

Research UK

Economic recovery is set to continue

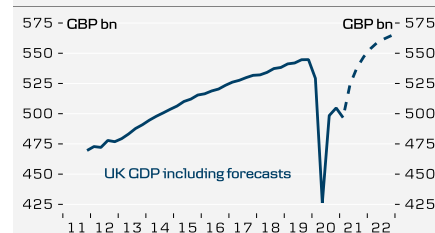
Key takeaways

- The UK economy was one of the hardest hit by the pandemic but we think the economic outlook looks bright. The relationship between new cases and hospitalisations have weakened significantly and the economy is fully re-opened. Consumer and business confidence are high.
- We expect GDP growth of 7.5% this year and 6.4% next year.
- We expect the unemployment rate will be back below 4% by the end of 2022.
- We expect CPI inflation to move higher, peaking in early 2022 and then ease to around 2% in H2 22.
- Brexit uncertainties have declined but remain high. EU-UK trade has recovered somewhat but not fully since the implementation of the new free trade agreement in January. Brexit has moved to the background as a market theme but risks remain due to discussions over the implementation of the Northern Ireland Protocol.
- Bank of England is moving gradually in a more hawkish direction. We expect the Bank of England will end QE this year (perhaps even prematurely) but not hike until H2 22.

Growth outlook: Recovery is set to continue

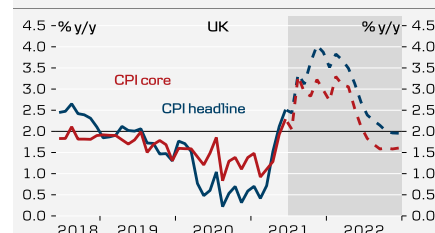
Looking at the UK economy, the UK was one of the hardest hit countries by COVID-19 but things have improved a lot since then. There has been a lot of focus on the UK over the past month due to the delta variant, but new cases have started to move lower again, although we do not know the full implications of the re-opening of nightclubs etc. Regardless, the good news is that the relationship between new cases and hospitalisations/deaths has weakened a lot due to vaccines, which is also the main reason why the UK government decided to move on with the full re-opening.

UK GDP including forecasts



Sources: ONS, Macrobond Financial, Danske Bank projections

CPI inflation is set to peak in early 2022, then moderate to around 2%



Sources: ONS, Macrobond Financial, Danske Bank projections

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New UK macro forecasts

% change q/q	2021				2022				2020	2021	2022
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	-1.6	5.5	2.7	1.7	1.2	0.9	0.5	0.5	-9.8	7.5	6.4
Private consumption	-4.6	8.0	3.5	2.0	1.5	1.0	0.5	0.5	-10.6	5.1	7.9
Government consumption	1.5	1.0	0.5	0.5	0.5	0.5	0.5	0.5	-6.5	10.2	2.1
Fixed investments	-1.7	4.0	4.0	3.0	2.0	2.0	1.0	0.8	-8.8	10.2	9.7
Exports	-6.1	4.0	2.0	1.5	1.0	1.0	0.8	0.8	-15.8	-0.5	5.5
Imports	-13.5	6.0	3.0	2.0	1.5	1.5	1.0	1.0	-17.8	0.2	8.0
Unemployment rate (%)	5.1	4.8	4.7	4.5	4.3	4.2	4.1	4.0	4.4	4.7	4.1
Wage growth (% y/y)	4.3	7.5	6.1	3.8	3.5	2.9	3.1	3.0	2.1	5.1	3.2
CPI (% y/y)	0.6	2.0	3.0	3.8	3.7	3.1	2.3	2.0	0.9	2.4	2.7
Core CPI (% y/y)	1.2	1.8	2.8	3.0	3.0	2.6	1.7	1.6	1.4	2.2	2.2
BoE Bank Rate (%) (end of period) ⁴	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.10	0.10	0.25

Sources: ONS, Bank of England, Macrobond Financial, Danske Bank projections

The UK strategy has changed significantly, as the idea now is that people should learn how to live with the virus instead of imposing restrictions, helped by the vaccines.

Monthly GDP rose by 2.1% m/m in April and 0.7% m/m in May so even without any growth at all in June, Q2 GDP grew by 4.4% q/q. Based on retail sales, private consumption rose significantly in Q2 after declining in Q1, as retail sales rose more than 10% (see chart to the right). Consumer confidence has recovered significantly (see chart to the right) suggesting still decent private consumption growth going forward. Private consumption remains the most important growth driver in the UK.

GDP declined by 9.8% in 2020 but we project GDP will rise by 7.5% this year and 6.4% next year. We expect GDP to be above pre-pandemic levels in Q4 this year.

Employment recovery is set to continue

The labour market was hit by the pandemic but not as hard as in e.g. the United States, as employment was supported by the furlough scheme. Employment fell by nearly 1 million from February 2020 until January 2021 but employment has recovered since. We only have data to May but given the re-opening and more economic activity, we expect employment also rose in June. As employers intend to hire more people, we expect employment to continue moving higher (see chart to the right). The unemployment rate increased from 3.8% to 5.2% during the pandemic but we expect the unemployment rate will drop back below 4% by the end of 2022.

