Economic review

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SUMMARY

Gross Domestic Product output slowed modestly in 2008 quarter one compared with the previous quarter. Growth was driven by slower service sector output, offset by virtually flat total production growth. Manufacturing output returned to positive growth in the latest quarter. On the expenditure side, household spending and business investment weakened in quarter four in comparison with quarter three. The current account deficit narrowed in quarter four; the goods trade deficit was unchanged in quarter four and contributed negatively to growth. The labour market continues to be buoyant in 2008 quarter one although average earnings remain relatively subdued. The public sector finance position deteriorated in March 2008. Consumer price inflation was unchanged in March 2008 and was above the Government's inflation target. Producer output and input price inflation accelerated in 2008 quarter one.

GROSS DOMESTIC PRODUCT

First quarter growth of 0.4 per cent

The preliminary estimate of Gross Domestic Product (GDP) growth for the first quarter of 2008 is now available. GDP growth for the first quarter of 2008 is estimated to have slowed compared with the previous quarter. Growth was a modest 0.4 per cent, a deceleration from 0.6 per cent growth in the previous quarter. The initial estimate

for the annual rate of growth was 2.5 per cent, down from 2.8 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**).

The growth rate in the UK economy in quarter one continued to be driven by relatively strong service sector output, although this was slower when compared with the previous quarter. Industrial production growth continued to display weakness for the third successive quarter,

with output decelerating in the latest quarter. Within total production, there was a fall in the output of the mining & quarrying (including oil & gas) as well as the electricity, gas and water supply industries. This was offset by a modest upturn in manufacturing output. The construction sector continued to grow fairly strongly.

OTHER MAJOR ECONOMIES

Global growth weakens in quarter four

Data for 2008 quarter one was not yet available for the other major OECD countries at the time of writing. Data for 2007 quarter four reported a mixed but a broadly weakening picture of global growth, reversing the generally strong picture of growth recorded in the previous quarter.

US GDP data for the fourth quarter of 2007 showed a sharp deceleration compared with quarter three. Growth was just 0.2 per cent on a quarter on quarter basis compared to 1.2 per cent growth in the previous quarter. The marked slowdown in growth was primarily due to a contraction in inventories, which occurred after positive growth was shown in the previous quarter. There was a slowdown in net exports, although it still contributed positively to growth, with exports exceeding imports. Consumption growth decreased. Residential investment also contributed to lower growth with continued contraction in this sector.

Japan's GDP growth showed a marked acceleration in 2007 quarter four. Growth was 0.9 per cent compared with 0.3 per cent in the previous quarter. Growth was mainly driven by an increase in business investment and net exports. Government expenditure also added to growth, though to a lesser extent. This was offset by continued contraction in residential investment growth. Private consumption made a relatively subdued contribution to growth.

Data for Italy was not available for 2007 quarter four as it is in the process of revising its methodology for measuring GDP. Data will be available with the next quarterly release (23 May). Growth for the other two big mainland EU economies – Germany and France – showed a weakening in 2007

Figure 1
Gross domestic product

quarter four compared with the previous quarter. According to Eurostat's estimate, euro area GDP decelerated to 0.4 per cent in 2007 quarter four compared with the strong 0.8 per cent growth in quarter three.

German GDP grew by only 0.3 per cent in 2007 quarter four, a marked slowdown from growth of 0.7 per cent in quarter three. The breakdown to the growth was not available at the time of the headline release; indications are that the slowdown in growth was likely to be led by lower private consumption growth.

French GDP growth decelerated to 0.3 per cent in 2007 quarter four, from 0.8 per cent growth in the previous quarter. The weakening in growth was mainly due to a marked slowing in private consumption growth and decelerating inventories. This was offset by solid investment growth and a positive net trade picture.

FINANCIAL MARKETS

Share prices weaken; pound depreciates

Equity performance has displayed volatility in the last couple of years. In recent quarters, equity growth has been particularly weak. In the latest quarter, the FTSE All-Share index fell substantially, by around 9 per cent. This

follows growth of just 0.5 per cent in the previous quarter. The weakness in equity growth can mainly be attributed to global growth concerns, particularly regarding the US economy, brought on by financial uncertainty and continued problems regarding the credit squeeze, attributable to the US housing and the sub-prime mortgage market.

