Market briefing: March 2020

Key developments in the housing and mortgage markets

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Note:
The far-reaching measures being taken to address the coronavirus pandemic are creating the need for unprecedented Government interventions to help mitigate the knock-on financial impacts for households and families. This report was prepared before the Chancellor unveiled a £350 billion bailout to keep Britain's businesses and workers afloat on 17 March. Further measures are likely, an indication of the widespread nature of the short-term hit that the UK economy may experience.

Executive Summary

- We are in every sense in uncharted territory, given the rapid pace of developments associated with the Covid-19 pandemic and the backward-looking nature of market and wider economic indicators.
- The coronavirus outbreak represents an additional headache for the UK Government, given that it threatens to derail our economy at a time when global slowdown and the need to adjust to life outside the EU makes the UK especially vulnerable.
- The UK authorities have responded with a determined and coordinated effort to pre-empt the challenges that preventative measures will give rise to and to limit the economic fall-out.
- Mortgage lenders, and financial firms more widely, have been quick to play their part, offering timely help to households and businesses.
- The next several months will undoubtedly be challenging for the housing and mortgage markets (and more widely), but, with a solid framework for damage limitation in place, we can at least be relatively optimistic about the medium-term.

The great disruption

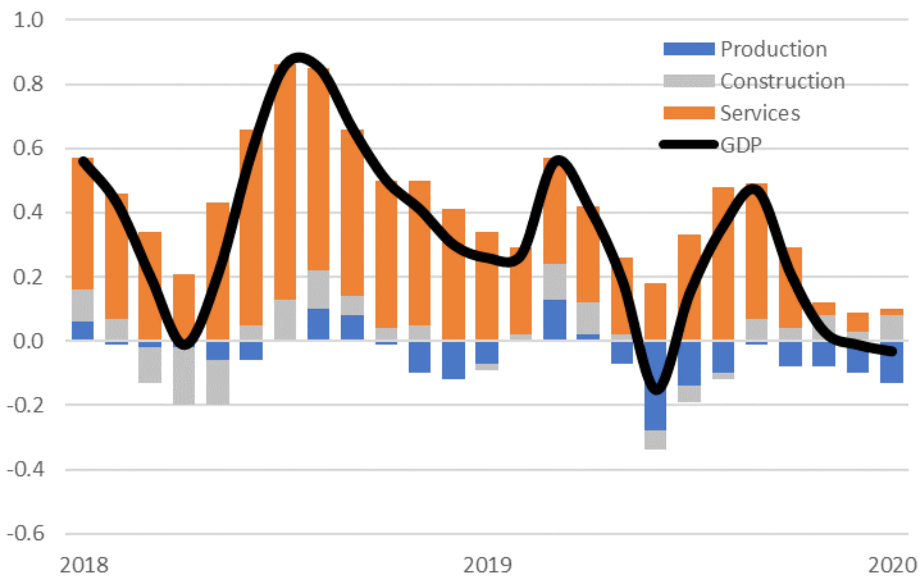
The global coronavirus (Covid-19) outbreak currently dominates news headlines across the globe and this will continue to be the case for several more months to come.

Policy-makers and financial markets are alert to the prospect that the drastic measures needed to halt its spread will materially disrupt the activities and spending behaviour of households and businesses, and so hit demand, with adverse consequences for economic growth.

Several respected international organisations estimate that Covid-19 will reduce global economic growth by at least 0.5% this year, and potentially a lot more. Coming at a time when the global economy is already weak because of trade wars, this risks tipping world growth below the 2.5% threshold, seen by economists as indicating global recession.

Whilst the UK seems as well-placed as any country to implement effective counter-measures that limit the threat to life, the pandemic comes at a challenging time for the UK.

Chart 1: Contributions to 3-month GDP growth, %



Source: Office for National Statistics
Note: Figures show contributions to growth on previous 3 months.

The UK economy see-sawed last year, as the Brexit drama played out. Although we managed growth of 1.4% across 2019 as a whole - marginally better than the year earlier – this was one of our weakest performances since the financial crisis a decade ago.

