UK Monthly Economic Review

January 2015

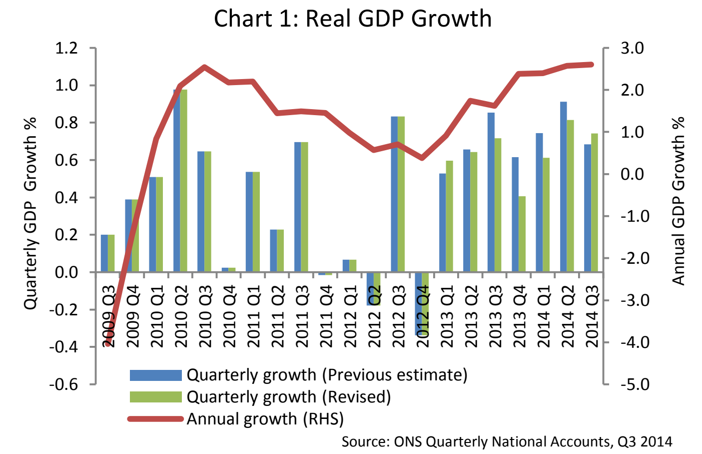
(Based on December 2014 data releases)

Monthly headlines:

- Annual UK GDP growth revised down in Q3, as current account deficit reaches record high
- Q4 QES indicates more growth, with most of the key balances improving in the quarter
- The UK jobs market continues to strengthen as wages edge above inflation

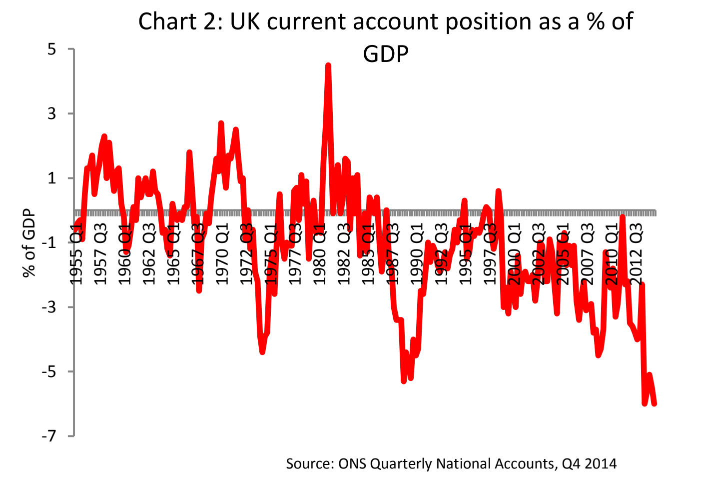
Annual UK economic growth revised down...

The third official estimate of economic growth (GDP) for Q3 2014 was unrevised at 0.7%. However, **due to downward revisions for previous quarters (see Chart 1), the UK's economic performance over the past year was slightly worse than previously thought**. In annual terms, the UK economy grew by 2.6% in Q3 2014, down from the previous estimate of 3.0%. The revised figures mean that UK economic output in the third quarter of this year was 2.9% higher than its pre-recession peak in Q1 2008, down from the previous estimate of 3.4%.



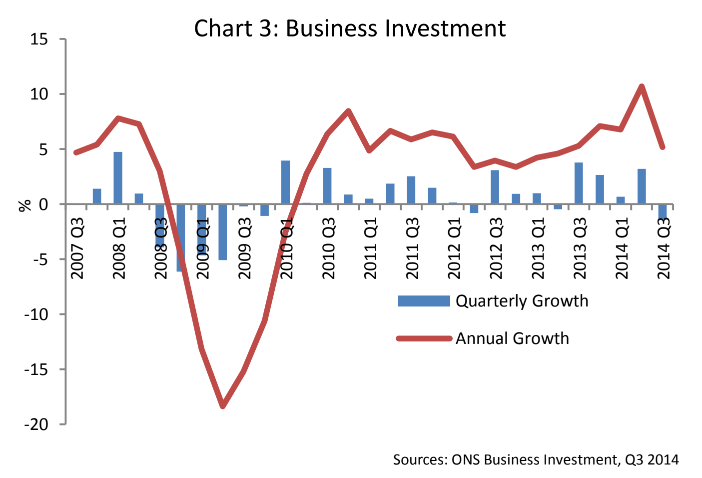
...driven by weaker trade performance...

