Market briefing: March 2019

[A quarterly update exclusively for IMLA members][1]

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[1] IMLA's Management Committee has asked the author to summarise the key developments affecting the UK housing and mortgage markets each quarter. This report is primarily for information, and members are welcome to email any views, questions or other feedback to the author or to Kate Davies, Executive Director.

Executive Summary

- The housing market has not been immune from the wider Brexit uncertainties adversely affecting the UK.
- This, together with growing job insecurity, has sapped household confidence and weighed down on housing market activity and property prices.
- Mortgage credit terms and availability remain mostly favourable, however, and, once there is a degree of clarity about the UK's future relationship with the European Union, we could see a bounce-back as pent-up demand is released.

Economic overview

The future of the UK's relationship with the European Union has dominated the political life of the UK for three years and seems set to continue to do so for some considerable while.

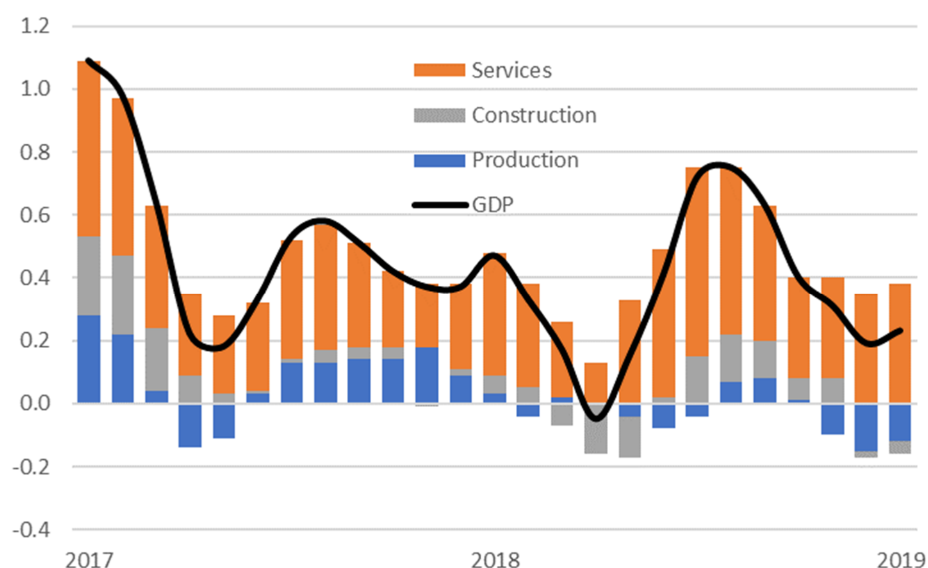
At the time of writing this report, it remains unclear whether Parliament will eventually support Theresa May's deal. But a delay to the withdrawal agreement beyond 29 March seems inevitable, and we still then face a transition period – currently set at 21 months - during which we must negotiate the precise nature of our trading and wider economic relationship with the rest of the EU.

Although the performance of the UK economy since the EU referendum in 2016 cannot be described as sparkling, things held up pretty well until the middle of last year. Since then, the picture has weakened, as the global economy has slowed and Brexit uncertainties have had an increasingly adverse impact on businesses and, increasingly, households.

UK GDP growth slowed to 0.2% in Q4, dragging overall growth for the year down to 1.4%, the joint weakest since 2009.

Although a pick-up in January reversed December's poor showing, the underlying picture (see Chart 1) has not improved. And it may be that the latest figure is flattered by firms stockpiling ahead of Brexit.

Chart 1: Contributions to GDP growth, rolling 3 months



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

Business surveys suggest that activity, particularly in manufacturing and construction, stalled further in recent weeks, and that expansion or investment plans are the worst for a number of years.

The boom in the UK jobs market over recent years has been impressive - employment in the three months to January climbed by 222,000 to 32.7 million, the highest since records began and recent wages growth has been the strongest in a decade.

But this now looks to be coming to an end. Significantly, recent surveys point to greater caution around job hiring and highlight a number of sectors anticipating job cuts.

This change in the jobs outlook appears to have fed through into concern about job security and undermined household sentiment.

Consumer confidence measures from research company GfK has been trending lower over the past few years, but subdued household expectations about their personal financial situation has been a more recent phenomenon. IHS Markit reports household financial well-being at its lowest for more than a year.

Interest rates

As the global picture has softened, the pressure to tighten monetary policy has eased. This is most obvious in the Eurozone, where the European Central Bank has responded to sharply lower economic growth forecasts by deferring any rise in

interest rates until at least 2020 and announcing plans to provide a fresh round of cheap 2-year funds to banks from later this year.

