



Market Briefing: June 2024

Key developments in the economy, housing and mortgage markets

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Executive summary

- UK economic growth rebounded sharply in Q1 to 0.7%, after two consecutive quarters of falls in the second half of 2023. The services sector accounts for the bulk of the growth in 2024 so far while construction activity continues to decline with private house building particularly weak.
- CPI inflation fell to the Bank of England's 2.0% target rate in May for the first time since July 2021. Core CPI inflation (excluding food and energy prices) also fell, to 3.5% in May, down from 3.9% in April. Inflation in the services sector fell from 5.9% to 5.7%. However, after 8 months when it was almost flat, the CPI index increased by 1.8% in the four months to May and the headline rate of CPI inflation is expected to rise during the second half of this year.
- The labour market continued to soften modestly with job vacancies falling to their lowest level since May 2021 and the unemployment rate reaching 4.4%, the highest rate since summer 2021. Despite this, regular earnings growth remained at 6.0% in February-April although pay settlement data show average settlements running at between 4.6% and 5.0% in recent months.
- The Bank of England Monetary Policy Committee (MPC) voted to keep Bank Rate at 5.25% in June by a 7-2 majority. However, Governor Andrew Bailey struck a slightly more cautious tone about future rate cuts, suggesting the next decision could be finely balanced.
- Housing market activity has rebounded from its January lows, with 239,000 transactions in the three months to April, 5% above the previous figure. The RICS Residential Market Survey for May suggests that transactions could continue to rise over the next few months, buoyed by a better flow of stock onto the market.
- A modest but clear upward trend in house prices is evident so far in 2024. The Land Registry reported prices up 1.1% in the year to April while Nationwide showed a 1.3% rise in the year to May. This may reflect improved buyer affordability following falls in fixed-rate mortgage pricing since the peak of last summer.
- Mortgage lending and approvals have both been on an upward trend so far in 2024. House purchase approvals have been particularly strong, up 47% in the three months to April compared to the previous three months.
- Short-term mortgage arrears (1.5<2.5% of the loan balance) fell in both the owner-occupied and buy-to-let markets in Q1, reversing the trend of the previous two years. The rise in arrears over 2.5% of the loan balance also slowed sharply.

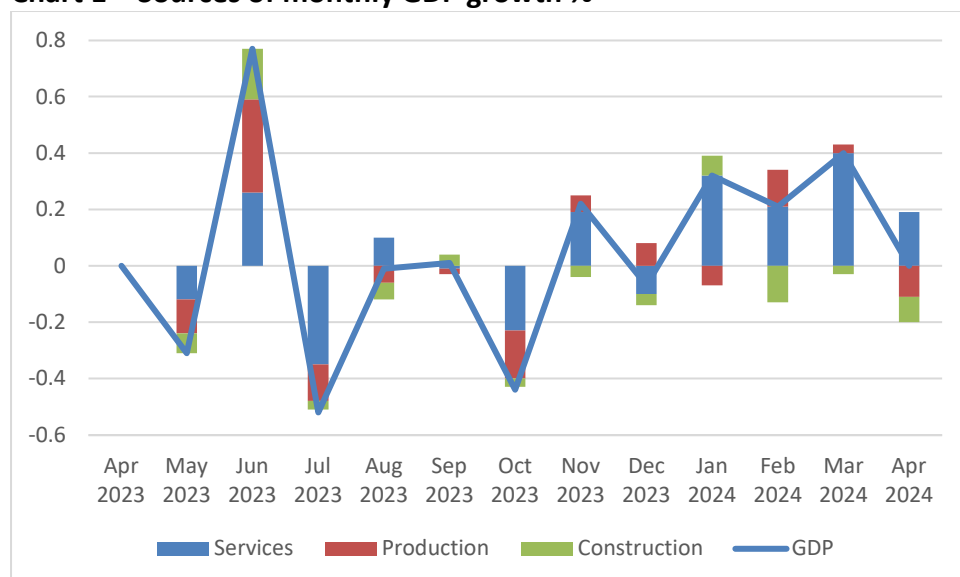
The economy

Output

After the economy entered a shallow recession (two quarters of consecutive contraction in GDP) in the second half of 2023, the early months of 2024 have seen a robust recovery. GDP rose by an estimated 0.7% in Q1 (revised up from 0.6%) followed by a flat performance between March and April as wet weather contributed to both weak retail sales and lower construction activity.

Services output has been driving the recovery this year as Chart 1 shows, with production and construction output both down on December. There was growth across most sub-sectors of services led by professional, scientific and technical activities and transportation and storage. Within construction, new private housing output was a source of weakness, falling 4.4% in April to stand 12.4% down on April 2023 output.

