UK FINANCE

MONTHLY ECONOMIC INSIGHT

May 2022

Written by:

Lee Hopley
Director,
Economic Insight and Research

Charles Cornes
Analyst,
Data and Research

Cost of living concerns are dominating the headlines and domestic political agenda. With inflation at seven per cent and energy price and tax rises which came into effect in April, households' building concerns about the squeeze on incomes will be starting to materialise. This month's review takes a look at the data in the run up to these pressures starting to bite.

GDP GROWTH SLOWS IN FEBRUARY

Data from the ONS reveals growth in the UK economy slowed in February, registering expansion of only 0.1 per cent following a 0.8 per cent rise in January. February's rise pushed GDP to 1.5 per cent above pre-pandemic levels. As ever there are divergent trends underneath the headlines.

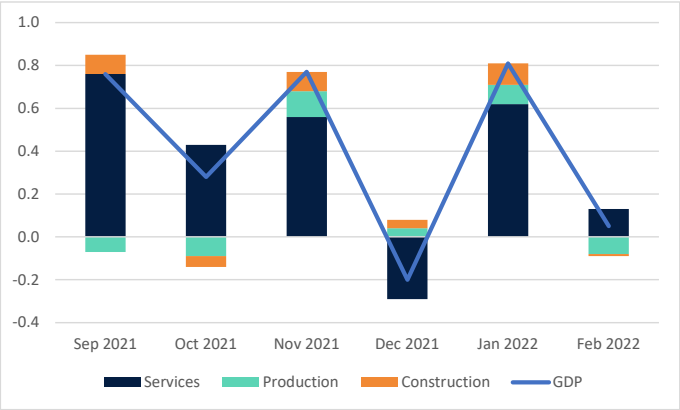
Out of the three sectors, only services experienced growth in February. The tourism and accommodation industries drove growth following a bounce-back from the Omicron variant in late 2021. This contributed to a 0.7 per cent month-on-month rise in consumer-facing services in February. Nevertheless, these industries have yet to fully recover from various lockdown restrictions over the past two years and output remains 5.2 per cent below pre-pandemic levels.

The outlook for these sectors looks challenging for the remainder of 2022. The combination of increasing energy prices, rising national insurance contributions and the freezing of income tax thresholds last month presents a hit to disposable incomes; this will no doubt have consequences to those services that can be regarded as 'luxury'.

Elsewhere in the data three storms throughout February caused disruptions across the UK, weighing particularly on construction activity, which resulted in delays to activity and a small drop on output on the month. In addition, manufacturing, notably the auto sector, continues to be hobbled by ongoing material shortages and supply chain disruptions.

However, the most notable development in February's numbers (and in the months to come) is the impact of the wind down of NHS test and trace and vaccination activity. This fell by almost 50 and 65 per cent respectively in February after the height of Omicron and the end of restrictions. The ONS data indicates these specific decreases in activity detracted 1.1 percentage points from overall GDP growth.

Chart 1: Sector contribution to monthly GDP growth, percentage points



Source: ONS

... AND RETAIL SALES FALL BACK

While growth continued in February with consumer-facing service activity still increasing, the same cannot be said of retail activity. The latest ONS retail sales figures reported a second monthly fall in volumes. The 1.4 per cent decline in March was greater than markets were expecting. That said, volumes continue to hold above pre-pandemic levels.

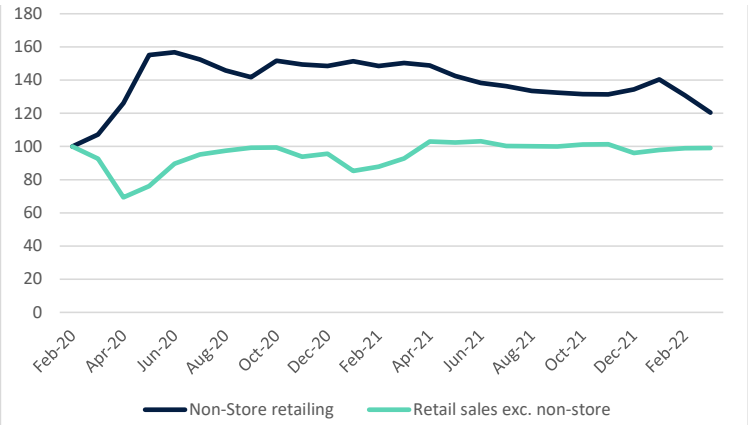
There were a number of contributors to the decline, the main one being a near eight per cent fall in non-store retailing **(chart 2)**. The proportion of online spend also fell back to its lowest level since February 2020. Stripping out non-store spend, the picture looks a bit more stable, although declines in sales in food stores were also reported for the fourth month running.

