

▶ A NEW ECONOMY
PUBLICATION

A red watering can is positioned in the upper left quadrant, tilted as if pouring. Below it and to the right are four small, round, terracotta pots, each containing a different variety of green succulent. The background is a solid, light grey color. 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

February 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 February 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	x	▲	97.5 in January from 97.4 in December
BDO Optimism Index	✓✓	▲	103.7 in January from 102.2 in December
BDO Inflation Index	✓✓	▲	104.5 in January from 103.8 in December
BDO Employment Index	✓	▲	101.9 in January from 101.1 in December

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 rose to 97.5 in January 2017 from 97.4 in December 2016. The rise, which was driven by service sector output growth, is the the third consecutive monthly increase in the output index.

The latest BDO indices point to an improvement in the economic outlook for the UK over the year ahead. A range of indicators - from GDP growth to the unemployment rate - highlight resilience in the UK economy, which has fared considerably better than many predicted it would following the Brexit vote in June. Consistent growth and a strong finish to 2016 appear to have inspired confidence in the year ahead: the BDO Optimism Index rose to 103.7 in January, after standing at 102.2 in December.

With gathering momentum in the global economy, and key export markets continuing to post robust growth, prospects are bright, with the BDO Optimism Index at its highest level since June 2015. A key economic factor is the weaker pound, which boosts UK export competitiveness but pushes up import costs to put pressure on both consumers and companies - a double-edged sword

The BDO Inflation Index stood at 104.5 in January, up from 103.8 in December. Producer costs have been rising sharply in recent months, as a consequence of sterling's depreciation and a recovery in global oil prices. The effect on consumers has been pronounced, with prices rising across a wide range of goods and services. In particular, petrol and diesel costs have risen to their highest levels since December 2014. Over 2017, high inflation will put pressure on real wages, weakening household spending growth.

Strong indicators in the labour market have been reflected in an improvement in the BDO Employment Index, which rose 101.9 in January, up from 101.1 in December. The Index is now at its highest level since May 2016. Unemployment remained at a low 4.8% in the three months to November, and the employment rate stood at 74.4%, just 0.1 percentage points off the record high posted earlier in 2016.

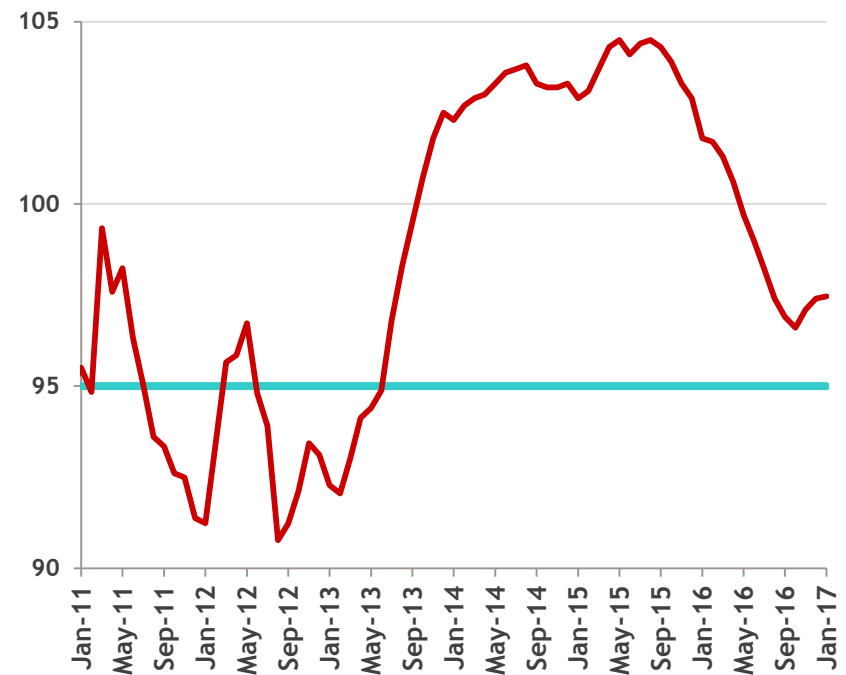


OUTPUT INDEX RISES FOR 3RD MONTH RUNNING

- The BDO Output Index rose slightly from 97.4 in December 2016 to 97.5 in January 2017, a third consecutive monthly increase, suggesting an improvement in the short-term economic prospects in the UK.
- The increase in the BDO Output measure was driven by the service sub-index which increased to 97.7 from 97.4 in December.
- Manufacturing output, by contrast, fell to 96.4 in January, a 1.0 point fall from December. However, the Optimism Index suggests a turnaround in prospects is on the way.
- Given services make up a high proportion of total output, the rise in the service sector was enough to outweigh the dip in manufacturing output.
- There have been mixed fortunes in the manufacturing industry in recent months. UK car production reached a 17-year high in 2016, and the aerospace industry is another success story - air and spacecraft production increased 8% year-on-year in the three months to November 2016.
- However, Britain's manufacturers are under pressure from rising input costs. January's Markit/CIPS Purchasing Managers' Index (PMI) showed factory raw material costs rose at their fastest pace since PMI records began 25 years ago, as a result of higher prices for oil, steel and other import costs.

