BUSINESS BRIEF

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Riding out the storm

Raymond Ashton examines the effect raising interest rates could have on the housing market in Guernsey

PROPERTY owners are becoming increasingly apprehensive about increasing interest rates over the next 12 months. So far this year there have been four changes in the Bank of England interest rate and rates are forecast to increase early next year to 6.5% or 7%. This will put property owners under increased pressure in an already difficult economic environment.

Economic effects of interest rate rises

There are two aspects to this issue – the effect in England and specifically the effect in Guernsey. Inevitably the economic effects in England will have an impact, albeit more gradually, on Guernsey. At the moment house prices in England are dropping, with significant falls recorded by the Halifax of 2.6% on an annual basis.

In Guernsey the position is more mixed. Agents are reporting that at the moment there is little change in house prices up to £800,000 but a change in the terms of trade above this limit from being a sellers' market to a buyers' market. In terms of the open market, the problem is the absence of stock.

Currently borrowers have been facing an increase in interest rates of 4% between May 2022 and June 2023. What will be more difficult will be another 2% or more between now and say March 2024. This will put a significant extra burden on borrowers who potentially will face, via falling prices, a decline in the equity they own in their property. Obviously individuals at the lower end of the property market will suffer disproportionately more than those at the higher end of the market.

At an economy level, whether in the UK or Guernsey, it is also necessary to take into account the effect of higher interest rates in the economy as a whole. Increases in interest rates have the effect of reducing profitability which is likely to lead to a decline in economic activity or a slow down in possible wage increases which, in turn, will put extra burdens on individuals.

What are the implications for the next six to nine months? Inevitably individual family budgets will come under increasing pressure.

At the margin, some families will be forced to sell their property or to raise more money on their property, or to 'downsize' where they are more established in the market. One question which has been put to me, is what can the property owner do?

The influence of the general election 2024

The other factor which must be taken into account is that there will be a general election in 2024. The government will be anxious, for obvious reasons, to lower interest rates which implies a reversal in the decline in house prices and generally expansion of the economy.

This should be good for house prices in Guernsey and particularly the open market. There will also be the increased Labour phobia of increased taxes in the UK which will drive up prices in Guernsey.

What should individuals at the lower end of the market do?

They should hold onto their property if at all possible by suggesting to their lender that they defer some of the interest/capital by asking for a longer mortgage term.

This can always be reversed at a later date when interest rates fall. This factor is frequently under-estimated by both lenders and borrowers.

Borrowers have got to find temporary expedients to overcome this short term 'blip' in house prices as the overall trend over a 10-year period will be upwards, as it has always been, and as stated above, raise further finance on their property.

Conclusions

Should interest rates go over 7% or more, the States should consider extra mortgage interest relief for tax purposes. This relief would be targeted at the lower end of the income/capital spectrum, say up to £300,000-450,000 and be strictly temporary until rates fall again.

While poorer families are adversely affected by the increase in interest rates the economic hardship is unlikely to last for more than a year when lower interest rates and greater prosperity in the UK and elsewhere will hopefully be the norm. These will ease the pressure on poorer households but I suspect the people who will gain the most will be owners of open market property. While there might be a shortage of stock at the moment, increased prices will bring greater supply to match the demand.

Overall, the analysis is that Guernsey has been relatively insulated as compared to England and that the temporary hardship will be relatively short term.

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