

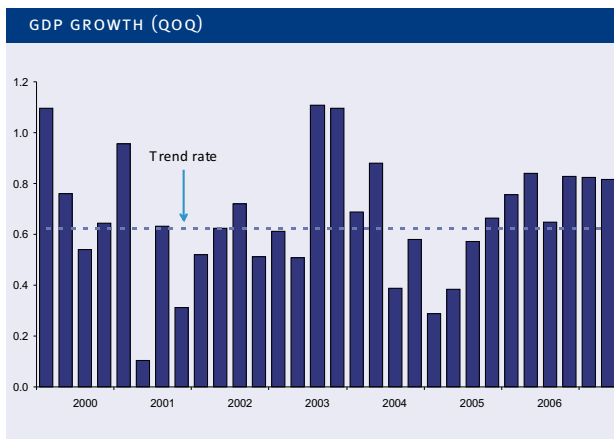
UK GDP forecasts reassessed in the wake of financial turbulence

Forecasts for UK GDP in 2008 have suggested a slowdown in growth for a while. Now, in the wake of turbulence in financial markets during August and September, expectations are for a slightly more noticeable reduction in growth.

According to forecasters, growth of the UK economy is set to slow in 2008 which, given we have seen five interest rate increases in just over a year and above-trend growth for the past seven quarters, is not surprising. What has changed recently is the extent of the predicted slowdown. The IMF and OECD have both signalled a downward revision to their 2008 UK forecasts, as did new chancellor Alistair Darling in his pre-budget report. Growth next year is now seen in the range of 2.0-2.5%, down from 2.5%-3.0%. The latest CBI economic forecast predicts a rise in GDP of 2.2% during 2008, a downward revision from 2.4%.

Revisions to growth forecasts follow turbulence in financial markets during August and September. As well as direct effects from lower bonuses and employment within the City, there may be wider effects as lenders restrict funds and

charge higher interest rates to some consumers and businesses. The trouble for analysts and policy makers will be separating effects of the credit crunch from those of higher interest rates.



CBI ECONOMIC FORECASTS (SEPTEMBER 2007)

% yoy unless stated	2005	2006	2007	2008
Real GDP	1.8	2.8	3.0	2.2
Household consumption	1.5	2.1	2.7	2.0
Government consumption	2.7	2.4	2.1	2.3
Fixed investment	1.5	8.0	5.2	3.0
of which : Business Investment	15.7	8.0	5.7	3.8
Manufacturing output	-1.2	1.3	0.9	0.8
CPI	2.1	2.3	2.4	1.9
Unemployment (ILO measure), mn	1.43	1.68	1.64	1.60
Public Sector Net Borrowing (£bn)*	41.7	31.5	31.3	29.7
Current Account (£bn)	-30.5	-47.8	-45.4	-50.6
£ effective exchange rate	103.3	101.0	104.3	103.1
World GDP**				
United States	3.1	2.9	2.0	2.4
Japan	1.9	2.2	2.0	1.9
Euro-13	1.6	2.9	2.6	2.0
of which :				
France	1.7	2.2	1.8	1.9
Germany	0.8	2.9	2.6	2.2
Italy	0.2	1.9	1.8	1.4

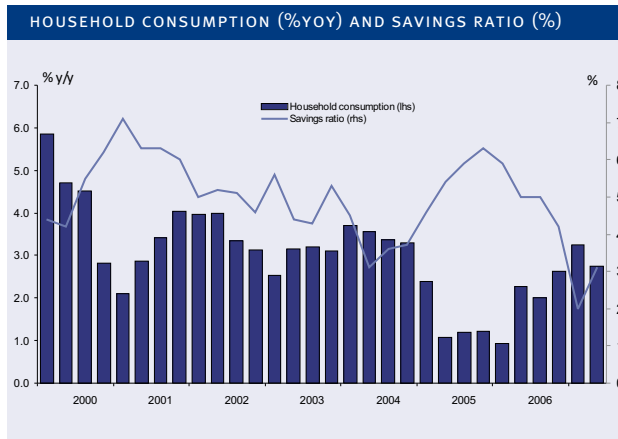
* Financial years

** Source: Consensus Forecasts October 2007

NOTE: Data used for forecasts was the latest available at the time. The data may since have been revised - the latest data can be found on page 4

A greater tendency towards fixed-rate mortgages – now accounting for almost 80% of total new mortgages, compared with 30% at the beginning of 2004 – has increased the time taken for interest rate rises to filter through to the wider economy and, as such, will make separating the effects of rate rises and the credit crunch more difficult. Indeed, we are only just beginning to see signs that past interest rate hikes are cooling the housing market, with September's decline in the Royal Institute of Chartered Surveyors (RICS) price index to -14.6% (the lowest since September 2005), the clearest indication yet.

