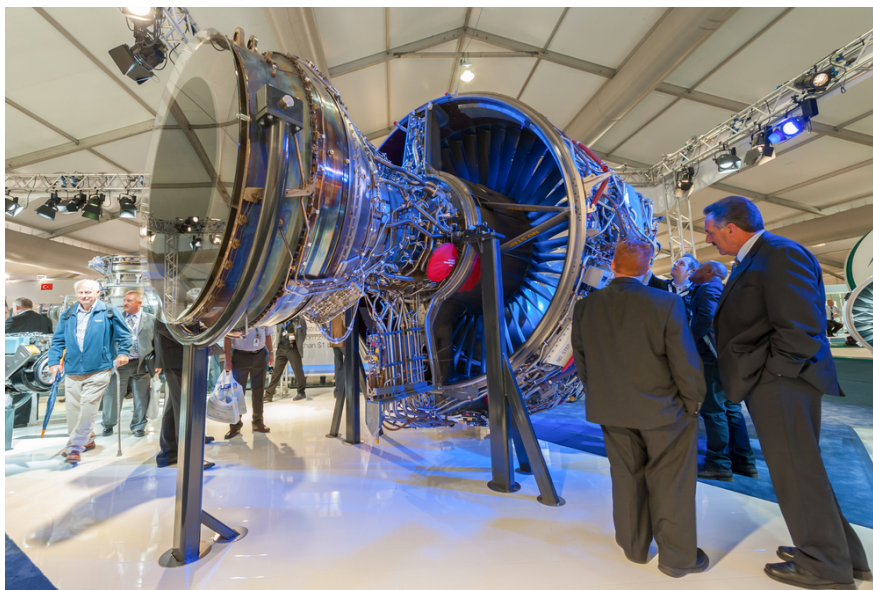


UK manufacturing output slips as Brexit risks mount

Life is unlikely to get any easier for UK manufacturers as talk of a 'no deal' Brexit continues to ramp up



At 54.0, the latest UK manufacturing PMI is the lowest in three months and is a far cry from the levels seen towards the end of 2017. Weaker domestic demand saw new orders fall and the rate of output growth slip to the lowest in 16 months. Interestingly though, demand from abroad hit a six-month high, implying that firms are still reaping the rewards of better global growth, despite the recent moderation in Europe.

But over coming months, life for manufacturers is unlikely to get any easier. The recent escalation in trade tensions is clearly a challenge, but increasingly the biggest headache for businesses is likely to be the threat of a 'no deal' Brexit. This scenario would likely see huge congestion at ports and disruption to supply chains. While we suspect the probability of the UK leaving without an agreement in March next year is relatively low, an agreement may not come until late in the day.

Until then, confidence could begin to fall as uncertainty increases – the latest PMI suggests the degree of positive sentiment is already at a 21-month low.

54.0 UK manufacturing PMI

Lower than expected

Having said all of that, today's slip in the PMI is unlikely to faze Bank of England policymakers ahead of tomorrow's decision. Representing around 10% of output, manufacturing is a relatively small part of the UK growth mix. Importantly, the recent data flow – particularly in the much larger service sector – has largely backed up the Bank's view that the economy has regained poise after the weak first quarter.

For that reason, we think the Bank of England will increase interest rates this week. But the key thing to watch is what the Bank has to say on its next steps. In an ideal world, we think policymakers would like to hike rates again much sooner than markets are currently pricing (towards the end of 2019). But with Brexit uncertainty considerably ramping up, realistically we think the Bank will struggle to raise rates again before the UK leaves the EU next March.

After Thursday, we currently don't anticipate another hike before May 2019.

In case you missed it: Our August BoE scenarios

| Bank of England view/comments | | | | | | |
|---|------------------------|---|---|---|--|--|
| | No. of rate hike votes | Growth | Inflation/Wages | Brexit progress | Rate hike path | Market impact |
| ① No rate hike Brexit forces rethink | 3 Hike votes | Lowers growth outlook on trade war concerns, 'no deal' Brexit risk & consumer caution | Core inflation falling faster. Wage growth to rise more slowly than hoped | Subtle nod to 'no deal' risk. Emphasises importance of transition period | Removes signal that "ongoing tightening" required over "forecast period" | May 2019 hike probability: 20% (↓) EUR/GBP: 0.904 GBP/USD: 1.285 |
| ② Rate hike Committee divided | 6 Hike votes | Growth largely rebounded but notes some modest risks to global growth | Highlights slower wage growth, but still expects it to slowly rise over time | Reintroduces language about Brexit being most significant source of uncertainty | Reiterates tightening bias, but perhaps more emphasis on "limited" & "gradual" | May 2019 hike probability: 40% (↓) EUR/GBP: 0.895 GBP/USD: 1.300 |
| ING base case | | | | | | |
| ③ Rate hike Cautious optimism | 8/9 Hike votes | 2Q growth has rebounded. Demand to continue rising slightly faster than supply | Unfazed by wage growth dip. Sees some upside to pay given tight jobs market | No comment on Chequers plan. If asked in press conf, Carney says it's "too early to assess" | Reiterates that "gradual" hikes still needed but no further hints on timing | May 2019 hike probability: 50% (=) EUR/GBP: 0.886 GBP/USD: 1.315 |
| ④ Rate hike Full speed ahead | 9 Hike votes | Economy has rebounded and is starting to build fresh momentum | Expects wage growth to re-accelerate, risk of persistently above-target inflation | Comments on Chequers plan – says frictionless borders would be positive | Hints that curve too flat, next hike may be earlier than markets expect | May 2019 hike probability: 70% (↑) EUR/GBP: 0.880 GBP/USD: 1.325 |

Source: ING

Currency forecasts by ING's FX Strategy Team

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