UK Political Cycle and the Effect on National House Prices: An Exploratory Study

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ABSTRACT

Over the last two decades, many developed countries have experienced notable changes in house prices. This exploratory study considers if house price movements in the UK can be linked to the political cycle as governments realise homeowners represent a large portion of the voter base and their voting decisions could be influenced by the magnitude and direction of house price changes. Specifically, the paper investigates whether house prices behave differently before and after elections and under different political regimes. To examine this relationship, the study analyzed quarterly UK national house price data since 1960, along with data on the results of UK parliamentary elections during the same period. Over this period, real UK house prices increased by an average of 2.84% per annum. While there is no evidence that house prices in the UK behave significantly differently under different political parties, it is evident that house prices perform much better in the last year before an election, compared to the first year after an election. Over the time period defined for this study, house prices increased by 5.3% per annum on the average in the last year before an election compared to 1.3% per annum in the first year following an election. As this research clearly identifies major variations in house price performance around election times, residential property investment decisions should take into consideration the political cycle.

Key words: *Housing market, Residential house prices, Property cycles, Political Studies, United Kingdom*

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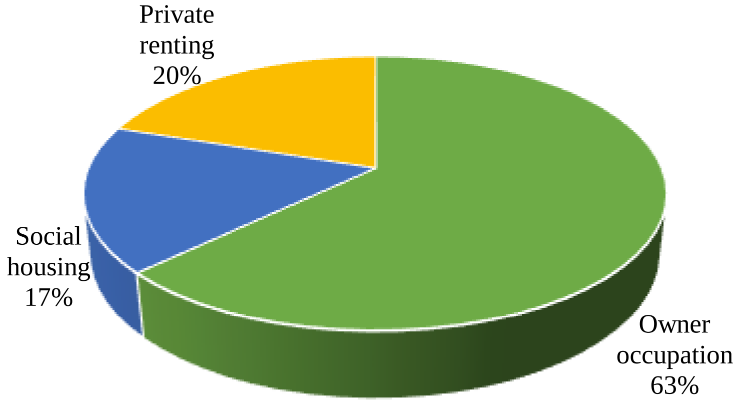
1. INTRODUCTION

Housing is a unique and valuable asset class. It is a key component of social wellbeing in providing shelter and as a source of economic activity through new residential housing supply and on-going housing alternations and maintenance requirements. Importantly, for most individuals and families in the UK, housing represents their main investment. Therefore, a vibrant and sound housing market is an important component of the UK's prosperity and, as such, controlling the various aspects of housing is clearly a core long-term government mandate.

House price movements create a lot of interest and media coverage in the UK, in part, this is due to the residential ownership profile, see Figure 1.

Figure 1: **UK Home Ownership Profile**



Source: Department for Communities and Local Government, 2016

Figure 1 shows the extent of private home ownership across the UK. There are approximately 28 million residential properties of which 63% are owner-occupied, with the owners either owning outright or paying off a mortgage on the property (ONS, 2016).

Although neo-classical economic theory suggests that house prices are determined by supply and demand forces, the housing market also operates within a dynamic open system, indicating that factors external to the housing system can impact on house prices. As housing is important to social wellbeing, governments often feel the need to regulate the housing market and since homeowners represent a large percentage of the voter base, housing-related policies implemented close to an election may influence their voting behaviour.

A growing body of literature finds evidence to the effect that governments sometimes attempt to manage the economy in line with their own political motives by the use of both fiscal and monetary policy (see for example: Brender and Drazen 2005, Heckelman and Wood 2005). As monetary and fiscal policies are of fundamental importance to the housing and housing finance markets, the impact and consequences of politically-motivated decisions on the housing market can be considerable yet because of the complexities of housing systems, not all eventualities are predictable or taken into account.

In acknowledging government's responsibilities for housing, the type and timing of policies across various levels of government can have far-reaching effects on house prices. In detailing government housing policies, policy timing and implementation can be used to manage and stimulate the housing market. The impact of these policies on house prices could be gradual or immediate. If a link between house prices and the political cycle can be established, future research on house price dynamics and property cycles may be enriched by incorporating political variables.

