Resolution Foundation
Macroeconomic Policy Unit

The Macroeconomic Policy Outlook

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The Bank of England has raised interest rates 12 times in a row, and UK families are dealing with the largest rise in more than 30 years. With all signs suggesting that the Bank is at least nearing the end of this rate cycle, this edition of our Macroeconomic Policy Outlook focuses on the mortgage market and examines how much impact rate rises have already had – and how much of a squeeze is still to come. Here, the rising popularity of fixed-rate mortgages means that changes in rates take much longer to feed through to higher mortgage repayments: while fixed rates made up less than half of mortgage lending prior to the financial crisis, they accounted for more than £9 in every £10 lent in 2022.

Despite interest rates nearing their peak, only half of the households that will eventually be impacted have been impacted so far and only a third of the mortgage pain they will collectively bear has been felt. We estimate that – in aggregate – annual mortgage bills have increased by £4.2 billion since the Bank started raising rates, with around £8 billion more to come in the next few years, and over £5 billion of that being felt in the next year. When that mortgage pain does arrive as households remortgage it will be significant, with annual mortgage bills rising by £2,300 on average for the 1.6 million households with expiring fixed-rate deals in the coming year.

But that impact won't be felt equally. While around three-quarters of the aggregate increase in repayments will fall on households in the top two income quintiles, households with bigger mortgages relative to their income will be disproportionately affected by higher rates. That means poorer and younger households will be hit the hardest on average. Looking ahead to Q4 2026, when the adjustment to higher rates will be mostly complete, repayments are to set to have increased by more than 4 per cent of income for mortgagors in the second income quintile, compared to just 2 per cent for mortgagors in the top income quintile. And repayments are projected to increase by 3.4 per cent of income for 18-34-year-old mortgagors, nearly double the 1.8 per cent figure for mortgagors aged 55 and above. So while rate rises look likely to be coming to a halt shortly, much of the pain they bring for some UK households is very much still to come.

Families are being hit with the largest rate rises in more than 30 years

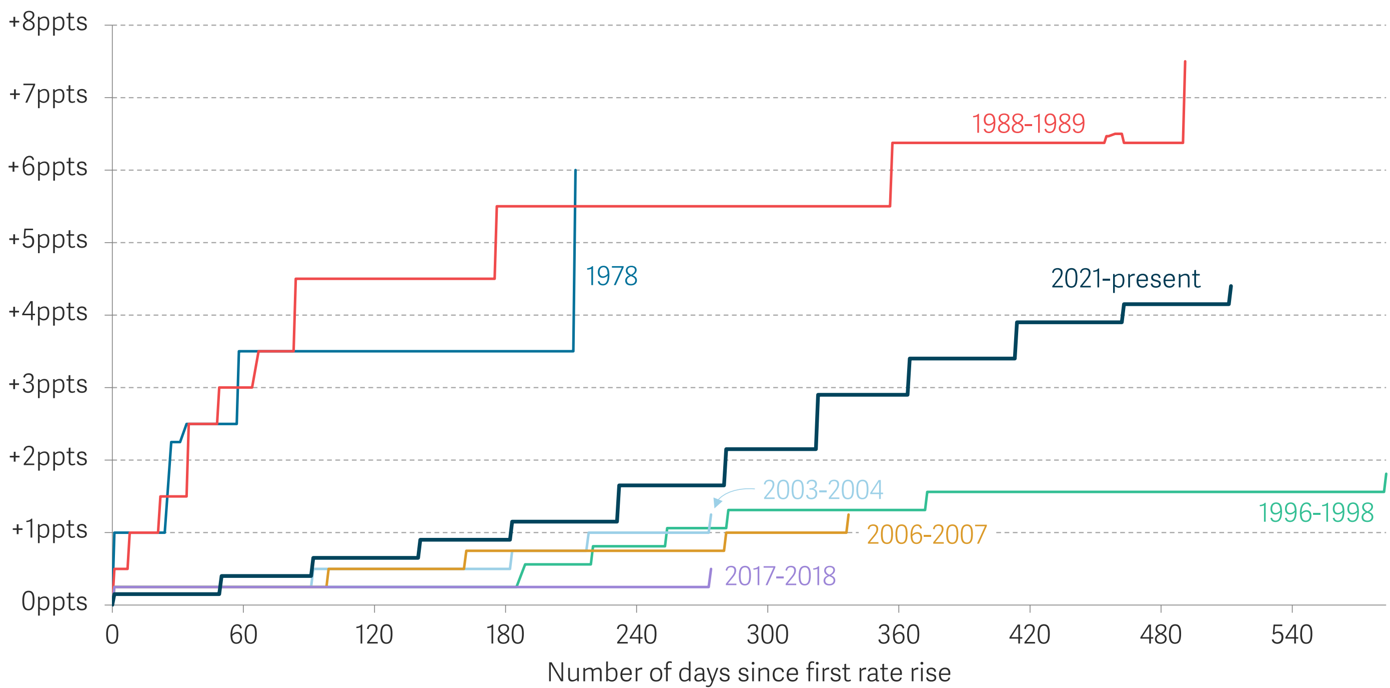
This week, the Bank of England continued its fight against inflation with yet another rate rise. Double-digit inflation for the first time since 1982 has prompted the Bank's Monetary Policy Committee (MPC) to raise rates at 12 successive meetings. The latest rise – of 0.25 percentage points – has left Bank Rate at 4.5 per cent, a far cry from its 0.1 per cent level less than 18 months ago. Not since the volatile interest rate environment of the late 1980s have UK families faced such a large rise in rates (Figure 1).

