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MACRO NEWS

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UK INDUSTRIAL OUTPUT: THIRD SLUMP IN 8 YEARS

Berenberg Macro Flash

March, mom %	Industrial Manufacturing	
Actual	0.3%	0.1%
Previous	-0.2%	-0.9%
Consensus	0.5%	0.3%
Berenberg	0.4%	0.2%

Hard times for UK production industries: Industrial output contracted by 0.4% qoq in Q1 2016. This follows a quarterly decline of 0.4% in Q4 2016. Manufacturing – the largest industrial sector - contracted by 0.5% qoq. On a monthly basis, industrial output expanded by 0.3% versus expectations of 0.5%; manufacturing output increased by just 0.1% against a consensus of 0.3%. This is the third time the industrial sector has entered a technical recession since 2008. After sharp declines during the Lehman-recession, in 2011 the sector contracted again for six quarters in a row. On a positive note, while production industries underperformed against expectations on a monthly basis, it has not affected the estimate of Q1 GDP published two weeks ago. While March's industrial data was weaker than expected, there were modest upward revisions to back data. As such, we are still on course for growth of 0.4% qoq in the second estimate of Q1 GDP to be published at the end of the month.

Weak global demand and strong sterling hurt UK exporters: Production industries are export oriented and are thus highly sensitive to changes in global demand and exchange rates. Since 2011, goods exports to the EU – the UK's largest export market – have fallen by 20%. And as Chart 1 illustrates, industrial export orders are below long-term averages. The rocky start to 2016 in financial markets has furthered dampened global demand. While sterling has recently fallen off the mid-2015 high – down 10% in trade weighted terms – the benefits of this will take time to feed through. But there is a risk we won't see an improvement in exports at all. If, as we expect, the UK votes to stay in the EU on June 23, sterling will likely regain ground thereafter. If export oriented manufacturers assume that this competitive gain is only temporary, they could just use it to temporarily boost margins rather than reduce prices.

Industrial declines do not usually signal wider economic malaise: Only 15% of the UK economy is industrial output. The 0.4% qoq decline of industrial output in Q1 will subtract less than a tenth of a percentage point from the overall GDP growth rate. In the final quarter of last year, the UK economy grew by 0.6% qoq despite a 0.4% qoq decline in industrial output. Although the UK's current growth momentum is softening ahead of the Brexit vote, we expect domestic demand to snap back in Q3 if the UK votes to stay in the EU. This will boost demand for domestic related service industries (80% of GDP), which are far more important to the UK economy than the productions industries. For 2016 overall, we expect the UK economy to expand by 1.9% yoy.



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Chart: 1 Weak export orders hurt manufacturing



Source: ONS, CBI, Berenberg. Data 6 month moving average

% change	MAR	FEB	JAN	DEC	NOV	OCT
Industrial production, yoy	-0.2	0.1	0.6	-0.2	0.9	1.6
Industrial production, mom	0.3	-0.2	0.6	-1.1	-0.8	0.2
Manu. production, yoy	-1.9	-1.6	-0.4	-1.7	-1.2	-0.2
Manu. production, mom	0.1	-0.9	0.5	-0.3	-0.3	-0.4

Source: ONS

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