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The economy and construction in a Brexit world

CIC Economic and Policy Forum

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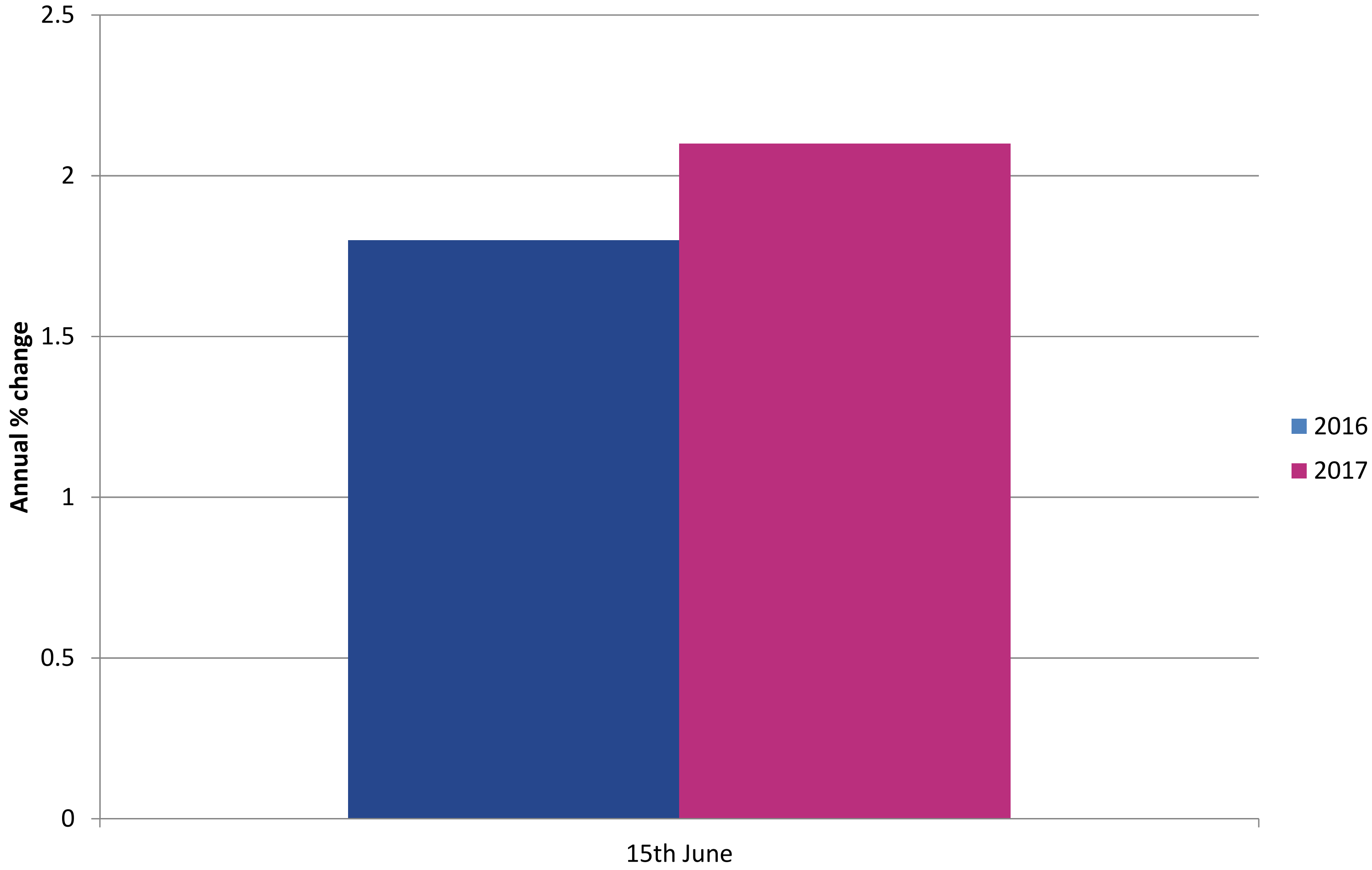
Contents

