Monthly Economic Review

April 2017

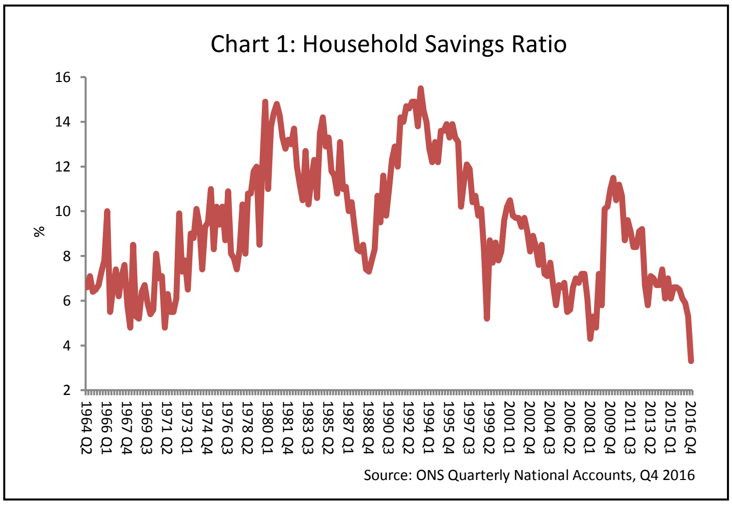
(Based on March 2017 data releases)

Monthly headlines:

- BCC upgrades its UK economic growth forecast for 2017, but downgrades outlook for 2018
- Inflation breaches the Bank of England's 2% target as earnings growth continues to slow
- Federal Reserve raises US interest rates and more rises are expected this year

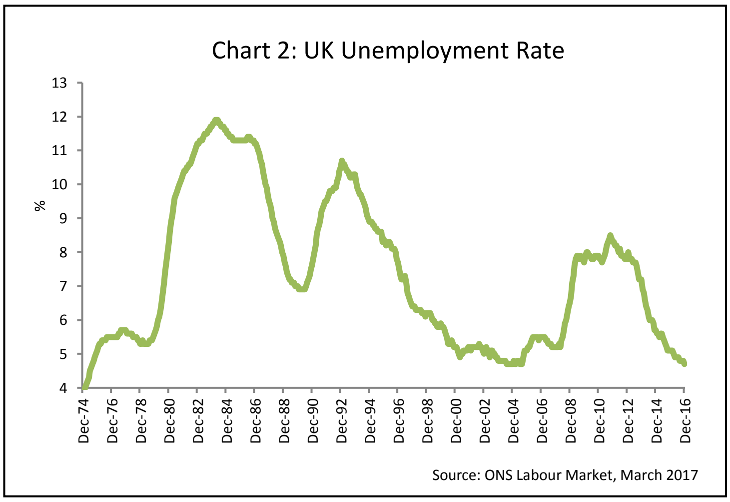
Economic growth in Q4 unrevised…

The third official estimate for Q4 2016 economic growth (GDP) was 0.7%, unrevised from the previous estimate. Household disposable income fell by 0.4% in Q4. However, **consumer spending continues to be a key driver of UK growth** with the household savings ratio - the percentage of disposable income that is saved - dropping to 3.3% in Q4, the lowest on record **(see Chart 1)**. UK's growth prospects are likely to come under increasing pressure in the coming quarters from higher inflation. **Overall, we expect UK GDP growth of 0.4% in Q1 2017.**



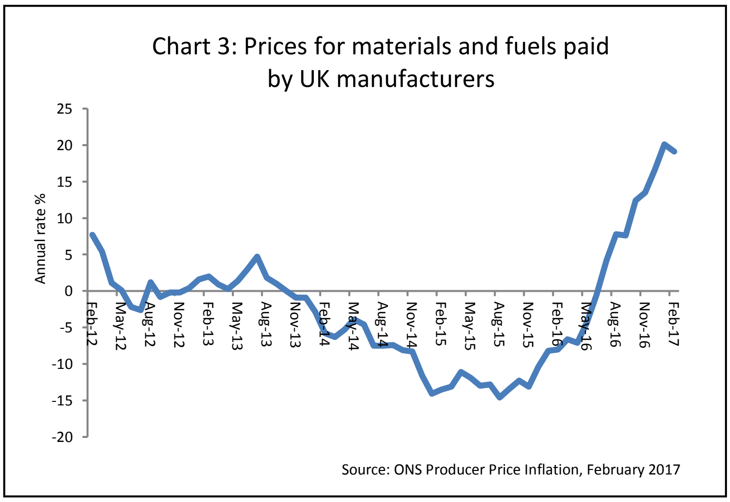
...while UK labour market remains strong...

