Economic Research

August 2021

Market Monitor – United Kingdom

Lockdown Easing vs Spread Of Delta Variant

UK economic recovery momentum fading

The UK economy has improved with lockdown easing. GDP was up 3.6% in March-May from the previous 3-month period, the largest growth since November 2020. However, in month-on-month terms, growth slowed to 0.8% in May, down from April's 2.0% and below the market expectation of 1.5%.

Nevertheless, the labour market remains tight, thanks to the reopening of non-essential retailers and the hospitality sector. The number of payrolled employees jumped by 356,000 monthly in June, the largest increase since records began. Wages (excluding bonuses) also saw a historically high growth of 6.6% in May.

Economic growth hinges on whether impact of lockdown easing can offset that of the delta variant

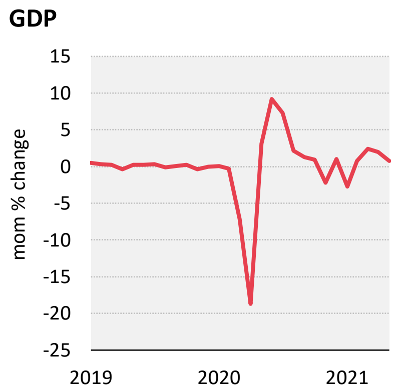
In the coming months, economic performance will greatly depend on the success of lockdown easing. The UK government has withdrawn all lockdown measures on 19th July. Mask wearing is now recommended but no longer required, while nightclubs have been allowed to reopen. This has been enabled by the country's massive vaccination drive. As of 31st July, 69% of the UK population has been inoculated with at least one dose, while about 56% were fully vaccinated. Withdrawing all movement restrictions is expected to boost consumer spending and investment in the third quarter.

Yet, the final stage of reopening came amid the rampant spread of the delta variant. This has clouded the economic outlook, as newly confirmed cases kept surging. The 7-day rolling average of new cases reached a new peak of over 47,000 in mid-July, the highest since mid-January, before dipping again towards the end of the month. If the ongoing pandemic cannot be kept under control in the near term, the government may need to

Economic outlook hinges on lockdown easing and rate of confirmed cases.

Despite rising inflation and lockdown easing, the Bank of England is expected to keep the Bank rate unchanged due to the delta variant and the end of the furlough scheme.

Home price growth expected to moderate following the scaling down of tax breaks and the end of the furlough scheme.



Source: Bloomberg, data as of 31/7/2021

re-impose movement restrictions, which will derail economic recovery.

Mixed views at Bank of England's monetary policy committee

The full reopening of the economy will also alter the stance of the Bank of England (BoE), as inflation may start to rise. The BoE has been stating that the current inflationary pressure is temporary. However, the recent spike in inflation, which reached 2.5% in June and exceeded the BoE's expectation, has turned some interest rate policy makers more hawkish. The BoE's governor Andrew Bailey indicated in mid-July that the BoE will assess whether the current inflationary pressure is transitory. Two more Mon etary Policy Committee (MPC) members considered that the BoE may need to end the monetary stimulus that was implemented earlier.

That said, in view of the fact that economic recovery may be dragged down by the spread of the delta variant, some MPC members opted to maintain the current stimulus. The end of the furlough scheme at end-September adds a further downside risk. Jonathan Haskel, one of the BoE rate setters, said it is too early to tighten monetary policy.

Thus, the BoE kept the Bank Rate at 0.10% at its August meeting, while holding the asset purchasing programme at £895 billion. At this meeting, the BoE also released its latest forecast for GDP and inflation. While the GDP growth projection in 2021 was unchanged at 7.25%, BoE expected that the inflation would rise to 4% during the year, up from previous projection of 2.5%.

Housing market supported by policies and changing preferences

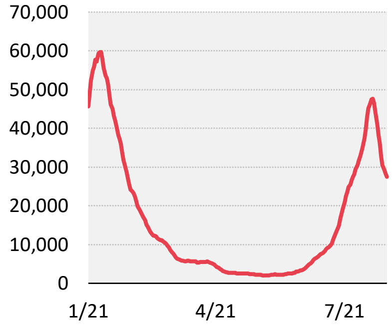
The Nationwide housing price index dropped by 0.5% month-on-month in July, compared to the 0.7% increase in the previous month. It rose 10.5% year-on-year. The market was cooled, after a surge in activity in June, as the rush to move home before the tapering of the stamp duty holiday began to fade.

