UK Macro Economic Forecast

Sample Report

UK
Sample Report

CONTENTS*

******Please note that the Office for National Statistics (ONS) has recently moved its base year and reference by one year from 2015 to 2016. We will be making this move later this year. As a result, our historical values may not match the most recent publication from the ONS.*

Summary

Brexit uncertainty intensifies

In June the government published a white paper setting out its proposals for the future relationship between the UK and the EU. A key economic tenant of what has come to be known as the "Chequers Deal" is a proposal for a "common rulebook" on the trade of goods. For services the paper pushes for a bespoke agreement that would allow the UK to "chart its own path in the areas that matter most for its economy", but with an acknowledgment that "the benefits of the single market come with obligations".

The UK Foreign Secretary remains steadfast in his support for the "Chequers deal", despite strong criticism from Brussels, who have stated that relinquishing control of the EU's borders and trade revenue to a third country through a "common rulebook" would destroy the integrity of the EU common market, on-top of the significant practical challenges involved in implementing the policy. Furthermore, the proposal to opt-out of free movement rules as the "Chequers Deal" does is unlikely to be accepted.

The governments proposal has also faced stern criticism from Eurosceptic MP's back in the UK who see the deal as not going far enough. They argue that under such a deal the UK would continue to be bound by EU rules, and would be unable to trade freely with third party countries.

Until there is a material change in agreed policy our central forecast will continue to assume that a "soft" Brexit will be the final outcome, with the UK gaining similar access to the EU single market as it does currently.

UK	15	16	17	18	19-22
National accounts (% change, real terms)					**Avg**
GDP					
Consumer spending					
Investment					
Government					
Exports					
Imports					
Other indicators					
Employment (% change)					
Unemployment (% workforce)					
Consumer prices (% change)					
Fiscal balance (% GDP)					
Current account balance (% GDP)					
Bank Rate (% p.a)					
10 yr bond yield (% p.a)					
Exchange rate (US$ per £)					

Output growth accelerated to 0.4% in q2, up from 0.2% in q1.

- Office for National Statistics (ONS) data shows that UK GDP increased by 0.4% (q-on-q) in real terms, in xxxxq2.
- A more up-to-date ONS estimate for July, based on the limited data available shows that GDP growth strengthened to 0.6% in the three months to May-July, driven by services and construction, with a small drag on growth from production, although the gains are flattered by the comparison to weak February and March outturns.
- Purchasing Manager Index (PMI) data for August suggests that output growth is unlikely to accelerate in q4, with a strong gain in services output tempered by a deterioration in manufacturing and construction expansion.
- Household budgets have moved in the right direction according to the most recent data. Inflation rose to 2.5% in July, but total pay growth accelerated to 2.6%, with regular pay growing by 2.9%.
- Retail sales volumes, grew by 2.1% in the three months to May – July, the largest increase since January xxxx. Growth in food and clothing sales volumes were particularly strong, buoyed by exceptionally good weather conditions and high profile events such as the World Cup and the Royal Wedding.
- According to data released by the British Retail Consortium (BRC) the impact of favourable weather conditions unwound in August with total retail sales growth on an annual basis slowing to 1.3%, down from a gain of 1.6% in the year to July.
- Employment grew by 3,000 in the three months to May – July. In the same period unemployment fell by 55,000 and the unemployment rate dropped to 4%, the lowest it has been since the winter of xxxx.
- GDP growth is expected to remain muted in the coming quarters as the impetus from consumer spending remains constrained by a prevailing weakness in household budgets. The pressure facing consumers should slowly ease through xxxx, in line with a slowdown in inflation, and an improvement in pay gains. However, with households currently smoothing their real consumption by borrowing more and saving less, there is little scope for spending and GDP growth to accelerate before next year at the earliest.

Key risks

- EU and global trade growth has built some momentum in recent quarters, which is providing a boost to UK exports. If the outlook weakens the UK will be unable to capitalise fully on what remains an historically weak exchange rate. The emerging trade war between China and the USA is of particular concern.
- If the gentle acceleration in pay growth of earlier in the year unwinds further, consumer confidence and spending will suffer, renewing the strain on output growth in the consumer facing services industries.
- In the mid to long term, the UK's economic fortunes will largely be shaped by the final terms of the Brexit deal. The impact on external trade, foreign direct investment and migration flows are of particular importance as these influence the UK's long-term economic growth potential via labour supply and productivity. There will be a trade-off between market access and control over EU migration, so there is a real risk that the UK will have to accept significantly less favourable terms of access, which could undermine prospects for trade and investment. No adjustments have been made to the underlying population projections in our base case, but downside risks clearly exist on this front from a potential slowdown in EU migration.

