

# The UK and Global Macro Outlook

## Inside of What's Ahead

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# Recap I: Still feeling the effects of two massive shocks

## 1. COVID-19 pandemic

- Supply constrained by lockdowns and other Covid measures, particularly in Asia. China has only recently reopened. Higher labour inactivity in the US and UK (early retirement, long-term sick).
- Incomes supported by massive direct payments in the US and furlough schemes in Europe, which resulted in “excess savings”. Monetary policy overly loose well after GDP had snapped back.
- Expenditure-switching from services to goods (and now back again), mostly US driven but caused global shortages and a surge in freight costs.

## 2. Russia-Ukraine war

- Conflict and western sanctions led to a surge in commodities prices, particularly energy and food, which has spread into core inflation. Heightened economic uncertainty.



# Recap I!: Outcomes and policy responses

## Outcomes:

- Headline inflation hit 40-year highs but has peaked; core inflation sticky
- Falling real incomes, weak GDP growth
- Tight labor markets and high nominal wage growth -> “risk” of a wage-price spiral, but very unlikely (longer-term inflation expectations well anchored, real wages falling).

## Policy responses:

- Central banks have aggressively tightened monetary policy. But most of the impact on output (peak effect 12 months later) and inflation still to come (peak effect 18-24 months later).
- Fiscal support for low-income households and energy price caps has supported economic activity
- Profound longer-term impacts: green transition, supply-chain resilience over efficiency, friend-shoring, higher public debt

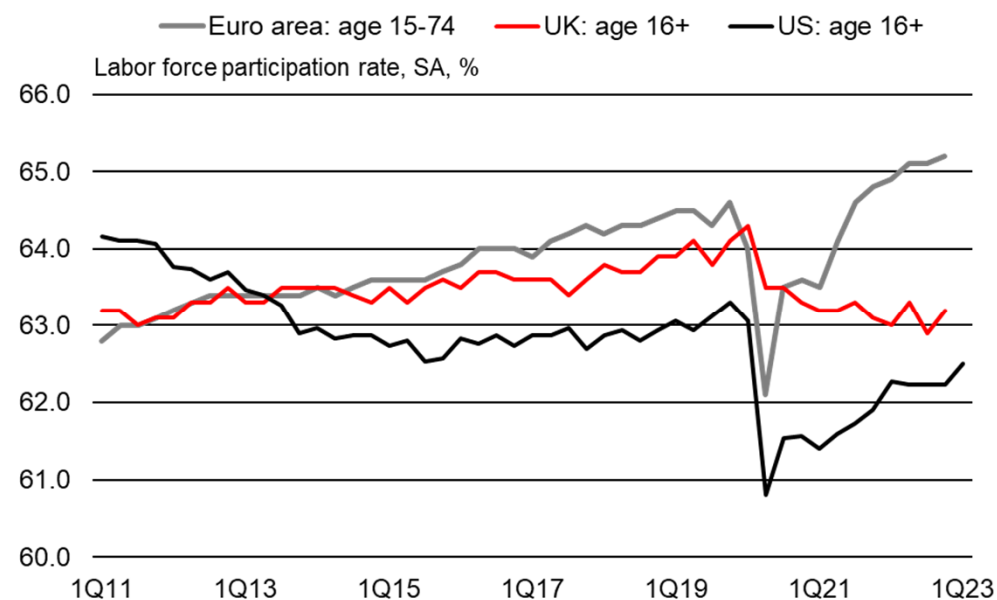


# Road map

- The **drivers of inflation** and key differences across countries.
  - Headline inflation is set to fall fairly rapidly while core inflation will be stickier
- Why **economic activity** has so far proved **resilient**, but downside **risks are building**
- The **outlook for interest rates and FX**
  - Key rates likely not far from the peak, but don't expect rate cuts for the Fed, ECB and BoE until 2024



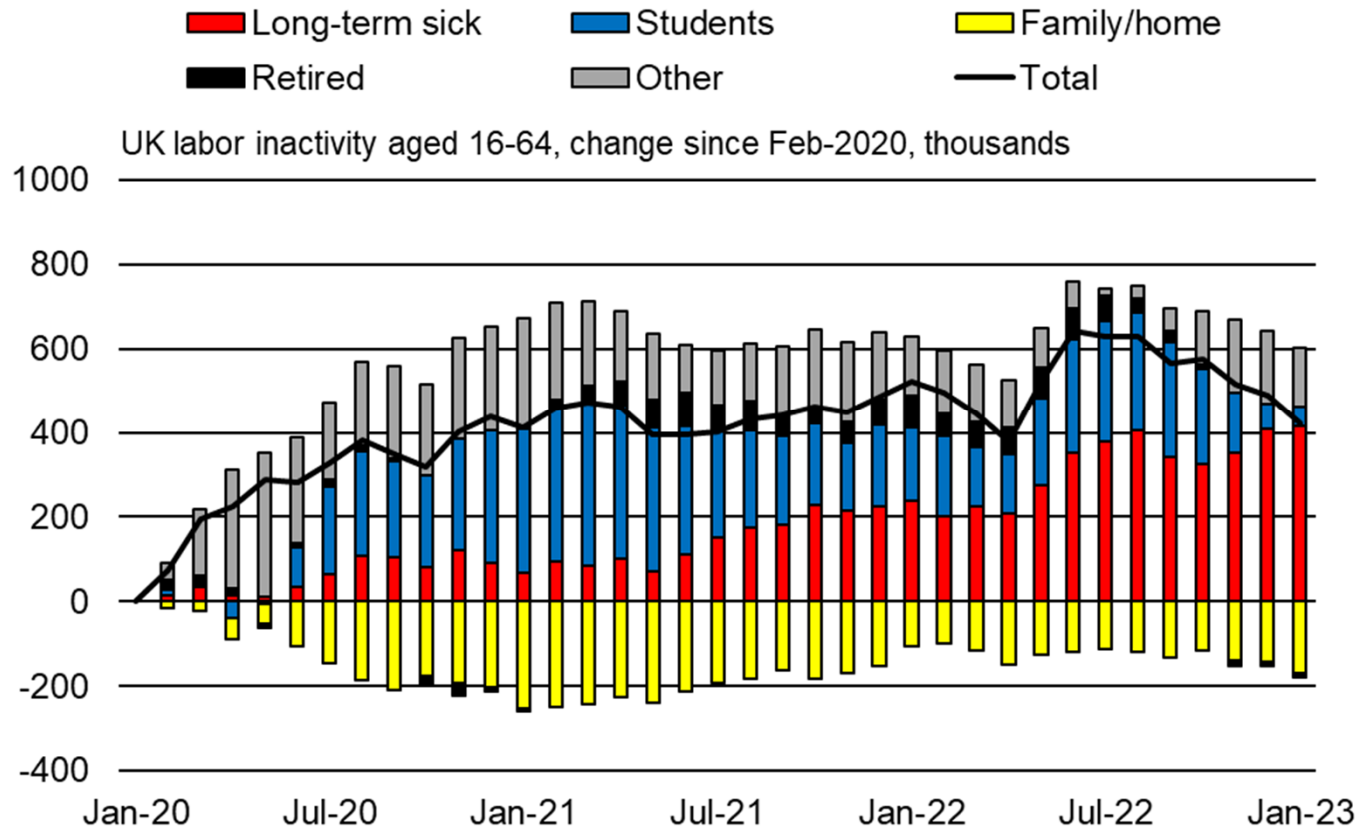
# Supply shocks (European energy imports; US and UK labor inactivity)



