# CBI ECONOMIC FORECAST

DECEMBER 2017 *(EMBARGOED UNTIL MONDAY 4TH DECEMBER)*

## GDP

UK GDP growth has been fairly lukewarm over 2017 so far, averaging 0.3% per quarter—almost half the average rate seen since 2013. Our business surveys suggest that momentum has remained tepid going into Q4. Conditions are particularly challenging for consumer-facing sectors, which have been hit by falling real household earnings. However, conditions in the manufacturing sector are more upbeat, with exporting firms continuing to benefit from competitiveness gains from the lower pound. But across the board, cost pressures remain elevated, as the weaker exchange rate pushes up the price of imported goods.

We expect subdued economic growth to persist ahead. Our latest forecast is for GDP growth of 1.5% in both 2017 and 2018 (from 1.8% in 2016)—broadly unchanged from our previous forecast. The key drivers of our growth outlook remain the same: household spending remains under pressure from squeezed real earnings; uncertainty over Brexit weighs on business investment; but net exports see more of a boost, aided by the lower pound and strong global growth.

We are forecasting similarly muted growth in 2019, of 1.3%. Our forecast assumes that agreement with the EU on a time-limited transition period is reached sometime in Q1 2018, and implemented upon the expiry of Article 50 in March 2019—thus ensuring a relatively smooth transition to a new relationship with the EU. The main drivers of our forecast remain unchanged in 2019, with domestic demand staying soft but support from net trade continuing.

The downside risks to our forecast remain high, particularly in 2019, when a more disorderly outcome from EU negotiations could have a more adverse impact on economic activity and financial markets.

## Monetary policy and inflation

The Monetary Policy Committee (MPC) voted 7-2 to raise interest rates in November (by 25 basis points, to 0.5%), marking the first rate rise in over ten years. The decision was mostly driven by greater pessimism regarding the economy's supply potential: the MPC believe that years of weak productivity growth have reduced the economy's ability to grow without stoking inflation. So even though the MPC expect only modest GDP growth ahead, they still expect CPI inflation to remain above their 2% target over the medium-term.

As a result, we expect a further three rate rises, each of 25 basis points, over our forecast—one in mid-2018 and two in mid-2019—bringing Bank rate to 1.25% at the end of 2019. However, this would still leave monetary policy very loose by historical comparison, particularly when also taking into account the Bank's £435bn stock of asset purchases (which we expect to remain in place).

Against the backdrop of a rate rise, CPI inflation has risen to 3%, its highest in five-and-a-half years. However, we expect inflation to have peaked and for it to fall back gradually further ahead, as the impact of sterling's past depreciation on prices fades. Nonetheless, inflation remains above the MPC's target throughout our forecast period, ending 2019 at 2.3%.

## Households

Looking through distortions in car sales over the last couple of quarters (related to tax changes), household spending has been losing steam persistently over the past year. Much of this is likely linked to falling real earnings, which have been squeezed by a combination of higher inflation and tepid wage growth.

But with the labour market still fairly tight and set to remain so, we do expect a gradual pick up in wage growth ahead. In particular, our surveys continue to flag acute skill shortages in some sectors, which should put some upward pressure on pay. This is broadly corroborated by our members, who expect some modest pressure on pay from both ongoing recruitment difficulties and higher inflation.

However, we expect only a limited pick up in real earnings, both because inflation will fall back only gradually, and because weak productivity will continue to weigh on earnings growth. As a result, we still expect less support to the economy from household spending further ahead—in particular, its contribution to GDP growth almost halves between 2017 and 2018.

## Investment

The ONS' annual *Blue Book* revisions paint a better picture of business investment since the EU referendum—it is now estimated to have risen by over 1% in the past year, compared to a *fall* of 0.3% previously. However, the outlook ahead is more mixed: investment plans for the year ahead in our business surveys had been improving during 2017, but recently fell back to their level just after the referendum (which is nonetheless in line with the long-run average). This chimes with special surveys that we've conducted both in July and November, where around 40% of businesses have said that Brexit is negatively affecting their investment plans.

We expect uncertainty to bite on business investment growth ahead, with quarterly growth averaging just 0.2% per quarter through the year—well-below average growth of over 1% per quarter since 2010. Growth stabilises over 2019, settling at (a still tepid) 0.3%.

## Trade

There are clear signs that UK exporters continue to reap the benefits of the lower pound and strong global growth. Indeed, our latest manufacturing survey showed that export order books were at among their strongest positions since the late 1970s. This seems to have been mirrored in official data, with exports (both goods and services) having risen by 6% since sterling's decline in June 2016, although this has been matched by import growth, leaving the overall economic impact neutral.

Looking further ahead, we continue to expect exports to be supported by a low pound and firm global growth. Furthermore, the weak exchange rate should also lead to softer growth in imports. As a result, we expect net trade to register a more meaningful contribution to GDP growth over our forecast.

