UK Monthly Economic Review

November 2014

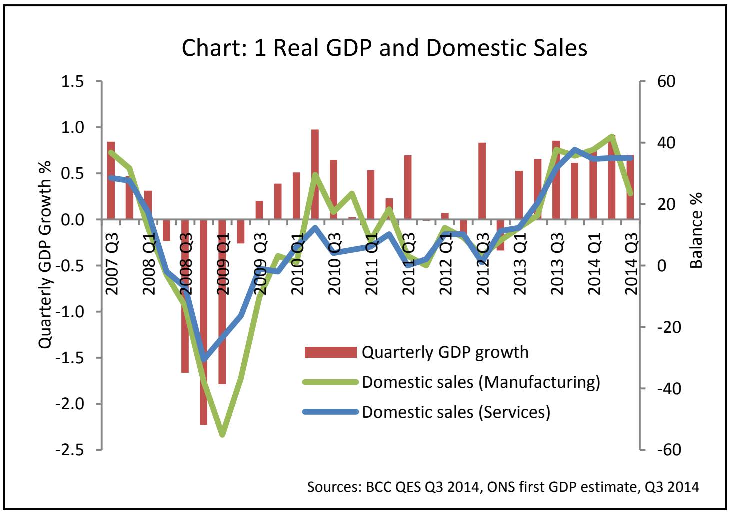
(Based on October 2014 data releases)

Monthly headlines:

- UK economy remains strong despite economic growth slowing in Q3
- The service sector remains the key driver of UK economic growth
- Falling inflation and lower real wages strengthen the case for holding interest rates at 0.5%

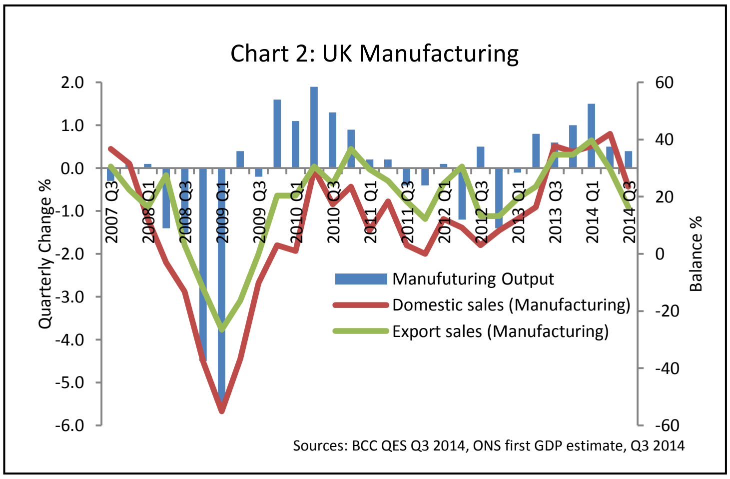
UK economy grew by 0.7% in Q3...

The first official estimate of economic output (GDP) put **UK GDP growth at 0.7% in Q3 2014, slower than the growth of 0.9% recorded in the previous quarter**. This mirrors the latest BCC Quarterly Economic Survey (QES) with the results pointing to an easing in the pace of economic growth **(see Chart 1)**. The level of economic output in the UK is now estimated to be 3.4% higher than its pre-recession peak in Q1 2008. However, **despite the slowdown in Q3, the UK economy is still outperforming many of its major competitors.**



