Market Briefing: December 2023

Key developments in the housing and mortgage markets

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December 2023

Executive summary

- Output has continued to show a broadly flat picture. In Q3, GDP was down 0.1% from Q2 and in October it was down 0.3% on the month but flat compared to October 2022. One data release was more positive, with the latest Purchasing Managers Index (PMI) for the services sector reading 52.7 in December, suggesting growth is picking up sharply in the largest sector.

- CPI inflation fell unexpectedly to 3.9% in November following a sharp fall in October, as the energy price spike from October 2022 fell out of the 12-month comparison. Core inflation (excluding food and energy prices) also fell, to 5.1% in November, but producer input and output prices have started rising again on a 3-month on 3-month comparison.

- After the latest MPC interest rate decision, Andrew Bailey, Governor of the Bank of England, played down talk of early cuts in Bank Rate. Bank Rate was held at 5.25% in December.

- The Office for National Statistics (ONS) has stopped publishing data based on its labour force survey after concerns that it is no longer providing reliable results. The survey has been replaced with what the ONS calls an experimental data series, which shows unemployment remaining unchanged at 4.2% over August-October.

- Housing transactions in the 3 months to October were up 9% on the previous 3 months but the number of house purchase approvals was down 19% over the same period, pointing to weaker house purchase lending going into 2024.

- There has been a divergence of trends recently between Land Registry house prices and those of the Nationwide and Halifax. In the 3 months to October, the Land Registry reported that house prices rose 1.8% compared to the previous 3 months but over this period Nationwide and Halifax both reported falls.

- Fixed-rate mortgage pricing continued to ease in November. Average 2-year fixed-rate pricing fell almost 1% between the end of July and the end of August as swap rates fell. Products fixed for less than 5 years have overtaken 5 year fixes as a share of new lending as borrowers avoid fixing for longer in the hope that interest rates will fall.

- There was a 9% rise in mortgage arrears of more than 2.5% of the loan balance between Q2 and Q3 to 0.92% of all loans. Buy-to-let arrears continued to rise fastest, up 29% to 0.57%, but for the first time since 2017, owner-occupier arrears of 2.5% reached 1% of loans.

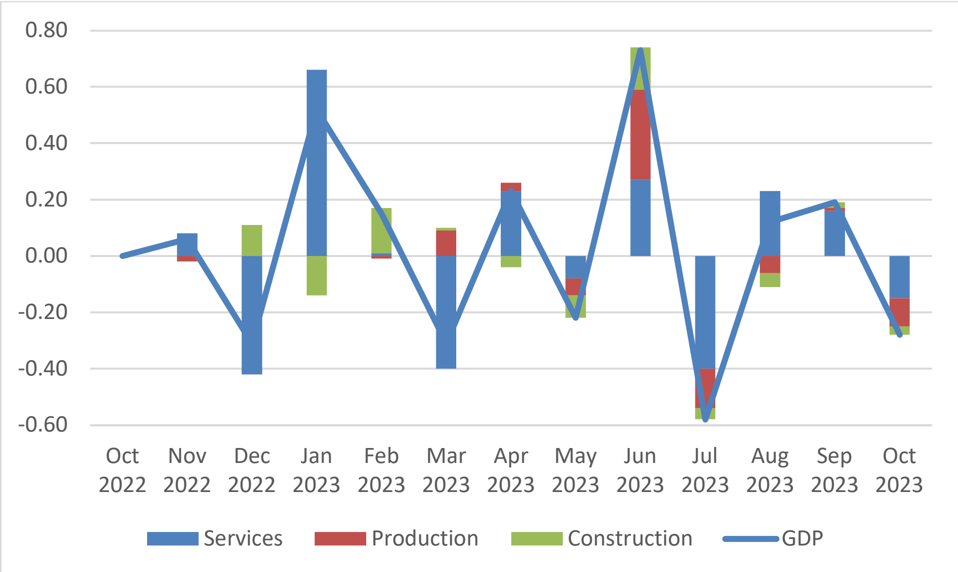
The economy

Output

Output fell 0.3% in October, and was flat over the 3 months to October. This continued the broadly flat pattern seen in 2023: Q3 saw a 0.1% fall after output was flat between Q1 and Q2. Output in October was also flat compared to October 2022.

On a sectoral level, services, production and construction all fell in October (see Chart 1), but this followed relatively strong performances in services in August and September. The largest driver of the recent weakness in construction has been new private housing which fell by 5.2% in October. A more forward-looking indicator of activity, the Purchasing Managers Index (PMI) recorded a robust uptick from 50.9 in November to 52.7 in December (anything above 50 signalling growth) but the corresponding figure for manufacturing remains below 50.

