UK Outlook

October 2023

Economic Update

Subdued growth, rising geopolitical risks

Since our last set of forecasts in July, revisions by the Office for National Statistics indicate that the UK economy has performed better over the past 18 months than was previously thought. Ironically, this has occurred at the same time as the high frequency data, such as the PMIs, has weakened. Following GDP growth of 0.5% over the course of the first half of this year (0.3% in Q1, 0.2% in Q2), it looks as if economic activity has probably been flat at best, if not down slightly, over recent months, as the full effects of the Bank of England's monetary policy tightening hit the economy.

Turning to the outlook, we expect the current soft patch to persist for the rest of the year – with full year GDP growth of 0.5% for 2023. We expect a moderate expansion to resume early next year, led by consumer spending. However, tight monetary policy, weak trading partner growth and the after-effects of Brexit mean that the outlook for investment and exports is quite weak, and this will weigh on overall activity. We are forecasting GDP growth of 0.7% for 2024 (versus 0.8% previously).

The labour market has loosened a bit over recent months, and this process is likely to continue – we expect unemployment to rise to 4.6% next year. Inflation is likely to continue to ease steadily - averaging 7.5% in 2023 and 3.5% in 2024 - as the full effects of the large decline in wholesale gas prices continues to feed through, accompanied by declining food price inflation and, eventually, an easing of services sector inflation. However, inflation remains well above the 2% target and there is clearly a risk that it does not drop back as quickly as hoped. As such, we expect the Bank of England to hike one more time, taking the policy rate to 5.50%.

Downside risks have risen lately, particularly on the geopolitical front - the Russia-Ukraine war is ongoing, tensions between the US and China are rising, and conflict has escalated in the Middle East. Other risks include the possibility that the lagged impact of monetary tightening slows growth by more than expected, while stresses in the global financial system could flare up again.

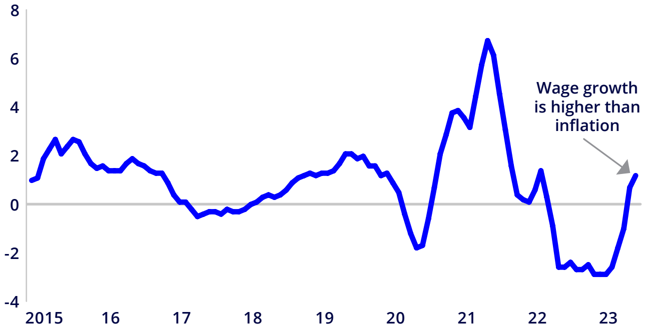
	2022	2023(f)	2024(f)
Consumer Spending	5.2%	0.5%	0.7%
Government Consumption	2.5%	0.0%	1.0%
Investment	8.0%	1.5%	-1.5%
Exports	8.6%	2.0%	0.5%
Imports	14.1%	0.7%	1.0%
GDP	4.3%	0.5%	0.7%
Employment Growth	1.0%	0.6%	0.4%
Unemployment Rate	3.7%	4.2%	4.6%
Inflation Rate	9.1%	7.5%	3.5%

Bank of Ireland

Consumer and Business

Resilient consumer spending

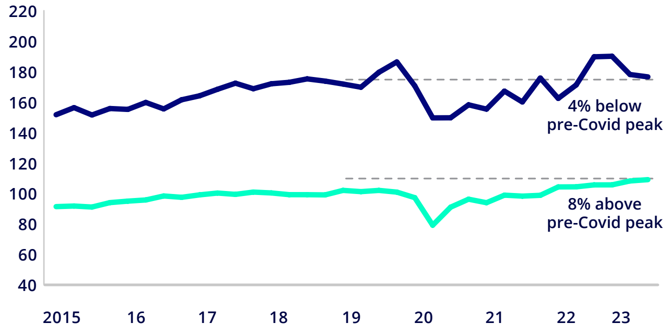
Recent data indicates that consumer spending has held up better in the face of elevated inflation than was previously thought, likely reflecting robust wage growth and the drawdown of some of the savings accumulated by households during Covid. Consumption expanded by 0.7% quarter-on-quarter in Q1, and 0.5% in Q2. Moderate growth in consumer spending over the balance of this year and into next seems likely. Solid disposable income growth - with wage growth ahead of inflation - and a pick-up in consumer confidence will be supportive, but other factors such as higher mortgage rates will be a drag on spending.



