PROPERTY VISION

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The big one?

The next year will be testing for the top end of the property market – particularly in London: testing because it will test the theory that central London property has become a safe store of value, like gold and US Treasuries, in a world of incipient sovereign default – or its cousins inflation and currency debasement.

The question hovering around in everyone's minds is, "Is this the big one?" After the false starts, or rather stops, of the last twenty-five years – the crash of 1987, the Russian Default of 1998, the Millennium tech bubble and the bankruptcy of Lehman's – is this now the beginning of not necessarily a depression but the sort of Japanese semi-permanent recession that has ground on for twenty years while the rest of Asia has boomed? And if it is, what does it mean for the prime property market in the UK?

The bulls point to affordability – which with current interest rates has not been as good for many years. They also point to the 'lesson' of the 1970s – that if we are in a stagflationary environment, then quality property is the place to be as a 'hard' asset that will hold its value when paper money is being debased. Anyway, whatever happens, so the upbeat story goes, the rich are always with us and UK property, particularly in Central London, will always be in demand by the international rich.

The bears say, "Be careful what you wish for." Ultra-low interest rates (which is the only reason property is currently so affordable) are only that way because if they were any higher, they would expose the vulnerability of the property market – tipping overextended borrowers, and probably the banks that allowed them to get that way, into insolvency. Japan has been 'affordable', by this metric, for many years – but who would want that? The inflation argument has more merit – though it would seem that inflation can come in many forms. The wage-driven inflation of the 1970s doesn't seem to be quite the same sort – essentially imported – that we have now. And the sort that central bankers seem to secretly want in order to sort out the seemingly intractable debt problem might be more difficult to dial to order than it would appear: volume of money is one thing; velocity another – as the Japanese have found out. It is interesting that the inflation-hawk, Ken Rogoff, who learnt his trade at the knee of Paul Volker, is now recommending limited inflation as a means of dealing with the debt overhang. Things must be bad.

But does any of this add up to a decline in property values in the prime areas of London? If we end up in a depression – or something that feels like it – then it is unlikely that any property will hold up. The inflation situation is more difficult to predict – but it is likely that property's reputation as an inflation hedge might be a self-fulfilling prophecy in that it becomes that port-of-call of choice and gets bid up by everyone looking for the same protection – like US Treasuries in this current iteration of the crisis.

Will this be all property? Unlikely – as the sort of property that is dependent on bank lending won't thrive in the mortgage drought that we are in now. The de-leveraging of banks is only at an early stage and they are also facing the headwind of Basel 3 – which can only suck future lending out of the system in order to satisfy the regulators' demands for reserve capital. And this is without any crystallisation of losses on commercial property or Greek and other dodgy Latin bonds. It is all very well the government telling banks to lend more – but they can't do that and follow the new rules at the same time.

In practical terms it is likely that the markets that the international rich love most will do best – or least badly depending on whether you are an optimist or a pessimist (the joke goes that an optimist is someone who still thinks the future is uncertain). This means Central London and the Home Counties of the Wentworth variety. The rich domestic should be ok: this means areas in London like Wandsworth and Fulham, or

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rectories in Gloucestershire, where there is still an injection of new capital in the way of bonuses, and where banks are comfortable lending on loan-to-value ratios that allow them a good night's sleep.

In the here and now, the market is doing what it always does when a crisis hits – it slows right down with both buyers and sellers sitting on their hands. At the lower, bite-size levels in London it is quite busy. At the top, where asking prices are often delusional, there is some action but also a familiar stand-off between buyer and seller that will take some really bad news to bridge. In the country and in France, the optional purchases are being shelved for the time being: when all is said and done, no one needs to buy a second home in Rock or Antibes. Where a decision has been made to move the family home, and supply is always an issue, there are still buyers and active ones at that, though prices – asking prices anyway – are 10% less than six months ago.

One by one the traditional safe havens are looking less attractive. Even at current levels of inflation, US Treasuries are costing you money – yields need to double to tread water. If the rational bond vigilantes start winning the argument, then a hefty capital loss will be the result for that safe haven. Gold is – well, everyone by now knows the argument – but anything that has moved so far so fast is vulnerable. As the price rises, it attracts sellers who suddenly find that the necklace around their neck is a high proportion of their net worth – and suddenly the argument that there isn't much more of it around is confounded. The Hunt brothers found this in the 1980s when they cornered the silver market to suddenly find it flooded by silver teapots from innumerable attics around the world. Cash? Which bank? Which is the next Iceland? This leaves London property – illiquid, large bite-sizes – and no one would claim it's cheap.

Take your pick.

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