UK FINANCE

MONTHLY ECONOMIC INSIGHT

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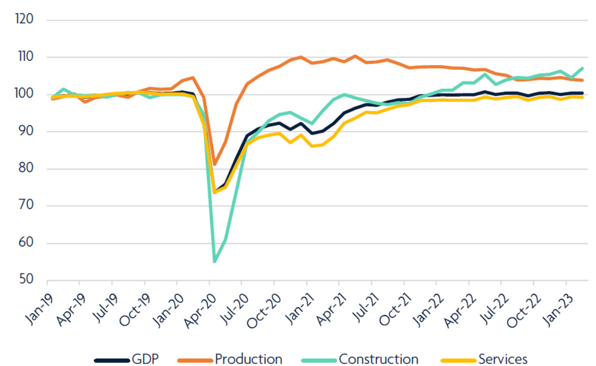
We return to inflation this month ahead of the Bank of England's next Monetary Policy Report and rate decision, as well as looking at how the key activity indicators are developing so far this year.

2023... THE STORY SO FAR

The latest monthly GDP numbers showed the UK economy was flat in February after an upwardly revised increase of 0.4 per cent in January. The three months on three months growth rate was a modest, but nevertheless positive, 0.1 per cent. The detail of the data indicated some resilience in the economy, but an uneven picture across sectors **(chart 1)**.

Starting with signs of resilience; this came primarily from the construction sector, which posted a strong recovery in February with growth of 2.4 per cent on the month after a fall in January. Better weather helped boost activity supported by an uplift in repair and maintenance, and new work – though given the downpours of March, we might expect to see this unwind in the next tranche of data.

Chart 1: Growth in GDP and main sectors, monthly index 2019=100



Source: ONS

It was more of a mixed bag across services in February. The sector, in aggregate, declined by 0.1 per cent after a solid 0.7 per cent expansion in January. Industrial action again had a role to play in the weakness of the headline number, particularly in the education sector and some civil service strikes weighing on public administration. With health, education and transport related strikes rolling into the spring, we're likely to see some continued volatility in related sectors in the months ahead.

There was better news in consumer facing services, which continue to close the, still sizeable, gap with pre-Covid-19 output levels. There was a decent 1.2 per cent growth in retail and personal services. More timely insight from the services purchasing manager's index (PMI) for March and April suggest continued momentum. April's flash index pointed to services activity rising at its fastest pace for a year.

Finally, good news relating to manufacturing has been thin on the ground of late. The official data for February showed activity was flat and the manufacturing PMI remained in contractionary territory in April, but with reports that supply chain constraints were easing.

Overall, there are some points of resilience and we can probably pencil in a small quarter on quarter expansion in GDP in Q1, but ongoing industrial action, inclement weather and another extra bank holiday will likely bear down on activity going into Q2.

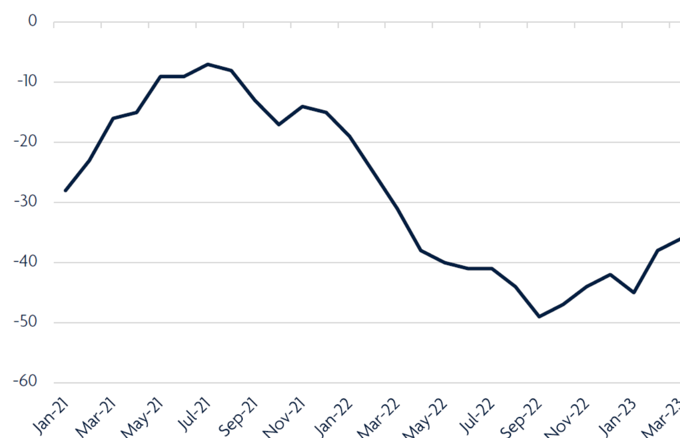
CONFIDENCE RECOVERS

Sticking with positive data movements (for now), consumer confidence continued to climb in April. The headline index gained six points to hit its highest reading, of -30, since February 2022 **(chart 2)**.

There were improvements across all components of the index. There was an eight-point increase in how consumers' see prospects for their own personal financial circumstances; a seven-point increase in the measure for the general economic situation of the country; and a six-point rise in economic expectations for the year ahead. This has contributed to the major purchase component rising to its highest level in more than a year – potentially a chink of light for retailers.

While again we see things heading in the right direction, the reality check on the confidence numbers is that current levels are still pretty close to the 2020 lockdown troughs. Consumers don't seen any more shocks to their finances on the horizon, such as the energy price hike that hit following the Ukraine conflict, but real incomes remain under pressure and for many households balancing the budget will continue to be a struggle in the months to come.... As we come to next.

