UNITED KINGDOM
2023-2024 SCENARIO

MONETARY TIGHTENING WEIGHS ON THE OUTLOOK

October 2023

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

A SECOND HALF OF THE YEAR THAT IS LOSING MOMENTUM

The economy is weakening under the weight of monetary tightening.

In Q223, activity grew 0.2% QoQ,slightly better than expected by the consensus and the Bank of England (BoE), which were expecting zero growth and 0.1% QoQ respectively (our forecast was 0.3% QoQ). The details showed that domestic demand was still strong overall given the extent of the past rise in interest rates (515 basis points since the start of tightening in December 2021) and the significant rebound in corporate bankruptcies (to their highest level since 2009).

However, since the end of the summer, the short-term outlook has darkened. The composite PMI was in contraction territory in October for the third consecutive month (at 48.6 on average, versus 52.5 in the period from May to July). The weakness is due to a setback in demand in the service sector, which has been resilient until now, and a continued contraction in activity in industry. Companies are complaining of rising energy bills (rebound in fuel prices), high wage costs, and rising rates that are weighing on demand. In terms of hard activity data available for the third quarter, real GDP contracted by 0.6% in July MoM before rebounding by 0.2% in August, laying the foundations for a slightly negative growth for the third quarter (carry-over effect of -0.1 percentage point).

The labour market continues to ease.

The slowdown in activity is impacting the labour market, where a decline in employment over the last three months is accompanied by a rapid rise in the unemployment rate (to 4.3% over the three months at end-July versus 3.8% over the three months at end-April). Inactive people have been returning to the labour market: the vast majority are people who have been forced to stay at home for family reasons and, to a lesser extent, students and pensioners. On the other hand, the high proportion of those with long-term illness (nearly 30% of the inactive) explains why the participation rate, at 63.5% in July, remains around one percentage point below its pre-Covid level. The normalisation of the activity rate is therefore likely to remain incomplete. Meanwhile, nominal wages have continued to grow strongly (at 8% in the private sector over the last three months at end-August), but leading indicators suggest that the peak in growth should now be reached. However, any future moderation seems uncertain as long as tensions remain.

Our scenario now assumes a mild recession in the second half of the year.

This should be driven by a slowdown in household consumption and investment, with a drop in residential investment in particular, but also by weakening external demand. However, we expect only a very slight decline in activity, by 0.2% and 0.1% QoQ in Q323 and Q423 respectively, which would leave growth on a year-on-year basis still slightly positive, albeit down (to 0.2% YoY in Q423 versus 0.6% YoY in Q223).

Household consumption could, in fact, slow down without collapsing: households will benefit from real income growth that has finally returned to positive territory and significant excess savings accumulated during the pandemic. In this respect, the savings rate still exceeds its pre-Covid level (9.1% in Q223, compared with 6% in the Q419). On the other hand, the deterioration in the growth outlook leads us to revise up our forecasts for the unemployment rate, which would now reach 4.7% by the end of the year, above the long-term equilibrium unemployment rate, which would be consistent with an increase in spare capacity in the economy. Finally, uncertainty, rising interest rates and *Brexit* will remain powerful obstacles to investment, while exports, already down sharply for three quarters, are expected to continue to contract amid an expected slowdown in the United States and the eurozone.

SUMMARY

MONETARY POLICY: THE BOE IS LIKELY TO KEEP RATES UNCHANGED IN THE SHORT TERM

The BoE has stalled since our last scenario in July.

After a surprise rise in Bank rate of 50 basis points in June, the pace of tightening slowed to 25 basis points in August, before being put on hold unexpectedly in September. These decisions were largely driven by the flow of "overnight" economic data, particularly inflation data. After several consecutive months of upside surprises, core inflation came out well below expectations in September (-0.4 percentage points under BoE forecasts), which tipped the balance in the Monetary Policy Committee (MPC) in favour of the *status quo*. However, the MPC was highly divided: five members voted for the *status quo*, while four would have preferred an additional 25 basis points rate hike. The majority have become more attentive to the real activity data, which is a significant change in the MPC's communication. The minutes highlighted the weakening of the real estate sector and, more generally, in business surveys.

Less upside risk around inflation

The forward guidance in the September minutes maintained a hawkish bias: "further rate hikes would be required if there were signs of persistent inflationary pressures". The BoE considered that there was still an upside risk to its inflation forecast, but that it has declined since May. In particular, household consumption indicators held up well, and real incomes started to grow again. The labour market is still tight, and wage growth has remained stronger than expected. Core inflation could therefore continue to offer unpleasant surprises. Another rate hike is therefore not ruled out, but its probability has diminished.

Inflation versus activity: a finely balanced trade-off

In September, the decision to put monetary tightening on hold was the result of a "finely balanced" trade-off: a balance between the risk of not doing enough, when inflationary pressures could continue to persist, and the risk of not sufficiently taking into account the fact that past monetary tightening has not yet had all its effects on activity and inflation. This suggests a reaction function that is probably more sensitive to signs of economic weakness than previously thought.

Rates are expected to remain unchanged in November

The MPC is expected to keep rates unchanged at 5.25% at its November monetary policy meeting for the second month in a row. Leading activity indicators have deteriorated, and the labour market has eased slightly. The inflation rate in services did not surprise on the upside in September. This should lead a majority of the MPC to vote for the *status quo*, but probably not unanimously.

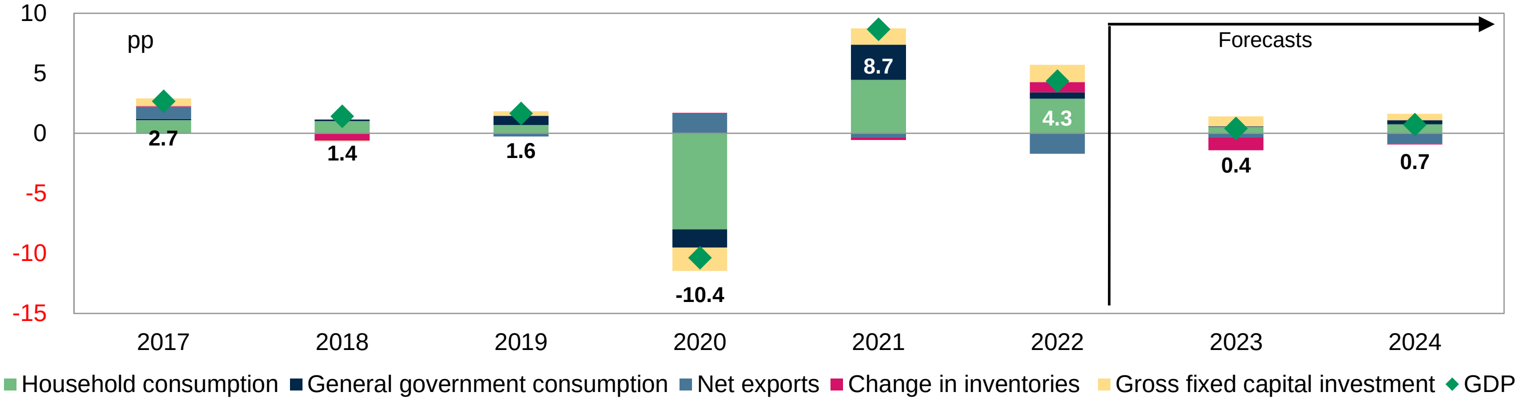
Scenario:* status quo *on short-term rates

Our central scenario is consistent with keeping rates unchanged in the coming months. Indeed, it expects a slight recession, as described above, and a rapid fall in the CPI inflation rate, to 4.5% in December 2023 and to 2.5% at the end of 2024 (5.6% and 2.8% respectively for the underlying CPI). In addition, **our scenario argues in favour of a rate cut earlier than expected three months ago**: we are moving forward the first rate cut to Q224 (versus Q324 in the previous scenario).

SUMMARY

FORECAST

Contributions to annual GDP growth



Sources: ONS, Crédit Agricole SA / ECO

United Kingdom	2022	2023	2024	2022				2023				2024			
				Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP (%)	4.3	0.4	0.7	0.5	0.1	-0.1	0.1	0.3	0.2	-0.2	-0.1	0.3	0.3	0.4	0.4
household consumption	4.9	0.9	1.3	0.7	0.3	-0.9	-0.1	0.7	0.5	0.3	0.3	0.3	0.3	0.3	0.3
public consumption	2.5	0.3	1.6	0.8	-2.0	0.7	-0.7	-1.2	2.5	0.4	0.4	0.2	0.2	0.2	0.2
investment	7.9	4.5	2.7	5.7	0.1	1.2	0.0	2.5	0.8	1.0	0.5	0.5	0.5	1.0	1.0
change in inventories*	0.9	-1.1	-0.1	1.4	-0.2	-2.0	1.0	-0.6	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
net exports*	-1.7	-0.4	-0.9	-5.3	1.0	4.5	-0.1	-1.6	-1.0	-0.6	-0.5	0.0	0.0	0.0	0.0
Unemployment rate (ILO)	3.7	4.3	4.5	3.8	3.6	3.7	3.7	3.8	4.3	4.5	4.7	4.7	4.6	4.5	4.4
Inflation (CPI, YoY%)	9.1	7.4	3.1	6.2	9.2	10.0	10.7	10.2	8.4	6.7	4.6	4.3	3.0	2.8	2.5
Core CPI (YoY%)	5.9	6.3	3.7	5.1	6.0	6.3	6.4	6.1	6.9	6.4	5.7	5.3	3.7	3.1	2.8
Current account (% GDP)	-3.1	-3.9	-4.5	-7.7	-4.0	-1.6	0.6	-2.3	-3.7	-	-	-	-	-	-
General gov. balance, % GDP	-5.4	-4.5	-3.0	-	-	-	-	-	-	-	-	-	-	-	-
Public debt % GDP	101.0	97.2	96.7	-	-	-	-	-	-	-	-	-	-	-	-
Bank rate**	3.5	5.25	4.50	0.75	1.25	2.25	3.50	4.25	5.00	5.25	5.25	5.25	5.00	4.75	4.50

** Contributions to GDP growth*

*** End of period*

Source: ONS, BoE, Crédit Agricole S.A.