Source: BLS, Eurostat, OECD, ONS, UniCredit Research



# UK the “sick man” of Europe

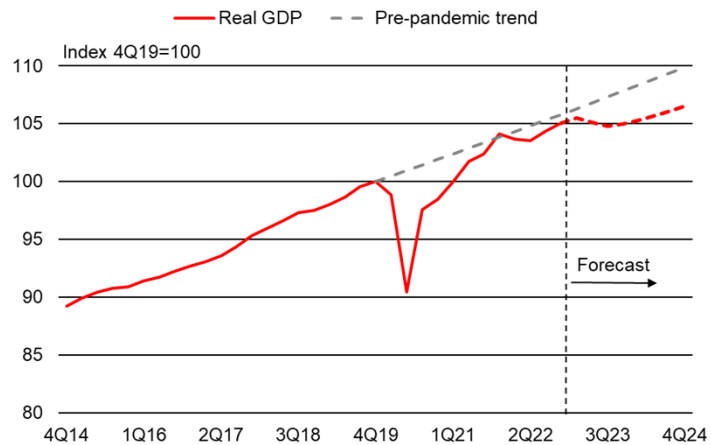


Source: ONS, UniCredit Research

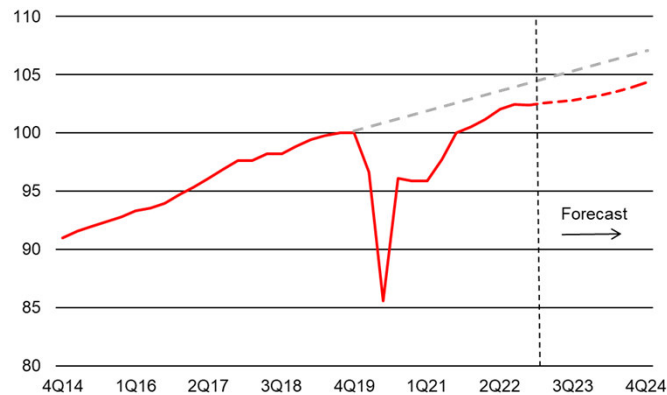


# Different recovery paths, all below pre-pandemic trend; similarly weak outlook

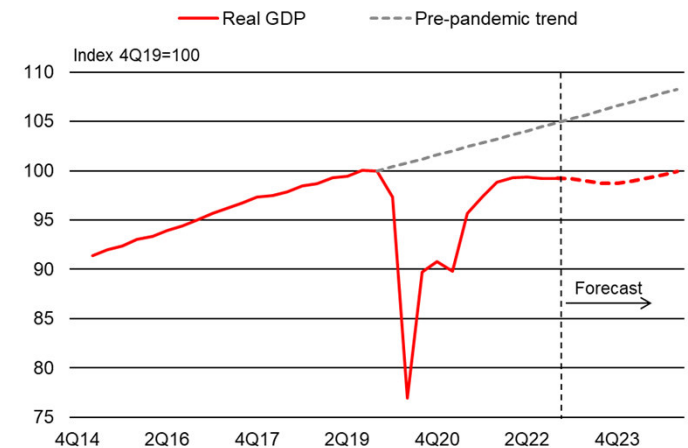
## US



## Eurozone



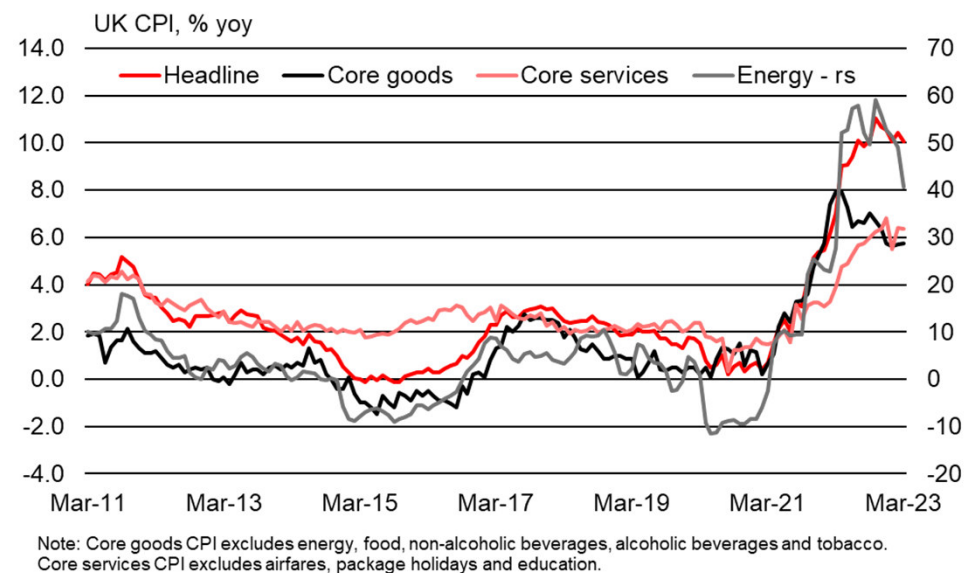
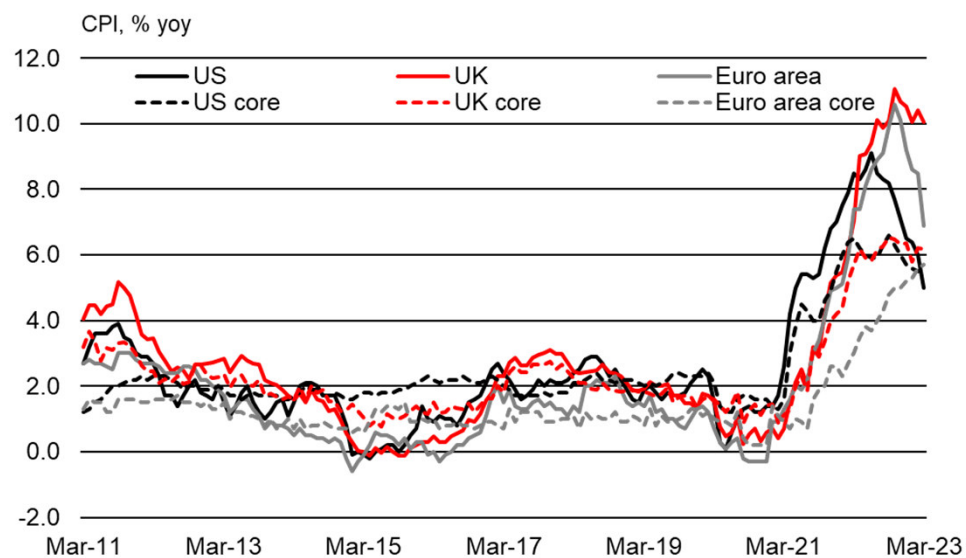
## UK



Source: BEA, Eurostat, ONS, UniCredit Research



# Inflation too high but headline past the peak; core sticky



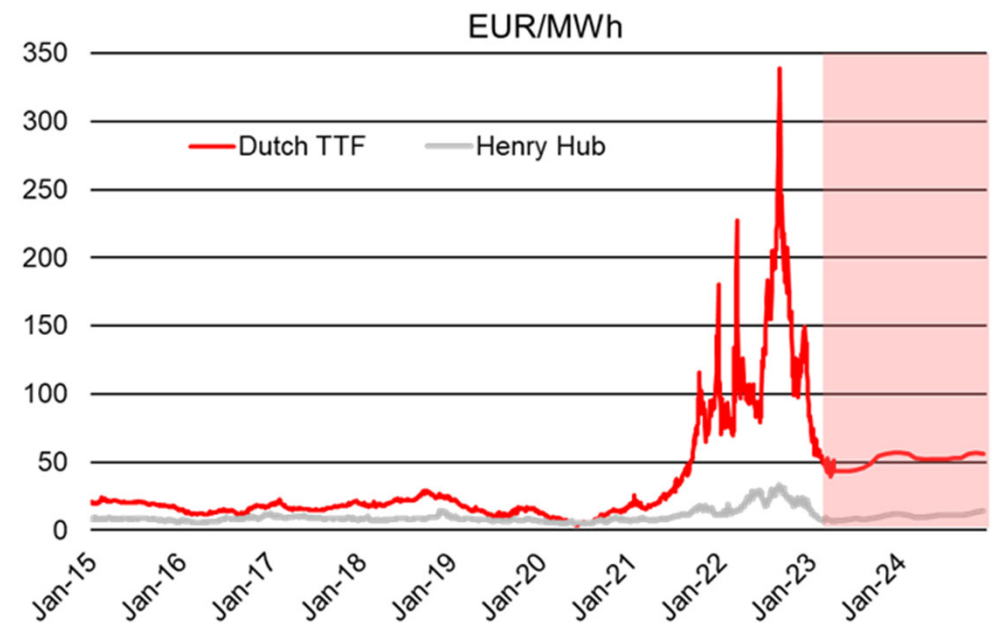
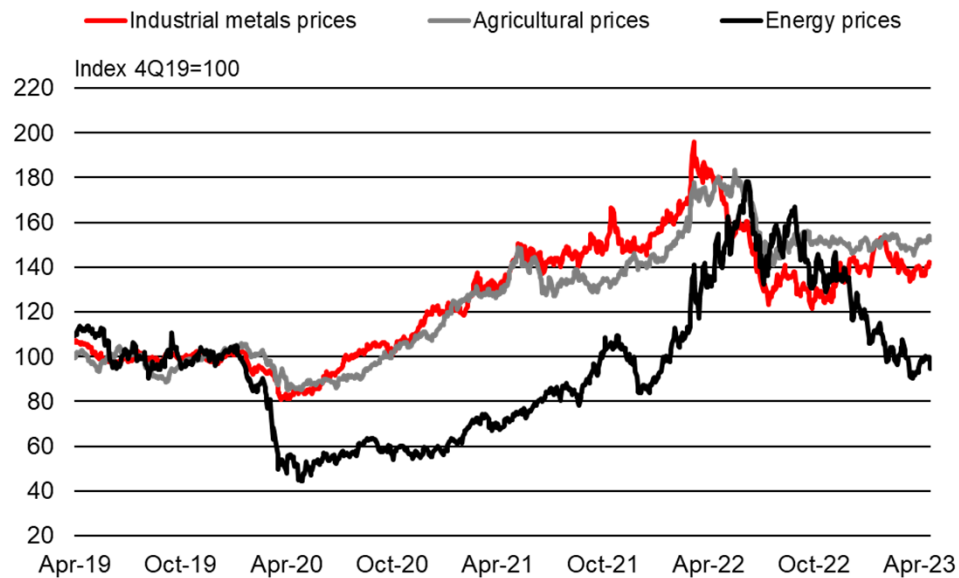
Source: BLS, Eurostat, ONS, UniCredit Research





