UNITED KINGDOM: RECESSION

UK growth contracted sharply in Q3, confirming that the economy has gone into recession. Household and business surveys confirm this fall in consumption and investment, which is likely to continue in the coming months. Faced with persistent inflation which continues to spread, the Bank of England is continuing to tighten its monetary policy, despite the economy entering recession. The simultaneous announcement of a support plan for households and fiscal consolidation measures by the new government should help in the fight against inflation while supporting the lowest income households.

Unlike the major economies of the euro zone and the United States, whose growth is resilient and was positive in Q3, the United Kingdom quarterly GDP growth fell by 0.2% (q/q) in Q3, compared with +0.7% in Q1 and +0.2% in Q2 (after revision). This decline in growth can be explained by a greater than expected destocking dynamic as well as by a contraction in private demand (household consumption and corporate investment), while public demand again supported growth. The very strong contribution from foreign trade helped to limit the contraction in growth. According to our forecasts, UK GDP would continue to contract in Q4, marking the entry into recession of the economy: GDP should, in fact, continue to contract over the next three quarters, to the point that growth in 2023 on average would also be negative (-0,9%). This downturn in activity is likely to slow inflation, with the peak expected in Q4 2022.

SLOWDOWN IN PRIVATE DEMAND

Household consumption contracted in Q3 and this trend is likely to continue in the coming months. The financial situation of households remains under pressure due to the high inflation in food products (+16.5% y/y), at its highest for 45 years, and energy (+90% y/y), despite the support measures put in place by the government since October. The rise in interest rates increases the cost of mortgage loans and rents, which in turn contributes to the reduction in household purchasing power. Despite a slight improvement in November, the GfK consumer confidence index remains close to its record low (-44 points).

The slowdown in consumption is also likely to affect business investment. According to various surveys by the Confederation of British Industry (CBI), business optimism continues to fall sharply in the industrial and service sectors. When asked about barriers to investment, companies say that they are more concerned about the uncertainty in demand than about labour shortages or financing costs.

PERSISTENCE OF INFLATION

Inflation continues to spread throughout the economy, driven by high volatility in energy and food prices and a particularly tight labour market. The consumer price index (CPI) rose by one percentage point to +11.1% (y/y) in October (+2% m/m). However the government's cap on electricity and gas prices for households and businesses helped to reduce inflation by 2.7 points in October, which otherwise would have been 13.8% according to the ONS. Core inflation remained stable year-on-year (+6.5%), but continued to rise month-on-month (+0.7%), which is likely to justify a further rise in key rates, which is expected to be 50 basis points according to our forecasts, at the December meeting of the Monetary Policy Committee (MPC).

The persistence of inflationary pressures is forcing the Bank of England (BoE) to continue raising its key rates and to further reduce its balance sheet (quantitative tightening), despite the economy falling into recession. Furthermore, the measures announced by the government should on this occasion contribute to the fight against inflation, which should allow the Bank of England to reach its terminal rate more quickly than expected.

GROWTH & INFLATION

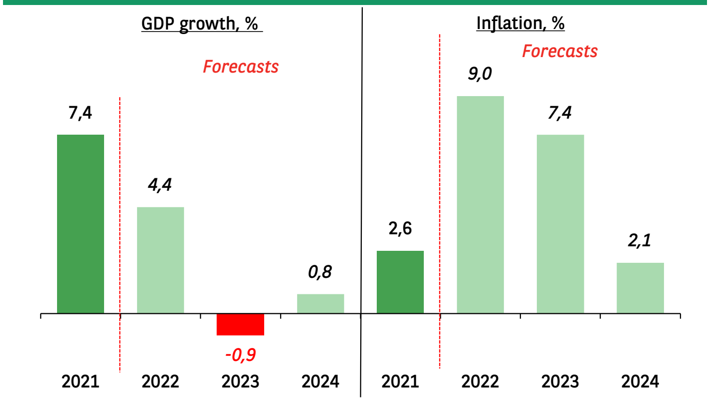

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

NEW FISCAL PARADIGM

While public demand supported growth in Q3, the situation could well reverse, in light of the recent measures announced by Jeremy Hunt, the Chancellor of the Exchequer, in his Autumn Statement. The plan for "stability, growth and public services" consists of two elements with different objectives. Firstly, the government foresees the continuation of targeted support for purchasing power (£26 billion) thanks to an extension of the Energy Price Guarantee from April 2023 onwards, as well as the increase in the National Living Wage (+9.7%) and social security and pension benefits (+10.1%). Companies will not see an extension in April of the support measures they have benefited from since October. Secondly, the plan envisages a policy of fiscal consolidation with a dual objective: to combat inflation and to guarantee the sustainability of public finances by generating revenues of £55 billion by 2027-2028. In this context, the government plans to increase tax revenues by around £25 billion over five years, in particular due to the increase in corporation tax (from 19% to 25% in April 2023) as well as by applying an exceptional (windfall) tax on oil and gas companies. In addition, the government is aiming for savings in public expenditure (£30 billion), despite announcements of further spending for the National Health Service (NHS), education and research and development.

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