The UK's trade deficit widened from £10.9 billion in Q2 2014 to £11.8 billion in Q3 2014. This was driven by a 1.3% rise in imports in Q3, outstripping the 0.6% increase in exports over the same period. Similarly, the UK ran a current account deficit (the difference between what we earned from other countries and what we spent) of £27 billion in Q3 2014, up from £24.3 billion in Q2 2014. As a result, the **UK's current account deficit was equivalent to 6% of GDP in Q3 (see Chart 2), the highest deficit as a percentage of GDP since records began in 1955.**



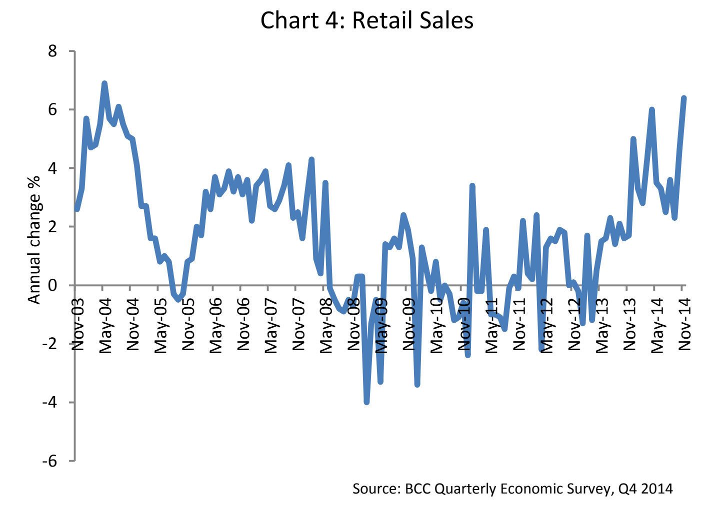
...and lower investment and public spending.

The downward revision to annual GDP in Q3 2014 was also driven by lower business investment and government spending. Business investment was downgraded sharply to a 1.4% contraction, double the previous estimate of a 0.7% decline. However, despite the downgrade, business investment in Q3 was still 5.2% higher than at the same point in 2013 **(see Chart 3)**. Government spending was also downwardly revised to 0.3% from the previous estimate of 1.1%. In contrast, consumer spending was upwardly revised from 0.8% to 0.9%.



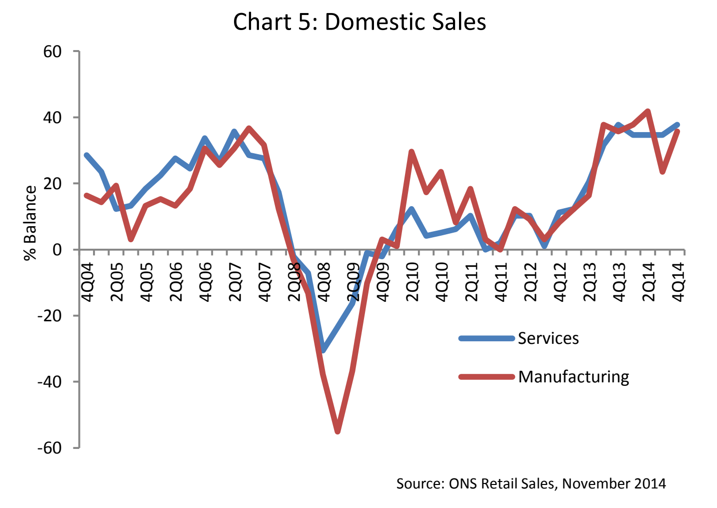
Strong retail sales data in November…

Retail sales rose by 1.6% in November with growth recorded in all main store types for the first time since December 2013. **In annual terms, retail sales increased by 6.4%, the biggest increase since May 2014 (see Chart 4).** Electrical goods sales jumped 32% in annual terms and sales at department stores were up 15%, as **Black Friday,** which mirrors the US tradition of heavily discounted sales on the Friday after Thanksgiving, **had a marked impact on the figures**. Average store prices fell by 2% in annual terms, the largest drop since 2002 and supports our view that inflation will remain low in the near term.



