September 2023

ECONOMIC UPDATE.

THE MORTGAGE LENDER
real life lending

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

Activity is softening as higher rates bite. Does the Bank finally feel it has done enough?

- The last month has brought more evidence that the unprecedented tightening of monetary policy is cooling the economy. Money supply growth has turned negative. The latest survey of Purchasing Managers shows activity contracting in August, while unemployment on the volatile single month measure hit 4.6% in June, only just below the peak of 4.7% we expected to be reached next year.
- A shallow recession is likely in the coming months. But is it enough to give the Bank of England cause to pause? That largely depends on wage and price news later this month. Developments in August point to a further rise to 5.5%. But with the Bank's Chief Economist expressing a view that rates could remain at 5.25% and then stay there for longer than markets expect, a pause would not be a surprise.
- House prices fell 0.8% in August on the Nationwide measure. If the wider economy is largely muddling through, the impact of higher rates is likely to be felt for some time in the housing market. Given the moribund state of activity, especially in the First-Time Buyer market, prices need to fall at least another 5% to return affordability to a more sustainable position.

Risk outlook

- The hardest yards in the battle to get inflation back to target may be yet to come. The energy price cap will fall by 7.3% in October but wholesale gas and petrol prices are now on the rise again. And while worries about Russia's blockages of grain are lessened, the impact of extreme weather on food prices has not.
- China's property market is often cited as a potential source of instability, both for that country and wider world. The economy is clearly spluttering, and efforts are again being made to kick-start domestic demand. The nature of the Chinese state means it can take economic measures that would be unacceptable elsewhere.
- But its bumpy progress could lead to deflationary pressures and other forms of instability given the interconnected nature of world goods and financial markets.

Inflation and interest rates

Although inflation fell sharply in July as the domestic energy price cap was cut, the underlying picture is still worrying.

Core inflation remains stubbornly high, and services inflation rose to 7.4% (up from 7.2%). Hotel and air transport made big upward contributions. Monthly rises remain too high for comfort.

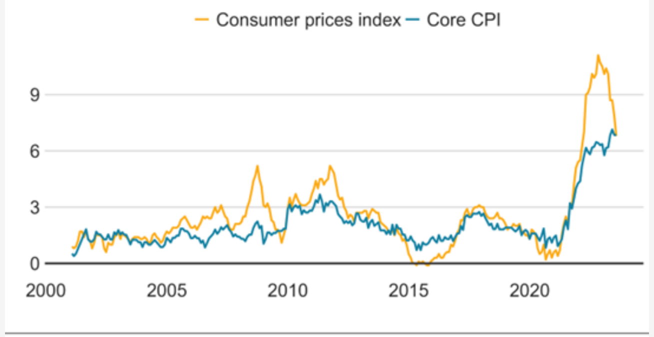
It is not all bad news. Prices of milk, bread and cereals fell between June and July.

The peak in interest rates feels close: markets expect a further 50bp of tightening. What comes next depends on wage and inflation numbers between now and the MPC meeting on September 21.

The danger is that the Bank does too much. On balance the stubbornness of core inflation points to one final increase to 5.5%, although a pause is arguably justified by recent business surveys showing the economy and labour markets cooling.

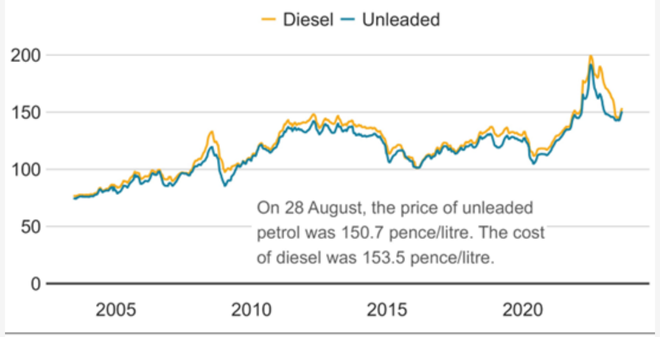
Headline inflation dropped to 6.8% in July; core inflation remained unchanged at 6.9%

