May 2024

THE MORTGAGE LENDER
real life lending

ECONOMIC UPDATE.

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

Inflation is down, but not out

- While figures later this month might show inflation hit the 2% target in April, the rate may not stay there for long. Petrol prices are on the rise and early survey evidence shows pressure on firms' costs have increased sharply with the rise in the minimum wage.
- The same surveys that point to rising costs also confirm that the recovery is gathering pace, led by the service sector, with financial services and tech/IT the strongest performers. But transport and hospitality are clearly struggling; those industries were high up the league table of business insolvencies over the last year and more firms believe they are at moderate risk of failure than at the start of the year.
- Although the unemployment rate has risen from 3.8% last year to 4.2% now, the story here is less one of workers losing their jobs – although a few more are – than a reflection of it becoming harder to find a new role – long-term unemployment, along with inactivity are constraining the economy.
- With real wages lifting consumer spending, GDP is expected to grow 0.7% this year and 1.5% in 2025. A small rise in the unemployment rate to 4.4% is forecast, while inflation is expected to hover a little above target until Spring next year.

Risk outlook

- The economy was unable to live with real interest rates of 3%+ over the last decade. Some areas, particularly the housing market, are struggling under the strain. While house prices stabilised as mortgage rates eased, affordability is still stretched. Big falls in house prices seem unlikely if the rest of the economy is recovering. But the fundamentals – notably the proportion of income spent on a new mortgage – still suggest valuations are too high.
- Geopolitical risks, while always present, feel like they are growing. The election of a new US President is an event with implications well beyond its own borders. More trade protectionism could be on the cards whoever wins. A win for Donald Trump would shake up the world order, embolden Putin and put much more pressure on Europe to take responsibility for protecting its own borders and paying for the Ukraine's defence.

Inflation and interest rates

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Inflation did not fall much as hoped in March. While a return to 2% in April is still quite possible, the stickiness of prices in the service sector may prevent early cuts in interest rates.

There are also unhelpful developments in transport costs, where petrol prices have been rising even before oil prices spiked after Iran's attack on Israel.

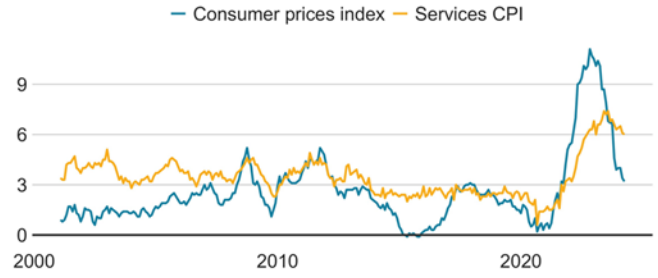
Reading too much into one month's numbers would be a mistake; high interest rates are working as expected, by removing money from the economy and discouraging investment. But inflation is expected to end 2024 above target at 2.3%.

Even if inflation could briefly be back to 2%, the elevated level of services and wage inflation mean markets have significantly pulled back their view of how quickly rates will come down.

August now looks like the earliest the Bank will be ready to move unless wage growth weakens significantly in the next couple of months.

Headline inflation fell to 3.2% in March. But services inflation is still uncomfortably high at 6.0%

