MPC - ESSENTIAL READING

UK Demand & Output Monthly

March 2015

UK Team

GDP and latest nowcasts*

	ONS 2nd estimate	UK Team expectation	Consensus	Latest backcast
Q4	**0.5%**	**0.5%**	**0.5%**	**0.6%**
	Latest nowcast		Last month's expectation	
Q1	**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)	2014 Q4	Feb IR	Contrib. to error	2014 Q3	2014 Q2
GDP	0.5	0.5	0.0	0.7	0.8
Consumption	0.3	0.8	-0.3	0.7	0.5
Govt consumption	0.0	-0.1	0.0	0.5	1.4
Investment	0.0	1.9	-0.4	0.6	1.2
- Business	-1.4	2.5	-0.4	-1.2	3.4
- Housing	0.8	0.6	0.0	-0.4	4.5
- Government	0.9	2.0	0.0	10.6	-13.1
Net Trade*	0.6	0.6	0.0	-0.7	0.3
- Exports	3.5	1.7	0.5	-0.8	-0.3
- Imports	1.3	-0.2	-0.5	1.4	-1.3
Other (inc. stocks)*	-0.2	-0.9	0.7	0.7	0.4

*contributions to quarterly GDP growth

Monthly Output Indices	Dec	Nov	Oct	Sep	Aug
Index of Services	0.6	0.1	0.2	0.5	0.0
- PNDS	0.8	0.0	0.3	0.6	-0.1
- Distribution	0.4	0.8	0.2	0.4	0.4
Index of Production	-0.2	0.0	-0.2	0.7	-0.3
- Manufacturing	0.1	0.8	-0.7	0.6	0.0
Construction output	0.4	-1.8	-1.5	1.9	-2.3

Trade and Retail Sales	Jan	Dec	Nov	Oct	Sep
Retail sales vols (inc fuel)	-0.3	0.2	1.5	1.2	-0.4
Retail sales vols (exc fuel)	-0.7	-0.1	1.6	1.2	-0.4
Goods imports	n/a	4.5	-1.9	0.0	5.4
Goods exports	n/a	2.4	0.6	1.6	4.1

Survey Measures	Feb	Jan	Dec	Nov	Ave
CIPS Services*	n/a	57.2	55.8	58.6	55.1
CIPS Manufacturing*	n/a	53.9	52.7	52.8	53.3
CIPS Construction*	n/a	59.1	57.6	59.4	54.6
GfK Consumer Conf	1.7	1.0	-0.8	-1.7	-9.5

*CIPS Manufacturing, Construction and Services are confidential until the 2nd, 3rd and 4th March.

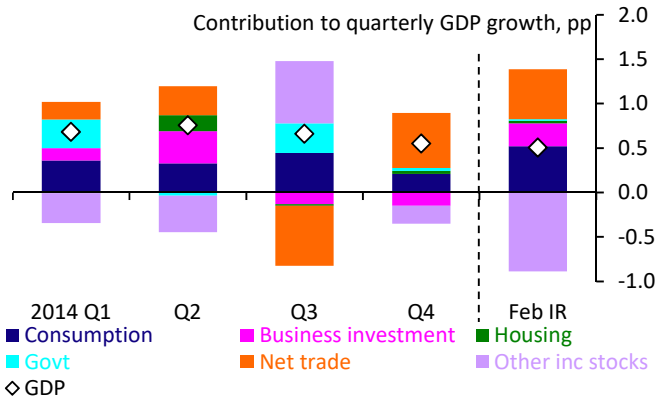
CBI Service Sector Survey	2015 Q1	2014 Q4	2014 Q3	2013 Q1	Ave
Business optimism	17	16	34	1	2
Employment: next 3 months	31	33	33	15	10
Inv. Intentions: vehicles, plant & machinery	11	7	6	0	-7
Investment intentions: machinery	16	5	6	16	-2

Business investment disappointed again, and consumption was also weaker than expected. But the February IR forecast is otherwise on track.

The second estimate of GDP revealed net trade and consumption were the drivers of growth in Q4, which was unrevised at 0.5%. But consumption's contribution was lower than expected, and business investment fell for the second quarter in a row.

We still expect GDP growth to be 0.7% in Q1 (0.6% preliminary). There have been no major moves in the surveys, which remain consistent with steady growth around trend.

