More Different Futures Network Topic Review: Housing Systems and Economic and Financial Instability

1. Housing Affordability, Productivity and Instability

Housing sector advocates and analysts in the ABC countries (Australia, Britain and Canada) typically focus on a trinity of affordability issues (homelessness, lengthening queues for social housing and record high payment burdens for up to middle income renters and owners). After three decades of key policy settings that have driven real house price and rent rises ahead of average incomes, and especially lowest quintile incomes, this emphasis is understandable but is also seriously incomplete. The MDFN Network has already agreed that rising housing costs not only exacerbate inequalities and exclusion but that the quality of housing outcomes and the burdens on household incomes associated with them can have significant effects on productivity.

The wider ‘economic’ arguments for housing policies are discussed in the Topic Review (Making Economic Cases). They reach beyond the already significant issues of productivity and affordability. Economic policies are concerned not only with distributional (affordability) and growth (productivity) outcomes but they also address concerns about the implications for sectors, such as housing, on the stability of the economy and the financial system. Stability concerns relate to whether sectors have characteristics that reduce or reinforce cyclical instabilities but also how they impact the resilience and stability of core economic and financial systems in the face of non-cyclical, unanticipated shocks.

The (Great Financial Crisis) GFC and Covid-19 are two such fundamental shocks within a decade. Economic historians suggest that there have been (around) 10 such shocks in the last century prior to Covid-19. Since the GFC there has been a burgeoning literature on how housing and housing finance markets function in such events and whether they play lead or reinforcing roles. Recent research by the IMF suggests that housing-housing finance system changes have been at the heart of the creation of half of downturns, including the GFC. However, in almost every downturn (shock or cyclically driven) housing sector decisions tend to reinforce initial shocks. In broad terms the housing system is procyclical and reinforces tendencies to economic booms and busts.

In the present crisis the housing and housing finance sectors, in contrast to 2008, did not lead a financial collapse that then shaped recession. The shock has come from a public health crisis stopping economy wide supply and demand processes that is inducing downturn that may be reinforced by recession effects on housing market activities and mortgage debts. The housing sector will, through debt, default, wealth price and expectation effects have key roles in shaping both how deep and how long the current recession may become.

This note, reviewing and integrating discussions within the MDFN, examines macroeconomic instabilities, and measures to avert them, and how they have interacted with the growing instabilities of the lifetime housing pathways of individuals.
2. Instability, Macroprudential Policy and Housing Markets

Context

The ABC countries have important similarities and differences in their economic contexts and macroeconomic policy approaches. They are all open economies with significantly deregulated capital markets that have, since the 1980’s more fully integrated their housing finance systems into national money and capital markets and at the same time integrated their national capital markets into better connected international capital markets. That is the potential links between housing market changes, mortgage markets, the economy and global shocks have strengthened. An important question is whether the ABC countries have reshaped housing market and system governance capacities to reflect these new arrangements.

In relation to market context, Australia and Canada encountered modest economic damage in the GFC and experienced no banking crises. They have not endured the long decade of (chosen) austerity policies that have restricted growth in the UK. In the housing sector, significant UK house price falls between 2008-2010 induced a prolonged correction though most regions and cities in the UK had recovered to 2008 nominal price levels by 2016. Growing locations such as London and Edinburgh had real price pressures and market processes in similar to the growing Australian and Canadian cities. Macroeconomic contexts of real income growth (with Australia ahead of Canada ahead of Britain), high immigration rates (with Australia and Canada at the top of OECD rates of immigration) and natural increases driving steadily rising household numbers led to demand outstripping supply with real house prices (with some downturn years interspersed) characterising the three decades since 1990. Real house prices and rents outpaced real income growth and at the same time income and wealth inequalities grew sharply in all three countries.

Strengthening Macroprudential Influences

The major frameworks for macroeconomic policies to boost growth and monetary and macroprudential policies to temper instability have been largely similar in all three countries. The orthodoxies of monetary policies, in broad terms, have been essentially the same in all three, though after 2010 the Bank of England made extensive use of £400bn of Quantitative Easing (boosting cash and demand in the economy by purchasing key financial assets), and has added another £200bn since March 2020, largely to fund government debt. These non-conventional monetary policies are now being considered by the RBA and the BOC as interest rates, the conventional major tool of monetary policy, tend toward zero. In the UK, QE contributed to the surge in credit that fuelled the growth of the ‘investor’ rental sector and arguably reinforced long-term instability issues.