% change on year



Source: ONS

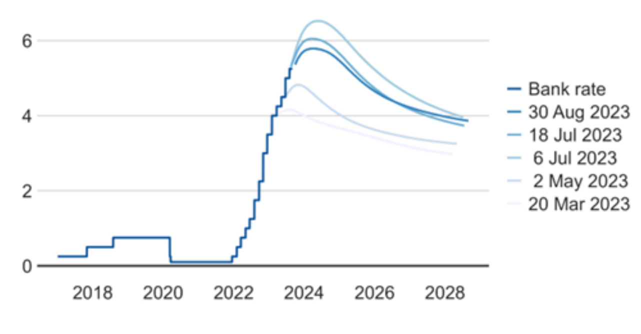
Petrol prices have edged up again in recent weeks



Source: BEIS

The markets expectation of peak Bank Rate is back down to just above 5.75%

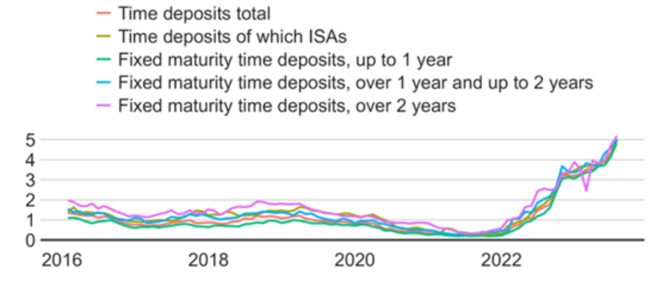
%



Source: Bank of England

The effective rate on total time deposits rose by 50bps in July

Effective interest rates for individuals and individual trusts, on new time deposits (%)



Source: Bank of England. Data to July

Labour market

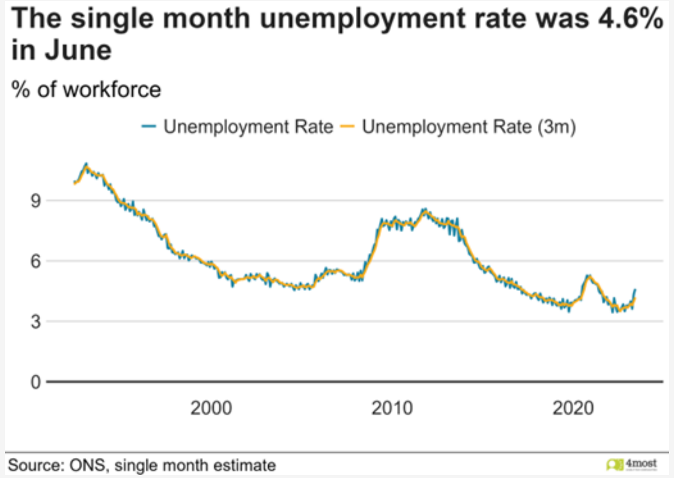
The labour market has softened more than expected. While the April-June unemployment rate was 4.2%, the latest single month figure was considerably higher.

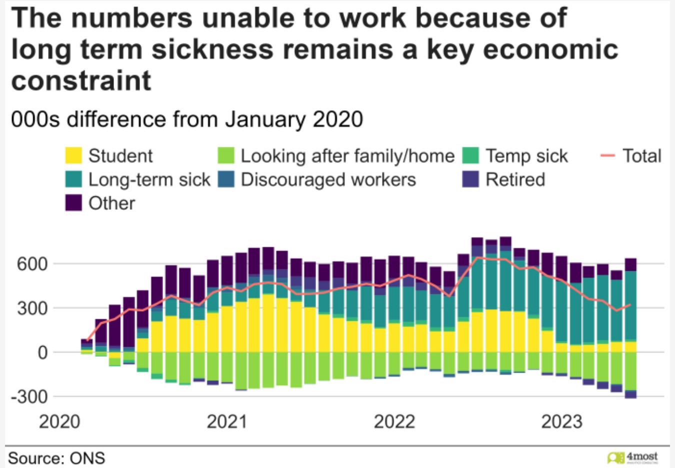
Some of the rise in those unemployed is probably those entering the labour force from family care not finding jobs. But there were also 66,000 fewer people employed in Q2.