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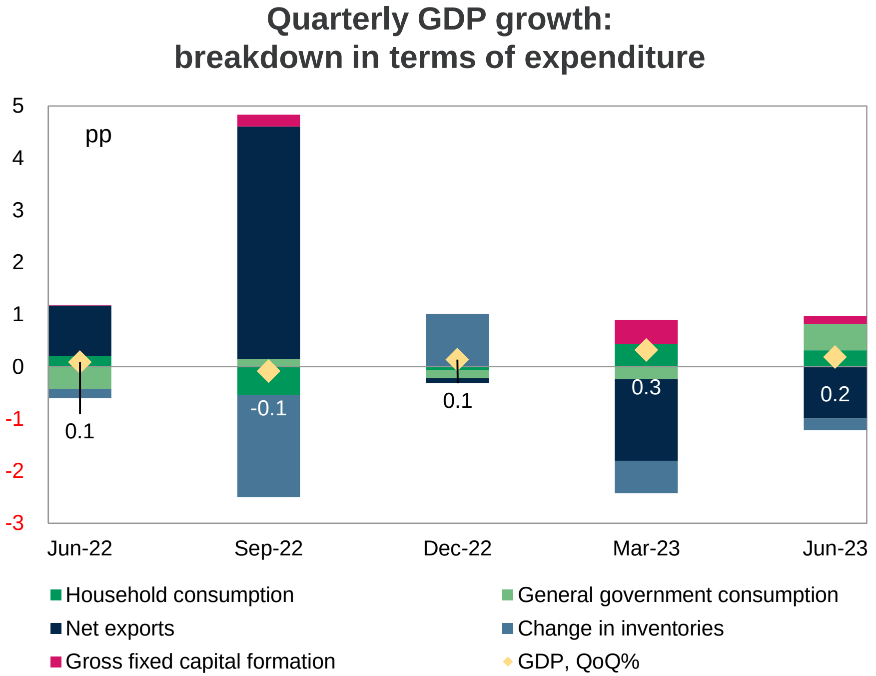
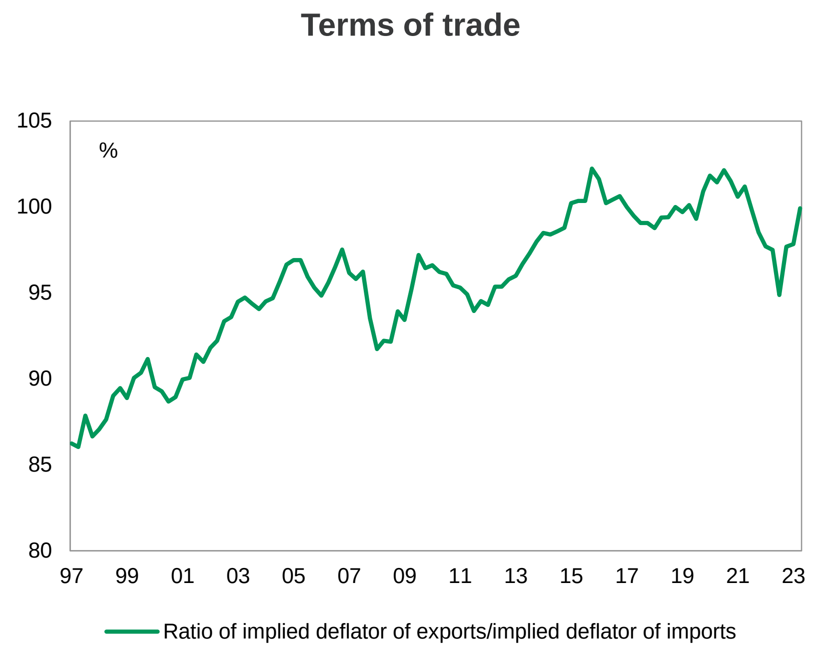
RECENT ECONOMIC DEVELOPMENTS

GROWTH ACCELERATED IN THE FIRST HALF



Sources: ONS, Crédit Agricole SA / ECO



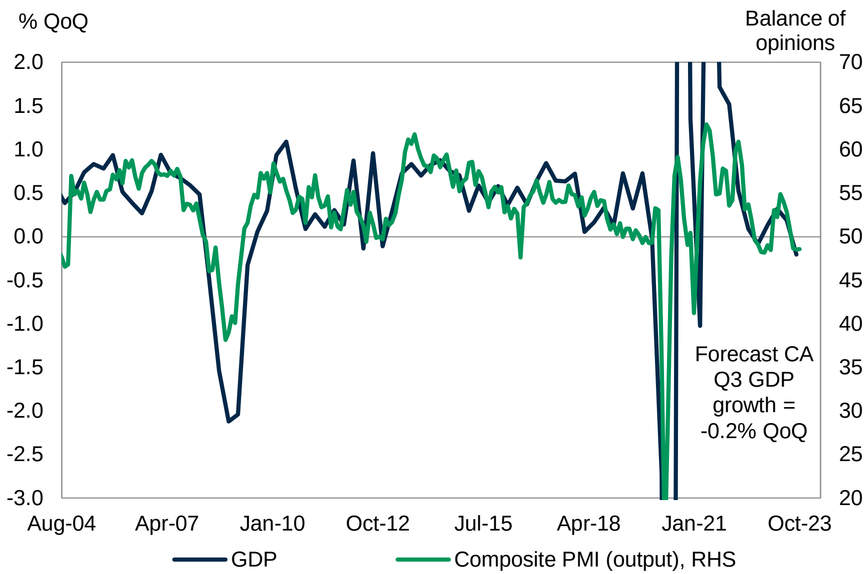
Sources: ONS, Crédit Agricole SA / ECO

GDP grew by 0.5% in H123, a resilience that can be explained by the improvement in terms of trade since Q422. Growth in domestic demand accelerated, first and foremost household consumption (up 0.6% QoQ on average in Q123 and Q223, after 0% QoQ on average per quarter in 2022). **Households benefited from a rebound in their real disposable income (+1.2% QoQ in Q223, +2.9% YoY)** thanks to sustained growth in wages (8% in the private sector, 6.8% in the public sector), social aid and falling energy prices. This enabled them to both consume more and increase their savings rate (to 9.1% in Q223, higher than pre-Covid levels). Private consumption, however, remains 1% below its pre-Covid level.

Another component that surprised positively was business investment (+4% QoQ in Q123, +4.1% QoQ in Q223). It was supported by the progress of investment projects ahead of the expiry of the "*super deduction allowance*" (replaced by another less generous scheme). Effective between 1 April 2021 and 31 March 2023, this measure allowed companies to deduct their tax bill up to 25p for each pound invested in eligible assets. In addition, investment growth remained relatively strong in Q2 thanks to an increase in investment in transport equipment, particularly aircraft (increase in imports from the US), while investment in IT equipment fell. Finally, exports declined in H123, and foreign trade weighed on growth over the past three quarters.

PMI SURVEYS: WEAK BUSINESS CLIMATE, DECLINE IN EMPLOYMENT, DISINFLATION

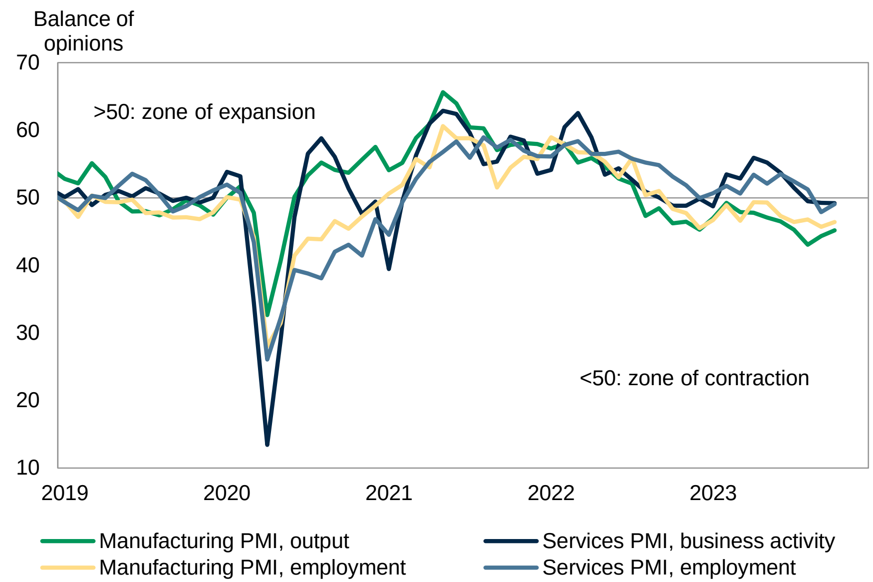
PMIs suggest a decline in activity in the third quarter



