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UK GDP HIT BY BREXIT ONE-OFFS, UNDERLYING TREND WEAK

Berenberg Macro Flash

UK real GDP, qoq %, Q2 2019

Actual:	-0.2
Previous:	0.5
Consensus:	0.0
Berenberg:	-0.1

Brexit and global uncertainties hurt: UK real GDP in Q2 declined by the most since 2012 Q4. After expanding by 0.5% qoq in Q1, the ONS estimates that real GDP contracted by 0.2% in Q2 (Chart 1). A correction in stockpiling linked to firms' Q1 preparations for a hard Brexit accounts for much of the quarterly volatility (Chart 2). The average of the first two quarters is a better reflection of the still-weak underlying trend so far this year. The 0.6% annualised average growth rate for real GDP in H2 2019 remains well below potential (c1.7%). In addition to Brexit-related uncertainties, the protracted softness in global trade and production - linked to the China slowdown and noisy US-China trade negotiations - weighed on export-oriented industrial production which contracted by 1.4% qoq in Q2 (Chart 3).

Key takeaways:

- **Real consumption remained buoyant** despite softer consumer confidence linked to increased anxieties about Brexit. Real household consumption expanded by a strong 0.5% qoq - in line with the three year average. The robust spending growth suits our long standing positive view about the UK consumer, against a general pessimism by the market overall. Consumer fundamentals are in good shape. The labour market is solid - real wages are on the up and labour demand is at a near-record high. Household net-worth is at a near-record high and credit conditions are easy.
- **Uncertainty hurts business investment:** The broadest measure of investment, real gross fixed capital formation (GFCF), declined by 1.0% qoq in Q2. Real business investment shrank by 0.5% in the quarter. Compared to Q2 2016, before the Brexit vote, business investment was up just 0.2%. Compared to the pre-referendum trend, business investment was down c13%.
- **Correction in imports and stockpiling:** After building up stocks equivalent to 1.1% of GDP in Q1, firms reduced stocks by an amount equivalent to 0.8% of GDP in Q2. Firms will probably begin to accumulate stocks again in Q3 again in case of a hard Brexit on 31 October. Stockpiling trends linked to Brexit exacerbate the usual volatility in the quarterly trend in GDP growth this year. This also affects trade which contributed to the growth in Q2. After rising by 10.8% qoq in Q1 imports contracted by 12.9% in Q2.

The ONS notes that "the path of GDP and some of its components has been particularly volatile through the year so far, largely reflecting changes in timing of activity related to the UK's original planned exit date from the European Union in late-March."

Outlook: Political uncertainties have intensified of late, as the new UK Prime Minister Boris Johnson has stepped up the hard Brexit rhetoric. We see only a 30% chance of an orderly Brexit on 31 October. This implies a 70% probability that the Brexit-related uncertainties will extend into Q4 in the form of either a hard Brexit on 31 October 2019 or political changes (election?) with an uncertain outcome in the UK. In turn, real GDP growth will likely remain below potential in the near term linked to persistent weakness in investment

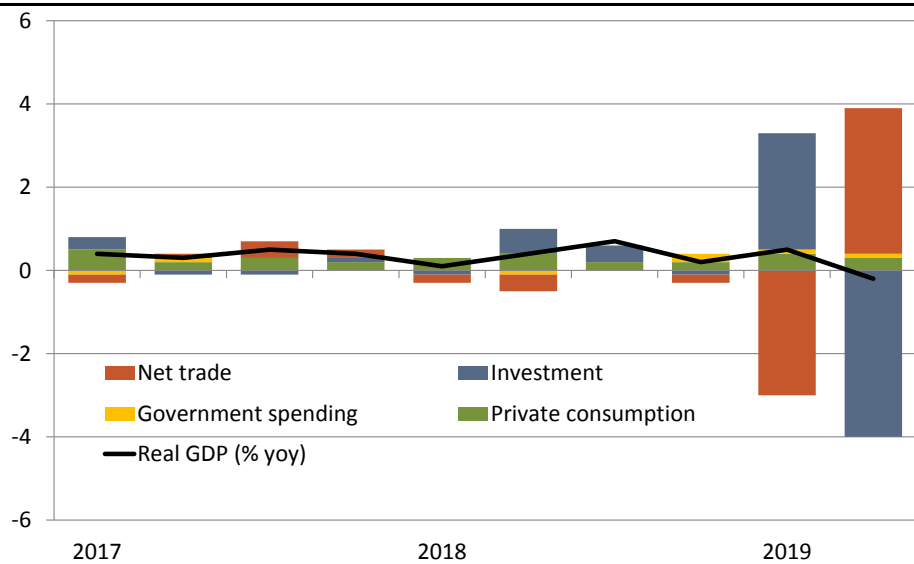


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and consumer spending on big-ticket items. Continued soft global demand will weigh on export-oriented industries too.

