National Institute of Economic and Social Research

Briefing Note: Projecting the Effect of Peak Bank Rate on Mortgage Holders

Max Mosley

Summary:

NIESR has previously estimated the effect of the expected peak bank rate on those households with a variable rate mortgage (Mosley, 2022b). This briefing note extends the previous analysis by estimating the effect the higher bank rate will have on those households that need to re-mortgage their fixed-rate plan.

In doing so, we have incorporated the estimated increase in monthly mortgage repayments into our existing projections regarding household savings to provide insights into the compounding effect this latest shock to real incomes has had within the context of the cost-of-living crisis.

Findings:

- Overall, nearly 4 million households will see higher monthly mortgage repayments as a result of the higher bank rate.
- The typical monthly repayment on a fixed-rate mortgage will rise from around £700 to £1,100 on average, and from around £500 to £900 on average for those on a variable-rate mortgage; this is a 50 per cent increase.
- This £400 increase in monthly repayments will wipe out the savings of a further 1.4 million households by 2024 as a result of higher mortgage repayments; the total number of households without savings will stand at around 7 million (1 in 4, or 25 per cent).
- The households who will lose out the most are concentrated in the West Midlands, the North-West, Wales and Scotland.
- £1.2 billion per month, or £14 billion per year, will be spent on increased mortgage repayments (0.5 per cent of GDP)

Methodology:

This work is an extension of NIESR analysis into the effect of peak bank rate on households with a variable rate mortgage (Mosley 2022b) and coupled with previous analysis into household savings projections (Mosley 2022a).

The former - published in NIESR Autumn Outlook (NIESR Series A Vol.8) – creates an endogenous monthly mortgage repayment in the latest round of the ONS Wealth and Assets Survey (2022) using the standard Robert Kohn equation (Kohn, 1990). The data itself provides us with a representative sample of around 15,000 households, including their financial characteristics and what part of the country they are in.

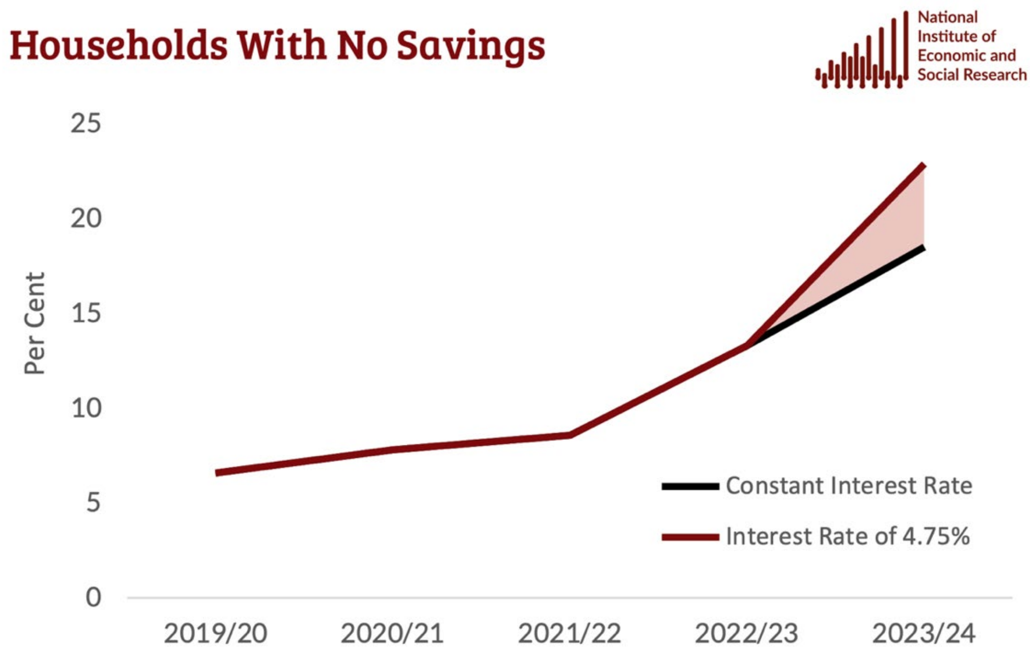
This allows us to increase the bank rate in line with market expectations or existing NIESR forecasts. At the time of the previous analysis, this work was exclusive to variable rate mortgages, as they would be affected in the short-run from changes in the bank rate.

