CBI ECONOMIC FORECAST

JUNE 2018 *(EMBARGOED UNTIL FRIDAY 8TH JUNE)*

GDP

The UK economy saw a shaky start to 2018, as bad weather caused GDP to near flatline (at just 0.1%), with the construction and retail sectors particularly badly hit. While survey data point to some pick-up in activity over Q2, they also suggest that underlying conditions remain tepid. Consumer-facing sectors are facing a particularly difficult time, grappling with anaemic growth in real household earnings and, in the case of retail, large structural changes as business models shift to capture online and digital sources of growth.

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 forecast: 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). Our forecast is conditioned on the agreement of a transition period with the EU until the end of 2020 and no significant bumps in the negotiations.

The key judgements underpinning our forecast remain unchanged: net trade supports GDP growth, aided by a strong global economy and the lower pound; household spending remains under pressure from squeezed real earnings; and uncertainty over Brexit weighs on business investment. We nonetheless expect slightly more strength in business investment over our forecast than previously, with a growing number of our members spending on automation, robotics and training to circumvent skill shortages.

Risks to the UK's tepid growth outlook remain skewed to the downside. In particular, a more disorderly outcome to EU negotiations could have significant bearing on financial markets and activity. Global risks have also shifted higher, particularly the prospect of protectionist actions on trade escalating further, choking off the nascent recovery in world trade flows.

Monetary policy and inflation

CPI inflation has been falling persistently since the end of 2017, to stand at 2.4% in May—the lowest in a year. Much of this fall reflects the waning impact on prices of the post-referendum depreciation in the pound. We expect this impact to continue fading, and therefore for inflation to gradually fall back a little further.

The Monetary Policy Committee (MPC) held off raising interest rates at their May meeting, despite strongly signalling further rate rises following the last move up in November 2017. The Committee seemed to be swayed by softer economic data over Q1, and are waiting to see whether this was entirely down to bad weather or whether it marks the start of a more prolonged slowdown.

However, the Bank's May *Inflation Report* forecasts show that they expect firmer, but still sluggish, growth to resume from Q2 onwards. Furthermore, the MPC continued to signal an "ongoing tightening" in monetary policy further ahead, as long as the economy evolved in line with their expectations. While the Bank expect only muted growth ahead, they still believe that the economy will grow above its potential rate, thus stoking inflationary pressure. Indeed, the recent firming in wage growth may be an early sign of domestic inflationary pressures building.

With output growth expected to recover in Q2, we expect the MPC to raise interest rates at their August meeting, by 25 basis points (to 0.75%). We expect another two rate rises next year (also of 25bps each), consistent with the Bank's guidance suggesting gradual and limited increases in Bank rate ahead.

Households

Consumer spending has remained weak over the past year, with household budgets caught between sluggish wage growth and high inflation. However, the worst of the consumer squeeze appears to be over: after a year of decline, real wage growth has edged into positive territory over the last couple of months.

The tightness in the labour market should lead to some further improvement in wage growth ahead. In particular, skill shortages remain high across our surveys, and many businesses are raising pay for key roles to both attract new staff and retain their existing workforce. But any further pick up in pay will be tempered by weak productivity, which we expect to persist over our forecast.

As a result, we expect both real wage and household spending growth to remain subdued. The contribution of consumer spending to GDP growth falls by a third in 2018 (to +0.7ppts, from +1.1ppts in 2017), and by a further 40% in 2019 (+0.4ppts).

Investment

Business investment fell slightly in Q1 (by 0.2%), after an almost uninterrupted run of growth since the EU referendum. Investment intentions also remain subdued in our business surveys relative to their pre-referendum level (albeit above their long-run averages), as Brexit uncertainty continues to bite hard on spending plans.

However, businesses increasingly report that they're turning to innovative forms of investment to deal with heightened skill shortages across the economy. A growing number of our members are looking at adoption of artificial intelligence (AI) and robotics, alongside more "intangible" forms of investment such as upskilling and re-training their existing workforce.

