

## THE INFLATION QUESTION

All eyes are turning to the Bank of England's decision on interest rates next month, and there is plenty of economic data for policymakers to weigh up. Meanwhile, UK prices ticked up in June after several months of slowing growth, while activity increased across prime sales markets.

### Key facts July 2017

**UK house prices rose by 1.1% in June**, taking the annual increase to 3.1%, up from 2.1% in May

**Average values of existing properties in prime central London were unchanged in June**, taking the annual change to -6.3%, from -6.6% in May, amid rising activity

**Prime country house prices were flat in Q2**, but activity levels in this market are also rising

**Values in the prime Scottish market slipped 0.2% in Q2** and are down 0.9% on the year, although values in Edinburgh are up 3.7% in the year to June 2017



**GRÁINNE GILMORE**  
Head of UK Residential Research

“Despite the easing in residential property price growth over the last 12 months, low mortgage rates and a lack of homes coming onto the market for sale are acting as firm anchors for pricing.”

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### Economic and housing market overview

The Bank of England's rate-setting committee has a big decision to make in August. There has been much speculation that, amid rising inflation, the central bank may move to raise interest rates as it publishes its quarterly Inflation Report. Even if rates rise by a quarter point, they will still be near record-lows at 0.5%. However, it will mark the first rate rise in around a decade, and will likely have some impact on sentiment as well as mortgage repayments.

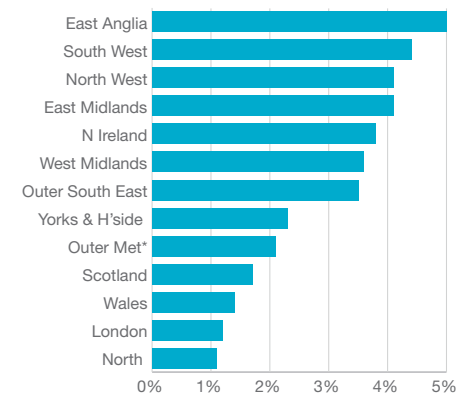
The Bank's hand may be stayed by recent data from the UK economy, which suggests that the growth in output has been slowing since the beginning of the year, amid concerns over Brexit negotiations and the more recent General Election result. In the first three months of this year, GDP was 2% higher than in the same period last year, but the quarterly rate of growth was just 0.2%, one of the lowest rates in the EU.

Ultra-low mortgage rates are one of the factors putting a floor under pricing in the housing market at present. While house price growth is slowing on the whole,

albeit with a tick-up in June, according to Nationwide, there are still large regional variations, as shown in the chart below.

### Regional house price growth

Year to Q2 2017

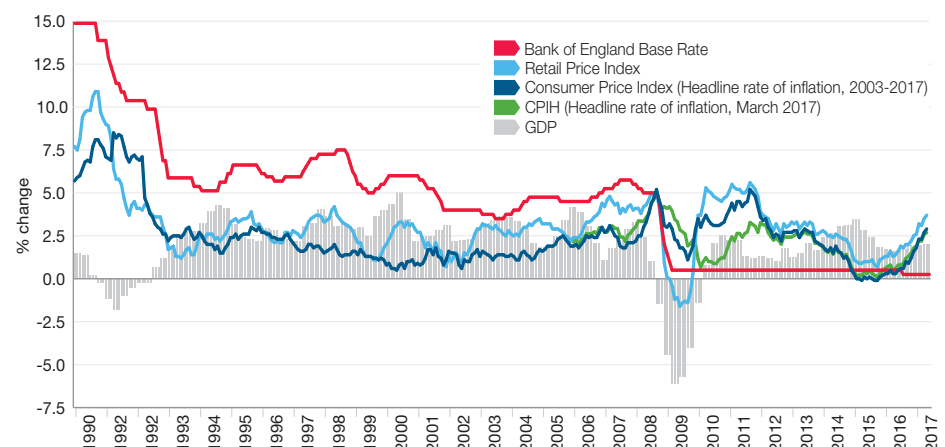


Source: Knight Frank Research/Nationwide  
\*Outer London Metropolitan area

What is also noticeable in recent months is that the traditional picture of house price growth in the South of England outpacing that in the North has reversed – with prices in the North and Midlands showing greater growth than the Southern regions

### Interest rates v Inflation and Economic Growth

UK, 1990 - 2017



Source: Knight Frank Research/ONS/BOE

in the year to the end of Q2. In London, price growth is now less strong than many other regions across England, although cumulatively, price growth in the capital has outperformed the rest of the country over the last four years.

