Daily Themes

4 November 2009

The fog of economic battle

Monday saw the release of the stronger-than-expected UK Manufacturing Purchasing Managers' Index (PMI) for October. This suggests that when the Composite PMI is released later today it will, unlike the official GDP data, continue to signal that the economy has emerged from recession. Analysis of historical revisions to GDP data indicates that over time, the official data will be revised so that it looks more consistent with the PMI evidence. Inconsistent economic data is the norm around turning points. While this does not make the Bank of England's task any the easier when it meets to set monetary policy tomorrow, we continue to expect that the Bank will decide to extend its quantitative easing programme.

Monday's stronger-than-expected Manufacturing PMI suggests that when the Composite PMI for October is released, it will at the very least, hold September's reading of 55.3. It might even rise further above the 50 level, which has historically marked the threshold between economic expansion and contraction. The Composite PMI is currently consistent with the UK economy growing at a quarter-on-quarter pace of around 0.5%.

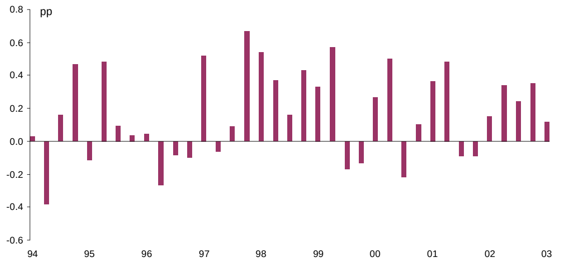
The PMI evidence of growth is in stark contrast to the first official GDP estimate for the third quarter which showed a contraction of 0.4%. So, either the UK economy expanded or contracted by about half a percent depending on whether you believe the PMI or official GDP data.

In reality, the truth probably lies somewhere between these two extremes. Since the PMI data series only started in 1998, it has no record of tracking the economy through a severe recession. Consequently, it is probably overestimating the strength of the economy. In contrast, the historical tendency for first estimates of GDP data to be revised upwards suggests that the official GDP data are probably presenting too gloomy a picture of the economy.

The compilation of quarterly GDP estimates does not end after the publication of the first estimate. GDP estimates continue to be revised for a number of years after the initial publication, reflecting the availability of more data and of improvements in measurement methods. While the first estimate of GDP, which comes out 25 days after the end of the quarter contains just 44% of the data, the second estimate, which comes out 55 days after the end of the quarter contains 67% of the data, and the third estimate, which comes out 85 days after the end of the quarter, contains 80% of the data. Changes in methodology can result in revisions going back over many years.

Since 1994 the mean revision between the first and the third estimate of quarter-on-quarter GDP growth is just +0.04 percentage points, with a range of -0.30 pp to +0.30 pp. However, between the first and the latest estimate that is at least three years old, the mean revision is a more significant +0.17 pp with a range of -0.38 pp to +0.67 pp.

GDP revision between first estimate and latest



Source: OECD, Coutts

Despite the evidence that the GDP data might paint too bleak a picture of the economy, we expect the Bank of England to err on the side of caution and to extend its quantitative easing programme.

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