ARBUTHNOT BANKING GROUP PLC

PERSPECTIVES

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November's growth takes GDP above the pre-pandemic February 2020 level for the first time

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Introduction: GDP buoyant in November

GDP increased by greater-than-expected 0.9% (MOM) in November, after the 0.2% rise in October (revised), and was above the pre-pandemic February 2020 level for the first time, by 0.7%.[1] Concerning the industrial breakdown, services, production and construction all increased in November.[2-4]

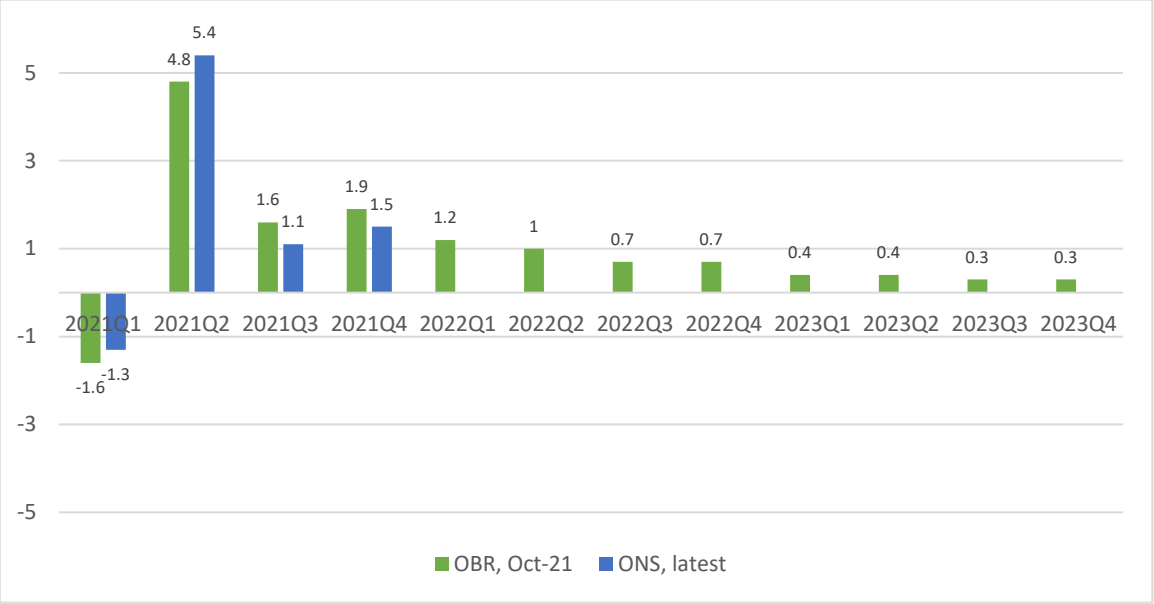
The service sector grew by 0.7% (MOM), to be 1.3% above the February 2020 level. Output in consumer-facing services (retail trade, food and beverage serving activities, travel and transport, and entertainment and recreation) grew by 0.8%, mainly because of a 1.4% increase in retail trade (retail sales were unexpectedly buoyant), while all other services rose by 0.6%. Consumer-facing services are, however, still 5.0% below their pre-coronavirus levels, while all other services are 2.9% above. At the services sub-sector level, 8 of the 14 had surpassed their pre-coronavirus levels, with the largest contributions from human health and social work activities, wholesale and retail trade, and arts, entertainment and recreation.

Output in the production sector increased by 1.0% (MOM) but was still 2.6% lower than in February 2020. Within output, manufacturing increased by 1.1%, with positive growth in 9 out of the 13 manufacturing sub-sectors. The main drivers of this growth were the manufacture of machinery and equipment nec and the manufacture of transport equipment. After two months of contraction, output in the manufacture of motor vehicles increased by 7.8% with anecdotal evidence around improvements to the sourcing of parts, although other businesses in this industry noted a continued supply shortage. "Electricity, gas, steam, and air conditioning supply" and "water supply and sewerage" also grew. Mining and quarrying was the only production sector to fall in November 2021, reflecting a fall in extraction of crude petroleum and natural gas. Finally, construction output increased by 3.5% (MOM) in November and the sector was 1.3% above its pre-coronavirus pandemic level. The increase in monthly construction output was driven solely by an increase in new work, while repair and maintenance saw a slight decline. At the sector level, the main contributors were infrastructure and private new housing.

