Economic review

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SUMMARY

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

GROSS DOMESTIC PRODUCT

Third quarter growth of 0.7 per cent

GDP growth for the third quarter of 2007 is estimated to have grown strongly, by 0.7 per cent, slightly down from 0.8 per cent growth in the previous quarter. The annual rate of growth has now reached 3.3 per cent up from 3.2 per cent in quarter two (**Figure 1**).

The growth rate in the UK economy in quarter three continued to be driven by strong service sector output. This was offset by a weakening in industrial output growth in the production sector of the economy, in particular there was a slowing in manufacturing and mining and quarrying. The construction sector continued to grow strongly.

OTHER MAJOR ECONOMIES

Global growth rebounds

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.

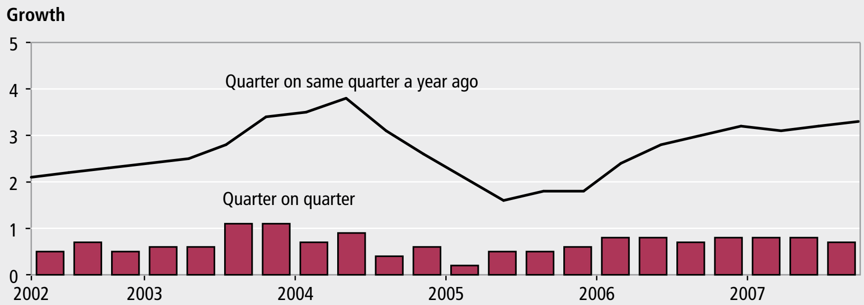
Growth in the three biggest mainland EU economies – Germany, France and Italy – recorded rebounds in GDP growth after a disappointing quarter two. According to Eurostat's estimate, euro area GDP grew by 0.7 per cent in 2007 quarter three. This is an acceleration compared to growth of 0.3 per cent in 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 growth of 0.3 per cent in quarter two. Exports increased sharply, combined with a decline in the rate of import growth. Household consumption expenditure 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.

Figure 1
Gross Domestic Product



FINANCIAL MARKETS

Share prices weaken and pound stabilises

Equity performance recorded a weakening in 2007 quarter three after showing evidence of fairly buoyant growth in 2007 quarter two. The FTSE All-Share index fell by around 3 per cent in quarter three following growth of around 4 per cent in quarter two. The decrease in equity growth can mainly be attributed to concerns regarding a slow-down in the world economy following fears over the US economy particularly in the financial sector, in part connected to the markets risk aversion towards assets associated with the US sub-prime market. Also, it can be part attributed to the recent rise in UK short term interest rates.

In the currency markets, 2007 quarter three saw sterling's average value broadly flat compared to the previous quarter. The pound appreciated against the dollar by 1.7 per cent in 2007 quarter three, similar to the rate in the previous quarter. Against the euro, sterling's value depreciated by 0.2 per cent after depreciating by 1.2 per cent in the previous quarter. Overall, the quarterly effective exchange rate was flat after depreciating by 0.5 per cent in 2007 quarter two (**Figure 2**). In the two months to November, the pound appreciated on average by around 1.2 per cent against the dollar. Against the euro, the pound depreciated by 1.4 per cent. Overall, the quarterly exchange rate fell by around 1.0 per cent.

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 appreciation of the pound against the dollar in 2007 quarter three may be partly linked to perceptions of stronger UK economic growth, leading to greater inflationary pressures and therefore the prospects of higher interest rates. In the UK interest rates were increased by the Bank of England in May 2007 by 0.25 per cent; rates were increased by a further 0.25 per cent in June 2007 to 5.75 per cent. The trend may begin to decline as the November Inflation Report signalled that the markets had priced in interest rate cuts in 2008. 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 contrast, there have been particular concerns in recent months regarding the relative weakness of US GDP growth, compounded by housing market weakness and the sub-prime crisis. In fact, US interest rates were lowered by a further 25 basis points in December to 4.25 per cent, and this was the third consecutive cut, following on from those in September and October. 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 third 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 per cent in December after increasing by 0.25 per cent in June, partly in response to concerns about inflationary pressures. However, compared to US and UK rates, euro-zone interest rates still remain fairly moderate and accommodative.

