Market briefing: December 2019

Key developments in the housing and mortgage markets

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Executive Summary

- Concerns about the domestic political situation, economic slowdown and job security have been adversely affecting household sentiment. December's clear General Election result offers a short-term psychological boost. It is not clear to what extent this will specifically benefit the housing market.

- Negotiations regarding our future trade relationship with the EU are important for the UK's longer-term prospects and, at this stage, a source of uncertainty.

- The housing market is more or less in a steady state currently, as far as house prices and activity levels are concerned.

- The phasing out of the Help to Buy Equity Loan Scheme from 2021 will loom ever more strongly next year, and it is to be hoped that the forthcoming Budget addresses this issue.

Economic overview

The emphatic General Election result removes the near-term uncertainty around Brexit and should provide a short-term economic lift.

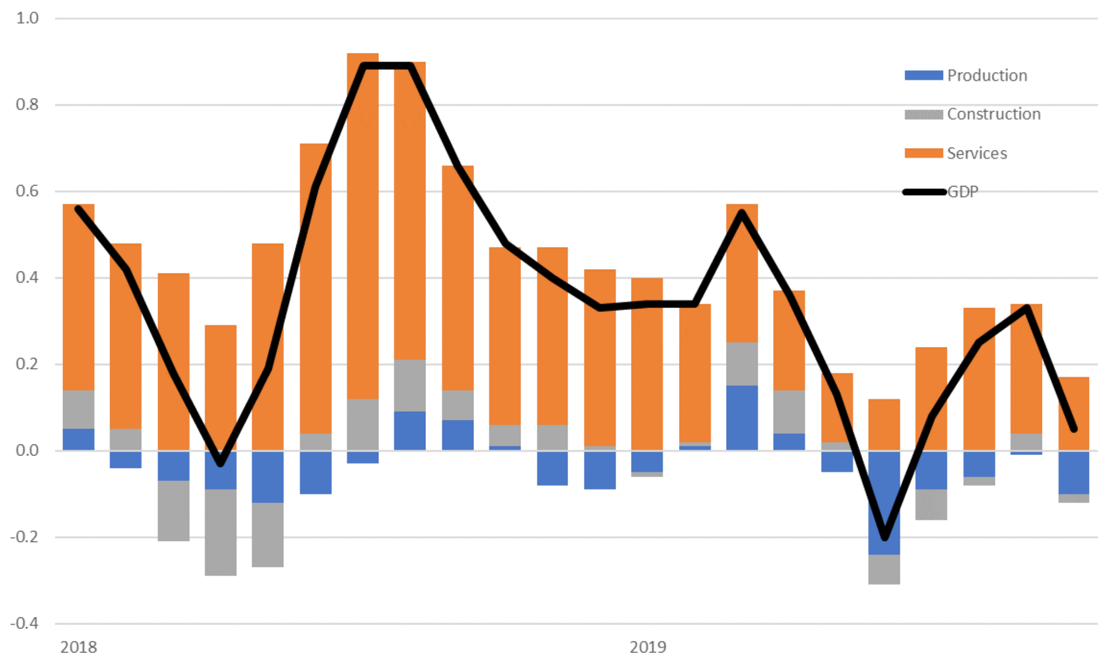
Any bounce is likely to be limited at this stage, however, as attention will soon shift onto negotiations for a new trade agreement between the UK and the EU, which will be key to our future economic prospects.

Here, the choice seems to be between an unambitious bare-bones agreement by the end of 2020 or a fuller more business-friendly deal that potentially takes much longer to negotiate. A disruptive no-deal Brexit at the end of 2020 cannot be ruled out at this stage and uncertainty around this may act as an ongoing drag on UK economic performance.

Brexit uncertainties have clearly undermined the UK economy this year. The see-saw pattern of activity slightly masks the fact that underlying year-on-year growth has halved to barely 1%.

The UK economy was flat during the three months to October, with few signs of goods being stockpiled ahead of the once-mooted 31 October Brexit departure date.

