MPC

FPC

RECENT DEVELOPMENTS IN, AND PROSPECTS FOR, THE HOUSING MARKET

From: [redacted] from MA-MASD, [redacted] from MA-SEAD and [redacted] from FSSR-MRD

Outline of the note and key points

Section 1: Recent developments in the housing market

- In May 2014, we forecast mortgage approvals for house purchase to rise sharply, while annual house price inflation was expected to continue to rise, before slowing in early 2015. Approvals were significantly weaker than expected in 2014 H2, while house price inflation began to cool slightly earlier than expected.

Section 2: Explanations for the recent developments

- Data suggest that the housing market started slowing in the first half of 2014.
- Operational constraints associated with the introduction of the MMR probably accounted for part of the early slowdown, and persisted for somewhat longer than we expected. There is a risk that it has had a larger impact on housing demand than we think, but we do not expect a sizable persistent effect.
- Other factors affecting underlying housing demand are also likely to have played a role, in particular those affecting sentiment and house price expectations. And factors affecting existing mortgagors probably also played a role in reducing housing market activity, although they are likely to have had less impact on prices.
- We do not think that the direct impact of the FPC's actions were a particularly significant driver of the slowdown in 2014, in part because the data suggest that the start of the slowdown predates the FPC's announcement in June. The measures taken by lenders prior to, and in response to, the FPC's announcements might have had an impact on the availability of credit at the margin in Q3 and Q4, but are likely to have been small. And while it is difficult to disentangle what caused the dip in house price expectations, anecdotal evidence suggests that other factors were more important.

Section 3: February 2015 *Inflation Report* forecasts and risks

- The latest forecast for approvals is considerably weaker in the near term than was expected in May 2014. But further out, activity is boosted by recent and projected falls in mortgage rates and as the effects of some of the factors above unwind.
- Annual house price inflation is assumed to have peaked in 2014 Q2, and falls back to around 4% by 2015 Q4, marginally higher than nominal income growth.
- We judge that the balance of risks to the house price forecast is likely to be to the upside in the medium term. The yield curve has fallen substantially since May 2014. Besides the direct effect of the resulting fall in mortgage rates on house prices through higher demand for housing, lower rates could encourage a 'search for yield' from buy-to-let investors, and could combine with income growth and higher house price expectations to generate further upward pressure on demand from home buyers in areas where LTI ratios are lower.
- But there are downside risks in the near term. Increases in political uncertainty could depress house prices via an expectations channel. It is also likely that the FPC LTI limit will bite more over the forecast [redacted] although the direct effect will still probably be small. Over the longer term, several political parties have pledged to increase housing supply; if that came to pass, it would generate downward pressure on prices.

Section 1: Recent developments in the housing market

1. At the time of the May 2014 *Inflation Report*, our proxy for housing activity – mortgage approvals for house purchase – were expected to level off in Q2 (relating to temporary, operational constraints associated with the introduction of the Mortgage Market Review (MMR)), before picking up strongly throughout 2014 H2. Outturns for mortgage approvals for house purchase surprised on the downside, averaging just 60,000 a month in 2014 Q4, compared with our forecast of 85,000 a month (**Chart 1**). Overall housing transactions – which are currently close to their historical average – fell by much less than mortgage approvals over 2014 (**Chart 2**), suggesting that the number of cash buyers may have actually picked up over this period.

2. Compared with the May 2014 forecast, gross lending has been lower than expected, reflecting weaker mortgage approvals. But as a large part of the weakness in mortgage approvals reflects fewer people moving house, repayments have also been lower than expected, and net secured lending has come in broadly in line.

