Ulster Economix

Last week saw an avalanche of data releases. A mixed picture indeed. On the one hand, GDP growth petered out and other activity indicators deteriorated. On the other, inflation eased a notch, whilst the labour market remains tight. How will the Bank of England react? We shall find out this week!

Small rebound. The UK economy stagnated in the three months to July —similar to -0.1% in June, driven by the ongoing squeeze on households' income and rising costs for businesses. On the single month measure, GDP registered a modest gain of 0.2% in July (-0.6% in June). The good news is that services is holding up well, expanding 0.4% and were the main driver of July's gain, thanks to increased ICT output. Consumer-facing services, up by 0.6%, also expanded. The bad news? Both industrial production and construction posted losses for a second consecutive month. Construction was 0.4% lower than in April, as higher prices for materials dampen demand. The outlook remains downbeat; business surveys for private sector activity have weakened since July, as have consumption figures.

Food for thought. The latest Northern Ireland output surveys for Q2 were a mixed bag. Private sector services, the largest sector, saw a 0.3% q/q decline from its’ recent high. A more substantial fall (-2.4% q/q) was evident with the Retail Sales Index during the same period. That figure is expected to push further south as the cost-of-living crisis intensifies. Manufacturing, on the other hand, notched up its fifth successive quarter of growth, albeit the 0.6% q/q rise was half the growth rate of the previous quarter. Food and beverage production was a star performer with a stonking 6.2% quarterly gain in Q2 and 13.9% y/y. The latter was the largest annual increase, outside of the pandemic, since the series began. A period that largely coincides with the introduction of the NI Protocol. Coincidence?

A bigger squeeze. GB retail sales fell again in August (-1.6% compared with July) as households battled with high inflation and falling real wages. It’s broad brush too, with all the main consumer sectors feeling the pinch. Indeed, the pain is also shared across both online and real-world businesses, although it’s worth highlighting that the lockdown shift to internet shopping remains somewhat sticky. Online sales volumes are still 24.4% above their Feb 2020 levels. Despite the welcome slowdown in the rate of inflation, the big squeeze continues. However, the government’s massive energy-relief package will provide a boost this winter.

Nearing its peak. It doesn’t hurt that UK CPI inflation eased a touch, to 9.9% in August, from 10.1% in July, in line with the MPC’s forecast. This was led by a sharp decline in transport costs, due to lower motor fuel prices. But core inflation continued to pick up, led by higher services and food prices – the latter surging to highest level since August 2008. Looking ahead, we expect price pressures to cool after peaking in October; the latest fiscal measures effectively freeze the UK’s energy bills at current levels for two years for households and 6 months for firms. This significantly reduces the real income squeeze for households and should also take pressure off upcoming wage negotiations. Similarly, firms are likely to benefit from lower energy input costs.

A blank cheque. Speaking of which, new analysis from the Resolution Foundation argues that the Energy Price Guarantee will soften the coming squeeze on incomes by reducing inflation by around four percentage points in January 2023. But households are still likely to end the current parliament significantly poorer than they were at the start of it. Average earnings in 2026 are projected to be no higher than they were 20 years earlier. Turning this around will not only require global energy prices to fall, but to address the UK’s sluggish growth rates that have underpinned recent stagnation in living standards.

Weighing down. The UK’s consumer squeeze was further evident in real-time indicators, with card spending declining by 5% in August. The fall was broad based and took spending to below pre-covid levels for the first time since February. 43% of businesses experienced an increase in input prices in August, while 20% reported an increase in the output prices. However, there were also a few tentative signs of labour market slack. Online job adverts fell for the sixth time in the past 8 weeks; a cumulative decline of 10%.

Tight. Despite the apparent stagnation in growth, the UK labour market remained tight in July, despite expectations that some slack is building up. Despite the ongoing squeeze on real wages, labour supply contracted in July after briefly bouncing back in June. The result? The unemployment rate dropped to 3.6%, defying consensus estimates that it would remain stable at 3.8% for yet another month. Demand for workers is surely softening, with fewer unfilled positions reported in July. And it seems only a matter of time before declining real wages push some workers back into the labour force. A cooling seems like a given, even if it’s distant right now.

How long? Amid all this, UK house prices increased by 15.5% y/y in July, up from 7.8% in June, the most rapid growth since May 2003. But this sharp jump does not underscore a housing market that is weathering the storm of surging mortgage rates. Rather, it was a product of a base effect from falling prices seen this time last year, due to changes in the stamp duty holiday. Nonetheless, the pandemic fuelled structural change – people wanting to work from home and cladding issues – continue to drive prices: prices for detached homes rose by 17.3% y/y in July, while flat prices rose by a much smaller 9.3%. However, prices are expected to come under pressure in the second half of the year as mortgage costs surge.

Wrong way. Coming back to inflation, similar trends were observed in the US. The pace at which prices are rising in the US was widely expected to moderate in August. It didn’t. Instead, consumer prices rose 0.1%, keeping the annual inflation rate stubbornly high, at 8.3% (slightly from 8.5% in July). Core inflation gathered even more steam: prices were up by a roaring 0.6% on the month. The pickup in price rises was widespread right across the economy, from vehicle repairs to household goods and medical services. Cue a stock market sell-off on Wall Street amidst fears that the Federal Reserve will need to keep raising interest rates rapidly, triggering a ‘hard landing’ for the US economy.

Share this:

- Twitter
- Facebook
- LinkedIn
- Email