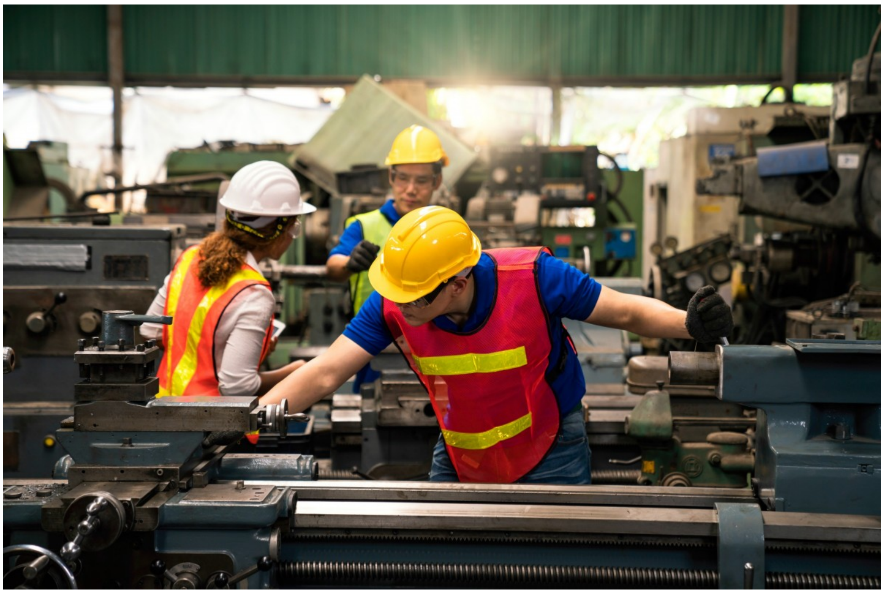
UK manufacturing surge lifts second quarter growth

A surprisingly large increase in manufacturing production has meant that second quarter GDP increased by more than we'd expected. For the Bank of England, next week's inflation and wage numbers matter much more



Manufacturing surge boosts UK GDP growth

The UK economy grew faster than expected in June, helped by a surge in manufacturing production. Monthly GDP rose by 0.5% on the month, though the 2.4% increase in manufacturing between May and June is extremely unusual (at least outside of the Covid-19 period). The result is that overall second-quarter economic growth came in at 0.2%, a bit higher than expected.

The ONS puts this down to pharmaceuticals and car production. And while the latter can probably be partly explained by the ongoing improvement in supply conditions (production is up 15% since last summer's low), it's hard to explain why so much of this growth fell in June specifically. The impact of May's bank holiday appears to have been fairly minimal in comparison to past royal events.

Still, while much of the positive surprise can be explained by those manufacturing sectors, the rest of the economy looks fairly resilient too. That was helped by better weather in June which seems to have boosted the likes of hospitality and retail.

Third quarter looking better, but growth is likely to slow thereafter

What next? Well, June's large rebound means the starting level for the third quarter is pretty favourable. In other words, even if we get only very modest growth over the summer months, third quarter GDP is still likely to come in at roughly 0.4%. The gradual resolution of worker strikes also adds a bit of upside potential for some public industries, perhaps including transport. The circa 20% fall in household energy bills at the start of July should also offer a tailwind for consumption.

Like many analysts, we are doubtful that this sort of growth figure will be repeated later in the year, as the mounting impact of higher interest rates weighs on the economy. So far, the average rate being paid on outstanding mortgages has risen from 2% to 2.9%, considerably less than the 6%+ rates being quoted on new lending. Around 85-90% of mortgages are fixed, albeit only for two or five years in the vast majority of cases. The impact of higher rates will therefore gradually increase over the next 12 months, although it's worth remembering that a smaller share (less than 30%) of households now have a mortgage compared to the 1990s/2000s. A greater share of households own their home outright.

Services inflation and wage growth much more important

Ultimately, today's growth figures are of limited consequence for the Bank of England. That's partly because they are only slightly above what it had expected (0.1% for the second quarter), and because its third-quarter forecast of 0.4% now looks reasonable, having looked a tad optimistic when it was released.

But the Bank has also made it abundantly clear that it's watching services inflation and wage growth much more closely. We'll get fresh data on both of those next week, and on the former (services CPI), the Bank expects a slight uptick. We think the risks are tilted towards a flat or slightly lower reading, and if we're right, that would boost the chances that a September rate hike will be the last such move.

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