World's Worst Housing Bubble Menaces Britain

by Mary Burdman and Lothar Komp

The crisis over the British Prime Minister Tony Blair's disastrous Iraq war policy is pushing him closer and closer to the political brink; but Blair would be lucky, were this the only problem looming over his government. The proverbial "second shoe" hanging above Downing Street, is the enormous debt bubble otherwise called the "British economy." Britain is suffering from the world's worst speculative real estate bubble, as City of London insiders have affirmed to *EIR;* housing prices have doubled in less than a decade. On top of this is the huge morass of personal debt which—as the Bank of England, the Financial Services Authority, and Members of Parliament have been warning since last Summer—threatens to ruin millions of people.

Blair's "New Labour" government has followed the destructive path of free-market Thatcherism. Chancellor Gordon Brown may be attempting to challenge Blair's leadership, but his own political position, based on the alleged "stability" of the British economy, is hardly to be envied.

Awful as the U.S. real estate is, the British one is worse, given the size of the country. As of the beginning of February, the average price of a what is classified as a "first home" had broken through the £100,000 barrier, Halifax Bank announced. (The pound is now worth $1.86.) Prices paid by first-time buyers have risen 22.6% in the past year to over £101,747, Halifax stated, and they went up another 2.2% in January. Overall, house prices rose by 16% over 2003. Other mortgage lenders are claiming slower price rises, but that means prices rose "only" by 14.3%.

Last year, first-time buyers were forced to borrow—if they could—more than *four times* their yearly salary, on average, to buy a home. Key public sector workers, such as nurses, teachers, firefighters, and police officers, are simply being priced out of the housing market. In half of all the towns and cities of Britain, such vital workers cannot buy a first house. The average house price is six times the average salary of nurses and firefighters.

Southeast England has long been the worst case, but northern England and Wales are not far behind. There, although house prices are lower, they were rising at almost twice the rate of the Southeast during late 2003. In Wales, house prices went up 25%.

Over two-thirds of Britain's "net worth" is in this huge real estate bubble. At the end of December, the British Office for National Statistics reported its findings, that Britain overall is worth £4.983 trillion, but 55% of that—£2.7 trillion—is the "value" of British homes. The second biggest chunk, £565 billion, is the "value" of commercial and public property.

Just ten years ago, in 1994, residential property was worth less than half its current value, "only" £1.2 trillion. Britain's net worth then was £2.8 trillion.

Martin Weale, of the National Institute of Economic and Social Research, warned the *Guardian* on the consequences: "Sharp increases in house prices crowd out productive investment. The country as a whole cannot become better off by pushing up house prices, whereas it can by building roads and factories." Sharply rising house prices mean new generations will not be able to afford houses, he said. "It's paying for the present by robbing the future."

The British government is also deeply in debt, with a net worth of *minus* £124 billion. Until 1980, Weale said, "the government owned quite a lot of what were then nationalised industries and had positive net worth. Since then it's been selling them off and borrowing money." Britain now is only better off compared to its situation after World Wars I and II, when it was totally bankrupted. Then, it had to be bailed out by the United States. Now, the United States is the world's most indebted nation.

'Sinking in Debt'

Last August, after the Bank of England had to report that new personal borrowing had exploded to the highest monthly figure ever in June—£10 billion—the Parliament and the press were full of dire warnings.

"Britons Are Sinking in Debt" and "Millions of Consumers Risking Ruin" were headlines in the Aug. 1 and 2 London *Times.* The average British household now has £45,000 of debt, equivalent to 130% of annual income. In June, Britons borrowed £2.2 billion of consumer credit and £7.8 billion for mortgages, sending the annual pace of new borrowing up to 14%, the highest level in a decade—the period since the last financial crash in Britain.

At that time, interest rates in Britain, following the lead of the U.S. Federal Reserve, were, at 3.5%, the lowest since 1955! The Bank of England (BoE) has since broken ranks with the Fed. First on Nov. 6, 2003, and then on Feb. 5, the BoE raised its prime rate, each time by a quarter percentage point. The Bank was the first of the world's four leading central banks to raise rates since 2000. The benchmark interest rate is now 4%.

