RESIDENTIAL RESEARCH

UK RESIDENTIAL MARKET FORECAST

FORECAST OVERVIEW

We last reviewed our UK house price forecast in November 2015. At that point, a continued moderation in price growth underpinned our predictions for prices. This remains the case, although the market faces a number of new challenges.

Headlines March 2016

Policy changes and political decisions could weigh on activity and prices in 2016

The uncertainty over the outcome of the EU Referendum in particular could have a dampening impact on the market

Despite new headwinds, the fundamentals underpinning the UK housing market remain positive

Household incomes are set to grow, an interest rate rise is looking more remote and demand continues to far outstrip supply

The risk that UK interest rates rise more rapidly than expected or that the global economy suffers a notable slowdown in activity remain the biggest threats to the UK housing market

A number of policy changes and political decisions could create headwinds in the market this year. These include the introduction of the 3% additional stamp duty charge for additional homes, the Mayoral Elections in London in May and a decision on whether the UK should stay in the European Union in June.

The uncertainty over the outcome of the referendum in particular could weigh on activity in the run-up to the vote.

However, the fundamentals underpinning the housing market remain positive. Despite a slowdown in UK economic growth, the annual rate is still outperforming that seen in many countries in the G8.

The deposit 'hurdle' for those hoping to get onto the housing ladder still remains significant, and affordability remains a key issue in some parts of the market. However, household incomes are also set to grow, and an interest rate rise is now looking more remote, with the first rate rise now expected in 2017, keeping mortgage rates at record lows for longer.

We have examined this, as well as other factors with the potential to impact the market, in more detail in our Risk Monitor on page 2.

The demand for housing continues to far outstrip supply, despite a significant pick-up in construction activity. The imbalance between supply and demand will continue to underpin prices.

Investment in house building is rising, especially in light of recent government initiatives, but the delivery of new homes is still well below the annual totals needed to address the shortfall in homes, particularly in London and parts of southern England.

Knight Frank Residential Market Forecast March 2016

	2015 (actual)	2016	2017	2018	2019	2020	2016-2020
Mainstream residential sales markets							
UK	4.2%	3.9%	4.1%	3.5%	3.1%	4.0%	20.0%
London	12.1%	5.0%	4.5%	3.0%	3.0%	2.5%	19.3%
North East	2.3%	2.5%	2.5%	2.5%	2.0%	3.0%	13.1%
North West	0.6%	2.0%	2.0%	2.5%	2.5%	3.0%	12.6%
Yorks & Humber	0.4%	2.0%	3.0%	3.0%	2.5%	3.0%	14.2%
East Midlands	3.6%	4.0%	3.5%	3.0%	2.5%	4.0%	18.2%
West Midlands	1.5%	3.5%	3.5%	3.0%	2.5%	4.0%	17.6%
East	2.3%	4.5%	4.0%	4.0%	3.5%	4.5%	22.3%
South East	6.7%	4.0%	4.0%	4.0%	3.0%	4.5%	21.2%
South West	3.8%	4.0%	4.0%	3.5%	3.0%	4.0%	19.9%
Wales	0.7%	3.5%	3.0%	2.5%	2.5%	3.0%	15.4%
Scotland	-2.0%	1.5%	2.5%	2.5%	2.5%	3.0%	12.6%
Prime residential sales markets							
Prime Central London East*	4.5%	5.0%	5.0%	4.5%	4.5%	5.0%	26.4%
Prime Central London West**	-0.6%	-2.0%	0.0%	3.0%	4.0%	5.0%	10.2%
Prime Outer London	3.1%	4.0%	4.0%	4.0%	5.0%	5.0%	24.0%
Residential rental markets							
UK	2.5%	2.2%	2.3%	2.3%	2.5%	2.6%	12.5%
Prime Central London East*	1.5%	2.5%	3.0%	3.5%	3.0%	3.0%	15.9%
Prime Central London West**	0.2%	1.0%	2.0%	3.0%	3.0%	3.0%	12.6%
Prime Outer London	0.6%	2.0%	2.5%	3.0%	3.5%	3.5%	15.4%

Source: Knight Frank Research

*City & Fringe, Islington, Southbank, King's Cross and Riverside

**Notting Hill, Kensington, South Kensington, Chelsea, Knightsbridge, Belgravia, Hyde Park, Marylebone, Mayfair, St John's Wood

"Despite a slight slowdown in UK economic growth, the annual rate of growth is still outperforming that in many countries in the G8."

