Bedfordshire Monthly Economic Review.

October 2018

Based on September 2018 data releases

Bedfordshire Chamber of Commerce

The Stats.

UK GDP growth over the first half of 2018 was the weakest in seven

The latest BCC QES indicates that UK growth remained subdued in the third quarter of 2018

US interest rates rise again as rates in Argentina hit 60%

The Findings.

UK GDP growth in Q2 unrevised...

The second official estimate of economic growth (GDP) recorded UK GDP growth of 0.4% in Q2 2018, unrevised from the previous estimate and up from the downwardly revised Q1 growth figure of 0.1%. As a consequence, the UK economy grew by 0.5% in the first half of 2018 compared with the second half of 2017, the weakest six-monthly growth since the second half of 2011. **The UK's confirmed GDP growth of 0.4% was the fifth slowest in the G7**, with the US (1.0%) recording the strongest growth followed by Canada and Japan (both 0.7%).

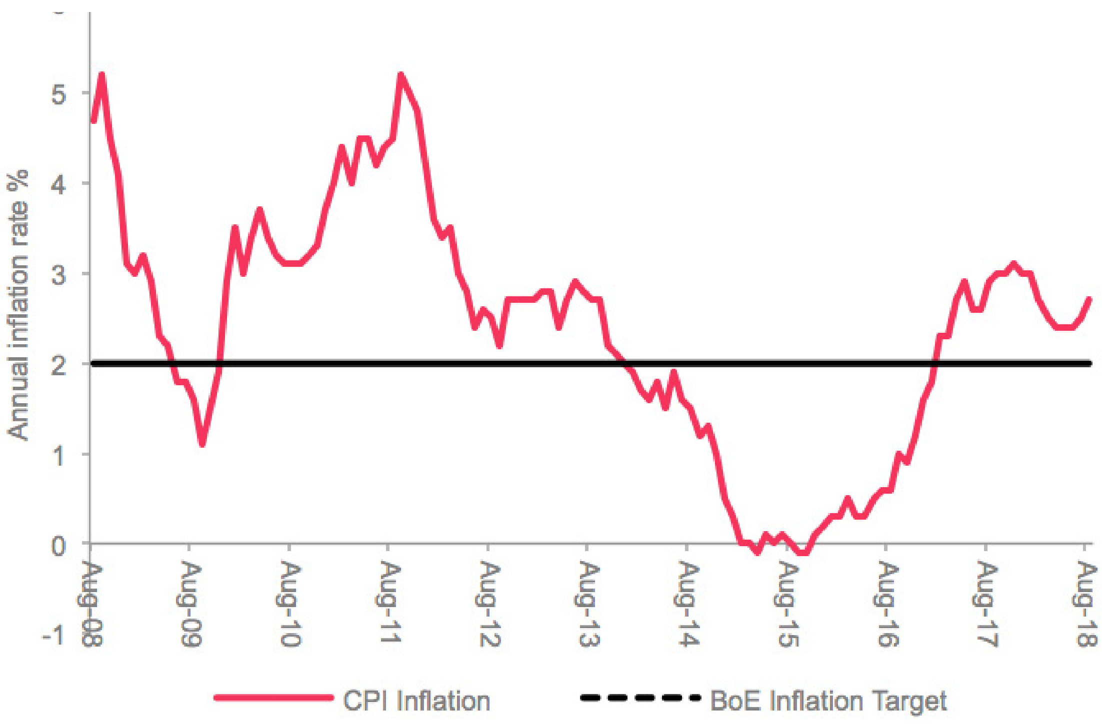
...and was driven mostly by the service sector...

Growth in output from the service sector, which accounts for over three quarters of UK economic output, doubled in Q2 to 0.6%, from 0.3% in Q1 2018 and is the **second successive quarter that service sector growth has outpaced overall UK GDP growth.** While UK construction output rose by 0.8% in Q2, Q1 output from the sector was revised down from a fall of 0.8%, to a drop of 1.6%. Industrial production remains a weak spot with output declining by 0.8% in Q2. Output from the agricultural sector rose by 0.1% in the quarter.

...as business invesment growth falls...

There is **further evidence that the cost of doing business in the UK and broader Brexit uncertainty is weighing on investment activity.** The latest GDP estimate revealed that business investment fell by 0.7% in Q2 2018, the second successive quarterly decline. Consumer spending, which accounts for around two-thirds of UK economic output, was a key driver of Q2 growth, rising by 0.4% in the quarter, slightly slower than the growth of 0.5% recorded in the previous quarter. Overall, the latest estimate confirms that the UK economy remains unbalanced.

UK CPI Inflation



Source: ONS Consumer Price Inflation, August 2018

...inflation pick-ups again...

CPI inflation in the UK stood at 2.7% in August 2018, the highest rate since February 2018. Rising prices transport services and clothing produced the largest upward contributions to the change in the rate. The current upward pressure on prices remains transitory and inflation should ease back towards target once the impact of the recent increase in oil prices eases. **The possibility of a disorderly Brexit is the key risk to the UK's outlook for inflation** as it could result in a substantial decline in sterling, which could significantly increase inflation and exacerbate the financial squeeze on consumers and businesses.

...real wage growth still subdued...

