

▶ A NEW ECONOMY
PUBLICATION

A red watering can is positioned in the upper left quadrant, tilted as if pouring. Below it, four small, round, terracotta pots containing various types of green succulents are arranged on a grey surface. A vertical red bar runs down the center of the page, with a diagonal cutout at the top and bottom.

BDO MONTHLY BUSINESS TRENDS INDICES

April 2017

INTRODUCTION

The BDO Monthly Trends Indices are ‘polls of polls’ that pull together the results of all the main UK business surveys. This edition of the BDO Business Trends Report gives the Index numbers at the beginning of April 2017, using the results from business surveys that were carried out between the first and last days of the previous month.

Summary and key findings

Index	Current reading	Movement in month	Index level
BDO Output Index	xx	▽	95.9 in March from 97.2 in February
BDO Optimism Index	✓	▽	102.2 in March from 103.3 in February
BDO Inflation Index	✓✓	△	105.2 in March from 104.0 in February
BDO Employment Index	✓	△	102.0 in March from 101.9 in February

KEY: ✓ = above 100; ✓✓ = above 100 and (joint) highest in 12 months
x = below 100; xx = below 100 and (joint) lowest in 12 months

KEY FINDINGS

The BDO Output Index fell to 95.9 in March from 97.2 in February 2017. Declines in both the manufacturing and services sub-indices contributed to the fall. Higher input costs and fading domestic demand may be weighing heavy on UK firms. After finishing 2016 on a strong note, there are signs of fragility in the UK economy in 2017.

Although services contributed heavily to GDP growth in 2016, the sector has started the year poorly. From December to January, economic output across service industries declined 0.1% according to data from the ONS, with weak performances from the retail and restaurant industries. According to the BDO Service Optimism Index, confidence in the sector fell to 100.6 in March from 103.0 in February.

The outlook for the manufacturing sector is brighter. Although the Output Index declined slightly in March, the Manufacturing Optimism Index rose to 110.6 in March, its highest point since February 2015. The sector ended 2016 on a high note, as the weaker pound and strong international demand drove growth. Furthermore, order books were strong in March according to the latest Markit/CIPS Purchasing Managers' Indices (PMI) data, highlighting a potential rebalancing of the UK economy towards greater exports.

The BDO Inflation Index rose to 105.2 in March, up from 104.0 in February. The Index is now at its highest level since January 2012, as international oil prices and the weaker pound continue to exert upward pressure on prices. Annual Consumer Price Index (CPI) inflation increased to 2.3% in February. By putting considerable pressure on real wages, inflation is likely to limit consumer spending power in 2017. Inflation is also being felt by producers, as rising costs for imported goods and material pushed factory gate prices higher in February.

