Economic review

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SUMMARY

GDP output slowed in 2008 quarter two compared with the previous quarter – driven by slowing and subdued service sector output, together with a weakening in total production growth. Manufacturing output contracted sharply in the latest quarter following positive growth in the previous quarter. On the expenditure side, both household spending and business investment weakened in quarter two compared with the previous quarter. The current account deficit narrowed in quarter one. The goods trade deficit narrowed in the latest quarter. The labour market showed further signs of weakening in 2008 quarter two; average earnings remain relatively subdued. Public sector finances deteriorated in July 2008. Consumer price inflation accelerated further in July 2008 and was considerably above the Government's inflation target. Producer output and input price inflation accelerated in 2008 quarter two and remained buoyant in July 2008.

GROSS DOMESTIC PRODUCT

Second quarter growth of zero per cent

GDP growth for the second quarter of 2008 is estimated to have weakened compared with the previous quarter. GDP growth was flat, a downward revision from the 0.2 per cent initial estimate and a deceleration from 0.3 per cent growth in the previous quarter. The estimate for the annual rate of growth was 1.4 per cent, down from 2.3 per cent growth in the previous quarter (**Figure 1**).

The latest month two GDP release for 2008 quarter two contains more information than that contained in the preliminary estimate. It gives first estimates for the main expenditure categories and more complete information on the output side. It is still, however, based on as yet incomplete information.

The stagnant growth rate in the UK economy in quarter two was largely due to subdued service sector output. Industrial production growth continued to display weakness for the fourth successive quarter, with a deeper deceleration in

output in quarter two. The fragility in total production was driven by a sharp contraction in manufacturing output growth and also by a fall in the output of the electricity, gas and water supply industries. This was offset by an acceleration in mining and quarrying (including oil and gas) output. The slowdown in GDP growth was also led by the contraction in the output of the construction sector after showing positive growth in the previous quarter.

OTHER MAJOR ECONOMIES

Global growth showed mixed fortunes in quarter two

Preliminary data for 2008 quarter two for the other major OECD countries are now available. Performance appears to be somewhat mixed, although overall the picture is of weakening global growth compared with the previous quarter.

US GDP growth accelerated in 2008 quarter two achieving a rate of 0.5 per cent compared to 0.2 per cent in the previous quarter. The improvement in GDP growth was largely driven by increased consumer spending and which may partly be attributed to the government fiscal stimulus plan between late April and early July. Net exports also contributed to growth for the fifth consecutive quarter helped by a weak dollar and imports contracting sharply. Government spending also boosted growth as well as non-residential investment. Residential investment on the other hand continued to contract – for the tenth consecutive quarter.

Japan's GDP weakened in the latest quarter. Growth contracted by 0.6 per cent in quarter two compared to an increase of 0.8 per cent in the previous quarter. Most components of GDP decreased. Lower growth was primarily led by contraction in private consumption. Residential investment also decreased in the latest quarter after having posted positive growth in the previous quarter. Business investment recorded virtually flat growth. Net exports also subtracted from growth in the second quarter – for the first time since 2004 quarter four.

Euro-zone growth deteriorated in the latest quarter. According to Eurostat's

Figure 1
Gross Domestic Product

Percentage growth

estimate, euro area GDP growth contracted by 0.2 per cent after increasing by 0.7 per cent in quarter one – the first contraction since the early 1990s. Growth for the three big mainland EU economies – Germany, France and Italy – also showed a weakening picture compared with the previous quarter.

German GDP contracted by 0.5 per cent in 2008 quarter two – for the first time in four years. This follows growth of 1.5 per cent in quarter one. The detailed breakdown of growth was not available at the time of writing, although initial indications suggest a construction slump as a major factor.

French GDP growth contracted by 0.3 per cent in quarter two; the first decline since 2002 quarter four. Private consumption recorded virtually flat growth. Overall investment contracted markedly, led by a fall in household investment. Exports also subtracted from growth with exports registering the sharpest fall since 2001 quarter four.

Italian GDP fell by 0.3 per cent in the latest quarter following growth of 0.5 per cent in quarter one. The breakdown of growth was not available at the time of writing.

