Market Commentary

Residential Analysts

United Kingdom – October 2021

- **Looking Ahead But Don't Look Back**
- **Rising Rate Risk**
- **Transactions – A Return To Trend?**

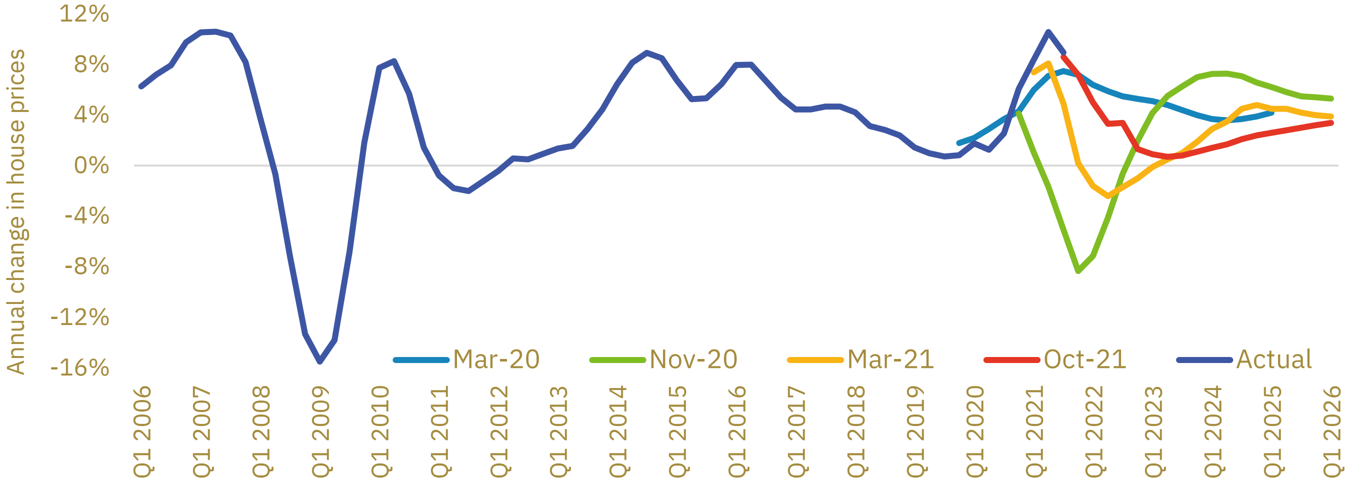
As the end of the year draws nearer, attention is increasingly focussed on what might happen to the housing market in 2022. There may be two months of the year left but estate agents, economists, and market commentators have been busy updating their house price forecasts for next year. After last year's poor showing, forecasters' expectations for 2022 are much lower than the growth recorded so far this year. High inflation and rising interest rates are a major cause for concern, while transactions are unlikely to repeat this year's stamp duty holiday fuelled boom. This month's market commentary looks at the latest OBR forecasts for the housing market.

Looking Ahead

The housing announcements in this week's Budget and Spending Review were relatively underwhelming and there's already plenty of commentary on what they might mean for the market. It is possible that we will get more clarity on the government's aspirations for housing in coming months, once Michael Gove has had time to settle in his renamed department. Therefore, it is probably more interesting to focus on the OBR forecasts for the housing market and how that compares to other predictions. When the pandemic hit in 2020, the OBR was quick to flag the potential for a large house price crash and the scenarios they published in the July 2020 FSR were regularly used by other organisations when highlighting the risks to the housing market. Since then, they've gradually reduced the scale of the predicted downturn, with the latest forecasts simply showing a slowdown in annual price growth to 1.3% in 2022 and 1.1% in 2021. The much threatened house price crash appears to have disappeared.

Fig 1: Annual Change in UK House Prices – Actual & OBR Forecasts

Source: ONS, OBR



Don't Look Back

It's not just the OBR that have seen the pandemic make a mockery of their forecasting ability. The uncertainty it created along with the timing and numerous extensions to government support made it difficult for everyone to accurately predict what might happen to the market this year. In the end, the stamp duty holiday extension, reopening of the economy, falling mortgage rates, excess savings, race for space, and a number of other factors all contributed to much faster house price growth than many forecast this time last year. Looking ahead to 2022 and most forecasters are expecting house price growth to slow with concerns about inflation and rising interest rates lowering growth back down to typical pre-pandemic rates.

