Hertfordshire Chamber of Commerce

Chamber Lunches

VWV

FEBRUARY CHAMBER LUNCH

SHENDISH MANOR HOTEL,
HEMEL HEMPSTEAD

23.02.2023

12:00 - 14:00

JOE GANLEY, DEPUTY AGENT FOR FINANCIAL STABILITY, BANK OF ENGLAND

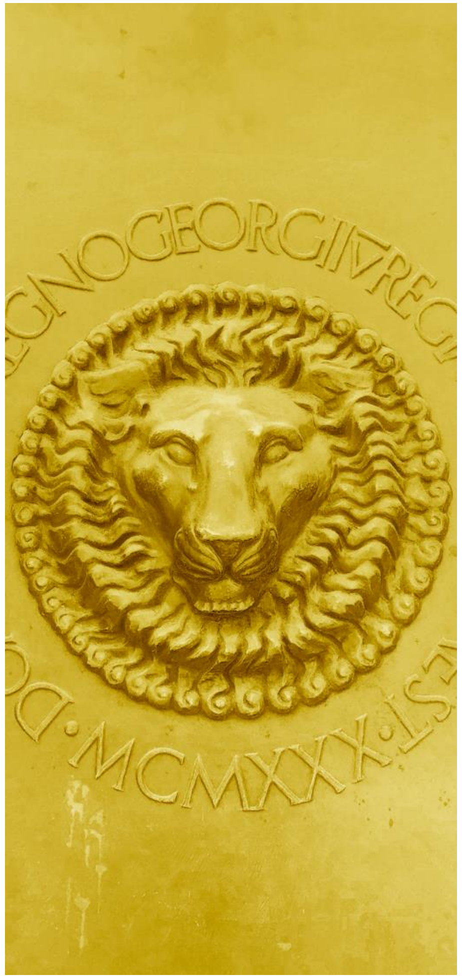
Bank of England

Economic Update for Herts Chamber of Commerce

Joe Ganley
Deputy Agent for Greater London

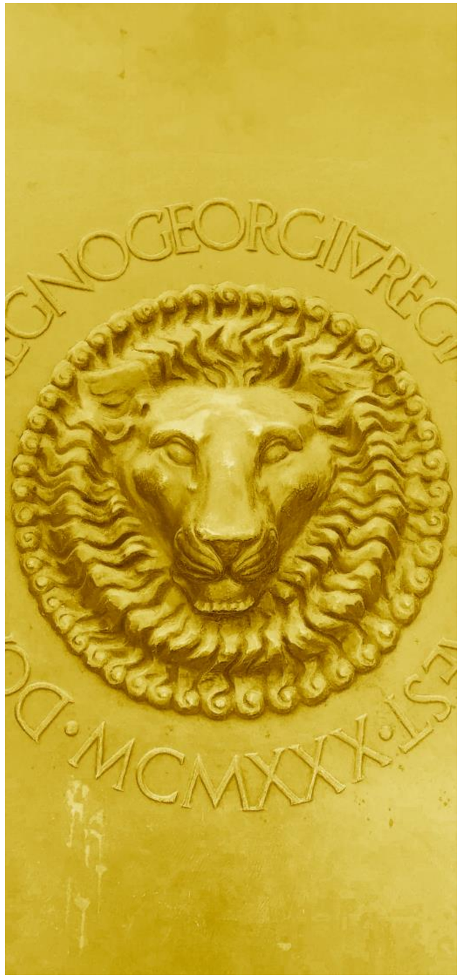
Thursday 23rd February 2023

Welcome



- BoE Agency network
- Latest Bank Rate decision + forecasts for inflation, GDP & unemployment

Reminder



- **Target** = 2% annual CPI inflation

- **Policy** = set Bank Rate every 6 weeks by a vote on Monetary Policy Committee (MPC)

“Difficult Times for Many People”

“We recognise the hardship associated with elevated inflation rates. For those who spend a higher proportion of their income on energy and food – unfortunately, a group particularly numerous among the less well off – recent price rises have imposed a significant squeeze on their real incomes. These are difficult times for many people.” - Huw Pill (BoE Chief Economist)

Growth Outlook – “mild” recession in 2023…

- We expect fairly mild recession in 2023. GDP to fall 0.7%. Better than we expected a few months ago.

- Headwinds: High inflation squeezing households + firms. Re-fixing mortgages at higher interest rates – albeit lower than peak rates in autumn 2022.

- In April, Energy Price Guarantee rises from £2.5k to £3k, squeezing households further.

Why is growth outlook less weak in our Feb forecast?

- In Nov we expected GDP to fall 2% this year….Several factors now reduce downside risk in 2023.

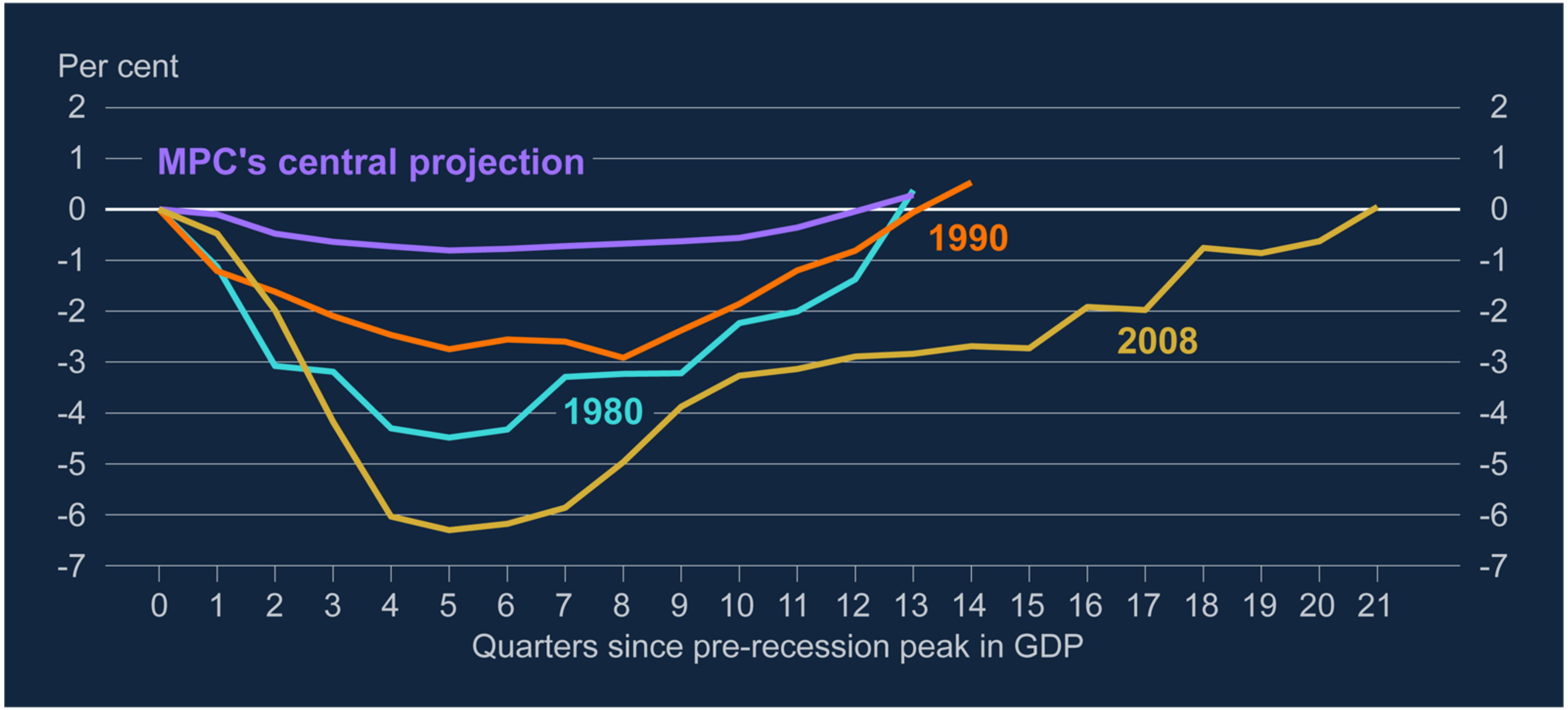
- From H2 households get benefit of lower energy prices in their bills.

