

Novus Capital Markets Research

ONS – a law unto itself

6 October 2011

GDP revised down: not for the first time the ONS has spurned the opportunity to re-write recent economic history in a way that makes more intuitive sense. The combination of a large decline in GDP and a relatively modest drop in unemployment, with its totally implausible implications for productivity, has always looked bizarre. The Bank has never believed it and does its own ‘backcast’ of the data to re-write GDP upwards. This time the scene seemed set for an upward revision. Updating the base year reduces the weight of sectors that fell sharply in the recession (manufacturing) and raises the weight of sectors that did less badly (services). Using the CPI rather than the RPI as a basis for deflating the nominal data was expected to lower inflation and boost volumes. This is not what happened. Growth was revised up in the early and mid-2000s but lowered from 2008 onwards. The peak-trough fall in GDP was increased to 7.1% from 6.4% with the result that whole economy productivity fell by around 5% (depending on the measure). More plausibly the latest data reveal the ferocity of the squeeze on household spending, which is back at 2004 levels, and a stronger performance by net exports.

Another £75bn QE: while I was a convert to more QE last month and judged in the light of last month’s Minutes that *it would be a surprise if there were not some votes for QE next [this] month and a majority for it by November at the latest*, I was not persuaded that the MPC would re-launch the programme today (I put the odds at 50:50 – I note that my old shop gave it only 20%). Some of the latest indicators, notably this week’s PMIs, were a little more buoyant and a case could have been made for waiting until the November forecast. But they didn’t, possibly because they wanted something on the table to take to the upcoming G20 meeting. The statement highlighted the problems in the euro area and tensions in the global economy which ‘threaten the UK recovery’ and which required an immediate policy response.

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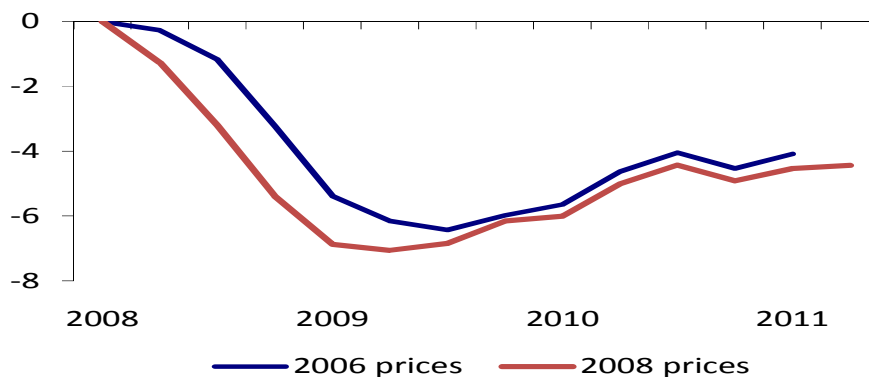
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GDP – an even deeper recession

After what I wrote last week the first thing I looked at in the new national accounts was the peak-trough fall in GDP to see whether, as I had surmised, the recession was less deep on the new 2008 price basis. Some hope. The peak is still 2008q1 but the low point of the recession has been shifted forward one quarter to 2009q2. So, on the 2008 price basis, the recession lasted five quarters instead of six but the peak-trough fall was 7.1% rather than 6.4%. The good news is that the recovery started a quarter earlier and that (from the lower starting point) it has been slightly stronger though we are further adrift of the 08q1 peak than we were before (Chart 1). So why, I keep asking myself, did employment not fall by more than 2.3% peak-trough?

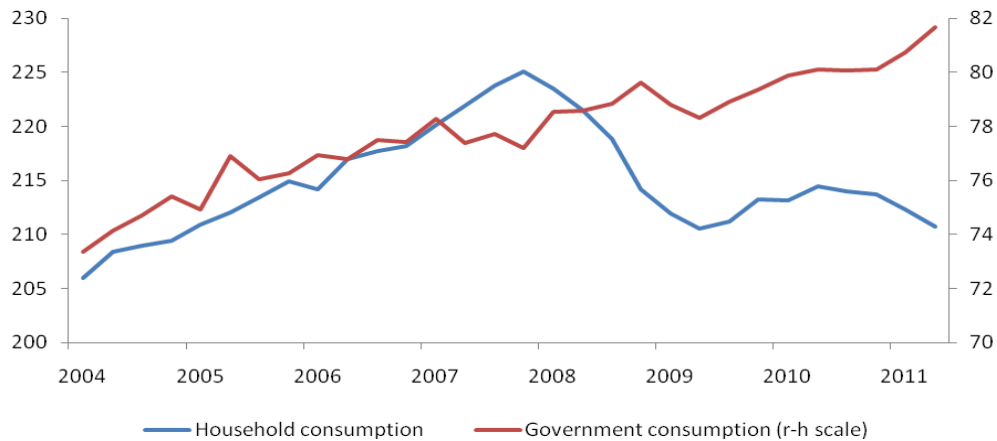
Chart 1: GDP (% change from 2008q1)



