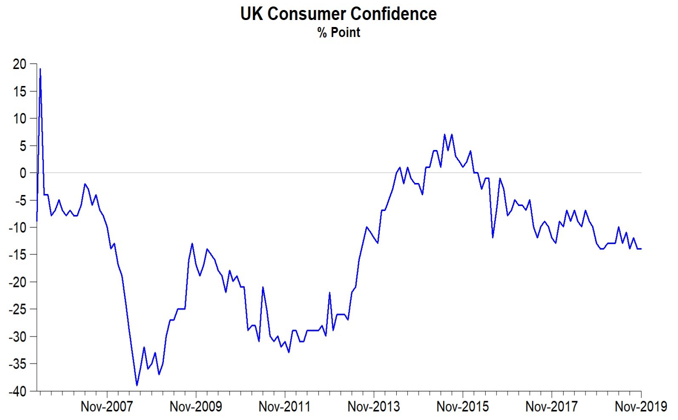
11th December 2019

Investment Review:

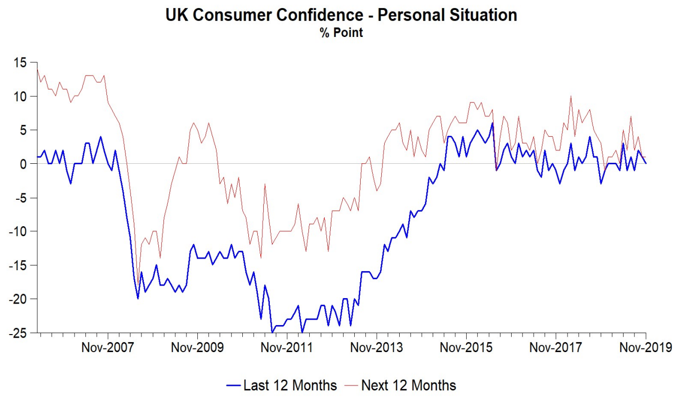
UK: A Pictorial Review

Andrew Hunt Economics

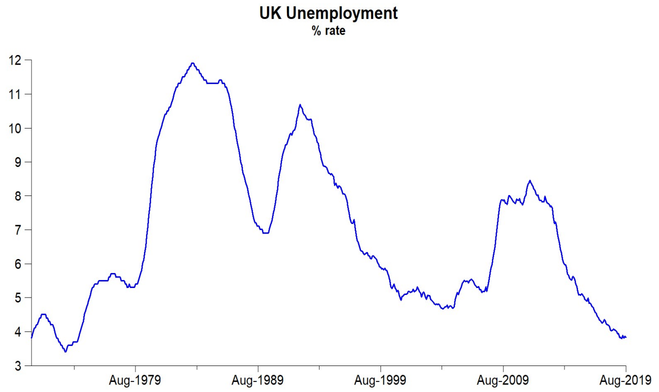
e-mail: **economist@hunteconomics.com**



UK consumer confidence has been trending lower since well before the 2016 BREXIT referendum. The data is by no means weak in an absolute sense but it plainly is not strong either.



Interestingly, when consumers are asked about their own personal situation (which we suspect they are better at gauging than the 'overall economic situation'), we find that households still seem quite confident.



This is perhaps not too surprising given that at present the rate of unemployment is very low by historical standards.

