

## UK growth outlook improving despite fourth quarter setback

The UK may have met the definition of a technical recession in the fourth quarter, but the data appears to be hugely volatile beneath the surface and in any case, the growth outlook is looking brighter for 2024. Remember too that the Bank of England is focused not on growth, but services inflation and wages as a guide for when to begin cutting rates



We think that things are slowly beginning to brighten up for the UK economy

### The fall in UK GDP reflects a lot of volatility beneath the surface

The UK economy fared worse than expected in the final quarter of last year, and the 0.3% drop in activity in the three months to December narrowly meets the definition of a technical recession – that is, two consecutive quarters of negative growth. But there are three reasons why we shouldn't overdo the gloom following today's figures.

Firstly, the bigger-than-expected fall in GDP masks a lot of underlying volatility in the data and we aren't alone in saying that the monthly output data has been fairly unhelpful over recent months. The fourth-quarter fall seems to largely boil down to a couple of main drivers, one of which was the sharp fall in retail sales at the end of last year. We think will be reversed in the first couple of

months of 2024 and may reflect changing seasonal patterns in spending that aren't fully adjusted for in the data.

The fourth quarter was also hugely volatile for manufacturers, with an unusually sharp fall back in October. That was fully reversed by December, but overall across the fourth quarter, output was down. The flip side of that is that even if manufacturing stays flat in the first quarter, flattering base effects mean it'll most likely positively contribute to GDP this quarter. Indeed, we don't expect a third overall contraction in GDP in the first three months of 2024 and suspect we'll see a modest rebound.

## The growth outlook is improving

While that's partly arithmetic, it's also true that the general macro outlook is starting to look brighter. Green shoots are appearing in some of the survey data and most notably in the services purchasing managers index (PMI), which is now firmly in expansion territory, in sharp contrast to the equivalent eurozone data. Consumer confidence is up and real wage growth is set to remain positive throughout this year. And while the fall in market rates has partially reversed over recent weeks, the anticipation of rate cuts means the impact of tighter monetary policy will start to wane over coming months. As a rule of thumb, the passthrough of higher rates to mortgages is probably around two thirds complete and will continue to be gradual.

The Chancellor should also still have some headroom for tax cuts in a few weeks' time, even if the boost he'll receive from lower rates has been tempered over recent weeks. While not a gamechanger for growth, tax cuts will probably add a tenth of a percentage point or two to growth overall in 2024.

## Services inflation and wages, not GDP, to guide BoE policy

Finally, it's worth emphasising that the growth figures are fairly low down on the list of data that the BoE is looking at right now. As always, it's services inflation and wage growth that will determine the timing of the first rate cut. Both have fallen more quickly than the Bank of England had expected just a few months ago, but the February meeting showed that policymakers are wary about future progress. Data we've had so far this week, which showed stickier wage growth but lower than expected services CPI, is unlikely to change that assessment. For now, we expect the first rate cut to come in August.

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