1 The author would like to thank James Smith and Torsten Bell for helpful comments and suggestions, and Rhys Humphries at the ONS for advice on using mortgage data.

But is the Bank raising rates by too much, as some members of the MPC who voted against the latest rate rise believe? A key issue in this context is how much of the effect of tightening has come through, and how much is still to come. In this edition of our Macroeconomic Policy Outlook we focus on a crucial aspect of this – the impact on mortgages – looking at the size and distribution of the impact so far.

FIGURE 1: **The Bank of England has increased rates by over four percentage points in less than 18 months, which hasn't been seen since the 1980s**

Percentage point change in Bank Rate during tightening cycles of more than six months since 1975

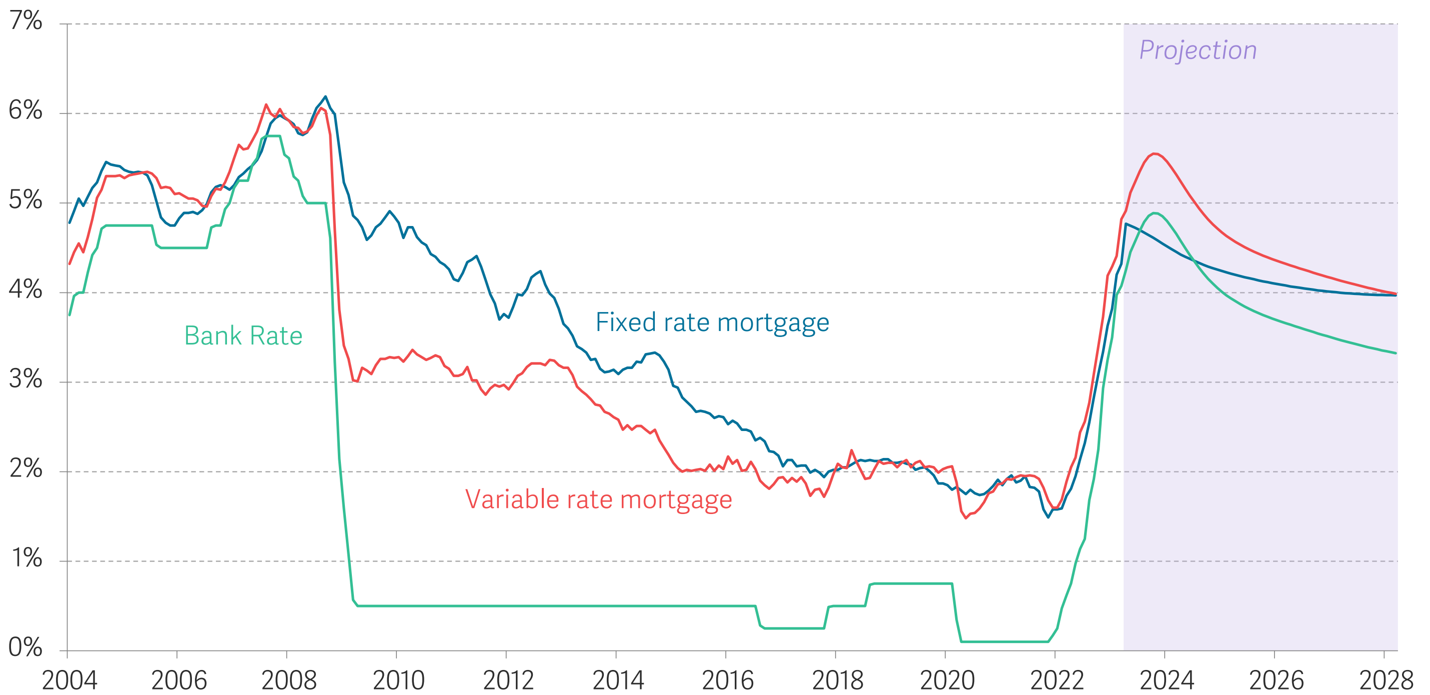


SOURCE: RF analysis of Bank of England, Bankstats.