UK	Prospects & Key Risks
Recent Trends	UK GDP growth accelerated to 0.4% (q-on-q) in xxxxq2, up from 0.2% in the previous quarter. A more up-to-date estimate for July, shows that growth strengthened to 0.6% in the three months to May-July
Business Planning Assumptions	The MPC voted unanimously at their August meeting to increase Bank Rate by 25bps, to 0.75%, only the second rise since the financial crisis. Future increases are likely to be at a gradual pace and to a limited extent.
2-Year Outlook	Real GDP growth is forecast to grow by 1.3% this year, down from 1.8% in xxxx. **Key risks**: The momentum gathering in the global economy falters. The emerging trade war between China and the USA is of particular concern. Wage growth stutters holding back consumer spending further. Brexit related uncertainty negatively impacts on business investment and consumer confidence.
Longer-Term Outlook	GDP growth of 1.6% a year in xxxx, with annual employment growth of 0.5%. **Key risks:** Public finances suffer from low economic growth and relaxation of austerity to support the economy. High debt exposure of public and private sectors becomes a serious burden.
Consumer	Spending growth to be sustained but at a much slower pace than in recent years. **Key risks:** Lingering above target inflation and weak earnings growth inhibit spending. Further Bank Rate hikes hit highly-exposed borrowers.
Trade	Trade should benefit from sterling's weakness. **Key risk**: If sterling eventually appreciates, export price competitiveness diminishes impeding growth.
Inflation	Inflation accelerated to 2.5% in July. **Key risk**: There is a renewed depreciation in sterling, and associated import price pressures build. The upward trend in global oil prices continues.
Labour Market	Gains in employment are expected to slow compared to xxxxh1, however competition for employees is should see pay growth accelerate. **Key risk**: Productivity gains stall, constraining pay.
Government	Fiscal policy expected to loosen in the coming year as suggested by the Chancellors Spring Statement. **Key risk**: An easier fiscal stance could raise concerns about the impact of high government debt on growth prospects.

Interest rates

In line with our forecasts, the nine-strong Monetary Policy Committee (MPC) voted unanimously to increase Bank Rate by 25bps, to 0.75%, at their August rate setting meeting, only the second rise since the financial crisis. The MPC's decision to hike rates was driven by a perceived requirement to combat domestic cost pressures, namely from wage growth, that they say are building in line with a tightening labour market.

(% per annum)	2015	2016	2017	2018	2019
Base rate (y/e)					
10 yr yield (y/e)					

KEY RISK

The possibility of a fresh Sterling depreciation as Brexit uncertainties persist is a key inflation risk. This could lead to higher interest rates, earlier than in the Base case.

Exchange rates

The Bank of England's effective exchange rate index, a weighted average of the movements in cross-exchange rates against a basket of other currencies had been steadily rising in the year to April on expectations of a May rise in Bank Rate. However, with the interest rate rise failing to materialise, the exchange rate subsequently eased back. The August rate rise has of yet done little to reverse the downward trend.

	2015	2016	2017	2018	2019
US$ per £ (y/e)					
£ per € (y/e)					
REER (Jan 2005=100)					

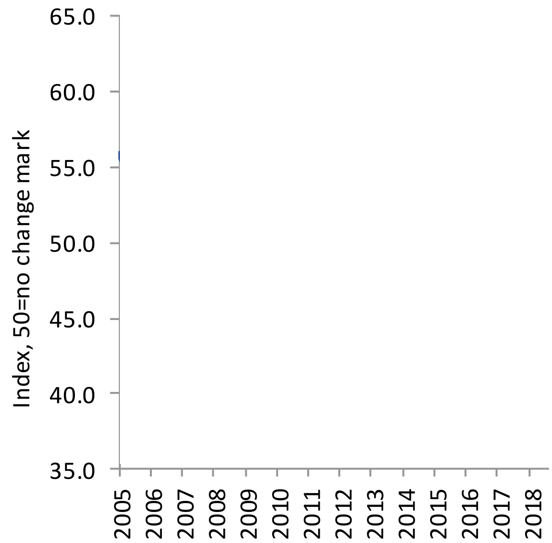
KEY RISKS

Consumers will benefit as inflation slowly eases in line with softer import prices. However, household budgets remain under pressure and this is expected to continue to hold back outturns in the services industries, the main engine of the UK economy, throughout xxxx. If consumer confidence deteriorates further, any consumption driven recovery could falter. Furthermore, the slight narrowing in the trade deficit in xxxx, is not enough to suggest that export led sectors such as manufacturing can plug the gap left by reduced services sector gains.

