UK Economic Forecast

The Q2 2017 ICAEW Economic Forecast, is based on the views of those running UK plc: ICAEW Chartered Accountants working in businesses of all types, across every economic sector and in all regions of the UK, surveyed through the quarterly ICAEW Business Confidence Monitor (BCM).

Following an inflation-induced slowdown in the first three months of 2017, economic activity has strengthened a little in Q2. The business confidence index looks positive for the first time since before the EU referendum and there has been strong output data reported for the manufacturing sector. That said, consumers will face challenges for the remainder of 2017 thanks to falling real wages, while business investment remains constrained by domestic political uncertainty and upcoming Brexit negotiations.

Q2 Key findings:

- **The economy is forecast to grow by 1.7% in 2017**. GDP growth slowed sharply from Q4 2016 to Q1 2017 (the 0.2% reported in the first three months of this year being the slowest increase since 2014). We expect GDP growth to rebound a little in the remainder of 2017, with exports playing a greater role in driving growth than in previous years. We have nudged up our forecast for GDP growth in 2017, from 1.6% in our last report to 1.7% in this edition.
- **Weaker business investment in 2017, with potential for faster rebound**. Investment recovered a little in Q1 2017, but we continue to forecast a modest fall for the year. However, firms' financial positions and profit margins remain good, and

borrowing costs will remain low for quite some time. Given the uncertain domestic political outlook and difficult Brexit negotiations to come, firms are likely to exercise restraint in their capital spending.

- **Labour market to remain tight.** Recent labour market data suggests the degree of spare capacity remains historically low, while BCM evidence shows firms expect to continue to create jobs in the year ahead. At just 0.7% for the year, the rate of private sector employment growth will be the slowest since 2012. Given the continued growth in working-age population, this rate of job creation will be just enough to stabilise the unemployment rate close to the current reading.
- **Real income losses for households.** Weaker growth in demand for workers, along with upward pressure on non-wage labour costs faced by firms, suggest that wage growth will remain around 2% in 2017. With the Bank of England expecting inflation to remain close to 3% for the year, this will mean real income losses for households in 2017.
- **Long-term fiscal risks still not being tackled**. The last fiscal year delivered the smallest budget deficit in cash and GDP terms for almost ten years. But early evidence for 2017-18 suggests that the slowing economy is hurting the UK's fiscal position. The election campaign has demonstrated that no consensus exists on how to tackle longer-term risks to the public finances.

Economic outlook

The UK economy slowed sharply in the first quarter of 2017 as consumers finally succumbed to the impact of faster inflation. However data for April and May suggests that the second quarter might be stronger, with GDP growth for the year at 1.7%. Following the election result, we should see relatively little change in the fiscal stance, while monetary policy will remain on hold through what is likely to be a temporary period of higher inflation.

The economy slowed in the first three months of the year, from quarterly GDP growth of 0.7% in Q4 2016 to 0.2% in Q1 2017. The consumer lost momentum, with quarterly spending growth of 0.3%, the weakest since Q4 2014. Latest retail sales data suggest a tentative recovery - sales rose 2.3% month-on-month in April. But this could be partly due to the Easter holiday and the good weather. We therefore remain cautious about consumer prospects, especially since inflation accelerated to 2.9% in May.

Elsewhere, the gradual rebalancing of activity continues. The manufacturing PMI rose to a 3-year high in April, and with Eurozone and wider global trade rebounding in the first half of this year, this is unlikely to be solely down to a weaker pound. The pickup in business confidence in the latest BCM suggests better GDP growth in Q2, possibly as strong as 0.5%. This is unlikely to be sustained in full in the second half of 2017, given that inflation will remain high. Our forecast for GDP growth of 1.7% for the year seems a reasonable expectation given the positive signs in the export sector, and the likelihood that investment will stabilise later in the year.

From a policy perspective, the election result means a change in fiscal stance is unlikely. The Monetary Policy Committee is likely to tolerate a period of above-target inflation, keeping rates on hold to help support economic activity.

Please note that 2017 data in this report is forecast.