Inflation is set to moderate next year but stay around 2%

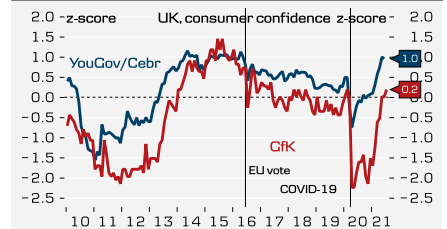
Like in other countries, inflation pressure is rising in the UK. We see that all main subcomponents are contributing to higher inflation at the moment. While we think both CPI headline and core will rise in coming months, we expect a peak in early 2022 and that inflation will moderate. This is due to a combination of base effects dropping out, easing of price pressure within the manufacturing sector (as global goods demand eases) and a stronger GBP. Also some of the initial price changes connected to the re-opening will drop out next year. In addition, inflation expectations remain well-anchored in the UK suggesting that inflation is not going to spin out of control. In that sense, the UK inflation story is very similar to what we expect in the US. We expect, however, that CPI headline inflation will be around 2% in H2 22.

Brexit is no longer a market theme but tensions remain

Brexit has moved into the background as a market theme since the free trade agreement was finalised in late December 2020, but it is definitely still a hot political one. The UK and the EU are still discussing the Northern Ireland protocol and how to protect both the integrity of the EU and the UK single markets. The UK government thinks the current protocol is too restrictive allowing goods from Great Britain to enter Northern Ireland. So far, the EU and the UK have agreed to extend the grace period (with limited checks in order to give businesses time to adapt to the new, future regime) for three months until 1 October.

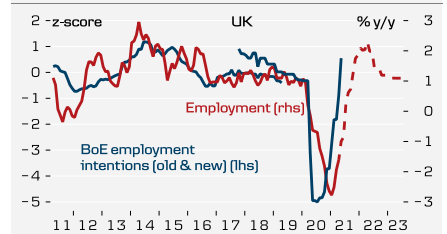
We do not expect neither the UK nor the EU to push the “nuclear button” although the UK government has threatened to invoke Article 16, which allows both sides to unilaterally override parts of the protocol. What we have learned over the past years is that the two sides can fight a lot but they find common ground eventually. This is also, why we do not think Brexit will become a major market theme although it remains a risk to monitor. If the situation “explodes” EUR/GBP is likely to move higher.

UK consumer confidence has recovered



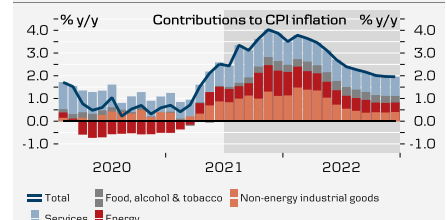
Sources: YouGov, GfK, Macrobond Financial

UK businesses intend to hire more people



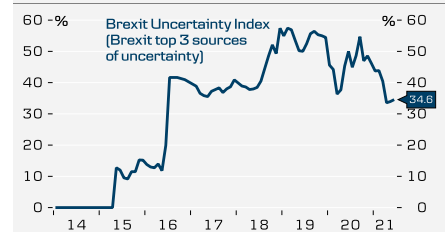
Sources: Bank of England, ONS, Macrobond Financial, Danske Bank projections

CPI headline is set to fall towards 2% in H2 22 after a peak in early 22



Sources: ONS, Macrobond Financial, Danske Bank projections

Brexit uncertainty has declined but remains elevated



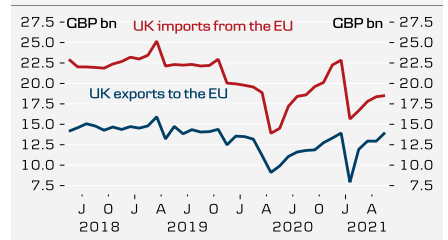
Sources: Bank of England, Macrobond Financial

With respect to EU-UK trade, we have seen a recovery since the beginning of the year, when trade (both exports and imports) took a hit from a combination of businesses struggling with getting used to the new trading relationship and because businesses have bought a lot of goods to inventories in November and December, just in case there was not a deal eventually. We expect the exports/imports normalisation to continue. The Brexit Uncertainty Index has declined but remains high.

Bank of England: Gradually tighter monetary policy

Bank of England has started to send more hawkish signals lately with some policymakers arguing for an early stop for more bond buying. Regardless, QE is set to end no later than by the end of the year and focus will shift to when to expect the first rate hike. As we expect a strong economic recovery with high employment growth and inflation will remain close to 2% also in H2 22, we expect the Bank of England to turn gradually more hawkish and hike the Bank Rate by 15bp in H2 22. We expect two additional 25bp rate hikes in 2023.

UK-EU trade is recovering but not back to normal yet



Sources: ONS, Macrobond Financial

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The author of this research report is Mikael Olai Milhøj, Senior Analyst.

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Ad hoc

Date of first publication

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