OUTPUT

Services sector drives economic growth

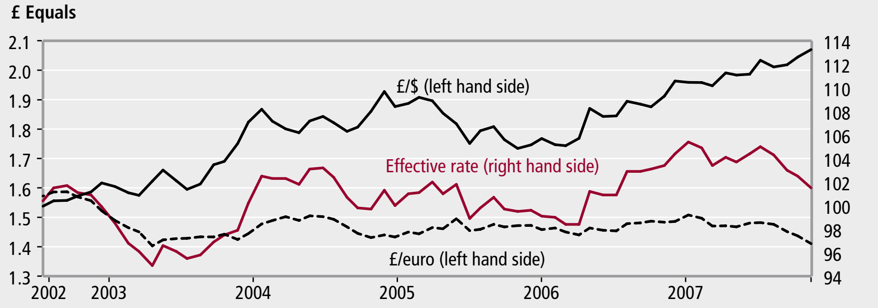
GDP growth in 2007 quarter three was estimated at 0.7 per cent, down from 0.8 per cent in the previous quarter. On an annual basis it was 3.3 per cent, up from 3.2 per cent in the previous quarter.

Construction activity continued to grow strongly in the third quarter of 2007. Construction output is estimated to have grown by 0.8 per cent, unchanged from growth in the previous quarter. Comparing the quarter on the same quarter a year ago, construction output rose by 3.5 per cent following growth of 3.6 per cent in the previous quarter (**Figure 3**). In terms of external surveys of the construction sector, the CIPS survey signalled strengthening activity in 2007 quarter three with the average headline index at 62.3, up from 59.3 in the previous quarter. Stronger activity was driven by a rise in commercial activity. In November, the headline index fell to 54.3, but still indicative of strong growth. The RICS construction survey for 2007 quarter three reported a stabilisation in construction growth at a high level with the balance at plus 16, unchanged from the previous quarter.

Total output from the production industries recorded unchanged growth in 2007 quarter three after an increase of 0.7 per cent in the previous quarter. On an annual basis it rose by 0.3 per cent, down from 0.5 per cent in the previous quarter. The main driver for the slow-down in production was manufacturing output. Manufacturing output was unchanged in quarter three, after fairly strong growth of 0.8 per cent in the previous quarter. On an annual basis, manufacturing output growth decelerated to 0.4 per cent from 0.9 per cent in the previous quarter (**Figure 4**). Lower production was also partly driven by a large contraction in the output of the mining and quarrying industries (including oil and gas). Output fell by 1.1 per cent following growth of 1.1 per cent in the previous quarter. This was offset by a strengthening in the output of electricity, gas and water supply which increased by 0.8 per cent compared to a contraction of 0.1 per cent in the previous quarter. On an annual basis utilities output was up 0.1 per cent after falling by 0.8 per cent in the previous quarter.

Production growth has generally been

Figure 2
Exchange rates



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 due to a decline in the rate of manufacturing output growth. However, manufacturing output has been volatile in recent quarters.

The output of the agriculture, forestry and fishing industries weakened in the latest quarter with output falling by 0.6 per cent after flat growth in the previous quarter.

According to the latest production figures in October, the index for the output of the production industries was 0.1 per cent lower than in the previous three months. Within total production, manufacturing output increased by 0.1 per cent, output of the electricity, gas and water supply industries increased by 0.3 per cent; this was offset by a decrease of 1.7 per cent in the output of the mining and quarrying industries, compared with the previous three months.

External surveys of manufacturing for 2007 quarter three showed a mixed 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 55.6, up from 54.5 in the previous quarter. In November the headline index was 54.4. The CBI in its 2007 quarter three Industrial Trends survey reported a weak picture with the total orders balance at minus six. According to the latest survey in December, the order books balance eased to plus two from plus eight in November. The BCC in its 2007 quarter three survey reported a mixed but overall a fairly buoyant picture of manufacturing activity. The home sales balance was plus 36 and the home orders balance was plus 26.

Overall the service sector, the largest part of the UK economy, continues to be the main driver of UK economic growth. Growth was 0.8 per cent in 2007 quarter three, unchanged from the previous quarter (**Figure 6**). Growth on an annual basis was 3.9 per cent, up from 3.8 per cent in the previous quarter. Growth was recorded across all four broad sectors. The main contributor to the growth continued to be the business services and finance sector which grew by 1.3 per cent in the latest quarter, down slightly from growth of 1.4 per cent in the previous quarter. There was also strong growth in the distribution, hotels and catering sector of 0.8 per cent, similar to the growth in the previous quarter. The transport, storage and communication sector recorded growth of 0.5 per cent, down from 1 per cent in the second quarter. There was a slight increase in the growth of the government and other services sector compared with the previous quarter. Growth was 0.3 per cent in quarter three compared to 0.1 per cent in quarter two.

The external surveys on services continued to show a fairly robust picture in line with the official picture. The CIPS average headline index in 2007 quarter three was 57.1, down slightly from 57.4 in the previous quarter but above the long-run average. Growth continued to be led by new orders. In November the headline index grew at a slower rate with the balance at 51.9. It should be noted that the CIPS survey has a narrow coverage of the distribution and government sectors.

