June 2024

THE MORTGAGE LENDER
real life lending

ECONOMIC UPDATE

4most
ANALYTICS CONSULTING

Let’s introduce something awesome

We’ve teamed up with 4most Analytics Consulting to provide you with a monthly economist update.

The information in this pack is for educational and information purposes and does not constitute advice.

Overview

Better growth. But big structural problems need to be fixed

- Even though the economic picture is a little better, the decision not to have one more fiscal event before the General Election was slightly surprising. GDP growth was strong in Q1 2024. And inflation dropped sharply in April on the back of lower energy bills. But with wage and services inflation proving stubborn, a cut in interest rates before August now looks unlikely.
- What will a new Labour government bring? The reality of the public finances suggests no room for big spending projects and the 'stealth' tax rises already planned by the current administration mean the tax burden will rise. There may well be a more cordial relationship with the EU, and while full membership of the Single Market is off the cards, a 'lite' version seems likely. Housing and health should be a key focus. Ambitious plans to build more houses are at odds with falling numbers of construction workers and pledges on immigration. More regulation of the Buy-to-Let sector seems likely given the Renters Reform Act was completely ditched.
- Although households are less pessimistic, the persistent weakness of consumer spending highlights just how much more of income is now spent on essential items like food, energy and housing costs, leaving less for discretionary purchases. Households may need more time to rebuild resilience.
- Nevertheless, rising real wages should underpin a modest, more durable, recovery through 2024 with GDP growth of around 1% this year and 1½%+ in 2025. Inflation may finally reach target in July but is expected to end the year at 2¼%.

Risk outlook

- Economies are coping better than expected with higher interest rates. Economists have no great certainty around what the 'correct' long-term level of rates is. The ultra-low rates of the past may have been a mistake that distorted asset prices and investment decisions. Rates could fall by less than expected.
- Given this, there are still questions to be asked about the valuations of residential and commercial property. But the risks feel less acute than a few months ago. More households are behind on mortgage payments, but events to date support a conclusion that stressed affordability assessments at origination have worked.
- Political developments will be key source of uncertainty in the coming months. There is not much doubt about who will win the UK election. The US is different. If Donald Trump wins, a difficult situation in Ukraine will become worse and Europe will have to devote more resources to defence. Tensions between China and Taiwan would be more likely to flare up. If he loses, he may well not accept the outcome and chaos could ensure.

Inflation and interest rates

Although inflation fell sharply in April as domestic energy prices tumbled, the underlying picture does not look conducive to an immediate cut in the Bank Rate.

Mobile phone bills and rail fares rose significantly. Services inflation at close to 6% has not been consistent with keeping inflation at target in the past: this will be exercising the MPC.

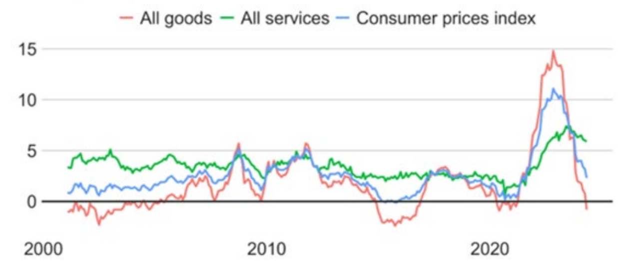
The inflation rate is expected to end the year at 2.3%. Energy bills are set to fall significantly in July. Optimists can also point to declining oil prices. But on balance the risks, as illustrated by rises in the price of food, are still upside.

Markets are no longer pricing in two full 25bp cuts this year, and expectations of the pace of easing have been pushed out in the next couple of years. Even if this proves wrong, it has an impact on mortgage rates.

Lower interest rates clearly brought negative consequences in terms of neutering conventional monetary policy and inflating asset prices bubbles. With economies largely shrugging off higher rates, the case for 'higher for longer' is growing.

