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THE SUNDAY TIMES

@dsmitheconomics

The Economic and Housing Outlook

Prospects in a time of uncertainty

Four questions

- Have we avoided recession and what are the prospects for recovery?
- Now we have passed the peak in inflation, how fast will it fall?
- Will interest rates rise again, or have they peaked, and when will they fall?
- What does this mean for the housing market?

It has been one thing after another

- The global financial crisis.
- Brexit & the Trump trade wars
- The pandemic.
- The Russian invasion of Ukraine

Like the Four Horsemen of the Apocalypse

Or Brenda ("Oh no, not another one") from Bristol

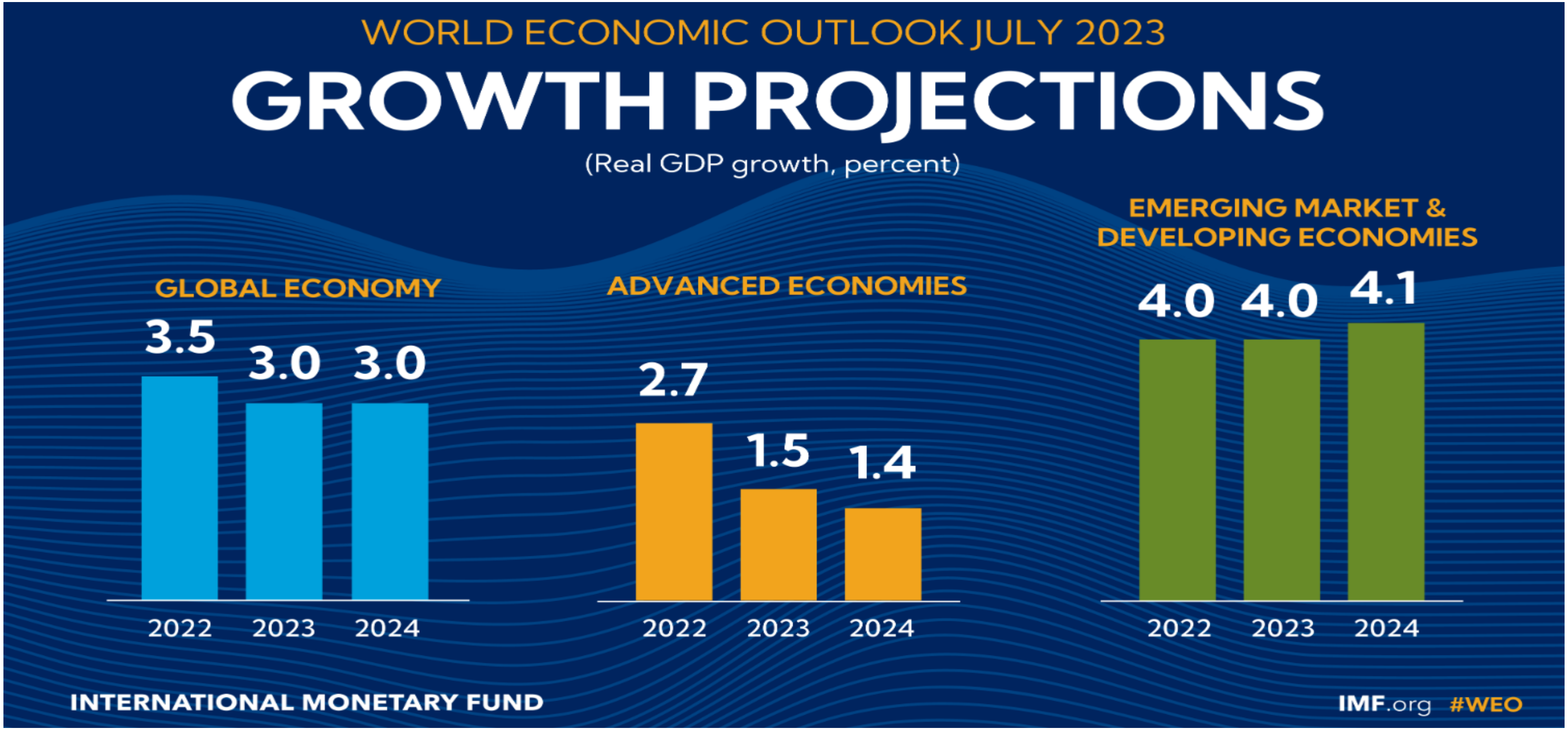
Trussonomics was, briefly, another shock

But new management took over

This might have been a fifth horseman but wasn't

What’s the outlook?