# Inflation drivers

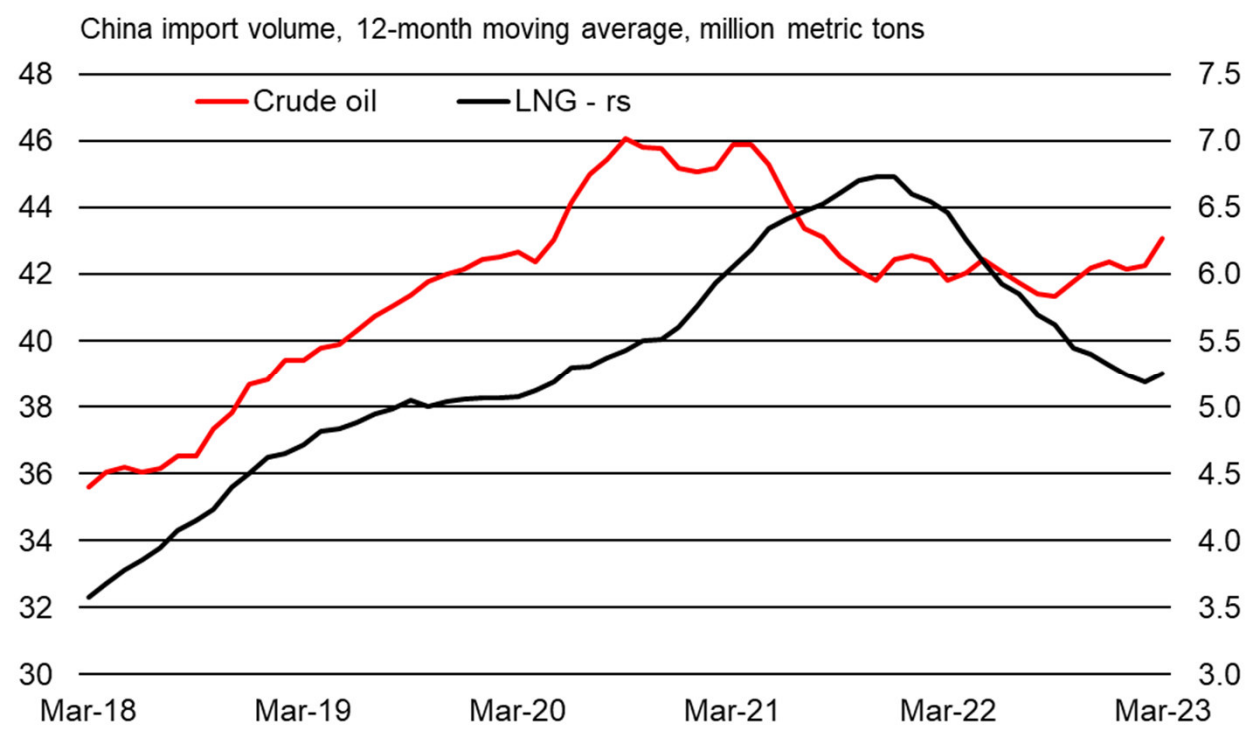
## 1. Commodity prices have moved lower, mostly energy ...



Source: Bloomberg, UniCredit Research



... but China's reopening poses upside risks

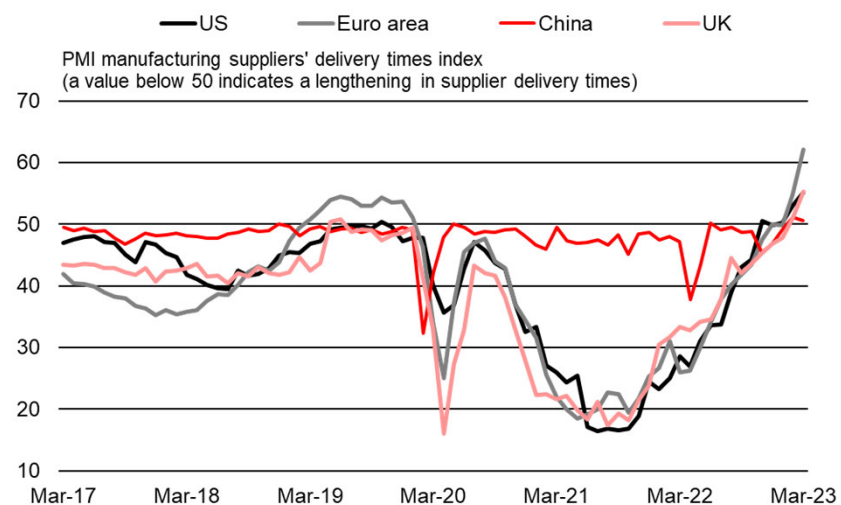
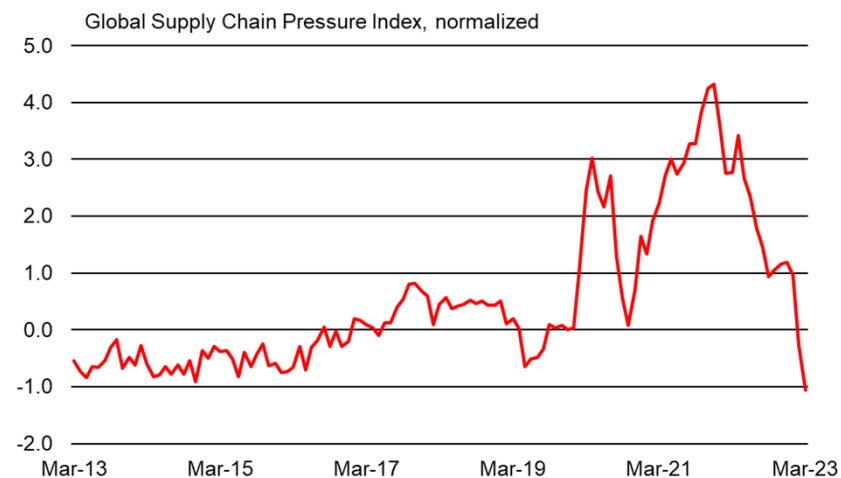
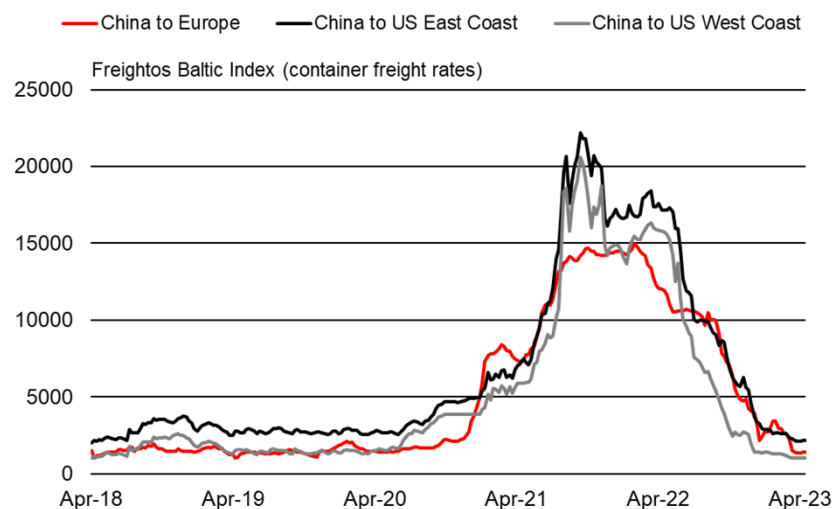


Source: NBS, UniCredit Research



# Inflation drivers

## 2. Supply-chain constraints back to normal?



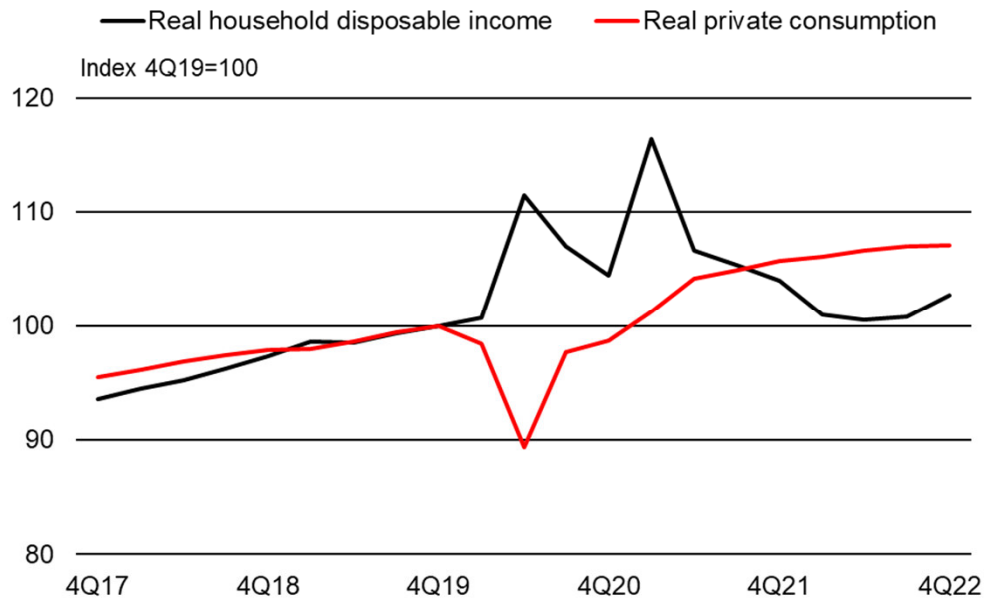
Source: Freightos, NY Fed, S&P Global, UniCredit Research



