January 2024

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

While 2024 is unlikely to finally mark the start of the Roaring Twenties, there is more cause for optimism

- With real incomes supported by cuts in NI rates at the top of the income distribution and a 10% rise in the minimum wage at the bottom, GDP is now expected to grow 0.4% in 2024. Although the outlook is lacklustre, by the time of a general election – most bets are for the second half of the year – the government may be able to point to falling interest rates and an inflation rate that is back to 2%.
- Better news on inflation is a big part of the calculation of when to go to the polls. Domestic energy prices for a typical user rose 5% in January but will likely fall 14% in April. There is even a chance inflation will be below target then. Markets are placing their bets: a 40% probability of a cut in interest rates is priced in for March. But May, a forecast month for the Bank, is when we expect the first move.
- Earnings growth is still too high, pushing up the prices of services. But with vacancies continuing to fall, the labour market is cooling. Unemployment is expected to reach 4.7%. But with no sign of redundancies rising, the next forecast revision may well be downwards.
- Overly tight monetary policy is the main risk for the major economies in 2024. In the UK, around half the impact of higher rates on mortgage payers is yet to be felt and this is the main reason our forecast is slightly cautious when it comes to predicting a more solid recovery.

Risk outlook

- Whoever wins the general election will have to deal with a set of public finances that leave little room for manoeuvre if tax rises are off the agenda. If Labour wins as seems likely, the relationship with the EU could improve, with less divergence from their standards. But it is the housing market that could see more change. Energy conservation measures could be back on the agenda.
- It has become much easier to argue for upside risks regardless of the political cycle. Real wages are growing. The big rise in the minimum wage in April could boost consumer spending more than expected. After the surge in equity markets and recovery in bond prices, some of those at the opposite end of the income spectrum will be feeling better off than a few months ago.
- Tension continues to mount in the Middle East. Oil prices remain around $80pb, but shipping costs are soaring because of the situation in the Red Sea and low water levels in the Panama Canal. Hopes we had seen the back of supply chain problems could be misplaced.

Inflation and interest rates

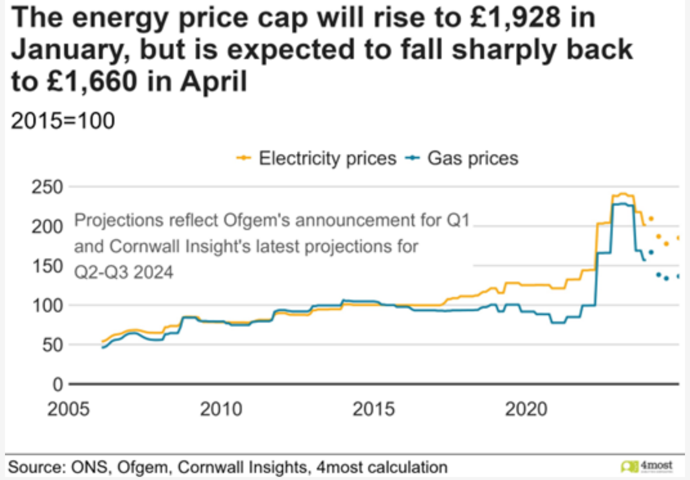
Inflation dropped below 4% in November as transport costs tumbled 1.7%. Encouragingly, the price of services was flat on the month.

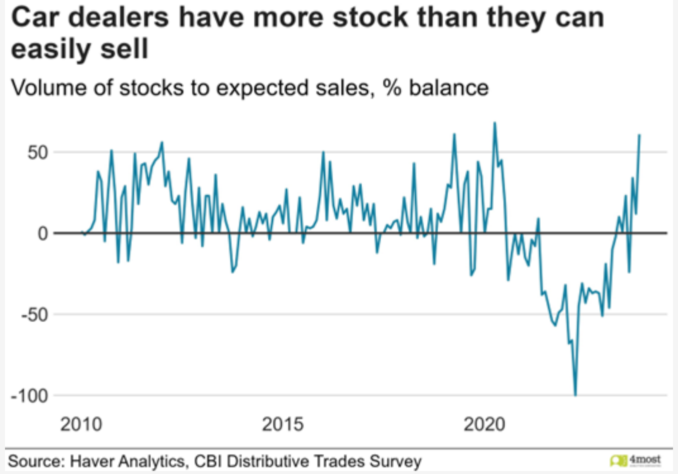
The Bank of England's gloomy forecasts made in November look even wider of the mark. Especially given oil and petrol prices continued to fall in December. And the domestic energy price cap is set to fall 14% in April.