The pre and post referendum consensus

All fairly rosy for GDP just prior to referendum

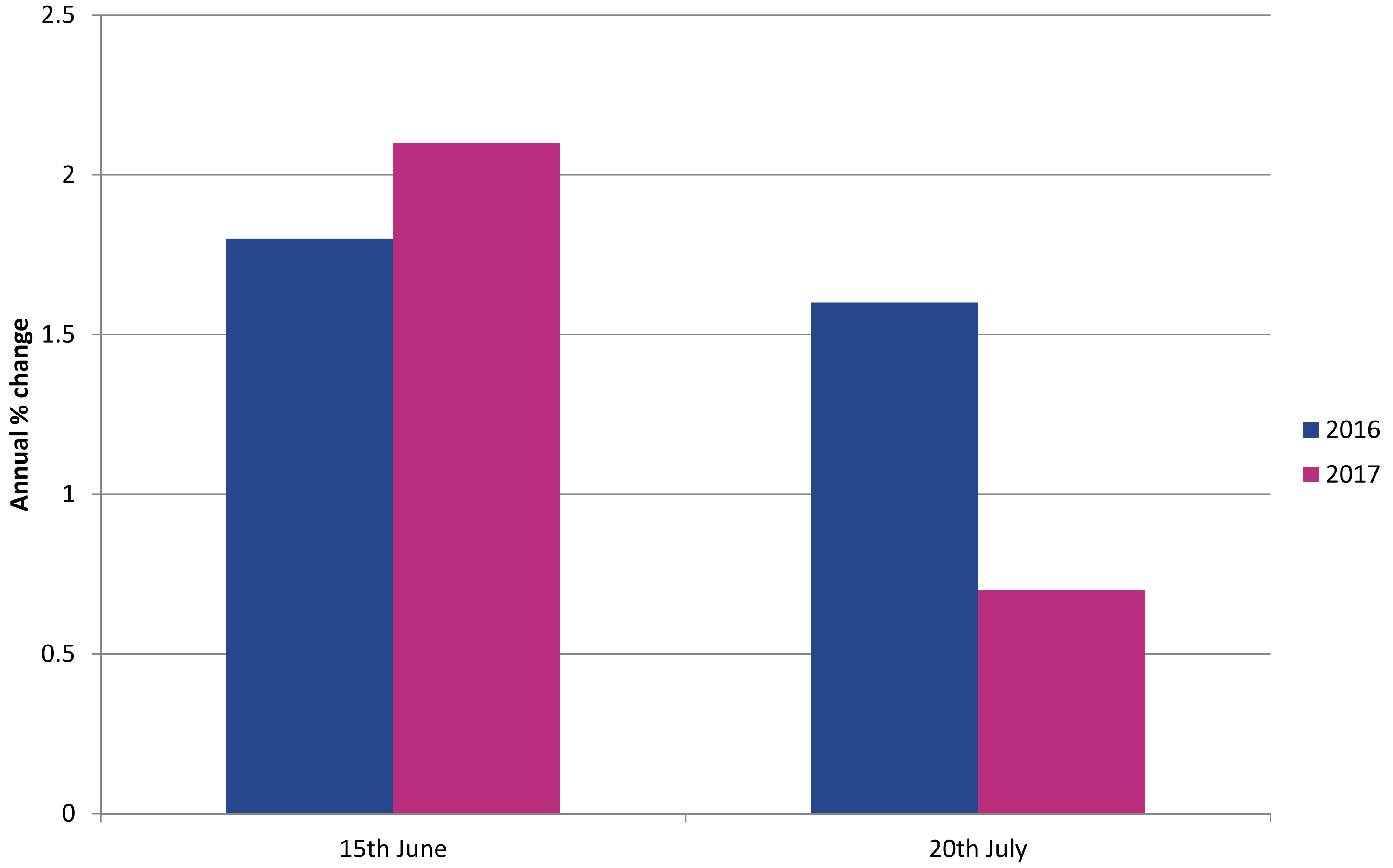
In line with average over past 25 years



Source: Treasury Comparison of Indedendent Forecasts

2017 takes a big hit in the immediate aftermath

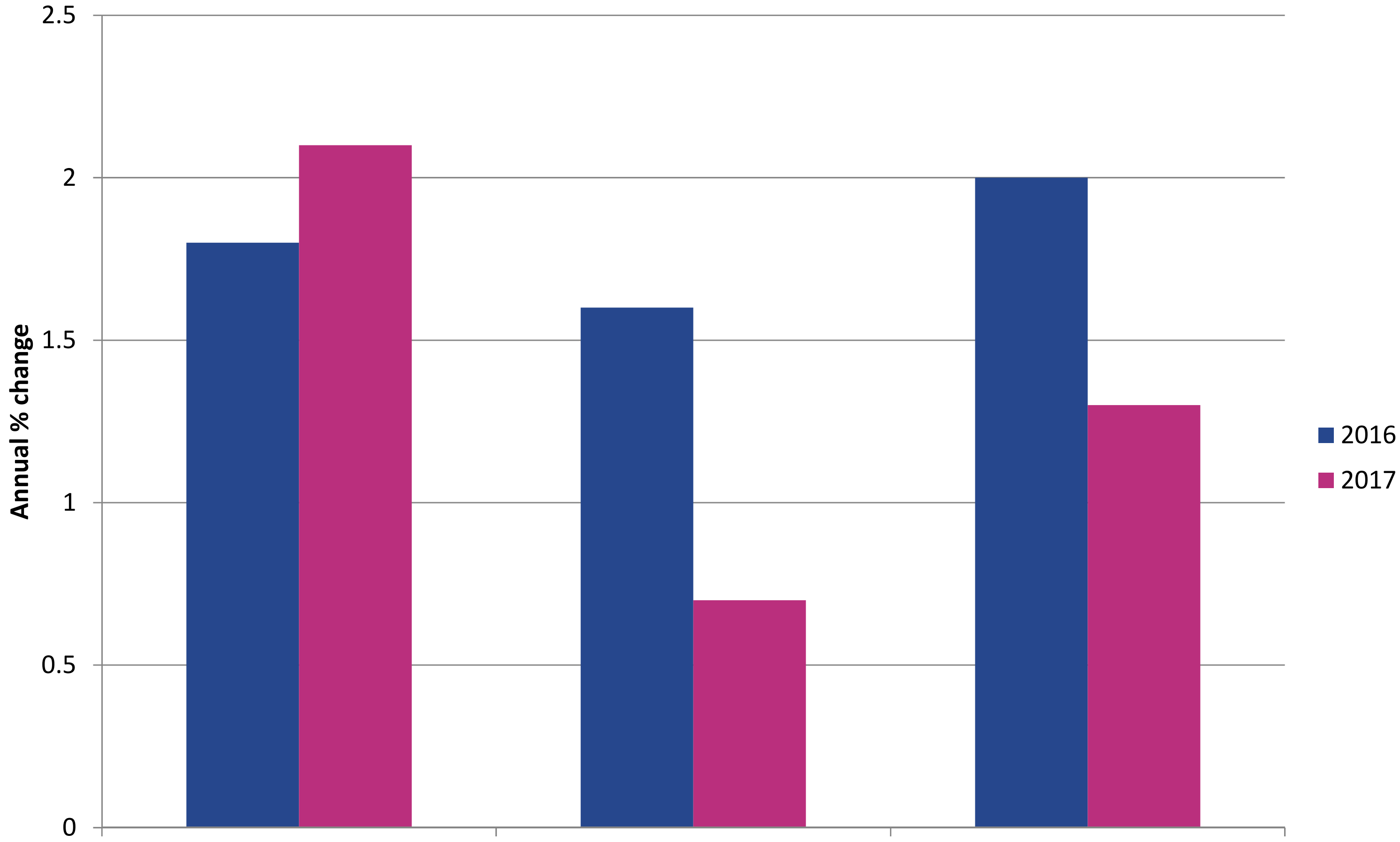
Consensus drops to just 0.7% growth in July



Source: Treasury Comparison of Indedendent Forecasts

Consensus has bounced back for 2017

But not all the way



Source: Treasury Comparison of Indedendent Forecasts

Why?

