

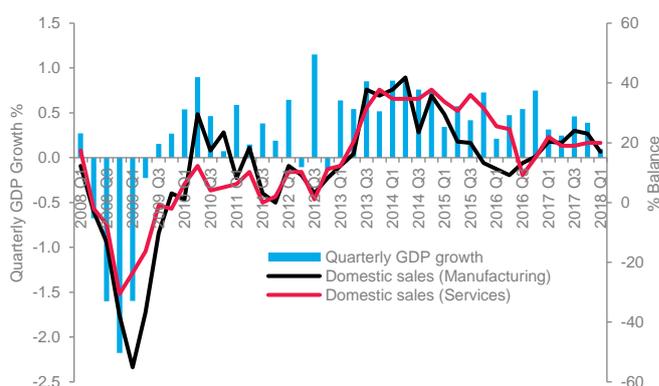
Monthly headlines:

- UK GDP growth in Q1 2018 unrevised as business investment declines
- UK labour market remains a bright spot but productivity falls in Q1
- GDP growth slows in the US and the Eurozone as Japan's economy contracts

UK GDP growth in Q1 unrevised...

The second official estimate for Q1 2018 UK economic growth (GDP) stood at 0.1%, unrevised from the previous estimate and mirrored the results of the latest Quarterly Economic Survey (QES) which indicated that the UK economy slowed in Q1 (See Chart 1). Nonetheless this was still the 21st consecutive quarter of growth. Output from the service sector increased by 0.3% in Q1, while construction sector output declined by 2.7% over the same period. Overall, the second estimate of UK GDP does little to alter our view that the UK economy is slowing.

Chart 1: Real GDP and Domestic Sales



Source: ONS Second Estimate of GDP, Q1 2018

Chart 2: UK Business Investment



Source: ONS Business Investment, Q1 2018

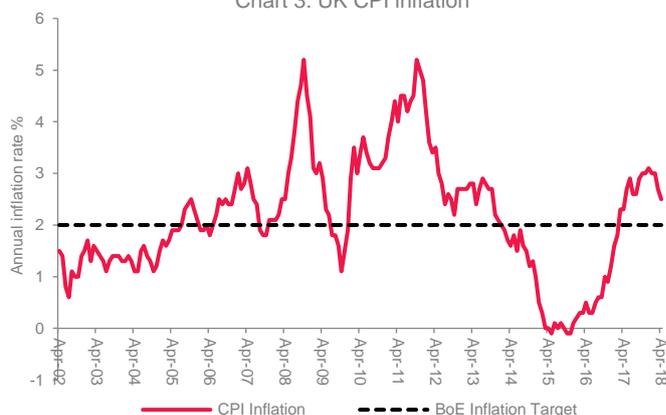
...as business investment falls...

The latest Q1 2018 GDP estimate revealed that **business investment fell by 0.2% in the quarter, the first decline since Q4 2016** and markedly weaker than the growth of 0.3% recorded in the previous quarter (see Chart 2). The UK's trade deficit narrowed slightly to £9.2 billion in Q1, from £9.4 billion in the previous quarter. The improvement was driven by a 0.6% fall in imports in Q1 which more than offset a 0.5% drop in exports over the same period. Consumer spending, a key driver of UK GDP growth, increased by 0.2% in Q1 2018.

...inflation continues on its downward path...