Chart 1: Contributions to GDP growth, rolling 3 months



Source: Office for National Statistics

Gloomy readings from an assortment of business surveys indicate that manufacturing and the dominant services sectors fell sharply in November. Overall GDP growth is likely to have been negligible in the fourth quarter and the weakest for the year as a whole since the global financial crisis.

Headline figures point to a jobs market that is still resilient in the face of disappointing growth, with employment at 32.8 million in the three months to October, up 309,000 on a year earlier, and an unemployment rate of 3.8%, its lowest since the mid-1970s.

But there are signs of softening. Employment levels have bobbled about over recent months and official figures report vacancies at their lowest level for two years. Elsewhere, a quarterly study by Manpower is the latest to show that hiring intentions among employers are the weakest for several years.

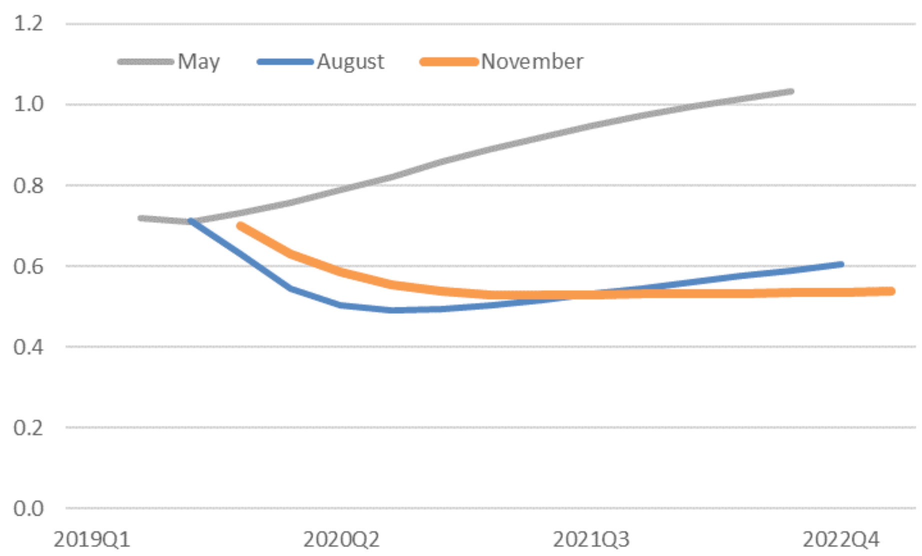
While labour market conditions are still relatively tight, nominal pay growth has started to nudge lower – regular pay was up by 3.2% in the year to October, down from its recent peak of 4.0%. Given that consumer price inflation has also slowed, earnings are still growing by more than 1½% in real terms, continuing the strongest period of gains for more than three years.

Nevertheless, household savings are drifting higher and most surveys indicate that people are less confident about the future state of their personal finances and so cautious about major purchases.

Interest rates

Inflationary pressures are currently relatively benign, helped by lower energy prices. The annual rate of inflation, based on the Consumer Prices Index including owner occupiers' housing costs (CPIH) remained at 1.5% in November, down from a recent peak of 2.8% and the weakest figure for three years.

Chart 2: Bank Rate expectations used by MPC



Source: Monetary Policy Report, Bank of England, November 2019
Note: Based on 15-day average forward rates derived from Overnight Index Swap rates.

In November's rebranded Monetary Policy Report, the Bank of England was a little more pessimistic about short-term economic growth, but this was mainly because the global outlook has deteriorated rather than the technical changes to how it models Brexit (which attracted the media focus).

The Monetary Policy Committee (MPC) anticipated that consumer price inflation would ease back further in the early months of next year and then move onto a gentle rising trajectory through to the end of 2022.

More recent economic data have been broadly in line with the November Report.

By the time of December's MPC meeting, the expected path for Bank Rate in three years' time was around 10 basis points higher than that on which the November Report projections had been conditioned (shown in Chart 2). The Bank attributes this to a more optimistic Brexit assessment by financial markets.

