UK FINANCE

MONTHLY ECONOMIC INSIGHT

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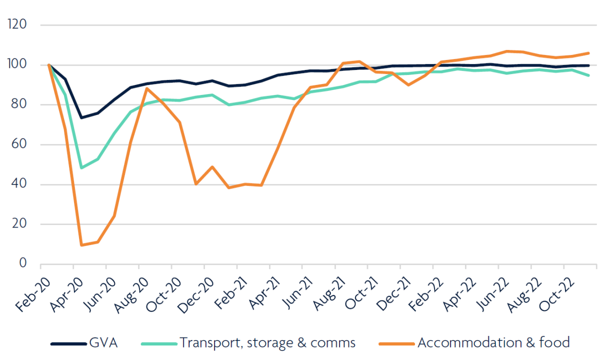
Key data on consumer activity and economic performance in the Christmas period is starting to roll in and this month we take a look at the extent to which cost of living concerns are making their presence felt. We'll also review the latest inflation picture, the health of the labour market and the impact of industrial action.

Q4 GROWTH TO STAY IN THE BLACK?

Against gloomier expectations, the UK economy continued to chug along in November. GDP is estimated to have increased by 0.1 per cent after the post-bank holiday bounce of 0.5 per cent in October.

Many forecasters had pencilled in another quarter-on-quarter contraction in the economy at the end of 2022, following the 0.3 per cent fall in GDP in the three months to September. This would have signalled that the economy was in recession. However, November's growth (assuming it isn't subsequently revised away) means it looks like the economy will escape recession, for now. The Bank of England's latest forecast update, published in the February Monetary Policy report assumes a modest 0.1 per cent expansion in Q4.

Chart 1: Gross value added, Feb 20 = 100



Source: ONS

Looking at the detail, the services sector chalked up another month of growth, at 0.2 per cent in November, boosted by the information and communication sector. In addition, hospitality also posted growth in the month, and the Office for National Statistics (ONS) pointed to the likely support to the sector from the start of the football world cup (chart 1). Maybe some of this effect will linger into December as England made it to the quarter finals (and alas, no further).

Weakness in manufacturing continued with output falling in November. There was, however, a more notable drop of 2.7 per cent in output in the transport, storage and communications sector. This includes warehousing, transportation, and postal and courier services – all of which dropped back as a result of strikes in the month. This is the most direct evidence on the impact of industrial action on the economy, though likely more widespread than this, the ONS noted that it was not possible to isolate this in the wider economy.

INDUSTRIAL ACTION IMPACT CONTINUED...

However, survey evidence from the ONS BICS survey does indicate more widespread impacts of strikes that have been gathering pace since the summer.

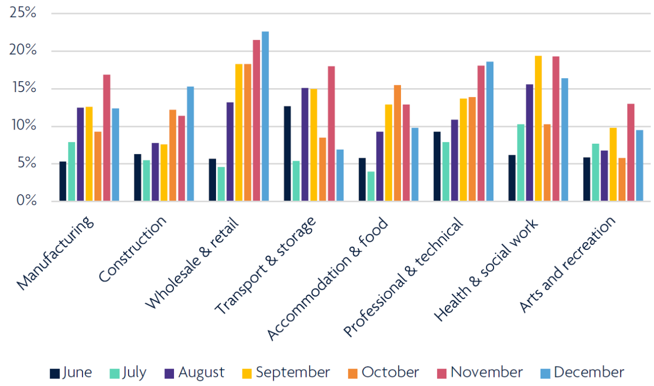
As **chart 2** illustrates, and in line with the ONS official data, there was a clear pick-up in the percentage of businesses in the transport and storage sector affected by strikes in November. But a greater proportion of businesses in the wholesale and retail sector have been affected, with the share ramping up over the autumn and winter months. The main impact seen across these businesses was an inability to obtain goods. Construction firms were hit for the same reason.

Whereas in the health sector, unsurprisingly, more responded that employees were involved in the action or had to change their work location.

The ONS public opinion survey also points to impacts on households' working patterns, travel and leisure activity. Most notably around one in five were hit by rail strikes, with half of those reporting that leisure activities were affected, which was unlikely to be good news for consumers facing services over the festive season.

