December 2024

THE MORTGAGE LENDER
real life lending

ECONOMIC UPDATE

In partnership with 4most – December 2024

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

Growth likely to disappoint as caution prevails

- While survey evidence is mixed, on balance the current soft patch looks likely to be extended. The latest Purchasing Managers Index suggests output in the service sector stalled in November, while manufacturing contracted. Consumer confidence rose a little as some of the Budget uncertainty was lifted but is still very subdued.
- Growth next year is now expected to be just 1.3%, down from 1.6% a few months ago as firms help back on investment and recruitment. This is despite the front-loading of government investment which the OBR believes will see GDP rise 2.0% in 2025. Unemployment – to the extent that we can measure it – is not expected to rise.
- Financial markets continue to digest the contents of the Budget. While the Bank Rate is still expected to fall more slowly and not quite as far as priced in pre-Budget, long-term gilt yields are now back to where they were before the Chancellor's speech. This is good news for the government's debt service costs bill and reinforces the view that risks of further big falls in commercial property prices are now unlikely, as high rates had been a key driver of the falls over the last two years.
- While inflation is expected to remain slightly above target, this is not a barrier to cuts in interest rates given policy remains restrictive. We expect the Bank Rate to end 2025 at 4%. Affordability is still challenging in the housing market. But both activity and prices are rising as more people start to get on with their lives after the pause as rates went up.

Risk outlook

- The world still feels like a riskier place than it did a few months ago. Equity markets seem sanguine about Donald Trump's plans to shake up the global economy. Are the risks of a possible global slowdown fully reflected in financial markets? If not, a large reappraisal of the value of riskier assets is possible. The Bank of England recently pointed to low risk-premia and the UK's exposure to market-based finance. It doesn't help that memories of the last financial crisis are fading.
- The era of protectionism we may be entering could well exacerbate the weak economic performance of the UK's key trading partners in the EU. Domestically, the crowding out of private sector activity and potential job cuts as employment becomes more expensive and the labour market less flexible looks to be a key concern. Voices of employers' organisations are getting louder on this issue.
- The outline of a more optimistic view would start from the position that the UK's household and corporate sector balance sheets are good shape. The same is true of the banking sector according to the results of this year's desktop stress test. Government spending will stimulate more activity in areas like construction. There is still a good case to be made for stronger growth in 2025.

Inflation and interest rates

Although the 10% rise in energy bills was no surprise, the jump in headline inflation to 2.3% was a little higher than expected and speaks to the stickiness of the overall picture, especially in services.

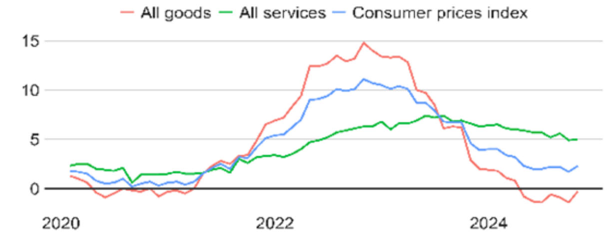
Stepping back, the government is going to be spending more at a time when there is very little spare capacity in the economy. That will tend to raise the cost of goods and services. And where possible, firms may look to share the cost of higher NICs with customers.

Some of the dust has settled in financial markets over the last month and the expected near-term path for interest rates has eased down slightly. With more inflation about, a fall in the Bank Rate to 4% by end-2025 is priced in. But after that the market view is just another 50bp of easing.

That terminal rate is far higher than most economists expect. Given the economy has not coped well with real interest rates this high in the past, the 4most view is that rates will eventually settle at 2.75%.

Headline inflation jumped to 2.3% in October as domestic energy bills rose by an average of 10%

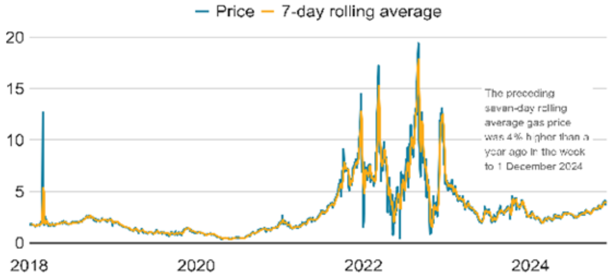
Inflation, %



Source: ONS

Wholesale gas prices are now higher than at the same time last year

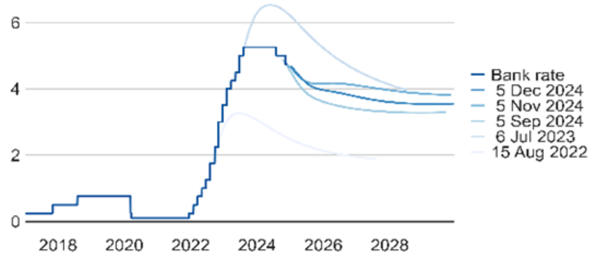
System Average Price (p/kWh)