Chart 1 – Sources of GDP growth %



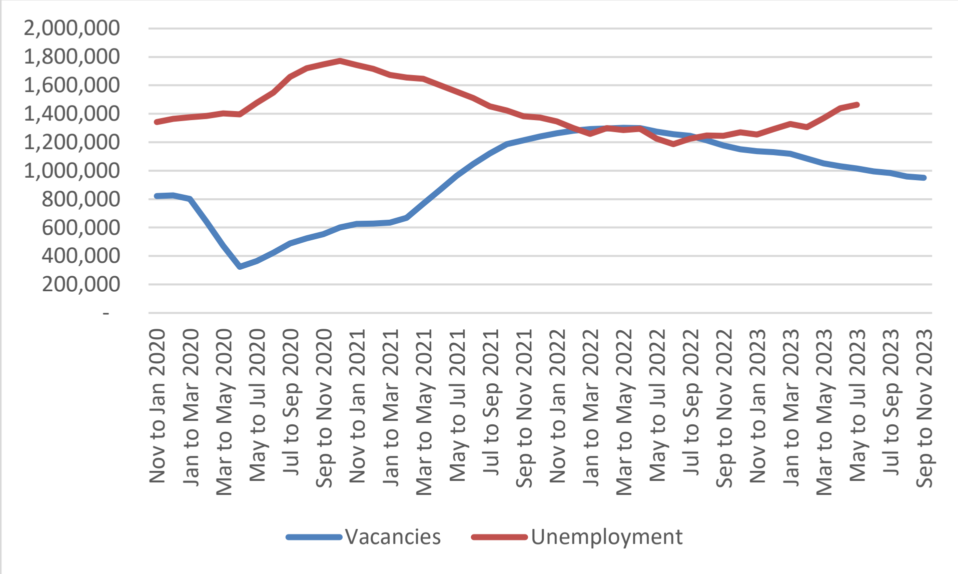
Source: Office for National Statistics

Labour market

Problems with ONS data collection has led the agency to replace its labour force survey with an experimental series on unemployment and employment. The response rate to the survey had fallen in recent years and the ONS has warned that its results have diverged from other data sources.

Some of the labour market data that has been released as normal continues the recent trend of a moderately weakening picture, with for example, a 10,000 fall in job vacancies comparing August to October and September to November (see Chart 2).

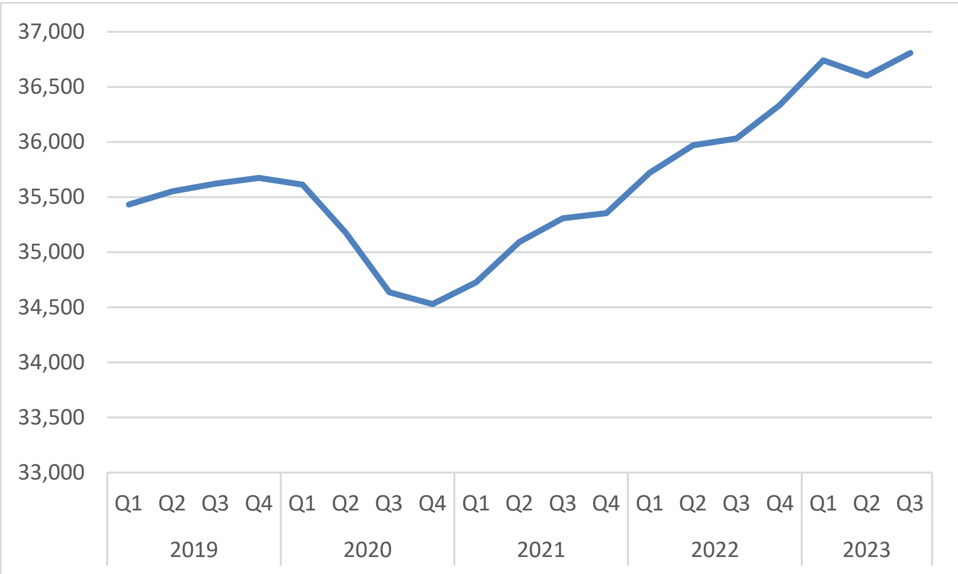
Chart 2 – Job vacancies and unemployment



Source: Office for National Statistics

However, while unemployment had been rising (see Chart 2) and employment falling according to the labour force survey, the new experimental ONS data series shown in Chart 3 shows a rise in total employment. The new data also shows that unemployment remained at 4.2% over the August-October period, a little lower than the last data from the labour force survey.