The more detailed instruments of macroprudential policies have been different across countries. The broad legal frameworks for the mortgage industry are similar in the UK and Australia but system differences do exist that are important influences in how policies are designed and implemented. In Canada, for instance, subsidised insurance for loans meeting policy criteria is important in implementing mortgage stress tests. In Australia the extensive superannuation system means that most households have a pot of superannuation equity, now more liquid than in the past, that can be used to managed difficult income-expenditure periods; in the UK, the entitlement to mortgage benefit, within the social security system, for distressed low-income mortgage holders mitigates lender and borrower risks from income losses and fosters limited market stability.

The broad philosophy of monetary and macroprudential policies in the ABC countries until the GFC was that monetary policy should concentrate of managing interest rates and the supply of money to meet inflation targets. Asset prices, though informing decisions, were not regarded as a key target of monetary policy and were assumed to reflect the well-informed choices of business and the public.

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However, since the GFC central bank scrutiny of the role of housing sectors in shaping or reinforcing economic instabilities and systemic financial risks has gained increasing significance. For instance, within the 2015-17 period both OECD and the IMF have commented (with limited modelling and, ex post, relatively inaccurate predictions) on the likely, imminent dangers of bursting bubbles in major markets in all the countries including London, Sydney, Melbourne, Toronto and Vancouver.

**Signs of Market Stress**

The central banks in all three countries have been much concerned with the macroprudential consequences of housing market outcomes. In Canada, CMHC have argued for the importance of macroprudential arguments in shaping the design of housing policies and the basis for that concern is evident.

A critical factor in linking macroeconomic policy to the housing sector has been the growth in the stock of mortgage debts associated with rising house prices, increasing household numbers and, until the last decade, rising homeownership rates. These processes are not examined in detail here but rising prices relative to incomes have seen typical loan to income ratios for first time home-buyers rise from 2-3 to 6-8 and, although dampened by the GFC, loan to value ratios exceeding 0.95 have been commonplace. That is, individual potential exposure to loan default has been thought to have increased (although mortgage defaults in ‘normal’ market periods have remained low). This has concerned macroprudential policymakers because individual behaviours ‘add up’ to macro-outcomes.

There has been growing macro-policy concern with household debt to GDP ratios, particularly after 2010. The UK has a substantially lower household and mortgage debt to GDP ratio than Canada and Australia, perhaps reflecting the much larger share of the population (20pc as opposed to around 5pc) housed in non-market homes (with consequently higher government debt to GDP ratios for the UK). Since the start of this millennium the Australia and Canada household debt to GDP ratios have grown consistently and significantly. Towards the end of 2019, gross household debt to income ratios were at record (and internationally) high ratios of 1.90 for Australia and 1.74 for Canada (and in the UK, they had fallen from 1.48 in 2008 to 1.27). Immediately pre-covid-19, the household debt to GDP ratios for Australia was 1.28, 1.00 for Canada and 0.84 for the UK.

Since the GFC advisory and regulatory measures by the central banks in all three countries have restricted loan-to-value ratios, loan-to-income multiples and subjected loans to ‘stress testing’ (but usually solely in relation to future interest rate scenarios and not the income and job loss effects likely in the covid-19 pandemic). These have been significant measures in reducing the pro-cyclical and systemic financial sector risks of housing market shocks. In Canada policy tightening has been particularly focussed upon stress test scrutiny to qualify for subsidised mortgage insurance.

**Concerns about Macroprudential Policies**

Many of these ‘prudential’ measures are noted in Topic Review Paper 2. In general these macroprudential policy shifts have most impacted first-time buyers, who typically have high loan to income demands and low stocks of equity to invest, and raised their user cost of housing capital and rationed loans in ways that increased the home-ownership entry cost hurdles as noted for Canada by Will Dunning and David Graham in the bilaterals. In the UK the ability of already established older, housing wealth rich home-owners to use their housing equity to secure further mortgages to outbid younger potential buyers, and then let to them as tenants, led the UK government to change loan, transfer and capital gains taxes to rebalance outcomes towards first-home ownership.

There have been concerns expressed about the gross debt to income measures used in macroprudential policies. There are reservations about cross-national comparisons (for instance
Australia’s high gross household debt is also matched by extensive household superannuation holdings); whether gross debts should be replaced by a net debt measure as loans have been used to secure assets (homes) that have increased in value (though the key issue is how liquid assets will be in a downturn and that would likely reduce housing asset values); and whether extended family wealth holdings, rather than simply individual consumer incomes, now play stabilising roles in owner behaviours in recessions. Similar comments could be made about the adequacy of mortgage stress tests (they test mortgage serviceability against different potential future interest rates: with low rates expected for years ahead but stress tests not incorporating income and job loss probabilities, that research suggests are the real drivers of defaults in downturns) and their uniform applications across pressured and sluggish markets within nations. However, these are, given the looming difficulties in the housing markets of the ABC, really second order issues at this time.