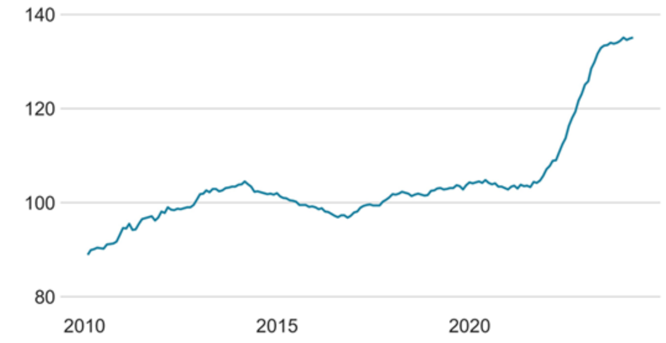
% change on year



Source: ONS

Food prices rose 0.1% in March

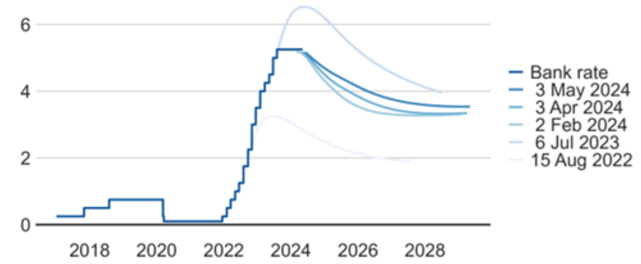
Price level, 2015=100



Source: ONS

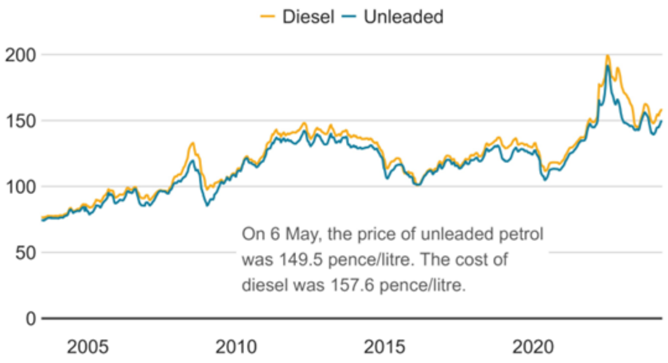
After weak US payrolls data, markets are pricing in two 25bp Bank Rate cuts by end 2024 again

Expectation of Bank Rate implied by the OIS curve, %



Source: Bank of England

Petrol prices are up 7% from January's low



Source: BEIS

Labour market

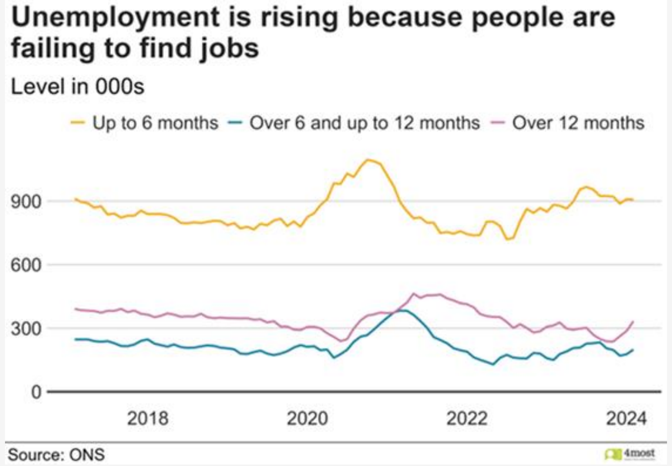
It is difficult to find anything positive in the latest labour market news. Although the figures are volatile and subject to sampling issues, inactivity is up, employment rates are down, and the unemployment rate rose to 4.2%.

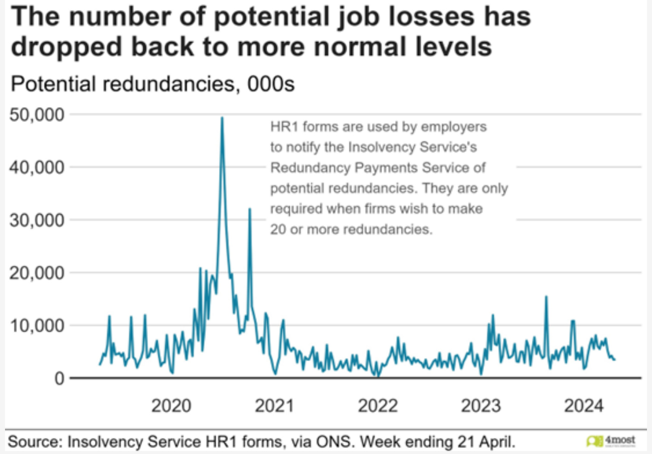
The recent rise in unemployment is not really a story about jobs losses – redundancies are up but stable. Instead, more people have been looking for work for over a year – jobs are harder to find.

