Market Briefing: March 2024

Key developments in the housing and mortgage markets

Rob Thomas, Principal Researcher,
Intermediary Mortgage Lenders Association (IMLA)

Executive summary

- The UK entered a shallow recession during the second half of 2023 with GDP falling 0.1% in the third quarter and 0.3% in the fourth. However, these figures are subject to possible revision and GDP rose by 0.2% in January while business surveys have also improved.

- CPI inflation fell to 3.4% in February, down from 4.0% in January. Core inflation (excluding food and energy prices) also fell, to 4.5% in February, but perhaps the most positive news on inflation came from producer input and output prices, which were 3.5% and 1.2% down in the latest three months compared to the previous three despite a rise in commodity prices and disruption to shipping in the Middle East.

- The Governor of the Bank of England has signalled that rate cuts are most likely on the way this year and that cuts do not have to wait until CPI inflation hits its 2% target after the MPC voted 8-1 to leave Bank Rate unchanged at 5.25% in March.

- The labour market continues to show signs of a modest softening with job vacancies falling for the twentieth consecutive month on the latest figures. But the unemployment rate has bucked this trend, being 3.9% in the three months to January, below the level of last summer. One possible explanation is that a slight softening in employment levels has been more than matched by higher inactivity (people neither in work nor looking for it).

- Housing market activity remains weak with transactions down 13% in the three months to January compared to the previous three months. However, the forward-looking components of the RICS Residential Survey suggests activity levels are set to recover over the coming months.

- House prices were broadly flat over the course of 2023 but the latest data from the Halifax and Nationwide indices suggest that a gentle recovery is underway. This may reflect improved buyer affordability following falls in fixed-rate mortgage pricing during recent months.

- Improved swap rates over recent months have driven fixed-rate mortgage pricing down sharply. However, this trend stalled in February as financial markets reassessed the timing of Bank of England rate cuts.

- At the end of 2023, mortgage arrears of more than 2.5% of the loan balance reached 1% of all loans for the first time since 2015. However, shorter-term arrears were up less than 0.5% between Q3 and Q4, pointing to a possible slowdown in the rise in arrears overall in 2024. Owner-occupier arrears of 2.5% or more were up 7% on the quarter while buy-to-let arrears were up 18%.

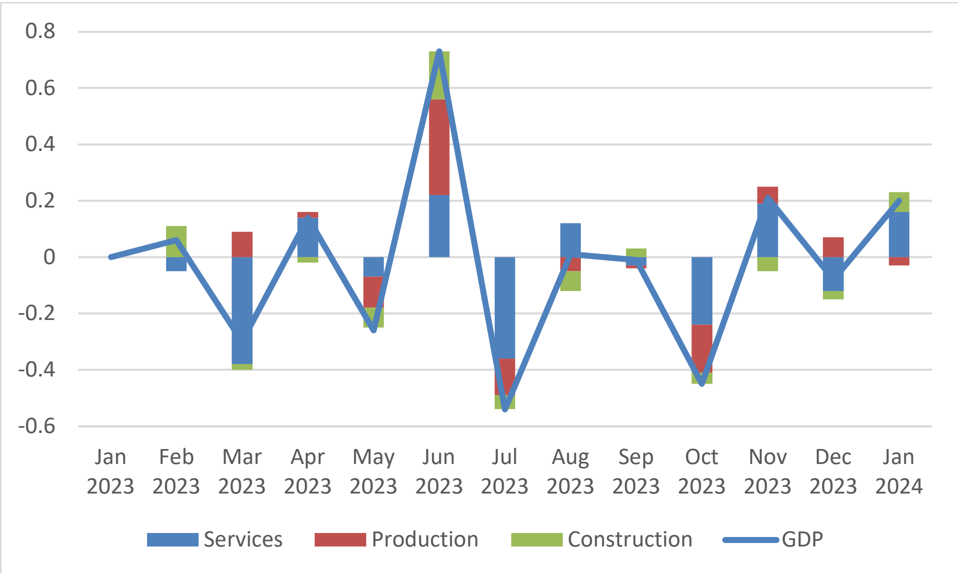
The economy

Output

ONS figures for the fourth quarter of 2023 show that the UK fell into a technical recession during the second half of last year, with GDP down 0.3% in Q4 after a 0.1% decline in Q3. However, with the numbers close to zero, there is a reasonable likelihood that this recession will be revised away in future estimates, as upward revisions to GDP numbers are common. For 2023 as a whole, GDP is estimated to have risen by a modest 0.1% over 2022's level.

There was better news with the monthly GDP release for January (see Chart 1), which showed a 0.2% rise in output against December. Services was the largest contributor to growth in January with a 0.2% increase. Construction saw a 1.1% rise in output but production was down 0.2%. Within construction, repair and maintenance has been on the rise in recent months but new construction project output has been on a downward trend.

