

Monthly Economic Review

January 2017

(Based on December 2016 data releases)

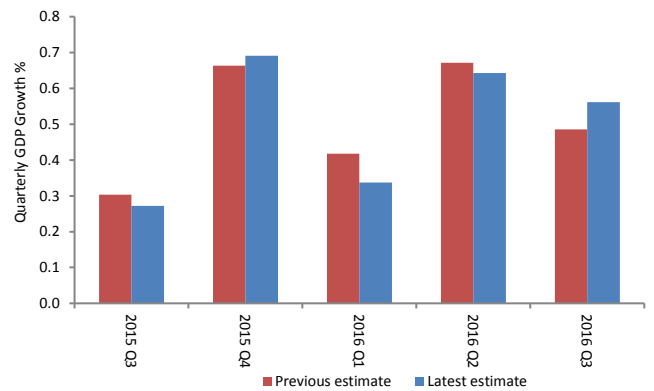
Monthly headlines:

- Q3 UK GDP growth revised up and latest QES points to solid growth in Q4
- Higher inflation and uncertainty over Brexit likely to weigh on UK's growth prospects
- US Federal Reserve raises interest rates and further rises are likely in the coming months

UK growth revised up in Q3...

The third official estimate of UK economic growth (GDP) recorded growth of 0.6% in Q3 2016, up from the previous estimate of 0.5% (see Chart 1). The upward revision was driven by stronger business and financial services output which rose by 0.8% in Q3, up from the previous estimate of 0.3%. However, UK growth was downwardly revised in Q1 from 0.4% to 0.3% and from 0.7% to 0.6% in Q2. Despite the revisions economic output remains 8.1% above its pre-recession and confirms that the **UK economy is growing in line with historic trends.**

Chart 1: Real GDP Growth Revisions

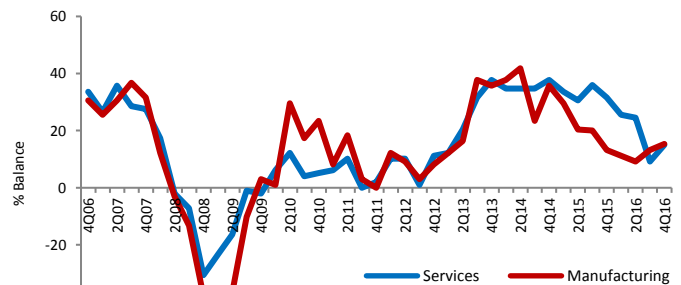


Source: ONS National Accounts, Q3 2016

...Q4 QES indicates continued growth...

The Q4 2016 BCC Quarterly Economic Survey (QES) revealed that output from both the manufacturing and services sectors continued to expand. The balance of manufacturers reporting increased domestic sales rose to +15% from +13% (see Chart 2), and those reporting increased advance orders remained level at +7%. The balance for domestic sales in the services sector was up from +9% to +15%. **Overall, the latest QES data suggests that the UK economy grew in line with its long-term trend in the final quarter of 2016.**

Chart 2: Domestic Sales

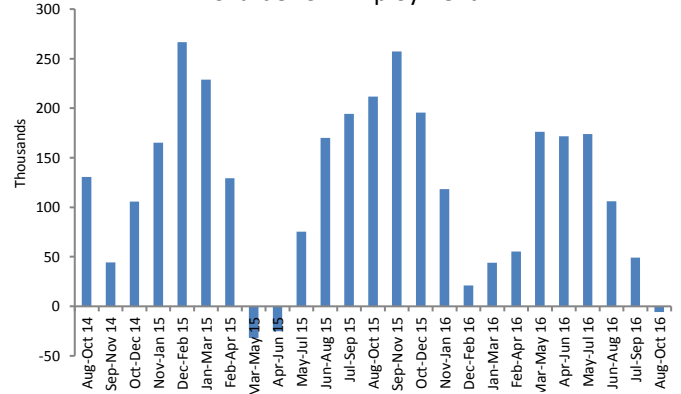


Source: BCC QES, Q4 2016

...but while UK unemployment is still falling...

In the three months to October, the number of people who are unemployed fell by 16,000. In contrast, UK employment fell by 6,000, the first decline since June 2015 (see Chart 3). Similarly, the claimant count (number of people claiming unemployment related benefits) rose by 2,400 in November, the third successive monthly rise. **Although UK unemployment could start to drift upwards in the coming months as economic growth slows, we expect that the labour market will remain a source of strength for the UK economy.**

