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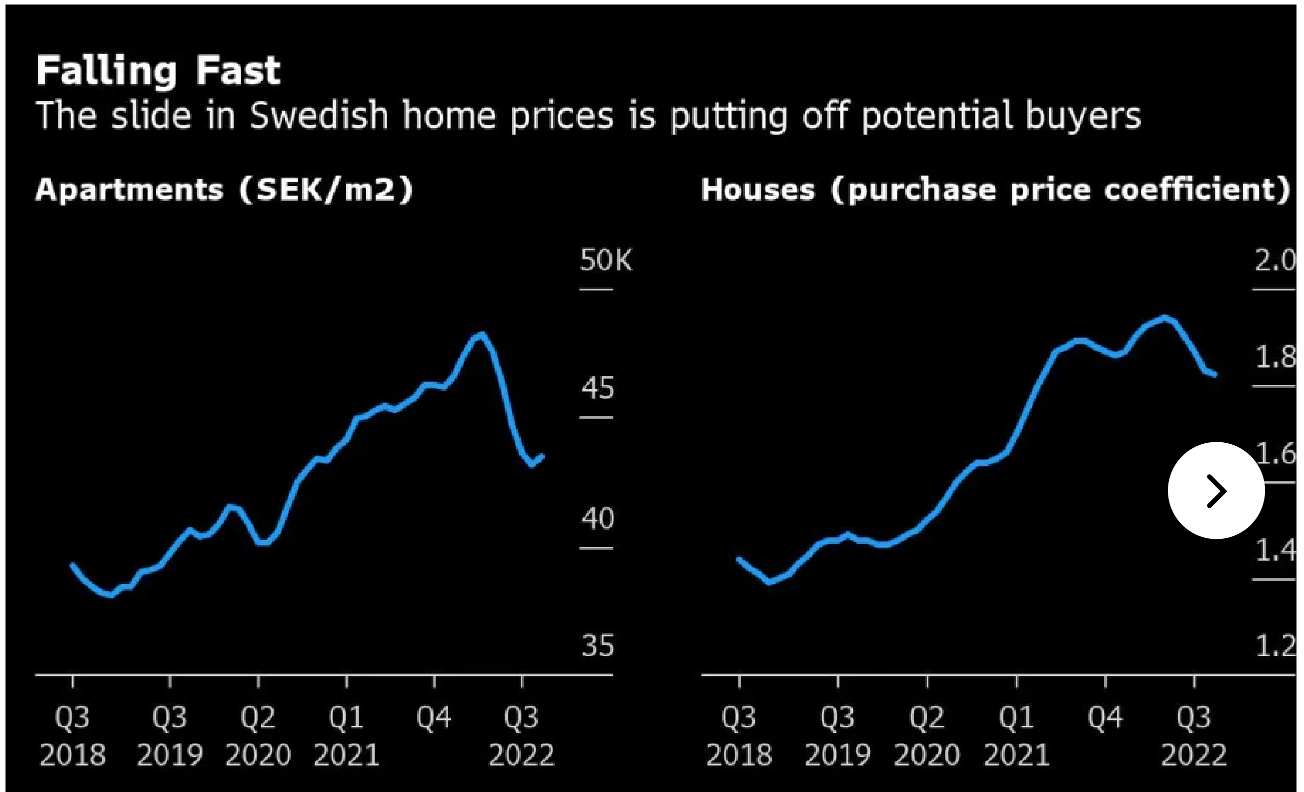
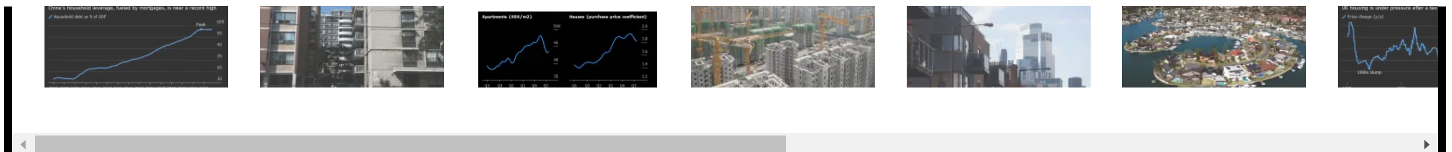
Global Housing Market Pain Has Echoes of a Crash 30 Years Ago



3/12 Global Housing Market Pain Has Echoes of a Crash 30 Years Ago



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Thu, October 20, 2022 at 4:00 PM · 9 min read

(Bloomberg) -- When Covid sent the UK economy into lockdown in 2020, the government jumped in to help the property market by cutting a tax on purchases. The temporary measure triggered a kind of mania among buyers, who responded by bidding up average prices by £31,000 ($35,000) — more than double the maximum tax saving.

