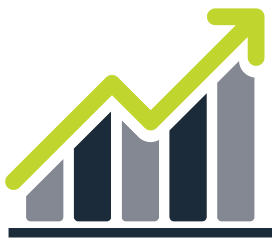
Bedfordshire Monthly Economic Review.



SEPTEMBER 2018

Based on August
2018 data releases

Bedfordshire
Chamber of
Commerce

The Stats.

UK GDP growth remains below the historic average, despite picking-up in Q2.

UK inflation rises for the first time since November 2017 as wage growth slows.

US GDP growth revised upwards as Romania sees the strongest growth among EU countries.

The Findings.

UK GDP growth increases in Q2...

The UK economy grew by 0.4% in Q2 2018, double the growth of 0.2% recorded in Q1. On the monthly measure, the UK economy grew by 0.1% in June. Despite the Q2 improvement, **UK GDP quarterly growth has been below its historic average of 0.6% for six successive quarters, the longest period of below average growth since Q2 2008-Q1 2010**. While the uptick in GDP growth in the second quarter of 2018 was welcome, the figures have been flattered somewhat by a very weak first quarter, and so does little to alter the UK's lacklustre growth trajectory.

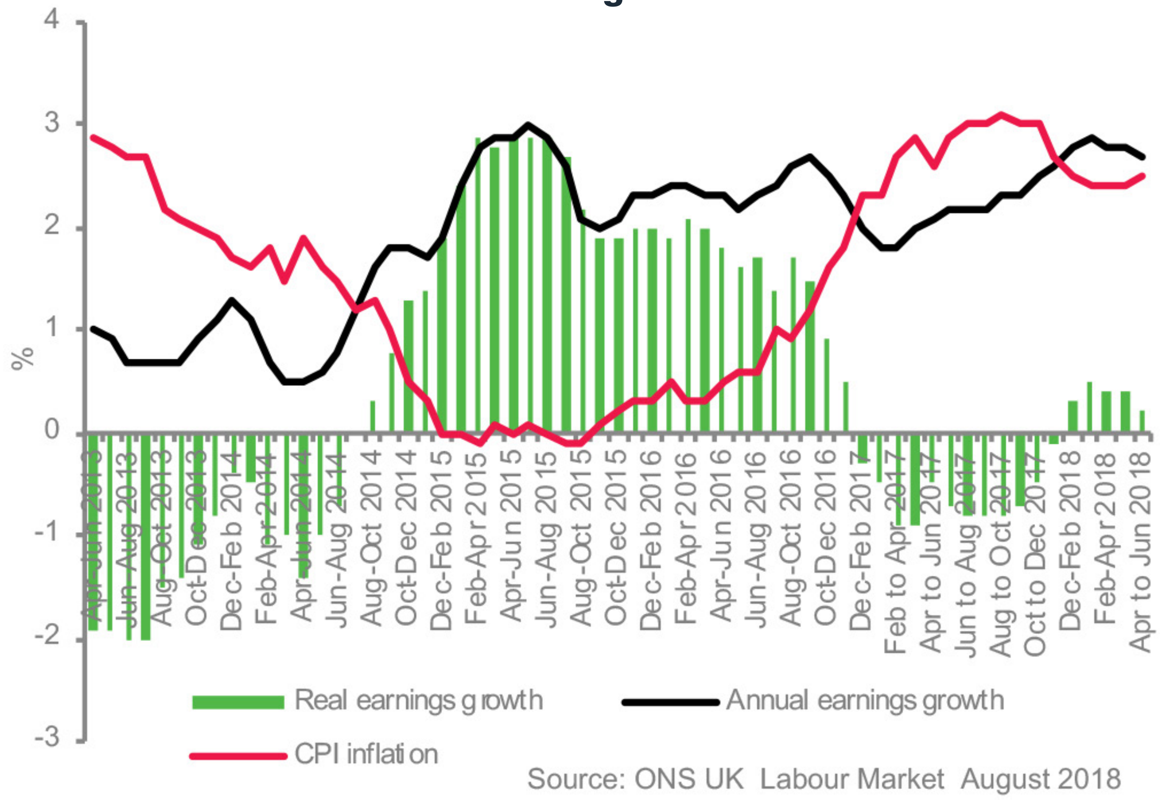
...reflecting stronger service sector output...

