MPC - ESSENTIAL READING

UK Demand & Output Monthly

UK Team

June 2015

GDP and latest nowcasts*

	ONS 2nd estimate	UK Team expectation	Consensus	Latest backcast
Q1	0.3%	0.4%	0.4%	0.5%
	Latest nowcast		Last month's expectation	
Q2	0.6% (0.7% final)		0.6% (0.7% final)	

* The root mean squared error since Q1 2004 is 0.3

This month's data at a glance

Demand (%qoq)	2015 Q1	May IR	Contrib. to error	2014 Q4	2014 Q3
GDP	0.3	0.3^	0.0	0.6	0.6
Consumption	0.6	0.7	-0.1	0.4	1.0
Govt consumption	0.6	0.0	0.1	-0.2	0.5
Investment	0.9	0.2	0.1	-0.3	1.8
- Business	1.7	0.8	0.1	-0.9	0.3
- Housing	1.6	-1.0	0.1	-1.1	1.4
- Government	1.0	-0.3	0.0	1.7	9.3
Net Trade*	-0.9	-0.5	-0.4	0.8	-0.5
- Exports	-0.3	-0.7	0.1	4.6	-0.1
- Imports	2.3	0.7	-0.5	1.6	1.4
Other (inc. stocks)*	0.5	0.3	0.2	-0.4	0.0

*contr butions to quarterly GDP growth ^preliminary estimate

Monthly Output Indices	Mar	Feb	Jan	Dec	Nov
Index of Services	0.1	0.3	-0.2	0.6	0.1
- PNDS	0.2	0.4	-0.4	0.7	0.0
- Distr bution	-0.2	0.2	0.3	0.7	0.9
Index of Production	0.5	0.1	-0.1	-0.1	0.0
- Manufacturing	0.4	0.5	-0.8	0.1	0.8
Construction output	3.9	-0.3	-1.9	0.6	-1.9

Trade and Retail Sales	Apr	Mar	Feb	Jan	Dec
Retail sales vols (inc fuel)	1.2	-0.7	0.6	0.2	0.0
Retail sales vols (exc fuel)	1.2	0.0	0.7	-0.3	-0.3
Goods imports	n/a	-0.2	2.8	-2.9	6.3
Goods exports	n/a	1.0	-3.3	-2.4	6.0

Survey Measures	May	Apr	Mar	Feb	Ave
CIPS Services*	n/a	59.5	58.9	56.7	55.1
CIPS Manufacturing*	n/a	52.9	57.4	56.2	53.4
CIPS Construction*	n/a	54.2	57.8	60.1	54.6
GfK Consumer Conf	0.1	5.0	4.4	1.7	-9.5

*CIPS Manufacturing, Construction and Services are confidential until the 1st, 2nd and 3rd June.

CBI Service Sector Survey*	15Q2	15Q1	14Q4	14Q3	Ave
Business optimism	29	17	16	34	2
Employment: next 3 months	34	31	33	31	10
Inv. Intentions: vehicles, plant & machinery	11	11	7	6	-7

*CBI Service Sector Survey data are confidential until the 29th May.

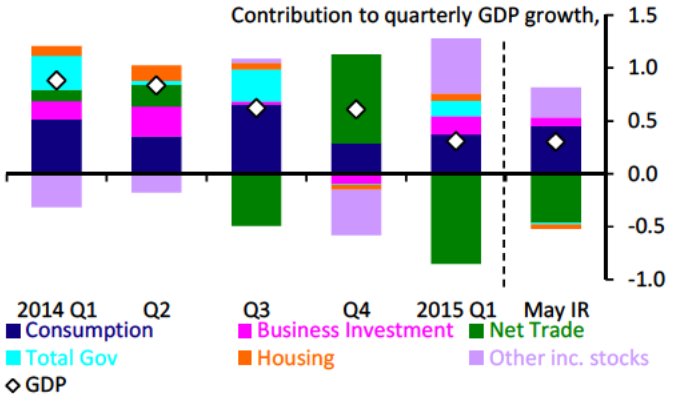
The news on the month supports our view that low growth in Q1 was largely erratic. We expect growth in Q2 to be 0.7%.

GDP growth in Q1 was unrevised at 0.3%, but we still expect an eventual upward revision to 0.5%.

There was mixed news in the expenditure split for Q1: consumption growth was a little weaker than expected but investment growth was stronger.

