

The Mortgage Crunch

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Recent signs that inflation is proving 'stickier' than hoped has raised the prospect of even more rate rises from Bank of England, and a deeper mortgage crunch for households.

Higher than expected inflation and earnings in April has led financial-markets expectations of the peak to the current interest rate rise cycle to rise to nearly 6 per cent – close to levels seen after the fallout from 'Trussonomics' last autumn.

This is swiftly translating into higher mortgage rates: annual repayments are now on track to be £15.8 billion a year higher by 2026 compared to when the Bank started raising rates in December 2021, up from £12 billion as recently as May. Annual repayments for those re-mortgaging next year are set to rise by £2,900 on average – up from £2,000.

The bad news for the Government is that three-fifths of the mortgage pain is still to come – with almost £5 billion set to hit in 2024 when an election is likely. The better news for the Government, however, is that while the current mortgage crunch is big, it is more concentrated than Britain has seen in recent decades. Back in 1989, almost 40 per cent of households owned a home with a mortgage and were therefore exposed to rising costs. By last year, the combination of more older people owning outright, and fewer young people owning at all, meant that the share of households with a mortgage had fallen below 30 per cent.

The latest moves in market interest rates suggest that a dire outlook for UK mortgagors just got worse. If rates move in line with expectations, UK families are set to face a prolonged and historic mortgage crunch. All households can do is hope that market expectations prove wrong amidst high uncertainty about the extent of rate rises that will be needed.

Recent data suggests inflation is likely to prove 'stickier' than hoped, raising expectations for how high the Bank of England is likely to raise rates

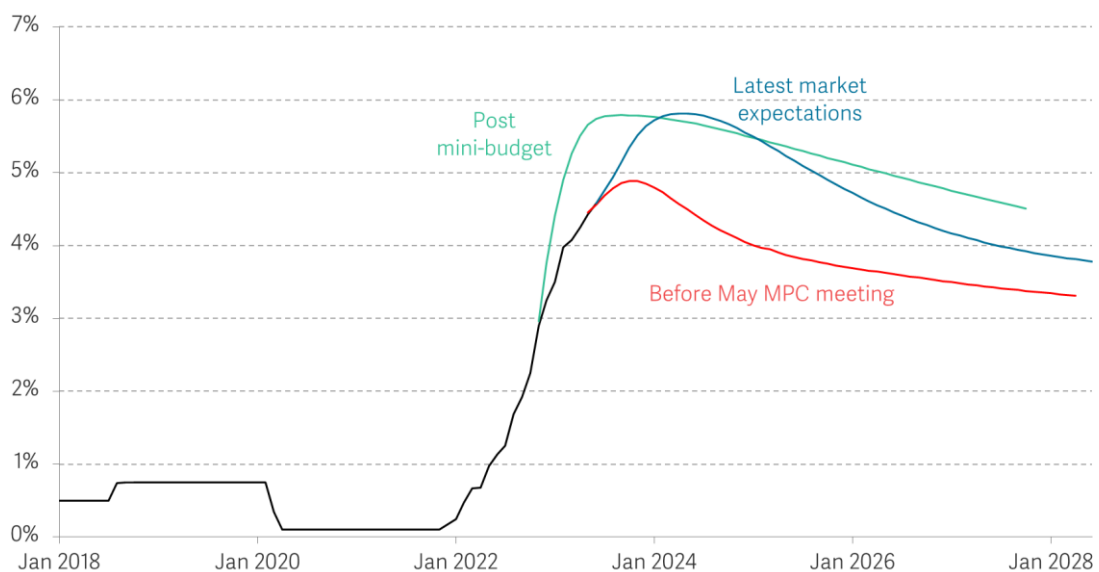
Inflation isn't going away as quickly as hoped – which is bad news for the Bank of England. Inflation data for April came in stronger than expected at 8.7 per cent (the Bank was expecting 8.4 per cent). And this week's data on pay reinforced perceptions that inflation

was proving stubborn with annual regular pay growth in April coming in at 7.5 per cent – the highest on record outside of the pandemic (when the data was affected by changing labour-market composition).

The recent news on inflation’s persistence has raised expectations of the Bank of England needing to raise rates higher and for longer. Bank Rate is now expected to peak at nearly 6 per cent in mid-2024, up from a peak of less than 5 per cent on the eve of the Bank’s last rate-setting meeting (Figure 1).² Such a high peak for Bank Rate expectations hasn’t been seen since the mini-budget sent rates skyrocketing last autumn.

