BCC ECONOMICS

BRITISH CHAMBERS OF COMMERCE

MONTHLY ECONOMIC REVIEW APRIL 2018

Monthly headlines:

- UK GDP growth for 2017 revised up as the current account deficit falls to six-year low
- The BCC upgrades its GDP growth expectations for the UK economy
- US raises interest rates and the Bank of England likely to follow suit next month

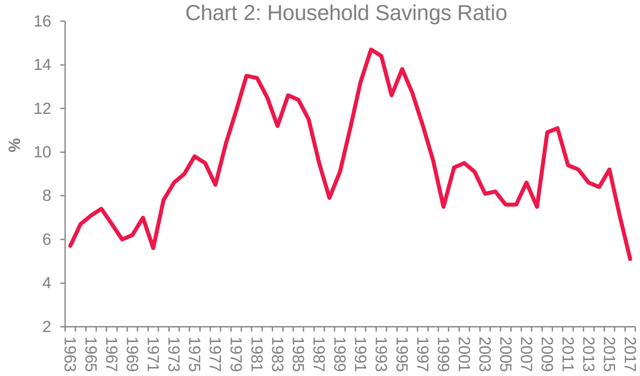
Annual UK GDP growth revised upwards...

The third official estimate of UK economic output (GDP) recorded growth of 0.4% in Q4 2017, unrevised from the previous estimate and down slightly from the growth of 0.5% recorded in Q3. The UK economy grew by 1.4% in annual terms in Q4, down from growth of 1.8% recorded in Q3. However, partly due to upward data revisions to GDP growth in the first half of 2017 **UK GDP growth for 2017 as a whole was revised up from 1.7% to 1.8% (see Chart 1).** Overall, UK economic output is now 10.6% above its pre-recession peak.

Chart 1: UK Real GDP Growth

Source: ONS Quarterly National Accounts, Q4 2017

Chart 2: Household Savings Ratio



Source: ONS Quarterly National Accounts, Q4 2017

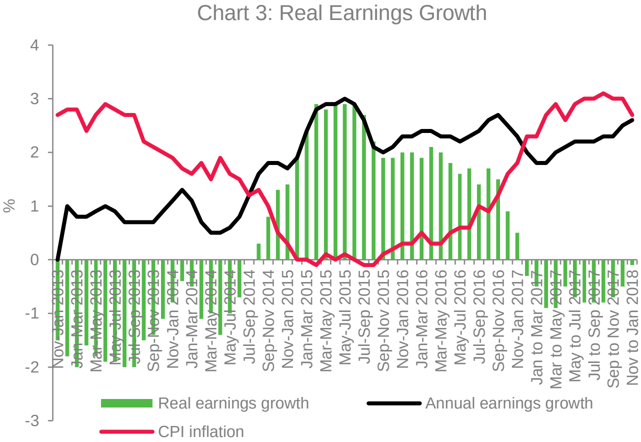
...but household finances weaken...

Household spending, which accounts for around two-thirds of UK economic output, grew by 0.3% in Q4, unchanged from the previous quarter. For 2017 as a whole, household spending grew by 1.7%, the slowest rate of annual growth since 2011. The latest data also indicates that consumers are drawing down savings or borrowing to help fund spending. **The households' saving ratio fell to 5.1% in 2017, the lowest rate on record (see Chart 2)**. As a result, households became net borrowers (household debt exceeding deposits) in 2017 for the first time on record.

...labour market remains a bright spot...

In the three months to January 2018, the number of people in employment rose by 168,000. The UK unemployment rate fell to 4.3%, the joint lowest rate since 1975. With regular pay growth increasing from 2.5% to 2.6%, **the gap between pay and price growth has narrowed significantly (see Chart 3)**, easing the squeeze on consumers. However, while regular real wage growth is now likely return to positive territory sooner rather than later, the extent to which pay growth can be kept consistently above inflation will be determined by the extent to which the UK can build on the recent increases in productivity.

