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ECONOMIC REVIEW

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INFLATION PERSISTENCE FORCES RATES HIGHER

The Bank of England (BoE) has sanctioned another hike in its benchmark interest rate after citing 'significant upside news' which suggests inflation is likely to take longer to fall back to the Bank's target level.

Following its latest meeting, which concluded on 21 June, the BoE's nine-member Monetary Policy Committee (MPC) voted by a 7-2 majority to raise Bank Rate by half a percentage point. This was the 13th successive increase taking rates to 5.0%, their highest level for 15 years.

The minutes to the meeting said there had been '*significant upside news in recent data that indicates more persistence in the inflation process.*' They also stressed that the MPC will continue to '*monitor closely indications of persistent inflationary pressures*' and '*if there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required.*'

Commenting on the day the decision was announced, BoE Governor Andrew Bailey said, "*The economy is doing better than expected but inflation is still too high and we've got to deal with it. If we don't raise rates now, it could be worse later.*"

Data published by the Office for National Statistics (ONS) the day before the MPC's announcement confirmed that the headline rate of inflation remains stubbornly high. The Consumer Price Index (CPI) 12-month rate – which compares prices in the current month with the same period a year earlier – stood at 8.7% in May, the same figure as the previous month and well above the 8.4% consensus prediction from a Reuters poll of economists.

The CPI inflation rate currently stands more than four times higher than the BoE's 2% target and economists now typically expect to see another two quarter-point hikes over the coming months. The MPC's next interest rate decision is due to be announced on 3 August.

SURPRISE RISE IN PAY GROWTH

Although the latest official earnings statistics revealed that nominal wage levels are now rising at a record pace, the release also showed that pay growth is still failing to keep up with the continuing rapid rise in prices.

Figures published last month by ONS showed that average weekly earnings excluding bonuses, rose at an annual rate of 7.2% in the three months to April. This was up from 6.8% recorded in the previous three-month period and also higher than a 6.9% rise predicted in a Reuters poll of economists.

ONS Director of Economic Statistics Darren Morgan noted that, in cash terms, basic pay is now growing at the fastest rate since current records began over 20 years ago, excluding the period when figures "*were distorted by the pandemic*". Mr Morgan added, "*However, even so, wage rises continue to lag behind inflation.*" Indeed, in real terms, regular pay actually fell by 1.3% on the year during the February-April period.

Changes to the minimum wage implemented at the start of April were a key contributor to the record jump in nominal pay growth. Nearly two million workers benefited from a 9.7% rise which took the National Living Wage up to £10.42 an hour for those aged 23 and over.

The BoE has been closely monitoring pay levels, and the Bank Governor said the data showed "*we've got a very tight labour market in this country.*" The BoE has warned that large pay rises are likely to prolong the UK's period of high inflation.

Recently published survey data also suggests pay settlements remain at a historically high level. Figures from XpertHR showed that the median basic pay settlement in the three months to the end of May held at the same record high that had been reported during the previous three-month period.

RETAIL SALES RISE UNEXPECTEDLY

The latest official retail sales statistics have revealed another surprise monthly increase in sales volumes, although more recent survey data does suggest retailers continue to face a difficult trading environment.

According to ONS data, sales volumes grew by 0.3% in May, exceeding economists' expectations of a small monthly decline. The figures were boosted by an extra bank holiday to mark the coronation of King Charles as well as the arrival of more summery weather during the second half of the month.

Commenting on the data, ONS Senior Statistician Heather Bovill said, *"Retail sales grew a little in May, with online shops doing particularly well selling outdoor goods and summer clothes, as the sun began to shine. Garden centres and DIY stores also saw growth, as the good weather encouraged people to start home and garden improvements."*

Survey data released last month also suggests that UK consumers remain remarkably resilient, with sentiment hitting its highest level since January 2022 as households turned more optimistic about their finances and the economy. Evidence from the latest CBI Distributive Trades Survey, however, points to weaker sales in June, and the business group said conditions for retailers are likely to remain 'challenging' in the months ahead.

UK ECONOMY SEES MODEST GROWTH

Growth statistics released last month by ONS showed the UK economy edged higher in April, although forward-looking indicators do suggest any momentum may have been lost in the last couple of months.

The latest gross domestic product figures revealed that the UK economy grew by 0.2% in April, following a fall of 0.3% in March. ONS said retailers and the film industry, along with strong trade in bars and pubs were the main drivers of growth, outweighing contractions in both the manufacturing and construction sectors.

Data from the latest S&P Global/CIPS UK Purchasing Managers' Index (PMI) released towards the end of last month, however, suggests there are signs the economy may now be cooling as a result of tighter monetary policy. The preliminary composite headline figure fell to a three-month low of 52.8 in June, down from 54.0 in May.

Commenting on the findings from the June PMI survey, S&P Global Market Intelligence's Chief Business Economist Chris Williamson said, *"The pace of expansion slowed amid signs of a growing toll from the rising cost of living and higher interest rates. Most notably, consumer spending on services, a core growth driver earlier in the year, is now showing signs of faltering."*



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All details are correct at the time of writing (03 July 2023)

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