In the currency markets, 2008 quarter one saw sterling's broad average value depreciating markedly compared with the previous quarter. The pound's value against the dollar fell by around 3 per cent compared to appreciation of around 1 per cent in the previous quarter. Against the euro, sterling's value depreciated by approximately 7 per cent, a further depreciation from around 4 per cent in 2007 quarter four. Overall, the quarterly effective exchange rate depreciated by approximately 6 per cent in 2008 quarter one, following depreciation of around 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 both the dollar and euro in quarter one may have come in response

to fears about lower growth in the UK economy and the resulting prospect of lower interest rates to stimulate the economy. Indeed, the Bank of England reduced interest rates by 25 basis points in April 2008 to 5 per cent, the third cut in interest rates since December 2007, and this action came 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.

Also, the depreciation of the pound against the dollar may have occurred because of expectations amongst investors of further rate reductions in the UK compared with the US. US interest rates were lowered by a further 0.75 basis points in March 2008 to 2.25 per cent following a 0.75 basis points reduction in January – driven by the same growth concerns as the UK.

In contrast, in the euro area, the further depreciation of the pound against the euro in the first quarter of 2008 may have come in response to continued stability in interest rates in the euro-zone – with the likelihood that interest rates are unlikely to be cut in the medium term. The euro-zone interest rate is currently at 4 per cent, having been maintained there since the 0.25 basis point increase in June 2007, partly in response to concerns about inflationary pressures.

OUTPUT

Services sector slows but continues to drive economic growth

GDP growth in 2008 quarter one was estimated to have grown at 0.4 per cent, a deceleration from 0.6 per cent in the previous quarter. On an annual basis it was 2.5 per cent, down from 2.8 per cent in the previous quarter.

Construction activity weakened in the latest quarter but still grew modestly. Construction output is estimated to have grown by 0.5 per cent, down from 1.1 per cent growth in the previous quarter. Comparing the quarter on the same quarter a year ago, construction output rose by 2.8 per cent, up from 2.5 per cent growth in the previous quarter (**Figure 3**).

External surveys also signalled weakening activity, which has been attributed in part to the slowing housing market. The Chartered Institute of Purchasing and Supply (CIPS) survey average headline index declined to 51.2 from 55.9 in the previous quarter, but

Figure 2
Exchange rates

Figure 3
Construction output

still indicative of fairly buoyant growth. The Royal Institute of Chartered Surveyors (RICS) construction survey for 2008 quarter one reported a sharp fall in the growth of construction workloads with the balance at plus 1, down from plus 16 in the previous quarter.

Total output from the production industries weakened in the latest quarter, reversing the subdued upturn in the previous quarter. Growth fell by 0.1 per cent following growth of just 0.2 per cent in 2007 quarter four. On an annual basis output grew by 0.7 per cent, similar to the rate in the previous quarter.

The weakness in total production was driven by a contraction in the output of the mining and quarrying industries, which fell by 5.2 per cent compared with the virtually flat growth in the previous quarter. On an annual basis, output contracted by 5.1 per cent compared with growth of 1.8 per cent in the previous quarter. Weaker total production growth was also partly led by a fall in the output of the electricity, gas and water supply industries which decreased by 1.2 per cent after output increased by 2.8 per cent in the previous quarter. On an annual basis, growth was 1.7 per cent, down from 4.6 per cent growth in the previous quarter.

Manufacturing output in contrast showed a modest revival. Output grew by 0.5 per cent compared with flat growth in the previous quarter. On an annual basis, manufacturing output grew by 1.2 per cent, up from 0.2 per cent growth in the previous quarter (Figure 4).

Production growth has generally been slow since the second quarter of 2006 due to weakness in mining and quarrying and utilities output, offset through most of this period by relatively strong manufacturing output. There was a pick up in production in 2007 quarter two, but this appears not to have been sustained in the following two quarters due to weak manufacturing output growth. Manufacturing output has displayed volatility in the recent past. In the latest quarter there appears to be some sort of reversal with manufacturing output showing a modest upturn – but it remains to be seen whether this can be sustained.