Output is still expected to slow in December as new covid-related restrictions were introduced, following the Prime Minister's announcements (on 27 November and 8 December for England).[5] But the ONS commented that "if there are no other data revisions, quarterly GDP for 2021Q4 will either reach or surpass its pre-coronavirus level (2019Q4), provided our monthly December 2021 estimate does not fall by more than 0.2%". If GDP does indeed fall by 0.2% (MOM) in December, which does not seem totally

unreasonable, then QOQ growth in 2021Q4 would be around 1.5% (shown in chart 1, see annex table 1). However, this would be still down on the OBR's October forecast (1.9%), after a weaker-than-projected 2021Q3.

Chart 1 OBR forecast, ONS outturns, quarterly GDP growth profile (%)



Sources: (i) *ONS*, "GDP quarterly national accounts, UK: 2021Q3", 22 December 2021; (ii) *OBR*, "Economic and fiscal outlook", CP545, October 2021; (iii) *ONS*, "GDP monthly estimate: November 2021", 14 January 2022. See annex table 1.

…whilst the total trade balance improved a tad in November

The total trade (goods & services, including precious metals) balance showed a surplus of £0.6bn in November 2021, as the services surplus outweighed the goods deficit, compared with a surplus of £0.2bn in October.[6] A notable feature of the data was a large increase in the surplus on precious metals to £4.3bn (£1.6bn in October); most of the trade in precious metals is with non-EU countries. Excluding precious metals, the trade balance (the ONS's favoured "underlying" balance) deteriorated to a deficit of £3.7bn (after a deficit of £1.4bn in October).

Concerning the components (including precious metals):

- The visible (goods) deficit narrowed to £11.3bn (from £11.8bn in October), as exports rose by 8.5% (MOM) and imports increased by 4.9%. The improvement reflected a deterioration in the EU balance (a deficit of £5.7bn after October's £5.0bn) but an improvement in the non-EU balance (a deficit of £5.7bn after October's £6.8bn).
- Concerning services, the surplus was unchanged at £12.0bn, as exports grew by 0.2% (MOM), whilst imports rose by 0.4%.

The ONS noted that imports from non-EU countries continued to be higher than from EU countries (for the 11th consecutive month in November), partly reflecting the overall increase in imports of fuels from non-EU countries. The ONS also noted that "…previously announced timings of the UK leaving the EU and the subsequent transition period, along with the impact of the coronavirus pandemic, global recession and supply chain disruption, have caused higher levels of volatility in trade statistics in the past two years".

Productivity (output per hour) slipped in 2021Q3

The ONS has released its updated productivity estimates for 2021Q3.[7] There are two key measures, see table 1. The first measure, output per hour (the main measure of labour productivity, "productivity hours"), fell by 1.4% (QOQ) in 2021Q3, as gross value added (GVA) rose by 1.1% (QOQ) but total hours worked rose

by 2.5% (QOQ), reflecting falling furlough levels. The ONS has noted that …as furlough levels fell, hours worked rose. Furloughed workers were more likely to work in lower-productivity industries, so their return reduced whole economy productivity". Output per hour was, however, 1.1% above the level of pre-pandemic 2019 (average).

The secondly measure, output per worker rose by 0.3% (QOQ) in 2021Q3, as GVA rose by 1.1% but employment (workers) picked up by just 0.8%. Output per worker was, however, still 0.6% below the level of pre-pandemic 2019 (average), reflecting the continuation of the furlough scheme, who remained employed but work zero or reduced hours. The ONS has noted that "…with the ending of the CJRS in September 2021, 2021Q3 is the final quarter affected by furlough so the divergence between output per hour and output per worker should be much smaller from 2021Q4 onwards".