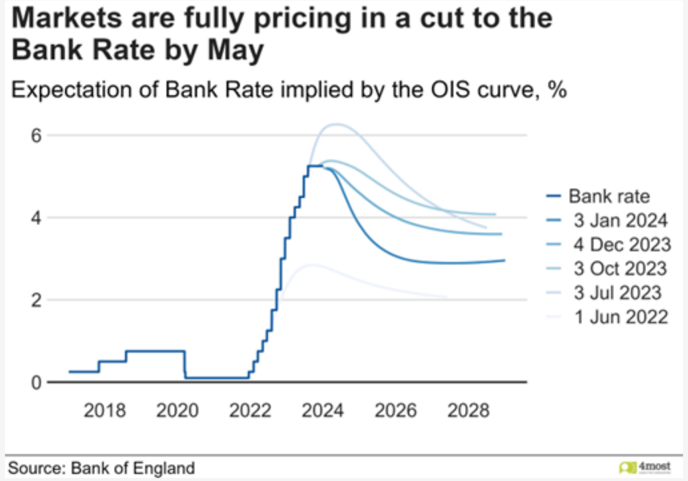
A case for a much more rapid fall in inflation is easy to make. The excess stock at car dealers is striking. Lower energy prices should feed thorough elsewhere.

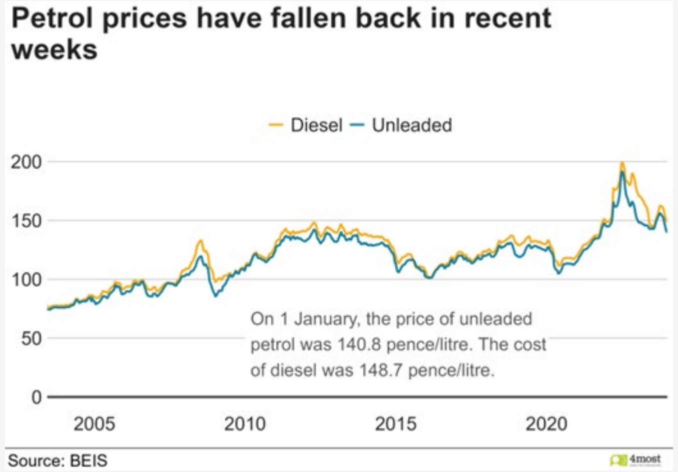
Although the Bank of England reaffirmed its view that policy needs to be "restrictive for an extended period of time" in December, markets are now pricing in a cut in Bank Rates to 4% by end-2024 with around a 40% weight attached to a start on this path in March.

A big hike in the National Living Wage could still spark a new round of wage inflation next Spring.









Labour market

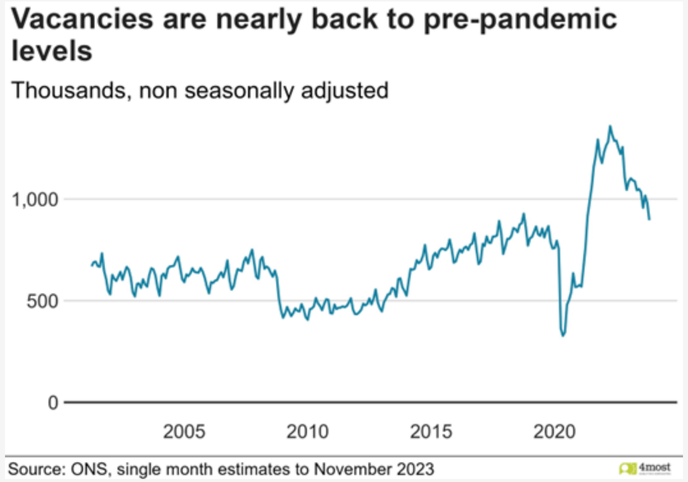
The cooling in the labour market is now more visible where it matters most, in wages. Given vacancies are still falling sharply, the trend should continue.

