

Monthly Economic Review

October 2015

(Based on September 2015 data releases)

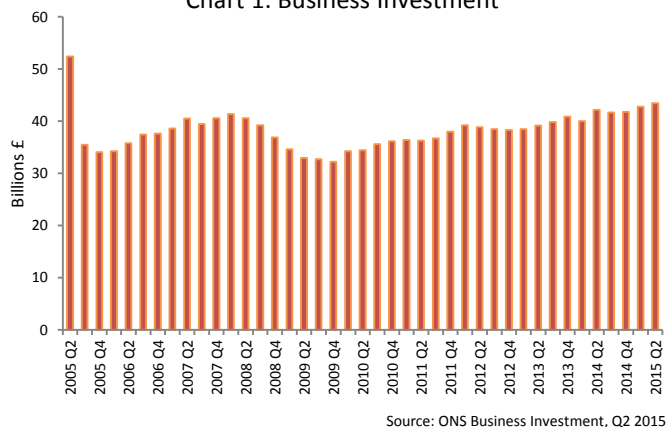
Monthly headlines:

- UK growth in Q2 unrevised with the service sector and consumer spending driving growth
- The QES for Q3 2015 signals moderate economic growth over the next year
- US interest rates kept on hold for now amid continued global uncertainty

UK economic growth unrevised at 0.7%...

The third official estimate of economic growth (GDP) revealed that the UK economy grew by 0.7% in the second quarter of 2015, unrevised from the previous estimate. Growth in the quarter was driven by the service sector and consumer spending which expanded by 0.6% and 0.8% respectively in Q2. Business investment grew by 1.6% in the quarter (see Chart 1). Q2 GDP growth in annual terms was downwardly revised from 2.6% to 2.4%. Overall, the latest GDP figures confirms that the UK economy continues to grow at a moderate pace.

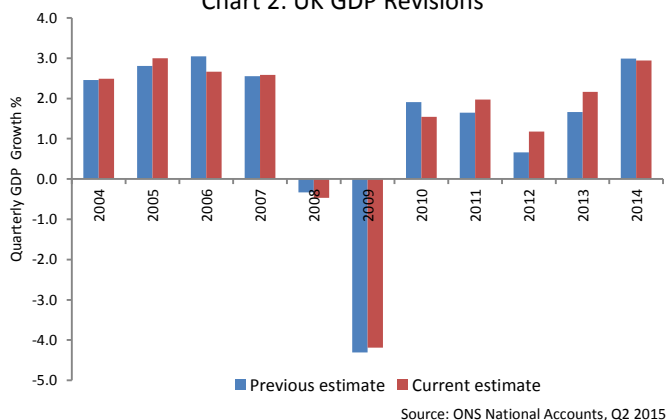
Chart 1: Business Investment



...but UK's recent GDP history is upgraded.

Due to upward revisions to GDP growth between 2011 and 2013 (see Chart 2) by the Office for National Statistics (ONS), the UK's recovery from the 2008-09 recession was faster than previously thought. The UK economy surpassed its pre-downturn peak in the Q2 2013, one quarter earlier than previously estimated. As a result, UK GDP is now 5.9% above its pre-recession peak, up from the earlier estimate of 5.2%. Despite these revisions, the 2008-09 recession remains the most severe in modern times.

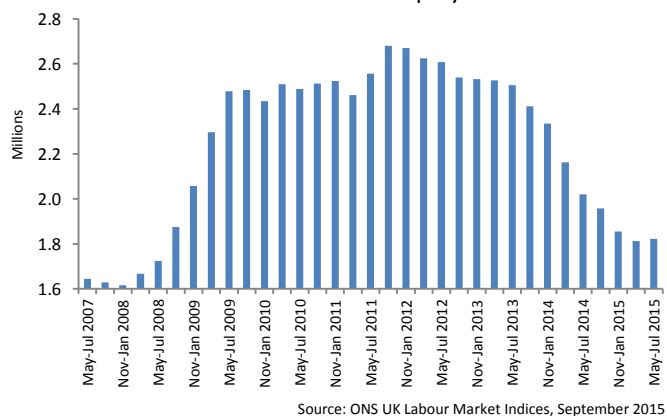
Chart 2: UK GDP Revisions



Latest jobs data paints a mixed picture...