Financial markets expect the Bank to stop raising rates soon. Indeed, market expectations suggests that Bank Rate will peak at nearly 5 per cent in November, at which point the Bank of England is expected to begin cutting rates. But interest rates are expected to move much more slowly on the way down than on the way up – with Bank Rate expected to fall by just 1.25 percentage points in the three years after its peak to reach around 3.5 per cent towards the end of 2026. This is projected to leave the average rate on new mortgages at just over 4 per cent, a level not seen in more than a decade.

FIGURE 2: **Interest rates are expected to peak soon, but mortgage rates are set to remain at levels not seen for more than a decade**

Monthly average interest rate on new mortgages and Bank Rate, outturns and projections: UK



NOTES: Based on market interest rates as of end-April 2023.
SOURCE: RF analysis of Bank of England, Bankstats and Yield curve.

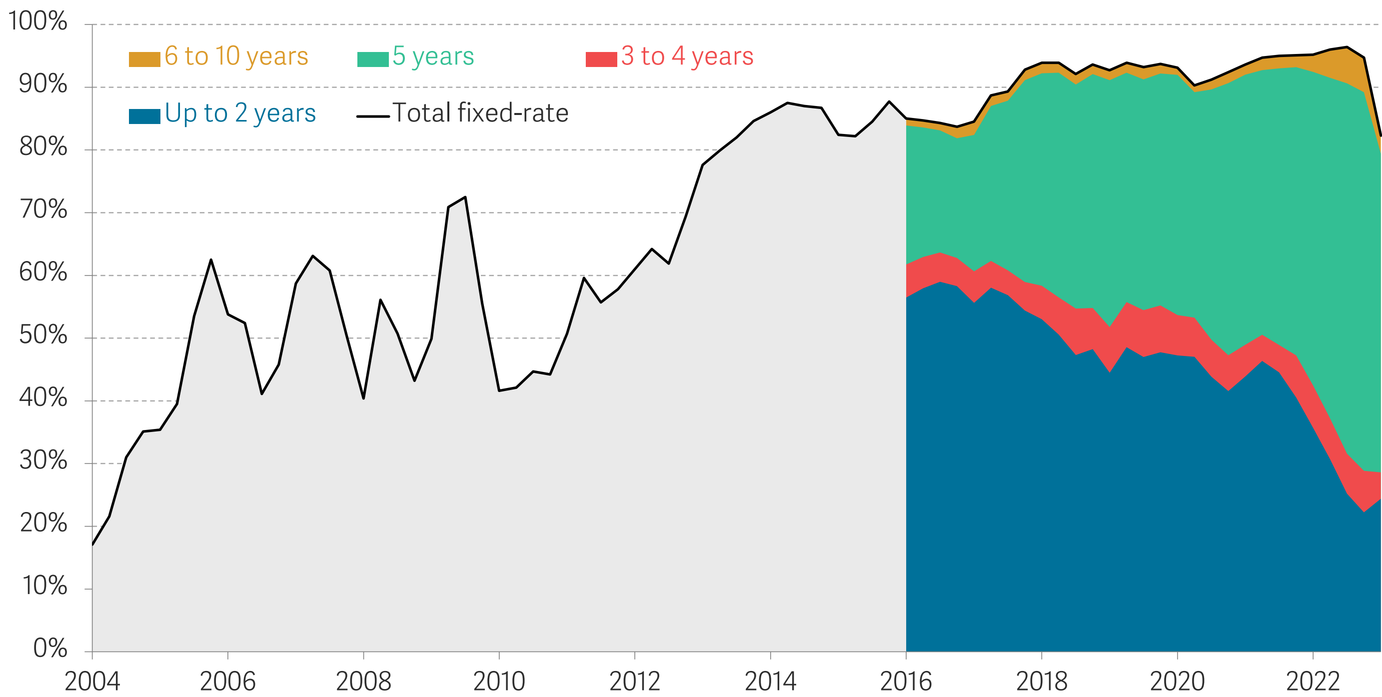
Mortgage repayments will adjust slowly to higher rates given the rise of fixed-rate deals

The impact of Bank Rate on mortgage rates is one of the main ways that households are affected by monetary policy decisions. Total mortgage debt in the UK stood at two-thirds of GDP (66 per cent) in 2022, up from under half of GDP (45 per cent) throughout the 1990s. But, over the past two decades, the increased popularity of fixed-rate mortgage deals has delayed the pass through of higher rates to the mortgage rates paid by households. For lots of families, the impact of a rate rise will only be felt at the point their fixed-rate deal expires.

