

GDP growth – 2nd estimate analysed

March 2012

Background

The ONS released the second estimate of GDP growth in the fourth quarter of 2011, confirming a contraction of 0.2%. Compared to the fourth quarter of 2010, GDP grew by 0.7% and during 2011 as a whole GDP grew by 0.8%. This brief paper looks at the underlying data of that release, allowing us to understand more about which parts of the economy are struggling.

GDP growth

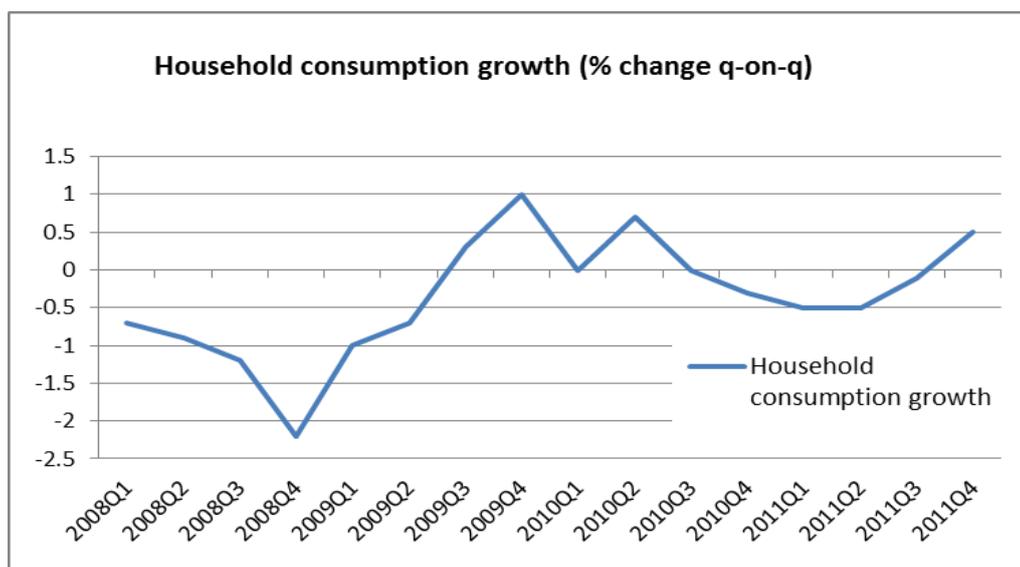
There are three different forms of measuring GDP. The output approach measures the total output by directly estimating the total value of all goods and services that are produced in a country. The income approach estimates the total factor income (i.e. wages, net interest received, rental income etc.) by residents. The expenditure approach is more of an output accounting method, focusing on finding the total amount of money spent.

The main sources of weaknesses in the three estimates of GDP in the last quarter were:

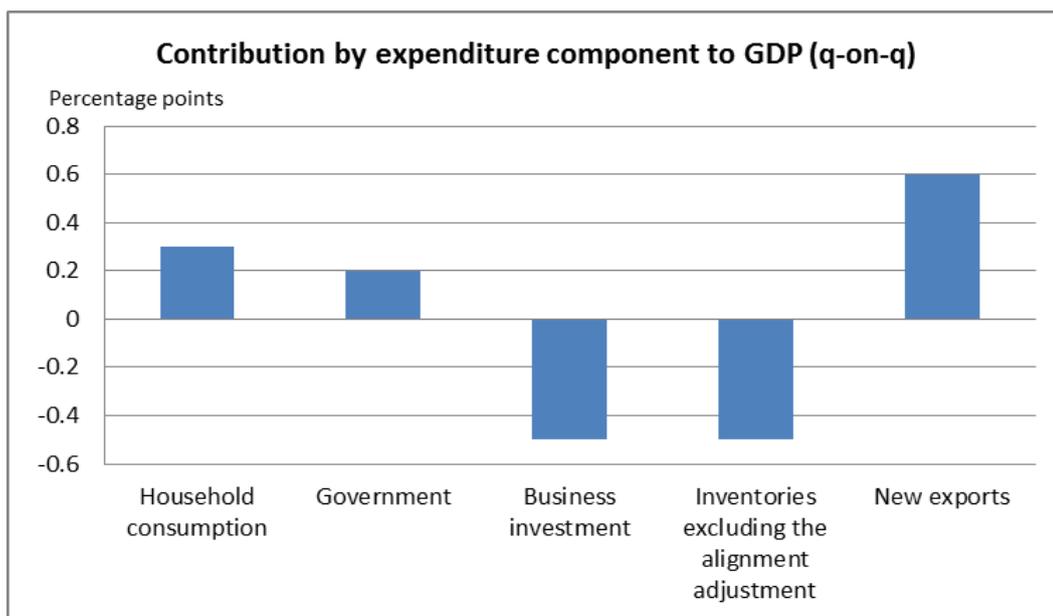
- Production industries (in the output measure of GDP)
- Gross fixed capital formation and inventories (expenditure measure)
- Compensation of employees (income measure)