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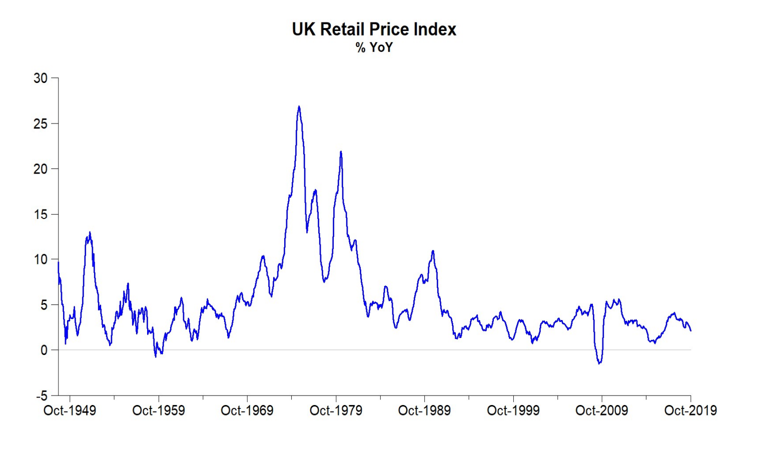
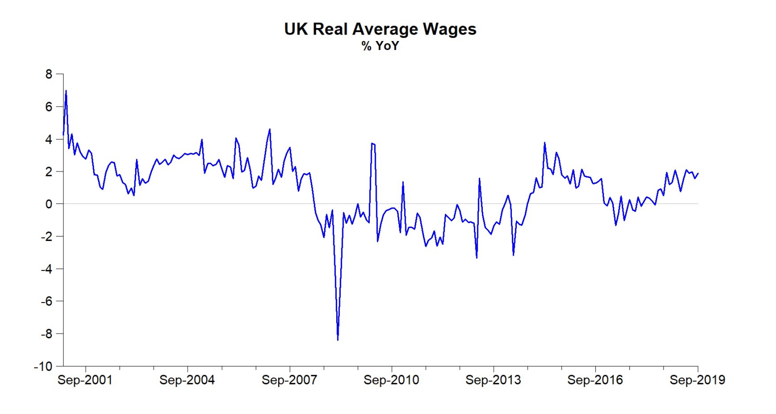
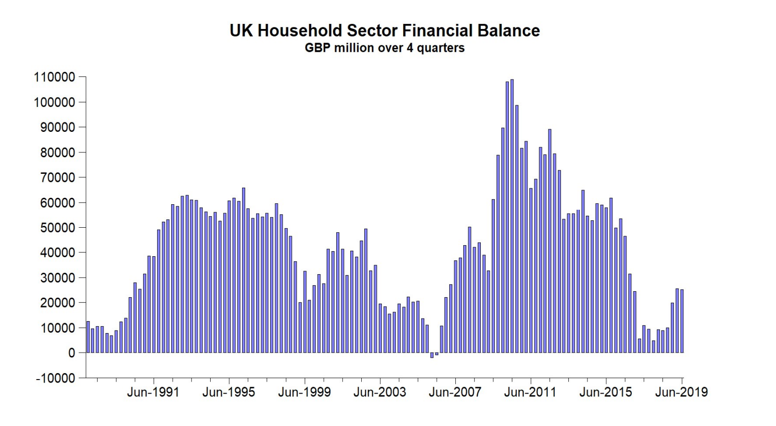


In addition, retail price inflation rates are subdued….



… and real wages are rising at what might be considered as being robust rates by the standards of the last 20 years.



The household sector's financial position appeared precarious in 2017/18 but it has improved a little of late.

