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UK GDP: BACK TO TREND AFTER TEMPORARY DIP

Berenberg Macro Flash

UK real GDP, qoq %, Q2 2018

Actual:	**0.4**
Previous:	0.2
Consensus:	0.4
Berenberg:	0.4

Bounce back after weather-related dip: In Q2 2018 UK real GDP expanded at a quarterly rate of 0.36% (1.5% annualised) – in line with our estimated range for long-run potential growth outside the EU (1.5-1.7% yoy). Despite severe risks linked to Brexit the UK economy seems to be on a stable growth path. The healthy expansion in Q2 is consistent with the pace of growth in H2 2017 (c0.35% qoq), suggesting that the dip in the quarterly growth rate in Q1 to 0.2% qoq was temporary.

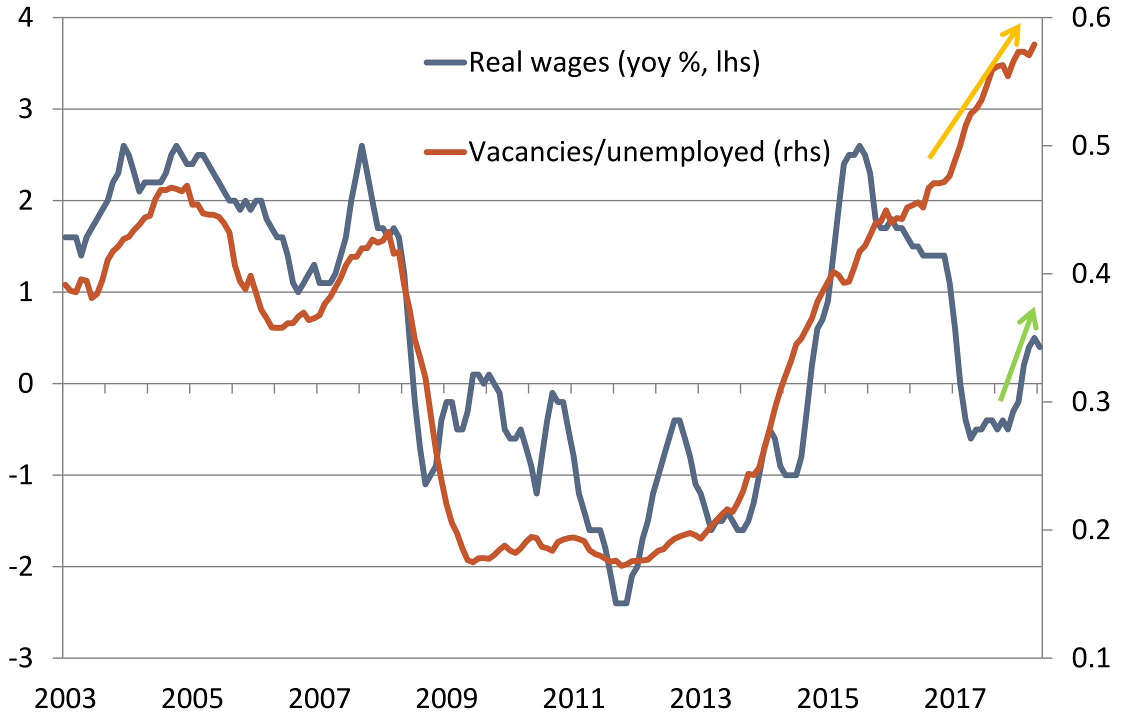
Key takeaways from the Q2 GDP print:

- A rebound in real household consumption growth underpinned the pick-up in headline real growth in Q2. Real household consumption (66% of GDP) growth accelerated from 0.2% qoq in Q1 to 0.3% qoq in Q2 (1.35% annualised). Encouraged by the nice weather in Q2 to go out and spend, households seem to be responding well to the on-going recovery in real wages – Chart 1.
- Uncertainty tends to show up the most in investment spending. Because the no-deal hard Brexit risk is casting a long shadow over the UK economic outlook firms are reluctant to take on major long-lived investment projects. However, as UK labour markets are tight and firms have low levels of spare capacity, at least some investment is necessary simply to expand production to meet the growing demand at home and abroad. Gross fixed capital formation (the broadest measure of investment spending) rebounded a little in Q2 (up 0.8% qoq) after falling 1.3% in Q1 – the sharp drop now looks largely due to the bad weather. Nevertheless, the annualised 3% growth rate for investment in Q2 is somewhat weak given the stage of the cycle and healthy global backdrop.
- Net trade subtracted 0.8ppt from growth in Q2. A fall in imports by 0.8% qoq was offset by a 3.6% drop in exports. But trade data are prone to quarterly volatility. Expect exports to correct in Q3. Abstracting from the hit of trade, together the major components of domestic demand expanded 0.43% qoq in Q2, ahead of the GDP growth. Amid the slowdown in real consumer spending since the Brexit vote, UK growth has rotated towards trade. Last year, net trade contributed 0.6ppts to economic growth. Softer demand for imports by inflation-squeezed households and the boost to export demand from the drop-in sterling helped narrow the UK trade-deficit. But these effects are gradually fading.

