Bank of England

Sefton Economic Forum: Economic Update

December 2022

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Plan

- Context
- Economic Outlook:
  - Growth
  - The Labour Market
  - Inflation
- MPC Perspective and Policy

Context

Context: Why are we where we are?

- **3 supply shocks to the UK economy:**

1. **Post covid disruption to supply chains**
2. **Surprisingly tight UK labour market**
3. **Energy price surge**

- **Adverse supply shocks increase prices and reduce output**
- **More problematic for monetary policymakers than demand shocks**

- **Government fiscal policy announcements**
  - **Growth Plan (23rd September)**
  - **Autumn Statement (17th November)**

Growth Outlook

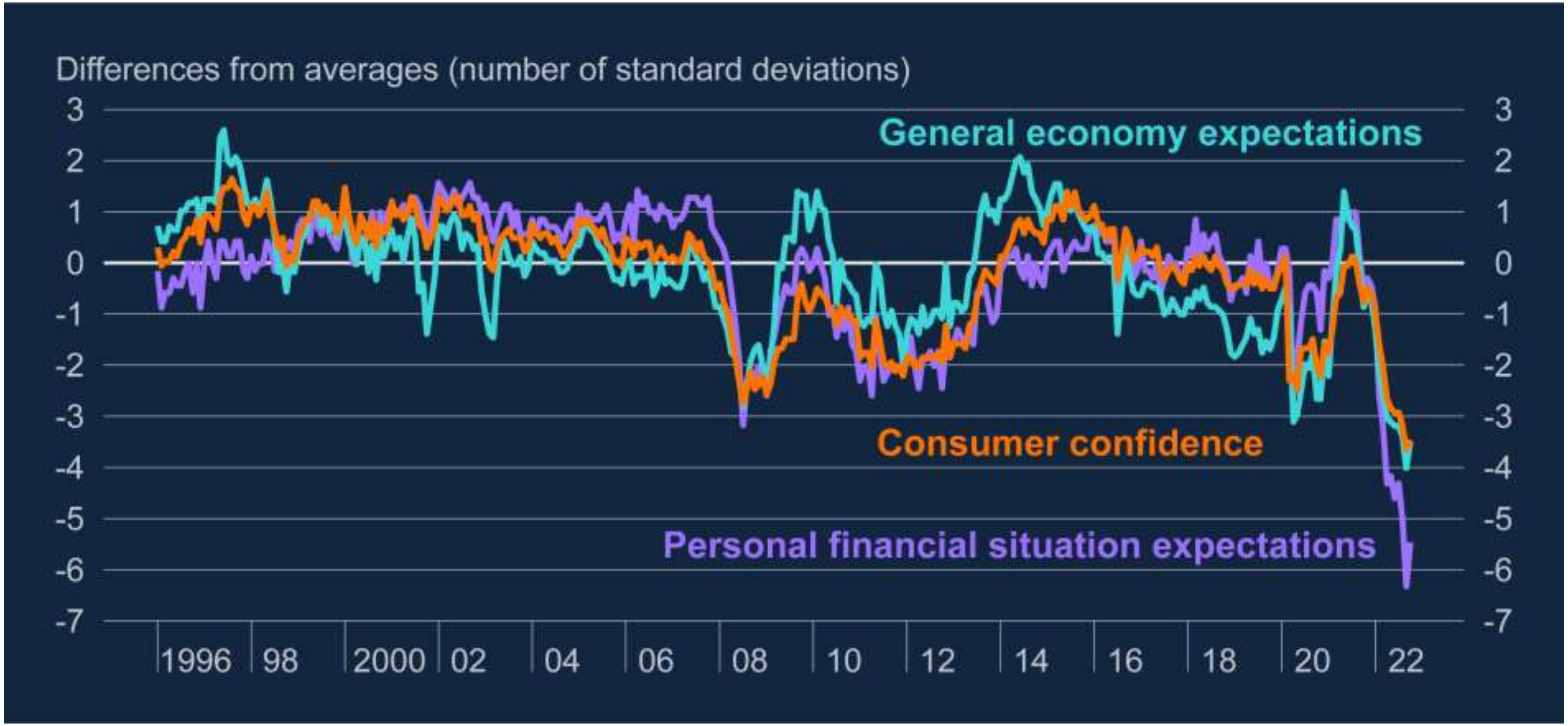
Chart 2.18: Contributions to four-quarter real household income growth

- Fiscal support cushions the fall in real household incomes in the near term
- Real post-tax household income is projected to fall a little in the year to 2022 Q4, but that fall is much smaller than expected in the August Report

Chart 2.12: Average quoted retail interest rates

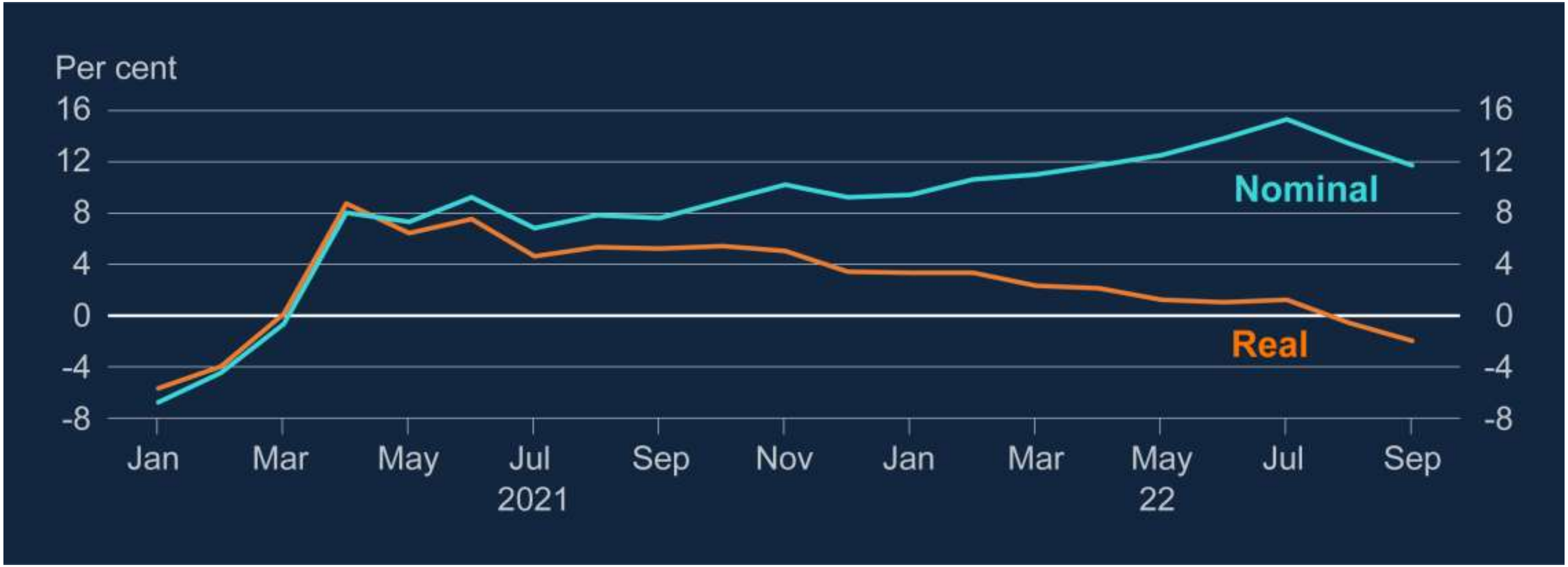
- Interest rates on mortgages and household savings products have risen sharply since August

Chart 2.21: Consumer confidence



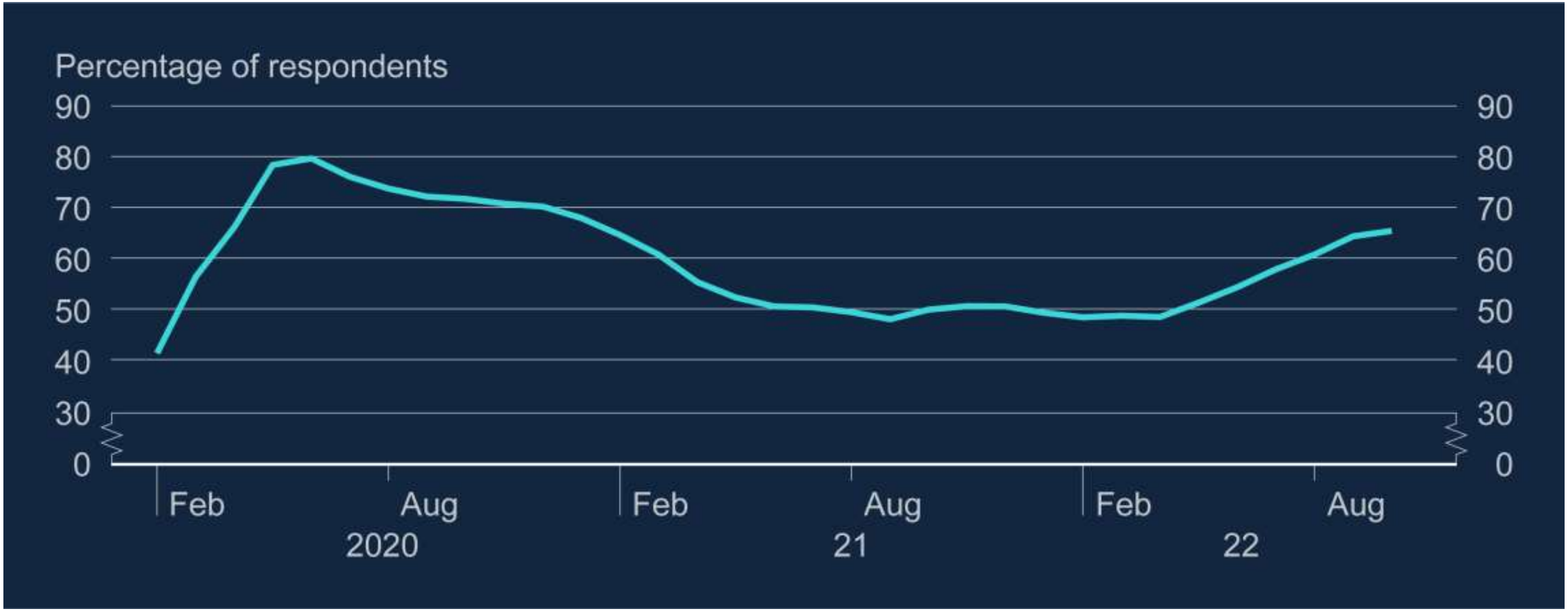
- GfK consumer confidence remained around record lows in October, as did expectations for personal financial situations and the general economy