Real Wage Growth (%, year-over-year, adjusted for inflation)
Source: ONS

Weak outlook for investment and exports

Business investment has been stronger than expected over recent quarters, with solid growth in H1, though housing investment has weakened. Export growth has been volatile, but has softened notably in recent months. Both investment and exports are facing headwinds which will weigh on growth in 2024 – including high interest rates, a weaker housing market, cost pressures, a higher corporate tax rate, and the ongoing adjustment to Brexit. In addition, growth in the UK's major trading partners, particularly in Europe, is likely to be subdued.

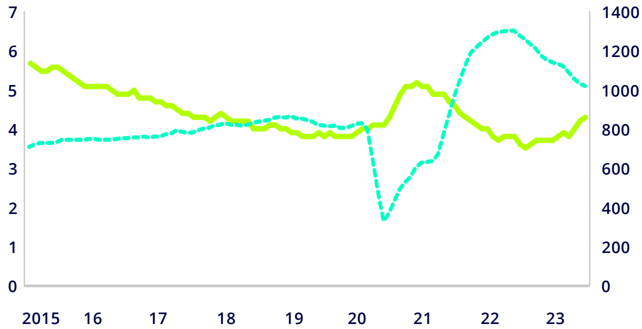


Investment (£, billions, constant prices) Exports
Source: ONS

Labour Market and Inflation

Labour market loosening

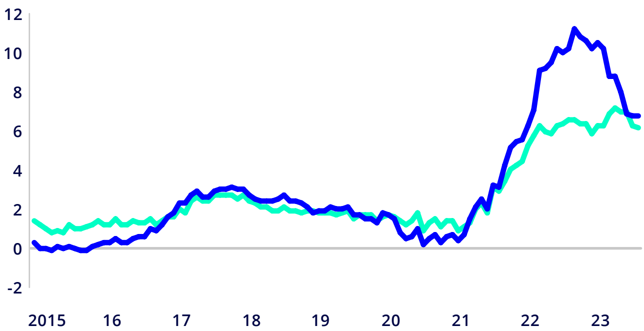
While the labour market remains tight, evidenced by still rapid wage growth, there are indications that it is loosening in the face of the Bank of England's monetary tightening. Unemployment has risen since the start of the year, while the number of vacancies has declined (though it still remains above its long run average). We expect this trend to continue with unemployment rising a bit further before stabilising at about 4.6%. Wage growth looks set to decline, though to what extent remains to be seen – it needs to fall quite sharply to reassure the Bank of England that wage dynamics are consistent with the 2% inflation target.



Unemployment Rate (LHS, %) Vacancies (RHS, '000)
Source: ONS

Inflation high but declining

Inflation has eased a bit over recent months. Headline CPI came in at 6.7% in September, unchanged from August but down from an average of 8.5% in Q2 as the reduction in the household energy price cap has fed through to lower energy bills. Core inflation eased slightly in September, though it remains quite high. We expect inflation to continue to moderate, though it will likely remain above the 2% inflation target throughout most of 2024 - averaging about 3.5% for the year as a whole - due to elevated wage inflation which is placing upward pressure on services sector prices in particular. Any renewed spike in oil or gas prices this winter is an obvious risk.

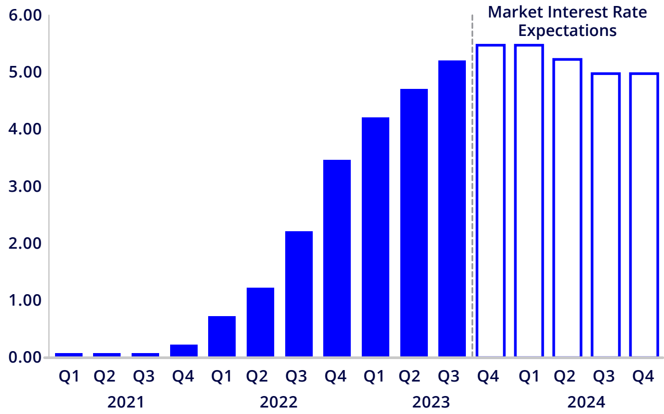


Headline CPI Inflation (%, year-over-year) Core CPI Inflation
Source: ONS

Monetary Policy and Markets

Tightening cycle nears its end

The Bank of England surprised the market at its most recent meeting, leaving the policy rate unchanged at 5.25%. The decision was close (5 votes to 4), but the MPC clearly concluded that, with growth weakening and inflation declining, it was appropriate to go on hold for now. However, the committee also clearly noted that significant risks remain, particularly given still strong wage growth. The market is now pricing in a roughly 60% chance of one further hike. We expect that one more 25bp increase will ultimately be needed. 10-year Gilt yields have climbed over the past 6 months, in line with bond yields globally, though they are off recent highs. Sterling has weakened versus the dollar of late, but held fairly steady versus the euro.