Figure 1 **Financial markets now expect Bank Rate to peak at nearly 6 per cent, up from less than 5 per cent just over six weeks ago**

Bank Rate and market-implied paths: UK, January 2018-June 2028

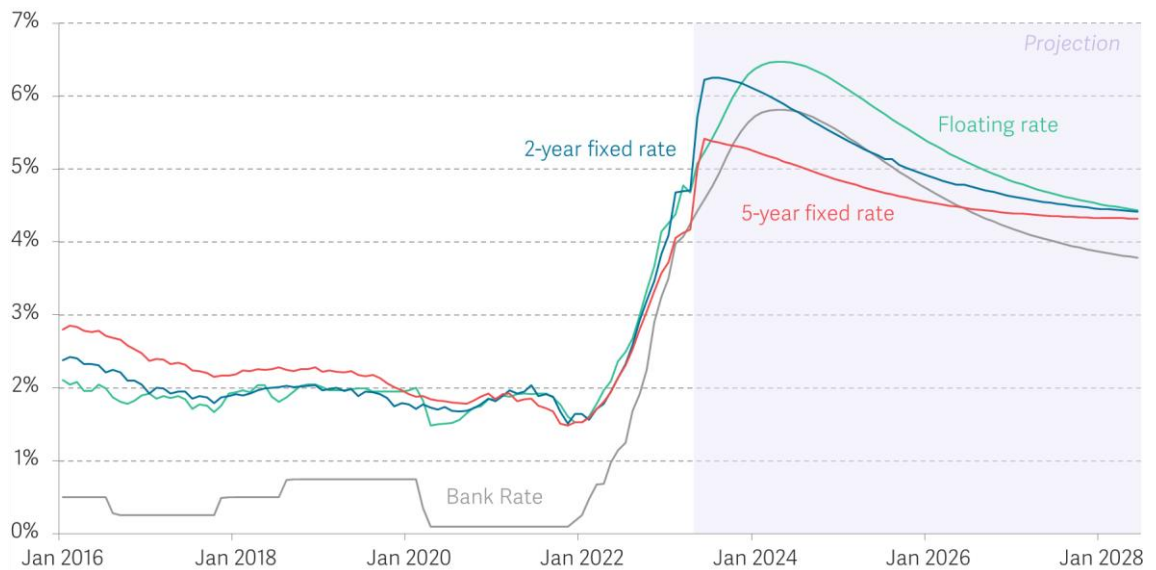


Notes: Market-implied paths for Bank Rate are taken from the overnight index swap (OIS) instantaneous forward curves at the specified point in time. 'Post mini-budget' refers to the market curve on 11 October 2022; 'Before May MPC meeting' refers to 28 April 2023; 'Latest market expectations' refers to 13 June 2023. Source: RF analysis of ONS; Bank of England, Yield curves.

Mortgage rates have already started to go up and could stay high for years to come

And higher rates are even worse news for anyone looking to remortgage soon. Mortgage rates have already begun to rise, as higher expectations for Bank Rate feed through to banks' funding costs today. This has come with hundreds of mortgage products being withdrawn from the market and replaced with new higher rate deals. And families in the UK shouldn't expect to see a quick reversal in rates any time soon. Based on the latest market expectations for Bank Rate, we estimate that the average rate on a two-year fixed-rate mortgage is likely to reach 6.25 per cent this year based on current market pricing and won't fall back below 4.5 per cent until the end of 2027 (Figure 2).

Figure 2 **Interest 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 based on market interest rates: UK, January 2016- June 2028



Notes: Based on market interest rates on 13 June 2023.

Source: RF analysis of Bank of England, Bankstats and Yield curves.

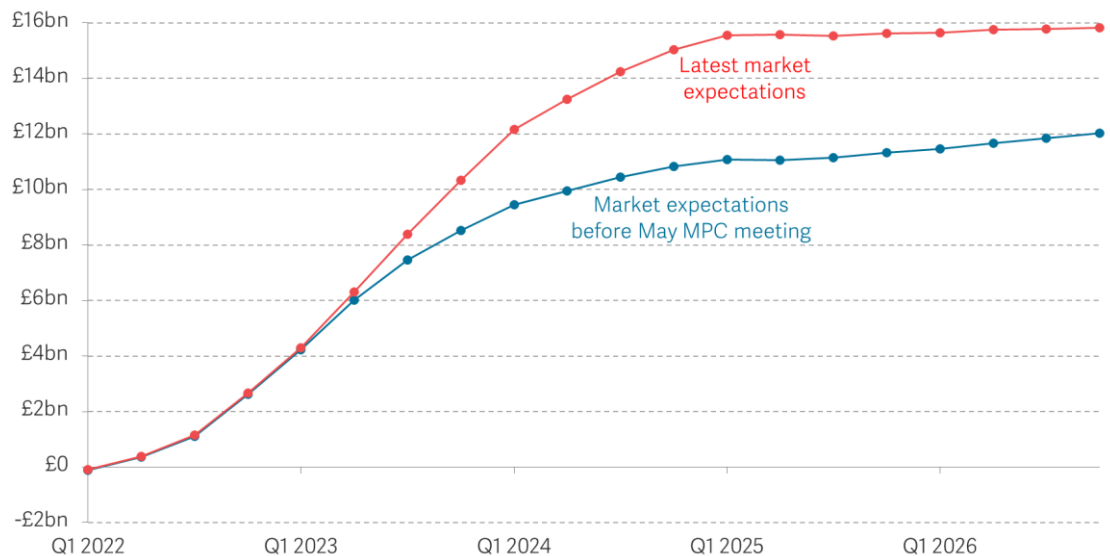
The rise in interest rates means that British families could now face nearly a £16 billion increase in their annual mortgage bill, up from £12 billion just six weeks ago