FINANCIAL MARKETS

Share prices rally; pound depreciates

Equity performance has displayed volatility over the last couple of years. In recent quarters, equity growth has been particularly weak. In the latest quarter, however, there appeared signs of a modest rebound in equity prices, after having fallen substantially in 2008 quarter one. In 2008 quarter two, the FTSE All-Share index rose by 1.7 per cent. This follows a decrease of 9.1 per cent in the previous quarter. The rise was partly driven by the purchase of stocks in the heavily-weighted mining and energy sectors. However, the FTSE All-Share index still remains low compared to the peaks seen in the second quarter

of 2007 – and may be attributed to global growth concerns, particularly regarding the US economy, brought on by financial uncertainty and continued problems regarding the credit squeeze. According to the latest figures in July, the FTSE All-Share index reverted back to negative territory by dropping around 7 per cent.

In the currency markets, 2008 quarter two saw sterling's broad average value continuing to depreciate but at a lesser rate compared with the first quarter. The pound's value against the dollar fell by around 0.5 per cent compared to a depreciation of around 3 per cent in the previous quarter. Against the euro, sterling's value depreciated by approximately 4 per cent in the second quarter, following depreciation of around 7 per cent in the previous quarter. Overall, the quarterly effective exchange rate depreciated by approximately 3 per cent in 2008 quarter two after depreciating by approximately 6 per cent in the previous quarter (Figure 2). According to the latest figures in July, the pound appreciated against the dollar by around 1 per cent. Against the euro, the pound's value was virtually flat. The overall effective exchange rate was flat.

The recent movements in the exchange rate might be linked to interest rate and growth factors. Exchange rate movements can be related to the perceptions of the relative strengths of the US, the euro and UK economy. The depreciation of the pound against both the dollar and euro in quarter one may have come in response to fears about lower growth in the UK economy and therefore prospects of lower interest rates to stimulate the economy. Indeed, the Bank of England reduced interest rates by 0.25 basis points in April 2008 to 5 per cent, the third cut in interest rates since December 2007 and was mainly in response to the effects of the sub-prime crisis in terms of downward risks to growth and inflation. These interest rate reductions may have made the pound less appealing to investors compared to other currencies.

The lower rate of depreciation of the pound against the dollar in the latest quarter may have been partly a result of expectations amongst investors that the Bank of England was unlikely to cut interest rates further in the short to medium term given the current inflationary pressures facing the UK economy. This perception coincided with US interest rates being lowered by a further 0.25 percentage points in April 2008 to 2 per cent following a 0.75 percentage points reduction in March.

In contrast in the euro area, the further depreciation of the pound against the euro in the second quarter of 2008 may have come in response to greater expectations of interest rates being raised by the European Central Bank (ECB). In fact, interest rates were increased by 0.25 percentage points in July 2008 to 4.25 per cent after having been at 4 per cent since June 2007. The main factor cited by the ECB for the rise was a perception of deteriorating inflationary expectations over the coming months and the need in particular to manage and anchor those expectations.

OUTPUT

Stagnant growth from falling services, construction and industrial output

GDP growth in 2008 quarter two was estimated to have grown at zero per cent, a deceleration from 0.3 per cent growth in the previous quarter. On an annual basis growth was 1.4 per cent, down from 2.3 per cent in the previous quarter.

Construction activity weakened in the latest quarter compared with the previous quarter. Construction output is estimated to have fallen by 1.1 per cent, after increasing by 0.4 per cent growth in the previous quarter. Comparing the quarter on the same quarter a year ago, construction output rose by 0.5 per cent, a slowdown from 2.4 per cent growth in quarter one (Figure 3).

External surveys pointed to sharp declines in housing activity in the latest quarter – attributing this to a combination of a slowing housing market and lack of availability of debt finance. The CIPS/Markit UK construction PMI (Purchasing Managers Index) reported that total construction contracted at record pace in the second quarter to a headline balance of 42.9 from 51.2 in the first quarter. In July 2008, the headline index deteriorated further to 36.7. The Royal Institute of Chartered Surveyors (RICS) construction

Figure 2
Exchange rates

Figure 3
Construction output

Figure 4
Manufacturing output

survey for 2008 quarter two reported that workloads broke more than 11 years of uninterrupted growth to decline at the fastest pace since 1995 quarter three; the workload balance was at minus 19 in the second quarter from plus 1 in the previous quarter.

