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THE WEEKLY U.K. ECONOMIC MONITOR

JULY 9, 2018
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Mark Carney's "greater confidence" in the economy was based largely on surveys, not hard GDP data.

We expect three-month on three-month GDP growth of 0.2% in May, but wouldn't rule out a weaker print.

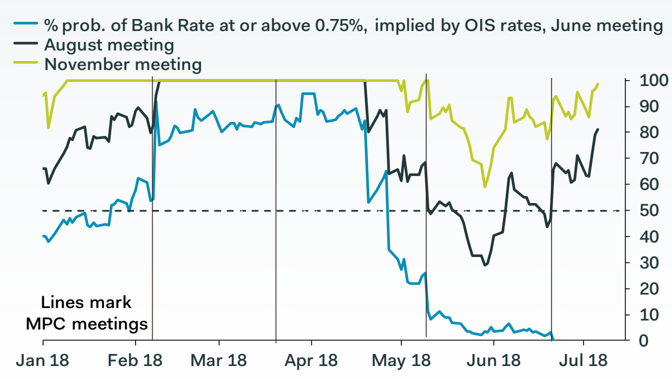
The economy doesn't need cooling, but the MPC's eagerness to hike suggests August is finely balanced.

May GDP Data will have the Final Word on an August Rate Hike

Mark Carney revealed last week that recent data had given him "greater confidence" that the weakness of Q1 GDP was almost entirely due to severe weather. The Governor, however, based his assessment largely on surveys, and he refrained from signalling unambiguously that he will vote to raise Bank Rate at the Committee's next meeting, on August 2. A pledge, for instance, to raise Bank Rate "over the coming months"—the turn of phrase used by the MPC last autumn to signal that rates would rise in November—was not forthcoming.

Instead, the Governor simply acknowledged that the economy was evolving broadly as expected in May's *Inflation Report*, when the Committee issued loose guidance that it likely would raise Bank Rate

MARKETS NOW THINK AN AUGUST RATE HIKE IS HIGHLY LIKELY



three times over the next three years. As a result, an August rate hike is not a done deal. ***This week's monthly estimate of GDP—the first in a new publication schedule—will have a major bearing on the Committee's next steps.***

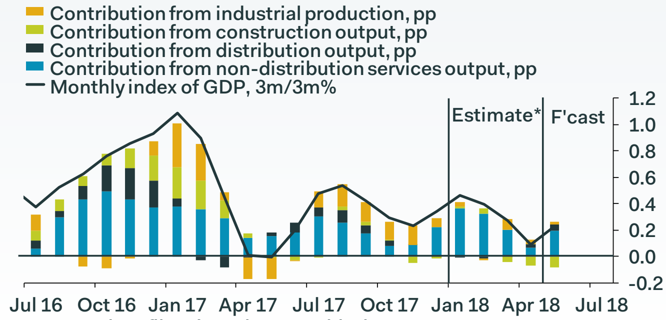
The preliminary estimate of GDP has been abolished because little data were available for the third month of the quarter, leading to large revisions. As a result, the ONS has decided to delay the publication of GDP data by two weeks and switch to producing a monthly estimate. This means that an estimate of GDP in Q2 as a whole won't be available until August 10, after the MPC's meeting. Instead, an estimate of month-on-month and three-month on three-month growth in GDP up to May, will be the only data published this month.

The MPC has downplayed the significance of the new publication schedule, stating in the minutes of June's meeting that "these changes would not materially alter the extent of the information available to the Committee at its policy meetings". But it does elevate the importance of May's data. At a minimum, the MPC will need to see three-month on three-month growth in GDP of 0.2% in May to support its forecast that it will rise by 0.4% on the same basis in June.

Forecasting May's GDP report is difficult because the ONS has not yet published revised estimates for the monthly level of output in the construction, industrial and services sector that are consistent with the latest national accounts. Recall that the *drop* in construction output in Q1 was revised in the accounts to just 0.8%, from 2.7% previously, triggering the latest estimate of quarter-on-quarter GDP growth to be revised up to 0.2%, from 0.1% previously. The monthly data available at this point are consistent with the initial 2.7% decline in construction output.

