August 2024

ECONOMIC UPDATE

In partnership with 4most – August 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

Taxes to rise. Will the recovery survive? Consumers hold the key

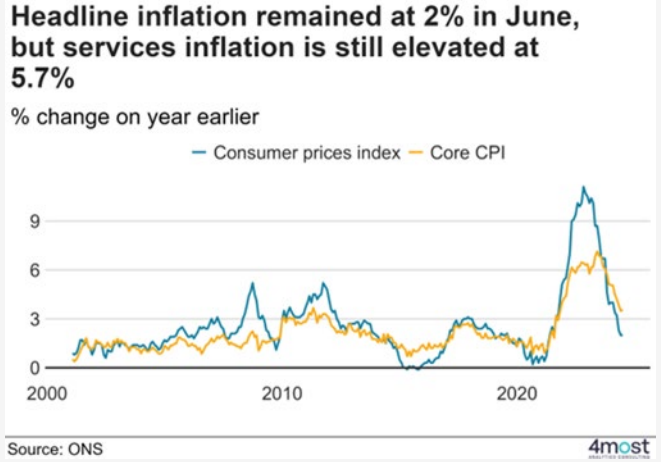
- While welcome, the Bank's decision to cut in August is slightly surprising. The Governor brushed off concerns about entrenched services price inflation, labour market tightness and public sector pay increases after the move. The Bank intends to keep policy "restrictive for sufficiently long". Latest estimates suggest energy bills will rise 10% in October and inflation could be near 2½% at year-end. Only one more rate cut is likely this year.
- Over the last month, financial market predictions of where rates will be have fallen right along the curve. The good news is bringing mortgage rates down to levels that should start to spur more activity. House prices falls now look unlikely.
- Prospects for growth are brightening and forecasts are being revised up on the back of strong growth in real wages and tentative signs consumers are coming out of hibernation. Our view is that GDP will grow by 1.3% in 2024 and 1.7% in 2025, slightly above consensus.
- Labour wasted no time in uncovering holes in the public finances. Given fiscal projections were scored on unrealistic cuts to public spending, tax rises were inevitable whoever won the election and are not a surprise from a forecasting perspective. The Budget on October 30 will probably see capital gains tax rise and perhaps bring pensions within inheritance tax rules. Changes to income taxes on average workers appear to have been ruled out.

