UK March GDP beats expectations as green shoots appear

The hit to UK activity in the first quarter was less bad than first feared, and more recently we've seen a range of indicators pointing to more buoyant economic conditions. We're looking for growth of 5% in the second quarter

1 UK GDP poised for a near-5% bounce in the second quarter

Fresh lockdowns and Brexit-related disruption at the start of the year translated into a 1.5% contraction in the size of the UK economy during the first quarter. This is considerably 'less bad' than first feared though, and more importantly, things have begun to improve since.

We can already see signs of this in the March data, which saw a 2.1% rebound in GDP. Admittedly, this is heavily driven by the reopening of schools, given child numbers feed directly into the calculations of education output. But we also saw a sizable recovery in retail sales during March, even before shops had reopened. Meanwhile, construction bounced by over 8% across February and March, taking activity there above pre-pandemic levels for the first time.

Since the start of the second quarter, we've also seen a broader improvement in everything from consumer confidence to the number of people taking public transport. In many cases, these moretimely indicators are now exceeding the level they reached last summer, which we think is linked to the public becoming more comfortable with going out and about again following the successful vaccine programme.

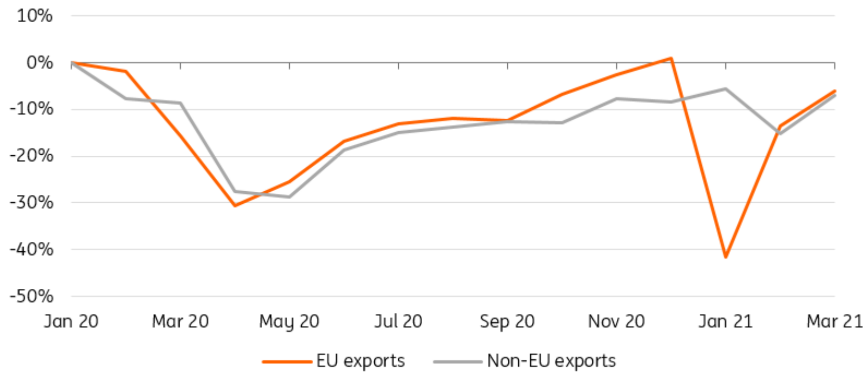
With a further reopening step now formally approved for Monday, we think GDP growth could come in just shy of 5% in the second quarter.

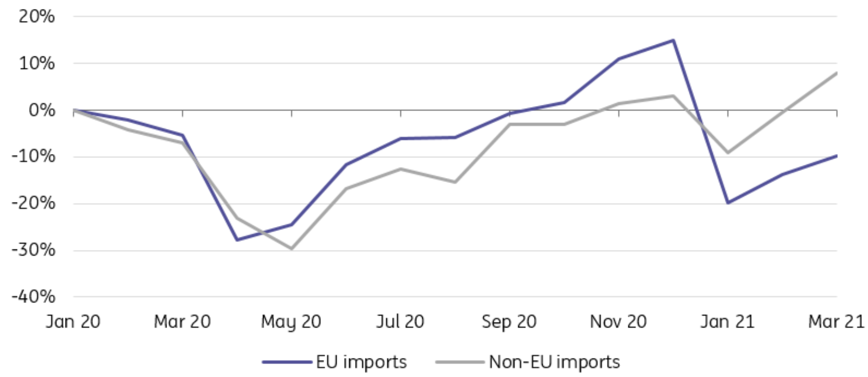
2 The economy could be close to pre-virus levels by year-end

We're a little more cautious than the Bank of England on this point, which thinks the economy will have exceeded pre-virus levels by the end of the year, though it all depends on three factors:

- Firstly, the level of pent-up demand is still fairly uncertain. Savings levels have risen and some of this buffer will undoubtedly get spent, though these cash balances have disproportionately benefited higher earners who tend to spend a smaller proportion of income gains.
- Secondly, the Treasury's 'super-deduction', a fairly generous tax incentive for firms to make investments in machinery/equipment, will boost (or more accurately perhaps, bring forward) CapEx this year – though again it's still fairly unclear by how much.
- And finally, the inclusion of Covid-19 testing and vaccines into the GDP figures has inflated the size of the UK economy, and by a big enough margin to make a difference to when the economy will return to pre-virus levels. Ultimately though, this is really just an accounting point.

EU vs. non-EU trade - percentage change from January 2020 levels





Source: ONS

Seasonally adjusted data. Jan 2020 = 0

3 UK trade situation improves as initial post-Brexit teething issues ease

One final piece of good news is that disruption stemming from the abrupt arrival of the UK-EU trade deal in January appears to have eased.

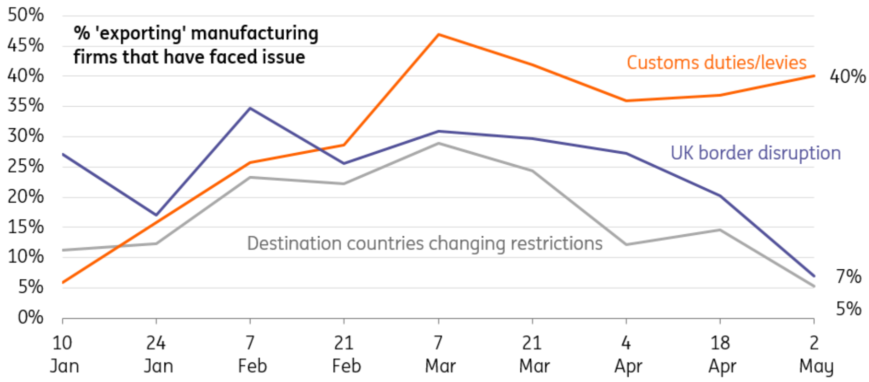
Exports to the EU – arguably the better barometer of difficulties, given most of the frictions so far have been on the EU-side – have recovered close to where they were at the tail end of last year. Imports are still lagging, but equally, there was evidence of stockpiling in 4Q last year, which distorts the picture.

This tallies with recent ONS survey data, which has shown a marked fall in the number of 'exporting' manufacturing firms reporting challenges with UK or overseas border disruption over recent weeks (though some of this may be Covid-related).

That said, other parts of the same survey show there's still a small chunk of firms still struggling with the changes. Trade data still shows things like food/live animal exports lagging more heavily behind late-2020 levels, reflecting higher levels of paperwork and transportation issues being experienced by the sector. Things are likely to become trickier again for various sectors when the UK government introduces full customs requirements from late-2021/early 2022.

The bottom line is that there will continue to be a slow-burning impact of new trade frictions on the UK economy, even if the immediate teething problems have passed.

The proportion of firms reporting export challenges from border disruption has fallen



Source: ONS Business Impact Survey, ING calculations

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Disclaimer