Kallum Pickering, Senior Economist | Kallum.pickering@berenberg.com | +44 20 3465 2672

UK GDP: IMPORT SURGE DRAGS ON GROWTH, DISTRACTS FROM HEALTHY FUNDAMENTALS

Berenberg Macro Flash

UK GDP (2nd), real, qoq %, Q1 2017	
Actual	**0.2%**
Previous	0.7%
Consensus	0.3%
Berenberg	0.3%

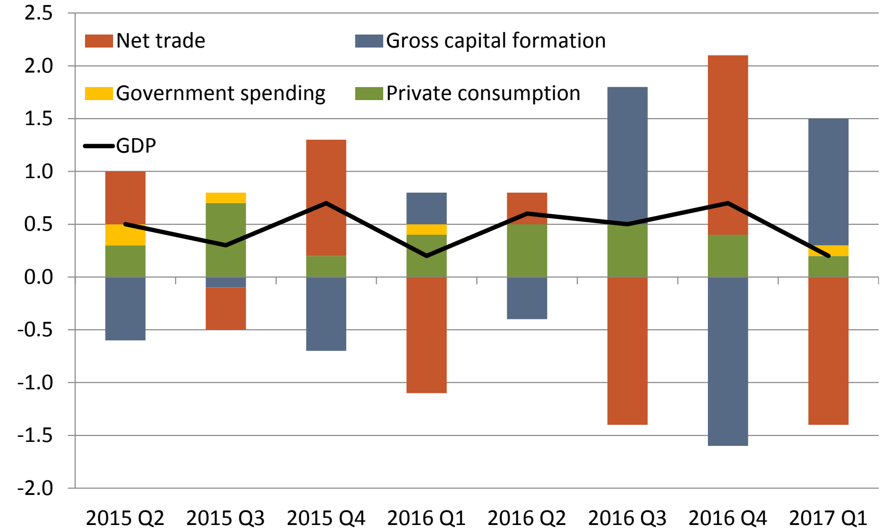
UK Q1 GDP revised down as net trade disappoints: After an unexpected surge in real GDP growth in the second half of 2016, with the data beating expectations, the economic expansion eased sharply in the first quarter of 2017. Real GDP growth slowed to 0.2% qoq in Q1, revised down from 0.3% in the first estimate and well below the 0.7% rate in Q4. Even though GDP expanded at a solid annual rate of 2.0%, Q1 marked the slowest quarterly rate since Q1 2016 – also 0.2% qoq. Should we be concerned? No, the dip is probably temporary. With both soft and hard data improving in Q2, the quarterly growth rate is likely to rebound to 0.4%. Household demand and investment (gross capital formation) were healthy, contributing 0.2pt and 1.2pt to growth, respectively. Meanwhile, following an unexpected drop in exports (-1.6% qoq versus est. +0.5%) and a surge in imports (+2.7% qoq versus est. +0.9%) net trade subtracted 1.4pt from the growth rate. Demand for transport equipment, machinery and chemicals made a notable contribution to the rise in imports. While the drag from imports is bad for headline GDP growth, these types of imports are typically used for industrial production – in a way, rising demand for such inputs is a positive sign. A critical point is that, despite the c10% drop in sterling after the Brexit vote and improving global demand, net trade continues to disappoint because UK household demand for imports remains solid. Net-trade has subtracted an average of 0.2pt from the headline quarterly growth during the past year.

Although real private consumption growth slowed in Q1 household demand remains solid: Despite the hit to real incomes from higher import prices consumptions remains strong. While the headline real rate of private consumption slowed from 0.7% qoq to 0.3% qoq in Q1, measures of nominal spending growth so far during 2017 have remained healthy. In nominal terms, household spending increased by 1.0% in Q1, well above the 10-year average of 0.7% qoq. Instead of buying fewer goods and services as inflation rises, households are opening up their wallets more in order to target a desired level of real consumption growth. Household balance sheets have strengthened since the Lehman crisis. The ratio of debt-to-income is lower, mortgage affordability has improved, wealth has risen and, thanks to cheap oil, households have enjoyed solid real wage gains over the past three years. Feeling confident after seven years of economic growth, households can borrow more and save less for a while. As inflation moderates over the medium-term and nominal wage growth accelerates a little, the rate of real consumption growth can pick up again.

Despite the turnaround, the climate for investment remains tough amid Brexit risks: Gross fixed capital formation – the broadest measure of investment - rebounded sharply in the first quarter, expanding by 1.2% qoq following just 0.1% growth in Q4 (part of this is related to non-monetary gold data – see note below). Business investment expanded by 0.6% qoq, above estimates of 0.3%. The turnaround follows an usually weak year for investment in 2016. Scarred by the excesses that led to the Lehman crisis, firms have been reluctant to pursue aggressive capital spending plans, despite healthy demand at home and abroad, low costs of capital and healthy profits and cash flows. Recently, key leading indicators for investment, such as firms' expected sales over the next 12 months, have turned up. But the outlook remains uncertain and firms will likely stay extra cautious amid Brexit uncertainty. Investment growth will probably remain lumpy well into the medium-term. At best, we may see a modest c2% per year expansion in investment until after Brexit – circa March 2019. Compared to other major developed economies where investment has turned up sharply at the start of the year, the UK investment outlook looks comparatively soft.

Note: Some of the divergence in net trade and investment is partially offsetting due to the behaviour of data for non-monetary gold. As the ONS points out 'non-monetary gold (NMG) is an erratic series that is a component of trade in goods and services; it also appears within gross capital formation (GCF) as valuables.' For more information please see [this page] on the ONS website.

Contributions to GDP growth (ppt) of main components. GDP – qoq %



Quarterly data. Source: ONS, Berenberg calculations

% change, sa	Q1	Q4'16	Q3	Q2	Q1	Q4'15
GDP, qoq	0.2	0.7	0.5	0.6	0.2	0.7
yoy	2.0	1.9	2.0	1.7	1.6	1.7
Private consumption, qoq	0.3	0.7	0.8	0.8	0.7	0.4
Gov. spending, qoq	0.8	0.0	-0.1	0.2	0.4	-0.2
GFCF, qoq	1.2	0.1	0.6	0.2	0.0	-0.9
Exports, qoq	-1.6	4.6	-2.1	1.3	-2.9	5.9
Imports, qoq	2.7	-1.0	2.3	0.3	0.4	2.1

Quarterly data. Source: ONS.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com