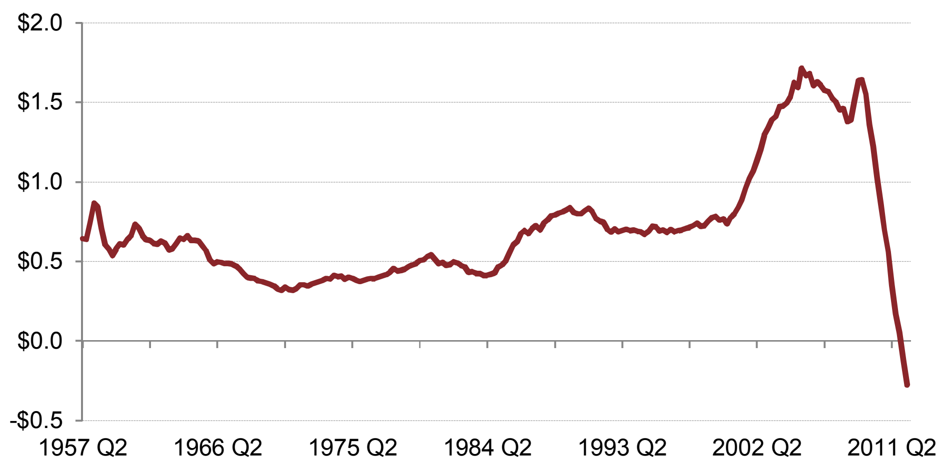
STEIN BROTHERS
LONDON-STOCKHOLM

If we shift to non-debt-induced growth

The return of rental housing

Two important developments throughout the post-war era have been the increasing importance of debt in underpinning output growth; and the seemingly unstoppable rise of owner-occupation as a goal for households, initially in the English-speaking developed economies, but more recently in other countries as well. The role of excess debt and housing bubbles in triggering the Great Recession is of course well known. In the United States, the five-year moving average of the dollar change in household debt per extra dollar of GDP was fairly steady from 1952 to 2000, moving in a band between 30 and 70 cents. It then began to shoot up, peaking at $1.70 in the five years to 2005 and remaining around $1.50 until late 2009, before plummeting. The deleveraging of the past years has taken the number to -30 cents. Similar numbers can be produced for other economies.

Incremental household debt/GDP ratio (five-year moving average of the dollar change in household debt per extra dollar of GDP)



Because the past 60 years have generally been years of inflation, if at different rates, we don't really have much experience and solid data about how households react following a debt-induced deflationary slump of the magnitude of the last five years. However, we do know that the generations that grew up in or lived through the deflationary experiences of the 1920s and 1930s, were extremely unwilling to go into debt. Such memories are long-lasting. Moreover, in spite of the attempts in most advanced economies to spur the growth of bank lending, banks (buffeted also by demands to hold higher capital) are still tightening their lending standards and households are unwilling to borrow. While it is impossible to be sure, it is quite likely that we are moving towards a future where output growth will be less dependent on debt than in the past decades. This obviously has a number of consequences for investment decisions.

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One is that corporate financing is likely to be more equity-based, which, in turn, should mean good news for equities. The bond bull market that we have seen as monetary authorities try every trick in the book (and a few others) to bring bond yields down and keep them there, may remain for some time, but is not going to be permanent.

Another likely development is that households are likely to shift towards renting, rather than owning property. This is due to a number of factors: banks' current unwillingness to lend and likely future unwillingness to lend at the same high loan-to-value ratios that we have seen in the past 20 years; the need, therefore, for households to build up savings in order to provide larger deposits, but needing somewhere to live in the meantime; the experience that house prices can actually fall – and fall substantially – leaving borrowers with negative equity, and therefore the need to curtail spending while they try to deleverage over long periods of time; and related to this the awareness that houses are not safe investments either and the need to diversify assets. (Strangely enough, it need not be the knowledge that housing prices are no longer immune from falling, that limits home-buying, as much as the knowledge or fear that their prices will not rise as in the past.) In addition, we have had a situation in many countries where buying was promoted over renting, officially – through taxation – and financially – through inflation. However, this is unlikely to be the case for a long time. Inflation is likely to remain subdued for many years to come (subject to central banks not abandoning their inflation targets). Governments need more tax revenues to deal with their large deficits, and cutting mortgage interest relief in the countries that still retain it (eg, the US or Sweden) is likely to be seen as a 'good' thing to do (government doing their bit to discourage the build-up of excessive household debt).

