

October 2024

# Monthly Economic Review

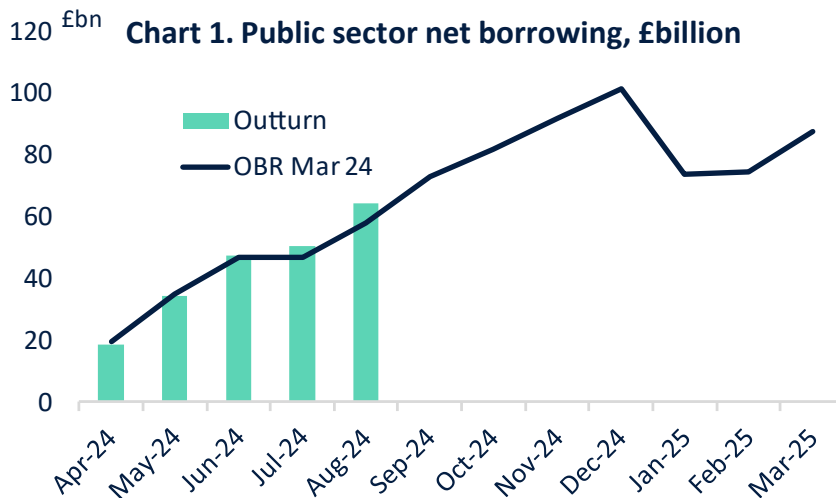


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With the new government’s first Budget scheduled for 30<sup>th</sup> October we take a look at the public finances it inherited and potential policy options. We also round up the latest central bank decisions and forecast outlook from the OECD.

## Budget backdrop

Since Labour’s election victory in July, the Chancellor and new ministers have been preparing the ground for a difficult set of Budget decisions in the upcoming October statement.



Source: ONS and OBR

Even before this the writing was on the wall, with uncertain spending plans beyond the current fiscal year and the previous Budget just scraping a pass on meeting the last

government's fiscal rules. As bodies, such as the Institute for Fiscal Studies, had warned, any new government was unlikely to find headroom for more spending without difficult tax and borrowing trade-offs.

The latest figures from the ONS (**chart 1**) show borrowing already tracking higher than the OBR's March forecast for this year. Higher borrowing so far this year has been driven by spending on public services and benefits outpacing growth in receipts. The year-to-date borrowing in 2023/24 is the third highest since comparable records began in 1983. In addition, HM Treasury analysis published in August pointed to significant in-year overspends in some departmental budgets, such as the Home Office, and higher pay awards. While some interim measures were announced to manage spending, such as the controversial changes to the winter fuel allowance, the clear message ahead of the Budget is that difficult decisions are still to come to manage borrowing and set the framework for the next spending review.

While borrowing in this financial year will likely overshoot the previous forecast, the OBR's recent *Fiscal risks and sustainability report* provides a bigger picture reality check on the public finances.

*“Public spending is at nearly 45 per cent of GDP in 2023-24 – its highest sustained level since the mid-1970s – as a result of increased spending on public services, welfare, and interest costs. To reduce the deficit and arrest the rise in debt over the next five years, the previous Government's fiscal plans were based on holding real growth in public spending below that of the economy, and the tax take increasing to 37.1 per cent of GDP, which would be its highest level since the late 1940s.”*

A month out from the Budget, the rumour mill is predictably whirring on likely policy options. One option is a change to the fiscal rules, which could create some room for manoeuvre, particularly for higher capital spending. This argument has been made by various economic organisations, including the [National Institute Economic and Social Research](#) for example, and seems like an eminently sensible first step.

The gloomy narrative on the public finances has not been without consequences. Following warnings of hard choices to come the GfK consumer sentiment index fell back sharply in September. Expectations for personal finances over the next 12 months, which has been showing signs of recovery, swung into reverse, as did the consumers' expectations for the economy. Similarly, the UK flash PMIs pointed to slowing momentum with firms across both services and manufacturing noting orders delayed with customers taking a 'wait and see' approach to decisions ahead of a clearer steer on government priorities in the Budget.