Chart 1 – Sources of monthly GDP growth %

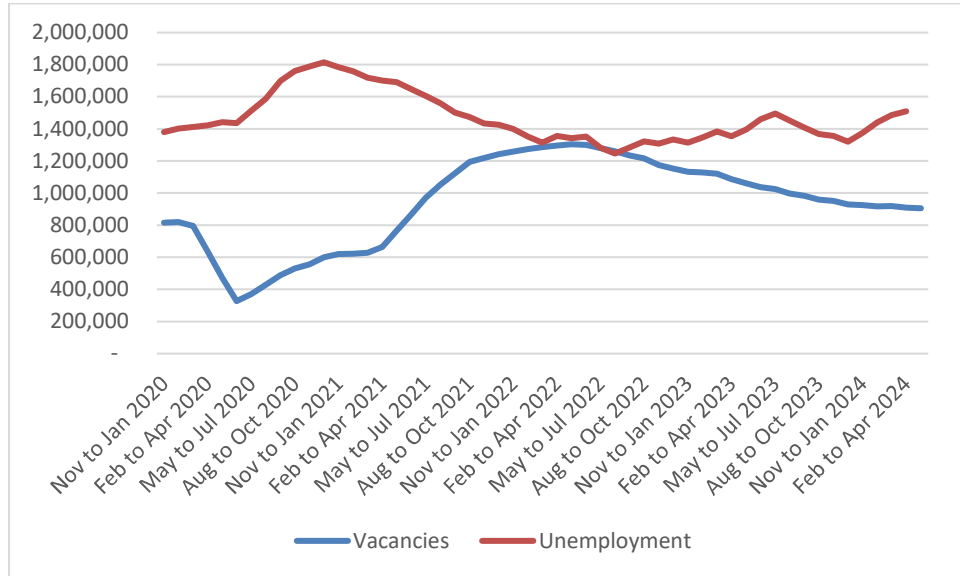


Source: Office for National Statistics

Labour market

Despite higher output, the number of job vacancies has continued to decline this year, although the pace of decline has slowed markedly (see Chart 2). The estimated number of unemployed has also been rising again after an unexpected fall in the second half of 2023. Unemployment numbers are based on the Labour Force Survey and the ONS has highlighted concerns about its accuracy given recent low response rates, suggesting they should be treated with some caution.

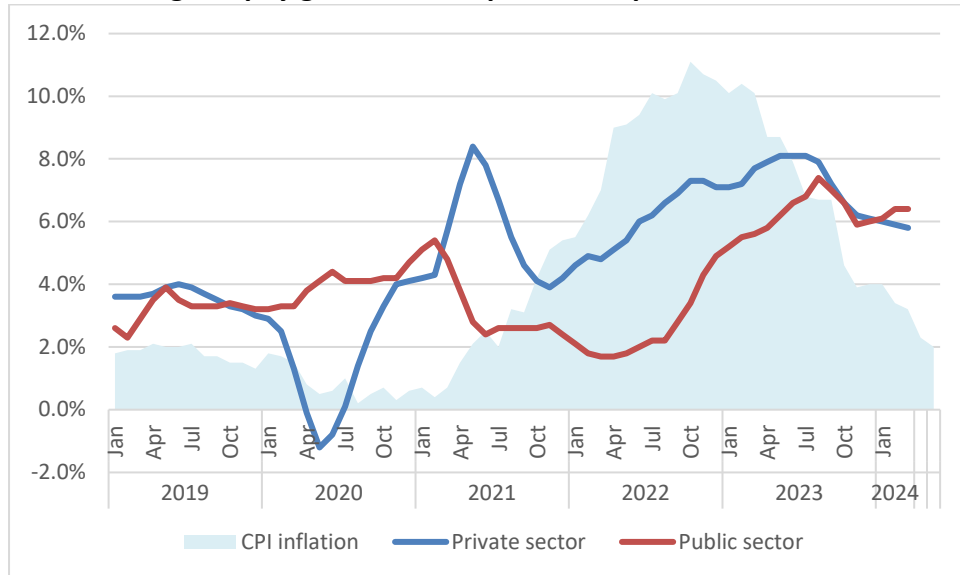
Chart 2 – Job vacancies and unemployment



Source: Office for National Statistics

Other measures of the labour market support the picture of a slight weakening. The unemployment rate rose to 4.4% in the February to April period, the highest rate since summer 2021, while the inactivity rate also rose on the latest quarter to 22.3%. The employment rate is down as the number of people in work fell 30,000 on the latest month and 140,000 on the latest quarter.

Chart 3 – Regular pay growth in the public and private sectors



Source: Office for National Statistics

Despite this softening picture, earning growth remained unchanged in February-April compared to the previous period at 6.0% for regular pay and 5.9% for pay including bonuses. As Chart 3 shows, earnings growth is now well above CPI inflation, allowing workers to claw back some of the real income lost during 2022 and early 2023. At 6.4%, public sector regular pay growth is now well above that of the private sector, at 5.8%. However, pay settlement data is running below this level. Data from Brightmine

show the median settlement was 4.6% in the three months to May while Incomes Data Research reports settlements averaging 5.0% in the three months to April.

Inflation and interest rates

After the extreme volatility of global commodity prices in 2022 created by the reopening of economies after Covid lockdowns and the Russian invasion of Ukraine, prices have settled down, illustrated by the S&P GSCI Sterling Commodities Index shown in Chart 4. By late June of this year, the index was down 1% on a month earlier and up a modest 4% on a year earlier. Oil prices have followed a similar pattern and these dipped in early June but have since more than recouped these losses.