Chart 2.15: Changes in nominal and real retail sales since 2019Q4



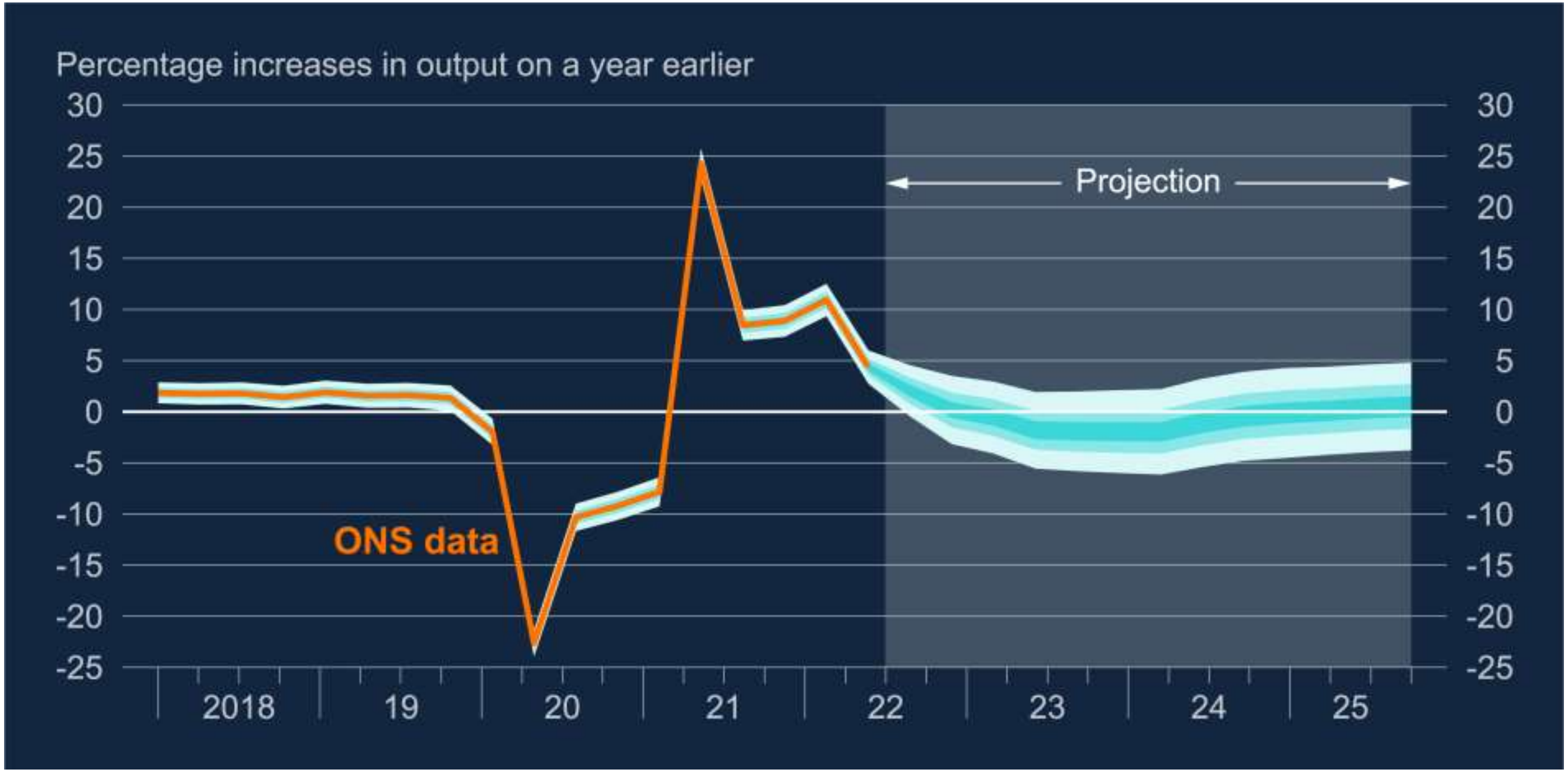
- Both the value and volume of retail sales have fallen in recent months

Chart 2.22: Business uncertainty



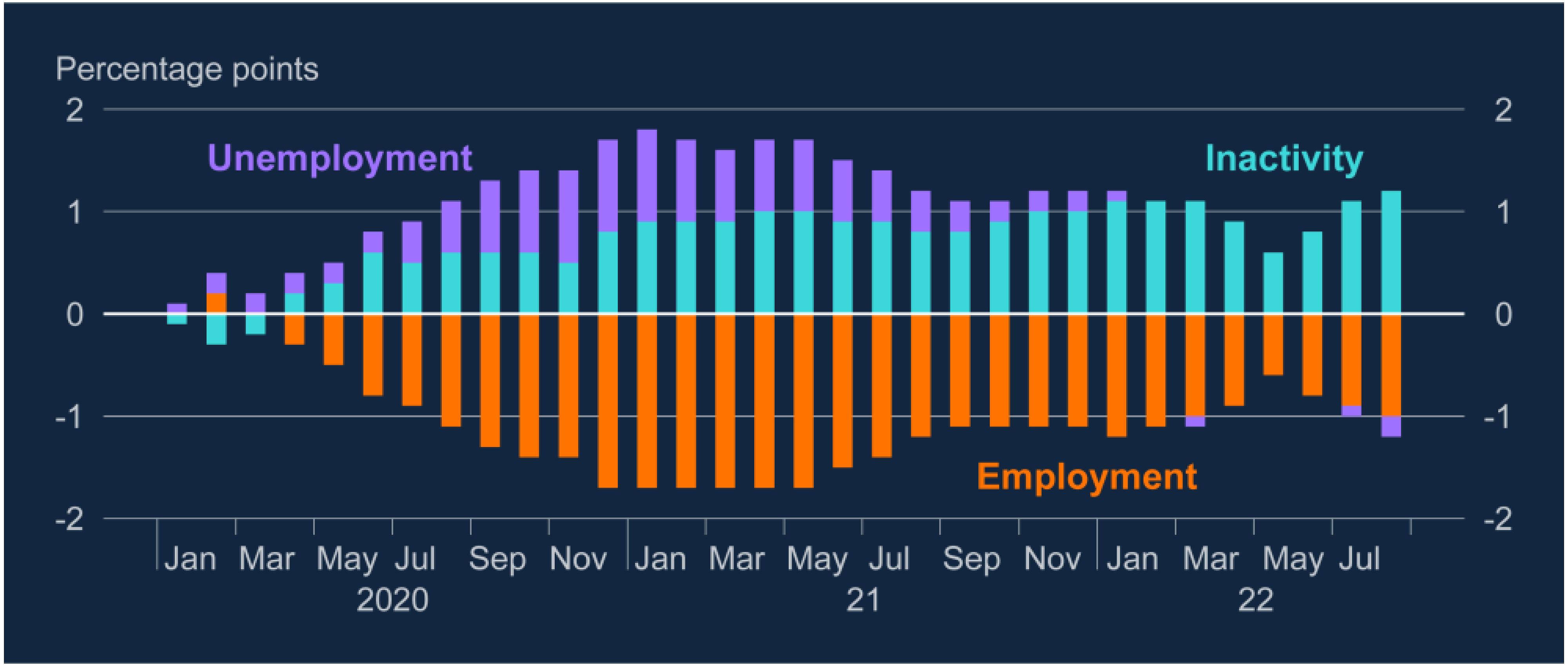
- Business uncertainty remained elevated in October, according to the DMP survey
- Alongside higher financing costs, likely to hold back investment

Chart 1.1: GDP growth projection based on market interest rate expectations, other policy measures as announced