Chart 1: Approvals for house purchase vs May forecast

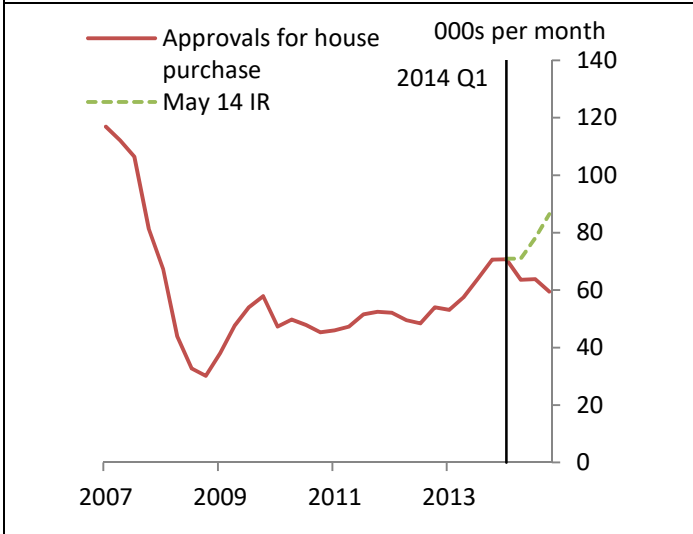


Chart 2: House prices, approvals and transactions

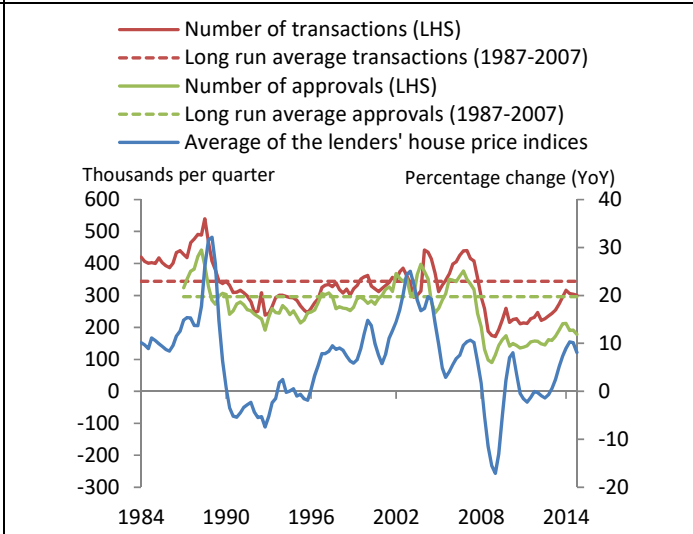


Chart 3: House prices vs May 14 forecast

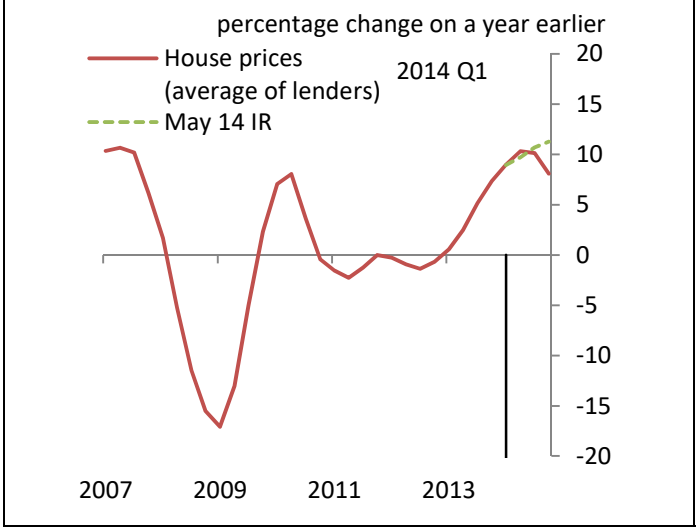
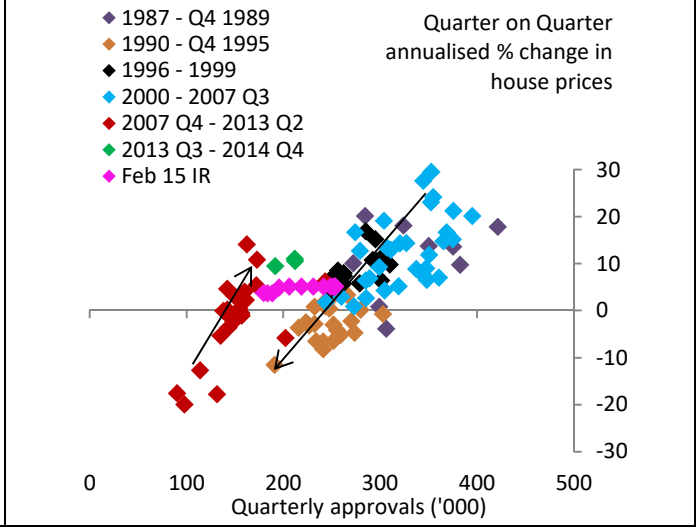


Chart 4: House prices and approvals



3. In May 2014, annual house price inflation was forecast to peak at just over 11% in 2014 Q4, before falling back to grow broadly in line with household incomes. But the average of the lenders' indices shows that annual house price inflation appears to have peaked in 2014 Q2 at 10% and declined to 8% in Q4 (**Chart 3**).

4. While house price inflation has been weaker than we expected in May 2014, the downside error was smaller in magnitude than our error on approvals. Approvals disappointed by around 145,000 over the period

2014 Q2-Q4– around 20% weaker than expected – while house prices increased by 5%, 3pp lower than expected. The green diamonds in **Chart 4** show that the recent outturns for house price inflation have been associated with a lower level of approvals than would have been expected based on the relationship observed in the pre-crisis period.

Section 2: Explaining recent developments in mortgage approvals and house prices

5. This section considers the factors that may account for developments in the housing market since the start of 2014. We consider the timing of the slowdown and then discuss evidence on some factors that could have driven it. We first consider policies that might have reduced the availability of credit, before turning to discuss other factors that could have contributed to weaker housing demand. Both of those would be likely to affect all people applying for a mortgage – first-time buyers and existing homeowners looking to move – but we think there are some specific factors that could have affected those who already have a mortgage, which we also discuss below.

6. Overall, it appears that a range of factors have accounted for the cooling in the housing market. The MMR probably accounted for part of the early slowdown, and its impact might have persisted somewhat. Other factors affecting housing demand are likely to have played a role, in particular those affecting sentiment and house price expectations. Factors affecting existing mortgagors probably also played a role in reducing housing market activity, but are likely to have had less impact on prices. We do not think that the direct impact of the FPC's actions were a particularly significant driver of the slowdown in 2014, in part because the data suggest that the start of the slowdown predates the FPC's announcement in June. And while it is difficult to disentangle what caused the dip in expectations, anecdotal evidence suggests that other factors were more important.

i) When did the slowdown start?

7. In the MPC/FPC/PRAB Joint Meeting in May 2014, we noted that there were some early signs that activity in the housing market could be slowing. It would have been bold to call a turning point in the market at that point, but, with the benefit of hindsight, it appears that the market started slowing in the first half of 2014. For example, mortgage approvals had been steadily increasing throughout 2013, but peaked in January 2014 before falling back sharply during the following few months (**Chart 2**). Moreover, RICS survey data show that net buyer enquiries, a proxy for housing demand, turned negative for the UK as a whole around the middle of 2014, and earlier in London (**Chart 5**). House price inflation started to weaken later, around September. However, evidence from Hometrack shows the proportion of UK postcodes with decelerating or negative house price inflation has been growing since May (**Chart 6**), with the proportion rising particularly sharply in London.

Chart 5: New buyer enquiries in London and the UK

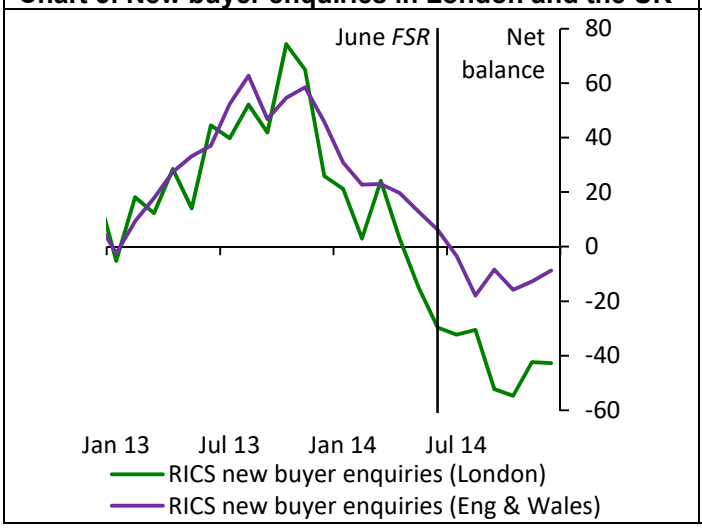
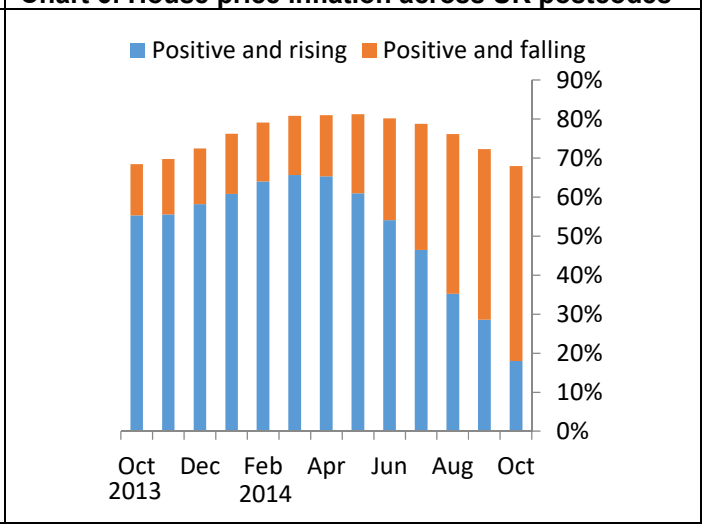