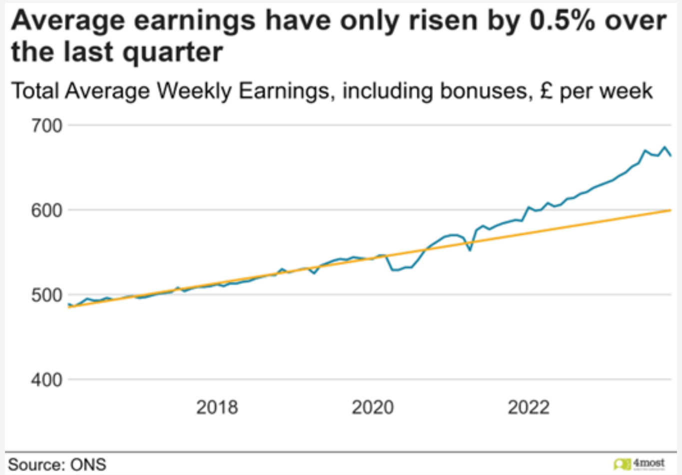
There might be a resumption of normal service in terms of ONS labour market statistics in January. Their best view is that the unemployment rate remained at 4.2% in August-September.

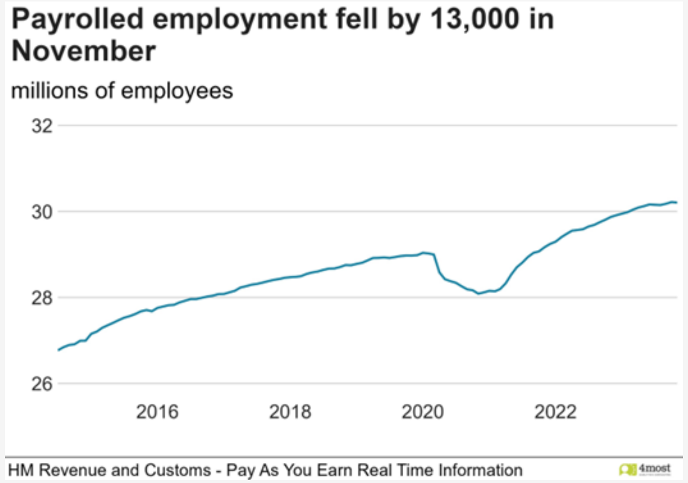
While the unemployment rate is expected to rise to 4.7% as higher rates keep growth subdued, the risks to the forecast now look downside.

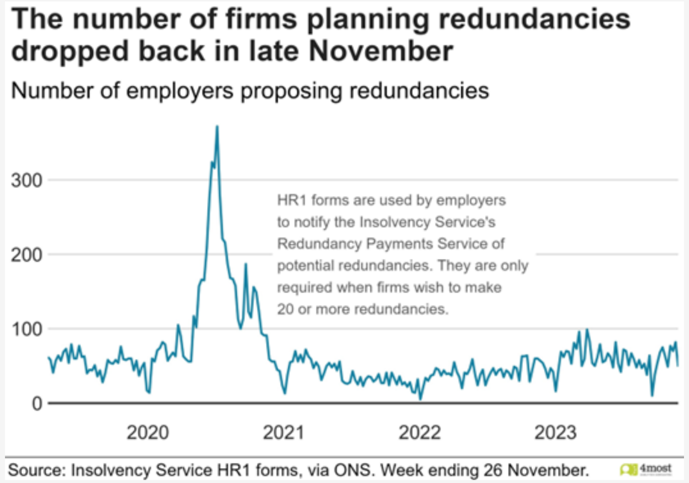
The path of earnings has been volatile. It is too early to be certain that normality has been restored.

