (apart from erratic quarterly changes), the fall has been in nominal as well as real terms.

Chart 3 House prices in the South and the post-tax mortgage rate, 1986-1991 2qt.



High interest rates since mid-1989 have transformed the financial arithmetic of home ownership

The relative advantages of holding financial assets and of borrowing to buy houses have been totally transformed by this development. We have seen that for 20 years until 1988 someone who had used a deposit to buy a house had nearly always done better financially than someone who had left it idle to accumulate interest. But from mid-1989 to mid-1991 the arithmetic has been quite different. Consider the case of an East Anglian house-buyer, with an income of £30,000, who by dint of careful saving had accumulated a £10,000 deposit and purchased his £100,000 property (i.e., on a three times multiple) at the peak of the last housing boom in the third quarter 1989. According to figures compiled by the Building Societies Association, the price of an average house in East Anglia fell by 21.5% between the third quarter 1989 and the second quarter of 1991. So the home- owner has suffered a loss of £21,500 on the house itself.

But that is not the end of the story. If he had left the money in the bank it would have earned, roughly, £2,000 in interest in the period. Because he put his deposit into the house and took out a mortgage, he has received no interest and instead has had to make mortgage interest payments of over £25,000. The loss due to buying a house rather than leaving the money on deposit has been almost £50,000! - and this for someone with an income of about £30,000 and net wealth which never amounted to more the £10,000 deposit which was invested in the house. It hardly needs to be said that - unless the unfortunate individual has been saving furiously in other ways - he probably now has debts in excess of his assets. (One qualification to the example is that he would have been paying rents if he had been, say, a council tenant. But these would have been a trivial fraction of £50,000.)

This illustration is, of course, extreme. But it accurately describes the essential character of the problem now facing the many thousands of people who bought houses for the first time in late 1987, 1988 and early 1989. Statistics from the Building Societies Association show that building societies extended 505,000 first- time loans in 1987, 580,000 in 1988 and 455,000 in 1989. Since banks and other intermediaries were also active in lending to first-time buyer, there are probably over a million households who have suffered badly from the housing slump of the last two years. The term "badly" in this context means a true loss (bearing in mind the house price fall and interest burden) similar to or greater than a year's income.

The British public has had its fingers burnt

These events will handicap the housing market for many years to come. The British public has had a lesson, which it will not forget in a hurry, that holding money on deposit can be more rewarding than maximizing mortgage debt. Financial behaviour is strongly conditioned by folk memories. The dominant folk memory of the early 1990s will not be the robbery of National Savings by inflation, but the struggle to service the debt on depreciating houses.

The change in the relative attractions of financial assets and houses, and the re-appraisal of whether houses should be bought from savings or by borrowing, is being reinforced by the evolution of the tax system. The Government has long had special incentives to encourage savings in non-deposit financial assets. Before 1984 insurance policies benefited from life assurance premium relief; now there are personal equity plans, additional voluntary contributions to pensions and such things as Business Expansion Schemes. But last year it decided that these discriminated against deposit-type financial savings, and set up TESSA accounts for banks and building societies.

Home ownership now less fiscally attractive than in the 1970s and 1980s

Meanwhile mortgage interest relief has been restricted to the standard rate of income tax and the real value of the £30,000 limit continues to be eroded by inflation. We have already seen that in the early and mid-1980s house price increases, even in the favoured South, beat pre-tax mortgage interest rates by a mere 1% - 2% a year. If the real value of the £30,000 limit is to wither over time, there is a definite possibility that the post- tax mortgage rate will no longer be beneath the rate of house price appreciation. A permanent change in the relative advantages of financial savings and home ownership is in prospect.

Despite this change the public still appears to think that housing is a good investment. A recent opinion poll carried out by MORI for the BBC's *Money Programme* showed that 61% of people believe that, in the long term, investment in property is the best hedge against inflation. According to an article by Mr. Robert Worcester in *The Times* on 4th November, "One in five say that, when the recession is over, and the economy is performing normally, they would invest in the housing market by buying a new house or increasing their mortgage to extend or improve their present home".

Fall in house prices has wiped out home equity - and therefore reduced or eliminated deposits in potential house move

The difficulty at present is that many people are unable to act on their beliefs. Even if they wanted to move, they cannot. The explanation is again to be sought in the fall in house prices. When the housing ladder was working properly, the value of people's equity in the housing market increased year by year. They therefore had the money for the larger deposit required to finance the next move upwards. But in the last two years a huge amount of housing equity has been wiped out. According to the Nationwide Anglia "all properties" index, house prices are now about 15% lower than at the peak in the third quarter 1989. With the value of the nation's stock of residential dwelling at the end of 1989 estimated to be £1.1b., the fall in value amounts to about £150b.

