

Monthly Economic Review

December 2016

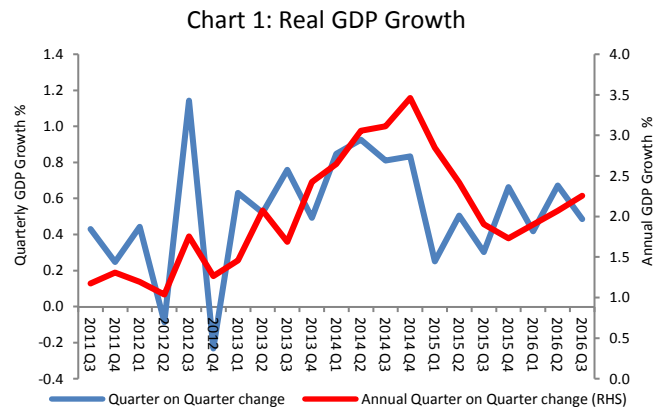
(Based on November 2016 data releases)

Monthly headlines:

- Q3 UK GDP growth unrevised with business investment supporting growth in the quarter
- OBR downgrades its economic and fiscal outlook for the UK
- US GDP growth revised up, but the pick-up in Indian GDP growth unlikely to be sustained

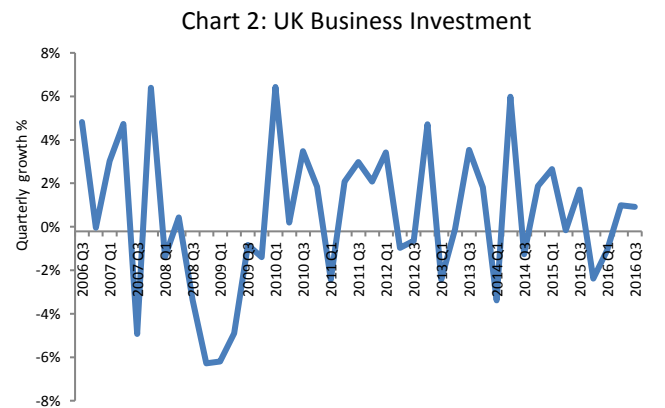
UK growth unrevised in Q3...

The second official estimate of economic growth (GDP) recorded UK economic growth of 0.5% in Q3 2016, unrevised from the previous estimate and lower than the 0.7% recorded in the second quarter (see Chart 1). Despite the slowdown, growth in Q3 marked the fifteenth successive quarter of GDP growth. In annual terms, GDP was up by 2.3% in Q3. UK economic output is currently 8.1% above its Q1 2008 pre-recession peak. **Overall, the latest GDP figures confirm that the UK economy is growing in line with the long-term historic average.**



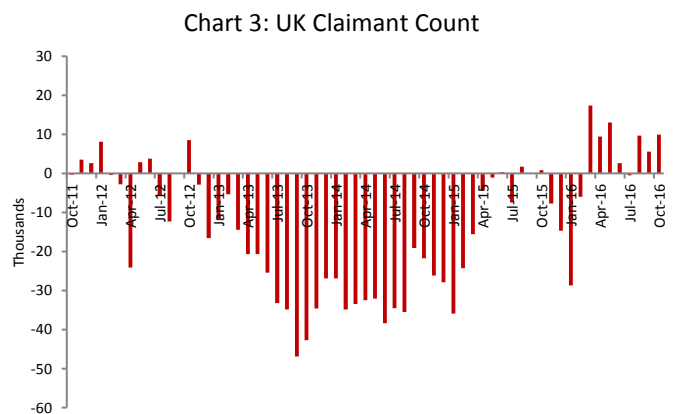
...as business investment boosts Q3 growth...

The latest Q3 2016 GDP estimate revealed that business investment grew by 0.9% in the quarter (see Chart 2). However, it remains 1.6% lower in annual terms. Although the UK's trade deficit narrowed to £12.4 billion in Q3 2016, down from £15.7 billion in the previous quarter, it remains high by historic standards. Consumer spending grew by 0.7% in the quarter. Overall, despite the improvement in trade and business investment, the **UK economy remains overly reliant on consumer spending to drive growth.**



...but while the UK jobs market strengthens...