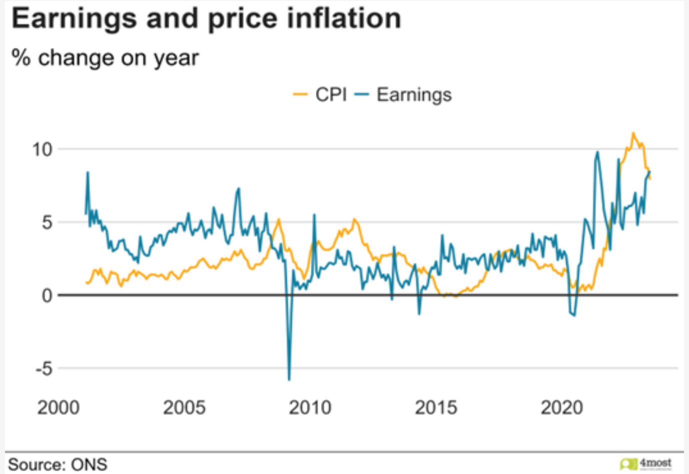
Wages grabbed the headlines again. Total pay rose 8.2% in Q2, but a one-off NHS bonus payment in June played a large part. Strong growth in financial services (9.4%) and manufacturing (8.2%) make for a tricky Bank of England decision in September.

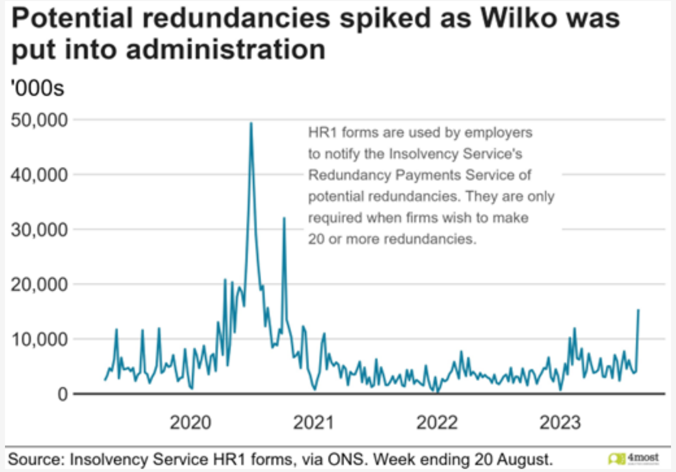
Some 12,500 jobs are at risk at Wilko. But more encouragingly, the number of firms proposing redundancies remains stable.

The unemployment rate is expected to peak at 4.7% next Spring.









Housing market

Although mortgage rates eased, asking prices fell 1.9% in August. While some of this reflects seasonal patterns, affordability constraints still dominate.

Housebuilder Crest Nicholson called out the absence of First Time Buyers in its trading update. Further price falls (and/or government subsidy) are needed to return the market to a more sustainable footing.

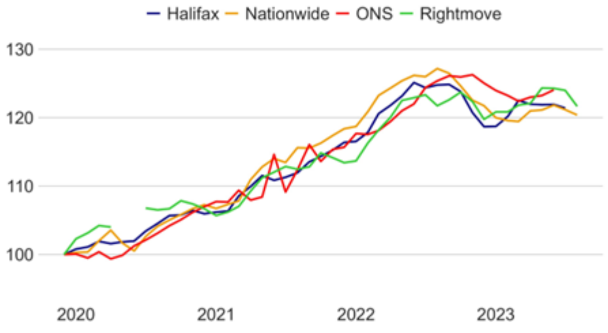
Prices are still expected to fall 10% from the peak last year. Surveyors in London are less pessimistic about the outlook for prices in the coming quarter than those elsewhere.

The average advance for house purchase has fallen 9% since Q3 last year. The average income on a mortgaged house purchase is at an all-time high. Demand continues to shift to smaller more affordable properties.

