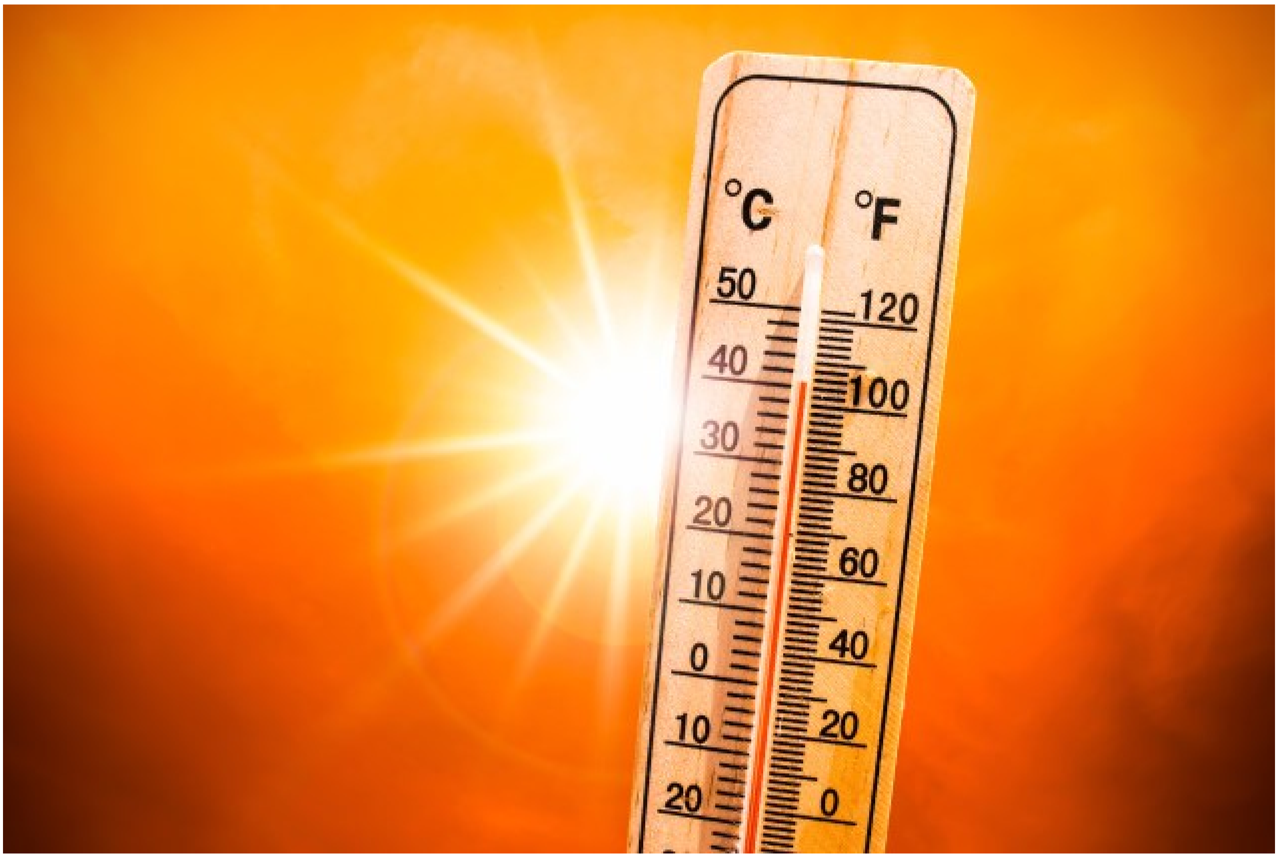
The UK reported better than expected growth in May. However, the elephant in the room is stubborn inflation. Americans are already feeling the heat, as inflation hit a fresh 40-year high last week. Surging price pressures and a darkening economic outlook for Europe is helping drive down the value of the euro, which briefly touched parity with the dollar for the first time in 20 years. Meanwhile the Bank of England is signal rate hikes might quicken!



