

# UK economy

## Bad weather causes renewed contraction of UK economy

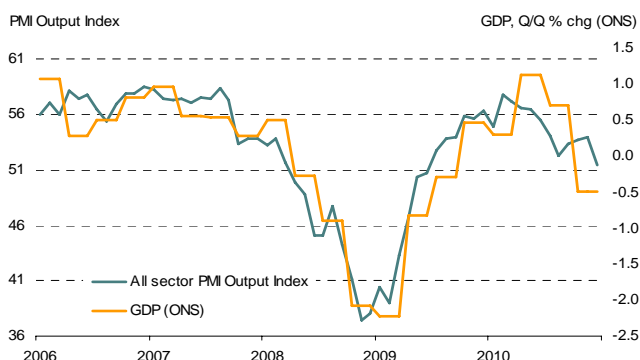
- GDP contracted in Q4.
- Manufacturing growth offset by falling activity in services and construction.

A surprisingly sharp fall in UK gross domestic product in Q4 (-0.5% compared to a 0.7% rise in the third quarter, according to the preliminary estimate) was even worse than the most pessimistic forecaster had anticipated. The decline was the first since 2009 Q3.

As we had reported, based on the PMIs, manufacturing growth was offset by falling activity in services and construction. However, the PMIs had merely signalled a slowing in the quarterly rate of growth to 0.4% for the quarter as a whole, with stagnation indicated for December (see [http://www.markit.com/assets/en/docs/commentary/markit-economics/2011/jan/UK\\_economy\\_11\\_01\\_06.pdf](http://www.markit.com/assets/en/docs/commentary/markit-economics/2011/jan/UK_economy_11_01_06.pdf)).

The surveys therefore suggest that the headline GDP number overstates the extent to which growth has weakened. The Office for National Statistics reported that the coldest December for a century affected many businesses, especially in construction and services, and accounted for much of the decline. The ONS themselves stated that *“the bad weather creates more uncertainty than usual and increases the chance that the GDP estimate will be revised”*. The fact that growth was estimated by the ONS to have been flat after allowing for the bad weather in December is nevertheless far worse than expected, and highlights how underlying demand has deteriorated sharply in recent months.

### GDP and the PMI



### Manufacturing fails to prop up a slumping economy

Looking at the detail:

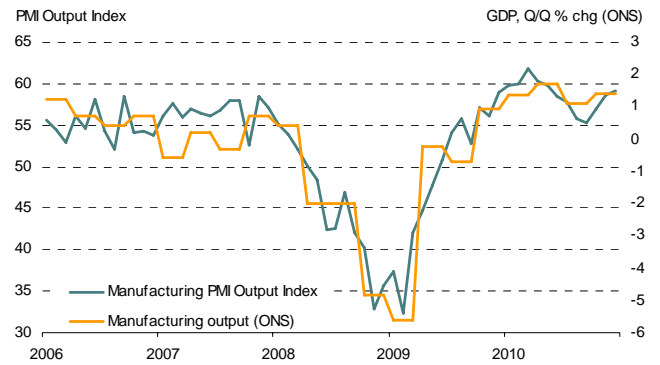
- Manufacturing helped prevent an even worse decline, with output increasing 1.4% in Q4 (up from 1.1% in Q3). This is almost exactly in line with the PMIs – in our note of 6 January we reported that *“the manufacturing survey data are pointing to production rising at a quarterly rate of 1.75% in December, putting Q4 growth for the sector at around 1.5%”*.
- The service sector saw a surprise fall in output, contracting 0.5% compared to a 0.5% rise in Q3. Sectors such as retail, restaurants and transport all suffered declines, no doubt linked to the severe weather. But a 0.7% decline in business services (the first decline since 2009 Q3) is more worrying. One ray of hope is that the ONS often struggle with accuracy for the service sector in their initial releases, and the services PMI merely pointed to a stagnation for Q4 as a whole (though a decline in December).
- Government spending fell 0.2%, the first decline since 2008 Q4.
- Construction collapsed 3.3%, compared to 7.0% growth in Q2 and a 3.9% increase in Q3. Again, the bad weather will have contributed to much of this fall, although the Construction PMI Activity Index has charted a gradual easing in the underlying trend of growth in this sector over the second half of last year.

### Further weakness expected in 2011 Q1

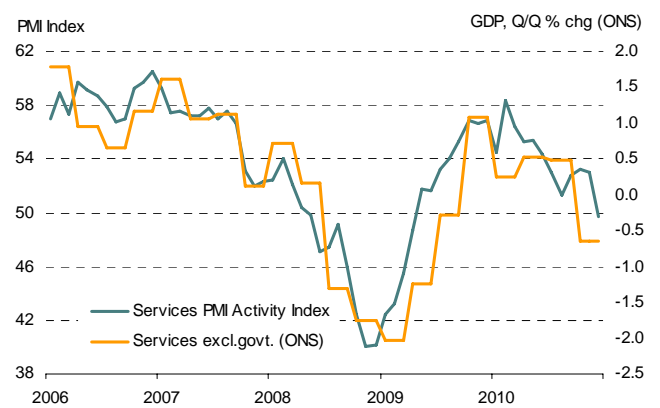
Given the distortion arising from the bad weather in December, plus concerns about the accuracy of the official data, we believe that the underlying picture was therefore probably one of stagnation or very modest growth.

However, looking ahead, the insight we have so far for January, such as information on household finances, suggests that the consumer will have acted as an increasing drag on economic growth at the start of the year. Strong demand from overseas markets such as Germany, China and the Middle East raises our hopes that UK exporters will have continued to help offset domestic weakness and revive the recovery, but the chances of a double-dip recession have surely increased.

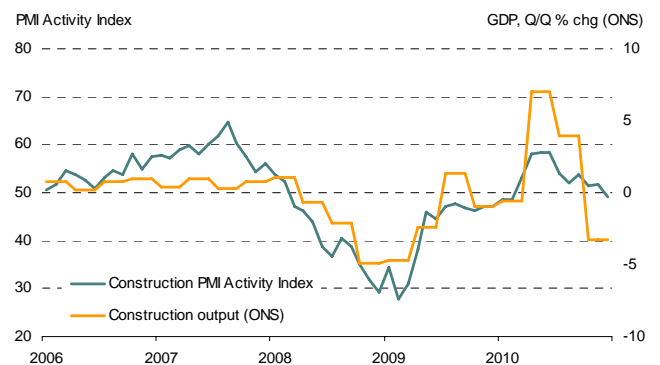
### Manufacturing output



### Services (non-government) activity



### Construction activity



Sources for all charts: Markit, ONS.

## Chris Williamson

### Chief Economist

Markit

Tel: +44 207 260 2329

Email: [chris.williamson@markit.com](mailto:chris.williamson@markit.com)

For further information, please visit [www.markit.com](http://www.markit.com)

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