

Housing and mortgage market forecasts: 2008

- Forecasting even the short-term outlook for the housing and mortgage markets remains problematic. So, we continue to limit our forecast horizon to the end of 2008.
- We assume that the Bank of England's special liquidity scheme, while not specifically targeted at the mortgage market, will have some modest beneficial flow-through effects in the second half of the year.
- The credit crunch has resulted in a gap in the availability of mortgage credit relative to demand. Lenders have changed their product ranges, tightened lending criteria and reviewed their pricing in order to maintain their individual ability to manage demand.
- Mortgage approvals for house purchase have weakened to historically low levels and look set to soften further in the next few months. Overall, we expect the number of mortgage approvals for house purchase and the number of property sales to be around 35% lower than last year.
- We now expect house prices to be about 7% lower in the fourth quarter of this year compared with the fourth quarter of 2007.
- Remortgaging activity is subject to different pressures. The large number of maturing fixed-rate products provides a strong level of underlying demand. But, there is reduced funding available and lending criteria have been tightened. Overall, we expect the number of remortgages to be up slightly on last year.
- We expect gross advances to be close to £285 billion this year, down from £363 billion last year. We expect net lending to be close to £55 billion this year, half last year's £108 billion.
- While payment problems may increase, there is no evidence yet of a significant deterioration against our October forecasts. We will revisit these when we publish our data on arrears and possessions for the first half of 2008 on 8 August.
- On the positive side, monthly payments on variable rate mortgages have fallen following cuts in official interest rates. And borrowers coming off fixed rate products in 2007 and 2008 appear to be managing the adjustment well, while the intensity of payment shock for those coming off fixed rates over the remainder of this year will moderate.

Author

[Jim Cunningham](#)

Senior Economist, CML

Table 1: Forecast summary

	2004	2005	2006	2007	2008
House price growth, Q4, year on year % change	15	5	10	5	-7 (1)
Property sales, England and Wales (Land Registry), millions	1.20	1.03	1.28	1.22	0.77 (1.01)
Gross advances, £bn	291	288	346	363	285 (340)
Net lending, £bn	101	91	110	108	55 (90)
Arrears, over 3 months, number at end period	104,400	122,900	119,500	129,800	170,000 (170,000)
Arrears, over 3 months, % of all mortgages at end period	0.88	1.06	1.02	1.10	1.45 (1.42)
Possessions, number in period	8,200	14,600	22,400	27,100	45,000 (45,000)
Possessions in period, % of all mortgages	0.07	0.13	0.19	0.23	0.38 (0.38)
GDP, %	3.3	1.8	2.9	3.0	1.75 (2.25)
Bank rate, end year, %	4.75	4.5	5	5.5	4.75 (5.0)

Source: Bank of England, National Statistics, HM Land Registry, HBOS, CML

Notes: (1) Figures for arrears and possessions are estimates and relate only to first charge lenders who are members of the CML. They do not include arrears and possessions relating to other secured lending or to firms that are not CML members. (2) October 2007 forecast shown in brackets.

The credit crunch

The credit crunch entered a new phase in the early months of this year. Lenders have been unable to sell or secure funding on assets in which markets have closed. This has increased uncertainty and contributed to continued stress in money markets and tighter credit availability.

The impact on the mortgage market has been a gap in the availability of credit relative to demand. Lenders have changed their product ranges, tightened lending criteria and reviewed their pricing in order to maintain their ability to manage demand as a response to the rationing of available funding.

Although the demand for mortgages has fallen back since last summer, as consumer confidence has weakened and household budgets have been squeezed by rising food, fuel and tax bills, the reduced availability of funding has been the dominant factor behind the sharp fall in the number of mortgage approvals for house purchase.

In the housing market, this is reflected in a sharp fall in the number of house sales and a softening in house prices which, at the national level, are now around 5% below the peaks of last summer.

The worst of the credit crunch may now be over. An important element behind this has been the Bank of England's special liquidity scheme, announced in April. The primary aims of this are to improve the liquidity of banks and to lower the current high level of wholesale money rates relative to the Bank rate.