Fixed-rate mortgages surged in popularity after the financial crisis. More than £9 out of every £10 lent in 2022 was at a fixed rate (96 per cent), compared to around £4 in every £10 (41 per cent) from 2004 to 2006 (Figure 3). Alongside a higher share of fixed-rate mortgages, the average length of fix has increased too. Between 2016 and 2022, the five-year fix overtook the two-year fix as the most popular mortgage product. As more and increasingly longer fixes have entered the mortgage stock, this has increased the extent to which families are shielded from a rise in interest rates in the short term.

FIGURE 3: **Fixed-rate mortgages surged in popularity after the financial crisis, and made up more than £9 in every £10 of mortgage lending last year**

Proportion of new mortgage lending at a fixed rate, by length of initial fix: UK, Q1 2004-Q1 2023



NOTES: Data is for loans secured on dwellings to households before 2016, and to individuals and individual trusts from 2016 onwards. A detailed breakdown of lending by initial period of fix is only available from 2016 onwards. In some recent quarters, less than 0.1 per cent of lending had an initial fix of more than 10 years, but this is not visible.
SOURCE: RF analysis of Bank of England, Bankstats.

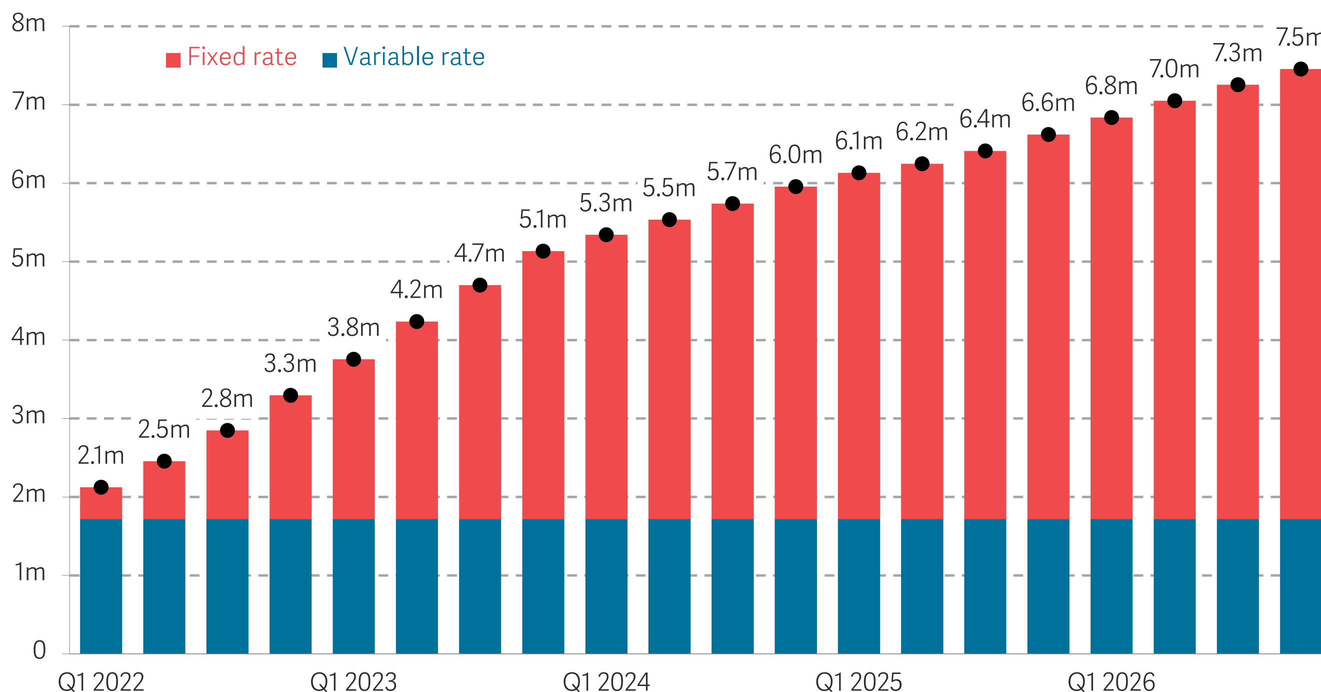
Around half of families have yet to see their mortgage rate change since the Bank started raising rates

We estimate that – as of Q1 2023 – 3.8 million households will have experienced a change in their mortgage rate since the Bank of England started raising rates in December 2021 (Figure 4). These households either had a variable rate mortgage in Q4 2021, or were part of the 35 per cent of fixed-rate mortgagors whose deal has expired since then, and together these households account for around half of all households with a mortgage. The remaining half (3.7 million households) have not seen their rate change as of Q1 2023.