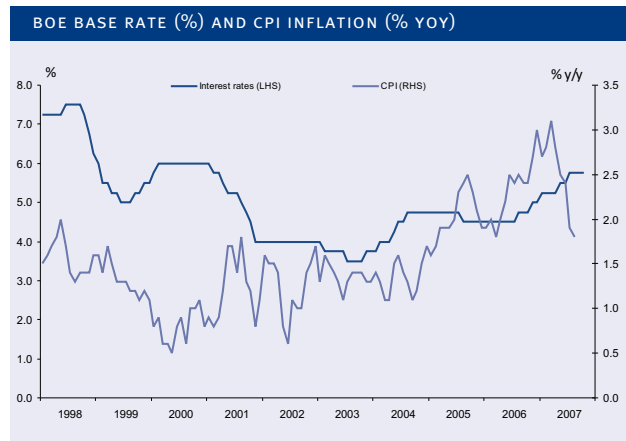
Consumer spending has been closely linked to housing wealth and, after a period of weakness in 2005, recovered during 2006 and into the start of this year. Lower house price inflation and tougher borrowing conditions could curtail this upturn. Although household expenditure rose by a healthy 0.8% in Q2 2007, more up-to-date survey data have already shown indications that growth of high-street spending and spending on consumer services is lower than earlier in the year. Other downside risks to spending exist from higher oil and food costs – possible negative influences on disposable income. With the savings ratio already historically low (though at 3.1% in Q2 slightly higher than the 47-year low of 2.0% in Q1), it is unlikely that consumers will be able to reduce their savings substantially in order to service spending.



With gross operating surpluses in Q2 2007 up 3.6% from the previous quarter for an annual rate of growth of 14.8% – the sharpest since the end of 1994 – and investment holding up well, businesses are arguably better placed than consumers to cope with any fall-out from the credit crunch. The GDP split for the second quarter showed that growth remained broad-based across sectors, although there is some evidence from recent surveys that growth has eased slightly so far in H2. The latest CBI/PwC Financial Services Survey showed that, though confidence for business volumes and profitability in the short-term dropped significantly, indicators for employment growth, investment

and constraints on business signal a brighter medium to long-term outlook.

Should spillovers from the credit crunch be seen in the real economy, recent downward surprises in CPI inflation mean that the MPC are in a better position to act by cutting rates. Prior to turbulence in financial markets, expectations had been for rates to hit 6% or higher before the end of the year. Now, markets expect the next move in interest rates to be down.



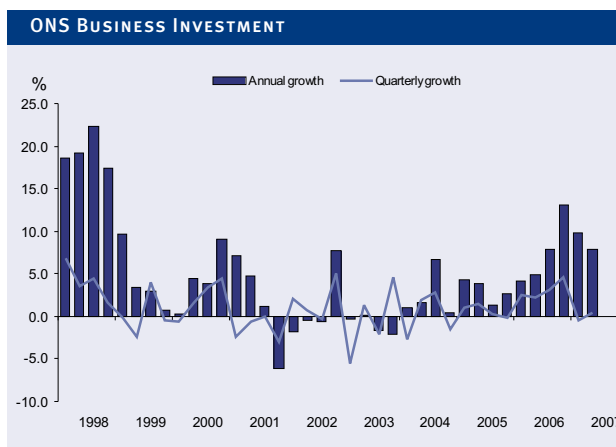
Unlike the Fed, the MPC has indicated that they will not cut rates solely to ease worries in financial markets. However, there are upside risks to inflation which could oppose the deflationary effects of a slowing economy and make a decision to cut rates, if delayed, harder to justify. Factory gate inflation accelerated to 2.7% year-on-year in September and, driven up by higher oil prices, input costs at manufacturers rose 3.2% on the month (for an annual increase of 6.4%). Concern will surround how much of these price increases are absorbed by businesses and how much are passed on to consumers. Food prices are also expected to rise in the coming months, following a brief period of severe competition among supermarkets that has driven prices and CPI inflation lower in recent months. Higher wheat and corn prices are likely to lead to increased costs for such items as bread, dairy products and meat products.

At present, signs of a slowing economy have been mainly confined to survey data, with official figures still quite buoyant. The greater proportion of fixed rate mortgages has certainly delayed effects on consumer spending and house prices from interest rate hikes, and so there is a possibility of a noticeable easing when combined with effects from the credit crunch. However, businesses remain in a healthy position and, with inflation as it stands at the moment, the MPC has room to manoeuvre should spillovers from the credit crunch be worse than expected.

