Monthly Economic Review

October 2016

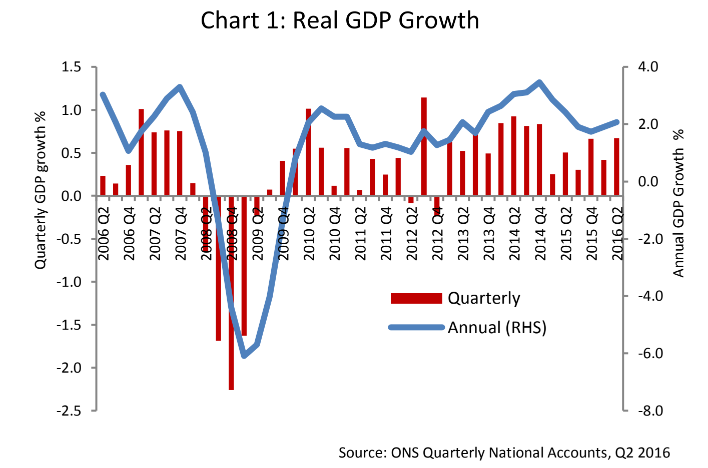
(Based on September 2016 data releases)

Monthly headlines:

- UK GDP growth in Q2 revised upwards, with stronger service sector output
- BCC cuts UK growth outlook with consumer spending and investment expected to weaken
- UK interest rates expected to be cut again by the end of 2016

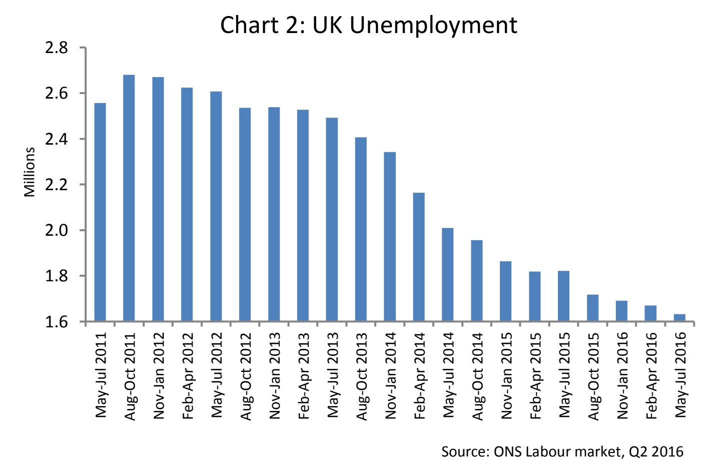
UK economic growth revised up to 0.7%...

The third official estimate of economic growth (GDP) revealed that the UK economy grew by 0.7% (see Chart 1) in Q2 2016, up from the previous estimate of 0.6%. The upward revision was mainly driven by service sector output rising by 0.6% in Q2, up from the previous estimate of 0.5%. Business investment grew by 1.0% in Q2, double the previous estimate of 0.5%. Q2 GDP growth in annual terms was revised down from 2.2% to 2.1%. **Overall, the latest GDP figures confirms that the UK economy grew at a good pace in the run-up to the EU referendum.**



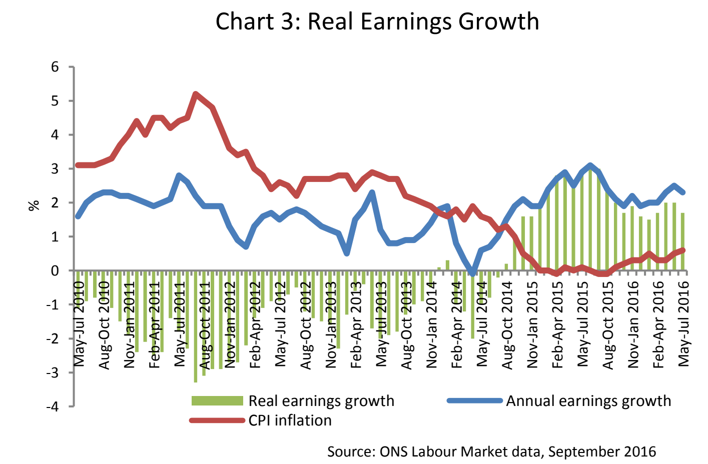
...but while the UK jobs market strengthens ...