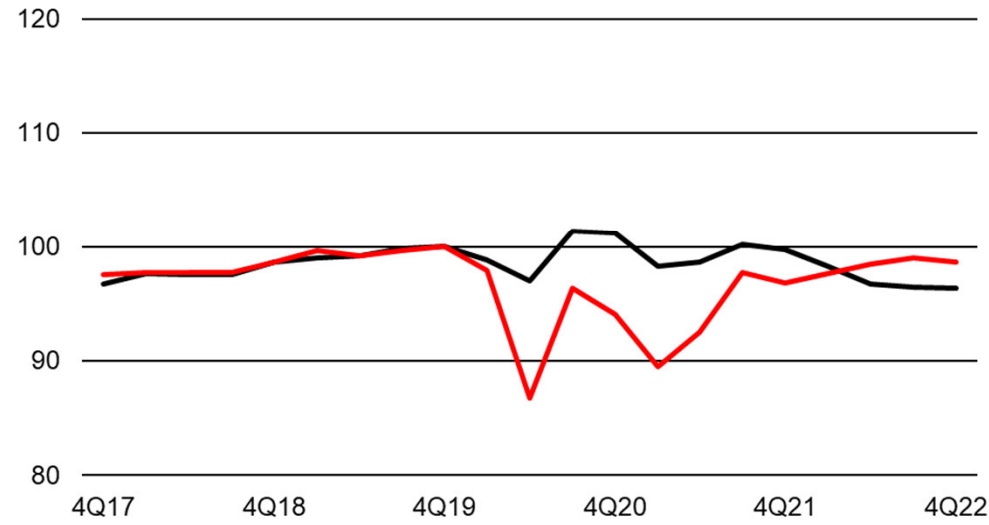
# Inflation drivers

## 3. Huge pandemic-related fiscal support for household incomes, especially in the US

### US



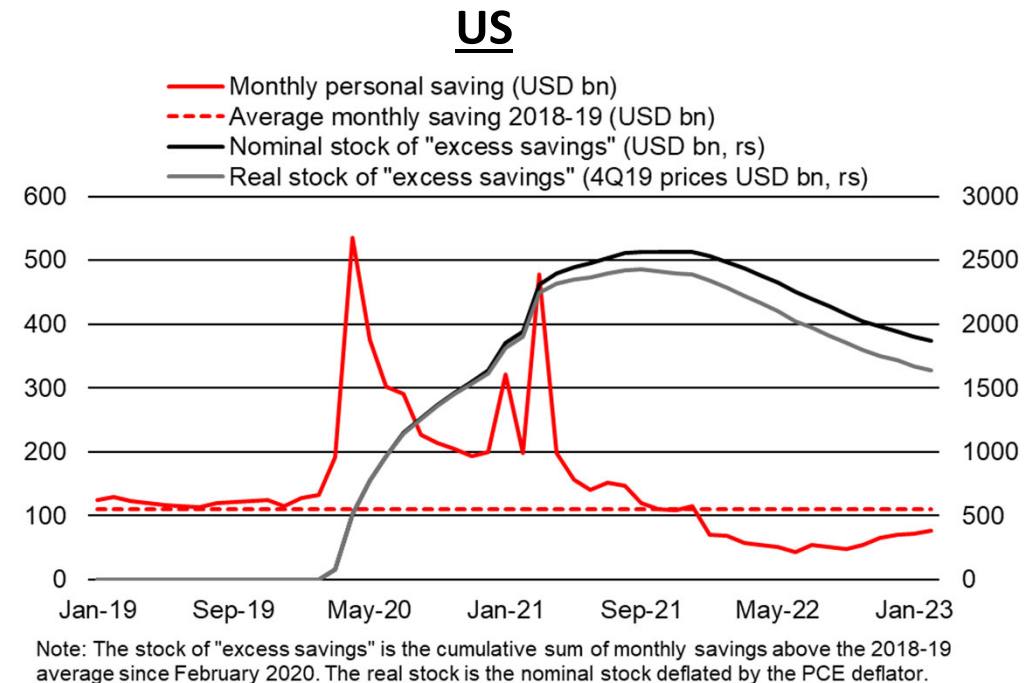
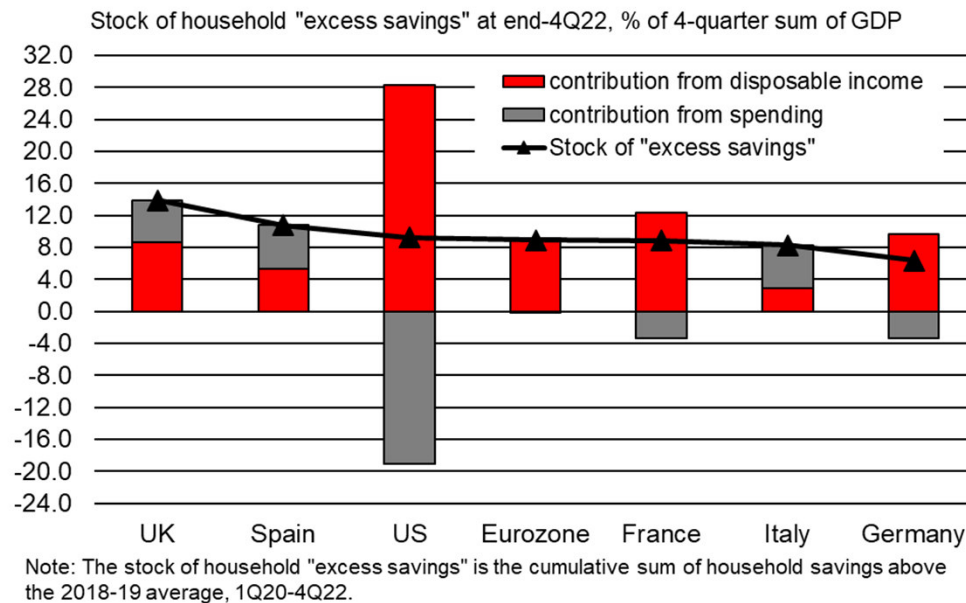
### Germany



Source: OECD, UniCredit Research



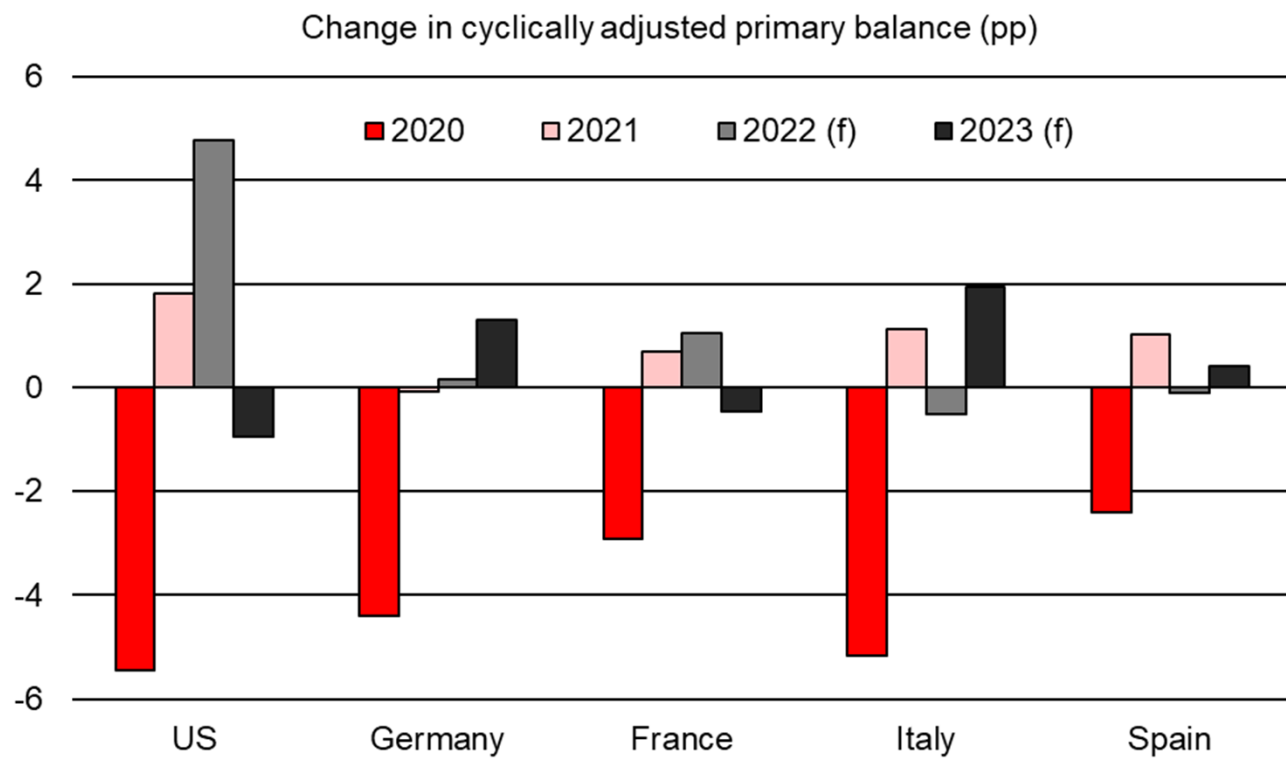
... which has manifested in large HH “excess savings”. But highly unevenly distributed and declining in the US, not Europe



