

UK Monthly Economic Review

February 2015

(Based on January 2015 data releases)

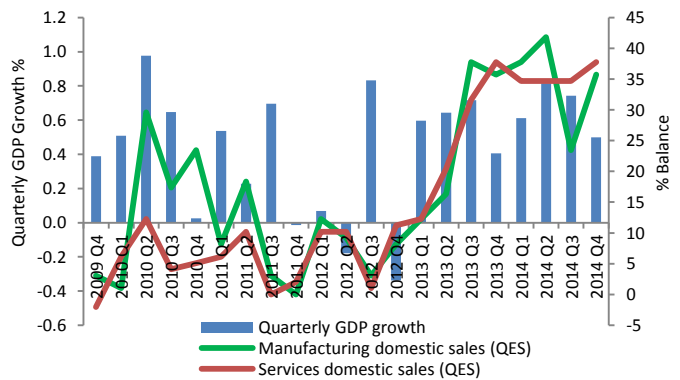
Monthly headlines:

- UK economic growth reaches seven-year high, despite slowing in Q4
- Services remains the key driver of growth as construction and industrial output weakens
- UK inflation drops to joint record low, reinforcing the case against an early interest rate rise

UK GDP growth slows in Q4...

The first official estimate of economic growth (GDP) revealed that the UK economy grew by 0.5% in Q4 2014, slower than the growth of 0.7% recorded in the previous quarter. The slight slowdown in growth since the start of the year is broadly in line with the latest Quarterly Economic Survey (QES) where although most of the key national balances rose in Q4, they remain below the high levels recorded earlier this year (see Chart 1). UK economic output is now estimated to be 3.4% higher than the pre-economic downturn peak in Q1 2008.

Chart 1: Real GDP and Domestic Sales

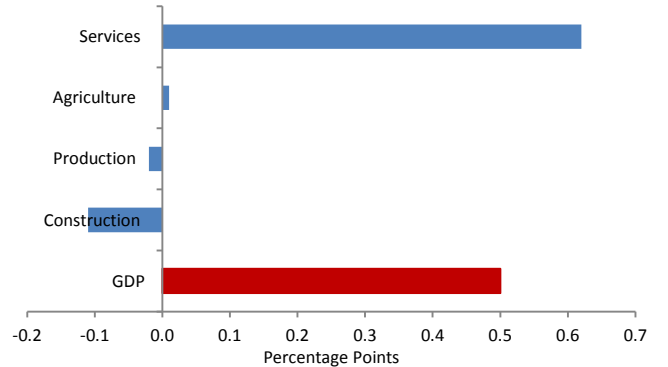


Sources: ONS Preliminary GDP estimate, Q4 2014, BCC QES Q4 2014

...driven by a sharp fall in construction...

Services remain the dominant sector of the UK economy, growing by 0.8% in Q4 and accounting for almost all of the growth recorded in the quarter (see Chart 2). This mirrors the latest QES with most of the key service sector balances improving in Q4. The agricultural sector, which accounts for less than 1% of UK economic output, grew by 1.3% in Q4. Construction was a drag on growth, falling by 1.8% in Q4 and knocking 0.1 percentage points off the overall figure of 0.5%. Industrial output was also a slight drag on growth, falling by 0.1% in the quarter.

Chart 2: Contributions to UK GDP Growth, Q4 2014

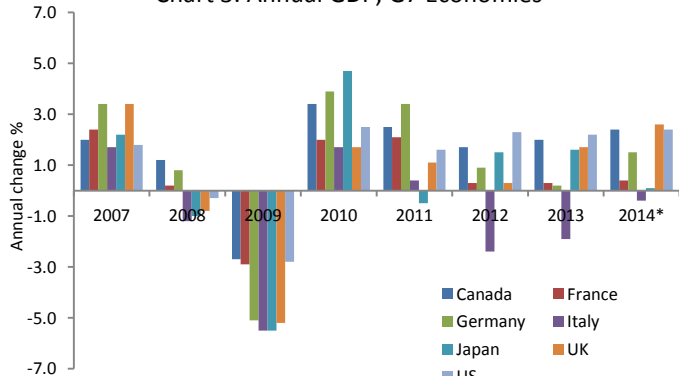


Source: ONS Preliminary GDP estimate, Q4 2014

...but 2014 growth still hits seven-year high...