The CBI and BCC also reported a fairly healthy picture of service sector activity (**Figure 7**). The CBI service sector survey for November reported modest growth

Figure 3
Construction output

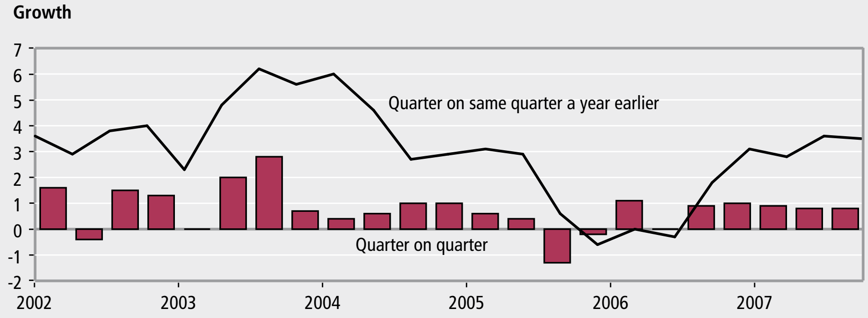


Figure 4
Manufacturing output

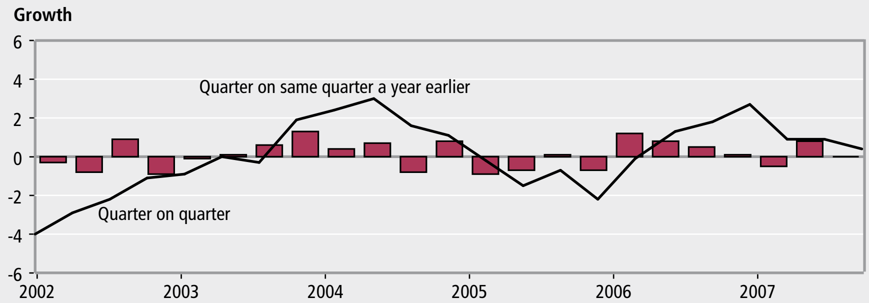
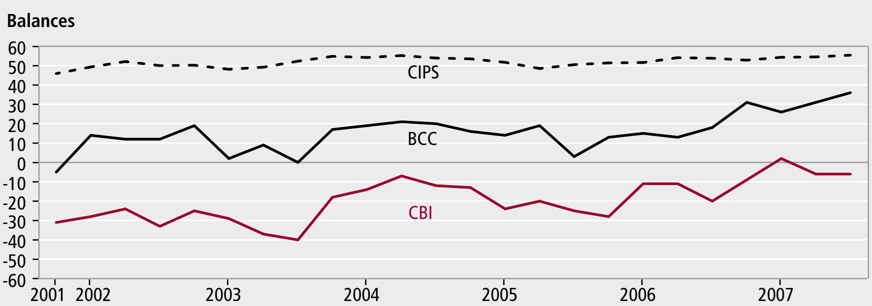


Figure 5
External manufacturing indicators



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 three survey reported a weakening picture of service sector activity, but overall balances for home orders and sales remained positive at plus 23 and plus 29 respectively.

The UK sectoral account shows the UK corporate sector once again as being a big net lender in 2007 quarter three. However, the level of net lending fell substantially in quarter three compared to quarter two. Despite the surplus, the overall debt level remains high due to the heavy borrowing between 1997 and 2001. The household sector remains a net borrower as income growth proved insufficient to finance total outlays. Households debt levels continue be relatively high, although the quarterly interest payments on the loans are still being kept down by low interest rates as a proportion of income, although they have steadily increased in recent quarters due to rises in interest rates. The level of central government borrowing eased modestly in 2007 quarter three from the previous quarter, but still remains high due to higher rises in cash expenditure exceeding tax receipts. The current account of the UK balance of payments continues to be in deficit.