We ended 2019 on a particularly weak note, with a faltering services sector and ongoing falls in manufacturing causing GDP to stagnate in the latest months for which the ONS has data (see Chart 1).

Although there was something of a rebound in activity and sentiment following the decisive general election result last December – the so-called “Boris bounce” - recent surveys appear to indicate that this has already begun to fade.

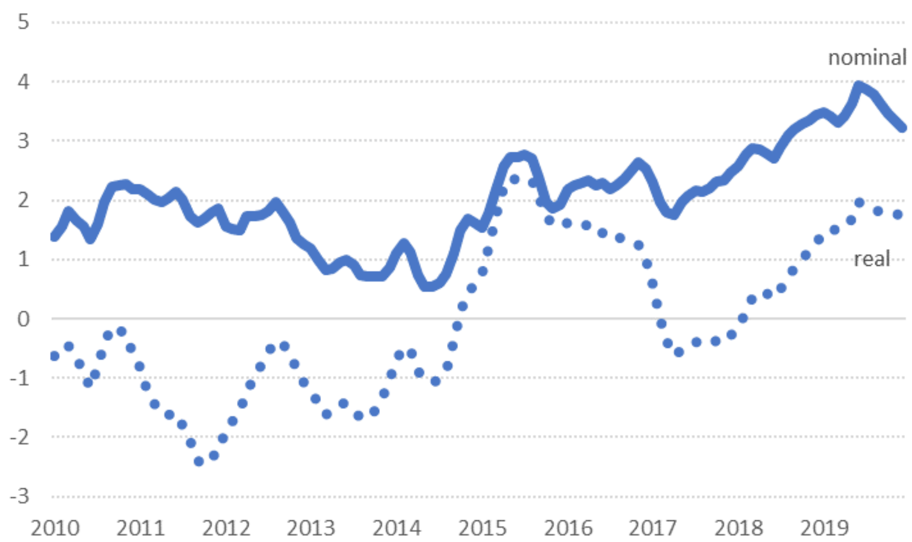
Even without Covid-19, economic forecasters – wary that firms had to adjust to changes in trading arrangements following the UK’s formal exit from the EU at the end of January – were pencilling in GDP growth of little more than 1% for the UK this year.

On a more positive note, the jobs market has been holding up well, and this has underpinned a strong recovery in household confidence.

The number of employed rose by 180,000 to reach 32.9 million in the fourth quarter. This follows a more subdued period last summer and brings employment to a new record high. The number of people out of work continues to edge a little lower, meaning that the unemployment rate remains at its lowest level since the mid-1970s - 3.8%.

Earnings growth, excluding bonuses, has eased back over recent months and stood at 3.2% in the fourth quarter. But, with inflationary pressures relatively benign, earnings have continued to grow strongly in real terms, and recently surpassed their pre-crisis peak after more than a decade of stagnation.

Chart 2: Earnings annual growth rates, %



Source: Office for National Statistics
Note: Figures relate to regular pay for Great Britain, seasonally adjusted, and show growth for 3 months compared with same period a year earlier

Economic policy

The Government has made a determined effort to get ahead of the sharply adverse effects that coronavirus may have for the UK economy over the near-term, coordinating its efforts with the Bank of England for maximum impact.

On 11 March, the Bank of England unveiled a cocktail of measures to help UK businesses and households cope with the economic shock arising from coronavirus:

Table 1: The Bank of England Actions on 11 March

Measure	Notes
Bank Rate cut by 50 basis points to 0.25%.	This returns official rates to their post-crisis low.
A new £100 billion Term Funding scheme with additional incentives for Small and Medium-sized Enterprises (TFSME).	This reprises the August 2016 scheme, which closed to new lending in February 2018. It aims to ensure that banks and building societies have funds to support lending and that lower Bank Rate feeds through to the interest rates charged on loans to businesses and households.
Need for UK banks to hold a countercyclical capital buffer suspended for at least the next 12 months.	The Bank estimates that this will support up to £190 billion of bank lending to businesses, many times banks' net lending to businesses in 2019.