Surveys continue to support our expectation that growth will rise in Q2, and our nowcast of 0.7%, consistent with a preliminary estimate of 0.6%, remains intact.

Chart 1: Contributions to GDP growth



GDP growth in Q1 unrevised

GDP growth in Q1 was unrevised at 0.3%. We still expect this to be revised up to 0.5%, based on the properties of past revisions and the relative strength of the surveys.

Although we had been expecting an upward revision to 0.4% as soon as this month, it was a close call, and in the event a small downward revision to services growth in March offset small upward revisions to production and construction.

News in expenditure was mixed

Consumption growth in Q1 was a little weaker than expected, but investment was quite a bit stronger (Chart 1). This was true of all the components of investment: business, housing, and government. Government consumption was also stronger than expected, meaning total final domestic demand was higher than anticipated in the May IR, offset in GDP by a larger drag from imports.

Consumption growth weaker than expected

Consumption grew by 0.6% in Q1, slightly below our expectation of 0.7%. Within that, there was a large increase

Chart 2: Business investment

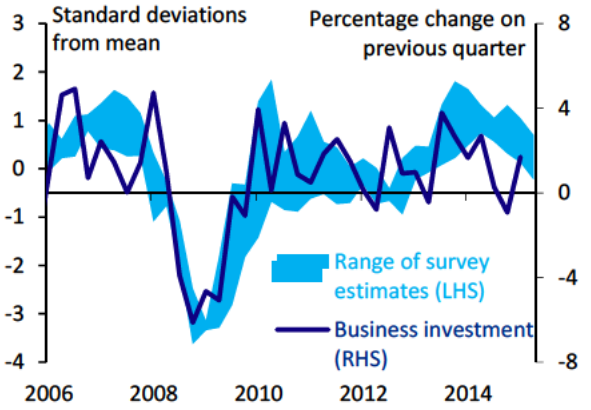


Chart 3: Construction and dwellings investment

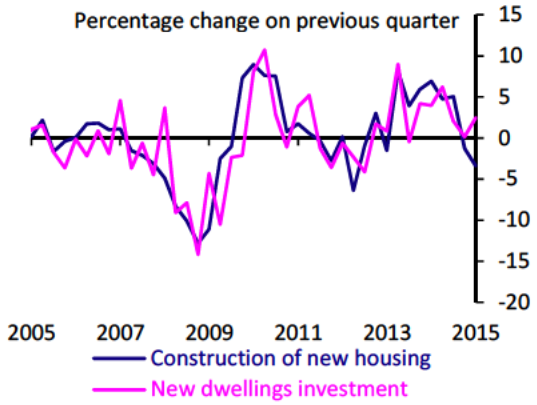


Chart 4: Imports and import-weighted demand

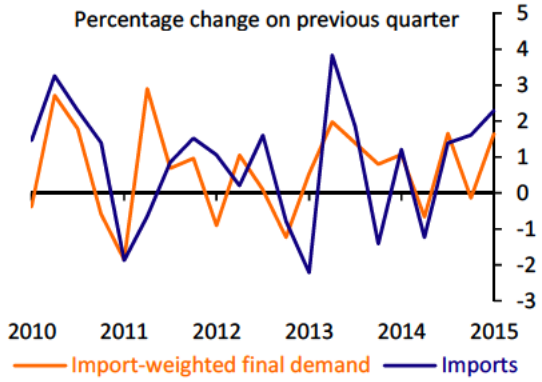
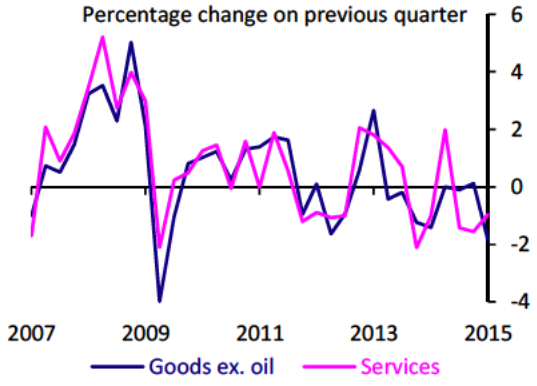


Chart 5: Import prices



in consumption by the non-profit sector (NPISH), unwinding a large fall in Q4. That means household consumption only grew by 0.5% in Q1.

Although this looks weak, it should be noted that the ONS's initial estimate of compensation of employees was even weaker: nominal compensation is estimated to have fallen by 0.2% on the quarter. So it may well be the case that the saving ratio, which we receive next month, will be lower than expected in the May IR (5.8%).

