UK's surprising growth after the Brexit vote

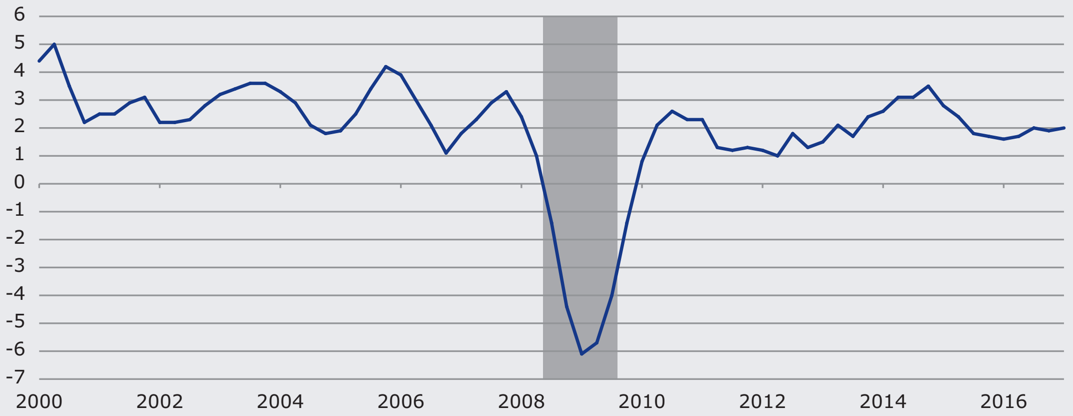
John Greenwood
Chief Economist
Invesco Ltd.

UK real GDP maintained momentum until 2017 Q1

UK real GDP has seen 29 consecutive quarters of continuous expansion since the Global Financial Crisis of 2008-09. The UK economy also continued to expand following June 2016's historic vote to leave the European Union, confounding most economic commentators with a vigorous pace of growth until 2017 Q1. In year-on-year terms, the real GDP growth in 2017 Q1 was 2.0%.

Figure 1: UK's real GDP maintained momentum despite Brexit fears until 2017 Q1

UK Real GDP % Y-O-Y



Source: Macrobond, May 2017.

UK recovery largely consumer-led

The main driver of economic growth since 2015 has been consumer spending, while business investment became a drag on growth over 2016 as uncertainty grew due to the Brexit referendum. Although consumer spending has continued to grow and the labour market has so far remained extremely buoyant, the 2017 Q1 GDP data slowed to 0.2% quarter-on-quarter reflecting the hit to consumer spending from the slowdown in real wage growth as inflation creeps up. Real wages were growing at only 0.7% year-on-year in February 2017.

Deleveraging process largely completed

Faster money and credit growth since April 2016 had been a key factor driving the sustained growth since the June referendum through 2016 Q3 and Q4, against a backdrop of sustained deleveraging of the private sector. With the household and financial sector's deleveraging process now largely complete, there has been a slight re-leveraging, especially by households increasing their borrowings of unsecured (or consumer) credit such as credit card debt and instalment debt. Bank lending to the household sector (mortgages and consumer credit) was growing at 4.3% year-on-year in February 2017.

Household savings rate near its 2008 low

The increase in household borrowing – mostly via via consumer credit -- has accompanied a decline in the personal savings rate. Since 2016 Q2 the savings rate has fallen to 5.2% in 2016 Q4, compared to 11.1% in 2010 Q3 and 5.1% in 2008 Q3. This recent decline appears to be linked to the improvement of consumer confidence, against the backdrop of an initially more benign economic environment post-Brexit than had been predicted even though real wage growth is now slowing.

Corporate sector stronger

Turning to the non-financial corporate (NFC) sector, total non-equity liabilities (which consist of loans, bonds and pension liabilities) were £2.6 tn in 2016 Q4. Against a background of low yields created by the weak recovery and by QE, combined with structural demographic headwinds created by an ageing population, corporate pension liabilities had increased hugely. However, the improved performance of equities and the rise in bond yields over the second half of 2016 significantly reduced those pension liabilities by as much as 20%.

Additionally, in 2016 Q4 the NFCs' financial assets totaled £2.17 tn (up 11% from 2016 Q1). Equity holdings of £1tn accounted for nearly half of this. Following the depreciation of sterling after the Brexit vote, the UK equity market rose markedly. From 23 June to 28 April, the FTSE100 rose by 17.4% in sterling terms. Many UK-listed companies earn cash flows in foreign currency, so revenues and reported profits have risen as the value of sterling fell. This is especially true of commodity companies such as mining and oil companies whose products are priced in dollars and are heavily weighted in the FTSE100.

UK budget deficit effectively financed entirely from overseas

The virtual disappearance of corporate and household sectoral surpluses (i.e. the surplus of savings over investment) means that the UK government's budget deficit (3.3% of GDP in 2016 Q4) must be financed almost entirely from the overseas sector, i.e. from capital inflows. This is sustainable only as long as growth of the UK economy is firm, inflation is low and the government maintains its credibility in the eyes of overseas creditors.