The UK narrowly avoids recession in Q4 2022. In fact, GDP stagnated at the end of the year after falling by 0.2% in Q3 2022, putting average growth in 2022 at 4.0%. However, the data for Q4 hides a clear evolution from more to less, culminating in a drop in GDP in December of 0.5%. The weakness at the end of the year leaves the economy at a rather delicate point for the start of 2023, and a drop in GDP of around 0.5% quarter-on-quarter cannot be ruled out in Q1 2023. The outlook for the rest of the year is not much more favourable and the UK is expected to drop by an average of 0.9% in 2023, which would place the economy still at almost 2.0% below its pre-pandemic level at the end of the year.

In this context of weakness, Rishi Sunak's government announced a package of measures in November to limit the impact of higher energy prices on households and companies, equivalent to 2.0% of GDP. In contrast to the plan presented by Liz Truss's government (which forced her resignation in October 2022), the current government’s fiscal package has the approval of the Institute for Fiscal Studies (IFS) and the Office for Budget Responsibility (OBR). According to the Bank of England (BoE), these measures would contribute 0.3 pp to growth this year, but given that they will be withdrawn at the start of 2024, growth could be cut by almost 0.4 pp until 2025.

On the other hand, high energy prices pushed inflation up to maximum levels of 11.1% in October 2022. It then began to drop and stood at 10.4% in February of this year. It is important to note the upward trend in the prices of services, which indicates the persistence of inflationary pressures. Also, the dynamism of the job market—the unemployment rate started the year close to the lowest at 3.7%—and the shortage of labour in sectors of the economy, especially in services, are putting upward pressure on wages. In February, they grew by 5.8% year-on-year, well above the average increase of 2.5% in the previous decade. A significant correction is not expected in the prices of services or in wages in the coming months, so it does not seem feasible that inflation will converge to its target of 2.0% before the end of 2024, according to BoE estimates. Given this scenario, it seems unlikely that the BoE will decide to cut interest rates throughout this year, and will opt to maintain financial conditions at current levels.

Finally, it should be noted that two years after Brexit came into effect, the British parliament has approved (with a large majority) the new agreement on the Northern Ireland Protocol, the so-called Windsor Protocol. This agreement simplifies the trade terms between Great Britain and Ulster, without removing customs with the rest of the EU. In addition, the Northern Irish government will be able to veto European regulations when it is proven that they could cause “serious, permanent” damage.
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