# QUARTERLY ECONOMIC BULLETIN

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Association of AMI Mortgage Intermediaries

## Introduction

AMI is delighted to welcome two guest contributors to our latest Economic Bulletin. Both are respected and celebrated economists, Barry Naisbett from Santander and Robert Gardiner from Nationwide.

They set out in the following pages their views on the current state of the economy, the housing and mortgage market. We hope you enjoy the contributions.

These are positive times with five consecutive quarters of economic growth, controlled inflation and public sentiment and confidence on the up. Housing transaction levels are recovering and lending volumes are in positive territory when looked at year on year. There is much to be positive about, although there are still potential risks on the horizon. The global economy looks less positive than the UK position, which is unusual and brings the risk of contagion. We are now moving toward a year from a General Election and the European elections and the referendum on Scottish independence all could cause attention to be diverted from ensuring economic recovery is embedded and sustainable.

Having said all of that MMR has now landed and intermediaries have never had a better opportunity to show that with their access to a variety of mortgages and experience in providing quality advice they are much better placed than those who work directly for lenders who are recently qualified and can only offer a limited product range.

This will be a year where we see another 20% increase in business, and for many this will be a doubling of what they wrote in 2011, delivered by both an increasing number of new-build properties and also consumers keen to see what options they may have ahead of what is becoming the inevitable rise in base lending interest rates.

Robert Sinclair

## The view from Santander – a better economy

The run of positive economic news has continued over the past couple of months. The latest survey results on economic activity in the manufacturing, construction and service sectors have continued to show high readings, although they have tended to be a little weaker than at the end of last year. On this basis we are likely to see another strong reading for GDP growth in the first quarter of the year. The IMF has, once again, raised its expectation for growth in the UK this year, now to 2.9%. Looking across the IMF's figures, this is the strongest growth outlook amongst the G7 economies, not a frequent occurrence for the UK.

However, despite the recent robust growth, the level of output in the economy (GDP) is still below that reached before recession hit. And policy interest rates remain at their all-time low level of 0.50%, which was introduced as a response to extraordinary circumstances over five years ago. So the economic environment is far from being 'back to normal'. If the current rate of progress continues, by mid-year we should be back to the pre-recession level of economic activity, but it will have taken over six years to achieve.

Perhaps we should savour these economic statistics about GDP while we can. The Office for National Statistics has announced that later this year it will introduce a revised methodology for compiling the GDP figures. This will not be a 'usual' revision to figures which is being made because new information has become available. It could be a considerable change because it relates to new international standards and focuses on issues such as the treatment of Research and Development spending in the national accounts. The expectation is that the current overall level of GDP will increase as a result. What we do not know is how the current figures will be revised – will the recession look deeper or shallower and will the recovery look stronger or weaker? That will certainly be something that the economic commentators will be watching out for around September and October.

While the GDP figures will continue to be closely watched, two themes seem to be dominating the economic headlines at present. The first concerns the cost of living and in particular that the long fall in real average earnings now looks to be ending. For a long time relatively high inflation (certainly above the 2% target rate) has been set against relatively low average earnings growth. But over the past 6 months inflation has gradually fallen – in fact we are now in the longest period of falling inflation since the CPI figures started in the late 1990s – and reached 1.6% in March, helped by lower petrol prices. At the same time, average earnings growth has edged up, reaching 1.4% in February on an underlying basis. This adjustment is now moving real average earnings growth nearer to positive territory and, if low inflation continues, will be a positive factor for households. Once again, however, it is worth noting that this is not a return to pre-recession experience. In the 5 years before 2008, annual earnings growth averaged about 2% above consumer price inflation. We are well away from that experience.

The second economic issue being keenly debated concerns the housing market. There is a considerable focus on house prices, both on their level and their rate of growth. The different price indicators provide different numerical outcomes but the key facts are clear – house prices are rising more rapidly in London than in other areas and the absolute level of prices in London is increasingly being reported as a problem for first-time buyers and those on relatively low earnings. The latest figures from the Office for National Statistics (ONS) show prices in London in February up 17.7% on a year earlier but in the North East they were only up 2.9%. This imbalance in performance is attracting press attention but may also be potential source of concern to the (relatively) new Financial Policy Committee (FPC) which could view persistent imbalances as potential indicators of instability.

In terms of market activity, there is again a positive story. The number of loans approved for house purchase in the three months to February was 35% higher than a year earlier, averaging just over 70,000 a month. Clearly, market activity has picked up from the low levels of a few years ago. But it remains around 30% below the average level seen in the 2000-7 period before the recession and the fall in house prices.

The key issue in the housing market, however, remains the imbalance between new supply and demand. Household formation levels continue to run ahead of new building, with this being particularly keenly felt in London. On the positive side, new house building has picked up, with new housing starts in the final quarter of last year up over 20% on a year earlier. With around 32,300 housing starts in the quarter, there remains scope for a considerable increase from there to move closer to demand levels.

The expectation that the economy will continue to record robust growth this year and that the gap between average earnings growth and inflation will close should continue to be positive factors for the housing market. House price growth in London may slow as the year progresses if the increase in new building continues. However, whatever the precise numbers show, house prices are likely to continue to be a talking point for a long while yet.