Despite all of the above, there might be some nuggets of brighter news from the OBR. It is likely to upgrade its growth forecast when it publishes updated economic projections alongside the Budget. While its previous forecast of 0.8 per cent was at

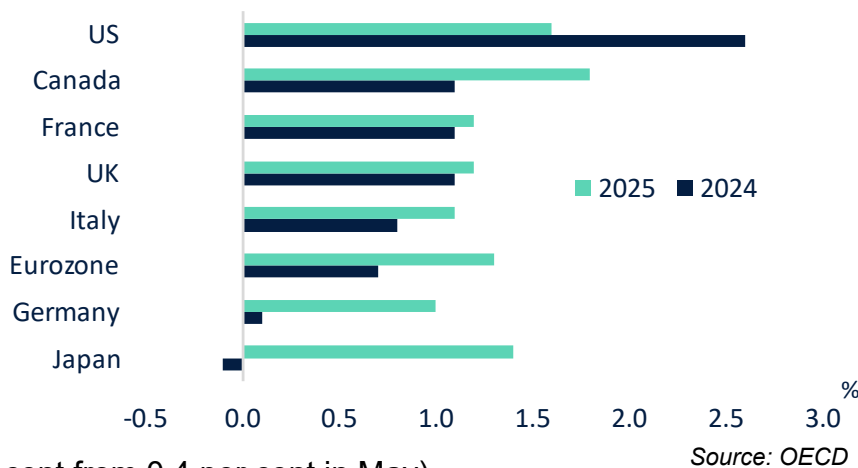
the higher end of the spectrum in March, the consensus is now 1.1 per cent GDP growth in 2023. In addition, the news on inflation and outlook for interest rates is more positive. We'll round up the OBR assessment of prospects next month.

## OECD: Turning a corner

Last month the OECD published its autumn assessment of the outlook for the global economy, encouragingly titled 'Turning a corner'. The main headlines for the global economy will be familiar to UK readers (and some themes covered in our recent briefings). Growth has been resilient this year – particularly in services, inflation is moderating, real incomes are recovering, which in turn will support household spending, and labour market pressures have eased.

Following the turbulence of recent years, this reads like a more upbeat view of current conditions than we've seen for some time. And it resulted in some upgrades, albeit

**Chart 2. G7 GDP growth forecast, percentage**



modest ones, to the growth forecast for a number of economies in 2023 (**chart 2**). World GDP is expected to be a shade higher at 3.2 per cent this year. And one of the largest upward revisions to growth this year was for the UK (to 1.1 per

cent from 0.4 per cent in May).

Inevitably, it wasn't all upside news. In the G7, growth in Germany and Japan was downgraded. We've covered Germany's economic woes in previous briefings, with consumer and business sentiment remaining in the doldrums and the large industrial sector dragging on activity. Indeed, the flash German manufacturing PMI for September, fell further into contractionary territory, posting the weakest reading in a year.

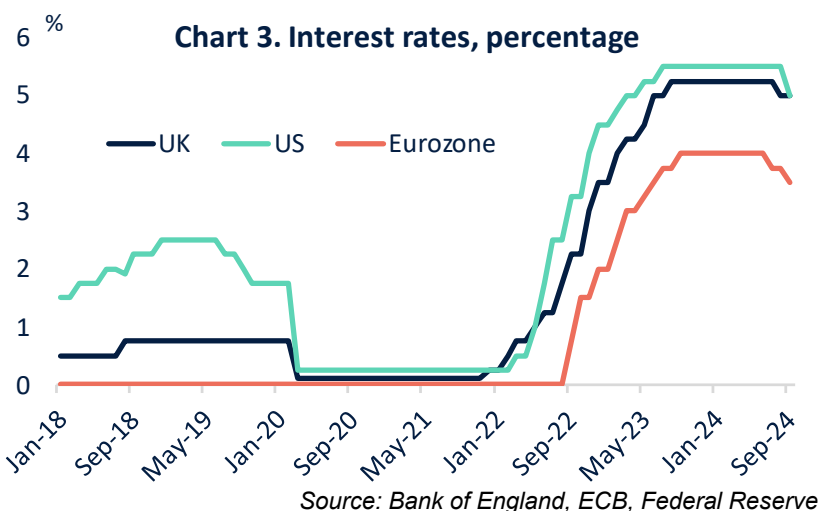
While global trade indicators were starting to look more positive earlier in the year, more recently these have softened, with the OECD suggesting that some orders for the peak sales period may have been placed earlier than normal to avoid congestion given ongoing disruptions in shipping routes.

As well as those disruptions, the OECD notes a range of further risks from persistent geopolitical and trade tensions hitting investment and raising import prices, and the

potential for financial market volatility if inflation deviates from a downward path. In light of all this the OECD also had messages for policy makers – on the fiscal side, pandemic debt burdens need to stabilise so governments can manage future shocks and meet upcoming spending priorities, and monetary policy easing should continue, but in line with the data.

## Cuts, no cuts, cuts to come

On the last of these recommendations, interest rate cuts from the main central banks are already in train. In recent months, the ECB has made two quarter-point cuts, the US Fed made the (somewhat surprising) announcement of a 50-basis point cut in September, while the Bank of England held Bank Rate at five per cent following the quarter-point cut in August (**chart 3**).