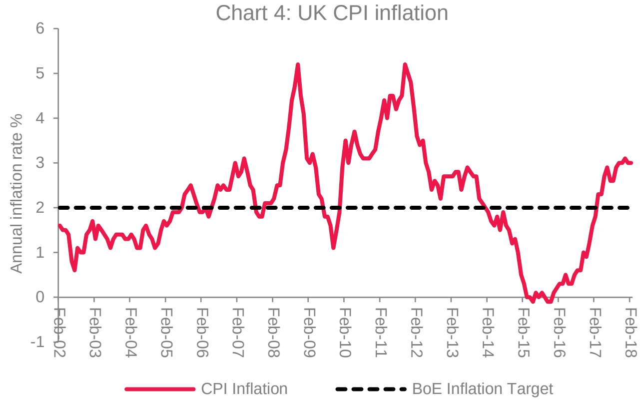
Chart 3: Real Earnings Growth



Source: ONS Labour market statistics, March 2018

British Chambers of Commerce

Chart 4: UK CPI inflation



Source: ONS Consumer price inflation, February 2018

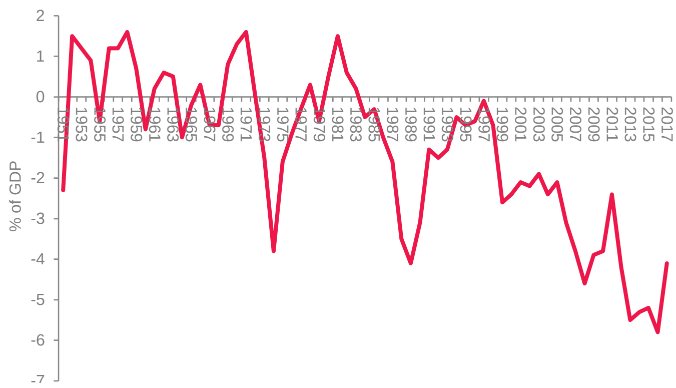
...as inflation slows further...

CPI inflation in the UK stood at 2.7% in February 2018, the lowest rate since July 2017 **(see Chart 4)** and down from the 3% rise in January. The largest downward pressure came from transport and food prices, which rose by less than a year ago. **It is probable that the UK is now past the peak of the recent spike in inflation** and will slow further over the coming months as the impact of the post-EU referendum decline in sterling fades. However, the upward pressure from rising commodity prices could well keep inflation above the Bank of England's 2% target over the near term.

...UK's current account deficit narrows…

The UK's current account deficit (the gap between what the UK earns and spends) narrowed from £19.2 billion in Q3 2017 to £18.4 billion in Q4 2017. The current account deficit in Q4 2017 equated to 3.6% of UK GDP, down from 3.7% in Q3 2017. **For 2017 as a whole, the UK's current account deficit equated to 4.1% of UK GDP, the lowest since 2011 (see Chart 5) but still almost four times the historical average.** The improvement was partly driven by an increase in income from overseas investment with UK direct overseas investment in 2017 reaching £65.7 billion, the highest since 2007.

Chart 5: UK Current Account position (as a % of GDP)



Source: ONS Balance of Payments, Q4 2017

Table 1: BCC UK GDP Growth Forecast Comparisons

GDP Growth (Annual % change)	Q4 17	Q1 18	Change
2018	1.1	1.4	0.3
2019	1.3	1.5	0.2
2020	-	1.6	-

Source: BCC

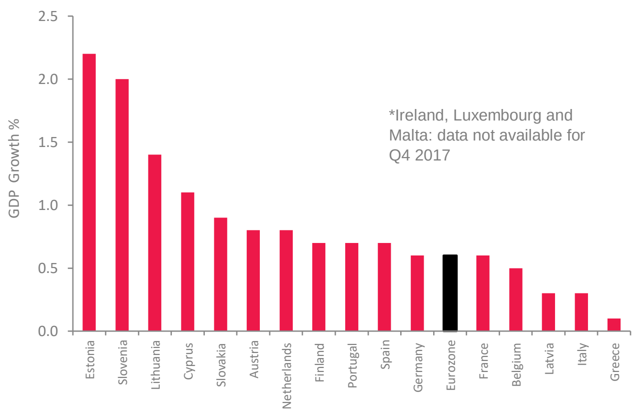
…BCC upgrades its UK growth forecasts…

The BCC has upgraded its UK economic growth (GDP) forecast for 2018 from 1.1% to 1.4% **(see Table 1)**. The BCC has also upgraded its UK growth forecast for 2019 from 1.3% to 1.5%, and the BCC's first forecast for 2020 is for 1.6% growth. The upgrades mainly reflect slightly stronger expected growth in consumer spending amid a moderate pick-up in pay growth. UK export growth is also expected to remain robust, supported by a strong global economy. However, UK GDP growth is still set to remain well below the historical average throughout the forecast period. **Our latest forecast also implies that the UK will remain among the slowest growing economies in the G7 until 2020 at the earliest.**