Here in the UK, the Bank of England has toned down its interest-rate language.

While February's *Inflation Report* judged that it would be appropriate to tighten monetary policy in due course, presuming a soft Brexit, it signalled that there might be only one base rate rise, from 0.75% to 1%, over the next three years. The stance of the Monetary Policy Committee continued unchanged at its meeting ending on 20 March.

The Bank has of course devoted considerable effort to ensure that the UK financial system is prepared for, and can cope with, whatever shade of Brexit occurs.

In recent weeks, several MPC members, including Mark Carney, have hinted that base rate is likely to be cut in the event of a hard Brexit.

The Bank has also announced temporary changes to its liquidity insurance facilities, as an added precaution, to guard against a financial shock in the event of a hard Brexit. This allows banks to access (Indexed Long-Term Repo) funds on a weekly, rather than monthly, basis through March and April.

Fiscal Policy

Brexit uncertainties provided an inconvenient backdrop to the Chancellor of the Exchequer's Spring Statement on 13 March.

Philip Hammond stuck to his promise that this would not be a big fiscal event, announcing little in the way of new tax or spending initiatives.

New Office for Budget Responsibilty (OBR) projections confirm that public finances are stronger, despite an economic slowdown.

This gives the Chancellor more wriggle room for the future. This includes the possibility of an Emergency Budget in the event of hard "no deal" Brexit, although his strong preference is for a Brexit deal over the coming weeks. This would then allow him to conduct a three-year spending review this summer and to unveil an "end of austerity" Autumn Budget.

Spring Statement highlights

There was a sprinkling of spending announcements from existing budgets including:

- A £3 billion Affordable Homes Guarantee scheme for housing associations to support the delivery of 30,000 affordable homes
- £717 million from the Housing Infrastructure Fund to support the building of 37,000 homes on sites in West London, Cheshire and the Oxford-Cambridge Arc.

Several planning reforms were also announced:

- additional planning guidance to support housing diversification on large sites in response to Sir Oliver Letwin's *Independent Report on Build Out Rates;*
- a package of reforms including allowing greater change of use between premises, and a new permitted development right to allow upwards extension of existing buildings to create new homes;
- a Green Paper setting out proposals to improve the planning process;
- a Future Homes Standard, that requires all new homes to be highly energy-efficient and fossil fuel-free by 2025

Elsewhere, it is worth noting that the Office for Budget Responsibility (OBR) has revised down the likely number of Support for Mortgage Interest loan claimants in 2018-19 to just 24,000 from 98,000 originally.

The OBR has also materially revised down forecast spending on the Help to Buy ISA, Lifetime ISA and Help to Save schemes (see section A.23 of *Economic and fiscal outlook March 2019*).

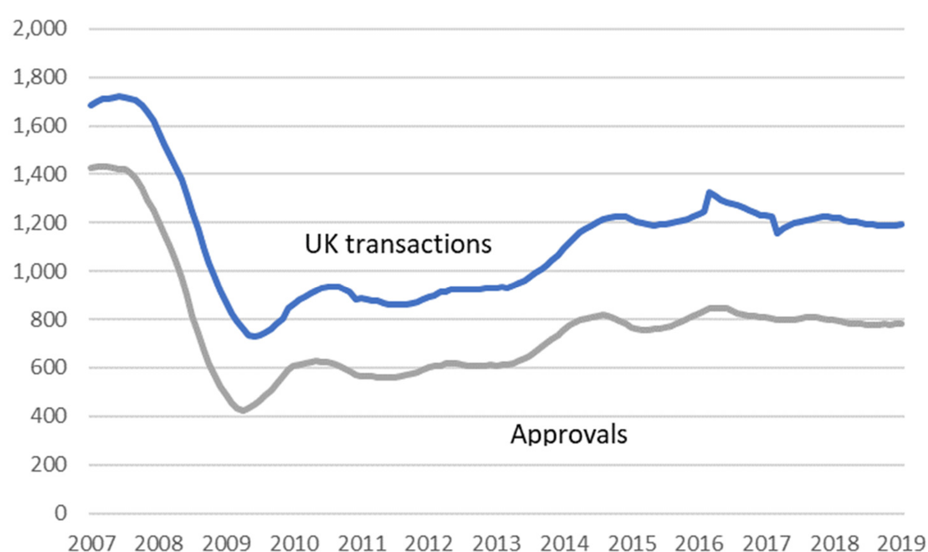
Housing and mortgage markets

Activity and prices

Recent months have shown that the housing and mortgage markets are not immune to the uncertainty engendered by Brexit. Given affordability pressures, that uncertainty has undermined household confidence and cast a shadow over the near-term outlook.