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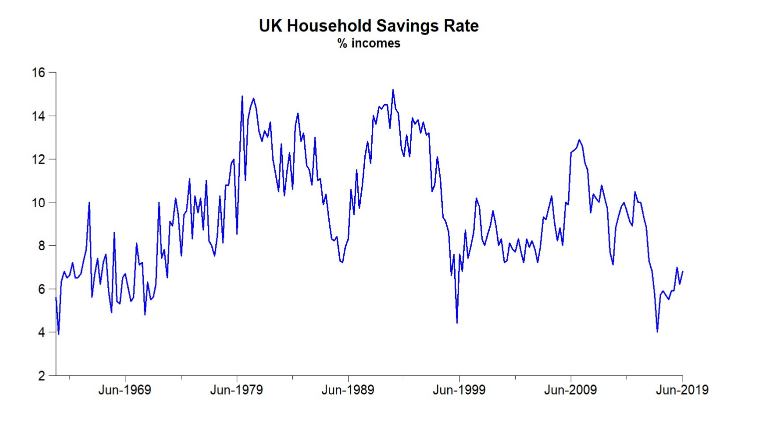
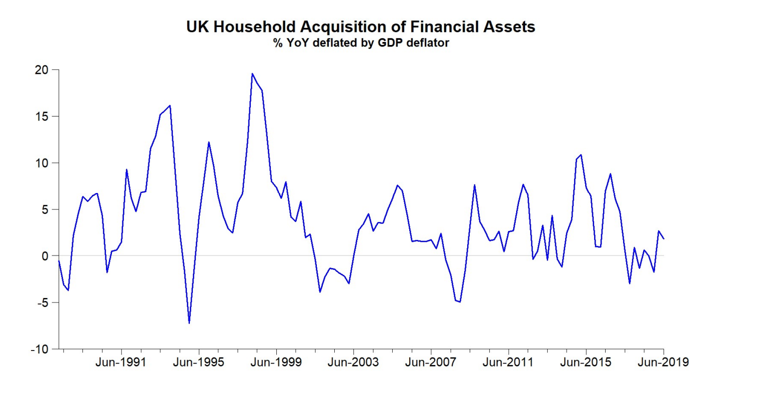
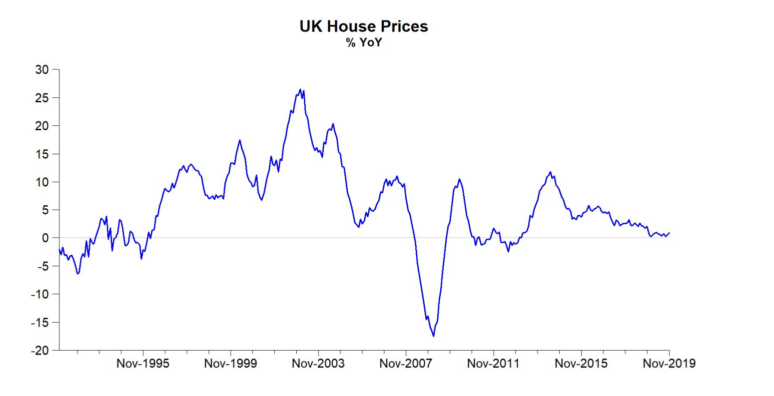


We continue to believe that the savings rate is too low (i.e. people have failed to adjust the trajectory of their expenditure to match the economy's weak productivity / real wage performance over recent years, but at least the data is now moving in the 'right direction'.



Households do appear to have found it difficult to build financial wealth over the last 2 – 3 years



And the rate of house price inflation has cooled, to the disappointment of home owners, but perhaps the relief of would-be buyers?

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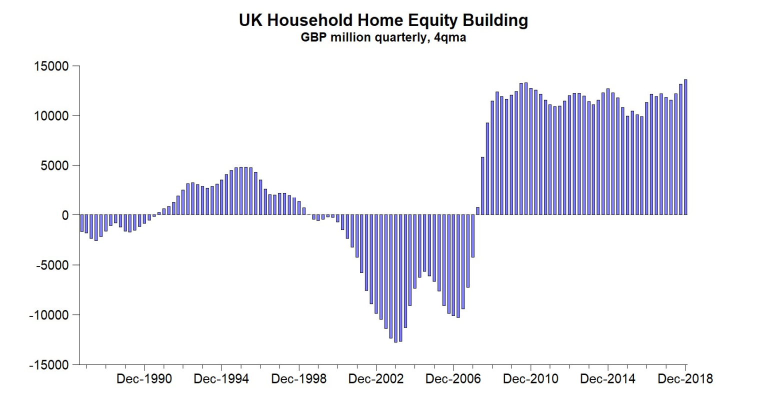
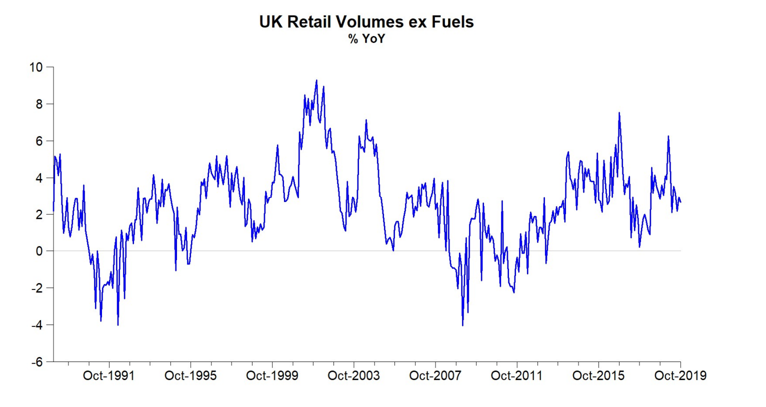
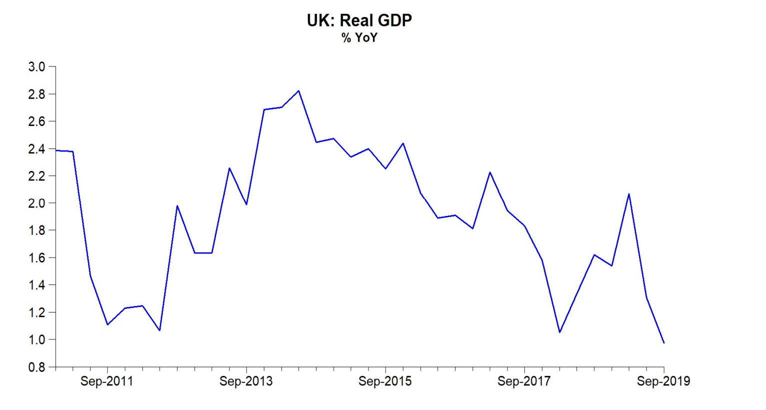


