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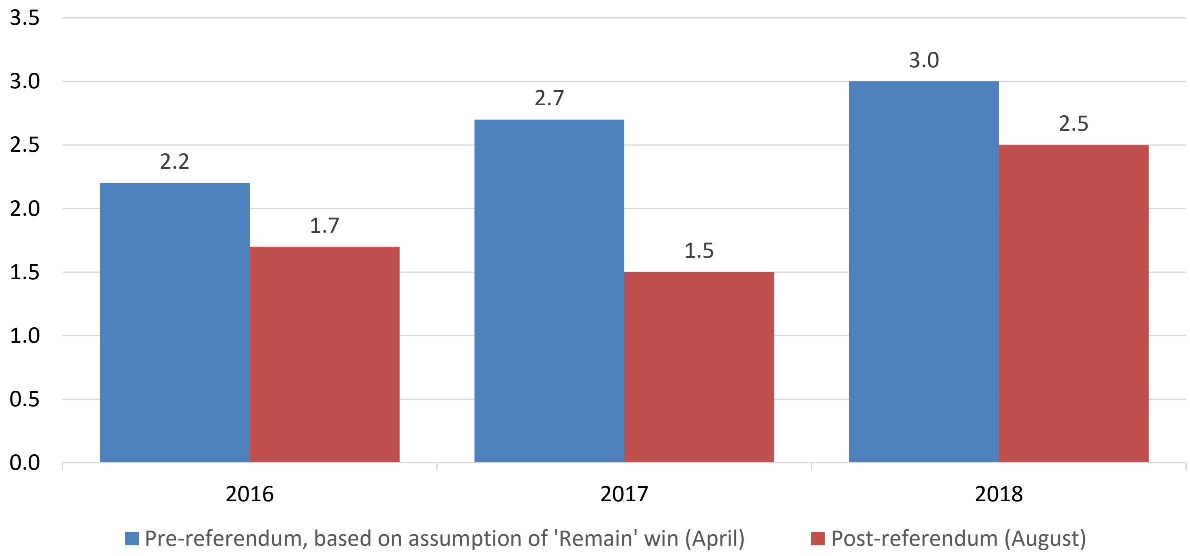
# Outlook for the housing market in England

This note explains Capital Economics' forecasts for house prices, completed transactions and new housing starts for England for the rest of this Parliament (up to and including 2020). As well as setting out the forecasts, the rationale behind them is explained – including the impact of the recent referendum decision.

## Macro-economic context

Prior to the EU referendum, we were optimistic about the British economy, based on the fundamentals, the global environment and expectations of a revival in productivity growth. We did not expect a 'Leave' vote to affect the long run performance of the economy (and that it could well be beneficial in some respects), but we did foresee the possibility of some short term disruption, with lower growth in the next couple of years mainly, but not exclusively, due to uncertainty. Our views are still the same now. Hence, as Figure 1 shows, our expectations of economic growth over the next few years have lowered.

**Figure 1: Forecasts for annual percentage change in real gross domestic product for the United Kingdom**




Source: Capital Economics

By 2018, we expect post-referendum uncertainty to have abated as the shape of future UK-EU relations becomes clearer. There will be scope for catch-up in deferred investments, so growth should rise back to pre-referendum levels. The economy may experience transition costs at the time of departure from the European Union (presumably sometime in 2019). However, this will be offset by catch-up growth from 2016 and 2017, by some savings in European Union contributions and, possibly, by the arrival of benefits from lower regulation and new trade deals. Thus, the economy should grow strongly in 2019 and 2020.

## Implications for the housing market

This post-referendum change in the prospects for the economy will have a noticeable effect on the housing market, though it changes some things more than others. With a moderate slowdown in the economy, transactions are more likely to be hit than prices. This is because the slowdown encourages both buyers and sellers to exercise their option of waiting. Sellers are naturally reluctant to reduce asking prices and so wait for better times ahead. Buyers are put off by uncertainty. Hence, prices are relatively unaffected.

