THE UK OUTLOOK

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ROBERT WOOD, CHIEF UK ECONOMIST
ELLIOTT JORDAN-DOAK, SENIOR UK ECONOMIST

GDP is proving resilient to high interest rates, rising a consensus-busting 0.6% quarter-to-quarter in Q1.

The MPC moved closer to a June rate cut by signalling the next two months' data could seal the deal.

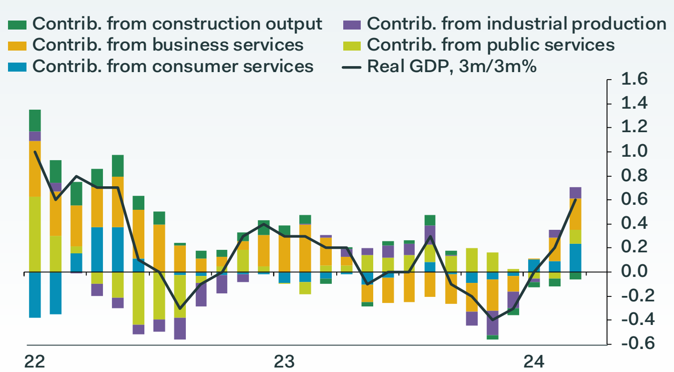
Sticky services inflation will keep the MPC to a cautious once-per-quarter rate-cutting pace.

Strong consumer income growth driving spending

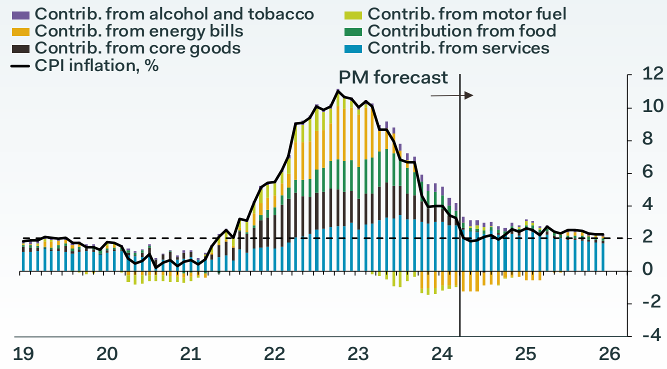
The UK economy is proving resilient to high interest rates. GDP grew by 0.4% month-to-month in March, propelling growth to a much-better-than-expected 0.6% quarter-to-quarter in Q1 as a whole. That was the strongest quarterly expansion since 2021. The economy has more than recovered the ground lost in last year's mild recession, and we estimate the underlying trend for GDP growth rose to 2.0% month-to-month annualised in March.

The recovery has been encouragingly broad-based across sectors, with only rain-hit construction still seeing output falling three-months-on-three-months in March, as our chart below shows. Meanwhile, breaking down growth by type of spending, rather than output, shows two-thirds of Q1 growth came from consumption and private investment.

THE GDP RECOVERY HAS BEEN BROAD-BASED



INFLATION WILL FALL BELOW 2% IN MAY,SERVICES STICKIER



A turnaround in global price pressures has propelled this economic upswing. The chart above shows we expect headline CPI inflation to dip below 2% in May, as energy prices fall and goods & food inflation slow. Private-sector average earnings excluding bonuses was still rising at 5.9% year-over-year in the three months to March, so consumers' total real wage income rose 4.3% year-over-year, more than double the average pace of increase between 2015 and 2019. Accordingly, we expect real consumer spending growth to reach 1.7% year-over-year in Q4 2024, and GDP to gain 1.6%.

Wage increases have dropped from the 2023 peaks, but still-solid pay gains— to which April's 9.8% minimum-wage hike will add in the next few months' data—have passed through to sticky services inflation. Headline inflation should rise modestly back above 2% later this year as energy-price falls fade and services inflation slows only gradually.

A triple whammy of changes from the MPC at its May interest rate decision meeting keeps it on track for a June rate cut. Policymakers think inflation will drop below 2% in the medium term if they don't cut soon, and they said data over the next two months could seal the rate-cut deal. ***We think the MPC will lower interest rates by 25bp in June, then again in September and December.***