The expenditure breakdown of growth showed positive contributions to growth from household expenditure (following four consecutive quarterly falls) and from net trade, with negative contributions from inventories and business investment.

However, it is important to note that although household consumption picked up in the fourth quarter, it remains more than 5% lower than its pre-recession peak, and has not regained the ground lost during 2011, being still almost 1% lower than its level in the third quarter of 2010.



A further source of growth was net exports. Exports strengthened, particularly of goods to non-EU trade partners, while imports weakened. Business investment and a slowing in the pace of inventory accumulation pulled down GDP growth by 1 percentage point. Business investment fell by 5.6% between the third and fourth quarters, while investment in other sectors grew by 1% and made a small positive contribution to GDP growth. Business investment in the final quarter of 2011 was more than 20% below its pre-recession peak.



The strong net trade performance contributed 1.2 percentage points to GDP growth between 2010 and 2011, greater than the figure for total GDP growth of 0.8%. This was offset by negative contributions from household final consumption (contributing -0.5 points to GDP growth) and fixed investment (-0.3 points).

Compensation of employees declined in the fourth quarter reflecting a combination of modest wage growth and weak employment growth in the fourth quarter. This was more than offset by growth in gross operating surplus of corporations and other sources of income, so that nominal GDP grew by 0.5%. This reflects the combination of the easing in inflation towards the end of 2011 and the weakness of real GDP growth.

Production

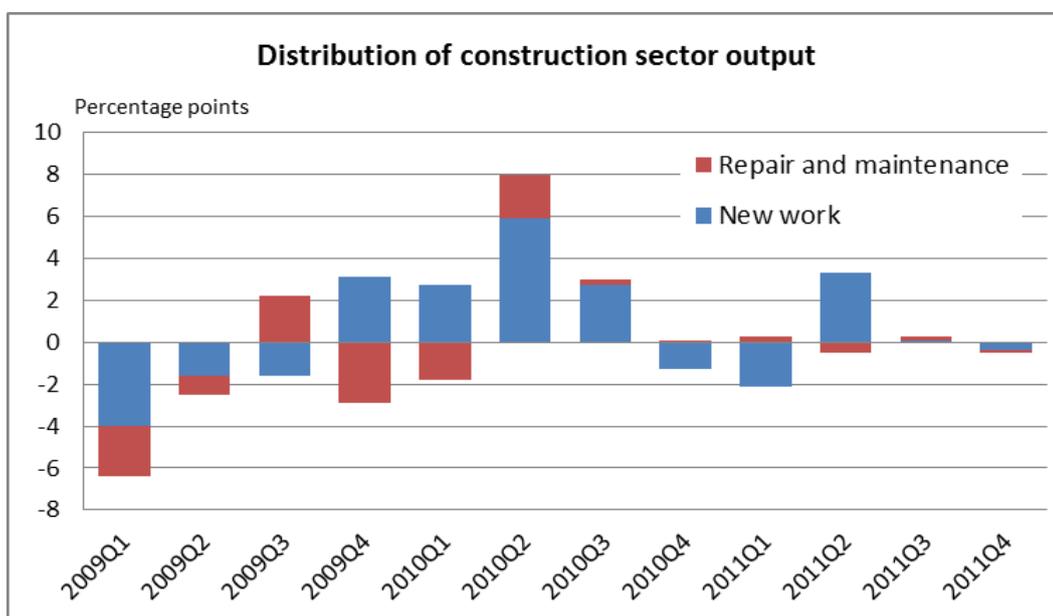
Although production sector output increased by 0.5% in December, output was 3.3% lower than a year earlier. Between the third and fourth quarters of 2011, output fell by 1.4% - the largest such fall since the first quarter of 2009.