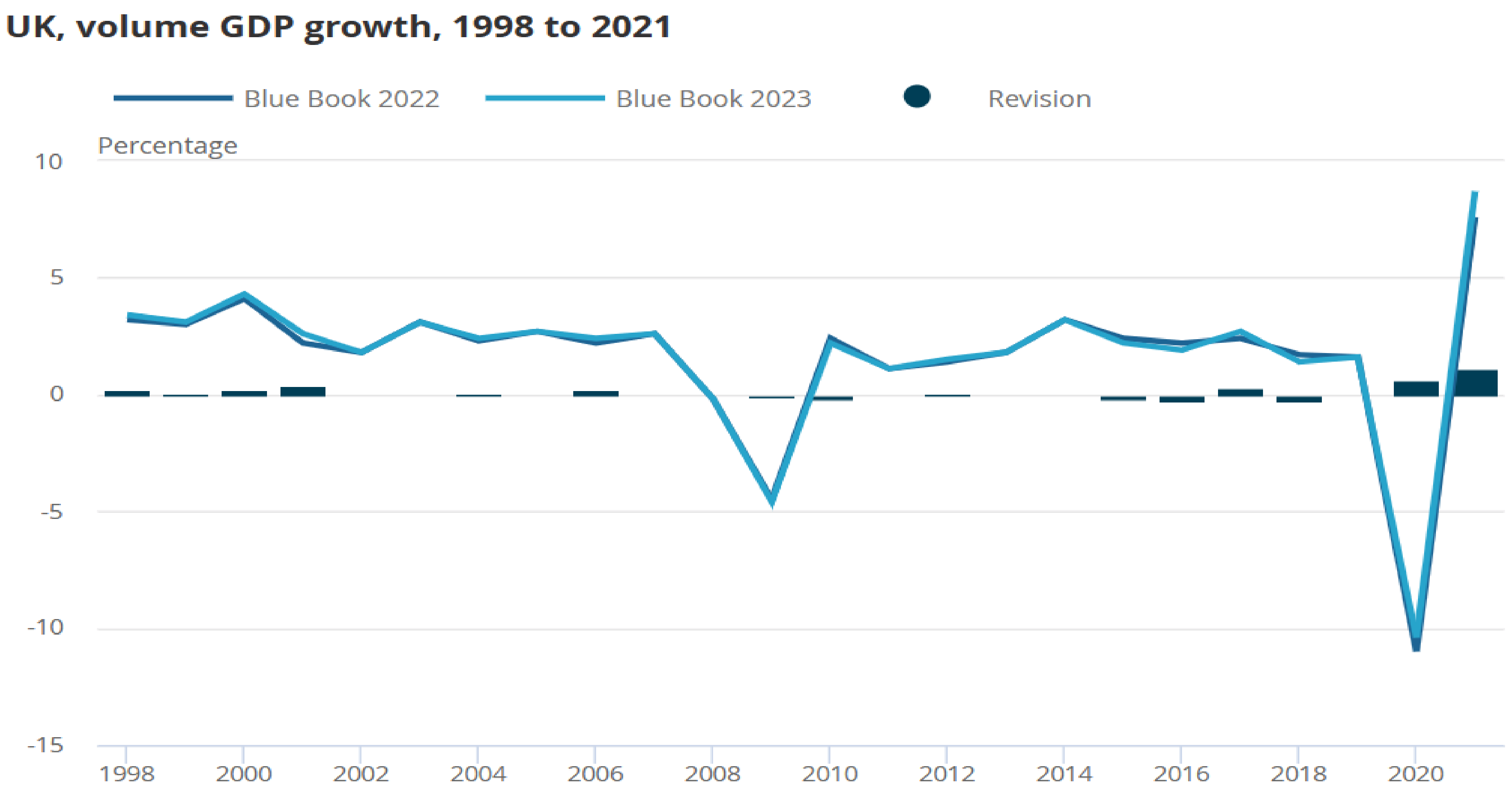
The global growth outlook is subdued



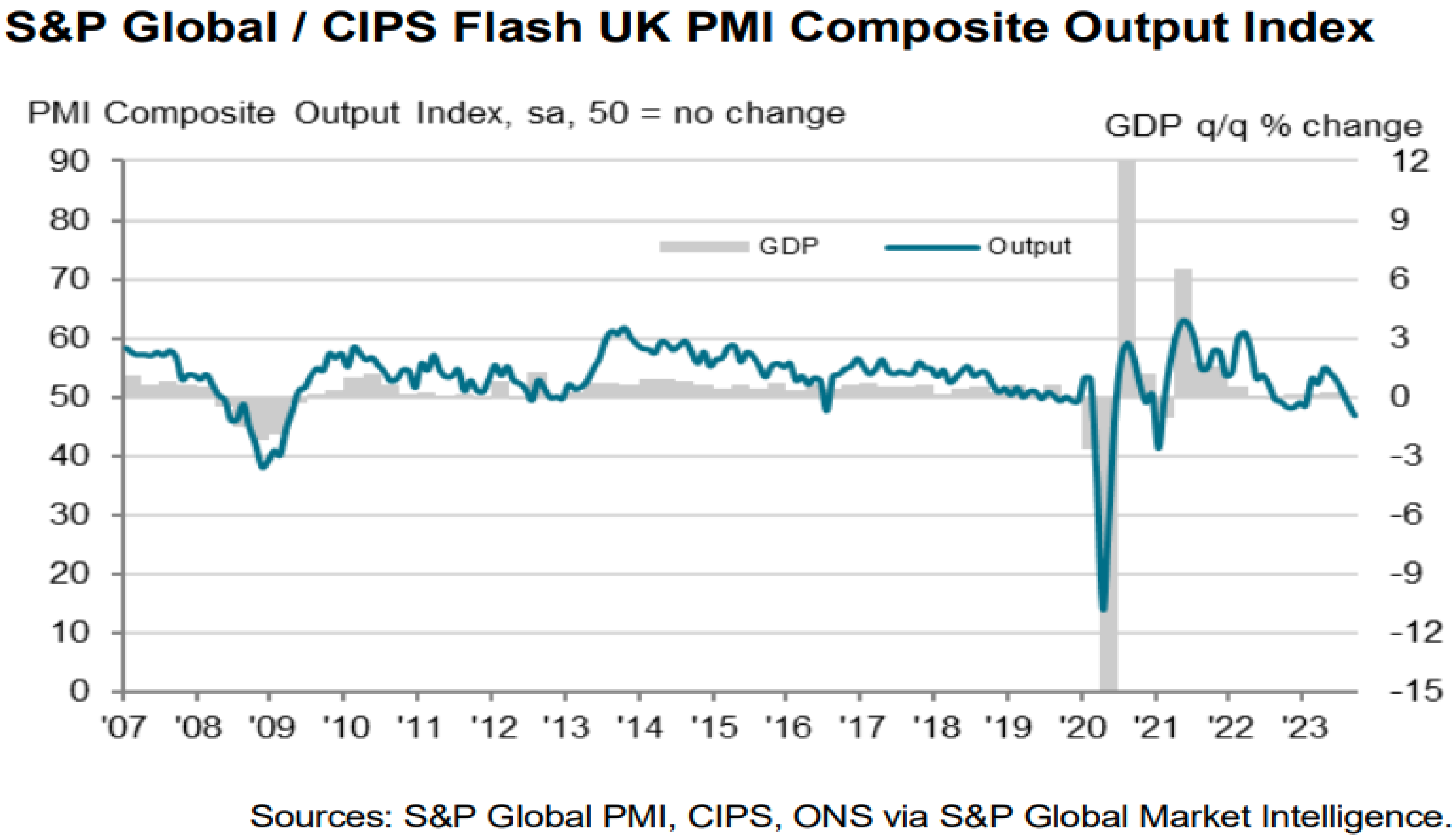
Because of …

- A huge energy price shock.
- Labour shortages.
- Supply-chain difficulties.
- Central banks are tightening policy, so the cost of borrowing is rising.