In the three months to July 2016, UK employment rose by 174,000 compared with the previous three months. The number of people who are unemployed fell by 39,000 over the same period **(see Chart 2)**. In contrast, the timelier claimant count measure rose by 2,400 in August. Although the UK labour market remains a major source of strength for the UK economy, **the BCC expect that UK labour market conditions will weaken over the next year** as mounting uncertainty weighs on recruitment intentions and slows employment growth.



...and real wage growth is strong for now...

CPI inflation was running at an annual rate of 0.6% in August 2016, unchanged from July with rising food prices and air fares, offset by falling fuel prices. With annual pay growth rising by 2.3% in the three months to July 2016, real earnings continue to rise at a solid pace, boosting consumer spending power **(see Chart 3)**. However, the **declining value of the pound is already feeding through into input costs and is likely to push inflation higher in the coming months, squeezing real incomes and consumer spending**, a key driver of economic growth.



…BCC downgrades its UK growth forecasts…

The BCC has downgraded its UK economic growth (GDP) forecast for 2016 from 2.2% to 1.8%. **(see Table 1)**. The BCC has also downgraded its UK growth forecast for 2017 from 2.3% to 1.0% and for 2018 from 2.4% to 1.8%. Mounting political and economic uncertainty is likely to weigh investment, while rising inflation and moderately weaker labour market conditions are expected to dampen consumer demand. On the upside, the drop in the value of sterling is likely improve in the UK's net trade position. **While we expect that the UK will avoid recession, UK economic growth is set too slow sharply.**

Table 1: BCC UK GDP Growth Forecast Comparison

	Q1 2016 (%)	Q3 2016 (%)
2016	2.2	1.8
2017	2.3	1.0
2018	2.4	1.8

Source: BCC

…as does the OECD…

The Organisation for Economic Co-operation and Development (OECD) has slightly upgraded its forecast for UK GDP for 2016 to 1.8%, from its previous forecast of 1.7%. However, **the OCED significantly downgraded UK growth forecast for 2017 from 2.0% to 1.0%.** OECD's latest forecasts are now in line with the latest BCC growth forecasts **(see Table 2)**. The OECD also downgraded its forecasts for global growth from 3.0% to 2.9% in 2016 and from 3.3% to 3.2% in 2017. This reflects downgrades in major advanced economies, partly offset by stronger growth from emerging-market commodity producers.

Table 2: UK GDP Growth Forecast Comparison

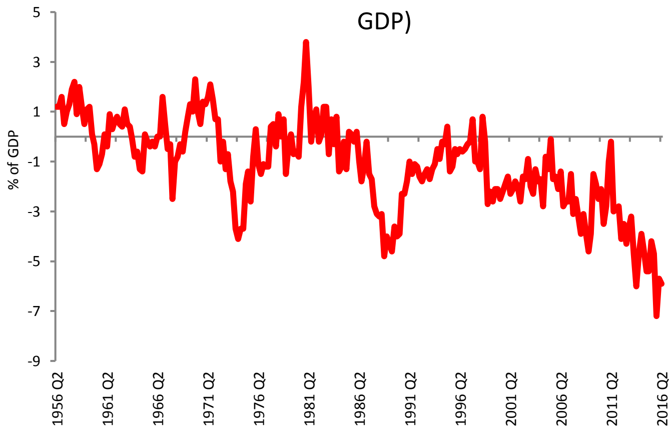
	2016 (%)	2017 (%)	2018 (%)
Bank of England	2.0	0.8	1.8
OBR	2.0	2.2	2.1
BCC	**1.8**	**1.0**	**1.8**
OECD	**1.8**	**1.0**	**1.8**
IMF	1.7	1.3	-

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

...and rebalancing remains a challenge...

