Economic review

August 2010

Graeme Chamberlin
Office for National Statistics

SUMMARY

New National Accounts data consistent with Blue Book 2010 shows that the total peak to trough fall in GDP during the latest recession was 6.4 per cent, compared to the previous estimate of 6.2 per cent. Preliminary estimates report that GDP growth was 1.1 per cent in the second quarter of the year, with the strong pickup in growth being driven by the business services and finance and construction sectors – which both contributed 0.4 percentage points to the overall growth rate. New data on non-financial balance sheets shows that net worth in the UK fell during the recession, predominately reflecting lower asset prices (such as for equities and residential properties). New Workforce Jobs estimates show that over 1 million jobs were lost in the recent recession, and a more detailed breakdown by industry, especially in the services sector, is provided. Finally, CPI inflation continues to exceed 3.0 per cent, but around 1.7 percentage points is accounted for by the January rise in the rate of VAT.

Expenditure release in May 2010. The figure also shows a recession index, where the level of GDP is converted into an index where GDP in 2008 Q1, the last quarter before the recession, equals 100. The most interesting result is that the total depth of the recession has been revised slightly downwards. Between 2008 Q1 and 2009 Q3 GDP declined for 6 successive quarters. According to the latest data this peak to trough fall was 6.4 per cent, compared to 6.2 per cent in the Pre BB data.

These results confirm that the latest recession has been the most severe since the Second World War. An article in this edition of *Economic & Labour Market Review* (see Chamberlin 2010) compares output and expenditure movements in the last three UK recessions in more detail – and shows that peak to trough falls in the early 1990s and early 1980s recession were 2.5 per cent and 5.9 per cent respectively.

Preliminary estimates for 2010 Q2 shows that GDP grew by 1.1 per cent relative to the previous quarter. This is the fastest quarter of growth since 2006 Q1, and GDP has now expanded for three successive quarters since reaching a trough in 2009 Q3. The latest quarterly figure is also an acceleration on the two previous quarters when growth was 0.4 per cent in 2009 Q4 and 0.3 per cent in 2010 Q1. However, despite this recent pick up the level of GDP is still 4.7 per cent below its pre-recession mark.

Construction and business services lead growth in the second quarter

Services industries account for three-quarters of total Gross Value Added (GVA) in the UK, so it is unsurprising that this sector as a whole tends to drive growth overall (see **Figure 2**). Growth slowed to 0.3 per cent in the first quarter of the year, reflecting a 0.7 per cent fall in the output of the distribution, hotels and restaurants sector. Here, bad weather in January may have affected footfall in this sector, and the increase in the rate of VAT back to 17.5 per cent on the first day of 2010 may have meant that some consumption was brought forward to the final quarter of 2009. This appears to be the case, as

Revised data show a deeper recession

In the last month ONS has published two new sets of GDP figures. On 12 July, the *Quarterly Economic Accounts*, presented the third estimate for 2010 Q1, but more significantly, these results were also consistent with the 2010 *Blue Book*. In this publication past data is benchmarked to annual data sources and supply and use balancing reconciles the output, income and expenditure sides of the economy by

product and by industry. Then, on the 23 July, ONS published the *GDP Preliminary estimate* for 2010 Q2

This year's *Blue Book* revisions have had a fairly small impact on the past record of economic growth in the UK, mainly because there were no major methodological changes made to the National Accounts this time. **Figure 1** shows the quarter-on-quarter, growth rates for the latest published data and that available before the *Blue Book* (Pre BB), which is the *Output, Income and*

Figure 1
GDP growth and the recession index

Source: GDP Preliminary estimate (2010 Q2) and Output, Income and Expenditure (2010 Q1)

Figure 2
Contributions to GVA growth, 2009 Q4 – 2010 Q2

Source: GDP Preliminary estimate (2010 Q2)

the output of the distribution, hotels and restaurants sector showed strong growth of 2.2 per cent in the final growth of 2009 Q4.

