

ECONOMIC PULSE

UNITED KINGDOM: CHANGE OF DIRECTION

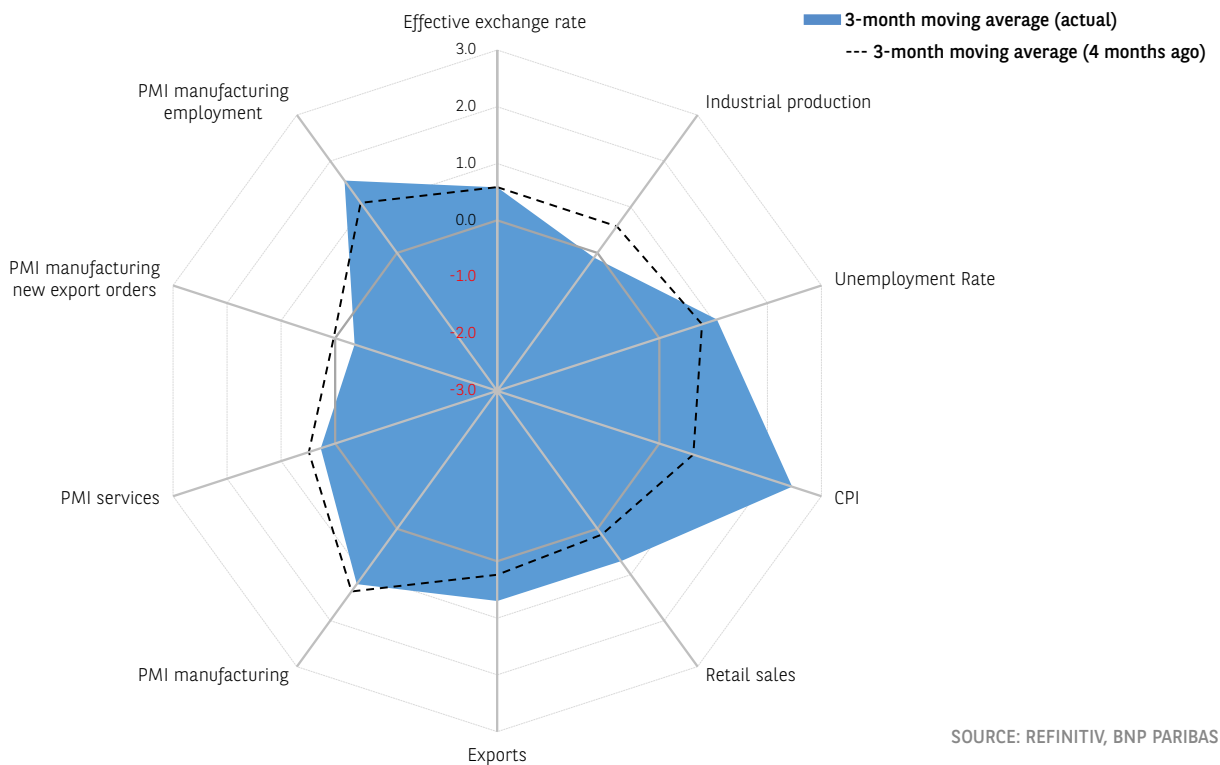
In the UK, like elsewhere, the upsurge in inflation is proving a constant source of surprise, and is prompting the central bank to act. Annual inflation is currently over 5% and the Monetary Policy Committee (MPC) expects it to hit 7% in April, its highest level for three decades. In response, the Bank of England is raising interest rates. Set at 0.1% during the crisis, its base rate was raised to 0.25% in December and then by a further quarter-point in February. Further rate hikes will follow, since the MPC, in line with market expectations, is aiming to increase the base rate to 1.50% by mid-2023.

In addition, like the US Federal Reserve, the Bank of England (BoE) will shrink its balance sheet by no longer reinvesting bonds purchased as part of its quantitative easing plan when they mature. The BoE currently has GBP 895 billion of bonds – mainly gilts – on its balance sheet, equal to around 40% of GDP. This monetary normalisation is taking place at a time when British economy is back to its late-2019 level. UK GDP was badly affected by the pandemic, since the country saw one of the world’s deepest recessions in 2020. It then rebounded spectacularly in 2021 (+7.5%) in large part thanks to an aggressive “whatever it takes” approach. According to the International Monetary Fund’s calculations, government transfers to households and businesses (excluding loans and guarantees) equalled 19% of GDP, practically twice the support provided in the Eurozone.

This caused the public-sector deficit to explode, and although it has since fallen as growth has returned, it remains fundamentally high: the Office for Budget Responsibility estimates that the structural deficit will be 8.3% of potential GDP in fiscal 2021/22. The government is therefore prioritising efforts to reduce it. Some or all of its Covid support measures (reduced VAT on hospitality, reduced stamp duty on property purchases etc.) have been withdrawn. The government is also planning to increase National Insurance contributions in April 2022 and corporate income tax from April 2023.

Jean-Luc Proutat

QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

The indicators in the radar are all transformed into ‘z-scores’ (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -3 and +3. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

