Economic review

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OTHER MAJOR ECONOMIES

Global growth rebounds in quarter three

Data for 2007 quarter four for the major OECD countries were not available at the time of writing this article. Data for 2007 quarter three reported an upturn in growth for the major OECD countries.

US GDP data for the third quarter of 2007 showed a continued upturn following stronger growth in quarter two. Growth was 1.2 per cent in quarter three compared with 1.0 per cent in quarter two. The contribution to higher growth in quarter three was mainly driven by a strong net export picture as well as higher inventories. Private consumption and business investment were also resilient. This was offset by continued weakness in residential investment growth.

Japan's GDP growth also showed an upturn in the third quarter. Growth increased by 0.6 per cent compared to a fall of 0.4 per cent in quarter two. The improvement was primarily driven by exports, combined with a fall in the rate of import growth. Positive growth was also recorded in private non-residential investment, private consumption and government consumption. Residential investment continued to record negative growth for the third consecutive quarter.

Growth in the three biggest mainland EU economies – Germany, France and Italy – recorded rebounds in GDP growth after a disappointing quarter two. According to Eurostat's estimate, euro area GDP grew by 0.7 per cent in 2007 quarter three. This is an acceleration compared to growth of 0.3 per cent in the previous quarter.

German GDP growth recorded an increase in growth in quarter three. Growth was 0.7 per cent compared to modest growth of 0.3 per cent in the second quarter. The main driver of growth was domestic demand, partly fuelled by inventories and partly by private consumption. This was offset by a weaker net export picture. Investment grew modestly.

French GDP growth increased in 2007 quarter three; growth was 0.7 per cent compared to 0.3 per cent in quarter two. Exports increased sharply, combined with a decline in the rate of import growth. Household consumption expenditure

SUMMARY

GDP growth continued to rise fairly robustly in 2007 quarter four, although at a slightly slower pace than in quarter three. Growth continued to be driven by the service sector offset by flat manufacturing output. On the expenditure side, household spending and business investment strengthened in quarter three in comparison with quarter two. The current account deficit and the trade deficit widened in quarter three. The labour market continues to be buoyant in quarter four but average earnings remain relatively subdued. The public sector finance position deteriorated in December 2007. Consumer price inflation was unchanged in December and was above the government's target. Producer output and input price inflation accelerated in December.

GROSS DOMESTIC PRODUCT

Fourth quarter growth of 0.6 per cent

The preliminary estimate of GDP growth for the fourth quarter of 2007 is now available. GDP growth for the fourth quarter of 2007 is estimated to have grown fairly strongly, by 0.6 per cent, slightly lower from growth of 0.7 per cent in the previous quarter. The initial estimate for the annual rate of growth was 2.9 per cent, down from 3.3 per cent growth in the previous quarter. It should be noted that

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

The growth rate in the UK economy in quarter four continued to be driven by strong although slightly lower service sector output compared with the previous quarter. This was offset by a modest pick up in total production growth, mainly driven by an upturn in mining and quarrying output; manufacturing output in contrast was flat. The construction sector continued to grow strongly.

Figure 1
Gross Domestic Product

and Gross Fixed Capital Formation also recorded strong growth.

Italian GDP growth rebounded in quarter three after a poor second quarter. Growth in quarter three was 0.4 per cent compared to 0.1 per cent in quarter two. Growth was mainly driven by investment, particularly capital and construction investment. Private consumption grew modestly. Net trade in contrast subtracted from growth with imports exceeding exports.

FINANCIAL MARKETS

Share prices flat; pound weakens

Equity performance recorded muted growth in 2007 quarter four, rising by just 0.5 per cent. This follows a fall of 3.1 per cent in quarter three. The weakness in equity growth can mainly be attributed to concerns regarding US economic growth prospects, brought on by continued problems in the housing and the sub-prime mortgage market. Increasing interest rates in the UK further contributed to this lack lustre performance.