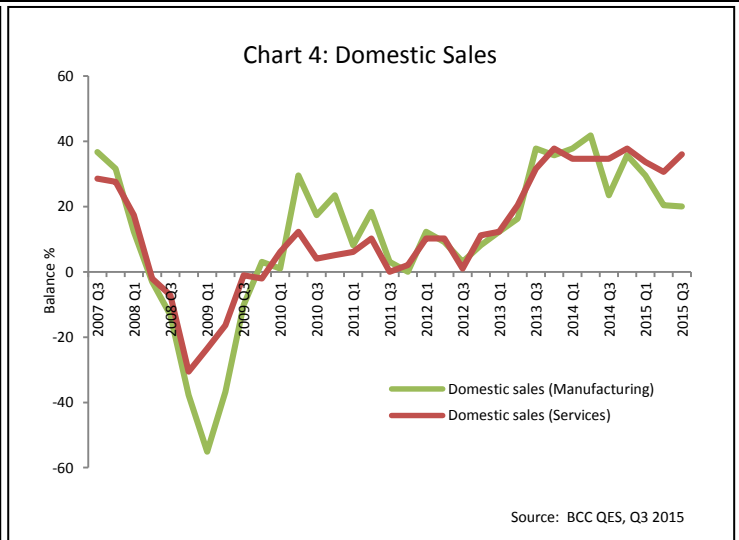
In the three months to July 2015, the number of people in employment rose by 42,000 to 31.1 million. Youth unemployment rate fell from 16.1% to 15.6% over the same period. However, the picture for the UK jobs market is becoming more mixed with unemployment rising by 10,000 to 1.82 million (see Chart 3) and the number of vacancies increasing by 6,000 between May and July 2015. Although the labour market remains a source of strength for the UK economy, the recent rises in unemployment indicates that the recovery remains fragile.

Chart 3: UK Unemployment



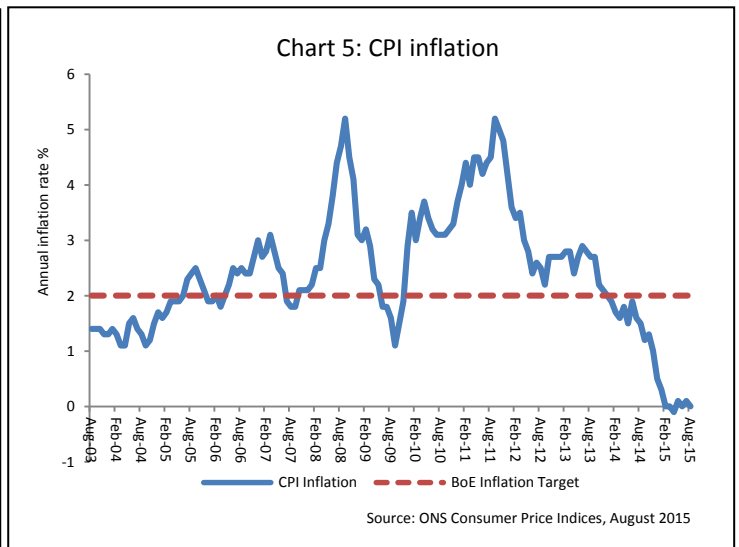
...as does the latest QES...

The Q3 2015 Quarterly Economic Survey (QES) revealed that while both manufacturing and service balances were generally weaker in Q3, **the manufacturing balances declined to a much larger extent than in services**. Notably, the services balance for domestic sales rose to its highest level since Q4 2014, while the manufacturing balance for domestic sales remained unchanged (see Chart 4). Although the latest QES shows that growth remains mixed at a sector level, the strength of the service sector (which accounts for 78% of UK GDP) **means we are likely to see moderate GDP growth over the next year**.



...but with low inflation aiding consumers...