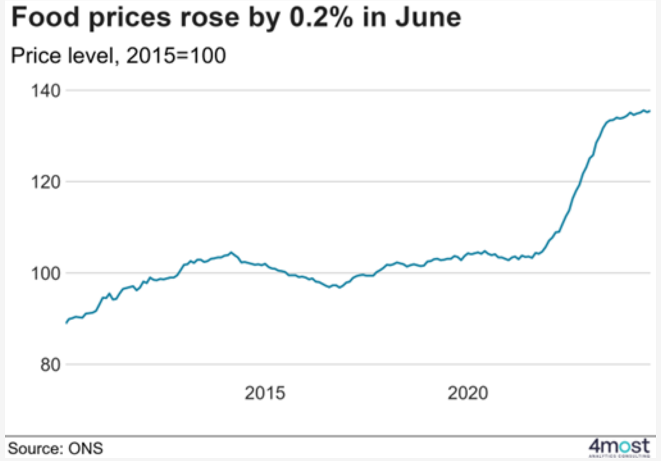
Risk outlook

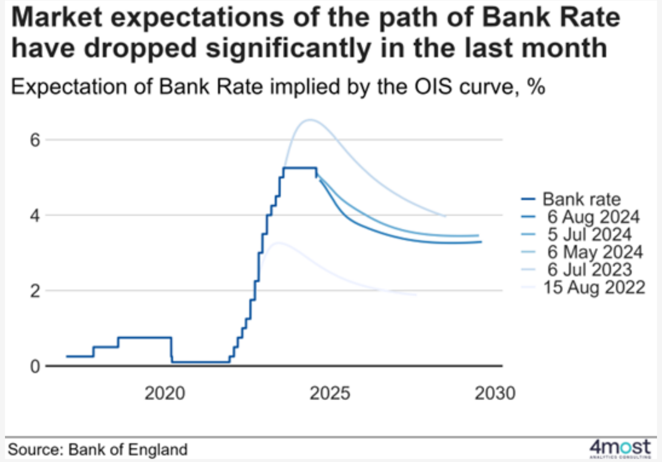
- As well as an end to no-fault evictions, Labour's plans for the rental sector include a requirement that properties are improved to at least EPC C standard by 2030. The environment for the BTL sector will remain challenging.
- The possibility of an escalation of the conflict in the Middle East feels greater than it was a few months ago.
- And turmoil in financial markets reflects several current concerns: overly restrictive monetary policy everywhere, especially in the US; worries of a potential bubble in hi-tech stocks and the fallout from investors on the wrong side of Japan's decision to raise interest rates.
- Talk of a US recession feels overdone based on one bad payrolls number. And while political uncertainty is still to the fore, speculation around who will represent the Democratic party is at least over – and the race is now too close to call rather than leaning towards a victory for Donald Trump.

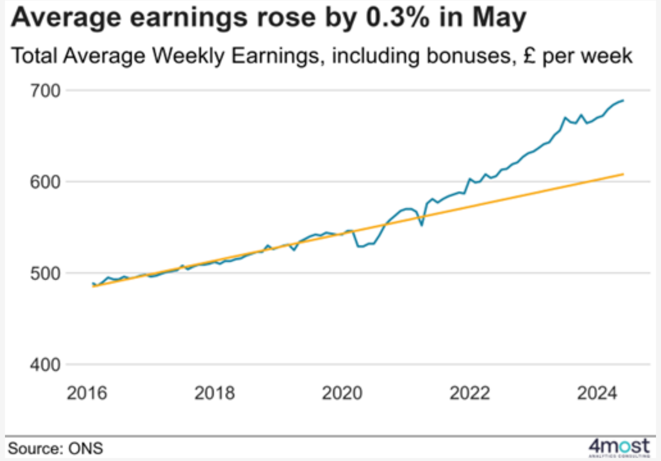
Inflation and interest rates

- Headline inflation remained steady at 2% in June, and services inflation stuck at 5.7%. The rise in hospitality prices was the main upward contribution to services prices.
- Risks remain upside. Food prices rose again after falling in May. PMI surveys suggests a rise in input costs in July, which means the negative trend in goods inflation may not persist.
- Energy prices are expected to rise back above Q2 2024 levels in October after the cut in July. This means that inflation will be slightly higher than previously expected, at 2½%, by the end of 2024.
- Over the last month, market expectations of the future Bank Rate path have been substantially marked down. After the August cut, markets fully price in one more cut this year and for rates to end 2025 at around 3.75%.









Labour market

Unemployment remained at 4.4% in March to May, although the volatile one-month figure edged up to 4.5%.

However, redundancies remain low, and the number of vacancies is much smaller (but may be close to the bottom). This is an economy where it is harder to find a job rather than one where more people are losing one.

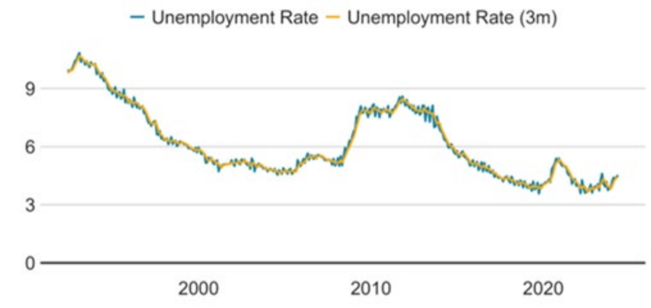
The rise in the unemployment rate (if one believes it amid problems with ONS figures) could be a lagging indicator of the recession in the second half of last year.

More recent evidence from the manufacturing PMI and the Lloyds Banking Group survey suggest recruitment is picking up as the economy brightens.

The government has plans to tackle the rising inactivity rates by working with local authorities through a skills and health plan to encourage more local people into the workforce. This would boost potential output in the medium term if it can be landed.

