Market briefing: September 2019

Key developments in the housing and mortgage markets

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Executive Summary

- The housing market has been relatively resilient in the face of Brexit uncertainties to date, with most measures indicating slightly higher activity as we headed into the summer.

- House purchase activity has been underpinned by the strong jobs market, competitive mortgage deals and slowing house price growth.

- Levels of remortgaging remain high but have begun to ease back following a lengthy upturn.

- Concerns about the domestic political situation, slowing economy and job security are adversely affecting household sentiment. The forthcoming Autumn Budget provides an opportunity for the Government to counter the gathering economic headwinds.

Economic overview

A change of Prime Minister from late July has not brought political calm or greater certainty about the Brexit process.

Before its prorogation, Parliament legislated that the Government should request a further extension, in preference to a disorderly Brexit. With a vital EU summit looming just a few weeks ahead of the 31 October deadline for the UK's scheduled withdrawal from the EU, it remains unclear whether an eleventh-hour deal acceptable to all sides can be negotiated and agreed.

A General Election looks likely before the end of the year, but it is not clear that even this will unblock the constipated nature of domestic politics.

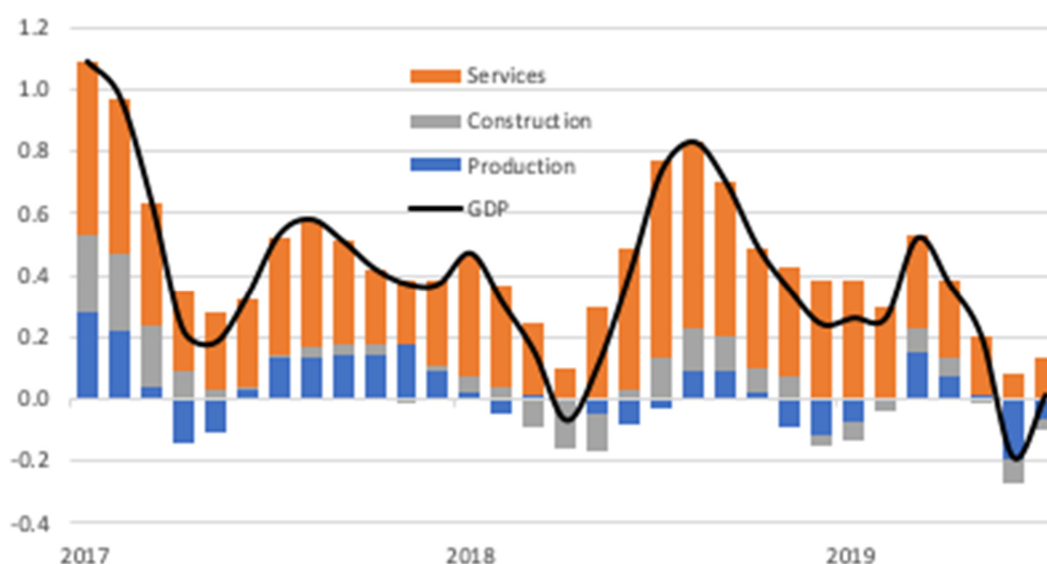
The prospect of a disruptive departure from the EU or yet further postponement, coming on top of a global slowdown and trade tensions, continues to undermine the UK's short-term economic position.

Business surveys have made for gloomy reading for some time and have recently begun to raise concerns as to whether the UK is moving into recession – defined by economists as two successive quarters of falling output.

Although the economic picture is far from promising, such pessimism may be overdone.

While it is true that GDP fell by 0.2% in the second quarter, this had a lot to do with the planned shutdowns in car production in April. Overall output has recovered modestly since, with a strong pick-up in the dominant services sector in July helping the economy return to a broadly flat position in the three months to July.

Chart 1: Contributions to GDP growth, rolling 3 months



Source: Office for National Statistics
Note: Figures show contributions to growth on previous three months

With manufacturing and construction (including house-building) already fading, much depends on how the services sector performs over the coming months.