CPI inflation fell from 0.1% in July to 0.0% in August (see Chart 5). A smaller rise in clothing prices on the month compared with a year ago was the main contributor to the slight fall in the rate. Annual inflation has averaged just 0.1% in the first eight months of 2015, well below the Bank of England's 2% inflation target. **With the recent pattern of very low inflation likely to continue over the next few months, there is little pressure on the MPC to start raising interest rates**. Furthermore, the associated rise in real earnings will help consumer spending to support growth.



...BCC ups its economic growth forecast.

The BCC has upgraded its UK economic growth (GDP) forecast for 2015 from 2.3% to 2.6%. The BCC's latest GDP growth forecast for this year is marginally more positive than the latest projections from other key organisations including the IMF and the Office for Budget Responsibility (OBR), but lower than the Bank of England's latest growth forecast for 2015 (see Table 1). The BCC has also upgraded its UK growth forecast for 2016 and 2017, from 2.6% to 2.7%. **Although the disappointing Q3 2015 QES results suggest a slight deceleration in growth in Q3, this will not in itself alter the BCC's forecast**.

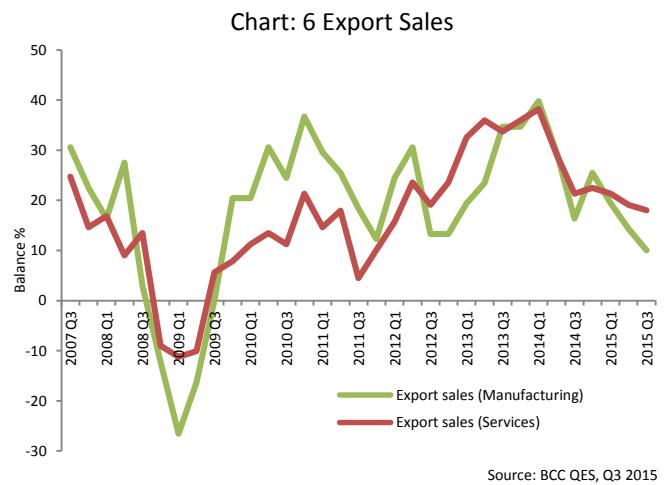
Table 1: GDP Forecast Comparison

	2015 (%)	2016 (%)	2017 (%)
Bank of England	2.8	2.6	2.5
BCC	2.6	2.7	2.7
OECD	2.4	2.3	-
IMF	2.4	2.2	-
OBR	2.4	2.3	2.4

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

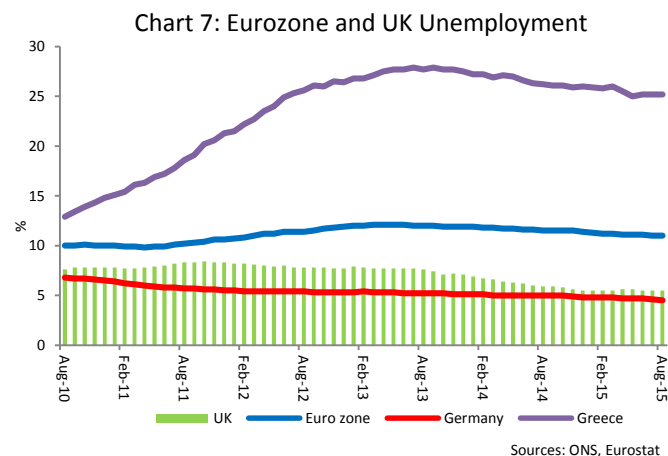
Rebalancing remains a major challenge...

The latest QES also revealed that the national export balances weakened in Q3 2015, for both manufacturing and services. The export sales balance in manufacturing dropped to its lowest level since Q3 2009, while the services export sales balance dropped to its lowest level since Q1 2012 (see Chart 6). This mirrors the latest official data which showed that the UK trade deficit widened by £2.6 billion in July to £3.4 billion. **The continued global uncertainty and the strength of sterling have helped drive the weaker export figures.** Overall, the latest QES data confirms that rebalancing UK growth remains a challenge.