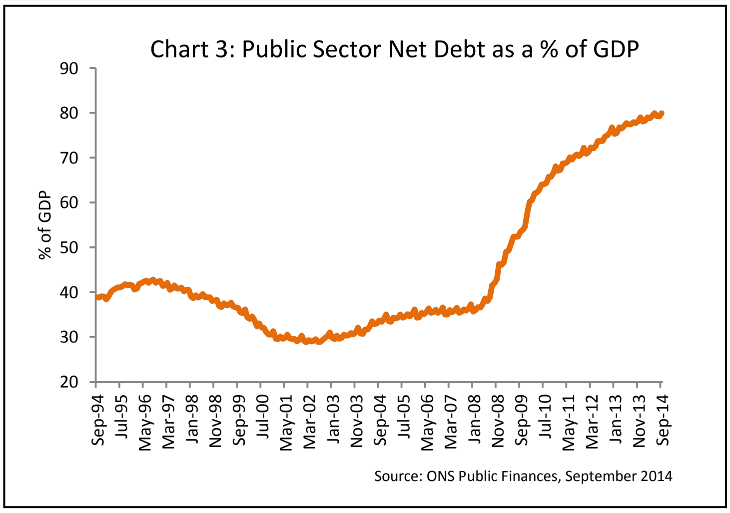
...driven by a dominant service sector...

All of the UK economy's major industrial sectors – agriculture, production, construction and services – **grew in Q3**. Agricultural output rose by 0.3% and construction grew by 0.8% in Q3. Industrial production rose by 0.5%, driven by a 0.4% rise in manufacturing output. This is in contrast to the latest QES which recorded falls in most of the key manufacturing balances **(see Chart 2)**. **Services are still the most dominant sector,** growing by 0.7% and accounting for 83% of the growth recorded in Q3.



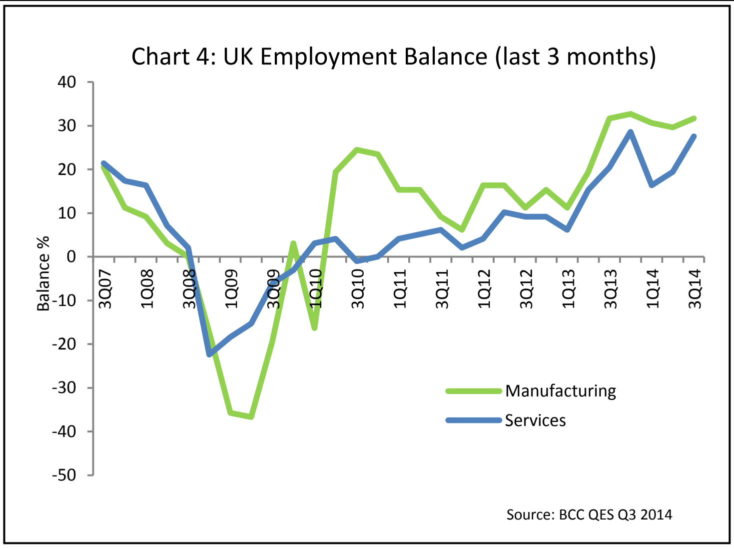
...but the public finances remain off target.

Public sector borrowing (excluding the public sector banks) totalled £58 billion in the first half of the 2014/15 financial year, £5.4 billion higher than the same period in 2013/14. Public sector net debt currently stands at 79.9% of GDP, more than double pre-crisis levels **(see Chart 3). Despite the UK economy growing at a good pace, tax receipts remain weak** growing by just 2.8% over the past year. The latest data on the public finances suggests that the government is likely to miss the 2014/15 debt reduction target announced in the last budget.



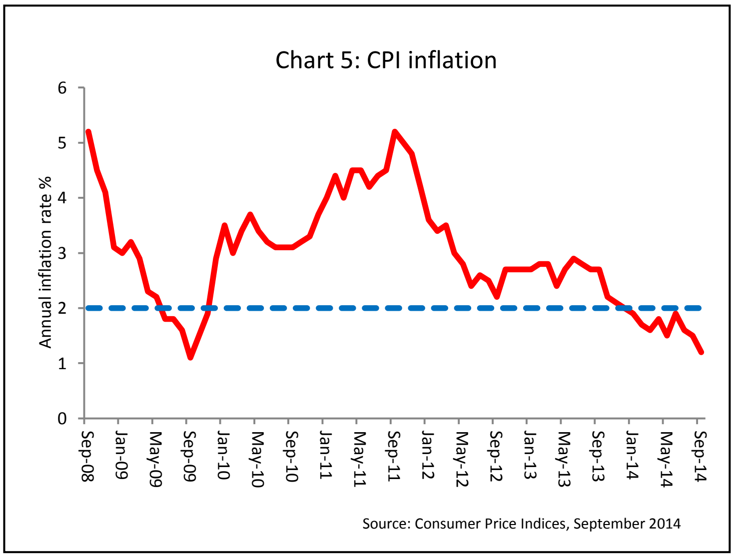
While UK unemployment falls...