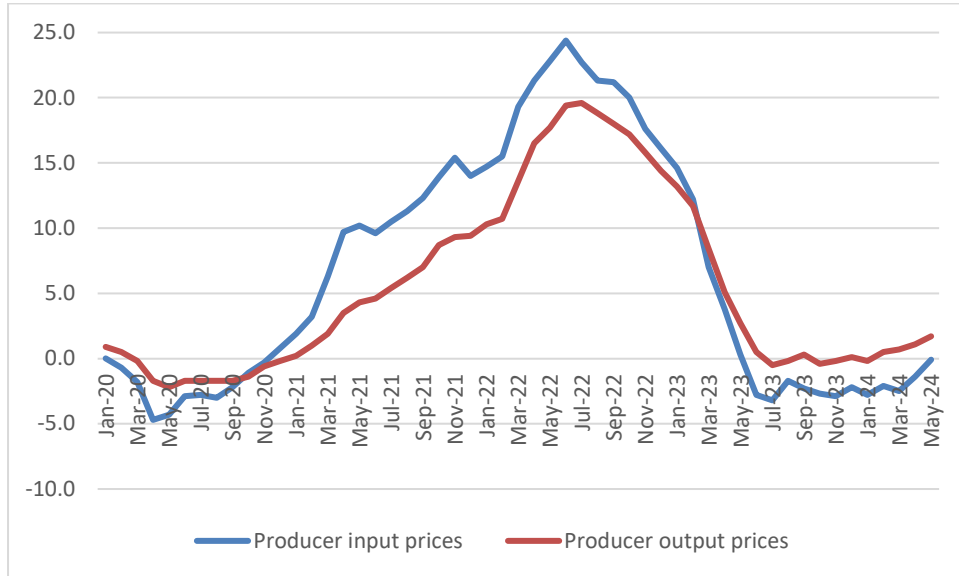
Chart 4 – S&P GSCI Global Commodities Price Index in Sterling



Source: S&P

UK producer input prices have also shown a more stable pattern since they peaked in October 2022 but have not fallen as much as commodity prices might suggest. The latest data shows a modest increase, with manufacturers' input prices up 1.5% comparing the latest three months to the previous three on an annualised basis and almost flat in May relative to a year earlier (see Chart 5). Output prices have also been on a modest upward trend in recent months. In May they were up 1.7% on a year earlier and 2.6% up in the three months to May compared to the previous three months annualised.

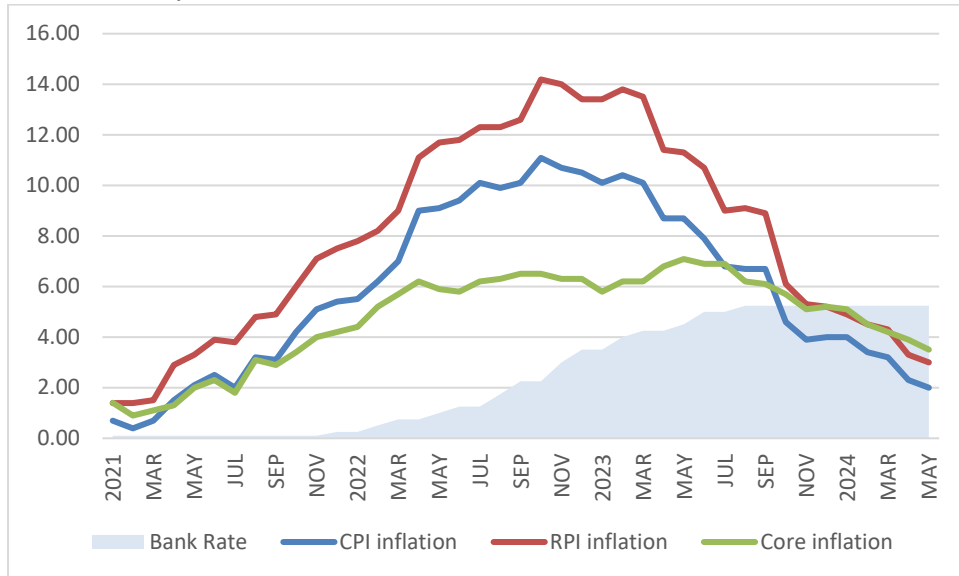
Chart 5 – Producer prices (% annual increase)



Source: Office for National Statistics

Annual CPI inflation fell to 2.0% in May, the first time it has been within the Bank of England’s target since July 2021. RPI fell to 3.0% and core CPI to 3.5%, down from 3.9% in April (see Chart 6). Inflation in the services component of CPI fell to 5.7% from 5.9% while goods inflation fell from -0.8% to -1.3%. The fall in core CPI is particularly encouraging. However, after remaining broadly flat in the eight months to January, the CPI headline index rose 1.8% in the four months from January to May, nearly a full year’s target inflation.

Chart 6 – CPI, RPI and core annual inflation and Bank Rate



Source: Office for National Statistics

It was widely expected that the Bank of England would hold rates unchanged in June due to the general election campaign, although 2 of the 9 members voted for a cut to 5%. Governor Andrew Bailey stated that “we need to be sure that inflation will stay low and that's why we've decided to hold rates at 5.25% for now”, a slightly more

