YORKSHIRE POST

50p WEST RIDING EDITION yorkshirepost.co.uk FRIDAY JANUARY 9 2009

Reality check for consumers on rate cut

Jonathan Davis

Jonathan Davis is a chartered financial planner and managing director of Armstrong Davis Ltd who are independent and impartial financial advisers in the City of London and in Hertfordshire. www.ArmstrongDavis.com

TOMORROW: *Tom Richmond*

THE Bank of England interest rate has been slashed from five per cent in September 2008 to, now, 1.5 per cent.

No doubt the eternal optimists (banks, estate agents, mortgage brokers, property developers, car dealers, furniture showrooms etc) will say the economy is saved. Hurrah!

Didn't they also say there would be "no house price crash"? Didn't they also say "there will not be a recession"?

They were wrong then and, when you hear them saying that all is not too bad, please remember they have a vested interest in what they're saying.

Let's look at how the housing market, mortgage payers and savers will be affected by yesterday's rate cut.

HOUSING MARKET

The bottom is still two years away, at least. Nationally, house prices are about 20 per cent off the August 2007 high, according to the Halifax and the Nationwide.

In our view, they will continue falling until at least 2010-11. This is because house prices do not rise for 15 years then fall for just one year. For a rise of 15 years, expect a fall of several. Also, unemployment is rising strongly and so are home repossessions because the economy is in recession.

The Government has introduced measures to slow repossessions – one will be able to defer mortgage payments for two years if one loses one's job.

However, we see this as just deferring the problem to the next government. Do they seriously believe that someone earning, say, £40,000 a year who loses their job, will simply walk into another one exactly two years later at the same salary – given we are in probably the biggest recession in decades?

The economy is falling and almost no amount of Gordon Brown printing money to save banks will help our failing economy. To paraphrase Napoleon – "Britain is a nation of house sellers and buyers". That is not the way to build a strong economy.

Prices will be 40-50 per cent down by the end. So, a £300,000 house, bought in the summer of 2007, is likely to fall to £150-180,000. Those who say "it may happen to the other guy but not my house" are deluding themselves.

The fact is there was too much easy lending (and borrowing) and the banks have lost literally trillions of pounds. Thus, their lending will return to the older norms – not to the levels seen in 2005-2007. Already, deposits needed are much larger than before and multiples of income loaned has fallen. There are further restrictions on lending to come.

In percentage falls terms, this housing crash is already worse than the 1989-95 slump and we are only just over a year in.

This is all bad news for the economy and for those who bought in the last few years. Of course, for those who are looking to trade up or for those who are renting this is great news. There are always two sides to a story.

MORTGAGES

Those on a variable mortgage, tracking the Bank of England rate, have seen their mortgage payments fall significantly over the last few months. An interest only mortgage of this type with £200,000 owed is now about £550 per month cheaper than three months ago.

If you are a holder of this type of mortgage, I suggest you use the savings wisely and you could, for instance, pay down your debts. Some 30 per cent of mortgage payers have this type of mortgage. Of course (there are two sides, remember...) while your monthly payments have come down some £550 per month recently, the capital value of your property has come down about £40,000 since August 2007, *ie*, about £2,500 per month (based on the national average).

Even though the Bank of England has slashed its interest rates, mortgage rates generally will remain high compared with the central Bank's rate. A quick look on a mortgage comparison website tells us that the average new fixed rate mortgage is about 4.5 per cent, trackers are about 1.5 per cent above the Bank of England rate and normal variables are about five per cent and these are only for the very lowest risk borrowers, *ie*, those with 25-40 per cent deposits.

Most borrowers' mortgages either do not track the Bank of England rate, if variable, or as they are fixed, the Bank cuts have left them feeling somewhat disappointed.

SAVERS

This is where most have lost out by Bank of England cuts. Many deposit accounts pay less than one per cent. Long gone are the days of seven per cent. There are still some four and five per cent rates available for fixed-term deposits. However, I suggest you be very quick if you want one.

For the longer term, our view is that from 2010-11 inflation will return and by the middle of the next decade we will have it in spades (due to huge government money printing and plummeting currency, largely) so inflation-linked investment accounts are a good bet.

There will always be those who say this or that regeneration will stop the rot – including the Prime Minister in Liverpool yesterday. Well, look at docklands all over the country – huge amounts of money poured into what are now white elephants.

Regeneration does not stop a housing crash. Long term and growing sustainable businesses will help. When they come, will someone please tell me?