The Bank of England's Credit Conditions Survey, published near the start of the year, reported sharp falls in demand for house purchase loans.

Chart 2: Activity levels, rolling 12 months, 000s



Source: HMRC, Bank of England

Property transactions totalled 1.19 million last year. This was a little below 2017's level and the lowest outcome since 2013, although to all intents and purposes housing market activity continues on a modest plateau.

Last year's performance was a little disappointing, not least because a number of factors supported activity, including reasonable economic growth, a strong jobs market, recovery in real earnings and highly competitive mortgage deals. It is possible that Brexit uncertainties have weighed on the market for some time.

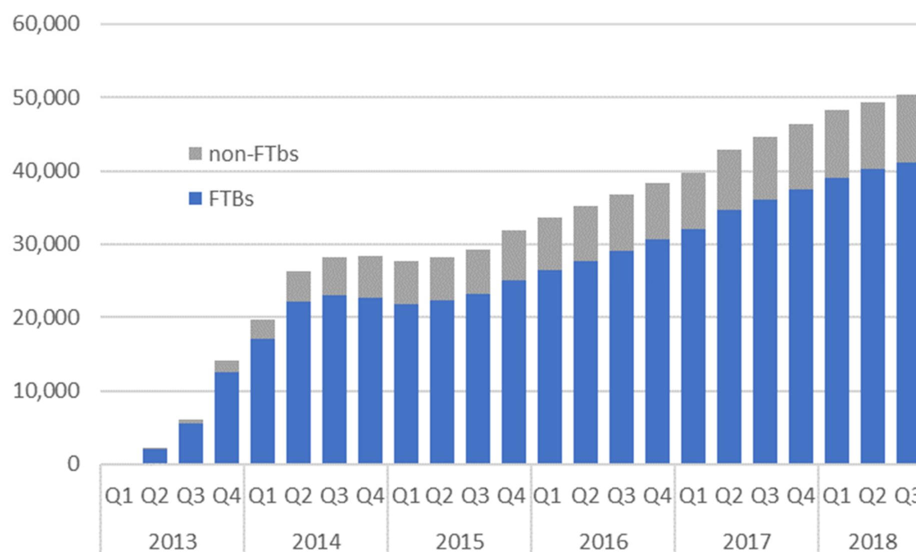
The mix of transactions has continued to tilt away from investment properties towards home ownership.

Property purchases by BTL landlords – at 66,000 – were the lowest since 2011,

reflecting the welter of adverse tax and regulatory measures introduced over recent years.

First-time buyers have been modest beneficiaries – with about 370,000 mortgages advanced to first-time buyers last year, 2% higher than 2017, and the strongest figure since 2006.

Chart 3: Help to Buy Equity Loan scheme sales, rolling 4 quarters



Source: MHCLG

This was by no means a stellar performance, however, given that it came against the backdrop of strong demographics and the removal (from late 2017) of stamp duty for the vast majority of first-time buyers. Indeed, the pick-up is only a little more than accounted for by higher Help to Buy Equity Loan scheme sales to first-time buyers.

While affordability pressures continue to be intense, it is noteworthy that March's Property Tracker survey from the Building Societies' Association highlights elevated concerns about job security and future falls in property prices.

The number of movers taking out a mortgage dipped slightly in 2018 and was overtaken by first-time buyers for the first time in two decades. However, it is worth bearing in mind that a significant proportion of cash purchasers comprise older home-owners moving home without the need for a mortgage (this will be covered in a forthcoming IMLA report on last-time buyers).