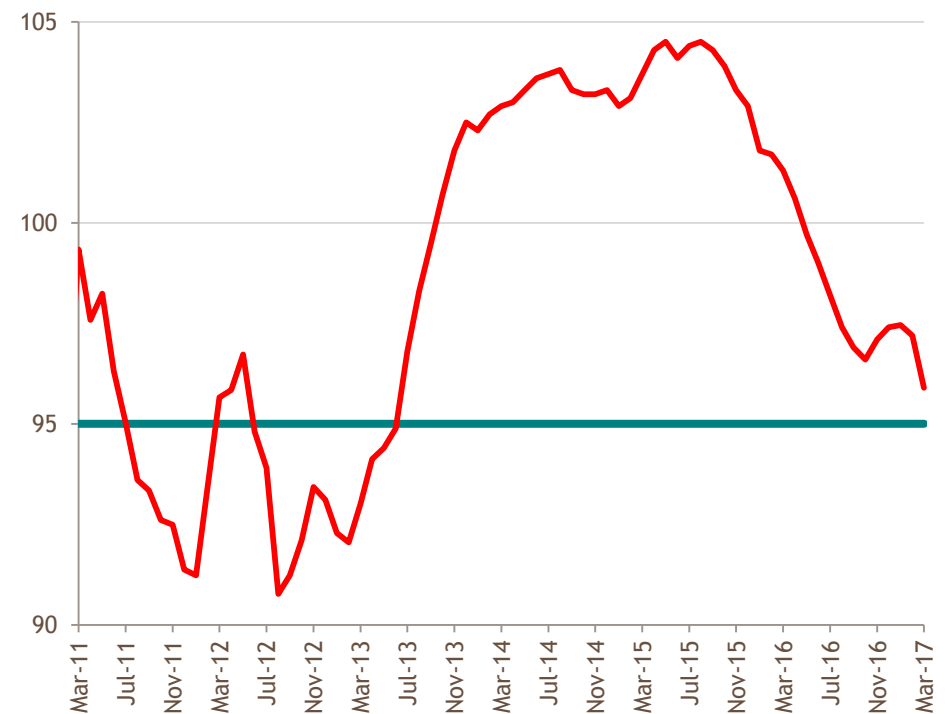
The BDO Employment Index rose slightly to 102.0 in March, up from 101.9 in February. The improvement is reflective of ongoing strength in the UK labour market - in the three months to January 2017, the employment rate remained at a record high of 74.6% and the unemployment rate fell to a four-decade low of 4.7%. However, earnings growth took a step in the wrong direction, growing by a relatively weak 2.2% annually in the three months to January.

OUTPUT INDEX FALLS FURTHER TO LOWEST LEVEL SINCE 2013

- The BDO Output Index saw a significant downturn this month, falling to 95.9 in March compared to 97.2 in February.
- Although the manufacturing sub-index fell from 97.7 in February to 97.2 in March, the main driver of the decrease was a 1.4 point fall in the Services Output Index to 95.7. According to the Index, the service sector is now at its lowest level since mid-2013.
- The service sector is under significant pressure from rising costs and fading consumer demand. With inflation outstripping nominal wage growth faster than many had expected, household expenditure is likely to be far weaker in 2017 than last year.
- This is dampening retail prospects - in the three months to February, retail volumes bought shrank 1.4% compared to the previous three-month period, the sector's worst performance in seven years.
- Overall, the service sector shrank 0.1% between December and January 2017, due to poor performances from restaurants and retail.
- The manufacturing sector also lost some of its momentum according to the latest PMI figures. Although the sector expanded for its eighth consecutive month, March's growth rate was the slowest in the past four months. Mounting cost pressures, stemming from the weaker pound and higher international oil prices, may be weighing down on producers.

BDO OUTPUT INDEX

100 = average trend growth. Greater than 95 = positive growth



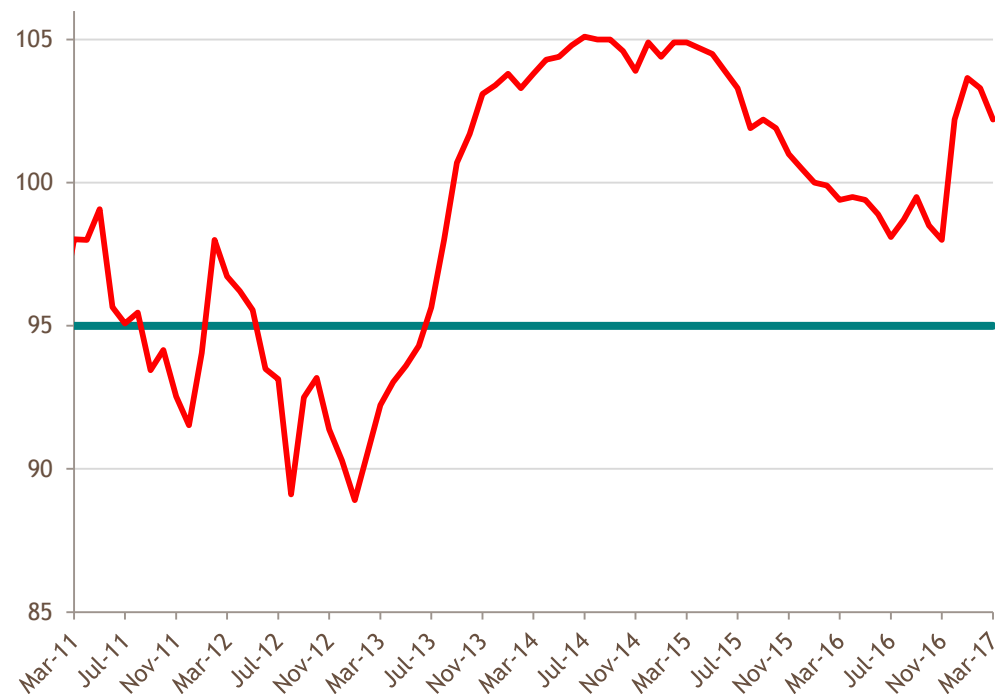
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