- Labour hoarding – firms expected to manage weaker demand thro attrition & reduced hours (rather than firing)

- Fewer redundancies means less precautionary saving $\Rightarrow$ supports household incomes + spending.

- Yield curve – lower market path for short-term interest rates.

Mild downturn in 2023 compared to past recessions

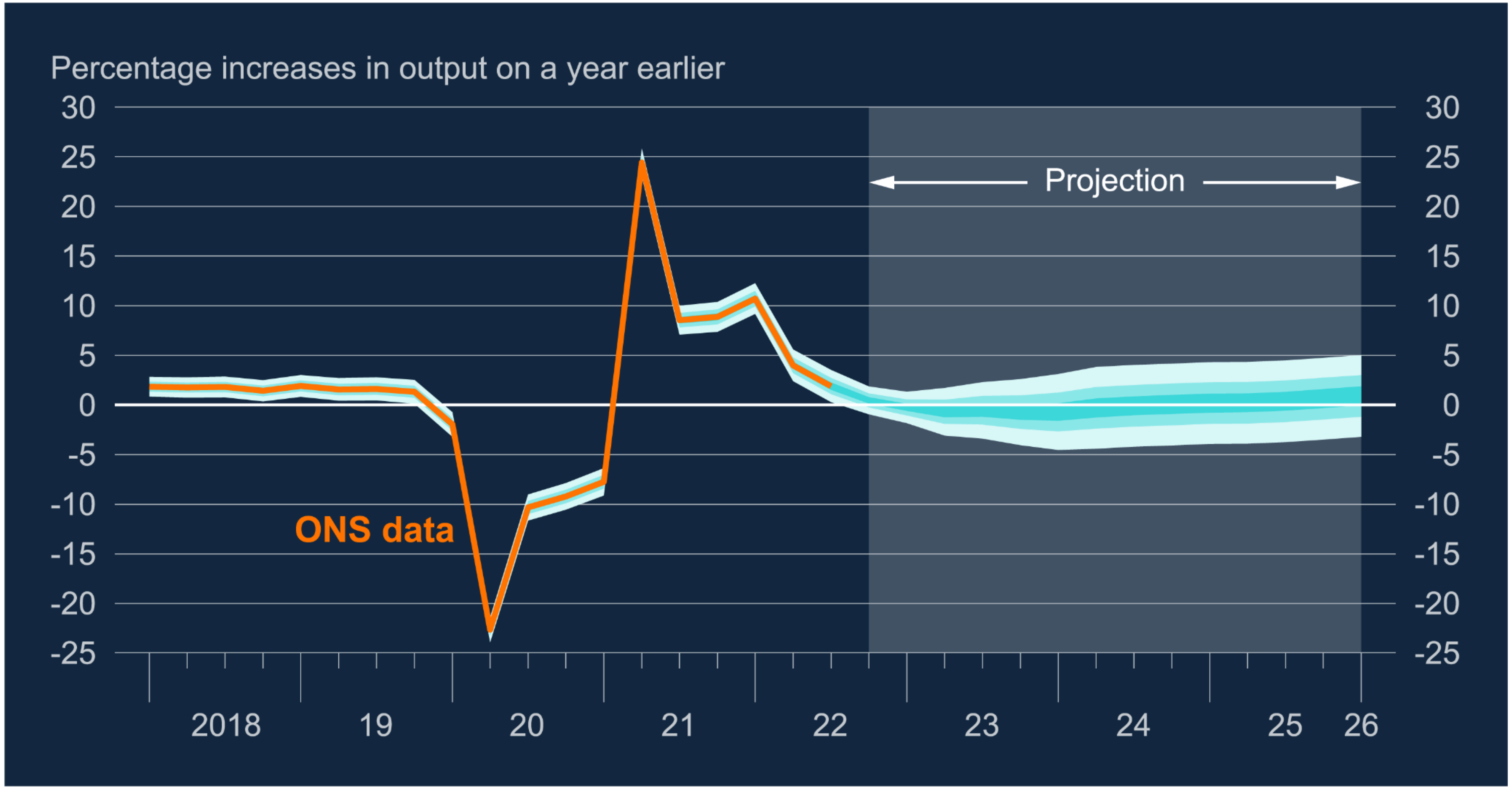


- **Purple Line** = mild recession in 2023, b/c lower energy prices, lower path for Bank Rate and better prospects for jobs.

Longer run outlook ⇒ speed limits on capacity to grow

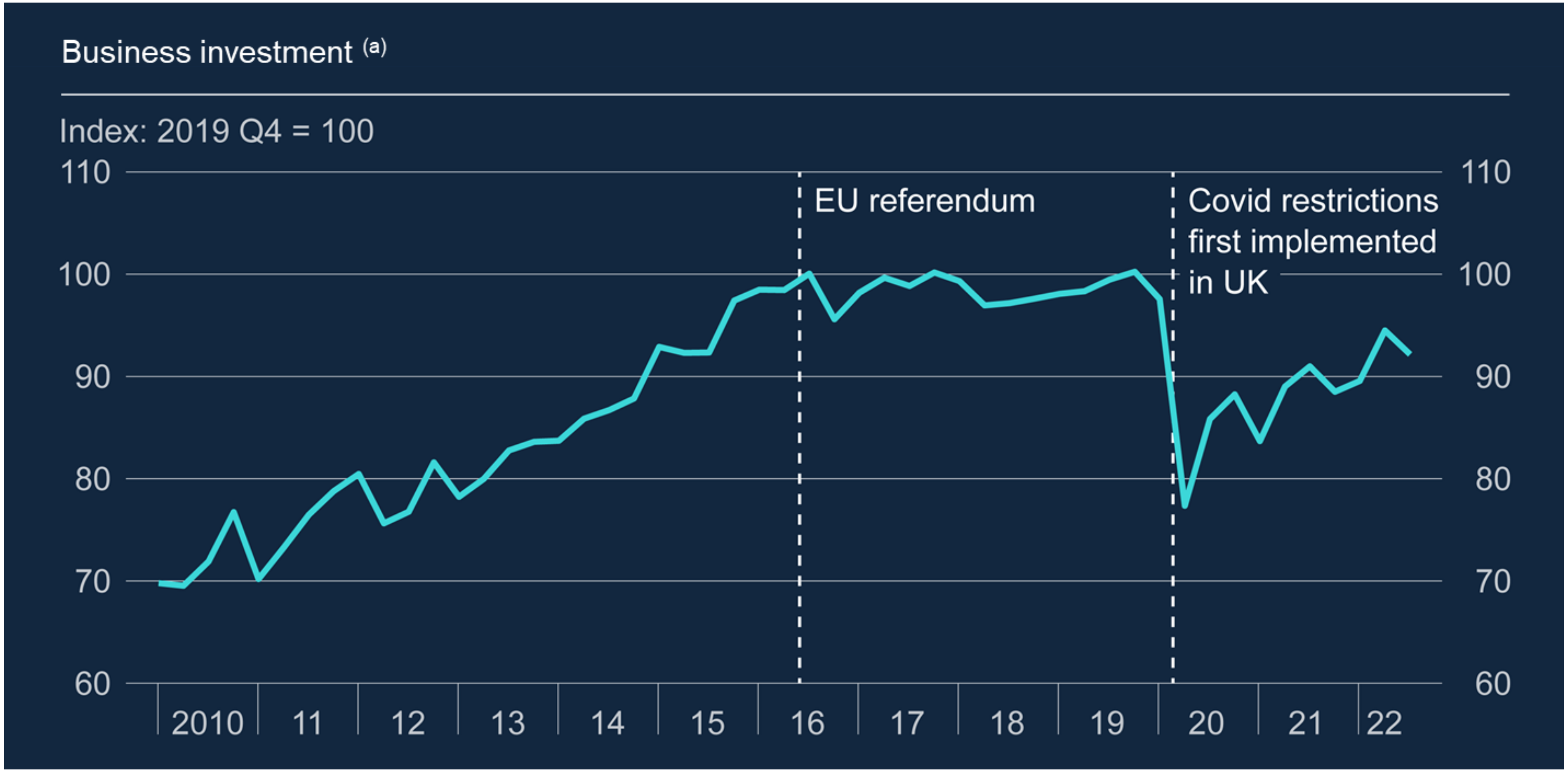
- From 2024/25 supply capacity grows at **less than 1% pa**….
- **Covid** ⇒ less on the job learning in lockdowns + postponement of inv plans
- **Brexit** ⇒ less open economy ⇒ less competition between UK and non-UK firms + less ideas transfer (less spread of best practice)
- **High energy prices** ⇒ alters P&L calculation on inv projects
- Implies smaller UK capital stock, with weak productivity & labour supply growth.

