MONTHLY ECONOMIC BRIEF

AUGUST 2018

Economic summary

- **New monthly GDP estimates from the ONS point to firmer growth in Q2 after a weather-addled Q1**
- **The latest CBI survey data shows some signs that good weather is aiding consumer-facing firms in the short term, while firm global growth and the lower value of the pound continues to support the manufacturing sector.**
- **The Bank of England's Monetary Policy Committee (MPC) voted unanimously (9-0) to increase rates by 25 basis points to 0.75% in August.**

CBI economic narrative

- A recovery in global investment is helping to support overall global momentum. The CBI forecasts continually solid global growth ahead, of 3.8% in 2018 and 3.6% in 2019.
- However, ***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. Q2 growth appears to have bounced back but some surveys of manufacturing activity for Q3 across developed and emerging markets have come 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 slowdown in global growth is expected to be gradual and the global economy is still expected to continue expanding at a healthy pace.
- In the ***UK, net trade*** continues to be lifted by the low pound and supportive global backdrop, which is supporting output growth and strong export order books in our manufacturing surveys.
- ***Consumer spending*** continues to be squeezed by weak real wage growth (i.e. the fact that wages are growing only marginally faster than inflation – consumer spending makes up two-thirds of GDP), which is creating challenging conditions for consumer-facing firms. Nevertheless, recent good weather appears to be helping both consumer services (restaurants, bars and hotels) and retail in the short term.
- ***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 plans remain weaker than pre-referendum, but above the long-run average. Brexit uncertainty is at least partly offsetting more supportive investment fundamentals at the moment: healthy corporate profitability, low borrowing costs, limited spare capacity and strong global activity.
- Notably, the manufacturing sector saw a **sharp drop in investment intentions for product and process innovation and training and retraining** in the July quarterly CBI survey. Respondents cited a mixture of Brexit uncertainty, cost pressures and investment cycles maturing.
- 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 (notwithstanding subdued investment plans more generally).
- Weather effects aside, ***the economy in 2018 has evolved broadly as we have expected***. We expect GDP growth of 1.4% in 2018 and 1.3% in 2019, which mark fairly sluggish rates of growth for the UK.

New monthly ONS GDP estimates indicate a pick-up in Q2 growth…

The ONS published its first monthly estimate of GDP growth as part of a wider strategy to improve how economic statistics are published and recorded. The monthly data suggest that growth has recovered somewhat during Q2, improving slightly in the three months to May (0.2% compared with flat activity in the three months to April). Nevertheless, the pace of growth remains relatively weak.

Consumer-facing industries saw particularly robust growth in the three months to May due to a boost from warm weather and the royal wedding, while industrial production and construction output fell compared with the previous three months. If GDP grows at a similar pace in June, the economy would grow at around 0.4% in Q2. This chimes with the CBI's growth indicator and indicates stronger growth than in Q1 (0.2% according to ONS).

…but mixed messages on activity at the start of Q3

However, survey data on growth in early Q3 is more mixed: the CBI's growth indicator suggests a further (modest) pick-up in growth in the three months to July, but the PMIs point to a slight softening in activity.

Consumer-facing firms are seeing a short-term boost from recent good weather, with CBI data showing that consumer services witnessed the first expansion in volumes in five months while retail saw growth for the first time since September 2017. Nevertheless, underlying conditions for these sectors remain tough, with consumers continuing to be squeezed by weak real wage growth.

