Funding the Future

Could 2008 happen again? Part 2

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No sooner had I finished my post on why the 2008 global financial crisis could happen all over again than I noticed this in the Guardian this morning:

Some couples applying for a Santander mortgage will see the maximum they can borrow increase by £130,000 overnight after the bank loosened its lending rules.

Santander is the latest in a line of lenders to allow some borrowers to access bigger mortgages after intervention by the City regulator and new guidelines from the Bank of England designed to help more people on to the housing ladder.

However, brokers said Santander was unusual in that it would now be allowing some higher earners with smaller deposits to borrow an extra 24% at a stroke.

The bank gave the example of a couple with an £80,000 deposit or the same amount of equity in their property, where one earns £75,000 a year and the other £50,000. On Monday they could borrow a maximum of £556,500, assuming a standard mortgage and a 25-year term, but on Tuesday this will rise to £687,500. That is 24% more than before.

I make no apologies for quoting at length: this issue is important.

As a consequence of Rachel Reeves' absurd desire to relax regulation in the City of London so that it might be reckless once more, coupled with bankers willingness to make loans that they know they will never have the responsibility for recovering, because the senior staff in these institutions will all (they hope) have retired before such eventuality arises, we are seeing a recklessness of the style seen from around 2005 onwards re-emerging in the UK mortgage market.

Just look at the figures in the example provided by the Guardian. Couples with earnings of £125,000, between them, will be able to borrow 5.5 times their combined earnings on a mortgage, with the annual cost of servicing this probably being at least £45,000, which will, in all likelihood, be near enough half of their likely net incomes per annum.

There are numerous very obvious risks here.

Firstly, by any definition, this is over gearing, i.e. this is borrowing too much in proportion to earnings. The capacity to cover possible additional mortgage repayment costs, should interest rates rise again —a scenario entirely possible given the current leadership at the Bank of England — is almost non-existent.

Secondly, whilst this morning's employment data suggests that earnings are still arising slightly above inflation, when that margin is just one percent there is little comfort for those taking mortgages of these scales that they will get any assistance from inflation over coming years to reduce the overall net value of their liabilities in a way that was commonplace in the past. In other words, these obligations are really onerous.

Thirdly, we do know that the UK employment market is getting tighter, and finding work is getting more difficult. We also know that the employment market is facing significant disruption as a consequence of AI. The potential for this to have serious consequences in the mortgage market is something that is not being talked about as yet, but should be, I think. This risk is not being factored into these loan offers, but it is very real.

Fourthly, we know that bankers have the capacity to mimic each other when it comes to making loans, so this type of offer from Santander is likely to be replicated elsewhere. But what we also know is that this will, almost certainly, give rise to further property price increases. It is a simple matter of fact that increased mortgage borrowing capacity has almost always given rise to property price rises. Whilst in the short term, bankers might love these because they appear to provide greater security for the loans that they have provided, in the long term, they very often are the indicators of a crash to come, and I think that will be the case in the environment that Rachel Reeves is now deliberately creating.

So, to return to the question that I asked in my first post on this subject this morning, is it possible that the conditions for another 2008-style global financial crisis are being put in place? The answer is that all the signs are that this is exactly what Rachel Reeves is trying to do in the UK. It would appear that she has learned nothing from the experience of Gordon Brown in the first decade of the century.

Foolhardiness is the order of the day again. I’m not saying when this crash will happen. What I am saying is it will happen. Everything to make it possible is being put in place.