In the three months to January 2017, the number of people in employment rose by 96,000. The UK unemployment rate fell to 4.7% over the same period, the lowest since 1975 **(see Chart 2)**. Average earnings growth slowed from 2.6% to 2.2%. **UK labour market conditions may cool over the next few years** as the expected slowdown in growth and the rising burden of upfront business costs stifle firms' hiring intentions. However, the BCC expects that the UK unemployment rate will reach a peak of 5.3% next year, still below the historical average.



…firms' input costs continue to climb…

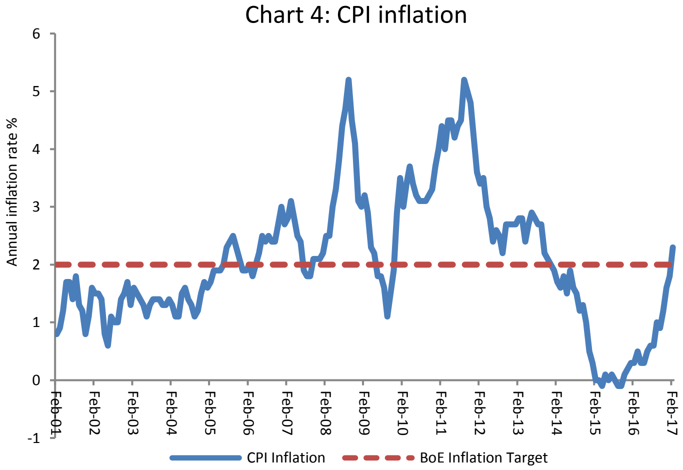
Factory gate prices rose by 3.7% in the year to February 2017, the eighth consecutive annual rise. Prices for materials and fuels paid by UK manufacturers rose 19.1% on the year **(see Chart 3)**, a slight decrease from the year to January 2017 but still the second fastest rate of annual growth since September 2008. This mirrors the latest BCC Quarterly Economic Survey which also confirms that the **rising cost of raw materials is intensifying inflationary pressures in the supply chain for businesses across the UK.**



...pushing inflation above target...

CPI inflation in the UK stood at 2.3% in February 2017, up from the 1.8% rise in January. This is the first time since November 2013 that inflation has been above the Bank of England's 2% inflation target **(see Chart 4)**. **The decline in the value of sterling and rising oil and other commodity prices, have increased inflationary pressures in recent months.** We currently forecast that inflation will remain above the Bank of England's 2% target over the near term, peaking at 2.8% in Q3 2018. Rising inflation is a key risk to the UK's growth prospects as it squeezes firms profit margins and consumer's spending power.

Chart 4: CPI inflation



Source: ONS Consumer Price Inflation, February 2017

…as BCC ups its 2017 UK growth forecast…

The BCC upgraded its UK economic growth (GDP) forecast for 2017 from 1.1% to 1.4%. (see Table 1). However, the BCC has slightly downgraded its UK growth forecast for 2018 from 1.4% to 1.3%. We expect the UK economy to enter a more subdued period with **rising inflation expected to weigh on the UK's growth outlook**. On the upside, the drop in the value of sterling and the improving outlook for the global economy is expected to improve the UK's trade balance. However, the boost to the UK's trade prospects over the forecast period is not likely to be enough to prevent a slowdown in overall GDP growth.

Table 1: BCC GDP Growth Forecast Comparison

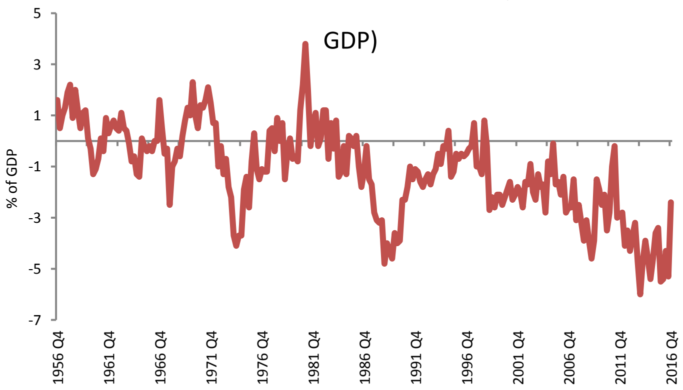
	Q4 2016 (%)	Q1 2017 (%)
2017	1.1	1.4
2018	1.4	1.3
2019	-	1.5

Source: BCC

...UK's current account deficit falls sharply…

The UK's current account deficit (the gap between what the UK earns and spends) **narrowed from 5.3% in Q3 2016 to 2.4% of GDP in Q4 2016, the lowest deficit since Q2 2011 (see Chart 5)**. The improvement was mainly driven by a narrowing in the UK's trade deficit in Q4 from £14.8 billion to £4.8 billion. This reduction was predominantly due to an increase in the exports of goods, which rose by £7.6 billion in Q4 2016. The UK ran current account deficit of £19.5 billion with the EU in Q4, whilst recording a surplus of £7.4 billion was recorded with non-EU countries over the same period.

