UK economic momentum slows further but budget boost is coming

UK GDP fell again in October, though that probably exaggerates the extent of the recent slowdown in economic momentum. Growth is likely to outpace much of Western Europe next year following the recent budget, though the downside risks are more obvious than the upside

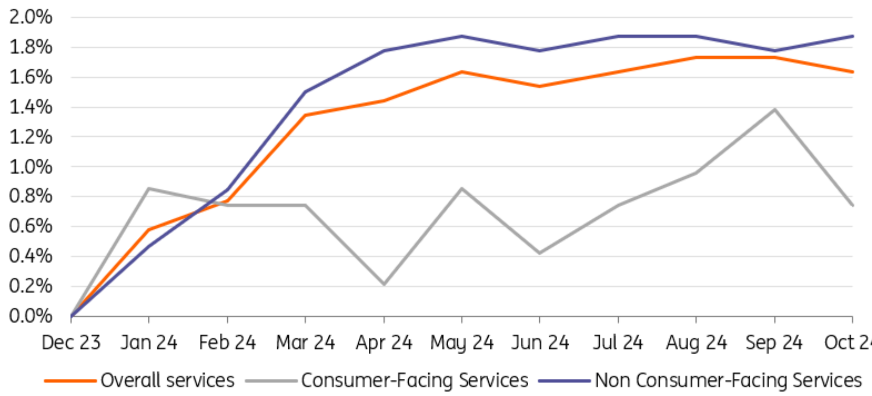
Source: Shutterstock

The UK economy has been on quite the journey this year, at least if the GDP figures are to be believed. Having started the year with an eyewatering – and indeed eyebrow-raising – 0.7% quarterly growth figure for 1Q, momentum has slowed considerably in the second half of the year. October's monthly GDP saw activity fall for the second consecutive month, albeit only by a marginal 0.1%. Overall fourth-quarter GDP is likely to be flat, we think.

In reality, the story is more nuanced than that. Much of that early 2024 strength was concentrated in sectors that are less tangible and typically not consumer-facing. Service sectors with a clear consumer focus and more intrinsically linked to underlying economic fundamentals actually performed more strongly over the summer when the broader economy appeared to be slowing – albeit we did see a sizable drop in activity in these areas during October.

Our conclusion from this is that the economy has probably slowed down, but neither the initial boost nor the more recent sluggishness is likely to have been as extreme as this year's monthly GDP data indicates.

Consumer-facing services saw activity plunge in October



Source: ONS

All of this of course is history anyway. We still think that the UK economy is poised to outpace most of Western Europe next year, judging by our 2025 annual GDP forecasts. That perhaps says more about the health of other parts of the continent, but it also heavily reflects the recent fiscal stimulus.

Public spending was increased by some £60bn – or more than 2% of GDP – relative to budget plans inherited from the previous Conservative government. Some of that might not materialise and we're sceptical that the planned, sudden increase in public investment can readily find its way into shovel-ready projects straight away. But the majority of the spending increase is going to government departments in day-to-day funds, much of which will end up in wages. And thus the fiscal multiplier – or the passthrough to wider economic growth – is likely to be pretty high.

Having said all of that, the risks are clearly tilted downwards. The UK is often singled out as being less affected by an impending US trade war, and that is true. But America still buys 20% of UK exports, even if the majority of that is in services which are not impacted by tariffs.

Then there's the jobs market. The official data is of dubious quality right now. But a range of indicators suggest hiring appetite has cooled materially this year and payroll-based data suggests that employment, outside of government-heavy sectors, has fallen by almost 1% since the end of 2023. We suspect this gradual cooling will continue into 2025, and risks being amplified by recent tax hikes on employers. Around half of Chief Financial Officers who responded to a recent Bank of England survey suggested they'd deal with those tax rises by reducing employee numbers.

However, unless growth materially disappoints, and that's not our base case, the Bank of England is going to remain laser-focused on inflation. With services inflation stuck around 5%, next week's meeting is likely to be a bit of a non-event, with policymakers opting to keep rates on hold again until February.

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