Nevertheless, the sector in aggregate is continuing to build equity in the housing market, despite the lacklustre rate of house price inflation.



In this environment, we are not surprised to find that consumer expenditure trends are moderate – even allowing for the improvement in the savings rate, consumers have received sufficient income growth to allow them to continue spending more.



However, despite the consumer's continued appetite for spending more, the economy has plainly slowed in aggregate over the last year or two.

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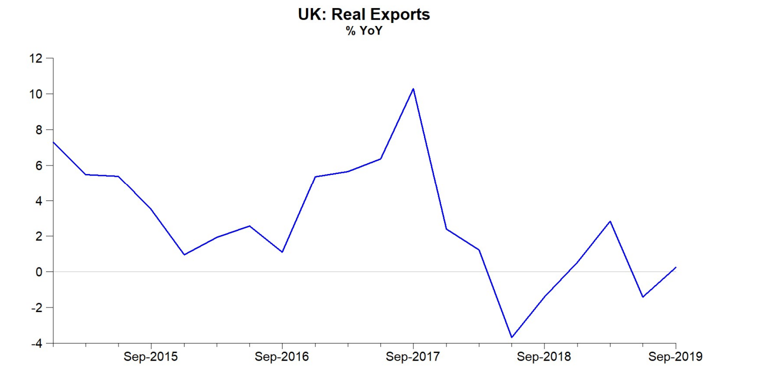
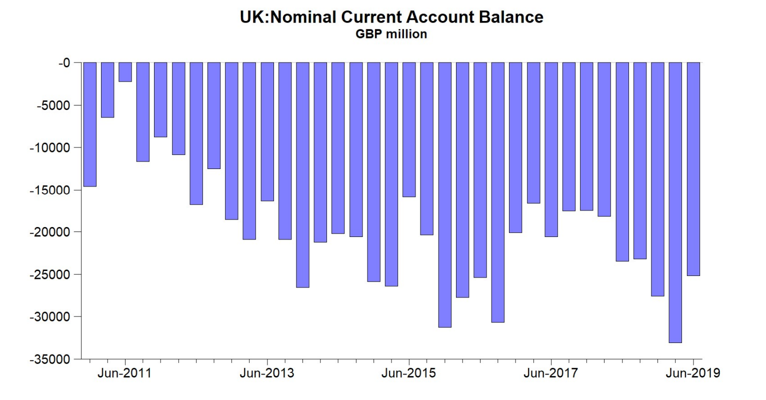
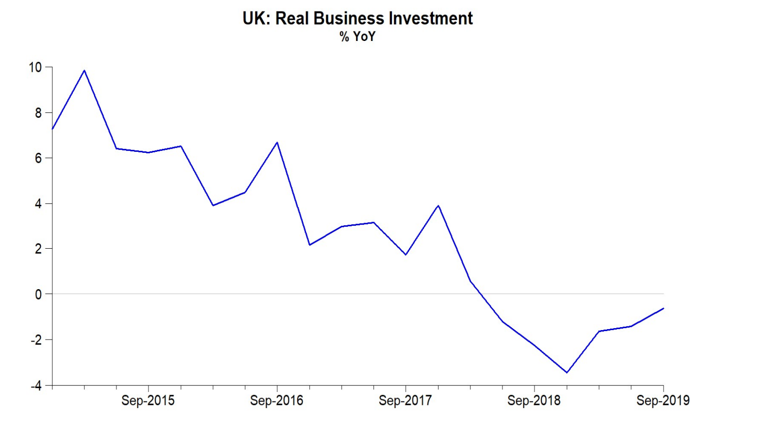


