Economic review

July 2008

Anis Chowdhury

Office for National Statistics

SUMMARY

Gross Domestic Product output slowed 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 strengthened, while business investment weakened in quarter one compared with the previous quarter. The current account deficit narrowed in quarter one. The goods trade deficit also narrowed in the latest quarter. The labour market continues to be buoyant in 2008 but shows signs of softening, while average earnings remain relatively subdued. Public sector finances deteriorated in May 2008. Consumer price inflation accelerated in May 2008 and was above the Government's inflation target. Producer output and input price inflation accelerated in 2008 quarter one and continued to increase in May 2008.

GROSS DOMESTIC PRODUCT

First quarter growth of 0.3 per cent

Gross Domestic Product (GDP) growth for the first quarter of 2008 is estimated to have weakened compared with the previous quarter. GDP increased by 0.3 per cent, a downward revision from the 0.4 per cent initial estimate, and a deceleration from 0.6 per cent growth in the previous quarter. The estimate for the annual rate of growth was

2.3 per cent, down from 2.8 per cent growth in the previous quarter (**Figure 1**).

The growth rate in the UK economy in quarter one continued to be driven by service sector output – albeit at a slower level 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 moderate

upturn in manufacturing output. The output of the construction sector slowed but grew modestly.

OTHER MAJOR ECONOMIES

Global growth shows mixed fortunes in quarter one

Data for 2008 quarter one are now available for most major Organisation for Economic Co-operation and Development (OECD) countries. Data reported a mixed, but overall strengthening, picture of global growth compared with the previous quarter.

US GDP growth continued to exhibit relative weakness in 2008 quarter one – growing by 0.2 per cent, up from 0.1 per cent in the previous quarter. This was, however, a marked slowdown from the 1.2 per cent growth seen in 2007 quarter three. The weakness in growth was mainly due to a significant deceleration in consumer spending, partly owing to negative conditions in the housing and credit markets. Fragile growth was also partly led by continued contraction in residential investment – for the ninth consecutive quarter. There was also contraction in non-residential investment following positive growth shown in previous quarters. The above weaknesses were partially offset by a positive net trade situation which contributed positively to growth.

Japan's GDP grew by 0.8 per cent in 2008 quarter one, an acceleration from 0.6 per cent growth in the previous quarter. Growth was led by a strengthening in household consumption and net exports. Residential investment also showed buoyant growth following contraction in the previous quarter. However, these factors were offset by a contraction in both private investment and inventories.

Euro-zone growth picked up. According to Eurostat's estimate, euro area GDP growth accelerated to a buoyant 0.8 per cent compared with modest 0.3 per cent growth in the previous quarter. Growth for the two big mainland European Union (EU) economies – Germany and France – showed an improved picture in 2008 quarter one compared with the previous quarter.

German GDP growth accelerated sharply in 2008 quarter one, increasing by 1.5 per

Figure 1
Gross domestic product

cent, up sharply from 0.3 per cent in the previous quarter. Growth was led partly by positive growth in household consumption following negative growth in the previous quarter. Capital and construction investment also contributed to growth with both accelerating in the latest quarter. Exports grew strongly and continued to be a key driver in Germany's economic growth.

French GDP growth showed a more modest acceleration in 2008 quarter one, rising by 0.6 per cent from 0.3 per cent in the previous quarter. The increase was driven by a sharp acceleration in corporate investment as well as net exports, with both contributing positively to growth. On the other hand, household consumption decelerated, with virtually flat growth recorded in the latest quarter. Italian figures were not available at the time of writing.

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 2008 quarter one, 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 concerning the credit squeeze, attributable to the US housing and the sub-prime mortgage market. According to the latest figures, there appears to be a rebound in the second quarter with the FTSE All-Share index rising on average by 4 per cent in the months April to May.

