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Global Markets Research

Research Alert

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.

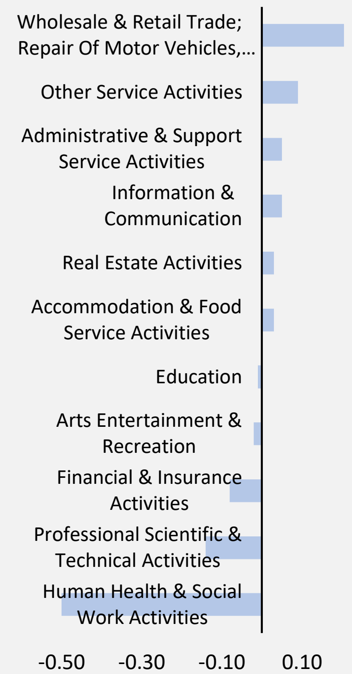
BOE likely sticks to 25 basis point increase

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.

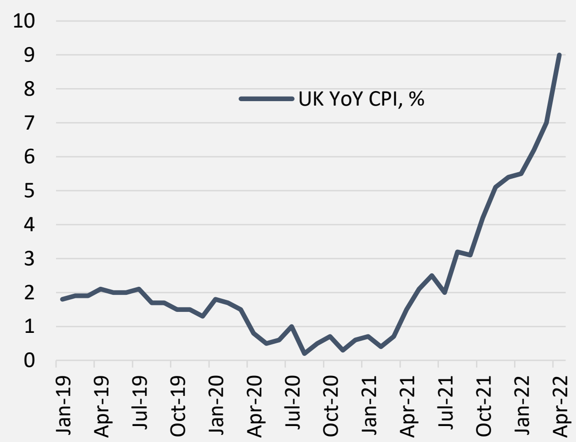
Consumer confidence fell to a record low (GfK consumer confidence hit -40) in May and the negative personal finance assessment

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



Source: ONS

Figure 2: CPI rate nearing 10%



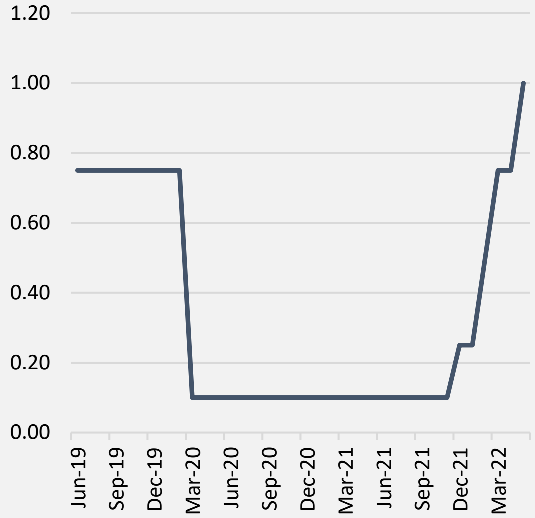
suggests that the broad consumer spending environment may turn even more cautious in the coming months, particularly in the area of more pricey and large ticket items. Retail sales has fallen for four months within a six-month period; in fact, the recent increase in sales in April (+1.4% m/m) was driven 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 Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my