BEA 東亞銀行

Economic Research

November 2022

Market Monitor – United Kingdom

Economy Shows Signs of Weakening amid Rising Inflation

GDP shrinks in August, following a downwardly revised figure for July

The UK economy recorded a worse than expected 0.3% month-on-month (MoM) drop in August, after a downwardly revised 0.1% growth in July. Key economic sectors saw diverging performances in August, with the services sector recording a MoM drop of 0.1% and manufacturing falling 1.6%. Output in the construction sector rose by 0.4% MoM in August, after a 0.1% growth in July. The output of consumer-facing services fell by 1.8% in August after a 0.7% growth in July, indicating that consumers are tightening their belts amid soaring prices, tighter monetary policy, and a gloomy economic outlook. Meanwhile, the fall in manufacturing output in August was mainly driven by sharp decreases in pharmaceutical products and manufacturing of transport equipment due to weakening demand and rising interest rates.

Nevertheless, the UK labour market remains tight. The unemployment rate for June-to-August declined to 3.5%, down from the 3.8% in March-to-May and the lowest since 1974. Wage growth edged down further from an elevated level in the three months to August, with average weekly earnings including bonuses rising 6.0% year-on-year (YoY) in June-to-August, down from a 6.4% YoY increase in March-to-May. Meanwhile, inflationary pressure in the UK remains elevated, driven by still accelerating food prices. The consumer price index (CPI) registered a 10.1% YoY growth in September, up from a 9.9% rise in August. The core CPI recorded YoY growth of 6.5%, 0.2 percentage points higher than in the previous month and hitting a new 30-year high. Consumer confidence remained weak in October, with households facing surging inflation, rising interest rates, and political chaos in Westminster. The Gfk consumer confidence index increased slightly to -47 in October, up from a historic low of -49 in September. Against the background of weak consumer confidence, retail sales volumes fell 1.4% MoM in September, following a 1.8% drop in August.

With inflation continuing to stay at record-breaking levels, the Bank of England (BoE) raised the Bank Rate by 75 basis points (bps) to 3.0% at its November meeting, the

UK GDP declines by 0.3% MoM in August, with contraction recorded in services and manufacturing.

Headline inflation accelerates further in September amid surging food prices.

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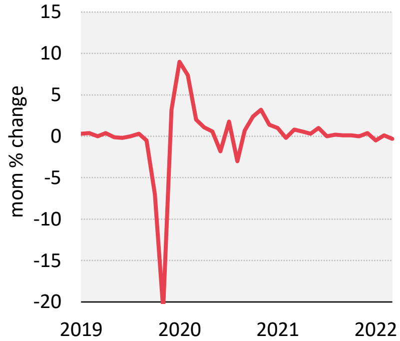
UK GDP



Source: Bloomberg, data as of 13/10/2022 biggest hike since 1989. Among the 9 Monetary Policy Committee members, only 2 voted for smaller hikes. The BoE said that the policy rate needs to continuously rise to bring inflation back to target, but the peak may be lower than current market expectations. They also forecasted that the UK will enter a recession starting in Q3 2022 and will last until 1H 2024, implying a sharp weakening of economic performance is needed to bring inflation back to target.

After a period of elevated financial volatility and political chaos, most of the tax cut measures in the "mini budget" proposed by former prime minister Liz Truss have since been axed, and the GBP2,500 price cap for average household energy bills will be shortened to 6 months starting from October 2022. The new prime minister, Rishi Sunak, is scheduled to announce the autumn budget on 17th November, with a fiscal package that is expected to be tighter than the previous "mini-budget". Looking ahead, UK households will continue to face financial pressure over the next few months amid surging prices and rising borrowing costs. If the autumn budget fails to convince the markets that the UK government can restore fiscal sustainability, business confidence and consumer sentiment will be negatively impacted, which could further dampen the outlook for the UK economy. It is clear that Rishi Sunak is taking over as prime minister at a challenging time, and will continue to face significant policy divisions within his own party on migration, economic policy, and more.

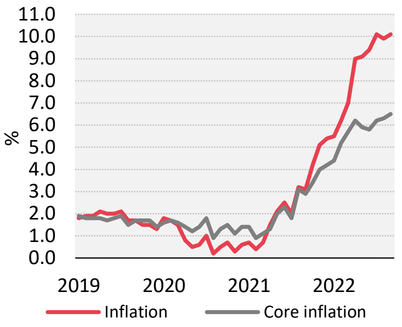
Financial markets stabilise after the appointment of the new prime minister

After most of the tax cut measures in the Truss administration's "mini-budget" were cancelled and the guaranteed period for household energy bill cap shortened, market confidence in the UK's fiscal sustainability recovered somewhat in October and its equity market experienced a rebound. As of 31st October, the FTSE 100 Index was about 2.9% higher than at the end of September.

In the bond market, UK government bond yields saw intense volatile movements in October. The benchmark 10-year government bond yield closed at 4.472% on 10th October, as the political chaos stemming from the "mini budget" undermined market confidence. However, after Rishi Sunak was appointed new prime minister and most tax cutting measures in the previous "mini budget" were cancelled, UK government bond prices rebounded. As of 31st October, the 10-year UK government bond yield stood at 3.516%, down 58 basis points from the end of September.

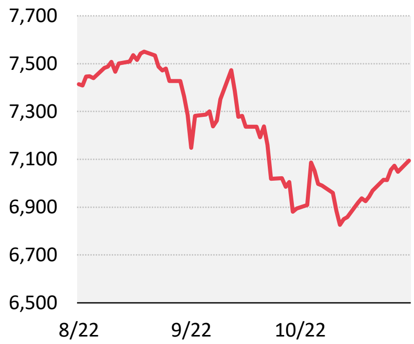
Against this background, the British pound strengthened against the US dollar and euro. As of 31st October, the British pound had appreciated by 2.7% against the US dollar and by 1.9% against the euro.

UK Inflation



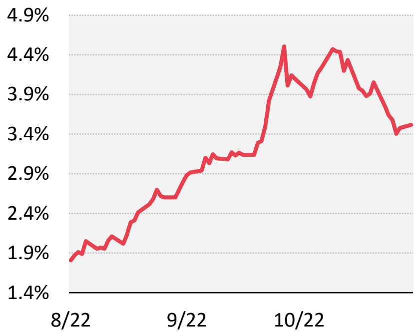
Source: Bloomberg, data as of 20/10/2022

FTSE 100 Index



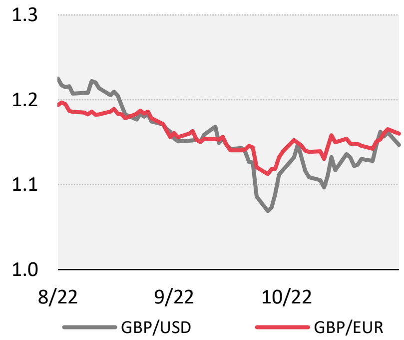
Source: Bloomberg, data as of 31/10/2022

UK 10-year Government Bond Yield



Source: Bloomberg, data as of 31/10/2022

British Pound Exchange Rate



Source: Bloomberg, data as of 31/10/2022

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