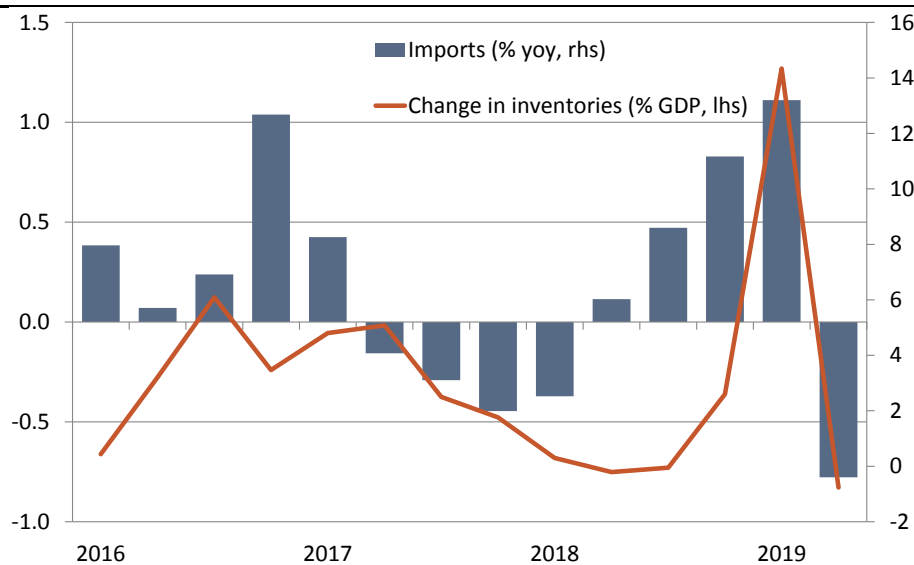
We expect momentum to remain soft in H2. For 2019, we forecast annual growth of 1.2% in 2019 and 1.8% in 2020. Part of the rise is likely to come from lost output growth this year that will be made up next year. Thereafter, we expect growth to return to trend (1.7%) in 2021. Due to the threat of a hard Brexit, or protracted uncertainty from a further delay, the risks to the medium-term are tilted to the downside.

Chart 1: Quarterly change in real GDP (% qoq)



Quarterly data. Source: ONS.

Chart 2: Brexit related volatility in imports and inventories

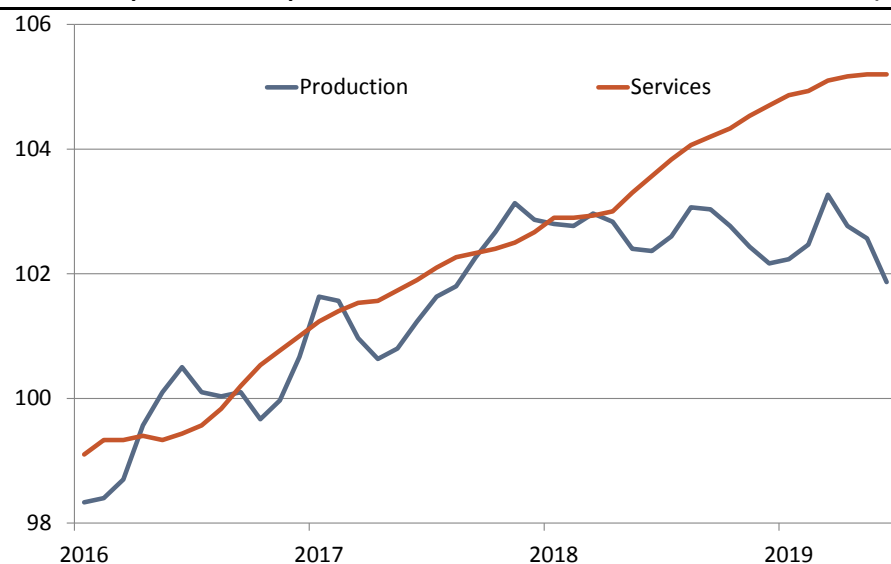


Quarterly data. Source: ONS.



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Chart 3: Export-oriented production soft, domestic-oriented services resilient (2016 =100)



Monthly data. Source: ONS. Three-month moving average.

Table 1: GDP by expenditure

	% qoq, sa						% yoy, sa		
	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	2016	2017	2018
Real GDP	0.1	0.4	0.7	0.2	0.5	-0.2	1.8	1.8	1.4
Nominal GDP	0.7	0.7	1.1	0.7	0.9	0.4	3.9	4.1	3.3
Private Consumption	0.5	0.5	0.3	0.3	0.6	0.5	3.1	2.1	1.7
Government Consumption	0.2	-0.4	-0.1	1.3	0.8	0.7	0.8	-0.2	0.4
Gross investment	-0.8	-0.6	0.9	-0.6	1.2	-1.0	2.3	3.5	0.2
Business investment	-0.6	-0.4	-0.6	-0.9	0.4	-0.5	-0.2	1.5	-0.4
Final Domestic Demand	0.7	1.1	1.4	0.7	2.9	-2.5	4.0	3.8	3.7
Exports	-1.3	-1.0	0.9	1.6	1.5	-3.3	1.0	5.6	0.1
Imports	-0.6	0.4	0.7	2.1	10.8	-12.9	3.3	3.5	0.7
GDP deflator	1.9	2.1	2.0	1.7	1.6	1.9	2.1	2.2	1.9

Source: ONS

Table 2: GDP by sector

	% qoq, sa						% yoy, sa		
	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	2016	2017	2018
Services	0.4	0.6	0.6	0.5	0.4	0.1	1.0	1.8	0.8
Industrial production	0.1	-0.6	0.6	-0.8	1.1	-1.4	4.1	7.1	0.3
Construction	-1.5	0.6	1.8	-0.6	1.5	-1.3	1.9	2.1	1.8
Farming and fishing	-2.1	-0.9	-0.1	0.7	-1.5	-0.4	-5.6	3.0	-2.3

Source: ONS

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