

# Monthly Economic Review

## August 2015

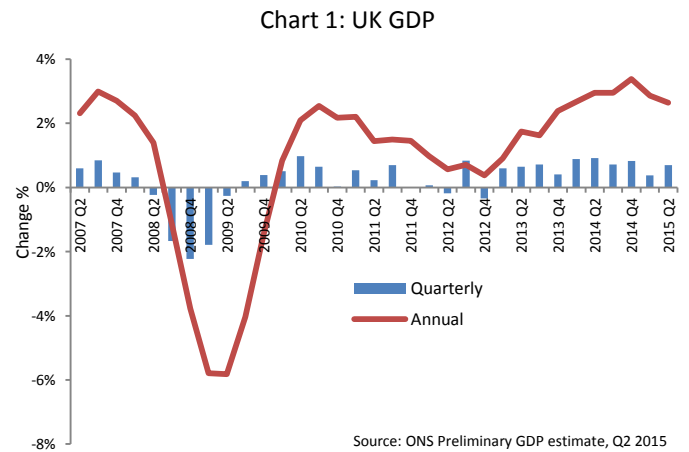
(Based on July 2015 data releases)

### Monthly headlines:

- UK economy grew by 0.7% in Q2, driven by a strong output from services and oil and gas
- Labour market conditions in the UK weaken and inflation falls back to zero
- Outlook for global growth weakens amid continued concern over China and Greece

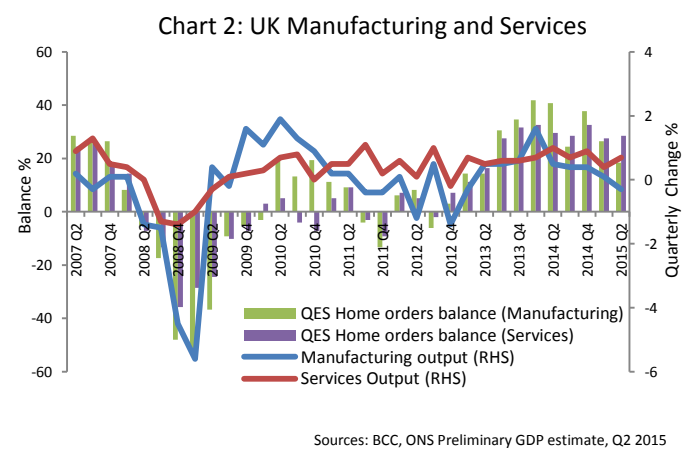
#### UK growth picks up in Q2...

The first official estimate of economic growth (GDP) revealed that UK GDP grew by 0.7% in Q2 2015, stronger than the growth of 0.4% recorded in Q1 (see Chart 1). Growth in Q2 also marked the tenth successive quarter of GDP growth, the longest period of sustained growth since before the financial crisis. As a result, UK economic output is now 5.2% above its Q1 2008 pre-recession peak. In annual terms, GDP was up 2.6% in the quarter. **Overall, the latest GDP figures confirm that the UK economy is growing at a good rate.**



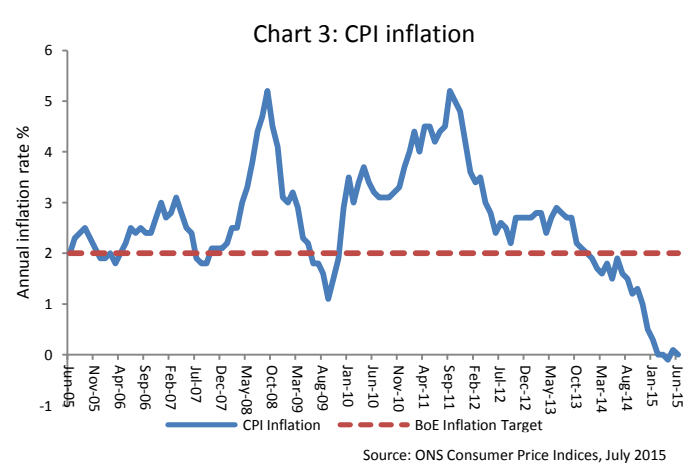
#### ...driven by a strengthening services sector...

Economic growth in Q2 2015 was largely driven by the services sector. Output from the services sector, which accounts for over three-quarters of the UK's economic output, rose by 0.7% in Q2 (see Chart 2). In contrast, manufacturing output fell by 0.3% in the quarter. This mirrors the Q2 2015 Quarterly Economic Survey (QES) because while most of key service sector balances recorded small increases, all the key manufacturing balances recorded declines in Q2. Oil and gas production also helped to drive growth in Q2, rising by 7.8% in the quarter.



#### ...but while inflation slips back to zero...

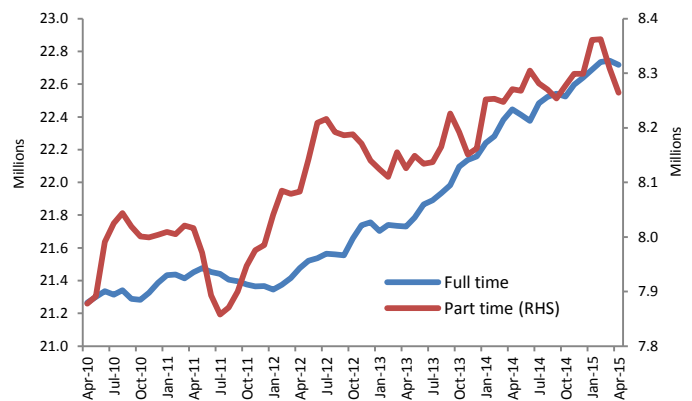
CPI inflation fell from 0.1% in May to 0.0% in June 2015 (see Chart 3). Falls in clothing and food prices were the main contributors to the change in the rate, along with smaller rises in air fares compared to a year ago. This is broadly in line with the latest QES results. The service sector, which accounts for over three quarters of UK GDP, continued to see a fall in the number of firms expecting higher prices. These figures reinforce our view that **inflation is likely to remain around 0% over the next few months, providing a boost for households.**



### ...UK employment surprisingly falls...

In the three months to May 2015, the number of people who are employed fell by 67,000, **the first decline in UK employment since 2013**. A breakdown of the data revealed that **the decline in employment was driven by a fall of 97,000 in the number of people in part-time employment**, which was only partly offset by a 30,000 rise in the number of people in full-time employment (see **Chart 4**). However, despite the slightly weaker data, the UK labour market remains strong and alongside rising average earnings, which increased at their fastest rate in five years in May, will help to support UK growth.