OPTIMISM DIPS BUT REMAINS ABOVE LATE 2016 LEVELS

- The BDO Optimism Index also took a step backwards in March, falling to 102.2 from 103.3 in February.
- Optimism levels are still higher than those posted in late 2016, reflecting strong end-of-year GDP figures. On quarterly terms, total UK output expanded 0.7% in the last quarter of 2016 compared with Q3, ending the year on its highest note.
- However, there are signs that the service sector, the greatest driver of GDP in growth in 2016, may be in for a weaker 2017 as domestic demand is likely to soften.
- With services making up around four-fifths of GDP, a consumer slowdown is worrying for the UK economy. However, prospects for greater goods exports may help rebalance the economy in 2017.
- With the weaker pound making UK goods more price-competitive, manufacturers are likely to feel a boost. The UK's current account deficit roughly halved from Q3 to Q4 2016. Manufacturing confidence on the BDO sub-index rose to 110.6 in March, its highest level since February 2015.
- Strong international demand should also support UK exports. In particular, the Eurozone economy showed further signs of strengthening as manufacturing PMIs reached a six-year high, and unemployment fell to an eight-year low across the bloc according to the latest data.

BDO OPTIMISM INDEX

100 = average trend growth. Greater than 95 = positive growth



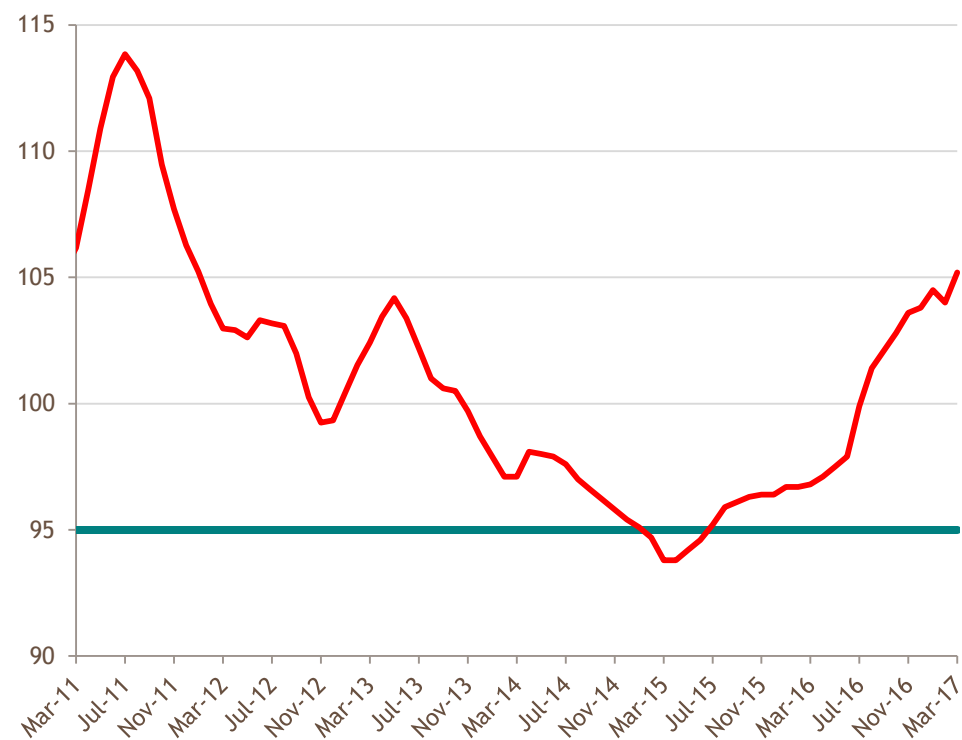
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