## CBI UK economic forecast

| 12mth% unless otherwise stated | 2017 | 2018 | 2019 | 2018 Q1 | Q2 | Q3 | Q4 | 2019 Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **UK forecasts** | | | | | | | | | | | |
| **GDP & domestic demand** | | | | | | | | | | | |
| Real GDP | 1.5 | 1.5 | 1.3 | 1.5 | 1.5 | 1.4 | 1.4 | 1.3 | 1.3 | 1.3 | 1.2 |
| Household consumption | 1.7 | 0.9 | 1.0 | 1.2 | 1.1 | 0.7 | 0.8 | 0.9 | 1.0 | 1.1 | 1.0 |
| Government consumption | 0.6 | 1.3 | 0.7 | 1.0 | 1.4 | 1.4 | 1.4 | 1.2 | 0.7 | 0.5 | 0.3 |
| Fixed investment | 2.4 | 1.2 | 1.6 | 1.7 | 1.1 | 1.1 | 1.0 | 1.1 | 1.5 | 1.8 | 2.1 |
| *of which: business investment* | 2.2 | 1.2 | 0.9 | 1.6 | 1.2 | 1.1 | 0.8 | 0.6 | 0.9 | 1.0 | 1.2 |
| **External trade** | | | | | | | | | | | |
| Exports | 4.5 | 3.0 | 3.1 | 2.8 | 2.0 | 3.6 | 3.5 | 3.3 | 3.2 | 3.0 | 2.9 |
| Imports | 2.9 | 2.2 | 2.2 | 2.2 | 2.5 | 2.0 | 2.2 | 2.3 | 2.2 | 2.3 | 2.1 |
| Net trade (pp. contribution to GDP growth) | 0.4 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.0 | 0.2 | 0.2 | 0.2 | 0.1 |
| Current account balance (% of GDP) | -4.5 | -3.4 | -2.5 | -3.8 | -3.5 | -3.3 | -3.0 | -2.8 | -2.6 | -2.5 | -2.3 |
| **Labour Market** | | | | | | | | | | | |
| Unemployment (ILO, mn) | 1.46 | 1.33 | 1.34 | 1.35 | 1.33 | 1.32 | 1.32 | 1.32 | 1.32 | 1.35 | 1.39 |
| Unemployment rate (%) | 4.4 | 4.0 | 4.0 | 4.0 | 4.0 | 3.9 | 3.9 | 3.9 | 3.9 | 4.0 | 4.1 |
| Employment (ILO, mn): | 32.05 | 32.19 | 32.24 | 32.15 | 32.18 | 32.21 | 32.22 | 32.23 | 32.25 | 32.24 | 32.24 |
| Average earnings (including bonuses) | 2.5 | 2.7 | 3.1 | 2.5 | 2.4 | 2.9 | 3.0 | 3.1 | 3.1 | 3.1 | 3.0 |
| **Prices** | | | | | | | | | | | |
| CPI | 2.7 | 2.7 | 2.4 | 2.7 | 2.7 | 2.7 | 2.7 | 2.6 | 2.5 | 2.3 | 2.3 |
| RPI | 3.5 | 3.7 | 3.1 | 3.5 | 3.7 | 3.9 | 3.9 | 3.2 | 3.1 | 2.9 | 3.1 |
| **Public finances*** | | | | | | | | | | | |
| Net borrowing (£bn) | 48.1 | 40.7 | 37.8 | | | | | | | | |
| % of GDP | 2.4 | 1.9 | 1.8 | | | | | | | | |
| Debt/GDP (%) | 86.4 | 86.4 | 86.3 | | | | | | | | |

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

### Global GDP growth forecasts

| | 2017 | 2018 | 2019 |
|---|---|---|---|
| Eurozone | 2.2 | 1.8 | 1.6 |
| US | 2.2 | 2.5 | 1.7 |
| Japan | 1.7 | 1.6 | 1.0 |
| China | 6.8 | 6.2 | 5.7 |
| India | 6.5 | 7.2 | 7.0 |
| Global GDP (puchasing power parity) | 3.6 | 3.7 | 3.4 |

### Forecast Assumptions

| | 2017 | 2018 | 2019 | 2018 Q1 | Q2 | Q3 | Q4 | 2019 Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| UK Bank Rate | 0.31 | 0.63 | 1.13 | 0.50 | 0.50 | 0.75 | 0.75 | 1.00 | 1.00 | 1.25 | 1.25 |
| Oil prices $ per barrel (Brent crude) | 53.3 | 56.6 | 55.2 | 57.3 | 56.8 | 56.4 | 55.9 | 55.6 | 55.3 | 55.0 | 54.8 |
| USD/GBP | 1.30 | 1.38 | 1.42 | 1.36 | 1.38 | 1.39 | 1.39 | 1.42 | 1.42 | 1.42 | 1.42 |
| EUR/GBP | 1.14 | 1.14 | 1.16 | 1.13 | 1.14 | 1.15 | 1.15 | 1.16 | 1.16 | 1.17 | 1.17 |