UK Economic Forecast

The Q4 2018 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).

Q4 Key findings:

Growth forecast to run at a subdued 1.2% this year but stronger momentum in 2019.

Business investment likely to drop in 2018 overall.

Improvement in the jobs market to moderate.

Structural factors will continue to weigh on pay growth.

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Economic outlook

Growth forecast to run at a subdued 1.2% this year, but stronger momentum in 2019

Following a pick-up in GDP growth from 0.1% in the first quarter to 0.4% in the second quarter of this year, Q3 saw momentum build further, delivering a 0.6% rise in output. Such a rise hasn't been seen since the last three months of 2016. Each of the three main output sectors (services, industry and construction) saw output expand, and consumer spending, total investment (public and private), government consumption and net trade all made positive contributions for the first time since Q4 2017.

However, the details of Q3's performance presented a less than favourable platform for expansion in the last quarter of 2018. The economy's strength in Q3 was entirely accounted for by a strong performance in July, with the monthly data showing GDP flat in both August and September. This suggests that the economy carried little momentum into Q4, a prediction reinforced by a modest 0.1% rise in output in October and a weaker set of CIPS activity surveys in October and November across the services, manufacturing and construction sectors compared to results in the third quarter. Our ICAEW Business Confidence Monitor (BCM) forecast suggests growth will slip back in Q4.

Looking ahead to 2019, growth prospects look brighter. The likelihood of a steady decline in inflationary pressures will support consumers' spending power. And our expectation that, notwithstanding recent events, a draft Brexit withdrawal agreement will ultimately be passed by Parliament should result in some pent-up business investment coming back. In addition, the fiscal loosening announced by the Chancellor in October's Budget represents a new source of economic support. All in all, these factors point to the economy expanding by 1.6% next year. This would still be weak even by the already modest standards of the current expansion, and the still-present risk of a 'no-deal' Brexit would see this forecast cut significantly.

Real GDP, annual growth

Business Investment

Business investment likely to drop in 2018 overall.

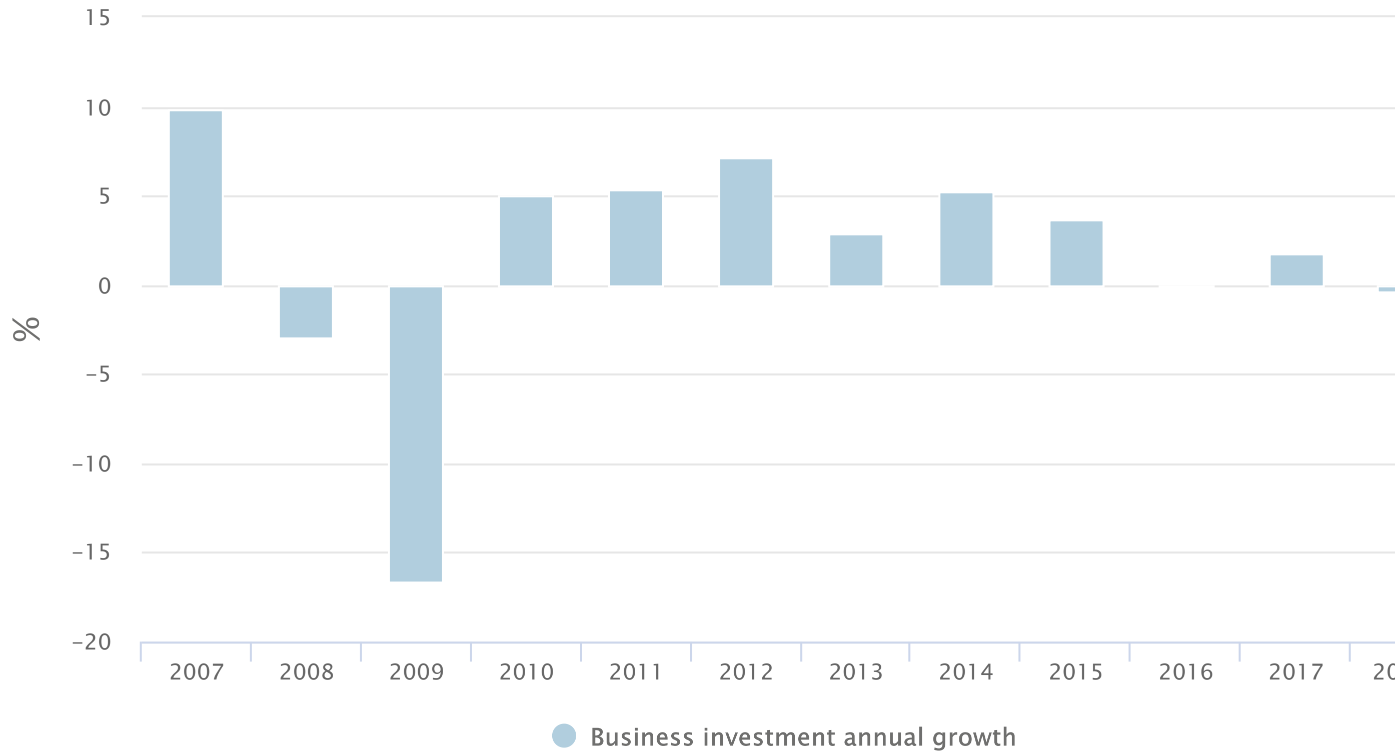
Q3 delivered further disappointment on the business investment front. Capital spending by companies dropped 1.2% on the previous three months, the third successive quarterly decline. This left business investment 1.9% down on a year earlier, the weakest performance since Q1 2016.

