



HOUSING MARKET PROSPECTS Q3 2017

ECONOMIC ACTIVITY

UK GDP expanded 0.3% in Q2, up from 0.2% in the first quarter. The majority of growth came from the service sector, which rebounded to grow 0.5%, following a 0.1% expansion at the start of the year. Construction and manufacturing fell 0.9% and 0.5% respectively. The second quarter GDP estimate was just below the Bank of England's (BoE) expectations of 0.4% growth but was in line with the consensus view. In its latest forecasts, the BoE revealed a downgrade to UK growth. Economic growth of 1.5% is expected this year and 1% in 2018, down from 1.9% and 1.7%.

Although the Bank forecasts now factor in a large amount of uncertainty about the eventual shape of the UK's economic relationship with the European Union, the Bank assumes a smooth exit from the EU. The new forecasts predict a deterioration in the economic outlook as rising inflation outpaces wage growth, restricting consumer spending.

Inflation has risen rapidly since the EU referendum in June last year, when the Consumer Prices Index was 0.5%. The referendum triggered a sharp fall in the value of sterling that has driven the cost of imported goods up.

"Inflation has risen rapidly since the EU referendum in June last year"

However, recent figures show inflation fell unexpectedly in June for the first time in nine months to 2.6% from a four-year high of 2.9% in May and stagnated in July. The rate was largely expected to be unchanged. The fall was mainly driven by lower petrol and diesel prices, reflecting weaker global oil prices.

The fall in inflation casts doubt over a rate hike later this year. Even if inflation does recover, the decision to raise rates still hinges in part on the outlook for growth.

BoE governor Mark Carney has said that the Bank needs to see stronger investment and a recovery in wage growth before tightening policy. BNP Paribas expects no rate hike this year, one in 2018 and two rate hikes in 2019.

Looking ahead, the economy is expected do better in the second half of the year compared to the first. Combined with low interest rates and solid employment growth, this should help increase demand.

"The Bank needs to see stronger investment and a recovery in wage growth before tightening policy"

However, with inflation squeezing incomes and house prices already so high, a renewed pick-up in housing demand is unlikely both this year and the next.

0.3%

UK GDP expanded in Q2

2.6%

Inflation fell unexpectedly

1.7%

Economic growth forecast by BoE in 2017



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HOUSING MARKET ACTIVITY

Most market data now confirms the subdued tone of the UK housing market. Nationwide recorded house price growth of just 0.3% between June and July, while the RICS reports average prices to be flat. However, this masks wide variations geographically and reflects support provided by the lack of activity and availability of stock.

The number of housing transactions dipped to their lowest level for eight months in June, while the number of mortgages approved for house purchase moderated to a nine-month low of around 65,000 (Council of Mortgage Lenders). This subdued picture is perhaps to be expected given political and economic uncertainty, but the reality is more complex.

“The number of housing transactions dipped to their lowest level for eight months in June”

Structural and Cyclical Market Slowdown

In June, the Council of Mortgage Lenders (CML) published a report *‘Missing Movers: A Long-Term Decline in Housing Transactions?’* which investigates the reasons for the low level of housing transactions that have become a feature of the UK market since the financial crisis.

The research finds long-term economic and demographic issues are responsible for the dip in activity, with ageing and equity-rich households reducing activity at one end of the market while affordability has sapped activity amongst mortgaged households, the former being the bedrock of housing activity.

“Long-term economic and demographic issues are responsible for the dip in activity”

With little expectation of either improving real incomes, or a growth in equity to make potential moves worthwhile, the report concludes that in the absence of any radical changes to housing or indeed wider related policies “we should expect for the foreseeable future movement among mortgaged households to remain constrained.” It is notable therefore that more affordable regions of the country such as, the West Midland and the South West, benefiting from a solid economic base are currently showing more robust levels of activity (RICS).

Overall, however, we should become accustomed to the outcome of the monthly RICS Residential Market Survey. The forward indicator of activity in the July report records stock levels falling to a new low, with little expectation of improvement to come with new buyer enquires and new instructions sitting in negative territory.

“Greater caution amongst lenders towards higher loan-to-value loans, inevitably more likely to impact on FTB activity”

Clearly there will be monthly variations over the year ahead, reflecting economic and political sentiment as we get underway with the practical issues of leaving the EU. However, even with the current strong employment backdrop, potential home movers will only be empowered by a step change in financial circumstances to enable a meaningful move. Low or falling real wage growth will do little to help, nor indeed will deteriorating confidence in the market outlook.

First-Time Buyers Vulnerable

As noted in our last report, the market has become increasingly reliant on first-time buyers, especially with the depletion of mortgaged movers from the market. Income weakness clearly has potential to dent activity amongst this group given the high average loan-to-value ratios needed to gain the first step on the ladder.

Furthermore, the latest Bank of England Credit Conditions Survey (CCS) showed greater caution amongst lenders towards higher loan-to-value loans, inevitably more likely to impact on FTB activity.

Those seeking owner occupation are seeing more new homes come to the market. The value of private housing construction grew at its fastest rate since December 2015. Completions in Q1 were 12% higher than the previous quarter (ONS). Despite the uncertainty, relatively buoyant levels of private housebuilding activity are being sustained, with private home starts 4% higher in Q1 2017 compared with the previous quarter. In London the level of completions will reach a record high in 2017 (Molior), although the pace of activity will then slow.