In the currency markets, 2007 quarter four saw sterling's average value broadly depreciate compared with the previous quarter. The pound appreciated against the dollar by around 1.0 per cent in 2007

quarter four, a lower rate of appreciation compared to 1.7 per cent in the previous quarter. Against the euro, sterling's value depreciated by around 3 per cent after depreciating by 0.2 per cent in the previous quarter. Overall, the quarterly effective exchange rate depreciated by approximately 3 per cent in quarter four after flat growth in the previous quarter (Figure 2).

The recent movements in the exchange rate might be linked to a number of factors. First, exchange rate movements can be related to the perceptions of the relative strengths of the US, the Euro and UK economy. The lower rate of appreciation in quarter four may have come in response to fears about lower growth in the UK economy and therefore prospects of lower interest rates to stimulate the economy. Indeed, the Bank of England reduced interest rates by 25 basis points in December to 5.5 per cent, mainly in response to the effects of the sub-prime crisis in terms of downward risks to growth and inflation.

In the US, however, there have been particular concerns in recent months regarding the relative weakness of GDP growth, compounded by housing market weakness and the sub-prime crisis. In fact, US interest rates were lowered by a further 0.50 basis points in January 2008 following

the 0.75 basis cut earlier to 3 per cent in response to concerns about a possible recession. These interest rate decreases will have made the dollar less appealing to investors compared to other currencies.

Another factor could be the lack of international appetite for US dollar denominated assets, particularly from central banks, who are choosing to spread their currency assets on their balance sheets (for portfolio and risk management purposes), thereby further undermining the value of the dollar.

In contrast, in the euro area the depreciation of the pound against the euro in the fourth quarter of 2007 may have come in response to prospects of monetary tightening in the euro-zone. Interest rates in the euro-zone were maintained at 4.0 per cent in December after increasing by 0.25 per cent in June, partly in response to concerns about inflationary pressures.

OUTPUT

Services sector drives economic growth

GDP growth in 2007 quarter four was estimated at 0.6 per cent, down from 0.7 per cent in the previous quarter. On an annual basis it was 2.9 per cent, down from 3.3 per cent in the previous quarter.

Construction activity continued to grow strongly in the fourth quarter of 2007. Construction output is estimated to have grown by 0.7 per cent, down from 0.8 per cent growth in the previous quarter. Comparing the quarter on the same quarter a year ago, construction output rose by 3.2 per cent following growth of 3.5 per cent in the previous quarter (Figure 3).

In terms of external surveys of the construction sector, the CIPS survey signalled weakening activity in 2007 quarter four with the average headline index at 55.9, down from 62.3 in the previous quarter, but still indicative of strong growth. The RICS construction survey for 2007 quarter four reported an easing in the growth of construction workloads with the balance at plus 16, down from plus 17 in the previous quarter.

Total output from the production industries recorded relatively subdued growth of 0.3 per cent in 2007 quarter four following flat growth in the previous quarter. On an annual basis it rose by 0.8 per cent, up from 0.3 per cent in the previous quarter. The pick up in production was driven by an upturn in mining and

Figure 2
Exchange rates

Figure 3
Construction output

quarrying output (including oil and gas) together with an acceleration in the output of the electricity, gas and water supply industries. The output of the mining and quarrying industries rose by 1.1 per cent in 2007 quarter four, reversing a contraction of 1.1 per cent of the previous quarter. On an annual basis, mining and quarrying output rose by 2.9 per cent following virtually flat growth in the previous quarter. The output of electricity, gas and water supply industries also strengthened. Growth accelerated to 1.7 per cent from 0.8 per cent in the previous quarter. On an annual basis utilities output was up 0.8 per cent from 0.3 per cent in the previous quarter.

Manufacturing output in contrast continued to exhibit weakness. Growth was flat in quarter four, similar to quarter three. On an annual basis, manufacturing output growth slowed to 0.3 per cent from 0.4 per cent 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 quarter three with only a modest pick up in quarter four due to a flat rate of manufacturing output growth in the latest two quarters. However, manufacturing output has been volatile in recent quarters.