Recent trends
PMI's for August a mixed bag

The latest Purchasing Managers Index (PMI) data for August shows that the service sector is likely to remain the key driver of output growth in the UK economy in the third quarter of the year. Business activity and incoming new work in the sector increased strongly underpinning a rise in the index to 54.3 in August. This is the second highest level since February, and above the average monthly reading since August xxxx of 54. Financial services outperformed all other sectors as has been the case so far this year. Despite the August uptick, business optimism for the year ahead sank to a five-month low, with Brexit uncertainty highlighted as a key concern.

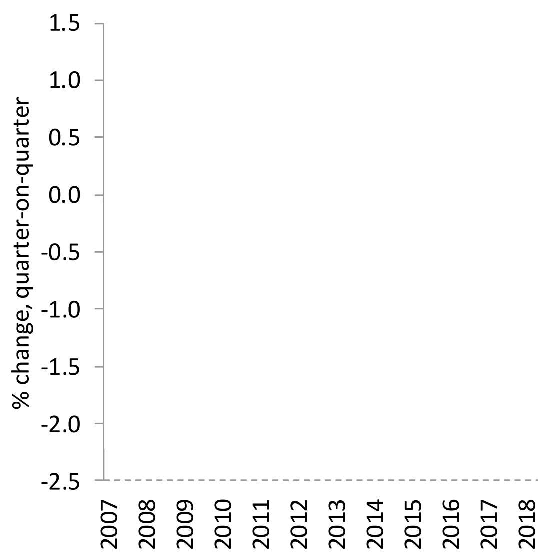
Services PMI recovers somewhat



Source: CIPS

Offsetting the August uptick in the services PMI, was an easing in manufacturing growth. Rates of expansion in both output and new orders slowed following the first contraction in new export business for over two years. Slower global economic growth and an uncertain trading environment appeared to weigh on foreign demand, offsetting any benefit from sterling weakness. The subdued performance of the sector also transmitted itself to the labour market, with the pace of manufacturing job creation slumping to near-stagnation. Furthermore, although companies maintained a positive outlook, with 47% expecting higher production in one year's time, optimism dipped to a 22-month low.

Growth accelerates in q2



Source: National Statistics, Experian

Construction output also disappointed in August, with growth dropping to a three-month low according to the PMI measure. Civil engineering was the worst performing area of the construction sector, with output in this category falling for the first time since March amid reports citing a lack of new work on infrastructure projects. House building has seen a particularly sharp slowdown since July, meaning that commercial construction was the fastest growing sub-sector.

The latest monthly ONS estimate which covers July shows that GDP grew by 0.6% in the three months to May-July. In q3 as a whole we expect GDP to post a 0.4% gain. An increase of this magnitude is consistent with the August PMI data, with the services sector continuing to drive expansion, but at a slower rate than in 2016.

Longer-term outlook

Uncertain outlook

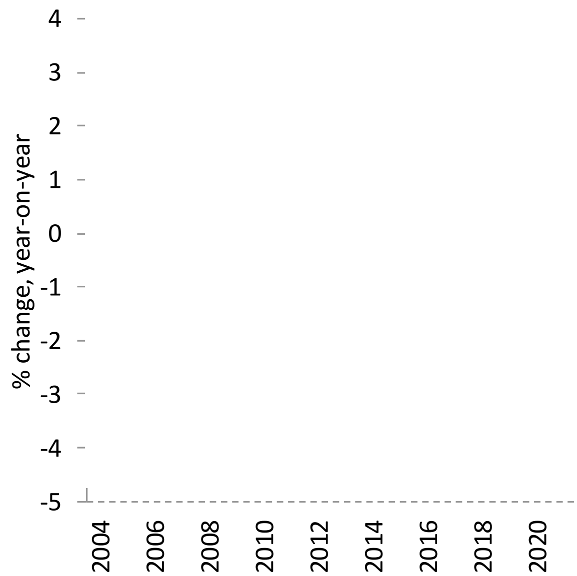
In January our macro forecasts incorporated the latest ONS population projections and a modest downgrade to productivity growth. The overall impact of these changes compared to last years forecasts was a 0.3% per annum downgrade to long-term GDP growth, to an average of 1.6%. This reflects weaker population and productivity growth.

The EU referendum result has created major uncertainties regarding the medium- and long-term outlook for the UK economy. Much will depend on the outcome of trade negotiations and terminating involvement with the EU and only time will tell how these issues affect economic performance.

Meanwhile the strong performance of the past four years means that the UK economy has recovered ground lost during the xxxx recession more quickly than seemed likely a few years ago. But the repercussions of the recession and above all the implications of the Brexit vote are set to hamper economic progress for a few years. The pace of expansion is likely to be well below the long-term trend throughout xxxx. GDP growth is expected to average 1.6% per annum during that period, against 2.6% from 1981 to xxxx.

