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MONTHLY UK ECONOMIC BRIEFING
FEBRUARY 2018

KEY POINTS

- UK GDP growth slowed to a quarterly 0.4% in Q4 2017 from a previous estimate of 0.5%, reducing 2017 growth as a whole to 1.7%.
- The Bank of England's (BoE) message during its latest inflation report was more hawkish than the markets had expected, highlighting the possibility of a rate hike as early as May.
- This change in tone from the Bank reflects expectations of slightly stronger growth and less slack compared with November, combined with persistently above-target inflation.
- Recent volatility in global stock markets followed concerns that central banks will raise interest rates this year by more than expected in response to inflationary pressures, causing a re-evaluation of risk. Since then however markets have steadied.
- The Bank raised its growth forecast for the UK economy to 1.8% this year, from its previous forecast of 1.6%.
- The labour market statistics provide mixed messages for the BoE; while an upturn in pay growth opens the door for interest rates to rise, signs of the labour market losing steam add to worries that growth is still fragile.

UK GDP growth in Q4 2017 was

0.4%

2017 growth as a whole came in at

1.7%

Bank of England expects UK growth for this year to reach

1.8%

In Q4 2017 annual average weekly earnings grew by

2.5%

In January inflation remained at

3.0%

The unemployment rate ticked up to

4.4%

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UK ECONOMIC UPDATE

UK GDP growth slowed to a quarterly 0.4% from a previous estimate of 0.5%, reducing 2017 growth as a whole to 1.7%, its lowest since 2012. The revision to GDP in part reflected a small downward revision to the estimated output of the production industries. Business investment growth was flat, although when compared with the same quarter a year ago it grew by 2.1%.

The BoE's message during its latest inflation report was more hawkish than the markets had expected, highlighting the possibility of a rate hike as early as May. The Bank retained its language pointing to a gradual and limited tightening cycle.

The decision to raise rates for the Bank has largely hinged on the economic outlook. Subdued growth is what has kept the Bank on hold, despite above-target inflation and a weak GBP.

This change in tone from the Bank reflects expectations of slightly stronger growth and less slack compared with November. As such inflation is unlikely to return to the 2% target without some increase in interest rates.

The slack refers to the output gap, which is an indicator of the difference between the actual output of an economy and the maximum potential output of the economy. The output gap provides an indication of potential inflationary pressures, because if actual output is greater than potential output there will be inflationary pressures.

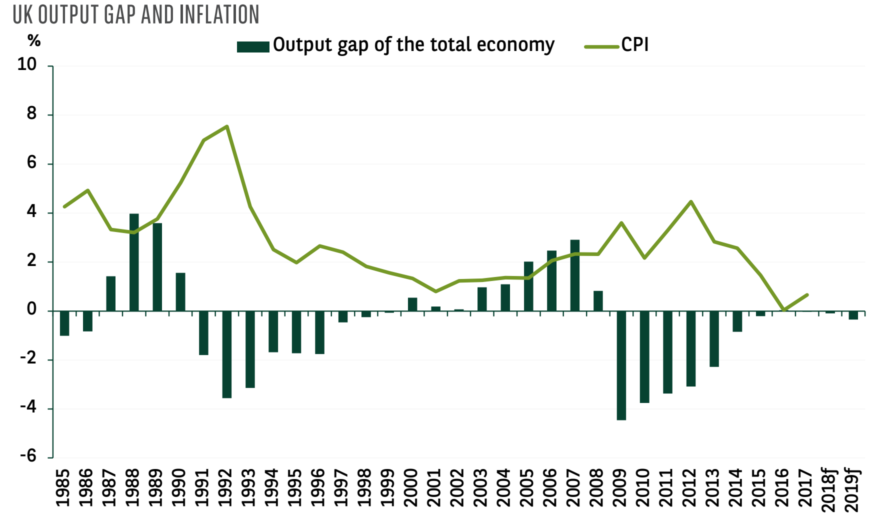
The Bank will be hoping that higher interest rates will encourage people to save – a method of curbing inflation.

During its latest briefing the Bank also raised its growth forecast for the UK economy to 1.8% this year, from its previous forecast of 1.6% made in November. It noted that the global economy was expanding at the fastest pace in seven years and that the UK was benefiting from that growth. Furthermore, the Bank believes UK wage growth will start to pick up, giving the economy a further boost. Annual average weekly earnings excluding bonuses grew by 2.5% in the fourth quarter of 2017, up from a rate of 2.3% in the previous quarter. Inflation remained at 3% in January, therefore, while earnings growth may be picking up, people are still not seeing wages rise quick enough to keep up with prices resulting in negative real wage growth. The BoE expects real wage growth to move into positive territory during 2018.

On the otherhand, the unemployment rate ticked up to 4.4%, up from a 42-year low of 4.3%. Although this was the first increase in unemployment in almost two years, the number of people in work continued to rise over the quarter. There is no evidence yet as to whether the latest figure is a blip or the beginning of an upturn in joblessness. The labour market statistics do however provide mixed messages for the BoE. While an upturn in pay growth opens the door for interest rates to rise, signs of the labour market losing steam add to worries that growth is still fragile.

"This change in tone from the Bank reflects expectations of slightly stronger growth and less slack compared with November, combined with persistently above-target inflation."

UK OUTPUT GAP AND INFLATION



Source: Macrobond