The single month unemployment rate was 4.5% in May

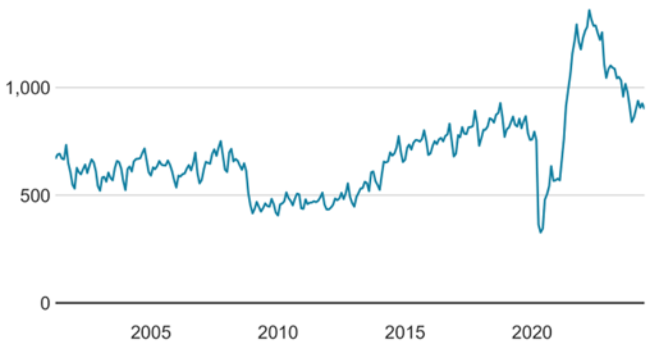
% of workforce



Source: ONS, single month estimate

Vacancies may be stabilising

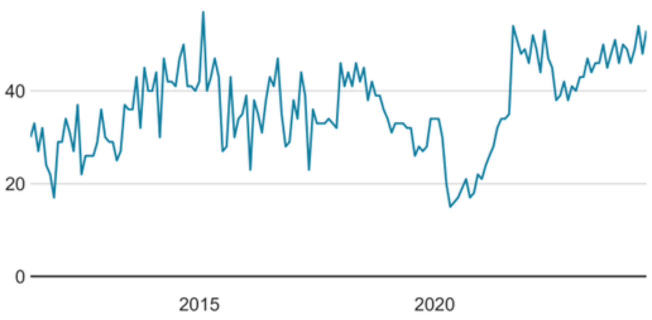
Thousands, non seasonally adjusted



Source: ONS, single month estimates to June 2024

The number of businesses intending to increase employment is rising

Staff levels next year vs past year, % of those surveyed



Source: Haver Analytics, Lloyds Banking Group. Data to July 2024.

The number of potential job losses remains low

Potential redundancies, 000s

Source: Insolvency Service HR1 forms, via ONS. Week ending 21 July.

Housing market

House prices are rising on most measures. The recent drop in borrowing costs will support demand. It is now harder to argue for further falls in house prices than it was a month ago.

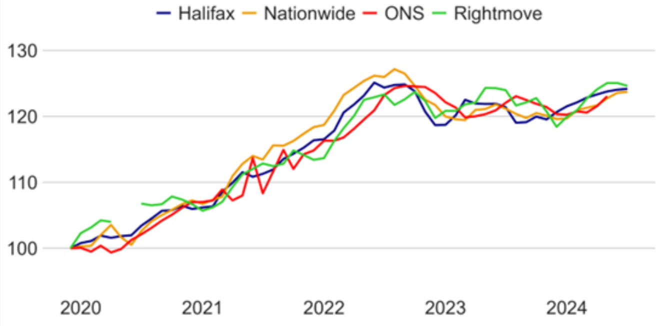
It is still a buyers' market. Just. But Zoopla reports buyers are paying a higher proportion of asking prices than a few months ago. With prices stable, this does suggest a little more pricing power for sellers.

Prices are no longer expected to fall despite lingering worries about affordability. Houses still look unaffordable for most First Time Buyers and the market still looks some way from what we might think of as normal.

Risks to prices are still downside until interest rates come down further and rising incomes restore affordability.

Despite weaker than normal activity, house prices are rising

Non-seasonally adjusted, indexed to December 2019=100



Source: Haver Analytics, ONS, Nationwide, Halifax, Rightmove 4most

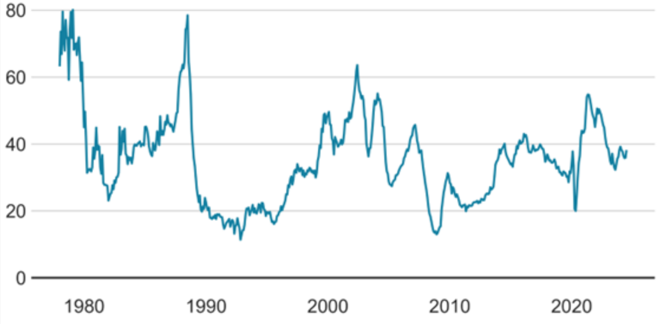
More surveyors now believe that prices will rise

