Demand and house prices in uk

Introduction:

This assignment is about changes in demand and house prices over the last two years in UK. What happened in last two years in the housing market, what factors are involved to change the demand of housing and pricing? What are the benefits of this research? Before going to the factors that affect the housing market in UK, it is important to know what is housing market and also see the time series graph which shows what happened with housing market in the last three years?

Definition of Demand: An economic principle that describes a consumer's desire and willingness to pay a price for a specific good or service. Holding all other factors constant, the price of a good or service increases as its demand increases and vice versa.

Definition of Supply: The term supply refers to the quantity of a particular product that suppliers (producers and/or sellers) will make available to the market at a particular price. The higher the price, the greater the quantity that suppliers will be willing to supply to the market.

(http://www. investopedia. com/terms/d/demand. asp)

Real estate economics is the application of economic techniques to real estate markets. It tries to describe, explain, and predict patterns of prices, supply, and demand. The closely related fields of housing economics is narrower in scope, concentrating on residential real estate markets as does the research of real estate trends focus on the business and structural changes impacting the industry. Both draw on partial equilibrium analysis (supply and demand), urban economics, spatial economics, extensive research, surveys and finance.

(http://en. wikipedia. org/wiki/Housing_market)

(http://www. housingmarket. org. uk/house-prices/current-uk-house-prices-trend/08/10. 8. 09)

If we consider the above two graphs of housing prices of UK, we come to know that the prices are going to fall from 2007, before that the prices are high. Now we analyze what happened with the housing market, and what factors are involved to change the demand curve in to the left. The factors affecting house prices and demand are as follows.

Factors Affecting The UK housing market:

Since the peak in July 2007, UK house prices have fallen considerable. The main reasons for falling house prices are:

- Difficulty of Getting Mortgage due to credit crunch.
- Low affordability (high house price to income ratios)
- Economic recession
- Rising unemployment
- Future price expectation
- Consumer confidence
- speculation

Mortgage:

Mortgage companies had to write off bad mortgage debts, there has been a shortage of liquidity in the banking system causing mortgages to be more expensive and difficult to get.

As people defaulted on mortgages, house prices which had been booming before the credit crunch started to fall. Falling house prices means the loss of banks, because the resale value of the house was much less than the initial mortgage.

Because of the bad experience with mortgage companies going bankrupt, financial institutions became much more cautious about lending money for mortgages. Also, because they had lost money, they couldn’t afford to lend more. Therefore, mortgage finance was in short supply causing banks to ration mortgages by requiring large deposits and increasing the interest rates.

Falling House prices exacerbate the credit crunch. Although defaults are currently low, falling house prices magnify the problem because it leaves homeowners with negative equity. Therefore, if a homeowner defaults, it multiplies the losses of banks such as Halifax.

It is a vicious cycle because the shortage of mortgage funds is causing a fall in demand for houses and therefore, house prices will fall further; this makes the mortgage industry more nervous. This is why the Bank of England has extended its emergency lending to the banking system.

The other problem is that people's decision to buy a house is based on confidence. Given the unrelenting bad news, most homeowners will defer the decision to buy causing further falls in demand.

(http://www. mortgageguideuk. co. uk/index. html)

(http://images. google. co. uk/images? hl= en&source= hp&q= demand+and+supply+curve&gbv= 2&aq= 3&oq= demand)

The graph also shows that the demand is changing towards left, it means the prices are going down but people are not interested to buy a home, because of uncertainty, people are more conscious to buy, because the price of houses continuously fall.

Future Price Expectation:

According to the independent analysts Oxford Economics, prices will continue to fall in 2010. The average price in London will drop by 16. 1 % this year, then a further 3. 4 percent next year.

Property values will then recover by 2. 1 per cent in 2011, 8. 9 per cent in 2012, 10. 7 per cent in 2013 and 7. 4 percent in 2014.

The report to the National Housing Federation claims the average price will boom to 354, 900 pounds. This is an overall rise of 27. 7 per cent from today, but more than 40 percent up on prices expected in late 2010.