Total output from the production industries decelerated further in the latest quarter. Output fell by 0.8 per cent following a decrease of 0.2 per cent in quarter one. On an annual basis, output contracted by 1.1 per cent, down from 0.4 per cent growth in the previous quarter.

The weakness in total production was driven by a contraction in the output of the manufacturing industries. Manufacturing output fell by 0.8 per cent in the second quarter reversing positive growth of 0.4 per cent in the previous quarter. On an annual basis, manufacturing output fell by 0.8 per cent, after having increased by 0.9 per cent in quarter one (Figure 4).

The weakness in total production in quarter two compared with the previous quarter was also to a lesser extent driven by a fall in the output of the electricity, gas and water supply industries. Output fell by 1.9 per cent compared with a fall of 1.3 per cent in the previous quarter. On an annual basis, output grew by 0.4 per cent down from 1.4 per cent growth in quarter one.

In contrast, the output of the mining and quarrying (including oil and gas)

industries strengthened in the latest quarter. Output increased by 0.6 per cent in the latest quarter, reversing the contraction of 4.7 per cent in quarter one. On an annual basis, output contracted by 5.4 per cent, a deceleration from a 4.9 per cent reduction in growth in quarter one.

Production growth has generally been slow since the third quarter of 2007 due to weakness in manufacturing for most of that period, and a contraction in mining and quarrying output, offset through some of this period by relatively strong electricity, gas and water supplies industry output. There was a modest pick up in manufacturing output in the first quarter of 2008 but this appears not to have been sustained into the latest quarter. It should be noted that manufacturing output has displayed volatility in the recent past.

The output of the agriculture, forestry and fishing industries was virtually flat in the latest quarter compared with 0.6 per cent growth in the previous quarter. On an annual basis growth was 0.9 per cent, down from 1 per cent growth in the previous quarter.

External surveys of manufacturing for 2008 quarter two showed a deteriorating picture compared with the previous quarter with weaker domestic demand cited as a major factor, broadly in line with official figures (Figure 5). In the past, it has not been unusual for the path of business indicators and official data to diverge over the short term. These differences happen partly because the series are not measuring exactly the same thing. External surveys measure the direction rather than the magnitude of a change in output and often inquire into expectations rather than actual activity.

The CIPS/ Markit manufacturing PMI indicated a slight contraction in the latest quarter; the headline index fell below the no change 50.0 mark to 48.5 from 51.0 in quarter one. In July, the headline index decreased further to 44.3. The CBI in its 2008 quarter two Industrial Trends survey reported continued weakness in total order books with the balance at minus 8 in the second quarter, compared with minus 13 in the previous quarter. In August 2008, the total order books balance was at minus 13. The BCC in its 2008 quarter two survey reported ominous results which highlighted serious risks of UK recession; the balances for home sales dropped by 15 points to minus 3 and the balance for home orders fell by 13 points to minus 5.

The service sector, the largest part of the UK economy, which has in the past driven UK economic expansion has somewhat made a negligible contribution to growth in the latest quarter. Services output growth showed below trend growth in the last couple of quarters compared to 2007.

Services output grew by 0.2 per cent in

Figure 5
External manufacturing

Figure 6
Services output

Figure 7
External services

Figure 8
Household demand

2008 quarter two, a marginal deceleration from growth of 0.3 per cent in the previous quarter but a marked slowdown from a recent high of 1.1 per cent recorded in 2007 quarter one (**Figure 6**). On an annual basis, services output expanded by 2 per cent, down from 2.6 per cent in the previous quarter.

Growth was recorded in varying degrees across all four broad sectors. The main contribution to the increase in services output growth came from transport, storage and communication where output growth rose to 1.1 per cent from 0.7 per cent in the previous quarter. On an annual basis, growth was 3.5 per cent, up from 2.5 per cent in the previous quarter. Total services output was also driven by fairly modest growth in government and other services output of 0.3 per cent down slightly from

0.4 per cent growth in the previous quarter. On an annual basis, growth was 1.9 per cent, unchanged from the previous quarter. This was offset by virtually flat growth in the distribution, hotels and catering and business services and finance sectors. Distribution, hotels and catering output grew by 0.1 per cent, a slowdown from growth of 0.3 per cent in the previous quarter. On an annual basis, growth was 1.4 per cent, down from 2.4 per cent in the previous quarter. Business services and finance output also grew by 0.1 per cent, down from 0.2 per cent growth in the previous quarter. On an annual basis, output decelerated to 2 per cent from 3.4 per cent in the previous quarter.

