Market Commentary

Residential Analysts

Powered by BuiltPlace

United Kingdom – January 2023

- **Can't Buy, Won't Buy**
- **How Big?**
- **Still Not Special**

Mortgage approvals have collapsed as high rates limit buyers ability to meet sellers' still high price expectations. While mortgage rates have fallen from their peak, they are still firmly above 4% and a price correction is still very likely (and may be underway). However, rapidly rising wages could ease some of the pain during the correction. Meanwhile, we are still not special as house prices are falling from their post-pandemic highs in other countries.

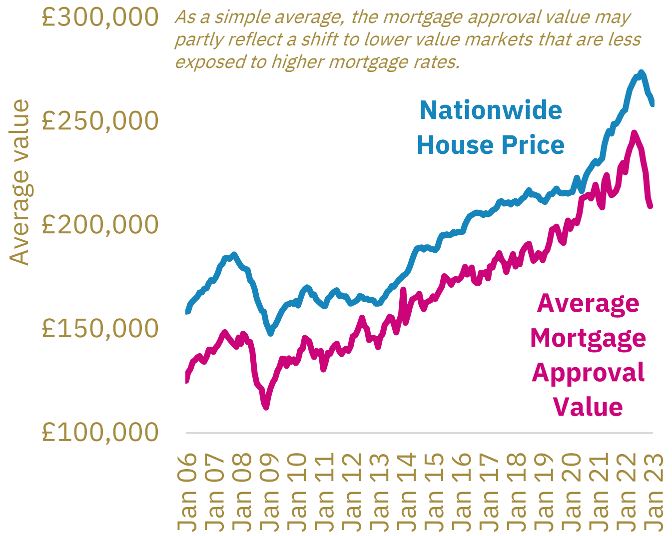
Can't Buy, Won't Buy

The latest Bank of England mortgage data highlights the scale of the problem facing the UK's housing market. As the penultimate chart in the report shows, the number of approvals for house purchase was 47% lower in December than the same month in 2019 as prospective buyers struggled to borrow given high mortgage rates.

The struggle to borrow has been increasing for months, tracking the rise in mortgage rates. Fig 1 highlights the fall in the simple average mortgage approval value for house purchase (total value / total number). It has fallen 15% since its May peak. Also shown is the fall in the mortgage-based Nationwide price index (down 5.6% since August). There are still plenty of people who would like to buy, especially given the state of the rental market, but can no longer afford to. The danger is, as the prospects for the housing market deteriorate, more decide they won't buy. That would create a problem for those needing to sell and lead to further price falls.

Fig 1: Average Mortgage Approval & Price

Source: Bank of England, Nationwide

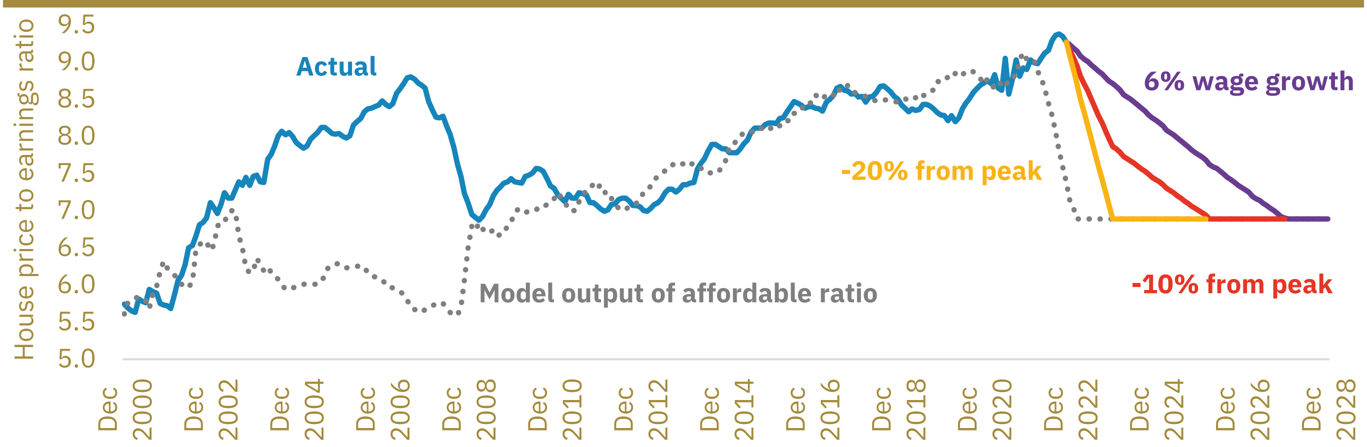


How Big?