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 approximately 3 per cent in the previous quarter. Going into the second quarter, the pound depreciated on average by approximately 1 per cent against both the dollar and the euro in the months April to May. The effective exchange rate also depreciated by around 1 per cent (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 the euro in quarter one may have come in response to fears about lower growth in the UK economy and the resulting anticipation 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 was taken 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 due to perceptions among investors of further prospect of interest rate reductions in the UK compared with the US. However, US interest rates were lowered by a further 0.25 basis points in April 2008 to 2 per cent following a 0.75 basis points reduction in March, and this action was driven by the same growth concerns as in 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 0.3 per cent, a deceleration from 0.6 per cent in the previous quarter. On an annual basis it was 2.3 per cent, down from 2.8 per cent in the previous quarter.

Construction activity also weakened in the latest quarter but still grew modestly. Construction output is estimated to have grown by 0.4 per cent, down from 0.9 per cent growth in the previous quarter. Comparing the quarter on the same quarter a year ago, construction output rose by 2.4

Figure 2
Exchange rates

Figure 3
Construction output

per cent, up from 2.3 per cent growth in the previous quarter (Figure 3).

External surveys also signalled weakening activity in the latest quarter, and this was caused partly by the slowing housing market. The Chartered Institute of Purchase and Supply (CIPS) survey average headline index declined to 51.2 from 55.9 in the previous quarter, but is still indicative of fairly buoyant growth. In May the headline index was 43.9, a further weakening from 46.1 in April. 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 one, down from plus 16 in the previous quarter.

Total output from the production industries weakened in the latest quarter, reversing the subdued upturn of the previous quarter. Growth fell by 0.2 per cent following growth of just 0.2 per cent in 2007 quarter four. On an annual basis output grew by 0.4 per cent, down from 0.7 per cent growth 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 4.7 per cent compared with the virtually flat growth in the previous quarter. On an annual basis, output contracted by 4.9 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 1.3 per cent after output increased by 2.8 per cent in the previous quarter. On an annual basis, growth was 1.4 per cent, down from 4.6 per cent growth in the previous quarter.

In contrast, manufacturing output showed a modest revival, growing by 0.4 per cent compared with the flat growth of the previous quarter. On an annual basis, manufacturing output grew by 0.9 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 have been some sort of reversal, with manufacturing

Figure 4
Manufacturing output

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 1.1 per cent in the previous quarter. On an annual basis growth was 1 per cent, down from 2.1 per cent growth in the previous quarter.

External surveys of manufacturing for 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 CIPS average headline index for manufacturing indicated a slowdown but still painted a fairly robust picture in the latest quarter. The headline index was 51.1, down from 53.4 in the previous quarter. The latest survey in May recorded a stagnant position with the balance at 50.0 from 50.8 in April. 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

Figure 5
External manufacturing

Figure 6
Services output

two in the previous quarter. According to the latest monthly survey, the CBI reported manufacturers' orders as holding up well, with the balance at plus one in June. The British Chambers of Commerce (BCC), in its 2008 quarter one survey, 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.

According to the latest Index of Production figures, the output of the production industries fell by 0.1 per cent in the three months to April, compared with the previous three months. In the latest three months, manufacturing output increased by 0.3 per cent, while mining and quarrying output decreased by 3.2 per cent. Output of the electricity, gas and water supply industries decreased by 0.4 per cent compared with the previous three months.

Overall, the service sector, the largest part of the UK economy, continues to be the main driver of UK economic growth. However, there was a significant easing in service sector growth in the latest quarter.

Services output grew by 0.3 per cent in 2008 quarter one, a reduction from 0.6 per cent growth in the previous quarter, and a further slowdown from growth of 0.8 per cent recorded in 2007 quarter three (Figure 6). On an annual basis, services output expanded by 2.6 per cent, down from 3.4 per cent in the previous quarter.