Very modest growth in the economy further out



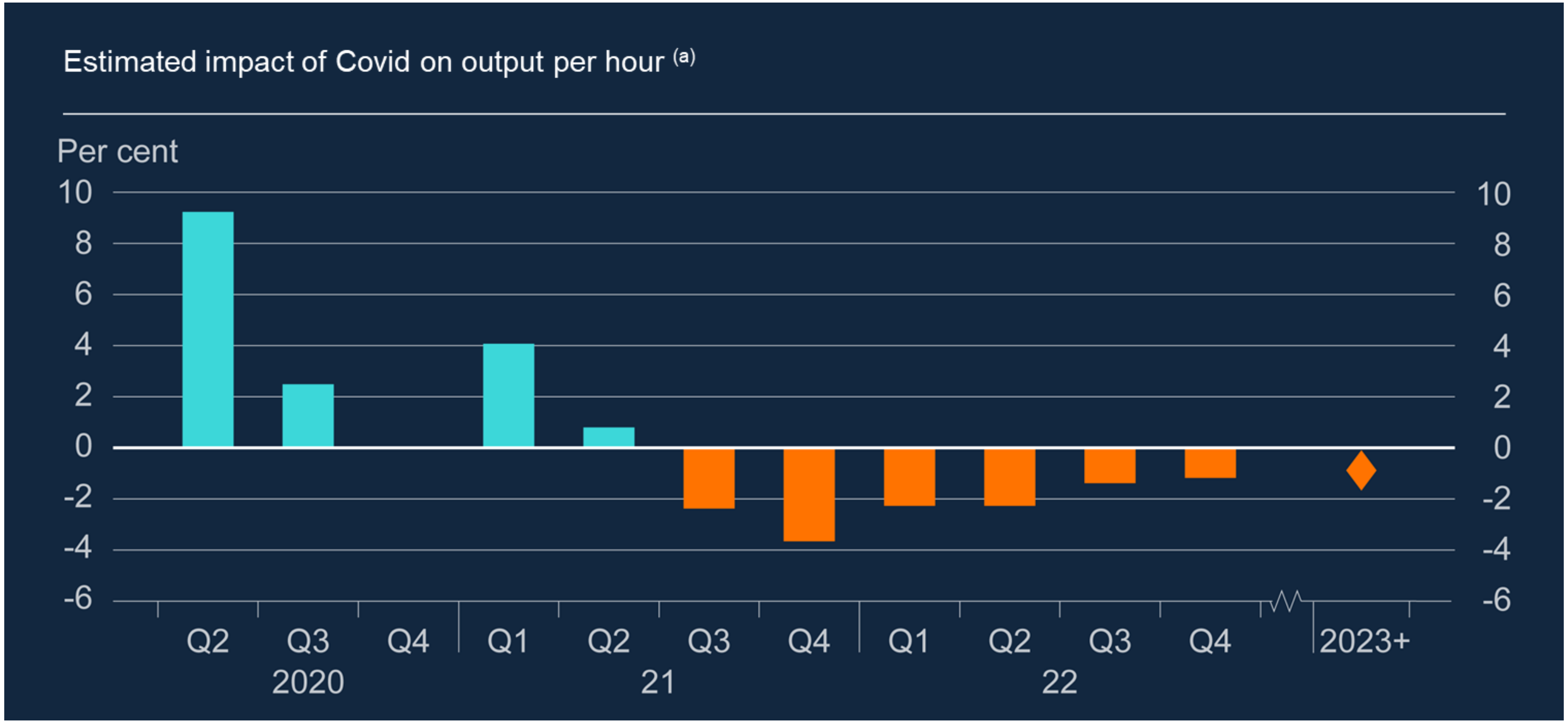
- Annual GDP growth: 2024 Q1 = -0.7%. 2025 Q1= 0.2%.   2026 Q1 = 0.9%.

Business investment, which affects productivity, is very subdued



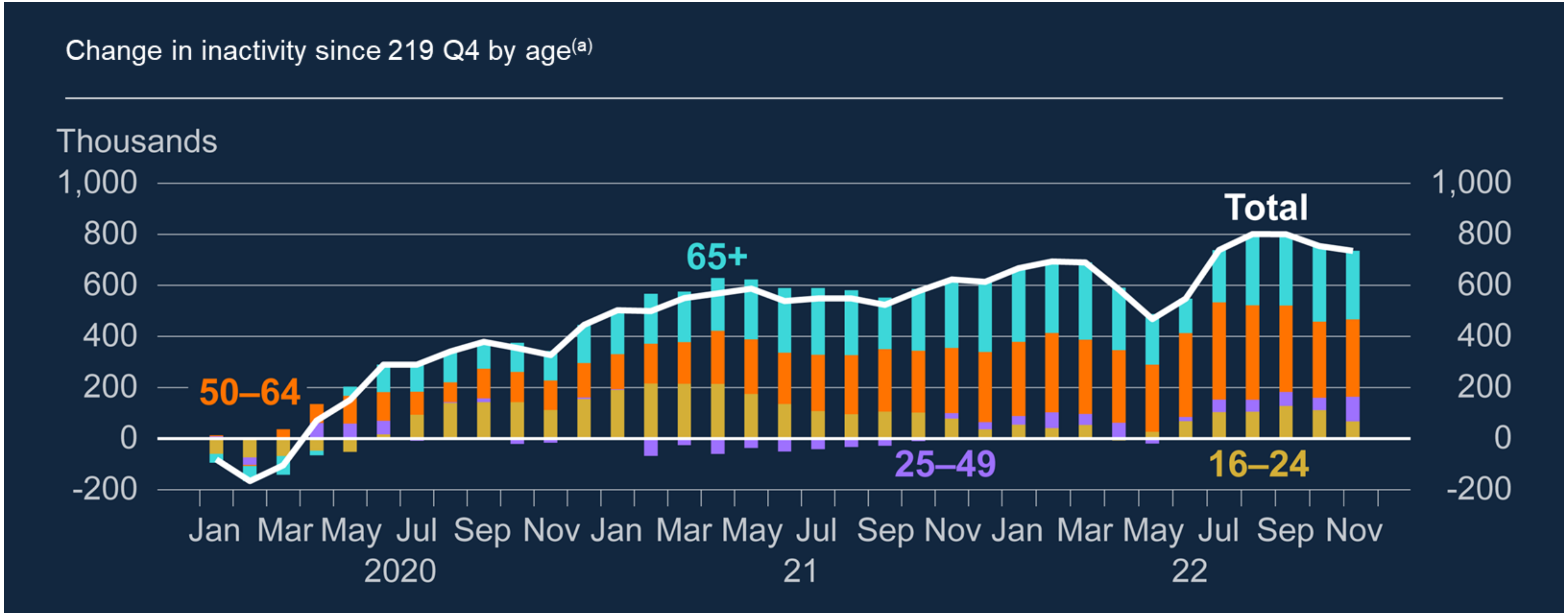
- Investment growth v weak since referendum + held back by Covid and high energy prices