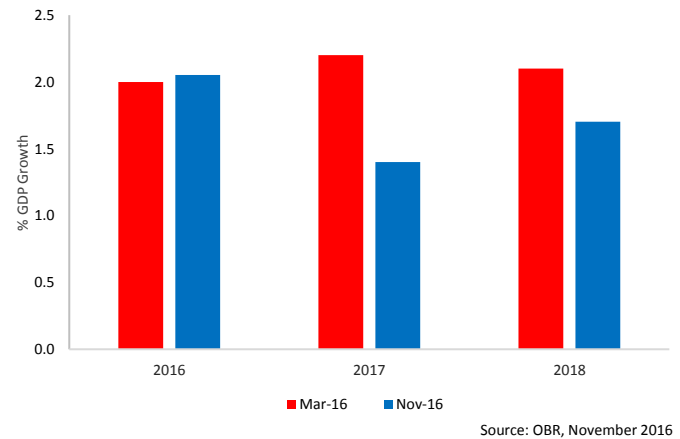
In the three months to September, UK employment rose by 49,000 compared with the previous three months. The number of people who are unemployed fell by 37,000 over the same period. As a result, the unemployment rate fell to 4.8%, the lowest rate since the three months to September 2005. In contrast, the timelier claimant count (number of people claiming unemployment related benefits) rose by 9,800 in October (see Chart 3). **If the UK economy slows as we expect, it is likely that labour market conditions will weaken over the next year.**



...OBR predicts slower UK growth...

In its latest economic forecast, the Office for Budget Responsibility (OBR) expects GDP growth of 2.1% for 2016, slightly higher than their previous forecast of 2.0% published in March 2016 (see Chart 4). However, the OBR's 2017 growth forecast has been downgraded from 2.2% to 1.4. Forecasted growth in 2018 has been cut to 1.7%, from their previous forecast of 2.1%. Overall, the OBR's latest GDP growth forecasts are slightly higher than the BCC's latest growth projections. Nonetheless, **the OBR's revised forecasts confirm that they are more pessimistic over the UK's economic outlook than at the March budget.**

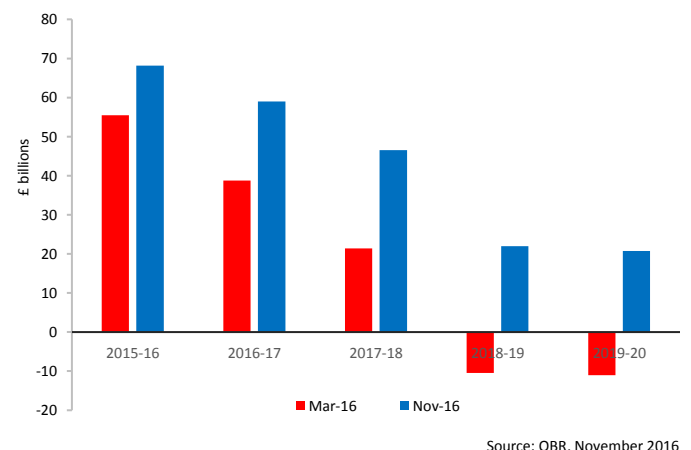
Chart 4: UK GDP Growth Forecasts



...and a weaker fiscal outlook...

The OBR now expects public-sector net borrowing to reach £68.2 billion in 2016-17, higher than their March 2016 forecast of £55.5 billion (see Chart 5). Overall, the OBR now expect that the **UK's Public Sector Borrowing will be £122 billion higher over this parliament** than they had forecast in March 2016. The deterioration has been driven by more pessimistic forecasts for tax revenue from slower expected growth. Significantly, the Chancellor announced a new framework for deficit reduction which included confirmation that the Government are no longer seeking to reach a budget surplus in 2019-20.

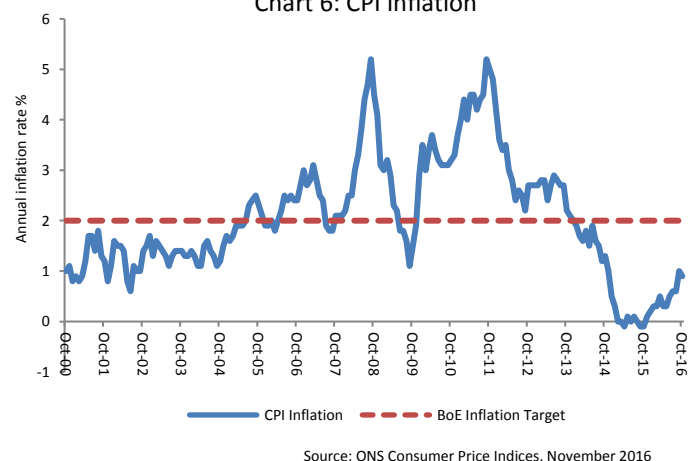
Chart 5: Public Sector Net Borrowing Forecasts



... with higher inflation to weigh on growth...

UK CPI inflation stood at 0.9% in October 2016, down slightly from the 1.0% recorded in September (see Chart 6). The main downward pressure on inflation came from prices for clothing and university tuition fees rising by less than they did a year ago. While the slight fall in inflation in October was a surprise, **with price of goods leaving factories rising at their fastest rate since April 2012, price growth is likely to resume its upward trend in the coming months.** Rising inflation is likely to weigh on the UK's near-term economic outlook by reducing disposable incomes in real terms and increasing costs for businesses.