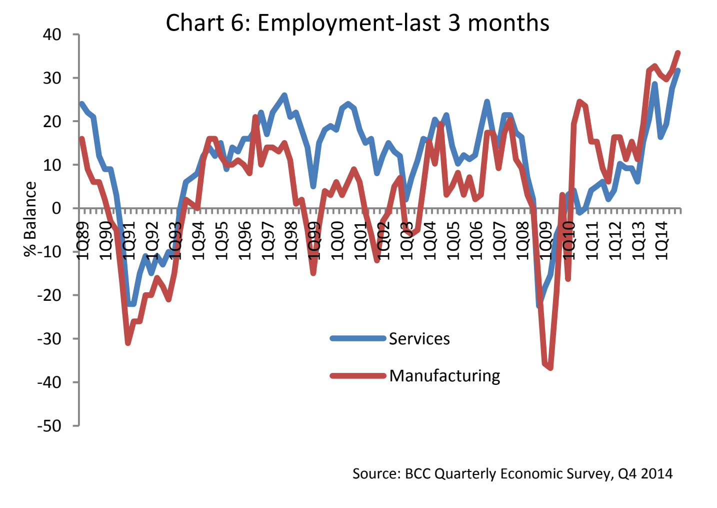
...and the Q4 QES points to more growth...

For the Q4 2014 BCC quarterly Economic Survey (QES), most of the key balances improved in the quarter. The services sector's balance for domestic sales rose to its highest level in a year and the manufacturing sector's balance for domestic sales also rose strongly in the quarter **(see Chart 5).** However, a number of balances still remain below the higher levels recorded at the start of the year, indicating that the pace of GDP growth could be starting to ease. **Overall the latest QES and retail sales data results point to continued growth, and we are currently expecting GDP growth of 0.7% in Q4.**



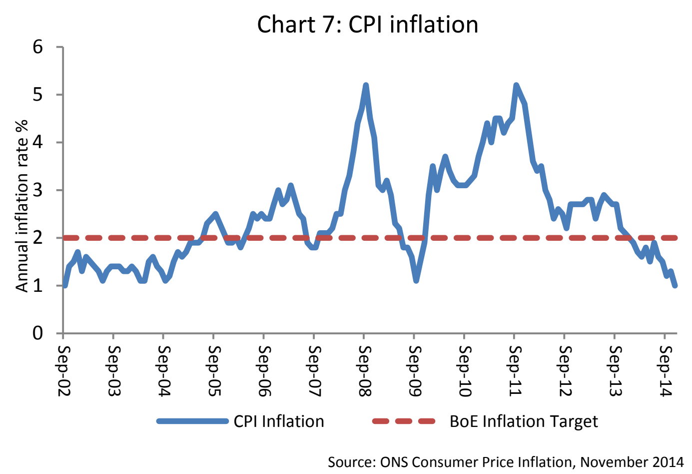
...and with the jobs market strengthening...