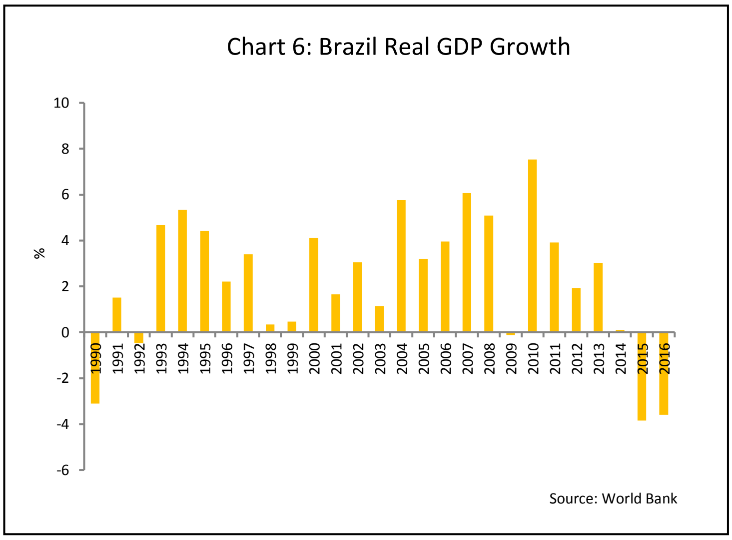
Chart 5: UK Current Account Position (as a % of GDP)



Source: ONS Balance of Payments, Q4 2016

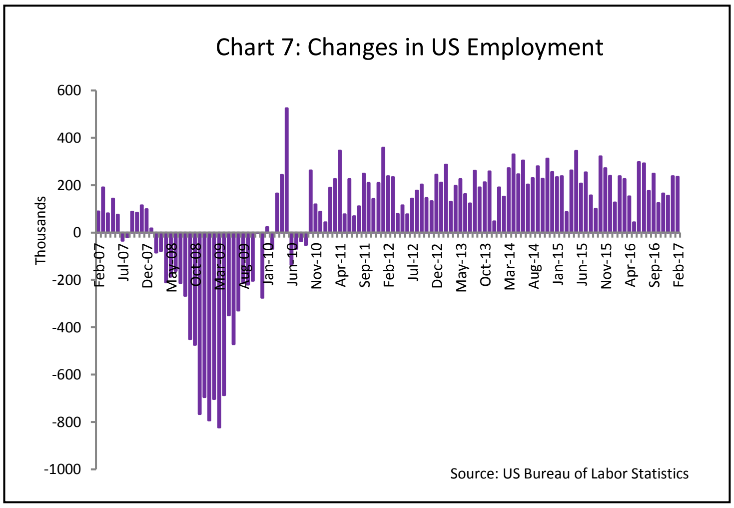
...as Brazil's recession deepens further…

Brazil, the largest economy in Latin America, contracted by 3.6% in 2016, slightly less than the decline of 3.8% in 2015 **(see Chart 6)**. However, this also means that **Brazil has been in recession for two years, their longest recession on record**. Brazil continues to struggle in the face of high unemployment and inflation as well as continued political unrest. However, there are signs that the economic outlook for Brazil is improving with inflation stabilising over recent months and a strengthening global economy likely to help boost commodity prices, an important driver of Brazilian GDP growth.



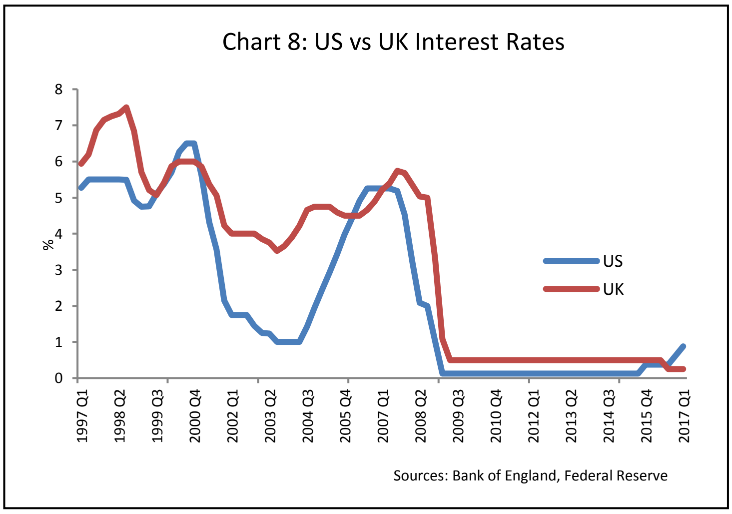
…while US tightens monetary policy again...

