UK Outlook

July 2023

Economic Update

Modest growth ahead, downside risks rising

For some time now our forecasts for the UK economy for 2023/24 have been broadly unchanged, with cumulative GDP growth of roughly 1% over the two years, well below the UK's potential growth rate. While market expectations were initially more negative than ours, they have now moved broadly in line with our view. Specifically, we are pencilling in growth of 0.2% for 2023 (unchanged) and 0.8% for 2024 (reduced from 1.0%). Growth is being held back by a range of factors, including high Inflation - which is weighing on consumer spending, rising business costs and tightening monetary policy - which is weighing on investment, and adjustment to the new post-Brexit trading arrangements - which is weighing on exports. We have been expecting the large decline in energy prices to lead to a pick up in growth as we move into late 2023 and 2024, and while that remains our base case, downside risks are rising as the Bank of England pushes monetary policy into increasingly restrictive territory.

While output growth has largely stalled, developments in the labour market have been more positive. The unemployment rate has ticked up a bit lately (from 3.7% to 4.0%), but this is due to people returning to the work force following Covid rather than a decline in jobs. We expect this trend to continue with unemployment rising a bit into 2024, though in the context of still positive employment growth.

Inflation has come in above expectations in the year to date, with price pressures shifting from energy and durable goods towards services sectors. We have increased our inflation projections to 7.7% this year (7.3% prior) and 3.5% next year (3.3% prior). We expect the Bank of England to increase interest rates to 5.75% before easing a bit next year.

Several other risks are worth noting. Energy and other commodity prices could spike higher again as we approach winter. While the UK's trading partners continue to grow the IMF has signalled rising downside risks into 2024. Finally, Brexit could weigh on export growth even more than is currently assumed in our forecasts.

	2022	2023(f)	2024(f)
Consumer Spending	5.6%	0.5%	1.0%
Government Consumption	1.8%	0.0%	1.0%
Investment	8.5%	-1.0%	-0.5%
Exports	9.9%	0.0%	1.0%
Imports	13.3%	-1.0%	1.0%
GDP	4.1%	0.2%	0.8%
Employment Growth	1.0%	1.0%	0.5%
Unemployment Rate	3.7%	4.0%	4.3%
Inflation Rate	9.1%	7.7%	3.5%

Bank of Ireland

Consumer

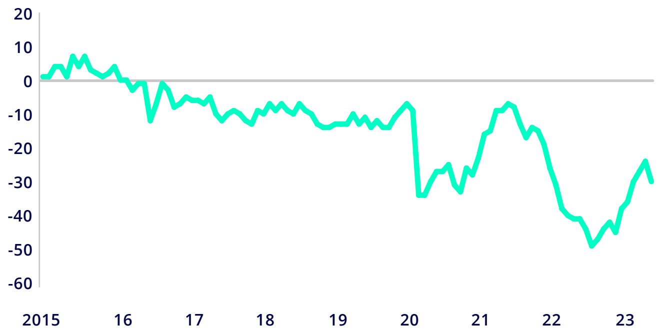
Consumer spending has picked up a bit

Although inflation has remained high, consumer spending has still managed to increase marginally over recent months, supported by quite strong wage growth (almost 7% year-on-year). Retail sales rose about 1.5% between end Q1 and end Q2 and are now broadly in line with pre-Covid levels. A reduction in the household savings rate has also played a role in supporting consumption, though at just under 9% it remains higher than before the pandemic (around 5.5%).

Retail Sales Volume (2019=100)
Source: ONS, Bank of Ireland

Continued moderate growth likely

A number of factors should support a modest increase in household consumption this year and next, despite still soft consumer confidence. With inflation easing back, driven by lower energy prices in particular, household disposable income growth should again outpace inflation – though only slightly. Furthermore, there is scope for households to reduce their savings rate further. As such we expect consumer spending to rise by about 0.5% this year, with growth picking up to 1.0% in 2024.