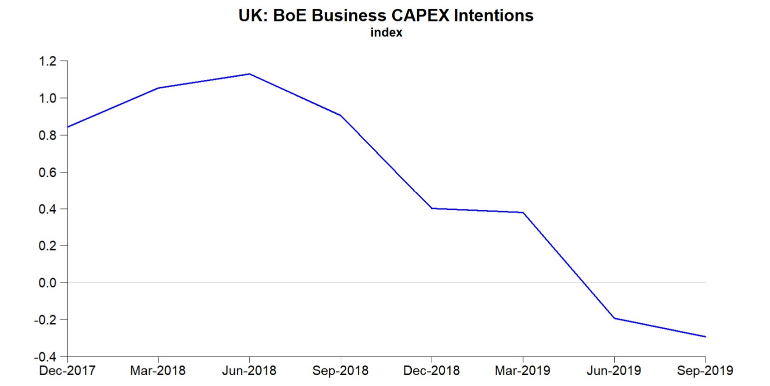
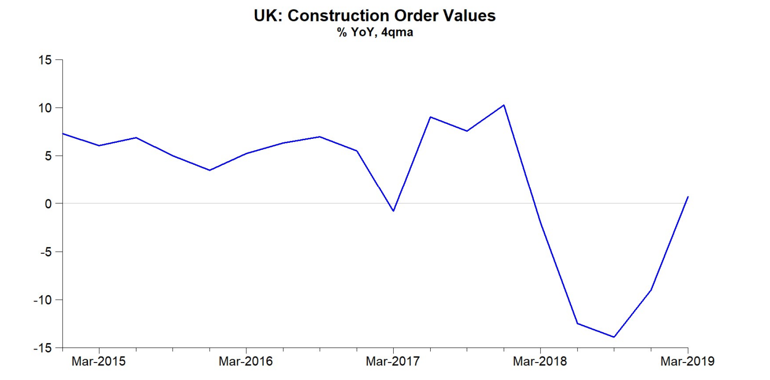
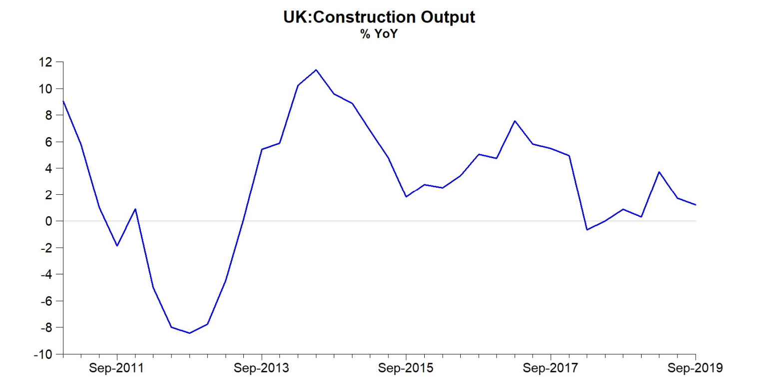
It has been of no surprise to find that export trends have been soft – although not as soft as those in some other countries.

