

Novus Capital Markets Research

January GDP – how big a rebound?

3 February 2011

The size of January’s rebound in activity is critical to the Q1 outturn – and hence to May’s rate decision. If, for example, January fully reverses December’s fall in construction and services, and industrial production continues to expand at its recent rate, GDP will rise by as much as 2.1% in January. The level of GDP (100.1 on my monthly estimate) would already be 0.8% above the Q4 average and we would be looking at a rise of 1% in the quarter as a whole. That would almost certainly be enough for the MPC to hike in May. If on the other hand, only half of December’s fall is made good in January, then Q1 GDP would struggle even to advance on Q4 and the MPC would not be raising rates in May.

At this stage I would guess that all of the loss of output in the construction sector will be made good in January, since projects that were halted by the snow in December will resume in January. This by itself will add around 0.9pp to January GDP. In services some of the output (for example Christmas spending in hotels & restaurants) will be lost permanently so the rebound might be less than 100%. Even so, GDP would be up 1.8% in January and, depending on what happens in Feb-Mar, we would still be on track for a 0.5-1% rise in Q1 GDP. Whether it is 0.5% or 1% is critical to the MPC decision.

Table 1: GDP estimates (central case)

	10q4	Oct	Nov	Dec	Jan	Jan/Q4
Industrial production	90.1	89.6	90.0	<i>90.8</i>	<i>91.2</i>	1.2
Construction	96.7	<i>101.9</i>	<i>100.5</i>	<i>87.7</i>	<i>100.5</i>	3.9
Services	101.9	102.4	102.4	<i>100.8</i>	<i>102.0</i>	0.1
GDP	99.2	<i>99.9</i>	<i>99.9</i>	<i>98.0</i>	<i>99.8</i>	0.5

Source: ONS, Novus estimates (italics)

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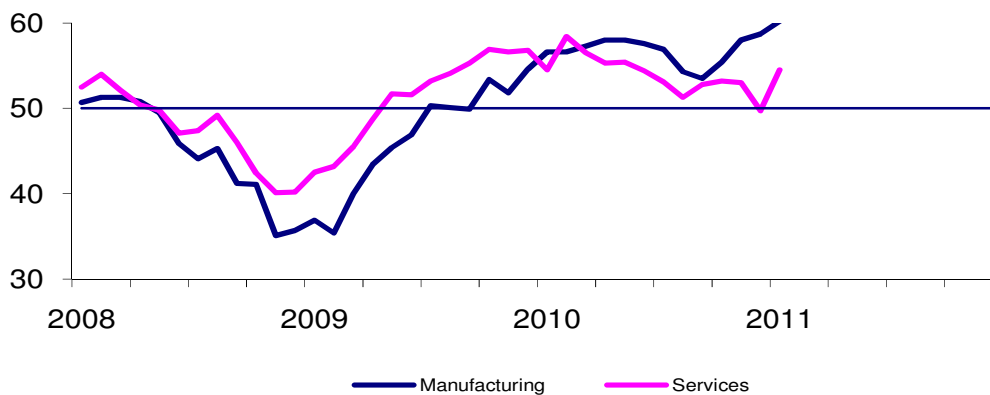
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GDP – losing momentum in 2010

Even before the 25 January data release, which showed GDP contracting 0.5% in 10q4, the economy was losing some momentum. This was most evident in the service sector where, on the monthly data released at the same time, output peaked in September, fell back 0.6% in October and was flat in November. The trend was replicated in the CIPS survey which dropped back from 56.5 in 10q1 to 52.4 in 10q3 (Chart 1). It was less apparent in manufacturing where annual growth picked up to nearly 6% last year, although, here too, the PMI had come off from a Q2 average of 57.9 to 54.9 in Q3. Construction having had a boost around the time of the election, was also growing more slowly.

Chart 1: PMIs



Source: Markit/CIPS survey

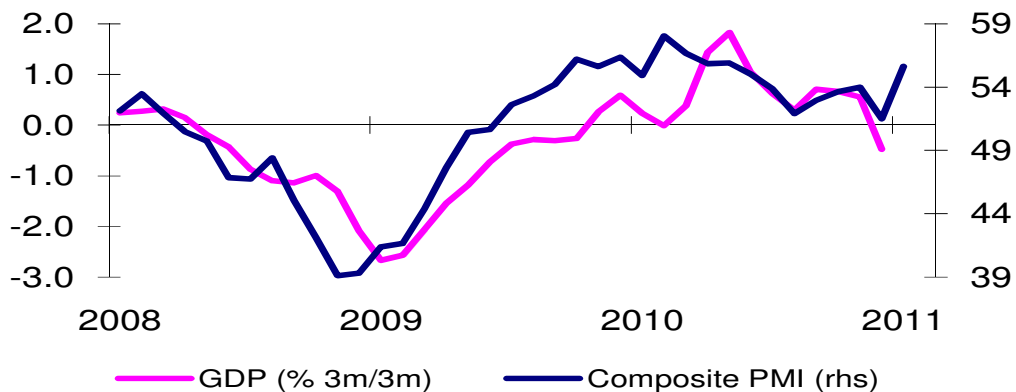
These trends are reflected in my monthly GDP series. On my calculations GDP peaked in September at 100.2 (2006 = 100) and eased back in Oct-Nov to 99.9. Too much should not be read into the monthly movements since a fall of 0.3% in the month is not uncommon. Nevertheless, ONS and PMI data combined do point to some modest loss of momentum in the early autumn of 2010. And, according to the ONS, Q4 would have been 'flattish' even without the December snow (the output of the service sector for example in Oct-Nov was flat on Q3 though industrial production was about ½% higher).

