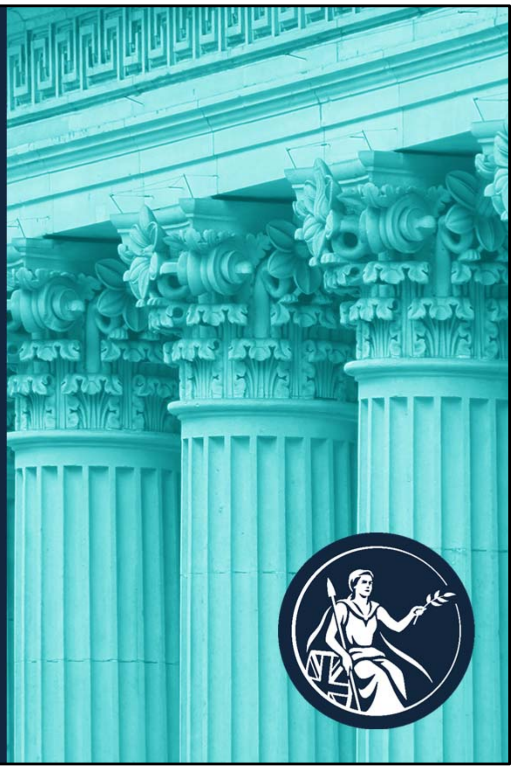
Bank of England

Update and outlook

MNI Connect

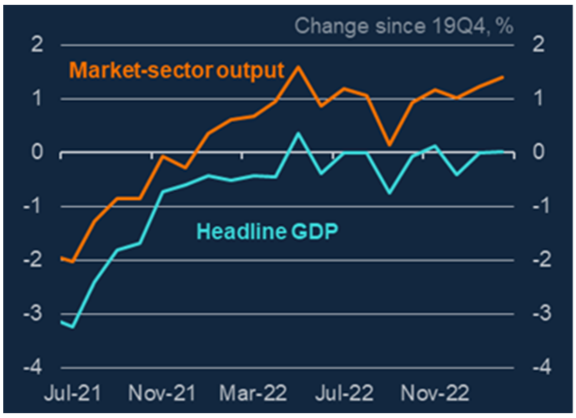
Huw Pill

Thursday 13 April 2023

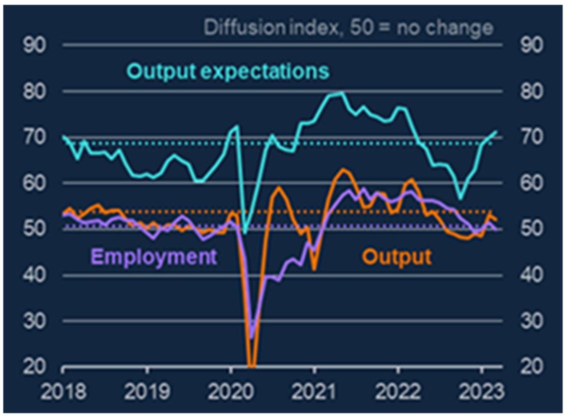


I would like to thank Saba Alam for help in the preparation of this presentation.

GDP broadly flat but PMIs have picked up of late



Source: ONS
Note: Data to February 2023



Source: S&P Global/CIPS
Note: Dashed lines represent historical averages. Data to March 2023

- Activity in the UK remains subdued, as the level of GDP was flat over the month in February. Bank staff continue to expect GDP to decline by 0.1% in 2023 Q1, as had been projected in the February MPR.

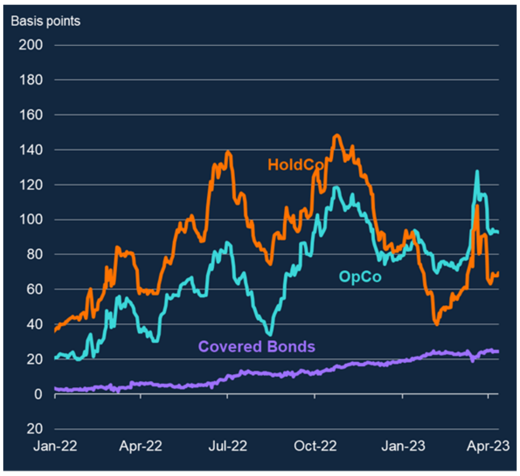
- PMIs have picked up notably of late, suggesting there is scope for modest growth in output and employment.

