July's sharp slowdown in UK GDP growth highlighted the supply- and demand-side challenges to the recovery. Supply chain disruption continues to be widespread and staff shortages remain an issue. Meanwhile, the largest tax shake-up in a decade is aimed at solving short- (Covid) and long-term (social care and ageing) funding challenges.

Stalled: in July the UK's GDP growth slowed to a crawl of 0.1%, after a 1% rise in June, showing the weakest monthly performance since January. As a result, output is still 2% below its pre-pandemic levels. Recovery lost momentum mainly due to flat output of services, which accounts for 80% of the economy. Output in consumer-facing services, which is where the ground to pre-Covid output peak needs to be made up, actually fell 0.1% hit by the rise of Delta variant. Production output grew by 1.2% driven mostly by the reopening of an oil production site, which was previously temporarily closed for planned maintenance. Construction contracted (-1.6%) for the 4th consecutive month due to rising costs and shortages of raw materials.

Slowdown. According to the PMIs, most of the UK regions saw business activity grow at a slower rate in August, and Northern Ireland was no exception. Last month marked local firms’ slowest rates of growth in output, orders and employment in five months. Growth may be slowing but input costs continue to rise with NI firms posting the steepest rise in costs and prices amongst the UK’s regions. Firms will continue to grapple with inflationary challenges, skills shortages, supply chain disruption and adapting to Brexit. But 2022 will also see increased taxation added into the mix too.

Breaking bad. Six months ago, the manifesto pledges ruling out tax rises on VAT, income tax and National Insurance were off limits. So too was reneging on the triple-lock pension guarantee. Politicians hate breaking pledges, even bad ones. But last week saw these promises binned. Suspending the triple-lock for a year to avoid uplifting pensions by a freak 8% rise in average earnings was expected. Less so the 1.25 pp hike in employee and employer National Insurance Contributions (NIC) and dividends tax from next April. This £14bn per year of tax revenue will fund NHS spending in 2022 & 2023. But from April 2023 the 1.25pp rise in National Insurance will become a new Health & Social Care Levy. That’s a third income tax.

Tight. In recent weeks business are pushing against the supply-side constraints according to the recent wave of Business Insights and Conditions Survey (BICS).13% of UK companies which are still trading, reported that vacancies were more difficult to fill in the last month compared with normal expectations for this time of year in late August 2021, up from 9% in early August 2021. In Hospitality this proportion increased to 30%. And about a quarter of companies reported that prices of materials in the last two weeks had increased more than normal price fluctuations. In Construction industry half of companies reported cost pressures. Both of those constraints are pushing on prices.

Fading: UK’s Construction PMI continue to follow a downward trend; fell to 55.2 in August from 58.7 in July (June’s figure was 66.3). Although it still expanded – above the 50-threshold – softening of the recovery became evident in the construction sector by reaching the lowest point since February. The softer rise was mainly due to supply chain disruptions fuelled by Covid-19 restrictions and Brexit, which created lengthy delivery times for raw materials and increased sharply the cost of building materials. New orders and job creation has also eased, with the latter reaching a four-month low, leading to increasing input costs and shortage of skilled workers. Looking forward short-term construction growth outlook is weak, given the withdrawal of the stamp duty holiday and rising costs.

Shhh. August is usually a quiet month for UK new car registrations anyway. This year the silence was deafening. With just 68,000 vehicles registered, volumes were well below average for the time of year (-8%); the most muted August since 2013 in the UK and on record in Northern Ireland (-25% y/y). Listen carefully though and you might just hear the gentle hum of electric motors driving-off forecourts. Sales of battery electric vehicles surged by 32% on the previous year, whilst those of plug-in hybrids jumped 72%. Together they captured nearly one-fifth of all car sales. With a rapidly growing range to choose from, dealerships may not stay quiet for long.

Lost connection. Supply constraints are biting, particularly labour supply. It’s a paradox that during a technological revolution, (some) human capital becomes more, not less, important. So, 13% of UK firms are finding vacancies harder to fill. Despite the suitability of some jobs to be done remotely, proximity matters. With travel still shackled, there’s a mismatch between jobs and skills. To close that gap, either jobs-based travel, including migration, will return, re-skilling accelerates, or we’ll have to learn to do more remotely. How this plays out will not only shape the sustainability of the recovery but also our future lifestyles.

Slower. At its latest Council meeting ECB president Lagarde announced that the pace of net asset purchases under the Pandemic Emergency Purchase Programme (PEPP) would be “moderately lower” in Q4 2021. Mrs Lagarde stated this move was a recalibration, not tapering. The PEPP would continue until “at least the end of March 2022”. The ECB upgraded its 2021 Euro area GDP forecast to 5% (from 4.3%), Euro area medium-term inflation projections were also revised higher. The ECB president stressed higher inflation was viewed as mainly “transitory” and “temporary”, but concluded underlying inflation pressures had edged up. Still, QE looks set to persist for some time, an ECB rate hike is a long way off.

Bucking the trend. China’sannual inflation rate unexpectedly was at 0.8% in August, compared with market expectation and July’s figure of 1%. This was the lowest figure in five months. This was driven by steeper decline in cost of food with pork prices dropping faster due to improved pork supply as farmers revamp their hog herds in the wake of African swine fever. Current reading is well within the official 2021 CPI growth target of around 3 percent, compared with 3.5 percent last year. On a monthly basis, consumer prices rose by 0.1% in August, missing forecasts of 0.5% and after a 0.3% rise in July.

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