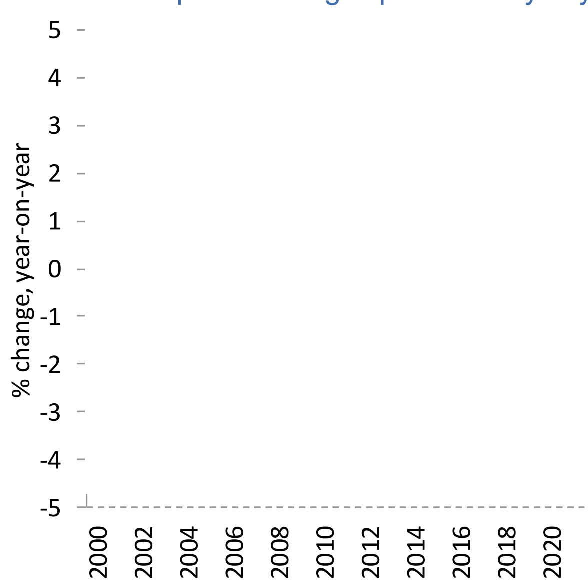
The weaker growth outlook reflects in large measure the expected slowdown in consumer demand, as real incomes are eroded by higher inflation and earnings growth that although accelerating, trails its historic average. Fiscal policy will be easier than in the past six years and the monetary stance will remain accommodative (even at 0.75% interest rates are at well below the historic average). This will help support activity but until the UK's post Brexit trading relationships are finalised it is not possible to determine whether this will be sufficient to avert an outright recession at some stage in the next few years.

Subdued GDP growth



Source: National Statistics, Experian

Consumption won't regain previous buoyancy



Source: National Statistics, Experian

Brexit Update
Uncertainty intensifies

In June the government published a white paper setting out its proposals for the future relationship between the UK and the EU. A key economic tenant of what has come to be known as the “Chequers Deal” is a proposal for a “common rulebook” on the trade of goods. For services the paper pushes for a bespoke agreement that would allow the UK to “chart its own path in the areas that matter most for its economy”, but with an acknowledgment that “the benefits of the single market come with obligations”.

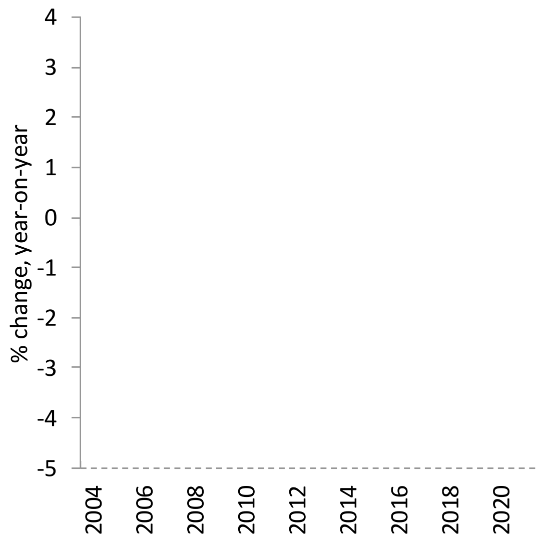
The UK Foreign Secretary remains steadfast in his support for the “Chequers deal”, despite strong criticism from Brussels, who have stated that relinquishing control of the EU’s borders and trade revenue to a third country through a “common rulebook” would destroy the integrity of the EU common market, on-top of the significant practical challenges involved in implementing the policy. Furthermore, the proposal to opt-out of free movement rules as the “Chequers Deal” does is unlikely to be accepted.

The governments proposal has also faced stern criticism from Eurosceptic MP’s back in the UK who see the deal as not going far enough. They argue that under such a deal the UK would continue to be bound by EU rules, and would be unable to trade freely with third party countries.

Given the question marks surrounding the “chequers deal”, a no-deal Brexit appears to be more likely than it was earlier in the negotiations. A Canada style agreement with the EU, which reduces tariffs for goods, but not services has also become a more probable outcome. Asking the EU for an extension of the Article 50 process in order to continue negotiations, or applying to stay in the European Economic Area, on similar terms to Norway, before coming to a final agreement are also distinct possibilities.

