Interest rates continue their march upwards. Last week the Bank of England joined the bandwagon of advanced economies in delivering a sizeable 75bps interest rate hike. Nonetheless, a recession seems inevitable next year. The key question of how deep it will be depends on impending changes to taxes and government spending, the level of energy prices and the willingness of households to use their excess savings. All remain to be seen.

Pop. Monetary Policy Committee (MPC) members voted 7-2 to raise official interest rates by 0.75%. That's the eighth hike in a row. The three-quarter-percent rise was widely expected. Still, it's the largest single rate increase in 33 years, taking rates to easily their highest since 2008. Despite that, the BoE was pretty dovish. The MPC opined that whilst "further increases in Bank Rate may be required" to control inflation, rates may well "peak lower than priced into financial markets".Cue falls in sterling and market rate expectations.

Sometimes we’re all guilty of living in a bubble. And then it pops.

Nearing the end. BoE’s rather candid assessment of market expectations is underscored by its rather bleak outlook for the UK economy. MPC projections outlined that if interests go as high as the 5.25% market-implied peak will take out too much heat from the economy, pushing it into a two-year long recession —the longest since WWII— with the unemployment rate peaking at 6.5% (+3 ppts from the current rate) and inflation undershooting the BoE’s 2% target. What’s more, a widely expected fiscal tightening will limit some of the pressure on the BoE to tighten rates so aggressively. But even if the current rate is maintained, the UK economy will still face a recession next year, with inflation staying above target. Was there any silver lining to all the Bank’s gloom? The end of the tightening cycle may occur sooner than expected.

Hesitant. Confidence seems to be falling rapidly now, with wariness taking its place. Consumer credit borrowing increased by only £0.7 billion in September —the lowest level since December 2021— revealing the UK public’s unwillingness to take on more debt. To salvage some sense of control, UK households increased their savings by £8.9 billion in September, well above the average £5.3 billion in monthly deposits seen over the last six months. Given the deteriorating outlook there is scant evidence so far that households will spend their amassed savings to offset a recession, while the majority of them wil prioritize to pay off debt rather than spend the cash. To top it all off, confidence is also diminishing in the housing market, with mortgage approvals in September dropping by 10% to 66,800, suggesting buyers are starting to succumb to mortgage rate hikes.

Business blues. The business climate continues to be challenging. Few businesses are worry-free with only 9% of UK businesses with more than 10 employees reporting no concerns. Others reported concerns around high energy prices (30%), inflation (26%) and supply chain disruptions (5%). But price signals are prompting behavioural change. In late

October 2022 40% of businesses had taken some form of action to reduce their energy costs over the last three months. A newer concern for businesses is the exchange rate. In September it presented an increased challenge for 39% of importing businesses and 29% of exporting businesses. With so many others to contend with, let’s hope that this challenge will be short-lived.

Inflation flatters. One of the many problems of high inflation is that is messes with the price signal. Even the pros can be hoodwinked by an inflationary sleight-of-hand. The Office for National Statistics stated that many real-time consumer indices were rising. That’s only cosmetically true. Spending on debit cards is indeed rising for many age groups. But then we also have double-digit inflation. Similarly, small business sales are up 4% annually. But again that’s before inflation. Inflation can flatter as well as pinch. Business owners and finance departments beware!

Soaring and fading. Eurozone inflation surged to 10.7% y/y in October from 9.9% in September, putting pressure on the ECB to continue raising rates despite a rapidly deteriorating growth outlook. The usual drivers of late were in evidence with higher energy (+42%) and food (+13%) prices taking the lead. There was some sunnier news with inflation slowing in almost half of the bloc member states. GDP figures, meanwhile, confirmed a slowdown in growth in Q3, rising only 0.2%, after 0.8% growth in Q2. A lurch into recession is widely expected in coming months. The toxic combination of rising inflation as well as higher interest rates and the energy crisis reinforces fears that a recession is now all but unavoidable.

Sustained slowdown. China’s economy is slowing, driven by the dual impact of the rolling lockdowns and a prolonged property crisis. The official manufacturing PMI fell to 49.2 in October (vs. 50.1 in Sep) dragged down by a decline in output and new orders, while export orders remained soft amid subdued global demand. Adding to the gloom, services activity also contracted in October to 48.7 (vs. 50.6 in Sep) as stringent Covid restrictions hit business and consumption. The path to recovery goes through a relaxation of the country’s zero-Covid policy. And there is now intense speculation as to when it will end. But at this juncture there is little to suggest there’s about to be a meanigful change.

Club 75bps. It may have been the BoE’s first 75bps hike last week, but the Fed’s 75bps move upward was the fourth on the spin, taking its benchmark rate to 3.75%-4%. Inflation had been coming in a little hot, justifying another chunky rise. It means that the process of “frontloading” rate hikes is largely completed, according to Chairman Powell, adding that the pace of rate hikes is not as important as the ultimate level or their duration. There was also some new language in the statement on taking into account “the cumulative tightening of monetary policy”. So more rate hikes to come, but at a slower pace in all likelihood.

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