On the basis of the ONS data for Q4, output fell 1.6% in the service sector in December while industrial production was up by nearly 1%. I estimate that construction, which had already fallen 1.7% in November according to eurostat data, was down another 12% in December. Overall I estimate that GDP fell 1.9% in December, similar to the 1.7% fall estimated for the previous January (which was similarly affected by the weather).

Regaining momentum?

If manufacturing was losing momentum in the autumn, it has recovered it since. Despite December's snow manufacturing output rose 1.4% in 10q4. And, on the basis of this week's PMI, it has started 2011 on a very firm footing – the January reading of 60.2 is the highest since the series was first compiled in 1992. Construction too has bounced back from December, the sector PMI rising to 53.7 in January.

Chart 2: Composite PMI and GDP



Source: ONS, Markit/CIPS, Novus estimates

The service sector is far more interesting: it is by far the largest sector (over 75% of GDP) and the one where the outlook is the most clouded. At first sight the jump in the service sector PMI to 54.5 in January answers that question. It suggests that after the weakness of December the sector bounced quite nicely in January. True, though it would have been a surprise if a sector that includes transport &

distribution hadn't staged something of a recovery from the December snows and the January reading still says nothing about the underlying rate of growth in services. Even so, the recovery in all three PMIs in January does point to a decent bounce in GDP (Chart 2).

January / Q1 GDP

We will not get the January ONS data for industrial production until 10 March with the index for services on 30 March (one day after the second estimate for Q4 GDP). None of these will be in time for the February MPC forecast which is being finalised over the next week. So, like the MPC, we can put in some guestimates for Jan/Q1.

The starting point would be if construction and services return to their November levels in January and industrial production continues to rise at its recent rate. The calculations, based on my estimates for the monthly GDP and construction data, are instructive. Simply reversing the December decline in services and construction in January and extrapolating the recent performance of the industrial sector produces a jump in GDP in January of 2.1% which takes the level of GDP in January to 0.8% above the Q4 average (Table 2). Further modest gains in Feb-Mar would give a Q1 GDP increase of 1% (which would probably be enough for the MPC to hike in May). If on the other hand only half of the loss is made good, GDP rises 1.1% in January and January is still very slightly adrift of the Q4 average (Table 3). In this case the same modest increases in Feb-Mar would see Q1 GDP flat on Q4 (which would almost certainly rule out a hike in May).

My central estimate, which is show on Table 1 (page 1) is for industrial production to continue to advance at its recent rate and for the construction sector to make good all of December's losses in January.

As before, it is the much larger service sector that is more interesting and more challenging. Some parts of the sector, most obviously the transport and distribution sectors, should fully reverse the losses that December's snow brought about. Others, such as hotels & restaurants will not recoup the Christmas trade which will be permanently lost. For other areas, such as retailing, the mood of the consumer in the face of January's VAT hike is more important than whether there were purchases that were postponed from December because of the adverse weather. (The January CBI survey showed annual growth

slowing between December and January.) Overall I have assumed that around three quarters of December's losses in the service sector are recouped in January. This gives a GDP increase of 1.8% in the month and puts Q1 on track for a rise of somewhere between 0.5%, which would probably not be enough to get a rate hike in May, and 1%, which almost certainly would.

Table 2: GDP estimates (full rebound)

	10q4	Oct	Nov	Dec	Jan	Jan/Q4
Industrial production	90.1	89.6	90.0	<i>90.8</i>	<i>91.2</i>	1.2
Construction	96.7	<i>101.9</i>	<i>100.5</i>	<i>87.7</i>	<i>100.5</i>	3.9
Services	101.9	102.4	102.4	<i>100.8</i>	<i>102.4</i>	0.5
GDP	99.2	<i>99.9</i>	<i>99.9</i>	<i>98.0</i>	<i>100.1</i>	0.8

Source: ONS, Novus estimates (italics)

Table 3: GDP estimates (50% rebound)

	10q4	Oct	Nov	Dec	Jan	Jan/Q4
Industrial production	90.1	89.6	90.0	<i>90.8</i>	<i>91.2</i>	1.2
Construction	96.7	<i>101.9</i>	<i>100.5</i>	<i>87.7</i>	<i>94.1</i>	-2.7
Services	101.9	102.4	102.4	<i>100.8</i>	<i>101.6</i>	-0.3
GDP	99.2	<i>99.9</i>	<i>99.9</i>	<i>98.0</i>	<i>99.1</i>	-0.2

Source: ONS, Novus estimates (italics)

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