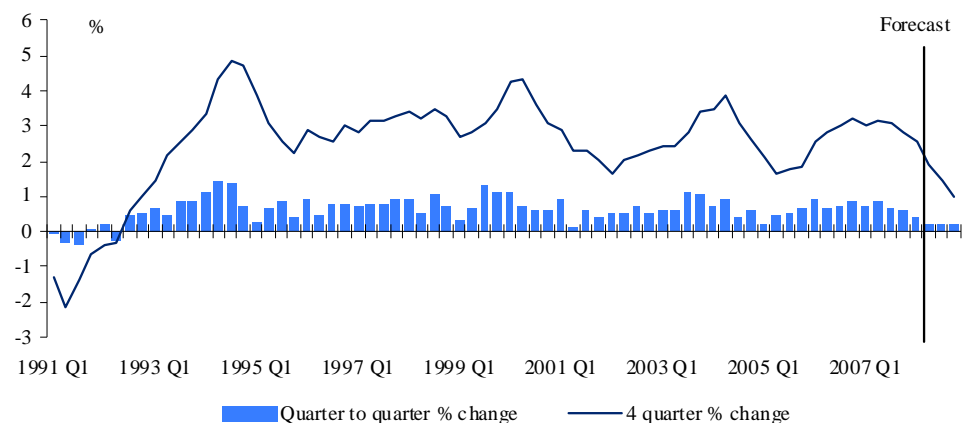
But this is only likely to take effect slowly, and in conjunction with the further disclosure and writing down of impaired and illiquid assets (and repairs to balance sheets and capital ratios). So, although the conditions for an easing of the credit crunch are falling into place, it is likely to be some time before there is a measurable improvement in terms of an easing in the availability and terms of mortgage credit. Indeed, we expect only a modest improvement, at best, in the availability of mortgage credit before the end of this year.

The economic background

Although the worst uncertainties of the credit crunch may now be behind us, its impact on the wider economy has only been partly felt so far.

Economic growth fell below the long-term trend rate in the first quarter of this year, and looks set to fall further over the remainder of this year. Although our forecast of growth averaging around 1.75% this year might appear reasonably positive, in view of the scale of the financial and inflationary shocks affecting the economy, it is consistent with growth falling to just 1% in the year to the fourth quarter.

Chart 1: Real GDP growth



Source: National Statistics, CML

This will be the slowest rate since 1992 and is slow enough to see employment fall and unemployment rise. And it is likely to mean that interest rates end the year a little below current levels despite the Bank of England's latest [Inflation Report](#) projection that inflation will remain above the 2% target for much of the next two years.

But, it also means that household spending will be more constrained than for many years, and that mortgage demand will continue to moderate, maintaining the downward pressure on house sales and house prices started by the credit crunch. And as incomes come under strain and employment weakens, mortgage payment problems are likely to increase for some borrowers.

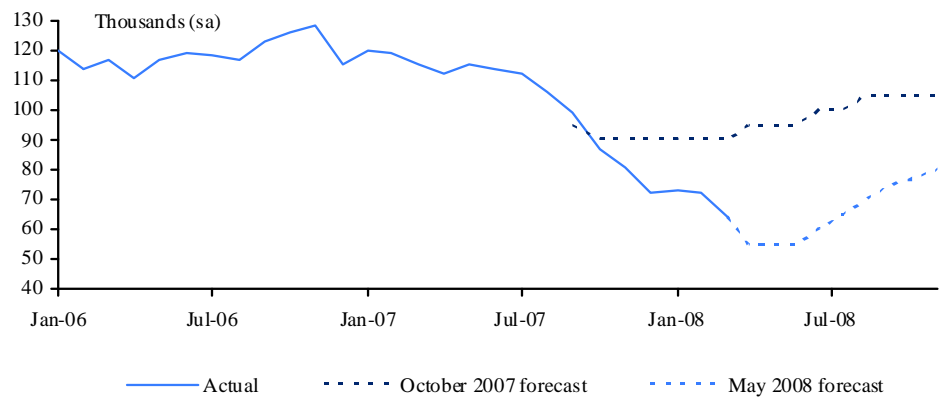
House purchase and house prices

Chart 2 shows the recent path of mortgage approvals for house purchase, and compares the profile we currently expect with our October projections.

Mortgage approvals for house purchase have been much weaker than expected in recent months. We expect them to weaken further in the next few months following a tightening in lending criteria since March. If mortgage supply conditions then start to ease a little, as we assume, we could see a modest improvement, albeit to still historically depressed levels and against a background of softening demand.

Overall, we expect the number of property sales to be around 35% lower than last year, with a similar fall in the number of mortgage approvals for house purchase.

