



**The Bank of England became the first major central bank to raise rates since the pandemic struck. It judged that rising inflation outweighed concerns over an Omicron-induced slowdown. In the meantime, COVID cases have leapt, prompting new restrictions and speculation of much more to come.**

**First of many?** The Bank of England (BoE) surprised markets with a pre-Christmas rate rise. With Omicron weighing-on the near-term economic outlook, the Monetary Policy Committee had been expected to leave interest rates on hold while assessing the extent of the fallout. Instead, Bank Rate climbs to 0.25% from the historic low of 0.10%. Committee members voted 8-1 for the rise, pointing to the increasingly tight labour market and signs of “greater persistence in domestic cost and price pressures”. With upwardly revised forecasts showing CPI inflation set to top 6% in April, policymakers are not willing to run the risk of what the International Monetary Fund terms “inaction bias”.

**Low-Fiving.** Economists received their seasonal surprise with UK CPI jumping to 5.1% y/y in November, exceeding the 4.8% print expected. A move into the low fives wasn't anticipated until next Spring. Increases in prices of petrol (+29.5% y/y) and second-hand cars (+27.1% y/y) were the key drivers of the latest surge in inflation. These increases drove consumer goods price inflation to 6.5% y/y the sharpest increase since August 1991. Back then Bryan Adams was topping the charts with "(Everything I Do) I Do It for You". Number one hits are always 'transitory' but that song still lasted a painful 16 weeks. Unfortunately, above target inflation is going to last much longer.

**Support.** The UK labour market continued its stellar performance in October before the emergence of Omicron. Employment rose to 75.5% despite the end of the government's coronavirus furlough scheme, up 0.2 percentage points on the previous three months, driven by a rise in part-time work. The unemployment rate fell to 4.2%. More timely administrative data suggested that payroll employment also continued growing in November. Wage growth also remained strong - average weekly earnings, excluding bonuses, increased by 4.3% in the three months to October. This strength in the labour market gave the Bank of England confidence to raise policy rate last week. The effect of Omicron will not be seen in the data for a couple of months.

**Loosing Steam.** UK house prices dropped 1.1% in October, according to the latest data. Average UK house prices increased by 10.2% over the year to October 2021, down from a record high of 12.3% in the previous month. UK's housing market has been booming amid pandemic induced search for space and stamp duty holiday. But this trend may not last with last week's rate rise from BoE signaled further increases in the months ahead, potentially dampening appetite for spending as budgets come under strain. With the prospect that rates may rise further in 2022 to inflationary pressures, and with government support measures phasing out, greater pressure on household budgets suggests house price growth will slow considerably.

**Euphoria.** Driven by early Christmas shopping due to warnings over product availability, UK retail sales rose by 1.4% in November from previous month and were 7.2% above their pre-pandemic levels. The boost, for a second solid month, was due to 2.0% increase in non-food sales - including toys, computers, and jewellery - and 2.9% increase in clothing sales which had risen above pre-pandemic levels for the first time. Black Friday deals as well as household's excess savings build during the pandemic drove the pick-up. However, the outlook of retail sales, depends on consumer confidence and GfK index edged down to -15 in December, from -14 last month suggesting that households remain cautious. That coupled with Omicron, rising taxes and last week surprise rise rate could weigh on spending.

**Good, for how long?** November's UK regional PMIs showed that most local economics continue to recover strongly, with almost all regions reporting increases in business activity. London was the standout performer in November - with the index reaching 64.1- and demand and hiring having the faster rate of expansion. Capital's services-intensive economy was less impacted by the supply bottlenecks that were causing severe disruption to manufacturing. Despite strong price pressures, demand conditions improved almost everywhere. And push by firms to meet higher demand continued to drive employment growth in all regions. However, all this pre-Omicron which added another layer of uncertainty and introduced fresh risks to activity and supply chains.

**Slowdown.** Official real time data in the week ending December 11, showed the strain from Omicron during the key festive trading period. Small decline in high street footfall due to higher spending in November, while card spending fell by 6 percentage points from the previous week and restaurant diners' number have dropped since news of the new variant. Separate figures from flash composite PMIs suggest that Omicron is depressing recovery driven by a drop in services sector, as consumers' caution increased again. Omicron cases surge, with the UK reporting over 90k daily new cases last week, casting a shadow over the economy, tighter restrictions might leave the city centres depopulated over the holidays,

slowing the pace of economic growth as we head into 2022.

**Turning off the tap.** The US Federal Reserve announced its intentions to start turning off the supply of loose monetary policy last week. First up is a promise to reduce its bond-buying activities a bit quicker than planned, meaning this phase of quantitative easing will be complete by March next year. Secondly, the Fed's members shared their forecasts for what interest rates were likely to be in the coming years, showing a majority in favour of three rate hikes in 2022. The Federal Open Market Committee (FOMC) clearly now thinks inflation poses a bigger threat to the economic recovery than a lack of demand.

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