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SOLID PMIS FOR Q1 SHOW THE UK STARTED 2017 ON A FIRM FOOTING

Berenberg Macro Flash

PMI services, March

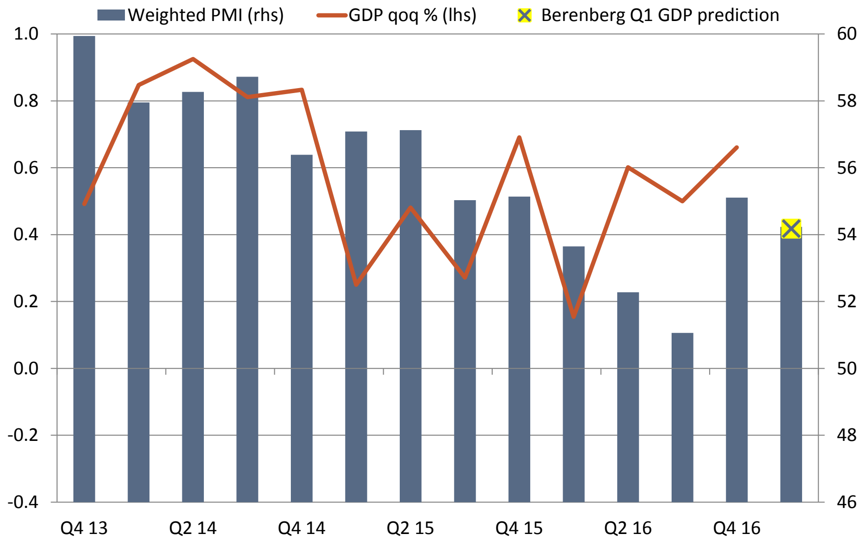
Actual	**55.0**
Previous	53.3
Consensus	53.4
Berenberg	53.5

Growth is normalising after a temporary - above-trend - acceleration in H2 2016: The surprise surge in real GDP growth in the second half of 2016 probably moderated to more normal levels at the start of the year. Our weighted PMI series indicates that real GDP growth slowed to 0.4% qoq in Q1, from 0.7% qoq in Q4 2016. That is in line with our forecast and in line with the UK's potential rate (0.4-0.5% qoq). With the UK in its eight year of expansion, and at full employment, growth at trend is perfectly good enough. Recent PMI data have underestimated the quarterly growth rate (see chart), risks to our Q1 call are therefore skewed a little to the upside. Today, Markit/CIPs published fresh data for the dominant services sector (c80% of GDP). The services PMI surprised strongly to the upside, rising to 55.0 in March, versus the consensus estimate of 53.4, and well above the previous month of 53.3. The upside surprise comes after both the March construction (52.2 vs. est. 52.5) and manufacturing (54.2 vs. est. 55.0) PMIs published earlier this week surprised to the downside. But that is par for the course. Monthly data are volatile. The key point is that the UK continues to enjoy a broad based expansion in output, and we strongly expect it to continue.

Risks to the outlook are tilted to the upside: We expect the economy to continue to expand at our estimated Q1 rate (0.4%) for the remainder of the year (2.0% for 2017 overall). Risks to our call are skewed a little to the upside as we see the potential benefits from the upturn in global demand outweighing the exaggerated risks to real domestic spending coming from the modest rise in inflation – 2.8% in 2017 - following the c12% depreciation in trade weighted sterling Brexit vote. The PMIs, European Commission surveys and the BoE's Agents' surveys point to rising demand at home and abroad. Meanwhile, demand for labour remains close to post-Lehman highs, and despite the heightened uncertainty from Brexit, investment intentions are modestly positive.

A healthy rebalancing is underway, rising exports can offset slower gains in consumption. Now that the oil boost is over, growth in real household spending will return to more normal levels. Household balance sheets are sufficiently strong to smooth consumption as rising inflation temporarily erodes real income growth over the medium-term. Suppose sterling took another 10-15% leg down and inflation hit 5%, then households would face some real problems. That, however, seems unlikely. Meanwhile, UK exporters are benefitting from the upturn in global demand that started in the second half of last year. The more competitive exchange helps too. Rising exports can add to growth as real household spending moderates. Since we do not expect sterling to make a meaningful recovery from its current lows 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 to enjoy a much needed rebalancing toward production away from consumption.

Weighted PMI indices versus quarterly real GDP growth



Quarterly data. Source: Markit/CIPS, ONS, Berenberg calculations.
A PMI of 50 indicates no change in output. PMI quarterly series based on monthly data.
Sector weights for PMI series: 80% services, 15% manufacturing and 5% construction.

Index	MAR	FEB	JAN	DEC	NOV	OCT
Service	55.0	53.3	54.5	56.2	55.2	54.2
Manufacturing	54.2	54.5	55.4	56.0	53.5	54.6
Construction	52.2	52.5	52.2	54.2	52.8	52.6

Source: Markit/CIPS

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