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UK GDP Q3 GROWTH SURGE - MORE AROUND THE CORNER?

Berenberg Macro Flash

UK real GDP, qoq %, Q3 2018

Actual:	0.6
Previous:	0.4
Consensus:	0.6
Berenberg:	0.6

The UK is a place on its own

The strong 0.6% qoq expansion in real GDP in Q3 (after 0.4% in Q2) sets the UK apart from the general trend of softer growth across major parts of Europe. For the first time since Q4 2016, the UK economy fared better than Germany, France and Italy. A combination of rising real wages, great weather, and England's good World Cup run underpinned a consumer spending spree over the summer. Despite the increasing level of noise from the Brexit negotiations, the UK economy has gradually gained momentum over the course of 2018. If the UK and EU strike a deal soon, as we expect, the UK is set for a decent pick-up in medium-term growth momentum.

Key takeaways from the Q3 GDP print

- A continued acceleration in real household consumption growth drove much of the pick-up in headline GDP growth. Real household consumption (66% of GDP) growth accelerated from 0.3% qoq in Q2 to 0.5% qoq in Q3. Households are raising their spending on the back of the on-going recovery in real wages – Chart 1.
- Although consumer fortunes are improving, Brexit risks continue to show up in the investment data. Gross fixed capital formation – the broadest measure of investment – expanded by 0.8% qoq, but this was mainly due to a surge in public sector spending. Business investment declined for the third quarter in a row – Chart 2. The drop in business investment has worsened over the course of the year (-0.5% qoq in Q2, -0.7% in Q3, and -1.2% in Q4). 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. This will change if a hard Brexit is avoided.
- Despite Italian-EU political difficulties, trade wars and the wobble in emerging markets clouding the international backdrop, a rebound in net-exports contributed 0.8pts to quarterly growth in Q3 - almost offsetting the 0.6pts drag in Q2. The improvement was driven by a 2.7% rise in exports amid flat imports. Trade data are prone to quarterly volatility. After adding 0.7pts to annual growth last year, net-exports are likely to be neutral for headline growth in 2018.
- Broad based gains by sector: services up 0.4% qoq, industrial production rose 0.9% - correcting the equivalent drop in Q2, and construction expanded by a healthy 2.1%.



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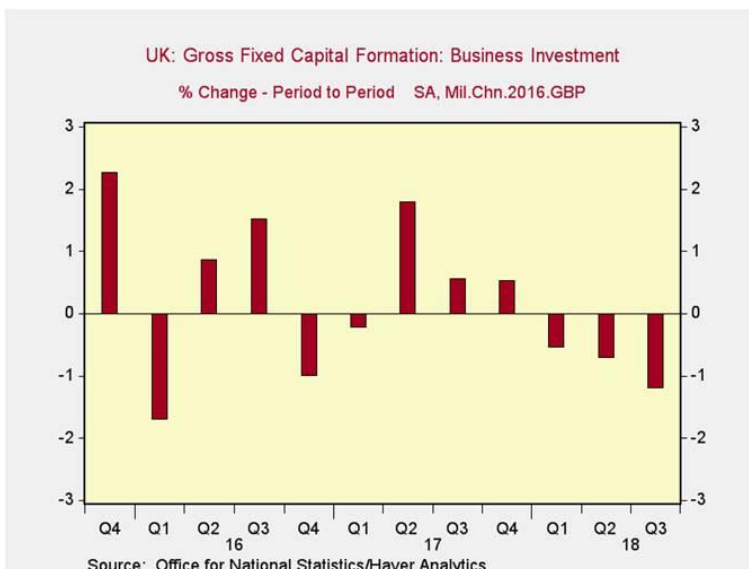
But this is all yesterday's news

For markets, the key question is what happens next? Our base case remains that, in the end, the UK and EU will strike a deal (80% chance) - probably by year-end - and avoid the no-deal hard-Brexit (20%). On this basis, with the hard-Brexit risk largely gone, economic agents and financial market participants should take a more favourable view on the UK. Despite the long-term damage to potential growth stemming from Brexit, the UK is poised for a growth spurt as the tail-risks fade and some of the short-term costs partly unwind. Growth may slow a little to 0.4% qoq in Q4 before a continued rise in consumption growth and mini-boom in business investment can add to growth momentum next year. Expect UK growth to accelerate from around 1.3% in 2018 to 1.8% in 2019. Based on recent consumer trends, risks are skewed to the upside.

Chart 1



Chart 2



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Table 1: GDP by expenditure	% qoq, sa						% yoy, sa	
	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	2016	2017
Real GDP	0.3	0.4	0.4	0.1	0.4	0.6	1.8	1.7
Nominal GDP	0.5	0.8	1.1	0.5	0.8	1.1	3.9	3.8
Private Consumption	0.3	0.3	0.3	0.5	0.3	0.5	3.1	1.8
Government Consumption	0.4	-0.2	0.3	0.2	-0.4	0.6	0.8	-0.1
Gross investment	1.8	0.2	0.7	-1.0	-0.5	0.8	2.3	3.3
Business investment	1.8	0.6	0.5	-0.5	-0.7	-1.2	-0.2	1.8
Final Domestic Demand	0.5	0.5	0.9	0.5	1.3	0.5	4.0	3.5
Exports	1.1	2.8	1.0	-0.8	-2.2	2.7	1.0	5.7
Imports	0.7	1.1	-0.1	-0.3	-0.2	0.0	3.3	3.2
GDP deflator	1.9	1.9	2.0	1.8	2.0	2.1	2.1	2.0

Source: ONS

Table 2: GDP by sector	% qoq, sa						% yoy, sa	
	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	2016	2017
Services	0.3	0.3	0.4	0.3	0.6	0.4	1.0	2.0
Construction	0.4	0.9	0.5	0.2	-0.9	0.9	4.1	7.2
Industrial production	0.2	0.6	0.6	-1.6	0.8	2.1	1.9	2.0
Farming and fishing	0.6	0.9	-0.3	-1.3	0.1	0.2	-5.6	2.9

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