UNITED KINGDOM

IN SEARCH OF A SECOND WIND

The UK economy is flirting with recession. The downturn in activity in the second half of 2023 is expected to continue until spring 2024 before an expected sluggish recovery, which nonetheless will be supported by the Bank of England (BoE) beginning its monetary easing cycle. Despite an uptick in December 2023, inflation remains on its downward trajectory, which is clearly reflected in production prices and CBI surveys. The turnaround in the labour market, which is still muted, is helping to reduce upward pressures on wages. While this is good news for inflationary momentum, it is also weakening private consumption. The BoE has little room for manoeuvre, with an initial policy rate cut expected to occur in June 2024. However, monetary easing is expected to be slow, with a drop of one percentage point (5.25% to 4.25%) anticipated in 2024.

Following a real GDP contraction of 0.1% q/q in Q3 2023, the ONS monthly figures indicate stagnating activity in October and November, and there is little sign of an upturn in December. Household consumption, impacted by the inflation crisis and the (moderate) deterioration of the labour market, fell in December. Retail sales (excluding fuel) were down 3.1% m/m in real terms in December, the sharpest monthly drop in three years. The end-of-year distortions of consumption patterns, caused by Black Friday, are not the sole cause for this decline, as retail sales fell 0.8% q/q over the entire last quarter.

Inflation rose slightly in December, to 4.0% year-on-year, but remains on a downward trajectory. The 3m/3m annualised rate for the CPI dipped below 1% in December, which clearly underlines the weakening price dynamics over the past few months, which will gradually materialise in the year-on-year rate. In addition, companies' production prices are not indicating that inflation is picking up again, as the fall of these prices, excluding energy, accelerated in December, taking it to -2.8% y/y. Consumer price disinflation is expected to continue during the first half of 2024, driven mainly by the slowdown in non-energy goods (food and household equipment). At the same time, although the deceleration in services prices will continue, it is expected to be more limited, once again due to sustained wage growth (see below).

Even though falling inflation should buoy consumption, a greater deterioration in the labour market would curb these effects. Its turnaround is seemingly muted so far, with the unemployment rate plateauing at 4.2% this autumn, after rising in Q2. However, the current recruitment trends are still difficult to analyse, as the Labour Force Survey (LFS) traditionally used by the ONS has been suspended since October 2023, due to statistical issues caused by falling response rates. The figures currently published are based on payrolls data and will be subject to substantial revisions. The ONS will start publishing the new LFS from spring 2024. Wages and job vacancies data continue to be updated as they come from different sources. A decline in this second indicator can be observed, and it is significant in a quarter of sectors, mainly in services (retail sales, transport and warehousing, information and communication), where the number of new vacancies has fallen below 2019 levels). The rise in regular wages has slowed as a result of the combination of falling inflation and rising unemployment. Even though the increase was still important year-on-year in December, at 6.0%, the 3m/3m annualised rate fell to 2.8%.

However, there are some positive developments to note. In particular, there is increasingly strong evidence that the property market is stabilising. Since last summer, the RICS survey has indicated a clear improvement in the outlook for housing transactions and prices. Since monetary tightening began in December 2021, property prices have fallen between 4% and 5% y/y according to various indicators (Halifax, Nationwide), but have seemingly started rising again since this autumn.

GROWTH & INFLATION

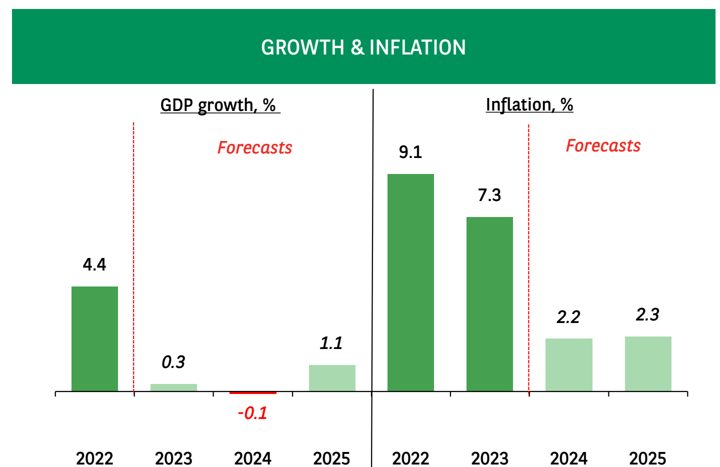

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

However, even though the negative effects of monetary tightening should gradually ease, they will linger during 2024. In its most recent Financial Stability Report, published in December 2023, the BoE estimates that just over half (5.5 million) of UK households with a mortgage have already refinance it since the rate hike cycle began at the end of 2021. Almost 5 million additional households are expected to do so by 2026. The tightening of credit conditions already left its mark in 2023. Arrears on mortgage repayments increased quite significantly, accounting for 1.1% of outstanding mortgages in Q3 2023, the highest proportion since Q2 2017[1]. These figures are still far below those seen during the 2008 crisis, when they peaked at 3.6% in Q1 2009. Nevertheless, household solvency is still under pressure, with mortgage interest payments continuing to rise sharply (+44.1% year-on-year in December, according to the retail price index).

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1 Source: British Financial Conduct Authority (FCA).