November 2024

ECONOMIC UPDATE

In partnership with 4most – November 2024

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

The road ahead looks bumpy

- A cursory view would suggest the UK economy is on the right track. Growth is back, unemployment and inflation are low, and interest rates are on the way down. But the election of Donald Trump and the difficult choices made in Budget increase the risks that the economy will be pushed off course.
- First, Donald Trump will shake up the global economy by building tariffs barriers to put US industry first. The UK is insulated a little because its exports to the US are dominated by services, rather than goods. The rest of Europe is far more exposed. Less trade and more inflation are likely outcomes. Additionally, the EU and UK will need to decide how much more they are willing to spend to help Ukraine plug the gap that looks likely as the US pulls its support.
- Second, although the Budget feels like it has already been overtaken by events, by rewriting the UK's fiscal rules, Rachel Reeves has taken a huge gamble that more investment and borrowing today will bring a brighter tomorrow. The spending is front loaded and substantial. The OBR believes the economy will now grow 2.0% in 2025, rather more than own forecast of 1.6%, which reflects our view that firms will look to cut costs and our initial assessment of the shift in geopolitical risks.
- Markets are now pricing in a much higher path for the Bank Rate. That reflects a worry that that inflation is about to return. We now expect the Bank Rate to end next year at 4% rather than 3.75%. But mortgage rates are likely to rise a little on the back of a big shift in market expectations. The recovery in the housing market looks vulnerable.

Risk outlook

- The world feels like a riskier place than it did a few months ago. As well as emboldening Russia, conflict in the South China sea is more likely given Trump's hands-off approach. The structure of the global economy could be shaken up and it is not clear where it will settle. Tariffs do point to higher costs, but worries about global growth are pushing commodity prices down.
- Domestically, chances of higher inflation have grown. There is no slack in the labour market and the OBR estimates that actual output is just 0.2% below potential. While the country clearly needs to repair its hospitals and schools, there is a real danger that spending fuels rising wages in sectors like construction and leads to cost overruns. The reassessment of how much interest rates will fall and the subsequent rise in bond yields show markets believe this is a real risk.
- But there are upside risks as well. It is difficult to 'score' the impact of easing regulation and planning restrictions. They are also difficult to deliver. It is widely recognised that change is needed. While firms are understandably upset where the burden has fallen, doing business could become easier.

Inflation and interest rates

The drop in inflation to a below-target 1.7% in September removed almost any doubt about a November interest rate cut.

Given lower petrol prices and climate-change commitments, it was a surprise that fuel duty was frozen. As always, it is scheduled to rise eventually, just not yet. Given the increase in government spending, we now expect the inflation rate to remain above target in 2025.

The Bank of England believes the increase adds around ½% point to inflation at its peak. And in addition to the Budget stimulus, trends in energy prices are unhelpful.

But the guidance is that the upward forecast revision is not an obstacle to further cuts after the move in November. Our forecast assumes the Bank Rate ends next year at 4% rather than the 3.75% pencilled into the Bank's latest forecasts.

That is also the rate implied in the market curve. The upward shift over the last month is striking and probably an overreaction.

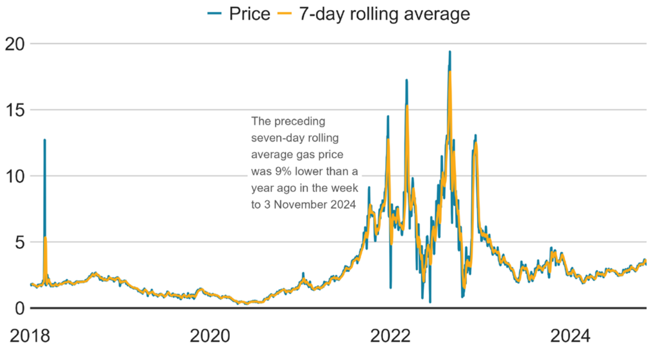
Headline inflation dropped to 1.7% in September, services inflation to 4.9%

