October 2024

ECONOMIC UPDATE

In partnership with 4most – October 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

Talk of ‘tough choices’ is worrying households

- Although GDP was flat in both June and July, surveys suggest growth will resume. But the long period between Labour’s election win and the Budget has created a void where speculation about the ‘tough choices’ to come has made households and businesses more cautious. Consumer confidence dropped back sharply in September.
- With the government pledging not to raise headline tax rates in the Budget, the main immediate impact on households is likely to be through Road Fuel Duty. The good news here is that petrol prices have fallen back recently, which will cushion the impact. The main Budget headlines will likely be rewriting of fiscal rules to allow more public investment.
- Recent revisions to the National Accounts produce two main conclusions. First, household income and saving is even higher than thought. An optimistic view would be that the latter will support a rebound in consumer spending in the coming months once the Budget is past. Second, the level of business investment is now only just above pre-pandemic levels, rather than 4% above. Again, optimistically, there is plenty of scope for improvement and business confidence is still solid.
- Interest rates are coming down and real wages are still rising. Inflation should be back to 2% by next Spring. We still expect the economy to grow 1.5% next year – close to the UK’s potential, but we are less confident of that than a few months ago.

Risk outlook

- Although Iran’s attacks were largely repelled by Israel, geopolitical risks feel slightly more elevated than usual. Oil prices have spiked after an escalation of the situation in the Middle East. But at $78pb they are only back to the levels seen in late August. The bigger issue may be shipping rates. The cost of bringing a container from Shanghai to Europe has doubled to $4,000. Worries about inflation are not over.
- The external environment is a growing concern for manufacturers. The latest manufacturing PMI points to weaker import demand from France and Germany. The latter appears to be in a permanent state of stagnation. And the huge stimulus being thrown at the Chinese economy feels like an act of desperation rather than a serious attempt to reset an economy that for too long has relied on external demand rather than internal growth to keep its economy on track.

Inflation and interest rates

Is inflation really beaten? The rise in services inflation from 5.2% to 5.6% undid the good news in July. And rising domestic energy bills will see the headline rate rise again in October. Inflation is set to end the year at 2½%.

There are good reasons why inflation should be back to 2% target by mid-2025. Wages have grown 0.8% over the past three months compared to the previous three, a pace that the Bank of England will be comfortable with.

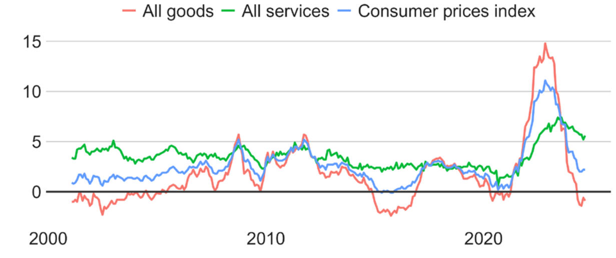
Also, the price of goods leaving factory gates is stable and the impact of lower fuel prices is still feeding through. But escalation of the conflict in the Middle East is an emerging risk – freight costs have risen sharply.

While the Bank of England maintained the Bank Rate at 5% in September, the message was rates are "now gradually on the path down". We expect the next cut to come in November. Assuming no nasty surprises, the rate is expected to fall to 3.75% by end-2025.

Gilt yields are edging up even as markets price in lots of cuts in 2025. New fiscal rules will likely see more borrowing. If the rates on risk-free assets rise, the cost of finance for firms will follow.

