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UK GDP: SLUGGISH Q4 - BREXIT AND GLOBAL RISKS HURT

Berenberg Macro Flash

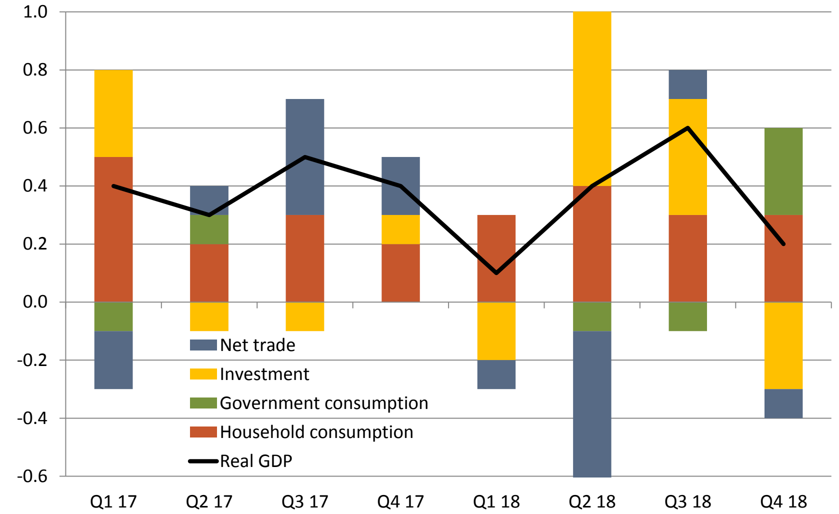
The hot summer faded into a cold winter fast: After the great weather and England's good World Cup run boosted spending over the summer, elevated risks weighed on investment and net-trade towards the end of the year. Real GDP growth slowed from a solid 0.6% qoq rate in Q3 to 0.2% (below consensus and Berenberg's estimate of 0.3%) amid a widespread drop in sentiment. At home, Brexit uncertainties increased as the final hurdle neared. The deal Prime Minister Theresa May's had tentatively agreed with the EU was poorly received in parliament, triggering an increase in emergency no-deal hard-Brexit preparations by both the government and the private sector. Meanwhile, the external environment deteriorated further. Overblown fears that the US could tip into recession in 2019 added to existing worries linked to the China slowdown, the US-China trade skirmish, and stalling Eurozone economies (especially Germany and Italy). On an annual basis, real GDP growth slowed from a rate of 1.7% in 2017 (close to trend) to 1.4% in 2018 - see Table 1 for a detailed breakdown.

Consumers continued in prop up demand in Q4: Despite households' softer confidence and dimming view of the economic outlook, household consumption growth remained firm in the final quarter and expanded by 0.4% qoq (versus 0.5% in Q3 2018). An unusually large rise in government spending, linked to increase in spending on general public services and defence, further boosted domestic demand. Government consumption grew by 1.4% qoq in Q4 and contributed c0.3% ppt to the headline quarterly growth rate. A small decline in net-trade in Q4 offset an equally modest gain in Q3. The big drag in Q4 came from business investment which declined for the fourth quarter in a row (down 1.4% qoq in Q4). Gross fixed capital formation, the broadest measure of investment, subtracted c0.3ppt from growth in Q4. Despite the increasing reports of emergency hard-Brexit preparations toward the end of the year, stockpiling remained modest – Chart 2.

The big dip in activity in December is worrying. UK real GDP declined by 0.4% mom in December, the biggest decline since March 2016 – Table 2. Consistent with the on-going sluggishness in core Europe, the monthly sector data for the UK suggest a broad-based weakening in economic activity – Table 2. Domestic-oriented services shrank by 0.2% mom following solid gains of 0.3% mom in October and November. Export-oriented industrial production dipped by 0.5% mom, the fifth consecutive decline in a row. The 2.8% drop in construction output was the biggest since June 2012. The sizeable contraction in real GDP in December is the reason why, probably along with the consensus, we overestimated the Q4 quarterly growth rate. Monthly data can be volatile. A small correction in services after solid gains is normal and one-off drops in construction – which is a lumpy sector anyway – are normal. Still, the downtrend in industrial output caused by weakening global trade and rising external risks at the start of the year points to a decidedly soft start to 2019 for the UK. See Global downtrend: looking for the circuit breakers and Stock rebound as global economies slump.