Chart 6: House price inflation across UK postcodes



ii) What caused the slowdown in the housing market?

Policies reducing the availability of credit

8. In the May 2014 *IR*, it was noted that some of the weakness in mortgage approvals at the beginning of 2014 may have reflected operational constraints surrounding the introduction of the MMR. The MMR was officially implemented in April. But many lenders introduced new systems associated with its implementation a few months earlier, which resulted in operational difficulties, and constrained mortgage approvals during much of 2014 H1. There is also some evidence from the 2014 Q3 *Credit Conditions Survey (CCS)* and supervisory intelligence that capacity constraints related to the new rules might have persisted for some lenders into 2014 H2.[1] There is also evidence that stricter affordability testing associated with the MMR may have affected some borrowers' ability to get a mortgage. While lenders did not report an effect from MMR on credit availability in 2014 Q4, that might be because some potential applicants are being "weeded out" by estate agents and brokers, or because they are not applying as they think they are likely to be rejected. Associations of brokers report that they have increased their share of mortgage business as a result of the new rules.

9. We would expect the new rules to have persistent effects on certain subsets of borrowers' access to credit (e.g. self-employed borrowers) – although we were expecting credit availability to remain tighter than it had been before the crisis even absent the introduction of MMR. But some intelligence, for example from the Agents, has suggested that they are unlikely to have a sizable permanent impact on the overall market. There is a risk, however, that the stricter rules have had, and continue to have, a larger impact on housing demand.

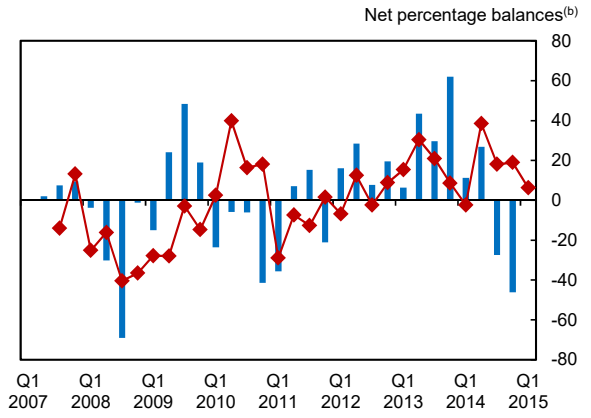
10. In June 2014, the FPC recommended that the interest rate used in stress tests was increased and announced a flow limit on high LTI lending to come into force in Q4. Given the timing of the slowdown, we think that it is unlikely that the FPC's actions could have played a large role in the slowdown of the housing market, although it is possible that the FPC's discussions of its potential housing tools at the end of 2013 affected people's expectations. But the measures taken by lenders prior to, and in response to the FPC's announcements might have had an impact on the availability of credit at the margin in Q3 and Q4. Recent data show that all of the B6 lenders reduced their high LTI lending in H2,[2] consistent with reports from some lenders in the *CCS* that they had reduced the availability of secured credit at high LTIs. But we think that the impact of those actions is likely to have been small: **Table 1** shows lenders' LTI policies around the time of, and following, the policy announcement (as well as some more recent ones), and estimates of their impact on the market. The impact of lenders' actions may start to bite more in future though – that risk is discussed further in Section 3.

Table 1: Lenders' LTI measures and maximum estimated impact on lending [(a)]

	Lender	LTI restriction	Maximum estimated impact on lending for house purchase (% of loans)
Pre-FSR		4 if loan value>£500k	0.1%
		4 if loan value>£500k	0.1%
		5 (down from 6)	0.8%
Post-FSR		4.75	0.4%
		4.5	0.2%
	Total		**0.6-1.6%**
2015		4.5	~1.2%
		4.5 for FTBs	~0.8%
		4.5	~0.1%
	Total		**~2%**

(a) Estimated using the number of borrowers above the LTI limit for each lender. Pre-FSR and post-FSR numbers are calculated based on Q2 figures and post-enforcement estimates are based on the loan level projection.

Chart 7: Household demand for overall secured lending from the *Credit Conditions Survey*



Other factors affecting housing demand

11. A range of evidence is consistent with part of the slowdown being driven by weakening underlying housing demand. For example, lenders responding to the *CCS* reported that the demand for secured lending for house purchase fell significantly in both 2014 Q3 and 2014 Q4 (**Chart 7**).

[1] and a forthcoming note by FSSR-BIAD on supervisory intelligence.

12. We think that it is unlikely that the fall in housing demand reflects the direct impact of changes in mortgage rates. Mortgage rates picked up in the middle of 2014, as the yield curve rose during the first half of the year, and possibly reflecting attempts by lenders to actively manage application volumes given operational constraints associated with the MMR. But our models suggest that secured lending should not have responded much to the observed movements in rates, and even then, only slowly. Moreover, mortgage rates have fallen substantially in recent months, reflecting both a lower yield curve and increased competition amongst lenders.