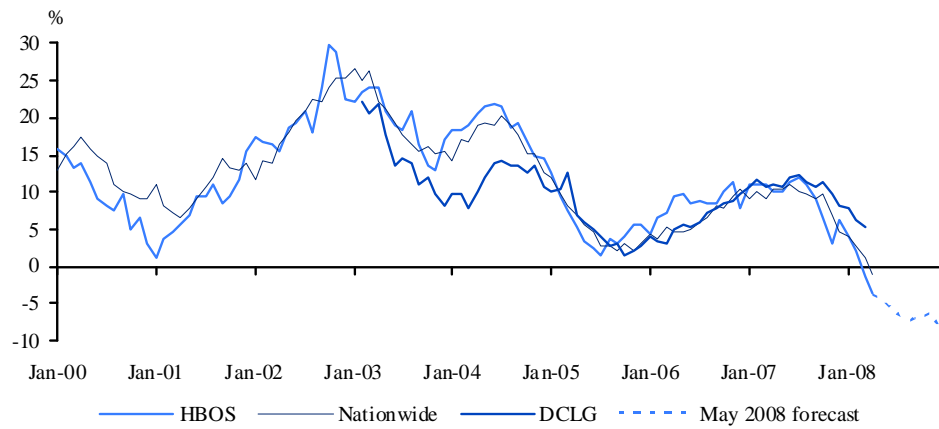
Chart 2: Mortgage approvals for house purchase



Source: Bank of England, CML
Notes: Seasonally adjusted

The weakening in activity has resulted in downward pressure on house prices since last summer. Downward pressure is unlikely to abate until there is an increase in mortgage approvals for house purchase driven by strengthening demand. This is unlikely to emerge until the uncertainties around the credit crunch and the outlook for incomes and employment lift. This is not in prospect for this year. Our central forecast is for average UK house prices to be about 7% lower in the fourth quarter of this year compared with the fourth quarter of 2007, but there is a downside risk that they will fall by more.

Chart 3: House price growth, % year on year



Source: HBOS, Nationwide, DCLG

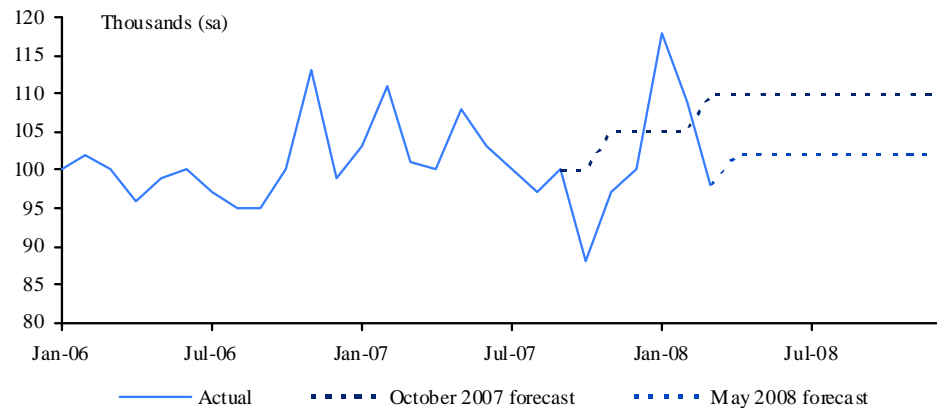
Remortgaging and further advances

Remortgaging activity continues to be subject to different pressures.

The number and value of maturing fixed-rate products will be significantly higher in 2008 than in 2007, giving a strong level of underlying demand. But, the reduced availability of funding for remortgaging has resulted in a tightening in lending criteria which means that remortgaging is either not available, or is not as attractive as in the past, for a larger number of borrowers. This will act as a constraint on business levels. This is particularly the case for borrowers with adverse credit histories and high loan-to-value ratios.

Balancing these influences, we now expect the number of remortgages to be about 2% higher this year compared with 2007. This compares with our forecast of a rise of around 5% in October.

