

Monthly Economic Review

July 2016

(Based on June 2016 data releases)

Monthly headlines:

- UK GDP growth unrevised in Q1 with consumer spending likely to support growth in Q2
- UK interest rates could fall, while the government abandons its target for a budget surplus
- Too early to gauge the economic impact of Brexit, despite financial market volatility

UK GDP growth unrevised in Q1...

The third official estimate for Q1 2016 growth in GDP revealed that **the UK economy grew by 0.4% in Q1 2016, unrevised from the previous estimate.** GDP growth for 2015 as a whole was revised down slightly to 2.2% (See Chart 1), from 2.3%. Also, as a consequence of historic data revisions the **2008-09 recession was slightly worse than previously thought** with output falling by 6.3% between Q1 2008 and Q2 2009, compared to the previous estimate of 6.1%. Overall, **the latest GDP data confirms that the UK economy is slowing.**

...driven by consumer spending...

Consumer spending rose by 0.7% in Q1 2016, the 5th successive quarter of growth and accounted for almost all of the growth recorded in the quarter. In annual terms, consumer spending rose by 2.8%. In contrast, business investment fell 0.6% in Q1 2016 (see Chart 2), down slightly from the previous estimate of a 0.5% decline. In annual terms, business investment was 0.8% lower than in Q1 2015. Overall, **the latest GDP data highlights the imbalances in the UK economy with an over-reliance on consumer spending to support growth.**

...which will also support growth in Q2...

Retail sales rose by 0.9% in May (See Chart 3), reflecting a 4.3% rise in clothing sales, the biggest rise for more than two years. This rise was partly supported by 5.4% growth in real disposable incomes, the strongest rate of growth since Q1 2001. The fall in average store prices, which fell by 2.8% in May, also contributed to rise in sales. On the rolling three-month-on-three-month measure sales rose by 1.5% in the three months to May. Overall, **the strong growth in retail sales suggests that the UK economy is likely to have grown at a reasonable rate in Q2.**

Chart 1: Real UK GDP Growth

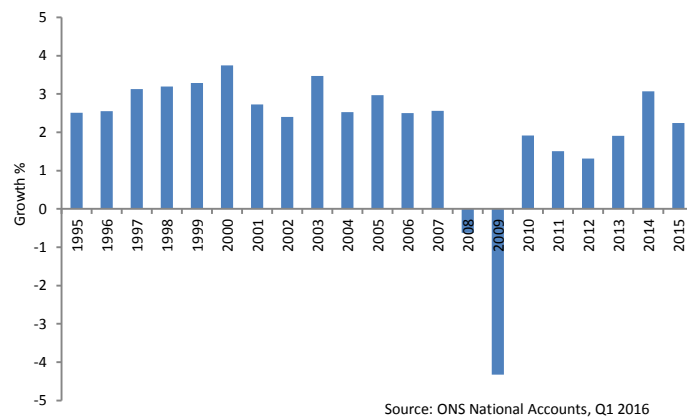


Chart 2: UK Business Investment

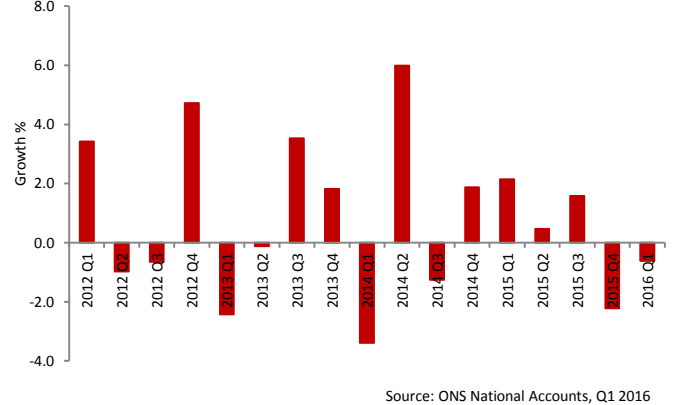
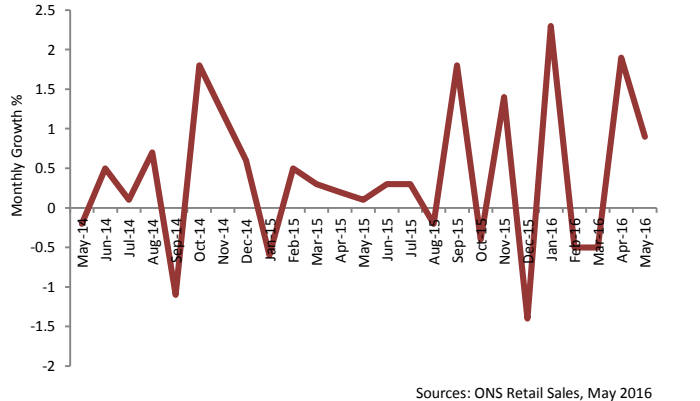