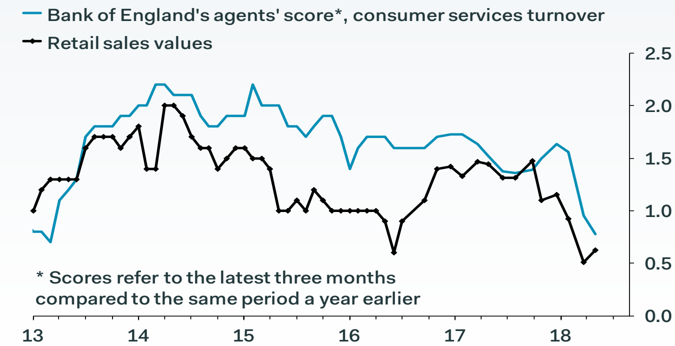
Revisions to monthly data in April, however, would have to be very positive to show that the economy

WILL THE RISE IN GDP GROWTH GIVE THE MPC ENOUGH CONFIDENCE?



* Assumed profile, given that monthly data consistent with latest GDP estimate are not available

GROWTH IN CONSUMER SERVICES SPENDING WEAKENED IN Q2

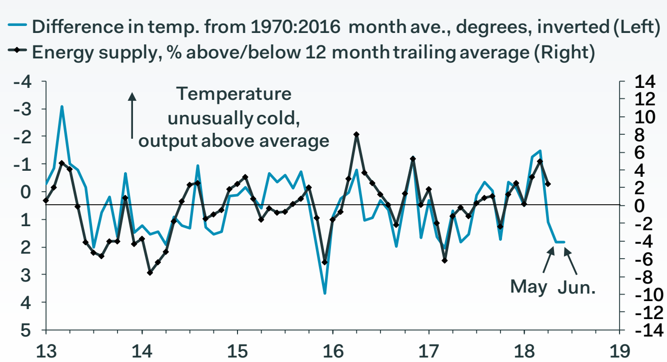


didn't start Q2 on a shaky footing. Services output and construction output rose by 0.3% and 0.5% month-to-month, respectively. But a 0.8% drop in industrial production, driven by a 1.4% decline in manufacturing output, implies that GDP rose by just 0.2% in April. That's a poor result, given that some activity was deferred from Q1 due to the bad weather.

The MPC suggested April's fall in manufacturing output might reflect lagged disruption from the adverse weather. But during snowstorms in January 2010, December 2010 and January 2013, the vast bulk of the fall in output was seen immediately, so April's data likely reflect some underlying weakness too. As such, we look for only a 1.2% month-to-month rebound in manufacturing output in May.

What's more, output in the energy supply sector likely fell by a further 2.0% month-to-month given that average temperatures were 1.8 degrees Celsius above their 1970-to-2017 May average, exceeding the 1.1 degree deviation in April. Mining and quarrying output likely fell too, perhaps by 3.0%, as

WARMER-THAN-USUAL WEATHER POINTS TO LOWER ENERGY OUTPUT



the Sullom Voe Terminal in the North Sea was closed for unscheduled maintenance early in the month. Accordingly, we think that industrial production rose by just 0.5% month-to-month in May, failing to rebound fully from April's decline.

Meanwhile, the 1.3% rise in retail sales volumes in May will boost growth in total services output by 0.09pp. But consumers likely funded part of this rise by cutting back on non-retail spending. Our final chart shows that the Bank's agents' score of growth in turnover at consumer services firms fell in June to its lowest level since April 2013. In addition, the services PMI was consistent with just 0.3% quarter-on-quarter growth in output in the private non-distribution services sector in May. As a result, we look for just a 0.2% month-to-month rise in total services output. We also have pencilled-in only a 0.2% rise in construction output, as surveys and official orders data indicate the sector is struggling to shake off its Q1 blues.

Summing up, then, we look for a 0.3% month-to-month rise in GDP in May, which would push up the three-month on three-month growth rate to 0.2%, from 0.1% in April. That *might* be strong enough—just—for the MPC to hike Bank Rate in August, provided reports later this month also show that CPI inflation rose in June and wage growth recovered in May. But with no good reason to expect GDP growth to pick up in the second half of 2018, the wait for the next rate rise will be long, if the MPC pulls the trigger next month.

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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, July 9

• **MPC member Broadbent speaks in London**
The Deputy Governor for monetary policy is giving opening remarks at a conference about economics and psychology.

