BRITISH CHAMBERS OF COMMERCE

MONTHLY ECONOMIC REVIEW JUNE 2017

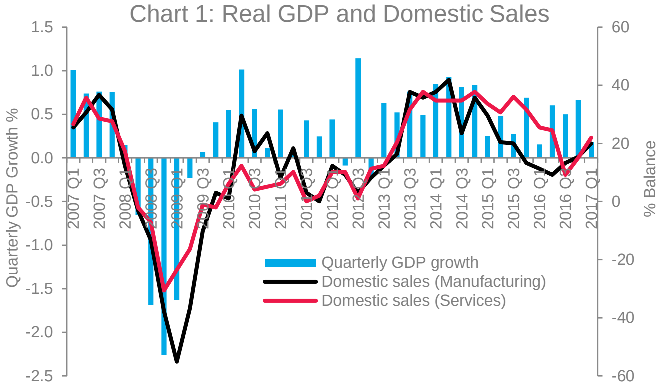
Monthly headlines:

- UK GDP growth in Q1 revised down as the trade deficit widens
- UK consumer price inflation rises to three-year high as pay growth continues to slow
- Indian economic growth slows sharply as Brazil emerges from two-year recession

UK GDP growth in Q1 revised down...

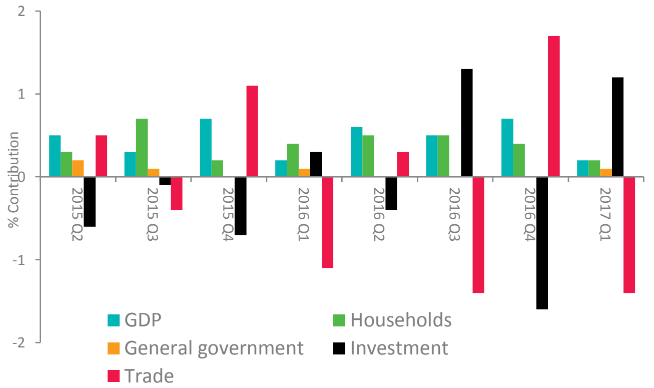
The second official estimate for Q1 2017 UK economic growth (GDP) stood at 0.2%, down from the previous estimate of 0.3% and is the slowest rate of growth since Q1 2016 **(See Chart 1)**. In annual terms, UK GDP rose by 2.0% in Q1, down from the previous estimate of 2.1%. **The downward revision was driven by service sector output growing by less than previously estimated.** Output from the industrial sector rose by 0.1%, while agricultural and construction sector output rose by 0.3% and 0.2% respectively. Overall, the latest GDP data indicates that the UK economic conditions are softening.

Chart 1: Real GDP and Domestic Sales



Sources: QES, ONS GDP second estimate, Q1 2017

Chart 2: Contribution to UK GDP growth



Source: ONS GDP second estimate, Q1 2017

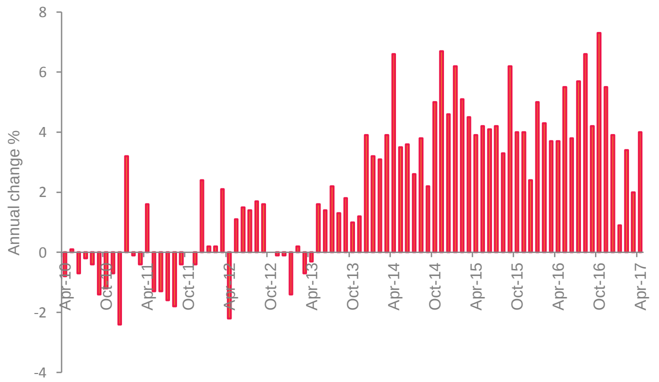
...as the trade deficit widens...

The UK's trade deficit widened to £11.9 billion in Q1 2017, more than double the deficit of £4.8 billion recorded in the previous quarter. This was driven by a 4.2% rise in imports and a 0.5% drop in exports in Q1. As a consequence, **net trade was a major drag on GDP growth in the quarter**, knocking 1.4 percentage points off Q1 growth **(see Chart 2)**. Business investment rose by 0.6% in Q1, following a 0.9% drop in the previous quarter. Consumer spending remains a key driver of UK growth despite growing by just 0.3% in Q1, slower than the growth of 0.7% recorded in the previous quarter.

