UK Viewpoint

Entrenched inflation = high for long

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Economics
United Kingdom

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Weak supply = persistent inflation

Four supply shocks - energy prices, supply chains, Brexit, workforce sickness – have caused weak UK potential growth. This is how no growth since 2019 has resulted in strong domestic inflation pressure. In our view that inflation pressure is now entrenched to a degree, as the structural economic changes combined with high inflation have modestly deanchored inflation expectations.

High for long interest rates

To fight entrenched inflation the Bank of England will have to keep growth weak with restrictive interest rates. With headline and core inflation now falling we expect only one more rate 25bp rate hike in September. But we expect the BoE to hold rates at that 5.5% terminal through end-2024. We see risks to that terminal rate skewed up.

Tentative signs growth softening

PMIs fell sharply over the summer, but they may exaggerate the slowdown. Broader trackers suggest weak but growth. We expect 0.4% qoq GDP growth in 3Q, helped by the bounceback from the extra May public holiday, and 0.0% in 4Q. The PMIs pose a risk, but with real wage growth soon turning positive we raise our growth forecast to 0.6% in 2023 from 0.4% before.

Labour market easing

The labour market has eased faster than expected recently because of a one-off supply improvement from students returning to work. The chronic labour supply problem of increased workforce sickness remains. Further labour market easing will likely require weak demand rather than coming benignly from improving supply. We forecast the unemployment rate over the next year to rise at half the pace of the past year.

But is it enough?

While unemployment is rising, recruitment difficulties easing, and growth weak, inflation persistence has worsened. Services inflation continues to annualise close to 8%, private wage growth has again far exceeded BoE forecasts and runs at 8.2% excluding bonuses. The BoE argues a variety of structural changes (temporarily higher NAIRU, steeper Phillips Curve, lower FX passthrough, indirect effects of higher energy costs, changed pricing behaviour) can help explain this, and those changes do not necessarily imply risks of higher inflation ahead. Indeed, a steeper Phillips Curve could signal weaker inflation if the labour market eases. The argument the BoE doesn't consider in our view is that inflation expectations may have somewhat deanchored. We see evidence in favour of that as part of the explanation for inflation / wage surprises. This suggests risks to BoE interest rates remain skewed up.

One more hike then hold

The BoE sounds cautious about further hikes. We expect one more 25bp hike to 5.5% terminal. We express our view about the risks of entrenched inflation by forecasting no rate cuts before end-2024. We see risks to that profile skewed up.

Timestamp: 01 September 2023 01:30AM EDT

Big picture: structurally weak and deanchored expectations = inflation

- UK macro driven by four main shocks: global supply chain problems; rising workforce sickness; Brexit; energy prices.

- Shocks have cut potential growth, which is how no growth since 2019 has translated into a tight labour market and strong inflation. In our view that inflation is now entrenched to a degree.

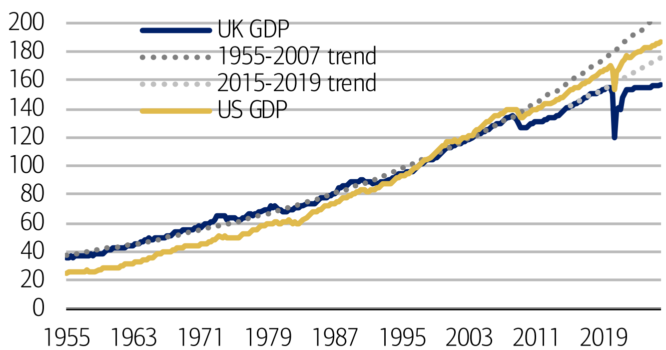
- While two supply shocks have eased, two persist (Brexit and workforce sickness). And even the easing shocks have left behind some entrenched inflation in the form of deanchored inflation expectations.

- Key macro developments in first half of year were easing of the energy shock and global supply chain problems boosting growth prospects, and more persistent wage and price inflation than expected boosting terminal rates. We suspect continued persistent wage and price pressure will solidify expectations of very delayed rate cuts.

- We estimate UK potential growth of 1% a year and we see inflation expectations as modestly deanchored. This means persistent inflation if growth remains modestly positive or alternatively that the BoE needs to keep interest rates higher for longer than other developed economies.

Exhibit 1: UK and US GDP, BofAf

GDP below pre-Covid level, running well below previous trends...



Source: BofA Global Research, ONS, BEA

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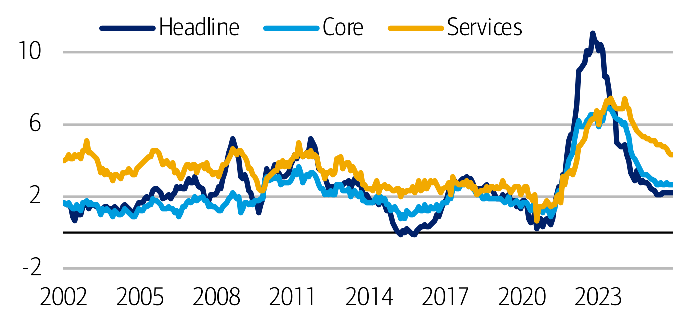
Exhibit 2: CPI inflation, BofAf

... While core, not just headline, inflation surged



Source: BofA Global Research, ONS

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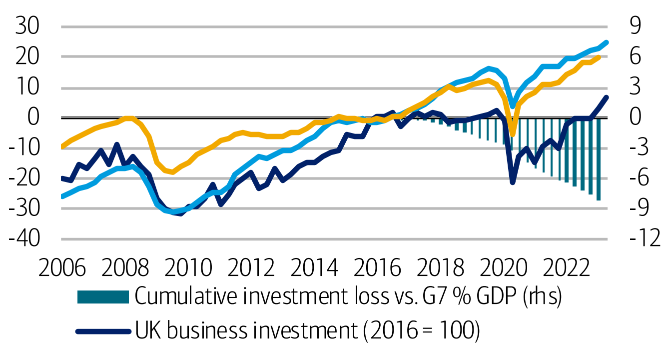
Exhibit 3: Business investment, change since 2016

Brexit resulted in cumulative £180bn, c. 8% GDP, investment loss



Source: BofA Global Research, BEA, Eurostat, ONS

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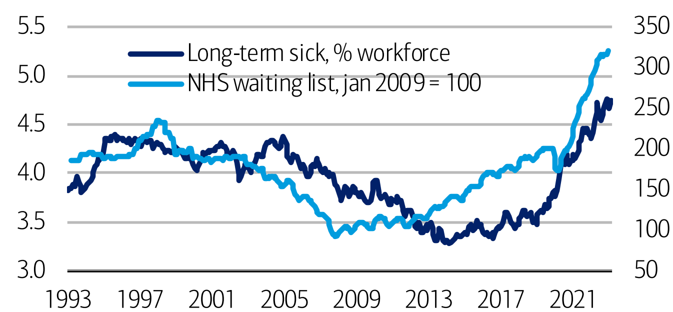
Exhibit 4: % population not looking for a job due to long-term sickness

Rocketing long-term sickness cut the workforce



Waiting list series splices monthly and quarterly data on different definitions, treat with caution.

Source: BofA Global Research, ONS

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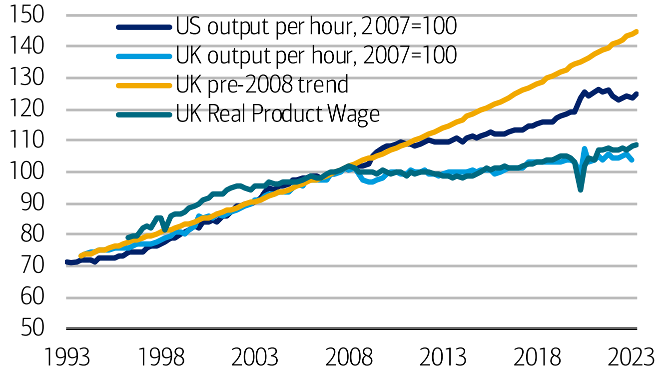
Exhibit 5: Productivity and real product wage

UK productivity growth has been weak for 15 years, likely to continue



Real product wage = regular pay deflated by GDP deflator. **Source:** BofA Global Research, BEA, ONS.

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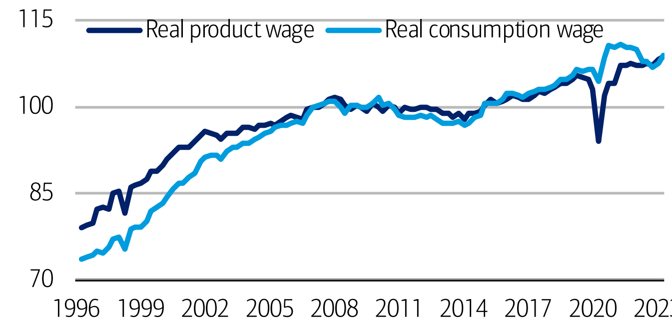
Exhibit 6: Real product and consumption wages

Consumer spending power structurally squeezed by import costs as well as productivity. Wage rose faster than productivity in late 90s/early 2000s as import prices fell, reverse process now



Real product wage = regular pay deflated by GDP deflator, real consumption wage = pay deflated by consumption deflator. **Source:** BofA Global Research, ONS

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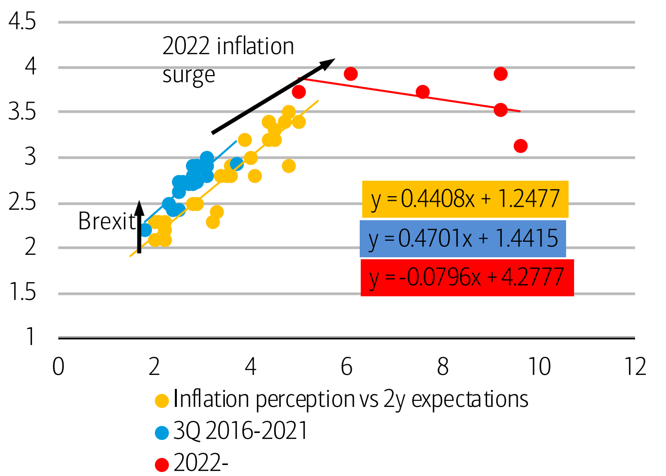
Exhibit 7: Inflation perceptions vs expectations

UK inflation expectations modestly deanchored



Source: BofA Global Research, BoE.

