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UK GDP SOFTENED IN Q4, OUTLOOK HINGES ON BREXIT OUTCOME

Berenberg Macro Flash

Amid the building domestic and external risks, the UK economy lost momentum in the fourth quarter. After solid gains of 0.6% qoq in Q3, the rolling 3m/3m growth rate of real GDP slowed to 0.3% in November from 0.4% in October. At home, the fear that the UK could crash out of the EU on March 29 2019 spread beyond the business sector. Despite the continued pick-up of real wages in Q4 (Chart 1) and healthy gains in employment, consumer confidence softened. Sluggish consumption contributed to the slowdown in real demand growth. Externally, the UK faced headwinds from softer Eurozone demand and shaky global financial markets that further weighed on sentiment.

Every cloud and all that: UK real GDP probably expanded by 0.3% qoq in Q4, the slowest rate since the very soft 0.1% qoq in Q1 2018. Despite the softening, we see three positives: 1) real GDP growth accelerated modestly towards the end of the year on a monthly basis. After the very strong mid-year gains had given way to a brief stagnation in August and September, the November monthly growth picked up to 0.2% from 0.1% in October; 2) relative to other major European economies the UK outperformed. The likely H2 2018 qoq average growth of circa 0.45% sits well compared to Germany (c0.1%); France (c0.25%) and Italy (c0.0%); 3) the UK economy managed to expand at a respectable pace despite the heavy drag from Brexit uncertainty and rising global risks.

Key takeaways from the monthly output data for November:

- **Services:** The UK's largest sector expanded by 0.3% mom, up from 0.2% in the previous month. On a 3m/3m basis, growth in domestic-oriented services remained stable from October at 0.3%, but was down from a mid-year peak of 0.7% in July.
- **Industrial production:** In line with the picture across the rest of Europe, industrial production dipped in November, dropping 0.4% on the previous month. It marked the third monthly drop in a row. On a 3m/3m basis, export-oriented production declined by 0.8%. Output in manufacturing, the biggest sub-sector, fell by 0.8% on a 3m/3m basis. Unlike some of the recent survey data, the Office of National Statistics did not report any increase in production or stockpiling by firms in case of a hard Brexit.
- **Construction:** Because of the long-term risks and liabilities involved in building, construction is normally the most sensitive sector to shifts in confidence. Still, the sector has remained surprisingly resilient. Output expanded by 2.1% on a 3m/3m basis.

Depending on how Brexit goes, Q1 could be a funny quarter for the UK: Hoping for the best, but preparing for the worst, UK households and business will begin to take steps in Q1 to prepare for an unlikely (20% risk) outcome of a hard Brexit. Fearing the supply-chain disruptions that an unmanaged hard Brexit could herald, companies may import more components and business and households may stockpile essential goods. This temporary effect may offset some of the likely drop in investment and spending on big ticket items until there is more clarity about the Brexit outcome. While our base case is that it will be 'business as usual' by mid-February, because parliament will soon take the necessary steps secure an agreement with the EU and avoid a hard Brexit, the current Brexit uncertainty may persist through to the end of the quarter. This poses a significant risk to our call that the UK economy will expand by 0.4% qoq in Q1. Furthermore, Q2 may also be affected by destocking as the one-off effect on any inventory build-up that occurs in Q1 is unwound.

Better growth ahead if the Brexit handbrake is released: After a very messy period in the coming weeks, we still see an 80% chance that the UK will avoid a damaging no-deal hard Brexit – see '[Brexit: the real crisis may be yet to come]'. While the long-term risks to UK potential growth from Brexit loom large, the prospect of a deal presents considerable upside potential for the UK economy over the medium-term. Just as the market consensus overestimated the extent to which the UK economy would soften after the Brexit vote, we think the consensus is now underestimating the extent to which growth will pick-up this year following a deal. We look for UK real GDP growth to accelerate from 1.4% in 2018 to 1.8% in 2019 and 2020. (Bloomberg consensus for 2019 is 1.5% and for 2020 is 1.6% – taken on 11 January 2019). For more see '[Global outlook 2019]'.