Covid weighing on productivity since 2021 & expected to do so in 2023 and beyond



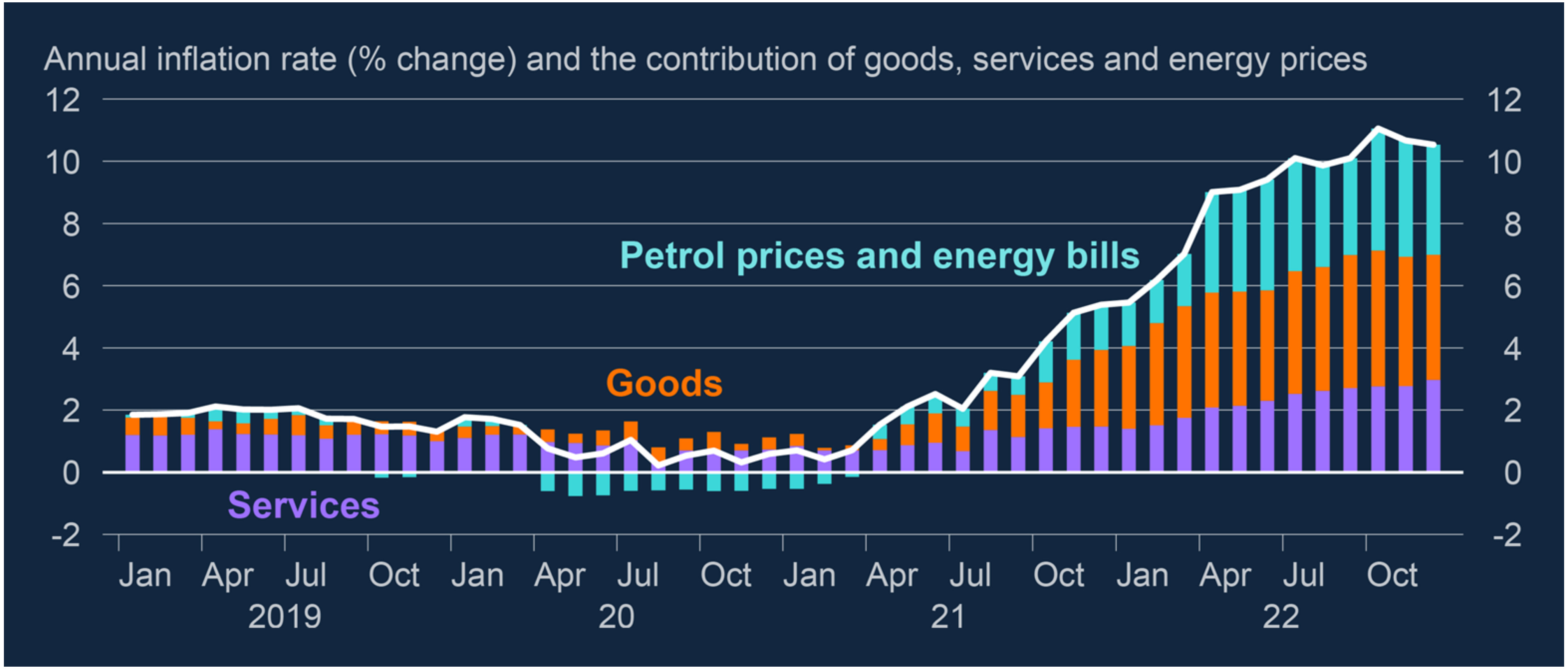
- Decision Maker Panel (DMP) Survey reports lingering effects from pandemic on productivity.

Rising inactivity [shrinking labour supply] through pandemic

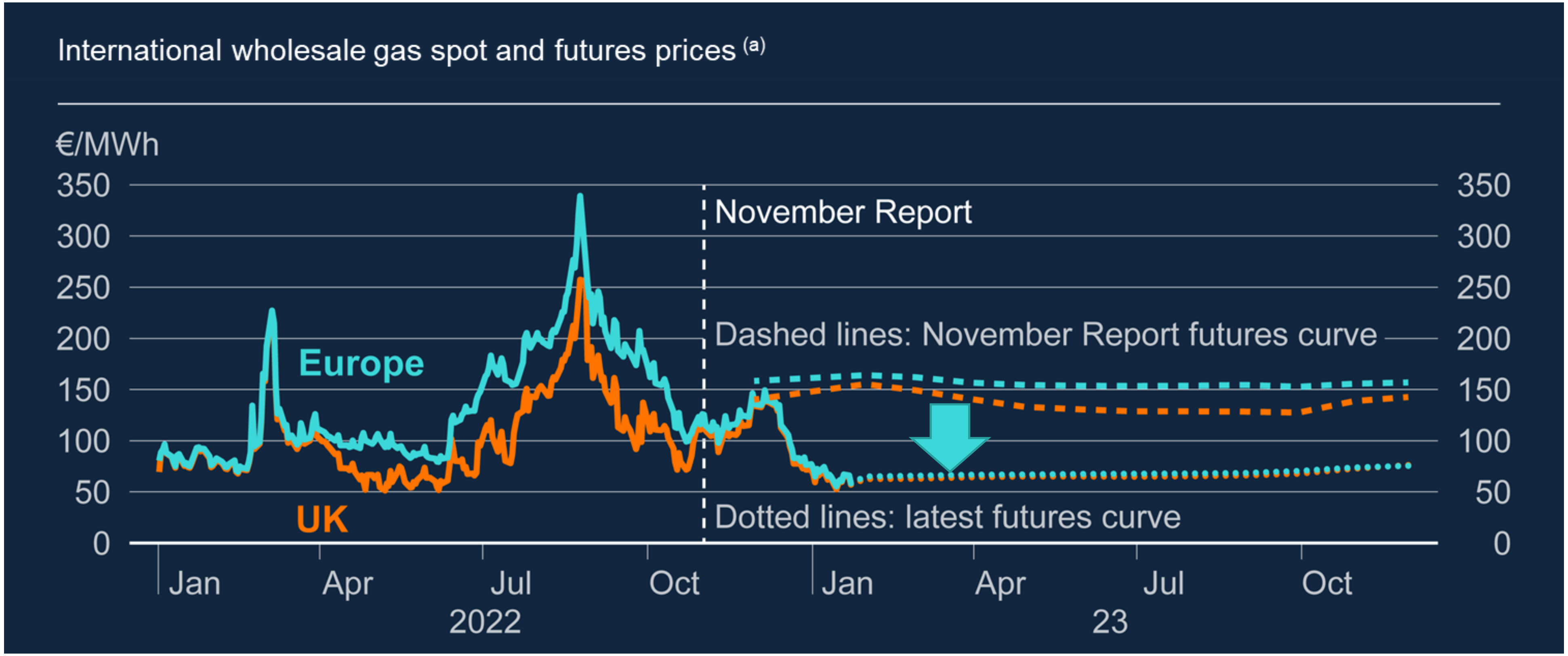


- Rising inactivity (people leaving the labour force) cuts labour supply.
- Early retirement; rise in long-term sickness; greater detachment from labour force.

