# Market Briefing: June 2022

*Key developments in the housing and mortgage markets*

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## Executive summary

- Inflation measured by the 12-month change in the CPI hit 9.1% in May, the highest rate since March 1982, with the RPI showing an even faster 11.7% increase. A 54% rise in the energy price cap in April was a major factor but prices are rising across a broad range of goods and services and producer input prices rose 22.1% in the year to May, pointing to still more upward pressure on inflation to come.

- Unemployment was 3.8% in the February-April period, a slight rise on the first quarter figure, while over the same period job vacancies reached a record 1.3 million, equal to the number of unemployed workers. The combination of a strong labour market and soaring inflation has put significant upward pressure on wage rates which including bonuses were up 6.8% in the February-April period and by 8.0% in the private sector against only 1.5% in the public sector.

- Rising inflation and building upward pressure on wage rates is putting further pressure on the Bank of England to raise interest rates. Bank Rate was raised again in June by 0.25% to 1.25%, the fifth increase since December, to reach the highest level since 2009. Mortgage rates have risen in response, the sharpest increases being on lower LTV products. 60% LTV 2-year fixed rate loans averaged 2.56% in May, the highest rate since 2012. But there has been a dramatic shrinkage in the margin between high and low LTV products with 95% mortgages now averaging only 63pb more than 60% LTV, down from 267pb a year earlier.

- Output growth is stalling in the face of the headwinds of rising import prices, labour shortages, rising interest rates and disrupted supply chains. In April GDP is estimated to have fallen by 0.3% after a decline of 0.1% the previous month. With consumer real incomes being squeezed and some firms having to reduce margins, prospects for the year ahead are poor.

- Despite the highly uncertain economic environment, the housing market continues to be characterised by limited supply and strong demand, putting upward pressure on prices. 3-month rolling average house prices increased by 2.7% in April with prices reaching a record £281,200 in April. The lettings market appears even stronger with RICS reporting soaring tenant demand and declining landlord instructions resulting in rising rent expectations.

- The government is to launch a comprehensive review of the mortgage market. It will examine "how we can give our nation of aspiring homeowners better access to low-deposit mortgages, and what our own mortgage industry can learn from counterparts around the world who have all kind of alternative ways of offering finance, managing risk, and unbolting the door to ownership."

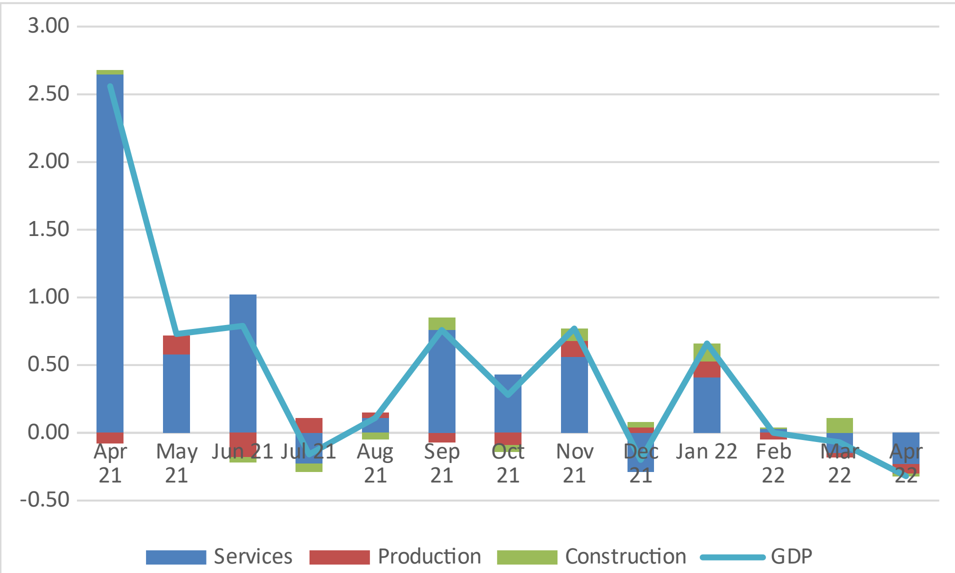
- On 20 June, the Bank of England announced that it was removing the affordability test requirement, following a consultation recommendation it made earlier in the year. Lenders no longer have to apply a 3% stress to the reversionary mortgage rate when assessing affordability but other affordability constraints remain.

## The economy

The UK economy grew by 0.8% in the first quarter of 2022 taking output to 0.7% above its pre-coronavirus level (Q4 2019), driven in part by much stronger investment in the public sector. On a sectoral basis, having been the main driver of growth previously, the services sector was, at 0.4%, not as strong as production (up 1.2%) or construction (up 3.8%). Within the production sector, manufacturing output was strong, up 1.3%, despite continued supply chain disruption in some sub-sectors.