Uncertainty

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Uncertainty

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- We do not know what Brexit will finally look like
- We do not know what trade agreements we will be able to negotiate over the next few years
- It is a more uncertain world out there

Some recent data

Labour market

The labour market has been softening a little in recent months.

- **Employment fell in both the three months to October and November last year, although it did pick up again in December.**
- **However all the 37,000 increase in the three months to December was in self-employment (13,000), government supported trainees (21,000) and unpaid family workers (4,000) while the number of employees was unchanged.**
- **In the months building up to the referendum employment growth had been exceeding 100,000 a quarter, peaking at 135,000 in the three months to July. It has been trending down since then, declining in the three months to October and November before the December rise.**
- **Unemployment has continued to drop, but only by 7,000 in December to 1.6 million, with the rate remained at 4.8%**

Retail sales

- Retail sales experienced their largest monthly fall since April 2012 last December, with volumes dropping by 1.9%. This compares with a 0.6% decline in December 2015 and a 0.9% rise in December 2014.
- However, they were still 1.2% up three months on three months and 5.6% higher than a year ago.
- Predominantly food stores sales volumes struggled in the final quarter of 2016. Weak sterling is increasing the price of food imports and inflation in the sector rose sharply in December.
- Department stores sales volumes have grown robustly in the last couple of years, but a poor outturn in December resulted in a contraction in the final quarter of the year.
- Clothing & footwear stores sales volume growth has improved somewhat since April, though this unwound in December.
- Household goods stores: Aside from December, sales volumes have grown strongly in the final quarter of the year.

Inflation

- Consumer price inflation (CPI) rose by 1.8% in the year to January, up from 1.6% in December. CPI is the highest it has been since June 2014, and is quickly approaching the Bank of England's 2% target.

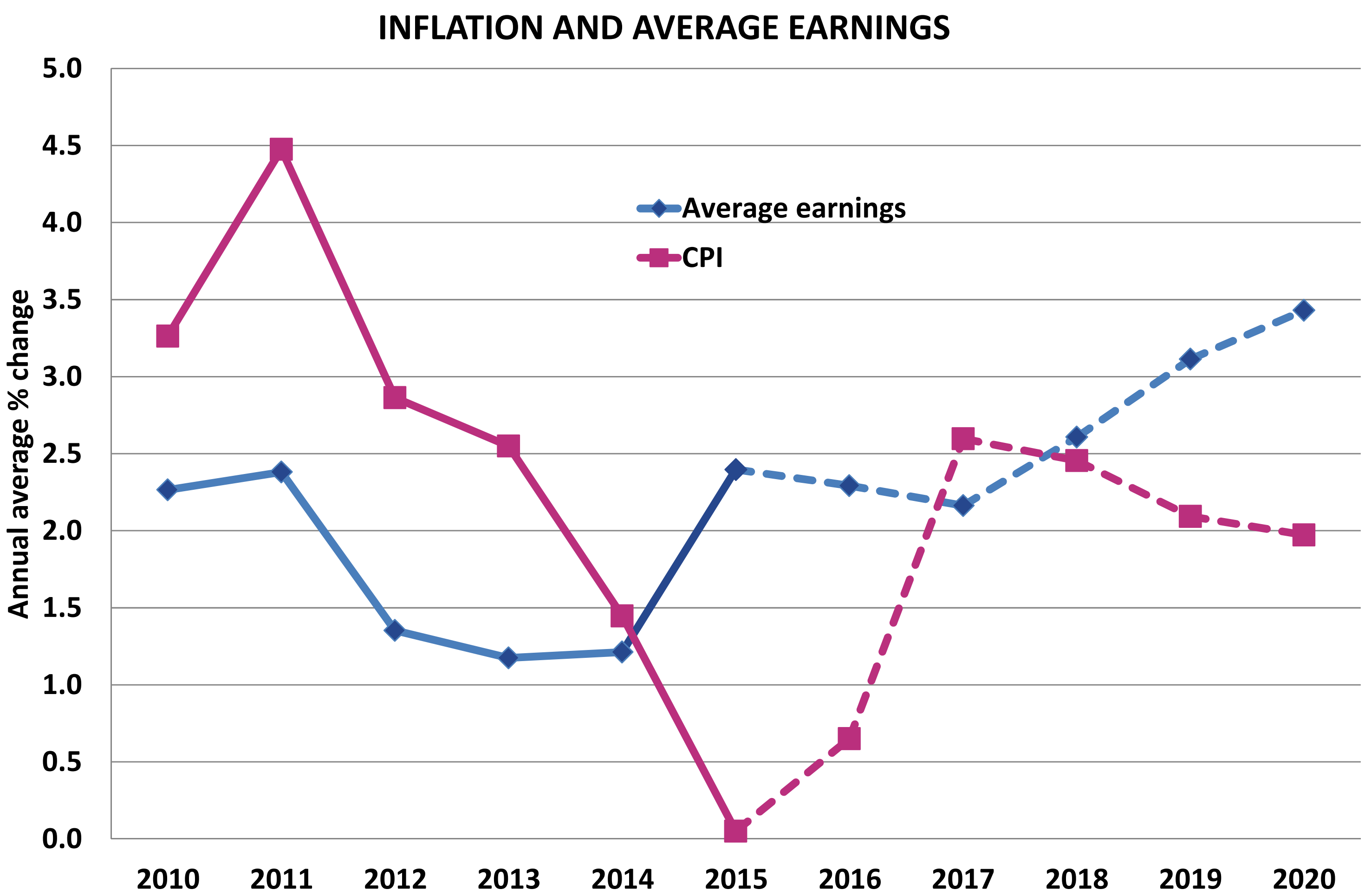
- The slump in the value of sterling, and the associated increases in import costs are driving up prices domestically. Goods inflation increased from 0.7% in December to 1.1% in January. Within the goods industries, the transport and food sectors that rely heavily on imports drove the increase in CPI. In the services industries, that are less impacted by import prices, inflation increase by just one point, from 2.5% to 2.6%.