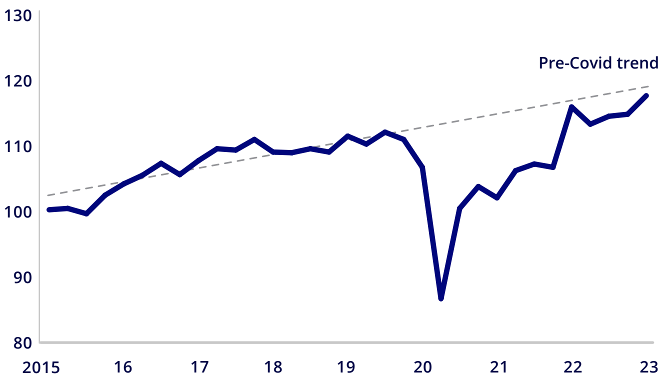


Consumer Confidence (net balance)
Source: GfK

Investment and Trade

Capital spending to soften

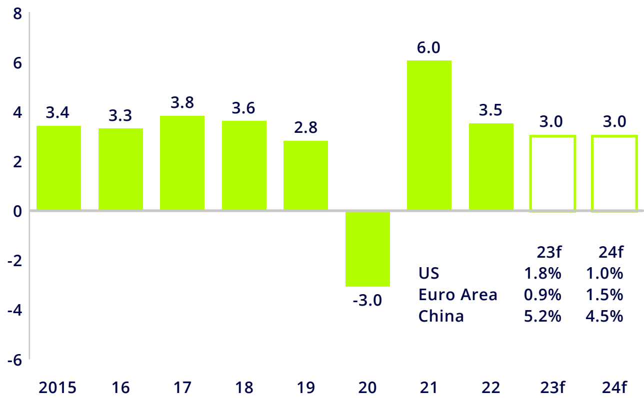
Investment performed fairly well in Q1, up around 2.5% quarter-on-quarter, supported by robust increases in government and business investment – though house building was down. Relative to peer economies the post-Covid rebound in investment in the UK has actually been fairly solid. However, the environment going forward is challenging - weak growth, high costs and higher interest rates are all likely to weigh, though as of now the Bank of England's investment intentions survey is not showing any sharp deterioration. We expect investment to decline slightly this year and next, with housing investment in particular retrenching.



UK Investment (Q1 2015=100)
Source: ONS, Bank of Ireland

Continued lacklustre export growth

Trade has had a weak opening to the year, with exports down in Q1, while leading indicators for Q2 are not much better, as Brexit continues to exert a negative effect. The IMF's latest forecasts for global growth were left broadly unchanged – the Fund continues to expect marginally below trend growth for the global economy and for the UK's main trading partners, though it did signal that downside risks to growth are rising. Against this background we expect a continued fairly subdued export performance, with negligible growth this year before a modest pick up next year.