With mortgage rates still above 4%, a house price correction is still highly likely – and is probably already underway. There are numerous ways to assess the scale of correction that might be required given higher mortgage rates. There are also a number of ways that the correction could be lower than the headline numbers generated by models. A shift to wealthier buyers could offset some falls while rising wages will also be important. To assess the impact of wages, we have used our simple house price model based on ONS wages and house prices along with BoE mortgage rates. Fig 2 below shows the actual price to earnings ratio along with our model of what an affordable ratio would've been given prevailing mortgage rates. It shows the two lines were relatively close over the last decade but diverged during the last year as mortgage rates increased. Based on mortgage rates of 4%, the model suggests a 20% price fall would be required to return the ratio back to affordable levels.

Fig 2: House Price to Earnings Ratio & Scenarios

Source: ONS, BoE, BuiltPlace



Market Commentary

Powered by BuiltPlace

To assess the impact of wages on a house price correction, we have created three scenarios. They are intentionally simple and could be too optimistic: assuming mortgage rates hold at 4% and wage growth continues at current high rates (6%) through the period. The first scenario is based on an immediate correction where prices fall 20% during 2023, bringing them back into line with our model of an affordable ratio. As Fig 3 shows, this then allows house prices to grow at rates determined by underlying wage growth from the end of 2024.

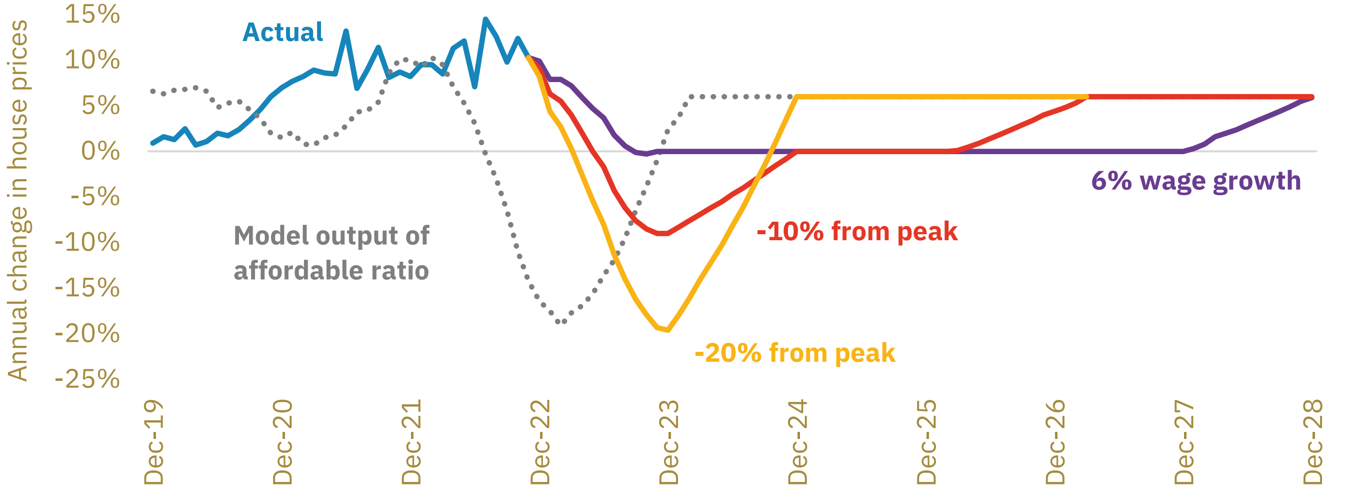
The second scenario is based on a 10% price fall and then relies on wage growth for the remainder of the correction in the house price to earnings ratio. Annual price falls might be over by the end of 2024 but it takes a further two years for prices to correct relative to earnings. If wage growth is slower than 6% then this period of minimal growth would be further extended while activity would still be low due to stretched affordability.