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

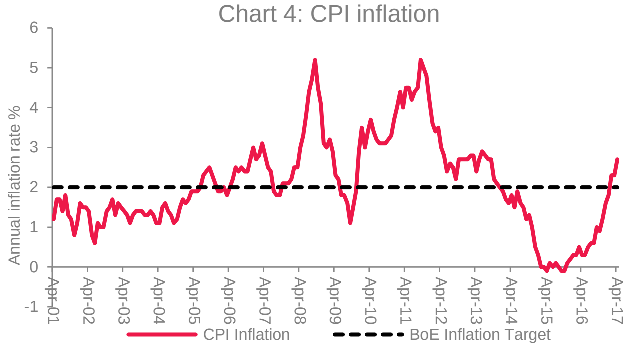
Retail sales rose by 2.3% in April, the strongest rate of growth since January 2016. Retail sales were up by 4.0% in annual terms **(see Chart 3)**. On the rolling three month-on-three-month measure, a better indicator of the underlying trend, retail sales rose by 0.3% in the three months to April. The improvement was largely due to a 5.1% rise in the sales of clothing, footwear and textiles in April. However, with wage growth expected to continue falling in real terms, the downward pressure on retail sales is likely to increase in the coming months.

Chart 3: Retail Sales



Source: ONS Retail Sales, April 2017

Chart 4: CPI inflation



Source: ONS Consumer Price Inflation, April 2017

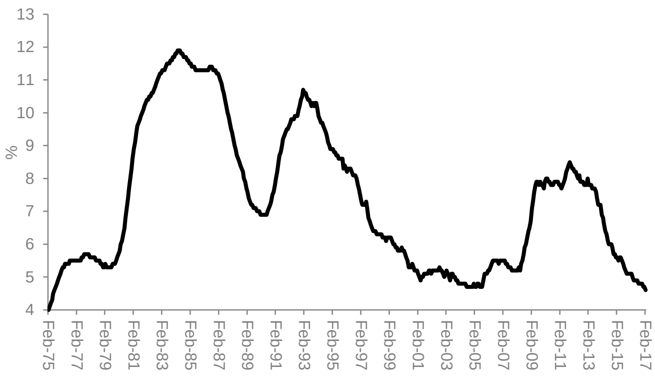
…inflation resumes its upward path…

UK CPI inflation stood at 2.7% in April 2017, up from the 2.3% rise in March and is the highest rate since September 2013 **(see Chart 4)**. April's increase was largely due to a 19% rise in air fares, which reflected the shift in the timing of Easter. While the annual growth in input prices slowed to 17% in April, from a peak of 20% in January 2017, such costs are still filtering through the supply chain, and are therefore likely to lift consumer prices higher in the coming months. **Higher inflation is likely to be a drag on UK GDP growth over the near term by squeezing both consumers and businesses.**

…and pay growth weakens further…

The latest UK labour market figures revealed that in the three months to January 2017, the number of people in employment rose by 122,000. Unemployment declined by 53,000 over the same period and the **UK unemployment rate dropped to 4.6%, the lowest in over 40 years (see Chart 5)**. However, with regular earnings growth slowing from 2.2% to 2.1% and inflation rising to 2.7% in April, earnings growth is now comfortably trailing behind price growth. If this trend continues as we predict, household spending is likely to slow further, weakening overall economic activity.

Chart 5: UK Unemployment Rate



Source: ONS Labour Market Statistics, May 2017

Table 1: Bank of England Forecasts, May-17

	2017 (%)	2018 (%)	2019 (%)
GDP	1.9	1.7	1.8
Inflation	2.7	2.6	2.2
Business Investment	1.8	3.3	3.0
Exports	2.8	1.8	0.8

Source: Bank of England

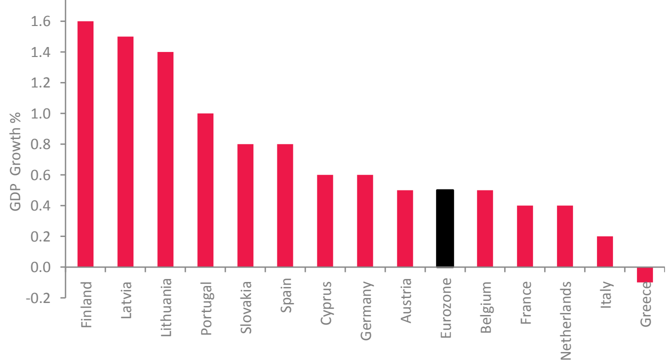
...leaving UK's economic outlook subdued...

In its latest inflation report, the Bank of England downwardly revised its UK GDP forecast for 2017 to 1.9%, from its previous estimate of 2.0% **(see Table 1)**. However, the central bank did upgrade its forecast for 2018 to 1.7%, from 1.6%. The Bank of England also raised its forecast for inflation this year to 2.7%, from its February forecast of 2.4%. However, in our view**, the Bank of England's latest forecasts are still too optimistic** and we expect that inflation will weaken economic activity by more than the central bank is currently predicting, with wage growth in real terms expected to continue falling over the next few years.

