

Market Monitor – United Kingdom

More Challenges Ahead on the Road to Recovery



**BoE rate hike in December surprises market**

The UK economy saw growth slow in October, with GDP rising just 0.1% month on month, after a 0.6% growth in September. The monthly GDP growth was mainly dragged down by a 1.8% monthly drop in the construction sector and zero growth in manufacturing – with continual supply chain bottlenecks, despite the services sector recording 0.4% monthly growth.

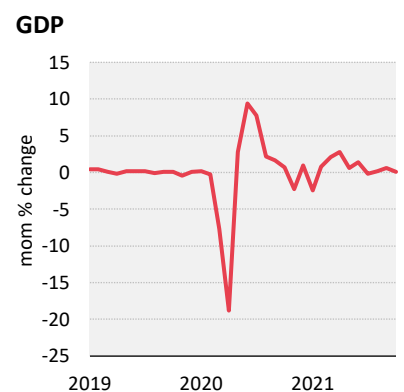
At the same time, the UK labour market remained resilient, although the government’s furlough scheme ended in late September. The unemployment rate fell to 4.2% in the three months to October, down from 4.3% in the three months to September. Besides this, inflation further accelerated in November, with the headline consumer price index (CPI) rising 5.1% year-on-year in November, following a 4.2% rise in the previous month, and reaching a 10-year high. Core CPI also registered 4% growth during the month, up from 3.4% growth in the previous month.

Accelerated inflation and rising Covid-19 infections negatively impacted consumer confidence in December. As of 24<sup>th</sup> December, the 7-day average of newly confirmed Covid-19 cases had risen to over 100,000, up from about 42,560 cases at the end of November. The GfK Consumer Confidence Index edged down to -15 during the month from -14 in November. Market participants generally expected that the Bank of England (BoE) would hold the bank rate unchanged at its December meeting amid the spread of the Omicron variant. However, the BoE unexpectedly raised the bank rate to 0.25% at the December meeting, up from 0.1% previously, as the central bank expects inflationary pressure to linger in the upcoming months and to peak at around 6% in April 2022.

**BoE raises bank rate to 0.25% unexpectedly at December meeting, prompting some investors to price in quicker rate hikes by the BoE in 2022.**

**Virus variant and potential tensions with the EU pose uncertainties for economic outlook.**

**Financial markets may see increased volatility in 2022.**



Source: Bloomberg, data as of 31/12/2021

## Economic Research

January 2022

### More economic challenges in 2022 outlook

Looking forward to 2022, the UK economy faces a number of challenges, although general market expectation is that UK GDP growth will average 4.7% in 2022, after an estimated 7.7% growth in 2021. Meanwhile, market participants expect UK inflation to remain elevated at 4% in 2022, up from the estimated rise of 2.5% for 2021. The BoE's move at its December meeting has prompted some investors to price in a rise in bank rates to 0.5% by March 2022 and to 1.0% by September 2022. In a Reuter's poll released in early December before the meeting, market participants generally expected that the bank rate would rise to 0.5% in May or June 2022 and then to 0.75% in Q4 2022. The BoE has said that it would consider actively selling some of its purchased assets when the bank rate reaches 1.0%. The emergence of new virus variant may intensify global supply chain disruption if governments around the world re-impose stringent lockdown measures to curb the spread of the virus. This would further fuel inflationary pressure in the UK and raise the expectation of quicker rate hikes by the BoE.

Moreover, the rate of National Insurance contributions will rise by 1.25 percentage points, with the same increase also applying to a tax on dividends starting from April 2022. Consumers may see their disposable income squeezed further, and sentiment may be dampened. In addition, the normalisation of interest rates by the BoE may help to calm surging house prices. As of November 2021, the Nationwide House Price Index had risen by 8.8% from the level at the end of 2020. Inflated housing prices may see slower growth in 2022, and the reduced wealth effect may also lower consumers' willingness to spend on big-ticket items. Moreover, potential tensions between the UK and the European Union (EU) stemming from Brexit may also pose additional uncertainties affecting the economic outlook in 2022.