Figure 6
Services output

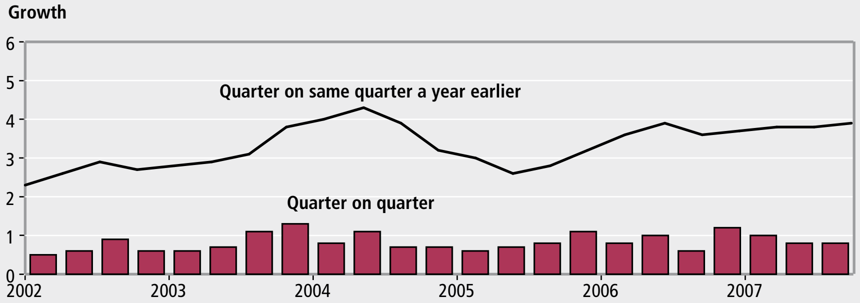
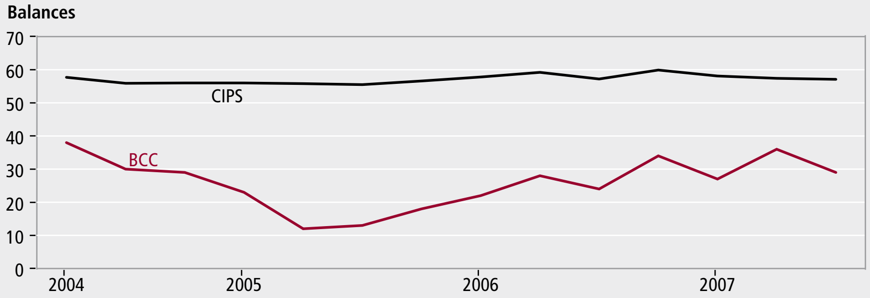


Figure 7
External services



EXPENDITURE

Consumers' spending buoyant

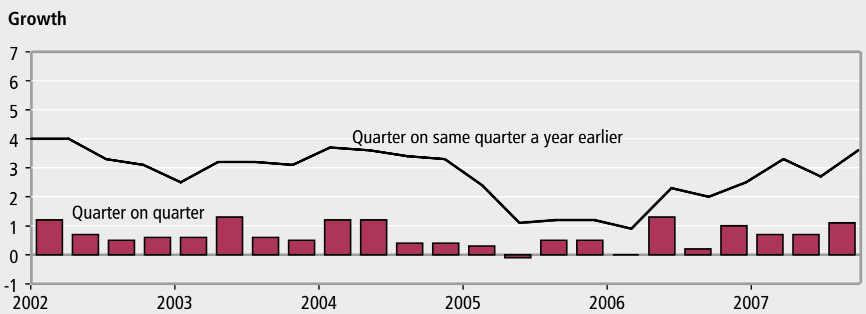
Household consumption expenditure growth accelerated in 2007 quarter three at a strong rate of 1.1 per cent. This follows growth of 0.7 per cent in the previous quarter. Growth compared with the same quarter a year ago was 3.6 per cent, up from 2.7 in quarter two (**Figure 8**). Growth was recorded across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

The impact on the UK economy from the US sub-prime housing crisis and the subsequent credit crunch is still uncertain. Early indications suggest that the impact in the UK, in terms of consumer expenditure has not had much effect. However, in the future there may be some impact on mortgage borrowing, possibly 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.

One key indicator of household expenditure is retail sales. Retail sales growth strengthened in 2007 quarter three from quarter two. Retail sales grew by 1.6 per cent in quarter three, an acceleration from growth of 1.4 per cent in the previous quarter. However, the underlying picture suggests that the increase in retail sales has been generated in many cases by heavy discounting in shops and early sales which are reflected in the price deflator (i.e. shop prices) which fell on average by around 1.2 per cent in the latest quarter compared to relatively modest growth of 0.5 per cent on average in the previous quarter.

Retail sales figures are published on a monthly basis and the latest available figures for November signalled a slight slowing compared to October but still suggested relatively strong growth (**Figure 9**). In the three months to

Figure 8
Household demand



November the volume of retail sales increased by 1.1 per cent compared to a 1.3 per cent increase in the three months to October. On an annual basis in November, the latest three months growth compared to the same three months a year ago recorded growth of 4.8 per cent, slightly down from 4.9 per cent growth in October. This underlying positive growth may suggest that in the fourth quarter past interest rate rises have not yet had an impact on consumers and their spending. However as mentioned earlier, discounting is continuing to support retail sales growth – the implied price deflator continued to record negative growth.

Retail sales can be disaggregated into 'predominantly food' and 'predominantly non-food' sectors. In three months to November 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 2.1 per cent. Growth in this sector was driven by the 'non-store retailing and repair' sector which grew by 3.8 per cent, followed by the 'textile, clothing and footwear stores' sector which grew by 1.5 per cent. The 'household goods' store sector in contrast contracted by 0.3 per cent. The 'predominantly food' sector grew by 1 per cent in the three months to November, down marginally from 1.1 per cent growth in the three months to October.

External surveys for retail sales presented a modest 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 1.2 per cent in retail sales on a like-for-like basis in November, up from 1 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 increasing debt servicing costs may discourage borrowing and in the process displace consumer expenditure on certain goods. However, various indicators on lending and borrowing in quarter three indicate otherwise and tend to support the acceleration in household expenditure.