BDO OUTPUT INDEX

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



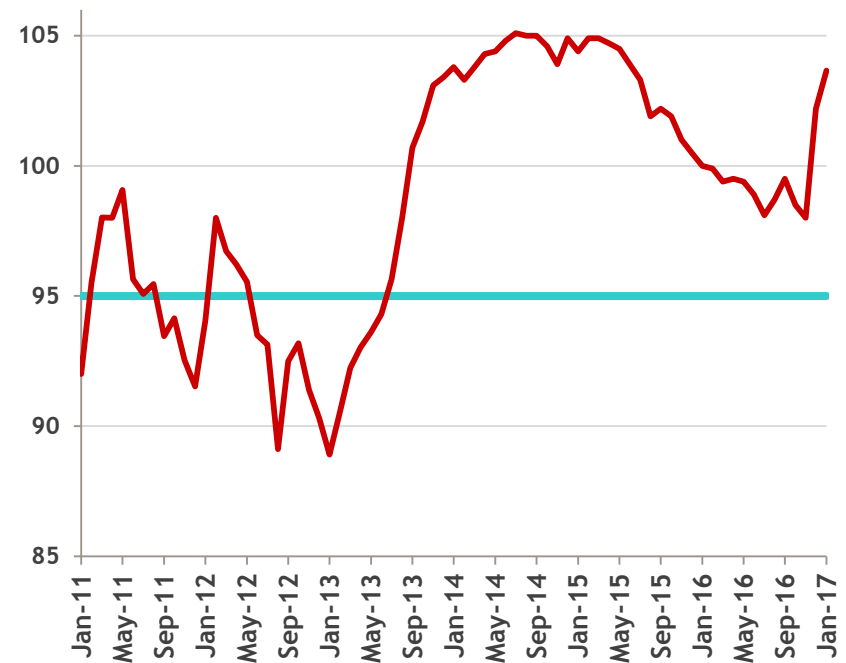
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

GROWTH INSPIRES CONFIDENT START TO 2017

- After ending 2016 strongly, the BDO Optimism Index has risen once again. After standing at 102.2 in December, optimism rose to 103.7 in January. This is the highest reading since June 2015. The Optimism Index increased for both the manufacturing and service sectors.
- The ongoing resilience of the UK economy looks to be underpinning optimism. With 0.6% quarterly GDP growth in Q4 2016, the same rate seen in both Q2 and Q3, hard data continues to defy predictions of a post-Brexit downturn.
- The devaluation of the pound makes UK exports more competitive, boosting prospects for UK manufacturers. However, a weaker sterling is a double-edged sword, as it pushes up the price of imports for firms and consumers alike.
- There are some promising signs on the horizon internationally, with key export markets performing well. The Eurozone economy continues to improve - growth increased to 0.5% in quarter four and unemployment is falling. The Federal Reserve rate rise in December indicates strengthening in the US economy, although there are concerns over Donald Trump's stances on international trade.