Affordability issues and uncertainty are suppressing the rate at which new housing is being absorbed. Although, as the Buy-to-Let market settles at a lower pace of activity owing to higher tax obligations, FTBs unconstrained by tighter mortgage criteria will continue to benefit from the lower levels of competition for new build stock.

In 12 months to the end of April 2017 compared with previous 12 months



First Time Buyers

8% ▲

Source: CML



Movers

9% ▼



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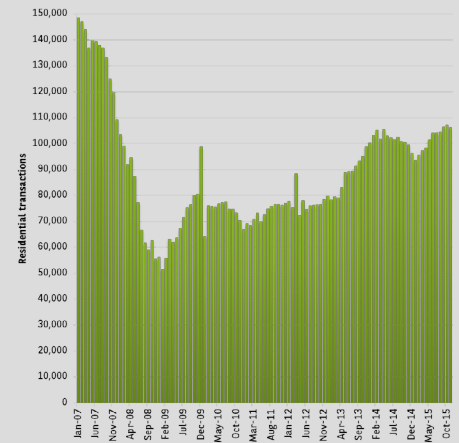
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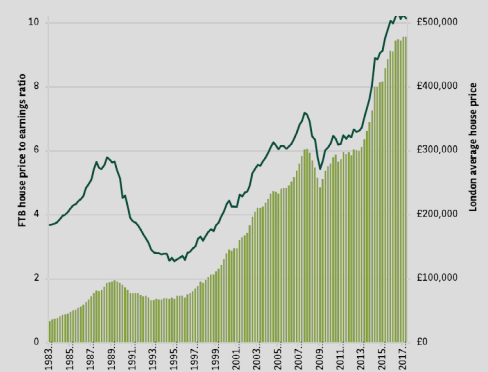
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Number Of UK Residential Transactions



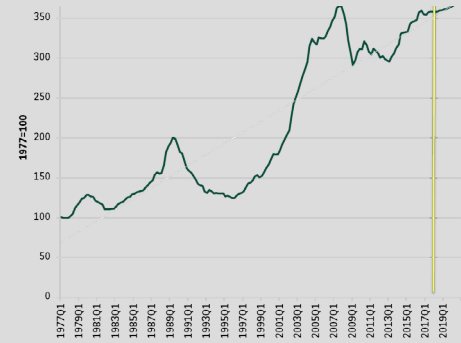
Source: HM Customs & Revenue; CML Regulated Market Survey

Average House Price In London



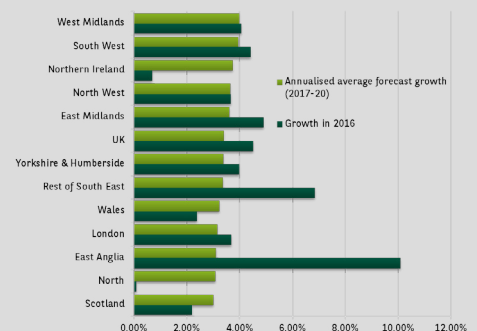
Source: Nationwide

Index Of Average Real UK House Prices And Forecast



Source: Nationwide (historic); BNP Paribas (forecast)

Forecast Of Average Annualised House Price By Region



Source: Nationwide (historic); BNP Paribas (forecast)

OUTLOOK

Our Q2 forecast for a period of muted activity and price change remain unchanged. We expect the average UK house price to rise by around 3.5%, effectively remaining close to flat in real terms given the current pace of inflation. We expect the average UK home to have increased in value by 13.7% or just over £28,000 over the next four years. This translates to an average UK house price increase of 3.4% per annum, although given the political and economic uncertainty ahead, the journey is unlikely to feel quite so benign with the average masking inevitable volatility.

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London Stalemate

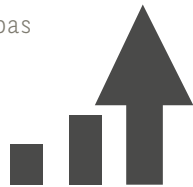
Such volatility is likely to be most sharply felt in London. While hometrack have reported an upturn in values over the summer months, falling prices persist in the higher value sub markets, which had enjoyed the greatest growth during the recovery period following the financial crisis. Recent Nationwide figure suggest this weakness is extending across the South East. However, despite the uncertainty surrounding our long term relationship with the EU there is little evidence of an exodus of domestic or overseas investors from the London market, or indeed widescale job losses and economic contraction. This will protect against a wholesale price adjustment, although localised price weakness, particularly in areas with higher value new build homes, is likely over the coming 12-24 months. On average we expect values in the capital to rise by less than 3% per annum over the next three years. Longer term this market stalemate is likely to persist until affordability, incomes and investment demand recalibrate. This depends to a great extent on London and the UK's economic future outside the EU.

Growth to Come in the Midlands

Outside the capital and its South East hinterland, where meaningful moves up the housing ladder are increasingly prohibitive, there is activity. Housing affordability combined with a relatively buoyant economic backdrop in areas such as the East and West Midlands is providing a spur to demand and price growth. We expect the West Midlands to see the highest pace of house price growth in 2017, up 5.8%, with a close to 16% total uplift over the next four years. The East Midlands, which is also seeing similar levels of economic growth combined with relative affordable housing, is not far behind these levels.

UK Forecasts

Source: BNP Paribas Real Estate



Average house price at end of 2017

£213,675



Average house price at end of 2020

£231,094



Total forecast in the value of the average UK home (2017-20)

13.6%



Average annualised house price growth (2017-20)

3.4%



Forecast increase in the value of the average UK home (2017-20)

£28,157