The business services and finance sector has shown the most robust growth, output rising by 1.3 per cent on the quarter and contributing 0.4 percentage points to overall GDP growth. Furthermore, output in this sector was less affected by the bad weather at the beginning of the year, so stronger growth in the second quarter is less likely to reflect a rebound from weather-related disruptions to activity in the first quarter. Recent Purchasing Managers Index (PMI) reports on the service sector have pointed to strengthening activity in the key business-to-business services sector. And the British Chambers of Commerce (BCC) *Quarterly Economic Survey* reported that domestic orders in the services sector were at the highest level since 2008 Q1, although it also notes that confidence remains weak.

One particular source of growth in this sector may be the indirectly measured output of the financial services industry-known as FISIM (financial intermediary services indirectly measured). This accounts for the fact that much of the output of the financial sector is not charged for explicitly, but indirectly through a spread between the prices at which financial assets are bought or sold, or on the interest charged on loans and paid on deposits. An increase in spreads would tend to increase FISIM output, even if output volumes remained unchanged. Recent evidence from the CBI/PwC *Financial Services Survey* has reported just that, widening spreads across the financial sector including banks.

The manufacturing sector has also shown a steady recovery after output reached a trough in 2009 Q3. Since then, manufacturing output has expanded by 1.1 per cent, 1.4 per cent and 1.6 per cent respectively in the following three

quarters up to and including 2010 Q2 when it contributed 0.2 percentage points to total GDP growth. PMI data, the *Industrial Trends Survey* published by the Confederation of British Industry and the BCC *Quarterly Economic Survey* all concur with the story of strengthening manufacturing output, stemming from an increase in new orders and as businesses begin to rebuild stock levels in anticipation of higher future demand.

The largest increase in second quarter output though was in the construction industry where output increased by 6.6 per cent and contributing 0.4 percentage points to overall growth. Given the relatively low weight of this sector in total GVA (around 6 per cent according to 2006 weights), this pickup in growth looks both large and sudden, and was the main factor explaining why GDP growth was ahead of consensus forecasts in the second quarter.

While both the production and services sectors have now grown for three successive quarters, output in the construction sector has been slower to show signs of recovery. In fact, after quarter-on-quarter contractions of 1.6 per cent in both 2009

Q4 and 2010 Q1 construction output reached a new trough in the first quarter of the year, 15 per cent below its pre-recession level. Even accounting for the latest quarter of sturdy growth, construction output is still 9.4 per cent lower than its pre-recession level, not much different to production output which is around 11.8 per cent below its pre-recession level. Most recent data show that GDP as a whole reached its trough in 2009 Q3. Relative to this, construction output was 3.6 per cent higher in 2010 Q2 whilst manufacturing output was 4.2 per cent higher. Therefore, on the basis of quarter-on-quarter changes construction output exhibits greater volatility, but viewed over a longer period of time output movements have been less marked and more in line with production (manufacturing) output. It is also unclear to what extent the latest quarter of strong growth is as a result of the poor weather in January. By hampering activity in the first quarter, output in the second quarter may simply just look stronger in comparison.

Construction new orders and output show signs of recovery

ONS publishes more detail on the construction industry in two quarterly statistical bulletins covering output and new orders. The most recent publications cover the period up until 2010 Q1, so it will be necessary to wait for the next release to understand better the large movements in construction output in 2010 Q2.

Construction activity has generally been in the doldrums during the last two years. **Figure 3** plots the value, in constant prices and seasonally adjusted, of the main categories of construction output

Figure 3
Construction output by main category of activity

Source: Output in the construction industry

Figure 4
New orders and new work output in the construction industry

Source: *Output in the construction industry and New orders in the construction industry*

Figure 5
Main categories of new orders in the construction industry

Source: *New orders in the construction industry*

since 2006. The recession has clearly been associated with strong falls in (mainly private) new house building (down 37.2 per cent between 2007 Q1 and 2009 Q3) and new private commercial and industrial work (down 33.9 per cent between 2008 Q1 and 2009 Q4). In both cases falling property prices and the hiatus in mortgage and business lending have weighed on demand. In contrast, public sector and infrastructure new work have increased strongly, perhaps due to a different source of funding than available to the private sector.

