

UK gross domestic product

Official data show that the UK economy contracted by 0.5% in Q3, but are things really that bad?

Key findings

- **0.5% fall in GDP in Q3 looks likely to be revised to show shallower contraction.**
- **But PMI data suggest conditions are set to deteriorate further in Q4.**

Q3 GDP surprised on the downside...

Official gross domestic product (GDP) data, published today, showed the UK economy contracted by 0.5% in Q3 following a stagnation in Q2. Economists had expected a contraction of just 0.2%.

... but the ONS has a poor track record of estimating growth in downturns

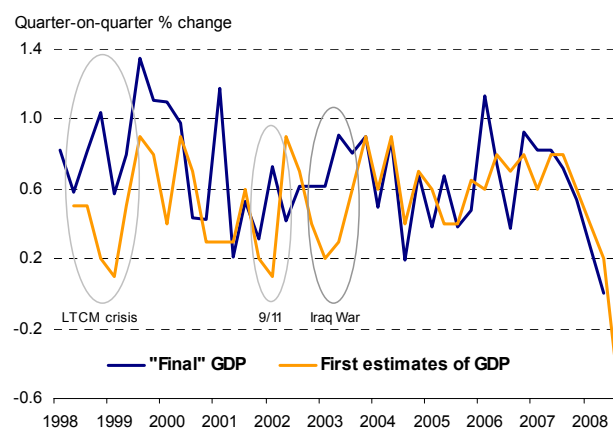
This is the Office for National Statistics (ONS) first estimate for Q3, and history tells us that revisions to these first estimates are not uncommon, especially in times of economic weakness. In particular, official first estimates of GDP showed marked slowdowns in response to the LTCM crisis, 9/11 terrorist attacks and the Iraq War. However, subsequent revisions to these data have led to a retelling of history and, instead of slowing, the UK economy appears to have grown solidly throughout these past "crises".

- Looking at the LTCM crisis, the ONS initially reported that GDP rose by just 0.2% in Q4 1998 and 0.1% in Q1 1999, pointing to an economy almost in recession. However, revised data now show that the economy in fact grew by a scorching 1.0% in Q4 1998 and a respectable 0.6% in Q1 1999.
- In the first quarter of 2002, the ONS reported that GDP grew a paltry 0.1% as business and consumer confidence continued to suffer in the aftermath of the 9/11 bombings. However, growth for that quarter is now estimated at an above-trend 0.7%.

- In the second quarter of 2003, at the height of the Iraq War, the ONS initially reported that GDP rose by just 0.3%. They now estimate growth was three times stronger, at 0.9%.

The initial first estimates by the ONS are plotted against final GDP in chart 1 and shown in the appendix, which also explains the differences between the ONS GDP releases.

Chart 1: Revisions to official GDP data



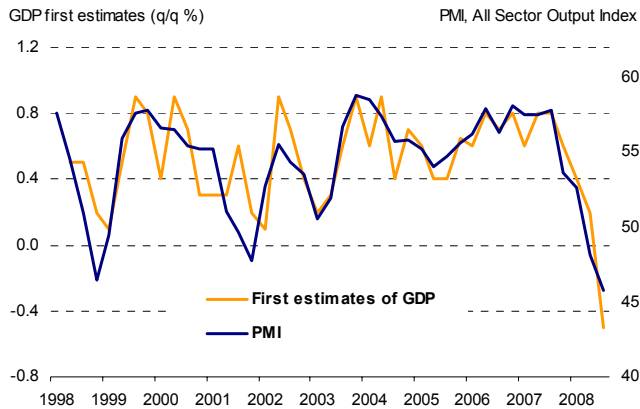
The ONS's track record therefore suggests that we should treat their estimate of a 0.5% drop in GDP in Q3 2008 with caution, and there is a strong chance that the figure will be revised up at some point in the future.

PMIs suggest output deteriorated markedly towards the end of Q3, pointing to weak Q4

However, any revision to the Q3 GDP number will most likely reflect additional information not yet available, relating to income and expenditure trends, rather than just output data (output data are used to calculate the first GDP estimates – see appendix). It is these output data that are tracked so accurately by the PMIs and the differences between the vintages of GDP

explain why the PMI data, which measure pure output, are particularly valuable in anticipating official first estimates of GDP, and helps explain why economists were expecting to see only a 0.2% contraction in Q3.