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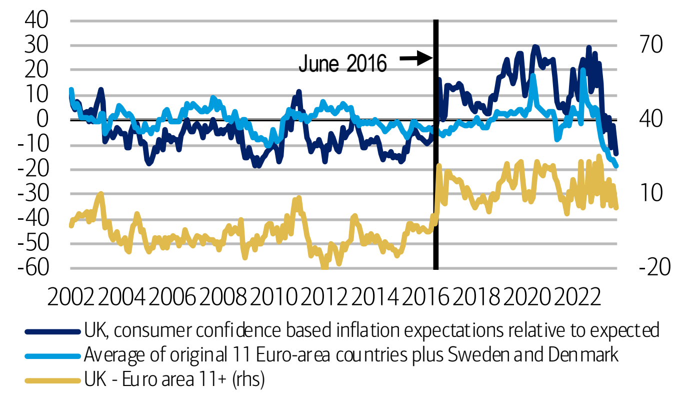
Exhibit 8: Consumer confidence-inflation expectations

UK inflation expectations deanchored to the upside



Blue lines show the residual from a regression of the net balance of consumers expecting prices to rise on the net balance of consumers saying prices rose over the past twelve months, the net balance of consumers expecting unemployment to rise, food and oil price inflation. EA 11 average excludes the Netherlands which is an outlier. The yellow line shows the difference between the UK and Euro area 11 plus Sweden and Denmark lines. **Source:** BofA Global Research, GfK, EC.

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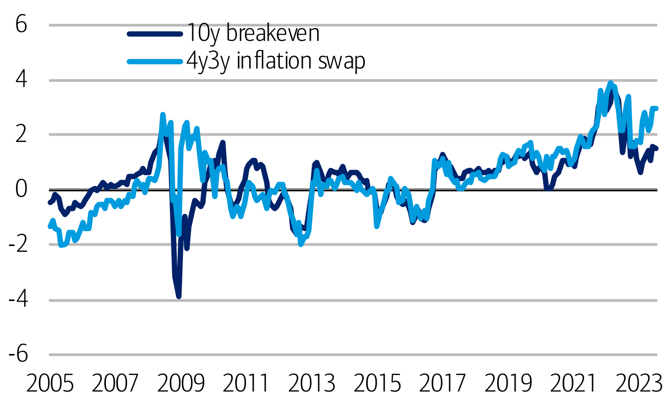
Exhibit 9: Market inflation pricing

Market expects persistently above target inflation



Standard deviations from pre-2019 average. **Source:** BofA Global Research, Bloomberg.

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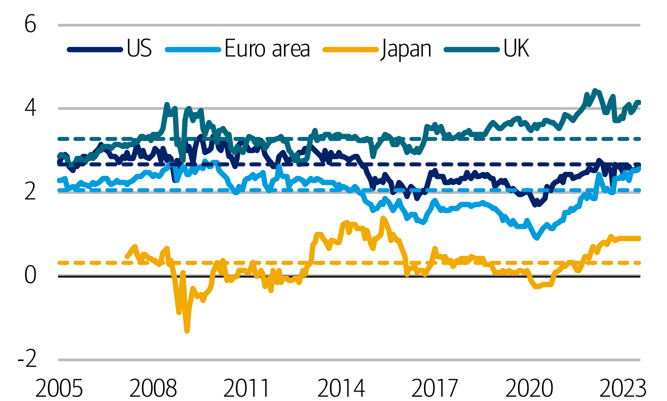
Exhibit 10: 5y5y market inflation expectations (4y3y for UK)

Markets price UK having a unique problem, building since 2017



Source: BofA Global Research, Bloomberg

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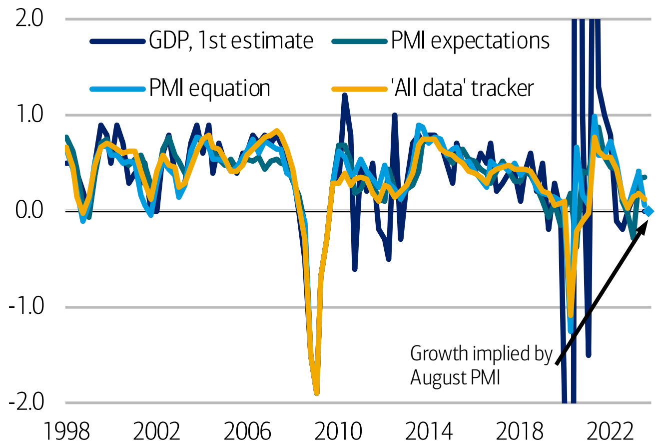
Tentative signs of weakening growth

- Sharp drops in two surveys, the PMIs and CBI retail survey, give tentative evidence of weakening growth. However, the PMI has not been a good guide to growth lately. The surge in the PMI in the Spring seemed to overestimate the expansion. The recent drop sits at odds with a range of other surveys. Our 'all data' tracker, taking account of a wide range of data suggests growth remains weak but positive.

- We expect 0.4% qoq growth in 3Q due to the bounceback from the extra public holiday in May for the King's Coronation. We look for growth of 0% qoq in 4Q. In other words, we are not placing a lot of weight on the latest PMIs falling into contraction territory. They pose a downside risk to growth.

- Big picture = economy stagnating since May 2022 when real income began to fall.

Exhibit 11: GDP growth qoq and survey-based trackers
Surveys suggest weak but positive growth



Source: BofA Global Research, S&P global, ONS

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Exhibit 12: GDP nowcast, 3Q 2023
We track 0.4% growth in 3Q

	Weight, %	Sep-23	Contribution to qoq GDP growth
Index of production	13.5	0.4	0.0
o/w			
Manufacturing	9.7	0.1	0.0
Extraction	1.1	1.2	0.0
Utilities	2.7	0.8	0.0
Index of services	79.6	0.4	0.3
o/w			
PNDS	50.7	0.4	0.2
Distribution	10.5	0.3	0.0
Government	18.4	0.7	0.1
Construction	6.2	0.3	0.0
Agriculture	0.7	0.4	0.0
GDP			0.4
GDP*	96.2		0.4
GDP**	90		0.4

GDP* excludes construction, GDP** additionally excludes energy, PNDS = private non-distribution services. **Source:** BofA Global Research, ONS

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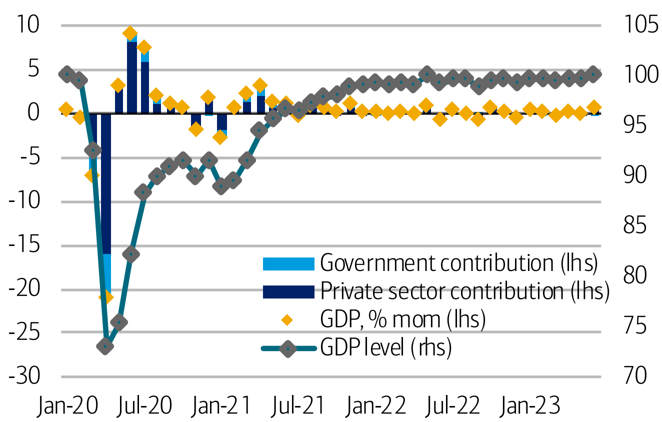
Exhibit 13: UK GDP and contributions to growth (% mom)
UK economy stagnating since end-2021



Source: BofA Global Research, ONS

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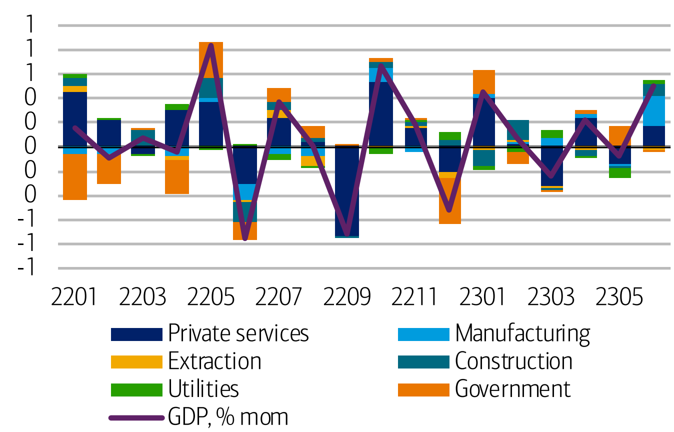
Exhibit 14: Contribution to GDP, % mom
Bounceback from extra public holiday in May boosts June



Source: BofA Global Research, ONS.

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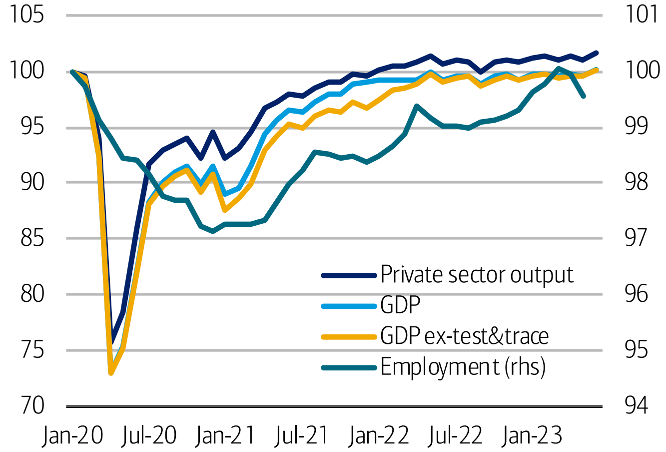
Exhibit 15: UK GDP, January 2020=100
Ex-test-and-trace economy stopped growing in May 2022



Source: BofA Global Research, ONS.