Turning to the monthly profile, a strong performance in January has given way to a weakening picture over February-April (see Chart 1). Services, production and construction all fell in April. Within production, manufacturing fell by 1.0% with supply chain issues and rising input costs as probable causes.

**Chart 1 – Sources of GDP growth %**

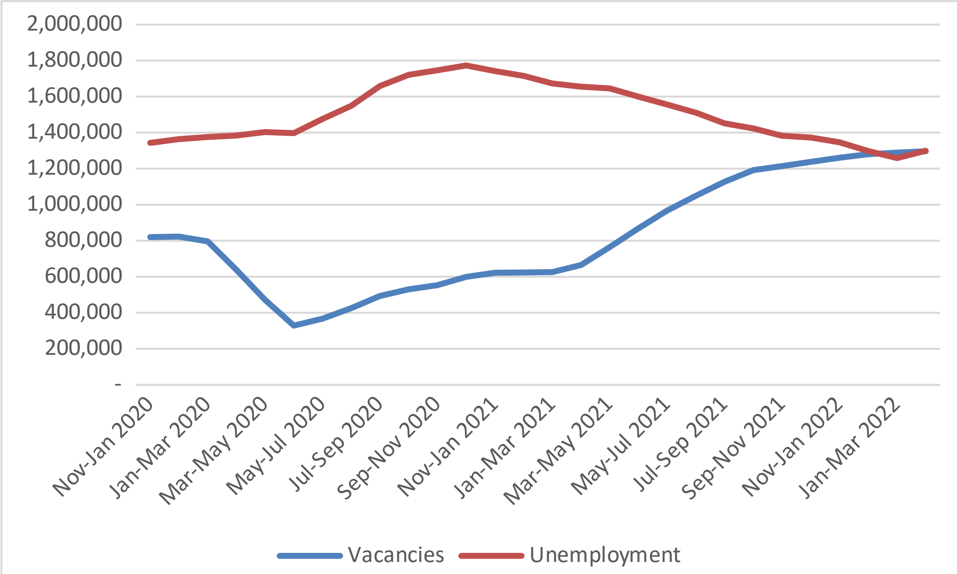



Source: Office for National Statistics

### Labour market

The labour market continues to enjoy exceptionally strong conditions. The employment rate rose to 75.6% while unemployment was 3.8% over the February-April period. The unemployment rate was up slightly compared to the first quarter but the number of job vacancies rose 20,000 to 1.3 million in February-April, equal to the number of unemployed workers (see Chart 2).

**Chart 2 – UK job vacancies and unemployment**




Source: Office for National Statistics

While it was feared that the coronavirus pandemic would reduce job opportunities pushing unemployment up, it actually led to a significant number of workers leaving the labour force, and this is the primary reason for labour market conditions becoming so tight. The total number of people in full time employment has risen since the start of 2020 but this has been more than offset by falls in part-time jobs and the self-employed (see Chart 3) as the number of economically inactive people between 16 and 65 years of age has risen by over 400,000 since the start of 2020.

**Chart 3 – Employment trends**


Source: Office for National Statistics

Unsurprisingly, the tightness of the labour market is pushing wages higher. In the three months to April wages rose 4.2% but when bonuses are taken into account the figure was 6.8% and 8.0% in the private sector against a much more modest 1.5% in the public sector. As such high private sector wage growth will put further upward pressure on prices, the Bank of England will see this as a particularly concerning development, requiring further action on interest rates.

**Chancellor's measures to protect families from rising energy prices**

On 26 May, Rishi Sunak announced a package of measures to dent the impact on household finances of soaring energy costs.

Key highlights:

**Universal payment to all utility bill payers**
Every utility payer to receive £400 towards their energy bill as a grant under the Energy Bills Support Scheme, replacing the earlier announced loan of £200 which was to be reclaimed through energy bills in later years.

**Targeted support for the less well off**
A one-off £650 payment to more than 8 million households on means tested benefits such as Universal Credit, Tax Credits, Pension Credit and legacy benefits, with a separate one-off payment of £300 to all pensioner households and £150 to individuals receiving disability benefits.