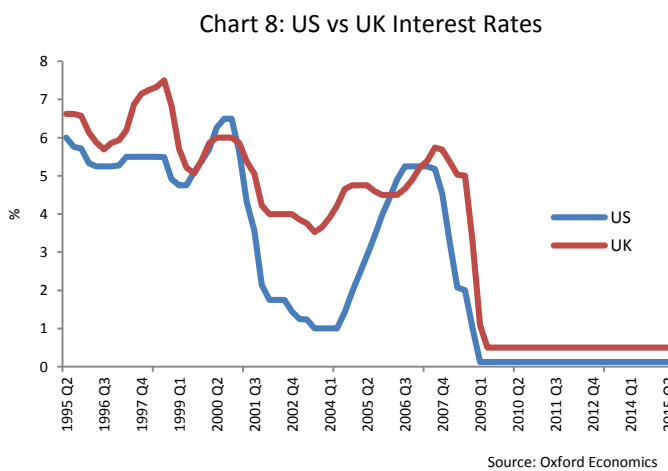
...with the Eurozone still weak...

The unemployment rate in the Eurozone, one of the UK's major trading partners, remained unchanged at 11.0% in July, the lowest rate since February 2012. However, the Eurozone unemployment rate remains almost double the current UK unemployment rate of 5.5%. Furthermore, **the improvement in the overall Eurozone unemployment rate masks major disparities between member countries** with the highest jobless rate in the Eurozone in Greece at 25.2%, over five times the lowest unemployment rate of 4.5% in Germany (see Chart 7).



...and global pressures keep US rates on hold.

The Federal Reserve decided against raising US interest rates, keeping them at the same level they have been at since December 2008. Fears that raising rates in the world's largest economy would exacerbate the current global uncertainty influenced the Fed's decision. Historically, changes in UK interest rates have been closely aligned to movements in US rates (see Chart 8). Therefore when US rates do start to rise, possible by the end of the year, the probability of a rise in UK rates is likely to increase. **We expect the first rise in UK interest rates to 0.75% in Q2 2016.**



Bottom line: *Although the UK economy is likely to grow at a moderate pace over the next year, the disappointing QES figures are a timely reminder that more needs to be done to help fix the fundamentals – skills, infrastructure and access to capital – if we are to secure our economic future.*

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Economic summary chart

		Deteriorating ■ No change ■ Improving ■												
Sector	Indicators (sources)	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15
Household	Retail Sales (ONS)	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving
	Consumer Confidence (GfK NOP)	Improving	Deteriorating	No change	Deteriorating	Improving	No change	Improving	No change	Deteriorating	Improving	Deteriorating	Improving	Deteriorating
	House Prices (Halifax)	Improving	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Deteriorating	Improving
	New car sales (SMMT)**	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Mortgage approvals (Bank of England)	Improving	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving
Business	Business confidence (BCC)***	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Business lending (Bank of England)	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Service sector output (ONS)	Improving	No change	Improving	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving
	Production output (ONS)	Improving	No change	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving	Improving	Deteriorating
	Investment intentions (BCC)**	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
Labour market	Employment (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Improving
	Unemployment (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating
	Claimant count (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Improving	Deteriorating
	Earnings (ONS)	No change	Improving	Improving	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	No change	Improving
	Economic Inactivity (ONS)	Deteriorating	Deteriorating	Deteriorating	No change	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving
Government	10 year Government bonds (Bloomberg)	Deteriorating	Improving	Improving	Improving	Improving	Deteriorating	Improving	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving
	Public sector net borrowing (ONS)**	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating
	Public sector net debt % of GDP (ONS)**	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating
	Tax receipts (ONS)**	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Current Budget Deficit (ONS)**	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating
External	UK trade balance (ONS)	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Deteriorating	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Deteriorating
	Exchange rate (Bank of England)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating
	Export Sales (BCC)***	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Export orders (BCC)***	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
Global	US GDP (BEA)****	Improving	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	US unemployment (BLS)	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Eurozone GDP (Eurostat)****	No change	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Eurozone Unemployment (Eurostat)	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	China GDP (Oxford Economics)	No change	No change	No change	No change	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	No change	No change	No change	No change

*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.