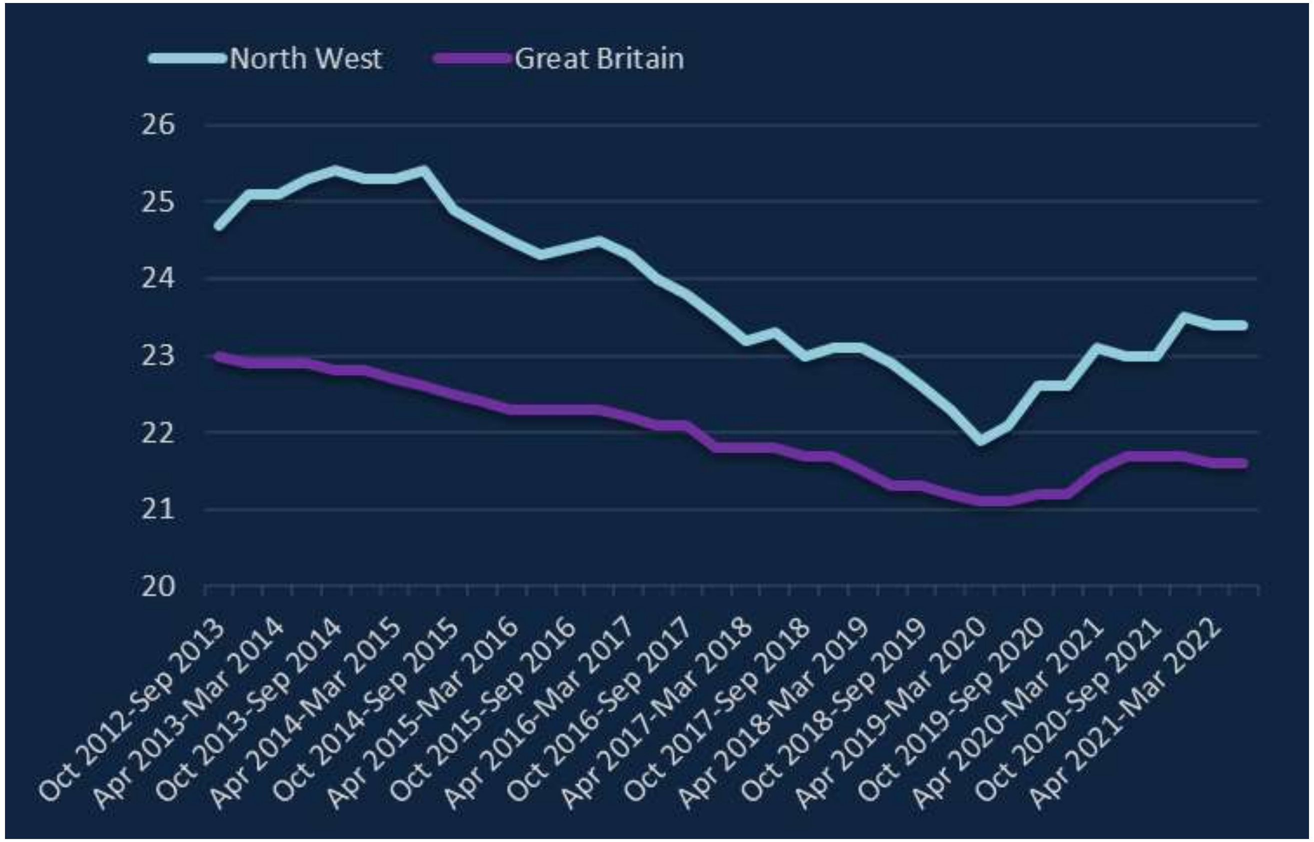
Labour Market Outlook

Chart 2.24: Changes in employment, unemployment and inactivity as a share of the working age population since 2019Q4



- Inactivity relative to the working age population remains much higher than in 2019 Q4, while employment remains below.

Inactivity Rates in the North West of England relative to Great Britain



- After converging pre-Covid the inactivity rate in the NW has increased more sharply than the national rate since mid-2020.

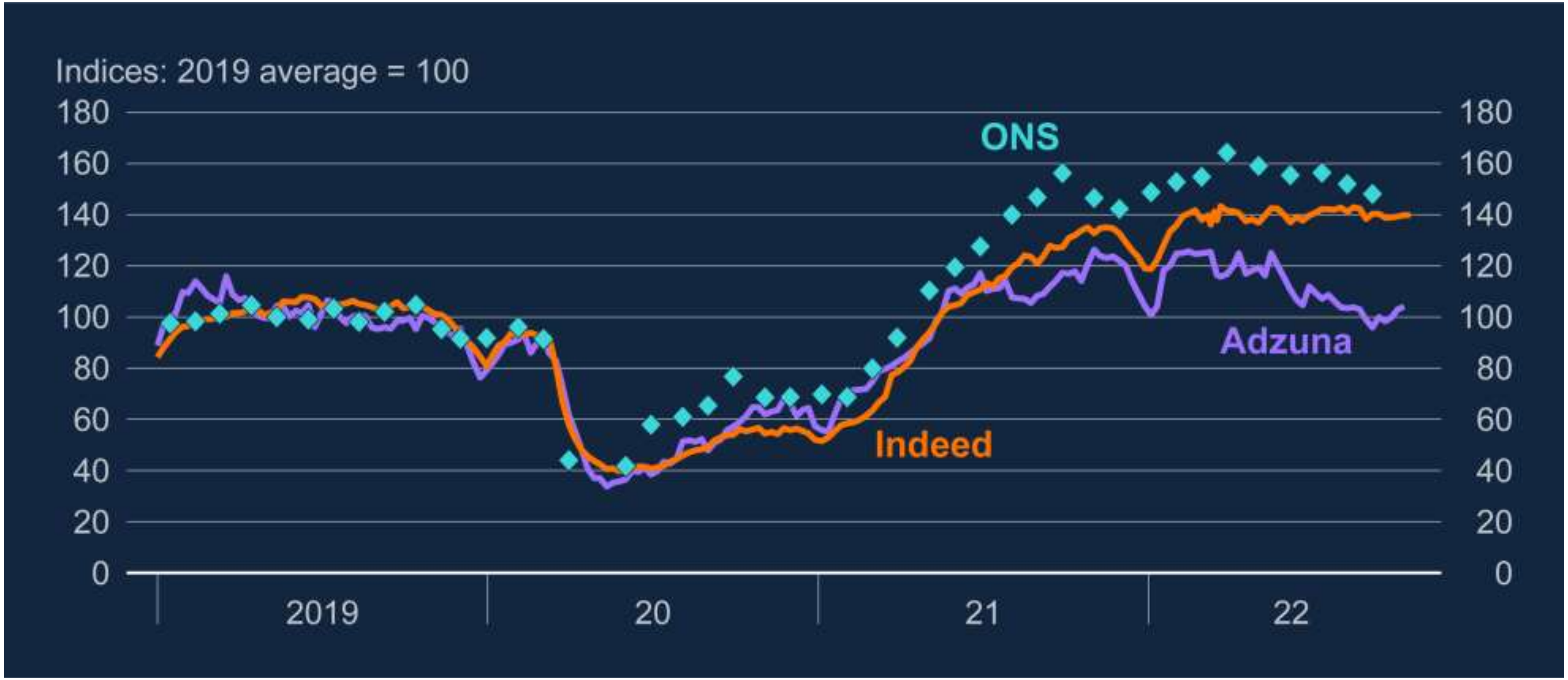
Labour Market Indicators by sub-region of the North West

Labour Market Indicators by sub-region (Jul 2021-Jun 2022)

County	Employment Rate (%)	Unemployment Rate (%)	Inactivity Rate (%)
Cheshire & Warrington	76.0	3.1	21.6
Cumbria	78.6	1.9	19.8
Greater Manchester	71.8	5.0	24.3
Lancashire	71.1	5.0	25.1
Liverpool City Region	73.3	3.5	22.5
All North West	**76.6**	**4.2**	**23.4**

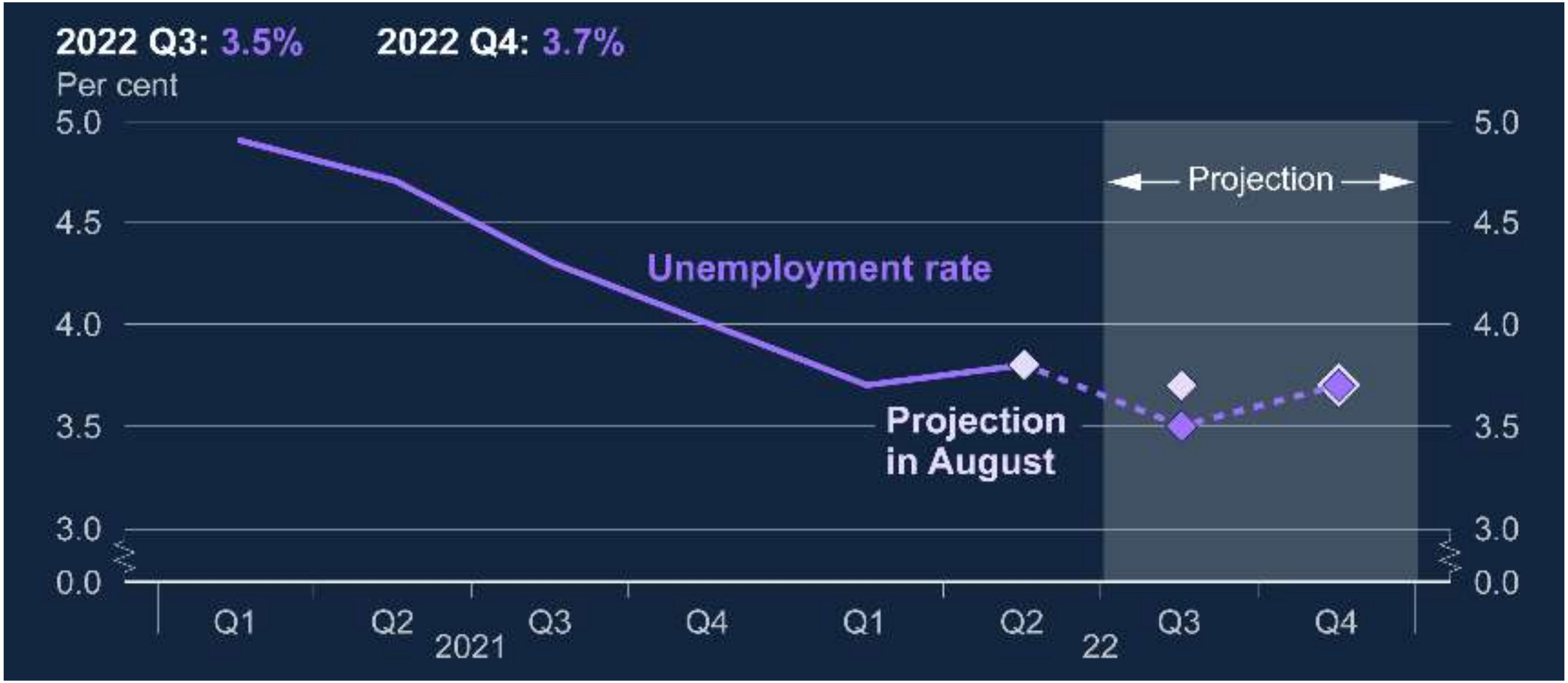
- The region as a whole has slightly higher unemployment rates than average but this hides some variation by sub-region e.g. in Cumbria. Consistent with intelligence from some contacts.

