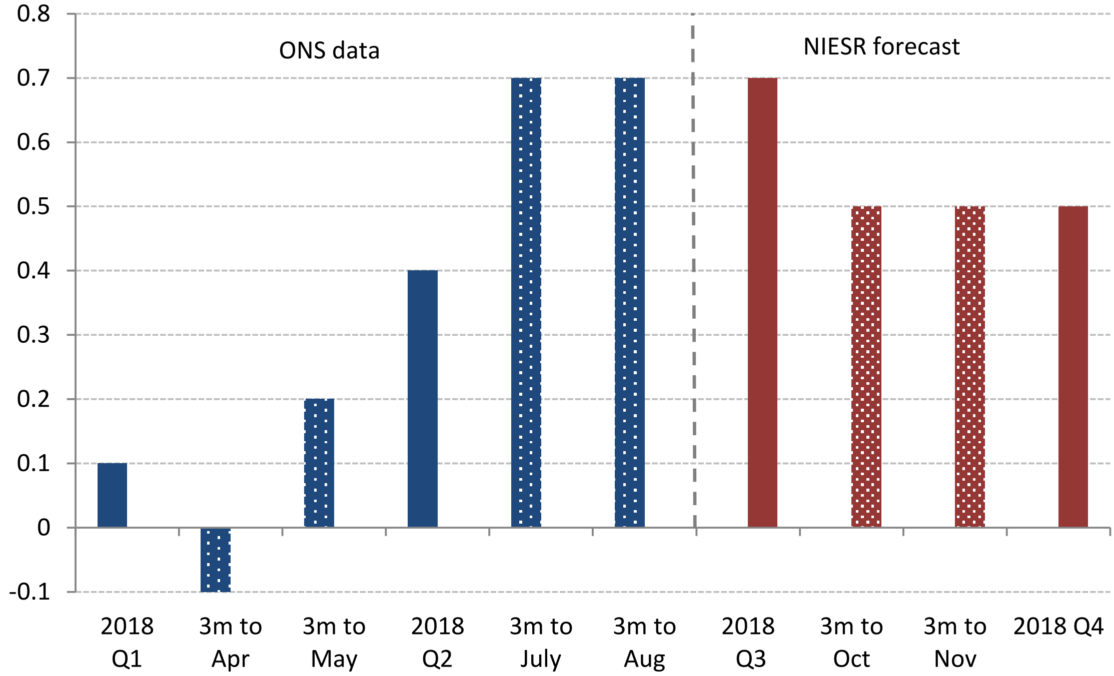
Press Release

NIESR MONTHLY GDP TRACKER: October 2018

UK economy gathers even more momentum

Figure 1: UK GDP growth (3 months on previous 3 months, per cent)



Source: NIESR, ONS
Note: the solid bars show the 3m/3m growth rate for complete calendar quarters and the shaded areas show rolling 3m/3m growth rate for the intervening months. There may be inconsistencies in the growth rate arising from rounding

Main points

- Latest economic data confirms that the UK economy has recovered from a soft patch earlier in the year and is now growing at a pace that is well above potential.

