

## Economic Review

December 2023

### Inflation drop sparks rate cut speculation

A surprise sharp decline in the rate of inflation has ignited hopes of an interest rate cut by spring, despite the Bank of England (BoE) insisting it is *'too early'* to speculate about when rates might be reduced.

Following its latest meeting, which concluded on 13 December, the BoE's Monetary Policy Committee (MPC) voted by a six to three majority to leave Bank Rate unchanged at 5.25%. This marked the third successive meeting where the benchmark interest rate had been maintained at its current 15-year high.

The decision was once again a close call, however, with three of the nine-member panel voting to raise rates by a further 0.25 percentage points. The minutes to the meeting also repeated previous guidance that monetary policy needs to remain *'sufficiently restrictive for sufficiently long'* in order to return inflation to target.

Commenting on the day the decision was announced, BoE Governor Andrew Bailey reiterated this message. Although Mr Bailey did say he hoped rates were at *"the top of the cycle,"* he also said he couldn't *"definitively"* say rates had peaked. He added, *"My view at the moment is it's really too early to start speculating about cutting interest rates."*

Last month's consumer prices data, however, which was published by the Office for National Statistics (ONS) a week after the MPC meeting, has raised hopes that the Bank may begin cutting rates sooner than expected. The headline annual CPI inflation rate fell to 3.9% in November, below all forecasts in a Reuters poll of economists, and a significant drop from the previous month's figure of 4.6%.

After release of the inflation data, investors fully priced in a rate cut by May 2024 and saw an almost 50% chance of a reduction by March. The next MPC announcement is scheduled for 1 February.



### UK economy picks up some momentum

Although last month's release of UK gross domestic product (GDP) statistics did reveal a lacklustre economic performance between April and October, survey evidence suggests the year may have ended on a more positive note.

The latest monthly GDP statistics released by ONS showed the economy shrank by 0.3% in October. This was worse than analysts had expected with the consensus prediction from a Reuters poll of economists suggesting the economy would flatline across the month.

Downward revisions to data from earlier in 2023 also show the economy performed more poorly than previously thought. The updated data reported no growth during the second quarter of last year – down from a previous estimate of a 0.2% rise – while the economy shrank by 0.1% in the third quarter after initial estimates suggested growth had been flat.

The third-quarter contraction also means the UK may now be on the verge of a technical recession, which is typically defined as two consecutive quarters of negative growth. Survey evidence though does suggest the economy performed more strongly towards the end of last year with some analysts suggesting this pick-up may be enough to ensure a recession is avoided.

Data from the closely-watched S&P Global/CIPS UK Purchasing Managers' Index, for instance, showed an expansion in private sector business activity in the final two months of 2023. The preliminary composite headline Index rose to 51.7 in December, up from November's final reading of 50.7 and the highest recorded level for six months.

Commenting on the findings, S&P Global Market Intelligence's Chief Business Economist Chris Williamson said, *"The UK economy continues to dodge recession with growth picking up some momentum at the end of the year to suggest that GDP stagnated over the fourth quarter. This is, however, a dual-speed economy, with manufacturing contracting sharply while services regained some poise."*






**Major global indices closed 2023 in positive territory. Although the UK's benchmark and mid-cap indices ended the year higher, they trailed markets in Europe, the US and Japan.**

The blue-chip FTSE 100 index closed December on 7,733.24, a gain of 3.77% for 2023 as a whole. A late rally bolstered the index to reach its highest closing level since late May. The domestically focused FTSE 250, more closely correlated to the UK economy, closed the year 4.43% higher on 19,689.63, while the FTSE AIM closed on 763.32, a loss of over 8% in the year.

In the US, major indices registered double-digit annual gains, buoyed by a robust year-end rally, with investors contemplating easier monetary policy in the year ahead. The Dow closed the year up over 13% on 37,689.54, while the tech-orientated NASDAQ closed the year up over 43% on 15,011.35. Meanwhile, the Nikkei 225 ended the year on 33,464.17, up over 28%, posting its biggest annual gain since 2013. The Euro Stoxx 50 closed the year up over 19% higher on 4,521.65.

On the foreign exchanges, the euro closed the month at €1.15 against sterling. The US dollar closed at \$1.27 against sterling and at \$1.10 against the euro.

Supported by hopes the Federal Reserve could reduce interest rates in the Spring, gold closed the year trading around \$2,078

Index	Value (29/12/23)	% Movement (since 30/11/23)
 FTSE 100	7,733.24	▲ +3.75%
 FTSE 250	19,689.63	▲ +7.99%
 FTSE AIM	763.32	▲ +6.94%
 EURO STOXX 50	4,521.65	▲ +3.18%
 NASDAQ COMPOSITE	15,011.35	▲ +5.52%
 DOW JONES	37,689.54	▲ +4.84%
 NIKKEI 225	33,464.17	▼ -0.07%

a troy ounce, an annual gain of over 14%. Brent crude closed the year trading at around \$77 a barrel, an annual loss of over 8%, its largest annual drop since 2020. OPEC+ production cuts have not succeeded in boosting prices in 2023, as supply growth outside of the group has dominated.

**Jobs market shows signs of stalling**

**The latest release of labour market statistics has revealed a further softening in the UK jobs market, with the total number of vacancies falling again and wage growth easing.**

Figures published last month by ONS showed that the unemployment rate remained unchanged at 4.2% in the three months to October, while the overall level of employment rose by 50,000 over the same period. However, the data did reveal a slight drop in the number of payrolled employees in November, which were estimated to have fallen by 13,000 compared to the previous month's figure.

The overall number of job vacancies also fell, with 45,000 fewer reported in the September to November period in comparison to the previous three months. While this does represent the 17th consecutive month reporting a decline in vacancies, the total number still stands at 949,000, which is significantly above pre-pandemic levels.

In terms of earnings, the latest data release revealed that regular pay (which excludes bonuses) rose at an annual rate of 7.3% in the August to October period. Although this does mean wage growth is still outpacing inflation, the figure represents a significant easing compared to the growth rate of 7.8% reported in the three months to September.

**Retail sales growth beats expectations**

**Official retail sales statistics have revealed stronger than expected growth in sales volumes during November, although more recent survey data suggests retailers still face a 'tough-demand environment.'**

According to ONS figures published last month, total retail sales volumes rose by 1.3% in November. This growth, which was stronger than the 0.4% consensus forecast predicted in a Reuters poll of economists, was largely driven by an early start to the Black Friday sales event as well as more widespread discounting.

The latest CBI Distributive Trades Survey, however, shows the retail environment remains challenging with the headline measure of sales volumes in the year to December falling to -32% from -11% the previous month. The survey also found that most retailers appear to be relatively gloomy about the sector's prospects as we move into the new year.

Commenting on the survey, CBI Principal Economist Martin Sartorius said, "The retail sector ended 2023 on a glum note, with the ongoing downturn in sales volumes deepening during the crucial holiday trading period. Strained household finances and higher interest rates continue to take a toll on consumer spending, suggesting that retailers will have to navigate a tough demand environment in the months to come."

All details are correct at the time of writing (02 January 2024)

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