Chart 2.23: Indicators of the stock of job vacancies



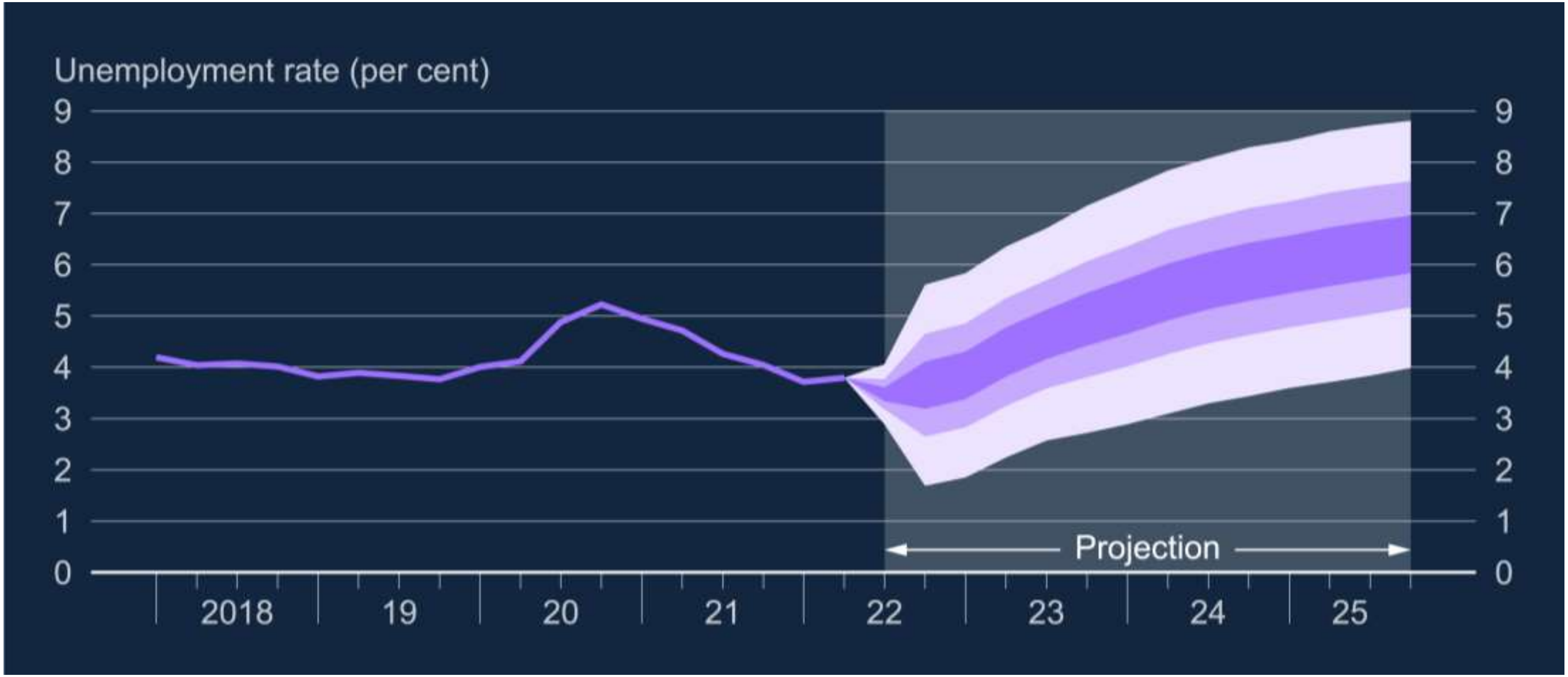
- The ONS single-month vacancy survey and Adzuna job advertisements suggest the stock of vacancies has begun to fall in recent months, but it remains very elevated

Chart 2.1: Near-term projection for unemployment



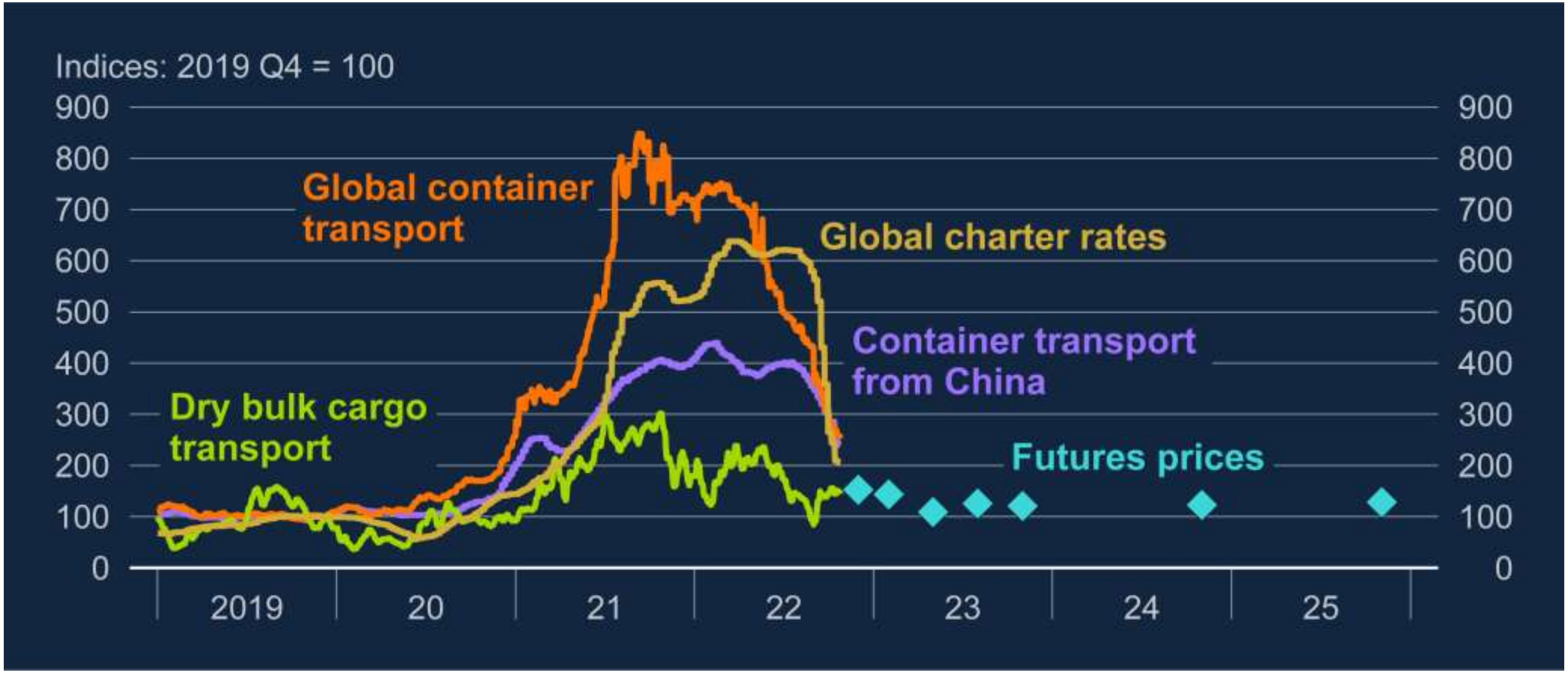
- Unemployment is projected to remain at very low levels in the near term

Chart 1.3: Unemployment rate projection based on market interest rate expectations, other policy measures as announced