Source: ONS

The second thing that caught my eye was the pattern of demand in the latest quarter and over the recovery period. Household consumption had another miserable period, falling 0.8% for a fourth successive quarterly decline and 1.7% from the previous year. It was less than 0.1% above the recession low (09q2) and, that single quarter apart, the lowest since 2004. It is a sobering thought that in volume terms consumer spending has not advanced in more than six years and that two years into recovery it is still going backwards (Chart 2). Again on the new 2008 price basis the recession was worse than previously – a peak-trough fall in consumption of 6.5% against less than 5% on a 2006 price basis.

Chart 2: Household and general government consumption (2008 prices)



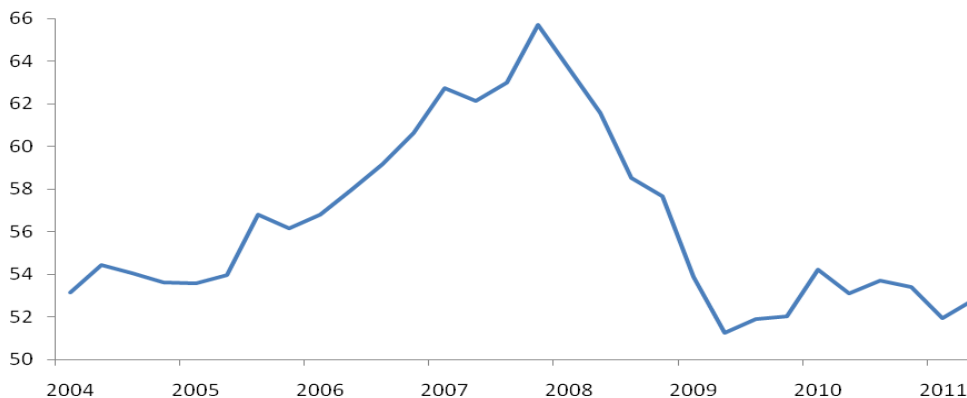
Source: ONS

It is – and despite all the Chancellor’s plans – an entirely different story on government consumption which rose 1.1% in the second quarter and 1.9% over 12 months to a new all-time high. The contrast with private consumption could scarcely be more marked (Chart 2). Galbraith’s private affluence, public squalor it is not.

It is of course the cash spend that counts for the public finances and here at least the latest quarter showed a move in the right direction – a fall of 0.6% from the 11q1 peak (which implies that general government prices fell 1.7% q/q). Again the contrast with the private consumer is marked. Over the last year an increase in the private cash spend of 2.7% has produced a 1.7% real fall (inflation of 4.4%) where for the public sector the cash outlay has risen 1.1% to produce a real increase of 1.9%. That implies that the goods & services bought in by general government have fallen 0.8% in the last year. The freeze on wages accounts for some of this but it is hard to see why other government purchases (which will include energy) have fallen over the last year when the equivalent private sector prices have risen so much.

The public-private contrast is there but the other way round on investment. There was a strong rebound in business investment (+11.6% q/q) led by manufacturing (13.8%) though this still leaves the former 15% and the latter 21% below pre-recession peaks. General government investment collapsed, falling 23% to its lowest level since mid-2008 – no sign here of the investment that is usually a feature of an ‘expansionary fiscal contraction’. With housing little changed in the quarter, total investment rose 1.7%, insufficient to reverse the near-3% fall of the previous quarter and leaving investment down nearly 20% on the pre-recession peak. Like private consumption, investment is languishing at the levels of the mid-2000s (Chart 3).