Business investment strong, but uncertain

Business investment grew by 1.7% in Q1, higher than the 0.8% expected in the May IR. This strength is consistent with survey indicators of investment intentions (Chart 2), but this month the data come with a note of caution: the survey response rate was abnormally low (67%, compared to a normal rate of 78%). So the uncertainty around this initial estimate, which is usually significant anyway, is even higher than normal.

Housing investment surprisingly strong

Housing investment grew by 1.6% in Q1, compared to an expectation of -1.0% in the May IR. Our negative expectation was a function of the weak approvals data and weak construction data (see below). But it seems neither has fed through into the expenditure data to the extent we had assumed: both dwellings investment and "other" investment (which contains spending associated with property transactions) were stronger than expected. However, as with business investment, these data come with health warnings. At this stage, ONS dwellings investment data are largely forecasts. Once more data have been incorporated the series tends to look similar to the relevant component of construction output (Chart 3), since in many cases they share source data. This suggests the risk of revision to dwellings investment is skewed to the downside.

Exports as expected, but imports stronger

Export growth was largely as expected, given the normal volatility of the data (-0.3% vs -0.7%). But growth in imports was much higher than expected (2.3% vs 0.8%). Together, this meant net trade subtracted 0.9pp from growth in Q1, compared to our expectation of a 0.5pp drag in the May IR.

This large negative contribution is not too concerning. The trade data are volatile, and Q1's negative contribution offsets a large positive contribution in Q4 (0.8pp). And it is common for net trade contributions to be partially offset by stockbuilding, as it was this quarter (stocks contributed +0.6pp to growth in Q1). This meant that the growth in imports was only a little stronger than import-weighted final demand (Chart 4).

Supporting volumes growth, import prices (inc. oil) fell by 3.6% in Q1, greater than our expectation of a 2.5% fall. The breakdown by product suggests that this is not entirely an oil story: the prices of imported goods excluding oil and imported services also fell by more than 1% on the quarter (Chart 5).