Prices have already fallen significantly in real terms. Strong growth in income does make it possible to argue for a period of stagnation rather than large falls, providing mortgage rates fall further.

Asking prices fell sharply in August

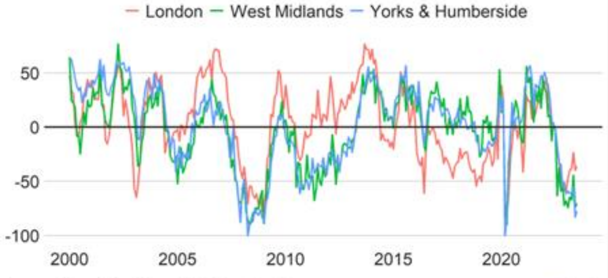
Non-seasonally adjusted, indexed to December 2019=100



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

Surveyors in London are less gloomy than those elsewhere

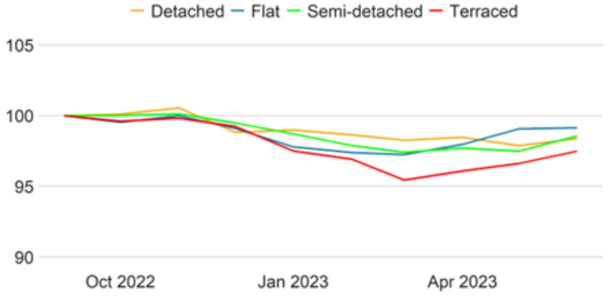
% balance of surveyors expecting house prices to rise in the next three months



Source: Haver Analytics, RICS. Data to July

The price of flats is holding up better than larger property

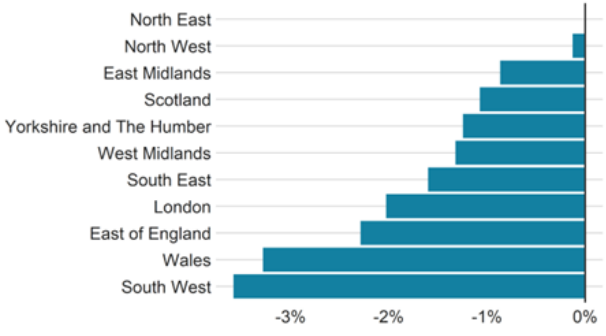
September 2022=100, non-seasonally adjusted



Source: Land Registry

Peak to trough fall in house prices

% change from the peak, seasonally adjusted index



Source: ONS

Rental market

There is now a little more evidence that landlords are selling up. By end-June there were 20,000 fewer Buy-to-Let mortgages outstanding than in December. And accelerated landlord possession claims are rising.

That removal of supply may help explain some of the current upward pressure on rents, the ONS stock measure is gradually catching up with growth in the cost of new lets.

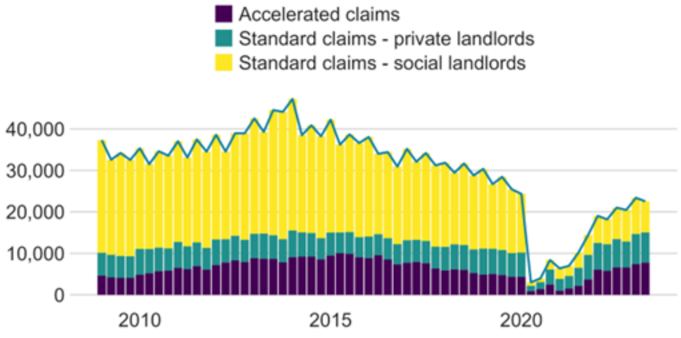
But strong wage growth is just as persuasive an explanation. Demand remains strong despite the rising cost of renting.

More selling-up is likely before the Renters Reform Bill is introduced. The economics of Buy-to-Let are likely to remain challenging.

Stretched affordability may mean more demand for shared accommodation, or for some, returning to parental homes.