The output of the agriculture, forestry and fishing industries weakened in the latest quarter with output increasing by 0.6 per cent, decelerating from growth of 2.1 per cent in the previous quarter. On an annual basis growth was 2.3 per cent, down from 2.8 per cent growth in the previous quarter.

External surveys of manufacturing for

Figure 4
Manufacturing output

2008 quarter one showed a deteriorating picture compared with the previous quarter (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 Chartered Institute of Purchasing and Supply (CIPS) average headline index for manufacturing painted a fairly robust picture in the latest quarter, despite indicating a slowdown. The headline index was 51.1, down from 53.0 in the

previous quarter. The Confederation of British Industry (CBI) in its 2008 quarter one Industrial Trends survey reported a weakening in its total order books, with the balance dropping to minus 13 from plus two in the previous quarter. In its 2008 quarter one survey, the British Chamber of Commerce (BCC) also reported a weakening picture of manufacturing activity. The home sales balance dropped to plus 12 from plus 32 in the previous quarter – the lowest since 2005 quarter three.

Overall the service sector, the largest part of the UK economy, continues to be the main driver of UK economic growth. Growth continued to be fairly buoyant despite easing in the latest quarter

Figure 5
External manufacturing

Figure 6
Services output

compared with the previous quarter.

Services output grew by 0.6 per cent in 2008 quarter one, a slight reduction from 0.7 per cent growth in the previous quarter and a further slowdown from growth of 0.9 per cent recorded in 2007 quarter three (**Figure 6**). On an annual basis services output expanded by 2.9 per cent, down from 3.4 per cent in the previous quarter.

Growth was recorded in varying degrees across all four broad sectors, though there was a slowdown overall. The main contribution to the decline in services output growth came from businesses services and finance, where output decelerated to 0.4 per cent from 0.6 per cent in the previous quarter. On an annual basis growth was 3.9 per cent, down from 4.4 per cent in the previous quarter. The output of the transport, storage and communication industries also decelerated with growth of 1 per cent, down from 1.7 per cent in the previous quarter. On an annual basis growth was 3.2 per cent, down from 3.9 per cent in the previous quarter.

There was also a weakening in the output of government and other services, which grew by 0.4 per cent, down from 0.7 per cent in the previous quarter. On an annual basis growth was 1.8 per cent, down from 2.1 per cent in 2007 quarter. This was partially offset by stronger growth in the output of the distribution, hotels and catering industries. Growth accelerated to 0.9 per cent from 0.2 per cent in the previous quarter. On an annual basis, growth was 2.6 per cent, down from 3 per cent in the previous quarter.

The external surveys on services showed a mixed picture of service sector activity in 2008 quarter one. The CIPS survey pointed to a stable but still healthy picture of service sector activity. The average headline index in 2008 one was 52.9, up from 52.5 in the previous quarter. It should be noted that the CIPS survey has a narrow coverage of the distribution and government sectors.

The CBI and BCC reported a generally weakening picture of service sector activity (**Figure 7**). The CBI service sector survey for February 2008 reported falling sentiment and business volumes for the business and professional services sector and the consumer service sector compared to the previous quarter. The consumer services volume balance was at minus seven down from plus four in the previous quarter. For business and professional services, the balance was at plus six, down from plus 26 in the previous quarter. The BCC survey for 2008 quarter one reported a

Figure 7
External services

Figure 8
Household demand

weakening picture of service sector activity, but overall balances for home orders and sales remained positive at plus 14 and plus 17 from plus 18 and plus 28 respectively.

EXPENDITURE

Consumers' spending weakens

Household consumption expenditure decelerated in 2007 four compared with the previous quarter. Growth was just 0.1 per cent, down markedly from that of 0.8 per cent in quarter three. Compared with the same quarter a year ago, growth was 2.4 per cent, down from 3.5 per cent in quarter three (**Figure 8**). Lower spending was primarily driven by a fall in durable goods expenditure and slower growth in semi-durables and non-durable goods expenditure. There was fairly buoyant growth in services expenditure.