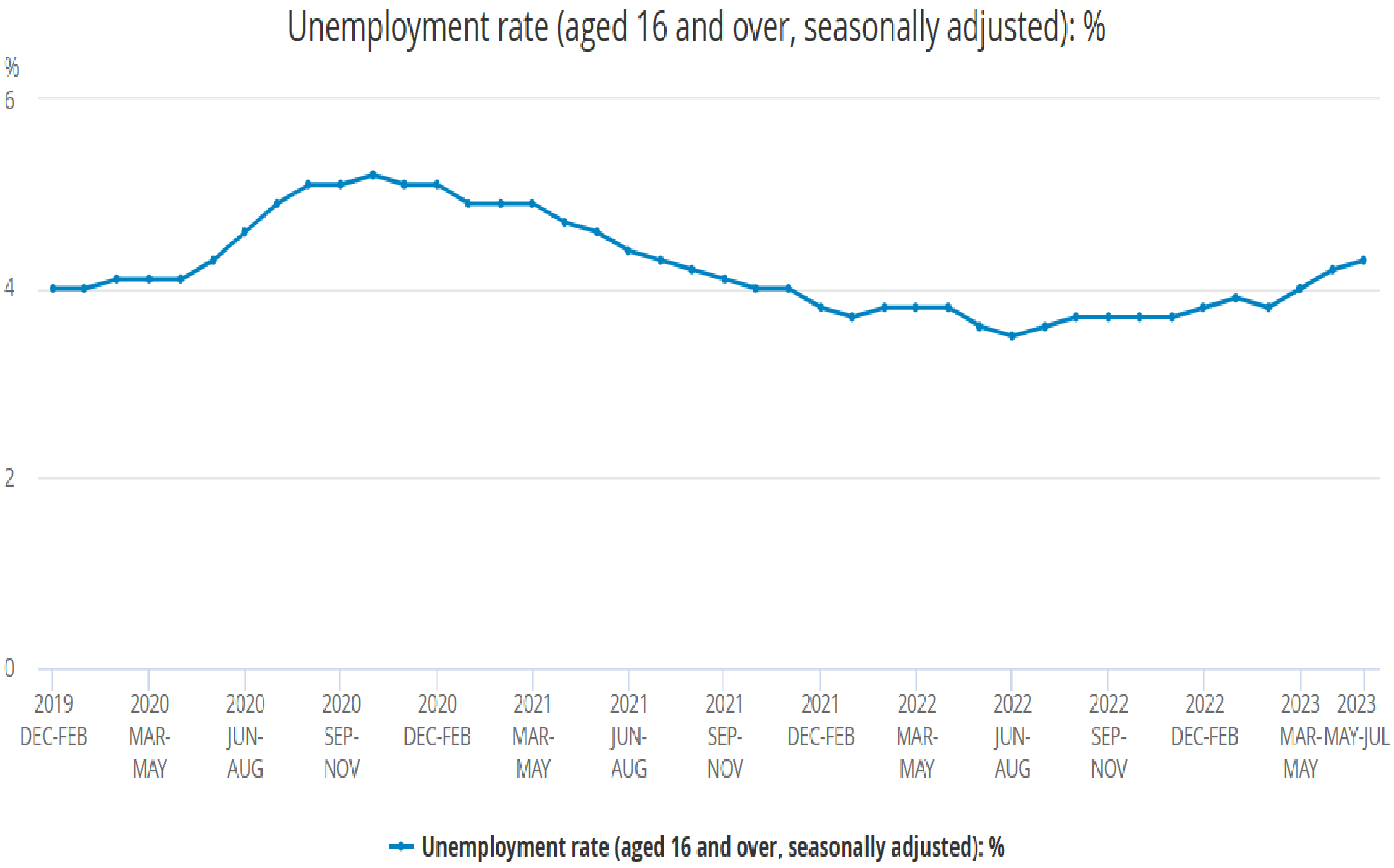
The UK bounced back more quickly after the pandemic



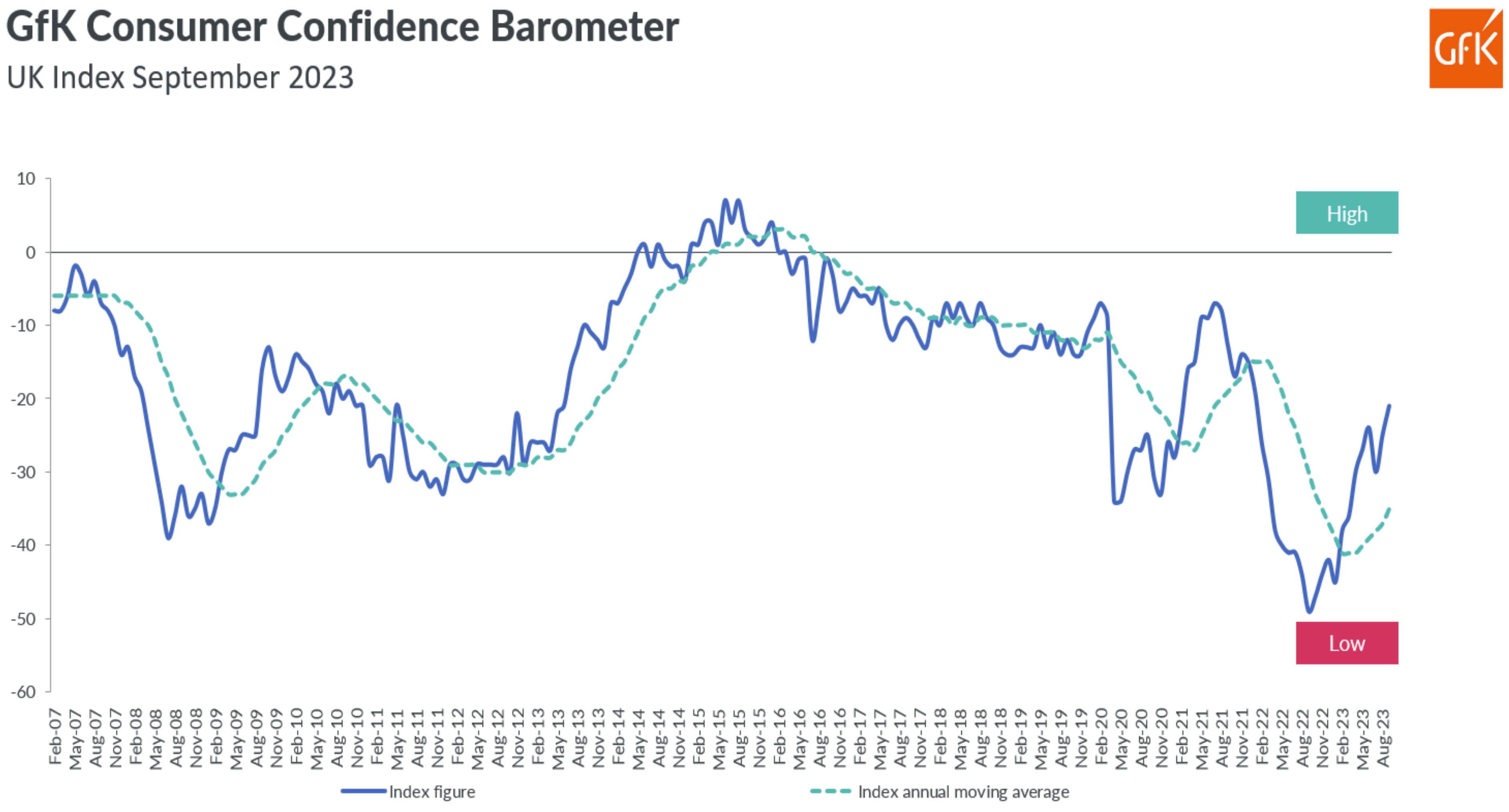
But growth since is weak, and getting weaker