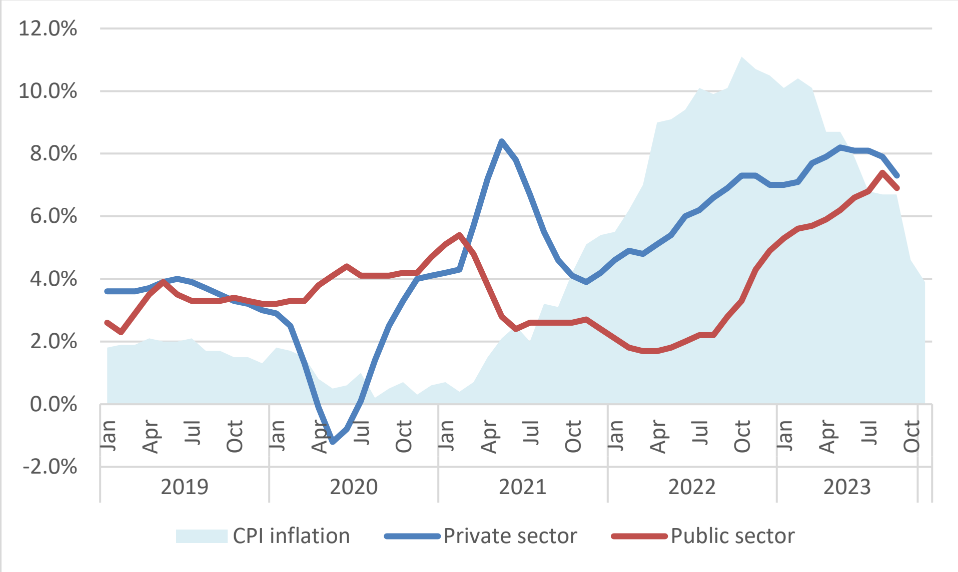
Chart 3 – Trends in employment (ONS experimental data series)



Source: Office for National Statistics

The modest weakening in the labour market appears to be starting to reduce upward pressure on wages. In August to October regular pay (excluding bonuses) rose by 7.3%, down sharply from 7.8% in July to September. But the sharp fall in CPI inflation in October and November means that real earnings growth is now firmly positive after 18 months of decline until last summer. Both the public and private sectors contributed to earnings growth slowing in August to October (see Chart 4).

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



Source: Office for National Statistics

Inflation and interest rates

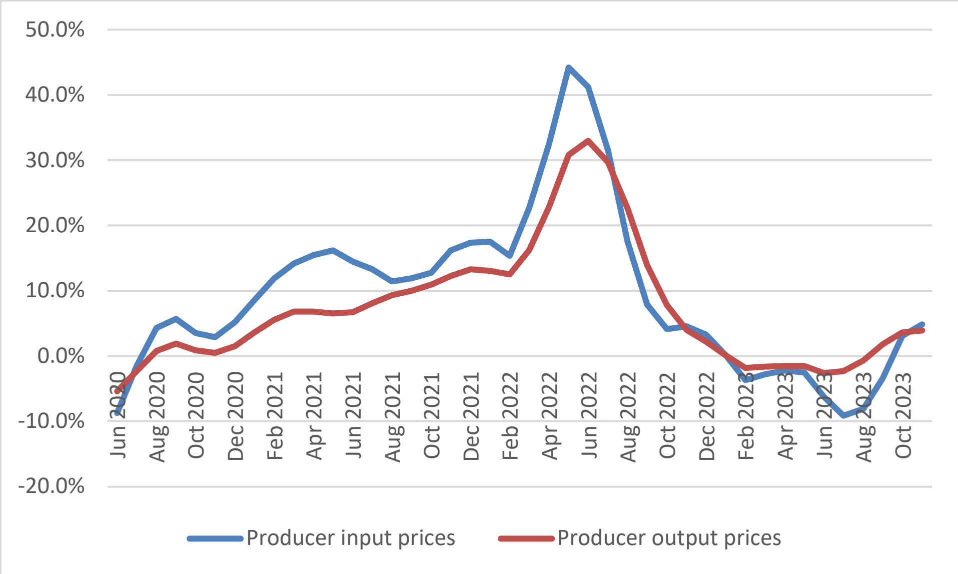
Further positive news on inflation has come from falling global commodity prices. The S&P GSCI Sterling Index fell 15% in the 3 months to 15 December (see Chart 5), falling oil prices being a notable driver. However, the recent falls reverse the gains of the autumn, with the index just 2% below the level of 15 June 2023.

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

Source: S&P

Falling global commodity prices helped drive down UK producer input and output prices. As Chart 6 shows, both input and output prices were falling from February 2023, comparing the latest 3 months with the previous 3 months. However, despite the continued fall in commodity prices, in the 3 months to November producer output prices rose 3.9% on the level of the preceding 3 months on an annualised basis, with input prices rising by 4.9%. These changes tend to feed into consumer prices with a lag.

