The UK economy on a knife edge as we enter election year.

Vicky Pryce

Early January 2024, election year, and the news is dominated by air strikes in Yemen as maritime trade is being disrupted, the Post office scandal and HS2 costs continuing to rise. Meanwhile, even the good news about inflation is clouding over despite record drops in grocery price inflation, recruitment demand apparently slowing down and weak retail volumes in December and over Christmas according to the British Retail Consortiumi(BRC). It is true that in Europe, annual inflation moved up to 2.9% in December from 2.4% the previous month and in the US from 3.1% to 3.4%ii. The result has been a revision of views on when interest rates are likely to start coming down with many commentators now suggesting that it won't happen until much later in the year- possibly not until the last quarter of 2024.

But of course, very little of this inflation pick up has had much to do with excess demand which is what normally can be cured after a period of high interest rates. And yet, talk of not just keeping rates high but even possibly raising them seems to be returning. This despite the World Bank having just issued one of its most downbeat assessments of the global economy , lowering its forecast for growth in 2024 to just 2.7%, implying that this half- decade of the 2020s is threatening to be the weakest in terms of economic growth since the 1990s.The World Bank also estimates that by the end of this year, a large part of the world's population, particularly among developing nations, will be poorer than they were before the pandemiciii.

The inflation uptick was of course widely anticipated as energy subsidies are lowered or removed in many countries affecting the 'base' from which prices are calculated and hence raising inflation rates compared to their level 12 months earlier. One example is Germany right now where the withdrawal of diesel subsidies that were there a year ago is now leading to big protests by farmers and others. Another will quite likely be the UK when the January inflation figures are published given the fact that this is the month that the pre-announced the 5% hike in the electricity price cap for households is taking effect. Similarly in the US where on the positive side core inflation fell from 4% in November to 3.9% in December: the main reason for the headline inflation rise had much more to do with supply chain issues, higher energy and housing costs rather than excessive domestic activity. Inflation expectations among consumers are falling sharply.

Yes, the US economy seems more resilient than had originally been expected. Jobs data remain reasonably robust- as they are in the EU. But half of the rise in the US inflation was due to higher energy costs and housingiv. And it is once again international factors, such as the Eastern Mediterranean conflicts and hostilities in the Red Sea, which are disrupting global trade and pushing container prices up sharply in recent days which higher domestic interest rates can do little to solve. Even taking all this into account, ING analysts still expect inflation in the UK to fall to 1.6% in May. In their calculations, a likely fall again in household energy bills in April of some 15% will more than reverse the 5% January risev. The markets have taken it all to heart and gilt yields and mortgage rates are falling. Even the Bank of England Governor Andrew Bailey in his latest appearance in front of the

Treasury Select Committee[vi], though avoiding saying much on what monetary policy might do from here on, indicated that he hoped the mortgage rate decline would continue!

And a closer look at trends in the Eurozone reveals that despite the slight reversal of the downward trend in inflation in the bloc last month, Baltic countries like Latvia and Lithuania for example have seen the rate of annual price increases drop from over 20% a year ago to hover around 1% in December[vii].

How resilient the global economy proves to be, notwithstanding the World bank gloom, will be crucially important for the UK in an election year. The UK GDP data for November2023[viii] just out at least showed a reversal of the 0.3% GDP fall seen in October while the latest PMIs suggested a pick-up in services in the last couple of months of 2023. But this is not happening across all sectors – output in consumer facing industries is still more than 5% below pre pandemic levels. Retail sales fell in real terms according to the BRC in December with the hospitality industry looking particularly weak so far in January 2024. And the latest PMIs suggest that manufacturing and construction are still in contraction territory. The forecasts are at best suggesting flatlining or a small increase in GDP of certainly less than 1% for 2024. It will be a shame if the latest international trade upheavals make even these meek prospects less likely.

Vicky Pryce is a board member at CEBR, Visiting Professor at BCU and King’s College London and a former Joint Head of the UK Government Economic Service