

Brexit dashboard Q2 2018

11 June 2018

This is the second quarterly issue of the Global Counsel Brexit dashboard. Two years on from the vote - and with just nine months before the UK leaves the EU - we are taking the macro pulse of the UK economy each quarter, using a balanced set of 15 indicators. We are not attempting to isolate the impact of Brexit from all of the other factors affecting the economy, as that is near impossible. Instead, we are providing a health check, to see where the economy is faring better or worse, compared to the years before the vote.

Sensing light through the gloom







































The UK economy hit the brakes in the first quarter of this year, with GDP growth slowing from 0.4% in the final quarter last year, to just 0.1% in the first quarter this year, well below market expectations. That might be partly due to bad weather, particularly as the worst performing sector in the quarter was construction. Even so, the consensus forecast for growth in 2018 has been marked down, from 1.5% to 1.4%. That's not much, but it shows that most forecasters believe at least some of the Q1 slowdown won't be revised away or reversed later this year.

The services sector is continuing to struggle. Banking stocks have fallen further. Brexit concerns are a possible factor. The services sector, more generally, is having to adjust to a tighter labour market, compounded by a sharp and sustained drop in net migration from the EU.

But there are some signs of light amid the gloom. Economic policy uncertainty has fallen sharply over the past couple of months, which is consistent with survey evidence that the Brexit transition deal, reached in March, has reduced uncertainty for business. It remains to be seen whether that lasts.

Consumer sentiment also looks to be perking up, with all three dashboard indicators improving, albeit only modestly. Consumer resilience has provided an important support for the economy since the referendum. A pick up in real earnings growth could help sustain consumer spending. It will also be a relief for the government, given the political sensitivity about this. But with oil prices higher, household budgets may soon begin to feel the pressure from rising prices once more.

Snapshot of latest indicators | last available month or quarter

 Consumers	Last	Trend	 Investment	Last	Trend
 Real earnings	0.4		 Economic policy uncertainty	168.2	
 Retail sales	1.3		 Business investment	2.0	
 Durable goods consumption	2.4		 London house prices	-1.0	
 Industry	Last	Trend	 Services	Last	Trend
 Industrial production	2.0		 Services output	1.2	
 Manufacturing PMI	54.4		 Services PMI	54.0	
 Goods exports to the EU	2.0		 FTSE 350 Banks	60.8	
 People	Last	Trend	Legend		
 Visitor arrivals of EU residents	-11.6		 Above pre-referendum trend		
 Net migration of EU nationals	-45.4		 Within pre-referendum trend		
 Vacancies in health & social work	5.0		 Below pre-referendum trend		

For definitions, sources and more information, see technical notes at the end of this document.



Perking up

There is positive news on all three consumer indicators we track. The uptick in real earnings will be particularly welcome for the government, given how politically sensitive this is. But there are still some risks. While inflation has fallen back faster than expected, as the effects of the post-referendum sterling depreciation on import prices have washed out, the oil price has increased, and this is beginning to be felt by consumers in petrol prices and in utility bills. It may be a while before we know whether the modest growth in real earnings is sustained.

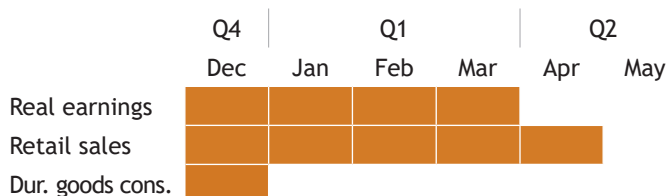
Retail sales are up, but still not that impressive. This is, however, one of the components of consumer spending that is most sensitive to the weather and the snow in the first quarter may have depressed this.

Consumer durable spending has bounced back. A large part of the downward spike in 2017 can be blamed on falling demand for new cars, in turn due to distortions created by tax changes. With car purchases stripped out, growth in consumer durable spending looks more resilient and less erratic.