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The frenzy echoed the buildup to the house price crash that started at the end of the 1980s, when the government announced it would cut a tax relief for couples buying property, leading to a surge in demand. The slump that followed was brutal, with the market taking almost nine years to return to its previous high.

The housing market now faces similar challenges, according to Simon French, chief economist at investment bank Panmure Gordon, who forecasts a 14% fall in house prices over the next three years. That would take values back to 2013 levels in real terms. Bloomberg Economics expects values to drop about 10% next year.

It's not just in the UK that property markets are flashing signals of downturns from 30 years ago.

The big losers then — which included Australia, Canada and Sweden — all saw home prices reach records in recent years as cheap credit made home ownership possible even as values soared. But now, they're facing a reckoning as central banks battle to cool inflation.

That means interest rates are rising rapidly, bringing to a close the era of easy money that's defined the years since the 2008 global financial crisis. There are also implications for household wealth and economic growth at a time when recession risks already hang over many countries.

"There are parallels between now and then," said Manoj Pradhan, founder of research firm Talking Heads Macroeconomics and a former Morgan Stanley economist. But soaring inflation means "things could be significantly worse. The overall increase in and level of debt is quite high compared with that time. The sensitivity to interest rate rises is huge."

Here's a look at some of the key developments then and now in countries where property is at risk, or already in a downswing.

Canada

Drive from Toronto's main airport toward downturn and you pass row upon row of apartment blocks developed during the easy money era.

That has echoes of the 1980s boom in the city, driven by speculation on condos, which ended suddenly, leaving prices plunging. Then, as now, inflation was on the march, and interest rates had to move sharply higher to combat it. In 1990, mortgage rates topped 13% and the Toronto housing market tumbled into a deep freeze for years. Sales plummeted, and prices didn't hit bottom until 1996 after losing more than a quarter of their value.

Today, the economy is in better shape. But after a nearly unbroken 25-year period of price increases, Toronto looks shaky again. Affordability is as bad as it was during the late 1980s bubble, according to National Bank of Canada. Royal Bank of Canada's economics department calls it a "historic correction," and says national home resale volumes may fall more than they did in the early 1990s, peak-to-trough.

The most frenzied speculation this time around took place in the suburbs and outlying cities near Toronto to which people flocked when Covid hit, searching for more space.

There, the correction has arrived swiftly. In the cities of Kitchener and Waterloo, Ontario, about a 90-minute drive west, the benchmark price is down 16% in six months. In Oakville and Milton, two closer suburbs that are home to many finance professionals, they've dropped 14%.

But prices are still significantly higher than they were before the pandemic, so there could be more declines to come.

China

Images of unfinished housing blocks symbolize the bleak state of Chinese real estate, where buyers are paying for homes that they can't occupy. That led to a mortgage boycott this year, with homebuyers threatening to halt making payments.

About 2 million unfinished homes presold by developers have halted construction, according to estimates from S&P Global Ratings. That's reminiscent of a property bust 30 years ago on Hainan Island, the country's tropical resort island dubbed "China's Hawaii."

Property developers emerged there in the 1980s after it became one of the first areas of China to liberalize its economy, drawing migrants seeking work. That in turn boosted demand for housing, minting the country's first batch of property entrepreneurs including Soho China Ltd.'s founder Pan Shiyi.

Home prices more than tripled between 1989 and 1992, but the boom imploded the following year after Beijing tightened monetary policy and lending into the sector. More than 600 buildings were left abandoned, local media reported at the time.

China has pursued similar policies to contain its boom over the last three years. Financing has been squeezed and the government asked banks to slow the pace of mortgage lending. That triggered a wave of defaults and left millions of square feet of unfinished buildings.

In 1999, the State Council stepped in to help resolve unfinished projects, including turning part of them into subsidized housing for low-income workers. The government has turned again to that playbook, offering 200 billion yuan ($28 billion) in special loans to ensure stalled housing projects are delivered.

According to George Magnus, a research associate at Oxford University's China Centre, the underlying fundamentals look "pretty glum for the foreseeable future."