While the rising minimum wage has broadly been a positive, there is a growing danger that firms in retail and hospitality on thin margins will not be able to bear this cost.









Housing market

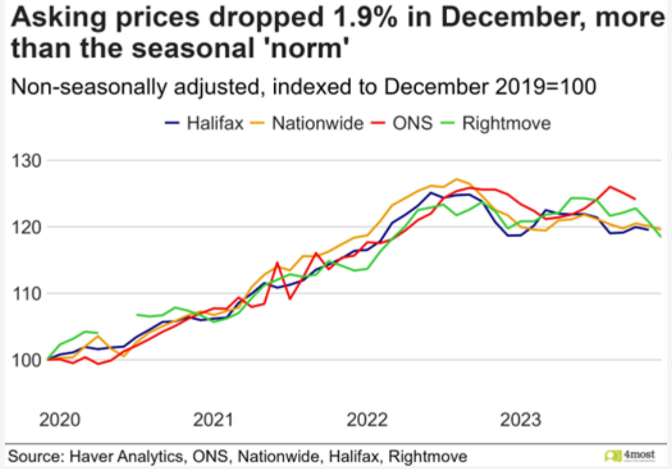
The market looks more attractive to buyers than it has for some time. Supply of new properties, if not increasing, is no longer contracting. It is demand that seems to be underpinning prices.

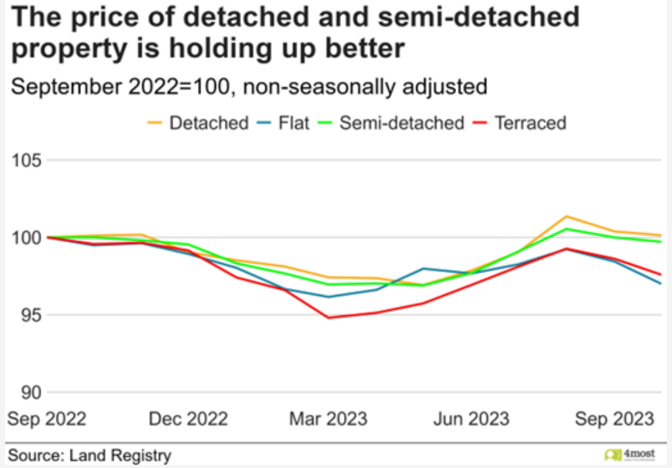
Most significantly the reassessment of where rates are headed – the market is pricing in a long-term Bank Rate of 3% rather than the 4% of a few months ago – makes the affordability picture looks better.

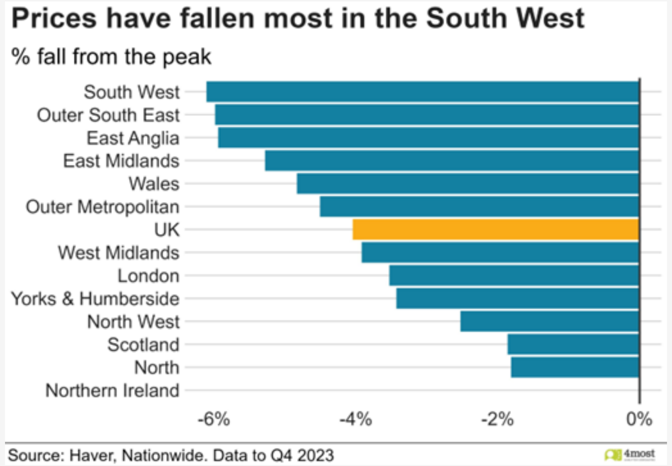
While a further 5% drop in house prices over 2024 is still a prudent assumption, it is much easier to make a case for better outcomes.