Given that business investment data is particularly prone to revision, we should be careful drawing inferences from early estimates of the data. But falling investment backs up the narrative that Brexit-related uncertainty is leading businesses to cancel or place capital spending decisions on hold, a story supported by a decline in business confidence in the latest BCM to the lowest level in nearly a decade. Given the year-to-date performance, we forecast business investment will fall 0.4% over 2018 as a whole.

Any reduction of Brexit-related uncertainty could give businesses exposed to the EU more confidence to invest, if the UK and EU can arrive at an amicable Brexit arrangement. But the ongoing political furore over Brexit in the UK makes this a very big 'if'. And, broader conditions remain favourable. Although borrowing costs are creeping up, they are still very low by historical standards, while rates of corporate profitability are above the norm.

A weak end to this year isn't a good starting point for growth in 2019, however, we still anticipate business investment will rise, albeit by only 0.5% next year, compared to average growth of 3.9% per year from 2010 to 2017.

Business investment, annual growth



Labour market

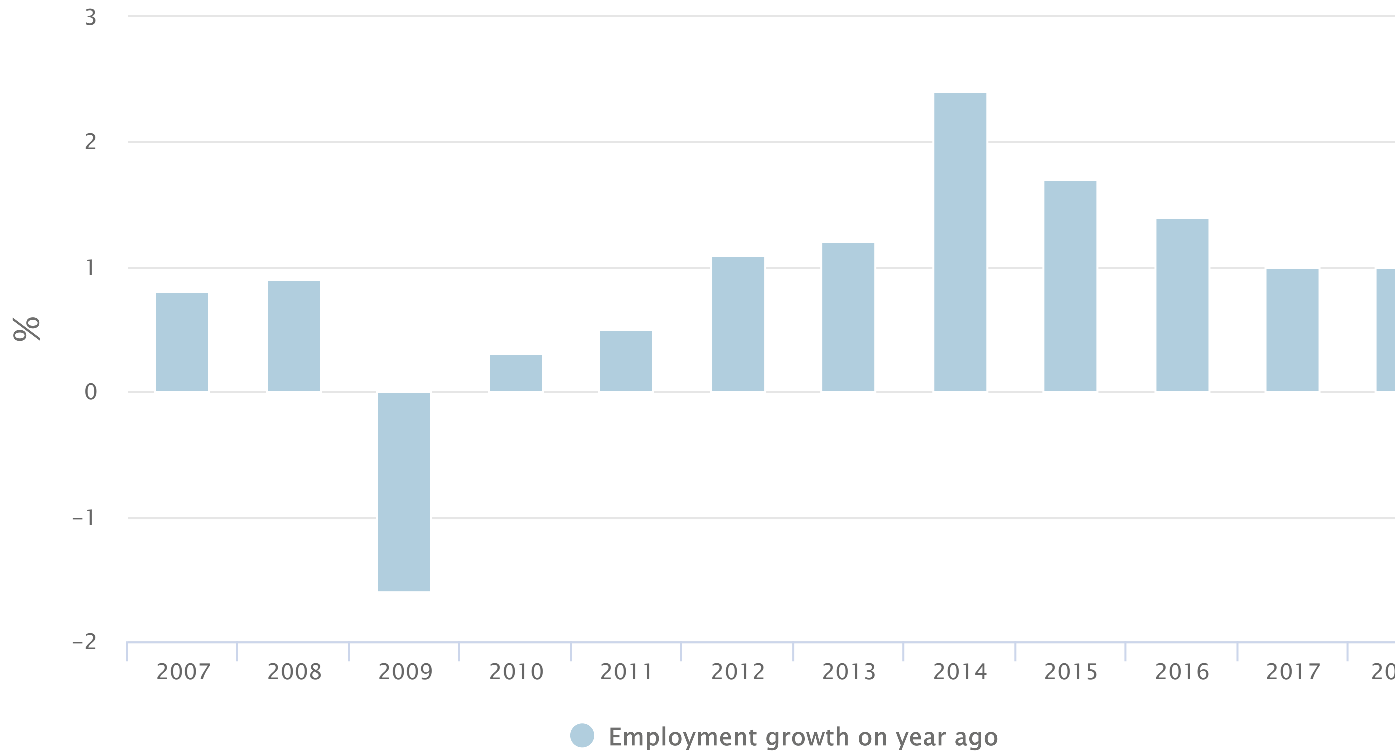
Improvement in the jobs market to moderate

Q3 saw the jobs market continue to improve. The number of people in work rose 1.1% on a year earlier to a record high of 32.4m, slightly faster than the second quarter's 1% increase. However, there were some less positive developments: Q3 was only the third quarter since the start of 2016 to see a rise in unemployment. The increase in the jobless total of 21,000 was modest, though, and still left the unemployment rate at 4.1%, which is very low by the standards of recent decades.

