Subdued activity in the housing market could add to retail woes

If recent data by the HMRC is to be believed, property transactions recorded across the whole country slipped below 90k in July (as shown in Chart 1). However, it is important to recognise that there is a tendency for the initial reading of this series to be revised upwards in subsequent releases. Nevertheless, the trend in activity remains flat at best. Moreover, key indicators that RICS collates as part of the monthly Residential Market Survey suggest that the sluggish picture is likely to persist for a while to come. This is clearly visible in Chart 2 which shows the RICS Newly Agreed Sales net balance measure as a good guide to future transactions (leading by some six months). On the back of the latest signals from this RICS series and indeed other metrics such as sales expectations, we would not be surprised if HMRC transactions for the whole of 2019 come in below 1.15 million. This would represent the lowest number of sales in a year since 2013.

An interesting question is what an extended period of subdued housing activity might mean for the wider economy and, more specifically, for the retail sector. Most analysis in this area tends to focus on how changes in house prices influence consumer expenditure primarily through the wealth channel. But this approach, while arguably generating the greatest impact, ignores the direct effect purchasing a home is likely to have on expenditure of goods that are complementary to that acquisition, such as large household appliances and furniture.

The research that has been conducted in this area is suggestive of a relationship of some significance. For example, Benmelech, Guren, Melzer [1] found that in the US, households spend $3700 on durable goods and home maintenance in the month before and in the year following a home purchase. Also in the US, a paper by McCarthy and Steindal[2] found a causal relationship between the growth rates of housing sales and home related expenditures. Meanwhile in the UK, an article by the Bank of England in 2005[3] argued that a change

1 Benmelech, Guren, Melzer (2017) Making a house a home: The Simulative Effect of Home Purchases on Consumption and Investment
2 McCarthy and Steindel (2007) Housing Activity and Consumer Spending
3 Benito and Wood (2005) How important is housing market activity for durables spending

Chart 1: Housing Transactions

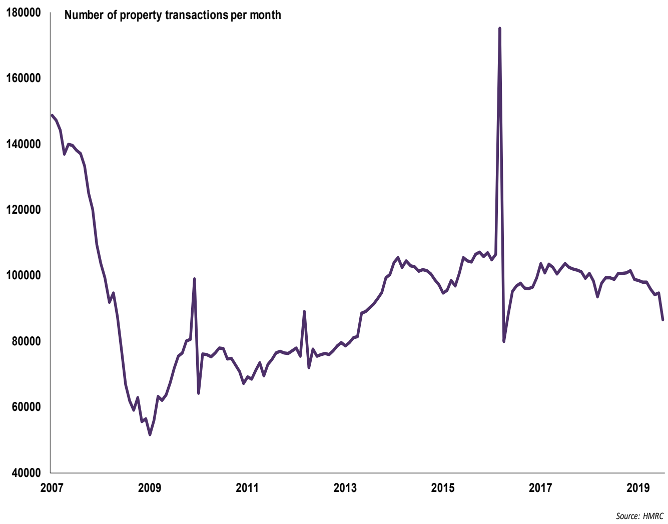
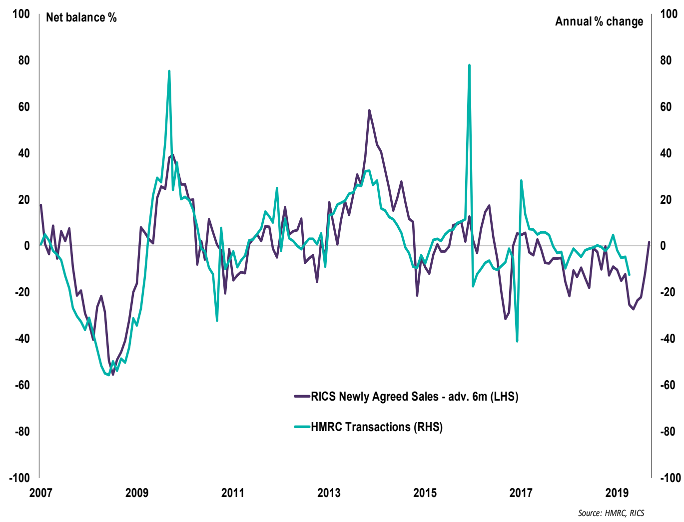


Chart 2: RICS Newly Agreed Sales Indicator



in the number of housing transactions can alter the short term profile for consumer spending on some specific types of goods. And more recently, a survey by the Bank[4] noted that; "Growth in retail sales values had slowed, reflecting weaker spending on white goods and homewares. This was potentially associated with subdued housing market activity".