BDO OPTIMISM INDEX

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



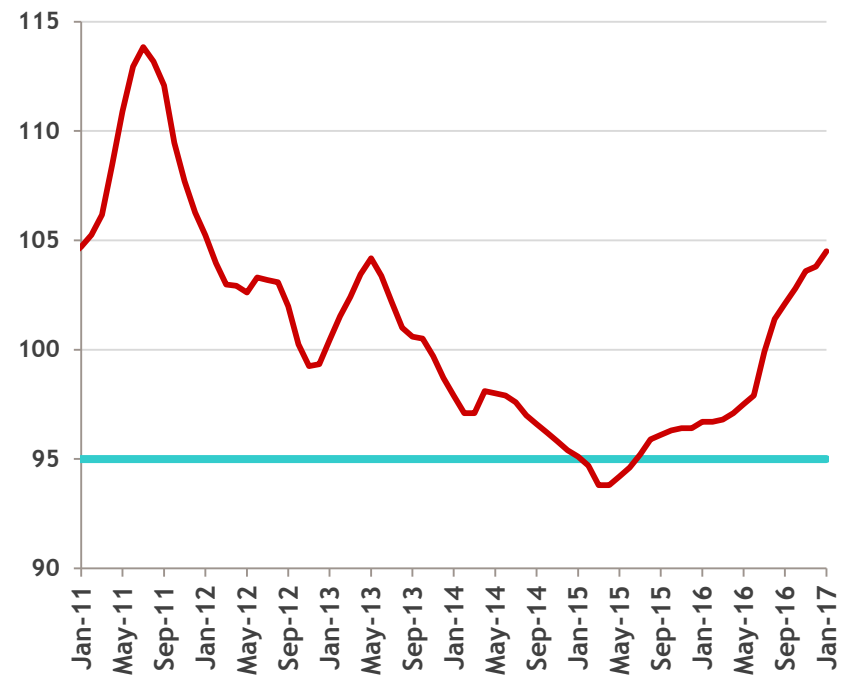
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

PRICE PRESSURES PUSH INFLATION HIGHER

- The BDO Inflation Index rose to 104.5 in January, up from 103.8 in December.
- The depreciation of sterling since the Brexit referendum has been a key contributor to rising prices in the UK. Higher import prices were the main driver of a 15.8% year-on-year rise for producer prices in December; output prices rose 2.7% annually.
- The impact upon consumers has been considerable, with broad-based price increases across goods and services. With inflation likely to overtake wage growth in 2017, consumer spending will be constricted over the coming year.
- Furthermore, the recovery in global oil prices, following OPEC's production cuts in November, puts further upwards pressure on prices. The cost of barrel of Brent crude has risen from a multi-year low of \$29 in January 2016 to over \$55, which affects consumers (for example, though motor fuels) and firms using oil as an input, through indirect effects, such as higher transport costs. As a result, petrol and diesel costs at the pump have hit their highest levels since December 2014.

BDO INFLATION INDEX

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



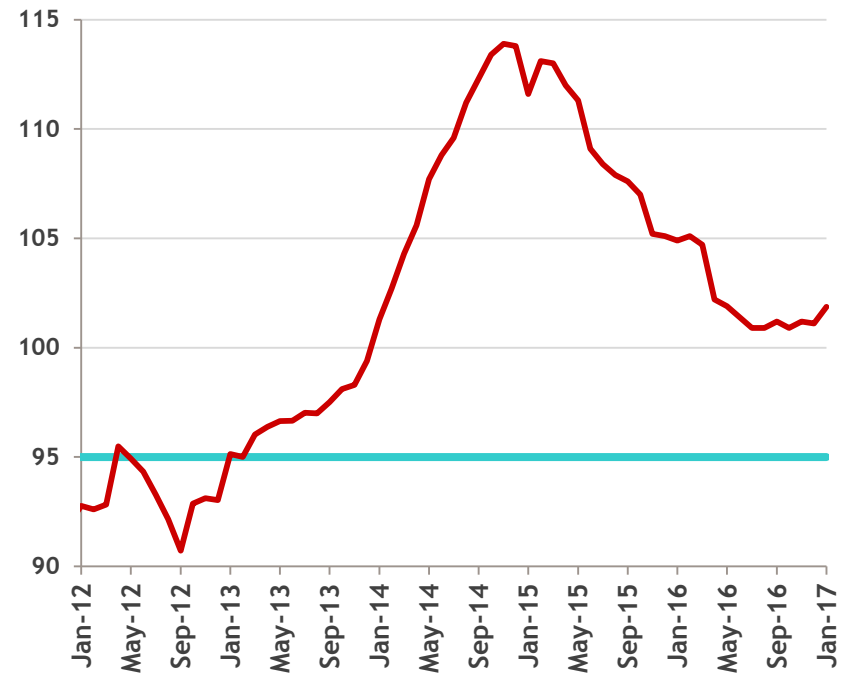
Source: Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

LABOUR MARKET IN STRONG SHAPE

- The BDO Employment Index stood at 101.9 in January, up from 101.1 in December to reach its highest level since May 2016.
- The improvement in the Employment Index reflects continued robustness in the UK labour market. Unemployment remained at 4.8% in the three months to November, staying at its lowest level for over 10 years.
- The proportion of people aged 16 to 64 in work remained at 74.4%, just 0.1 percentage points off the record high of 74.5% posted in the three months to October 2016.
- There was also an uptick in earnings growth, which rose by 2.8% (including bonuses) annually in the three months to November, compared to 2.6% in the three months to October.
- While current conditions reflect a robust labour market, it is possible the job market could soften in coming months, as cost pressures and economic uncertainty may cause firms to put off hiring. Employment growth has slowed in recent months, but there were 748,000 job vacancies in the October to December 2016 period, indicating there is still room for employment to grow if firms are willing to hire.