- Composite output expectations PMI continued to strengthen (and was revised up from the flash estimate), pointing to much stronger prospective growth than any of the other business survey indicators that we track.

- But there are mixed signals from other surveys, suggesting the collective steer from business surveys continues to point towards uncertain growth expectations.

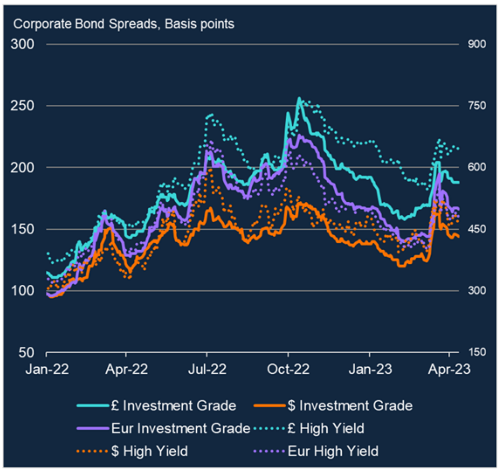
Bank funding costs are below recent highs

Bank funding spreads to Euribor



Source: Refinitiv Eikon from LSEG, ICE and Bank calculations.
Note: Series an average of 5-year EUR denominated bond spreads (vs 6m Euribor) for the five largest UK banks, weighted by banks' share of new gross lending. Data to 11 April

£, $, € -denominated corporate bonds spreads



Source: Bloomberg Finance L.P. and Bank calculations
Note: Data to 11 April, IG (LHS) and HY (RHS)

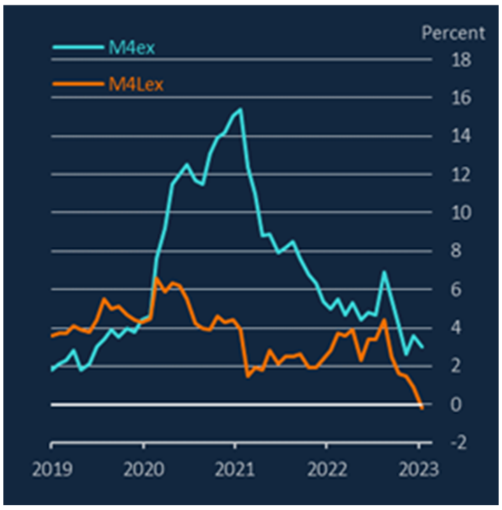
- We have observed financial tensions in recent weeks, reflected in developments in US and European banking markets. The impact on UK financial conditions and credit markets so far appears to be contained.

- Bank funding costs and corporate bond spreads rose in the immediate aftermath of the distress but have fallen from recent highs, marking a stabilisation risk sentiment.

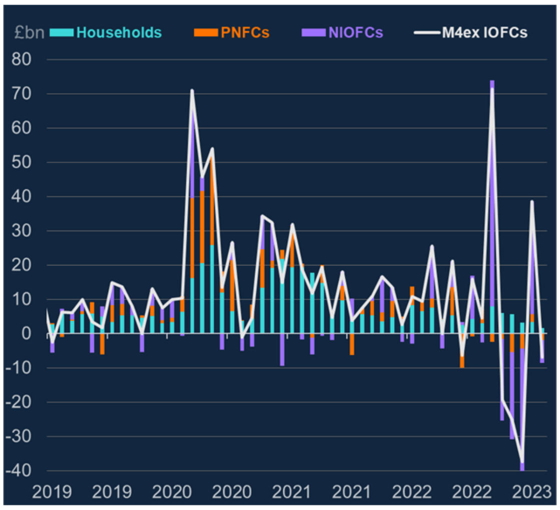
- Overall borrowing costs, taking into account the impact of a rising Bank Rate, are higher as monetary policy tightening transmits through the financial system.

- MPC remains vigilant to signs of tightening financial conditions and will be prepared to respond to the macro implications of any dislocation to credit markets to the extent that they influence the outlook for inflation.