- The main upward contribution to the 12-month rate came from the transport sector. The largest upward effect came from motor fuels, with prices rising by 3.4% between December 2016 and January 2017, having fallen by 2.6% a year earlier. Over the last year the global oil price has risen from $33 a barrel, to around $55, and could rise further over the coming year as OPEC cuts production.

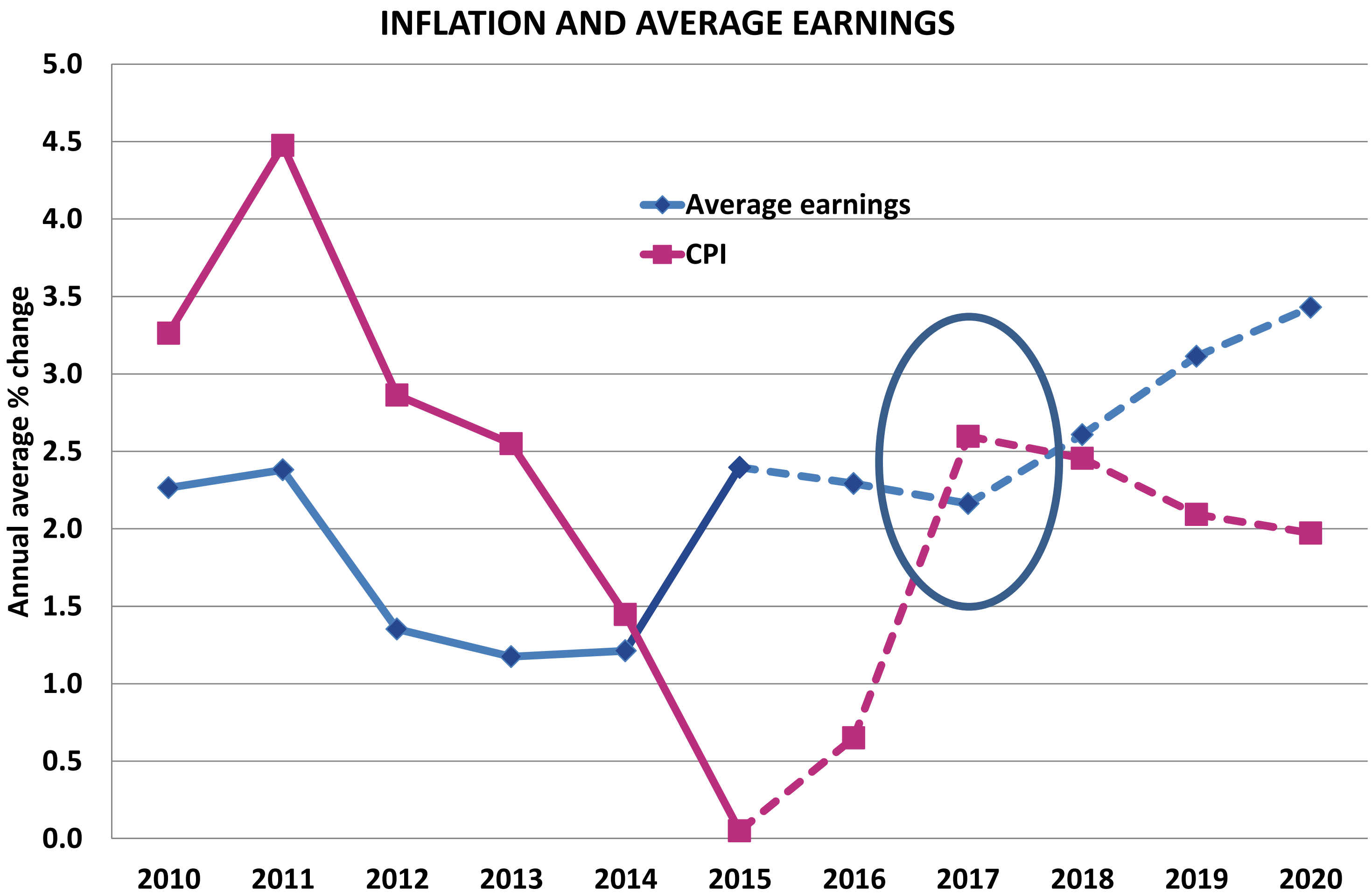
- Producer price inflation statistics released alongside the consumer price statistics showed that the price for materials and fuels paid by UK manufacturers for processing (input prices) rose by 20% in January, compared to a year earlier. It is difficult to see how manufacturers can absorb price rises of this magnitude without passing on some of the increase in costs to consumers. Indeed, in January output prices rose by 3.5%, up from 2.8% in December.