The external surveys on services showed a bleaker picture of service sector activity in 2008 quarter two. The CIPS/Markit services

PMI survey pointed to a deteriorating picture of service sector activity. The average headline index in 2008 quarter two fell to 49.1, below the no change 50.0 mark, from 52.9 in the previous quarter. In July 2008, the headline index weakened further to 47.4. It should be noted that the CIPS survey has a narrow coverage of the distribution and government sectors.

The CBI and BCC also reported a generally weakening picture of service sector activity (**Figure 7**). The latest CBI service sector survey in June reported weakness as a whole in the sector and in line with the February survey. For consumer services, volume of business fell sharply with the balance at minus 44 per cent, the lowest since November 2001. For business and professional services, the balance was at plus 10, but still below the long-term average of plus 19. The BCC survey for 2008 quarter two highlighted alarming falls in the domestic sector's services balances. The net balance for home sales declined 19 points to minus 2 and the net balance for home orders fell 21 points to minus 7.

EXPENDITURE

Consumers' spending contracts

Household consumption expenditure decelerated markedly in 2008 quarter two from the previous quarter.

Growth fell by 0.1 per cent compared to an increase of 1.1 per cent in the previous quarter. Compared with the same quarter a year ago, growth was 2.3 per cent, down from 3 per cent in the previous quarter (**Figure 8**). Lower spending was primarily driven by a fall in durable and semi-durable goods expenditure. This was offset by modest growth in services expenditure.

The weakening in consumer expenditure in the latest quarter appears mainly to reflect the continued impact of the financial turbulence in the UK economy and the intensifying pressures on real disposable income arising from modest wage growth coupled with higher inflation, particularly from higher fuel, utility and food prices.

One key indicator of household expenditure is retail sales. Retail sales growth weakened in 2008 quarter two compared with the previous quarter – driven by a sharp fall in June from strong growth in May. Retail sales volumes slowed to 0.6 per cent in quarter two, a marked deceleration from growth of 1.7 per cent in the previous quarter. One reason perhaps for the slower growth in retail sales may have been due to the price deflator (that

is, shop prices) where discounting appears not to be prevalent or widespread as was the case in quarter one. The price deflator fell on average by 0.2 per cent in quarter two compared with an average fall of 0.8 per cent in the previous quarter. In June, the price deflator increased by 0.6 per cent. This possibly suggests that the underlying picture regarding consumer finances is in a far weaker position than retail sales volume growth of the previous quarter indicated, with retail sales growth being discount as opposed to being income led. In July the price deflator increased further by 1.6 per cent.

Retail sales figures are published on a monthly basis and the latest available figures for July 2008 showed a rather resilient picture (**Figure 9**). In the three months to July the volume of retail sales increased by 0.7 per cent compared with an increase of 0.6 per cent in the three months to June. On an annual basis in July, the latest three months growth compared with the same three months a year ago recorded fairly strong growth of 3.9 per cent, although a slow down from 4.4 per cent growth in June.

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In the three months to July 2008 retail sales growth in volume terms was driven, by the 'predominantly non-food stores' offset by virtually flat growth in the 'predominantly food stores' sector. The 'predominantly non-food stores' sector grew by 1.2 per cent, up from 1 per cent in the previous month. Within this sector there was a strengthening in the 'textile, clothing and footwear stores' where growth jumped sharply to 3.1 per cent following growth of 1.4 per cent in the previous month. There was a rebound in 'household goods stores' with growth of 0.4 per cent, reversing a contraction of 0.4 per cent in the previous month. This was offset by slower growth in a number of stores. The 'non-specialised stores' grew modestly at 0.6 per cent, although slowing sharply from 2.3 per cent growth in the previous month. There was also a weakening in 'other stores' with growth of 0.3 per cent, down from 1.3 per cent in the previous month and 'non-store retailing and repair' also rising by 0.3 per cent but down from a 0.9 per cent increase in the previous month. The 'predominantly food stores' sector in contrast recorded virtually flat growth of 0.1 per cent in the three months to July, compared to a stagnant position in the previous month.

