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UK Households' Resilience To Challenge BoE

Demand re-acceleration a clear risk as housing market warms

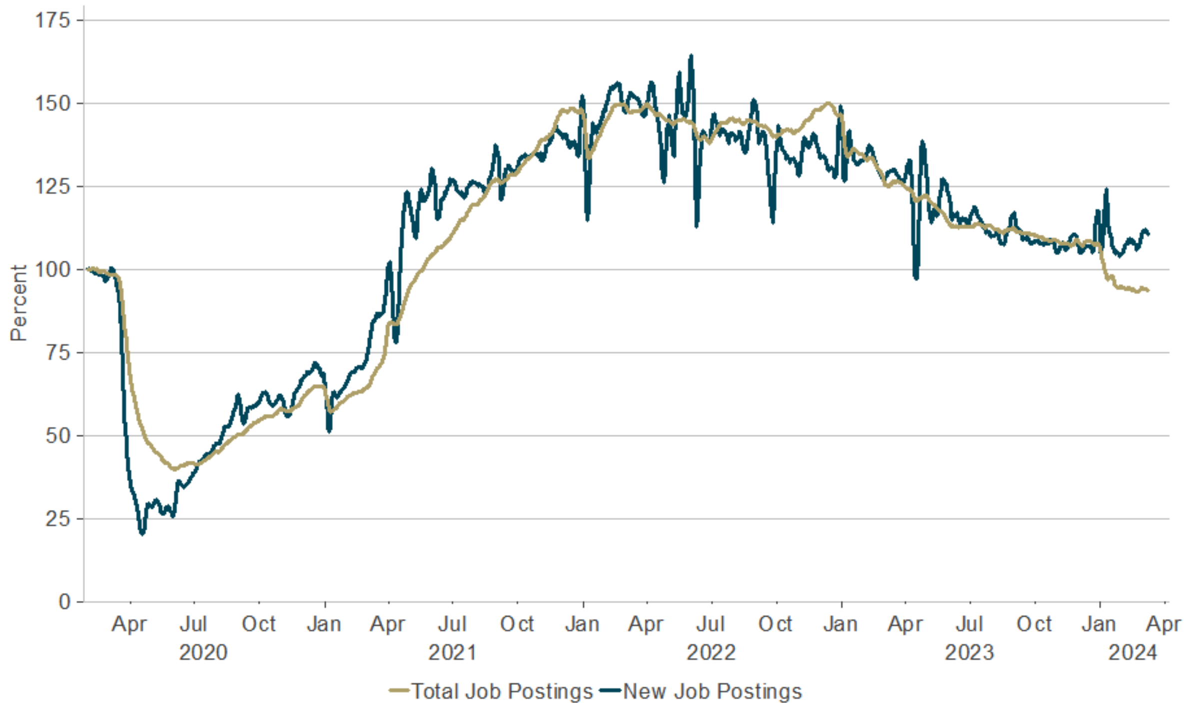
- Wage picture still unclear but labour market loosening remains elusive
- Recent real estate indicators indicate pick-up in purchase interest
- Resilient household balance sheets continue to offset rate effects

BoE to explore bias change, but early cuts still hard to justify

The outcome of the Bank of England's policy meeting Thursday is not expected to be eventful. Compared to the consensus at the European Central Bank, the BoE's Monetary Policy Committee has been far less committed to easing this side of summer, let alone converging around a time frame to begin rate cuts. Judging from her latest comments, Catherine Mann – the most hawkish MPC member – isn't inclined to stop voting for further hikes, either. Compared to prior meeting cycles, data in the run-up to this week's decision has been more supportive of her stance. For example, there have been few indications of the labour market cooling sharply enough to warrant a shift in bias. What's more, upside risks to demand are emerging amid a highly resilient aggregate household balance sheet.