With further strikes likely in the offing in the early part of 2023, the impact noted by businesses in surveys may become more evident as a drag on economic activity.

Chart 2: Businesses affected by industrial action, percentage of respondents by sector



Source: ONS BICS

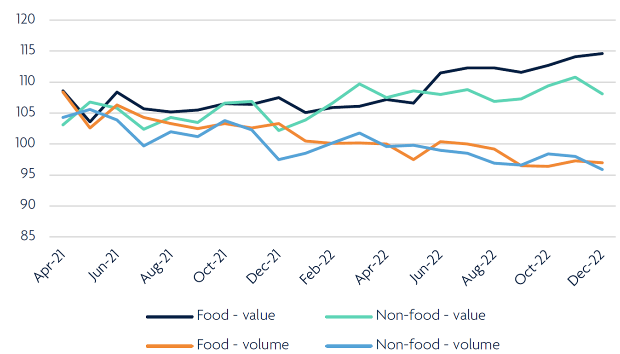
COST OF LIVING PRESSURE EVIDENT ON THE HIGH STREET

In addition to the potential impact of industrial action on pre-Christmas spending, we know that consumers are also buffeted by high inflation creating acute cost of living challenges. With confidence levels still on the floor there were worries that consumers would sharply rein in spending at the end of the year.

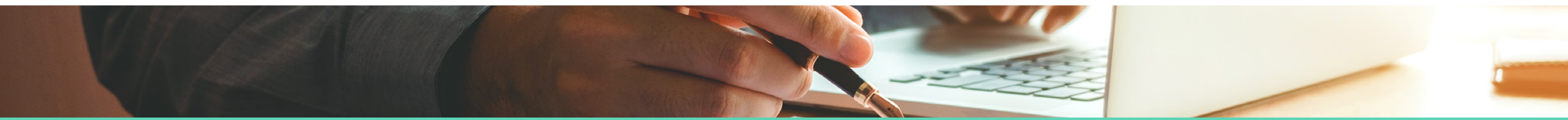
That wasn't quite the story, with some retailers reporting that sales were better than expected. **Chart 3** shows that while shoppers didn't make drastic reductions to their spending in the run up the Christmas, particularly on food, they were getting less for their money as volumes dropped by over six per cent compared with a year ago.

On the non-food side, after a bounce in November due to seasonal black Friday offers, retails sales values and volumes headed lower in December following a trend seen in previous years.

Chart 3: Retail sales, volume and value index 2019 = 100



Source: ONS



CPI PEAKS, BUT...

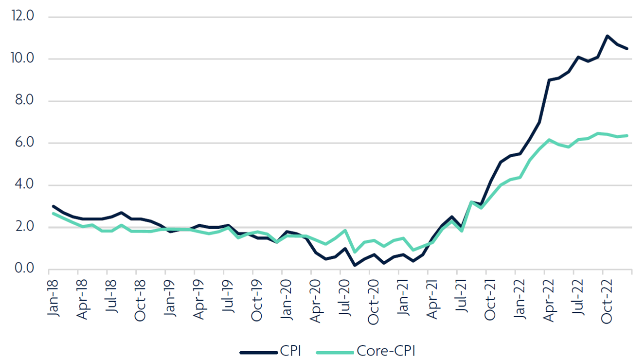
Is the pressure on households likely to abate? We've seen CPI edge down from its peak of over 11 per cent over the past couple of months, but at 10.5 per cent we're still close to 40-year highs and some distance from the Bank of England's two per cent inflation target (**chart 4**).

The big factors behind high inflation remain, with large upward contributions from electricity and gas bills, and food and drink, with the latter further accelerating in December. The contribution from transport is however continuing to ease as oil and petrol prices have fallen.

Core inflation, which excludes energy and food prices also remains elevated and outside the Bank of England's comfort zone. Its Monetary Policy report notes that core services inflation is becoming a more important driver, pointing to rising pay growth as a significant contributor.

Good inflation is, however, moving in the right direction partly as a consequence of softening global demand, lower commodity prices and a continuing easing of supply chain bottlenecks. The Bank expects this trend to continue in the early part of 2023, but there may yet be a bit further to go on services inflation.

