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UK INDUSTRIAL PRODUCTION: UPTURN CONTINUES DESPITE SMALL DIP IN JANUARY

Berenberg Macro Flash

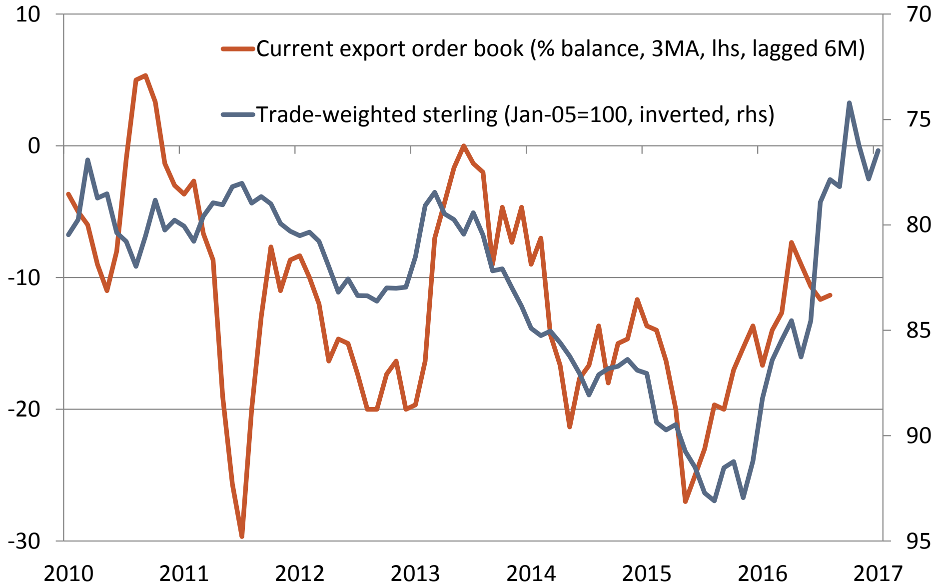
Jan, 2017	Industrial, mom%	Manufacturing, mom%
Actual	**-0.4**	**-0.9**
Previous	0.9	2.2
Consensus	-0.5	-0.7
Berenberg	-0.3	-0.5

Two steps forward, one step back - but that's the way it goes: The little monthly correction in industrial production in January doesn't change the broad based upward trend. After solid monthly gains in November (2.3% mom) and December (0.9%) industrial producers eased off more or less in line with expectations in January (-0.4%). Smoothing the monthly volatility reveals the true state of conditions. On a 3m/3m basis industrial production increased by 1.9% with gains across all major sub-sectors. Manufacturing, the largest sub-sector, expanded by 2.1% on a 3m/3m basis, its fastest rate since May 2010. Separate data released today on UK trade showed goods exports increased in January for the fourth consecutive month as the trade deficit narrowed on a 3m/3m basis by £4.7 billion to £6.4 billion.

Fundamentals look good for industrial producers in 2017: Driven by solid domestic demand and the global upswing that began in H2 last year, and now compounded by the Trump led pick-up in demand from the US, the UK industrial sector is on track for solid year of growth after some six years in the trenches. Our chart shows the strong relationship between export orders and the exchange rate with a lag of around six months. Since we do not expect sterling to make a meaningful recovery from its current low until at least early 2018, demand for UK exports should continue to improve strongly in the months ahead. The stage is set for the UK's export-oriented laggard sector to finally make a positive contribution to growth, and, possibly, encourage a much needed rebalancing toward production away from consumption.

The benefits, and costs, of a more competitive exchange rate: While a weaker exchange rate is a positive for export demand, it also raises input costs. This rise in input costs will squeeze producers' margins and may limit the extent to which they can pass the gains from a more competitively priced sterling onto foreign consumers. Producers who buy inputs in dollars and whose main market is the Eurozone will get hit the worst. Sterling is down 18% versus the US dollar since the Brexit vote but down 12% versus the euro. Nonetheless, helped by the global upturn in demand, the positive effects from the gain in sterling's competitiveness should outweigh the costs over time.

Export order books (lagged 6 months) versus trade-weighted sterling



Source: CBI, Bank of England, Berenberg calculations

% change	JAN	DEC	NOV	OCT	SEP	AUG
Industrial prod., yoy	3.2	4.3	2.3	-0.8	0.5	0.9
Industrial prod., 3m/3m	1.9	0.4	-0.5	-0.8	-0.4	0.3
Industrial prod., mom	-0.4	0.9	2.3	-1.2	-0.3	-0.3
Manu. prod., yoy	2.7	4.2	1.8	0.0	0.6	1.0
Manu. prod., 3m/3m	2.1	1.2	0.4	-0.2	-0.7	-0.3
Manu. prod., mom	-0.9	2.2	1.4	-1.0	0.6	0.3

Source: ONS

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