UNITED KINGDOM

RECESSION DELAYED

The UK economy avoided recession in H2 2022 thanks to corporate investment and public and private consumption. Inflation figures in February surprised on the upside and remained at an exceptionally high level, which should continue to erode household purchasing power. As a result, the recession may only have been postponed. We now expect GDP to contract by -0.3% QoQ in Q1, then by -0.2% in Q2 2023. Faced with this situation, the Bank of England (BoE) is not expected to raise its key rate beyond a final hike of 25 basis points in March. This, plus accelerating disinflation, would allow a rebound in growth from H2 onwards.

The resilience of growth in Q4 2022 (+0.1%% QoQ) looks very much like the last stop before recession, which the country is not expected to avoid in H1 2023. Household consumption grew only +0.2% q/q in the last quarter and their situation is anticipated to deteriorate in Q1 2023. At 10.4% YoY in February (peak at 11.1% YoY in October), inflation continues to erode household purchasing power (real household disposable income in Q4 was 1.2% below its pre-pandemic level). This inflation is at historically high levels, particularly for food (+18.0% YoY) and for catering (+11.4% YoY). Real estate prices, impacted by the rise in credit rates (7% in February, the highest level since 2008, compared with 5.1% in September), also continued to fall in March (-3.0% YoY, the sharpest drop since July 2009).

As for companies, 2022 saw real investment growing by 10.8% compared to 2021. This increase is largely due to a catch-up effect after the sharp drop seen in 2020 (-12% on annual rythm), which was followed by only a modest upturn in 2021 (+0.9%). Nevertheless, the current level remains 3.1% below its pre-pandemic level. This investment support for growth is not expected to last in 2023, impacted by the combination of weak growth prospects and rising credit costs.

The labour market remained resilient at the beginning of the year, with the unemployment rate remaining at record lows (3.7% in January). The increase in nominal wages (+6.5% YoY excluding bonuses in January) is significant but not enough to offset inflation. Households should therefore see their purchasing power continue to diminish in H1 2023 before recovering in H2 under the effect of the expected disinflation which will not, however, be enough to offset the accumulated loss.

Our scenario forecasts recession in H1 (-0.3% then -0.2% QoQ in Q1 and Q2), before factors less negative than previously feared - notably a less restrictive budgetary policy than expected - facilitate a moderate upturn in H2 (+0.3% then +0.2% in Q3 and Q4). As an annual average, growth would nevertheless be negative (-0.4%), the only negative growth in this scenario of the main OECD economies that we track.

DISINFLATION: WILL THIS BE GRADUAL IN H1 AND FASTER IN H2?

Inflation has fallen since its October peak but remains above the 10% threshold. The full impact of the rise in interest rates will be felt this year, and inflation should fall more rapidly in H2, reaching around 3% in December. The first favourable base effects linked to the drop in energy prices should be visible in Q2. Inflation expectations have started to drop and will also contribute to disinflation in H2.

Faced with this situation, the BoE raised its key rate by 25 basis points to 4.25% at its meeting on 23 March. We expect this to be the last hike, and the BoE is expected to keep its key rate at this level until the end of the year. Quantitative tightening operations (reduction of the BoE balance sheet) are expected to continue in 2023, but the BoE should remain cautious in the face of the risks of recession affecting the UK economy by limiting its monetary tightening.

GROWTH & INFLATION

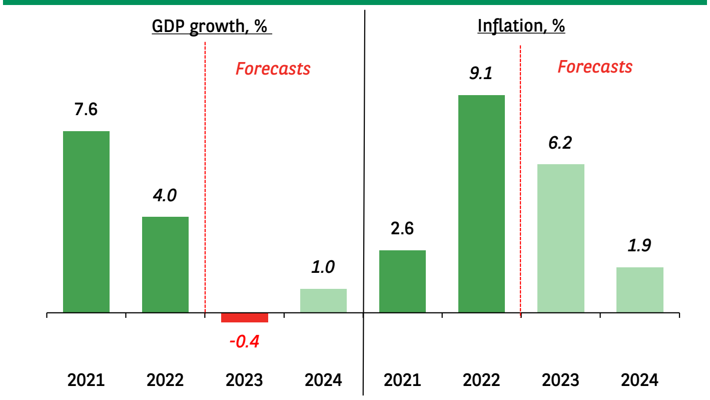

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

A LESS RESTRICTIVE PUBLIC BUDGET THAN EXPECTED

According to the latest forecasts from the Office for Budget Responsibility, the public deficit (Public Sector Net Borrowing) will be reduced by 0.4 GDP points per year in average until 2028 compared to the November forecast. This improvement, due to more resilient activity than expected (upward revision of 0.8% of GDP by 2028 by the OBR), has enabled the government to announce a less restrictive budget than anticipated. The Energy Price Guarantee has already been extended until June, and the wage increases offered in the public sector could be higher than initially proposed. In our view, a revaluation of 5%, instead of the current 3.5%, would have an additional cost of GBP 3.7 billion per year for the government. Other measures aimed at increasing the labour force participation rate are also included (for an annual cost equivalent to 0.3% of GDP until 2028) and will help support households. At the same time, the government has also announced measures to support corporate investment equivalent to 0.4% of GDP per year until 2026 (GBP 9 billion) in order to offset the rise in the corporation tax rate, which will go up from 19% to 25% in April.

The agreement entered into with the EU on the Northern Ireland Protocol should avoid the cost to activity that would have occurred if this agreement had not been reached, but should ultimately have a limited impact on growth (making investments in Northern Ireland more attractive, but with a more marginal national economic impact).

After bond-related tensions in September 2022, a calmer political environment should therefore help restore budgetary leeway, providing support to the UK economy in the face of a difficult economic climate.

Stéphane Colliac (with Louis Morillon, intern)
stephane.colliac@bnpparibas.com