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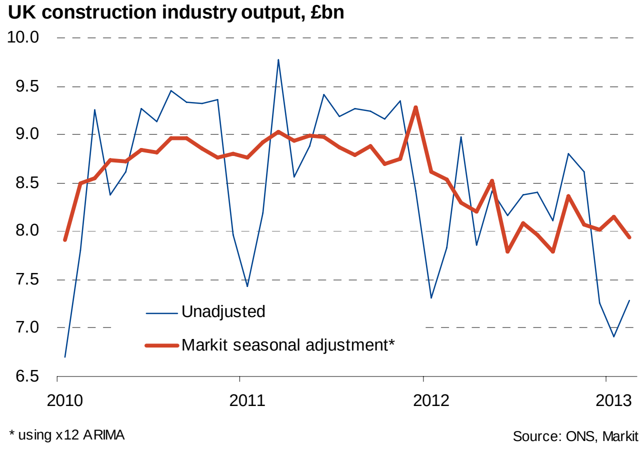
United Kingdom

Construction set to act as drag on economy in first quarter

- **Output down 7% on year ago in February**
- **PMI points to ongoing weakness in March**
- **Downturn adds to triple-dip recession risk**

UK construction output



A downturn in the construction sector has added to the risk of having slid back into recession in the first quarter. UK construction industry output fell 7.0% on a year ago in February, worse than the 5.5% decline seen in January, according the latest data form the Office for National Statistics. For the first two months of the year, output is down 6.3% on last year.

The data are not seasonally adjusted, making it difficult to make sense of the numbers when looking at anything other than year-on-year comparisons. The ONS notes that output was up 5.5% on January, but both January and February have seen particularly low volumes of work. January's had seen the lowest since the series began at the start of 2010, while February's was the third lowest. In the previous three years, output has also risen to a greater extent between January and February than the 5.5% seen this year.

A basic seasonal adjustment analysis suggests output fell 2.5% in February, and that the average level of work so far in the first quarter is 1.3% below that seen in the fourth quarter.

This has therefore clearly been a poor start to the year for the construction industry. The bad weather experienced in the UK so far in 2013 will have inevitably hit the output of the sector, but a more detailed look at the data suggest that public sector infrastructure spending cuts are also having a big impact: total new work was down 10.7% in February led by a 23.7% cut in public sector projects.

The weakness is likely to have persisted throughout the first quarter. Markit/CIPS PMI survey showed construction output falling in March, signalling that the sector is currently undergoing the steepest quarterly downturn since early-2009.

At present the data suggest that this construction sector decline will have been offset by stronger growth in the far larger service sector, leaving the economy either flat or showing very marginal growth.

However, while the construction sector is therefore likely to have acted as a drag on the economy in the first quarter, this could change in the second quarter. Encouragingly, confidence has lifted among the country's builders, with expectations about future activity rising sharply to the highest for almost a year in March. This improvement is due in part to increased house building activity, which bucked the wider trend by rising for a second successive month, but also reflects the fact that activity generally should pick up once the spell of adverse weather, which has plagued the industry so far this year, has passed.

A positive contribution to the economy from construction in the second quarter is important because, although the sector accounts for less than 7% of GDP, the severity of its decline in recent years has been a key contributor to the weakness of the economy, and a resurgence in the sector will be an important element of a robust recovery.

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