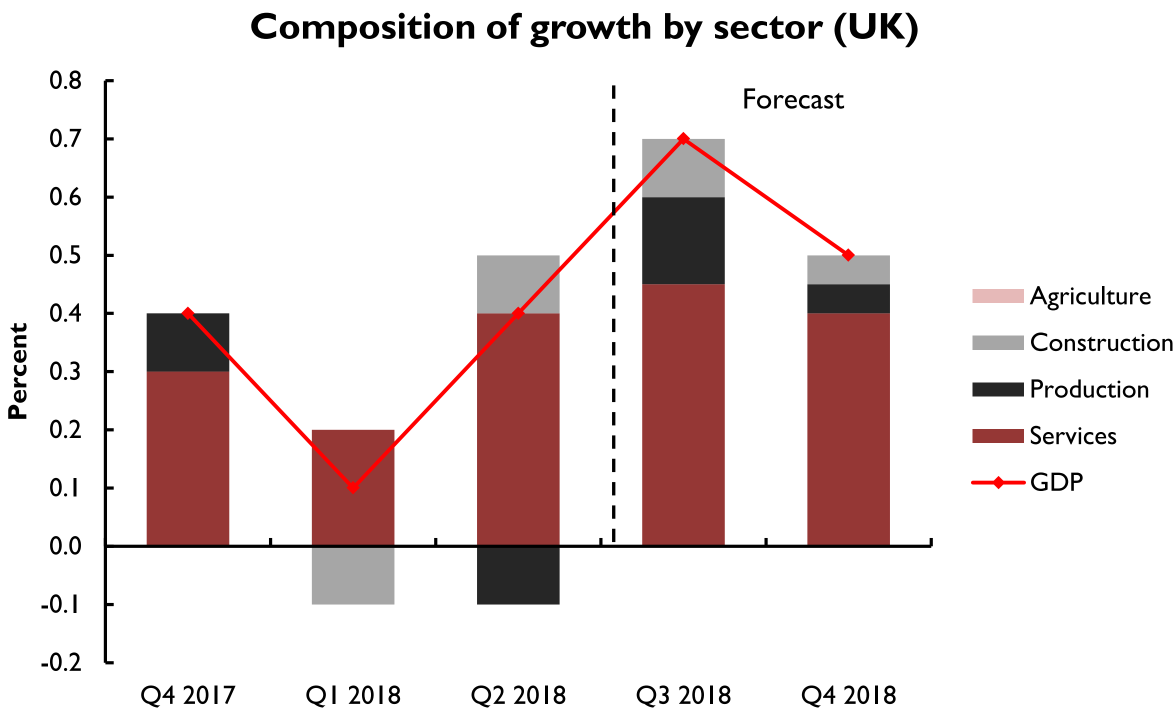
- According to new ONS statistics published this morning, the UK economy expanded by 0.7 per cent in the 3 months to August after growing by 0.4 per cent in the second quarter (three months to June). The outturn was slightly higher than the 0.6 per cent monthly GDP forecast that we published last month for the same period and the error is partly because of back data revisions. **Building on the official data, our monthly GDP Tracker suggests that the economy will expand by 0.7 per cent in the third quarter and by 0.5 per cent in the final quarter of this year.**

- The biggest surprise was from the production sector and, in particular, manufacturing output which expanded by 0.8 per cent. This strength was across the board and the outturn was above our forecast for the same period, partly because of changes to the back data.

Amit Kara, Head of UK macroeconomic forecasting, said *"The economy has rebounded from the weather-related disruption in the first quarter to a pace that is considerably faster than our estimate of potential. This comes at an opportune moment for the Chancellor just days ahead of the Budget and also gives him room to consider additional spending in line with our recommendations. At the same time, these numbers raise the prospect of an early policy rate increase by the Bank of England. Our forecast, which is conditioned on a soft Brexit scenario, is for a 25bp rate increase in February next year and now appears more likely.*

On our forecast, the economy expands by 0.7 per cent in the third quarter and by 0.5 per cent in the final quarter. This amounts to a growth rate of 1.5 per cent in 2018 as a whole."

Figure 2: Contributions to quarterly GDP growth (percentage points)



Production (14 per cent of GDP)

The production sector comprises of the manufacturing sector, mining and quarrying; electricity gas, steam and air conditioning; water supply and sewerage; and oil and gas extraction. Production output expanded by 0.7 per cent in the three months to August compared with the previous three months. The outturn was well above our forecast of 0.1 per cent that we published last month and the official data suggests that the strength was broad-based. This partly reflected downward revisions by the ONS to the April and May data.

Manufacturing

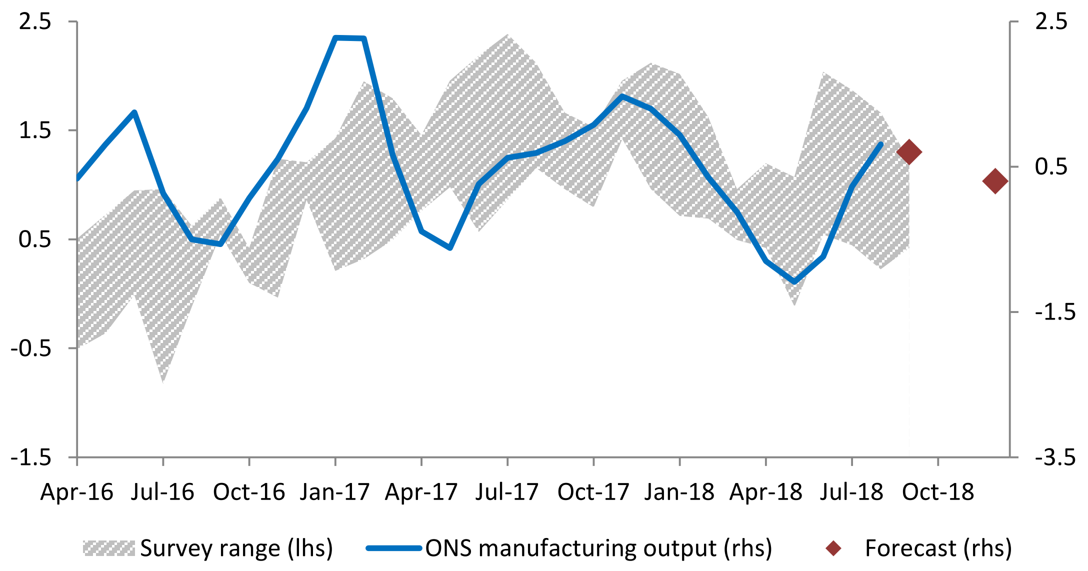
Within production, the dominant manufacturing sector expanded by 0.8 per cent over this period. The rebound marks a turnaround from the performance in the second quarter of this year when output fell by the same amount.