Chart 1 – Sources of GDP growth %

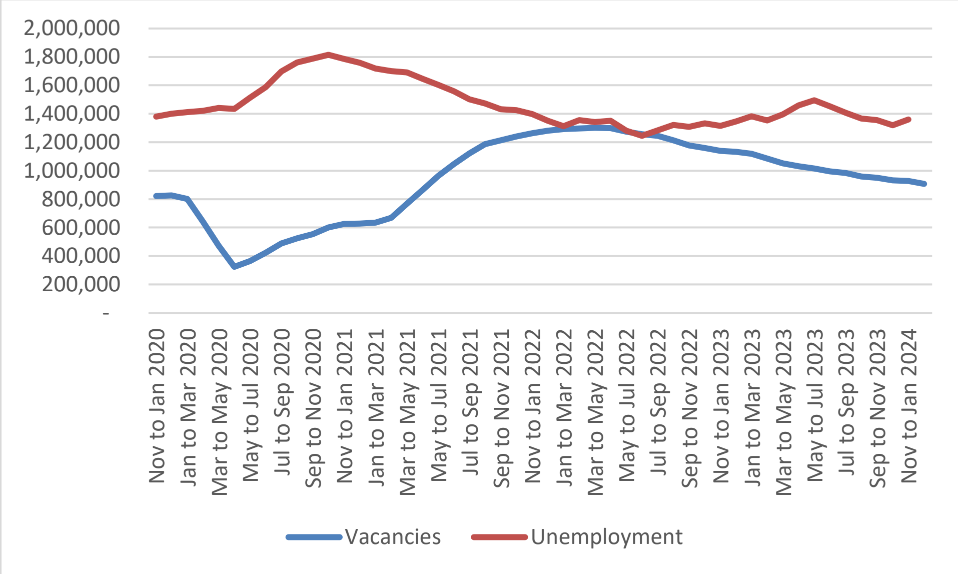


Source: Office for National Statistics

Labour market

The number of job vacancies has fallen for each of the last 20 months, reaching 908,000 in the December to February period. Compared to their peak in March to May 2022, total vacancies have fallen 30%. However, as Chart 2 shows, the number of unemployed, having started to rise from mid-2022 to mid-2023, has fallen back since then. Although the November to January figures showed a 39,000 rise, the number of unemployed remains 137,000 below its mid-2023 peak, although the ONS has highlighted that the Labour Force Survey on which unemployment statistics are based has been less reliable in recent months due to smaller sample sizes.

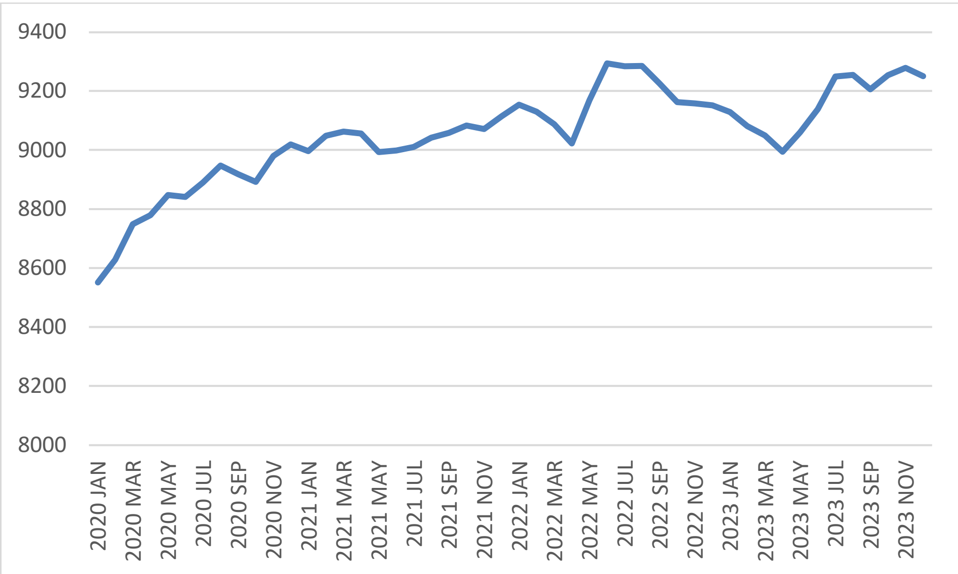
Chart 2 – Job vacancies and unemployment



Source: Office for National Statistics

There was a small decrease in the employment rate to 75.0% in the November to January period. This remains about a percentage point below the pre-pandemic level. The total number employed was 33,175,000, down 21,000. One of the reasons why employment levels are lower than before Covid is that economic inactivity (those not in work, looking for work or in full time education) has increased as can be seen from Chart 3. Despite the prominence given to the rise in long-term sickness that has reduced employment amongst workers aged 50-64, it is those aged 16-24 who have seen the largest percentage increase in inactivity.

