Economic Research Unit

UK Outlook

November 2015

Solid Economic Growth

2015

GDP	EMPLOYMENT	UNEMPLOYMENT	INFLATION
2.4%	1.4%	5.4%	0.0%

Domestic demand driving growth
Employment rising
Inflation subdued
Sterling to strengthen against euro

> “The economy is set to continue growing at a solid pace, with rising employment and earnings supporting spending.”

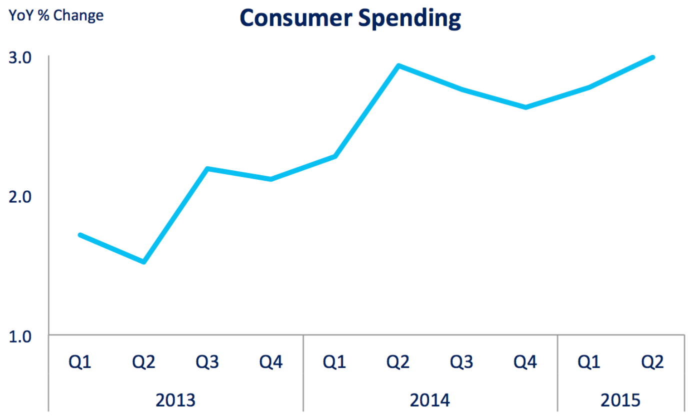
Loretta O'Sullivan
Group Chief Economist

Overview The UK economy grew by 2.9% in 2014, the fastest pace of expansion since it emerged from recession in 2009. Growth has eased during 2015, but it remains solid, averaging 2.5% over the first three quarters. For the year as a whole, GDP is forecast to increase by 2.4%. The outlook for next year is also positive, with the economy projected to again grow by 2.4%. Activity is being underpinned by healthy consumer spending, which is benefiting from rising incomes as earnings pick up and job gains continue. Business investment is increasing too, supported by strong domestic demand and the need to expand capacity. While export growth has lagged the recovery in the broader economy, it did pick up over the first half of this year, with improving conditions in the Euro area (including strong growth in Ireland) expected to provide further support. Although inflation is subdued, the economy is moving towards full employment - the unemployment rate has fallen to 5.3% and is projected to average 5.1% in 2016 - and so we expect the Bank of England to begin raising interest rates over the first half of next year. This is likely to result in sterling strengthening against the euro, though uncertainty regarding the UK's continued membership of the EU may at some point weigh on the currency.

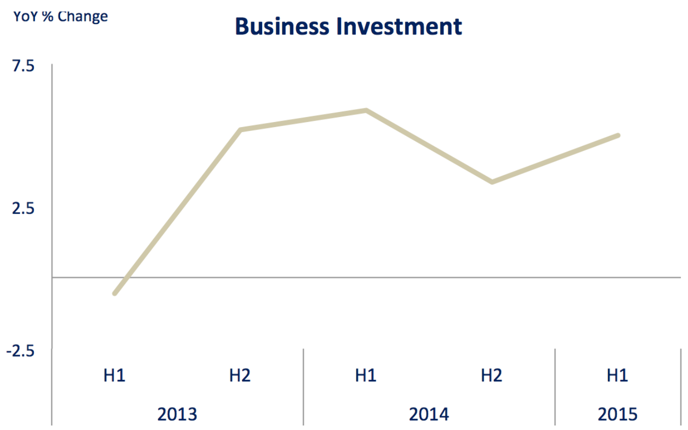
Outlook	2014	2015 (f)	2016 (f)
Personal Consumption	2.6%	2.9%	2.6%
Government Consumption	1.9%	1.8%	1.0%
Investment	7.5%	4.0%	5.0%
Exports	1.8%	3.2%	3.2%
Imports	2.8%	3.0%	3.8%
GDP	2.9%	2.4%	2.4%
Employment	2.3%	1.4%	1.0%
Unemployment Rate (Average)	6.2%	5.4%	5.1%
CPI	1.5%	0.0%	1.2%
£/€ (End Year)	1.29	1.41	1.43
£/$ (End Year)	1.56	1.52	1.50

Domestic demand driving growth

Domestic demand has been the main driver of growth in recent years. Consumer spending, the largest component of domestic demand, rose for a 15th consecutive quarter in the second quarter of 2015, with the latest retail sales data pointing to another increase in the third quarter. On an annual basis, growth accelerated to 3.0% in Q2, the strongest in almost eight years. Looking ahead, spending will continue to benefit from rising incomes, high consumer confidence and subdued inflation (which is boosting households' spending power). We expect personal consumption to increase by 2.9% this year and by 2.6% in 2016. Government consumption is forecast to rise by 1.8% and 1.0% this year and next respectively.