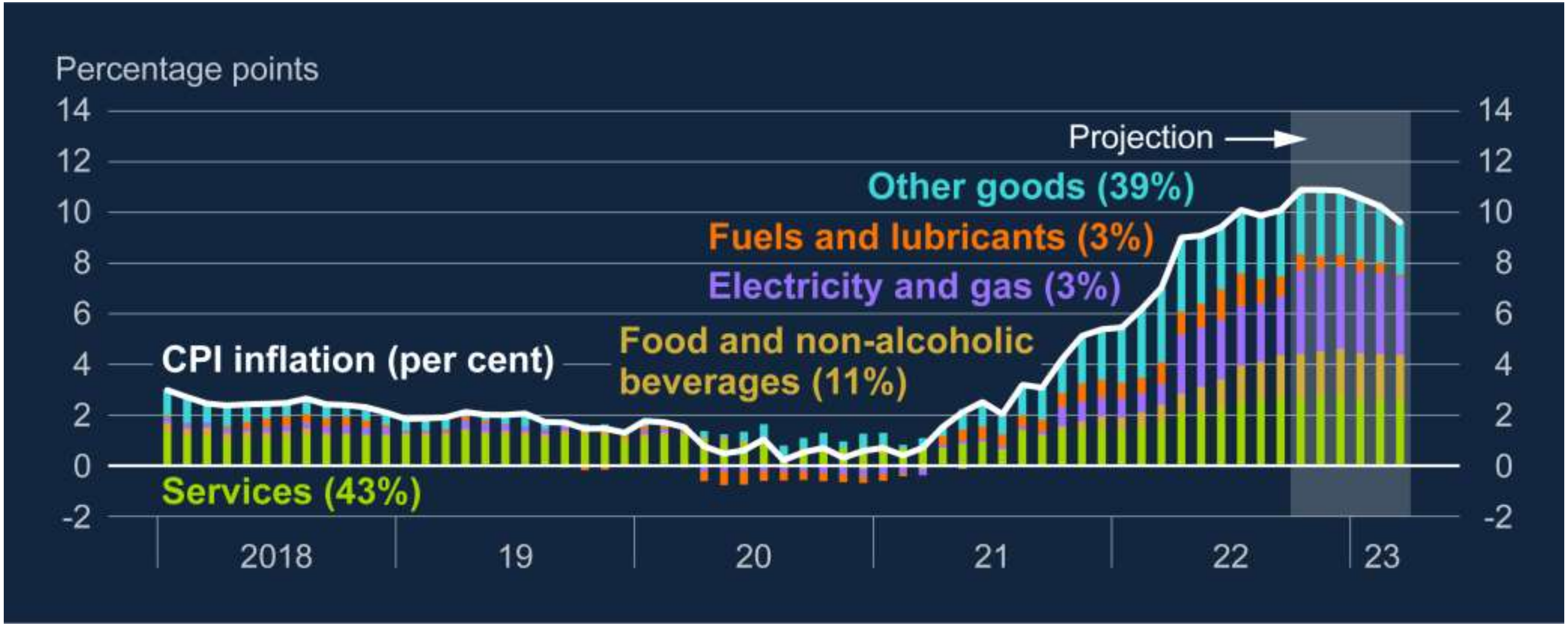
Inflation Outlook

Chart 3.5: Shipping costs and forward freight agreement prices



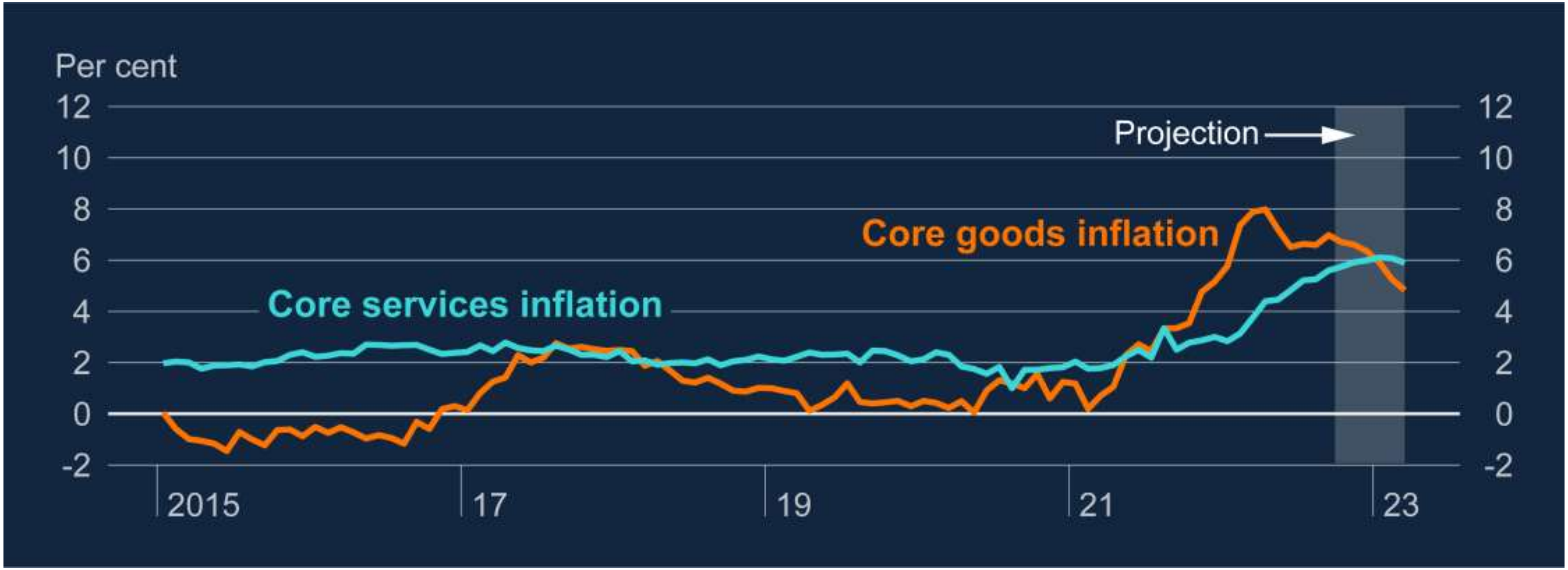
- Shipping costs have fallen significantly, after rising sharply during the pandemic

Chart 2.26: Contributions to CPI inflation



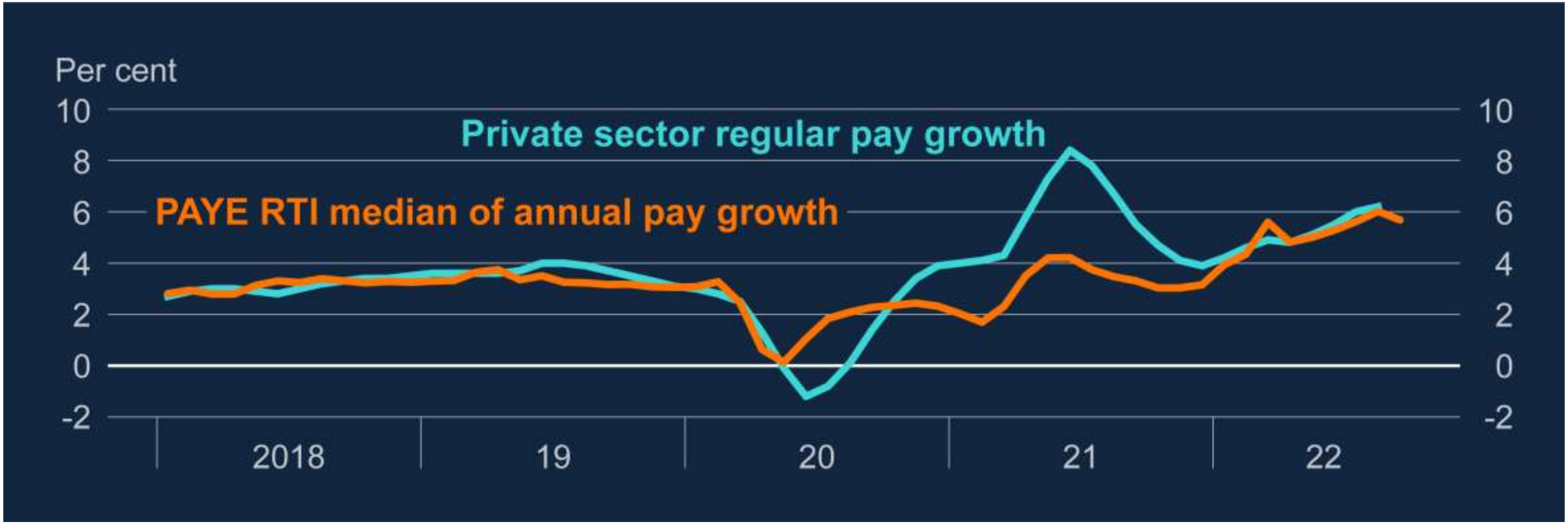
- Inflation is expected to be pick up to just under 11% in October, mainly due to energy prices, but contributions of fuels and other goods may have peaked

Chart 3.6: Core goods and core services inflation



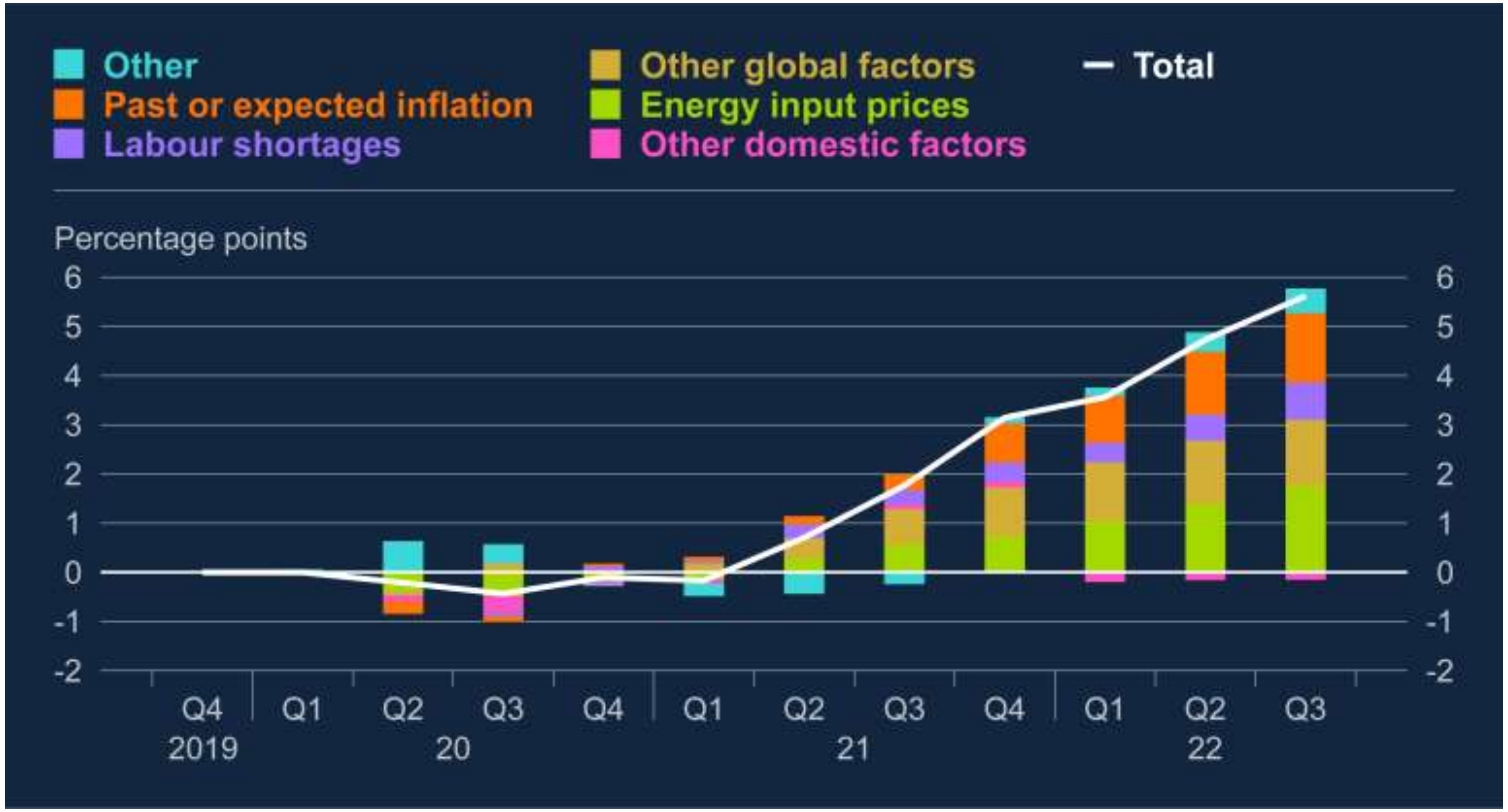
- Core goods inflation has been higher than core services inflation, but is expected to fall back over the next six months
- Core services inflation still rising

