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ECONOMIC NOTE **24 OCTOBER 2014**

Hermes Chief Economist, Neil Williams, comments on today's GDP figures:

"Today's data nudge the UK further down the recovery road, but there's still further to go. Seven years after the first traces of crisis, and we have only a three-speed recovery. In the fast lane are the US, Canada, NZ, and Australia. In the middle, the UK's GDP is now about 4% higher than pre-crisis. But, in the slow lane, Japan and the euro-zone are barely back to 'square one'.

Yet, over the same period, wages have not outpaced inflation. The UK's RPI is 27% higher, but average wages are up 13%. UK growth will not be surrendered while demand-inflation stays calm.

The absence this time of wage growth, even as UK and US unemployment falls, is still a conundrum for central banks. And, based on the UK's growing and US's shrinking labour forces, the chances of wage growth are better in the US than UK.

Aggressive rate hikes make no sense while real UK wages are deflating, currently about 2% YOY. So, the BoE may as well sit on its hands in terms of rate hikes till summer 2015, after the general election.

When UK rates do go up, they will likely 'peak out' at a much lower level than we're used to and no higher than 3%. But there's no free lunch. A lower peak rate will be delivered by the BoE pulling on the second monetary lever – that is, selling back after 2015 some of the government bonds it bought under QE.

In short, the labour market will be critical to completing the UK's recovery 'jigsaw'. The issue for the BoE in 2015 is whether to be proactive on rate hikes, or wait till the last piece (real-wage growth) has slotted in. We suspect it'll do the latter."

-ENDS-

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Notes to Editors:

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