There’s no doubt the war in Ukraine has clouded the economic outlook. Commodity prices have soared following Russia’s invasion putting more pressure on households’ real disposable income, and dampening growth prospects. But there’s real momentum behind the UK recovery going into this more challenging period, as underlined by last week’s estimate-beating GDP data for January.

Bounce back. The UK economy shrugged off the Omicron scare, recording 0.8% growth in January after falling by 0.2% in December. GDP is now 0.8% above its pre-pandemic level. All sectors grew in January, with services up 0.8%, production up 0.7% and construction up by 1.1%. Consumer-facing services and production are still well below (-6.8% and -2.0%) their pre-pandemic levels, while all other services and construction are now well above (+3.4% and +1.4%). February also has some encouraging signs for rebounding spending habits. Thereafter there is a growing risk of a loss of steam. But the trend of recent months is an important one: the UK’s recovery has shown plenty of resilience in the face of adversity.

Gradual ascent. Not everything we believe is true. Yet many things come to pass simply by virtue of the fact we hold them to be the case. Policymakers at the Bank of England (BoE) are therefore keeping a close eye on data showing a continued upward drift in inflation expectations. In February, households’ median expectation for inflation in five years rose to 3.3%, up from 3.1% last quarter. There’s no cause for immediate concern: 3.3% is merely the average over the 2010s. Question is, with prices now rising at the fastest pace for decades, does the BoE need to do more to demonstrate its commitment to the 2% target?

The coming squeeze. Inflation is rising month by month, with forecasters now expecting a peak of as high as 8-9% in April. April will also see a raft of tax and benefit changes affecting all households, unless the Chancellor of the Exchequer sets a different course in his Spring Statement next week. What do all these add up to? The Resolution Foundation thinks it will be the biggest squeeze on households in many decades with real incomes falling by 6% over the next two years. The pain will be spread widely but as food and energy get more expensive it is especially striking that large families are expected to be worst off, with half of families with 3 or more children living in relative poverty by 2025.

Exposure. As famed financier Warren Buffet once quipped, “only when the tide goes out do you discover who’s been swimming naked”. And a vast number of households will soon be financially exposed when the energy price cap leaps in April. Over a third (35%) spent more than they earned before the pandemic. Only half had a large savings towel, with 46% unable to cover their overspend for more than a year. Folk in northeast of England were most vulnerable to their budgets being squeezed. And two million households were in poverty for the triple whammy of income, spending and savings.

Still bad. The UK's trade deficit widened to £16.2bn in January, as imports from the EU surged by 24% (£4.7bn), while exports to the bloc fell by 21% (£3.0bn). This was partially due to the changes in measurement of EU trade, which accounted for two-thirds of the drop in exports, while the rest can be attributed to Omicron related disruptions. Additionally, the UK's trade deficit is under pressure from higher natural gas prices. That'll worsen in the short-term as prices have spiked. The broader outlook for trade is challenging, too. According to the Kiel Trade indicator, global trade declined in February (-5.6% vs. January). While the conflict in Ukraine is putting global supply chains to the test again.

Good, but not without concerns. High frequency indicators on growth picked up further in the week to 3rd March. Card spending rose by 10 ppt, driven primarily by increase in work related spending as a higher share of workers returning to their normal place of work. Though some of it is also driven by higher fuel prices. Social spending remained strong; restaurant reservations were c.20% above its pre-pandemic level. But there are challenges, mainly with an inflation theme to them. A higher share of businesses reported higher hourly wages for existing (12%) and new hires (10%) in February vs January. The pressure was most acutely felt in the hospitality sector. Further, businesses are concerned about goods and services inflation (21%) and higher energy prices (15%) in the months ahead.

Hawks in command. The ECB surprised with the announcement that it will wind-down its asset purchase program faster than planned, signalling it's getting a little more concerned about building inflationary pressures. The mood has shifted due to a jump in energy and commodity prices that has raised the risk of stagflation. The ECB revised its 2022 forecast for inflation to 5.1% from 3.2% and for growth to 3.7% from 4.2%. The bank bought itself some flexibility by not committing to a timeline for rate hikes – it would happen after asset purchase ends but it won't be automatic.

Peak Higher? US consumer price growth reached 7.9% in February ahead of the surge in energy prices following Russia’s invasion of Ukraine. Prices rose by 0.8% m/m (vs 0.6% rise in January) and core inflation jumped 6.4% compared to the same month last year, or 0.5% m/m. The rise was fuelled by higher energy, food, and shelter costs. The headline CPI rise was driven by surging petrol prices, which were up 6.6% on the month (and have continued rising since!), together with 1% increase in food prices. Russia’s invasion of Ukraine will push overall inflation even higher and delay its retreat, while also adding pressure to the Fed to tighten monetary policy.