INFLATION BACK ON THE UP AS CONSUMERS FEEL THE SQUEEZE

- After a slight fall in February, the BDO Inflation Index rose to 105.2 in March, up from 104.0 in February. The Index is now at its highest level since January 2012.
- The uptick comes as no surprise with continued rises in both consumer and producer inflation in recent months.
- The Office for National Statistics (ONS) showed that Consumer Price Index (CPI) inflation rose to 2.3% in February, a significant rise from 1.8% in January.
- While prices increased across a broad range of goods and services, higher food and fuel costs particularly drove higher inflation in February.
- Consumer demand will be eroded by such inflation, already seen in the sluggish start to the year for the retail sector.
- For producers, inflation is also exerting significant pressure. The cost of imported goods and materials rose 19.0% in the year to February, contributing to a 3.7% rise in factory gate prices.

BDO INFLATION INDEX

100 = average trend growth. Greater than 95 = positive growth



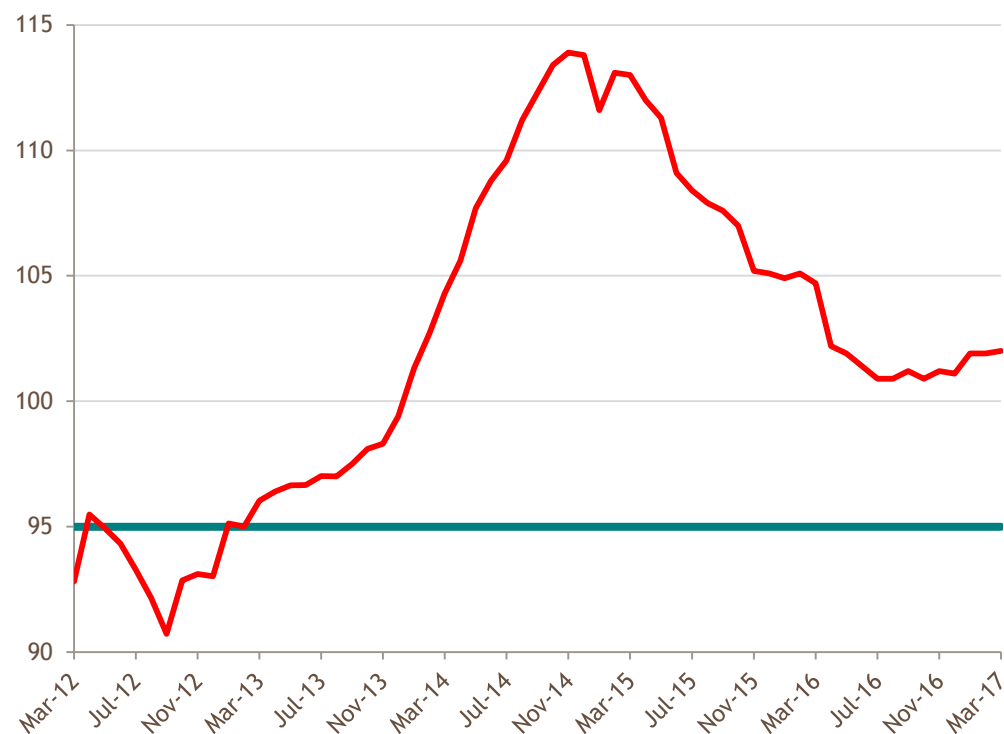
Source: Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

