

BRITISH CHAMBERS OF COMMERCE

# MONTHLY ECONOMIC REVIEW DECEMBER 2018

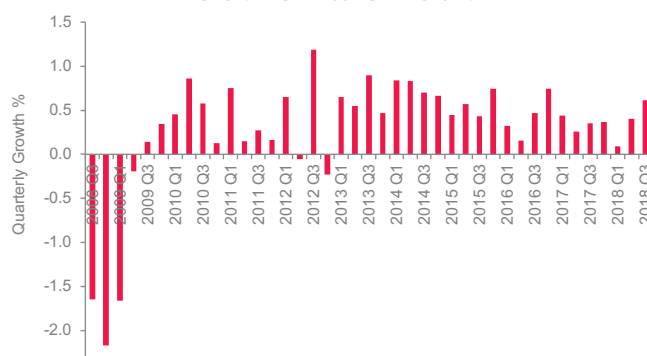
## Monthly headlines:

- UK GDP growth increased in Q3 while business investment and productivity weakened
- Real wage growth continues to strengthen as inflation holds steady
- Outlook for global economy weakens as the economies of Germany and Japan contract

## UK economy strengthened in Q3...

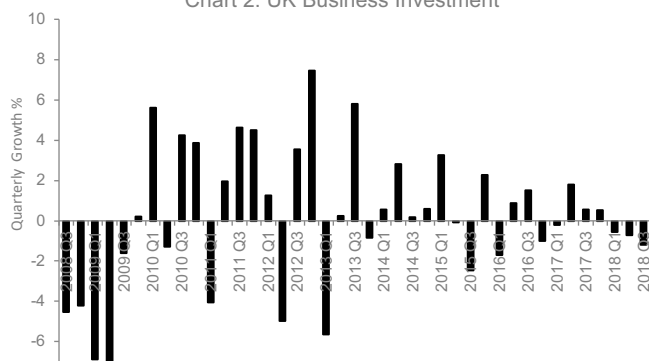
The first official estimate of UK GDP put growth in the third quarter at 0.6%, the strongest growth since Q4 2016 up from the growth of 0.4% recorded in Q2 (see **Chart 1**). UK economic output is now 11.5% above its Q1 2008 pre-recession peak. In annual terms, the UK economy grew by 1.5% in Q3. **It remains likely that the stronger growth recorded in the third quarter is a one-off**, with Brexit uncertainty and the significant financial squeeze on consumers and businesses likely to weigh on overall economic activity in the final quarter of this year.

Chart 1: UK Real GDP Growth



Source: ONS UK GDP estimate, Q3 2018

Chart 2: UK Business Investment



Source: ONS UK GDP estimate, Q3 2018

## ...but business investment contracts...

The latest Q3 2018 GDP estimate revealed that business investment fell by 1.2% in the quarter, almost double the decline of 0.7% recorded in the second quarter of 2018. Business investment has now fallen for three successive quarters, the longest period of sustained contraction since 2008 (see **Chart 2**). While the fall in business investment is a concern as it stifles productivity and growth, measures such as the increase in the **Annual Investment Allowance announced in the Autumn Budget should provide a boost to investment over the near term**.

## ...and productivity declines...

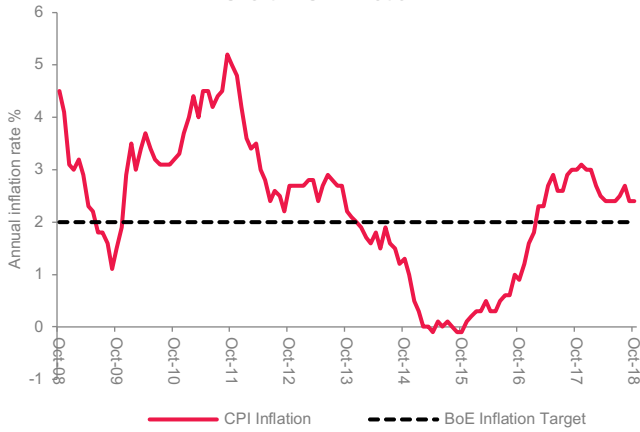
UK productivity, as measured by average output per hour worked, fell by 0.4% in Q3 2018, down from the 0.5% increase in Q2. In annual terms, UK productivity rose by 0.1% in Q3, down from growth of 1.4% in Q2 (see **Chart 3**). **The increase in productivity in Q3 was driven by a 1% rise in total hours worked which more than offset the pickup in GDP growth in the quarter (see Chart 1)**. UK's productivity performance continues to be hampered by the failure to address the deep-rooted problems facing our economy, from skills shortages to the chronic underinvestment in infrastructure.

