

Monthly Economic Review

June 2016

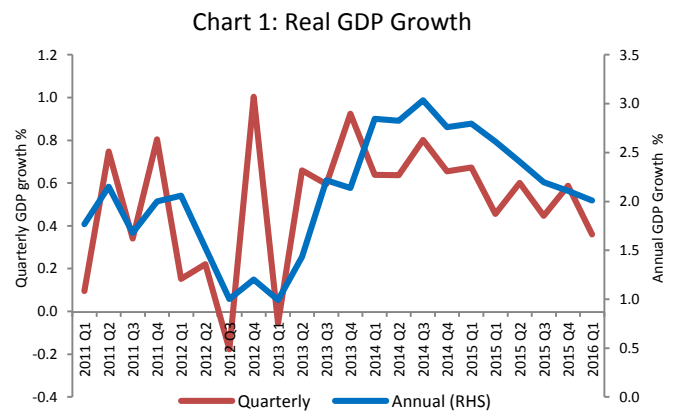
(Based on May 2016 data releases)

Monthly headlines:

- Q1 UK GDP growth unrevised, amid weakening investment and a record high trade deficit
- Bank of England cuts forecast for UK growth, with deficit reduction proving a real challenge
- Japan avoids another recession as growth in the Eurozone picks up in Q1

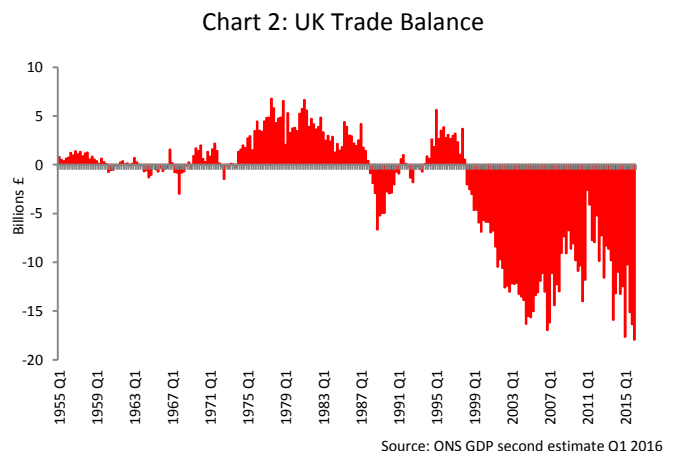
UK GDP growth in Q1 unrevised at 0.4%...

The second official estimate for Q1 2016 growth in UK GDP was unrevised at 0.4%, and was therefore still slower than the growth recorded in the final quarter of 2015 (see Chart 1). Nonetheless this was still the 13th consecutive quarter of growth. In annual terms, the UK economy grew by 2.0% in Q1, revised down slightly from the previous estimate of 2.1%. As a result, UK economic output is currently 7.2% above its pre-recession peak of Q1 2008. Overall, the second estimate of GDP does little to alter our view that the UK economy is slowing.



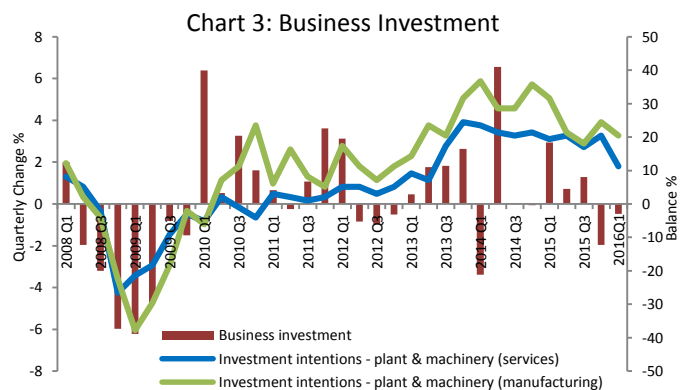
...as the UK's trade deficit hits record high...

The UK's net trade position (exports minus imports) continues to weaken. The UK's deficit in trade widened from £16.4 billion in Q4 2015, to £18 billion Q1 2016, the largest deficit since records began in 1955 (see Chart 2). This deterioration was driven by a 0.8% rise in imports in Q1 and a 0.3% decline in exports. Consequently, trade was a drag on overall economic growth in the first three months of 2016, knocking 0.4 percentage points off GDP growth in the quarter and confirms that rebalancing the UK economy remains an uphill task.



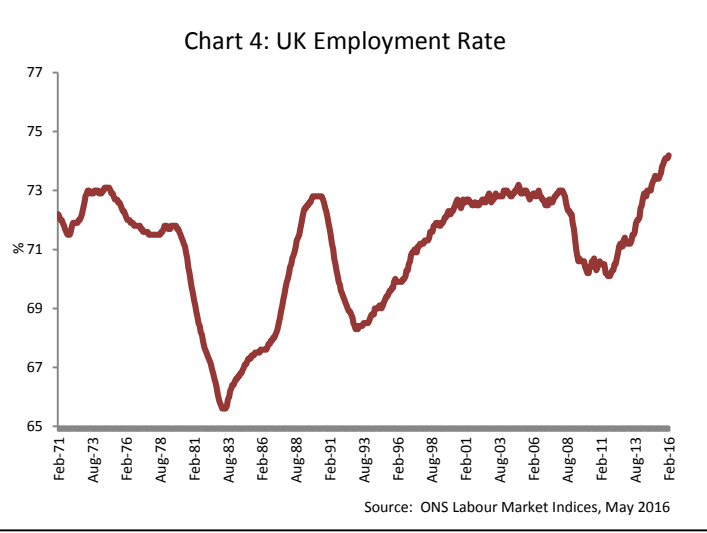
...business investment weakens...