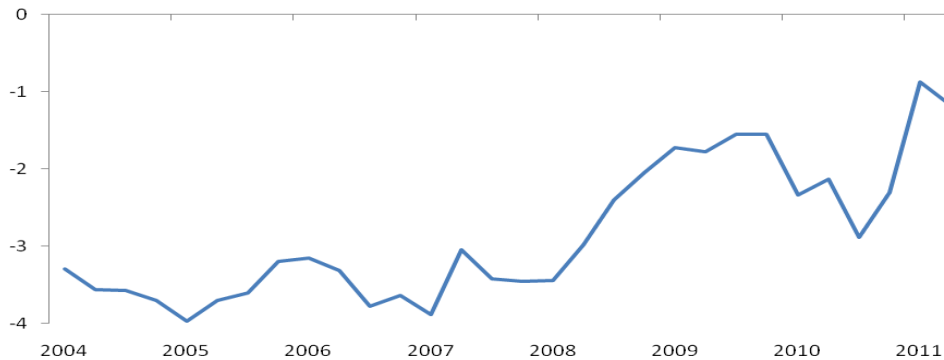
Chart 3: Investment (2008 prices)



Source: ONS

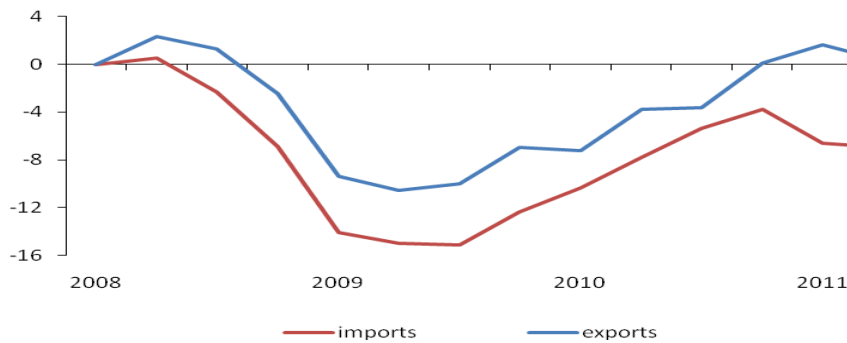
Exports were also disappointing in Q2, falling 1.3% (goods down 3.5%, services up 2%), more than imports which were down 0.3% (goods -1%, services +1.8%). Even so, the gap between the two (£4.1bn at 2008 prices) is less than half its 2010 average. In real terms the deficit is running at just over 1% of GDP, well down on the 2005 peak of 4%; the slow improvement since the onset of the crisis is apparent (Chart 4). This reflects a recovery in exports relative to imports: despite the Q2 decline, exports were just (0.3%) above the pre-crisis peak whereas imports were nearly 7% lower (Chart 5). The move to 2008 prices makes the recovery in exports stronger and in imports weaker than at 2006 prices. That part of the rebalancing story is more evident than before.

Chart 4: Net trade (% GDP, 2008 prices)



Source: ONS

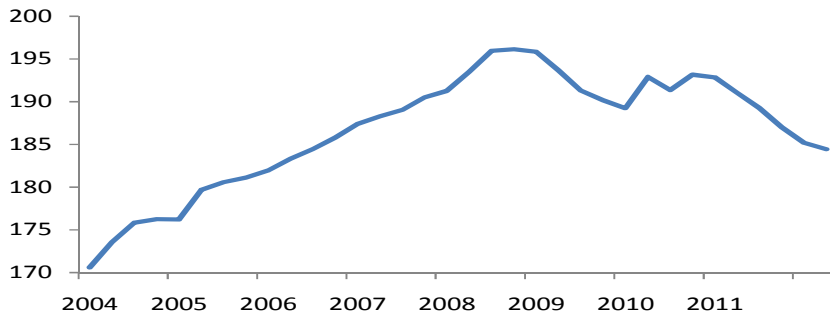
Chart 5: Exports & imports (% change from 2008q1)



Source: ONS

The ONS has not at this stage been able to publish the full national accounts with real household disposable income and the saving ratio but we can get an idea of the squeeze on household incomes by deflating the series for total employee compensation by the consumer price deflator (consumer spending at current prices divided by constant prices). This reveals that real incomes have been falling with only a brief interruption since the onset of the recession and, like consumption, are currently at the levels of the mid-2000s (Chart 6).