Data summary

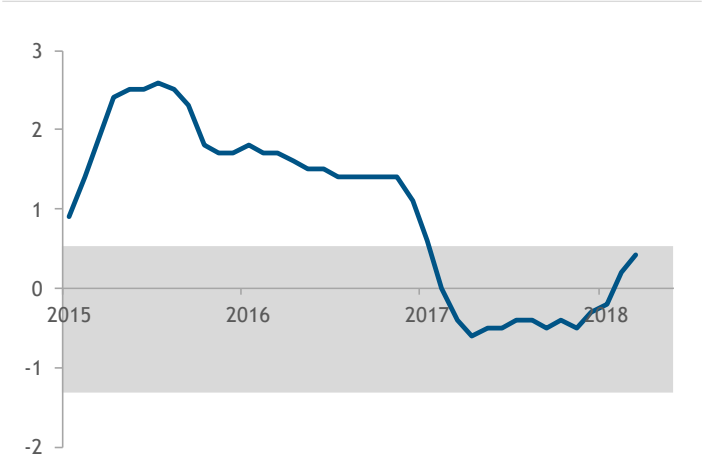
	Real earnings	Retail sales	Durable goods consumption
Last	0.4	1.3	2.4
Period	Mar 18	Apr 18	Q4 17
Previous	0.2	1.3	1.4
50% range	-1.3/0.5	0.5/2.9	1.6/7.3
Frequency	Monthly	Monthly	Quarterly

6-month heatmap



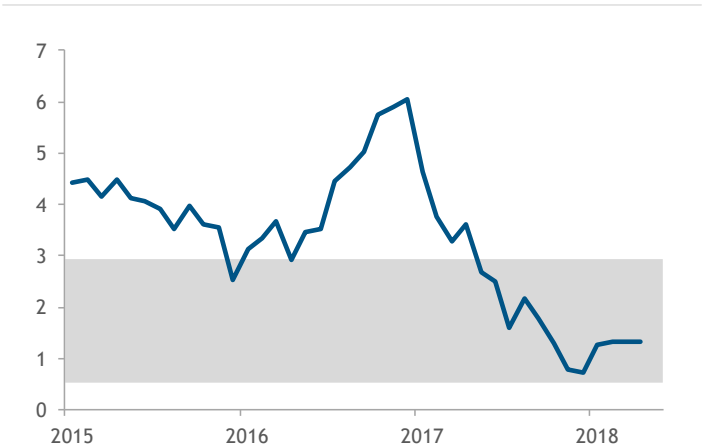
Real earnings

%-change year-on-year



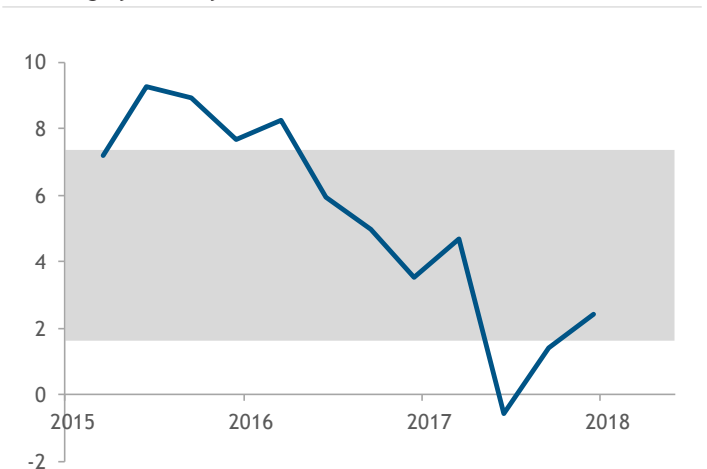
Retail sales

3-month moving average, %-change year-on-year



Durable goods consumption

%-change year-on-year





Brexit transition boost?

Business investment is growing at a respectable rate, but not fast enough to power a stronger recovery in the UK economy, or to suggest that higher capital intensity is about to help solve the UK's productivity problem.

