Economic Research

March 2022

Market Monitor – United Kingdom

Intensified Expectation of Further Rate Hikes by the BoE

UK GDP saw rebound in 2021, but inflation accelerates further in January 2022

Despite the month-on-month drop of 0.2% in UK's GDP in December 2021, which was mainly attributable to the spread of Omicron, the UK economy still managed to see continued growth in the last quarter of 2021. UK GDP grew by 1% quarter on quarter in Q4 2021. For 2021 as whole, UK GDP expanded by 7.5% year on year, following a 9.4% fall in 2020. Against this backdrop, the UK jobs market continued to be resilient, with the unemployment rate staying at 4.1% in the three months to December 2021.

Meanwhile, inflation has accelerated further at the beginning of 2022. The headline consumer price index (CPI) rose 5.5% year on year in January, following a 5.4%% rise in the previous month. The yearly rise in CPI in January was the highest since March 1992. Core CPI also registered a 4.4% growth during the month, up from a 4.2% rise in the previous month. As inflationary pressure grows, consumer confidence further deteriorates, with the GfK Consumer Confidence Index falling to -26 in February, down from -19 in the previous month.

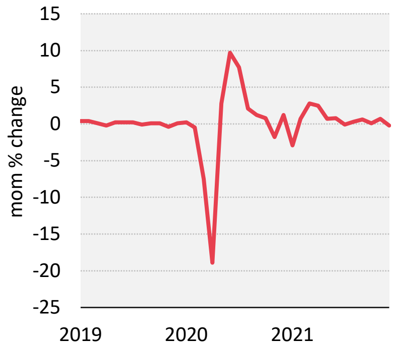
Going forward, UK inflation is expected to continue to rise in the coming months, mainly because energy bills are set to rise significantly as the country's regulator allows the cap on energy prices to rise by more than 50% starting from April. Financial markets generally expect the Bank of England (BoE) to raise the interest rate at its March meeting in view of mounting inflationary pressure. The ongoing policy normalisation by the BoE may pose challenges to valuations of assets, such as property, that previously benefitted from low interest rates. In January, the Nationwide House Price Index had risen by 11.2% from a year earlier, after a 10.4% rise in 2021. The robust rise seen in property prices may moderate later this year as the BoE continues to tighten its policy stance.

UK GDP rebounds in 2021 with 7.5% growth.

Inflation accelerates in January, with CPI rising 5.5% year on year.

Market participants generally expect the BoE to raise the interest rate again at its March meeting.

GDP



Source: Bloomberg, data as of 17/2/2022

Equity market sentiment impacted by geopolitical tensions towards the end of February

Despite the government's plan to end Covid-19 restrictions in England by the end of February, about one month earlier than originally planned, the UK equity market saw its gain erased at the end of February, mainly due to rising tensions between Ukraine and Russia. As of 28th February, the FTSE 100 Index dropped by about 0.1% from the level at the end of January.

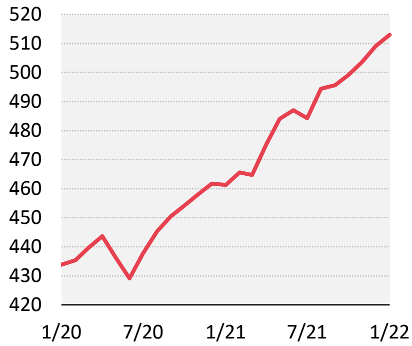
Upward trend in government bond yields eased and the pound weakened amid rising risk aversion

In the bond market, yields continued to rise in February as market expectation of another rate hike by the BoE in March intensified amid higher inflation. Nonetheless, the upward trend slightly eased towards the end of February as Russia launched military attack in Ukraine. As of 28th February, the 10-year government bond yield stood at 1.410%, about 11 basis points higher than the level at the end of January.

In the foreign exchange market, the pound weakened against US dollar and the euro towards the end of February amid the geopolitical tensions around Ukraine. Between the end of January and the end of February, the pound depreciated against the dollar by about 0.2%, and against the euro by about 0.1%.

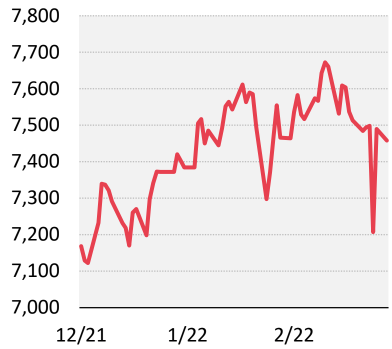
Looking ahead, as supply chain disruption may persist at least in the first half of 2022, inflationary pressure could continue and the BoE is expected to carry on with policy normalisation. A mid uncertainty caused by the Ukraine conflict and the risk of new virus variants, the UK financial markets may become more volatile in the months ahead.

Nationwide Housing Price Index



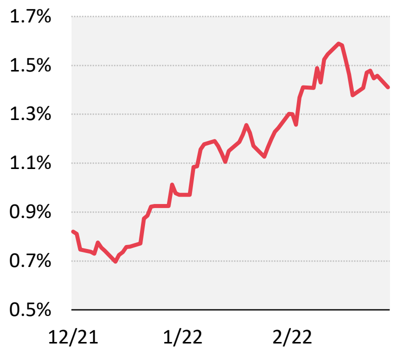
Source: Nationwide Building Society, data as of 1/2/2022

FTSE 100 Index



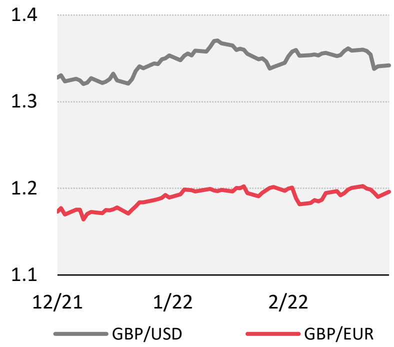
Source: Bloomberg, data as of 28/2/2022

UK 10-year Government Bond Yield



Source: Bloomberg, data as of 28/2/2022

British Pound Exchange Rate



Source: Bloomberg, data as of 28/2/2022

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