Recent UK survey data points to a modest expansion in manufacturing sector output (Figure 3) with mixed signals from the major business surveys. The latest CBI Industrial Trends Survey suggests that growth has fallen to a four-month low in September, but at the same time businesses expect output to recover in the next three months. By contrast, the IHS Markit/CIPS UK manufacturing PMI survey suggests that production rose to a four-month high in September. The analogous JP Morgan global manufacturing PMI however, suggests that output balance fell to a two-year low for the same period. At the global level, the slowdown is most pronounced in the Emerging Markets.

What is common across most of the surveys is a strengthening in pricing pressures. The PMI survey has signalled an increase in both input and output prices and although the output price balance in the CBI survey eased in September, the latest reading remains well above the long run average.

The surveys are fairly sanguine on the impact of Brexit on output or exports. In fact, the PMI survey suggests that Brexit has had little impact on export volumes so far, but others such as from Delloite explicitly rank Brexit is the risk that poses the biggest threat to business over a twelve month horizon.

Figure 3: Manufacturing sector surveys and ONS manufacturing sector growth (3 months on previous 3 months, per cent)



Source: ONS, CBI, Markit, Bank of England Agents, NIESR

Mining and quarrying

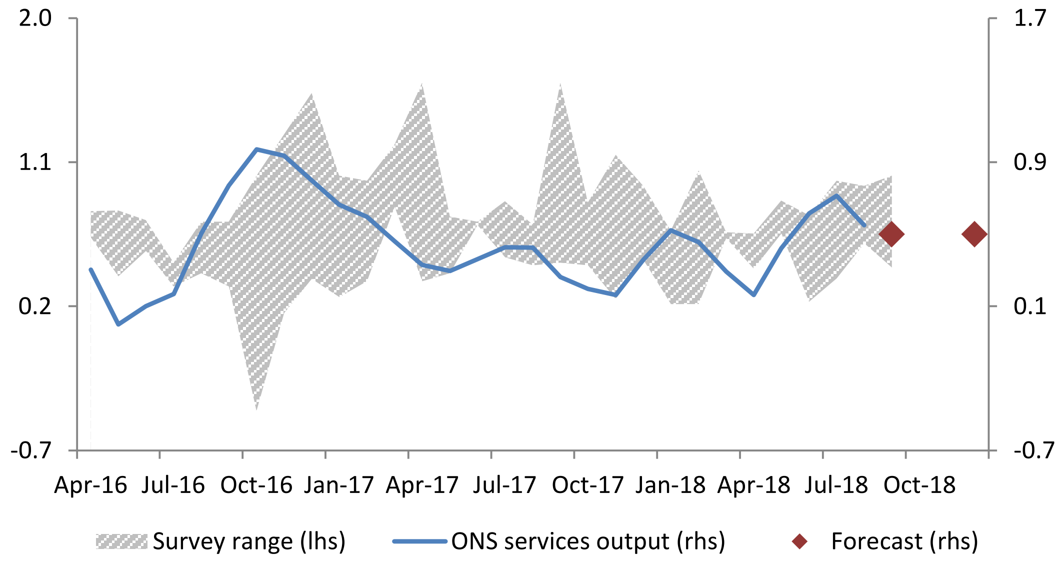
Mining and quarrying is a small and erratic component of the industrial production sub-component. Output expanded by 2.1 per cent in August according to the ONS. Oil and gas extraction rose by 2.6 per cent over this period and this sector accounts for much of the overall strength.

