Economic review

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SUMMARY

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

GROSS DOMESTIC PRODUCT

Growth contracts in third quarter

GDP growth for the third quarter of 2008 is estimated to have shrunk compared with flat growth in the previous quarter. Growth fell by 0.5 per cent, a weakening from zero per cent growth in quarter two. The initial estimate for the annual rate of growth deteriorated sharply growing by a subdued 0.3 per cent, down from 1.5 per cent growth in the previous quarter (Figure 1). The latest month two

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

This contraction in the UK economy was largely due to a decline in growth in service sector output. Industrial production growth continued to display weakness for the fifth successive quarter, with a deeper deceleration in output in quarter three compared to the previous quarter. The

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

OTHER MAJOR ECONOMIES

Global growth contracts in quarter three

Preliminary data for 2008 quarter three for the other major OECD countries are now available. Data showed most of these major economies to be in recession.

US GDP growth decelerated in 2008 quarter three. Growth contracted by 0.1 per cent – the first contraction since the third quarter of 2001 – compared to an increase of 0.7 per cent in the second quarter. The slowdown in GDP growth was primarily led by a decline in domestic demand, particularly consumer spending. This could be put down to a number of factors: Firstly, the waning of the fiscal stimulus plan unveiled in the second quarter; second, higher unemployment; third, the continued impact of the credit crunch and fourth; continued weakness in the housing market. Fixed investment contracted in the third quarter, driven by eleventh consecutive negative growth in residential investment. This was offset by positive contributions from net exports and government spending.

Japan's economy entered recession in the latest quarter. Growth contracted by 0.1 per cent in quarter three, a lower rate of contraction compared to a decrease of 0.9 per cent in quarter two. There was a decrease in private investment and net exports; this was offset by a slight increase in private consumption.

Euro-zone growth also entered recession in the latest quarter. According to Eurostat's estimate euro area GDP growth contracted by 0.2 per cent, similar to the decrease in the previous quarter. Growth for the two big mainland EU economies – Germany, and Italy – showed negative growth for the second successive quarter. The French economy appears to have escaped recession.

Figure 1
Gross Domestic Product

German GDP contracted by 0.5 per cent in 2008 quarter three. This follows a decrease 0.4 per cent in quarter two. The shrinkage in the latest quarter was largely driven by a large negative contribution from external demand, led by a strong rise in imports. The investment picture was stagnant. These downsides were offset by increases in private and public consumption.

French GDP growth showed a marginal increase of 0.1 per cent growth in quarter three after falling by 0.3 per cent in the previous quarter. This was in part due to a slight recovery in household consumption and in part due to a lesser contraction in total investment compared with the previous quarter. Net exports made a neutral contribution to growth in quarter three.

Italian GDP fell by 0.5 per cent in quarter three following a fall of 0.4 per cent in quarter two. The breakdown to the growth was not yet available at the time of writing this article.

FINANCIAL MARKETS

Share prices fall; pound depreciates

Equity performance has displayed volatility over the last couple of years. In 2008 quarter three, share prices fell back substantially into negative territory following positive growth in the previous quarter. In 2008 quarter three, the FTSE All-Share index decreased by around 10 per cent compared to a rise of around 2 per cent in quarter two. The fall was mainly driven by a sell-off in shares in the financial and banking sectors. The weakness in share prices may be attributed to global growth concerns particularly in terms of recessionary fears, brought on by continued financial sector liquidity problems and its negative impact on the real economy. In October, the FTSE All-Share index had fallen further by around 19 per cent.

In the currency markets, 2008 quarter three saw sterling's broad average value continuing to depreciate. The pound's value against the dollar fell by around 4 per cent compared to a depreciation of around 1 per cent in the previous quarter. In October 2008 the pound fell below the \$1.60 mark for the first time in five years. Against the euro, sterling's value was virtually flat in the third quarter, following depreciation of around 5 per cent in the previous quarter. Overall, the quarterly effective exchange rate depreciated by approximately 2 per cent in 2008 quarter three after depreciating by approximately 3 per cent in the previous quarter (Figure 2). In October, the pound depreciated by approximately 6 per cent against the dollar. Against the euro, the pound appreciated by around 1 per cent. The effective exchange rate depreciated by around 1 per cent.