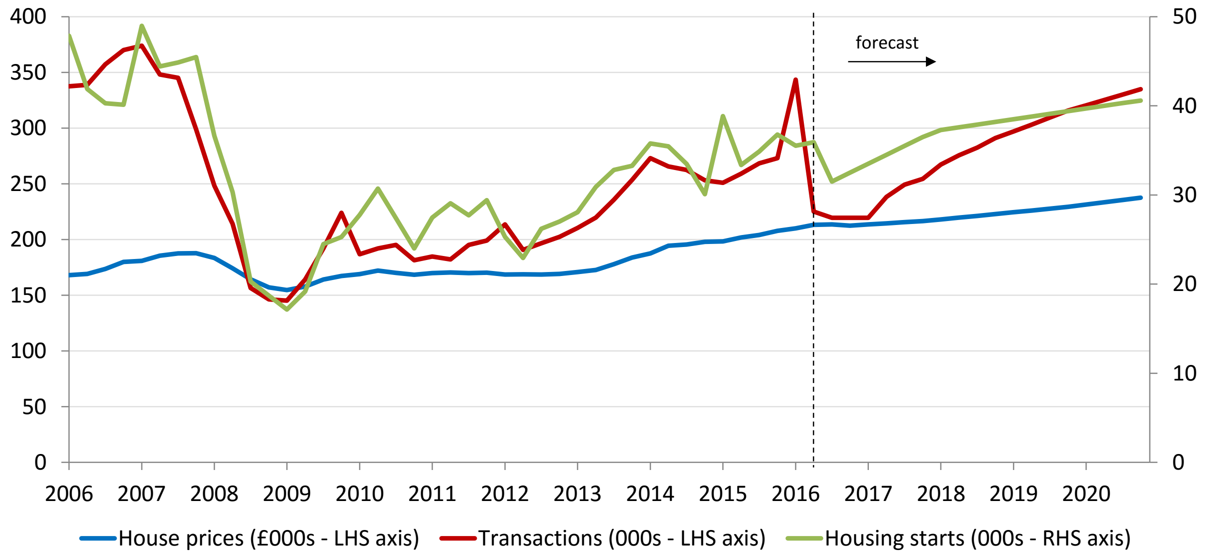
Consequently, we expect house price growth to remain positive, but modest, over the next few years. Only if the downturn was more severe could an actual fall in prices be expected – a result of sellers being forced to sell quickly and thus lower asking prices. Away from transactions and prices, housing starts can also be expected to decline. Indeed, the twelve months following the referendum are expected to see an eight per cent decline in new housing starts (before recovering in the second half of 2017). This stems directly from the fall in demand, which can be expected to reduce the numbers of new projects initiated.

From 2018 onwards, and consistent with our expectations regarding the recovery of the macro-economy, all indicators in the housing market should experience growth, but the pattern will be different for each variable. Prices will continue to grow, but only in line with or a touch below growth in incomes (at approximately three per cent per annum), reflecting high starting the high starting point and overvaluation in parts of the country (particularly London and the south). Transactions, which were the most sensitive variable to the period of slower growth, can be expected to be the most responsive to the recovery and should therefore make up a great of the lost ground by 2020. Housing starts, which were affected, but not severely, by the slowdown, can, however, likewise expect slower growth to linger out to 2020.

There are reasons for the slow recovery in housing starts. Construction is likely to take a hit over the next twelve to eighteen months. When growth rebounds, builders may be restricted in how quickly they can ramp up production. Labour constraints have dogged housebuilding for several years and we anticipate that they will impose constraints once more as construction picks up. The current period of uncertainty could also mean that developers cut back on the number of new projects going into the planning pipeline, thus reducing the number of shovel-ready developments in the first few years of recovery.

Figure 2 presents our overall expectations for the evolution of prices, transactions and starts for England. We forecast that housing starts will total 734,000 during this Parliament (the five years to Q2:2020).

**Figure 2: Historical data and forecasts for house prices, transactions and housing starts in England**




Sources: Thomson Datastream, Nationwide and Capital Economics

## Appendix

Table 1 shows our expectations for prices, transactions and starts over the period 2016 to 2018 and how these have changed since April (when our forecasts assumed a 'Remain' vote).

**Table 1: Short term forecasts for key housing indicators**

| | | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| House prices, year-end (£000s) | Pre-referendum forecast (April 2016) | 212.5 | 216.6 | 222.9 |
| House prices, year-end (£000s) | Post-referendum forecast (August 2016) | 212.5 | 216.6 | 222.9 |
| | | | | |
| Completed transactions (000s) | Pre-referendum forecast (April 2016) | 1.13 | 1.16 | 1.20 |
| Completed transactions (000s) | Post-referendum forecast (August 2016) | 1.01 | 0.96 | 1.12 |
| | | | | |
| Housing starts (000s) | Pre-referendum forecast (April 2016) | 152 | 164 | 176 |
| Housing starts (000s) | Post-referendum forecast (August 2016) | 135 | 140 | 151 |

Source: Capital Economics