Chart 1: Contributions to GDP growth



GDP growth remains 0.5% in Q4

The second estimate of GDP growth in Q4 was unrevised, at 0.5%. Although there were small revisions to earlier quarters, calendar year growth in 2014 was also unrevised at 2.6%.

The expenditure split revealed that net trade and consumption were the drivers of growth in Q4, accounting for +0.6pp and +0.3pp respectively (Chart 1). The contribution of trade was broadly in line with our expectation; consumption's was somewhat weaker.

Business investment fell for the second quarter in a row, contrary to our expectation for a rebound. Government investment and housing investment grew broadly as expected.

Business investment disappoints

The fall in business investment is concerning. We flagged last month that reduced investment by the extraction sector was a live risk to the investment forecast, and this risk may have transpired. The ONS said in their commentary that a large part of the fall in business investment was due to the

Chart 2: Business investment by industry

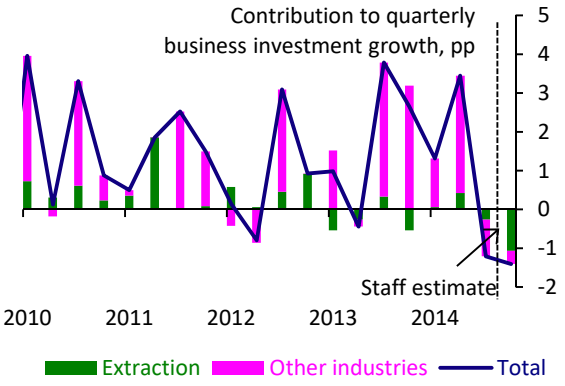


Chart 3: Uncertainty about demand

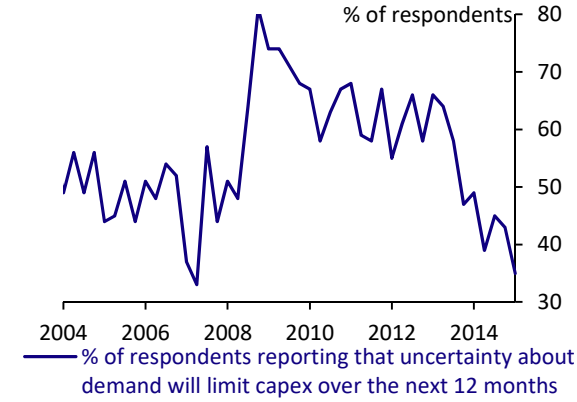


Chart 4: Consumption growth

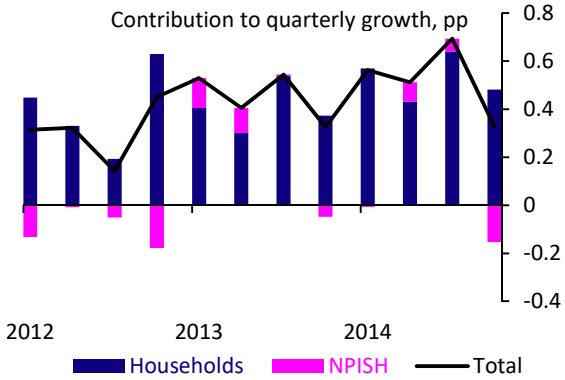
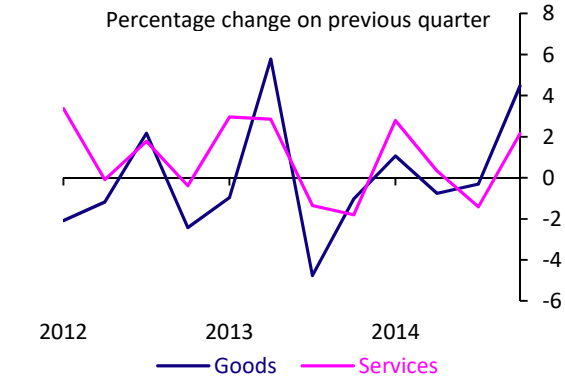


Chart 5: Goods and services exports



oil and gas extraction industry, and our estimate of the contribution using ONS capex survey data supports this (Chart 2). Nevertheless, business investment would have been broadly flat without the drag from this sector, which would still have been below our expectation. So there remains some unexplained weakness in investment.