13. A model akin to a demand side equation would suggest that slowing house price inflation reflects falls in underlying demand, and specifically declining house price expectations.[3] We have done some new modelling work, focussing on house prices in London, in part given the London housing market appeared to start slowing before the rest of the country, and partly because it is where the FPC LTI flow limit is most likely to bind, so could shed light on the impact of the policy. We include a number of factors that might be expected to affect underlying demand for housing, such as wage growth, mortgage spreads and expectations about house prices, and estimate our equations using data up to end-2013. Our findings suggest that the slowdown in London house price inflation can be broadly explained by falls in underlying demand, with a strong driver of the slowdown being the fall in house price expectations.[4]

14. We have attempted to understand what might be driving that fall in house price expectations, but equations using variables including mortgage spreads, recent prices and demand-supply imbalances cannot account for the extent of the weakening during 2014 (**Chart 8**). Instead, the weakness in expectations is likely to be explained by a number of factors that affect sentiment, and are difficult to measure and so to disentangle. Evidence from the RICS surveys and the Banks' Agents suggests that sentiment might have been affected by talk around monetary policy tightening in the summer, the MMR, and political uncertainty (**Chart 9**). But there are much fewer references to the FPC's actions.

Chart 8: House price expectations in London: model prediction and data

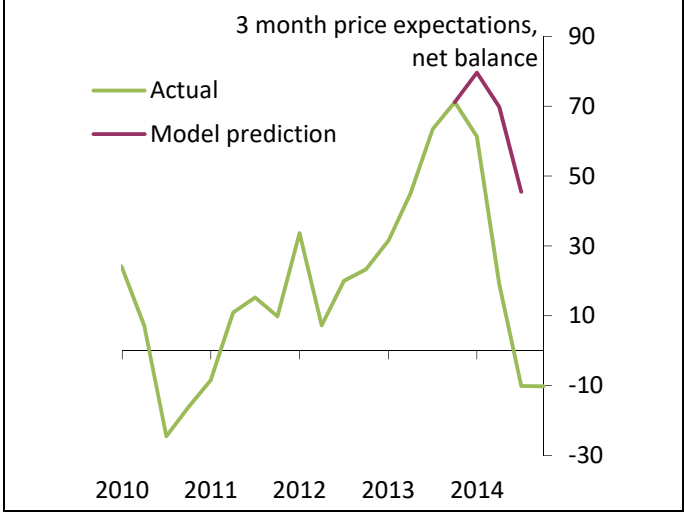
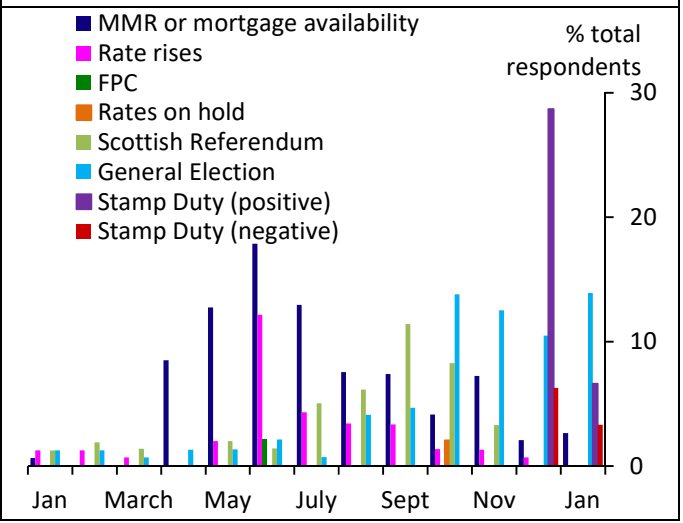


Chart 9: RICS survey textual analysis



Factors affecting existing mortgagors

15. Mortgage approvals for house purchase reflect approvals for three groups: first-time buyers, buy-to-let investors, and home-movers. **Chart 10** shows that the number of home mover approvals has recovered little since the crisis, and so remains further below pre-crisis levels than approvals for first time buyers and buy-to-let mortgages. We were expecting approvals to home-movers to pick up during 2014, but the continued weakness suggests that existing home owners have remained reluctant to move, resulting in fewer existing houses being put up for sale. As well as dampening housing demand, that results in a lower secondary market supply of houses, and so is consistent with greater weakness in mortgage approvals than prices, relative to our forecast.[5]

[2] The total share of new mortgages with LTIs>=4.5 has fallen by 1pp. .
[3] for technical details.
[4] In our model, expectations are defined using RICS data gathered from estate agents to proxy for market expectations. The results are robust to different model specifications and explanatory variables.
[5] For a discussion of the latest Market Intelligence and Supervisory intelligence supporting this hypothesis,

16. This weakness probably reflects a few factors. First, relative to the pre-crisis period, the spread between high-LTV ratio mortgages and low-LTV mortgages is now considerably higher. The increased tiering of mortgage rates by LTV ratios reduces the incentive for borrowers to 'trade-up' by increasing their mortgage debt, since this will increase their LTV ratio and therefore the rate they pay on a given stock of debt. **Chart 11** shows that, while the total number of mortgages was lower in 2013 relative to 2007, a much higher proportion of those were taken out at lower LTV ratios in 2013.

Chart 10: Approvals by type of borrower

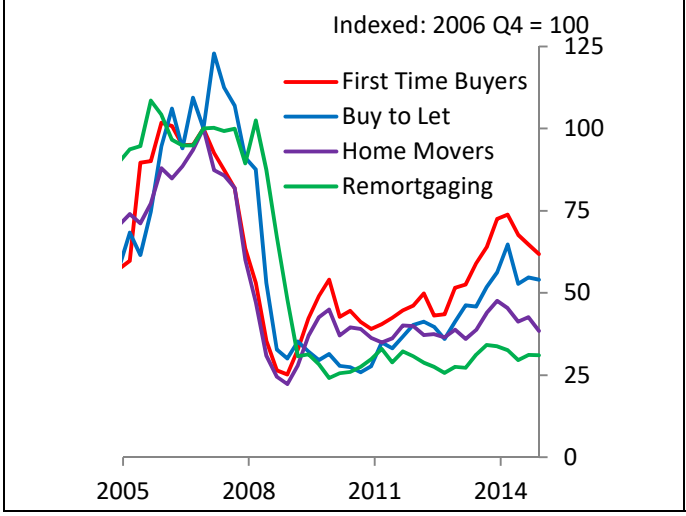
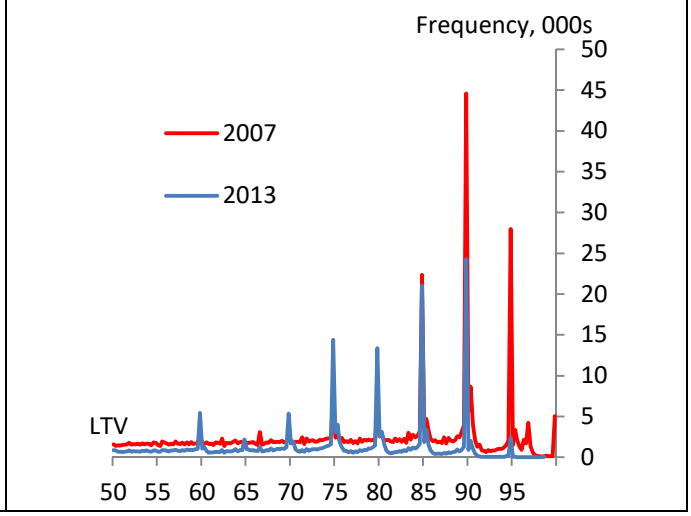