Aggregate lending measures slowed slightly in nominal terms



Source: Bank of England, Note: M4ex & M4Lex growth Data to February 2023



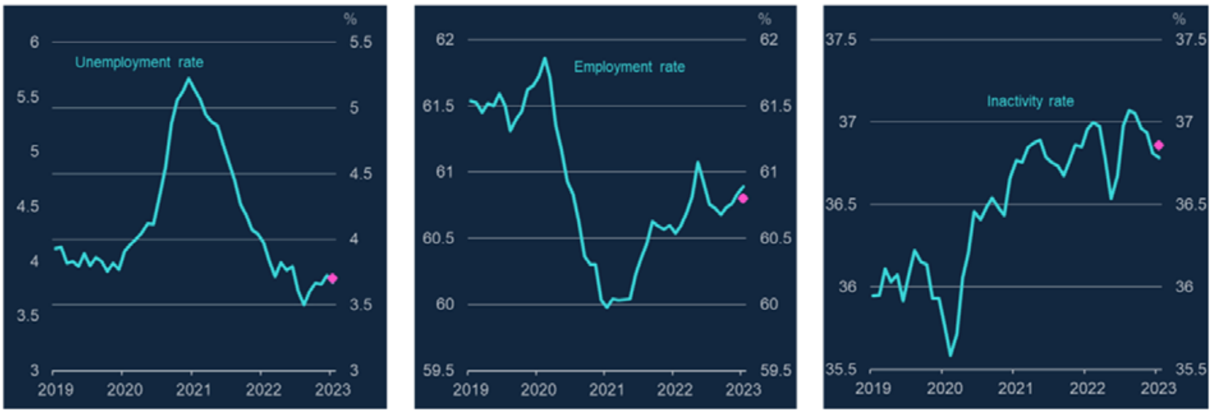
Source: Bank of England, Note: M4ex sectoral components flows, seasonally adjusted. Data to February 2023

- Thus far, aggregate lending measures have slowed only slightly and lenders have adjusted lending conditions to changes in the risk environment, but not re-trenched beyond this.

- The continued weakness of net mortgage lending to households in February, which declined for the sixth consecutive months, consistent with weaker demand and tighter lending conditions.

- Meanwhile, sterling broad money flow (M4ex) decreased sharply in February, driven mainly driven by negative NIOFCs' M4 net flows. This followed an all time high in December and all time low in September of last year. In annual growth rate terms M4ex decreased to 3.0% in February, falling below it's previous six month average.

Unemployment rate has stabilised at low levels as expected

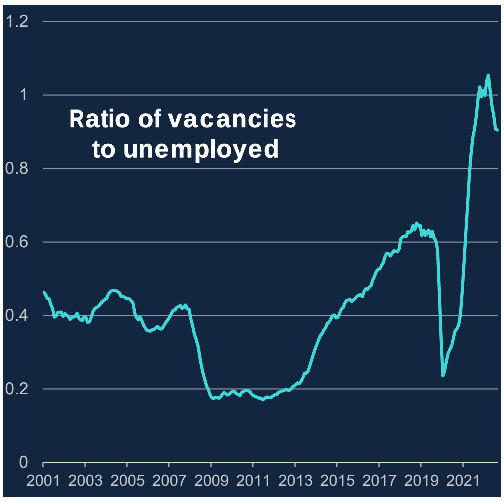


Source: ONS
Note: Diamonds show February MPR Forecasts for the three months to February 23

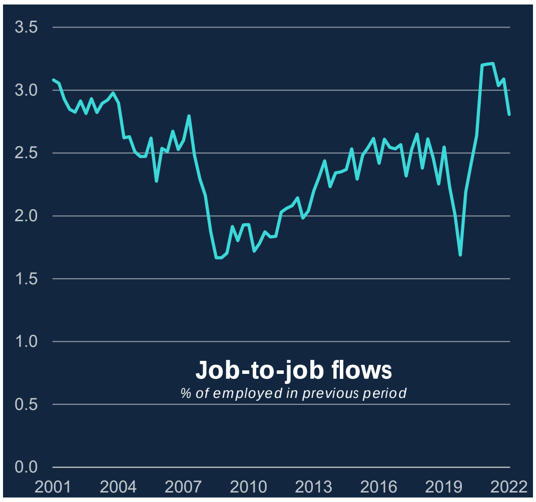
- Consistent with MPC expectations of a tight labour market, the unemployment rate has remained near low levels.

- Stronger employment growth in the data had been the counterpart to a fall in the inactivity rate of the 16+ population. LFS data for 2022 Q4 suggested that the flow into inactivity from employment and unemployment had fallen to around pre-Covid levels, alongside a decline in the share of the inactive aged 50-64 who did not expect to work again.