Chart 3: UK Productivity (Output per hour worked)



Source: ONS Productivity Flash Estimate, Q3 2018

Chart 4: CPI inflation



Source: ONS UK Consumer Price Inflation, October 2018

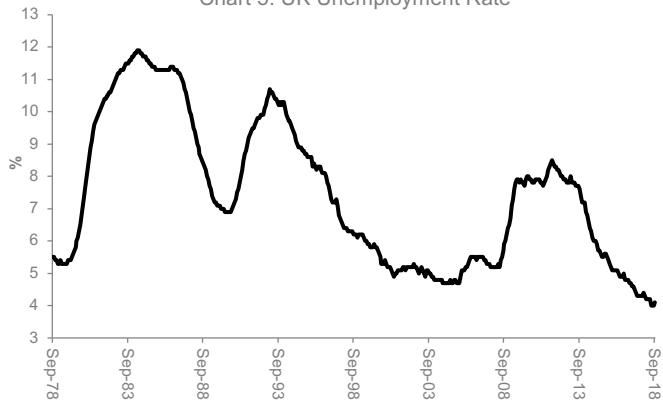
**...inflation holds steady...**

CPI inflation stood at 2.4% in October 2018, unchanged from the previous month and still higher than the Bank of England's 2% inflation target (see Chart 4). The large downward contributions to the rate mainly came from weaker food prices, which helped offset by upward pressure from rising fuel prices. Inflationary pressures in supply chains remain sizeable with producer prices rising by 3.3% on the year to October 2018, up from 3.1% in September. **The possibility of a no deal Brexit is the key risk to the UK's outlook for inflation** as it would likely drive a substantial decline in sterling, which could significantly lift inflation.

**...UK wage growth continues to strengthen...**

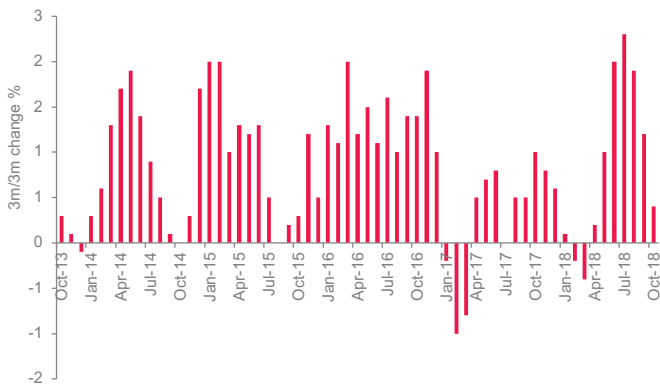
There are signs that the UK jobs market may be starting to falter under the weight of persistent Brexit uncertainty and chronic skills shortages with the UK unemployment rate rising from 4.0% to 4.1% in the three months to September 2018 (Chart 5). There is continued evidence of the growing skills gap with the number of job vacancies rising by 14,000 to 845,000, a new record high. While pay growth increased to a decade high of 3.2%, the recent improvements largely reflect a number of temporary factors, including a rise in actual hours worked.

Chart 5: UK Unemployment Rate



Source: UK Labour Market data, November 2018

Chart 6: UK Retail Sales



Source: ONS Retail Sales data, October 2018

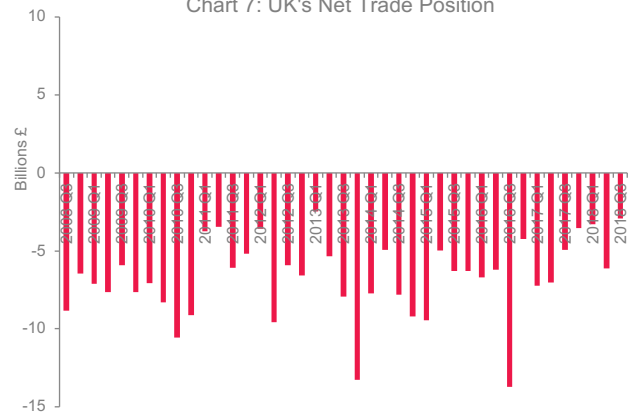
**...retail sales weaken...**

Retail sales fell by 0.5% in October 2018. The decline in the month was largely driven by a 3.0% drop in household goods stores. **On the rolling three month-on-three-month measure, retail sales rose by 0.4, the weakest outturn since April 2018** (see Chart 6). While some of slowdown can be attributed to consumers delaying spending ahead of Black Friday in November, with real wage growth subdued and consumer confidence weak, spending is likely to remain sluggish over the near term, maintaining pressure on retailers.

