November 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

The economy flirts with recession as consumer confidence falls back

- While the economy has shown plenty of resilience in the face of an unprecedented period of monetary tightening, more cracks are starting to appear. Consumer confidence slipped back in September and October's survey of purchasing managers suggests the economy continues to flirt with recession. Like the Bank of England, we do not expect any growth in 2024 – a view that is more pessimistic than the consensus.
- While the Bank held the Bank Rate at 5.25% in November, its guidance was that the next move was more likely to be up than down. Markets and most economists believe rates will not start to fall until next summer. But there is growing concern that – with half the impact on mortgage holders still to come – monetary policy is already too tight.
- There is mixed news on inflation. Oil prices have retreated a little, while earnings growth is still too high but moving quickly in the right direction. Looking further ahead, domestic energy prices could rise again next year after turmoil in futures prices.

Risk outlook

- The monetary policy tightening in the UK has mirrored that in the US. But that economy is much stronger. The growing worry is that the US can live with higher for longer rates, especially long-term rates where it sets the benchmark, but that the rest of the world cannot.
- While most firms and households are muddling through, homebuilders are struggling with the detrimental impact of higher rates on housing activity. Work is being completed, but many new projects are on hold. House prices have stabilised for now but not at levels consistent with a vibrant housing market.
- Geopolitical risks are still to the fore. If conflict spreads in the Middle East, oil prices could spike to $150pb and send the global economy into recession.

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Inflation and interest rates

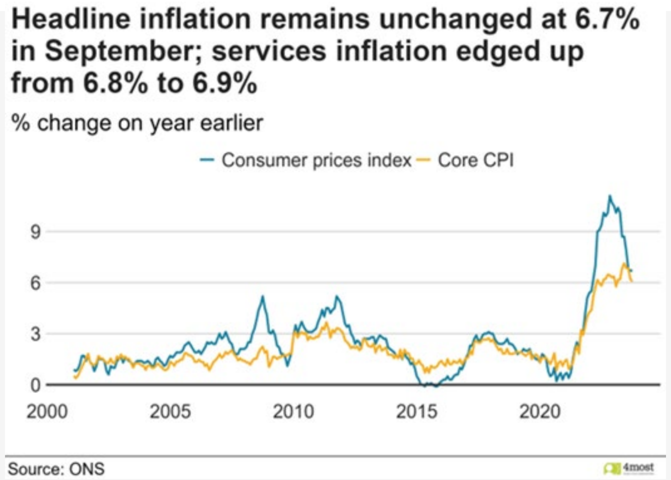
Inflation proved stubborn in September; prices rose 0.5% on the month. Rising motor fuel prices and hotel room rates prevented the headline inflation rate from falling.

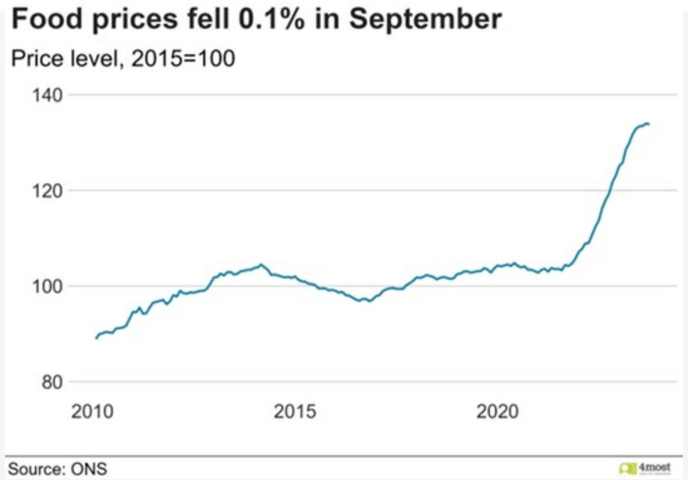
While core inflation edged down, services inflation edged up. But the 12% drop in the energy price cap will help bring down headline inflation in October, possibly to below 5%.