Source: National Gas Transmission, via ONS

Markets are still pricing in higher rates than was the case three months ago

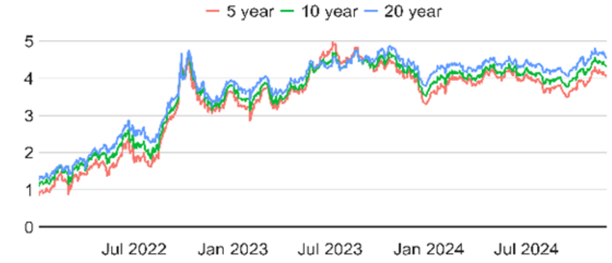
Expectation of Bank Rate implied by the OIS curve, %



Source: Bank of England

Gilt yields are back below where they were just before the Budget

%



Source: Bank of England

Labour market

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Reading the UK labour market remains challenging given the poor state of the headline statistics – the survey issues may not be solved until 2027.

The uncomfortable truth is that the main labour market statistics are not fit for purpose. There is an argument for suspending the figures again.

But the pieces of the puzzle we do have suggest job creation has come to a halt. The rise in employer NICs will exacerbate this.

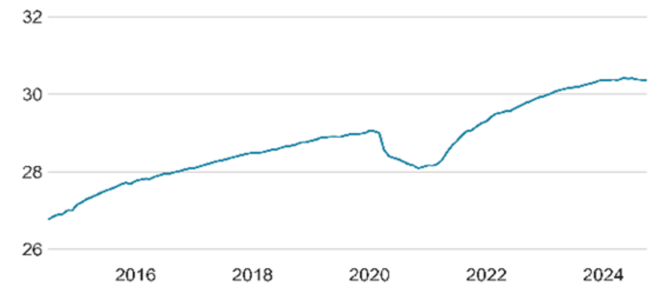
Yet there is no sign that more workers are losing their jobs than usual.

The squeeze from higher labour costs is most likely to be felt in scaled back recruitment plans. The Institute of Directors says there are more firms looking to shed workers than there are creating new jobs. The Lloyds Banking Group survey disagrees.

The increase in NICs and minimum wage could lead to significant job losses in retail and hospitality. The OBR projects an unemployment rate of 4.1% in a year's time. Our view is that it will stay around 4½%.

Payrolled employment fell by 5,000 in October and is 48,000 below its peak

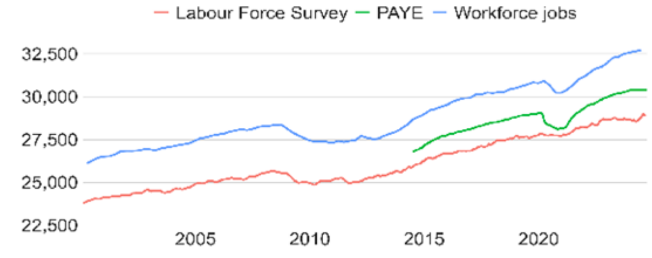
millions of employees



HM Revenue and Customs - Pay As You Earn Real Time Information — 4most

Alternative views of the labour market paint a more positive picture than the Labour Force Survey

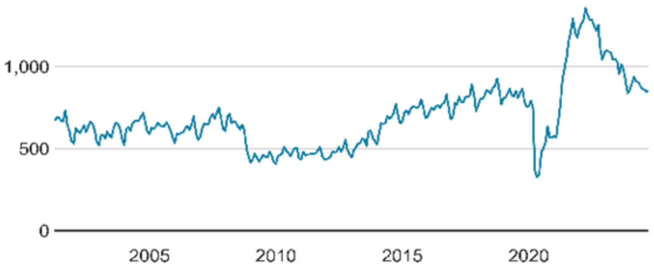
Employees, thousands



Source: ONS — 4most

There are 400,000 fewer vacancies than there were two years ago. The largest falls are in retail and hospitality