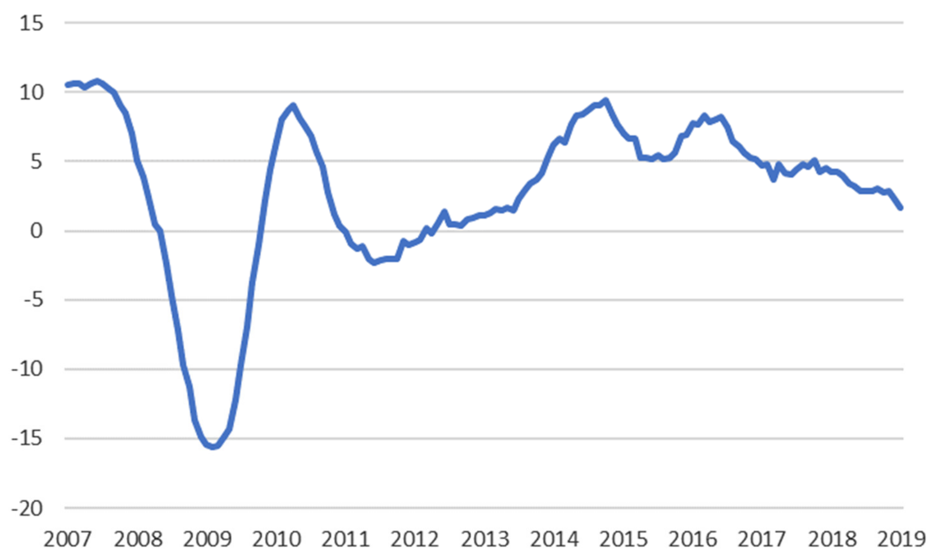
Geographically, while London and the rest of southern England have seen much earlier and more persistent declines in activity, recent weakness has applied across most parts of the UK, with the exception of Northern Ireland.

We would not read too much into the higher approvals and modest year-on-year gains in first-time buyers and movers reported for January.

The unambiguous message from the latest RICS survey is that Brexit uncertainty is holding back buyers and sellers, with sustained falls in buyer enquiries, sales and new instructions in February.

UK house price inflation has progressively slowed from the most recent peak rates observed in early 2016

Chart 4: House price inflation, UK, % change YoY



Source: ONS

The latest figures from the Office for National Statistics, for January, show that house prices nationally had slowed to 1.7%%, the weakest pace of growth since mid- 2013.

While most countries and regions of the UK are experiencing slower house price inflation than a few years ago, the slowdown has been sharpest in London, where house prices have fallen (a little) for much of the past year. This is likely to reflect special factors, including more stretched affordability, an earlier pick-up in house prices, disproportionate impact from tax and regulatory changes, and also lower net migration from the EU.

More up-to-date figures suggest that house price inflation has ebbed away further, and across most parts of the UK, as uncertainties relating to jobs and/or Brexit bear

down on household sentiment. The latest RICS survey found that surveyor sentiment about house prices was its weakest since 2011, and broadly consistent with a flat market. [Most commentators have discounted the 5.9% monthly rise in February, recently reported by Halifax, as an outlier.]

The OBR report, released alongside the Spring Statement, downgraded its forecast for UK house price growth in 2019, predicting a brief dip into negative territory towards the end of the year. Presuming that there is an orderly Brexit, the OBR then envisage a quick bounce back broadly in line with expected growth in nominal incomes.

Mortgage lending

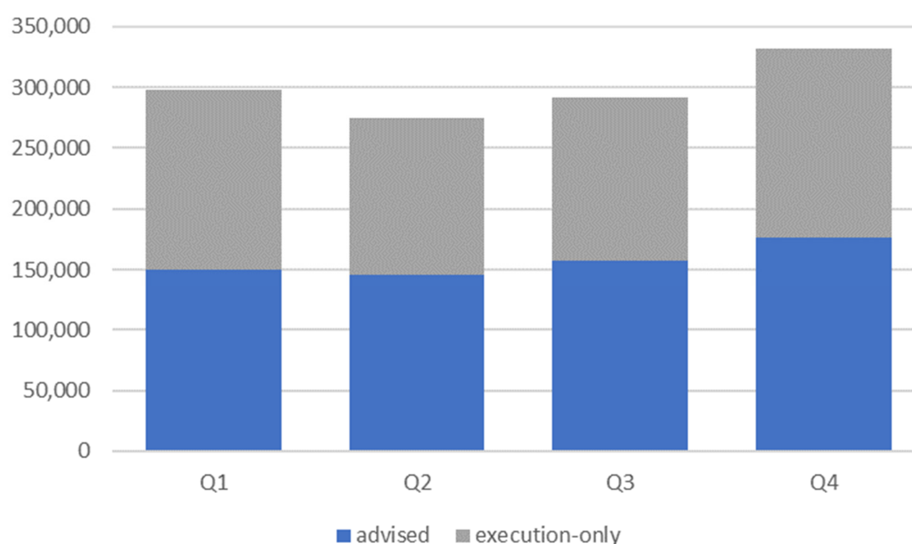
Total gross advances last year were £269 billion, up from £260 billion in 2017 and the highest figure since 2007.

Although the total number of purchase loans edged lower last year, their value was just a tad higher because of higher loan size.

Most of last year's increase in total lending reflected higher levels of refinancing activity.

