# Ed Conway

## The task of averting another financial crisis begins at home

*Ed Conway is Economics Editor of Sky News*

If there's one thing to be said for last week's market misery, it is that it did at least remind us just how infrequently bad economic news has made the front pages in recent months. A good economy is, from a news editor's point of view, a boring economy; and in recent months Britain has been the one place to bore them all.

With gross domestic product running at an annual rate of 3.2 per cent, Britain is set to grow faster than any other leading advanced economy this year. The Office for National Statistics' GDP revisions mean that the recession turned out to be shallower than previously thought. And with unemployment falling at a record rate, the proportion of people in work is close to a record high.

True, there are one or two serious blots on the copybook: wages remain desperately low, meaning that for many families the recovery has resulted in a fall in living standards. Plus the country's trade balance is so lamentable that the current account deficit this year will be the worst in the G7.

However, beyond that, so many longstanding economic concerns simply haven't been borne out by events.

That worry about the recovery being terrifically imbalanced? As it happens, services, manufacturing and construction have all grown by more than 3 per cent in the past year, something that has happened only once in the past quarter of a century.

Fears about British households being massively indebted? In fact, total private sector indebtedness has fallen from 210 per cent of GDP in 2010 to 166 per cent in the second quarter of 2014. This, according to Citi's Michael Saunders, is the biggest fall of any advanced economy, bigger even than those seen in the Republic of Ireland or Spain.

True, the absolute level of indebtedness remains high and, as yesterday's figures showed, the government's deficit is higher than expected. However, it's hard not to conclude that Britain is doing better — far better — than many had expected.

The political response has been depressingly predictable. The release of every decent statistic at 9.30am on a given morning is followed at 9.31am by two press releases from the Conservative chancellor and his LibDem chief secretary to the Treasury, both trying to claim credit. These are followed a quarter of an hour later by an email from the shadow chancellor deriding his opponents and implying that the good news derives, in some way, from the work done when Labour was in office.

A more honest response to this might be as follows: "Wow. Well how about that? Frankly, we've no idea why things are going so well. Most probably it's a combination of patience and good luck: and, given how far GDP plunged during the recession, there was always a chance it would bounce back quite quickly. But seeing as things are looking good, perhaps now is a good time to make some of those reforms we were too scared to go through with during the crisis."

That's right: now that we're comfortably into the recovery, it is time for the difficult work to begin. One could pinpoint any number of niggling long-term problems with Britain's economy — low productivity, an over-expensive welfare state, a dismal balance of trade — but let's start with the big one: the housing market.

Although the focus on property is waning as the London bubble begins to deflate, Britain's housing problem remains as deep and structural as ever. It is painfully clear that the country's economy runs to the rhythm of the mortgage market, responsible for almost every financial boom and bust in recent history.

This mess isn't an accident, it is a consequence of decades of policy decisions. Home ownership is explicitly supported through the tax code, and not merely through measures such as Help to Buy. Unlike in many other countries, homes are not subject to capital gains tax. The planning system acts to discourage homebuilding and home extensions. The upshot of which is that an ever-growing chunk of our money is bound up in a housing market that is not expanding to reflect the demand.

The consequences have been laid bare in a recent paper by Òscar Jordà, Alan Taylor and Moritz Schularick. They find that the share of bank lending accounted for by property has risen from 16 per cent in 1928 to 63 per cent in 2007. In a sign of growing vulnerability of the financial system, leverage also steadily increased; in other words, those debt increases were not accompanied by proportionate increases in home values.

If Britain is to avert another financial crisis in a few years' time, it needs to address its debt problems, which in turn means confronting the perversity of housing policy. Happily, there is no shortage of possible solutions. When it comes to supply problems and planning constraints, Kate Barker has published an excellent new book, *Housing: Where's the Plan?*, while Sir Michael Lyons has just produced a review for the Labour Party.

Another issue is to tackle the demand side: in other words, reconsidering why, when and where we should be subsidising home ownership through tax breaks and monetary policy. And in the short term the Bank of England will need to bite the bullet and raise interest rates. Investors believe that last week's market mayhem will convince them not to do so until next summer or autumn, but the monetary policy committee should be wary of raisng too late. There is nothing normal about 0.5 per cent interest rates.

Bear this in mind when you hear about the latest GDP figures on Friday. They may not make the front pages. That is good news.

The real question is whether our leaders use them to try to seek political capital — or actually seize the moment to start confronting our economic problems.

**Problems ahead**

Ratio of bank lending to GDP