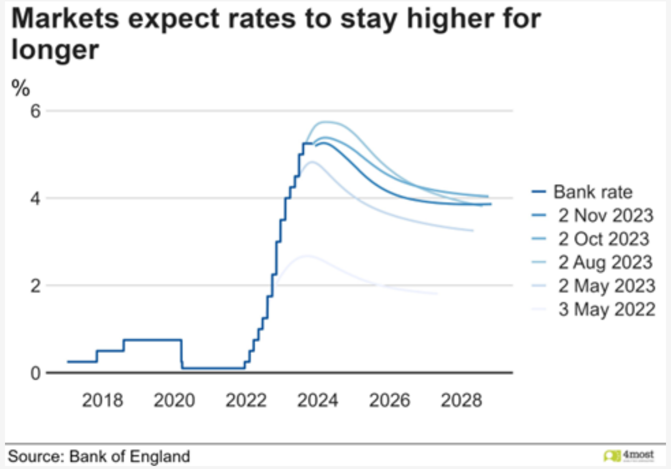
The good news is that monthly food prices fell for the first time since September 2021 as the prices of milk, cheese and eggs all declined.

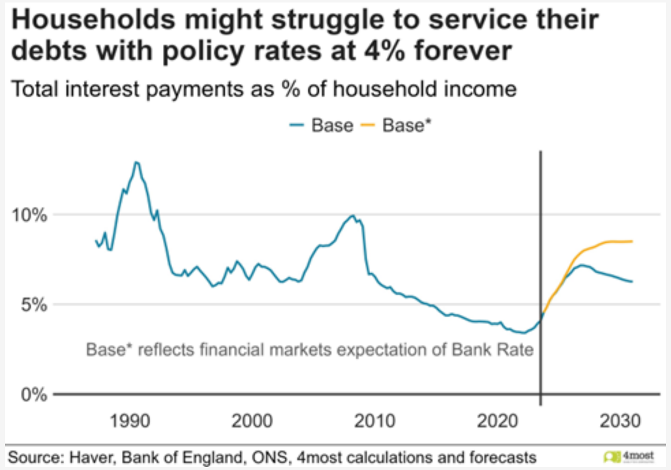
While the Bank of England kept the Bank Rate at 5.25% in November, it was a 'hawkish pause' with a message that the next move was more likely to be up than down.

Whether this line holds if the Bank's dire forecast of no growth next year materialises, is moot. The economy is already struggling, even before more than half the impact on those with mortgages is felt.