The recent movements in the exchange rate might be linked to interest rate and growth factors. Exchange rate movements can be related to the perceptions of the relative strengths of the US, the euro and UK economy. The depreciation of the pound against the dollar in quarter three may have come in response to fears about lower growth and a possible recession in the UK economy, compared with the better outlook for the US and therefore the prospect of greater easing of interest rates in the UK to stimulate the economy. Indeed, the Bank of England reduced interest rates by 150 basis points in November 2008 and by a further 1 per cent in December to leave rates currently at 2 per cent. This together with earlier cut in UK interest rates may have made the pound less appealing to investors compared to other currencies, also in terms of the risk premiums associated with holding sterling assets. Another factor for the relative strength of the dollar against the pound may have been due to the recent fall in oil prices with lower oil prices seen as less of a drag on US growth and therefore increased confidence in the US economy

being reflected in a stronger dollar. US and euro-zone growth prospects were further reinforced with the Federal Reserve and the European Central Bank both cutting their rates by 50 basis points to 1 per cent and 3.25 respectively in November 2008.

OUTPUT

Negative growth from contraction in services, construction and industrial output

GDP growth in 2008 quarter three was estimated to have fallen by 0.5 per cent, a deceleration from zero per cent growth in the previous quarter. On an annual basis growth was 0.3 per cent, down markedly from 1.5 per cent growth in the previous quarter.

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

External surveys pointed to sharp declines in housing activity in quarter three – attributing this to a combination of a slowing housing market and lack of availability of debt finance. The CIPS/Markit UK construction PMI (Purchasing Managers Index) reported that total construction contracted at record pace in the third quarter to a headline balance of 38.7 from 42.9 in the second quarter. In October the index fell further to 35.1. The Royal Institute of Chartered Surveyors (RICS) construction survey for 2008 quarter three reported that construction workloads declined for the second successive quarter and at a faster pace – with the net balance falling to minus 38 from minus 19 in the previous quarter.

Total output from the production industries decelerated further in quarter three. Output fell by 1.1 per cent following a decrease of 0.7 per cent in quarter one. On an annual basis, output contracted by 2.1 per cent, compared to a contraction of 1.1 per cent in the previous quarter.

The weakness in total production was mainly driven by the deterioration in the output of the manufacturing industries. Manufacturing output fell by 1.3 per cent in

Figure 2
Exchange rates

Figure 3
Construction output

Figure 4
Manufacturing output

the third quarter, a weakening from the 0.9 per cent contraction in the second quarter. On an annual basis, manufacturing output fell by 1.9 per cent, from a 0.9 per cent decrease in the second quarter (**Figure 4**).

The weakening in total production in quarter three compared with the previous quarter was also to a lesser extent driven by weakness in the output of the electricity, gas and water supply and mining and quarrying industries where output fell by 0.3 per cent and 0.6 per cent respectively. This compares with virtually flat growth recorded for both in the second quarter. On an annual basis, electricity, gas and water supply output registered stagnant growth following 2 per cent growth in the previous quarter. The output of the mining and quarrying industries contracted by 5.9 per cent, similar to the previous quarter.

Production growth has generally been weak in the last couple of years, mainly due to weakness in manufacturing for most of that period, and a contraction in mining and quarrying output, offset through some of this period by relatively strong electricity, gas and water supplies industry output. Manufacturing output has displayed volatility in the recent past. There was a modest pick up in manufacturing output in the first quarter of 2008 but this appears not to have been sustained in subsequent quarters.

The output of the agriculture, forestry

and fishing industries increased by 0.4 per cent in the latest quarter, unchanged from the previous quarter. On an annual basis growth was 2.6 per cent, up from 1.8 per cent growth in the previous quarter.

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

The CIPS/ Markit manufacturing PMI indicated a slight contraction in the latest quarter; the headline index fell further below the no change 50.0 mark to 43.5 from 48.5 in quarter two. In October 2008, the index was at 41.5. The CBI in its 2008 quarter three Industrial Trends survey reported a weakening in its total order books with the balance at minus 39 in the third quarter, compared with minus 8 in the second quarter. According to the October Survey, the total orders index stood at minus 39. The BCC in its 2008 quarter three survey reported alarming results with results pointing to the UK being in recession; the balances for home sales dropped by 10 points to minus 13 and the balance for home orders fell by 12 points to minus 17.

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

Services output declined by 0.4 per cent in 2008 quarter three, a deceleration from somewhat negligible growth of 0.2 per cent in the previous quarter but a marked slowdown from a recent high of 1.2 per cent recorded in 2007 quarter one (**Figure 6**). On an annual basis, services output expanded by 0.7 per cent, down from 2.2 per cent in the second quarter.

