CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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UK Economy Down, But Not Out

The Bank of England's (BoE) latest set of detailed economic forecasts show it is no longer expecting a recession in the UK. The forecasts are contained in its quarterly Monetary Policy Report for May 2023. The shifts in the BoE's macro forecasts have been quite dramatic over the past six months, moving from expecting a two-year long recession to modest economic growth.

For this year, the BoE has upgraded its UK GDP growth forecast to +0.25%, from –0.5% in February and the fall of 1.0-1.5% it projected last autumn. For next year, the BoE is now expecting growth of 0.75%, compared to the 0.25% fall in GDP projected in February and decline of up to 1% forecast last November. Further out, the BoE is forecasting growth of 0.75% in 2025, up from 0.25% previously. These are the biggest upgrades to its growth forecasts since 1997.

However, as the BoE Governor pointed out, this is still a very subdued outlook, with growth running at below 1% over the period 2023-25, following twelve months of virtual economic stagnation. Activity remains very anaemic, with the economy growing by just 0.1% in the first quarter of 2023, matching the weak performance seen in the final quarter of 2022.

The fragility of the economy was underscored by March figures showing an unexpected fall of 0.3% in GDP in the month. It means that the UK remains the only G7 country in which GDP has not yet recovered to its pre-COVID level. UK GDP in the first quarter of 2023 was still 0.5% below its end 2019 level, in contrast to the US and Eurozone where is was 5.3% and 2.5% higher, respectively.

On the inflation front, the central bank reaffirmed that despite the CPI being higher than envisaged to date in 2023, it still expects the annual rate to decline sharply over the balance of the year, helped by sharp falls in energy prices. Its latest projections indicate, though, that the BoE is now expecting inflation to fall more slowly than before, declining to circa 5% by the end of this year, compared to the previous forecast of 4%.

Inflation is then projected to fall to 2.3% by end 2024. It is now not seen falling below its 2% target until 2025 compared to mid-2024 previously. Furthermore, the Bank emphasised that the risks around its inflation forecasts are skewed significantly to the upside.

Following the hike of 25bps at this month's meeting, the twelfth increase in this cycle that brought the Bank rate to 4.5%, the BoE refrained from giving clear guidance on the future course of monetary policy. However, it indicated a willingness to hike rates further if required and it did seek to alter the market's view that some 25-50bps of additional tightening is in the pipeline in the UK.

Given the recent significant upgrades to its growth and inflation forecasts, further tightening does indeed seem likely. In fact, the Bank's own mean CPI forecast, which sees inflation falling to its medium term target of 2% in 2025, is predicated on a further increase in interest rates. Thus, the long march of the BoE to higher rates does not seem over yet.

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