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Wealth

# technical news

For professionals working with international clients

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## UK property becoming more affordable

UK house prices are set to tread water while incomes rise, making property more affordable.

The numbers aren't looking good for residential property investors. House price growth in the US fell to a mere 1% at the beginning of this year. Look at global data across the 18 largest economies in the world and things don't look much more encouraging. This could be the year in which we see global growth dip to its lowest pace in a decade. Investment is slowing fast.

The UK is no outlier here. The Nationwide index and the Rightmove Asking Prices index show prices and asking prices respectively to be all but flat. The Halifax House Price index shows a better annual number but suggests prices fell mildly in the summer. You can see the same trend in Hometrack data, which suggests that the falling prices we have seen in London are beginning to spread: over a third of homes are now in areas with annual price falls (the higher value the market the more likely this is), although the absolute levels of falls is small. So what next? Most analysts expect the market to tread water from here – although a successful Brexit deal would lead to a little London bounce.

This is probably correct. There is still some support for prices meaning prices are generally flat. Housing construction is falling slightly (so

the supply of housing is not rising much). Interest rates are low and will go lower if Brexit goes horribly wrong. The banks' wholesale funding costs have also edged down, and that should soon feed into mortgage rates. At the same time wages have jumped (year-on-year growth excluding bonuses hit an 11-year high in April) and household disposable incomes are also on the up.

**5.03**  
UK house price to earnings ratio  
**2019**

That makes houses – even at today's inflated prices – seem more affordable. Values are likely to be at least supported by healthy labour market conditions and low borrowing costs. That said, there isn't much to push prices much higher. Property is still expensive relative to incomes. The tax and regulatory hit to buy-to-let is discouraging buyers in that market. An unwelcome (to big property owners, at least) overhaul of property taxation may be on the way. And the Help to Buy scheme (which has played a clear part in pushing prices up) is likely to be scaled back soon. Put all those factors into the mix and it is hard to see a rebound in prices in 2019 or beyond.

The key thing to bear in mind there is that this is not bad news – unless you very recently paid too much for a house. UK property is still too expensive relative to average earnings. That makes it tough to get on the ladder and tough to move up the ladder.

The fact that house prices are not really rising in nominal terms, combined with the small real rise in wages over the last two years, is beginning to change this situation. In 2007, Nationwide's house price to earnings ratio for the UK was 5.42. At the end of 2016 it was 5.25. Today it is 5.03 times. That's not ideal – but if this gentle drift down continues and we end up at more like four times, it will suddenly be an awful lot easier to buy (and sell) houses. That would be a very good thing.

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## Labour's tax plans need attention

As a UK general election must surely be approaching, Labour's plan to abolish 'non domicile' status is not getting the attention it deserves.

The media have picked up on headline grabbing ideas like their plans for the expropriation of private school assets by the state. Yet the threat to 'non doms' in the UK will make the country less attractive and leave a big whole in the budget.

Labour has said that in its first Budget it would abolish non-domiciled status as part of a "comprehensive plan to increase tax transparency and clamp down on tax avoidance and evasion". UK residents,

said Labour's John McDonnell, "should pay their tax to support our public services and infrastructure."

Of course, someone has to pay the taxes to keep the UK's welfare state on the go. But the thing is that the UK is not exactly the only country that offers favourable tax deals for newish immigrants. The truth is that the very-well-off have choices. Lots and lots of choices.

Italy, for example, is very keen to welcome 'non doms' since they boost the economy so significantly. Move there, and, while you have to pay ordinary income tax on income actually generated in Italy, the rest can be dealt with by one single lump sum payment of €100,000 a year, regardless of how much you as a non-dom might actually have made. No income taxes, wealth taxes or local taxes due. You can hang on to this generous tax avoidance scheme for 15 years and (unlike in the UK regime) remit both assets and income to Italy anytime without incurring any new tax liabilities. Very attractive for the internationally mobile.

Portugal is at it too: there's a reason rich people like living in Lisbon. Under the non habitual residency rule (NHR) you effectively get a tax holiday for the first ten years you live there – paying a flat 20% income tax (the usual top rate is 48%) if you work in a sector classified as "high value added". Income from outside Portugal fares even better – it is totally tax free for the first ten years you live in Portugal.

On to famously high-tax France. Anyone who relocates there to work and, in doing so, makes France their primary residence can end up partially exempt from French income tax for eight years. They are also exempt from the French wealth tax on all assets held outside France for the

first five years for their residence.

