

# UK in Focus

## Economics United Kingdom

### Finding signals through the fog

- ◆ Labour market weakness continued at pace in April, but perhaps a tentative sign of improvement in May
- ◆ Retail sales demand has picked up, but is yet to see a translation into broader consumption
- ◆ Higher than expected inflation complicates both monetary and fiscal policy

#### Finding signals through the fog

It's been a period of conflicting economic data releases for the UK economy, in part a reflection of the data being for the months either side and including April, which saw a lot of volatility and could prove a key inflection point for the UK economy.

On the one hand, labour market indicators for April continued to show weakness in labour demand. PAYE employment fell 33k and, while that number will likely be revised, nearly every sector has reported a decline in vacancies since the start of the year (chart 1). Moreover, surveys pointed to a faster pace of headcount reductions and weaker demand for labour. And, although the labour market has been softening since 2022, the higher unit labour costs associated with a sharp rise in the national living wage and employer national insurance contributions hike provided further impetus. However, those factors came into effect in April and the PMI employment index was marginally improved in May, so labour market sentiment may, at least, be stabilising.

Despite weaker employment prospects, retail sales reported a fourth consecutive month of growth in April and a 5.0% rise y-o-y, its strongest pace of growth in three years. Some caution is needed in taking strong signals from retail sales as overall household consumption growth has struggled to find a footing amid continued rate pass through and cost of living increases. However, the upward trend in retail sales demand is in full swing (chart 2), forward-looking components of consumer confidence saw decent gains in May, and net household deposit growth has continued to slow to more historically normal rates.

#### Inflation surprises make for policy conundrum

A plethora of known price rises in April and some surprise underlying price growth saw headline inflation accelerate to 3.5% y-o-y. More concerning, services price inflation jumped to 5.4% y-o-y, higher than the BoE had forecast. Combined with still elevated wage growth, initial estimates from PAYE data point to wage growth of 6.4% y-o-y in April, which means greater uncertainty over the future path for rate cuts. Indeed, financial markets have pulled back expectations on rate cuts this year (chart 3). Longer-dated government bond yields have also continued to rise amid global uncertainty and a large risk premium associated with fiscal policy. That raises the risk of lower fiscal headroom in the autumn and a 'doom loop' for fiscal policy.

#### KEY UK DATA

▲ 0.7%

GDP growth in 3M to March

▲ 3.5%

Consumer Price Inflation, April y-o-y

▲ 4.5%

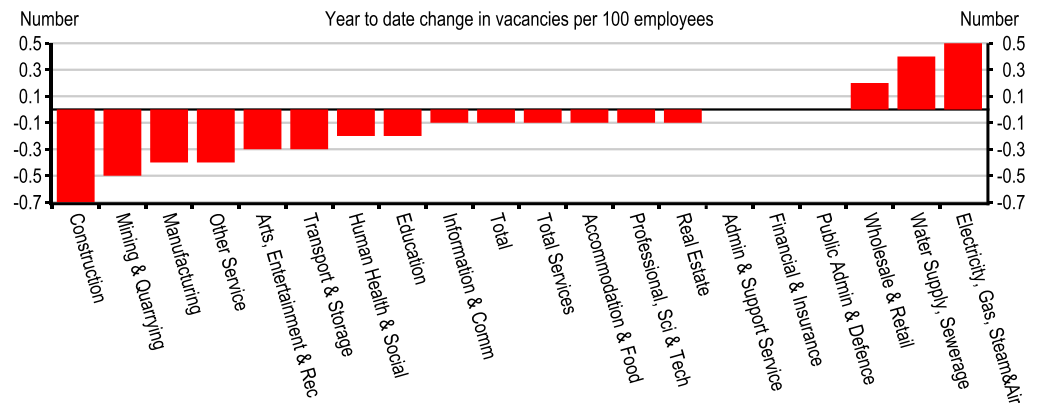
Unemployment rate, March

▼ 4.25%

Bank of England Base Rate

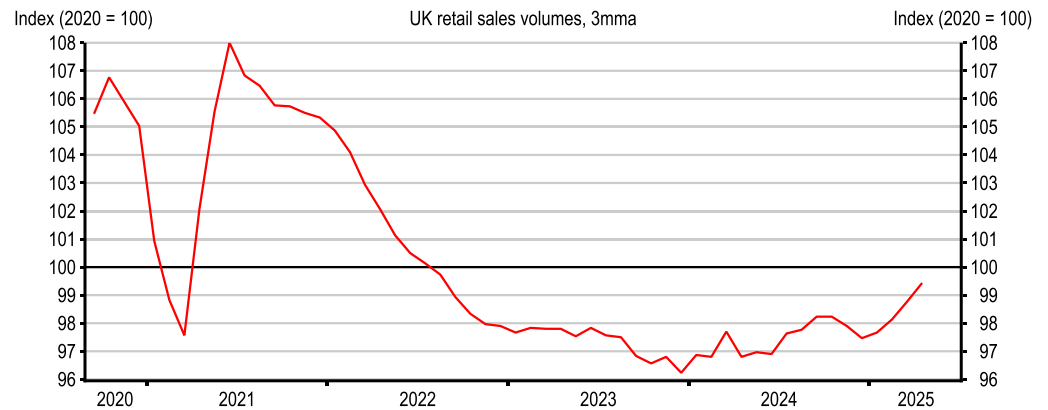
Source: HSBC

### 1. Vacancies per 100 employees have fallen across most sectors so far this year...



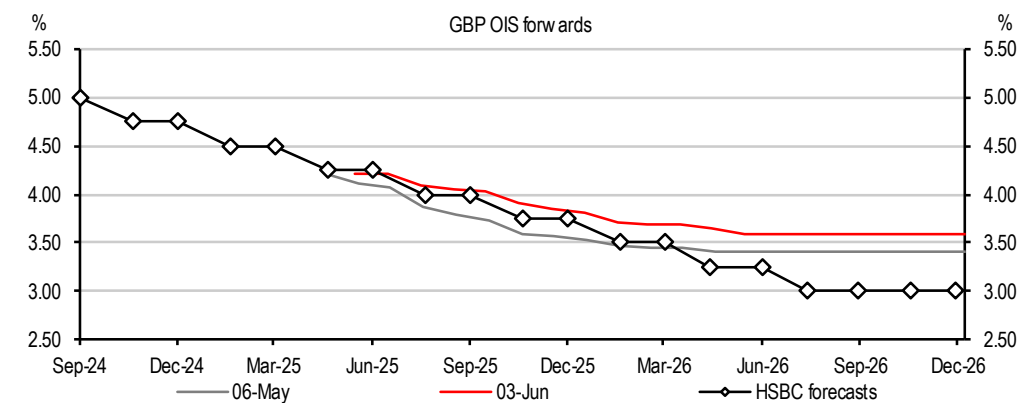
Source: Macrobond, ONS, HSBC

### 2. ...but retail sales volume growth has accelerated its recovery



Source: Macrobond, ONS, HSBC

### 3. Higher inflation saw markets re-evaluate their interest rate cut expectations



Source: Bloomberg, HSBC forecasts

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