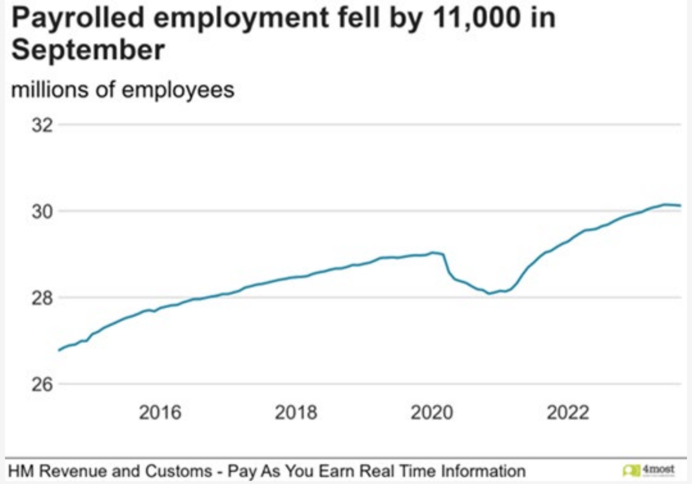
Labour market

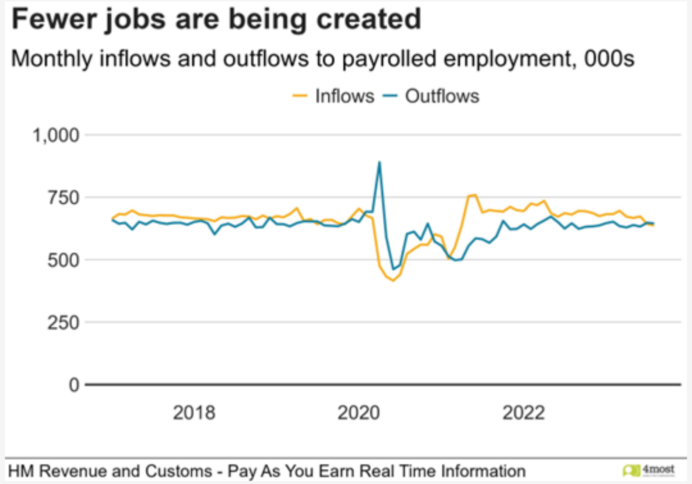
Low survey response rates means the ONS is falling back on 'experimental' measures to estimate employment and unemployment.

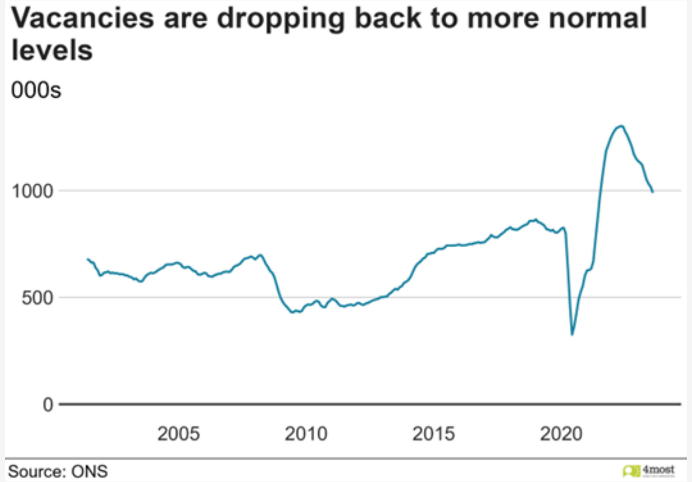
Tax records show employment falling slightly in September. Surveys of purchasing managers suggest employment has contracted again in October. Redundancies remain subdued but there are not as many new jobs.

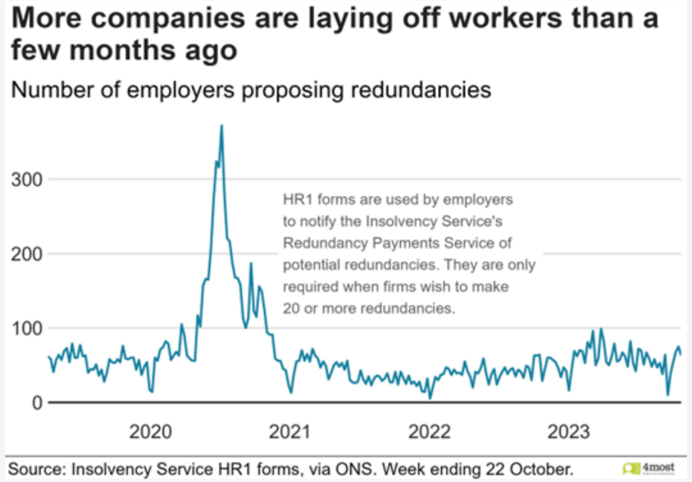
It is possible that the ONS will not resume normal service until next Spring. But the information we do have indicates the job market is cooling. Weekly earnings growth remains high but is drifting down.

The unemployment rate was estimated to be 4.2% in June-August and is expected to peak at 4.7% in the first half of 2024.









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Housing market

With market expectations of the likely path of the Bank Rate shifting dramatically, it has become easier to argue that house prices are not significantly overvalued on affordability grounds.

But while activity should now improve, it is too early to remove our assumption that prices will fall another 5% to give a 10% overall peak-to-tough drop. Surveyors concur that more falls are likely.

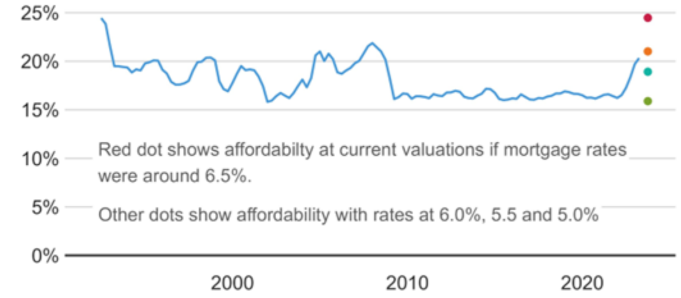
There is no conclusive regional pattern. The South West has low rental yields. But so does London and, as yet, it has seen prices fall less than the UK average.