The marked weakening of production sector output towards the end of 2011 is due to a gradual weakening of manufacturing output growth, which fell in the final quarter of the year, coupled with a sharp contraction of mining and quarrying output – largely North Sea oil and gas.

Construction

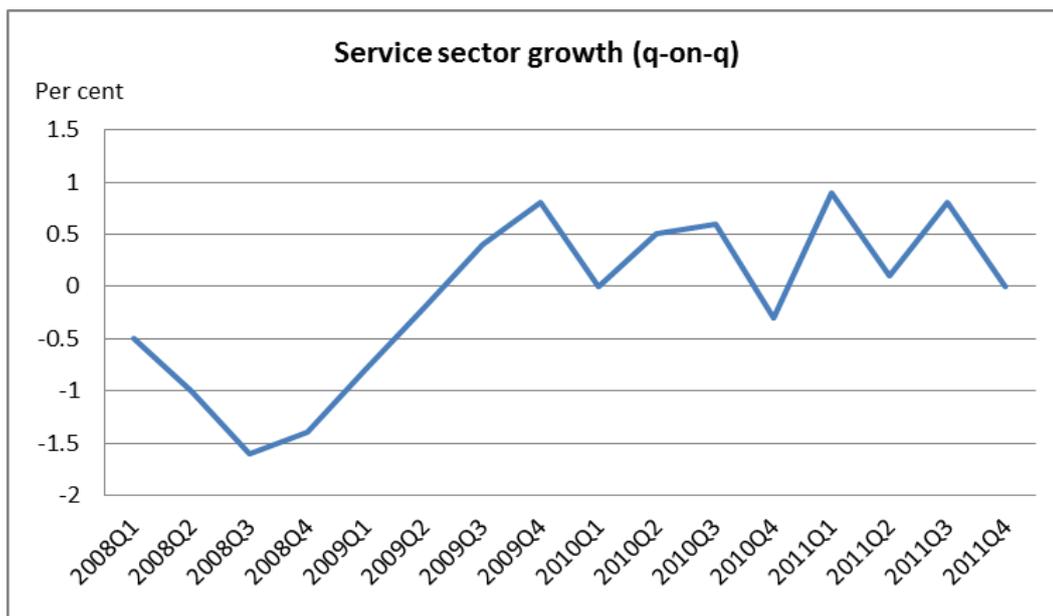
Construction sector output is predominantly driven by changes in the amount of new work undertaken, with repair and maintenance making a smaller contribution to construction sector growth (chart below).

The construction industry made a strong contribution to GDP growth during 2010, but this was more limited in 2011. During 2010 the construction sector grew by an average of 2.7% a quarter, compared with only 0.2% in 2011.



Services

The services sector was unchanged between the third and fourth quarters of 2011. This followed relatively strong growth in the third quarter of 0.8%. But since the second half of 2009, services sector growth has been somewhat volatile. Within the final quarter, the services sector experienced reasonably solid growth in November and December, following a weak performance in October.



Conclusion

The detailed data underlying the latest disappointing quarterly GDP estimate sheds light on what parts of the economy are performing well and what parts continue to struggle. From an output perspective, it shows that the production, services and construction sectors all have their own problems in creating sustained growth – with particular weakness in the early part of the final quarter of 2011.

In terms of the objective of ‘rebalancing’ the economy, the data provides some interesting insight. Positively, it appears that net trade is making an increasing contribution to GDP growth – developing a more export-oriented economy is a key element of the overall objective. However, household expenditure and recent retail sales figures seem to suggest that re-orienting the economy away from a reliance on domestic consumption is proving harder (although, of course, we face a difficult balancing act as we also need consumers to play a key part in any sustained recovery).

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Contacts

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