

Monthly Economic Review

December 2015

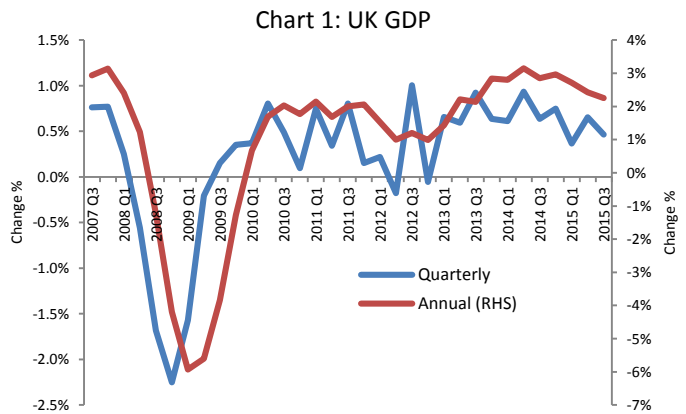
(Based on November 2015 data releases)

Monthly headlines:

- Q3 UK GDP growth unrevised with net trade a major drag on growth in the quarter
- OBR forecasts steady UK growth and an improving fiscal outlook
- US GDP growth revised up, but Japan falls back into recession once again

UK growth unrevised in Q3...

The second official estimate of economic growth (GDP) revealed that UK GDP grew by 0.5% in Q3 2015, unrevised from the previous estimate and lower than the growth of 0.7% recorded in the previous quarter (see Chart 1). Despite the slowdown, growth in Q3 marked the eleventh successive quarter of GDP growth. In annual terms, GDP was up 2.3%. UK economic output is currently 6.4% above its Q1 2008 pre-recession peak. **Overall, the latest GDP figures confirm that the UK economy is growing at a solid rate.**



...as the OBR predicts solid UK growth...

In its latest economic forecast, the Office for Budget Responsibility (OBR) expects GDP growth of 2.4% for 2015, unchanged from their previous forecast published in July 2015. This is slightly lower than the latest BCC forecast of 2.6% and the latest forecasts from the Bank of England and the IMF (see Table 1). The OBR's growth forecast for 2016 has been upgraded from 2.3% to 2.4%. Despite the slight differences, **the OBR's latest forecasts of UK GDP supports our view that the UK economy is likely to grow at a solid pace over the next few years.**

Table 1: UK GDP forecast comparisons

	2015 (%)	2016 (%)	2017 (%)
Bank of England	2.7	2.5	2.6
BCC*	2.6	2.7	2.7
IMF	2.5	2.2	2.2
OBR	2.4	2.4	2.5

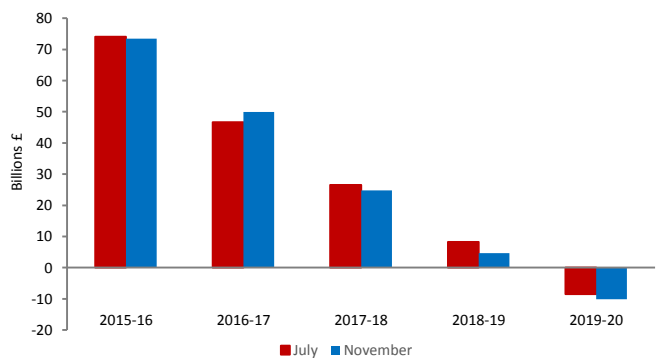
*New forecast to be published on 9th December

Sources: BCC, IMF, OBR and Bank of England

...and an improved fiscal outlook...

The OBR now expect that the **UK's Public Sector Borrowing will be £23 billion lower over this parliament**, than they had forecast in July 2015. The improvement has been driven by more optimistic forecasts for tax revenue and government's debt interest payments. This enabled the Chancellor to reduce the scope of the spending cuts implied by the summer budget by a third. **Despite the expected improvement, the task of reaching the budget surplus of £10.1 billion by 2019/20 predicted by the OBR remains a major challenge (see Chart 2).**

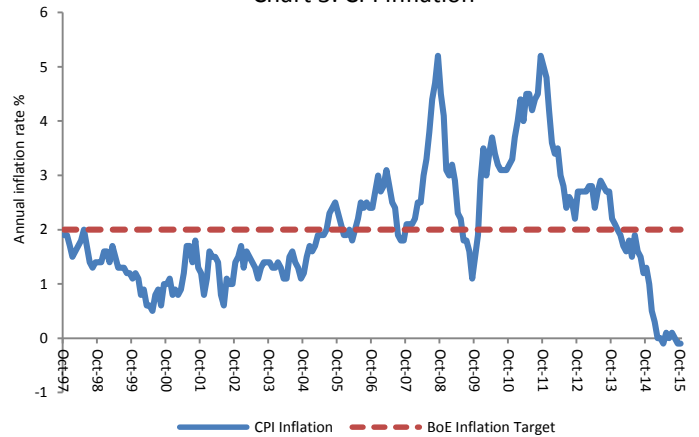
Chart 2: Public Sector Borrowing Forecasts



...supported by weak inflation...