Services (80 per cent of GDP)

According to ONS, growth in the dominant service sector recovered from 0.3 per cent in the first quarter of this year to 0.6 per cent in the second quarter before easing to 0.5 per cent in the 3 months to August. The outturn for the three months to August was slightly was in line with our forecast.

Within the service sector, wholesale, retail and motor trade made the biggest contribution to the three-month growth rate for the fourth consecutive month. That strength is likely to be temporary. One reason for this is the boost in retail sales growth from the football World Cup and the unusually warm summer. In fact, the October BRC-KPMG the retail sales monitor and the CBI monthly Distributive Trades Survey suggest that the sector lost momentum in September and there are indications from the CBI survey, in particular, that the retail sales growth is set to weaken further. Also, the data for August show that the motor trades sector benefitted from the introduction of new emission standards in September 2018 and new data from the Society of Motor Manufacturers and Traders show that the market has fallen since then.

Figure 4: Service sector surveys and ONS manufacturing sector growth (3 months on previous 3 months, per cent)



Source: ONS, CBI, Markit, Bank of England Agents, NIESR

Turning to the outlook for the service sector, business surveys point to stable growth of around 0.5% in the third quarter of this year (Figure 4). The PMI-Markit Service sector business activity balance nudged a little lower in September but the overall message remains the same – stable and solid growth, capacity constraints, expansion in employment and a build-up in the backlog of work. That said, there are indications in this survey of heightened Brexit-related uncertainty which appears to be acting as a constraint on growth and business confidence. In spite of that and very much in common with the manufacturing sector, the service sector appears to have enough momentum to deliver growth that is close to its post-crisis average.

Another aspect that is common across both the manufacturing and services sectors is the upward pressure on input costs. Some of the factors driving that increase, such as fuel prices, appear to be temporary, but others, such as higher wage bills for the service sector and supply shortages for the manufacturing sector are likely to persist.

Construction (6 per cent of GDP)

The construction sector rebounded in the second quarter with growth of 0.8 per cent compared with a 1.5 per cent fall in the first quarter. According to official data, monthly output fell in August but the three month growth rate remained healthy at 2.9 per cent, albeit somewhat lower than our forecast of 3.9 per cent for the same period.

Looking ahead into August and September, the latest reading from the IHS Markit/CIPS construction PMI survey signals a further loss in growth momentum as the catch-up effect fades.

Outlook for the whole economy in 2018

NIESR publishes a comprehensive global and UK macroeconomic forecast each quarter. Under the central scenario of our August forecast, which was conditioned on a soft Brexit, we were expecting GDP growth of 1.4 per cent in 2018. Our monthly GDP tracker broadly confirms that view. We emphasised in August that the risks to that forecast were tilted to the downside because of economic and political uncertainties related to Brexit negotiations. This uncertainty continues to act as a drag on investment spending and also a key risk going forward according to the Bank of England Decision Maker Panel. At the global level, there are some very early signs in business surveys that the risk from an escalation in protectionism and a more hostile international trading environment is holding back investment and activity more generally. Input costs for businesses are also rising.

Our next full UK and global forecast will be published on 31st October, but the pre-released to the media on 26th October.

Health warning:

NIESR's short-term predictions of monthly GDP growth are based on bottom-up analysis of recent trends in the monthly sub-components of GDP. These predictions are constructed by aggregating statistical model forecasts of ten sub-components of GDP. The statistical models that have been developed make use of past trends in the data as well as survey evidence to build short-term predictions of the sub-components of monthly GDP. These provide a statistically-based guide to current trends based on the latest available data.

Each month these predictions will be updated as new ONS data and new surveys become available.

It is important to stress that the timelier NIESR guide to quarterly GDP growth will be less reliable than the subsequent ONS data releases as its data content is lower, particularly for estimates of the current quarter which in some months will be based only on forecasts rather than hard data. To mitigate this issue, NIESR will provide a guide to average errors based on past performance. NIESR will also each month provide clear guidance on how the latest news has caused its estimates of GDP growth in the current and preceding quarter to change and thereby quantify how the short-term outlook is being affected by recent data releases.

As we have adopted a new bottom-up methodology for producing estimates of GDP growth for the current and preceding quarters, we do not yet have a track record of estimates produced by the new approach. Nevertheless we would expect our estimates for GDP growth in the quarter prior to publication to be at least as reliable as those using the old methodology. Using the old methodology, the root mean square error of NIESR's early estimates of GDP for complete calendar quarters was 0.188% point for the period 1999Q3 – 2015Q4 once a noticeable outlier in 2010Q4 is excluded.