Headline inflation 'only' fell to 2.3% in April. Services inflation is uncomfortably high

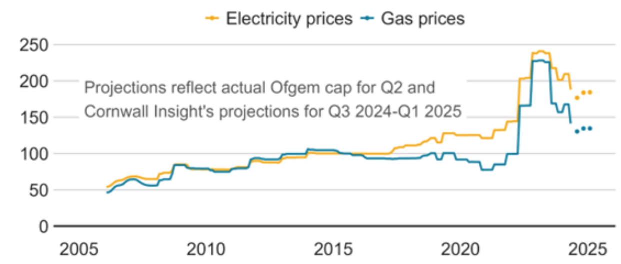
% change on year



Source: ONS

Despite recent falls, energy bills remain much higher than they were before the war in Ukraine

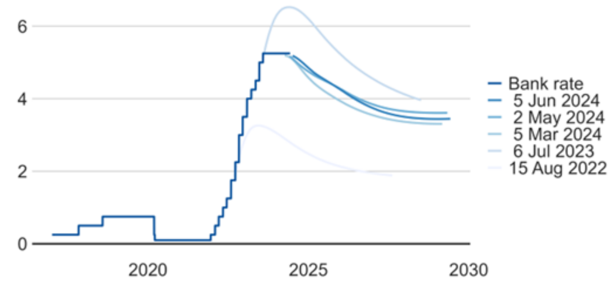
2015=100



Source: ONS, Ofgem, Cornwall Insights, 4most calculation

Markets aren't fully pricing in a cut until September

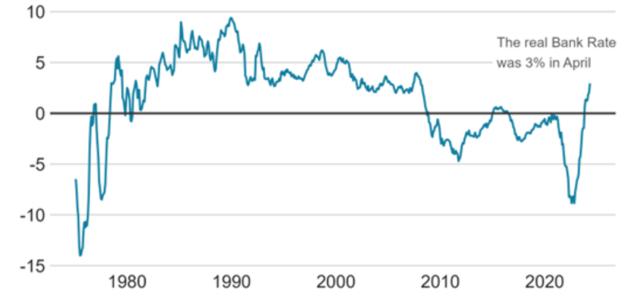
Expectation of Bank Rate implied by the OIS curve, %



Source: Bank of England

Real interest rates are well above levels considered as normal a decade ago

Bank Rate minus CPI inflation, %



Source: ONS, Bank of England, 4most calculation

Labour market

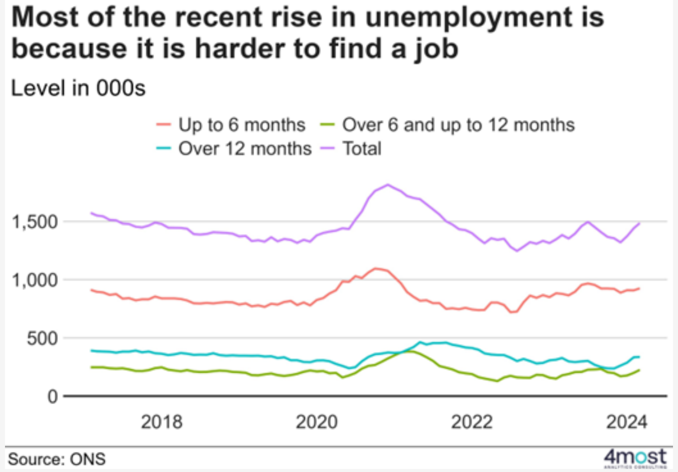
Another poor month for the labour market. The unemployment rate rose to 4.3%. There are no more people in the labour force than there were before the pandemic.

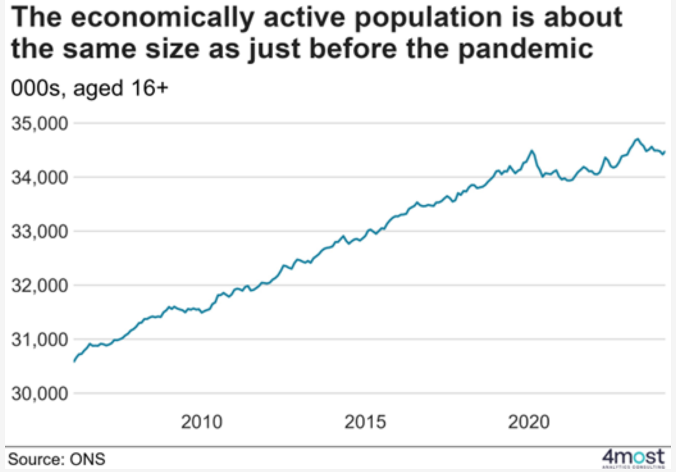
Long-term unemployment is growing because there are fewer jobs for those looking for them. But the number of people losing their jobs, while edging up, is still relatively low.