% change on year

Source: ONS

Wholesale gas prices are on the rise

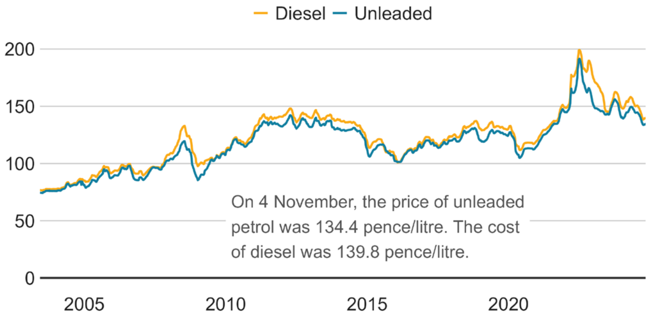
System Average Price (p/kWh)



Source: National Gas Transmission, via ONS

Lower petrol prices played an important role in inflation's fall in September

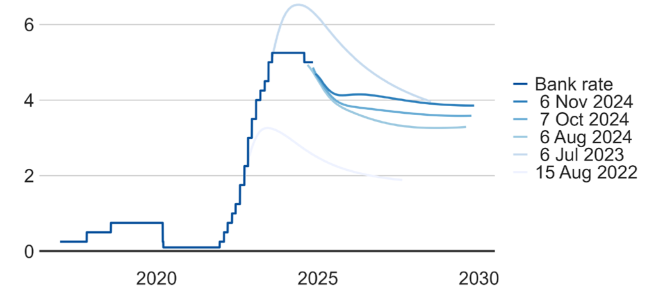
Pence/litre



Source: BEIS

Markets see rates staying much higher for much longer after the Budget

Expectation of Bank Rate implied by the OIS curve, %



Source: Bank of England

Labour market

The low headline unemployment rate of 4.0% in June-August gives an overly rosy impression at odds with the fall in payroll employment of 15,000 in September and of 60,000 since May.

With potential redundancies edging up in late September, we expect the unemployment rate to end the year at 4.3%.

But the uncomfortable truth is that the main labour market statistics are not fit for purpose and forecasts come with wide error bands. There is a possibility the figures are suspended again.

The Employment Rights Bill has started its progress through Parliament. The Federation of Small Businesses has already warned that the 28 new measures “adds to the risks associated with hiring people”.

A rise in employer NICs, arguably a tax on jobs, does little to assuage these worries. Despite all the measures, the OBR estimate of the equilibrium unemployment rate remains at 4.1%. But risks are upside.

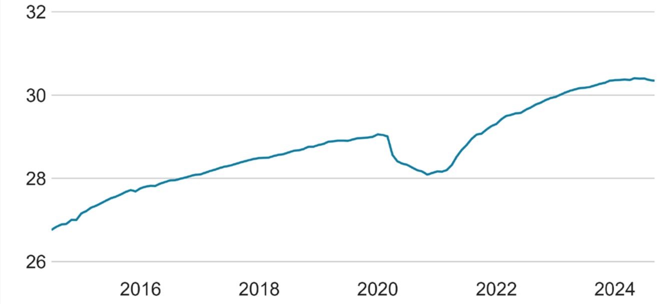
The single month unemployment rate was 4.0% in August

% of workforce

Source: ONS, single month estimate

Payrolled employment fell by 15,000 in September

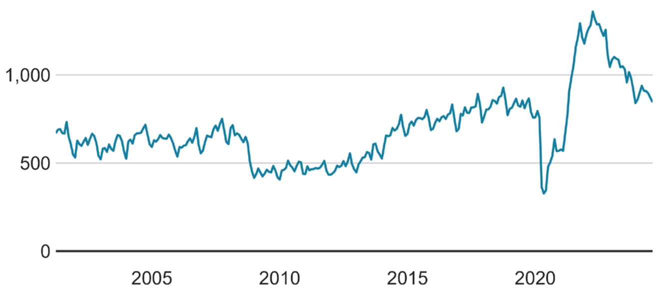
millions of employees



HM Revenue and Customs - Pay As You Earn Real Time Information

It is harder to find a job than it was in the vacancies 'boom', but the number of job openings is just back to more normal levels