Is this an early warning sign of consumers tightening the purse strings as fears of pressures on household budgets mount? Probably. We've seen consumers' appetite to make major purchases fall away in recent months (more on that later), so it is not surprising that the official data is pointing to falls in some areas of discretionary spend.

It could also signal a reversal of the switch away from services and towards more goods purchases during the pandemic. Retail sales account for some 40 per cent of consumer spending and as noted in the GDP data, other services such as hospitality and travel remain relatively buoyant.

This is confirmed in UK Finance's own card spending data, which show strong growth in spending in services, particularly travel, but weaker online and retail spend. Given inflationary pressures, it is likely we will continue to see softer data on consumer activity as households manage increases in energy and food costs. Many have, however, also accumulated savings in the past two years that will support some, likely modest, growth this year.

Chart 2: Retail sales, February 2020 = 100



Source: ONS

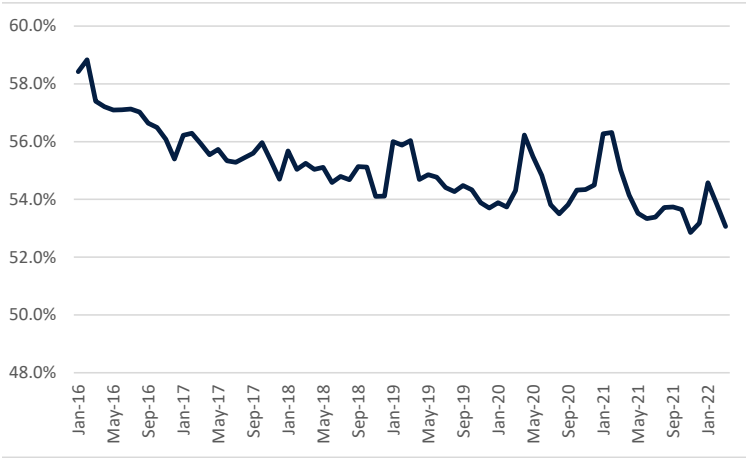
OUTSTANDING CARD BALANCES BELOW PRE-COVID-19 TREND

Elsewhere in UK Finance's card spending data, we can take a look for signs of emerging stress on finances. One measure is the proportion of credit card balances bearing interest – essentially amounts rolled over for which interest is charged.

Chart 3 shows that the percentage of interest-bearing balances has been trending down for a number of years. As Covid-19 lockdowns reduced opportunities to spend, we saw a sustained period of repayments outstripping new credit card borrowing through much of 2020 and 2021 taking the percentage of interest-bearing balances to a series low in November 2021.

There was a subsequent uptick, but this is a seasonal effect of consumers increasing card purchases in the festive season and paying off bills in subsequent months, but the proportion of interest-bearing balances resumed its downward trend in the most recent data for March.

Chart 3: Credit card interest bearing balances, percentage



Source: UK Finance

UNEMPLOYMENT FALLING TOO

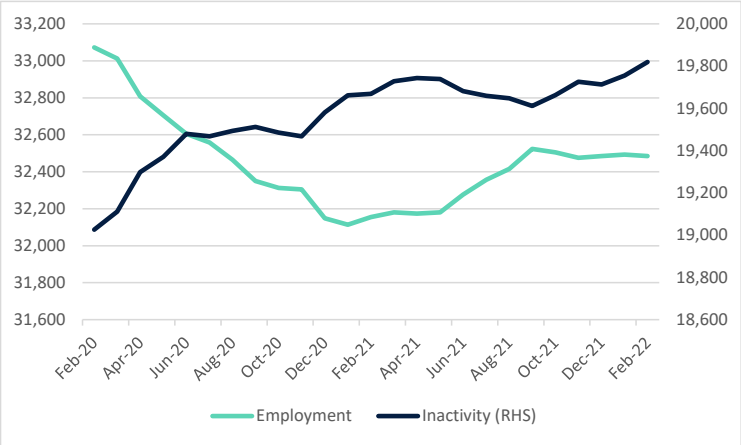
Any possible reasons for cheer? One continuing economic bright(er) spot is the labour market. Unemployment continued on a downward trajectory in February with the rate at 3.8 per cent, down on that recorded just before the pandemic.

However, the rebound in employment following the end of restrictions and the furlough schemes appears to have tailed off in recent months, even as vacancies recorded yet another record high in the three months to March.