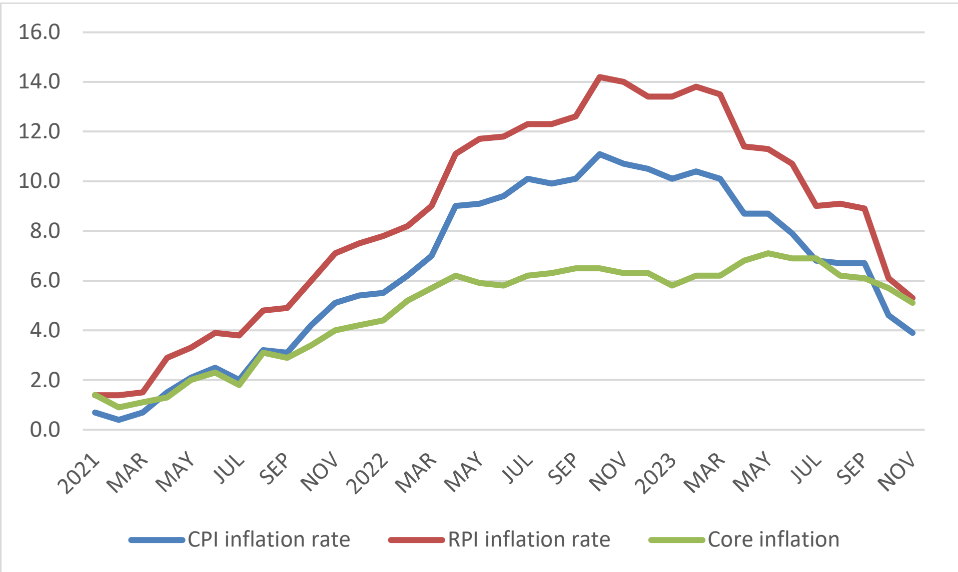
Chart 6 – Producer prices (3 month on previous 3 months annualised)



Source: Office for National Statistics

Consumer price inflation has been on a clear downward course since its peak a year ago (see Chart 7). There were particularly large falls in October and November from 6.7% to 4.6% to 3.9%, helped by the energy price spike of October 2022 falling out of the 12-month comparison. But as Chart 7 shows, core inflation, which excludes food and energy prices which tend to be quite volatile, peaked later and has fallen less. Core inflation was at 5.1% in November and services inflation at 6.3%.

Chart 7 – CPI, RPI and core annual inflation



Source: Office for National Statistics

The recent good news on inflation has raised expectations that the Bank of England could start cutting Bank Rate in 2024. Financial markets are predicting that Bank Rate will start falling next summer and could reach 4.25% by the end of the year. Market optimism over the future direction of interest rates also helped to reduce swap rates and therefore fixed-rate mortgage pricing, as discussed in mortgage pricing and products below.

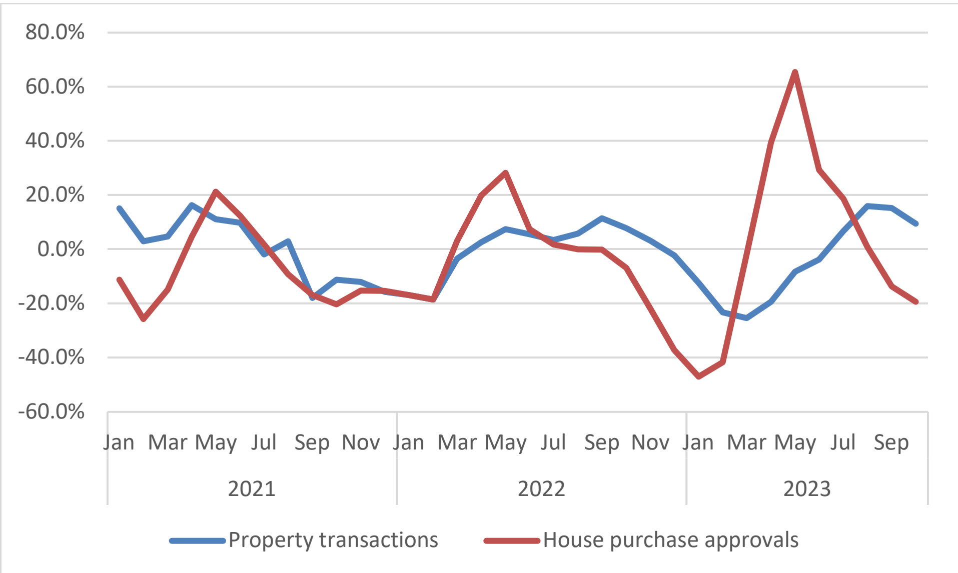
However, after the latest MPC rate decision announcement on 14 December, the Bank of England Governor, Andrew Bailey, played down the likelihood of rate cuts, emphasising the need to combat inflation by saying that Bank Rate would need to be kept high for an extended period. Given the strength of domestic inflationary pressures, the Bank is likely to pay particular attention to the upcoming trend in earnings growth, which is currently at 7.3%, and to pay settlements. According to XpertHR, the median basic increase in the 12 months to the end of October 2023 was 6.5%. Both these figures appear at odds with 2% inflation given the lack of productivity growth, but if they fall rapidly in 2024, the chances of rate cuts will increase.

Housing and mortgage markets

Activity

After the turbulence brought about by the September 2022 mini-budget, the housing market has shown signs of stabilising in recent months. One indication is the level of property transactions which were depressed in the early months of 2023 but have been showing gains, comparing the latest 3 months to the previous 3 months, since July (see Chart 8). However, approvals for house purchase loans have shown a different pattern, falling sharply after the mini-budget, then recovering strongly but now showing falls on a 3-month comparison.