External surveys for retail sales presented

a slowing picture of growth in 2008 quarter two compared to the previous quarter. The CBI reported an average balance of minus 16 in the latest quarter, down from plus 1 in the previous quarter. According to CBI's monthly distributive trades' survey, the sales volume balance had deteriorated further to minus 36 in July 2008. The BRC reported average growth of 2.6 per cent in 2008 quarter two on a total sales basis, down from 3.3 per cent in 2008 quarter one. In July, growth had fallen further to 1.7 per cent (**Figure 10**).

Another indicator of household consumption expenditure is borrowing. Household consumption has risen faster than disposable income in recent years as the household sector has become a considerable net borrower and therefore accumulated high debt levels. Bank of England data on stocks of household debt outstanding to banks and building societies shows household debt at unprecedented levels relative to disposable income. Until recently, this borrowing has fuelled consumption, but this appears to be less the case in the latest quarter.

There are two channels of borrowing available to households: i) secured lending, usually on homes; and ii) unsecured lending, for example on credit cards. The impact of the credit squeeze may have intensified in the latest quarter. According to the Bank of England's Credit Conditions

Survey, lending conditions were tightened in quarter two, that is, by applying stringent credit-scoring criteria and by decreasing maximum loan-to-value (LTV) ratios – with lenders reporting that they had reduced the availability of both secured and unsecured lending to households. The tightening was driven by the slowdown in the housing market, the reduced appetite for risk and the worsening economic climate.

The Bank of England reported that total net lending slowed in 2008 quarter two to around £16 billion from around £25 billion in the previous quarter. Lending secured on dwellings fell to around £13 billion from £20 billion in the previous quarter. Unsecured lending also decreased to around £3 billion from around £4 billion in quarter one.

The slowdown in secured lending may have impacted on house prices in terms of lower growth. Nationwide and Halifax reported house prices falling by 8.1 per cent and 8.8 per cent respectively in July 2008. The housing market plays a major influence on consumer expenditure patterns. Firstly, as a barometer of confidence in the economy and therefore a willingness to spend; secondly, in terms of demand it creates for household goods via house purchases; and thirdly, household expenditure may be linked to household equity withdrawal (HEW) – slower house

Figure 9
Retail sales

Figure 10
External retailing

price growth can signify lower equity growth and therefore decreasing purchasing power. The recent slowdown in house prices and the housing market generally may have affected all three of the above, compounded by the credit squeeze.

One uncertainty in the latest quarter is the savings ratio. In 2008 quarter one households resorted to a draw-down in their savings to fund consumption. There is a question whether households will dip further into their savings or choose to retrench; all this may be determined by their outlook with regard to confidence in the economy and labour market conditions.

BUSINESS DEMAND

Business investment weakens

Total investment fell by 5.3 per cent in 2008 quarter two decelerating further from the fall of 1.5 per cent in quarter one. On an annual basis, total investment fell by 2.1 per cent, reversing positive growth of 1.4 per cent in the previous quarter. The decrease in total investment was due to both business and dwelling investment falling over the quarter (**Figure 11**).

Business investment continued to contract in the latest quarter. Growth decreased by 1.9 per cent in the latest quarter, roughly similar to the fall of 1.8 per cent in the previous quarter. On an annual basis, business investment grew by 1.9 per cent, a slowdown from 4.5 per cent growth in 2008 quarter one.

Business investment could have decreased for a number of reasons. Firstly, increased uncertainty and pessimism in regards to global and domestic demand, may have deterred investment; secondly, the downturn in investment could have come on the back of lower corporate profits; thirdly, the weakness in the equity market in recent quarters may have constrained revenue generation and hence investment; and last but not least, the general weakness in the property market in terms of lower price growth may have inhibited investment spending.