Monetary policy was once again left on hold. As in November, two external MPC members voted for an immediate rate cut - to 0.5% - because of downside risks from the weaker world outlook and Brexit uncertainties.

But market expectations of an early downwards move in official interest rates appear to have retreated a little.

Macro-prudential policy

The Financial Policy Committee (FPC) continues not to be unduly concerned about downwards domestic risks, according to December's *Financial Stability Report*.

The regulator expresses few concerns about current housing market developments or associated mortgage lending, given modest rates of credit growth and low debt-servicing costs, but does note that borrower demand could pick up on easing Brexit uncertainties.

The Report sets out the findings of the FPC's latest review of its mortgage recommendations (pages 47-58).

It offers a robust and familiar set of arguments in support of the LTI flow limit and affordability test that have been in force since 2014, and asserts (not for the first time) that the measures should be seen as structural measures intended to remain in place through the housing cycle.

Without naming IMLA, the FPC counters our recent challenge[1], as to whether its rules are unnecessarily cautious and risk preventing many potential first-time buyers from getting on the housing ladder, by citing Bank staff analysis that private renters are primarily constrained by insufficient savings.

The Committee continues to hold to a long-standing view that its measures have had only a limited effect on mortgage availability, highlighting that lending remains well below the 15% LTI flow limit, that approvals are steady and that the share of first-time buyers has risen since 2014. None of these points represent watertight arguments, especially the last point given that government policy and Bank of Mum and Dad have boosted first-time buyer numbers, whilst movers have had to be more self-reliant, are less able to stretch mortgage terms and face high transaction costs.

Slightly more positively, the FPC did at least acknowledge the point, made in a report[2]from UK Finance and Hometrack, that its rules might have a larger adverse impact on first-time buyers in London and the South East where house prices were high relative to incomes.

Lastly, the FPC - noting that reversion rates had been relatively static over the period when official rates had fallen - undertook to monitor how any future Bank Rate increases are passed through to reversion rates to assess whether a recalibration of its affordability test might be warranted.

[1] *The intergenerational divide in the housing and mortgage markets*, IMLA, October 2019

[2] *The changing shape of the UK mortgage market*, UK Finance, December 2019

Fiscal Policy

Fiscal policy has been put on an expansionary trajectory, following the £13.8 billion increase for 2020−21, unveiled by the Chancellor of the Exchequer, Sajid Javid, in September. This marks the beginning of an important re-balancing of policy, after successive governments have relied on monetary policy to lift the economy since the credit crisis.

The timing of the general election meant that we did not have an Autumn Budget.

A Budget in the first quarter of 2020 looks set to be a significant economic event for the UK, with a further material loosening of fiscal policy, higher Budget deficits (already rising because of subdued rates of economic growth and accounting changes) and revised fiscal framework all likely to be announced.

Although housing was an important issue during the recent General Election campaign, it did not achieve breakthrough status, and so it is not clear how much priority housing will get in the forthcoming Budget.

Housing Policy

The return of a Conservative administration means that many aspects of housing policy will continue along familiar lines. So, for example, reform of shared ownership and a proposed end to no fault evictions continue.

The Conservative Party's manifesto document has shifted the focus back to homeownership, and featured new ideas around lifetime fixed rate mortgages and First Homes discounts for local first-time buyers:

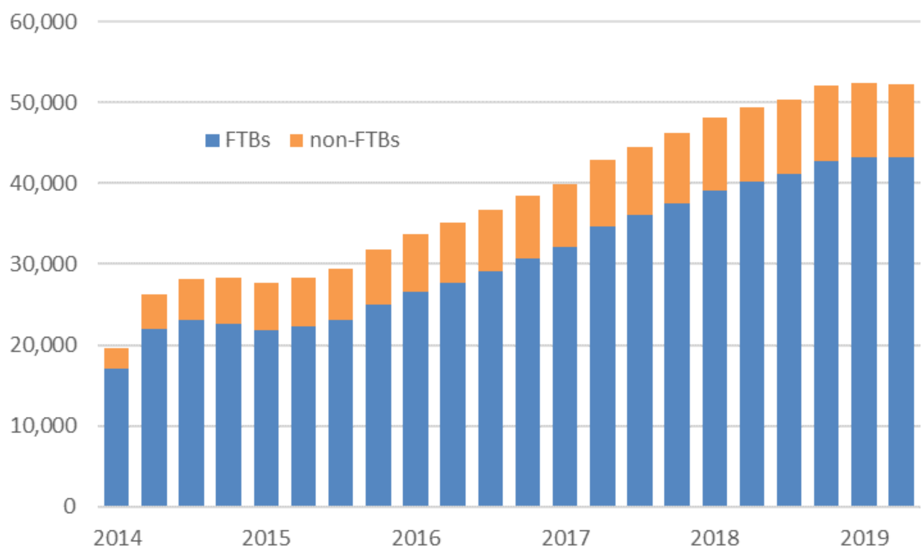
- Lifetime fixed rate mortgages aim to boost affordability for first-time buyers by allowing them to take out higher LTV loans (up to 95%). This appears to rely on lenders using their ability to disapply the 3% stress test mandated by the Financial Policy Committee (FPC).
  The success of a scheme would depend upon many factors, including pricing and flexibility for consumers to make early repayments - both functions of what funding model is proposed – and bringing intermediaries on board with a suitable system of trail commissions.

- Under First Homes, flagged in December's Queen's Speech, local authorities would use developers' contributions via the planning process to offer discounts of a third to local first-time buyers. In contrast to the Starter Homes Initiative, launched in 2015 but which failed to deliver any homes, the First Homes discount would apply in perpetuity. This will make valuation issues easier but restrictive covenants around resale are likely to mean that take-up may be quite limited. A consultation is expected shortly.

On stamp duty, where IMLA recently argued for a far-reaching review as part of its general election wishlist[3], the only manifesto commitment was to bring in a 3% surcharge on non-UK resident buyers. A general commitment to lower the burden of stamp duty to encourage greater housing market activity, aired in the early days of Johnson's leadership, appears to have been quietly dropped.

Housebuilding is an area where the Conservative manifesto document was surprisingly muted. The manifesto simply repeated an earlier commitment to provide a million more homes in England over the next five years. This is a lower annual rate than the 241,000 achieved in 2018-19 (214,000 of which were new-build) , although admittedly this was the strongest performance in 30 years. In a similar vein, the manifesto only committed to renewing the Affordable Homes Programme at its current level.

Chart 3: Help to Buy Equity Loan Scheme completions, rolling 12 months



Source: MHCLG

This will be a key area of interest for mortgage lenders in the forthcoming Budget, given the importance of Help to Buy Equity Loan Scheme for overall new-build and its scheduled closure in stages from 2021 onwards.

As the latest figures show (to mid-year), the Help to Buy Equity Loan Scheme continues to run at pace. Sales in the 12 months to June totalled more than 52,000, 6% higher than a year earlier. Demand in London continues to grow strongly – up about a quarter – and now accounts for nearly half of overall growth

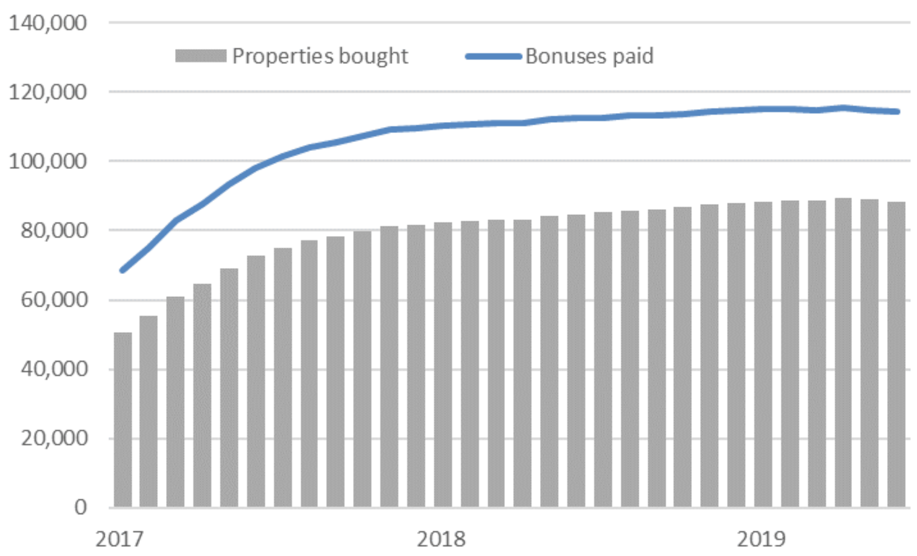
[3] *General Election Wishlist*, IMLA, November 2019