Tightness in the labour market



Source: ONS Labour Force Survey



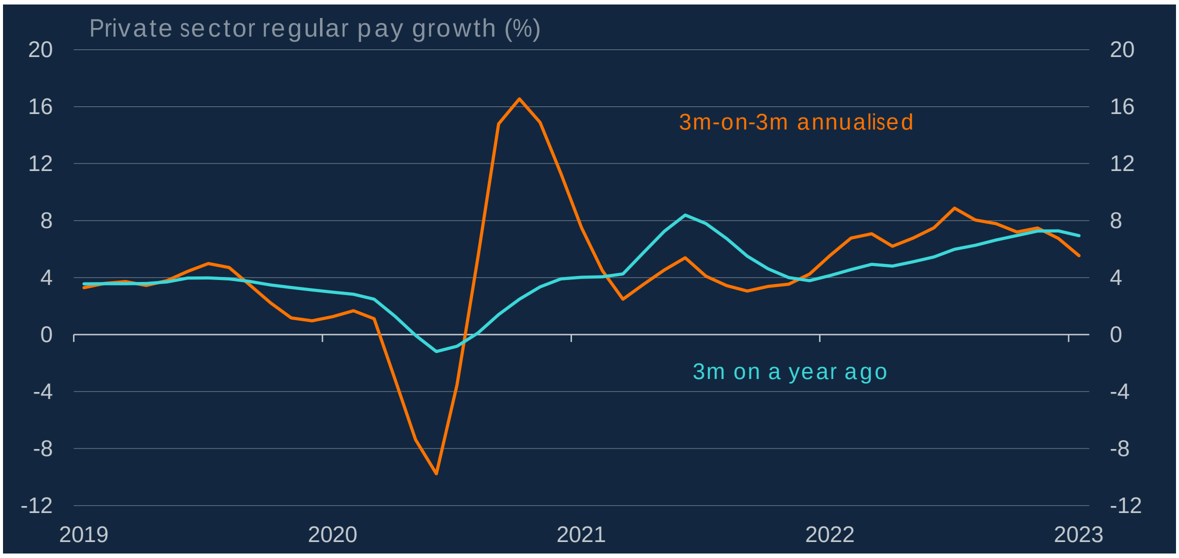
Source: ONS Labour Force Survey

- I shared some reflections on drivers of bargaining power and inflation persistence in Geneva a few weeks ago (Inflation persistence and monetary policy – speech by Huw Pill | Bank of England). As the impact of higher energy prices on UK real incomes and spending power unwinds, the scope for intrinsic inflation persistence will determine appropriate monetary policy choices.

- Whilst monetary policymakers don't have a mandate to make distributional judgements, their decisions do have implications for aggregate demand which in turn influence the power and position of participants in the bargaining process between households and firms.

- Labour market indicators of bargaining power include the evolution of unemployment, the extent of mismatch in the labour market and the pace of churn in the market. The latter two of these measures have eased of late, from historically high levels that characterise the current tightness in the labour market.

