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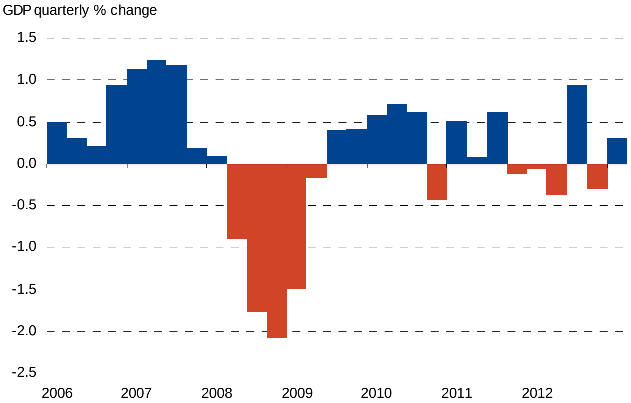
25/04/2013

United Kingdom

Economy avoids triple-dip recession with faster than expected expansion

- **First estimate of Q1 GDP shows 0.3% increase**
- **Growth largely dependent on service sector, as manufacturing and construction output falls, corroborating business survey evidence of skewed upturn**
- **Economy barely changed over past 18 months**

UK economic growth



Source: Office for National Statistics.

The UK avoided sliding into its third recession in five years by growing more than expected in the first quarter. The likelihood of policy action by the Bank of England has fallen significantly with this better than expected outcome, but the fact that the economy has more or less stagnated over the past 18 months suggests that the return to growth will do little to alleviate pressure on the government and the Bank of England to find ways to ensure the latest upturn turns into a sustainable and robust recovery, and that the economy does not falter once again.

The economy grew 0.3% in the first quarter following a 0.3% decline in the final quarter of last year, according to the Office for National Statistics.

This is a skewed upturn though, largely limited to the service sector. The upturn was led by a 0.6% increase in service sector output, followed by a 0.2% increase in industrial production. The latter, however, was buoyed in part by the fourth quarter having been subdued by disruptions to oil and gas extraction in the North Sea. Manufacturing output fell by 0.3%. Construction output meanwhile fell by 2.5%.

The upturn tallies with recent survey data that have hinted at a lop-sided recovery. The service sector PMI is currently showing a strengthening recovery in business activity, but surveys of manufacturing and construction signaled ongoing downturns in March, with the goods-producing sector in particular seeing the rate of decline in output gather further momentum.

However, the upturn in the first quarter merely makes up for the decline in the final quarter of last year and leaves output largely unchanged over the past year-and-a-half. The worry is that, even if the economy is gaining some momentum, the best we can expect is very meager growth for as long as inflation runs high and the eurozone crisis rolls on.

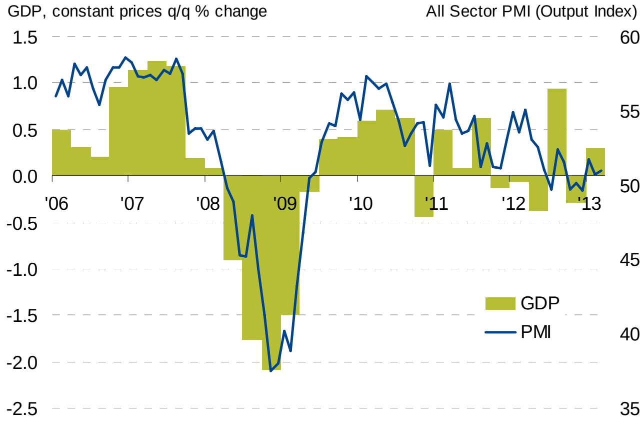
Second quarter growth not assured

A continuation of growth in the second quarter is by no means assured. The eurozone crisis is not only hurting exports but is also having a damaging effect on global business confidence. At the same time, weak domestic spending and investment by businesses can be linked to lingering uncertainty about the economic outlook and a lack of lending. Consumer spending is meanwhile being subdued by job worries, low pay and high inflation.

With the government managing to meet its debt target for last year and the economy avoiding a triple-drip recession, the Chancellor will feel able to resist calls to soften the austerity drive, but today's GDP data should not be cause for complacency that the recovery is firmly back on track.