The economic policy uncertainty index has fallen over the past two months and that may be partly related to the Brexit transition deal reached at the European Council at the end of March. A survey by Deloitte suggests the deal has improved business sentiment and that weak demand has replaced Brexit as the biggest concern for CFOs. Most survey evidence suggests, however, that businesses remain cautious about their investment plans, certainly when compared with 2014 and 2015.

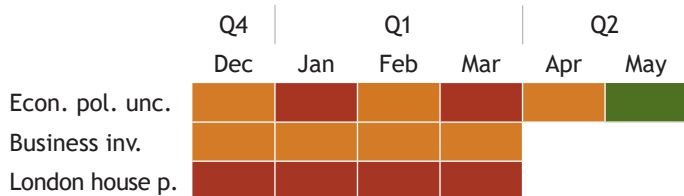
Finance could be part of the problem. Bank lending rates for businesses have been edging up in recent months, according to the Bank of England, and equity risk premia for companies have increased in the UK.

Falling house prices in London are a crude gauge of broader economic sentiment. They also provide a clear market signal for the construction sector. New housing starts are thought to have slowed at the start of this year, although that is partly the temporary effect of bad weather.

Data summary

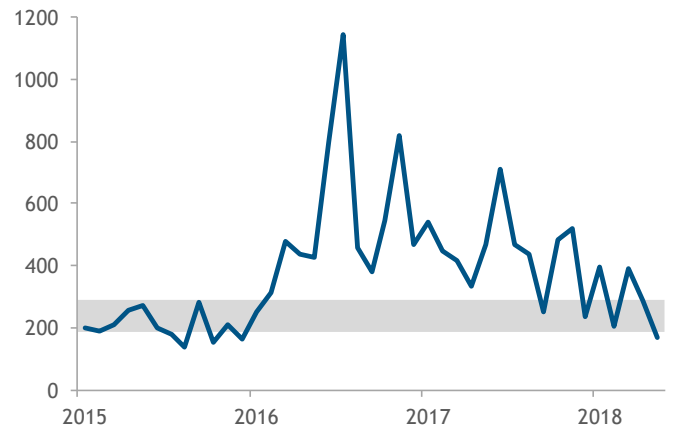
	Economic policy uncertainty	Business investment	London house prices
Last	168.2	2.0	-1.0
Period	May 18	Q1 18	Q1 18
Previous	289.8	2.6	-0.5
50% range	186.0/291.6	1.5/7.2	4.7/13.8
Frequency	Monthly	Quarterly	Quarterly