The impact of higher mortgage rates will take time to be felt fully. Based on [previous Resolution Foundation analysis](#), we estimate that, by the end of June, 4.2 million households in Britain will have seen their mortgage rate change since the Bank of England started raising rates in December 2021. This is around half of all mortgaged households (56 per cent), with the remaining 3.3 million households (44 per cent) yet to see their fixed-rate deal expire.

Based on recent moves in interest rates, the outlook for British mortgagors is much worse than it was just weeks ago. Based on current market expectations, we estimate that total annual repayments could increase by £15.8 billion by the end of 2026 compared to where they were in December 2021, compared to an estimated £12 billion increase based on market expectations for interest rates at the end of April – a rise of nearly a third (Figure 3). By the end of 2026, almost all British households with a mortgage (7.5 million) will have moved on to a higher rate, and are set to end up with annual mortgage bills that are £2,000 higher on average compared to December 2021.

Figure 3 **Aggregate mortgage repayments are projected to rise by £15.8 billion, with nearly two-thirds of the rise still to come**

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



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 capital repayment mortgage.

Source: RF analysis of ONS, Wealth and Assets Survey; Bank of England, Bankstats and Yield curve.

The bad news for the Government is that much of Britain's mortgage pain is still to come

Many UK families have already seen a significant increase in their mortgage costs as rates have risen. We estimate that aggregate annual mortgage repayments will have increased by £6.3 billion for UK households between December 2021 and June 2023 – an average increase of £1,500 for the 4.2 million households who will have seen their rate change.

But, that means that three-fifths (£9.5 billion) of the projected total increase in repayments is still to come, and £4.7 billion of this increase is due to fall in 2024. This is bad news for the Government with a 2024 election looking likely.

With Bank Rate now expected to reach its peak in 2024, next year could be a particularly painful one for British mortgagors. Based on current market expectations, households whose fixed-rate deal expires in 2024 will face an average increase in repayments of £2,900 – compared to £2,000 if rates followed the outlook from the end of April. And households who opt for a floating-rate loan, where the rate they pay is directly linked to Bank Rate, will also face significantly higher repayments. By the end of 2024, 95 per cent (£15.0 billion) of the total projected increase in repayments up to the end of 2026 will have come through.

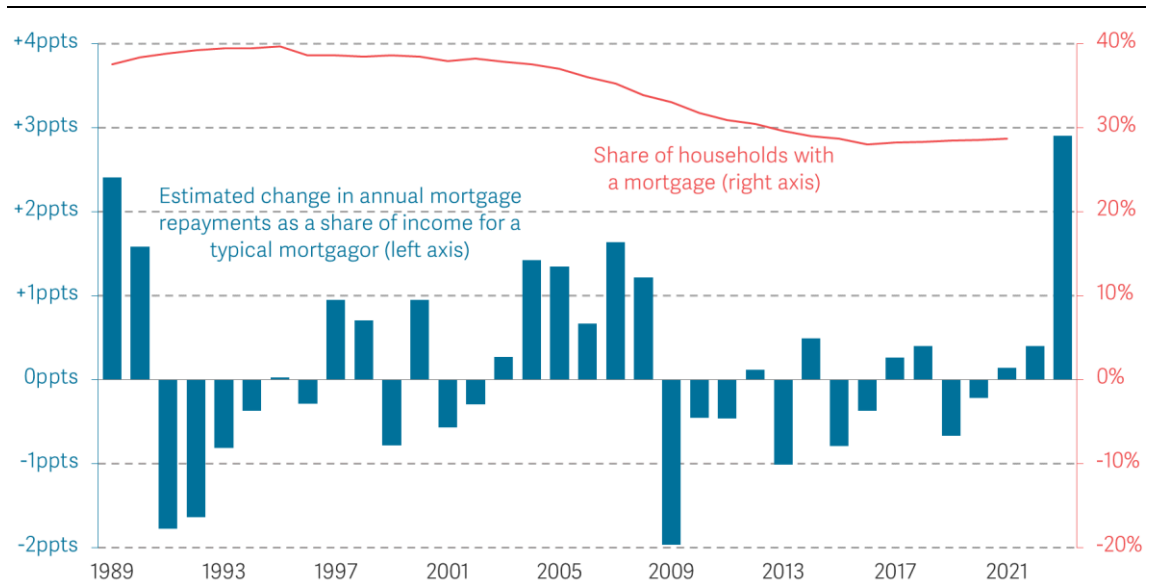
But the good news for the Government is that today's mortgage crunch will be less widespread than that of the early 1990s