Headline inflation remained unchanged at 2.2% in August, but services inflation rose to 5.6%

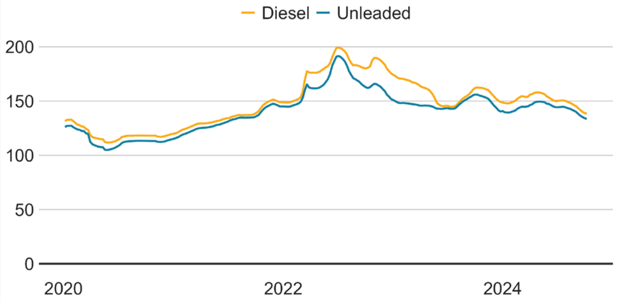
% change on year



Source: ONS 4most

The price of unleaded petrol is back to levels last seen in July 2021

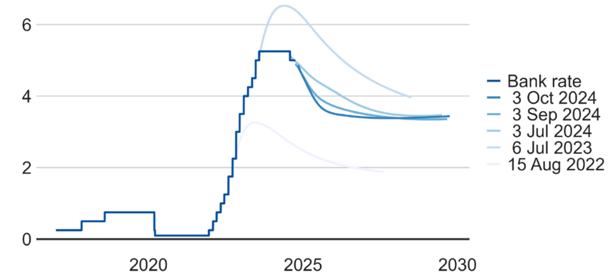
Pence/litre



Source: BEIS 4most

Markets now 'expect' the Bank Rate to end 2025 at 3½%

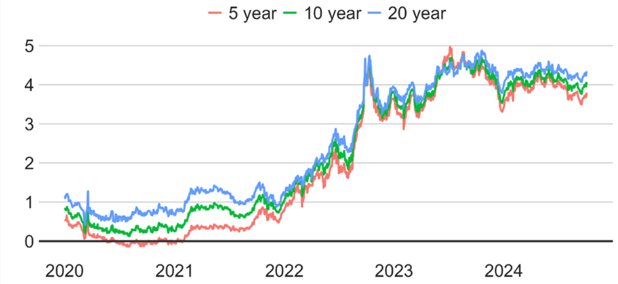
Expectation of Bank Rate implied by the OIS curve, %



Source: Bank of England 4most

Gilt yields could rise if worries about the level of government borrowing increase

%



Source: Bank of England 4most

Labour market

While there are huge caveats with current estimates, the labour may be softening. Payrolled employment fell in July and August, although these figures are often heavily revised in subsequent releases.

The low unemployment rate of 4.1% in May-July gives a misleading impression: it is pulled down by an odd-looking single month figure of 3.6% in June that will drop out of the figures in two months' time.

Stepping back from the noise, the overall story is still one where potential redundancies remain low and where vacancies are almost back to more normal levels. The unemployment rate is expected to be 4.4% in Q3 and then remain around this level through 2025.

The government will introduce a new Employment Rights bill. This will strengthen employment rights including a ban on zero-hour contracts.

None of the measures is particularly controversial. But the cost could be a slightly less flexible labour market and a higher structural unemployment rate.

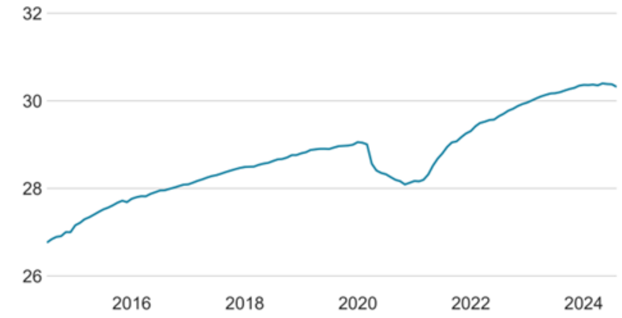
The single month unemployment rate was 4.3% in July