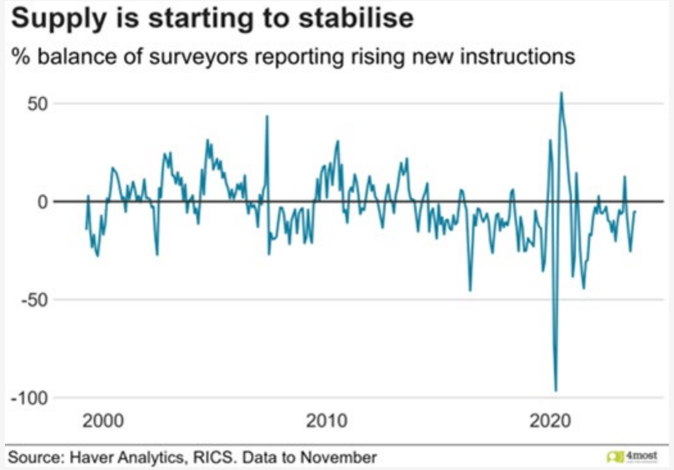
Potential forced selling from BTL landlords is still a key downside risk to prices.

Part of the reason the affordability picture has improved, and prices stabilised, is more high loan to income lending and longer mortgage terms. It is not clear either is sustainable in the medium term.









Rental market

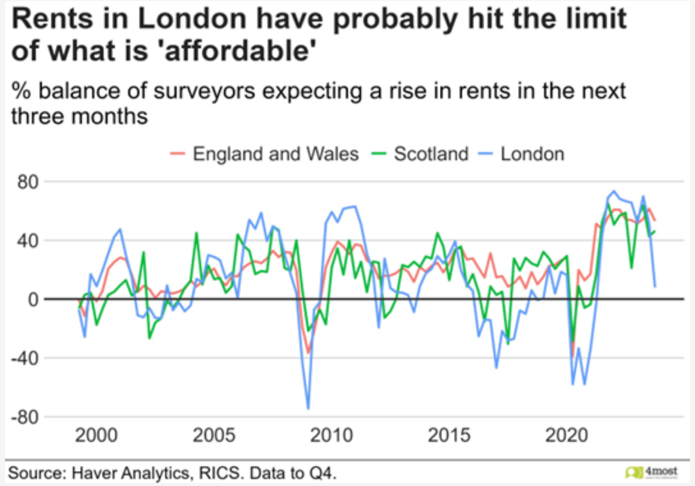
Affordability is the main challenge for the rental market in 2024. Although income growth will be supportive, the scope for more large rent rises feels limited.

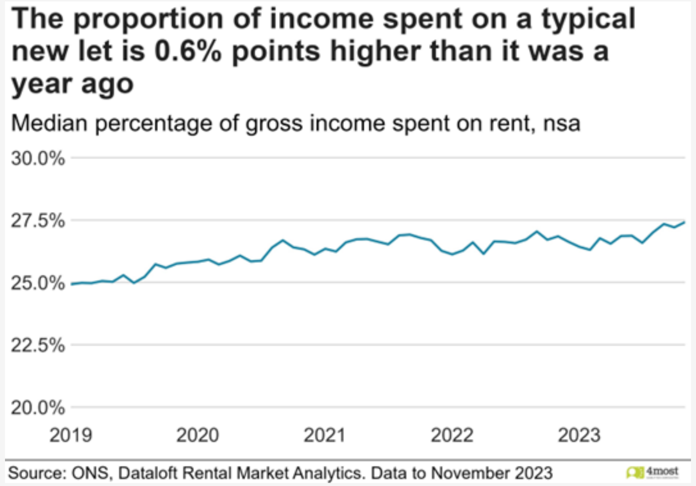
Zoopla reports enquiries per rental home is now below year-ago levels but are still high by historic standards.

