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News release

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Momentum in the housing market: affordability, indebtedness and risks - speech by Sir Jon Cunliffe

In a speech on Thursday, Sir Jon Cunliffe considers recent developments in the UK housing market.

Speaking to the Worshipful Company of International Bankers, he notes that UK house prices grew by 10% in the year to March and have returned to the levels they reached in late 2006. Growth has not been limited to London – house prices rose by more than 5% in 10 out of 12 UK regions across that year.

He attributes this momentum in the housing market to several factors: a pick-up in confidence and more readily available mortgage credit including through the government's help to buy scheme. Together these factors may have unleashed pent-up demand.

The unusually low level of housing market transactions seen in the aftermath of the crisis means that transactions were, cumulatively, over 3 million lower, between 2008 and 2012, than their long term average. Given that many house purchases are strongly linked to life cycle changes, many of these lost transactions may have only been delayed until credit conditions and confidence about the future improved. It is not at all implausible that this pent up demand could significantly add to pressure on the market for the next few years.

Historically, supply has not kept pace with demand for housing in the UK, with the effect that when demand grows strongly, house prices can keep rising quickly for a long time. "This is a movie that has been seen more than once in the UK," Jon notes.

Jon notes that, despite suggestions of a pause in some of the activity data, expectations for further rapid rises in prices appear to be setting in. He notes, "there is good reason to believe that a mutually reinforcing combination of strong demand, weak supply and expectations of a rising market could lead to a period of sustained and very powerful pressure on house prices in the UK."

"It would be dangerous to ignore the momentum that has built up in the UK housing market since the spring of last year. The extent to which that will jeopardise financial stability depends on whether that pressure actually results in more transactions at higher prices, whether that in turn leads to an increase in household indebtedness and where that debt is concentrated."

Jon says that the Bank and the FPC have to decide whether to address the momentum in the housing market and the rapid rates of growth in prices and transactions, which, in the past, have tended to lead to rapid growth in mortgage debt.

He points out that it is particularly important to ensure now that current low levels of borrowing costs do not mask the likely cost of mortgages and create more headroom for prices to rise. In this regard, the reforms following the FSA's Mortgage Market Review, which came into force last week, should help to ensure that affordability constraints do act against pressures on house prices. But they have not yet been tested.

One possibility is that the housing market could be in for a soft landing, with house price growth slowing as affordability constraints bite. A second is a major overshoot in prices and build-up in debt followed by a sharp correction with negative equity and an overhang of debt for many households. Jon observes that there have been more precedents in the UK for periods of a rapidly growing housing market to end in this way.

Financial institutions are better placed than they were before the crisis, with capital requirements against UK residential mortgages broadly trebling. The stress test of major UK banks this year, which will feature a housing market shock, will also help the FPC assess banks' resilience.

Jon notes that the Bank and Treasury have already taken some action in response to the growing momentum in the housing market by withdrawing the cheap funding and favourable capital treatment of mortgage lending from the Funding for Lending Scheme.

"Whether and how to act further if, following the pause of the last couple of months, momentum continues to build, will be the most challenging judgement the FPC will have to take in the coming months."

The FPC's response will depend on the nature of the risks to stability: its powers of direction on bank capital will bear most directly on lenders ability to weather a downturn and a housing bust once it has emerged; while its powers to make recommendations to the FCA and PRA could bear more directly on underwriting standards and affordability constraints like debt to income, loan to income and loan to value.

Jon concludes that "the growing momentum in the housing market is now, in my view, the brightest light on that dashboard. It has not yet been accompanied by a substantial increase in aggregate mortgage debt, though gross mortgage lending is growing and there are signs that debts are becoming more concentrated. This could fade as affordability and lender constraints act increasingly as a brake on momentum. But other outcomes are very possible and the Financial Policy Committee will need be both vigilant and ready to act."