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

Source: Haver Analytics, RICS. Data to July 4most

A tightening market make further price falls unlikely

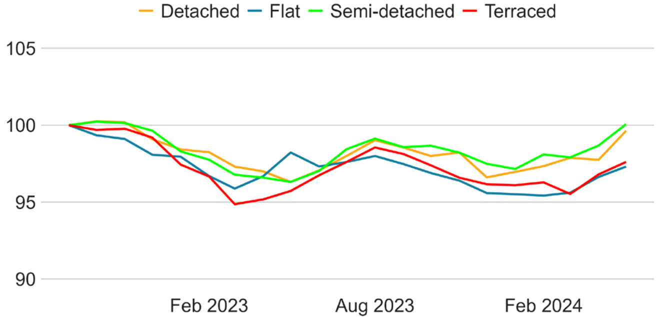
Ratio of sales to stock of unsold property



Source: Haver Analytics, RICS. Data to July 4most

The price of larger properties is back to the previous peak

September 2022=100, non-seasonally adjusted



Source: Land Registry 4most

Rental market

If one statistic sums up the current state of the rental market it is the 17 enquiries the average property gets. This is down from 26 in 2023, but it was just 8 in 2019.

The RICS survey shows a fewer properties coming to market. The risks is that rents continue to rise and remove purchasing power from other parts of the economy as they absorb a greater proportion of income.

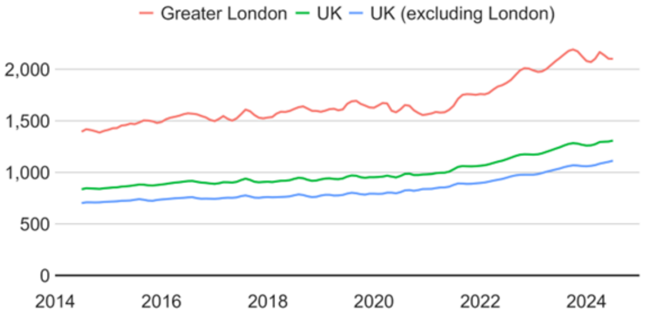
Labour's plans for the rental sector include the scrapping of Section 21 no-fault evictions but will come with more guidance on when possession is allowed.

The Bill, which is at the discussion phase, aims to prevent 'unreasonable' rent increases and prevent bidding wars. This feels close to rent controls and will obviously make BTL less attractive.

Another change that we have trailed for some time is the requirement for landlords to ensure properties have an EPC rating of C or above. This has been confirmed, as part of net-zero targets with a deadline of 2030.

Average rent on a new tenancy in London fell by 0.1% in July

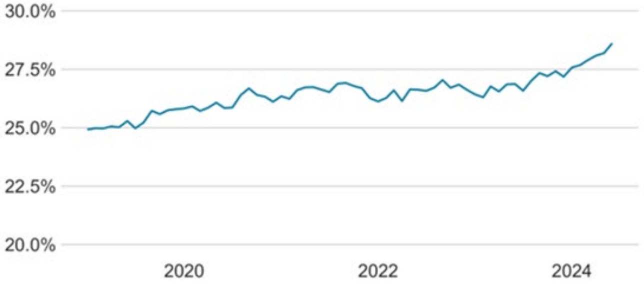
£, monthly rent on newly let property



Source: Homelet. Data to July.