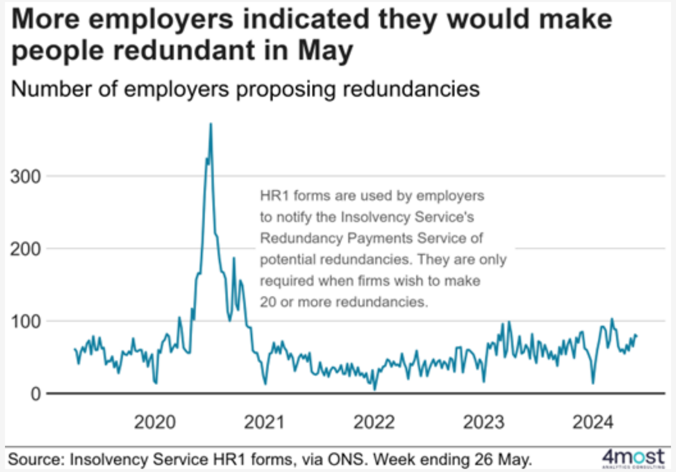
This month we will see the initial impact of the increase in the minimum wage in the statistics. The labour market is hard to read and may be cooling as much as hoped. The MPC would like to see signs it is.

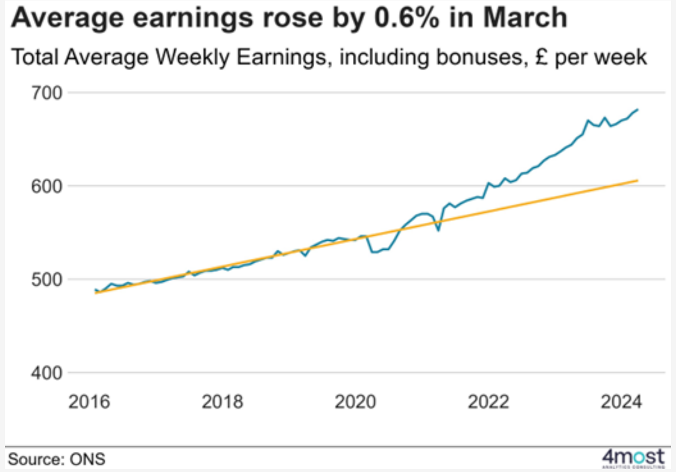
Although the ONS has rejigged the Labour Force Survey, there is huge doubt about the quality of many of the estimates because of low response rates. Vacancies and redundancies data are probably the best guide right now.

If the figures are taken at face value, the fall in the numbers of 18–24-year-olds in work is striking. Getting these people back into work would boost economic potential as well as those directly affected: a key post-election challenge for Labour.









Housing market

Sellers are returning. Given the depressed state of the market over the last year, the need to get on with life may be surfacing. Sensibly priced property is selling quickly.

Rightmove report a strong (seasonal unadjusted) rise in asking prices in May, led by larger properties. Nationwide prices, based in approvals, also edged up.

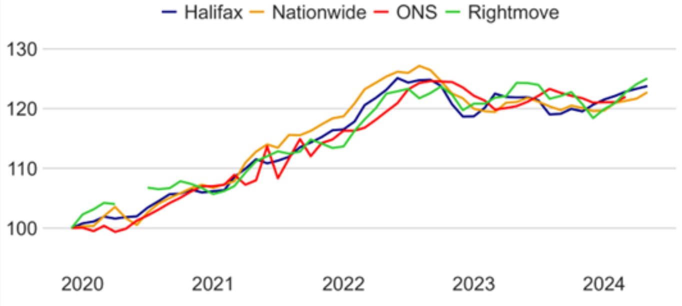
There is a growing disconnect in what affordability measures suggest about the path of prices and reality. Our view is that given where mortgage rates are, and with supply rising more than buyer enquiries, house prices will drift down.

Some are making upside cases: Savills expect prices to rise by an average of 2.5% in 2024, 3.5% in 2024 and 21.6% in 2024-2028.