Much of this fall has been inflicted on home-owners who have either entirely repaid their mortgages or whose mortages represent only part of the value of their properties. These home-owners still retain substantial home equity. Many of them no doubt could move to a larger house if they wished. However, people who have repaid mortgages are predominantly in their fifties or sixties and they are often considering a move to a smaller house because their families have grown-up. The potential second- and third-time buyers of the early 1990s are the first- time and second-time buyers of the late 1980s.

It is here that we come to a new and disturbing problem. As we have seen, in the 1970s and 1980s first- and second-buyers let house price inflation do their "saving" for them. Rising house prices built up the equity in their existing homes and so provided them with the deposits for their upward moves on the housing ladder. In the last two years not only have the deposits of first-time buyers been wiped out, but in many cases mortgage debt exceeds the value of the borrowers' homes. For this group of people, which probably means the overwhelming majority of households in the South of England where the first house was bought after 1986, an upward move is at present impossible. They simply do not have the money, either in the form of housing equity or other assets, to put together the deposit for their second purchase. The sad plight of these people is affecting the whole housing market. Second-time buyers are needed to buy the properties of third-time buyers, third-time buyers are needed to buy the properties of fourth-time buyers and so on. If one rung in the housing ladder is removed, there may not be a meaningful ladder at all. Indeed, it is not going too far to say that the housing ladder has fallen down.

Adverse "wealth effect" of falling house prices may explain weak response of mortgage credit to lower interest rates

The collapse of the housing ladder may be responsible for one of the most surprising macroeconomic developments of 1991. In the 1970s and 1980s the incentive to maximize mortgage debt had an important consequence. When interest rates fell, houses became more "affordable" in the sense that monthly mortgage payments were lower for any particular property. As a result sharp falls in interest rates, of the 3%, 4% or 5% order, were always followed by surges in mortgage demand. Mortgage booms (of the kind seen in 1972, 1978, 1982-3 and 1986-7) were a reliable means of stimulating the economy.

Mortgage demand in 1991 should be following the same pattern. Since October 1990 clearing bank base rates have dropped from 15% to 10 1/2% and base rates of 10 1/2% are indeed below the average of the last decade. But mortgage demand has conspicuously not revived. On the contrary, building societies' mortgage commitments today are lower than in the autumn of 1990, while some of the specialised mortgage lenders (such as National Home Loans) have suspended new lending and are actually running down their mortgage books. Net mortgage advances in 1991 will be lower than in 1990, even though interest rates will average 3% less. The failure of mortgage demand to respond to lower interest rates is at variance with the last 20 years of experience in the British housing market.

We have argued that the most plausible explanation for the change in behaviour is that potential second- and third-time buyers have suffered a heavy loss of home equity and are unable to move. In our October *Gerrard & National Monthly Economic Review* we set out the case for believing that an increase in

Housing market problems will constrain macroeconomic recovery

mortgage demand is a precondition for genuine economic recovery, because monetary growth (and, hence, corporate balance sheets) will remain weak unless there is more lending for house purchase. It is clear that - if our analysis in this *Review* is correct - the so-called "recovery" will prove abortive unless the problems of the second- and third-time buyers are eased. Here is the connection between the troubles in the housing market and the scepticism now being widely expressed about the official forecasts of strongly rising consumption and general economic "recovery" in 1992.

So how can the potential second- and third-time buyers be rescued? Obviously, a sharp fall in interest rates would help. Since a change in interest rates is the cleanest and most straightforward macroeconomic instrument available, the case for lower interest rates seems compelling. The difficulty, of course, is that the UK belongs to the European exchange rate mechanism, which requires that our interest rates be high enough to keep the pound stable against other European currencies. As the pound has been rather weak in the ERM in the last two or three months, the scope for lower interest rates is limited. Various alternative ideas could be considered, including direct assistance to the household budgets of first-time buyers, but they fall foul of the prevailing consensus that housing should no longer be fiscally privileged in any way.

One further dimension of the housing *malaise* needs to be mentioned. The spateof mortgage repossessions has inflicted unprecedented losses on financial institutions involved in mortgage lending in the Lawson boom, including insurance companies (who issued mortgage indemnities to banks and building societies) as well as banks and building societies. The building societies have suffered significant erosion of their capital reserves, which will oblige them to curb balance-sheet expansion in coming years. The insurance companies have been obliged to raise mortgage indemnity premiums, which is an additional cost for home-buyers. The attitudes of mortgage lenders have become more cautious, just as mortgage borrowers have been forced to pull back from heavy and deliberate indebtedness.

At the end of the last two recessions (in 1974 and 1981) big falls in interest rates stimulated strong growth in mortgage borrowing. Higher mortgage borrowing was one influence on faster monetary growth and so on subsequent economic activity (and inflation). The economic situation in late 1991 is very different. At present interest rates mortgage credit will remain sluggish and the much-vaunted "recovery" will not materialise.