Economic Research

December 2021

Market Monitor – United Kingdom

Economic Outlook Uncertainties Mount

UK GDP growth continues to improve in September but inflation accelerates in October

The UK economy registered 0.6% month-on-month growth in September, up from the 0.2% growth in previous month. Services sector was the main contributor to the growth in September with a 0.7% growth during the month. It was mainly because of a large rise in face-to-face appointments at general practitioner (GP) surgeries, resulting in a 6.4% growth in health services sector. Meanwhile, manufacturing sector recorded 0.1% drop in output, mainly attributable to the ongoing supply chain challenges faced by carmakers. For Q3 2021 as a whole, UK GDP grew by 1.3% quarter-on-quarter.

The UK jobs market continues to improve, with the unemployment rate further dropping to 4.3% during the three months to September, down from 4.5% in the three months to August. However, the government's furlough scheme has just ended in September, which could have a gradual impact on the jobs market. It is possible that the unemployment rate could rebound in the coming months until the pandemic is brought under control.

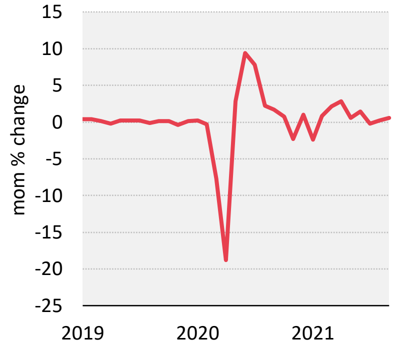
UK inflation accelerated in October, with the headline consumer price index (CPI) rising 4.2% year-on-year, up from 3.1% in September and reaching the highest level in a decade. Core CPI registered 3.4% growth during the month, up from 2.9% in September. The surge in inflation was mainly driven by energy prices and the impact of supply shortages. Despite higher inflation, the retail sales volume saw 0.8% month-on-month growth in October. Meanwhile, the GfK Consumer Confidence Index also unexpected rose to -14 in November from the -17 in previous month, mainly due to higher purchase intentions in the run-up to festive season.

Monthly GDP growth continued to improve in September.

Inflation accelerates in October, with persistent supply chain bottlenecks and high energy prices.

Renewed tensions with the EU over Northern Ireland and Omicron variant may pose additional uncertainties to economic outlook.

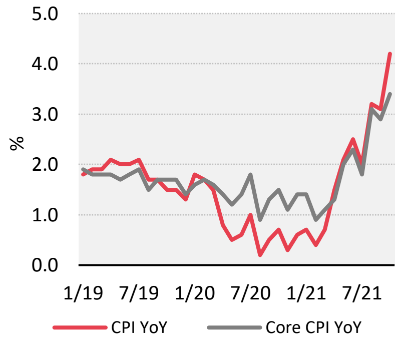
GDP



Source: Bloomberg, data as of 30/11/2021

Looking forward, the UK's economic recovery may be clouded by uncertainties. Apart from the ongoing inflationary pressure and an upcoming increase in taxes that will squeeze household incomes and adversely impact consumption, renewed tensions between the UK and EU over the Northern Ireland Protocol may pose an additional risk to the economic outlook. If Article 16 of the protocol (a mechanism that allows either party to unilaterally suspend part of the agreement in the event that the protocol leads to "serious economic, societal or environmental difficulties that are liable to persist, or to diversion of trade") is triggered, it could result in a trade war between the UK and EU in the worst case scenario. Renewed uncertainties from Brexit may have a negative impact on business confidence and could hurt investment in the UK, potentially dragging down economic growth. Besides, additional risks may also be resulted from the Omicron variant that is recently reported.

UK Inflation

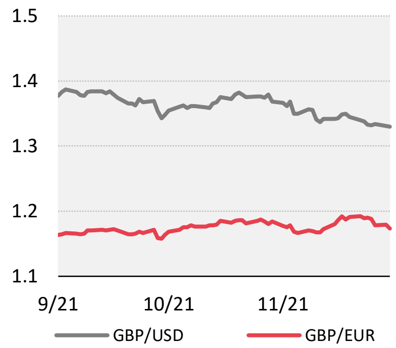


Source: Bloomberg, data as of 30/11/2021

Pound weakens amid renewed tensions with the EU and as BoE holds back from rate hike at its November meeting

In the foreign exchange market, the pound sterling has weakened against the US dollar, as the Bank of England (BoE) held back from raising interest rates at its November meeting. Renewed tensions with the EU related to the Northern Ireland Protocol also resulted in the pound weakening against the euro. Besides, the US dollar also further strengthened amid the risk aversion stemming from the Omicron variant. As of 30th November, the pound had depreciated by 2.8% against US dollar and by 0.9% against the euro compared to the end of October.

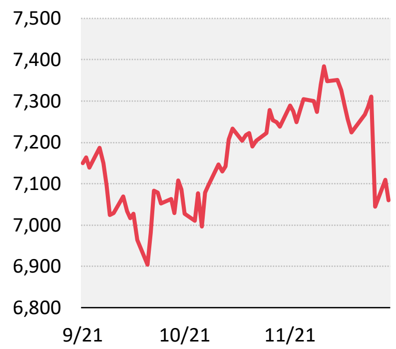
British Pound Exchange Rate



Source: Bloomberg, data as of 30/11/2021

Since the pound weakened after the BoE held off on an interest rate hike in November, market participants have perceived that export-oriented companies in the FTSE 100 Index may benefit from a weaker pound. FTSE 100 index rose in early November. Nonetheless, investor confidences weakened as new virus variant, Omicron, was detected in late November and market fell at the end of the month. As of 30th November, the FTSE 100 Index had fallen by 2.5% when compared to the level at the end of October.

FTSE 100 Index

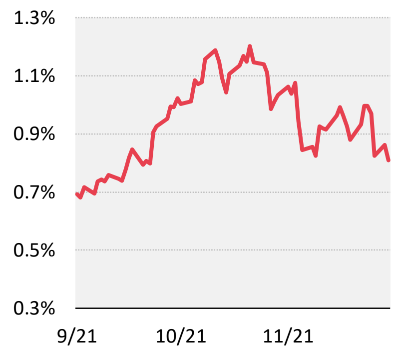


Source: Bloomberg, data as of 30/11/2021

UK bond yields have declined in November. Market participants were surprised by the BoE's decision at its November meeting. Besides, as Omicron variant was reported in late November, investors became more risk averse, further driving down government bond yields. As of 30th November, the 10-year UK government bond yield stood at 0.809%, about 23 basis points lower than the level at the end of October.

Looking ahead, as inflation has accelerated, market expectation may remain that the BoE will lift the interest rate in the coming months. As well as uncertainty caused by the lingering dispute with the EU over the Northern Ireland issue and Omicron variant, UK financial markets will face rising volatility in the coming months.

UK 10-year Government Bond Yield



Source: Bloomberg, data as of 30/11/2021

Disclaimer

For more information, please visit our webpage at https://www.hkbea.com/html/en/bea-about-bea-economic-research.html. For any enquiries, please contact the Economic Research Department (email: lerd@hkbea.com, tel: (852) 3609-1504, post: GPO Box 31, Hong Kong).