The Bank of England has pencilled in growth of 0.2% for the third quarter. Looking further ahead, even assuming an orderly Brexit, the Bank has put the odds of a recession early next year at 33%. This is a return to the degree of pessimism the central bank showed immediately after the EU referendum in 2016.

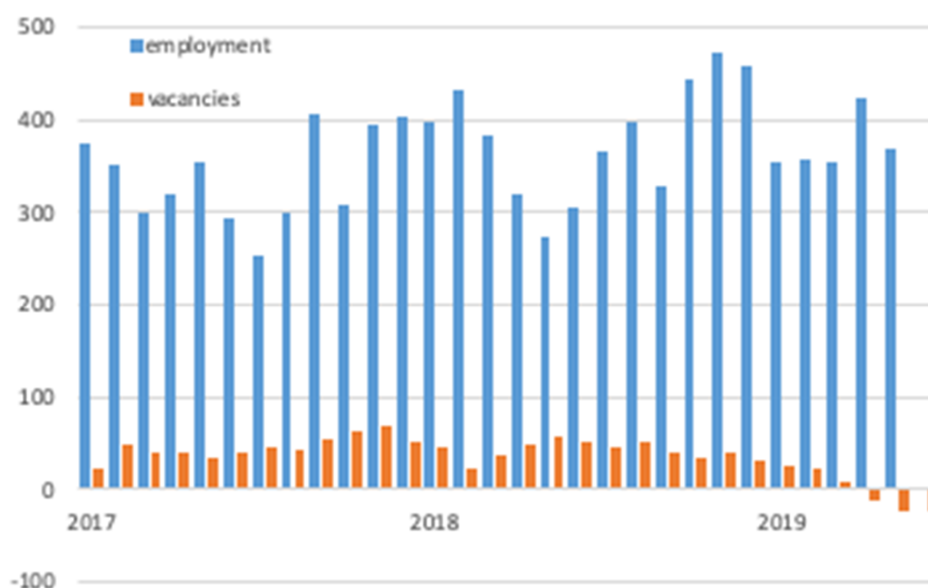
For the time being, however, the weaker growth picture has not dented the jobs market.

Employment in the three months to July rose to nearly 32.8 million, up 369,000 on a year earlier, and the employment rate at 76.1% was the joint highest on record. Meanwhile, the tightness of the labour market has underpinned the strongest rate

of nominal pay growth for a decade, with earnings growth up by 4%. This is more than 2% in real terms, the strongest pace since 2015.

If we dig a little beneath the positive headline figures, however, there are some potential early warning signs of a more challenging period ahead. Trends in vacancies have been less positive in recent months, with recruitment surveys reporting a drop-off in hiring both permanent and temporary staff.

Chart 2: Changes in employment and vacancies on a year ago, 000s



Source: Office for National Statistics
Note: Figures showing rolling three months compared with the corresponding period a year earlier

The latest batch of household surveys indicate that worries about the economy and jobs market are making households less confident about the future state of their personal finances. Households have become more cautious about major purchases and wary about the outlook for house prices.

Interest rates

Current inflationary pressures remain relatively benign. The annual rate of inflation, based on the Consumer Prices Index including owner occupiers' housing costs (CPIH) – the ONS's preferred measure – fell to 1.7% in August, down from 2.0% in July and the weakest figure since late 2016.

Despite cuts by the US Federal Reserve and the European Central Bank, the Bank of England's Monetary Policy Committee (MPC) left monetary policy on hold at its September meeting. In essence, the Bank is keeping its powder dry until there is greater clarity around the economic implications of Brexit.