## The view from Nationwide - Housing market upturn – on a solid foundations?

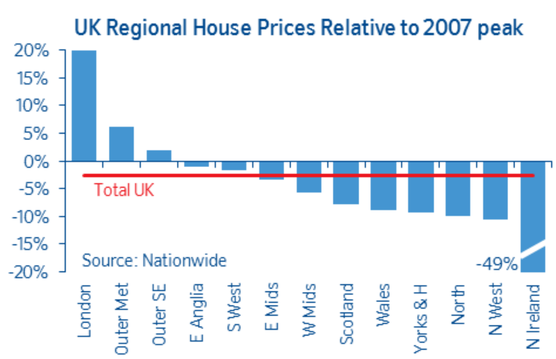
There is little doubt that the recovery in the housing market is now firmly established, with activity levels picking up and house prices recording their fifteenth successive monthly increase in March. There are some tentative signs of moderation, with the monthly pace of price growth slowing to 0.4% in March down from 0.7% in February and 0.8% in January. Nevertheless, viewed in annual terms, price growth is continuing to run at a robust pace, with the price of a typical home 9.5% higher than in March 2013.

Record low mortgage rates, improved availability of credit and the brighter economic outlook are all leading to increased demand for housing. However, the upturn in the supply side of the market continues to lag far behind, with the number of new homes being built in England still around 40% below pre-crisis levels (and this was already insufficient to keep up with the increase in the number of households being formed). Hopefully, supply will ramp up in the quarters ahead and help to ensure we achieve a sustainable upturn in activity. There are certainly encouraging signs that the upturn is becoming more broad-based.

### Pickup broadly based across regions

For the third quarter in a row, all thirteen regions saw annual house price growth in Q1 2014, though the south of England continued to see the strongest pace of price growth – especially London. Indeed, London house prices were up 18% year on year in Q1, taking the price of a typical home in the capital to £362,699 – more than twice the level prevailing in the rest of the UK when London is excluded. Indeed, the gap between house prices in London and the rest of the UK is the widest it's ever been, both in cash and percentage terms.

The southern regions have been outperforming for some time, with the result that house prices in London, the Outer Metropolitan and Outer South East have now surpassed their pre-crisis peaks. Similarly, East Anglia and the South West are less than 5% below their 2007 highs. By contrast, the North of England, Wales, Scotland and Northern Ireland still have more ground left to recover, as shown in the chart below.




### First time buyers a key driver behind the upturn

Another promising sign for the sustainability of the upturn is that first time buyers appear to be a key driving factor behind the recovery, with numbers rising strongly in recent quarters. Indeed, at 79,400 in Q4 2013, they were up 30% compared with the same period in 2012 and accounted for around 45% of activity – an all-time high as a share of lending activity.

This is important because first time buyers are the lifeblood of the housing market. As well as accounting for a significant proportion of housing transactions (historically around 40% of transactions involving a mortgage), they also play an important role in the wider market, for example in helping to complete chains, enabling those that already own a property to move.

**Few signs of affordability constraints curbing FTB numbers**

At present, the typical first time buyer home costs 4.7 times average earnings. While this is above the 20 year average of 3.7 times earnings, it is well below the highs of 5.4 recorded in 2007. Moreover, thanks to the decline in interest rates, lower house prices (currently 3% below their 2007 peak) and a modest increase in nominal earnings, the typical mortgage now accounts for around 19% of borrowers' average monthly earnings, below the 24% recorded before the financial crisis and close to the long term average.

There is less scope for buyers to reduce monthly payments by opting for an interest only mortgage, as these products are less readily available (interest only accounted for 2% of new lending to first time buyers in January, down from a peak of 37% in September 2007).

However, there is a trend towards borrowers lengthening the term of their mortgage, with 54% of mortgages currently over 25 years, up from 40% in 2007. This may, in part, be to lower their monthly repayments, though the shift may also reflect that people are both living and working for longer. The typical first time buyer is still putting down a 20% deposit, but the greater availability of mortgages for borrowers with a smaller deposit is also likely to be supporting demand.

| First Time Buyers | 2007 Q4 | 2012 Q4 | 2013 Q4 |
|---|---|---|---|
| Number of loans | 80,800 | 61,300 | 79,400 |
| % of total house purchase | 36% | 42% | 45% |
| Median age | 28 | 29 | 30 |
| Median income | £35,300 | £34,100 | £35,900 |
| Median LTV | 90% | 80% | 80% |
| Interest rate | 6.2% | 4.3% | 3.5% |
| Median income multiple | 3.37 | 3.26 | 3.40 |
| Mortgage payments as % of income | 25% | 20% | 19% |

Source: Council of Mortgage Lenders

**No room for complacency**

However, the most decisive factor in achieving a sustained increase in first time buyer numbers and a pickup in housing market activity more generally is likely to be the performance of the wider economy - especially the labour market. It is therefore particularly encouraging that most economists are now forecasting healthy economic growth and further gains in employment over the next few years.

The significant improvement in the economic outlook in recent months also raises the prospect of higher interest rates ahead. While we do not expect interest rates to rise until mid-2015, borrowers should be prepared for the prospect of interest rates increasing back towards more normal levels. Indeed, more than a million first time buyers have entered the market since the Bank Rate was cut to a 300 year low in early 2009, many of whom have yet to experience a hike in interest rates.

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