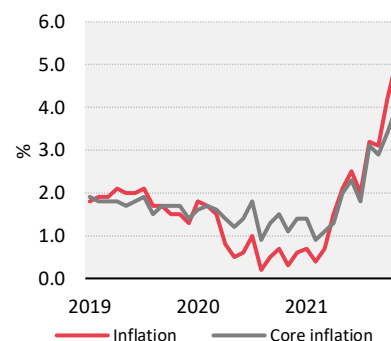
### In 2022, UK financial market trends will hinge on the pandemic and the country's relationship with the EU

The UK's financial market performance in 2021 was mainly influenced by the gradual reopening of the economy and the expectation of BoE policy normalisation. The FTSE 100 Index recorded a 14.3% rise between end-2020 and 31<sup>st</sup> December. When compared to end-November, the FTSE 100 Index had gained 4.6%.

In the bond market, the 10-year UK government bond yield stood at 0.971% as of 31<sup>st</sup> December, about 77 basis points higher than the level at the end of 2020. This was mainly due to the mounting expectation of quicker normalisation by the BoE amid higher inflation. The 10-year bond yield was also about 16 basis points higher than the level at the end of November.

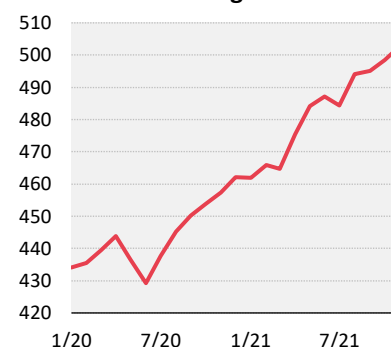
In the foreign exchange market, the pound sterling performed differently against the US dollar and the euro. The pound depreciated by 1% against the US dollar between end-2020 and end-2021, while strengthening by 6.3% against the euro. On a month-on-month basis, the pound had appreciated against the US dollar by 1.8% and the euro by 1.4%, respectively as of 31<sup>st</sup> December. This was mainly due to divergent expectations about upcoming monetary policy directions by the various central banks.

#### UK Inflation



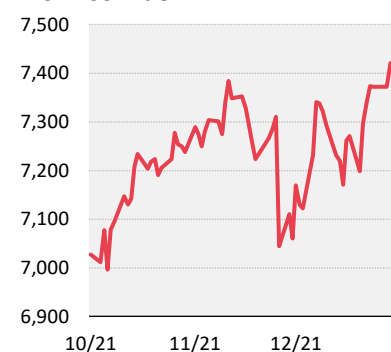
Source: Bloomberg, data as of 31/12/2021

#### Nationwide Housing Price Index



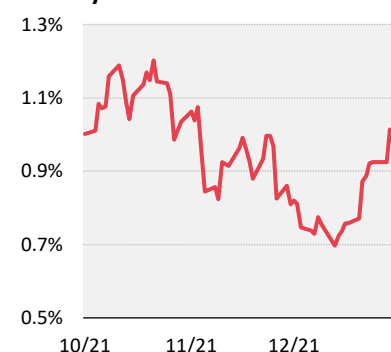
Source: Nationwide Building Society, data as of 1/12/2021

#### FTSE 100 Index



Source: Bloomberg, data as of 31/12/2021

#### UK 10-year Government Bond Yield



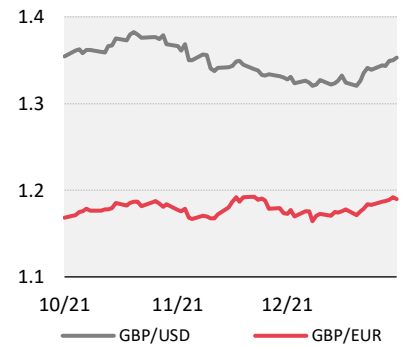
Source: Bloomberg, data as of 31/12/2021

## Economic Research

January 2022

Looking ahead, the performance of UK financial markets in 2022 will depend on the development of the pandemic and the post-Brexit relationship with the EU. If there are renewed Brexit-related tensions with the EU or if the UK government needs to tighten Covid-19 restrictions again, the UK financial markets will see increased volatility in 2022.

### British Pound Exchange Rate



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