Meanwhile, there was some evidence in Q3 that the long-awaited reaction to a tight jobs market – faster growth in pay – may be materialising. Average weekly earnings rose at an annual rate of 3% in Q3, up from 2.4% in the second quarter and the first time pay growth had reached the 3% mark since the third quarter of 2015. A 3.2% rise in regular pay stood out even more, being the fastest rise in almost 10 years.

Looking ahead, with the employment rate hovering around a record high, joblessness at a 43-year low and inward migration declining, the BCM data suggest that employment growth will slow as we move into 2019. The number in work is forecast to rise 0.4% next year, down from an expected 1% in 2018. However, with workers' bargaining power undermined by globalisation and the threat of automation, an ostensibly tight jobs market is unlikely to trigger much of an upsurge in wages growth, despite recent positive moves in that direction. Average earnings are forecast to rise by 2.5% next year, up only slightly from 2.4% in 2018.

Employment growth on year ago



Average earnings, annual growth

Focus - Structural factors will continue to weigh on wage growth

One disappointing aspect of the current economic expansion has been the past failure of pay growth to pick up in response to an ever-tighter jobs market. Having peaked at 8.4% in late-2011, the unemployment rate had dropped close to a 43-year low of 4.1% in the third quarter of 2018. Yet over that period, annual growth in average weekly earnings was only 1.9%, compared to the pre-financial crisis norm of around 4%-5%.