There are more accelerated landlord claims than before the pandemic

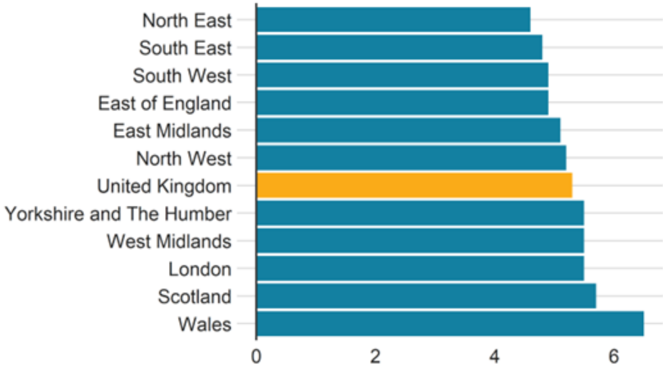
Number of claims in quarter, England and Wales



Source: Ministry of Justice

UK rents grew 5.3% in the year to July

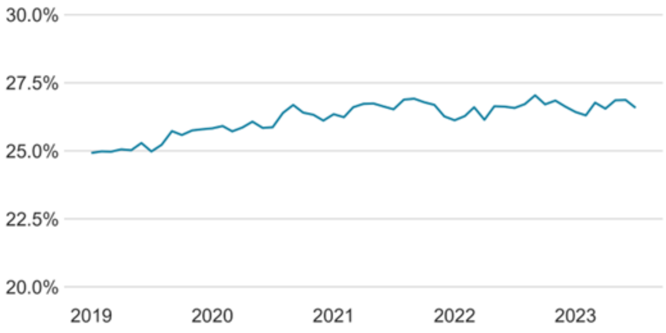
% year



Source: ONS

The proportion of income spent on new lets remains stable

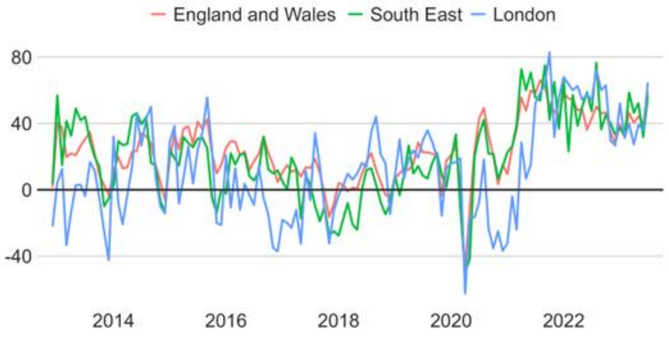
Median percentage of gross income spent on rent, nsa



Source: ONS, Dataloft Rental Market Analytics. Data to July 2023

Despite higher rents, demand is still strong

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



Source: Haver Analytics, RICS. Data to July

Mortgage market - activity

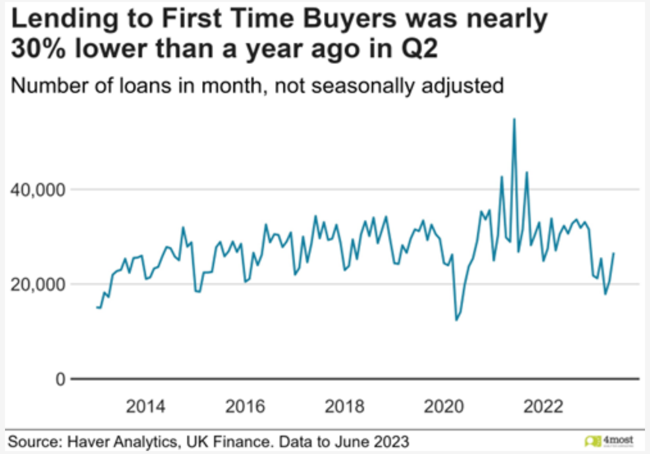
With mortgage rates continuing to ease after the turmoil in July, activity is likely to improve. But the market still feels a long way from 'normal'.