Chart 2.25: Indicators of annual pay growth



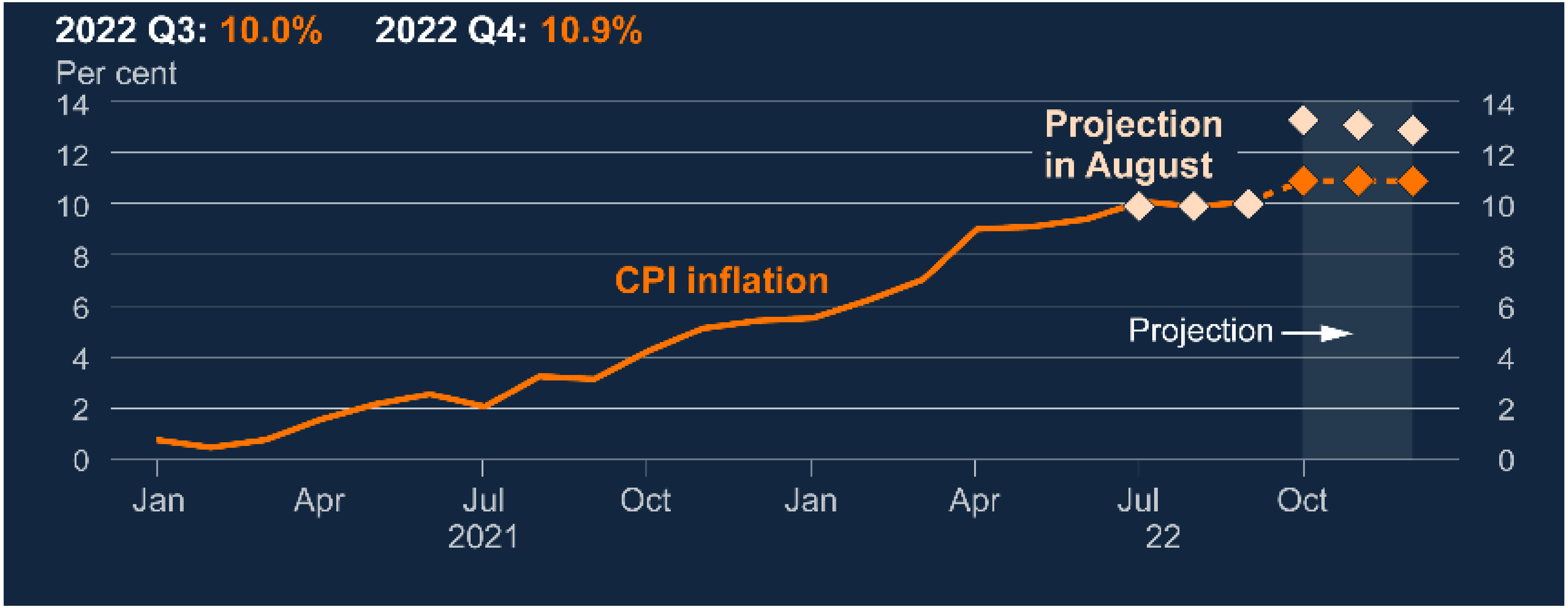
- Pay growth has continued to increase, more rapidly than expected, and is expected to remain elevated in the near term
- National Living Wage increase to come

Chart 3.4: Contributions to changes in firms' realised price inflation since 19Q4



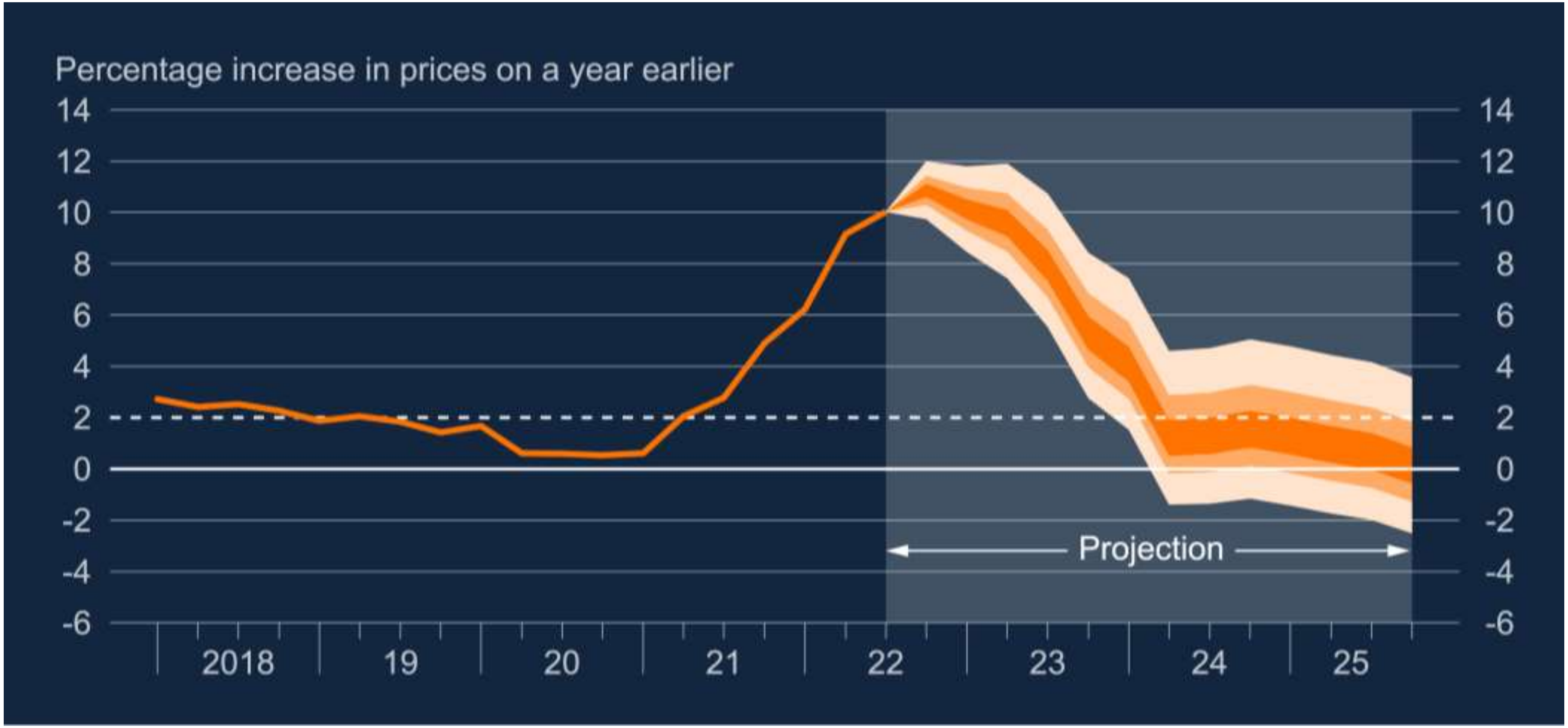
- Firms in the DMP Survey report that energy input prices and other external factors are a key reason why they have raised their prices. But past or expected inflation also important

Chart 2.1: Near-term projection for inflation



- Inflation is expected to rise a little in Q4, but by less than expected in August

Chart 1.4: CPI inflation projection based on market interest rate expectations, other policy measures as announced



MPC perspective and policy

BoE November 2022 Monetary Policy Report Summary

- **Bank Rate raised by 0.75 ppts to 3.0%** on the 3rd November
- **Very challenging UK outlook** – prolonged recession likely and CPI inflation will stay at ~10% over the winter
- **Inflation likely to fall sharply from mid-2023** to some way <2% target, as energy prices decline, economic slack increases & unemployment rate rises
- **Risk** that **inflation will be higher** than in central forecast **in the medium term**
- **Further interest rate increases may be required for a sustainable return of price inflation to target**

Table 1.A: Forecast summary

	2022Q4	2023Q4	2024Q4	2025Q4
GDP[b]	0.2 (0.1)	-1.9 (-1.2)	-0.1 (0.1)	0.7
CPI inflation[c]	10.9 (13.1)	5.2 (5.5)	1.4 (1.4)	0.0
LFS unemployment rate	3.7 (3.7)	4.9 (4.7)	5.9 (5.7)	6.4
Excess supply/Excess demand[d]	¾ (-¼)	-2 ½ (-2 ½)	-3 (-3 ¼)	-3
Bank Rate[e]	3 (2.4)	5.2 (2.9)	4.7 (2.4)	4.4

- GDP falls over 2023 and 2024H1. Back to growth, but sub-trend, by 2024H2.
- Unemployment starts extremely low but rises to around 6½%
- Inflation at 10.9% but is close to 5% within a year, and below target in year 2 and especially year 3
- …all assuming Bank Rate rises to 5¼%

Assumptions in our projections

- **Fiscal policy** – As announced to 17 October; no assumptions made around 17 November Autumn Statement.
- **Energy support** – Energy price guarantee (EPG) as announced for 6 months, then next 18 months a stylised path half way between current EPG and energy prices implied by downward-sloping future curves. No further support beyond 6 month for non-households.
- **Bank Rate** – As implied by financial markets in the 7 working days to 25 October. (Peak 5 ¼% Q3).
- **£ exchange rate** – A path halfway between starting level & path implied by interest rate differentials.
- **Oil prices** – Monthly Brent futures prices
- **Gas prices** – Monthly natural gas futures prices

Key Judgements

- **KJ1**: Higher market interest rates and energy prices weigh on spending, despite government support. UK economy is expected to remain in recession throughout 2023 and 2024 H1, and GDP is expected to recover only gradually thereafter

- **KJ2**: Greater margin of excess demand currently, but continued weakness in spending leads to an increasing degree of economic slack emerging from 2023 H1, including a persistently rising unemployment rate.

