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Economics Group

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United Kingdom Continues to See Stronger Growth

The United Kingdom saw a third consecutive posting of stronger GDP growth in Q3, which implies that the economy may be on its way to self-sustaining recovery.

Consumer Spending Drives Growth

Data released this morning for Q3 GDP continued to point to stronger growth in the U.K. economy. The sequential growth rate of 0.8 percent (3.2 percent annualized) was in line with the consensus forecast, and it was the third consecutive quarter of positive GDP growth, implying that the United Kingdom may be entering into a self-sustaining recovery (top chart). Although the breakdown for demand is not yet available, there are indications that consumers have been the primary driver of this growth.

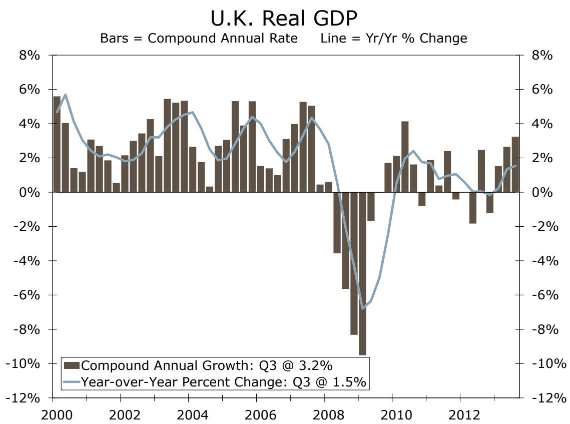
Growth in real consumer spending has been positive over the past six quarters, and many sectors are beginning to benefit. Output in the overall service sector rose 0.7 percent in Q3, and manufacturing production grew 0.9 percent for the second consecutive quarter. The volume of retail spending was up 2.2 percent on a year-ago basis in September (middle chart). As we discussed in *Will British Consumers Continue to Spend?,* which is available on our website, this rise in consumer spending has been supported by a decline in the consumer savings rate and an upward trend in consumer confidence.

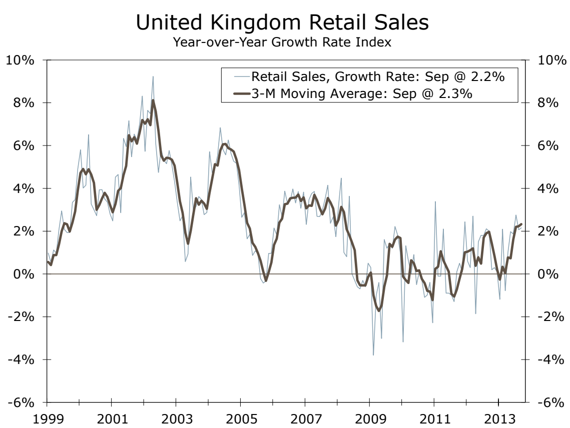
BoE Not Ready to Increase Interest Rates

So the good news is that the United Kingdom appears to be entering a self-sustaining economic recovery. The bad news, however, is that the British economy is, in a sense, still depressed. That is, the level of real GDP in the United Kingdom remains 2.5 percent below its Q1-2008 peak. Furthermore, the unemployment rate at present remains elevated at 7.7 percent (bottom chart).

Therefore, the Bank of England (BoE) likely will not be tightening monetary policy anytime soon. Although the CPI inflation rate is higher than the BoE would like at present—CPI inflation is currently 2.7 percent—the BoE also has stated that it does not intend to raise rates until the unemployment rate drops below 7 percent. Although the BoE has stated that it does not expect to raise rates until 2016, our forecast looks for the tightening to commence in mid-2015.

Signs of stronger growth in the U.K. economy have caused the British pound to appreciate 10 percent versus the dollar since early July. This strengthening is further sign that the recovery is starting to take hold. At this point, however, we believe that most of the good news has been discounted by the market, and we look for the dollar/pound exchange rate to essentially move sideways over the next few quarters. We also forecast that U.K. GDP will continue to grow at a moderate pace over the next few quarters, with an annualized growth between 2-3 percent. We expect that this growth will continue to be driven by personal consumption, which in turn will lead to further gains in the service and manufacturing sectors.





Source: IHS Global Insight, Bloomberg LP and Wells Fargo Securities, LLC

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