The number of people who are in employment stood at 30.8 million in the three months to October 2014, a rise of 115,000. This mirrors the latest QES where the backward-looking national employment balances rose to all-time highs for both manufacturing and services **(see Chart 6)**. However, UK employment rose by 63,000 over the same period, the smallest quarterly increase since 2013 and suggests an easing in the pace of growth. **Overall the latest Office for National Statistics (ONS) and QES jobs data confirms that the labour market remains an area of strength for the UK economy.**



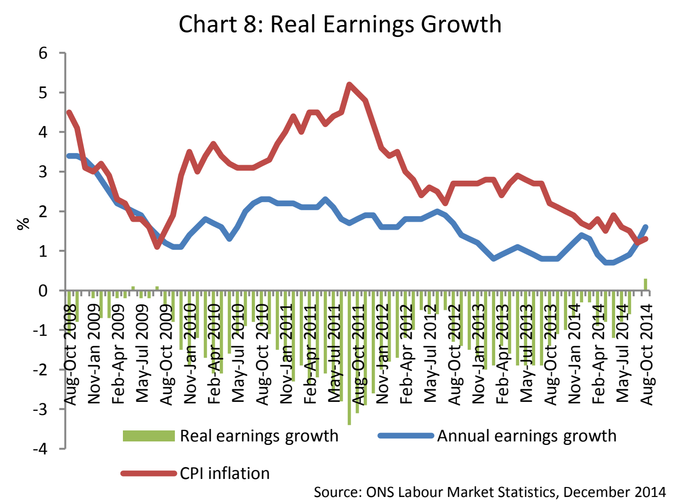
...and inflation falling to 12 year low...

CPI inflation fell from 1.3% in October to 1.0% in November, the lowest rate since September 2002 (see Chart 7). This is the eleventh successive month that inflation has been below the Bank of England's 2% target. The slowdown was driven by falls in transport costs and the price of recreational and cultural goods. Although the latest QES revealed that intentions to raise prices are up for both manufacturing and services, they remain weaker than earlier in 2014. **Overall, we expect inflation to remain below the 2% target until well into 2016.**



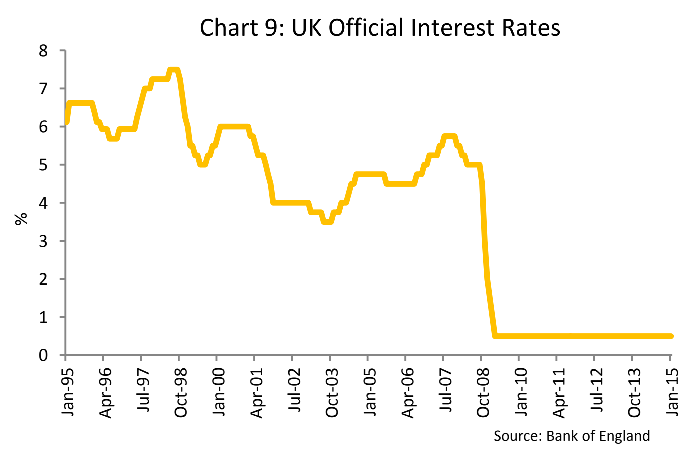
...wages are growing faster than inflation...

Annual pay growth (excluding bonuses) rose to 1.6% in the three months to October 2014, the highest rate of growth in two years and higher that CPI inflation reading of 1.3%. As a consequence, **average earnings are currently rising by 0.3% in real terms. (see Chart 8).** This is a significant improvement on the same period in 2013 when prices were rising at almost three times the growth in average earnings. Although pay increases are still very low by historical standards, we think that earnings growth will continue to edge up slowly in the next few years, in line with stronger economic activity.



... but this is not an excuse for early rate hike.