Growth was recorded in varying degrees across all four broad sectors, with a slowdown overall. The main contribution to the decline in services output growth came from businesses services and finance, where output decelerated to 0.2 per cent from 0.4 per cent in the previous quarter. On an annual basis growth was 3.4 per cent, down from 4.6 per cent in the previous quarter. The output of the transport, storage and communication industries also decelerated with growth of 0.7 per cent, down from 1.7 per cent in the previous quarter. On an annual basis, growth was 2.5 per cent, down from 4 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 0.6 per cent in the previous quarter. On an annual basis, growth was 1.9 per cent, down from 2 per cent in 2007 quarter four. This was partially offset by marginally stronger, but still fairly subdued, growth in the output of the distribution, hotels and catering industries. Growth rose to 0.3 per cent from 0.2 per cent in the previous quarter. On an annual basis, growth was 2.4 per cent, down from

Figure 7
External services

Figure 8
Household demand

3.1 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. In the second quarter, the CIPS survey reported a marked weakening in the average headline index. The balance was 49.8 in May, falling below the 50.0 no change mark. 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. 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 ten, still below the long-term average of plus 19. The BCC survey for 2008 quarter one reported a 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 (Figure 7).

The UK sectoral account shows the UK corporate sector being a net lender in 2008 quarter one. However, the level was relatively modest and was an improvement compared with the substantial net borrowing position of the previous quarter. Despite the surplus, the overall debt level remains high due to heavy borrowing between 1997 and 2001. The household sector remains a net borrower as income growth proved insufficient to finance total outlays. Households debt levels continue to be relatively high, although the quarterly interest payments on the loans are still being kept down by low interest rates as a proportion of income. The level of central government borrowing decreased in 2008 quarter one from the previous quarter, but still remains high due to increased rises in cash expenditure exceeding tax receipts. The current account of the UK balance of payments continues to be in deficit.

EXPENDITURE

Consumers' spending strengthens

Household consumption expenditure accelerated in 2008 quarter one from the previous quarter. Growth was 1.1 per cent, up markedly from the 0.4 per cent

in quarter four. Compared with the same quarter a year ago, growth was 3 per cent, up from 2.7 per cent in the previous quarter (**Figure 8**). Higher spending was primarily driven by a rise in durable and semi-durable goods expenditure. This was offset by slower growth in non-durable goods expenditure. There was modest growth in services expenditure.

One key indicator of household expenditure is retail sales. Retail sales strengthened in 2008 quarter one compared with the previous quarter contributing, to a certain extent, to buoyant consumer spending in quarter one. Retail sales volumes grew by 2.0 per cent in quarter one, an acceleration from growth of 0.5 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 (that is, 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 May 2008 showed a robust picture – partly attributable to warm weather conditions (**Figure 9**). In the three months to May, the volume of retail sales increased by 1.8 per cent compared with an increase of 1.5 per cent in the three months to April. On an annual basis in May, the

latest three months growth compared with the same three months a year ago recorded strong growth of 5.4 per cent, up from 4.6 per cent in April.

In the latest month, discounting appears to have played a lesser role compared with the previous month. The price deflator fell by 0.3 per cent in May 2008 compared with a fall of 1 per cent in April.

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In the three months to May 2008, retail sales growth in volume terms was driven by the 'predominantly non-food stores' and to a lesser extent by the 'predominantly food stores' sector. The 'predominantly non-food stores' sector grew by 2.5 per cent, up from 1.7 per cent in the previous month – reflecting growth across all stores. Within this sector there was a rebound in the 'household goods stores', which grew by 0.8 per cent after contracting by 1.4 per cent in the previous month. There was also a strengthening in the 'textile, clothing and footwear stores' and 'other stores', with volume of retail sales growing by 1.2 per cent and 5.4 per cent respectively. Non-store retailing and repair in contrast slowed, with growth of 2.2 per cent, down from 3.4 per cent in April. The 'predominantly-food stores' sector grew by 0.7 per cent in May, down marginally from

0.9 per cent growth in the previous month.