Organisation	2021 Forecast	2022 Forecast
OBR	-8.3%	1.3%
CBRE	1.0%	4.5%
Experian Economics	-6.0%	1.0%
ITEM Club	1.5%	2.5%
JLL	-1.5%	NA
Knight Frank	1%	4%
Oxford Economics	-5.4%	-1.4%
Rightmove	4%	NA
Savills	0.0%	3.5%
Zoopla	1%	3%

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Rising Rate Risk

With mortgage rates at record lows and inflation increasing, rising interest rates could be one of the biggest risks for the housing market over the next few years. Mortgage rates have been regularly predicted to rise for over a decade, since they fell rapidly during the financial crisis. Instead, the trend has been consistently downwards and recent months have seen them hit record lows. At least for lower loan-to-value products. However, with inflation rising, it appears more likely than ever that interest rates will rise in the near term. While this raises concern for current house price levels, the impact of rising mortgage rates on the market is still uncertain as it would depend on both the scale and speed of the increase relative to household income growth. As Fig 2 shows, the OBR are forecasting household debt servicing costs to rise faster than disposable income from late 2022 onwards, possibly putting pressure on household finances. However, as Fig 3 highlights, the predicted rises will do little to increase average debt servicing costs as a percentage of income from their current record lows. If mortgage rate rises follow the OBR forecast, mortgage payments should remain affordable for most owners, with the immediate impact of any rate rise also dampened by the large proportion of outstanding mortgages on fixed rate periods.

Fig 2: Household Debt Servicing Costs
Source: ONS, OBR

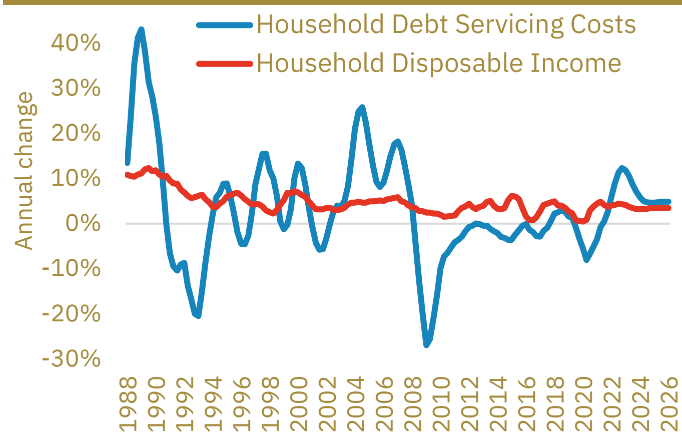
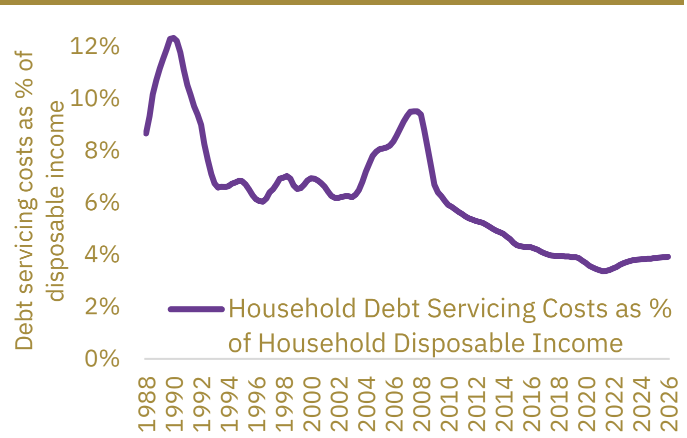


