Weekly Report

Selected Market News

The eurozone is continuing to recover from the debt crisis as the 0.3% growth in output exceeded expectations for the last quarter of 2013. Italian data shows that output grew by 0.1% in Q4 of 2013, and even though national output is still more than 8 times lower than pre-recession levels, it is a huge step forward for Italy to be out of their recession. Politically, Italy is still in turmoil, Prime Minister Letta resigning after being voted out by his government. Matteo Renzi will take over next week, but as Italy's youngest-ever prime minister he has to prove that he can do a better job of leading the coalition government by pushing through the structural reforms that Enrico Letta struggled with. The Italian markets responded well to this news as they rose 1.6%.
New Federal Reserve chairwoman Janet Yellen made her first public appearance this week and assured there would be "a great deal of continuity" in US monetary policy. The industrial production report released on Friday showed a 0.8% decrease in manufacturing output in January as many factories had to close temporarily due to the poor weather. There was also a retail sales decrease of 0.4% for January, meaning it is likely that analysts will be revising back forecasts for first quarter growth. Adding all of this together, there is growing concern that US growth is not as strong as previously thought.

Commodity Market Overview

Poor data from the US and a weak dollar have contributed to gold's biggest weekly gain in 6 months: closing the week at $1,318 per barrel. After a 28% fall in 2013 - its worst annual performance in over 30 years - the precious metal is up 9% in the year to date. The recent turbulence in emerging markets has led investors to play on gold's status as a haven, partially explaining the price rise. However, it is too early to say with any certainty that a rally will ensure, as there is no definitive motive for investors to reallocate their money at this stage.
West Texas Intermediate closed the week at $100.30 after a Reuters sentiment index was flat at 81.2 this month while supplies slipped to a three months low at Cushing, Oklahoma, the location to where futures are delivered. Currently 4.5% higher since the start of the year, WTI shows contrasting fortunes to Brent Crude, which is down 7.5% this year. Now changing hands at $109 a barrel, Brent has been flat this week, with a rise on Friday from $107.95 preventing the downward trend continuing into this week.
The poor weather in the US over the last week or so has led to a sharp increase in demand for natural gas (households demanding it for heating purposes). The increased demand has caused supply to fall to its lowest seasonal point in a decade. Storage levels are at a five-year low and natural gas is 3.2% more expensive than a week ago despite the energy boost from increased shale production.
Next week, all eyes will be on the Fed's minutes from their most recent meeting, which will give the market guidance on the pace of the taper, given a spate of lower than expected economic data – particularly relevant given the dovish tone set by Janet Yellen upon her recent acceptance of the lead role within the Fed.

London Housing Market

The situation

The current market fears regarding the London housing market being a bubble has been supported by key institutions (EY fearing average price reaching £600,000 in London by 2018), in addition to key statistics worrying the market. The media focus has been on the hardship of first time buyers with the average borrowing limit 3 times gross income (currently stagnant) and average house prices closing in at £350,000 (Nationwide

Property Index), where Land Registry estimates range to £405,000. This then suggests that without the Help to Buy scheme, where best estimates are indicating a wind-down by end of 2014, first time buyers will find it increasingly difficult to jump onto the property ladder.

The risk of the bubble bursting would lead many homeowners into a negative equity situation, where the outstanding balance of the mortgage is greater than the value of the property. This will occur for almost all help-to-buy buyers if there is a significant drop in house prices, due to the low deposit and low equity standing they have in newly purchased properties.

Institutions also fear a bubble in the housing market mainly because the boom-bust cycle is much longer compared to equities on average. Furthermore, output losses are usually greater because of the interdependence of the housing market and various aspects of consumption and growth.

Is it a bubble?

The main reason some institutions fear a bubble is due to the growth in average prices (nearly 12% from 2013-14 according to the ONS), volume of transactions, and the increase between the north/south divide in property.

However, Mark Carney also added that although the growth rate is high, it is starting from “quite a low level” since the recession, and average house prices in London haven’t hit the peak seen in the noughties.

Also, sharp price increases aren’t always indicative of a bubble. The normal definition of a bubble revolves around average prices being mismatched with the fundamentals of the market. It is then important to ask: how mismatched are house prices from the fundamentals at the moment?

Many argue that the growth in this sector is purely an issue of supply and demand. The growth has been fuelled by the combination of a limited supply of housing stock within central London and increased demand from new graduates (now exceeding 60% of the workforce in central London – ONS) and foreign investors (only 27% of new home sales went to UK buyers over the past two years – Civitas), with London ranked top city for foreign property investment opportunities (Reuters). One of the major reasons for increased foreign presence in the London property market is the more stringent regulation in other countries (outside the EU) in comparison. With London increasing its opportunities for high net worth individuals, they are not only purchasing high value properties but also medium sized houses and benefiting from the loose buy-to-let regulations and tax benefits associated with investing in the UK housing market.

Future Outlook

The Bank of England have kept interest rates low, and although there are fresh concerns about the forward guidance policy, an announcement by the governor on the policy to link monetary decisions to a multitude of indicators should reinsure investors on the bank’s outlook. There are expectations of a rise not being implemented until 2015; the housing market has continued reason to be optimistic.

With the withdrawal of the Funding for Lending Scheme (which has pumped central bank money into the financial system for the purpose of increasing lending for mortgages and small-medium sized loans), the stance of the Bank of England is becoming increasingly clear that they believe the market is overheating to some extent. With the Help to Buy scheme up for review in a few months, the Bank of England may have recommendations for an early removal or change of terms.

There are also movements for a recommendation for policies within London to be similar to that of Singapore and Australia, where there are regulations in place for international buyers. The idea is that foreign buyers (outside the EU) can only buy property within London if and only if they add to the housing stock, thus the market does

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not get flooded by international buyers, which can be viewed as a strong contributor to the demand in London at the moment.

So until there are further developments from either the government or Bank of England, we will continue to see price rises in the London area, where some homeowners have made more in equity growth of their property than their gross annual income over the past year, while renters have suffered the worst of the situation.

The fundamentals do not seem to support the bubble-like view which many uphold, especially with increased international demand which without regulation will not cease. However, there is still room for speculators, and dependent on the actions taken by key policy makers the foundations are in place for a potential bubble in the future.

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