The ONS also reported that public service productivity was 8.1% lower in 2021Q3 than the 2019 average level, as the growth in 18.6% inputs had outpaced output growth of 8.9%.[8]

Table 1 Productivity measures, growth, 2021Q3

	QOQ	YOY	Compared with 2019 (annual average)
Output per hour	-1.4%	-4.5%	+1.1%
Output per worker	0.3%	6.2%	-0.6%
Constituent data:			
GVA	1.1%	6.7%	…
Hours worked (total)	2.5%	11.9%	…
Employment (workers)	0.8%	0.5%	…

Source: ONS, "Productivity overview, UK, 2021Q3", 11 January 2022. The data for GVA, hours worked, and employment (workers) are from figures 1 and 2, and the dataset.

The OECD reports inflation highest for 25 years…

The OECD has reported that inflation in the OECD area had surged to 5.8% (YOY) in November 2021, compared with 5.2% in October, and just 1.2% in November 2020, reaching the highest rate since May 1996 (chart 2a).[9] The rise was particularly marked in the US, where inflation climbed from 6.2% in October to 6.8% (YOY) in November. Note that US CPI inflation rose to 7.0% (YOY) in December, the highest rate since June 1982, driven by higher prices for shelter, used cars and trucks and food (energy prices actually slipped in the month).[10-11] In the euro area, inflation also increased strongly to 4.9% in November, although it remained lower than in the OECD area as a whole. UK CPI inflation was 4.6% in November.

Crucially energy prices "soared" by 27.7% (YOY) in the OECD area in November, and the highest rate since June 1980 (chart 2b). Food price inflation in the OECD area picked up strongly to 5.5% in November. Excluding food and energy, OECD inflation rose more moderately, to 3.8% (YOY) in November.