The service sector was the main driver behind the pickup in UK GDP growth in the second quarter. Growth in service sector output, which accounts for around threequarters of UK economic output, increased from 0.3% in Q1 to 0.5% in Q2 2018. Output from the construction sector, which accounts for around 6% of UK economic output, rose by 0.9% in Q2. In contrast, **the industrial sector was a drag on GDP growth in the second quarter** with industrial production falling by 0.8% in the second quarter, knocking 0.11 percentage points off Q2 growth.

...inflation picks up...

UK inflation rose from 2.4% to 2.5% in July 2018, the first increase since November 2017. The largest contribution to the change in the rate came from higher prices for transport fares, driven by rising fuel costs. **Inflation may rise a little further in the short term as the recent increases in oil prices pass through supply chains**, fuelling higher consumer prices. However, the upward pressure on UK inflation remains transitory in nature and the headline rate should resume its downward trajectory once the impact of the recent pick-up in oil prices subsidies.

Real Earnings Growth



...slowing real wage growth...

In the three months to June 2018, the number of people out of work declined by 65,000. As a consequence, the UK unemployment rate fell to 4%, the lowest rate since 1975. **The number of EU nationals working in the UK fell by 86,000 to 2.28 million, the largest annual decline on record**. With regular pay growth slowing from 2.8% to 2.7% and inflation increasing, the gap between pay and price growth is narrowing (see Chart). Achieving sustained rises in wage growth remains challenging, with sluggish productivity, underemployment and high upfront business costs weighing down on pay settlements.

...UK trade drags on UK growth...

The UK's trade deficit (goods and services) widened by £4.7 billion to £8.6 billion in Q2 2018, the largest deficit since Q3 2016. **The widening in the deficit was driven by a 3.6% fall in goods exports in Q2 and a 2% increase in imported goods over the same period**. The UK's trade deficit in goods with EU countries widened by £2.6 billion in Q2 and by £2.9 billion with non-EU countries. The deterioration in the UK's net trade position is further confirmation that achieving a rebalancing of our economy remains some way off.

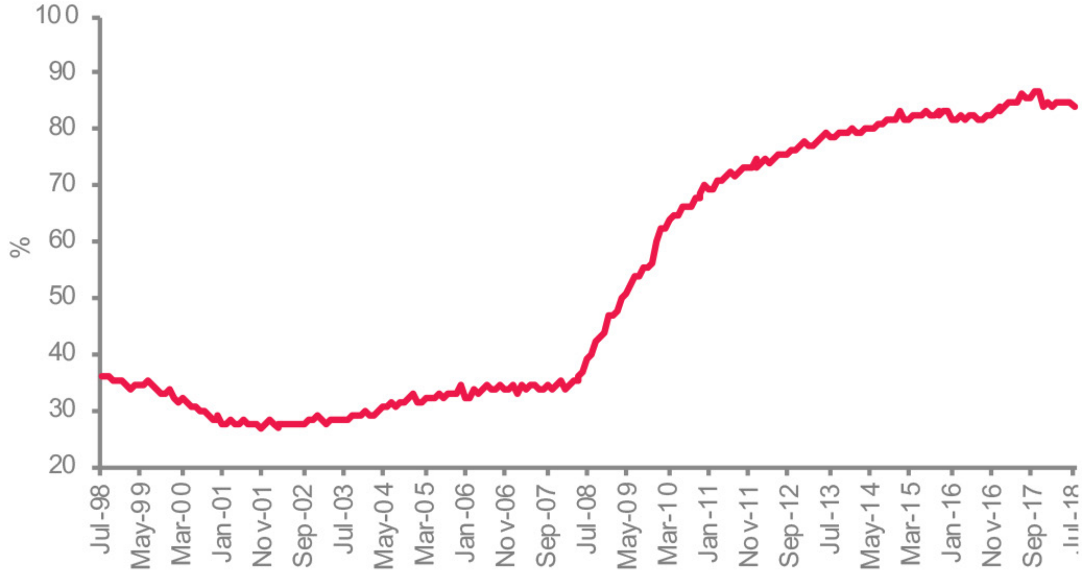
...there is a good start to Q3...