Help to Buy: ISA scheme

The Help to Buy: ISA scheme has recently closed to new savers looking to buy their first home. The scheme gave first-time buyers a 25% boost to their savings when buying a property of £250,000 or less (with a higher price limit of £450,000 in London).

Since its launch four years ago, it has paid out bonuses to a third of a million individuals buying a quarter of a million homes. Although account holders can continue saving into their account for another ten years, the size and profile of bonuses suggests that young adults have predominantly been using the scheme as a short-term instrument.

Chart 4: Help to Buy ISAs, bonuses paid and properties bought, rolling 12-month totals



Source: Help to Buy: ISA Scheme Quarterly Statistics, HM Treasury, November 2019

The Help to Buy: ISA has been succeeded by the Lifetime ISA (LISA), available from

Although the equity loan scheme will continue for first-time buyers through to 2023, we have already seen the closure of Help to Buy: ISAs (see boxed article) and there is a growing sense that a fresh initiative (or set of initiatives) may be needed if first-time buyer numbers are to continue growing.

In Scotland, where Holyrood has devolved housing powers, a First Home Fund has just been launched, to run alongside, but not to be used in conjunction with, Help to Buy (Scotland). The £150 million pilot scheme, scheduled to run until March 2021, aims to help at least 6,000 people to buy their first home by offering interest-free equity loans up to £25,000. First-time buyer numbers are currently running at about 33,000 annually, according to UK Finance.

Housing and mortgage markets

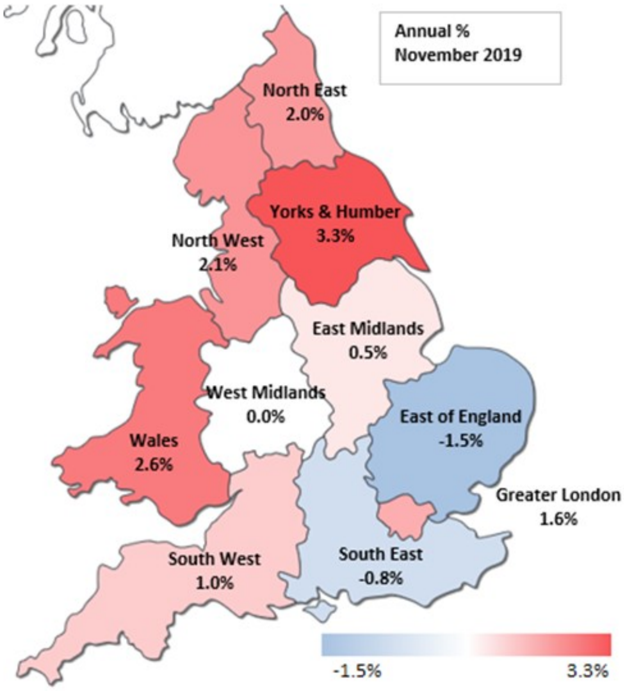
Prices

House price inflation nationally continues to be subdued, although most indicators show a distinct pick-up for November. Halifax reported a particularly sharp rise for the month, up from 0.9% to 2.1% year-on-year, but the general view is that annual house price inflation is currently about 1%. Nationwide has reported annual house price growth nationally of less than 1% for the past 12 months.

House prices continue to modestly outpace consumer price inflation in Northern Ireland, Wales and parts of northern England, according to the Office for National Statistics figures for October.