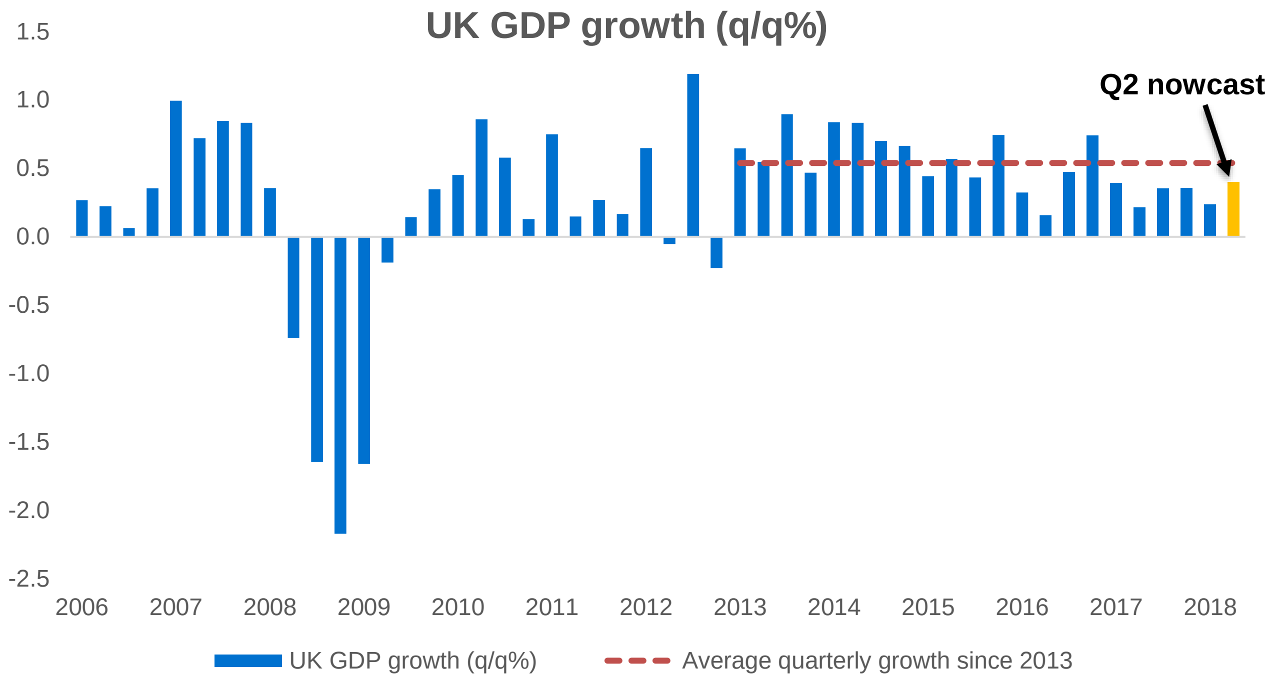
Meanwhile, the CBI's quarterly Industrial Trends Survey showed manufacturing output growing at the fastest pace in a year. Orders grew at a steady pace, with export orders particularly remaining strong.

However, capacity pressures have ramped up and concerns that labour shortages would restrain capital spending increased to the highest on record. Investment intentions for "intangible" assets also turned negative, with planned spending on product and process innovation and training and re-training expected to fall at the fastest rate since 2009. Anecdote from respondents suggests that this is mainly due to Brexit uncertainty, with other firms blamed cost pressures, while others cited investment cycles maturing after a period of elevated capital spending in these areas.