Estimating the impact on households over time is an uncertain exercise, due to a lack of granular publicly-available data on when mortgages are due to expire. But we use the ONS's Wealth and Assets Survey and combine it with data from other sources, including Bank of England data, to estimate the flow of households onto new mortgage deals, and financial market data to estimate the impact of higher interest rates on repayments. For more on this approach see the explanatory notes in our previous work on mortgage rates.

FIGURE 4: **Around half of households with a mortgage have yet to see their rate change since the Bank of England started raising rates**

Estimated cumulative number of households facing a change in mortgage rate since Q1 Q4 2021: UK



NOTES: Only includes one owner-occupier mortgage per household, additional mortgages (where applicable) are excluded. Some households with a variable rate in Q4 2021 may have switched to a fixed-rate deal, and vice versa, but this is not captured here.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; Bank of England, Bankstats.

That means there's still a £5 billion hit to household incomes to come in the next year

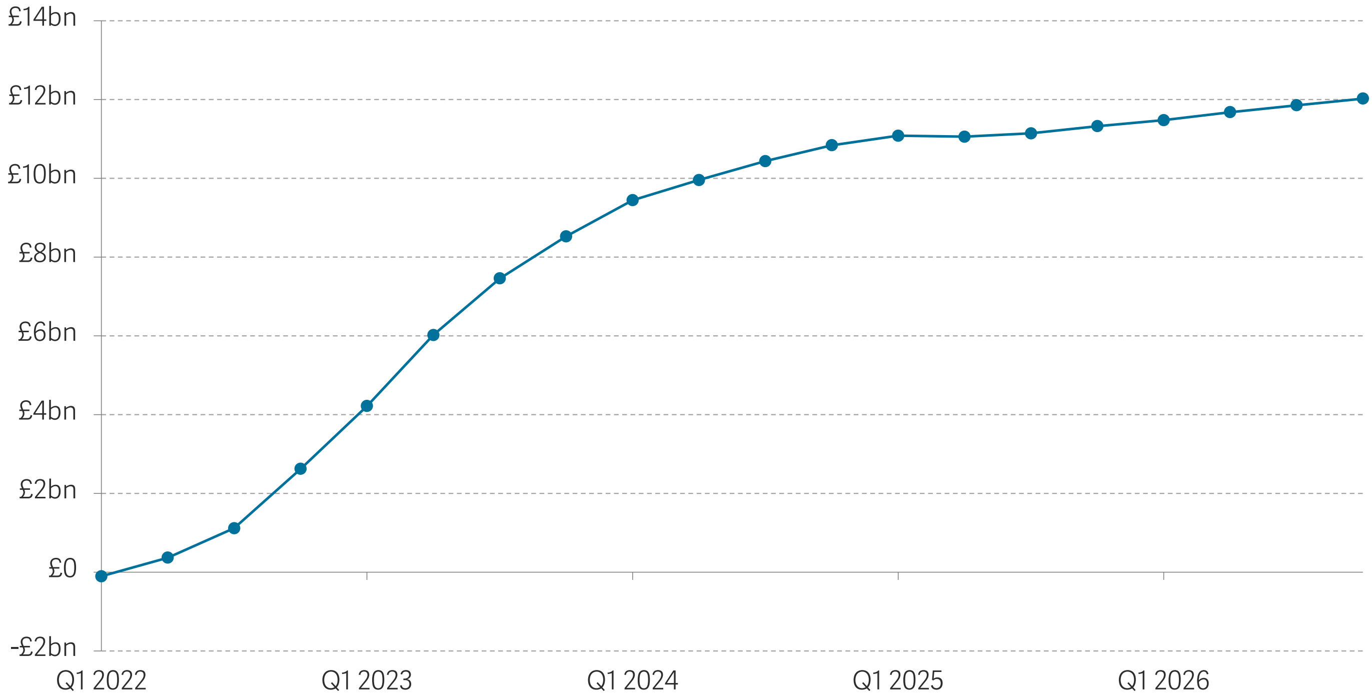
For UK households, the total burden of mortgage repayments has increased significantly already.[2] And repayments are set to increase further as more and more households roll off their fixed-rate deals over the coming years. We estimate the magnitude of the increase by changing the rate on variable-rate mortgages and expiring fixed-rate mortgages in line with the rate projections shown in Figure 2. Between Q4 2021 and Q1 2023, we estimate that aggregate annual mortgage repayments have increased by £4.2 billion for UK households, as shown in Figure 5. This equates to an average increase of £1,100 for the 3.8 million households who have seen their mortgage rates change since Q4 2021.

