UNITED KINGDOM

A SERIES OF SHOCKS

The time has passed for unlimited fiscal and monetary support in the UK, and priority is now being given to reducing deficits and lowering inflation. To counter the shock triggered by Russia's invasion of Ukraine, which promises to further increase the energy and food bills of UK households, the government's measures to boost purchasing power seem to be rather mild so far. Consequently, we foresee a significant economic slowdown in 2022.

The UK's exposure to Russian trade is not the highest: it purchases virtually no gas from Russia, which accounted for only 0.7% of UK merchandise exports in 2019 (compared to 2% for Germany). Yet in the UK, as in all of Europe, the sanctions and shortages triggered by the Russian war in Ukraine are exacerbating inflationary pressures and undermining economic prospects.

TOWARDS 9% INFLATION?

In its spring report, the Office for Budget Responsibility (OBR) lowered its 2022 growth forecast to 3.8% from 6%. Moreover, it esteems that the annual rate of inflation, which is already above 6%, could peak at 9% in the months ahead. Once again, energy is the driving force behind escalating prices, and the energy bill rose sharply in April due to the upward revision of regulated gas and electricity prices (+54%). Inflation is also maintained by persistent labour shortages in key sectors, such as agriculture and transportation, due not only to the Covid-19 pandemic, but also to Brexit.

The loss of purchasing power will accentuate (chart 2) for UK households, whose real revenues have begun to decline. For Rishi Sunak, Chancellor of the Exchequer, the time for "whatever the cost" as passed. Although the new finance bill that took effect in April took a more restrictive turn[1], a few corrective measures were nonetheless announced: the fuel tax will be reduced by 5 pence per litter (EUR 0.06), the VAT rate on solar panels will be 0%, and the Household Support Fund will be doubled. According to OBR, however, these measures are far from offsetting the increase in fiscal pressure programmed in 2022 and beyond.

As to monetary policy, there is no longer any room for complacency, as if it were necessary to offset the inaction after the inflation target was surpassed in 2021. On 16 March, the central bank raised its key policy rate for the third consecutive time, bringing it to 0.75%. Although the Monetary Policy Committee (MPC) expressed concern about the impact of the Russian war in Ukraine, it voted almost unanimously (8 votes to 1) for additional monetary tightening. Noting the upturn in inflation expectations in the short and medium term, the MPC esteems that another "moderate" rate increase is still appropriate in the months ahead.

The time has thus passed for unlimited fiscal and monetary support in the UK, and government measures to boost purchasing power have been mild so far. Consequently, we foresee a sharp economic slowdown in 2022.

4 April 2022

Jean-Luc Proutat
Jean-luc.proutat@bnpparibas.com

GROWTH & INFLATION

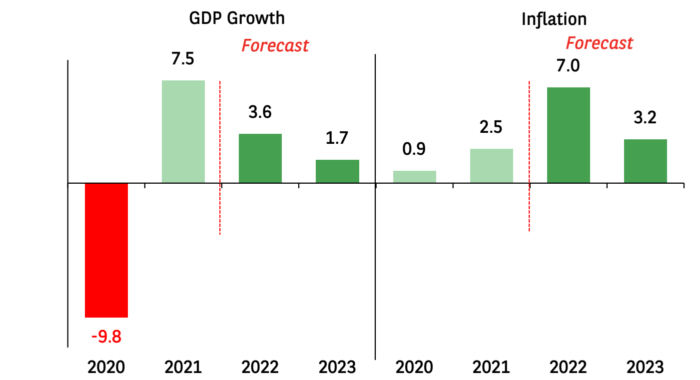

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

UNITED KINGDOM: REAL WAGES (Y/Y % CHANGE)

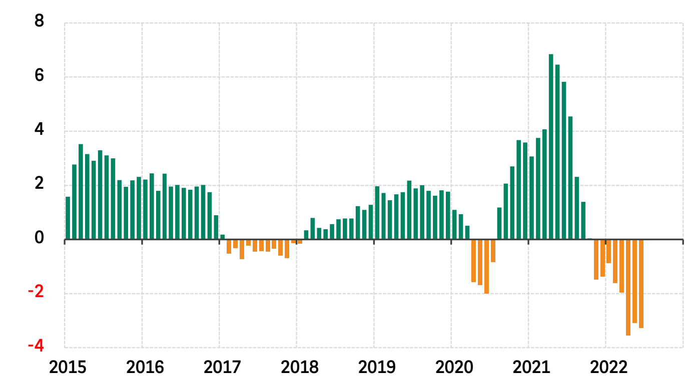

CHART 2 SOURCE: ONS, ESTIMATES BNP PARIBAS

1 Including, for example, a freeze on the income tax indexation rate and a 1.25 increase in the health insurance contribution rate, for additional annual revenues estimated at GBP 12 billion.