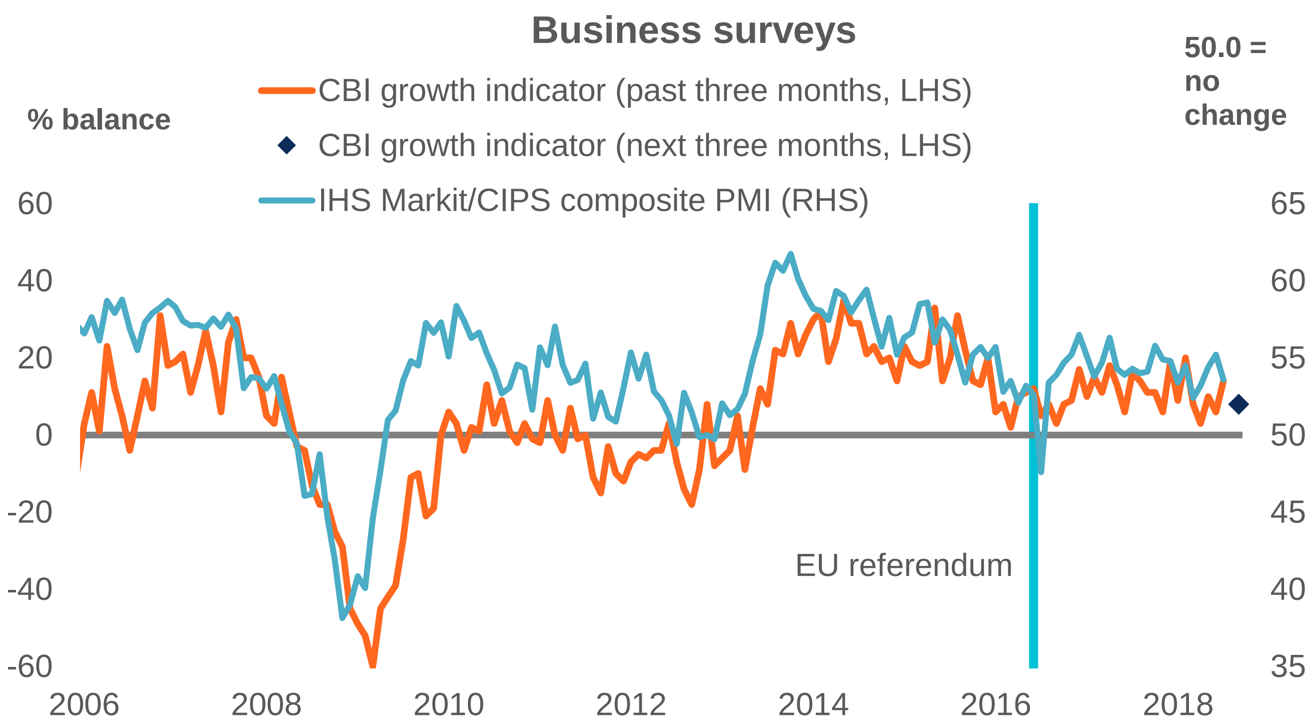
MPC vote unanimously to raise interest rates

"Super Thursday" saw the Bank of England's MPC vote unanimously (9-0) to increase rates by 25 basis points to 0.75%. The decision to hike rates was in line with the CBI's and consensus expectations. The MPC's decision was supported by UK economic activity regaining some of its momentum in Q2 after a weak Q1 (due to the poor weather), consistent with the MPC's forecasts in May. The Committee also have their eye on the tightness in the UK labour market, and the potential for this to push up wage pressures going forward.

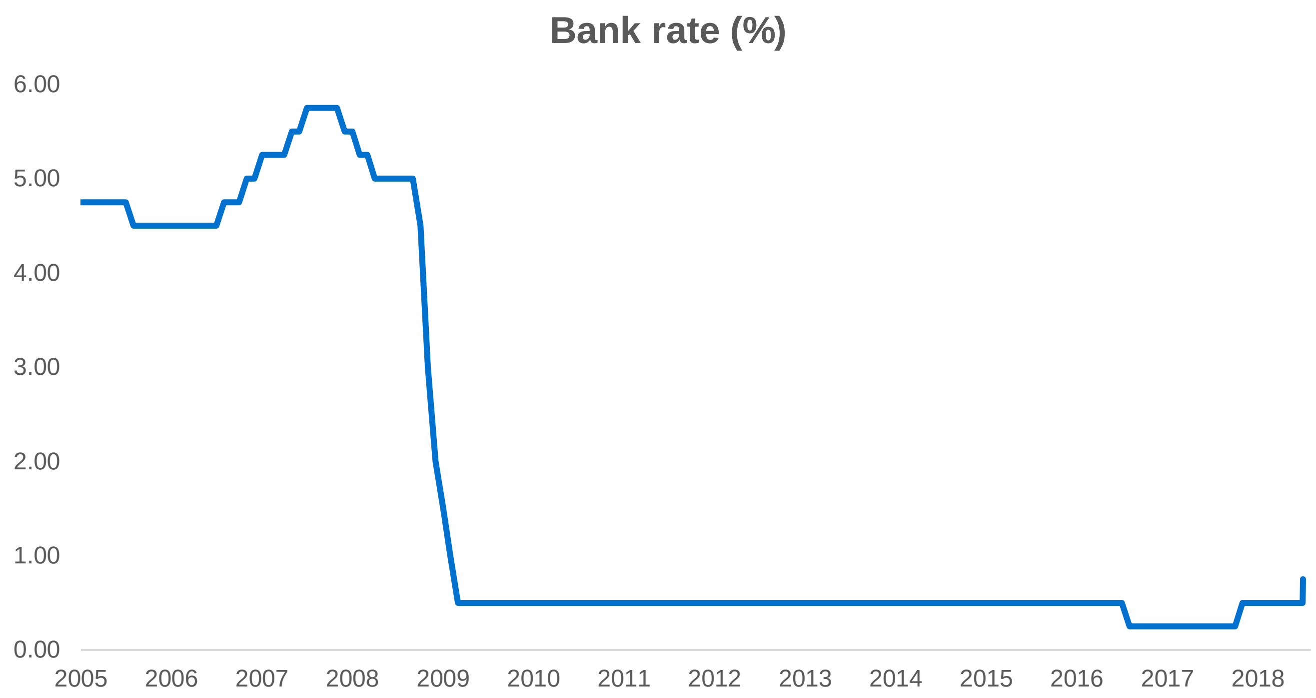
The MPC's guidance on the future path of rate rises remained unchanged: an ongoing tightening in monetary policy will be necessary to return inflation to target, assuming that the economy evolves in line with the MPC's forecast. Crucially, this is because the Bank expect the UK economy to continue growing above its "potential" rate (the rate of growth consistent with stable inflation). They believe that even the tepid growth that they expect is enough to push inflation above the MPC's 2% target – hence the need for further rate rises ahead.