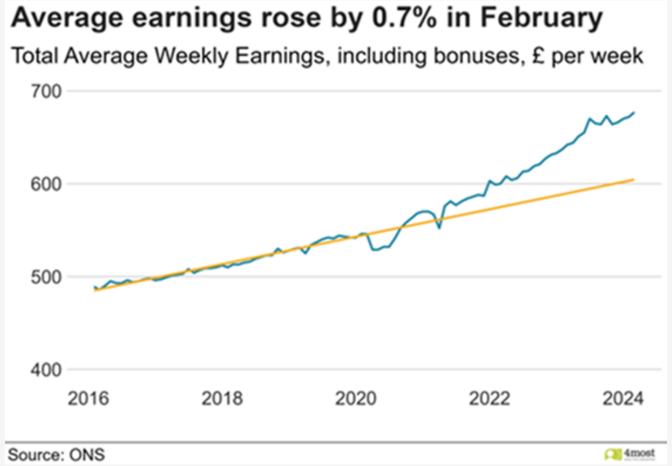
This isn't putting much downward pressure on wage growth, which is not retreating as the Bank of England would wish. The latest reading makes a June cut in Bank Rate less likely.

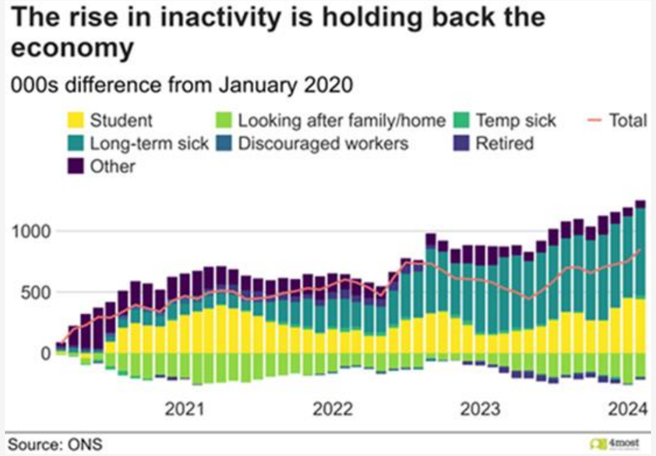
The big rise in the minimum wage in April looks like a key economic event, both in terms of the impact on wages and monetary policy, and employment in low wage industries.

The rise in inactivity since 2019, which largely reflects an increase in sickness, is a disaster for those affected; it also holds the economy back. Fixing this, as the Budget recognised, would boost growth and help with labour shortages.









Housing market

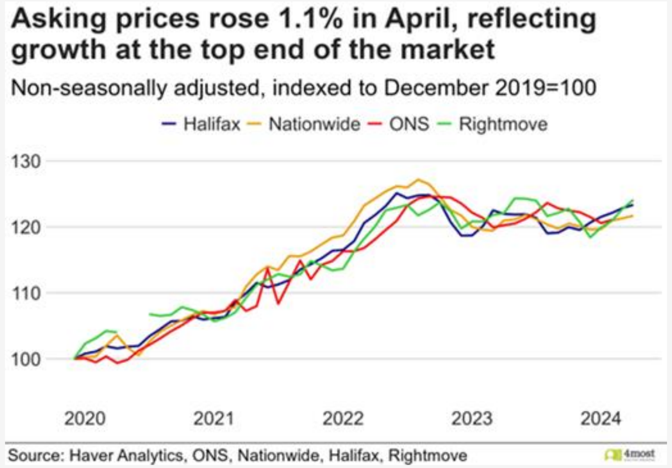
The signals are mixed. Agents are more bullish about prospect for both activity and asking prices. But with quoted mortgage rates edging up over the last three months, house prices have started to fall again; the Nationwide index dropped another 0.4% in April.

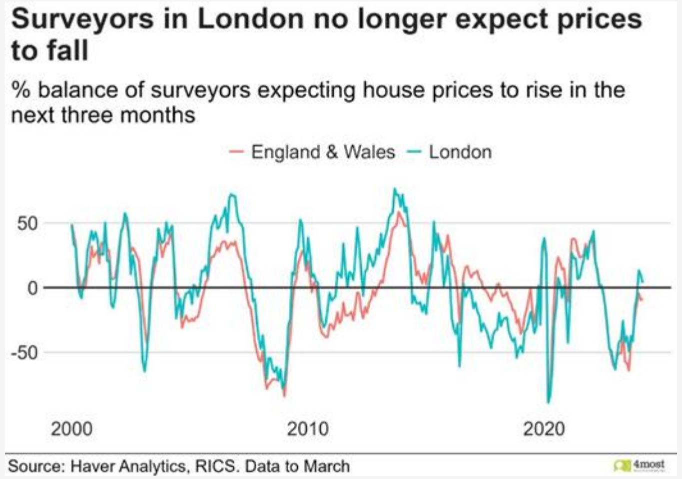
Surveyors no longer expect falls at the national level. Given the recent firming of interest rate expectations, this change of view may be premature.

