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Markit Economic Research

27/06/2014

United Kingdom

Economic recovery buoyed by surge in business investment

- **GDP up 0.8% in Q1, unchanged on prior estimate**
- **Business investment revised higher, up 5.0% in Q1 and +10.6% on a year ago**
- **Consumer spending up 0.8%**
- **Manufacturing, services and construction all show strong growth, but exports lag**

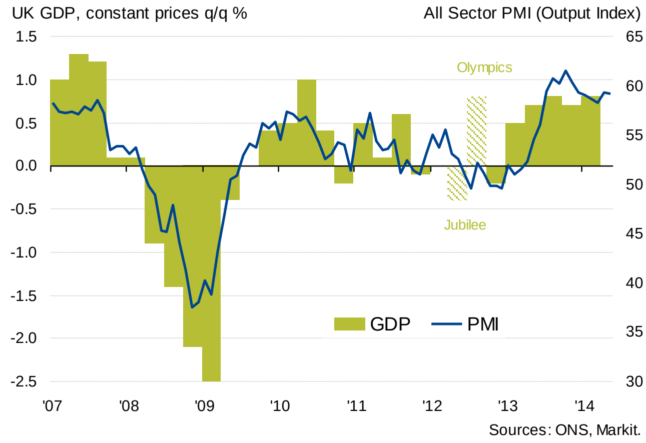
A lack of any upward revision to economic growth in the first quarter increases the chances of the first hike in interest rates being pushed back until next year. However, policymakers will be cheered by news that the upturn is being supported by rising business investment, which makes for a more sustainable economic recovery.

The UK economy grew by 0.8% in the first quarter, identical to the prior estimate, according to the Office for National Statistics. The unchanged picture of overall growth at the start of the year will be greeted with some disappointment at the Bank of England, where policymakers have been expecting the data to be revised higher, ultimately to 1.0%. The weaker than hoped for rate of growth therefore adds to the case for interest rates to remain on hold until next year.

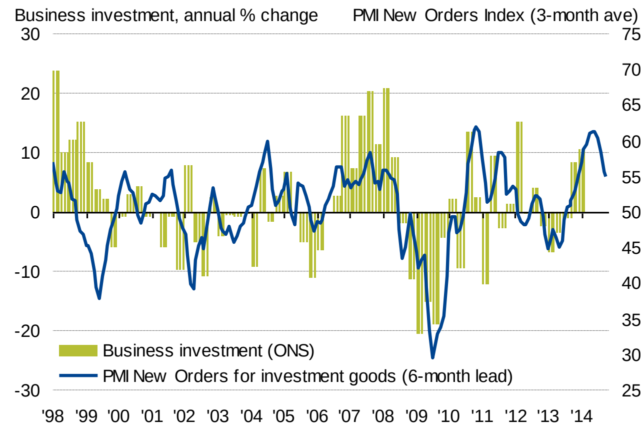
However, all will of course depend on how the economy fares as we move into the second half of the year. Policymaking will be 'data-driven', meaning the outlook for interest rates has the potential to change with every major economic release.

Policymakers appear to be working on the basis that the first hike in interest rates will be delayed until next year if wage growth remains subdued and the economy slows in the second half of this year. Any signs of growth momentum being sustained or accelerating in the third quarter will therefore add to the likelihood of rates rising later this year. The PMI surveys for June, published next week, will provide the first insight into how much growth momentum the economy had in the second quarter, and what the trajectory looks like for the third quarter. The surveys at present point to another quarter of robust growth of 0.8% in Q2.

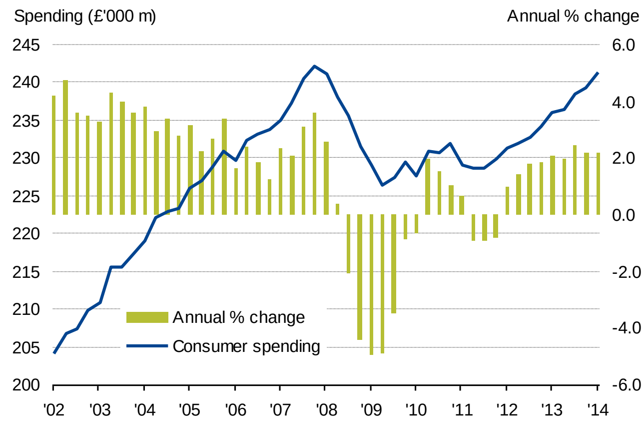
UK gross domestic product



UK business investment



UK consumer spending



Investment booms

Where today's data do change the economic recovery story is in terms of the quality of the upturn. There has been widespread concern that the recovery is being supported merely by rising consumer spending, in turn fueled by mounting consumer debt and a housing market boom. However, business investment spending was revised up sharply in the first quarter, growing by 5.0% against a prior estimate of 2.7%. That was the largest increase for two years and means business investment has surged 10.6% higher than last year.