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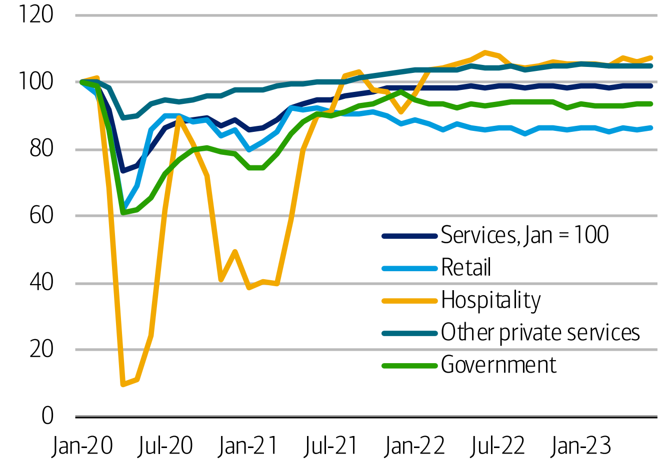
Exhibit 16: Sectoral output, Jan 2020 = 100
As reopening boost to hospitality ended



Source: BofA Global Research, ONS

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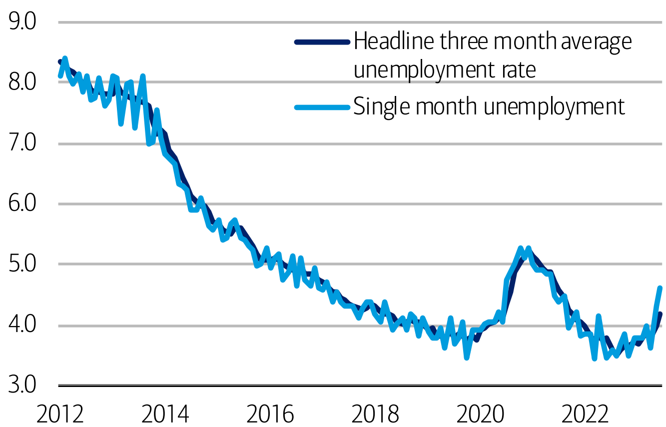
Labour market easing but remains tight

- The labour market is easing due to improved labour supply. But the supply gain was a one-off, so further labour market easing requires weaker demand.
- Recruitment difficulties have eased sharply, and unemployment has risen more than expected in recent months, as the participation rate rose. Students returning to work post-Covid is the main explanation for the rise in participation, but that was a one-off. Further labour market loosening will likely require weaker employment. The chronic change in labour supply from rising workforce sickness continues to worsen.
- Employment fell in the latest labour market data but there are as yet few signs that employment will continue falling.
- There are tentative signs that the shift of the Beveridge curve, a measure of labour market mismatch, back to normal has stopped. This suggests the inflation neutral unemployment rate may have risen.

Exhibit 17: Unemployment rate
Unemployment rate has risen more than expected



Source: BofA Global Research, ONS

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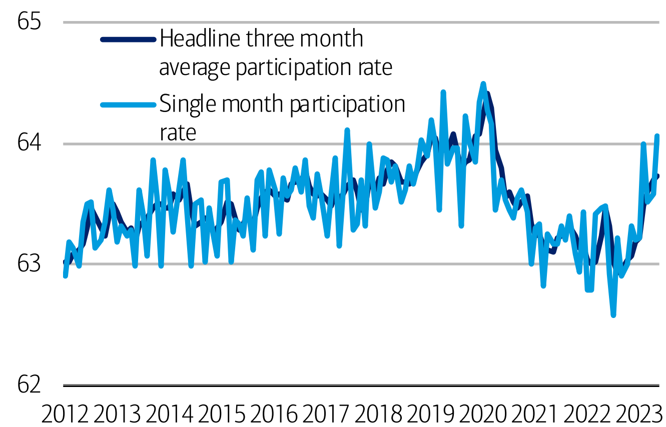
Exhibit 18: Participation rate
Primarily as participation rate rose



Source: BofA Global Research, ONS

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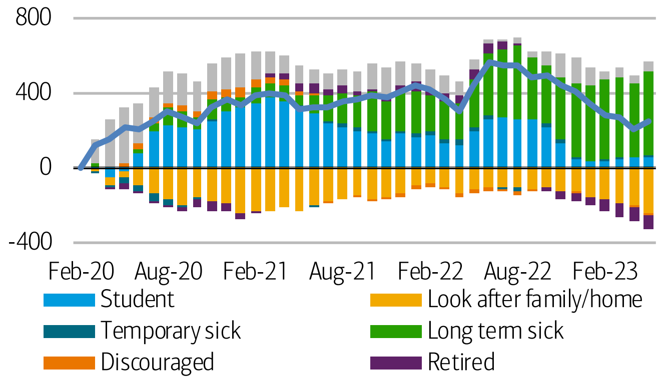
Exhibit 19: Change in inactivity since February 2020, thousands

Mainly one-off improvement in inactivity as students return to work, although falling inactivity due to looking after family and retirement. Structural labour supply weakness (sickness) continues to worsen



Source: BofA Global Research, ONS

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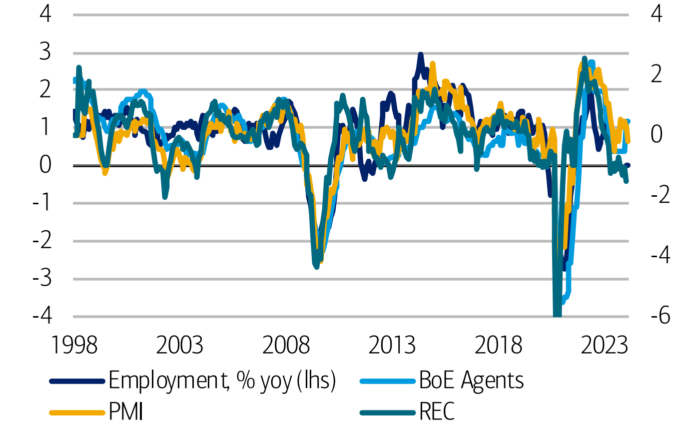
Exhibit 20: Employment and survey indicators of recruitment

Employment fell in June but surveys mostly suggest modest growth



Source: BofA Global Research, ONS, REC, S&P Global, BoE

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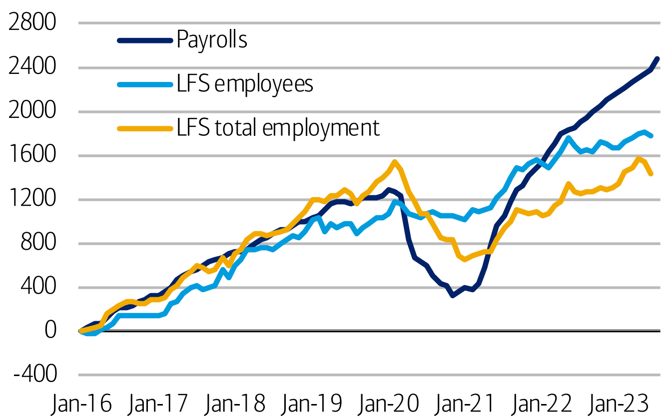
Exhibit 21: Labour Force Survey (LFS) employment vs payrolls

Payrolls continues to rise, although it's an unreliable indicator



Source: BofA Global Research, ONS

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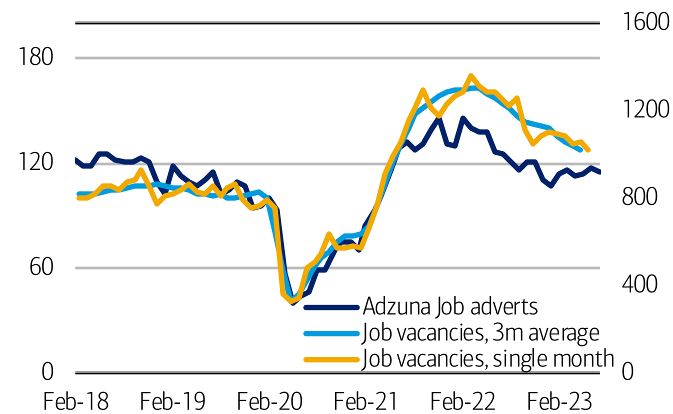
Exhibit 22: Vacancies and job adverts

Official vacancies continue to fall but survey indicators suggest stabilisation



Source: BofA Global Research, ONS

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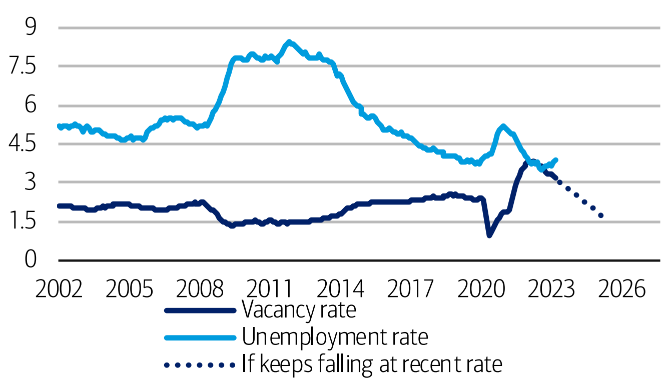
Exhibit 23: Vacancy and unemployment rate

Will return to pre-Covid level early 2024 if continues falling at recent pace



Source: BofA Global Research, ONS

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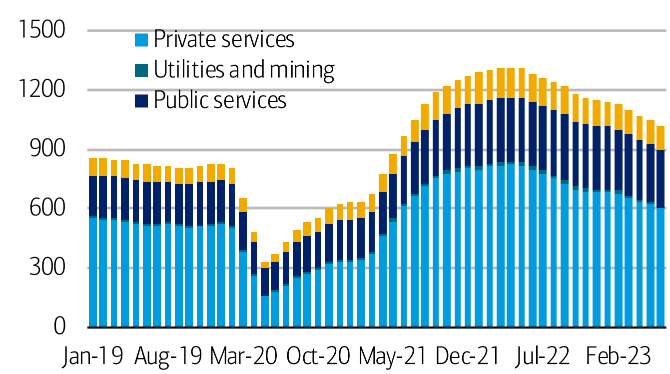
Exhibit 24: Vacancies by sector

Private services vacancies will return to normal by year end if they keep falling at recent rate



Source: BofA Global Research, ONS

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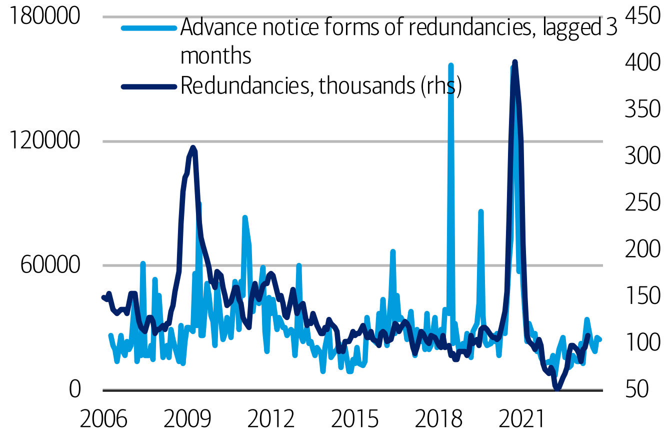
Exhibit 25: Redundancies and HR1 form advance notices
Redundancies remain low



Source: BofA Global Research, ONS

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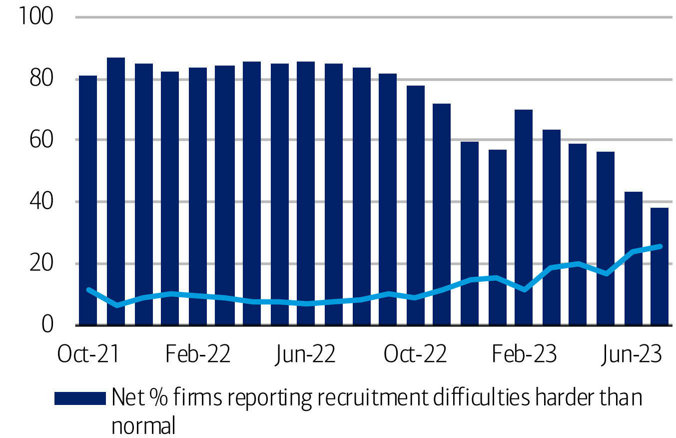
Exhibit 26: Decision Maker Panel Recruitment Difficulties
Recruitment difficulties easing



Source: BofA Global Research, BoE.

