



UK economy faltering under the shadow of Brexit

It may have taken some time to register, but the UK vote for Brexit in mid-2016 is now really reaping its toll on the economy. The UK has gone from being the fastest growing major economy ahead of the vote to the slowest by the final quarter of 2017, with even Japan and Italy surpassing it.

This trend has continued in the opening quarter of 2018, with UK GDP rising by a paltry 0.1%, and the year-on-year growth rate slowing further to 1.2%, the weakest since mid-2012. This is at a time when the world economy has gained momentum, with the IMF forecasting close to 4% global growth this year, up from 3.2% back in 2016.

While severe weather in March played a part in the weaker growth in quarter one, the effects are estimated to be relatively small. The construction sector, in particular, was very weak right throughout the quarter, with output falling in all three months and not just during March's period of heavy snowfall.

There were hopes that the economy would regain momentum in April after the bad weather of March. However, survey data for the month have disappointed, showing no meaningful rebound in activity.

The PMI for the services sector remained at a low level in April, while the manufacturing PMI fell further. The April CBI Distributive Trades Survey was also disappointing, with data from the British Retail Consortium showing a sharp drop in sales in April. No wonder then, that the Bank of England left interest rates unchanged at its monetary policy meeting last week.

The economy should regain some momentum over the summer. The recent fall in inflation will help raise real incomes, while continuing low interest rates, a weak sterling and strong global growth are all supportive of UK growth prospects. Thus, the indications from the Bank of England are that rates are still likely to rise modestly over the next couple of years. The market expects the next rate hike to come before the end of the year.

Brexit, though, continues to cast a large shadow over the economy, with the UK set to leave the EU next March. The EU and UK have agreed there should be a post-Brexit transition period that would maintain the current free trade arrangements until the end of 2020. This is to be included in the Brexit Withdrawal Agreement that is due to be concluded between the EU and UK in the autumn.



However, the UK has yet to decide on what kind of trade relationship it wants with the EU after the transition period ends, especially in regard to customs arrangements. This will form a crucial element of the Withdrawal Agreement.

There is still very strong resistance in parts of the UK Government to the idea of any form of customs partnership with the EU after the transition period ends, as it is seen as hindering the UK's ability to negotiate trade deals with other countries.

The Prime Minister is finding it very difficult to come up with a plan for future customs arrangements that satisfies everyone in her cabinet as well as the EU. The deep divisions in the Conservative party on the issue mean that it could be a challenge to get any withdrawal agreement through Parliament. Thus, much uncertainty still abounds about Brexit as the clock ticks towards next March's exit date.

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