Indications for consumer expenditure in 2008 quarter one appear to be mixed. Primary amongst them is the extent of the impact of the credit crisis and past interest rate rises feeding through to spending decisions. Both these factors may have contributed to some extent towards spending weakening in 2007 quarter four and may be factors again in the latest

quarter. In particular, the Bank of England's 2008 quarter one Credit Conditions Survey (CCS) highlighted lenders reducing their credit both on secured and unsecured lending, mainly due to an uncertain macroeconomic outlook and a reduction to risk exposure. The recent decreases in interest rates may offset some of that credit constraint, although it is worth noting that interest rate changes work on a lagged effect.

One key indicator of household expenditure is retail sales. Retail sales strengthened in 2008 quarter one compared with the previous quarter. Retail sales volumes grew by 2.0 per cent in quarter one, an acceleration from growth of 0.6 per cent in 2007 quarter four. The robustness in retail sales in the latest quarter may be partly attributed to continued, widespread discounting which is reflected in the price deflator (i.e. shop prices). This fell on average by 0.9 per cent in 2008 quarter one.

Retail sales figures are published on a monthly basis and the latest available figures for March 2008 showed a robust picture (**Figure 9**). In the three months to March the volume of retail sales increased by 2 per cent compared with an increase of 1.2 per cent in the three months to February. On an annual basis in March, the

latest three months growth compared with the same three months a year ago recorded strong growth of 5.6 per cent, up from 5.1 per cent in February.

In the latest month, discounting seems to be playing a greater part in retail sales growth compared with the previous month. The price deflator fell by 1.2 per cent in March 2008 compared with a fall of 0.6 per cent in February.

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In the three months to March 2008 retail sales growth was mainly driven by the 'predominantly food stores' sector which recorded growth of 1.7 per cent, accelerating from 0.9 per cent growth in the three months to February. The 'predominantly non-food stores' sector also registered strong growth of 1.8 per cent, up from 0.9 per cent in the previous month. Within this sector 'non-store retailing and repair stores' grew by 5.5 per cent, followed by growth in 'other stores' with growth of 5.2 per cent. The 'household goods stores' sector in contrast showed weakness, with growth falling by 0.1 per cent.

External surveys for retail sales presented a subdued picture of growth in March 2008. The CBI's monthly Distributive Trades survey for March reported a balance of plus one, although there was an improvement

from minus three in February. The British Retail Consortium (BRC) reported a decrease of 1.6 per cent in retail sales on a like-for-like basis in March 2008, reversing the increase of 1.5 per cent in the previous month (**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.

There are two channels of borrowing available to households: i) secured lending, usually on homes; and ii) unsecured lending, for example on credit cards. On a general level, an increase in interest rates increases debt servicing costs, may discourage borrowing and displace consumer expenditure on certain goods in the process.

Latest Bank of England data showed lending secured on dwellings was £7.4 billion in March, well below the previous six month average. Mortgage approvals also fell in February to 73,000 from 74,000 in January – nearly 40 per cent lower than

a year earlier. However, there was a jump in unsecured credit of £2.4 billion from £0.9 billion in January. This may suggest that households could be resorting to this type of finance for re-mortgaging or for spending purposes. Another explanation is that some of this increase could be accounted for by student loans.

The slowdown in secured lending could be primarily attributed to the credit squeeze. This may have manifested itself in banks and building societies adopting tight lending criteria, particularly towards first-time buyers and those considered higher risk. There may also be an impact in the form of higher interest rates charged by banks for customers who have borrowed on variable interest rate mortgages in the short term, and in the longer term, there may be an impact on those who took out fixed rate mortgages. On a general level, there has been an increase in the cost of mortgage credit due mainly to tight funding in the wholesale market. The higher cost of borrowing from the wholesale markets has led to some banks and building societies increasing interest rates on some of their lending products to customers.

The slowdown in secured lending may have impacted on house prices in terms of lower growth. 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. Both Nationwide and Halifax report an easing in growth in house prices in 2008 quarter one. Halifax reported annual house price growth of 1.1 per cent in the latest quarter, down from annual growth of 5.2 per cent in 2007 quarter four. According to the Nationwide, annual house price growth in 2008 quarter one was also 1.1 per cent, down from 6.9 per cent growth in the previous quarter.

The savings ratio is also a determinant of household expenditure. In 2007 quarter four, there appeared to be signs of retrenchment amongst consumers in light of ongoing economic uncertainty as a result of the credit crisis. The savings ratio in 2007 quarter four was 3.3 per cent, up from 2.6

Figure 9
Retail sales

Figure 10
External retailing

per cent in the previous quarter. This curtailment in expenditure could continue and possibly tighten further in the latest quarter.