Chart 6: Services output

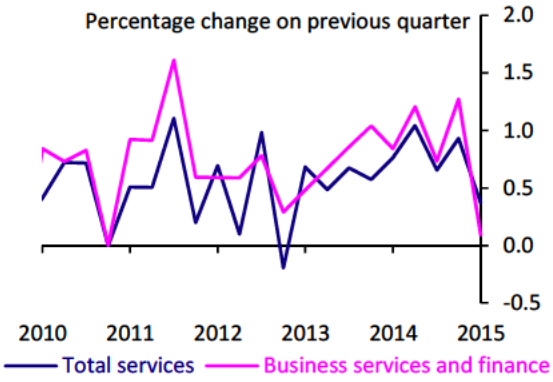


Chart 7: Construction output

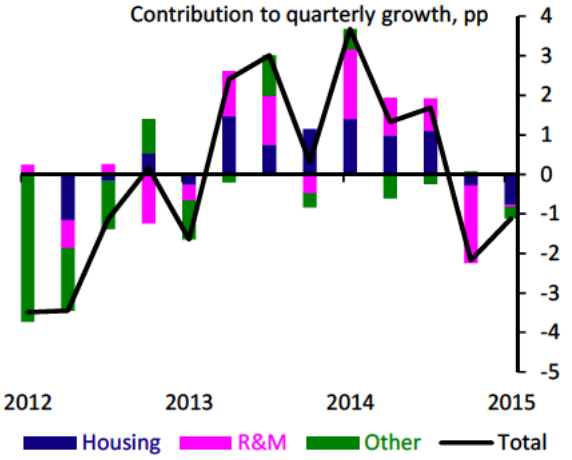


Chart 8: Starts and completions

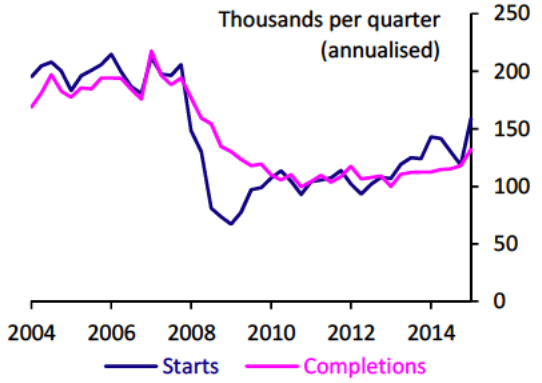
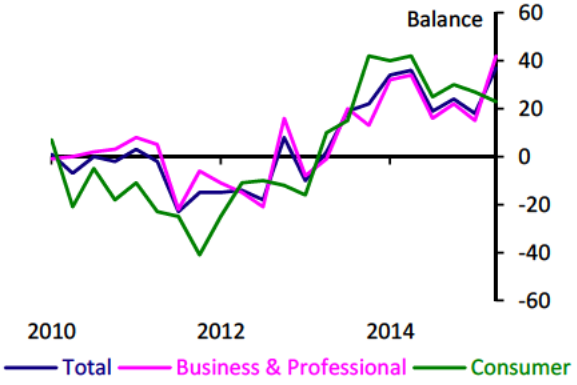


Chart 9: CBI Service Sector Survey



Small tweaks to the output measure of Q1 GDP

As mentioned above, although headline GDP growth was unrevised, there were some small changes to the composition of output. Upward revisions to extraction and construction offset downward revisions to services.

Weakness in services should be temporary

The service sector is now estimated to have grown by 0.4% in Q1, the slowest rate since 2012 Q4 (Chart 6). As was the case last month, the weakness was concentrated in business services and finance. This sector has been a crucial source of growth over the past two years, growing at an average rate of 0.9% a quarter since 2013. The slowing in Q1 might therefore be cause for alarm. But the strength the most recent CBI Service Sector Survey (see below) reinforces our view that the weakness will be temporary.

Construction data remain puzzling

Despite being revised up, output in the construction sector is still estimated to have fallen by 1.1% in Q1, following a fall of 2.1% in Q4. The weakness has been fairly broadly-based across the sector: although repair and maintenance was largely responsible for the weak Q4 number, construction of new housing was responsible in Q1 (Chart 7).

We are still not reading much into the weakness of construction output. The construction sector is one of the more difficult components of output to measure, so we assess the health of the sector with as wide an array of indicators as possible. No other indicator paints as bleak a picture of the sector as the ONS output data. Reports by the Agents and the surveys by Experian and CIPS/Markit are consistent with a moderation of growth around the turn of the year, but do not corroborate outright declines in output. Employment in the sector grew by 1.5% in Q4 (the latest data available). And DCLG estimate that both housing starts and completions picked up in Q1, suggesting the prospects for output in this component of construction are good. In the case of starts, the increase was large, growing by 30% on the quarter (Chart 8). Taking all these indicators together, the true state of the construction sector is probably better than the ONS data imply, and we do not expect output to fall again in Q2.

GDP growth likely to rise in Q2

The surveys continue to support our expectation that growth will be faster in Q2 than in Q1, although the expected improvement differs by survey provider.

The CBI released three surveys this month, all of which were very positive. The CBI Service Sector Survey, which covers all private non-distributive services excluding finance (almost 40% of the economy), was the strongest of the three. In this survey, the balance of firms reporting that output had increased over the quarter increased markedly to its highest level since 2005 (Chart 9). This was especially true for the business and professional services sector. Taking all the CBI surveys together, they are consistent with quarterly growth as high as 1% in Q2.

Chart 10: Markit/CIPS composite

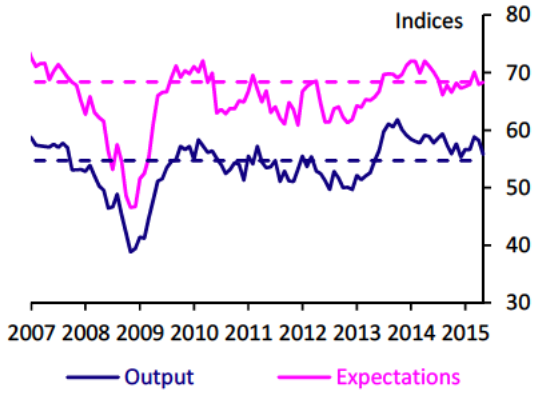
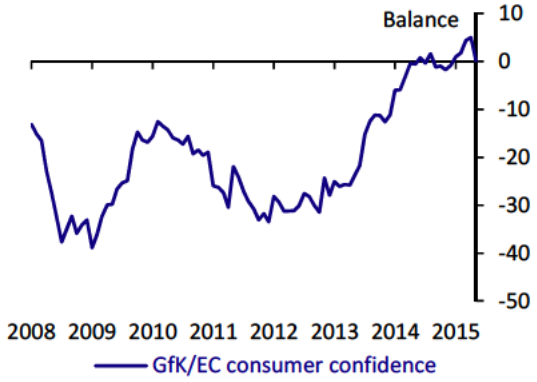


Chart 11: GfK consumer confidence



The Markit/CIPS surveys remain a little weaker. On the month, the backward-looking indices weakened a touch, although they are still consistent with growth in Q2 around 0.7%. In contrast, although the forward-looking indices ticked up slightly, the absolute levels of the indices remain low (Chart 10), so they point to growth as low as 0.4% in Q3.