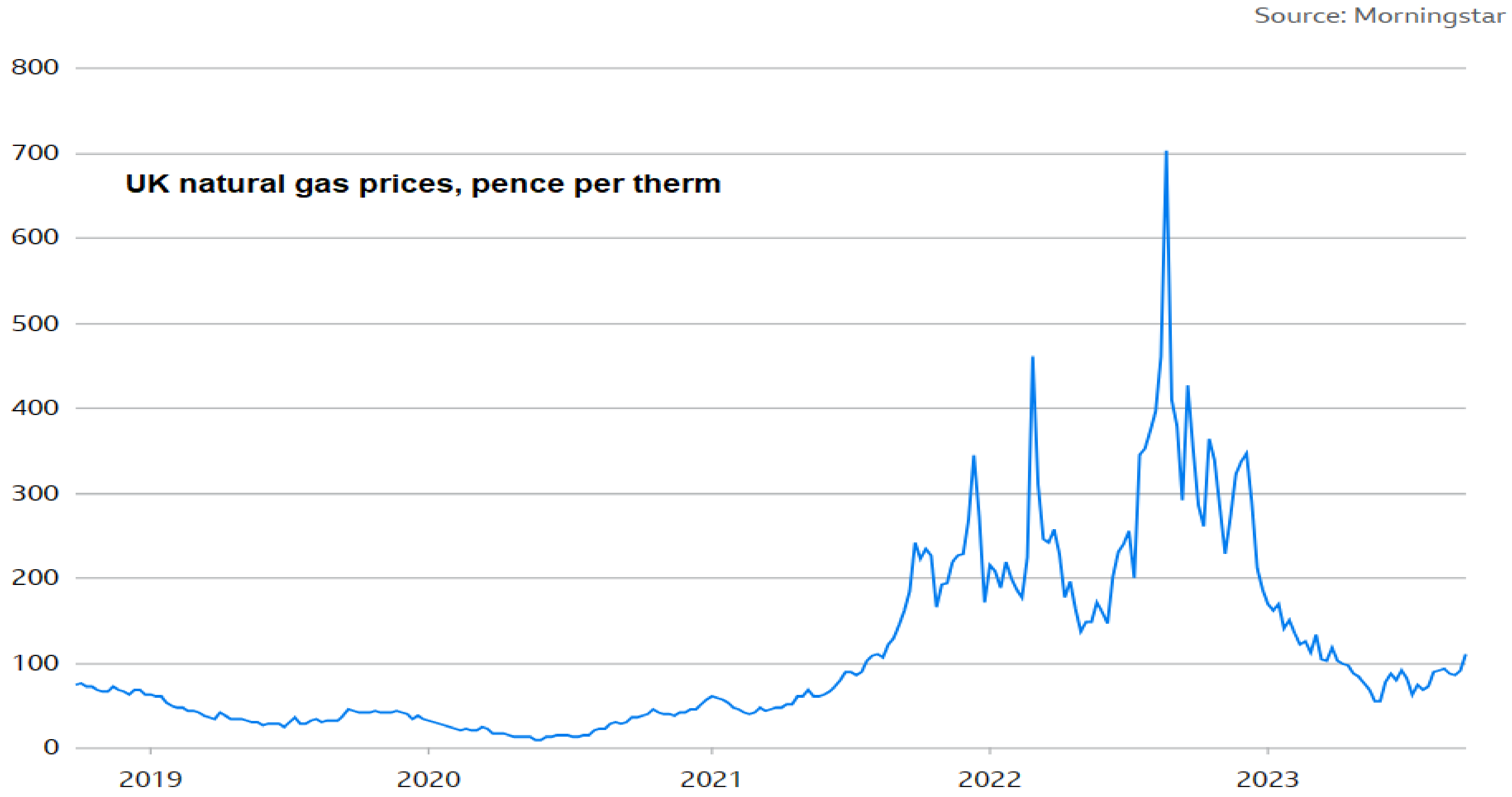
With the job market now on the turn



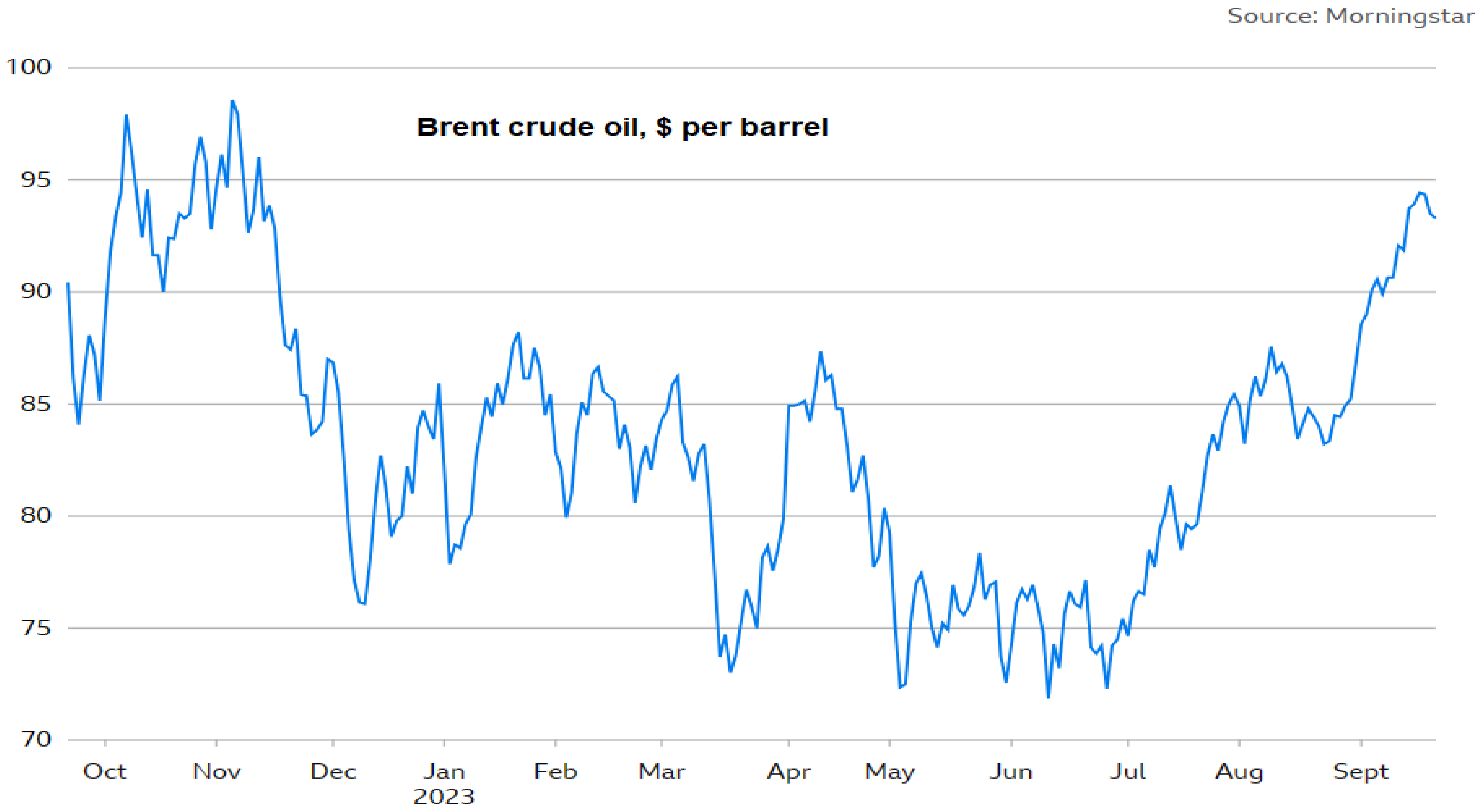
UK consumer confidence is up from its lows



