CBI ECONOMIC FORECAST

NOVEMBER 2016 *(EMBARGOED UNTIL WEDNESDAY 2ND NOVEMBER)*

CBI

GDP

The immediate aftermath of the EU referendum was characterised by heightened volatility in financial markets. While equity prices have since risen above pre-referendum levels, sterling remains weak and volatile—down 16% since the vote on a trade-weighted basis as of 28th October. Looking ahead, further volatility in sterling is likely, with market participants highly sensitive to economic data and political rhetoric.

Our forecast for GDP growth this year (2.0%) is unchanged from May, as a stronger-than-expected first half offsets our expectation of a weaker second half. Economic activity has been stronger than expected since the vote, although it has weakened relative to earlier in the year. GDP is estimated to have risen by 0.5% over Q3—broadly in line with the quarterly average over the last few years (0.6% since 2013), and higher than analysts' expectations both immediately following the vote (of flat or falling output) and directly ahead of publication (expectations were for growth of 0.3% ahead of the Q3 GDP release).

Growth is expected to moderate considerably over 2017, falling back to 1.3% for the year vs our previous forecast of 2.0%. Most of this reflects lower business investment, as heightened uncertainty and softer activity bear down on capital spending. Some of the downgrade also reflects slower consumer spending growth, as a higher path for inflation erodes real household incomes. We expect GDP growth to edge lower again in 2018 (to 1.1%), as consumer spending growth eases again, while business investment falls further.

The contribution to growth from net trade is stronger over 2017/18, as a weaker outlook for domestic demand drives lower import growth and the lower pound supports export growth. But upward pressure on import costs is likely to take the edge off of this competitiveness boost. Although the CBI's October *Industrial Trends Survey* showed record improvements in competitiveness in EU markets, a snap survey of participants found that while 32% of exporting manufacturers thought that sterling's depreciation was a net positive for their business, 47% considered it to be net negative, with 22% considering the overall impact to be neutral.

The risks around our forecasts for the next two years have risen significantly, and remain skewed to the downside. The process and outcome of EU negotiations is a particular source of uncertainty, as is the interaction between the exchange rate and the overall economy. Meanwhile productivity remains sluggish, and global growth momentum could disappoint, offsetting the more positive impact from sterling on UK trade flows.

Investment

Following the referendum, our business surveys showed a deterioration in investment plans for the year ahead from the highs recorded earlier in the year. This chimes with anecdote from our members, who have cited many examples of new capital spending being paused or put on hold.

However, investment projects already in the pipeline pre-referendum are generally reported to still be going ahead. And investment intentions have fallen from a high base before the vote, and are still above their historic averages. Our October *Industrial Trends Survey* showed a small improvement in investment plans among manufacturing firms—although they remain short of their pre-referendum highs.

Our survey data still point to growth in business investment over Q3 and as the current pipeline of projects moves forward, we expect investment to rise modestly over the near-term. But uncertainty around EU negotiations and future economic conditions is expected to bear down on business spending further ahead, and we expect business investment to fall between mid-2017 and early-2018, before stabilising thereafter. Our downgrade to business investment growth in 2017 (flat vs a 6.8% rise in our May forecast) drives a large part of the downward revision to our GDP growth forecast in 2017.

Inflation and monetary policy

CPI inflation rose to 1.0% in September—the highest in almost two years, but unrelated to sterling's deprecation. After a long period of low inflation, this likely marks the start of a more prominent pick up, as previous falls in fuel prices fall out of the annual rate. Sterling's sharp fall is expected to push up inflation further, with early signs of this impact already coming through. Our October *Industrial Trends Survey* showed the fastest rise in unit costs since April 2013, while our members are also observing that the cost of imported inputs have risen—in some cases, these are expected to be passed on as higher prices.

We anticipate a somewhat faster rise in CPI inflation over the next two years than in our last forecast. We now expect it to peak at 2.4% at the end of 2017 (tailing-off thereafter), against a convergence to the Bank of England's 2% target back in May.

Households

Indicators of household spending have generally held up since the end of June: our consumer spending "nowcast" points to growth of around 0.7% over Q3 so far—a touch above the average since 2013 (0.6%). Our retail sector members have also noted the positive impact from the lower pound encouraging more spending by visitors to the UK.