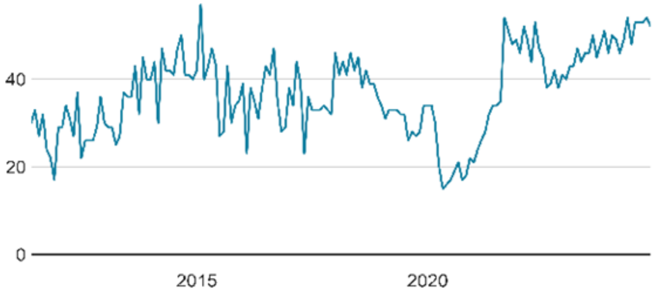
Vacancies. thousands, non seasonally adjusted



Source: ONS, single month estimates to October 2024 — 4most

A narrow majority of firms intend to increase employment next year

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



Source: Haver Analytics, Lloyds Banking Group. Data to November 2024. — 4most

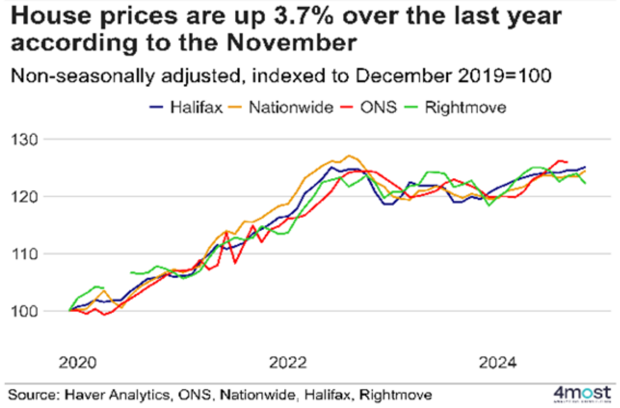
Housing market

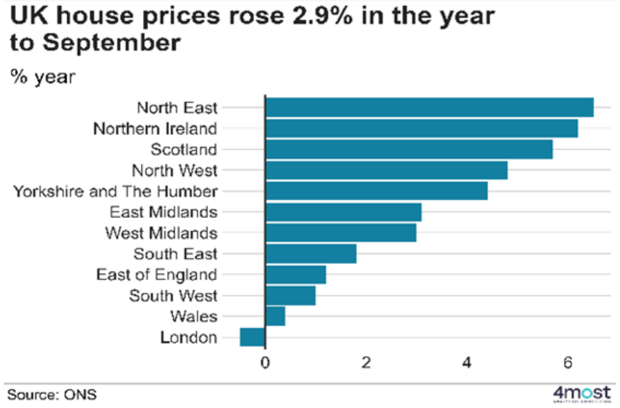
Regardless of any lingering worries about affordability, which were not helped by the Budget, house prices are heading up. And, as ever, the simplest and most persuasive explanation is that the market is tight.

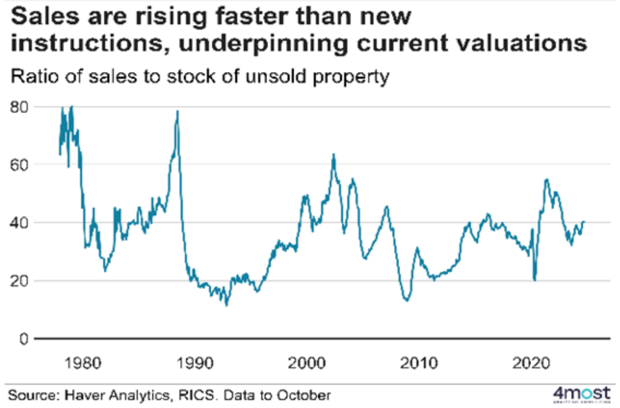
Prices are back at all-time-highs according to the ONS (whole market, completions), and Halifax (mortgage approvals), but not quite if you look at the Nationwide (approvals) and Rightmove (asking prices).