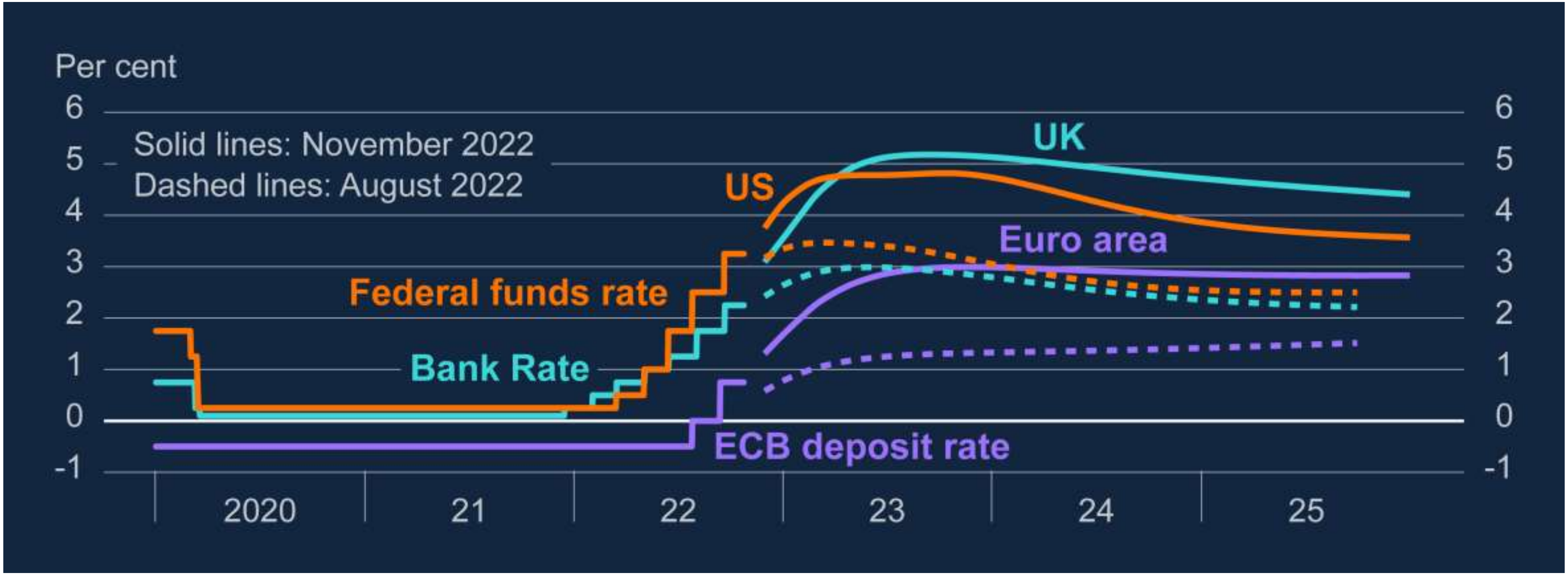
- **KJ3**: Global price pressures decline and there’s a significant fall in the contribution of household energy prices to CPI inflation. But domestic inflationary pressures remain strong over the next year. Further out, economic slack depresses domestic pressures. With market interest rates elevated, CPI inflation declines to below the 2% target in the medium term. Risks skewed to the upside.

Extract from the November Monetary Policy Summary

- *“In view of these considerations, the Committee has voted to increase Bank Rate by 0.75 percentage points, to 3%, at this meeting.*
- *The majority of the Committee judges that, should the economy evolve broadly in line with the latest Monetary Policy Report projections, further increases in Bank Rate may be required for a sustainable return of inflation to target, albeit to a peak lower than priced into financial markets.*
- *There are, however, considerable uncertainties around the outlook. The Committee continues to judge that, if the outlook suggests more persistent inflationary pressures, it will respond forcefully, as necessary.*
- *The MPC will take the actions necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit. The Committee will, as always, consider and decide the appropriate level of Bank Rate at each meeting.”*

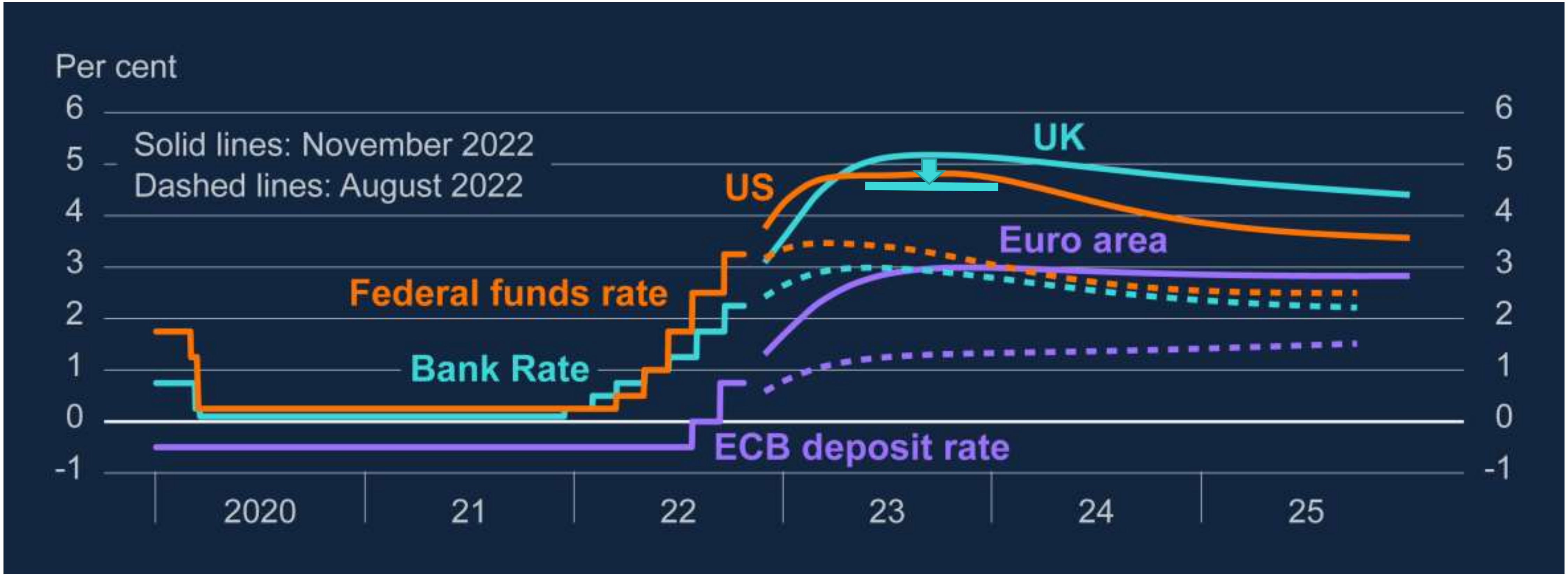
Chart 2.7: There has been a large increase in expected policy rates in the UK, US and euro area since August

International forward interest rates [(a)]



Sources: Bloomberg Finance L.P. and Bank calculations

Financial market expectations of UK interest rates shifted down in recent days



- Market expectations of policy rates in the UK, US and euro area have risen markedly since the August Report, but particularly so in the UK

Chart 2.9: The recent moves in long-term rates have been driven by UK factors

Decomposition of the change in the 10-year UK nominal government bond yield since the start of 2022 [(a)]

Sources: Bloomberg Finance L.P., Tradeweb and Bank calculations.

