

Monthly Economic Review

January 2016

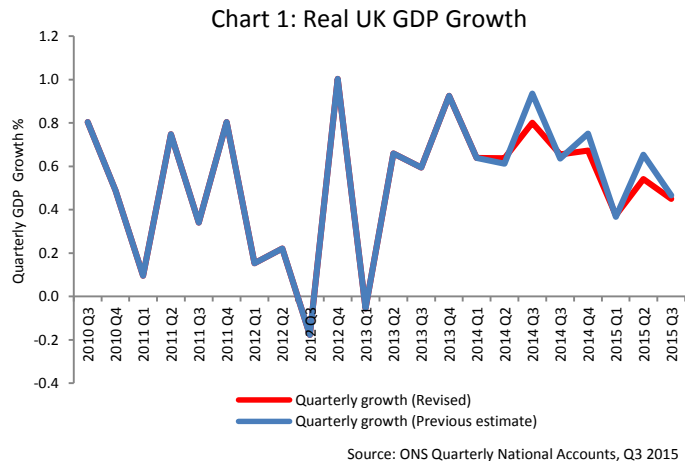
(Based on December 2015 data releases)

Monthly headlines:

- Q3 UK GDP growth revised downwards with slower than expected service sector growth
- The Q4 2015 QES signals slower near-term growth for the UK economy
- US raises interest rates as monetary policy loosens further in the Eurozone

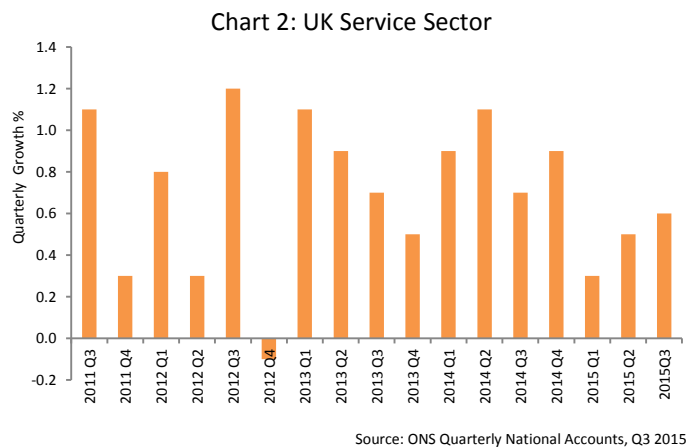
UK economic growth revised down...

The third official estimate of economic growth (GDP) for Q3 2015 was 0.4%, revised down from the previous estimate of 0.5%. GDP growth in Q2 2015 was also downgraded from 0.7% to 0.5% (see Chart 1). In annual terms, the UK economy grew by 2.1% in Q3, down from the previous estimate of 2.3%. The revised figures mean that UK economic output in Q3 was 6.1% higher than its 2008 pre-recession peak, lower than the previous estimate of 6.4%. **Overall, the downward revisions to UK GDP provides further evidence of the challenges facing the UK economy.**



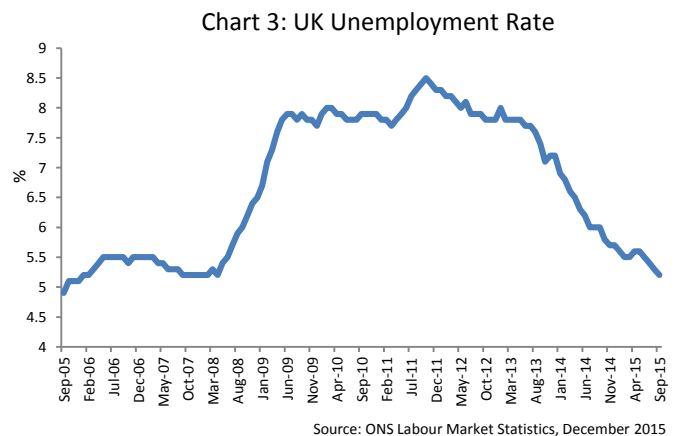
...driven by slower service sector growth...