In the three months to August 2014, the number of people who are unemployed fell by 154,000 to reach 1.97 million. This is the **first time since 2008 that UK unemployment has fallen below two million**. This is in line with the latest QES which reported an improvement in the employment balances for both manufacturing and services **(see Chart 4)**. UK employment rose by 46,000 over the same period, although this was the smallest quarterly increase since mid 2013. Overall, **the latest UK jobs data confirms that the labour market remains an important source of strength for the UK economy.**



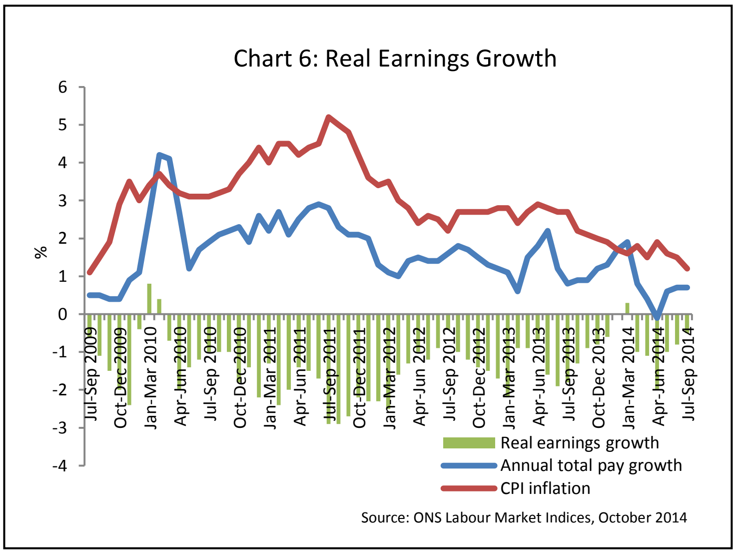
...and inflation declines...

CPI inflation fell from 1.5% in August to 1.2% in September, the lowest rate since September 2009 (see Chart 5). This is the ninth successive month that inflation has been below the Bank of England's 2% target. Falls in transport costs (notably sea fares and air fares), which reflected declining fuel costs over the past year, and lower prices for a range of recreational goods, including laptop and tablet computers, provided the largest contributions to the drop in inflation. However, **the latest QES suggests that higher inflation remains a risk** with expectations of further price rises increasing slightly in Q3.



...real wages continue to fall...

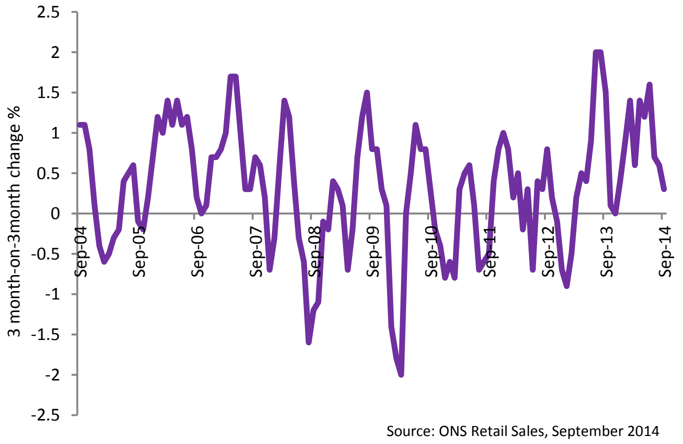
Although inflation fell in September, price rises continue to outstrip earnings growth. September's CPI inflation reading of 1.2% was almost double the latest rise in total pay of 0.7%. As a consequence, **average earnings are currently falling by 0.5% in real terms (see Chart 6).** With around two-thirds of UK economic growth driven by consumer spending, the persistent fall in real wages remains a risk to the recovery. **The decline in inflation, coupled with falling real wage growth, reinforces our call for the MPC to keep interest rates at their current level for the foreseeable future.**