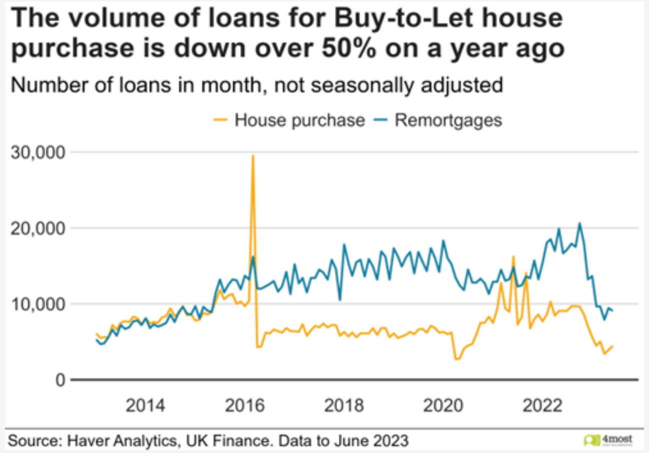
New landlords are largely shunning the Buy-to-Let market; the poor economics of the investment, the coming Renters' Reform Act, and energy efficiency requirements are all disincentives.

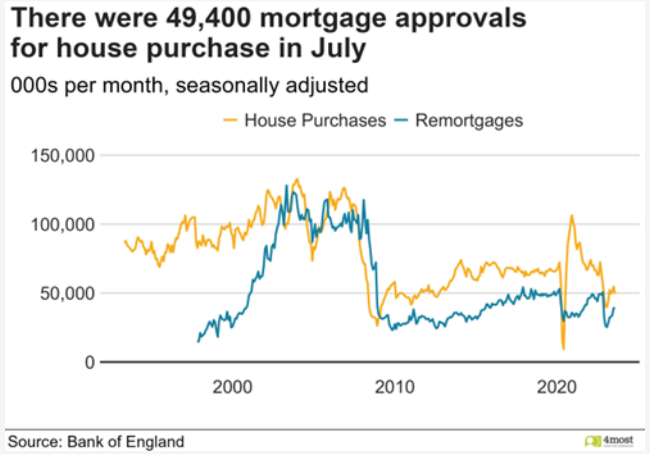
Affordability constraints continue to rule out a lot of potential First-Time Buyer activity. Lower house prices are still the main route to an improvement here.

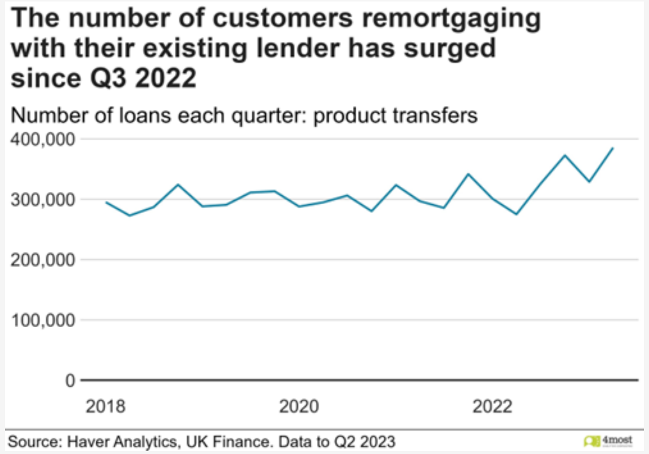
Bank of England remortgage figures do not capture those staying with their existing lender. UK Finance confirm product transfers are one of the few areas of market growth.

With the 'new' market thin, existing lenders will continue to focus on retention. Organic growth of mortgage books will remain difficult.