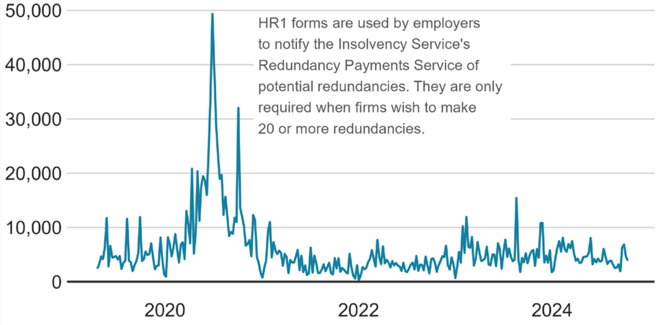
Vacancies. thousands, non seasonally adjusted



Source: ONS, single month estimates to August 2024

Proposed redundancies are higher than in recent months

Potential redundancies, 000s



Source: Insolvency Service HR1 forms, via ONS. Week ending 13 October.

Housing market

As with the wider economy, uncertainty around the Budget has seen plans put on hold. And with markets pricing in fewer rate cuts, the recent increase in demand may not be sustained.

Affordability, which won't be helped by a rise in Stamp Duty for some First Time Buyers next year – is still stretched. Rightmove sees buyers having the whip hand as more properties come to market.

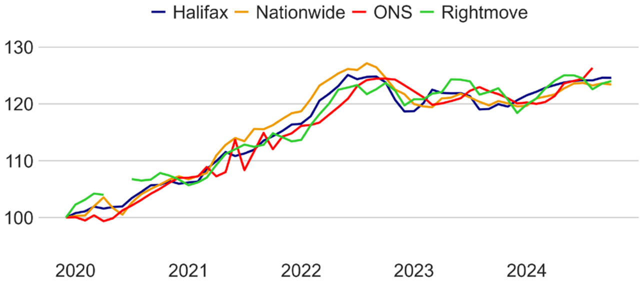
But the picture is mixed. Prices are rising. The RICS survey shows the suggests little slack in the market. Sales have risen more than the number of properties on their books in recent months.

The rise in rate expectations underpins our view that prices will remain flat over the next year; affordability issues have not been resolved. We note that most forecasters are more optimistic than this.

There was not as much help for Generation Rent as we expected in the Budget. The planned reduction in the Stamp Duty threshold from £425,000 to £300,000 in April will go ahead. Under the higher limit, around 20% of First Time Buyers are paying Stamp Duty. Before the temporary increase, the figure was 29%.

Asking prices edged up 0.2% in October as Budget uncertainty put a recovery in activity on hold

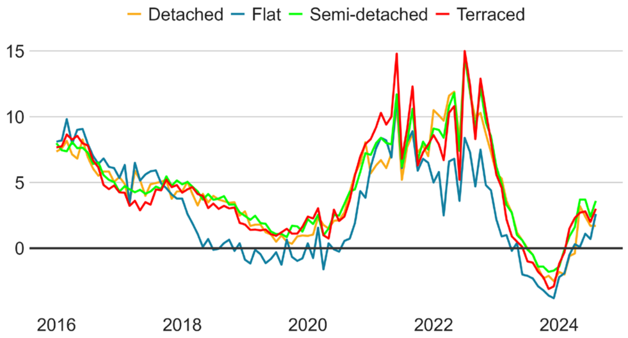
Non-seasonally adjusted, indexed to December 2019=100



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

Inflation across property types has converged

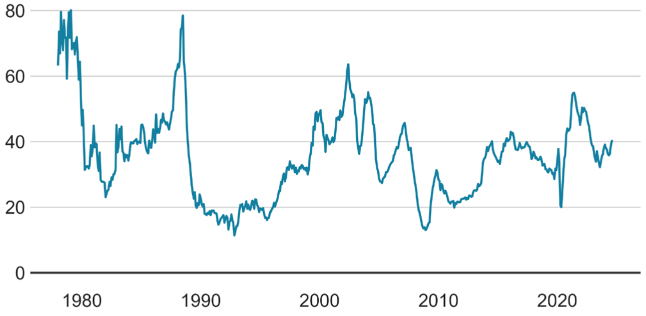
% year



Source: ONS

Sales are rising faster than new instructions, underpinning current valuations

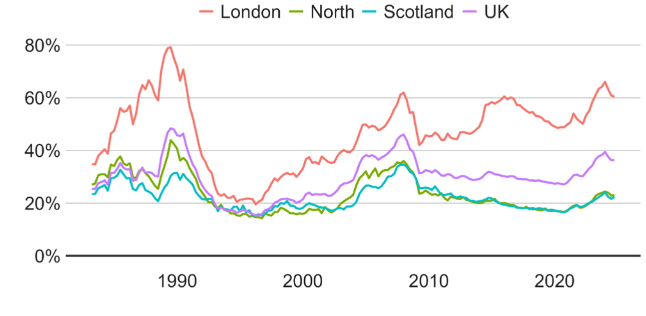
Ratio of sales to stock of unsold property