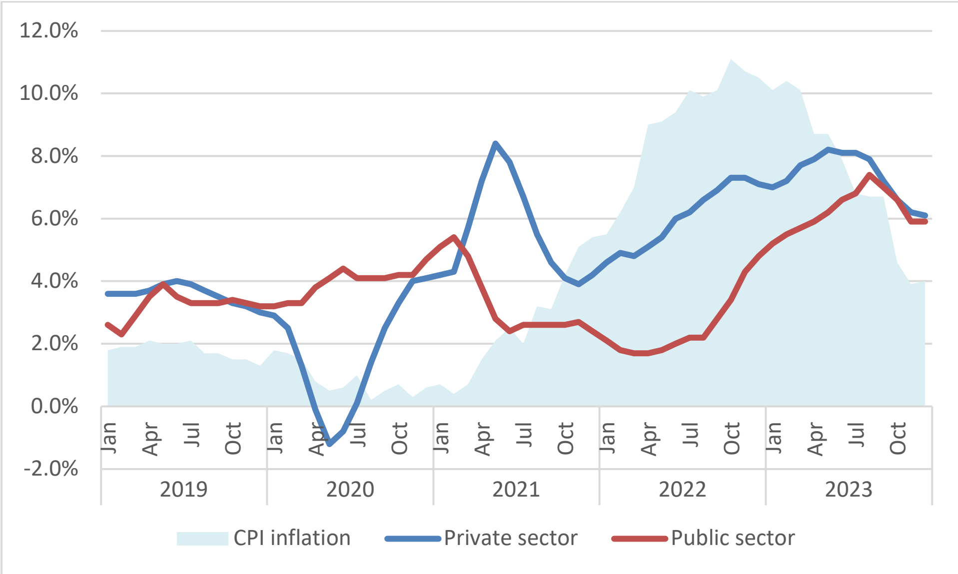
Chart 3 – Economically inactive individuals aged 16-64



Source: Office for National Statistics

Falling headline inflation and the modest weakening in the labour market has started to be reflected in slowing wage growth. In November to January regular pay (which excludes bonuses) rose by 6.1%, down from 6.2% the previous month and 6.7% the month before that. Growth in earnings including bonuses was lower at 5.6%. As Chart 4 shows, public and private pay growth are now running at similar levels. Despite the fall in earnings growth across the labour market, because CPI inflation has fallen more rapidly, workers are now enjoying real earnings growth of 2.1% in regular pay.

Chart 4 – Regular pay growth in the public and private sectors



Source: Office for National Statistics

Inflation and interest rates

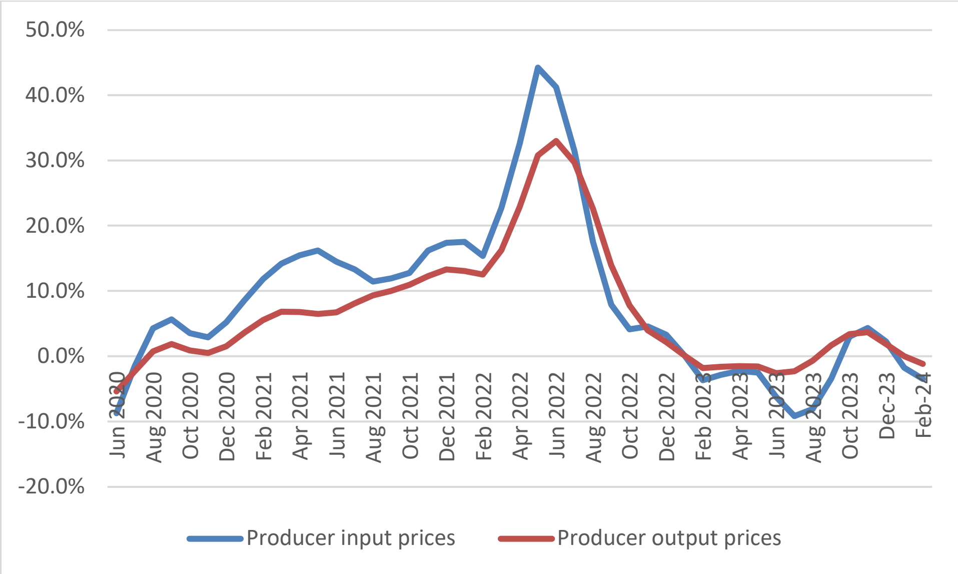
The last three months have seen a steady gentle upward trend in global commodity prices illustrated by the S&P GSCI Sterling Commodities Index shown in Chart 5. From the low recorded on 12 December, the index was up 9% by mid-March. One factor driving prices up is the attacks on shipping near the Arabian peninsular, which have raised shipping rates and oil prices.

Chart 5 – S&P GSCI Global Commodities Price Index in Sterling

Source: S&P

Despite the modest rise in commodity prices, UK producer input prices have fallen back. Comparing the latest three months with the previous three months, input prices fell 3.5% in February against 1.8% in January (see Chart 6). On the same comparison, producer output prices were also down in February, by 1.2%, having been flat in January.