The final scenario is based on house prices remaining unchanged across the period, with all the work of the correction being done by rising wages. Based on 6% wage growth, our model suggests this would take around five years. If wage growth falls back to lower rates then this would extend the period of stagnation. This outcome could actually be more damaging over the long-term to the housing market, housebuilding, and the economy than a short and sharp correction. In the absence of a massive deregulation in mortgage lending, turnover would collapse and the market would only be accessible to wealthier and higher income buyers.

This final scenario also highlights the challenge with political promises to fix house price affordability by building more homes. The objective of higher housebuilding is not to create an oversupply and resulting house price crash but to suppress future house price inflation, keeping it lower than wage growth. The actual correction is then dependent on the gap between wage and price growth. However, it is highly improbable that this gap would be consistently as high as the 6 percentage points in our model. This is why increasing new supply can take multiple election cycles to have an impact on house prices though the effect on rents can be much more immediate.

Fig 3: Annual Change in UK House Prices

Source: ONS, BoE, BuiltPlace



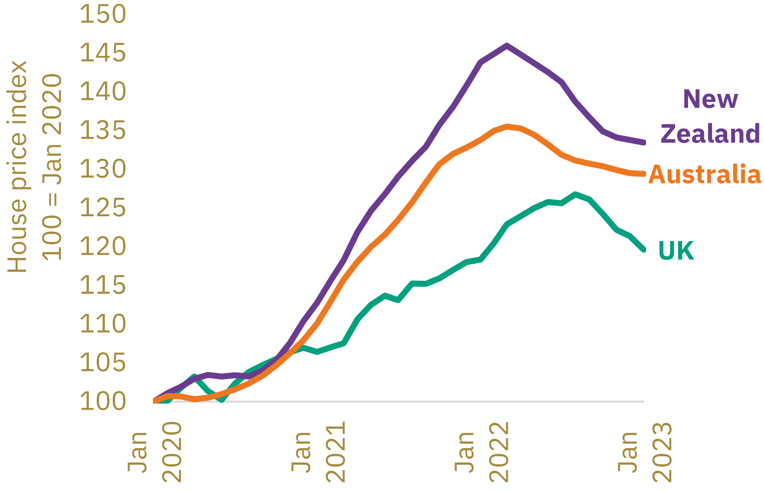
Still Not Special

We've previously highlighted how the UK's housing market has not been unique in experiencing a housing boom in the years since the pandemic hit. As Fig 4 shows, it is now far from unique in facing a period of falling house prices. It appears house prices peaked last year in many of the international markets that recorded a large pandemic boom.

For example, the PropTrack index for Australia shows prices have fallen 4.5% since their peak in March while the CoreLogic index for New Zealand reports prices have fallen 8.6% over the same period. Meanwhile, the Teranet-National Bank index for Canada (not shown) reports prices have fallen 10% since May and the S&P/Case Schiller index (not shown) reports US prices have fallen 3.6% since June.