An alternative measure of expenditure also showed a weakening picture. M4 (a broad money aggregate of UK money supply) fell to £4.9 billion in February compared with £24.3 billion in January. M4 lending also fell, to £16.4 billion in February from £21.4 billion in the previous month.

Finally, pressures on current disposable income, together with uncertainty regarding future projection of incomes, may be continuing factors that affect consumption expenditure in 2008 quarter one.

BUSINESS DEMAND

Business investment buoyant

Total investment grew by 1.8 per cent in quarter four compared to growth of 2.7 per cent in the previous quarter. On an annual basis, total investment by 4.1 per cent, a slowdown from 5.1 per cent growth in the previous quarter. The growth in total investment was primarily due to an increase in machinery and capital equipment investment (**Figure 11**).

Business investment grew relatively strongly in the latest quarter although it slowed compared with the previous quarter. Business investment recorded robust growth of 1.8 per cent in 2007 quarter four, a deceleration from growth of 2.7 per cent in quarter three. On an annual basis, business investment grew by 5.3 per cent, down from 7.8 per cent in the previous quarter.

Business investment could have slowed for a number of reasons. Firstly, increased uncertainty and pessimism, particularly with regards to global 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; 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 weak picture. According to the latest quarterly BCC survey, the balance of manufacturing firms planning to increase investment in plant and machinery fell by nine points to plus 12, the lowest since 2005

Figure 11
Total fixed investment

Figure 12
Government spending

quarter four. The CBI's Quarterly Industrial Survey in 2008 quarter one report also portrayed a bleaker investment picture, with the investment balance of plant and machinery weakening to minus 18 from minus 12 in the previous quarter.

GOVERNMENT DEMAND

Government expenditure falls

Government final consumption expenditure contracted in the latest quarter. Growth fell by 0.5 per cent following an increase of 0.6 per cent in the previous quarter. On an annual basis, growth was 1.3 per cent, down from 2.3 per cent in the previous quarter (**Figure 12**).

Public sector finances deteriorate

The latest figures on the public sector finances reported a deterioration in the current financial year to March 2008 compared with the last financial year. They also showed a higher current budget deficit and a higher level of net borrowing. Overall, the Government continued to operate a financial deficit, with government expenditure continuing to exceed revenues, partly to fund capital spending. In the

financial year April to March 2007/08, the current budget deficit was £7.6 billion; this compares with a deficit of £4.3 billion in the financial year to April to March 2006/07. In the financial year April to March 2007/08 net borrowing was £35.6 billion; this compares with net borrowing of £30.1 billion in the financial year April to March 2006/07. Although corporation, income tax and VAT receipts rose on a calendar basis, this was outweighed by a larger increase in total current expenditure, particularly on capital projects by central government, leading to the higher current budget deficit together with the higher 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 March 2008 was 36.7 per cent of GDP, up from 36.0 in February. In the financial year 2006/07, net debt as a percentage of GDP was 36.6 per cent.

Figure 13
Balance of payments

Figure 14
Employment and unemployment

TRADE AND THE BALANCE OF PAYMENTS

Current account deficit narrows; goods deficit unchanged

The publication of the latest quarterly Balance of Payments figures shows that the current account deficit narrowed in 2007 quarter four to £8.5 billion, from a deficit of £19.1 billion in the previous quarter (**Figure 13**). As a proportion of GDP, the deficit fell to 2.4 per cent of GDP from 5.5 per cent in 2007 quarter three. The narrowing in the current account deficit in 2007 quarter four was due to a switch from a deficit on income to a surplus on income, together with a higher surplus on services. The surplus on income stood at £9.3 billion and the surplus on trade in services widened to £10.1 billion. The deficit on trade in goods was unchanged at £23.2 billion compared with the previous quarter.

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.

Data for 2007 quarter four recorded a continuation of the large trade deficit in goods. Exports of goods fell but imports of goods fell by a lesser amount, resulting in the wide trade deficit. The goods trade deficit was £23.2 billion in the fourth quarter, unchanged from the previous quarter. In terms of growth, exports of goods fell by 0.9 per cent while goods imports fell by 0.6 per cent. Services exports fell by 0.2 per cent and services imports fell by 2.7 per cent. Over the quarter, total trade contracted by 1.0 per cent following growth of 4.3 per cent in the previous quarter.