Focus on.....Business Investment

Although the peak in the current business investment cycle appears to have been reached in late 2006, figures for the first half of 2007 remain strong, with annual growth of 7.8% in the second quarter of this year.

Despite the credit crunch, the most recent CBI forecast for business investment has only marginally changed. Strong growth of 5.7% is forecast for the whole of 2007. Recent CBI surveys continue to show relatively upbeat investment intentions across a broad range of sectors. Official statistics also point to notable growth in corporate profits and high net rates of return on capital. For example, the profitability of UK companies outside the financial sector reached a high in the second quarter of this year, with the net rate of return on capital rising to 15.7%.

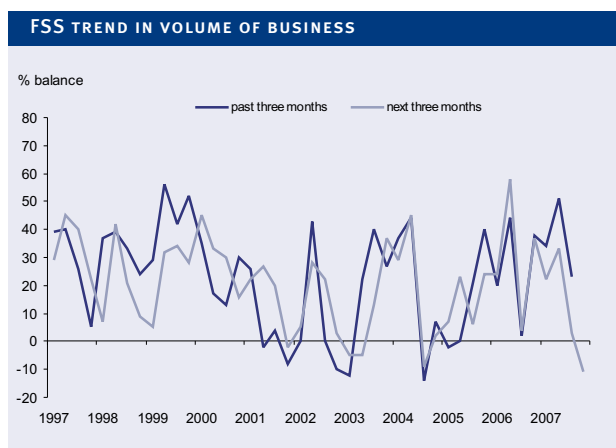


Moving into 2008, growth in business investment is forecast to moderate to 3.8%. Although this is markedly slower than in 2006 and 2007, it is still above the average annual rate of growth seen since the end of the investment boom in 1998.

Recent CBI Survey Results

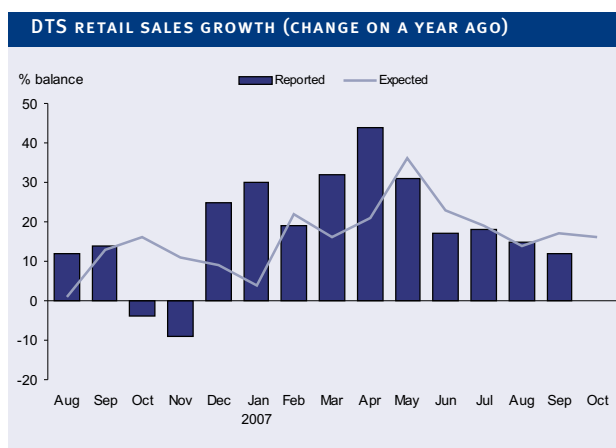
Quarterly CBI/PwC Financial Services Survey

- The financial services sector enjoyed unexpectedly good business in the three months to September. However, in the wake of the credit crunch, business volumes, income and profitability are expected to fall over the three months to December. While business sentiment has fallen sharply and the sector expects a tougher quarter ahead, firms still plan to take on more staff and investment plans are holding up. This suggests that the industry expects to recover from recent shocks.



Monthly Distributive Trades Survey

- High street spending continued to grow over the year to September, despite five interest rate rises since August 2006 and the recent crisis of confidence in the financial markets. But the trend of slower growth in annual retail sales seen since May has continued. Nevertheless, sales growth remains above the average rate recorded during the second half of 2006. Retailers also thought sales were around average for the time of year and expect the more moderate growth in sales to be sustained into October.



