QUARTERLY ECONOMIC BULLETIN

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Association of AMI Mortgage Intermediaries

Introduction

AMI is delighted to repeat the performance from our 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.

The UK economy continues to recover with many positive and strong indicators which herald a continuing robust recovery. There are still risks on the horizon, with the principal of these being political in terms of the results from the Scottish referendum and the 2015 UK General election. The European recovery is still limited with residual risks in the European banking sector and government debt exposure. This will take another decade to resolve fully.

We continue to have 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, with MMR having landed and the May and June lending figures indicating a soft landing which means we are likely see in excess of £200bn gross lending this year for the first time since 2008. 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.

So opportunity remains despite the need for the Bank of England and the Financial Policy Committee to impose restrictions which are designed to stop the market running too fast. The macro-prudential limits imposed on loan to incomes have confused some in the market. Lenders have to employ blunt tools to ensure they do not breach these limits as the Bank will not react well. Therefore until they can apply more sophisticated measurement tools, individual product caps seem the only way ahead. This is confusing as we have moved to more robust affordability rules at the same time, but none of us want to see runaway property prices that are not sustainable in the long term and make it impossible to buy in parts of the country.

Robert Sinclair

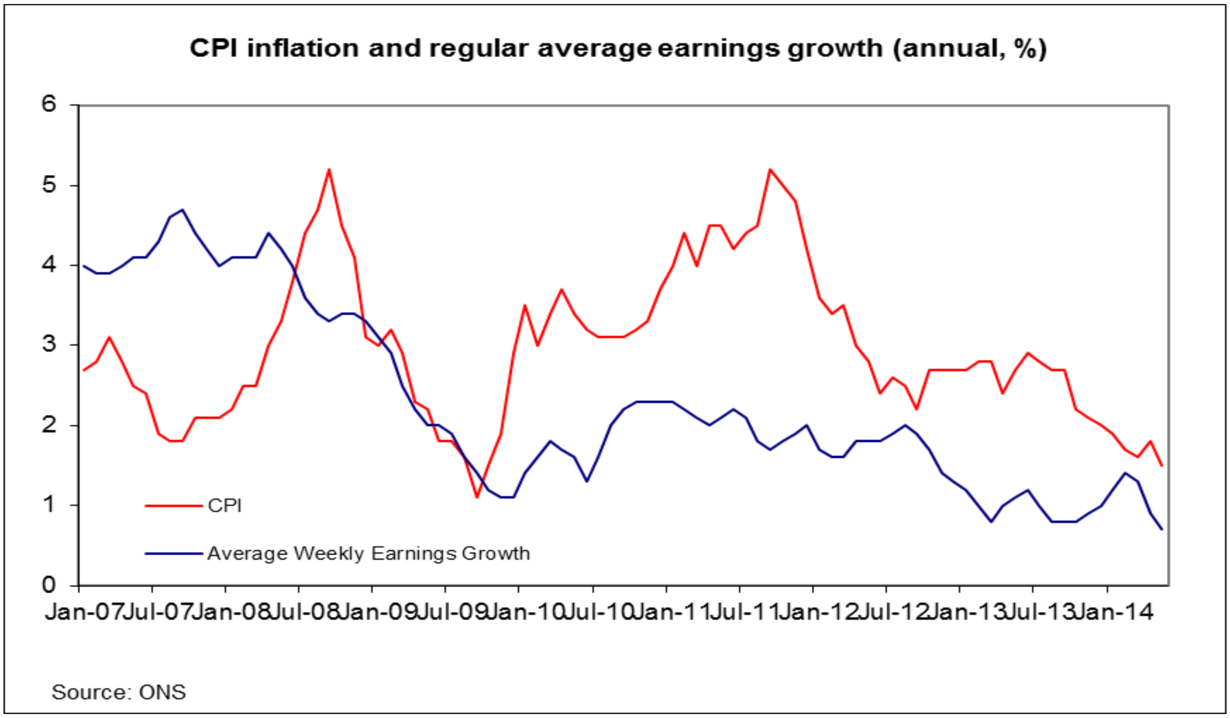
The view from Santander – back to where we started

The momentum of positive news on economic activity in the UK has continued over the past quarter, albeit with a few hiccups. By the time this goes to print, the official statisticians will have decided on their first view of GDP growth in the second quarter. Whether the actual figure turns out at +0.8%, the current consensus expectation, or a little higher or lower, it is clear that the past eighteen months has been a strong period for growth in the UK. The latest data should also show that the economy is now producing more (but only a little more) than it did before recession hit. It has taken over five years to get back to that level.