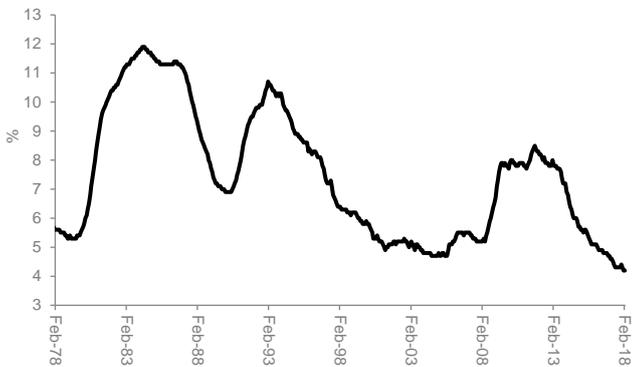
UK CPI inflation stood at 2.4% in April 2018, down from the 2.5% rise in March. (see Chart 3). April's slowdown was largely due to a 7.9% annual fall in air fares, which reflected the shift in the timing of Easter compared to 2017. There maybe a slight uptick in inflation over the coming months with evidence that price pressures in supply chains are rising. The cost of raw materials increased by 5.3% on the year to April 2018, up from 4.4% in March 2018. However, this probably will be a temporary rise with UK inflation continuing its overall trend back towards the Bank of England's 2% target.

Chart 3: UK CPI inflation



Source: ONS Consumer Price Inflation, April 2018

Chart 4: UK Unemployment Rate



Source: ONS Labour Market data, May 2018

...while UK labour market remains a bright spot...

The latest UK labour market figures revealed that in the three months to March 2018, the number of people in employment rose by 197,000. Unemployment fell by 46,000 over the same period. The unemployment rate currently stands at 4.2%, down from 4.6% a year earlier and is the joint lowest since 1975 (see Chart 4). Average weekly earnings (excluding bonuses) rose by 2.9%. While the latest data confirms that the labour market remains a bright spot, labour market data tend to lag behind the wider economy, so a weakening in economic conditions is unlikely appear in the figures for some time.

...productivity growth declines...

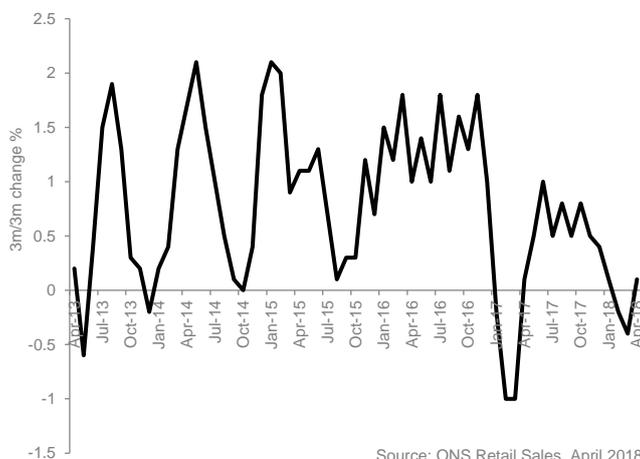
UK productivity, as measured by average output per hour worked fell by 0.5% in Q1 2018, the joint largest fall since Q4 2015 (see Chart 5). The decline in the quarter was driven by a 0.6% rise in hours worked and in employment in Q1, outpacing the 0.1% GDP growth over the same period. The persistent weakness in UK productivity reflects the longstanding structural problems in the UK's economy from a chronic skills shortage, to our creaking infrastructure and the escalating cost of doing business that continue to undermine the UK's productive potential.

Chart 5: UK Productivity (Output per hour worked)



Source: ONS Labour Productivity, Q1 2018

Chart 6: UK Retail Sales



Source: ONS Retail Sales, April 2018

...while there was a good start to Q2...

Retail sales rose by 1.6% in April 2018, the strongest rate of growth since October 2016 and more than offset the 1.1% decline in March. The improvement was largely due to a 4.7% rise in petrol sales, following a 6.9% decline in the previous month as sales recovered from the impact of the 'Beast from the East' weather system. On the rolling three-month-on-three-month measure, a better indicator of the underlying trend, retail sales remain subdued, rising by just 0.1% in the three months to April 2018 (see Chart 6). Furthermore, with real wage growth still subdued, retail sales are likely to remain sluggish in the coming months.

...UK's economic outlook more subdued...