Chart 2a CPI inflation (YOY): OECD, US, euro area and the UK

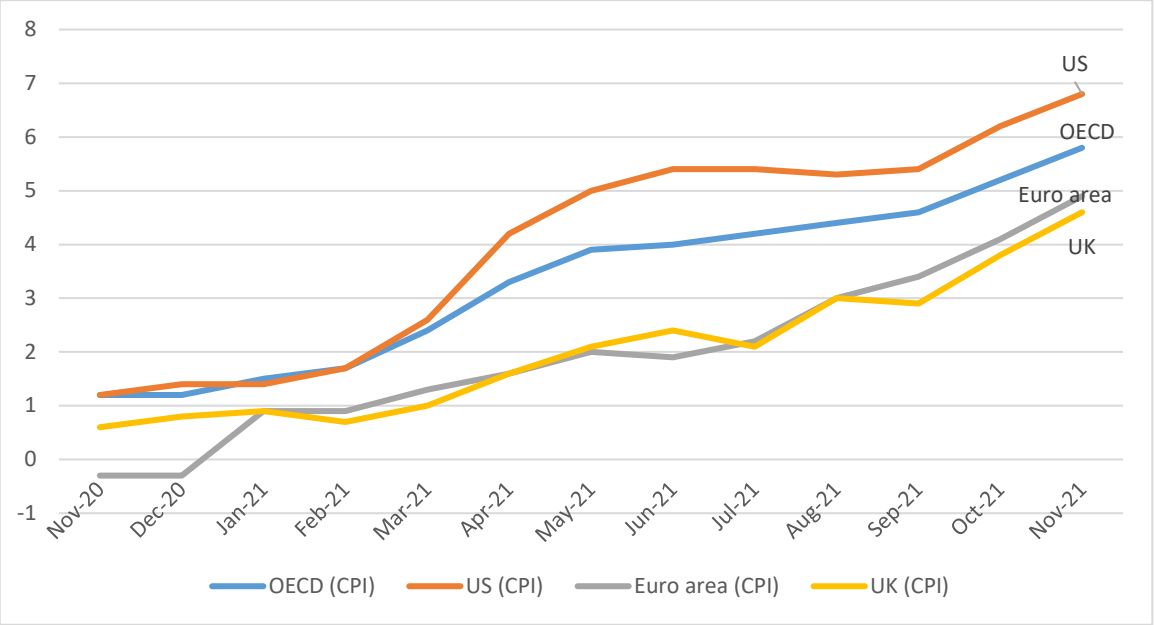
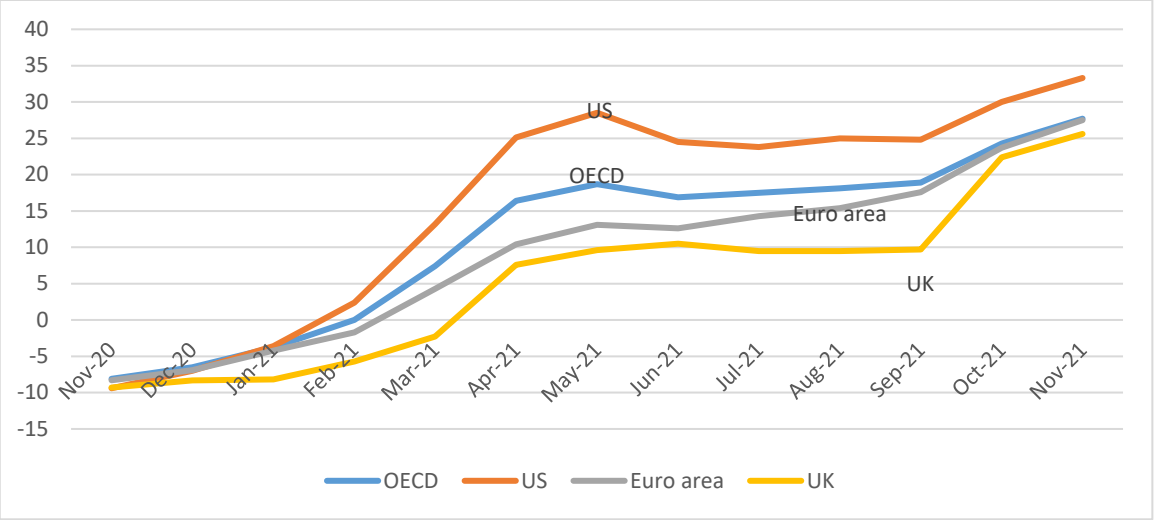


Chart 2b Energy prices inflation (YOY): OECD, US, euro area and the UK



Source: *OECD*, "Inflation in the OECD area continues to surge to 5.8% in November 2021, the highest rate in 25 years", 11 January 2022.

…and the World Bank sees growth slowing

The World Bank concluded in its latest *Global Economic Prospects* report that "…following a strong rebound in 2021, the global economy is entering a pronounced slowdown amid fresh threats from COVID-19 variants and a rise in inflation, debt, and income inequality that could endanger the recovery in emerging and developing economies."[12] Global growth is expected to decelerate markedly from 5.5% in 2021 to 4.1% in 2022 and 3.2% in 2023 as "…pent-up demand dissipates and as fiscal and monetary support is unwound across the world", see charts 3a-3b.

The World Bank commented that the slowdown will coincide with a widening divergence between advanced economies and emerging and developing economies (EMDEs). Growth in advanced economies is expected to decline from 5% in 2021 to 3.8% in 2022 and 2.3% in 2023 and, even though the pace is moderating, it is expected to be sufficient to restore output and investment to their pre-pandemic trend in these economies. By 2023, the advanced economies were expected to have achieved a full output recovery. In contrast output in the EMDEs, particularly in Sub-Saharan Africa, Latin America and the

Caribbean (LAC), the Middle East and North Africa (MENA), and South Asia, was expected to remain below its pre-pandemic trend over the forecast period.

