MONTHLY ECONOMIC INSIGHT

January 2024

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This month we jump on the January bandwagon with a look ahead to some of key economic and policy developments in the year ahead. We'll focus on the indicators that we'll be keeping a particularly close eye on – both in the official statistics and in our own data sources.

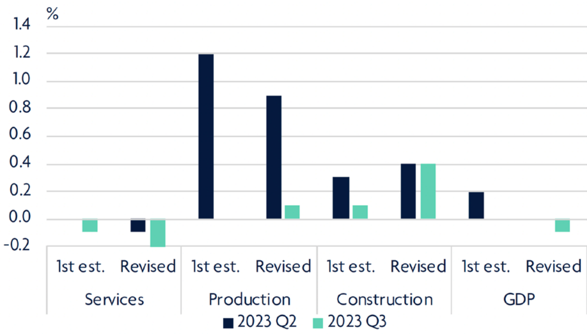
GROWTH – CAN WE EXPECT MUCH?

In last month's briefing we outlined the expectations for 2024 GDP growth from the Bank of England and the Office for Budget Responsibility (OBR). In short, predictions are for another year of sluggish growth with the OBR forecasting 0.7 per cent growth in GDP next year with the Bank being at the lower end of the forecast spectrum, pencilling in zero growth in 2024. The average independent forecast, as published by HM Treasury, sits somewhere in the middle, at 0.4 per cent GDP growth.

Wherever we land at the end of next year, growth will likely be subdued again, with an ongoing squeeze in real incomes from still elevated inflation and higher interest rates, bearing down on demand (more on that later), with little offsetting boost from investment or net trade.

The starting point going into next year looks pretty fragile (**chart 1**) looking at the recent revisions to official data from the Office for National Statistics (ONS). The first estimate for growth was flat GDP in the three months to September, this has subsequently been revised to a modest 0.1 per cent contraction. Added to this, growth in the preceding quarter (Q2) was also revised away to nothing.

Chart 1: Quarterly change in output, percentage



Source: ONS

The downgrades were primarily driven by a weaker performance across the services sector in both Q2 and Q3 than first thought, with a slightly better outturn production and construction not quite enough to stop GDP tipping into contractionary territory in Q3. The profile of growth over this six-month period continues to speak to the squeeze on spending and caution across the private sector about future demand.

Indicators for the remainder of 2023 indicate that a fairly weak picture is in prospect in the near term, but it seems premature to call recession following one quarter of falling output. The key pre-Christmas period doesn't appear to have been a disappointment with November retail sales boosted by Black Friday discounting, the services PMI moving back into positive territory and a further improvement in consumer confidence levels.

A better-than-expected festive period will come as a relief for retailers, but doesn't signal a more material turnaround in economic fortunes is on the cards. At UK Finance, we'll continue to keep a close eye on our card spending data, signs of precautionary saving and indications of households continuing to meet their debt obligations.

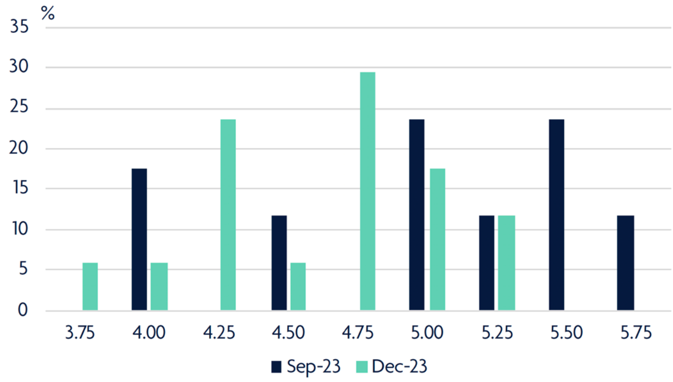
INTEREST RATE MOVES – WHICH DIRECTION?

With the Bank of England holding rates at 5.25 per cent since August 2023 and the recent drop in inflation to 3.9 per cent, the question is now when the Monetary Policy Committee (MPC) will vote for rate cuts. The minutes of MPC recent meetings have been clear that the choice has been hiking or holding rates with insufficient evidence, as yet, that inflation and pay growth are on a firmly downward path. Indeed, some MPC members continued to vote for Bank Rate to rise to 5.5 per cent in December.