That forecast assumes interest rates decline rapidly. The longer that does not happen, the greater the chance of a more abrupt stop for both the economy and housing.

Asking prices rose another 0.8% in May, reflecting stronger demand for bigger properties

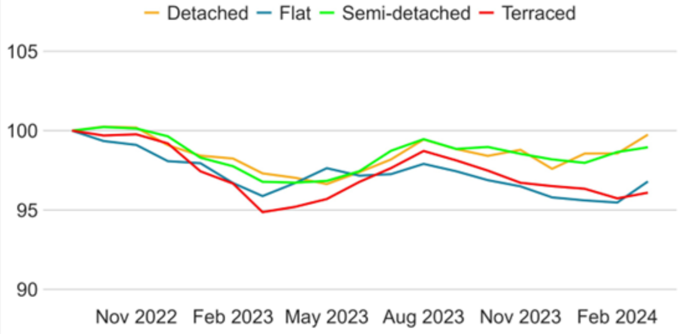
Non-seasonally adjusted, indexed to December 2019=100



Source: Haver Analytics, ONS, Nationwide, Halifax, Rightmove

The price of larger properties has fallen less

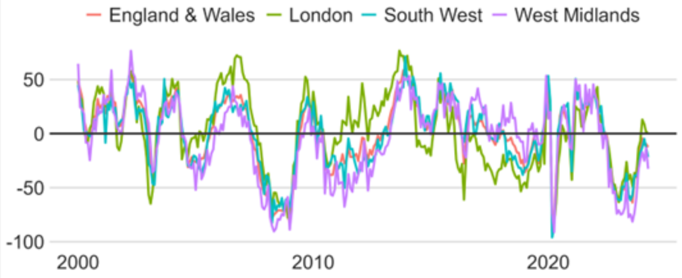
September 2022=100, non-seasonally adjusted



Source: Land Registry

Surveyors in the South West and West Midlands are more downbeat than those elsewhere

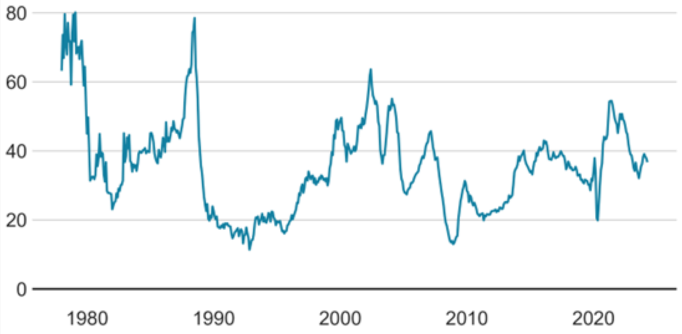
% balance of surveyors expecting house prices to rise in the next three months



Source: Haver Analytics, RICS. Data to April

The housing market has been tight, but more supply but could change this

Ratio of sales to stock of unsold property



Source: Haver Analytics, RICS. Data to April

Rental market

While it feels that the ceiling of what tenants can afford to pay must be near, rents are still rising. And surveyors expect this to continue, even in London.

The market clearly is tight: tenant demand outside London is rising and new instructions falling. Tenants are renting smaller places in less convenient locations. But they are also presumably cutting back spending elsewhere to meet the higher cost of housing.

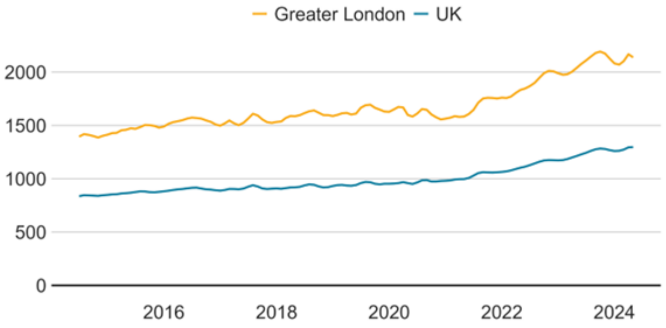
There are significantly more private sector landlord possession claims than pre-pandemic. Temporary removal of property may explain some of the supply/demand imbalance. But it is not obvious that these properties are being sold to FTBs.

