Economic review

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SUMMARY

GDP output contracted in 2008 quarter three - driven by negative growth in services, manufacturing and construction output. On the expenditure side, household spending and business investment showed a weak position in the second quarter. The current account deficit widened in quarter three, whilst the goods trade deficit narrowed slightly. The labour market showed further signs of weakening in 2008 quarter three; average earnings remain relatively subdued. Public sector finances deteriorated in September 2008. Consumer price inflation increased further in September 2008 and was considerably above the Government's inflation target. Producer output and input price inflationary pressures persisted in quarter three.

GROSS DOMESTIC PRODUCT

Growth contracts in third quarter

The preliminary estimate of GDP growth for the third quarter of 2008 is now available. GDP growth is estimated to have shrunk compared with flat growth in the previous quarter. Growth fell by 0.5 per cent, a weakening from zero per cent growth in the previous quarter. The initial estimate for the annual rate of growth deteriorated sharply growing by a subdued 0.3 per cent, down from 1.6 per cent growth

in the previous quarter. It should be noted that these estimates are based on the output approach to measuring GDP. The headline figure will be firmed up later as more data becomes available (Figure 1).

This contraction in the UK economy was largely due to a decline in growth in service sector output. Industrial production growth continued to display weakness for the fifth successive quarter, with a deeper deceleration in output in quarter three compared to the previous quarter. The fragility in total production was broad based but was mainly driven by a sharp

contraction in manufacturing output growth. The output of the electricity, gas and water supply and mining and quarrying (including oil and gas) industries also recorded negative growth. The slowdown in GDP growth was also led by a faster contraction in the output of the construction sector compared with the previous quarter.

OTHER MAJOR ECONOMIES

Global growth showed mixed fortunes in quarter two

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 0.8 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 estimate, euro area GDP growth contracted by 0.2 per cent after increasing by 0.7 per

Figure 1
Gross Domestic Product

cent in quarter one – the first contraction since the early 1990's. 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 1.3 per cent in quarter one. All the components of demand with the exception of government expenditure contracted during the second quarter with the sharpest falls recorded for household consumption and construction investment.

French GDP growth contracted by 0.3 per cent in quarter two and 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 contraction was mainly driven by weakness in private consumption, investment and net exports.

FINANCIAL MARKETS

Share prices fall; pound depreciates

Equity performance has displayed volatility over the last couple of years. In 2008 quarter three, share prices fell back substantially into negative territory following positive growth in the previous quarter. In 2008 quarter three, the FTSE All-Share index decreased by around 10 per cent compared to a rise of around 2 per cent in quarter two. The fall was mainly driven by a sell-off in shares in the financial and banking sectors. The weakness in share prices may be attributed to global growth concerns particularly in terms of recessionary fears, brought on by continued financial sector liquidity problems and its

negative impact on the real economy.

In the currency markets, 2008 quarter three saw sterling's broad average value continuing to depreciate. The pound's value against the dollar fell by around 4 per cent compared to a depreciation of around 1 per cent in the previous quarter. In October 2008 the pound fell below the \$1.60 mark for the first time in five years. Against the euro, sterling's value was virtually flat in the third quarter, following depreciation of around 5 per cent in the previous quarter. Overall, the quarterly effective exchange rate depreciated by approximately 2 per cent in 2008 quarter three after depreciating by approximately 3 per cent in the previous quarter (Figure 2).

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 the dollar in quarter three may have come in response to fears about lower growth and a possible recession in the UK economy, compared with the better outlook for the US and therefore the prospect of greater easing of interest rates in the UK to stimulate the economy. Indeed, the Bank of England reduced interest rates by 50 basis points in October 2008 which left UK rates standing at 4.5 per cent. This together with earlier cut in UK interest rates may have made the pound less appealing to investors compared to other currencies. Another factor for the relative strength of the dollar against the pound may have been due to the recent fall in oil prices with lower oil prices seen as less of a drag on US growth and therefore increased confidence in the US economy being reflected in a stronger dollar. The most recent UK reduction in interest rates was done in co-ordination with major central banks in recognition that a monetary stimulus was needed to ward off a possible world-wide recession resulting from the credit crisis and at the same time provide a boost to share prices. US and euro interest

rates were also reduced by 50 basis points to leave interest rates at 1.5 per cent and 3.75 per cent respectively. US growth prospects were further re-inforced by a further 50 basis points reduction in interest rates in late October to 1 per cent.