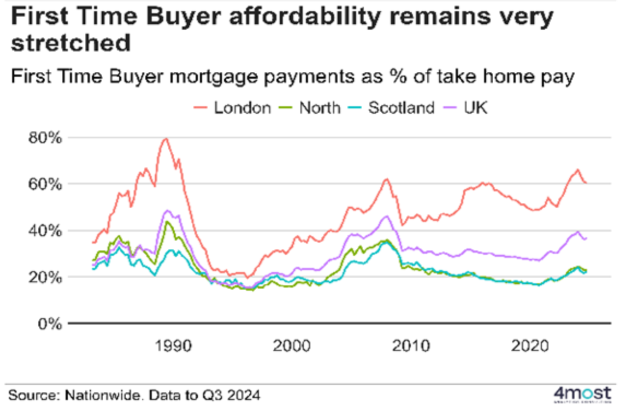
Our flat forecast for prices over the next year is cautious because the monthly cost of a new mortgage still feels inconsistent with a vibrant market.

But the consensus view is that prices will rise around 2% in the year to Q4 2025. And prices have continually surprised on the upside.









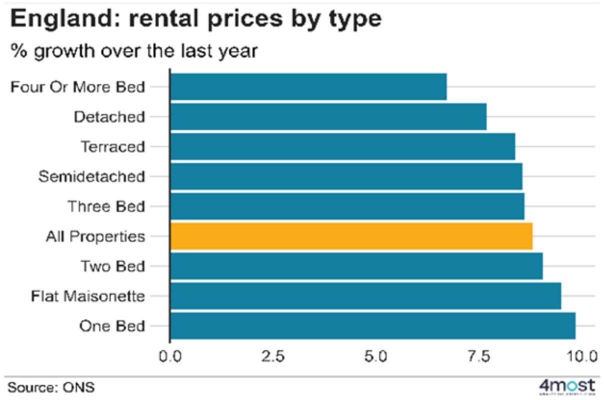
Rental market

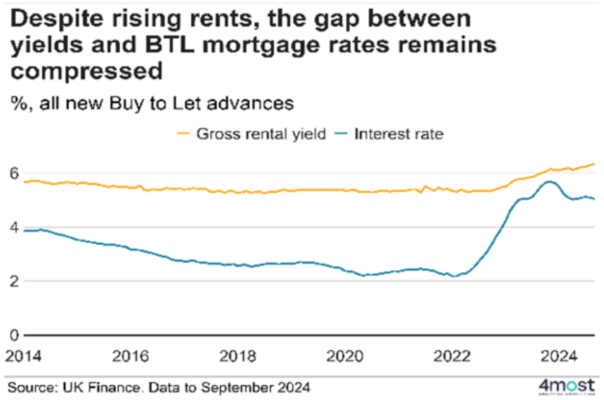
The average cost of a new let rose 3.4% in the year to October (Homelet). But the average private sector rent for existing lets was 8.7% higher over the same period – a better current summary of the squeeze on tenants' finances.

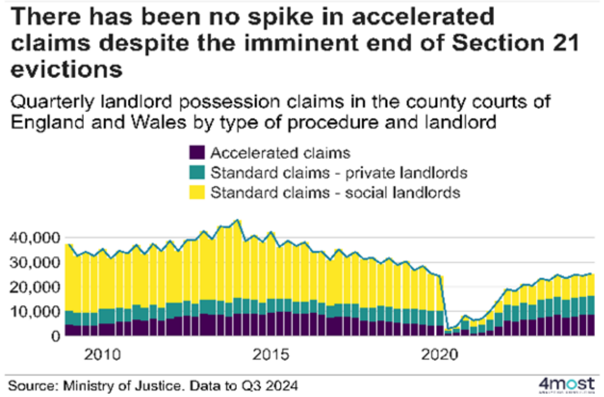
The market remains very tight according to surveyors. Demand is still strong, and the number of new instructions is still shrinking. New rents are now expected to rise in line with earnings growth of around 3%. The 'stock' measure will gradually reflect this.

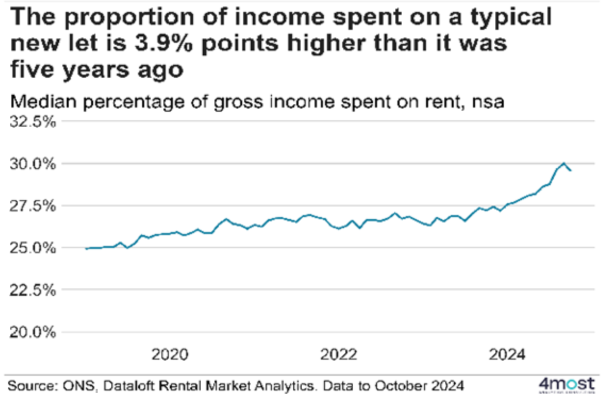
A big rise in bank deposits may mean a few landlords sold up in advance of a potential Capital Gains Tax in the Budget. But Section 21 notices, while higher than in 2018/19 indicate most landlords are staying put.