Although most London boroughs continue to experience price falls, the overall story for London is one of a gradual recovery since the summer, according to LSL/Acadata. A gentle ripple effect from London means that prices have softened a little elsewhere in southern England, mostly the South East and East of England.

Chart 5: House price changes, year to November



Source: LSL/Acadata

Activity

Residential property transactions appear to be running at similar levels to a year ago.

HM Revenue & Customs reports a noticeable pick-up in monthly transactions in October. But its figures have been erratic in recent months and it is probably best to look at the rolling 12-month picture, which shows activity being a shade weaker than a year ago.

This narrative sits reasonably well with the Bank of England's approvals data, also to October. While approvals for house purchase, of about 65,000, are a bit softer compared with recent months, the rolling 12-month position is marginally stronger than comparable figures a year ago.

The underlying picture then is one of reasonable stability, a not unreasonable outcome given all the Brexit uncertainties that have been present.

Mortgage lending

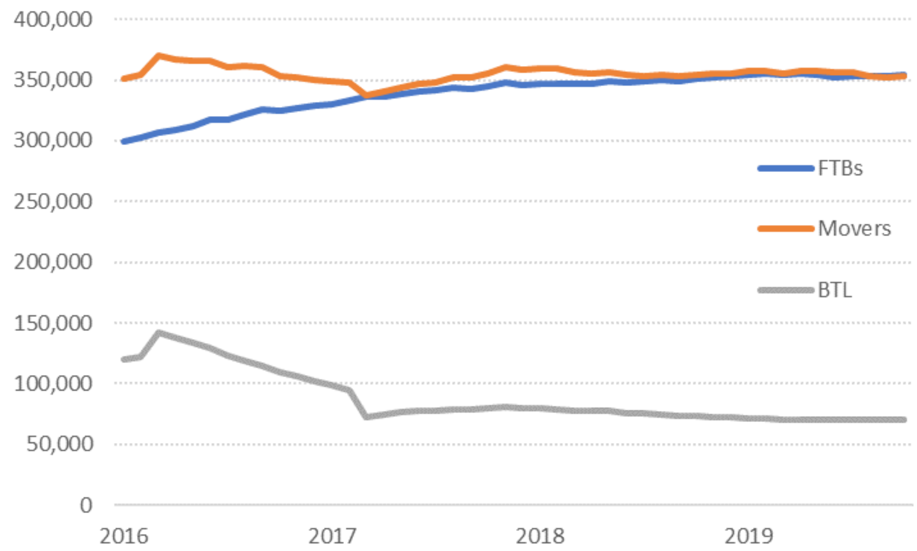
Gross mortgage lending in October – a little below £28 billion on a seasonally adjusted basis - was a few percentage points weaker than in September and also compared with a year ago. This reflects stalled growth in both house purchase and remortgage business.

First-time buyer numbers continue to be underpinned by limited property price inflation across much of the country and competitive mortgage deals, although the underlying trend suggests a plateau, according to the latest UK Finance figures, The annual value of lending to first-time buyers continues to hover around £60 billion, but activity levels are a shade below their peak in the Spring.

Regional figures from UK Finance show that first-time buyer numbers are flat in England, but continue to see year-on-year growth in Northern Ireland, Wales and Scotland.

The profile for movers is broadly similar to that for first-time buyers.