It should be remembered that a significant part of construction output consists of repair and maintenance which has also fallen. However, as Figure 3 shows, this category of output tends to be less cyclical than new work. This makes some sense. Although households and businesses may delay some maintenance expenditures when cash flows are weaker, there is probably less scope to cut this spending than with new projects. Also, the search for cost savings may lead to a substitution away from replacing to repairing the building fabric. The government also brought forward some repair and maintenance work as part of its fiscal stimulus package. Having said this, it was this part that contributed the most to the further fall in construction output in

2010 Q1, just as new works were beginning to strengthen.

The value of new orders in the construction industry is presented in **Figure 4** alongside the value of total new work (see Figure 3). Clearly both series follow the same cyclical pattern, although new orders have shown stronger movements and, as would be expected, tend to lead new work output. In recent quarters new orders have shown some sign of recovery, picking up from the trough in the first quarter of 2009. This would be expected to eventually pass-through into new work output, and might explain some of the growth observed in construction output in 2010 Q2. PMI data on the construction industry concurs with this strong second quarter growth, with activity balances improving sharply from March 2010 onwards. Furthermore, this was attributed to an improvement in new orders, as Figure 3 also suggests.

Figure 5 shows the trends in the main categories of new orders. While private industrial and commercial orders fell abruptly in the recession, and in line with new work output, the decline has now at least slowed. Improvements to new orders in housing and public and infrastructure sectors though have started to emerge, which were also reported in recent PMI

data. The housing market has shown some signs of recovery in the last year, and even though turnover and mortgage lending remains depressed, there is still a structural undersupply of homes in the UK.

Government net-borrowing increases as households and corporations become increasing-net lenders

The net-lending position of a particular sector is a good summary of its overall balance sheet. A sector is a net-lender if its gross saving – that is its disposable income minus consumption – exceeds its investment spending (what it actually spends on capital items). In this case, the surplus balances can be lent to other sectors of the economy, or overseas. Net-borrowing reflects the opposite scenario, where a particular sector's investment spending exceeds the internally generated funds available. In this case, external finance (borrowing from other sectors or overseas) is required to fund investment. Sectors normally become net-borrowers as consumption and investment increase above income, and vice-versa for net lending sectors.

Figure 6 displays the net-lending/borrowing positions of the general government, household, corporate sectors and rest of the world sectors and how they have changed over the recent period of recession. Two very marked trends are visible. First, the household and corporate sectors have become increasing net-lenders. In the case of the household sector, it actually switched from being a net-borrower to a net-lender around the start of the recession and has maintained that position ever since. This is clearly evidence that these sectors of the economy have reduced current and capital spending (consumption and investment) relative to income – perhaps to pay down debt levels and strengthen balance sheets.

Secondly, and in stark contrast, the general government sector has become an increasing net-borrower. This is a clear manifestation of the large budget deficits posted in the last two calendar years as government spending (consumption and investment) increases relative to a sharp fall in general government income.

In fact, the rise in government borrowing has generally offset the rise in private sector lending (households and corporations), as evidenced by the fairly stable trend

Figure 6
Net-lending/borrowing by sector as a percentage of GDP

Source: UK Economic Accounts

Figure 7
Current budget balance and net borrowing as a proportion of GDP

Source: UK Economic Accounts

in the net-lending position of the rest of the world sector. These sector accounts should be a closed system, so the rest of the world position reflects the net lending and borrowing positions of the domestic sectors. It should also, for the same reason, reflect movements in the current account. As the rest of the world has been a fairly constant net lender to the UK economy it suggests the UK has run, as a percentage of GDP, a fairly stable current account deficit in recent years – which it more or less has once sporadic quarterly movements in investment income are smoothed over a longer period (see later in the article).