Chart 11: LTV tiering, 2 year fixed rate mortgages



17. A second reason for lower secondary market supply and demand is that there exists a group of borrowers who took out mortgages on favourable terms in the pre-crisis period when spreads were very low. For example, data suggest that 24% of loans paid a rate of less than 2% above Bank Rate in 2014 Q3.[6] In the current market, in which mortgage spreads are higher, these borrowers may be unable to obtain a mortgage on such attractive terms if they wish to trade up the housing ladder. But recent falls in mortgage rates may increase the willingness of these people to move in future.

18. A third reason for the weakness in the secondary market is that some mortgagors may be considered to be 'mortgage prisoners', since they are unable to move from their existing mortgage provider, either because they are in negative equity or because of a lack of product availability due to their risk characteristics, e.g. those that are self-employed, or who have interest-only mortgages. In August 2014, . Mortgage prisoners should not be constrained by the MMR, as they should be helped by 'transitional arrangements' which permit lenders to provide new mortgages to creditworthy borrowers who have existing mortgages even if they do not meet the new MMR affordability requirements. But there have been reports that lenders have so far been reluctant to use those.

Section 3: February 2015 *Inflation Report* forecasts and risks

19. Given the low level of approvals seen in recent months, the evidence of a moderation in demand and the ongoing weakness in home moving, the profile for approvals in the February 2015 *Inflation Report* is considerably weaker in the near term than in May 2014 (**Chart 12**). But, further out, the drag on approvals relative to the May 2014 forecast unwinds as recent and prospective falls in mortgage rates stimulate activity.[7]

20. Relative to May 2014, the house price forecast has also been revised down (**Chart 13**), although to a lesser extent than approvals, reflecting the fact that fewer home movers result in weaker secondary market supply of housing, as well as demand. In the latest forecast, annual house price inflation is assumed to have peaked in 2014 Q2, and falls back to around 4% by 2015 Q4, marginally higher than household income growth.

[6] Some of those mortgages will have been taken out recently, but a large proportion are likely to be people who took out floating rate mortgages in the pre-crisis period.
[7] For the latest secured lending forecast and other Balance Sheet Model projections,

Chart 12: Latest approvals forecast

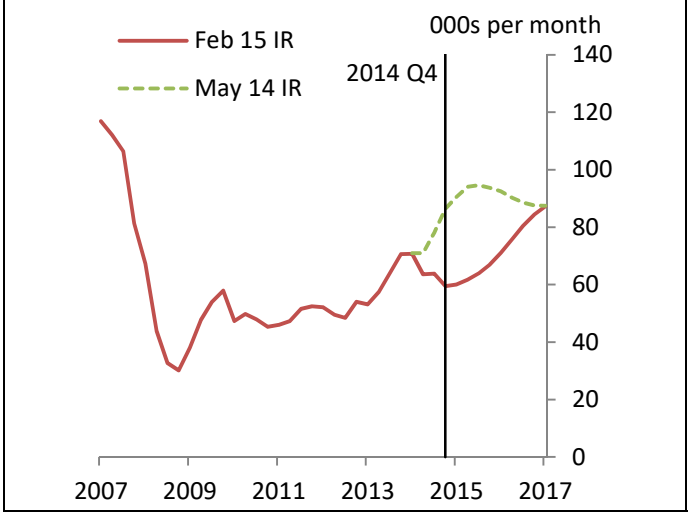
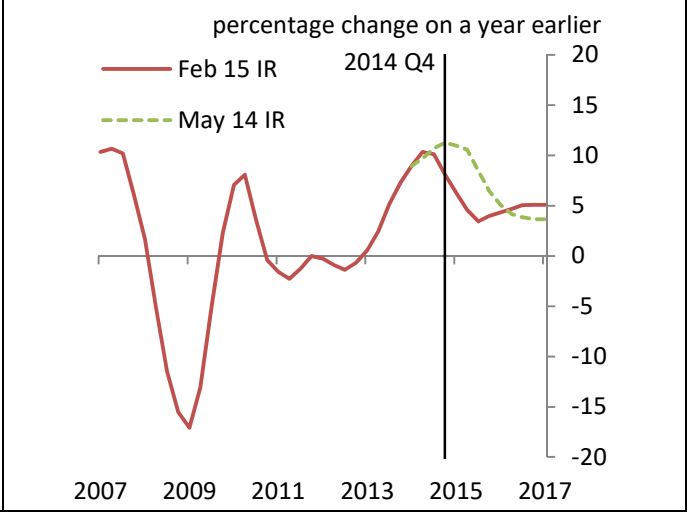


Chart 13: Latest house price forecast



21. There are risks on both sides of the February *IR* housing market forecasts. **Table 2** summarises our view on the risks around the house price forecasts, which are likely to be more relevant for the FPC since they tend to have a big influence on household debt to income.[8]

Table 2: Summary of the risks to our house price forecast in the medium term

Risk	Direction for house prices	Timing
FPC policy affects lender behaviour towards riskier borrowers.	**Down**	**Short term**
Uncertainty surrounding general election, including over the possible introduction of a mansion tax and Brexit/devolution issues.	**Down**	**Short to medium term**
Longer-term rise in housing supply.	**Down**	**Medium to long term**
Fall in the yield curve encourages further 'search for yield' in the buy-to-let market, potentially exacerbated by recent and prospective changes to the pension annuity regime.	**Up**	**Short to medium term**
Fall in the yield curve, income growth and strong house price inflation could interact to cause irrational exuberance in the owner-occupier market. May be especially relevant in areas of the UK outside London and the south east where house price inflation has previously been more muted.	**Up**	**Medium term**
Home owners begin to move as prices continue to rise, increasing secondary market supply as well as demand, and making it easier for 'trapped mortgagors' or home-owners who bought their houses during the house price peak in 2007/08 to move.	**Ambiguous**	**Medium term**

22. The latest data on house prices has shown stronger increases than we had expected; in January the average of the lenders' indices rose by 1.1% and the latest ONS and Land Registry monthly rises for December and January respectively were both around 1% – above our forecast of 0.3%. These have not yet been factored in to the forecast and therefore provide some immediate upside news which will need to be considered alongside the risks outlined below.