A shift to more rental housing sounds easy. But it would involve some substantial changes. For one thing, if we are talking about a 'continental-style' rental market, where the tenant has full and indefinite possession of the property and can trade it, there would need to be legal changes in many countries, eg, Britain. More importantly, there would need to be a substantial change in attitude among households in favour of long-term, perhaps lifetime, renting, not as a temporary situation due to financial pressure or before you buy. And, perhaps most important, unless you want to see a permanent shortage of housing, there can be no rent control, however attractive politically.

Long-term less household mortgage borrowing is bad news for banks and other financial intermediaries. But greater scope for rental is good news for long-term institutional investors, notably pension funds. Any investor seeking a steady, predictable long-term income stream, will find owning blocks of residential real estate an attractive alternative to corporate and government bonds – not least since at least the latter have ceased to be as risk-free as they were once perceived to be. This is already the situation in some countries, eg, the Nordics or Germany, where residential real estate constitutes an asset class of its own.

This does not mean that owner-occupation will disappear. Even in continental Europe, the proportion of households who live in rented accommodation is according to Eurostat less than 50%, with the highest share (42.5%) in Austria. (NB: data for Germany is lacking.) If you eliminate tenant-reduced (ie, public or social housing), the number is even lower. However, its importance is likely to diminish in coming years.

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But what about the other way around? If rented accommodation will grow at the expense of owner-occupied in, eg, the Anglo-Saxon economies, is there not a case for assuming a rise in owner-occupied at the expense of rental in countries where rental is relatively more important? In theory, it is possible. In practice it is perhaps less likely. First, because here, too, a shift in attitude would be needed. But the combination of house price falls with excess household debt does make the case for moving from renting to buying very attractive right now. Second, because it is highly unlikely that governments anywhere among advanced economies would now or in the near future move towards foregoing income in order to give tax advantages to households wanting to take on more debt by buying houses.

Nor is there any evidence of such a move, at least not at this moment. Looking at ECB data for lending to households for house purchases by country, and restricting ourselves to the largest, non-crisis hit countries (coincidentally, the ones with the largest rental sectors), we find that housing loans are generally trending down and in some cases (Netherlands, Belgium) contracting. Germany is somewhat of an exception, with home loan growth accelerating – but even here, the growth rate is only 1.5% per annum. Of course, German households have large savings and may finance home buying from those, rather than by borrowing – ie, putting down larger deposits. But if so, this is only a once-off, which cannot be repeated. As far as can be ascertained today, the future in at least some advanced economies will involve a shift from owning to renting; with little sign of this being off-set by a move in the other direction elsewhere.

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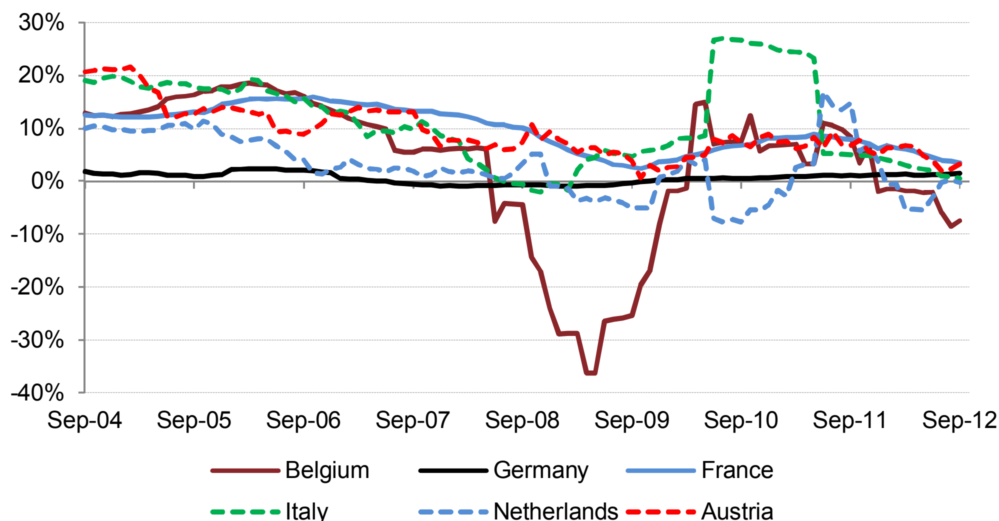
Lending for house purchases, 12-month change, %



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