In the three months to July 2018, the number of people in work rose by 3,000 and UK unemployment fell by 55,000 over the same period. However, there is further evidence of the growing skills shortage with **the number of job vacancies rising by 14,000 over the past year to 833,000 in the three months to July 2018, the highest on record.** While regular earnings growth, rose from 2.7% to 2.9%, the gap between pay and price growth remains minimal stifling consumer spending, a key driver of UK growth.

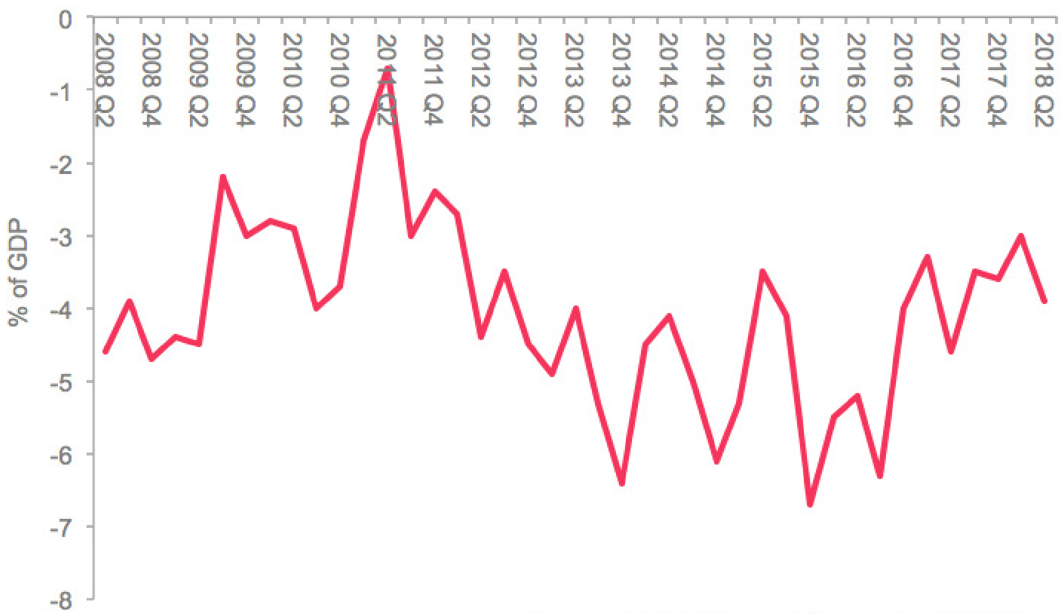
...the UK's fiscal position remains solid...

Public sector net borrowing (excluding public sector banks) increased by £2.4 billion in August 2018. The deterioration in the month was driven by weakening tax receipts and higher spending. However, UK public sector net borrowing totalled £17.8 billion in the current financial year-to-date (April–August), the lowest equivalent year-to-date borrowing for 16 years and £7.8 billion lower than in the same period in 2017. **UK's current fiscal position continues to give the government sufficient scope to use the upcoming Autumn budget deliver a marked fiscal loosening.**

...and UK's current account deficit widens...

The UK's current account deficit (the gap between what the UK earns and spends) rose to £20.3 billion in Q2 2018, the largest deficit since Q2 2017. The current account deficit in Q2 2018 equated to 3.9% of UK GDP, up from 3.0% in Q1 2018. The was driven by an increase in the deficits on primary income and trade. The primary income deficit increased by £2.1 billion in Q2, which mostly reflected an increase in foreign earnings on investment. The UK's total trade deficit widened to £2.8 billion in Q2 2018, driven by an increase to imports of goods, which reached a record high of £121 billion.

UK Current Account position (as a % of GDP)



Source: ONS Balance of Payments, Q2 2018

…as the latest QES points to a sluggish Q3…

The results of the latest BCC Quarterly Economic Survey (QES) suggest that **the current period of below average GDP growth continued into the third quarter of 2018.** The balance of firms in the service sector reporting increasing export sales dropped from +15 to +14. The proportion of firms in the manufacturing sector reporting improved exports sales declined from +24 to +19, the lowest level since Q4 2016. The latest QES revealed that the percentage of services firms looking to recruit fell from 60% to 47%, the lowest since Q1 1993. Of those that did, 72% reported recruitment difficulties, a record high.

…as Argentina's economy weakens…

Argentina's economy, the second largest in South America, contracted by 4% in Q2 2018, the biggest fall since Q4 2008. The decline was largely driven by a 14% fall in exports, after a drought drove a 32% fall in output from the agricultural sector. In annual terms, Argentina's economy contracted by 4.2% In Q2 2018. **Argentina continues to be weighed down by a currency crisis** driven by concerns over policymaker's ability to control inflation and the continued tightening in US monetary policy. This has prompted the central bank to raise interest rates to 60% and the government to cut spending.

…as US growth is upwardly revised.

The Federal Reserve increased US interest rates by 0.25 percentage points in September to a target range of between 2% and 2.25%, the eighth rate rise since 2015. The tightening in US monetary policy has been mainly driven by the improving economic outlook with the US economy growing at an annualised rate of 4.2% in Q2 2018, almost double the growth of 2.2% recorded in previous quarter. **US interest rates are likely to rise at least once more this year** and 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.

The bottom line...

Taken together September's economic data provides further evidence that the UK economy remains locked onto a low growth trajectory. Against this backdrop, it is vital that the focus of the upcoming Autumn Budget is on radical measures to kick-start business investment, to drive greater productivity growth in the face of Brexit headwinds.

Bedfordshire Chamber of Commerce