The downward revision to UK GDP in Q3 2015 was mainly driven by the service sector growing more slowly than previously estimated. The service sector – which accounts for over three quarters of UK economic output – grew by 0.6% in Q3 2015, lower than the previous estimate of 0.7%. However, this was still an improvement on the growth of 0.5% recorded in Q2 (see Chart 2). Production output increased by just 0.2% in Q3. **The latest revisions confirm that the UK economy remains heavily reliant on the service sector to drive growth.**



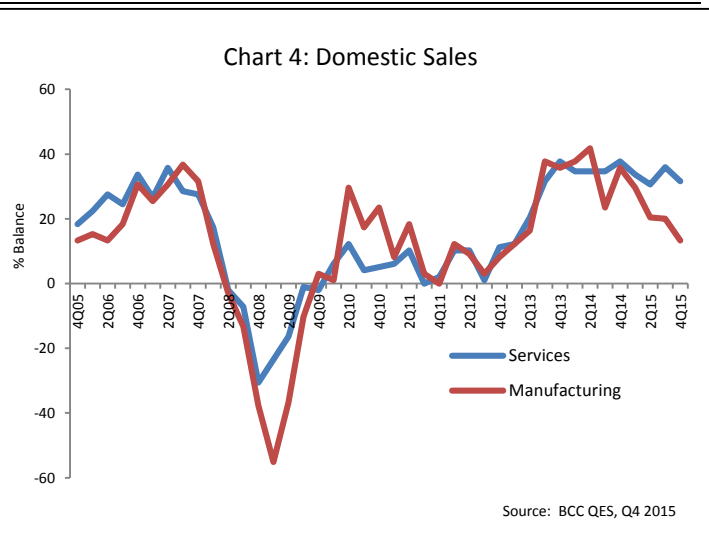
...and while UK unemployment falls again...

The number of people who are in employment stood at 31.3 million in the three months to October 2015, a rise of 207,000. UK unemployment fell by 110,000 over the same period. **The UK unemployment rate fell to 5.2%, the lowest rate since the three months to January 2006 (see Chart 3).** Similarly, the youth unemployment rate fell to its lowest level since 2005. Although wages are still rising faster than prices, total pay growth slowed in the three months to October 2015, from 3.0% to 2.4%. **Overall, the labour market remains a key area of strength for the UK economy.**



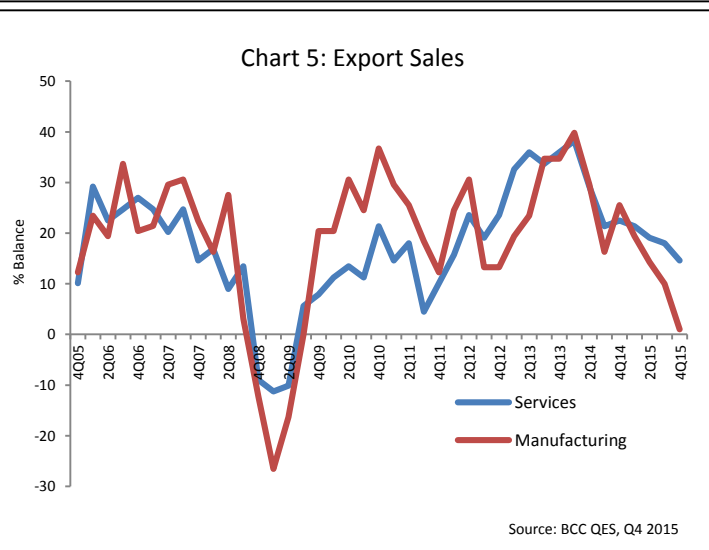
...Q4 QES indicates slower near-term growth...