Chart 1: The Brexit factor – rising real wages but falling confidence

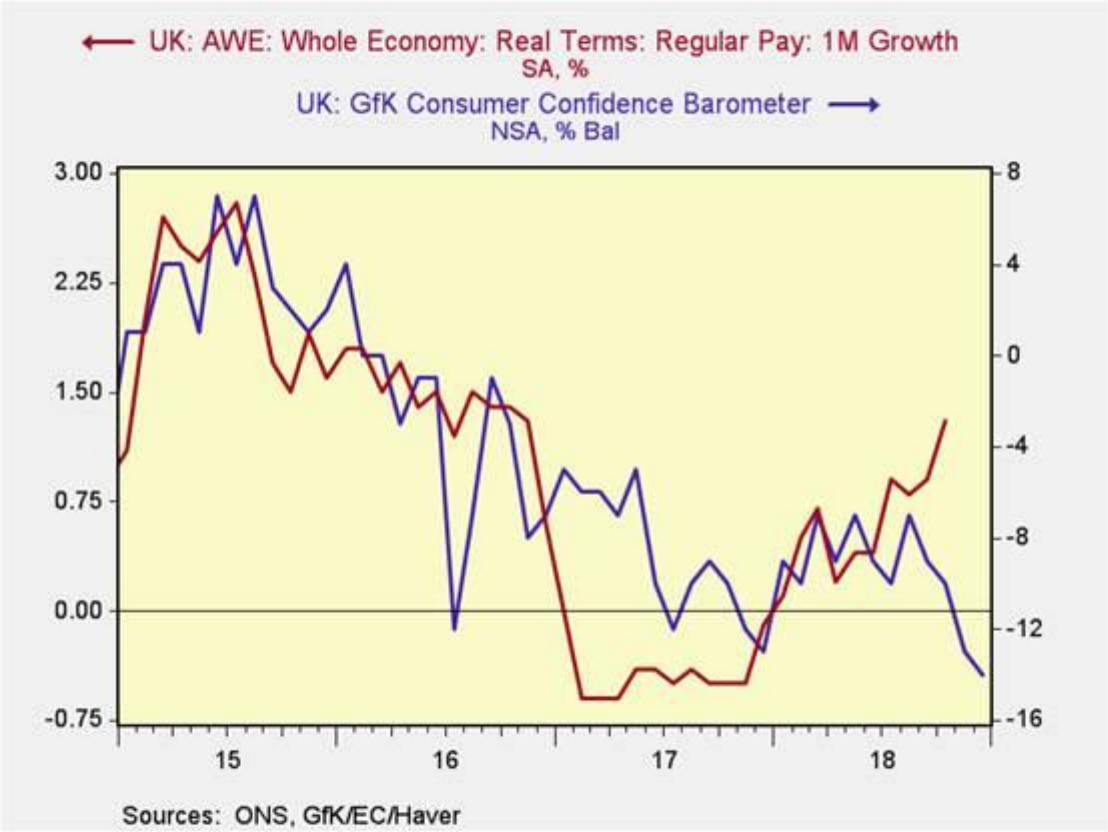

Chart 2: Real GDP growth slowed in Q4 2018

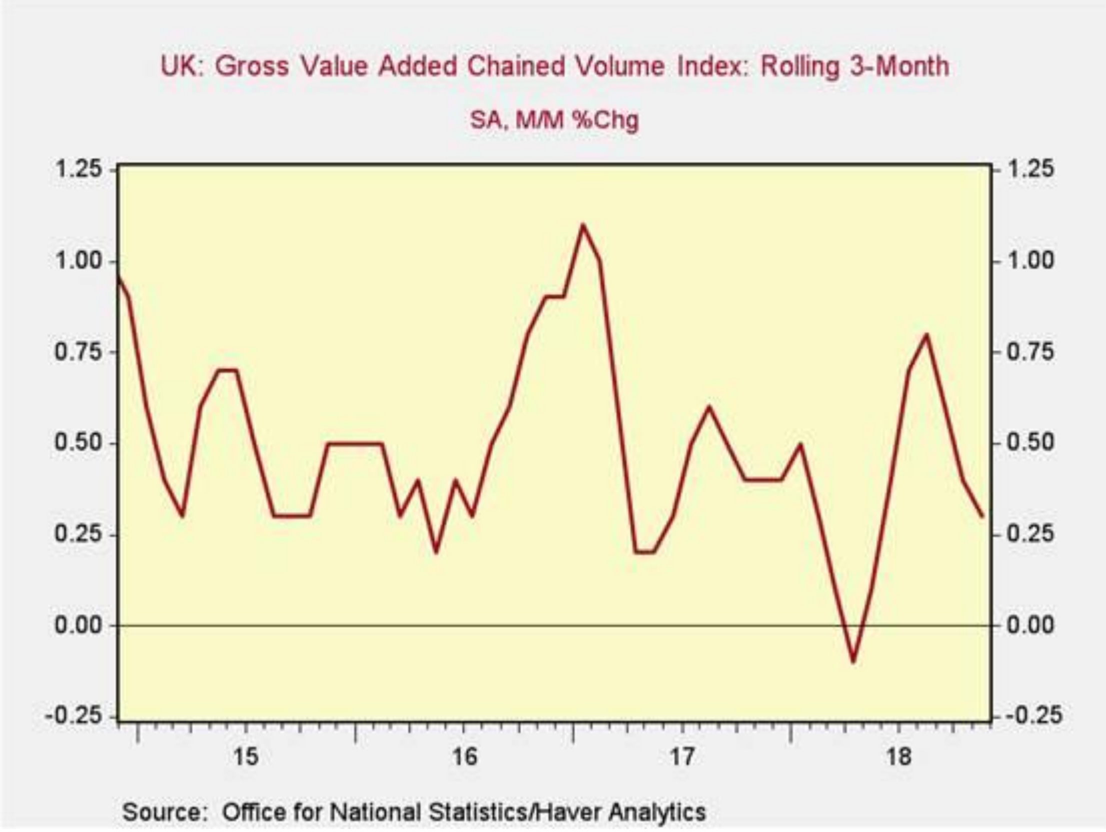

Table 1: Real GDP by sector

	Nov	Oct	Sept	Aug	Jul	Jun
GDP						
mom (%)	0.2	0.1	0.0	0.0	0.3	0.3
3m/3m (%)	0.3	0.4	0.6	0.8	0.7	0.4
Services						
mom (%)	0.3	0.2	-0.1	0.1	0.3	0.1
3m/3m (%)	0.3	0.3	0.5	0.6	0.7	0.6
Ind. production						
mom (%)	-0.4	-0.5	-0.5	0.0	0.4	0.9
3m/3m (%)	-0.8	0.1	0.6	0.7	-0.2	-0.7
Construction						
mom (%)	0.6	0.0	1.9	-0.2	0.4	0.8
3m/3m (%)	2.1	1.6	2.3	2.8	2.8	0.5

Source: ONS

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