Strong wage growth supports the argument that adjustment can take place via higher incomes rather than falling prices.

Higher for longer interest rates increase worries about financial stability. A credit crunch and repricing of risk could yet disrupt this improving picture.

At mortgage rates of 5.0%-5.5%, house prices begin to look fairly valued

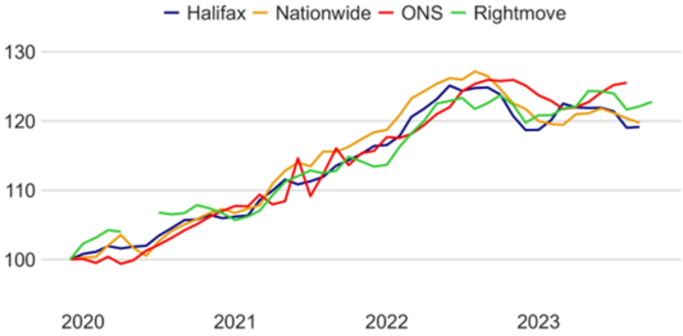
Payments as % of income for a typical new mortgage for house purchase



Source: UK Finance, DCLG, Bank of England, 4most estimates

The rise in asking prices in October was below the seasonal norm

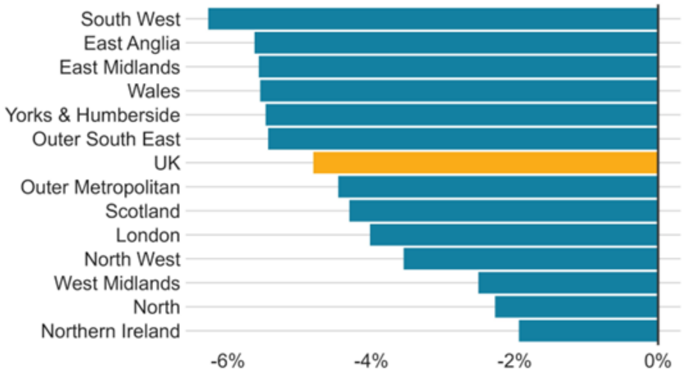
Non-seasonally adjusted, indexed to December 2019=100



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

Prices have fallen most in the South West

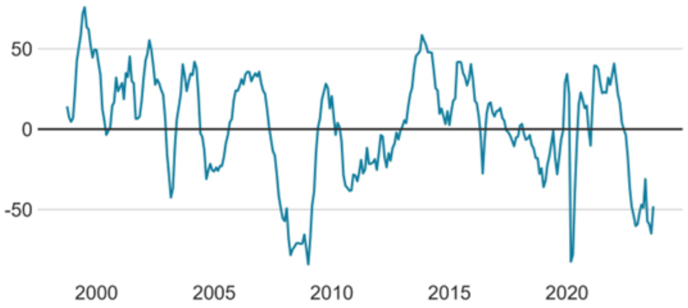
% fall from the peak



Source: Haver, Nationwide. Data to Q3 2023

Most surveyors think prices have further to fall

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



Source: Haver Analytics, RICS. Data to September

Rental market

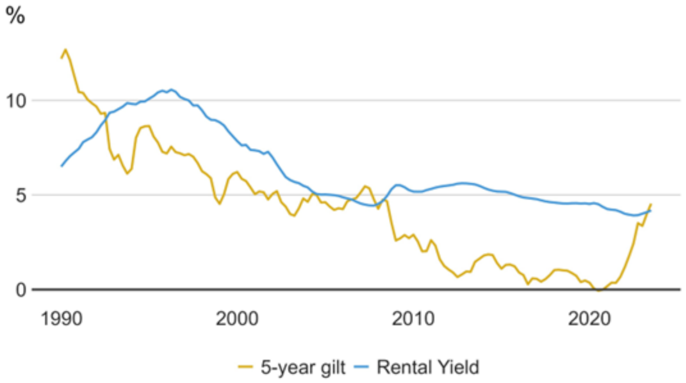
After removing energy efficiency requirements, it now looks like the government might row back on no-fault evictions.