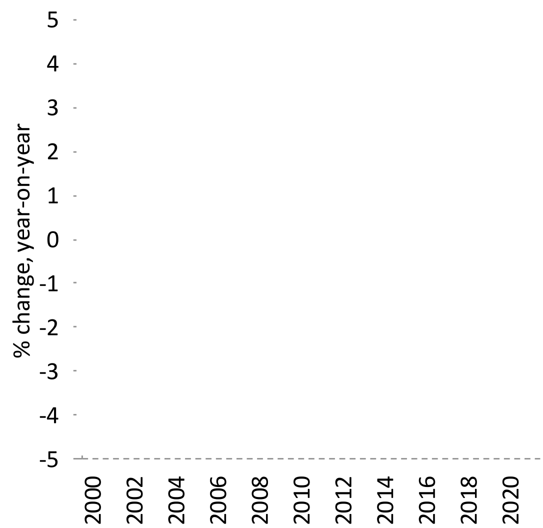
Until there is a material change in agreed policy our central forecast will continue to assume that a “soft” Brexit will be the final outcome, with the UK gaining similar access to the EU single market as it does currently.

Subdued GDP growth



Source: National Statistics, Experian

Consumption won’t regain previous buoyancy



Source: National Statistics, Experian

Consumers

Consumer spending growth slows

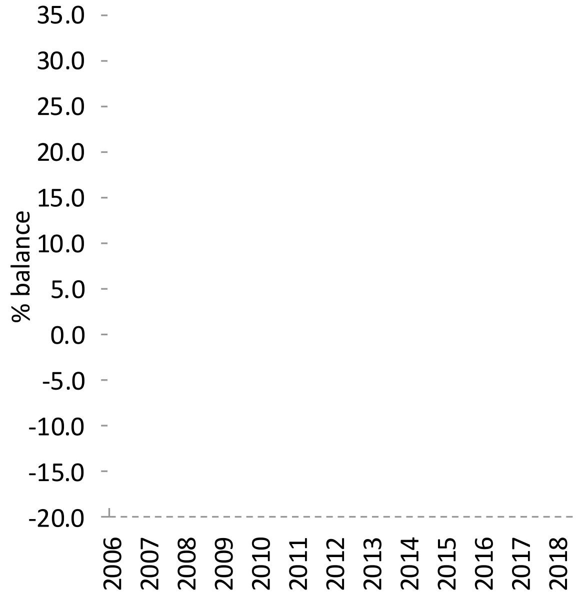
Exceptionally good weather conditions, and high profile events such as the World Cup and Royal Wedding helped support a healthy rise in food store sales volumes in the summer months. Sales of clothing, particularly summer ranges, also offered support, briefly bucking an otherwise downward trend in the sector. This underlined a rise in total retail sales on the ONS measure of 2.1% in the three months to May – July, the largest increase since January xxxx.

According to data released by the BRC the impact of favourable weather conditions unwound in August with total retail sales growth on an annual basis slowing to 1.3%. This is down from a gain of 1.6% in the year to July and represents a marked slowdown compared to the 2.4% rise registered in August last year. In-store non-food sales were particularly badly impacted, contracting by 2.2%, the steepest rate of decline since records began in January xxxx.

Consumer spending of which retail sales makes up roughly a third, grew by just 0.2% in the first quarter of the year. It is likely that this picked-up somewhat in q2 in line with a strengthening in retail sales growth. However, the gains look set to moderate in the third quarter of the year, not least because of a renewed deterioration in household budgets, with inflation coming in at 2.5% in July, outstripping growth in total pay of 2.4% in the year to April – June.

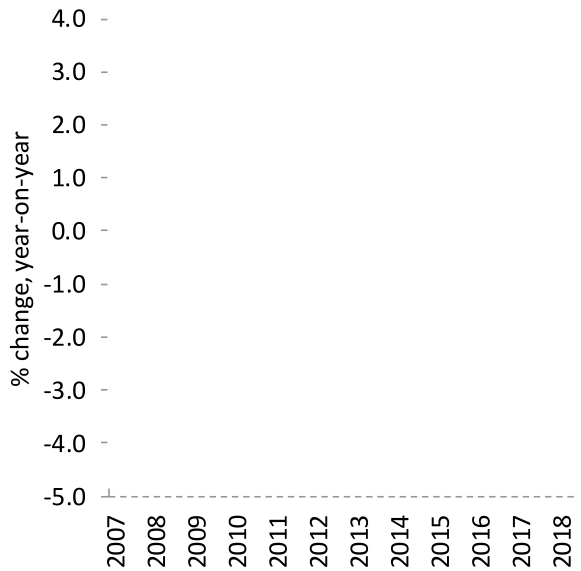
Household finances have been in a state of acute weakness for over a year now. Furthermore, consumer credit growth remains high by historic standards, at 8.5%, while the savings ratio hovers just above its all time low, at 4.3%. With little scope for households to complement consumption by borrowing more or running down savings consumer spending is expected to come in at 1% in xxxx as a whole, down from 1.7% in xxxx.