The economics of the investment is still a big constraint. There are 60,000 fewer BTL mortgages outstanding then there were a year ago, probably more reflective of a lack of new sales than landlords selling up.

The Renters' Reform Act didn't make it into law. Labour may have bigger immediate priorities. But it is hard to believe they won't bring in a more 'tenant friendly' regime.

Average rent on a new tenanacy rose by 0.2% in May

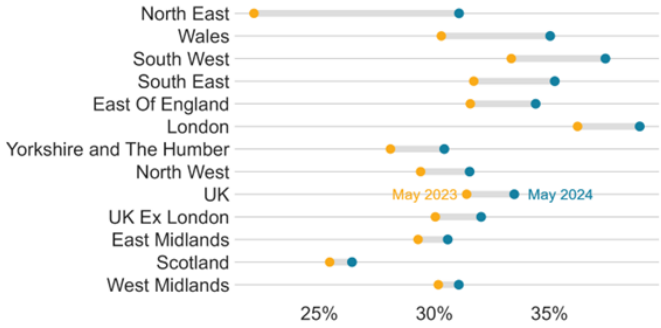
£, monthly rent on newly let property



Source: Homelet. Data to May.

Rental affordability has deteriorated everywhere over the last year

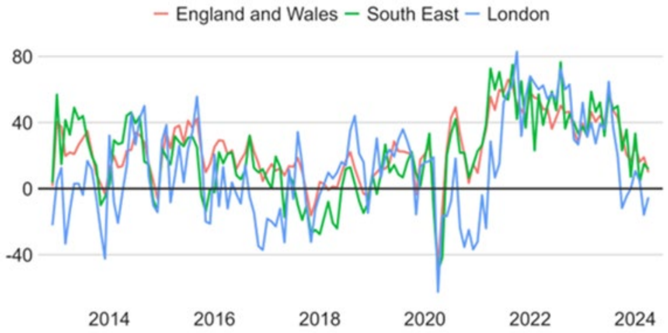
% of income spend on new lets, today vs a year ago



Source: Homelet. Data to May.

Demand in London is no longer growing

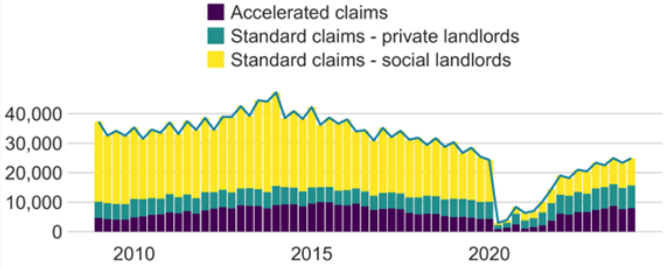
% balance of surveyors reporting rising tenant demand in the last three months



Source: Haver Analytics, RICS. Data to April

More private landlords are taking possession. But talk of a rush to the exit looks over done

Quarterly landlord possession claims in the county courts of England and Wales by type of procedure and landlord



Source: Ministry of Justice. Data to Q1 2024

Mortgage market - activity

Although both Buy-To-Let and First-Time-Buyer completions rose in Q1, the overall level is well below where it was before rates started rising.

The lower rates seen at the start of the year do mean a better pipeline is developing. But again, affordability is still holding the market back.

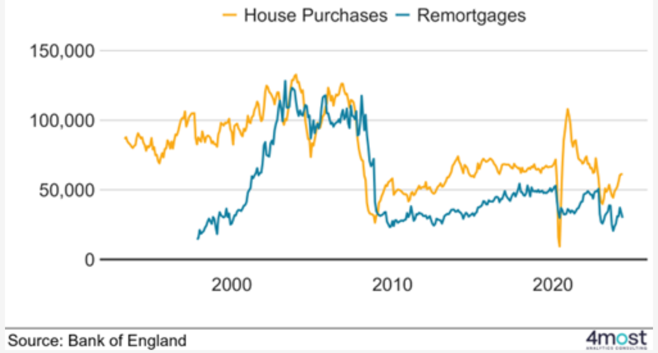
Most of the property websites support the view in the latest RICS survey: sellers are coming back to the market but while buyer enquiries are improving, there is a mismatch created by the combination of still high prices and rates.