Brexit hurts already: Overall, the UK economy is not in bad shape. The post-financial crisis upswing is maturing nicely: the expansion is now in its ninth year; employment is at a record high and real wages are edging up; the Bank of England is finally feeling confident enough to gradually normalise monetary policy; and the fiscal deficit is slowly edging back towards a safe level. Meanwhile, there are no obvious signs of excess that would signal the UK recovery should end soon. However, because of Brexit, the normally fast-growing UK – at least on a relative basis versus other advanced economies – is currently missing out on the fun – Chart 2. While the global economy enjoys growth above its potential the UK is bogged down by Brexit. Last year the UK expanded by 1.7% (check for revisions). We estimate that growth would have been closer to 2.7% without the Brexit-related effects (higher uncertainty and inflation) – see Brexit hurts already. Abstracting from the weak Q1, the 1.7% average annualised growth rate for 2018 will once again be well below what one would normally expect for the UK in context of a solid global backdrop.

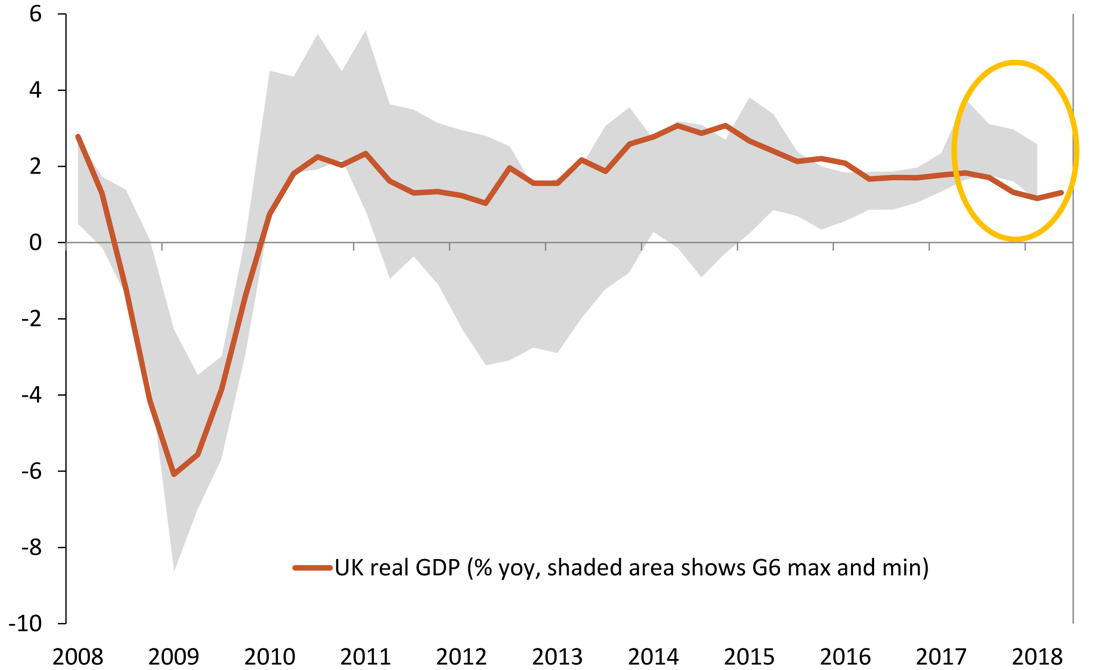
Real wages rebound key to sustained growth momentum: We look for the UK to maintain a growth rate of around 0.4% qoq for the next few quarters before a little pick up to 0.5% qoq during 2019 after Brexit - call it a little relief rally when the UK avoids a hard Brexit (20% chance) in March 2019. We expect annual real GDP growth to rise from 1.4% in 2018, to 1.8% in 2019 and 1.7% in 2020. We are above consensus across the forecast horizon: 1.x% in 2018, 1.x% in 2019 and 1.x% in 2020 (taken from Bloomberg on 10/08/2018). As we wrote in - Solid recovery ahead as Brexit-vote shock fades - stronger household consumption growth amid steadily accelerating real wage growth is likely to be the major driver of UK growth over the medium-term – Chart 3.

