BEA 東亞銀行

Economic Research

November 2021

Market Monitor – United Kingdom

Market Bets on Early Rate Hike by the Bank of England

UK GDP growth picks up in August after the end of most lockdown measures in July

The UK economy saw growth pick up in August, with GDP rising 0.4% month on month, after a downward revision to a 0.1% decline in July. With most of the lockdown measures having ended in July, services output grew by 0.3% in August 2021. Accommodation and food services activity was the main contributor to services growth during the month, registering a 10.3% uptick.

UK inflation remained elevated in September, with a yearly growth of 3.1% in the headline consumer price index (CPI), compared to 3.2% in August. Core CPI registered 2.9% growth during the month, down from 3.1% in August. The slight easing in CPI in September was mainly due to the base effect resulting from the end of the "Eat Out to Help Out" scheme last year. Mounting inflation pressure and supply chain bottlenecks have adversely impacted consumer confidence. The GfK Consumer Confidence Index fell to -17 in October, down from -13 in September. Retail sales volume in September unexpectedly fell by 0.2% month on month, compared to the market expectation of 0.6% growth. Retail sales value also recorded a monthly drop of 0.2% in September.

Rising inflationary pressure is pressuring the Bank of England (BoE) to start raising interest rates earlier. At an online panel with central bankers in October, BoE governor Andrew Bailey warned that high inflation would last longer with rising energy prices. The remark spurred market expectation that the BoE may raise the benchmark interest rate as early as at its meeting in November. However, the BoE decided to keep interest rate at 0.1% at the meeting in November, mainly because officials preferred to know the end of furlough scheme would affect job market. Meanwhile, Bailey said that BoE would raise interest rate in coming months if the economy performed as expected.

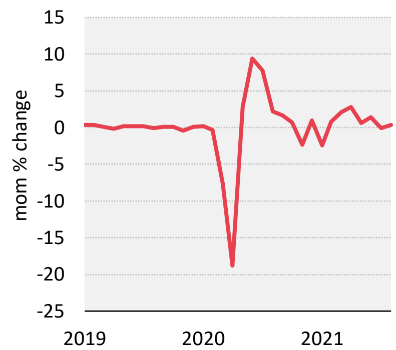
The Chancellor of the Exchequer Rishi Sunak announced the Autumn Budget in late October. Overall departmental spending will grow by GBP 150 billion by fiscal year 2024-25, amid more optimistic economic forecast by the Office for Budget Responsibility

GDP growth picks up in August, mainly due to the relaxation of lockdown measures in July.

Persistent inflationary pressure fuels expectation that the BoE will raise interest rates earlier.

Upcoming rise in taxes, combined with persistent inflation, may eat into household disposable income and pose risks to future recovery momentum.

GDP



Source: Bloomberg, data as of 31/10/2021

(OBR). The OBR forecast the UK economy to grow by 6.5% year-on-year in 2021 in October, compared to the 4% forecast in March. Meanwhile, National Living Wage will increase next year by 6.6%, to GBP9.50 an hour and planned rise in fuel duty will be cancelled. A 50% new business rates discount for the retail, hospitality, and leisure sectors will be provided in fiscal year of 2022-23, when current business rates reliefs expire next March.

Going forward, despite the continued fiscal support announced in recent budget, the UK's economic recovery may still be hampered by uncertainties. Newly confirmed Covid-19 cases have risen since late September. As of end-October, the 7-day average of newly confirmed cases had risen to about 40,800, compared to about 34,600 as of the end of September. If the government needs to re-impose stringent lockdown measures, consumer and business confidence and hence economic growth in Q4 2021 may be adversely impacted. With the national insurance contribution rate and dividend tax rate hike announced in September, a higher tax burden amid rising energy and food prices may eat into the disposable income of households and pose challenges to the economic recovery in the longer run.

Pound strengthens ahead of expected rate hike

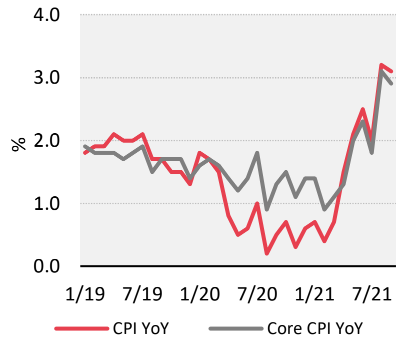
As of 29th October, the FTSE 100 Index had risen by 2.1% when compared to the level at the end of September, mainly driven by energy and banking shares. Rising energy and commodity prices lifted the share prices of companies in these sectors in the FTSE 100 Index, while banks' share prices were also driven higher. Investors were optimistic about a steady recovery and expected a better profit outlook for large banks in light of a potentially earlier rise in interest rates in the major advanced economies.

Volatility was seen in bond market in October. Market expectation of an early rate hike by the BoE once drove up UK bond yields. The 10-year UK government bond yield stood at 1.202% on 20th October, about 18 basis points higher than the level at the end of September. Towards the end of October, as the Debt Management Office spelt out a cut in planned government bond sales in 2021-22 fiscal year by about GBP 57.8 billion from its April forecast, which was larger than market expectation. As a result, government bond prices rise and yields dropped. As of 29th October, the 10-year UK government bond yield stood at 1.034%, only about 1 basis point higher than the level at the end of September.

In the foreign exchange market, the pound sterling has strengthened against US dollar and euro amid expectation of an early interest rate normalisation by the BoE. As of 29th October, the pound had strengthened by 1.5% against the US dollar and by 1.7% against the euro.

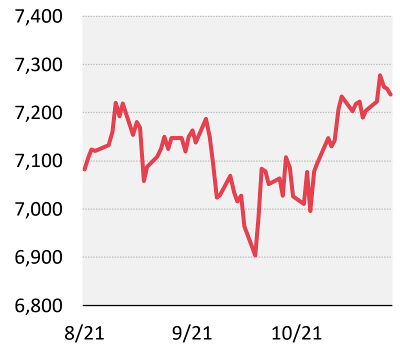
Looking ahead, with business leaders warning that the UK's supply chain issues could last until at least 2023, inflation may rise further in the months ahead. This may intensify investors' expectation that the BoE will raise interest rates faster. UK government bond yields may rise again and the pound may strengthen further if market participants speculate that the BoE will normalise policy faster than other major central banks.

UK Inflation



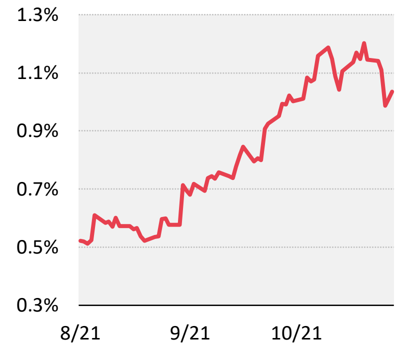
Source: Bloomberg, data as of 31/10/2021

FTSE 100 Index



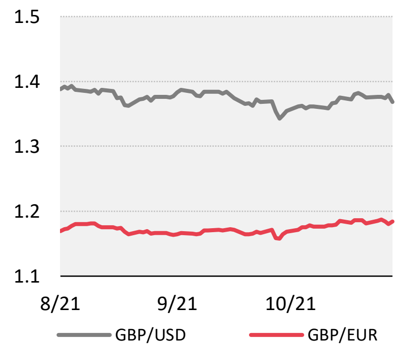
Source: Bloomberg, data as of 31/10/2021

UK 10-year Government Bond Yield



Source: Bloomberg, data as of 31/10/2021

British Pound Exchange Rate



Source: Bloomberg, data as of 31/10/2021

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