BCC ECONOMICS

BRITISH CHAMBERS OF COMMERCE

MONTHLY ECONOMIC REVIEW JANUARY 2019

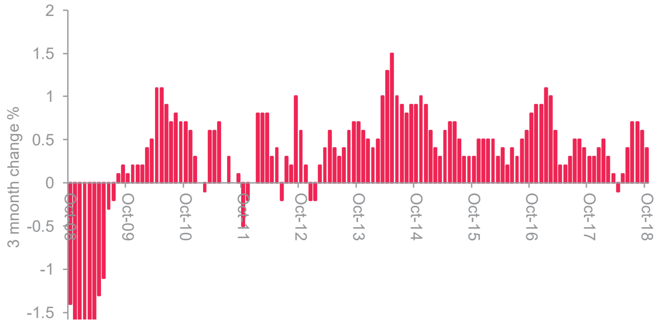
Monthly headlines:

- UK GDP growth subdued in October as latest QES points to a sluggish Q4
- UK labour market continues to tighten as inflation weakens to 20-month low
- BCC forecast that UK GDP growth will remain subdued over the next few years

UK GDP growth subdued in October...

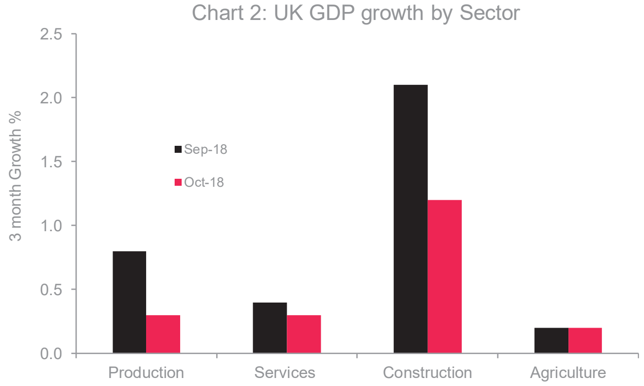
The latest official monthly estimate for UK economic growth (GDP) revealed UK economic growth of 0.1% in October, following two successive months of zero growth. However, on the rolling three-month-on-three-month measure, **UK GDP growth stood at 0.4% in October, down from growth of 0.6% in the previous three-month period (see Chart 1)**. The latest GDP data is further evidence that the drag effect of persistent Brexit uncertainty and the significant cost pressures faced by consumers and businesses is taking its toll on the UK economy.

Chart 1: Real UK GDP Growth



Source: ONS UK GDP estimate, December 2018

Chart 2: UK GDP growth by Sector



Source: ONS UK GDP estimate, October 2018

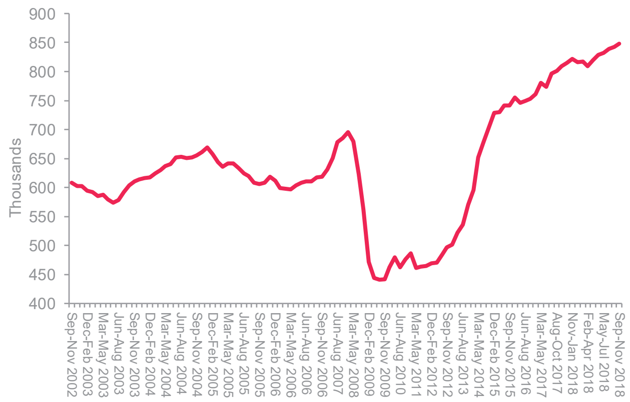
...services sector still the main driver of growth...

On the rolling three-month measure, output from the services sector grew by 0.3% in October, down from growth of 0.4% in the previous three-month period. **(see Chart 2)**. Output from the construction sector rose by 1.2%, while total industrial production increased by 0.3% in the month. **However, the services sector, which accounts for around 80% of UK economic output, remains the main driver of UK GDP growth**. On the monthly measure, construction (-0.2%) and industrial output (-0.6%) declined in October, while service output rose by 0.2% in the month.