"We may get a property bust," he said. "China has joined up with the rest of the world in experiencing property problems."

While many economists say the crippling housing downturn won't get much worse and that the stimulus will kick in this year or next, few are calling for a sharp rebound. But the policy moves, along with a gradual easing of Covid restrictions, may help the market find a floor.

Australia

Australia saw a big run up in the home prices during the pandemic, but the central bank has jacked up its benchmark interest rate by 250 basis points in a matter of months, and the market has gone into reverse.

Values are falling faster than they were during the early 1980s and the early 1990s recessions, according to Tim Lawless, research director at CoreLogic.

The firm's combined capitals index, which includes home values in Australia's eight capital cities, dropped 5.5% in the past five months. Over the same timeframe in the 1990s downturn, housing values were down 2.9%. It's even worse in Sydney, where prices have fallen for eight consecutive months and are now 9% off the peak.

"In 1994, we had the most rapid increase in interest rates," said Paul Cameron, senior economist at real estate firm PropTrack. "We saw a kind of two downturns in the property market — one after the 1989 run-up in prices and the other after the increase in interest rates. At the moment, we have got both those scenarios."

One concern in Australia, and echoed in other economies too, is stretched household finances. The debt-to-income ratio is at 187%, compared with about 70% during the 1990s.

“Arguably households are much more sensitive to the cost of debt now than what they were back in those previous recessions,” Lawless said, though he stressed the economy remains strong, as does employment.

Sweden

There are similar dynamics at play in Sweden. Property continued to boom through the pandemic, but that’s changed after interest rates jumped from zero to 1.75% this year.

House prices are falling — at a record pace based on some measures — and highly-leveraged commercial property companies are coming under pressure from rising rates, which has parallels to the 1990s financial crisis.

Back then, rising rates popped a commercial real-estate bubble fueled by credit deregulation. The bust, which reverberated across the financial sector, thrust Sweden into a crisis that would see public debt and unemployment soar, and force the government to take control of distressed private banks.

While policy makers are concerned, there are factors that could prevent events now from spiraling out of control in the same fashion. Leverage among commercial property owners is far below levels at the beginning of the 1990s, which followed a period of rampant credit expansion.

But at the same time, household borrowing is a massive risk, with debt-to-income ratios around 200%, up from about 150% before the global financial crisis.

- Why Sweden’s $41 Billion of Property Debt Is Alarming Europe

UK

Back in the UK, Prime Minister Liz Truss’s government has again cut the rate of stamp duty to bolster the market.

That was announced as part of a big tax giveaway (some of which was subsequently cancelled) that hurled UK markets into turmoil. Bond yields jumped, contributing to soaring mortgage interest rates, and a number of lenders even pulled home loan products off the market.

That backdrop will make it hard to encourage demand, which property portal Zoopla says has fallen 20% since the so-called mini-budget, leaving it at its weakest since the pandemic started.

“The steep repricing of mortgages — with rates unseen for more than a decade and a sharp deterioration of affordability” may “shock buyers and freeze housing activity until rates normalize at least a bit and buyers readjust their expectations,” said Iwona Hovenko, Bloomberg Intelligence European housing analyst.

Broker Hamptons International warned before the stamp duty cut that home prices are likely to decline if the Bank of England’s base rate exceeds 2.5%. It’s already at 2.25%, and expected to rise to at least 3% early next month. The average 5-year fixed rate mortgage reached a 14-year-high this month.

“Rather than a credit crunch, the current shock looks more like the one that landed in the early 1990s when interest rates spiked, house prices slumped and the recovery was slow,” said Niraj Shah, an economist at Bloomberg Economics.

- Bloomberg Economics: Click here for the UK INSIGHT on the housing market

The last two housing slumps began in London before spreading out from there, according to Danny Dorling, professor of human geography at the University of Oxford, who's researched the UK crash in the 1990s.

And the capital is showing some signs of trouble now. Prices are more than £4,000 below their February peak, researcher Acadata Ltd. says, and values are falling in 10 of the city's 33 boroughs.

"Property is another asset that will suffer globally from the harm inflicted by the Fed and other central banks," said Hugh Hendry, a real estate investor and former hedge fund manager. "Stressed investors will dump, prices will swoon."

--With assistance from Swati Pandey, Derek Decloet, Niclas Rolander, Emma Dong, Gina Turner and Ronan Martin.

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