Investment has been on a firm footing since mid-2013. Business investment rose by 5.1% year-on-year over the first half of 2015, having increased by 4.6% in 2014, and will continue to be supported by strong domestic spending, the need to expand capacity and favourable financing conditions. Investment in private dwellings (including improvements) rose by almost 13% last year. Most of this increase was concentrated in the first quarter, however, and annual growth has slowed since (turning negative in the first half of 2015), probably in response to an easing in housing demand during 2014. The latter has picked up recently, which should be reflected in a recovery in this component of investment. Total investment is projected to rise by 4.0% in 2015, followed by an increase of 5.0% in 2016.



Exports have lagged the recovery

Exports have lagged the recovery in the broader economy in the last few years. Growth averaged 1.2% annually between 2012 and 2014, as stagnant goods exports partially offset rising services exports. With imports increasing at a faster pace, net exports made a negative contribution to GDP growth over this period. The weakness of exports partly reflects subdued demand from the Euro area, but also the impact of sterling's sharp appreciation since early 2013.

Export volumes did pick up year-on-year over the first half of 2015 though, and the latest PMI manufacturing survey shows a rise in orders. The firming of the Euro area recovery, including in Ireland (where we are forecasting GDP growth of 6.2% and 4.8% in 2015 and 2016 respectively), will help UK exports to the zone. Total exports are expected to increase by 3.2% both this year and next, while import growth of 3.0% is projected for this year, accelerating to 3.8% in 2016.

Employment rising

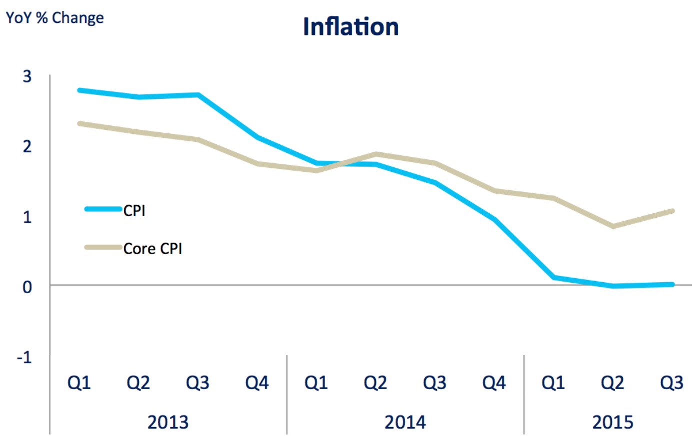
Employment grew by 1.4% year-on-year in the third quarter, a net increase of 419,000 jobs taking the numbers in work to a record high of 31.2 million. This has contributed to a further decline in the unemployment rate, which at 5.3% is now more than 3 percentage points below its peak in 2011. Earnings have picked up in response to the improvement in the labour market, with an annual increase in average weekly earnings (excluding bonuses) of 2.5% in Q3 (up from 1.2% in the same period of 2014). Our GDP forecasts are consistent with employment growth of 1.4% this year and 1% in 2016, resulting in a fall in the unemployment rate to 5.1% next year from an average of 5.4% this year.

Housing market picking up

A gradual strengthening in the housing market is underway after a 'soft patch' in 2014. Both housing transactions and mortgage approvals have picked up recently, increasing by 5.4% and 12.7% year-on-year in September respectively, while new (gross) mortgage lending was up more than 11% on the previous September. Annual house price inflation has also strengthened according to the Nationwide Index, accelerating to 3.9% in October from a recent low of 3.2% in April. Although the Bank of England is set to begin raising interest rates in 2016, it is likely to do so at a gradual pace and rising employment and incomes should continue to support the housing market.