Chart 2 : PMI and ONS first estimates of GDP



Plotting composite PMI data against GDP data relating to the same parts of the economy which are tracked by the PMIs (namely manufacturing, construction and traded services) shows that the PMI data were consistent with a 0.5% drop in *private sector output*. for Q3. More worrying still, the PMI dived towards the end of Q3 suggesting growth could deteriorate further into Q4.

Chris Williamson

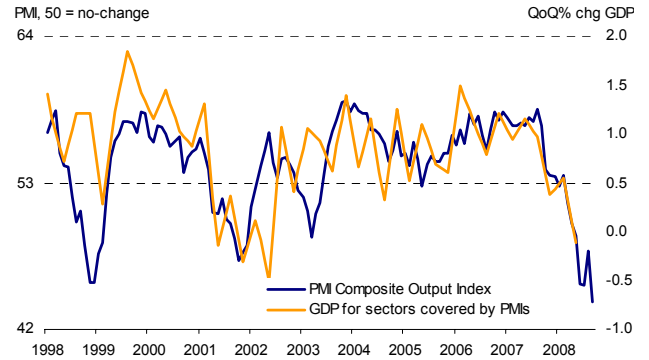
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Chart 2: UK Private Sector Output



So, while the official estimate of GDP in Q3 may in the future get revised up from -0.5%, the likelihood is that a 0.5% contraction or worse may be seen in Q4 unless the PMI numbers improve towards the end of the year.

The October PMI for manufacturing is published on 3 November, followed by construction on 4 November and services on 5 November.

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APPENDIX

Background to ONS GDP releases

In the United Kingdom, the Office for National Statistics publishes three estimates of GDP:

First release: The ONS's first estimate of GDP is published around 24 days after the end of each quarter. This first estimate is based mainly on the output measure of GDP, or GDP(O), which is derived from production data available for the first two months of the quarter and partial information for the third month from all main sectors of the economy.

Second release: In the following month, the ONS revises this first estimate of GDP(O), improving on the first estimate principally by including more complete output data. Some early information on income and expenditure measures of GDP are also published in this release, but the headline GDP numbers continue to be based principally on GDP(O).

Third release: A further estimate is then published in the third month after the end of the quarter. This is known as the "final" estimate. The key difference between this and earlier releases is usually that the output measure published in the second month is adjusted in order to reconcile the figure with the other (income and expenditure) methods of calculating GDP, which until this time were not fully available.

Blue Book: Even these "final" data tend to be revised in future months, often due to methodological issues such as rebasing and the inclusion of information from annual data sources. These data are published in the Blue Book. In fact, even years after the Blue Book is published, GDP data still get revised historically.

Table 1: Official GDP

		Latest estimates	First estimates
1998	Q1	0.8	n/a
	Q2	0.6	0.5
	Q3	0.8	0.5
	Q4	1.0	0.2
1999	Q1	0.6	0.1
	Q2	0.8	0.5
	Q3	1.4	0.9
	Q4	1.1	0.8
2000	Q1	1.1	0.4
	Q2	1.0	0.9
	Q3	0.4	0.7
	Q4	0.4	0.3
2001	Q1	1.2	0.3
	Q2	0.2	0.3
	Q3	0.5	0.6
	Q4	0.3	0.2
2002	Q1	0.7	0.1
	Q2	0.4	0.9
	Q3	0.6	0.7
	Q4	0.6	0.4
2003	Q1	0.6	0.2
	Q2	0.9	0.3
	Q3	0.8	0.6
	Q4	0.9	0.9
2004	Q1	0.5	0.6
	Q2	0.9	0.9
	Q3	0.2	0.4
	Q4	0.7	0.7
2005	Q1	0.4	0.6
	Q2	0.7	0.4
	Q3	0.4	0.4
	Q4	0.5	0.6
2006	Q1	1.1	0.6
	Q2	0.7	0.8
	Q3	0.4	0.7
	Q4	0.9	0.8
2007	Q1	0.8	0.6
	Q2	0.8	0.8
	Q3	0.7	0.8
	Q4	0.5	0.6
2008	Q1	0.3	0.4
	Q2	0.0	0.2
	Q3	n/a	-0.5

Sources: Markit Economics; Office for National Statistics.

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