**Despite the latest financial sector turmoil, major central banks emerged steadfast in their pursuit of curbing inflation, with both the Bank of England and the Federal Reserve raising interest rates last week (ECB hiked theirs the week before). For now, the BoE has kept its options for future rate decisions open, pending more compelling evidence of the impact of rising borrowing costs on the economy. Meanwhile the Windsor Framework Brexit deal was voted through at Westminster and will now be adopted.**

**Balancing act.** The BoE raised its key interest rate by 25 bps to 4.25%, in a bid to rein in the still-untamed inflation. The latest inflation reading, a gradually improving outlook and a resilient labour market were the reasons behind the motivation to hike. However, coupled with the backdrop of vulnerability, the expectation of inflation to ease in the near-term could strengthen the case to hit the brakes on further tightening. Looking ahead, the central bank will be tasked with keeping a close eye on financial stability while bringing down inflation in

a controlled manner. It is a tight rope walk for the MPC, and the ravines on either side have become deeper.

**Wrong way!** UK inflation rose unexpectedly to 10.4% in February, a level described by chancellor Jeremy Hunt as "dangerously high". The increase exceeded the consensus forecasts of 9.9%, after inflation had steadily decreased from a peak of 11.1% in October. The largest upward pressure came from restaurants and cafes, in addition to increases in food and drink prices, which rose at the highest rate in over 45 years (+18% y/y). There are mixed views on whether the government will reach its target of halving inflation by the end of the year, but Prof. David Miles from the OBR in his comments to MPs said there is a "very strong chance" the target will be met, evidencing the recent fall in oil and gas futures.

**Caution.** Bolstering the case for an impending downward move in inflation, the UK PMI output price index fell to a 19-month low in March, suggesting core services inflation has already peaked. But concerns about stress in the banking system caused the UK composite PMI output index to drop to 52.2 in Mar, from 53.1 in Feb. Both services and manufacturing PMI fell below consensus. Nonetheless, businesses are the most upbeat in a year about demand in the next 12 months. Everything suggests the economy is faring well even in the face of high inflation and interest rates. So, have we avoided a recession in Q1? Hard to say. The composite PMI excludes 49% of GDP which comes from the retail, construction, and public sectors, the latter two of which are embattled by high borrowing costs and strikes, respectively.

**Tipping Point.** The typical UK house "earned" £17,000 in the year to January, a 6.3% rise. Not bad for doing nothing. It takes the average price across the UK to £290,000. Yet here's a thing or two. Firstly, annual house price inflation is slowing (it's 1% in Scotland). Secondly, 'real', inflation-adjusted, prices are falling. And third, prices flat-out fell in nominal terms on a monthly basis in January (they also did in December). As the hard

constraints of economic reality bite, the housing market turns. It's not entirely unwelcome. Full-time employees in England typically spend around x8.3 their annual earnings buying a home.

**False positive.** GfK's UK consumer confidence index for March reported an increase of 2 points to -36. While this is the highest reading in a year, it is still well below zero and refelcts consumers' continuing concerns about their personal finances and the cost-of-living crisis, amidst soaring energy bills, food prices and interest rates. But in a glimpse of good news, GfK saw a minor uptick in consumers' likelihood to add to their savings and willingness to make expensive purchases. This week also saw further falls in electricity and gas prices, with decreases of 16% and 8% respectively, which will continue to slowly ease pressure on households' squeezed budgets.

**Grim reading.** In its final instalment of the Sixth Assessment Report, the Intergovernmental Panel on Climate Change's (IPCC) finds that there is a greater than 50% chance the rise in global temperature will reach or surpass 1.5°C before 2040. To limit it from significant overshooting, emissions must peak before 2025 and then drop rapidly, declining 43% by 2030 and 60% by 2035, relative to 2019 levels. In 1.5°C pathways just a net 510 GtCO2 Carbon budget is left. Yet future emissions from existing and planned fossil fuel infrastructure alone are reaching 850 GtCO2. To keep us on Paris aligned trajectory global funding for climate mitigation must increase sixfold this decade and finance for fossil fuels must be rapidly scaled back.

**Trade-offs.** The US Fed was at pains to stress how strong the economy was, but it was stress in the banking system that attracted greater attention. The rate decision, to raise the range for federal funds rate to 4.75%-5%, will further dampen demand, with the aim of ultimately reducing inflation. But persistent concerns over whether US regional banks were nursing losses from falling bond prices could end up having a greater chilling effect on

lending in the economy and ultimately activity. As markets remain skittish, corporates have not been able to raise capital, effectively heralding the start of a credit crunch. Central banks may find their next move is to try to get credit flowing again.

**Resilient.** Eurozone business activity seems unaffected by the recent banking turmoil and continues its ascent from the energy crisis. The flash composite PMI rose to 10-month high of 54.1 in March, from 52 in Jan, and remained above the 50-point waterline for a third consecutive month. The increase was fuelled by a revival of the services sector, while manufacturing activity weakened. On a similar trend, US PMI also expanded in March, hitting a score of 53.3 up from 50.1 in Feb. That was the highest reading since last May. The rise in orders was concentrated in the services sectors given improved demand conditions. But the tightening in financial conditions of late casts a shadow over the outlook.

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