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Markit Economic Research
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United Kingdom

Another quarter of robust growth

- **Economy grows 0.7% in final quarter of 2013, finishing best year since 2007**
- **Manufacturing and business-services led upturn, construction falls in likely blip**
- **Further robust growth likely in Q1**

The UK economy continued to grow at a robust pace in the final quarter of last year, confirming that the country is seeing the best period of growth since 2007. Further robust growth is also likely for the first quarter, with the recovery also becoming more broad-based and sustainable-looking.

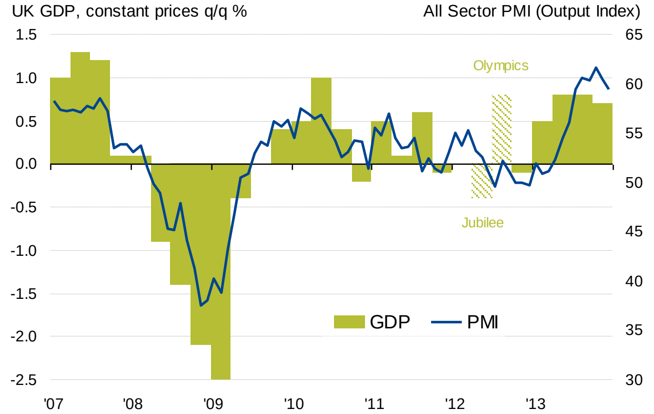
The economy was 0.7% larger than in the third quarter, according to the initial estimate of gross domestic product from the Office for National Statistics. The expansion follows strong growth of 0.8% seen in each of the second and third quarters, and means the economy grew by 1.9% over 2013 as a whole; its best year since 2007.

The initial estimates come with a major health warning, tending to be revised, often substantially, when more information on the full quarter become available. But in this case the likelihood is that the initial estimate understates the pace of growth seen in the closing quarter of the year. Recent past GDP estimates have tended to be revised away (remember the double-dip that we then learned never actually occurred?), moving more into line with the signals from business surveys such as the PMI. The PMI has been running at levels consistent with GDP growth of approximately 1.0% in the fourth quarter, with surging rates of expansion seen in manufacturing, services and construction.

Manufacturing and business services lead

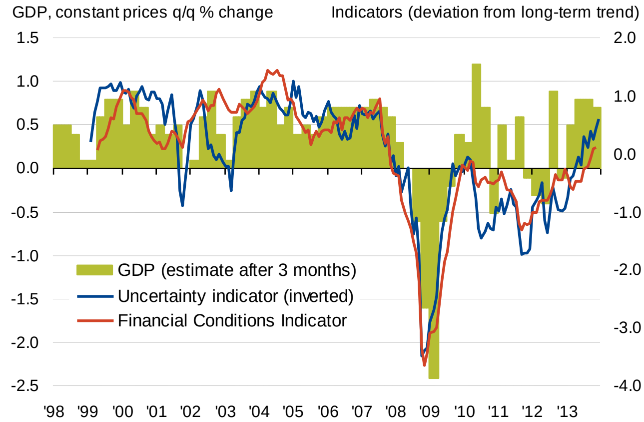
The detail of the fourth quarter GDP release showed that services grew by 0.8%, driven by business and financial services growing by an impressive 1.2% for a second successive quarter. Industrial production meanwhile expanded by 0.7%, with a 0.9% jump in manufacturing output offset by a drop in north sea oil and gas output. The expansion of manufacturing was the best since mid-2010.

Economic growth and the PMI



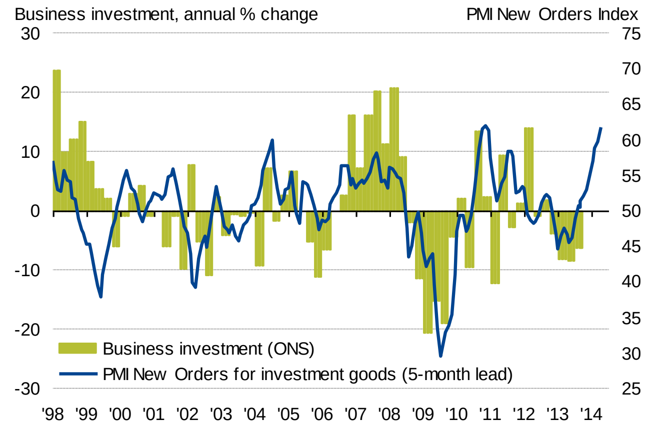
Sources: Markit, ONS.

Both economic uncertainty and financial conditions are now supportive of stronger growth



Sources: Markit, ONS.

Business investment and orders for investment goods



Sources: Markit, ONS.

Construction fell 0.3% following 2.6% growth in the prior two quarters, which – when viewed alongside buoyant survey data – looks like either a temporary weather-related downturn or a fall that is likely to be revised away.

Strong growth to be sustained

There seems every reason to believe that robust growth will be sustained into 2014, not least because of the promise of ongoing ultra-loose monetary policy stance from the Bank of England and additional stimulus such as the Funding for Lending and Help to Buy schemes.