6-month heatmap



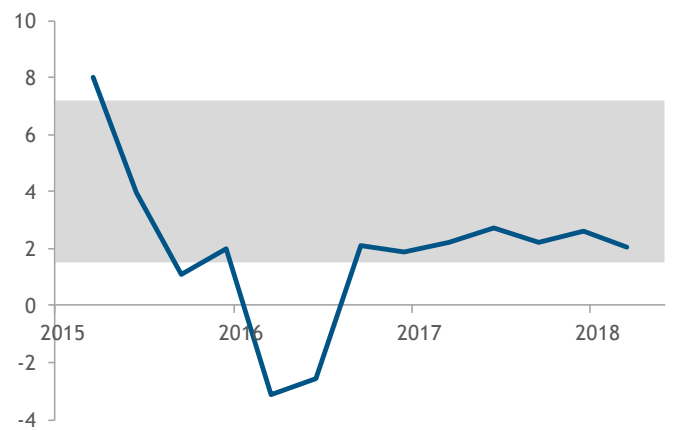
Economic policy uncertainty

Index based on newspaper articles



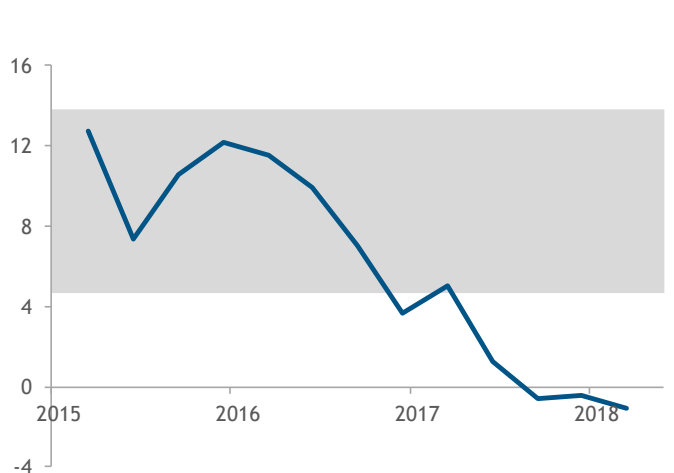
Business investment

%-change year-on-year



London house prices

%-change year-on-year





EU export drag

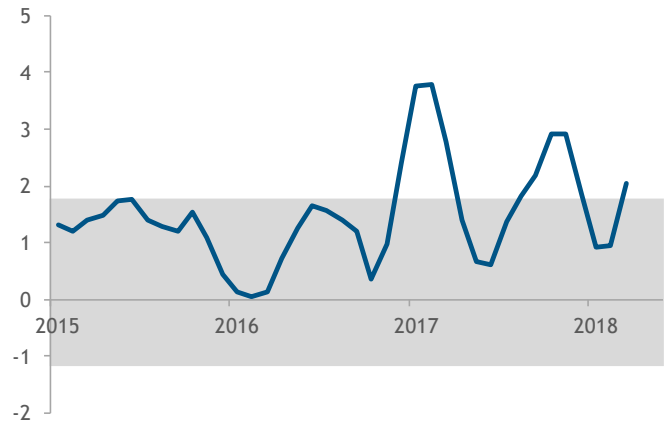
Industrial production can be volatile, but, most recently, we have seen activity picking up, and our indicators suggest that industry is still faring better than services.

The most recent uptick has been driven by an increase in manufacturing growth. Manufacturing sentiment, as shown by the PMI, remains relatively high, but still below the levels seen during much of last year, suggesting that many businesses remain cautious about the outlook.

The Bank of England has been bullish recently about the prospects for exports, driven by buoyant global demand and the impact of the post-Brexit referendum fall in the value of sterling. But it has recently also warned that the outlook for net trade will also depend on how the supply chains of companies evolve in response to Brexit. This could be good or bad news for individual firms, with indications that at least some companies are sourcing more goods and services from inside the UK. What is clear, however, is that export growth to the EU remains below the impressive rate seen in the middle part of last year.

