



## Economics Weekly

1 March 2010

### Can UK exports boost the recovery in 2010?

Net trade is expected to boost UK growth in 2010, but recent evidence suggests the opposite

Part of the reason is that sterling reversed some of its depreciation, and the markets where most of UK exports are destined grew only slowly or contracted

Hence, the UK has a challenge to ensure that net trade contributes positively to growth in 2010

Figures for December showed a widening in the UK's trade deficit in goods with the rest of the world to £7.3bn from £6.8bn in November. This represented the worst monthly outcome since January 2009 and called into question the expectation that UK growth in 2010 will be boosted by 'net trade', as exports exceed imports. In December, UK imports of goods rose by 5.2% while exports rose by 4.5%. Figures in the second release of UK gdp for Q4 2009 highlight how difficult the path to a strong economic recovery will be in 2010. Although Q4 growth was revised up from 0.1% in the first release to 0.3% in the second, all of the growth came from stocks and government spending. A slower pace of de-stocking added 0.5 of a percentage point to Q4 growth, while government spending contributed a further 0.3 of a point. UK net trade (total exports minus total imports) deteriorated, however, depressing Q4 growth by 0.2 of a percentage point, despite signs of a pick-up in global demand and the competitive boost afforded by the sharp fall in the pound.

In other words, had it not been for the stocks and government spending components, which are unsustainable sources of growth over the medium term, UK Q4 GDP would have posted its seventh consecutive negative reading. In 2009 as a whole, net trade did contribute positively to gdp growth, but in Q4 this contribution became negative, see chart a. What is surprising is that the worsening trend of net trade in 2009 occurred even though the pound was weak on a trade-weighted basis against the UK's top trading partners, and the economy contracted by 5% in the year as a whole. The latter - weaker growth in domestic demand - usually contributes to a lessening of import demand. In addition, a weaker currency is also

Table 1: UK trade in goods by sector

Industrial sector	£bn, net trade balance (exports less imports)
Chemicals and chemical products	8.7
Fishing	0.1
Machinery and equipment	-0.6
Coke, refined petroleum and nuclear fuel	-1.0
Non-metallic minerals	-1.2
Pulp, paper, publishing	-2.1
Wood and wood products	-2.3
Rubber and plastic products	-2.8
Basic metals and fabricated products	-2.9
Leather and leather products	-3.4
Other manufacturing	-6.4
Agriculture, hunting and forestry	-6.5
Mining & quarrying	-7.4
Transport equipment	-9.5
Textiles and textile products	-11.8
Food products and beverages	-13.7
Electrical and optical equipment	-19.1
Total	-81.9

expected to contribute to a rise in exports and a fall in imports. This combination is supposed to lead to a narrowing in the external deficit and hence to a positive contribution of net trade to real gdp growth.

For last year as a whole, the story of a positive contribution from net trade does seem to hold true. While exports dropped 10.9% in 2009, imports dropped by 12.1%, leading to a net contribution to real gdp growth of 0.7 of a percentage point (exports took 3 percentage points from gdp but imports took 3.7 percentage points off gdp so a relative gain of 0.7 of a point occurred). But as the chart shows, as the year progressed, the positive contribution of net trade to gdp lessened dramatically - so much so that by Q4 it had turned negative for gdp. Although we are hopeful that net exports will provide a meaningful contribution to growth over the coming quarters, so far there is little sign that either (i) more expensive imports are encouraging a shift towards domestic demand; or that (ii) UK exporters are using the

Chart a: Net trade contribution to gdp turns negative

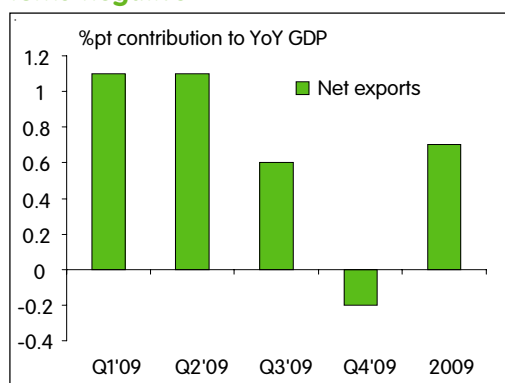
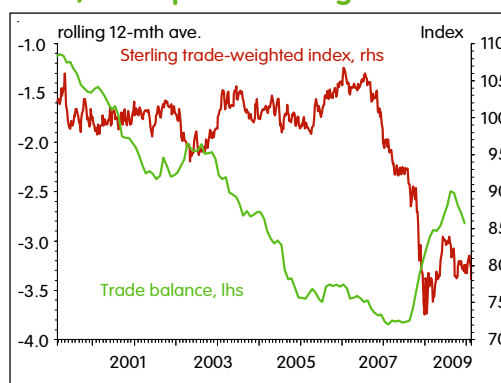


