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UK GDP: A BETTER Q3, BUT STILL MISSING OUT ON THE PARTY ELSEWHERE

Berenberg Macro Flash

Real GDP, qoq %, Q3 2017	
Actual	**0.4%**
Previous	0.3%
Consensus	0.4%
Berenberg	0.4%

A little pick up in Q3: After one-off factors weighed on growth in the first half of the year UK real GDP growth accelerated by 0.1pt to 0.4% qoq in Q3, in line with the first estimate published one month ago and just a touch below the rate the UK can sustain in the long-run outside of the EU (0.45% qoq). Despite the Brexit driven temporary real wage squeeze caused by rising import prices, households are still coping well. Private consumption growth accelerated to 0.6% qoq from 0.2%. Sterling has fallen by c12% on a trade-weighted basis since the Brexit vote in June 2016. Households are smoothing their real consumption by borrowing a little more and saving a little less for a while until real wages begin to rise again – probably early next year.

Gross fixed capital formation (GFCF), the broadest measure of investment, expanded by 0.2% qoq, a slightly softer rate than the 0.6% growth in Q2. Within GFCF, business investment expanded by 0.2% qoq. Despite the long-term uncertainty linked to Brexit, firms continue to increase their investments in order to raise productive capacities to meet the growing real demand at home and abroad. After a very strong second quarter (+1.7% qoq) exports corrected a little in Q3 (-0.7%). This is no cause for concern. Trade data are typically volatile, expect a rebound in Q4.

The current pace of UK GDP growth is ok, but it could be better. While the short-term risks to demand since the Brexit vote have not materialised in a serious way, the UK economy should be riding high on the back of the on-going global upswing. Uncertainty from Brexit is weighing on firm and household confidence. As neighbouring Eurozone growth accelerates to a decade high of 2.3% this year, UK growth looks set to slow to a modest 1.6% – well below its pre-Brexit potential rate of 2.2%. After managing one of the strongest post-Lehman recoveries of all advanced economies, the UK growth rate would probably be nearer 2.5% this year if it weren't for Brexit. Further out, we expect real GDP to expand by 1.6% in 2018 and 1.7% in 2019, above the market consensus of 1.4% and 1.6%, respectively (Bloomberg consensus on 23/11/2017).

What will the long term effects of Brexit be? That depends on the outcome of the on-going negotiations between the UK and the EU. Faced with a choice between a deal on EU27 terms or no deal at all, in late 2018 we expect the UK to accept a transition deal (possibly similar to the Norway deal minus some financial market privileges) for 2 or 3 years (70% probability). Since it will be difficult to change such an arrangement very much, over time, this arrangement will probably solidify into the final terms for post-Brexit trade between the UK and the EU. In this base case, Brexit could reduce trend growth to 1.8% from the pre-Brexit rate of 2.2%. The key risk remains that the UK will opt for a hard Brexit with few follow-up arrangements for privileged access to the EU27 market (30% risk). In case of a hard Brexit, UK trend growth could fall to 1.5%.

% change, sa	Q3	Q2	Q1'17	Q4	Q3	Q2'16
GDP, qoq	0.4	0.3	0.3	0.6	0.4	0.5
yoy	1.5	1.5	1.8	1.6	1.8	1.8
Private consumption, qoq	0.6	0.2	0.4	0.4	0.6	0.9
Gov. spending, qoq	0.3	0.1	0.2	0.2	0.0	-0.1
GFCF, qoq	0.2	0.6	0.5	0.4	0.8	1.9
Exports, qoq	-0.7	1.7	-0.3	5.4	-1.9	2.5
Imports, qoq	1.1	0.2	1.0	-0.7	3.0	0.8

Source: ONS

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