



UK economy better than dire predictions, but budget test awaits

Ahead of an expected difficult Budget on November 26th, the UK Chancellor must shepherd an economy which, while resilient, continues to churn out mediocre growth. Last week's UK labour market and GDP data provided the latest snapshot of activity in the economy, and paints a nuanced picture, better than some of the more hellish narratives surrounding the UK economy at present.

On the growth side, GDP rose by 0.1% on the month in August. The 3-month growth rate was just 0.3% in August, down from 0.7% in April, and the annual growth rate eased from 1.5% to 1.3%. However, the economic base is larger than previously thought, with recent upward revisions to the level of GDP. The breakdown shows some softness in the key services sector, which was flat on the month, and an outright fall in construction, but this was offset by solid gains in hospitality and manufacturing. Overall, the outlook is for further modest gains for the remainder of the year, which is likely to leave annual GDP growth in the range of 1.2-1.4% for 2025. While not stellar, that is likely to beat the anaemic growth expected in the Eurozone and would represent a second year of accelerated growth for the UK economy.

The labour market trends look more concerning. Payroll employment fell once again in September, continuing a series of weak out-turns in recent months. The unemployment rate edged up to 4.8% from 4.7% but remains historically low. Meanwhile, despite a softer jobs market, wage growth remains elevated in a 5-6% range based on various measures. That rate of wage inflation presents the Bank of England with a dilemma as it prepares its Monetary Policy Report for November. While the weak jobs market might merit a rate cut, the central bank has placed more store on inflation indicators which suggest it is far from achieving its 2% inflation mandate.

The weak jobs numbers may be due to the continued impact of the tax rises announced in last year's budget by the Chancellor, particularly the rise in employer national insurance contributions, which also feed into higher inflation. The November 2024 budget damaged business and consumer

sentiment and this year's budget could well do the same, if the expected tax hikes materialise on November 26th. This remains the key near-term risk for the UK economy alongside ongoing external geopolitical threats.

A Chancellor who has backed herself into a corner with a razor thin margin to meet her new fiscal rules must now revisit tax hikes, following the failure to implement promised welfare cuts and the fresh commitment to more defence spending. The budget tightrope is made even more challenging by the renewed scrutiny of bond markets on the fiscal sustainability of the UK government.

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