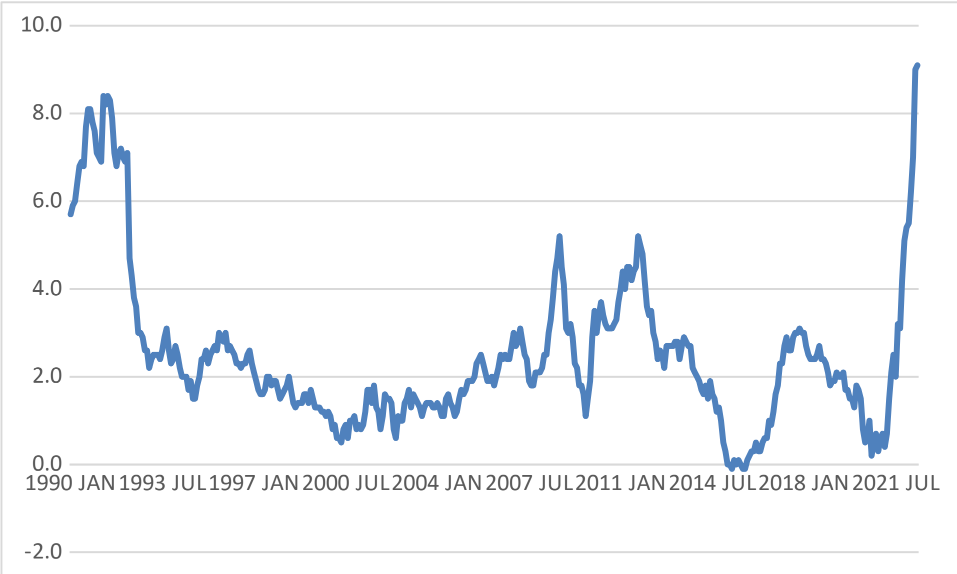
**Cost**
The total cost of these measures is over £15 billion but the government has subsequently hinted that it might take further measures to soften the impact of the cost of living crisis on households.

**Energy Profits Levy**
Temporary Energy Profits Levy on oil and gas firms, expected to raise £5 billion over the next year to partially fund the package with a new investment allowance to encourage firms to invest in oil and gas extraction in the UK.

**Inflation and interest rates**

The 54% upward adjustment in the energy price cap in April sent CPI inflation soaring to 9.0% (see Chart 4), with a further rise to 9.1% in May, the highest rate since March 1982, while the RPI reached 11.7%. With a range of commodity prices affected by Russia's invasion of Ukraine, inflation is likely to go significantly higher in the coming months. The Bank of England has said it expects CPI inflation to reach around 11% later this year but still thinks it will be close to 2% in around 2 years' time.

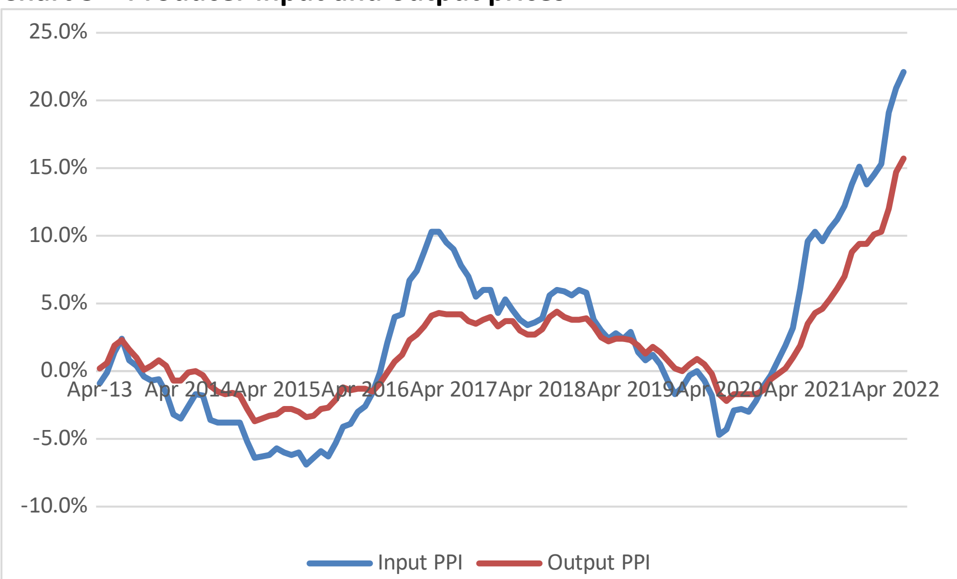
**Chart 4 – CPI annual inflation rate, %**




Source: Office for National Statistics

Producer input and output prices signal the risk of higher consumer prices in the months to come (see Chart 5). In May, output prices were rising by 15.7% and input prices by 22.1%.

