ESSENTIAL READING

UK DEMAND & OUTPUT MONTHLY

UK Team

August 2015

GDP and latest nowcasts

	ONS estimate	UK Team expectation	Consensus	Latest backcast
2015 Q2	**0.7%**	**0.6%**	**0.7%**	**0.7%**
	Latest nowcast/forecast		Last month nowcast/forecast	
2015 Q3	**0.7%**		**0.7%**	
2015 Q4	**0.7%**		**0.7%**	

This month's data at a glance

Output growth (%qoq)	2015 Q2 latest	Q2e	News	2015 Q1	2014 Q4
GDP	0.7	0.6	0.1	0.4	0.8
Services	0.7	0.6	0.1	0.4	0.9
- PNDS	0.8	0.7	0.1	0.5	1.2
- Distribution	0.7	1.1	-0.4	1.0	1.4
- Govt	0.2	0.1	0.1	0.1	-0.2
Production	1.0	0.9	0.1	0.2	0.4
- Manufacturing	-0.3	-0.3	0.0	0.1	0.4
- Energy	4.3	4.0	0.3	0.5	0.5
Construction	0.0	-0.4	0.4	-0.2	0.2

Monthly Output Indices	May	Apr	Mar	Feb	Jan
Index of Services	0.3	0.2	0.2	0.3	-0.3
- PNDS	0.5	0.1	0.3	0.3	-0.5
- Distribution	-0.2	0.7	-0.1	0.2	0.3
Index of Production	0.4	0.3	0.6	0.1	0.0
- Manufacturing	-0.6	-0.4	0.4	0.5	-0.8
Construction output	-1.3	-0.5	1.4	-0.9	-1.1

Trade and Retail Sales	Jun	May	Apr	Mar	Feb
Retail sales vols (inc fuel)	-0.2	0.3	0.7	-0.7	0.7
Retail sales vols (exc fuel)	-0.2	0.4	0.5	0.0	0.7
Goods imports	n.a.	-5.5	-1.8	2.2	2.8
Goods exports	n.a.	0.1	5.4	1.5	-3.4

Survey Measures	Jun	May	Apr	Mar	Ave
Markit/CIPS Services*	58.5	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

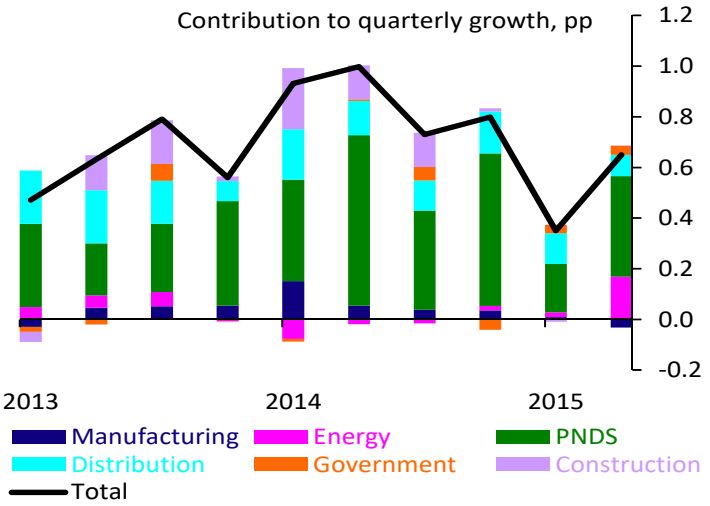
CBI Qtly Ind. Trends	2015 Q2	2015 Q1	2014 Q4	2014 Q3	Ave
Business optimism	8	3	15	8	-5
Export optimism	-5	-9	1	-3	0
Investment intentions: buildings	-14	-19	-5	-14	-18
Investment intentions: machinery	-3	-6	16	5	-2

GDP growth bounced back in Q2, so the weakness in Q1 looks to be temporary. We expect solid growth of 0.7% to continue in Q3.

Prelim Q2 GDP growth was 0.7%, 0.1pp higher than we expected ahead of the release. That reflected a slightly firmer rebound in private non-distribution services output than we predicted, after erratic weakness in Q1. But our Q2 backcast remains at 0.7%, so there is no news to the A15 BMK forecast.

We still expect solid GDP growth of 0.7% in Q3, consistent with little news in the survey output indicators this month. But there is slight downside risk to that nowcast. The surprising weakness in output growth excluding energy over H1 could prove to be more persistent.