Chart 4: UK Full time vs Part time Employment



Source: ONS Labour Market Statistics, July 2015

### ...and OBR confirms a weaker outlook...

**The Office for Budget Responsibility (OBR) has downgraded its outlook for the UK economy.** The OBR cut its GDP forecast for 2015 to 2.4%, from its previous forecast of 2.5%, but still slightly above the latest BCC GDP growth forecast for 2015 of 2.3% (see **Table 1**). The IMF also downgraded its outlook for UK growth in 2015 from 2.7% to 2.4%. While the OBR's 2016 growth forecast was unchanged at 2.3%, they upgraded their 2017 growth forecast to 2.4%, from 2.3%. Overall, **the OBR's and IMF's latest forecasts of UK GDP are now more closely aligned with our latest forecast.**

Table 1: UK GDP Forecast Comparisons

	2015 (%)	2016 (%)	2017 (%)
Bank of England	2.9	2.9	2.7
IMF	2.4	2.2	-
OBR	2.4	2.3	2.4
<b>BCC</b>	<b>2.3</b>	<b>2.6</b>	<b>2.6</b>

Sources: IMF, BCC, OBR and Bank of England

### ...as global growth is also downgraded...

As well as downgrading its outlook for the UK economy, the IMF also downgraded its forecast for global growth. The IMF now expects the global economy to grow by 3.3% in 2015, lower than its previous forecast of 3.5%. The downward revision to global growth for 2015 was mainly driven by weaker than expected growth in a number of major economies in Q1 2015. Although the IMF also downgraded its forecast for US growth in 2015, from 3.1% to 2.5%, **the IMF predicts that the US will be the fastest-growing economy in the G7 this year, followed by the UK (see Table 2).**

Table 2: IMF GDP Forecast, G7 Countries

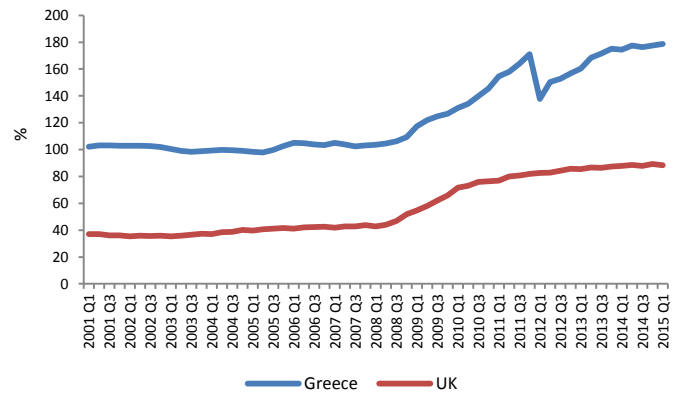
G7	2015 (%)
US	2.5
<b>UK</b>	<b>2.4</b>
Germany	1.6
Canada	1.5
France	1.2
Japan	0.8
Italy	0.7

Source: IMF

### ...and with Greece's outlook still uncertain...

With Greece seeming close to agreeing a third multi-billion euro bailout deal, a Greek exit from the Eurozone looks a little less likely, at least in the short term. However, the measures that Greece has to implement to qualify for the bailout, will be a major burden on the Greek economy. Furthermore cutting the deficit in Greece remains a considerable challenge. Greek government debt currently stands at around 180% of its GDP, more than double the UK's debt to GDP ratio (see Chart 5). Without major debt relief or significant economic growth, the outlook for Greece remains bleak, even with a third bailout.

Chart 5: UK vs Greece: Gross Government Debt as a % GDP



### ...and Chinese stock prices plummeting...

Stock prices in China have fallen by 30% since mid June 2015 (See Chart 6). This followed a 54% rise in stock prices in the first half of the year, which was largely driven by small-scale investors borrowing to buy shares. The subsequent collapse partly reflects indebted investors having to sell shares to meet their debts. There are also concerns that the state of the Chinese economy is being overstated by the official data. A weakening China, the world's second-biggest economy, would be major drag on global economic growth.

Chart 6: Chinese Stock Prices



### ...the MPC must keep rates on hold.

Although earnings are growing faster than inflation it would be a mistake to interpret this as an argument for interest rate rises. With inflation likely to stay below target in the near term, major global uncertainties, intensified by current state of play in China and Greece, and the 8% rise in the value of Sterling in the year to July 2015 (see Chart 7), which has made UK exports more expensive, the MPC should not consider raising interest rates for the foreseeable future. We currently expect the first rise in interest rates, to 0.75%, will take place in Q2 2016.

Chart 7: Sterling Effective Exchange Rate Index



**Bottom line: Last month's data releases confirm that the UK economy is growing at a good pace, but that growth remains unbalanced. Furthermore, given the considerable international uncertainty, the MPC must 'jump the gun' on interest rates to ensure that the UK's recovery is not derailed.**

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## Economic summary chart

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

\*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.