

*Market Monitor – United Kingdom*

**Inflation Hits 40-year High**



**GDP contracts month on month in March, while inflation accelerates in April**

UK GDP grew by 0.8% quarter on quarter in Q1 2022, down from 1.3% growth in the previous quarter. The quarterly growth in Q1 2022 mainly reflects the fact that 0.6% quarter-on-quarter growth in household consumption was partly offset by a 4.9% drop in total exports and a 9.3% rise in total imports during the quarter. The UK economy as a whole contracted by 0.1% month-on-month in March. This was mainly due to a 0.2% decline in the services sector in March, chiefly reflecting a 2.8% decrease in wholesale and retail trade. This may be a sign that households are struggling to sustain spending amid surging inflation.

Meanwhile, inflation continued to rise, with the consumer price index (CPI) registering year-on-year growth of 9% in April, up from 7% growth in March and now at a 40-year high. The jump in headline inflation mainly reflects a 54% increase in the energy price cap as of April. The core CPI also recorded year-on-year growth of 6.2%.

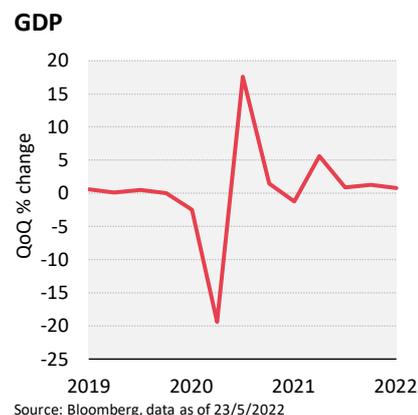
Although the UK labour market continued to improve, with unemployment dropping further to 3.7% in the three months to March, hitting a 48-year low, consumer sentiment remains gloomy amid mounting fears that the UK is heading for a recession caused by the squeeze on family budgets. The GfK Consumer Confidence Index further fell to -40 in May, hitting the lowest level since records began in 1974. To alleviate the impact of rising energy bills on households, Chancellor Rishi Sunak unveiled a GBP15 billion package on 26<sup>th</sup> May, funded partly by a new 25% energy profits levy.

Looking ahead, apart from worries about the Russia-Ukraine war and global supply chains, the UK also faces potential risk from the long-standing dispute over the Northern Ireland Protocol following Brexit. The EU set out a number of proposals on the protocol last October, which include an 80% reduction in checks on food products arriving in Northern Ireland and halving the amount of paperwork. Nonetheless, the UK government rejected

**UK GDP grows 0.8% quarter on quarter in Q1 2022, but sees monthly contraction of 0.1% in March.**

**Inflation surges further to a 40-year high, with the CPI registering a 9% year-on-year rise in April.**

**GfK Consumer Confidence Index falls to -40 in May, the lowest level since 1974.**



the proposal this May, judging that it would worsen the current trading arrangements. If the tensions over trade between the UK and the EU grow, the UK may face additional supply chain uncertainties and a still more gloomy economic outlook.

### Equity market performance improved towards the end of May

As the Bank of England (BoE) warned of the risk of economic contraction at its May's meeting and UK GDP saw a monthly contraction in March, worries over the economic outlook are mounting and the UK equity market had been on downward trend since the beginning of May. Nonetheless, as Chancellor Rishi Sunak announced a fresh support package for households on 26<sup>th</sup> May, FTSE 100 index rebounded towards the end of May as share prices of major retail firms rose. As of 31<sup>st</sup> May, the FTSE 100 index was up 0.8% from the end of April.

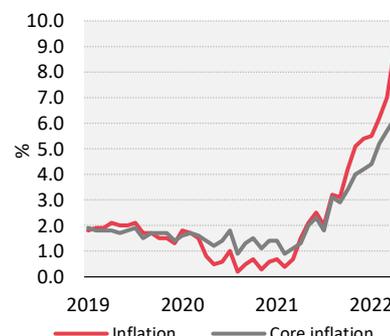
### Pound weakens against euro but strengthens against dollar, while bond yields become volatile

UK government bond yields saw volatile movement in May, influenced by growth concerns and the trajectory of inflation. On 12<sup>th</sup> May, the 10-year UK government bond yield closed at 1.661%, about 24 basis points lower than at the end of April. It was mainly driven by safe haven demand as the UK GDP saw monthly contraction in March. Nonetheless, as the UK and Eurozone inflation data showed persistent inflationary pressure, the UK 10-year government bond yields rebounded towards the end of May. As of 31<sup>st</sup> May, the 10-year UK government bond yield stood at 2.101%, about 20 basis points higher than at the end of April.

In the foreign exchange market, the pound weakened against the euro in May, amid market expectations that the European Central Bank will start raising interest rates in the summer and prevailing concerns over the UK's growth outlook. Between the end of April and the end of May, the pound weakened by 1.6% against the euro. Meanwhile, as US dollar weakened towards the end of May, the pound registered first monthly gain against dollar in 2022. Between the end of April and the end of May, the pound appreciated by 0.2% against dollar.

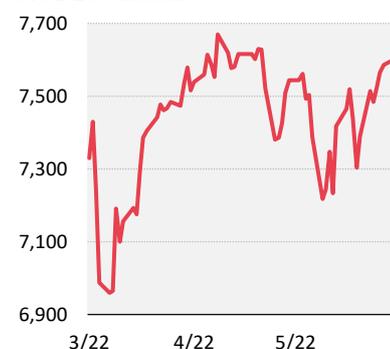
Going forward, UK's financial markets may see increased volatility amid mounting headwinds facing the economic outlook. The ongoing disputes between the UK and the EU may trigger a sudden change in investors' risk appetite and influence the performance of the pound and bond yields. Meanwhile, more risky assets like equities may face a continued threat to their valuations as the BoE continues to tighten policy.

### UK Inflation



Source: Bloomberg, data as of 23/5/2022

### FTSE 100 Index



Source: Bloomberg, data as of 31/5/2022

### UK 10-year Government Bond Yield



Source: Bloomberg, data as of 31/5/2022

### British Pound Exchange Rate



Source: Bloomberg, data as of 31/5/2022

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