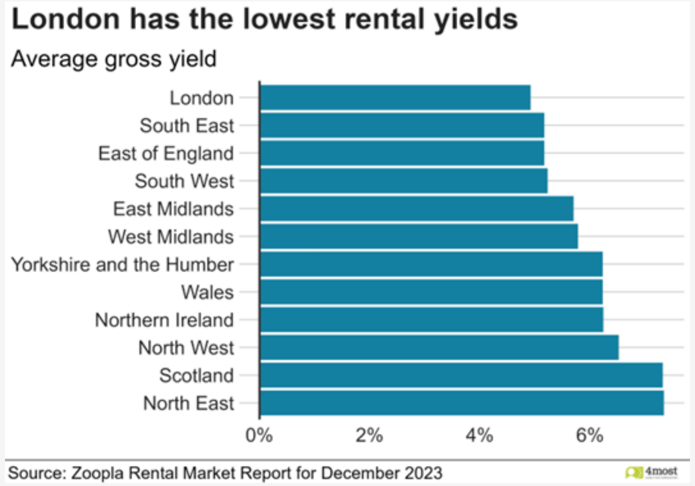
New research by the Bank of England shows how high rates have driven a big shift in Interest Coverage Ratios (ICR) on new BTL lending. Until this changes, the market for new lending will remain small.

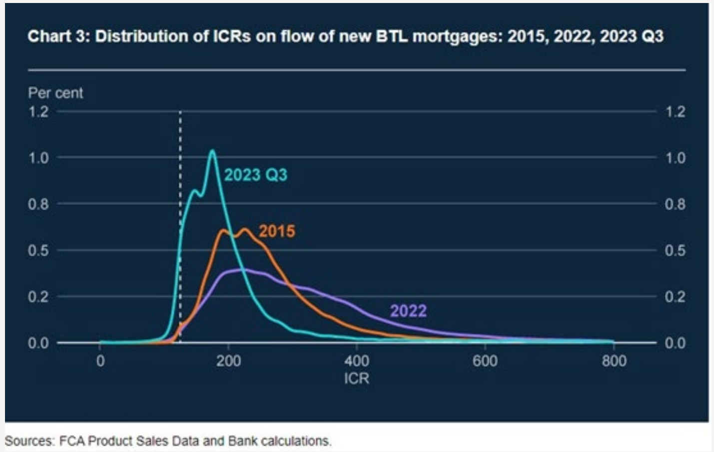
The economic challenges, including ICR requirements, could well see an even more pronounced move to the use of Limited companies.

Housing policy is one area that could change a lot under a Labour government. . A Labour government could put EPC improvements back on the agenda.









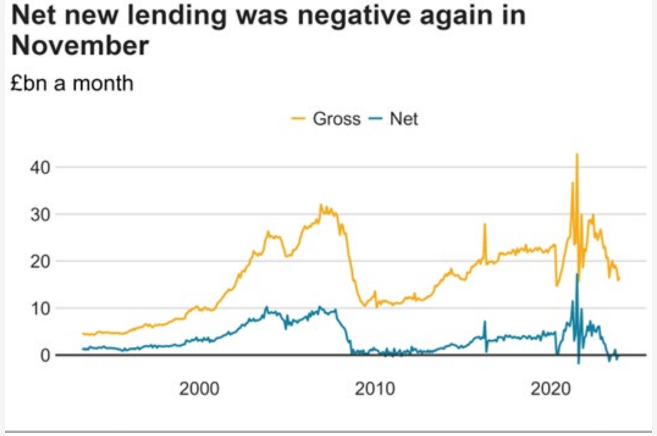
Mortgage market - activity

Although net lending contracted again in November, that represents a view in the rear-view mirror – the fall in mortgage rates means approvals should improve in 2024.