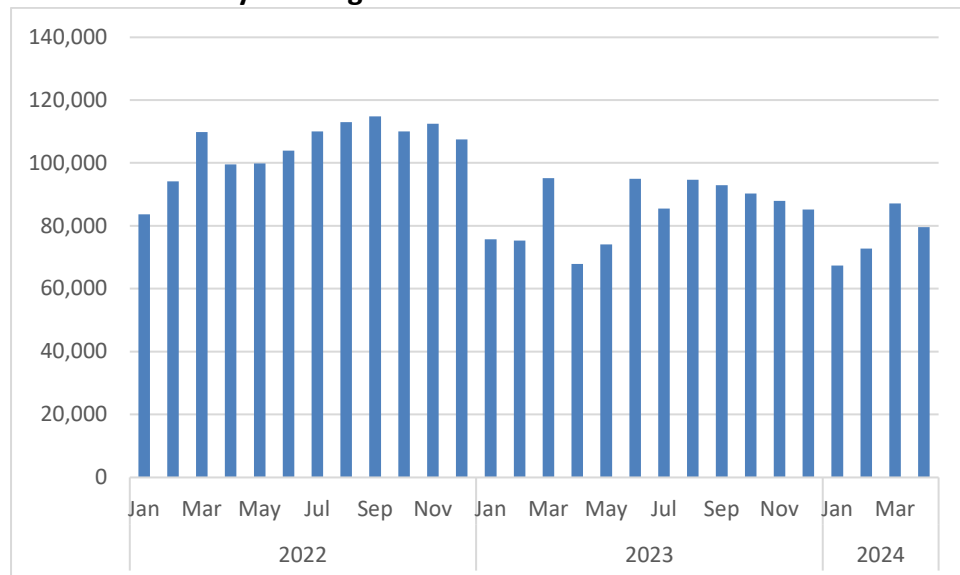
cautious tone than he struck the previous month. Persistently high earnings growth and the sharp rise in CPI since January are concerns that may delay a rate cut in the coming months unless future months see a noticeable improvement in these trends.

Housing and mortgage markets

Activity

Housing activity has picked up sharply since the recent low in January (see Chart 7). There were 239,000 housing transactions in the three months to April, 5% above the previous figure and slightly above the three months to April 2023. The RICS Residential Market Survey for May suggests that transactions could continue to rise over the next few months, buoyed by a better flow of stock onto the market.

Chart 7 – Monthly housing transactions



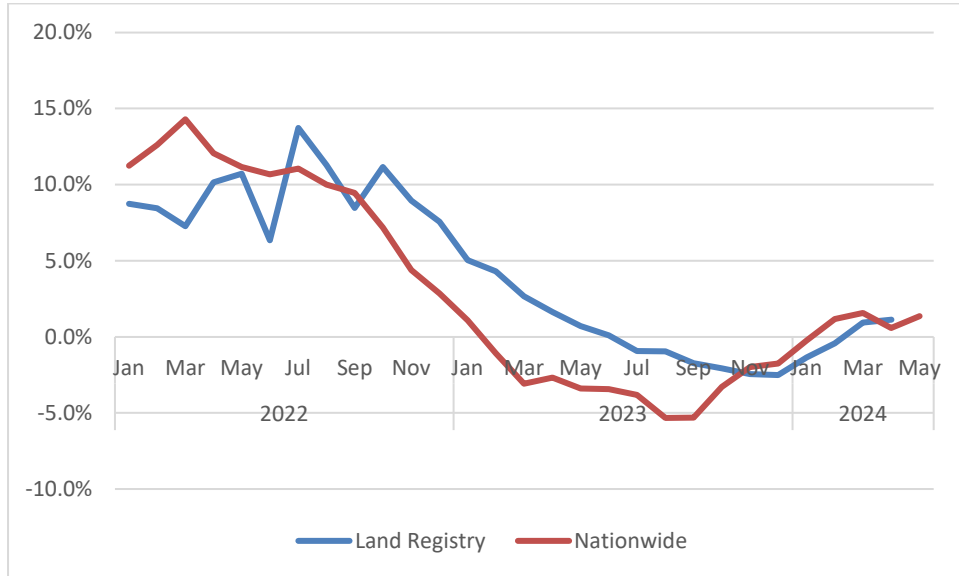
Source: HMRC

House prices and rents

After the slight drop in house prices in 2023, a modest but clear upward trend has been established in 2024. Land Registry prices were up 1.1% in the year to April (see Chart 8) and up 0.3% between March and April. The Nationwide and Halifax indices rose 1.3% and 1.5% respectively in the year to May while the Rightmove index of asking prices rose 0.6%.

Taken together, the house price and transaction data point to a healthier sales market in 2024 which has been supported by the significant reduction in fixed-rate mortgage pricing since the peak in July 2023 when the swaps market was reacting to poor inflation data. Both 2- and 5-year fixed rate mortgage rates have reduced by over 1 percentage point since then but have been on a gentle upward trend since February, suggesting the market may cool a little later in the year.

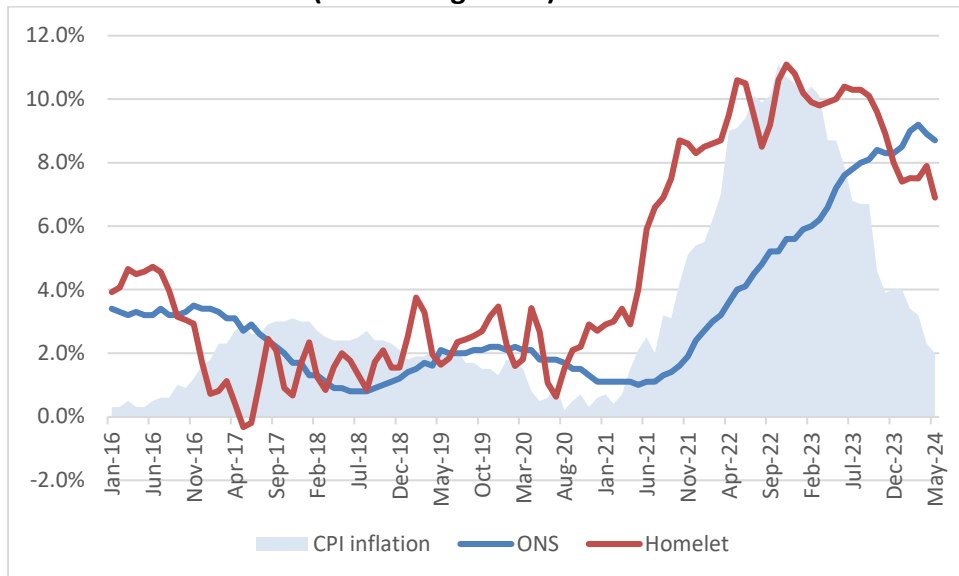
Chart 8 – House prices (annual growth rate)