Downside risks

FPC policy

23. In the near term, there is a risk that last year's FPC LTI limit will have an impact on our forecast. We incorporated no impact from the announcements on LTIs by lenders that occurred around the time of the *FSR* (those in the top part of **Table 1**); even the upper bound estimates of the direct impact were quite small. The LTI policy came into force in Q4, and that seems to have led some banks to take further actions: since the February *IR*, The direct impact of

[8] Each of the risks discussed is also likely to affect housing transactions, at least in the short term – the likely direction of the short-run risks to transactions is outlined in Appendix 1.

those actions is still likely to be relatively small, although more material than those taken in 2014. Using our loan level projections,[9] and assuming that there is no substitution between lenders for high LTI borrowing and that borrowers above the lenders' limits do not get a mortgage at all, we estimate that around 2% of loans for residential house purchase could be affected by the most recent caps (**Chart 14**). This represents 20% of the LTI >=4.5 market, and 3% of loans extended to FTBs.

24. We think that FPC policies are most likely to act as a constraint only in the near term. mortgage brokers are likely to facilitate substitution between lenders once they have adjusted to the new rules. And banks that have imposed tight caps could ease them as they become more confident in their ability to manage their high LTI flow. However, supervisory intelligence suggests that some of the lenders with the most headroom have little appetite to do so.

Political uncertainty

25. A further near- to medium-term risk stems from the uncertainty surrounding the forthcoming general election, which has been labelled the most uncertain election ever[10] and has featured housing as a key policy debate. One of the major areas of debate surrounds the introduction of a mansion tax, supported by the Labour, Liberal Democrat and Green parties.[11] The effects of this policy would vary across regions – and would be likely to be much larger in London – although there could be knock on effects on market liquidity. Potential election policies concerning the private rental sector – for example rent caps, compulsory tenancy lengths and build to rent policies – may also create uncertainty among buy-to-let investors. Non-housing policies – for example, discussions of the UK leaving the EU and/or options for devolution – could also impact sentiment in the housing market, particularly in London where some buyers are more strongly linked to international and financial markets. These uncertainty effects may dampen investment in the housing market in the near term, but most are likely to dissipate once the results of the election are known – and could even provide boost to the housing market, depending on the result.

Chart 14: Impact of LTI caps on approvals forecast

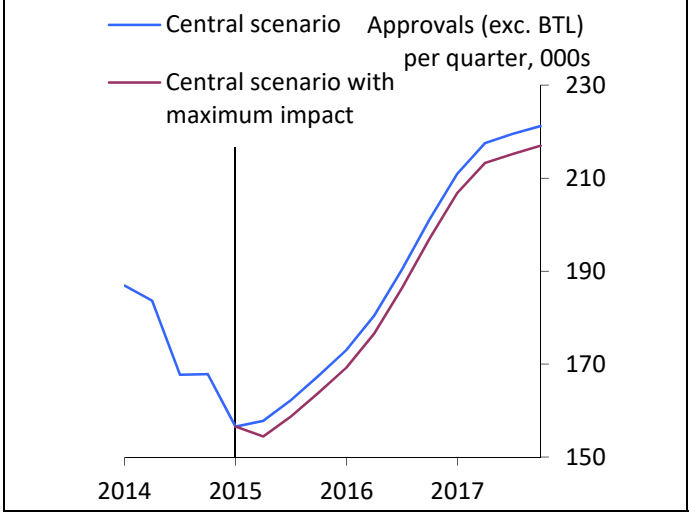
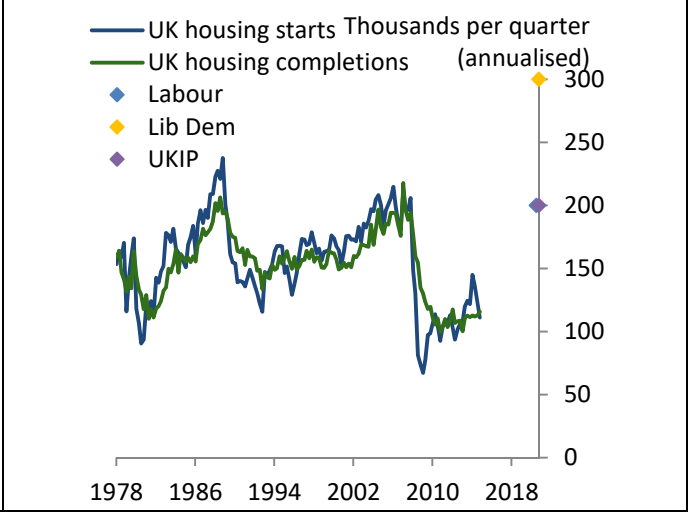


Chart 15: Housing starts and completions



Primary supply of housing

26. Over the medium- to longer-term, a key determinant of house prices is the stock of UK housing. All else equal, an increase in the supply of housing will reduce any upward pressure on house prices, although, because the flow of new builds is so small relative to the outstanding stock, it could take a long time for prices to be affected, unless house price expectations adjust.

[9] See Appendix A of for more information on the loan level projections.
[10] for more information.
[11] See Knight Frank report on the pre-election outlook.

27. Since the crisis, the level of housebuilding (and hence new supply) has been very subdued, and recent data on housing starts have also disappointed (**Chart 15**). In large part, we think that specific market factors, such as materials and skills shortages, have constrained activity, although weak sentiment could also be playing a role. However, in the run-up to the general election, some parties have announced policies that could imply a significant pickup in supply: the diamonds on **Chart 15** show the positions of some of the announced targets. The most extreme policy stance is that of the Liberal Democrat party who would aim to build 300,000 houses per year. Assuming that the demand for housing remains roughly constant, this policy would present significant downside risks to the February 2015 house price forecast, although we only ascribe a very small probability to this type of outcome coming to pass quickly, in part given capacity constraints in the housebuilding industry.

