UK housing weakness hits spending
What if the slowdown gets worse?

Key Takeaways

- Affordability is dampening property prices and sales
- Improved housebuilding is holding back prices too
- At least that might allow more people to buy

UK housing market remains weak, with demand flat-lining at best. That is acting as a headwind to household spending, but could it get worse?

Sales, broadly unchanged since late 2013, may now be falling. Annual house price inflation, around 2% nationwide, compares with a 12% average between 2000 and the 2007 financial crisis and London prices are now dropping. The rental market is even weaker, with rent inflation at record lows.

Housebuilding has improved, but completions still lag the growth in new households, leaving supply below potential demand.

The weak demand stems from the squeeze on real household incomes, changing government policies, and affordability constraints, particularly in London.

Despite real income growth picking up as inflation eased, we expect no significant further gains in wage growth or employment growth. Saving to buy a home will thus remain difficult.

The government’s help-to-buy scheme helped fuel the housing market in 2013 and 2014 by partly funding first-time buyers’ deposits, but this fillip seems to be over.

But probably the biggest policy-related drag affects the buy-to-let market. A 3% stamp-duty surcharge on second-home purchases from April 2016 was followed by a gradual reduction in the mortgage interest offsettable against rent for tax calculations. These changes continue to depress this market.

Meanwhile affordability has become a major issue as rising prices increase the deposit needed to buy. The average UK first-time-buyer pays around £180,000, making a 20% deposit almost £40,000. The London equivalent is double that.

This partly explains why house prices trends are weakest in London. Demand is holding up, but so is supply. Housebuilding there rose 31% in 2016, beating other UK regions, but rising stocks of unsold homes are depressing prices.

Given these headwinds, a change in current trends is unlikely. But a slump in house prices would need a catalyst and we don’t expect household income growth to weaken further; we don’t foresee a Brexit upset; government will avoid policies that hit prices; and existing homeowners are not over borrowed.

Further, UK house prices crash only during recessions or building booms and we expect neither. We forecast UK house prices will rise 1% to 3% over the next couple of years, with London continuing to underperform. But that is well below historical averages, and implies stagnation in real house prices.

The housing market can affect the broader economy directly through housebuilding and investment, through house buyers purchasing durable goods, and through the wealth effect influencing consumer spending.
Combining those effects, we estimate that since 2001, rising house prices have typically added around 0.5 percentage points a year to real household spending growth. A stagnant housing market is thus reducing annual spending growth by 0.5 points and a 10% price fall would, all else equal, cut household spending by 1.1%.

However, lower house prices could have upsides, not least if caused by a housebuilding surge that boosts supply and stimulates the economy. Most UK people want to own a home: lower prices would make that aspiration more realistic.

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Disclosure

Analyst Certification

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Additional disclosures

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