March 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

A pre-election giveaway. A post-election headache

- Tax cuts could deliver a short-term lift. But the big picture is that cutting debt relative to GDP is only possible with a very optimistic growth projection and by slashing some areas of public spending in the years ahead in a way that is probably unrealistic. This is of course will be a problem for the next government to solve.
- Some optimism is warranted in the short term. With business confidence strong and households not quite as worried about their personal finances, the level of output in Q4 2024 in our forecast is expected to be 1.4% higher than a year earlier.
- Revamped labour market figures reveal the unemployment rate is 3.8% rather than the previously estimated 4.2%. That chimes better with strong wage growth. Given the revisions, unemployment is expected to peak at 4.4% rather than 4.7%. The minimum wage represents a key risk not just to inflation but the profitability of sectors like retailing and hospitality.
- Inflation could well be below the 2% target in April. But the Bank of England may well want to see the impact of the big rise on the minimum wage. Markets are starting to look to August rather than June for the first cut.

Risk outlook

- Buyers are tentatively returning to the housing market. With little slack, house prices are no longer expected to fall significantly. But affordability measures still suggest big downside risks if the economy falters.
- Uncertainty about how the lags in the transmission of monetary policy will play out remain. An increase in direct debit failure rates is a reminder that muddling through forever is not possible; there is also a lot of remortgaging at higher rates to come.
- Geopolitical risks are always with us: the situation in the Middle East looks like it will be dragged out; China's has the challenge of its bad debt; and the US election has the obvious potential to lead to a flight from risk and to embolden Russia.

PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

A Budget that identifies many of the challenges. But which leaves big decisions for after the election

- Cuts in National Insurance (NI) rates and lower inflation mean short-term prospects for real income and overall growth are brighter. But as ever, it is the underlying detail where the true picture emerges. Freezing tax allowances over the next five years means the tax take – both personal and in aggregate – is increasing as a share of GDP and is set to be 37% of GDP in 2028/29, the highest level since 1948 – a message at odds with the tax cutting credentials claimed by the Chancellor.

- Lower headline NI rates tax cuts are partly funded by changes to the 'non-dom' rules. But it is restraint in government spending that sees the OBR pencil in a fall in debt relative to GDP in the outer years of the forecast. Real public spending is expected to rise just 1%pa. Health, defence and schools will receive more as protected areas.

- But this protection implies significant cuts in other areas such as social care, adult education and the justice system in a world where delivery of all these services is creaking. A full Public Spending review after the election will likely inject a dose of reality.

- Improving public sector productivity, which has lagged well behind that in the private sector, would help enormously. Properly funding the NHS productivity plan is perhaps the one measure that everyone will cheer. Delivery of efficiency improvements is a challenge where the answer has proved elusive, but the prize would be huge.

- For a start, rising long-term sickness is holding the UK economy back. While there are a host of other active labour market policies aimed at getting more people into job – carrots for working parents and sticks for others not in work, which may or may not deliver – an improvement in the nation's health would ease many of the country's problems.

- Investment is also a key weakness where it is recognised improvement is needed. The UK's recent experience is that low taxes alone are not enough to cure this ill. A fall in government investment of 9% between 2023 and 2024 doesn't bode well for tackling problems with the country's infrastructure. Elsewhere, changes to public sector pension funds and ISA rules to encourage domestic investment do not feel transformative.

Limited help for those struggling at the bottom of the income distribution. And little for the housing market

- Some measures will affect lenders directly. After taking the advice of the Citizens Advice Bureau, the Chancellor abolished the £90 charge for obtaining a Debt Relief Order. He also raised the debt limit to £50,000 from £30,000 and the value of a single motor vehicle disregarded in assets from £2,000 to £4,000. This will help those seeking to resolve their problems but does not alleviate the pressures that created the situation.
- Those at the bottom of the income spectrum will also receive a small benefit from the extension of the Household Support Fund. This works through local councils to help people who are vulnerable or who cannot pay for essentials. But the extension is only for six months and again does not really the underlying issue.
- After the possibility of support for 99% LTV mortgages for First-Time-Buyers was mooted and then dropped, the Budget was light on big-picture housing measures that will move the market.
    - ➢ The tax relief that holiday-home owners that let out their properties get on furniture and other spending will end from April 2025.
    - ➢ Stamp Duty relief for investors buying multiple properties is also scrapped.
    - ➢ The Capital Gains tax rate on second properties will be reduced from 28% to 24%
- At the margin, these measures may see more landlords sell up, and accelerate the move to incorporation. But compared to the current slump in housing market activity, and the measures in the coming Renters Reform Bill, the impacts feel marginal.

PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

Inflation and interest rates

With Ofgem's energy price cap falling 12.3% to £1,690 in April, it looks increasingly likely that headline inflation will be back at 2% in April.

It may not stay there long. Some of the higher minimum wage may be passed on by retailers, and in hospitality and social care. And, although duty was frozen in the Budget, petrol prices have edged up again recently.

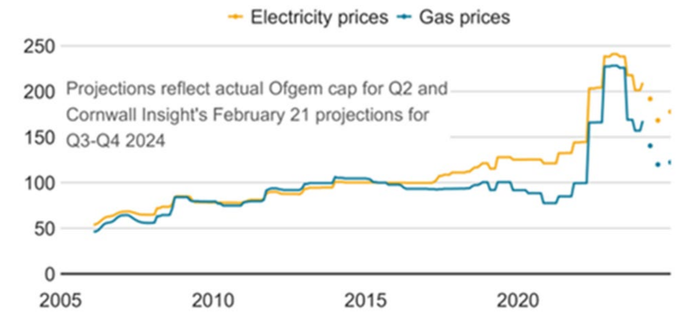
However, downside risks to inflation are probably underplayed. Food prices could fall much further given global prices. China's current economic woes could see it (again) export deflation to the rest of the world rather than lift demand at home.

With the Bank of England seemingly in 'wait and see' mode, markets have pulled back on expectations of rate cuts. Only two 25bp cuts are fully priced in for the end of 2024.

The key question for rates is how much more evidence the Bank of England will need to see to be convinced the job is done. This may not be clear until August.

The energy price cap will fall to £1,690 in April

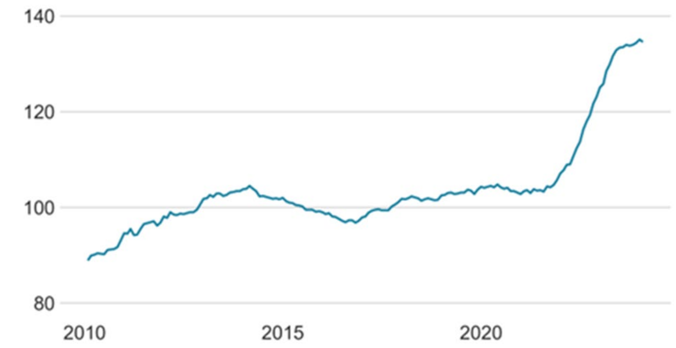
2015=100



Source: ONS, Ofgem, Cornwall Insights, 4most calculation

Food prices fell 0.4% in January

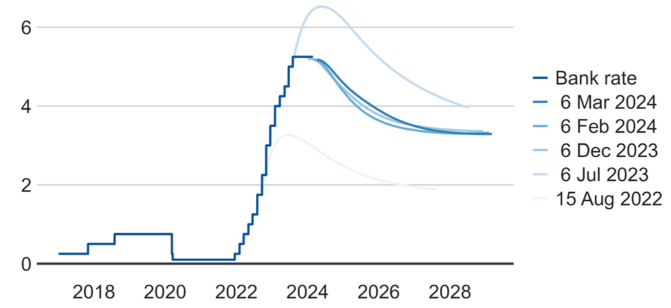
Price level, 2015=100



Source: ONS

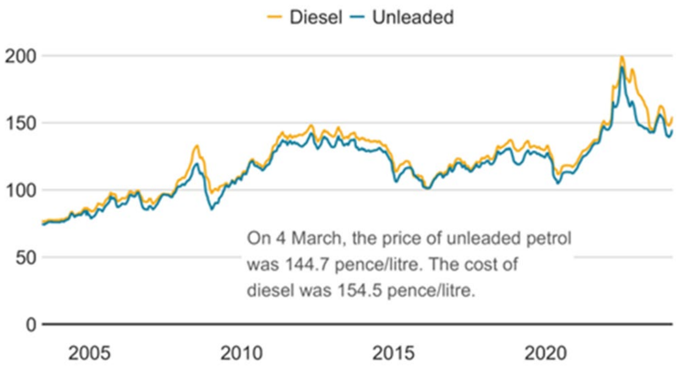
Markets scaled back expectations of future cuts during February

