

UK GDP shows little sign of Omicron

It's increasingly clear that the UK economy is unlikely to see much (if any) lasting damage from Omicron. But while the jury's out on whether the UK is now headed for recession - and if so how severe - growing inflation pressures will make it hard for consumer spending to avoid a downturn later this year



Woman passes parked buses near Oxford Street in London

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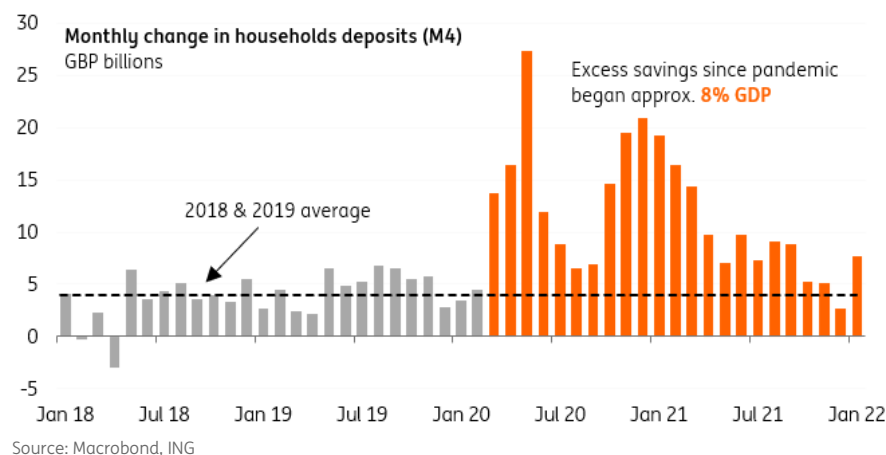
A glance at the latest UK GDP figures shows very little lasting damage from Omicron at the headline level. January GDP rose by 0.8% on the month, having declined by 'only' 0.2% in December. That means that activity levels are back slightly above pre-virus levels.

Admittedly there is a bit more divergence when you dig a little deeper. Consumer services industries including hospitality and entertainment/recreation were still quite some way below pre-Omicron levels in January. However much of this will be made up in February, given we know from Bank of England debit/credit card data that 'social spending' has been back to comparable 2020 levels (before the virus hit) for a good few weeks now.

Interestingly, we saw strong gains in both manufacturing and construction in January, which hints both that staff illness rates had little bearing on activity, but also that some of the supply constraints plaguing both industries may have begun to ease.

Of course, these kinds of monthly growth rates are unlikely to last too much longer. The extreme volatility in wholesale energy prices means it's hard to predict exactly where inflation will land this year, but on current futures prices it's hard to see headline CPI dipping below 6% this year. That means consumer spending will struggle to avoid a downturn later this year.

UK households have built a large stock of 'excess savings' through Covid



The jury's out on whether this is enough to trigger an economy-wide recession, and if it does how deep it might be. Certainly, there's already a lot of pressure on consumer confidence. But we also know that there's roughly 8% of GDP worth of 'excess savings' in household bank accounts from the pandemic, albeit concentrated in higher-income earners. The near-term outlook for investment also looks fairly decent, reflecting improved business confidence and the government's 'super-deduction', which incentivises certain types of investments.

In the end, a lot will depend on how much further government support is ramped up, both for consumers and energy-intensive industries. For instance, for the government to neutralise the increase in household energy bills expected in October, the consumer £200 rebate announced earlier in February would now need to be in the region of £1000 to achieve the same result.

We still expect a rate hike from the Bank of England next week, most likely 25 basis points. But once Bank rate hits 1%, probably in May, we think policymakers will put increased emphasis on the deteriorating growth outlook. That suggests markets, which are pricing six further rate rises this year, are overestimating the pace of tightening.

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