The heat is yet to come out of the UK economy. Business activity is rebounding steadily, the labour market is still very tight with sticky wages, and the drop in the pace of inflation remains slow. This presents a strong case for the Bank of England to raise rates again in May. But there are reasons for caution, too, including housing.

Green shoots. Growth in business activity is gradually picking-up pace as we enter Q2. So says the UK's flash PMI, which rose more than expected in April, hitting a one-year high of 53.9. The manufacturing sector is still stuttering: PMI falling to 46.6. But services are driving gains: PMI of 54.9. New orders are increasing more rapidly, and firms remain optimistic about the outlook, pointing to a budding private sector recovery. A prima facie case for another interest rate hike then. Still, declining input cost pressures (lowest rises in 25 months) and only modest employment growth suggest that may be an overkill.

Hidden slack. Another month of healthy-looking labour market conditions in the UK. The unemployment rate inched up to 3.8% in Feb, after staying flat at 3.7% for the last four months. In NI the comparable figure is at a near record low of 2.4%. Redundancies in the UK remained historically low. But strong employment figures mask the slack emerging in the labour market. Much of the rise in employment was driven by self-employed workers. Within employees, the rise was only in part-time workers while full-time workers saw a decline. This change in hiring pattern is likely to continue in the months ahead as reflected in business surveys and composition of job openings. Despite the recent slowdown, wage growth pressures remain sticky, giving MPC members food for thought before their next meeting in May.

Sticky wicket. The wait for single-digit inflation continues with UK CPI easing to just 10.1% y/y in March. Petrol and diesel prices may be falling but food price inflation accelerated to a fresh 45-year high of 19.6% y/y. That increase in food prices over the last 12 months matches the rise in the previous 12 years! Inflationary pressures aren’t just a food and energy story. Underlying or ‘core’ CPI remained unchanged at 6.2% last month. Services inflation, which is sensitive to wage pressures, also remained unchanged at 6.6% y/y. So more food for thought for the BoE. The wait for a peak in interest rates continues.

Steady improvement. High inflation has made it a challenging start to the year for UK businesses, but there are signs of improving performance and outlook. Almost a fifth of businesses reported increased turnover in the first two weeks of April, the highest value in the last year and about six percentage points higher than a year ago. Meanwhile, despite CPI inflation remaining stubbornly high, firms reported that fewer of their costs are going up, indicating that price pressures are starting to abate. That can’t come soon enough for the embattled consumer.

Downcast. That explains the renewed drop in UK retail sales volumes of 0.9% m/m in March, after a 1.1% rise in February. Spending decreases were seen across the board, in non-food stores, food stores, and non-store retailing alike. Some cushion is expected to come from rise in the state pension in April, a 20% drop in households' energy bills in July, and a slower pace of food price rises. But households that re-mortgage this year are facing around an 8 ppts jump in the share of their disposable incomes being spent on monthly mortgage payments. The GfK consumer confidence too, despite improving slightly in April, remained in the bottom 6% of all past readings since 1974.

Under Pressure: Cost-of-living pressures have hammered the final nail in the coffin for 'the race for space'. Although UK house prices are up 5.5%y/y, February saw the third monthly decline, leaving the typical house price worth £288,000. Now, that's £5000 below peak but still £16,000 more than a year ago. As the average buyer puts down a 25% deposit, they're having to scrape together an extra £4000. The outlook for house prices is uncertain. If inflation remains stubbornly high, rate setters at the Bank of England will be under pressure, which in turn puts further downward pressure on house prices, while raising mortgage costs for homebuyers. A double whammy for the sector.

Housing matters. According to the Resolution Foundation survey, 10% of UK citizens (6.5M) live in poor quality housing, defined as homes that are not in a good state of repair, have damp, where the heating, electrics or plumbing are not working. After controlling for income-related and demographic factors, people living in poor quality housing were 4 ppts more likely to say their general health is poor, and 6 ppts more likely to have had poor mental health. While the cost-of-living crisis has affected renters more – 15% of social and 10% of private renters have fallen behind on their housing costs over the last three months, compared to 4% of mortgagors.

Green shoot times 2. Across the Channel, business activity continues to expand, reaching an 11-month high of 54.4 in the latest PMI flash results. Like the UK, services activity is the key driver to growth in the Eurozone, at 55.0. On the other hand, manufacturing limps behind with a reading of 48.5. Looking towards the US, the PMI reached an 11-month high at 53.5. The US has benefitted from both services (53.7) and manufacturing activity (52.8) climbing, However, for both the EU and the US, inflation remains an ongoing issue potentially pointing to a weaker outlook for H2.

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