Since then, UK Finance have estimated that 1.8 million households on a fixed rate mortgage will have to refinance in 2023. This allows us to extend the previous analysis to incorporate the effect of re-mortgaging. As 1.8 million is 27% of the total number of households on a fixed rate mortgage (6.5 million), we randomly assign the new higher interest rate to 27% of households on a fixed rate mortgage in our sample and increase their monthly repayments accordingly.

This provides us with the above estimates of the effect on typical monthly mortgage repayments. To determine what effect these higher monthly payments have, in conjuncture with existing higher energy and food bills etc., on the living standards of those affected, we apply these findings to our previous projections of household savings. This allows for our model to split rent and mortgage payments apart and to have them develop at differential rates.

Discussion and Conclusion:

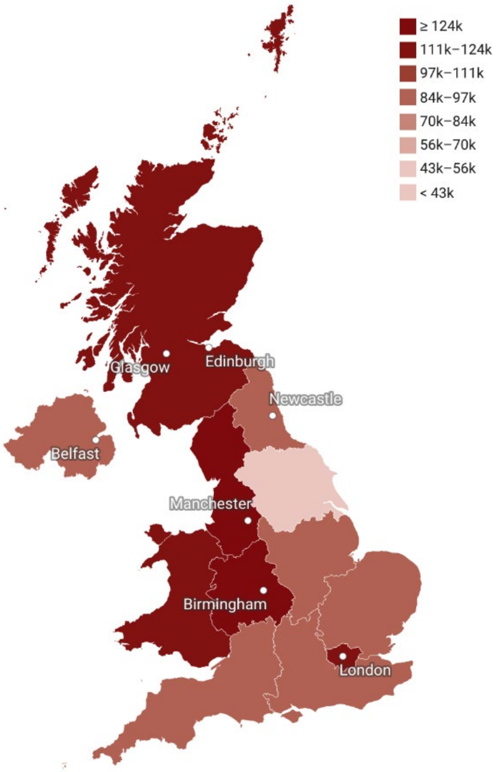
Unlike previous analysis into the cost-of-living crisis, this work has the advantage of anticipating a shock to real incomes in advance. Our findings simulate what is likely to be on the horizon for millions of households in the UK and provides policy makers not only with a stark warning of what is to come but also identifies the pathway of how this could impact living standards.



Source: NIESR Analysis of the ONS Wealth and Assets Survey (2022), LINDA, NiGEM

Although our previous analysis looking only at those on a variable rate found a noticeable increase in repayments, it did not yield much of an effect on our indicators of living standards (i.e., savings levels). This is likely due to the fact that the average interest rate on a variable rate mortgage is low as a result of previously low interest rates and that households with a variable rate are likely further into their contract, so would have less of their mortgage to pay off. By comparison, those on a fixed rate are earlier into their repayments, so will have a higher interest rate and higher monthly repayment. The latter group is mostly protected from changes in the bank rate, but at the point of re-mortgaging the effect will be stronger.

Households with No Savings as a Result of Higher Mortgage Repayments



Source: NIESR Analysis of the ONS Wealth and Assets Survey (2022), LINDA, NiGEM

A £400 per month increase in monthly repayments for nearly 4 million UK households will exacerbate the recent shocks to real incomes from soaring energy and food prices. It will also have second-round effects in the form of the macroeconomic challenges this will pose in terms of lower consumption and therefore lower growth. This analysis suggests around £1.2bn per month or £14bn per year will be spent on higher mortgage repayments, which is approximately 0.5% of GDP.

Our analysis shows that increased mortgage repayments could have been absorbed by households in 'normal times', but the once-in-a-generation cost-of-living crisis means that increased mortgage repayments will likely push millions of households to the edge of insolvency. We need further targeted help to limit private indebtedness and avoid the prospect of home repossession.

References

Bhattacharjee, A., Mosley, M. Pabst, A. and Szendrei, T. (2022), 'UK Regional Outlook: Autumn 2021', National Institute UK Economic Outlook, National Institute of Economic and Social Research, vol. 0(8 Autumn), pp. 49-67.

Kohn, R. (1990), 'A capital budgeting model of the supply and demand of loanable funds', *Journal of Macroeconomics* 12 (Summer), pp. 427-436.

Mosley, M. (2022a), 'Box C: Households savings amid the cost-of-living crisis', National Institute UK Economic Outlook, National Institute of Economic and Social Research, vol. 0(7 Summer), pp. 34-36.

Mosley, M. (2022b), 'Box E: Projecting the Impact of Peak Interest Rates on Variable Rate Mortgages', National Institute UK Economic Outlook, National Institute of Economic and Social Research, vol. 0(8 Autumn), pp. 70-72.