

UK economy

Recovery continues in Q1, but initial GDP estimates most likely understate growth

Recovery continued in Q1, but understated by official data?

The initial estimate of UK gross domestic product (GDP), published today by the Office for National Statistics, showed that the recovery continued. Having risen by 0.4% in 2009 Q4, a further 0.2% expansion was seen in Q1.

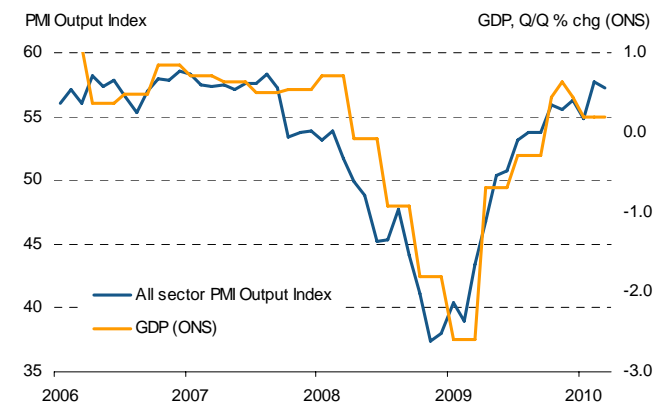
Growth was weaker than expected, but there are good reasons to believe that the initial estimate of growth in Q1 may understate the actual expansion experienced at the start of 2010.

First, initial GDP estimates are based on only partial data for the quarter and are therefore subject to revision. With 2009 Q4 data revised up from an initial estimate of 0.1% to the current estimate of 0.4%, it appears that the initial estimates are under-estimating the gathering growth momentum of the upturn.

Second, PMI survey data have a good relationship with historical GDP data (after revisions) and suggest that growth in Q1 was stronger than the initial ONS estimates. This had been the case in 2009 Q4, when the meagre 0.1% initial estimate contradicted a more buoyant picture of growth from the PMI surveys, which subsequently turned out to have been accurate (see out commentary note from 6 January 'PMI data signal strong end to 2009'¹).

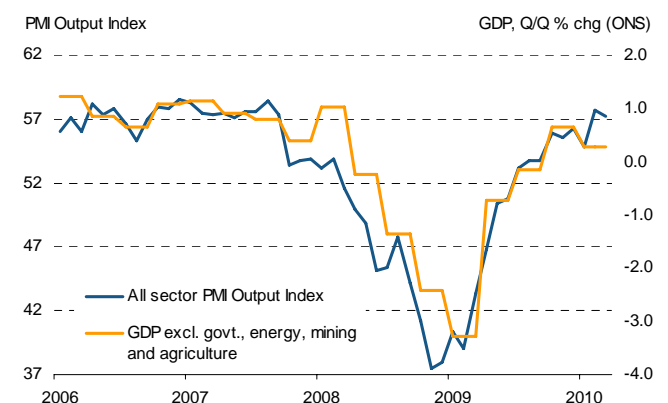
The 'all-sector' PMI Output Index combines business output and activity measures from the services, manufacturing and construction CIPS/Markit surveys, and relates to private sector activity only. The closest equivalent measure from the ONS (i.e. using similar sector coverage – the only difference being that retail and wholesale cannot be stripped out of the ONS data) now shows private sector output to have risen 0.7% in Q4 (we estimated 0.8% on 6 January).

GDP



The ONS estimate that growth for the PMI sectors slowed to 0.3% in Q1, but the rise in the PMI average 'all-sector' PMI Output Index reading for Q1 to 56.6 from 55.9 in the final quarter of last year suggests that this could eventually get revised up above the 0.7% seen in Q4.