Declines in growth were recorded in most sectors. The largest contribution to the deceleration in services output in quarter three came from distribution, hotels and catering where output fell by 1.9 per cent following growth of 0.2 per cent in quarter two. On an annual basis, growth fell by 1.3 per cent following a rise of 1.2 per cent in the previous quarter. Output of the transport, storage and communication sector weakened with growth falling by 0.2 per cent after increasing by 1 per cent in quarter two. On an annual basis, growth

Figure 5
External manufacturing

Figure 6
Services output

Figure 7
External services

rose by 1.6 per cent in quarter three, a slowdown from growth of 1.8 per cent in the previous quarter. Business services and finance output also decreased, by 0.4 per cent – the first decline since 2002 quarter one – from virtually flat growth in quarter two. On an annual basis, growth was 1 per cent, down significantly from 3.2 per cent growth in the second quarter. These decreases were offset by moderate growth in government and other services output of 0.5 per cent in quarter three, up from 0.2 per cent growth in the previous quarter. Growth was 1.3 per cent on the year, unchanged from quarter two.

The external surveys on services showed a bleak picture of service sector activity in 2008 quarter three. The CIPS/Markit services PMI survey pointed to a deteriorating picture of service sector activity. The average headline index in 2008 quarter three fell further to 47.5 from 49.1 in quarter two. In October 2008 the index fell further to 42.4. It should be noted that the CIPS survey has a narrow coverage of the distribution and government sectors.

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

volumes for business and professional services, deteriorated at a record pace with the balance reaching minus 31 from plus 10 in the previous survey. The BCC survey for 2008 quarter three recorded alarming declines. The net balance for home sales declined 5 points to minus 7 and the net balance for home orders dropped 6 points to minus 13.

EXPENDITURE

Consumers' spending contracts

Household consumption expenditure contracted marginally further in quarter three compared with the previous quarter. Household spending fell by 0.2 per cent compared to a fall of 0.1 per cent in the previous quarter – but a marked

deceleration from 0.8 per cent growth seen in 2008 quarter one. Compared with the same quarter a year ago, growth slowed to 1.1 per cent, from 2.5 per cent in quarter two (Figure 8). Lower spending was primarily driven by a fall in durable and non-durable goods expenditure. This was offset by growth in semi-durable goods and services expenditure.

The continuing weakness in consumer expenditure in quarter three may mainly appear to reflect the continued impact of the financial turbulence and the credit crunch in the UK; coupled with pressures on real disposable income arising from modest wage growth and relatively high inflation. Weaker spending could also be a reflection of the looser labour market conditions and low level of consumer confidence in the UK economy.

One key indicator of household expenditure is retail sales. Retail sales growth continued its slowdown in 2008 quarter three from the previous quarter with retail sales volume growing by a negligible 0.1 per cent, down from 0.5 per cent growth in quarter two. One reason perhaps for the slower growth in retail sales may have been due to the price deflator (that is, shop prices) where discounting appears not to be prevalent or widespread as was the case in quarter two. The price deflator rose on average by 1.2 per cent in quarter three compared with an average fall of 0.1 per cent in the previous quarter, further compounding the pressures on household disposable income.

Retail sales figures are published on a monthly basis and the latest available figures for October 2008 showed a stagnant picture (Figure 9). In the three months to October the volume of retail sales grew by zero per cent, similar to growth in the three months to September. On an annual basis in October, growth in the latest three months growth compared with the same three months a year ago was 2.2 per cent, unchanged from growth in September.

Figure 8
Household demand

Figure 9
Retail sales

Percentage growth

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In the three months to October 2008, the flat growth in retail sales was mainly driven by a slowdown in 'predominantly non-food stores' offset by a lower rate of contraction in 'predominantly food stores'.

The 'predominantly non-food stores' sector showed stagnant growth in the three months to October compared with 0.4 per cent growth in the three months to September. The deceleration was driven by a decrease in 'household good stores' where growth fell by 1.3 per cent. Growth in 'predominantly food stores' fell by 0.7 per cent in October compared with a fall of 1 per cent in the three months to September.