UK labour market tightens...

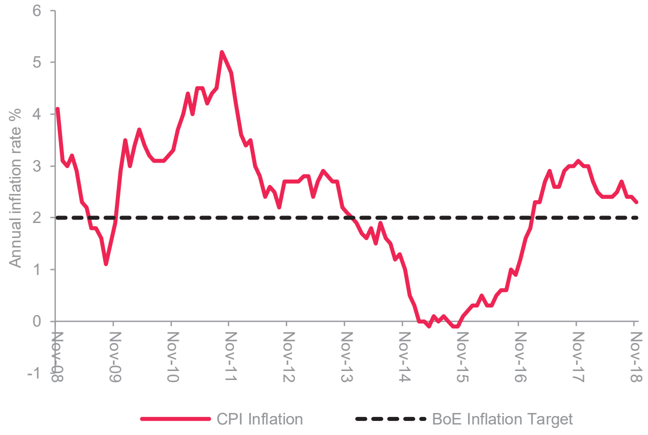
In the three months to October 2018, the number of people in employment rose by 79,000 to 32.5 million. **While the number of people out of work rose by 20,000 over the same period, this was largely due to a 95,000 decline in the number of people who are economically inactive** (not seeking or available to work). There is further evidence of the worrying skills shortage with the number of job vacancies rising by 40,000 over the past year to 848,000 in the three months to November 2018, the highest since comparable records began in 2001 **(see Chart 3)**.

Chart 3: Job Vacancies



Source: ONS UK Labour Market data, December 2018

Chart 4: CPI inflation



Source: ONS UK Consumer Price Inflation, November 2018

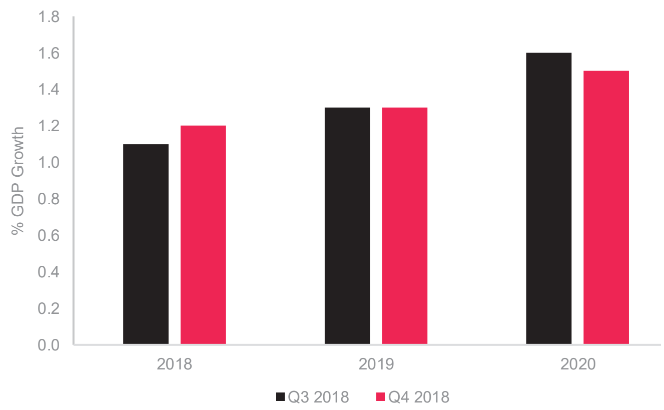
…inflation slows to 20-month low…

CPI inflation in the UK stood at 2.3% in November 2018, the lowest rate since March 2017 and down from 2.4% in October **(see Chart 4)**. However, UK inflation has now been above the Bank of England's 2% inflation target for 22 successive months. The largest downward contribution to change in the rate came from falls in petrol prices. Prices for materials and fuels slowed to 5.6% on the year to November 2018, down from 10.3% in October 2018. Despite the recent slowdown, **the persistent weakness in sterling is likely increase the upward pressure on prices** in the coming months by increasing the cost of imported raw materials and could well keep inflation hovering above target over the near term.

