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Western European Indicators and Insights

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UK: Back in recession.

No policy implications, either on the monetary or fiscal side!

Real GDP decreased by 0.2% in Q/Q terms last quarter, accentuating the 0.3% fall seen in Q4 2011. This result, which knocked the Y/Y rate down half a percentage point to zero was below consensus thinking, it also suggesting that the UK is in formal recession given the two successive quarters of recorded contraction in economic activity.

No great surprise

While below the consensus, the further drop in GDP is of no great surprise. Indeed, the BoE explicitly pointed to such a risk as far back as its early-April MPC meeting, worried that activity will be lowered by weak construction, albeit artificially so as surveys for this sector (and the economy more broadly) point to a relatively stronger backdrop.

Implies some improvement at the end of the quarter

Notably, however, these GDP figures show more widespread weakness with output rising only in the service sector and then by just 0.1% Q/Q. In contrast, construction output dropped 3.0% Q/Q, not as much as some had feared but enough to knock 0.2 percentage point off of quarterly GDP growth, ie thereby being responsible for the actual drop in GDP. However, the surprising weakness was in energy production, with little recovery from the weather-induced drop seen in the final part of last year. Much of this is seemingly based around presumed and resumed declines in March, probably a reflection of the warm weather seen during the month. If so, then current-quarter GDP may benefit, especially given the below-norm temperatures evident so far.

On a more positive note, the data actually implies a clear bounce in manufacturing activity in March suggesting that the sector may actually be on the surer footing hinted at by surveys such as that from the CBI today. No such bounce is anticipated for services, however, making the divergence between officially-recorded output in this sector and the message of surveys all the more puzzling, possibly even more than the well-advertised weakness in construction.

BoE paying more attention to surveys, on hold in coming months

Regardless, the BoE has said it will be paying more attention to the relatively more upbeat survey data, well aware that the host of distortions, ranging from unusual weather, the leap year, and the additional holiday in Q2 may mean that official recoded GDP may be (artificially) depressed not just in Q1 but for the whole of the first half of the year. Even so, the BoE must be wary that any persistence of bad economic news may weigh on weak consumer and business confidence.

Nevertheless, any extension of asset purchases beyond that destined to finish next month is unlikely in May, particularly with the BoE also highlighting its deepening worries about stubborn core UK inflation. As for the Government, it has already asserted there will be no shift away from its fiscal consolidation program, implicitly blaming the Eurozone woes for the fresh UK recession. This ignores the fact that irrespective of the various distortions that may be disguising underlying activity, the economy has failed to grow at all on net since the Government came to power in mid-2010.