Chart 8 - Transactions and approvals for house purchase (latest 3 months on previous 3 months)



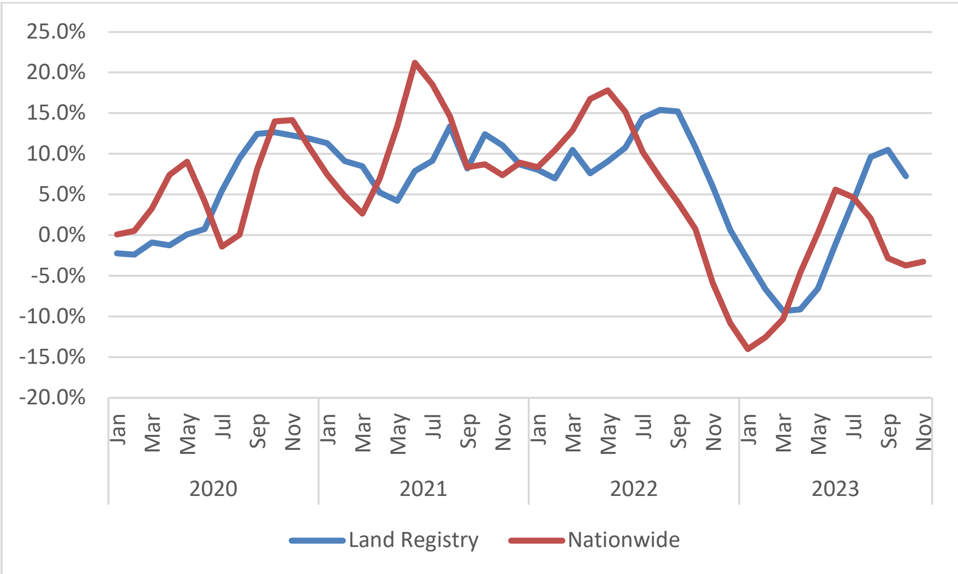
Source: HMRC, Bank of England

The RICS Residential Market Survey has also shown improvements in the net balances of agents with regard to buyer enquiries and seller instructions although these remain negative, as do agreed sales. But, unusually for a period of weak buyer demand, the stock of properties for sale per surveyor has remained low, suggesting that buyers' ability to achieve price reductions may be quite limited.

House prices and rents

House prices also suggest that the housing market is stabilising, but recent data show a divergent trend between the Land Registry figures and those from Nationwide and Halifax (see Chart 9). While Land Registry figures shows house prices firming since March, the Nationwide Index has been broadly flat and the Halifax shows house prices falling by 1.5% between March and November. This divergence may partly reflect affordability pressures facing mortgage borrowers and the comparatively stronger position of cash purchasers (as the Nationwide and Halifax figures are based on those taking mortgages from these lenders). UK Finance data show that the average amount paid by mortgaged buyers fell 5% in the year to October.

Chart 9 – House price inflation (latest 3 months on previous 3 months annualised)



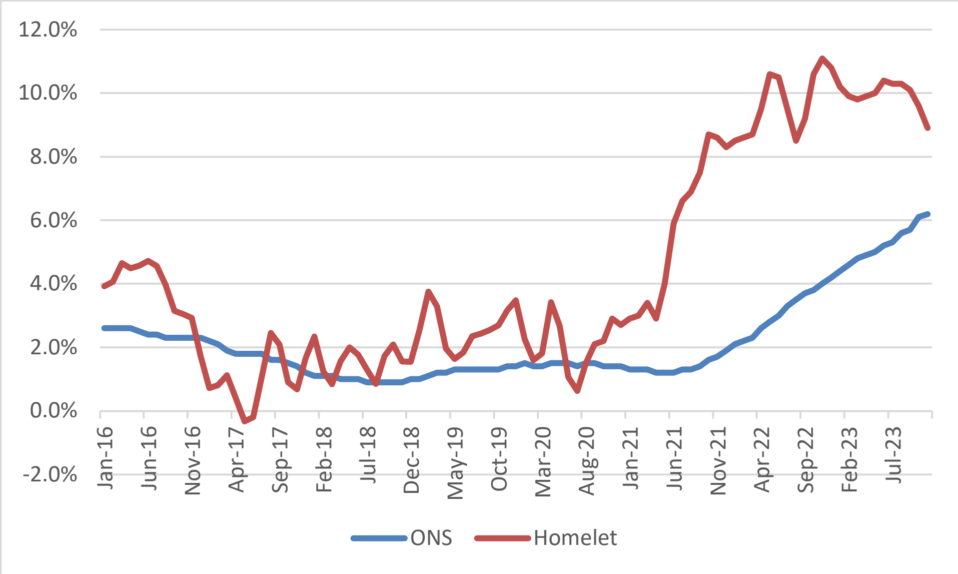
Source: Nationwide Building Society, Land Registry

The rental market remains robust but with early signs of a softening of upward price pressures. The net balance of respondents to the RICS Residential Market Survey reporting higher demand shows a falling positive balance in recent months coupled with a slightly less negative balance for landlord instructions. The HomeLet Rental Index showed a 0.3% fall in rents nationally in November, although a dip in the run-up to Christmas is normal. On a 12-month comparison, the index showed new rents up 8.9%, down from 9.6% in October.