The financial account shows that the general movement from net lending to borrowing since 1992 has primarily been facilitated by increases in both secured and unsecured lending. In 2007 quarter three there was strengthening in both, with lending continuing to be driven by loans on secured dwellings. In the latest quarter, borrowing secured on dwellings rose to around £33 billion from around £27 billion in the previous quarter. Unsecured lending also rose, to around £4.3 billion, up from around £2.4 billion in 2007 quarter two.

Household expenditure can be linked to household equity withdrawal (HEW). Both Nationwide and Halifax report an easing in growth in house prices in quarter three compared to quarter two; however, despite this slowdown, house price growth is still holding up fairly well and may have provided a boost to expenditure. According to the Nationwide, house price growth in quarter three was 1.6 per cent compared to 1.9 per cent in the previous quarter. Halifax report house price growth of 0.9 per cent in quarter three from 2.3 per cent in quarter two.

An alternative measure of expenditure showed a relatively strong picture. M4 (a broad money aggregate of UK money supply) rose to £52.8 billion in quarter three from £50.3 billion in quarter two. M4 lending (including cash and bank deposits) rose sharply to £76.9 billion from £52.6 billion in the previous quarter. This data appears to show a delayed impact of the credit crisis as banks stop holding wholesale deposits whilst the retail banking sector seems to be less affected.

The strength in consumer spending may also be explained by the fall in the savings ratio. The household savings ratio in quarter three was 3.4 per cent, down from 4.0 per cent in the previous quarter.

Finally, underlying fundamentals such as the prevalence of a relatively healthy labour market, together with a confident outlook on the economy by consumers, may have underpinned buoyant consumption growth. Consumers may also have resorted to current spending in anticipation of higher borrowing costs in the future.

Figure 9
Retail sales

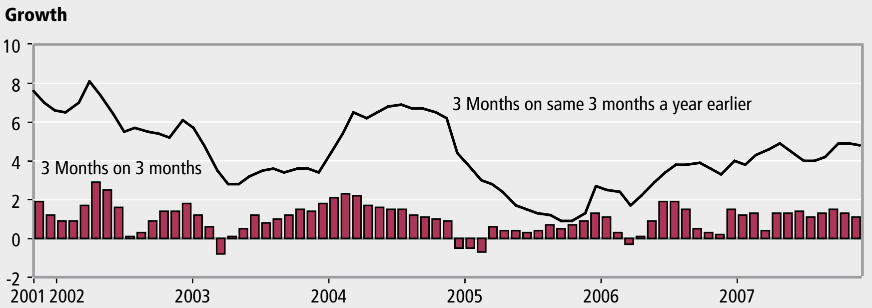
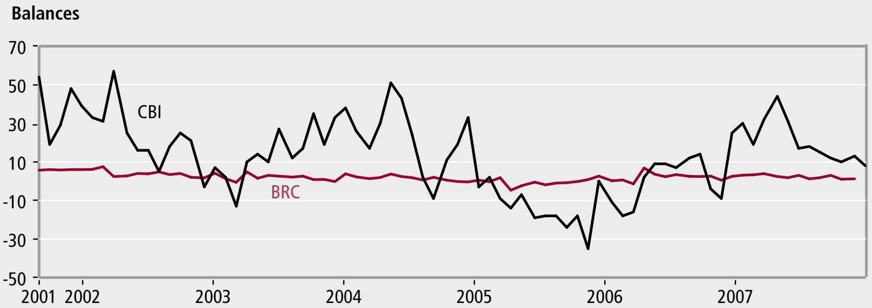


Figure 10
External retailing



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 slowdown from 6.4 per cent in the previous quarter. The strengthening in total investment was primarily driven by government investment and dwellings (**Figure 11**).

Business investment grew relatively strongly throughout 2006. In 2007 quarter 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, a slowdown from 7.8 per cent growth recorded in the previous quarter.

Evidence on investment intentions from the latest BCC and CBI surveys showed a mixed picture. According to the latest quarterly BCC survey, the balance of manufacturing firms planning to increase investment in plant and machinery rose five points to plus 33 and in services firms fell two points to plus 17 in 2007 quarter three. The CBI Industrial Survey for October reported a subdued investment picture, with the investment balance of plant and machinery weakening to minus 14 from minus six in the previous quarter.

According to the sectoral accounts, the private non-financial corporate sector was a net lender in 2007 quarter three, lending £1.08 billion, down from £5.3 billion in the previous quarter. This is mainly due to lower distributed income of corporations. Corporate sector debt levels remain high despite the sector surplus of recent years. The financial balance sheet shows the corporate sector had net liabilities of around £1.9 billion.