Meanwhile, inflation was running at the highest rates since 2008, globally and in advanced economies. In EMDEs, it had reached its highest rate since 2011 and "…many EMDEs were withdrawing policy support to contain inflationary pressures, well before the recovery is complete".

Chart 3a World Bank growth forecasts (%): January 2022

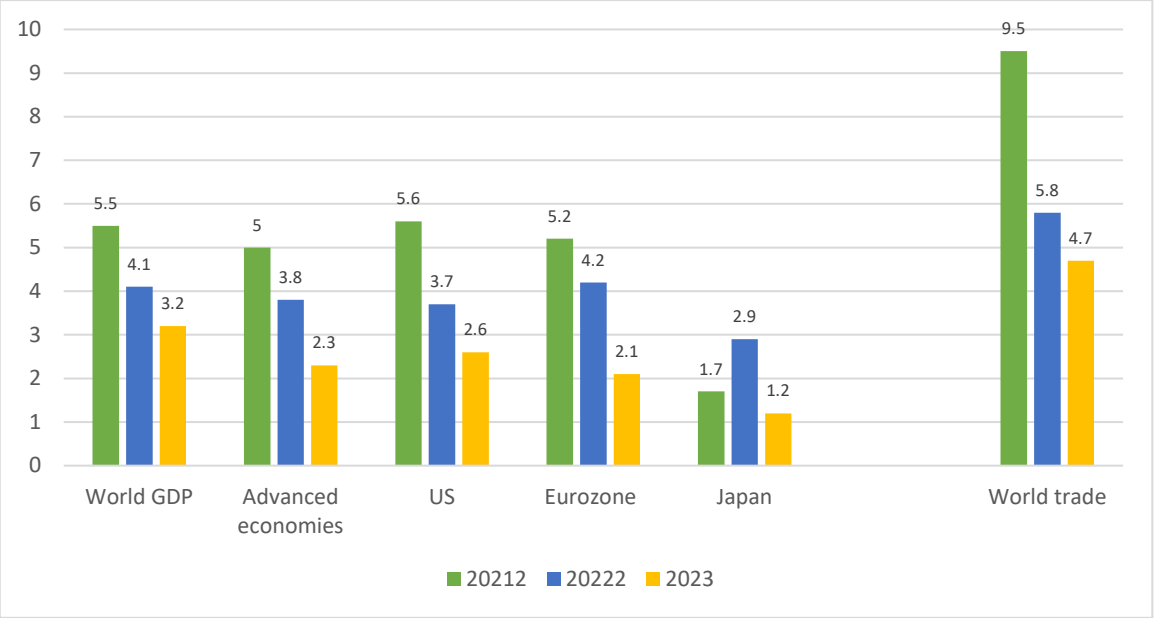
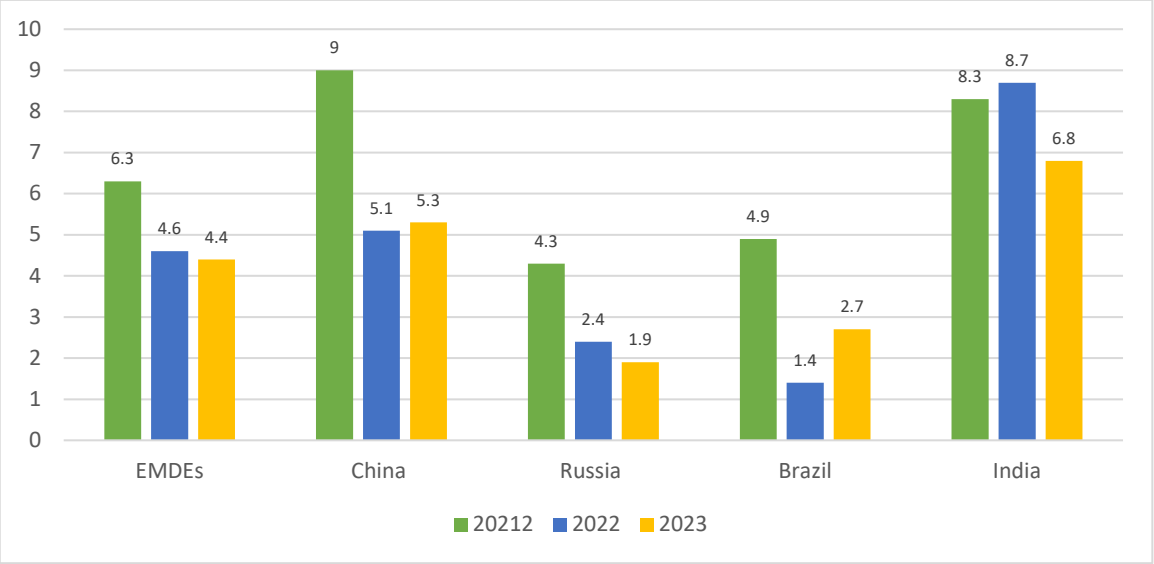