The case for monetary easing has been building for several months on the back of disappointing economic growth. Two external members of the Monetary Policy Committee (MPC) had been voting for lower rates since November's meeting and January's Monetary Policy Report hinted that the committee was coming round to the view that action on rates might be warranted to support the UK's economic recovery.

Action by the UK authorities has been widely expected for a while, especially as several countries, notably the US, had already lowered rates in response to Covid-19.

The Bank's actions, which follow recent assurances by outgoing Governor, Mark Carney, that the Bank still had considerable firepower at its disposal and would "take all necessary steps to support the UK economy and financial system", mark a sensible response at this stage.

While by no means a panacea, they should enable banks and building societies to address the short-term finance needs of businesses and households, and so help mitigate the adverse shock for the wider economy.

It goes without saying that the Bank will be monitoring the situation very closely. Both the Monetary and Financial Policy Committees have scheduled meetings later this month, and a key take-away is that the Bank will do everything it can to support the economy as the situation evolves.

For the new Chancellor of the Exchequer, Rishi Sunak, there were two priorities for his 11 March Budget:

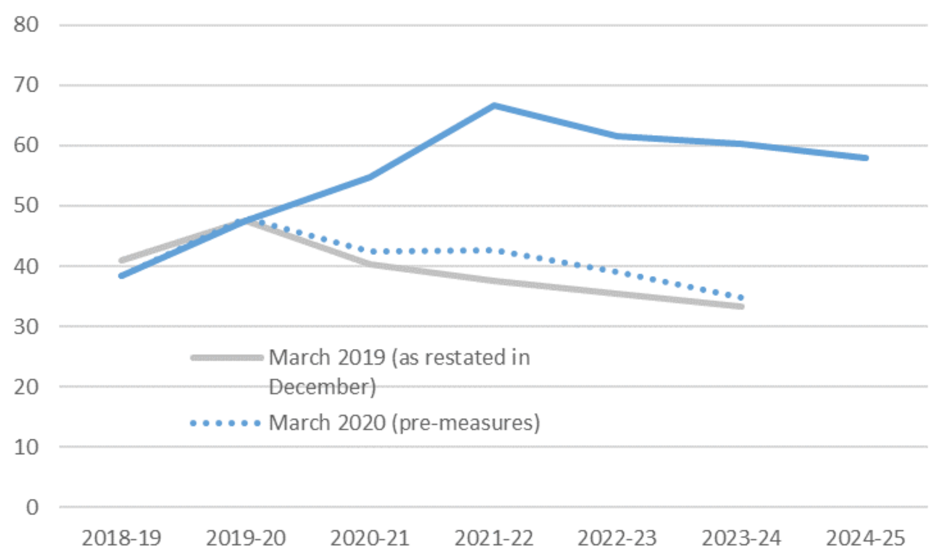
- to reassure that the Government was doing everything it could both to address the health risks associated with the coronavirus pandemic and to minimise the adverse impact that preventative measures would have on households, businesses and the wider economy.

- to begin an ambitious policy of fiscal expansion, to honour manifesto commitments, to give substance to the Conservative Party's "levelling up" agenda and, more implicitly, to support the adjustment of the UK economy to life outside the EU.

The Chancellor announced £12 billion of emergency measures to support the NHS, businesses and households, and pledged more if it was needed.

Beyond coronavirus, Sunak announced an extra £18 billion worth of measures for this year as part of a massive expansion of public sector spending over the medium-term – described by the Office for Budget Responsibility (OBR) as the "largest sustained fiscal loosening since Norman Lamont's pre-election Budget in 1992".

Chart 3: Public sector net borrowing, £ billion



Source: Office for Budget Responsibility, March 2020 Economic and fiscal outlook

Housing-related Budget measures

Stamp duty

No fresh give-aways. The government will introduce a 2% Stamp Duty Land Tax (SDLT) surcharge in England and Northern Ireland for all purchases of residential property by non-UK residents, with effect from 1 April 2021.

Public Works Loan Board

Lower interest rates to be charged to LAs for social housing and infrastructure

Housing investment

An additional £9.5 billion for the new Affordable Homes Programme from 2021-22 onwards. Grant funding under the five-year programme will help more people into homeownership and those most at risk of homelessness.