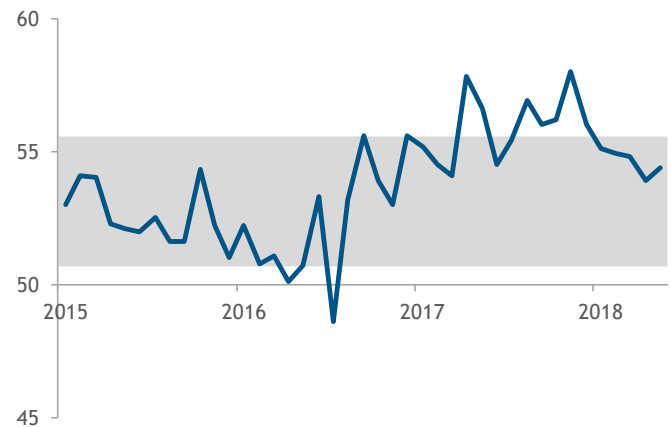
Industrial production

3-month moving average, %-change year-on-year



Manufacturing PMI

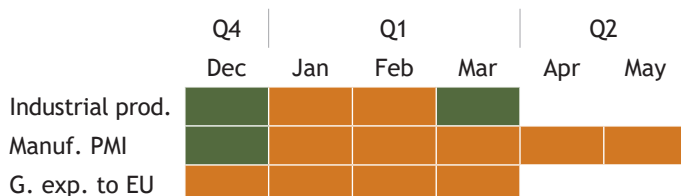
Above 50 indicates output expansion



Data summary

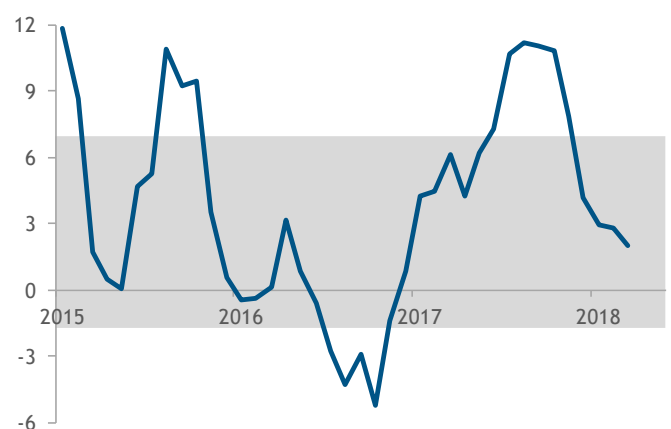
	Industrial production	Manufacturing PMI	Goods exports to the EU
Last	2.0	54.4	2.0
Period	Mar 18	May 18	Mar 18
Previous	0.9	53.9	2.8
50% range	-1.2/1.8	50.7/55.5	-1.7/6.9
Frequency	Monthly	Monthly	Monthly

6-month heatmap



Goods exports to the EU

3-month moving average, %-change year-on-year





Still struggling

In the three months to March 2018, services output increased by 1.2% compared with the three months ending March 2017. Over the last quarter, business services and finance made the largest contribution to growth, with distribution, hotels and restaurants underperforming.

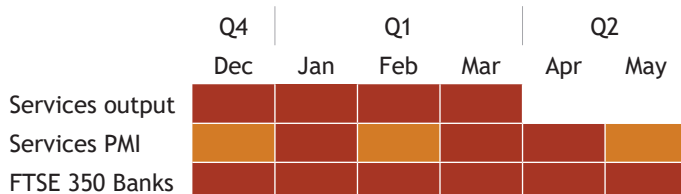
Despite the recent sluggish growth of the sector, there are hints that business sentiment is picking up. The services PMI is at 54, just below where it was three months ago, but consistent with a quarterly growth rate in services of between 0.3 to 0.4%. Some analysts are concluding this will encourage the Bank of England to raise interest rates sooner rather than later, but harder evidence of a pick up in the sector may be needed before that happens.

UK banking stocks continue to underperform the market. Brexit could be a factor, as the sector is one of the more exposed. The UK wants to negotiate mutual recognition of regulations for financial services with the EU, but there has been little to indicate over the quarter that the EU will entertain the idea.

Data summary

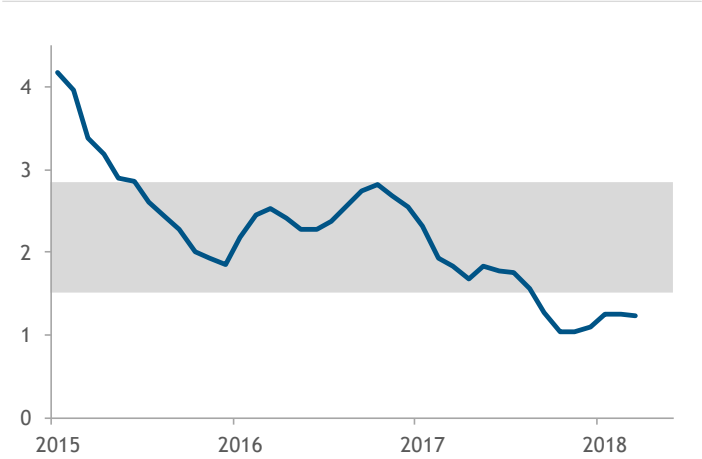
	Services output	Services PMI	FTSE 350 Banks
Last	1.2	54.0	60.8
Period	Mar 18	May 18	May 18
Previous	1.3	52.8	63.2
50% range	1.5/2.8	53.2/57.2	70.5/87.1
Frequency	Monthly	Monthly	Monthly