The financial accounts for each sector, which ONS publishes routinely each quarter as part of the *UK Economic Accounts*, are a useful resource for understanding and analysing the financial positions of different parts of the UK economy. These can now be looked at in a little more detail.

Current budget deficit exceeds 7.0 per cent of GDP in 2009/10

As explained already, the net-lending position of the public sector, (general government plus public corporations) will tend to reflect the main trends in the public sector finances. **Figure 7** shows the

current budget balance and Public Sector Net Borrowing (PSNB), both as a percentage of GDP. For each there are two measures, including and excluding the effects of the government's various interventions in the financial sector.

The current budget deficit reached 7.08 per cent of GDP in the financial year 2009/10 (7.53 per cent excluding financial interventions), up from 3.5 per cent (3.47 per cent) in 2008/09 and compares to an almost balanced current budget in 2007/08. The abrupt deterioration in the public finances is a clear consequence of the recession – as transfer payments (such as out of work benefits) increase and taxation revenues fall. Stimulus packages have also maintained (and in some instances increased) government spending through the recession adding to the deficit.

PSNB increases in line with the growing deficit as the government increases its liabilities. It also consists of borrowing to finance capital spending (public sector investment) which is not included in the current budget balance and which the previous government has generally maintained as a proportion of GDP in the last two financial years. As a result, PSNB was 10.25 per cent of GDP (11.03 per cent excluding interventions) in 2009/10, compared to 6.05 per cent (6.07 per cent)

in 2008/09 and just 2.35 per cent (2.38 per cent) in 2007/08.

It is noticeable that the current budget balance and PSNB measures are worse once the government's financial interventions are excluded. This is because the government, through its stakes in the banking sector and through the Bank of England's asset purchase scheme has accumulated assets that have generated positive revenues, hence lowering the budget balance and the borrowing requirement. However, as the government intends to one day disinvest itself of these assets and return them to the private sector, the revenues they presently generate for the public purse must only be temporary. As a result, excluding the effects of these interventions provides an underlying measure of the public sector finances.

Corporate sector net lending continues to rise as gross capital formation falls

The corporate sector consists of financial corporations (FC), public corporations (PC) and private non-financial corporations (PNFC). The rise in corporate sector net lending, as seen in **Figure 6**, can be best observed by looking at the PNFC sector – which is the largest of the three. **Figure 8** shows the two main inputs into net lending, the gross disposable income of PNFCs and also gross capital formation. Both are expressed as a proportion of GDP. It can be seen that net lending has grown due to a relatively larger fall in the capital formation of the sector compared to disposable incomes, which mark the internally generated funds available for investment and has been more stable as a proportion of GDP through the recession.

The fact that PNFC disposable income, as a proportion of GDP, has not shown such a large fall in itself hides a number of different trends. Most notably, corporate profitability has fallen in the recession, which other things being equal, would lower the corporate sector's disposable income. According to ONS's latest Profitability of UK companies statistical bulletin, the net rate of return for PNFCs was 10.2 per cent in the first quarter of 2010 Q1. This figure, which excludes the high impact of UK Continental Shelf companies, is a three percentage points fall from the 13.2 per cent net rate of return in 2008 Q1. The fall in profitability was more acute in the

Figure 8
Net-lending of private non-financial corporations as a proportion of GDP

Source: UK Economic Accounts

Figure 9
Household saving, gross capital formation and net-lending¹

Note:

Source: UK Economic Accounts

¹ Figures are presented as a percentage of household total resources.

manufacturing sector. However, a number of factors have acted to offset the fall in profitability on disposable income.

First, taxes have fallen in line with profits. Second, major reductions in interest rates have reduced the cost of servicing debts and freed up cash flows. And finally, there is evidence that the sector on the average has cut dividend payments to share holders. Each of these would act to increase the internally-generated funds available for investment.