**Chart 5 – Producer input and output prices**




Source: Office for National Statistics

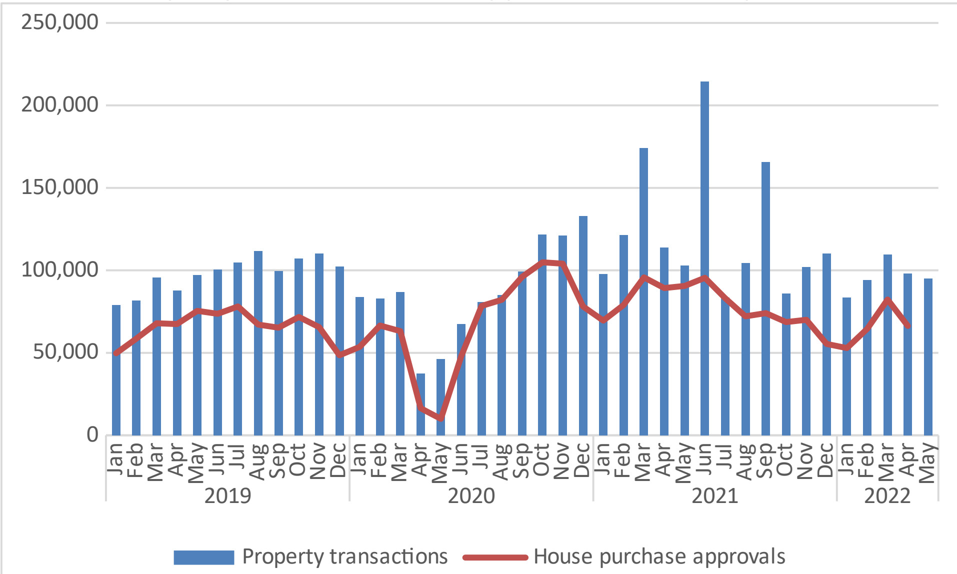
The Bank of England no longer sees the current surge in inflation as temporary, and has now raised Bank Rate five times to 1.25%. However, with real household incomes under pressure from rising energy prices, concerns about inflation will be tempered by the likely impact on economic activity. The Bank has a difficult tightrope walk ahead to balance the need to contain inflation without exacerbating the economic slowdown too much. Wages inflation will play a particularly important role in determining whether the Bank adopts a hawkish stance and the news that private sector wages including bonuses rose 8.0% in the February-April period is likely to have tipped the balance further in favour of higher interest rates.

## Housing and mortgage markets

### Activity

After the volatility in transaction levels brought about by the stamp duty holiday, the housing market has entered a more settled period (see Chart 6). Transactions averaged 97,000 a month over the first five months of 2022, roughly in line with the 2019 average. House purchase mortgage approvals have also settled down to pre-Covid levels.

**Chart 6 - Property transactions and approvals for house purchase**




Source: HMRC, Bank of England

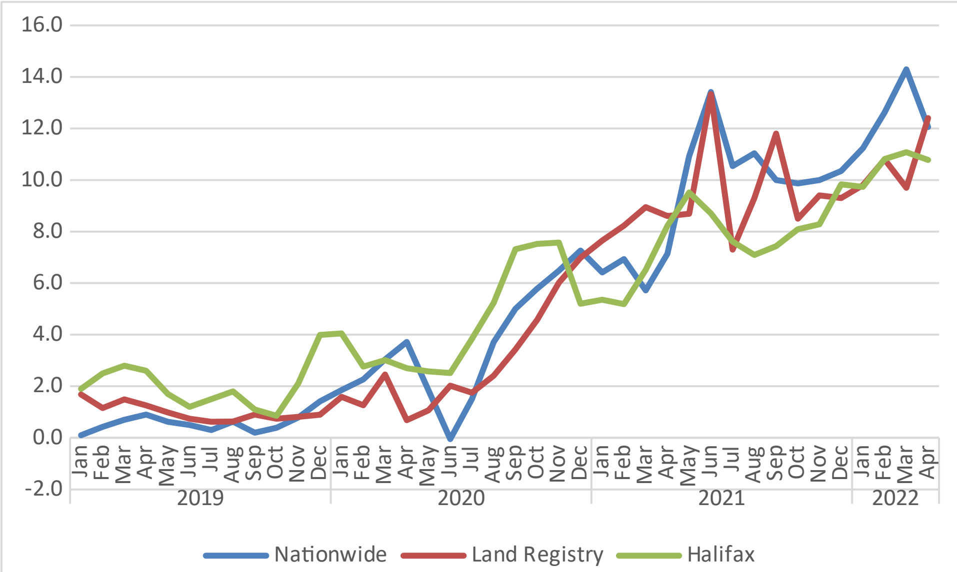
In the May RICS Residential Market Survey, the inventory of properties for sale per surveyor branch remained close to its all-time lows. However, other findings from the survey pointed to a softening of the market. New buyer enquiries turned negative and price expectations, although still positive, are not as strongly positive as they were. Mortgage lending for house purchase figures reflect subdued activity in the market. In the first four months of 2022, loans for house purchase averaged 54,000 a month, 7% less than the 2019 average. However, rising house prices meant the value of these transactions rose 8% over the same period.

But rising mortgage rates have triggered a surge in remortgage activity, with many homeowners switching to longer term fixed rate products to protect themselves from further rises. Remortgage volumes averaged £9 billion a month over the first four months of 2022, 41% above the figure a year earlier. By contrast, product transfers have been subdued: in the first quarter they were nearly 1% below the corresponding period of 2021 in value terms.

## Prices and rents

The unprecedented shortage of properties both for sale and rent continues to put upward pressure on prices and rents. Land Registry figures showed that prices rose 2.7% in February-April compared to the previous three months with the annual rate of increase rising to 12.4% in April, up from 9.7% in March. The Nationwide and Halifax indices also showed house price inflation in excess of 10% in April (see Chart 7).

