

**30 October 2008**

## **MPC Predictions: Expected Base Rate Cut Is No Magic Bullet**

Following the US Federal Reserve's 0.5% rate cut yesterday, November's meeting of the Bank of England's Monetary Policy Committee (MPC) is increasingly expected to announce a further base rate cut of 0.5%; but this may not bring relief for homeowners.

Neil Young, CEO of property portfolio managers, Young Group, explains that whilst this would be good news for the 30% of home owners that currently have tracker mortgages, a reduction in base rate alone will not be the cure-all that many expect.

"A cut in base rate alone is not a magic bullet. The credit markets rely heavily on the bank's confidence, reflected in the rate of interbank lending. The 3 month LIBOR rate has not fallen significantly since the Bank of England's surprise half a per cent cut in base rate at the beginning of October and remains around 6 per cent. Unless LIBOR falls further, the cost of finance to banks and mortgage lenders remains significantly higher than base rate and lenders will not reflect the base rate change in their products because their cost of borrowing hasn't dropped – and consumers taking out new mortgages won't benefit.

"I wouldn't be surprised if lenders begin to offer mortgage products that track LIBOR rather than base rate in the near future."

Since the 0.5% base rate cut on 8 October, many lenders have discontinued their tracker products on the assumption that further base rate cuts are in the offing and are now only offering fixed rate products.

Indeed a number of lenders have withdrawn tracker products, only to relaunch them with higher interest rates. Abbey, now one of the UK's largest mortgage lenders following their take over of the Alliance & Leicester, raised the interest rate on their 2 year tracker products by 0.5% immediately after the last base rate cut announcement.

Neil Young also points out that those considering new tracker products should be careful; "A number of well-known high street lenders have imposed collars on their tracker deals, limiting the amount by which the mortgage holder can benefit in the event of substantial base rate reductions. We're looking very closely at the small print of products currently on offer and urge everyone to do the same and understand fully the products that they are signing up to."

Repossession rates have increased according to the Council of Mortgage Lenders' most recent figures, but the situation is by no means dire. Repossession is currently at a level of 0.16% of all outstanding mortgages, still less than a quarter of the rate reached in the early 1990s. Furthermore, the rate of repossession is no higher for buy-to-let mortgages than for residential mortgages; 1,764 buy-to-let properties were taken into possession during the first half of 2008.

Nevertheless, the government and lenders themselves must do more to support the housing market to instil confidence in the sector and ease the current difficulties experienced by some borrowers, but this is by no means a quick fix. Neil Young points out; “The government last week put in place rules to enable homeowners in difficulty to switch from repayment to interest only mortgages, but these are not being adopted by the lenders, or indeed enforced by the Treasury, as reports suggest that Lloyds TSB is blocking homeowners from switching to interest only products.”

Long term, prospects remain good with consensus forecasts indicating that the property market will see strong recovery over the medium to long term, particularly in the South East of England and London where the disparity between property supply and demand is expected to drive a relatively rapid recovery of prices, once confidence returns.

“We will find out on 6 November – or indeed sooner if last month’s surprise announcement has set a precedent – if the MPC believes that the UK economy will benefit in the medium term from a further cut in base rate, but whether the majority of homeowners see any benefit remains to be seen,” explains Neil Young.

“The nation’s focus on base rate is becoming less and less relevant as banks protect their positions. It’s increasingly clear that a cut in base rate is by no means a quick, easy fix to the current credit market conditions; we need lenders and the Government to work together to inject confidence as well.”