Expectation of Bank Rate implied by the OIS curve, %



Source: Bank of England

Petrol prices are on the rise again



Source: BEIS

PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

Labour market

After the ONS's statistical overhaul, the unemployment rate is now thought to be 3.8%, not 4.2%. And there are more people neither in work or looking for it than previously thought.

This tighter labour market may help better explain some of the heat in wages. But the story of a cooling, led by firms not looking to recruit, rather than laying off workers, still holds.

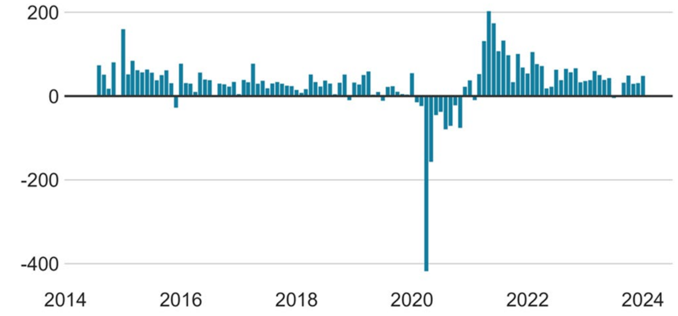
Given the lower starting point, the unemployment rate is now expected to peak at 4.4% rather than 4.7%.

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.

Payrolled employment grew by 48,000 in January

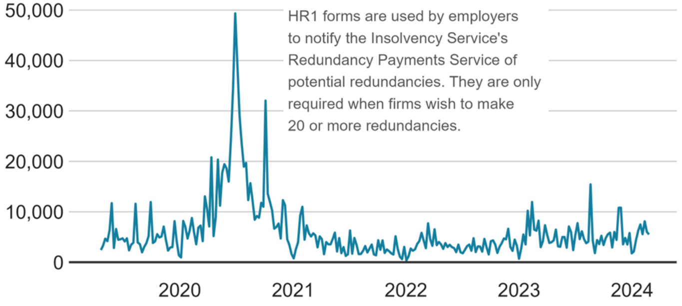
monthly change in employees (000s)



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

The number of potential job losses has risen slightly at the start of 2024 but is lower than it was a year ago

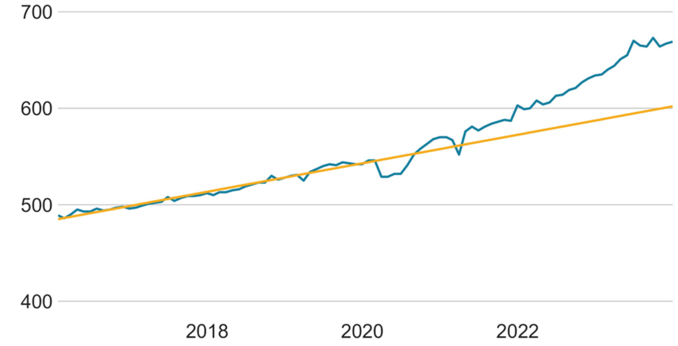
Potential redundancies, 000s



Source: Insolvency Service HR1 forms, via ONS. Week ending 25 February.

