MONTHLY ECONOMIC INSIGHT

April 2024

This month we review what might be the penultimate fiscal event of this parliament, the latest deliberation from the Monetary Policy Committee (MPC) and provide a preview of UK Finance's new Buy-to-Let data dashboard.

Written by:

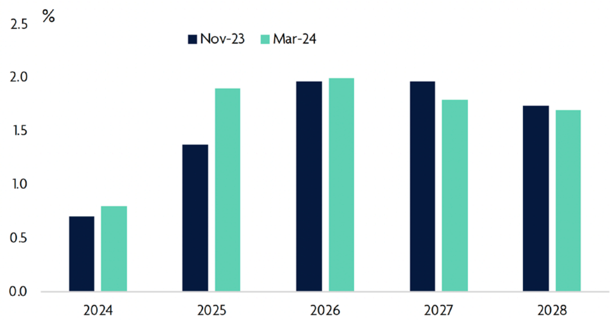
Lee Hopley
Director,
Economic Insight and Research

Ermir Selmani
Analyst,
Data & Research

OBR UPDATE

Last month the Chancellor delivered the government's spring budget, which is likely to be the penultimate fiscal event of this parliament (according to recent media interviews). Following the usual format, the policy measures were accompanied by an update to the economic and fiscal outlook from the Office for Budget Responsibility (OBR).

Chart 1: Annual change in GDP, percentage



Source: OBR

It's only been a little over three months since the OBR's last forecast, therefore changes to the near team growth outlook were relatively modest (**chart 1**). The OBR expects growth of 0.8 per cent in 2024, followed by a robust (by recent standards at least) 1.9 per cent growth in 2025, an upward revision to the earlier estimate of 1.4 per cent.

Factors such as declining interest rates and rising household incomes are expected to fuel some acceleration in the pace of growth from a stagnant 2023, this year and next. Indeed, GDP growth will be dependent on a stronger profile for household spending in the coming years, with a recovery in business investment lagging and expectations of subdued export growth given weak global trade growth and the continuation of Brexit frictions.

Key to the improvement in the household consumption outlook is that the OBR (in line with the Bank of England) expects inflation to decline at a faster pace than previously envisaged, primarily attributed to falling energy prices from April. In addition, the main policy announcement from the Chancellor – another 2p cut to national insurance contributions, also aids the recovery in living standards.

Stronger household spending will be a welcome contributor to the UK's top line growth numbers following the past couple of years of cost-of-living challenges. However, the relative lack of support coming from other parts of the economy does look over-reliant on household income recovery and not best aligned with the kinds of activity required to deliver the sustained productivity gains the economy needs in the longer term.

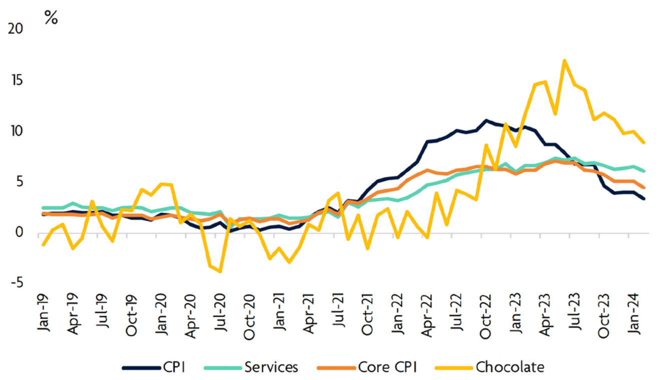
INFLATION CONTINUES TO FALL BACK

As noted above, the OBR predicts inflation to reach the Bank of England's two per cent target as early as Q2 2024, a year ahead of previous expectations. The latest data from the ONS suggests that CPI is heading in the right direction. Inflation fell to 3.4 per cent in February – the lowest rate of increase since September 2021 (**chart 2**). Declines across the CPI basket were fairly widespread, but one of the biggest contributors was the fall in food price inflation to five per cent, compared with rises in food prices of 18 per cent a year ago.

