

GDP

UK GDP rose by a solid 0.7% in Q2 2015 as growth bounced back from an unexpectedly soft Q1 (when growth slowed to 0.4%). With survey indicators of activity and anecdote from our members suggesting solid, steady growth over the first quarter, we continue to expect Q1 GDP data to be revised upwards over time.

More recent indicators for the third quarter once again point to firm growth. Thereafter, we expect GDP growth to remain solid out to the end of 2016, averaging around 0.7% a quarter. We have revised up our GDP growth forecasts for both 2015 (to 2.6%) and 2016 (to 2.8%) from our projections in June (2.4% and 2.5% respectively), on the back of stronger support from household spending and business investment. However, we expect net trade to exert a greater drag on growth both in this year and the next, reflecting a somewhat weaker outlook for global growth and a stronger sterling exchange rate.

Once again, the main downside risks to the UK's outlook stem from the world economy. While the near-term threat of a Greek exit from the Eurozone has receded—notwithstanding recent election shenanigans—the UK remains exposed to any further flare-ups. Meanwhile, the recent stock market rout in China could have a greater impact than expected on its domestic economy—while the UK's direct links to China are small, the resultant effect on global growth could bear down on UK trade even further. Looking to the US, the timing and pace of interest rate rises risks triggering currency and stock market volatility in emerging markets. In terms of domestic risks, the nascent recovery in productivity could fail to gain traction, which would weigh on wage growth and longer-term growth potential.

Labour market

Recent data suggests that the UK labour market has softened. Following persistently strong growth since 2013, employment fell over the second quarter and unemployment rose. But solid GDP growth over the same period suggests that productivity (as measured by output per hour) has risen further, building on the recovery seen over the past year.

Looking ahead, we expect productivity to rise modestly, but at a rate below its pre-crisis average, as some of the cyclical constraints holding it back begin to fade. Alongside the strength in Q2, this should feed through to wages, with our forecast for average earnings growth this year (2.5%) and in 2016 (2.8%) higher than in June (2.0% and 2.4%). But this still remains well below average pay growth in the years preceding the financial crisis (around 4%). Burgeoning skills shortages in the UK—as flagged by our business surveys and our members—could also help push up wage growth in the near-term.

As productivity growth recovers and the labour market tightens, we expect some slowing in employment growth and a modest rise in unemployment from the end of 2015. But the cumulative rise in unemployment next year (83k) reverses only 8% of the decline since early 2012 (923k up until Q3 2015).

Domestic demand

We expect domestic demand to remain the mainstay of growth in both 2015 and 2016. In particular, the combination of stronger earnings growth and low inflation lifts households' purchasing power, providing a welcome boost to consumer spending. Business investment is also expected to be robust: our surveys point to solid plans for capital spending in the year ahead, with expanding capacity and providing more services becoming more prominent drivers of investment. Over 2016, we should also see a small positive contribution to growth from government consumption, following the smoother pace of fiscal consolidation announced in the summer Budget.

UK trade

Data for the second quarter so far suggest that net trade has made a positive contribution to growth in Q2. But we do not expect this to last—net exports are expected to drag on GDP growth thereafter. Our forecast for export growth has been revised sharply lower in 2016 particularly, driven by both a weaker global outlook and a stronger Sterling bearing down on competitiveness. Indeed, our *Industrial Trends Survey* shows that manufacturing competitiveness in EU markets has deteriorated significantly in recent quarters. This chimes with anecdote from our members, who cite that a rising Pound against the Euro is eating into export volume growth.

Monetary policy and inflation

Minutes of the August Monetary Policy Committee meeting showed the first split vote in eight months, with one member voting to raise interest rates (by 25bp). However, several others on the Committee voiced concerns about upside risks to medium-term inflation and commentary from the Bank of England has become noticeably more hawkish recently. Alongside the continued strengthening in domestic demand, this has led us to pencil in the first interest rate rise in Q1 2016, a quarter earlier than in our previous forecast. We still expect only gradual rise in rates thereafter (25bps a quarter), in line with the Bank's messaging.

Prospects for inflation in the near-term are slightly lower than in June, reflecting a renewed fall in global commodity prices. We expect CPI inflation to bounce around zero until the end of this year, after which it should begin to pick up more decisively. By the end of 2016, inflation should stand close to the Bank of England's 2% target.