External surveys for retail sales presented a mixed picture of growth in 2008 quarter one. The CBI reported an average balance of plus one in the latest quarter, down from plus ten in the previous quarter. The latest balance in May, according to the monthly Industrial Trends survey, was minus 14. The British Retail Consortium (BRC) reported average growth of 3.3 per cent in 2008 quarter one on a total sales basis, up from 2.8 per cent in 2007 quarter four. According to the latest May figures, total sales growth was 4.6 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, though it appears to be of a lesser case in the latest quarter.

There are two channels of borrowing available to households: secured lending, usually on homes; and unsecured lending, for example on credit cards.

The financial account shows that the general movement from net lending to borrowing since 1992 has primarily been facilitated by increases in both secured and unsecured lending, and it has mainly driven by loans on secured dwellings. In the latest quarter, there was a substantial fall in secured lending, which rose by approximately £14 billion compared with around £21 billion in the fourth quarter and £33 billion in the third quarter. This is mainly attributable to the credit crisis. Unsecured lending also fell, to around £2.7 billion, down from approximately £3 billion in 2007 quarter four and around £4 billion in 2007 quarter three. Despite this easing, borrowing is still contributing to some extent in household consumption growth in the latest quarter.

Another factor that could be cited as having a considerable influence in the acceleration in household expenditure in the latest quarter is the savings ratio. It appears the savings ratio is a major factor, with households resorting to the draw down in their savings to fund consumption. The weakening in total lending and borrowing has been compensated by a fall in the savings ratio, thus contributing towards

Figure 9
Retail sales

Percentage growth

Figure 10
External retailing

Balances

strong final consumption expenditure. The slowdown in the savings ratio also reflects wages and salaries failing to keep up with strengthening tax payments on income and wealth. The saving ratio in 2008 quarter one was 1.1 per cent – the lowest since 1959 quarter four when it was 0.7 per cent. This compares with 3 per cent in 2007 quarter four (Figure 11).

BUSINESS DEMAND

Business investment weakens

Total investment fell by 1.5 per cent in 2008 quarter one compared with growth of 2.2 per cent in the previous quarter. On an annual basis, total investment grew by 1.4 per cent, a slowdown from 4.4 per cent growth in the previous quarter. The decrease in total investment was due to both business and dwelling investment falling on the quarter (Figure 12).

Business investment decelerated markedly in 2008 quarter one, contracting by 1.8 per cent, following growth of 3.1 per cent in 2007 quarter four. On an annual basis, business investment grew by 4.5 per cent in the latest quarter, a slowdown from 6.7 per cent growth in the previous quarter. The slowdown in business investment was due to sharp declines in construction, consumer goods manufacturing and distribution.

Business investment could have decreased for a number of reasons. First, increased uncertainty and pessimism, particularly with regards to global demand may have deterred investment; second, the downturn in investment could have come on the back of lower corporate profits; third, 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 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 quarter four. The CBI's Quarterly Industrial Survey in 2008 quarter one also reported a bleaker investment picture,

Figure 11
Household saving ratio

Figure 12
Total fixed investment

Figure 13
Government spending

with the investment balance of plant and machinery weakening to minus 18 from minus 12 in the previous quarter.

According to the sectoral accounts, the private non-financial corporate sector reported net lending of £0.2 billion in the latest quarter, reversing net borrowing of £3.2 billion in the previous quarter. This was driven by decreases (destocking) in inventories and net property income. Despite this, corporate sector debt levels remain high regardless of the sector surplus of recent years. The financial balance sheet shows the corporate sector had net liabilities of around £1.8 billion.

GOVERNMENT DEMAND

Government expenditure increases

Government final consumption expenditure accelerated in the latest quarter. Growth jumped to 0.9 per cent following growth of 0.2 per cent in the previous quarter. On an annual basis, growth was 2 per cent, up from 1.7 per cent in the previous quarter (Figure 13).