The speed of rate rises today means that – for the households that have a mortgage – the income hit from higher rates this year is worse than anything seen in previous decades. Although Bank Rate isn't expected to reach the highs of the late 1980s and early 1990s, mortgaged households today are more leveraged than their historic counterparts. That means that, for a typical mortgagor, the rise in rates in 2023 alone is expected to increase repayments by 3 per cent of household income – or around £2,000. This is a bigger annual hit than at any time in almost five decades. When repayments surged in 1989, as the Bank of England raised rates to nearly 15 per cent, the increase in repayments was only about £1,200 in today's money for the typical mortgagor, or 2.4 per cent of household income.³

But the pain of higher repayments is set to be much less widespread than in the past. Back in 1989, almost 40 per cent of households owned a home with a mortgage, and so were exposed to rising costs. By last year, the combination of more older people owning outright, and fewer young people owning at all, meant that the share of households with a mortgage had fallen below 30 per cent (Figure 4). This is good news for the Government as it means that the mortgage pain is more concentrated among the electorate.

Figure 4 **Today's mortgage crunch is acute, but will affect fewer households than previous rate-rising episodes**

Estimated change in typical annual mortgage repayments as a share of income at prevailing mortgage rates, and share of households owning with a mortgage: GB/UK, 1989-2023



Notes: Tenure data in the Labour Force survey since the onset of the pandemic in 2020 is re-weighted to hold tenure constant, so exact values for these years should not be taken as representative - but broadly align with other survey data. The estimated impact of rate changes is based on a typical household with a mortgage in a given year, and the average interest rate on new mortgages. The impact of mortgage interest relief at source (MIRAS) is accounted for prior to its abolition in 2001. The average rate on new lending for 2023 has been projected based on market interest rates on 13 June 2023. Survey data is not available before 1994 so has been back-projected to earlier years. See endnote for more detail.

Source: RF analysis of ONS, Family Resources Survey, Households Below Average Income, Labour Force Survey; UK Finance; Bank of England, Effective rates and Yield curves.

The latest moves in market interest rates suggest that a dire outlook for UK mortgagors just got worse. If rates move in line with expectations, UK families are set to face a prolonged and

historic mortgage crunch. But market expectations can be wrong, and recent experience has taught us just how much uncertainty there is around where rates will go in the future. Millions of mortgagors across the UK will be hoping that rate rises don't turn out to be as bad as currently feared.

¹ The author would like to thank Cara Pacitti, James Smith and Torsten Bell for their help in preparing this Spotlight.

² Throughout this Spotlight, "current" or "latest" market interest rates refer to end-of-day market interest rates on 13 June 2023, as published by the Bank of England. At the time of writing, data for 14 June 2023 had been made available, suggesting that market expectations for Bank Rate had moderated slightly, but were still well above levels seen before the May Monetary Policy Committee meeting.

³ In each year, annual repayments are calculated for a household with median values – among mortgaged households – for outstanding balance, remaining term and gross household income, and based on the average rate on new mortgage lending in a given year. This is a somewhat stylised calculation that allows for a historic comparison, and does not account for the pace with which rate changes feed through to households in practice. Survey data is not available prior to 1994, and values for outstanding balance, remaining term and gross household income have been projected backwards to 1989. We assume that incomes evolved in line with the income of new mortgagors, and that remaining term was constant. Most critically for our results, we also hold constant the ratio of outstanding balance to income. The [aggregate ratio of mortgage debt to income was broadly flat between 1989 and 1994](#), which helps to justify this assumption. For 2020-2023, median mortgagor income has been projected using the Resolution Foundation's [projections for household income](#) – again holding constant mortgage term and the ratio of outstanding balance from the latest wave of survey data.