



The first estimate of GDP growth in the final quarter of 2010 has defied all expectations. Instead of recording positive but muted growth, as had been widely anticipated, output staged a chilling return into negative growth territory and fell by 0.5%, according to the Office of National Statistics. This contraction is attributed to severe weather conditions in the quarter rather than underlying weakness in the economy. Also, it should be noted that this estimate is a preliminary one based on limited data for December.

It is possible that the effects of the weather have been over- (or under) stated which will mean that the second and final estimates of growth in the quarter will probably be subject to some revisions. Nonetheless, in our opinion, the more worrying issue is the ONS' claim that if weather effects are excluded from the analysis, growth would have been flat rather than negative. This suggests that underlying growth was still much weaker (i.e. flat) than the 0.4-0.5% expansion that had been widely expected for 2010q4.

The broad sectoral detail suggests that manufacturing was the only key sector to see growth (+1.4%) in the final quarter of 2010. Construction output fell by 3.3% in the quarter while growth in services also recorded a decline of 0.5%. The weather is estimated to have had the greatest impact on the leisure, transport and hotels & catering sectors. Output fell by 0.5% in hotels & restaurants, by

0.8% in the transport sector, by 0.7% in business & financial services and by 0.2% in government services.

Due to this unexpected dip in economic growth in 2010q4, overall growth in 2010 now stands at an estimated 1.4%.

This latest estimate has certainly dampened any hopes of the recovery strengthening and has reignited fears of a double dip recession. As things currently stand, it is possible that growth in 2011q1 could benefit from a bounce-back after an excessively weak 2010q4. The danger is that there are many risks that could offset this potential gain. The VAT increase has kicked in and inflation surges ahead. Against such a fragile backdrop, it would take very little – perhaps another bout of poor weather – to easily tip the balance towards negative growth once again. Even if that is not the case, it is clear that the economy is standing at the brink of

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stagnation: flat output growth and rising inflation. These are difficult times and headwinds to growth are strengthening.

The only positive is that pressure will ease off the Monetary Policy Committee to raise interest rates. The Committee has held off raising rates citing inherent lingering weakness in the economy as their main reason. For the moment, their stance seems to have been vindicated.

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