

Evaluate the microeconomic and macroeconomic effect of falling house prices

Demand-pull disinflation, whereupon AD decreases leading to a decrease in overall price level, is a possible macro effect from falling house prices. House prices falling by “10-20%” translates to homeowner value asset decreasing, whereupon they “feel” relatively less wealthy, despite no change in real income, causing their marginal propensity to save to be greater than their marginal propensity to consume. In theory, consumption being 60% of AD tied with the fact 60% of the UK are homeowners, an inwards shift from AD1 to AD2 is plausible, as visualised in diagram 1. Thus demand-pull disinflation is achieved.

On the contrary, house prices falling by “10-20%” makes the housing market more accessible to lower income bands, as per extract A “a greater proportion of UK individuals can now buy homes”. House prices becoming relatively more affordable, causes homeowner percentage to increase. This may dampen any demand-pull disinflation as the new consumption (buying homes) may offset/dampen disinflation, and may restore prices as demand and price are pro-cyclical, demand increases while price drops. However, considering the fact interest rates “reached over 5.5%”, as per the extract, first-time buyers may have a higher MPS than MPC, factoring in the cost of mortgage. Therefore said effects, is unlikely.

Geographical mobility of labour increasing is a possible micro effect. Housing becomes “relatively more affordable”, as inferred by extract A’s remark “its a buyers market now” - suggesting its in their favour. Prior to which, workers may be detracted from moving closer to jobs due to high property prices pre house prices falling “10-20%”, enabling more workers to enter the housing market. Therefore labour supply increases from S1 to S2, as shown, this benefits employers who have a greater hiring pool, increasing competition, yet means wages decrease w1, to w2, which decreases cost of production, this benefits workers previously unemployed. however, this greatly depends on whether skilled or unskilled relocating geographically

As a knock-on macro effect, were geographical mobility of labour to increase, employment would follow suite. If this increase in newly-bought homes is concentrated in “England’s southeast, a buyers market now”, as per the extract.

Yet, the problem of NIMBYISM and government failure due to rent-seeking politicians fails to bring this into practice falling house price, homeowners are more likely to take out equity withdrawals or remortgage? as they know their assets are worth less? may increase MPS, to increase their MPC, as their relationship between MPC and MPS is anti-cyclical? such that, AD will shift inwards, this can be reflected from the inwards AD shift.. however, to counter evaluate the magnitude of effects is highly dependent on the fall ranging closer to 10% or 20%, double is more drastic in these sense, negative gap is much wider, and RO falls more drastically from

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Y1 to y2? moreover, the extract points to the greatest impact taken place on “englands southeast” this suggests effects will not be experienced nationwide. However, XYZ% percent of the UK’s consumtpoin is int he south east, with 40%?? alone stemming from London, which suggests scale-wise the entire uk will be affected, research how many homes are bought in the south-east compared to the rest of the country

Conclusion, 2008

2008 vindicates the possibility of demand-pull disinflatoin as per Figure 4, when home prices fell by 17.5%kkj