But there is still a lot more pain to come. Many households have yet to see their mortgage rate change, and some were fortunate enough to re-fix in the first half of 2022 when mortgage rates were rising, but still relatively low. As a result, families have only experienced about one third of the £12 billion increase in total annual repayments that we expect to see between Q4 2021 and Q4 2026. The next year is set to bring a sharp increase in repayments. From Q1 2023 to Q1 2024, we estimate that aggregate repayments will increase by a further £5.3 billion. About 1.6 million households will see their fixed-rate deal expire over this period, and are set to face an average increase in their annual mortgage bill of around £2,300 if they re-fix. By Q1 2024, aggregate annual repayments are projected to be £9.4 billion higher than in Q4 2021, which is about four-fifths of the total projected increase up to Q4 2026.

2 Here we look at total mortgage repayments (i.e. interest cost plus capital repayment) rather than just the interest cost component, which is sometimes used to measure mortgagors' housing costs. Total repayments are the cash amount that households spend, and are therefore most relevant for household consumption. When interest rates rise, the repayment schedule of a mortgage shifts in such a way that decreases the proportion of capital repayment in the short term. Therefore, the change in total repayments is smaller than the change in interest costs after an increase in interest rates.

FIGURE 5: **Aggregate mortgage repayments have increased by more than £4 billion since the Bank started raising rates, but there is still a further £8 billion of adjustment to come**

Estimated increase in aggregate annual owner-occupier mortgage repayments relative to Q4 2021: UK



NOTES: Only includes one owner-occupier mortgage per household, additional mortgages (where applicable) are excluded. Some households with a variable rate in Q4 2021 may have switched to a fixed-rate deal, and vice versa, but this is not captured here. Repayments include interest costs and capital repayments, and are calculated assuming that all households have a repayment mortgage.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; Bank of England, Bankstats and Yield curve.

Poorer and younger mortgagors will experience the biggest squeeze from higher interest rates

Sitting behind these aggregate figures is a vast range of experiences for individual households. A small minority of households took out long-term fixed-rate deals in the years before the current tightening cycle. Having one of these deals, where the initial rate is typically fixed for 10 years, could allow some households to sail through this entire rate cycle unscathed. But for the vast majority of households, who didn't lock in low rates for so long, the biggest factor influencing the hit they face is the size of their mortgage.

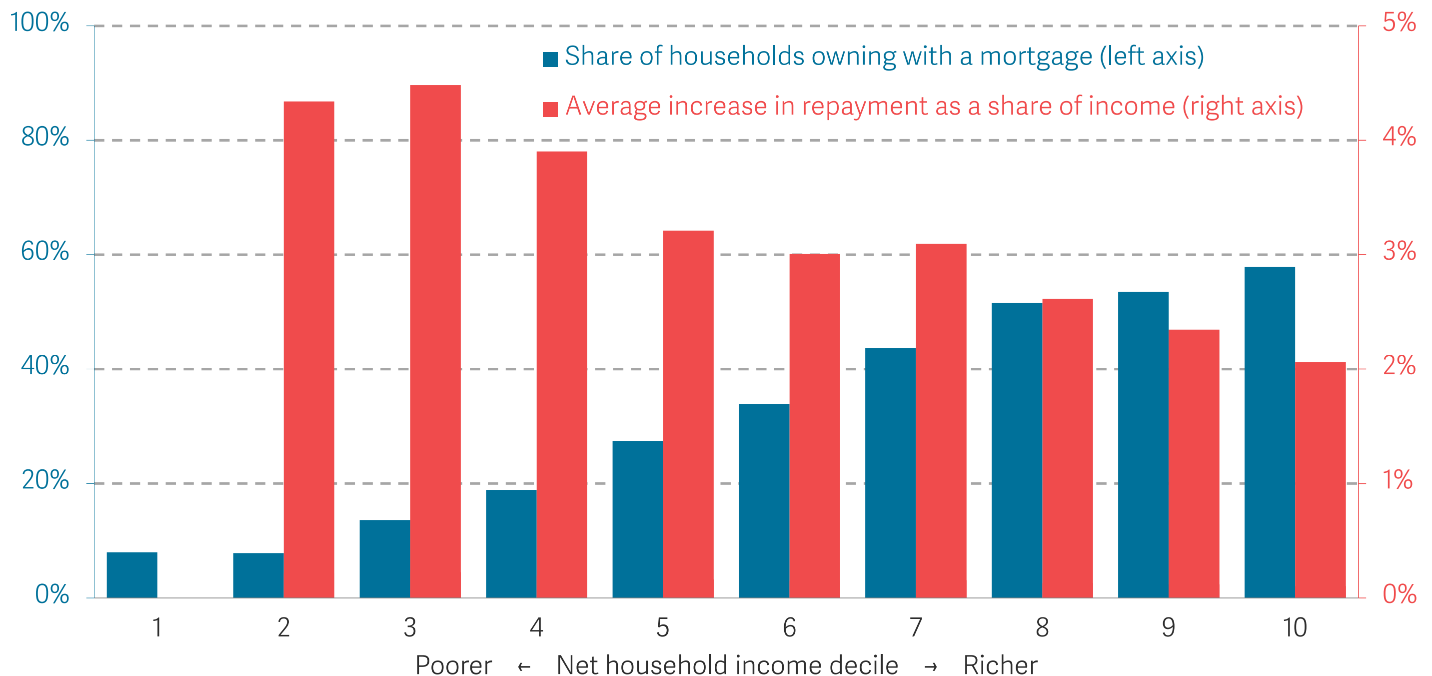
In cash terms, households at the upper end of the income distribution will face the biggest rise in repayments. Richer households are more likely than poorer households to own their home with a mortgage, and those that do have larger mortgages in absolute terms. As a result, around three-quarters of the £12 billion aggregate five-year increase in repayments will fall on households in the top two income quintiles.