GOVERNMENT DEMAND

Government expenditure moderates

Government final consumption expenditure continued to grow at a fairly modest pace in quarter three. Growth in quarter three was 0.3 per cent, a deceleration from growth of 0.5 per cent in quarter two. Growth quarter on the same quarter a year earlier was 1.9 per cent, down slightly from the 2 per cent growth recorded for quarter two (**Figure 12**).

Figure 11
Total fixed investment

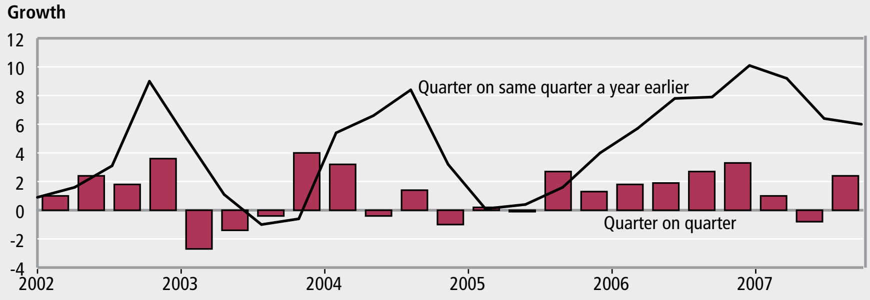
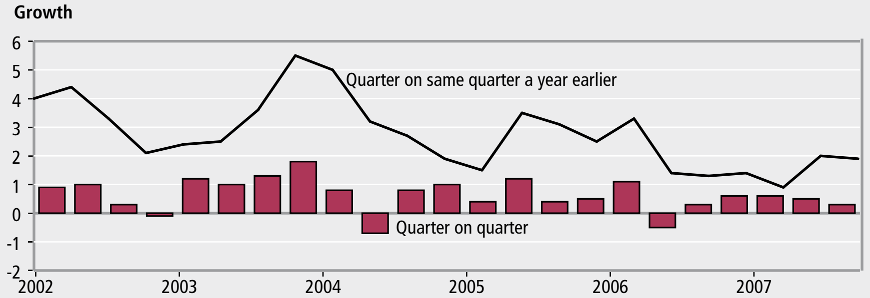


Figure 12
Government spending



Public sector finances deteriorate

The latest figures on the public sector finances reported deterioration in the current financial year to November 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 November 2007/08, the current budget deficit was £23.1 billion; this compares with a deficit of £14.6 billion in the financial year to April to November 2006/07. In the financial year April to November 2007/08, net borrowing was £36.2 billion; this compares with net borrowing of £26 billion in the financial year April to November 2006/07. Whilst there was an increase in total current receipts, this was exceeded by total current expenditure, particularly on capital projects, leading to a higher current budget deficit and higher net borrowing.

The financial account shows that the issuance of both sterling treasury bills and government securities has financed this net borrowing. The latest quarter saw the outstanding amount of government securities at £450 billion and of Treasury bills at £16.1 billion.

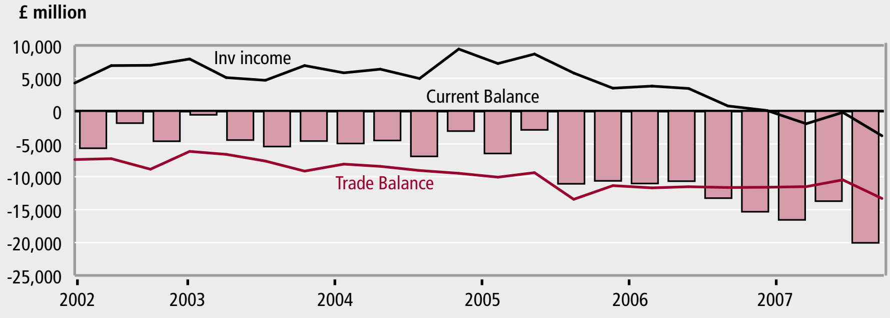
Since net borrowing became positive in 2002, following the current budget moving from surplus into deficit, net debt as a proportion of annual GDP has risen steadily. Public sector net debt in November 2007 was 36.7 per cent of GDP, up from 36.4 in November 2006. In the financial year 2006/07, net debt as a percentage of GDP was 35.1 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

Figure 13
Balance of payments



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 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 per cent over the quarter. Services exports rose by 0.6 per cent and services imports also rose by 0.6 per cent. Over the quarter, total exports increased by 2 per cent whilst total imports increased by 4.7 per cent.