Despite the slowdown in Q4, the UK economy grew by 2.6% in 2014 as a whole, the fastest rate of growth since 2007 and double the average growth of 1.3% over the past decade. Furthermore, based on current projections, the UK is now expected to have been the fastest growing G7 economy in 2014 (see Chart 3). This represents a marked turnaround from two years ago when the UK was the second worst performing G7 economy in 2012 as it struggled to recover the output lost during the economic downturn.

Chart 3: Annual GDP, G7 Economies

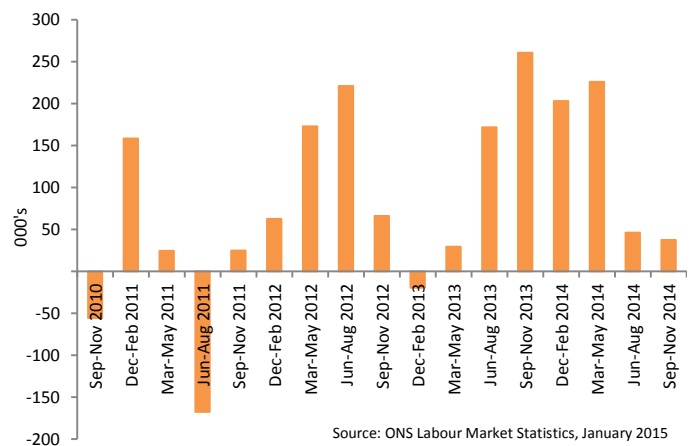


Sources: ONS, IMF

...as UK unemployment falls to six year low...

In the three months to November 2014, **UK unemployment fell by 58,000 to 1.91 million, the lowest level for six years.** The unemployment rate also continues to decline, falling from 6% to 5.8%. **However, there are signs that the rate of improvement in the UK labour market is starting to ease** with the number of people in employment rising by 37,000, the smallest rise since 2013 (see **Chart 4**). In addition, the number of young people who are out of work rose for the first time since mid-2013. **Nonetheless, the labour market remains a source of strength for the UK economy.**

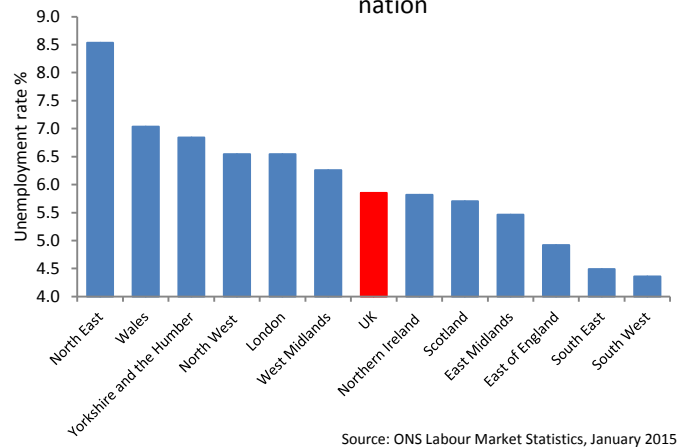
Chart 4: Changes in UK Employment



...although there are big local differences.

Although the UK labour market picture remains positive, there are notable disparities between the UK's regions and nations. Half of the twelve regions and nations in the UK currently have an unemployment rate that is above the UK average of 5.8% (see **Chart 5**). In the three months to November 2014, the **North East of England recorded the highest unemployment rate (8.5%),** followed by Wales (7.0%) and Yorkshire and the Humber (6.8%). In contrast, **the South West (4.4%) has the lowest unemployment rate in the UK,** followed by the South East (4.5%) and the East of England (4.9%).

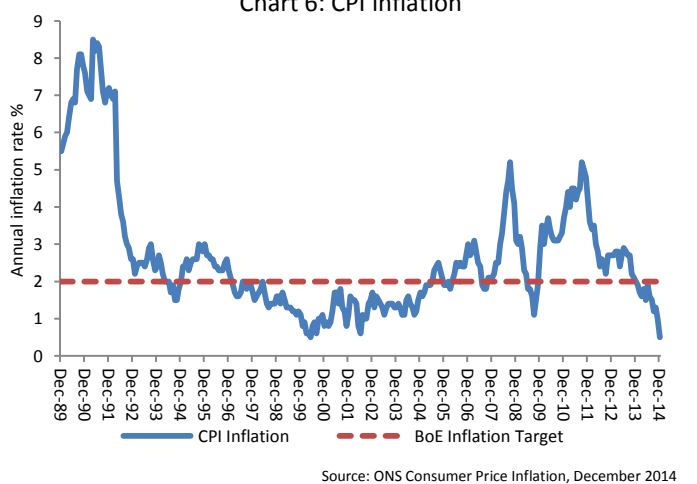
Chart 5: Unemployment rate, by UK region and nation



With inflation falling to joint record low...