Lower natural gas prices have made all the difference



Though oil has been rising again



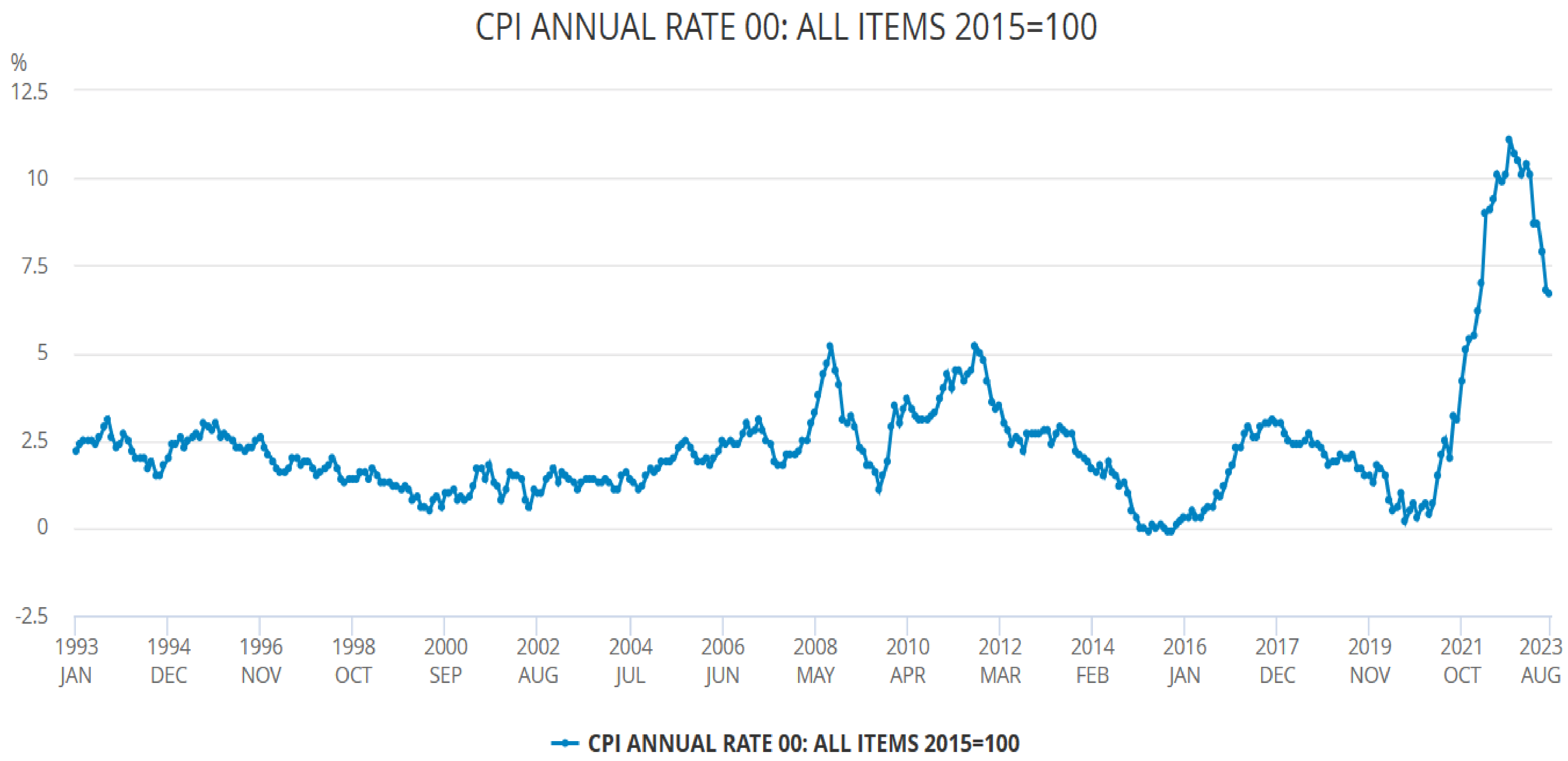
Now a battle between two forces

- Lower inflation will provide a boost to real incomes.
- Many of the savings built up over the past 2-3 years are waiting to be spent, though are attracting higher rates.
- **But** the impact of tighter monetary policy – higher interest rates - has yet to feed though, as it will.