...and with signs of a consumer slowdown...

Retails sales fell by 0.3% in September, the weakest growth since January 2014. A key driver behind the fall was weaker demand for clothing and footwear with sales falling by 7.8% in September. On the rolling three-month-on-three-month measure, a better indicator of the underlying trend, retail sales rose by just 0.3% in September, the weakest growth since November 2013 **(see Chart 7)**. **There are signs that the UK housing market is starting to lose momentum.** The number of mortgages approved - a leading indicator of housing market activity - fell by 4.4% in September to 61,267, the lowest level since July 2013.

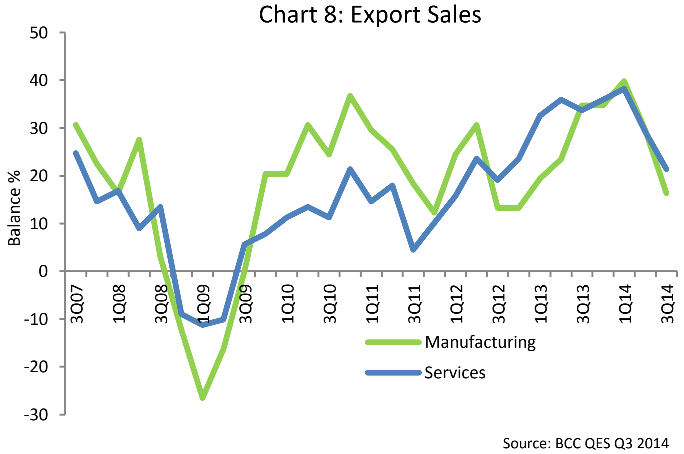
Chart 7: Retail Sales



...and a weakening outlook for UK exports...

The UK's trade deficit narrowed in August 2014 to £1.9 billion, from £3.1 billion in July. However, this narrowing was driven by imports falling at a faster rate than the decline in exports. Although exports fell by £0.7 billion in August, imports fell by £2.0 billion over the same period, the largest monthly drop since 2006. **The Q3 2014 QES revealed a worsening picture for UK exports with all key export balances declining, though still in positive territory (see Chart 8).** This decline has been partly driven by the renewed weakness in the Eurozone and the strength of sterling.

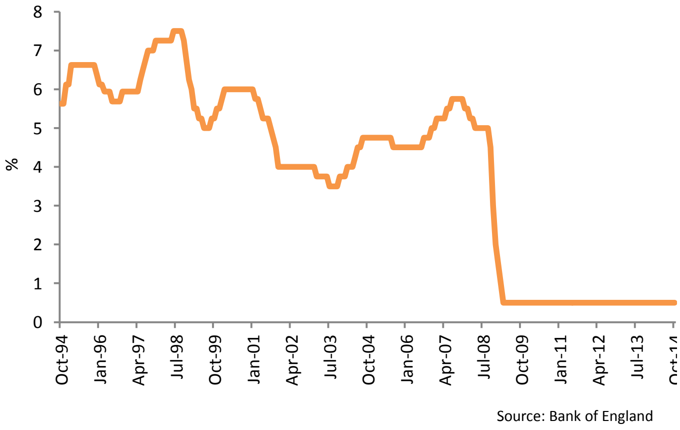
Chart 8: Export Sales



...the case against rate rises is strengthening.