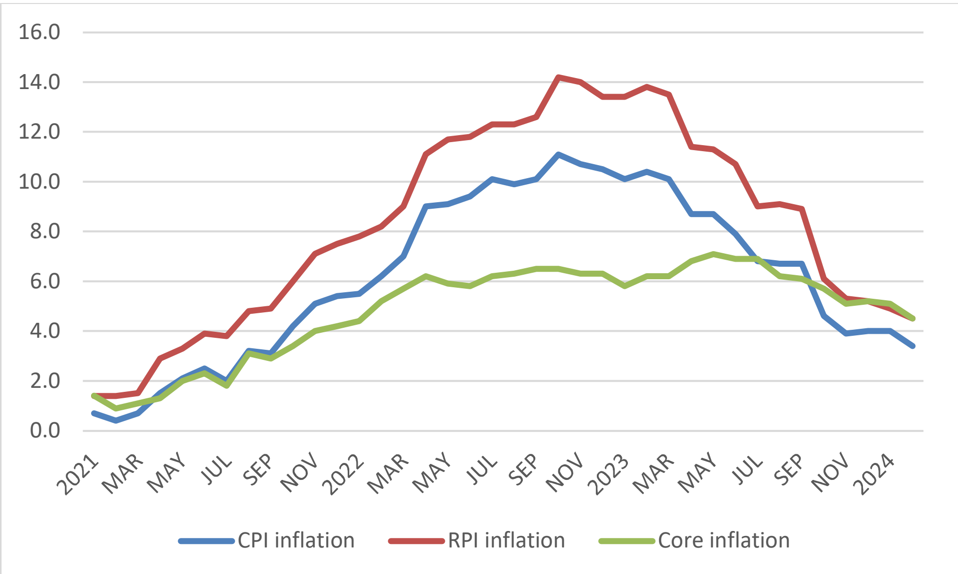
Chart 6 – Producer prices (3 month on previous 3 months annualised)



Source: Office for National Statistics

Annual CPI inflation fell to 3.4% in February, the lowest rate since September 2021. The largest downward contributions to CPI inflation came from food, restaurants and cafes, while the largest upward contributions came from housing and household services, and motor fuels. Core CPI, which excludes food and energy costs, fell from 5.1% to 4.5%. Inflation in services fell from 6.5% to 6.1%.

Chart 7 – CPI, RPI and core annual inflation



Source: Office for National Statistics

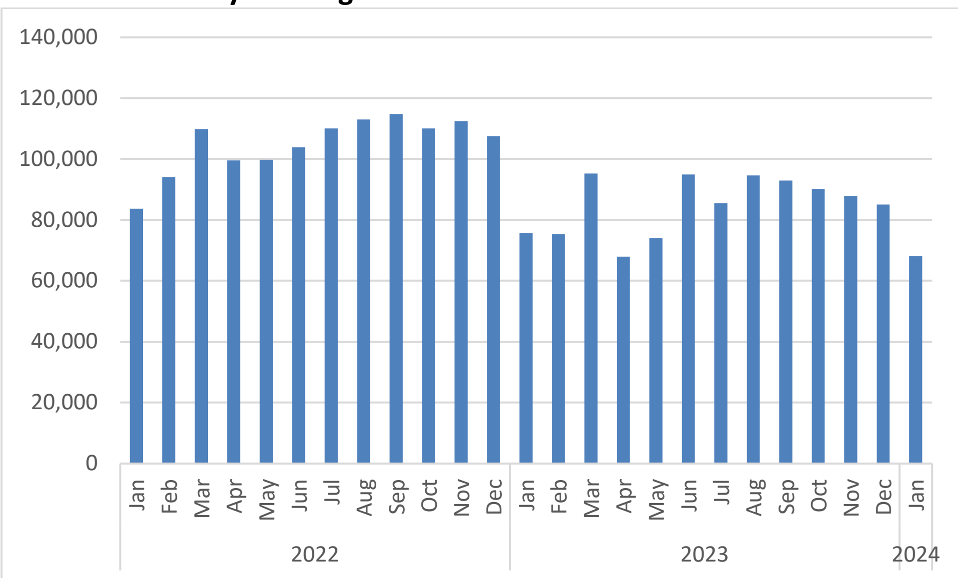
Following the MPC's March meeting, Bank of England Governor Andrew Bailey signalled that Bank Rate cuts could be on the way this year. Following the 8-1 decision to hold rates in March, with no MPC members calling for a rate rise for the first time since September 2021, Bailey said "we're not yet at the point where we can cut interest rates, but things are moving in the right direction." He added that it was "reasonable for markets to be taking that view" in response to a question about the market's forecast of 2-3 rate cuts this year.

Housing and mortgage markets

Activity

January's housing transactions data was the lowest monthly total since April 2023, the second lowest since the Covid lockdown of 2020 and 10% down on January 2023 (see Chart 8). It followed subdued figures in November and December. This left transactions in the three months to January 13% down on the previous three months but slightly above the lows reported in mid-2023.