Sources: ONS, S&P Global PMI /CIPS data at end-October, CA SA / ECO

After holding up well in H123, given the available data, activity is expected to fall back slightly in Q323. Real GDP contracted by 0.6% MoM in July before rebounding by 0.2% MoM in August, laying the foundations for a slightly negative growth in Q323 (carry-over effect of -0.1 percentage point). **Going ahead, PMI surveys in the private sector suggest weaker short-term outlook due to the impact of monetary policy on demand.** They were in contraction territory in September and October in each of the three major sectors (services, industry and construction). The composite PMI was below 50 for the third consecutive month in October (at 48.6 on average). The pace of GDP contraction suggested by the PMI surveys is still modest, -0.1% for Q323, but companies are more pessimistic about the outlook in the coming months. While industrial activity has been falling steadily since mid-2022, in services too the outlook has darkened. Services activity has contracted slightly over the past three months and employment has fallen over the past two months. **On a more positive note, input inflation slowed for the third month in a row in October**, hitting its lowest level since January 2021 thanks to declining manufacturing production costs and moderating cost pressures in services. Conversely, output prices accelerated in October for the third consecutive month, at the highest rate since July. This is due to an acceleration in prices in services.

Services plunged into contraction zone & employment declined for 2nd consecutive month in October

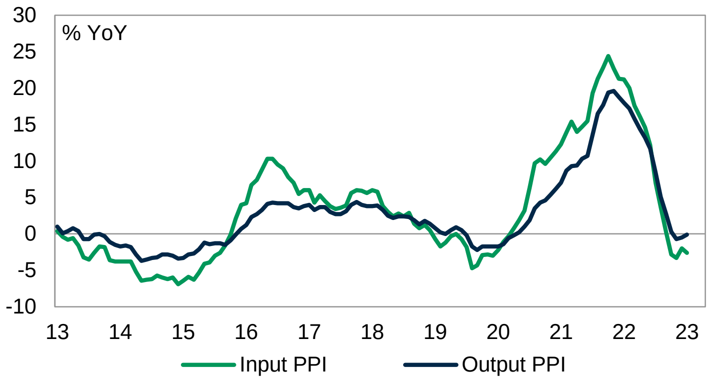


Sources: S&P Global PMI/CIPS, Crédit Agricole SA/ECO

RECENT ECONOMIC DEVELOPMENTS

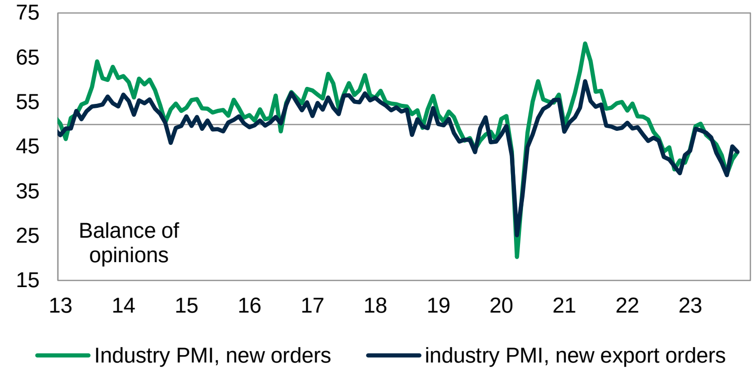
DECLINE IN INFLATIONARY PRESSURES UPSTREAM, PRESERVATION OF MARGINS

Producer prices



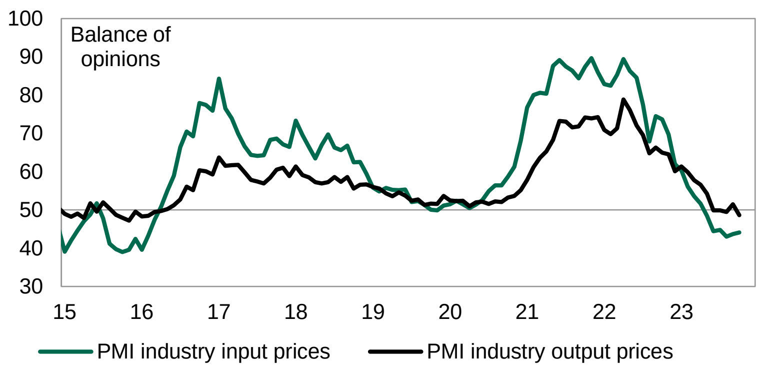
Sources: ONS, Crédit Agricole SA / ECO

Domestic and foreign demand down in industry



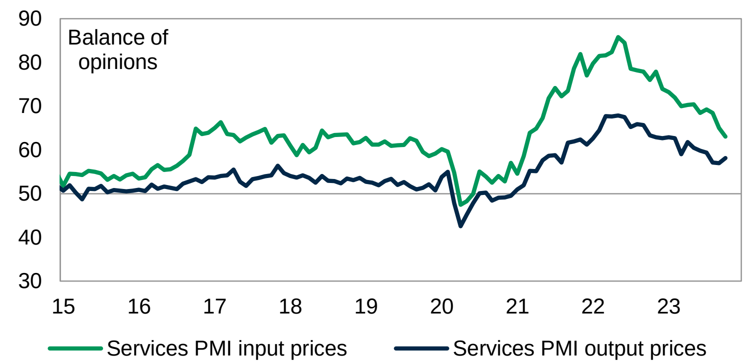
Sources: S&P Global PMI / CIPS - Industry PMI at end-October, Crédit Agricole SA / ECO

Cost deflation in industry, stabilisation of output prices



Sources: S&P Global PMI / CIPS - Industry PMI at end-October, Crédit Agricole SA / ECO

Disinflation of costs in services, rebound in output prices

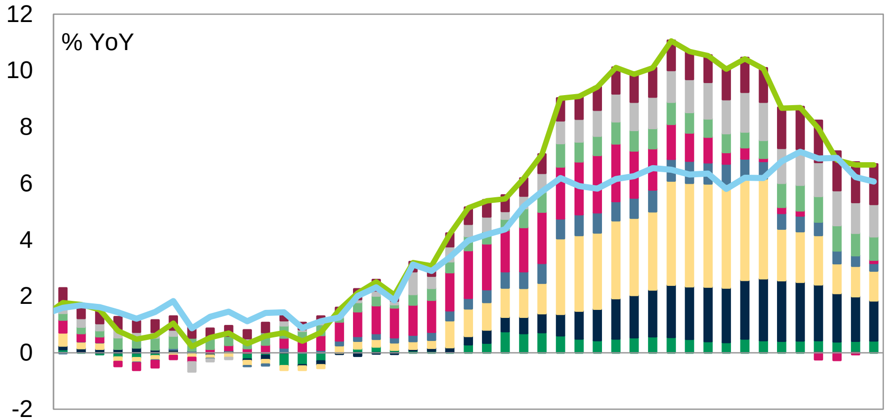


Sources: S&P Global PMI / CIPS – PMI services at end-October, Crédit Agricole SA / ECO

RECENT ECONOMIC DEVELOPMENTS

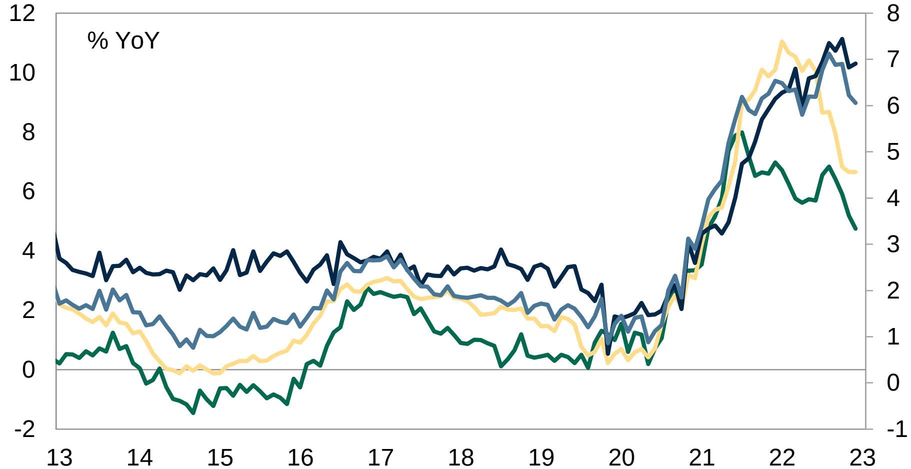
AN INFLATION RATE THAT IS STILL RISING IN SERVICES

CPI inflation and contributions by main components



Sources: ONS data at end-September, Crédit Agricole SA/ECO calculations

The rigidity of inflation in services supports core inflation



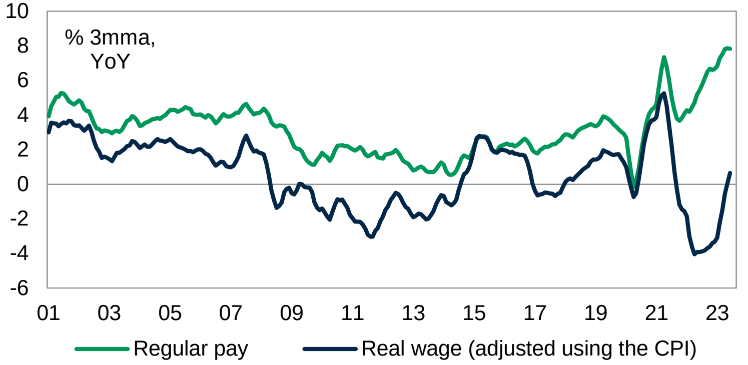
Sources: data at end-September from the ONS, Crédit Agricole SA / ECO

