Weaker than expected Euro area growth, unexpected contraction of the US economy and concerns about the Chinese economy, clouded the outlook last week. In the week ahead, the Bank of England is facing the toughest balancing act between curbing recent record high inflation and not weighing too heavily on GDP growth amid a cost-of-living crisis.

Counting the cost. £152bn! That's how much UK Government spending exceeded tax receipts in the last fiscal year. Such a big deficit is hardly a surprise – testing and vaccination schemes don't come cheap, let alone direct support for the economy through the furlough scheme. Net debt now sits north of £2 trillion, roughly 83% of UK GDP. The Chancellor's fiscal rules dictate that debt as a share of GDP should be falling at the end of a rolling 3-year period. Despite high borrowing last year, this debt measure did indeed fall as the economy rapidly recovered from Covid shocks. But that test will be harder to meet in future as growth slows towards 1-2% a year.

The big squeeze. UK households have been hit by the full force of the cost-of-living crisis, with around 91% reporting an increase in their cost of living, up from 60% in November. What's worse, 41% find it difficult to pay energy bills and a similar proportion are buying less food, according to a survey from the Office of National Statistics covering the period in two weeks to April 24th. Confirmation that after the big jump in energy prices and a rise in national insurance contributions, things are getting worse. People aged 30 to 49 are worst hit, with a higher share reporting that they had to borrow money as well as cut spending.

Public squeeze. While consumers are bearing the brunt of the cost-of-living crisis, they are not alone. Public services (health, education, defence, prisons, police, and probation) are similarly exposed to rising prices. Note that when the budget for these services for FYE 2023 was set in October last year, inflation was expected to be 'transient' after peaking at just over 4% in Q2 22. These services spend less than 5% on energy, transport, food, and construction. But every penny will still pinch. And a bigger risk are second order impacts (i.e., higher wages or higher core goods and services inflation).

Riddle. How come average wage growth soared in 2020-21 even though individual pay rose modestly? New analysis resolves the apparent paradox, showing that the composition of the workforce changed beyond recognition over the period. Many more part-time and low paying jobs disappeared during the pandemic than higher paid, degree-educated roles. The result? Average wages shot-up despite unremarkable individual pay settlements. Covid shaped the jobs market in other ways too: the employee sickness absence rate hit a decade-high of 2.2% in 2021, with the virus responsible for 1-in-4 sick days last year.

Park Life. Falling over the long Easter weekend, the set of real-time indicators proved to be a mixed bag. Both card spending and eating out fell (by 9% and 5%) as did mobility, except for parks. It seems we spent the extra days off enjoying time outside. And despite efforts by some Cabinet Ministers, the work from home trend continued to rise (18% of us now use a hybrid working pattern). Lastly, average wholesale gas prices dropped by 22%. A distant silver lining perhaps? But near term, pressures on households continue to mount.

Inflation.Stagflation? Euro area GDP growth weakened during the first quarter, while inflation hit a new record high in April, raising the fears of stagflation. Euro area GDP rose 0.2% in Q1’22, compared with the 0.3% in the previous quarter. Looking ahead, business surveys, such as the PMIs, point towards robust growth in Q2 though evidence is more mixed from real time indicators. The adverse effect of the ongoing Russia-Ukraine war remains a key risk. On the inflation front, consumer prices rose 7.5% in April. The increase was more sizeable for the core component due to rise in both services and industrial goods inflation. While there was some respite on energy prices, it was outweighed by a surge in food prices. All said, the latest growth and inflation reading point towards rising support for monetary tightening by the ECB.

Cost of zero-covid. Lockdowns in Shanghai and other cities started to bite for the world’s second-biggest economy. Caixin and official manufacturing PMIs for April both declined to 46.0 (Mar:48.1) and to 47.4 (Mar: 49.5) respectively. The lowest readings since February 2020. It’s a similar story for the official non-manufacturing PMI, which slid to 41.9 (Mar: 48.4). The plunge in activity comes with no surprise; lockdowns and disrupted supply chains. Output, new orders and new exports orders were all down. Activity is likely to remain depressed for the time being given the uncertainty regarding plans for reopening. All in all, that suggests a negative signal for China’s growth in Q2 and bad news for the global trade.

False flag. News that the US economy contracted by 1.4% on an annualised basis (i.e., 0.35% Q/Q) in Q1 took analysts by surprise. A marked slowdown from Q4 robust 6.9% expansion was expected, a decline was not. The headline is somewhat confusing as it came despite stronger rates of growth in personal consumption (+2.7%) and business investment.

The latter’s growth rate more than tripled to 9.2% relative to the previous quarter. So why the contraction? Net trade is the primary reason. Imports surged by almost 18% and exports fell by 5.9% leading to a record trade deficit. A slowdown in inventory accumulation didn’t help either. Beyond these technical factors the US economy retains considerable momentum with initial jobless claims expected to fall. No sign of recession yet.

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