UK growth contraction caps week of economic turbulence

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The British economy experienced a contraction in the second quarter, the first such event for seven years, in what is another indication of a slowdown in the world economy. Gross Domestic Product (GDP) fell 0.2 percent in the three months to June, down from an increase of 0.5 percent in the first quarter and under market expectations of a flat rate.

Underlying trends revealed in yesterday's data from the Office for National Statistics point to the possibility of a further contraction in the third quarter. This would put the UK in a recession, defined as two consecutive quarters of economic contraction.

The decline was across the board. There was a 2.3 percent fall in manufacturing, business investment contracted by 0.5 percent and construction was down by 1.3 percent from the previous quarter. Growth in the services sector, one of the mainstays of the UK economy, slowed to 0.1 percent, its lowest level in three years.

The output data were impacted by the uncertainty over Brexit. In the first quarter, growth was boosted as firms added to their inventories in the run-up to the original Brexit deadline of March 29. They then ran them down when the deadline was extended to October 31, with changes in inventories subtracting 2.24 percentage points from GDP growth in the June quarter.

Household spending increased by 0.5 percent for the quarter and the expectation is that consumer spending may avert another overall contraction. However, that is not sustainable over the longer term.

As the chief economist at the Institute of Directors, Tej Parikh told the *Financial Times*: "While consumers have helped keep the economy afloat, it is increasingly worrying that underlying growth is largely absent."

The British GDP data ended a week of deepening uncertainty in financial markets and growing fears of a recession in major areas of the global economy.

Data from Germany on exports and manufacturing showed that its economy is being significantly impacted by the uncertainties created by the US-China trade war.

The German purchasing managers' index, a key indicator of economic activity, dropped to a seven-year low in July. Activity in the construction industry has dropped for the first time in nine months and the weakness in manufacturing is now being reflected in the labour market with hiring intentions falling to a six-year low.

The European Central Bank is expected to provide further monetary stimulus next month either by taking its base interest rate further into negative territory (it is already minus 0.4 percent) and/or resuming its purchases of financial assets.

But these measures will do little or nothing to boost the real economy. They will simply create further distortions in financial markets, which this week saw German government bonds trading with negative yields across the board.

Editorials in the world's two leading financial newspapers, the *Wall Street Journal* and the *Financial Times* have pointed to the worsening trends revealed in events of this week.

In an editorial entitled "Europe's Autumn of Discontent," the WSJ noted that while markets "were melting down over the US-China trade war," Europe's economy was "hitting the skids."

"Dismal recent data, with more expected, highlight the baleful consequences of President Trump's hostility to global trade—but also Europe's chronic refusal to help itself."

It noted that the 5.2 percent year-on-year fall in

German industrial production for June was worse for being part of a trend—the contraction in the UK economy, disappointing growth results for France and growing pessimism in Italy.

In its editorial comment, the *Financial Times* said volatility in financial markets had returned in "full force" with global stock and bond markets going into a "tailspin" as hopes of a permanent truce in the US-China trade war evaporated.

"Global economic growth is also set to slow. Worse still, the best-case scenario for the world economy is now simply the status quo," it said.

The financial markets staged a partial correction in the latter part of the week. However, any return to earlier norms is unlikely because China's decision to let its currency slide past seven renminbi to the dollar and the "subsequent, incoherent, decision by the US Treasury to designate China a currency manipulator" had left a "new and volatile backdrop for global markets."

While what it called the "August upheaval" signalled all "is not well in the global economy," the editorial held out the prospect that it was not "careering towards recession."

But this was hardly a vote of confidence. It noted that layered on top of the economy are geopolitical tensions that stand in the way of "coherent economic policies. Rising protectionism means past US-led co-ordinated policy to restore global economic order will not be repeated."

Central banks, it concluded, would have no option but to intervene in a situation where one quarter of the world's bond stock is returning negative yields, with more to follow. "In the absence of a sturdy anchor, a very bumpy ride lies ahead."

The week concluded with clear indications that any solution to the US-China trade war—one of the immediate causes of both financial turbulence and economic slowdown—is further away than ever.

US President Trump said that talks with China planned for next month could be called off. The talks were already in doubt following Trump's threat to impose a 10 percent tariff on an additional $300 billion worth of Chinese goods from September 1.

"We'll see whether or not we keep our meeting in September," Trump told reporters. He said the two countries still had "an open dialogue" but the US was "not ready to make a deal."