Upside risks to the house price forecast

28. Since May 2014, mortgage rates have fallen sharply and the yield curve has fallen over the forecast. That has resulted in a much lower projection for mortgage rates in the February *IR* relative to May 2014 (**Chart 16**).[12] The direct impact of a reduction in the cost of mortgage borrowing increasing the level of house prices via a rise in demand for house purchase is already incorporated in the current forecast.[13] However, the fall in risk-free rates may also interact with other fundamentals in order to drive further increases in house prices.

Chart 16: Change in the average forecasted mortgage rate relative to May 2014

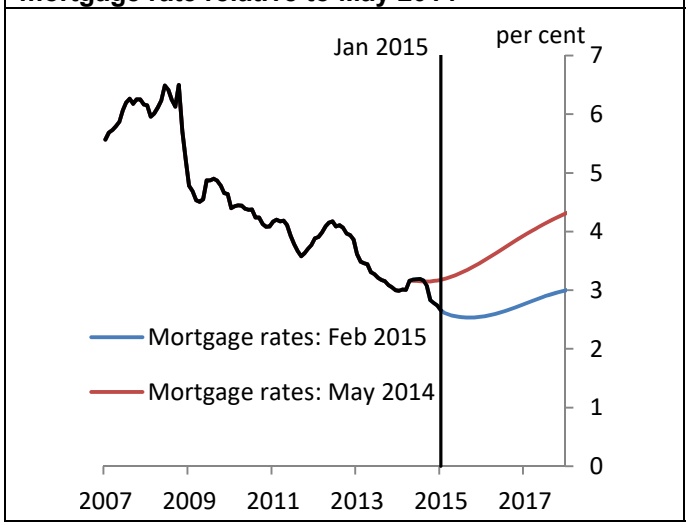
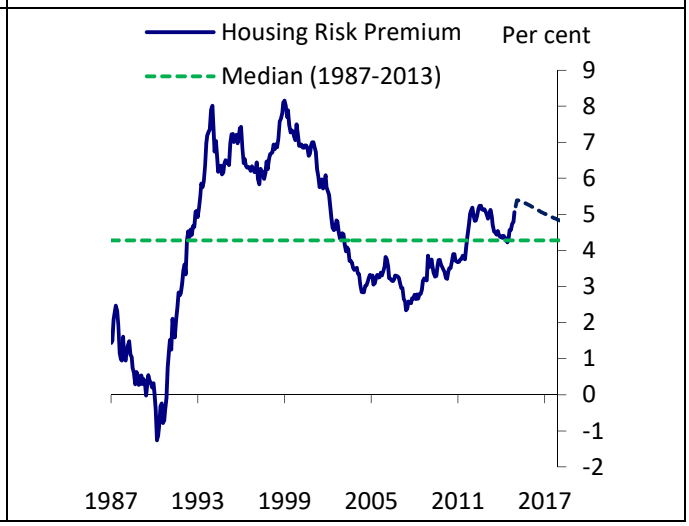


Chart 17: DDM-implied housing risk premium



29. First, the current low interest rate environment may encourage a 'search for yield' in the buy-to-let market in the near term. For buy-to-let investors, the key factor is the excess risk premium which they expect to earn from investing in housing instead of other assets. **Chart 17** shows the excess risk premium buy-to-let investors can expect to earn above the return on gilts, as implied by our Dividend Discount Model, using surveys of rental price expectations. The housing risk premium is higher than its long-run average over the forecast, suggesting that house prices may be a little lower than their sustainable level for investors. This may partly reflect high demand for rental accommodation – especially in London where the cost of home ownership is relatively high. If the housing risk premium returned to its long-run average – consistent with more buy-to-let investors entering the market because of the level of the risk premium, or following the forthcoming pension changes – we would project that to add around 10% to the forecasted level of house prices by end-2017.[14]

30. Second, there is a risk that, in the medium term, very low mortgage interest rates combine with real income growth and house price inflation to cause 'irrational exuberance' amongst home-buyers. That could lead

[12] The cost of secured borrowing is estimated as the average of the mortgage rates contained in the Credit Spread Adjustment.
[13] We estimate that lower mortgage rates imply a rise in the level of real house prices of around 7% relative to the May *IR* by 2017.
[14] From April 2015, compulsory annuities will be abolished, meaning that those entering retirement will be able to withdraw their pension pot in cash. It is possible that some pensioners will choose to invest this cash in the buy-to-let market. But analysis by the Bank and CML suggests that the impact on the housing market is unlikely to be significant since most DC pension pots are too small to make a significant property investment, and BtL mortgages might not be accessible for many pensioners due to minimum income requirements and age limits for borrowers. However, we do not know the impact of the marginal investor on prices, and if proposals to let people cash in existing annuities went ahead, the impact could be more significant.

to higher demand for housing and higher prices. This is most likely to occur if households form expectations adaptively, so that they expect stronger house price and income growth to persist.

31. **Chart 18** shows that house price expectations are currently higher in regions where the level of house prices is lower (in particular Scotland and the North West where prices fell more during the crisis). If these regions were to see a sharp pick-up in earnings growth, or a fall in unemployment, this could combine with high house price expectations to create further upward momentum in the housing market. Such upward momentum should be possible in these areas given FPC policies, since LTI ratios are likely to be relatively low, although LTV constraints could bind more quickly. It is possible, however, that these upside risks from irrational exuberance could be partially offset by affordability constraints elsewhere, particularly in areas which have seen strong house price growth relative to income over the past year.

