

UK Economic Review

MARCH 2017

Based on February 2017 data releases

Bedfordshire Chamber of Commerce



- UK GDP growth for Q4 upgraded to 0.7%, but growth for 2016 revised down to 4-year low
- UK retail sales weakens further as inflation continues to rise and earnings growth slows
- German GDP growth picks-up in Q4 as Greece's economy shrinks

UK Economy

Economic growth in Q4 revised up to 0.7%...

The second official estimate for Q4 2016 UK economic growth (GDP) stood at 0.7%, up from the previous estimate of 0.6% and is the fastest rate of growth since Q4 2015. In annual terms, UK GDP was up by 2.0% in Q4. However, UK growth in the half of 2016 was downwardly revised. As a consequence, for 2016 as a whole, the UK economy grew by 1.8%, down from the previous estimate of 2.0% and is the weakest rate of growth since 2012. **Overall, the latest GDP estimate confirms that the UK economy enjoyed a solid end to 2016.**

...driven by stronger manufacturing output...

The upward revision was driven by manufacturing sector output growing more strongly than previously expected. Manufacturing output rose by 1.2% in Q4, up from the previous estimate of 0.7%. This meant that total industrial output increased by 0.3%, up from the previous estimate of zero growth. Construction output rose by 0.2% in Q4, up from the previous estimate of 0.1%. **The service sector remains the main driver of UK GDP** growth with output from the sector growing by 0.8% in Q4 and accounting for 80% of the growth recorded.

...but business investment falls.

Business investment fell by 1% in Q4 2016. For 2016 as a whole, business investment dropped by 1.5%, the first decline since 2009. In contrast, exports grew by 6.7% in the quarter. However, the large quarterly movements in trade in particular were largely driven by a revision to the data for non-monetary gold (gold held for investment purposes by organisations other than the central bank). With consumer spending accounting for almost all of UK growth recorded in 2016, **the UK remains much too reliant on the consumer to drive growth.**

Public finances enjoy a strong January...

UK public sector finances (excluding public sector banks) recorded a surplus of £9.4 billion in January 2017, the highest since May 2000. From April 2016 to January 2017, public sector net borrowing was £13.6 billion smaller than over the same period in the previous financial year.

This improvement means that the government is likely to undershoot the Office for Budget Responsibilities borrowing forecast for this financial year. However, if growth becomes more subdued, the UK will find it more challenging to generate the tax receipts needed to deliver real progress in cutting the deficit.

...while UK inflation rises further...

UK CPI inflation stood at 1.8% in January 2017, the highest rate since June 2014. The main contributors to the increase in the rate were rising fuel and food prices. There is further evidence that inflationary pressures in the supply chain are intensifying with factory gate prices recording their seventh consecutive period of annual growth and are now at their highest since December 2011. Overall, a sustained period of materially higher price growth looks increasingly probable. **UK inflation remains on course to breach the 2% inflation target, possibly as early as this month.**

...and earnings growth slows...

The latest UK labour market figures revealed that in the three months to December 2016, the number of people in employment rose by 37,000. Unemployment declined by 7,000 over the same period. Annual earnings growth, including bonuses, slowed from 2.8% to 2.6%. With consumer price inflation rising to 1.8% in January, **the differential between price increases and wage growth continues to close.** If this trend persists earnings in real terms could be squeezed, stifling consumer spending, which is an important determinant of UK growth.

...retail sales continue to weaken...

Retail sales fell by 0.3% in January, the third successive monthly decline. In annual terms, retail sales were up by 1.5% in January, the weakest rate of growth since November 2013. On the rolling three month-on-three month measure – a better indicator of the underlying trend – retail sales fell by 0.4% in January, the first decline since December 2013. Rising prices in fuel and food are significant factors in this slowdown with average store prices rising by 1.9% on the year. **The latest retail sales figures suggest that the pressure from rising inflation is starting to weigh on consumer spending.**

...inflation also picking up elsewhere...

According to the flash estimate, Eurozone inflation stood at 2.0% in February 2017, the highest rate since January 2013. Inflation is now above the European Central Bank's target of just below 2% for the first time in four years. Across the Eurozone, inflation is currently highest in Belgium (3.1%). In contrast, inflation was lowest in Ireland (0.2%). US inflation rose by 0.6% in January, the highest rate since February 2013. **Higher fuel and other commodity prices are increasing inflationary pressures across other western economies.**

...as Eurozone GDP growth remains mixed.

The Eurozone economy grew by 0.4% in Q4 2016, lower than the Q4 growth of 0.7% recorded in the UK. Germany's economy, the Eurozone's biggest, grew by 0.7% in Q4. **Latvia and Slovakia (both 0.8%) recorded the strongest growth, followed by Spain (0.7%).** The economies of Finland and Greece contracted in Q4. While the Eurozone is likely to grow at a reasonable rate over the next year, concerns over a number of the southern European economies and broader political uncertainty could weigh on their near-term growth prospects.

The bottom line...

Although the UK economy enjoyed a strong end to 2016, higher inflation is an increasing challenge for businesses as well as consumers. The 2017 spring budget must be used to ease the burden of up-front costs faced by firms including further, more fundamental reform of business rates.