At the margin both these decision would help the economic case for new Buy-to-Let when viewed as an investment. But the increase in risk-free returns elsewhere is probably a bigger driver – transactions will likely remain subdued.

Rental affordability has deteriorated recently. New ONS figures show rents in London and the rest of the south were already above or close to what is seen as affordable over a year ago.

Tenants will increasingly be drawn to smaller property and to multi-occupancy accommodation.

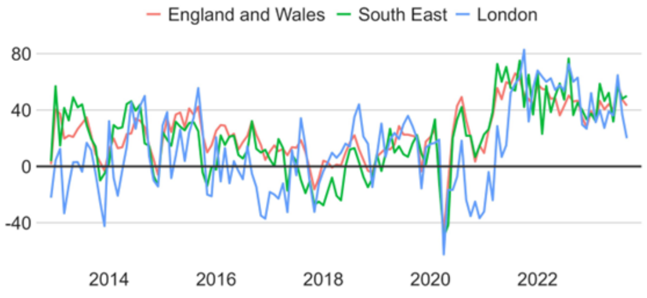
Rental property looks unattractive as an investment



Source: Bank of England, OECD, Nationwide, ONS, 4most calculations

Demand in London is still growing, but not as quickly as a few months ago

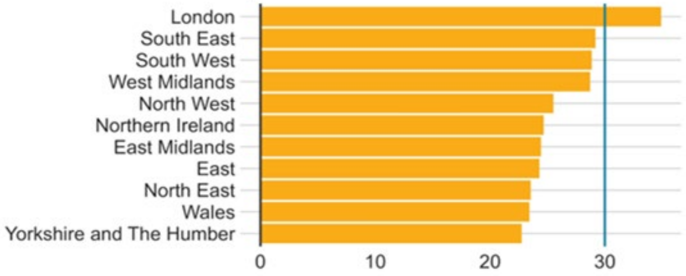
% balance of surveyors reporting rising tenant demand in the last three months



Source: Haver Analytics, RICS. Data to September

London is the least affordable region for living in private rent, and the only region above a 30% affordability threshold

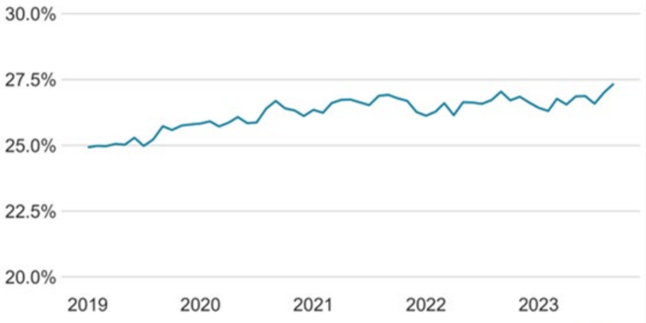
Percentage of a median income of private renting households that a median rent is equivalent to



Source: ONS. Financial year ending 2022

The proportion of income spent on new lets has risen in recent months

Median percentage of gross income spent on rent, nsa



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

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Mortgage market - activity

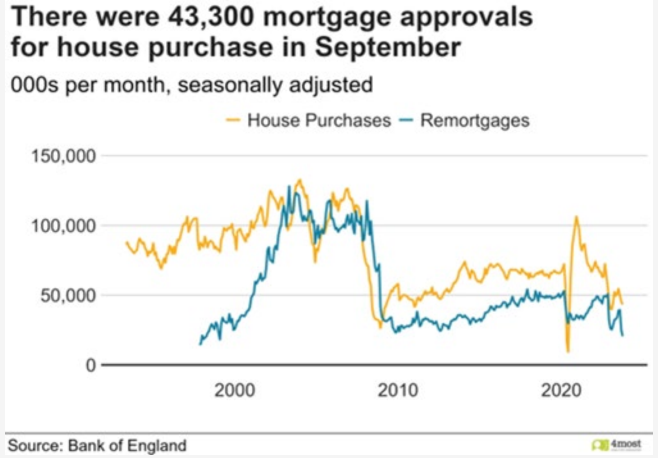
Although quoted mortgage rates eased in September, there was no sign of a revival in approvals. Despite improved affordability, buyer enquiries are still falling.