Source: HM Land Registry, Nationwide Building Society

Inflation in the private rental market continues to ease off but remains well above the general rate of inflation on a 12-month comparison as illustrated by Chart 9. The Homelet Rental Index was up 6.9% in the year to May but most of the rise occurred in the period up to October, since when rents have only risen by around 1%. Annual growth in the ONS private rental series is now above that of Homelet as it tends to lag changes in market rents because, unlike the Homelet index, it includes existing as well as new contracts.

Chart 9 – Private rents (annual % growth)



Source: Office for National Statistics, Homelet

The RICS Residential Market Survey for May shows that respondents expect the upward pressure on rents to continue, with a smaller reduction in landlord instructions than previous months being offset by a higher balance of respondents

reporting higher tenant demand. There is no sign that the longstanding shortage of private rented properties relative to tenant demand is easing.

Political parties set out their stall on housing ahead of the general election

In the wake of the Prime Minister's unexpected decision to call a general election for 4 July, the main parties have issued their manifestos which include proposals relating to the housing and mortgage markets as outlined below.

Labour

With a commanding poll lead, the greatest attention is being paid to the Labour Party's manifesto pledges. The party has put a strong emphasis on boosting house building through changes in the planning system and restoring mandatory housing targets, promising to build 1.5 million houses during the next parliament (though this is no higher than the old Conservative target of 300,000 a year in a full parliamentary term). They want to build a series of new towns. They have also pledged to make the government's mortgage guarantee scheme supporting 95% LTV lending permanent.

Labour is pledging to deliver the biggest increase in social and affordable housebuilding in a generation and to abolish fixed-term tenancies in the private rented sector (PRS).

Conservatives

The Conservatives are promising to build 1.6 million new homes in England in the next parliament but with a greater emphasis on protecting greenfield sites and focusing on brownfield development and higher urban densities. They are offering a new Help to Buy equity loan scheme and a permanent increase in the stamp duty threshold for first-time buyers to £425,000.

In the PRS, the Conservatives are offering to implement the Renters Reform Bill, which will abolish fixed-term tenancies while strengthening other grounds for evicting anti-social tenants, as well as a two-year temporary capital gains tax relief for landlords who sell to their existing tenants.

Liberal Democrats

The Liberal Democrats want to build 380,000 homes a year, the highest target of any major party, including 150,000 social housing units, developing new garden cities and implementing what they call "community-led development." They are proposing to abolish residential leaseholds and cap ground rents at a nominal fee.

In the PRS, in common with the Labour Party and the Conservatives, they propose to end so-called "no-fault" evictions but also want to make three-year tenancies the default contract.

Reform UK

The Reform UK contract talks of “unleashing” housing across the country but also suggests that cutting immigration would ease housing demand. On the PRS, Reform is proposing to abolish the Renters Reform Bill but also to boost housing enforcement to tackle bad landlords. It is also proposing to restore full mortgage interest tax deductions for landlords.

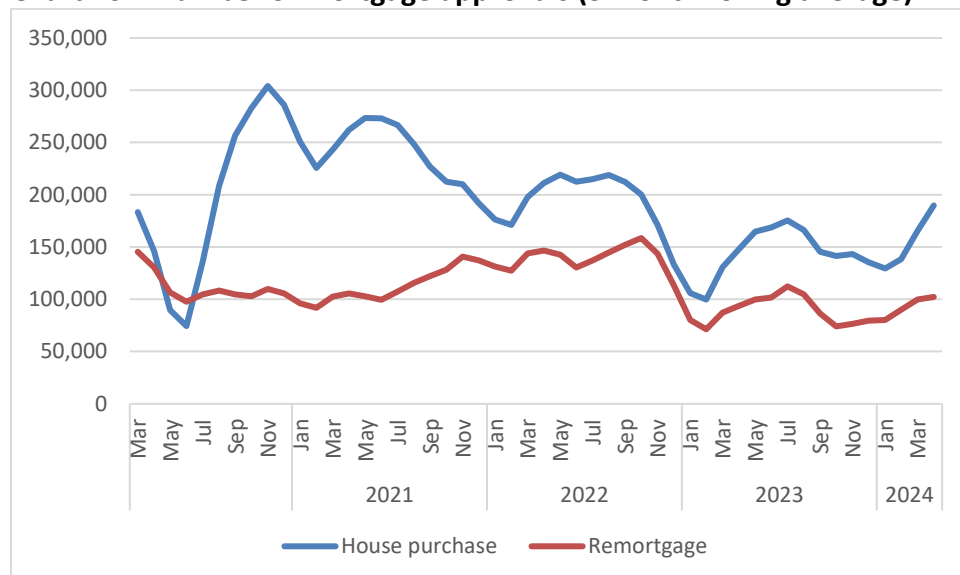
Green Party

The Green Party has committed to building 150,000 social housing homes a year. They also propose to spend £29 billion improving the insulation of the existing housing stock with another £9 billion to support low-carbon heating systems such as heat pumps. In the PRS they want to end so-called “no-fault” eviction but also to introduce rent controls that local authorities can implement.