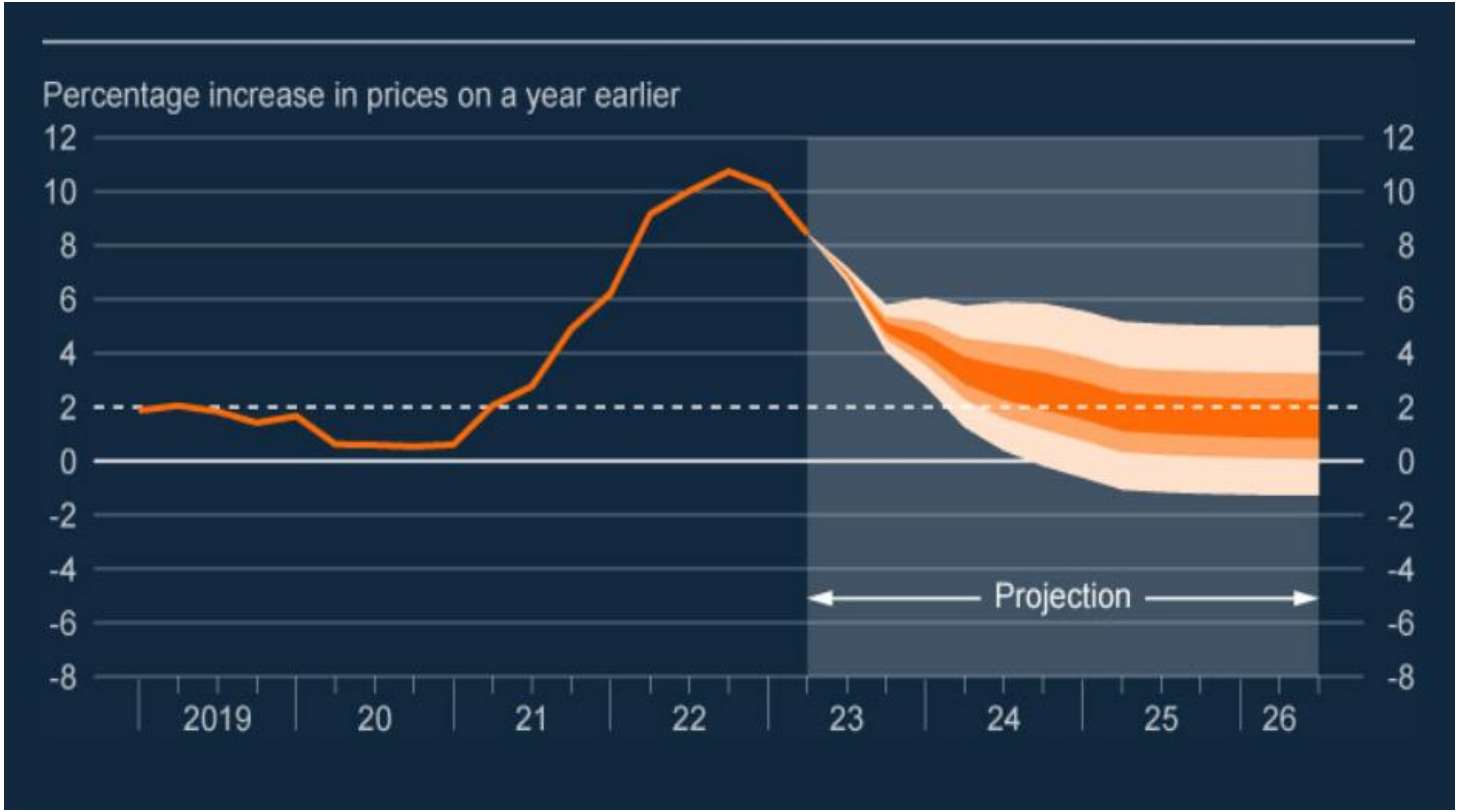
So probably no recession but not much growth either

- Consensus forecasts are for 0.3% UK growth this year, and 0.3% again in 2024.
- Both the Bank of England and Office for Budget Responsibility (OBR) say there should not be a “technical” recession of two successive quarters of falling GDP
- It could be touch and go over the next few months.
- And the UK still has a growth and productivity problem.