6-month heatmap



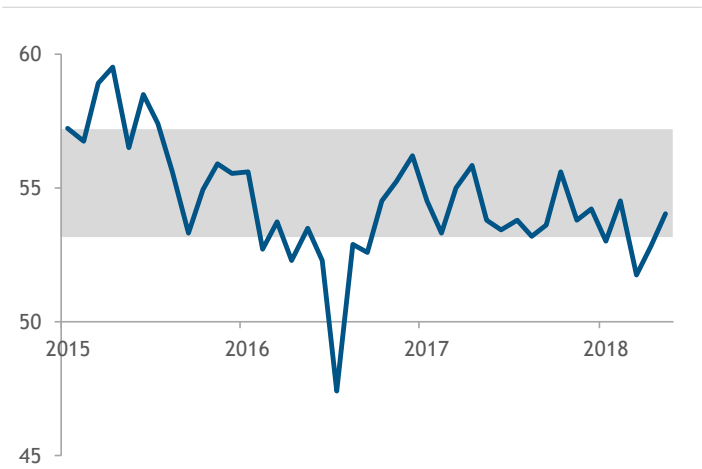
Services output

3-month moving average, %-change year-on-year



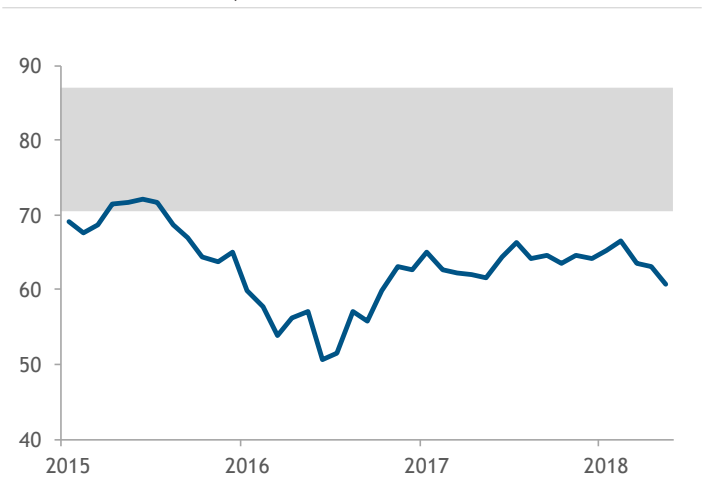
Services PMI

Above 50 indicates output expansion



FTSE 350 Banks

Relative to FTSE 350, Jan 2010 = 100





Tightening labour market

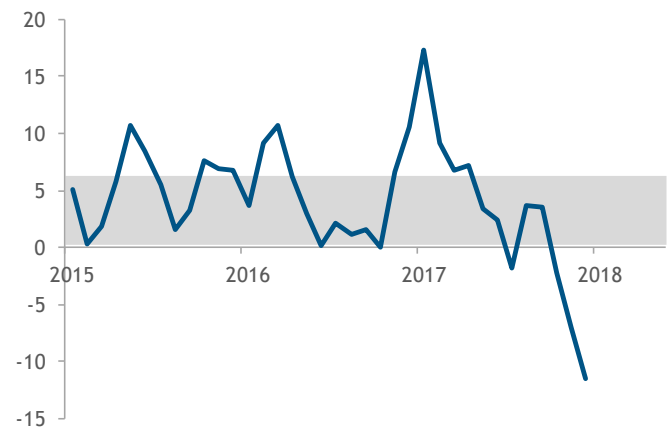
Unemployment has continued to fall, and the number of vacancies has risen, despite slower growth in the first quarter. The tightness of the UK labour market remains a subject of debate. There appears to be only limited scope for the participation rate to increase, but slack may still exist as some of those in employment may be willing to work longer hours. The number of part-time employees who want full-time jobs has fallen but remains high.

This means that, if the labour force is to grow, much of that will need to come through net migration. Overall, net migration edged up slightly in the third quarter last year (the most recent quarter for which data is available), but as our dashboard shows, net migration from the EU is still falling. Net migration from inside and outside the EU have tended to move together in the past, and the diverging path has only really been seen in the most recent quarters.