Chart 1: Output contributions to quarterly GDP growth



Prelim Q2 growth was slightly higher than expected

The ONS estimate that GDP grew by 0.7% in Q2 (**Chart 1**). This was slightly higher than our expectation immediately ahead of the release (0.6%), but in line with the market median. The prelim news was only small however; so our backcast, which captures our view of the mature estimate of growth, is unchanged in Q2 at 0.7%.

Erratically weak Q1 PNDS output unwound in Q2

The +0.3pp bounce back from weak Q1 GDP growth in the ONS data mostly reflects a rebound in private non-distribution services (PNDS) output. We had predicted most of that rebound, so were right not to read too much into the surprisingly weak monthly services output data earlier this year. The quarterly erratic PNDS output movements occurred within finance & insurance and professional, scientific & technical activities, two large subsectors, which expanded again in Q2 after temporary weakness in Q1 (**Chart 2**).

Chart 2: Contributions to quarterly PNDS growth

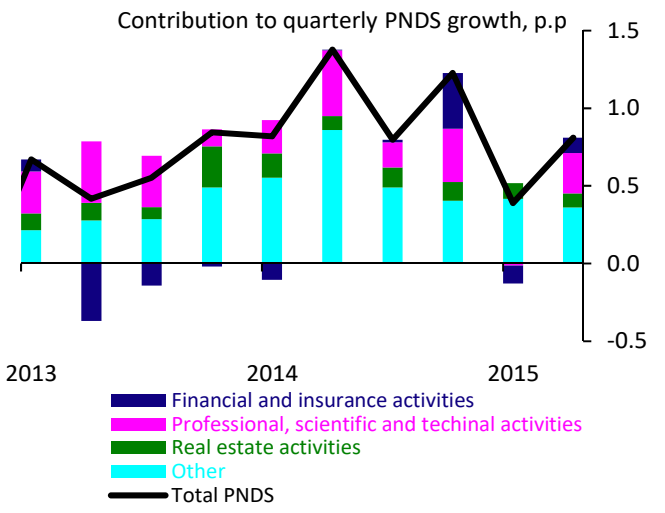


Chart 3: Construction output, surveys and our Q3 nowcast

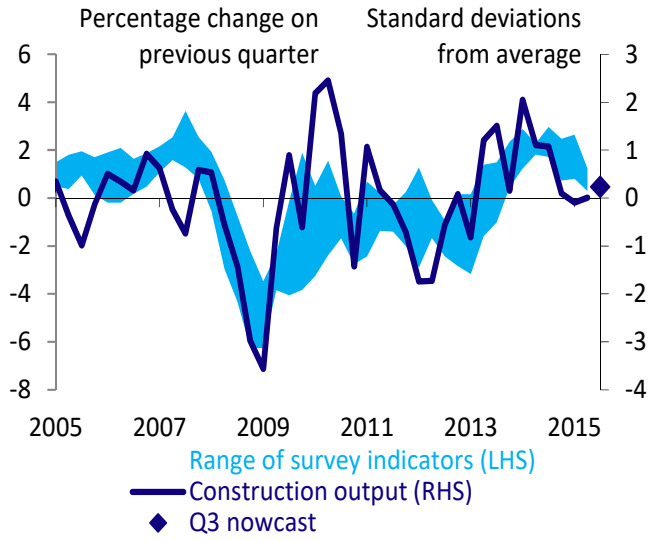
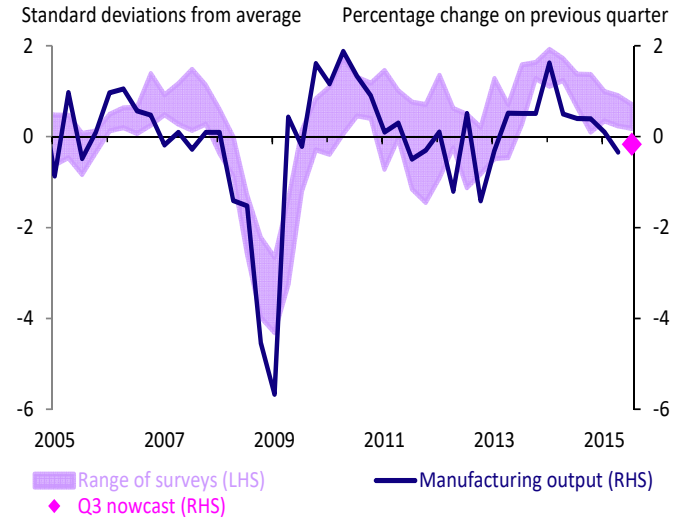


