

# State of Play

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## Pay problems



13 July 2023

Central banks have spent almost two years playing catch up as inflation returned building pressure on policymakers to respond. Their credibility rests with overcoming the price rises whilst attempting to navigate a soft economic landing. So far this year they have been waiting for the inflation pressure to ease before feeling able to press the pause button on rate rises. Will this week's latest earnings and inflation data finally offer some respite? Simon Durling from Santander Asset Management shares his thoughts in this week's State of Play.

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### Key highlights from this week's State of Play

- UK earnings update
- Latest infaltion data
- Market update

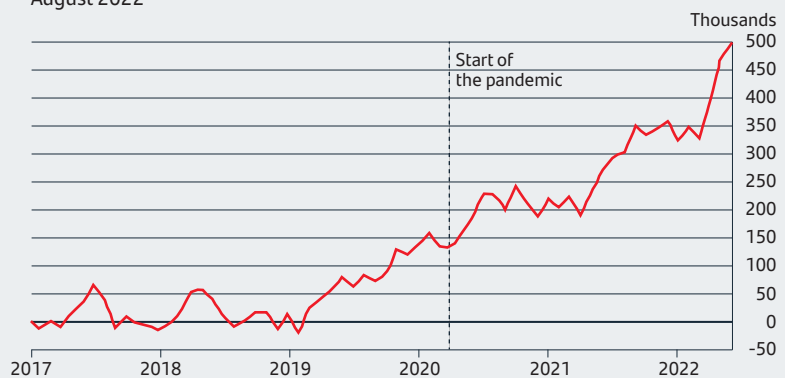
## UK employment and earnings update?

When the nine members Bank of England Monetary Policy Committee meet again in the first week in August to discuss and debate their next move on interest rates, the pressure on these pivotal policymakers will be arguably at its highest given what has transpired in the last two years. Last month headline inflation remained the same whilst core inflation, which excludes energy and food prices, increased further, exacerbating the need to respond with an even higher rate rise than had been predicted. Whilst all developed economies around the world have faced similar inflation causes post pandemic, the UK has some differences which appear to make the task of the MPC even harder. All other major economies have seen employment return to the same level as before COVID-19 triggered a global lockdown and all the disruption this caused, except for the UK. Whilst the chart below shows how inactivity has been growing in recent years, the period since the pandemic has escalated further. This is perhaps a minor problem if isolated, but coupled with the UK leaving the EU, vacancies have soared well above 1 million, almost double the long run average.<sup>1</sup> Employers competing for talent means pay packages have soared as a combination of rising prices and tight labour market make it almost impossible for certain employers in certain sectors to hire the right skilled workers without offering better packages to entice the right candidates.

So, will this week's latest statistics released by the ONS provide any respite for policymakers? Sadly, despite the unemployment rate increasing for March to May 2023 by 0.2% on the quarter to 4.0% (which bizarrely is good news for inflation), growth in employees' average total pay (including bonuses) was 6.9% and growth in regular pay (excluding bonuses) was 7.3% in March

**The number of people out of the labour markets because of long-term sickness has been rising in recent years**

Cumulative change in number of people aged 16 to 64 years inactive owing to long-term sickness, seasonally adjusted, UK January to March 2017 to June to August 2022



Source: Office for National Statistics – Labour Force Survey

to May 2023. This is higher than forecast and slightly higher than previous reading a month ago, which was already a record.<sup>2</sup> This has prompted calls from both the Chancellor, Jeremy Hunt and the Governor of the Bank of England, Andrew Bailey for wage restraint in their recent speeches at the Mansion House speech.

Some of the news like the economic inactivity rate decreasing by 0.4% on the quarter and vacancies continuing to fall, is encouraging, but the speed of change isn't helping the Bank of England that much in concluding that now is the right time to pause rate rises. The decrease in economic inactivity during the latest quarter was largely driven by those inactive for other reasons, those looking after family or home, and those who are retired, according to the ONS. The increases in the employment and unemployment rates and the decrease in the inactivity rate during the latest quarter were mainly attributed to men. Vacancies continued to fall (12 months consecutively) by 85,000 and but importantly remains above 1 million.<sup>3</sup>

The immediate of response of market participants to the news on employment and earnings continued the recent momentum which has prompted lenders to increase their rates in anticipation of what they expect to see when the MPC decide their next move on 3 August. The average 2-year fixed rate according to Moneyfacts has risen above the mini budget crisis at 6.66%. Given some 1.5 million borrowers fixed rates expire in the next 18 months, this will be further bad news for household disposable incomes. In many respects, this last comment is precisely the point of raising rates. Policymakers aim to remove or reduce disposable income to cool demand to bring down price rises. The challenge is that when you compare 2008 mortgage rates with now, the difference highlights why the lag in the impact of raising rates is so stark. Back then 56% of borrowers were on a floating rate compared with just 13% today.<sup>4</sup> Put simply, this means policymakers must wait much longer for rate rise impacts to have any real effect leading to more difficult decisions about when to pause. Next week, investors and policymakers focus will turn to crucial UK inflation data to try and understand what this might mean for the rate decision and synopsis provided by the MPC.

