U.K. Economy Unexpectedly Shrinks in Longest Slump

By Jennifer Ryan

Oct. 23 (Bloomberg) -- U.K. gross domestic product unexpectedly dropped in the third quarter as enduring slumps in services, manufacturing and construction kept the economy mired in its longest recession on record. The pound tumbled.

GDP fell 0.4 percent from the previous three months, the Office for National Statistics said today in London. Economists predicted a 0.2 percent increase, according to the median of 33 forecasts in a Bloomberg News survey. None forecast a contraction. The economy has now shrunk over six quarters, the most since records began in 1955.

The figures add to Prime Minister Gordon Brown's woes as he struggles to cement a recovery in time for a general election due by June, and suggest Bank of England officials may need to extend their bond-purchase program on Nov. 5. Chancellor of the Exchequer Alistair Darling said today he stands by his forecast that the economy will start growing this year.

"The fact that the economy is still contracting despite the huge amount of policy stimulus supports our view that the recovery will be a long, slow process," said Vicky Redwood, U.K. economist at Capital Economics Ltd in London and a former central bank official. "An extension to QE at the upcoming November meeting now looks even more likely."

The pound fell as much as 1.3 percent after the report and traded at $1.6415 as of 10:50 a.m. in London.

First Report

The data, the first for the third quarter from a Group of Seven nation, suggests Britain may turn out to be the last of them to exit the recession sparked by the worst financial crisis since the Great Depression.

Central banks in Canada and Italy both forecast slumps in their economies ended in the same period, and the U.S. probably also returned to growth then, according to the median forecast of economists in a Bloomberg News survey. France, Germany and Japan exited their recessions in the second quarter.

U.K. services industries, which account for 76 percent of the economy, shrank 0.2 percent on the quarter, the statistics office said. The drop was led by distribution, hotels and catering, followed by transport, storage and communication, and business services and finance.

Industrial production shrank 0.7 percent as manufacturing contracted 0.2 percent, the statistics office said. Construction slumped 1.1 percent.

Across the Board

"The surprise is across everything," said Michael Saunders, an economist at Citigroup Inc. "It means the debate for QE is still very much alive." At the same time, "these data will probably get revised upwards, they usually are."

The Bank of England already plans to buy 175 billion pounds worth of government bonds and officials say they won't decide on whether to purchase more until they have new forecasts in time for next month's rate decision.

The economy's output is "well below" the levels of a year earlier and there should be no illusion of a "smooth and painless" return to sustainable growth, Bank of England Governor Mervyn King said this week. Officials said at the Oct. 8 meeting that there is still a danger of further losses.

Credit losses and writedowns worldwide now total $1.6 trillion. Lloyds Banking Group Plc and the government are weeks away from an agreement on whether the lender can escape a program to insure up to 260 billion pounds of potentially toxic assets, a person familiar with the matter said yesterday.

Setback for Brown

Today's report is a setback for Brown as his ruling Labour party struggles to erode the poll lead held by David Cameron's Conservatives. The opposition party had a 17 percentage-point gap over Labour in an ICM Research poll for the Guardian newspaper published on Oct. 21.

"I have always been clear that growth will return at the end of the year, as my budget forecasts assumed," Darling said in a statement released by the Treasury in London today.

The report contrasts with data from Europe today showing the region’s recovery is picking up.

A composite index of manufacturing and services industries rose to 53 from 51.1 in September, the highest since December 2007, Markit Economics said. German business sentiment improved to the highest since September 2008 this month, according to the Ifo institute, and French consumer spending rose in September for the first time in three months.

‘Intensive Care’

“The U.K. is certainly still in intensive care as the euro-area shows signs of recovery,” said Colin Ellis, an economist at Daiwa Securities SMBC Europe Ltd. who used to work at the central bank. “There has clearly been a divergence.”

Some U.K. companies are weathering the slump. British Sky Broadcasting Group Plc, the U.K.’s biggest pay-television provider, said today that first-quarter profit rose. “We have won more clients despite the tough economic environment and I’m confident that we will continue to grow,” Chief Financial Officer Andrew Griffith said in an interview on Bloomberg TV.

Today’s data show the recession shrank the U.K. economy by 5.9 percent, compared with a total 6 percent slump in the recession that ended in 1981, the statistics office said.

Unemployment may keep rising even after the end of the recession as a lagged effect of the slump. St. Ives Plc, the U.K. printer of the Economist and Vogue magazines, has shed about 12 percent of workforce, Finance Director Matt Armitage said on Oct. 19.

The National Institute for Economic and Social Research said this week that the Bank of England should pause its bond purchase program at the Nov. 5 decision, when officials will have revised forecasts on the economy. The British Chambers of Commerce has called for a further expansion of the plan to reach 200 billion pounds to secure the recovery.

“This is desperately disappointing news, especially given that it was hoped that a modest recovery had begun,” said John Philpott, chief economist at the Chartered Institute of Personnel and Development. “The U.K. economy is continuing to shrink, with six quarters of contraction in output making this recession look more like a depression.”

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