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UK ECONOMY – DEFIANT GROWTH

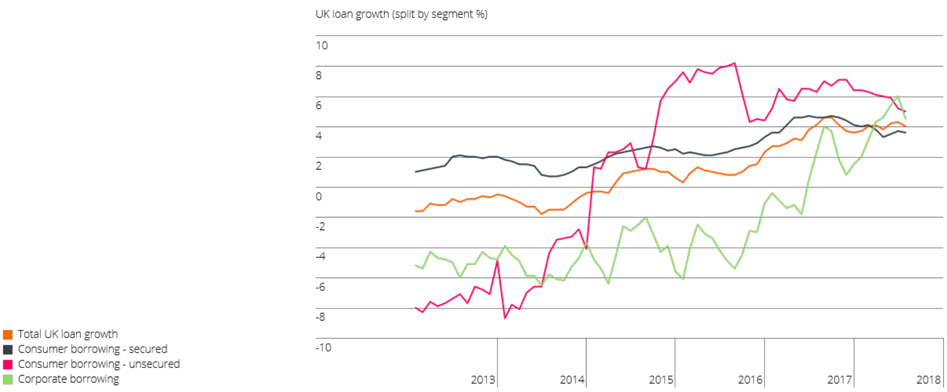
Mitchell Fraser-Jones, 20 September 2017

Some interesting charts have crossed my desk over the last few weeks which reaffirm what we have been expecting – the UK economy is performing well and the concerns about the growth outlook and debt accumulation are misplaced.

Much has been written over the summer about the consumer debt burden and its implications for future monetary policy and growth. We are less concerned about this, partly as a result of the low interest rate environment which we expect to prevail for some time. The recent inflation data, and the Bank of England's response to it, don't change this view. Clearly, the probability of an interest rate increase in the near future has increased but this does not, in our view, herald the start of meaningfully tighter monetary policy. Indeed, the stronger pound that has greeted the recent policy rhetoric, ironically does much to counter the inflationary forces that prompted the talk of rate hikes in the first place.

We believe consumer debt levels are manageable in the context of household incomes. Furthermore, as the chart below illustrates, it is evident that the growth in debt that we have been seeing over the last eighteen months hasn't really been the result of a pick-up in consumer borrowing – it is corporate borrowers that have been taking advantage of the renewed appetite for lending in the UK banking sector.

Businesses taking advantage of UK banks' renewed appetite for lending...
Source: Redburn, Woodford



And, in the context of recent history, although the rate of debt growth has increased as the banking sector has rehabilitated itself, it remains modest compared to the rates of growth seen in the early years of the new millennium. Further evidence, as far as we're concerned, to suggest that worries about consumer debt are overdone.

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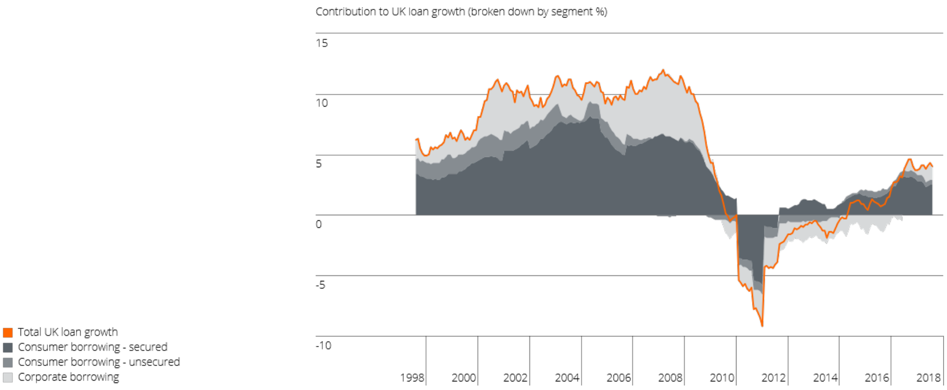
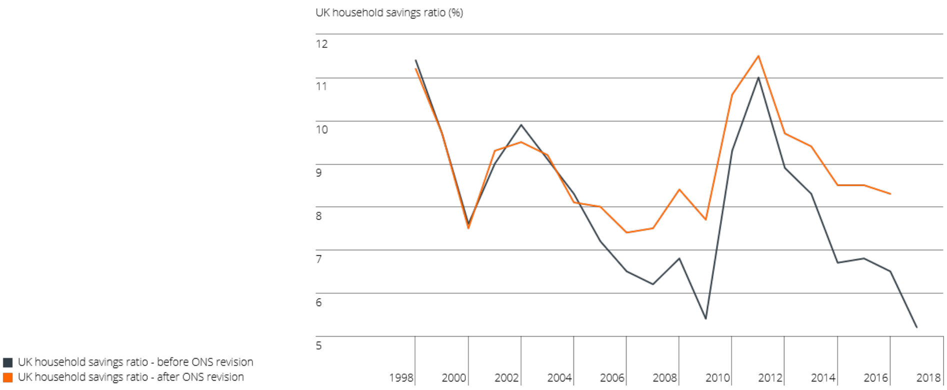
Total UK loan growth still at modest levels...
Source: Redburn, Woodford



Meanwhile, recent revisions to the way that the UK's household savings ratio is calculated should also diminish the level of these concerns. Figures released by the Office for National Statistics last month suggest that UK household savings have been running at 8-10% in recent years, compared to previous estimates which fell to c. 5% last year. Admittedly, the UK savings ratio has still been on a downward trend, as one might expect in a period when the value of other parts of the balance sheet, such as equities and, most households' primary asset, the house itself, has been rising. The pace of the decline in savings, however, has been much less sharp than previously estimated.

UK households have been saving more than previously estimated...
Source: Office for National Statistics, Bloomberg, Woodford



Overall, official data confirms that the UK economy has remained resilient in 2017, despite predictions that the Brexit negotiations would precipitate a collapse in activity. That never seemed likely to us, and the data, thus far, is supportive of our view. Indeed, recent data, including today's better-than-expected retail sales numbers, suggest a modest improvement in economic activity in recent months which, alongside renewed growth in money supply, bodes well for UK GDP growth in the second half of 2017 and beyond.

We remain positive on the outlook for the UK economy – much more positive than the gloomy prognosis implied by market valuations – and that is reflected in our long-term investment strategy. The evidence that the UK economy is in better shape than many have expected, continues to mount...