The overall contraction in outstanding balances reflects this lack of new business.

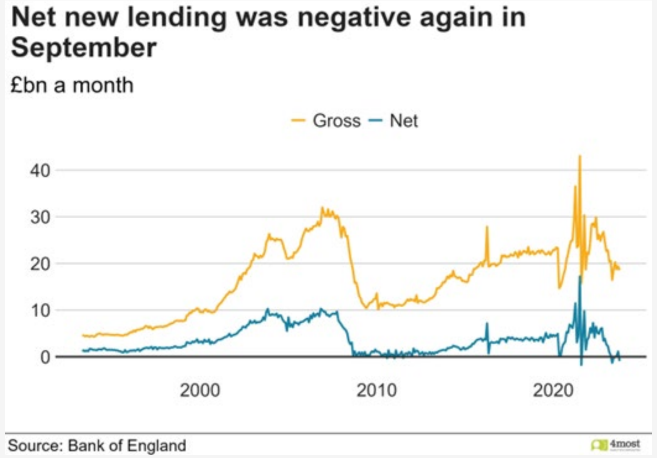
This all suggests that prices have not fallen far enough to restore a more normal market. The average price paid by a First-Time-Buyer in Q2 was 5.4% lower than in Q3 last year. But the rise in rates mean the average income needed to enter the market was up 2.1%.

With existing homeowners reluctant to lower prices and narrowing scope for lower interest rates, the market may move sideways until rising incomes restore affordability.

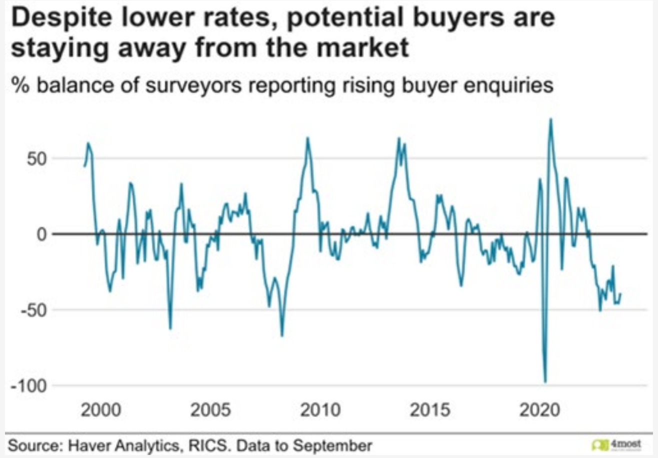
There is less talk about BTL landlords selling up. But higher interest rates for longer could encourage home ownership at the expense of Buy-to-Let.