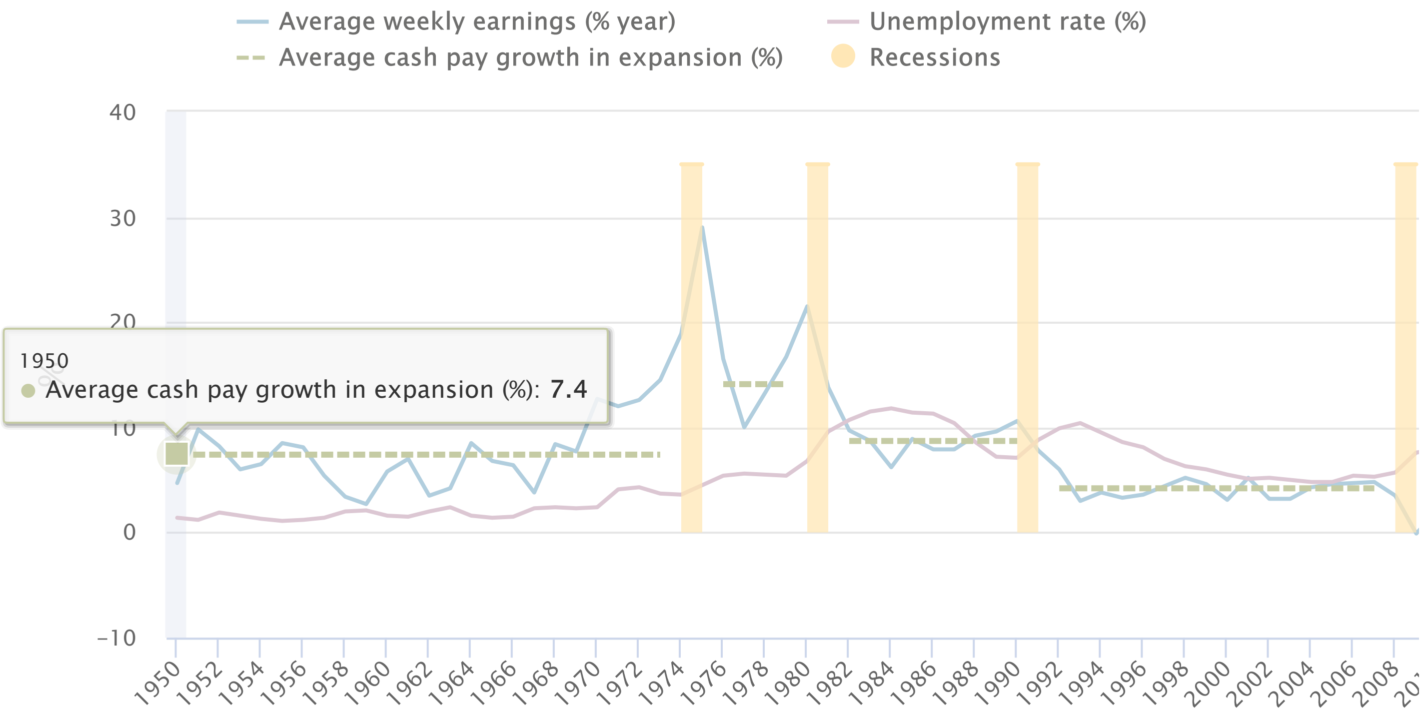
But could times be changing? The year to Q3 2018 saw total pay rise by 3%, the joint-highest rate in a decade. Regular pay growth touched 3.2%, also a post-2008 high. And the benefit of that pickup to households' spending power has been reinforced by a fall in inflation. This dropped from a recent peak of 3% in Q4 2017 to 2.5% in Q3 2018. As a result, average earnings have started to grow again in real terms, albeit very modestly.