Signs of slowing momentum alongside declining pay growth

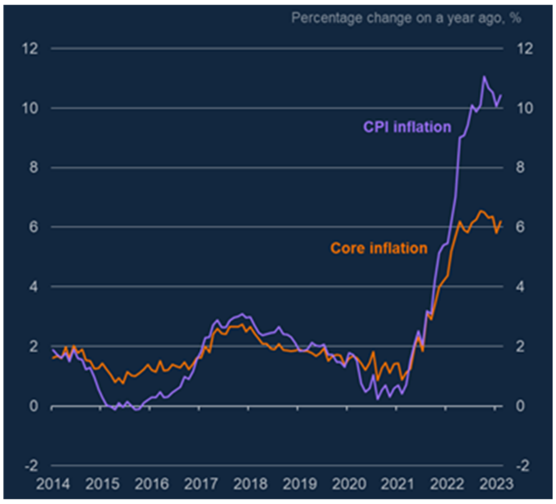


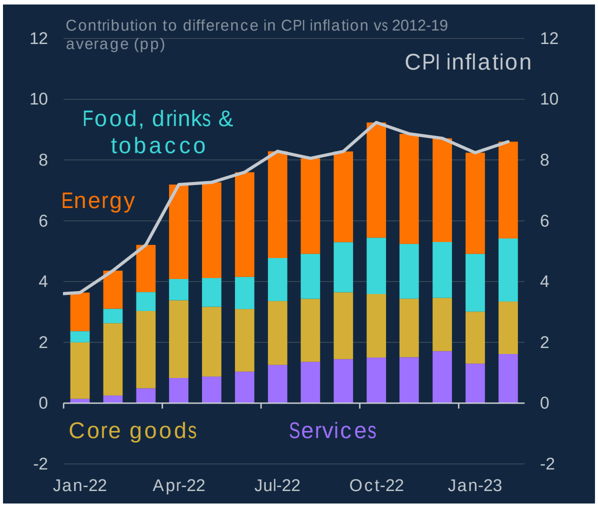
Source: ONS Labour Force Survey

- Pay growth has eased, evidenced by indicators of earnings across the whole economy and private sector. Moreover, high frequency indicators of momentum in wage developments appear to be easing. Three-month-on-three-month annualised private sector regular pay growth is 5.5%, its lowest level since December 21, and is now below the annualised rate.

- Sample variability could explain these developments, but forward-looking indicators such as the REC have been pointing to a deceleration for some time. That may partly reflect lower actual and expected inflation, with Agency intelligence suggesting that some companies expect pay settlements to ease over the course of the year, as inflation recedes.

Headline inflation is due to fall but core is higher





Source: ONS
Note: Data to February 2023

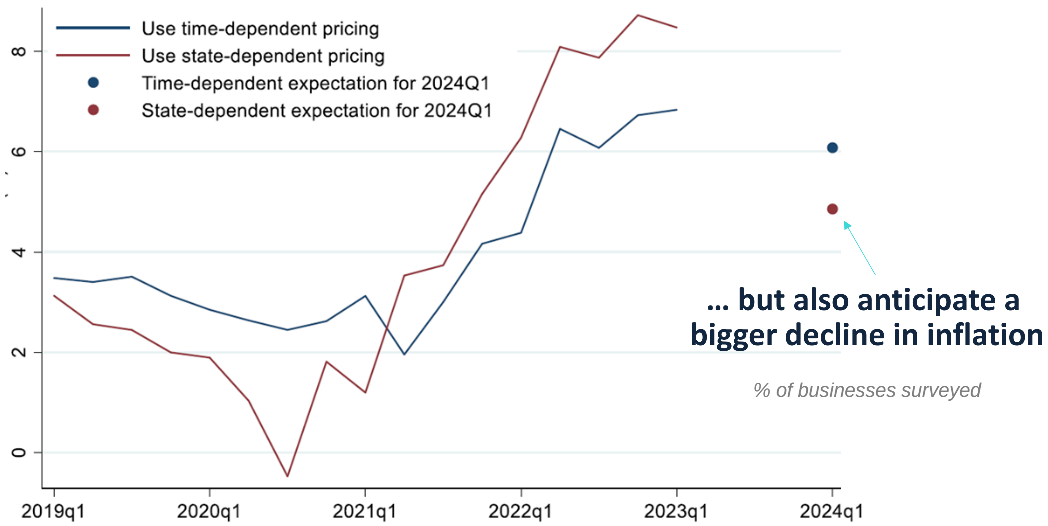
- CPI inflation rose to 10.4% in February, from 10.1% in January. This was a material upside surprise to our February MPR projection. Core inflation rose to 6.2 and services inflation at 6.6% was largely isolated to catering services.

- Higher-than-expected food price inflation accounted for two-fifths of the upside news to our latest nowcast on inflation. The ONS noted that food shortages might have been at play.

- We still expect CPI inflation to fall in Q2, as large rises in energy prices from last year drop out of the annual comparison, and to a lower rate than in the MPR projection following the announcements in the latest Government Budget to freeze the EPG and fuel duties

- Recent releases serve as a reminder that the precise path of inflation may be bumpier than we expect.

State-dependent pricing firms report a bigger rise in inflation …



Source: Bank of England Decision Maker Panel survey
Note: Question wording – 'Which of the following best describes how your business usually sets prices?'; (i) 'Mostly change prices in response to specific events (e.g. changes in costs or demand)'; (ii) 'Mostly change prices at fixed intervals (e.g. once a year or once a quarter, etc.)'