% of workforce

Source: ONS, single month estimate

Payrolled employment fell by 59,000 in August

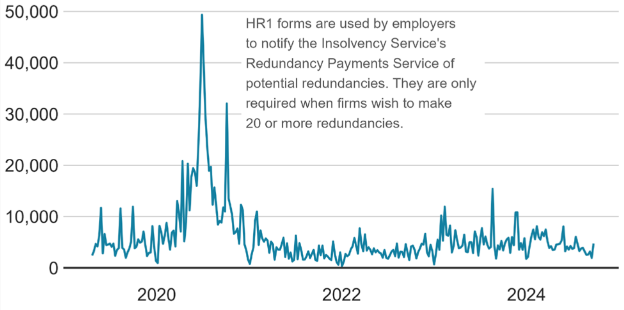
millions of employees



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

The number of people losing their jobs is in line with historic trends

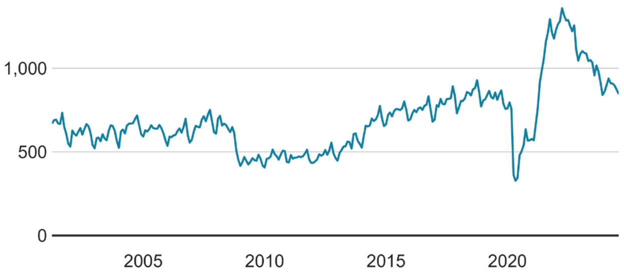
Potential redundancies, 000s



Source: Insolvency Service HR1 forms, via ONS. Week ending 22 September.

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

Housing market

There are more signs of life in the housing market: asking prices rose by 0.8% in September as more buyers entered the market. Buyer enquiries rose by 15% and sales agreed by 27% on a year ago (Source: Rightmove).

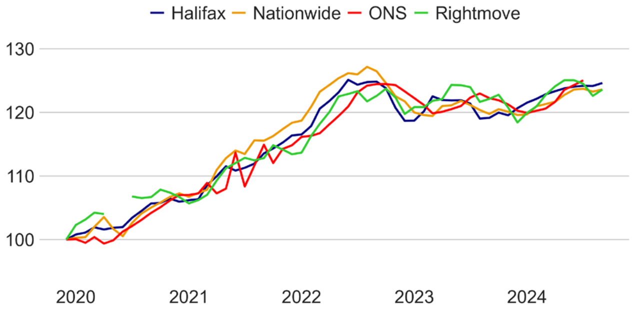
But higher asking prices will only stick if the finances stack up for buyers. Sensibly priced properties are selling quicker. And prices are rising more in more affordable areas where buyers are not as priced out.

Despite lower mortgage rates and real incomes gains, we expect a flat picture for house prices over 2025. Affordability is still stretched in terms of the proportion of income required to service a mortgage at origination, especially for First Time Buyers.

Affordability is still our key concern. But an alternative view of the current market is that this is the new normal in terms of affordability because post-Covid good housing has become more important.

Asking prices rose more than is typical in September

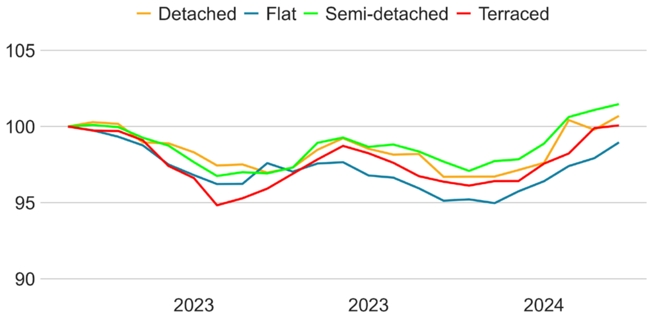
Non-seasonally adjusted, indexed to December 2019=100



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

Only the price of flats is still below the previous peak

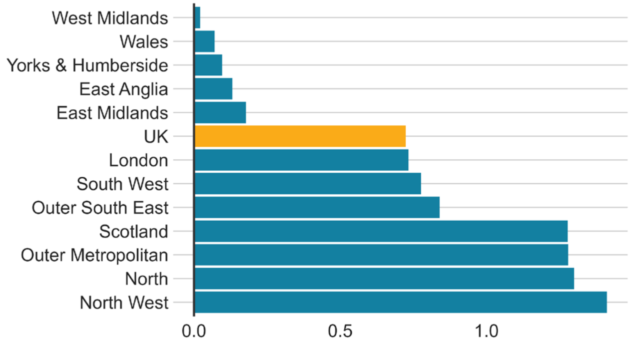
September 2022=100, non-seasonally adjusted