**...while UK's trade position improves...**

The UK trade deficit in goods and services was £2.9 billion in the third quarter of 2018, a narrowing of £3.2 billion on the previous quarter (see Chart 7). The improvement was driven by a £2.9 billion narrowing in the trade deficit in goods. The UK's trade surplus in services widened by £0.3 billion. The UK's trade deficit in goods with the EU narrowed by £2.5 billion in Q3 and by £0.4 billion with non-EU countries. Despite the Q3 improvement, **Brexit uncertainty, slowing global growth and the prospect of a trade war are likely to increasingly weigh on UK export growth.**

Chart 7: UK's Net Trade Position



Source: ONS UK Trade, September 2018

Table 1: OECD GDP Growth Forecasts

GDP Growth (Annual % change)	2018	2019	2020
World	3.7	3.5	3.5
US	2.9	2.7	2.1
Canada	2.1	2.2	1.9
Eurozone	1.9	1.8	1.6
<b>UK</b>	<b>1.3</b>	<b>1.4</b>	<b>1.1</b>
Japan	0.9	1.0	0.7

Source: OECD

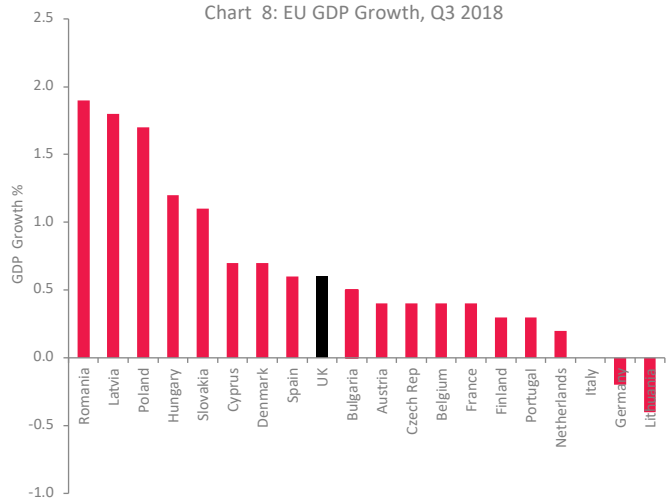
**...the OECD lowers global growth outlook...**

The Organisation for Economic Co-operation and Development (OECD) are currently forecasting global GDP growth of 3.7% this year, unchanged from its previous forecast. However, the OECD downgraded its global GDP growth forecast for 2019, from 3.7% to 3.5% (See Table 1). The OECD GDP growth forecasts for the Eurozone and Japan have been revised downwards and they expect the UK economy to grow by 1.3% this year, before rising to 1.4% in 2019. **The more subdued outlook reflects rising trade tensions, tighter financial conditions and the weaker outlook in emerging markets.**

**...as Germany's economy contracts...**

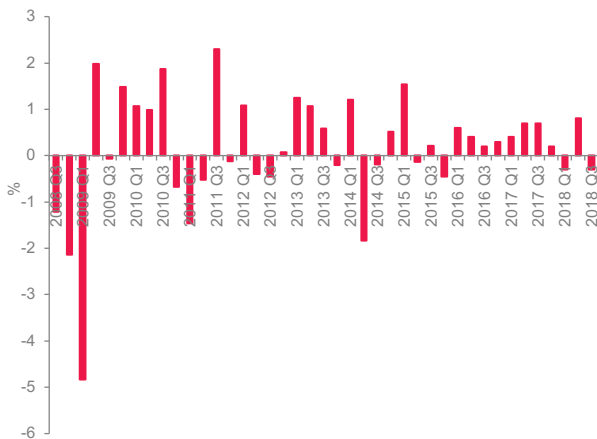
Germany, the biggest economy in the EU, contracted by 0.2% in the third quarter of 2018, the first decline since Q1 2015 and below the growth of 0.5% recorded in the previous quarter. **The Q3 contraction was largely due to a weakening in Germany's net trade position** with exports declining by 0.9% and imports rising by 1.3%. Of the available data, Germany was the second weakest performer in the EU in Q3, behind Lithuania where economic output dropped by 0.4% in the quarter (see Chart 8). In contrast, Romania (+1.9%) recorded the strongest growth in Q3. UK recorded the ninth strongest growth in the quarter.

Chart 8: EU GDP Growth, Q3 2018



Source: Eurostat

Chart 9: Japan Real GDP Growth



Source: The Cabinet Office, Japan

**...as does Japan.**

Japan, the world's third-largest economy, contracted by 0.3% in Q3 2018, the second time this year that Japan has recorded a quarterly decline and down from the growth of 0.8% recorded in the previous quarter (see Chart 9). In annual terms, Japan's economy shrank by 1.2%. **The decline in the quarter largely reflected the impact of a series of natural disasters**, including a major earthquake, and continued trade tensions between China and the US. Household spending, which accounts for around two-thirds of Japanese economic output fell by 0.1%. Japanese exports declined by 1.8% in Q3 and business investment dropped by 0.2% in the quarter.

**Bottom line:**

**Taken together, November's data suggests that economic conditions are deteriorating with persistent Brexit uncertainty and the financial squeeze on consumers and businesses likely to lower UK GDP growth in the final quarter of this year. Against this backdrop, it is vital that businesses get the clarity and precision they need on the terms of trade they will face with the EU and many other countries sooner rather than later.**

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# ECONOMIC SUMMARY CHART

Deteriorating ■ No change ■ Improving ■

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

\*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.