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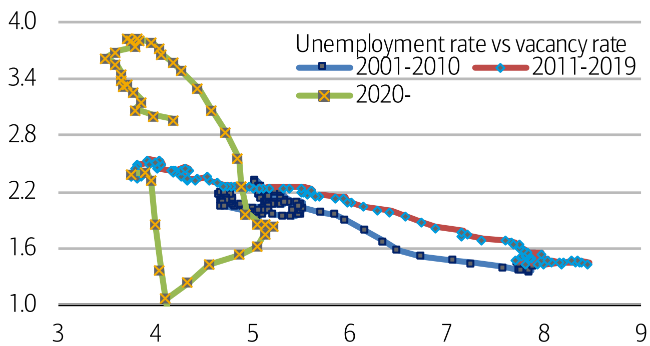
Exhibit 27: Beveridge curve
Tentative signs shift of Beveridge curve back to normal has stalled... coincident falling vacancies and rising unemployment could be shift out along new, higher, Beveridge curve



Source: BofA Global Research, ONS.

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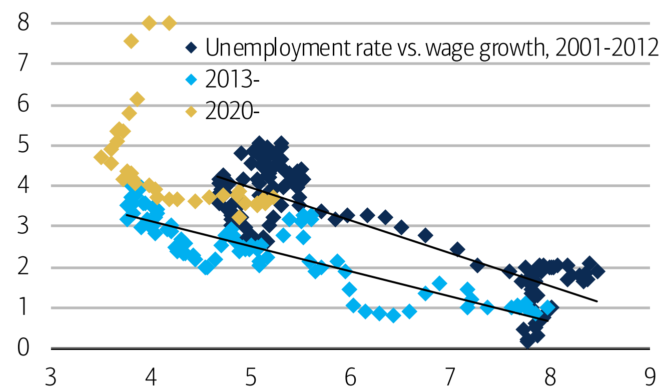
Exhibit 28: Wage Phillips Curve
Responds to higher inflation



Source: BofA Global Research, ONS

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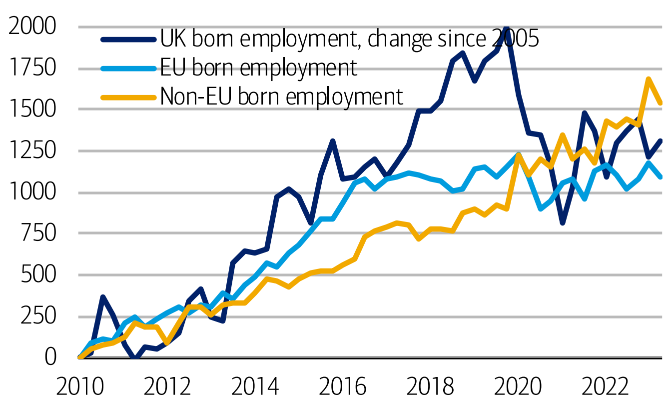
Exhibit 29: Employment by country of birth, change since 2010, thousands
Immigration making up for some of drop in UK born workers



Source: BofA Global Research, ONS

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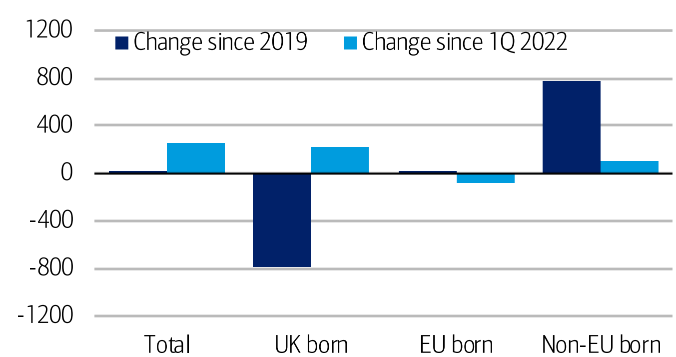
Exhibit 30: Employment by country of birth, change, thousands
Higher immigration may be helping to ease labour supply difficulties, would need to continue for extended period to fill vacancies. Immigration brings demand as well as supply so uncertain how much this changes aggregate labour supply imbalance vs. sectoral pressures



Source: BofA Global Research, ONS

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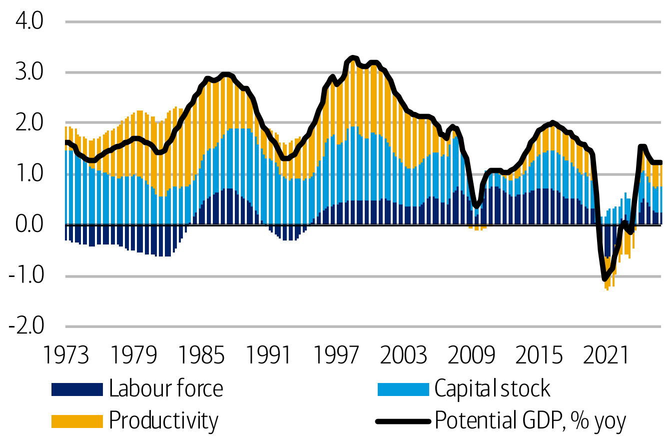
Supply improvement

- Recent signs of improved labour supply, though increased participation and migration, lead us to raise our UK potential growth estimates slightly.

- Our estimates of potential GDP growth, shown in Exhibit 31 and Exhibit 32, make the point that some of the easing in capacity constraints recently likely reflects stronger supply growth. The boost to labour supply has given the BoE a helpful start to easing capacity constraints. But with that boost likely to fade for the reasons described above we expect the unemployment rate to rise half as much in the next 10 months as it has in the last 10.

Exhibit 31: BofAe potential GDP growth
Potentially supply growth likely improved as labour supply recovered



Source: BofA Global Research

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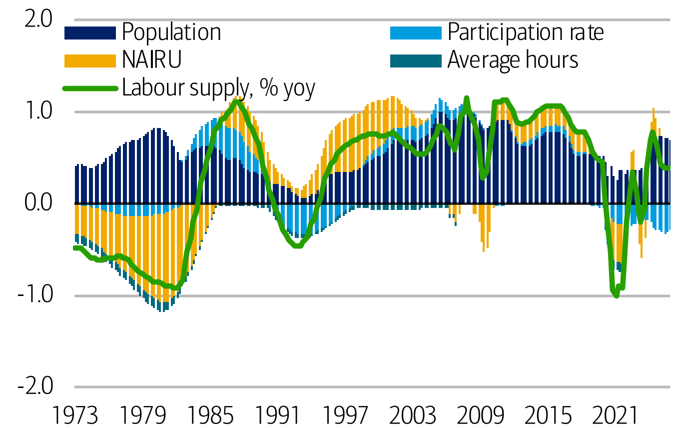
Exhibit 32: BofAe potential labour supply growth
Improving labour supply driven by stronger population growth (immigration) increasing participation and falling NAIRU



Source: BofA Global Research

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Inflation persistence worsens

- As the tide of supply shocks has gone out it's revealed a more serious than, we or markets, expected inflation persistence problem. While near-term inflation prospects have improved since mid-2022 medium-term prospects have worsened.

- Core inflation re-accelerated in the Spring, to well above the Euro-area level. Cyclical and persistence weighted inflation show scant signs of slowing. Annualised core services inflation has stabilised at a very elevated level.

- Core goods inflation shows clearer signs of slowing now, as fading supply chain difficulties and the subsequent weaker cost price inflation passes through. So the global component of the UK's high inflation seems to be fading finally, but the more domestic component remains strong and importantly stronger than expected.

- Wage growth continues to surprise the BoE on the upside even as the labour market eases more than expected. Wage growth seems to us consistent with a change in behaviour, with wages increasingly based on recent inflation rather than more stable inflation expectations (see UK Watch: Wage growth higher for longer 14 July 2023).

- Why have wage growth and domestic inflation continued to accelerate? There are dovish and hawkish arguments. BoE Deputy Governor Ben Broadbent recently argued that UK wages and domestic inflation had been stronger than other countries because of a bigger energy price (terms of trade) shock. The similar increasing trajectories of UK and Euro area services inflation vs. the US would be consistent with that.

- Broadbent also suggested the NAIRU may have risen more in the UK due to the larger terms of trade shock. But that would still mean the labour market had been easing for some time, as unemployment rises and the Beveridge curve shifted in, yet wage growth kept rising. Importantly, the process of the NAIRU falling may have stalled suggesting some structural change behind the wage story.

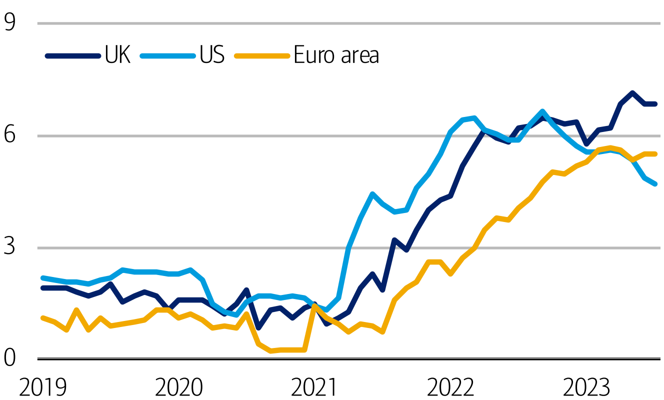
- We could have greater indirect effects of higher imported costs on UK output. But that process should be coming to an end and yet services inflation continues to annualise at a high rate, again suggesting something else may be going on.