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

External surveys for retail sales presented a deteriorating picture of growth in 2008 quarter three compared to the previous quarter. The CBI reported an average balance of minus 32 in the latest quarter, from minus 16 in the previous quarter. According to the monthly distributive survey, the sales volume balance was at minus 27 in October. The BRC reported average growth of 1.4 per cent in 2008 quarter three, down from 2.6 per cent in 2008 quarter two on a total sales basis (Figure 10). In October the BRC reported total sales as flat.

Another indicator of household consumption expenditure is borrowing. Household consumption has risen faster than disposable income in recent years

as the household sector has become a considerable net borrower and therefore accumulated high debt levels. Bank of England data on stocks of household debt outstanding to banks and building societies shows household debt at unprecedented levels relative to disposable income. Until recently, this borrowing has fuelled consumption, but indicators appear to suggest this to be less so in the latest two quarters.

There are two channels of borrowing available to households: i) secured lending, usually on homes; and ii) unsecured lending, for example on credit cards. The impact of the credit squeeze continued to have a substantial impact in quarter three. According to the Bank of England's Credit Conditions Survey, lending conditions were tightened further in quarter three, that is, by applying stringent credit-scoring criteria and by decreasing maximum loan-to-value (LTV) ratios – with lenders reporting that they had reduced the availability of both secured and unsecured lending to households. The tightening was driven by concerns about the economic outlook and falling collateral values.

Another indicator highlighting the downside risks to consumer expenditure is described by Bank of England lending figures. There were signs of further slowdown with total lending growing by approximately £7 billion in the third

quarter, down from around £16 billion in the second quarter. Over the same period, lending secured on dwellings fell to around £5 billion from around £12 billion in the second quarter. Unsecured lending grew roughly by £2 billion, down from £3 billion in the second quarter.

The slowdown in secured lending may have impacted on house prices in terms of lower growth. Nationwide and Halifax both reported house prices falling in quarter three by around 5 per cent, broadly unchanged from the previous quarter. The housing market plays a major influence on consumer expenditure patterns. Firstly, as a barometer of confidence in the economy and therefore a willingness to spend; secondly, in terms of demand it creates for household goods via house purchases; and thirdly, household expenditure may be linked to household equity withdrawal (HEW) – slower house price growth can signify lower equity growth and therefore decreasing purchasing power. The recent slowdown in house prices and the housing market generally may have affected all three of the above, compounded by the credit squeeze, rising unemployment and lower household income.

BUSINESS DEMAND

Business investment continues to be weak

Total investment fell by 2.4 per cent in 2008 quarter three compared with a fall of 2.8 per cent in the previous quarter. On an annual basis, total investment fell by 5.4 per cent, a deeper contraction compared with the 2.1 per cent fall in quarter two. The decrease in total investment was due to both business and dwelling investment falling over the quarter (Figure 11).

Business investment continued to contract in the latest quarter, although it showed signs of improvement compared to

Figure 10
External retailing

Balances

Figure 11
Total fixed investment

Percentage growth

the previous quarter. Business investment decreased by 0.2 per cent in the latest quarter, compared with a 1 per cent contraction in quarter two. On an annual basis, business investment fell by 0.5 per cent, reversing growth of 1.2 per cent in quarter two.

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

Evidence on investment intentions from the latest BCC and CBI surveys painted a picture of weakness. According to the latest quarterly BCC survey, the balance of manufacturing firms planning to increase investment in plant and machinery dropped by 6 points to minus 4. The CBI's Quarterly Industrial Survey in 2008 quarter three also reported a bleaker investment picture, with the investment balance of plant and machinery weakening to minus 38 from minus 24 in the previous quarter.

GOVERNMENT DEMAND

Government expenditure strengthens

Government final consumption expenditure increased in 2008 quarter three. Growth rose by 1 per cent, up from 0.5 per cent in quarter two. On an annual basis, government expenditure expanded by 2.7 per cent, up from 2.1 per cent in quarter two (Figure 12).

Public sector finances deteriorate

The latest figures on the public sector finances to October 2008 illustrated a weakening position. The figures showed a higher current budget deficit together with an increased net borrowing situation – reflecting government expenditure continuing to exceed tax revenues. In the financial year 2008/09 to date, the current budget was in deficit by £23.3 billion; this compares with a budget deficit of £9.5 billion in the same period of 2007/08. Public sector net borrowing in the financial year 2008/09 to date was £37.0 billion; this compares with net borrowing of £20.1 billion in the same period of 2007/08. Slower growths in current receipts were exceeded by a larger increase in the rate of

current expenditure, particularly on capital projects – resulting in both a higher budget deficit and net borrowing.

