

Snap | 10 November 2023

UNITED KINGDOM

# UK economy flatlines in the third quarter

UK GDP was a little better than expected, but in reality, the economy has largely stagnated this year. We expect that trend to continue over coming quarters as the impact of higher rates continues to bite, though a recession can't be ruled out



We think the most likely path for the economy is stagnation or very modest growth next year, but a recession can't be fully ruled out

## UK economy flatlined in the third quarter

We shouldn't make too much of the fact that the UK economy performed a little better than expected in the third quarter. The level of real GDP was flat relative to the second quarter, compared to consensus and our own expectation of a 0.1% decline.

The details reveal that the economy was rescued by net imports, a category that tends to be pretty volatile between quarters. Other key areas – notably consumption and business investment – were negative on the quarter. But we also have to remember that it's been a fairly wild few months for several key sub-sectors of the GDP figures. June saw a massive 0.7% rise in activity, owing to a highly unusual surge in manufacturing. And July saw a corresponding 0.6% drop as that production boost partly unwound, but also on a number of public sector strikes in health/education. What's happened since – with GDP growing by 0.1%

in August and 0.2% in September – is as much about those trends unwinding as it is about genuine economic activity growth.

**0.0** **Third quarter GDP growth**  
(QoQ%)

Higher than expected

### Bank of England remains more focused on inflation

The fact that the UK economy didn't contract in the latest quarter will, temporarily, dampen some of the discussion about a recession. Our best guess at the moment is that we'll get a return to very modest growth in the fourth quarter, though this is partly down to base effects after that weakness in July. Instead, the discussion of a potential recession should be more focused on what's happening in the jobs market. There has been a clear cooling in hiring demand, though issues with the unemployment figures make it difficult to say how far this has translated into higher joblessness. We'd expect redundancies to rise gradually as the impact of higher rates continues to squeeze margins for businesses.

Higher mortgage rates will also be a drag on activity. With around 4-5% of mortgage holders refinancing each quarter, many of which coming off a 5-year fixed deal with rates that start with either a 1 or a 2, the average repayment will continue to increase – even though it looks like the Bank of England's tightening cycle is over. We expect the average rate on outstanding mortgage debt to climb from just over 3% now to just under 4% by the end of 2024. That said, we have to remember that only around a quarter of households have a mortgage these days, and this pain will be partly offset by positive real wage growth over coming quarters. In short, we think the most likely path for the economy is stagnation or very modest growth next year, though a recession can't be ruled out.

These latest GDP figures are of limited consequence for the Bank of England, and the committee's focus will be more centered on next week's services inflation and wage growth figures. Both are still too high for the Bank's liking, but barring any huge upside surprises in both sets of figures, we think the next move for Bank Rate will be down with cuts beginning next summer.

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