

Economics

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UK – GDP Recovers Despite Headwinds

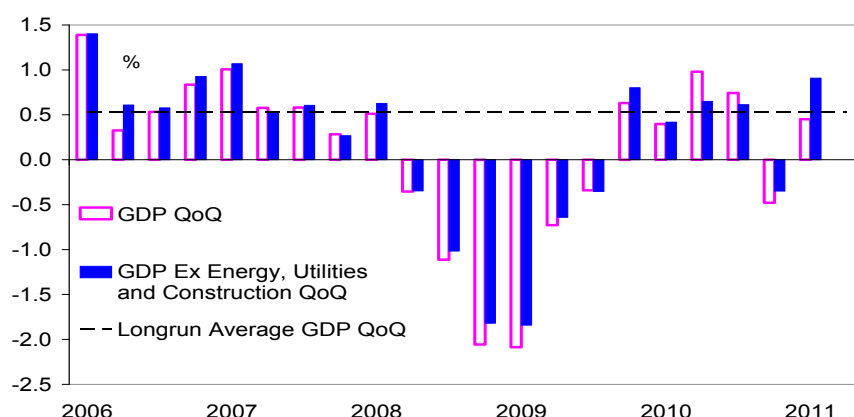
- The ONS report that GDP rose 0.5% QoQ in Q1, reversing the 0.5% drop in Q4. The figure equals the consensus, but is 0.1% above our forecast. The ONS note that GDP is flat in Q4 plus Q1 combined. However, in our view, that does not quite reflect the economy's underlying momentum. The split for Q1 shows unusually large falls in construction (down 4.7% QoQ) and utilities (down 3.5% QoQ), plus a further drop in oil and gas output (down 0.5% QoQ). Together, the falls in energy, utilities and construction cut 0.4-0.5% off Q1 GDP growth, the biggest drag for 25 years.
- It is not usually advisable to construct figures that simply exclude all the weak bits, but there are grounds for regarding the falls in construction and utilities as erratic. Utilities output is often volatile from quarter to quarter, and the Q1 drop follows the snow-related Q4 surge. The construction data are not usually so volatile, but have swung wildly since early 2010 (when the ONS introduced new monthly output data). According to the ONS, construction output surged 11.2% in Q2 and Q3 of 2010 combined, the best two quarters for over 45 years, and then plunged in Q4 and Q1. Other guides to construction (eg surveys and ONS construction orders data) do not show such volatility. We suspect that the ONS data overstate the strength in Q2 and Q3 of 2010, as well as the recent falls. With services output up 0.9% QoQ (best since 2006), manufacturing up 1.1% QoQ and agriculture up 0.6% QoQ, we estimate that GDP excluding energy, utilities and construction rose 0.9% QoQ – a bit above the long-run trend (0.5% QoQ). This follows a 0.3% fall in Q4 but, overall, the economy has shown underlying growth in the last two quarters once erratic swings in construction are stripped out. This is not so bad given the heavy headwinds from fiscal tightening and high inflation.

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Figure 1. UK – GDP QoQ, and GDP Excluding Energy, Utilities and Construction QoQ, 2006-11



Sources: ONS and Citi Investment Research and Analysis

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

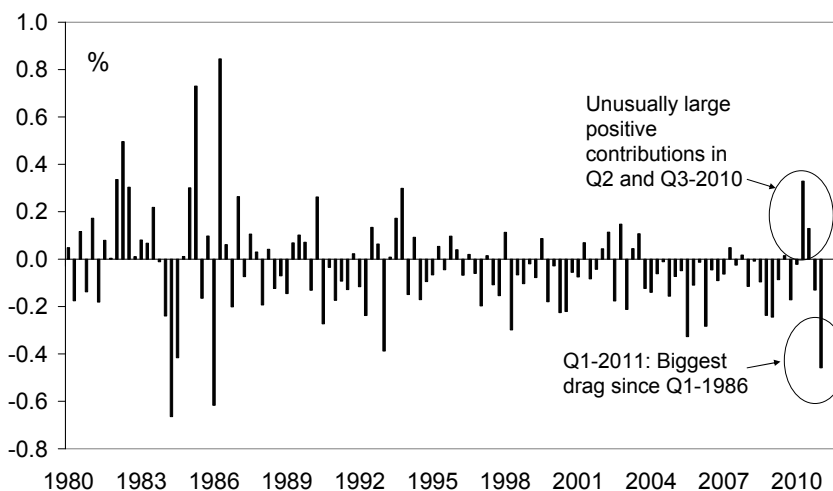
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GDP Recovers Despite Headwinds

Moreover, the ONS has a clear track record of revising GDP growth up after the first release (often more than a year later). The UK publishes GDP figures faster than any other G7 country. The cost of that greater timeliness is that the UK GDP figures are often revised substantially: the UK has the biggest upward revision bias to the GDP data among G7 countries. The labour market data – showing roughly stable unemployment and rising employment over the last two quarters – as well as business surveys, all suggest that the economy has shown underlying growth over the last two quarters. Indeed, they suggest the ONS data may well be revised up over time.

Note that it is wrong to believe the economy is about to “hit the wall” of fiscal tightening. The UK’s fiscal tightening programme began about a year ago. The Budget estimated that the structural primary fiscal balance already tightened by 2.3% of GDP in the past fiscal year (2010/11), and the actual tightening may have been even a little greater given that the fiscal deficit undershot slightly. The fiscal stance is due to tighten by a similar amount (2.2% of GDP) in the current fiscal year (2011/12), and then by an average of 1-1.5% of GDP per year for the next four years. The economy has achieved growth – not spectacular but not disastrous either – in the face of this heavy fiscal tightening, plus the erosion of real incomes from high inflation, and business surveys suggest the economy will continue to grow (perhaps erratically) in coming quarters. Any lingering fears of a “double dip” can be put to one side.

Figure 2. UK – Effects of Energy, Utilities and Construction on QoQ GDP, 1980-2011



Sources: ONS and Citi Investment Research and Analysis

Appendix A-1

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