Chart 4: Official manufacturing output, surveys & our Q3 nowcast



An unusually large positive output contribution from energy

The pickup in Q2 GDP growth was also partly driven by an unusually strong, positive contribution from energy output (+0.2pp, see **Chart 1**); specifically oil and gas extraction. Last month we had noted intelligence from DECC, suggesting that strong production was likely to reflect higher output from existing pipelines, and tax cuts boosting profitability for older fields (July D&O Monthly). So the large 7.8% rise in Q2 total extraction output was not news.

The latest intelligence from DECC suggests that production will remain elevated in Q3 relative to the levels seen over the last few years, and only slightly below Q2. Consequently, we expect energy output to make no contribution to GDP growth in Q3.

Supply constraints holding back construction output growth

Construction output was flat in Q2, similar to Q4 and Q1, with the official data still weaker than suggested by the surveys (**Chart 3**). Early estimates of quarterly construction growth since early 2013 have tended to be revised up quite heavily (even excluding the last revisions for the new interim construction output price measure). So we may see a stronger picture of the sector in future data vintages.

Nonetheless, the survey data and our Agents are consistent in highlighting a negative impact from supply constraints for construction output. Materials constraints (eg bricks) have eased in response to increased supply, but skilled labour shortages remain. For example, sub-contractor workers are scarcer, and charging higher rates as a result. Some of the industry anecdote also suggests that pent-up demand for housing construction has receded. Overall, taking all of these factors into account, we expect only a small rise in construction output in Q3.

Further weakness in manufacturing output likely

Manufacturing output fell by 0.3% in Q2, recording a contraction for the first time in over two years. The sharp slowing in the sector since early 2014 tallies with the steer from the business surveys (**Chart 4**). The latest manufacturing surveys readings this month are little changed, suggesting ongoing output weakness in the sector.

Substantial net trade news from monthly goods data

Besides prelim Q2 GDP, the May goods trade release provided the most noteworthy data news this month. Goods exports were stronger and imports weaker than we had expected, and there were also revisions to April. Those Q2 to date figures indicated a net trade contribution to GDP of +1.2pp from goods alone (**Chart 5**). And that far exceeded the total Q2 (goods & services) net trade contribution that had been incorporated in the A15 BMK forecast (+0.3pp). Although monthly goods trade data are volatile and prone to revision, analysis of past real-time data show they are a good indicator of the quarterly goods data incorporated into estimates of GDP growth. As a result, that large Q2 net trade news was taken on board in the A15 Draft forecast.

