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Markit Economic Research

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United Kingdom

Official data confirm second quarter economic growth spurt

- **GDP rose 0.7% in Q2, but still 3.3% below pre-crisis peak**
- **Manufacturing and construction growth revised higher, services still expanding strongly**
- **Upturn to gather pace in Q3**

The UK economic recovery gained momentum in the second quarter, and a further acceleration of growth looks likely in the third quarter in what's looking likely an increasingly broad-based and sustainable looking upturn.

The third estimate from the Office for National Statistics showed the economy grew 0.7% in the three months to June, in line with the previous estimate and as widely anticipated. Disappointingly, growth in the third and fourth quarters of last year was revised down, but the estimate for the first quarter of this year was hiked up to 0.4% from 0.3%.

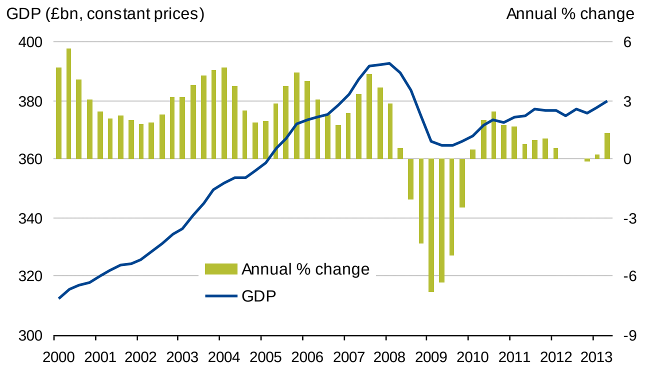
The revisions leave the economy still 3.3% smaller than its pre-crisis peak, which will be primary concern for policymakers and a key reason for keeping policy ultra-loose.

There's a strong likelihood that the pace of growth accelerated further in the third quarter. With PMI surveys hitting record highs in recent months, GDP is likely to have risen by at least 1.0% in the three months to September.

With the surveys also suggesting that the pace of growth accelerated towards the end of the third quarter, and given there are no obvious reasons why growth should suddenly weaken, it is reasonable to expect the economy to also fare well in the final quarter of the year.

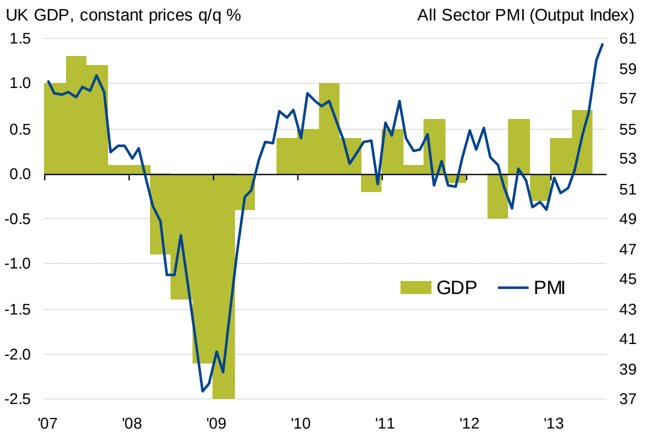
In an increasingly broad-based and sustainable-looking upturn, both manufacturing and construction saw faster than previously thought growth, accompanying strong growth in services. Meanwhile, the eurozone, our main trading partner is recovering from recession, which should help boost exports and likewise adds to the sustainability of the upturn.

UK GDP and the PMI business surveys



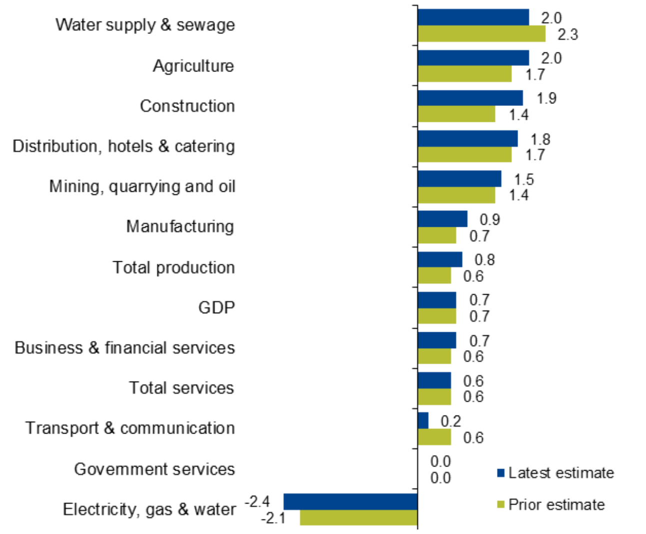
Source: ONS.

