BEA 東亞銀行

Economic Research

July 2022

Market Monitor – United Kingdom

Mounting Uncertainties for UK Economic Outlook

GDP sees a further month-on-month decline in April, while labour market remains tight

The UK's GDP fell 0.3% month on month in April, dropping further than the 0.1% decline in March and marking negative growth for two consecutive months. The services sector fell by 0.3% month on month, mainly reflecting the change in the UK government's Covid-19 policy with reduced spending on virus tracking and testing. At the same time, as high energy prices and supply chain bottlenecks persist, the manufacturing sector dropped by 1% month on month, widening from a 0.2% decline in March. The construction sector contracted 0.4% month on month in April after five straight months of growth.

The UK labour market remains tight. The unemployment rate for February-to-April rose slightly to 3.8%, up 0.1 percentage point from the January-to-March figure. The slight rise in unemployment mainly reflects a decline in economic inactivity rate. Wages continued to see strong growth, with average weekly earnings including bonuses rising by 6.8% year on year in February-to-April after a 7% year-on-year increase in January-to-March. At the same time, inflationary pressure in the UK remains high, with the consumer price index (CPI) registering year-on-year growth of 9.1% in May, up from a 9% rise in April. The core CPI also recorded year-on-year growth of 5.9%.

With another noteworthy energy price cap rise expected in October, UK inflation is likely to stay high in the coming months before peaking in Q4 2022, intensifying worries that the UK may be heading for a recession amid a real income squeeze for households. Consumer sentiment remains sluggish. The GfK consumer confidence index fell further to –41 in June, a new low since records began in 1974.

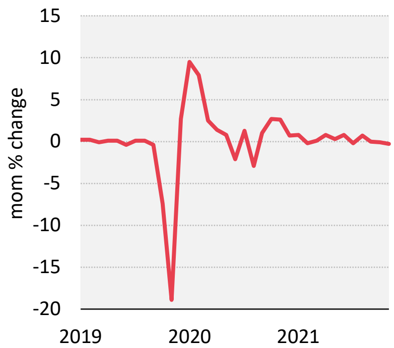
Looking ahead, the UK economy will face additional downside risks apart from high inflationary pressure and ongoing monetary policy tightening. The risk of renewed

UK GDP contracts 0.3% in April, accelerating from a 0.1% monthly decline in March.

BoE raises bank rate by another 25 basis points to 1.25% at its June meeting and revises down GDP growth projection.

Inflationary pressure will remain high, with the energy price cap set to rise further in October.

GDP



Source: Bloomberg, data as of 30/6/2022

tensions with the EU regarding the revision of the Northern Ireland Protocol, a likely second independence referendum for Scotland and Prime Minister Boris Johnson's resignation will raise further uncertainties, dampening consumer and business confidence. In June, the UK government unveiled a bill to revise the Northern Ireland Protocol. At the same time, first minister of Scotland Nicola Sturgeon has proposed plans to hold a second referendum in October 2023. Besides, Boris Johnson resigned as Conservative leader after mutiny in the party and will step down when a new leader is found. According a Bloomberg survey taken in June, market expectation is that UK GDP will grow by 3.7% in 2022, 0.1 percentage point lower than in May's survey, while CPI inflation is expected to rise 8.1%, 0.6 percentage points higher than expected in May. In July's survey, it is expected that the economic growth will be downgraded but the inflation forecast will be raised.

BoE raises interest rate again at June meeting, while UK property prices continue to see double-digit rises

The Bank of England (BoE) raised the Bank Rate by 25 basis points to 1.25% as expected in its June meeting. Three out of nine Monetary Policy Committee (MPC) members voted to raise rates by 50 basis points. The BoE expects that inflation will rise to over 9% in the next few months and even to top 11% in October. In addition, the BoE expects the UK economy to contract by 0.3% quarter on quarter in Q2, significantly lower than its previous forecast of 0.1% growth. The BoE said that it would take necessary action to return inflation to its 2% target over the medium term, while the scale, pace, and timing of any further increases in the Bank Rate will depend on expert assessment of the economic outlook and inflationary pressures. Bloomberg's survey in June shows the markets expecting the BoE's policy rate to rise to 1.75% in Q4 2022, 25 basis points higher than the survey in May predicted.