**Chart 7 – House price inflation**



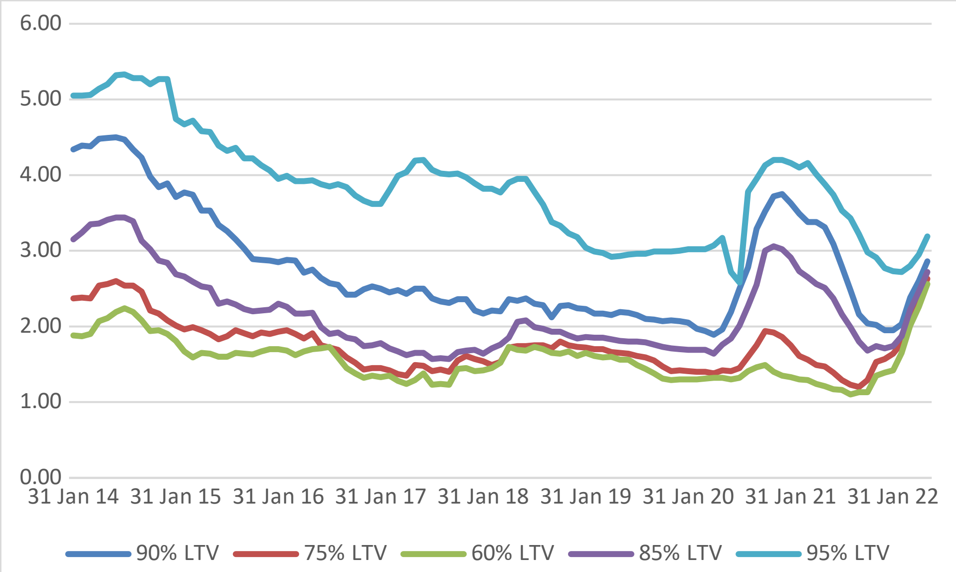

Source: Nationwide Building Society, Land Registry, Halifax

In many parts of the country, the shortage of rental accommodation is even more severe than that of the sales market. The May RICS Residential Market Survey showed tenant demand up sharply and new landlord instructions down over the previous three months. This is reflected in the Homelet Index, which tracks newly agreed rents. In May, it recorded a rise of 10.6% in rents nationally and 15.7% in London. The ONS private rental index in contrast showed rental gains of only 2.8% across the UK and 1.5% in London in the year to May but this tracks a sample of existing tenancies suggesting that landlords are not generally putting existing rents up by much.

## Mortgage pricing and products

Since the end of November, Bank Rate has been raised by 115bp. Between November and May, comparing 2-year fixed rate mortgage pricing, only 60% LTV loans have seen a larger increase (121bp) and 95% LTV loans have only risen in price by 28bp. This large rate compression has left 95% LTV mortgage rates at their lowest premium to 60% LTV loans since before the financial crisis. Falling rate differentials would normally imply that lenders' risk appetite has increased, but is more likely to reflect the impact of rising funding costs on lenders' lowest LTV products.

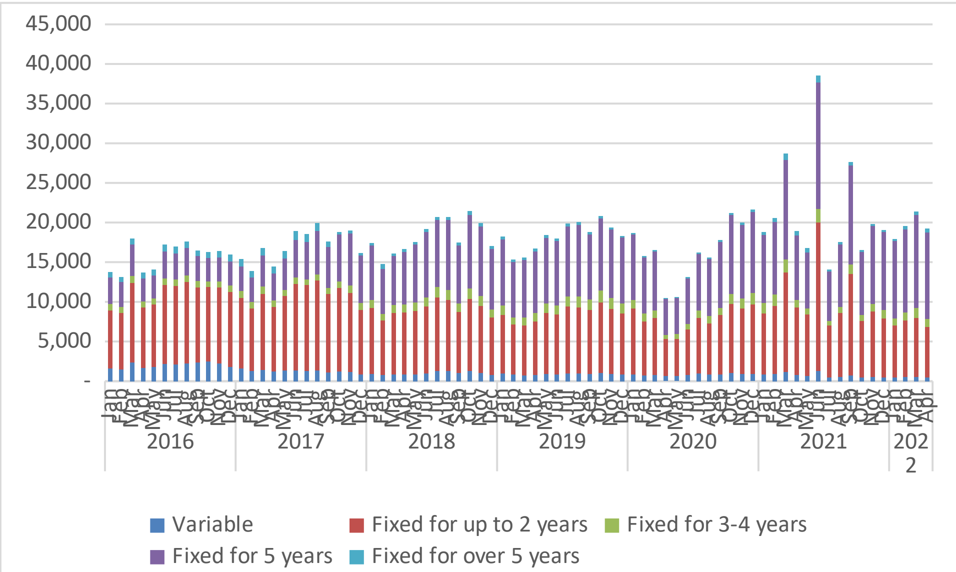
**Chart 8 – Average 2-year fixed rate mortgage rates, % pa**




Source: Bank of England

The shift towards 5-year fixed rate products has continued in recent months, driven by concerns about further interest rate rises. Q1 was the first quarter in which a majority of borrowers took out a 5-year fixed rate product with 54% choosing to fix for this period. However, fixes of more than 5 years still only constituted 2% of the market.

