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UK PRODUCTION: STEADY REBOUND AMID AN UNUSUAL MIX OF RISKS

Berenberg Macro Flash

Aug 18, mom %	Industrial	Manufacturing
Actual	0.2	-0.2
Previous	0.4	-0.2
Consensus	0.1	0.1
Berenberg	0.2	0.2

Hat trick for UK industrial production

After a tough first of half 2018, conditions for UK producers have improved significantly in recent months. Latest data for the month of August show that total volumes increased for the third consecutive month. The healthy rebound follows the sharp 1.5% correction in the volume of industrial production between February and May. Despite better fortunes of late, any optimism that export-oriented producers in the UK can get back to the strengths of late-2017 should be tempered by the risk-laden international environment.

As our global PMI heatmap (Chart 1) shows, after surging in H2 2017 on the back of accelerating global demand and trade, manufacturing output in the advanced world has moderated in 2018. Still, the rebound that started in Q2 and continued into Q3 bodes well for our call that the quarterly real GDP growth probably accelerated a little to 0.5% qoq in Q3 following growth of 0.4% in Q2 and the paltry 0.1% in Q1.

Key highlights from the August data:

- (1) Total production rose by 0.2% mom in August. Output increased by 0.7% on a 3m/3m basis and 1.3% on an annual basis (Chart 2);
- (2) Manufacturing output, the largest sub-sector, shrank by 0.2% on a monthly basis, but expanded by 0.8% on a 3m/3m basis and by 1.3% yoy (also Chart 2);
- (3) Comparing the monthly data available for Q3 (July and August) to Q2 shows a broad based expansion across all major sub-sectors of industrial production. Mining and quarrying posted the biggest uptick (2.9%);
- (4) If industrial output remained stable in September, it will likely have added 0.15 ppt to the quarterly real GDP growth rate in Q3.

An unusual mix of risks cloud the medium-term outlook for producers

First the good news: economic fundamentals in the advanced world remain healthy. The US economy continues to power ahead. A fiscal stimulus and supply-side reform underpin solid gains in demand and employment (expect average growth of c2.5% for the next couple of years). Although European growth has sagged a bit this year under the weight of several risks (see below), current growth momentum and the outlook (ex. UK) has improved versus a few years ago. The Eurozone can probably manage real GDP growth slightly above trend (c1.7%) in the coming



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years. Meanwhile, we see no major signs of excess that would signal the current upswing should come to an end soon, say within the next three years.

This auspicious backdrop can underpin a continued expansion in industrial production in the advanced world. There are however, several key risks to this call:

- **Trade wars:** Despite the recent renegotiation and agreement on North American trade, and a simmering down of US-EU tensions, the trade-skirmish between the US and China continues to escalate. European economies earn around a third of their GDP from exports, roughly twice as much as the US. Unless the US and China can find a resolution to their trade dispute, outward facing industrial producers in the UK will remain risk averse amid the heightened uncertainty about the future of the global trading system.
- **Brexit:** A hard Brexit (20% risk), that led to a stagnation (or worse) in UK growth, and severely damaged trading links between the UK and its biggest market, would strike a major blow to UK producers. Luckily, that is not our base case. A trade-deal that preserves trade in goods between the UK and the EU (60%+ chance) will protect the interests of UK producers in the long-run. After all, nearly half of all UK exports go to the EU. Still, some of the most export-oriented UK producers, especially ones that specialise in low-end price sensitive products, may initially suffer if sterling appreciates strongly on the good news that a hard-Brexit has been avoided. See [Brexit: Irish support for UK plan can unlock negotiations](#) and [Brexit: entering the hot phase](#).
- **Italy:** The tail risk that Italy’s radical government may spark a genuine debt crisis soon has risen in the last few days - see [testing the limits](#). Memories of the euro-crisis and the 2015 conflict between populists in Greece and the EU are still fresh. Even if Italian leaders back down eventually, a persistent hit to confidence could weigh on overall European demand for a while.
- **Oil price:** The rise in the price of Brent crude to \$85 per barrel in recent weeks will add a of few tenths of a percentage point to headline inflation rates in the UK and elsewhere. The temporary modest squeeze to real incomes may act as a modest drag on real demand growth until the effects pass or nominal wage growth improves.