Chart 2: Consumer confidence, index



Source: GfK

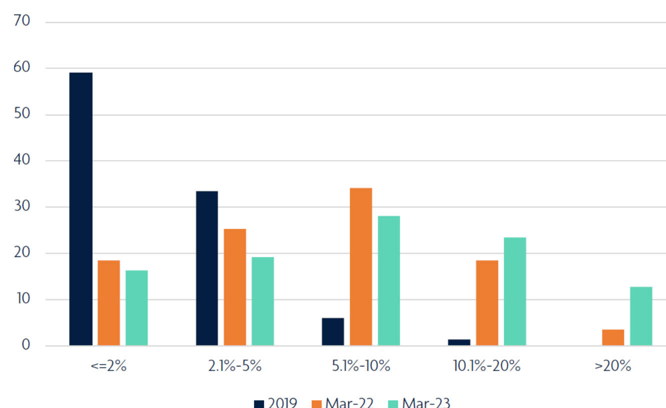
INFLATION (AGAIN)

Last month we looked at what was behind February's surprise rise in inflation to 10.4 per cent. The latest reading shows the headline rate is back down at 10.1 per cent. Good news of sorts and at least a move in the right direction, helped by price decreases in transport, particularly fuel.

There were however a number of concerning takeaways in the data – though none of them new. Food price inflation hit a 45-year high, up by over 19 per cent compared with a year ago. Increases of this magnitude across these staple elements of the CPI basket hit lower income households harder, given the greater share of disposable income spent on food, housing and energy.

However, while food and energy have been the headline culprits of high inflation over the past year, **chart 3** illustrates the now broad- based nature of rapidly accelerating prices. The chart shows the proportion of CPI categories (of which there are over 280) rising at an annual rate of less than two per cent to over 20 per cent.

Chart 3: Inflation rates across CPI basket percentage of total



Source: ONS

The latest March data shows that around one in eight items included in the CPI calculation had recorded price increases in excess of 20 per cent, up from less than five per cent a year ago and in the last year of normal (2019) this was unheard of. Notably the chart shows that double digit inflation across the basket has become more common over the past year. To a large degree these are the second round effects of rising energy and commodity prices feeding through to other goods and services. This gives some weight to concerns that inflation may be more persistent than recent forecasts assumed, and CPI may not fall as quickly back to target once last year's energy price hikes drop out of the calculation.

However, the flash PMI does point to continued easing in cost pressures for businesses. April data pointed to the slowest increase in input costs for over two years, due to lower fuel and energy prices as well as improving supply conditions.

The Bank of England will be updating its inflation and wider growth projections ahead of its May Monetary Policy Report and next MPC meeting. Many analysts had predicted that Bank Rate would peak at its current level of 4.25 per cent, but the March inflation data prompted a rethink with markets pricing in a 97 per cent chance of another quarter point rise in May.

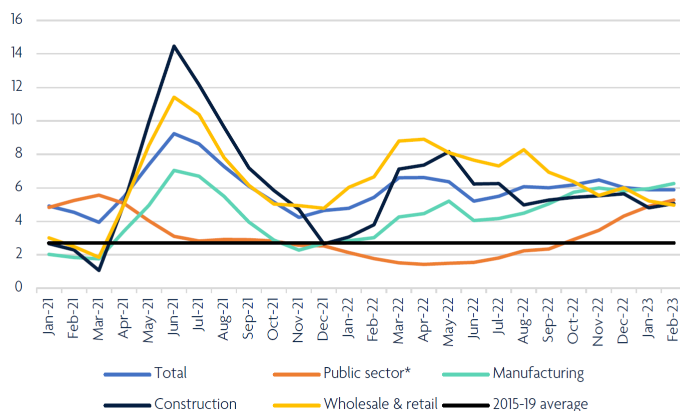
EARNINGS GROWTH

Another Bank of England concern has been further wage inflation and there isn't much to reassurance on that front in the recent numbers or surveys.

Chart 4 shows the evolution of total pay growth (including bonuses) across the economy and key sectors. Across the whole economy pay growth has been hovering at an annual rate of around six per cent since last summer. There's been some moderation in sectors such as construction and retail after some punchy wage growth in the first half of 2022 – in part driven by demand for workers and skills challenges.