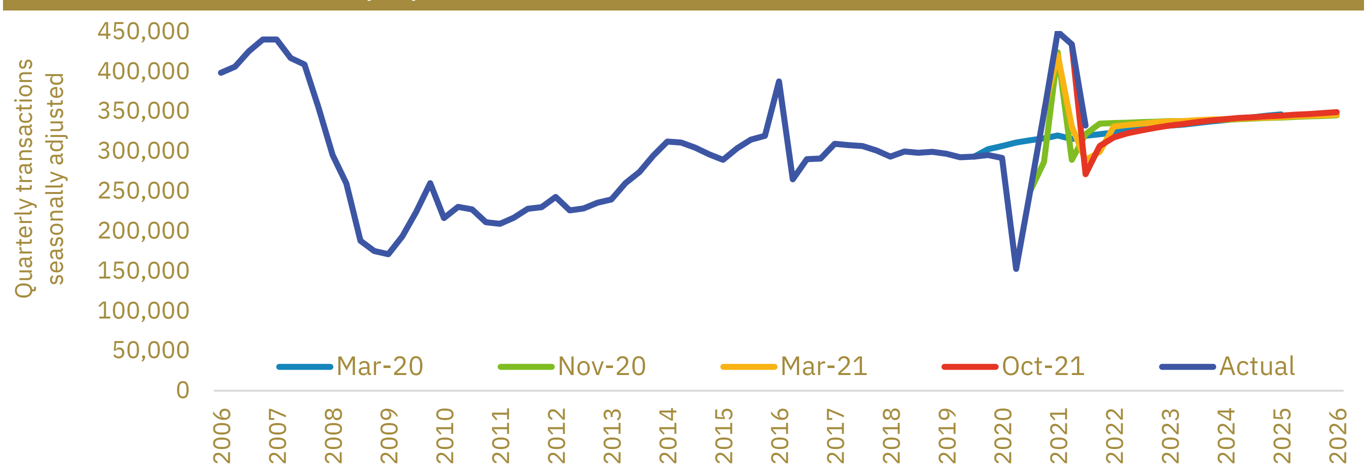
Fig 3: Debt Servicing Costs as % of Income
Source: ONS, OBR



Transactions – A Return To Trend?

The OBR analysis suggests existing owners are unlikely to be significantly stretched by rising mortgage rates but the situation for new buyers in the market could be more serious. Mortgage dependent buyers could see their borrowing capacity reduced, though for many this would also depend on what happens to the mortgage stress test rate. Meanwhile, the price investors are willing to pay could fall if the rental yields they require were to rise in line with broader interest rates, though rapidly rising rents could offset this effect. Ultimately, the housing market has experienced thirty years of falling interest rates. It is far from certain what could happen if that long-term trend were to reverse. Despite these risks, the OBR continues to forecast transactions rising from their pre-pandemic average of around 300,000 per quarter to 350,000 in five years time. This is apparently based on a return to longer-term average rates of housing market turnover. At the least, with both house prices and transactions expected to rise, the forecast for stamp duty receipts will have pleased the Chancellor.

Fig 4: Quarterly UK Residential Transactions – Actual & OBR Forecasts
Source: HMRC, OBR – Seasonally Adjusted1



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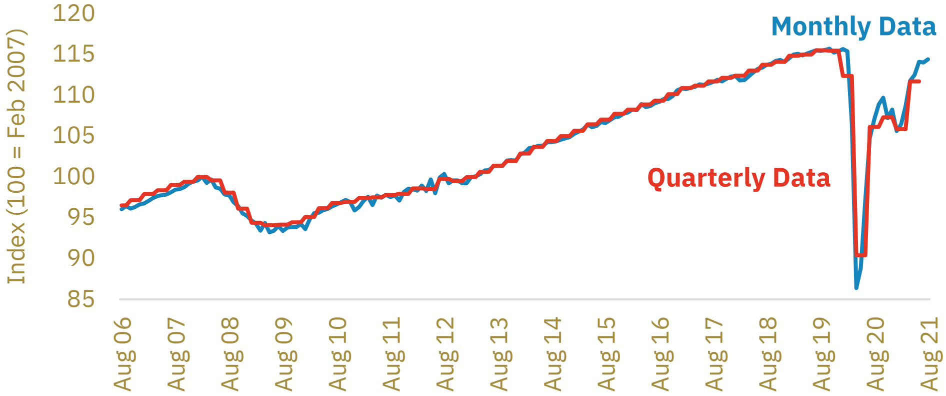
Market At A Glance