Gross capital formation (GCF) consists of both gross fixed capital formation (GFCF) capital goods with a life length in excess of one year) and stockbuilding (the stocks of raw materials, works in progress and finished goods that companies use to meet future demand). Therefore, part of the fall in PNFC investment reflects the running down of stocks as the UK entered recession. The contraction in both types of capital spending is an indicator that the corporate sector sees less need to maintain future capacity when there is great uncertainty over future demand, but this may not be the only reason explaining weakening investment.

Some firms may be only too willing to

invest more but have been constrained by the tightening in credit availability. Lending to businesses has fallen sharply, despite government efforts to use their stakes in the banking sector to this end, although it is not certain the extent to which the fall in lending can be attributed to the demand or supply of credit. Investment spending may also have been cut back in order to protect or build cash reserves, to act as a buffer against uncertainty, make additional contributions into deficit pension schemes, and to pay down existing debts.

Households continue as net-lenders

Households have also become increasing net lenders to the rest of the economy, and largely for the same reasons as the corporate sector. The household saving ratio predominately shows the balance of household disposable income and consumption spending. Although both would be expected to fall in a recession, consumption generally falls faster and the saving ratio increases, as has been the case (see **Figure 9**). In 2008 Q1 the household saving ratio was at a low of -0.9 per cent,

meaning that household consumption exceeded disposable income. Since then, the saving ratio has risen, reaching a peak of 8.5 per cent in 2009 Q3, which is not high by historical standards but is certainly the case for more recent times.

Household disposable incomes, like those of corporations, have been subject to a number of opposing forces. Increasing unemployment and moderation in wage growth has constrained labour income. But because the household sector is an overall net debtor in interest bearing assets, due mainly to the large increase in secured mortgage debt built up in the last decade, the major reduction in interest rates has, in the aggregate, supported income available for consumption and investment. The taxes and benefits system has also behaved as an automatic stabilizer, protecting household incomes from some of the consequences of the weakening labour market through lower taxes and higher benefit payments. All in all, disposable incomes may not have fallen by as much as could be feared.

Household consumption though has contracted significantly. **Figure 10** shows the main contributions to the quarter-on-quarter growth rates through the recession. Large falls in 2008 Q4 and 2009 Q1 correspond to sharp rises in the saving ratio (which went from 1.5 per cent in 2008 Q3 to 7.9 per cent in 2009 Q2). The fall in household consumption has also been fairly broad-based across the main components. There are two items of note from **Figure 10**.

The first is the contribution of durable goods to consumption growth in the second half of 2009, especially in the final quarter. This may partly reflect the vehicle scrappage scheme. The temporary reduction in VAT to 15 per cent between December 2008 and January 2010 may also have resulted in some (durable) consumption being brought forward from 2010 Q1 to 2009 Q4. In that quarter alone consumption grew by 0.6 per cent, of which 1.0 percentage point was accounted for by spending on durables, and the saving ratio dropped by 1.3 percentage points from the previous quarter.

Second is the contribution of net tourist spending, which has often been significant even though it rarely attracts much attention. This component of household consumption balances out the consumption of UK resident households overseas, and the spending of overseas residents in the UK. As it refers to the household sector these spending flows are largely synonymous with tourists. Net tourist spending has generally made a negative contribution to household consumption growth in recent quarters.

Figure 10
Contributions to household consumption growth¹

Note:

Source: UK Economic Accounts

1 Figures are presented as a percentage of household total resources.

This appears to be a result of a larger fall in visits abroad by UK residents than in the visits to the UK by overseas residents. According to the ONS's Monthly Overseas Travel and Tourism statistical bulletin, the number of visits to the UK by overseas residents' fell by 15.6 per cent between 2008 Q1 and 2010 Q1. Over the same period, the number of visits by UK residents to overseas fell by 28.0 per cent. Given that there hasn't been a noticeable change in the average amounts spent by visitors to and from the UK, these trends in passenger numbers suggest that net tourist spending has fallen. An article in this edition of Economic & Labour Market Review (see Webber, Buccellato and White 2010) finds evidence of a *staycation* effect, where UK residents substitute foreign travel to domestic travel. One factor at play here may have been the depreciation in sterling, which makes UK visits relatively cheaper compared to foreign trips.

