



1 March 2011

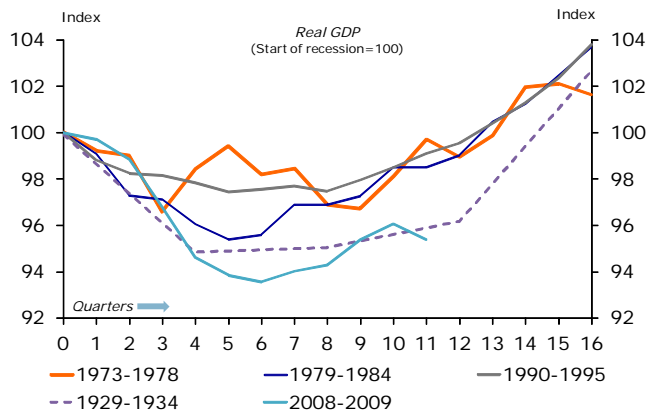
A truly chilling GDP growth figure in 10Q4

Year-on-year change (%)	'10	'11	'12
Gross Domestic Product	1.3	1½	1¾
Private consumption	0.8	½	¾
Government expenditure	1.0	-2½	-2
Private investment	3.4	5½	5
Exports	5.8	7½	5½
Imports	8.5	4	¾
Inflation	3.3	3¾	2
Unemployment (%)	8.1	8¾	8¼
Government balance (% GDP)	-10.1	-7¾	-6¾
Government debt (% GDP)	75.0	80¾	84¼

Source: EcoWin, Rabobank

- The 0.6% q-o-q contraction of GDP in 10Q4 was in a word, disappointing.
- The harsh winter explains part of the slowdown but there are unfortunately other signs pointing to a struggling recovery.
- Warmer weather may lead to a temporary boost in GDP in 11Q1, but the growth outlook in the coming quarters is not much brighter.
- Consumers are facing strong headwinds (e.g. deteriorating labour and housing markets) while nervous monetary policymakers are contemplating premature rate hikes.
- On a positive note, the other demand components (investment and exports) might finally lend some support to the weak economy.

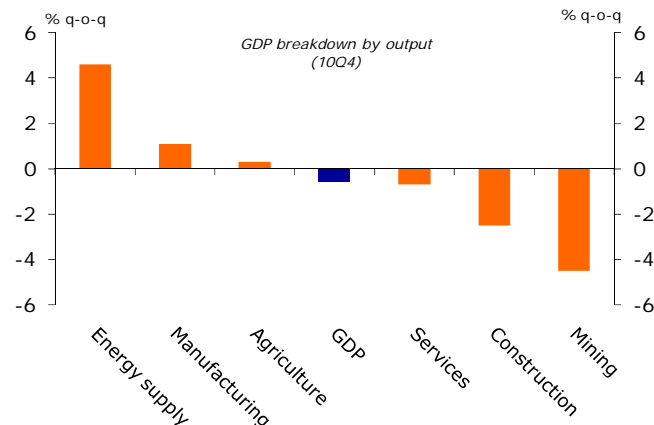
Economic slowdown



Source: Reuters EcoWin, Capital Economics

The very disappointing GDP growth figure in 10Q4 (-0.6% q-o-q) served as a chilling reminder that the UK economic recovery is still very weak. Of course, much of this slowdown was due to awful weather conditions. The statistical agency (ONS) reckons that weather effects knocked about 0.5% off GDP (i.e. economy would still have contracted without the weather impact). The breakdown by spending component showed that investment and net trade drove the drop in GDP. Net trade accounted for 0.3% of the 0.6% drop. And both business and overall investment fell by 2.5% q-o-q. Meanwhile consumer spending fell by 0.1%. Note that growth remained supported by government spending (+0.7%).

Was it only snow, or were other factors at play?