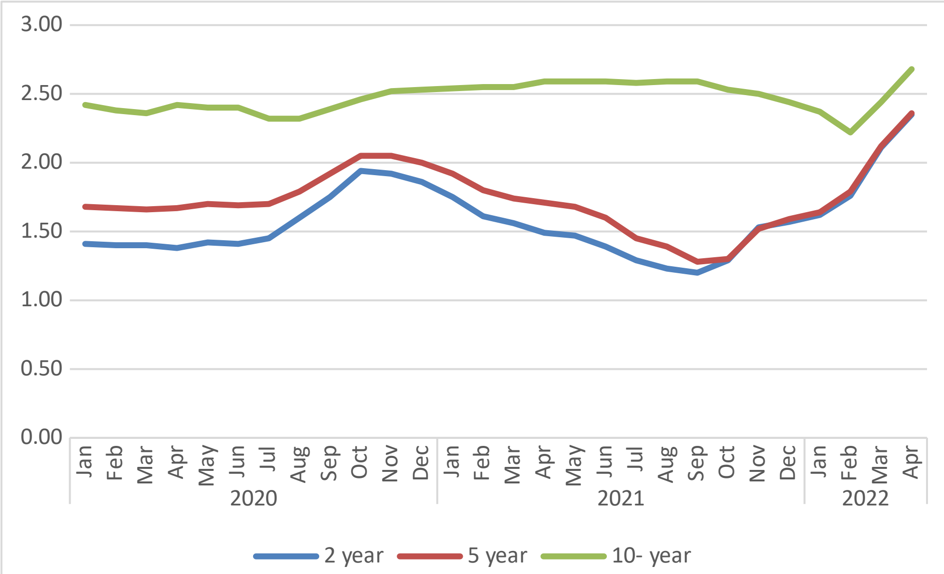
**Chart 9 – Fixed and variable rate share of new lending**




Source: UK Finance

As Chart 10 illustrates, as well as fears of rising interest rates the attraction of longer-term fixed rates has been enhanced by a sharp decline in the premium over shorter-term ones – by April there was almost no differential in pricing between 2 and 5 year fixes. Interestingly, even 10-year fixed rate loans have looked quite competitive, the spread between 2 and 10 years having fallen from 140bp in September to 30bp in April. However, interest rate swap rates have gone up by some 2 percentage points in recent months, more than Bank Rate, as longer term interest rate benchmarks rise and this has not yet been reflected in fixed rate mortgage pricing, pointing to possible larger future increases in the price of 5 and 10 year fixes.

**Chart 10 – Fixed rate mortgage pricing**



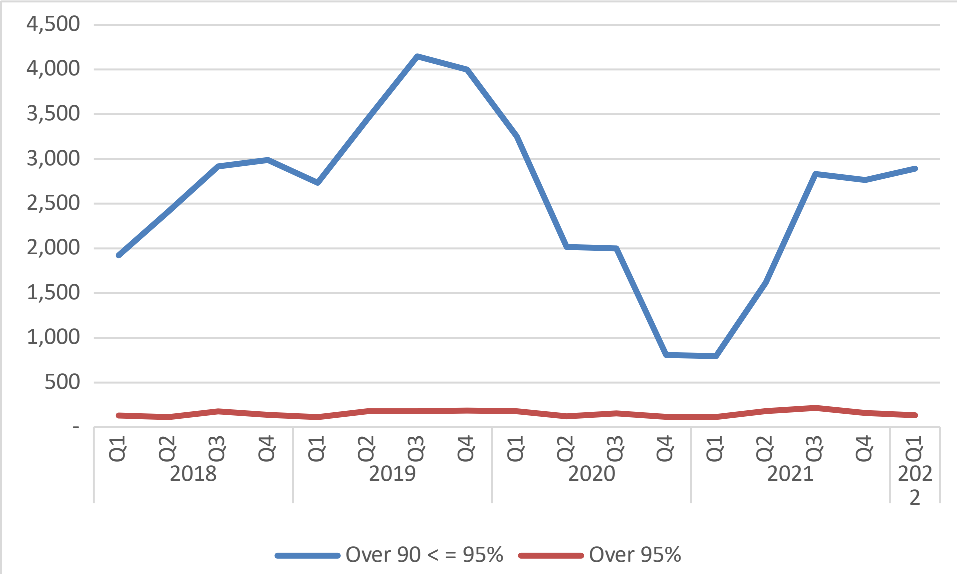

Source: Bank of England

## High LTV lending

As Chart 11 illustrates, high LTV lending was severely curtailed during the Covid pandemic. Despite a healthy recovery since early 2021, high LTV lending has not regained its 2019 share of total lending. This is despite the introduction of the government's Mortgage Guarantee Scheme in March 2021.