Chart b: Weaker sterling has boosted trade, but impact is waning



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## 2010 calendar of central bank meetings

**European ECB** (1.00%)  
4 March, 8 April, 6 May,  
10 June, 8 July  
**US FOMC** (0-0.25%)  
16 March, 28 April, 23 June  
**UK MPC** (0.50%)  
4 March, 8 April, 6 May, 10  
June, 6 July

## Rolling calendar of UK data releases and events

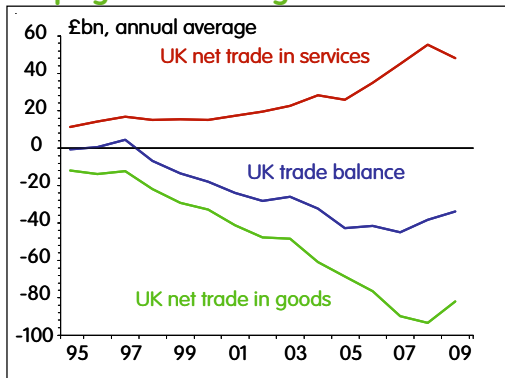
Mortgage approvals (01/03)  
PMI manufacturing (01/03)  
Services PMI (03/03)  
Producer prices (05/03)  
Trade balance (09/03)  
Industrial production (10/03)  
NIESR GDP est (10/03)  
BoE MPC minutes (17/03)  
Labour market stats (17/03)

## Rolling calendar of US data releases and events

Core PCE deflator (01/03)  
ISM manufacturing (01/03)  
ADP employment (03/03)  
ISM non-manu. (03/03)  
Fed Beige Book (03/03)  
Factory orders (04/03)  
Nonfarm payrolls (05/03)  
Average earnings (05/03)  
Consumer credit (05/03)

\* All charts are sourced to Lloyds TSB Corporate Markets Economic Research, Bloomberg, and Thomson Datastream

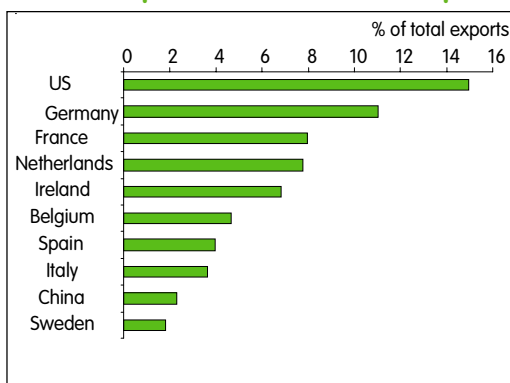
## Chart c: UK services trade crucial in keeping deficit manageable



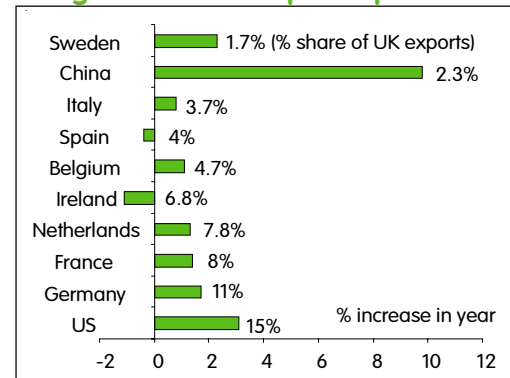
competitive advantage from the fall in the exchange rate to gain market share. Worryingly, our analysis (see Weekly - 8th February), suggests that UK exporters have responded to the decline in sterling by raising prices. While this should have some positive spillovers in terms of supporting domestic demand, it is not as effective for the economy as a rise in the volume of exports by allowing export prices to fall in line with the weaker currency.

