

Measured BOE hike amid slowing growth outlook

- **Headline monthly GDP contracted for the second month**
- **Hiring continued as labour market appears to be solid**
- **BOE likely maintains 25bps rate hike tomorrow; pressure to hike 50bps grows**

The latest set of headline UK output indicators point to a broad economic weakness, in large part attributed to the negative contribution from the human health sector which shed 0.5ppts from the headline index following a substantial scaling back in the NHS Test and Trace activity. The monthly nominal GDP contracted by 0.3% m/m in April, versus -0.1% in March and forecast of 0.1% growth.

All the sub-indicators posted losses in April. Production fell 0.6% m/m (Mar: -0.2%) of which manufacturing output recorded a sharp 1.0% m/m fall (Mar: -0.2%). Manufacturing has now fallen for the third successive month, attributed to the supply chain constraints and higher prices. Construction fell 0.4% m/m after the strong 1.7% growth prior. Services fell 0.3% m/m (Mar: -0.2%) mainly reflecting the sharp reduction in human health activity (-5.6% m/m) which was offset by the growth in the wholesale and retail trade (alongside the repair of motor vehicles) activity.

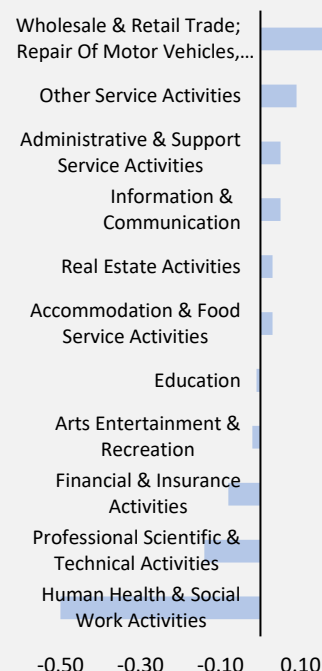
BOE likely sticks to 25 basis point increase

Meanwhile, the labour market continued to display relative strength. Payrolled employees increased more than expected in May (+90k vs +70k expected) while another government measure also showed employment increasing by 177k in the period of Feb-April 2022 (compared to +106k expected). Unemployment rate fell to 3.8% in the period, down from 4.0% in the previous three-month period (Nov 2021- Jan 2022).

Looking ahead, inflation remains a major uncertainty driving the near-term outlook. The higher wage growth resulting from the structurally tight labour market, global supply chain constraints, elevated energy prices related to the current Russia-Ukraine conflict as well as Brexit-related factors continue to drive the inflation narrative. The UK headline CPI rate hit a record high of 9.0% y/y in April whereas the underlying rate also at an all-time high of 6.2%. In fact, UK households are expected to foot larger energy bills in the coming months if energy regulator Ofgem increases its price cap by approximately 42% to £2,800/month as UK gas prices tracked the price hike in Europe even though the country imported relatively little gas resources from Russia.

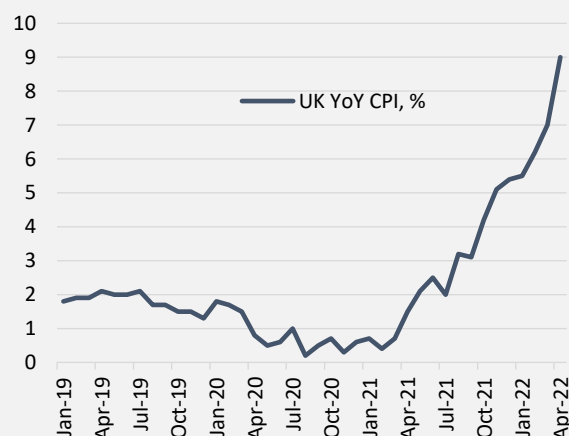
Consumer confidence fell to a record low (GfK consumer confidence hit -40) in May and the negative personal finance assessment

Figure 1: The reduction of NHS Test & Trace activity weighed on monthly GDP



Source: ONS

Figure 2: CPI rate nearing 10%



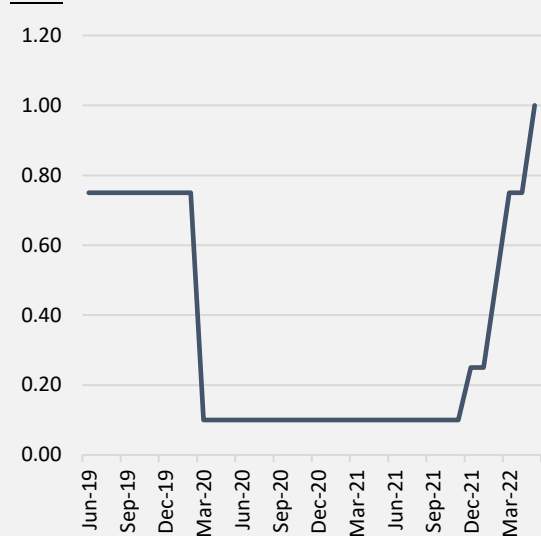
suggests that the broad consumer spending environment may turn even more cautious in the coming months, particularly in the area of more pricey and large ticket items. Retail sales has fallen for four months within a six-month period; in fact, the recent increase in sales in April (+1.4% m/m) was driven by food sales after months of declines as well as some rebound in online sales, clothing and auto fuel.

