# **RESIDENTIAL RESEARCH**





# MIXED ECONOMIC MESSAGES

A more challenging domestic and global economic outlook means the immediate threat of interest rate rises has receded. However political uncertainty in the lead-up to next year's General Election is weighing on property price growth, not least in prime central London.

# UK economic and housing overview

The UK's economic resurgence seems clear when you examine the GDP data (figure 1), which shows consistent quarterly growth since the beginning of last year.

The forecast 3.1% annual growth expected this year will make the UK the best performing G7 nation in terms of output. However below the headline data is a more mixed picture.

Wage growth has been sluggish, so while the economy is finally emerging from the post-crisis recession, many workers are not feeling the full benefits.

Some would argue however, that it is precisely the wage squeeze which has allowed businesses to step up production while avoiding greater labour costs.

## **UK economy recovers**



#### Source: ONS

At the same time, the UK economy is facing additional challenges from overseas, not least the travails in the <u>Eurozone</u> and the withdrawal of quantitative easing in the US. Global economic growth has also slowed to a six-month low.

It is a combination of these factors which prompted the Bank of England to push

Mortgage rates dip 5-year swap rates



Source: Macrobond

back its expectations of when the first base rate rise will occur.

With a much more benign outlook for inflation, the markets are now pricing in a rise in October 2015, with the expectation that the base rate will still only be at 1% well into 2016.

As a result of the new outlook for interest rates, mortgage rates have receded again, which is good news for homebuyers and those re-mortgaging their home.

Swap rates, the money market rates which determine fixed-rate mortgage pricing, dipped sharply last month, as shown in the chart below.

However there are also factors weighing on the mortgage market – which are likely to feed through to slower activity, such as the new loan to income criteria from the <u>Bank</u>. <u>of England</u>, as well as the new rules for mortgage applications under the Mortgage Market Review started in April this year.

For more on the outlook for the UK housing market, read our latest <u>Residential</u> <u>Market Forecast</u>.

# Key facts November 2014

UK house prices rose by 0.5% in October, with the annual rate of growth slowing to 9%

Prime central London house prices remained static in October, the first month in four years in which no growth was recorded

Annual growth in prime central London prices slowed to 6.5%

Rents in the prime home counties market fell by 0.8% in Q3, but the annual rate of growth moved into positive territory at 0.1%



GRÁINNE GILMORE Head of UK Residential Research

# "A more benign outlook for inflation means markets are pricing in the first interest rate rise in the second half of next year"

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Source: Knight Frank Residential Research

## **Prime markets**

Price growth in the prime central London market continues to moderate amid growing political uncertainty in the run-up to next year's general election. Prices remained static in October, the first month in which values have not risen since October 2010. The annual rate of growth continued its slow downward trajectory to hit 6.5%.

The election is primarily causing unease because of the property tax measures which depend on the outcome. Both Labour and the Liberal Democrats have pledged some sort of tax on higher value properties, whether a 'mansion tax' or a re-banding of council tax. Ed Balls, the shadow chancellor, pledged that those in homes currently valued at £2 million to £3 million a year would not pay more than £250 a month, or £3,000 a year (after tax) as part of this additional tax levy, however his comments have only raised more questions about how much those in homes worth £3m+ will pay.

The disquiet about this potential property tax was evident in prime outer London locations too, with average prime prices in areas from Fulham to Hampstead falling by an average of 0.2% in Q3, slowing the annual rate of growth from 11.8% to 10.1%.

The current movement of prime central London prices are in line with forecasts we made last year. While our latest forecasts show no growth in prime central prices in 2015, there is a chance that without a mansion tax, there could be some rebound in prices in the second half of the 2015.

Prime country house prices rose by 4.7% year on year to the end of September, while values in Scotland rose by 1.4% over the same period. It is expected that there will be a surge of activity, especially at the top end of the market, before new stamp duty levies are introduced on April 1st next year. The chart below shows how the levy will change the tax payable by price band.

New 'stamp duty' rates for Scotland



Source: Knight Frank Residential Research

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House Price Sentiment

# **Rental market**

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Average UK rents rose 1.5% in the year to September, just under the 1.6% growth

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**UK Housing Market** Forecast Q4 2014

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Home Counties Lettings Index Q3 2014





Prime Central London Sales Index Oct 2014

seen in prime central London over the same time period. The most recent PCL rental data, however, shows that rental growth climbed to 2.6% in the year to October, the highest rate of growth since December 2011. Yields rose to 2.9%.

Yet the recovery in rents and yields in central London remains hesitant, with changeable levels of activity in the market. While the number of viewings and tenancies agreed in October higher than on the same month last year, the number of tenancies started was lower, signalling that it may be a slower path to full-on recovery in the prime rental market.

Corporate demand in the market has no doubt been affected by the difficulties in the Eurozone as well as closer to home. As mentioned earlier - the headline economic figures from the UK may be positive, but new data from E&Y shows that the number of profit warnings from quoted UK companies hit a six-year high between July and September this year.

In the prime home counties market, rents are up 2.4% since the start of the year, but this has only resulted in 0.1% year-on-year growth.



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