Chart 3b World Bank GDP forecasts (%), EMDEs: January 2022



Source: *World Bank*, "January 2020 Global Economic Prospects: Global growth to slow through 2023, adding to risk of "hard landing" in Developing economies", 11 January 2022, see annex table 2. EMDE=Emerging Market & Developing Economies.

Oil and gas prices update

Oil prices weakened in November over concerns about the omicron Covid variant, raising concerns over new travel restrictions and a general undermining of the demand for oil. However, prices have since recovered as Governments have, on the whole, resisted tough lockdown restrictions, thus supporting activity and, crucially, the demand for oil.[13] Brent crude oil futures were around $86pb on 14 January, having dipped to under $69pb on 1 December 2021 (chart 4a). As widely expected, OPEC+ agreed at their 4

January 2022 meeting to increase their overall production total by 400,000 bpd for the month of February 2022, as previously planned.[14-15]

Natural gas prices have picked up strongly since mid-2021, reflecting reopening businesses after lockdown, geopolitical tensions with Russia and expectations of a cold winter (chart 4b). UK natural gas futures spiked at a record of over 450 pence per therm (p/therm) on 21 December 2021 but have since eased back, helped by warmer weather and "a flotilla of US LNG tankers".[16] Prices had fallen to 170 p/therm by 31 December, but firmed to 235 p/therm on 6 January 2022. Prices weakened in the second week of January, as it was reported that the Dutch government was mulling over boosting output at its largest natural gas field. Prices were 203 p/therm on 13 January 2022. Despite this easing of gas prices, it should be noted that, at 206 p/therm, prices are still around 4 times greater than they were in 2021H1. In January 2021, they were around 55-65 pence per therm.

Chart 4a Brent oil futures, $ per barrel ($pb), monthly prices (1st of month, or nearest), 1 June 2014-1 January 2022, & 14 January 2022

