ESSENTIAL READING

UK DEMAND & OUTPUT MONTHLY

UK Team

July 2015

GDP and latest nowcasts

	ONS estimate	UK Team expectation	Consensus	Latest backcast
2015 Q1	0.4%	0.4%	0.4%	0.5%
	Latest nowcast/forecast		Last month nowcast/forecast	
2015 Q2	0.7%		0.7%	
2015 Q3	0.7%		0.7%	

This month's data at a glance

Expenditure growth (%qoq) *contributions	2015 Q1 latest	2015 Q1 2nd release	Revision (pp)	2014 Q4	2014 Q3
GDP	0.4	0.3	0.1	0.8	0.7
Consumption	0.9	0.6	0.4	0.5	1.0
Govt consumption	1.0	0.6	0.3	0.1	0.0
Investment	2.6	0.9	1.7	-0.8	1.9
- Business	2.0	1.7	0.3	0.3	-0.2
- Housing	2.4	1.6	0.8	-0.5	2.4
- Government	1.2	1.0	0.2	-0.2	11.7
Net Trade*	-0.6	-0.9	0.2	0.8	-0.7
- Exports	0.4	-0.3	0.7	4.5	0.4
- Imports	2.3	2.3	0.0	1.6	1.3
Other (inc. stocks)*	-0.2	0.5	-0.8	-0.2	0.4

*contribution to GDP growth

Monthly Output Indices	Apr	Mar	Feb	Jan	Dec
Index of Services	0.2	0.2	0.3	-0.3	0.6
- PNDS	0.1	0.3	0.3	-0.5	0.9
- Distribution	1.0	-0.1	0.2	0.3	0.5
Index of Production	0.4	0.6	0.1	0.0	-0.1
- Manufacturing	-0.3	0.4	0.5	-0.8	0.2
Construction output	-0.8	1.4	-0.9	-1.1	2.0

Trade and Retail Sales	May	Apr	Mar	Feb	Jan
Retail sales vols (inc fuel)	0.2	0.9	-0.6	0.6	0.2
Retail sales vols (exc fuel)	0.2	0.8	0.1	0.7	-0.3
Goods imports	n.a.	-4.8	2.2	2.8	-3.6
Goods exports	n.a.	4.8	1.5	-3.4	-0.5

Survey Measures	Jun	May	Apr	Mar	Ave
Markit/CIPS Services*	n.a.	56.5	59.5	58.9	55.1
Markit/CIPS Manu*	51.2	52.1	52.3	58.4	53.3
Markit/CIPS Construction*	58.1	55.9	54.2	57.8	54.6
GfK/EC Consumer Conf	4.7	0.1	5.0	4.4	-9.4

*Markit/CIPS Services data are confidential until the 3rd July 2015.

BCC Economic Survey	2015 Q2	2015 Q1	2014 Q4	2014 Q3	Ave
Man. Domestic sales	20	30	36	23	11
Man. Business confidence	45	47	45	54	28
Serv. domestic sales	31	34	38	35	19
Serv. Business confidence	45	41	46	45	30

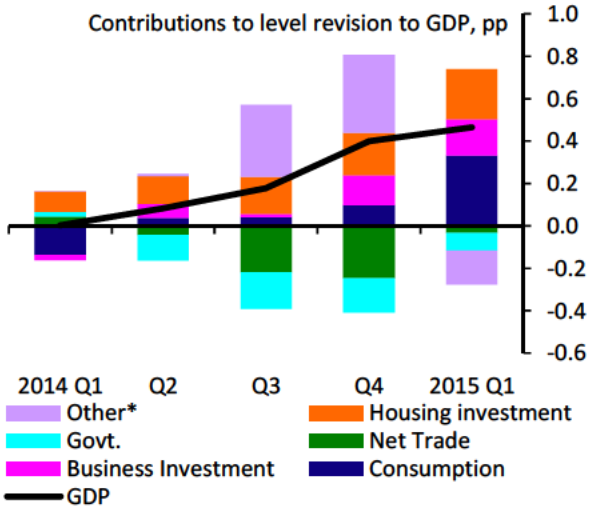
*CARE: BCC data are confidential un il he 9th July 2015.

2015 Q1 GDP growth was revised up to 0.4%, as expected, and GDP revisions further back paint a stronger picture of growth over the past year. The near-term outlook is little changed: we continue to expect solid growth of 0.7% in Q2 and Q3.