The rise in the saving ratio explains half the growing net-lending position of households. The other half is accounted for by a fall in household investment. For the household sector the main investment item is residential property, so the reduction here reflects both the fall in house prices and the weaker turnover, which may be in itself the result of tighter restrictions on mortgage lending.

Current account back in deficit in 2010 Q1

The balance of payments records one nation's transactions with the rest of the world. Within this the current account records flows of trade in goods and services, income and transfer payments across countries. **Figure 11** shows the recent path in the UK current account and the trade and income (including transfers) components, all expressed as a proportion of GDP.

Clearly quarterly movements in the current account can be and have been volatile, so often a better picture can be taken by looking at longer-term movements in the data. The balance of trade is the difference between exports and imports in goods and services; where the UK's large deficit in goods trade is partly offset by its surplus in services trade. As a proportion of GDP, the trade balance improved at the outset of the recession as imports fell at a faster rate than exports. However, since the UK and global economies have started to recover, UK imports have picked up at a faster rate than exports arresting the improvement in the current trade deficit. This is despite the large depreciation in sterling in the second half of 2008 – which seems to have had little impact on the UK's trade position – although it is hard to disprove the possible counterfactual that things may have been worse otherwise. Findings from recent business surveys have not reported overly optimistic balances regarding future export orders, with the exchange rate also having little noticeable effect in stimulating export orders.

The balance on income flows also includes current transfer payments. Current transfer payments include aid

spending and the costs of belonging to supranational organisations such as the European Union or the United Nations, and is a remarkably stable component in the balance of payments with the UK running a deficit of about 1.0 per cent of GDP. Income includes remittances by workers, but most substantially investment income flows. These are payments associated with the international ownership of assets. The UK has typically generated positive investment income due to its large accumulated stock of foreign direct investment assets. In recent quarters these flows have been volatile, and due to their size they have impacted on the overall current account. For example, between 2009 Q4 and 2010 Q1 the current account position switched from a surplus of 0.1 per cent of GDP to a deficit of 2.7 per cent of GDP.

Investment income flows can be volatile. As mentioned earlier, much of the UK's investment income is derived from its stock of foreign direct investment, which unlike interest-bearing assets, exhibits higher but also more volatile returns. At times of equity market and exchange rate volatility investment income flows are likely to be even more variable. Some of the pattern of recent movements in the current account balance can also be seen in the net-lending position of the rest of the world sector in Figure 7.

Recession hits net-worth of the UK

In the UK *Economic Accounts* which ONS publishes each quarter a full set of financial accounts are presented for each sector of the economy. These include net-positions in the holdings of financial assets. Similar balances for net-holding of non-financial assets are published annually in the Blue Book, and have just been made available up until 2009. Interest will lie in

Figure 11
UK current account balance and its main components relative to GDP

Source: UK Balance of Payments

Figure 12
Net-worth in the UK by sector

Source: Blue Book

Figure 13
Net-worth of the general government sector

Source: Blue Book

how the recession has affected the UK's overall net-worth or wealth – the difference between total assets and total liabilities. These positions for 2007, 2008 and 2009 for the corporate, general government, household and UK are shown in **Figure 12**. Two things are immediately apparent. The first is that the net worth of the UK fell in the two years of the recession in 2008 and 2009. Second, the household sector accounts for almost all of the net worth position of the UK.

In 2007 the net worth of the UK was around £7.07 trillion. In 2008 this had fallen to £6.76 trillion, and in 2009 a further but smaller fall to 6.67 trillion. Residential buildings were the largest category of net worth. In line with the fall in house prices during 2008 the value of residential buildings assets fell from £4.31 trillion in 2007 to £3.92 trillion in 2008 – a drop of £390 billion. However, as house prices regained some of their value in 2009 the value of residential property assets increased by £130 billion to £4.05 billion. The value of commercial, industrial and other buildings have also fallen, from £700.1 billion in 2007 to £596.5 billion in 2008 and then further to £559.1 billion in 2009.