The CPI inflation rate disappointed expectations of a fall in September. It was stable at 6.7% YoY compared to August, while core inflation, as measured by the CPI excluding energy, food, alcohol and tobacco, fell, but less than expected, to 6.1% YoY after 6.2% YoY in August. **The surprise came from inflation in services, which rose slightly to 6.9% YoY from 6.8% YoY in August**, while remaining below its July peak of 7.4% YoY. This is due to an acceleration in prices in recreation and culture services, which rose by 8.1% YoY, while inflation in housing services stabilised at 6.3% YoY (close to its peak of 6.4% YoY in July) and that of travel and transport services fell to 8.3% YoY (compared with a peak of 10.6% YoY also in July). After two months of negative contribution, energy prices (-0.2% YoY in September, after -3.2% YoY in August) once again contributed positively to the inflation rate due to the rebound in oil prices. **On the other hand, the inflation rate of industrial goods excluding energy remained on a downward trend for the fourth consecutive month**. It stood at 4.7% YoY after 5.2% YoY in August and compared with 6.8% YoY in May. Disinflation also continued in food for the fifth consecutive month. The pace of food and non-alcoholic beverage inflation fell to 12.1% YoY from 13.6% YoY in August and a peak of 19.1% YoY in March. Conversely, alcohol and tobacco prices have accelerated to 11.2% YoY, a record pace since the start of the series in 1997.

RECENT ECONOMIC DEVELOPMENTS

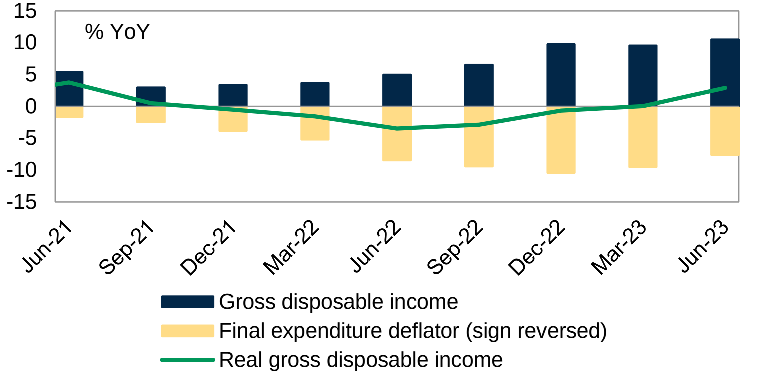
CONSUMERS ARE FEELING GLOOMY DESPITE A RECOVERY IN PURCHASING POWER

Nominal wages and real wages: the end of the great squeeze



Sources: ONS, data as of end of September

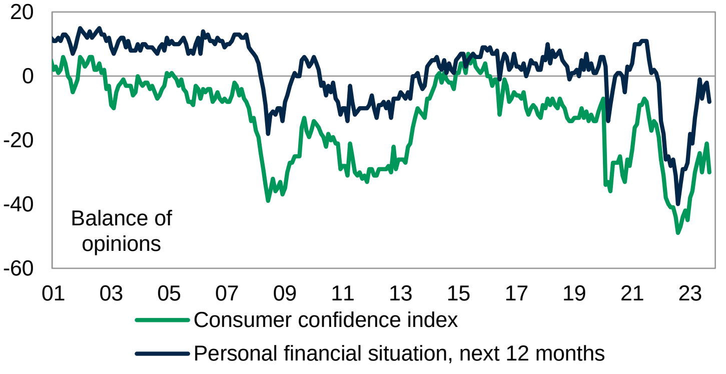
Purchasing power: strong rebound in real disposable income in Q223



Sources: ONS, Crédit Agricole SA/ ECO

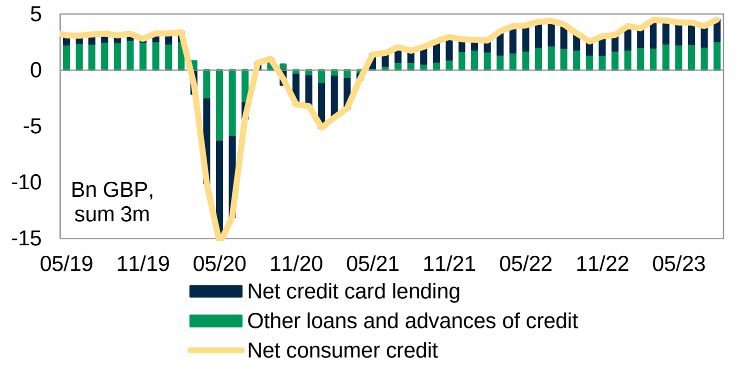
*Gross disposable income deflated by the deflator of consumer spending

Consumer confidence: morale is not in good shape



Sources: GfK, Crédit Agricole SA/ECO

Consumer credit: going up despite high rates

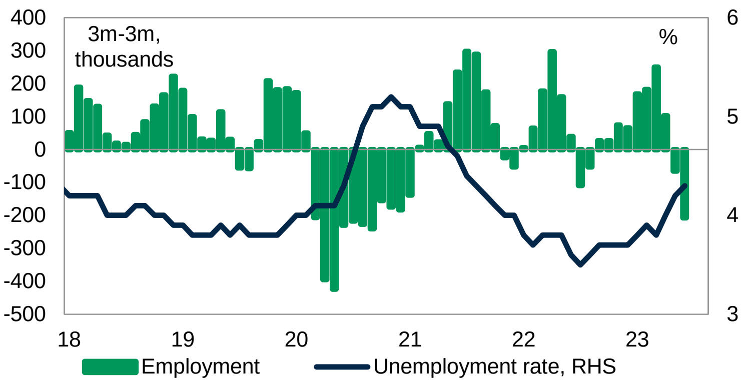


Sources: BoE, Crédit Agricole SA/ECO

RECENT ECONOMIC DEVELOPMENTS

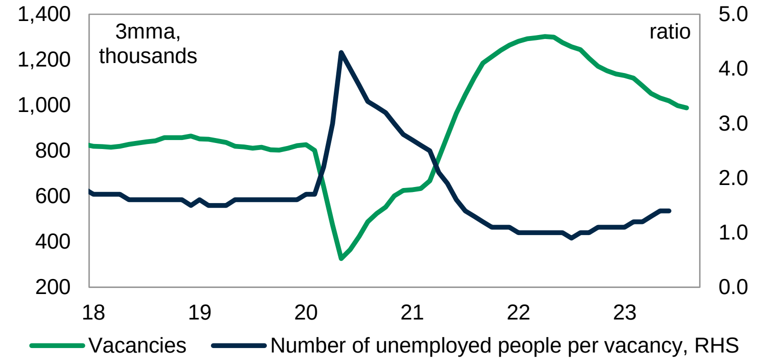
LABOUR MARKET CONDITIONS ARE SLOWLY EASING

Employment & unemployment rate: unemployment rate rose to 4.3% in July (from 3.8% in April)



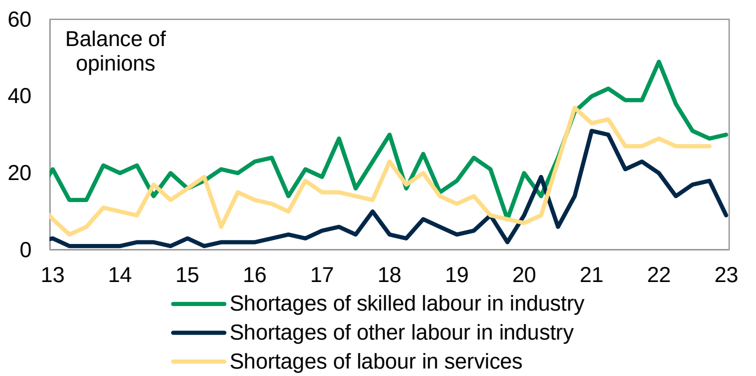
Sources: ONS (LFS data), Crédit Agricole SA / ECO