The purpose of this research, therefore, is to study the behaviour of house prices in relation to the UK political environment. This is achieved by examining real house price performance over time for the UK residential housing market. For this research, UK house price data from 1960 to date was used. In grouping house price movement before and after elections, the impact of the political cycle can be compared to long-term average real residential property returns.

It should be noted that this research is not intended to endorse particular political parties, but rather to illustrate an approach for evaluating the impact of the political cycles on house prices. Similarly, it is outside the scope of this research to examine specific political factors which have impacted house prices.

Following this introduction, Section Two provides a literature review on the housing market and political cycles. Section Three details the selected national residential property market data with national political elections and the research methodology. Section Four provides the empirical findings and the implications thereof. The last section provides the concluding comments and recommendations.

2. LITERATURE REVIEW

A vast amount of literature exists attempting to model national and regional house price movements. Single country time series, as well as multi-country studies, abound explaining house price movements. Among the leading research looking at the UK housing market are the works of Meen (2001), Muellbauer & Murphy (1997), Taltavull de la Paz & White (2012), White (2015), and Whitehead & Williams (2011). The basic neoclassical theory of house price determination is that house prices are set by the interaction supply and demand functions and a process of price adjustment which bring demand and supply into balance (Muellbauer 2012). House price movements are therefore linked to a host of supply and demand side variables.

According to Tsatsaronis and Zhu (2004), factors that influence demand for housing in the long run include:

- Growth in household disposable income
- Demographic changes

- Changes in aspects of tax system that might encourage home ownership over other forms of wealth accumulation
- Long-term interest rates
- Inflation
- Availability and cost of land
- Construction costs
- Investments in the improvement of existing housing stock.

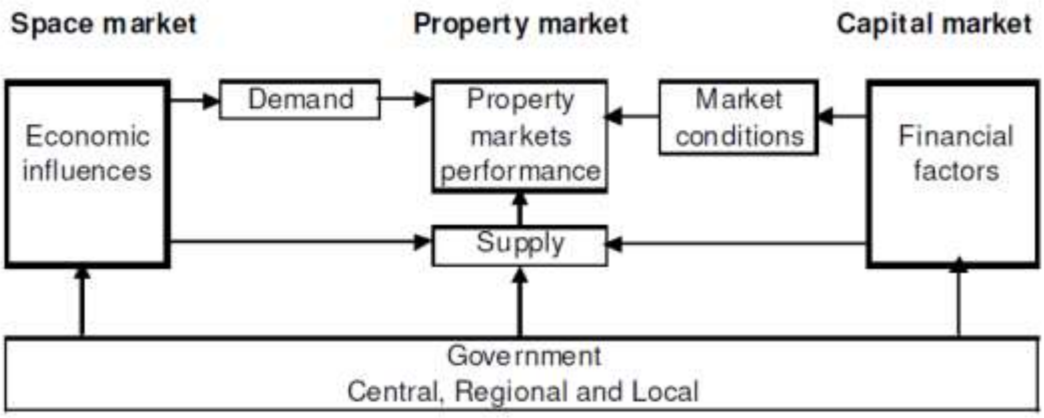
On the other hand, in the short term, factors such as the length of planning restrictions and construction phases and inertia in existing planning systems may constrain growth in housing stock, thereby affecting house prices. Throughout the literature on house price determination, it is widely acknowledged that imperfection and inefficiency exist in the residential housing market and as such systemic mispricing can persist (Muellbauer, 2012).

Economic theory, however, has evolved with major milestones providing new ways of thinking about the nature and theory of managing economic markets. Work by Marx (1867), Keynes (1936) and Friedman (1962) have introduced new concepts that have shaped economic strategies. Importantly, Keynes (1936) acknowledged the role of government to use all powers at their disposal to influence aggregated demand.