Our central economic prognosis

Disposable incomes come under pressure again…

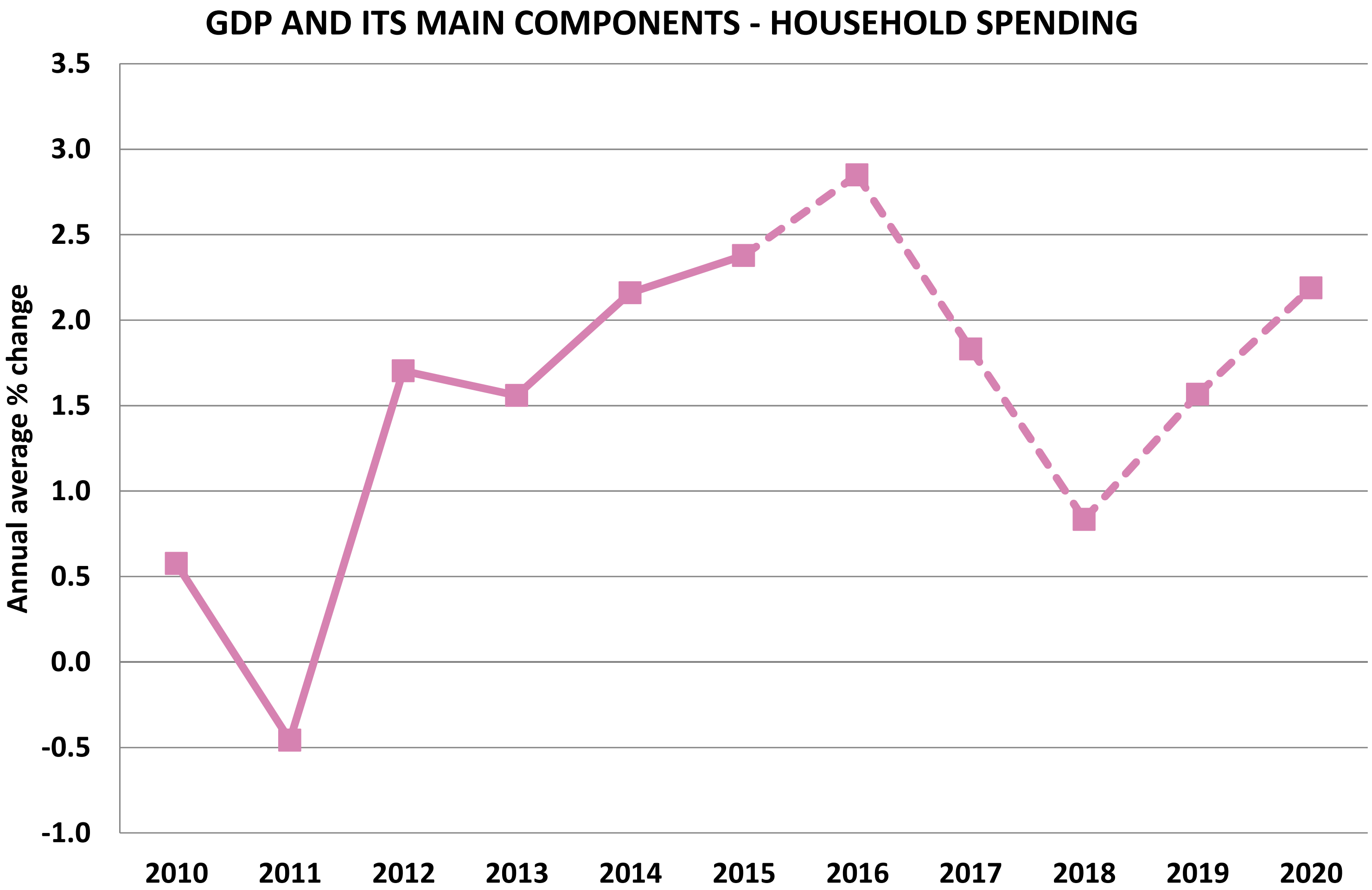


…with inflation exceeding average earnings growth for a while



This will impact household spending