The output of the agriculture, forestry and fishing industries strengthened in the latest quarter with output increasing by 1.3 per cent after falling by 0.6 per cent in the previous quarter.

External surveys of manufacturing for 2007 quarter four showed a fairly positive picture (**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 stable but robust picture in the latest quarter. The headline index was 53.4, although down from 55.4 in the previous quarter. The CBI in its 2007 quarter four Industrial Trends survey reported a strengthening in its total order books with the balance at plus two, up from minus six in the previous quarter. The BCC

Figure 4
Manufacturing output

in its 2007 quarter four survey reported a mixed, but overall fairly buoyant, picture of manufacturing activity. The home sales balance was plus 32 from plus 37 in the previous quarter.

Overall the service sector, the largest part of the UK economy, continues to be the main driver of UK economic growth. Growth was 0.7 per cent in 2007 quarter four, slightly lower than 0.8 per cent growth in the previous quarter (**Figure 6**). Growth on an annual basis was 3.4 per cent, down from 3.9 per cent in the previous quarter. Growth was recorded across all four broad sectors. The main contribution to the growth rate came from a marked acceleration in the output of the transport,

storage and communication industries which grew by 1.9 per cent in quarter four, up from 0.5 per cent in quarter three. There was modest acceleration in the output of the distribution, hotels and catering industries which grew by 1.0 per cent, up from 0.8 per cent in quarter three. There was also modest acceleration in government and other services output with growth of 0.5 per cent in quarter four, up from 0.3 per cent in the previous quarter. This was offset by a marked weakening in the growth of the output of the business services and finance industries. Growth decelerated to 0.4 per cent from 1.3 per cent in quarter three.

The external surveys on services showed a weakening, but still fairly robust, picture

Figure 5
External manufacturing

Figure 6
Services output

in line with official data. The CIPS average headline index in 2007 quarter four was 52.5, which although markedly down from 57.1 in the previous quarter is still above the long-run average. It should be noted that the CIPS survey has a narrow coverage of the distribution and government sectors.

The CBI and BCC reported a generally weakening picture of service sector activity (**Figure 7**). The CBI service sector survey for November reported modest growth in business volumes for the business and professional services sector and the consumer service sector. The consumer services volume balance was at plus 15, unchanged from the previous quarter. For business and professional services, the balance was at plus 19, down from plus 31 in the previous quarter. The BCC survey for 2007 quarter four survey reported a weakening picture of service sector activity, but overall balances for home orders and sales remained positive at plus 18 and plus 28, from plus 26 and plus 29 respectively.

EXPENDITURE

Consumers' spending buoyant in quarter three; but possible slowdown in quarter four

Household consumption expenditure growth accelerated in 2007 quarter three at a strong rate of 1.1 per cent. This follows growth of 0.7 per cent in the previous quarter. Growth compared with the same quarter a year ago was 3.6 per cent, up from 2.7 in quarter two (**Figure 8**). Growth was recorded across most sectors with the acceleration in household expenditure driven mainly by expenditure on durable and non-durable goods.

Indications of consumer demand for 2007 quarter four appear mixed. What is yet still uncertain is the impact on the UK economy from the US sub-prime housing crisis and the subsequent credit crunch. In 2007 quarter four, there may be tentative indications of some slowdown on various expenditure indicators that could be attributable to the credit crunch.

One key indicator of household expenditure is retail sales which slowed in 2007 quarter four compared with quarter three. Retail sales grew by 0.4 per cent in quarter four, a deceleration from growth of 1.4 per cent in the previous quarter.

