The UK economy stuck in stagnation

A plethora of UK data last week provided conflicting evidence on the strength of the economy of late. For the optimists, continuing strength in the labour market and solid retail sales figures for January suggest the UK consumer is recovering some momentum. However, sticky inflation and moribund GDP growth point to a wider malaise in the UK economy.

On the labour market, unemployment fell to 3.8% in December, down from 4.2% a month earlier. Regular earnings growth – a key benchmark for the Bank of England - also slowed to 6.2% from 6.7% and is now on a clear downward trajectory. However, with core inflation stuck at 5.1% for a third month running in January, a still-tight labour market remains the primary driver of relatively high UK inflation. To add to the uncertainty, measurement issues with the UK labour market data provide a large caveat in interpreting the strength of the UK jobs markets at present. Nevertheless, markets digested this news by trimming expectations for Bank rate cuts this year to c.70 basis points (bps) by end-2024, from 75bps at the start of last week, underpinned by a stronger-than-expected print for retail sales in January, up 3.4% on the month.

However, the Q4 GDP data provided further evidence of a longer-term trend of stagnation in the UK economy. GDP declined by 0.3% on the quarter, rounding off a calendar year growth of just 0.1% in 2023, and the economy is now just 1% above its pre-Covid level in Q4 2019. This compares to 3% and 8.2% growth in the Eurozone and US GDP economies, respectively, during that same period, highlighting the relatively weak trajectory of UK GDP in recent years. With the labour market beginning to show signs of weakness, reflected in recent industry surveys, and inflation expected to slowly moderate to its 2% target, the Bank of England should be on course to begin cutting rates later this year in line with the other Central Banks, which should provide a boost to growth in the near term.

On the main currency markets over the past week, the GBP/USD was the main mover, with markets reacting to the UK macro news. However, the sterling gains earlier in the week, rising above \$1.268, were largely given back by the end of the week, trading below \$1.26 by Friday. EUR/USD was also unchanged on the week at $1.078 on Friday, with dollar gains on the back of a stronger-than-expected US CPI number unwound once again by the end of the week.

Turning to the week ahead, the main release of note will be the flash PMIs for February in the Eurozone, US and UK. In the Eurozone, the PMIs have been in contraction mode for a number of months. However, the manufacturing PMI has edged higher over the winter, averaging 45.1 compared to just 43.3 in the three months to October. Meanwhile, the services sector reading has been little changed, averaging 48.6 in the winter, versus 48.1 in the autumn. Despite some modest improvement this month, both sector readings are expected to remain consistent with declining activity.

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