Importantly, governments have available fiscal measures including changes in tax rate and spending, alongside monetary measures associated with the management and supply of money. Neo-classical economic analysis of the housing market links the housing market to the macroeconomy mainly via changes in interest rates and availability of credit to households. However, as monetary and fiscal policies are of fundamental significance to housing and housing finance market, the impact and consequences of politically-motivated decisions on the housing market can be considerable (King, 2009).

As Higgins and Reddy (2011) illustrated, the extent to which government policies do impact on the housing market can be examined by considering the structure of the property market, using the basic three-market model of the property market proposed by Ling & Archer, (2007). This simplified model is shown in Figure 2.

Figure 2 **A Model of the Property Market Structure**



Adapted from Ling & Archer (2007)

Figure 2 indicates that the performance of the real estate market is influenced by a host of forces impacting on the space, capital and the property market. Within this framework, it can easily be appreciated that several policy-influenced decisions may impact on house prices. Among the key government policies that may influence UK house prices are presented below:

Space market (Demand/occupier)

- Population policies (quotas on migration)
- First time home buyers, incentives
- Opportunities for overseas owners to purchase residential properties

i) Capital market (Finance)

- Monetary policies (money supply, government bonds)
- Changes in property taxes (transaction tax - stamp duty)
- Regulations that impact on alternative asset classes
- Changes in pension/superannuation policies (in an indirect way)

ii) Property market (Property market conditions and supply)

- Release/rezoning of new residential land
- Changes in planning policies (housing density)
- Building regulations (sustainability agenda)

Source: Higgins and Reddy, 2010

In providing the tools to manage the economy, government actions may be politically motivated to assist in the election of governments. Nordhuas (1975) presented the "*Political Business Cycle*" theory suggesting government policies can manipulate the economy for electoral gain. These have been identified in three key areas:

i) Macroeconomic outcomes: economic growth, lower inflation and lower unemployment etc.
ii) Beneficial rewards: voter tax breaks etc.
iii) Monetary policy: money supply and interest rates (in some countries interest rates are set independently by an appointed organisation, for example, Bank of England).

Source: Ladewig (2008)

In detailing government strategies that can affect the political business cycle, there is criticism that the literature is often theoretically and empirically weak surrounding these key areas (Drazen 2000, Keech 1995 and Suzuki 1991). Contrary to the debatable links to the economy, research, particularly in the US, has coupled the political business cycle to investment asset classes. The relationship to equity and bond markets is centred on the performance of the asset classes, with reference to the political parties that were in power. Available studies provide conflicting evidence as to which political party provided overall better returns (Ramchander *et al* 2009, Santa Clara and Valkanov 2003).

Berry and Dalton (2004) likewise commented on the security of a "*bricks-and-mortar*" investment being supported in the past and continued to be influenced by Australian government housing and social policies. The persistence of government policy interventions can change housing market outcomes with a range of effects, some being unintended and some contradictory.

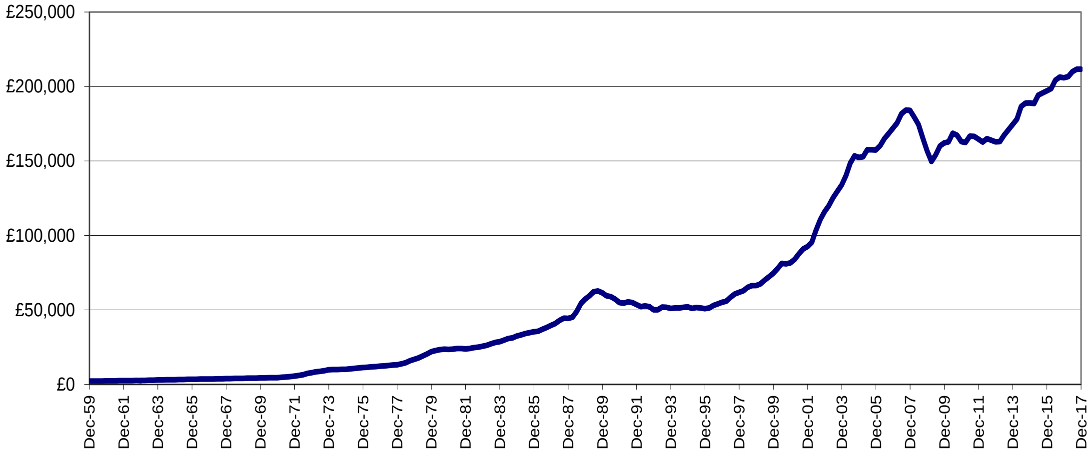
In summary, many house price drivers have links to government macroeconomic policies, which are made within a political framework. Consequently, in this environment, housing outcomes, although difficult to validate, can be an important election vote winner as homeowners represent a large voter base.