The proportion of income spent on a typical new let is 2% points higher than it was two years ago

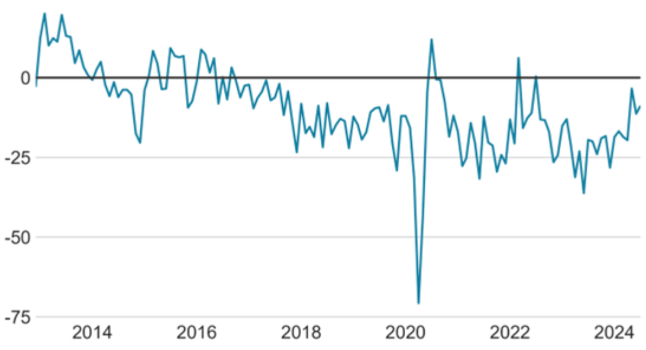
Median percentage of gross income spent on rent, nsa



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

There is a shortage of rental property

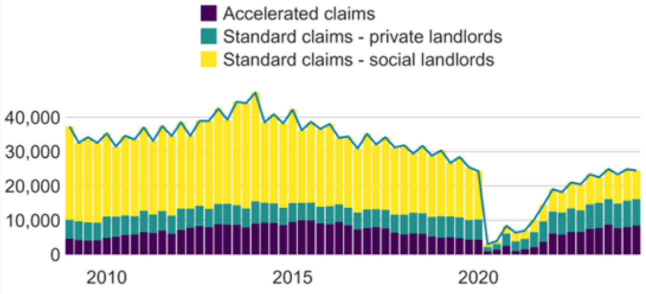
% balance of surveyors reporting rising instructions



Source: Haver Analytics, RICS. Data to July

Accelerated claims may rise in advance of Section 21 evictions being scrapped

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



Source: Ministry of Justice. Data to Q2 2024

Mortgage market - activity

It may still be a buyers' market, the stock of homes for sale is 16% higher than a year ago according to Hometrack, but the number of monthly approvals is stuck around the 60,000 per month mark.

However, borrowing costs fell further during July and surveyors are expecting sales to improve. Lenders asked by the Bank of England are not so sure

Affordability is still the main challenge, a problem that will only be solved gradually if prices remain at current levels.

Falling rates, and perhaps the perception that we are near 'new normal levels' meant more people were happier to fix for longer in Q2. But the two-year fix is still the dominant product.

Labour plans to build 1.5 million homes over the course of the parliament. The aim is to boost the supply of new homes in England to 370,000pa by then. That would increase the size of the mortgage market. But it represents a huge rise from the 231,000 built in 2023, illustrating the size of the challenge.

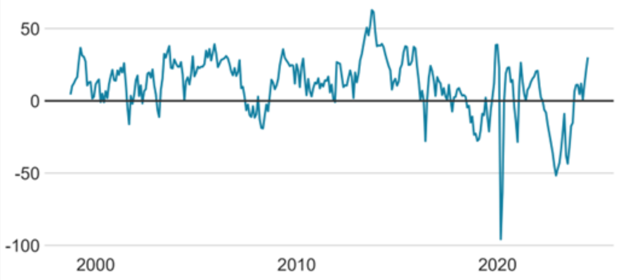
There were 60,000 mortgage approvals for house purchase in June

000s per month, seasonally adjusted

Source: Bank of England

Surveyors are a lot more optimistic about the outlook for sales

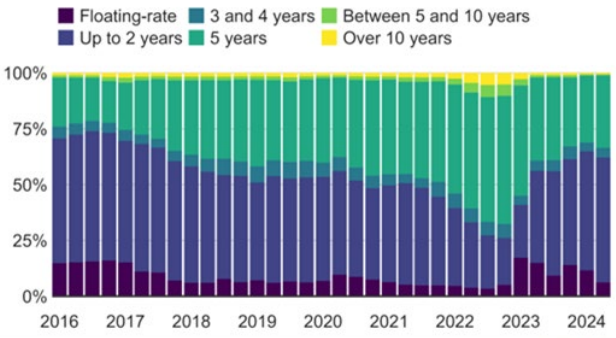
% balance of surveyors expecting sales to rise in the next three months