The housing market is characterised by constrained activity at present, as uncertainty over the country’s economic path and the increased burden of property taxes in some parts of the market weigh on transactions. However, low mortgage rates and a lack of homes coming onto the market for sale are acting as firm anchors for pricing.

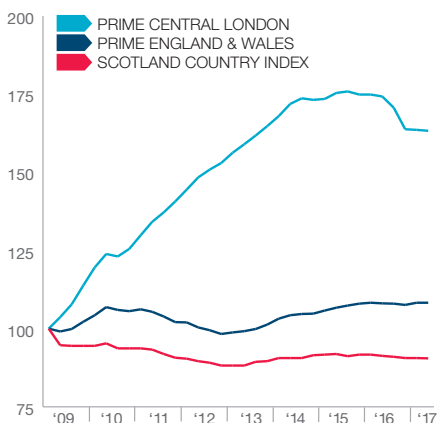
Given the lack of homes available for purchase, the government is coming under sustained pressure to boost the delivery of new homes. In light of this, the announcement of the opening of bids for the £2.3 billion Housing Infrastructure Fund to help local authorities unlock land for new housing earlier this month was significant. A less obvious, but also important announcement, was the £1 billion for new roads in the UK pledged by Chris Grayling, the Transport Secretary. Improving transport infrastructure can often expand opportunities for new housing.

**Prime market update**

Across the prime markets, there is evidence that demand is picking up, although this is not translating into price rises across the board. Average values for prime property in central London remained flat in June, but this was accompanied by a pick-up in activity. The number of exchanges recorded in prime central London (PCL) between January and May were 17% higher than during the same period in 2016.

**Prime price growth compared**

Indexed 100 = Q1 2009



Source: Knight Frank Research

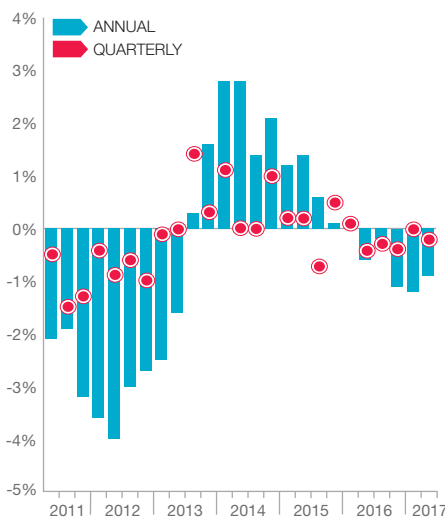
Across the rest of England, activity also rose in the prime market, with sales volumes rising by more than a half between April and May compared to the same period in 2016, and by 29% compared to sales in April and May in 2015.

Average prime values in Edinburgh rose by 2.1% in the second quarter of the year, taking the annual rate of growth to 3.7%. Prices are rising amid an uptick in demand, with a 17% increase in new prospective buyers registering in Q2. This has not been matched by supply, which has remained constrained, with a 15% drop in homes available for sale in the Scottish capital in the three months to June compared to the same period in 2016.

Across Scotland, prime property prices remained broadly flat, slipping by 0.2% in Q2 and by 0.9% on the year. However, the General Election result has rolled back some of the political uncertainty surrounding a second independence referendum, which may result in increased demand, especially as prime country house prices remain more than 20% below the previous market peak more than ten years ago.

**Prime Scotland price change**

Annual and quarterly price growth



Source: Knight Frank Research

**Rental market**

Average rents rose by 1.8% in the year to May across Great Britain, with a 1.9% rise in England and a 1.3% increase in London.

In prime central London, prime rents fell by 0.7% in the three months to June, taking the annual decline to 4.4%, the

most modest decrease since August 2016, amid strengthening demand and a fall in the supply of property. When it comes to super-prime rentals, (properties let out for more than £5,000 a week), demand has continued to strengthen as potential buyers adopting a “wait-and-see” position enter the rental market.



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