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UK GDP: H1 GROWTH SLOWEST SINCE 2013, IMPROVEMENT LIKELY

Berenberg Macro Flash

GDP (a), real, qoq %, Q2 2017	
Actual	**0.3**
Previous	0.2
Consensus	0.3
Berenberg	0.3

THE UK GROWTH ENGINE SPLUTTERED IN H1

Although real GDP growth accelerated a little to 0.3% qoq in Q2, in line with estimates, in H1 2017 the UK economy grew by just 1% annualised - the slowest annualised pace in four years. Domestic-oriented services provided all the growth in the second quarter while export-oriented industrial production and volatile construction contracted. Services grew by 0.5% qoq, contributing 0.42pt to the growth rate. All major components of services contributed to growth. Noteworthy were the expansions in retail and business services – two bellwethers of domestic activity. After two consecutive quarters of growth, industrial production declined by 0.4% qoq, subtracting 0.06pt from the headline growth rate. Amid the continued upswing in global demand and the competitive exchange rate, industrial production should rebound and add to growth again in Q3. Along with modest gains in domestic demand, a rebound in industrial production should enable the overall GDP growth rate to accelerate to an annualised pace of c1.7% in H2 – a little under its post-Brexit potential rate of 1.8%. The typically up-and-down construction sector contracted by 0.9% following on from two quarters of growth, also subtracting 0.06pt from the quarterly growth rate.

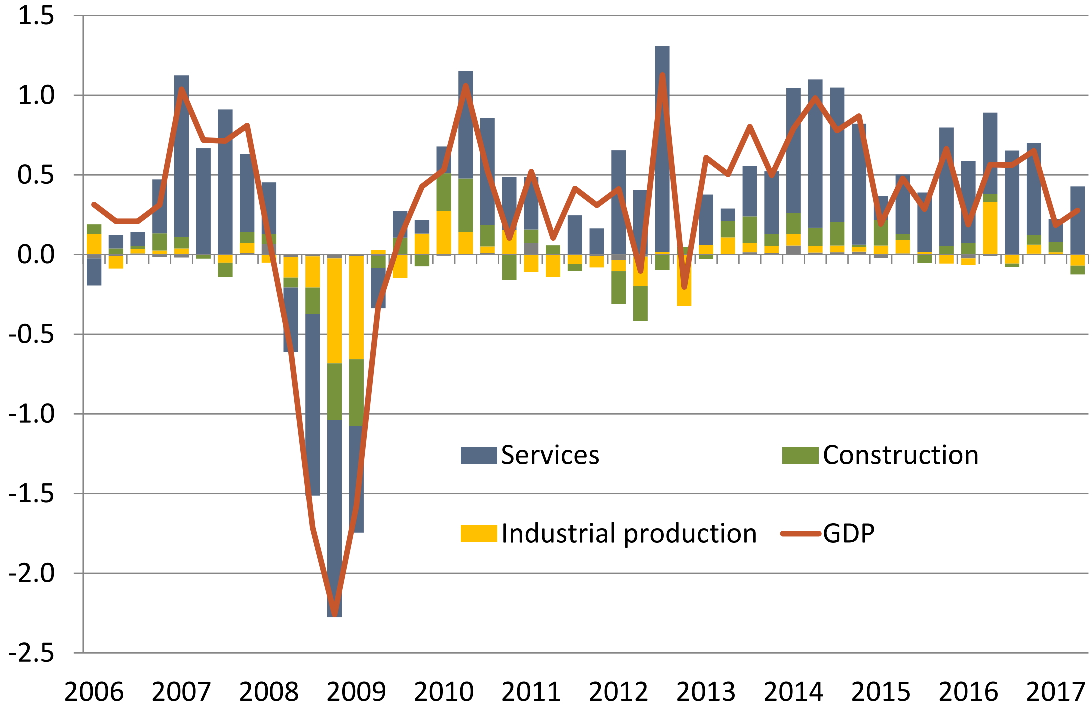
MISSING OUT ON THE PARTY ELSEWHERE

Despite the unhealthy environment of heightened political and economic uncertainty linked to Brexit, real GDP growth is likely to continue to expand at a reasonable pace over the medium term, driven by resilient domestic demand and an improving external backdrop. However, the UK's economic performance could be much better without the Brexit vote and its political fallout. Since the Lehman recession, the UK has sat comfortably at the top of the G7 growth league. But whereas growth has accelerated significantly so far this year in continental Europe and many emerging markets, the UK is missing out. While the downside risks from the Brexit vote have not yet played out in a major way, the uncertainty stemming from Brexit is leading to caution in all areas of spending and policy that have long-term implications. The UK would probably be growing at 2.5% or above this year were it not for Brexit, with strong gains in real wages and more business investment. We forecast real GDP growth of 1.6% in 2018 and 1.7% in 2019.

MONETARY POLICY OUTLOOK

With little slack in the economy, domestic inflationary pressures will prevent headline inflation from returning to the 2% target after the imported inflation passes. Core inflation has risen over the past year in bottlenecks caused by resilient demand growth and caution by firms when increasing supply. Despite the growth slowdown over the medium-term versus the post-Lehman trend, we expect headline inflation to remain above the BoE's 2% target beyond the end of 2019. Communicating its policy guidance amid lower long-term growth adds to the BoE's set of challenges. At the upcoming August Inflation Report (3 August) the Bank of England is likely to maintain its guidance for a forthcoming rate hike. Before hiking, we first expect the BoE to wait for clear evidence that the economy held up in Q3 (after the snap election). We then look for a first hike of 25bps at the final Inflation Report of the year in November. A continued tightening thereafter will be very, very gradual. We expect two more hikes in 2018 and one further hike in 2019.

Chart 1: Quarterly change (%) in sector components of GDP



Quarterly data. Source: ONS, Berenberg calculations

qoq %	**Q2 17**	**Q1 17**	**Q4 16**	**Q3 16**	**Q2 16**	**Q1 16**
GDP	0.3	0.2	0.7	0.5	0.6	0.2
Services	0.5	0.1	0.8	0.9	0.6	0.7
Production	-0.4	0.q	0.4	-0.4	2.2	-0.3
Construction	-0.9	1.1	1.0	-0.3	0.9	1.0

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