Q1 GDP growth was revised up by 0.1pp (to 0.4%), and our view that the weakening in growth in Q1 is likely to reflect volatility, rather than signalling a slowdown, remains intact. Most notable in the Q1 revisions is stronger consumption growth, with annual growth the strongest since 2007 Q4. In net terms there has been relatively little news from the surveys and indicators over the past month, so we continue to expect growth of 0.7% in Q2 and Q3 (mature estimates).

Further revisions to GDP back to the start of 2014 have increased the level of GDP by 0.5% (Chart 1). The boost was mostly a result of revisions to construction output, which has also increased the estimates of housing and business investment.

Chart 1: Revisions to the level of GDP



* Includes the statistical discrepancy, alignment adjustment, stockbuilding and acquisitions less disposals

Consumption growth now looks stronger…

On the expenditure side, the upward revision to GDP in Q1 was driven by consumption. Consumption is now estimated to have grown by 0.9% in Q1 (compared with 0.6% in the previous release). This changes the recent growth picture: rather than slowing, annual consumption growth has continued to pick up since mid-2014, and growth in Q1 was the strongest since 2007 Q4 (**Chart 2**). This is closer to the profile in the February *IR*, so we may have taken too much of a signal from the slowing in consumption growth in Q4 in the May *IR*. Nonetheless, it is still early in the data cycle for Q1 estimates, and early expenditure estimates are prone to revision.

Chart 2: Consumption growth

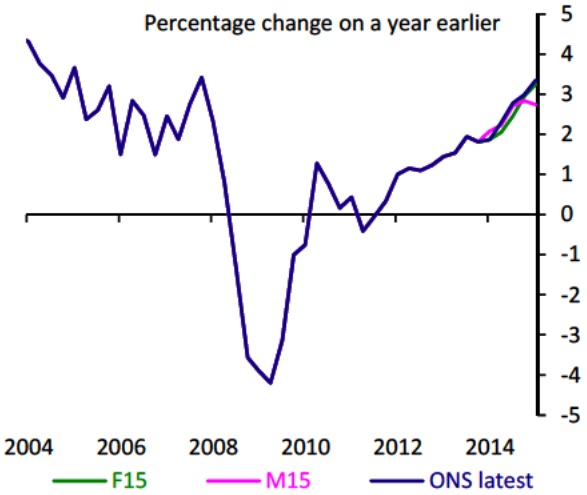


Chart 3: Saving ratio

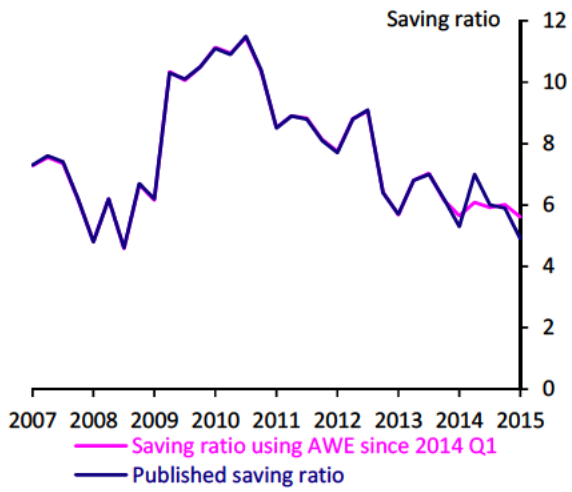
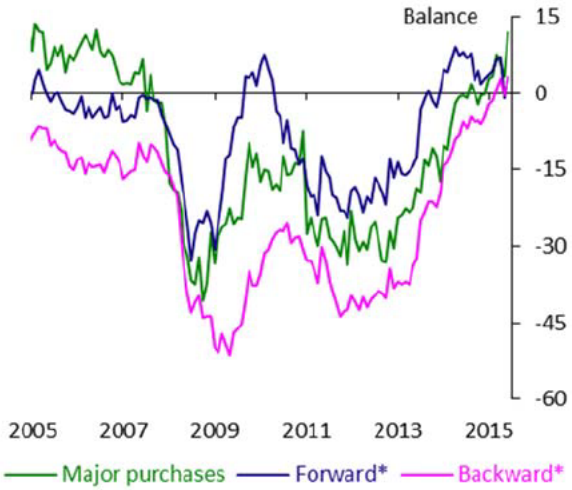


Chart 4: GfK/EC consumer confidence



*The forward series show the average of the balance for the general economic situation and financial situation of households over the next 12 months. The backward series shows an average of the equivalent balances over the last 12 months.