LABOUR MARKET STRENGTHENS BUT WAGE GROWTH SLOWS

- The BDO Employment Index rose marginally from 101.9 in February to 102.0 in March, continuing its recent trend of steady improvements.
- The continuity of the Employment Index reflects the consistent, gradual strengthening in the UK labour market in recent months. In the three months to January, the unemployment rate fell to a four-decade low of 4.7%. The unemployment rate has now not risen since mid-2015.
- Furthermore, the employment rate - the proportion of 16 to 64- year olds in work - remained at 74.6%, its joint highest point on record.
- However, although an increasing number of people are joining the labour market, wage growth remains poor. Typically, low unemployment leads to higher wages as workers are in high demand. However, low productivity and flexible contracts mean earnings growth is still weak.
- In the three months to January, annual earnings growth stood at just 2.2%, a notable deceleration from 2.6% posted in the fourth quarter of 2016. This is a particular concern for cash-stripped households, with wages stretched by higher inflation.

BDO EMPLOYMENT INDEX

100 = average trend growth. Greater than 95 = positive growth



Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

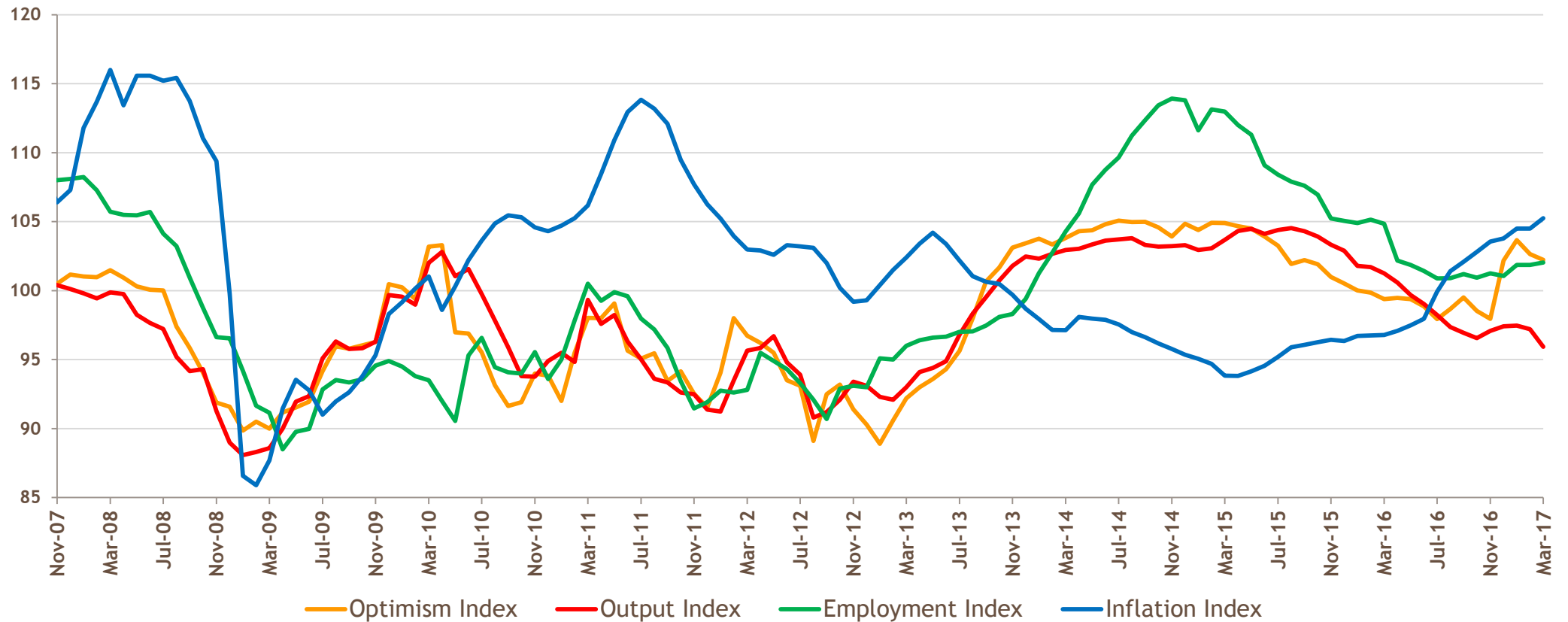
BDO INDICES TO LATEST MONTH

		Jan 2016	Feb 2016	Mar 2016	Apr 2016	May 2016	Jun 2016	Jul 2016	Aug 2016	Sep 2016	Oct 2016	Nov 2016	Dec 2016	Jan 2017	Feb 2017	March 2017
The BDO Optimism Index	Total	100.0	99.9	99.4	99.5	99.4	98.9	97.9	98.7	99.5	98.5	98.0	102.2	103.7	103.3	102.2
	Manuf.	90.2	90.4	87.0	87.3	86.1	83.8	81.0	85.8	91.3	92.0	94.1	99.4	102.2	105.1	110.6
	Service	101.9	101.7	101.8	101.8	102.0	101.8	101.2	101.2	101.1	99.8	98.7	102.7	103.9	103.0	100.6
The BDO Output Index	Total	101.8	101.7	101.3	100.6	99.7	99.0	98.2	97.4	96.9	96.6	97.1	97.4	97.5	97.2	95.9
	Manuf.	94.7	95.0	96.0	94.4	95.9	95.8	95.4	93.9	95.1	94.1	94.9	97.4	96.4	97.7	97.2
	Service	103.2	103.0	102.3	101.8	100.4	99.7	98.8	98.0	97.3	97.0	97.5	97.4	97.7	97.1	95.7
The BDO Inflation Index	Total	96.7	96.7	96.8	97.1	97.5	97.9	99.9	101.4	102.1	102.8	103.6	103.8	104.5	104.0	105.2
The BDO Employment Index	Total	104.9	105.1	104.8	102.2	101.9	101.4	100.9	100.9	101.2	100.9	101.2	101.1	101.9	101.9	102.0