Average earnings were flat in Q4 2023

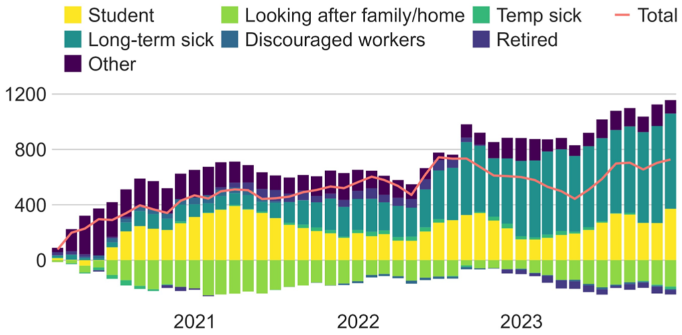
Total Average Weekly Earnings, including bonuses, £ per week



Source: ONS

The numbers unable to work because of long term sickness is holding the economy back

000s difference from January 2020



Source: ONS

PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

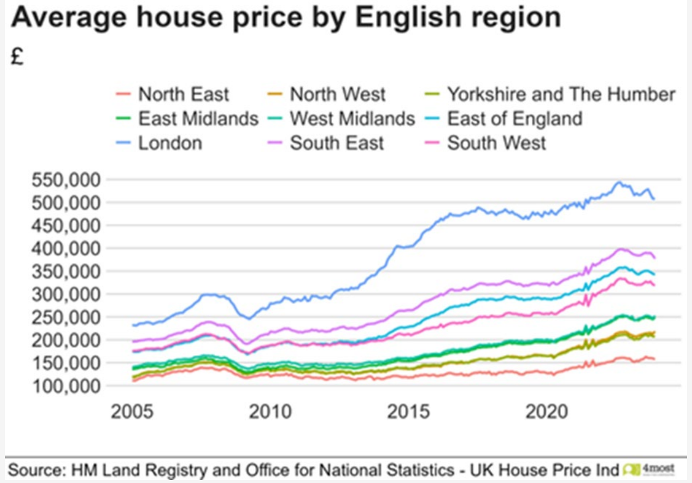
Housing market

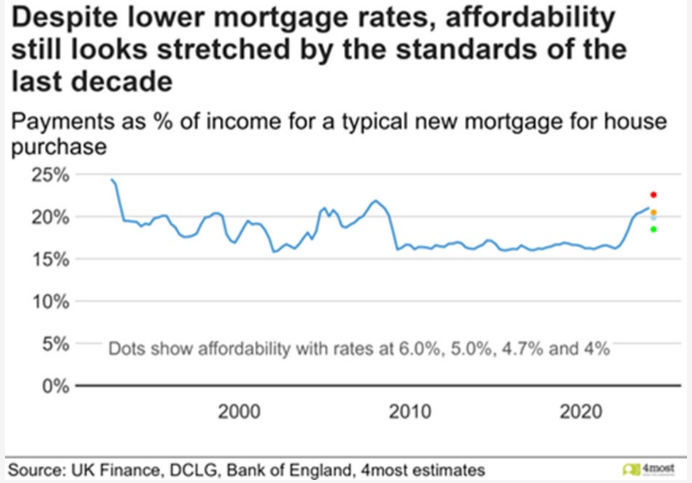
While affordability still looks stretched at current mortgage rates, asking prices in February were slightly higher than a year ago. Pent-up demand is emerging.

Hometrack still believes this is a buyers' market, but there just isn't the slack that accompanied the big corrections seen in the 1990s and the financial crisis.

While we still expect prices to edge down slightly given the lack of demand from First Time Buyers (FTBs), this line is becoming harder to maintain.

As long as affordability remains stretched, risks to house prices remain downside. But it feels like it would take an unexpected economic shock to jolt the market from its current path first.





PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

Rental market

Have rents peaked? Average new rental prices in February were 1.6% below the October peak. Those in London have fallen 5.6% according to Homelet.

Anecdotal evidence suggests more supply from homeowners renting rooms. But the fall could also reflect a different mix of lets, or seasonal impacts.

Most surveyors still see a very tight market. There are more landlords selling up than a few years ago, but this trend is often exaggerated in the media.