Finally, Denmark. How does six-year flat rate of income tax at 32.84% sound? Its not as good as Portugal (nor as easily accessible) but meet the criteria and it will still leave you an awful lot better off than living in Corbyn's Britain.

The point here is that it's going to be pretty easy for our non-doms to pack their bags and go (in the main, their bags are already packed). But given the attractions of, say, working from home in the Algarve or perhaps a villa just outside Rome, it won't take much in the way of income and wealth tax rises in the UK for our rich doms to see the attractions of being a non-dom somewhere else.

It is unlikely that the Labour Party has factored the loss of every non-dom to somewhere more sympathetic to their needs into their budget calculations.

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## Trade truce : both sides back down

China and America have agreed to a pretend trade deal. Donald Trump has lauded a 'phase one' trade agreement, but the details are so thin that the Chinese side preferred not to use the term 'deal' at all. That didn't stop the markets cheering. Both US and Chinese stocks rose on the announcement.

The latest developments amount to a ceasefire rather than a peace treaty. Washington has agreed to cancel upcoming tariff hikes, with Beijing promising to more than double its purchases of US agricultural products in return. Faced with mounting evidence of the impact his trade war has had on US manufacturing, agricultural incomes and business confidence, Trump is worried that

his re-election campaign could be in trouble. The White House seems to be trying to paint a climbdown as a victory.

China's negotiators have their own reasons for avoiding the term 'deal' Any final agreement that doesn't remove the punitive tariffs altogether would draw unfavourable comparisons with China's 19th-century 'unequal treaties' with colonial powers and trigger nationalist vitriol. But that doesn't mean that the Chinese don't want an interim accord. The country's exports and imports have shrunk more than expected and leading indicators remain grim. Many analysts had thought that Chinese policymakers would be content to wait for next year's US elections as they would rather negotiate with somebody less bent on causing havoc.

Investors should not overestimate the impact of a deal that barely moves beyond agriculture. Hundreds of billions of dollars of Chinese goods will still remain subject to American tariffs. And the trade war is not the only thing ailing the global economy. China's slowdown, occasioned by a crackdown on shadow banking, is weighing on everything from Chilean copper miners to German car makers.

The economic effects of the trade war have been exaggerated. It has probably only accounted for 25% of the slowdown in global GDP in recent years. The 'mini-deal' now on the table doesn't even begin to cover deeper disputes about intellectual property, technology transfer and industrial strategy between the two sides. Expect the "slow and steady drift towards a more antagonistic" trans-Pacific relationship to continue. Investors should be prepared for this decoupling.

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## Who will save the Euro after Draghi?

Mario Draghi – a safe pair of hands at the European Central Bank is handing over the presidency to his successor, former International Monetary Fund (IMF) managing director and French finance minister Christine Lagarde. That might just look like one technocrat handing over to another. But it might have serious and worrying consequences for investors.

When Draghi took office, the euro crisis was just starting. Greece was running out of money. Ireland had already had to be bailed out to fix its banking crisis. Portugal was not far behind, and Italy and Spain were teetering on the edge of financial collapse. The bond markets were refusing to fund national governments and the euro at times looked close to collapse. The new president was stepping into a storm.

Draghi's record and legacy might look like nothing special. After close on a decade, he printed over two trillion euros of new money, chucked it at the banking system and only managed to generate a tepid recovery. Slashing interest rates to zero and taking some key rates into negative territory hasn't helped much either. The ECB has not been able to create the kind of sustained recovery from the financial crash seen in the US and to a lesser extent in the UK. Instead, it has slowly turned into the new Japan. There is not much in that record to brag about.

Except for this: it could have been a lot, lot worse. Draghi steered the eurozone through a crisis that took it to the edge of a break-up. His success was by no means inevitable. With his now famous promise to do "whatever it takes" to ensure the survival of

the single currency, he tore up the rule book and started the process of turning the ECB into an activist central bank. Many people assumed it couldn't print money or intervene in the markets to rescue over-spending governments (after all, the treaties do seem to rule that out), but Draghi went ahead and did it anyway.

He wasn't shy of intervening in national politics when he had to either. It was the ECB's decision to turn off the cash machines that bought the Greeks into line and when Italian prime minister Silvio Berlusconi made noises about leaving the euro, Draghi made sure the bond markets quickly changed his mind. Draghi turned the ECB into the only European institution with the power to shape events rather than just react to them.