Inflation, while now falling, was stubbornly high



Though heading for a bigger fall

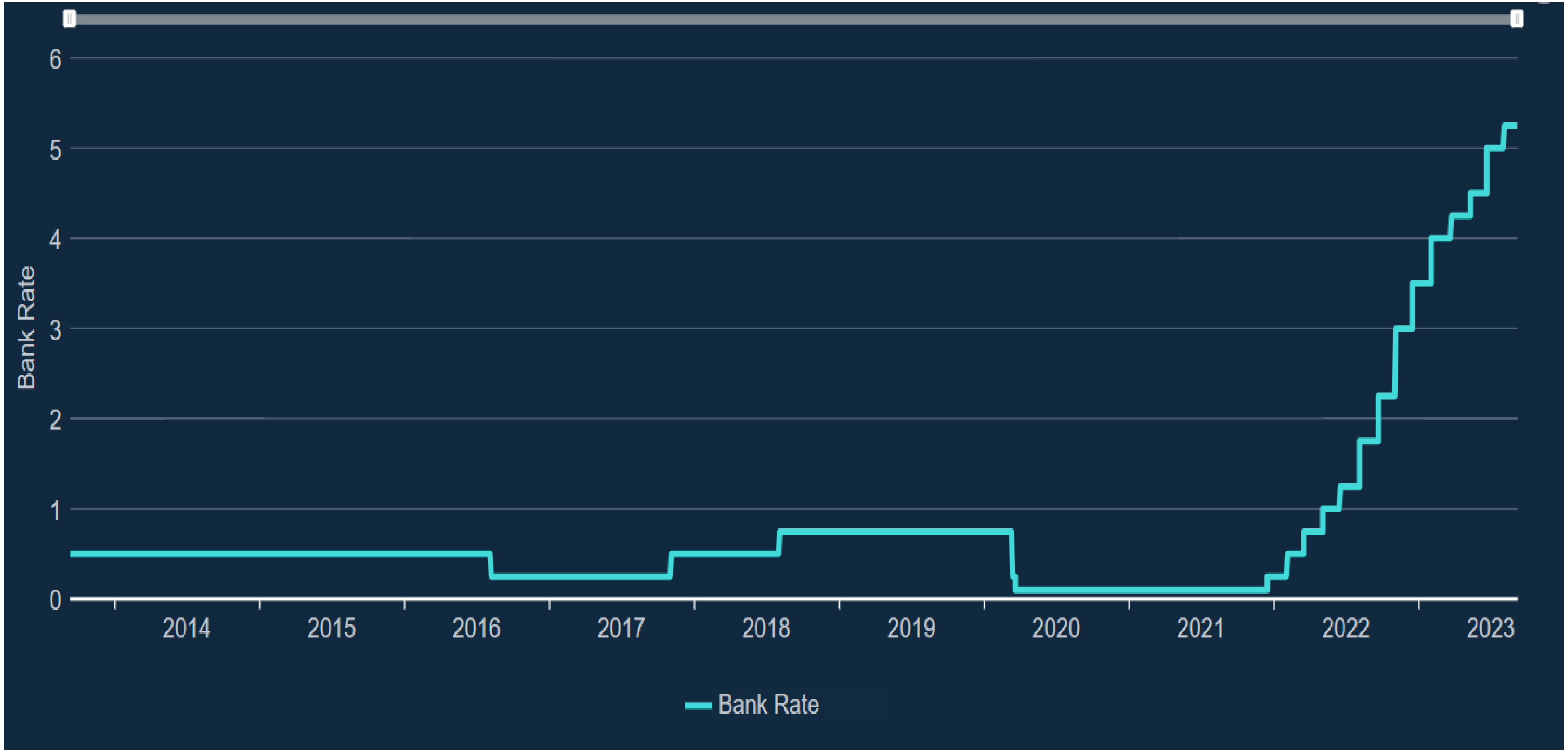


Several reasons why high inflation should not have been permanent

- Energy price spikes tend not to last, despite Russia-Ukraine.
- Despite labour shortages and faster rises in pay, there isn't a full-blown wage-price spiral.
- The big money supply expansion associated with QE is over.
- Producer price inflation is now negative by 2.3% for input prices, and 0.4% for output prices.

The interest rate dog has been barking a lot recently

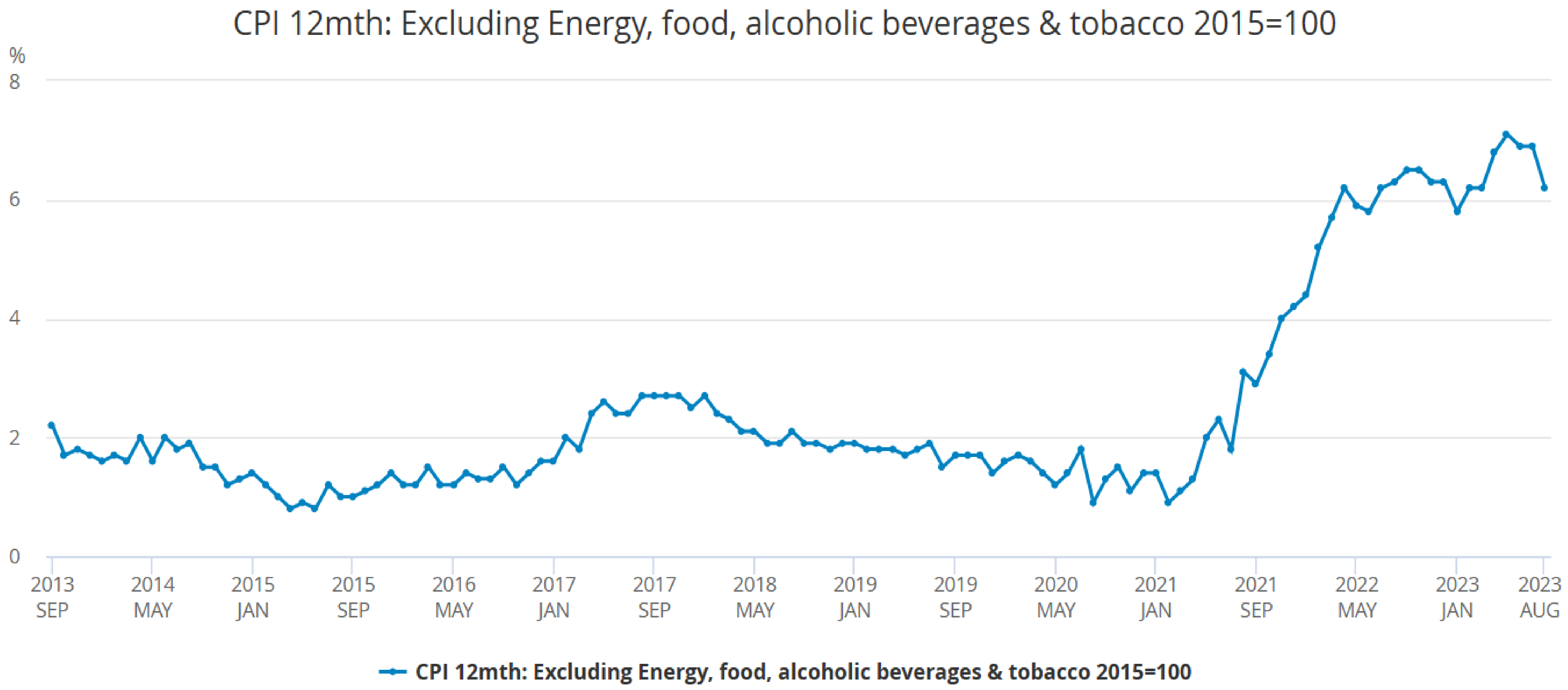
Taking Bank Rate to its highest in 15 years



But not last month

“The Bank of England’s Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending on 20 September 2023, the MPC voted by a majority of 5–4 to **maintain** Bank Rate at 5.25%. Four members preferred to increase Bank Rate by 0.25 percentage points, to 5.5%. The Committee also voted unanimously to reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100 billion over the next twelve months, to a total of £658 billion.” **Bank of England, September 21 2023**

The Bank was reassured by a drop in 'core' inflation



And economic weakness should mean its job is done

- The vote to hold was close and some MPC members still want to hike. November is the next decision time.
- But it will be hard to justify further rate rises when inflation is clearly falling.
- The big risk is pay. If the next wage round is too high for comfort, rates could still go higher.
- But the labour market is weakening, with employment and vacancies sharply down.
- And the economy has clearly softened.

