UK: On track for recovery

- **UK continued to report strong set of economic data**
- **High vaccination rate reduced the risk of prolonged lockdown and economic malaise**
- **BOE likely to stay pat for remainder of 2021**

Background

The stabilisation of the pandemic in the UK and its quick vaccination rate have allowed the UK government to keep up with its phase-by-phase reopening plan thus far. Now at stage three of the reopening plan, the approval of stage four could see lifting of restrictions on nightclubs, performances as well as social events such as weddings. The labour market revival gathered pace, which bodes well for the consumption outlook. However, the recent emergence of a new Covid variant risks delaying the reopening plan.

Positive development in labour market

The jobless rate fell to 4.8% in March, after peaking at 5.1% in December at the height of the pandemic. Notably, the 3-month average job gains, turned positive for the first time since March last year as hiring finally outpaced layoff. Vacancies are trending higher albeit still below the pre-pandemic level (656.7k vs above-800k pre-pandemic).

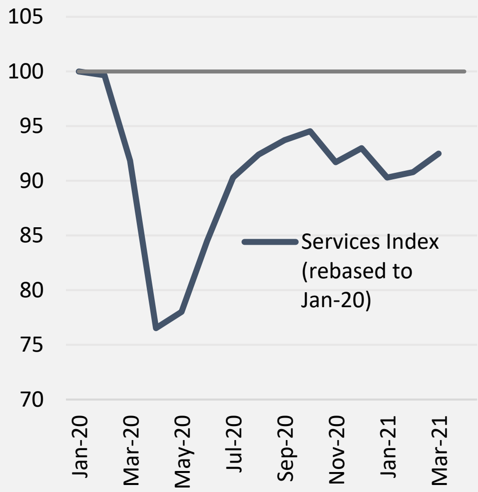
The firmer consumer and business confidence should continue to support the recovery in the services sector. The 9.0% m/m surge in retail sales in April reflects consumers' eagerness to spend for post-quarantine lives. While sales rose across most categories of brick-and-mortar stores, online sales were holding up relatively well too, as the release of pent-up demand were broad-based. However, we expect retail sales growth to ease in the coming months as consumers shift towards more experienced-based spending such as in the entertainment, accommodation, food dining and beverages (pubs).

Overall, there is still room for the services sector to grow. After the initial lockdown last year, the services index jumped back to the near pre-pandemic level, before sliding in October during the third Covid wave, and this was before the advent of the vaccines.

Manufacturing activity supported by overseas' demand

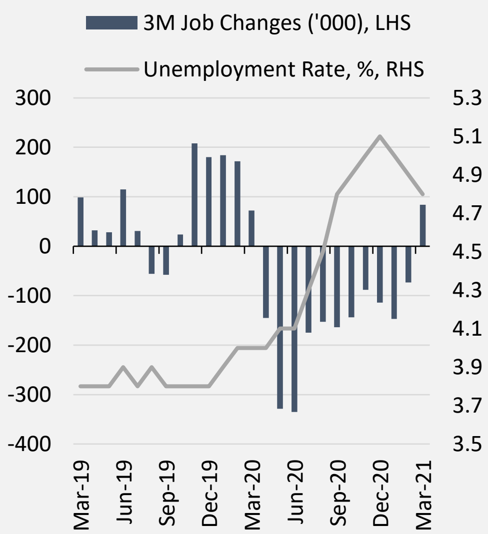
On the manufacturing front, output has grown the past two months (+2.1% m/m in March), against a backdrop of the global manufacturing resurgence. Forward indicators implied at higher future output. New exports orders are expected to be supported by overseas' demand, namely from the EU, US and China. However, rampant raw materials inflation risks biting into businesses' bottom lines. The recent PMI survey also suggests that smaller firms enjoyed less robust expansion/sales. To mitigate this, firms have largely ramped up purchasing activity to weather through higher prices; that are likely to last for the remainder of the year.

Figure 1: More room to grow



Source: Bloomberg

Figure 2: Job growth turned positive in March



Source: Bloomberg

Monetary Policy Outlook

Our base scenario is for the BOE to maintain policy throughout 2021 – base rate at 0.1% and QE at £895b. The BOE had been consistently cautious over its outlook assessment and may likely remain so, in view of the emerging Covid variant. The job market is not yet up to full speed and remained supported by the job retention scheme (to expire in September this year); consumers have continued to deleverage their balance sheets instead of borrowing. The mortgages lending data may still likely be distorted throughout 2Q.

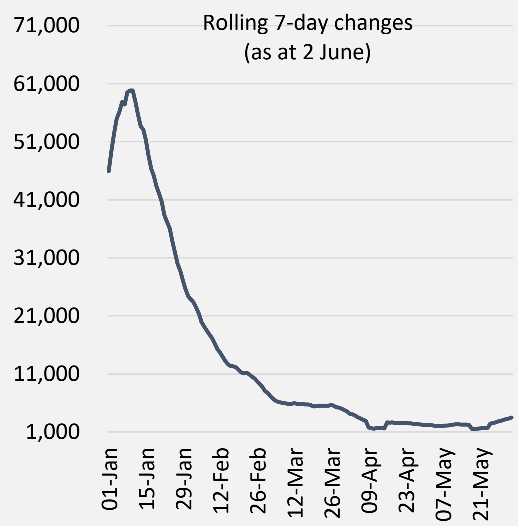
The record high net mortgages borrowing (£11.5b) in March reflects the rush to buy properties over expectations that a government's stamp duty exemption would not be extended beyond March (the measure was then extended to June this year). Like most central banks, the BOE also sees the surging inflation as being transitory, as it expects CPI inflation to hit above 2% towards end-2021, before easing back to around 2% after that.

FX Outlook

We see some strength in GBP alongside EUR for now, as the Covid epicentre is in Asia. After the surge in the first quarter, we expect GBP to retain its bullishness all the way to the third quarter, before trending down towards the end of 2021, barring from any negative development in the UK's pandemic situation.

The threat of a new wave remains very real. The upside is that, with nearly 58% of the UK population already receiving at least one jab, not to mention that inoculated individuals tend to experience milder Covid symptoms, the risk of a strained healthcare system was much lower compared to last fall. This could also mean that the likelihood of a prolonged lockdown (should there be any) is lower and may only delay, not stifle economic recovery.

Figure 3: New infections rose recently



Source: Bloomberg

Figure 4: Forecasts

	Indicative	2Q21	3Q21	4Q21
GBP/USD	1.4163	1.43	1.44	1.42
GBP/MYR	5.8385	5.91	5.98	5.82
GBP/SGD	1.8743	1.89	1.89	1.86

Source: HLBB Global Markets Research

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