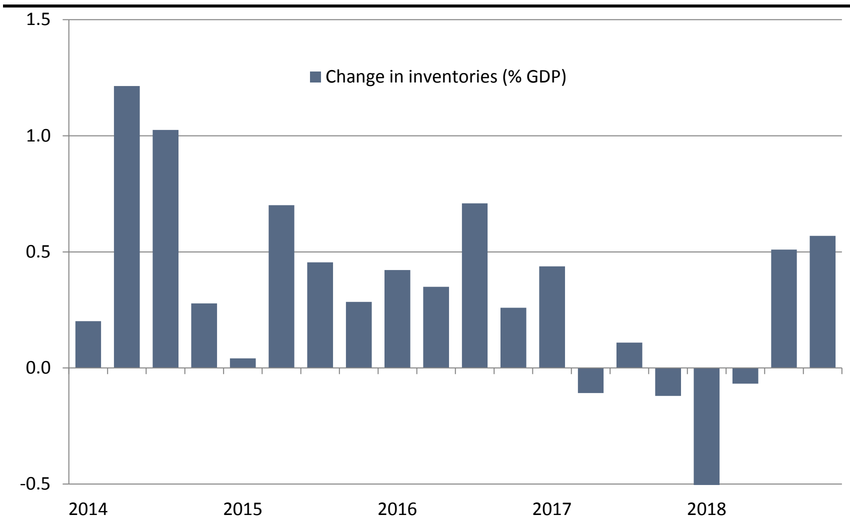
If the UK avoids hard Brexit (70% chance), the outlook can brighten. Real GDP growth in the first quarter is likely to disappoint again. We look for growth of just 0.2% qoq. The broad-based contraction in activity in December suggests the risks to this call are tilted to the downside. Such weakness is likely to persist until – and if – parliament passes a Brexit deal. But once markets and business get some clarity on the Brexit outlook – a majority vote in parliament for some deal would do the trick – domestic activity should rebound nicely. Helped by continued gains in employment and real wages, and a planned income tax cut in April, real GDP growth can accelerate to 1.7% in 2019 and 1.8% in 2020. Of course, this call hinges on a resolution to Brexit in Q1. Any delay in resolving Brexit would also imply a delay to the economic recovery.

Chart 1: Real GDP (qoq %) – ppt contribution by major components



Quarterly data. Source: ONS.

Chart 2: Change in inventories as % GDP



Quarterly data. Source: ONS.

Table 1: GDP by expenditure	% qoq, sa						% yoy, sa		
	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	2016	2017	2018
Real GDP	0.5	0.4	0.1	0.4	0.6	0.2	1.8	1.8	1.4
Nominal GDP	1.1	1.0	0.4	0.8	1.1	0.6	3.9	4.1	3.2
Private Consumption	0.5	0.3	0.4	0.6	0.4	0.4	3.1	2.1	1.7
Government Consumption	0.1	0.0	0.1	-0.4	-0.3	1.4	0.8	-0.2	0.2
Gross investment	0.3	0.7	-0.6	-0.9	0.6	-0.5	2.3	3.5	0.0
Business investment	0.9	0.4	-0.6	-0.5	-1.2	-1.4	-0.2	1.5	-0.9
Final Domestic Demand	0.8	1.0	0.2	1.4	1.4	0.7	4.0	3.8	3.5
Exports	1.9	0.1	0.0	-2.0	0.2	0.9	1.0	5.6	0.2
Imports	0.6	-0.6	0.3	0.1	0.0	1.3	3.3	3.5	0.8
GDP deflator	*2.1*	2.1	1.6	1.9	1.9	1.6	*2.1*	*2.2*	*1.7*

Source: ONS

Table 2: Real GDP by sector

	Jun	*Jul*	*Aug*	*Sept*	*Oct*	*Nov*	*Dec*
GDP							
mom (%)	0.3	0.3	0.0	0.0	0.2	0.2	-0.4
3m/3m (%)	0.4	0.7	0.8	0.6	0.4	0.3	0.2
Services							
mom (%)	0.1	0.3	0.1	-0.1	0.3	0.3	-0.2
3m/3m (%)	0.6	0.8	0.7	0.5	0.4	0.4	0.4
Ind. production							
mom (%)	0.8	0.5	-0.1	-0.5	-0.3	-0.3	-0.5
3m/3m (%)	-0.6	-0.3	0.5	0.6	0.1	-0.7	-1.1
Construction							
mom (%)	0.7	0.3	-0.1	1.6	-0.4	0.1	-2.8
3m/3m (%)	0.3	2.5	2.6	2.1	1.2	1.4	-0.3

Source: ONS

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