

Monthly Economic Review

August 2016

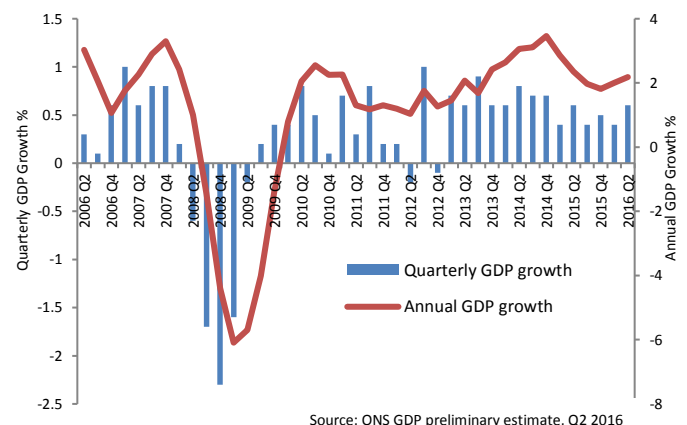
Monthly headlines:

- UK GDP growth picks-up in Q2, but the latest QES indicates weaker growth
- Bank of England cuts UK interest rates to a new record low of 0.25% and expands QE
- Eurozone GDP growth weakens in Q2, while consumer spending boosts US GDP growth

UK GDP growth picks up in Q2...

The first official estimate for Q2 2016 GDP growth revealed that the UK economy grew by 0.6% in Q2 2016, up from the growth of 0.4% recorded in Q1. In annual terms, UK GDP was 2.2% higher in Q2 2016. UK economic output is currently 7.7% above its pre-recession peak (**see Chart 1**). Overall, the latest official GDP data suggest that the UK economy was growing at a reasonable rate in the run-up to the EU referendum. Importantly, **it is still far too soon to draw firm conclusions on the impact of the Brexit vote on the UK's medium-term growth prospects.**

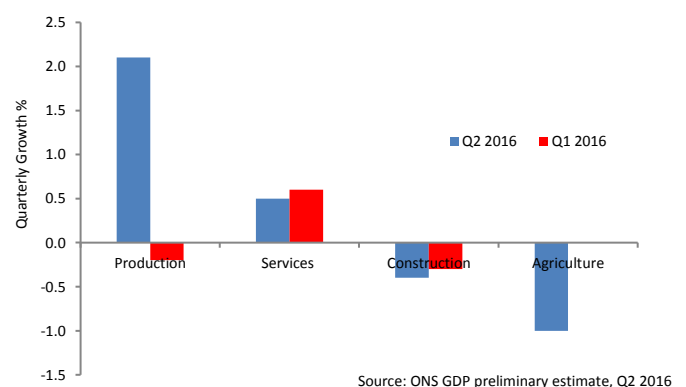
Chart 1: UK Real GDP Growth



...as industrial output hits 17 year high...

The first estimate of UK GDP revealed that industrial production rose by 2.1% in the second quarter of 2016 (**see Chart 2**), the fastest rate of growth since Q3 1999. This increase was driven by a 1.8% rise in manufacturing output. This is in contrast to the Q2 2016 Quarterly Economic Survey (QES) which revealed a weaker picture for the sector. Output from the services sector rose by 0.5% in Q2, down from the growth of 0.6% recorded in Q1. This mirrors the latest QES which recorded that both domestic and export sales for the service sector fell in the quarter.

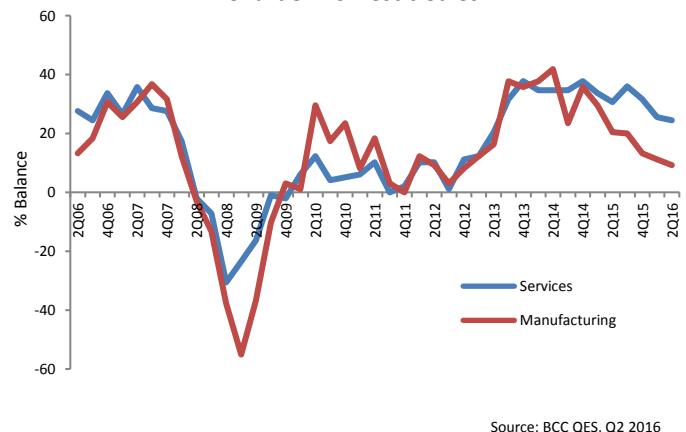
Chart 2: UK GDP by Sector, Q2 vs Q1 2016



...but the Q2 QES suggests a weaker picture...