OUTPUT

Negative growth from contraction in services, construction and industrial output

GDP growth in 2008 quarter three was estimated to have fallen by 0.5 per cent, a deceleration from zero per cent growth in the previous quarter. On an annual basis growth was 0.3 per cent, down markedly from 1.6 per cent growth in the previous quarter.

Construction activity weakened further in quarter three compared with the previous quarter. Construction output is estimated to have fallen by 0.8 per cent, following a fall of 0.5 per cent in the previous quarter. There were decreases in nearly all new work categories but the decline was driven primarily by falls in new private housing. Comparing the quarter on the same quarter a year ago, construction output slowed to growth of 0.7 per cent from 2 per cent growth in the previous quarter (Figure 3).

External surveys pointed to sharp declines in housing activity in quarter three – 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 third quarter to a headline balance of 38.7 from 42.9 in the second quarter. The Royal Institute of Chartered Surveyors (RICS) construction survey for 2008 quarter three reported that construction workloads declined for the second successive quarter and at a faster pace – with the net balance falling to minus 38 from minus 19 in the previous quarter.

Total output from the production industries decelerated further in quarter three. Output fell by 1 per cent following a decrease of 0.7 per cent in quarter two. On an annual basis, output contracted by 1.1 per cent, compared to a contraction of 1.1 per cent in the previous quarter.

The weakness in total production was mainly driven by the deterioration in the output of the manufacturing industries. Manufacturing output fell by 1 per cent in the third quarter, a weakening from the 0.9 per cent contraction in the second quarter.

Figure 2
Exchange rates

Figure 3
Construction output

Figure 4
Manufacturing output

On an annual basis, manufacturing output fell by 1.6 per cent, from a 0.9 per cent decrease in the second quarter (**Figure 4**).

The weakening in total production in quarter three compared with the previous quarter was also to a lesser extent driven by weakness in the output of the electricity, gas and water supply and mining and quarrying industries where output fell by 0.4 per cent and 1.4 per cent respectively. This compares with virtually flat growth recorded for both in the second quarter. On an annual basis, electricity, gas and water supply output registered stagnant growth following 2 per cent growth in the previous quarter. The output of the mining and quarrying industries contracted by 6.7 per cent compared to a fall of 5.9 per cent in the previous quarter.

Production growth has generally been weak in the last couple of years, mainly 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. Manufacturing output has displayed volatility in the recent past. There was a modest pick up in manufacturing output in the first quarter of 2008 but this appears not to have been sustained in subsequent quarters.

The output of the agriculture, forestry and fishing industries increased by 0.5 per

cent in the latest quarter compared with 0.4 per cent growth in the previous quarter. On an annual basis growth was 2.6 per cent, up from 1.8 per cent growth in the previous quarter.

External surveys of manufacturing for 2008 quarter three showed a further deteriorating picture compared with the previous quarter with both weaker domestic and external demand cited as a major factors (**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 contraction in the latest quarter; the headline index fell further below the no change 50.0 mark to 43.5 from 48.5 in quarter two. The CBI in its 2008 quarter three Industrial Trends survey reported a weakening in its total order books with the balance at minus 39 in the third quarter, compared with minus 8 in the second quarter. The BCC in its 2008 quarter three survey reported alarming results with results pointing to the UK being in recession; the balances for home sales dropped by 10 points to minus 13 and the balance for home orders fell by 12 points to minus 17.

The service sector, the largest part of the UK economy, which has in the past driven UK economic expansion has made a negative contribution to growth in the latest quarter. Services output growth contracted in quarter three accelerating the slowdown of the earlier three quarters.

Services output declined by 0.5 per cent in 2008 quarter three, a deceleration from somewhat negligible growth of 0.2 per cent in the previous quarter but a marked slowdown from a recent high of 1.2 per cent recorded in 2007 quarter one (**Figure 6**). On an annual basis, services output expanded by 0.7 per cent, down from 2.2 per cent in the second quarter.

Declines in growth were recorded in most sectors. The largest contribution to the deceleration in services output in quarter three came from distribution, hotels and catering where output fell by 1.9 per cent following growth of 0.2 per cent in quarter two. On an annual basis, growth fell by 1.4 per cent following a rise of 1.2 per cent in the previous quarter. Output of the transport, storage and communication sector weakened with growth falling by 0.6 per cent after increasing by 1 per cent in quarter two. On an annual basis, growth rose by 1.2 per cent in quarter three, a slowdown from growth of 1.8 per cent in the previous quarter. Business services and

Figure 5
External manufacturing

Figure 6
Services output

Figure 7
External services

finance output also decreased, by 0.3 per cent – the first decline since 2002 quarter one – from virtually flat growth in quarter two. On an annual basis, growth was 1.1 per cent, down significantly from 3.2 per cent growth in the second quarter. These decreases were offset by moderate growth in government and other services output of 0.4 per cent in quarter three, up from 0.2 per cent growth in the previous quarter. Growth was 1.2 per cent on the year, marginally down from 1.3 per cent growth in quarter two.