The announcement of the government scheme worked to restore confidence in the high LTV market, spurring many lenders to reintroduce 95% LTV products outside of the scheme in part because of its cost. With a lower differential in rates between high and low LTV loans and a wide range of 95% LTV in the market now (with the exception of new build), it is perhaps surprising that high LTV lending has not been even stronger.

**Chart 11 – Value of lending by high LTV band (% of total)**




Source: Financial Conduct Authority

Between its launch in April 2021 and December 2021, the Mortgage Guarantee Scheme supported 12,400 mortgage advances, of which 86% were to first time buyers. Over this period, the total value of lending under the scheme was £2.2 billion, giving an average loan size of only £179,500.

Over the same period, the new Help to Buy equity loan scheme (restricted to first time buyers with regional property price caps) supported twice as many purchases at 24,900, with an average property value of £288,200, giving a total of £7.2 billion of new build property sales under the scheme.

**Prime Minister's speech of 9 June**

**Government proposal for a review of the mortgage market**

On 9 June, the Prime Minister gave a speech which outlined the government's plan to launch a comprehensive review of the mortgage market.

Referring to the review, Boris Johnson said "reporting back this Autumn it will look at how we can give our nation of aspiring homeowners better access to low-deposit mortgages, and what our own mortgage industry can learn from counterparts around the world who have all kinds of alternative ways of offering finance, managing risk, and unbolting the door to ownership."

The announcement follows on from the 2019 Conservative Party manifesto commitment to "encourage a new market in long-term fixed-rate mortgages" although there are no details on whether the review will emphasise this aspect of the market or others such as mortgage insurance, which Michael Gove made reference to recently.

**Right-to-buy extension to housing association properties**

Boris Johnson also confirmed the government's intention to extend right-to-buy to homes rented from housing associations. It will work on detailed plans that are "responsibly capped at a level that is fully paid for; affordable within our existing spending plans, and with one-for-one replacement of each social housing property sold."

**Benefits to bricks**

Johnson talked of 'benefits to bricks'. Under this heading, the government will explore how to exclude savings in Lifetime and Help to Buy ISAs from the Universal Credit eligibility rules that limit a households' savings to £6,000 before benefits are tapered. It also plans to allow people to access support for paying their mortgage earlier than is presently the case.

The Prime Minister also highlighted plans to change the rules on welfare so that the 1.5 million working people who are in receipt of housing benefits have the choice of spending benefit on rent as now or putting it towards a first mortgage. It is unclear how this will work in practice.

**Buy-to-let market**

Remortgage lending in buy-to-let has mirrored that of the wider market, with landlords moving into longer term deals in reaction to concerns about rising interest rates. Buy-to-let remortgaging has averaged £2.8 billion a month this year, 28% up on 2021 as a whole. Although house purchase buy-to-let volumes are down 10% on 2021 they continue to run well above their pre-pandemic levels. In the first four months of this year, average house purchase volumes were 41% above the 2019 monthly average as landlords responded to the strength of tenant demand.

**A fairer private rented sector White Paper**

On 16 June, the government published its White Paper entitled *A fairer private rented sector*. This contained a 12-point plan of action that represents the most significant policy changes to the private rental market in England since the 1988 Housing Act that established Assured Shorthold Tenancies.

**Abolition of Section 21 'no fault' evictions**

Foremost amongst its proposals is the abolition of Section 21 evictions, sometimes referred to as no fault evictions, that give landlords the right to evict tenants at the end of an Assured Shorthold Tenancy. Landlord organisations have emphasised that such a change must be accompanied by enhanced rights of eviction for anti-social behaviour and rent arrears. The National Residential Landlords Association welcomed government proposals on such grounds for possession and court reform but warned that the detail needs to reflect the objective of protecting responsible landlords against unreasonable behaviour by tenants.

**Property portal (landlord register)**

The paper proposes the introduction of a national landlord Property Portal for England. It will be mandatory for landlords to join the portal, making it a landlord register, although it will also have information for landlords on the full range of rules they must comply with.