- BoE Chief Economist Pill suggests the Phillips Curve may have steepened – suggesting wage growth will slow faster than expected as the labour market eases. This may be true, but we suspect that quantitatively cannot explain all the surprising wage strength, and the longer wage growth remains the more likely it is that a part of the strength of wage growth is due to deanchored expectations.

- In the short term a steeper Phillips Curve is hard to distinguish from a *higher* Phillips Curve due to inflation expectations rising. We suspect one additional argument to add to the BoE's suggestions is modestly deanchored inflation expectations.

Exhibit 33: Core CPI inflation

UK trajectory diverges from US and Euro area



Source: BofA Global Research, ONS, BEA, Eurostat

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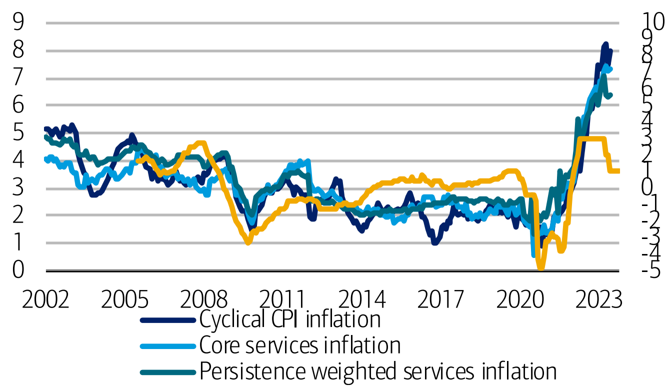
Exhibit 34: Cyclical CPI inflation and spare capacity

Core services inflation, cyclical inflation and persistence weighted inflation are not yet slowing decisively, disconnected from spare capacity



Source: BofA Global Research, BoE

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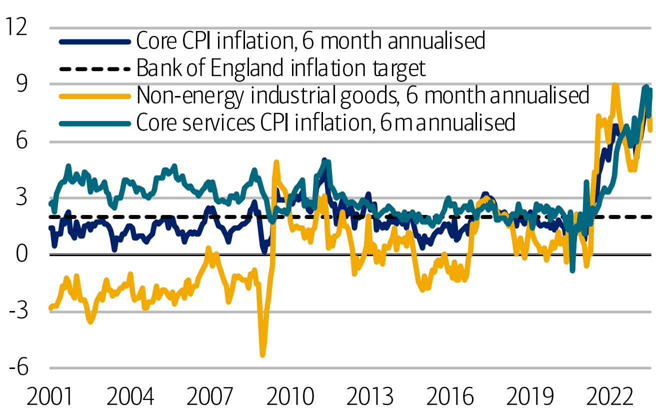
Exhibit 35: 6 month annualised seasonally adjusted inflation

6-month annualised core services inflation remains close to 9%, core goods high but more convincing signs of slowing



Seasonally adjusted with X12. **Source:** BofA Global Research, ONS.

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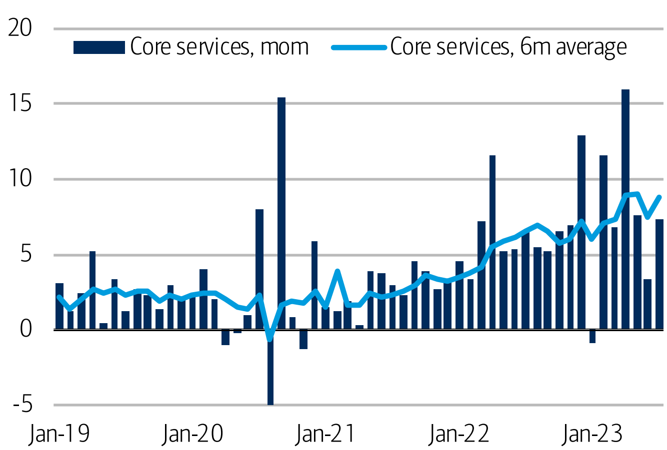
Exhibit 36: Annualised seasonally adjusted core services inflation

Services inflation stabilised at a high level



Source: BofA Global Research, ONS

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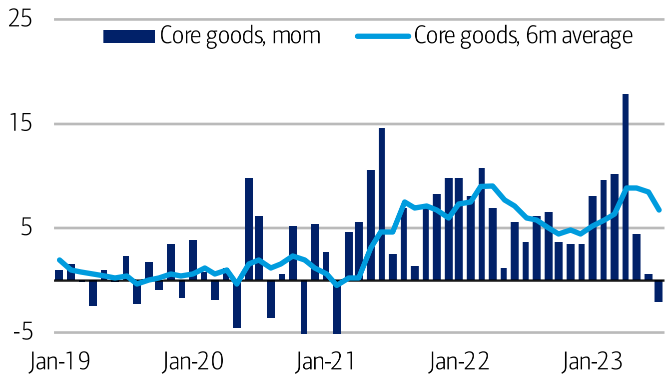
Exhibit 37: Annualised seasonally adjusted core goods inflation

Goods inflation increasingly seems to have slowed back to normal



Source: BofA Global Research, ONS

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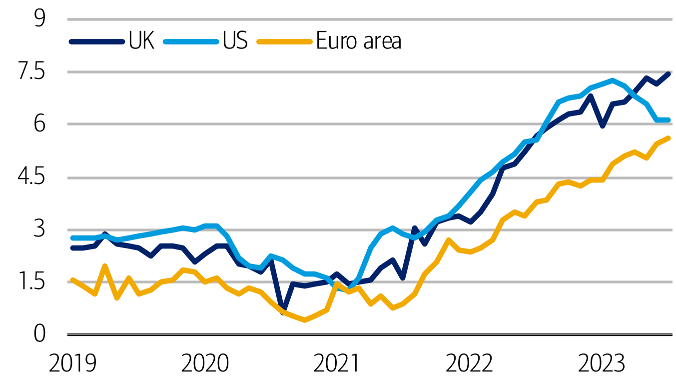
Exhibit 38: Services inflation

UK and Euro area rising, but UK increasingly large gap from Euro area



Source: BofA Global Research, ONS, BEA, Eurostat

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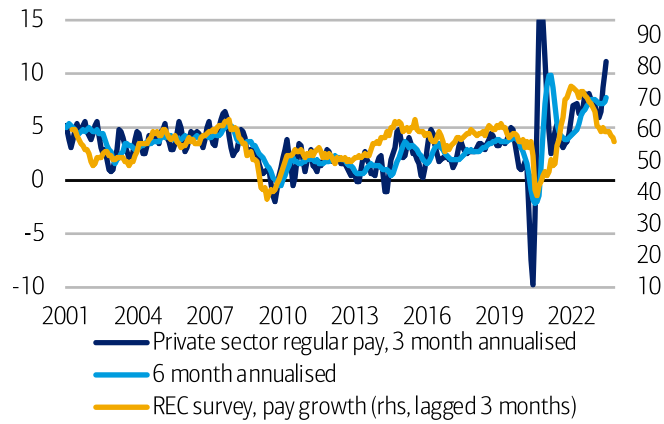
Exhibit 39: Private sector ex-bonus pay growth and REC survey

Pay growth continues to accelerate even as surveys slow



Source: BofA Global Research, ONS, REC (Recruitment and Employment Confederation)

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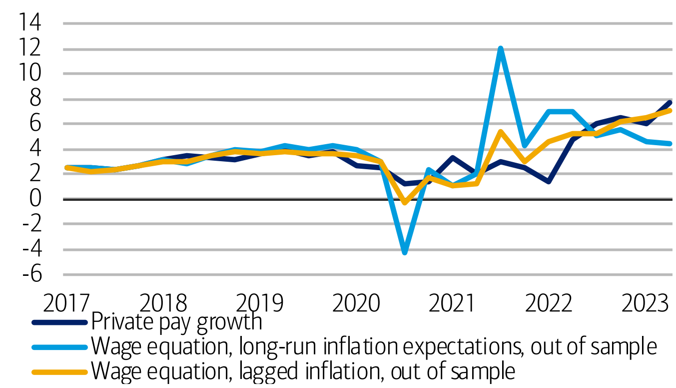
Exhibit 40: Private pay growth

Wage data consistent with change in worker/firm behaviour to setting wages based on recent spot inflation rather than (more stable) inflation expectations



Private pay growth is ONS data except from 2020-2022 when we use the BoE's estimate of pay growth adjusted for compositional effects from the Furlough scheme. Wage equations used discussed in UK Watch: Wage growth higher for longer 14 July 2023. **Source:** BofA Global Research, ONS, BoE.