The external surveys on services showed a bleak picture of service sector activity in 2008 quarter three. The CIPS/Markit services PMI survey pointed to a deteriorating picture of service sector activity. The average headline index in 2008 quarter three fell further to 47.5 from 49.1 in quarter two. It should be noted that the CIPS survey has a narrow coverage of the distribution and government sectors.

The CBI and BCC also painted a generally weak picture of service sector activity (Figure 7). The latest CBI service sector survey in August reported that for consumer services, volume of business was broadly flat at plus 2 although an improvement from the minus 44 of the previous survey in June. In contrast, volumes for business and professional services, deteriorated at a record pace with the balance reaching minus 31 from plus

10 in the previous survey. The BCC survey for 2008 quarter three recorded alarming declines. The net balance for home sales declined 5 points to minus 7 and the net balance for home orders dropped 6 points to minus 13.

EXPENDITURE

Consumers' spending contracts

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

Household spending fell by 0.1 per cent compared to an increase of 0.8 per cent in the previous quarter. Compared with the same quarter a year ago, growth was 2.5 per cent, down from 3.6 per cent in the previous quarter (Figure 8). Lower spending was

primarily driven by a fall in durable goods and services expenditure. This was offset by fairly strong growth in semi-durable goods and non-durable goods expenditure.

The weakening in consumer expenditure in quarter two may mainly appear to reflect the continued impact of the financial turbulence in the UK economy with pressures on real disposable income arising from modest wage growth coupled with higher inflation, particularly from higher fuel, utility and food prices. Indicators for consumer expenditure appear to be on the downside in quarter three.

One key indicator of household expenditure is retail sales. Retail sales growth continued its slowdown in 2008 quarter three from the previous quarter with retail sales volume growing by a negligible 0.1 per cent, down from 0.5 per cent growth in quarter two. 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 two. The price deflator rose on average by 1.2 per cent in quarter three compared with an average fall of 0.1 per cent in the previous quarter, further compounding the pressures on household disposable income.

Retail sales figures are published on a monthly basis and the latest available figures for September 2008 showed a virtually stagnant picture compared with the previous month (Figure 9). In the three months to September the volume of retail sales rose by just 0.1 per cent compared with a decrease of 0.9 per cent in the three months to August. On an annual basis in September, growth in the latest three months growth compared with the same three months a year ago was 2.3 per cent, slightly down from 2.4 per cent growth in August.

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In the three months to

Figure 8
Household demand

Figure 9
Retail sales

September 2008, the slowdown in retail sales was driven by continued weakness in the 'predominantly food-stores' sector offset by modest growth in the 'predominantly non-food stores' sector. Growth in 'predominantly food stores' fell by 1.1 per cent compared with a fall of 1.3 per cent in the three months to August.

In contrast, growth in 'predominantly non-food stores' rose by 0.6 per cent in the three months to September, reversing the contraction of 0.8 per cent in the three months to August. Within this sector growth was primarily driven by 'non-store retailing and repair' which grew by 2.6 per cent, an acceleration from 1 per cent growth in the previous three months. Growth was also led by 'textile, clothing and footwear stores' which rose by 2.1 per cent following an increase of 1 per cent in August and 'other stores' which grew by 1.1 per cent, rebounding on a fall of 1.3 per cent in August. This was offset by a decline in growth in 'Non-specialised stores' where growth fell by 1.4 per cent from a 0.6 per cent decrease in August. Household goods stores also showed weakness with volume of sales falling by 0.3 per cent compared to a contraction of 2.4 per cent in the three months to August.

It should be noted that household consumption accounts for a much broader range of spending than just retail sales. For instance, household purchases of services, motor vehicles and housing (imputed rents) are not included in retail sales. Since the beginning of 2006 quarter two, retail sales generally have grown faster than household consumption as a whole. However, the gap appears to have narrowed in 2008 quarter two and may conceivably be minimal in quarter three.