But looking at the relative increase in repayments across the income distribution, it's clear that low-to-middle income mortgagors are facing the sharpest hit to living standards. Although fewer low-to-middle income households own their home with a mortgage than richer households, those that do tend to spend a larger share of their income on repayments. Between Q4 2021 and Q4 2026, annual

repayments are expected to increase by more than 4 per cent of income for mortgagors in the second income quintile, compared to just 2 per cent for mortgagors in the top income quintile (Figure 6).

FIGURE 6: **Relatively fewer low-to-middle income households own their home with a mortgage, but those that do face the sharpest increase in repayments**

Proportion of households that own their home with a mortgage and estimated average increase in annual mortgage repayments from Q4 2021 to Q4 2026, by income decile: UK



NOTES: Only includes one owner-occupier mortgage per household, additional mortgages (where applicable) are excluded. Some households with a variable rate in Q4 2021 may have switched to a fixed-rate deal, and vice versa, but this is not captured here. Repayments include interest costs and capital repayments, and are calculated assuming that all households have a repayment mortgage. We exclude results for decile 1 due to well-known concerns over the reliability of income data for those on the lowest incomes.
SOURCE: RF analysis of ONS, Wealth and Assets Survey; Bank of England, Bankstats and Yield curve.

Age is another dimension along which the impact of higher mortgage rates is not felt equally. Younger households tend to have bigger outstanding mortgages relative to their income. Compared to older cohorts, they have had to stretch further to get on the housing ladder, and have had less time to pay down their debt. They are therefore set to see a larger increase in repayments as mortgage rates rise. For example, repayments are projected to increase by 3.4 per cent of income for 18-34-year-old mortgagors between 2021 Q4 and 2026 Q4. This is nearly double the 1.8 per cent figure for mortgagors aged 55 and above.

The good news is that turmoil in the banking sector is not making things worse, at least not yet

Recent ructions in the global banking system have raised fears that this will lead to tighter credit availability for UK households. But, so far at least, these fears are yet to materialise.

