

Three calls for the UK

We're cautious about predictions that the UK will underperform the eurozone in 2024, though don't expect buoyant growth either. Headline inflation should be nudging 2% by May and that should help unlock rate cuts next summer



The UK inflation story is finally heading in the right direction. The bulk of that fall is down to food – where producer prices point to prospective discounting

1 Headline inflation to close in on 2% from the second quarter

The UK inflation story is finally heading in the right direction and headline CPI should be very close to target by May. The bulk of that fall from the latest 4.6% figure is down to food – where producer prices point to prospective discounting – and core goods, aided by improved supply chains and higher inventory levels. We expect headline CPI to sit in the 2%-2.5% range for the latter half of next year, before dipping below target in 2025.

Core inflation will be stickier. But surveys of pricing intentions have consistently pointed to fewer firms raising prices, while we think the full impact of the fall in energy prices is yet to show through fully in areas like hospitality. We expect services inflation – the Bank of England's area of focus – to reach the 4% area next summer, much closer to the pre-Covid averages of 2.5-3%.

2 UK to narrowly avoid recession on positive real wage story

Expectations made at the start of this year that the UK would be towards the bottom of the growth pack proved unfounded, as (largely) have concerns over the summer that the UK had a

much worse inflation problem than elsewhere. We're similarly cautious about consensus expectations for the UK to underperform the eurozone in 2024.

Admittedly, the jobs market is cooling and the level of unfilled vacancies is likely to be back to 2019 levels by the spring. And while we aren't expecting a pronounced spike in unemployment, Bank of England surveys suggest that worker shortages have become far less acute. Private sector wage growth is likely to halve by next summer (from 7.8% now). Even so, that suggests wage growth can continue to outpace inflation and that will prop up consumption.

At the margin, the economy may get a slight boost from the recent changes to personal taxation, and a further tax cut in the spring can't be ruled out with an autumn election looking likely. But the scope for further fiscal changes appears limited.

Overall, we expect stagnation through the first half of the year. Whether that turns into a recession will predominantly hinge on whether rate hikes begin to translate more noticeably into job cuts.

3 Rate cuts to start in August

Admittedly the UK is more of an outlier on interest rate pass-through. Unlike countries that have already seen a sharp hit (eg Sweden/Canada), 85-90% of mortgages are on fixed rates. But most home lending is fixed for less than five years. As more people refinance, we expect the average rate on existing mortgage lending to rise from just about 3% now to almost 4% by the end of next year. That will offset some of the improvement in real wages, though remember, only around a quarter of households have a mortgage – and perhaps only 20% of those will be refinancing next year. The macro impact therefore shouldn't be overstated, but it is a consideration for the BoE.

Ultimately the Bank has made it clear that rate cut timing will depend on services inflation, private-sector wage growth and the state of the jobs market. As we've explained, all three are likely to be in a more comfortable position from the BoE's perspective by next summer. While not all of those variables will be back to levels consistent with a 2% inflation target, we suspect the BoE will feel it can begin to take its foot off the brake. We expect 100bp of rate cuts in the second half of next year, starting in August.

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