External surveys for retail sales presented a deteriorating picture of growth in 2008 quarter three compared to the previous quarter. The CBI reported an average balance of minus 32 in the latest quarter, from minus 16 in the previous quarter. The

BRC reported average growth of 1.4 per cent in 2008 quarter three, down from 2.6 per cent in 2008 quarter two on a total sales basis (**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 indicators appear to suggest this to be less so in the latest two quarters.

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 continued to have a substantial impact in quarter three. According to the Bank of England's Credit Conditions Survey, lending conditions were tightened further in quarter three, 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

concerns about the economic outlook and falling collateral values.

Another indicator highlighting the downside risks to consumer expenditure is described by Bank of England lending figures. There were signs of further slowdown with total lending growing by approximately £5 billion in the two months July to August, down from around £15 billion in the second quarter. Over the same period, lending secured on dwellings fell to around £3 billion from around £12 billion in the second quarter. Unsecured lending grew roughly by £2 billion, down from £3 billion in the second quarter.

The slowdown in secured lending may have impacted on house prices in terms of lower growth. Nationwide and Halifax both reported house prices falling in quarter three by around 5 per cent, broadly unchanged from the previous quarter. 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 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, rising unemployment and lower household income.

There are a number of unknowns in the third quarter in terms of determinants of consumer expenditure. First is the savings ratio: In the second quarter, the weakness in household expenditure may have been partly attributable to the savings ratio – with signs of a retrenchment amongst households reflected in a modest rise in the savings ratio of 0.4 per cent, but it also could have been a reflection and symptom of the spending pressures faced

Figure 10
External retailing

by households'. In the third quarter, the question is what scope there is for a further draw down or consolidation in household savings? Second, the recent fall in oil prices may play a significant factor in consumer expenditure not only in terms of boosting disposable income but also in terms of consumers' being able to switch to durable goods expenditure. Third, consumer expenditure is determined by the 'confidence' factor and this in turn will be affected by the situation in regards to labour market activity and the growth in real disposable incomes.

BUSINESS DEMAND

Business investment contracts

Total investment fell by 2.8 per cent in 2008 quarter two compared with a fall of 2 per cent in the previous quarter. On an annual basis, total investment fell by 2.1 per cent, reversing positive growth of 0.3 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. Business investment decreased by 1 per cent in the latest quarter, compared with 1.9 per cent growth in the previous quarter. On an annual basis, business investment grew by 1.2 per cent, a slowdown from 3.1 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 dropped by 6 points to minus 4. The CBI's Quarterly Industrial Survey in 2008 quarter three also reported a bleaker investment picture, with the investment balance of plant and machinery weakening to minus 38 from minus 24 in the previous quarter.

GOVERNMENT DEMAND

Government expenditure moderates

Government final consumption expenditure slowed in 2008 quarter two. Growth registered a fairly modest 0.5 per cent compared with growth of 1 per cent in the previous quarter. On an annual basis, growth was 2.1 per cent, similar to the rate in the previous quarter (Figure 12).

Public sector finances deteriorate

The latest figures on the public sector finances to September 2008 illustrated a weakening position. The figures showed a higher current budget deficit together with an increased net borrowing situation – reflecting government expenditure continuing to exceed tax revenues. In the financial year 2008/09 to date, the current budget was in deficit by £25.5 billion; this compares with a budget deficit of £13.1 billion in the same period of 2007/08. Public sector net borrowing in the financial year 2008/09 to date was £37.6 billion; this compares with net borrowing of £21.5 billion in the same period of 2007/08. Slower growths 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 September 2008 was 43.4 per cent of GDP (including Northern Rock), up from 42.7 per cent in August 2008. In the full financial year 2006/07, net debt as a percentage of GDP was 42.8 per cent.

TRADE AND THE BALANCE OF PAYMENTS

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

The publication of the latest quarterly Balance of Payments figures shows that the current account deficit widened in 2008 quarter two to £11.0 billion, from a revised deficit of £5.5 billion in the previous quarter (Figure 13). As a proportion of GDP, the deficit increased to 3 per cent of GDP from 1.5 per cent in 2008 quarter one. The widening in the current account deficit in 2008 quarter two was due to a lower surplus on income, partially offset by a fall in the deficit in current transfers. The surplus on income decreased by £6.0 billion to £4.5 billion and the deficit

Figure 11
Total fixed investment

Figure 12
Government spending

Figure 13
Balance of payments

in current transfers fell by £0.4 billion to £3.5 billion. The lower surplus on income was mainly due to higher interest payments from UK securities dealers combined with lower losses recorded by foreign banks with UK operations.