The Federal Reserve increased US interest rates by 0.25 percentage points to a target range of between 0.75% and 1%, the second time in three months that the US central bank has raised rates. Stronger US labour market data – US employment rose by 235,000 in February **(see Chart 7)** – and an improving near term economic outlook have given the Federal Reserve sufficient scope to gradually raise rates. **If US monetary policy continues to tighten as expected, it will increase the downward pressure on sterling, which is likely to push UK inflation higher.**



…the MPC keeps rates on hold.

In contrast to the US, the Bank of England's Monetary Policy Committee (MPC) kept UK interest rates on hold at 0.25% **(see Chart 8)**. There was surprising shift in the committee's voting pattern, with one member - Kristin Forbes - voting for a rate rise. However, with Kristin Forbes leaving the MPC after its June meeting, the outlook for UK interest rates has changed little. As UK economic growth is expected to slow, the MPC are likely to tolerate a period of high inflation. Therefore, **while the next move in rates is likely to be upwards, this is unlikely to happen until the end of 2018.**



Bottom line: *Overall, UK growth remains unbalanced despite a strong end to 2016. As the process for exiting the EU unfolds it is vital that policymakers do not become preoccupied with Brexit and ignore the other major issues that continue to weigh on growth prospects, including tackling the up-front costs faced by businesses.*

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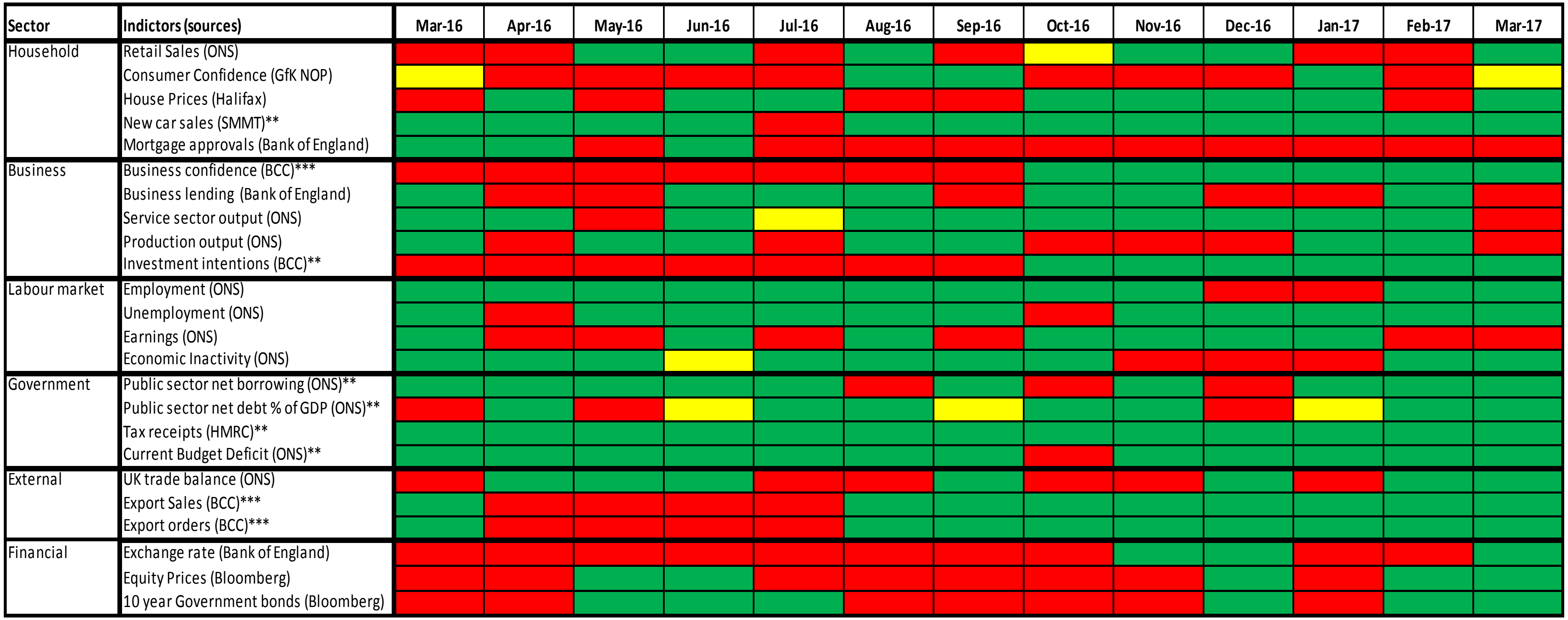
Economic summary chart

Deteriorating No change Improving



*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.