UNITED KINGDOM

THE OLD LADY HESITATES

To raise or not to raise interest rates? That is the question facing the Bank of England as inflation accelerates and the number of Covid-19 cases surges again, this time with Omicron, the new Covid-19 "variant of concern". After rebounding strongly through summer 2021, economic growth has also lost the support of public spending, and is showing a few signs of levelling off.

Although the UK government showed no lack of determination in countering the Covid-19 pandemic (direct transfers to the economy as part of the health crisis were estimated at 20 points of GDP according to the IMF, more than double the European average), it was also one of the first to declare the end of "whatever the cost". In October 2021, it terminated the main job retention measures – the Coronavirus Job Retention Scheme (CJRS) and the Self-Employed Income Support Scheme (SEISS). About 1.5 million British workers on "leave" from their companies had to return to the labour market during the fall months. This could have an impact on the unemployment rate, which had fallen to 4.3% of the labour force last August. In addition to these job subsidies, other support measures also expired, including the universal credit (GBP20 per week), the reduced VAT rate for hotel and restaurant services and the special reduced transfer tax rate.

GROWTH AND INFLATION

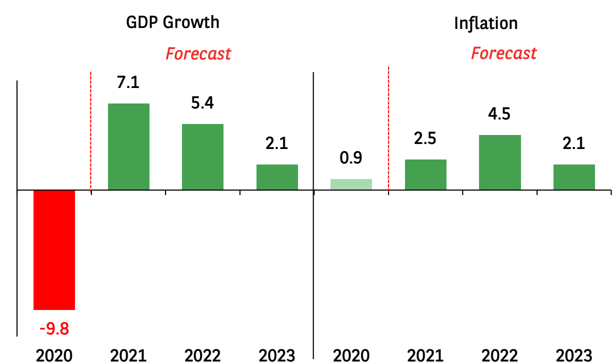

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

A LESS EUPHORIC OUTLOOK

Unsurprisingly, the number of real-estate transactions plunged again in the wake of these measures, and cyclical indicators in general seem to be looking less euphoric (chart 2). Although purchasing manager surveys were still upbeat through November, there seems to be some erosion of household confidence and spending, the main growth engines behind the catching-up movement. 3m/3m path in retail sales showed a decline in purchases of manufactured goods, and cars in particular. At the time we went to press, statistics had not yet taken into account the outbreak of the new Omicron variant. Hit by numerous new cases of the Delta variant, the government opted to launch new restrictive measures (mandatory self-isolation for both vaccinated and unvaccinated contact cases), the first since restrictions were lifted in early July.

Driven up by higher regulated prices for energy, price inflation has accelerated a little faster than expected by the Bank of England. At 4.2% year-on-year in October, inflation continues to rise above the official 2% target, leading the bank's Governor Andrew Bailey to adopt a harsher tone concerning monetary policy. Initially set for the end of December, he confirmed the end of quantitative easing, with the goal of stabilizing the central bank's asset holdings at GBP 895 bn (40% of GDP). The BoE had intended to raise its key bank rate at the same time (held at 0.10% since March 2020), but the Old Lady now seems to be hesitating.

To tighten or not to tighten monetary conditions? That is the question at a time when the economy is less supported by fiscal policy (after emergency measures were halted, social welfare contributions will be raised as of April 2022), and new headwinds seem to be taking shape with a new wave of the Covid-19 pandemic.

COMING IN FOR A LANDING

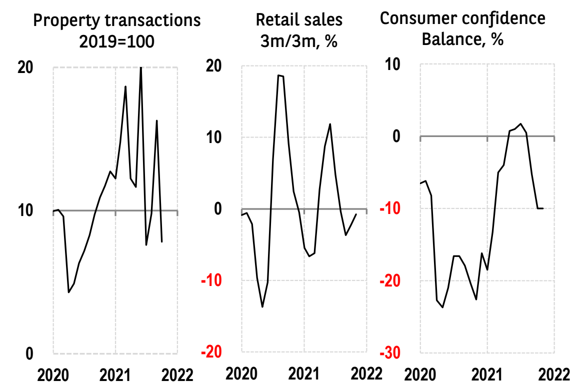

CHART 2 SOURCE: ONS, HMCE

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