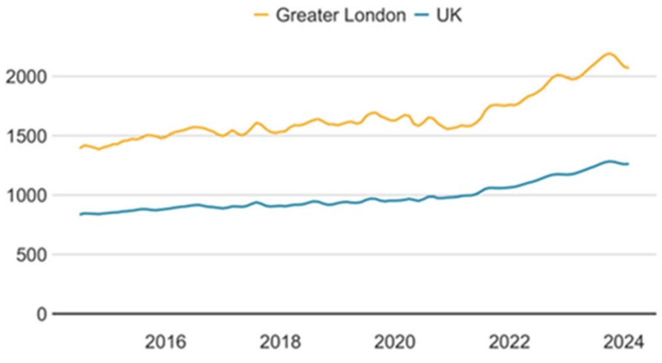
From the tenant's perspective, building more property is key to affordable rents. Signs that this is happening through more 'build to rent' are encouraging.

The Budget cuts to capital gains tax rates could see more landlords take their profits and exit the market. This might make the market tighter. But given the cut is permanent there is unlikely to be an immediate rush for the exit.

Rumours are swirling (again) that no-fault evictions could be removed from the Renters Reform Bill.

Rents may have peaked

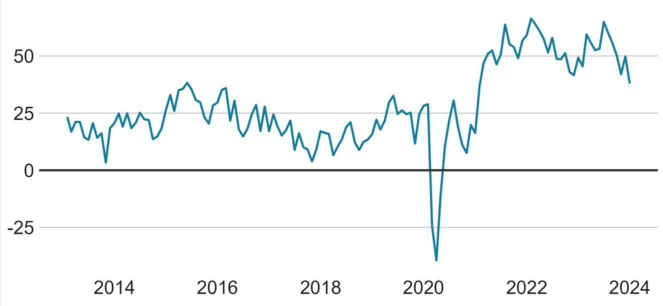
£, monthly rent on newly let property



Source: Homelet. Data to February.

While some of the heat is coming out of the rental market, the vast majority of surveyors expect further rent rises

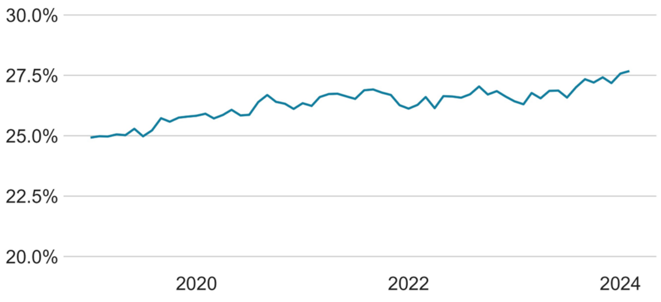
% balance of surveyors expecting a rise in next three months



Source: Haver Analytics, RICS. Data to January

The proportion of income spent on a typical new let is 1.4% points higher than it was a year ago

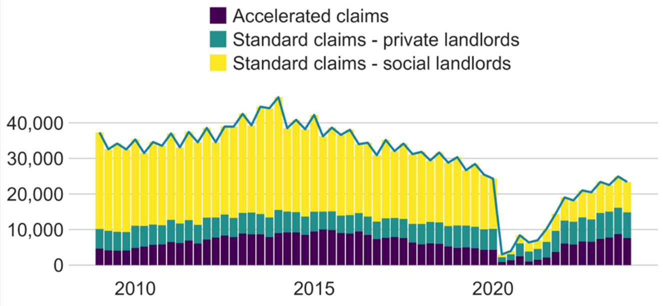
Median percentage of gross income spent on rent, nsa



Source: ONS, Dataloft Rental Market Analytics. Data to February 2024

There are more private landlord possession claims than before the pandemic

Quarterly landlord possession claims in the county courts of England and Wales by type of procedure and landlord



Source: Ministry of Justice. Data to Q4 2023

PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

Mortgage market - activity

Although affordability and a weak investment case took its toll on First Time Buyers and Buy-to-Let sales last year there are tentative signs of a rise in enquiries.

