28st October 2015

ESSENTIAL READING

UK DEMAND & OUTPUT MONTHLY

November 2015

UK Team

GDP and latest nowcasts

	ONS Prelim	UK Team expectation	Consensus	Latest backcast
Q3	**0.5%**	**0.5%**	**0.6%**	**0.6%**
	Latest nowcast		Last month's expectation	
Q4	**0.6%**		**0.7%**	

This month's data at a glance

Output growth (%qoq)	2015 Q3	Q3e	Contrib. to error*	2015 Q2	2015 Q1
GDP	0.5	0.5	0.0	0.7	0.4
Services	0.7	0.7	0.0	0.6	0.4
- PNDS	1.0	0.9	0.0	0.7	0.3
- Distribution	0.9	1.0	0.0	1.1	1.1
- Govt	0.0	-0.1	0.0	0.1	0.1
Production	0.3	-0.1	0.1	0.7	0.3
- Manufacturing	-0.3	-0.6	0.0	-0.5	-0.1
- Energy	1.5	1.3	0.0	3.3	1.2
Construction	-2.2	-1.4	0.0	1.4	0.2

*Contributions do not sum due to rounding

Monthly Output Indices	Aug	Jul	Jun	May	Apr
Index of Services	0.0	0.2	0.6	0.2	0.1
- PNDS	0.0	0.3	0.8	0.3	-0.1
- Distribution	-0.3	0.2	1.0	-0.2	0.8
Index of Production	1.0	-0.4	-0.2	0.3	0.0
- Manufacturing	0.5	-0.8	0.2	-0.9	-0.4
Construction output	-4.3	-1.0	2.4	-0.7	-1.8

Trade and Retail Sales	Sep	Aug	Jul	Jun	May
Retail sales vols (inc fuel)	1.9	-0.4	0.5	-0.2	0.3
Retail sales vols (exc fuel)	1.7	-0.7	0.8	-0.3	0.3
Goods imports	n/a	0.4	4.6	11.2	-8.6
Goods exports	n/a	5.3	-6.9	10.0	-3.1

Survey Measures	Oct	Sep	Aug	Jul	Ave
CIPS Services*	-	53.3	55.6	57.4	55.1
CIPS Manufacturing*	-	53.2	53.0	52.7	53.3
CIPS Construction*	-	59.9	57.3	57.1	54.7
GfK Consumer Conf	-	1.9	4.3	3.3	-9.3

*CIPS Manufacturing, Construction and Services are confidential until the 2nd, 3rdand 4t of November.

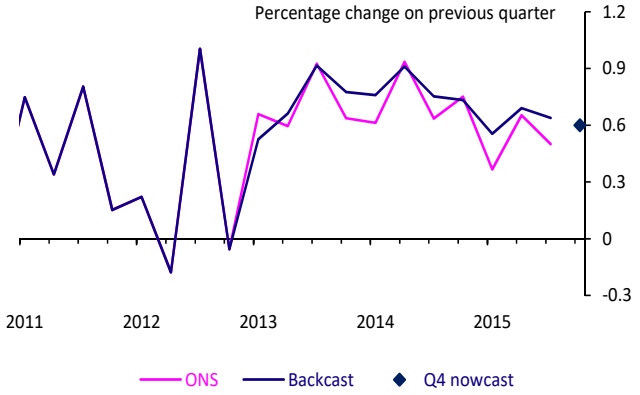
CBI Qtly Ind. Trends	2015 Q3	2015 Q2	2015 Q1	2014 Q4	Ave
Business optimism	-12	8	3	15	-5
Export optimism	-14	-5	-9	1	0
Investment intentions: buildings	-15	-14	-19	-5	-18
Investment intentions: machinery	-3	-3	-6	16	-2

GDP grew by 0.5% in Q3, in line with our expectation, and we expect it ultimately to be revised up to 0.6%.

Broad based weakness in manufacturing and construction was only partially offset by strong private services in Q3.

Our Q4 nowcast is now 0.6%, 0.1pp lower than the Benchmark forecast.

Chart 1: GDP growth



Q3 GDP growth was 0.5%

The ONS estimate that GDP grew by 0.5% in Q3 (Chart 1) in line with our expectation immediately before the release, but 0.1pp below our expectation in the August IR. We expect growth to be revised up to 0.6% as the estimate matures.

Quarterly growth slowed by 0.2pp between Q2 and Q3. That reflected a sharp turnaround in construction and a smaller positive contribution from the energy sector (Chart 2), only partly offset by stronger services sector output growth.

