



Financial Planning Ltd
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HFB Financial Planning Ltd
Shardlow Business Centre
No.1 Mill, The Wharf, Shardlow,
Derby, Derbyshire, DE72 2GH

Tel: 01332 987624
Fax: 0872 113 1115
Email: admin@hfbfinancial.co.uk
www.hfbfinancial.co.uk

ECONOMIC REVIEW

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INTEREST RATE PEAK MAY BE APPROACHING

Last month the Bank of England (BoE) announced another hike in its benchmark interest rate but hinted that rates may now be nearing a peak, as the tide in its battle with inflation begins to turn.

Following its latest meeting held at the beginning of February, the BoE's nine-member Monetary Policy Committee (MPC) voted by a 7–2 majority to raise Bank Rate by 0.5 percentage points to 4.0%. This was the tenth consecutive increase sanctioned by the MPC and took rates to their highest level in over 14 years.

The minutes to the meeting noted that *'considerable uncertainties'* around the outlook remain and that risks to inflation are *'skewed significantly to the upside.'* However, they also stated that updated MPC projections show *'inflation falling back sharply'* from current elevated levels, with the headline rate expected to dip to around 4% towards the end of the year.

Commenting after announcing the MPC decision, BoE Governor Andrew Bailey cautiously acknowledged that price rises have begun to edge back. Mr Bailey said, *"We've seen the first signs that inflation has turned the corner. But it's too soon to declare victory just yet – inflationary pressures are still there."*

The latest official inflation statistics also suggest the headline rate is now on a downward path. The Consumer Prices Index (CPI) annual rate – which compares prices in the current month with the same period a year earlier – fell to 10.1% in January. This represents the third successive monthly decline since CPI inflation hit a 41-year high of 11.1% in October.

Although analysts do still typically expect the MPC to sanction at least one more hike, there does seem to be a growing consensus that the high point in the current interest rate cycle is approaching. The next MPC meeting is due to conclude on 23 March.

BoE PREDICTS SHALLOWER RECESSION

Updated economic forecasts published last month by the BoE suggest the UK will enter recession this year but that the downturn will be less severe than previously feared.

According to the latest economic growth figures released by the Office for National Statistics (ONS), the UK narrowly avoided entering recession at the end of 2022. Despite monthly data showing the economy shrank by 0.5% in December, growth in the previous two months resulted in an overall growth rate of zero across the final quarter of last year.

While this figure is only a first estimate and may therefore be revised, either up or down, it does currently show the UK avoided a second successive quarterly contraction which would have met the technical definition of a recession. Analysts, however, still expect further economic weakness this year – CBI Lead Economist Ben Jones, for instance, commented, *"We may have avoided a technical recession late last year, but we probably won't avoid one this year."*

The BoE's latest economic assessment also suggests the UK will enter recession during the coming months, although their revised projections imply any downturn will be *'much shallower'* than previously envisaged. The Bank now expects the economy to shrink by 0.5% during 2023, significantly lower than the 1.5% contraction forecast in November, with the recession expected to last five quarters rather than eight as previously predicted.

Survey data released towards the end of last month has even raised hopes that the UK might actually avoid recession altogether during the first half of this year. The preliminary headline figure from the S&P Global/CIPS UK Purchasing Managers' Index jumped to 53.0 in February, up from 48.5 the previous month. This is the first time since July that the reading has been above 50, the threshold which indicates growth in private sector output.

RETAIL SALES REBOUND UNEXPECTEDLY

Official data has revealed a surprise increase in sales volumes during January, although more recent survey evidence does suggest the retail outlook remains challenging.

According to the latest ONS data, total sales volumes in January rose by 0.5%, as shoppers sought to take advantage of New Year sales promotions. ONS said discounting helped lift sales at online retailers as well as jewellers, cosmetic stores and carpet and furnishing shops, although growth was also partly driven by an increase in fuel sales as prices at the pumps continued to decline.

Data revisions, however, saw December's figure fall more sharply than previously reported, with updated data showing a drop of 1.2% from November rather than the originally estimated 1.0% decline. Darren Morgan, Director of Economic Statistics at ONS, commented, "After December's steep fall, retail sales picked up slightly in January, although the general trend remains one of decline."

This challenging environment was also highlighted in the CBI's latest Distributive Trades Survey, with retailers reporting broadly unchanged sales volumes in February while expecting sales to fall this month. CBI Principal Economist Martin Sartorius said, "Whilst retail sales volumes were largely unchanged in the year to February, firms remain pessimistic about their business outlook."

CHANCELLOR RECEIVES PRE-BUDGET BOOST

The latest public sector finance statistics revealed an unexpected budget surplus giving Chancellor Jeremy Hunt a little more leeway as he prepares to deliver his Spring Budget.

Figures released by ONS showed that UK public sector net borrowing (the gap between the country's overall income and expenditure) returned to a surplus of £5.4bn in January. This figure, which was boosted by the highest self-assessed Income Tax receipts since records began in 1999, was significantly better than economists had been expecting.

As a result, total government borrowing across the first ten months of the current fiscal year now stands at £117bn. While this does still represent a large shortfall by historic standards, the figure is just over £30bn lower than the Office for Budget Responsibility had predicted when it produced forecasts for the Chancellor's Autumn Statement in November.

This data does therefore appear to provide the Chancellor with a little more wiggle room as he sets out the tax and spending plans he will deliver in the Spring Budget on 15 March. Mr Hunt, however, has played down any suggestions of significant tax cuts recently saying, "It is vital we stick to our plan to reduce debt over the medium term."



Approver Quilter Financial Planning Solutions Limited. 08/03/23.

All details are correct at the time of writing (01 Mar 2023).

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