## Latest US Inflation Data

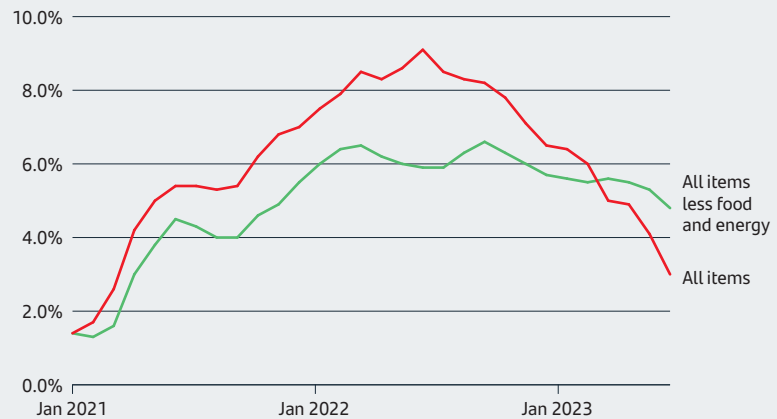
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The Federal Reserve's (The Fed) aggressive increasing of interest rates appear to be finally working in bringing down inflation in the US. The latest data release from the US Bureau for Labor Statistics for both Consumer Price Index (CPI) - the headline rate - and Core CPI - which excludes energy and food costs, fell further than had been predicted. Core Inflation has fallen to 4.8% from 5.3% last month and much lower than the 5% forecast. The headline rate now sits at 3%, still 1% above their target of 2%, but gradually reducing from the high of 9% last year.<sup>5</sup>

This may provide light at the end of the tunnel and give the Fed food for thought when they meet in two weeks to decide on the next rate move. With inflation finally appearing to be under control, they may feel they are able to remain on pause for a little longer to gather more economic data to measure the impact of the rate rises over the last 18 months before feeling the need to increase once again. The strength of the US economy in many respects has been a headache for policymakers trying to tame inflation. They have much to ponder between now and the end of July.

## Latest US inflation

### Year-over-year



Source: US Bureau of Labor Statistics · Monthly changes are seasonally adjusted, yearly changes are unadjusted.

## Market update

Investor suffered a difficult time last week as markets continued to sell-off as participants grappled with more resilient economic news which indicates that central banks are likely to keep interest rates higher for longer. All the major indices fell with both the UK FTSE 100 and European indices suffering the biggest drops of between 3.5% and 4%. Whilst the US markets fell, they were less severe at between 1% and 2%. Pretty much all bond yields rose in response to policymakers need to stay higher for longer, prompting small falls in value. Bond yields across all types, whether this be government debt, corporate bonds or high yield now offer a very competitive yield and the very real prospect that when inflation does indeed finally start to fall more significantly and central banks are able to pause rate rises, the market sigh of relief is likely to be reflected in lower yields and subsequently higher bond values. Sadly, for either those making these decisions or those waiting to see what unfolds, the time to pause does not appear to be right now and the all-important pivot to cutting rates appears further away than first thought.

## The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions, and risk comfort. If you already have a plan in place, or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Note: Data as at 13 July 2023.

<sup>1</sup> Office for National Statistics (ONS), 11 July 2023

<sup>2</sup> Investing.com, 12 July 2023

<sup>3</sup> Office for National Statistics (ONS), 06 July 2023









<sup>4</sup> The Times, 11 July 2023

<sup>5</sup> US Bureau of Labor Statistics, 07 July 2023

<sup>6</sup> Refinitive Datastream, 07 July 2023





















## Performance

Index	Value	Change	%	12 Month High	12 Month Low
					
<b>FTSE 100</b>	7,257	-274.59	-3.65%	8,014	6,826
<b>FTSE 250</b>	18,004	-412.72	-2.24%	20,615	16,611
					
<b>Dow Jones Industry</b>	33,735	-672.72	-1.96%	34,590	28,726
<b>S&amp;P 500</b>	4,399	-51.43	-1.16%	4,456	3,577
<b>NASDAQ</b>	15,037	-142.36	-0.94%	15,209	10,679
					
<b>Hang Seng</b>	18,366	-550.73	-2.91%	22,689	14,687
					
<b>Nikkei 225</b>	32,388	-800.62	-2.41%	33,753	25,717
					
<b>CAC 40</b>	7,112	-288.18	-3.89%	7,577	5,677
					
<b>DAX</b>	15,603	-544.50	-3.37%	16,358	11,976
					
<b>FTSE Eurofirst 300 Eurozone</b>	2,357	-95.78	-3.91%	2,547	1,950
					
<b>S&amp;P TSX Composite Index</b>	19,831	-324.25	-1.61%	20,767	18,206
<b>Commodity markets*</b>					
<b>Gold</b>	\$1,929.50	13.50	0.70%	\$2,047.01	\$1,628.00
<b>Crude Oil</b>	\$78.40	3.93	5.28%	\$116.68	\$70.96

Source: Eikon, prices displayed in the local currency.

\*Gold Bullion London Bullion Market \$ Per Metric Tonne Ounce Delay & Brent Forties and Oseberg Dated Free on Board Northsea Crude used for commodity performance.  
Source Data from the 03 July 2023 to 17 July 2023.

## 10-year bond yields

Country		Variation	12 Month High	12-Month Low
 UK	4.65%		4.66%	1.81%
 US	4.05%		4.23%	2.61%
 Japan	0.44%		0.51%	0.17%
 Euro	2.64%		2.75%	0.76%
 Germany	2.64%		2.75%	0.76%
 France	3.19%		3.24%	1.35%
 Italy	4.36%		4.82%	2.95%
 Spain	3.69%		3.79%	1.86%
 China	2.69%		2.99%	2.62%

-0.20%    0.00%    0.20%

## Currencies

Currency	Conversion	Price	Change	12 Month High	12 Month Low
Dollar	GBP > USD	\$1.28	<b>0.01%</b>	\$1.28	\$1.07
Euro	GBP > EUR	€ 1.17	<b>0.01%</b>	€ 1.20	€ 1.11
Yen	GBP > YEN	¥182.41	<b>-0.85%</b>	¥183.76	¥154.73

Source: Eikon.

Source Data from the 03 July 2023 to 07 July 2023.

**Learn more!**

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## **Important Information**

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