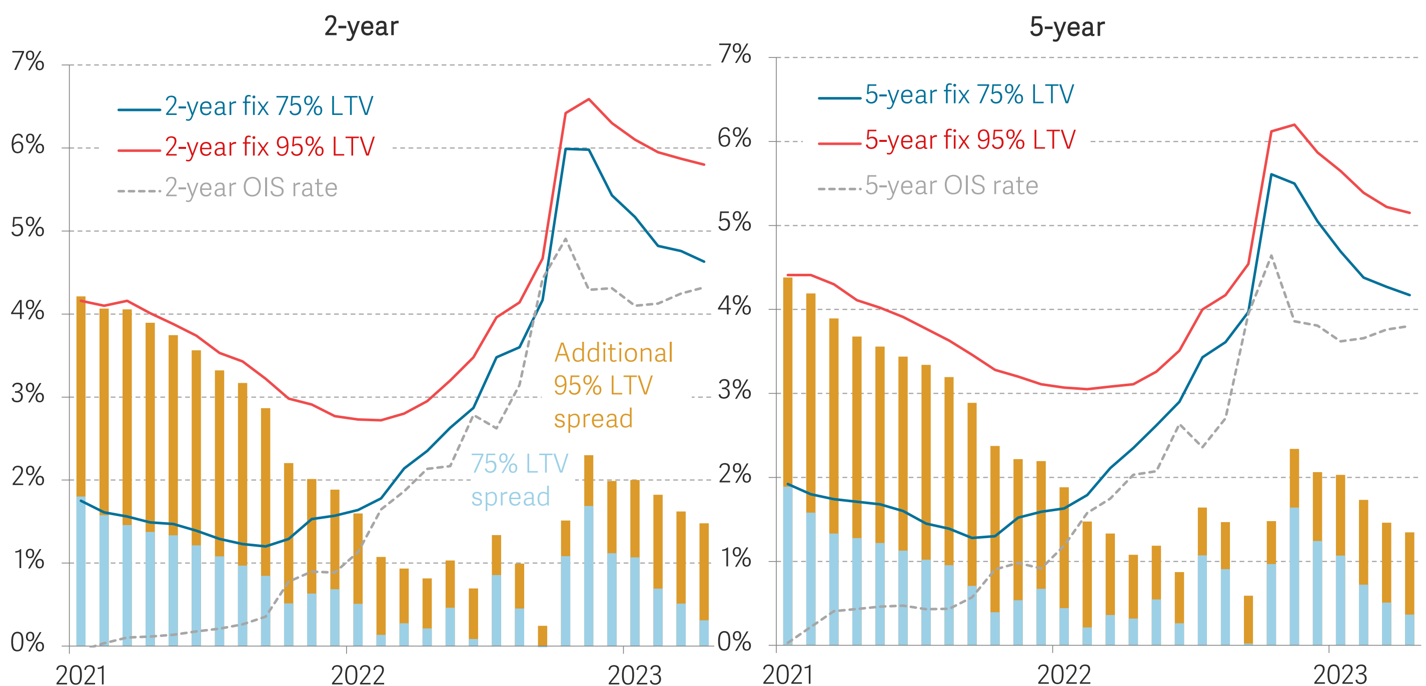
Financial markets do not seem concerned about the health of UK banks. Given the web of global interconnections in the banking system, it would have been possible that high-profile bank failures abroad (including Silicon Valley Bank in the US and Credit Suisse in Switzerland) raised the risk of

bank failure in the UK. But, as highlighted in the Bank's May 2023 Monetary Policy Report, any impact on UK banks' funding costs after the failure of Silicon Valley Bank was short lived and is unlikely to affect the interest rates faced by households. Banks' funding costs have gone up because risk-free rates have gone up, but there's no obvious sign that they have been pushed higher by concerns over creditworthiness.

And, while higher risk-free rates have pushed up banks' funding costs, banks themselves are not increasing the premium they charge households when issuing a mortgage. At lower loan-to-value (LTV) ratios, the spread between quoted interest rates and risk-free rates has narrowed significantly in recent months. For example, the gap between two-year OIS rates and the average quoted rate on a 75 per cent LTV two-year fixed-rate mortgage was just 0.3 percentage points in April, down from 1.1 percentage points at the end of last year (as shown in Figure 8). Spreads at higher LTV ratios have also narrowed, albeit less materially. This could reflect banks' concerns about a significant fall in house prices, which was evident in the responses to the Bank of England's 2023 Q1 Credit Conditions Survey. It remains to be seen whether banks will be able to resist raising mortgage rates should these concerns escalate in the coming months.

FIGURE 7: **Spreads on new mortgages have narrowed in recent months**

Monthly average quoted rates, matching-maturity Overnight Index Swap (OIS) rates and spreads for two-year fixed-rate mortgages (left panel) and five-year fixed-rate mortgages (right panel)



SOURCE: RF analysis of Bank of England, Bankstats and Yield curve.

Unless problems in the banking sector worsen significantly, it's likely that average mortgage rates will start to fall over the course of this year as the Bank of England comes to the top of this rate cycle. But that doesn't mean that the pain of higher mortgage repayments is over –the prevalence of fixed-rate deals means that two-thirds of the pain is still to come. Relatively few households are on variable-rate deals that immediately benefit from falling rates, and many households have yet to come off their fixed-rate deals that were secured at historically low rates.

Resolution Foundation

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We do this by undertaking research and analysis to understand the challenges facing people on a low to middle income, developing practical and effective policy proposals; and engaging with policy makers and stakeholders to influence decision-making and bring about change.

For more information on this report, contact:

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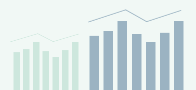

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