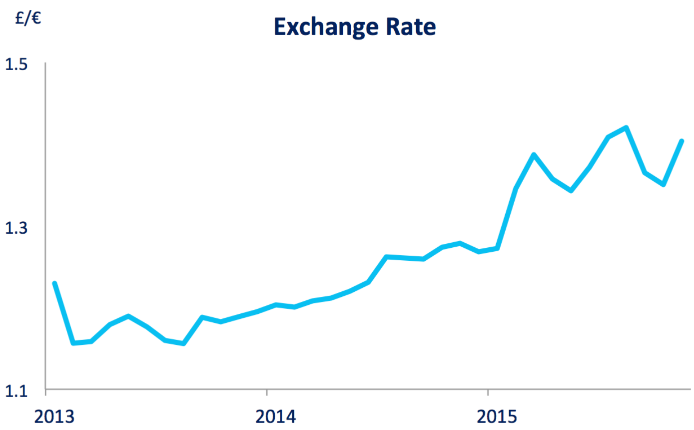
Inflation subdued

As in many other economies, annual consumer price inflation is subdued and stood at -0.1% in September, almost 1.5 percentage points lower than in September 2014. The collapse in oil prices since the middle of last year has resulted in a sharp decline in energy prices, which is dampening overall inflation. The appreciation of sterling, which in trade-weighted terms has risen by almost 20% since early 2013, is also bearing down on the headline number via lower import prices. Both of these effects should prove transitory, however, and the annual inflation rate is likely to move up during 2016. Firmer wages as the economy moves towards full employment will also put upward pressure on prices. Accordingly, inflation is projected to average 1.2% in 2016 after 0% this year.



Sterling to strengthen against the euro

The Bank of England's Monetary Policy Committee (MPC) left interest rates unchanged at 0.5% in November, though one member voted for a 0.25% hike. Its latest Inflation Report sees continued growth in 2016-2017, with unemployment falling further and inflation rising to slightly above the 2% target by end-2017. Given this, we expect the MPC to begin raising rates over the first half of 2016, though the market is not 'pricing in' a first full 25bps hike until Q4 of next year. The prospect of rising UK interest rates, alongside a probable near-term easing of monetary policy in the Euro area, is likely to see sterling strengthen against the euro. However, uncertainty regarding the UK's membership of the EU may at some point begin to weigh on the currency.



Budget deficit falling

The budget deficit, or public sector net borrowing (PSNB), peaked at 10.2% of GDP in the financial year (FY) 2009-2010 before falling to 4.9% in the FY ending March of this year. The Office for Budget Responsibility envisages the PSNB declining to 3.7% in FY2015-2016 and falling steadily thereafter, with a small surplus recorded by the end of this decade. Public sector net debt is also projected to decline, from just under 81% of GDP in the last financial year to 71.5% by end-March 2020. Using EU measures, the general government deficit is expected to average 4.3% and 2.8% of GDP in calendar years 2015 and 2016 respectively (down from 5.8% in 2014), while the gross government debt to GDP ratio is forecast to decline to 87.9% this year (from just over 89% in 2014) and to 87.1% in 2016.

Northern Ireland economy

The Composite Economic Index of activity, published by the Northern Ireland Statistics and Research Agency, rose by 1.7% year-on-year over the first half of 2015, following a full year increase of 1.1% in 2014. This rise in activity was driven by the private sector, which saw broad-based gains across services, manufacturing and construction, offsetting a decline in the public sector (reflecting a fall in public sector employment). The latest PMI data suggest private sector output expanded again in Q3, with the Business Activity index rising to 52.2 from 51.4 in the second quarter. Employment fell slightly to 816,000 over the year to the third quarter, leaving the unemployment rate little changed at 5.9% - the latter is down from a peak of over 8% in 2013.

Risks to the outlook

As always, there are risks to the economic outlook. On the downside, a pronounced slowdown in the global economy could weigh on UK exports, while increased uncertainty regarding the UK's continued membership of the EU may prompt businesses to postpone investment, both of which would weigh on economic growth. In addition, there is uncertainty about how households and businesses might respond to an increase in the Bank of England interest rate. On the other hand, earnings may pick up more strongly than expected as the labour market tightens, boosting consumer spending and GDP growth.

THE UK ECONOMY

Bank of Ireland

SOLID GDP GROWTH

2014	2015f	2016f
2.9%	2.4%	2.4%

Underpinned by ...

Strong Consumer Spending

Main driver of growth

Confidence at a high level

Retail Sales
6.5% YoY in Sept 2015

Subdued inflation supporting spending power

Consumer Spending
2014: 2.6%
2015f: 2.9%
2016f: 2.6%

... on the back of an ...

Improving Labour Market

Getting close to ‘full employment’

YoY 3 months to Sept 2015
419,000 net job gains

Earnings (ex. bonuses) 2.5%

Unemployment rate falling

6.2% 2014
5.4% 2015f
5.1% 2016f

Employment
2014: 2.3%
2015f: 1.4%
2016f: 1.0%

... with low interest rates supporting ...

Increasing Investment

Investment also benefitting from strong domestic demand and the need to expand capacity

Investment
2014: 7.5%
2015f: 4.0%
2016f: 5.0%

... and ...

Exports Picking Up

Both goods and services exports YoY in H1 2015

Headwind from strong £

Exports
2014: 1.8%
2015f: 3.2%
2016f: 3.2%

Prepared by: Bank of Ireland Economic Research Unit
Sources: Bank of Ireland, Office of National Statistics, GfK

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