Given the growing focus on AI and robotics particularly, we expect a little more strength in business investment relative to our previous forecast. But with Brexit uncertainty still looming large, we still expect growth in business investment to remain weak. Growth averages just 0.3% per quarter over the next year—well below average growth of over 1% per quarter since 2010—and stabilises at 0.4% in the second half of 2019.

Trade

There are continued signs that the strength in the global economy and the low pound are supporting UK exports. Net trade registered a substantial positive contribution to GDP in 2017 (+0.6ppts, the highest since 2011), and our April manufacturing survey showed that export orders continued to rise at the fastest pace since the mid-1990s.

Ongoing strength in the global economy should continue to support export growth going forward, and we still expect net trade to lift GDP growth further ahead. On a quarterly basis, the positive contribution wanes a little in the second half of 2019, partly reflecting the impact of previous falls in sterling having peaked. Furthermore, the UK's trade prospects over the longer-term will be heavily dependent on its new relationship with the EU post the agreed transition period.

CBI UK economic forecast

12mth% unless otherwise stated				2018				2019			
	2017	2018	2019	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UK forecasts											
GDP & domestic demand											
Real GDP	1.8	1.4	1.3	1.2	1.6	1.4	1.3	1.5	1.2	1.2	1.3
Household consumption	1.7	1.1	0.7	1.0	1.2	1.1	1.0	1.0	0.5	0.6	0.7
Government consumption	0.1	1.4	0.9	1.2	1.3	1.6	1.4	1.1	0.9	0.8	0.7
Fixed investment	4.0	2.7	2.0	4.3	2.7	2.3	1.5	1.2	1.8	2.3	2.7
of which: business investment	2.4	1.1	1.4	2.0	1.1	0.6	0.7	1.2	1.3	1.4	1.5
External trade											
Exports	5.7	1.8	3.4	2.3	1.6	0.7	2.5	3.8	3.4	3.2	3.0
Imports	3.2	1.4	2.1	1.6	1.7	1.1	1.2	2.4	2.0	2.0	2.1
Net trade (pp. contribution to GDP growth)	0.6	0.1	0.3	0.0	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Current account balance (% of GDP)	-4.1	-3.3	-2.4	-3.7	-3.4	-3.2	-2.9	-2.7	-2.5	-2.3	-2.2
Labour Market											
Unemployment (ILO, mn)	1.48	1.42	1.45	1.43	1.42	1.42	1.42	1.43	1.43	1.45	1.48
Unemployment rate (%)	4.4	4.2	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.3	4.4
Employment (ILO, mn):	32.06	32.43	32.59	32.34	32.42	32.46	32.50	32.54	32.58	32.61	32.63
Average earnings (including bonuses)	2.7	2.6	3.1	2.6	2.5	2.5	2.7	3.1	3.1	3.1	3.0
Prices											
CPI	2.7	2.5	2.2	2.7	2.4	2.4	2.3	2.3	2.3	2.1	2.1
RPI	3.6	3.1	2.7	3.6	3.0	2.9	3.0	2.8	2.8	2.6	2.5
Public finances*											
Net borrowing (£bn)	40.5	37.9	39.4								
% of GDP	2.0	1.8	1.8								
Debt/GDP (%)	85.8	86.1	86.0								

*2017/18; 2018/19; 2019/20

Global GDP growth forecasts

	2017	2018	2019
Eurozone	2.5	2.2	1.7
US	2.3	2.8	2.3
Japan	1.7	1.1	1.1
China	6.9	6.3	5.8
India	6.4	7.3	7.1
Global GDP (puchasing power parity)	3.7	3.8	3.6

Forecast Assumptions

				2018				2019			
	2017	2018	2019	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UK Bank Rate	0.29	0.61	1.02	0.50	0.50	0.67	0.75	0.92	1.00	1.00	1.17
Oil prices $ per barrel (Brent crude)	54.2	75.0	74.8	66.8	76.2	79.2	78.0	76.7	75.4	74.2	72.9
USD/GBP	1.29	1.42	1.48	1.39	1.42	1.43	1.45	1.47	1.47	1.48	1.49
EUR/GBP	1.14	1.13	1.14	1.13	1.14	1.13	1.13	1.13	1.14	1.15	1.16