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UK Q1 GDP: BACK TO REALITY, BUT THE OUTLOOK REMAINS POSITIVE

Berenberg Macro Flash

UK GDP (a), real, qoq %, Q1 2017

Actual	0.3%
Previous	0.7%
Consensus	0.4%
Berenberg	0.4%

Par for the course: After an unexpected surge in real GDP growth in the second half of 2016, with the data beating expectations for the previous two quarters in a row, the economic expansion eased sharply in the first quarter of 2017. Real GDP expanded by 0.3% qoq, slightly below expectations of 0.4%, following growth of 0.7% qoq in Q4 2016 – Chart 1. While the deceleration looks a little scary, the UK's trend rate is 0.4%. The expansion is entering its eighth year and the labour market is at full employment. Against this backdrop, growth with some volatility around its trend rate during the middle of the cycle is more than satisfactory. As we discussed yesterday - [UK growth: 10 reasons to be optimistic for 2017](#) - the UK story remains positive. Even with the slowdown in the quarterly rate, we expect real GDP to expand by 2.0% in 2017, in line with the recent upgrades by the IMF and BoE. Today's data shifts the risk to this estimate a little to the downside. In our base case, we expect Brexit to reduce long-term trend growth from 2.2% to 1.8%.

Domestic driven services slowed as household appetites moderated (c79% of GDP): Real services output expanded by 0.3% on a quarterly basis, half of the post-Lehman average quarterly growth rate of 0.6%. The fizz from low oil prices is over. Household real consumption growth is moderating as inflation rises towards 3% this year following the c10% drop in trade-weighted sterling after the Brexit vote. Chart 2 shows the sub-sectors of services that made the largest and smallest contributions to the quarterly change in output. Consumer oriented components such as retail contributed the most to the slowdown. After splurging late last year, households may need to pay a little back in H1. However, household balance sheets have strengthened since the Lehman-crisis; debt-to-income is lower and household wealth has risen. Feeling confident after seven years of economic growth, households will temporarily save a little less and borrow a little more to smooth consumption as inflation picks up. While services output growth will moderate relative to recent years, growth can remain healthy over the near-term.

Global upturn and competitive sterling boosted industrial production (c15% of GDP): Industrial production expanded by 0.3% qoq after growth of 0.4% qoq in Q4. Taken in context, that is a good quarter for the UK's second biggest sector. The post-Lehman quarterly average growth rate is a meagre 0.1% qoq. Manufacturing, the biggest industrial sub-sector, expanded by 0.5%. Fundamentals look good for industrial producers in 2017. Driven by healthy 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, and the acceleration in Eurozone growth, the stage is set for the UK's export-oriented laggard sector to finally make a sustained positive contribution to growth.

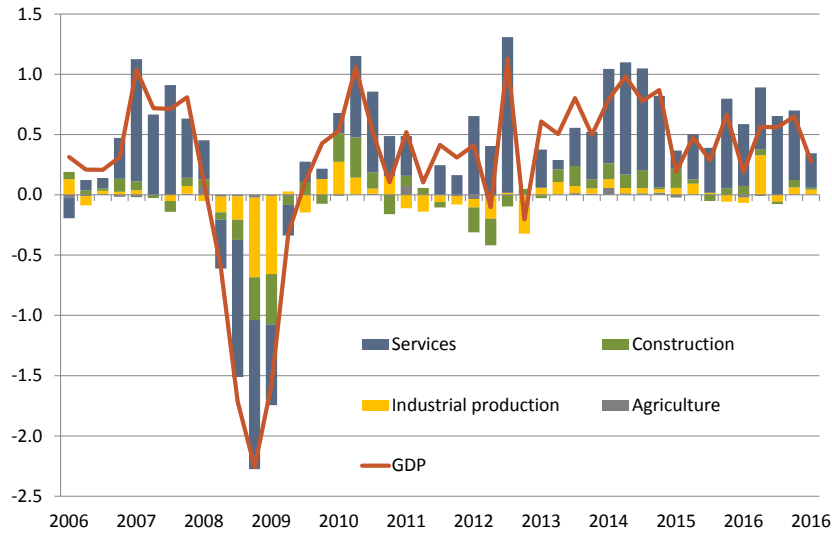
Construction remains resilient despite heightened long-term uncertainty (c6% of GDP): Despite the long-term uncertainty stemming from the Brexit vote, construction output remained resilient and expanded by 0.2% qoq in Q1. In times of uncertainty, because it requires confidence in the long-term outlook to commit to long-lived liabilities, construction can suffer badly. While growth remains modest relative to the post-Lehman average of 0.8% qoq, the average quarterly growth rate of 0.3% since the Brexit vote is better than



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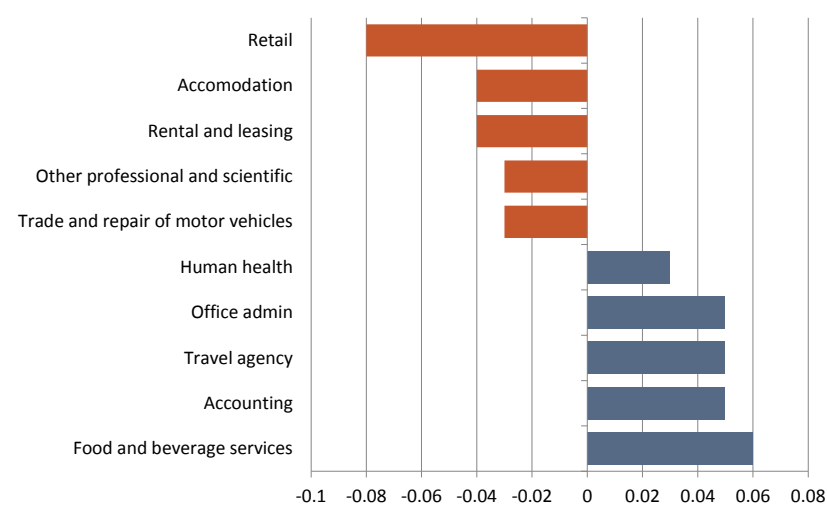
we would have expected. If the global upturn continues to flourish and Brexit negotiations don't go badly wrong, construction growth can accelerate over the medium-term.

Chart 1: Headline real GDP growth rate in %, and sector contribution to growth rate in ppt



Quarterly data. Source: ONS, Berenberg calculation.

Chart 2: Largest and smallest qoq contributions of services industries to headline GDP growth (ppt)



Quarterly data. Source: ONS.

qoq %	Q1 17	Q4 16	Q3 16	Q2 16	Q1 16	Q4 15
GDP	0.3	0.7	0.5	0.6	0.2	0.7
Services	0.3	0.8	0.9	0.6	0.7	1.0
Production	0.3	0.4	-0.4	2.2	-0.3	-0.4
Construction	0.2	1.0	-0.3	0.9	1.2	1.0

Source: ONS.



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