April 27, 2016

Economics Group

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U.K. GDP Growth Downshifted in Q1 2016

Weakness in manufacturing and construction contributed to the slowdown in Q1. The upcoming referendum on continued EU membership adds uncertainty to the U.K. economic outlook.

Weakness in Manufacturing Weighs on Overall GDP Growth

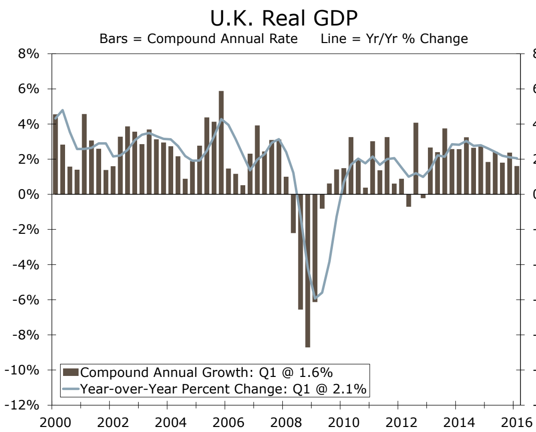
Real GDP in the United Kingdom grew 0.4 percent (1.6 percent at an annualized rate) in the first quarter, marking the 13th consecutive quarter in which the British economy has expanded on a sequential basis (top chart). The outturn matched the consensus forecast, but it represented a downshift relative to the growth rate that was posted in the preceding quarter.

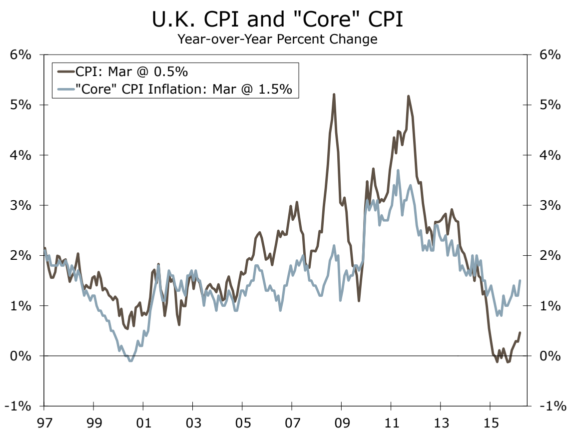
A breakdown of the preliminary GDP data into its underlying demand components will not be available for another month, but the high-level sector disaggregation that was released this morning offers some insights into the current drivers of GDP growth in the United Kingdom. Specifically, it appears that the British economy continues to be driven largely by consumer spending at present. That is, output in the service sector rose 0.6 percent (not annualized) in Q1. Most services are consumed largely at home.

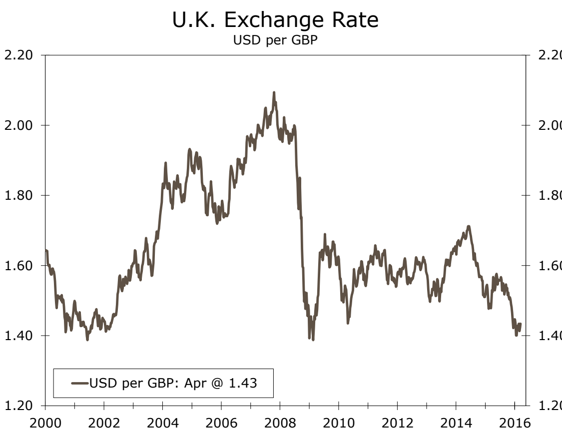
In contrast, manufacturing output declined 0.4 percent in the first quarter. The continued weakness in manufacturing production—it was down 1.3 percent on a year-over-year basis—suggests that export growth likely remained weak in Q1. In addition, weakness in manufacturing output indicates that investment spending may have weakened as well in the first quarter. In that regard, the Bank of England recently noted that there are some signs that capital spending has been negatively affected recently by uncertainty regarding the outcome of the upcoming referendum on continued British membership in the European Union. Another notable sector of weakness in the first quarter was construction, which contracted 0.9 percent.

Speaking of the Bank of England, the Monetary Policy Committee (MPC) has maintained its main policy rate at 0.50 percent for seven years, and a rate hike in the foreseeable future does not appear to be in the cards. The CPI inflation rate continues to run well below the MPC's target of 2 percent (middle chart). Moreover, the MPC is simply not about to tighten policy ahead of the EU referendum on June 23. If U.K. voters decided to leave the European Union, the MPC likely would ease policy further in an attempt to support the economy against the growth-restraining effects of uncertainty.

Sterling has risen a bit against the U.S. dollar in recent weeks, but it generally remains near a 7-year low versus the greenback (bottom chart). Our currency strategy team looks for the British pound to remain on the defensive in coming quarters, even if the United Kingdom decides to remain in the European Union. In our view, the MPC will not hike rates until early next year, at the earliest. (For further reading on "Brexit," see our website for the two reports we have written on the subject recently.)







Source: IHS Global Insight and Wells Fargo Securities, LLC

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