It is unlikely his successor will be anything like as good. Indeed, Lagarde's record shows she will stick to a rigid consensus, seeking compromises instead of solutions even if another crisis hits. Unlike Draghi, she is a lawyer by training, not an economist. As France's finance minister she presided over a huge budget deficit and squandered the opportunity for reform that then-president Nicolas Sarkozy briefly opened up. Another decade of stagnation was the result. At the IMF, she colluded in policies that created the worst depression in recorded history in Greece and then led the IMF's largest ever rescue package in Argentina, which promptly led to another default and a fresh crisis in that country.

At the ECB she is likely to broker compromises and keep her political masters on board, but will ignore what is happening to the economy and tune out warning signs from the markets. Much as it did in Argentina,

that may well lead to disaster. She's unlikely to show any of the flexibility or creativity that allowed Draghi to get ahead of events and bring the markets under control. If there is a recession and a fresh euro crisis during her term it is hard to feel confident she will be able to manage her way through it. A break-up of the euro will be messy, pricey and traumatic. Banks will go down, unemployment will soar, firms will go out of business and equity markets will crash. Without Draghi in charge and with the clueless Lagarde taking over, that is a lot more likely. At some point the markets are going to miss having the man who saved the euro in charge of the ECB.

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## Global stocks will catch up with US

When stock investors chase after winners, it is striking how often they end up in the US. So complete has the country's equity dominance become that all of the top five stocks in the FTSE All World index by market weight are American tech giants. Wall Street stocks have eclipsed others over the past decade and continued to outperform this year.

Yet, the S&P 500 has officially entered an 'earnings recession' after corporate profits fell in both the first and second quarters of this year. Upcoming US third-quarter earnings are expected to be little better. Brokers are warning clients of another outright decline, although we will have to wait for the actual figures to see if they have been managing down expectations.

The record-long US bull market has been based on strong earnings growth, while rich valuations are based on the promise that the

earnings juggernaut will march on. Meanwhile, the MSCI USA index has returned an average 13% annual return since 2009, compared with just 5% for the rest of the world.

On a price/earnings basis that has left non-US shares trading on a roughly 20% discount to their American counterparts. The long outperformance of US equities looks set to end.

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## Avoid higher stamp duty

The higher rate of stamp duty on second properties comes with several exceptions.

Boris Johnson wants to overhaul stamp duty. He has proposed axing it on properties worth less than £500,000 and lowering the rate on properties worth more than £925,000. Whether or not he sticks to this pledge, it's worth knowing the stamp-duty exemptions that currently exist.

One aspect of stamp duty that comes with several exemptions is the higher rate due on the purchase of second homes. This applies if, at the end

of the day on which the transaction takes place, you own more than one property.

Importantly, however, it doesn't apply if you own more than one property but the property you are buying is replacing your main residence, if that is being sold. Moreover, if you buy a new home, but still own your previous main residence, you can claim a refund of the higher rate if you sell it within the next three years. Just note that you need to claim your refund within 12 months of the sale of the previous residence or within 12 months of when you file your stamp-duty tax return, whichever is later.

Somewhat confusingly, there is another loophole that applies where someone is buying a new main residence, but not actually replacing a current main residence that they own. Normally in this situation, you would have to pay the higher rate if you happen to own other properties.

However, if, within the previous three years you have sold a main residence, you are also entitled to avoid the surcharge. This particular loophole could be helpful for buy-to-let landlords who are currently living in rented accommodation, for instance.

A slightly less complicated exception may be of use if you have recently inherited property. The additional stamp-duty levy will also not apply if you are buying a second home but the interest you have in another property is a less-than 50% share of a property that you inherited within the previous 36 months.

Finally, it's useful to know the types of transaction that attract commercial, rather than residential, stamp-duty rates. Commercial rates range from 0% for the value of a property between £0 and £150,000, 2% for £150,001 to £250,000 and 5% on a value above £250,001. This compares to residential rates, which can go up to 15% for value more than £1.5m. Examples of non-residential transactions include the purchase of mixed-use properties (so if you bought a building made up of a flat above a shop), and the purchase of six or more residential properties in one go.

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## Contact us

If you require further information about our services and how we can assist your clients, then please call us or send us an email about how and when we can contact you.

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