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UK economy

UK grows more than expected in Q3, but outlook remains one of stagnation

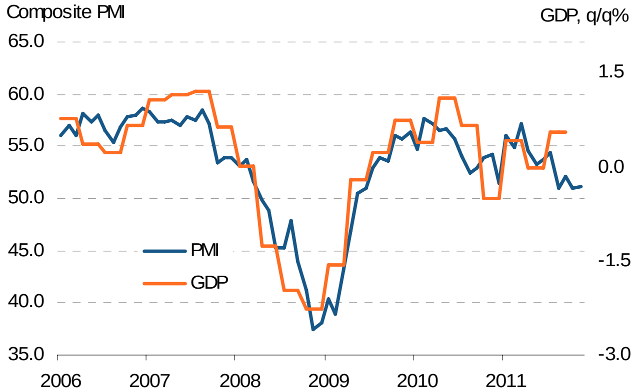
- **GDP growth revised up to 0.6% in Q3**
- **Stagnation still expected for Q4**

The latest government data showed the UK grew by 0.6% in the three months to September, up from the Office for National Statistics' previous estimate of 0.5%. However, the expansion largely reflected a bounce-back from temporary weakness in the second quarter, which had been caused by the extra bank holiday and disruptions to business globally due to the Japanese earthquake. In fact, the second quarter was even worse than previously thought, with meagre growth of 0.1% revised down to zero.

The underlying trend is very clearly one of an economy that is struggling in the face of what seems to be an ever-growing list of headwinds, notably the Eurozone's financial crisis, constrained bank lending, weak growth in the UK's export markets and the current difficulties that households are facing due to job worries, low pay growth and high inflation.

The data available so far suggest that the economy probably stagnated in the fourth quarter, which is in line with the Bank of England's current estimates, and there is a growing likelihood of a slide back into recession in the new year.

GDP and the PMI



Sources: Markit, CIPS, ONS

Manufacturing weaker than previously thought, services stronger

Looking at the third quarter in more detail, manufacturing growth was revised down from 0.2% to 0.1%, and total production down from 0.4% to 0.2%. In contrast, service sector growth was revised up from 0.6% to 0.7%. The fastest growing service sector was business and financial services, which grew by a buoyant 1.2%. The construction sector also expanded by 0.3% instead of the previous estimate of a 0.2% contraction.

Growth boosted by stock-building, hit by falling exports

A further indication of the temporary nature of the uplift in GDP was provided by confirmation that the expansion was aided by strong stock-building. Given the current weakness of demand, an unwanted build-up of stocks may hit production in the fourth quarter and beyond.

Further worrying news came from a 0.8% fall in exports, which contributed to the largest trade deficit recorded since data were first available in 1955. Any hopes of an export led manufacturing recovery have therefore been dented by these numbers.

Government spend revised down, business investment up

Some good news came from a modest increase in business investment, which was thought to have fallen in previous estimates.

Government spending was revised down from 0.9% to just 0.2%, which corresponds more closely with a retrenching public sector as austerity cuts start to bite than the surprisingly strong growth previously estimated. Household spending was meanwhile unchanged, which was the first time households had not cut their spending for a year but hardly a sign of consumer exuberance.

UK outperforms Eurozone, which remains main risk to recovery

The UK nevertheless looks to have outperformed the Eurozone in the fourth quarter, which is likely to have contracted by around 0.5%, and matched the performance of Germany, for which survey data also point to stagnation. The Eurozone, and the potential for the region's financial crisis to escalate, remains the main risk to the UK's economic recovery in 2012, which is only expected to grow by 0.7% according to the government's Office for Budget Responsibility. However, the US appears to have seen a revival of growth in the final months of the year, bucking a weakening trend seen throughout the rest of the world, which may provide some help to UK exporters.

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