UK Residential Research – 16th April 2020

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How UK residential behaves in downturns

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Characterising the last four recessions

The coronavirus pandemic will have a substantial negative impact on the UK's economy. Consensus among economic forecasters is that the UK will experience severe economic contraction in 2020 Q2, with recovery following once restrictions are lifted. In this note we look back to previous recessions to see how residential values, transactions, and development respond to economic recession.

The recession anticipated in Q2 this year has unique causes and so the recovery will look very different from past recoveries. Economic growth will return as restrictions start to lift, so the time from peak to trough looks likely to be much shorter than the four previous recessions, which took between five and eight quarters to reach the trough. However, consumer confidence could well take longer to recover fully.

There have been four periods in the last seventy years when UK GDP has fallen significantly:

- 1970s – the Oil Crisis;
- 1980s – the early 1980s recession;
- 1990s – the early 1990s recession; and
- 2000s – the Global Financial Crisis (GFC).

In each of these economic downturns residential values fell in inflation-adjusted terms. In the latter two recessions, house prices also fell in nominal terms.

The recessions in the 1980s and 1990s were associated with a spike in inflation. By contrast, RPI was negative during the GFC (i.e. there was deflation) because housing costs fell; CPI, which excludes housing costs, remained positive.

Table 1 Economic and housing market impact of previous UK recessions

	Decade	**1970s**	**1980s**	**1990s**	**2000s**
	Recession	**Oil Crisis**	**Early 1980s**	**Early 1990s**	**GFC**
GDP	Peak 1	1973 Q4	1980 Q1	1990 Q3	2008 Q2
	Trough	1975 Q4	1981 Q2	1992 Q2	2009 Q4
	Back to peak	1977 Q2	1983 Q2	1993 Q2	2013 Q2
	Peak-trough duration (months)	24	18	15	18
	Peak-trough GDP change	-3.92%	-4.10%	-1.23%	-5.38%
	Peak-peak duration (months)	39	39	27	57
Real house prices	Peak 1	1974 Q1	1980 Q2	1989 Q4	2008 Q1
	Trough	1978 Q1	1982 Q4	1996 Q1	2013 Q2
	Back to peak	1980 Q2*	1985 Q2	2002 Q1	n/a*
	Peak-trough duration (months)	45	27	78	66
	Peak-trough HPI change	-31.7%	-15.5%	-36.5%	-23.7%

*Average residential values are still below their 2008 peak in RPI-adjusted terms **Source** Savills Research, ONS, Nationwide

All four previous recessions were associated with rising unemployment. However, the severity of the rise in unemployment varies, from relatively mild increases during the Oil Crisis to unemployment doubling in the 1980s.

We have taken GDP forecasts from a range of economic forecasters and compared them to the GDP falls recorded in the past four recessions. The forecast falls in economic output range in severity from relatively mild to the largest fall in UK GDP since World War II. Most forecasts predict GDP will return to growth by the end of 2020. Opinions vary on the speed of the subsequent recovery.

Table 2 Economic forecasts compared to previous downturns

Economic Forecasts	**Date**	**2020**	**2021**	**Comparable historical recessions**
Fitch Ratings	02/04/2020	-3.90%	n/a	Oil Crisis (1970s)
CEBR	30/03/2020	-4.00%	n/a	Between the Oil Crisis (1970s) and the early 1980s
Oxford Economics baseline	08/04/2020	-5.10%	+6.0%	Global Financial Crisis (2000s)
Morgan Stanley baseline	17/03/2020	-5.10%	+5.60%	Global Financial Crisis (2000s)
Capital Economics	27/03/2020	-7.00%	+8.50%	Greater impact than any recession of the past seventy years
Bank of America	07/04/2020	-7.40%	n/a	Greater impact than any recession of the past seventy years
Morgan Stanley downside	17/03/2020	-7.90%	+3.70%	Greater impact than any recession of the past seventy years
Oxford Economics downside	08/04/2020	-10.10%	+2.80%	Greater impact than any recession of the past seventy years
OBR reference scenario	14/04/2020	-12.80%	+17.90%	Greater impact than any recession of the past seventy years