The economics of the BTL investment decision will remain challenging. But the gap between gross returns and the typical product rate is widening and is now back to 174 basis points.









Mortgage market - activity

A removal of some of the uncertainty after the Budget appears to carry greater weight than the prospect of slightly higher product rates. The recovery continues.

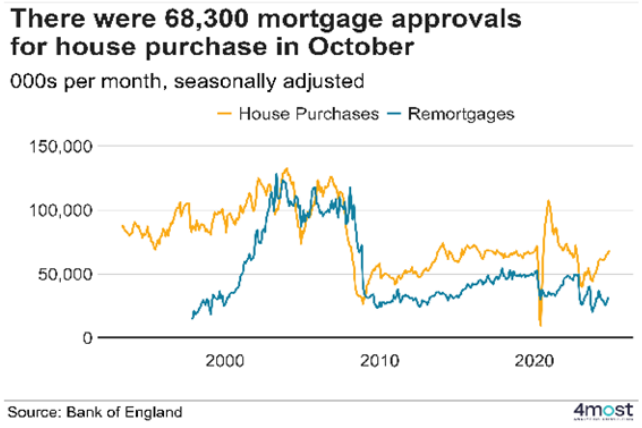
The combination of slightly lower interest rates and pent-up demand means the recovery in First Time Buyer (FTB) volumes is almost complete.

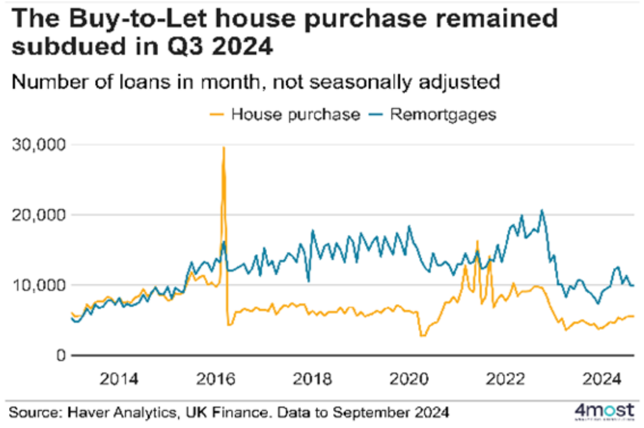
Meanwhile, the new Buy-to-Let mortgage is a much smaller market than in 2022, and the total number of mortgages outstanding has fallen by 5% (100,000)

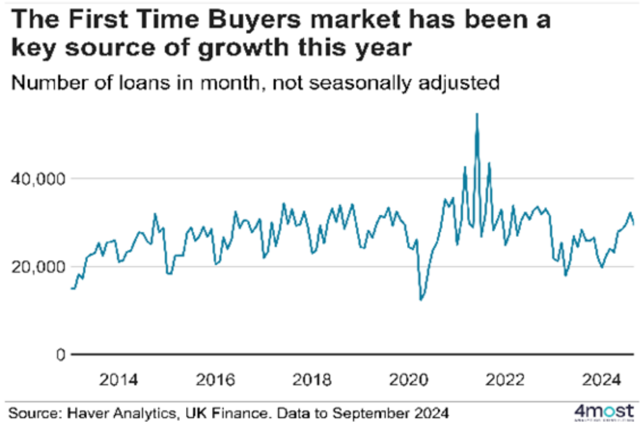
The Bank of England's Financial Stability Report is a reminder of just how many households – around 4.4 million – have yet to refinance at higher rates.