The Q4 2015 Quarterly Economic Survey (QES) revealed that while both manufacturing and service balances were weaker in Q4 2015 than in Q3, the overall picture is worse in the manufacturing sector than in services. The manufacturing domestic sales balance fell to +13% in Q4 2015 from +20% in Q3 2015, the lowest level since Q1 2013. The service sector's domestic sales balance fell from +36% in Q3 2015 to +32% in Q4 2015, the lowest level since Q3 2013 (see Chart 4). The falling balances in the Q4 QES and the weak Q3 QES data suggest that the pace of UK growth could slow further in the near term.



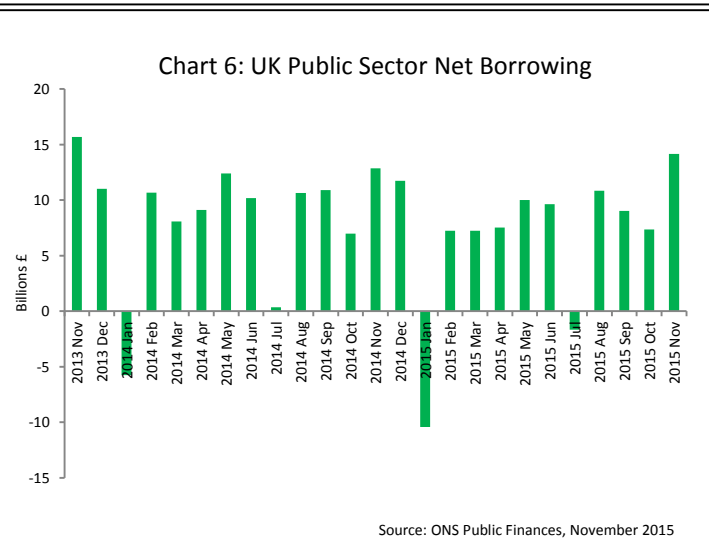
...rebalancing remains a difficult task...

The third official estimate of economic growth (GDP) for Q3 2015 also revealed that the UK's trade deficit widened to £14.1 billion in Q3, from £9.7 billion in Q2 2015. The widening deficit was driven by a 0.3% fall in exports and a 2.7% rise in imports in the quarter, compared with Q2. This deterioration is mirrored by the latest QES where the manufacturers export sales balance fell to its lowest level since Q3 2009. Similarly, the service sector balance for export sales dropped to its lowest level since Q4 2011 (see Chart 5). The latest official and QES data confirms that rebalancing the UK economy remains a major challenge.



...as does cutting the deficit.

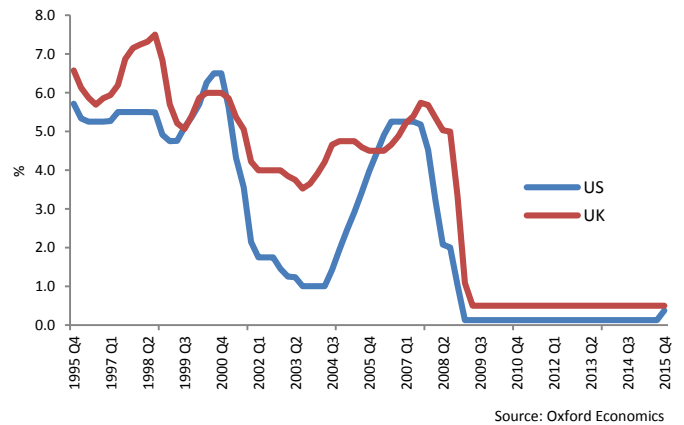
Public sector borrowing (excluding the public sector banks) stood at £14.2 billion in November 2015, £1.3 billion higher than in the same month a year ago (see Chart 6). With total borrowing for this financial year to date already standing at £66.9 billion, it is now unlikely that the Chancellor will be able to meet the OBR's borrowing forecast of £73.5 billion for 2015/16 as a whole announced in the recent Autumn Statement. Public sector net debt currently stands at 80.5% of GDP, more than double pre-crisis levels. Overall, the government target of reaching a budget surplus by 2019/20 remains a difficult one.



While US tightens monetary policy...