The UK ran a current account deficit (the difference between what we earned from other countries and what we spent) **of £28.7 billion in Q2 2016, 6% higher than the deficit of £27 billion in Q1**. The UK's current account deficit was equivalent to 5.9% of GDP in Q2, up from the 5.7% recorded in Q1 **(see Chart 4)**. The widening of the UK's current account deficit was partly driven by the widening of the trade deficit from £10 billion in Q1 to £12.7 billion in Q2. **The size of the UK's current account deficit leaves the UK exposed to economic shocks and confirms that rebalancing the UK economy remains a major challenge.**

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

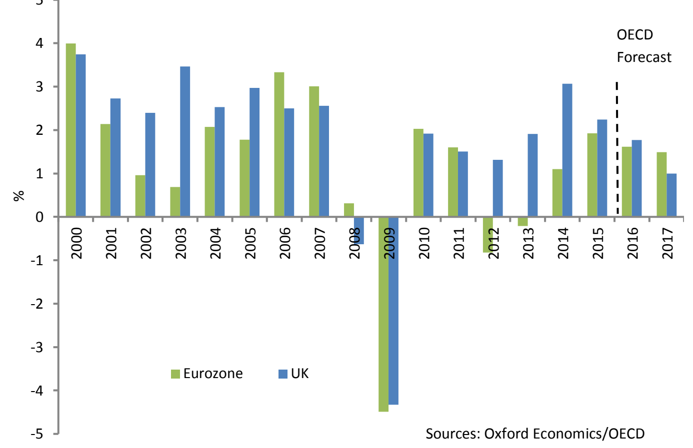


Source: Balance of Payments, Q2 2016

...while Eurozone growth is unrevised...

The second estimate of Eurozone GDP had growth at 0.3% for Q2 2016, unrevised from the previous estimate, but down from the growth of 0.5% recorded in Q1. Germany's economy, the biggest in the Eurozone, grew by 0.4% **(see Chart 5)**, down sharply from the growth of 0.7% recorded in Q1. Slovakia (0.9%) recorded the strongest growth, followed by Spain (0.8%) and Cyprus (0.7%). In contrast, France, Italy and Finland recorded no growth in the quarter. However, while the outlook for the Eurozone remains weak, **the OECD predicts that in 2017 the Eurozone will outgrow the UK for the first time since 2011.**

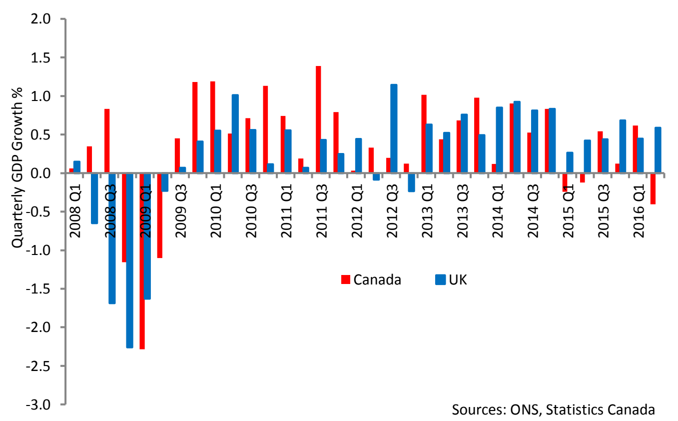
Chart 5: Real GDP: Eurozone vs UK



...Canada's economy weakens...

Canada, the tenth largest economy, contracted by 0.4% in Q2 2016, the largest decline since Q2 2009 (see Chart 6). The decline was largely driven by a 4.5% fall in exports in the quarter as well as the effects of the Alberta wildfires on energy production. Business investment dropped by 0.1%, the sixth successive quarterly decline. In annual terms, Canada's economic output was 0.9% higher compared to Q2 2015. While growth is likely to bounce back in Q3, the continued adjustment towards lower oil prices mean that the outlook for Canada remains subdued.

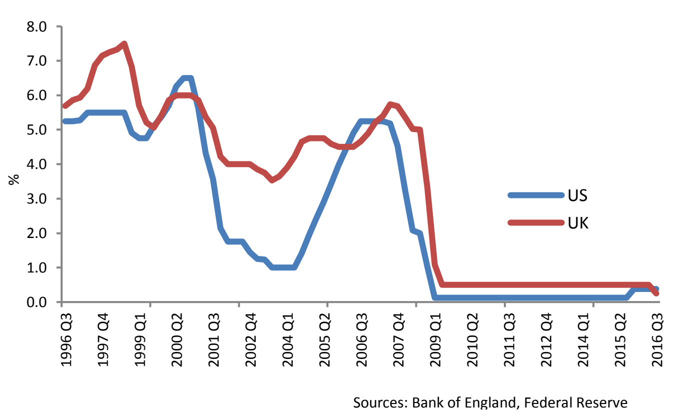
Chart 6: Real GDP: UK vs. Canada



…and US monetary policy set to tighten again.