An average London property bought last year for 331500 pounds will still be worth less in 2013, at 330600 pounds.

It expects the2012 Olympics to provide a welcome boost. Its Chief executive David Orr said low income families would struggle to get credit. (London Lite Monday, 3 August 2009 Page 15).

These two research shows that prices are still going down in the next two years, after that it is expected the prices will boom, in these circumstances people are not willing to buy house, and research also shows that due to credit crunch low income families are also struggling for getting credits.

Credit Crunch:

The major factor that affects the demand for houses and prices of houses are credit crunch. The credit crunch which began two year ago shows no signs of abating. With declining economic fortunes in most OECD economies, there is also the prospect of things getting worse before getting better. These are some of the problems stemming from the credit crunch.

(http://www. economicshelp. org/2008/07/problems-of-credit-crunch. html)

Due to shortage of credit, banks are decline in their reserves as they write off bad debts. In UK, mortgage approval has fallen, causing fall in demand of houses and prices, people lose their confidence to buy and declines of profits of banks and share value.

Because of high cost of mortgage, people have less ability to buy that is also big cause that fall the demand of houses and price.

Unemployment:

The other big factor that affects demand for houses and prices in UK is unemployment, after the credit crunch lot of people are unemployed and in other words they lose their jobs, if we look for the last three years ratio of unemployment in UK, we have better idea and we are in better position to find analysis of what actually happened for the house market.

(http://www. economicshelp. org/2008/10/unemployment-in-uk. html)

If we consider both of these graphs, we come to know that in April 2007, the employment rate is higher and in April 2009 it totally fell down. Same case happened in the second graph which shows that in April 2007 the unemployment rate is very low, but after the credit crunch, April 2009 the unemployment rate is so high. In other words we say that unemployment is high or lots of people are going to benefits.

This is the big factor that affects the demand of houses and price; a lot of people lose their jobs, people do not have the ability and reserve to pay high rate of deposit or high mortgage, this is the cause the demand of houses shift to left.

(http://images. google. co. uk/images? hl= en&source= hp&q= demand+and+supply+curve&gbv= 2&aq= 3&oq= demand)

Interest Rate:

Interest rate play a very important role of getting mortgage, If your interest rate is lower you have to give back less money if you have high interest rate you have to pay back more. But in last two years the interest rate is going down and down at 0. 5%. According to general demand supply rules, the demand is high, but if we consider the factor that is directly linked with interest rate is mortgage, the mortgage companies are badly collapsed because of recession. However the interest rate is low people still not interested to buy homes. The main reason is that the mortgage demand high deposit, people do not have money to pay high deposit, this means even the interest rate is lower but mortgage deposit rate is high, that affect the directly to demand of housing and prices. If demand is less definitely the prices goes down.

In this analysis, the interest rate is not the direct factor of reducing the demand, but the linked factor of mortgage affect the demand of housing and prices.

(http://images. google. co. uk/images? hl= en&source= hp&q= demand+and+supply+curve&gbv= 2&aq= 3&oq= demand)

Economic Recession:

Many professionals and experts around the world believe that a true economic recession can only be confirmed if GDP (Gross Domestic Product) growth is negative for a period of two or more consecutive quarters. The roots of a recession and its true starting point actually rest in the several quarters of positive but slowing growth before the recession cycle really begins. Often in a mild recession the first quarter of negative growth is followed by slight positive growth, then negative growth returns and the recession trend continues.

While the “ two quarter” definition is accepted globally, many economists have trouble supporting it completely as it does not consider other important economic change variables. For instance, current national unemployment rates or consumer confidence and spending levels are all a part of the economic system and must to be taken into 0account when defining a recession and its attributes.

(http://recession. org/definition).

It is actually more common than you might realize for countries around the world to experience mild economic recessions. Recession (or contraction) is a natural result of the economic cycle and will adjust for changes in consumer spending and consumption or increasing and decreasing prices of goods and labor.