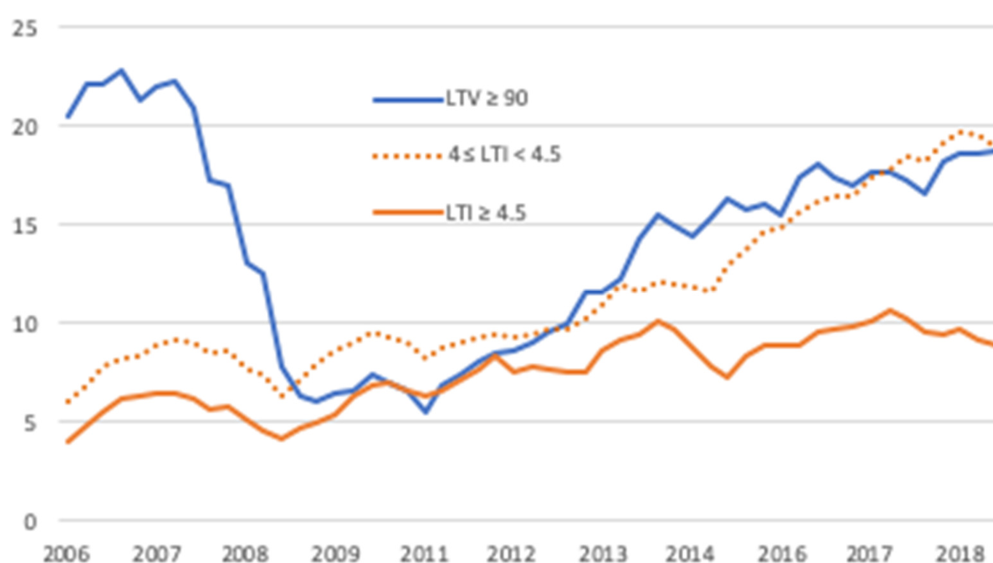
Macro-prudential policy

The notes of recent meetings imply that the Financial Policy Committee (FPC) is not currently troubled by housing market developments.

Whilst noting that mortgage lender risk appetite remains strong, and that competition has pushed up the proportion of new mortgage lending at loan to value (LTV) ratios at or above 90% to a new post-crisis peak of 18.7% in the first quarter, July's *Financial Stability Report* draws some comfort from the fact that lending at high loan to income (LTI) ratios has nudged lower, that debt-service costs are historically low and that overall credit growth has slowed.

Its primary concern around housing currently appears to be that borrower demand might rebound sharply if Brexit uncertainties fade.

Chart 3: Mortgage lending terms



Source: *Financial Stability Report* July 2019 Chart B.1

Fiscal Policy

In early September, new Chancellor of the Exchequer, Sajid Javid, unveiled a limited spending round, covering just the 2020-21 financial year.

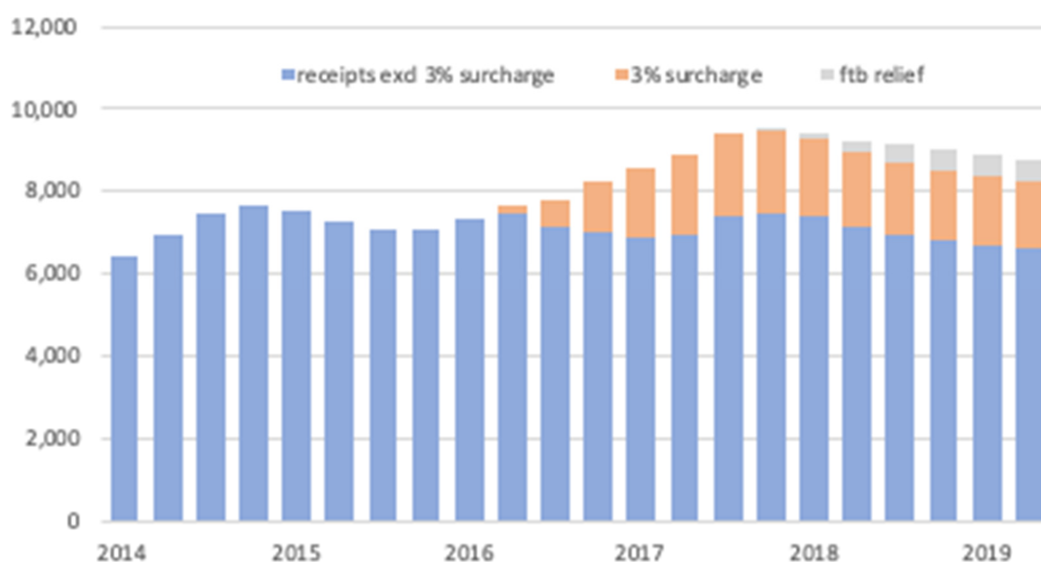
In what many commentators saw as a pre-election move, the Chancellor announced that public spending would grow by 4.1%, or around £13.8 billion, between 2019–20 and 2020–21 in real terms. This would be the fastest rate of annual growth in 15 years, building on the "end of austerity" theme of his predecessor.