According to the latest trade figures, in the three months ended February 2008, the deficit on trade in goods and services narrowed to £13.6 billion, from a £13.7 billion deficit in the previous three months. The deficit on the trade in goods narrowed to £22.9 billion in the three months to February compared with £23.8 billion in the previous three months. The surplus on the trade in services narrowed to £9.3 billion compared with £10.1 billion in the previous three months.

However, these figures are distorted by volatility in VAT Missing Trader Intra-Community (MTIC) fraud and therefore need to be treated with caution. According to the latest figures, the level of trade in goods excluding trade associated with

MTIC fraud is estimated to be £0.1 billion in February 2008 and was £0.2 billion in the fourth quarter of 2007.

External surveys on exports reported a subdued picture for the latest quarter. The BCC reported that the export sales net balance fell by six points to plus 16, the lowest position since 2005 quarter four. The latest CBI quarterly survey also reported a weaker picture. The export orders balance was minus 12 in 2008 quarter one, deteriorating from minus four in the previous quarter.

LABOUR MARKET

Labour market activity buoyant

The labour market in the latest reference period illustrated a continued strong picture - with high levels of employment and low levels of unemployment as seen throughout 2006 and in 2007. The robust labour market continues to be a reflection of relatively strong demand conditions in the UK economy.

The latest figure from the Labour Force Survey (LFS) pertains to the three-month period up to February 2008. The number of people in employment and the employment rate rose. The number of unemployed people and the unemployment rate fell. The claimant count fell. The inactivity rate and the number of inactive people of working age have both fallen. The number of vacancies rose. Average earnings including bonuses fell while excluding bonuses increased. Overall average earnings remain subdued with weak real wage growth.

Taking a detailed look, the increase in the employment level was mainly driven by employees and full-time employment. The current working age employment rate was 74.9 per cent in the three months to February 2008, up 0.2 percentage points from the three months to November 2007 and up 0.6 percentage points from a year earlier. The number of people in employment rose by 152,000 in the three months to February 2008 compared to the previous quarter to an employment level of 29.51 million - the highest since records began in 1971. The unemployment rate was 5.2 per cent in the three months to February 2008, down 0.1 percentage point from the three months to November 2007 and down 0.4 percentage points from a year earlier (**Figure 14**). The number of unemployed people decreased by 39,000 in the three months to February 2008 and was

down 90,000 from a year earlier, leaving the current level of unemployment at 1.61 million.

According to the LFS, in the period December to February 2008, the number of people in employment rose by 152,000. The increase was led by a rise in employees of 98,000 and a 42,000 rise in self-employment. In terms of full- and part-time workers, the numbers of people in full-time employment rose by 99,000 while the number of people in part-time employment increased by 54,000.

Workforce jobs increases

According to employer surveys, there was an increase of 13,000 jobs in the three months to December 2007. The largest quarterly contribution to the increase came from distribution, hotels and restaurants (up 43,000), followed by transport and communication (up 18,000), and education, health and public administration (up 10,000). This was offset by decreases across a number of sectors with the largest decrease in manufacturing (down 29,000), followed by construction (down 19,000) and other services (down 13,000). Over the year, total workforce jobs increased by 208,000. Of the total, the largest contribution to the increase over the year came from finance and business services (up 149,000) followed by distribution, hotels and restaurants (up 103,000) and education, health and public administration (up 23,000). The manufacturing sector, in contrast, lost the largest number of jobs on the year (down 53,000), followed by other services (down 12,000).

Claimant count level continues to fall

The claimant count measures the number of people claiming the Jobseeker's Allowance. The latest figures for March 2008 showed the claimant count level at 794,300, the lowest level since 1975. The claimant level was down 1,200 on the previous month and down 110,600 on a year earlier. The claimant count rate in March 2008 was 2.5 per cent, unchanged from the previous month but down 0.3 percentage points from a year earlier.

