UNITED KINGDOM

HEADING TOWARD RECESSION?

Inflation continues, driven by factors specific to the UK economy. On the one side, we have a labour market with full employment, favouring wage rises. On the other side, we find the UK economy's exposure to the consequences of the invasion of Ukraine putting considerable pressure on energy prices. Despite increasing its policy rate early, and then building on this with a succession of further hikes, the Bank of England is struggling to control rising prices. The government has little choice but to intervene to bolster household purchasing power. The economy is already slowing, and there is a risk it will worsen.

Inflation has continued since the beginning of the year (9.1% y/y in May), driven by a sharp increase in the price of goods (12% y/y in April) and a rise in the price of services (5% y/y in April). Despite the MPC's successive increases in the policy rate, core inflation has continued to rise rapidly (6.2% y/y). When it comes to energy prices, the trends have been spectacular. In April, the price of the energy components of the consumer price index increased sharply: 113% for fossil fuels, 95% for domestic gas and 54% for electricity.

These inflationary pressures have hit households hard and consumer confidence in future prospects has collapsed to record lows. The GfK index has fallen to -40 points, with very negative expectations for the next twelve months for both the economy (-56) and personal financial situation (-25).

Although it has still not returned to its pre-pandemic levels, the labour market remains resilient. Between February and April 2022, the employment rate continued to climb, taking it to 75.6%, but it remains 0.9 of a point below its pre-Covid level. Driven by an upward trend in wages, the activity rate has increased (79%), which has contributed to an increase in the quantity of labour available. The return of inactive workers to the labour market does not necessarily translate into a return to employment. Although the unemployment rate is low by historical standards, it started to rise again in April, when it was 0.1 of a point higher than in March; however, it remains close to the full employment level at 3.8%.

Tension in the labour market is generating a significant increase in nominal wages. Average wages (including bonuses) are growing at 6.8% y/y, benefiting much more the private sector (+8%), particularly the financial and business services sector (+10.6%), than the public sector (+1.5%).. Nevertheless, real average weekly earnings (AWE) saw positive growth (of 0.4%) only by virtue of bonuses, most notably in the financial and business services sector. Faced with wage trends that are still too timid and unevenly spread across sectors to offset the loss of purchasing power, social unrest is becoming apparent, and the threats of strikes are multiplying, particularly in transport and healthcare.

Faced with the rising number of such disputes Rishi Sunak, the Chancellor of the Exchequer, has opted to boost household purchasing power through a GBP15 billion support package. Bigger and more targeted than expected, this package should support consumption, or at least limit its contraction, over the autumn. It will also offset the planned increase in fiscal pressure that households have been facing since February 2020 (increase in social security contributions in April 2022 and a new tax to finance health and social care from April 2023).

Against this background of economic and political pressure, the number of negative indicators is piling up. With the measures to support households not due to come into force until the autumn, inflation is continuing to rise and the slowdown in growth is already clearly visible. The contraction in the economy has worsened over several months (-0.3% m/m in April from -0.1% m/m in March). This slowdown was confirmed in May, with retail sales falling by 4.7% y/y. Nor are the survey data (Flash PMI) particularly encouraging, with the manufacturing PMI down to 53.4 and the services PMI stagnating at the low level of 53.4. The Bank of England has continued its monetary tightening at the steady and moderate pace of 25 basis points, but this has not yet managed to slow inflation. The necessary continuation of monetary tightening can only further damage growth, with the risk of dragging the UK into a recession before the end of the year.

GROWTH & INFLATION

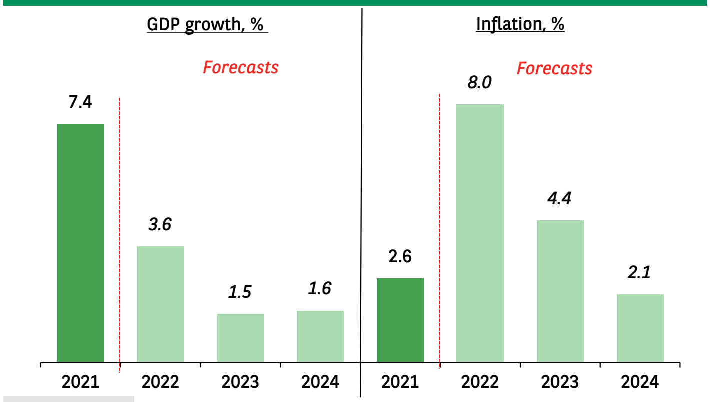

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

UNITED KINGDOM: SURGE IN ENERGY PRICES

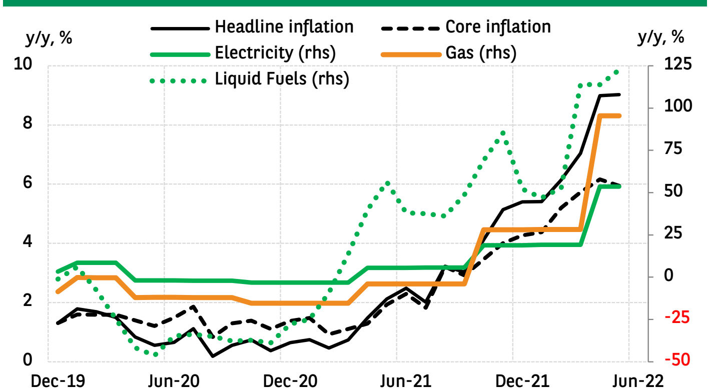

CHART 2 SOURCE: ONS, BNP PARIBAS

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