

# North/ South Divide to Widen

August 2010

*“As the UK emerges from the downturn, the divide between house prices in the North and South is set to widen.”*

*“The engines of economic growth in the new business cycle will continue to be located in London and the South East. This will drive jobs growth and subsequent wage inflation, placing pressure on housing markets in the south of the country.”*

*“The stock of available properties is below the required level to meet expected need. As a result we anticipate growth in house prices and rents over the medium term.”*

## Introduction

The North/ South divide is not a new phenomenon. The economy in London and the South East has consistently outpaced the rest of the country since 2003. A recent report by the Centre for Cities<sup>1</sup> highlights the differences in employment prospects, noting ‘for every extra private sector job generated in the North and Midlands between 1998 and 2008 ten were created in London and the South’.

Economic outperformance in the South has manifest itself in perennial higher house price growth. Nationwide data shows that the South was harder hit by the downturn, but subsequently recovered at a much faster pace. Price growth was higher in the South for 13 of the last 16 quarters and since Q1 2009 has risen by 18% compared with the North at 9%.

## Different Market Make-up

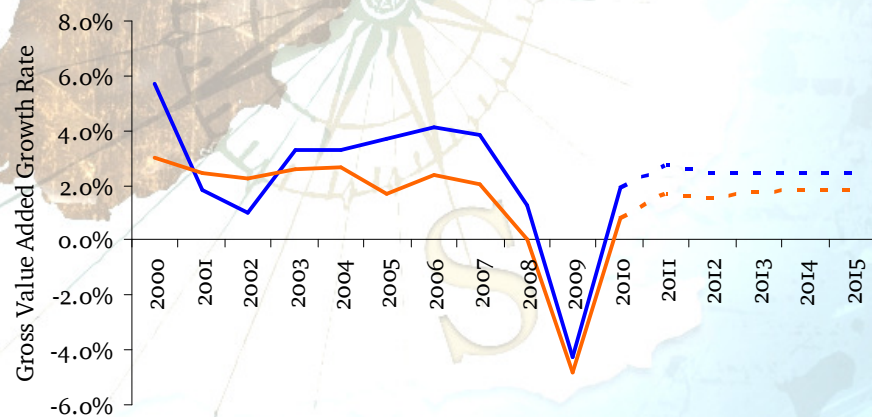
The South of England, emanating out from London, is a dynamic and largely international economy. Global connections are political and cultural, in addition to the business activities of some of the world’s pre-eminent firms.

This affords the South with a dominant position in the UK economy. It also means that the regional economy is highly diversified, with a benign reliance on the public sector.

This places the South of England on the front line of Government plans for rebuilding the UK economy. Fortunately, estimates suggest that the region is well placed to deliver. As shown below, Gross Value Added (GVA) growth is expected to rebound more strongly than in the North. However, this is likely to place severe pressure on housing markets around London and the commuter belt in particular.

House Price Forecasts	2010	2011
UK	- 1%	3%
London	2%	5%
South of England	2%	4%

## The London Effect: Stronger Economic Performance



— South\* — North\*\* - - - South (forecast)\* - - - North (forecast)\*\*

Source: Experian, Hamptons International, \* includes London, South East \*\* includes: South West, East of England, East & West Midlands, Yorkshire & Humber, North East, North West

<sup>1</sup> Private Sector Cities: Centre for Cities, June 2010

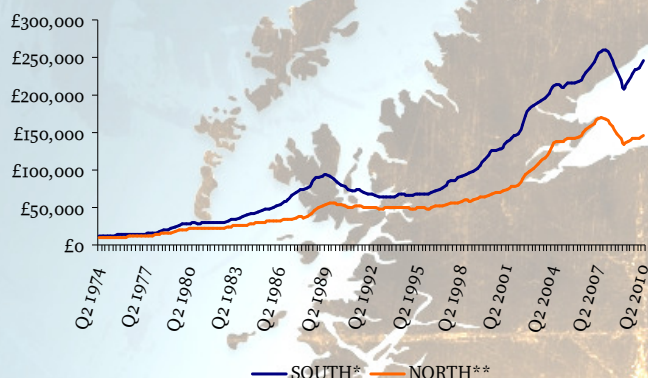


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## House Price Divergence



Source: Nationwide



## Short-term Challenges...

Despite the prospect of regional growth in the South over the medium term, the short term outlook for the UK as a whole remains less certain.