<u>Source</u>: ONS, Macrobond



<u>Source</u>: CBI



Source: Bank of England, Macrobond.

Results of July CBI Surveys[1]

Key
- Positive
- Neutral
- Negative

	Optimism	Orders	Output/Volumes[2]	Prices and costs	Employment	Investment
CBI Industrial Trends Survey (quarterly) ***Covers*** *Manufacturing sector* ***Conducted*** *Quarterly: 26th June – 12th July*	**Both overall (-3%) and export sentiment was unchanged (-2%) in July. The latter was the weakest balance in two years.**	**New orders grew at a robust pace (+15%), driven by a pick-up in domestic orders growth (+8% from +1%). Meanwhile, export orders growth slowed slightly (+21% from +27%), but remained above the LR average (+2%).**	**Output growth remained strong in the three months to July (+27%). However, growth is expected to ease next quarter (+14%).**	**In the 3m to July, cost growth accelerated (+36%, av: +30%) but slower growth is expected (+28%). Export price growth eased (+12% from +16%) and is set to slow further (+7%). Domestic price growth picked up (+20% from +14%) but is set to ease next quarter (+13%).**	**Employment growth slowed slightly in the three months to July (+17% from +21%), but remains far above the negative LR average, (11%). Over the next quarter, growth in headcount is expected to ease (+8%).**	**Plans for buildings (-14%) & plant and machinery (+4%) investment remained above their long-run averages in July. However, investment intentions for training & re-training and innovation fell at the fastest pace since 2009.**
CBI Distributive Trades Survey (monthly[3]) ***Covers*** *Retail* ***Conducted*** *Quarterly: 26thApril – 11th May* *Monthly: 28th June - 13th July*	**Sentiment deteriorated in May (-8% from +4%).**	**Orders placed on suppliers fell in the year to July (-8% from +20%). In the year to August, orders are tipped to be flat (-3%).**	**In the year to July, retail sales growth slowed slightly (+20% from +32%, av: +10%), though remained firm. Sales are set to be flat in the year to August (+0%).**	**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) (monthly[3]) ***Covers*** *Consumer services* ***Conducted*** *Quarterly: 27th April – 11th May* *Monthly: 28th June - 13th July*	**In the quarter to May, sentiment in consumer services deteriorated after an improvement in the preceding quarter (-11% from +8%).**		**Volumes grew for the first time since Feb (+18% from -15%) in the three months to July. But growth is expected to ease next quarter (+4%).**	**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) (monthly[3]) ***Covers*** *Business & Professional* ***Conducted*** *Quarterly: 27th April – 11th May* *Monthly: 28th June - 13th July*	**Sentiment improved in the quarter to May (+14% from -1%).**		**Volumes growth was broadly unchanged in the three months to July (+4% from +5%). Next quarter, volumes are set to be flat (0%).**	**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 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.