According to the latest trade figures for October, the UK's deficit on trade in goods and services is estimated to have narrowed. The total trade balance was in deficit by £4.1 billion, down from a deficit of £4.8 billion in September. The narrowing deficit was due mainly to a lower deficit in trade in goods with EU countries which fell to £2.7 billion from £3.3 billion in September. There was a slight fall in the deficit in trade in goods to Non-EU countries to £4.4 billion from £4.6 billion in September. In growth terms, total exports rose by 1.2 per cent whilst total imports fell by 2.7 per cent. In the three months ended October, the deficit on trade in goods and services widened to £13.1 billion, from an £11.9 billion deficit in the previous three months. In terms of growth, total exports grew by 2 per cent, whilst total imports rose by 2.9 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 October, unchanged from the previous month, and by £0.2 billion in the third quarter of 2007.

Overall, the persistence of the current account deficit has led to the deterioration in the UK's International Investment Position (IIP) with the rest of the world. The net asset/liability position was negative to the tune of £318.8 billion at the end of the third quarter of 2007 compared with net external liabilities of £337.6 billion at the end of the previous quarter. UK assets abroad increased by £225.8 billion from the end of the second quarter to a level of £6,190.3 billion at the end of the third quarter. UK liabilities increased by £207 billion over the same period to a level of £6,509.1 billion. The rise in the level of both UK assets and UK liabilities in the third quarter reflects net investment.

External surveys on exports reported a less positive picture for exports compared to earlier in the year. The BCC reported that the export sales net balance fell by one point to plus 29 and the export orders balance remained unchanged at plus 26 in 2007 quarter three. The latest CBI survey reported a balance of plus two in December compared to minus four in November.

LABOUR MARKET

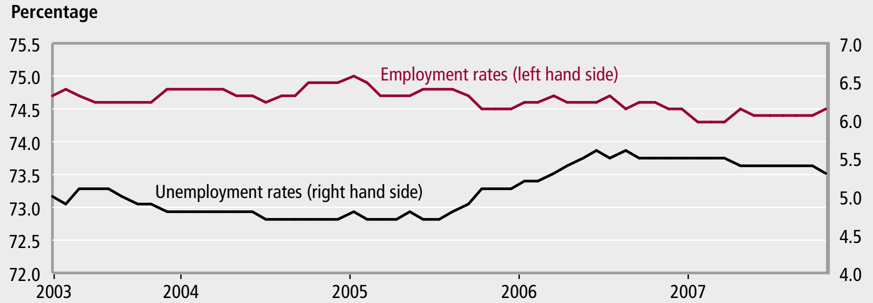
Labour market activity buoyant

The labour market in the latest reference period showed a benign picture continuing the trend of high levels of employment and low levels of unemployment seen throughout 2006 and in 2007. The robust labour market picture continues to be a reflection of fairly strong demand conditions in the UK economy.

The latest figure from the Labour Force Survey (LFS) pertains to the three-month period up to October 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. In terms of average earnings, including and excluding bonuses, earnings growth decreased. 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

Figure 14
Employment and unemployment



was 74.5 per cent in the three months to October, up 0.1 percentage point from the three months to July 2007 but unchanged from a year earlier. The number of people in employment rose by 114,000 in the three months to October compared to the three months to July, to an employment level of 29.29 million in the three months to October. The unemployment rate was 5.3 per cent in the three months to October, down 0.1 percentage point from the three months to July 2007 and down 0.2 percentage points from a year earlier (**Figure 14**). The number of unemployed people decreased by 15,000 in the three months to October and was down 59,000 from a year earlier, leaving the current level of unemployment at 1.64 million.

According to the LFS, in the period August to October 2007, the number of people in employment rose by 114,000. The increase was led by a rise in employees of 110,000 and a 20,000 rise in self-employment. In terms of full- and part-time workers, the number of people in full-time employment rose by 103,000 while the number of people in part-time employment increased by 10,000.

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 and 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 November showed the claimant count level at 813,000 down 11,100 on the previous month and down 134,200 on a year earlier. The claimant count rate in November 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 680,700 job vacancies in the three months to November 2007, up 14,500 from the previous three months and up 81,100 from the same period a year earlier.

Inactivity level falls

The working age inactivity rate was 21.2 per cent in the three months to October, down 0.1 percentage point on the three months to July 2007 but up 0.2 percentage points from a year earlier. In level terms, the number of economically inactive people of working age was down 16,000 over the quarter, reaching a level of 7.96 million in the three months to October 2007. In terms of level changes over the quarter, the largest level fall in inactivity was recorded for those categorised as 'looking after family/home' (down 40,000), followed by the 'long-term sick' category (down 15,000) These were offset with the largest increase in the 'student' category (up 26,000), followed by the 'temp-sick' (up 11,000).