…as the Eurozone growth remains strong…

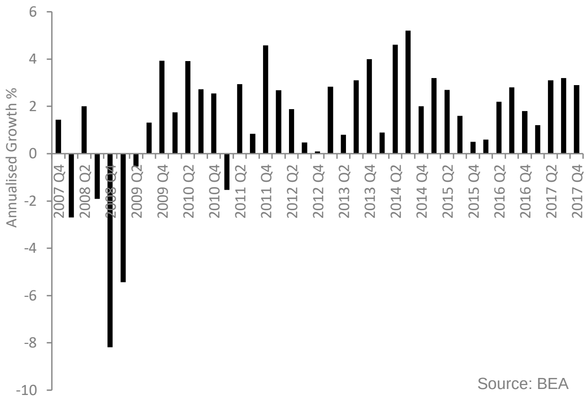
The Eurozone economy grew by 0.6% in Q4, unrevised from the previous estimate. Eurozone growth in Q4 was partly driven by consumer spending, which rose by 0.2% in the quarter. There were also positive contributions from investment and net trade in Q4. **Estonia (2.2%) recorded the strongest growth among Eurozone countries in Q4 (see Chart 6)**, followed by Slovenia (2.0%). In contrast, Greece (0.1%) recorded the weakest Q4 growth, followed by Italy and Latvia (both 0.3%). Over 2017 as a whole, GDP rose by 2.3% in the Eurozone, up from growth of 1.8% recorded in 2016.

Chart 6: Eurozone GDP Growth*



Source: Eurostat

Chart 7: US Real GDP Growth



...Q4 US growth revised up...

The US economy grew by an annualised rate of 2.9% in Q4 2017, according to the third official estimate **(see Chart 7)**. This was up from the previous estimate of 2.5% but lower than the growth of 3.2% recorded in previous quarter. Consumer spending, which accounts for over two thirds of US economic output, grew by 4% in Q4, revised up from the previous estimate of 3.8% and is the strongest rate of growth since Q4 2014. **In contrast, net trade was a drag on growth in the quarter** as a 14.1% rise in imports more than offset a 7% increase in exports over the same period. The US economy grew by 2.3% in 2017 as a whole, up from an increase of 1.5% in 2016.

…as US raises interest rates again...

The Federal Reserve increased US interest rates by 0.25 percentage points in March to a target range of between 1.50% and 1.75% **(see Chart 8)**. The tightening in US monetary policy has been mainly driven by the improving economic outlook for the US with the central bank upgrading is GDP growth forecast for 2018 to 2.7%, from their previous forecast of 2.5%. Significantly, the US unemployment rate currently stands at 4.1%, the lowest since 2000. **If US monetary policy continues to tighten as expected, it is likely to increase the downward pressure on Sterling, increasing the upward pressure on UK inflation.**

Chart 8: US Interest Rates

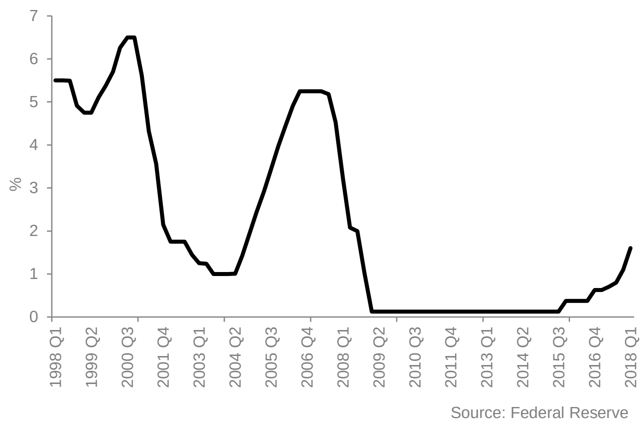
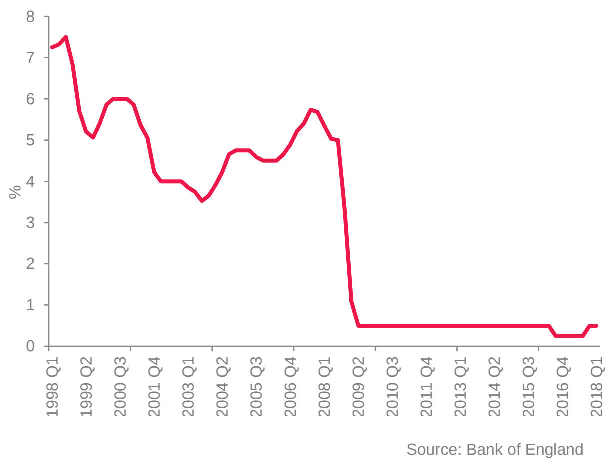


Chart 9: UK Interest Rates



…the MPC keeps UK rates on hold for now.

