MONTHLY ECONOMIC BRIEF

JULY 2018

Economic summary

- **Q1 GDP growth was revised up a touch to 0.2%, from 0.1% in earlier estimates**
- **Business surveys point to an improvement in growth in Q2 relative to Q1 official data**
- **The latest Financial Services Survey reveals flat volumes and no improvement in optimism**
- **Chances of a Bank of England rate rise in August increase**

CBI economic narrative

- A recovery in global investment is helping fuel overall global, momentum – which is positive, because it makes global growth more sustainable. The CBI forecasts global growth of 3.8% in 2018 and 3.6% in 2019.
- ***Q1 saw a slowdown*** in growth in some advanced economies, mainly attributed to temporary factors such as the weather, the timing of Easter and seasonal adjustment issues. Surveys of manufacturing activity across developed and emerging markets came down from their peaks in previous months, which may be linked to the end of the inventory building cycle. Nevertheless, even if growth has peaked, the global economy is still expected to continue to expand at a healthy pace.
- In the ***UK, net trade*** is being lifted by the low pound and supportive global backdrop, which is supporting strong export order books in our manufacturing surveys.
- ***Consumer spending*** continues to be squeezed by higher inflation (consumer spending makes up two-thirds of GDP), which is creating challenging conditions for consumer-facing firms – this continues to be reflected in our latest survey data, which show lacklustre conditions in consumer-facing sectors (retail, restaurants, bars, hotels, etc.).
- ***Brexit uncertainty*** continues to apply the brakes to some areas of ***investment spending***, particularly bigger projects, but smaller investment projects seem to be going ahead. Our surveys show that investment spending plans remain weaker than pre-referendum, but above the long-run average, supported by healthy corporate profitability, low borrowing costs, limited spare capacity and strong global activity. Brexit has also made it ***more difficult to recruit and retain workers*** according to some companies, some of whom are increasingly focussed on investing in automation, AI and training/upskilling their workforce. Agreement on a transition period for the UK is an important milestone in the negotiations, but clarity over the future relationship with the EU is still critical in order for future investment plans to go ahead.
- Weather effects aside, ***the economy has evolved broadly as expected in our last forecast in December***. As a result, there is little change to our latest economic forecast (released in June): we expect GDP growth of 1.4% in 2018—revised down slightly from 1.5% previously, due to the impact of bad weather in Q1—and 1.3% in 2019 (unchanged from our previous forecast).

Q1 GDP growth revised up a touch

The ONS revised up Q1 GDP growth (which had been hit badly by the Beast from the East) to 0.2%, from earlier estimates of 0.1%. The upward revision was mainly due to changes in the way construction is measured, leading to construction output contracting less than previously thought. Nevertheless, the story overall was unchanged: Q1 saw the weakest growth in consumer spending for four years, with a slightly more positive contribution from net trade than seen in previous estimates. Fixed investment however was revised downward in the latest estimate (-1.3% from 0.9%) in part reflecting methodological changes to the ONS' measurement of investment.

The UK economy's mixed sector performance appears to have continued into Q2 with official data for May still varied. Consumer-facing firms remain under pressure, although the latest official data for retail sales suggests that growth was supported by warmer weather and royal wedding celebrations in May. However, manufacturing production declined in April, the largest monthly fall since October 2012, while the construction sector showed no sign of improvement with the industry remaining in recession.

Surveys point to a pick-up in growth in Q2

Business surveys indicate that Q2 growth may be slightly stronger than in Q1, leaving growth over H1 on a par with the weak outturns seen over 2017. The CBI's growth indicator points to private sector growth of around 0.4% in Q2, following Q1 growth of 0.2%. IHS Markit/CIPS data supports CBI data indicating stronger Q2 growth. The services PMI indicated that growth picked up to the fastest since October 2017, buoyed by the strongest increase in new work since May 2017. The construction sector, which dragged on Q1 GDP growth, also saw a solid expansion in activity underpinned by greater residential work. Meanwhile, the manufacturing PMI revealed subdued growth in June and over Q2 as a whole but remained firmly in expansion territory.

