Just Ahead of the November Budget, the Markets Have It…

Vicky Pryce

The latest UK data for GDP in September painted a sorry picture. Services activity dropped significantly and output across the economy suffered leading to an 0.6% drop in GDP and a drop of 0.2% in the third quarter . Yes, as we had all anticipated , an extra bank holiday for the Queen's funeral was always going to affect September figures . But what we are seeing is a worrying trend with manufacturing in the quarter down by 2.3%, with every sub-sector within it in falling, something not seen, as the ONS reminded us, for 40 years. Interestingly, in contrast, GDP grew by 0.2% in the Eurozone and the EU as a whole in the third quarter and there was positive activity was positive in all the larger countries in the EU such as France, Germany, Italy and Spain[i].

In normal times you would expect the negative impact of an extra bank holiday to be soon made up by increases in future months as it is just a postponement of activity , mostly made up for it later. But this does not seem to be happening at present. The latest PMIs for October show both manufacturing and services in decline. Consumer confidence, though stabilising, is near all time record lows. Similarly with business confidence as the CBI's extremely weak Q4 manufacturing sentiment indicator has shown[ii] . Confidence sank to lowest level since Q2 2020 and was the fourth successive quarterly fall. What is more businesses reported a worsening export environment and input costs remained an issue. And for the general population, general cost of living issues have if anything intensified .

So what does it mean for the future. When the Bank of England raised its rates by the highest percentage in 30 years, it also published a forecast which not only suggested a two year period of stagnation or recession . This was hardly surprising and will be reinforced if rates carry on rising and some sort of austerity is introduced by whatever measures are announced in the November 15 autumn statement.

But the worry is for later. The forecast also suggested a very anaemic recovery in the years afterwards with growth rates not returning to pre- pandemic, pre Brexit and certainly not pre-financial crisis levels[iii]. Why is that? Firms are now increasingly mentioning Brexit as having increased the costs of doing business and having worsened supply chains in the UK and leading to prices increasing faster than other countries in Europe. There is increasing concern that business investment has been negatively affected by Brexit and in a way that may have done irreparable damage to UK productivity and competitiveness[iv]. The withdrawal of hundred of thousands of workers from the UK labour market and the tightness of labour supply has partly reflected departing and not returning EU workers . Trade intensity has also been reduced which means lower exports (and imports) as a percentage of GDP. Lower trade intensity and reduction in relative trade openness normally signifies a fall in longer term productivity and growth. On fact Roula Khalef, the editor of the FT , talking to the BBC on Sunday , November 13, referred to Brexit as the elephant in the room when looking at the trends in the UK's economy[v].

Of course a weaker pound can partly compensate- and the near 20% reduction we have seen since the beginning of the year might help. However the drop also signifies that the markets have once again downgraded prospects for UK growth, almost a repeat of what we saw after the Brexit vote. And this could look even worse depending on the measures that will be outlined in the autumn statement on November 17. And as we know from the recent chaos in the capital markets following the Liz Truss era short lived 'mini budget', the markets are often right .

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[i] https://ec.europa.eu/eurostat/documents/2995521/15131967/2-31102022-BP-EN.pdf/090ecf01-ae9b-be08-0ae9-e23b1705e4bb#:~:text=In%20the%20third%20quarter%20of,office%20of%20the%20European%20Union.

[ii] https://tradingeconomics.com/united-kingdom/business-confidence

[iii] https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy-report/2022/november/monetary-policy-report-november-2022.pdf

[iv] Influences on investment by UK businesses: evidence from the Decision Maker Panel | Bank of England

[v] https://www.bbc.co.uk/iplayer/live/bbcone