The latest Q1 2016 GDP estimate also revealed that business investment fell by 0.5% in the quarter, the second successive quarterly decline. Business investment was 0.4% lower in Q1 in annual terms. The decline in business investment mirrors the latest QES results with most of the national investment balances weakening in Q1 (see Chart 3). In contrast, household spending, which accounts for around two-thirds of UK economic output, was the main driver of growth in Q1, growing by 0.7% in the quarter, the eleventh successive quarter of growth.



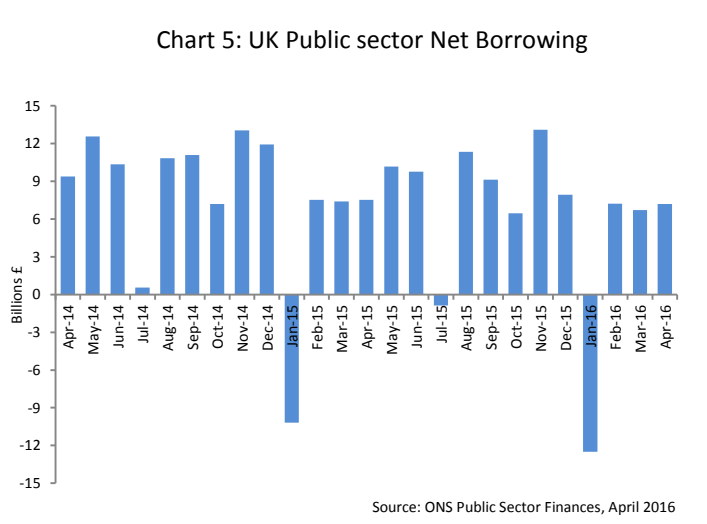
...and while the UK jobs market strengthens...

In the three months to March 2016, UK employment rose by 44,000 compared with the previous three months. As a consequence the employment rate rose to a record high of 74.2% (see Chart 4). However, there are signs that UK labour market conditions are starting to soften with unemployment declining by just 2,000 in the three months to March 2016 and the number of job vacancies falling by the largest amount since 2011. This was reinforced by the latest QES with the backward-looking national employment balances weakening in the quarter. Difficulties in recruiting staff was highlighted as a key constraint for businesses.



...deficit reduction proving a real challenge...

UK public sector net borrowing (excluding public sector banks) recorded a deficit of £7.2 billion in April 2016, down £0.3 billion from April 2015 (see Chart 5). However, for the 2015/16 financial year as a whole, government borrowing totalled £76 billion, up by £2 billion from the previous estimate and means that the government missed its own borrowing target by almost £4 billion. Furthermore, the weakening in economic activity in the UK is making it more difficult to generate tax receipts. This reinforces our own view that reaching a budget surplus is likely to take longer than the government currently expects.



...the UK's economic outlook weakens...

In its latest inflation report, the Bank of England downwardly revised its UK GDP forecast for 2016 to 2.0%, from its previous estimate of 2.2%. If achieved this would be the lowest rate of growth since 2012. The central bank's growth forecast is below the BCC's latest GDP forecast but in line with the latest outlook from the Office of Budget Responsibility (OBR) (see Table 1). The Bank of England also downgraded its growth forecast for 2017 to 2.3%, from 2.4%. However, despite the slight differences, the Bank of England's latest forecast mirrors our own view that the UK's economic outlook is weakening.

Table 1: UK GDP Growth Forecast Comparisons

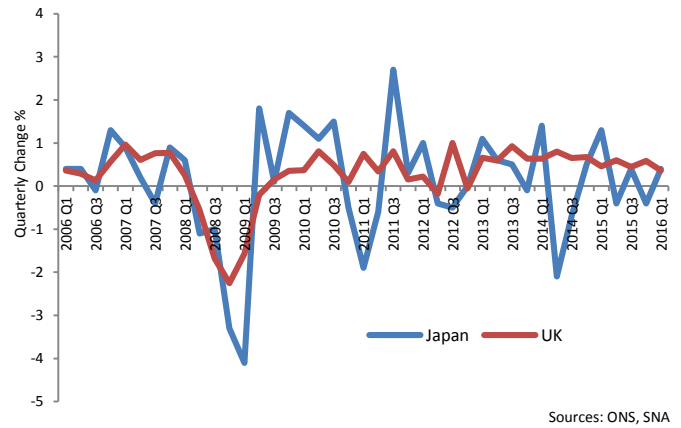
| | 2016 (%) | 2017 (%) | 2018 (%) |
|------------------------|------------|------------|------------|
| BCC | 2.2 | 2.3 | 2.4 |
| Bank of England | 2.0 | 2.3 | 2.3 |
| OBR | 2.0 | 2.2 | 2.1 |
| IMF | 1.9 | 2.2 | - |

Sources: BCC, Bank of England, IMF and OBR.