The movement in net financial assets over this period appears small in

comparison, with liabilities of £323.3 billion in 2007 improving to liabilities of £101.5 billion in 2008 before deteriorating to net liabilities of £275 billion in 2009. This is because a lot of the net financial assets and liabilities are held between different sectors in the UK, so in the aggregate there is a lot of netting out.

Rising public sector debt reduces the government's net-worth

One feature in Figure 12 is the fall in the net worth of the general government sector. In 2007 its net-worth position was £356.2 billion, but this has subsequently fallen to £258.1 billion in 2008 and then to just £77.5 billion in 2009. A breakdown between the contributions of non-financial assets and financial assets is shown in **Figure 13**. Although the net-holding of non-financial assets have fallen, in line with general falls in asset prices and particularly property prices, the main factor behind the deterioration in the general government sector's net worth has been the rise in its financial liabilities. In 2007 these stood at net liabilities of £400 billion, and have now increased to over £600 billion in 2009. These have been incurred as the government borrows in order to fund its growing PSNB.

Also included in Figure 13 are recent levels of Public Sector Net Debt (PSND), and clearly this has grown in line with the general government's financial liabilities. In 2007 PSND stood at £634.4 billion (£534.6 billion excluding the government's interventions in the financial sector), but had grown to £865.5 billion in 2009 (£744 billion excluding the interventions). Note that public sector net-debt excluding the interventions is lower as it does not reflect the debt incurred in the purchase of assets such as the stakes in Lloyds and RBS, any contingent liabilities and the costs of the Bank of England's asset purchase scheme. As it is intended that these assets will only be temporarily held by the general government sector they are excluded from headline (underlying) figures in the public sector finances.

In the July Public Finances statistical bulletin it was reported that Public Sector Net Debt had increased to £926.9 billion (£813.7 billion). If this continues through to rising net financial liabilities it is likely that the government will have negative net-worth by the end of 2010.

Household net worth

The household sector dominates the holdings of net worth in the UK. This is hardly surprising, as it owns most residential property, and through its investments in pension funds and life insurance it owns much of the equity in the corporate sector as well. Trends in the main parts of the household sector's net worth since 2000, as a ratio to GDP, are shown in **Figure 14**. Clearly total net-worth has increased over the years, despite a fall in 2008 and that net-worth in 2009 was still below that in 2007. These movements were driven by changes to residential property prices. As a result, net-worth in all non-financial and financial assets was 2.5 times GDP in 2000, was 3.5 times in 2007, before falling back slightly to 3.1 times in 2008 and finally recovering to 3.3 times GDP in 2009.

The household sector has generally held positive balances in financial assets, mainly due to the equity held on its behalf by pension funds. However, during the first half of the 2000's decades net financial wealth fell as a multiple of GDP. This was being driven by the accumulation of mortgage debt to fund the accumulation of wealth in residential property, so the household sector was largely using financial liabilities to accumulate non-financial wealth. In 2008 the fall in net

Figure 14
Household sector net-worth, 2000 – 2009

Source: Blue Book

Figure 15
Unemployment by duration

Source: Labour Markets Statistics

Figure 16
Change in jobs by industry, 2008 Q2–2009 Q4

Source: Labour Markets Statistics

financial wealth of households partly reflected the fall in equity markets in that year as the financial crisis took hold and the economy fell into recession. Equities though have rallied since the second half of 2009 helping to restore some of this net-financial wealth position. Note that the fall in equity valuations actually reduces the claims on the corporate sector and improved its net wealth position in 2008. This can also be seen in Figure 12 and explains why the fall in household net-worth in 2008 was greater than that of the UK as a whole.

Rising durations of unemployment

Between March-May 2008 and March-May 2009 the level and rate of unemployment in the UK increased sharply, from 1.61 million (5.2 per cent) to 2.38 million (7.6 per cent). However, in the last year the rise in unemployment has steadied, reaching 2.47 million (7.8 per cent) in the three months March-May 2010. In fact, for most of the last year unemployment has generally hovered at just below 2.5 million (8.0 per cent).