Energy & goods prices drove the initial surge in inflation

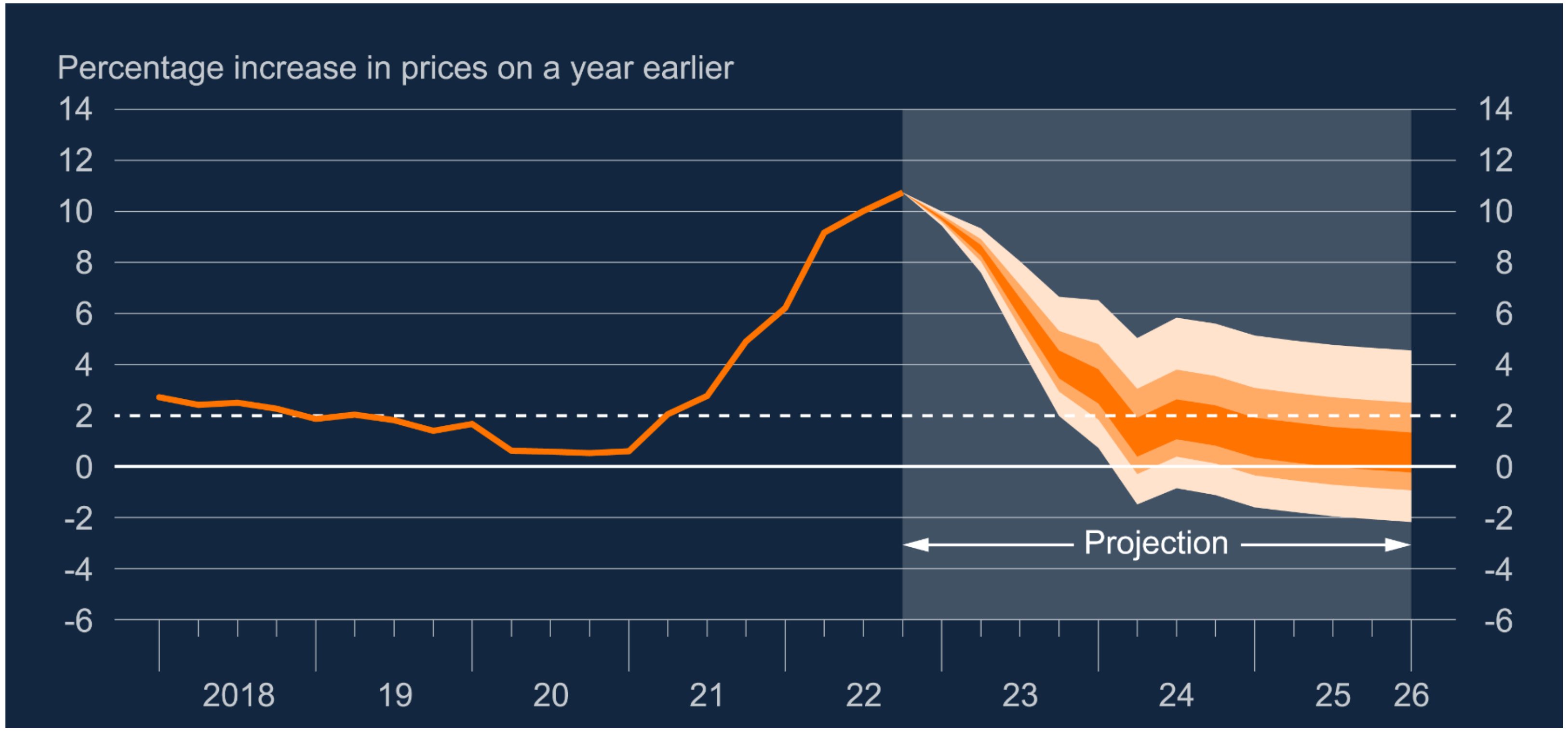


Gas spot and futures prices sharply down since November



- Retail energy prices rise in April as EPG increases from £2.5k to £3k.
- But 50% fall in wholesale prices ⇒ retail prices will fall below EPG cap from Q3.

CPI inflation expected to fall sharply in 2023 H2



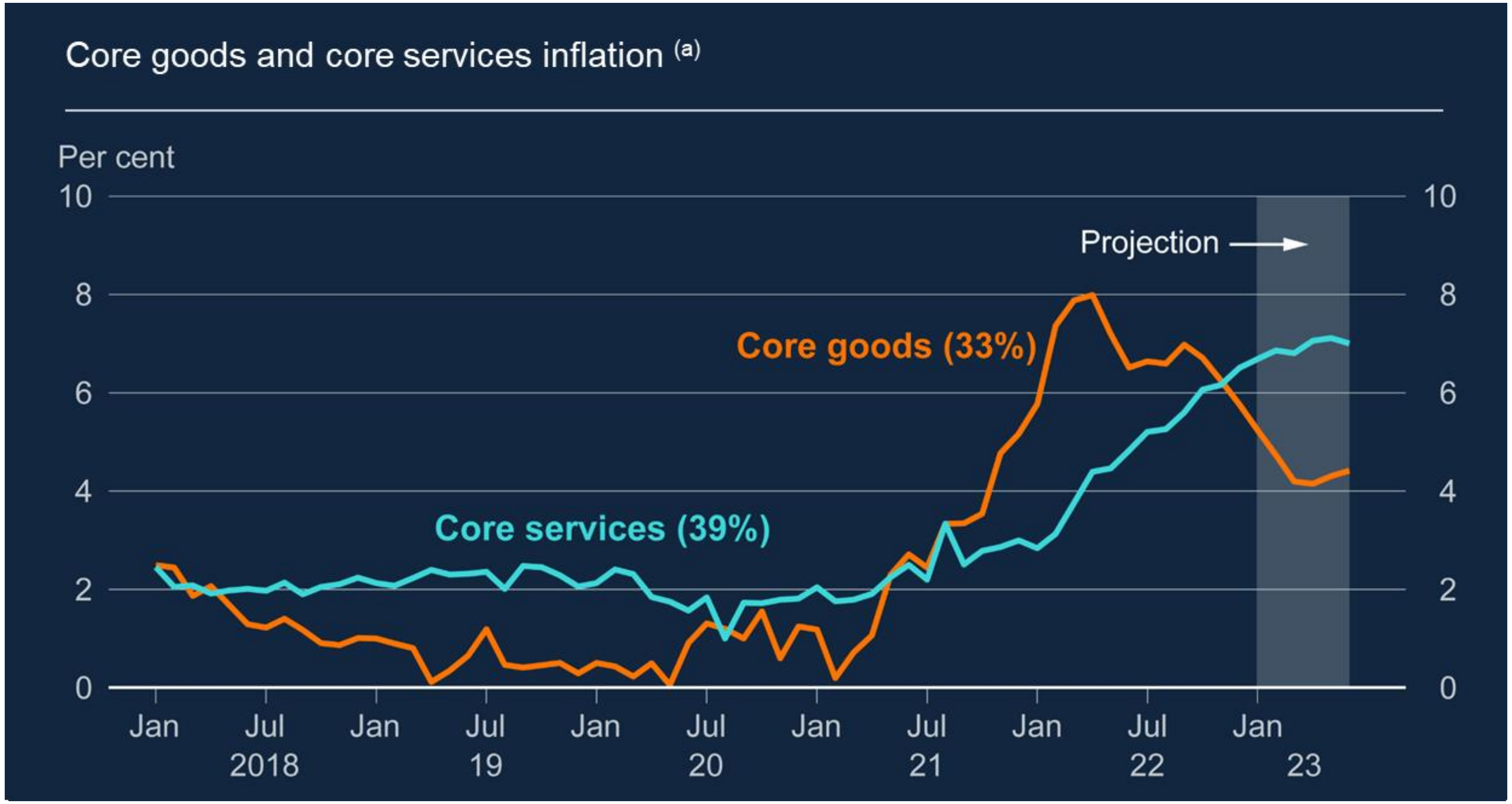
- Inflation expected to fall to **3% by 2024 Q1**.
- Below target thereafter: 1% in 2025 Q1 & 0.4% in 2026 Q1.
- *But big upside risks from persistence of strong growth in domestic wages and prices.*

Extract from MPC Minutes (para 36) – 2nd Feb. 2023

- ***"…risks to inflation skewed significantly to the upside, primarily reflecting the possibility of greater persistence in domestic wage and price setting****, and also upside risks to the wholesale energy price conditioning assumption.*