Chart 8 – Monthly housing transactions



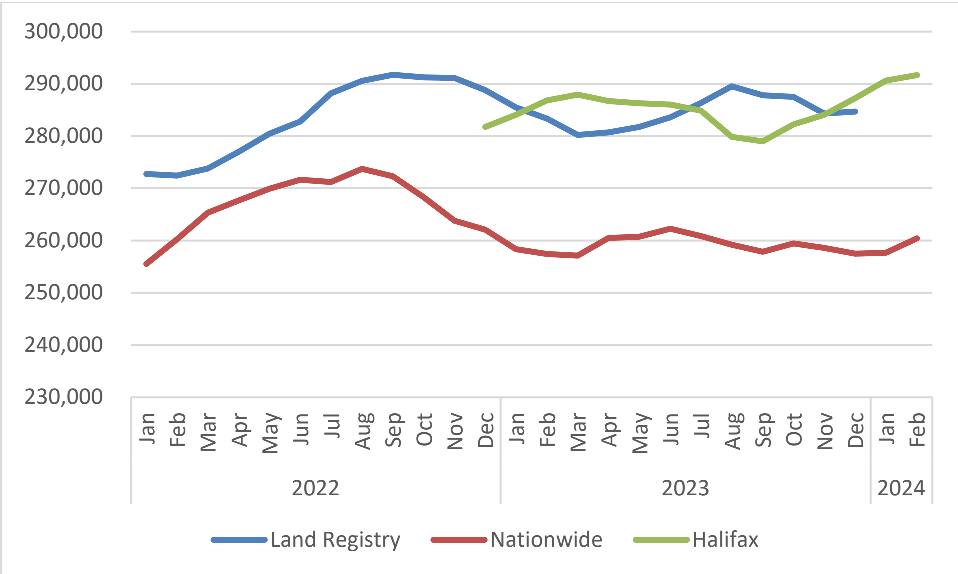
Source: HMRC

However, the forward-looking components of the February RICS Residential Market Survey paint a brighter picture with new buyer enquiries and new vendor instructions in positive territory. Sales expectations are also positive on both a three-month and twelve-month basis and achieved sales and housing stock for sale per surveyor have picked up, suggesting that there is now more choice for buyers after a period when supply was abnormally low.

House prices and rents

Although the main house price indices differ slightly in their movements, taken together they suggest that house prices have been broadly flat since the start of 2023 but with a modest upward trend now apparent, perhaps reflecting falls in fixed-rate mortgage pricing. The last five monthly movements in the Halifax Index have been up as have the last two on the Nationwide Index. By February these indices stood 1.7% and 1.2% above their level of a year earlier respectively. The regional picture is relatively uniform with the North and Scotland showing broadly flat house prices over the year to Q4 and southern regions showing modest falls of up to 5% according to the Nationwide.

Chart 9 – House prices

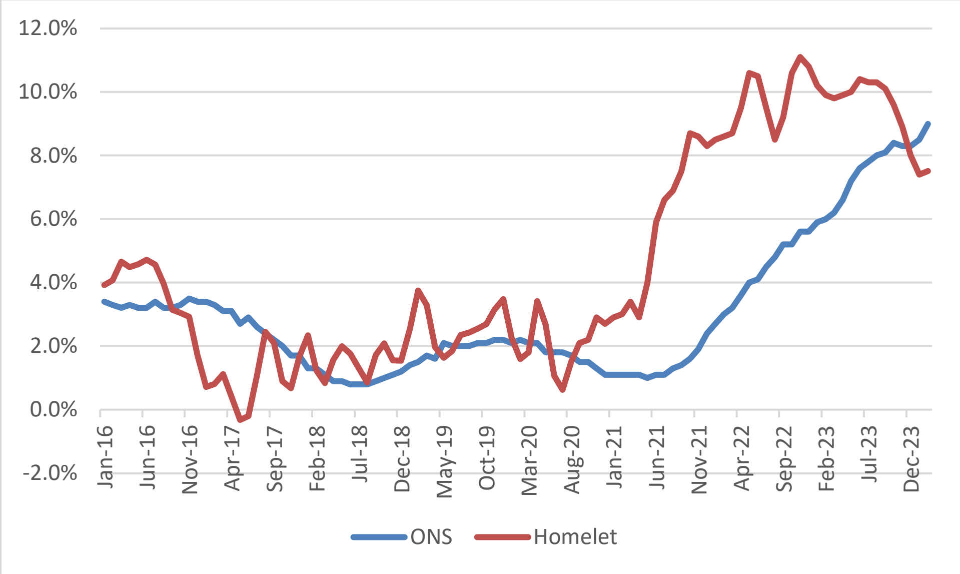


Source: Halifax, Nationwide Building Society, Land Registry

Inflation in the private rental market is easing off. According to the Homelet Rental Index, rents rose by 32% in the three years to October 2023, when average rents peaked at £1,283 a month, a compound annual rate of 9.7%. But since then rents have eased back slightly, slipping back to £1,262 in February, bringing the headline annual rate of increase down to 7.5%. However, the RICS Residential Market Survey shows tenant demand still rising and landlord instructions still falling. As a consequence, a positive balance of respondents expect rents to continue to rise although the balance has fallen in recent months.

The ONS's Price Index of Private Rents measures both new and existing tenancies and therefore tends to be less volatile and lags changes in the Homelet Index. Annual rental inflation is now ahead of the HomeLet Index on this measure, reaching a new high of 9.0% in February (see Chart 10) based on provisional numbers. Rents are one of the components now contributing most to higher inflation as energy and food price inflation falls back.