On Aug. 1, MP John McFall, chairman of the Commons Treasury Committee, told the *Times* that the debt explosion was putting many peoples' futures "on the line." McFall summoned five of the biggest credit card providers to his Committee to "grill" them on their "irresponsible" fueling of an unsustainable rise in debt.

By October, soon after his appointment, new Bank of England Governor Mervyn King was warning of the vulerna-

Seventy percent of the net worth of Britain is now real estate, its value having doubled in a decade—and most of that "value" is in residential homes; i.e., household debt. The British real-estate bubble is out of control; warnings of its collapse come from all quarters, even as the Bank of England raises interest rates to try to take some of the air out.

bility of the consumer bubble. At a public event in Leicester on Oct. 14, King said that the level of borrowing had increased the risk of a "sharp correction" in consumer spending, and he let it be known that interest rates would soon be raised.

This was just one day after the Leeds University Credit Management Research Centre had published a report on the debt situation. Total credit card lending has doubled in the last four years, there are some 1,500 different credit cards available in Britain, some carring usurious interest rates of over 30%, and even 177%. In the last year, 20 million cases have been sent to debt collectors, and British bailiffs are trying to collect a record £7 billion of bad debt, a 70% increase over two years. Typical of the over 6 million households with debt problems, is a debt burden now of £25,000, up from £10,000 just three years ago.

On Oct. 16, McFall, using the Leeds University report, called the chief executives of British banks before his Committee to account for their "easy credit" policies, which are "allowing credit card holders to tip-toe into disaster."

Millions 'At Risk'

The situation has not improved since. Britain's Financial Services Authority (FSA) warned in its "Financial Risk Outlook for 2004" on Jan. 21, that millions are "at risk" due to soaring debt. A large number of British households have overestimated their ability to repay, and even a 1% rise in interest rates could force families to cut spending or sell their homes, the "Outlook" warned. Signs of financial stress, such as increasing cash withdrawals on credit cards, were already evident, and these could get much worse as interest rates or unemployment rise. "There are signs that some households have already borrowed more than they can comfortably afford," the report stated. "Households may begin to reach the limits of their ability to borrow relative to their income and a small change in borrowing costs or household outgoings may have a significant impact."

The day after the Feb. 5 interest rate hike, the Department of Trade and Industry had to report that individual bankruptcies rose by almost one-third in 2003, to the highest level since late 1993. Over 10,000 people filed for bankruptcy in the fourth quarter alone, a 12% jump from the previous quarter. One debt advisory group warned that the rate hike will increase the number of people "struggling" to pay their debts, from 2.3 million to 6.46 million! The total population is just under 60 million.

In a commentary published in the *Guardian* on Feb. 9, Vincent Cable, "shadow" Chancellor of the Liberal Democratic Party, warned that Britain's indebted households are "living on borrowed time." "Four-fifths of [household] debt is secured against house prices which, in relation to income, are at levels comparable to those just before the house price crashes in 1973-75 and 1990-92," he wrote. This has "potential wider implications. Economic stability depends on the absence of a crash in house prices plunging substantial numbers into negative equity." Housing prices are now an "asset bubble," while "aggressive lenders are pushing loan-to-value ratios into uncharted territory," and Britain has no mechanism to deal with this asset bubble. While Gordon Brown is hoping for another "soft landing," it is "the government's task to prepare for the worst-case scenarios, which are all too plausible," Cable warned.

As for industry, that is mostly a distant memory in Britain. Shopping for bargains now dominates the economy, and the January sales have salvaged the precarious economic situation in the last two months. However, Britain's Office for National Statistics had to report a 0.1% fall in manufacturing output in December, following an 0.6% decrease in November. Chemical, electrical, and optical equipment industries—which means computers and mobile phones—all contracted. For the longer term, as the *Guardian* reported Jan. 10, "between 2002 and 2003, as a whole, [manufacturing output] was flat."