CPI inflation fell from 1% in November to 0.5% in December; the joint lowest on record (see Chart 6). The main contributions to the slowdown came from the continued fall in motor fuel prices and the impact of the earlier gas and electricity price rises of December 2013 falling out of the calculation. Although inflation is now likely remain below 1% for the rest of the year; **concerns over the possibility of deflation in the UK are overdone** with the latest QES revealing that intentions to raise prices in the coming months are up slightly for firms in both manufacturing and services.

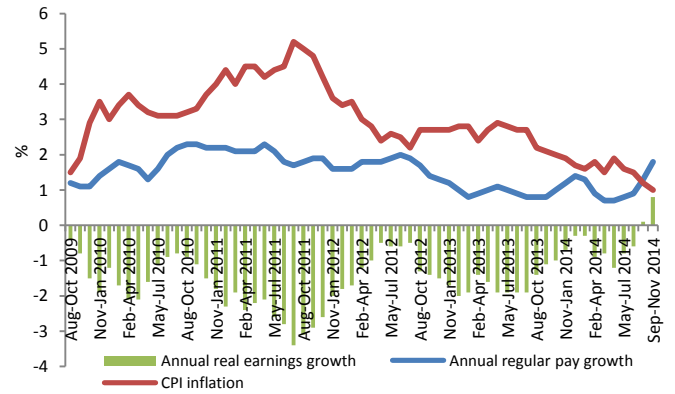
Chart 6: CPI inflation



...the squeeze on the wages is easing...

Regular pay growth, excluding bonuses, reached 1.8% in annual terms in the three months to November 2014 (see Chart 7). This is the fastest rate of growth since September 2012 and beat November's comparable inflation rate of 1%. **Stronger wage growth coupled with the continued fall in inflation means that wages are rising in real terms.** However, although real wage growth is in positive territory, **earnings have got a long way to make up for lost ground.** Since 2009, prices have increased by nearly double the rise in earnings over the same period.

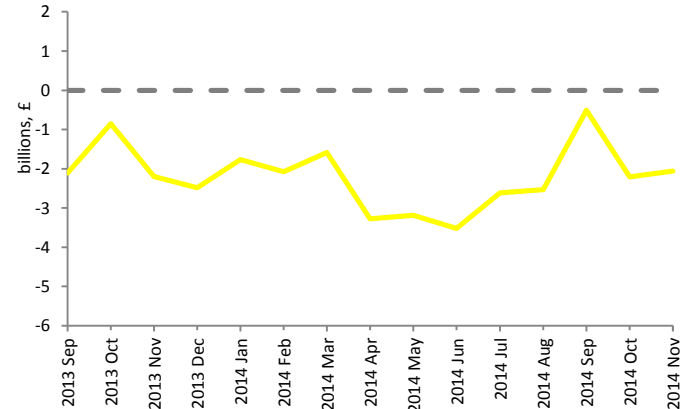
Chart 7: Real Earnings Growth



...and as risks to the recovery remain...

Although the UK recorded the strongest growth for seven years in 2014, risks to the recovery remain. In the near term, the main risk facing the UK economy is the possibility that the slowdown in growth evident in recent months could worsen further. Despite the recent improvement in the trade deficit, which narrowed for the second successive in November (see Chart 8), the UK economy is still overly reliant on consumer spending rather than investment and trade. **The general slowdown in the global economy, particularly in the Eurozone is also a major risk to the recovery.**

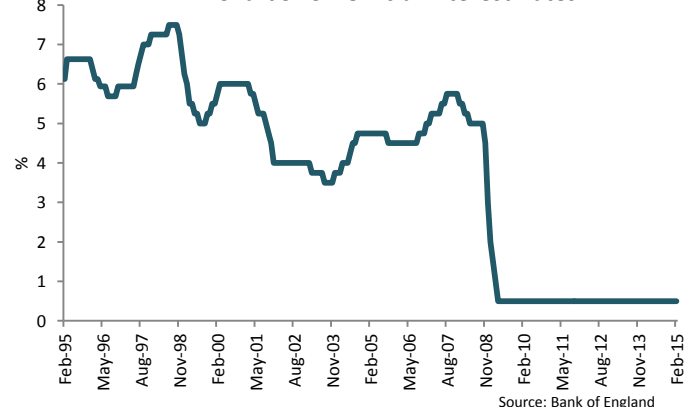
Chart 8: UK's Net Trade Position



...the prospect of a rate rise recedes further.