Consumer confidence still below pre-referendum levels….



Source: GFK and Experian

…predicating a slowdown in consumer spending



Source: National Statistics, Experian

Labour market

Employment gains remain healthy

The latest figures from the ONS show that the labour market remains in good health. An up-tick in pay growth is particularly good news in relation to consumers.

The key points comparing the three months to July xxxx with the previous three months are:

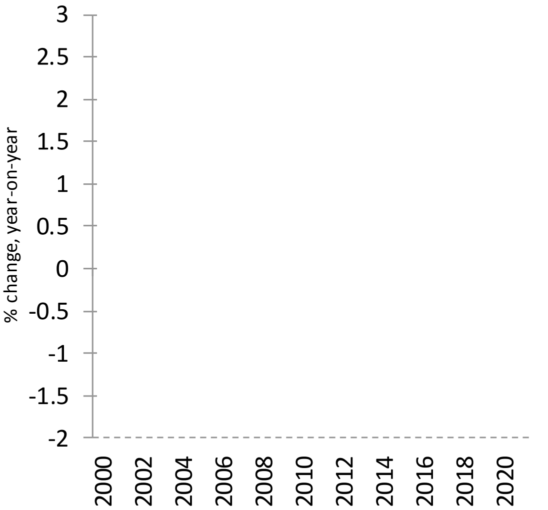
- Employment grew by 3,000 to 32.4 million.
- The number of full-time workers increased by 100,000, while the number of part-time workers declined by 98,000
- Unemployment dropped by 55,000 to 1.4 million and the unemployment rate eased to 4.0%
- The number of people in part-time work, because they could not find a full-time job, eased by 48,000
- Comparing May-July with a year earlier, pay for employees in Great Britain increased by 2.9% excluding bonuses, and 2.6% including bonuses.

The latest batch of labour market data shows that competition for workers in the UK economy remains intense with the unemployment rate the lowest it has been since the mid-xxxx's, the employment rate near its all-time high and job vacancies the highest they have ever been, and growing.

Encouragingly, tight labour market conditions finally appear to be driving up pay growth. Comparing July xxxx with July xxxx pay grew by 3.1%, which was the largest increase in three years. The private sector gain was 3.2%, while public sector pay growth picked up to 3%, from 2.5% a month earlier.

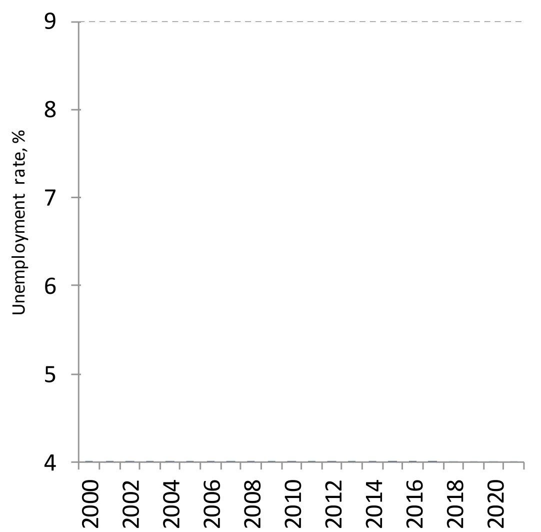
In the coming months pay growth is anticipated to continue to accelerate in line with a tightening labour market. At 2.9%, regular pay growth on the three-month measure, which evens out volatile movements in the data is once again outpacing inflation, which came in at 2.5% in July, and is anticipated to gently ease through the remainder of the year. This will provide some much needed respite for consumers, who have seen their household budgets eroded over the past year and a half.

Employment growth slows



Source:National Statisitcs, Experian

Unemployment set to rise marginally



Source: National Statisitcs, Experian

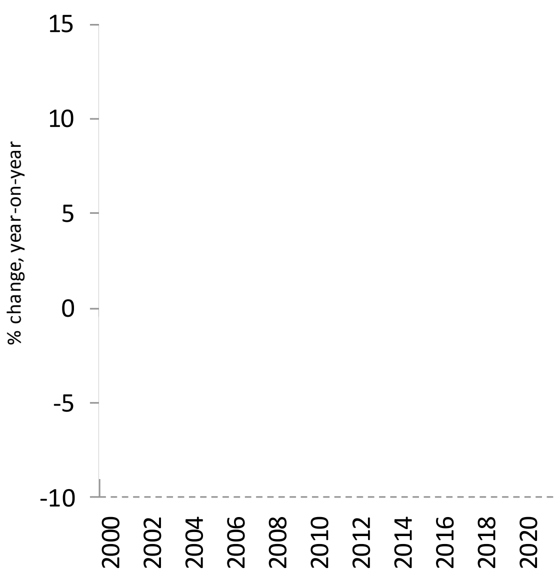
Trade

Deficit widens on 3-month measure

The total UK trade deficit (goods and services) narrowed £1.4 billion to £3.4 billion in the three months to July xxxx, as exports of goods and services both increased more than imports. The trade surplus the UK has in services widened £0.7 billion to £29.2 billion; exports of services increased £0.8 billion, while imports increased by a lesser £0.1 billion. The trade in goods deficit narrowed by £0.6 billion, as goods exports rose £4.3 billion compared with goods imports, which increased £3.7 billion.