There is some good news for the government, as the growth rate of vacancies in the politically-sensitive health and social work sector has fallen.

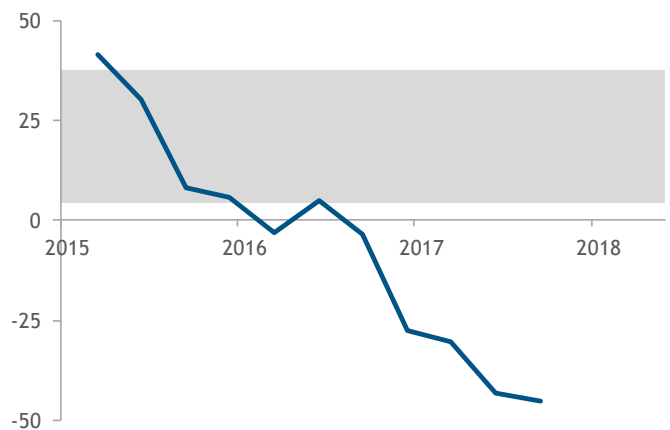
Visitor arrivals of EU residents

3-month moving average, %-change year-on-year



Net migration of EU nationals to the UK

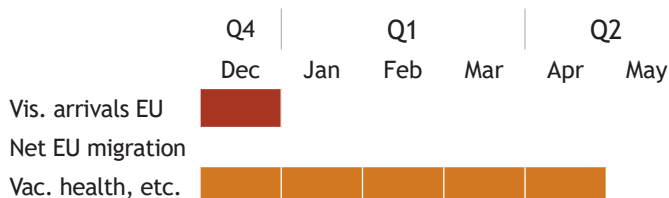
4-quarter moving average, %-change year-on-year



Data summary

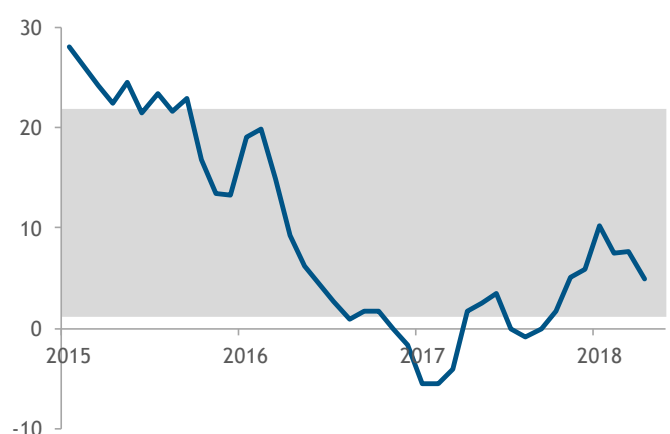
	Visitor arrivals of EU residents	Net migration of EU nationals	Vacancies in health & social sector
Last	-11.6	-45.5	5.0
Period	Dec 17	Q3 17	Jan 18
Previous	-7.1	-43.4	7.6
50% range	0.2/6.3	4.4/37.9	1.2/21.9
Frequency	Monthly	Quarterly	Monthly

6-month heatmap



Vacancies in health and social work

3-month moving average, %-change year-on-year



Technical notes

Global Counsel's Brexit dashboard seeks to take the macro pulse of the British economy, using a balanced set of 15 indicators each quarter. We are not attempting to isolate the impact of Brexit, from all the other factors affecting the economy, as that is near impossible. Instead, we are providing a health check, to see where the economy is faring better or worse, compared to the years before the vote.

We look at data in five areas, with three indicators each. These indicators are in most cases growth rates, which reflect the dynamics in the British economy. In some cases, the data is smoothed using moving averages to reveal the dynamics more clearly.

The dashboard indicates how well the economy is performing compared to the post-financial crisis, pre-referendum period from January 2010 to May 2016. For each indicator, we identify the range - shown by a grey band - within which we would expect to see half of all observations based on the data in the reference period and assuming each series is normally distributed, which may only be approximately correct for some of the data series. The width of the grey band is calibrated to 0.675 times the standard deviation in each case, so that it contains 50% of the probability distribution. This is the basis for the green, amber and red colour coding for the most recent observation, with amber used where the value falls within the grey band and green or red used for favourable or unfavourable values respectively outside the band.