PMI data on new orders for investment goods act as a good lead indicator for business investment (see chart) and anticipated the boom in investment in the first half of this year. However, some softening in growth is signalled for later this year, though investment is set to continue to rise.

Consumer spending rises

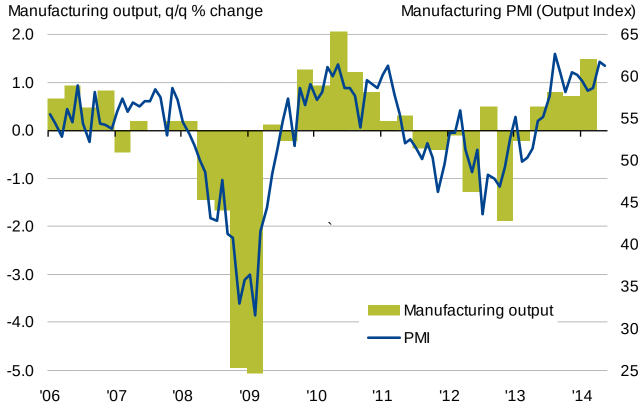
That's not to say the consumer is not also playing an important role in the recovery, but this is in no way a 'consumer boom'. Household spending rose 0.8% in the first three months of the year, and was up 2.2% on a year earlier.

Export weakness

The main source of weakness is exports, which fell 0.1% in the first quarter. But we question these data, and suspect the trade figures will either get revised higher, in line with various buoyant business survey data, or we will see a strong rebound in the second quarter.

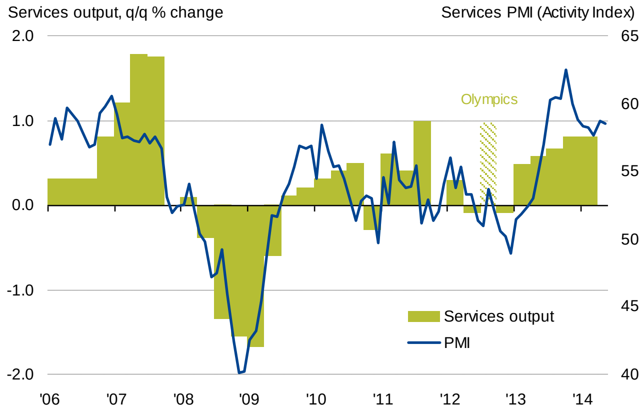
By sector, growth was encouragingly broad-based. A 1.5% leap in manufacturing output (revised up from 1.4%) was accompanied by an identical jump in construction output (revised up from 0.6%), while service sector output rose 0.8% (slightly lower than the prior estimate of 0.9%). Within services, all sub-sectors expanded, with the strongest growth seen in the retail, hotels and catering sector, which enjoyed a 1.7% rise in activity.

Manufacturing



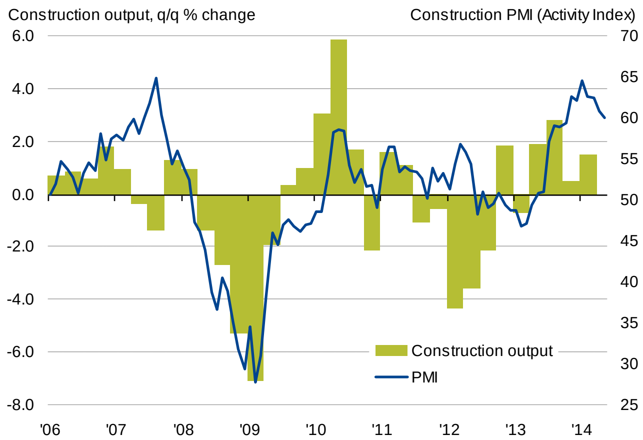
Sources: Markit, ONS.

Services



Sources: Markit, ONS.

Construction



Sources: Markit, ONS.

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