BNY

iFlow

MACRO MORNING BRIEFING

July 31, 2024

Household Pressure Supports BoE Doves

Enough evidence for a precautionary cut

- Vote expected to be close as services inflation remains robust
- Clear signs of changes in household behavior as demand falls
- Tight labor supply will limit pace of inflation decline

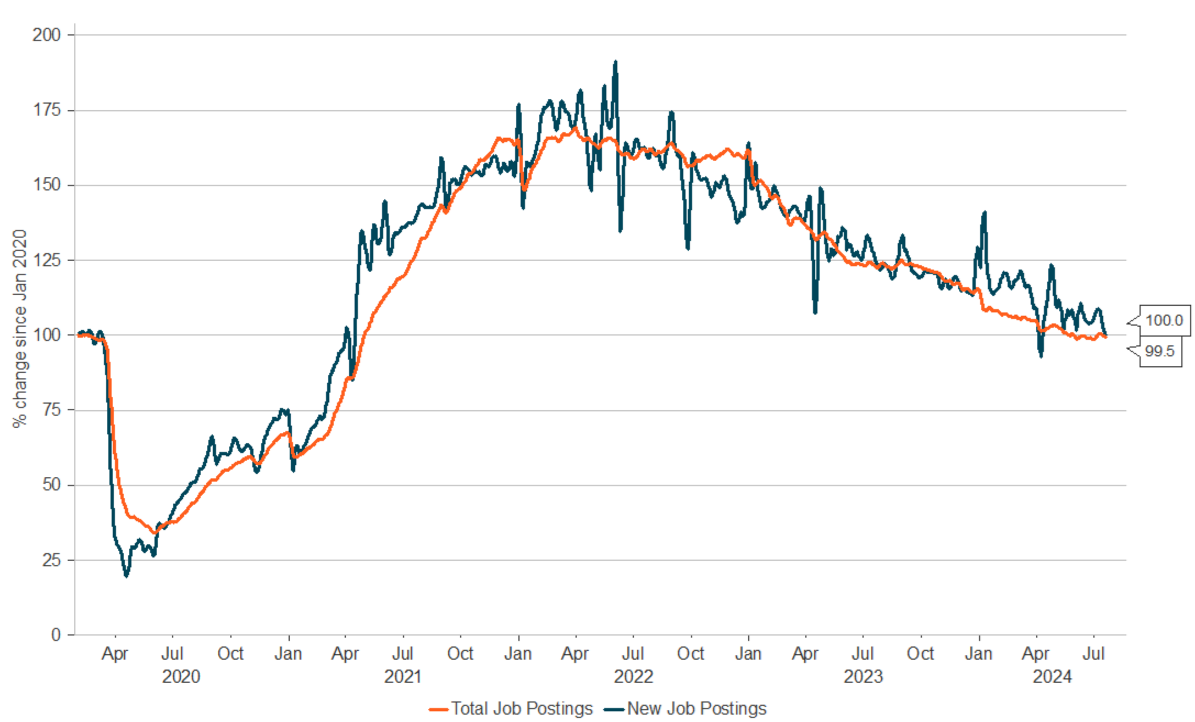
Normalization in labor demand satisfies core condition for easing

Out of all the central bank decisions this week, the Bank of England's Monetary Policy Committee (MPC) vote will likely be the closest. The market is currently leaning toward a cut, but the vote will probably be 5-4, as Governor Bailey and other core BoE officials shift their bias. Any additional votes for easing would be seen as a very dovish outcome and increasing pricing for cuts for the final three decisions of the year, whereas presently only one more 25bp move is expected from September onward. Originally, there was every chance that a cut would have been undertaken in June, but the surprise general election did cause some degree of disruption, not least in communication as MPC members refrained from public commentary during the campaign period.

UK inflation falling back to the 2.0% target in May was seen as having opened the door to easing, a notion that Governor Bailey and many colleagues did not dispel. However, there are material differences in the various inflation components that the MPC cannot easily dismiss, especially given the focus on high wage growth, which continues to support prices and potential demand. Services inflation – in which the wage component is dominant in pricing – continues to run at a very high 5.7%y/y, and the run-rate for the first six months of the year is above 6%. These figures are high enough in themselves. Of greater concern is the strength of sequential services price momentum: the last five months' consecutive increases would yield an annualized growth figure of almost 10%.