Chart 4: Approvals for remortgaging



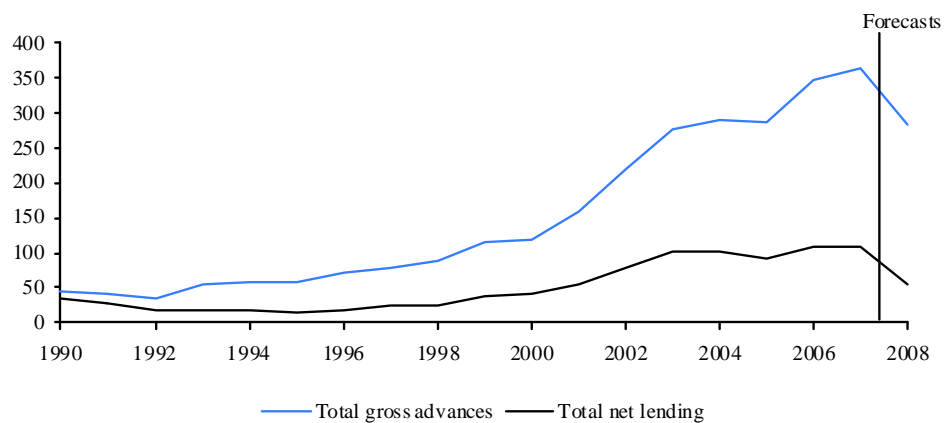
Source: Bank of England, CML
Notes: Seasonally adjusted

The number of approvals for further advances is running well below the level of a year ago. We expect this to continue until the wider economic outlook improves, but we have not changed our forecast from last October.

Gross and net lending

We expect gross advances to be close to £285 billion this year, down from £363 billion last year. Lending for house purchase will slow particularly sharply. Within this, buy-to-let purchases may hold up relatively well, supported by demand from professional landlords.

Chart 5: Gross and net lending, £ billion



Source: Bank of England, CML

With much slower house purchase activity, lower house prices and a reduced demand for further advances, we expect net lending to be close to £55 billion this year, little more than half last year's £108 billion. This is the lowest level since 2001 and means that the value of mortgages outstanding will rise by 5% this year compared with 10% last year.

Arrears and possessions

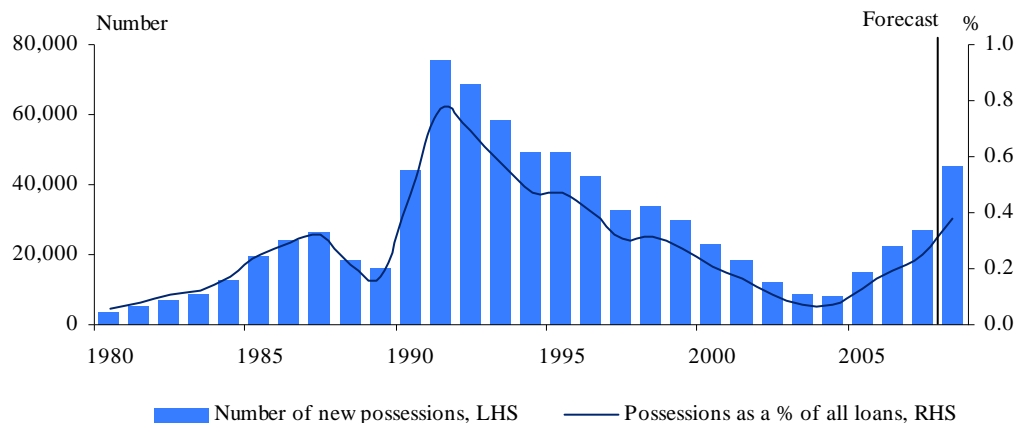
A number of factors look set to combine to produce a rise in mortgage payment difficulties this year. Those that were already known ahead of the credit crunch were the rise in interest rates in the year to July 2007, and the large number of individuals with fixed-rate products maturing into a higher interest rate environment than when they took out their original loan.

Additional pressures on households will result from the tightening in lending criteria following the credit crunch and the squeeze on disposable incomes from rising food and fuel prices.

A favourable factor for mortgage performance is the decline in monthly payments on variable rate mortgages which have followed the cuts in official interest rates. And any further cuts will be passed on in full to borrowers with base rate tracker mortgages.

Borrowers who have come off fixed-rate products since the beginning of 2007 appear to have managed the adjustment well, while the shock facing those coming off fixed rate products over the remainder of this year will be more moderate and decline as the year progresses.

Chart 6: Possessions



Source: CML

Notes: These figures are estimates and relate only to first charge lenders who are members of the CML. They do not include arrears and possessions relating to other secured lending or to firms that are not CML members.

We have not changed our forecasts from October. There is no evidence yet of a significant deterioration in arrears and possessions against these forecasts. They show a rise in the number of loans in arrears of more than three months from 129,800 at the end of 2007 to 170,000 at the end of this year. The number of possessions taken by first-charge mortgage lenders is forecast to rise from 27,100 last year to 45,000 this year. We will review these forecasts when we publish figures for the first half of this year on 8 August.