No major housing announcements were made, although the Spending Review reiterates the Government's continued support to increase home ownership through the Help to Buy equity loan and other housing programmes.

Javid is keeping his options open as to the timing of his Autumn Budget, but has signalled his intention to review (and presumably loosen) the current fiscal framework. With public finances relatively healthy, despite the economic slowdown, the prospect of further populist measures and a material loosening of fiscal policy are not really in doubt.

A big question for the mortgage industry is whether housing will feature in a significant way. The need to lower the burden of stamp duty to encourage greater housing market activity was aired in the early days of this administration, and is one possible candidate although, as a recent Savills report noted[1], meaningful reform is not straightforward as it would result in significantly lower revenue to the Treasury.

Chart 4: Stamp duty receipts, £m, rolling year basis



Source: HMRC
Notes:
1. Figures from Q2 2015 onwards only contain data for England, Wales and Northern Ireland and from Q2 2018 onwards only England and Northern Ireland.
2. Grey shaded bars indicate value of SDLT receipts foregone as a result of the relief claimed by eligible first-time buyers

Housing Policy

With a General Election likely to be called soon, the industry is alert to the direction of policy across the main political parties. A wide range of policies have been aired

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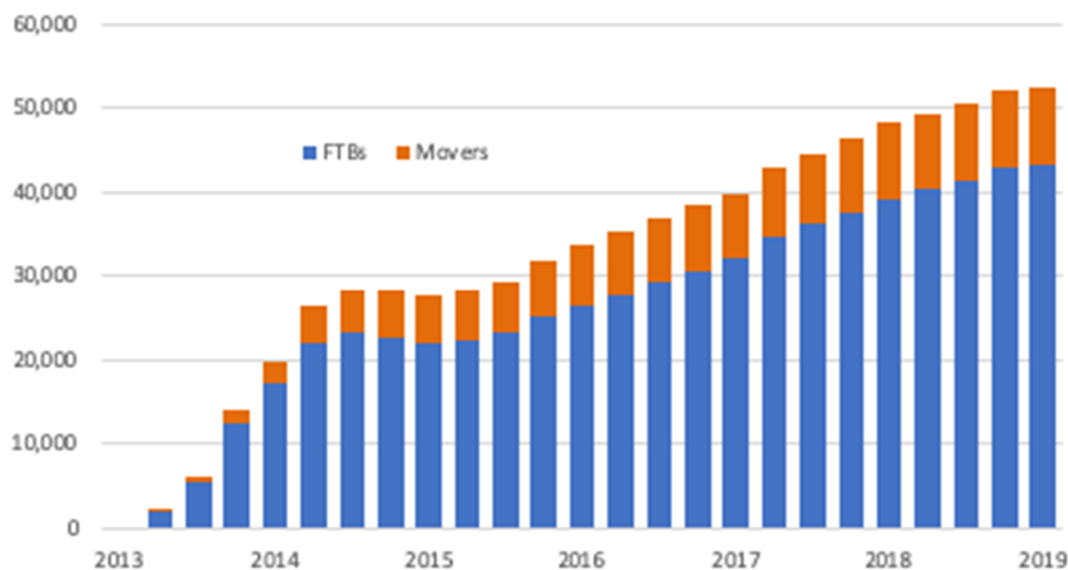
[1] *The case for stamp duty reform*, Savills August 2019

in Labour circles over recent months. Some of these, such as a mooted Right to Buy for private renters and changes to inheritance tax could, if adopted and implemented, have profound effects for parts of the housing market.

