Brexit economy: inflation surge shows impact of vote finally beginning to bite

The latest monthly Guardian analysis finds the UK at a turning point as it heads into 2017

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UK consumers are still spending, but there are signs that inflation may hit real wages Photograph: Jack Taylor/Getty Images

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Britain’s vote to leave the EU is finally feeding through to the UK economy, according to a Guardian analysis that shows rising inflation is offsetting brisk trade for businesses.

Buoyant consumer spending, a low unemployment rate, rising house prices and continued growth for the country’s dominant services sector point to a strong finish to the year, defying earlier forecasts from the Bank of England and others that the economy would grind to a standstill.

But worries are growing over prospects for 2017 as signs emerge that the Brexit vote’s blow to
the pound is stoking inflation and hitting people’s spending power.

As the starting date for negotiations over leaving the EU approaches, the pound has come under fresh pressure in recent weeks and been prone to further downward lurches with every political mention of Brexit – most recently from Scotland’s first minister Nicola Sturgeon raising the prospect of a new independence vote for Scotland.

To track the impact of the Brexit vote on a monthly basis, the Guardian has chosen eight economic indicators, along with the value of the pound and the performance of the FTSE.

The dashboard for December shows a better than expected performance in four of the eight categories. Two were as expected, one was worse and inflation was higher than economists had forecast, fanning fears that household budgets will be squeezed by higher prices next year.

Six months on from the vote to leave the EU, the latest batch of figures show wage growth remains solid, headline unemployment remains low, business activity continues to expand and house prices are still rising. The FTSE 100 leading share index is close to an all-time high hit in October and the more domestically focused FTSE midcap index is above its pre-referendum level.

But the pace of hiring has slowed, retail sales growth has eased off and inflation is at a two-year high as the weak pound raises the cost of imports to the UK. The public finances were in a worse state than forecast in November and, looking ahead, they are expected to be in deficit for far longer than had been predicted before the referendum.

Britain’s trading position improved more than expected in the latest monthly figures but substantial revisions to earlier data show the trade gap with the rest of the world ballooned to a near three-year high in the three months following the referendum.

Economists point to several indicators suggesting negative effects of the Brexit vote could be more keenly felt in 2017. Surveys and business investment figures suggest British-based firms are more reluctant to spend. Consumers have become more cautious and they expect inflation to quicken over the coming year.

Writing in the Guardian, a former member of the Bank’s monetary policy committee, David Blanchflower, said some of the data since the Brexit vote had come in better than he had feared but that there were signs this could be as good as it gets for the economy.

“Business confidence is low and there is evidence that optimism is falling among businesses and consumers. My suspicion is that the news is not going to get better,” said Blanchflower, professor of economics at Dartmouth College in the US.

“The consumer has held up pretty well and still seems to be spending and GDP growth at 0.5% is not to be sneezed at. But the fall in the pound and the steady rise in inflation because of the rise in import prices was always going to have an impact,” he added.

A report from the Bank of England’s regional agents on Wednesday flagged the impact of higher import prices on inflation. But the agents – the Bank’s eyes and ears on the ground – noted silver linings from the weaker pound. Tourist spending was rising and exports had also been helped by the currency’s fall, which makes UK goods more competitive overseas.
Since the last dashboard, the government’s independent forecasters at the Office for Budget Responsibility (OBR) have published a new outlook for the economy. They predict weaker business spending and a squeeze on consumers from higher inflation will dent the economy next year, but warnings for a post-referendum recession should prove unfounded.

Publishing its forecasts alongside Philip Hammond’s autumn statement of tax and spending measures, the OBR said the economy would likely expand by just 1.4% in 2017, compared with the 2.2% it had predicted before the referendum. Hammond, was quick to point out that even that lower growth would still leave Britain outperforming France and Italy next year and possibly Germany too.

Andrew Sentance, also a former member of the MPC, said the signs of weaker investment and employment and a squeeze on consumer spending pointed to slower growth for the UK economy next year. But much depended on the country’s key trading partners, the rest of the EU and the US, Sentance wrote in the Guardian.

“Current forecasts suggest that Europe and the US will continue to grow reasonably well in 2017, which will help temper the UK slowdown. Next year may not be so bad for the UK after all, but we will need a reasonably healthy global economy to keep us moving forward.”

Experts have warned that the potential Brexit blow to the economy, coupled with the government’s continued push to bring down spending will leave many households struggling with lower incomes next year.

Mark Carney, the governor of the Bank of England, has warned that the UK is suffering its “first lost decade since the 1860s” and highlighted a squeeze on household budgets that predates the referendum.

Respected thinktank the Institute for Fiscal Studies said workers in Britain face the longest squeeze on their pay for 70 years. This week, the Resolution Foundation thinktank warned the UK faces the risk next year of a return to the squeeze in real pay suffered earlier in the decade. It said 2015-16 had been the fastest year of real wage growth since 2001 but said the combination of low inflation and strongly rising employment would not be repeated.

For the housing market, forecasters expect a slowdown next year. A longstanding shortage of homes will mean prices keep rising but at a much more modest pace of 3%, predicts the Royal Institution of Chartered Surveyors. Property firm Savills has suggested that prices will remain flat across the UK. The UK’s largest building society, Nationwide, expects the UK average price to increase by 2% over the year, below the rate of growth it has reported in 2016.

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