…BCC forecasts subdued growth…

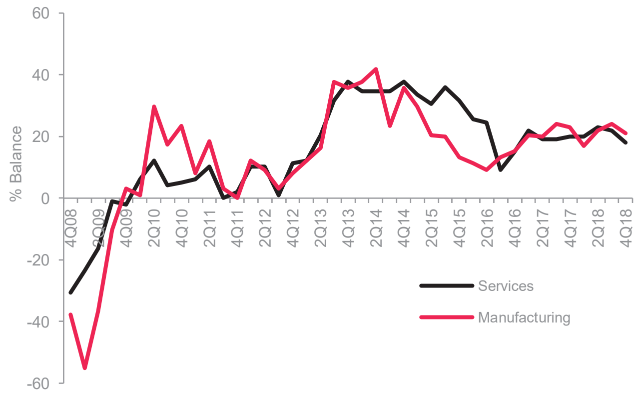
The BCC has marginally upgraded its UK GDP growth forecast for 2018 from 1.1% to 1.2% (**see Chart 5)**. This was due to a stronger than expected Q3 outturn as growth received a boost from a number of temporary factors, including the World Cup and the hot weather. The BCC's forecast for 2019 GDP growth remains at 1.3%, while its 2020 GDP growth forecast has been downgraded to 1.5% (from 1.6%). **A disorderly departure from the EU is the key risk to the UK's economic outlook** as it would likely weaken the UK's near-term growth and productive potential.

Chart 5: BCC UK GDP Growth Forecasts



Source: BCC

Chart 6: Domestic Sales



Source: BCC QES, Q4 2018

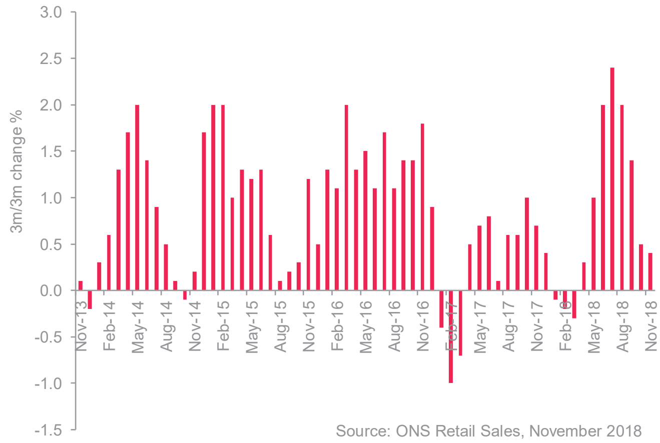
...as the latest QES points to a sluggish Q4…

The results of the latest BCC Quarterly Economic Survey (QES) suggest that UK GDP growth slowed in the final quarter of 2018. The balance of firms in the key service sector reporting increasing domestic sales dropped from +22 to +18, the lowest since Q4 2016. **(see Chart 6).** The proportion of firms in the manufacturing sector reporting improved domestic sales declined from +24 to +21. The latest QES revealed that 81% of manufacturing firms reported recruitment difficulties, a joint record high. **As result we expect that UK GDP growth slowed to 0.1% in Q4 2018.**

...while Black Friday boosts retail sales…

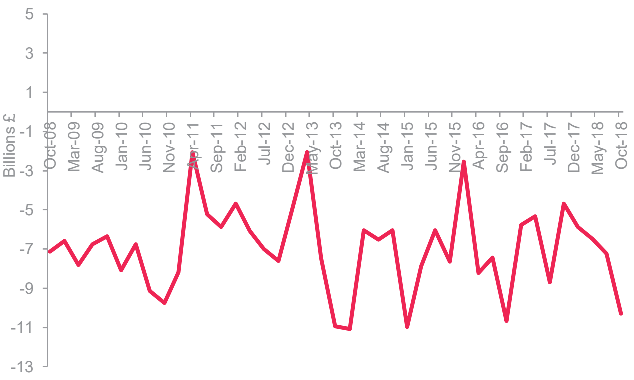
Retail sales rose by 1.4% in November. The increase in the month was mostly driven by a 5.3% rise in sales of household goods as 'Black Friday' boosted activity. **On the rolling annual three month-on-three-month measure – a better indicator of the underlying trend** – sales rose by just 0.4% in the three months to November, down from the growth of 0.5% in October and lower than the July peak of 2.4% **(see Chart 7)**. With earnings growth only marginally higher than price growth consumer spending is likely to remain squeezed, maintaining the pressure on the retail sector.