Fig 4: International House Price Indices

Source: Australia: PropTrack, UK: Nationwide, NZ: CoreLogic



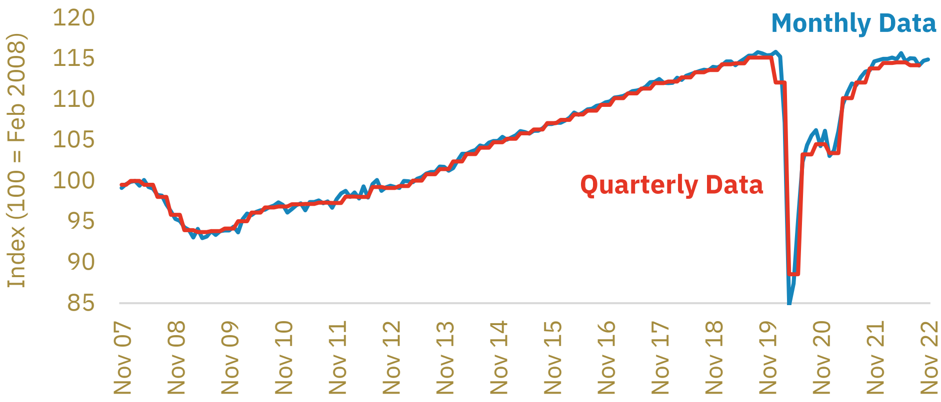
Market Commentary

Powered by BuiltPlace

Market At A Glance

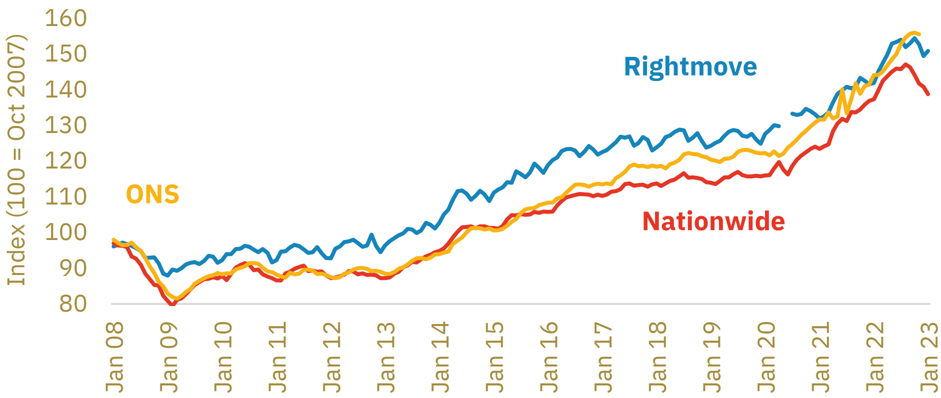
Economy - UK

The ONS monthly estimates reported GDP was 0.2% higher in November 2022 than the same month in 2021. This left monthly GDP 0.8% below the pre-pandemic peak recorded in January 2020. However, this data will inevitably be revised in coming months and years.



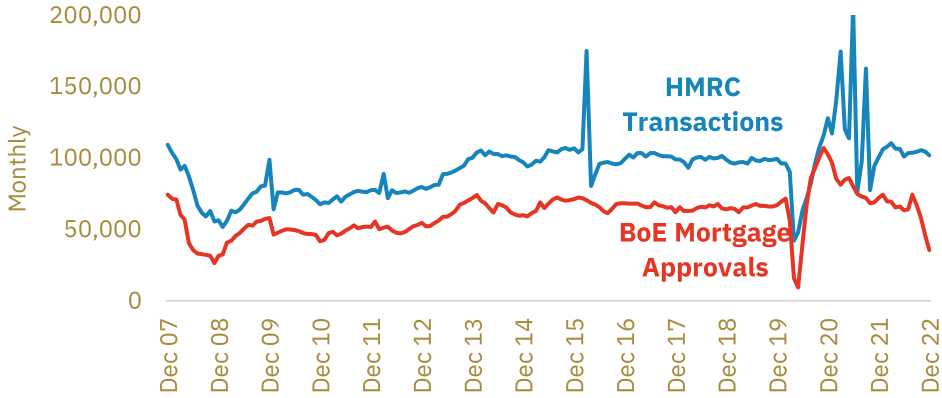
House Prices - UK

Rightmove reported a 6.3% annual rise in asking house prices in January 2023 while Nationwide reported a 1.1% annual rise in their mortgage approval based index in the same period. Meanwhile, the ONS reported 10.3% annual growth in its sales agreed index for the year to November 2022.



Transactions – UK

HMRC provisionally reported 102,000 residential transactions in December. This was 2.4% higher than the same month in 2019. Meanwhile, the Bank of England reported mortgage approvals for house purchase were 47% lower in December 2022 than the same month in 2019.



New Supply - England

The latest net additions data for 2021/22 reported 233,000 net new homes in England with 210,000 new build completions. The latest quarterly house-building data suggests there were 216,500 completions in the year to Q3 2022 while there were 252,500 new build Energy Performance Certificates in the year to Q4 2022 – a leading indicator for net housing supply.