Credit Risk Market Update
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House Price – Growth or Fall?

With the economic outlook and the cost-of-living crisis seemingly worsening month on month, house prices have continued to remain resilient throughout 2022, in fact the 4most in-house HPI recorded a c.8.6% increase across England and Wales year-on-year in Q2 2022.

Survey evidence showed less (housing) buyer interest. However the rise in housing transactions in July was a surprise. In addition, declining mortgage approvals in June still suggest falling incomes. In real terms, stretched affordability and rising interest rates will dampen the market in the coming months.

The overarching question is will house prices fall over the next few months and into 2023? Rightmove reported a headline-grabbing fall in asking prices in August but this is a seasonal trend and the values are not seasonally adjusted. While the outlook does look gloomy, and a fall in house prices is widely expected, in the absence of forced sellers it could be that the slowdown is more visible in lower numbers of transactions rather than a collapse in prices.

Can UK Banks Weather A Global Recession?

At face value UK banks can weather a global recession.

Across the major banks the CET1 capital ratio was 14.5% in Q1 2022, down from 16.3% at end-2021 but still much higher than before the global financial crisis.

But the coming recession looks very different from those that were used to calibrate the 'right' amount of capital.

Inflation	Inflation is expected to peak at 13% in October and remain around this level into the new year.
Real incomes	The drop in real incomes is unprecedented. Real incomes have been falling since Q1 2021 and the total peak-to-trough fall could be as much as 9% given the latest estimates of the increase in the energy price cap.

Employment

In the 1990s recession, the numbers in employment contracted by 6%, leading to huge numbers losing their homes. That scale of job losses feels unlikely this time.

Cost of Living

But the cost-of-living crisis affects everyone, not just those losing their jobs. With the possibility of energy bills exceeding £500 per month in January, the big concern is that a large proportion of households will not have enough cash to pay those bills and eat properly, let alone meet their credit commitments.

Given the shock is unprecedented, it is harder to calibrate the likely impact on the banks, although they did conduct affordability assessments when customers started to borrow. In early July, the Financial Policy Committee published analysis that showed the proportion of households with dangerous debt service ratios for both unsecured and secured lending would change little between the start and end of this year, mainly because of the fiscal package announced by the government in May.

In early August just under a third of adults were already finding it difficult or very difficult to pay their rent or mortgages, although there were no signs of a rise in those actually behind on payments. A similar conclusion could be taken from the number of enquiries for debt advice at the Citizens Advice Bureau in July.

Yet, this all feels like a glimpse in the rear-view mirror. The recent soaring price of gas futures means the Ofgem cap for October (£3,549) and projections for January are much higher than anticipated a few weeks ago. For many households and businesses, the crisis now looks existential.

Before this latest shock, the Bank of England's view was that the coming recession would be comparable to that seen in the 1990s, assuming no further government policy action. The big systematic banks are well capitalised to weather this sort of shock, although the fall in real incomes adds an extra unwelcome twist that tempers this conclusion.

But of course, there will be further government action, and it will be on a huge scale. On a human scale, it would be disastrous if vast numbers of people and firms went bust because of Russia's war in Ukraine. It is likely that government borrowing will soar, creating a problem for another day. The stress on the private sector cannot be entirely eliminated – energy may well be rationed if its use is not reduced. But governments can spread the cost of tackling problems over a long time period. And that is what is about to happen.

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