Chart 18: RICS price balances by region

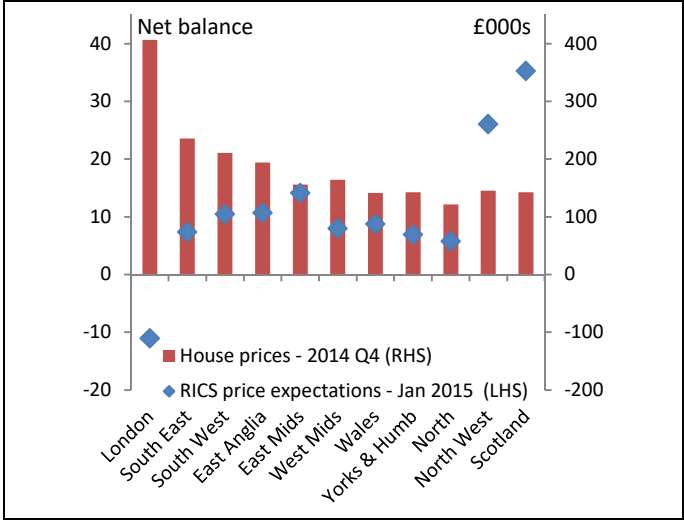
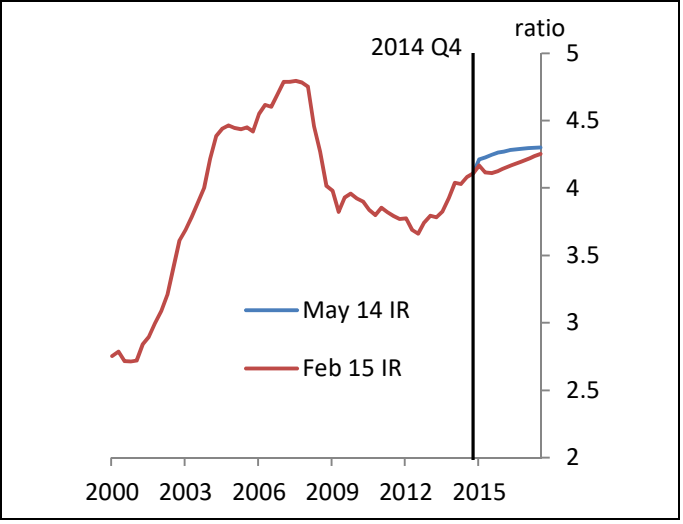


Chart 19: House prices to income



Ambiguous risks

32. Section 2 discussed the possibility that the weakness in transactions partly reflects home owners not moving, either because they are unable or unwilling. These borrowers may be contributing to a higher level of house prices since they are effectively constraining the supply of houses for sale. Over the forecast, some of the factors constraining mortgagors from moving may dissipate – for example, if mortgage rates continue to fall, or if house prices increase strongly over the forecast, so that households receive a higher price on the sale of their property and should be able to remortgage at a lower rate. But the effect of a rise in home moving on house prices is ambiguous, since it depends on the extent to which movers also contribute to higher demand in the housing market. If the households creating the secondary supply are last-time sellers, the impact on house prices is likely to be negative, but if they seek to trade up, the higher demand may cancel out the impact of higher supply, leaving prices broadly unchanged.

Balance of risks

33. Whilst there are risks on both sides of the February *IR* house price forecast, our view is that the upside risks are somewhat more likely to outweigh the risks to the downside in the medium term. In the near term, the downside risks associated with lender behaviour following the FPC recommendations, and the general election are perhaps more likely to come to pass. Our assessment, however, is that they are generally likely to be temporary, and any more persistent downward effects – for example, from an increase in housing supply – would be slow moving. In contrast, the projected path for mortgage rates is low, and when combined with income growth, could generate further upwards pressure on house prices. Given that the current forecast implies a lower house price to income ratio than in May 2014 (**Chart 19**), any upside risk is perhaps less concerning. And, even if house prices do start to rise substantially faster than forecast, it is likely that LTI ratios will also rise. The current level of LTI ratios therefore matters, and, for regions with low leverage now, prices could rise significantly before borrowers reach ratios above 4.5. In cases where LTI ratios are already elevated, the FPC's policy actions could constrain lending, holding back any significant further price inflation.

Appendix 1: The relationship between house prices and transactions over the forecast

The factors discussed in this note – if they occur- will be likely to affect both house prices and transactions over the forecast horizon. This box discusses a simplified framework, where the overall stock of housing is fixed, for thinking about how the various shocks may affect both house prices and transactions.

Diagram 1: change in the effective supply of housing

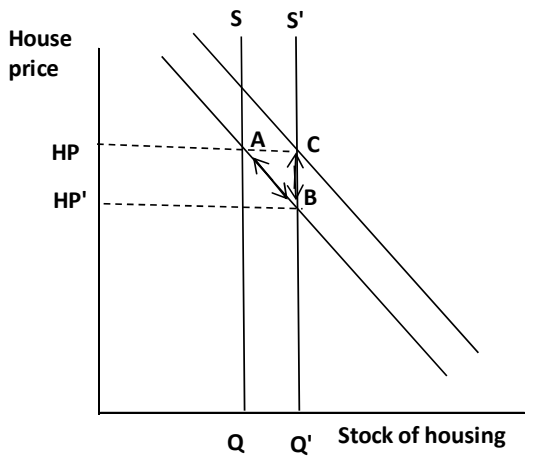
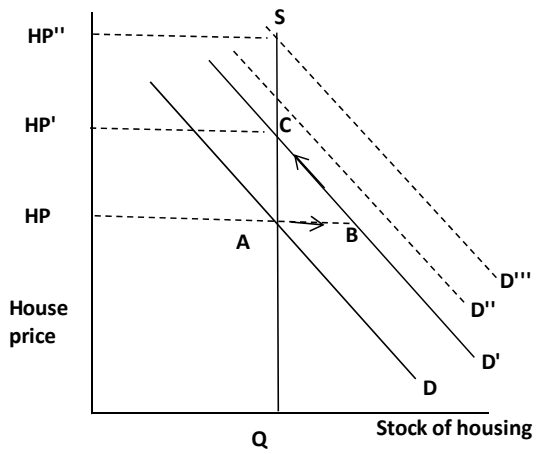


Diagram 2: change in the demand for housing



Arrows: → indicate transactions.

Risk	Direction on transactions	Direction on house prices
Fall in the yield curve encourages 'search for yield' in the Buy to Let market.	**Up (short-term)** – movement from A to B in Diagram 2.	**Up** – movement from HP to HP' in Diagram 2.
The fall in the yield curve, strong house price inflation and higher income growth could interact, causing irrational exuberance in the home-buyer market.	**Continuous upwards movements** – following the outwards shifts in the demand curves in Diagram 2.	**Continuous upwards movements –** from HP to HP'' in Diagram 2.
Uncertainty surrounding general election, including over the possible introduction of a mansion tax.	**Down (short-term)** – movement from C to A in Diagram 2.	**Down** – movement from HP' to HP in Diagram 2.
Longer-term rise in housing supply.	**Up (short-term)** – movement from A to C in Diagram 1.	**Down** - movement from HP to HP' in Diagram 1.
Home owners begin to move as prices continue to rise, increasing secondary market supply as well as demand, and making it easier for 'trapped mortgagors' or home-owners who bought their houses during the house price peak in 2007/08 to move.	**Up** – movement from A to C in Diagram 1.	**Ambiguous** – depends on size of shifts and slopes of the demand and supply curves in Diagram 1 – the Diagram implies that house prices remain at HP.