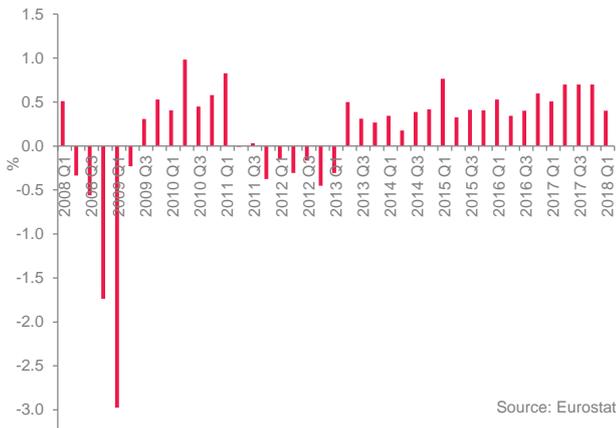
In its latest inflation report, the Bank of England downwardly revised its UK GDP growth forecast for 2018 from 1.8% to 1.4%, which is now in line with the BCC's latest forecast (see Table 1). The central bank also downgraded its forecasts for 2019 and 2020 to 1.7%, from 1.8%. In our view the Bank of England remains too bullish about the UK's growth prospects over the next few years despite the downgrade to their 2018 forecast. Business investment is likely to be more sluggish than the Bank of England is currently forecasting, with the cost of doing business in the UK and wider uncertainty likely to weigh on investment decisions.

Table 1: UK GDP Growth Forecast Comparison

	BCC	Bank of England
2018	1.4%	1.4%
2019	1.5%	1.7%
2020	1.6%	1.7%

Sources: BCC, Bank of England

Chart 7: Eurozone Real GDP Growth



Source: Eurostat

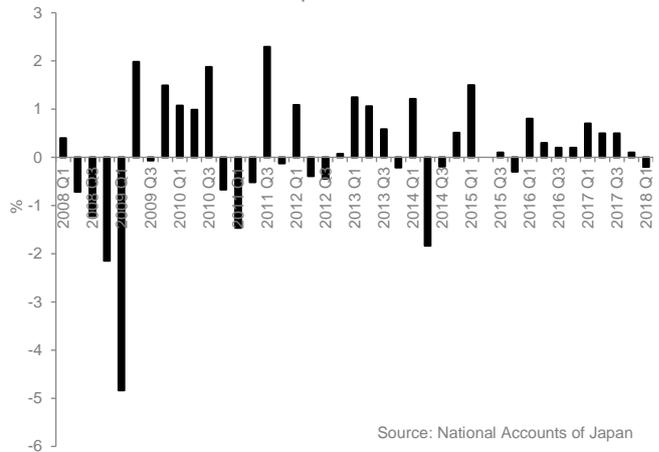
...Eurozone growth slows in Q1...

The Eurozone economy grew by 0.4% in Q1 2018, slower than the growth of 0.7% recorded in the previous quarter (see Chart 7). In annual terms, the Eurozone economy grew by 2.5% in Q1, down from 2.8% in Q4 2017. **Germany's economy, the biggest in the Eurozone, grew by 0.3% in Q1, down from the growth of 0.6% recorded in the previous quarter.** Latvia (1.7%) recorded the strongest growth in the quarter, followed by Finland (1.1%) and Spain (0.7%). While the adverse weather conditions had an impact, there are signs that the boost to the Eurozone GDP growth from strong global trade is starting to fade.

...Japan's economy contracts...

Japan, the world's third-largest economy, contracted by 0.2% in Q1 2018, the first decline since Q4 2015 and down from the growth of 0.1% recorded in the previous quarter (see Chart 8). The contraction in Q1 marked the end to eight consecutive quarters of growth, which was the longest period of unbroken economic expansion since the late 1980's. Consumer spending, which accounts for almost two-third of Japanese GDP growth, was unchanged in Q1 and business investment contracted by 0.1% in the quarter. In annual terms, Japan's economy grew by 1.4% in Q1, down from 1.9% in the previous quarter.