Source: Haver Analytics, RICS. Data to September

First Time Buyer affordability remains very stretched

First Time Buyer mortgage payments as % of take home pay



Source: Nationwide. Data to Q3 2024

Rental market

Renters' post-housing incomes remain under pressure: the proportion of income spend on a new let has hit new highs.

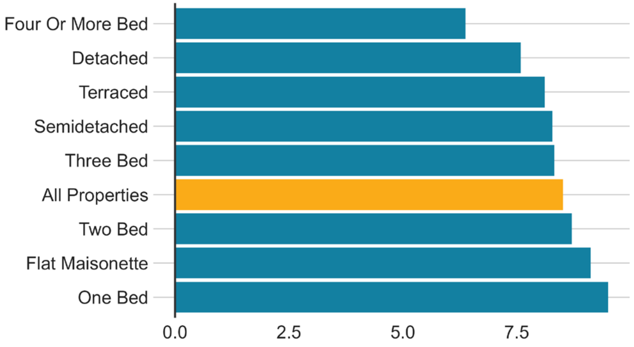
The market is cooling a little. According to Rightmove rents outside Greater London were up 5.2% in the year to Q3, down from 6.8% in Q2. But the damage has largely been done.

From a landlord's perspective there will be relief that Capital Gains Tax was not raised. But the increase in Stamp Duty of course makes the investment decision less attractive.

Gross rental yields have risen with higher rents. But the gap between yields and product rates is still very compressed. The recent increase in the number of smaller portfolios will probably not last.

England: rental prices by type

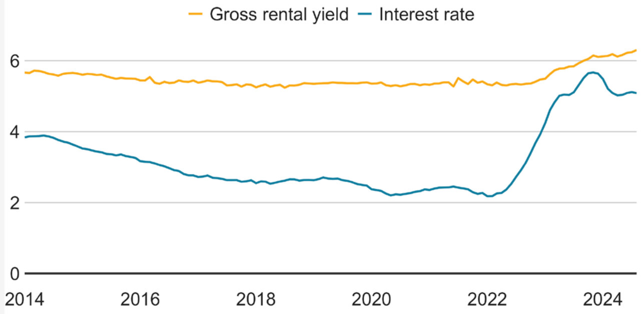
% growth over the last year



Source: ONS

The gap between yields and BTL mortgage rates remains compressed

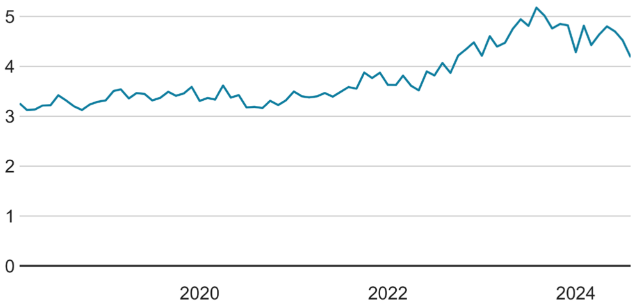
%, all new Buy to Let advances



Source: UK Finance. Data to August 2024

Average portfolio sizes have edged down this year

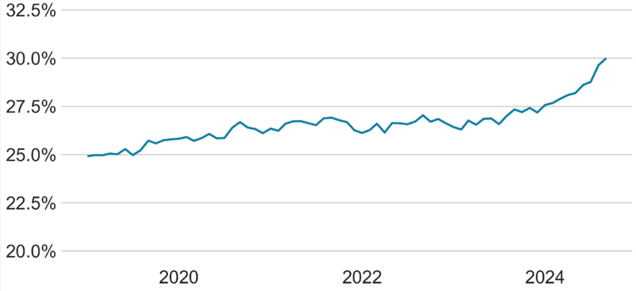
Mean portfolio size (including new property)



Source: UK Finance. Data to August 2024

The proportion of income spent on a typical new let is 4.3% points higher than it was five years ago

Median percentage of gross income spent on rent, nsa



Source: ONS, Dataloft Rental Market Analytics. Data to September 2024

Mortgage market - activity

Although the market continued to recover in September, the rise in rate expectations post-Budget casts doubt over just how durable this will prove.