3. METHODOLOGY

3.1. Data

Across the UK, determinants of the residential property markets can vary with local influences. Although, historically, there is a limited divergence of long-term regional performance from that of the overall UK housing market performance. Figure 3 illustrates long-term UK nominal house price movement since 1960.

Figure 3 **UK Nominal House Prices: 1960-2017**



Source: Nationwide 2017

Figure 3 illustrates the movement in nominal UK house prices. The quarterly house price movement represents 2.03% (annualised 8.63%). The level of movement varies over time with substantial growth occurring from the mid-1990s till the onset of the GFC of 2007/08, leading to a correction which lasted close to two years but rapid appreciation kicked in again with house prices exceeding pre-crisis levels by the last quarter of 2014.

In detailing UK house price movement, annualised UK inflation ranged -1.6% to 26.6% over this time period (ONS, 2017). The changes in inflation would impact on a comparison of different time periods. Therefore the research examined real house price movement with inflation removed. This approach best reflects the movement in house prices separate from external factors.

The democratic political system in the UK has been in operation since 1707 with the union of England and Scotland. Key political decisions are made at a national level under the UK parliamentary democracy system with House of Commons and House of Lords. The central government elections are held on a five-yearly basis with non-compulsory voting for those over 18 years of age.

Since 1918, the UK political system has been dominated by two partie; Conservatives (Republicans) and Labour (Democrats). Table 1 shows the national governments and the election dates since 1960. To coincide with the quarterly property data, the election dates are shown after the election on a quarterly basis.

Table 1 **UK Government and Election Details**

Prime Minister	Party in government	Election Date	Assumed Office	Retired from Office	Period of service (Quarters)
Harold Macmillan	Conservative	08-Oct-59	Dec-59	Dec-64	20
Harold Wilson	Labour	15-Oct-64	Dec-64	Jun-70	30
	Election	31-Mar-66	Mar-66		
Edward Heath	Conservative	18-Jun-70	Jun-70	Mar-74	15
Harold Wilson	Labour	28-Feb-74	Mar-74	Jun-79	21
	Election	10-Oct-74	Dec-74		
Margaret Thatcher	Conservative	03-May-79	Jun-79	Jun-97	76
	Election	09-Jun-83	Jun-83		
John Major	Election	11-Jun-87	Jun-87		
	Election	09-Apr-92	Jun-92		
Tony Blair	Labour	01-May-97	Jun-97	Jun-10	52
	Election	07-Jun-01	Jun-01		
Gordon Brown	Election	05-May-05	Jun-05		
David Cameron	Conservative	06-May-10*	Jun-10	Sept-16	27
	Election	07-May-15	Jun-15		
Theresa May	Election	08-Jun-17#	Jun-17		
* Coalition government # Minority government					

Source: House of Commons Library: UK Election Statistics: 1918-2017

Table 1 details the elected UK Prime Ministers for the past 58 years. There have been 16 UK general elections since 1959 leading to six changes of government. On eight occasions the Conservatives won the most seats while Labour won the most seats on seven occasions. In 2010, the Conservatives won the most seats and entered government in coalition with the Liberal Democrats. The shortest period of government was the Edward Heath, Conservative-led government (47 months), compared to Margaret Thatcher - John Major lead governments of over 15 years, having been re-elected three consecutive times.

3.2. Methodology

To examine the relationship between the political cycle and house price movements, the data was initially examined using descriptive statistics over each decade beginning from 1960. In addition, the performance of house prices during each elected national political party was examined over the defined time period.