Evidence on investment intentions from the latest BCC and CBI surveys painted a picture of weakness. According to the latest quarterly BCC survey, the balance of manufacturing firms planning to increase investment in plant and machinery plummeted by 10 points to plus 2. The CBI's Quarterly Industrial Survey in 2008 quarter two also reported a bleaker investment picture, with the investment balance of plant and machinery weakening

Figure 11
Total fixed investment

Figure 12
Government spending

to minus 24 from minus 18 in the previous quarter.

GOVERNMENT DEMAND

Government expenditure moderates

Government final consumption expenditure slowed in 2008 quarter two. Growth registered a modest 0.4 per cent compared with growth of 0.9 per cent in the previous quarter. On an annual basis, growth was 1.9 per cent, down slightly from 2 per cent growth in the previous quarter (**Figure 12**).

Public sector finances deteriorate

The latest figures on the public sector finances to July 2008 continued to illustrate a relatively weak position.

The figures showed a higher current budget deficit together with an increased net borrowing situation – reflecting government expenditure continuing to exceed revenues. In the financial year 2008/09 to date, the current budget was in deficit by £13.3 billion; this compares with a budget deficit of £4 billion in the same period of 2007/08. Public sector net borrowing in the financial year 2008/09 to date was £19.1 billion; this compares with net borrowing of £8.4 billion in the

same period of 2007/08. Slower growth in current receipts were exceeded by a larger increase in the rate of current expenditure, particularly on capital projects – resulting in both a higher budget deficit and net borrowing.

Since net borrowing became positive in 2002, following the current budget moving from surplus into deficit, net debt as a proportion of annual GDP has risen steadily. Public sector net debt in July 2008 was 37.3 per cent of GDP, up from 36.1 per cent in July 2007. In the full financial year 2006/07, net debt as a percentage of GDP was 36.9 per cent.

TRADE AND THE BALANCE OF PAYMENTS

Current account deficit narrows; goods trade deficit narrows in quarter two

The publication of the latest quarterly balance of payments figures shows that the current account deficit narrowed in 2008 quarter one to £8.4 billion, from a revised deficit of £12.2 billion in the previous quarter (**Figure 13**). As a proportion of GDP, the deficit fell to 2.4 per cent of GDP from 3.5 per cent in 2007 quarter four. The narrowing in the current account deficit in 2008 quarter one was due to a higher surplus on income, together

with lower deficits on trade in goods and on current transfers, partially offset by a fall in the surplus on trade in services. The surplus on income increased by £2.2 billion to £9 billion. The deficit in current transfers narrowed to £3.9 billion, while the surplus on trade in services fell to £9.2 billion. The deficit on trade in goods fell by £1.4 billion to £22.7 billion.

The run of current account deficits since 1998 reflects the sustained deterioration in the trade balance. The UK has traditionally run a surplus on the trade in services, complemented by a surplus in investment income, but this has been more than offset by the growing deficit in trade in goods partly due to the UK's appetite for cheaper imports.

The figures in 2008 quarter two showed a continuation in the goods trade deficit but a slight narrowing from quarter one. The goods trade deficit was £22.6 billion in 2008 quarter one, down from a deficit of £22.6 billion in the previous quarter. Overall, there was a fall in imports which outstripped the fall in exports – leading to a fall in the total trade balance to £12.6 billion in 2008 quarter two from £13.4 billion in quarter one. Over the quarter, in terms of growth, total exports fell by 0.5 per cent and total imports fell by 1.4 per cent. Exports of goods grew by 1 per cent while goods imports fell by 0.8 per cent. Services exports fell by 2.7 per cent and services imports decreased by 3.3 per cent.

External surveys on exports reported a mixed picture for the latest quarter. The BCC reported that the export sales net balance rose by 12 points to plus 28. The latest CBI quarterly survey reported a weak picture. The export orders balance was minus 7 in 2008 quarter two, from minus 12 in the previous quarter. According to the latest monthly figures, the export balance was minus 9 in August.

LABOUR MARKET

Labour market activity weakens

The labour market in the latest reference period showed further signs of softening, but overall, still reflected a fairly buoyant picture – with relatively high levels of employment and low levels of unemployment seen throughout 2006 and in 2007. The weakening in certain indicators of the labour market in the latest period may reflect the lagged effect of the slowdown in the economy which began in the third quarter of 2007 and which has quickened in the last two quarters, starting

to feed through into a deeper and probably an extended period of weakness in labour market activity.