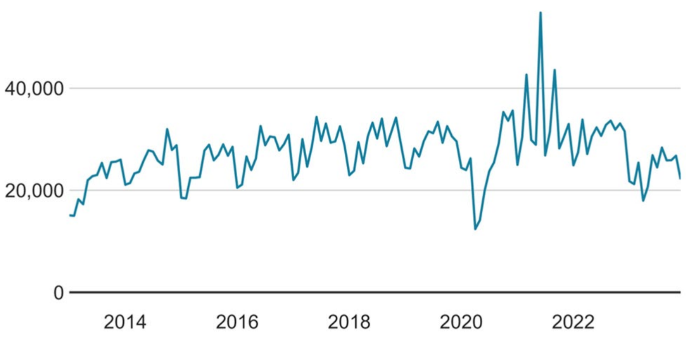
This will take a while to show up in approvals for house purchase; a return to what we think of as normal is unlikely this year given affordability is still stretched.

Lenders expect demand for remortgaging to improve. But most of those refinancing will probably remain with their existing lender. Nine out of every ten remortgages in December was a product transfer.

The Budget was a pretty much a non-event from a housing market perspective. But it may not be the last fiscal event before the election.

The number of loans to First Time Buyers in 2023 was 22% lower than in 2022

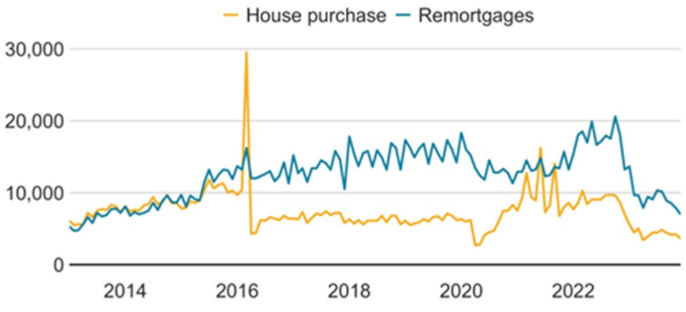
Number of loans in month, not seasonally adjusted



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

The volume of loans for Buy-to-Let house purchase in 2023 was half the level in 2022

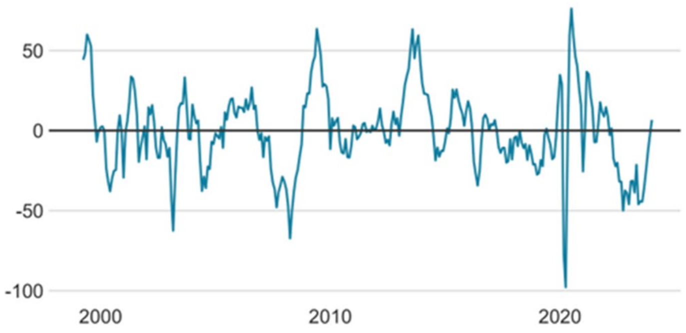
Number of loans in month, not seasonally adjusted



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

Potential buyers are coming back to the market

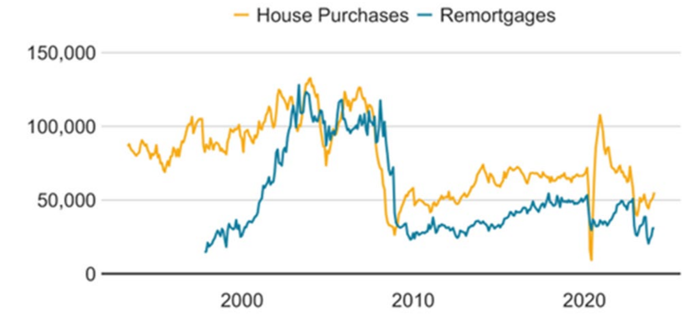
% balance of surveyors reporting rising buyer enquiries



Source: Haver Analytics, RICS. Data to January

There were 55,200 mortgage approvals for house purchase in January

000s per month, seasonally adjusted



Source: Bank of England

Mortgage market - rates

After a period of over exuberance in financial markets where opinions of the pace of future rate cuts got ahead of reality, some realism has been restored.