Improvements in the balances of both goods and services in the 12 months to July xxxx resulted in the trade deficit narrowing £13.8 billion to £17.0 billion. The improvement in the balance was driven by exports of goods and services increasing by more than their respective imports. The main driver was the trade in services surplus, which widened by £8.4 billion to £117.1 billion. Services exports rose by £10.7 billion compared with £2.3 billion for imports. The goods deficit narrowed by £5.4 billion to £134.1 billion.

Export recovery offers limited support to growth



Source: National Statisitcs, Experian

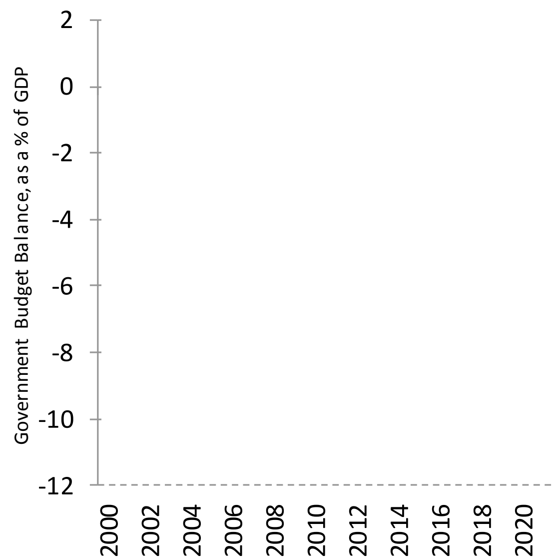
Public finances

Current budget in surplus

Public sector net borrowing (excluding public sector banks) in the latest full financial year (April xxxx to March xxxx) was £39.4 billion; that is, £6.4 billion less than in the previous financial year (April xxxx to March xxxx) and £5.8 billion less than official (Office for Budget Responsibility) expectations; this is the lowest net borrowing since the financial year ending March xxxx.

Of this borrowing, £40.6 billion was borrowed to cover capital spending (or net investment), such as on infrastructure. The borrowing to cover the "day-to-day" activities of the public sector (the current budget deficit) was in surplus by £1.3 billion. This current budget surplus is the first annual surplus since the financial year ending March xxxx.

Fiscal policy set to be eased



Source: National Statisitcs, Experian

Inflation and monetary policy

CPI edges up to 2.5% in July

Consumer price inflation (CPI) rose to 2.5% in July, up from 2.4% in June, the first rise in the rate since November xxxx.

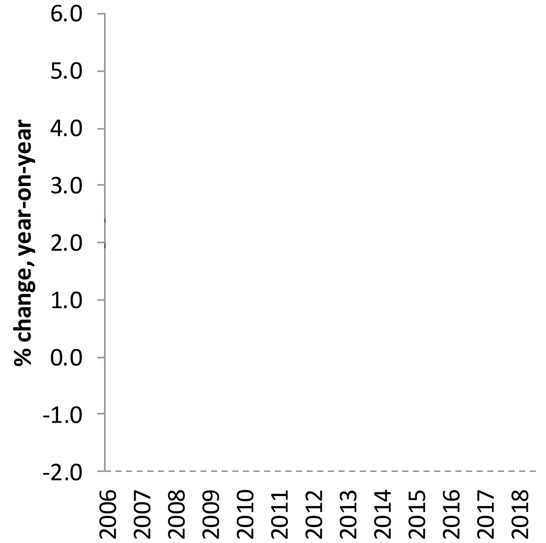
Transport continued to make the largest upward contribution to CPI, with a 5.7% annual increase in prices in July, the largest rise in over a year. The uptick was underlined by growth of 12.4% in the price of fuels and lubricants linked to an increase in the global oil price. In addition, as oil is priced in dollars, the recent weakening in the sterling/dollar exchange rate has pushed up fuel import costs.