The minutes from the October's Monetary Policy Committee (MPC) meeting revealed that the committee remain split on what should happen to interest rates, voting 7-2 in favour of keeping interest rates on hold at 0.5% **(see Chart 9)** for the third successive month. However, with signs that economic growth is slowing, inflation well below the MPC's 2% target, wage growth weakening and the appreciation in sterling, which increases the price of UK exports, **interest rates must be kept at their current low levels well into 2015.**

Chart 9: UK Official Interest Rates



Bottom line: ***October's economic data releases support our view that while the UK economy continues to perform well, the pace of growth is slowing.*** *There needs to be a more concerted effort to support the recovery, including keeping interest rates on hold well into 2015 and using the Autumn Statement to support enterprise and growth.*

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British Chambers of Commerce

UK economic summary chart

Deteriorating ■ No change ■ Improving ■

Sector	Indictors (sources)	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14
Household	Retail Sales (ONS)	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating
	Consumer Confidence (GfK NOP)	Deteriorating	Deteriorating	Deteriorating	Improving	No change	Improving	Improving	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating
	House Prices (Halifax)	Improving	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Deteriorating	Improving	Deteriorating	Improving	Improving	Improving
	New car sales (SMMT)**	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Mortgage approvals (Bank of England)	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Deteriorating
Business	Business confidence (BCC)***	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating
	Business lending (Bank of England)	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Deteriorating	Deteriorating	Improving	Deteriorating
	Service sector output (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	No change
	Production output (ONS)	Deteriorating	Improving	Improving	No change	Improving	Improving	Improving	Deteriorating	Improving	Deteriorating	Improving	Improving	No change
	Investment intentions (BCC)**	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating
Labour market	Employment (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Unemployment (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Claimant count (ONS)	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving
	Earnings (ONS)	Improving	Deteriorating	No change	Improving	Improving	Improving	Improving	No change	Deteriorating	Deteriorating	Deteriorating	No change	Improving
	Economic Inactivity (ONS)	Improving	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating
Financial	FTSE100 (Bank of England)	Improving	Deteriorating	Improving	Deteriorating	Improving	Deteriorating	Improving	Improving	Deteriorating	Deteriorating	Improving	Deteriorating	Deteriorating
	Wholesale funding (Bank of England)	No change	No change	Improving	Improving	No change	No change	No change	Deteriorating	No change	No change	Improving	No change	Deteriorating
	Retail funding (Bank of England)	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	Improving	No change	Deteriorating
	Oil prices (Bank of England)	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Improving	Improving
	Gold prices (Bank of England)	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Deteriorating	Improving
Government	10 year Government bonds (Bloomberg)	Improving	Deteriorating	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving
	Public sector net borrowing (ONS)**	Improving	Improving	Deteriorating	Improving	Deteriorating	Deteriorating	Improving	Deteriorating	Deteriorating	Deteriorating	Improving	Deteriorating	Improving
	Public sector net debt % of GDP (ONS)**	Deteriorating	Improving	Deteriorating	Deteriorating	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Deteriorating
	Tax receipts (ONS)**	Improving	Improving	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Improving	Improving	Improving	Improving	Improving
	Current Budget (ONS)**	Improving	Improving	Deteriorating	Improving	Deteriorating	Deteriorating	Improving	Deteriorating	Deteriorating	Deteriorating	Improving	Improving	Deteriorating
External	UK trade balance (ONS)	Deteriorating	Deteriorating	Improving	Improving	Improving	Deteriorating	Improving	Improving	Deteriorating	Deteriorating	Improving	Deteriorating	Improving
	Exchange rate (Bank of England) +	Deteriorating	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating	Improving	Improving
	Eurozone GDP (Eurostat)****	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	No change	No change	No change
	Export Sales (BCC)***	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating
	Export orders (BCC)***	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Improving	Deteriorating	Deteriorating	Deteriorating	Deteriorating

*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.