The official government rental price index measures both new and existing tenancies and therefore tends to be less volatile. It has picked up since its recent low in mid-

2021 but has lagged the HomeLet Index and continues to rise, reaching 6.2% in November (see Chart 10).

Chart 10 – Private rental price growth

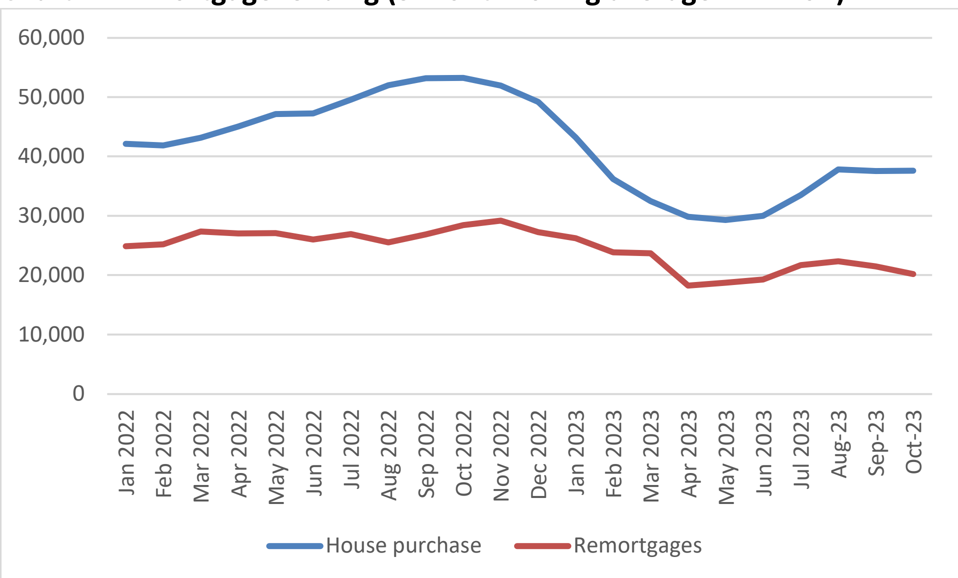


Source: Office for National Statistics and Homelet

Mortgage lending

Chart 11 shows the substantial fall in house purchase lending from November 2022 to its low in May 2023 measured on a three-month rolling average basis. After May there was a reasonable recovery but this has stalled over the past three months. The remortgage market shows a similar pattern. Although the fall from late 2022 was not as steep, the subsequent recovery has also been more muted and remortgage activity has weakened again over the past two months.

Chart 11 – Mortgage lending (3 month rolling average £ million)



Source: Bank of England

Mortgage approvals, which tend to lead lending by around three months, have been weaker in recent months. In the three months to October, the number of house purchase approvals was down 19% on the previous three months and remortgage approvals by 34%, pointing to weakening lending going into 2024.

Autumn Statement

This year's Autumn Statement contained a few measures related to the housing and mortgage markets:

The Mortgage Guarantee Scheme, where the government offers insurance on mortgages of >90-95% LTV, is to be extended until end of June 2025.

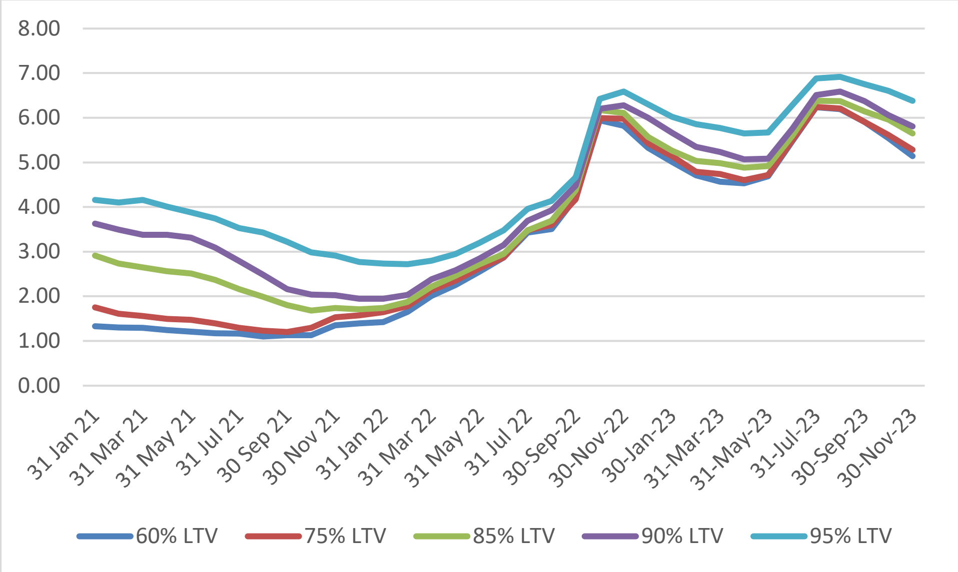
The planning system is to be reformed to speed up development, including the introduction of new premium planning services across England with guaranteed accelerated decision dates for major applications.