Chart 1: Brexit hit to real wages: mind the gap



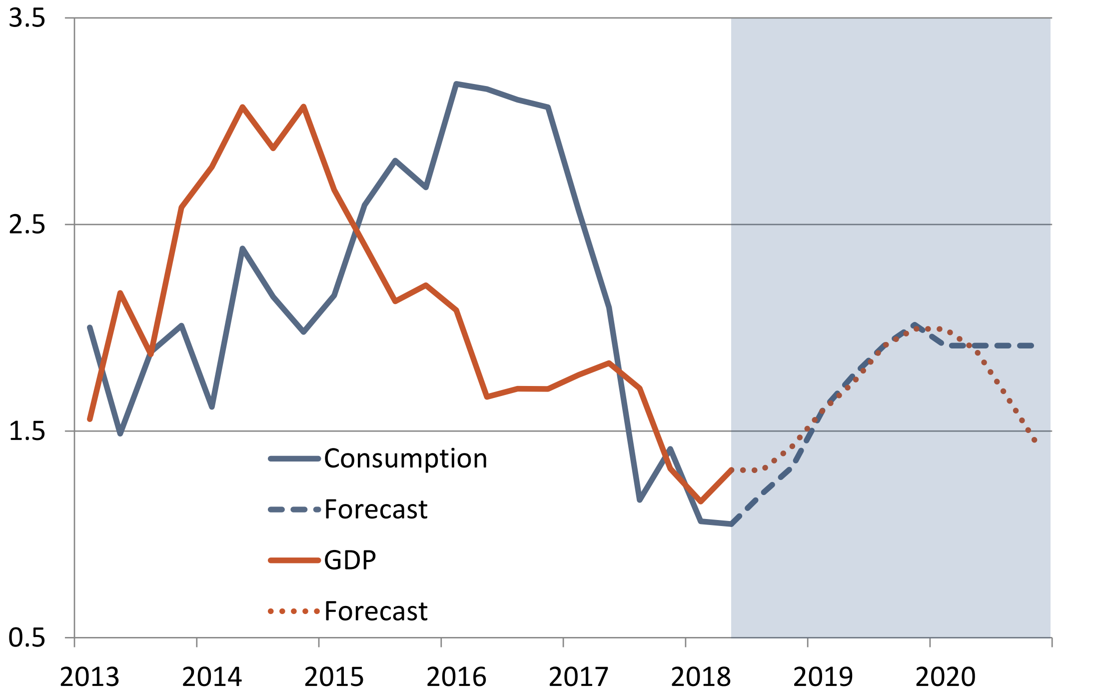
Monthly data. Real wages = average weekly earnings adjusted by headline CPI. Source: ONS

Chart 2: UK real GDP still close to the bottom of the G7 table



Quarterly data. Source: ONS, Bureau of Economic Analysis, Statistics Canada, Eurostat, Cabinet Office of Japan, Berenberg calculations

Chart 3: Annual change in real consumption and real GDP (%)



Quarterly data. Chart shows the headline annual change in real household domestic expenditure and real GDP (%). Data from 2Q 2018 to 4Q 2020 show Berenberg forecasts. Source: ONS, Berenberg

% change, sa	Q2	Q1'18	Q4	Q3	Q2	Q1'17
GDP, qoq	0.4	0.2	0.4	0.4	0.2	0.4
yoy	1.3	1.2	1.3	1.7	1.8	1.8
Priv. consumption, qoq	0.3	0.2	0.3	0.2	0.3	0.6
Gov. spending, qoq	0.4	0.4	0.4	-0.1	0.5	-0.5
GFCF, qoq	0.8	-1.3	0.8	0.4	1.6	1.1
Exports, qoq	-3.6	0.0	1.0	0.8	0.6	0.8
Imports, qoq	-0.8	-0.2	-0.2	0.5	0.4	0.9

Source: ONS

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