

# Trade and industry

15<sup>th</sup> March 2010

**The recovery in the West appears to have begun with a whimper rather than a bang in January. Industrial output had a shaky start to the year and trade flows for the UK and US slackened off – hardly indicative of a “re-balancing” towards the production and export of goods that policymakers would like to see.**

**The UK’s hope for an export led recovery faded slightly in January as the trade deficit widened.** The difference between the value of imports and exports increased by £1.2bn in January to £3.8bn - the largest gap since August 2008. The deterioration was the result of a slump in exports, which fell 4.4% compared to December. It’s important not to read too much into changes over a single month. Cold and icy weather disrupted production (see below) and interfered with goods getting to port. The weak pound is likely to support UK exports going forward, but at the same time it will increase the price of imports and this will make it harder to close the trade gap.

**UK industry started the New Year with a stutter as production fell for the first time in five months.** Output fell 0.4% compared to December as production declined in nine out of the thirteen manufacturing sub-sectors. Non-manufacturing production (i.e. oil and gas extraction and energy supply) increased over the month, but this was not enough to offset the declines elsewhere. The now familiar scapegoat of cold weather was blamed for the disappointing out-turn, an explanation that fits nicely with a greater demand for heating which boosted the supply of electricity and gas. Looking beyond the month-to-month fluctuations, the underlying trend in production is flat – not falling further, but not leading the recovery either.

**The Royal Institution of Chartered Surveyors (RICS) provided further evidence the UK housing market recovery may be softening.** The net balance of estate agents reporting price rises fell in February, down to almost half the level it was in January. The RICS survey also reported that the sales to stock ratio, a measure of the balance between supply and demand, fell slightly, suggesting an easing in the supply constraints that have supported prices in recent months. New instructions to sell outpaced new buyer inquiries for the second consecutive month and most agents expect this trend to continue. A majority of agents still expect prices to rise over the next three months, although they anticipate the pace of price growth will moderate.

**By contrast, commercial property prices continued their recovery in February.** Prices rose by 1.3% m/m, the seventh consecutive increase since their trough in July last year. Capital valuations have risen 11% since then, but remain 38% below their 2007 peak. The increase was led by retail property, while industrial property prices (factories, etc.) lagged behind. As capital valuations have risen, so property yields have fallen. With long-term interest rates starting to rise, and hence making property yields relatively less attractive, property values might struggle to advance at the same pace for much longer.

**In the US, the trade deficit narrowed unexpectedly in January, shrinking \$2.6bn to \$37.3bn.** The value of imported goods dropped 1.7% m/m as the US imported the lowest number of barrels of oil in any month for a decade. Petroleum inflows tumbled \$2.3bn compared to December - a surprising outcome given the cold weather. Exports also dropped for the first time in nine months. Much of the decrease was due to a drop in aircraft and automobile exports, the former being particularly prone to large fluctuations.

**US consumers look to be gaining in confidence.** Retail sales improved last month, with headline spending up 3.9% compared to February 2009. Core retail sales, which exclude highly volatile auto and gas spending and give a better assessment of consumer demand, advanced 2.0% y/y. Monthly sales were markedly stronger than in January despite the severe winter weather but spending on automobiles fell for the third consecutive month, indicating weak underlying demand since the end of the “cash for clunkers” program in November. It is unclear if this upward trend in spending can be sustained given the ongoing weakness in the labour market.

**Industrial output in the euro area started the year in more buoyant fashion.** Goods production rose 1.7% m/m in January, the fastest rate of increase in two decades. This rebound was fuelled by a rise in energy output and in the production of durable consumer goods, which rose by 2.6% and 2.0% respectively. Total output increased for the first time on a year-on-year basis since April 2008, though industrial production remains around 20% below its pre-recessionary level.

**Within the euro area there was a significant variation in performance.** In Ireland industrial production rose 15% in January compared to December (following a very weak final quarter of 2009), while output in the region’s largest economy, Germany, rose 0.6% m/m. Both did much better than Spain, where output slumped 1.1%.

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