Most measures are now showing softening house prices across the UK, which we began to notice across the Hamptons UK network in the middle of the 2<sup>nd</sup> Quarter. Our Q2 Price Index revealed a fall of 1.7% over the period.

The price adjustment is being driven by low levels of demand by historic standards, while the supply of properties available for sale continues to grow. Constrained demand is due to a combination of factors, including a challenging mortgage market and considerable uncertainty over the direction of the economy.

The key markers of future house price pressure continue to offer mixed signals. Positive data, including an estimated 1.1% UK GDP growth for the 2<sup>nd</sup> Quarter, was matched by even more impressive figures of our largest trading partners, France and Germany. However, this is in contrast with the recent downgrade of GDP forecasts from the Bank of England. Importantly for the housing market, this uncertainty is also divided geographically between the North and South. Our view is that house prices are likely to find more solid footing in the Spring of 2011 and this will occur first in the South due to employment growth in the private sector.

## Supply Will Not Form Part of the Solution

Supply constraints have left the South ill prepared for growing housing demand. There were only 42,970 homes built in London and the South East in 2009<sup>[2]</sup> and this figure is likely to fall further in 2010. Set against needs-based government targets of over 66,000 units, delivery of new housing is woefully inadequate. This embarrassing shortfall has made it easy for the Coalition Government to abolish regional targets altogether.

Housing development viability has suffered through the downturn from weak demand and falling prices. More recently, new developments have also been directly affected by cuts to grant for affordable housing. Appraisals have been largely reliant on grant funding in order to stack up, but Government austerity measures have hit the Homes and Communities Agency (including £230 million for 2010/11 alone). This has forced a dramatic reduction in the funding streams for affordable housing delivery. The resulting negative impact on the viability of the overall scheme will reduce the delivery of private homes in the medium term as well.

The new Localism agenda, promoted by Housing Minister Eric Pickles, places greater power in the hands of Local Authorities. Although the reality of Localism still requires further clarity, there is a real danger that important planning decisions will become more politicized by local NIMBYist activity. Strategies to encourage parish councils to take a direct role in the expansion of these communities will be equally fraught, introducing further uncertainty into housing delivery. **Unfortunately, a weak appetite from Government to increase housing supply will continue to underpin house price growth.**

<sup>2</sup> Department of Communities and Local Government

### ...But Longer Term Outperformance

London will be the main driver of new employment in the early stages of this business cycle. According to Experian, London together with the South East could gain around 475,000 jobs in the 5 years to 2015. This represents 43% of all new jobs across the UK over the period. Although growth will be broad based, the key industries will continue to be in the service sector and high-value manufacturing, including finance, business services (FBS), information technology and engineering. Public sector job cuts are likely to act as a drag on some of this growth. However, at approximately one-fifth of all employment in the South, the impacts will be less severe than in other regions of the UK.

Higher unemployment and weak demand for new hires is currently holding back wage inflation for businesses, as workers are not able to demand higher pay. However, this slack in the economy will begin to tighten first in London and the South East, meaning that employees will have greater leverage to ask for pay increases to counteract 2-3 years of flat or falling real incomes. Most FBS firms have undergone painful retrenchment, with revenues and profitability beginning to show stark improvements. Come bonus season, employees will begin to demand their share of this stronger cash position.

This economic and employment growth will subsequently place greater pressure on housing prices in London and the surrounding commuter areas. In addition, the demand profile for London and the South East is also much more international. The weak pound will continue to buoy foreign demand for property in the South of the country for at least the next two years. Combined, these factors should ensure that house price growth in the South will remain ahead of any improvements in the North.



### In Summary...

As a result of these economic factors, we anticipate continued outperformance of London and South East house prices against the national average. Many of the constraints that will plague the market at a national level over the medium term are less pronounced in the South and the economic prospects, while still muted, remain much brighter.

The coalition Government should take heed of the pending challenges in the housing market for the South of the country. Higher average house price growth will only serve to perpetuate this 'have vs have-not' geographical divide and weakens the flexibility of workers to chase new employment opportunities. This will have the potential to constrain economic growth; a very undesirable scenario for a nation trying to re-establish a firm footing in the new business cycle.