Interest rates in the US, the world's largest economy, were increased for the first time since 2006. The US Federal Reserve raised interest rates, which have been at near 0% since December 2008, by 0.25 percentage points (see Chart 7). The move reflects an improving outlook for the US economy with the US central bank also upgrading its forecast for US economic growth for 2016 from 2.3% to 2.4%. Historically, changes in UK interest rates have often mirrored changes in US rates and so the rise in US interest rates has increased speculation that UK interest rates may soon rise.

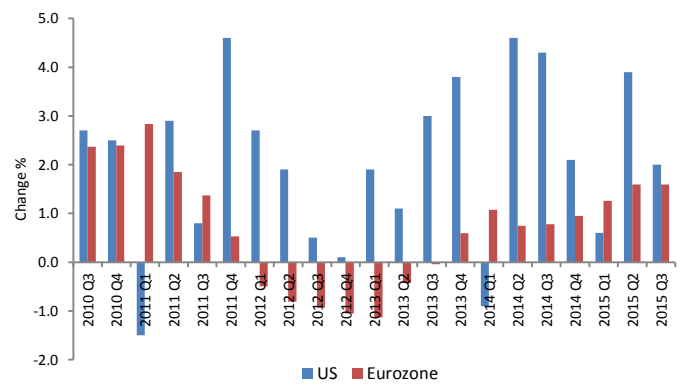
Chart 7: US vs UK Interest Rates



...the opposite happens in the Eurozone...

In contrast to the US, the European Central Bank (ECB) further loosened monetary policy in the Eurozone. The ECB cut its key overnight deposit rate from -0.2% to -0.3% and extended its monthly €60 billion stimulus programme. However, the main interest rate was kept on hold at a record low of 0.05%. The divergence in monetary policy between the US and the Eurozone reflects the differing economic performance, with the Eurozone growing at an average of 0.7% in annual terms since 2010, a third of the average US growth of 2.1% over the same period (See Chart 8).

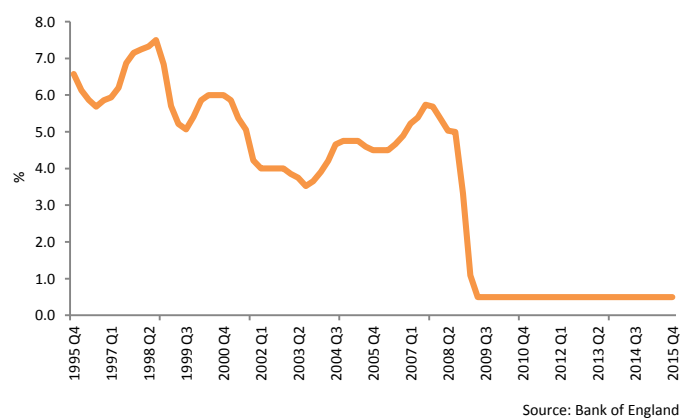
Chart 8: Annual GDP Growth: US, Eurozone



...and the MPC holds the middle ground.

In contrast to both the US and the Eurozone, the Bank of England's Monetary Policy Committee (MPC) kept UK interest rates on hold at 0.5%. UK rates have now been on hold since March 2009 (see Chart 9). The policy changes announced by the Federal Reserve and the ECB represent most significant monetary policy divergence among major economies since the ECB's rate rises in 2011. The slower UK GDP growth in Q3 and the weaker QES data reinforce the case for keeping UK rates on hold. We currently expect the first rise in UK interest rates, to 0.75%, in Q3 2016.

Chart 9: UK Interest Rates



Bottom line: Overall, last month's data releases provides further evidence that although the economic outlook for the UK remains broadly positive, there are mounting headwinds facing the UK economy. This should send a message to government that more needs to be done to support growth.

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Economic summary chart

Deteriorating ■ No change ■ Improving ■

| Sector | Indicators (sources) | Dec-14 | Jan-15 | Feb-15 | Mar-15 | Apr-15 | May-15 | Jun-15 | Jul-15 | Aug-15 | Sep-15 | Oct-15 | Nov-15 | Dec-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 unemployment (BLS) | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| | 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.