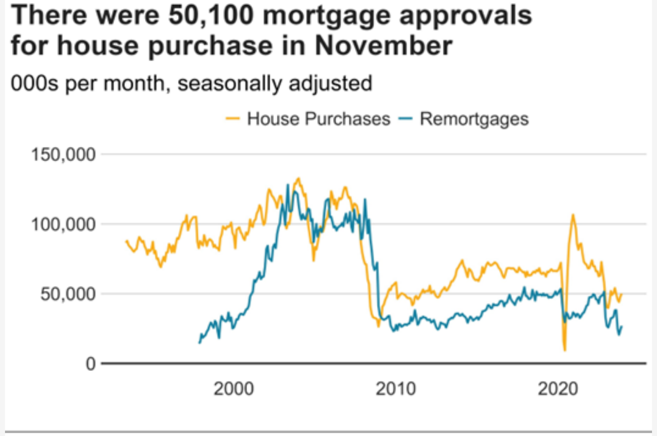
With five-year fixes below 4% and two-year fixes at around 4.5%, affordability is heading back what we might think of as normal but is not there yet.

Overall approvals for house purchase are not fully expected to recover given a lack of appetite in the Buy-to-Let market.

The Bank of England remortgage measure does not capture product transfers. But given the scope for lenders to better assess affordability and risk, up until recently this has been the only area of the market that is thriving.



Source: Bank of England



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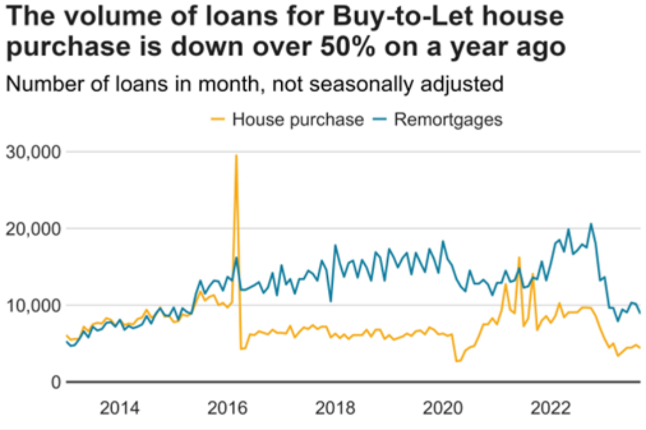
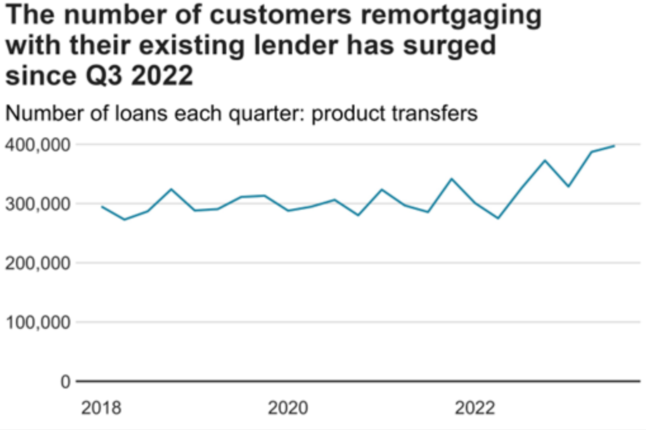


Source: Haver Analytics, UK Finance. Data to September 2023



Source: Haver Analytics, UK Finance. Data to Q3 2023

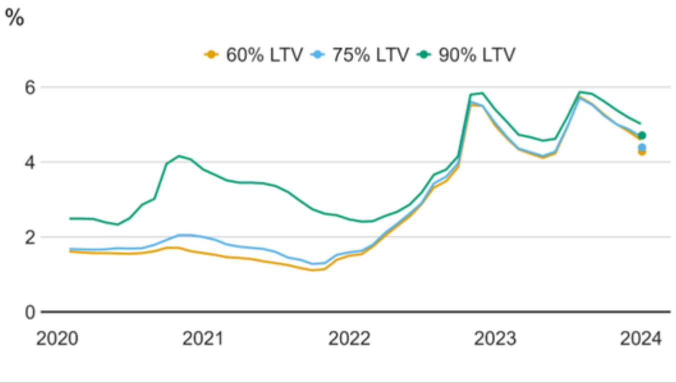
Mortgage market - rates

The expectation of where the Bank Rate will be in five years has dropped from 4.2% at end-September to 3% in early January. Consequently, mortgage rates are heading towards 4% and are already below that level for a few people.