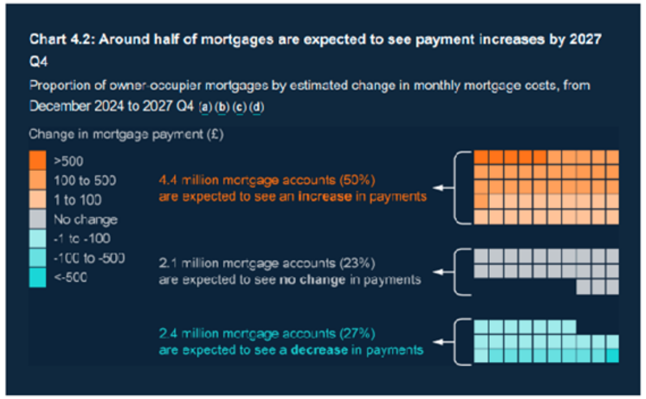
The share of Product Transfers for remortgaging remains above 80% (source: UK Finance) as the advantages of internal affordability assessments hold sway. But the pipeline of potential external remortgages is improving as borrowers roll off expensive two-year fixes.

In the near term, the market should (and probably already is) seeing a surge of FTB activity before the stamp duty threshold is cut.









Sources: Bloomberg Finance L.P., FCA Product Sales Data and Bank calculations.

Mortgage market - rates

The effective rate on completed new mortgage business dropped 8bp in September as lower rates continue to feed through.

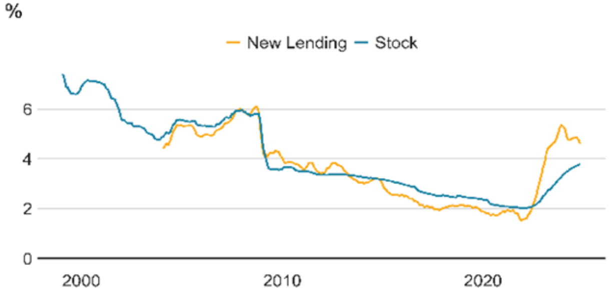
But the rates quoted by lenders (which reflect the business that might be done rather than that which is being done) edged up as markets took a dim view of the Budget.

There has been slightly better news on product rates since as financial markets continue to chew over the implications of the government's plans. Overall, prospects for rates are better than a month ago but worse than in August.

With Bank Rate expected to stay higher for longer, typical mortgage rates around 4%-4½% look like the new normal.

But even at these levels, as the Bank of England points out, there are 2.4 million borrowers who will be looking for a cheaper deal as their expensive fixes come to an end between now and end-2027.

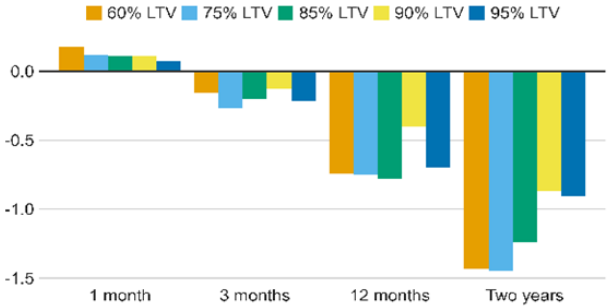
The effective rate on new secured lending fell to 4.62% in October



Source: Bank of England. Data to October 4most

Quoted mortgage rates edged up in November

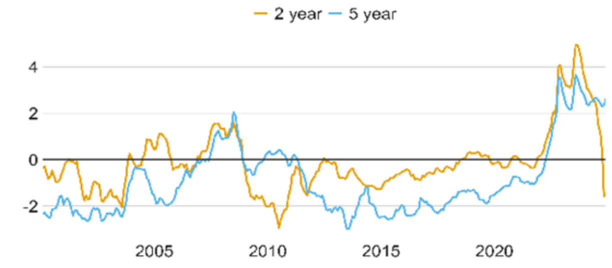
Change in 2-year fixed mortgage rates (% points)



Source: Bank of England. Data to November 2024 4most

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

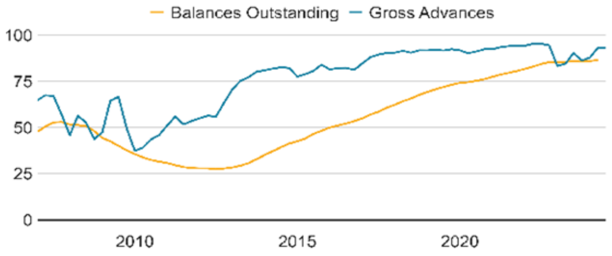
% point change in two and five year fixes over two and five years



Source: Bank of England. Data to November 2024 4most

The proportion of new mortgages written at fixed rates is slightly lower than before the Bank Rate rises

% of business at fixed rate



Source: Haver Analytics, Bank of England MLAR statistics. Data to Q3 2024 4most

THANK YOU.