Source: Land Registry

House prices rose across all regions in Q3

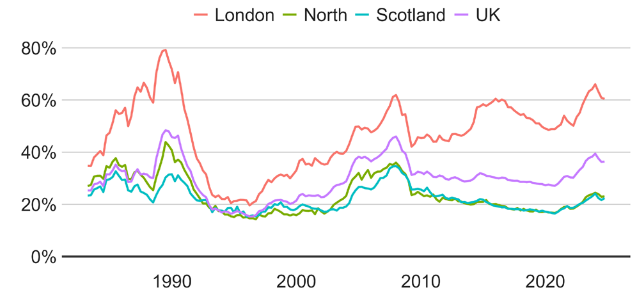
% quarter, seasonally adjusted index



Source: Haver, Nationwide

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

There are signs the rental market is cooling, but you have to look hard to see them. Rents on newly let property are up 4.3% on a year ago across the UK and 1.0% in London. Both figures are slightly lower than in August.

The deterioration in the rent to income ratio is sobering. And with more income going on rent, there is less to be spent in the rest of the economy. Many are still facing payment shock as rents are renegotiated.

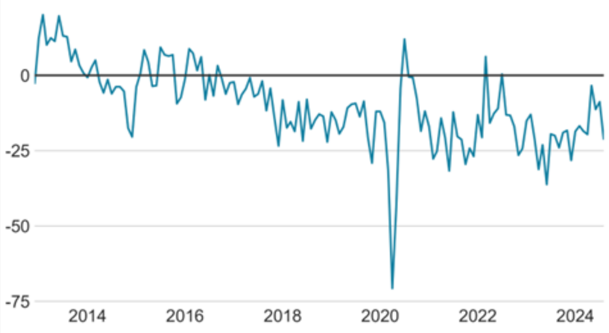
Demand is strong, partly because many potential FTBs cannot afford to buy. But the recent deterioration may also reflect temporary supply constraints: landlords taking properties off the market to sell because of interest rates/arrears/higher costs to come from EPCs/CGT.

Labour's Renters' Rights Bill proposes the end of bidding wars between tenants by stopping landlords from charging more than the advertised rent. There would also be a ban on more than one in-tenancy rent rise.

While this is a step towards rent controls, market forces will ultimately win out. The real problem is a lack of supply. That will not be resolved quickly.

There is a shortage of rental property

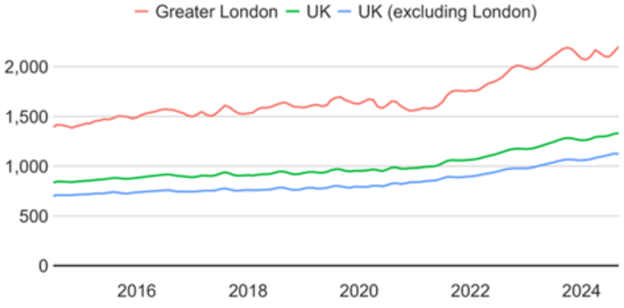
% balance of surveyors reporting rising instructions



Source: Haver Analytics, RICS. Data to August

Average rent on a new tenancy in London rose 2.5% between August and September

£, monthly rent on newly let property



Source: Homelet. Data to September.

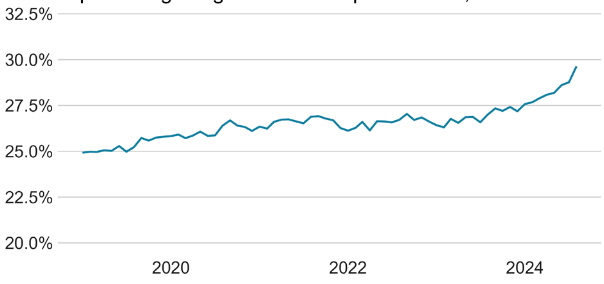
The vast majority of surveyors expect further rises in rent

% balance of surveyors expecting a rise in next three months

Source: Haver Analytics, RICS. Data to August

The proportion of income spent on a typical new let is 4.4% 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 August 2024

Mortgage market - activity

As expectations of lower interest rates get baked into product rates, the gradual recovery in activity continues. The number of house purchase approvals in August was the highest in two years.