…the Eurozone enjoys a strong start to 2017…

The Eurozone economy grew by 0.5% in Q1 2017, unchanged from the previous estimate. Germany's economy, the biggest in the Eurozone, grew by 0.6% in Q1, up from the growth of 0.5% recorded in the previous quarter. Finland (1.6%) recorded the strongest growth in the quarter **(see Chart 6)**, followed by Latvia (1.5%) and Lithuania (1.4%). In contrast, **Greece's economy slipped back into recession** following a 0.1% contraction in Q1 2017 and a 1.2% decline in Q4 2016. Nonetheless the latest data confirms that the Eurozone recorded a relatively strong start to 2017.

Chart 6: Eurozone GDP Growth by country*



Source: Eurostat

*Ireland, Luxembourg, Slovenia, Estonia and Malta: data not available for the first quarter of 2017.

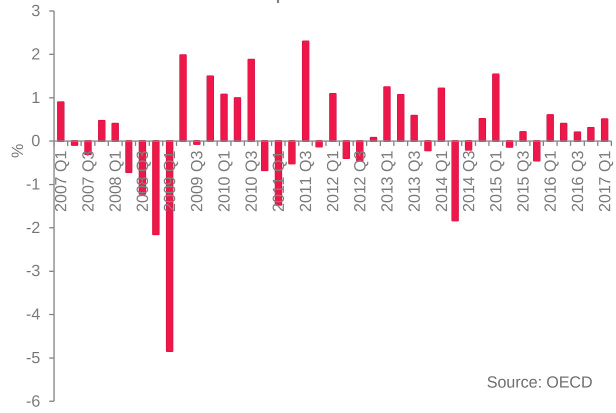


Chart 7: Japan Real GDP Growth
Source: OECD

...as Japan's economy continues to grow…

Japan, the world's third-largest economy, grew by 0.5% in Q1 2017, up from growth of 0.3% recorded in Q4 2016 and is the fifth successive quarter of growth **(see Chart 7)**. There are signs that 'Abenomics' (a combination of monetary and fiscal stimulus and structural reform) is having a positive impact on Japan's economy. **Growth in Q1 was mainly driven by stronger household consumption and export growth**. Exports rose by 2.1% in the quarter as the declining value of the yen continues to help boost Japan's economy. Consumer spending, which accounts for almost two-thirds of Japan's economic output, rose by 0.3% in Q1.

…India's slows sharply...

India's economy, the world's seventh-largest, grew by 6.1% in annual terms in Q1 2017, down sharply from the growth of 7.0% recorded in the previous quarter and is the weakest rate of growth since Q1 2014 **(see Chart 8)**. **The slowdown means that India has lost its place as the fastest growing economy to China, who grew by 6.9% in Q1**. The construction sector was one of the biggest drags on growth in Q1 with a decline of 3.7% in the quarter. Much of the Q1 slowdown was due to the liquidity squeeze caused by Prime Minister Modi's ban on using Rs500 and Rs1,000 banknotes.

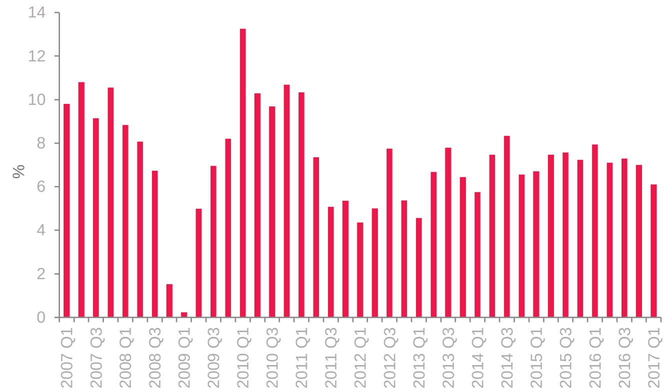


Chart 8: India Real GDP Growth
Source: OECD

...and Brazil emerges from recession.