Figure 14
Balance of payments

Public sector finances deteriorate

The latest public sector finances to May 2008 figures illustrated a negative picture. The figures showed a current budget deficit together with a net borrowing situation, reflecting government expenditure continuing to exceed revenues. In the financial year 2008/09, the current budget was in deficit by £9.3 billion; this compares with a budget deficit of £7.1 billion in the same period of 2007/08. Public sector net borrowing in the financial year 2008/09 was £12.7 billion; this compares with net borrowing of £8.4 billion in the financial year 2007/08. Slower growth in current receipts was exceeded by a larger increase in current expenditure, particularly on capital projects, resulting in both a higher budget deficit and increased net borrowing.

The financial account shows that the issuance of both sterling treasury bills and government securities has financed this net borrowing. The latest quarter saw the outstanding amount of government securities at £496.7 billion and of Treasury bills at £17.6 billion.

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 May 2008 was 37.2 per cent of GDP, up from 36.5 in May 2007. In the financial year 2006/07, net debt as a percentage of GDP was 36.7 per cent.

TRADE AND THE BALANCE OF PAYMENTS

Current account deficit narrows; goods trade deficit narrows

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 14). 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 latest figures show a continuation in the goods trade deficit which was £22.7 billion in 2008 quarter one. In terms of growth, exports of goods grew by 0.8 per cent while goods imports fell by 2 per cent. Services exports grew by 0.4 per cent and services imports grew by 1.3 per cent. Over the quarter, total exports increased by 0.6

per cent. In contrast, total imports fell by 1.2 per cent.

Overall, the persistence of the current account deficit has led to a deterioration in the UK's international investment position with the rest of the world. The net asset/liability was negative to the tune of £329.0 billion at the end of the first quarter of 2008, compared with net external liabilities of £350.4 billion at the end of the previous quarter. UK assets abroad stood at £6797.0 billion compared to a level of £6486.5 billion at the end of the fourth quarter. UK liabilities stood at £7125.9 billion in the first quarter compared to a level of £6836.9 billion in the fourth quarter. The rise in the level of both UK assets and UK liabilities in the first quarter reflected net investments, the depreciation in the value of sterling and increases in the price of some debt securities.

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. According to the latest figures in June, the export orders balance was at minus five.

According to the latest trade figures, in the three months ended April, the deficit on trade in goods and services narrowed to £12.4 billion, from a £14.1 billion deficit in the previous three months. In terms of growth, total volume exports grew by 1.3 per cent while total imports fell by 1.8 per cent in the three months to April.

LABOUR MARKET

Labour market activity buoyant but shows further signs of softening

The labour market in the latest reference showed further signs of softening but, overall, still painted 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 latest quarter, starting to feed through to the labour market.

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

Employment continues to proceed at record levels. The current working age employment rate was 74.9 per cent in the three months to April 2008, unchanged from the three months to January 2008 and up 0.5 percentage points from a year earlier. The number of people in employment rose by 76,000 compared with the previous quarter, to an employment level of 29.55 million – the highest since comparable records began in 1971. However, this compares with an increase of 117,000 in the three months to March, which may suggest a softening in employment growth. Unemployment levels, on the other hand, continued to see a steady increase from the previous month, which marked the first rise in the year. The number of unemployed people increased by 38,000 but was down 34,000 from a year earlier, leaving the unemployment level at 1.64 million in the three months to April 2008. The unemployment rate also increased, to 5.3 per cent, up 0.1 percentage point from the three months to January 2008, but down 0.2 percentage points from a year earlier (Figure 15).

Looking at a detailed level, the increase

in the employment level was mainly driven by employees and full-time employment, offset by a small decline in self employment. Employees rose by 66,000 while the self-employed decreased by 7,000. In terms of full- and part-time workers, the number of people in full-time employment rose by 80,000, while the number of people in part-time employment fell by 4,000.

Workforce jobs increases

According to employer surveys, there was an increase of 44,000 jobs in the three months to March 2008. The largest quarterly contribution to the increase came from other services (up 27,000), followed by construction (up 11,000). This was offset by a decrease across a number of sectors, with the largest decrease being in business services and finance (down 20,000), followed by manufacturing (down 11,000). Over the year, total workforce jobs increased by 237,000. Of the total, the largest contribution to the increase over the year came from finance and business services (up 85,000), followed by distribution, hotels and restaurants (up 83,000). The manufacturing sector, in contrast, lost the largest number of jobs on the year (down 52,000).