which accounts for 65% of GDP on the expenditure measure



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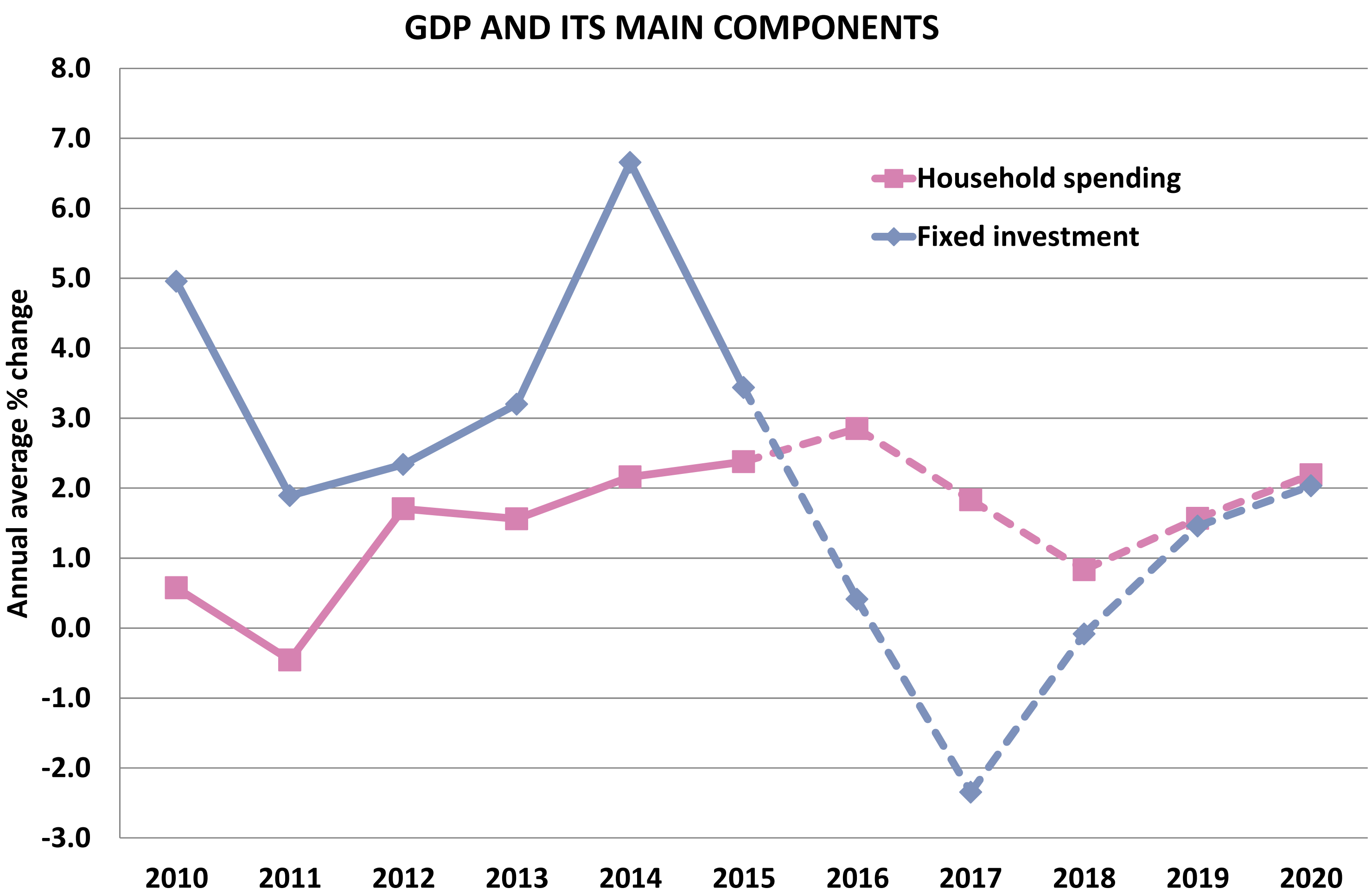
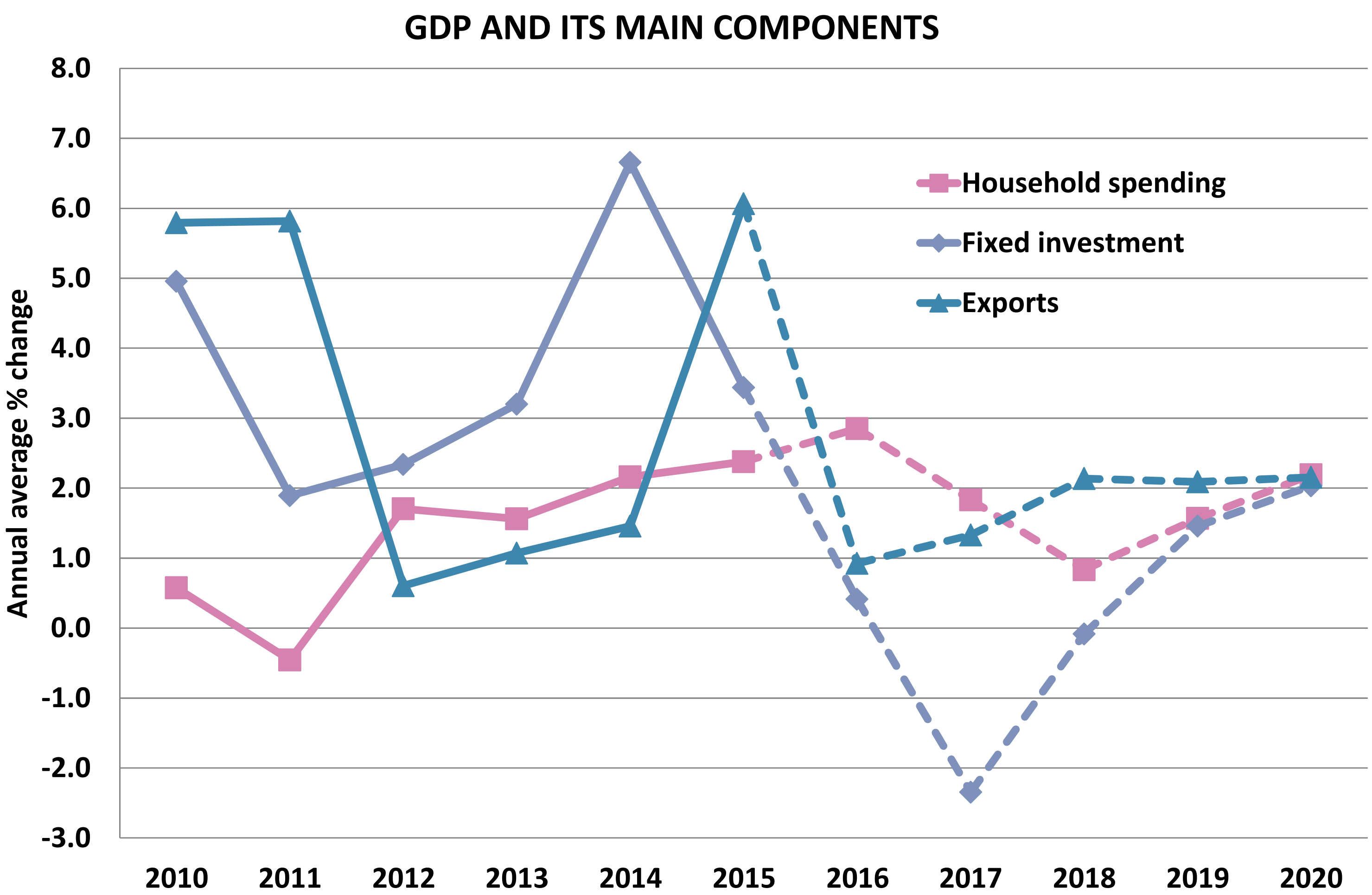
Investment growth likely to turn negative in 2017