...as Japan avoids another recession...

Japan, the world's third-largest economy, grew by 0.4% in Q1 2016 (see Chart 6). This meant that Japan avoided entering another recession (defined as two successive quarters of negative growth), having recorded a decline of 0.4% in Q4 2015. Q1 Growth was mainly driven by government and consumer spending as well as the extra day of economic activity in February that the leap year provided. However, **concerns about the outlook for consumer spending, which accounts for 60% of Japan's economic output, mean that prospects for a sustained recovery remains remote.**

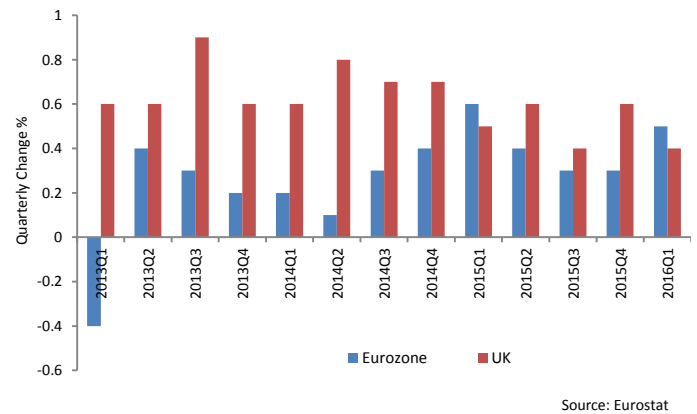
Chart 6: UK vs Japan GDP Growth



...Eurozone growth picks-up in Q1...

The Eurozone economy grew by 0.5% in Q1 2016. Although this was revised down from the previous estimate of 0.6%, this was still up from the growth of 0.3% recorded in the previous quarter and slightly stronger than the growth of 0.4% recorded in the UK in Q1 (see Chart 7). **Germany's economy, the biggest in the Eurozone, grew by 0.7% in Q1 2016, more than double the growth recorded in Q4.** Spain, at 0.8%, recorded the strongest rate of growth, while Greece and Latvia were the only countries to record negative growth in the quarter.

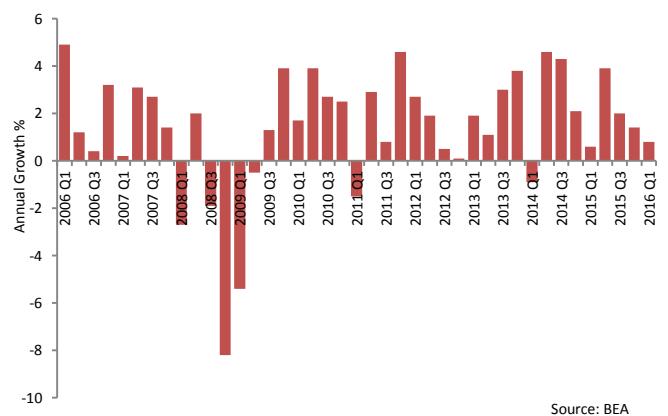
Chart 7: UK vs Eurozone GDP growth



...and US growth is revised up.

The second estimate of US GDP revealed that the US economy grew at an annual rate of 0.8% in Q1 2016, up from the previous estimate of 0.5%, but still the weakest rate of growth since Q1 2015 (see Chart 8). The upward revision was partly driven by stronger levels of residential property investment as well as an increase in inventory investment by businesses. However, consumer spending, which accounts for 75% of US GDP, was unrevised at 1.9%. **The upgrade to US GDP raises the possibility that US interest rates will soon be on the rise again, possibly this summer.**

Chart 8: US GDP Growth



Bottom line: May's data releases further highlight the continued imbalances in UK growth, with an over reliance on consumer spending and the service sector to drive UK economic output. More must be done to address the deep-rooted structural imbalances in our economy, including supporting UK exporters in their efforts to break into growing markets.

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Economic summary chart

Deteriorating ■ No change ■ Improving ■

| Sector | Indicators (sources) | May-15 | Jun-15 | Jul-15 | Aug-15 | Sep-15 | Oct-15 | Nov-15 | Dec-15 | Jan-16 | Feb-16 | Mar-16 | Apr-16 | May-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 | 10 year Government bonds (Bloomberg) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Public sector net borrowing (ONS)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Public sector net debt % of GDP (ONS)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Tax receipts (HMRC)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Current Budget Deficit (ONS)** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| External | UK trade balance (ONS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Exchange rate (Bank of England) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Export Sales (BCC)*** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Export orders (BCC)*** | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| Global | US unemployment (BLS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | Eurozone Unemployment (Eurostat) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |

*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.