After days of drama last week, the UK will soon have a new prime minister. The new administration will inherit stagnation in productivity, falling real incomes plus soaring inflation. In the meantime, the wind has changed for many commodity prices, which have slumped dramatically partially due to recession fears, while Europe is preparing for Russian gas to be cut off this winter.

Prime Minister’s Office in 10 Downing Street in London

Dark clouds ahead. On a quarterly health check of the UK financial system, the Bank of England (BoE) painted a bleak picture. The economic outlook for the UK and the world has deteriorated in light of high inflation and ongoing monetary policy tightening. To add to that, the economy is subject to multiple downside risks, many directly or indirectly linked to the evolution of war in Ukraine. High inflation and rates would put pressure on finances for both businesses and households. However, BoE remains optimistic that domestically, both sections are well placed to weather the crisis, with vulnerabilities limited to smaller sub-sections. Likewise, banks appear well capitalized to support the economy in these difficult times.

(Not) Growing. During the 15 years between 2004 and 2019 – pre-covid and pre-Brexit – households’ disposable incomes were growing three times slower (0.7% pa) than during the preceding 45 years (2.3% pa). In Europe only households in Greece and Cyprus saw a worse performance, according to new research fromt the Resolution Foundation. In addition, the ten most unequal years on record have all happened since the turn of the century, and five of them were between 2013 and 2019. Given the current cost-of-living crisis, the UK’s record over the past several decades, and its position relative to other countries, a sustained period of strong, progressive income growth should be a shared goal.

Uncomfortable reading. Not the fifty-odd ministerial resignation letters tendered last week but the Bank of England’s key business survey. Responses show price pressures continuing to escalate. Private sector output prices leapt by 7.5% in the year to June, up 0.2ppts since last month; a new record. Over the year ahead, firms expect unit costs to jump another 8% and plan to raise selling prices 6.3% in response. Pay growth is now running at a striking 5.7% and wages are expected to rise another 5.1% over the coming year. Scant consolation since inflation is now expected to remain higher for longer: 7.4% next June and 4% in years’ time. Awkward.

New reality or realisation? Steep fall in self-employment was a key feature of the pandemic. Speculation at the time focussed on whether people felt an employee job was more secure and were voting with their feet at a time of heightened uncertainty. But new analysis from the ONS shows that very many of those who moved from self-employment to employed status actually stayed in the same job. How? Well, lots of people who were running their own business, but still paying themselves through PAYE previously considered themselves self-employed. But their perspective changed when the furlough scheme was introduced. So, has people’s appetite for self-employment really fallen? A fairer answer is probably, “not much” and instead there’s more subtlety to people’s employment status than our standard categories allow.

A rough ride. As the drop in households’ real disposable income continues to grow, car sales have gone into reverse gear. In June private new car registrations totalled 69.5K, down 22%YoY, and total registrations measured 141.0K, below 186K recorded in Jun’21. Demand for private car sales remains stubbornly weak and it will probably remain so. Overall private car sales were 29.4% below their 2015-to-2019 average. What can reverse that trend? Well, excess savings and willingness of households to draw on them could increase spending figures on cars. Opposing forces are in play though, with consumer confidence extremely fragile and interest on unsecured borrowing also likely to rise. Both put households in cautious position over major purchases.

Some respite. Consumer behaviour indicators improved marginally the week ending 30th of June from last week, showing increased activity. UK seated diners increased by 12 ppts, transit station visits rose by 5% and transactions at the majority of Pret A Manger store locations also picked up. However, inflation woes persist and stiffen as “work-related” spending, which includes spending on road fuel, rose by 2% May to June. Further, a net 50% of trading businesses reported an increase in the prices of goods or services bought in June, compared with the previous month. And millions of pay pockets, fretting over rising living costs, received a boost last week with the threshold at which NICs become payable rising from £9,880 to £12,570.

‘Peeling an onion’. It’s become commonplace these days for monetary policy makers to state that they would do “whatever is necessary” to contain inflation, which is expected to reach 11% later this year. And the UK MPC members are no exception. The Bank of England’s Chief Economist reiterated in his speech last week that he is “in the price stability business”. But it is important to progressively work from the most visible part of the inflation story to a more detailed argument to understand the MPC’s future actions. For one, tightening will be calibrated to prevent greater harm to those most exposed to the cost-of-living crisis – the lowest income decile. And lastly, the UK’s situation was different from other countries, which are more self-sufficient in energy like the US, thereby, facing a lower growth-inflation trade off. Bottom line, actions will remain calibrated.

What recession? While recession talk is everywhere and consumer sentiment fell to an all-time low in June, the jobs market remains exceptionally strong for the world’s largest economy. In contrast with consensus expectations for a slowdown, the US economy added 372,000 jobs in June while the unemployment rate stayed unchanged at 3.6% – just above its pre-pandemic threshold. Professional and business services saw the biggest gains on monthly job creation. Yet the labour force participation dipped to 62.2% vs. 62.3% in May, still below the pre-pandemic level. Wage growth remains subdued relative to inflation; average weekly earnings ticking up by 0.3% in May and are now 5.1% higher on year-over-year basis. All in all, a resilient job market gives more room for Feb to raise interest rates in order to put a lid on a multi-decade inflation high.

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