Since net borrowing became positive in 2002, following the current budget moving from surplus into deficit, net debt as a proportion of annual GDP has risen steadily. Public sector net debt in October 2008 was 42.9 per cent of GDP, slightly up from 42.6 per cent in October 2007. In the full financial year 2007/08, net debt as a percentage of GDP was 42.8 per cent.

TRADE AND THE BALANCE OF PAYMENTS

Current account deficit widens; goods trade deficit widens in quarter three

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

Figure 12
Government spending

Percentage growth

Figure 13
Balance of payments

£ million

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

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

The figures in 2008 quarter three showed a continuation in the goods trade deficit. In the third quarter, the deficit on trade in goods and services widened to £13.1 billion, from a £12 billion deficit in the previous quarter. Over the quarter in terms of growth, total exports fell by 0.3 per cent while total imports increased by 0.1 per cent. Exports of goods grew by 0.3 per cent while goods imports rose by 0.6 per cent. Services exports fell by 1.2 per cent and services imports decreased by 1.3 per cent.

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

LABOUR MARKET

Labour market activity slowdown accelerates

The labour market in the latest reference period showed further signs of deterioration. In recent months there has been a broader weakening in indicators of the labour market suggesting the lagged effect of the slowdown in the economy which began in the fourth quarter of 2007 and which has markedly deteriorated in subsequent quarters beginning to make a deeper negative impact on labour market activity.

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

(excluding bonuses) was unchanged but average earning (including bonuses) fell; overall, average earnings remain subdued with weak real-wage growth.

Near record levels of employment continue despite the sharp fall in employment in the current period, compared with the previous quarter. The number of people in employment decreased by 99,000 in the three months to September but rose 134,000 on a year earlier. The current working-age employment rate was 74.4 per cent in the three months to September 2008, down 0.4 percentage points from the three months to June 2008 and down 0.2 percentage points from a year earlier – leaving the employment level at 29.41 million. Unemployment levels on the other hand rose and for the seventh month in a row. The number of unemployed people increased by 140,000 in the three months to September 2008 and up 182,000 from a year earlier, leaving the unemployment level at 1.82 million. The unemployment rate also rose, to 5.8 per cent in the three months to September 2008, up 0.4 percentage points from the three months to June 2008 and up from 0.5 percentage points a year earlier (Figure 14).

Looking at a detailed level, the decrease in the employment level was mainly driven by self-employment and to a lesser extent by employees. The self-employed decreased by 44,000 while employees fell by 33,000. In terms of full and part-time workers, the numbers of people in full-time employment fell by 106,000 while the number of people in part-time employment increased by 7,000.

Workforce jobs increases

According to employer surveys' there were 31.68 million workforce jobs in June 2008, up 26,000 over the quarter and up 142,000 on a year earlier. The largest quarterly contribution to the increase came from education, health and public admin (up 27,000), followed by agriculture, forestry

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

Claimant count increases further

The claimant count measures the number of people claiming the Jobseeker's Allowance. The latest figures for October 2008 showed the claimant count level rose by 36,500 – the ninth consecutive monthly increase. On a year earlier the claimant count level increased by 154,800 to reach a level of 980,900. The claimant count rate in October 2008 was 3.0 per cent, up 0.1 percentage point from the previous month and up 0.5 percentage points from a year earlier.

Vacancies continue to fall

The number of vacancies fell further compared to the previous quarter reflecting weakening demand conditions in the UK economy. Job vacancies fell by 40,000 from the three months to July 2008 and were down 83,000 from a year earlier reaching a level of 589,000 vacancies in the three months to October 2008.

Inactivity level increases

In level terms, the number of economically inactive people of working age increased by 15,000 over the quarter but fell by 54,000 over the year to reach 7.89 million in the three months to September 2008. The largest rise in level of inactivity was recorded for those categorised as

Figure 14
Employment and unemployment

'long-term sick' (up 63,000) followed by the 'student' category (up 26,000). This was partially offset by a number of decreases, with the largest fall in inactivity amongst those categorised as 'looking after family/home' (down 46,000). The working-age inactivity rate was 20.9 per cent in the three months to September 2008, unchanged on the three months to June 2008 but down 0.2 percentage points from a year earlier

Average earnings growth subdued

Growth in whole-economy average earnings showed a relatively muted picture in the three months to September 2008. Average earnings (including bonuses) increased by 3.3 per cent, down 0.1 percentage point from the previous month. Average earnings (excluding bonuses) rose by 3.6 per cent, unchanged from the previous period. Public and private sector earnings grew modestly in the latest month. In terms of the public and private sector split, the gap in average earnings (excluding bonuses) widened in the latest month. Public sector earnings growth was 3.9 per cent, up 0.2 percentage points from the previous month. Private sector earnings were unchanged from the previous month, growing by 3.6 per cent.