UK GDP and the PMI business surveys



Sources: ONS, Markit.

GDP by sector, ranked by quarterly % change in Q2



Economic growth for 2013 could therefore come in at 1.7%, above the current consensus of 1.4% and well above the Office for Budget Responsibility's estimate of just 0.6%, published back in March.

This is clearly good news for the deficit, as stronger growth brings higher tax revenues. Growth of 1.7% this year would help to bring the deficit down well below the government's £120bn target.

Productivity puzzle

The big question, of course is the extent to which the upturn in economy will generate new jobs, which will in turn dictate when the Bank of England will start to raise interest rates.

The Bank believes that low productivity growth in recent years indicates that many companies have hoarded labour, meaning they will be able to take on more work without taking on more staff. The Bank therefore believes it will be a long time (2016) before unemployment falls below the 7% threshold it needs to see crossed before contemplating rate hikes.

If the theory that companies have hoarded staff is wrong, we could see the jobless total falling faster than the Bank expects. And in that respect it's worth noting that recruitment agencies, who are often the first to see the labour market pick up, have suddenly grown noticeably busier. Employment agency revenues from temporary and contract staff workers rose at the fastest rate for 15 years in August. That's simply not something that happens if companies have existing staff sitting around waiting for business to pick up.

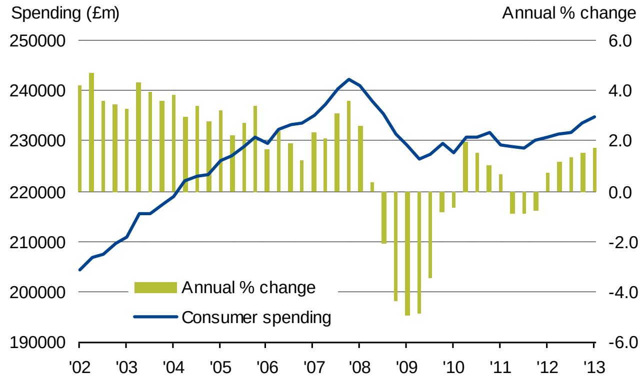
Broad-based upturn

The detail of the latest release from the Office for National Statistics confirmed the earlier estimate of service sector growth at 0.6%. Industrial production rose 0.8% (upgraded from 0.6%), with manufacturing output up 0.9% (revised up from 0.7%) and construction output surged 1.9%, up from a prior estimate of 1.4%.

Household spending rose a mere 0.3%, while exports jumped 3.0% (albeit weaker than the previous estimate of 3.6%).

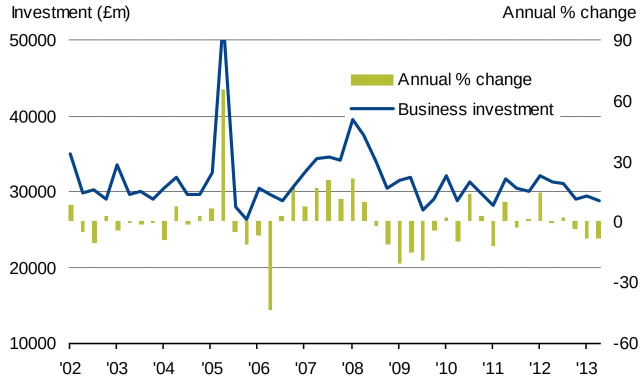
The big disappointment came from a steep downward revision to business investment. Instead of growing 0.9%, investment fell 2.7%. However, the extent of the revision and the volatility of these numbers should perhaps be seen more as a reminder of how unreliable the GDP statistics can be rather than a genuine cause for concern at this stage.

Household spending



Source: ONS.

Business investment



Source: ONS.

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