Source: BEA, Eurostat, ONS, UniCredit Research



# Fiscal policy now broadly neutral



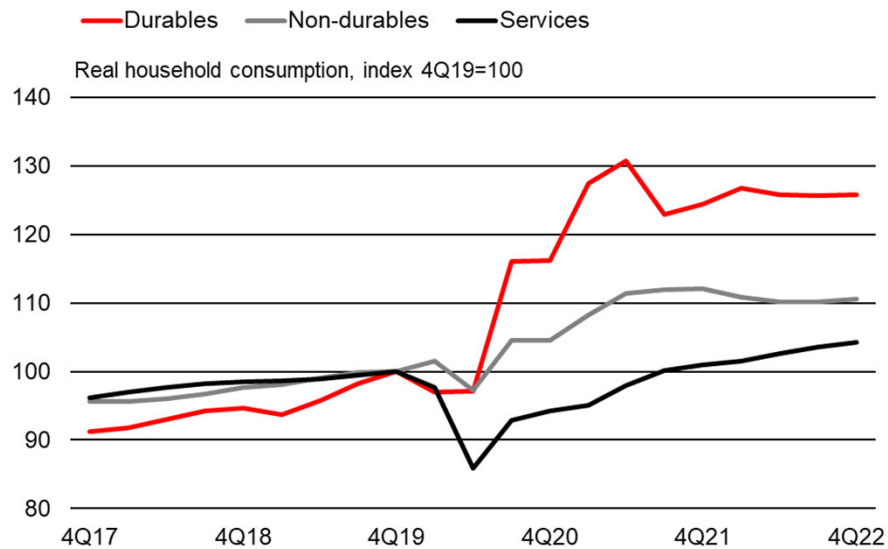
Source: IMF, UniCredit Research



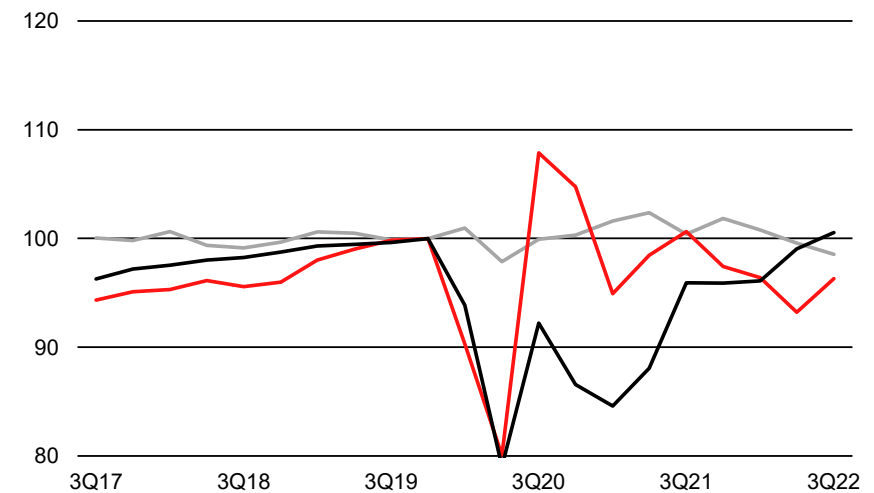
# Inflation drivers

## 4. Expenditure-switching back towards services from goods

### US



### Eurozone

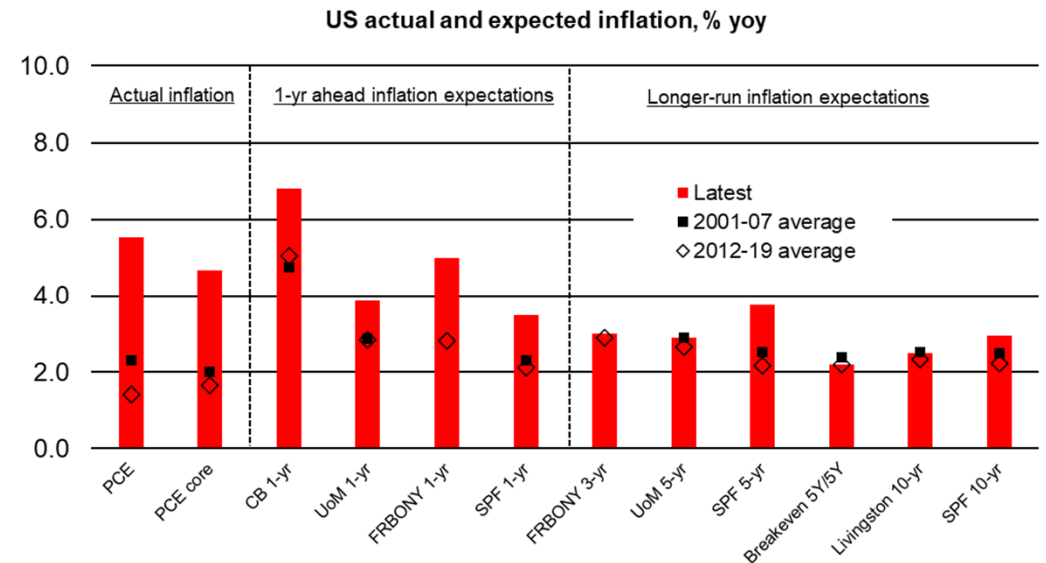
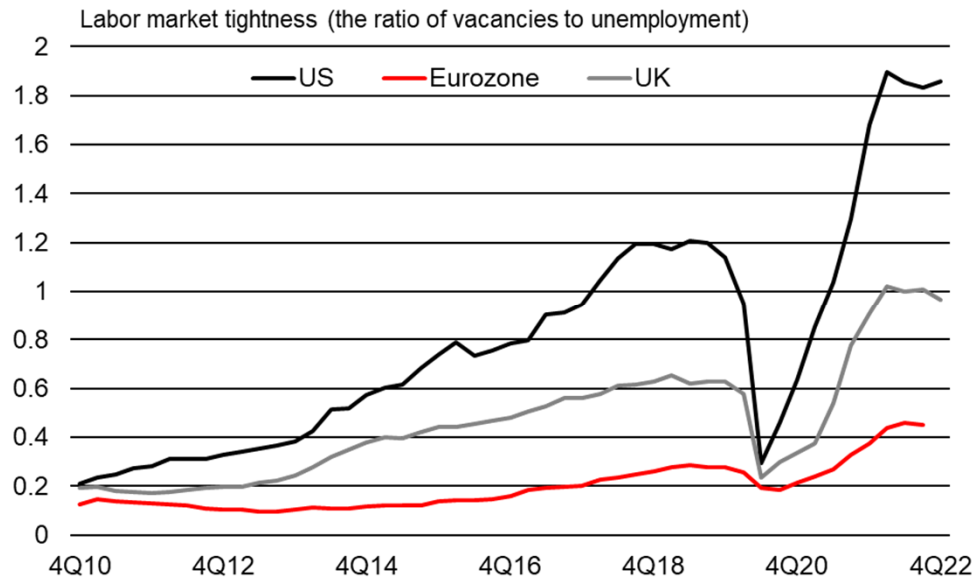


