As central banks around the world tightening monetary policy, our own Bank of England warned that the UK economy could enter a recession. Yet inflationary pressure continue to build; the G-7 countries pledged on Sunday phasing out or banning the import of Russian oil (the EU, US and UK made similar announcements before). Meanwhile Northern Ireland’s electorate waits to see when / if Stormont’s Executive can be restored. After all, there are no shortage of difficult issues to get stuck into.

Up again. The Bank of England’s Monetary Policy Committee (MPC) raised Bank Rate to 1% last week, its fourth consecutive hike – a first in the 25 years since it was granted independence – as inflation continued to soar. The strongest price rises are in energy and commodities, but the MPC sees extra inflationary pressure from domestic sources, especially from higher wages, and decided to act. In fact, three members of the committee wanted to see rates rise to 1.25% already. Governor Andrew Bailey made clear that these hikes won’t prevent inflation from rising further, but judged they were needed to prevent it becoming entrenched.

Harsh reality. Russia’s war against Ukraine is taking a heavy toll on the UK economy, adding to the dilemma facing policymakers. Even assuming interest rates are held at 1%, downgraded Bank of England forecasts envisage the recovery temporarily grinding to a halt over the coming year, as rising prices sap consumer demand. GDP is actually forecast to shrink by 0.6% in Q4. But will a ‘soft landing’ be enough to bring inflation back under control? Hiking rates to 2.5%, in line with market expectations would only add to the pain, knocking a further 1.7ppts off GDP growth over the next two years, sending unemployment climbing towards 5.5%.

Hungry housing. The cost of living crisis hasn’t yet dampened housing demand, with households upping their mortgage debt by £7bn in March, vs. £4.2bn in February. Lots of reasons for this, but note lender competition weakens the pass-through from official to mortgage rates. The Bank of England raised rates by 0.25ppts in March, whereas average new lending rates rose by just 0.14ppts. And the monetarists among you will be pleased that the overall money supply remains benign from an inflationary standpoint. Despite edging up to 5.5% in March, annual money growth is way down from the c.30% peak in Jan 2021.

Hitting hard. Rising prices of energy, raw materials and labour are weighing adversely on UK businesses, particularly in the hospitality sector. Half of all firms reported an increase in input prices in March. The share was notably higher for hospitality sector, at 77%, while more than 60% of construction, retail trade and manufacturing firms flagged pressures. Some of the rising costs were passed on to consumers: a fifth of the firms reporting higher selling prices. But the question remains – how much further? 13% of the firms reported a weakening in domestic demand, once again substantially higher for the more vulnerable sectors mentioned above.

Wait and see. Despite the gloomier picture, there are some fast-moving indicators that point to signs of resilience in the economy. Debit and credit card purchases, for instance, increased by 6 ppts in the week ending 28th of April, while Google Mobility data, which grew in all categories except park visits, indicated that people are out and about after a 2-year long hiatus. But the incessant surge in energy and goods price will have a material impact on disposable income, with inflation taking an even bigger bite. The economic position of UK is highly volatile and whether it will be able to ride this wave out smoothly is yet to be seen.

Flood risk. Approximately 2% of the UK homes are in locations with medium or high risk of flooding. Interestingly, places ranked in the middle for economic and social deprivation fare the worst, as the most deprived places are typically in better flood-defended cities. More houses are also being built 50% in risk-prone areas vs. the rest. But location isn’t the only factor determining vulnerability. Just a third of poorest households hold insurance against flooding, while a similar proportion is willing but unable to afford it. More defences for the non-urban poor areas, making houses or environments flood-proof and subsidising insurance for poor should help.

Soft landing. As expected, the Federal Reserve delivered its first 0.5% rate hike in 22 years taking its benchmark Fed funds rate to 0.75%-1.0%. Fed Chair Jerome Powell signalled that similar-sized increases are on the cards in June and July as the Fed tries to tame inflation that has already hit a forty-year-high. The last time back-to-back increases of half-a-percentage-point occurred was in 1994-95. Plans to shrink the US central bank’s massive $9 trillion balance sheet were also unveiled. Aggressively tackling inflation but avoiding a recession – navigating a so-called ‘soft landing’ – is a challenge. Powell reckons there is a “good chance” of achieving a “soft or softish landing”. Until then buckle up!

Mixed bag. U.S. unemployment rate remained unchanged in April at 3.6%, close on its pre-pandemic low of 3.5%, as employers struggled with worker shortages and demands for higher wages. There was a modest downshift in payroll growth, as the US added 428k jobs in April (vs. 702k in Feb). Yet a drastically different picture from household surveys shows that employment shrank 353k. US labour shortages will persist as labour market participation dropped modestly by 0.2ppts to 62.2% (vs. 62.4% in Mar) and remains way below its pre-pandemic level (63.4%). Despite employers forced to compete for talent, growth in average hourly earnings slowed in April (0.3% vs. 0.5% prior), moderating to 5.5% YoY. Wage growth may have peaked, though the pace is still much faster than what is consistent with Fed’s 2% inflation target.

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