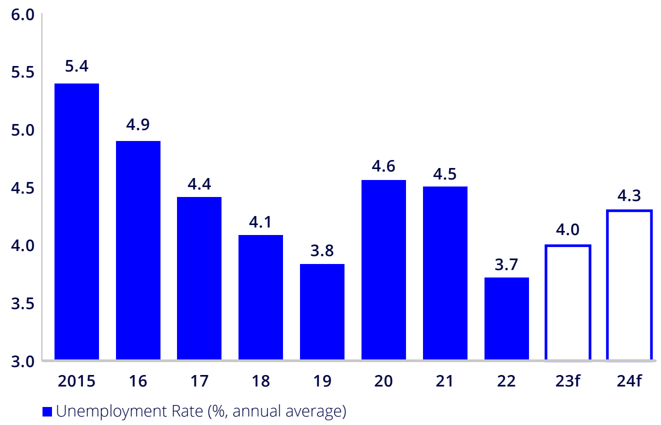


Global GDP (annual % change)
Source: IMF

Labour Market & Inflation

Solid labour market performance

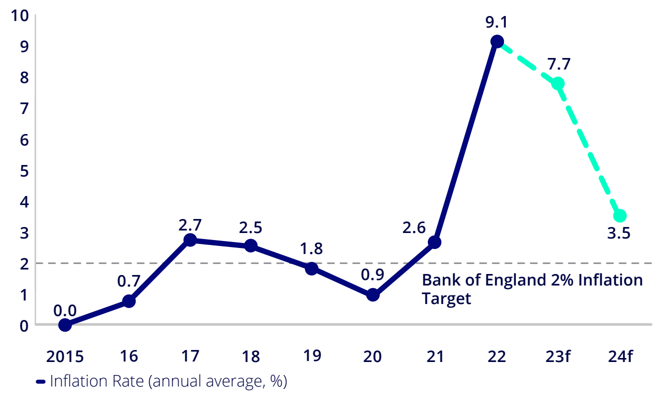
Over recent months the unemployment rate has increased slightly, to 4.0% in the March-May period from 3.7% at the end of last year. However, this largely reflects a pick up in labour force participation as people return to the work force following the pandemic - employment growth has actually remained solid. As such, overall the labour market remains fairly tight and this is reflected in the data on wages, with total pay up just under 7% year-on-year in March-May. We expect these trends to continue, with unemployment ticking up this year, while wage growth remains high, though moderating.



Source: ONS & Bank of Ireland

Inflation pressures still elevated

Inflation has surprised on the upside over recent months, albeit with some tentative signs of an easing of pressures in the latest data. Specifically, headline CPI inflation was 7.9% in June, with core at 6.9%, both down a bit from May, but clearly well above the Bank of England's 2% inflation target. Inflation pressures have now rotated from goods sectors (aided by the sharp fall in energy prices) towards services sectors. Inflation is likely to decline gradually going forward, though any renewed rise in energy prices before inflation moves decisively lower represents a significant risk.

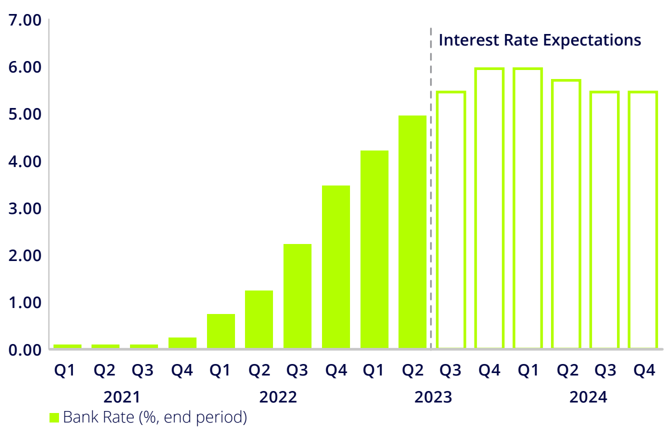


Source: ONS & Bank of Ireland

Policy and Markets

Monetary policy now restrictive

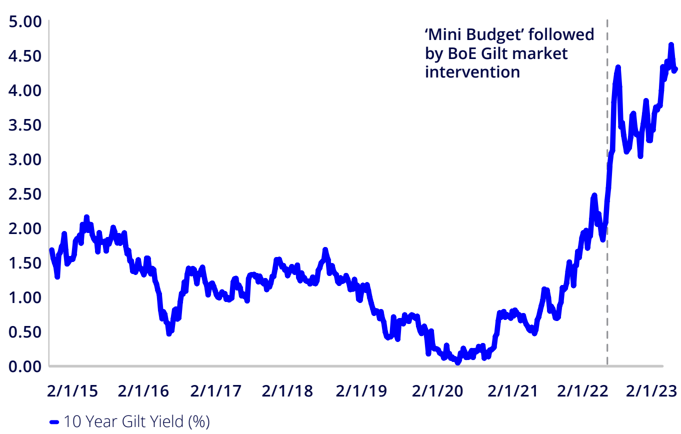
Responding to elevated inflation pressures the Bank of England has tightened by more than we, or the market, expected at the start of the year – and further increases are anticipated. The policy rate has been hiked up to 5.00%, with markets pricing in a peak rate of 5.75% or 6.00% later this year - before some modest cuts next year. After its most recent monetary policy decision the Bank indicated it retains a cautious stance, noting that "if there were to be evidence of more persistent pressures, then further tightening... would be required".