One reason the drop in FTBs has not been even more pronounced is the rise in mortgage terms of 36-40 years from pre-pandemic levels of 6% to over 18%. This does not feel comfortable or sustainable.

Product Transfers were the only growth area in the mortgage market last year with the share hitting all-time-highs. In Q1, product transfers were up 9% on a year earlier, and external re-mortgaging down 21% - a mix that is unlikely to change much until affordability improves.

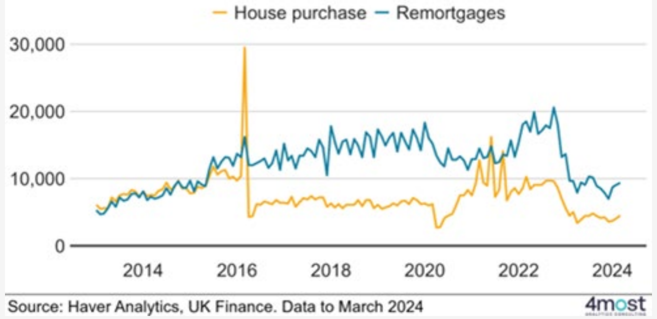
There were 61,100 mortgage approvals for house purchase in April

000s per month, seasonally adjusted



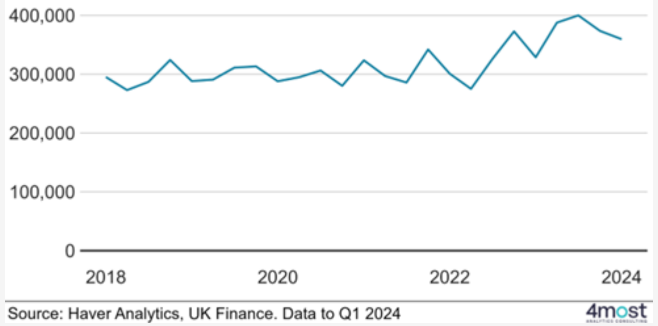
The volume of loans for Buy-to-Let house purchase in Q1 2024 was 18% lower than a year earlier

Number of loans in month, not seasonally adjusted



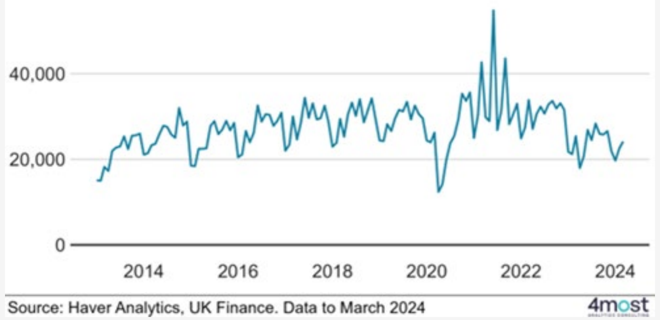
The number of customers remortgaging with their existing lender has surged since Q3 2022

Number of loans each quarter: product transfers



Despite a better Q1, affordability is keeping many First Time Buyers out of the market