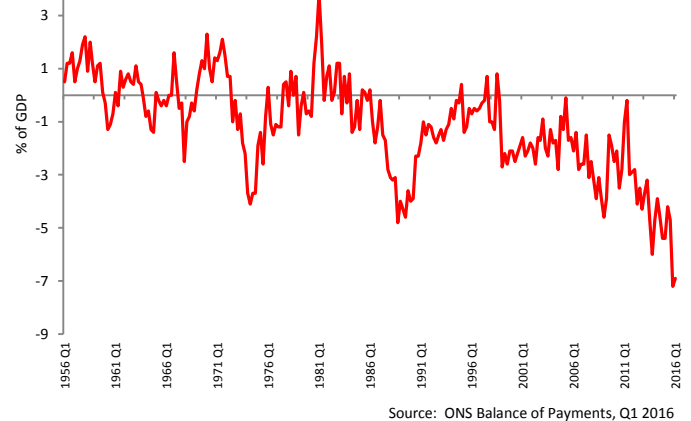
Chart 3: UK Retail Sales



...but rebalancing is still a major challenge...

The UK's current account deficit (the gap between what the UK earns and spends) stood at 6.9% of GDP in Q1 2016, lower than the 7.2% recorded in Q4 2015. Despite this improvement, the UK's current account deficit in Q1 was still the second highest on record and almost seven times the historic average of -1% (see **Chart 4**). A breakdown of the data revealed that the UK's trade deficit widened to £12 billion in Q1 2016, from £11.6 billion in Q4 2015. **The size of the UK's current account deficit means that the UK is more exposed to external shocks and risks a further downgrade to its credit rating.**

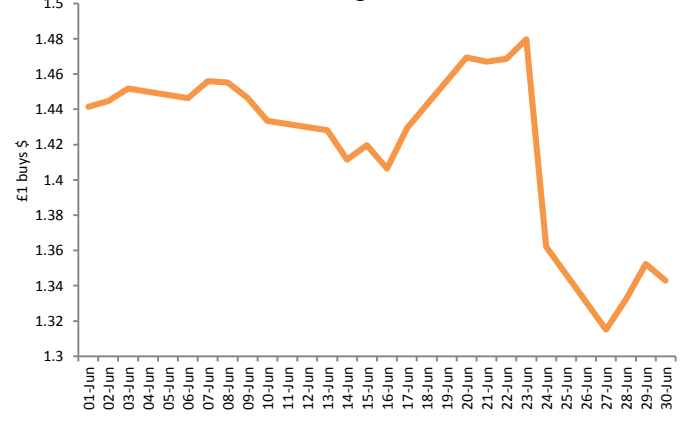
Chart 4: UK Current Account Position (as a % of GDP)



...as financial markets hit major turbulence...

Sterling fell significantly during June amid major market volatility. The value of Sterling as well as stock prices rose in the run-up to the EU referendum with polls pointing to a 'remain' vote. But when it became clear financial markets had got ahead of themselves, a major market correction followed with sterling falling by 8% against the dollar on the day after the EU referendum (see **Chart 5**). This was the biggest one day fall since records began in 1975. **A weak pound is something of a 'double-edged sword'** because while it can make UK exports more price competitive, it can also raise the price of goods.

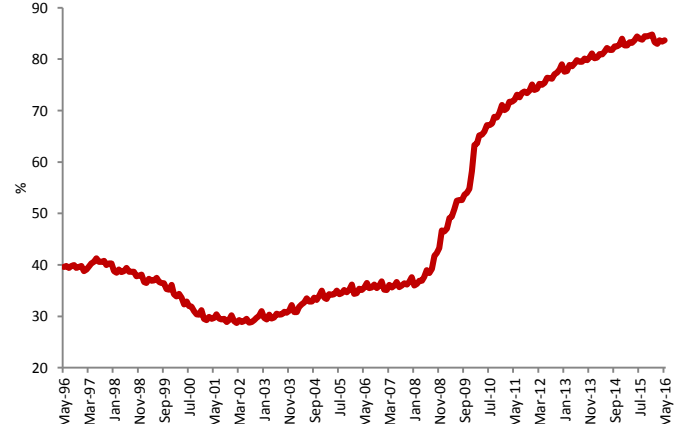
Chart 5: Pound Sterling vs US Dollar, June 2016



...Chancellor abandons his surplus target...