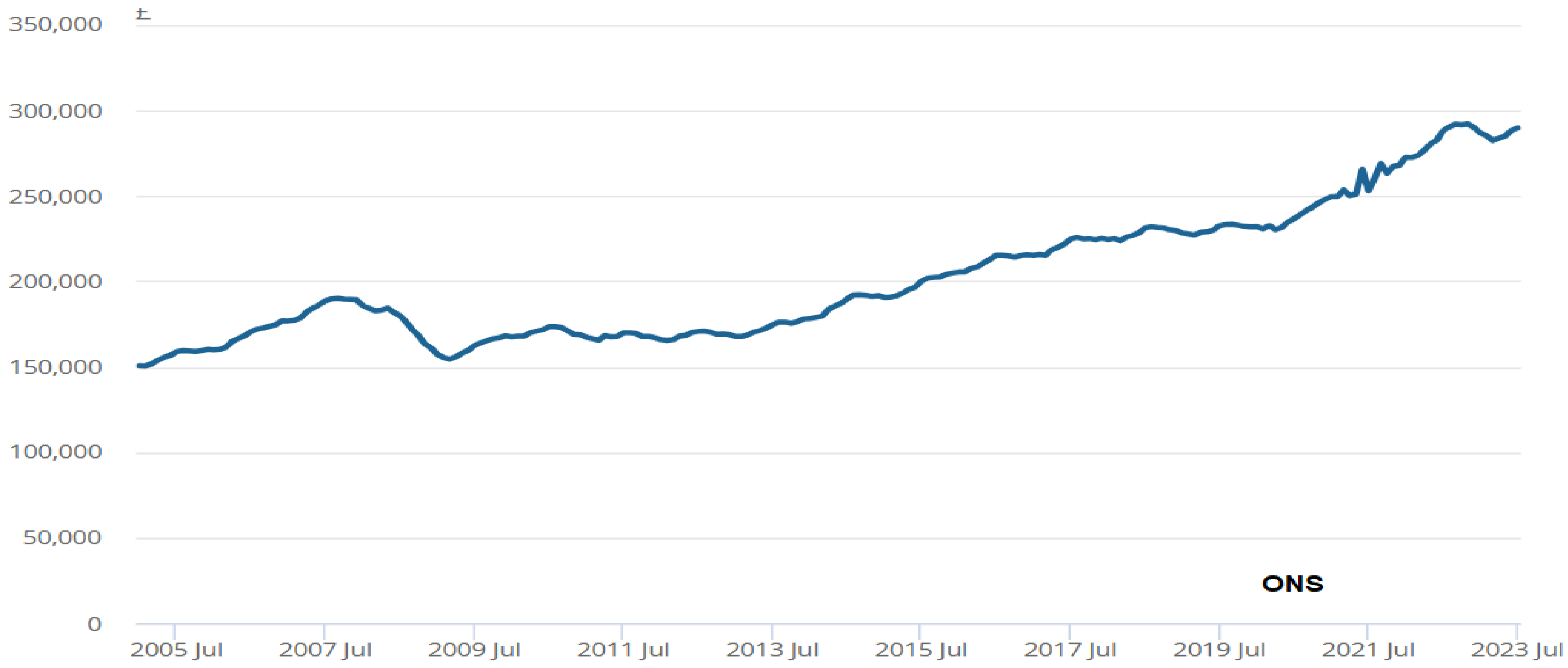
The Bank favours Table Mountain, not the Matterhorn

What I said about housing last year

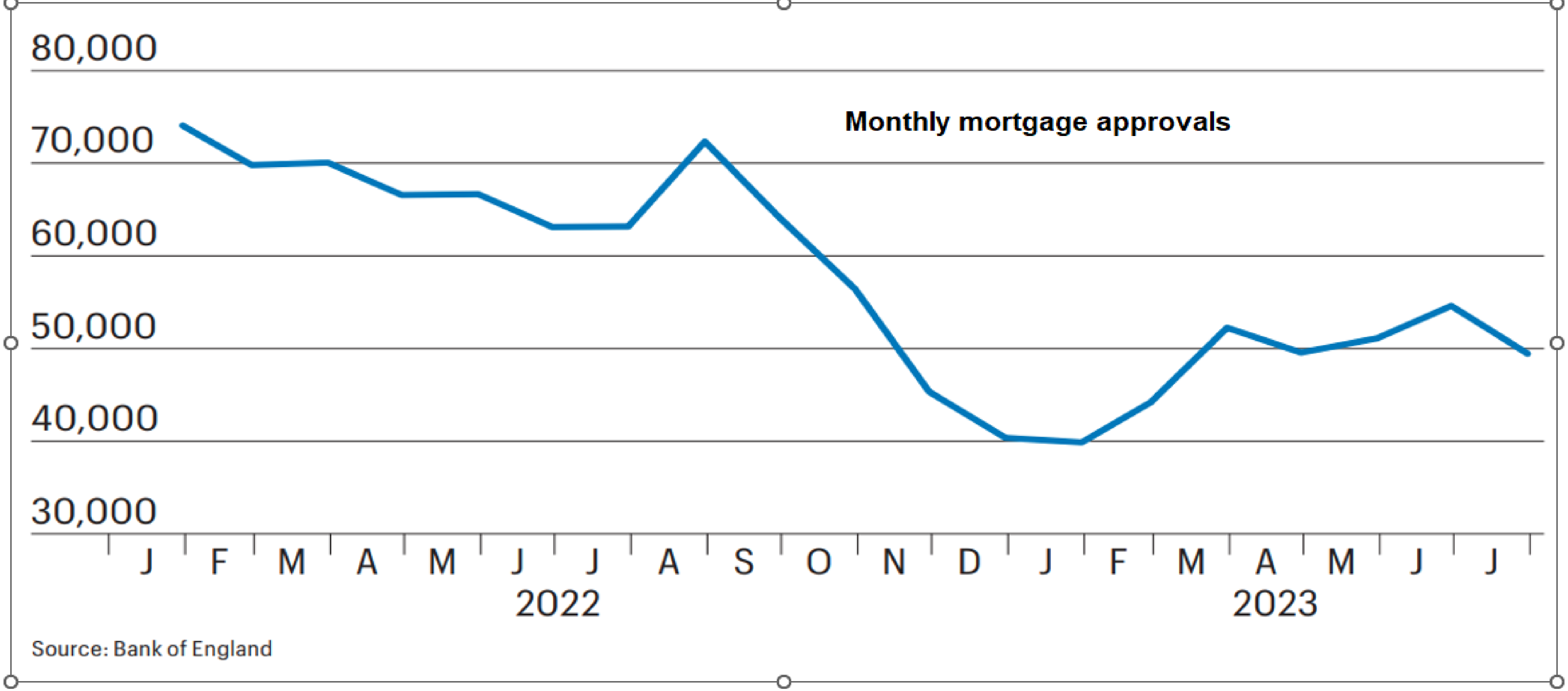
- Sharply rising mortgage rates meant that affordability was being stretched on both fronts.
- But a tight labour market argued against the forced selling of the early 1990s.
- No crash in house prices but certainly a softening.
- A bigger impact on housing market activity.
- How is all that working out?

A modest correction in house prices

Average house price, UK, January 2005 to July 2023



But a bigger drop in activity



Another battle between pluses and minuse

On the plus side:

- Mortgage rates are not as high as feared.

- Real incomes are starting to rise again.

- Consumer confidence is recovering.

On the minus side:

- Much of the effect of higher interest rates has yet to feed through.

- Higher rates stretch affordability.

- Unemployment is rising again.

Meanwhile, keep an eye out for further shocks and surprises

And don’t forget to count those skips