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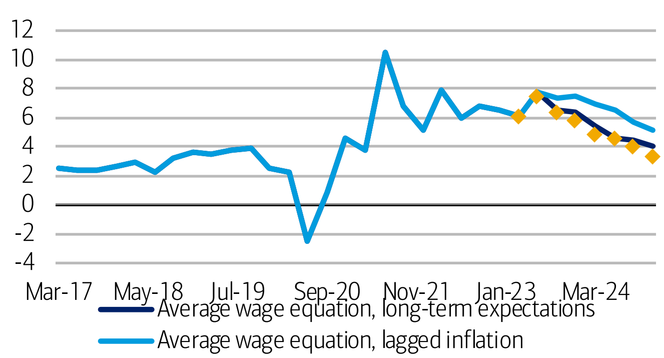
Exhibit 41: Private sector pay growth forecasts

Pay growth likely to persist for longer than BoE expects



*BoE provides forecasts for private sector regular pay for 2023 only. We show private sector total pay (including bonuses). We add an estimate of the bonus contribution to the BoE's ex-bonus pay forecasts and estimate their private sector pay forecast for 2024 with their published whole economy pay forecast. **Source:** BofA Global Research, ONS, BoE

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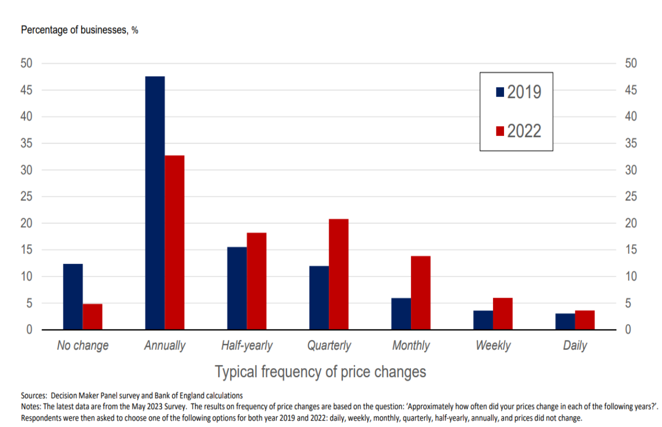
Exhibit 42: Survey evidence on frequency of firm pricing decisions

Firms shift to more frequent price changes



Source: Bank of England

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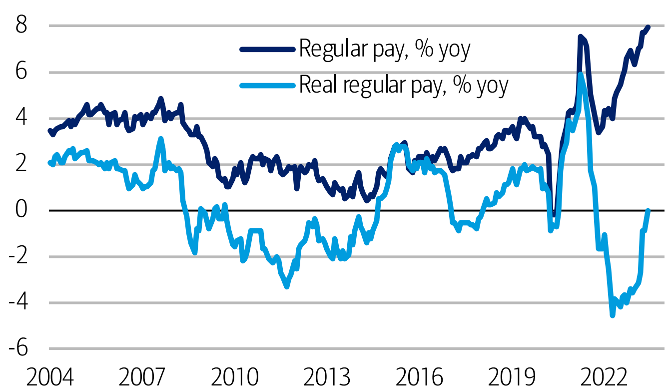
Income gains vs. interest rates

- Real pay growth will soon turn positive as nominal pay remains strong while inflation falls. This should lead to positive but still weak real disposable income growth (Exhibit 44). Working against the rise in real wages will be the withdrawal of government energy price support next year and frozen tax thresholds (Exhibit 45). We expect real income at end-2024 to be almost unchanged from end-2019.
- A key judgement is whether that return to real income growth dominates the drag on consumer spending from interest rate hikes. In our view the BoE needs to keep economic growth from accelerating to keep easing labour market conditions.
- Rising unemployment, weak financial wealth, and the impact of rate hikes will, in our view, lead to small falls in consumer spending through 2024. In short, we expect modestly higher disposable income to feed through to higher saving rather than higher spending. This is a finely balanced judgement, however.
- A smaller impact of rate hikes on consumers now than in the past, because of fewer variable rate mortgages, could lead consumer spending to be stronger than we expect. On the other hand, we have been surprised that the saving rate has not fallen further during the period of weak income growth. Households precautionary saving motives may be rising more than we factor in (Exhibit 47).

Exhibit 43: Nominal and real pay, % yoy

Economy stopped growing around six months after real pay began falling



Source: BofA Global Research, ONS

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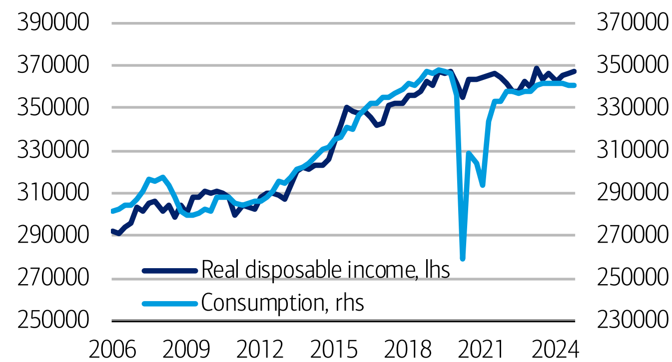
Exhibit 44: BofAf real income and consumption

Real disposable income troughed in 4Q 2022, we expect it to growth 1.3% over the two years to 4Q 2024



Source: BofA Global Research, ONS

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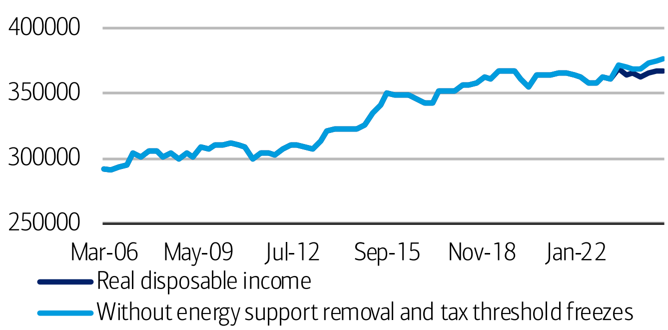
Exhibit 45: BofAf real income with and without government energy support and tax hikes

Real income to rise less than real wage growth because of tax hikes and withdrawal of government energy support



Source: BofA Global Research, ONS

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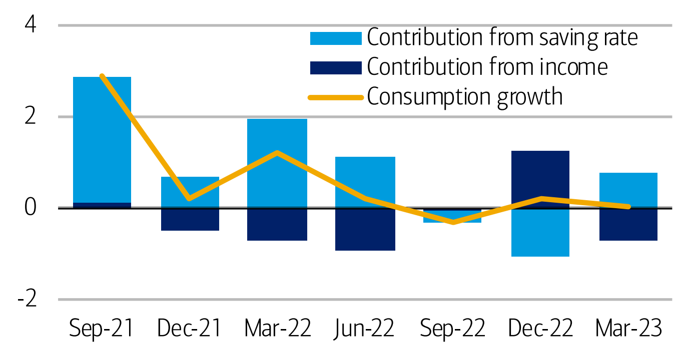
Exhibit 46: Consumption growth, % qoq, and contributions from income and saving

Consumers cut saving rate to keep spending through real income falls



Source: BofA Global Research, ONS

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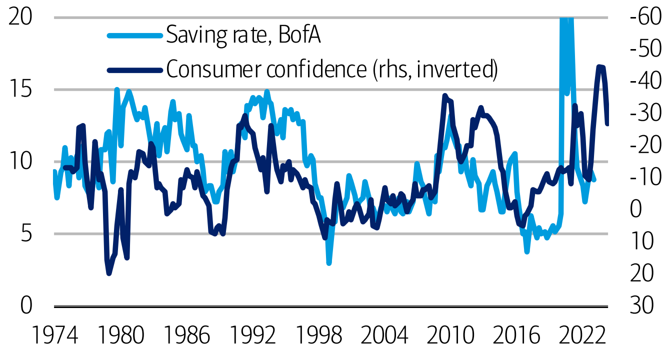
Exhibit 47: Household saving rate and consumer confidence
Consumer confidence suggests households' precautionary saving motives rose



Source: BofA Global Research, ONS, GfK

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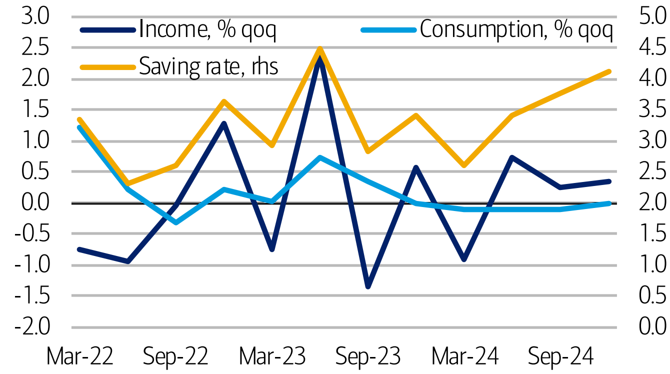
Exhibit 48: BofAf income, consumption, saving rate
Consumption growth stays weak as saving rate rises a little



Source: BofA Global Research, ONS

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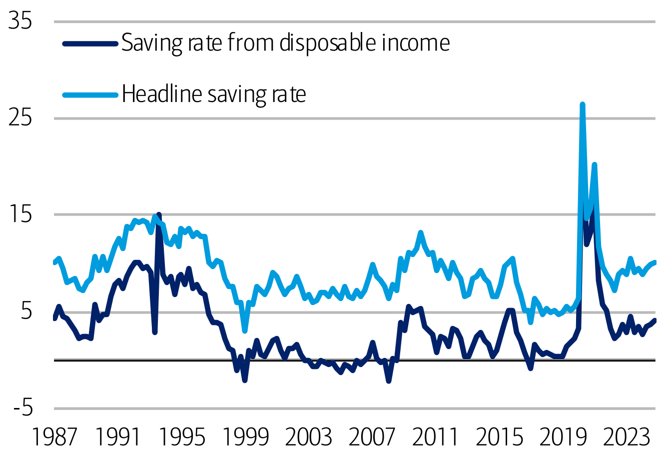
Exhibit 49: BofAf household saving rate
Surprise has been how little households cut saving rate, likely the result of higher interest rates and weak wealth growth



Source: BofA Global Research

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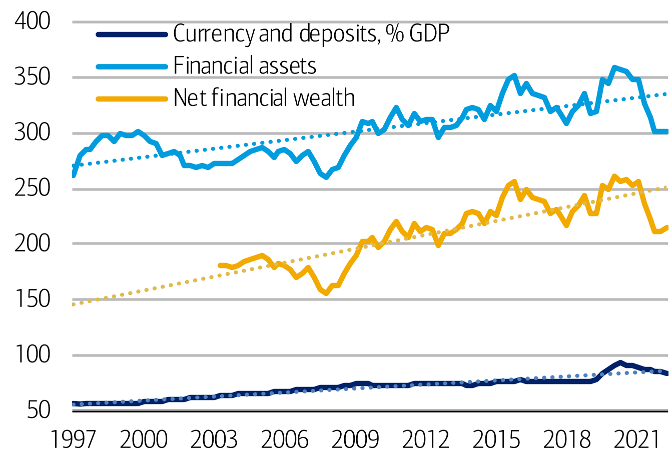
Exhibit 50: Household financial assets, % GDP
Covid savings eaten up by rising inflation and asset price falls



Source: BofA Global Research, ONS

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One last BoE rate hike, risks of more

- The BoE has some good news on capacity pressures easing and headline inflation falling, but bad news on inflation persistence. Meanwhile although PMIs suggest the UK may be tipping into recession other surveys are not as negative on balance and the return of real wage growth suggest risks skew to economic growth holding up. The easing of capacity pressures will, in our view, slow.