The Help to Buy Equity Loan scheme continues to be a key consideration for the mortgage industry. A recent Parliamentary report[2] underlines that the policy attracts major criticism from some quarters.

For the time being, however, it continues to run at full pace, with completions continuing to run comfortably above 50,000 per annum. In late August, MHCLG improved the affordability calculation, by lifting the maximum mortgage term allowed under the scheme from 25 to 35 years.

Chart 5: Help to Buy Equity Loan scheme completions, England, rolling year basis



Source: MHCLG

While Help to Buy underpins the new-build sector currently, house-builders are already being impacted by the planned narrowing of the scheme from 2021 and planning for its closure in 2023.

It is worth noting that the new administration has not ruled out extending HTB beyond its scheduled closure in 2023. Nevertheless, the industry is giving considerable thought as to how to wean the property market off the Help to Buy Equity Loan scheme with as little impact as possible on house-building rates.

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[2] *Help to Buy: Equity loan scheme*, Public Accounts Committee September 2019

This is a huge challenge, given the scale of Help to Buy scheme sales. No silver bullet solution seems likely. Instead, we are more likely to see a suite of measures, including schemes to encourage more higher LTV lending on new-build, more shared ownership (where MHCLG is currently consulting on improvements to the scheme), and perhaps even a re-boot of the failed Starter Home initiative.

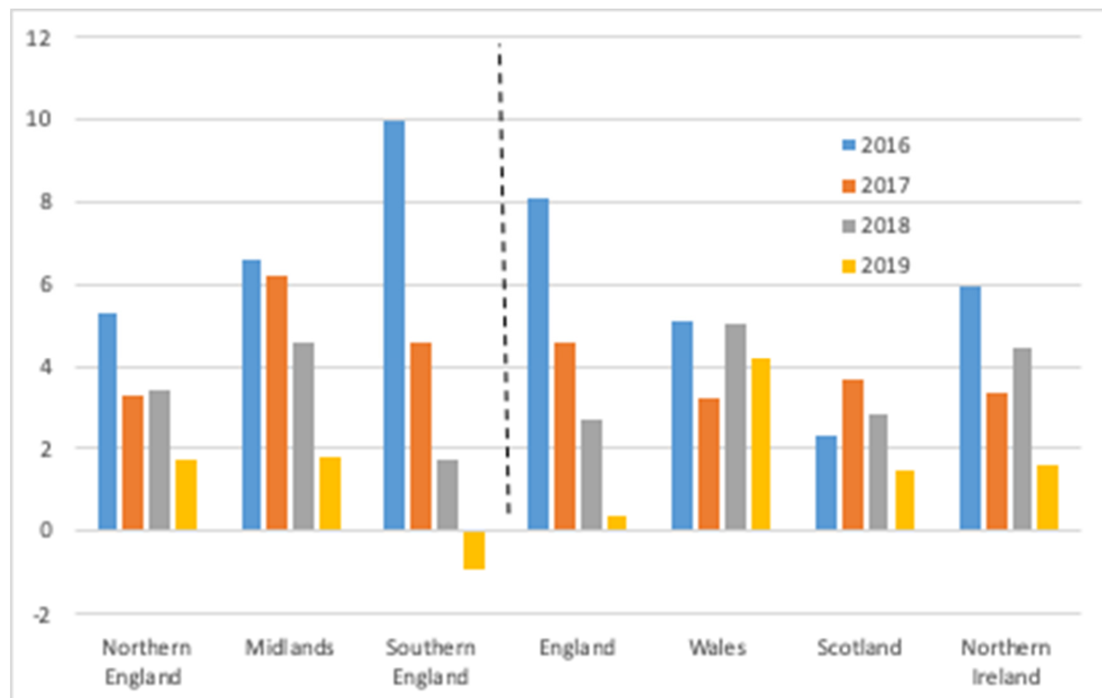
Housing and mortgage markets

Prices

There is now a clearer picture on house prices, following a revamp of the methodology underpinning the Halifax house price figures, which bring them more into line with other metrics.