While public sector pay has lagged, a key contributor to the industrial action discussed above, this has accelerated in recent months rising to 5.3 per cent in the three months to February. Wage growth across all the major economic sectors is running at more than twice the average of the five years prior to the pandemic. But this is still lagging behind inflation.

Chart 4: Total pay growth, percentage change past three months on a year ago



Source: ONS

Surveys offer little comfort that we're near the peak. For example, services PMI respondents noted strong wage growth in April, feeding through to higher output prices. And the ONS business condition survey notes that 53 per cent of businesses (excluding those with fewer than ten employees) said staff costs had risen in past three months and this rises to 58 per cent for those expecting higher costs in the next three months. There is continuing wage pressure in the accommodation and food service industry where more than three-fifths of businesses predict further increases in staffing costs, linked to persistent recruitment challenges.

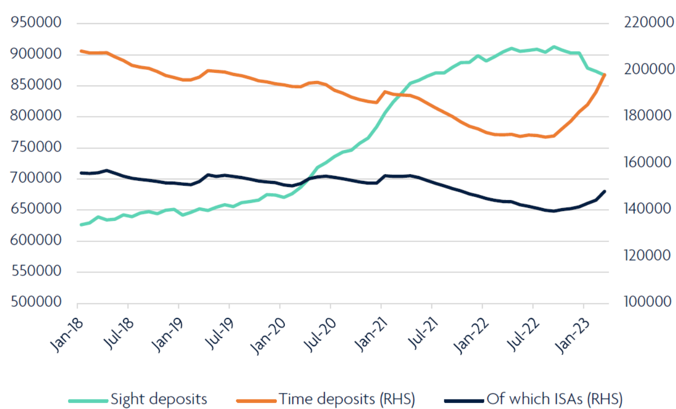
ISA SEASON?

While there is rightly much discussion about the pressure on household finances from rising inflation and falling real incomes, the other side of the balance sheet is the still substantial lump of savings accumulated during the pandemic. The last data covering Q1 shows that total deposits have been trending down since the start of the year.

As we noted in our last **Household Finance Review** the overall picture masks a continuing divergence of behaviour with some, concentrated amongst higher income households, still able to put away savings, even against the backdrop of increasing cost pressures and those now depleting them to maintain spending and meet financial obligations.

This is reflected in a growth in the stock of savings held in notice accounts. Following nearly a decade of uninterrupted decline in longer-term savings through the era of ultra-low interest rates, the Bank Rate rises through 2022, reflected in savings rates, have finally begun to attract increased demand.

Chart 5: Household savings, £ millions



Source: UK Finance

Savings rates remain below the rate of inflation, keeping real rates of return firmly negative. However, it is now possible to get a rate of return on savings that does exceed that of many customers' fixed rate mortgages, particularly those that were taken out in 2020 and 2021. This can, for some, change the equation when balancing out whether to put away spare monthly income or use it to pay down their mortgage debt.

As **chart 5** shows there has also been an upturn in savings in ISAs – not seen for a decade. As the data moves to cover the end of the financial year we expect to see a further rise is ISA deposits as some households took advantage of competitive rates on these products.

ROUND UP

The round up usually covers the main upcoming policy decisions, while the next one is the MPCs next rate decision is obviously a key one (with another rise looking likely) a more significant one for the country is (arguably) the King's coronation that comes with another exceptional Bank Holiday.

As we've seen with the late Queen's jubilee and funeral these additional holidays create come noise in the economic data. We can expect to the see the same again in GDP numbers in Q2. The impact across sectors, however, is likely to be mixed with tourism, retail and hospitality benefitting from increased activity.

Though there are plenty of industries concerned about the productivity impact of an extra's days leave, including sectors such as business services.

Evidence is mixed about the net effect on the economy. The CEBR estimated that an additional post-Covid holiday could boost the economy by around £500m, but research in Australia poopooed the idea suggesting there would be an adverse impact.

Calls for extra Bank holidays in the UK come and go – they are less generous here than in other European countries. It doesn't feel like an additional permanent one is on the cards, but I'd, nevertheless, be very much in favour!

Indicator	Period	Value	Change	2023 Forecast*
GDP	Q4 2022	0.1%	↑	-0.1%
CPI inflation	Mar 2023	10.1%	↓	6.1%
Unemployment rate	Feb 2023	3.8%	↑	4.2%
Average earnings	Feb 2023	5.9%	↔	5.0%
Brent crude	Mar 2023	$78.43	↓	-
$ Exchange rate	Mar 2023	$1.21	↔	-
PSNB	Mar 2023	£21.5 bn	↑	£136.3bn

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