RISK MONITOR

HIGHEST RISK 10 9 8 7 6 5 4 3 2 1 LOWEST RISK

Knight Frank's residential market Risk Monitor provides our latest assessment of key risks to the UK's residential markets. Our risk score, out of a maximum 10, is based on two assessment, firstly our view of the likelihood of the described scenario occurring, and secondly the potential market impact. Both these elements are scored from one (low) to five (high), collectively contributing to our combined Risk Score. Our measure of risk is deliberately narrow – namely the risk that house prices could under perform our central forecast scenario.

			UK			PRIME LONDON		
RISK	SCENARIO	IMPACT	LIKELIHOOD	IMPACT	RISK SCORE	LIKELIHOOD	IMPACT	RISK SCORE
INTEREST RATES	The Bank of England raises base rates more rapidly than expected	Our expectation is that the UK base rate will rise for the first time in 2017. Economic fundamentals suggest that rates are likely to remain low for several years, but any rapid rise could put pressure on mortgage borrowers. Rising rates are likely to make alternative investments more attractive, and could prompt investors to look less favourably on lower yielding property investments.	1	5	6	1	4	5
GLOBAL ECONOMY	The UK economy is hit by weaker global activity	The UK economy is slowing slightly but it is still outperforming many developed markets. However, a key risk to future growth is global economic weakness, stemming from slower than expected growth in emerging locations, especially in China, combined with concerns over the ability of central banks to stimulate their economies. Low oil prices are compounding the issue. A global slowdown could have a knock-on effect on UK economic fundamentals.	3	3	6	3	2	5
MACRO PRUDENTIAL POLICY TOOLS	The Bank of England imposes restrictive mortgage policies	The Bank of England's Financial Policy Committee has been granted powers to intervene in the mainstream mortgage market and has introduced criteria that will make it more difficult to secure a mortgage on a buy-to-let property. Lenders, already dealing with the EU Credit Directive coming into force in March, may react to signals from the Bank by becoming more cautious about lending, potentially weighing on mortgage availability.	2	3	5	2	3	5
EU REFERENDUM	The prospective referendum causes economic uncertainty	The possibility of the UK leaving the EU is likely to cause a degree of uncertainty in the market ahead of the vote. This will likely gather pace in the run-up to polling day, weighing on activity on all parts of the economy and housing market, producing a 'Brexit' effect irrespective of the result. We will monitor the polls and other indicators to assess the risks associated with the final result as the date of the referendum approaches.	3	2	5	3	3	6
GEO-POLITICAL CRISIS	Worsening geopolitical crises feeding a wider economic fall-out	Political tensions are still high on a global scale, from the stalemate in the Middle East to the EU strains over large-scale migration. The World Economic Forum has identified such issues as being among the biggest risks to the world in the coming year, and these could affect world trade, and as a result global growth.	3	2	5	3	2	5
DOMESTIC ECONOMY	Economic weakness leads to sharply lower economic growth	The Bank of England has downgraded its forecast for UK economic growth in 2016 to 2.2%, from 2.5% with a forecast of 2.5% growth by 2017, citing concerns over weak emerging market growth. This is still solid growth, but a further slowdown could have a knock-on impact on jobs and wages which would in turn affect demand in the housing market.	2	3	5	2	2	4
NEW BUILD SUPPLY	Housing supply exceeds demand	An oversupply of housing is unlikely to be an issue for most of the UK, where local housing markets are largely characterised by a lack of new homes. However, in some areas on the edges of central London, the issue of oversupply may be worth monitoring, particularly in higher price brackets. Turning to the type of housing being built, local policies must reflect the array of demand across affordability and age spectrums.	2	2	4	2	3	5
POLITICAL RISK	New property taxes and restrictions on non-resident buyers	Property taxes remain a favoured tool of politicians in tackling wider affordability issues, irrespective of their effectiveness. Indeed, the Conservatives, both since the last election and as part of the previous coalition have been one of the most active parties on property taxes. Overseas buyers and the rental market have been live issues in the run up to the London Mayoral election in May.	2	2	4	2	3	5
CURRENCY RISK	The pound strengthens against other currencies	After falling from a 2007 high of $2.10 to a 2009 low of $1.36, the pound/US dollar rate has dipped to below $1.45 after the Federal Reserve raised interest rates in December 2015, making UK assets including property look better value. Our forecast is based on the assumption that the rate will remain below $1.75 to the end of our forecast period. The impact of the recent weakening of some emerging market currencies poses an additional risk to the London market, though this has been tempered by the weakening of sterling ahead of the EU referendum.	1	1	2	1	3	4

Methodology Statement: House price forecasts are based upon time series regression analysis of relevant statistically significant macro-economic variables adjusted in-house to encompass externalities such as likely risk factors.

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