In contrast to the official data, the latest QES revealed a much more subdued economic picture with key indicators either static or weaker in Q2. In the service sector, the balance of firms reporting a rise in domestic sales slowed to its lowest level since Q2 2013. In manufacturing, most indicators remained weak by historical standards with the balance of firms reporting a rise in domestic sales slowing to its lowest level since Q4 2012 (**see Chart 3**). Similarly, business confidence that profitability will improve declined in both manufacturing and services in Q2.

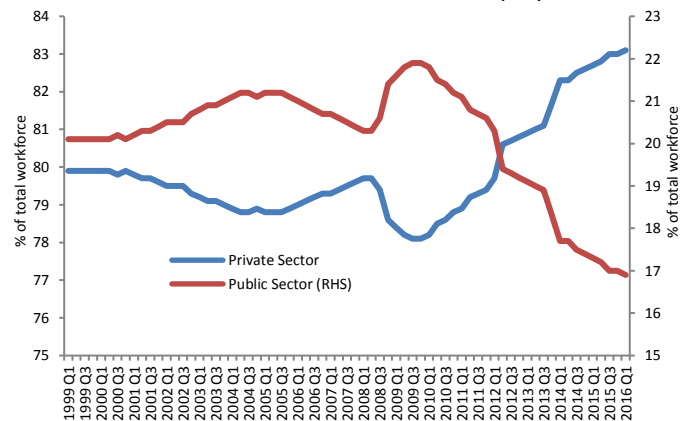
Chart 3: Domestic Sales



...while UK employment strengthens further...

In the three months to May 2016, UK unemployment dropped by 54,000 and the unemployment rate fell to 4.9%, the lowest rate since Q3 2005. **Businesses continue to support the UK jobs market** with 482,000 private sector jobs created over the past year, more than offsetting the 21,000 fall in public sector employment over the same period. As a result, 16.9% of people in employment currently work in the public sector, the lowest proportion since records began in 1999 (see Chart 4). Overall, the latest figures confirm that the UK labour market remains a major bright spot for the UK economy.

Chart 4: Public and Private Sector Employment

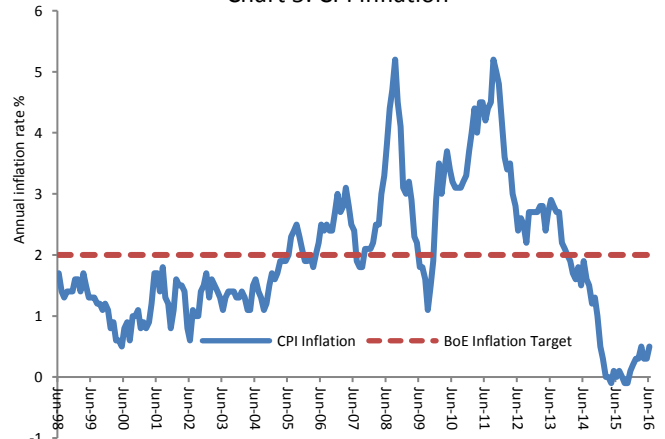


Source: ONS Labour Market data, July 2016

...inflation in the UK is set to rise...

CPI inflation rose to 0.5% in June 2016, up from 0.3% in May. Much of the rise was driven by a 10.9% increase in the cost of flights in the month, the highest on record, and rising petrol prices. Although inflation has been below the Bank of England's 2% target since December 2013 (see Chart 5), the 10% fall in sterling since the outcome of the EU referendum was confirmed is likely to push inflation higher in the coming months. **Higher inflation is likely to squeeze real earnings and could therefore hit consumer spending – a key driver of economic growth - in the coming months.**

Chart 5: CPI inflation



Source: ONS Consumer Price Inflation, July 2016

...and IMF confirms a weaker UK outlook...