Source: Bloomberg

Borrowing costs rise

Reflecting the rise in expectations for monetary policy tightening the UK 10-year Gilt yield has increased materially over the past couple of months and is now at the levels reached following the 'Mini Budget' last year. On the exchange rate front sterling has appreciated versus the dollar and now stands a bit below $1.30, while it remains largely range bound versus the euro (at c. 86p). UK natural gas prices have ticked up a bit lately though they remain well below the levels seen earlier this year and in 2022. Brent crude oil prices are also up somewhat lately.



Source: Bloomberg

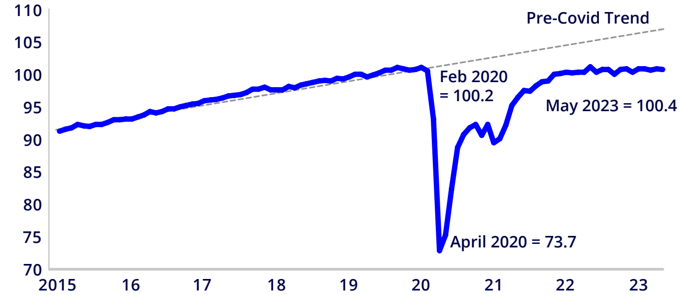
Outlook

GDP inching higher

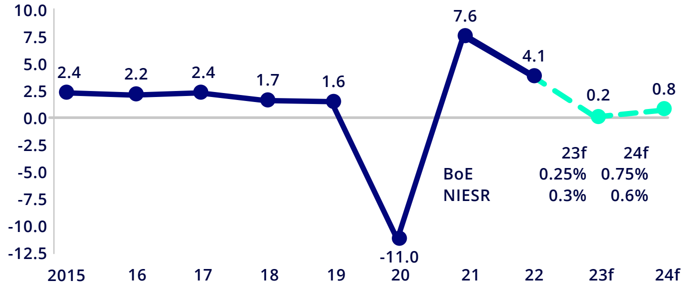
As we noted in previous outlooks, GDP growth largely stalled once the rebound from Covid had petered out towards the end of 2021. This largely remains the case, though activity is now likely expanding at a very modest pace of perhaps 0.1% quarter-on-quarter. Growth continues to be weighed down by a range of factors including high inflation, which has weighted on household spending, tightening monetary policy, and the negative effects of the new post Brexit trading arrangements on exports.

Modest growth ahead, risks are rising

We expect a continuation of the recent trend of modest growth over the balance of this year, yielding a growth rate for the year as a whole of between 0% and 0.5%. Largely reflecting easing inflationary pressures – in turn due to lower energy prices – we expect slightly better, though still below trend growth next year in the 0.5% to 1.0% range. However, the risks to next year have risen recently due to the Bank of England shifting monetary policy into increasingly restrictive territory. As such, it would not take much to tip the economy back into contraction territory – such as, for example, a renewed rise in energy prices as winter approaches.



Source: ONS, Bank of Ireland

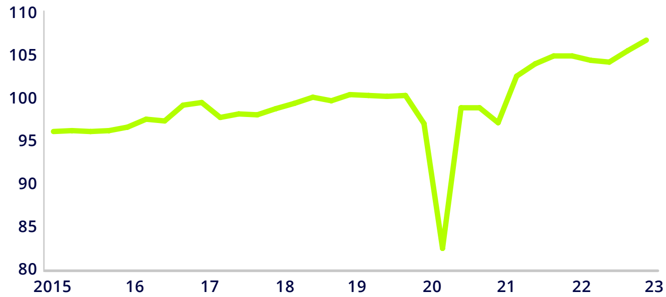


Source: ONS & Bank of Ireland

Northern Ireland

Solid growth amidst political uncertainty

The Northern Ireland economy, as measured by the Composite Economic Indicator, expanded by 1.1% quarter-on-quarter in Q1, leaving economic activity just over 6% above pre-Covid levels. Furthermore, the economy is creating jobs and unemployment remains low. However, risks remain on the political front – the lack of a power-sharing Executive is having a negative impact on consumer and business sentiment and could lead to sharp cuts in public spending if unresolved, which would clearly have a dampening impact on growth.



Source: NISRA

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