£110 million is being made available through the Local Nutrient Mitigation Fund to support planning applications affected by nutrient neutrality rules, potentially unlocking the development of up to 40,000 new homes over the next five years.

The Local Housing Allowance (LHA) rate, which has been frozen for two years, will be increased. The LHA is based on the 30^{th} percentile of local rents but had previously been held at the 2020-21 30^{th} percentile. The Autumn Statement said this change would benefit 1.6 million households with an average of £800 of extra support.

Mortgage pricing and products

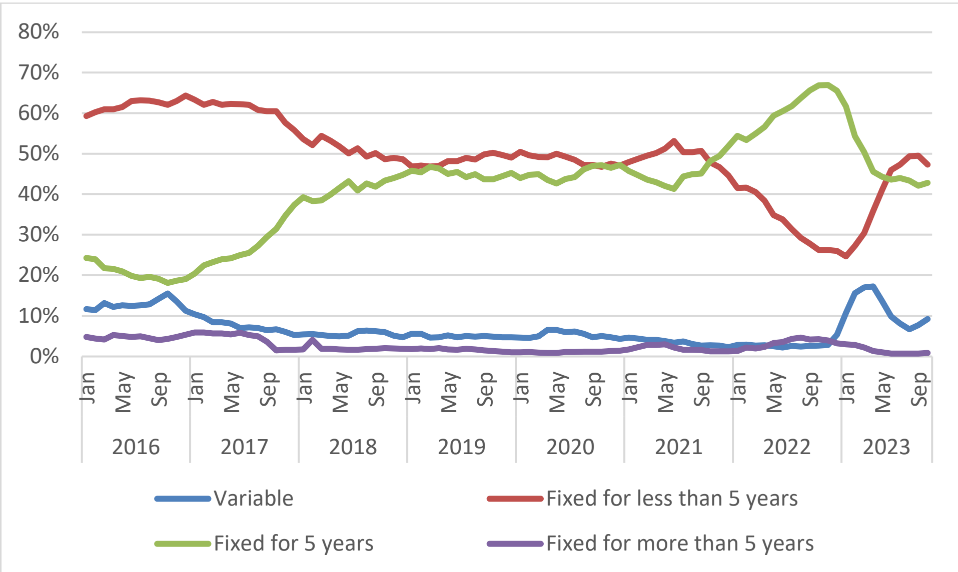
Chart 12 – 2 year fixed-rate % mortgage pricing



Source: Bank of England

As Chart 12 shows, fixed-rate mortgage pricing has been declining since its July peak, as better news on inflation has persuaded the markets to cut swap rates in the expectation that Bank Rate will start to fall in 2024. The largest fall over this period was in 2-year fixes, where the price fell by almost 1%. The low inflation figures in November should ensure that this pattern of declining fixed rates continues into the new year.

Chart 13 – Fixed and variable rate share of new lending



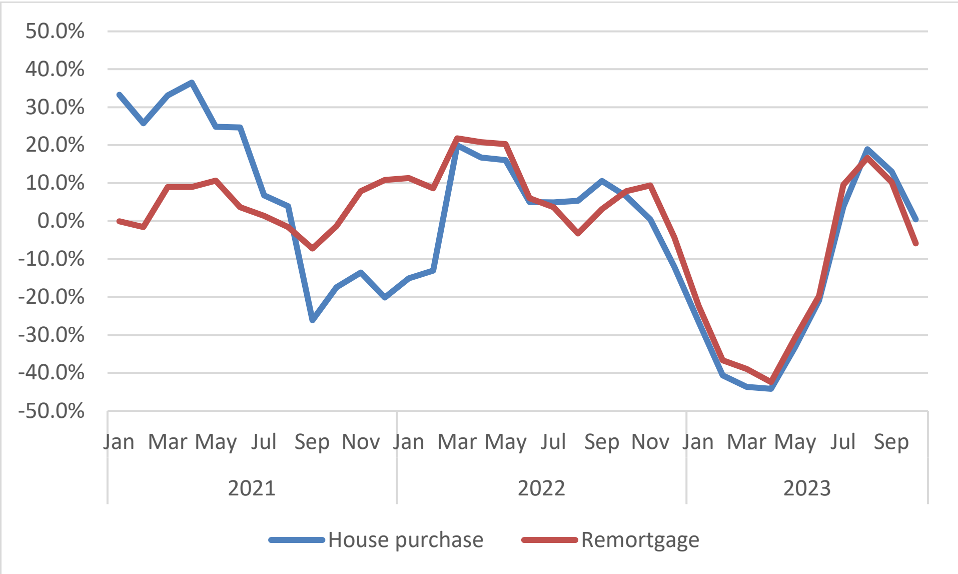
Source: UK Finance

Falling fixed-rate pricing has encouraged consumers to switch away from variable rate products (see Chart 13), but borrowers or the brokers that advise them are also wary of committing to longer-term fixes at a time when mortgage rates are high relative to the last decade and many expect them to fall back over the next year or two. This has driven a shift back to two-year deals.