But false dawns have occurred in the past, where pay growth has picked up only to fall back again. And the acceleration seen in recent months has received an unusually large boost from changes in the composition of the workforce, with disproportionate growth in better-paid jobs pushing up average pay levels. The rise in growth in underlying pay has been more modest.

A third reason for caution comes from observing past cycles of recessions and expansions. Each recession since the early-1980s has shocked down pay growth, with the subsequent expansion seeing little move back towards what the 'norm' was previously. This suggests that structural factors – the decline of union membership and the consequence of globalisation in terms of offshoring activity and increasing migration – have undermined the power of workers to bargain for significant increases in pay. Automation presents another factor strengthening employers relative to employees.

Hence, while the recent recovery in cash pay rises might be sustained in part, the prospect of workers enjoying a sizeable revival looks less solid, a prediction reinforced by little move in the latest pay settlement surveys. On a more positive note, the gain to real, inflation-adjusted, pay growth from lower inflation should become more apparent as we move through 2019. A stronger pound (assuming the Brexit process proceeds smoothly) and the recent drop in oil prices point to annual CPI inflation falling below 2% next year and stabilising at just over 1.5%.

UK: Unemployment and earnings



Economic Forecast reports are produced with ICAEW's partner Oxford Economics, one of the world's foremost advisory firms. Their analytical tools provide unparalleled ability to forecast economic trends.

ICAEW's forecasts for economic growth, business investment and the outlook for the labour market are based on the correlation between **ICAEW Business Confidence Monitor (BCM) (https://www.icaew.com:443/technical/economy/business-confidence-monitor)** indicators and official economic data. The BCM contains data – from a survey of 1,000 UK businesses – on business confidence, financial performance, challenges and expectations for the year ahead to provide a unique analysis of future developments in the UK economy.

Webinars

- **Q4 2018 Budget Brexit and Business Confidence (https://event.on24.com/wcc/r/1888390/D86278595CE9914A59C58CAEFF999A8B)**
- **Q3 2018 Autumn Economic Weather Forecast (https://event.on24.com/eventRegistration/EventLobbyServlet?target=reg20.jsp&referrer=&eventid=1831111&sessionid=1&key=82A8CE60B8AD30D7058FF46AAEED264C&regTag=&sourcepage=register)**

- **Q2 2018 – End of term Economic Report Card: The outlook gets cloudier (https://event.on24.com/eventRegistration/EventLobbyServlet?target=lobby20.jsp&eventid=1773897&sessionid=1&key=BD4616D80B96EDD9B6B960D42D071956&eventuserid=205766133)**
- **Q1 2018 - Is a rise in interest of interest to businesses? (https://event.on24.com/eventRegistration/console/EventConsoleApollo.jsp?&eventid=1632842&sessionid=1&username=&partnerref=&format=fhaudio&mobile=false&flashsupportedmobiledevice=false&helpcenter=false&key=F125066CD0B5B2CBA183B12F435CC9DD&text_language_id=en&playerwidth=1000&playerheight=650&overwritelobby=y&eventuserid=197612065&contenttype=A&mediametricsessionid=173107864&mediametricid=2335225&usercd=197612065&mode=launch)**
- **Q4 2017- Autumn Budget 2017: What does the future hold for the UK Economy? (https://event.on24.com/eventRegistration/console/EventConsoleApollo.jsp?&eventid=1522744&sessionid=1&username=&partnerref=&format=fhaudio&mobile=false&flashsupportedmobiledevice=false&helpcenter=false&key=20FE07D86A58756BAFF1A4D67583FBEC&text_language_id=en&playerwidth=1000&playerheight=650&overwritelobby=y&eventuserid=183393813&contenttype=A&mediametricsessionid=173107145&mediametricid=2183477&usercd=183393813&mode=launch#)**

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