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The year ahead: a balancing act of economic growth and inflation

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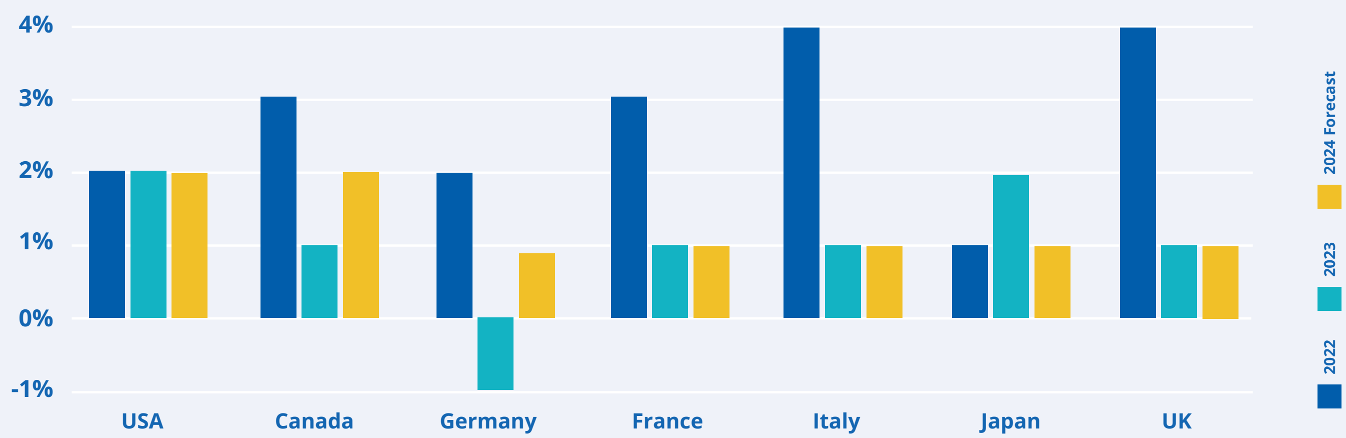
2023 round-up - a challenging year dominated by cost-of-living pressures

The economic landscape in the UK in 2023 was dominated by cost of living pressures for British households and businesses. The UK post-pandemic recovery was further slowed down by a new crisis - skyrocketing fuel and energy prices caused by the war in Ukraine.

The UK economy was on the brink of recessions for the best part of 2023 and is expected to finish the year with a modest growth of 0.5%. IMF predicts similarly subdued growth in 2024 of 0.7%, which will make the UK the worst performing G7 economy.

G7 Countries: Real GDP Growth



‘The UK economy was on the brink of recessions for the best part of 2023’

So why was the UK economy slow to recover?

There were a number of factors that exacerbated the economic downturn in the UK in 2022/2023. The high fuel prices spiralled into price increases in all three sectors of the economy - services, production, and construction and in October 2022 inflation rate peaked at 11.1%.

Despite economists expecting inflation to sharply fall in 2023 it remained at double-digit levels in Q1 2023. As the year advanced, inflation started to ease off but at a slower rate than expected. Core inflation (excluding energy, food, alcohol and tobacco) which is a crucial measure determining the BoE monetary policy remained particularly persistent until Q3 2023 and gave little respite to households facing high food and energy bills and erosion of real wages.