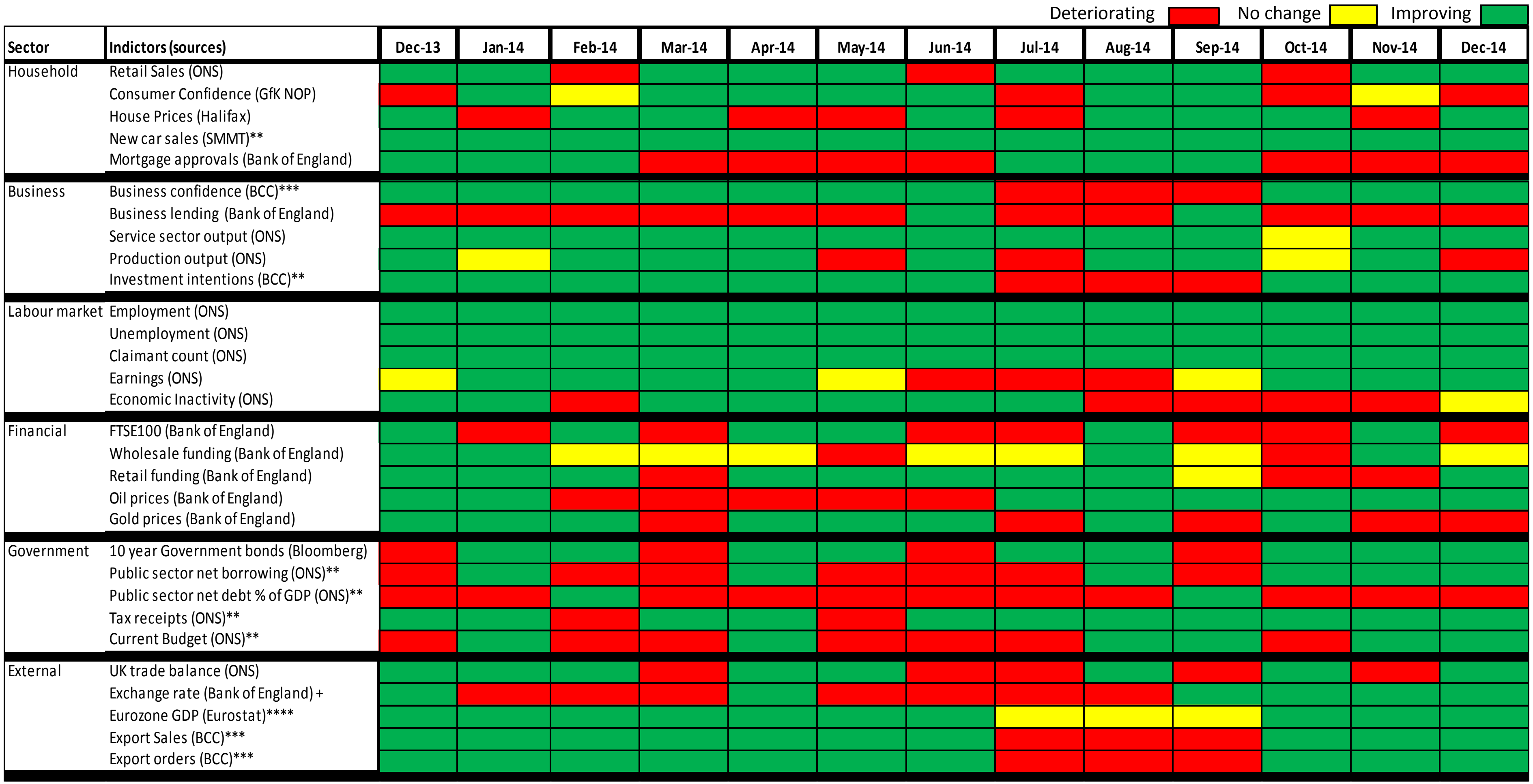
Although the fact that earnings are growing faster than inflation is an encouraging development, it would be a mistake to interpret this as an argument for early interest rate rises. With earnings growth expected to remain modest, inflation likely to stay below target in the near term and global headwinds, including the continued weakness in the Eurozone, posing risks to the UK's economic recovery, **the MPC should not consider raising interest rates, which have been on hold since March 2009 (see Chart 9), until the final months of 2015.**



Bottom line: *The data releases in December and the latest QES support our view that **the UK's medium-term economic growth will be slightly higher in the next few years than the Office for Budget Responsibility (OBR) forecast predicted in the Autumn Statement.** However, the UK economy will continue to face major challenges and more must be done to ensure that growth is sustainable for the long-term.*

For more information please contact: Suren Thiru, UK Economist. Email: s.thiru@britishchambers.org.uk. Tel: 020 7654 5801

Chart 9: UK economic summary chart



*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.