It is not only output growth that has been strong – but employment growth has been strong too. In May the number of people in work was 493,000 (1.6%) higher than six months previously. Within this total, full-time employment was up 396,000 (1.8%) and part-time up 98,000 (1.2%). However, the biggest story in the labour market is probably the increase in self-employment. This was up 224,000 (5.1%) over six months and 404,000 (9.7%) over the year. Indeed the official figures show that about one in every seven people working is now self-employed. Unfortunately, as with many emerging trends, we know relatively little about the characteristics of this rapidly growing group. In particular, we do not know whether this increase will turn out to be a temporary phenomenon or whether it might mark a more fundamental change to the economic landscape.

The labour market figures also show two other interesting features. The first is that the percentage of people over 65 years old working has risen steadily and is the highest recorded on the current statistical basis. With a rising participation rate, this group of workers now accounts for 3.6% of those in work. Again, we know relatively little about the motivations behind the recent increase these figures - the increase may be a lifestyle choice reflecting increased longevity or it might be due to a financial need to supplement income in retirement. Either way, such changes in behaviour and market structure can have wider effects in the economy and for financial services companies.

The other statistic that caught the eye of commentators was on average earnings growth. In the year to May overall average earnings were up by just 0.3%, still well below the rate of inflation (at 1.5% in May). This figure has been pushed down by changes in the timing of bonus payments in the past couple of years, so looking at regular earnings might give a better steer. However, this is only up by 0.7%, also well below the inflation rate over the same period. Despite the growth and the rise in employment (and welcome fall in unemployment, with the rate at 6.5% in May compared with 7.8% a year previously), there appears to have been no appreciable increase in wage growth. As a result, the squeeze on real average earnings has continued. This has been highlighted recently by the Institute for Fiscal Studies in a report which noted that the median income after adjustment for inflation was 5.8% lower than its pre-recession peak.



CPI inflation and regular average earnings growth (annual, %)

Source: ONS

In light of the continued fall in real earnings, it is perhaps surprising that consumers report such a strong increase in confidence as surveys show – one survey shows the highest consumer confidence reading since 2005. However, the continued fall in real earnings and the increases in house prices may form part of an explanation for the slowdown in the growth of mortgage lending for house purchase that has been seen so far this year. The number of approvals for house purchase in May dropped a little further, to be 18.7% off the recent high in January. Approvals were, however, still 4.4% ahead of a year earlier. As the Mortgage Market Review was introduced this year, this may also be a factor that has contributed to the slowdown in activity in recent months.

The consensus view is that average earnings growth will pick up as continued economic growth makes further inroads in reducing economic ‘slack’ and inflation is likely to stay close to the Bank of England’s 2% target. As a result, positive growth in real earnings is expected to resume, though possibly not until next year. In turn, a rise in real earnings should help to support continuing growth in consumer spending and activity in the housing market.

Another interesting development in the housing market is that increases in house prices have now become a wider experience in the economy. The latest figures from the Office for National Statistics (ONS) show that prices in London are still rising rapidly (up 20.1% year on year in May). But other regions too are now seeing rising prices. Prices in the North East, for example, are up 4.8% on year earlier and in the South West they are 7.1% higher. The key issue is whether the pace of increase is slowing. Here the evidence is mixed. There have been some monthly falls in prices registered on some of the published indices, but there is no settled pattern as yet.

It is against this economic background that the Monetary Policy Committee (MPC) will be drawing up its outlook for the economy for the August Inflation Report and for its next few monetary policy decisions. The Governor’s Mansion House speech on the 12th June certainly influenced financial markets and commentators on the possibility of Bank Rate rising earlier than previously expected. When questioned about this at the House of Commons Treasury Committee hearing on the Financial Stability Report, the Governor explained that “we were concerned that markets were not reacting to data, a fairly long run of data that was as good as expected, if not slightly better. There had not been an adjustment in terms of expectations at the time of the first rate increase, despite pretty clear guidance that we had given: that it was going to be data driven, that we had no pre-set path and the only guidance that the MPC is now giving is around the expected medium-term path of interest rates, not the timing of the first move”.

So the in-coming economic news, especially on the labour market and economic activity, will be critical factors for the MPC in considering how and when to adjust monetary policy. While we cannot be certain of what that economic news will be, we can be sure that it will generate a lot of debate.