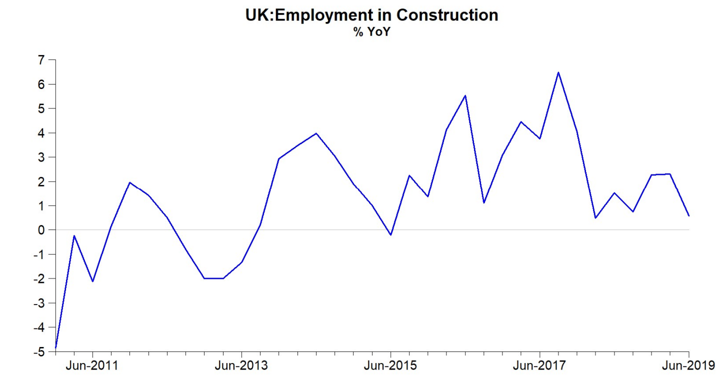


The UK current account deficit is problematic (another reflection of domestic savings rates that are too low) but it is at least broadly stable at present.

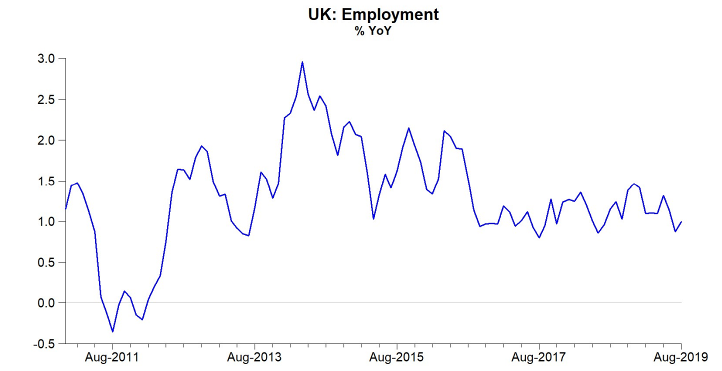


Business investment has been weak since the global slowdown began in 2018.

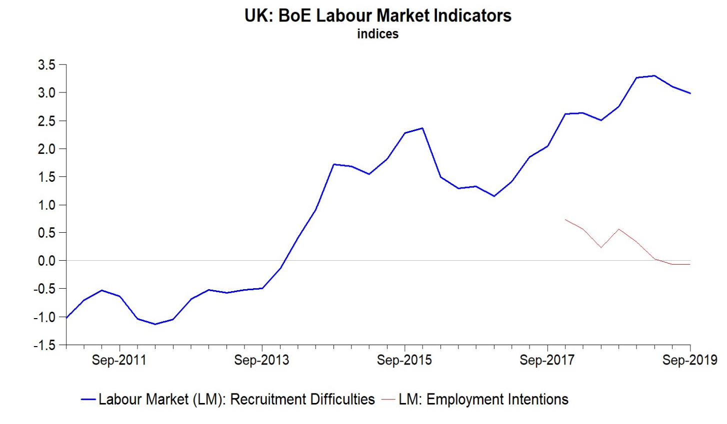
	Clearly, the combination of the global slowdown, BREXIT and domestic politics have taken their toll of productive CAPEX trends.
	Moreover, the construction sector has, in addition to the depressing factors mentioned above, also lost the beneficial and at times very substantial support that was previously provided by the granting of various tax holidays in the major metropolitan centres during the middle of this decade.
	Certainly, construction activity growth seems to be slowing.



This has started to be reflected in the construction sector employment data



So far, there are few signs that the weaker construction industry data is materially impacting the headline employment data. Indeed, the labour market in general has been strong this year.



However, we may be beginning to witness a turn in labour market conditions. If this is correct, then consumers could lose 'income support' for their spending next year. There is clearly a risk that the slowdown in the business sector could begin to spread to the consumer sector in 2020.