The consensus view for the UK as a whole is one of only limited property price inflation – just 0.7% for the year to July – the weakest since 2012 - according to the Office for National Statistics.

Chart6: Annual house prices, % change



Source: Office for National Statistics
Note: Figures show 12-month percentage change as at July each year

There are signs that the price correction seen in London over the past year or so has now largely drawn to a close. But the ripple effect from London means that prices

are softening a little across much of southern England, and there are signs of house price inflation slowing in the Midlands. While northern regions continue to be more resilient (at least according to some metrics), residential property price inflation across much of the UK is more subdued than a year ago. LSL/Acadata figures suggest that for England as a whole, prices have broadly stagnated since the start of the year.

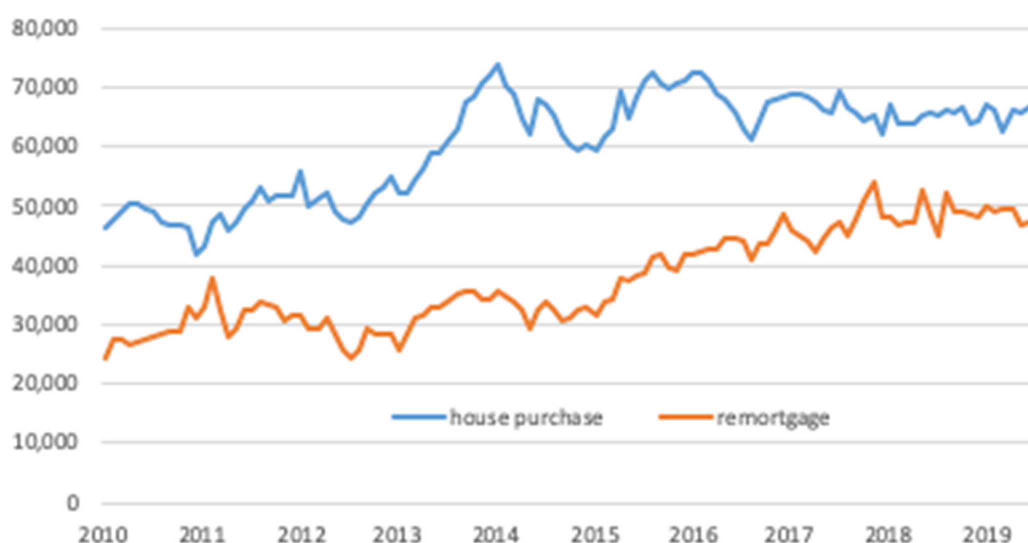
Wales, with nominal price rises of 4-5% per annum, stands out as the only country still experiencing above-inflation property price growth.

Activity

Just as one picture becomes clearer, another seems to get blurred.

Whilst the underlying picture is not particularly strong, there is currently some uncertainty about the true path of property transactions, with unusually large revisions being made to monthly figures from HM Revenue & Customs. The sharp fall that it reported for July transactions sits oddly with other market indicators, especially the Bank of England's house purchase approvals figures which have been running a little above year-earlier levels for the past four months. Approvals climbed to 67,306 from 65,506 in June, reaching the highest level since July 2017, according to the Bank.