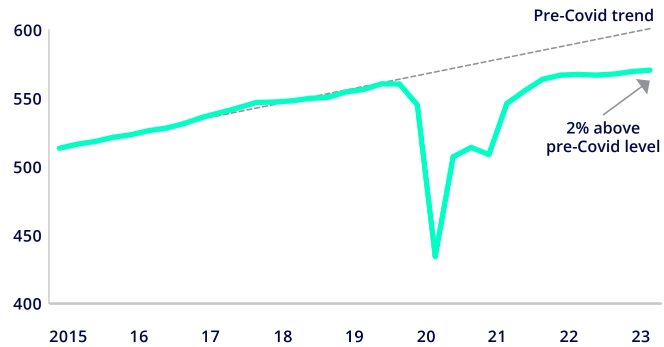


■ Bank Rate (%, end period)
Source: Bloomberg

Growth Outlook

Growth stalls

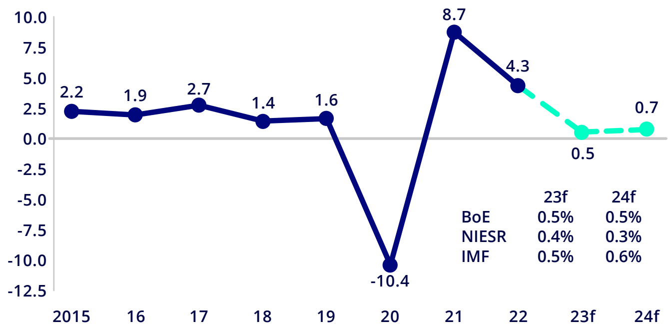
New data from the Office for National Statistics indicates that UK economic performance has been a bit better than previously thought over the past couple of years. GDP is now estimated to have expanded by 0.3% quarter-on-quarter in Q1 (vs 0.1% previously) and 0.2% in Q2, while revisions to 2021 and 2022 mean that output is now estimated to be roughly 2% above pre-Covid levels, instead of marginally below. However, recent high frequency data has been soft, with the Composite PMI coming in below 50 in both August and September, indicating that economic activity has probably been flat at best, if not down slightly, over recent months.



- GDP (£, billions, constant prices)
Source: ONS

Subdued outlook, downside risks

Our macroeconomic outlook has not changed much since our July publication. We expect GDP growth of roughly 0.5% this year (revised from 0.2%) on foot of the better outturn in H1, while growth in H2 is assumed to be close to zero. Moving into next year we expect growth to resume, though it will remain soft. Although declining inflation will support a pick-up in consumer spending, it is likely to be modest. Meanwhile tight monetary policy will weigh on investment, while weak trading partner growth, and the effects of Brexit, will negatively impact exports. We are pencilling in GDP growth of 0.7% for the year as a whole (revised down slightly from 0.8%), well below the UK's potential growth rate of around 1.5%. Furthermore, downside risks, particularly related to geopolitics, have risen of late.

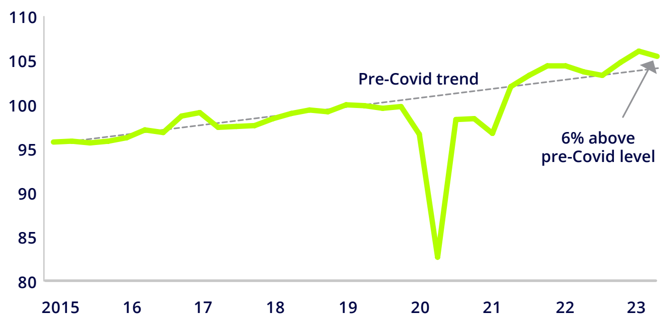


- GDP (annual % change)
Source: ONS & Bank of Ireland

Northern Ireland

Weakening outlook, political challenges

The economic data has weakened somewhat over recent months following a solid performance in the first half of the year – the Composite PMI dropped to 45.9 in September, with all four sectors (industry, services, construction and retail) now well below the 50 level that separates expansion from contraction, pointing to a broad based decline in economic activity. This may be partly due to the ongoing political deadlock, which is dampening consumer and business confidence and leading to a curtailment of public spending with spill-over effects to the rest of the economy.



- Composite Economic Index (2019=100)
Source: NISRA

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