Allocations of £1.1 billion from the Housing Infrastructure Fund to build almost 70,000 homes in nine high-demand areas.

A new £400 million Brownfield Housing Fund for pro-development councils and Mayoral Combined Authorities with the aim of creating more homes by bringing more brownfield land into development.

Building Safety Fund

An additional £1 billion to remove unsafe cladding from every private and social residential buildings above 18 meters. Government will also intensify efforts to ensure that developers and building owners also act.

HM Land Registry

Funding to enable HMLR to become part of central government and to continue with its ongoing project to digitise land registration in England and Wales, and enable further innovation in the property market and the wider UK economy.

Flood defences

Funding for flood defences in England over the next six years has been doubled to £5.2 billion. £120 million made available immediately to fund the repair of damaged defences following the recent winter floods, and another £200 million promised to build resilience in areas most at risk of repeated flooding.

This higher public spending is financed in part from the fiscal savings associated with Brexit and by cancelling the corporation tax cut that was due in April 2020, but for the most part through higher borrowing.

it seems unlikely that public sector borrowing will rise as modestly over the next few years as the Budget documents show, not least because the OBR forecasts do not take into account the potentially severe impact of Covid-19 on short-term economic growth.

A review of the current fiscal framework is taking place over the coming months, and we may have to wait for the Autumn Budget before we get a better idea of fiscal trajectory (and potentially new fiscal rules).

Notwithstanding the ambitious nature of the March Budget, housing did not feature prominently.

The boxed article summarises the main relevant Budget measures.

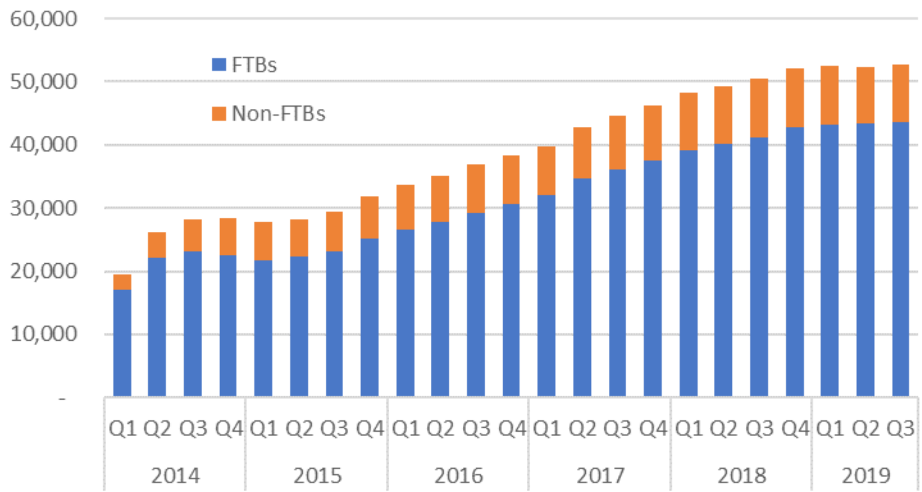
Post-Budget, the housing minister Robert Jenrick issued a paper, stressing the Government's desire to facilitate wider home ownership and outlining ideas to improve the housing market. This was very much a holding document. White Papers on planning reform and social housing, and legislation on building safety and rental reform are promised, as part of an overall housing strategy to be published later in the year.

The paper references the proposed First Homes Scheme, which aims to provide discounted market sale new homes to local first-time buyers in England, and on which the Government is currently consulting.

It also touches on lifetime fixed rate mortgages an idea floated in the Conservative Party manifesto document and recently promoted in a think tank report, but only to the extent of saying that the Government will work with lenders to explore whether they could keep deposits low for first time buyers looking to get on the housing ladder and, if so, how a market in long-term fixed rate mortgages might be encouraged.

The Government's Help to Buy Equity Loan Scheme did not warrant a mention either in the Budget or Jenrick's paper. A surprising omission, given its current importance for house-builders and the major changes planned for it.