CPI inflation stood at -0.1% in October, unchanged from the previous month. This was the first time that the CPI inflation index has fallen on an annual basis for two months in a row since records began in 1997 (see **Chart 3**). The downward price pressures came from university tuition fees, food, alcohol and tobacco. **In addition to boosting people's spending power, falling inflation has also reduced the government's debt interest payments** (RPI inflation determines interest payments for index-linked gilts). We expect inflation to remain very weak, remaining below the Bank of England's 2% target until well into 2017.

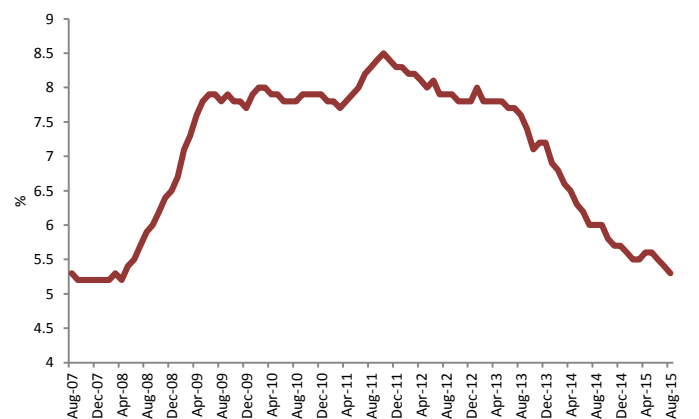
Chart 3: CPI inflation



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

In the three months to September 2015, UK employment rose by 177,000 compared with the previous three months, reaching 31.2 million. The number of people who are unemployed fell by 103,000 over the same period to 1.75 million. As a result, the unemployment rate fell to 5.3%, the lowest rate since 2008 (see **Chart 4**). In contrast, the claimant count (number of people claiming unemployment related benefits) increased for the third month in a row, up by 3,300 in October to 795,500. Overall, **the UK labour market remains an important driver of UK economic growth.**

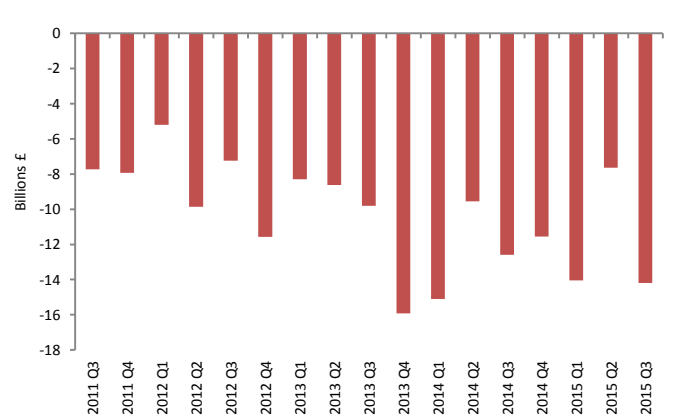
Chart 4: UK Employment Rate



...trade is a major drag on growth...

The UK's trade deficit widened from £7.7 billion in Q2 2015 to £14.2 billion in Q3 2015, the biggest deficit since Q1 2014 (see **Chart 5**). This was driven by a 5.5% rise in imports in Q2, over six times the 0.9% increase in exports over the same period. As a consequence, **net trade was a major drag on GDP growth in the quarter, knocking 1.5 percentage points off Q3 growth, its biggest negative contribution since records began in 1997.** Overall, the latest GDP figures confirm that while the UK economy continues to expand at a decent pace, growth remains far too unbalanced.

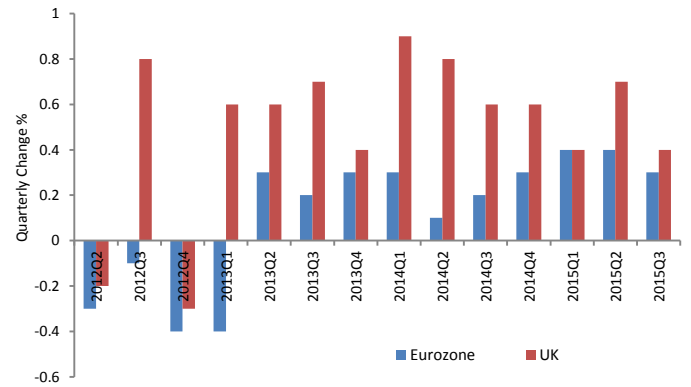
Chart 5: UK Trade Balance



...with Eurozone economy remaining weak...