In the coming months, the housing market will continue to be supported by a preference for more spacious properties and their limited supply. Nevertheless, housing price growth is expected to moderate in the second half of the year following the scaling back of the tax break and the end of the furlough scheme.

Muted gains in financial markets as investors remain undecided about lockdown easing and virus spread

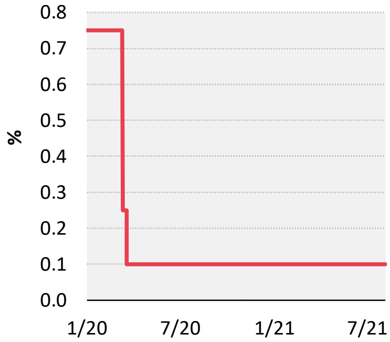
In the stock market, the FTSE 100 Index dropped 0.1% between end-June and end-July. Although the lockdown measures have been eased, the market is concerned about the recent surge of infections. The worse-than-expected monthly economic growth also weighed on market sentiment.

7-day rolling average of daily new cases



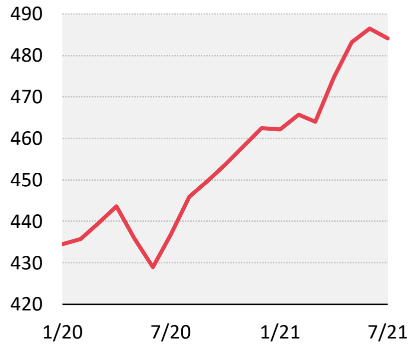
Source: UK Government, data as of 31/7/2021

Bank Rate



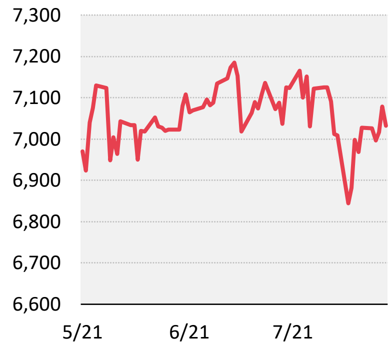
Source: Bloomberg, data as of 5/8/2021

Nationwide housing price index



Source: Nationwide Building Society, data as of 5/8/2021

FTSE 100 Index



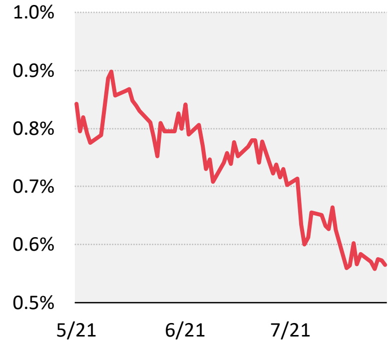
Source: Bloomberg, data as of 31/7/2021

In the bond market, the 10-year UK government bond yield dropped 15 basis points during end-June to end-July. Despite a surge in inflation, investors have become more risk averse in light of a rapid global surge of new delta variant cases. This fuelled demand for bonds and dragged down bond yields.

In the foreign exchange market, the pound appreciated by 0.4% against the euro between end-June and end-July. The pound has benefitted from the lockdown easing and the fact that some BoE members have turned more hawkish. Meanwhile, as the US dollar turned weaker amid the US Federal Reserve's dovish stance, the pound appreciated 0.5% against the US dollar.

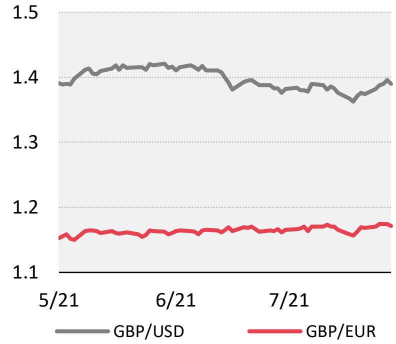
Looking ahead, the UK financial markets face a potential drag from the continual surge in Covid-19 cases and the end of furlough scheme. In the meantime, the stance of BoE policy makers will dictate the pound's performance. The rate-hike course of the US Federal Reserve will also affect the pound's outlook.

UK 10-year Government Bond Yield



Source: Bloomberg, data as of 31/7/2021

British Pound Exchange Rate



Source: Bloomberg, data as of 31/7/2021

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