However, if one was planning to indulge in an easter egg or two, prices are likely to be a fair bit higher than last year as chocolate prices are some nine per cent higher than last year. And the outlook for chocolate-lovers isn't good with cocoa prices hitting record highs on the back of poor weather conditions in West Africa.

Anyway, back to broader inflation trends – the MPC was no doubt encouraged by the fall in CPI, which was a little below expectations – but the minutes of the recent meeting continued to highlight those inflation metrics which are not falling back as fast as the Committee might wish. Services inflation, for example is drifting down only gradually and still stood at 6.1 per cent in February, though there was some volatility in airfares, package holiday prices and education services.

Chart 2: Annual change in prices, percentage



Source: ONS

Additionally, the Committee noted mixed signals on the wage outlook – the pace of growth is moderating, but how quickly this gets back to levels consistent with the inflation target is still uncertain. The forthcoming and significant increase in the National Living Wage could complicate things if it drives higher pay growth at the lower end of the pay scale in order to maintain differentials with the minimum wage.

With questions remaining including short terms one around ongoing supply chain disruptions (potentially exacerbated by the tragic bridge collapse at the port of Baltimore), eight MPC members voted to maintain Bank Rate at 5.25 per cent in March. The Committee judged that monetary policy would need to remain restrictive and '*a further accumulation of evidence on inflation persistence would be required to warrant a shift in the monetary policy stance*.'

One member disagreed, preferring a quarter point reduction in interest rates. Notably this was the first meeting since September 2021 in which no member voted for a rate increase. Markets continue to expect the first cut to come in the summer.

SUPPLY CHAIN DISRUPTIONS – WHAT'S THE ANSWER?

The topic of supply chain disruptions has been a theme in recent years – from the emergence from the pandemic and weather-related events to more recent geopolitical tensions in Ukraine and the Middle East. It impacts on producer lead times and puts upward pressure on prices.

The latest Business Insights and Conditions survey from the ONS suggests that the proportion of business hit by global supply chain disruptions has subsided from a peak in early 2022 (**chart 3**) following Russia's invasion of Ukraine. But events which undermine supply chain resilience feel like a more common occurrence.

But this isn't really new. Firms have been outsourcing or relocating aspects of production activity for decades both to take advantage of lower cost locations and to be closer to new market opportunities. Events, including (as far back as) the global financial crisis, started to raise questions about the resilience and visibility of supply chains stretched across continents and the importance of retaining some production capacity domestically or at least nearer to market.

Chart 3: Businesses experiencing global supply chain disruption in the past month, percentage

Source: : ONS BICS

A recent survey commissioned by Medius suggests there continues to be a focus on this 'reshoring' trend with around three-fifths of manufacturers returning some aspects of production closer to end-customers to reduce costs and improve supply chain security. Increased investment in automation, for example, can help make the business case for moving away from lower-labour cost locations.

This could be a good news story for UK industry if a trickle of reshoring back to the UK translates into more significant investment in capacity.

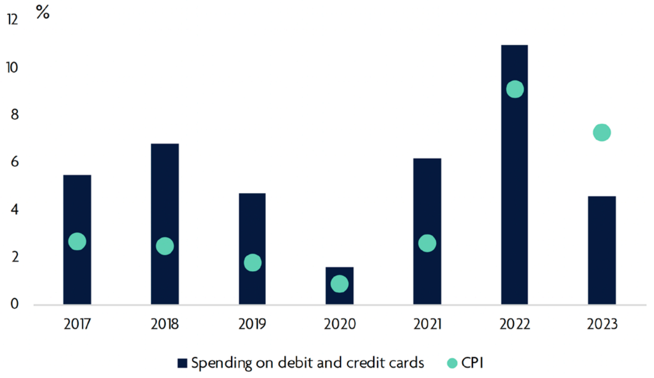
WEAK CONSUMER SPENDING

Recent briefings have discussed, in some length, the challenges facing consumers from high inflation and rising interest rates and the depressing effect this has had on confidence and spending patterns.

The impact of those pressures over the past year is perhaps starkly illustrated in **chart 4**. UK Finance recently published its monthly **Card Spending Update** (CSU), which showed the value of spending by UK cardholders on debit cards in December 2023 was down 1.4 per cent on the previous December. This continued the moderating trend in spend throughout 2023.