Brazil, the largest economy in Latin America, grew by 1.0% in Q1 2017 **(see Chart 9)**. This is the first time that Brazil's economy had grown since Q4 2014 and means that it has now emerged from the country's longest recession in history. Strong export growth, helped by a bumper harvest, drove the pick-up in growth in the quarter. However, in annual terms, Brazil's economic output was 0.4% lower compared to Q1 2016. Despite the Q1 improvement, the outlook for Brazil's economy remains **weak with significant political unrest and high unemployment likely to weigh heavily on Brazil's growth prospects.**

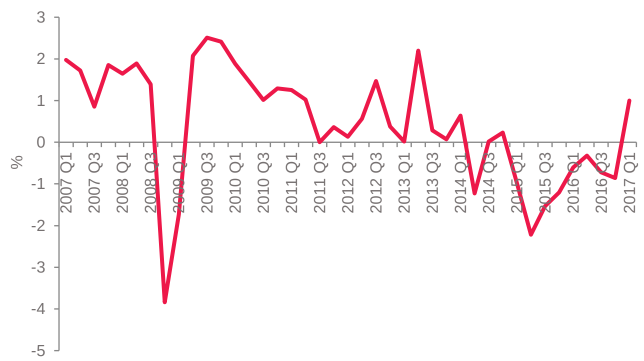


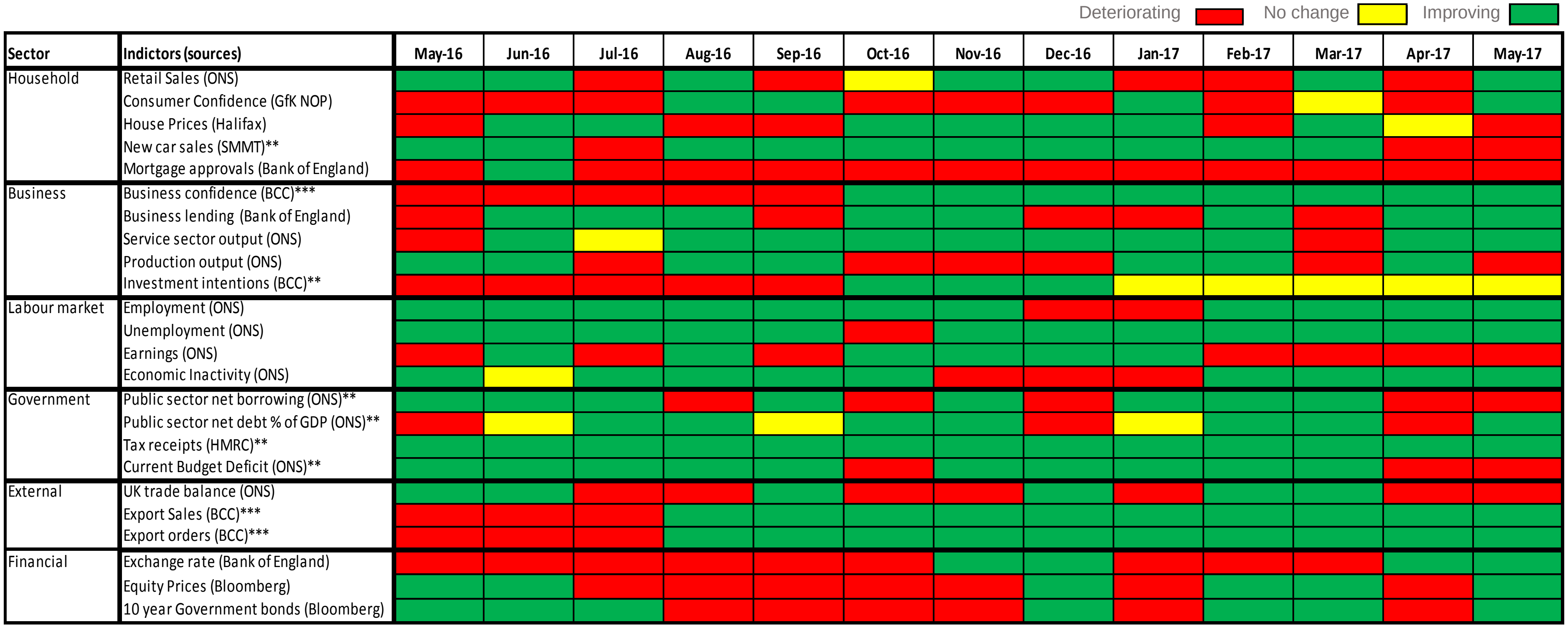
Chart 9: Brazil Real GDP Growth
Source: OECD

Bottom line:

Rising inflation remains a key risk to UK's growth prospects. Businesses across the UK are facing an uphill struggle to absorb the rising cost of imports – a task made more difficult by the myriad of upfront costs imposed on businesses. Against this backdrop, it is vital that the next government does more to ease the cost pressures facing firms by tackling the burden of upfront business costs, including more fundamental reform of business rates.

For more information please contact Suren Thiru, Head of Economics and Business Finance.
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.