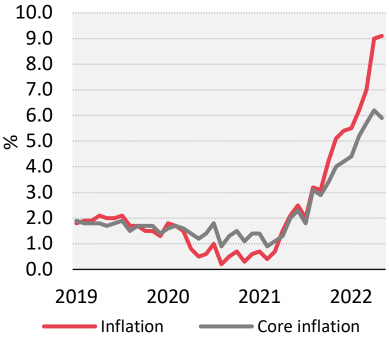
As the BoE has raised rates by 115 basis points so far, the UK property market is showing some signs of cooling, though it still recorded double-digit year-on-year price growth. The Nationwide Housing Price Index rose 10.7% year on year in June, 0.5 percentage points lower than 11.2% in May. However, amid the uncertain economic and inflation outlook and the continuous tightening of monetary policy, the UK property market is expected to continue to further slow down.

Equity market drops amid growth concerns and continuous monetary tightening, while bond yields surge and pound weakens further

As the monthly contraction of UK GDP widened in April, market concerns over the UK's growth outlook intensified. Meanwhile, the BoE and major central banks like the US Federal Reserve (Fed) continued to tighten monetary policy, leading to a deterioration of market sentiment. The FTSE 100 index saw a correction in June; as of 30th June, it was down 5.8% from the end of May.

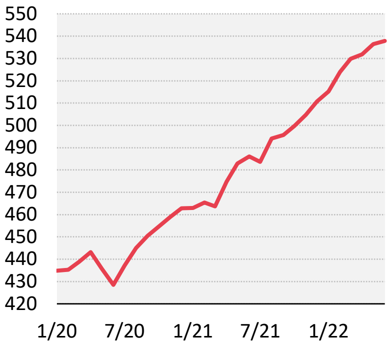
In the bond market, UK government bond yields rose alongside higher interest rates. On 21st June, the 10-year UK government bond yield rose to 2.654%, about 55 basis points higher than at the end of May and its highest since July 2014. However, as the worries over recession grow, some investors bet on the peaking of interest rates and the rise in the UK government bond yield eased at the end of June. As of 30th June, the 10-year UK government bond yield settled at 2.229%, about 13 basis points higher than that at the end of May.

UK Inflation



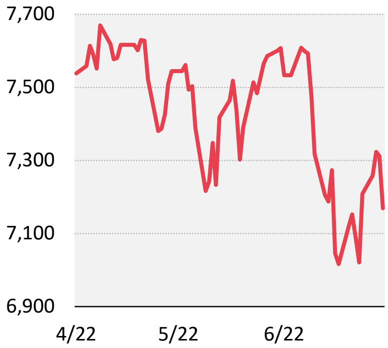
Source: Bloomberg, data as of 22/6/2022

Nationwide Housing Price Index



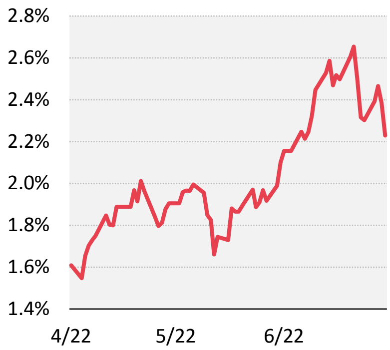
Source: Nationwide Building Society, data as of 6/7/2022

FTSE 100 Index



Source: Bloomberg, data as of 30/6/2022

UK 10-year Government Bond Yield

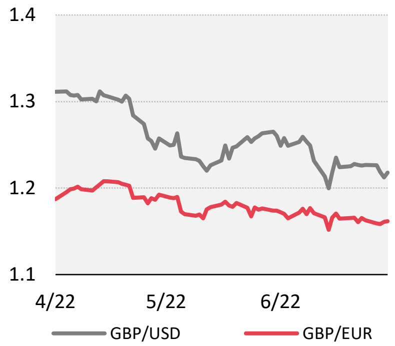


Source: Bloomberg, data as of 30/6/2022

In the foreign exchange market, the US dollar and euro continue to strengthen amid market expectation of further rate hikes, with the pound weakening further against both currencies in June. Between the end of May and the end of June, the pound depreciated by 3.4% against the US dollar and by 1% against the euro.

Going forward, investor sentiment concerning both UK equities and bonds could be impacted by the development of UK-EU relations, as well as by domestic economic conditions. Meanwhile, the pound's performance will still hinge on the pace of BoE policy tightening as compared to other major central banks, as well as on the UK's economic fundamentals.

British Pound Exchange Rate



Source: Bloomberg, data as of 30/6/2022

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