No Relief for the UK Housing Market

What will be the result for the broader economy?

Many have predicted a crash in the UK housing market, a view that is of no surprise given the meteoric prices rises of the last ten years. However the market has shown remarkable resilience especially in the face of recent crisis in the mortgage market. House prices in the UK are, on average, 1.3% higher than at the beginning of the year according to property website rightmove.co.uk. Unfortunately this also includes a drop of 1.8% this month, the worst July on record. Far more telling and of more concern are new figures from the British Bankers Association (BBA) which show that the number of mortgage approvals for house purchases has fallen by more than two thirds in a year. It is now at its lowest level since records began in 1997.

The sudden drop in mortgage approvals has been partly caused by lenders raising their rates and fees at a time when most people - especially first-time buyers - are having trouble with their finances. The figures also show that fewer people are choosing to move house, preferring to sit tight until the market regains a bit of stability.

Britain has the second-largest mortgage market in the world after the US. This has driven one of the highest levels of home ownership on the planet, which must on the whole be thought of as a plus. What's enabled this growth is wholesale funding of the mortgage markets. Mortgage-backed securities funded around a third of UK mortgages before the market dried up. The Bank of England “Special Liquidity Scheme” certainly avoided complete seizure of the credit markets by purchasing mortgaged back securities that no other counterparty would touch; but it was only envisaged as a short term solution. However, one can only assume that they will feel it necessary to extend the duration of this scheme.

The Minutes from the last Bank of England interest rates setting committee show dissent amongst the committee suggesting that a rate hike (felt necessary to ward off higher inflation) may be on the cards. Such a move may prove the final nail in the

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coffin for the housing marketing and consequently the UK economy as a whole. Chief economist at the Royal Institution of Chartered Surveyors recently commented that "The continuing lack of availability of mortgage finance is proving a major drag on the level of property transactions and is increasingly being felt in the real economy." Indeed, the deputy governor of the BofE warned that "there is a risk that the credit crunch leads to a deeper and more prolonged slowdown"

The release of extremely poor retail sales figures this week (down 3.9 per cent on the month), the worst figures since the series began in 1986 add credence to this view. The Office for National Statistics figure for growth during the second quarter of this year are forecast to show a rise of between zero and 0.3 per cent on the first three months of 2008. That would push the average annual growth in the economy down from 2.3 per cent to about 1.6 per cent – the sharpest deceleration since 1995.

It gives us no pleasure to hear David Blanchflower, a member of the Bank of England's Monetary Policy Committee, declare that: "I think we are going into recession and we are probably in one right now." Basically agreeing with what we have been writing for many months now.

Without wishing to sound too repetitive we can only reiterate our earlier comments; now is not the time to be taking any undue risk with portfolio allocation. A diversified, defensive portfolio with significant liquidity will out-perform during this difficult period.

[LP TO ADD]

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