UNITED KINGDOM

UK HOUSEHOLDS REMAIN UNDER PRESSURE

The party that wins the general election on 4 July will inherit an economy running out of steam. The scenario of a slowdown in growth in Q2 (+0.2% q/q), and over 2024 as a whole, remains our central forecast. Surveys data (PMI, GfK consumer confidence index) and investment have recovered, but household consumption remains depressed. While disinflation supports purchasing power, rising unemployment and the persistence of high interest and savings rates are limiting its effects. The rise in mortgage payment arrears indicates that the refinancing shock is continuing to spread. The return of inflation to 2% in May will support the Bank of England in its decision to initiate a first cut in key rates in August, according to our forecasts, which will give households (little) breathing space.

After months of resilience, are the latest developments in unemployment marking the beginning of a turnaround on the job market? It's still too early to say. Nevertheless, the claimant count, which had already climbed to a level significantly higher than the period before the health crisis, rose by 50,300 in May, the strongest monthly increase, excluding Covid-19, since 2009[1]. However, PMI surveys remain positive. The composite index has been stable and in positive territory since the beginning of 2024 (53.0 in May), while the employment sub-indicator is not dropping, albeit just about in expansionary territory (50.6). Household confidence is also rising against the backdrop of purchasing power gains: in May, the GfK index reached its highest level since December 2021.

Nevertheless, persistently high interest rates are keeping households under pressure. The average mortgage interest rate has been stable since September, and close to 8%. The proportion of arrears on all outstanding mortgages has risen since summer 2022, as a result of the triggering of the monetary tightening cycle, reaching 1.3% in Q1 2024. During the subprime crisis, this figure rose to 3.5% in Q2 2009[2]. Although a strict comparison may be misleading, it provides, at least, an important point of reference. In addition, monetary tightening has a lagged effect, and some UK households having borrowed at fixed rates for a relatively short term (2-5 years) still have to renew their mortgages at higher rates. In an unfavourable scenario, where unemployment increases and mortgage interest rates remain high, the proportion of payment arrears would continue to increase, further weakening household consumption and the UK economy as a whole.

The lowering of the cap on regulated gas and electricity tariffs in April (-12.3%), which will continue in July (-7.2%), allowed headline inflation to fall to 2% in May. Nevertheless, inflation in services remains strong, buoyed by the robust increase in regular pay (+5.7% y/y in April). The latest PMI surveys suggest that there will be further disinflation in services in the future (the input price index fell 7 points in May, the second strongest monthly decline ever). Nevertheless, the trade-off for the BoE, between price stability and economic growth, remains delicate.

Weak productivity gains and sustained wage growth are also impacting the profitability of companies. In the last quarter of 2023, unit labour costs rose by 6.9% y/y compared with CPI inflation of 4.2%. While some companies seem to have been able, initially, to absorb this increase in wage costs, through higher sales prices and/or lower margins, the question is how long this can last. In any case, the UK economy should continue to underperform most other G7 economies in the coming quarters.

Guillaume Derrien
with the collaboration of Elisa Petit, intern
guillaume.a.derrien@bnpparibas.com

GROWTH AND INFLATION

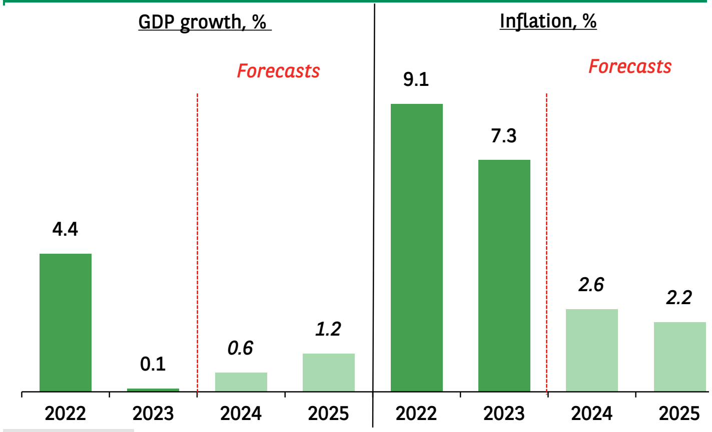

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

Measures to support household purchasing power

The Conservative Party and Labour Party manifestos were unveiled on 13 June. The major household support measures put forward by the Conservatives include cutting national insurance rates for employees again, abolishing the main rate for self-employed as well as abolishing stamp duty for first time buyers. There is also the introduction of a new Help to Buy scheme and the strengthening of the State pension mechanisms (Quadruple Lock or Triple Lock Plus)[1]. These measures would be funded primarily by tightening up on access to unemployment benefits, tackling tax avoidance and accelerating the transition from decentralised legacy benefits to the unified Universal Credit system.

For the Labour Party, direct purchasing power support measures are less explicit in the manifesto, which focuses more on measures aimed at improving public services (education, healthcare). Labour has already announced its intention to extend eligibility for the National Living Wage to 18-20-year-olds, and to reform the system of "zero hour contracts" and parental leave. The party is giving itself one hundred days after its election to introduce new legislation to improve the conditions of British workers. These measures would be funded by abolishing tax benefits for non-doms, increasing stamp duty for non-UK residents by 1%, introducing VAT and taxation for private schools, and strengthening the fight against tax avoidance.

1 The Help to Buy Scheme, introduced between 2013 and 2023, allowed households buying a new home to fund part of this purchase through a loan taken out from the government, with no interest for the first five years and with repayment of the principal after 25 years or on sale of the property. The Quadruple Lock would require the minimum tax threshold, currently frozen at £12,570, to be adjusted each year to the largest increase between the inflation rate (CPI), average wage growth and 2.5% growth.

1 These figures come from administrative sources and are not affected by the issues with the Labour Force Survey (LFS), which is in the process of being revamped.
2 These data come from the Financial Conduct Authority (FCA) and may vary in level with UK Finance statistics due to different methodologies, in particular concerning the threshold used (from 1.5% in arrears on the amount borrowed for the FCA and 2.5% for UK Finance). The arrears figure announced by UK Finance was 1.1% in Q1 2024.