BoE Chief Economist Huw Pill in his March 1 speech identified three key indicators of UK inflation persistence: services price inflation, pay growth, and tightness of the labour market. Those are linked, with source risks in the lattermost. Accurate data remains a challenge for markets and the BoE, so we continue to examine other measures of labour demand. High-frequency surveys paint a mixed picture (exhibit 1). Although total job postings as of Q1 have finally fallen below pre-pandemic levels (the re-introduced Labour Force Survey suggests the opposite), there is also a noticeable rise in new job postings on a trend basis. Coupled with an inactivity rate of 21.8% (9.25 million people aged 16-64 are economically inactive) that has continued to rise, there is a strong case for those still economically active to have strong pricing power in labour markets. This could challenge the normal link between wage growth

and labour market tightness. As wages are the main component in services inflation, and with recent data pointing to ongoing expansion in services demand, inflation persistence as determined by the BoE will likely remain firmly in place.

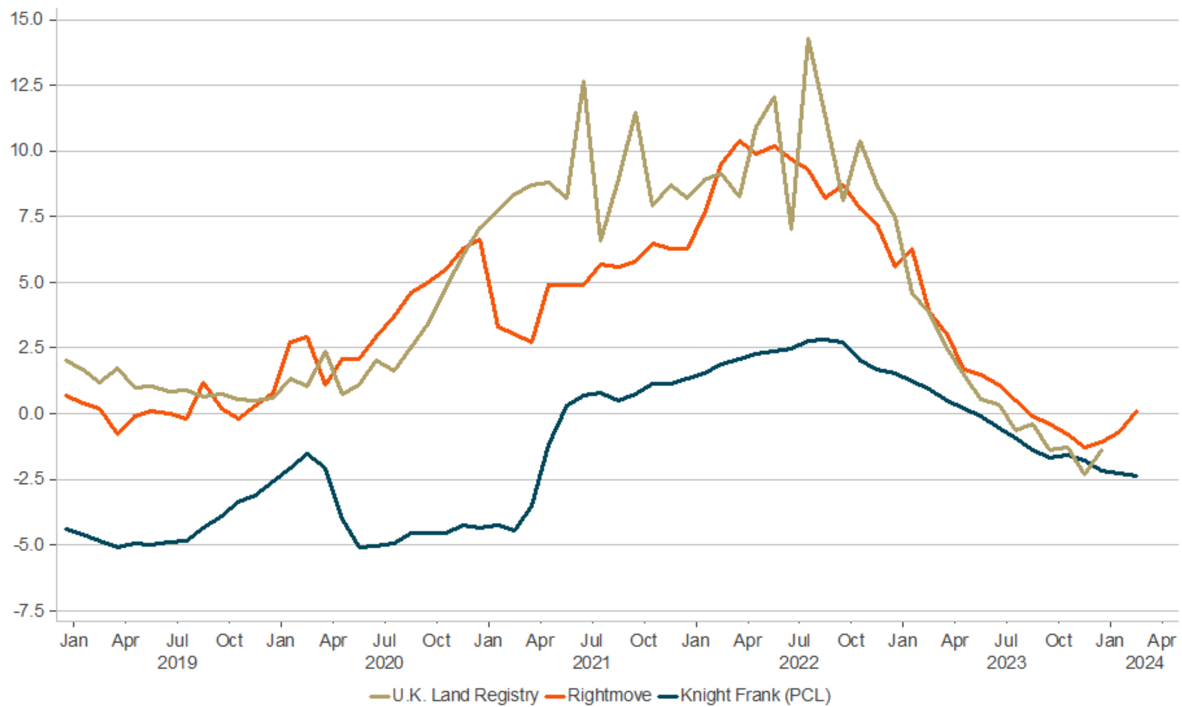


Source: Macrobond, BNY Mellon

Another demand-positive risk we expect the BoE to address this month is the state of the housing market. Prices have generally started to stabilise, but in some cases there are indications that price expansion has returned, after barely falling in the first place. Based on multiple indicators covering London and the wider market (exhibit 2), national prices declined by up to 2.5% y/y towards end-2023. The numbers would be large in real terms due to high inflation, but this was not the severe correction portended by higher mortgage rates since H2 2022. The wealth effect associated with higher housing prices and transmission to stronger demand thereafter – especially in services – is another upside risk to inflation persistence.