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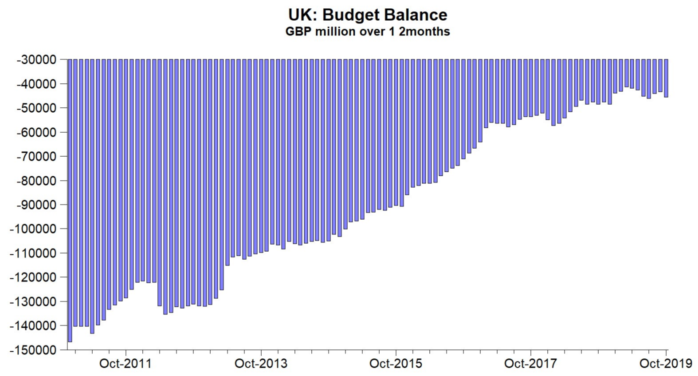
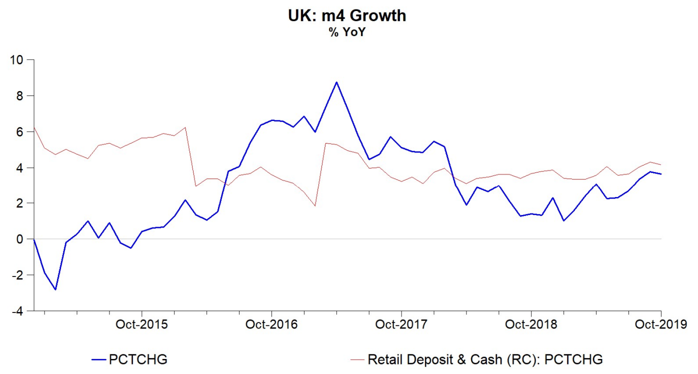
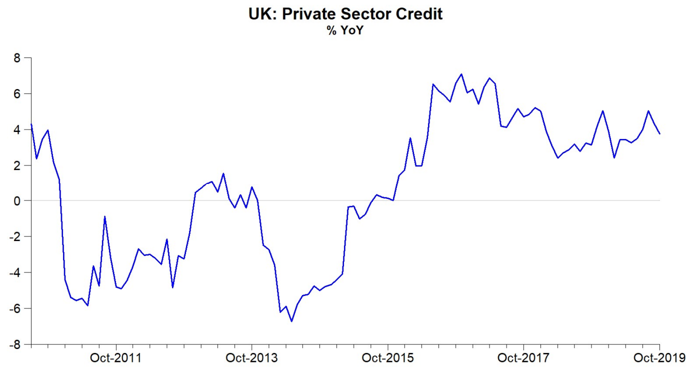


At present, fiscal policy seems to be broadly neutral but this could change next week…..



Monetary growth rates, particularly outside of the cash holdings of financial institutions remain on the weak side of moderate



Certainly, private sector credit trends remain subdued.

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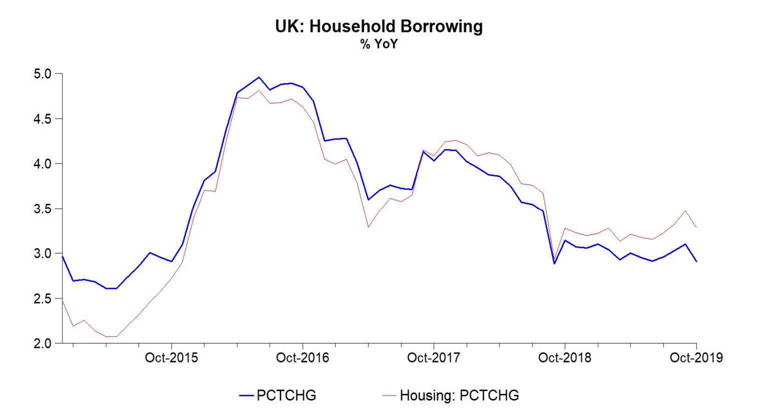
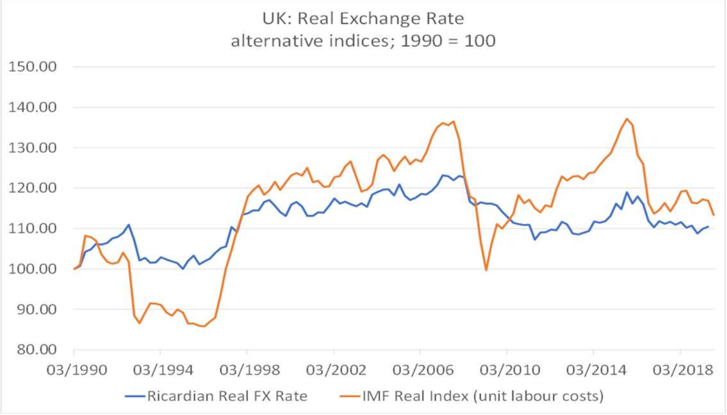
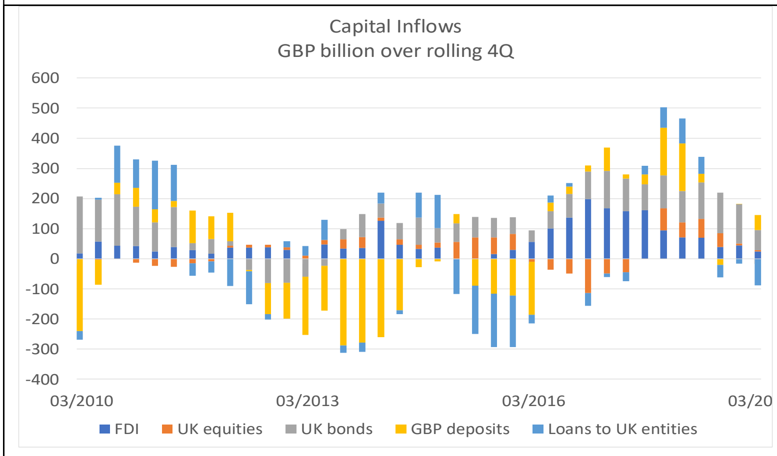


