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UK HOUSING MARKET RESILIENT IN JULY

Berenberg Macro Flash

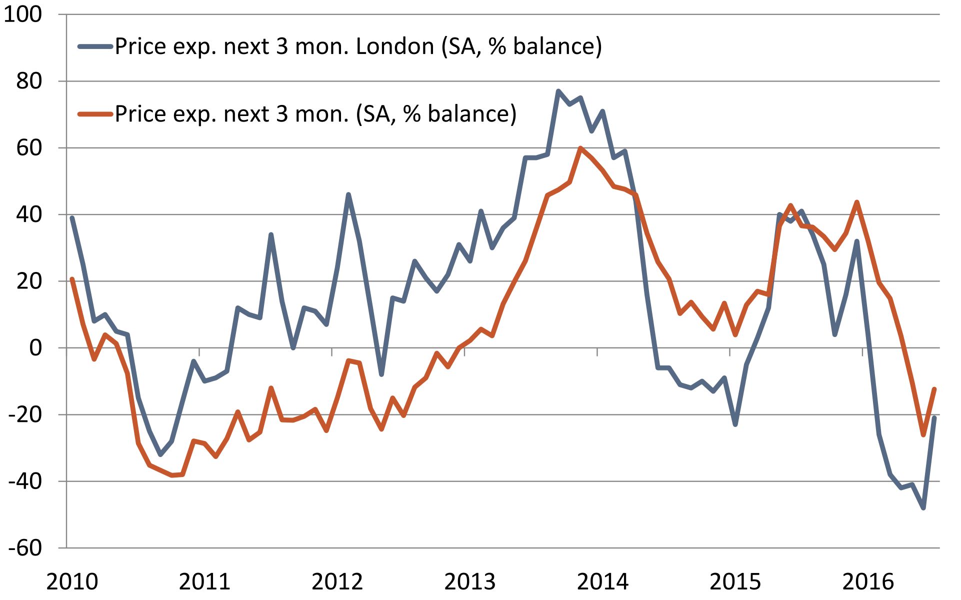
Loans for house purchase resilient in July. According to the British Bankers' Association, the number of loans for house purchase dropped only slightly to 37,662 in July, from 39,763 in June. While the number of loans for house purchase has fallen in recent months after peaking at 46,386 in January, they remain far above the lows of the financial crisis (17,087 in Nov 2008) and the euro crisis (27,752 in Dec 2010). The fall in loans for house purchase is in part due to the heightened uncertainty and lower confidence since the Brexit-vote. The higher rate of stamp duty on second homes since April is also a significant factor. Separate data for July from HM Revenue and Customs (HMRC) showed that residential property transactions remained stable after the vote. There were 94,550 transactions in July according to HMRC compared to 95,430 in June - up from the April low of 80,090 when stamp duty changes came into effect.

So far, so good – market soft but no crash. With just one month's data, it is too early to call the outlook for the UK housing market with any real confidence. However, early data is relatively upbeat. Data for July points to a softer, but resilient, housing market in the coming months. Some data have improved. As chart 1 shows, price expectations for the next three months recovered in July after falling since the beginning of the year. Regional level data points to more stress in the London market. This is to be expected as London prices have risen much faster than the rest of the country since financial crisis. House prices in London have almost doubled since 2009 whereas prices the in UK excluding London and the south east have increased by just 25%. Weaker foreign demand due to Brexit uncertainty and more extended domestic buyers (London price/earning ratio of 10.3 in Q1 2016) makes London more vulnerable to weaker demand than the rest of the country.

Watch out for the consumption risk: Historically, house prices and household consumption have tracked closely at ratio of around 4 to 1 - a 10% rise in house prices yoy would normally go along with 2.5% growth in consumption, as chart 2 shows. Consumption makes up almost two-thirds of UK GDP. Because UK households hold the majority of their wealth in the housing market, declining prices negatively affect consumption and GDP. When consumers feel less wealthy, they spend less and save more. But there is an additional risk. Although household balance sheets have improved since 2009, the average house price/income ratio in the UK has risen to 6.2 from 4.5. Even modest declines in house prices that might not generate large wealth effects could still negatively impact the regular spending habits of homeowners who are highly leveraged. A nation-wide decline in house prices is our key risk over the coming months. Early signs indicate that this risk is not materialising.