By design, the Budget will not help the Buy To Let market, although existing landlords will be relieved that the rate of Capital Gains Tax on sales was not raised.

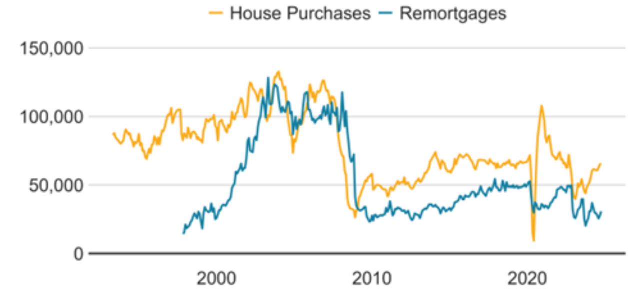
An immediate rise in the higher rate of Stamp Duty for those buying second homes from 3% to 5% will reduce demand for new Buy-to-Let loans. This should mean First Time Buyers will step in to fill the gap. But affordability challenges may be even more acute after the Budget.

Building more homes is the only long-run solution to the problems in the housing and mortgage markets – everything else is just window dressing. An increase in supply would obviously increase lending opportunities.

The government's Budget spending promises and reform to planning are encouraging. But with a shortage of construction workers and uncertain profitability in housebuilding, delivery is a whole different story.

There were 65,600 mortgage approvals for house purchase in September

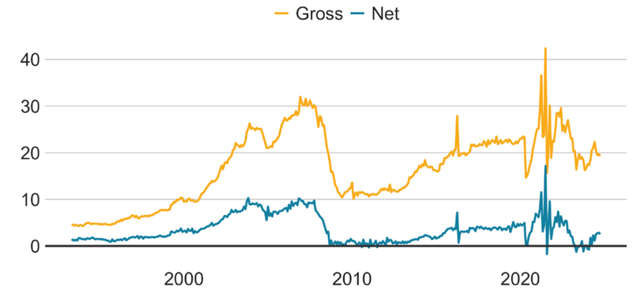
000s per month, seasonally adjusted



Source: Bank of England

Individuals borrowed, on net, £2.5bn of mortgage debt in September

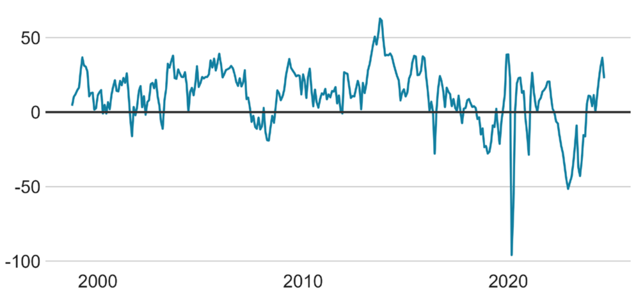
£bn a month



Source: Bank of England

Pre-Budget, the outlook for sales had improved significantly

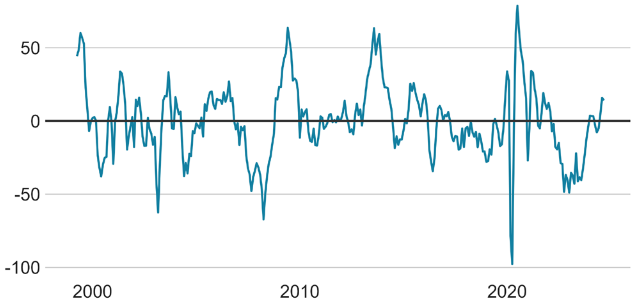
% balance of surveyors expecting sales to rise in the next three months



Source: Haver Analytics, RICS. Data to September

Lower interest rates have brought more buyers back to the market

% balance of surveyors reporting rising buyer enquiries



Source: Haver Analytics, RICS. Data to September

Mortgage market - rates

The effective rate on completed new mortgage business dropped by 8bp in September.