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 £23.1 billion in 2008 quarter one, down from a deficit of £23.2 billion in the previous quarter. Overall, there was a fall in imports together with stagnant exports – leading to a fall in the total trade balance to a deficit of £12.0 billion in 2008 quarter two from £12.1 billion in quarter one. Over the quarter in terms of growth, total exports flat and total imports fell by 0.5 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.

According to the latest trade figures, the UK's deficit in trade in goods and services widened to £13.9 billion in the three months to August, from £11.3 billion in the previous three months – driven by the widening of the goods trade deficit to £24.4 billion from £22.5 billion in the three months to May, and from a decrease in the surplus in the trade in services to £10.5 billion from £11.3 billion in the three months to May. In terms of growth, total exports in volume terms grew by 1.6 per cent in the three months to August compared with the previous three months while total imports grew by 2.2 per cent over the same period.

External surveys on exports reported a weakening picture in quarter three. The BCC reported that the export sales net balance dropped 25 points to plus 3. The CBI quarterly survey reported the order books balance at minus 32.

LABOUR MARKET

Labour market activity slowdown deepens

The labour market in the latest reference period showed further signs of deterioration, but overall, still reflected a fairly buoyant picture – with relatively high levels of employment and low levels of unemployment seen throughout 2007 and early 2008. However, there was a broader weakening in indicators of the labour market in the latest reference period, reflecting the lagged effect of the slowdown in the economy which began in the fourth quarter of 2007 and which has markedly deteriorated in subsequent quarters.

The latest figures from the Labour Force Survey (LFS) pertain to the three-month period up to August 2008. Most indicators appear on the downside. There was a fall in both the number of people in employment and the employment rate. The number of unemployed people and the unemployment rate increased. The number of inactive people of working age increased but the inactivity rate was unchanged. Vacancies

fell. Growth in average earnings (both including and excluding bonuses) fell; overall, average earnings remain subdued with weak real-wage growth.

Near record levels of employment continue despite the sharp fall in employment in the current period, compared with the previous quarter. The number of people in employment decreased by 122,000 in the three months to August – the biggest fall since the beginning of 1993 – but rose 199,000 on a year earlier. The current working-age employment rate was 74.4 per cent in the three months to August 2008, down 0.4 percentage points from the three months to May 2008 and down 0.1 percentage point from a year earlier – leaving the employment level at 29.42 million. Unemployment levels on the other hand rose and for the sixth month in a row. The number of unemployed people increased by 164,000 in the three months to August 2008 – the fastest increase for 17 years – and up 146,000 from a year earlier, leaving the unemployment level at 1.79 million. The unemployment rate also rose, to 5.7 per cent in the three months to August 2008, up 0.5 percentage points from the three months to May 2008 and up from 0.4 percentage points a year earlier (Figure 14).

Looking at a detailed level, the decrease in the employment level was mainly driven by employees and to a lesser extent in self-employment. Employees fell by 52,000 while the self-employed decreased by 31,000. In terms of full and part-time workers, the numbers of people in full-time employment fell by 152,000 while the number of people in part-time employment increased by 30,000.

Workforce jobs increases

According to employer surveys' there were 31.68 million workforce jobs in June 2008, up 26,000 over the quarter and up 142,000 on a year earlier. The largest quarterly contribution to the increase came from education, health and public

Figure 14
Employment and unemployment

admin (up 27,000), followed by agriculture, forestry and fishing (up 15,000). This was offset by decreases across a number of sectors with the largest decrease in distribution, hotels and restaurants (down 11,000) followed by manufacturing (down 10,000). The largest contribution to the increase over the year came from education, health and public administration (up 43,000) followed by finance and business services (up, 40,000), partially offset by manufacturing (down 47,000).

Claimant count increases further

The claimant count measures the number of people claiming the Jobseeker's Allowance. The latest figures for September 2008 showed the claimant count level rose by 31,800 – the eighth consecutive monthly increase. On a year earlier the claimant count level increased by 104,900 to reach a level of 939,900. The claimant count rate in September 2008 was 2.9 per cent, up 0.1 percentage point from the previous month and up 0.3 percentage points from a year earlier.

Vacancies showed another big fall

The number of vacancies fell further compared to the previous quarter reflecting weakening demand conditions in the UK economy. Job vacancies fell by 40,000 and were down 62,000 from the same period a year earlier reaching a level of 608,000 vacancies in the three months to September 2008.