- Diagnosing the structural changes in the economy in real time is genuinely hard. Before the financial crisis setting interest rates was straightforward, as most shocks were demand shocks. So, there was no trade-off between growth and inflation – rate hikes stabilise both if demand picks up – and less uncertainty about economic developments: the BoE can observe demand growth, it cannot observe supply growth. The point is the BoE is feeling its way to the right policy setting.

- How much spare capacity is needed and how much the BoE needs to hike to deliver that is extremely uncertain. Interest rates are, in our view, in restrictive territory now. The weak housing market testifies to that. It's not so much a question of the BoE catching up with policy anymore, but rather how restrictive rates need to be.

- That will depend on the mixture of shocks. The BoE (Broadbent, Pill) suggest data surprises have been the result of structural changes that do not necessarily all suggest upside risks to inflation. The BoE will likely be cautious about hiking further.

- We assume the BoE keeps hiking until it sees evidence of core inflation sustainably falling and wage growth stops surprising on the upside. We think those conditions will be fulfilled by the November policy meeting. In our view private sector regular pay growth has now peaked and we see core inflation slowing gradually. So we expect one more 25bp rate hike in September and the BoE to pause in November.

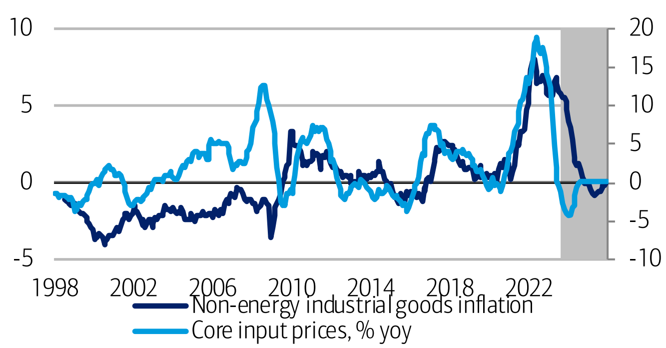
- Uncertainty is high. We see risks to our interest rate forecast skewed up for two reasons. First, the UK monetary policy multiplier seems to have weakened. In the past most UK mortgages were variable rate, now they are mostly fixed for 2-5 years with an average duration a little over 3 years. In our view this substantially slows passthrough of interest rate changes to household cash flow which is a key channel of monetary policy transmission. We estimate the cash flow impacts of rate hikes on consumer spending have more than halved (see UK Macro and Financials: Government rather than consumer stress, although maybe consumer stress too 11 July 2023). The BoE may have to do more because policy is less effective.

- Second, in our view UK inflation expectations have modestly deanchored, which suggests inflation will be more persistent than the BoE expects and /or more resistant to rate hikes (if expectations have deanchored the BoE will have to run a persistent margin of spare capacity to re-anchor expectations).

- Given the BoE's preference for a 'table mountain' path for rates, as BoE Chief Economist Huw Pill recently put it, we express our view of the persistence of inflation by forecasting UK interest rates to remain higher for longer than other countries. We expect no rate cuts before end-2024. We see risks skewed to rates even higher for even longer. Another hike in November, or next February as further information on 2024 wage settlements start to flow in, are plausible in our view

Exhibit 51: Producer price inflation and non-energy goods inflation

Goods inflation could slow faster than we expect if margin rebuild ends sooner



Source: BofA Global Research, ONS.

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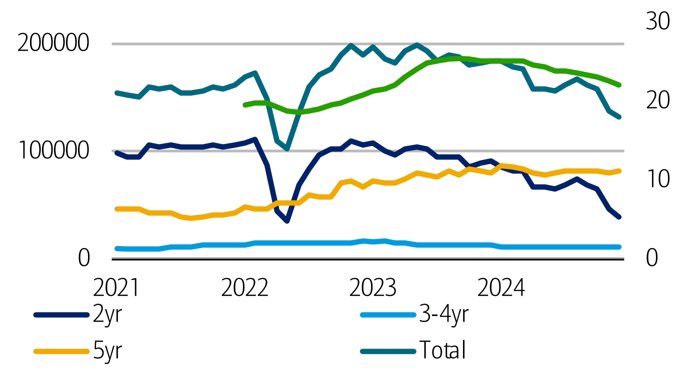
Exhibit 52: BofAe monthly number mortgages at end of fix

A quarter of mortgages will drop off a fixed interest rate in 2023



Source: BofA Global Research, UK Finance, BoE

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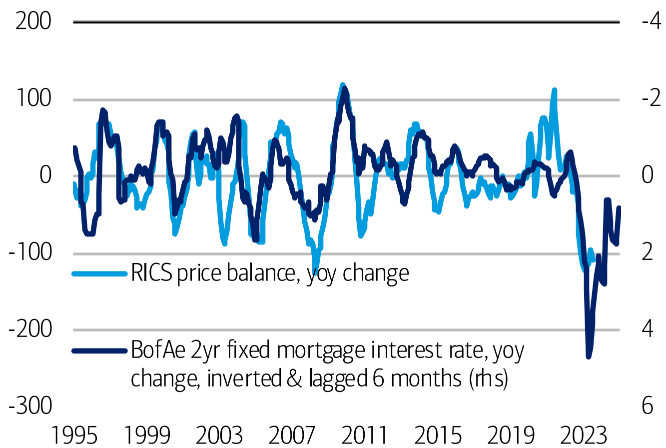
Exhibit 53: RICS price balance and 2yr mortgage rate

Likely renewed rise in mortgage rates to keep house prices falling, weighing on consumer spending



Source: BofA Global Research, RICS (Royal Institution of Chartered Surveyors), BoE.

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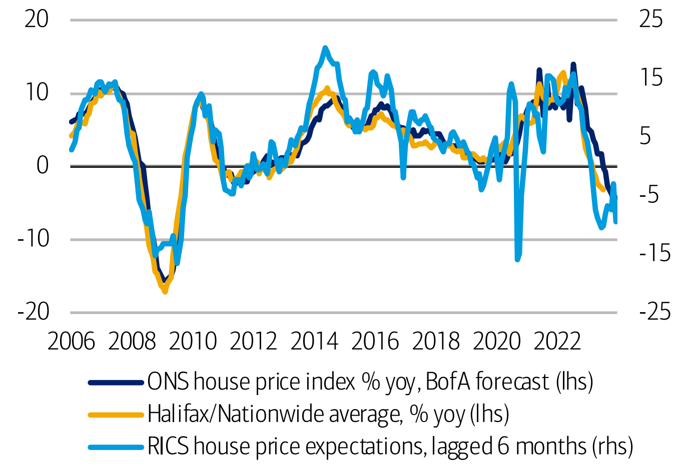
Exhibit 54: BofAf house prices, % yoy

Falling house prices likely to drag on consumer spending



Source: BofA Global Research, RICs, Halifax, Nationwide, ONS

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Raise growth forecast

- We raise our growth forecasts, to 0.6% for 2023 from 0.4%. We keep 2024 and 2025 at 0.3% and 0.6% respectively. This reflects stronger than expected 2Q GDP growth and the stronger path for real wages as nominal pay growth continues to rise. That stronger path for real wages is facilitated by improved near-term potential supply. We continue to think the BoE will have to keep growth close to zero through 2024 to keep the labour market easing. We see risks to our forecast skewed to stronger growth in 2024 than we expect, with risks therefore of higher interest rates to quell inflation which would result in weaker growth in 2025. We do not see the recent data flow as demonstrating a painless way to lower inflation.

Heatmaps

Exhibit 55: Output indicators

PMI moves from most optimistic to the least, probably exaggerates the change in growth momentum

Where data are monthly, figure shows the average reading in the quarter so far. The right- hand panel of data shows the monthly pattern of data. Green denotes data above average, yellow data in line with its average and red below average. Averages, standard deviations and correlations calculated 1997-2019 excluding the financial crisis years so that colours reflect growth relative to more 'normal' times and to avoid spurious correlation (all data were highly correlated during the financial crisis). Source: BofA Global Research, ONS, S&P Global, CBI, BCC, Lloyds, BoE, Deloitte.

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Exhibit 56: Expenditure indicators

Consumer confidence improves as real wage growth returns, investment indicators much weaker than hard data, housing market remains extremely weak, employment growth remains steady

Where data are monthly, figure shows the average reading in the quarter so far. The right- hand panel of data shows the monthly pattern of data. Green denotes data above average, yellow data in line with its average and red below average. Averages, standard deviations and correlations calculated 1997-2019 excluding the financial crisis years so that colours reflect growth relative to more 'normal' times and to avoid spurious correlation (all data were highly correlated during the financial crisis).

Source: BofA Global Research, ONS, S&P Global, CBI, BCC, RICS, BoE, UK Finance, Deloitte, ONS.

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Exhibit 57: Expectations indicators

Expectations deteriorate

	Correlation w/ hard data: Goods exports	Total
Exports		
BoE Agents	0.39	0.45
CBI export orders	0.30	0.28
PMI new export orders	0.27	0.21
BCC export sales	0.24	0.19
CBI manufacturing export deliveries	0.23	0.20
BCC export orders	0.17	0.12
Confidence/expectations		
Manufacturing		
PMI new orders/inventories	0.11	0.37
PMI new orders	-0.03	0.40
BCC orders	-0.08	0.36
CBI optimism	-0.03	0.35
BCC confidence	-0.11	0.39
CBI expected output	-0.15	0.30
CBI orders	-0.18	0.12
Services		
PMI Future business expectations	0.36	0.56
PMI new orders	0.29	0.48
BCC confidence	0.19	0.61
CBI optimism	0.15	0.37
BCC orders	0.10	0.53
Construction		
Housing starts	0.47	0.38
Construction new orders	0.47	0.22
PMI future business activity	0.47	0.10
RICS expectations	0.38	-0.05
PMI new orders	0.11	-0.15

See previous chart for methodology. Source: BofA Global Research, ONS, S&P Global, RICS, CBI, BCC, BoE,.