The minutes from the latest Monetary Policy Committee (MPC) meeting revealed that all nine Bank of England policymakers voted to keep interest rates on hold this month. This is the first time since July 2014 that there has been a unanimous decision on interest rates, which have been on hold for nearly six years (see Chart 9). Since July, two members of the MPC, had been calling for a rate rise. But with inflation well below target, **our view is that interest rates will stay at their current low level at least until the first half of 2016.**

Chart 9: UK Official Interest Rates



Bottom line: Last month's data releases support our view that while the UK economy continues to outperform many of its international competitors, the pace of growth is slowing. More must be done to rebalance the economy towards trade and investment and the MPC must delay raising interest rates for as long as possible."

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Chart 9: UK economic summary chart

Deteriorating ■ No change ■ Improving ■

Sector	Indicators (sources)	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15
Household	Retail Sales (ONS)	Green	Red	Green	Green	Green	Red	Green	Green	Green	Red	Yellow	Red	Green
	Consumer Confidence (GfK NOP)	Green	Yellow	Green	Green	Green	Green	Red	Green	Green	Red	Yellow	Red	Green
	House Prices (Halifax)	Red	Green	Green	Red	Red	Green	Green	Green	Green	Green	Green	Green	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	Red	Red	Red	Red	Red	Green	Green	Green	Red	Red	Red
Business	Business confidence (BCC)***	Green	Green	Green	Green	Green	Green	Red	Red	Red	Green	Green	Green	Green
	Business lending (Bank of England)	Red	Red	Red	Red	Red	Green	Red	Red	Green	Red	Red	Red	Red
	Service sector output (ONS)	Green	Green	Green	Green	Green	Green	Green	Green	Green	Yellow	Green	Green	Green
	Production output (ONS)	Yellow	Green	Green	Green	Red	Green	Red	Green	Green	Yellow	Green	Red	Red
	Investment intentions (BCC)**	Green	Green	Green	Green	Green	Green	Red	Red	Red	Green	Green	Green	Green
Labour market	Employment (ONS)	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
	Unemployment (ONS)	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
	Claimant count (ONS)	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
	Earnings (ONS)	Green	Green	Green	Green	Yellow	Red	Red	Red	Yellow	Green	Green	Green	Green
	Economic Inactivity (ONS)	Green	Red	Green	Green	Green	Green	Green	Red	Green	Red	Red	Red	Yellow
Financial	FTSE100 (Bank of England)	Red	Green	Red	Green	Green	Red	Red	Green	Red	Red	Green	Red	Green
	Wholesale funding (Bank of England)	Green	Yellow	Yellow	Yellow	Red	Yellow	Yellow	Green	Yellow	Red	Green	Yellow	Yellow
	Retail funding (Bank of England)	Green	Green	Red	Green	Green	Green	Green	Green	Yellow	Red	Red	Green	Green
	Oil prices (Bank of England)	Red	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green	Green	Green
	Gold prices (Bank of England)	Green	Green	Green	Green	Green	Green	Red	Green	Red	Green	Red	Red	Red
Government	10 year Government bonds (Bloomberg)	Green	Green	Red	Green	Green	Red	Green	Green	Red	Green	Green	Green	Green
	Public sector net borrowing (ONS)**	Green	Red	Red	Red	Red	Red	Red	Green	Red	Green	Green	Green	Red
	Public sector net debt % of GDP (ONS)**	Red	Green	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green	Red
	Tax receipts (ONS)**	Green	Red	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green	Green
	Current Budget (ONS)**	Green	Red	Red	Red	Red	Red	Red	Green	Green	Red	Green	Green	Red
External	UK trade balance (ONS)	Green	Green	Red	Green	Green	Red	Red	Green	Red	Green	Red	Green	Green
	Exchange rate (Bank of England) +	Red	Red	Red	Red	Red	Red	Red	Red	Green	Green	Green	Green	Red
	Eurozone GDP (Eurostat)****	Green	Green	Green	Green	Green	Green	Yellow	Yellow	Yellow	Green	Green	Green	Green
	Export Sales (BCC)***	Green	Green	Green	Green	Green	Green	Red	Red	Red	Green	Green	Green	Green
	Export orders (BCC)***	Green	Green	Green	Green	Green	Green	Red	Red	Red	Green	Green	Green	Green

*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. Dates refer to the release dates for each indicator.

Annual changes. *Quarterly changes. ****Latest figures are estimates.