Such headline figures point to strong labor demand, but the Bank of England is unlikely to change its assessment from June that “the restrictive stance of monetary policy is weighing on activity in the real economy, is leading to a looser labor market and is bearing down on inflationary pressures.” High-frequency labor market data confirm this (Exhibit #1), with total labor market openings having fallen back to pre-pandemic levels, and the general level of weekly labor market openings is similarly reverting lower. As such, labor demand is not in place, but the BoE has frequently highlighted the problem with labor supply, which remains extremely weak as the UK faces acute pressures in economic inactivity and participation. Furthermore, MPC members continue to face the problem of data quality. In June, the policy statement highlighted that “the considerable uncertainty around estimates derived from the ONS Labour Force Survey means that it is very difficult to gauge the evolution of labor market activity…the MPC judges that the labor market continues to loosen but that it remains relatively tight by historical standards.” As things stand, data quality is not expected to improve soon, but the MPC cannot afford to wait until better data come through, lest it paint a picture far more downbeat than anticipated, as by then any form of easing would be too late.

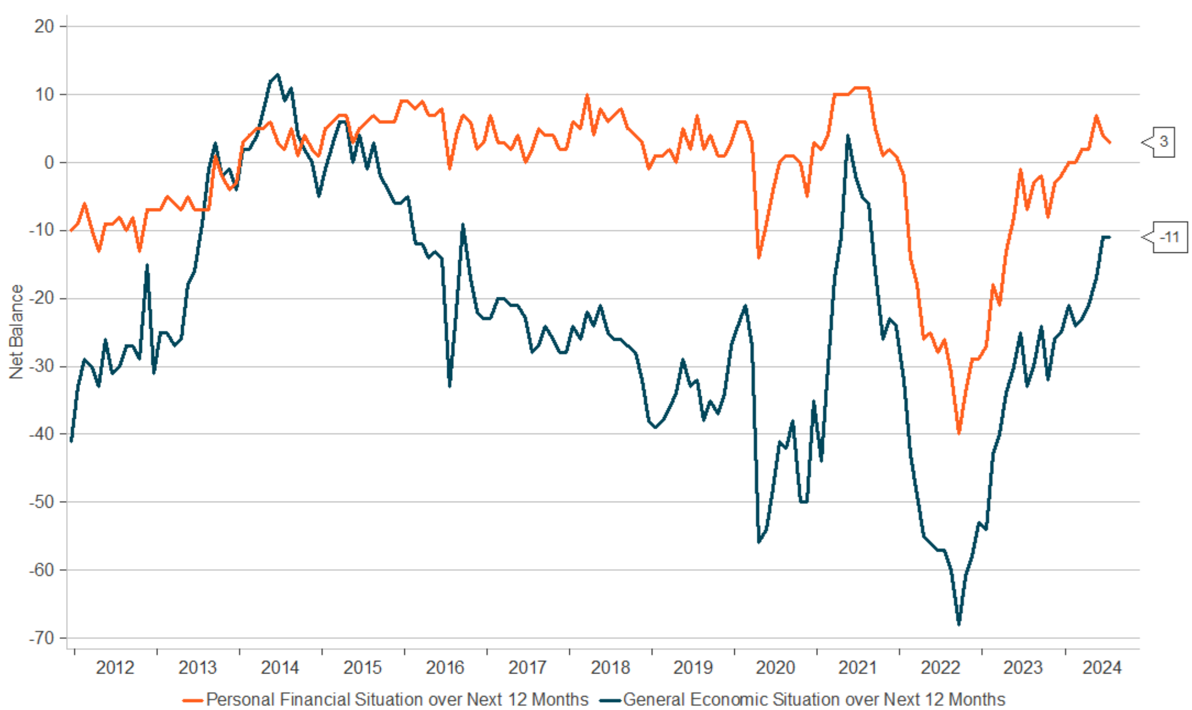
Exhibit #1: UK job postings



Source: Macrobond, Indeed, BNY

We can see a case for the hawks to profess stability and wait for another round of data before acting at the next meeting, and there are additional upside risks to wage inflation, such as impending public sector pay rises, most of which have been accepted by unions. Even so, what separates the current outlook for the UK economy compared to earlier in the cycle is that the household reaction function is now different. Real wage and income growth remains firm, but demand is a vastly different story, as UK households have become far more cautious (Exhibit #2). Survey data suggest that households' views on their personal financial circumstances remain favorable, but the balance of outlook on the economy is clearly negative and could be stalling. Compared to 2020 before the pandemic, the forward economic outlook is much weaker and could start to show as a material downward drift, which was the case in 2014 as public spending restraint started to take hold.