And household sector borrowing trends are relatively soft by historical standards.

Aside from a *possible* 'post-election bounce in confidence' (possible but we feel unlikely), or a dramatic shift in fiscal policy following the election of a Labour Government (and even that might be at the expense of a fall in business investment), we see little that is likely to revive the domestic economy 'naturally' in the near term.

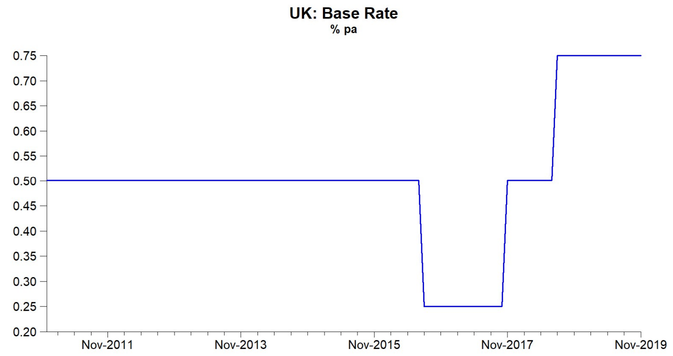


The country should at present be gaining some support from its modestly undervalued FX rate – but in the midst of a Global Trade Recession this 'support' is more likely to represent a 'reduced negative' for the economy.



We do however expect some movement in the GBP following the election.

Given the country's large current account deficit, it is by definition dependent on attracting equally large capital inflows. Over recent years this has been proving more difficult to achieve.



If the Conservatives win, we suspect that the UK's relatively high yields will once again encourage flight capital from the EZ that potentially push the GBP higher over the next six months. Given the economic slowdown, this might well oblige the BoE to reduce rates. However, a capital-control-touting Corbyn regime could encourage actual capital flight and potentially force the BoE into defending the GBP through higher yields. The outlook for rates may well be determined tomorrow.

Conclusions

(i) The UK economy has plainly slowed despite the relative resilience of consumer spending trends.

(ii) Exports and business investment trends have been weak for some time, and the 2015-17 boom in construction activity that was itself the product of tax breaks and large inflows of foreign capital appears to be winding down.

(iii) There is a significant risk that consumer trends will soften in 2020 as the labour market cools.

(iv) The outlook for rates – both currency and interest rates – will however likely be determined primarily by tomorrow's election results.

(v) If the UK appears to offer a stable investor friendly outlook, we would expect large yield-seeking inflows of capital to return to the country, thereby placing upward pressure on the GBP and downward pressure on yields.

(vi) However, hints of the potential introduction of capital controls and even the possible confiscation of private capital could cause a large repatriation of capital from the UK and a degree of domestic capital flight that forces a decline in the GBP and the BoE into a defence of the currency.

(vii) The election is being fought against the background of a weakening economy with adverse weather predicted, factors that may not favour the incumbent government.