% change	Aug	Jul	Jul	May	Apr	Mar
Industrial prod., yoy	1.3	1.0	0.7	0.2	1.4	2.5
Industrial prod., 3m/3m	0.7	-0.3	-0.8	-0.5	-0.1	0.1
Industrial prod., mom	0.2	0.4	0.9	-0.6	-0.6	-0.2
Manu. prod., yoy	1.3	1.4	1.8	1.1	1.0	2.2
Manu. prod., 3m/3m	0.8	0.2	-0.7	-1.1	-0.8	-0.1
Manu. prod., mom	-0.2	0.0	1.0	0.3	-0.9	-0.4



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Chart 1: PMI heat-map: softer momentum in the advanced world

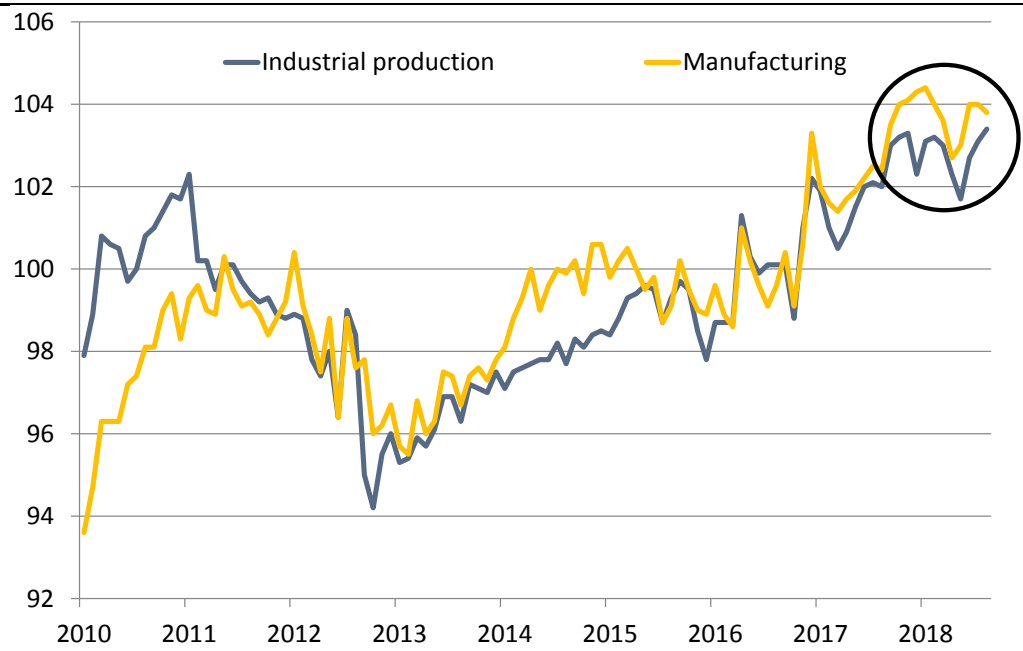
	Oct 16	Nov 16	Dec 16	Jan 17	Feb 17	Mar 17	Apr 17	May 17	Jun 17	Jul 17	Aug 17	Sep 17	Oct 17	Nov 17	Dec 17	Jan 18	Feb 18	Mar 18	Apr 18	May 18	Jun 18	Jul 18	Aug 18	Sep 18	
High GDP per capita																									
Switzerland	55.2	55.5	55.9	55.0	58.1	57.5	58.3	55.7	60.0	60.3	61.4	62.2	61.5	64.6	65.6	65.3	65.5	60.3	63.6	62.4	61.6	61.9	64.8	59.7	
Ireland	52.1	53.7	55.7	55.5	53.8	53.6	55.0	55.9	56.0	54.6	56.1	55.4	54.4	58.1	59.1	57.6	56.2	54.1	55.3	55.4	56.6	56.3	57.5	56.3	
U.S.	53.4	54.1	54.3	55.0	54.2	53.3	52.8	52.7	52.0	53.3	52.8	53.1	54.6	53.9	55.1	55.5	55.3	55.6	56.5	56.4	55.4	55.3	54.7	55.6	
Denmark	57.3	57.5	62.6	57.6	56.5	56.6	49.2	57.9	63.6	63.5	60.5	61.5	58.7	58.7	61.2	66.7	70.7	61.1	54.3	47.6	49.7	55.5	59.1	53.2	
Sweden	58.5	57.2	60.2	62.1	60.8	65.2	62.6	58.8	62.4	60.3	54.8	63.7	59.3	63.2	60.3	56.9	59.8	55.9	54.5	55.7	54.2	57.4	52.5	55.2	
Netherlands	55.7	57.0	57.3	56.5	58.3	57.8	57.8	57.6	58.6	58.9	59.7	60.0	60.4	62.4	62.2	62.5	63.4	61.5	60.7	60.3	60.1	58.0	59.1	59.8	
Austria	53.9	55.4	56.3	57.3	57.2	56.8	58.1	58.0	60.7	60.0	61.1	59.4	59.4	61.9	64.3	61.3	59.2	58.0	58.0	57.3	56.6	56.8	56.4	55.0	
Canada	51.1	51.5	51.8	53.5	54.7	55.5	55.9	55.1	54.7	55.5	54.6	55.0	54.3	54.4	54.7	55.9	55.6	55.7	55.5	56.2	57.1	56.9	56.8	54.8	
Germany	55.0	54.3	55.6	56.4	56.8	58.3	58.2	59.5	59.6	58.1	59.3	60.6	60.6	62.5	63.3	61.1	60.6	58.2	58.1	56.9	55.9	56.9	55.9	53.7	
UK	53.9	53.3	55.6	55.2	54.6	54.1	57.7	56.5	54.3	55.5	57.0	55.6	56.2	58.3	56.0	55.1	54.9	54.9	53.9	54.3	54.2	53.9	53.0	53.8	
Japan	51.4	51.3	52.4	52.7	53.3	52.4	52.7	53.1	52.4	52.1	52.2	52.9	52.8	53.6	54.0	54.8	54.1	53.1	53.8	52.8	53.0	52.3	52.5	52.5	
Israel	51.1	54.3	67.2	62.6	61.2	54.8	52.0	56.2	50.3	54.3	58.4	57.2	53.2	49.7	53.4	53.5	53.6	54.7	54.0	49.6	52.6	58.0	50.4		
France	51.8	51.7	53.5	53.6	52.2	53.3	55.1	53.8	54.8	54.9	55.8	56.1	56.1	57.7	58.8	58.4	55.9	53.7	53.8	54.4	52.5	53.3	53.5	52.5	