In analysing the performance of the political parties, the political cycle can be examined using the performance of the UK house prices one year before and one-year post-election. An important consideration while interpreting the results is that the data only accounts for governments that have served more than an 18-month post-election period.

In testing the robustness of the results, the analysis compared different performance periods over the dataset. Statistical significance (t-test) provided inconclusive evidence that the means of the two groups were statistically different. It is possible that any house price movement and the political cycle relationship are simply due to co-movements with external factors, for example, global financial crisis and natural disasters.

4. RESULTS

The first step was to review the descriptive statistics for the UK residential property market over a 10-year interval. This is shown in Table 2.

Table 2 **Changes UK Real House Prices Descriptive Statistics: 1960-2017**

	1960's	1970's	1980's	1990's	2000's	2010-17	Total
Mean	3.34%	4.35%	3.77%	-1.36%	5.40%	1.31%	2.84%
Median	2.52%	1.44%	5.31%	-0.46%	8.28%	1.79%	2.51%
Standard Deviation	4.43%	15.77%	10.70%	9.88%	11.79%	6.48%	10.70%
Range	18.26%	78.90%	59.79%	36.04%	59.94%	32.10%	78.90%
Minimum	-4.23%	-27.99%	-17.42%	-22.33%	-26.42%	-15.14%	-27.99%
Maximum	14.03%	50.91%	42.36%	13.71%	33.52%	16.96%	50.91%

Table 2 shows that over the last five decades, the average annual percentage change in real UK house prices ranged from 18.26% in the 1960's to 59.94% in the 2000's. The 2000's provided strong returns (5.40%), being 90% above the long-term trend (2.84%). The volatility in house price movement, especially from the 1970s to the last decade, was very close to the long-term average of 10.70%.

Besides examining the mean and the variation from the mean (standard deviation), the shape of the data can provide valuable information. The skewness shows the symmetry of the data around the mean (low figure preferred) and the kurtosis illustrates the "peakedness" of the data. A high kurtosis reading (above zero) means the data is grouped close to the mean. In each decade, the low skewness and low kurtosis readings demonstrate a flat bell curve as illustrated by high standard deviation readings above 8% (except for the 1960's and 2010's which had relatively stable house price growth), with a narrow data range of 18.26% and 32.10% respectively. This shows that the movement in residential property market can be substantial and unrelated to movement in inflation.

Next, the study examined whether the performance of house prices vary under different political regimes. The descriptive statistics for UK house price performance under different political parties is shown in Table 3.

Table 3 **Changes in UK House Prices under Different Political Parties**

	Labour	Conservative	Overall
Mean	2.89%	2.80%	2.84%
Median	3.56%	2.09%	2.51%
Standard Deviation	10.82%	10.65%	10.70%
Range	60.0%	70.0%	74.0%
Minimum	-23.1%	-19.1%	-23.1%
Maximum	36.9%	50.9%	50.9%
Count	86	112	198

Table 3 details a relatively narrow annual house price range, 2.80% to 2.89%, between the political parties. This represents a relatively small difference of ± 2% from the overall average of 2.84%. The standard deviation difference would suggest that Labour governments have slightly more volatile returns than that of the Conservative governments. Across the political parties, similarities appear to be evident with low skewness and low kurtosis readings.

A t-test was used to examine if the performance of house prices varied significantly under different political regimes. The results are displayed in Table 4.

Table 4 **T-Test for Equality of Means**

	Mean Difference	Std. Error Difference	T test	df	Sig. (2-tailed)
Equal variances assumed	.090	1.538	.059	196.000	.953
Equal variances not assumed	.090	1.541	.058	181.563	.953

As evidenced from the results shown in Table 4, the t-test shows that there is no statistically significant difference (t-values significantly less than 2), at 95% confidence level, in UK house price performance either under the Labour Party or Conservative Party lead House of Commons. The minor difference between the two parties may be attributable to sampling variation, given that the labour party has been in power for 86 quarters compared to 112 quarters of the Conservative government during the period observed in this study.

