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## Maskells Quarter End Comment

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“At the National Level, the relationship between house prices and the stock market is characterised by left tail dependence, i.e. they are more likely to *fall* together than boom together”

*R. Bissoondeal & L. Tsiaras – The Journal of Real Estate and Economics 2021*

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We remain in uncertain times: Following the failure, for want of a better word, of Silicon Valley Bank and others in the US, the purchase of Credit Suisse by UBS and the jitters surrounding Deutsche Bank (which many believe are unfounded); and a new round of “Quantitative Easing” in the USA via the Bank Term Funding Program, there is a general sense that the financial markets are “risk-off” for the time being. Fund Managers that I have spoken to sense that there may be another round of interest rate increases and following that a period of rate stability to allow the prior increases to take effect to tackle inflation. This is echoed in JP Morgan’s commentary for the week ending 27<sup>th</sup> March where they maintain “we continue to look for one more 25bps hike in May and an extended pause before the Fed eases in 2Q24”.

**“We believe that the UK will follow, and this means the supply of cash for consumers will continue to tighten”.**

The financial markets tend to react quickly to events, whereas the housing market lags. This is not a bad thing as it gives vendors and buyers time to digest news and react rather than make decisions which are affected in part by month-end portfolio pricing. And at the same time the housing market does not act homogeneously. What effects one part of society does not affect the other and each produces its own drivers for the house prices.

Given the recent market volatility and the difficult prior year in the financial markets, we did some research: The article by Bissoondeal & Tsiaras that

we have quoted from above is extremely technical and seeks to understand if there is correlation between stock markets and housing markets. Their summarised view is that outwardly there is limited correlation using standing linear comparisons. They quote studies done in the USA (Okunev et al) in 2000 amongst others, however the authors also argue that when more complex statistical analysis is used, (Granger Causality and Copula probability theory for those who want to look it up) they find left tail dependence. Or, in other words, a correlation between house market crashes and stock market crashes. In addition to their own research, they cite Knight et al in 2005, which is a comparison between the UK Housing Market and the UK stock Market between 1986 to 2004. There is no suggestion here that any

“crashes” are going to happen.

The authors go on to argue that the housing market does not act as one because homeowners are different and the housing market moves depending on location, international factors and the wealth of the homeowners. Particularly the authors found that those families with financial product investments behave differently to those who do not have any. Therefore, behaviours in each part of the housing market are also different. Looking at the market today, this makes sense. With large interest rate increases, we are seeing a slow down in house prices nationally but at different paces. Nationwide, the mortgage lender, announced on Friday that residential property prices have dropped by 3.1% year on year (excluding Prime Central London), the largest drop since July 2009. Additionally, housing starts, completions and mortgage approval rates also suggest that the market is less active. House building starts are 39,220 (as at Jan 2023 – latest data ONS), a 9% drop on the previous quarter and are lower than house building completions of 46,080 which was a 10% increase vs Q4 2021 (ONS). An argument could be that builders are building less as affordability has fallen

evidenced by mortgage approval rates, but building costs have not. This is certainly going the wrong way and supports Michael Gove’s recently quoted comments in the Times, that the Housing Market was “broken” and “we desperately need more homes to bring ownership within reach of many more people”.

Continuing this theme, we note that mortgage approval rates have dropped: 39,637 for January 2023 and 43,500 for February 2023 compared with 73,789 over the same period last year. Excluding the onset of Covid, house purchase approvals are at their lowest since January 2009 (32,400). (Gov.uk)

And at the same time, The Royal Institute of Chartered Surveyors (RICS) in their January 2023 UK Residential Market Survey noted “a muted market backdrop at the present, with new buyer demand, sales, fresh listings and prices all reported to be on a downward trend. Near term expectations suggest this picture is likely to remain in place for a while longer as the market adjusts to the higher interest rate environment”

And this is the key – a higher interest rate environment. Certainly, for housing outside London and the South-East, the market has

slowed, as higher interest rates take hold and affordability is reduced.

However, for London and the South-East, the effect is different. We have seen a decline in prices – 2.8% YOY for Prime Central London according to Lonres.com but we have also seen properties under offer increase by 10.5% since pre-pandemic levels. Prices may have been a touch high, but the increase of offers is a good indicator that we have found a compromise between vendors and buyers. However, our market operates differently to the rest of the Country:

Firstly, many wealthier families who live in London and the South-East are now enjoying interest on their cash deposits: From earning 0% for nearly a decade, they can now earn nearly 4% on 3 month term deposits. Secondly, mortgage debt levels tend to be lower, so owners are less impacted by an increase in interest rates. Thirdly, sterling remains relatively weak and therefore foreign buyers are still active, particularly from countries with their own economic issues. Fourthly we don’t see the stock market crashing as there is too much cash waiting to be put to work.

If a driving factor for a potential left tail dependence between the stock market and the housing market is the behaviours of the wealthy

who own stock, then those who are in the financial markets are already in defensive positions or they are in cash and cash equivalents. We can see the argument made by the academics as to left tail dependence in the event of a crash, but we don't agree that this is the only correlation, and we don't see a crash. The behaviours

of buyers and sellers in the housing market, particularly in London and the South-East are driven by confidence. Confidence in their investments, their lives, families and so many areas that it is impossible to pin down. Short of a global financial crisis, these buyers and sellers have considerations which are above that of a mortgage

interest rate. Deliberations over their housing needs may lead to period of considered inactivity and potentially a further decline in pricing, but we don't see this as a long-term trend. We do believe that procrastination may miss the current influx of buyers: we have 14 properties under offer, often with multiple buyers bidding.

In conclusion, we wrote this piece as we wanted to consider the activity in the stock market and the activity in the housing market. Acknowledging that the housing market is not homogenous, with large parts reacting to interest rate increases, we hope that our thoughts provide some comfort that our market is still active and with multiple drivers, over and above activity the stock market and the increase in interest rates. What happens over the next two or three quarters however is unclear, and the spectre of a Labour government remains. For now, however, the market is working, and it has depth.



## CONTACT US

If you would like to sell, buy or rent a property, or if you would just like some impartial advice, we would be delighted to help.



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