Retail sales figures are published on a monthly basis and the latest available

Figure 7
External services

Figure 8
Household demand

figures for December signalled a slowdown compared with November (**Figure 9**). In the three months to December the volume of retail sales increased by 0.4 per cent compared with a 1.0 per cent increase in the three months to November. On an annual basis in December, the latest three months growth compared with the same three months a year ago recorded growth of 3.6 per cent, down from 4.7 per cent growth in November. The slowdown in retail sales has occurred despite widespread discounting and early sales which are reflected in the price deflator (i.e. shop prices), which fell on average by around 1.1 per cent in the latest quarter. This could suggest the impact of previous interest rate rises and the effects of the credit crunch may have been

a constraining factor in retail sales growth, together with diminished confidence on the part of consumers.

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In three months to December the 'predominantly non-food' sector recorded growth of 0.8 per cent, while this is still showing growth it is at a lower rate than in recent months – in the three months to August this sector grew by 2.0 per cent. Growth in this sector was driven by the 'non-store retailing and repair' sector which grew by 4.4 per cent, followed by the 'other' stores and the 'household goods sector' sector which grew by 0.6 per cent and 0.4 per cent respectively. The 'Non-specialised goods' store sector

Figure 9
Retail sales

in contrast contracted by 1.6 per cent. The 'predominantly food' sector grew by a modest 0.3 per cent in the three months to December, down from 0.9 per cent in the three months to November.

External surveys for retail sales presented a slowing picture of growth. The CBI monthly Distributive Trades survey for December reported the slowest high street growth for over a year in early December with the balance at plus eight. The BRC reported an increase of 0.3 per cent in retail sales on a like-for-like basis in December, down from 1.2 per cent in the previous month (**Figure 10**).

Another indicator of household consumption expenditure is borrowing. Household consumption has risen faster than disposable income in recent years as the household sector has become a considerable net borrower and therefore accumulated high debt levels. Bank of England data on stocks of household debt outstanding to banks and building societies shows household debt at unprecedented levels relative to disposable income.

There are two channels of borrowing available to households: i) secured lending, usually on homes; and ii) unsecured lending, for example, on credit cards. On a general level, an increase in the interest

rates increases debt servicing costs may discourage borrowing and in the process displace consumer expenditure on certain goods.

According to the latest figures from the Bank of England, there are signs that past interest rate rises may have begun to impact on lending and borrowing in 2007 quarter four, possibly due to the credit crunch. With regards to total net lending, figures showed a slowdown with total net lending at £9.1 billion in December, down from £10.9 billion at the end of September 2007. This was driven by lower growth on lending for secured dwellings which grew by £8.6 billion in December, down from £9.5 billion at the end of September 2007, and also from a weakening in unsecured lending from £1.3 billion at the end of quarter three to £0.6 billion at the end of December 2007.

An alternative measure of expenditure also showed a weakening picture. M4 (a broad money aggregate of UK money supply) rose by around £35.0 billion in 2007 quarter four compared with around £50.0 billion in quarter three. M4 lending (including cash and bank deposits) also fell sharply from around £77.0 billion in quarter three to around £51.0 billion in 2007 quarter four.

The slow-down in lending could possibly

be as a result of tighter lending criteria adopted by some banks and building societies, particularly towards first time buyers and those considered higher risk. There may also be an impact in the form of higher interest rates charged by banks for customers who have borrowed on variable interest rate mortgages in the short term, and in the longer term, there may be an impact on those who took out fixed rate mortgages. However, the recent decrease in UK interest rates may reverse some of this trend. Some lenders have already passed on the cut to borrowers with variable rate mortgages.

Household expenditure can be linked to Household Equity Withdrawal (HEW). The situation regarding house prices in terms of contribution to consumer expenditure remains uncertain. Both Nationwide and Halifax report an easing in growth in house prices in quarter four compared with quarter three. However, despite this slowdown, house price growth is still holding up fairly well and may support consumption expenditure. According to the Nationwide, annual house price growth in quarter four was 6.9 per cent compared with 9.3 per cent in the previous quarter. Halifax reported annual house price growth of 5.2 per cent in quarter four, down from 9.8 per cent in quarter three and below the long-run average of 8 per cent.

