UK Outlook

May 2023

Economic Update

Sluggish growth, elevated inflation

Since our last set of forecasts, at the end of February, the UK economy has continued to be characterised by weak growth and elevated inflation. Preliminary data indicates GDP was up 0.1% quarter-on-quarter in Q1, while high frequency indicators such as the PMIs point to something similar in Q2. The labour market remains tight, though unemployment has risen marginally. Recent inflation readings have surprised on the upside, particularly core inflation.

Turning to the outlook, in the near term we continue to expect more of the same when it comes to growth – activity may expand marginally in coming quarters, with GDP for the year as a whole up perhaps 0.2% (revised up from 0% previously). The large decline in wholesale energy prices is a positive for the economy, as is modestly supportive fiscal policy, and these factors should support a pick-up in growth to 1.0% next year (unchanged).

However, while we continue to expect inflation to decline over the coming year, due to the fall in energy prices, stronger than expected price pressures in a range of other sectors have forced us to push up our inflation projections somewhat - to 7.3% for this year (6.5% prior) and 3.3% next year (3.0% prior). The labour market is likely to remain fairly tight, though unemployment may drift marginally higher over time as some workers return to the workforce. With inflation well above target and unemployment low, the Bank of England is likely to hike rates to a peak of 5.00% later in 2023, before easing in 2024.

There are still no shortage of risks to the outlook. With the Russia-Ukraine war ongoing the threat of renewed spikes in energy and other commodity prices remains, as do risks in relation to the lagged effect of monetary tightening. Risks related to the global financial system have increased on foot of strains in the US banking system. However, the successful negotiation of the Windsor Agreement is a positive development – though the longer term hit to the economy from Brexit remains largely unchanged.

	2022	2023(f)	2024(f)
GDP	4.1%	0.2%	1.0%
Employment Growth	1.0%	0.7%	0.5%
Unemployment Rate	3.7%	3.9%	4.1%
Inflation Rate	9.1%	7.3%	3.3%

Bank of Ireland

Consumer and Business

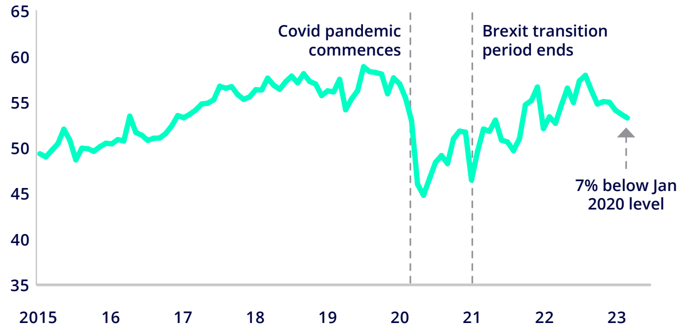
Subdued consumer spending

Consumer spending has continued to be squeezed by sharp increases in the cost of living. Household consumption was flat in quarter-on-quarter terms in Q1 according to preliminary national accounts data, though retail sales were up 0.8% in the three months to April. Consumer confidence has improved over recent months on foot of signs inflation is peaking, still low unemployment and supportive fiscal policy measures. This points to a recovery in consumer demand in the second half of this year – albeit it is likely to be a modest one.

Consumer Confidence (net balance)
Source: GfK

Headwinds for investment and exports

The first estimate for GDP in Q1 points to modest growth in business investment (+0.7% quarter-on-quarter). Exports however did not fare as well – trade volumes (excluding precious metals) were down in Q1 and remain well below pre-Covid levels. Both investment and exports are facing headwinds which will weigh on growth over coming quarters – including high interest rates, cost pressures, an increase in the corporate tax rate to 25% and the ongoing adjustment to the new post-Brexit trading regime.

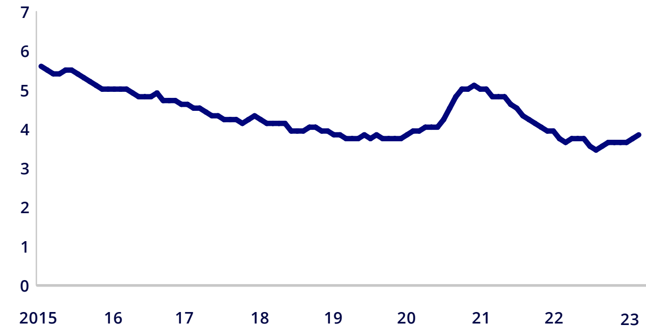


Exports Excluding Precious Metals (£, billions)
Source: ONS

Labour Market and Inflation

Unemployment remains low

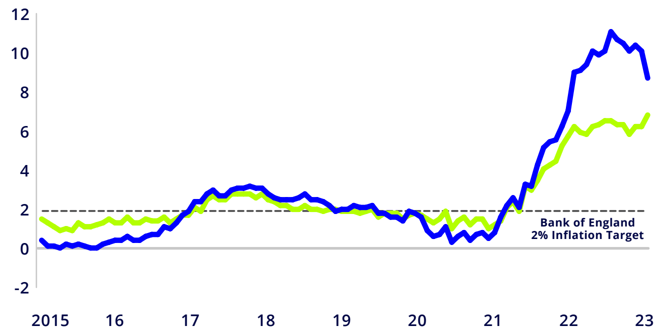
The performance of the labour market has remained resilient in the face of high inflation and sluggish output growth, though unemployment has ticked up slightly over recent months, from a low of 3.5% last summer to 3.9% now. This largely reflects a pick up in labour supply while employment growth has been steady. Wage growth remains elevated – at over 6% year-on-year - as workers attempt to claw back some of the decline in their real (i.e. inflation adjusted) pay packets.