Of course, the best individual forecast of growth weights these competing estimates by their past predictive power. Our Weighted Survey Model, which does just that, predicts growth of 0.6% in both Q2 and Q3.

Consumer confidence dips unexpectedly

Although it is not an output survey – and therefore not included in our Weighted Survey Model – there was a notable development in the GfK/EC measure of consumer confidence this month. The headline GfK/EC seasonally adjusted balance fell sharply in May, by 5.0 points to +0.1 (Chart 11). The equivalent balance for the euro area saw only a small fall, suggesting a UK-specific factor was behind the dip. Since the majority of respondents took the survey after the General Election, it is possible that it might reflect concerns about further fiscal tightening and/or the prospective EU referendum.

While this might suggest downside risks to our consumption growth forecast, it may simply be an erratic reading, so we have not taken much signal from this.

Monthly "hand-off" is now a little less favourable

Our central nowcast is formed using a range of models, including the Weighted Survey Model described above. One other model is the Industry Model, which draws heavily on the monthly output data, and as a result is influenced by the "hand-off" from Q1 to Q2 (the "hand-off" to Q2 is the *quarterly* growth rate that would prevail if the *monthly* level of output remained at its March level throughout Q2 i.e. monthly growth were 0% in April, May and June). This hand-off was unusually large last month, at 0.5%, contributing to its strong forecast of 0.9%. The revised monthly pattern of growth has moderated both the "hand-off" and the model prediction by 0.1pp.

Our nowcast for Q2 is unchanged on the month

Taking all our models together, our nowcast is unchanged on the month. We expect GDP to grow by 0.7% in Q2. This would be consistent with a preliminary estimate of 0.6%. Although there remains a risk we have taken too little signal from slow growth in Q1, the relative strength of the surveys and our range of models support our expectation that growth will be higher in Q2.

ANNEX: UK DATA DETAIL

This page provides links to charts and tables that give more detail on recent data.

Individual data releases

The table below contains links to standard charts and tables for each data release, as well as the official ONS or survey commentary.

GDP	Released	Data up to	Indicator
GDP (Prelim)	28/04/15	Q1 2015	GDP: Preliminary indicator
GDP (Second estimate)	28/05/15	Q1 2015	GDP: Second estimate indicator
GDP (QNA)	31/03/15	Q4 2014	GDP: Quarterly National Accounts indicator

Monthly ONS data	Released	Data up to	Charts
Index of Services	28/05/15	Mar-15	IoS Charts
Index of Production	12/05/15	Mar-15	IoP Charts
Construction output	15/05/15	Mar-15	
Retail Sales	21/05/15	Apr-15	Retail Sales charts
UK Trade	08/05/15	Mar-15	Trade charts
Output surveys			
CIPS Services	03/06/15	May-15	CIPS services charts
CIPS Manufacturing	01/06/15	May-15	CIPS manufacturing charts
CIPS Construction	02/06/15	May-15	CIPS construction charts
BCC	09/04/15	Q1 2015	
CBI Quarterly Industrial Trends	27/04/15	Q1 2015	CBI QIT charts
CBI Services	29/05/15	Q2 2015	CBI SSS charts
CBI Financial Services	30/03/15	Q1 2015	CBI FSS charts
CBI Monthly Trends Enquiry	21/05/15	May-15	CBI MTE
Experian Construction	02/04/15	Feb-15	Experian charts
Consumption Indicators			
Consumer Confidence	28/05/15	May-15	Consumer confidence charts
BRC Retail Sales Monitor	12/05/15	Apr-15	BRC RSM charts
CBI Distributive Trades	26/05/15	May-15	CBI DT charts
SMMT car registrations	07/05/15	Apr-15	SMMT charts

Yellow denotes new data this month

Red denotes latest data are not publically available at time of circulation (link will be updated when it is available)