This doesn't stop the speculation (not just in the UK – the question is also being asked of the US fed and the ECB), and most forecasters (as surveyed by HM Treasury) are expecting Bank Rate to end 2024 lower (**chart 2**).

The question is by how much and when will the first cut come? Around half of forecasters reporting to HM Treasury are currently expecting one or two interest rate cuts this year, which would likely put the first move to reduce rates into the second half of the year.

Chart 2: Bank Rate in 2024 Q4, percentage



Source: HM Treasury

Notably, no respondents are expecting rates to end the year higher than currently – a marked change in expectations from four months previously, when in September around half of forecasts were predicting rates to end 2024 at 5.25 per cent or higher.

While borrowers will no doubt welcome any reduction in borrowing costs, the scale of cuts expected next year will be a case of the Bank easing its foot off the brake rather than hitting the accelerator. And monetary policy will continue to be restrictive until inflation is firmly making its way back to the Bank's target.

COST OF LIVING PRESSURES – WILL WE FEEL THEM EASE?

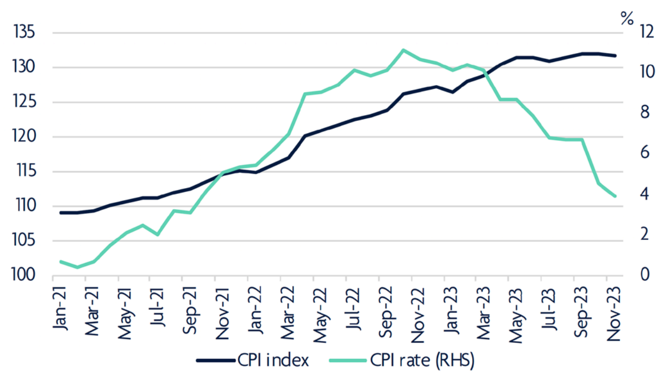
As noted, CPI inflation took a notable step down in November, coming in at 3.9 per cent, the slowest pace of increase in more than two years. And there were falls in the rate of price growth across nearly all major CPI components – particularly transport (mainly falling petrol prices), food (with prices rising by much less than a year ago) and recreation and culture.

Two measures that the Bank of England has a particularly keen eye on, core CPI and services inflations, also fell from 5.7 per cent to 5.1 per cent, and 6.6 per cent to 6.3 per cent respectively.

Falling inflation also was cited as a factor in the continued recovery in the GfK consumer sentiment index at the end of 2023, with households becoming a bit more optimistic about their financial situation in the year ahead.

However, your regular note of caution, that households are only seeing an easing in the pace of price growth (**chart 3**) and the pressure on incomes will only dissipate with a sustained period of catch up in earnings growth. Survey suggest that the pace of earnings growth this year is unlikely to match the highs of 2023.

Chart 3: Consumer prices, index 2015=100 and annual percentage change



Source: : ONS

Moreover, we know that the energy price cap will rise a little from the start of this year, meaning energy costs remain materially higher than 2021. This is continue to pose to challenge for many, particularly lower income, households. Ofgem data already points to a material build up of domestic customer debt and arrears over the past year.

History also tells us that events can lead to some potentially significant upside surprises in price movements. Up to the end of last year commodity prices had been continuing to drift down, which should bode well for inflation globally, however, geopolitical tensions in the Middle East and the risk of further escalation, presents some risk to oil prices (though not yet evident) and the functioning of supply chains, particularly distribution through the Suez Canal. Climate risk and potential impacts on food supply chain are an increasing risk to supply and prices – as we saw with the great tomato shortage of 2023. All of which reinforces the Bank's caution about the decline in inflation this year.

MORTGAGE MARKET ACTIVITY – AN IMPROVEMENT ON THE CARDS?