The fall in oil prices is likely to have boosted consumption growth in 2015 Q1. In the May *IR* we estimated that the boost to quarterly consumption growth from the fall was likely to be around 0.2pp in Q1. The official data on the month are broadly consistent with this estimate.[1]

The saving ratio in 2015 Q1 was almost a full percentage point lower than we were expecting, which at 4.9% is the lowest since 2008 Q3. But this was affected by weak wages and salaries, which were much weaker than pay growth calculated using average weekly earnings (AWE) and employment data.[2] The ONS have suggested placing more weight on the AWE measure for the time being, given concerns about the wages and salaries data. Using the AWE measure of pay growth since the start of 2014, instead of wages and salaries, would imply a relatively flat saving ratio over the past year (**Chart 3**).

...and consumption indicators suggest strength will continue

Retail sales volumes – one of our most timely, albeit relatively poor, indicators of consumption – remained solid in April and May, with 3m-on-3m growth around average. Nonetheless, growth has slowed relative to the strong growth in 2014Q4, consistent with the slowing in retail output.

Measures of consumer confidence are strong; our preferred measure (using seasonally adjusted GfK data from the EC) rebounded in June, after an unexpected fall in May, and returned to historically high levels (the series is around its highest level since September 2002). As we noted last month, the dip in May was likely to be affected by the General Election. The rebound suggests the dip was more likely to reflect (temporary) uncertainty about the implications of the General Election than renewed concerns about fiscal consolidation. The major purchases balance in particular rose sharply in June, to its highest level in nine years (**Chart 4**). The survey period ended too early to capture any impact from events in Greece over the past week or so.

Taking the consumption indicators together, we are expecting consumption to remain strong in the near-term, growing by 0.9% in Q2 and 0.8% in Q3 (a little stronger than in the May *IR*).

Housing and business investment both revised up, and stronger than expected in the May IR

Both housing and business investment have been revised up, consistent with the upward revision to construction output (see **Box** below for more detail on the revisions). Housing investment growth in particular was much stronger in 2014H1, but still slowed in 2014H2. Meanwhile, indicators of housing market activity have picked up recently, particularly housing starts and mortgage approvals. Locking in the revision to the level of housing investment in the back data alone would boost the growth forecast for 2015 by 4½pp. Taking the revisions together with the positive news in the indicators, we expect housing investment to grow by 6½% in 2015, much stronger than the 1% in the May *IR*.

[1]

[2] The ONS use AWE*employment as the basis for the estimate of quarter-on-quarter growth in non-seasonally adjusted wages and salaries.