Number of loans in month, not seasonally adjusted



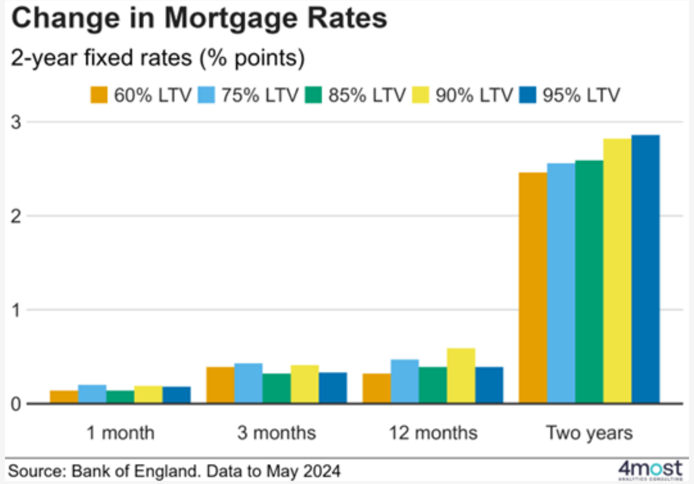
Mortgage market - rates

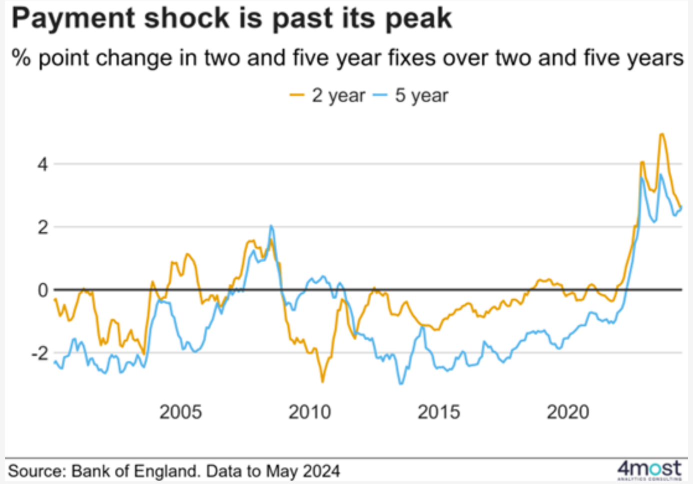
Quoted rates for mortgage lending crept up May, but payment shock is much lower for those who are refinancing today than it was last August.

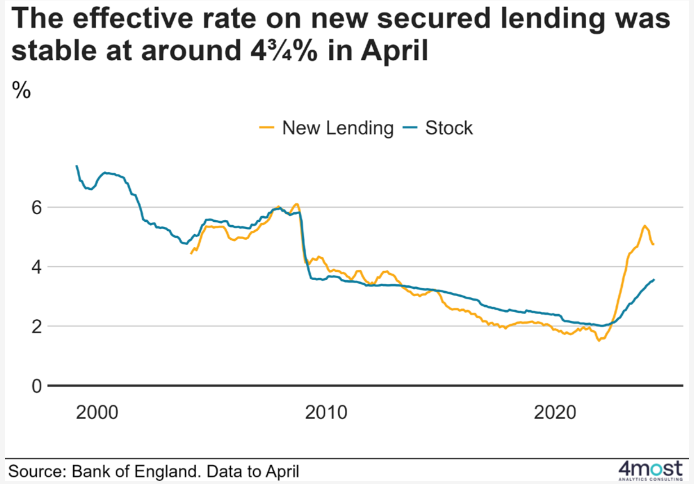
The effective rate of 4.75% a month earlier in April on actual rather than notional completions is close to the quoted rate at the 75% LTV price point. This suggests that the mix of business being done is skewed towards those with bigger deposits.

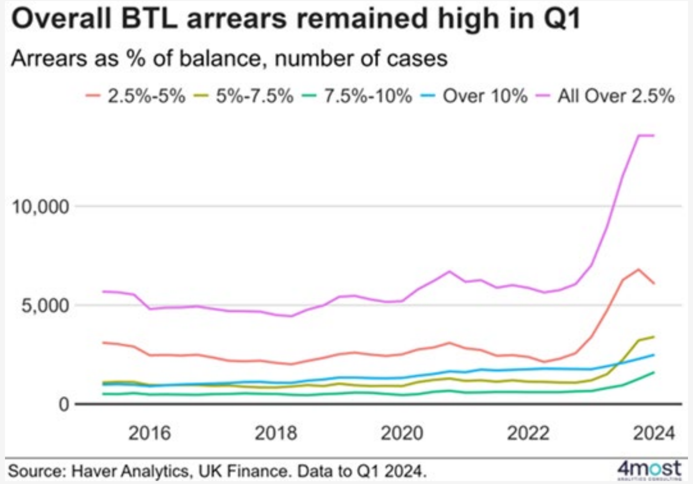
While the gentle rise in the effective rate on the stock of outstanding mortgage tells us many are still to refinance, in Buy-to-Let, where the impact of higher rates has been more immediate.

The total number of BTL landlords in arrears flattened off in Q1. It is far too early to call the peak, particularly given higher rents have make tenants less resilient to other shocks. But the signs are encouraging. And compared to previous episodes, the stress has of course been far less.









THANK YOU.