Vacant positions: down from high levels



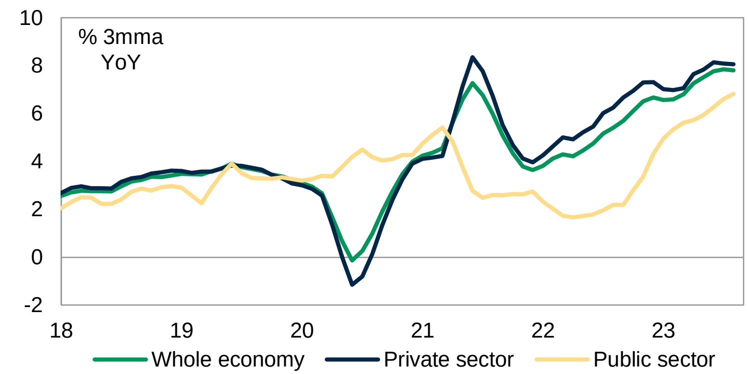
Sources: ONS, Crédit Agricole SA / ECO

Recruitment difficulties: labour remains scarce



Sources: CBI, Crédit Agricole SA / ECO

Wage growth: upside surprises

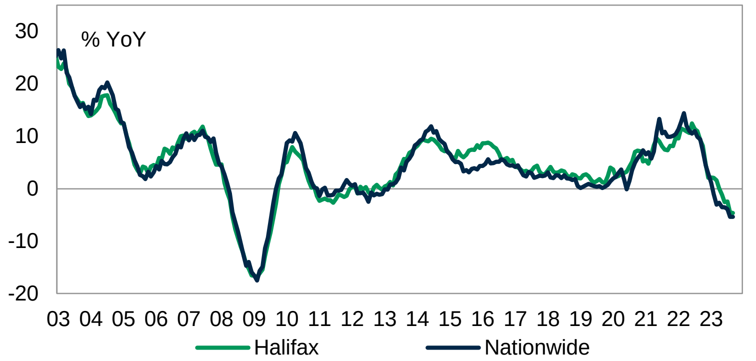


Sources: ONS, data as of end of September, CA SA / ECO

RECENT ECONOMIC DEVELOPMENTS

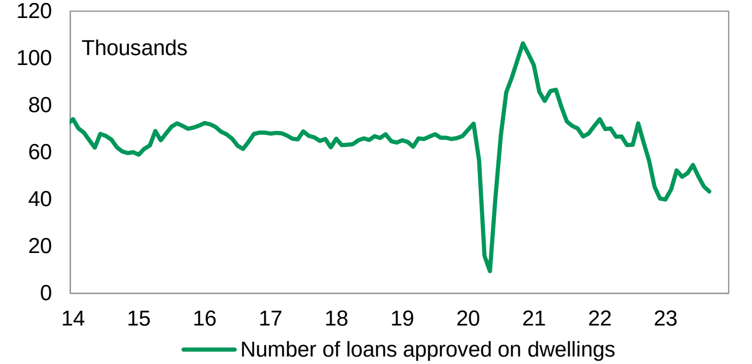
HOUSING MARKET CORRECTION CONTINUES

House prices in the residential sector: fall of ~5% YoY in September



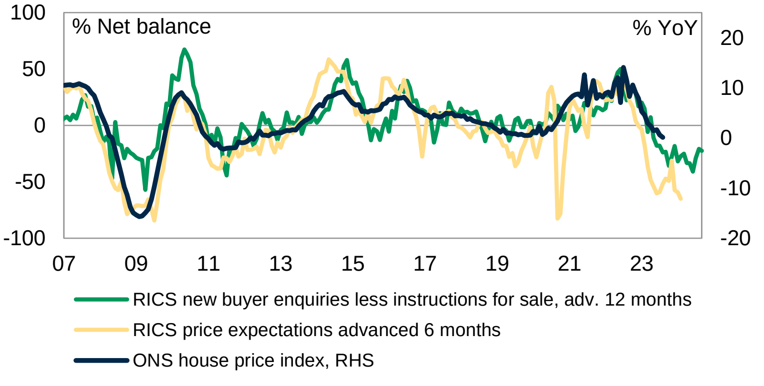
Sources: Halifax, Nationwide, Crédit Agricole SA / ECO

Loans for house purchases: ~ 30% below their pre-Covid level



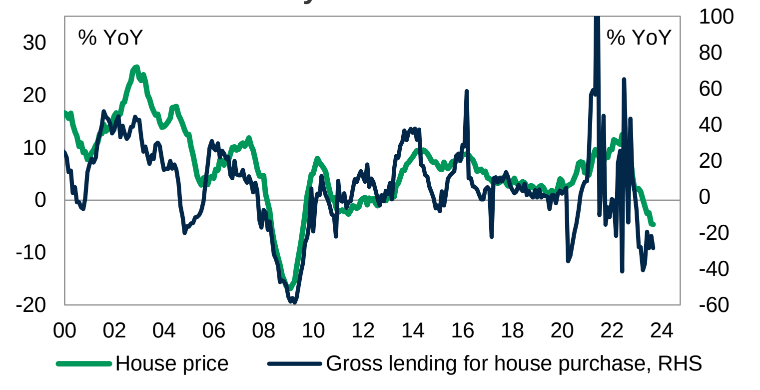
Sources: BoE, Crédit Agricole SA / ECO

RICS surveys suggest the decline in prices is likely to continue



Sources: RICS, ONS, Crédit Agricole SA / ECO

Mortgage lending is falling by ~20% YoY



Sources: Halifax, BoE, Crédit Agricole SA / ECO

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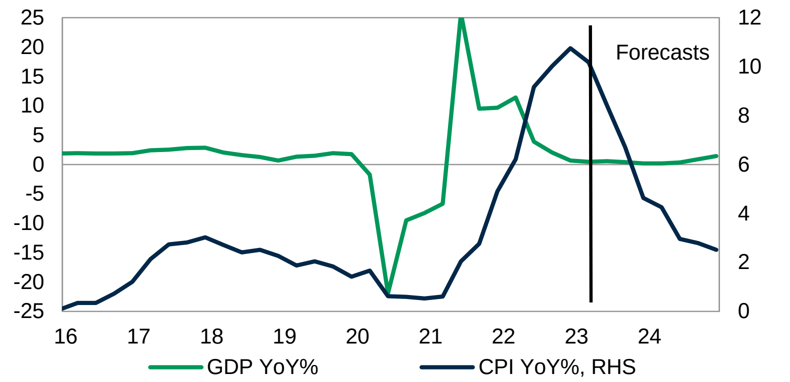
THE OUTLINE OF OUR SCENARIO

GROWTH: SLIGHT RECESSION EXPECTED IN THE SECOND HALF OF 2023

We expect a slight recession in H223, with GDP falling by 0.2% QoQ in Q323, followed by -0.1% QoQ in Q423. However, our 2023 annual growth forecast remains unchanged at 0.5% due to the ONS's upward revision of Q1 GDP QoQ growth (to 0.3% QoQ from 0.1% QoQ previously estimated), while Q2 growth was confirmed at 0.2% QoQ, very close to our July forecast (0.3% QoQ). Our scenario is slightly more optimistic on household consumption and investment than three months ago, but more pessimistic on foreign trade. The peak of the BoE rate hike is earlier and is 50 basis points lower than expected in July. The first rate cut was brought forward by one quarter, to Q224.

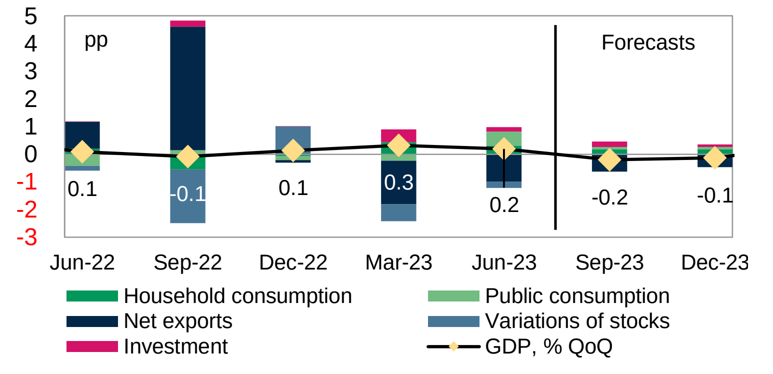
- **Resilience of household consumption**. Rising rates and rents, the correction in the real estate market and the impact of uncertainty on confidence will weigh on household consumption. However, we expect it to remain resilient. The purchasing power crisis seems to be over, although upside risks to inflation, particularly energy prices, remain. The savings rate is higher than its pre-Covid level, and the excess savings accumulated during the pandemic remains significant. The good health of household balance sheets should enable them to withstand the rise in rates, especially as the BoE has probably reached the end of its monetary tightening cycle.
- **Slowdown in private investment.** We have upgraded our investment forecasts to a slowdown rather than a decline. For companies, persistent uncertainty and rising interest rates will hamper productive investment. Nevertheless, some support factors should prevent the contraction: state aid, although less generous (in the form of capital allowances, research tax credits), and solid margins, supported by lower production costs.
- **Downward revision of net export forecasts.** We now expect foreign trade to make a negative contribution to growth this year and next, with import growth outpacing export growth. However, risks are tilted to the upside. We recently changed our scenario for the United States, and it no longer foresees a recession over the horizon of our forecast period.

GDP growth and CPI inflation



Sources: ONS, Crédit Agricole SA / ECO

Quarterly GDP growth and contributions



Sources: ONS, Crédit Agricole SA / ECO

THE OUTLINE OF OUR SCENARIO

INFLATION: UPCOMING ACCELERATION OF THE DECLINE (BARRING A NEW SHOCK)

CPI inflation fell sharply over the summer, from 10.2% YoY in Q123 for to 6.7% YoY in Q323. This downward trend is expected to continue in the coming months thanks to the dissipation of terms of trade shock, deflation in energy and disinflation in food prices. These dynamics are also expected to gradually feed through to core inflation, but the decline in core inflation will continue to be slowed by sustained domestic pressures.