Less positive is the recent rise in inactivity rates. Sickness and retirement are two of the main factors behind people withdrawing from the labour market. This will add to the recruitment challenges and skills shortages that business have been reporting through the Covid-19 recovery.

But for those in employment, average earnings picked up again in the three months to March, with total pay rising by 5.4 per cent on the previous year. While this is elevated relative to pre-pandemic rates of pay growth, wage growth has been lagging price increases since last autumn. Moreover, there is a widening gap in pay growth between the private (6.2 per cent) and public sectors (1.9 per cent).

Chart 4: Employment and inactivity levels, thousands



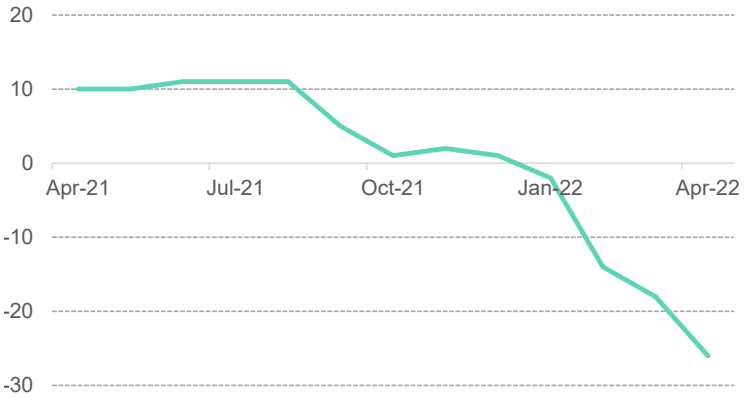
Source: ONS

BUT CONSUMER SENTIMENT CONTINUES NOSEDIVE

While there are limited signs of the direct impact on the economy of cost-of-living challenges this far, the effect on household confidence is clearly evident. GfK's consumer confidence index decreased seven points to -38 in April – only one point above record lows. Falls of this magnitude have previously been a predictor of recession. All components of the index recorded a marked decline compared with the previous month.

One specific measure within the index, surveying individuals' personal financial forecasts for the forthcoming 12 months, provides useful insight into household spending. As **chart 5** shows, this measure has been on the decline since November, when inflation first rose by nearly a percentage point in one month. The cost-of-living pressures have taken a toll on consumers: UK households are now more pessimistic with regards to their future financial situation than they were during the 2008 financial crash.

Chart 5: Personal financial situation in the next 12 months



Source: GfK

Insight from the ONS Opinions and Lifestyle survey provides further evidence of concern among households, with key findings showing 87 per cent of adults had seen an increase in their cost of living in the previous month (March) compared with 62 per cent in November; nearly a quarter reported difficulties paying household bills; and four in ten believed they would be unable to save in the coming 12 months.

With such low confidence in personal finances, we are likely to see this translate to a significant drop in spending across most sectors in the coming months, as households prioritise ongoing costs such as utility bills.

ROUND UP

While economic growth has continued to tick over at the start of 2022, growth signals have become more mixed and headwinds are clearly building. We noted **last month** that the Ukraine conflict, now running into its third month, would have global economic consequences from higher inflation and weaker growth. In addition, while Covid-19 disruptions have largely ended in the UK, its resurgence in China is prolonging supply-chain problems. The US economy recorded a surprise contraction at the start of this year too. While the fall was modest and driven by businesses running down inventories and net trade, this is perhaps a further indicator that future prospects are becoming more finely balanced.

So once again we return to how monetary policy makers might process these developments when they meet again in May and have the benefit of updated forecasts. Expectations are for a further rise in Bank Rate to one per cent.

The inflation outlook can't be described as anything other than concerning and the Bank is likely to again revise up its forecasts. In a recent speech one MPC member reiterated concerns about this becoming more persistent and the flow through to expectations. Although we also might expect to see more concern about the growth outlook reflected in the minutes.

Indicator	Period	Value	Change	2022 Forecast*
GDP	Q4 2021	1.3%	↑	4.1%
CPI inflation	Mar 2022	7.0%	↑	7.2%
Unemployment rate	Feb 2021	3.8%	↓	4.1%
Avergae earnings	Feb 2021	5.4%	↑	4.7%
Brent crude	Mar 2022	$117.70	↑	-
$ Exchange rate	Mar 2022	$1.32	↓	-
PSNB	Feb 2022	£18.1 bn	↑	£97.0 bn

Source: ONS, HM Treasury, Bank of England