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

PRICES

Producer output and input price pressures persist in quarter three but shows signs of easing in quarter four

Industrial input and output prices are an indication of inflationary pressures in the economy. During the third quarter of 2008, output and input prices continued to remain elevated and broadly unchanged from the second quarter – a sign that the rise in world

commodity prices was continuing to exert considerable influence in generating UK inflation through higher product prices. In the latest quarter, there appeared signs of easing in input price growth compared to marginally faster growth in output price inflation – which possibly suggests that firms were intent on maintaining their profit margins by passing on the relatively high input costs to customers.

Input prices on average rose by 28.2 per cent in 2008 quarter three. This compares with 29.8 per cent in 2008 quarter two. On the core measure, which strips out the effect of food, beverages, tobacco and petroleum prices, input prices on average rose by 20.7 per cent in 2008 quarter three (12 month non-seasonally adjusted growth), an acceleration from growth of 18.8 per cent in the previous quarter. The strength in input prices continued to be generated mainly by fuel and imported food materials prices which rose on average by 40 per cent and 25 per cent respectively in quarter three. According to the latest monthly figures, input prices rose by 13.8 per cent in the twelve months to October 2008, a slow-down from 24 per cent growth in September. Growth was mainly driven by a 23.8 per cent increase in imported food material prices and a 24 per cent rise in fuel prices.

Output prices grew on average by 9.2 per cent in 2008 quarter three, a marginal increase from growth of 8.8 per cent in the previous quarter. The underlying picture also suggests inflationary pressures. On the core measure which excludes food, beverages, tobacco and petroleum, producer output prices rose by 5.7 per cent in 2008 quarter three, up from 5.2 per cent in the previous quarter. The main contributions to the increase in output prices were provided by rises in petroleum products and food prices which grew on average by 31.2 per cent and 13.2 per cent respectively

in quarter three. According to the latest figures, output prices rose by 6.8 per cent in the twelve months to October, an easing from 8.5 per cent growth in September. Growth was driven mainly by a 15.2 per cent increase in petroleum products prices.

Consumer prices fall but still above target

Growth in the consumer prices index (CPI) – the Government's target measure of inflation – fell in October to 4.5 per cent, down from 5.2 per cent in September but still considerably above the Government's 2 per cent inflation target (Figure 15).

The largest downward pressure on the CPI annual rate came from transport costs where the price of fuels and lubricants fell this year but rose last year. The decrease this year was triggered by a sharp fall in the price of crude oil. The average price of petrol fell by 7.1 pence per litre between September and October this year, to stand at 104.5 pence, compared with a rise of 2.7 pence last year. Diesel prices fell by 7.0 pence per litre this year, to stand at 116.3 pence. There was also a fall in the price of both air transport and sea transport. The effect from air fares came mainly from the cost of European flights.

There was another large downward contribution from food and non-alcoholic beverages. The effect came largely from the price of meat, which fell this year compared with a rise last year. Prices fell for a range of pork products and beef prices fell, with discounting in supermarkets. There was a small downward effect from biscuits and a partially offsetting upward effect from the price of milk.

There were further large downward contributions from:

- recreation and culture, where the effect came mainly from pre-recorded DVDs and computer games

Figure 15
Inflation

Percentage change over 12 months

- miscellaneous goods and services where, overall, bank charges decreased and home delivery charges rose by less than last year
- education services where the upward effect from increased tuition fees is less than the previous year

Retail Prices Index (RPI) inflation slowed to 4.2 per cent in October, down from 5.0 per cent in September. The main factors affecting the CPI also affected the RPI. Additionally, there was a large downward contribution from housing with the main effect coming from house depreciation, which is excluded from the CPI.

RPIX inflation – the all items RPI excluding mortgage interest payments – was 4.7 per cent in October, down from 5.5 per cent in September.