Financial services activity stable in Q2

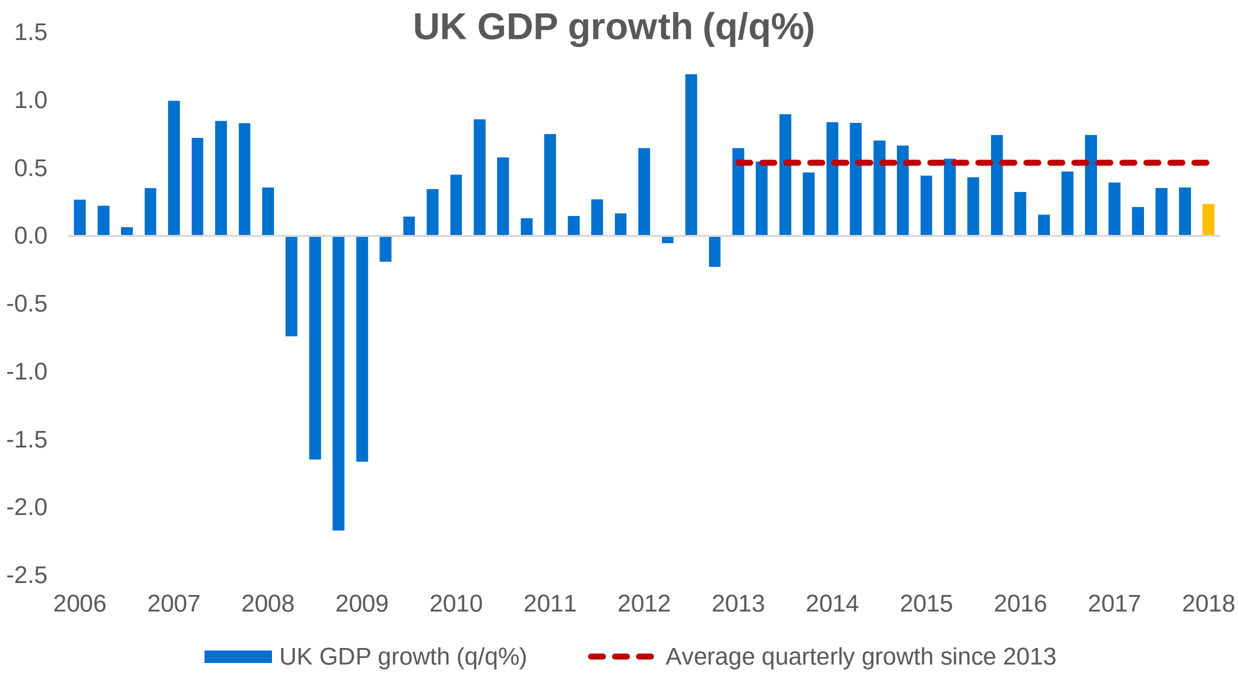
The CBI's latest Financial Services Survey showed that optimism about the overall business situation showed no improvement, having fallen in all but one quarter since the beginning of 2016. Overall business volumes were flat with building societies reporting that volumes rebounded, after falling in the previous quarter. Meanwhile, volumes were unchanged in banking, and grew at a fairly tepid pace in general insurance and investment management. Overall business volumes are expected to pick-up over the coming three months.

Bank of England's MPC more hawkish in June meeting

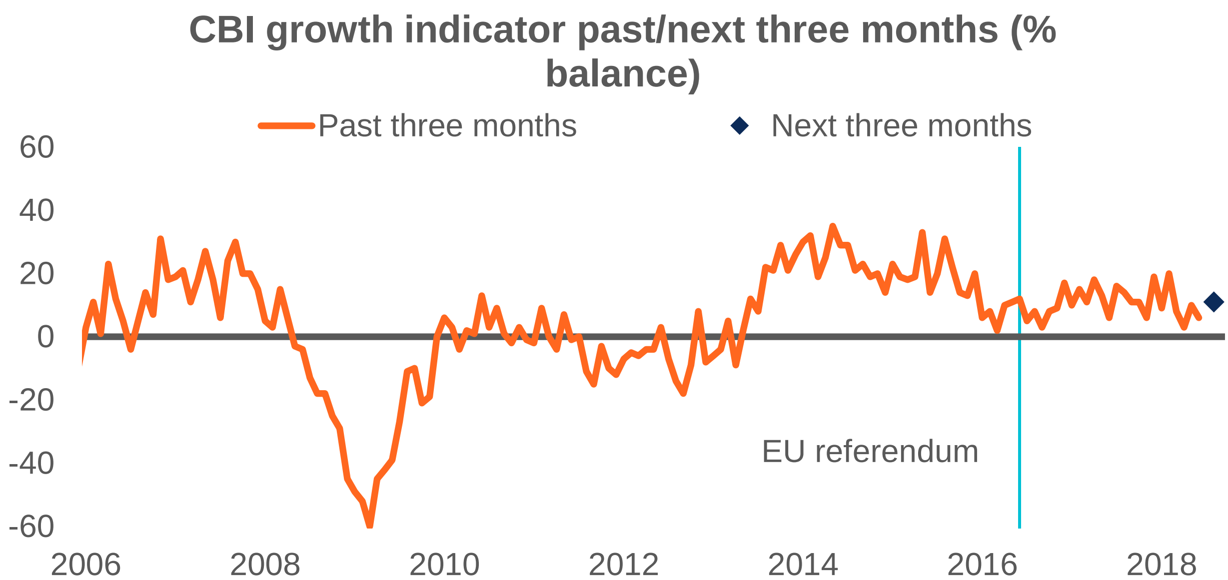
In June, the Bank of England's Monetary Policy Committee (MPC) voted 6-3 to keep interest rates on hold. The surprise was that Andy Haldane, the Bank of England's Chief Economist, joined the ranks for those voting to raise rates. His change of heart boosts the chances of the MPC voting for an interest rate rise in August, in line with the CBI's latest economic forecast.