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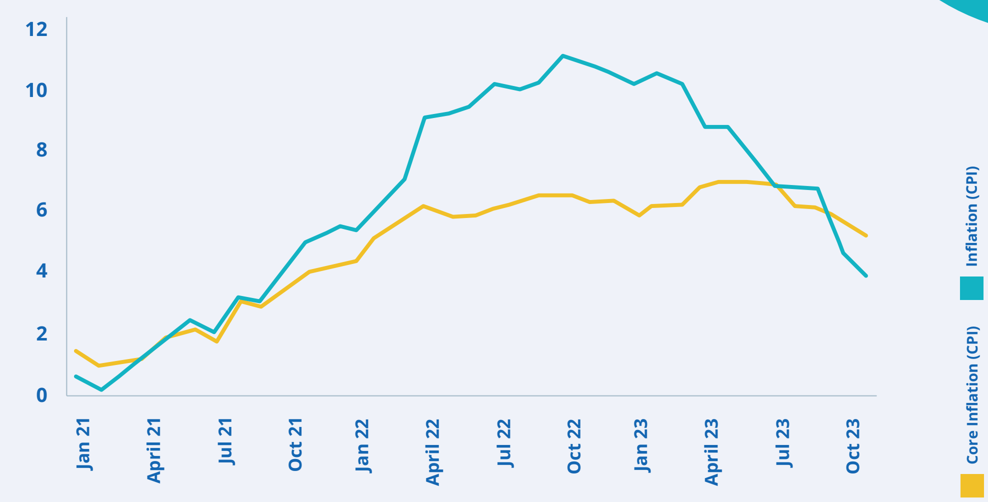
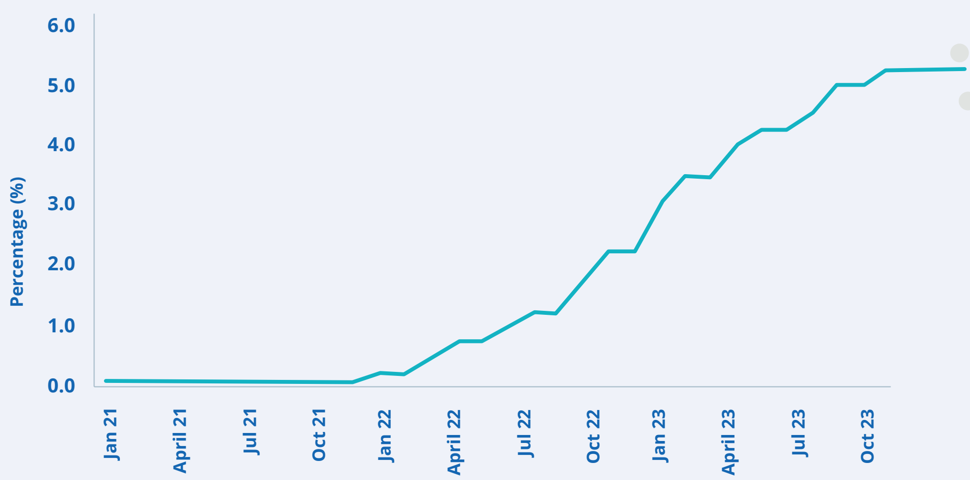
UK Inflation rate month-by-month



Bank of England Base Rate



To tackle this persistent inflation, the BoE undertook a course of a tight monetary policy eventually hiking the base interest rate to a 15-year high of 5.25%. This policy proved effective by halving inflation to 4.6% in October 2023, a downside being a sharp increase in mortgage rates, deepening the economic crisis for home owners and stalling the housing market and construction output.

In addition to a record-high inflation, the UK economy has been facing significant structural challenges for a number of years, and these are summarised by the OBR including: stagnant business investment and productivity – exacerbated by Brexit, the pandemic, the energy crisis, and rises in the post-tax cost of capital; and significant fall in the labour market participation – triggered by the pandemic and coupled with ageing population which has left the total labour force 520k people smaller compared to pre-pandemic levels.

Looking ahead to 2024 - what can we expect ?

The year ahead will be a balancing act of boosting economic growth whilst tackling persistent inflation.

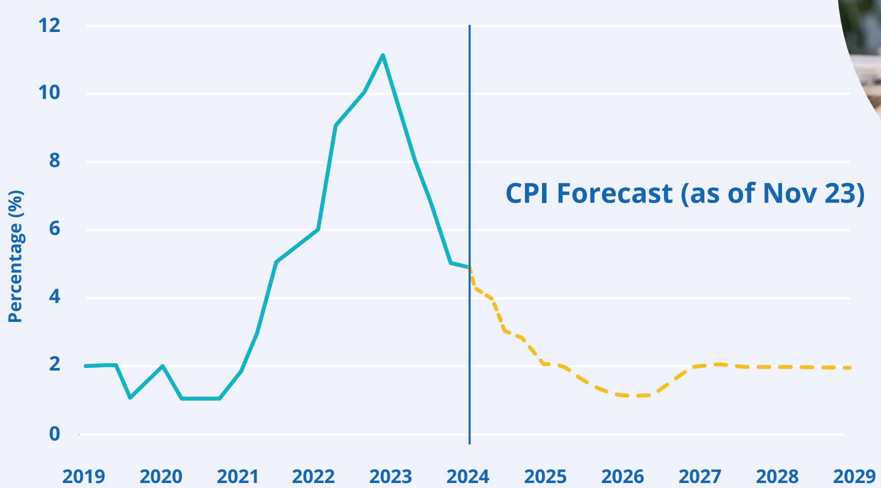
According to the OBR, Inflation is expected to gradually subside although it would not return to its 2% target until the first half of 2025. Markets expect that interest rates will need to remain higher for longer to bring domestically fueled inflation under control, so the cost of borrowing will remain high throughout 2024.