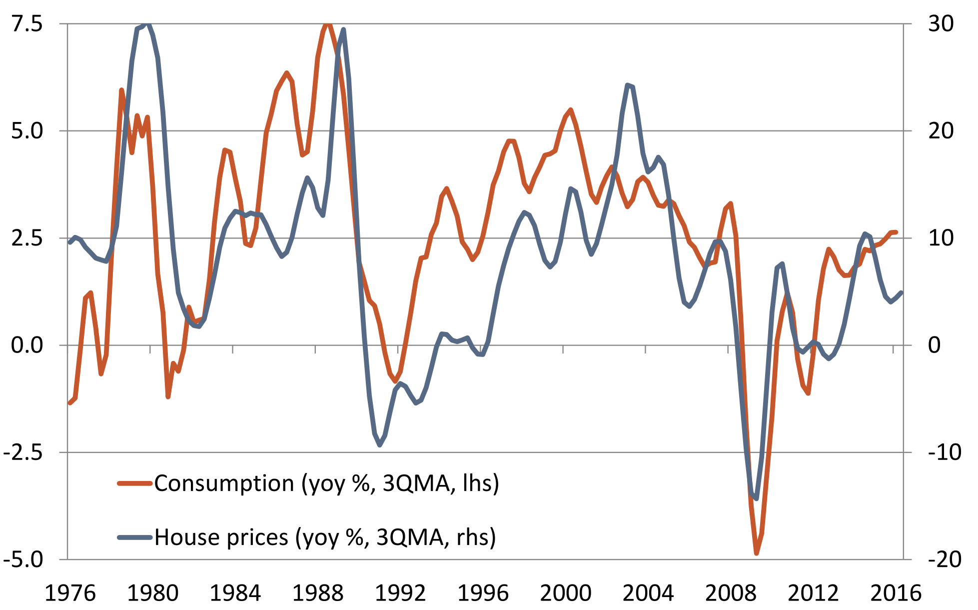
Supply/demand imbalance limits the risk: Even if house prices were to begin to fall sharply, history shows that supply/demand fundamentals would probably limit the duration and scale of the declines. While the short-term issue might be a lack of demand, the long-term issue in the UK housing market is asymmetric elasticity of supply. As chart 3 shows, a slowdown or modest decline in house prices is linked to a sharp cut in housing starts. Housing starts however, only begin to increase when house prices begin to rise rapidly. This supply asymmetry, combined with existing demand-side policies such as Help to Buy and Help to Buy London, plus low interest rates, would likely prevent a sharp or extended drop in house prices. Even if house price rises slowed or started to fall, the deterioration probably would not last for long. House builders would anticipate weaker demand and reduce supply. This would help to preserve the wedge of excess demand to ensure prices resumed their upward trend after only a few months/quarters.

Chart 1: RICS price expectations next 3 months: UK versus London



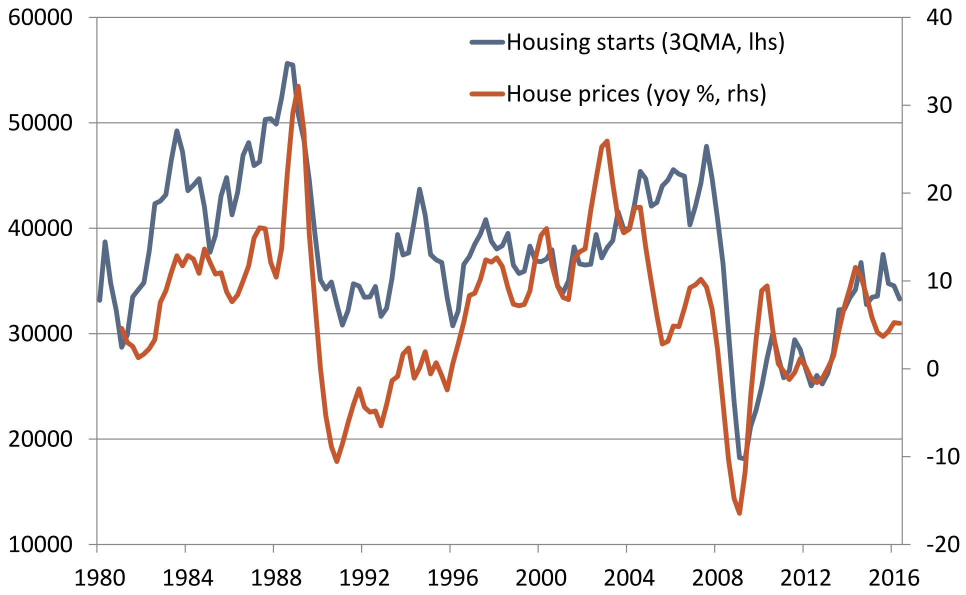
Monthly data. Source: RICS

Chart 2: Consumption versus house prices



Quarterly data. Source: ONS, Nationwide

Chart 3: Housing starts versus house prices



Quarterly data. Source: DCLG, Nationwide, Berenberg calculations. Note: Starts cover England only.

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