The minutes from the Federal Reserve's September meeting show the majority of policymakers expect a rise in US interest rates by the end of the year. While the Federal Open Market Committee opted to hold rates between 0.25% and 0.5%, three officials voted against the decision, the most dissents since December 2014. US interest rates rose for the first time in almost a decade in December 2015 **(See Chart 7)**. While US GDP growth remains subdued, a further rate rise is a signal that the **central bank believes that US economic conditions are normalising.**

Chart 7: US vs UK Interest Rates



***Bottom line**: Overall, last month's economic data releases confirm that the UK economy remains in decent shape. However, if UK economic growth slows as we expect it is vital that more is done to support business investment and confidence, including much needed investment in our infrastructure.*

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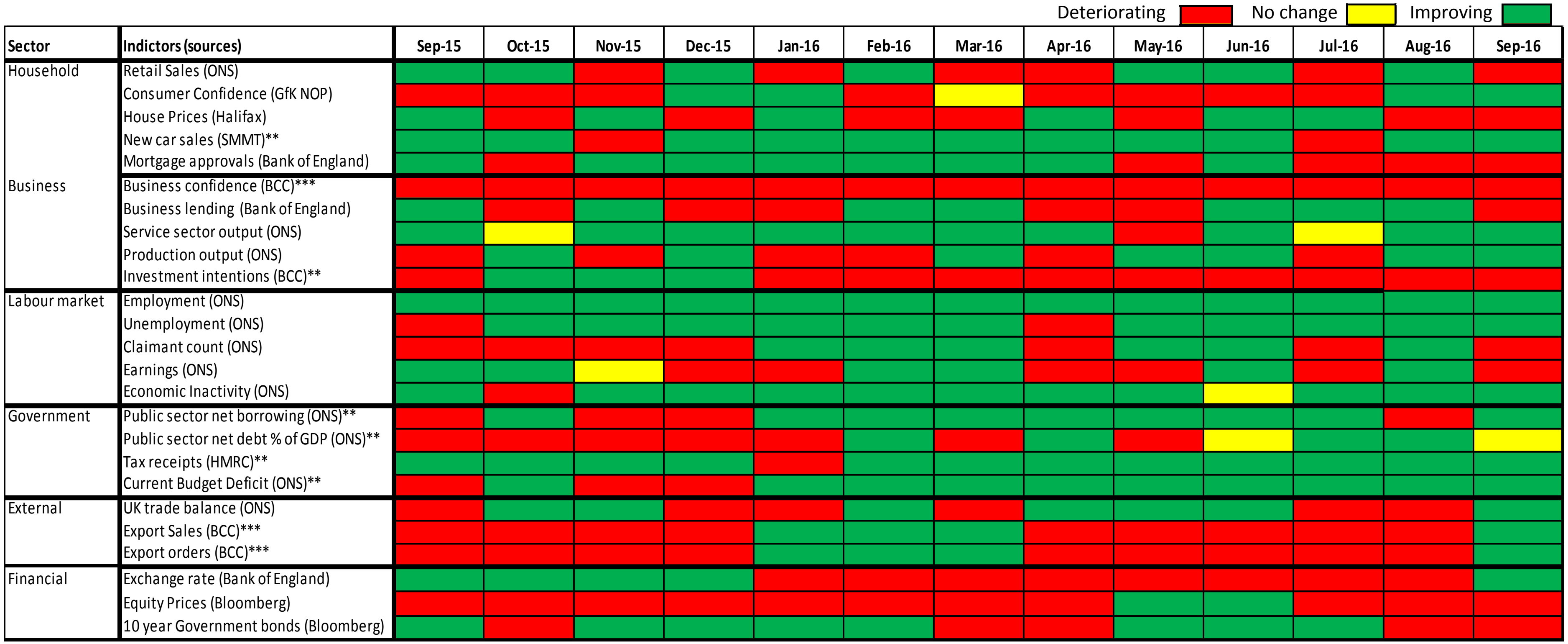
Economic summary chart



*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.