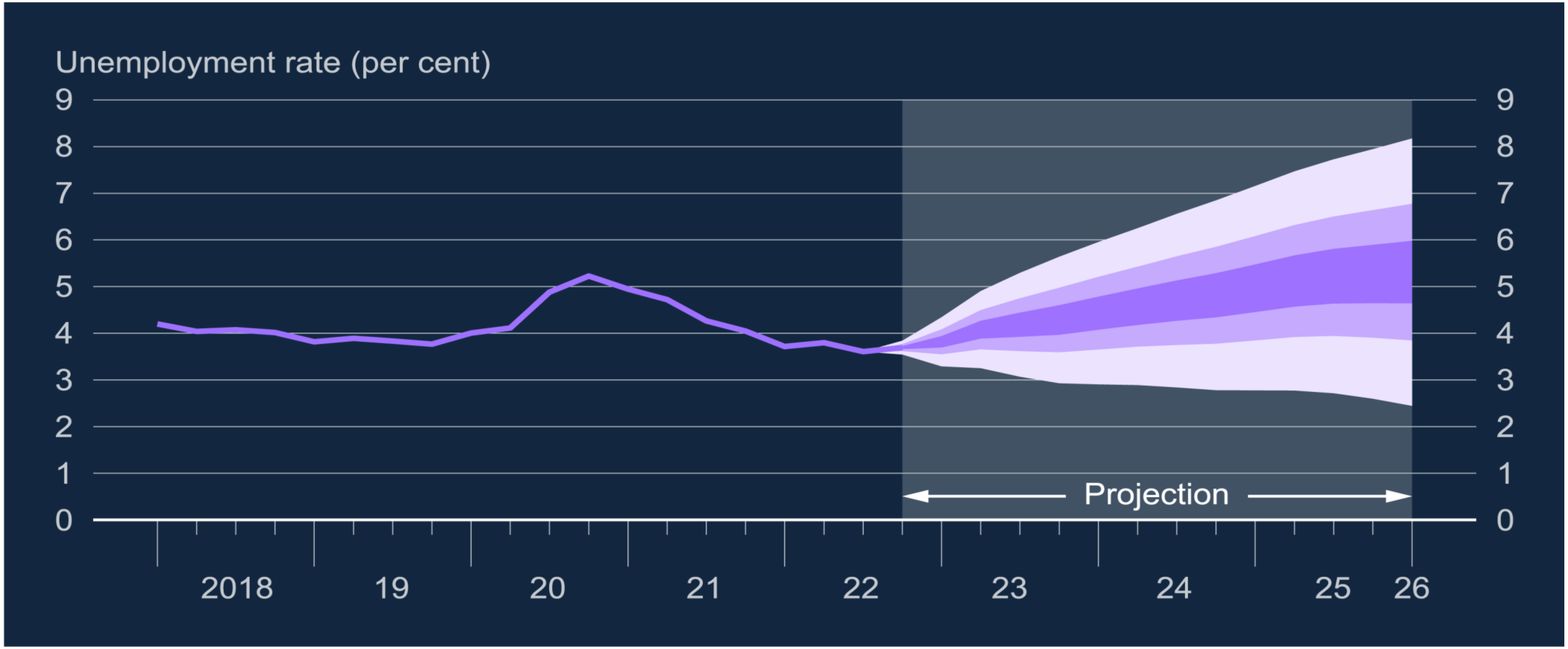
- *Qualitatively,* ***an inflation forecast that took into account these upside risks was judged to be much closer to the 2% target*** *at the policy horizon than the modal central projection."*

Goods inflation down, but Services inflation still rising…



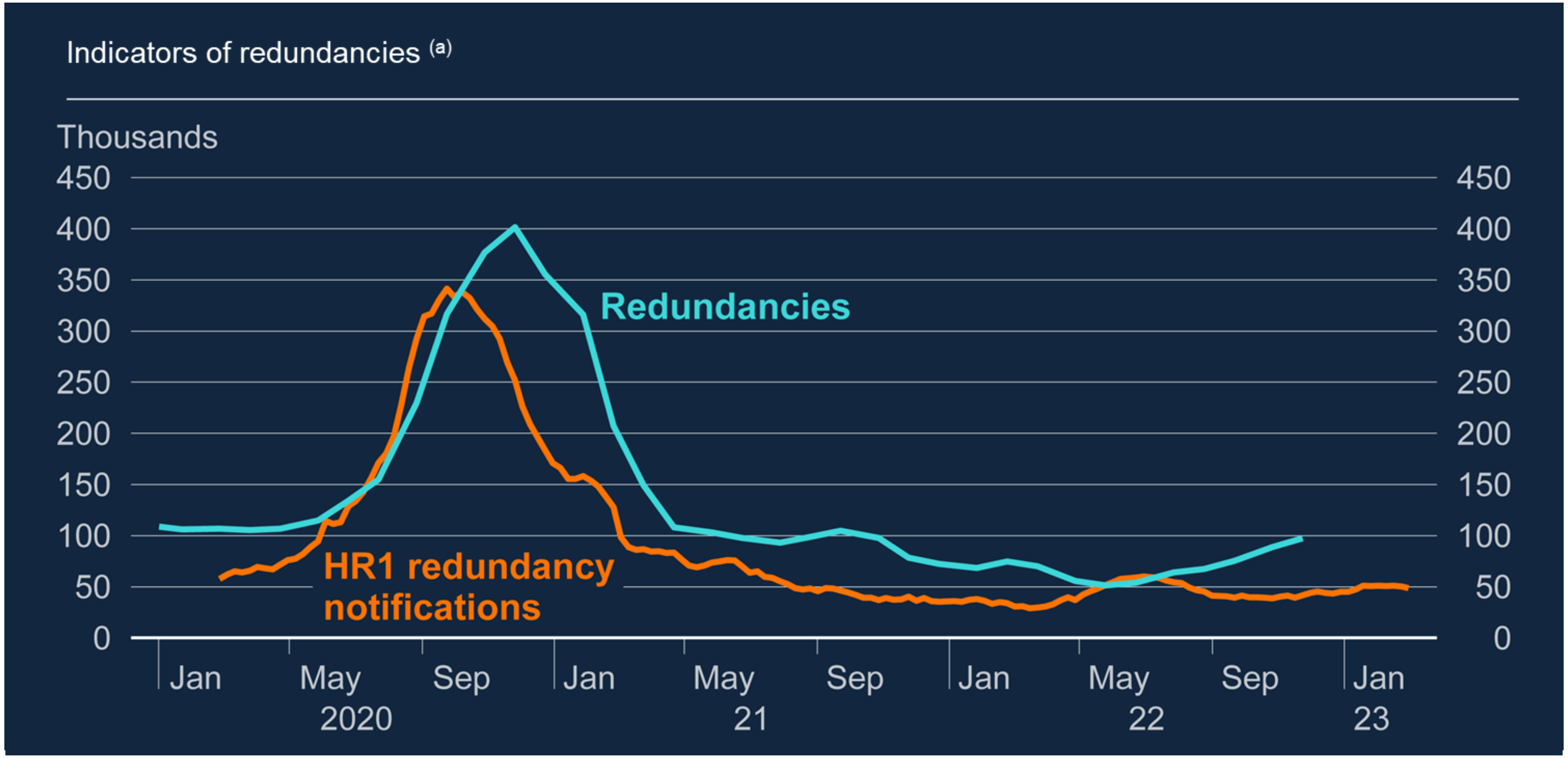
- Core goods inflation falling as cost pressures from supply chains ease
- *Core services inflation recently hit 30-year high and still rising*.

Unemployment to rise slowly to 5.3% by 2026



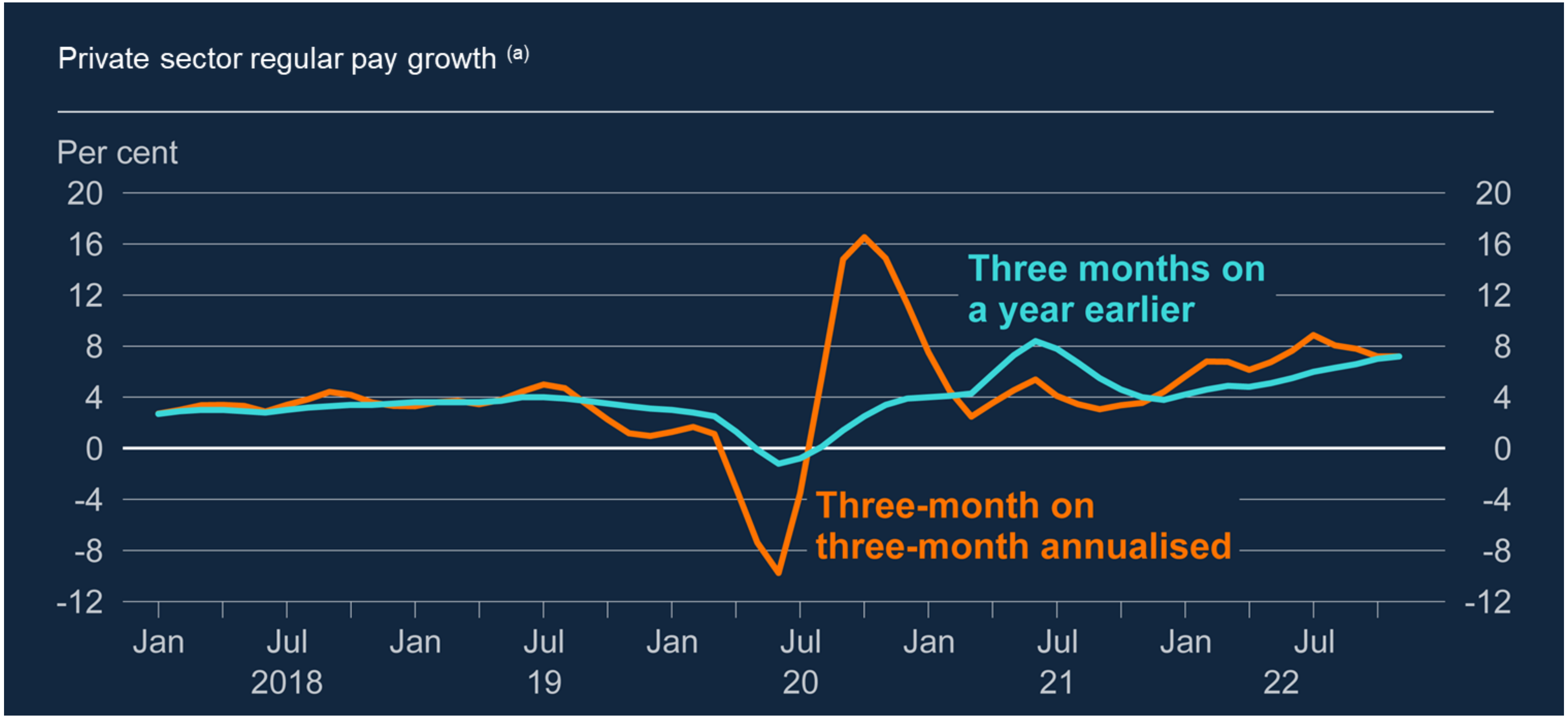
- Unemployment still close to record lows, with vacancies high/redundancies low.
- Labour hoarding – firms accommodate weaker demand thro attrition and fewer working hours.