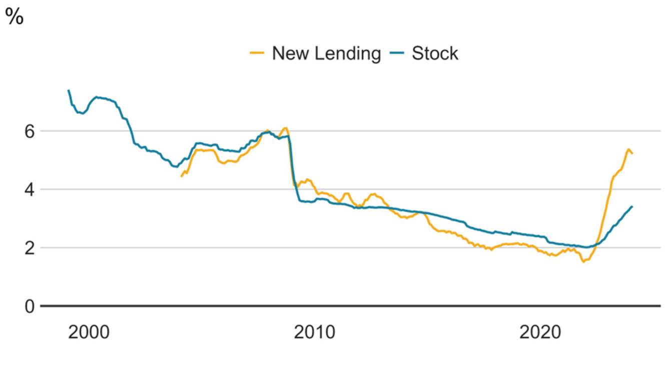
That looks justified: there appears to be a bias to keep rates at current levels on the MPC. This is understandable given the criticism than would follow if inflation flared up again.

Many lenders have raised mortgage rates as market pricing adjusts to this message. Given the movement in the OIS curve, rates could firm further in the very short term.

But if the OBR forecast for inflation is right – inflation will be well below target in H2 – then there could be more significant downward movement in rates later in the year.

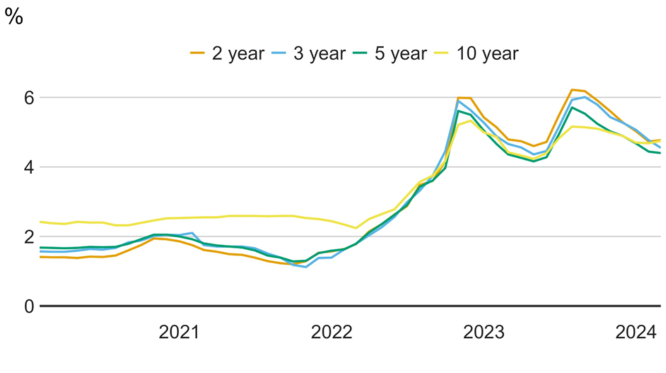
The incentive for remortgaging remains as large as ever. But for now, much of this business is remaining with the existing lender.

The effective rate on new secured lending edged down to 5.21% in January



Source: Bank of England. Data to January

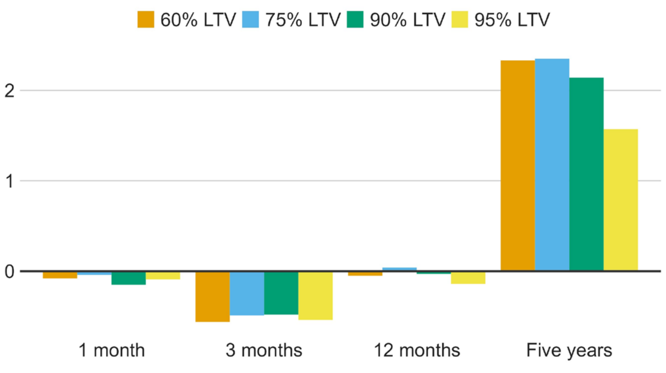
Rates on 75% LTV residential lending on 2 and 10-year fixes edged up in February



Source: Bank of England. Data to February 2024

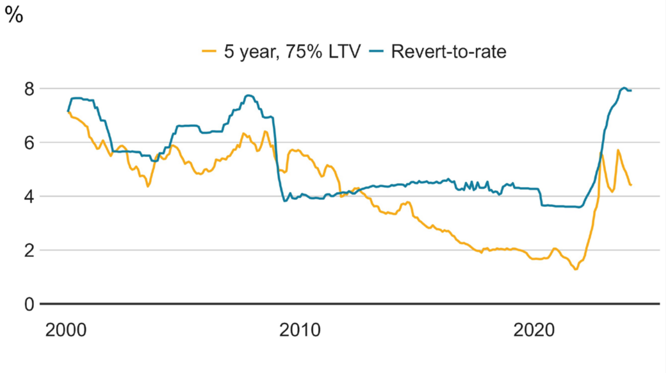
Change in Mortgage Rates

5-year fixed rates (% points)



Source: Bank of England. Data to February 2024

The typical 'revert-to' rate was 7.92% in February



Source: Bank of England. Data to February 2024

PRIVATE & CONFIDENTIAL, NOT FOR REDISTRIBUTION

THANK YOU.