In the eurozone, the ECB's decision in September was widely expected. Inflation has continued to fall in line with forecasts, and the Bank expects a rapid decline in core inflation in the coming years. Labour market pressures are easing, and growth is subdued with the Bank predicted a slightly weaker profile for domestic demand than its June forecast. The ECB offered little guidance on the future path of rates beyond being driven by data. But since the meeting, inflation data from France, Italy, and Spain have come in much lower than expected and weaker than expected PMI readings across much of the bloc mean an October cut could be on the table.

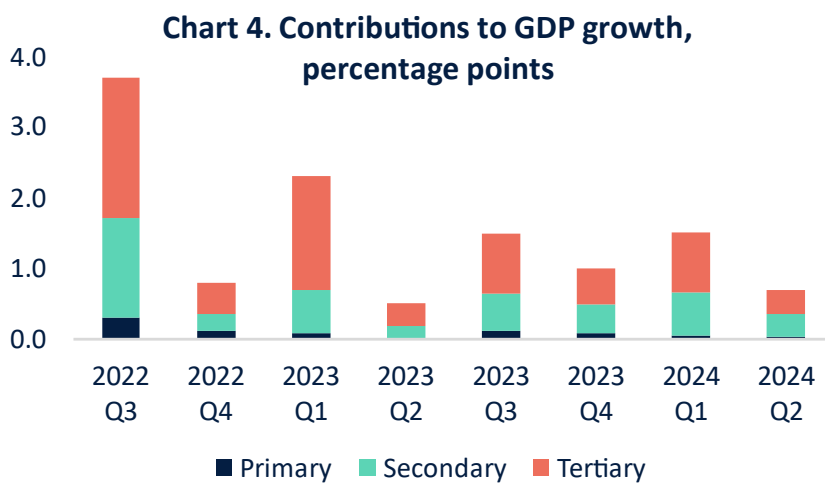
Across the pond, the Federal Reserve's 50-bp cut was a bolder than expected start to the rate-cutting cycle. Policy makers are more confident about the path of inflation, but there are also concerns about rising unemployment and the risk that poses to a soft landing. Fed forecasts signalled further cuts were likely this year, and with recent US inflation data also undershooting expectations, analysts suggest this could pave the way for a further half-point cut when the Fed meets again in November (just a few days after the election).

Finally, no change to UK interest rates in September. In short, there hadn't been any material developments since the August meeting, though some greater uncertainty

about the near-term global outlook was noted. However, one member thought the data was consistent with inflation moving sustainably back to target, subdued demand and labour market easing made the case for a further 25-bp cut in September. The Bank’s market participants survey continued to point to another quarter point cut at the next meeting in November.

## China stimulus

Seemingly not turning a corner is China. The Chinese economy has registered eight consecutive quarter of expansion, but growth in the three months to June was the



weakest in a year (chart 4). China is facing multiple headwinds from weak domestic demand, rising unemployment, ongoing challenges in the beleaguered property sector, and the impact of bad weather events.

With the economy not on course to meet the government’s five per cent growth target this year (or next), and, moreover, mounting signs that a longer-term structural slowdown may be in play, action was needed. First up, the People’s Bank of China announced a number of stimulus measures including interest rate cuts and a reduction in the reserve requirement ratio to free up new lending. Further fiscal measures are also expected to be in the offing to boost domestic demand and help local governments tackle debt problems.

Further weakness in China will continue to weigh on global activity, adding to the impact of fractious relations between China, the US and Europe. Pulling the stimulus trigger should start to help the ailing economy, but it may not be enough to get growth back on target or deal with the bigger structural adjustments the economy is undergoing.

## ICYMI and coming up...

Last month we published our quarterly [Household Finance Review](#), covering the latest developments in the mortgage market, household spending and saving, and [Business Finance Review](#), with the latest data on lending to SMEs by the main high street banks.



Applicable UK Finance members and associate members can access long run data relating to our publications via the [My UK Finance portal](#)

Coming up in October our Card spending update will be published on 16<sup>th</sup> October and Buy-to-Let lending will be updated on w/c 21<sup>st</sup> October. Find all our releases [here](#).

## Key indicators

Indicator	Period	Value	Change	2024 Forecast*
GDP	Q2 2024	0.6%	↓	1.1%
CPI inflation	Aug 2024	2.2%	↔	2.6%*
Unemployment rate	Jul 2024	4.1%	↓	4.3%*
Average earnings	Jul 2024	4.0%	↓	4.7%
Brent crude	Aug 2024	\$80.36	↓	-
\$ Exchange rate	Aug 2024	\$1.29	↑	-
Bank Rate	Sep 2024	5.0%	↔	4.7%*

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

\*Q4 2024