Italy	50.9	52.2	53.2	53.0	55.0	55.7	56.2	55.1	55.2	55.1	56.3	56.3	57.8	58.3	57.4	59.0	56.8	55.1	53.5	52.7	53.3	51.5	50.1	50.0	
Korea	48.0	48.0	49.4	49.0	49.2	48.4	49.4	49.2	50.1	49.1	49.9	50.6	50.2	51.2	49.9	50.7	50.3	49.1	48.4	48.9	49.8	48.3	49.9	51.3	
Spain	53.3	54.5	55.3	55.6	54.8	53.9	54.5	55.4	54.7	54.0	52.4	54.3	55.8	56.1	55.8	55.2	56.0	54.8	54.4	53.4	53.4	52.9	53.0	51.4	
Czech Rep	53.3	52.2	53.8	55.7	57.6	57.5	57.5	56.4	56.4	55.3	54.9	56.6	58.5	58.7	59.8	59.8	58.8	57.3	57.2	56.5	56.8	55.4	54.9	53.4	
Greece	48.6	48.3	49.3	46.6	47.7	46.7	48.2	49.6	50.5	50.5	52.2	52.8	52.1	52.2	53.1	55.2	56.1	55.0	52.9	54.2	53.5	53.5	53.9	53.6	
Hungary	58.2	57.5	49.5	59.0	58.7	56.8	60.0	65.3	58.3	55.3	54.8	56.2	63.4	61.0	60.6	60.4	58.9	55.5	58.2	57.8	56.3	53.1	57.9	56.0	
Poland	50.2	51.9	54.3	54.8	54.2	53.5	54.1	52.7	53.1	52.3	52.5	53.7	53.4	54.2	55.0	54.6	53.7	53.7	53.9	53.3	54.2	52.9	51.4	50.5	
Turkey	49.8	48.8	47.7	48.7	49.7	52.3	51.7	53.5	54.7	53.6	55.3	53.5	52.8	52.9	54.9	55.7	55.6	51.8	48.9	46.4	46.8	49.0	46.4	42.7	
Low GDP per capita																									
Malaysia	47.2	47.1	47.1	48.6	49.4	49.5	50.7	48.7	46.9	48.3	50.4	49.9	48.6	52.0	49.9	50.5	49.9	49.5	48.6	47.6	49.5	49.7	51.2	51.5	
Russia	52.4	53.6	53.7	54.7	52.5	52.4	50.8	52.4	50.3	52.7	51.6	51.9	51.1	51.5	52.0	52.1	50.2	50.6	51.3	49.8	49.5	48.1	48.9	50.0	
Brazil	46.3	46.2	45.2	44.0	46.9	49.6	50.1	52.0	50.5	50.0	50.9	50.9	51.2	53.5	52.4	51.2	53.2	53.4	52.3	50.7	49.8	50.5	51.1	50.9	
Mexico	51.8	51.1	50.2	50.8	50.6	51.5	50.7	51.2	52.3	51.2	52.2	52.8	49.2	52.4	51.7	52.6	51.6	52.4	51.6	51.0	52.1	52.1	50.7	51.7	
China	51.2	50.9	51.9	51.0	51.7	51.2	50.3	49.6	50.4	51.1	51.6	51.0	51.0	50.8	51.5	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0	
Indonesia	48.7	49.7	49.0	50.4	49.3	50.5	51.2	50.6	49.5	48.6	50.7	50.4	50.1	50.4	49.3	49.9	51.4	50.7	51.6	51.7	50.3	50.5	51.9	50.7	
Vietnam	51.7	54.0	52.4	51.9	54.2	54.6	54.1	51.6	52.5	51.7	51.8	53.3	51.6	51.4	52.5	53.4	53.5	51.6	52.7	53.9	55.7	54.9	53.7	51.5	
India	54.4	52.3	49.6	50.4	50.7	52.5	52.5	51.6	50.9	47.9	51.2	51.2	50.3	52.6	54.7	52.4	52.1	51.0	51.6	51.2	53.1	52.3	51.7	52.2	
Myanmar	49.0	50.2	49.4	51.7	51.9	53.1	52.9	52.0	49.4	49.1	49.3	49.4	51.1	51.6	51.1	51.7	52.6	53.7	55.5	52.6	50.0	47.9	46.4	47.5	