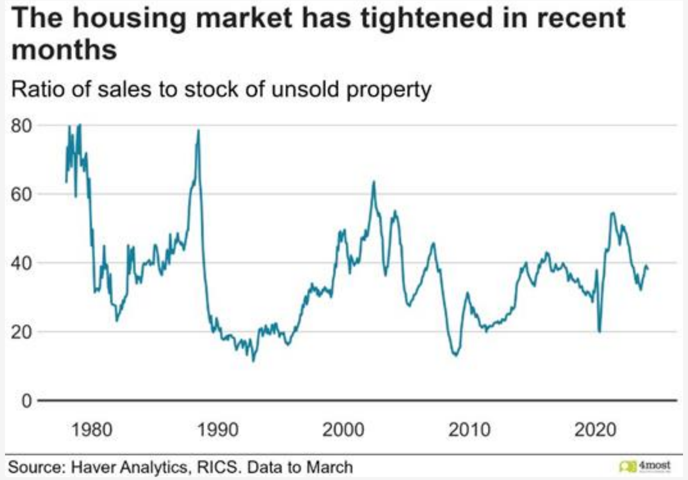
The deterioration in First Time Buyer affordability still makes it possible to argue that valuations are 20% too high. But without forced selling on a large scale, such falls look less likely than six months ago.

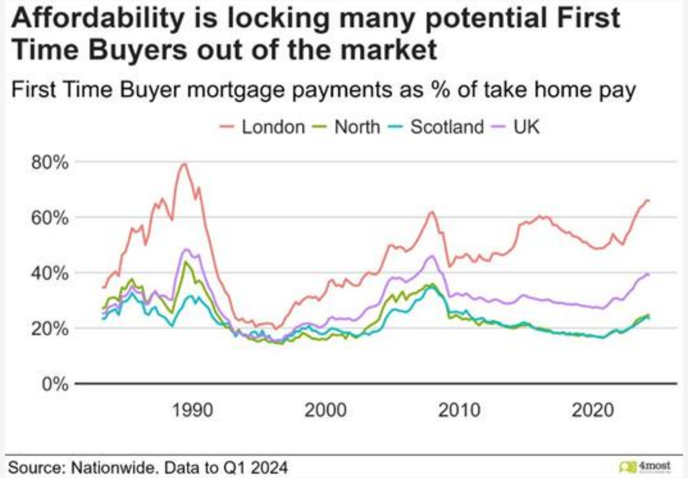
One potential source of forced selling could be from Buy-to-Let landlords struggling with higher interest rates. For now, the impact looks marginal. But the landscape for BTL may change with the government.

The longer interest rates remain high, the more likely a more abrupt revaluation becomes.









Rental market

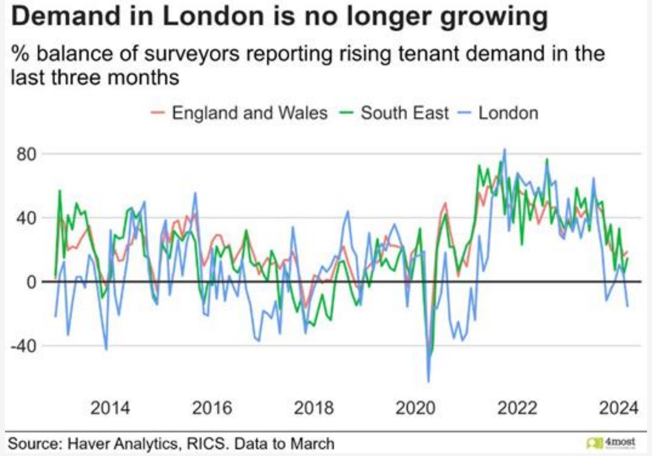
Demand for rental property in London is falling again, That supports the view that we are reaching the limits of what affordability will allow in the south.

