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MACRO NEWS 12/12/16

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# UK MACRO UPDATE: SUMMARY OF THE DATA FOR THE WEEK AHEAD-

## Berenberg Macro Flash

**A key week ahead:** Data on inflation, the labour market and retail sales, in addition to the release of the minutes from the BoE's December meeting will be published over the next few days. We provide a brief overview on what to look out for.

**Inflation (Tuesday) – 9:30am GMT – higher inflation on the horizon**

- After a surprise drop to 0.9% in October (1.0% in September) we expect inflation to have continued its upward trend in November (1.1%) - this would mark the highest rate since October 2014.
- The main sources of inflationary pressure in the coming months will be import costs, which have risen sharply over the course of 2016 – Chart 1. After declining for almost three years on sterling strength, import costs are currently rising by around 6% yoy following a c15% yoy depreciation in trade-weighted sterling. Energy prices will also begin to add to inflationary pressure after being a deflationary force for almost two years. On a sterling basis oil prices are currently up c50% yoy.
- We expect inflation to peak 2.8% in Q3 2017 before gradually declining towards the BoE's 2% inflation target thereafter as the FX effects begin to wash-out.
- Unless nominal wage growth surprises on the upside in 2017 (30% chance), rising inflation could cause real wages to decline for the first time since 2014. This will act like a modest drag on consumption growth in 2017 and 2018.
- If GDP growth surprises on the upside in the coming quarters, the BoE will reduce its estimate of the output gap and raise its estimate for inflation – possibly above the 2% target - after the sterling effects have passed. There is a small but not insignificant chance the BoE hikes in 2017 – see section MPC minutes summary (below).
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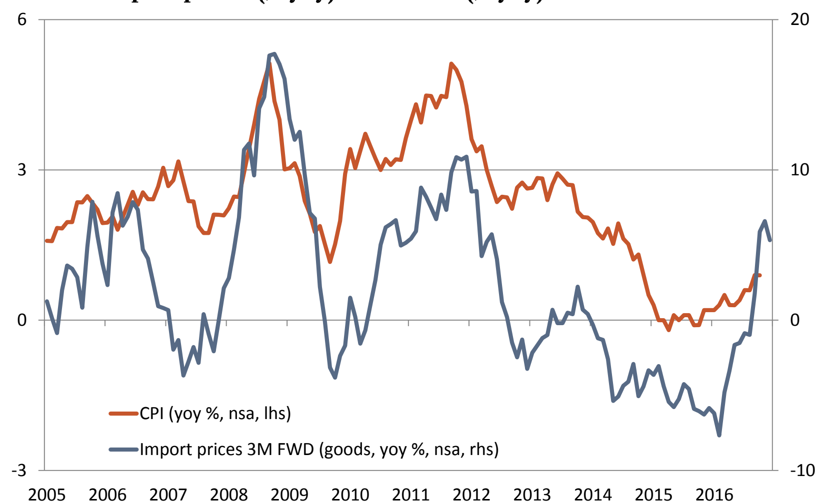
**Chart 1: Import prices (% yoy) versus CPI (% yoy)**