Chart 10 – Private rental price growth

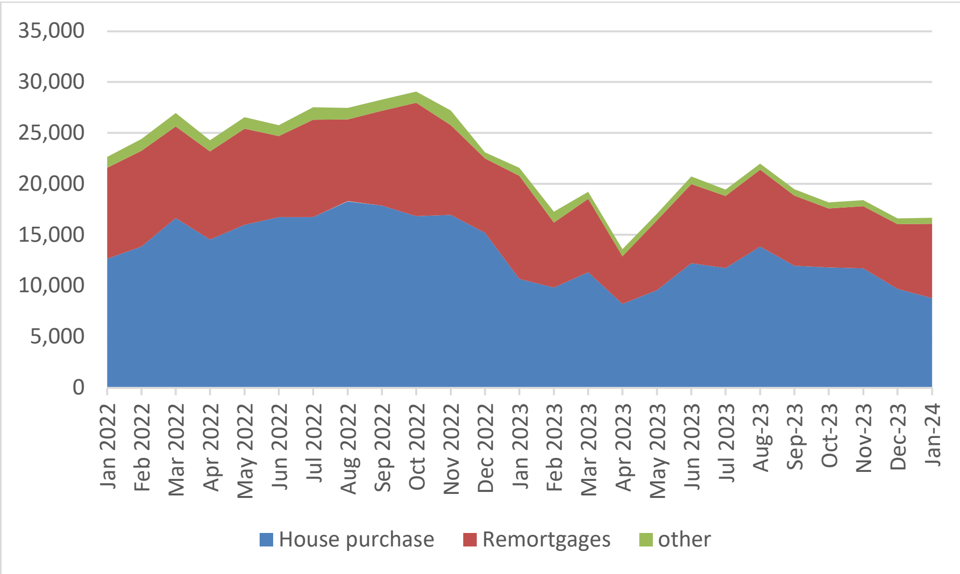


Source: Office for National Statistics and Homelet

Mortgage lending

As Chart 11 shows, the decline in lending in the latter months of 2023, which affected both house purchase and remortgage activity, was not as severe as the downturn that followed the 2022 mini-budget. But there was still a 13% fall in total lending in the final quarter compared to Q3. Like the earlier dip, it followed a spike in mortgage rates with a lag of around six months, and as fixed-rate mortgage pricing has eased considerably since then, it suggests that lending is likely to be on an upward trajectory over the next few months.

Chart 11 – Mortgage lending (£ million)



Source: Bank of England

The likelihood of an improving market in the coming months is supported by mortgage approvals data, which tend to lead lending by around three months. Total approvals by value were up 17% in January with remortgage approvals up by 13% and those for house purchase by 19%. The market has been buoyed by falling mortgage rates across the fixed-rate spectrum (see Page 10).

March budget

The Chancellor unveiled this year's Spring budget on 6 March. The most prominent announcement overall, the 2% cut in employees' National Insurance Contributions, will provide a marginal benefit to borrowers by improving affordability calculations slightly. But there were few measures relating directly to the housing and mortgage markets which collectively are not expected to have much impact:

Capital Gains Tax (CGT) was cut from 28% to 24% for higher and additional rate taxpayers on the sale of residential property. However, it had already been announced that from the forthcoming tax year personal CGT allowances are set to fall from £6,000 to £3,000, so not all sales will result in lower CGT bills.

The Furnished Holiday Lets regime, which provided tax breaks to owners letting their properties as holiday homes or short-term lets, has been removed to encourage landlords to switch to letting on a long-term basis. Short and long term lets will now be treated on the same basis.

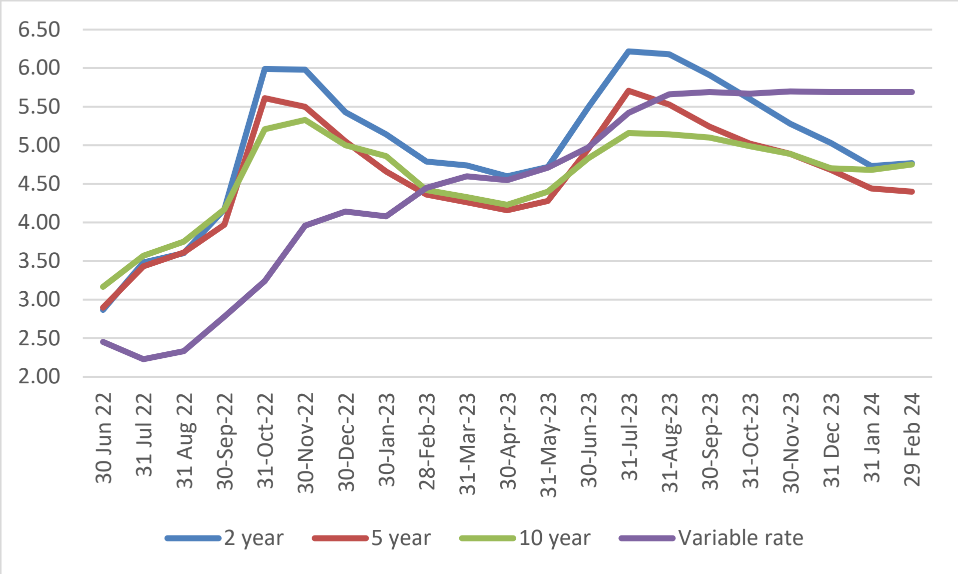
Multiple Dwellings Stamp Duty Relief was removed after the Chancellor claimed that it was being abused by properties being split up and sold together. This change will raise the amount of stamp duty payable when an investor purchases several properties in a single transaction and therefore risks reducing investment in the PRS.