The savings ratio is also a determinant of household expenditure. In quarter three, household spending was given a boost by the fall in the savings ratio which fell to 3.4 per cent, down from 4 per cent in quarter two. This well may be a factor in the latest quarter.

Finally, underlying fundamentals such as the prevalence of a relatively healthy labour market, together with levels of disposable income could be factors in affecting consumption growth in 2007 quarter four.

BUSINESS DEMAND

Business investment accelerated

Total investment rose by 2.4 per cent in quarter three compared to a fall of 0.8 per cent in the previous quarter. On an annual basis, total investment grew by 6 per cent, a slow-down from 6.4 per cent in the previous quarter. The strengthening in total investment was primarily driven by government and dwellings investment (**Figure 11**).

Business investment grew relatively strongly throughout 2006. In 2007 quarter

Figure 10

External retailing

Figure 11

Total fixed investment

one business investment weakened but then recovered into quarter two recording fairly modest growth. In quarter three, growth accelerated to 2 per cent from 0.5 per cent in quarter two. On an annual basis, business investment grew by 6.6 per cent in quarter three, a slowdown from 7.8 per cent growth recorded in the previous quarter.

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 from plus 33 to plus 21. The CBI's Quarterly Industrial Survey for January 2008 reported a subdued investment picture, with the investment balance of plant and machinery weakening at minus 12 from minus 14 in the previous quarter.

GOVERNMENT DEMAND

Government expenditure moderates

Government final consumption expenditure continued to grow at a fairly modest pace in quarter three. Growth reached 0.3 per cent, a deceleration from quarter two's 0.5 per cent. Growth quarter on the same quarter a year earlier was 1.9 per cent, down slightly from the 2.0 per cent recorded for quarter two (Figure 12).

Public sector finances deteriorate

The latest figures on the public sector finances reported a deterioration in the current financial year to December 2007, compared with the last financial year. It showed a higher current budget deficit and a higher level of net borrowing. Overall, the government continued to operate a financial deficit, with government expenditure continuing to exceed revenues, partly to fund capital spending. In the financial year April to December 2007/08, the current budget deficit was £ 28.1 billion; this compares with a deficit of £ 18.4 billion in the financial year to April to December 2006/07. In the financial year to April to December 2007/08 net borrowing was £ 43.6 billion; this compares with net borrowing of £ 32.3 billion in the financial year April to December 2006/07. The higher current budget deficit together with the higher net borrowing was due to a combination of lower corporation tax and

Figure 12
Government spending

Figure 13
Balance of payments

VAT receipts, with modest gains in income tax and National Insurance contributions continuing to be exceeded by total current expenditure, particularly on capital projects.

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 December 2007 was 37.7 per cent of GDP, up from 37.3 in December 2006. In the financial year 2006/07, net debt as a percentage of GDP was 36.6 per cent.

TRADE AND THE BALANCE OF PAYMENTS

Current account deficit widens; goods deficit widens

The publication of the latest quarterly Balance of Payments shows that the current account deficit widened in 2007 quarter three to £ 20 billion, from a revised deficit of £ 13.7 billion in the previous quarter (Figure 13). As a proportion of GDP, the deficit rose to 5.7 per cent of GDP from 4 per cent in 2007 quarter two. The widening in the current account deficit in 2007 quarter three was due to a higher deficit on income and on trade in goods, partially offset by a higher

surplus on trade in services. The deficit on income increased to £3.8 billion and the deficit on trade in goods widened to £22.6 billion. The surplus in trade in services increased to £9.3 billion. The deficit in current transfers was little changed at £3.0 billion. The increase in the income deficit was driven by a rise in earnings on other investment abroad, which outweighed a fall in earnings on direct investment abroad.