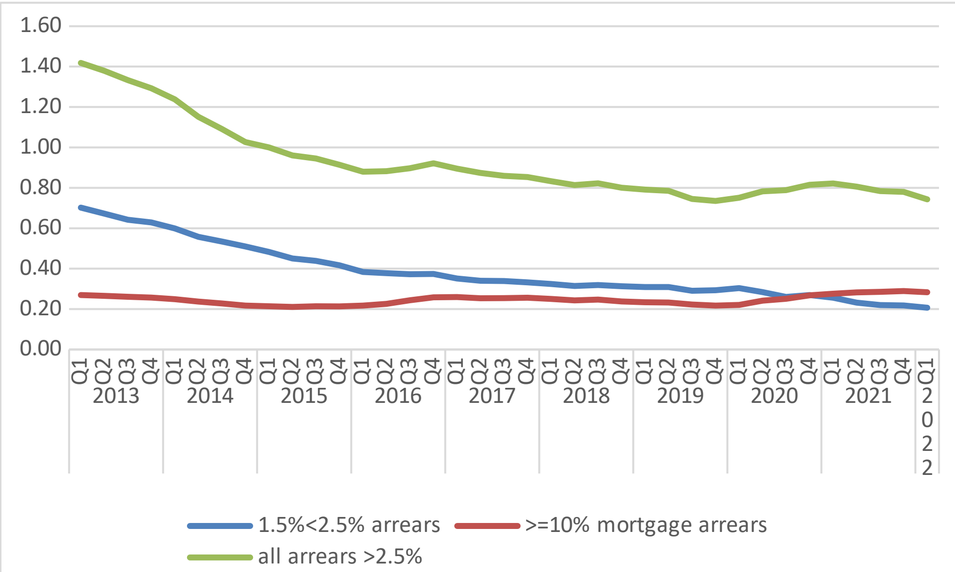
**Measures that curtail landlords' rights of control over property**

Among the more controversial proposals are plans to legislate to make it illegal for landlords or agents to have blanket bans on renting to families with children or those in receipt of benefits and to provide tenants with the right to request a pet in their property, which the landlord will not be able to unreasonably refuse.

**Arrears and possessions**

Mortgage arrears continued to fall in Q1, including both short- and long-term arrears. The strong jobs market and continued low mortgage rates have helped to contain arrears. Although mortgage rates are now starting to rise, most existing borrowers are on fixed rates of between 2 and 5 years, meaning it will take some time before these rate increases start to impact the majority of borrowers. This will extend the traditional lag between higher mortgage rates and arrears.

**Chart 12 – Mortgage arrears (percentage of balance)**




Source: UK Finance

Possessions are starting to show a clear upward trend, reaching 980 in the first quarter, 38% above Q4's total. However, the Q1 figure is still less than half the 2,000 quarterly average in 2019 and nearly a year after the end of the Covid-related moratorium, the numbers remain far below what might have been expected, with the rate of repossession being well below any historical comparison.

**Withdrawal of affordability stress requirement**

On 20 June, the Bank of England announced that, in line with its recommendation from this year's consultation and with effect from 1st August, it is dropping the mortgage affordability stress test which required lenders to assess borrower affordability on reversionary rates plus 3%. IMLA agreed with the recommendation. However, it should be noted that the MCOB responsible lending rules require lenders to take into account expected interest rate increases when assessing affordability and the regulatory rule limiting lenders' issuance of loans at or above 4.5 times income to 15% continues to constrain lenders, so the rule change is unlikely to have much impact in the current environment.

## Prospects

The surge in global energy and other commodity prices represents the most serious external shock to the UK economy since at least the 1970s. The economy is still in the early stages of adjusting to this jolt but we have insights into its possible future impact from previous similar external energy price related shocks in the mid-1970s, early 1980s and early 1990s. All resulted in higher interest rates, declining output, higher unemployment and lower real house prices.

The spike in energy and other commodity prices that occurred in 2008 proved more transitory and therefore had less of the impact on the global economy. The easing of Covid supply disruption might have been expected to produce a similar deflating of today's commodity price 'bubble' but the Russian invasion of Ukraine has, instead, considerably worsened the situation. An early end to hostilities would provide some respite but this outcome does not appear to be close at hand.

There is a consensus that central banks, including the Bank of England, will have to raise interest rates further but no clarity about what level they will need to reach before policymakers are satisfied that domestic inflationary pressures are under control. But again, we can look to the past for a guide. Despite the negative impact on real incomes that higher energy costs had in the mid 1970s, early 1980s and early 1990s, interest rates were raised sharply and the economy was pushed into recession. It may be impossible for the economy to avoid another sharp recession this time.

As an interest rate sensitive sector, the housing market is bound to slow in response to higher interest rates. But several factors suggest that the market may not be impacted as severely as it was in earlier downturns such as the early 1990s. Firstly, far more borrowers are on fixed rate mortgages, staggering the point at which their monthly payments will rise.

Secondly, tighter affordability requirements over the past decade mean that borrowers have more headroom to afford higher mortgage costs than earlier generations. In particular, the most vulnerable borrowers in the past were those who had really stretched themselves financially to get on the housing ladder or those who repeatedly re-mortgaged to release equity to spend. Current affordability rules severely limit the extent to which borrowers have been able to engage in these behaviours.

Finally, in contrast to earlier cycles, the mortgage market has remained subdued over the past decade. Rather than the housing equity withdrawal that typified earlier economic upswings, we have seen homeowners in aggregate reducing mortgage debt once the value of physical investment in the housing stock is taken into account. This has left the housing stock with the lowest overall leverage seen for decades, suggesting that the housing and mortgage markets are quite well placed to weather any difficult times.