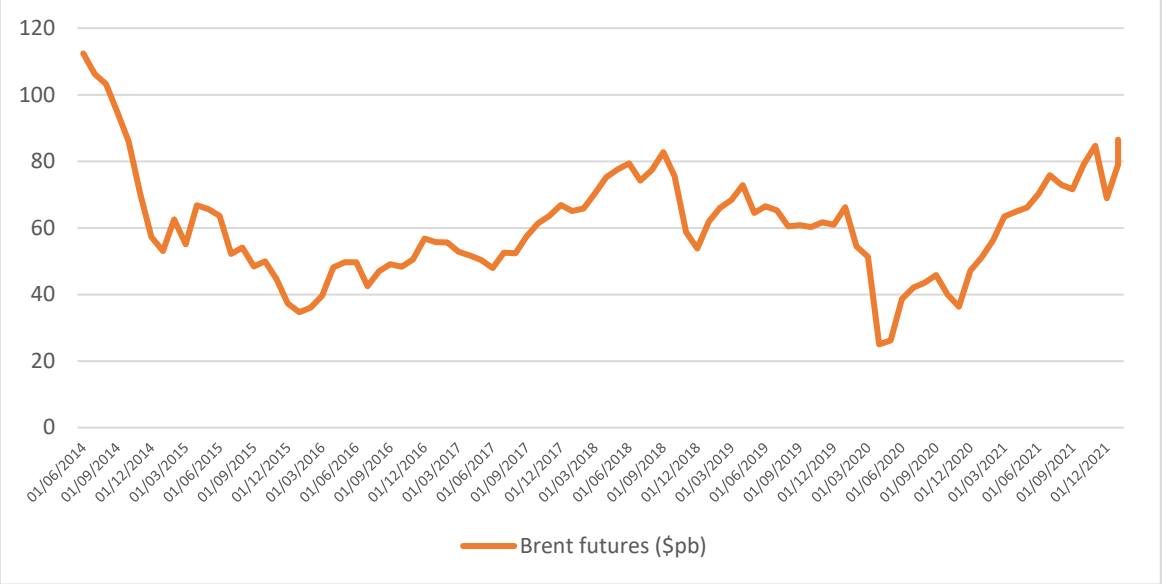
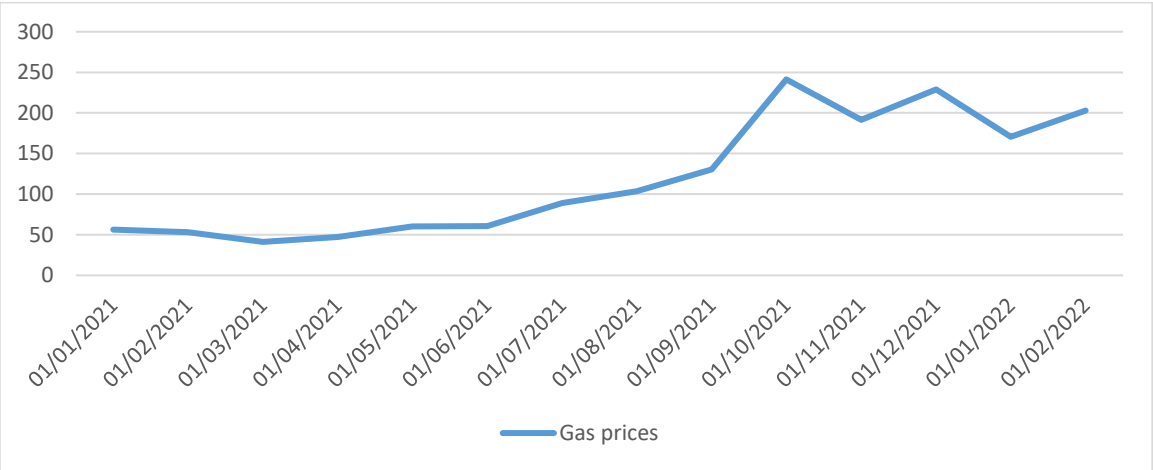


Chart 4b Natural gas prices (p/therm) (1st of month, or nearest), 1 June 2021-1 January 2022, & 14 January 2022



Sources: (i) Brent crude historical prices, www.uk.investing.com; BBC website 1 January 2021-1 January 2022, and 14 January 2022 ("01/02/2022" on chart for presentational purposes); (ii) natural gas prices (pence per therm), BBC website 1 January 2021-1 January 2022, and 14 January 2022 ("01/02/2022" on chart for presentational purposes).