Chart 6: first-time buyers and movers, rolling 12 months



Source: UK Finance

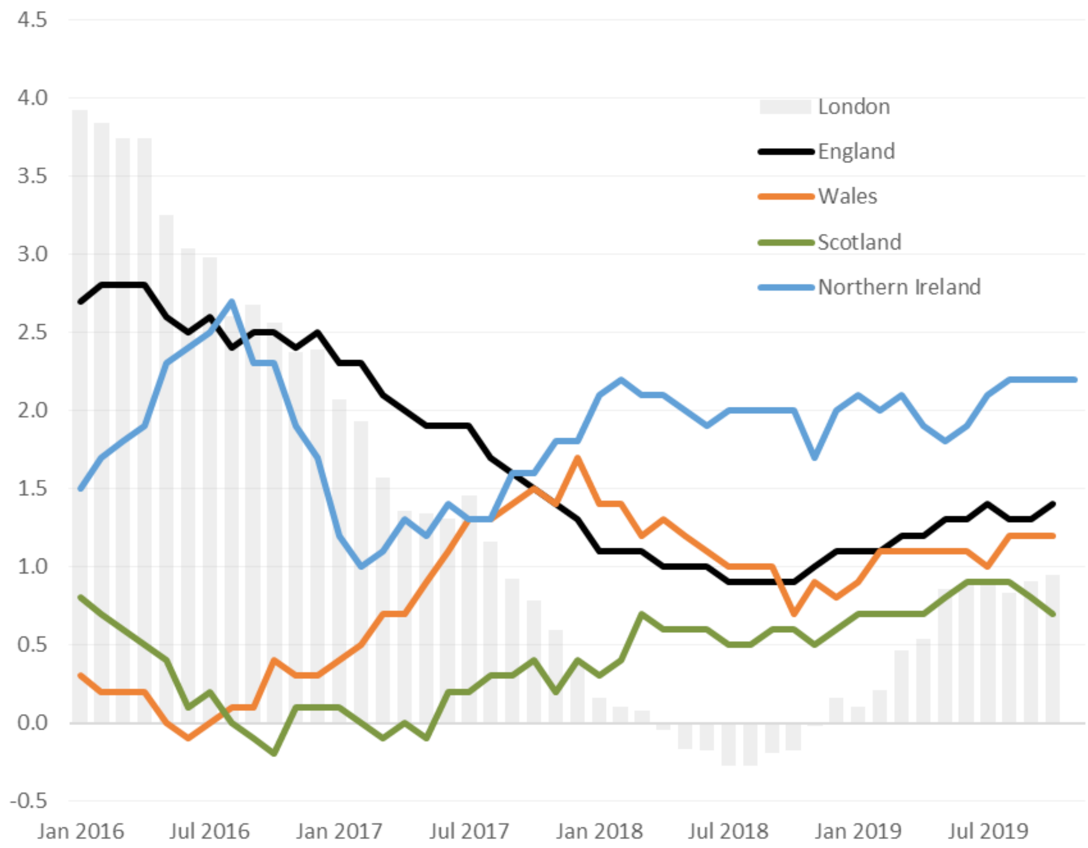
Meanwhile, private sector landlords appear to be coming to terms with the headwinds from income tax changes - the full impact of which will only be seen from the 2020-21 tax year onwards - and various other policies.

For several months now, year-on-year declines in house purchase activity by BTL landlords have been in single percentage figures, in contrast with the sharp downward correction of previous years.

Landlords have deployed a range of coping strategies, but stronger tenant demand, higher rents and more competitive mortgage deals have been significant factors behind the recent stabilisation.

ONS figures for November show that rental growth was stronger than a year ago across much of the UK including six of the nine English regions.