Mortgage lending

Chart 10 shows the impact of both the mini-budget of 2022 and the sharp rise in swap rates in mid-2023 in response to poor inflation numbers. Since then the market has recovered, supported by lower fixed-rate mortgage pricing. The rise in house purchase approvals has been particularly robust, hitting 190,000 in the three months to April, 47% above the three months to January.

Chart 10 – Number of mortgage approvals (3 month rolling average)

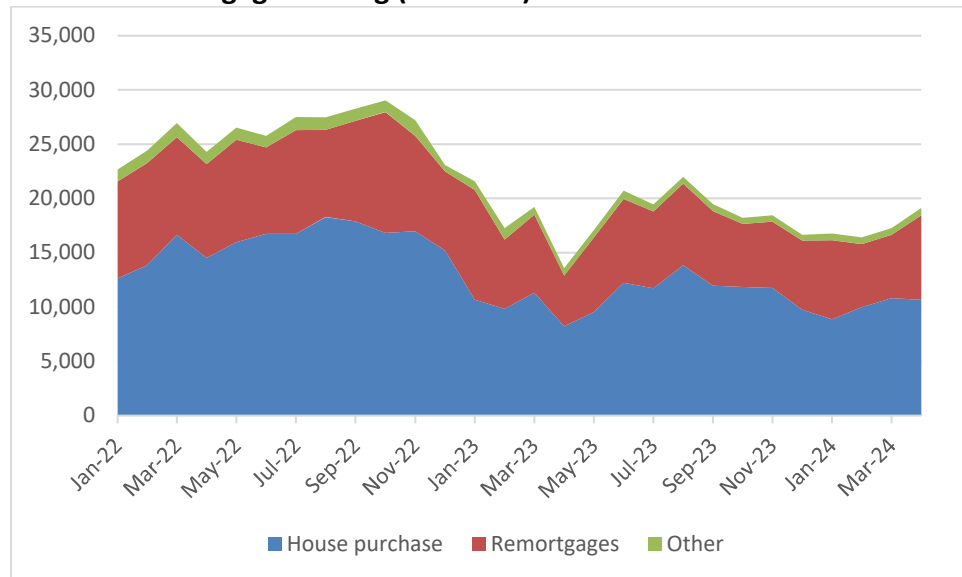


Source: Bank of England

Mortgage lending tends to follow approvals with a lag of around 3 months, suggesting that the rise in lending seen since the start of the year is set to continue for a while, although the slightly higher fixed rates we have already seen since February may act to cool the market later in the year. As Chart 11 shows, both house purchase and remortgage lending has improved: in the three months to April, house purchase

lending was 6% above the three months to March with remortgaging up 3% over the same period.

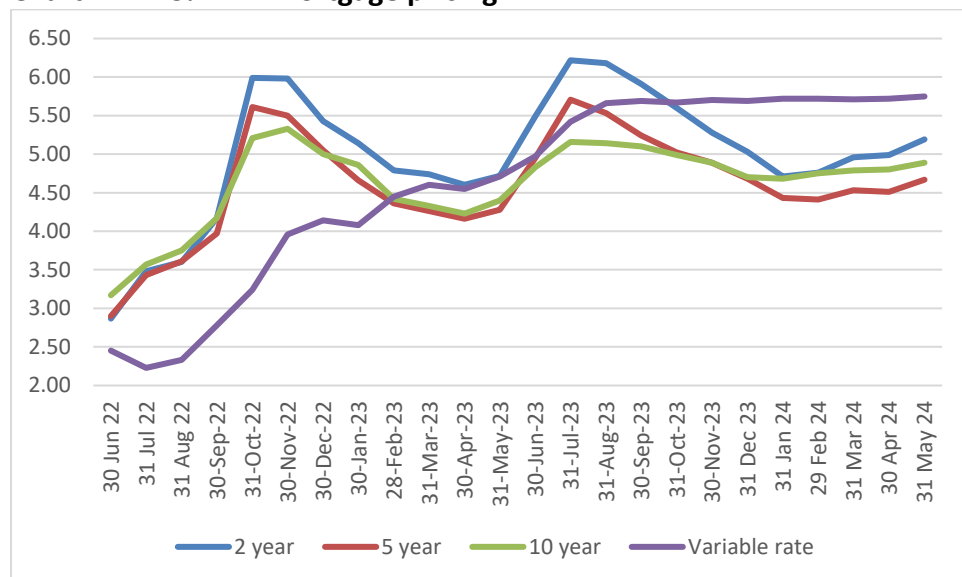
Chart 11 – Mortgage lending (£ million)



