Chief Economist's Weekly Brief

The Royal Bank of Scotland Group

# Economic resurrection

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**Spring has sprung and even the economic news is starting to brighten. The manufacturing sectors of the world's major economies have recovered momentum, and the much-watched US labour market is adding jobs at encouraging if unspectacular rate.**

**Industrial activity is gaining momentum across the globe.** In the UK, the headline manufacturing PMI, a leading indicator of activity, recorded its sixth consecutive month of expansion (above 50) rising from 56.5 in February to 57.2 in March. This was the strongest gain in over fifteen years. Not to be outdone, manufacturers in Germany recorded the largest increases in almost ten years as its PMI increased above 60 from 57.2 in February. No mean feat given this strength was enough to propel the Eurozone equivalent to its highest reading in three years, at 56.6. A strong performance was also evident on the other side of the Atlantic, as the US ISM index of manufacturing jumped to its highest level since 2004. There are still risks, but rising new orders and gains in employment across the economy suggest that the US recovery may finally be self-sustaining.

**The weak pound finally looks to be helping the UK's trade position.** The UK's deficit with the rest of the world narrowed sharply in Q4, declining from £5.9bn in Q3 to £1.7bn, or 0.5% of GDP. Only in one quarter over the last ten years has the balance of payments been in better shape. Interestingly, the UK's deficit on trade in goods actually deteriorated, as imports rose faster than exports. But this was more than offset by a higher surplus on the income account, which almost doubled to £10.3bn, thanks to higher earnings from the UK's business investments abroad. A weak pound played its part by making foreign currency earnings worth more when converted to sterling.

**There were more mixed signals from the UK housing market.** The number of house purchase approvals fell back slightly to 47k in February, the third consecutive monthly fall. This is broadly consistent with relatively weak demand reported by the Royal Institution of Chartered Surveyors and the Bank of England's Credit Conditions Survey. Net mortgage lending was also flat on the month. That said, usually a decline in approvals one month is echoed in similar weakness in house prices the next. Yet house prices increased by 0.7% m/m in March, according to Nationwide, reversing February's fall. Annual growth is now positive in all regions except for Northern Ireland. The phenomenon of fat prices in thin markets continues.

**As 2009 drew to a close the UK grew a little more than previously thought.** The economy grew at a more sprightly 0.4% q/q pace in Q4, rather than 0.3% as previously thought. The largest revision was to domestic demand, which saw a hearty 0.8% q/q jump from an earlier estimate of 0.5%. Unfortunately, the impetus came from stocks, which were run-down at a much slower rate than in previous quarters.

**UK employee compensation fell for the first time on record in 2009, in data stretching back to the 1950s.** Despite declining incomes, households still pushed to save more over the course of the year. The saving ratio (i.e. how much households save from their income) moved to c7% by Q4 - a marked change from before the financial crisis when households were living beyond their means and the savings ratio was negative (with households spending more than they were earning). This has been a difficult adjustment - saving more has meant spending and borrowing less. Nevertheless, this marks a move to a more sustainable pattern. Rather than rely on asset price increases to accumulate wealth, households are saving more. Future spending increases could be tied more closely to the growth in incomes and saved wealth than asset price increases.

**Employment in the US looks like it may be turning the corner**. The number of workers on firms' payrolls increased by 162K last month, the fifth rise in five months and the largest gain since March 2007. Much of this increase came from the private sector taking on more employees. Construction, retail and manufacturing all added to their staff, in contrast to financial services where employment slipped again. We can expect government hiring to boost payroll figures over the next few months, as workers are recruited to complete this decade's census.

**In the euro area everything was up, but it wasn't all good news**. The flash estimate of CPI for March suggests that inflation jumped to 1.5% from 0.9% in February. This is the fastest rate of inflation since December 2008, but is more likely to reflect higher energy prices than mounting demand pressures. Indeed, the unemployment rate reached double-digits in March for the first time since August 1998. Slovenia was the only Eurozone country to see unemployment fall, and then by only 0.1 percentage points.

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