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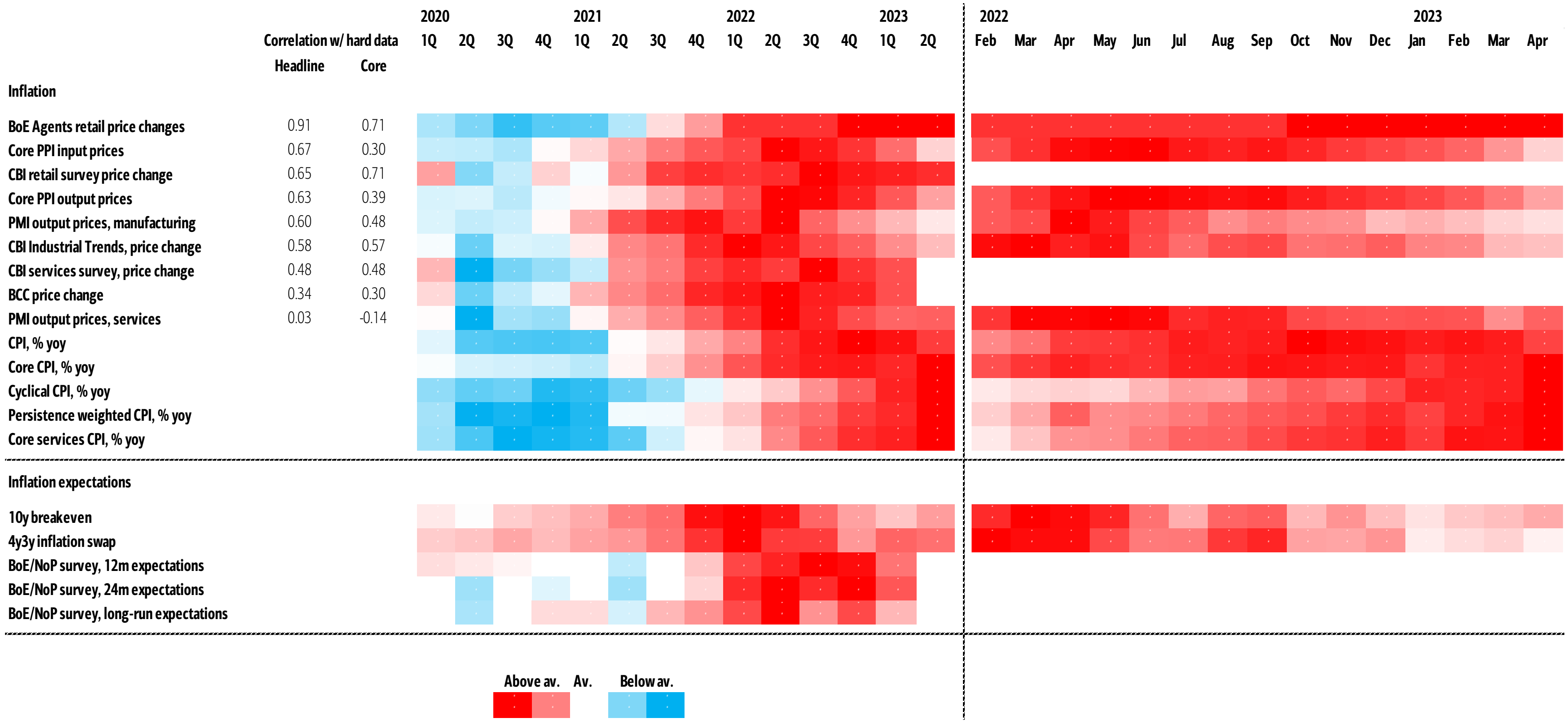
Exhibit 58: Inflation indicators

Continued easing of supply chain pressures but retail signals remain red hot and measures of persistent inflation remain very elevated



Source: BofA Global Research, ONS, S&P Global, CBI, BoE, BCC, Bloomberg

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Exhibit 59: BofA UK forecasts

We forecast weak but positive growth and persistent inflation

		2022	2023	2024	2025	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25
GDP	% qoq					0.1	0.2	0.4	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.3
	% qoq ann.					0.6	0.8	1.6	0.0	0.0	0.0	0.4	0.4	0.4	0.8	0.8	1.2
	% yoy	4.1	0.6	0.3	0.6	0.2	0.4	0.9	0.8	0.6	0.4	0.1	0.2	0.3	0.5	0.6	0.8
Private Consumption	% qoq					0.0	0.6	0.4	0.0	-0.1	-0.1	-0.1	0.0	0.2	0.2	0.2	0.2
	% yoy	5.6	0.7	0.1	0.4	0.3	0.5	1.2	0.9	0.8	0.2	-0.3	-0.3	0.0	0.3	0.6	0.8
Government Consumption	% qoq					1.7	1.2	0.9	0.4	0.1	0.3	0.3	0.3	0.3	0.5	0.5	0.5
	% yoy	1.8	1.4	2.1	1.5	-2.2	2.6	2.8	2.7	4.6	1.7	1.0	0.9	1.2	1.4	1.7	1.8
Investment	% qoq					2.4	0.0	-1.2	0.1	0.0	-0.2	-0.2	0.0	0.1	0.2	0.3	0.4
	% yoy	8.6	2.0	-0.8	0.4	1.5	3.8	1.4	1.3	-1.1	-1.3	-0.2	-0.4	-0.2	0.2	0.6	1.0
Final Domestic Demand[1]	% qoq					0.1	1.0	0.2	0.1	0.0	0.0	0.0	0.1	0.2	0.3	0.3	0.3
	% yoy	5.4	1.1	0.3	0.7	0.0	1.5	1.5	1.3	1.2	0.2	0.0	-0.1	0.2	0.5	0.8	1.1
Net exports[1]	% qoq					-1.0	-1.1	-0.1	-0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
	% yoy	-1.2	0.2	-0.3	0.0	4.1	1.7	-2.6	-2.2	-1.2	-0.1	0.1	0.1	0.1	0.0	-0.1	-0.2
Stockbuilding[1]	% qoq					1.1	0.3	0.3	-0.1	0.1	0.0	0.1	0.0	-0.1	0.0	0.0	0.0
	% yoy	-0.1	-0.8	0.3	-0.1	-3.8	-2.9	1.9	1.6	0.6	0.3	0.1	0.1	0.0	0.3	-0.2	-0.1
Current Account Balance	% of GDP	-3.8	-3.5	-3.8	-3.7	-2.3	-3.8	-3.9	-3.9	-3.9	-3.8	-3.7	-3.7	-3.7	-3.7	-3.8	-3.8
Manufacturing output	% qoq					0.7	1.6	1.5	0.0	0.1	0.3	0.5	0.6	0.6	0.6	0.6	0.6
	% yoy	-3.7	1.8	1.9	-3.7	-1.7	0.8	4.3	3.8	3.2	1.9	0.9	1.5	2.0	2.3	2.4	2.4
Unemployment rate [2]	%	3.7	4.1	4.6	4.8	3.9	4.2	4.2	4.3	4.4	4.6	4.7	4.8	4.8	4.8	4.8	4.7
RPI Inflation[2]	% yoy	11.6	9.9	4.4	3.2	13.6	11.1	9.1	6.0	5.4	4.3	4.2	4.0	3.6	3.1	3.1	3.2
CPI Inflation (harmonised)[2]	% yoy	9.1	7.5	3.3	2.2	10.2	8.4	6.9	4.8	4.4	3.1	3.1	2.8	2.5	2.1	2.2	2.3
CPI (core)[2]	% yoy	5.9	6.5	4.2	2.7	6.1	6.9	6.7	6.2	5.7	4.3	3.7	3.2	3.0	2.7	2.7	2.7
General govt balance [5]	% of GDP	-5.6	-4.7	-3.2	-2.8												
General govt debt [3,5]	% of GDP	96.2	96.9	98.4	98.7												
General govt debt	% of GDP	101.0	100.0	100.8	101.7												
Bank Rate [4]	%	3.50	5.50	5.50	4.25	4.25	5.00	5.50	5.50	5.50	5.50	5.50	5.50	5.25	5.00	4.75	4.25

Source: BofA Global Research, ONS, Bank of England.

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Exhibit 60: BofA inflation forecasts

Updated forecasts

	CPI		CPIH	RPI	
	Headline %yoy	Core %yoy	% yoy	Index	Headline % yoy
Dec-22	10.53	6.35	9.23	360.4	13.44
Jan-23	10.05	5.80	8.84	360.3	13.41
Feb-23	10.42	6.20	9.16	364.5	13.83
Mar-23	10.06	6.19	8.86	367.2	13.52
Apr-23	8.66	6.77	7.84	372.8	11.42
May-23	8.68	7.12	7.87	375.3	11.33
Jun-23	7.95	6.89	7.30	376.4	10.70
Jul-23	6.83	6.90	6.38	374.1	9.02
Aug-23	7.06	6.65	6.39	377.7	9.42
Sep-23	6.87	6.44	6.30	378.8	8.97
Oct-23	4.99	6.32	4.83	378.8	6.33
Nov-23	4.80	6.23	4.67	379.7	5.96
Dec-23	4.71	6.01	4.53	381.4	5.83
Jan-24	4.89	6.11	4.75	380.9	5.70
Feb-24	4.32	5.62	4.27	384.3	5.43
Mar-24	3.94	5.30	3.93	385.7	5.04
Apr-24	3.27	4.49	3.38	389.8	4.55
May-24	3.04	4.23	3.19	391.2	4.23
Jun-24	2.91	4.05	3.04	391.5	4.02
Jul-24	3.43	3.91	3.48	391.1	4.54
Aug-24	3.02	3.69	3.28	393.2	4.09
Sep-24	2.78	3.43	3.09	393.5	3.87
Oct-24	2.84	3.25	3.19	394.1	4.05
Nov-24	2.80	3.22	3.14	394.8	3.99
Dec-24	2.74	3.16	3.05	396.3	3.90
Jan-25	2.59	3.13	3.09	394.9	3.68
Feb-25	2.45	2.97	3.02	398.1	3.59

Exhibit 60: BofA inflation forecasts
Updated forecasts

CPI		CPIH	RPI		
Mar-25	2.35	2.83	3.09	399.2	3.50
Apr-25	2.05	2.63	2.99	402.1	3.17
May-25	2.04	2.62	2.95	403.3	3.11
Jun-25	2.12	2.72	3.11	403.8	3.14
Jul-25	2.14	2.68	3.17	403.5	3.16
Aug-25	2.15	2.68	3.19	405.5	3.13
Sep-25	2.19	2.72	3.33	405.8	3.13
Oct-25	2.17	2.62	3.29	406.4	3.13
Nov-25	2.17	2.60	3.32	406.9	3.08
Dec-25	2.19	2.61	3.36	408.3	3.05

Source: BofA Global Research, ONS

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