Tuesday, July 10

• **D: BRC Retail Sales Monitor (6)/00:01 BST**
We think that the BRC's measure of year-over-year growth in like-for-like sales values slowed to about **0.5%** in June, from 2.8% in May. **Consensus: N/A.**

• **D: Monthly Estimate of GDP (5)/09:30 BST**
Industrial production likely struggled to rebound fully in May from its 0.7% month-to-month drop in April; we look for a 0.5% rise. Sharp falls in output in the energy supply and mining and quarrying sectors likely offset a revival in manufacturing output. Meanwhile, we expect subdued rises in construction output and services output of 0.2%. Households likely financed the 1.3% rise in retail sales volumes by cutting back on consumer services. As a result, we expect the new monthly index of GDP to rise by **0.3%** month-to-month and just **0.2%** on a three-month on three-month basis in May. **Consensus: 0.3% m/m, 0.2% 3m/3m.**

• **D: Trade Balance (5)/09:30 BST**
We expect the trade deficit to decline to about **£3.0B** in May, from a huge £5.3B in April. The deficit was big in April partly due to a £1.2B deficit in erratics trade, which should be fleeting. Exports of finished manufactures also suffered, but this likely reflected disruption caused to production lines by the heavy snow in Q1. **Consensus: £3.4B.**

Wednesday, July 11

• **BoE Governor speaks in Boston, USA/16:35**
Mark Carney will speak at a National Bureau of Economic Research Conference on the global financial crisis.

Thursday, July 12

• **D: RICS Residential Market Survey (6)/00:01 BST**
We expect the balance of surveyors reporting that house prices have risen over the last three months to edge up to **-2** in June, from -3 in May. **Consensus: -2.**

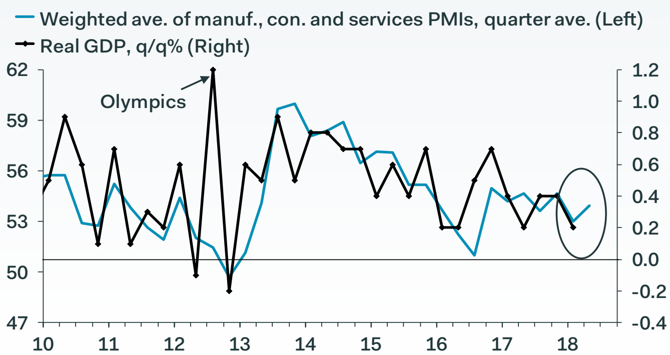
• **BoE Credit Conditions Survey (Q2)/09:30 BST**
We will be looking to see whether banks still are reducing the supply of unsecured credit.

• **White Paper on post-Brexit customs plans**
The Government will publish details of proposals agreed by the Cabinet over the weekend for how Britain will trade with the E.U. after Brexit. MPs should be able to vote on the plans before the summer recess begins on July 20.

Friday, July 13

• **MPC member Cunliffe speaks in Cumbria/12:00 BST**
Sir Jon voted against raising Bank Rate in November 2017 and has been the Committee's most outspoken dove.

CHART OF THE WEEK: PMIS POINT TO A NEAR-0.4% RISE IN GDP IN Q2



PANTHEON'S FINANCIAL FORECASTS

		End-month:				
	5pm Fri.	Jun	Sep	Dec	Mar 19	Dec 19
Bank Rate	0.50	0.50	0.50	0.50	0.75	1.00
3m Libor	0.71	0.60	0.60	0.80	0.90	1.30
12m Libor	1.00	0.90	1.00	1.10	1.20	1.60
2-year Gilt	0.75	0.80	1.00	1.10	1.20	1.60
10-year Gilt	1.27	1.40	1.50	1.70	1.90	2.20
30-year Gilt	1.71	1.90	2.00	2.20	2.30	2.50
FTSE 100	7617	7500	7400	7400	7500	7600
USD/GBP	1.33	1.33	1.34	1.36	1.38	1.40
EUR/GBP	1.13	1.14	1.17	1.24	1.25	1.27
Sterling TWI	77.8	77.9	79.5	83.4	84.6	85.9

PANTHEON'S ECONOMIC FORECASTS

	Period average:						
	Q1 18	*Q2 18*	*Q3 18*	*Q4 18*	*2017*	*2018*	*2019*
GDP, q/q%	0.2	0.3	0.3	0.4	-	-	-
GDP, y/y%	1.2	1.3	1.2	1.3	1.7	1.2	1.7
Employment, y/y%	1.2	1.2	1.3	1.0	1.0	1.2	0.6
Unemp. rate, %	4.2	4.2	4.2	4.2	4.4	4.2	4.1
Wkly earnings, y/y%	2.6	2.6	2.8	2.7	2.3	2.7	3.0
CPI, y/y%	2.7	2.5	2.5	2.3	2.7	2.5	2.0
RPI, y/y%	3.6	3.3	3.2	3.3	3.6	3.3	2.8
PSNB FY, £B	-	-	-	-	43	38	35
Cur. acc't., % GDP	-3.4	-4.5	-3.8	-3.5	-3.9	-3.8	-4.0
House prices, y/y%	4.4	3.6	2.4	1.5	4.7	3.0	1.5