4most Market Update

Keeping you up-to-date with our latest expert insights

October 2021

A cost of living crisis is on the way for many people

October will likely prove a key point in terms of the UK's path to recovery. Much of the support that kept the economy afloat during the pandemic will be removed. This comes at a time when several sectors are still not trading normally and individuals are facing hikes in cost of living.

Most of the restrictions on corporate winding-up orders were lifted at the end of September

Pursuit of smaller debts are exempt and commercial rents will still require proof that Covid was the not the underlying issue. Compulsory dissolutions are running well ahead of 2018 and 2019 levels, but were suppressed last year.

Firms will no longer have the support of the Coronavirus Job Support Scheme from October.

An estimated 1 million workers were still furloughed as the scheme was wound down. Despite record vacancies the unemployment rate is likely to rise towards 5% from the current 4.4%.

Households are seeing a reduction in Universal Credit by £20 per week

Introduced at the start of the crisis and now being withdrawn, this will be one of the biggest worries for many households, especially as this represents a c10% fall in income for some families

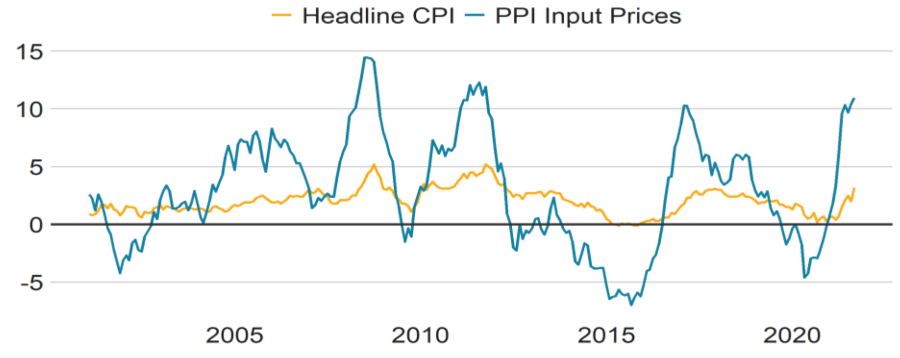
Soaring energy prices and inflation are putting pressure on living costs which is yet to peak

The planned increase in the energy price cap was already set to add £139 a year to those affected and wholesale prices are already much higher which may lead to a difficult winter, especially for those on low incomes.

Inflation is already above 3% and there is still pressure on living costs in the pipeline. A peak well above 4% is likely.

Consumer price inflation increased to 3.2% in August

% change on year earlier



Source: ONS

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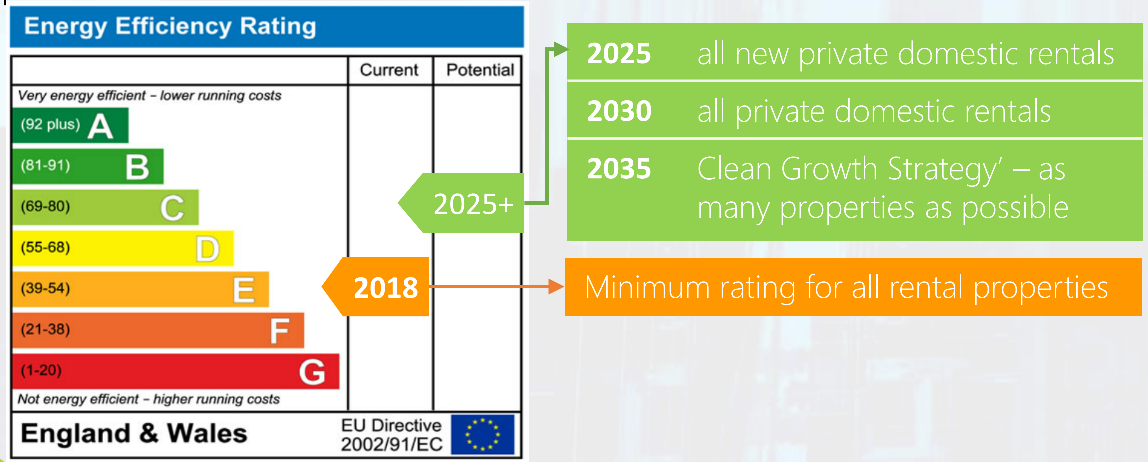
Energy Prices

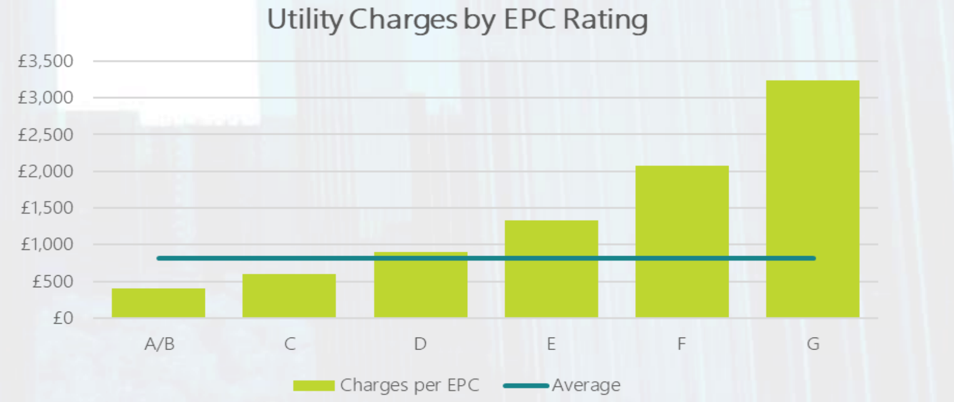
With the current energy price crisis and as we approach winter, focus has come onto the residential market, and in particular, the energy efficiency of properties which are graded via an Energy Performance Certificate (EPC). An EPC is required whenever a property is built, sold, or rented and details the energy costs of the property and provides recommendations on how energy efficiency can be improved.

The current UK roadmap towards becoming carbon net neutral by 2050 with a target to reach minimum rating of 'C' on as many properties as possible:



In times of stress, those in lower efficient properties typically have larger bills and these outgoings are likely to impact a customer's affordability and ongoing ability to pay.

Increasing energy prices are going to have a much larger impact on those who are residing in less energy efficient properties, and regardless of whether the property is tenanted or mortgaged, there are likely to be customers who face financial distress due to the increased energy costs in both secured and unsecured portfolios.



Source: EPC records from 2019 onwards including water, heating and lighting

Hybrid PD

Post the Global Financial Crisis, the BoE's FPC required the PRA to limit pro-cyclicality of RWAs and hence PDs. At the recent Credit Scoring and Credit Control Conference, held by the University of Edinburgh Business School, a keynote session from the PRA highlighted common themes in feedback to IRB firms implementing Hybrid PD approach for mortgages, including:

► Limiting use of bureau scores (but not necessarily characteristics) in IRB models due to lack of transparency; And

► The evaluation of cyclicality of final rating system to ensure undue cyclicality is avoided and hence limit RWA pro-cyclicality

The PRA raised concerns that the final rating systems had exaggerated cyclicality due to decisions made throughout the development process, in particular the calibration of the final risk pools to the TTC and hybrid PD. Therefore, firms have been asked to assess cyclicality as a key feature of the rating system development and not as an output.

The aim is to ensure that cyclicality is kept at 'reasonable' levels with capital requirements not being overly concentrated in Pillar 2.

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