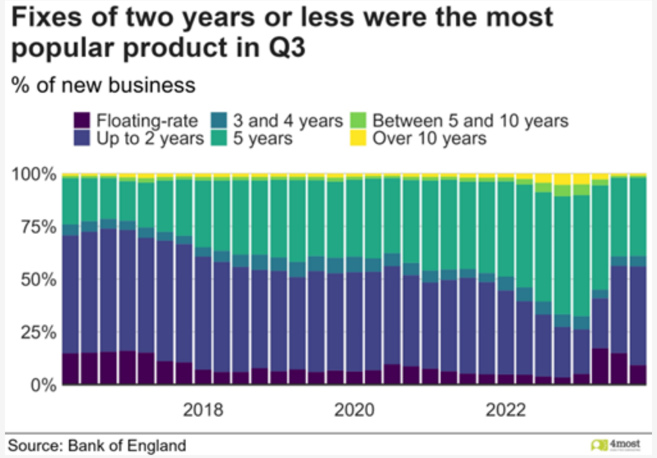
Source: Bank of England



Source: Bank of England



Source: Haver Analytics, RICS. Data to September



Source: Bank of England

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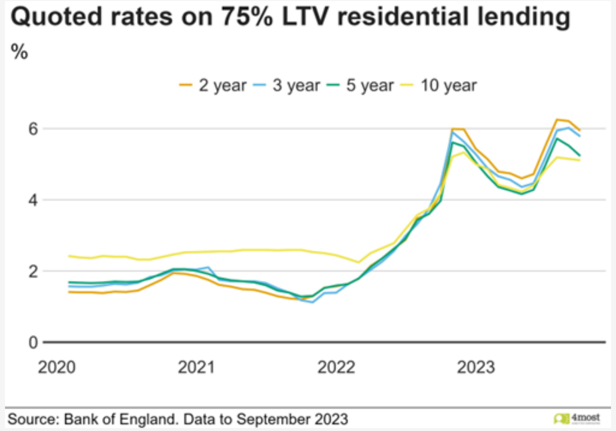
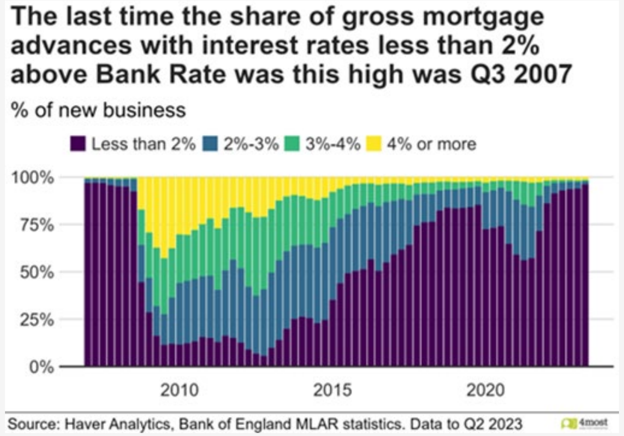
Mortgage market - rates

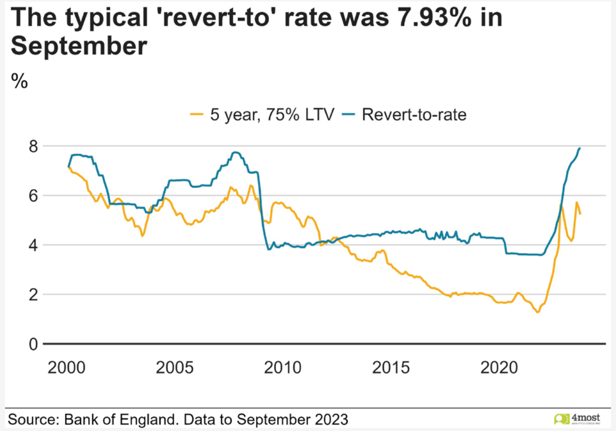
With financial markets believing higher for longer Bank Rates are likely, the scope for much lower product rates is constrained.

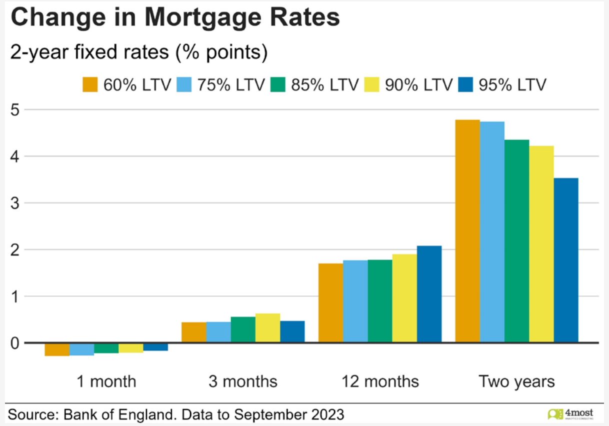
It also seems likely that the margin between new business and risk-free rates will widen again from its current compressed state.

The gap between revert to and product rates has widened once more as the latter have come down. Those people who have been putting off the decision to take out a new fix for their remortgage have ample incentive again.









THANK YOU.