According to UK Finance, nearly half a million (477,000) households switched their mortgages to another provider last year and landlords remortgaged a record 169,000 BTL loans. The total value of remortgage deals was £112 billion, comprising £85 billion regulated and £27 billion buy-to-let loans.

Chart 5: Product transfers, 2018



Source: UK Finance

As well as this remortgage activity, there was a considerable volume of product transfer business (although this is not included in the Bank of England's total market metrics).

This is the first year for which UK Finance has published product transfer metrics.

UK Finance estimates that almost 1.2 million households switched £159 billion worth of mortgages with their existing lender last year.

Of this total number, 624,900 transfers, worth £86 billion, were conducted on an advised basis and 564,300 transfers, worth £73 billion, were execution-only. This means that a little more than half of these transfers took place on an advised basis (although note that this will include instances where the mortgage lender has provided advice).

With so much lending activity representing churn, overall mortgage credit growth has continued to be relatively subdued.

Net mortgage lending – at £45 billion last year - was actually a little less than in 2017. This corresponded to an annual growth rate of about 3.3% - broadly in line with that of household earnings and so unlikely to raise macro-prudential concerns.

With overall lending growth relatively modest, and Brexit uncertainties coming to the fore, these are challenging times for some mortgage lenders. Despite higher bank funding costs over recent months, there appear to have been only limited rises in new mortgage interest rates, in part because a by-product from the implementation of bank ring-fencing has been more intense competition for mortgage business.

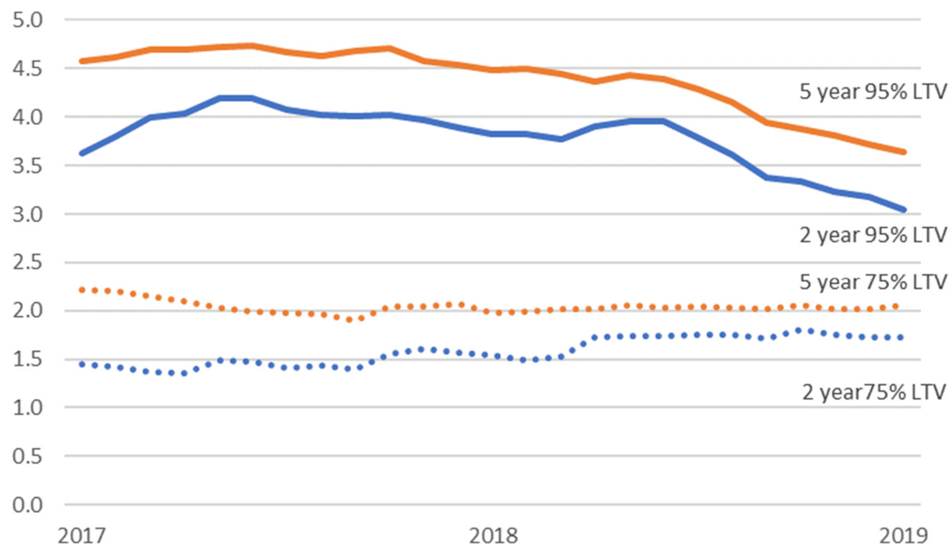
These conditions, together with an expectation that they will persist for a while, have prompted a small number of specialist lenders to withdraw from new lending for the time being at least.

Mortgage rates

Bank of England figures up to January show that rates on mortgage products were typically at or a little above those prevailing in September.

Interest rates on 95% LTV loans are a notable exception to this, with rates falling significantly since last summer – a development seen by the Bank of England as an easing of credit risk appetite.

Chart 5: Quoted mortgage rates, %



Source: Bank of England

Prospects

Brexit uncertainties have introduced a degree of nervousness into the housing market. The trajectory of house prices has already softened considerably across much of the UK, and this may well reinforce caution on the part of borrowers and lenders over the coming months.

With mortgage credit availability ample for the time being, a lack of household confidence is the restraining factor.

Any correction in the housing market is likely to be seen primarily on activity levels rather than prices in the first instance, given that most households enjoy a considerable degree of discretion around if/when they commit to buy or sell.

A no-deal Brexit would be disruptive for the wider economy and the housing market, although policy-makers have considerable fiscal, monetary and macro-prudential resources to help mitigate the most adverse impacts, including how mortgage arrears develop.

On a more positive note, If the UK concludes an orderly withdrawal agreement, then, once there is a degree of clarity about this, we could see an upswing in housing and lending activity as the pent-up demand of people waiting to buy and pent-up supply of people waiting to sell are released. This could be a year of two halves for IMLA members!

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