Source: Haver Analytics, RICS. Data to July

More people are fixing for slightly longer

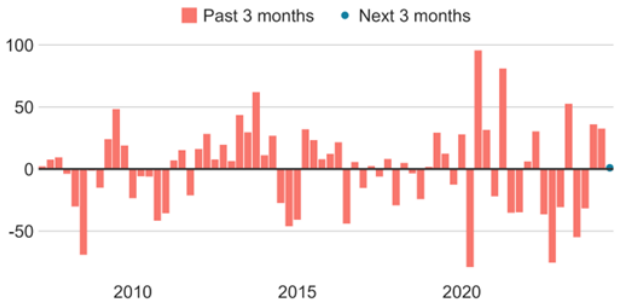
% of new business completed by length of fix



Source: Bank of England. Data to Q2 2024

Lenders see demand for mortgages remaining flat in the near term

Demand for secured lending for house purchase, % balance



Source: Bank of England Credit Conditions Survey, Q2 2024, via Haver Analytics

Mortgage market - rates

The downwards revision of where the Bank Rate is heading has already rippled through into mortgage rates.

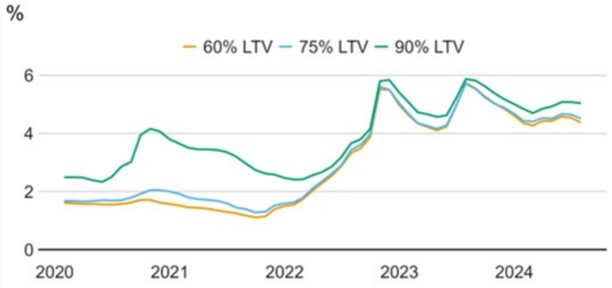
Average typical quoted rates on new lending in July were in the range 4.5%-5%, but those with the largest deposits are again looking at sub-4% rates. 75% LTVs are around 4.3%.

New Bank of England forecasts show inflation below target if market expectations seen in late July materialise. Subsequently markets priced in a lower 'new normal' of 3.3%. This is arguably still too high.

Mortgage rates have fallen more than we expected. They could fall further if the view of the 'new normal' in the medium term comes down again, perhaps on big moves in the US.

Lenders expect spread to widen a little. Whether this is consistent with the level of competition for market share is another question.

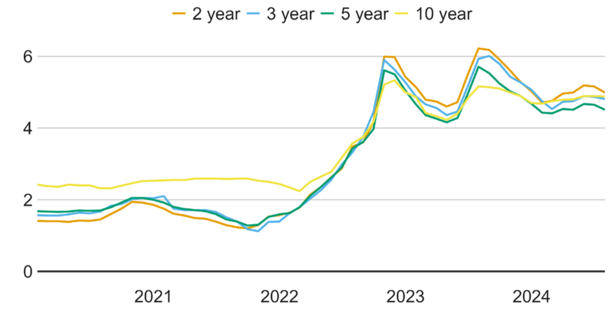
Quoted rates on five-year fixed rates at 60% LTV averaged 4.37% in July but sub-4% deals are now on offer



Source: Bank of England. Data to July 2024

Five year fixes are looking attractive

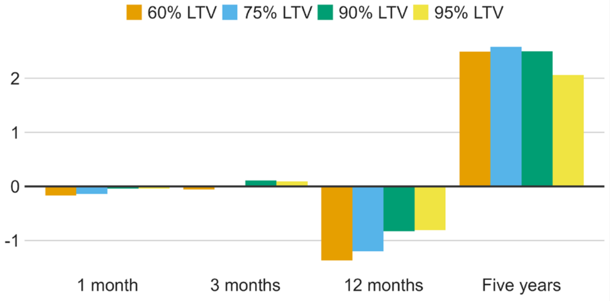
Quoted rates on 75% LTV residential mortgages, %



Source: Bank of England. Data to July 2024

Rates have fallen most at lower LTV points over the last year

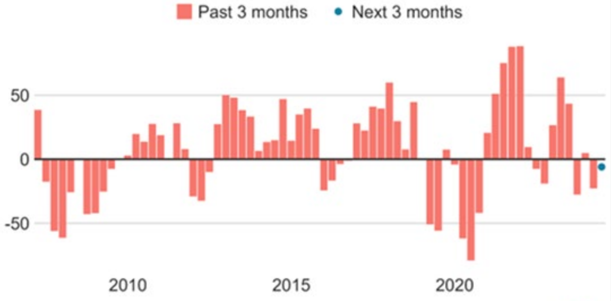
Change in quoted 5-year fixed rates (% points)



Source: Bank of England. Data to July 2024

How have overall secured lending spreads changed?