Surveys of investment intentions remain strong, so are somewhat at odds with the official data. According to the Q1 CBI Service Sector Survey, uncertainty about future demand has fallen sharply over the past 2 years and is almost at a record low (Chart 3). The proportion of respondents expecting to increase investment over the next 12 months remains above the pre-crisis average; this is true for every category of asset asked about in the survey. These indicators, plus our assessment that the conditions for investment remain favourable (as set out in the Feb IR), mean that we continue to believe that investment will grow strongly over the coming year. However, the recent data suggest there are downside risks to that view.

Consumption also weaker than expected, but not alarmingly so

Total consumption grew by 0.3% in Q4, which was weaker than expected. And growth in Q3 was revised down from 1.0% to 0.7%.

But there are good reasons not to be too concerned about this. First, consumption by the non-profit sector (NPISH), which is a small but volatile component of consumption, dragged on growth in Q4 (Chart 4). Household consumption growth did not slow significantly in Q4, growing by 0.5%, in line with GDP.

Second, high frequency indicators of consumption, including retail sales and consumer confidence, have been very strong recently, probably reflecting the recent pick-up in real incomes. The headline GfK consumer confidence balance rose to its highest level since 2002 this month, and retail sales have been growing at their fastest rate in over 10 years (see box for more information). These indicators provide little evidence so far that consumers have adopted a 'deflation mindset'.

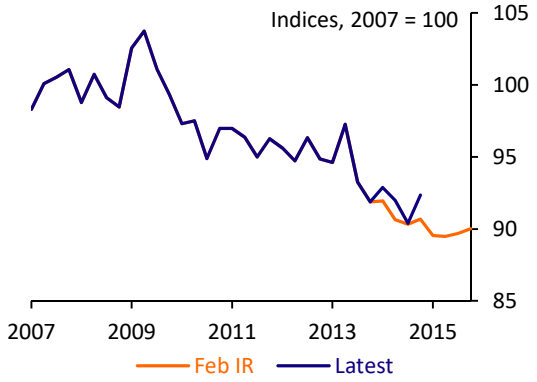
Finally, a more modest profile for consumption over 2014 should assuage concerns about the sustainability of growth, particularly because it was accompanied by another quarter of strong growth in the compensation of employees. Real employee compensation is up 2.8% on a year ago; in comparison, real consumption is 2.1% higher than a year ago. We estimate that the saving ratio was broadly flat over 2014, at around 7%, meaning consumption over 2014 was not funded by reduced saving, and there remains plenty of room for growth in 2015.

Nonetheless, consumption growth would now have to pick up significantly in Q1 to deliver the February IR projection.

Net trade recovers from Q3 dip

Although net trade contributed +0.6pp to growth in Q4, it had detracted -0.7pp from growth in Q3 (Chart 1). So,

Chart 6: UK export share



overall, net trade made no contribution to growth over the second half of 2014.

However, although net trade was broadly as expected in Q4, both exports and imports were stronger than expected. Exports grew by 3.5% on the quarter, with both goods and services growing strongly (Chart 5). This growth undoes some of the damage done to the UK's export share over the past year, which has fallen sharply since 2013 (Chart 6).

We expect growth of 0.7% in Q1

As usual, our expectation for growth in Q1 is based on early indicators of output, rather than early estimates of expenditure. There has been little news in these indicators this month. Both the Markit/CIPS composite output and expectations indices were broadly unchanged in February. The major balances from the CBI Service Sector Survey were also flat on the quarter, and continue to point to steady growth in the service sector.

Overall, we still expect growth in Q1 to be 0.7%, and for the preliminary estimate of growth to be 0.6%.

Box: The recent strength of retail sales

Retail sales data have been unusually hard to interpret over the past few months. Black Friday was a bigger event than ever before in the UK, causing demand to peak much earlier in the festive period than previously. To make matters worse, as far as the ONS's reporting periods are concerned, it occurred in November this year, having occurred in December last year. Such changes in timing muddy year-on-year comparisons and reduce the value of seasonal adjustment. Finally, many other providers of data on the retail sector – such as the British Retail Consortium (BRC) and the CBI - capture the *value* of total sales, meaning falling retail prices make these measures look relatively weak, when consumer demand - the variable we are most interested in - is a real concept.