There can be no doubt that macroprudential policies have increased the safety of the debt profile of the home-ownership sectors in the ABC. The conclusion, that policy has been positive, does not imply it has been anywhere close to optimal. Several key questions remain.

**Connecting Macroprudential and Housing Market Policies**

It is pertinent to ask whether the governance at national or federal levels of policies that shape housing outcomes have been integrated and well-designed in the ABC countries. This is an important question. Geoff Meen observed that the collateral consequences of policies with wider aims than housing affordability often have significant housing system outcomes. This has, arguably, been particularly true of monetary and financial policy measures aimed at ‘macro-prudential borrowing, and lending’ to reduce the pro-cyclical effects of housing borrowing and house price outcomes. For the last three decades, and in Australia and Canada more than the UK, the traditional concerns, powers, budgets and power of housing ministries have shrunk (as national and federal programmes have contracted).

At the same time the growth in home-ownership, housing wealth and housing debt have all raised the impacts of macro-policy on housing outcomes on housing affordability and stability. Few would now argue, in relation to the housing sector, that the traditionally defined Housing Ministries of the ABC, that have also lost policy ground and budget to Social Security Ministers, have the clout of their Finance Departments and Central Banks.

In that context, have housing budgets, and other areas of fiscal policy, been used to offset the consequences of macroprudential policies? Has it been consistent of governments to pursue macroprudential policies that raise hurdles to first home-ownership whilst first-homeowner grants and equity share programmes seek to maintain the growth of the sector? Has monetary and macroprudential policy recognised the IMF’s research findings that in recent decades there may be an unlinking of major, growing metropolitan areas form their ‘national’ market progress but increasing synchronisation with other growing ‘world cities’. It may be that ‘localisation’ of economic activity in the wake of covid-19 will halt and reverse global housing market connections but in the meantime it raises questions whether monetary and macroprudential measures for Vancouver and Toronto are relevant to Halifax and Winnipeg, or those for Sydney and Melbourne work for Newcastle and Geelong.

Central Banks must question whether they have imposed significant housing costs on some markets and places. Having moved from agnosticism on asset(house)prices to macroprudential concern should there now be a new emphasis in the mandates and missions of the Treasury/Finance Ministries and Central Bank missions to facilitate a more orderly development of national housing markets with combatting house price inflation given a policy as great as wage inflation and to reduce the damaging effects of high rates of real house price inflation on productivity and instability. Of course, monetary authorities do not bear all the responsibility for the inflated and debt exposed state of the ABC housing
markets, but nor can they lay the responsibility for these outcomes at the doors of municipal planning authorities.

Macroprudential policy must be more than trying to restrain surges that monetary policy has created. Each of the ABC countries urgently requires an understanding of and strategy for its national housing markets and whilst recognising that so much of housing is local have a mission to work with subnational governments to ensure ore effective housing market outcomes. The looming disaster in the markets of the ABC countries and the huge fiscal burdens of offsetting the worst effects of the covid-19 crisis gives, oddly, the opportunity of governments to reset the role of house prices and reduce, in the decades ahead, the detrimental distributional and growth effects that persistently rising house prices, with occasional recurrent crashed, have imposed on inclusive growth.

3. Instability in Ownership Rates and Individual Ownership Trajectories

As concerns for the effects of housing markets, usually with a focus on home-owner decisions, on macro-system stability have increased there have also been significant changes in microeconomic patterns of saving, borrowing, wealth and debt within owner occupation. In particular, there has been a growing gap between the rhetoric of every national/federal government in the ABC and the reality of home ownership (and interestingly, the government of New Zealand recognised the emerging new realities of home-ownership markets in its Housing Policy Review of 2008). Growing home-ownership rates has been expressed aim of most governments (Gavin Wood told us that had been an Australian priority since 1907) and policy narrative stresses the importance of climbing the ‘home-ownership ladder’ and until the last few years governments have claimed success in raising rates.