Chart 7: Mortgage approvals



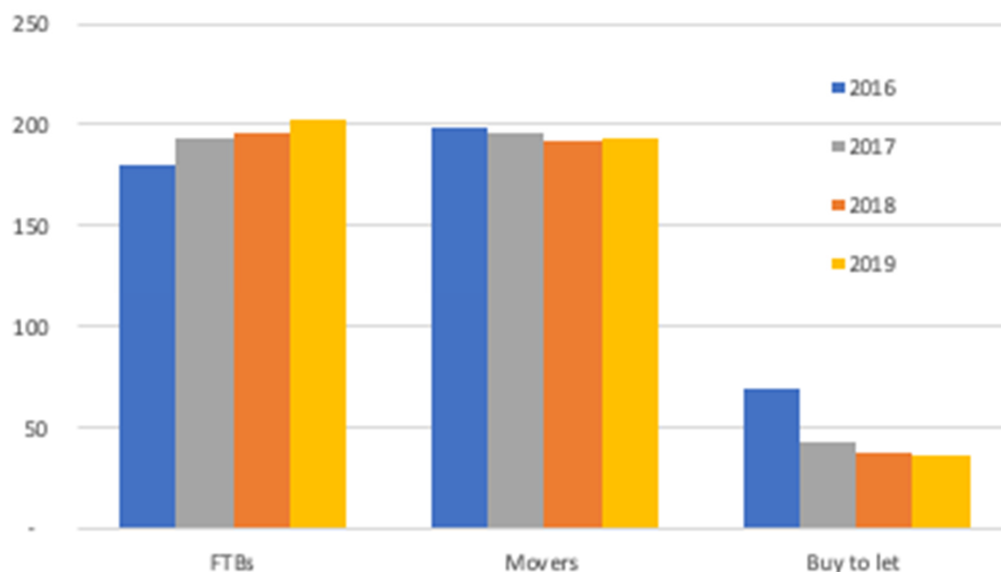
Source: Bank of England

Indeed, the latest UK Finance figures point to a pick-up in first-time buyers and movers in July – up 6% and 1% on a year earlier respectively. First-time buyer numbers nudged higher to 364,000 in the year to July, the strongest showing since

2007. A number of factors have bolstered affordability, including competitive mortgage deals, the buoyant jobs market and the subdued pace of property price inflation across much of the country.

July was also a relatively favourable month for landlord investment, according to UK Finance, with the number of properties bought – 5,800 – being the strongest so far this year.

Chart 8: Trends in mortgage lending by borrower, Jan – July, 000s



Source: UK Finance

Although the welter of adverse tax and regulatory measures introduced over recent years continue to be a drag on investment activity by landlords, there are signs that the sharp downward correction may be drawing to a close, helped by a pick-up in rental yields. For several months now, the levels of house purchase activity by BTL landlords have been similar to a year earlier, as shown in the year to date figures in Chart 8. This is the strongest performance for some time, and chimes with recent analysis from Hamptons International that landlords have begun to account for a smaller proportion of house sales and a larger proportion of purchases.

Mortgage lending

Monthly gross mortgage lending, after adjusting for seasonal factors, has been around £22 billion for much of the past year.

The underlying picture has softened a little of late, as growth in remortgage activity – so long a feature of the market – has stalled. Remortgage approvals for the twelve months to July were barely 1% higher than the corresponding figure a year earlier.

This is likely to reflect natural limits to growth after a such a lengthy period of growth and also growing competition from product transfers (which UK Finance report separately and which continue to run at high levels).

There is certainly no abatement in the availability of competitive mortgage deals, particularly for 5-year fixed rate products. Financial markets have anticipated interest rate reductions over recent weeks, on the back of weaker global economic growth prospects and, closer to home, worries about a no-deal Brexit. This in turn has driven swap rates lower, spurred competition and brought down the pricing of five-year fixed rate products to their most competitive all year.

Prospects

The ongoing Brexit saga and dislocated nature of domestic politics make it hard to frame short-term prospects.

For the immediate future, competitive mortgage deals seem likely to continue to drive business volumes for a while longer, but ultimately the health of the housing and mortgage markets is tied to prospects for the wider economy.

With household sentiment growing more cautious, the likelihood is that housing sales will be fairly flat and that house price growth will ease a little further (allowing a gradual improvement in the affordability position of buyers).

Should recessionary headwinds appear, policy-makers have considerable firepower at their disposal to keep the housing market on an even keel. The Autumn Budget may be an important one for the lending industry.

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