Red Sea risks fuel inflation fears as UK jobs market loses momentum

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- Oil surges back above $107 a barrel, with threats to shipping through the Strait of Hormuz and Bab el-Mandeb raising fresh concerns over global supplies and the inflationary fallout.
- Bond markets are braced for higher rates, with 10-year gilt yields remaining highly elevated and the US 10-year Treasury yield pushing above the psychologically important 5% level.
- The UK jobs market is losing momentum, with payrolled employment down 145,000 over the year and vacancies falling to 702,000, their lowest level outside the pandemic since 2014.
- Higher public sector pay awards, and the timing of them, have pushed up average pay to 3.9% - a measure which will be used to set the state pension increase, and is set to reignite the triple lock debate.
- Stagflation fears risk returning, as a weakening jobs market collides with stubborn inflation and a fresh energy shock, leaving the Bank of England facing an increasingly awkward balancing act.

Susannah Streeter, Chief Investment Strategist, Wealth Club

“There’s no let-up in the volatility rippling through financial markets, with energy prices staying painfully elevated and worries swirling about the knock-on effect for inflation and interest rates. A sea of red could be set to wash over indices, just as attention turns to the Red Sea and mounting threats to shipping and oil exports. The FTSE 100 is turning lower in early trade, and the sell-off hitting US markets this week, exacerbated by concerns about high risks of rapid AI advancements, looks set to continue.

Brent crude has climbed back to highly unwelcome levels, above $107 a barrel as supply concerns are back front and centre. There are more twists in Iran’s story of retaliation, with escape routes for exports blocked off and passing the Strait of Hormuz remaining highly risky. Saudi Arabia’s pipeline stretching from the East of the country to the Red Sea port of Yanbu is closed due to drone attacks, with repairs forecast to take weeks. Houthi rebels have seized the key Hanish islands, which now threaten ships’ passage through the Bab el-Mandeb Strait, the vital shipping route linking the Red Sea with the Gulf of Aden, raising the risk of further disruption to global oil flows. Given the can of worms which has been ripped open, with fresh threats popping up all over the place, it’s not surprising it’s adding another layer of pressure to highly watchful markets. The conflict has become more entrenched, with Iran clearly in this fight for the long haul, and it’s led to fresh worries that higher energy costs will become embedded in economies, leaving companies with little choice but to hike prices on a vast range of goods.

That’ll be concentrating the minds of the raft of central bankers meeting this week on both sides of the Atlantic to decide on rate hikes. The bond markets are reflecting concerns that the only way is up, and the worries that the ascent could be a steep one. 10-year gilt yields remain highly elevated at levels not seen since the Great Financial Crisis. It’s a fraught picture for US Treasuries, with the 10-year Treasury yield also creeping over the psychologically important 5% mark, flirting with a rate not seen since 2007.

Corporate debt is proving to be a formidable rival to government debt offerings, with the hyperscalers increasingly tapping bond markets to fund the enormous cost of data centres, chips and computing capacity.

The latest jobs figures add another awkward piece of the picture for the UK economy, which may keep central bankers puzzling about how to react. Payrolled employment has fallen by 145,000 over the year, with another 26,000 people dropping off payrolls in August, while vacancies have slipped to 702,000, which is the lowest level outside the pandemic since 2014. Unemployment is holding at 4.9%, so while this is not a jobs market in freefall, businesses are clearly becoming more reluctant to take people on as labour and other costs remain painfully elevated.

Pay growth is cooling too, with regular earnings growth (including bonuses) easing to 3.9%, but that is hardly enough to make the inflation problem disappear. This snapshot points to a 3.9% rise in the state pension next April under the triple lock, with average earnings growth, the measure used for the calculation, being pushed higher by particularly strong public sector pay growth. Public sector pay is running at 6.3%, more than twice the 2.9% pace in the private sector, which reflects the impact of pay awards and the timing of them.

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That’s likely to reignite the debate around the triple lock, particularly when government debt is already so high, and the cost of servicing it is painfully expensive. It may be even more controversial given that a pay measure which has been boosted by public sector wage awards is helping drive up the state pension bill at the same time as the government is already under pressure to contain spending and borrowing.

With inflation already stubbornly above target and energy prices surging again, the UK is facing an increasingly uncomfortable combination of a jobs market losing momentum at the same time as another inflationary shock is potentially building, and pressure on public spending is mounting.

So the spectre of stagflation is still looming over the UK economy. Although the latest growth figures surprised on the upside, there will be concern that GDP is not robust enough to sustain a drop in confidence among households and consumers if the energy crunch continues. Fewer vacancies, falling payroll numbers and cautious employers point to an economy losing some of its hiring power, just as higher energy costs descend. Policymakers at the Bank of England will be mindful that the economy is struggling to gain momentum, yet some are increasingly concerned about the rising inflationary risks. While a pause still looks likely on Thursday, four interest rate hikes are now being priced in, and those expectations will show up in higher borrowing costs in the mortgage market, so households are already bracing for high bills ahead.”

Ends

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