Chart 5: ONS goods net trade contribution to real GDP

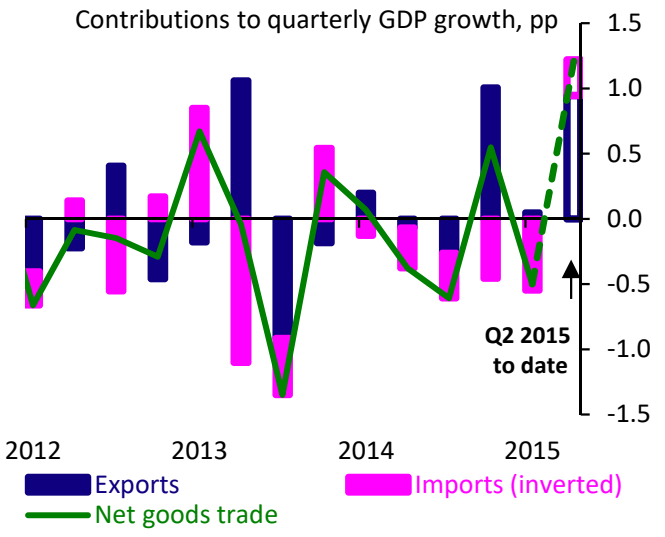


Chart 6: Markit/CIPS and CBI manufacturing survey export orders

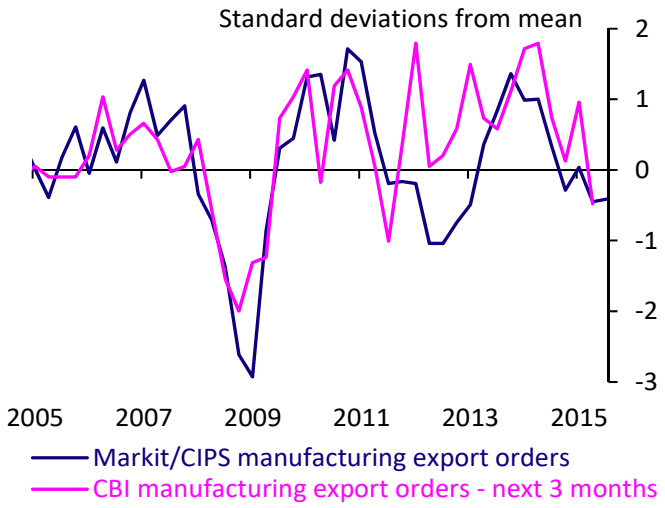
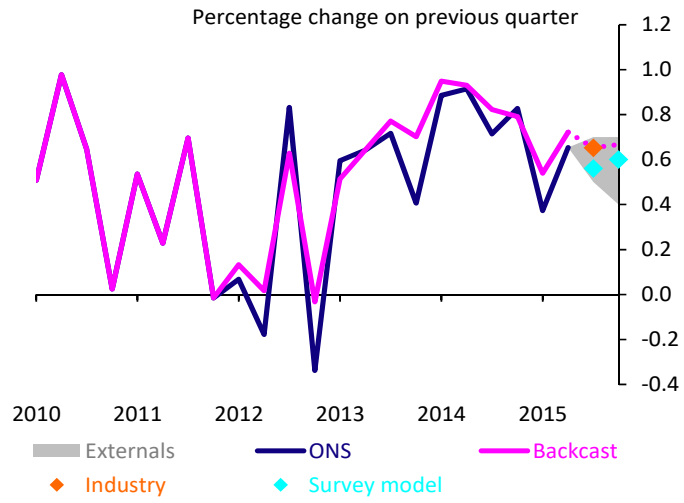


Chart 7: Model predictions and external forecasts for GDP growth



No news for consumption and investment relative to the A15 BMK forecast

There were very few new indicators for consumption and investment this month. Retail sales dipped in June (-0.2% on the month), slightly weaker than we expected, but that looked like usual monthly volatility rather than signalling weaker consumer demand. Moreover, the 3m-3m retail sales growth rate in June was a healthy 0.7%, in line with its historical average. We have not yet received the July GfK/EC consumer confidence data. But the YouGov/CEBR survey measure, which displays similar trends, was little changed in July. That suggests no visible impact on UK consumer sentiment from any heightened uncertainty stemming from overseas e.g. Greece. Similarly, the July CBI Industrial Trends Survey showed no evidence of an uncertainty impact on manufacturing investment plans. Both of these surveys concur with the anecdote from the Agents.

Overall, the predictions for Q2 and Q3 consumption and investment growth in the A15 BMK constraints are intact in the Draft A15 forecast. The offset to the large upside news to Q2 net trade in the Draft A15 expenditure constraints is in stocks. That treatment maintains the volatile quarterly pattern of broadly offsetting net trade and inventory contributions to GDP in the ONS data since mid-2014.

Weak manufacturing export demand in prospect

Although the official goods exports data have recently been very strong, survey data suggest a gradual weakening in manufacturing export demand. That contrasts with much of the 2013-14 period, when the surveys pointed to much stronger exports than the official data. The expected export orders balance in the July CBI Industrial Trends survey fell into negative territory for the first time since mid-2011. The Markit/CIPS exports orders was similarly weak relative to its historical average in Q2 (**Chart 6**). The appreciation of sterling is likely to be a key contributing factor.

Near-term GDP outlook is unchanged from A15 BMK; but slight downside risk

Our Q3 GDP nowcast remains at 0.7%, which is slightly above the Weighted Survey Model estimate and at the top of the range of external forecasts (**Chart 7**). We still expect solid growth, but the balance of risk is marginally to the downside, mainly because underlying growth (ie GDP ex-energy) was weak in 2015 H1, and that weakness may persist.