Nonetheless, the Bank of England will have no choice but to continue raising rates to rein in price pressures and to the consistent tune of 25bps tomorrow, its soon-to-be fifth hike since December last year. The pressure to hike 50bps builds up in recent days as the Fed looks poised to deliver a 75bp increase early tomorrow morning. The dominating view remains for the BOE to hike 25bps, taking the bank rate to 1.25% as the job and output data were mixed from a collective point of view, resulting in successive selloff in the sterling to below 1.20.

Like most central banks in the world, the challenge was to strike a balance between subduing prices and avoiding an economic downturn. The UK government’s recent announcement of a £15b cost-of-living package that includes direct cash pay-outs to households offered some reprieve to the BOE, while the arrival of summer may also offer some short-term boost to tourism and related activity.

We expect the BOE to tread cautiously, and our base case remains for the BOE to deliver another one 25bp hike in August after this week’s move; a pause afterwards is expected as a slowdown in demand would have caught up in the fourth quarter while energy prices may have begun its downward trend, meaning that the bank rate will stay at 1.50% through 1Q23. Further guidance will be sought in the MPC statement.

Figure 3: BOE has hiked rates to above pre-pandemic level



Source: Bloomberg

Hong Leong Bank Berhad

Fixed Income & Economic Research, Global Markets

Level 8, Hong Leong Tower

6, Jalan Damansara

Bukit Damansara

50490 Kuala Lumpur

Tel: 603-2081 1221

Fax: 603-2081 8936

Email: HLMarkets@hlbb.hongleong.com.my**DISCLAIMER**

This report is for information purposes only and does not take into account the investment objectives, financial situation or particular needs of any particular recipient. The information contained herein does not constitute the provision of investment advice and is not intended as an offer or solicitation with respect to the purchase or sale of any of the financial instruments mentioned in this report and will not form the basis or a part of any contract or commitment whatsoever.

The information contained in this publication is derived from data obtained from sources believed by Hong Leong Bank Berhad ("HLBB") to be reliable and in good faith, but no warranties or guarantees, representations are made by HLBB with regard to the accuracy, completeness or suitability of the data. Any opinions expressed reflect the current judgment of the authors of the report and do not necessarily represent the opinion of HLBB or any of the companies within the Hong Leong Bank Group ("HLB Group"). The opinions reflected herein may change without notice and the opinions do not necessarily correspond to the opinions of HLBB. HLBB does not have an obligation to amend, modify or update this report or to otherwise notify a reader or recipient thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

HLB Group, their directors, employees and representatives do not have any responsibility or liability to any person or recipient (whether by reason of negligence, negligent misstatement or otherwise) arising from any statement, opinion or information, expressed or implied, arising out of, contained in or derived from or omission from the reports or matter.

Potential and actual conflict of interest may arise from the activities of HLB Group. HLB Group constitute a diversified financial services group. These entities engage in a wide range of commercial and investment banking, brokerage, funds management, hedging transactions and other activities for their own account or the account of others. In the ordinary course of their business, HLB Group may effect transactions for their own account or for the account of their customers and hold long or short positions in the financial instruments. HLB Group, in connection with its business activities, may possess or acquire material information about the financial instruments. Such activities and information may involve or have an effect on the financial instruments. HLB Group have no obligation to disclose such information about the financial instruments or their activities.

The past performance of financial instruments is not indicative of future results. Whilst every effort is made to ensure that statements of facts made in this report are accurate, all estimates, projections, forecasts, expressions of opinion and other subjective judgments contained in this report are based on assumptions considered to be reasonable as of the date of the document in which they are contained and must not be construed as a representation that the matters referred to therein will occur. Any projections or forecasts mentioned in this report may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information. No assurance can be given that any opinion described herein would yield favorable investment results. Recipients who are not market professional or institutional investor customer of HLBB should seek the advice of their independent financial advisor prior to taking any investment decision based on the recommendations in this report.

HLBB may provide hyperlinks to websites of entities mentioned in this report, however the inclusion of a link does not imply that HLBB endorses, recommends or approves any material on the linked page or accessible from it. Such linked websites are accessed entirely at your own risk. HLBB does not accept responsibility whatsoever for any such material, nor for consequences of its use.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation. This report is for the use of the addressees only and may not be redistributed, reproduced or passed on to any other person or published, in part or in whole, for any purpose, without the prior, written consent of HLBB. The manner of distributing this report may be restricted by law or regulation in certain countries. Persons into whose possession this report may come are required to inform themselves about and to observe such restrictions. By accepting this report, a recipient hereof agrees to be bound by the foregoing limitations.