Source: Bank of England

Mortgage pricing and products

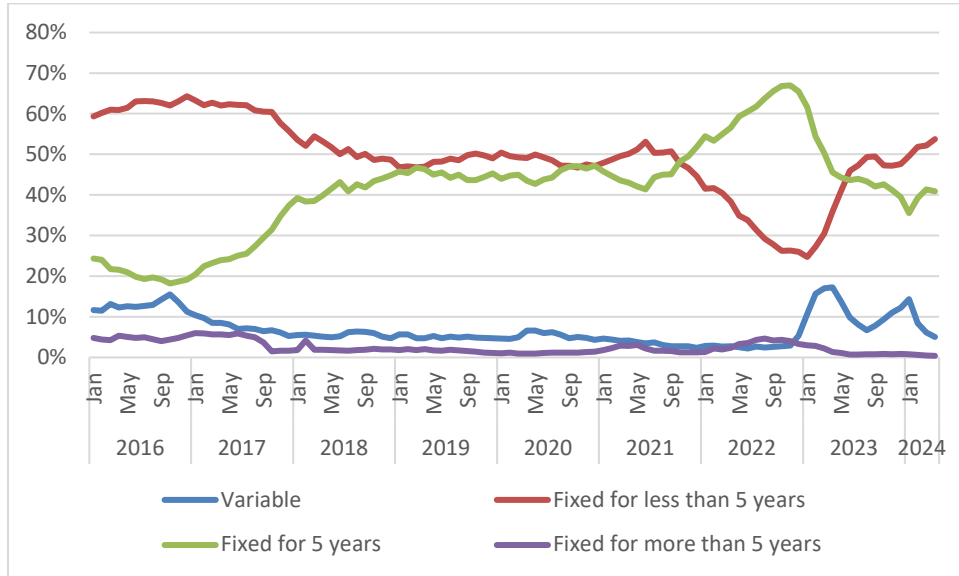
Chart 12 – 75% LTV mortgage pricing



Source: Bank of England

As Chart 12 shows, fixed-rate pricing bottomed out around February, with modest increases since then. The largest increase between the end of January and May was in 2-year fixed-rate pricing, with an average rise of 48 basis points, twice the increase on 5-year products. Fixed rates remain below variable rates as the interest rate swaps market anticipates rate cuts over the next few years but since the start of this year optimism about how quickly those rate cuts would materialise has dampened.

Chart 13 – Fixed and variable rate share of new lending



Source: UK Finance

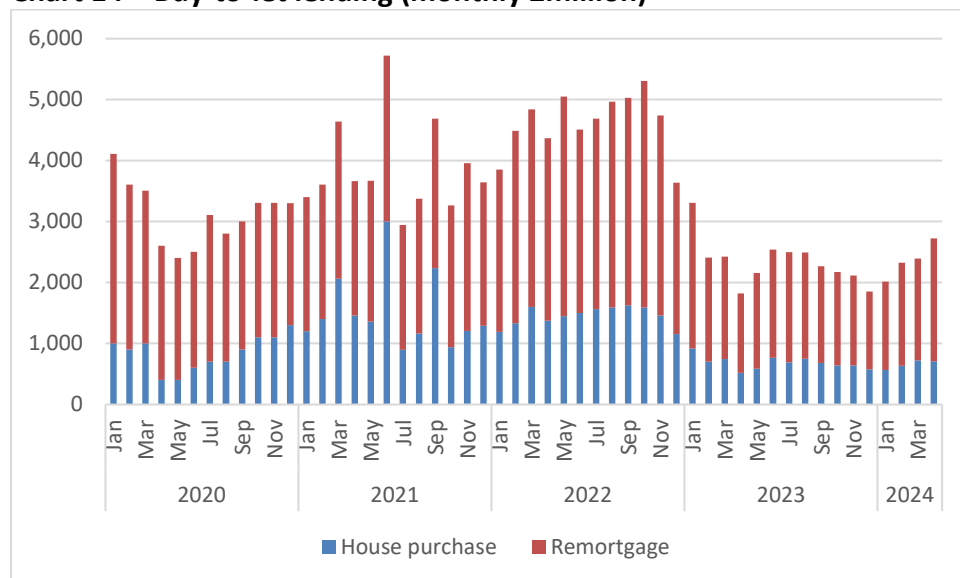
Despite the greater increase in 2-year fixed rate pricing in recent months, this has become the most popular product, taking a market share of 54% in April (see Chart 13). Variable rate products, which saw a surge in popularity in 2023 and at the start of 2024, have fallen out of favour, as buyers may feel the fixed rates on offer now represent good value. Interestingly, products fixed for more than 5 years fell to their lowest level of popularity on record in April: less than 0.4% of the total, perhaps reflecting borrowers' reluctance to lock into long-term deals when interest rates are perceived as high.

The June Bank of England Financial Stability Report includes an analysis of the expected impact on households whose current fixed rate is expiring over the next few years. It reports that over three million, or 35%, of mortgage accounts are still paying rates of less than 3%, the majority of whom will have their fixed rate expire before the end of 2026. For the typical owner-occupier mortgagor rolling off a fixed rate between June 2024 and end-2026, their monthly mortgage repayments are projected to increase by around 28%. Within this average, a small proportion are likely to experience significantly larger increases: around 400,000 households are projected to see an increase in their payment of 50% or more.

On a brighter note, however, the report points out that a growing number of households who have moved onto new fixed-rate products over the past couple of years are already paying relatively high rates. The Bank believes that some of these households should be able to reduce mortgage payments when they next finance.

Buy-to-let market

Chart 14 – Buy-to-let lending (monthly £million)



Source: UK Finance

The buy-to-let market has established a much more optimistic tone this year after the difficulties of 2023, when gross lending fell by 51% to £29.1 billion (see Chart 14). In the three months to April, buy-to-let remortgage lending was £5.4 billion, 28% above the three months to January. House purchase lending rose 16% to £2.1 billion over the same period. The easing of fixed-rate mortgage pricing, coupled with a continued rise in rents, has improved affordability, which for some landlords had become a barrier, particularly to remortgaging.