and stagnate in the following year

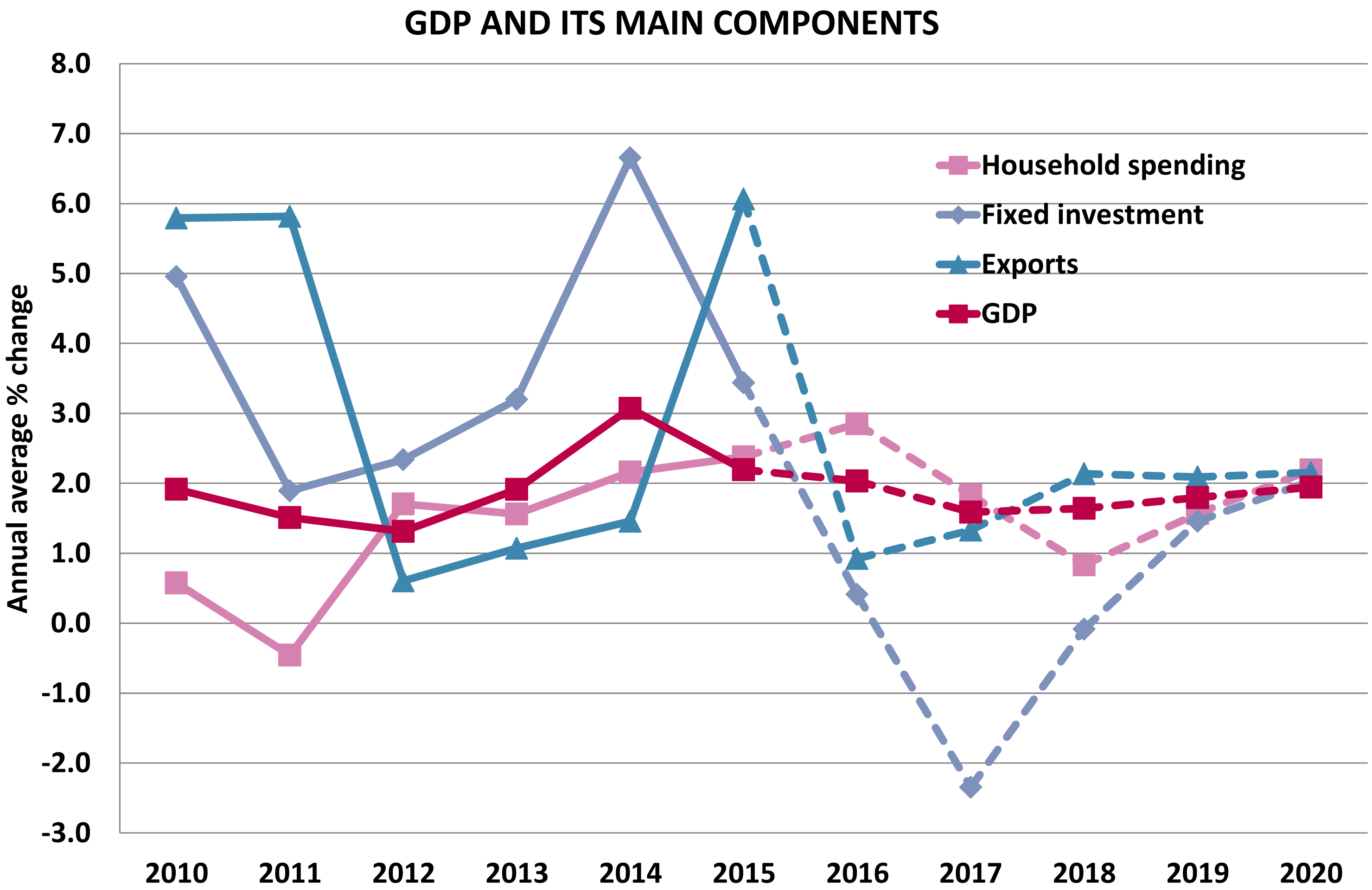


Export growth is sluggish
despite the fall in sterling



GDP growth below trend for next three years

taking trend as 2% average between 1990 and 2015



Our Brexit position

"Our current baseline forecast assumes that a deal will eventually be struck within a 4 year time horizon and it will include some form of trade access to the single market. As it is unlikely that the terms will be as good as the current situation, we have made a small downgrade to our long term export and investment projections, compared to our pre-Brexit vote baseline. No adjustments have been made to underlying population projections in our base case but downside risks clearly exist on this front from a potential slowdown in EU migration."

Construction vulnerabilities

The good news and the not so good news

No 'Brexit' induced recession

Some very big infrastructure projects in the pipeline, including HS2, Hinkley Point and Wylva

Private housing growth continues despite 'Brexit' uncertainties

Forecast highlights

Abandonment of 2020 fiscal target may mean a little more money for public capital projects

A slowdown in commercial construction growth rather than outright decline

Forecast highlights

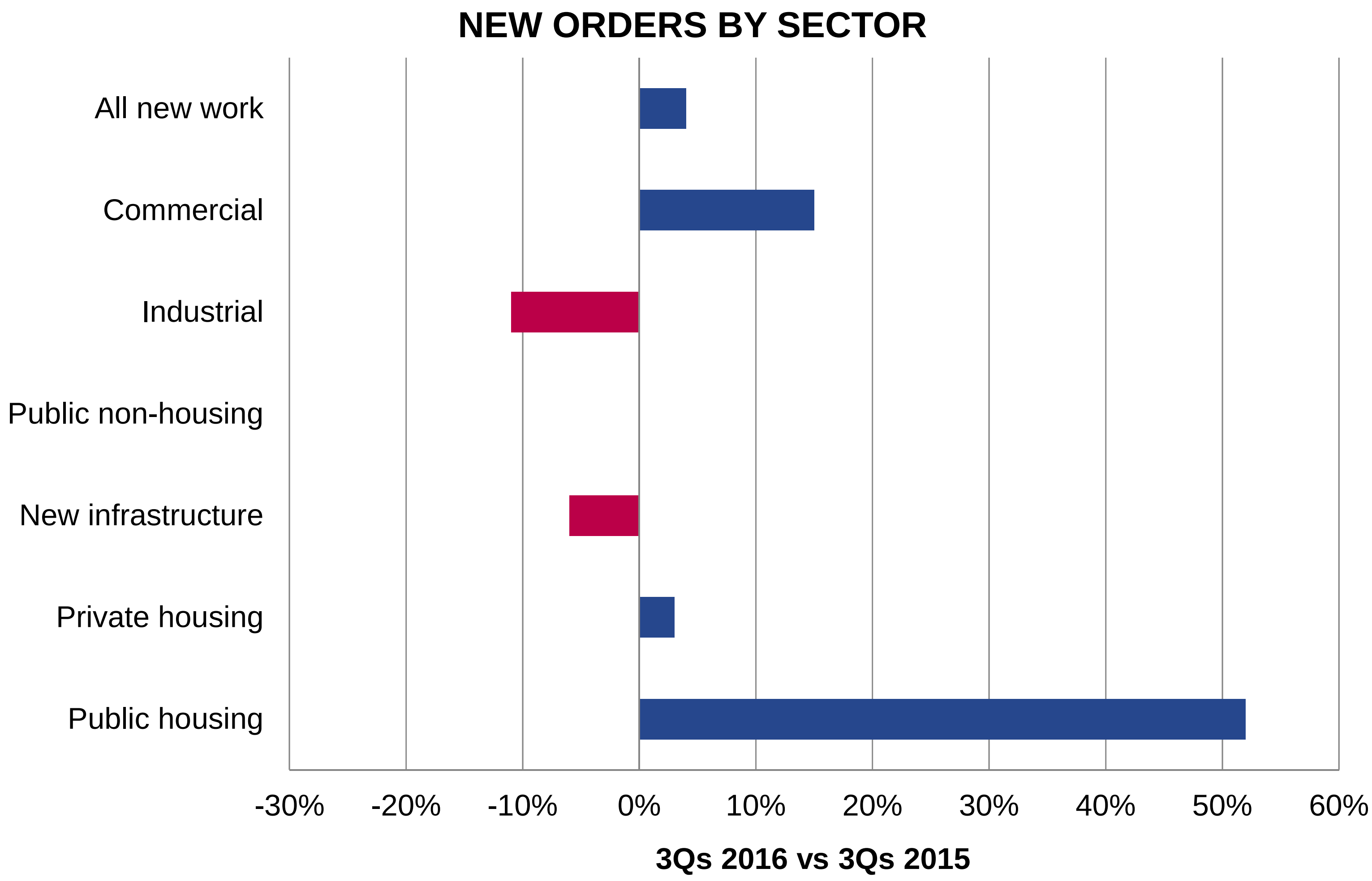
Higher export growth unlikely to mitigate a slowdown in domestic demand for manufacturing

