



UK economy stalls

As Bank of England pumps more money into the economy, the divergence in the UK housing market continues

Key figures

UK house prices fell 0.2% in January, but are up 0.6% year-on-year

Prime central London prices rose by 0.9% in January, annual growth is now at 11.9%

Knight Frank/Markit future house price sentiment index remained in negative territory in January, points to house price falls this year

End of stamp duty exemption for first-time buyers looms

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UK housing market and economic overview

House prices dipped by 0.2% in the first month of the year, meaning that prices are now just 0.6% higher than in January 2011, according to data from Nationwide.

Separate figures from Halifax paint a slightly different picture, showing a 0.6% rise in house prices in January. But the data also shows that house prices are down 1.6% year-on-year. While the details may differ, the overall impression is one of a stalled market, with prices losing little ground but making little progress.

The exception to the rule is prime central London, where prices hit new record highs in January, as examined later.

There are a number of policy changes coming up which could affect the market, for example the ending of the stamp duty exemption for first-time buyers next month could cause a surge of activity before the cut-off date on 24th March.

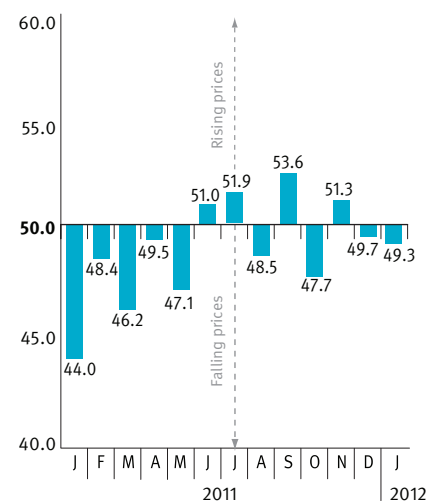
Meanwhile the Chancellor is preparing for the Budget next month. There has been much talk among the Liberal Democrats about a possible annual tax on properties worth more than £2 million, but there are questions about how such a scheme would be run. There are also issues around how to make sure any such rule would avoid penalising income-poor families who have seen the value of their family home rise above the threshold.

UK house prices are currently being supported by record low interest rates, which have cut interest repayments for many borrowers. Looking ahead, rates show little sign of rising this year. This was further emphasized this month as the Bank of England opted to pump an additional £50 billion into the economy via quantitative easing (QE).

There is good reason for more QE, as official data out late in January suggested that the economy shrank in the final quarter of 2011.

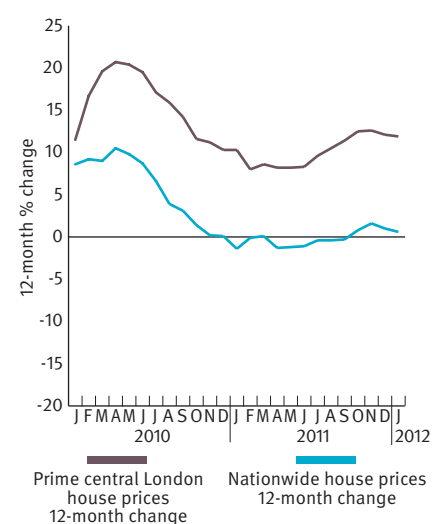
But there was some brighter news from the coal face of the economy in January. The Markit/CIPS

Figure 1
Future House Price Sentiment Index (HPSI)



Source: Knight Frank/Markit
NB: A score of 50 equates to no change, above or below representing growth or decline respectively.

Figure 2
12-month price change
London versus Nationwide average residential price change



Source: Knight Frank Residential Research



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“PRICES IN PRIME CENTRAL LONDON CLIMBED FOR THE 15TH CONSECUTIVE MONTH IN JANUARY, RISING BY 0.9%. PRICES ARE UP 11.9% YEAR-ON-YEAR.”

services purchasing managers' index (PMI), which measures activity in the UK's dominant services sector rose to a 10-month high in January, a better than expected result which could indicate that the contraction seen at the end of last year will not be repeated.

This positive indicator must be considered against more downbeat employment data, which showed that unemployment rose again in the three months to September to 2.62 million. In addition, data from the British Retail Consortium showed that high streets suffered in January – indicating that consumer spending is not going to power the country out of recession.

The direction of travel in the UK economy is also dependent on external factors, primarily the Eurozone crisis. Greek policymakers have reached a deal on austerity measures needed for a new international bailout, but some commentators note that it is a fragile one. As such, there are still worries lingering over the Eurozone region.

Economists and policymakers know that a definitive resolution is key as continued uncertainty is damaging, not just for the Eurozone but for the wider global economy.

Prime market performance

While the Eurozone crisis is casting a shadow over the UK economy, it has actually fuelled more growth in the prime central London (PCL) market. Italians became the biggest overseas purchasers of PCL property in January, accounting for 8% of all sales, displacing the

Russians who have held the position for several years. Anecdotal evidence suggests that this investment in luxury property in the UK reflects a desire to diversify holdings to include non-euro-denominated assets.

Constrained supply continues to underpin prices. The scale of this undersupply is reflected in a rise in the ratio of potential buyers to the number of properties available. The average ratio has been 3.7 over the last five years, but has risen to 4.1 over the last three months despite the gloomier economic environment.

Prices in PCL climbed for the 15th consecutive month in January, rising by 0.9%. Prices are up 11.9% year-on-year.

Prime English country house prices are down 3.1% year-on-year, while prices in Scotland are down 3.2%. But it was interesting that agents in Edinburgh noted a rise in interest from Russian buyers towards the end of last year.

Rental market

Average rents across the UK fell again in December, dropping by 0.8%, but are still up 4% year-on-year.

Rents in prime central London also continue to slip, falling by 0.2% in January, the fourth consecutive monthly decline. But rents are still higher than the previous market peak in 2008, and rental growth is expected to continue, albeit much more modestly, as demand continues to outstrip supply.

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