Additionally, the MPC also gave some updated guidance on the future unwinding of QE. They now expect to start reducing the stock of purchased assets when interest rates reach 1.5%, compared to the 2% threshold in previous guidance.

There didn't seem to be any material change in the MPC's thinking about the economy, and their judgement on the pace of future rate rises ahead. The MPC seemed optimistic about a bounce-back in Q2 growth, particularly given a pick up in a number of household spending indicators. The MPC also seemed unconcerned by some of the weaker official data for Q2 so far, noting that much of weakness in manufacturing output in April may have reflected the lagged impact of bad weather, and a reversal of involuntary stockbuilding in Q1. The MPC also noted the recent rise in the sterling oil futures curve in the minutes, which implied a slightly higher profile for inflation in the next six months.

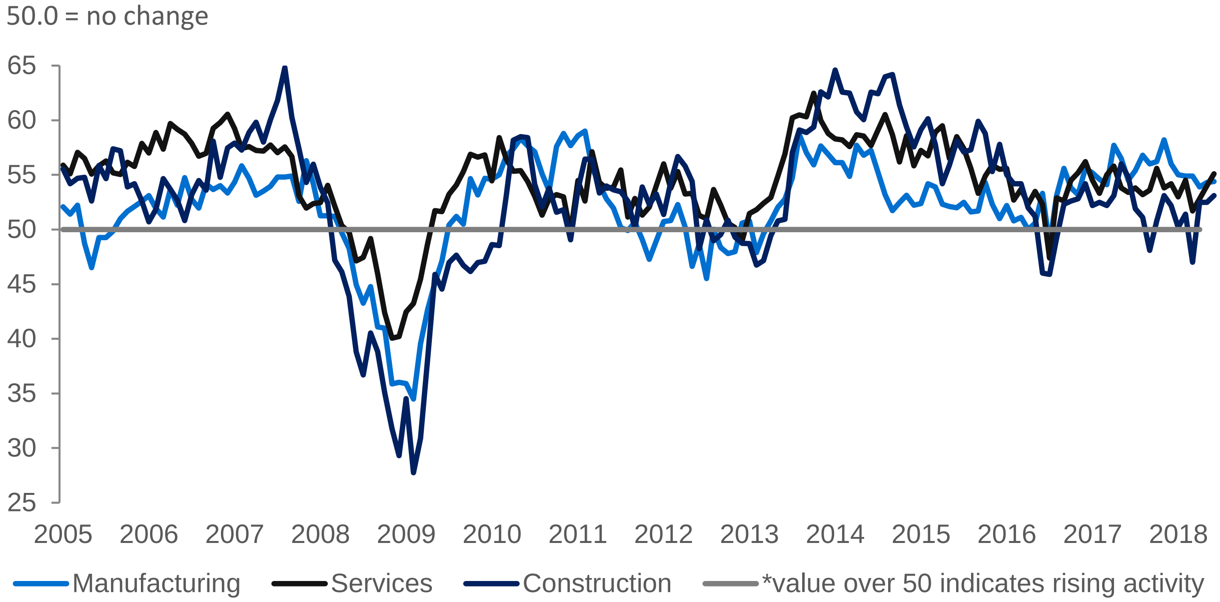


Source: ONS, Macrobond



Source: CBI

Markit/CIPS UK PMIs



Source: IHS Markit/CIPS, Macrobond

Results of June CBI Surveys[1]