For 2023 as a whole total spend on both credit and debit cards was 4.6 per cent higher than in 2022, notably lower than the rate of price growth – a rare event, not least given that credit and debit cards account for the vast majority of spontaneous payments (i.e. excluding regular payments such as bills and rent or mortgage). This largely mirrors the weakness seen in official data on, for example, retail sales.

Chart 4: Annual change in spending on cards (UK cardholders) and CPI, percentage



Source: ONS and UK Finance

Moreover, our CSU data also show that average debit card spend moderated in 2023 for the third year running, with the average spend of £30.20, down from nearly £39 in 2020 and over £40 in 2016. Some of the factors underlying these trends, such as small, more frequent supermarket spending to manage budgets as well as changing commuting patterns, which we identified in our **UK Payment Markets report for 2022**, appear to have remained in play last year.

With a turnaround in household spending expected to provide some boost to growth this year, we'll be keeping a watch on how these metrics evolve in the months ahead.

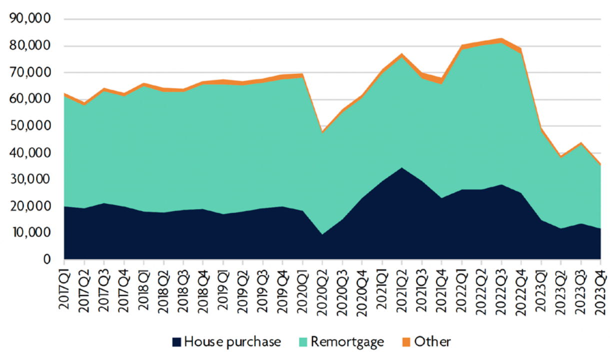
WHAT'S GOING ON IN BUY-TO-LET?

This briefing throws the occasional spotlight on what's going on in the housing market, with primarily a focus on homeovers and first time buyers. **As we discussed in January**, 2023 was a difficult year for the mortgage market as higher interest rates and cost-of-living pressures hit affordability for prospective buyers. Our forecasts also suggested a further year or relative weakness in 2024 was in prospect.

This quarter, we are adding a new Buy-to-Let dashboard to our suite of mortgage insights, which can be accessed **here** (UK Finance members can access the full report on **My UK Finance portal**).

The Buy-to-Let market has also faced challenges in the past couple of years (**chart 5**). Interest rates are key in property investment, impacting borrowing capacity and landlords' return on investment. We have seen weaker demand for new BTL loans for house purchase, reflected in the value of new BTL house purchases falling 56 per cent in Q4 2023 compared with the final quarter of 2022. BTL remortgages followed a similar pattern, with a 55 per cent year-on-year fall in the final quarter of 2023 to £4.3 billion.

Chart 5: Number of new buy-to-let mortgage loans



Source: UK Finance

For BTL landlords, rent increases have not translated into higher profit margins. Our data shows that the average Interest Cover Ratio (defined as rental income expressed as a proportion of mortgage interest payments) has fallen by 58 percentage points year on year, and now stands at 180 per cent.

The number of BTL mortgages in arrears greater than 2.5 per cent of the outstanding balance, reached 13,570 in Q4 2023, up 124 per cent on the same quarter a year earlier. Although clearly a significant increase, it is important to put this in context, just 0.68 per cent of all BTL mortgages are in arrears – this is lower than in the residential sector.

Despite the current challenges facing the sector, rental demand remains strong, and most landlords are showing resilience. We'll be updating our insight on the BTL market every quarter.

Indicator	Period	Value	Change	2024 Forecast
GDP	Q4 2023	-0.3%	↓	0.3%
CPI inflation	Feb 2024	3.4%	↓	2.1%*
Unemployment rate	Jan 2024	3.9%	↑	4.7%*
Average earnings	Jan 2024	5.6%	↓	4.0%
Brent crude	Feb 2024	$83.48	↑	-
$ Exchange rate	Feb 2024	$1.27	↑	-
Bank Rate	Mar 2024	5.25%	↔	4.4%*

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

** Q4 2024*