The latest figures from the Labour Force Survey (LFS) pertain to the three-month period up to June 2008. On the upside, the number of people in employment rose. The number of inactive people of working age fell slightly. On the downside, the employment rate fell. The number of unemployed people and the unemployment rate increased. The claimant count increased. The number of vacancies fell. Average earnings, including and excluding bonuses decreased. Overall, average earnings remain subdued with weak real-wage growth.

Near record levels of employment continue despite the pace of employment increase slowing in the current period, compared with the previous quarter – suggesting that lower GDP growth is starting to impact on lower employment growth. The number of people in employment rose by 20,000 in the three months to June and by 384,000 on a year earlier; this compares with respective increases of 61,000 and 413,000 on the three months to May 2008. The current working-age employment rate was 74.8 per cent in the three months to June 2008, down 0.1 percentage points from the three months to March 2008 but up 0.3 percentage points from a year earlier – leaving the employment level at 29.56

million. Unemployment levels on the other hand rose and for a fourth month in a row. The number of unemployed people increased by 60,000 in the three months to June 2008, a steeper increase compared to previous months and was up 15,000 from a year earlier, leaving the unemployment level at 1.67 million. The unemployment rate also rose, to 5.4 per cent in the three months to June 2008, up 0.2 percentage points in the three months to March 2008 but unchanged from a year earlier (Figure 14).

Looking at a detailed level, the increase in the employment level was mainly driven by employees and full-time employment offset by decreases in self-employment and part-time employment. Employees rose by 35,000 while the self-employed decreased by 15,000, continuing the trend from earlier months. In terms of full- and part-time workers, the numbers of people in full-time employment rose by 26,000 while the number of people in part-time employment fell by 7,000.

Workforce jobs increases

According to employer surveys, there was an increase of 30,000 jobs in March 2008. The largest quarterly contribution to the increase came from other services (up 27,000), followed by agriculture, forestry and fishing (up 18,000). This was offset by decreases across a number of sectors with the largest decrease in business services and finance (down

Figure 13
Balance of payments

Figure 14
Employment and unemployment

20,000) followed by manufacturing (down 11,000). Over the year, total workforce jobs increased by 209,000. Of the total, the largest contribution to the increase over the year came from finance and business services (up 84,000) followed by distribution, hotels and restaurants (up 83,000). The manufacturing sector, in contrast, was the only sector to lose jobs on the year (down 52,000).

Claimant count level increases

The claimant count measures the number of people claiming the Jobseeker's Allowance. The latest figures for July 2008 showed the claimant count level rose by 20,100 – the sixth consecutive monthly increase and was up 10,900 on a year earlier to reach a level of 864,700. The claimant count rate in July 2008 was 2.7 per cent, up 0.1 percentage point on the previous month but virtually unchanged on a year earlier.

Vacancies fall

The number of vacancies was down compared to the previous month which may reflect weaker demand conditions in the UK economy. There were 634,900 job vacancies in the three months to July 2008, down 47,400 from the previous three months and down 23,200 from the same period a year earlier.

Inactivity level falls slightly

The working-age inactivity rate was 20.9 per cent in the three months to June 2008, unchanged on the three months to March 2008 but down 0.3 percentage points from a year earlier. In level terms, the number of economically inactive people of working age decreased by 3,000 over the quarter and by 84,000 over the year to reach a level of 7.88 million in the three months to June 2008. The largest fall in level of inactivity was recorded for those categorised as 'long-term sick' (down 35,000). This was partially offset by a number of increases, with the largest rise in inactivity amongst those categorised as 'looking after family/home' (up 29,000).

Average earnings decrease

Growth in whole-economy average earnings showed a relatively subdued picture in the three months

to June 2008. Average earnings including bonuses increased by 3.4 per cent, down 0.4 percentage points from the previous month. Average earnings excluding bonuses also rose by 3.7 per cent, down 0.1 percentage points from the previous month. Public and private sector earnings growth slowed in the latest month. In terms of the public and private sector split, the gap in average earnings (excluding bonuses) maintained the parity of the previous month with a difference of 0.1 percentage point. Public sector earnings growth was 3.8 per cent, down 0.1 percentage points from the previous month. Private sector earnings grew by 3.7 per cent, also falling by 0.1 percentage point from May 2008.