Private-sectors surveys of late suggest that purchase intentions are also picking up, indicating no longer expecting or willing to wait for lower mortgage rates and house prices before taking the plunge. Improved affordability is likely a factor behind the recovery in intentions – matching our view that households' balance sheets have shown exceptional resilience over the past 18 months. The BoE in February acknowledged that “current indicators of economic activity had remained subdued, but real household incomes had continued to edge up, and forward-looking indicators of output had remained positive.” National insurance cuts in the recent budget will augment in-work household income further.

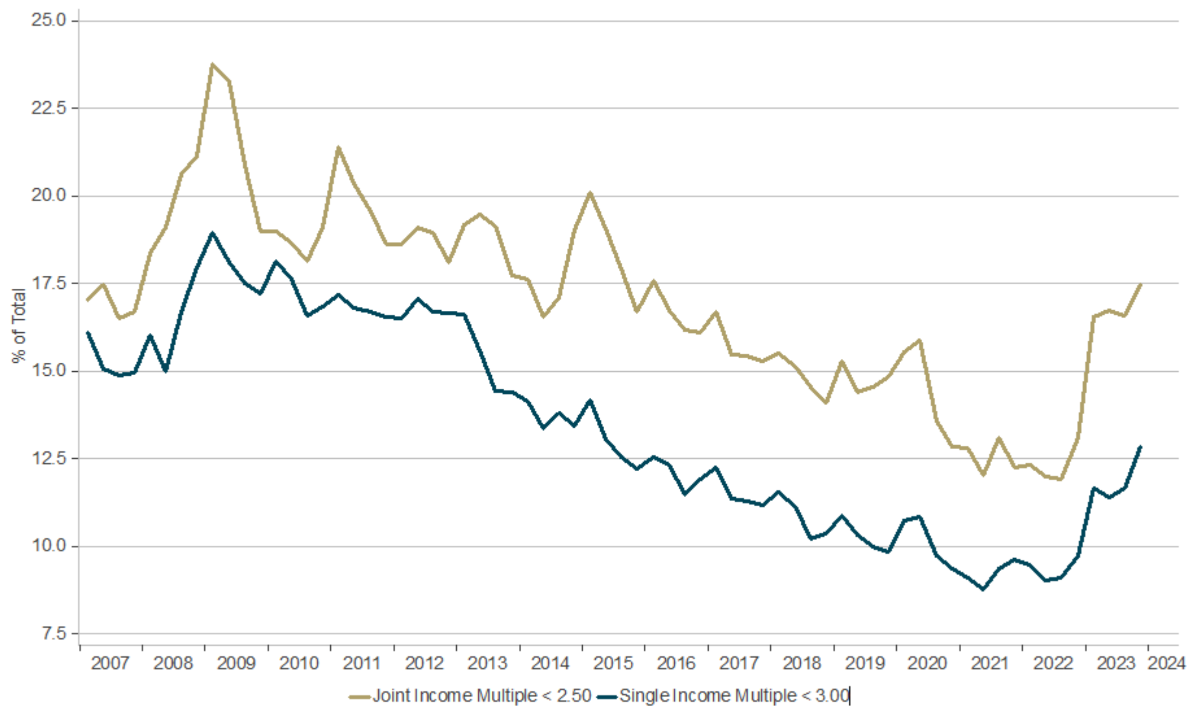
Exhibit #2: UK Real Estate Price Indices



Source: Macrobond, BNY Mellon; PCL = Prime Central London

The current combination of wages and monetary and fiscal policies is very positive for further improvements in household cashflow, but this aggregation does a disservice to the reaction function of UK households to the rise in interest rates since 2022. As exhibit 3 shows, after nearly 15 years of unbroken decline, the share of mortgage borrowers on the lowest income multiples has been rising aggressively since 2022. The share of single- and joint-income households with mortgage borrowing multiples below 2.5 and 3.0, respectively, has risen to the highest levels in almost a decade – reversing nearly seven years of decline in just about two years. Numerator and denominator effects both apply: due to higher debt-servicing costs and a slower real estate market, borrowing has become far more conservative, especially if banks are also more stringent in applying loan standards. The lapsing of government schemes which enabled high loan-to-value borrowing may have also played a role. As household incomes have been increasing in real terms but house prices falling during the same period, there would be a natural increase in affordably. Thus, more households could begin to 'climb the ladder' with the same income multiples.