But factors other than a desire by firms to just widen profit margins may also be at work. First, chart c shows that the improvement in the trade balance coincided with a sharp fall in the effective exchange rate index, but this fall has partly reversed and now so has the improvement in the trade deficit. This would imply that a greater degree of sterling weakness at a lower permanent level is required to lead to a sustained improvement in net trade. Second, the UK deficit

## Chart d: Top ten markets for UK exports



## Chart e: Consensus projections for 2010 GDP growth for UK's top 10 export markets



in goods is so poor that only two sectors, chemicals and fishing, are in surplus, see table 1. Although the trade deficit in goods for 2009 as a whole improved to £81.9bn after hitting a record of £93.4bn in 2008, it remains large at 5.9% of gdp. As chart c shows, only a large surplus in services, 3.5% of gdp, brings the UK's total external deficit down to a manageable 2.4% of gdp.

The third factor is that the current mix of UK export markets may not be the best combination required to lead to an improvement in net trade. Chart d depicts the UK's ten top export markets, as a share of its exports of goods in 2009. Top of the list is the US; bottom of the list is Sweden. Looking at economic growth in 2010, based on consensus forecasts for these countries (see chart e), shows that the strongest growing market, China, accounted for just 2.3% of UK exports in 2009. Admittedly, the next fastest growing of this list, the US, accounted for 15% of UK exports. However, the other economies, (aside from Sweden that absorbed 1.7% of UK exports) are expected to expand fairly modestly or contract in 2010. This means that 2010 may not see as much of a contribution from net trade as expected, making it harder for the economic recovery to build momentum. In short, the headwinds facing the UK economy in 2010 remain substantial, even after a poor 2009.

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## Weekly economic data preview

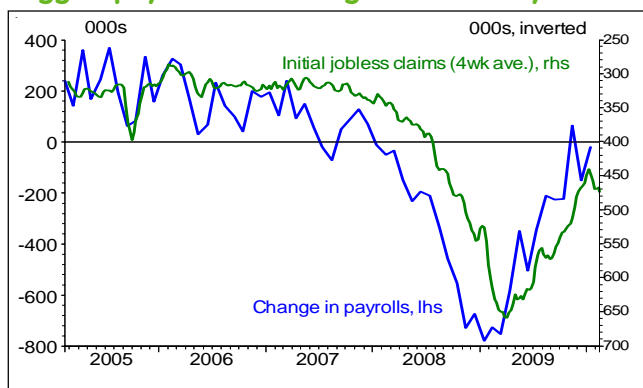
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### Poor weather to cast cloud over upcoming data

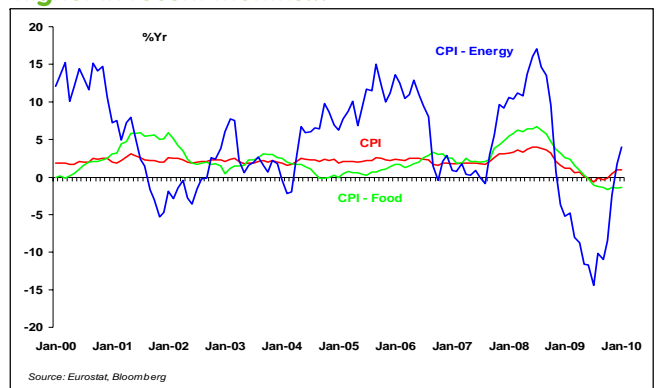
- The UK Monetary Policy Committee (MPC) reconvenes this week amid continued bewilderment as to why the Committee failed to raise the QE target last month, despite the benign medium-term inflation forecast outlined in the Bank of England's latest Inflation Report. Last week's upward revision to Q4 GDP, from 0.1%q/q to 0.3%q/q, may provide some ex-post justification for the decision although, on closer inspection, the improvement was driven predominantly by stocks and government spending, neither of which is expected to be sustained. Nevertheless, the upward revision, coupled with the temporary surge in CPI inflation, suggests little prospect of any change in policy this week. We expect Bank rate to be left unchanged at 0.5%, with the suspension of the APF almost certain to be kept in place. On the UK data front, the February PMIs are likely to take centre stage. After the sharp improvement in January, we expect the manufacturing PMI to drop back a little (from 56.7 to 56.5). Meanwhile, the services PMI is forecast to have picked up (from 54.5 to 55.2) after the weather-distorted drop in January. The PMIs point to continued growth in GDP in Q1 2010, although in recent quarters the correlation between these surveys and the official GDP data has not been particularly strong. The PPI and net consumer credit reports are also due. Producer prices are expected to show both output and input prices rose by 0.2% on the month in February, while the rise in VAT and the cold weather point to a renewed fall in net consumer credit last month. Also this week, we should see confirmation of the weather-impacted downturn in the housing market, with mortgage approvals forecast to have dropped sharply last month.
- As is so often the case, the data highlight in the US this week is provided by the labour market report on Friday. The severe weather in February has added another degree of complexity to forecasting monthly payrolls, with its impact generally expected to lead to a further modest fall. The consensus estimate is -40K, while we look for something closer to -50k, supported by the weak initial claims data, see chart 1. After an unexpectedly sharp fall in the unemployment rate in January, we look for it to edge up slightly to 9.8% from 9.7%, while earnings growth is likely to remain subdued. The details of the report will underline that the recovery remains fragile and why the Fed is in no hurry to raise interest rates. The other main US data releases this week, including January personal spending (Monday), February ISM surveys of manufacturing (Monday) and services (Wednesday) and January factory orders (Thursday) will provide clues about growth prospects in Q1, after figures last week showed the economy expanded by 5.9% in the previous quarter.
- In the euro-zone, latest developments regarding Greece have centred on the ratings agencies, where both Standard & Poor's and Moody's have hinted at a possible reduction in Greece's long-term credit rating. Complicating the picture further were reports that a number of German banks would not be investing new money in Greek government bonds, raising possible questions about the effectiveness of any future EU bailout for Greece. The spread of 10-year Greek government bond yields over equivalent German bunds has widened out to around 350bp. This week's main feature will be the ECB's monetary policy decision, where we expect the main refinancing rate to stay on hold at 1%. Since February's Governing Council meeting, euro-zone Q4 GDP data have disappointed so we expect little change in Jean-Claude Trichet's language that the euro area recovery path is likely to be 'uneven' going forward. This week's meeting also sees the latest set of ECB staff economic projections, while markets will also be watching for the precise terms of the ECB's last 6-month Long-Term Refinancing Operation. Other data releases this week include the second estimate of euro-zone Q4 GDP, where we look for an unrevised outturn of +0.1% quarter-on-quarter, February's final PMI survey data and preliminary euro-zone CPI data for February, where we envisage an unchanged annual rate of 1.0%.