Barry Naisbitt
Chief Economist, Santander UK

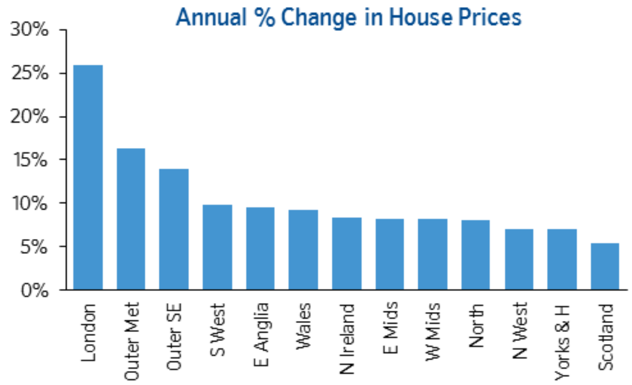
The view from Nationwide - Housing market update

House prices have continued to gain momentum as the outlook for the wider economy, especially the labour market, have improved. House prices reached their 2007 peak in Q2, just as UK economic output is likely to have surpassed the high water mark reached before the financial crisis.

However, there are tentative signs that activity in the housing market may be cooling, though it is unclear whether this reflects a temporary slowing as Mortgage Market Review measures bed down, or is symptomatic of an underlying loss of momentum. Recent policy measures adopted by the Bank of England are unlikely to dampen activity in the near term, but mounting expectations of interest rate hikes early next year may act to temper demand.

House prices rising across the UK, London still recording the strongest gains

House prices recorded their fourteenth successive monthly increase in June, rising by 1%. As a result, the annual pace of price growth picked up to 11.8% from 11.1% the previous month. While all regions recorded annual price gains for the fourth quarter in a row, there is still significant variation across the UK, with the South of England continuing to record the strongest rates of growth. In particular, London continued to outperform, with prices up by almost 26% in Q2 compared to the same period of 2013.



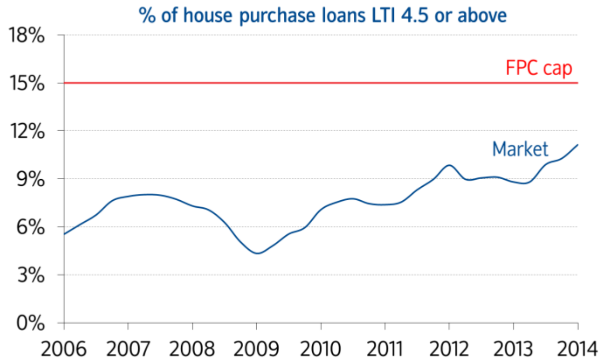
The price of a typical property in London reached the £400,000 mark for the first time, with prices in the capital now around 30% above their 2007 highs and more than twice the level prevailing in the rest of the UK when London is excluded. In the UK as a whole, prices are less than 1% above their pre-crisis peak. Excluding London they are 0.4% below peak.

The annual pace of growth in the capital will probably start to slow in the quarters ahead, given the high base for comparison from Q3 2013 onwards and given anecdotal evidence from surveyors and estate agents that activity may be starting to moderate.

Recent policy measures unlikely to have a significant impact in the near term.

The Financial Policy Committee's decisions to limit the proportion of lending at or above 4.5 times borrowers' income to no more than 15% of new loans and to introduce a stress test to ensure that borrowers can afford a three percentage point increase in Bank Rate are unlikely to have a significant impact on housing transactions or the pace of price growth in the near term.

Most major lenders are already using a stress rate in their affordability calculation that is broadly consistent with the new stress test. Similarly, the proportion of house purchase loans at or above 4.5 times borrowers' income is currently some way below the 15% cap (see chart).



Source: CML Regulated Mortgage Survey

However, these policy measures, along with previous actions, such as the introduction of Mortgage Market Review (MMR) measures, should help to limit the risk of house prices becoming detached from earnings without de-railing the recovery in the wider housing market.

This is important, since lending activity has slowed markedly in recent months, with mortgage approvals in May around 19% below January's high. The slowdown may partly be the result of the introduction of MMR measures, which may take a few months to bed down. However, the underlying pace of demand remains unclear, and transaction levels remain some way below historic averages.

Rising longer term interest rates may also dampen buyer demand.

Mounting expectations that interest rates may rise earlier than previously anticipated may also act to dampen housing market activity in the months ahead. As investors have become more confident that the Bank Rate will start to rise gradually from late 2014 or early 2015, so longer term interest rates have started to increase. If this is sustained, it is likely to feed through to mortgage rates, which would also help to prevent buyer demand rising too strongly.

Nevertheless, it is important to note that the Financial Policy Committee does not have the tools to address the fundamental problem in the housing market – the lack of supply. While there are encouraging signs that the pace of construction has picked up, the pace of house building is still well below the expected pace of household formation.

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