Exhibit #3: UK Mortgage Lending Income Multiples



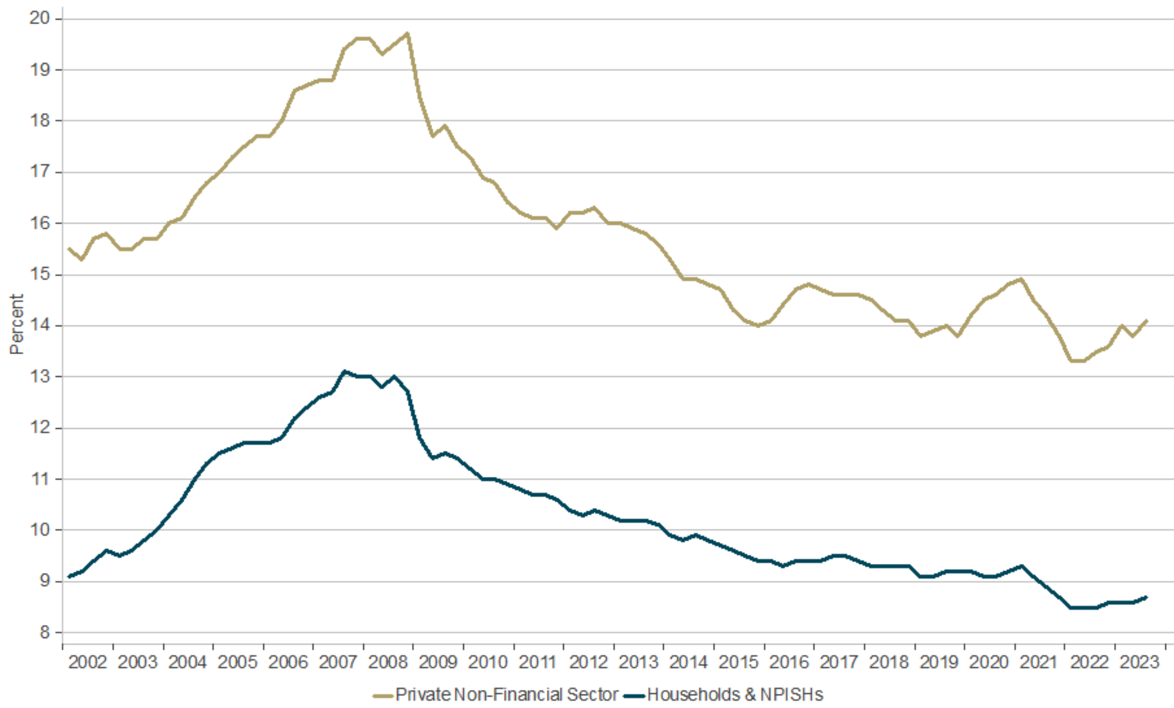
Source: Macrobond, BNY Mellon

With households taking on less housing leverage, some stabilisation or a rebound in house prices could prove to be a blessing in disguise for the BoE, which likely believes its ability to restrain demand has hit its limits. In hindsight, this was probably the wrong approach in the first place as household debt-servicing ratios remain stuck at the lows. Even for the private non-financial sector, borrowing costs (exhibit 4) remain at the lower end of the pre-pandemic range. Where expansion is possible amongst corporates, the UK appears to be running into unique labour market supply problems which remain difficult to quantify. That will likely keep upward pressure on prices which the BoE remains reluctant to call time on.

Considering that the BoE's press release in February contained the word ‘persistence’ or 'persistent' in an inflation context (but in both directions) a combined 13 times, plus Chief Economist Pill’s speech earlier this month a further 10 instances, a clear path towards price stability which could enable a full shift in the BoE's policy bias is still proving elusive.

We would certainly not rule out the BoE's MPC initiating easing later in the year, however.

Exhibit #4: UK Debt-Servicing Ratios



Source: Macrobond, BNY Mellon

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