Several changes related to housing which had been floated before the budget were not included. There was no announcement on government providing insurance on 99% loan-to-value mortgages, which had received considerable pre-budget coverage. Nor did the government bring back the Help to Buy equity loan scheme, despite housebuilder support for its return. Even the current temporary stamp duty concessions for first time buyers were not made permanent.

In all, this was a cautious budget designed to demonstrate that the Conservative Party wants to emphasise the importance of fiscal restraint. But there may still be another fiscal event before the general election if this is not called until the Autumn, which looks increasingly likely.

Mortgage pricing and products

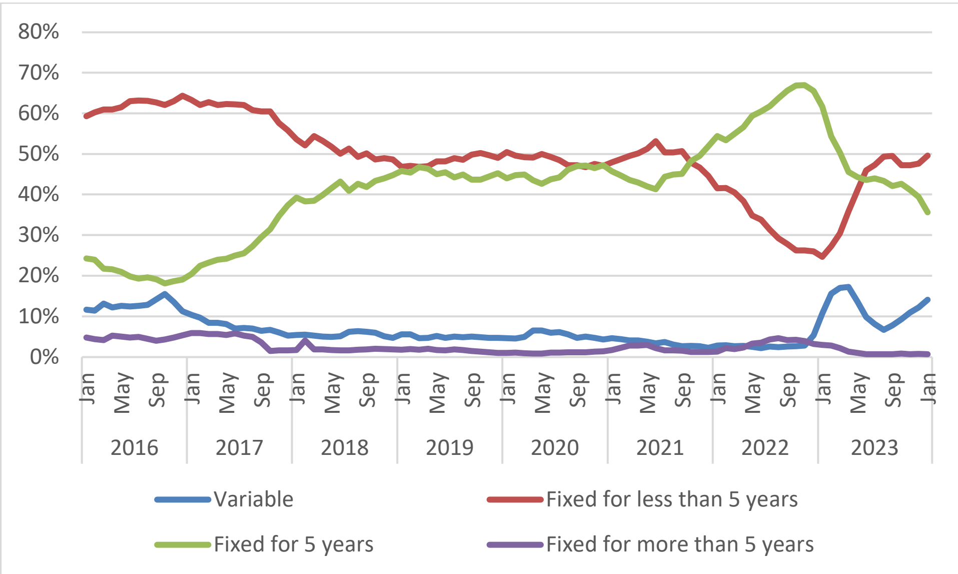
Chart 12 – 75% LTV mortgage pricing



Source: Bank of England

Since the peak in fixed-rate mortgage pricing in July, there have been significant reductions of rates of 2, 5 and 10-year products (see Chart 12). The greatest decline has come in 2-year fixes, where the fall averaged 1.5 percentage points but 5-year fixes also came down by 1.3 percentage points. These falls reflected falling swap rates as the market started to anticipate Bank Rate cuts but in February optimism about the speed of cuts receded and 2-year fix pricing actually rose very slightly.

Chart 13 – Fixed and variable rate share of new lending



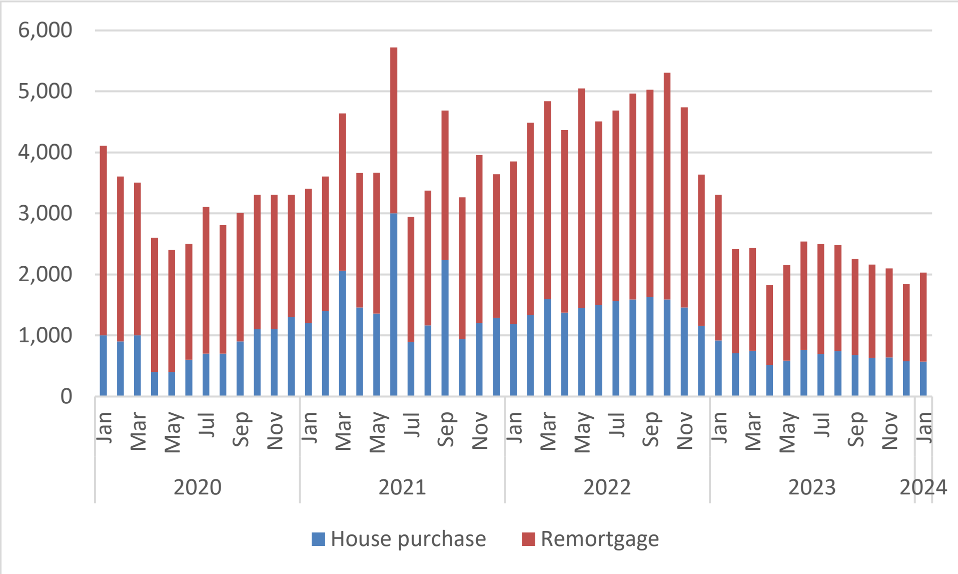
Source: UK Finance

Despite falling fixed-rate pricing, more borrowers have been opting for variable rate loans in recent months and 2-year fixes have also gained in popularity relative to 5-year ones. This probably reflects a feeling that rates are likely to start falling soon, making people unwilling to commit to fixes of 5 years or more for fear of being locked into a rate that becomes uncompetitive as rates in general fall.

