UK growth stalls in June after strong first half of the year

The UK economy has performed well so far this year, though we suspect these kinds of growth rates can't be sustained into the second half of the year. We also doubt the second quarter strength will have much of a bearing on how rapidly the Bank of England cuts rates over the coming months

We don't believe a strong first half of the year is likely to change the course of Bank of England rate cuts in 2024

The UK has had a strong first half

The first six months of data is in and the result is clear: the UK economy has had a much better start to 2024 than pretty much anyone had expected.

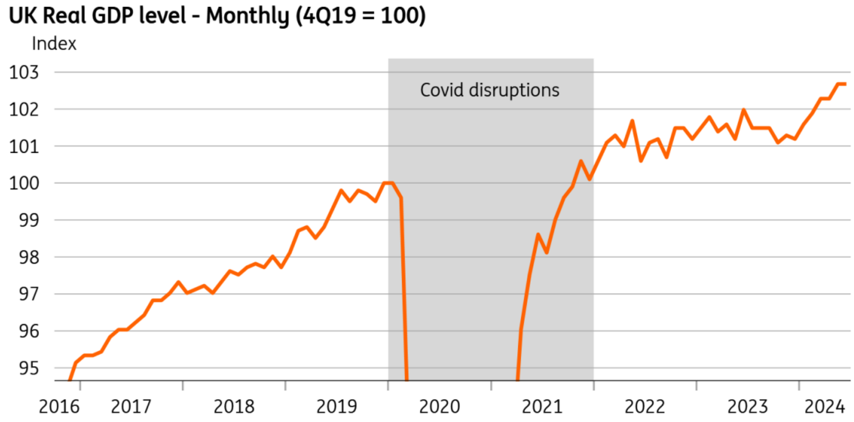
Admittedly, the economy flatlined if you look at June specifically. But overall second quarter growth of 0.6%, hot on the heels of 0.7% in the first quarter, marks a remarkable rebound from a very minor technical recession in the second half of last year.

The most obvious explanation is the improvement in real wages the UK economy is experiencing. The impact of lower natural gas prices, coupled with much more modest increases in food prices, comes at a time when nominal wage growth has stayed north of 5% over recent months. The most acute phase of the mortgage squeeze had also passed by the end of 2023, and that, combined with the impact of some personal tax cuts last November and again in March, probably helped too.

That said, it's clearly not the whole story. Household spending rose by 0.2% in the second quarter after 0.4% in the first, and that's clearly less rapid than overall GDP.

Services contributed strongly to second quarter growth, but a lot of that can't be explained by consumers. Instead, it was areas like professional services that gave the economy a boost. And in general, when we look over the other details, it's hard to pick out many other trends that persisted across both quarters. To take one example, manufacturing was a drag on overall second-quarter GDP, but output surged if you single out June. Imports have been swinging around wildly too.

The UK economy has looked strong so far this year



Source: Macrobond

Growth unlikely to alter the course of BoE rate cuts

Still, that shouldn't detract from what is clearly a better news story on UK growth. Will it continue? It's hard to see the UK sustaining these kinds of figures into the second half of the year, though continued impetus from disposable incomes should generate a respectable, if more modest, growth rate of 0.3% in the third quarter.

What does this mean for policy? From the Bank of England's perspective, policymakers told us in August that they're not reading too much into the stronger run of data in terms of what it means for future growth rates. That means today's figures shouldn't have too much bearing on what happens with interest rate cuts, and instead that hinges principally on services inflation. Our base case is that the next rate cut will come in November.

For the government, the question is whether stronger growth can help create more room in the budget to avoid the steep real-terms spending cuts baked into existing fiscal plans. Remember what matters here is not so much the short-term run of data, and instead it's what the Office for Budget Responsibility makes of the UK's medium-term growth prospects. And its growth forecasts for three to five years already look, if anything, slightly too optimistic. That suggests the room for growth upgrades is minimal, which means there's little or no room for better growth to unlock more room under the fiscal rules. Those rules dictate that government debt should be projected to fall as a share of GDP between years four and five of the OBR's forecasts.

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