Overall, the numbers still point to a fairly buoyant labour market, with employment at high levels and unemployment at a fairly stable level. However, the slowing economy may have begun to show signs of a deeper turning point in labour market activity, particularly in terms of slower employment growth and larger increases in unemployment levels. Average earnings show stable but fairly modest growth, consistent with softening in labour market activity and increase in supply in the labour force.

PRICES

Producer output and input prices accelerate

Industrial input and output prices are an indication of inflationary pressures in the economy. During the second quarter of 2008, output and input prices accelerated further from 2008 quarter one – another sign that a rise in world commodity prices was continuing to exert considerable influence in generating UK inflation through higher product prices. The rise in output prices suggests that firms were attempting to maintain their profit margins by passing on the higher costs of inputs to customers. However, the slower rate of growth of output inflation in the latest quarter compared to faster input price growth may suggest that firms have been tempered, in part, from passing on higher input price rises to customers due to spending pressures faced by households – with a possible impact on firms' profits.

Input prices on average rose by around 28 per cent in 2008 quarter two. This compares with around 20 per cent in 2008 quarter one. On the core measure, which strips out the effect of food, beverages, tobacco and petroleum prices, input prices rose by an average of around 14 per cent in 2008

quarter two (12 month non-seasonally adjusted growth), an acceleration from growth of around 9 per cent in the previous quarter. The sharp rise in input prices came mainly on the back of rising crude oil and home food materials prices. According to the latest monthly figures, the annual rate of input price inflation rose by 30.1 per cent in the twelve months to July 2008, down slightly from 30.8 in June – driven by a 79.3 per cent increase in the price of crude oil on the year.

Output prices grew on average by around 9 per cent in 2008 quarter one, an acceleration from growth of around 6 per cent in the previous quarter. The underlying picture also suggests inflationary pressures. On the core measure which excludes food, beverages, tobacco and petroleum, producer output prices rose on average by around 6 per cent in 2008 quarter one, up from around 3 per cent in the previous quarter. The main contributions to the increase in output prices were provided by rises in petroleum products and food prices. According to the latest monthly figures, annual output price inflation rose by 10.2 per cent in the 12 months to July, up from 10 per cent in June – mainly driven by petroleum products which rose 35.2 per cent on the year. Higher output and input prices appear to be fuelling consumer price inflation.

Consumer prices accelerates further and above target

Growth in the consumer prices index (CPI) – the Government's target measure of inflation – accelerated further in July to 4.4 per cent in July, up from 3.8 per cent in June 2008, and considerably above the Government's 2 per cent inflation target (Figure 15).

The largest upward pressure came from food and non-alcoholic beverages where prices rose this year but fell a year ago. Within this division, there were large upward effects from meat, bread and cereals, and vegetables.

There were further large upward pressures from:

- transport costs, mainly due to the price of fuels and air transport. The average price of petrol increased by 1.2 pence per litre between June and July this year, to stand at 118.8 pence, compared with a fall of 0.4 pence last year. The other large upward effect came from passenger air transport where fares rose by more than last year particularly on European routes

Figure 15
Inflation

Percentage change over 12 months

- housing and household services due to gas and electricity bills which were unchanged this year but fell a year ago
- furniture, household equipment and maintenance where overall price discounting was not as great as last year, particularly for furniture and furnishings
- clothing and footwear, where falls in price due to sales were not as large as last year, particularly for women's outerwear

A small downward pressure came from recreation and culture, where the price of computer games fell this year but rose a year ago and the price of pre-recorded DVDs fell by more than a year ago.

Retail Prices Index (RPI) inflation rose to 5.0 per cent in July, up from 4.6 per cent in June. The main factors affecting the CPI also affected the RPI. Additionally, there was a large downward contribution from housing with the main effect coming from house depreciation.

RPIX inflation – the all items RPI excluding mortgage interest payments – was 5.3 per cent in July, up from 4.8 per cent in June.