Chart 5: Expenditure contributions to growth

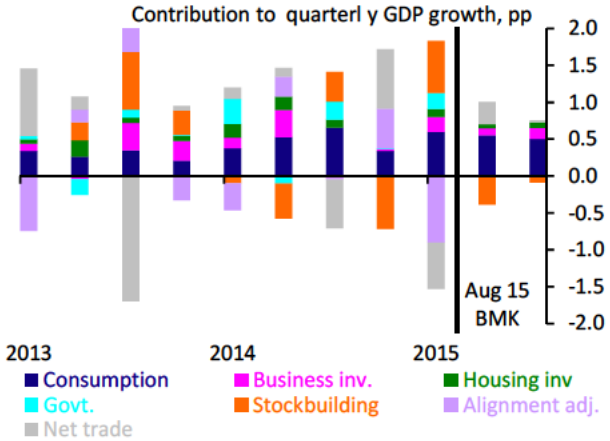


Chart 6: Monthly GDP

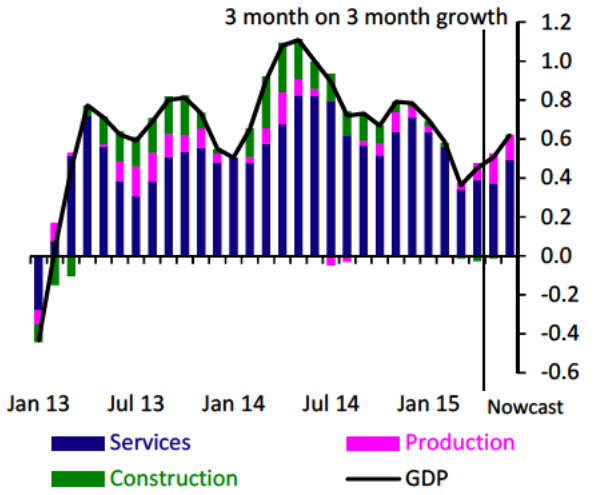
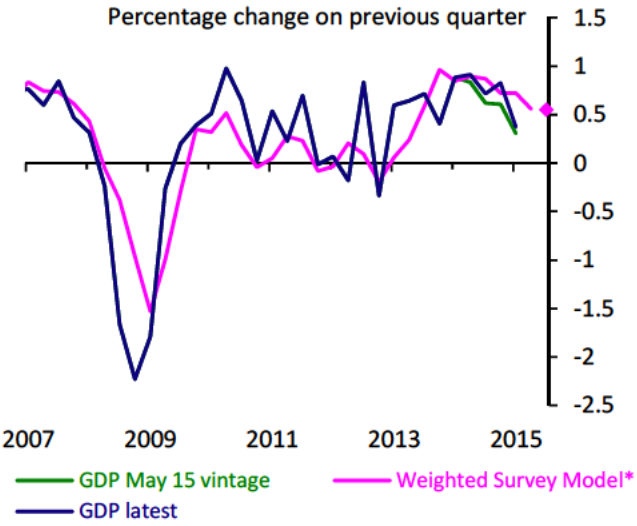


Chart 7: Weighted Survey Model predictions vs GDP outturns



* Diamond shows Q3 forecast, using the same Weighted Survey Model, but the weights on the surveys will be different from those for the nowcast quarter, owing to the different stage of the data cycle.

Business investment contributed a healthy +0.2pp to GDP growth in Q1 (**Chart 5**). A fall in extraction investment detracted slightly from business investment growth (-0.2pp), in line with our expectation.

Net trade likely to be positive in Q2

Net trade detracted from growth in Q1, but the monthly goods export data for April were surprisingly strong, suggesting a positive contribution to GDP growth in Q2 (**Chart 5**). Although we are expecting a positive contribution to growth in Q2, as a result of strong export growth, we are down-weighting the monthly data – they are notoriously volatile and the recent export strength has not been broad-based (concentrated in particular components and trading partners).

Monthly output has turned a corner

The slowing in GDP growth in Q1 (to 0.4%) was concentrated in services output (**Chart 6**). We noted previously that the Q1 weakness was mostly in business and finance services and some of this was likely to reflect volatility, rather than signalling a more persistent slowdown (May D&O Monthly). Indeed, output in this sector has picked up after the unexpected fall in January. We are expecting quarterly services growth of 0.7% in Q2, around the historical average and a little weaker than the average in 2014, although there remains a risk that we have taken too little signal from below average growth in 2015 so far.

Production output meanwhile picked up, boosted by oil and gas extraction. According to intelligence from DECC, the strength in extraction is likely to be a result of increases in production from existing pipelines, and tax cuts boosting profitability for older fields. Manufacturing, on the other hand, has been fairly subdued, with output broadly flat since mid-2014. According to intelligence from the Agents, the sterling appreciation against the euro has reduced manufacturers' competitiveness in the Euro Area, UK and third markets, affecting output and orders in 2015H1.

Looking through monthly volatility, construction output has been relatively flat since late 2014, and we expect this to remain the case in Q2 (with no growth on the quarter). That said, substantial revisions incorporated in this release mean the official data now paint a healthier picture of the sector (for more details see **Box**).

The near-term outlook (of solid growth) is unchanged

The business surveys continue to point to solid growth, with our weighted survey model (WSM) predicting 0.6% growth in Q2 and Q3 (**Chart 7**). Following the revisions to the official data, the predictions from the WSM have been very close to the latest data for 2014, and the continued strength of the surveys in 2015H1 provides re-assurance that the weakness in Q1 was likely to have been temporary.

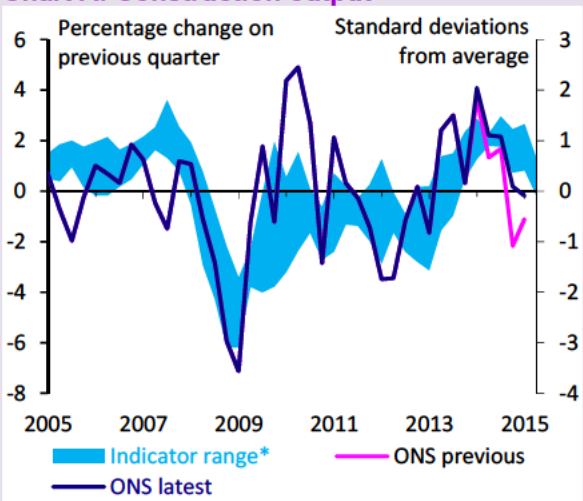
The news from the latest revisions is overwhelmingly positive, with a stronger picture for GDP growth over the past year. But we are not taking much of a signal from these revisions for near-term growth: the construction sector was the main source of the upward revision to GDP and we already thought that the true state of this sector was stronger than implied by the ONS data (June D&O Monthly).

