Appendix

Economic Overview (March 2022) – Provided by Link Asset Services

- The first quarter of 2022 saw:

- A 0.8% m/m rise in GDP in January more than reverse December's Omicron-induced 0.2% m/m fall;
- Signs that the economy has been resilient to the war in Ukraine so far;
- A further rise in CPI inflation to a new 30-year high of 6.2% in February;
- A fall in the unemployment rate to 3.9% and a diminished supply of workers fuelling faster wage growth;
- Bank Rate rising by 50bps, taking Bank Rate to the pre-virus and post-Global Financial Crisis high of 0.75%;
- The war in Ukraine contribute to financial conditions being as tight as after the vote to exit the EU in 2016.

- **The UK economy got off to a good start in Q1, growing by 0.8% m/m in January.** That more than reversed the 0.2% m/m fall in December triggered by the Omicron wave. It took GDP 0.8% above the pre-virus February 2020 level.
- **The survey data suggest that the economy continued to rebound swiftly in February.** The S&P Global/CIPS all-sector Purchasing Managers Index rose from 54.4 in January to an eight-month high of 59.8 in February, suggesting near-term annualised growth in the region of 5%. The economy has proven resilient to the effects of the war in Ukraine so far but whether it can ride out the upcoming cost-of-living squeeze is a matter of conjecture.
- **In Q4, all the solid 1.3% q/q rise in nominal household disposable income was wiped out by a 1.4% q/q rise in consumer prices.** That meant that real household incomes fell by 0.1% q/q, the third fall in a row. And the GfK measure of consumer confidence has now fallen for four consecutive months, reaching a 17-month low in March.
- **With inflation set to keep rising, households are in for a prolonged period of negative real wage growth.** The surge in CPI inflation to a new 30-year high of 6.2% in February means that it is now more than three times the Bank of England's 2% target. The rise in core inflation (excluding energy, food and alcohol) from 4.4% in January to 5.2% in February also left it at a 30-year high. A 1.0% m/m price rise this February meant that food and drink inflation rose from 4.3% to 5.1%. That was the highest rate since September 2011.
- **CPI inflation is expected to peak at around 8.3% in April and will stay above 7.0% for most of 2022 and above 3.0% for most of 2023.** The scheduled 54% rise in utility prices on 1st April will add an extra 1.4ppts to CPI inflation in April. And the surge in agricultural commodity prices triggered by the war in Ukraine means that food price inflation is expected to soon climb above 6%.
- **The Chancellor announced some support for households in his Spring Fiscal Statement in March, in the form of tax cuts.** Despite the downward revision to the Office for Budget Responsibility's (OBR) real GDP growth forecast for this year (from 6.0% to 3.8%) and for next year (from 2.1% to 1.8%), the OBR's public finances forecasts still improved and gave the Chancellor a windfall of about £20bn. Nevertheless, the £9.2bn (0.4% of GDP) package for 2022/23, or £18.2bn (0.8% of GDP) if the support measures announced in February are included, will help to offset about half the blow to household finances from higher energy and food bills.
- **Households are drawing on their estimated £161bn of excess savings to offset lower real incomes.** The household saving rate dropped from 7.5% in Q3 to 6.8% in Q4. And the £4.0bn rise in cash sitting in households' bank accounts in February, which was smaller than the 2019 average rise of £4.6bn, suggests that households have stopped adding to their excess savings and have begun to reduce them.
- **Meanwhile, the tight labour market will fuel the Bank of England's fears that high inflation is feeding through into a rise in wage growth that will feed back into inflation.**

The unemployment rate fell from 4.1% in December to 3.9% in January. That is only just above the pre-virus rate of 3.8%.

- **Job vacancies increased to a new record high of 1.3 million in February and maintained the upward pressure on wage growth.** The 3myy rate of average earnings growth rose from 4.6% in December to 4.8% in January. And earnings excluding bonuses rose by another strong 0.4% m/m, which lifted its 3myy rate from 3.7% to 3.8%.
- **Meanwhile, the lasting financial market effects from the war in Ukraine so far appear to be higher commodity prices, higher interest rate expectations and wider corporate bond spreads.** UK financial conditions have tightened to levels similar to those seen after the referendum in 2016.
- **Gilt yields have risen back above their pre-war levels, driven largely by an increase in breakeven inflation rates.**

MPC meetings 4th February and 17th March 2022

- After the Bank of England became the first major western central bank to put interest rates up in this upswing in December, it has quickly followed up its first 0.15% rise by a further two 0.25% rises to 0.75%, in what is very likely to be a series of increases during 2022.
- The Monetary Policy Committee voted by a majority of 5-4 to increase Bank Rate by 25bps to 0.5% on 4th February, with the minority preferring to increase Bank Rate by 50bps to 0.75%. The Committee also voted unanimously for the following: -
    - to reduce the £875n stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets.
    - to begin to reduce the £20bn stock of sterling non-financial investment-grade corporate bond purchases by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023.
- The Bank again sharply increased its forecast for inflation – to now reach a peak of 7.25% in April, well above its 2% target.
- The Bank estimated that UK GDP rose by 1.1% in quarter 4 of 2021 but, because of the effect of Omicron, GDP would be flat in quarter 1, but with the economy recovering during February and March. Due to the hit to households' real incomes from higher inflation, it revised down its GDP growth forecast for 2022 from 3.75% to 3.25%.
- The Bank is concerned at how tight the labour market is with vacancies at near record levels and a general shortage of workers - who are in a very favourable position to increase earnings by changing job.
- By the time the MPC met in March, the Russian invasion of Ukraine was well established. Serious supply side shocks impacting energy and food stuffs, as well as impediments to global trade, had persuaded MPC members, by a majority of 8-1, to increase Bank Rate to 0.75% but caution as to the extent of further increases was emphasised. One member of the MPC wanted rates to stay on hold at 0.5%.
- The CPI measure of inflation is now expected to exceed 8% in Q1 2022/23, and despite measures announced by the Chancellor in his Spring Fiscal Statement to try to reduce the impact of the cost-of-living squeeze on households by reducing fuel duty by 5p a litre and increasing the threshold for employees paying National Insurance by £3,000 from July, we are still about to see the biggest squeeze on households' living standards for over 50 years.
- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative tightening) holdings of bonds is as follows: -

1. Raising Bank Rate as “the active instrument in most circumstances”.
2. After Bank Rate hit 0.50% to start reducing its gilt/bond holdings and to stop reinvesting maturing gilts.

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