Chart 7: UK Retail Sales



Source: ONS Retail Sales, November 2018

Chart 8: UK's Net Trade Position



Source: UK trade data, October 2018

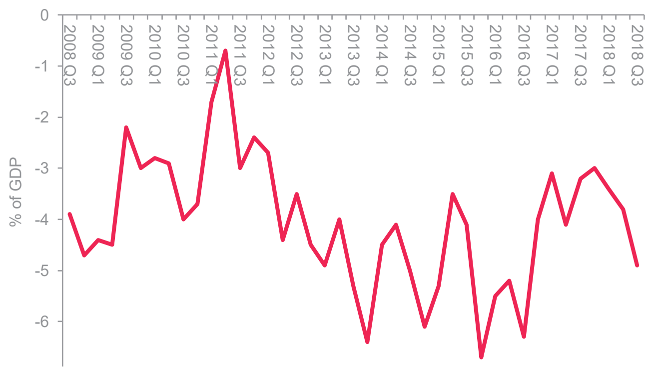
...UK trade deficit widens...

The UK's trade deficit (goods and services) widened by £3.1 billion to £10.3 billion in the three months to October 2018 **(see Chart 8)** as the goods deficit widened by £1.7 billion and the services surplus narrowed by £1.3 billion over the period. The widening in the goods deficit was due mainly to a £3.6 billion increase in imports. **Trading conditions for UK exporters are deteriorating amid moderating global growth, uncertainty over Brexit and trade tensions**. Businesses continue to report that the persistent weakness in sterling is hurting as much as its helping, with the weakening currency raising input costs.

...and rebalancing remains a key challenge…

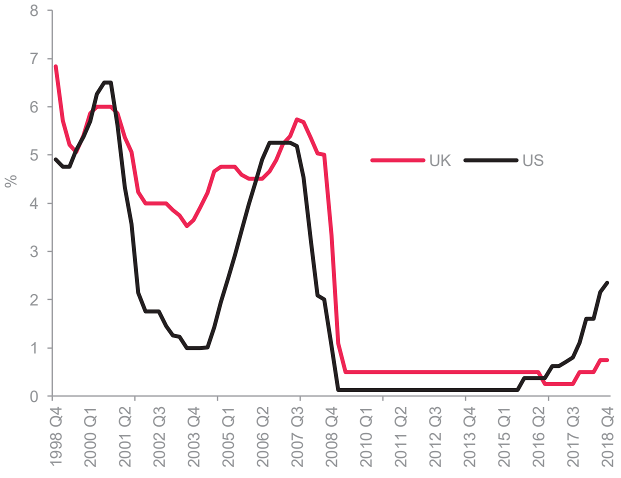
The UK ran a current account deficit (the difference between what we earned from other countries and what we spent) of £26.5 billion in Q3 2018, £6.6 billion higher than the deficit of £20.0 billion in the previous quarter. **The UK's current account deficit was equivalent to 4.9% of UK GDP in Q3, the largest since Q3 2016 and up from 3.8% in Q2 (see Chart 9)**. The widening in the current account deficit was driven by a widening of the deficits on income (e.g. money from investments) by £4.8 billion, and total trade by £1.8 billion in the quarter. The UK's current account deficit in Q3 2018 was more than three times the long-term average of -1.3%.

Chart 9: UK Current Account position (as a % of GDP)



Source: ONS Balance of Payments, Q3 2018

Chart 10: UK and US Interest Rates



Sources: Bank of England, Federal Reserve

…as the US raises interest rates...

The Federal Reserve raised interest rates in the US by 0.25 percentage points to a target range of between 2.25% and 2.5%, the fourth rate rise in 2018 (see Chart 10). The move reflects strong recent economic growth with the US economy growing by an annualised rate of 3.4% in Q3 2018, according to the latest official estimate. However, with the US economy expected to slow over the next year the pace at which the Federal Reserve tightens monetary policy is likely to slow. UK interest rates were kept on hold at 0.75% with the Monetary Policy Committee MPC once again voting unanimously to keep rates on hold. **The BCC currently expect that UK interest rates will next rise, to 1%, in Q4 2019.**

Bottom line:

December's data suggests that the UK economy had a subdued end to 2018, with significant political and economic turbulence and financial squeeze on consumers and businesses weighing on overall economic activity. Against this backdrop, it is vital that politicians avoid a messy or disorderly Brexit and be ready to boost business confidence and investment.