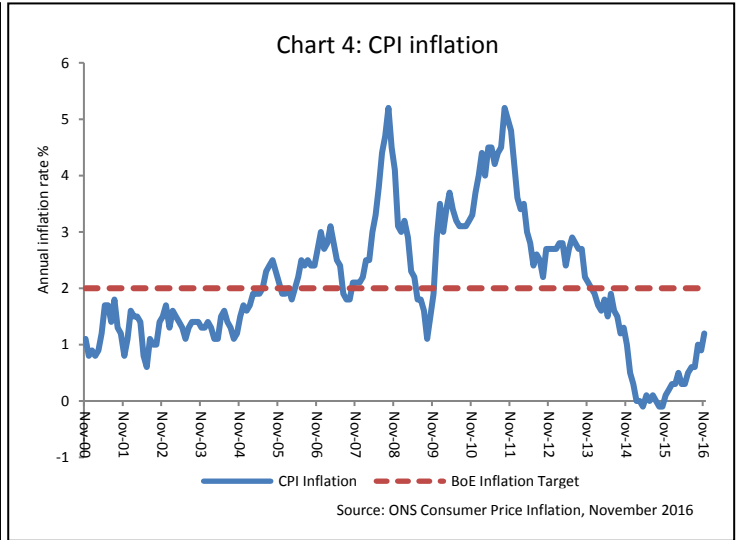
Chart 3: UK Employment



Source: UK labour market indices, December 2016

...with inflation continuing to rise...

UK CPI inflation rose to 1.2% in November 2016, the highest rate since October 2014 (see Chart 4) and up from the 0.9% rise recorded in the previous month. Rises in the prices of clothing and motor fuels were the main contributors to the rise in the rate. These increases were partly offset by falls in air fares. While price growth remains well below the historical average, we forecast that inflation will breach the Bank of England's 2% target this year, as the rising cost of raw materials filters through into a broader and more sustained rise in prices. **We current expect that UK inflation will rise to 2.5% by the end of 2017.**



...the outlook for UK growth remains weak...

The BCC has upgraded its UK economic growth (GDP) forecast for 2016 from 1.8% to 2.1% and for 2017 from 1.0% to 1.1% (see Table 1). However, the BCC downgraded its UK growth forecast for 2018 from 1.8% to 1.4%. We expect that higher inflation and continued uncertainty over Brexit will weigh on the UK's growth prospects, with consumer spending and business investment likely to be hardest hit. Overall, the BCC's latest forecasts confirm that the near-term outlook for the UK economy remains challenging. **That said, we do not expect the economy to enter into a recession over the next few years.**

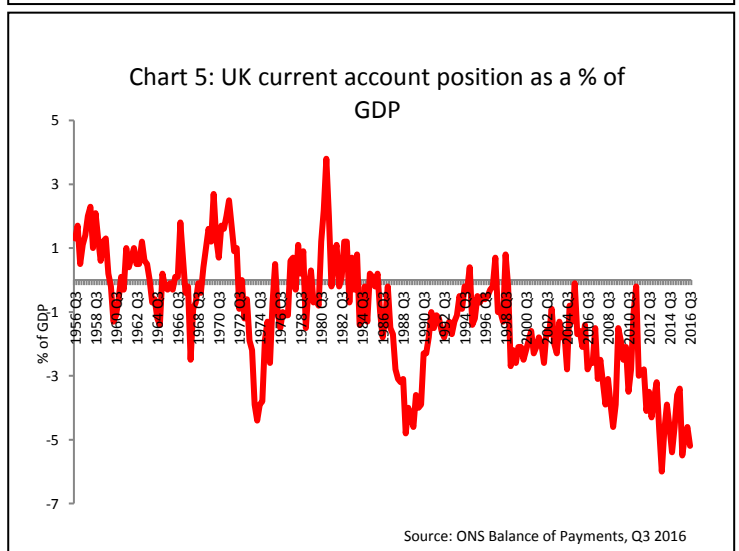
Table 1: BCC GDP Growth Forecast Comparison

	Q3 2016 (%)	Q4 2016 (%)
2016	1.8	2.1
2017	1.0	1.1
2018	1.8	1.4

Source: BCC

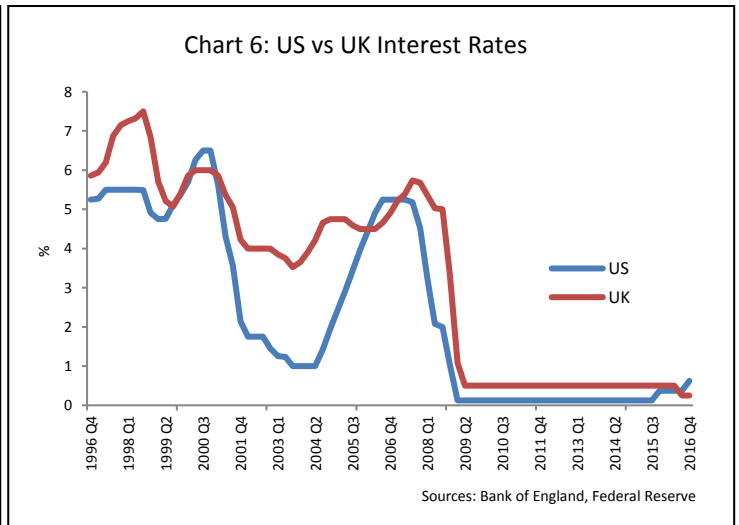
...and rebalancing is still a major challenge.