Forecast Error Analysis: Quarterly GDP growth (%)

Quarter	ONS first estimate	ONS latest estimate	NIESR estimate made in next quarter (early)	NIESR Prediction made in same quarter (very early)	Error in early estimate	Error made in very early estimate	ONS latest – first
2016Q4	0.6	0.7	0.5	0.7	0.2	0.0	0.1
2017Q1	0.3	0.4	0.5	0.6	-0.1	-0.2	0.1
2017Q2	0.3	0.3	0.3	0.4	0.0	-0.1	0.0
2017Q3	0.4	0.4	0.4	0.4	0.0	0.0	0.0
2017Q4	0.5	0.4	0.6	0.4	-0.2	0.0	-0.1
2018Q1	0.1	0.1	0.2	0.5	-0.1	-0.4	0.0
201802	0.4	0.4	0.4	0.0	0.0	0.4	0.0
Average absolute error					0.09	0.16	0.07

To check how our methodology would work in real time we have gone back to late 2016 to produce judgement-free forecasts of GDP growth in future months based on the monthly data series available for the components in November 2016 (this is the earliest vintage currently available on the ONS website) and in each subsequent three months. We can then use these projections to calculate the forecast quarter-on-quarter growth rates for the current quarter and can compare these to the ONS first estimates of quarterly growth. The average absolute error for the 7 quarters that we have calculated was 0.16 % points. The largest error was for 2018Q1 when our GDP tracker had initially expected growth to be 0.5%, 0.4% points higher than the ONS first estimate of GDP growth that was published in April 2018.

Notes for editors: For further information please contact the NIESR Press Office or Luca Pieri on 020 7654 1931/ l.pieri@niesr.ac.uk

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Table 1: Summary Table of GDP growth (2016=100)

