

## If House Prices Crash?

### News Story

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Tony Blair knows only too well the problem of debt. When he finally moves out of Downing Street, he can turn his attention to paying the mortgage on his £3.7m home in Mayfair.

Mr Blair's financial juggling act is being performed in almost every household in the land. Since Labour came to power, Britain's debt has ballooned almost threefold to £1.27trn.

Margaret Thatcher's "Big Bang" reform of the banking system made it easy to borrow while Gordon Brown's era of low interest rates has fuelled the appetite for debt.

While the vast majority of debt is tied up in mortgages, a significant chunk is unsecured borrowing. But does it really matter how much we collectively owe? As with all the most important economic issues, the answer depends on who you ask.

The Bank of England, whose job it is to set the interest rates that we pay on our debt, is relatively relaxed. Mervyn King, the Bank's governor, frequently says that rising insolvencies and home repossessions highlight a large amount of pain being suffered by a small number of people. In other words it is a social issue rather than an economic danger. It's a fair point. Households own £7.6trn worth of assets..

This looks healthy, unless of course house prices crash or interest rates - which have already gone up 40 per cent in the past three years - go through the roof.

Were that to happen it would be pretty disastrous. Families would lose their homes, leading to a drop in spending on the high street, in turn triggering a surge in unemployment and a potential banking crisis.

Far fetched? Not really - Japan has only just emerged from a decade-long period of stagnation after its debt bubble burst.

But neither risk looks likely to materialise. One bank, Alliance & Leicester, has calculated that the base rate, now at 4.75 per cent, would have to hit 8.5 per cent to put householders under the same level of pressure as at the peak of the Eighties boom.

The real danger is long-term. The larger the debt mountain, the less willingness consumers will have to take on more debt. At some point they might even decide to cut spending and rebuild savings to guard against a rainy day - Japan again provides the cautionary tale of what can happen to an economy.

At the same time the Bank of England may find the debt mountain makes it harder to set the right interest rate to tackle inflation. The larger the debt, the more painful the impact of any given increase. Critics say the current regime fuelled the debt boom by cutting interest rates each time the economy slowed. The next Chancellor will have to decide whether it is time to insist the Bank takes account of the potential dangers of a bubble in house prices. A little more pain now rather than a whole lot in a few years' time.