RESEARCH

UK ECONOMIC OVERVIEW NOVEMBER 2018

The UK economy grew at its fastest pace since 2016, increasing by 0.6% in Q3 2018. GDP rose 0.4% in Q2 and 1.5% compared with Q3 2017. Growth in July (+0.3%) drove the third quarter expansion, which fell in line with market expectations.

Summer this year lifted the British economy with short-lived factors such as warm weather and events like the World Cup. With Brexit remaining on everyone's lips, the Bank of England expects the economy to expand 1.7% in 2019 and 2020. These forecasts are based on the assumption of a smooth transition to the average range of potential divorce outcomes. Knight Frank on the other hand takes a less optimistic short-term view, projecting that GDP will only expand 1.5% in 2019 but accelerate to 1.9% in 2020.

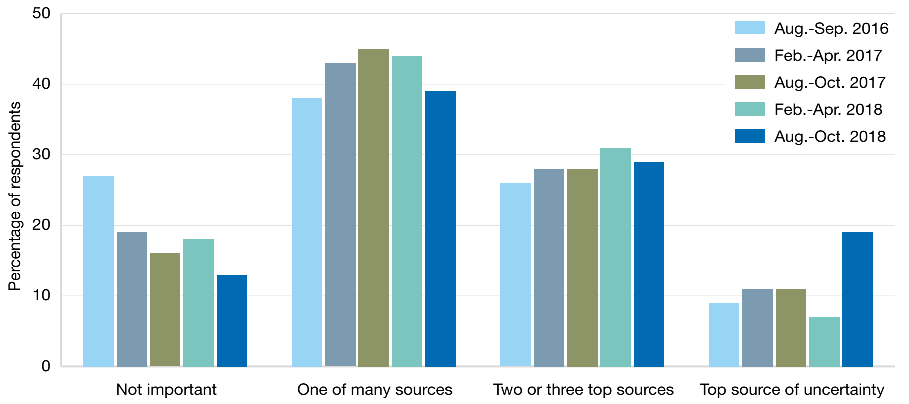
Services sector output increased at a rate of 0.4% in Q3 2018, slowing from the 0.6% growth reported between Q1 and Q2 2018, but up 1.7% from Q3 2017. The information and communication sector was the largest contributor to growth in the quarter owing to large programming businesses, followed by the professional, scientific and technical activities sector where growth was underpinned by the accounting and auditing activities industry.

Manufacturing output rose for the first time this year and increased 0.6% in the three months to September, thereby contributing to more than half of the total production output. Transport equipment, in particular motor vehicle production were the main thrust behind this growth. Manufacturing shows a broad-based weakness on a month-on-month basis, led by soft drinks, mineral waters and bottled water, due to high August figures.

Retail sales figures for September this year reported a +3.0% year-on-year increase with growth across all sectors except department stores. Month-on-month retail volumes declined by -0.8% in September, owing to the largest decline in food store sales since October 2015 (-1.5%). September 2018 registered record proportions of online sales for food stores (+5.8%) and clothing stores (+18.2%).

FIGURE 1

Decision makers remain divided over Brexit. Almost half still view it as one of top three sources of uncertainty.



Source: Bank of England survey: "How much has the result of the EU referendum affected the level of uncertainty affecting your business?"

CPI inflation's 12-month growth rate rose to 2.4% in September, down from 2.7% in August this year. Increased inflation came from food as the prices did not rise like they did in September last year. Further, ferry prices dropped, however, energy prices went up. The UK unemployment rate decreased by 10bps to 4.0% in the three months to August 2018, and by 30bps on the year.

The 10-year gilt yield increased slightly to 1.56% at the end of September, from 1.41% at the end of August. The IPD equivalent yield dipped 1 basis point to 5.82% in September, reducing the arbitrage from 4.42% in August to 4.26% in September. UK Office market yield gaps between the 25th and 75th percentiles are now below the historical average. This translates to investors being happiest taking property-level risk in Europe's core markets, where Central London remains the top pick.

Brexit-related uncertainty among companies has risen and pushed the correlation between the pound and euro to 0.8 against the dollar. The pound to euro exchange rate reached a high of 1.1447. US midterm election results have divided the US government, with Democrats controlling the House and Republicans retaining the Senate, which has weakened the US dollar. This gave the pound to dollar exchange rate a chance to recover to a multi-week best at 1.3148.

Key points

- UK economy grows at its fastest pace since 2016 but business investment slows to its lowest.
- Buoyant growth in July was offset by a slowdown in August and September.
- Economic activity may remain subdued as Brexit scepticism persists, and almost half of British decision makers deeming Brexit as a top three source of uncertainty.

COMMERCIAL RESEARCH

Sherin Gooi
Assistant Economist
+44 20 7861 5051
sherin.gooi@knightfrank.com