Chart 4: Inflation, percentage annual change



Source: ONS

Overall, however, the Bank continues to forecast CPI falling back over the course of this year, with inflation of around eight per cent expected mid-2023 as the impact of energy price hikes start to drop out of the series. Even as the energy price cap rises in April, the increase, year-on-year, will be less than that seen in 2022.

High inflation, notably firmer than expected services inflation that can be more persistent - combined with an acceleration in pay growth - convinced seven of the nine MPC members that further tightening was necessary to return CPI sustainably back to target. Bank Rate increased by another 50 basis points to four per cent.

The Committee also noted that there was still a large degree of uncertainty about the outlook. More evidence of persistent inflation would be needed for further tightening.

LABOUR MARKET COMING OFF THE BOIL

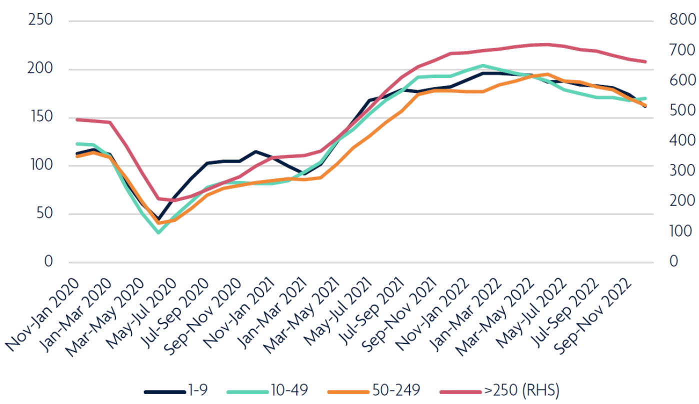
While the MPC and the Monetary Policy report note that labour market conditions remain tight with unemployment remaining low at 3.7 per cent in the three months to November and private sector earnings growth inching over seven per cent, there are signs that we're past the peak.

In addition to some surveys (notably the S&PGlobal/ CIPS purchasing managers' index) which point to weakening recruitment intentions, ONS data on vacancies show numbers drifting down in recent months. The falls were widespread across firms of all sizes and sectors. Looking at movements over the quarter, the largest decreases were amongst firms with fewer than ten employees and in transport and storage, and arts and recreation.

Despite the drop, the stock of vacancies relative to the number of unemployed people remains high and above that seen pre-pandemic. The persistence of inactivity caused by early retirement and long-term sickness is also adding to tightness in the labour market. Businesses in some sectors are continuing to report challenges filling vacancies.

As the economy remains weak in the coming quarters, further falls in recruitment are to be expected. This is likely to come before companies engage in reducing the size of their workforce, not least as many businesses that have faced worker shortages will be reluctant to lose people that may be hard to replace when activity picks up again.

Chart 5: Vacancies by firm size, thousands



Source: ONS

ROUND UP

While the UK economy may have just escaped another quarter of contracting GDP at the end of 2022, declines are likely in the first half of this year as cost of living pressures continue to bite and fragile business confidence weighs on investment.

The Bank of England now sees GDP falling by 0.5 per cent in 2023, rather less gloomy than its forecast of a fall of 1.5 per cent back in November, when markets were expecting a more aggressive pace of monetary tightening. Recent growth forecasts from the IMF were in a similar ballpark, but that also leaves the UK at the bottom of the G7 growth pack. Though the outlook for all developed economies is fairly weak, as monetary tightening works through the economy and risks to growth from the Ukraine conflict remain.

Downside risks for the global economy remain, but the IMF judges these to have moderated in recent months. And emerging economies may now be past the worst. The reopening of the Chinese economy should provide a boost to GDP (growth of 5.2 per cent is forecast compared with three per cent in 2022) and India remains a further bright spot.

Indicator	Period	Value	Change	2023 Forecast*
GDP	Q3 2022	-0.3%	↓	-0.9%
CPI inflation	Dec 2022	10.5%	↓	7.4%
Unemployment rate	Nov 2022	3.7%	↔	4.6%
Average earnings	Nov 2022	6.4%	↑	4.4%
Brent crude	Dec 2022	$80.92	↓	-
$ Exchange rate	Feb 2023	$1.22	↔	-
PSNB	Dec 2022	£27.4 bn	↑	£138.1bn

Source: ONS, HM Treasury, Bank of England, EIA