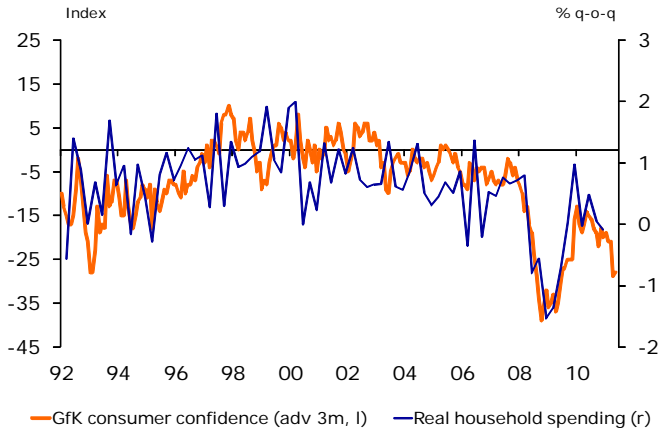
Source: Reuters EcoWin

Due to the volatility caused by the unfavourable weather conditions, it may be better instead to look at a wider range of data to get a clear picture of the current economic state of play. Sadly, there are signs that point to a struggling recovery. For example, the 0.7% q-o-q drop in business and financial services in 10Q4 is disturbing given that the sector is not prone to bad weather. What's more, the construction sector's poor performance cannot be solely attributed to the snowfall, but also to plunging public sector orders, which have been falling for months now. Of course, better weather conditions suggest that we may get a very strong, albeit temporary, reading for GDP growth in 11Q1.

Economic Update United Kingdom

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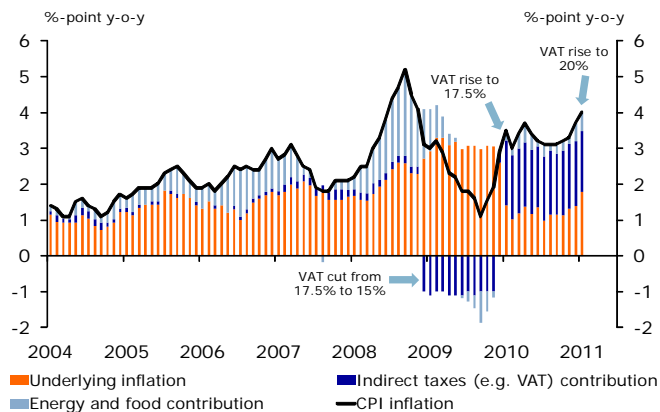
Is the consumption outlook much brighter?



Source: Bank of England

Heavy snowfall kept consumers off the High Street in 10Q4. But we are not sure if they will return now that the sun is shining. Households are going through a tough time while they are deleveraging. Home prices and real wages are still falling, credit conditions are not improving and the labour market is deteriorating further. These strong headwinds have made consumers pretty somber about the future. Even the strong surge in retail sales (ex. petrol) in January (1.5% m-o-m) does not serve as proof for consumption resilience as it came on the back of the sharp contraction in December. In fact, retail sales only rose by 0.2% in the three months to January in comparison to the previous three months.

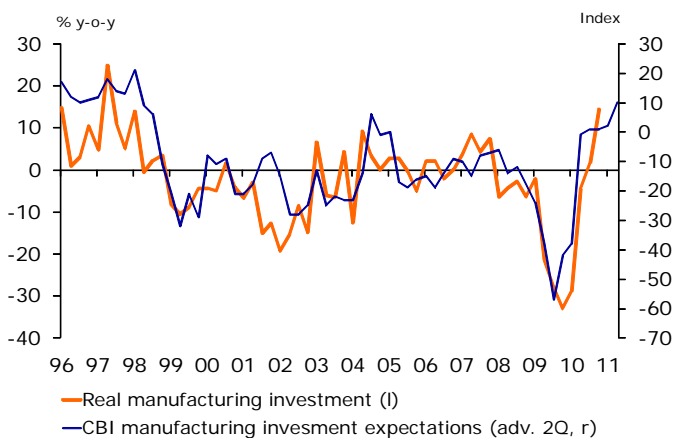
The Bank of England can complicate life even more



Source: Reuters EcoWin

Some of the 'hawkish' board members of the Bank of England are becoming very nervous about inflation (already three of the nine board members are voting for a rate hike) even though there are no real signs of mounting domestic price pressures nor risks of second-round effects. In fact, the inflation overshoot can be explained by the surge in commodity prices and the VAT hikes in 2010 and 2011. It goes without saying that a premature rate hike (e.g. in mid-2011) poses downside risks to our 2011-12 growth forecast given that the government's fierce austerity measures will also begin around the same time (April). Contractionary economic policy can only make life more difficult for the Britons.

Not all is doom and gloom in the UK



Source: Reuters EcoWin

There are certainly some bright spots visible in the UK economy. The corporate sector is in much better shape than the household sector, enjoying strong profits growth and large cash balances. Investment intentions of the manufacturing sector are rising at a healthy clip, which points to stronger capital expenditure going forward. However, the uncertain demand outlook may force firms to postpone investment decisions. Even if investment fails to pick up, the weakness of the sterling makes the UK exporters well-positioned to benefit from stronger external demand. Although we must not forget that the beleaguered peripheral eurozone countries continue to pose considerable downside risks.

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