Looking at factors such as the supply and cost of credit, inflation, the exchange rate and financial market volatility, financial conditions are also currently the most supportive of growth than at any time since 2007.

Similarly, economic uncertainty is running at its lowest since 2007, reflecting reduced concerns about a number of key issues, including the banking system, redundancies, corporate default, the collapse of the euro and the US debt crisis.

Both economic uncertainty and financial conditions were both clearly drags on the economy since 2007 and key reasons why the recovery has been so bumpy and disappointing to date. However, with both now supportive of stronger growth, the outlook for the sustainability of the economic recovery has improved, as has the likelihood of growth being fuelled by business investment rising alongside consumer spending.

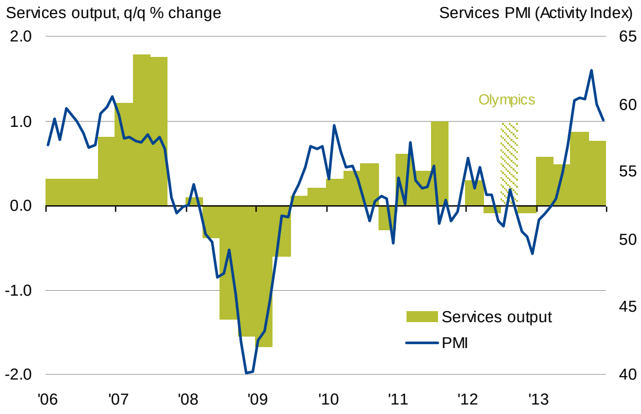
Higher business investment is already being indicated by the PMI survey's indicator of new orders for investment goods such as plant and machinery, which is rising at the fastest rate for at least 15 years.

UK households are meanwhile starting to feeling less downbeat about the outlook as inflation falls, house prices rise, incomes start to recover and employment prospects improve. Markit's Household Finance Index signalled a further upturn in confidence in January to match the previous pre-crisis high.

As good as it gets for a while?

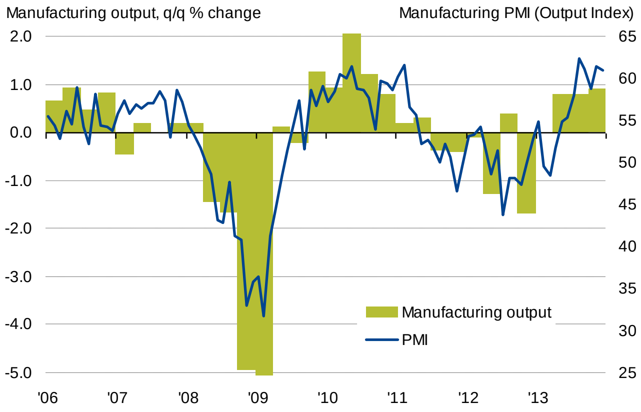
There remain factors that may well limit growth as 2014 proceeds, however, and the growth spurt that we saw in 2013 may be as good as it gets for a while. Wages continue to fall in real terms, which will put a cap on consumer spending growth. The Bank of England may also seek to use macro-prudential tools to cool the housing market. There are also growing

Services



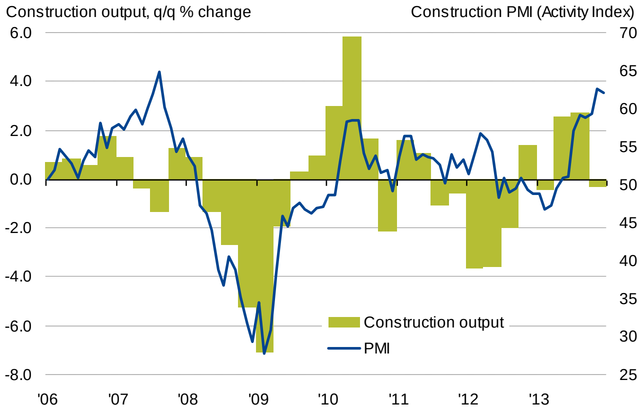
Sources: Markit, ONS.

Manufacturing



Sources: Markit, ONS.

Construction



Sources: Markit, ONS.

suspicions that the Bank will need to raise interest rates earlier than it had previously envisaged, with many commentators starting to talk of a hike before 2014 is over.

Bank lending also remains frustratingly weak. The eurozone is also still struggling to stage a convincing recovery, emerging markets are being hit as money is pulled out, repatriated to the US as the Fed taper intensifies.

All are factors to keep a close eye on, but at present appear to be issues which may merely subdue the UK recovery rather than derail it.

Policymakers to focus on spare capacity

As far as policy making is concerned, these data will do little to alter the Bank of England's view that rates will remain on hold for some time. The Bank's focus will no doubt be on the fact that the economy remains 1.3% smaller than its pre-crisis peak, and that with low inflation and falling real wages, there remains plenty of scope to leave policy ultra loose to allow a further catch-up of the lost ground caused by the recession.

Manufacturing remains some 9.0% smaller than its pre-crisis peak, and construction some 12.6% smaller. Services, however, has grown by 1.3%.

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