Buy-to-let market

Buy-to-let lending has seen the sharpest falls in 2023, both in house purchase lending and remortgaging (see chart 14). The second half of 2023 saw a recovery but this has now stalled. Going into 2024, lower fixed-rate pricing should ease the affordability pressures that have prevented some landlords from taking new deals, which could lead to a bounce in lending volumes, particularly in the remortgage market.

Chart 14 – Buy-to-let lending (3 months on previous 3 months)

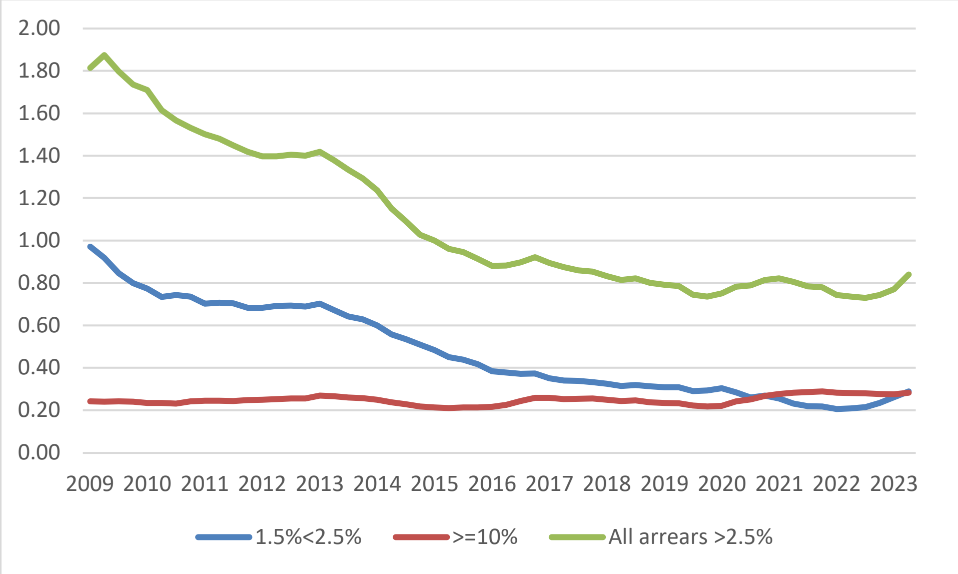


Source: UK Finance

Arrears and possessions

Mortgage arrears of 2.5% of the loan balance or more rose 9% in Q3, to 0.92% of all accounts. As Chart 15 shows, short-term arrears are now growing more quickly than longer-term arrears, as higher mortgage rates and the cost of living crisis impact the budgets of a wider range of households. But despite rising arrears, possessions remain at historically low levels. During the first three quarters of 2023, possessions were up 13%, but this was off a very low 2022 figure. A backlog of court cases is part of the reason for the continued low numbers of possessions but lenders also have a range of forbearance tools, including moving customers to interest-only, which have helped many who have been struggling financially.

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



Source: UK Finance

Buy-to-let continues to see the sharpest rise in arrears. In Q3, the number of mortgages with arrears over 2.5% of the loan balance rose 29% to 0.57% from Q2 and by 100% from a year earlier. Despite this, however, buy-to-let arrears remain below those of the mainstream market where in Q3 they reached 1% of all loans for the first time since 2017.

Prospects

2023 has been a difficult year for the mortgage market with higher interest rates putting pressure on finances for those households coming to the end of a fixed-rate deal. House purchase activity has also been dampened. However, the large fall in house prices that was widely predicted failed to materialise as a continued underlying shortage of accommodation supported both the sales and rental markets.

But 2023 was also a year of relative normality, where the economy began to settle down and adjust to the shocks that had hit it in 2020-22. By the end of the year, inflation was falling back quite sharply, which drove market expectations of rate cuts, which in turn allowed fixed-rate mortgage pricing to ease. This should set the scene for a more robust mortgage market heading into 2024, but headwinds remain. Core inflation is still, at 5.1%, well above the Bank of England inflation target of 2% and the economy has shown little growth over the past year with limited prospects for improvement in the short term.

Nonetheless, the path back to a more stable mortgage market with lower mortgage rates is increasingly visible. This can only help to boost confidence in the housing and mortgage markets going into 2024.