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Quilter Investors

Between the lines

October 2023

UK energy bills to rise despite falling gas prices

A mild winter helped Europe avoid the worst of an energy crisis last year. Since then wholesale gas prices have fallen but they remain high and extremely volatile. Meanwhile, although the UK's energy price cap has been lowered, reflecting the decline in wholesale gas prices, millions of UK households will still face higher energy bills.

What does this mean for investors?

When Russia ceased gas exports to Europe last summer it triggered an energy crisis and pushed inflation to multi-decade highs. However, a mild winter spared Europe from widespread gas shortages. It has since diversified its supplies and already reached its storage targets for the coming winter. This improving energy picture helped European equities to be the top-performing regional market with a return of 20% in the year to the end of September.

However, the outlook remains delicately balanced. Europe's energy markets are sensitive to supply disruptions or changes in global demand and wholesale gas prices remain volatile. Currently, China's struggling economy is a key cause of lower gas prices.

Meanwhile, despite the UK price cap falling, UK energy bills this coming winter are estimated to be up 13%. This is due to the withdrawal of the government energy subsidies and a rise in standing charges.

Key takeaways

- In the year to the end of September, European equities were the top-performing regional market, up 20%.
- Wholesale gas prices remain very volatile. China's declining economy is a key driver of lower gas prices.
- An estimated 6.3 million UK households face 'fuel poverty' this winter – a rise of over two million in two years.

Global bonds sell-off

By the start of October, September's sell-off in global bond markets had caused the cost of the UK's long-term borrowing to rise to a 20-year high. The yield, or interest rate, on 30-year gilts had hit 5.1% by 4 October, taking the cost of UK borrowing higher than during the Liz Truss mini-budget crisis a year ago.

What does this mean for investors?

The latest sell-off in global bond markets was broadly attributed to the US Federal Reserve (US central bank) suggesting that US interest rates would need to be higher for longer. Persistent inflation numbers, fuelled by rising oil prices, have also played a part as has the massive amount of government borrowing built up during lockdown when interest rates were just decimal fractions.

However, while strong US economic growth numbers continue to drive down the price of US Treasuries (US government bonds), in the UK, gilts (UK government bonds) are falling despite the weakening economic outlook. Much of this is because the Bank of England is crystallising losses of up to £150bn at the taxpayer's expense by selling huge tranches of the gilts it acquired.

Bond prices typically improve a few months after interest rates reach their peak; hence, the incessant investor focus on whether interest rates have further to go.

Key takeaways

- Countries with elevated levels of debt, like the UK, are likely to struggle.
- Expensive government debt leads to higher taxes, lower investment, and decreasing economic growth.
- Bond prices typically improve a few months after interest rates reach their peak.

UK property market in the deep freeze

Thanks to the steep rise in interest rates, UK house prices are falling. In the year to the end of September, they fell an average of 5.3%. This reduced the price of an average UK home by almost £14,500 to £257,808. Despite price falls in every UK region, mortgage approvals are at record lows due to falling affordability. This has put huge pressure on the UK rental market where rising interest rates and a shortage of supply have pushed rental costs to new all-time highs.

What does this mean for investors?

The latest figures from Nationwide suggest that UK mortgage approvals are now 30% below their pre-pandemic levels. This reflects the fall in affordability delivered by today's high interest rates.

According to Nationwide, "...someone earning an average income and purchasing the typical first-time buyer home with a 20% deposit would spend 38% of their take home pay on their monthly mortgage payment". This compares to the long-run average in the UK which is 29%.

The UK's high interest rates have also pushed up rents, both through landlords passing this cost on to their tenants, and by creating record levels of demand for rental properties. The resulting shortage of rental properties has seen average UK rental costs jump by 10% over the last year to their highest on record.

Key takeaways

- UK house prices continue to fall with the biggest decline in the south-west of England.
- UK rents are at record highs with the average rent outside of London now at £1,278 a month.
- Numerous UK cities have seen annual rent increases of more than 20%.

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