However, as **Figure 15** shows, although the level of unemployment has shown signs of stabilising, the duration of unemployment has continued to increase. At the outset of the recession, the ranks of the unemployment were predominately filled by those who had been unemployed for less than 6 months. As a result, the proportion that had been unemployed for over 12 months fell from 25 per cent in March-May 2008 to 22.5 per cent a year later. As the recession progressed this proportion has started to rise and the proportion of unemployed for less than six months has started to fall. In March-May 2010 the proportion of the unemployed over 12 months had increased to 31.9 per cent.

These labour market dynamics suggest that although the flows into unemployment have stabilised, the flows out are yet to pick up meaning the unemployed are moving up the duration classes. For example, the redundancy rate peaked at around 12.1 per 1000 in employment in the three months March-May 2009, but had fallen back to 6.5 in the same three month period a year later. In contrast, the ratio of unemployed to vacancies, which peaked at 5.7 in June-August 2009, has only shown a modest improvement to 5.1 in the three months March-May 2010.

New estimates show over 1 million jobs were lost in the recession

The latest Labour Market Statistics statistical bulletin reports new estimates of Workforce Jobs. These reflect a number of methodological improvements, including a change in the classification to the 2007 Standard Industrial Classification (SIC). Between the second quarter of 2008 and the final quarter of 2009 the total number of jobs in the UK fell by 1.03 million from 31.78 million to 30.75 million. In the latest quarter total, 2010 Q1, jobs rose by a modest 13,000 to 30.77 million.

Workforce Jobs are the preferred measure for providing an industry breakdown of developments in the labour market. Therefore the new estimates can be used to show how the peak to trough fall in jobs between 2008 Q2 and 2009 Q4 was distributed by industry (see **Figure 16**). The new SIC 2007 also provides greater detail on the services sector than before.

Manufacturing jobs fell by 10 per cent (286,000 jobs) in this period, whilst construction jobs dropped by 8.3 per cent (191,000 jobs). In the services sector as a whole, the total fall in jobs was relatively smaller at 2.0 per cent (513,000 jobs). Within the services sector though there were differences in the patterns of job changes. For example, wholesale and retail distribution jobs fell by 6.5 per cent (326,000) and administrative and support service activities by 6.3 per cent (156,000 jobs). But in the education and human

Figure 17
CPI, CPIY and CPI-CT inflation rates

Source: Consumer Prices

health sectors, the number of jobs actually rose by 4.4 per cent (114,000 jobs) and 4.7 per cent (177,000 jobs) respectively.

CPI inflation falls to 3.2 per cent in June

Figure 17 shows the recent path in Consumer Prices Index (CPI) inflation. In June 2010, the CPI was 3.2 per cent higher than in the same month a year before, with the annual rate of inflation falling from 3.4 per cent in the previous month. During 2010 the CPI inflation rate has exceeded 3.0 per cent, but monthly changes have generally reflected short-term price changes. For example, in the latest month the 0.2 percentage points fall in CPI inflation from the previous month was mainly accounted for by the transport category (fuel). The 0.3 percentage point fall between April and May also reflected fuel price changes, but more importantly

changes in food, beverages and tobacco prices. The rise of 0.3 percentage points between March and April was mainly attributed to food, beverages and tobacco and clothing and footwear. So the month on month changes in the annual CPI inflation rate have not reflected any sustained patterns in 2010.

Taking a longer term view of the inflation figures though shows that the increase in the rate of VAT in January 2010 has increased the annual rate of CPI inflation by around 1.7 percentage points. As Figure 17 shows, the CPIY measure of inflation where indirect taxes are excluded was 1.6 per cent in June, and the CPI-CT measure where indirect taxes are included but held constant was 1.5 per cent in June. Therefore, underlying inflation trends are much weaker than the headline measure suggests.

CONTACT

elmr@ons.gov.uk