21 March 2024

UK in Focus

Economics
United Kingdom

A plethora of policy updates

- March saw policy updates from both the government on fiscal policy and the Bank of England on monetary policy
- Economic data starts the year on a better footing, with positive growth and a falling rate of inflation
- But wage growth and services inflation remains too high for interest rate cuts just yet

UK data review (Jan/Feb 2024)

- **GDP** rose 0.2% m-o-m in January kicking off the new year on a more positive note having recorded a technical recession – two consecutive quarters of decline – in the second half of last year. Output growth in January was bolstered by the services sector +0.2% m-o-m, driven mostly by a rebound in wholesale and retail trade +1.9% m-o-m. Elsewhere, despite manufacturing holding steady (0.0%), a decline in water supply led to a fall in overall industrial production, -0.2% m-o-m, while the construction sector posted its first monthly expansion in four months, +1.1% m-o-m.

- **UK Labour Market** data continue to point to a degree of loosening. Employment fell (-21k) in the three months to January supporting a tick up in the unemployment rate to 3.9% 3m/yr. However, with the number of people leaving the workforce continuing to rise, an easing in the labour market is being driven predominantly by softer demand. Nevertheless, regular pay growth slowed further to 6.1% 3m/yr from 6.2% previously. Similarly, private sector pay also slowed to 6.1% and therefore looks consistent with an undershoot of the Bank of England's Q1 forecast of 5.7%.

- **CPI inflation** fell to 3.4% y-o-y in February from 4.0% in the prior month - its lowest annual rate since September 2021. Positively, the core rate of inflation – that excludes volatile food and energy prices – also fell sharply to 4.5% y-o-y from 5.1% previously. The slowdown was broad based with the greatest contribution to the fall in the headline rate driven by softer food and restaurant price inflation. However, a recent uptick in fuel prices created some upward price pressure, particularly across transport services. Despite the positive news, services inflation, of most concern for the Bank of England, remains elevated at 6.1% y-o-y.

- **Purchasing Managers Indices (PMI)** signalled further expansion in March with the flash composite PMI recording its fifth month above the 50-neutral mark at 52.9. Services activity saw slightly slower momentum while manufacturing output reported its first expansion in a year. Price pressures picked up amid higher raw material prices and wage pressures within services firms. Output prices charged also continued to rise but employment growth stagnated.

A plethora of policy updates

Spring budget offered little for businesses …

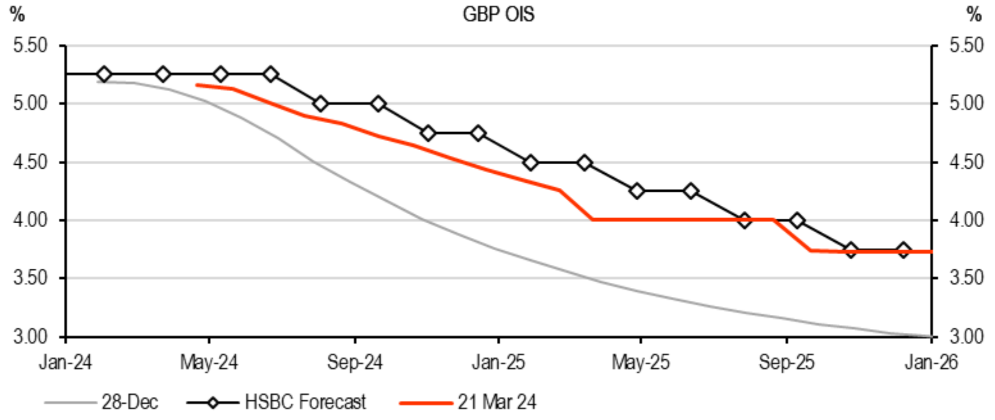
March treated us to the latest updates from both the government on fiscal policy and the Bank of England (BoE) on monetary policy. The beginning of the month saw Chancellor Jeremy Hunt's latest Spring Budget, the last of the parliamentary term. Unfortunately for Mr Hunt, there was no magic money tree as there was in the Autumn Statement, due to a softer economic growth outlook and a lower forecast profile for the rate of inflation, relative to last November. Therefore, in order to offer the headline announcement of a 2p cut in National Insurance Contributions, the Chancellor had to also announce a series tax rises as well as accept an even smaller margin of error (GBP9bn down from GBP13bn in November) to achieve his fiscal targets - notably, debt falling as a share of GDP in five years.

For businesses, the announcements were sparse. Beyond the usual fuel duty freeze, which has been extended since its incorporation over a decade ago, the Chancellor announced: the Growth Guarantee Fund, a GBP200mn fund to support the growth of businesses with a turnover <GBP45mn: an expansion of full expensing to leased assets: a rise in the VAT threshold to GBP95k: and an extension to the freeze in alcohol duty until February 2025.

… while the next government have a difficult job

However, the future of public finances is precarious with the forecasts predicated on significant real-term cuts to public sector spending and an increasing tax burden. Therefore, for whichever party wins the next general election, achieving a prosperous economy will be paramount to meeting their fiscal targets.

1. Financial markets currently expect the first rate cut to be in June



Source: Bloomberg, Macrobond, HSBC

Bank of England Policy Update

Bank of England take another step closer to interest rate cuts

The Bank of England's Monetary Policy Committee (MPC) opted to leave Bank Rate unchanged at 5.25% at their March policy meeting. The notable development came from how the nine-strong committee voted: this was the first policy meeting since September 2021 where no member opted for an interest rate hike. Instead, eight members voted to leave Bank Rate unchanged while one member preferred an interest rate cut.

However, despite a more collegiate decision on policy, the committee remain split on the degree to which persistent inflationary pressures have receded, and therefore require *"further accumulation of evidence on inflation persistence … to warrant a shift in the monetary policy stance"*. The MPC maintained its guidance of closely monitoring the underlying tightness of the labour market, wages and services inflation but added a recognition that with interest rates at their current level, monetary policy was weighing on activity and inflationary pressures. Therefore, financial markets currently expect the first cut in interest rates to be in June.

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