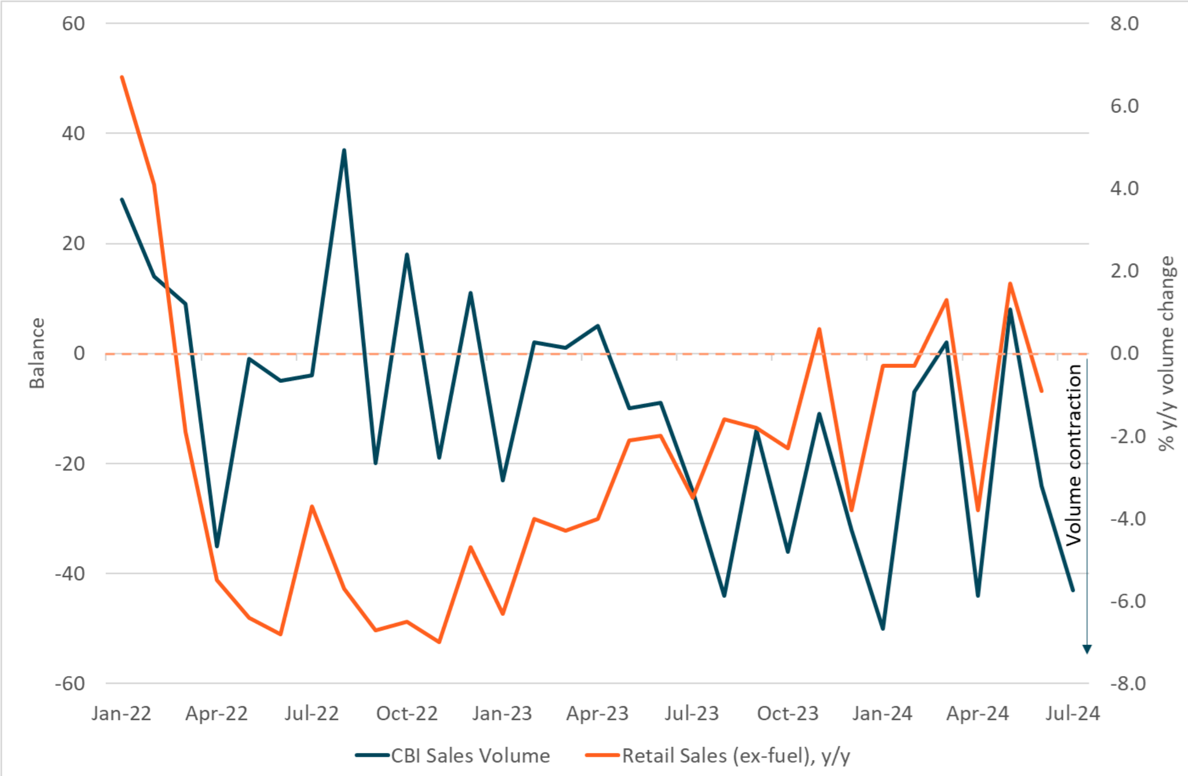
Exhibit #2: UK household sentiment surveys



Source: Macrobond, BNY

Similar conditions are coming through in sales figures. Globally, recent earnings reports point to weakness in spending. European airlines highly exposed to the UK market, for example, have been vocal about the unwillingness of households to accept further airfare increases, which mirrors conditions for households in the U.S., where we expect the Fed to confirm easing in the next two meeting cycles as well. Furthermore, in real terms (Exhibit #3) both retail sales figures and survey data point to material declines in household consumption (ex-fuel). In volume terms, annualized growth has barely been positive in nearly 18 months, while the Confederation of British Industry's surveys also point to a majority of firms reporting declines in volumes terms on a forward quarterly basis; majority reports of increased volumes have been scarce over the same period.