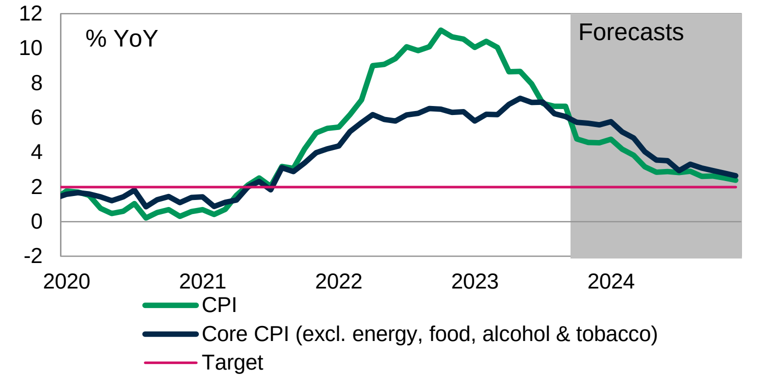
Base effects will be very powerful in Q423 due to the sharp rebound in energy prices in October 2022 and the fall in energy prices in October 2023. The regulator Ofgem has announced a reduction in its gas and electricity price caps from £2,074 to £1,923 (annualised bill for the typical household) from 1 October 2023.

The 2% target is still far away and seems out of reach before 2025.

- Core inflation is more rigid than headline inflation, not only because of the time that normally elapses between rising energy prices and its pass-through to other sectors. The unpleasant surprises have come from services, where inflation remains close to 7% YoY. This reflects resilient domestic demand, allowing companies to raise prices to support their margins.

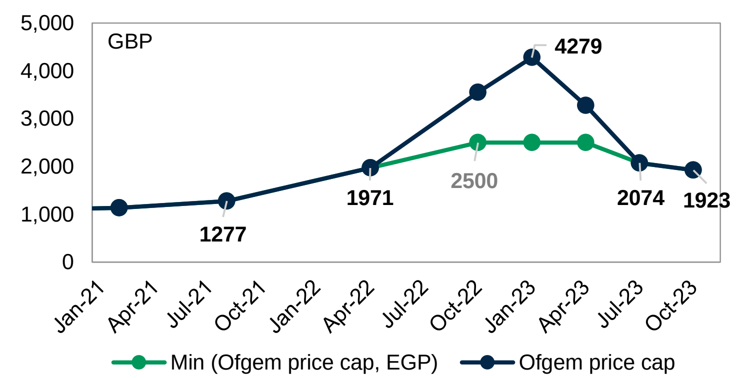
- Barring another significant shock to energy prices, prices in services will inevitably slow down following the fall in goods prices, but this disinflation is likely to be slow. Labour market conditions are still very tight, despite the recent easing, and wage growth remains strong. We expect core inflation to exceed headline inflation starting from October 2023 and until the end of the forecast horizon (December 2024).

CPI and core inflation



Sources: ONS, Crédit Agricole SA / ECO

Standard household annual bill (gas and electricity)

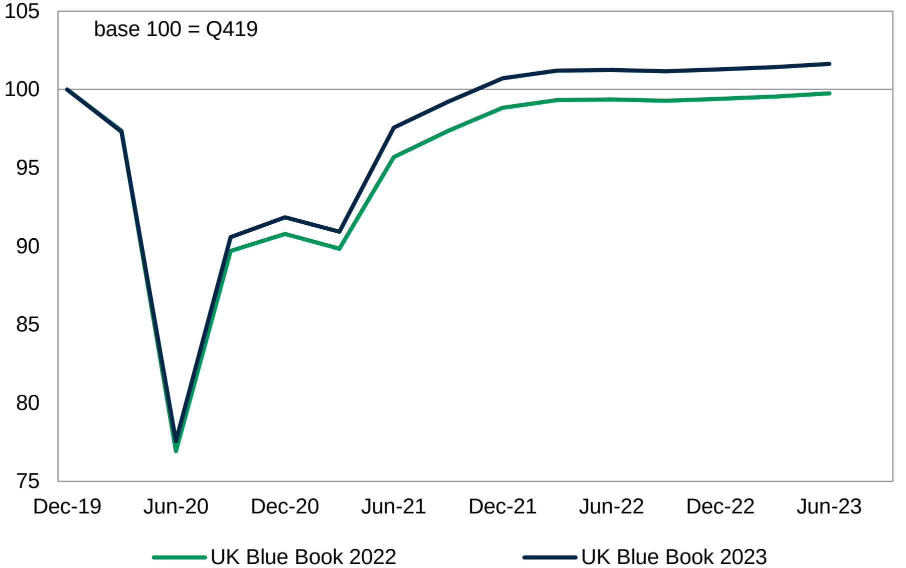


Sources: Ofgem, gov.uk., heattable.co.uk, CA SA / ECO

THE OUTLINE OF OUR SCENARIO

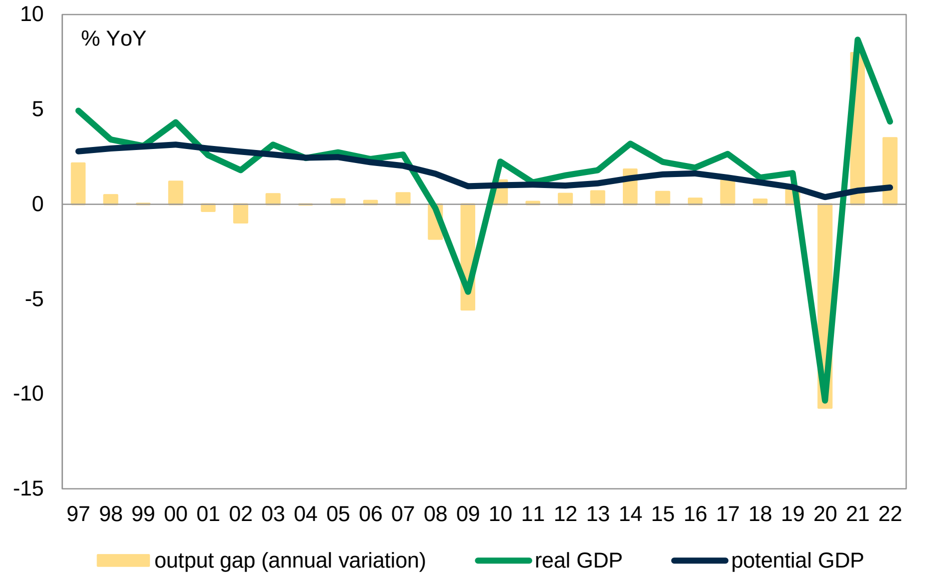
SIGNIFICANT REVISIONS TO NATIONAL ACCOUNTS

Real GDP



Sources: ONS, Crédit Agricole SA / ECO

Real GDP and potential GDP

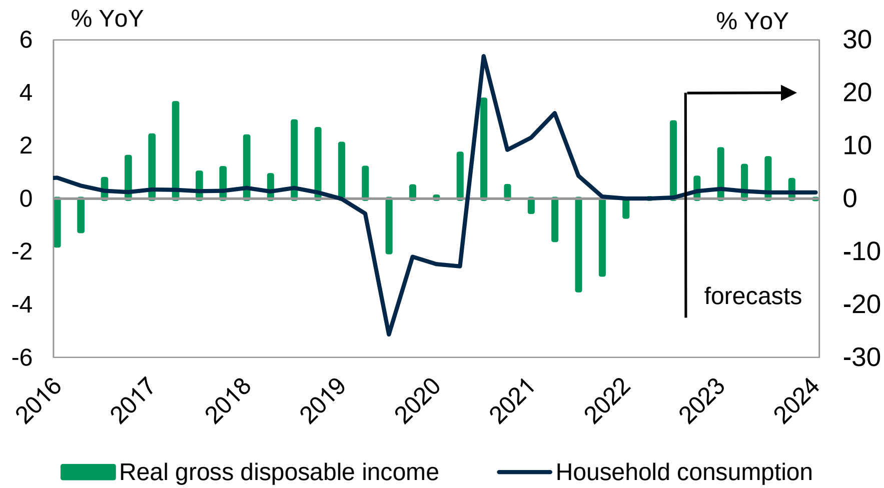


Sources: ONS, AMECO, Crédit Agricole SA / ECO

As part of its *Blue Book*, the ONS made significant revisions to the national accounts, particularly over the 2020 and 2021 period, due to several methodological changes and the integration of new data to improve international comparability. Key changes made by the ONS include readjustments in inventory changes and a significant upward revision in household consumption. Overall, the contraction in GDP in 2020 was revised downwards to -10.4% from -11% previously estimated, and the rebound in 2021 was revised to 8.7% from 7.6% in the previous estimates. **GDP is now estimated to have recovered to its pre-Covid level in Q421, and in Q223 it stood 1.8% above its Q419 level** (instead of 0.2% below according to previous estimates). The new data help to resolve the inconsistency between an overheating economy and a GDP that, according to previous data, had still not completed its post-Covid recovery in Q223. **The implications are a higher positive output gap than previously estimated**, which is in line with the observation of demand that has, until now, surprised by its resilience and higher-than-expected inflation. A natural slowdown in demand is expected to occur in the coming months, making it possible to erode the positive output gap and bring it back into negative territory by next year.