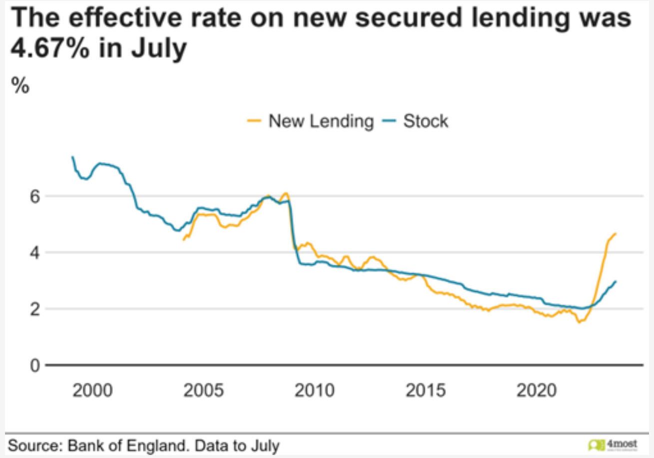
Mortgage market - rates

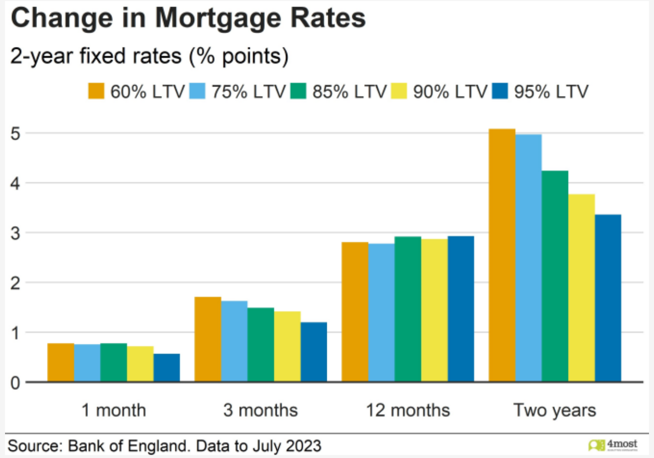
There is no incentive for the Bank to talk down market expectations of a sustained period of higher rates. The ‘higher for longer’ repricing in markets helps it do its job.

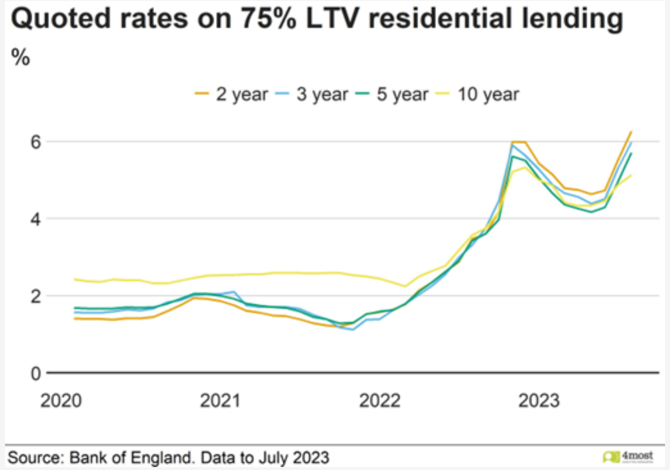
But the implied path mean much higher real rates than those seen since the Global Financial Crisis. It is not clear the economy can cope with that.

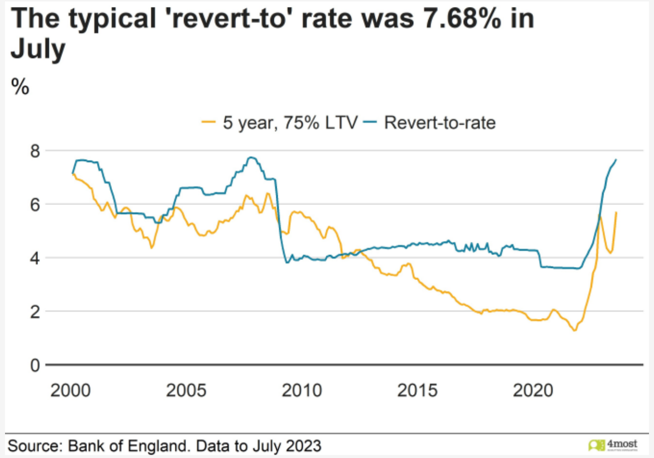
In recent days, the Bank’s chief economist has said he’d be comfortable if rates remained at 5.25% rather than rising further, but then stay at this level for longer than markets expect.

If events did unfold like this then the cost of shorter-term lending could fall relative to that of longer-term fixes. The recent dominance of the five-year fixe could be about to end.









THANK YOU.