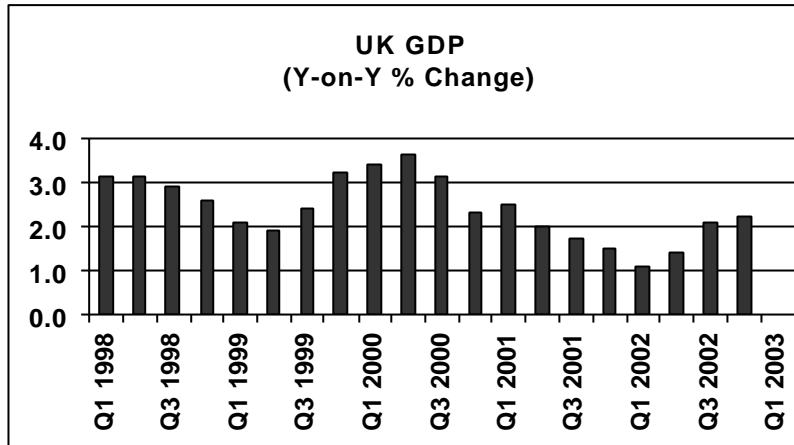


## UK Growth Subdued in Q4

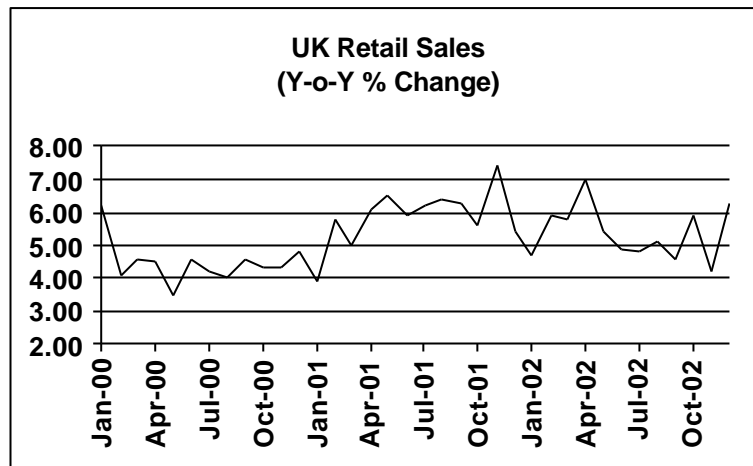


In the final quarter of 2002 the UK economy expanded by a modest 0.4 per cent, compared with 0.9 per cent in the previous quarter. The annual rate of growth was 2.2 per cent. Growth for the calendar year 2002 as a whole is estimated as 1.7 per cent over 2001. This follows growth of 2.0 per cent for 2001.

Construction output continued to be buoyant in the fourth quarter but manufacturing declined again. Service sector growth of 0.6 per cent compares with 0.9 per cent in Q3. There was evidence of more moderate growth across most parts of services. The data suggest a sharp slowdown. However, growth in Q2 and Q3 2002 was affected by the Jubilee Bank holiday. As a result of the holiday activity in manufacturing, retail sales and other business services was depressed in June, causing growth to be lower in Q2 and subsequently higher in Q3 than would have otherwise been the case.

The consumer was undoubtedly the mainstay of the UK economy in 2002. Expenditure grew by around 4% in real terms last year, supported by an accommodative monetary policy. The decline in unemployment to very low levels has further helped underpin household expenditure. Consumer spending has also been supported by the strong rise in house prices. House price inflation, at well over 20%, has seen increased equity withdrawal to finance consumer purchases. The level of current consumer spending being financed through borrowing or mortgage equity withdrawal is estimated to have risen to levels not seen since the late 1980s.

Towards the end of last year there were signs that the strength of consumer demand could be waning, with a fall back in the level of consumer borrowings and falling consumer confidence. However, several factors should continue to support the consumer sector. As yet, there has been little deterioration in the labour market, despite the difficulties facing the manufacturing sector. In addition, with interest rates at low levels, the burden of debt servicing should not become too onerous. Thus, while the pace of growth of consumer demand is likely to moderate in 2003, real growth in consumer spending could still be close to 3% year-on-year.



A sharp fall in house prices or a marked rise in unemployment would pose a serious risk to consumer demand in 2003. There are reports of lower house prices in some of the more expensive areas, around London in particular. Overall, though, there is, as yet, little indication of anything more than a modest decline in the pace of house price inflation. Our benchmark scenario is that house prices will continue to rise, but at a much slower pace than in 2002. Meanwhile, the labour market is expected to remain reasonably resilient as the economy is not growing that far below trend and labour hoarding is likely in the current tight jobs market. The strength of public sector employment growth is also helping support the labour market. Labour market conditions are thus unlikely to pose a major risk to consumer demand.

UK fiscal policy remains supportive of growth. On the basis of the pre-budget report and ahead of any changes announced in the budget itself, fiscal policy is expected to boost GDP growth by 0.3% in the fiscal year 2003/04. Government commitments to improve the public services mean that government expenditure is likely to rise by around 4% in real terms in 2003. However, with the strength of consumer demand expected to moderate, the manufacturing sector remaining depressed, thereby stifling investment growth, and in the absence of any strong rebound in external demand, GDP growth is likely to remain below trend in H1 2003. Growth, though, should pick up to around trend levels in the second half of the year if, as expected, the global economy recovers. This would mean that GDP growth could average close to 2.5% for the year as a whole, making the UK the most likely economy to achieve trend growth in 2003.

**Geraldine Concagh**  
**24 January, 2002**