Key	
Positive	Green
Neutral	Amber
Negative	Red

	Optimism	Orders	Output/Volumes[2]	Prices and costs	Employment	Investment
CBI Industrial Trends Survey (monthly[3]) ***Covers*** *Manufacturing sector* ***Conducted*** *Quarterly: 26th March – 13th April* *Monthly: 25th May – 13th June*	Sentiment deteriorated slightly in April (-4%) after a solid improvement in the previous quarter (+13%). Export optimism rose (+15%) at the same pace as the previous quarter.	The level of total order books improved (+13% from -3%) and export order books remained strong (+9% from +8%, av: -19%).	Output growth picked up significantly (+29% from +3%), back to the healthier rates seen in early 2018. Growth is expected to ease slightly next quarter (+18%).	Cost growth eased in April (+24% from +29%) and slower growth is expected (+10%). Export prices (+16%) rose at a steady pace but growth is set to pick-up next quarter (+19%). Domestic price growth eased (+14% from +20%) but is set to edge up (+18%).	Employment growth was steady in the three months to April (+21%). Over the next quarter, growth in headcount is expected to ease (+8%).	Plans for buildings investment were unchanged in Apr after a year of deterioration (0% from -15%, av: -17%). However, firms expect to cut back on investment in plant and machinery (-8% from +5%, av: -2%).
CBI Distributive Trades Survey (quarterly) ***Covers*** *Retail* ***Conducted*** *Quarterly: 26thApril – 11th May* *Monthly: 29th May - 13th June*	Sentiment deteriorated in May (-8% from +4%).	Orders placed on suppliers picked up in the year to June (+20% from +5%). In the year to July, orders are tipped to ease slightly (+11%).	In the year to June, retail sales volumes rose at the fastest pace since September 2017 (+32% from +11%). Sales growth is set to slow somewhat in the year to July (+18%).	Average selling price inflation picked up in the year to May (+58% from +52%; av +38%). Inflation is expected to remain steady in June (+57%).	Numbers employed declined for the sixth quarter running in May, but at a slower pace (-6% from -18%). Retailers set to keep headcount steady in the year to June (0%).	Investment intentions for the year ahead deteriorated in May (-7% from +16%).
CBI Service Sector Survey (1) (quarterly) ***Covers*** *Consumer services* ***Conducted*** *Quarterly: 27th April – 11th May* *Monthly: 29th May - 13th June*	In the quarter to May, sentiment in consumer services deteriorated after an improvement in the preceding quarter (-11% from +8%).		Volumes fell for the third consecutive month (-15% from -12%) in the three months to June. But, growth is expected to return next quarter (+8%).	Cost growth surged in the quarter to May (+61% from +43%, av: +37%). Cost growth is set to slow but remain elevated (+51%). Selling price inflation also picked up in May (+26% from +17%) but is set to slow (+15%).	Employment growth slowed in the quarter to May (+10% from +34%). Employment is set to be flat next quarter (-2%).	In May, firms expected to increase spending on all categories: IT (+28%), land & buildings (+4%) and vehicles, plant & machinery (+5%).
CBI Service Sector Survey (2) (quarterly) ***Covers*** *Business & Professional* ***Conducted*** *Quarterly: 27th April – 11th May* *Monthly: 29th May - 13th June*	Sentiment improved in the quarter to May (+14% from -1%).		Volumes growth slowed in the three months to June after strong growth in previous quarter (+5% from +25%). Next quarter, growth is set to be steady (+5%).	Cost growth edged higher in May (+38% from +33%) and a pick-up is expected (+42%). Selling price growth accelerated (+10% from +3%) and is set to edge higher (+14%).	Employment continued to expand in the quarter to May (+13% from +14%) with faster growth expected over the following quarter (+20%).	In May, firms expected to reduce spending on vehicles, plant & machinery (-4%), keep spending steady on land & buildings (+1%) and raise investment on IT (+20%).
CBI Financial Sector Survey (quarterly) ***Covers*** *Financial sector* ***Conducted*** *15th May – 8th June*	Optimism stabilised in three months to June (-4% from -17%), but has failed to show any significant improvement for three years.		Growth in business volumes stalled in the three months to June (-4% from +22%) and is expected to pick up only slightly over the three months to September (+7%).	In June, average spreads narrowed (-12%) with a further fall expected (-9%). Commissions/fees fell (-8%) but are expected to remain unchanged (-3%). Average operating costs were stable (-4%) but are set to ease (-10%).	Numbers employed grew for a second quarter (+24%, from +9%). Employment was expected to rise further over the three months to September (+15%).	In June, firms expected to raise investment in IT (+70%) at the strongest pace for over three years. Firms expected to spend less on vehicles, plant & machinery (-9%) but more on land & buildings (+5%).

[1] CBI survey results are reported as a 'balance' statistic – calculated as the difference between the percentage of respondents replying 'up' minus the percentage replying 'down'.
[2] The Industrial Trends Survey queries respondents on output, whereas the remaining surveys ask about volumes.
[3] Monthly ITS data covers orders and output, otherwise data is quarterly. Monthly DTS data covers orders and volumes, otherwise data is quarterly. Monthly SSS data covers volumes, otherwise data is quarterly. Monthly SSS data is unpublished, but is used to compile the monthly growth indicator. We do not include the monthly growth indicator in the scorecard as it is a composite of the CBI's survey data shown above.