Adam Chester, Jeavon Lolay, Mark Miller

**Chart 1: Softer weekly initial jobless claims figures suggest payrolls declined again in February**



**Chart 2: Energy prices have pushed euro-zone CPI higher in recent months...**





## 1 - 5 March 2010

Country	Time	Event	Actual	Consensus	Forecast	Previous
<b>Mon 1st</b>						
FR	08:50	Manufacturing PMI (Feb) F		54.6	54.6	54.6
GE	08:55	Manufacturing PMI (Feb) F		57.1	57.1	57.1
EC	09:00	Manufacturing PMI (Feb) F		54.1	54.1	54.1
UK	09:30	Net consumer credit (Jan)		-0.2B	-0.2B	0.1B
UK	09:30	Net lending sec. on dwellings (Jan)		0.8B	0.6B	1.2B
UK	09:30	Mortgage approvals (Jan)		49.0K	47.0K	59.0K
UK	09:30	M4 Money supply (Jan) F		n/a	n/a	0.6% (5.1%)
UK	09:30	Manufacturing PMI (Feb)		56.3	56.5	56.7
EC	10:00	Euro zone unemployment rate (Jan)		10.1%	10.0%	10.0%
CA	13:30	Industrial product price index (Jan)		0.5%	0.5%	-0.1%
CA	13:30	Raw materials price index (Jan)		1.9%	1.5%	-1.7%
CA	13:30	GDP (MoM) (Dec)		0.4%	0.3%	0.4%
CA	13:30	GDP annualised (Q4)		4.0%	4.0%	0.4%
US	13:30	Personal income (Jan)		0.4%	0.3%	0.4%
US	13:30	Personal spending (Jan)		0.4%	0.3%	0.2%
US	13:30	PCE deflator (Jan)		(2.2%)	(2.2%)	(2.1%)
US	13:30	Core PCE deflator (Jan)		0.1% (1.5%)	0.2% (1.6%)	0.1% (1.5%)
US	15:00	ISM manufacturing (Feb)		57.8	57.5	58.4
US	15:00	Construction spending (Jan)		-0.6%	-0.8%	-1.2%
JN	23:30	Household spending (Jan)		(2.7%)	(2.1%)	(2.1%)
JN	23:30	Jobless rate (Jan)		5.2%	5.2%	5.1%
<b>Tue 2nd</b>						
UK	02-06	Halifax house prices (Feb)		0.2%	n/a	0.6% (3.6%)
AU	00:30	Retail sales (Jan)		0.5%	0.7%	-0.7%
AU	03:30	RBA Cash target		3.75%	4.0%	3.75%
UK	09:30	Construction PMI (Feb)		48.8	48.9	48.6
EC	10:00	Euro zone CPI (flash) (Jan)		(1.0%)	(1.0%)	(1.0%)
EC	10:00	Euro zone PPI (Jan)		0.6% (-1.1%)	0.4% (-1.3%)	0.1% (-2.9%)
CA	14:00	Bank of Canada rate decision		0.25%	0.25%	0.25%
<b>Wed 3rd</b>						
AU	00:30	GDP (Q4)		0.9% (2.4%)	0.9%	0.2% (0.6%)
GE	07:00	Retail sales (Jan)		-0.7%	-0.6%	0.9% (-2.5%)
FR	08:50	PMI services (Feb) F		54.7	54.7	54.7
GE	08:55	PMI services (Feb) F		51.7	51.7	51.7
EC	09:00	PMI services (Feb) F		52.0	52.0	52.0
UK	09:30	PMI services (Feb)		54.9	55.2	54.5
EC	10:00	Retail sales (Jan)		-0.5% (-1.7%)	-0.7% (-1.7%)	0.0% (-1.4%)
US	13:15	ADP employment change (Feb)		-10K	-18K	-22K
US	15:00	ISM non-manufacturing (Feb)		51.0	51.0	50.5
<b>Thur 4th</b>						
EC	10:00	GDP (4Q) 2nd est		0.1% (-2.1%)	0.1% (-2.1%)	0.1% (-2.1%)
UK	12:00	BoE interest rate decision		0.50%	0.50%	0.50%
UK	12:00	BoE asset purchase target		200B	200B	200B
EC	12:45	ECB interest rate decision		1.00%	1.00%	1.00%
US	13:30	Nonfarm productivity (Q4) F		6.2%	6.2%	6.2%