Vacancies rise

The number of vacancies created in the UK continued to show a healthy demand position for the economy. There were 687,600 job vacancies in the three months to March 2008, up 12,000 from the previous three months and up 52,000 from the same period a year earlier.

Inactivity level falls

The working age inactivity rate was 20.9 per cent in the three months to February 2008, down 0.1 percentage point on the three months to November 2007 and down 0.3 percentage point from a year earlier. In level terms, the number of economically inactive people of working age was down 36,000 over the quarter and by 71,000 over the year to reach a level of 7.87 million in the three months to February 2008. Inactivity falls in level terms were recorded across most groups. The largest level fall in inactivity was recorded for those categorised as 'looking after family/home' (down 39,000). This was offset by increases in a couple of categories, with the largest increase in inactivity amongst the student category (up 42,000).

Average earnings subdued

Growth in whole economy average earnings showed a mixed picture in the three months to February 2008, but overall remains relatively subdued. Average earnings including bonuses increased by 3.7 per cent in the three months to February 2008, down 0.2 percentage points from the previous month. Average earnings excluding bonuses rose by 3.8 per cent, up 0.1 percentage point from the previous month. In terms of the public and private sector split, the gap in average earnings (excluding bonuses) was eradicated in February 2008. Both public and private sector wage grew in parity, at 3.8 per cent.

Overall, the numbers still point to a fairly buoyant labour market, with employment at high levels and unemployment at a stable level. This is consistent with higher workforce participation rates, underpinned by robust GDP growth. Average earnings show stable but fairly modest growth, consistent with increased supply in the labour force.

PRICES

Producer output prices and input prices accelerate

Industrial input and output prices are an indication of inflationary pressures in the economy. During the first quarter of 2008, output prices exhibited further signs of an acceleration of growth from quarter four 2007, and therefore provided signs of continued inflationary pressures. Input prices also accelerated in the first quarter of 2008 compared with quarter four 2007. This 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 in passing higher input price rises to customers, due to spending pressures faced by households – with possible impact on firms profits.

Input prices on average rose by around 20 per cent in 2008 quarter one. This compares with around 11 per cent in 2007 quarter four. The core input price index, excluding food, beverages, tobacco and petroleum, rose by an average of around 9 per cent in

Figure 15
Inflation

Percentage change over 12 months

2008 quarter one (12 month non-seasonally adjusted growth), an acceleration from growth of around 3 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 20.6 per cent in the 12 months to March 2008, driven by a 62.5 per cent increase in the price of crude oil in the year.

Output prices grew on average by around 6 per cent in 2008 quarter four, an acceleration from growth of around 4.5 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 3 per cent in 2008 quarter one, up from 2.3 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 6.2 per cent in the 12 months to March, mainly driven by petroleum products which rose 25 per cent on the year.

Consumer prices unchanged but still above target

Growth in the consumer prices index (CPI) – the Government's target measure of inflation – was 2.5 per cent in March 2008, unchanged from February. This is lower than the peak in March 2007 when inflation reached 3.1 per cent, but above the Government's 2 per cent inflation target (**Figure 15**).

The largest downward contribution to the change in the CPI annual rate came from furniture, household equipment and maintenance where the price of furniture and furnishings rose by less than a year ago. A further large downward contribution came from recreation and culture, principally from games, toys and hobbies where the prices of computer games and pre-school activity toys in particular fell this year but rose a year ago.

The largest upward contribution to the change in the CPI annual rate came from transport costs. This was principally due to passenger air travel on European and,

to a lesser extent, long-haul routes, with fares rising this year compared with falls a year ago. There was also a large upward contribution from housing and household services due to changes in the price of heating oil and gas. The price of heating oil rose by more than a year ago while gas bills were unchanged this year but fell a year ago.

Retail Prices Index (RPI) inflation fell to 3.8 per cent in March, down from 4.1 per cent in February. The main factors affecting the CPI also affected the RPI. Additionally, there was a large downward contribution from housing. The effect came mainly from mortgage interest payments as lenders passed on February's quarter point decrease in the bank rate and, to a lesser extent, from house depreciation which fell this year but rose a year ago. Both mortgage interest payments and depreciation are excluded from the CPI.

RPIX inflation – the all items RPI excluding mortgage interest payments – was 3.5 per cent in March, down from 3.7 per cent in February.