Chart 4: Help to Buy Equity Loan Scheme completions, rolling 12 months



Source: MHCLG

For now, the Help to Buy Equity Loan Scheme continues to run at pace. The number of properties bought through the scheme in England totalled 52,703 in the year to September, up nearly 5% on the year earlier and a significant proportion of all new homes sold.

IMLA has a particular interest as to how the Government defines first-time buyers for the purposes of the new scheme.

With official statistics suggesting that first-time buyers currently account for more than 80% of all Help to Buy Equity Loan Scheme sales (and about 95% in London), it would be natural to infer that the revised 2021 scheme, limited to first-time buyers, might depress sales by a fifth or slightly more to allow for the proposed regional caps. However, it seems likely that many buyers currently identifying as first-time buyers would not satisfy the strict Government definition applied to those seeking to benefit from stamp duty relief for first-time buyers. A comparison of SDLT metrics with UK Finance reporting suggests that as many as a third of “first-time buyers” do not satisfy the HMRC definition. Were the new Help to Buy Equity Loan Scheme to apply a similarly strict approach, it is possible that the step-decrease in activity might be nearer 40% than 20% - a material factor when considering the appetite for alternative arrangements.

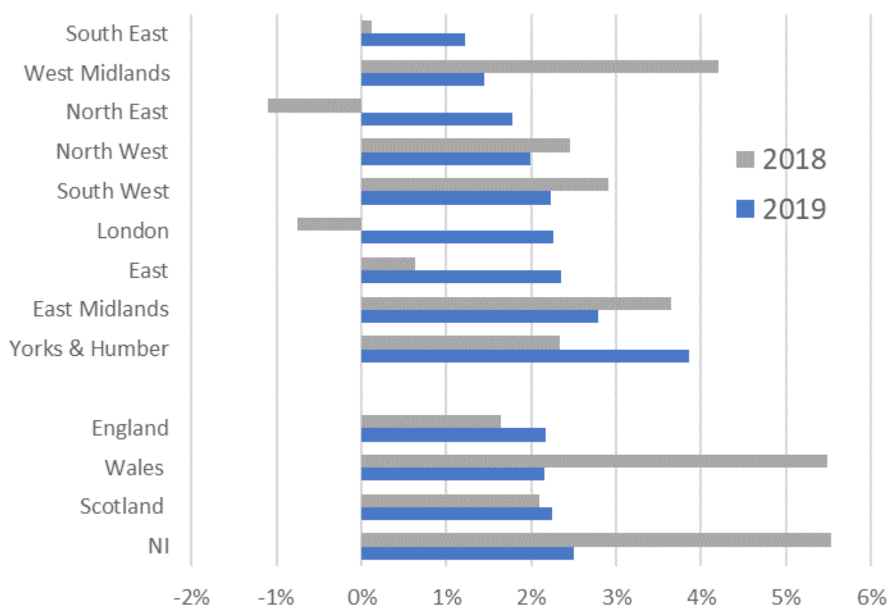
Housing and mortgage markets

Note:
At the time of writing this report, little is known about how Covid-19 will affect market activity and sentiment.

A slew of positive news surrounded the housing market at the start of the year, amid a broad consensus that a large Government majority and unwinding Brexit uncertainties would mean a gentle recovery in house prices and activity this year.

IMLA's Q4 survey exemplified the positive market sentiment, with well over 90% of intermediaries confident about prospects for the industry and the intermediary lending sector in particular, as they looked ahead to 2020.

Chart 5: House price movements, % change year-on-year



Source: Office for National Statistics
Note: figures are for December each year.

