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››› Dark clouds are gathering on the UK's economic horizon

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Signs of a slowdown are spreading

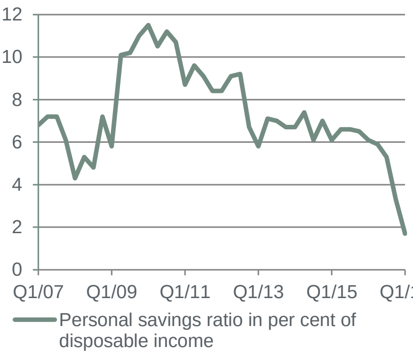
At first, the UK economy overcame last year's Brexit vote surprisingly well. Recently, however, growth momentum has slowed noticeably. After a weak first quarter 2017, second-quarter real GDP grew only moderately as well – by 0.3 % on the previous quarter. Private consumption expenditure was particularly disappointing, rising only slightly quarter-on-quarter. Sentiment indicators have dimmed and, while not heralding an economic slump in the further course of the year, are pointing to only moderate growth momentum. What is undisputed is that cyclical downward risks prevail. Private consumption in particular, the most important GDP aggregate with a share of 65 %, is threatening to lose even more growth momentum.

Consumers under pressure

During the first period after the Brexit vote, private households exhibited high staying power. Despite the strong rise in depreciation-induced inflation rates, real consumption expenditure initially continued to expand at respectable quarterly rates. But that came at a price. Since wage momentum remained moderate even though unemployment had dropped to a multi-year low (currently 4.4 %), private households increasingly resorted to savings deposits and higher debt to finance their consumption needs. However, that strategy is now reaching its limits. The savings rate has fallen to 1.7 %, the lowest level since the beginning of the 1960s (Figure 1). At the same time, consumer loans increased at annual rates sometimes exceeding 10 %. The Bank of England is thus now considering tighter regulatory requirements.

The development of private consumption expenditure will therefore be determined more strongly than before by real

Figure 1: Savings rate is in freefall



Source: Feri

income growth. But prospects are rather dim despite the good employment situation. The subdued growth outlook and ongoing Brexit uncertainty should further dampen wage momentum. This is exacerbated by structural factors adversely affecting wage development. They include weak productivity growth, a trend observable for quite some time, and not just in the UK, a low degree of unionisation, and the strong rise in atypical employment relationships in the past years. In the absence of any further strong currency depreciation, inflation-induced pressure on real incomes should decrease, but this will do little to change the less than encouraging overall picture. Whichever way you look at it, private households in the UK will ultimately have to tighten their belts. That realisation appears to be settling in. In the summer months, UK consumer confidence fell to its lowest level in a year. That does not bode well for the further development of private consumption.

Home prices enter correction mode

Trouble is also looming on the housing front. The increase in UK property prices has slowed noticeably (Figure 2). Prices in previously overheated sub-markets are falling already.

Figure 2: Development of UK house prices

Change year-over-year in per cent

Source: Bloomberg

The continuing supply shortage and the favourable interest rate environment speak against a sharp price drop on the UK real estate market. However, the cooling phase should still become more pronounced. In relation to long-term income and rental trends, UK real estate is already considered almost 40 % overvalued.

Other sectors will not be able to offset the downturn, or only to a limited extent. The manufacturing sector is benefiting from the weaker pound sterling, but capital expenditure is suffering from the Brexit uncertainty. Besides, with a share of around 10 % in overall value added, this sector is of minor importance for the British economy.

Tough times ahead

Real GDP growth is likely to weaken further, slipping from 1.8 % in 2016 towards 1 % in 2018. This bleak economic outlook makes it all the more urgent to finally make progress in the Brexit negotiations so as to reduce the uncertainty weighing on business activity. ■