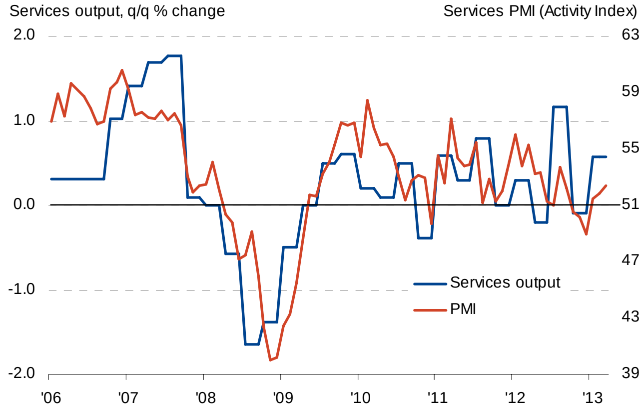
The upturn significantly reduces the likelihood of the Bank of England sanctioning further quantitative easing at its May meeting, but any renewed weakening in the business survey data during the second quarter could spur renewed action.

GDP and the PMI



Sources: Markit, ONS.

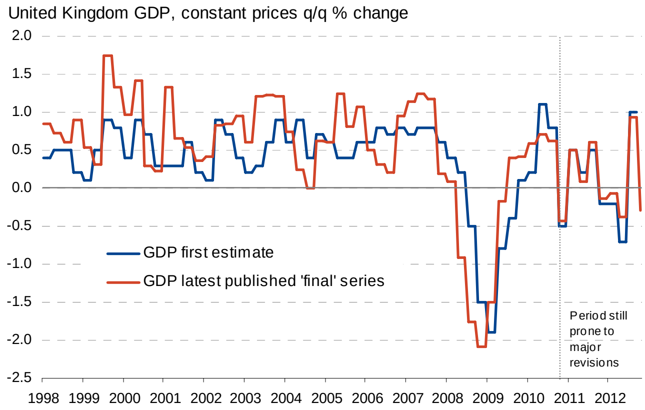
Services



Sources: Markit, ONS.

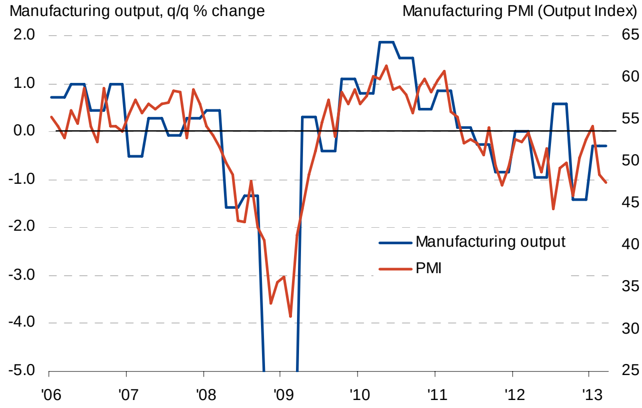
Finally, a word of warning. We should remember that these first estimates tend to be revised heavily. Going back to 1998, the average revision has been a huge +/-0.4%, with a tendency for growth rates to be revised higher. See chart below.

GDP revisions



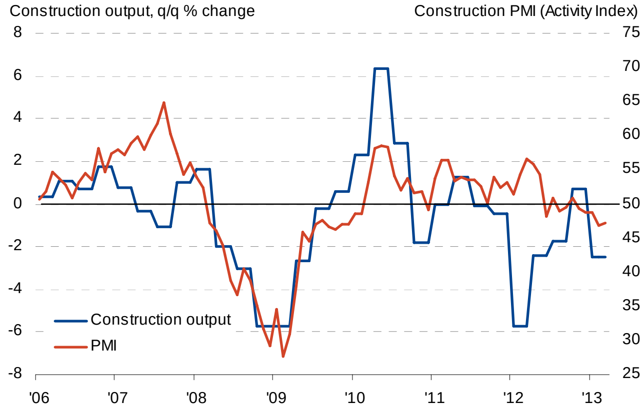
Sources: Markit, ONS.

Manufacturing



Sources: Markit, ONS.

Construction



Sources: Markit, ONS.

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