The retail construction sector continues to struggle to show much growth

Forecast highlights

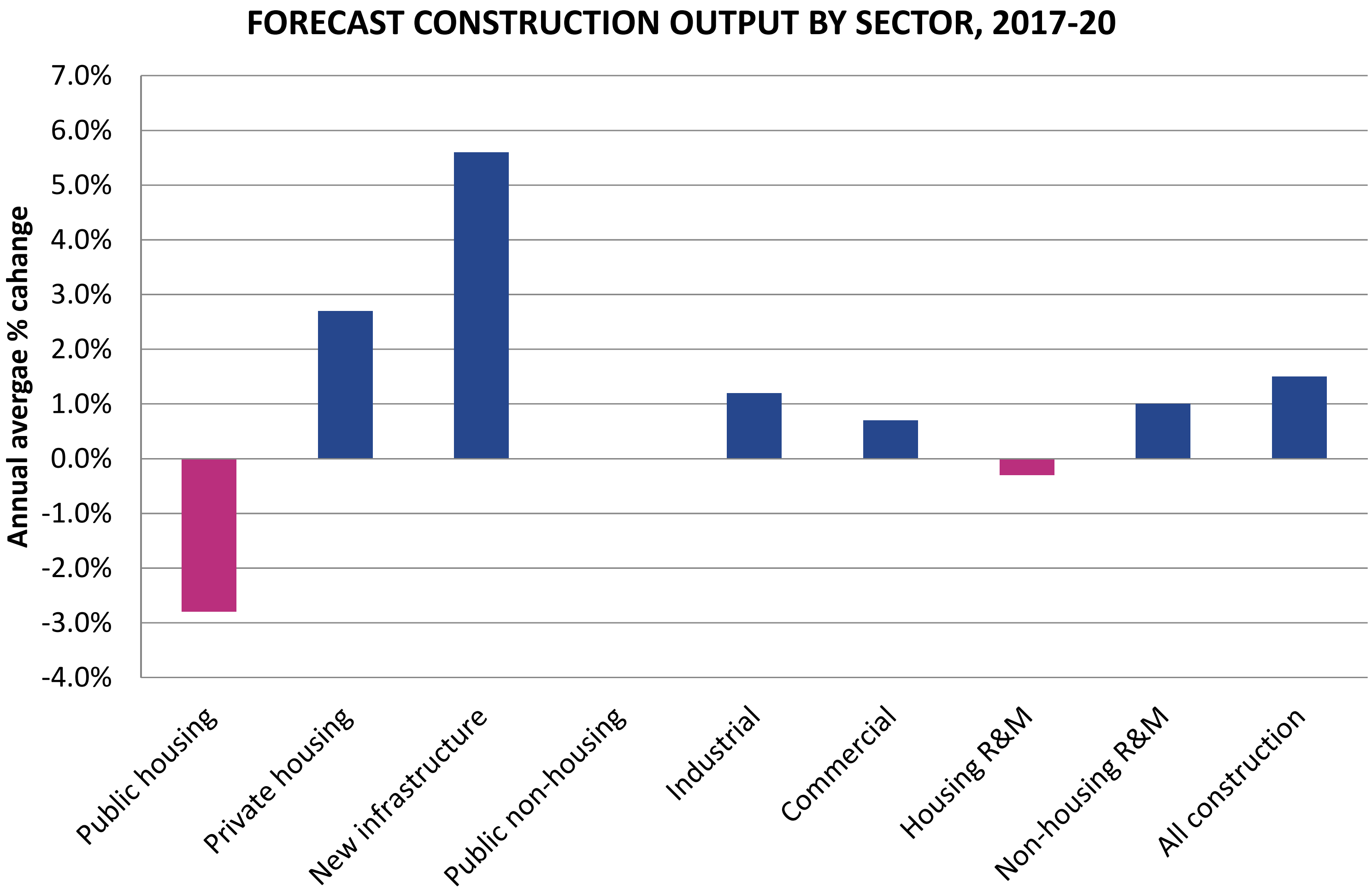
All new orders growth modest in 2016

But significant variation across sectors



Construction output to increase by 1.5% a year on average

with most sectors seeing some expansion



The main headlines

Will the public housing sector exist in 2020 after the proposed deregulation of social house builders and their reclassification to the private sector?

Strong infrastructure growth is predicated on no more slippage on HS2, Hinkley Point and Wylfa

The industrial and commercial sectors are the most vulnerable to declines in business investment

Any benefit from increased exports due to the decline in the value in sterling is likely to be more than counteracted by weaker domestic demand growth

The London commercial property development cycle is probably at its peak or past it anyway thus a weaker business investment scenario will sharpen the downward curve. Regional markets will probably hold up better

Weaker disposable income growth and labour market are likely to impact housing RM&I, at least in the short term

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