Table 5 compares the UK house price performance during the first and last years of government by the Labour Party and the Conservative Party. In other words, we examine the behaviour of the of house prices just before and immediately after elections to see if the elections have any impacts on house prices.

Table 5 **Governments First Year and Last Year Election Performance**

	Conservative Government		Labour Government		Combined Conservative. & Labour	
	First Year	Last Year	First Year	Last Year	First Year	Last Year
Mean	1.06%	4.43%	1.73%	6.70%	1.32%	5.25%
Median	0.98%	4.95%	4.57%	5.22%	2.28%	4.87%
S.D	4.13%	3.61%	5.51%	4.61%	4.66%	3.99%
Range	37.48%	35.89%	47.13%	45.17%	50.80%	55.03%
Minimum	-14.47%	-13.00%	-23.13%	-6.26%	-23.13%	-13.00%
Maximum	19.03%	19.46%	15.96%	36.86%	19.03%	36.86%

Table 5 illustrates nominal differences in UK house price performance during the first year of Labour and Conservative governments. The average annual percentage change in UK house price during the first term of Labour governments was 1.73%, slightly above the 1.06% recorded by the Conservative governments. A t-test shows that this difference is not statistically significant at 95% confidence level. In their last years in power, labour governments recorded average annualised growth rate of 6.70% compared to 4.33% under the Conservative government. This difference, once again, is not statistically significant at 95% confidence level. The difference in performance at Central government level may be related to expenditure policies as Anderson *et al* (2008) argued that left-of-centre governments are more concerned with controlling unemployment than right-of-centre governments.

Nonetheless, Table 5 reveals a more striking observation; It is perceived (in the last two columns) that UK house prices perform much better in the year before an election (irrespective of the party in power), compared to the first year after an election. Average year-on-year house prices increased by 5.25% in the last years before an election compared to 1.32% in the first years following an election. This implies average house price performance in the years before an election is about 85% above the long term average (2.84%) and about four times the performance in the first year after an election. On the contrary, average house price performance one year after an election is about 53% below the long term average.

In analysing the results, there appears to be a strong case that political parties see house prices as a key consideration prior to elections. This finding could also suggest that elections in the UK are usually held during periods of booms in the housing market (and perhaps the economy as a whole). This may be so since Prime Ministers are at liberty to call for elections at any time and would mostly do so only if they deem there to be a high chance of victory for their party. A strong housing market could be connected with a flourishing economy and serve as an indicator that the party in power may win the election.

While it may be the case that house prices fare well in periods of general economic boom, it is also plausible that given the disproportionate fraction of homeowners in the UK, political parties would use strong house price growth as a tool to secure more votes during elections. In such cases, pre-emptive policies by governments to support or stabilise house prices in the short-term could, at a later stage, inflate house prices. The long term effect on economic growth could be acutely suppressed by affordability issues across the residential property markets.

5. CONCLUSION

This study represents a preliminary systematic empirical examination of the influence of political cycle on UK house prices. By examining the long-term performance of real house prices in the UK, the study examined how house prices react to central government elections. Over the last five decades, real UK house prices increased by an annualised return of 2.84%. There appears to be limited variance in UK house price movement between the elected Labour and Conservative governments. However, the most striking finding of the analysis is that there is significant variation in house price movements one year before, compared to one year after the House of Commons elections. UK house price performance is significantly better in the year before an election compared to one-year post-election. In quantitative terms, this represents a ratio of about 1:4. This finding holds irrespective of the political party in power.

In recognising policymakers' active role in the management of house prices for political gain, the short-term benefits of appealing to a large number of voters may conceal underlying long-term flaws in the residential property market. Leaving these issues unaddressed could be more complex than often perceived.

These findings identify an array of potential areas of further study. By placing political cycles as part of the residential property research agenda, those that are linked to the residential property markets should include the election timings as part of the decision making process. Further research in this area will shed more light on the connections between house prices and the political cycles. This can include the performance of the housing market under regime changes compared to elections that keep the status quo which do not result in regime change. Political studies research may also benefit from improved models predicting electoral victories if housing market performance variables were considered.

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