Key statistics on the UK economy

ECONOMIC INDICATORS		12MTH% UNLESS STATED											
		2005		2006			2007						
		2005	2006	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	
GDP		1.8	2.9	1.6	1.8	1.9	2.4	2.9	2.9	3.1	3.2	3.2	
Total Fixed Investment		1.5	8.2	0.4	1.6	4.0	6.2	8.0	8.1	10.3	9.0	6.2	
Manufacturing Investment		14.4	-1.7	14.9	16.0	9.5	7.0	-7.0	-3.6	-2.6	6.2	7.2	
Construction Output		1.5	1.1	2.9	0.6	-0.6	0.0	-0.4	1.9	3.1	2.7	3.5	
Total Household Consumption		1.5	2.1	1.1	1.3	1.3	1.1	2.4	2.2	2.8	3.3	2.8	
Company Profits		0.8	5.5	1.2	-3.9	-1.4	1.0	0.0	12.8	8.3	10.1	14.8	
Savings Ratio (%)		5.6	5.0	5.4	5.9	6.3	5.9	5.0	5.0	4.2	2.0	3.1	
Current Account (£bn)		-30.5	-41.9	-2.5	-10.7	-10.5	-9.6	-7.1	-11.0	-14.2	-10.6	-9.1	
Services Trade Balance (£bn)		24.6	29.2	6.9	4.5	7.0	7.3	7.1	6.9	7.9	8.2	8.9	
		2007		2007		2007		2007		2007			
		2005	2006	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	
Manufacturing Output (3m/3m yr ago)		-1.2	1.4	2.3	1.6	1.1	0.9	1.0	1.1	0.9	0.8	NA	
Retail Sales (3m/3m yr ago)		2.0	3.3	3.5	4.1	4.4	4.7	4.5	4.0	4.1	4.4	NA	
ILO unemployment (mn)		1.43	1.66	1.69	1.69	1.70	1.68	1.66	1.65	1.65	1.66	NA	
Goods Trade Balance (£bn)		-68.8	-77.6	-6.4	-7.0	-7.1	-7.1	-6.7	-6.5	-7.4	-6.9	NA	
Consumer Prices Index (CPI)		2.1	2.3	2.7	2.8	3.1	2.8	2.5	2.4	1.9	1.8	1.8	
Retail Prices Index (RPI)		2.8	3.2	4.2	4.6	4.8	4.5	4.3	4.4	3.8	4.1	3.9	
Producer Prices Index - output		2.8	2.4	2.2	2.3	2.7	2.4	2.4	2.5	2.5	2.5	2.7	
- input		11.7	9.6	-2.1	-1.2	0.7	-0.8	1.3	2.5	0.5	0.6	6.4	
Manufacturing Unit Labour Costs		0.1	1.0	-0.6	0.3	0.2	-1.0	1.2	0.4	0.7	-0.6	NA	
Average Earnings (3mth avg) - manufacturing		3.6	5.2	4.1	3.7	3.5	3.4	3.7	3.8	4.2	3.6	NA	
- services		4.2	4.0	4.5	5.0	4.6	4.1	3.5	3.4	3.5	3.9	NA	
- whole economy		4.0	4.1	4.3	4.6	4.4	4.0	3.5	3.4	3.5	3.7	NA	
FINANCIAL INDICATORS		PERIOD AVERAGE											
		2005		2006		2007		2007		2007			
		2005	2006	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	
\$/£		1.83	1.82	1.96	1.95	1.99	1.99	1.99	2.03	2.01	2.02	NA	
Euro/£		1.47	1.46	1.50	1.47	1.47	1.47	1.48	1.48	1.48	1.45	NA	
£ Effective (Jan 2005=100)		101.6	100.5	104.9	103.4	104.1	103.9	104.5	105.1	104.3	103.0	NA	
UK Base Rate (end month)		4.65	4.65	5.25	5.25	5.25	5.50	5.50	5.75	5.75	5.75	5.75	
U.S. 3-mth interest rate		1.62	3.55	5.36	5.35	5.35	5.36	5.36	5.36	5.48	5.50	NA	
Eurozone 3-mth interest rate		2.11	2.18	3.82	3.89	3.97	4.07	4.14	4.22	4.55	4.57	NA	
UK 10-yr interest rate		4.87	4.41	4.94	4.85	5.05	5.16	5.43	5.41	5.13	5.13	NA	
FTSE 100		4521.4	5156.7	6360.2	6205.3	6430.8	6571.3	6606.1	6561.9	6546.4	6531.0	NA	
CBI SURVEY DATA*													
QUARTERLY		2005		2006			2007						
		Jan	Apr	Jul	Oct	Jan	Apr	Jul	Oct	Jan	Apr	Jul	
Industrial Trends Survey	- business confidence	-22	-15	-16	-21	-14	-2	-6	-10	-7	+16	-2	
	- unit cost expectations	+19	+18	+5	+13	+21	+10	+10	+18	+15	+4	+14	
	- plant investment intentions	-19	-16	-15	-19	-14	-9	-10	-15	-8	-7	-6	
MONTHLY		2006		2007			2007						
		Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	
Industrial Trends Survey	- output expectations	+5	+11	+12	+28	+21	+18	+18	+25	+10	+13	+17	
	- price expectations	+19	+8	+19	+19	+21	+16	+25	+16	+11	+16	+16	
Distributive Trades Survey	- retail sales volumes	-9	+25	+30	+19	+32	+44	+31	+17	+18	+15	+12	

* balance = % of respondents reporting increases less % of respondents reporting falls. For further details on official data please contact the Office for National Statistics, +44 (0)20 7533 6363/6364.

FURTHER INFORMATION

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