APPENDIX: INFLATION CONTINUES ITS ASCENT AS OUTPUT SLOWS

BDO INDICES

100 = average trend growth. Greater than 95 = positive growth



Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

FOR FURTHER DETAILS

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METHOD NOTES

The BDO Monthly Business Trends Indices are prepared on behalf of BDO LLP by the Centre for Economics and Business Research, a leading independent economics consultancy. Cebr has particular strengths in all forms of macroeconomic and market forecasting for the UK and European economies and in the use of business survey techniques.

The indices are calculated by taking a weighted average of the results of the UK's main publicly available business surveys. It incorporates the results of the quarterly CBI Industrial Trends Survey (and the CBI Monthly Trends Enquiry which is carried out in the intervening months); the Bank of England Agents' summary of business conditions; the Markit / the Chartered Institute of Purchasing and Supply's Surveys of Manufacturing and of Services; the DG ECFIN industrial and services confidence indices; the RICS construction market survey; the Manpower Employment Outlook Survey; and Eurostat's monthly business surveys.

Taken together the surveys cover over 4,000 different respondent companies, covering a range of different industries and of different business functions. Together they make up the most representative measure of business trends available.

The surveys are weighted together by a three-stage process. First, the results of each individual survey are correlated against the relevant economic cycles for manufacturing and services. This determines the extent of the correlations between each set of survey results and the relevant timing relationships. Then the surveys are weighted together based on their scaling, on the extent of these correlations and the timing of their relationships with the relevant reference cycles. Finally, the weighted total is scaled into an index with 100 as the mean and 95 as the level dividing expansion from contraction.

The results can not only be used as indicators of turning points in the economy but also, because of their method of construction, be seen as leading indicators of the rates of inflation and growth.