UK: Three events that will shape the outlook this month

This month's UK budget will likely result in lower energy bills than planned, but is unlikely to offer any medium-term support. The Bank of England is poised for a 25bp hike – which may well be its last

Agreement was reached between Prime Minister Rishi Sunak and Ursula von der Leyen over Brexit and Northern Ireland trade rules, 27 February 2023

Source: Shutterstock

New Brexit deal a welcome development, but no game changer

Three key economic events over the next month will help determine the growth outlook for the rest of this year.

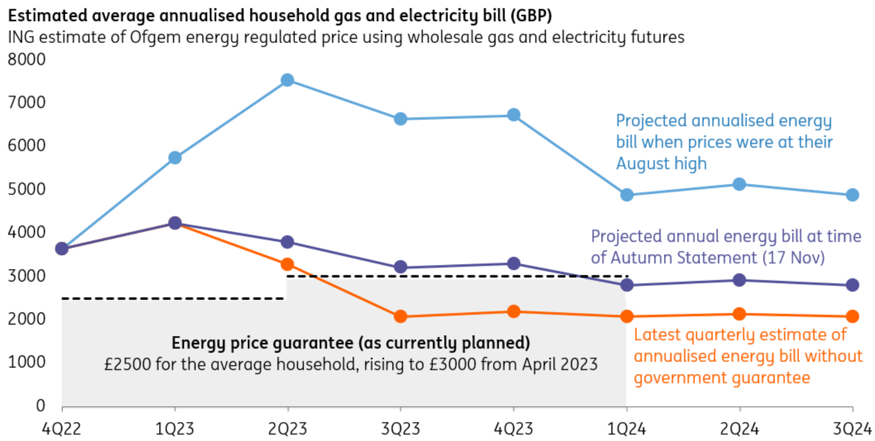
The first – and by far the least consequential – will be the progression of the new agreement recently announced between the UK and EU. The so-called Windsor Framework alleviates some of the major frictions that have emerged from the imposition of a customs and regulatory border between Northern Ireland and the British Mainland. But it's unlikely to make any material difference to the wider economic outlook – partly because it has no bearing on wider UK-EU trade terms, but also because it shouldn't alter corporate investment plans on a nationwide basis.

Budget set to cut energy bills but offers little to no medium-term stimulus

The second and economically more significant event will be the Spring Statement from the Chancellor. It will be the UK's third fiscal event since last September, though hopefully the least dramatic. The Chancellor will be able to bank the short-term gains of a reduced political risk premium in government borrowing costs, and more importantly, much lower gas prices. On its current trajectory, the FY2022 deficit is set to be £25-30bn lower than the Office for Budget Responsibility expected in November.

In practice, that means the government can afford to ditch the planned increase in the Energy Price Guarantee, which would have seen the average bill climb to £3000 (from £2500 currently, or £2100 once factoring an additional one-off discount).

UK energy bills set to fall close to £2000 by summer



Source: Ofgem, ING, Refinitiv

Indeed by the third quarter, the government will most likely no longer be supporting households at all. The default regulated pricing, which is based on wholesale gas/electricity futures, should allow the average bill to fall to £2100 as things stand. All of this means the UK's recession will be extremely mild – if it happens at all. We're pencilling in an annual GDP of -0.3% this year.

The issue for the Treasury is that this short-term positivity is likely to be counter-balanced by some offsetting downgrades to medium-term GDP and upgrades to inflation. That means the medium-term picture, which required the Chancellor to commit to some hefty – albeit currently very hypothetical – fiscal tightening later this decade, looks largely unchanged. In short, don't expect tax cuts this month.

Bank of England set for a 25bp hike in March – which could be its last

Finally, there's the March Bank of England decision, where we expect a 25bp hike. While the Bank hinted strongly last month that it stands ready to pause hikes, persistent wage pressures suggest there's still a little more work to do. Recent comments from officials narrowly suggest a March rate hike could be the last, but we aren't ruling out another move in May if inflation data doesn't show consistent signs of improvement.

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