Inactivity level increases

In level terms, the number of economically inactive people of working age increased by 16,000 over the quarter but fell by 74,000 over the year to reach 7.89 million in the three months to August 2008. The largest rise in level of inactivity was recorded for those categorised as 'student' (up 66,000) followed by the 'long-term sick' category (up 18,000). This was partially offset by a number of decreases, with the largest fall in inactivity amongst those categorised as 'looking after family/home' (down 42,000). The working-age inactivity rate was 20.9 per cent in the three months to August 2008, unchanged on the three months to May 2008 but down 0.3 percentage points from a year earlier.

Average earnings growth subdued

Growth in whole-economy average earnings showed a relatively muted picture in the three months to August 2008. Average earnings including bonuses, increased by 3.4 per cent, down 0.1 percentage point from the previous month. Average earnings excluding bonuses rose by 3.6 per cent, also down 0.1 percentage point from the previous period. Public and private sector earnings grew modestly in the latest month. In terms of the public and private sector split, average earnings (excluding bonuses) grew in parity in the latest month. Public sector earnings growth was 3.6 per cent, down 0.1 percentage points from the previous month. Private sector earnings also grew by 3.6 per cent, down 0.1 percentage point from the previous month.

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 is starting to show a deeper turning point in labour market activity, particularly in terms of declining 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 price pressures persist in quarter three

Industrial input and output prices are an indication of inflationary pressures in the economy. During the third quarter of 2008, output and input prices continued to remain elevated and broadly unchanged from the second quarter – a sign that the rise in world commodity prices was continuing to exert considerable influence in generating UK inflation through higher product prices. In the latest quarter, there appeared signs of easing in input price growth compared to marginally faster growth in output price inflation – which possibly suggests that firms were intent on maintaining their profit margins by passing on the relatively high input costs to customers.

Input prices on average rose by 28.2 per cent in 2008 quarter three. This compares with 29.8 per cent in 2008 quarter two. On the core measure, which strips out the effect of food, beverages, tobacco and petroleum

prices, input prices on average rose by 20.7 per cent in 2008 quarter three (12 month non-seasonally adjusted growth), an acceleration from growth of 18.8 per cent in the previous quarter. The strength in input prices continued to be generated mainly by fuel and imported food materials prices which rose on average by 40 per cent and 25 per cent respectively in quarter three.

Output prices grew on average by 9.2 per cent in 2008 quarter three, a marginal increase from growth of 8.8 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 by 5.7 per cent in 2008 quarter three, up from 5.2 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 which grew on average by 31.2 per cent and 13.2 per cent respectively in quarter three. Higher output and input prices appear to be fuelling consumer price inflation.

Consumer prices increases further and considerably above target

Growth in the consumer prices index (CPI) – the Government's target measure of inflation – increased further in September to 5.2 per cent, up from 4.7 per cent in August and considerably above the Government's 2 per cent inflation target (Figure 15).

The largest upward pressure on the CPI annual rate came from housing and household services because of rises in average gas and electricity bills this year compared with falls last year. Within this division there was also a small upward effect from materials for maintenance and repair, principally from paint.

There were further large upward pressures from:

- recreation and culture where, overall, prices rose by more than a year ago. The pressures came mainly from computer games, data processing equipment, admission to live music events and foreign holidays
- clothing and footwear where prices rose by more than a year ago, particularly for men's outerwear
- air and sea fares falling at the end of the summer by less than a year ago. With air fares, the upward pressure came from long-haul routes partially offset by a downward effect from European flights. The sea fares effect came from international routes

Figure 15
Inflation

Percentage change over 12 months

The largest downward pressure on the CPI annual rate came from food and non-alcoholic beverages with the largest single effect coming from shop-bought milk whose prices were little changed this year but rose by 4 pence a pint a year ago. There was also a large downward effect from fruit and smaller effects from bread and cereals, oils and fats, and mineral waters, soft drinks and juices. These were partially offset by a large upward effect from meat, particularly bacon.

There were also large downward effects from:

- second-hand cars and fuels and lubricants, with prices of both groups falling by more than a year ago. The average price of petrol fell by 1.7 pence per litre between August and September this year, to stand at 111.6 pence, compared with a fall of 0.9 pence last year. Diesel prices fell by 2.3 pence per litre this year compared with a fall of 0.1 pence last year
- education, where private school fees rose by less than a year ago

Retail Prices Index (RPI) inflation rose to 5.0 per cent in September, up from 4.8 per cent in August. 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 partially offset by buildings insurance. Depreciation and buildings insurance are excluded from the CPI.

RPIX inflation – the all items RPI excluding mortgage interest payments – was 5.5 per cent in September, up from 5.2 per cent in August.