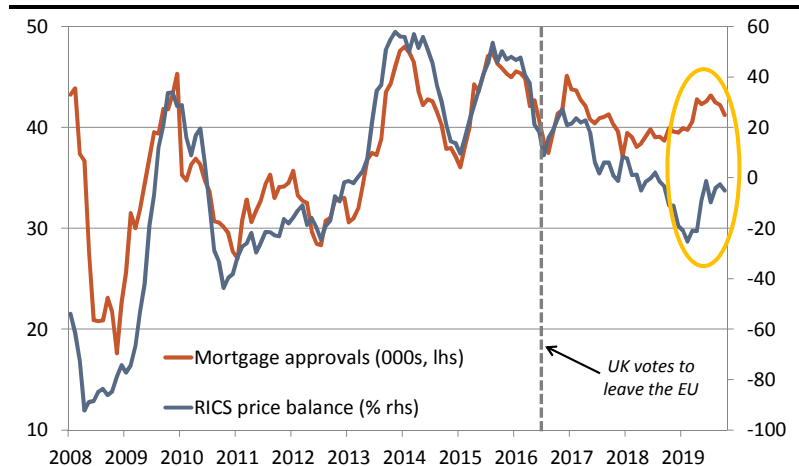


26 November 2019

UK housing: positive outlook, but watch the risks

Mind the gap: house prices versus mortgage approvals



Source: UK Finance, RICS. Mortgage approvals: high-street banks' number of approvals for house purchases (three-month moving average). RICS survey: change in prices over last three months (0 balance = no change)

- Loosing pressure:** UK house price growth last peaked at 5.4% yoy in Q3 2016 (Nationwide data). Since then, national house price inflation has steadily declined. Prices increased by just 0.3% yoy in Q3 2017. Initially, the weakness was concentrated in London and its neighbouring markets, where prices started to fall in mid-2017, while price growth in most regional markets remained steady, in the range of c2-5% yoy. More recently, however, the weakness has spread to some regional markets, including Yorkshire, the Midlands and the south-west of England, as well as Scotland.
- Mind the gap:** In the UK's supply-constrained markets, changes in demand tend to drive trends in house prices (see the chart). However, a gap has emerged since the Brexit vote in June 2016. After rising sharply in late 2016, – up by c20% between August and December – mortgage approvals declined throughout the whole of 2017, correcting nearly all of the late-2016 gains. The RICS survey shows that, while house prices broadly tracked these shifts in demand through 2017, house prices have continued to falter during the past two years – even as activity ticked up a little. But a further dip in October – approvals down by 4.5% from the July high – suggests the market is cooling again.
- Restrained demand:** The housing market has shown increasing signs of stress since the Brexit vote. This is no big surprise. Uncertainty weighs on demand and limits housebuilders' pricing power. Support from low interest rates, and policies like Help to Buy that subsidise deposits for mortgages, only modestly offset the weakness in underlying fundamentals. London suffers the double whammy of Brexit and the government's decision in 2015 to increase stamp duty on second homes. While this has weighed heavily on foreign demand, the modest correction in London has benefited locals in a market where the average price is c60% higher than the national average anyway.
- Positive supply-side trends:** Despite the softening prices and mixed demand-side fundamentals, recent trends in supply remain mostly healthy. The latest data show that c45.2k houses were completed in England in Q2 2019, 11% higher than a year before and the second-highest number on record since the government started to publish such data in 1990. The highest on record is c48.4k in Q1 2007. Of course, if demand remains subdued, supply growth will weaken eventually too if prices dip further. Data for housing starts suggest that this could have already started. The government reported c37.2k housing starts in England in the second quarter. While that remains well above the 34.3k average since 2010, it is 15.9% lower than the Q3 2018 peak. It could be a sign of what is around the corner if the political risks go badly wrong. A lot depends on the 12 December general election.
- Outlook:** [As our base case](#), we expect Boris Johnson and his Conservative Party to win a majority of seats in the general election. Supported by still cheap financing costs, improving economic fundamentals should lift housing demand over the medium term. With more pricing power, housebuilders will likely react by building more houses. This will add to economic activity and real GDP growth. But keep an eye on the risks. In the event of a hung parliament and uncertainty about who will govern the UK – watch out for far-left Labour leader Jeremy Corbyn – and the future of Brexit, the housing market could soften further. With more than two-thirds of household liabilities tied up in mortgages, a drop in house prices could seriously dent household consumption via negative wealth effects.

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