Source: OECD, Eurostat, UniCredit Research



# Inflation drivers

## 5. Tight labor markets & high short-term inflation expectations ...



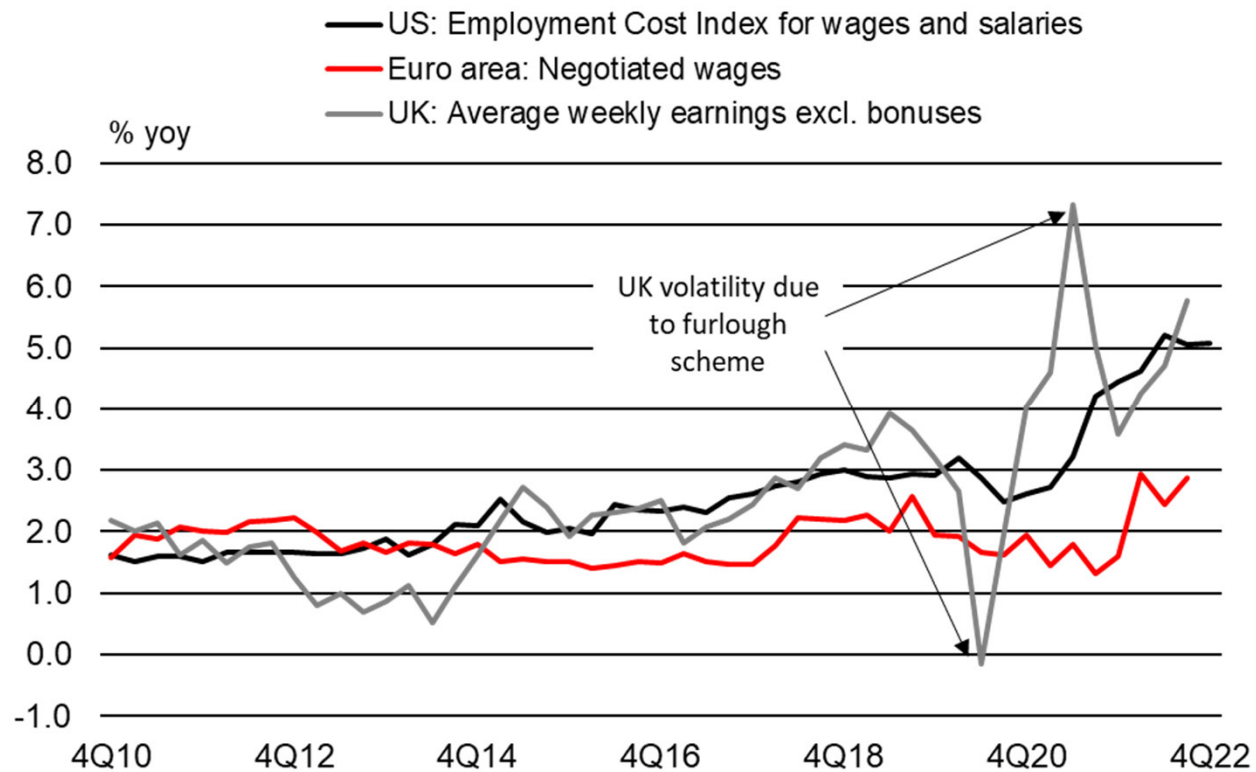
Note: CB=Conference Board, UoM=University of Michigan, FRBONY=New York Fed, SPF=Survey of Professional Forecasters (Phili Fed)

Source: Bloomberg, BLS, CB, ECB, Eurostat, Fed, ONS, UMich, UniCredit Research





... has led to higher wage growth - but will ease as inflation eases and labor market softens



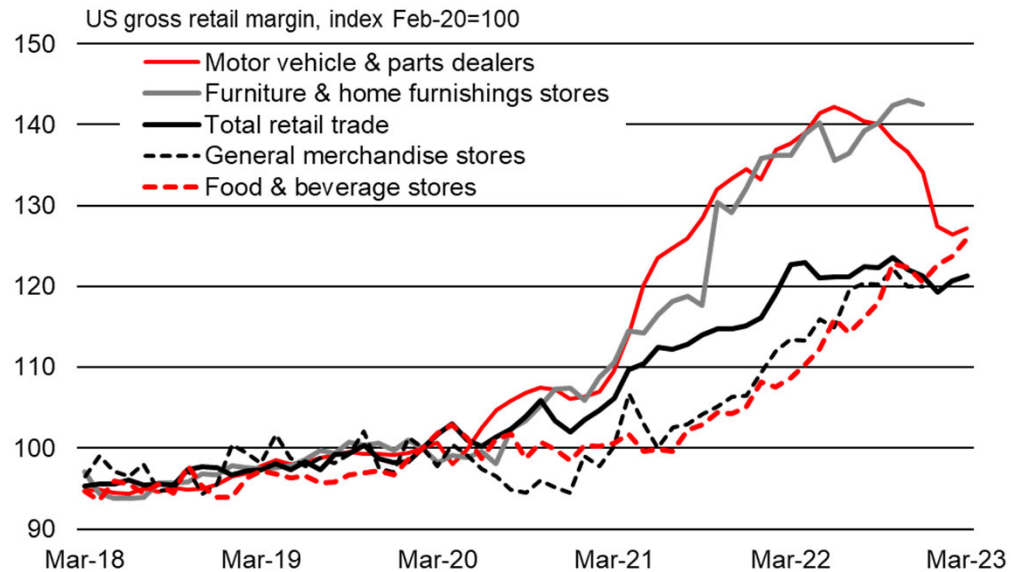
Source: BLS, ECB, ONS, UniCredit Research



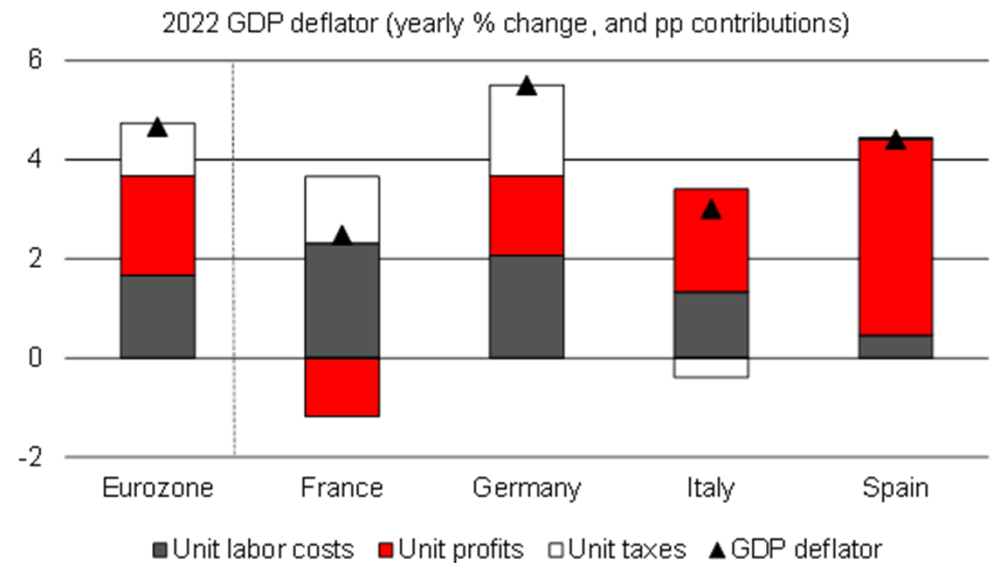
# Inflation drivers

## 6. Retail and profit margins have surged - pandemic-related pricing power?

### US



### Eurozone



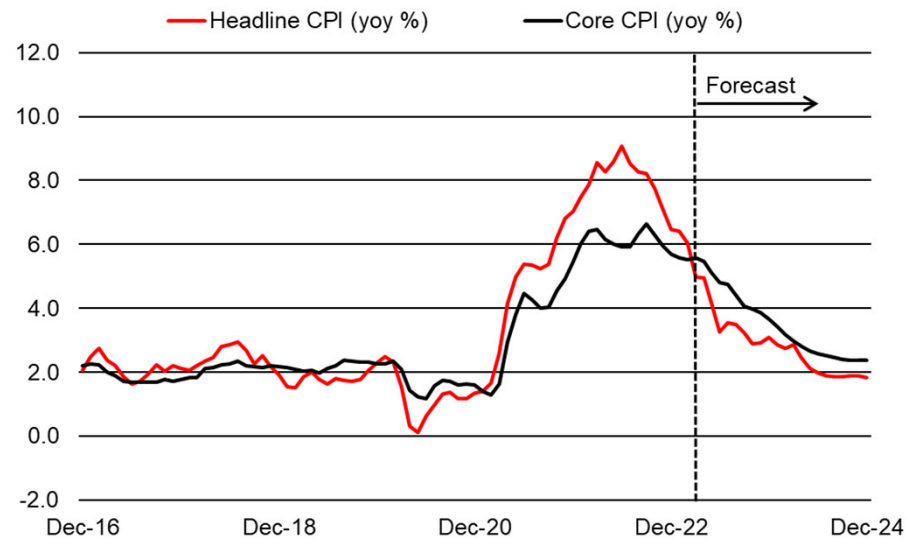
Source: BLS, Eurostat, UniCredit Research