Retail sales rose by 0.7% in July 2018. The rise in the month was partly driven by a 4.9% increase in the quantity bought in non-store retailing, supported by significant discounting. As a result, online spending share of all retailing stood at 18.2% in July 2018, the highest on record. On the rolling three month-on-threemonth measure, **retail sales rose by 2.1% in the three months to July, the strongest growth since February 2015**. Despite the improvement with real wage growth sluggish consumer spending is likely to remain weak, maintaining the pressure on the retail sector.

...as government borrowing falls...

Public-sector borrowing (excluding public-sector banks) was in surplus by £2 billion in July 2018, the biggest July surplus since 2000. July is typically a month of surplus for the public finances due to the timing of self-employed tax receipts. However, public sector net debt (excluding public sector banks) stood at 84.3% of UK GDP in July 2018, almost three times the pre-financial crisis average (see Chart). Despite the recent improvement, if **UK growth remains subdued, generating the tax receipts needed to deliver real progress in cutting the deficit is likely to prove challenging.**

Public Sector Debt as a % of GDP



Source: ONS Public Finances, July 2018

...Romania sees the strongest growth in the EU...

EU as a whole recorded GDP growth of 0.4% in Q2, in line with UK GDP growth over the same period and is unchanged from the previous quarter. In annual terms, EU GDP growth slowed to 2.2% in Q2 2018, from 2.4% in the previous quarter. Of the available data, **Romania (1.4%) recorded the strongest growth amongst EU countries in Q2**, followed by Sweden and Slovakia (both 1.0%). Germany, the biggest economy in the EU, grew by 0.5% in Q2, up from growth of 0.4% in the previous quarter. In contrast, France and Italy (0.2%) recorded the weakest growth amongst EU countries in the quarter.

...as Brazil's economy continues to grow...

Brazil, the largest economy in Latin America, grew by 0.2% in Q2 2018, as the nationwide trucker strike weighed on activity. However, this was still up from the 0.1% growth recorded in Q1. **Brazil's economy has now grown for six successive quarters, following the country's exit from its longest recession in history**. In annual terms, Brazilian GDP growth slowed to 1.0% in Q2, from 1.2% in the previous quarter. Service sector output rose by 0.3% in Q2, while industrial output declined by 0.6%. The outlook for Brazil's economy remains subdued with significant political uncertainty likely to weigh heavily on their growth prospects.

...as US growth is upwardly revised.

The US economy, the world's biggest, grew at an annualised rate of 4.2% in Q2 2018, up slightly from the previous estimate of 4.1%. This was almost double the growth of 2.2% recorded in previous quarter. Private domestic investment was revised up to growth of 0.4% in the second quarter, compared to the previous estimate of a 0.5% decline. This helped offset downward revisions to consumer spending and export growth. **It remains likely that the pace of US growth in Q2 will not be sustained** with the continued tightening in monetary policy likely to increasingly weigh on economic activity, particularly as the impact of the recent fiscal stimulus starts to fade.

The bottom line...

Overall, last month's data releases provide little evidence to suggest a sustained upturn in the UK's economic growth prospects, or evidence to corroborate the MPC's recent decision to raise interest rates. Against this backdrop, there must be a greater focus on lifting the UK out of its current low growth trajectory, including incentivising business investment and addressing the escalating burden of upfront costs facing UK firms.

Bedfordshire Chamber of Commerce