Chart 7: How rental prices have changed, % year-on-year

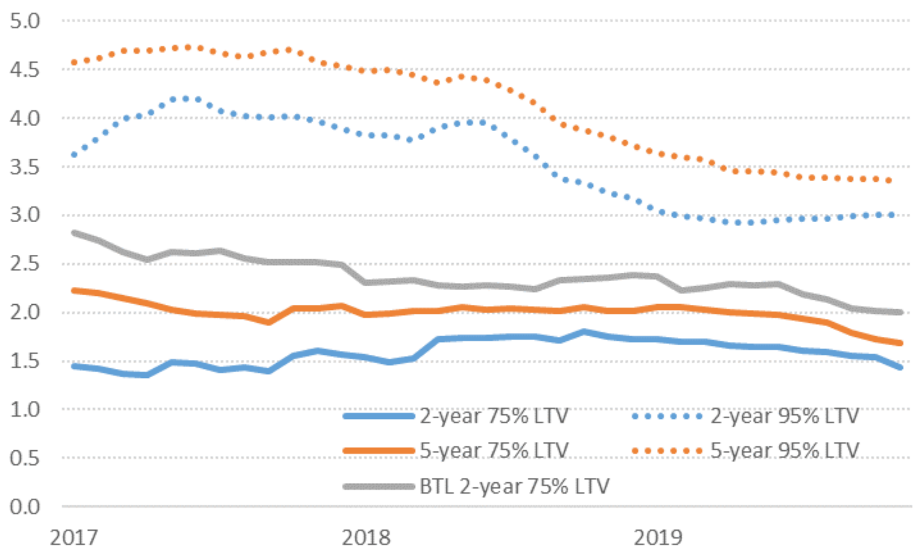


Source: ONS Index of Private Housing Rental Prices

Although rental growth remains below earning growth, rents are now rising at their fastest pace for 3 years, according to Zoopla[4], with the annual rate of UK rental growth at 2.0% up from 1.3% a year ago.

[4] Zoopla Rental Market Report Q3 2019Source: ONS

Chart 8: Household mortgage rates, %

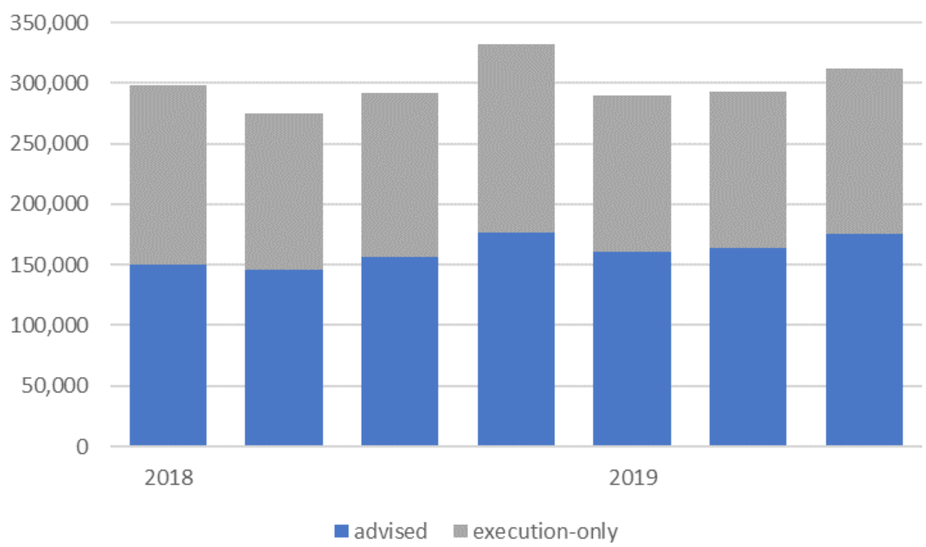


Source: Bank of England
Note: Weighted average quoted household mortgage rates

Although competitive deals abound – see Chart 8 - and continue to attract significant levels of refinancing activity, the lengthy period of strong growth in remortgages appears to be drawing to a close, with volumes weaker than a year ago in four of the last six months and materially so for October.

Product transfers continue to make inroads, with volumes up 12% over the year, at nearly £44 billion in the third quarter, according to UK Finance.

Chart 9: Quarterly product transfers



Source: UK Finance

Prospects

It is not clear how much of the recent sluggishness in the housing market can be attributed to Brexit uncertainties. That being said, the General Election result is, at the very least, likely to provide a short-term psychological boost to sentiment.

Looking further ahead, the Budget will be important in two key respects. Firstly, for the overall fiscal support given to offset any negative economic effects that our departure from the EU may cause. Secondly, with respect to the scale and nature of any specific housing measures, not least those aimed at mitigating the adverse effects from phasing out the Help to Buy Equity Loan Scheme.

The upside and downside risks for the housing market in 2020 are greater than normal, but policymakers have considerable firepower at their disposal to keep the housing market and wider economy on an even keel. We can look forward to an interesting year ahead!

19 December 2019