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

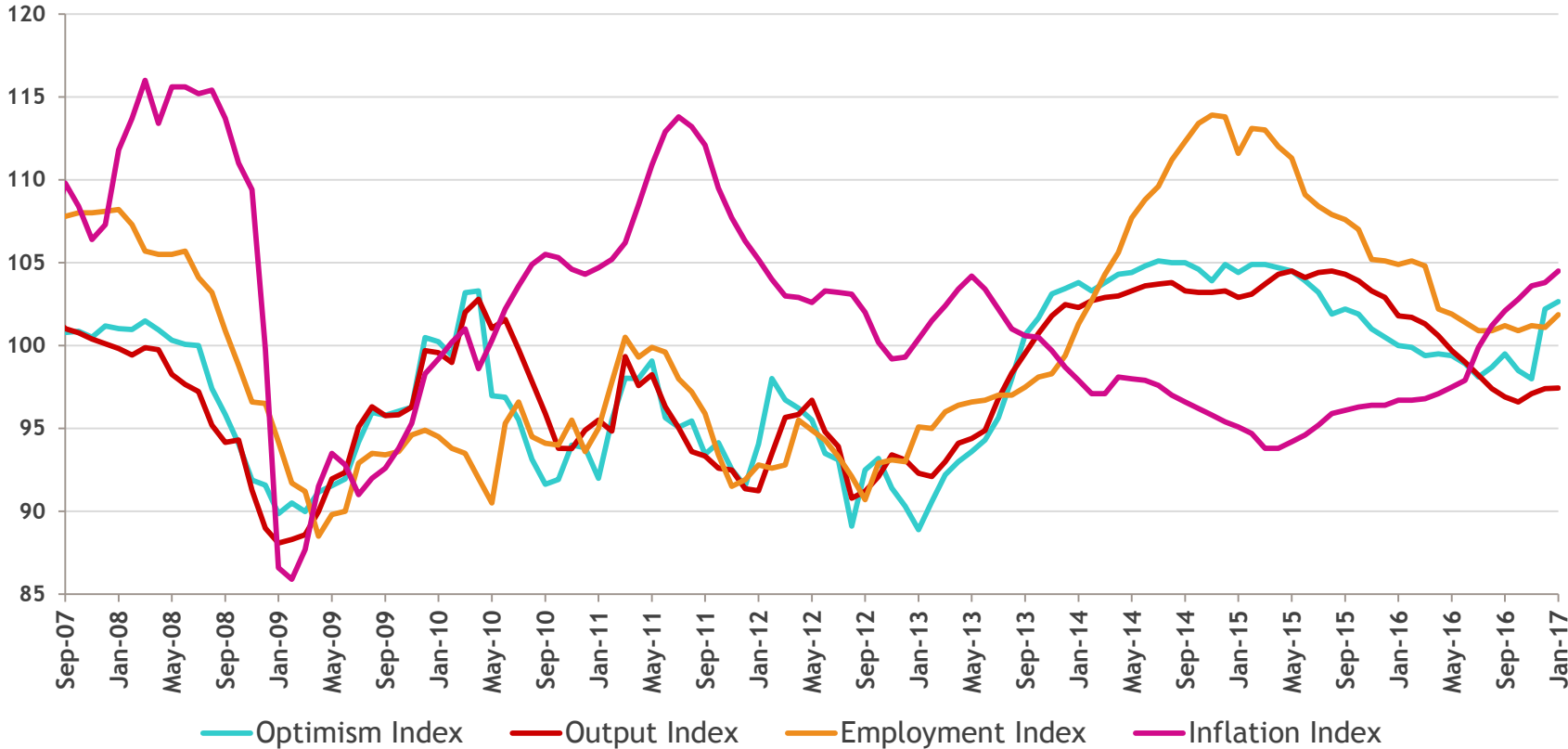
BDO INDICES TO LATEST MONTH

		Dec 2015	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
The BDO Optimism Index	Total	100.5	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
	Manuf.	89.6	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
	Service	102.7	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
The BDO Output Index	Total	102.9	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
	Manuf.	98.2	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
	Service	103.8	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
The BDO Inflation Index	Total	96.4	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
The BDO Employment Index	Total	105.1	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

APPENDIX: OPTIMISM STARTS THE YEAR STRONGLY

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.