Amongst the other components of CPI import cost pressures have generally diminished over the past year, as the much larger depreciation of sterling in xxxx drops out of the annual comparison. This can be seen in the latest producer price data which shows an easing in the headline rate of inflation for goods leaving the factory gate (output prices) to 3.1% in the year to July, down from 3.3% in June.

Clothing & footwear, a heavily imported good made the largest downward contribution to the 12-month rate in July, with prices falling by 0.4% year-on-year. This is the largest drop since October xxxx, and compares to annual rises of well above 3% in the Spring. Furthermore, core inflation which strips out the more volatile components of the headline index, including fuel, was unchanged at 1.9%, compared to 2.7% in January.

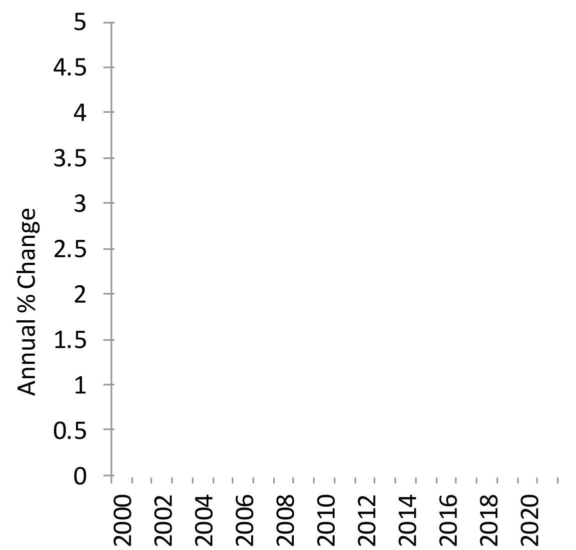
Diminishing import cost pressures are expected to continue to exert downward pressure on inflation, however much of this will be offset by higher fuel costs. This should keep inflation above the Bank of England's 2% target until the end of the year.

Inflation remains above target



Source: National Statistics, Experian

CPI to slowly ease



Source: National Statisitcs, Experian

Bank Rate

In line with our forecasts, the nine-strong MPC voted unanimously to increase Bank Rate by 25bps, to 0.75% in August, only the second rise since the financial crisis. The MPC's decision to hike rates was driven by a perceived requirement to combat domestic cost pressures, namely from wage growth, that they say are building in line with a tightening labour market.

Our economic forecasting expertise

Experian's team of 20 economists is a leading provider of global, national, regional and local economic forecasts and analysis to the commercial and public sectors. Our foresight helps organisations predict the future of their markets, identify new business opportunities, quantify risk and make informed decisions.

Experian Market Intelligence Group

Would you like to understand how your credit portfolio compares to your peers and how it is likely to be impacted by changes in lending policy, market competition and the economy in the future? Our experts in economics, credit risk, construction, market analysis and portfolio benchmarking combine to provide an in-depth understanding of the market and economic context in which you manage your business both now and in the future.

How we can help you:

- An independent unbiased view of the market based upon quantitative analysis of data.
- Benchmark your portfolio against your peers, both now and forecast into the future
- Provide economic forecasts specific to your sector
- Develop accurate business case(s) for entry into new markets
- Assess future market risk and predict potential economic pressures – at a granular level
- Highlight future revenue opportunities
- Meet regulatory requirements for stress testing and loss forecasting

Experian – helping organisations understand the market, economy and future changes in household and business finances.

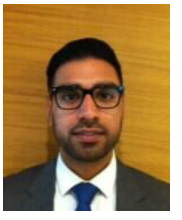
Contact our team on:

T: +44 (0) 207 746 8244 or
W: experian.co.uk/economics

Contacts

Mohammed Chaudhri

Head of UK Macro forecasting
E:Mohammed.Chaudhri@uk.experian.com
T: +44 (0) 207 746 8235



Mohammed joined Experian in April 2014 and leads in producing Experian's monthly UK macro forecast and the quarterly Consumer Credit Report. He is also the economist responsible for running economic stress scenarios. Before joining Experian Mohammed began his career as a fast-stream economist at Her Majesty's Treasury.

James Ison

Senior Economist
E: James.Ison@experian.com
T: +44 (0) 115 828 6002

James joined Experian in August 2013. He holds an Economics BSc (1st class honours) from the University of Sheffield, and an MPhil in Environmental Policy from the University of Cambridge. His role within the Economics team focuses largely on the UK consumer, and he is responsible for producing disaggregated income and spending forecasts by household.

Registered office address:
The Sir John Peace Building
Experian Way
NG2 Business Park
Nottingham
NG80 1ZZ
United Kingdom
experian.co.uk

Experian Ltd is authorized and regulated by the Financial Conduct Authority.
Experian Ltd is registered in England and Wales under company registration number 653331.