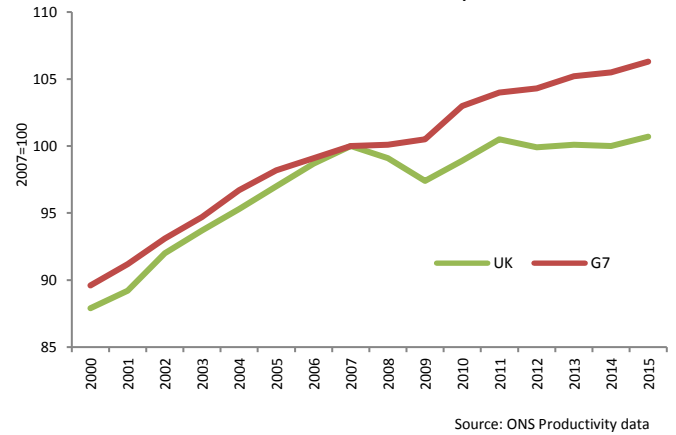
Chart 6: CPI inflation



...as the Chancellor focuses on productivity...

Measures to boost UK productivity formed a key part of the 2016 Autumn Statement. UK productivity, as measured by average output per hour worked, rose by 0.2% in Q3, lower than the growth of 0.6% recorded in Q2. **UK productivity has consistently been among the weakest in the G7 as deep-rooted structural problems - from skills shortages, to infrastructure bottlenecks and limited growth finance - have dampened productivity.** Although the UK narrowed its productivity gap with the rest of the G7 over the first half of the 2000s, that trend has now been in reverse since the financial crisis (**see Chart 7**).

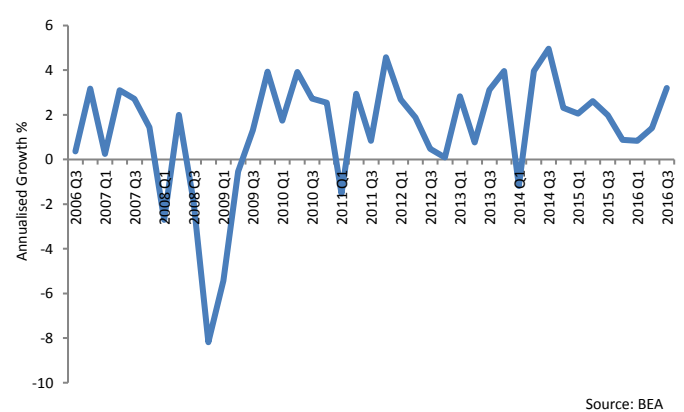
Chart 7: UK Productivity



...and while US growth is revised up...

The second estimate of US GDP revealed that the US economy, the world's largest, grew at an annualised rate of 3.2% in Q3 2016 (see Chart 8), the strongest rate of growth since Q3 2014 and up from the first estimate of 2.9%. The upward revision was driven by consumer spending, which accounts for around two-thirds of US economic output, rising by 2.8% in the quarter, up from the initial estimate of 2.1%. **The more positive GDP figures has increased speculation that US interest rates, which have been on hold since December 2015, will soon be on the rise.**

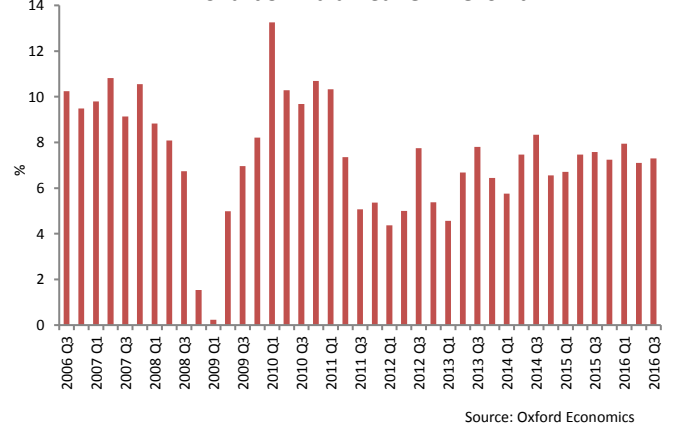
Chart 8: US Real GDP Growth



...Indian GDP growth is set to slow.

India's economy, the world's seventh-largest, grew by 7.3% in annual terms in Q3 2016, up from the growth of 7.1% recorded in the previous quarter (see Chart 9). Consumer spending, a key driver of India economic output, grew by 12%, while government spending increased by 20%. In contrast, investment remains a drag on growth, contracting by 3.2%. While the longer-term outlook for India's economy remains relatively good, **the liquidity squeeze caused by Prime Minister Modi's ban on using Rs500 and Rs1,000 banknotes is expected see growth slow sharply in the short-term.**

Chart 9: India Real GDP Growth



Bottom line: November's data confirms that the UK economy continues to grow in line with the long-term historic average. However, as the OBR's latest forecasts confirm the UK is set to enter a more challenging period. More must be done to address the high up-front taxes and costs of doing business in the UK, particularly business rates.

Economic summary chart

		Deteriorating ■ No change ■ Improving ■												
Sector	Indicators (sources)	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-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.