HOUSEHOLDS: GAINS IN PURCHASING POWER AND ABUNDANT SAVINGS *VERSUS* AN INCREASE IN RATES

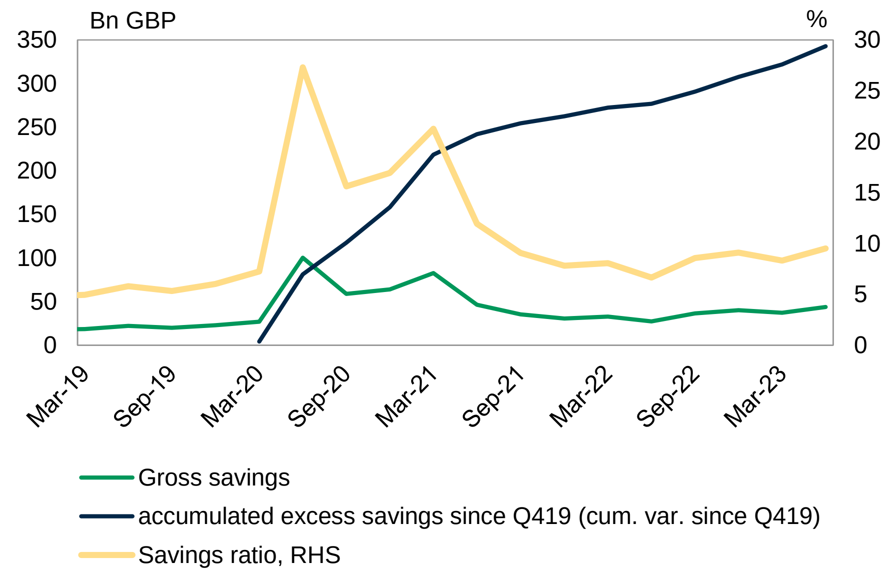
Purchasing power and household consumption



* *Household gross disposable income deflated by the consumer expenditure deflator*

Sources: ONS, Crédit Agricole SA / ECO

Savings rate higher than its pre-crisis level and significant excess savings



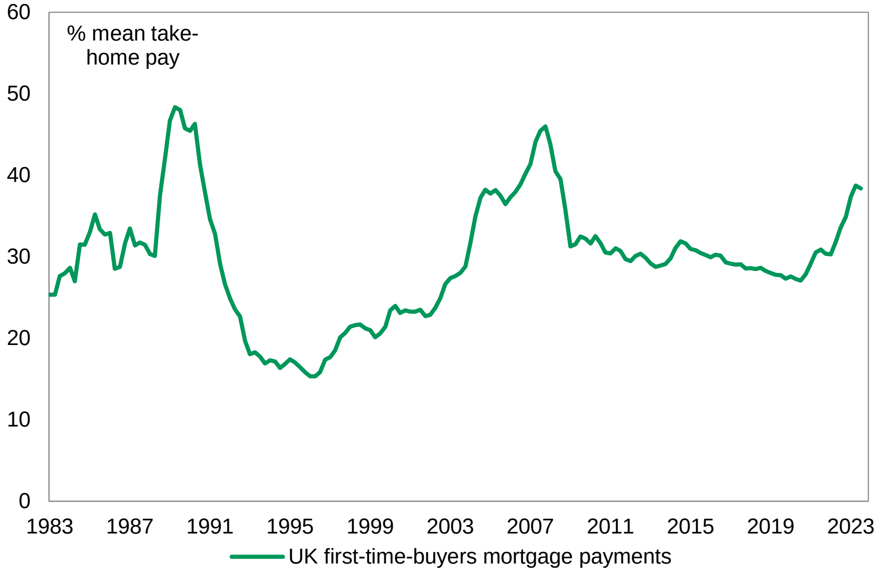
Sources: ONS, Crédit Agricole SA / ECO

The consumer outlook appears to be deteriorating in the short term: consumer confidence fell in September to its lowest since July and retail sales declined by 0.8% MoM in September. The unemployment rate has risen from very low levels. **Strong headwinds are weighing on sentiment: rising interest rates and rents, correction in the real estate market, uncertainty about the global outlook.** Nevertheless, the hard figures are reassuring: household consumption surprised positively in H123 (increases of 0.7% QoQ in Q123 and 0.5% QoQ in Q223). This resilience is explained by very tight labour market conditions that are conducive to very strong growth in wage remuneration, but also by high growth in income from financial assets and rental income, against a backdrop of state aid to address the energy crisis. Gross disposable income grew 10.5% YoY in Q223, a record pace since the early 90s. Moreover, CPI inflation has been declining since Q422, allowing real disposable income to grow again. **After six consecutive quarters of decline, real disposable income rose by a solid 2.9% YoY in Q223. The purchasing power crisis therefore seems to be over, although upside risks to inflation due to geopolitical tensions persist.** With disinflation expected to accelerate in the coming months, purchasing power should continue to improve. In addition, the savings rate was revised upwards to 9.1% in Q223 and the excess savings accumulated during the pandemic remains significant. The good health of household balance sheets should enable them to withstand the rise in rates, especially as the BoE has probably reached the end of its monetary tightening cycle. We therefore expect household consumption to remain resilient despite the headwinds and the recent fall in consumer confidence.

THE OUTLINE OF OUR SCENARIO

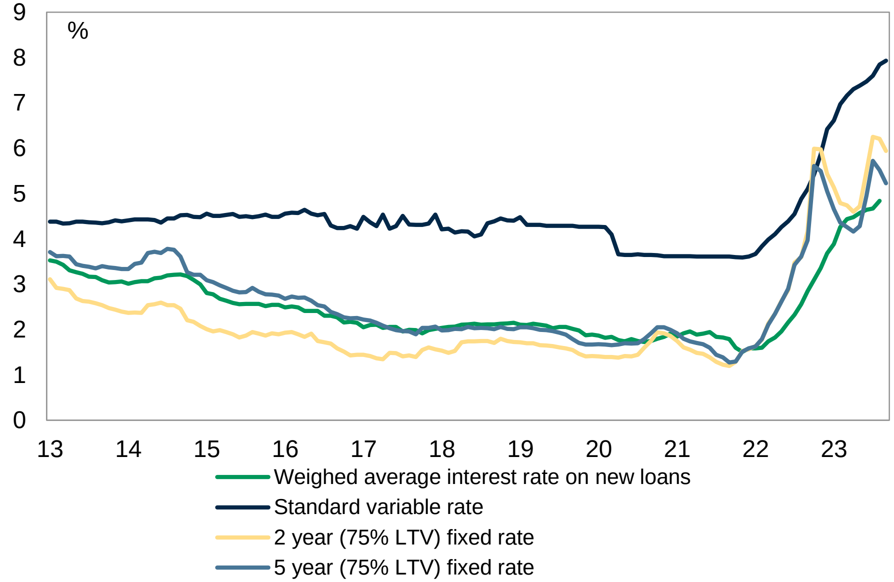
IMPACT OF THE RISE IN RATES VIA PERSONAL FINANCES

Share of mortgage repayments in first-time home buyers' income



Sources: Nationwide, Crédit Agricole SA / ECO

The average rate on new loans reached 4.8% in August



Sources: BoE, Crédit Agricole SA / ECO

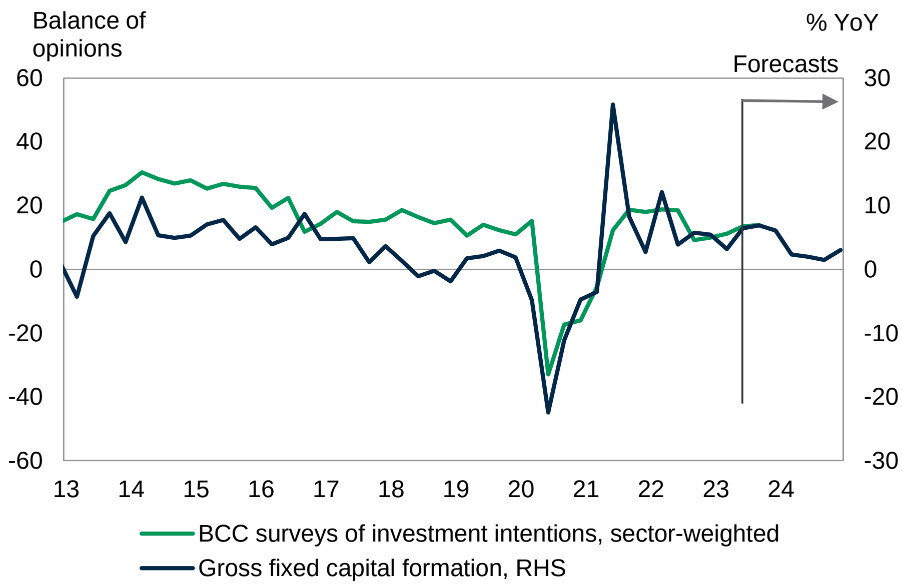
The rise in interest rates is weighing on household consumption through various channels. The first is the increase in the repayment flows of indebted households. However, **there are reasons to believe that the impact of this channel could be more limited than in previous tightening periods.** As the majority of existing loans are fixed-rate (with a maturity of five years or less) and no longer floating-rate, the impact on household balance sheets is spread over time. Only about half of households with mortgages have experienced an increase in the cost of borrowing since the start of monetary tightening in 2021. **The peak in mortgage refinancing is expected in Q124, with loan repayments reaching 40% of disposable income, approaching their 2007 peak.**

Moreover, there are fewer households with mortgages than in the past: their share fell to less than 30% in the 2000s, compared with 40% in 1989.