References

1. *ONS*, "GDP monthly estimate: November 2021", 14 January 2022.
2. *ONS*, "Index of Production, UK: November 2021", 14 January 2022.
3. *ONS*, "Index of Services, UK: November 2021", 14 January 2022.
4. *ONS*, "Construction output in GB: November 2021", 14 January 2022.
5. Ruth Lea, "Surveys suggest growth slowed in December, reflecting rising Covid cases and tighter restrictions", *Arbuthnot Banking Group*, 9 January 2022.
6. *ONS*, "UK trade: November 2021", 14 January 2022.
7. *ONS*, "Productivity overview, UK, 2021Q3", 11 January 2022.
8. *Daily Telegraph*, "Public sector less productive after record government spending", 12 January 2022.
9. *OECD*, "Inflation in the OECD area continues to surge to 5.8% in November 2021, the highest rate in 25 years", 11 January 2022.
10. *US Bureau of Labor Statistics*, "Consumer price index summary", 12 January 2022.
11. *BBC*, "US consumer prices rise at fastest rate in nearly 40 years", 12 January 2022.
12. *World Bank*, "January 2020 Global Economic Prospects: Global growth to slow through 2023, adding to risk of "hard landing" in Developing economies", 11 January 2022, table 1.1.
13. *Reuters*, "Oil rally to continue in 2022 as demand outstrips supply, analysts say", 12 January 2022.
14. OPEC, "24th OPEC and non-OPEC Ministerial Meeting", 4 January 2022.
15. *CNBC*, "OPEC+ agrees oil output hike from February as omicron Covid cases soar", 4 January 2022.
16. Trading Economics website. www.tradingeconomics.com, section on UK natural gas. UK Natural Gas Futures is a national benchmark price.

Annex

Table 1 GDP (2019=100), data from 2019Q1

	Quarterly (QOQ growth in brackets)	Annual (growth in brackets)
2019		100.0
2020Q1	97.6 (-2.6%)	
2020Q2	78.6 (-19.5%)	
2020Q3	92.4 (17.6%)	
2020Q4	93.8 (1.5%)	
2020		90.6 (-9.4%)
2021Q1	92.6 (-1.3%)	
2021Q2	97.7 (5.5%)	
July	98.8	
August	99.0	
September	99.5	
2021Q3	98.7 (1.1%)	
October	99.7	
November	100.6	
December	100.4 (-0.2%, MOM), projection	
2021Q4	100.2 (1.5%)	
2021		97.3 (7.4%)

Sources: (i) *ONS*, "GDP quarterly national accounts, UK: 2021Q3", 22 December 2021; (ii) *ONS*, "GDP monthly estimate: November 2021", 14 January 2022.

Table 2 World Bank GDP forecasts (%), January 2022

	January 2022			Percentage point differences from June 2021 projections		
	2021	2022	2023	2021	2022	2023
World	5.5	4.1	3.2	-0.2	-0.2	0.1
Advanced economies:	5.0	3.8	2.3	-0.4	-0.2	0.1
US	5.6	3.7	2.6	-1.2	-0.5	0.3
Eurozone	5.2	4.2	2.1	1.0	-0.2	-0.3
Japan	1.7	2.9	1.2	-1.2	0.3	0.2
EMDE:	6.3	4.6	4.4	0.2	-0.1	0
East Asia & Pacific:	7.1	5.1	5.2	-0.6	-0.2	0
China	9.0	5.1	5.3	-0.5	-0.3	0
Europe & Central Asia:	5.8	3.0	2.9	1.9	-0.9	-0.6
Russia	4.3	2.4	1.9	1.1	-0.8	-0.5
Latin America & the Caribbean:	6.7	2.6	2.7	1.5	-0.3	0.2
Brazil	4.9	1.4	2.7	0.4	-1.1	0.4
Middle East & North Africa:	3.1	4.4	3.4	0.6	0.8	0.1

South Asia:	7.0	7.6	6.0	0.1	0.8	0.8
India	8.3	8.7	6.8	0	1.2	0.2
Sub-Saharan Africa:	3.5	3.6	3.8	0.7	0.3	0
Memorandum items:						
World trade volume	9.5	5.8	4.7	1.2	-0.5	0.3
Oil price (change)	67.2	7.2	-12.2	16.9	7.2	-13.1

Source: *World Bank*, "January 2020 Global Economic Prospects: Global growth to slow through 2023, adding to risk of "hard landing" in Developing economies", 11 January 2022, table 1.1.
EMDE= Emerging market & developing economies.