So far the Bank of England’s rate hiking cycle had been made somewhat easy by the UK’s strong economic performance. But MPC members perhaps shifted in their chairs as last week’s data releases told a story of fading economic momentum and a cooling labour market. However, wage pressures remain intact, and inflation expectations have edged up. Oil’s been on an upward march of late, feeding higher prices at the pump: petrol’s at its highest level since last December. Lots to ponder ahead of Thursday’s rate decision.

Dampener. Another disappointing set of figures on UK economic performance: GDP fell 0.5% in July, dashing hopes of a return to sustained growth. Industrial action was partly to blame. Doctors strikes led to a painful 3.4% drop in health activity; striking teachers knocked 1% off education output; rail strikes disrupted travel plans. Britain’s washout summer – July was the wettest in 14 years – didn’t help either, contributing to 1% declines in retail activity and building work. Still, there’s plenty of scope for improvement as the weather reverts to seasonal norms (goodbye late summer sun!) and industrial disputes slowly get resolved.

Heavy sigh. The UK labour market is cooling faster than expected but this still hasn’t taken an effect on wage growth which remains elevated. The MPC expected UNP rate to reach 4.1% in Q3, but it reached 4.3% in the three months to July. The ONS labour force survey as well as timelier survey by the KPMG and REC unequivocally point to a downturn in labour demand. Supply is rising amid redundancies and layoffs. But regular pay growth remained pat at 7.8%, bolstering the chances of another quarter point hike at this Bank of England meeting.

Wrong direction. NI’s labour market data has been the go-to place for positive economic statistics of late. But there are signs of a broad-based weakening in the latest figures. Unemployment rose but remains historically low at 2.7%. Two growing concerns are the falling employment rate and rising economic inactivity rates. These hit 10-month highs (26.9%) and lows (71.1%) respectively in the three months to July. They also compare unfavourably with the position that prevailed before Covid-19 hit. The total number of people in work during May-July (863k) was 18,000 fewer than the previous quarter with full-time workers down 20,000 over the same period. Both these indicators are below pre-pandemic levels. Meanwhile median wage growth slowed to 6.0% y/y in August.

Not Upbeat. Bank of England’s latest quarterly survey of public attitudes to inflation showed that the median expectation of the rate of inflation over the coming year was 3.6%, up from 3.5% in May. When the respondents were asked about expected inflation in the 12 months after that, they gave a median answer of 2.8%, up from 2.6% in May. Although inflation is gradually retreating (falling from 7.9% in June to 6.8% in July), expectations are that it will edge up again when we get August’s reading on Wednesday (rising fuel costs are the culprit). Yet another reason for another interest rate hike. Hence, when asked about the future path of interest rates, 63% of respondents expected rates to rise over the next 12 months, up from 57% in May.

Hope. Inflation tensions now rest on whether the demand for pay rises fuels second-round effects. The good news is that the share of firms citing labour costs as the reason for rising prices spiked in June at 25.8% and it’s back to 20.9% in September (c.45% of firms are not considering raising prices). Most manufacturers have so far absorbed wage increases. Not so services. For lawyers, accountants and consultants, wage rises have to be passed through. But before we tut, their price increases have been relatively modest. In short, there’s a slither of hope that future wage rises may have a limited impact on inflation – at least for a while.

Mixed start. Consumer spending begun September on a strong footing. CHAPS card spend data rose 5% in the first week of this month vs August. What’s even better, the increase was broad based, led by staple and delayable. This was perhaps due to a renewed rise in UK consumer confidence in August which is likely to have persisted in September, given the fall in energy bills in July and the retreat in mortgage rates over recent weeks. This was also reflected in a rise in flight uptake in the first ten days of September over the previous month. But the labour market continues to cool. Job adverts were down 4% in the first week of the month, led by declines in the energy and construction sectors. Potential redundancies trended up as well.

No Time to Lose. Climate scenario analysis has long been championed as a way to address the uncertainties surrounding climate change The USS (Universities Superannuation Scheme) and University of Exeter argue that the existing approaches are failing to capture key aspects of the real world, including acute physical risk, politics and policy, unemployment, finance and complex feedback loops, among other dynamics. And so propose four global climate scenarios with a greater focus on the short-term (out to 2030), combining high/low policy activism with high/low market dynamism. The outcomes range from rapid decarbonisation to climate policy being the casualty of mounting geopolitical tension and protracted recession. A helpful hand for climate transition planning and financial decision-making.

Last Hurrah? The European Central Bank hiked its deposit and refinancing rates by 25bps, taking the former to an all-time high of 4%. This was justified on the basis its new forecast assumes inflation will be higher this year and next. However, its language suggested that this is the terminal rate which could be maintained for a sufficiently long period of time. That being said, the ECB is maintaining optionality on any further hikes as well as the timing of cuts. Markets expect rate cuts starting in early 2024, but the ECB’s stance suggests it would require sufficient amount of supportive data before it goes down that path.

It’s the core that matters. US inflation jumped to 3.7% y/y in August from 3.2% in July, and that marked the second month in a row that inflation has risen, after recent consecutive falls. More than half of the upward movement is explained by the recent jump in petrol prices, which is partially linked with the decision by Saudi Arabia and Russia to cut oil production. Of most interest to the Fed however is core inflation, which fell sharply to 4.3% y/y in August, from 4.7% in July. It’s the lowest rate in almost two years. While the latest jump raises the odds of another hike later in Q4, a pause at this week’s meeting remains the most likely outcome.

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