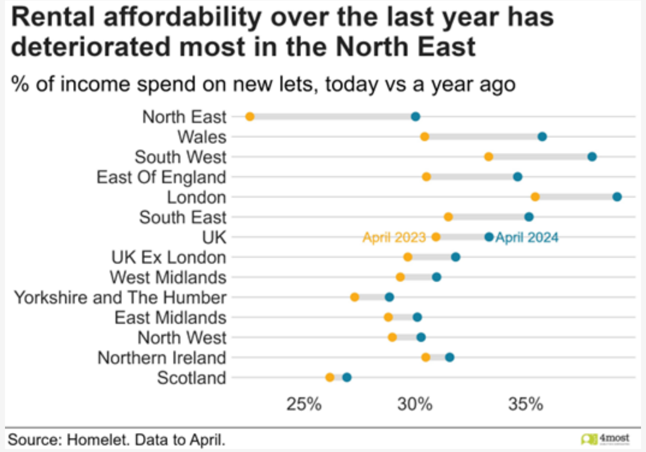
The surge in rents has helped improve the economics of the Buy to Let investment decision over recent months, although this could quickly change if interest rates do stay higher for longer.

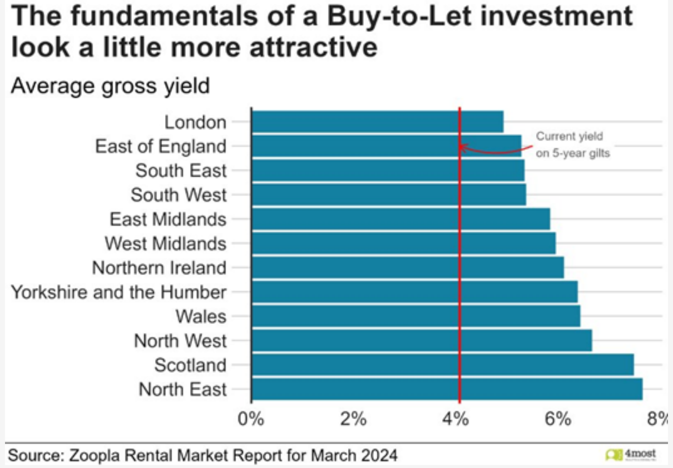
The ONS measure capturing the price of all rents – up 9.2% in the year to March – will stay high as expiring tenancy agreements are renegotiated to reflect current market conditions and may not be much lower at year-end.

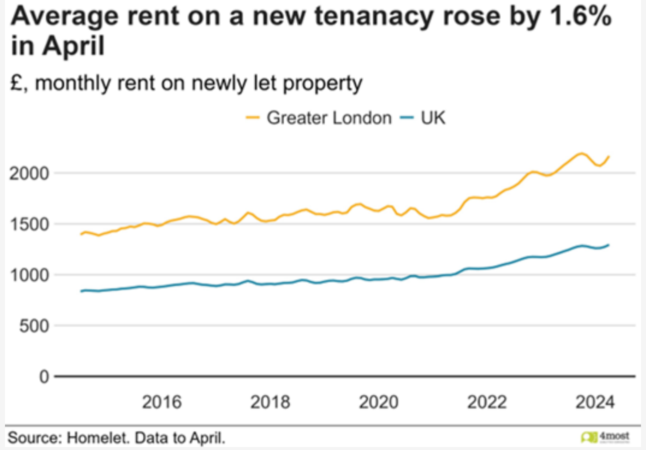
A much watered-down Renters Reform Bill was put before the House of Commons on 24 April. With a change of government likely, the landscape for renters and Buy to Let landlords may well change again next year.

Despite affordability challenges, most surveyors still see rents rising. March saw rents rise 1.6% according to Homelet. Markets outside the south could see upward pressure on rents sustained.