2016=100	GDP index	Index of Services	Index of Services - Components: Business services and finance	Government and other services	Distribution, Hotels and Restaurants	Transport, Storage and Communications	Index of Production	Index of Production - Components: Manufacturing	Electricity, gas, steam and air conditioning	Mining and Quarrying	Water Supply, Sewerage and Waste Management	Index of Construction	Agriculture
Latest weights	*1000*	*793*	*334*	*220*	*133*	*106*	*140*	*101*	*12*	*17*	*10*	*60*	*7*
Jan-18	103.2	102.9	103.5	100.3	102.8	106.5	103.1	104.4	97.4	102.6	101.0	107.5	102.2
Feb-18	102.9	102.6	103.1	100.3	102.9	105.5	103.2	104.0	100.7	100.6	101.7	106.6	101.9
Mar-18	103.0	102.8	103.3	100.7	102.4	106.5	103.0	103.6	102.6	97.7	102.3	104.9	101.9
Apr-18	103.2	103.2	103.6	100.9	103.3	107.0	102.3	102.7	99.6	104.6	100.8	104.9	102.1
May-18	103.5	103.5	103.4	100.8	104.9	107.6	101.7	103.0	95.4	99.1	102.1	107.9	102.2
Jun-18	103.7	103.5	103.2	100.8	104.8	108.5	102.7	104.0	95.8	99.2	104.5	108.9	102.0
Jul-18	104.1	103.8	103.7	100.7	105.6	108.3	103.1	104.0	97.5	102.8	104.1	109.4	101.8
Aug-18	104.1	103.9	103.7	100.6	105.3	109.2	103.4	103.8	99.3	104.9	104.8	108.6	101.6
Sep-18	104.3	104.1	104.0	100.6	105.6	109.6	103.4	104.1	99.5	102.0	104.9	109.2	101.5
Oct-18	104.4	104.3	104.3	100.6	105.8	109.8	103.4	104.2	99.9	101.2	105.0	109.4	101.6
Nov-18	104.7	104.5	104.6	100.5	106.0	110.3	103.7	104.2	101.1	101.5	105.2	109.8	101.7
Dec-18	104.8	104.6	104.9	100.5	106.2	110.7	103.7	104.3	101.1	101.1	105.4	110.1	101.9
Percentage change, 3 months on previous 3 months													
Mar-18	0.1	0.3	0.5	0.2	0.3	0.0	0.2	-0.1	1.1	2.5	-1.3	-1.5	-1.2
Apr-18	-0.1	0.2	0.2	0.4	0.2	-0.3	-0.1	-0.8	1.8	4.3	-0.7	-2.7	-0.8
May-18	0.2	0.4	0.2	0.5	0.9	0.5	-0.5	-1.1	-0.5	4.9	-0.3	-1.7	-0.2
Jun-18	0.4	0.6	0.1	0.4	1.6	1.4	-0.8	-0.7	-3.3	0.7	0.8	0.8	0.1
Jul-18	0.7	0.7	0.1	0.1	2.2	1.7	-0.3	0.2	-4.7	-0.6	1.9	3.1	0.0
Aug-18	0.7	0.5	0.1	-0.1	1.6	1.5	0.7	0.8	-1.7	1.8	2.7	2.9	-0.3
Sep-18	0.7	0.5	0.4	-0.2	1.1	1.2	1.1	0.7	1.9	2.2	2.1	1.7	-0.5
Oct-18	0.5	0.5	0.6	-0.2	0.5	1.3	0.9	0.3	3.5	2.3	1.3	0.3	-0.4
Nov-18	0.5	0.5	0.7	-0.1	0.6	1.1	0.4	0.2	2.7	-0.7	0.6	0.5	-0.2
Dec-18	0.5	0.5	0.7	-0.1	0.5	1.2	0.3	0.3	1.9	-1.9	0.6	0.7	0.1
Percentage change, month on same month in previous year													
Mar-18	1.2	1.2	1.7	0.3	0.6	2.6	2.5	2.2	11.2	-3.7	-2.0	-1.9	-0.7
Apr-18	1.4	1.6	2.4	0.2	1.4	2.9	1.4	1.0	3.5	5.2	-2.1	-1.7	-0.5
May-18	1.4	1.6	1.4	0.1	3.2	3.6	0.2	1.1	-3.3	-2.0	-0.7	1.2	-0.4
Jun-18	1.3	1.4	1.0	0.3	2.5	3.3	0.7	1.8	-2.0	-6.1	1.6	1.7	-0.9
Jul-18	1.8	1.8	1.6	0.3	3.1	3.5	1.0	1.5	-1.8	1.0	1.7	2.8	-1.5
Aug-18	1.5	1.7	1.3	0.0	2.8	4.0	1.4	1.4	-0.3	3.5	2.6	0.3	-2.0
Sep-18	1.6	1.9	1.6	0.3	3.6	4.0	0.4	0.6	-0.8	-1.5	2.7	1.7	-2.2
Oct-18	1.8	2.0	1.8	0.2	3.6	4.3	0.2	0.1	2.8	-4.0	1.9	2.8	-2.1
Nov-18	1.6	1.9	1.5	0.4	3.0	4.3	0.4	0.1	2.0	-2.2	2.5	1.7	-1.5
Dec-18	1.7	1.9	1.8	0.2	3.9	3.0	1.4	0.0	0.2	20.3	2.0	0.4	-0.9
Percentage change, month on previous month													
Mar-18	0.1	0.2	0.2	0.4	-0.5	0.9	-0.2	-0.4	1.9	-2.9	0.6	-1.6	0.0
Apr-18	0.2	0.4	0.3	0.2	0.9	0.5	-0.7	-0.9	-2.9	7.1	-1.5	0.0	0.2
May-18	0.3	0.3	-0.2	-0.1	1.5	0.6	-0.6	0.3	-4.2	-5.3	1.3	2.9	0.1
Jun-18	0.2	0.0	-0.2	0.0	-0.1	0.8	1.0	1.0	0.4	0.1	2.4	0.9	-0.2
Jul-18	0.4	0.3	0.5	-0.1	0.8	-0.2	0.4	0.0	1.8	3.6	-0.4	0.5	-0.2
Aug-18	0.0	0.1	0.0	-0.1	-0.3	0.8	0.3	-0.2	1.8	2.0	0.7	-0.7	-0.2
Sep-18	0.2	0.2	0.3	0.0	0.3	0.3	0.0	0.3	0.2	-2.8	0.1	0.6	-0.1
Oct-18	0.1	0.2	0.3	0.0	0.2	0.3	0.0	0.1	0.3	-0.8	0.1	0.2	0.0
Nov-18	0.2	0.2	0.3	0.0	0.1	0.4	0.2	0.1	1.3	0.3	0.2	0.4	0.1
Dec-18	0.2	0.2	0.3	0.0	0.2	0.3	0.0	0.1	0.0	-0.5	0.2	0.2	0.2

Note: There may be inconsistencies in the growth rates arising from rounding.