# Disinflation ahead; speed of descent highly uncertain

US

UK

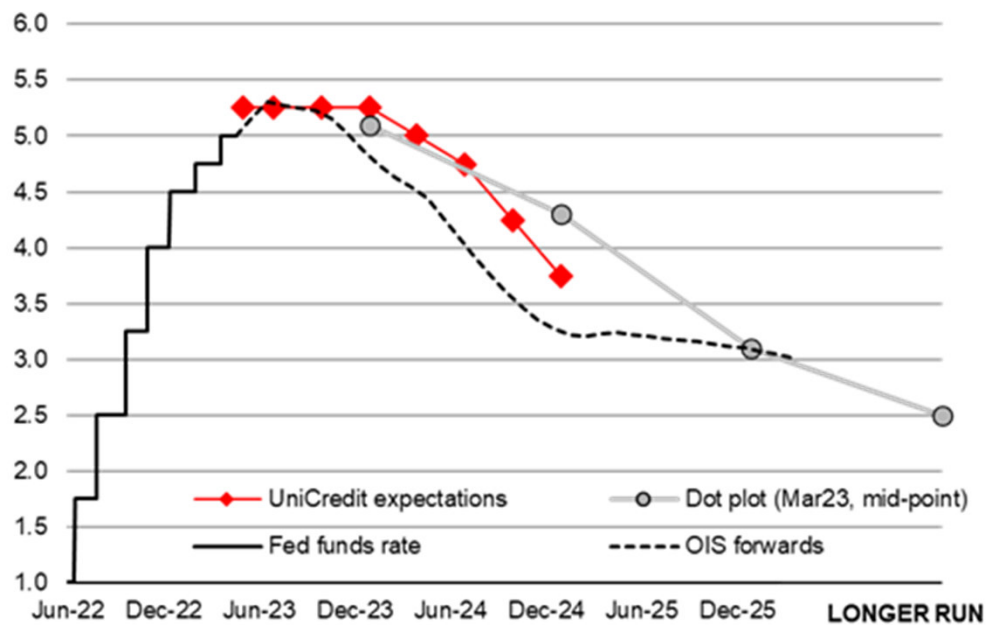


Source: BLS, Eurostat, UniCredit Research

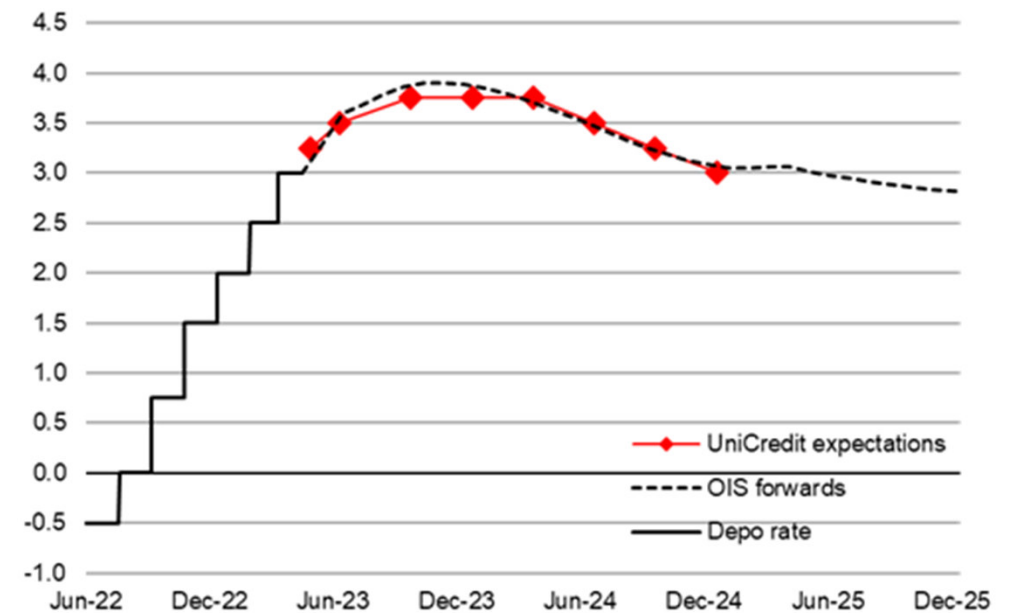


# Central banks have responded aggressively, and more to come

## US



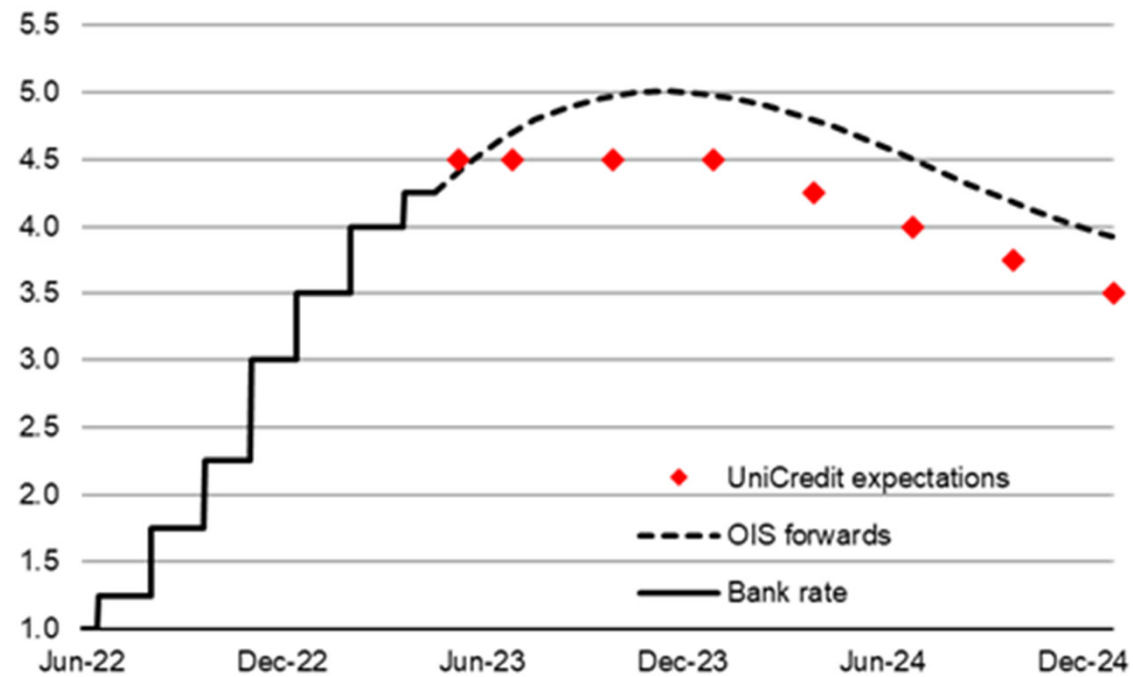
## Eurozone



Source: Bloomberg, ECB, Fed, UniCredit Research



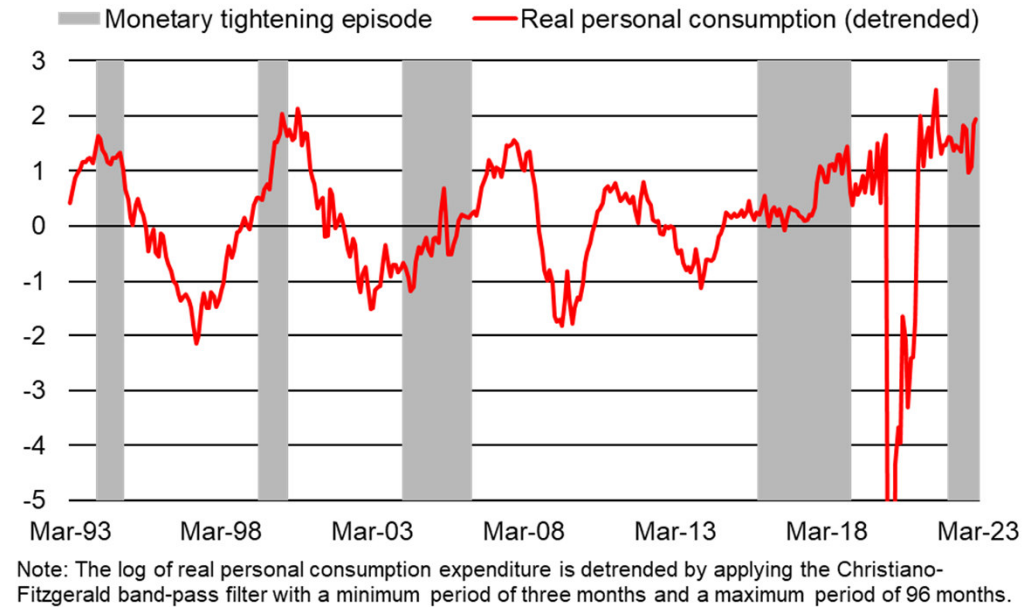
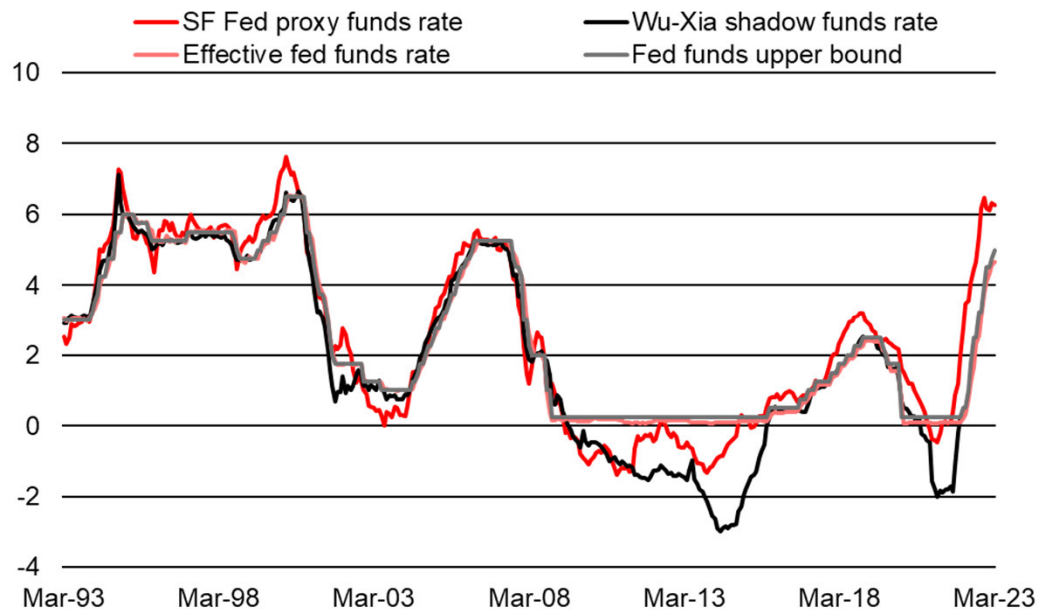
## BoE bank rate: market expectations vs. our forecast