Source As stated, Savills Research

Mainstream residential values

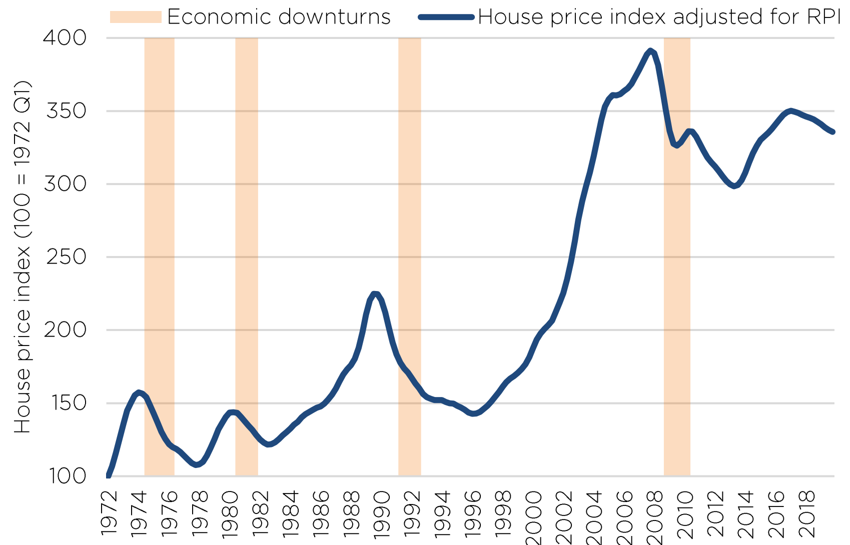
Mainstream house prices fell in real terms during each of the past four economic recessions. There are some common factors that apply across all four.

First, house prices continue to fall even after GDP has returned to growth. This may be because consumer confidence takes time to return even after the economy has started to recovery. If consumer confidence does not recover quickly, we can expect house prices to continue falling through this year even if the wider economy is in recovery.

Second, peak-trough house price falls are significantly greater than falls in GDP.

In previous recessions house prices began falling before GDP growth turned negative. House prices have already fallen -4.1% in RPI-adjusted terms since 2017 Q2. If we were to say house price falls peak-trough ended up at around -15%, like in the 1980s, that points us to further falls of around -10%.

Figure 1 Real house price growth during economic recessions



Source Savills Research, Nationwide, ONS

Transactions

We have data on residential transactions back to 1978. This means we can analyse the impact of the last three recessions on transaction activity.

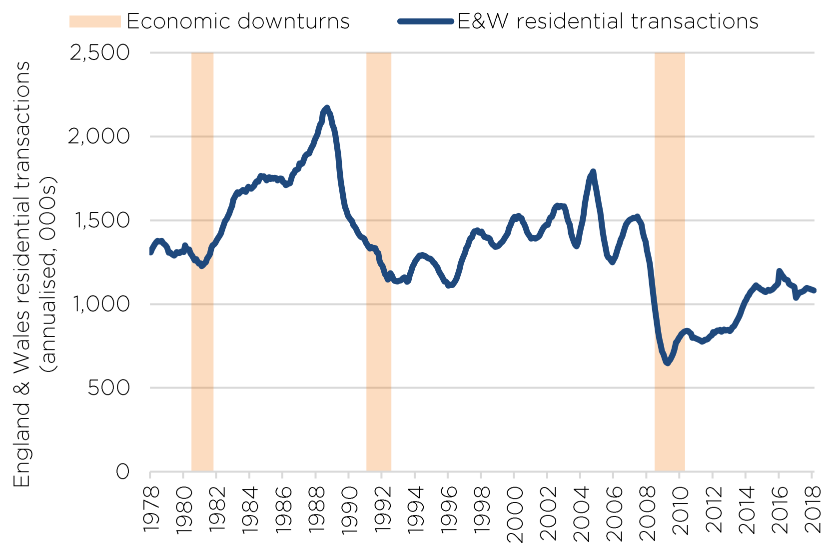
In the late 1980s/early 1990s transactions fell from 2.1 million in 1989 to 1.1 million in 1992, a fall of -48%. However, the 1988 spike in transactions was driven by changes to Mortgage Interest Tax Relief at Source (MIRAS). The fall in transactions from 12 months after the MIRAS changes to their trough in 1993 was –37%.

In the Global Financial Crisis transactions fell from 1.5 million in 2007 to 650,000 in 2009, -57%.

In our baseline indicative scenario transactions fall to 40% of their five year average by the middle of 2020, before returning to normal levels by Q2 2021. This would imply a -40% peak-to-trough fall in transaction volumes, less severe than in either of the last two recessions but further than during the early 1980s recession.

In our more negative illustrative scenario, transactions could fall to 20% of their five year average. This would imply a -58% fall in transaction volumes, similar to the Global Financial Crisis.

Figure 2 Annualised residential transactions in England and Wales



Source Savills Research, ONS, MHCLG

Table 3 Residential transactions in economic recessions

	Peak transactions		Trough transactions			
Recession	**Date**	**Volume**	**Date**	**Volume**	**Peak-trough duration (months)**	**% change in transactions**
Early 1980s	Apr-80	1,351,000	Apr-81	1,226,000	12	-9%
Early 1990s	Aug-89*	1,799,000	Feb-93	1,134,000	42	-37%
GFC	Aug-07	1,522,000	Jun-09	647,000	24	-57%

*We have taken the year after MIRAS pooling restrictions were lifted as our peak date
Source Savills Research, ONS, MHCLG

Development

Net housing supply has fallen either during or immediately following the past four economic recessions.