% balance, negative value indicates widening spreads



Source: Bank of England Credit Conditions Survey, Q2 2024, via Haver Analytics

Mortgage market - arrears

Fewer people – both homeowners and BTL landlords are in early arrears. For the former group, the overall number of cases is down, although this will also reflect more cases flowing from late arrears to possession.

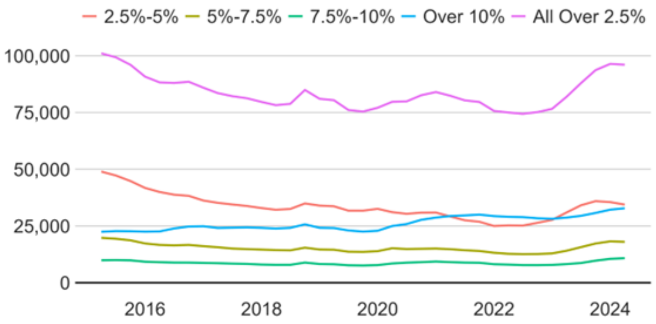
One reading of these trends is that they reflect the luck, or lack of it, that those coming to the end of fixed rates deals had in late 2022/mid-2023. Payment shock is potentially much lower for those whose deals have ended recently.

BTL, where variable rate, interest only products are more common, still has much higher arrears rates than before the Bank of England started raising rates. Possessions have further to rise.

The same is probably true in the homeowners' market given the rise in late arrears in the last two years. But with interest rates falling, the hope is that new cases will continue their decline.

The number of homeowners in arrears edged down in Q2 as the number of early cases fell

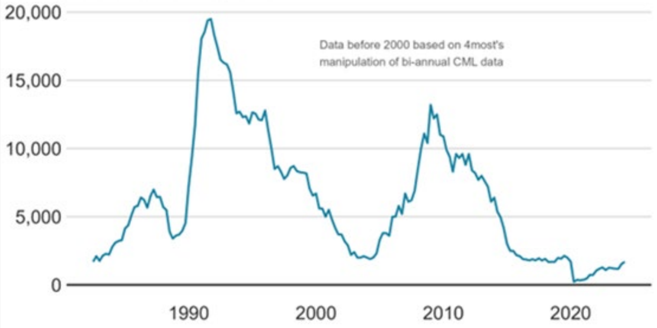
Arrears as % of balance, number of cases



Source: Haver Analytics, UK Finance. Data to Q2 2024.

Overall possessions are still below pre-pandemic levels

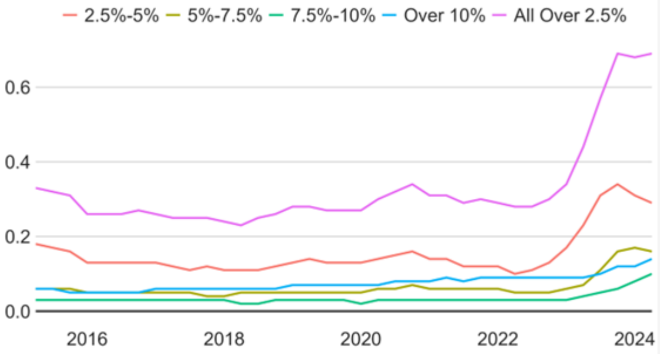
New possessions in quarter



Source: Haver Analytics, Council of Mortgage Lenders, UK Finance. Data to Q2

BTL arrears remain elevated

Arrears as % of balance, proportion of accounts



Source: Haver Analytics, UK Finance. Data to Q2 2024.

BTL possessions have risen significantly

% of mortgages outstanding at annual rate

Source: Haver Analytics, UK Finance. Data to Q2 2024.

THANK YOU.