The Eurozone economy grew by 0.3% in Q3 2015. This was down slightly from the growth of 0.4% recorded in the previous quarter and lower than the growth of 0.5% recorded in the UK over the same period (see Chart 6). In annual terms, the Eurozone economy grew by 1.6% in Q3. Germany's economy, the biggest in the Eurozone, grew by 0.3% in Q3 2015, down from the growth of 0.4% recorded in Q2. **Economic growth in Greece slipped back into negative territory in Q3**, after two quarters of expansion, declining by 0.5% in the quarter. In contrast, France's economy grew by 0.3% in Q3 after recording zero growth in Q2.

Chart 6: UK vs Eurozone GDP growth

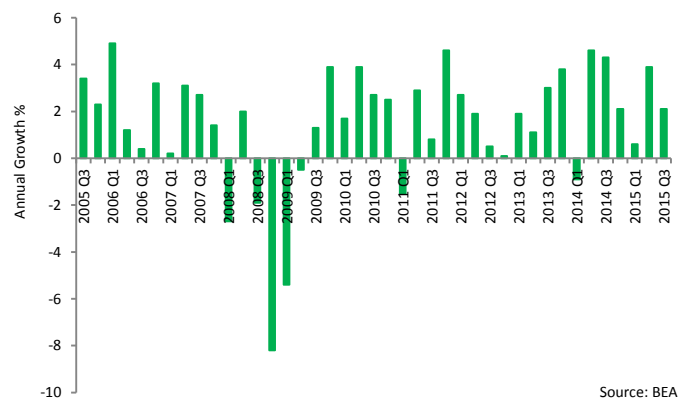


Source: Eurostat

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

The second estimate of US GDP revealed that the US economy grew at an annualised rate of 2.1% in Q3 2015 (see Chart 7), up from the first estimate of 1.5%. The upgrade reflected businesses accumulating \$90 billion worth of inventories in Q3, up from the previous estimate of \$57 billion. Q3 US growth was lower than the annualised growth of 3.9% recorded in Q2. Consumer spending slowed to 3.0% in Q3, from growth of 3.6% in Q2. **The more positive GDP figures has increased speculation that US interest rates will soon be on the rise, possibly as early as this month.**

Chart 7: US GDP Growth

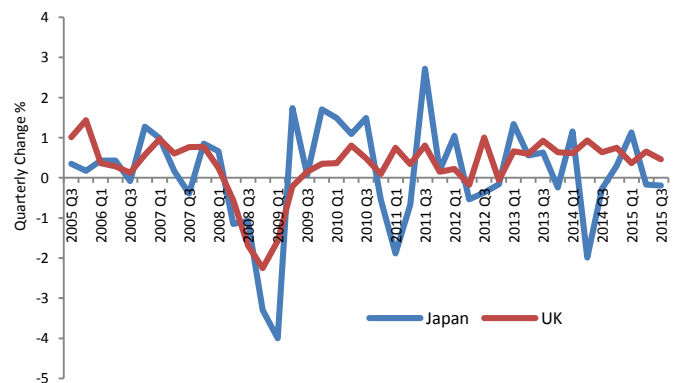


Source: BEA

...Japan slips back into recession

Japan, the world's third-largest economy, fell into recession again after the economy shrank by 0.2% in the third quarter, the second successive period of negative growth, marking a technical recession. **Significantly, this is the fifth time since 2008 that Japan has been in recession (see Chart 8).** Private consumption, which accounts for just under two-thirds of Japan's economic output, grew by 0.5% in the quarter. In contrast, business investment fell for the second successive quarter, declining by 1.3% in Q3. **Overall, the outlook for Japan remains subdued.**

Chart 8: UK vs Japan GDP Growth



Sources: ONS, Japan Cabinet Office

Bottom line: November's data releases confirm that although the UK economy is likely to continue to expand at a decent pace over the next few years, the substantial widening in the trade deficit is a warning sign that more needs to be done fix the fundamentals that hinder export growth if we are to achieve a rebalancing of our economy.

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Economic summary chart

		Deteriorating ■ No change ■ Improving ■												
Sector	Indicators (sources)	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15
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)**													
External	Current Budget Deficit (ONS)**													
	UK trade balance (ONS)													
	Exchange rate (Bank of England)													
	Export Sales (BCC)***													
Global	Export orders (BCC)***													
	US GDP (BEA)****													
	US unemployment (BLS)													
	Eurozone GDP (Eurostat)****													
	Eurozone Unemployment (Eurostat)													
China GDP (Oxford Economics)														

*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.