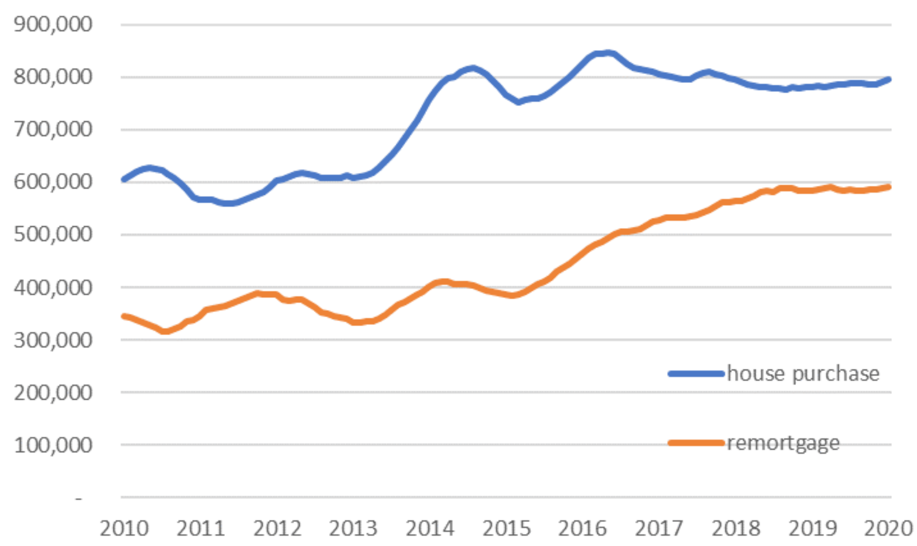
Residential prices have picked up over recent months. Figures from the Office for National Statistics show a recovery in the closing months of 2019. UK average house prices increased by 2.2% over the year to December 2019, up from 1.7% the previous month, helped b a turn-round in London and the south east.

Halifax reported that house prices nationally were increasing by 4% annually around the turn of the year, the strongest showing for nearly two years, but this has eased back to 2.8% in February.

Residential property transactions picked up noticeably in January, according to HMRC, with the seasonally adjusted figure rising above 100,000 for the first time in a year.

Recent surveys by Rightmove and RICS confirm an improving picture for listings, enquiries and sales.

Chart 6: Approvals, seasonally adjusted, 12-month rolling totals

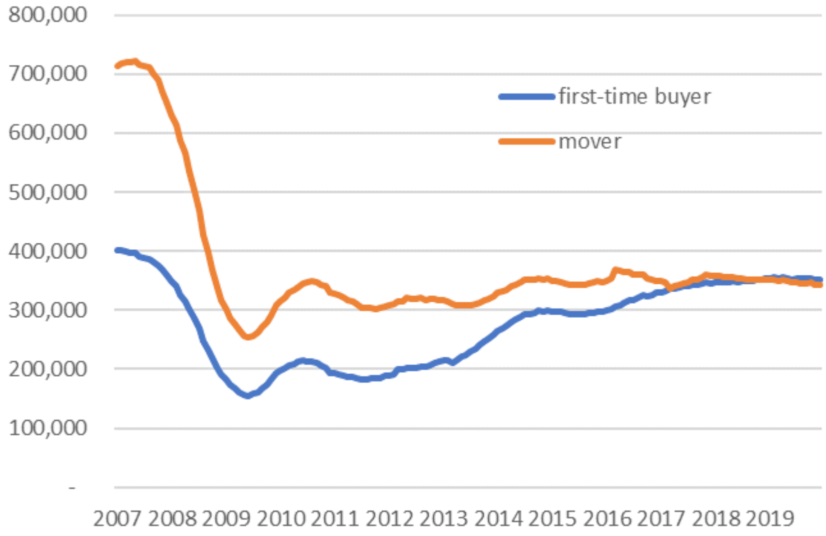


Source: Bank of England

Meanwhile, seasonally adjusted approvals for house purchase and remortgage posted year-on-year improvements in December and January. January house purchase approvals climbed above 70,000 for the first time in four year. Bank of England figures also imply that the average value of house purchase approvals has increased noticeably over recent months, consistent with reports of a developing upturn in London and the south east.

The underlying picture remains one of market activity improving very gently, but basically still on a plateau.

Chart 7: First-time buyers and movers, rolling 12-month totals



Source: UK Finance

As UK Finance recently reported, the volume of house purchase by first-time buyers and movers has edged lower over the past year, despite the Help to Buy Equity Loan Scheme and stamp duty concessions. Lending values were 2% and 1% higher respectively.