Tight labour market – Redundancies remain low



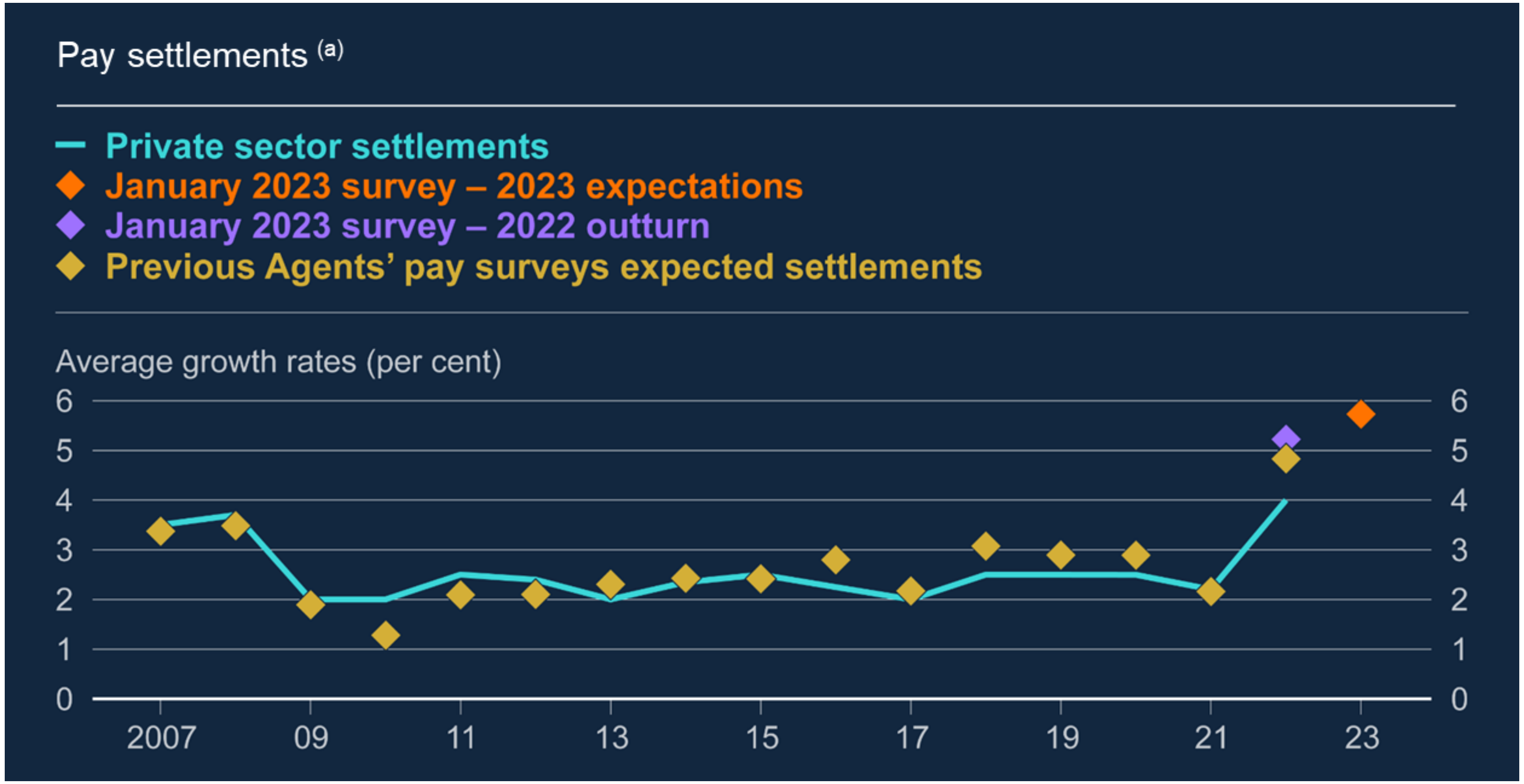
- High vacancies and low level of redundancies suggests companies may hoard labour as the economy slows.
- Will support real incomes and lead to less “precautionary savings”.

Tight labour market – private sector pay growth over 7%



- Private sector wage growth still surprising on the upside, to above 7%, but early signs of some easing.