The OBR forecast the largest reduction in living standards since records began in the 1950s, as measured by real household disposable income (RHDI) per person. RHDI is forecasted to drop by 3.5% by 2024-25 compared to its pre-pandemic level and to recover to that level as late as 2027-28, as resilient labour incomes begin to steadily outmatch slowing inflation.

The UK government has already signalled in the Autumn Statement the intention to encourage growth and productivity by reduction of taxes for consumers and businesses. The government also put forward welfare reform plans to support more people currently inactive to return to work by outlining a stricter approach to benefits and jobseeker allowance.

On this path to recovery, there needs to be careful consideration to managing the inflationary pressures which will continue to squeeze households' disposable incomes in 2024. Targeted support measures to protect the most vulnerable should continue to be in place to ensure robust recovery while safeguarding long-term economic stability.

CPI Inflation



The economic outlook in 2024 will remain challenging for many and it is important that people continue to be savvy about their finances. If consumers experience hardship and struggle to manage their financial commitments they should engage with their creditors as early as possible as there would be options to resolve their situation. Creditors in their turn, should continue to support their customers by offering forbearance and breathing space where appropriate and remain engaged in their customers' journey in a supportive way.

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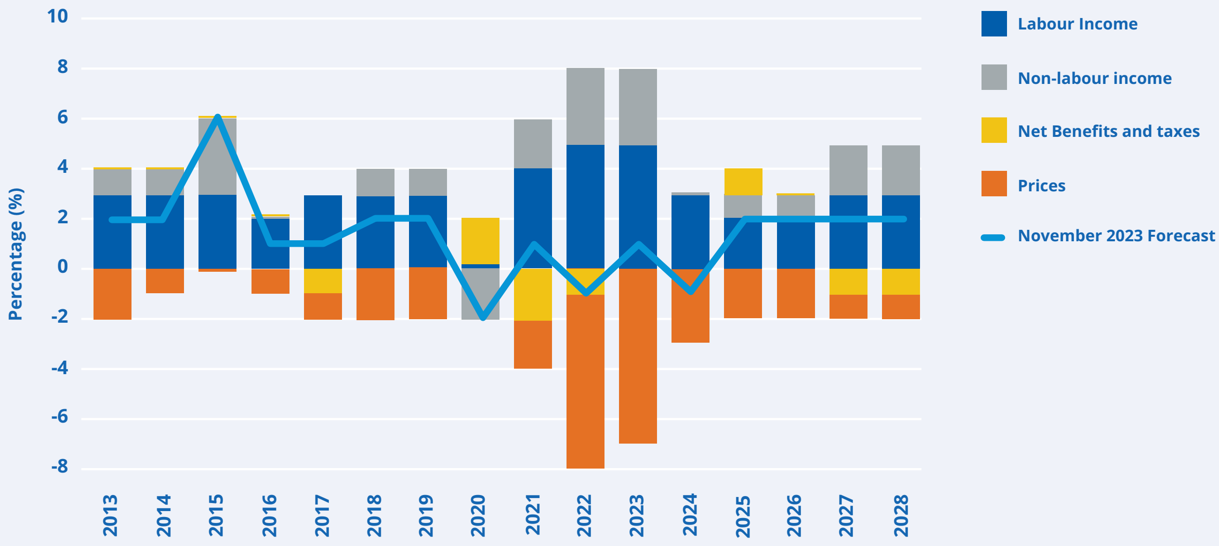
Real Disposable Household Income



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