Source: Bloomberg, BoE, UniCredit Research



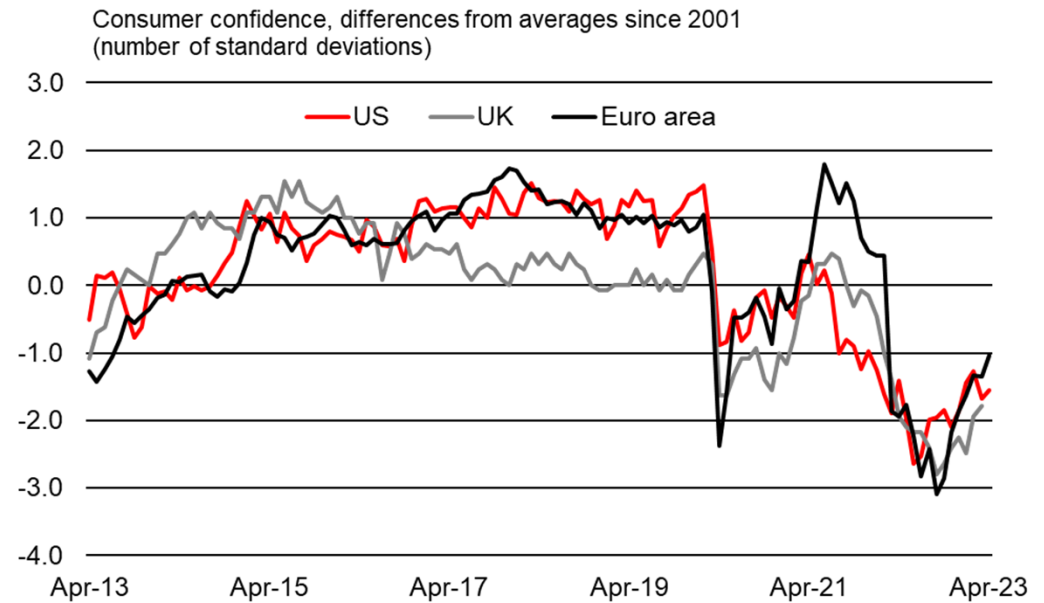
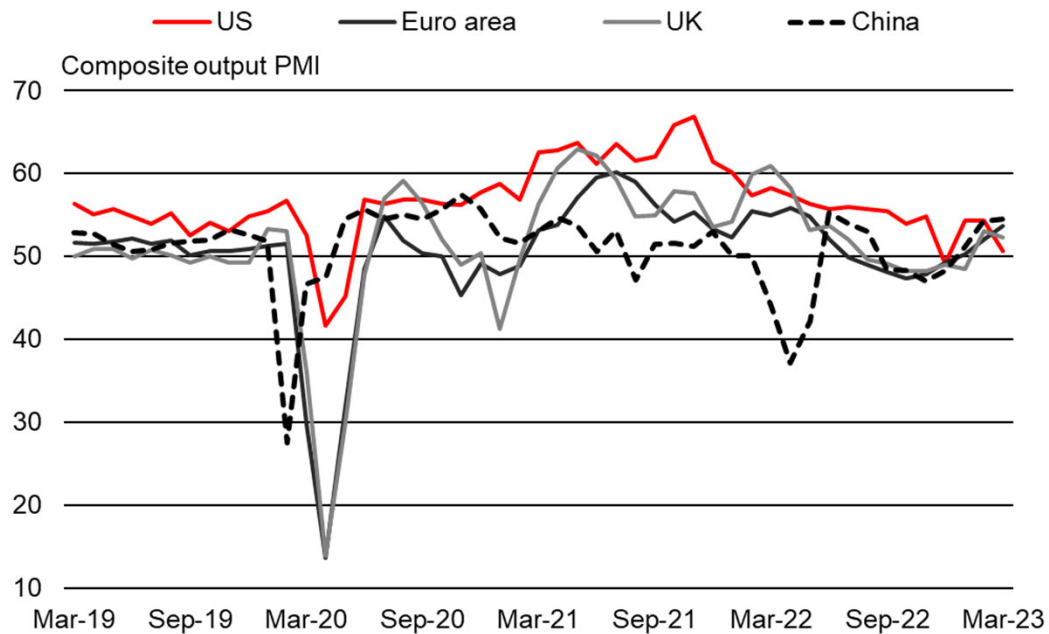
# Beware the monetary policy lags (US example)



Source: BEA, Bloomberg, St. Louis Fed, UniCredit Research



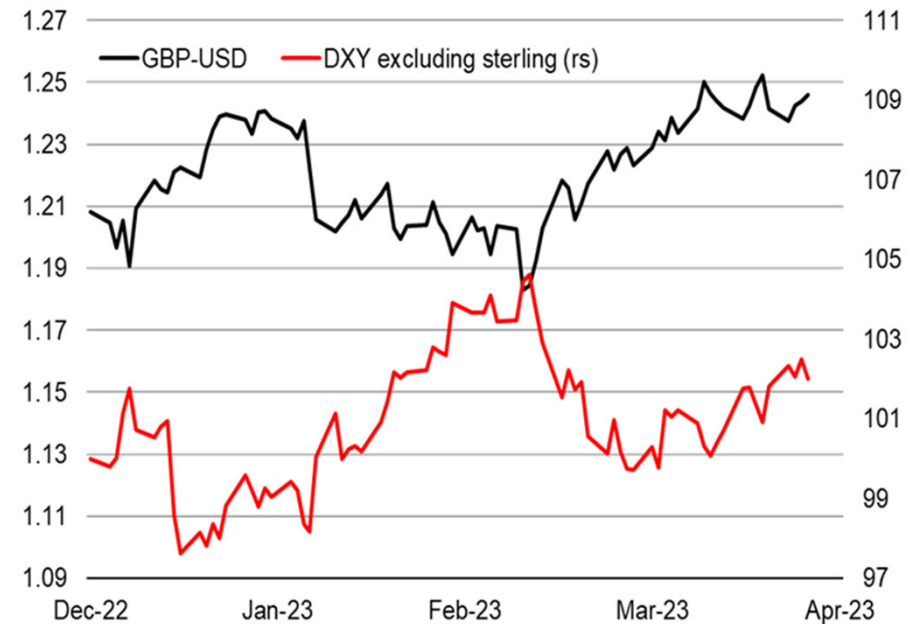
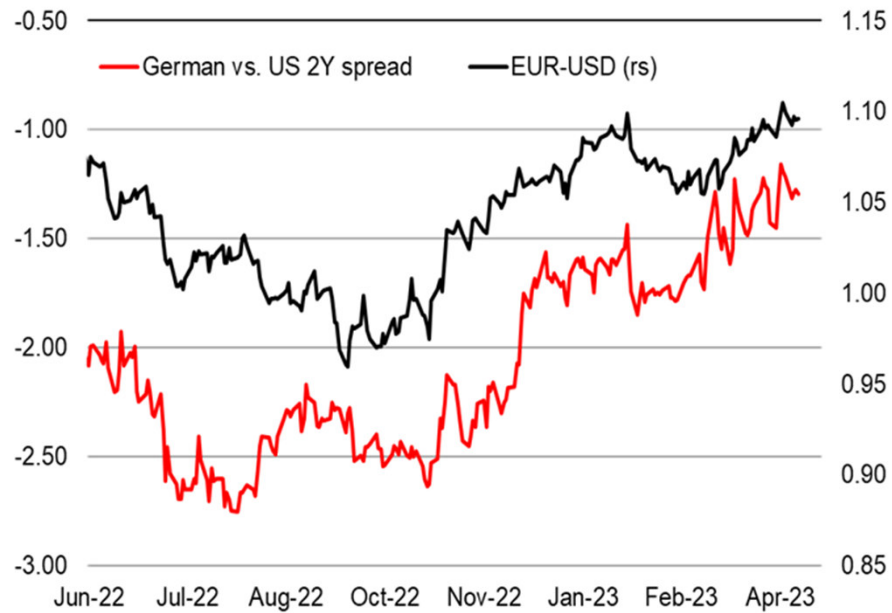
# Business surveys have picked up in Europe, weakened in the US



Source: S&P Global, European Commission, GfK, University of Michigan, UniCredit Research



## FX: Ahead, we see a higher EUR-USD, GBP-USD little changed



Source: Bloomberg, UniCredit Research





# Conclusions

- **Disinflation ahead**
  - All the reasons why inflation surged (higher commodities prices, supply-chain constraints, loose fiscal and monetary policy, tight labor markets, higher short-term inflation expectations, higher profit margins) either have already or are expected to **reverse**.
  - But, the process is **unlikely to be smooth**, core inflation will lag the fall in headline inflation (tight labor markets), and it's unclear what level inflation will settle at.
- **Mild technical recessions** in the UK and US and **stagnation** in the Eurozone, followed by a sluggish recovery.
- **Outlook more uncertain than usual**, with growth risks skewed to the **downside** including from **geopolitics, US debt ceiling negotiations, monetary policy overtightening**. Upside risk from China's reopening.



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