

## UK

### FPC Report, Announcement and Press Conference

- The BoE's Financial Policy Committee (FPC) today announced macro-prudential tightening measures aimed at limiting financial stability risks. The FPC did not use raise capital ratios, but announced that (1) lenders will have to assess borrowers' ability to service their loans if Bank Rate were to rise by 3% at any point over the first five years of the loan; (2) *"The PRA and the FCA should ensure that mortgage lenders limit the proportion of mortgages at loan to income multiples of 4.5 and above to no more than 15% of their new mortgages."* The cap will apply to borrowers with both a single income and multiple incomes.
- These measures aim to restrain the fringe of lending with high loan-to-income ratios rather than the mainstream. The FPC says that high LTV loans accounted for 9.8% of new mortgage new loans in Q1, up from 8.5% a year earlier and 8.3% two years ago. For first time buyers, 30.5% of new loans in Q1 were at an LTI of 4.5 times or more, the same as a year earlier. The FPC project that, under the MPC's central economic outlook (fairly strong economic growth, house prices up 20% over the three years ended 2017Q1), the share of new mortgages with an LTI of 4.5 times or higher would rise to about 15% in about a year and stay there further ahead. Under this base case, these measures would not have much effect. As the BoE say, *"If house prices and mortgage approvals grow in line with the central scenario, the impact of the policy action is likely to be minimal."* Indeed, the FPC estimates that the measures would stop only about 0.5% of potential home-buyers over 2014-17. The FPC present an alternative scenario, in which house prices rise by 45% YoY over the three years to 2017Q1 and, under this outlook, they estimate that – without today's measures – the share of high LTI loans would hit 25% in 2017 (with GDP 0.2% higher). Today's measures aim to prevent such a scenario occurring.
- We have some quibbles with the details. In particular, the LTI cap will apply to the *number* of loans, rather than their *value*. High LTI loans probably have a relatively high value, and hence could well be much more than 15% of new loans in value terms, hence raising the riskiness of lenders' balance sheets. Indeed, the FPC report that 11% of the *value* of outstanding mortgage loans is already at an LTI above 5 times. But the basic aim – to cut risks that the recovery develops into a rerun of the destabilising pre-crisis credit boom – is sensible, and raises the likelihood of a durable expansion. For markets, the key issue is that the FPC's measures are unlikely to bite immediately or in 2015. Hence, these measures are unlikely to derail the housing market or – given the boost from ultra-low policy rates and strong business investment – seriously slow the economy in the next year or two. As a result, the FPC measures probably will not remove the need for extended MPC tightening if, as we expect, the economy remains buoyant and the jobless rate keeps falling rapidly.

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