Within the services sector, growth in PNDS picked up by more than expected, 1.0% in Q3 from 0.7% in Q2. This was partially offset by weaker than expected distribution growth. Government services output was flat in Q3. Production growth came in stronger than expected both for manufacturing and energy. Energy contributed positively to growth for the third consecutive quarter in Q3, mostly accounted for by extraction, appearing to reflect fewer maintenance shutdowns of oil rigs than usual.

On the construction side, output fell 2.2% in Q3, the largest quarterly fall in construction output since Q3 2012. This came as downside news to our expectation of a contraction of -1.4%, based on monthly construction data received

Chart 2: Monthly GDP

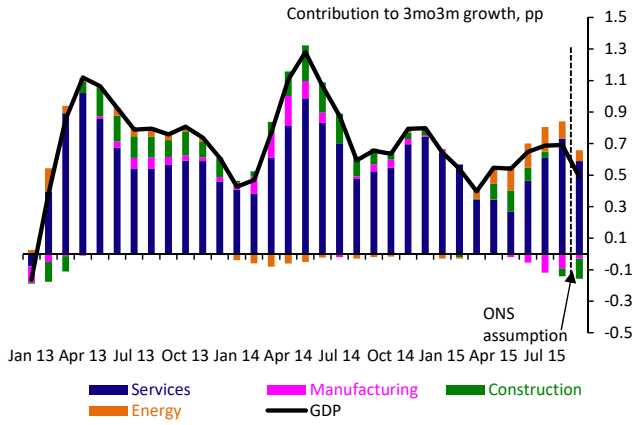


Chart 3: Retail Sales

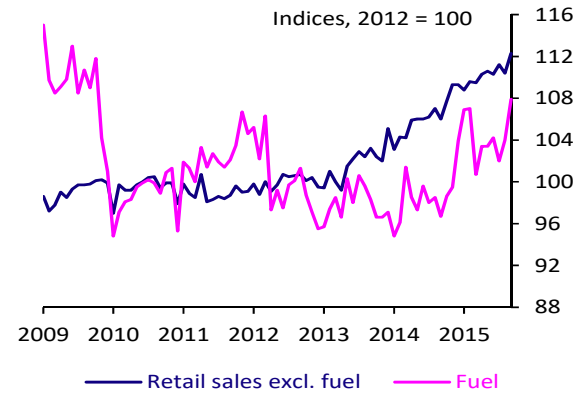
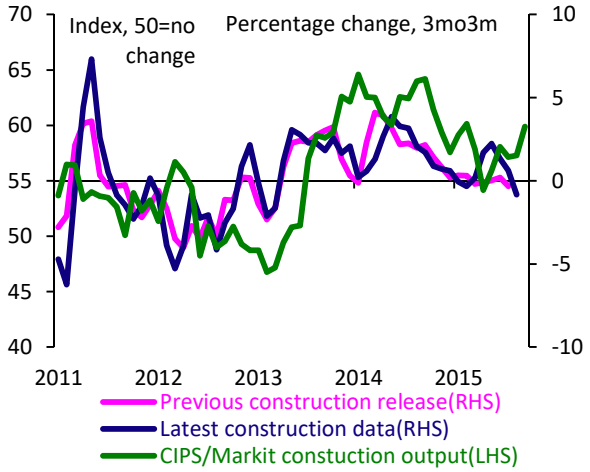


Chart 4: Construction Output*



*latest data vs last month's release

earlier in the quarter.

Strong distributive services and further boost from extraction

Retail sales volumes including fuel rose by 1.9% in September, representing the strongest monthly growth since December 2013 (Chart 3). While this release contained revisions to earlier in Q3 (downward in August and upward in July), overall three month on the month growth was still considerably stronger than ours and the market's expectation. There was strong growth across all retail sectors in September with the volume of fuel sales seeing the strongest growth on the month, increasing by 3.8%. There was also an increase in food store retailing for the first time in three months.

Extraction output unexpectedly contributed 0.05pp to quarterly GDP growth in Q3 for the third consecutive quarter. Annual growth, at 11%, was its highest since 1994. The strength is likely to reflect industry specific factors such as the low amount of maintenance undertaken this year. We expect a fairly flat profile for Q4.

Weak manufacturing and construction

Construction output fell by 4.3% in August (Chart 4), much weaker than our expectation. The recent weakness in the construction data is not supported by the latest survey data, which may suggest upward revisions.