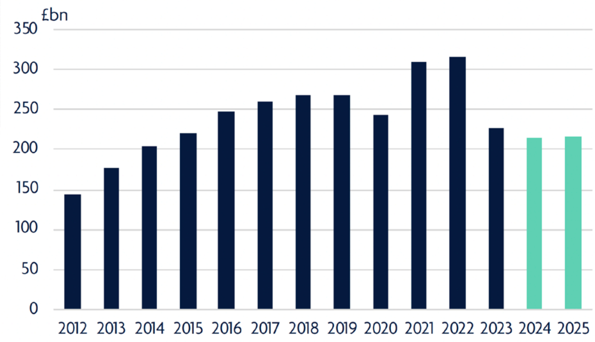
In 2023 higher interest rates and household costs limited access to mortgage credit. Affordability constraints have also dampened external remortgaging activity, although there was growth in the internal product transfer market, where affordability tests are not required.

The outlook for 2024 is one of continuing challenges in the mortgage market (**chart 4**); however, the main pressures on affordability look to be peaking now, not least as the year has started with lenders cutting rates on fixed rate deals. Whilst it will take some time for the pressure on household finances to recede, we expect things to begin to look up in 2025.

We are forecasting the following for 2024:

- Gross lending to fall by a further five per cent to £215 billion
- Lending for house purchase to fall by a further eight per cent to £120 billion.
- External remortgaging activity to fall by a further eight per cent to £60 billion.
- Internal product transfers to fall by eight per cent to £202 billion
- Buy to let purchase lending to fall by a further 13 per cent to £7 billion

Chart 4: Gross mortgage lending, £ billion



Source: UK Finance

In 2023 there was a fall in lending for house purchase of some 23 per cent, to £130 billion. In 2024, despite some easing in cost pressures, the level of prices and interest rates will continue to weigh heavily, and we forecast house purchase lending will fall by a more modest eight percent to £120 billion.

Next year, we anticipate that both external remortgaging and PTs will fall away slightly, following a peak in maturing two-year fixed rate deals in 2023.

New BTL house purchase lending fell by 53 per cent in 2023, and remortgaging by 47 per cent. This year, we forecast a smaller contraction but the greater challenges for BTL investors remain, particularly for smaller-scale landlords who are less able to spread costs across their portfolios.

UK Finance's full mortgage market forecasts can be found **here**.

ELECTIONS – WHEN WILL WE BE HEADING TO POLLS?

There will be a general election this year, even if it feels like the starting gun for campaigns was fired some time ago. The question is when. The Prime Minister sort of answered it at the start of the year as he is 'working on the assumption' that it will take place in the second half of the year.

Betting markets have taken him at his word, with odds on an election in Q4 shortening to 1/3 at the end of last week (**see below**). That would give us a good ten months to get the detail of the main parties' policy offerings for the next parliament and for the current government to have a least one more major fiscal event.

The UK general election isn't the only show in town, with elections for councils and mayors in England and police and crime commissioner in England and Wales taking place in May 2024.

Betting Odds - date of UK general election

	3rd Jan	4th Jan
October to December 2024	4/5	1/3
April to June 2024	11/8	10/1
July to September 2024	9/1	7/2
January to March 2024	11/1	14/1
2025 or later	16/1	16/1

Source: Sky Bet

ROUND UP

2024 looks like it will be a busy year for the UK Finance team, with an eye on economic developments and political engagement ahead of elections (the 10/1 odds on a May general election are tempting).

We'll continue to be monitoring the financial situation of households and businesses in our quarterly reviews and providing monthly update on card spending – all of which can be found on our **website** (with members' able to access relevant datasets on our **portal**).

In the next few months, we'll be focusing on the Bank's February Monetary Policy Report and looking ahead to the spring budget, which has been confirmed for 6th March.

Indicator	Period	Value	Change	2024 Forecast
GDP	Q3 2023	-0.1%	↓	0.4%
CPI inflation	Nov 2023	3.9%	↓	2.7%
Unemployment rate*	Oct 2023	4.2%	↔	4.7%
Average earnings	Oct 2023	7.2%	↓	3.8%
Brent crude	Dec 2023	$77.63	↓	-
$ Exchange rate	Dec 2023	$1.26	↑	-
PSNB	Nov 2023	£14.3 bn	↓	£101.4bn

Source: ONS, HM Treasury, Bank of England, EIA

** New ONS experimental series*