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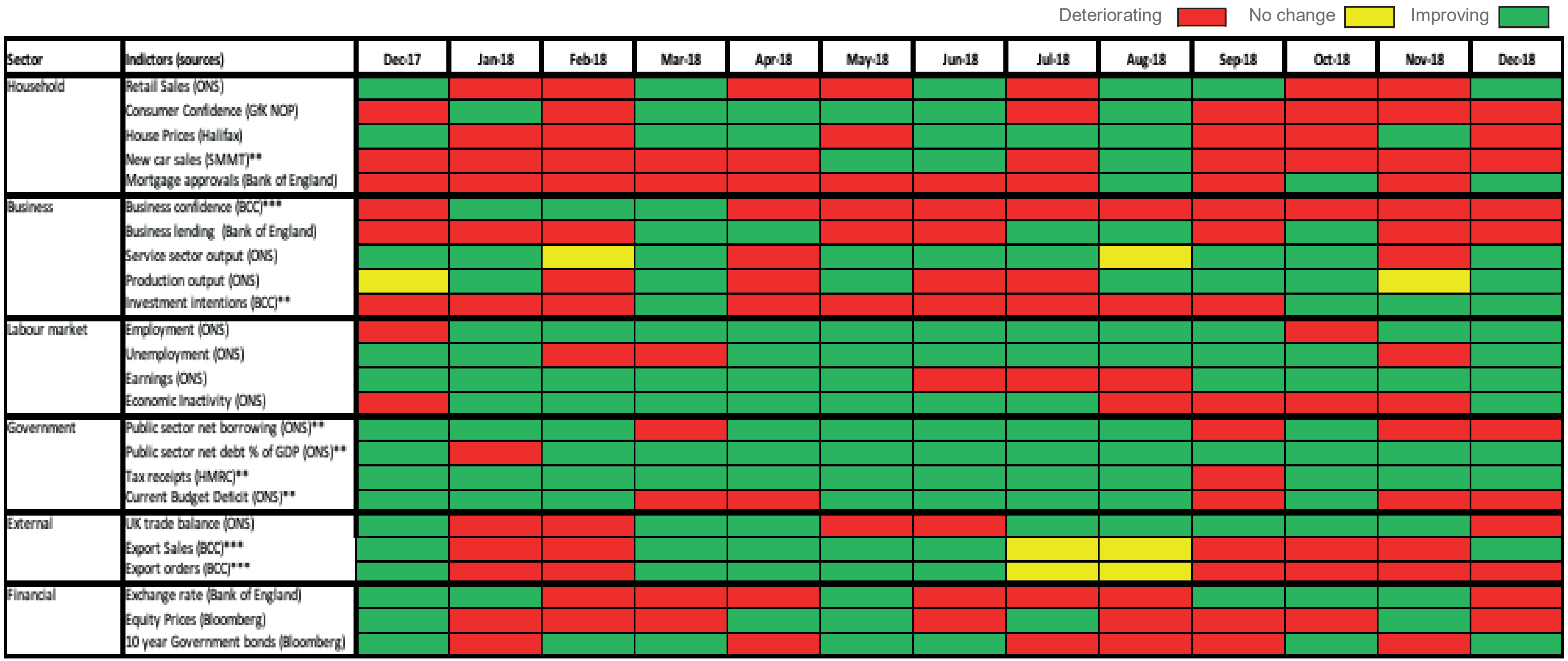
ECONOMIC SUMMARY CHART



*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.