

Market Monitor – United Kingdom

UK Regains Growth Momentum in Q2 2021



UK economy further improves in second quarter

With lockdown measures gradually lifted, the UK economy saw further improvement in Q2 2021, with GDP growing at 4.8% quarter-on-quarter, compared to a 1.6% contraction in the previous quarter. Household consumption rose by 7.3% during the quarter, mainly reflecting the easing of Covid-19 restrictions. The largest contributions were from spending on hotels and restaurants and on transport, areas which performed strongly with the reopening of the economy. In the meantime, business investment increased by 2.4% in Q2 2021, improving from a 10.7% drop in previous quarter. On a year-on-year basis, UK GDP grew 22.2% in Q2 2021.

Meanwhile, the consumer price index (CPI) was up 2.0% year-on-year in July, easing from the 2.5% in the previous month. The core CPI also edged down from the 2.3% in June to 1.8% in July. The slower CPI growth in July was mainly attributable to the base effects linked to the first easing of lockdown conditions last year.

Rapid spread of Delta variant poses uncertainty for recovery trajectory

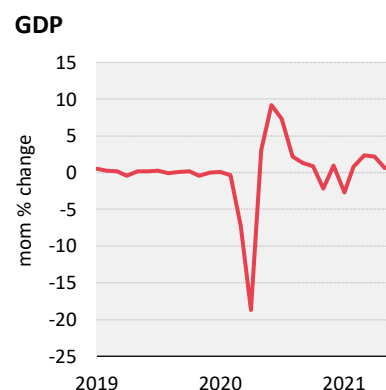
Despite better performance in the second quarter and the withdrawal of most of lockdown measures on 19th July, private sector growth slowed in July due to supply chain bottlenecks and staff shortages amid another wave of Covid-19 infections. The services PMI further dropped from 59.6 in July to 55.5 in August, while the manufacturing PMI dropped from 60.4 to 60.3 over the same horizon. At the same time, consumer confidence also edged down slightly to -8 in August from -7 in the previous month.

Looking ahead, although general market expectation is that the UK economy will continue to recover over the coming quarters, the recent resurgence in Covid-19 cases poses some uncertainty. As of 31st August, the 7-day average of new Covid-19 cases stood

GDP grows 4.8% quarterly in Q2 2021, improving from a 1.6% contraction in the previous quarter.

Resurgence in confirmed Covid cases creates uncertainty about ongoing recovery in 2021.

Financial markets see turbulence as representing worries over central bank’s tightening of monetary stimulus and spread of virus variant.



Source: Bloomberg, data as of 31/8/2021

Economic Research

at nearly 33,600, up from about 27,000 at the end of July. If the pandemic situation takes another turn for the worse, the government may need to tighten social distancing measures again to curb an outbreak, which could result in a slowdown of business activity and undermine consumer confidence.

Financial markets impacted by worries over virus variant and withdrawal of monetary stimulus

The Bank of England (BoE) signalled a hawkish shift at its meeting in August in view of persistent higher inflation, despite keeping the policy rate and asset purchase programme unchanged. The central bank set out how and when it will engage in quantitative tightening when it scales back its portfolio of assets. The BoE intends to cease reinvesting maturing assets when the Bank Rate has risen to 0.5%. Active selling is expected to begin when the Bank Rate reaches 1%, compared to 1.5% as set at the BoE's meeting in June 2018.

In the meantime, financial market sentiment has also been negatively impacted by the resurgence of Covid-19 cases with the spread of the Delta variant. The FTSE 100 Index once recorded a 2.7% gain on 11th August when compared to end-July, when the national reopening boosted market sentiment. Nonetheless, worries over virus variants and monetary tightening eclipsed earlier gains later in August. As of 31st August, the FTSE 100 index was 1.2% higher than the level at the end of July.

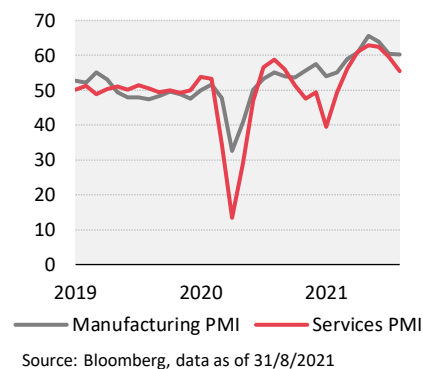
In the bond market, the 10-year UK government bond yield rise narrowed as investors became more risk averse as Covid-19 cases resurged in the US and other major economies, coupled with disappointing economic data out of China. Nonetheless, market participants anticipate that the European Central Bank will accelerate the reduction in bond purchases in view of rising inflation in Eurozone, resulting a rebound in the bond yields in the region at the end of August. As of 31st August, the 10-year UK government bond yield stood at 0.714%, about 15 basis points higher than the level at the end of July.

In the foreign exchange market, the pound weakened against the US dollar and the euro, mainly due to risk averse sentiment. As of 31st August, the pound had depreciated by 1.1% against the dollar and by 0.6% against the euro.

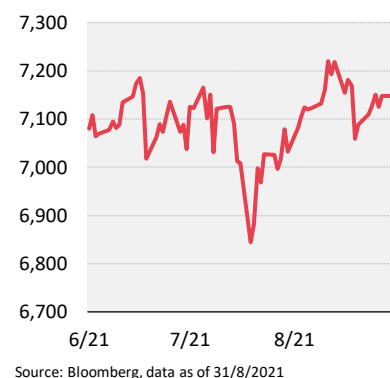
Looking forward, although the UK financial market is expected to be supported by the ongoing reopening of the economy, uncertainties from various sources may cloud the market outlook. Apart from the virus variants, the future relationship between the European Union and UK after Brexit will also result in turbulence in the UK financial market, mainly due to the lack of a comprehensive agreement on financial services. Besides, earlier and faster than expected tightening of monetary policies by the BoE and US Federal Reserve may cause bond yields to rise further. The future direction of the pound will be determined by the timing and pace of policy normalisation by the BoE and by economic conditions in the UK.

September 2021

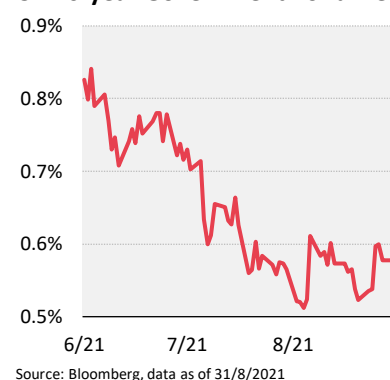
Purchasing Manager Index (PMI)



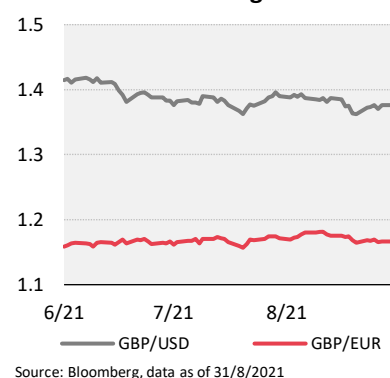
FTSE 100 Index



UK 10-year Government Bond Yield



British Pound Exchange Rate



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