Agents' survey ⇒ pay settlements in 2023 similar to 2022

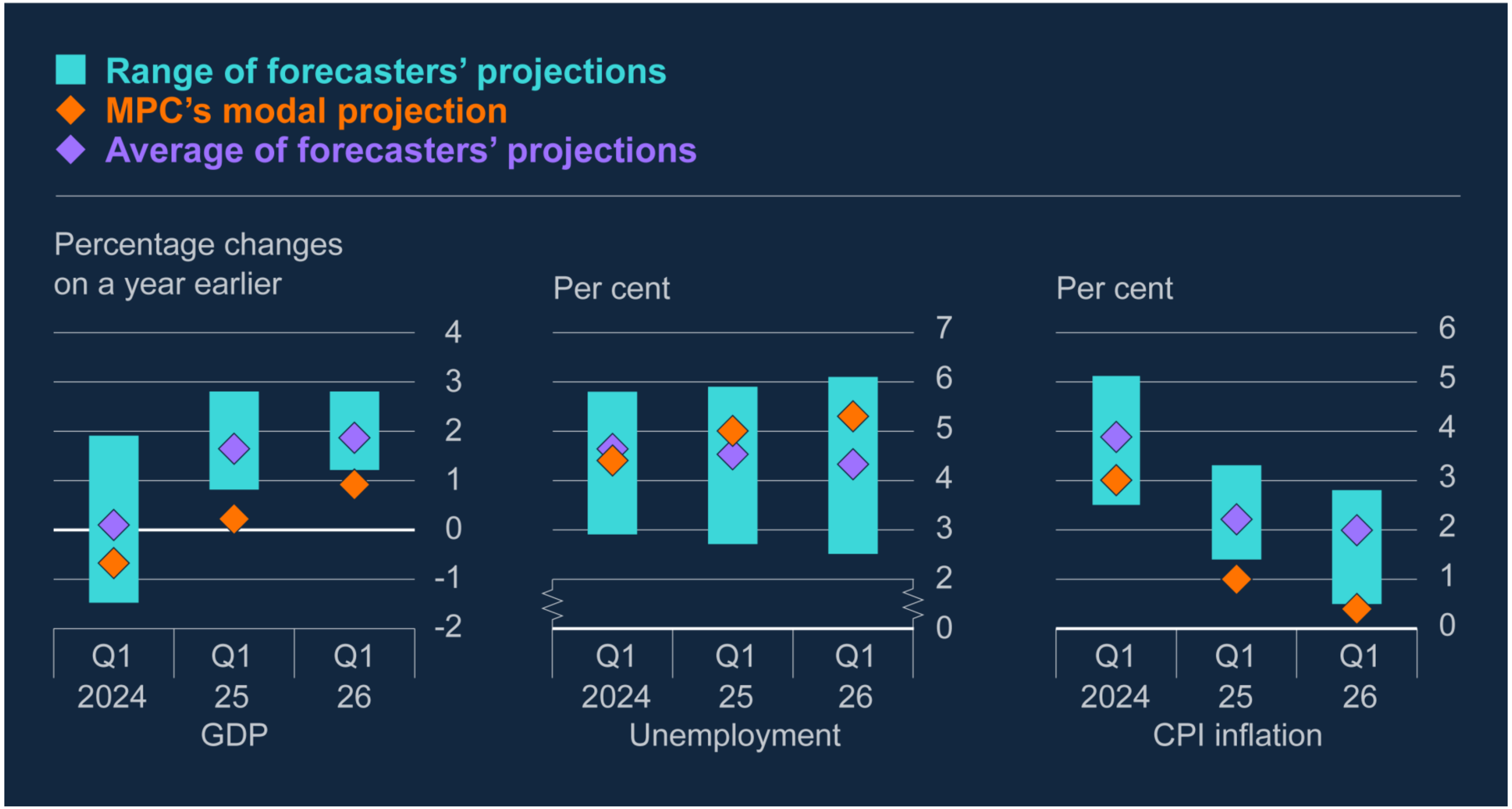


- Settlements in H2 expected to be lower than H1. And one-off pay adjustments expected to be less common.

Forecast summary

	2023 Q1	2024 Q1	2025 Q1	2026 Q1
GDP (c)	-0.3 (-0.6)	-0.7 (-2.0)	0.2 (0.1)	0.9
CPI inflation (d)	9.7 (10.1)	3.0 (4.0)	1.0 (1.2)	0.4
LFS unemployment rate	3.8 (3.8)	4.4 (5.2)	5.0 (6.0)	5.3
Excess supply/**Excess demand** (e)	0 (-¼)	-1½ (-2½)	-2 (-3)	-2
Bank Rate (f)	3.8 (4.3)	4.3 (5.1)	3.6 (4.7)	3.3

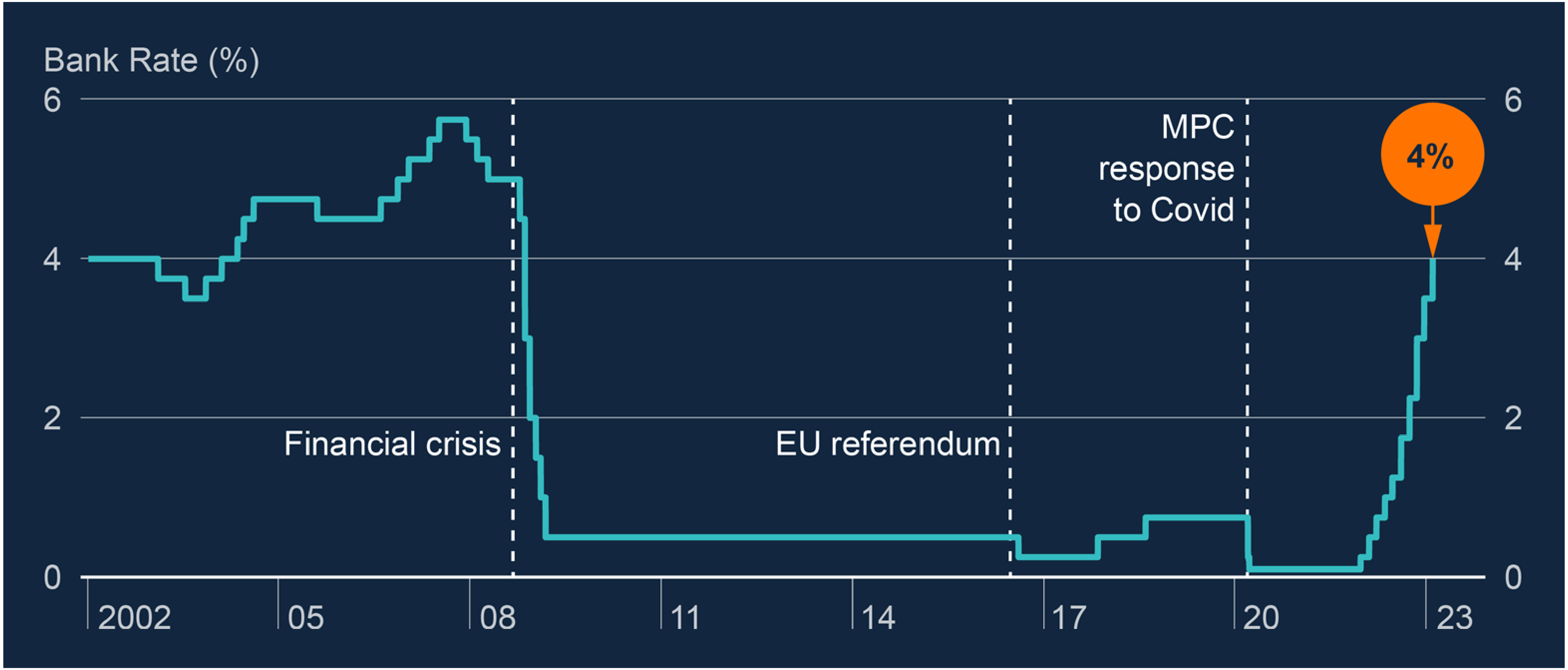
At three-year horizon, external forecasters expected GDP growth = 1.9%, unemployment = 4.3% and CPI inflation = 2%



Latest Bank Rate decision – 2nd Feb 2023

- As expected, MPC increased Bank Rate by 50bps to 4%.
- **7-2 Vote** – majority for +50bp. 2 voted for no change.
- 10th straight increase since Dec 2021.

10 back-to-back increases in Bank Rate



Extract MPC Minutes (para 38) – rationale for the decision #1

- *“**Headline CPI inflation had begun to edge back and was likely to fall sharply over the rest of the year**, as a result of past developments in energy and other goods prices.*

- *Economic activity had weakened, but there had been some **signs of greater resilience in the most recent data.***

- *However, the **labour market had remained tight and domestic price and wage pressures had been stronger than expected, suggesting risks of greater persistence in underlying inflation**.*

- *Measures of inflation expectations were still at elevated levels.”*

Extract MPC Minutes (para 38) – rationale for the decision #2

- *“The **risks to the inflation outlook in the medium term were both large and asymmetric, with a skew towards greater persistence**.*
- *This **warranted additional weight being put on recent strength in the labour market and inflation data**, and relatively less on the medium-term projections.*
- *A 0.5 percentage point increase in Bank Rate at this meeting would **address the risk that domestic wage and price pressures remained elevated even as external cost pressures waned**.”*

Extract MPC Minutes (para 38) – rationale for the decision #3

- Less hawkish language on future policy than at previous policy decisions.

- ***"MPC will continue to monitor closely indications of persistent inflationary pressures, including the tightness of labour market conditions and the behaviour of wage growth and services inflation. If there were to be evidence of more persistent pressures, then further tightening in monetary policy would be required."***

- *Looking further ahead, the MPC will adjust Bank Rate as necessary to return inflation to the 2% target sustainably in the medium term, in line with its remit."*

Interest rates over the medium term –

- *"Cyclical adjustments in short-term nominal interest rates – like those we are currently witnessing in the United Kingdom and abroad – will for the foreseeable future continue to be played out against **the backdrop of low global equilibrium real interest rates**."* – Andrew Bailey (12th July 2022)

Q&A

UPCOMING EVENTS

ENTRIES ARE OPEN FOR IHA 2023!*

ENTRIES CLOSE ON FRIDAY 10TH MARCH

MARCH CHAMBER LUNCH

THURSDAY 23RD MARCH, 12:00 – 14:00, AT MARRIOTT HANBURY MANOR

APRIL CHAMBER LUNCH

THURSDAY 20TH APRIL, 12:00 - 14:00, AT CROMWELL HOTEL STEVENAGE

SUMMER PARTY*

THURSDAY 6TH JULY, 18:00 - 21:00, AT SOPWELL HOUSE

*SPONSORSHIP OPPORTUNITIES AVAILABLE!

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