Could rates fall even more? The proportion of business written less than 2% above Bank Rate remains very high. But that overstates the impact on margins in a world where rate cuts are expected. The premium between the rates on high LTV and lower LTV lending is rising but still compressed by historic standards.

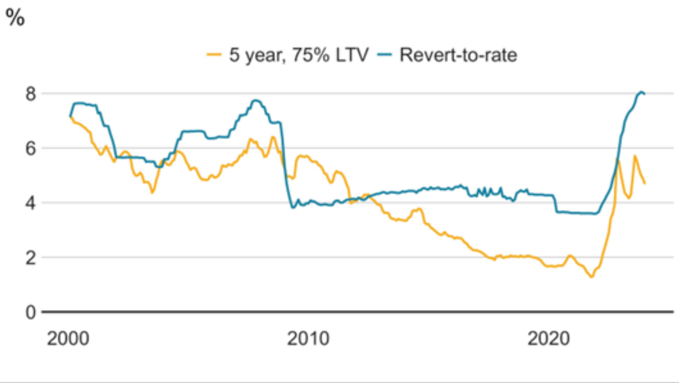
The 4most view is that markets have got ahead of likely cuts in the short-term, but that the neutral policy rate is around 2½% rather than 3%. Most of the good news feels priced in for now

Five year fixed rates on residential secured lending are heading towards 4%



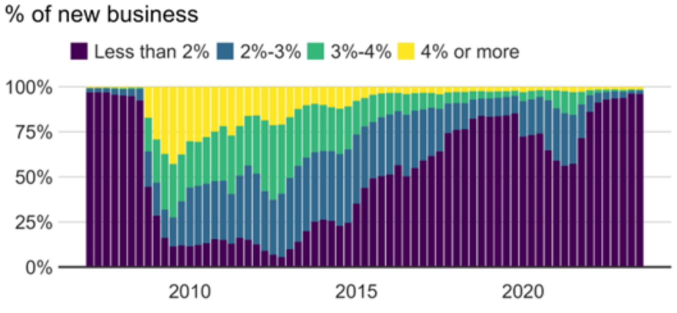
Source: BoE data to December 2023. MoneySavingExpert quote January 3

The typical 'revert-to' rate was 7.96% in December



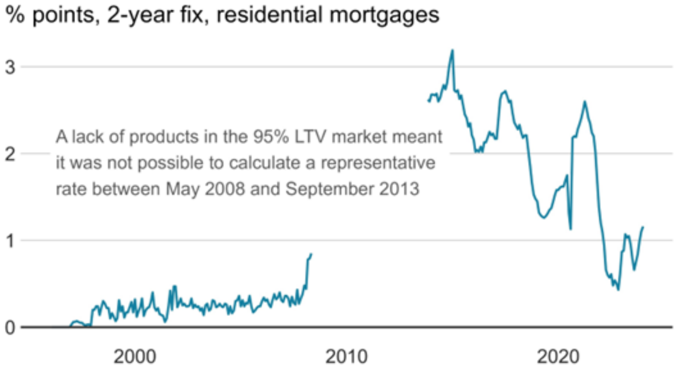
Source: Bank of England. Data to December 2023

The share of gross mortgage advances with interest rates less than 2% above Bank Rate decreased by 0.1% points to 96.1%, but remained 3.1% points higher than a year ago



Source: Haver Analytics, Bank of England MLAR statistics. Data to Q3 2023

Spread between 95% and 75% LTV lending rates



Source: Bank of England. Data to December 2023

THANK YOU.