GDP for sectors covered by PMIs

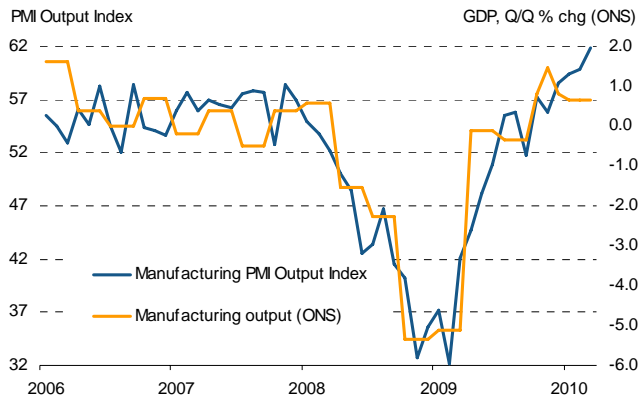


Manufacturing divergence in Q1

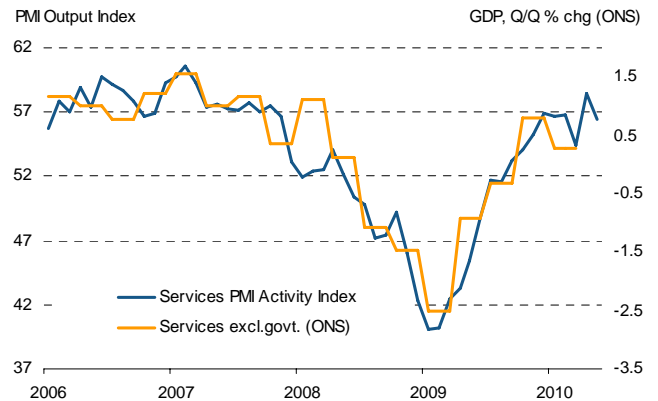
The divergence between the PMI surveys and GDP in Q1 is especially notable for manufacturing, for which the PMI showed growth accelerating particularly sharply towards the end of the quarter as UK exporters benefited from buoyant global trading conditions and a weakened currency. It is the final part of the quarter for which ONS data are likely to be most incomplete.

¹ http://www.markit.com/assets/en/docs/commentary/markit-economics/2010/jan/UK_allsectorPMI_10_01_06.pdf

Manufacturing



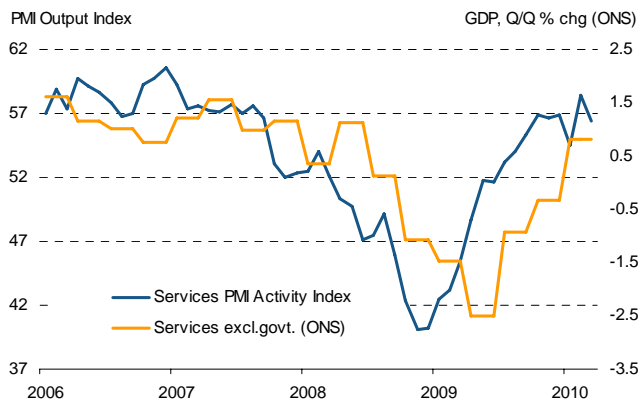
Services with PMI advanced by 3 months



Services augur well for Q2 growth

Also of interest is the divergence in the service sector. Excluding government, the ONS estimate that service sector growth slowed from 0.8% in Q4 to 0.3% in Q1. Some of this easing related to a weakening in retail, which is not covered by the PMIs. However, it is also evident that the PMI data for services have moved in advance of GDP data in recent years by approximately three months (see charts below).

Services



The leading indicator property of the services PMI therefore bodes well for GDP growth in Q2, suggesting that – for the service sector at least – growth is likely to be sustained in the 0.7%–0.8% range (see chart above). Alongside the sustained weakness of sterling and surging growth in the manufacturing sectors of some of the UK’s main export markets (notably the Eurozone and the US), it also seems likely that production should continue to expand in Q2 at perhaps an even faster pace than seen in services.

The main drag on GDP is expected to come from government spending, although the tightening of the public purse strings is not likely to occur until some time after the May General Election and the PMI data suggest that the pace of expansion in manufacturing and services should help to sustain the recovery in coming months.

Sources for all charts: Markit, ONS.

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