**1 - 5 March 2010**

Country	Time	Event	Actual	Consensus	Forecast	Previous
US	13:30	Unit labour costs (Q4)		-4.4%	-4.4%	-4.4%
US	13:30	Initial claims (w/e 27 Feb)		475K	480K	496K
CA	15:00	Ivey PMI (Feb)		55.0	55.0	50.8
US	15:00	Factory orders (Jan)		1.2%	1.2%	1.0%
<b>Fri 5th</b>						
UK	09:30	PPI input (Feb)		0.0% (7.5%)	0.2% (7.7%)	2.0% (8.4%)
UK	09:30	PPI output (Feb)		0.3% (4.1%)	0.2% (4.0%)	0.4% (3.8%)
UK	09:30	PPI output (core) (Feb)		0.2% (2.8%)	0.3% (2.9%)	0.3% (2.5%)
GE	11:00	Factory orders (Jan)		1.3%	1.5%	-2.3% (8.4%)
US	13:30	Change in nonfarm payrolls (Feb)		-40K	-50K	-20K
US	13:30	Unemployment rate (Feb)		9.8%	9.8%	9.7%
US	13:30	Average earnings (Feb)		0.2% (2.2%)	0.2% (2.2%)	0.2% (2.0%)
US	20:00	Consumer credit (Jan)		-\$3.4B	-\$6.0B	-\$1.7B

**Key events of the week**

<b>Mon 1st</b>	EC	ECB member Stark speaks in Germany (19:45)
	US	Fed member Lacker speaks in Washington (14:45)
<b>Tue 2nd</b>	UK	DMO to auction £2bn of 4.25% gilts due 2039 (10:30)
	US	Fed member Kocherlakota speaks in Minneapolis (18:00)
<b>Wed 3rd</b>	EC	Germany to auction €5bn of 5yr bonds (10:15)
	UK	DMO to auction £4bn of 2.75% gilts due 2015 (10:30), Fed member Rosengren speaks in Philadelphia (14:15), Fed member Lockhart speaks in New York (18:00), Fed releases its Beige Book economic report (19:00)
<b>Thu 4th</b>	EC	France to auction €8.5bn of bonds (10:00), ECB interest rate decision (12:45), followed by Trichet's conference (13:45)
	US	Federal Budget (05:00), Fed member Evans speaks in Chicago (18:00), Fed member Bullard speaks in Minnesota (18:15)
	UK	Bank of England MPC interest rate decision
<b>Fri 5th</b>		No key events

Source: Bloomberg

NB: Data in brackets denote YoY. Market consensus estimates are taken the preceding Friday.