The greatest falls came in the aftermath of the Global Financial Crisis, when net housing delivery dropped by -44%. Private housebuilding dominated the falls. Housing associations and local authorities grew their share of housing delivery from 10% in 2007 to 21% in 2011 as sites switched to delivering affordable housing.

Net housing supply fell more modestly during the Oil Crisis, -21%. Then, the fall in delivery was split more evenly between local authorities and private developers.

Most major housebuilders have announced a halt to construction in response to the coronavirus pandemic. This means we can expect to see housing delivery fall in 2020. Disruption to supply chains and staffing could make it difficult for developers to ramp construction activity back up again once lockdown measures are lifted.

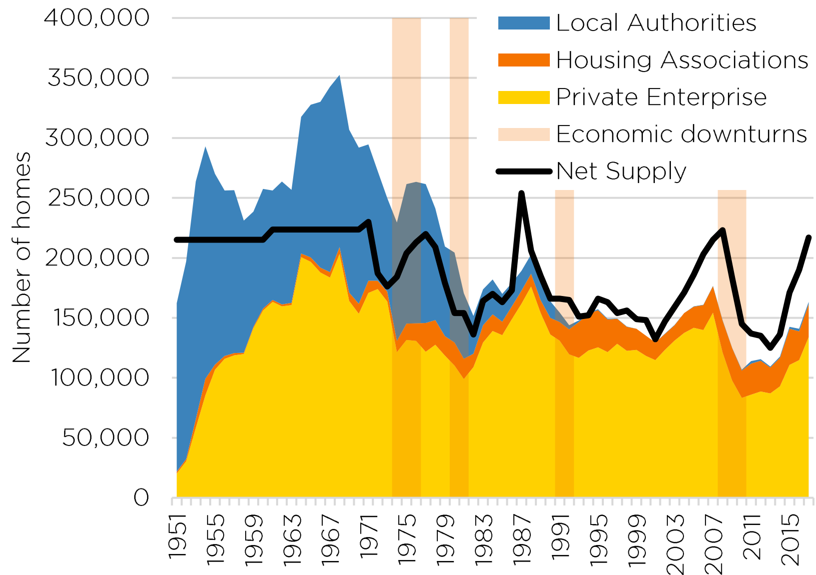
Prime Central London

Values in Prime Central London (PCL) began falling shortly before falls in GDP in the last three recessions. Buyers in PCL tend to be less reliant on mortgage finance than mainstream buyers, which means they can act much more quickly. In general, PCL has been the first part of the market to recover following a downturn.

In 2014 the stamp duty system changed, which increased the tax burden when buying high value properties. PCL values have fallen in RPI-adjusted terms every quarter since the end of that year. As a result, values in PCL are 20% below their 2014 peak in GB£ and around 40% below peak in US$ terms due to falls in the exchange rate.

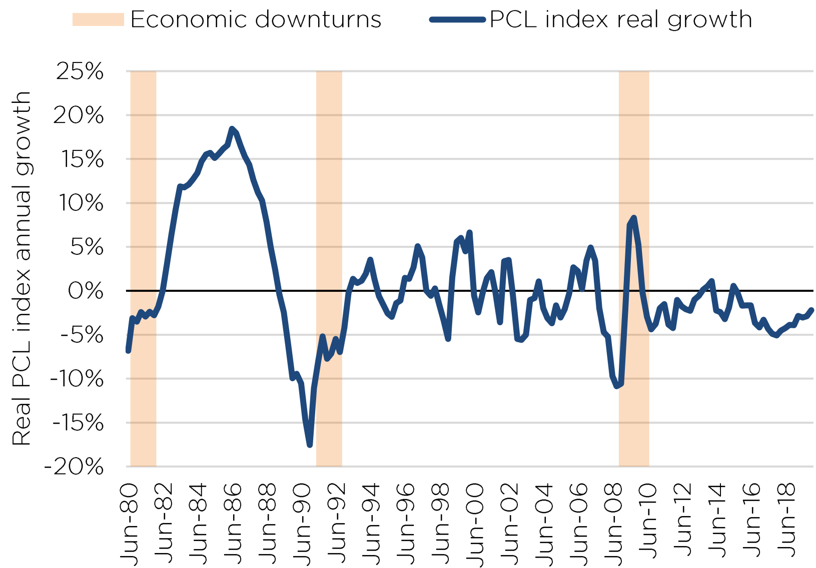
The coronavirus pandemic is likely to have a negative impact on PCL values in the short term. However, as in previous economic downturns, we predict it will be the fastest market to return to growth.

Figure 3 Components of housing delivery in England



Source Savills Research using MHCLG and ONS

Figure 4 Annual PCL index growth since 1980 adjusted for RPI



Source Savills Research, ONS

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