CBI UK economic forecast

12mth% unless otherwise stated

				2015				2016			
	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Growth & Consumption											
Real GDP	3.0	2.6	2.8	2.9	2.7	2.6	2.4	2.8	2.8	2.9	2.8
Manufacturing output	3.1	0.9	1.9	1.4	0.6	0.7	0.8	1.3	2.1	2.1	2.1
Household consumption	2.5	3.2	2.9	3.4	3.3	3.0	3.2	3.0	3.0	3.0	2.8
Government consumption	1.6	1.2	0.6	2.3	1.0	1.0	0.8	0.2	0.5	0.7	0.9
Household savings ratio	6.1	6.0	5.7	4.9	6.5	6.5	6.0	5.7	5.9	5.7	5.5
Investment											
Fixed investment	8.6	5.6	5.5	5.0	5.5	5.3	6.6	6.0	5.5	5.2	5.2
of which:											
Total business	8.0	6.2	6.5	5.7	4.4	6.6	8.0	7.4	6.5	6.0	5.9
General government	3.4	2.4	0.0	-4.1	12.8	1.0	1.2	0.0	0.0	0.0	0.0
Manufacturing	6.4	12.6	5.3	16.7	14.1	10.8	9.4	6.3	5.0	4.7	5.3
External Trade											
Exports	0.5	4.5	3.4	3.8	5.0	6.5	2.6	3.1	3.1	3.5	3.9
Imports	2.4	4.8	3.5	4.6	5.6	5.0	4.2	2.8	3.5	3.7	4.1
Current account (£bn)	-105.7	-101.9	-88.4	-26.5	-26.0	-25.1	-24.2	-23.2	-22.3	-21.8	-21.2
% of GDP	-5.9	-5.5	-4.6	-5.8	-5.6	-5.4	-5.1	-4.9	-4.6	-4.5	-4.3
Prices											
CPI	1.5	0.2	1.5	0.1	0.0	0.1	0.5	1.3	1.5	1.6	1.8
RPI	2.4	1.0	2.7	1.0	1.0	1.0	1.2	2.0	2.5	2.8	3.3
RPIX	2.4	1.1	2.2	1.0	1.0	1.0	1.2	2.0	2.2	2.2	2.4
Producer output prices	0.0	-0.8	2.6	-1.8	-1.6	-0.7	0.8	2.2	2.6	2.8	2.8
Labour Market											
Unemployment (ILO, mn)	2.00	1.78	1.81	1.81	1.79	1.76	1.76	1.79	1.81	1.82	1.85
Unemployment rate (%)	6.1	5.4	5.5	5.5	5.5	5.4	5.4	5.4	5.5	5.5	5.6
Unemployment (CC, mn)	1.01	0.79	0.83	0.81	0.80	0.77	0.78	0.80	0.82	0.83	0.86
Claimant count rate (%)	3.0	2.3	2.4	2.4	2.3	2.3	2.3	2.3	2.4	2.4	2.5
Employment (mn):	28.81	29.41	29.61	29.29	29.38	29.46	29.52	29.56	29.59	29.63	29.65
Average earnings*	1.5	2.5	2.8	4.4	2.3	2.1	1.4	0.9	3.4	3.3	3.3

* Including bonuses

Public Sector**

Net borrowing (£bn)	88.2	69.2	48.4
% of GDP	5.0	3.7	2.5
Debt/GDP (%)	80.8	80.3	79.4

**2014/15; 2015/16; 2016/17: excludes APF

Forecast Assumptions

				2015				2016			
	2014	2015	2016	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Global GDP	3.3	3.1	3.6	3.2	3.2	3.0	3.1	3.6	3.7	3.6	3.6
UK Bank Rate	0.50	0.50	1.13	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50
Oil prices \$ per barrel	99.0	57.8	61.2	53.9	61.7	57.1	58.5	59.6	60.6	61.7	62.7
GBP Trade-weighted index	86.9	92.1	95.3	89.4	91.2	93.6	94.0	94.7	95.2	95.5	95.8
USD/GBP	1.65	1.54	1.55	1.51	1.53	1.57	1.56	1.56	1.55	1.54	1.54
EUR/GBP	1.24	1.39	1.45	1.35	1.39	1.42	1.43	1.44	1.45	1.46	1.46