The following provides a description of the data, the sources used and the reasons why the indicator is included in the Brexit dashboard. Data in many cases has been provided through CEIC Data.

Consumers

Real earnings, or real average weekly earnings, are recorded as part of the Office for National Statistics' (ONS) monthly wages and salaries survey and published in the UK labour market statistical bulletin. The indicator shows values for regular pay only. Real earnings provide an indication of how consumers' purchasing power is changing.

Retail sales are recorded in the monthly business survey - retail sales inquiry of the ONS. The data excludes automotive fuel. It is based on volumes and seasonally adjusted. It provides an indication of the overall level of consumption.

Durable goods consumption, or household final consumption expenditure on durable goods, is recorded as part of the ONS's quarterly national accounts. Figures are real (chain-linked) and seasonally adjusted. The decision of a household to purchase a durable good is similar to making an investment decision, which can be delayed under unfavourable conditions.

Industry

Industrial production is based on the Index of Production released by the ONS. It measures the volume of production for the manufacturing, mining and quarrying, energy supply, and water and waste management industries. Figures are seasonally adjusted.

Manufacturing PMI, or the Manufacturing Purchasing Managers' Index, is published monthly by Markit. It shows to what extent the sector is expanding, based on a survey of purchasing managers who have early access to data about company performance. This makes it one of the most important leading indicators for changes in output. Manufacturing is the largest industrial sector in the UK and considered to have high multiplier effects for the wider economy.

Goods exports to the EU are released monthly by the ONS in the UK trade statistical bulletin. Figures are real (volume-based). The indicator shows to what extent trade ties between the UK and the EU are being disrupted or deepened.

Services

Services output is based on the Index of Services released by the ONS. The data is real (chain-linked) and seasonally adjusted. It is an indicator of growth in the sector.

Services PMI, or the Services Purchasing Managers' Index, is published monthly by Markit. It shows to what extent the sector is expanding, based on a survey of purchasing managers who have early access to data about company performance. This makes it one of the most important leading indicators for changes in output.

FTSE 350 Banks shows the relative performance of the FTSE 350 Banks Index (which consists of the UK's major banks that are also part of the FTSE 350 Index) to the FTSE 350 Index, re-based to 100 in January 2010. The data is provided by the FTSE Group. Banks are considered especially exposed to Brexit.

Investment

Economic policy uncertainty is an index based on the number of articles in two of the leading British newspapers, The Times of London and the Financial Times, which mention economic policy uncertainty. The source is 'Measuring Economic Policy Uncertainty' by Scott R. Baker, Nicholas Bloom and Steven J. Davis. Data can be found at www.policyuncertainty.com. The level of uncertainty about a country's economic policy direction impacts on its business environment and is important for investment decisions.

Business investment is recorded as part of the ONS's business investment in the UK statistical bulletin. Figures are real (chain-linked) and seasonally adjusted. Investment signals confidence in the economy and is critical for current and future growth.

London house prices are recorded on a quarterly basis by Nationwide. It is one possible proxy for the UK's attractiveness as an investment destination.

People

Visitor arrivals by EU residents are recorded in the ONS's overseas travel and tourism statistical bulletin. It indicates how attractive the UK is for tourists, business travellers and other visitors.

Net migration of EU nationals to the UK is recorded in the provisional long-term international migration estimates published by the ONS on a quarterly basis. Based on the internationally recognised definition, a migrant is a person who spends at least a year in the UK, so that the country effectively becomes the new

country of usual residence. It shows how attractive the UK is as a country to work, study and live.

Vacancies in the health and social work sector, or vacancies in the sector of human health and social work activities, are recorded in the ONS's monthly vacancy survey, published as part of the UK labour market statistical bulletin. Figures are seasonally adjusted. The UK health sector is seen as above-average reliant on migrant labour.

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