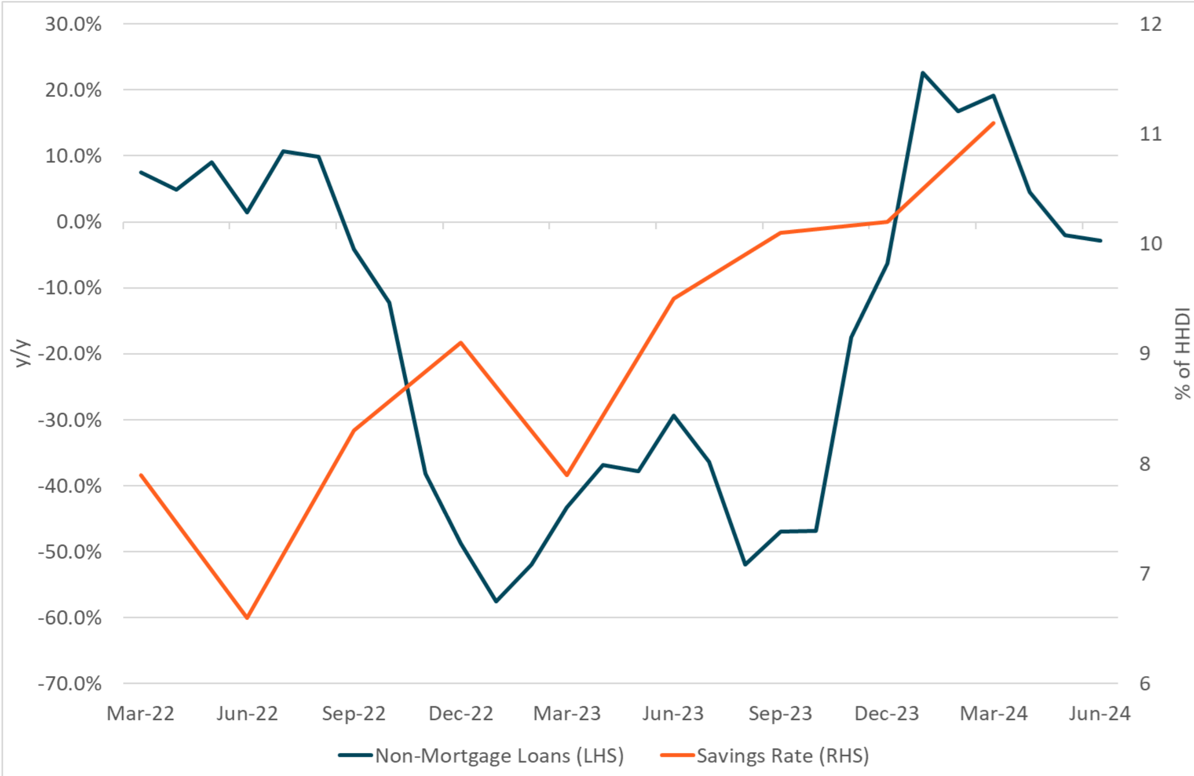
Exhibit #3: UK retail sales trends



Source: Bloomberg, BNY

If wage growth remains robust while spending is falling, then the net result should be a rise in precautionary savings, which current data confirm (Exhibit #4). Excluding the extraordinary cash flow adjustments during the pandemic, the last time UK households managed multiple quarters with a savings rate above 10% of household disposable income was during the global financial crisis. Unlike the 2009-2010 period, high interest rates have certainly increased the marginal propensity to save, and we acknowledge that the current cyclical condition of the UK economy is different from the post-2009 deleveraging phase for households, especially in housing. This week's lending figures point to a strong increase in net lending secured on dwellings, and there is no collapse in mortgage approvals either. However, we can see that non-mortgage lending is contracting again, and as the Bank of England delays rate cuts, unsecured lending will likely remain relatively expensive and constrain credit demand. This is especially true for discretionary spending and is consistent with the volume indicators in retail sales. The bottom line is that although the data are not pointing to a full-fledged slowdown, household behavior is already shifting in the direction, and it is incumbent upon the Bank of England to ensure the descent is orderly. Moving early but infrequently is the best path forward. In addition, cutting on Thursday will keep the door open for an additional move in Q4 if data surprises to the downside. At this stage in the cycle, maintaining maximum optionality is essential for policy execution.

Exhibit #4: UK savings and borrowing trends



Source: Bloomberg, BNY

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNY.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF

Can't see the email? View online

This message was sent from an unmonitored email box. Please do not reply to this message.

.