Claimant count level increases

The claimant count measures the number of people claiming Jobseeker's Allowance. The latest figures for May 2008 showed the claimant count level rose by 9,000 – the third consecutive monthly increase, though this is down 58,100 on a year earlier – to reach a level of 819,300. The claimant count rate in May 2008 was 2.5 per cent, unchanged from the previous month but down 0.2 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 678,600 job vacancies in the three months to May 2008, up 100 from the previous three months and up 35,200 from the same period a year earlier.

Inactivity level falls

The working age inactivity rate was 20.8 per cent in the three months to April 2008, down 0.1 percentage point on the three months to January 2008 and down 0.4 percentage point from a year earlier. In level terms, the number of economically inactive people of working age was down 23,000 over the quarter, and by 107,000 over the year, to reach a level of 7.86 million in the three months to April 2008. Inactivity falls in level terms were recorded across most groups. The largest level fall in inactivity was recorded for those categorised as 'long-term sick' (down 27,000), followed by the 'retired' category (down 13,000). This was offset by increases in a couple of categories, with the largest increase in inactivity amongst the 'discouraged' category (up 7,000).

Average earnings subdued

Growth in whole economy average earnings presented a mixed picture in the three months to April 2008, but overall remains relatively subdued. Average earnings including bonuses increased by 3.8 per cent in the three months to April 2008, down 0.2 percentage points from the previous month. Average earnings excluding bonuses rose by 3.9 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) widened in April 2008. Public sector wage growth was 4.1 per cent, up 0.2 percentage points from the previous month. Private sector wages grew by 3.8 per cent, unchanged 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 may have started to impact on the labour market in terms of higher unemployment levels. Average earnings show stable but fairly modest growth, consistent with increased supply in the labour force.

Figure 15
Employment and unemployment

PRICES

Producer output 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 suggests that firms may have been tempered in part, in passing higher input price rises to customers. This in part could be 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 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 27.9 per cent in the 12 months to May 2008, up from 24.3 in April – driven by a 83.8 per cent increase in the price of crude oil on 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 8.9 per cent in the 12 months to May, up from 7.6 per cent in April – mainly driven by petroleum products which rose 28.5 per cent on the year.

Consumer prices accelerate and above target

Growth in the consumer prices index (CPI) – the Government's target measure of inflation – was 3.3 per cent in May 2008, an acceleration from 3 per cent in April and considerably above the Government's 2 per cent inflation target (Figure 16).

The largest upward pressure came from food and non-alcoholic beverages, mainly meat and vegetable prices which rose this year but fell a year ago. This effect was partially offset by fruit prices rising, though by less than a year ago.

There were further large upward pressures from: housing and household services due to gas and electricity bills, which were unchanged this year but fell a year ago; heating oil prices, which rose this year but fell a year ago in part reflecting the rise in the price of crude oil this year; and recreation and culture, from across a range of goods and services. The main upward pressures came from books, newspapers and stationery where prices rose by more than a year ago, and foreign holidays where prices rose this year but fell a year ago. The upward effects were partially offset by a

downward contribution from recording media, in particular pre-recorded DVDs.

Small upward effects came from: alcoholic beverages and tobacco, where prices of alcoholic drinks rose this year but fell a year ago, particularly the price of spirits; miscellaneous goods and services where prices rose this year, but fell a year ago; and furniture and household goods, with the largest effect coming from goods and services for routine household maintenance, which includes items such as household cleaning products and domestic services

Retail Prices Index (RPI) inflation rose to 4.3 per cent in May, up from 4.2 per cent in April. 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 April's quarter point decrease in the bank rate and, to a lesser extent, from house depreciation.

RPIX inflation – the all items RPI excluding mortgage interest payments – was 4.4 per cent in May, up from 4.0 per cent in April.

Figure 16
Inflation