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MACRO NEWS

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UK: STRONG Q2 GDP - ROBUST DOMESTIC DEMAND PLUS UPSIDE SURPRISE ON INVESTMENT

Berenberg Macro Flash

UK GDP, real, qoq %, Q2 2016

Actual	0.6
Previous	0.6
Consensus	0.6
Berenberg	0.6

UK economic growth accelerated to 0.6% qoq in Q2 from 0.4% in Q1. As expected, the more detailed data today confirmed the first estimate published 27 July. Remarkably, the cyclical performance of the UK economy improved in the second quarter despite widespread signs in the soft data that economic growth was slowing, weighed down by the uncertainty related to the June 23 Brexit vote. Early signs suggest that this disparity between the hard and soft data has continued after the vote. July data for the labour market and retail spending improved despite the falls in reported consumer and business confidence.

Strong domestic demand in Q2. Consumption continued to provide the main source of growth, picking up to 0.9% qoq, compared to 0.7% growth in Q1. Household fundamentals look strong; employment is at a record level, real wages are rising at a healthy rate, homeowners benefit from the wealth effects of recent rises in house prices, and cheap oil and credit provide tailwinds. UK households look well positioned to ride out the Brexit induced uncertainty.

While consumption growth could slow a little over the medium-term as rising inflation - from the weaker sterling - eats away at real incomes, we expect household spending to remain the key driver of growth. Falling house prices present the major risk to this call, see our recent [note on the UK housing market](#).

Government spending decreased by 0.2% qoq. However, it looks set to pick-up over the next couple of years as the Treasury introduces some discretionary spending measures to support demand. Trade dragged as exports rose by less (0.1%) than imports (1.0%). The 16.5% depreciation in trade-weighted sterling since November may begin to modestly benefit the trade balance in the second half of the year as higher import costs weaken demand for foreign products while luring more tourist into the UK and boosting the competitiveness of UK goods and services.

Investment increased compared to Q1 despite the Brexit uncertainty. Gross fixed capital formation rose by 1.4% qoq compared to a small decline of 0.1% in Q2 and versus expectations of 0.4% growth. Business investment grew by 0.5% versus expectations of a 0.9% decline. The heightened uncertainty related to Brexit did not cause businesses to postpone investment decisions until after the vote. This was indeed a positive surprise and bodes well for the outlook for H2. We expect the UK economy to stagnate in the second half of the year, caused by a slowdown in consumption and a contraction in business investment. That both consumer spending and business investment picked up ahead of the vote may indicate more resilience to Brexit uncertainty than anticipated. It suggests an upside risk to our already above consensus calls for stagnation in the second half of the year and subdued growth in 2017 (1.2%).

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% change, sa	Q2	Q1'16	Q4	Q3	Q2	Q1'15
GDP, qoq	0.6	0.4	0.7	0.4	0.4	0.3
yoy	2.2	2.0	1.8	2.0	2.3	2.9
Private consumption, qoq	0.9	0.7	0.6	0.8	0.7	0.8
Government spending, qoq	-0.2	0.5	0.2	0.3	1.0	0.4
GFCF, qoq	1.4	-0.1	-1.0	0.5	1.2	1.5
Exports, qoq	0.1	-0.4	3.2	-0.2	-0.3	2.1
Imports, qoq	1.0	0.1	2.5	1.3	-2.1	3.8
Business investment, qoq	0.5	-0.6	-2.2	1.6	0.5	2.1

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