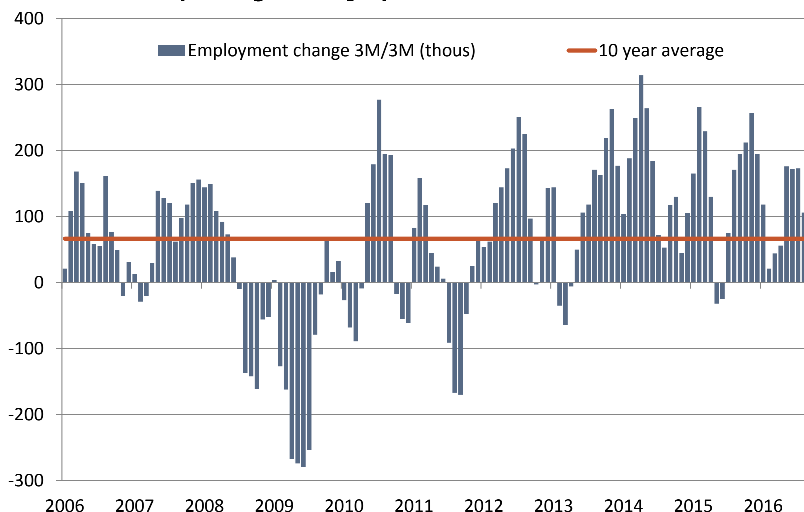



*Source: ONS, Berenberg calculations*

**Labour market (Wednesday) – 9:30am GMT – no signs of Brexit uncertainty yet**

- The labour market has outperformed expectations since the Brexit vote. Most notably, the strong rate of job gains pre-referendum have been sustained, vacancies have remained high, and the unemployment rate has fallen to an eleven year low of 4.8%.
- Even without Brexit, with the labour market approaching - or even at - full employment, the rate of job gains should begin to slow soon anyway. While the uncertainty from the Brexit vote has had little effect on the labour market so far, along with planned rises in minimum wages, it will remain a persistent downside risk to labour demand for the medium term.
- Remember, the labour market data release includes data for two months. In the main bulk of data, for October, we expect a continued modest pace of job gains (c50k) – Chart 2, unemployment to remain at 4.8% and wages ex. bonus to accelerate a little above the previous months rate of 2.4% yoy.
- The data for November includes the claimant count rate, the jobless claims change, and critically, data on the number of vacancies. We don't expect much action in the first two data but we are paying close attention to the vacancies data. The number of vacancies signals firms' demand for labour. Since the vote it has remained at close to record levels (c750,000). Changes in this indicator should signal likely changes in employment and unemployment.
- Overall, we expect the labour market to remain strong going forward, with the Brexit uncertainty and planned hikes in the minimum wage causing unemployment to rise only a little to 5.3% by 2018.
- The level of employment and the performance of wages are driven by demand for, and the revenues generated by, the goods and services labour produces. If the economy performs better than expected in the coming years then employment could be higher, and wage gains stronger, than expected, and vice versa. At present, we see risks to the outlook for growth of 1.5% in 2017 and 2018 as roughly balanced.

**Chart 2: Monthly change in employment**




*Source: ONS, Berenberg calculations*

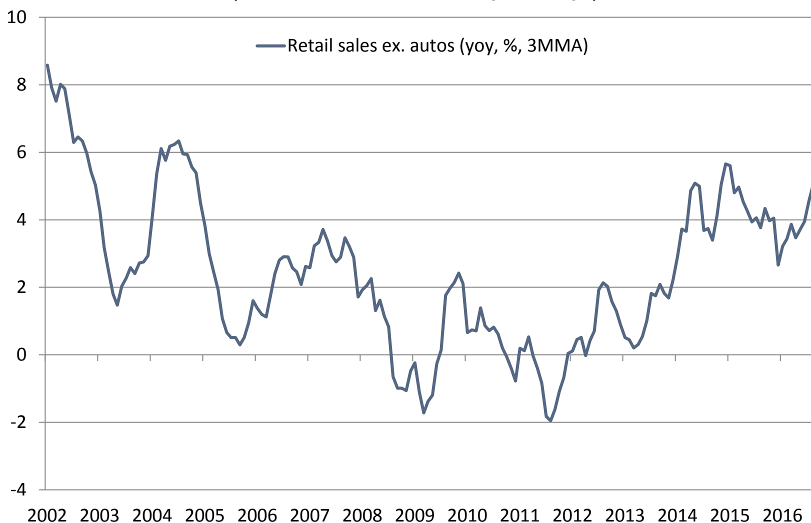
**MPC minutes (Thursday) – 12:00pm GMT – nothing much to see here**

- The final meeting of the year for the Monetary Policy Committee is likely to be a fairly unexciting affair. Since the Brexit vote, the MPC has been paying close attention to the Brexit-related downside risks to growth and any signals of the forthcoming rise in inflation. But for now at least, growth is stable at around trend and inflation remains subdued. There isn't much for the MPC to grip onto just yet.
- Two things are worth looking out for: (1) The MPC's prediction for the rate of growth in Q4, probably 0.4% qoq (maybe 0.5%), and (2) the MPC's assessment of risks from the recent sharp rise in inflation expectations.
- For 2017 and 2018: we expect no change to the BoE's current policy stance. However, if growth continues to beat expectations, with inflation expected to be above 2%, the BoE could shift from its current neutral stance to a more hawkish stance. There is a notable chance the BoE begins a tightening cycle in 2017 or 2018.

**Retail sales (Thursday) – 9:30am GMT – strong chance of downside surprise**

- We think there is a high chance that retail sales for November surprise on the downside despite market expectations for flat mom. Retail sales rose by 2.0% mom in October, strongly above expectations. They have not declined on a monthly basis for five months, marking a relatively long streak of unbroken monthly gains. Critically therefore, if retail sales do come in weak, it would not be a cause for concern but instead a due correction after a strong run.
- Why pay attention to retail sales? While they make up less that 20% of GDP, they are a timely measure of household demand. Households are the main growth engine in the UK economy. Two-thirds of GDP is consumption.
- While consumption will likely slow next year as inflation begins to rise, we expect a continued expansion in broad household spending. Households are well placed to ride out a period of turbulence. Fundamentals have remained strong after the Brexit vote; employment at a record high, nominal wages increasing, house prices rising and consumer credit growth at a decade high.

**Chart 3: Retail sales (yoy, %, 3 month moving average)**




*Source: ONS, Berenberg calculations*

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