

RESIDENTIAL MARKET
UPDATE.

Knight Frank



NOVEMBER 2010

DEMAND AND SUPPLY DIVERGE.



"Although considerable attention is paid to house prices, it is the volume of activity taking place that provides real insight into the underlying health of the residential market. While supply is increasing, mortgage lending is declining. Tighter funding conditions are contributing to a sharper-than-expected seasonal fall in demand. In light of recent trends our view is that UK house prices will decline by 6% on average in 2011, with considerable variations between the healthier London and southern England markets and the less resilient northern and Midlands regions."

Liam Bailey, Head of Residential Research, Knight Frank

"The imbalance between supply and demand meant the average number of unsold properties on surveyors' books rose, resulting in their largest unsold inventory since April 2009."

Market conditions

October saw the housing market weaken further with negative trends reported across almost all key indicators. The volume of unsold homes grew whilst mortgage lending contracted for the fifth consecutive month, and the majority of house price indices recorded falling prices. Only the Halifax index reported a month-on-month rise (of 1.8%), but this appears to relate to a readjustment following September's large decline of 3.7%, rather than a real improvement.

The RICS housing market survey for September confirmed that a growing number of surveyors are reporting increases in new sales instructions. There is rising evidence that suggests recent house price falls are failing to deter vendors from entering the market. But buyer enquiries in September fell for the fourth consecutive month. This imbalance between supply and demand led to an increase in the average number of unsold properties on surveyors' books, resulting in their largest unsold inventory since April 2009.

Growing pessimism

There is growing pessimism among surveyors in relation to the outlook for the market. The majority of surveyors expect house prices to be lower at the end of 2010 than they are now, but the wider view seems

to be that the volume of sales will be largely resilient, perhaps because buyers currently see little hope of an upturn in the short to medium-term. The Land Registry and HMRC both reported a rise in sales volumes in July (the latest available data), recording a 15% and 17% rise respectively in the first half of 2010.

The usually strong link between newly-agreed sales and mortgage approvals seems to have faltered in recent months. The unseasonably high number of newly-agreed sales during the summer months has yet to filter into mortgage approvals, which are still running at 50% of their peak in 2006.

London's relative resilience

The prime central London market is mirroring national trends with supply expanding and demand weakening, resulting in a marginal price fall of 0.2% in October. However, there is some indication of prices holding up in locations where international demand is strongest, in particular in Kensington and Chelsea, where prices began to rise again in October after small declines in the previous three months.

While bonuses are expected to be more varied this year compared to last year, there is very early evidence of bonus buyers entering the market to view available stock. We expect that bonus buyers will not rush into the market in November and December, and we will instead see a delayed

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process as these buyers wait to gauge the market's short-term direction, which could lead to it strengthening in January and February.

Economic outlook

GDP increased by 0.8% in the third quarter, wrong-footing many of the UK's economists. The growth, fuelled principally by the service sector and construction output, provided a welcome boost for the government following the publication of its comprehensive spending review (CSR) less than a week earlier. Despite the unexpected GDP results, key activity indices are pointing to a sharp slowdown in the economy in the final quarter of this year.

The UK's labour market data presents a mixed picture which can arguably be explained by the time-lag in data publication. According to the Office for National Statistics (ONS), employment grew by 178,000 in the three months to August, but more recent data, in the form of the claimant count measure, shows a slight increase of 0.4%. The CSR announced that a further 500,000 public sector jobs would be lost over the next four years, a factor which has no doubt added to the weak level of consumer confidence.

Base rate left unchanged

The Bank of England's MPC opted, for the 20th consecutive month, to keep the base rate at 0.5% in November. This decision comes despite the fact that inflation continues to elude its target rate of 2%, with the headline CPI rate holding steady at 3.1% in September. Nevertheless, the consensus seems to be that inflation will fall away next year, increasing the possibility of a new injection of quantitative easing in 2011.

Housing market outlook

It seems likely that the UK's economic recovery will slow in the fourth quarter of 2010. This, combined with the beginning of the government's austerity programme and the ongoing mortgage drought, will act to pull prices down by around 6% in 2011.

Our view is that the weakest markets will be those in the north of the UK and in Wales – where prices could fall by up to 8% over the next 12 months. In London and the South East, stronger economic conditions should limit price falls to around 4% or 5%.

Overall our forecast for 2011 suggests that UK property prices at the end of next year will stand at similar levels to those last seen in mid 2009, before the recent bounce took effect.

Our housing market model suggests that house price growth, albeit modest, will resume in 2012, in line with wider economic improvements.

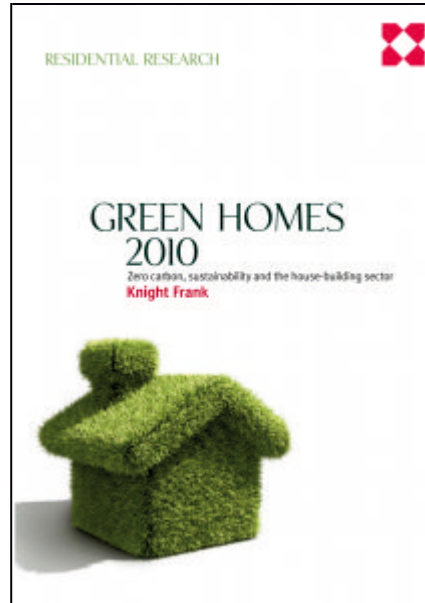
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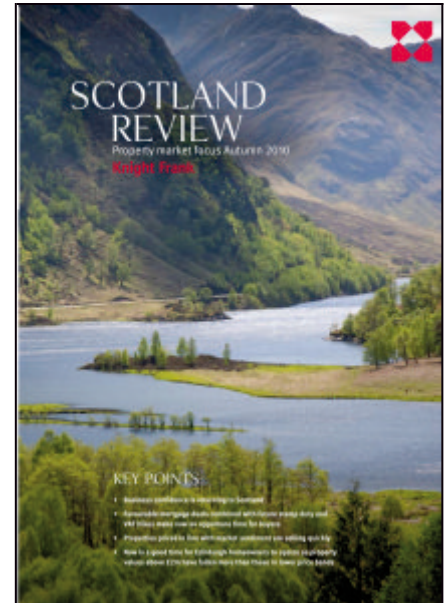
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Contacts



Liam Bailey
Head of residential research
liam.bailey@knightfrank.com
T +44 (0)20 7861 5133
M +44 (0)7919 303148



Andrew Shirley
Head of rural property research
andrew.shirley@knightfrank.com
T +44 (0)20 7861 5040
M +44 (0)7500 816217



James Kennard
Research consultancy
james.kennard@knightfrank.com
T +44 (0)20 7861 5134
M +44 (0)7500 065142

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