Chart 8: Japan Real GDP Growth

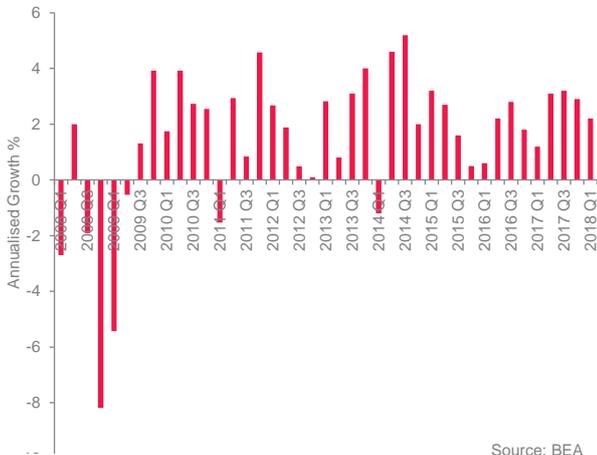


Source: National Accounts of Japan

...and US growth is revised down.

The second estimate of US GDP revealed that the US economy grew at an annualised rate of 2.2% in Q1 2018, down from the previous estimate of 2.3% and lower than the growth 2.9% recorded in the previous quarter (see Chart 9). The downward revision was largely driven by weaker outturns for exports, investment and consumer spending than previously estimated. Despite the Q1 slowdown, the outlook for the US economy remains relatively positive and as a consequence, US interest rates are likely to continue to rise through the rest of the year. **A sustained tightening in US monetary policy could increase the downward pressure sterling and the upward pressure on UK inflation.**

Chart 9: US Real GDP Growth



Source: BEA

Bottom line:

Last month's data releases suggest that the UK economy is going through a soft patch amid a continued squeeze on both consumer and businesses. Against this backdrop, we would caution against a sustained tightening in monetary policy, as it could dampen business and consumer confidence and further subdue UK GDP growth. Instead more needs to be done to lift the UK out of its current low growth trajectory, including incentivising long-term business investment.

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ECONOMIC SUMMARY CHART

Deteriorating ■ No change ■ Improving ■

Sector	Indicators (sources)	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18
Household	Retail Sales (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Consumer Confidence (GfK NOP)	■	■	■	■	■	■	■	■	■	■	■	■	■
	House Prices (Halifax)	■	■	■	■	■	■	■	■	■	■	■	■	■
	New car sales (SMMT)**	■	■	■	■	■	■	■	■	■	■	■	■	■
	Mortgage approvals (Bank of England)	■	■	■	■	■	■	■	■	■	■	■	■	■
Business	Business confidence (BCC)***	■	■	■	■	■	■	■	■	■	■	■	■	■
	Business lending (Bank of England)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Service sector output (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Production output (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Investment intentions (BCC)**	■	■	■	■	■	■	■	■	■	■	■	■	■
Labour market	Employment (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Unemployment (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Earnings (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Economic Inactivity (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
Government	Public sector net borrowing (ONS)**	■	■	■	■	■	■	■	■	■	■	■	■	■
	Public sector net debt % of GDP (ONS)**	■	■	■	■	■	■	■	■	■	■	■	■	■
	Tax receipts (HMRC)**	■	■	■	■	■	■	■	■	■	■	■	■	■
	Current Budget Deficit (ONS)**	■	■	■	■	■	■	■	■	■	■	■	■	■
External	UK trade balance (ONS)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Export Sales (BCC)***	■	■	■	■	■	■	■	■	■	■	■	■	■
	Export orders (BCC)***	■	■	■	■	■	■	■	■	■	■	■	■	■
Financial	Exchange rate (Bank of England)	■	■	■	■	■	■	■	■	■	■	■	■	■
	Equity Prices (Bloomberg)	■	■	■	■	■	■	■	■	■	■	■	■	■
	10 year Government bonds (Bloomberg)	■	■	■	■	■	■	■	■	■	■	■	■	■

*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.