UK public sector net borrowing (excluding public sector banks) recorded a deficit of £9.7 billion in May 2016, down £0.4 billion from May 2015. However, Public sector borrowing was £0.2 billion higher in the current financial year-to-date compared with the same period in 2015. Public sector net debt is currently equivalent to 83.7% of UK GDP (see **Chart 6**). Significantly, the UK government announced that it has abandoned its target of reaching a budget surplus by 2019. **The abandonment of the budget surplus target gives the government greater scope to spend in support of the UK economy.**

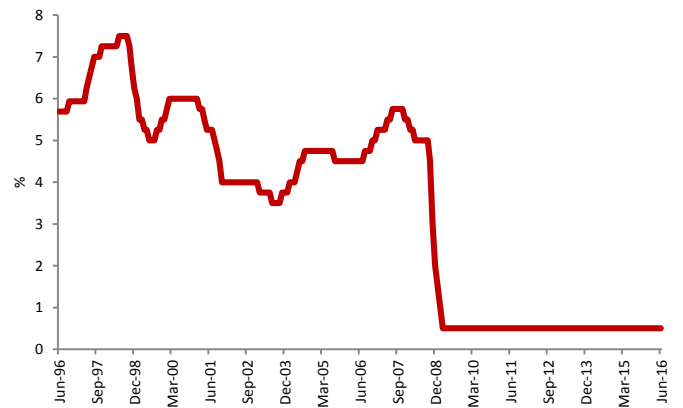
Chart 6: Public Sector Debt as a % of GDP



...as UK interest rates could be cut again...

The Bank of England's Monetary Policy Committee (MPC) kept UK interest rates on hold at 0.5%. UK rates have now been on hold for more than seven years (see **Chart 7**). However, the Bank of England's Governor, Mark Carney, has signalled that some 'monetary policy easing' will likely be required over the summer. This means that the **central bank could cut interest rates or we could see an expansion of its quantitative easing (QE) programme**. However, with interest rates already close to zero any further cuts are likely to have a limited impact, while additional QE should focus on the purchase of corporate assets.

Chart 7: UK Official Interest Rates



Source: Bank of England

...Eurozone economy improving...

The latest estimate of Eurozone GDP revealed that the Eurozone economy grew by 0.6% in Q1 2016, revised from the previous estimate of 0.5%. The pick-up in Eurozone growth in Q1 was driven by a 0.6% rise in household spending and a 0.8% in total investment. Cyprus (0.9%) recorded the strongest rate of growth, while Greece was the only Eurozone economy to contract in Q1 (see **Chart 8**). Despite the recent improvement, there remains uncertainty over the outlook for the Eurozone, including the impact of Brexit on member countries.

Chart 8: Eurozone GDP Growth*



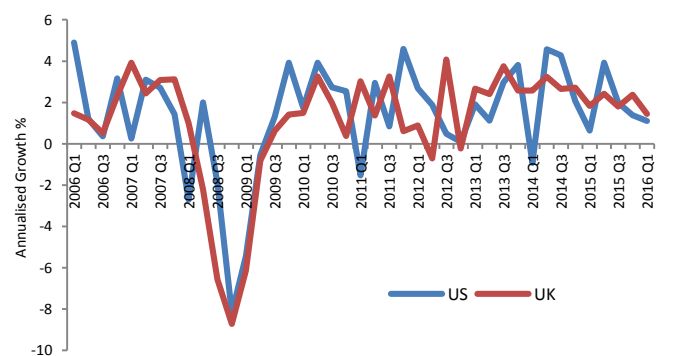
*Q1 2016 GDP data not available for Ireland, Luxembourg or Malta.

Source: Eurostat

...and US growth is revised up.

The third estimate of US GDP revealed that the US economy grew at an annual rate of 1.1% in Q1 2016 (see **Chart 9**), up from the previous estimate of 0.8%. The upward revision was driven by stronger export sales which rose by 0.3% in Q1, up from the previous estimate of a 2% fall. Consumer spending, a key driver of US growth was revised down to 1.5%, the slowest rate of growth since Q1 2014. While the upgrade to US GDP raises the prospect of a further rise in US interest rates, the uncertainty over the wider impact of Brexit is likely to delay any announcement until later in the year.

Chart 9: Real GDP Growth, UK vs US



Sources: ONS, BEA

Bottom line: Although the UK is likely to see decent growth in Q2, the economic outlook beyond that remains unclear. While the Bank of England are taking steps to provide stability, the government must focus on delivering a detailed plan to support the economy during the coming transition period, including much needed infrastructure investment.

Economic summary chart

Source: ONS National Accounts, Q1 2016

Deteriorating ■ No change ■ Improving ■

Sector	Indicators (sources)	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-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.