Taking all of our models together, we continue to expect solid growth of 0.7% in Q2 and Q3 (as in the May *IR*).[3] There remains a risk that we have taken too little signal from slow growth in Q1, but the strength of the surveys means we view it as a small risk. We also continue to monitor the events in Greece for any impact on UK growth in the near-term, but there is little evidence of an impact to date.

Box: Construction revisions lead to stronger GDP over the past year

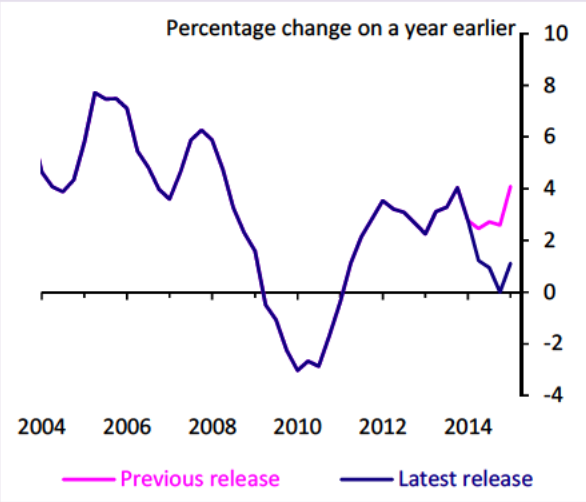
Construction output since the start of 2014 has been revised up significantly in the latest QNA release. The level of output is now 5% higher by 2015 Q1. Prior to these revisions, we had been puzzled by the falls in the construction output in the official data in 2014 Q4 and 2015 Q1; the weakness was at odds with the range of indicators (**Chart A**) and industry intelligence.

Chart A: Construction output



*For 2015 Q2, Experian data are up to April 2015. CIPS and the Agent scores are for the full quarter (to June 2015).

Chart B: Construction deflators

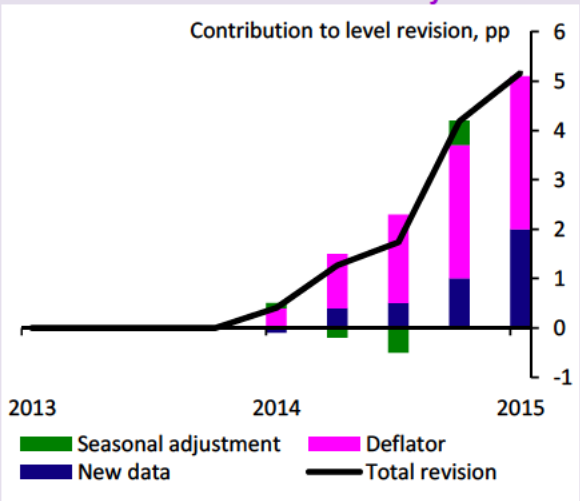


Source of the revisions

The revision to the level is largely because construction output prices are estimated to be much weaker than previously, following a method change prompted by quality issues with the Construction Price and Cost Indices (**Chart B**). New data and revised seasonal adjustment parameters also increased the level of construction output in the latest release (**Chart C**). Construction output and investment use the same survey data (for more details, see ONS article), so the revisions also affected dwelling and business investment.

The ONS will not be introducing the new construction deflator method for data prior to 2014 in the Blue Book this year (they do not have the necessary series). So we are not expecting further back revisions from this particular method change.

Chart C: Construction revisions by source



News to GDP and the near-term growth outlook

The construction revisions have pushed up total output by 0.3%. As we noted last month, we thought the true state of the construction sector was better than implied by the official data, so these revisions provide little news for the near-term outlook. Construction output has been relatively flat since late 2014, and we expect this to remain the case in Q2. Indeed, this is broadly consistent with the latest range of survey indicators for Q2.

[3] Please note: we focus on our expectation for the mature estimate of GDP, rather than the preliminary estimate, given its greater importance for assessing the cyclical state of the economy. As a result, all quoted GDP nowcasts and forecasts in our briefing material are mature estimates of GDP, unless stated otherwise. Previously we had tended to quote both preliminary and mature estimates.