CPI inflation projections based on market rates and constant rates

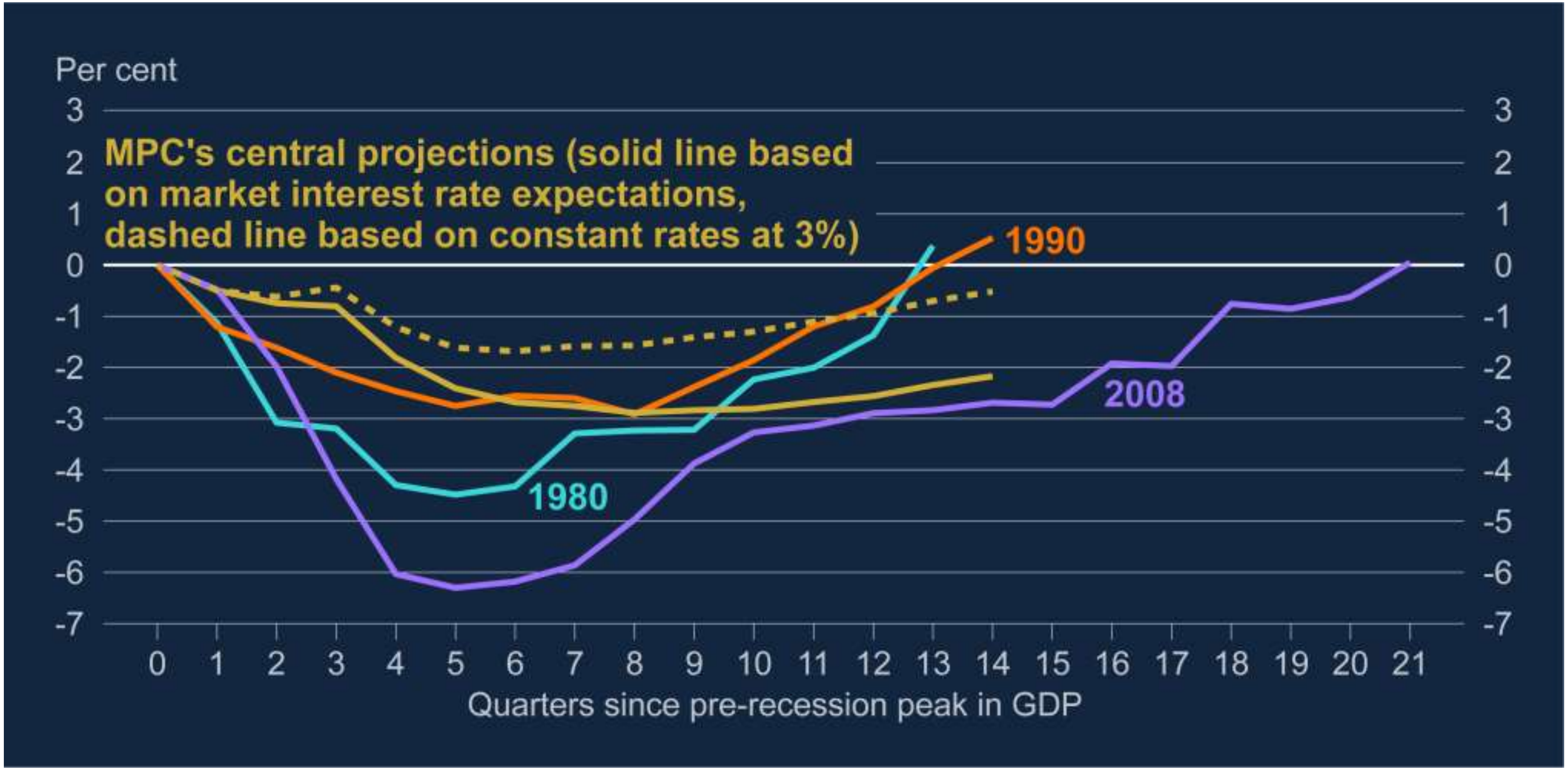
Market rates peaking at 5¼%

Constant interest rates at 3%

Chart 3.1: Wholesale gas spot price and futures curves

- Gas prices have fallen recently, but futures prices are higher than in August over most of the forecast period
- Ofgem cap had been set to rise to £3500 per year

Chart 1.2: Changes in GDP since pre-recession peak in past recessions and the MPC's November 2022 projections



Thank You

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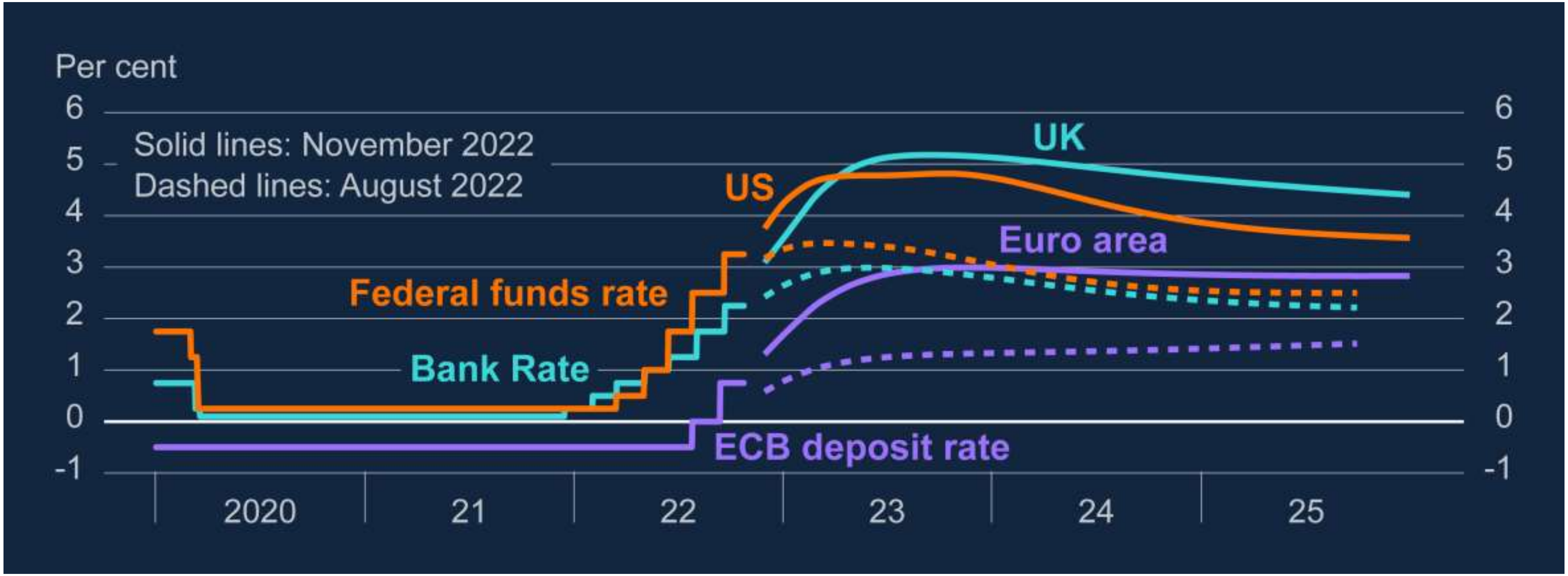
Chart 2.7: International forward interest rates



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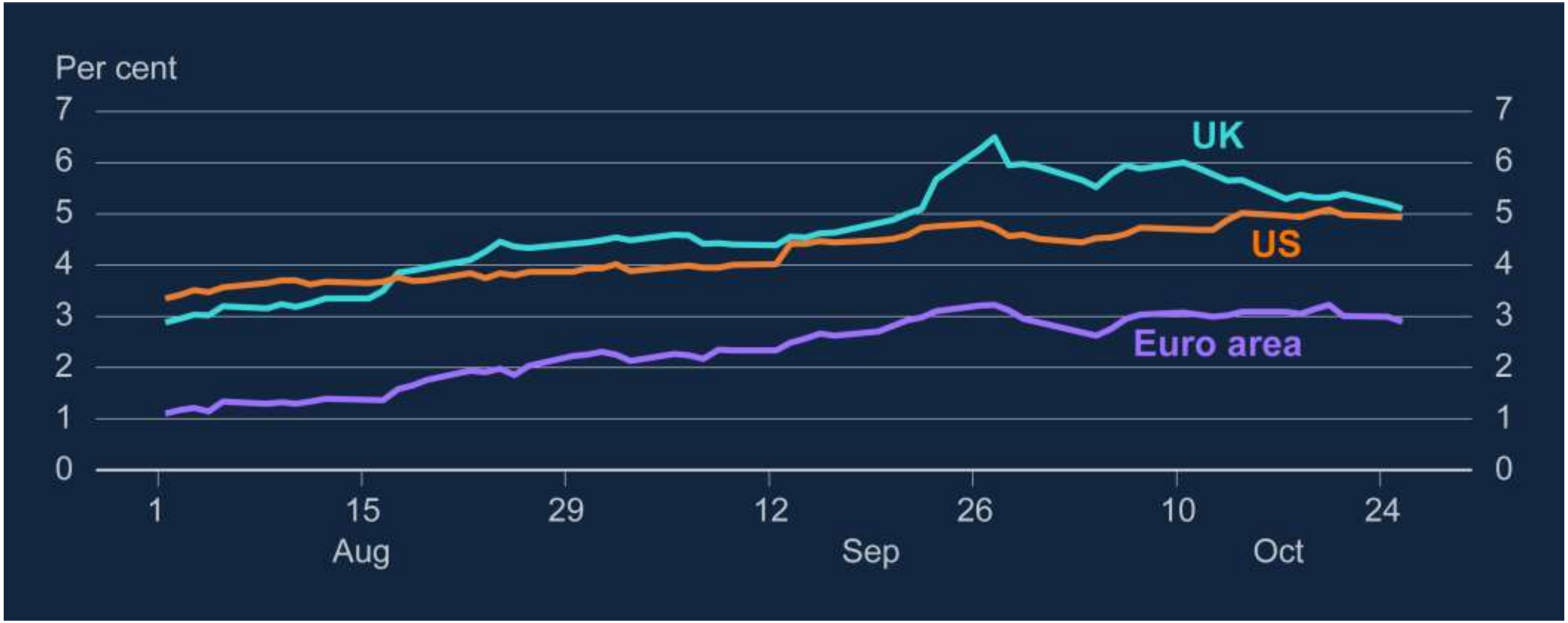
Market-implied rate peaks have risen since August



- Expectations for peak in Bank Rate had risen above 6% in late September, but have fallen back since

MPC’s fiscal policy and energy assumptions

- EPG caps average household energy bills at £2500/yr until April 2023
- Government has said that support for household energy prices will continue in targeted form, but hasn’t given details yet. No commitment on support for businesses being extended
- MPC’s working assumption is that after April 2023, generosity of the EPG is gradually reduced over the following 18 months, with a return to Ofgem price caps thereafter
- Otherwise MPC has taken fiscal policy as announced on 17 October. This represents a slight loosening relative to August (more in Box A).
- Will take stock on Autumn Statement measures into its December decision and incorporate in February forecast