But we expect household spending growth to soften as rising inflation eats into the strong growth in real incomes seen since 2015. The labour market has remained strong so far, but tends to lag economic developments; as somewhat weaker momentum feeds through, this will also weigh on consumer spending. However, the deterioration is relatively modest: we expect the unemployment rate to end 2018 at 5.4% (up from 4.9% currently), which only brings it back to its levels in mid-2015.

Following another strong rise in household spending in 2016 (2.7%), we expect growth to ease in 2017 (to 1.2%, vs 1.5% in our May forecast) and in 2018 (0.6%).

Trade

The lower pound appears to be feeding through favourably to exporters, with our *Industrial Trends Survey* recording a marked improvement in competitiveness in EU markets. Manufacturing export orders have also risen at the fastest pace since mid-2014, with further growth expected.

We expect a further boost to exports from the lower pound, aided by a broadly supportive global economic backdrop. With softer domestic demand also bearing down on import growth, we forecast a substantial positive contribution from net trade; accounting for almost a third of GDP growth in 2017, and half in 2018—the largest contribution since 2011.

CBI UK economic forecast

12mth% unless otherwise stated	2016	2017	2018	2017 Q1	Q2	Q3	Q4	2018 Q1	Q2	Q3	Q4
UK forecasts											
GDP & domestic demand											
Real GDP	2.0	1.3	1.1	1.8	1.3	1.0	1.0	0.9	1.1	1.2	1.2
Household consumption	2.7	1.2	0.6	2.1	1.4	0.8	0.6	0.6	0.6	0.6	0.5
Government consumption	1.0	0.5	0.7	0.2	0.4	0.7	0.7	0.7	0.7	0.7	0.6
Fixed investment	0.8	0.5	0.6	2.3	0.1	0.0	-0.4	-0.6	0.4	1.1	1.5
of which: business investment	-0.3	0.0	-1.2	3.7	0.9	-1.8	-2.8	-3.2	-1.4	-0.4	0.2
External trade											
Exports	3.3	3.1	3.3	2.3	4.1	2.9	3.0	3.2	3.3	3.4	3.4
Imports	3.9	1.6	1.3	3.2	2.0	0.7	0.5	0.9	1.2	1.4	1.7
Net trade (pp. contribution to GDP growth)	-0.3	0.4	0.6	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Current account balance (% of GDP)	-5.7	-3.6	-2.6	-4.1	-3.7	-3.5	-3.2	-2.9	-2.7	-2.5	-2.3
Labour Market											
Unemployment (ILO, mn)	1.63	1.73	1.78	1.65	1.72	1.75	1.77	1.77	1.77	1.78	1.79
Unemployment rate (%)	4.9	5.2	5.3	5.0	5.2	5.3	5.3	5.3	5.3	5.3	5.4
Employment (ILO, mn):	31.71	31.59	31.53	31.68	31.59	31.56	31.54	31.54	31.54	31.52	31.52
Average earnings (including bonuses)	2.3	2.4	2.6	2.1	2.5	2.5	2.6	2.6	2.7	2.6	2.6
Prices											
CPI	0.7	2.2	2.4	1.8	2.3	2.3	2.4	2.4	2.4	2.3	2.3
RPI	1.7	2.7	3.1	2.5	2.8	2.6	2.8	3.0	3.0	3.1	3.2
Public finances*											
Net borrowing (£bn)	63.8	61.7	53.4								
% of GDP	3.3	3.1	2.5								
Debt/GDP (%)	83.2	83.7	84.2								

*2016/17; 2017/18; 2018/19: excludes APF

Global GDP growth forecasts

	2016	2017	2018
Eurozone	1.6	1.5	1.6
US	1.5	2.2	2.1
Japan	0.5	0.8	1.1
China	6.6	6.2	5.8
India	7.7	7.2	7.1
Global GDP (puchasing power parity)	3.0	3.5	3.6

Forecast Assumptions

	2016	2017	2018	2017 Q1	Q2	Q3	Q4	2018 Q1	Q2	Q3	Q4
UK Bank Rate	0.37	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Oil prices $ per barrel (Brent crude)	43.7	52.6	54.9	51.3	52.4	53.1	53.6	54.2	54.7	55.2	55.6
USD/GBP	1.37	1.25	1.29	1.24	1.25	1.25	1.26	1.27	1.28	1.29	1.30
EUR/GBP	1.22	1.18	1.21	1.16	1.18	1.19	1.20	1.21	1.21	1.22	1.22