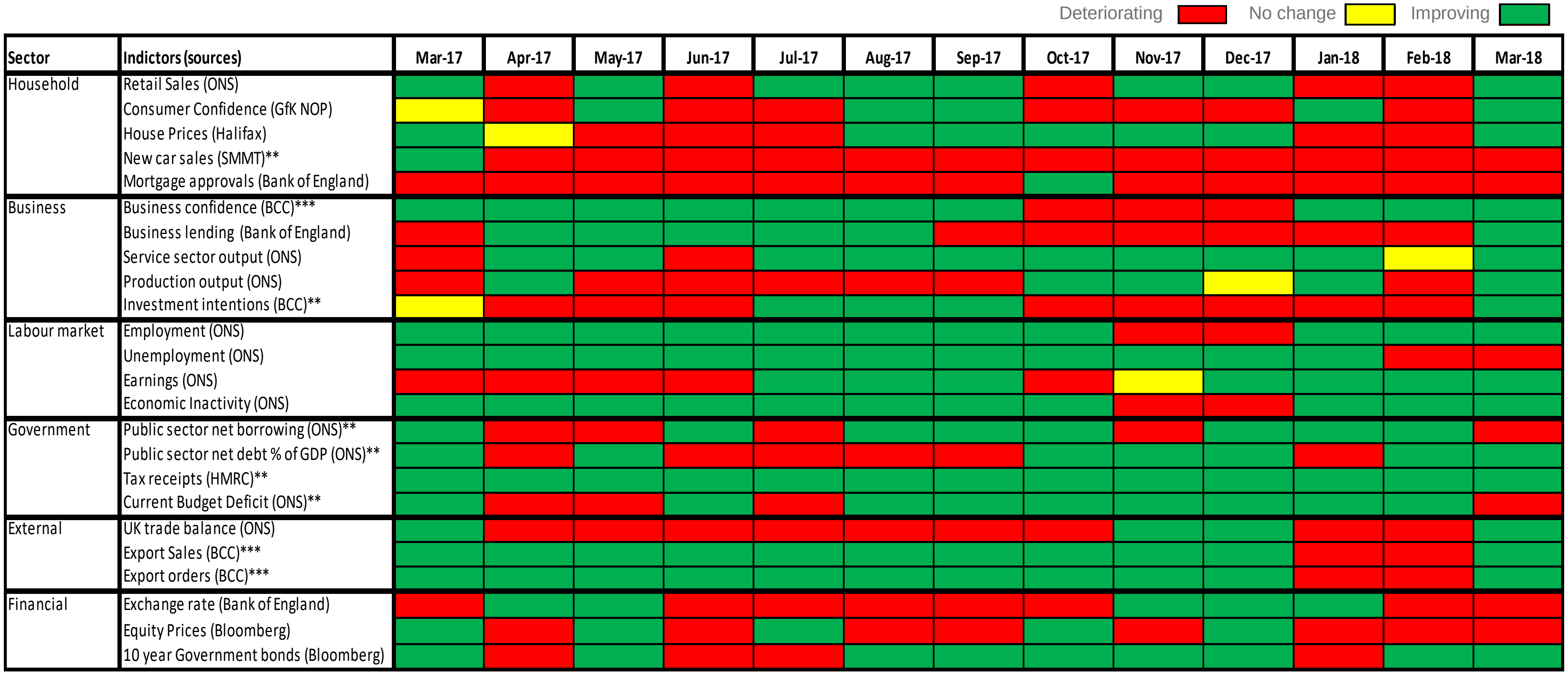
In contrast to the US, the Bank of England's Monetary Policy Committee (MPC) kept UK interest rates on hold at 0.5% **(see Chart 9)**. However, there was marked shift in the committee's voting pattern with the MPC vote splitting from 9-0 to 7-2 with two MPC members - Ian McCafferty and Michael Saunders - voting for a rate hike. Significantly, the latest MPC minutes suggest that a May rise in interest rates remains likely, stating that "ongoing tightening" is likely to be needed to get inflation back to the 2% target. However, with economic conditions still subdued the probability of multiple rate hikes looks unlikely at this stage. Overall, **we expect that UK interest rates will rise to 0.75% in May, followed by another rate hike, to 1%, in Q1 2019.**

Bottom line:

The latest data releases suggest that UK economic conditions remain sluggish. It is therefore vital that more is done to support firms looking grow their business and boost productivity, including easing upfront business costs and incentivising business investment. Furthermore, with economic conditions likely to become more subdued, the MPC should opt for a prolonged period of monetary stability and keep interest rates steady over the near term.

For more information please contact Suren Thiru, Head of Economics.
Email: s.thiru@britishchambers.org.uk. Tel: 0207 654 5801

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. 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 estimate.