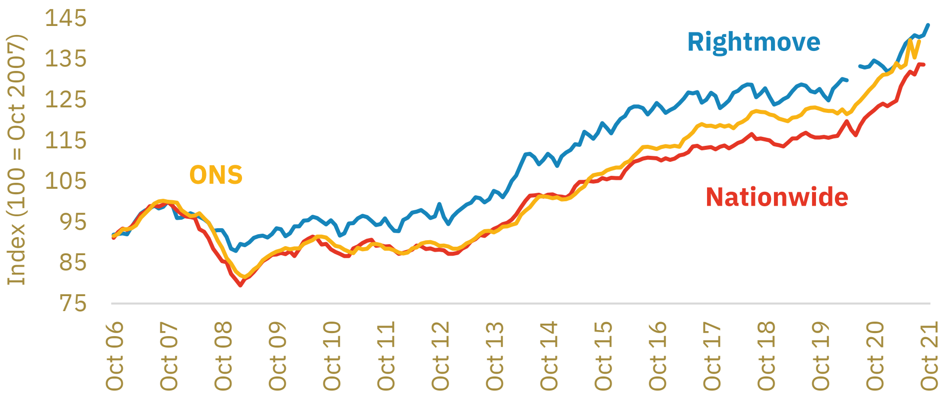
Economy - UK

The ONS monthly estimates reported GDP was 6.9% higher in August 2021 than the same month in 2020. This puts monthly GDP just 1.1% lower than the pre-pandemic peak recorded in January 2020. However, this data will inevitably be revised in coming months and years.



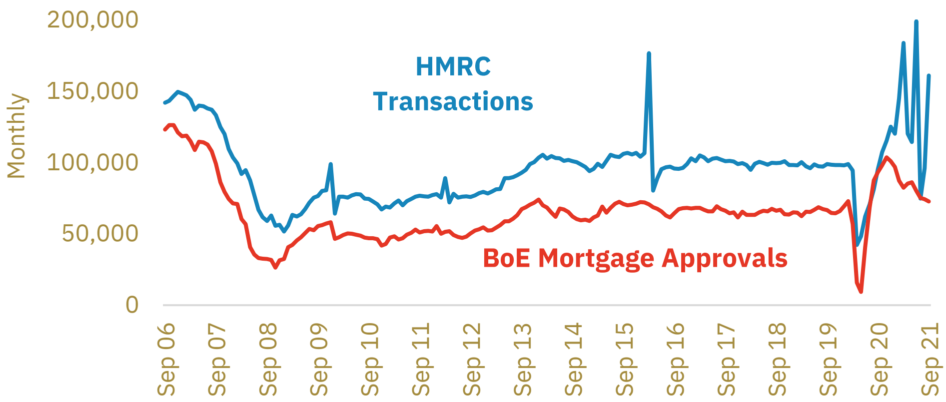
House Prices - UK

Rightmove reported a 6.5% rise in asking house prices in the year to October while Nationwide reported a 10% annual rise in their mortgage approval based index in September. The ONS is reporting higher growth in its sales agreed index with an 10.6% rise in the year to August 2021.



Transactions – UK

HMRC provisionally reported 161,000 transactions in September. This was 63% higher than the same month in 2019 and reflects the end of the stamp duty holiday in England and Northern Ireland. Meanwhile, the Bank of England reported another small fall in mortgage approvals for house purchase in September.



New Supply - England

There are issues with MHCLG's quarterly data though we have used it to suggest the potential path of completions (dotted line). The best leading indicator for supply is Energy Performance Certificates (EPCs) for new build homes with data for Q3 2021 showing a slight fall compared to Q3 2020 (-8%) and a rolling annual total of 246,000, similar to pre-pandemic levels.