

UK economy

Manufacturing uncertainty and consumer woes

- Official data show manufacturing growth stalled in February.
- Consumer spending has slowed after January surge.

Manufacturing stalls

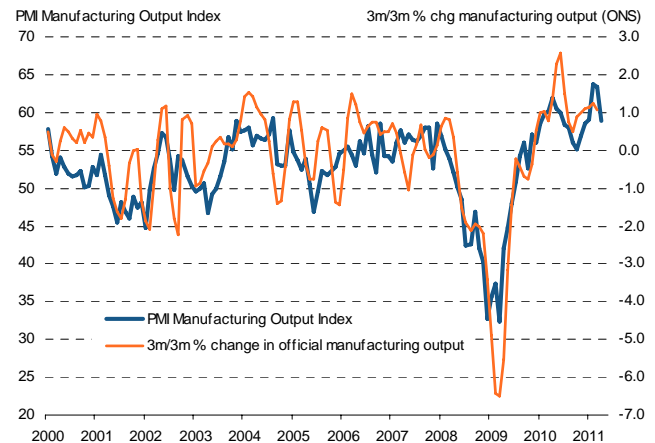
The manufacturing recovery stalled in February, according to official data from the Office for National Statistics. Output was unchanged compared to January, while the wide measure of industrial production slumped 1.2%, dragged down by a huge 7.8% drop in oil and gas extraction. The latter was apparently due to maintenance work, so should prove temporary.

The data fell well short of expectations (a poll by Reuters showed analysts anticipating a 0.4% increase in industrial production on average, driven by a 0.6% increase in manufacturing output). Together with a downward revision to growth in January (0.3% instead of the prior estimate of 0.5%), the stalling of manufacturing output in February poses a significant downside risk to gross domestic product (GDP) growth in the first quarter, and suggests that the Office for Budget Responsibility's estimate of 0.8% is already under threat, (having looked promising after the release of upbeat services PMI data yesterday).

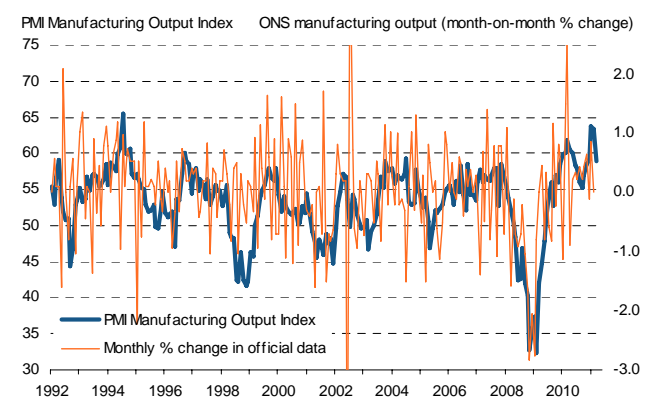
That said, we are puzzled by the weakness of the data relative to the more buoyant Markit/CIPS Manufacturing PMI survey, and believe that underlying growth momentum is stronger than these official data indicate. Certainly, the monthly official data are extremely volatile (see chart), and it would be neither surprising nor unprecedented to see the disappointing picture for February change dramatically with publication of March data.

Looking at a smoother three-month-on-three-month basis, the official data have historically correlated better with the less volatile PMI numbers, and pointed merely to an easing in the growth rate from 1.2% in January to 1.1% in February. But this is still

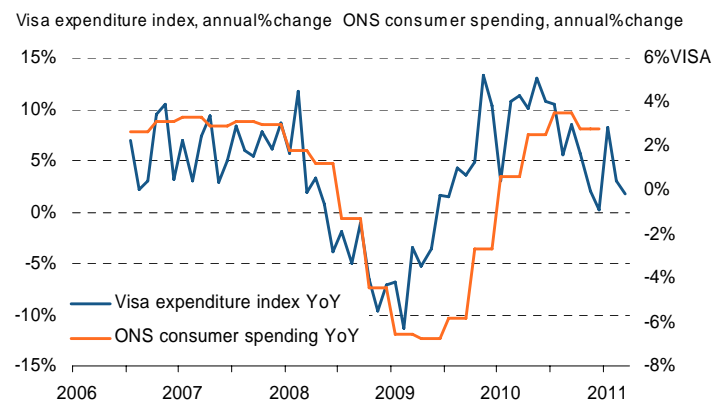
Manufacturing Production (official data smoothed)



Manufacturing Production (official data not smoothed)



Consumer spending



Sources: Markit, Visa, Office for National Statistics.

disappointing relative to the PMI signal of closer to 2.0% growth.

Consumer spending squeeze

The data will nonetheless provide ammunition for the doves on the Bank of England's Monetary Policy Committee, coming on the same day that other data indicate that the consumer sector – representing around two-thirds of GDP – is currently being increasingly squeezed by falling real incomes, deficit-fighting tax hikes and government spending cuts. The Visa Europe: UK Expenditure Index*, also published today, indicates that consumer spending may have stabilised following the 0.3% decline seen in the final quarter of last year, but that this reflected a surge in spending in the first two weeks of January as spending recovered from the bad weather over Christmas. Consumers also appear to have taken advantage of last-minute offers before retailers hiked VAT to 20%. Since then, the Visa data have exhibited a distinctly slower growth trend, especially in March.

It is likely that households will continue to retrench in the face of the numerous headwinds in coming months, meaning any upturn in the economy in the first quarter may prove to be short-lived, and that even the strongly-performing manufacturing sector will feel the impact from weaker domestic demand.

The majority of the Bank of England's policymakers may therefore choose to sit on their hands for a little longer, despite rising inflation, until a clearer picture of economic growth becomes available in the second quarter.

** compiled by Markit based on Visa debit and credit card spending. Adjusted for card usage, inflation and changing spending preferences, the Visa data have a strong correlation with equivalent official household expenditure data.*

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