

Market Monitor – United Kingdom

Inflation Accelerates and Consumer Sentiment Hits New Low



UK economic outlook clouded by sharp rise in inflation

The UK economy recorded a 0.1% quarter-on-quarter (QoQ) contraction in Q2 2022, mainly driven by a 0.2% decrease in household consumption. Gross fixed capital also slowed to 0.6% QoQ growth, down from a 3.8% growth in the previous quarter, as business investment growth was offset by a drop in government investment. On a monthly basis, UK GDP declined by a smaller-than-expected 0.6% month on month (MoM) in June, despite extra bank holidays to celebrate the Queen’s Platinum Jubilee and diminished spending on public health related to the pandemic. Therefore, the rebound in July might be more muted than expected, leading to a more modest gain for Q3 as a whole.

Despite the UK economy having contracted in Q2, its labour market remained tight. The unemployment rate stayed at 3.8% in the three months to June, while employment increased by a lower but still solid 160,000 more jobs than the previous quarter. Although the average year-on-year (YoY) growth in weekly earnings slowed to 5.1% in Q2 2022, the YoY growth in 1H 2022 averaged 6.1%, far higher than the average of 2.1% during 2010-2019.

The market focus is on another record-breaking inflation reading, with the headline consumer price index (CPI) rising 10.1% YoY, up from a 9.4% rise in the previous month. The general inflation was driven by both surging food prices and firm core inflation. The increase in food and non-alcoholic beverages accelerated by 2.8 percentage points to 12.6% in July, while the core CPI also rose by 6.2% YoY in July, 0.4 percentage points faster than in June. The CPI growth was driven by widespread strength in recreation, restaurants, clothing, rents, and other consumer sectors. Meanwhile, electricity, gas, and other fuels prices also rose by 70.3% YoY, edging up by 0.1 percentage point from the previous month.

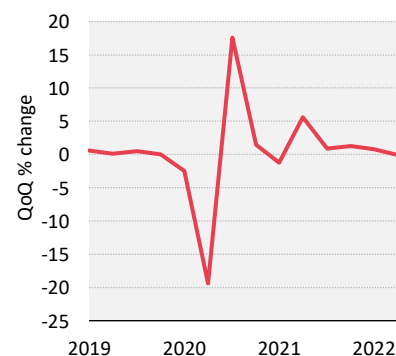
With inflation having climbed above 10% for the first time since 1982, consumer confidence has further deteriorated. The Gfk consumer confidence index fell to -44 in

UK GDP contracts 0.1% QoQ in Q2 2022, as household consumption drops and growth in investment slows.

Inflation hits a fresh 40-year high, with CPI rising 10.1% YoY.

In August, consumer confidence falls to lowest point since 1974.

UK GDP



Source: Bloomberg, data as of 12/8/2022

Economic Research

September 2022

August, down from -41 in July and now the lowest reading since 1974.

Looking ahead, inflation is likely to rise higher and persist for longer than previously expected, particularly as the Office of Gas and Electricity Markets (Ofgem) is now set to review price caps every quarter rather than semi-annually and has announced an 80% rise in the energy price cap from October onwards. UK inflation is expected to hover at an elevated level in the months ahead, implying the Bank of England (BoE) may have little time to waste to contain the inflationary pressure. The BoE will need to raise the bank rate by at least 50 bps in September, and the derivatives market has already priced this in. Amid soaring living costs and yet tighter financial conditions, the UK's overall economy and consumer spending will remain under pressure, with the BoE projecting that the UK economy will enter negative growth in Q4 2022. Meanwhile, Liz Truss has been confirmed as the next UK's Prime Minister on 6th September and announced an energy package with estimated cost of GBP150 billion on 8th September. It is expected that she will announce measures including reversing the increase in national insurance contribution rates and creating 'low-tax and low-regulation zones', etc., which aim to alleviate the household burden and support the UK economy going forward.

Equity market sees volatile movement while pound weakens further and bond yields bounce back

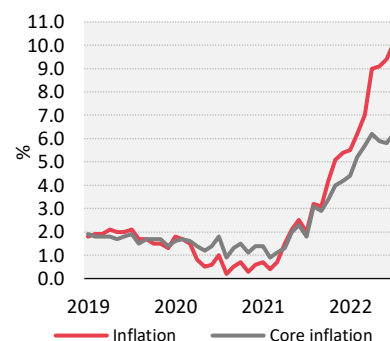
The UK equity market saw increased volatility in August, amid expectation of further monetary tightening by major central banks. The FTSE 100 Index was gaining steam in early August, but reached a peak on 19th August at a 1.7% rise from the end of July. However, these gains were completely erased after US Federal Reserve chairman Jerome Powell's hawkish remarks at the Jackson Hole Economic Symposium. As of 31st August, the FTSE 100 Index was down about 1.9% from the level at the end of July.

In the bond market, as investors expect the BoE to raise interest rates further amid elevated inflation, government bond yields with shorter tenors rose faster than those with longer tenors, resulting in an inverted yield curve starting from mid-August. As of 31st August, the 2-year UK government bond yield stood at 3.021%, about 131 basis points higher than the level at the end of July, while the 10-year government bond yield rose by 94 basis points to 2.801% over the same horizon.

In the foreign exchange market, the pound weakened against both the US dollar and the euro amid the UK's gloomier economic outlook. As of 31st August, the pound had weakened by 4.5% against the US dollar since end-July, while weakening by 2.9% against the euro over the same horizon.

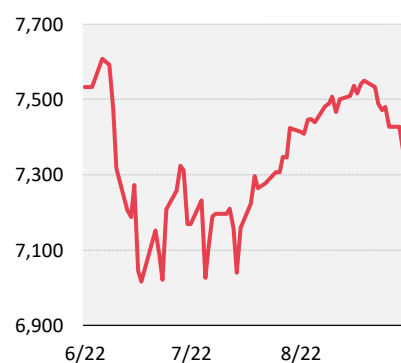
Going forward, uncertainties stemming from both the global and domestic economic outlook will continue to affect the UK's financial markets, as will political issues such as the potential for a second referendum on Scottish independence. Investors' risk appetite could change abruptly if uncertainties intensify and result in greater volatilities in the UK financial markets.

UK Inflation



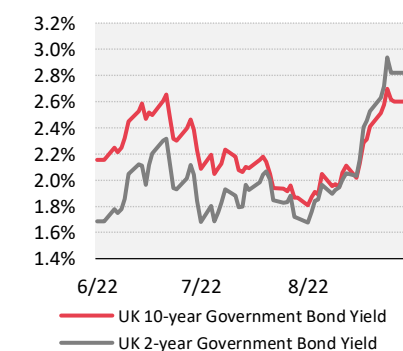
Source: Bloomberg, data as of 19/8/2022

FTSE 100 Index



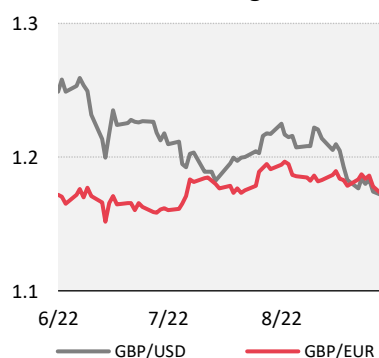
Source: Bloomberg, data as of 31/8/2022

UK Government Bond Yield



Source: Bloomberg, data as of 31/8/2022

British Pound Exchange Rate



Source: Bloomberg, data as of 31/8/2022

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