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

Data for 2007 quarter three recorded a continuation of the large trade deficit in goods. Total exports of goods rose but imports of goods increased by a higher margin resulting in a widening of the deficit. The goods trade deficit was £22.6 billion in quarter three, up from £19.6 billion in quarter two. In terms of growth, exports of goods rose by 2.8 per cent whilst imports of goods rose by 6.0 per cent over the quarter. Services exports rose by 0.6 per cent and services imports also rose by

Figure 14
Employment and unemployment

0.6 per cent. Over the quarter, total exports increased by 2.0 per cent whilst total imports increased by 4.7 per cent.

According to the latest trade figures for November, the UK's deficit on trade in goods and services is estimated to have widened marginally. The total trade balance was in deficit by £4.4 billion, up from a deficit of £4.3 billion in October. The deficit in the trade in goods was £ 7.4 billion, unchanged from October. In growth terms, total exports rose by 0.8 per cent whilst total imports increased by 1.0 per cent. In the three months ended November, the deficit on trade in goods and services widened to £13.4 billion, from a £12.1 billion deficit in the previous three months. In terms of growth, total exports grew by 1.4 per cent, whilst total imports rose by 2.5 per cent.

However, these figures are distorted by volatility in VAT Missing Trader Intra-Community (MTIC) Fraud and therefore need to be treated with caution. According to the latest figures, the level of trade in goods excluding trade associated with MTIC fraud is estimated to be to £0.1 billion in November, unchanged from the previous month, and by £0.2 billion in the third quarter of 2007.

External surveys on exports reported a mixed picture for exports in the latest quarter. The BCC reported that the export sales net balance fell by 9 points to plus 22 and the export orders balance fell 10 points to plus 19. The latest CBI quarterly survey in contrast reported an improving picture. The export orders balance was plus 10 from plus 6 in the previous quarter. The export deliveries balance also improved to plus 11 from plus 7 from quarter three.

LABOUR MARKET

Labour market activity buoyant

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

The latest figure from the Labour Force Survey (LFS) pertains to the three-month period up to November 2007. The number of people in employment and the employment rate rose. The number of unemployed people and the unemployment rate fell. The claimant count fell. The inactivity rate and the number of inactive people of working age have both fallen. The number of vacancies rose. Average earnings, including and excluding bonuses, remained unchanged from the previous month. Overall average earnings remain subdued with weak real wage growth.

Looking at a detailed level, the increase in the employment level was mainly driven by employees and full-time employment. The current working age employment rate was 74.7 per cent in the three months to November, up 0.3 percentage points from the three months to August 2007 and up 0.1 percentage point from a year earlier. The number of people in employment rose by 175,000 in the three months to November 2007 compared to the three months to August, to an employment level of 29.36 million in the three months to November. The unemployment rate was 5.3 per cent in the three months to November, down 0.1 percentage point from the three months to August 2007 and from a year earlier. The number of unemployed people decreased by 13,000 in the three months to November

and was down 29,000 from a year earlier, leaving the current level of unemployment at 1.65 million

According to the LFS, in the period September to November 2007, the number of people in employment rose by 175,000. The increase was led by a rise in employees of 178,000 and a 5,000 rise in self-employment. In terms of full- and part-time workers, the numbers of people in full-time employment rose by 117,000 while the number of people in part-time employment increased by 57,000.

Workforce jobs increases

According to employer surveys, there was an increase of 63,000 jobs in the three months to September 2007. The largest quarterly contribution to the increase came from finance and business services (up 57,000), followed by manufacturing (up 5,000) and other services (up 4,000). This was offset by small decreases across a number of sectors with the largest decrease in transport and communication (down 3,000) followed by construction and distribution, hotels & restaurants (down 1,000 respectively). Over the year, total workforce jobs increased by 287,000. Of the total, the largest contribution to the increase over the year came from finance and business services (up 201,000), followed by distribution, hotels and restaurants (up 75,000) and construction (up 40,000). The manufacturing sector, in contrast, lost the largest number of jobs on the year (down 37,000), followed by transport and communication (down 19,000).