Strong, but not for long. UK GDP rebounded in May, rising 0.5% over the month, surprising the consensus on the upside which was expecting flat activity. What’s holding up growth amidst an intensifying real income squeeze? The increase was broad based; output rose in manufacturing sector thanks to an easing of supply chain pressures, services benefitted yet again from a strong performing health sector, this time driven by a sharp rise in GP appointments. Construction activity rose for a seventh consecutive month while transport benefitted from consumers satisfying some of their pent-up demand for summer holidays. But there were areas of weakness. Consumer-facing services contracted as households cut down on their discretionary spend. And more is likely to come in the months ahead based on high frequency indicators.

Cool it. Whilst much of the UK will be sweltering this week, there’s clearly some cooling off of the economy going on. More retail and leisure businesses reported turnover fell from May to June, outnumbering those that saw growth by almost three to one. No prizes for guessing that tighter household budgets are having an effect there. The weaker demand outlook seems to also be finally filtering through into hiring intentions. Online job ads now 25% above their pre-pandemic level, having previously been as much as 45% higher earlier in the year.

Out of Kilter. Inflation is red-hot and rates are rising faster than the mercury, forcing banks to factor in higher prices into their mortgage calculations, and therefore making it tougher to secure a mortgage in Q2 ’22. The deteriorating economic outlook is also playing a role in the changes to the availability of credit. So availabillity has tightened for those with large levels of equity and those with lower levels. And banks expect credit demand to cool sharply too in the coming three months. It chimes with other evidence pointing to a slowdown in the housing market. The availability of unsecured credit is similarly tightening.

Stagnation nation. That’s the verdict of the Resolution Foundation’s inquiry into the state of the UK’s economy. At the heart of our problems lies persistently weak productivity growth: averaging just 0.4% p.a. since the financial crisis; half that enjoyed by the richest 25 OECD nations. That has fed directly to toxic combination of low growth and high inequality; real wages grew by an average of 33% a decade from 1970 to 2007, but this fell to below zero in the 2010s and exacerbated already stark inequalities (income, regional, generational). This combination has been disastrous for lower income households. The report calls for a new economic strategy to rectify these twin challenges. The prize is huge: we could be a fifth richer just by catching-up with peers like Canada, France & Germany.

The new normal. As we know, the pandemic accelerated a number of pre-existing trends. The shift out of bricks-and-mortar shopping was one. In February 2020 around 20% of retail spending was done online. At its peak a year later more that 37% was. Now we’ve moderated our online shopping somewhat to 27%, with the physical alternative as easy as it was previously. And there are some structural changes —online shopping for leisure and gardening, household goods and supermarket shopping all increased substantially relative to pre- pandemic levels. But the winners are flowers, plants, seeds, fertilisers, and pet foods, which are still on the upward trend.

Fill the gaps. Against a backdrop of elevated energy prices (and incipient demand rationing in Germany), the Climate Change Committee’s annual stocktake of the UK’s efforts at cutting carbon emissions didn’t make for terrific reading. The independent body, tasked with advising the UK and devolved governments on carbon reduction matters, said it unearthed “major failures in delivery programmes” for achieving net zero by 2050. But there are some positives: “credible plans” existed for 39% of required emissions reductions. It’s just that policy gaps abound. Filling them simultaneously makes net zero goals more achievable and presents one solution to the cost-of-living crisis.

Struggling to recover. China’s economic growth slowed sharply in the second quarter reflecting the economic damage from a prolonged period of lockdowns. The world’s second largest economy grew by 0.4% in Q2’22 from a year earlier—marking the second worst quarterly figure in 30 years— and down from the 4.8% recorded in Q1. Compared with the previous quarter GDP shrank by 2.6%, compared to a 1.4% gain in Q1. In the meantime, cases of Covid have picked up this month, sparking fears of more lockdowns. President Xi has reiterated the government’s commitment to the growth target of 5.5%, despite mounting challenges and slowing growth. That will likely require a hefty dose of stimulus.

How high can it fly? US CPI inflation accelerated in June to 1.3% MoM (from 1% in May), with the YoY rate posting a 40-year high of 9.1% (from 8.6% in May). This was significantly above market forecasts and raised concerns of a possible (and historic) 100-basis-point hike by the Fed in its upcoming July meeting. The monthly increase was broad-based. The energy index contributed to almost half the jump, followed by food prices. Core prices rose by 0.7% over May, fuelled by shelter, vehicle, and services (excluding energy) price increases. However, considering the drop in Brent crude below $100/barrel this month and a moderation in food prices, it seems the absolute worst may be behind the US.