And with lower rates, surveyors' optimism about sales in the next three months has rocketed. The market could be back to 70,000 approvals per month soon, a level we might think of as normal.

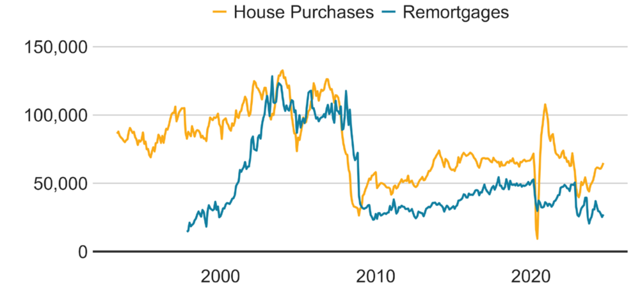
Affordability looks better than a few months ago but is still stretched in terms of the initial downpayment on a typical mortgage. But demand is clearly improving.

The amount of mortgage debt outstanding has stagnated as the 'new' market freezes and people pay off their existing debt. The key to changing this is to build more houses and to lift home ownership rates.

The former objective feels as far away as ever. It costs much more to build a house than it did a few years given soaring materials prices. The Budget probably won't address this. There might be some help for FTBs. But there are no cost-free options.

There were 64,900 mortgage approvals for house purchase in August

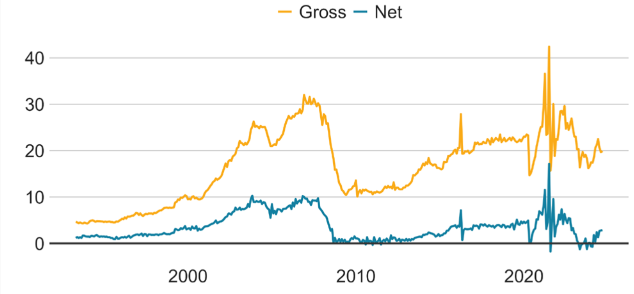
000s per month, seasonally adjusted



Source: Bank of England

Individuals borrowed, on net, £2.9bn of mortgage debt in August

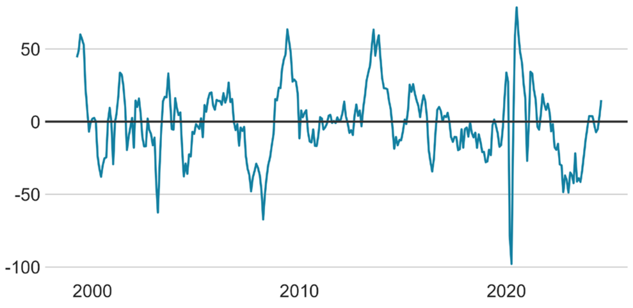
£bn a month



Source: Bank of England

Demand from home buyers shows tentative signs of improvement

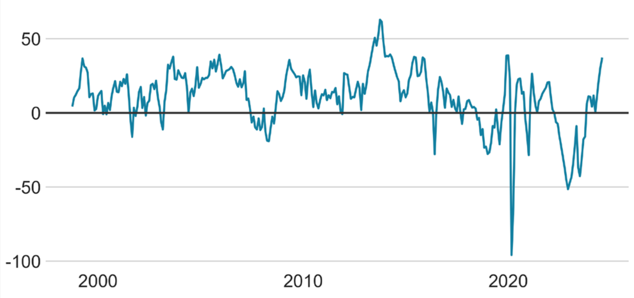
% balance of surveyors reporting rising buyer enquiries



Source: Haver Analytics, RICS. Data to August

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 August

Mortgage market - rates

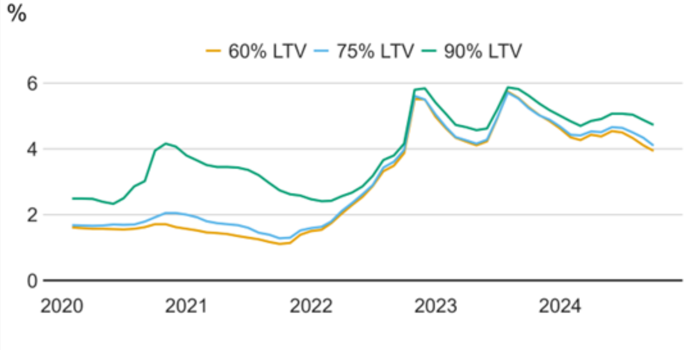
Markets are pricing in more cuts in 2025 than a month ago. This has brought the prices of two-year fixed rate mortgage deals closer to those of five-year fixes, which have been cheaper since late 2022.