So the release of the ONS's estimates of retail sales in January provide a natural opportunity to step back and look at the period as a whole. In this release, it was estimated that the volume of sales over the past 3 months (Nov-Jan) had grown by 5.2% on the same period a year ago (Chart B1) – the biggest annual increase since November 2004.

Growth has been uneven across sectors. Food stores only recorded volumes growth of 1.5% on a year ago, compared to non-food stores which grew by 6.9%. But this is consistent with growth being fuelled by falling prices and increasing disposable incomes; demand for food is likely to less price and income elastic than demand for household goods.

Overall, the strength of retail sales in the face of significant store price deflation suggests that UK consumers have not started deferring purchases in anticipation of further deflation. A significant retrenchment over the next few months might be a sign this is changing. But leading indicators of consumer demand, such as consumer confidence, do not support this expectation: in the February GfK consumer confidence survey, the balance of people saying that it was a good time to make a major purchase increased further to +3.2, having already picked up sharply over 2014 (Chart B2).

Chart B1: Retail sales volumes and prices

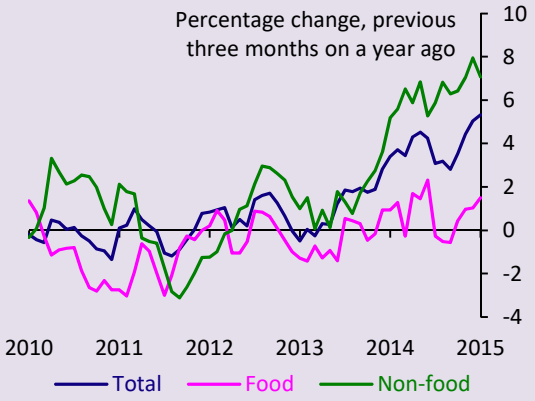
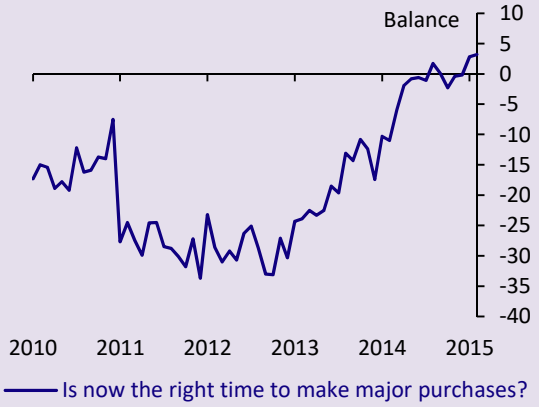


Chart B2: GfK consumer confidence



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)	**27/01/15**	Q4 2014	GDP: Preliminary indicator
GDP (Second estimate)	**26/02/15**	Q4 2014	GDP: Second estimate indicator
GDP (QNA)	**23/12/14**	Q3 2014	GDP: Quarterly National Accounts indicator

Monthly ONS data	Released	Data up to	Charts
Index of Services	**26/02/15**	Dec-14	IoS Charts
Index of Production	**10/02/15**	Dec-14	IoP Charts
Construction output	**13/02/15**	Dec-14	
Retail Sales	**20/02/15**	Jan-15	Retail Sales charts
UK Trade	**06/02/15**	Dec-14	Trade charts
Output surveys			
CIPS Services	**04/03/15**	Feb-15	CIPS services charts
CIPS Manufacturing	**02/03/15**	Feb-15	CIPS manufacturing charts
CIPS Construction	**03/03/15**	Feb-15	CIPS construction charts
BCC	**08/01/15**	Q4 2014	
CBI Quarterly Industrial Trends	**22/01/15**	Q4 2014	CBI QIT charts
CBI Services	**25/02/15**	Q1 2015	CBI SSS charts
CBI Financial Services	**19/01/15**	Q4 2014	CBI FSS charts
CBI Monthly Trends Enquiry	**19/02/15**	Feb-15	CBI MTE
Experian Construction	**02/02/15**	Dec-14	Experian charts
Consumption Indicators			
Consumer Confidence	**26/02/15**	Feb-15	Consumer confidence charts
BRC Retail Sales Monitor	**10/02/15**	Jan-15	BRC RSM charts
CBI Distributive Trades	**23/02/15**	Feb-15	CBI DT charts
SMMT car registrations	**05/02/15**	Jan-14	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)