Claimant count level continues to fall

The claimant count measures the number of people claiming the Jobseeker's Allowance. The latest figures for December showed the claimant count level at 807,700, down 6,400 on the previous month and down 131,400 on a year earlier. The claimant count rate in December 2007 was 2.5 per cent, unchanged from the previous month but down 0.4 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 681,100 job vacancies in the three months to December 2007, up 12,200 from the previous three months and up 79,000 from the same period a year earlier.

Inactivity level falls

The working age inactivity rate was 21.0 per cent in the three months to November, down 0.2 percentage point on the three months to August 2007 but unchanged from a year earlier. In level terms, the number of economically inactive people of working age was down 81,000 over the quarter reaching a level of 7.91 million in the three months to November 2007. Inactivity falls in level terms were recorded across most groups. The largest level falls in inactivity were recorded for those categorised as 'looking after family/home' (down 29,000), followed by the 'retired' category (down 24,000).

Average earnings subdued

Growth in whole economy average earnings was unchanged in the three months to November compared to the three months to October and remains relatively subdued. Average earnings including bonuses increased by 4.0 per cent in the three months to November, unchanged from the previous month. Average earnings excluding bonuses rose by 3.6 per cent, also unchanged from the previous month. In terms of the public and private sector split, the gap in average earning (excluding bonuses) narrowed in November. Public sector wage growth was 3.5 per cent, unchanged from October. Private sector wages, in contrast, fell by 0.1 percentage point to 3.6 per cent in November.

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

PRICES

Producer output and input prices accelerate

Industrial input and output prices are an indication of inflationary pressures in the economy. During quarter four,

output prices exhibited further signs of an acceleration of growth from quarter three 2007 and therefore provided signs of continued inflationary pressures. Input prices also accelerated in the fourth quarter compared with quarter three. This suggests that firms were attempting to maintain their profit margins by passing on the higher costs of inputs to customers after facing a profit squeeze earlier in 2007.

Input prices on average rose by 10.3 per cent in 2007 quarter four. This compares with 2.8 per cent in 2007 quarter three. The core input price index, excluding food, beverages, tobacco and petroleum, rose by an average of 3.0 per cent in 2007 quarter four (12 month non-seasonally adjusted growth), an acceleration from growth of 2.3 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.

Output prices grew on average by 4.5 per cent in 2007 quarter four, an acceleration from growth of 2.6 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 2.3 per cent in 2007 quarter four, up from 2.2 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.

Consumer prices unchanged but still above target

Growth in the consumer prices index (CPI) – the Government's target measure of inflation – was 2.1 per cent in December, unchanged from November. This is lower than the peak

in March when inflation reached 3.1 per cent but above Government's 2.0 per cent inflation target (**Figure 15**).

Large downward contributions to the change in the CPI annual rate came from: housing and household services due to gas and electricity bills which increased by less than last year when tariff increases were being phased in; and furniture and furnishings where the price of kitchen units fell, reflecting discounting on some lines, and prices increased by less than last December across a range of other furniture.

The largest upward contribution to the change in the CPI annual rate was from food and non-alcoholic beverages, particularly cauliflowers, tomatoes, onions and cabbages. Bread and cereals, and sugar, jam, confectionery and chocolate also contributed.

A further upward contribution came from clothing and footwear, mainly due to greater discounting of clothing the previous December across a range of men's and women's clothing. The largest effect came from women's dresses.

There was a small upward contribution from miscellaneous goods and services, chiefly due to an increase in mortgage arrangement fees within financial services.

RPI inflation fell to 4.0 per cent in December, down from 4.3 per cent in November. This was largely due to average mortgage interest payments, where there was a smaller increase than last December. Fares and other travel increased, which was due to air fares rising more than they did last year. Otherwise the main factors influencing the RPI were similar to those affecting the CPI.

RPIX inflation – the all items RPI excluding mortgage interest payments – was 3.1 per cent in December, down from 3.2 per cent in November.

Figure 15
Inflation