Buy-to-let market

In line with the owner-occupied market, buy-to-let lending has been falling in recent months, although there was an 11% rise in January. This partly reflects the lagged response to the higher interest rates seen in the middle of last year. The lower fixed-rate deals that are now available should allow volumes to pick up again but in the house purchase market concerns about the Renters Reform Bill currently before Parliament, which would remove fixed-term tenancies, may be holding back some landlords from purchasing new properties and there was little in the budget to encourage further investment.

Chart 14 – Buy-to-let lending (monthly £million)

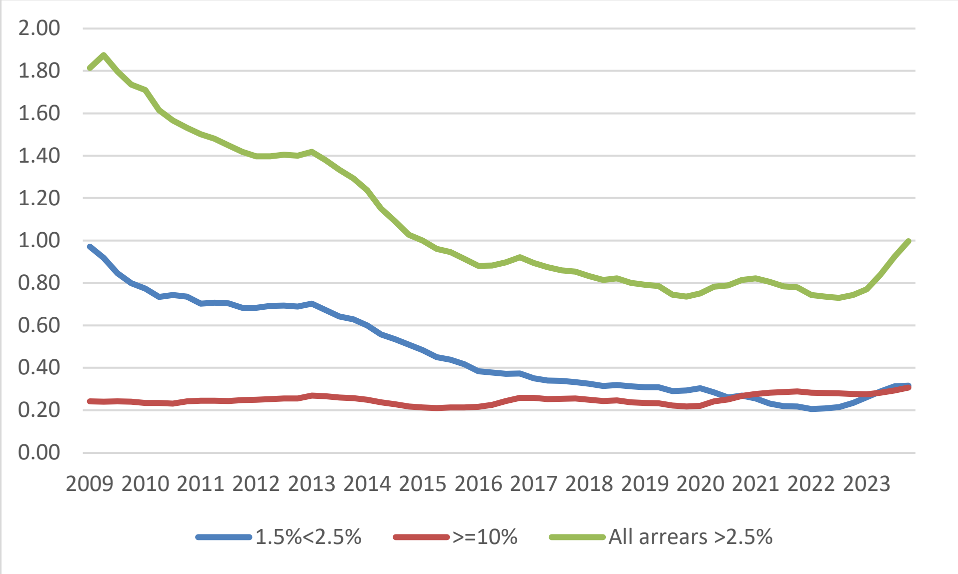


Source: UK Finance

Arrears and possessions

Mortgage arrears of 2.5% of the loan balance or more rose 8% in Q4, to 1.0% of all accounts, the highest rate since 2015, but slightly slower than the rate of increase the previous quarter. One positive development is that the rate of short-term arrears showed only a small (0.5%) rise in the fourth quarter, suggesting that fewer households may be falling into arrears despite the rise in mortgage rate many are experiencing when moving to a new product. Chart 15 puts the recent rise in arrears into perspective: arrears are still far below the levels of the first half of the 2010s despite forbearance measures that have kept possession rates at historically low levels.

Chart 15 – % of mortgages in arrears (by percentage of loan balance)



Source: UK Finance

Buy-to-let continues to see a faster increase in arrears than the owner-occupied market but from a lower base. In Q4, the number of buy-to-let mortgages with arrears over 2.5% of the loan balance rose 18% to 0.68% from Q3 and by 124% from a year earlier. In contrast, owner-occupier arrears rose 7% to 1.07% of all loans compared to Q3 and 25% from a year earlier.

Prospects

After a difficult year in 2023, which saw the housing and mortgage markets adjusting to sharply higher mortgage rates, there is increased optimism this year as a result of an easing of affordability pressures as fixed-rate mortgage pricing has come down. This more optimistic tone to the market has been reflected in house prices starting to show clear signs of rising again and in a tentative recovery in mortgage approvals.

The positive mood has been bolstered further by Andrew Bailey giving his strongest indication yet that Bank Rate will likely be cut this year. Following the March MPC meeting, the Governor of the Bank of England made it clear that headline CPI does not need to be back to 2% for the Committee to support rate cuts. But CPI inflation is likely to fall towards 2% over the next three months simply because large monthly increases from last year will be dropping out of the annual comparison.

However, in recent weeks, financial markets have pulled back slightly on their prediction on the timing and speed with which the Bank of England will cut interest rates this year leading to a modest upward adjustment of swap rates which has largely halted the downward trend in fixed-rate mortgage pricing. The latest readings for core inflation and regular earnings growth of 4.5% and 6.1% respectively are still well above the level needed to achieve a sustainable inflation rate of 2% but both are heading down and an expected fall in headline CPI inflation over the next three months should help to ease future pay settlements, potentially creating the conditions where the MPC can justify a rate cut.

In the meantime, the housing market has demonstrated its resilience. Even if monetary conditions do not ease as much as expected this year, it seems likely that house prices will end the year higher and mortgage lending can stage a recovery from 2023’s performance.