Scope for further falls in product rates feels limited though. Markets are almost fully pricing in a cut to Bank Rate to 3.5% by end 2025. But the consensus view among economists is that this is on the aggressive side.

The big question is where the 'new normal' is for product rates. Between 3.5% and 4.5% is the stumbles,.

But the market view of a 3.3% neutral Bank Rate feels high to us. However, this won't change until the economy next stumbles so the current level of rates is right for now.

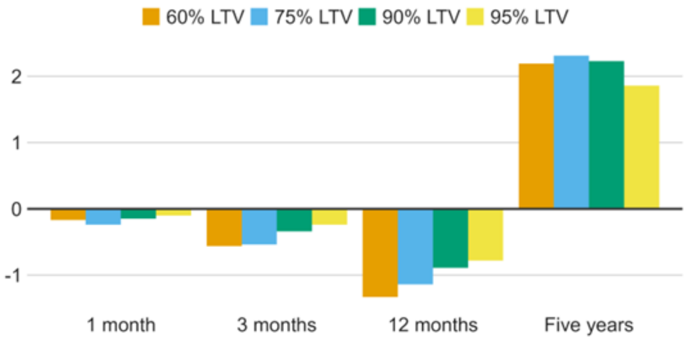
Quoted rates on five-year fixed rates at 60% LTV averaged just below 4% in September



Source: Bank of England. Data to September 2024

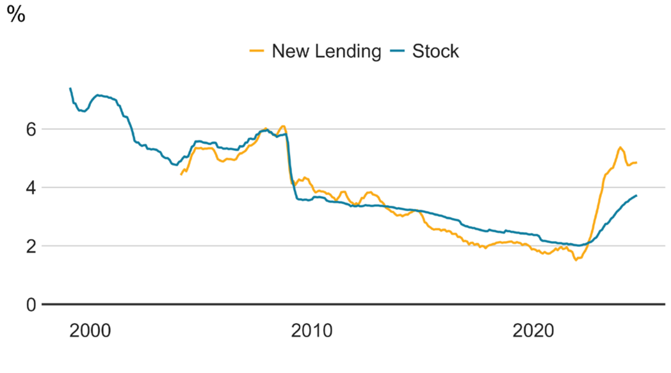
Rates have fallen most at lower LTV points over the last year

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



Source: Bank of England. Data to September 2024

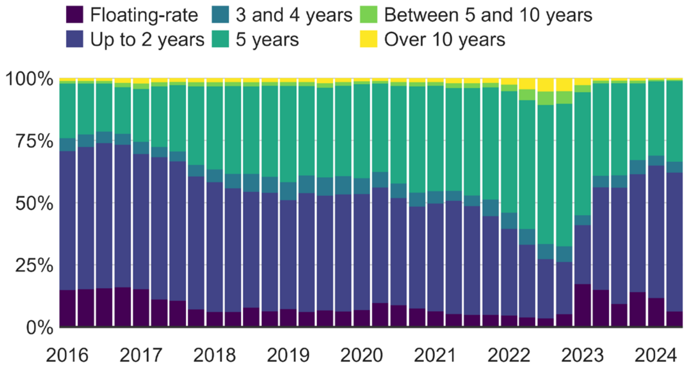
The effective rate on new secured lending was 4.86% in August



Source: Bank of England. Data to August

More people are fixing for slightly longer

% of new business completed by length of fix



Source: Bank of England. Data to Q2 2024

THANK YOU.