Unemployment Rate (%)
Source: ONS

Inflation pressures still elevated

Inflation has surprised on the upside over recent months - headline inflation was 8.7% in April, with core inflation at a multi decade high of 6.8%. Price pressures in a range of categories such as food, durable goods and services (entertainment, hospitality) remain acute, somewhat offsetting the pull back in energy prices. While inflation is likely to decline over the balance of the year, as the sharp drop in wholesale gas prices feeds through into household bills, there are upside risks as it has proven more persistent than many – including the Bank of England – had hoped.

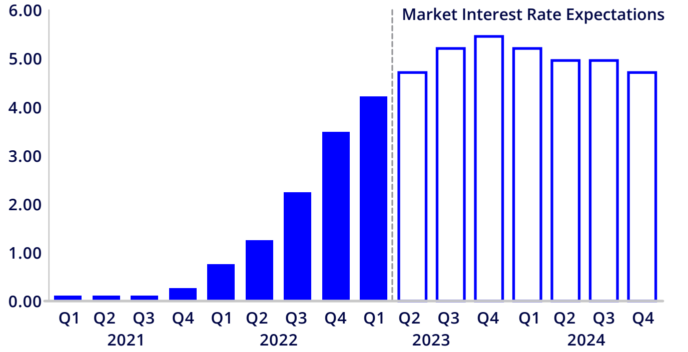


Headline CPI Inflation (%, year-over-year)
Core CPI Inflation (ex-energy, food, alcohol, tobacco)
Source: ONS

Monetary Policy and Markets

Tighter monetary policy in prospect

Still high inflation and strong wage growth is clearly likely to be a concern for the Bank of England. The market is now pricing in a peak for Bank Rate of either 5.25% or 5.50% later this year. We expect two more 25bp hikes, with rates peaking at 5.00%, with some scope for a few cuts in the second half of next year as inflation pressures ease. Reflecting this rise in interest rate expectations 10-year gilt yields have climbed and are now approaching the levels seen late last year following the 'mini-budget'. Sterling has been fairly steady versus the dollar and euro lately.



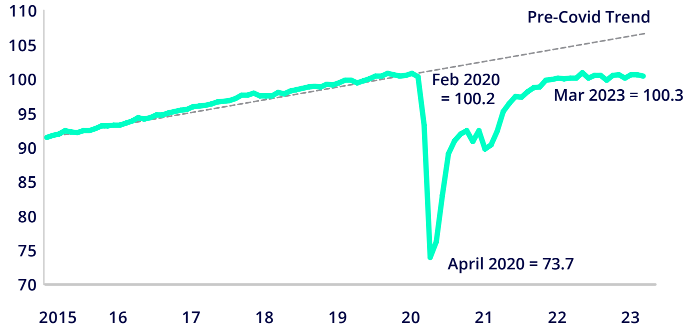
■ Bank Rate (%, end period)

Source: Bloomberg

Growth Outlook

Economic activity flatlining

UK GDP has continued to move sideways over recent months, with early indications suggesting GDP was up a marginal 0.1% quarter-on-quarter in Q1. High inflation and interest rates, and adjustment to the new post-Brexit trading arrangements have continued to weigh on economic activity. Output is now more or less back to pre-Covid levels, a weaker performance than either the US or the Eurozone (though some individual Eurozone countries – notably Germany – have registered similarly subdued performances).

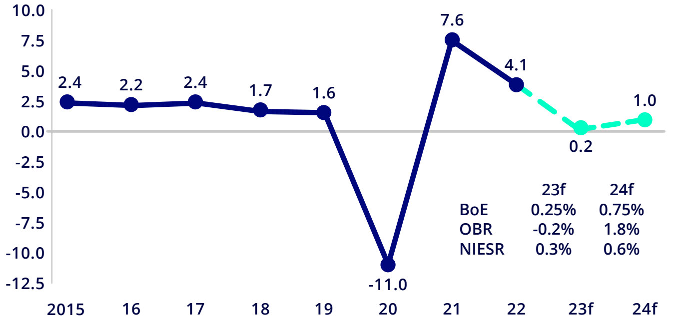


- GDP (Monthly Index)

Source: ONS, Bank of Ireland

Growth to pick up

While growth has been sluggish of late, we continue to expect a moderate pick up over the balance of the year and into 2024. Lower energy prices and fiscal policy measures should boost household spending power and reduce business costs, supporting a gradual pick-up in economic activity. Nonetheless, with businesses and consumers facing a range of challenges, growth is still likely to be modest. We are forecasting that GDP will increase by 0.2% this year and 1.0% (still slightly below trend) next year.



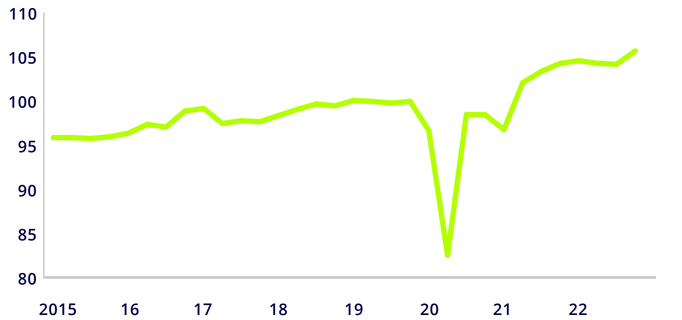
- GDP (annual % change)

Source: ONS & Bank of Ireland

Northern Ireland

Solid growth, but political challenges remain

The Northern Ireland economy has continued to perform solidly over recent months, with unemployment remaining low and the PMIs signalling ongoing growth. However, political challenges remain and there is still no government in place – this presents risks going forward, in particular in relation to the curtailment of public current and capital spending plans.



- Composite Economic Index (2019=100)

Source: NISRA

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