Chart 6: Real total employee compensation

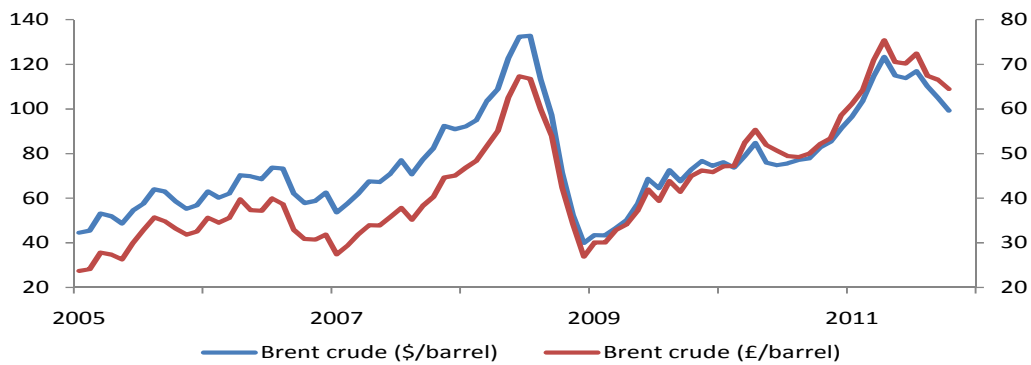


Source: ONS, Novus

Oil prices falling – even at pump

The price of Brent crude fell below \$100 a barrel this week. The price, which peaked in April at over \$120, fell back to the \$110-120 range over the summer months. Over the last month the decline has accelerated with prices falling 10% in September alone. Sterling, which was trading above \$1.63 two months ago, has fallen by around 10 cents with the result that the £ oil price has fallen less than the \$ price. Even so, the £ price has fallen by around £8 a barrel (11%) over the last three months (Chart 7).

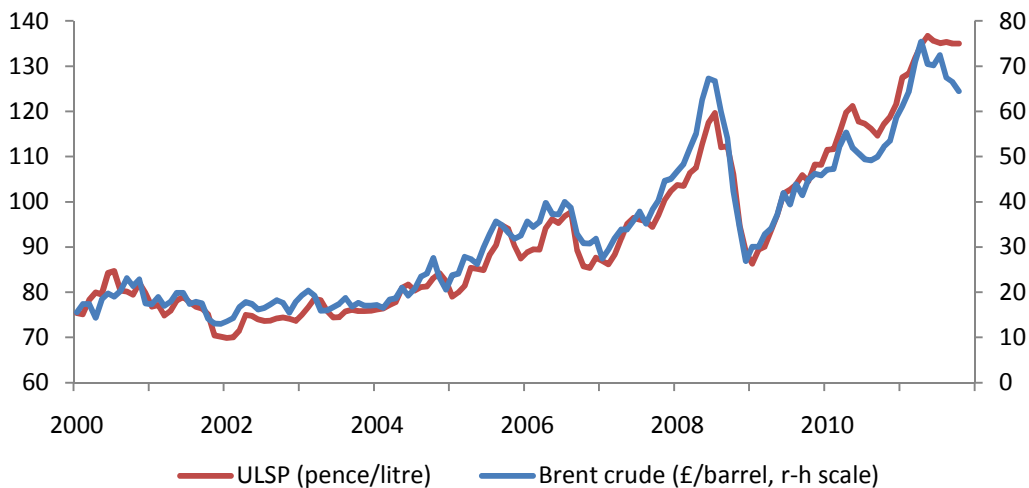
Chart 7: Brent crude (price per barrel)



Source: USEia, DECC, BoE

UK pump prices peaked in May at 137p/ltr (ULSP) and 143p/ltr (Diesel) since when they have moved in a narrow range. For three weeks in August the price was falling but the cuts were reversed in September when prices rose every week. The first week in October brought a cut, taking petrol prices to 135p and diesel to just below 140p. To judge by the gap which has opened up between the price of crude in £ and at the pump, the latter has further to fall in the weeks ahead (Chart 8).

Chart 8: Crude and petrol prices



Source: USeia, DECC, BoE

CPI petrol (fuel & lubricants) price inflation peaked at 15.9% in Feb-Mar, fell back to 12.7% in April with the 1p cut in duty, and has been rising steadily since. It was 17% in August and, on the basis of the DECC weekly fuel data will have reached around 17¼% in September. That will be the peak – the drop in pump prices in the first week in October has already lopped more than 1pp off the annual rate (and there should be more to come since prices rose every week in October 2010). That will be very helpful to the overall CPI at a time when household utility bills are pushing up the annual rate. Maybe CPI inflation won't go above 5% after all.

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