

UK growth data: The final nail in the May rate hike coffin?

We still narrowly think the Bank will raise rates in May, but a significant downside miss on UK growth this Friday could change all that



Source: Bank of England

Friday's growth data will be a major test ahead of the next Bank of England meeting

Markets were caught a little off-guard last week when Bank of England Governor Mark Carney unexpectedly appeared to talk-down the likelihood of a near-term rate hike. [We now think that the chances of a May hike rest on a knife-edge](#). And with a little over two weeks to go until the next meeting, and very few key data releases due between now and then, Friday's growth data could prove pivotal.

There's little doubt that the first quarter was weak, and it looks pretty likely that growth will undershoot the Bank's original 0.4% forecast it made back in February. Admittedly, much of this has to do with the torrid weather seen throughout the UK during March. For retailers, this resulted in stores closing, in some cases for multiple days on end. The snowy weather will have also seen some production and construction activities come to a halt, whilst the economy overall will have

suffered from staff shortages and the resulting drop in productivity.

0.3% Our 1Q growth forecast
(QoQ%)

Retail woes could trigger a downside miss in growth

But we don't think adverse weather is entirely to blame. A range of data – from retail sales to Visa credit card transactions – indicates that the last quarter was one of the worst for the high street since the financial crisis. Much of this has to do with consumer caution. Even though the worst of the household squeeze is now behind us, real incomes don't look set to become a meaningful tailwind anytime soon, and this is seeing consumers retain a cautious approach to non-essential purchases. This demand shortfall has been compounded by recent increases in the minimum wage, which along with rising business rates, have seen retail margins become severely squeezed and some high-profile names enter financial difficulty.

Retail sales have been a bit softer — we are all aware of the squeeze that is going on in the high street - Mark Carney, 19th April

All of this could feasibly see growth slip as low as 0.2% QoQ, which would be the slowest rate since the second quarter last year (and would rank as one of the worst quarters since the 2012 Euro crisis). It's worth remembering too that the first quarter figures will actually be propped up to some degree by the recovery in oil production following the repair of the North Sea Forties Pipeline (having been out of action for part of December) – without this, overall growth may have been up to 0.1ppt lower still.

This gives the Bank of England a major conundrum

Before Governor Carney's interview last week, we had thought that the recent uptick in wage inflation and Brexit progress would be enough to see policymakers vote in favour of a rate hike in May. After all, the Bank's recent talk of "earlier" tightening – whilst not a firm commitment to a May rate rise – had looked like a way of getting markets more aligned with this view.

But given the bad news coming from retail, policymakers may view a move in May as one headwind too many for a sector that already appears to be on the edge. A small delay until August would buy the Bank more time to see whether growth starts to recover as we head into the summer.

Barring a major downside surprise, we still think it's slightly more likely than not that the Bank will follow through with a rate rise next month. Before then, we'll get the latest PMIs next week and policymakers may receive some reassurance should they fully rebound

after the weather distortions in March.

The committee will also be acutely aware that this might be the best opportunity they get to tighten policy this year. Brexit talks have the potential to get quite noisy in the autumn, core inflation looks set to return to target fairly imminently, whilst the economic woes of the first quarter look set to persist for a little while longer. All of this could complicate efforts to hike rates later in 2018, and this also means that any thoughts of two-or-more rate hikes this year still look premature.

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