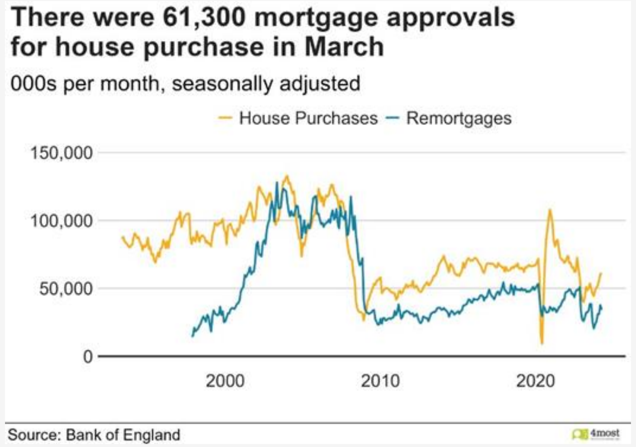
Mortgage market - activity

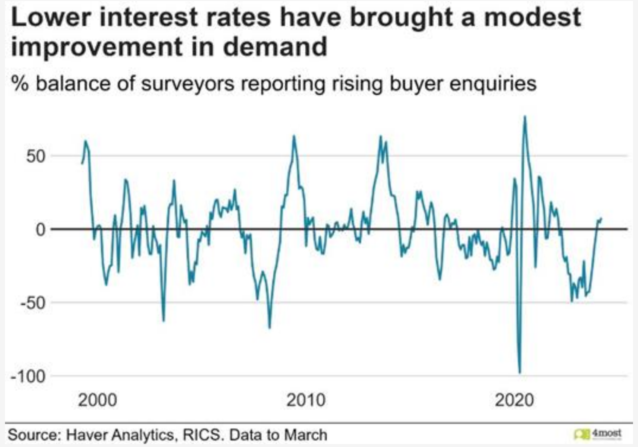
Unfortunately, the lower interest rates that would unlock the market look further away than a few months ago. Activity has improved but remains subdued.

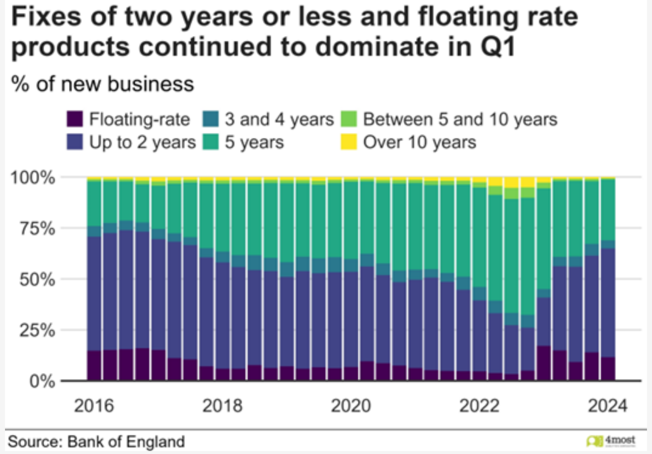
Potential sellers are coming back to the market. Lenders say credit is available. But stretched affordability means that buyers are still in limited supply. Those that are in the market are still taking out shorter length fixes in the hope rates will be lower in two years' time.

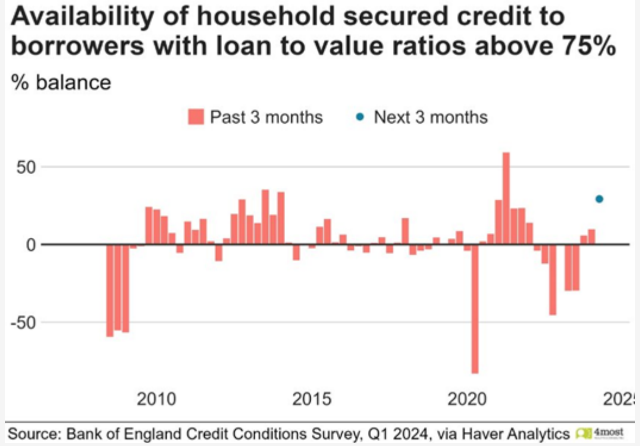
The effective rate on new mortgages fell to 4.75% in March but there is limited scope for much more and quoted rates were flat in April. Further falls in house prices may be the best bet for stimulating demand; modest falls are still expected.

Property websites like Zoopla are far more upbeat about the likely level of activity. Realism from sellers is the key to a more sustained recovery.