The UK's current account deficit (the gap between what the UK earns and spends) stood at 5.2% of GDP in Q3 2016, higher than the 4.6% recorded in Q2 2016. The UK's current account deficit in Q3 is more than five times the long-term average of -1% (see Chart 5). The deterioration was largely driven by the widening in the UK's trade deficit which almost doubled from £7.3 billion in Q2 to £13.6 billion in Q3 2016. **The scale of the UK's current account deficit continues to leave the UK vulnerable to rapid changes in economic conditions and a further downgrade to its credit rating.**



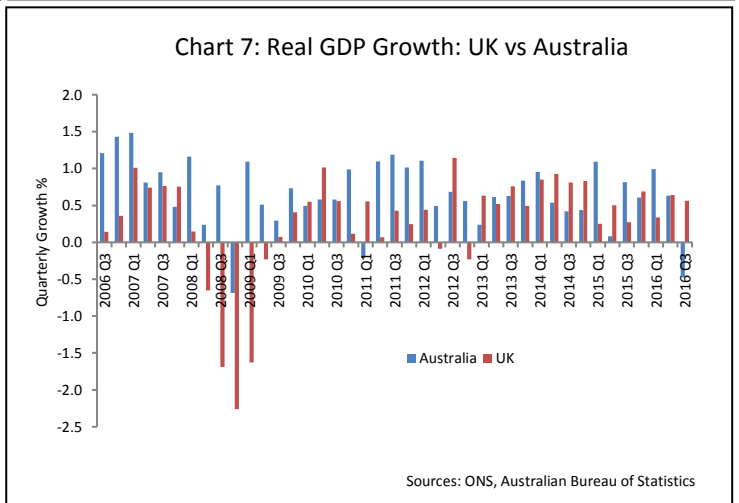
While US tightens monetary policy...

The Federal Reserve raised US interest rates by 0.25 percentage points to a target range of 0.5% and 0.75%, the first increase since December 2015 (see Chart 6). The move reflects an improving outlook for the US economy with the central bank also upgrading its forecast for US economic growth for 2017 from 2.0% to 2.1%. Further rises in US interest rate are expected in the coming months which will place further downward pressure on the value of sterling. Nonetheless, we currently expect that UK interest rates will remain on hold throughout 2017.



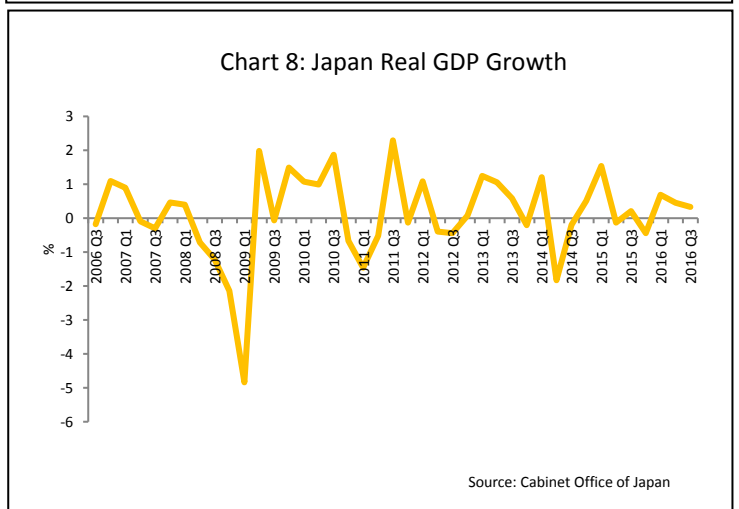
...Australia's economic growth slows...

Australia's economy contracted by 0.5% in Q3 2016, the first decline since Q1 2011 (see Chart 7) with investment and construction weakening in the quarter. New business investment dropped by 3.2%, the 12th consecutive quarterly fall and output from the construction sector declined by 3.6%. While the mining boom which has helped to keep Australia recession-free since 1991 has all but ended, Australia's economic outlook remains positive with record low interest rates expected to support investment and consumer spending.



...as does Japan.

Japan, the world's third-largest economy, grew by 0.3% in Q3 2016 (see Chart 8), down from the previous estimate of 0.5%. The downward revision was primarily driven by a smaller contribution from exports which rose by 1.6% in the quarter, down from the previous estimate of 2%. Japan's economy grew at an annualised rate of 1.3% in Q3, down from the previous estimate of 2.2%. While the revised GDP figures confirm that Japan's economy grew for the third successive quarter – the longest stretch in three years – growth remains sluggish.



Bottom line: While the UK economy continues to grow at a moderate rate, higher inflation and uncertainty over Brexit are likely to weigh on the UK's growth prospects. It is therefore vital that the upcoming Budget is used to improve the business environment, including addressing the high up-front taxes and costs of doing business in the UK.

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Economic summary chart

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