Although the number of purchases by landlords has fallen by a little bit more overall, sentiment in the buy-to-let sector has actually improved over recent months.

This is despite the fact that a number of tax changes have yet to be implemented – notably the final reduction in higher rate mortgage interest tax relief and a less generous Capital Gains Tax treatment, both taking effect from this April.

Landlord confidence has been buoyed by lower mortgage rates and improving rents, and this has prompted stronger investment appetite.

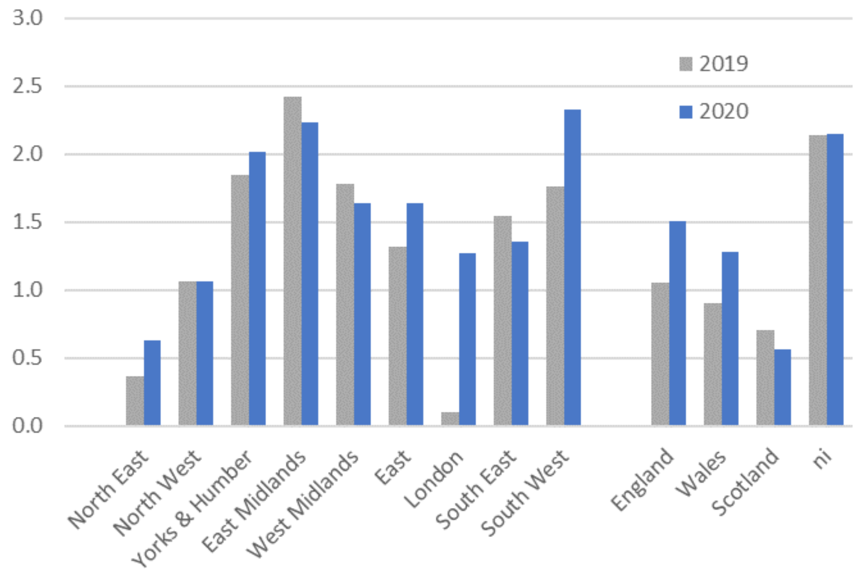
The tax and regulatory changes of recent years have caused some landlords to exit the market or shrink their portfolios. Hamptons International recently estimated that there are 2.66 million landlords in Great Britain, 8% fewer than the 2017 peak.

The inevitable consequence (as IMLA has pointed out many times) has been fewer homes available to rent relative to demand and higher rents.

ARLA recently reported that more than 40% of letting agents had seen landlords increase rents, up from 26% in January 2019 and 19% in January 2018.

Private rents in the UK rose by 1.5% in the 12 months to January 2020, up from 1.0% a year earlier, according to the ONS. This increase was almost entirely due to the sharp recovery in London, where the shortage of rental property has been particularly evident and where rents accelerated from 0.1% to 1.3%.

Chart 8: Private rents recover strongly in London, year-on-year % change



Source: Office for National Statistics
Note: These figures show rent changes for new and existing lettings

Other rental measures, which are based solely on new lettings show a more marked pick-up. Zoopla, for example, estimates that annual rental growth in Q4 2019 was up 2.6% nationally and 2.8% in London, the highest rates for three and four years respectively.

Such rent increases still lag behind the nominal growth in earnings. A recent research from the Deposit Protection Service shows that the proportion of income spent by tenants on rent decreased modestly between 2016 and 2019.

Despite a more positive market mood around the turn of the year total gross mortgage lending for 2019 as a whole edged down from £268 billion in 2018 to £267 billion. This was the first annual fall since 2010.

Remortgage activity continued at a high level, but has lost the upwards momentum of recent years. Product transfer activity was higher in 2019, by 1% and 5% in number and value terms respectively.

Even lifetime mortgages, which have seen a strong upwards trajectory for many years, stalled at just below £4 billion, according to the Equity Release Council.

The growing popularity of longer-term fixed rate products will, as a recent FCA report highlighted, exacerbate the intensifying competition between lenders as they compete for a shrinking market and experience margin compression.

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