Mortgage market - rates

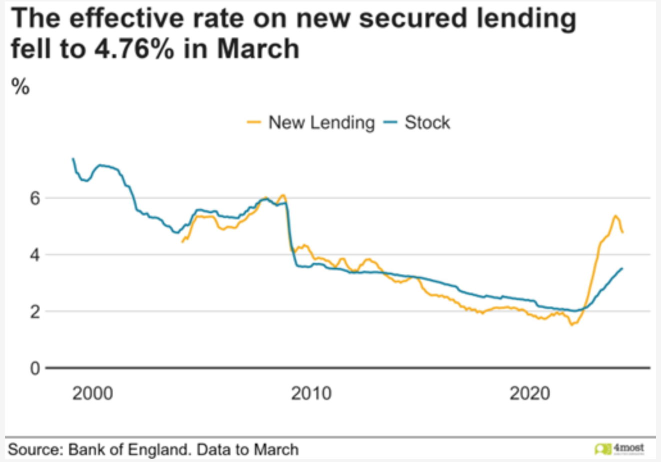
Monetary policy is clearly restrictive; The key question is whether the Bank will look through the unhelpful short-term news on inflation and wages or the bigger picture.

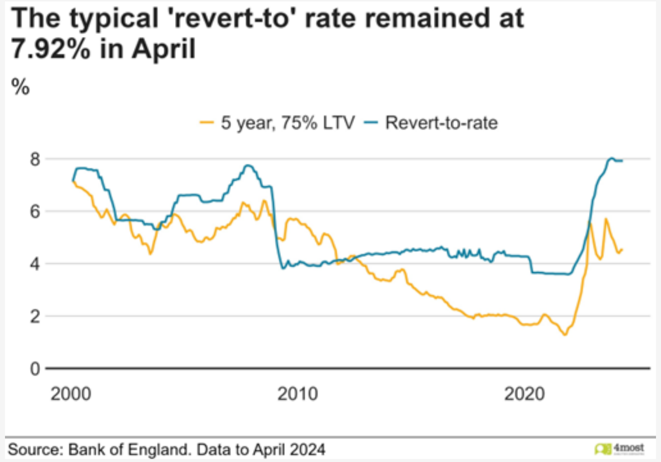
Markets expectations have been volatile but for now price in two full 25bp cut in the Bank Rate later this year. The expected delay in rate cuts to August (instead of June) means that the falls in mortgage rates are now further away from what we thought previously.

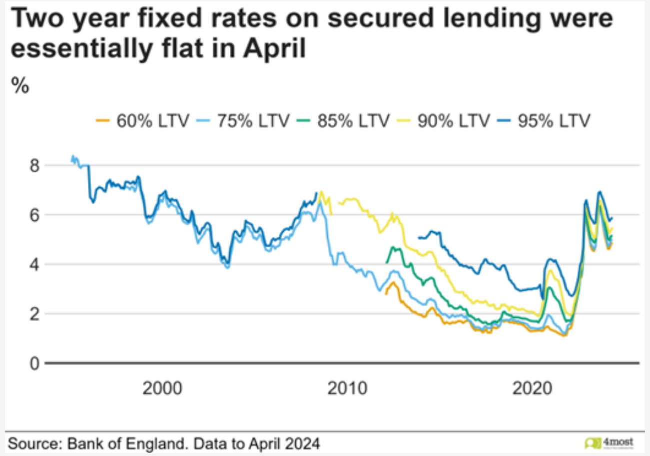
Many lenders have raised their mortgage rates recently. This trend is seen in the quoted rates for mortgage lending, which have crept up in the last couple of months.

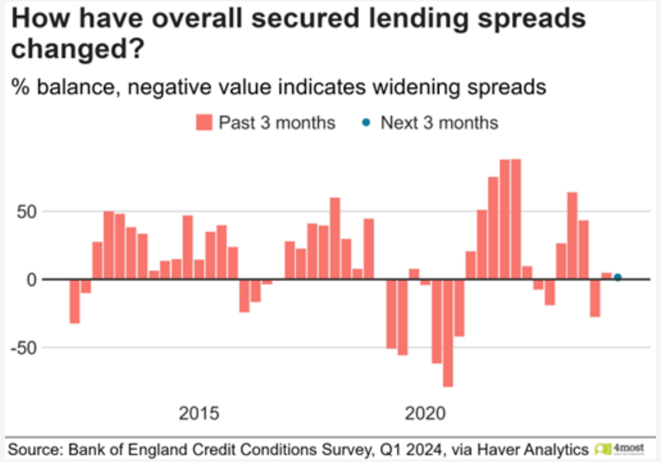
As a result, we expect product rates to remain elevated in the near term. Yet, the incentive for remortgaging remains high, though many are still with their existing lender.

Lenders expect spreads to remain unchanged in the coming quarter, unlike the widening seen in Q4 last year.









THANK YOU.