The CBI quarterly manufacturing output balance fell sharply in the three months to October and is now negative for the first time since Q1 2013 (Chart 5). This corroborates the weak monthly ONS manufacturing output data for Q3. The expectations balance for output in the next three months also fell in this survey, and is now below average for the first time in four years.

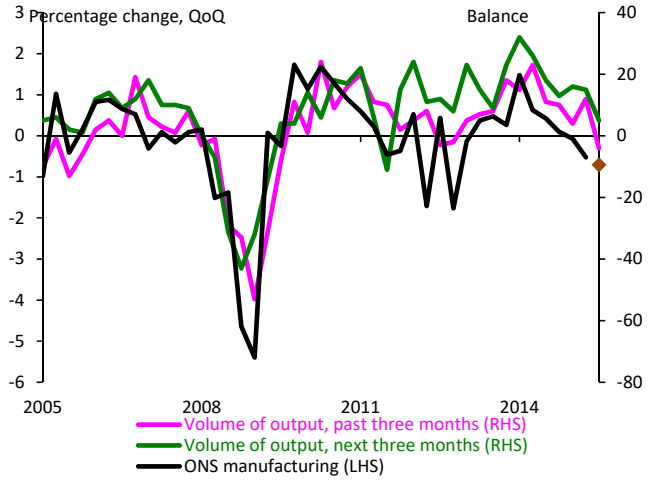
Composite CIPS/Markit flash estimates

Our flash estimates for the composite CIPS activity and expectations indices, which weight together the services and manufacturing indices, bounced back in October from the relatively weak outturns in September (Chart 6). [CARE: Market sensitive and confidential until 2nd Nov for Manufacturing and 4th Nov for Services]. CIPS activity and expectations indices get the largest weight in the Weighted Survey Model given their high correlation with the output data. The prediction of this model suggests steady growth of 0.5% for GDP between Q4 and Q1. We will provide more details on the sectoral split once the data become publicly available.

Our Q4 nowcast is at 0.6%

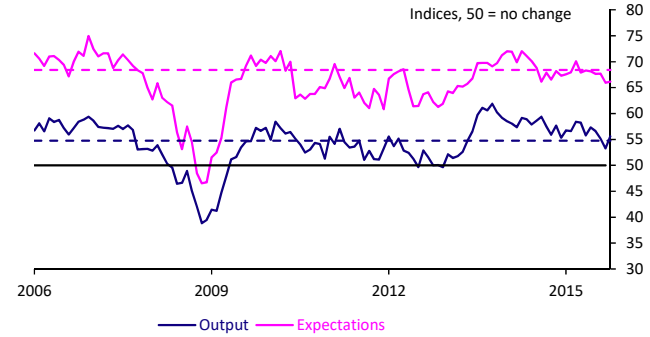
In part based on trends in the industry official and survey data discussed above, we expect Q4 growth to be 0.6%. This expectation is slightly lower than Benchmark and the August IR (0.7%), meaning that the slowing in growth between H1 and H2 would be a little more pronounced than we previously expected; annual growth would still be solid.

Chart 5: CBI Quarterly Industrial Trends



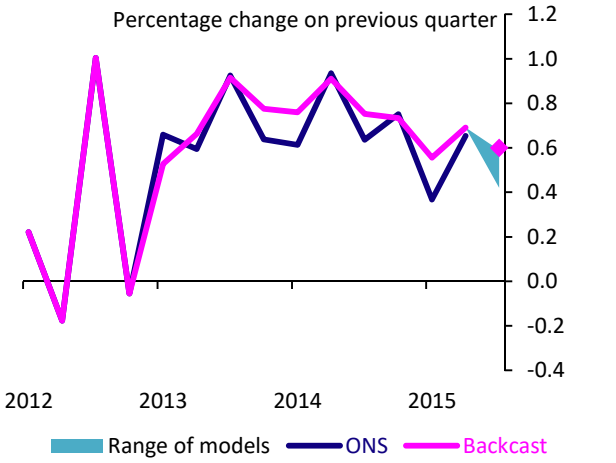
**Diamond indicates quarterly growth taking an average of monthly growth in Q3 2015 so far*

Chart 6: Composite CIPS



Dotted lines show 1997-2007 averages

Chart 7: Range of Models



Diamond shows current Q4 nowcast for mature GDP estimate. The range of models includes seven model predictions.

Our Q4 nowcast lies at the upper end of the range of our statistical models we use for nowcasting (Chart 7). Although it is consistent with the prediction of some of our best models, that range suggests downside risks to this prediction.