Another transmission channel for the rise in interest rates is the rental market. Landlords who have taken out a loan for rented housing can either pass on part of the rate increase to rents or suffer the increase in the cost of debt themselves. Rents increased sharply, at 5.7% YoY in September 2023 according to ONS data, a record pace since 1996. But above all, we are seeing a much more significant increase in the rents of new leases. According to the BoE, more and more homeowners are selling their rental properties, reducing the supply of rental homes and pushing up rents.

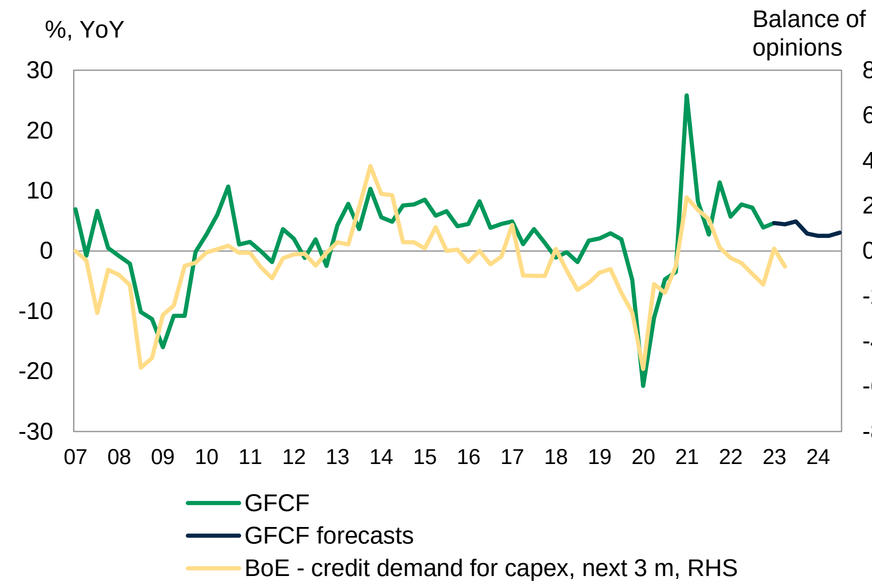
INVESTMENT: RISING RATES WEIGH ON OUTLOOK

Investment intentions and gross fixed capital formation (GFCF)



Sources: BCC, ONS, Crédit Agricole SA/ECO

Investment and demand in credit for investment purposes



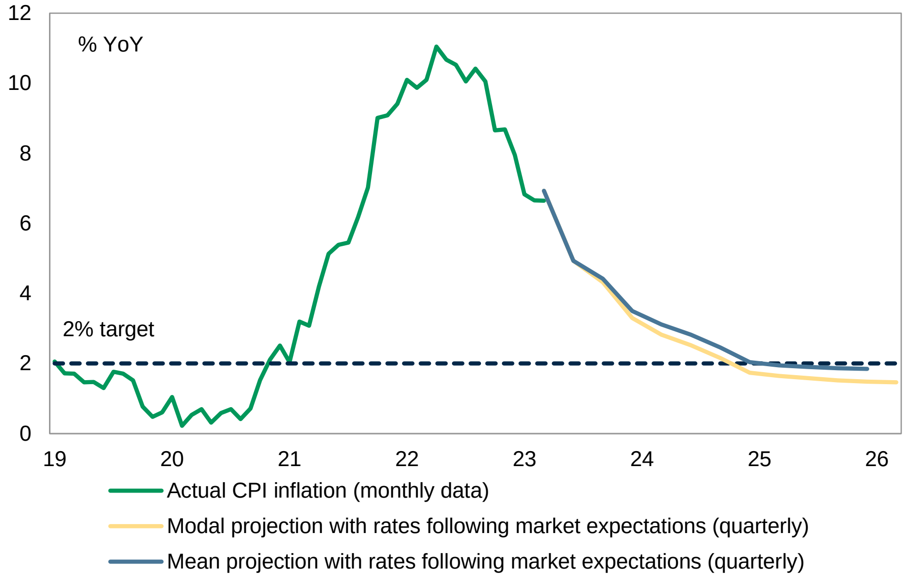
Sources: ONS, BoE Credit Conditions Survey, Crédit Agricole SA/ECO

Business investment was stronger than expected in H123, with a cumulative increase of 8.3%, according to revised ONS data. This strong rebound is partly explained by the anticipation of certain investment projects ahead of the expiry of the government's "super deduction allowance" on 31 March 2023. This measure was replaced by a similar but less generous measure from April. In Q223, investment was supported by increased investment in transport equipment, particularly aircraft (increase in imports from the US). **It is therefore unlikely that this sustained pace of investment growth will continue in the coming quarters.** Companies saw their margins eroded in Q223 due to cuts in state aid linked to energy prices.

Meanwhile, the average rate of new loans to non-financial companies continued to rise, reaching 6.97% in August, i.e. +209 basis points compared to December 2022. The BoE's survey of credit conditions in Q223 also shows a relapse in demand for investment-related credit expected for the next three months, while remaining above the low reached in H222. **We continue to expect a slowdown in investment in the coming months, but have ruled out a recession from our scenario.** Margins remain solid, supported by lower production costs, and state aid, although less generous, will be a supportive factor.

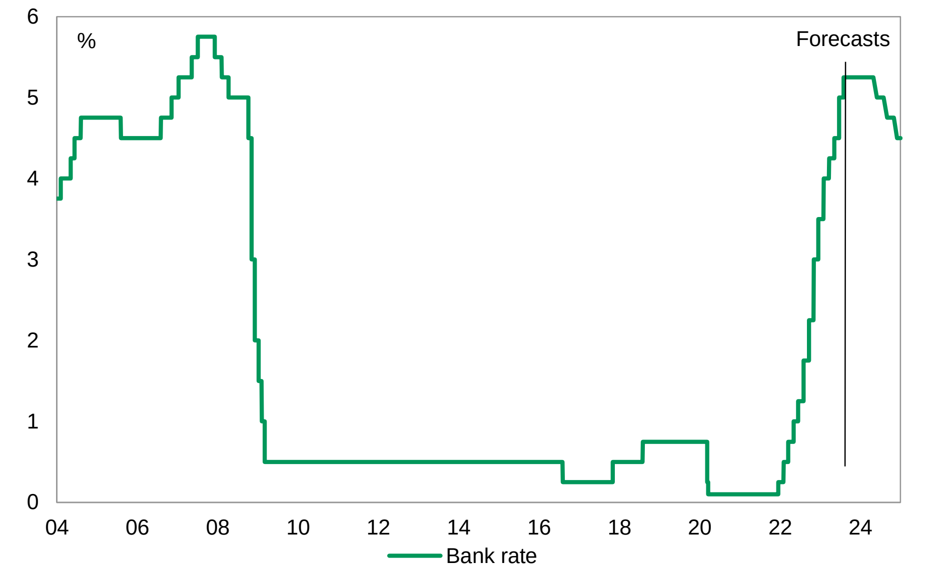
MONETARY POLICY: FIRST RATE CUT EXPECTED IN MAY

BoE's CPI inflation forecast: the target will be reached in the medium term



Sources: BoE Monetary Policy Report of August*, Crédit Agricole SA/ECO*

Key rate: peak at 5.25% and gradual decline from May 2024



Sources: ONS, Crédit Agricole SA/ECO

Our central scenario for the UK economy is compatible with maintaining the *status quo* on interest rates in the coming months. Indeed, we expect a slight recession, as described in our economic scenario above, and a rapid fall in the CPI inflation rate. Consequently, our scenario argues in favour of an earlier rate cut than expected three months ago: **we have advanced the first rate cut to May 2024 from August 2024. Hence, at its 2 November meeting, the BoE is likely to keep its key rate unchanged at 5.25%.** CPI inflation forecasts will likely be revised to the downside in the short term as a result of weaker than expected inflation in Q323 (CPI inflation came in at 6.7% YoY on average in Q323 against 6.9% expected by the BoE). This may be interpreted as a dovish signal on the part of the markets. **To avoid appearing too complacent, the BoE should leave its *forward guidance* unchanged in November, keeping the possibility of a rate hike on the table in the future**: "The MPC will continue to closely monitor signs of persistent inflationary pressures and the resilience of the economy as a whole, including tight labour market conditions and the behaviour of wage growth and service price inflation." **Moreover, the BoE's central inflation forecasts will probably continue to be surrounded by a positive skew.** This would be justifiable given the still too high pace of inflation and wage growth, still tight labour market conditions and recent geopolitical risks weighing on the outlook for oil prices. The MPC will also remain divided on the conduct of monetary policy (with some members continuing to vote for rate hikes).

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