

UK manufacturing rebound masks lacklustre growth story

A return to normal levels of car production boosted UK GDP in May, but the wider picture is still fairly subdued. With Brexit uncertainty set to intensify during the third quarter, we think the Bank of England will keep policy on hold this year



Source: iStockphoto

Car production rebound lifts May GDP

Making sense of the UK growth data is not straightforward at the moment. The economy rebounded by 0.3% during May, albeit this was predominantly driven by production.

Manufacturing output had plummeted back in April, for two main reasons. Firstly, various car producers brought forward their usual summer factory shutdowns to the start of April. Now that these are over, car production returned to more normal levels during May. Secondly – and more importantly – new orders have slumped as firms grapple with what to do with the stockpiles they built up during the first quarter, in anticipation of a possible ‘no deal’ Brexit. We expect this latter trend to continue into the summer months, which partly explains why manufacturing production failed to fully recover its April losses (-4.2%) during May (+1.4%).

Things don't look much better away from manufacturing

While all of this is ultimately a temporary phenomenon, the underlying growth story doesn't look a whole lot better. Recent PMIs indicate that the service sector – which makes up the lion's share of the UK economy – has struggled to regain momentum amid mounting Brexit uncertainty. Attention within firms will be increasingly turning back to contingency planning for a possible 'no deal' Brexit in October, which is often a costly exercise and will inevitably draw some resources away from possible investment projects. We expect investment to resume its downward trend over the summer.

Consumer activity has also looked more disappointing so far this quarter. Despite a modest improvement in real wages, consumer sentiment remains depressed and shoppers appear reluctant to make non-essential purchases.

Bank of England likely to stay on hold during 2019

All of this suggests that overall second quarter growth will come in flat, or possibly slightly negative. With the growth story unlikely to improve dramatically in the third quarter, we think the Bank of England is likely to keep policy on hold this year.

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