The International Monetary Fund (IMF) has downgraded its outlook for the UK economy. The IMF cut its UK GDP forecast for 2016 to 1.7%, from its previous forecast of 1.9% and for 2017 from 2.2% to 1.3%. The IMF have attributed much of this downgrade to their view that the Brexit vote has damaged the UK's near-term growth prospects. However, despite these downgrades, the UK is still expected to be the second-fastest growing economy in the G7 this year (see Table 1). **The IMF also downgraded its forecast for global growth for 2016,** from 3.2% to 3.1% and for 2017 from 3.5% to 3.4%.

Table 1: IMF GDP Forecast Comparisons, G7

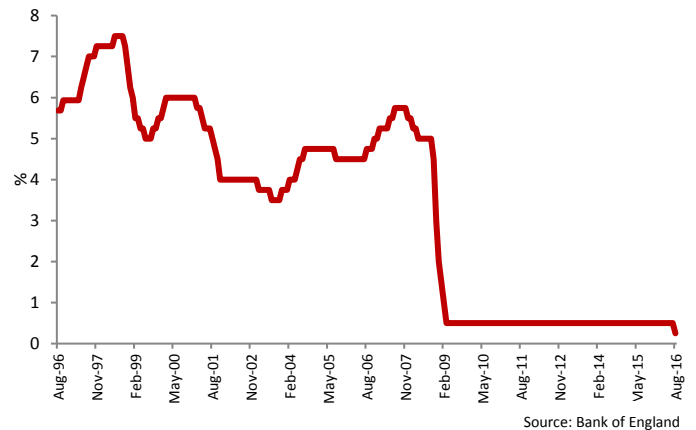
| G7 | 2016 (%) | 2017 (%) |
|-----------|------------|------------|
| US | 2.2 | 2.5 |
| UK | 1.7 | 1.3 |
| Germany | 1.6 | 1.2 |
| France | 1.5 | 1.2 |
| Canada | 1.4 | 2.1 |
| Italy | 0.9 | 1.0 |
| Japan | 0.3 | 0.1 |

Source: IMF World Outlook, July 2016

...as UK interest rates hit new record low...

The Bank of England's Monetary Policy Committee (MPC) have cut UK interest rates to 0.25%, the first time since March 2009 that UK interest rates have moved (see Chart 6). The MPC's decision to cut rates and expand its Quantitative Easing (QE) programme reflects their view that the UK's economic outlook has weakened substantially. In its latest inflation report, the Bank of England downgraded its growth forecast for 2017 to 0.8%, from 2.3%, the biggest downgrade between inflation reports since they were first launched in 1993. The report also suggests that there could be further cuts in interest rates in the near term.

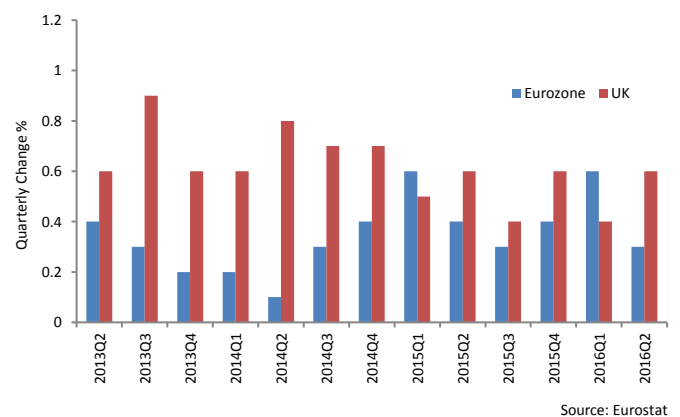
Chart 6: UK Official Interest Rates



...while Eurozone growth halves in Q2...