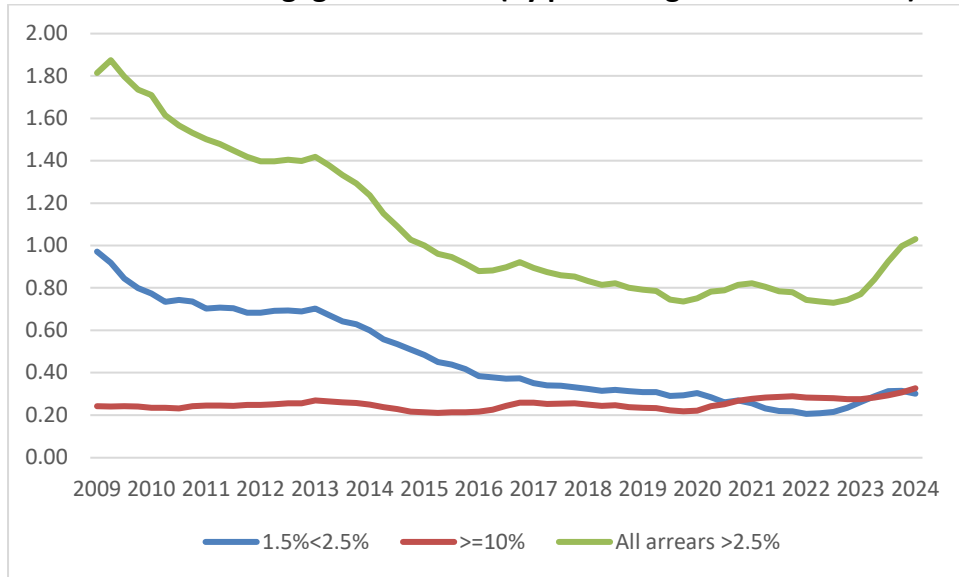
Perhaps because affordability had become so challenging, lenders have responded by reducing buy-to-let pricing relative to their owner-occupier offerings on a like-for-like basis. The average 2-year 75% LTV buy-to-let mortgage rate in May was 4.66%, 0.53% below the same figure for owner-occupiers, the largest pricing gap in favour of buy-to-let on record. Until 2022, owner-occupied mortgage pricing was consistently cheaper.

Arrears and possessions

There was positive news on mortgage arrears in Q1. Despite the fact that many borrowers have faced sharp increases in payments on the expiry of cheap fixed-rate deals entered into in the pre-2022 period, short-term arrears (1.5%<2.5% of the mortgage balance) actually fell from 0.32% of all loans to 0.30% (see Chart 15). The rate of increase of arrears over 2.5% also slowed sharply, going from 1.00% to 1.03%.

One area which remains a concern however is long-term arrears (10% or more of the loan balance), which remain at historically high levels and continued to rise in Q1. This in part no doubt reflects the historically low level of repossessions. 3,350 properties were taken into possession in Q1, the highest figure since Q3 2019, but the number remains a fraction of the figures seen in the pre-2015 period.

Chart 15 – % of mortgages in arrears (by percentage of loan balance)



Source: UK Finance


Arrears in the buy-to-let market, which were rising much faster than those of owner-occupiers, also saw positive trends in Q1. Short-term arrears were down and the number of mortgages in arrears of over 2.5% of the loan balance was unchanged at 13,570, a better performance than the owner-occupied market. This suggests that the current cyclical upturn in arrears is likely to peak well below the level of the previous cycle in 2008-9.

Prospects

2024 has seen a brighter economic picture emerge, with growth rebounding and inflation falling back to target for the first time since July 2021. With wage increases now comfortably above inflation and the labour market still relatively tight by historical standards, households should be able to sustain the recovery with higher real consumption, which comprises two thirds of aggregate demand. This more positive tone has also been felt in the housing and mortgage markets, with prices and activity on the rise, stimulating an increase in mortgage approvals and lending.

If the Bank of England feels able to cut Bank Rate over the summer, as many commentators expect, the emerging feel-good factor should be enhanced. However, the progress made on inflation to date mostly reflects the partial unwinding of the energy price shock that pushed prices up so much in 2022 and early 2023. The second-round effects of higher domestic prices and wages are still working their way through the system. Regular earnings growth, for example, was still 6.0% in the year to February-April.

The CPI highlights the benefits of these falling energy prices. Between May 2023 and January 2024, the overall index barely budged, up only 0.2%. Yet despite further falls in energy prices between January and May 2024, the index was up 1.8%, almost a



full year's target growth. This suggests that further progress on inflation will be much more reliant on squeezing domestic costs and this normally requires restrictive monetary or fiscal policy to achieve. Yet the green shoots of recovery this year suggest that monetary policy may not be as restrictive as it previously appeared. The economy is adjusting to higher interest rates. And that period of flat CPI between May 2023 and January 2004 means the next eight months are likely to see rising headline CPI. For example, if CPI inflation averages 0.2% a month between now and January 2025 headline inflation will reach 3.5% in January.

If there is solid evidence of slowing wages or core CPI in the coming months, a rate cut is possible, but with headline CPI set to rise in the coming months, the window of opportunity for such a cut may be quite short. Moreover, against this background, any negative surprises on inflation could pivot the markets from talk of rate cuts to rate increases.