The significance of housing market activity is also clearly visible in the approach taken by key macro forecasters such as the Office for Budget Responsibility (OBR) in their modelling for consumer expenditure. The OBR's model implies that a 10% increase (decrease) in property transactions raises (lowers) expenditure on durable goods by 0.4% as a share of total consumption in the short run. Essentially, this suggests that a drop in housing transactions, let's say by 50,000 (as implied by the RICS forecast) over the course of 2019 could potentially result in expenditure on durable goods falling by £200m.

In the context of the £135 billion spent on durable goods last year, a fall of £200m may be seen as small beer. Still, this analysis does suggest that if activity in the housing market were to weaken further, this could intensify the pressure on the retail sector.

The relationship is reflected in Chart 3 where housing transactions are shown to be positively correlated with consumer spending on durable goods (such as expenditure on major household appliances, furnishings, carpets and other floorings). The chart points to housing transactions providing a lead of anywhere between one and four quarters which, interestingly, seems to reinforce the results of the Benmelech, Guren, Melzer and the Bank of England studies discussed above.

Our own quantitative analysis tells a broadly similar story, though it is suggestive of a slightly bigger impact of housing transactions on durable goods expenditure than the OBR model. Whether this is the complete story is open to question given that an alternative to moving home could be upscaling existing accommodation which may also have a positive effect on expenditure of household goods. Nevertheless, these findings do shed a little light on the significance of housing activity for consumer behaviour.

The relevance of this is, arguably, greater at the present time with the negative narrative around the high street that is dominating the news headlines. Indeed, stark profit warnings have been issued by household goods stores such as B and Q, Carpetright and Homebase. Unsurprisingly, the retail commercial property picture also appears to be downbeat with contributors to the RICS UK Commercial Property Market Survey continuing to report diminishing appetite for retail sites. Against this backdrop, rents are envisaged to continue slipping in the near term (as shown in Chart 4) and over the medium term. Structural changes are clearly having a profound impact although, within this, there are inevitably winners as well as losers. However, the overarching pain inflicted by the trend toward digital

Chart 3: Transactions and Consumer Durables

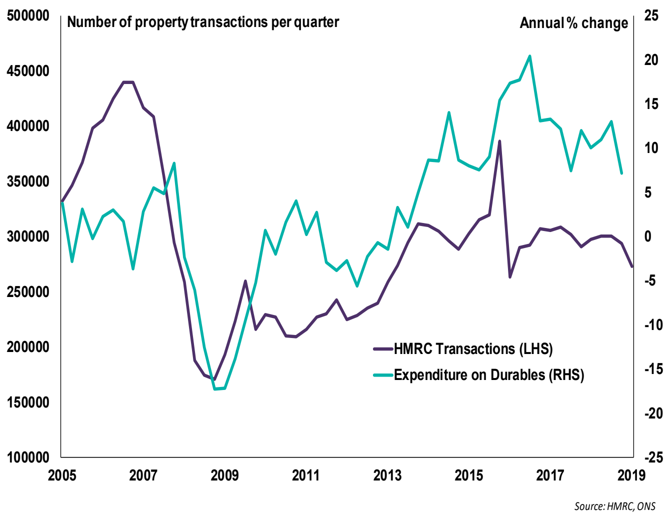
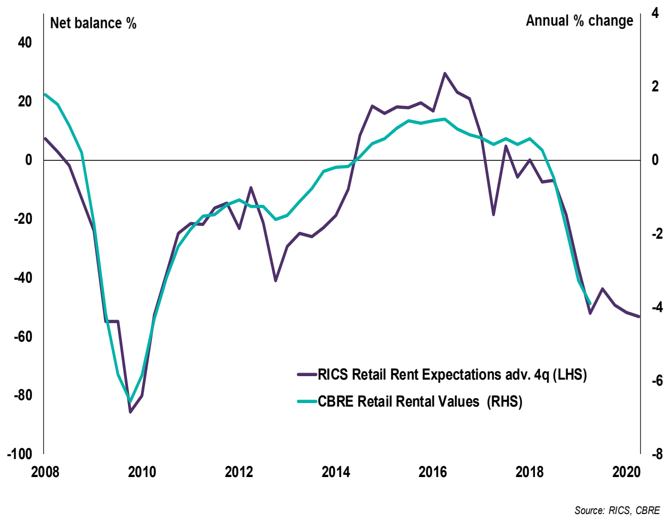


Chart 4: Retail Rents



consumption may well be compounded if the dip in turnover in the housing market persists.

RICS data suggests part of the blame for the current situation can be attributed to uncertainty relating to the Brexit process although stretched affordability in the housing market and supply related issues also remain key impediments. Medium term expectations for sales produced as part of the RICS Residential Market Survey do point to some improvement in the trading environment next year. Whether this materialises remains to be seen. Retailers are likely to be amongst those hoping that the more sanguine view of respondents to the survey, once a Brexit path has been agreed, are justified.

4 Bank of England Agents Summary of Business Conditions – 2018 Q1

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