The preliminary flash estimate of GDP revealed that the Eurozone economy grew by 0.3% in Q2 2016, half the growth of 0.6% recorded in the Eurozone in Q1 and in the UK in Q2 (See Chart 7). In annual terms, the Eurozone economy grew by 1.6% in Q2. Although there is little country level data available, the flash estimate did reveal that France, the Eurozone's second-largest economy, saw no growth in Q2 after expanding by 0.7% in the first quarter. The uncertainty following the Brexit vote is likely to weigh on the outlook for the Eurozone, as well as the UK.

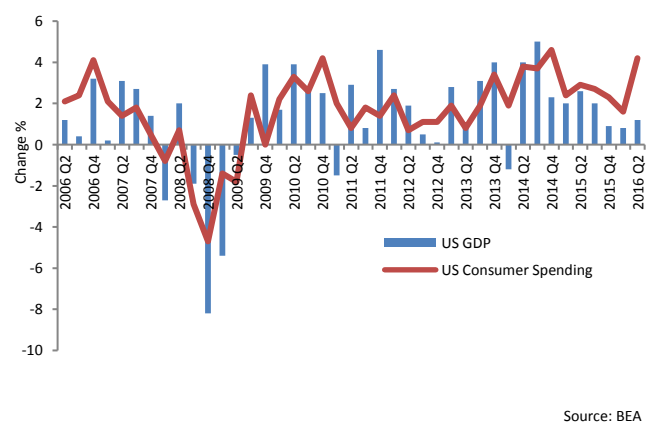
Chart 7: UK vs Eurozone GDP growth



...consumer spending lifts US growth

The US economy, the world's largest, grew at an annual rate of 1.2% in Q2 2016, up from the downwardly revised growth of 0.8% recorded in Q1, but still well below the average growth of 2.1% over the past five years (see Chart 8). The pick-up in growth in Q2 was driven by a 4.2% increase in consumer spending, almost three times the growth of 1.6% recorded in Q1. In contrast, business investment fell by 9.7%, the biggest fall since Q2 2009. Despite the Q2 rise, US GDP growth remains weak compared to historic standards, reducing the likelihood of an immediate rise in US rates.

Chart 8: US Real GDP Growth



Bottom line: While the decision to cut interest rates will do little to support long-term growth, the expansion of QE is likely to play a more substantial role, as will the new Term Funding Scheme and Corporate Bond Purchase Programme. However, the increasing economic uncertainty means that it is even more critical to address the long-standing issues facing the UK, including the chronic underinvestment in Britain's infrastructure such as transport and broadband.

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Economic summary chart

Deteriorating ■ No change ■ Improving ■

| Sector | Indicators (sources) | Jul-15 | Aug-15 | Sep-15 | Oct-15 | Nov-15 | Dec-15 | Jan-16 | Feb-16 | Mar-16 | Apr-16 | May-16 | Jun-16 | Jul-16 |
|---------------|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Household | Retail Sales (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Consumer Confidence (GfK NOP) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | House Prices (Halifax) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | New car sales (SMMT)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Mortgage approvals (Bank of England) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| Business | Business confidence (BCC)*** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Business lending (Bank of England) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Service sector output (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Production output (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Investment intentions (BCC)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| Labour market | Employment (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Unemployment (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Claimant count (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Earnings (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Economic Inactivity (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| Government | Public sector net borrowing (ONS)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Public sector net debt % of GDP (ONS)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Tax receipts (HMRC)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Current Budget Deficit (ONS)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| External | UK trade balance (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Export Sales (BCC)*** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Export orders (BCC)*** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| Financial | Exchange rate (Bank of England) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Equity Prices (Bloomberg) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | 10 year Government bonds (Bloomberg) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |

*Colours indicate an improvement or deterioration of each indicator and refer to monthly changes unless stated. For example, an improvement in employment refers to an increase, while an improvement in unemployment refers to a fall. Also a depreciation in the exchange rate refers to an improvement and an appreciation in the exchange rate refers to a deterioration. Dates refer to the release dates for each indicator.

Annual changes. *Quarterly changes. ****Latest figures are estimates.