Monthly data. Source: IHS Markit, Worldbank. Data above 50 (highlighted green) signal expansion while data below 50 (highlighted red) signal decline.



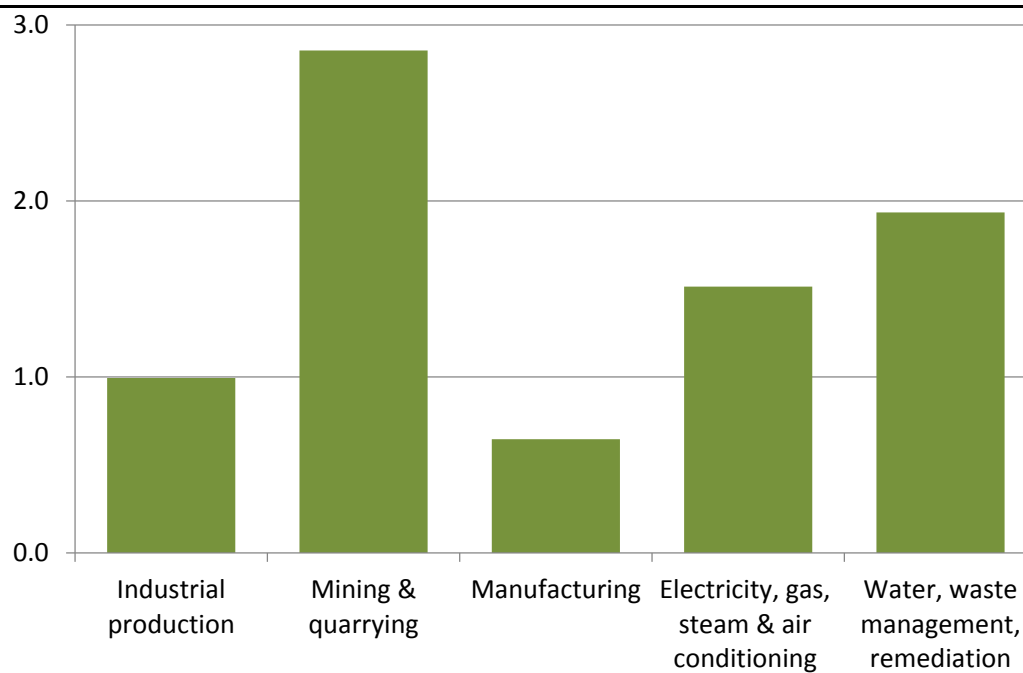
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Chart 2: Industrial production and manufacturing output (2016=100)



Monthly data. In real terms. Source: ONS

Chart 3: % change in output for major industrial sub-sectors (Jul-Aug vs. Q2)



Monthly data. In real terms. Source: ONS



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