The reality has been different. Aggregate home ownership rates have been fallen in the UK by 7 percentage points since 2000. They have fallen in Australia by 3 points and in Canada by 2, mostly since 2010. Underneath these headline rates there are more disturbing patterns. In Australia, Rachel Ong reported the percentage share of total households that are owners with a mortgage fell by 10pc between 2010 and 2016 and the home-ownership rate is now decreasing in every age group under 65. There are similar patterns in the UK and, in effect, age specific home-owner rates for the under 35’s have been decreasing since the middle 1990’s. For quarter of a century politics has missed the point that is has been growing longevity of the over 60’s and not rising prosperity for the under-35’s that sustained home ownership growth. Now non-affordable entry housing means that the majority of younger households can no longer leap high-up to reach an escalator (not a ladder) moving steadily away from them. The growth in precarious employment and more diverse less-prolonged relationships underpins some of these shifts. The ABC countries, pre-covid-19, already had a crisis in how to house younger households in the middle and bottom of the income distribution. For these households the rules-based prudential lending measures of central banks mesh with the unreality of political promises for home ownership and the flatness and insecurity of their incomes to produce disorderly progress through the housing system.

Within that context the supposed lifetime housing ladder or escalator of home ownership is a less strong statistical probability than in the past. Once households enter home ownership there is now less certainty that they will reach the end of their housing careers in ownership. Between 2000 and 2017, some 12 percent of entrants to private renting in the UK and 17 percent in Australia were formerly in home ownership. Rising proportions of owners over-60 in all three countries still have mortgages paying off late entry or re-entry to the sector. The instabilities for individuals in the housing system have evolved over time and the pathways assumed by much policymaking have been redundant for a decade and more. Achieving housing system stability is, then, not merely a high-level tweaking of stress tests but of rethinking the routes by which individuals save and acquire assets and the roles of housing within that. This requires a recognition that in developing a housing market
stability approach that changes in household circumstances have to be matched by reducing the costs of making tenure flexibilities.

Stimulus Policy Relevance

Current macroeconomic forecasts, that are highly uncertain, suggest that in the ABC economies face a prospective house price fall of 10-15 percent over the next two years. Yet some governments have in the last month announced significant stimulus packages to help first home owners to purchase units now. The Commonwealth Government of Australia and the Scottish Government have both heralded such packages in the last month. Given the macro-stability discussions above and the forecast price do these ownership stimulus packages imply a schizophrenia in policy making for the housing market? Where is the housing policy-housing finance policy rationale and interface? What should stimulus and recovery investment programmes in housing (and they will be needed for employment as well as housing reasons) look like? What is the point of offering grants to owners who will soon face a market-led equity loss that, on average, will exceed any subsidy payment?

In our plenary sessions CMHC have grasped the nettle, and in putting the horse in front of the cart, asked the questions about what housing policy choices would facilitate stability? They have argued that future housing policy choices for economic and financial stability should pay more attention to rental housing and not automatically prioritise home ownership. Almost all of the evidence presented in the network would support this policy stance. The network discussions and the supporting notes here highlight potential significant instabilities from growing ownership in stimulus and early recovery phases. There are then two further key questions. Which rental sector should be supported? And, drawing attention to the need for new tenure and policy flexibilities, could support to create middle-market renting involve subsidies to providers being recycled as purchase deposits to tenants when the post-covid-19 recovery is well established 3 to 5 years ahead. Stimulus packages that wish to align action now with future careers in home ownership will need to build more patient entry routes, through renting into ownership and that will require landlords who have an interest in the housing careers of this they house. A post-summit note will explore this idea on the MDFN blog.

4. Conclusions on Instability, Housing and Stimulus

1. Monetary and macroprudential policies have steadily increased their weight of impact in shaping housing outcomes in the ABC countries.
2. In terms of their own, narrowly conceived housing goals, they have been successful.
3. The emphasis of macroprudential/monetary policies has been on dealing with the consequences of inflationary housing markets and they should review their roles in allowing such outcomes to unfold.
4. There needs to be a coherent national housing market strategy, that recognises the inherent local nature of housing systems, but that brings together the monetary, fiscal, social security, housing and related national policy interests that significantly impact housing.
5. The insight for and integration of that key integrative system with the economies, societies and environments of the ABC countries should lie within the Prime Minister’s Office.
6. There are should be immediate efforts to address the contradictory and mutual effect-cancelling policies that already prevail.
7. Immediately in stimulus programmes governments should recognise that the promotion of home-ownership requires more balanced and patient measures and that for the foreseeable future stimulus measures should be to promote stable rental housing with policy features that may help households move towards their longer-term tenure aspirations as household and national budgets recover towards 2025.