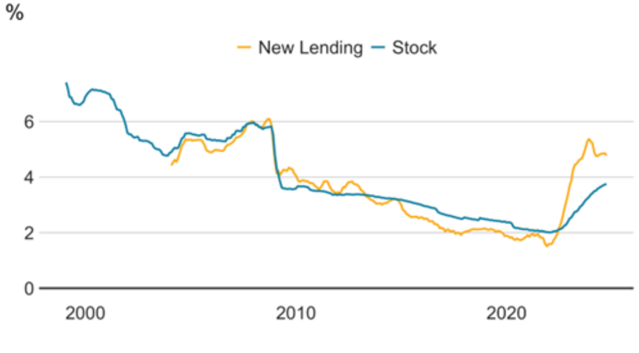
But it may not get much better given rates are now expected to stay higher for longer. Typical mortgage product rates around 4%-4½% look like the new normal.

The good news is that it is now two years since quoted mortgage rates peaked. Those who are now rolling off two-year fixes are set to enjoy much lower monthly payments and will be in a hurry to remortgage.

This is slightly tempered by the dominance of the five-year fixed rate business in 2022. In retrospect those people made a bad decision.

But the increase in popularity of the two-year fix from 2023Q1 onwards will help boost the remortgage pipeline next year.

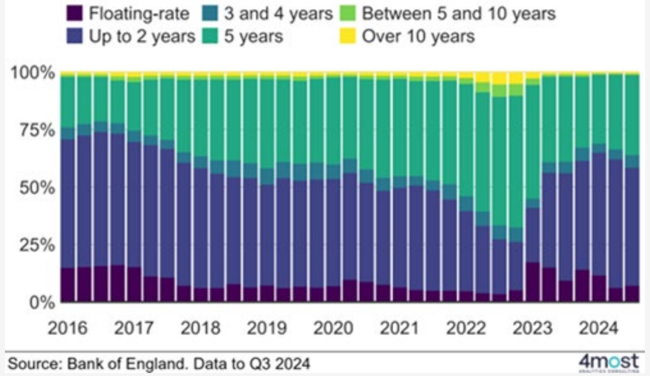
The effective rate on new secured lending was 4.78% in September



Source: Bank of England. Data to September

More people are fixing for slightly longer

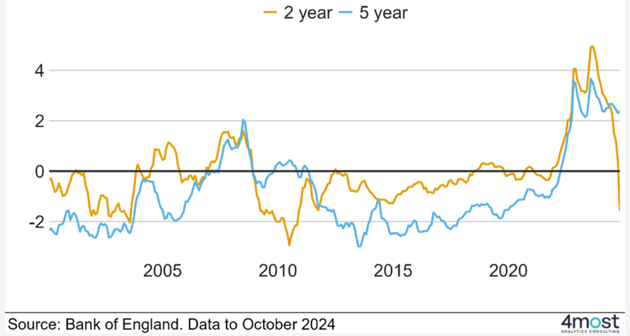
% of new business completed by length of fix



Source: Bank of England. Data to Q3 2024

Payment shock for those coming off two-year fixes has turned negative

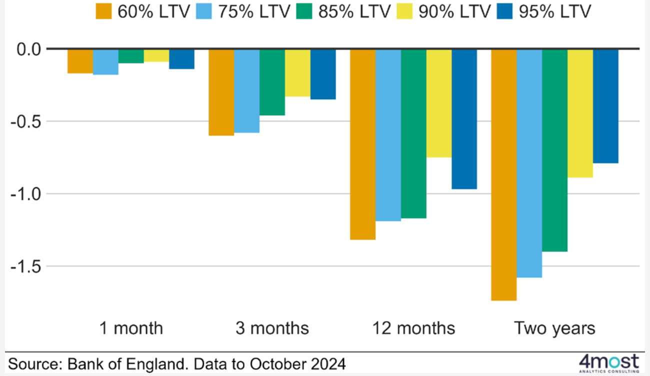
% point change in two and five year fixes over two and five years



Source: Bank of England. Data to October 2024

It is two years since mortgage rates peaked

Change in 2-year fixed mortgage rates (% points)



Source: Bank of England. Data to October 2024

THANK YOU.