Rarely though entirely possible, experiencing can a multitude of these negative factors simultaneously lead to a deep recession or even long economic depression.

Effect Of Economic Recession:

Generally, an economic recession can be spotted before it actually happens. There are ways to spot it before it actually hits by observing the changing economic landscapes in quarters that come before the actual onset. You will still see GDP growth, but it will be coupled with signs like high unemployment levels, housing price declines, stock market losses, and the absence of business expansion. When an economy sees more extended periods of economic recession, it goes beyond a recession and is declared that the economy is in a state of depression.

The only real benefit of an economic recession is that it will help to cure inflation. In fact, the delicate balancing act that the Fed struggles to pursue is to slow the growth of the economy enough so that inflation will not occur, but also so that a recession will not be triggered in the process. Now, the Fed performs this balancing act without the help of fiscal policy. Fiscal policy is usually trying to stimulate the economy as much as is possible through such things as lowering taxes, spending on programs, and ignoring account deficits.

(http://recession. org/definition)

Consumer Confidence:

During times of high consumer confidence, people are more willing to take out risky mortgages to be able to buy a house. For example, in the period 2001-07 100% mortgages and interest only mortgages were quite common. In the early 00s, people were optimistic about the housing market and so took out mortgages with a higher debt to income ratio.

(http://www. uk-houseprices. co. uk/housing_market/factors_affecting_prices. html)

After 2007 the recession time start, prices are continuously fall, people restricted to invest money, because they continuously fall, so the demand of houses also fall.

Speculation:

Everybody buy homes to live in, some people buy house for renting purposes o get more money and save the capital. But after the credit crunch the prices are going to fall, so the investors are not more interested to invest. This is bigger factor that affect the demand of houses and prices.

(http://images. google. co. uk/images? hl= en&source= hp&q= demand+and+supply+curve&gbv= 2&aq= 3&oq= demand)

Prediction:

From the above information about changes in house prices and demand, I did able to predict what will happen in next two years or more? The predictions are as follows.

- Because of recession time, the mortgage companies are still struggling for finance and banks are also struggling to get back the money from costumers, so in these circumstances prices of houses and demand will fall more in next two years. Independent analysts oxford economics shows that prices in London will drop16. 1% in 2009 and then further 3. 4% in 2010. After 2010 the property will recover 2. 1%, 8. 9%, 10. 7% and 7. 4% in the coming years. These figures show that the prices of houses and demand still fall in the next two years.
- Unemployment rate is continuously fall and expected that still fall in the coming years up to three million people are jobless in the coming two years. This also shows that the demand of houses and price will go down further.
- People are mostly unemployed, and others are on benefits, so average income is not compatible to mortgage deposit, however the interest rate is lower but people do not have reserve to pay deposit, so the demand is going further to fall in the next two years.
- The mortgage companies are still fall in finances, they are not willing to give lenders the risky loans, it has also effect the consumer

confidence, these two factors indicate further fall in demand and prices of houses.

- Speculation about the house prices, they are further fall in future, investors are not interested to invest, so these shows that the prices and demand further fall in future.

These are facts that predicts further fall in demand and prices of houses in UK, but after 2010 it hope the prices will recover and people confidence improved and demand shift to right.

Conclusion:

All the factors that affect demand and prices of houses shows that prices and demand further going to fall in the next two years, after 2010 it hope the prices will recover and demand of houses will be high. This is the recession time and mortgage companies and banks are lack of finance to support people to buy homes. However the Government reduces their interest rate but people do not have the ability or reserve to pay high deposit and second reason is that a lot of people are jobless or on benefits, they are not able to pay even less mortgage. These all factors that I discussed above are inter linked with each other, that’s why prices of houses and demands are going to fall. After 2010 it hope the recession time will be finish , mortgage companies and banks will be able to provide more finance to costumers, the job condition is better, income is high, so people are more able to purchase houses and demand will be high, if demand is high the prices should be rise.

References:

(London Lite Monday, 3 August 2009 Page 15).

http://recession. org/definition

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