Average earnings fall

Growth in whole economy average earnings was lower in the three months to October than in the three months to September and remains relatively subdued. Average earnings including bonuses increased by 4 per cent in the three months to October, down 0.1 percentage point from the previous month. Average earnings excluding bonuses rose by 3.6 per cent, down 0.1 percentage point from the previous month. In terms of the public and private sector split, the gap in average earning (excluding bonuses) narrowed in October. Public sector wage growth was 3.4 per cent, up 0.2 percentage points from September. Private sector wages, in contrast, fell by 0.1 percentage point to 3.7 per cent in October.

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

PRICES

Producer output prices buoyant; input prices rise

Industrial input and output prices are an indication of inflationary pressures in the economy. During quarter three, with the exception of a slight fall in August, output prices exhibited further signs of an acceleration of growth from quarter two 2007 and therefore provided signs of continued inflationary pressures. Input prices also accelerated in the third quarter. 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 around 2.6 per cent in 2007 quarter three. This compares with 1 per cent in 2007 quarter two. The core input price index, excluding food, beverages, tobacco and petroleum, rose by an average of 2.2 per cent in 2007 quarter three (12 month non-seasonally adjusted growth), a deceleration from growth of 2.9 per cent in the previous quarter. In November, input prices grew by 10.3 per cent, up from 8.5 per cent in October; the highest rate of annual input price inflation since July 2006. The largest contributions to the increase came from crude oil and home food materials which increased by 46.6 and 20.1 per cent respectively in the 12 months to November. The core input price inflation rose by 1.8 per cent in November compared to 2.8 per cent in October.

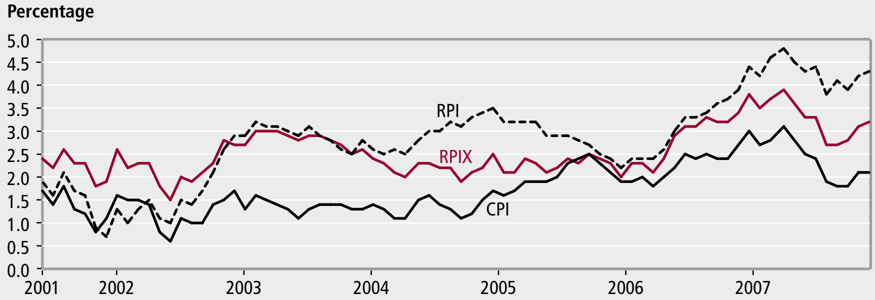
Output prices grew on average by 2.6 per cent in 2007 quarter three, a slight strengthening from growth of 2.4 per cent in the previous quarter. The underlying picture also suggests inflationary pressures. On the core measure which excludes food, beverages, tobacco and petroleum, producer output prices rose on average by 2.3 per cent in 2007 quarter three, unchanged from quarter two. In November, output prices increased further to 4.5 per cent from 3.9 per cent in October, the highest annual rate of annual rate of output inflation since August 1991. The largest contributions to the increase came from petroleum products and food prices, which increased by 18.5 per cent and 6.6 per cent respectively. The core output price index rose by 2.2 per cent compared to 2.3 per cent in September.

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 November, unchanged from October. This is lower than the peak in March when inflation reached 3.1 per cent but above Government's 2 per cent inflation target (**Figure 15**)

The main upward contribution came from changes in the price of road fuels. Average petrol prices rose by 3.5 pence per litre in November to stand at over £1 per litre; this compares with a fall of 0.4 pence per litre last year. Diesel prices also rose, by five pence per litre compared with a fall of 0.4 pence last November.

Figure 15
Inflation



There were also small upward effects from: heating oil which rose in price this year, reflecting movements in crude oil prices, but fell a year ago; and financial services, where the cost of exchanging foreign currency fell a year ago.

The main downward contribution to change in the CPI annual rate came from gas and electricity bills, which were little changed this year compared with price rises a year ago when there was continued phasing in of tariff increases.

Smaller downward effects came from: air travel, with fares on European routes falling by more this November than a year ago; vehicle maintenance and repairs; recreation and culture. The main downward contributions came from audio-visual equipment and books, and restaurants and hotels, mainly due to prices in staff canteens rising by less than last year.

RPI inflation rose to 4.3 per cent in November, up from 4.2 per cent in October. The main factors influencing the RPI were similar to those affecting the CPI, though there were additional upward contributions from food and motor vehicle purchase costs and a partially offsetting downward contribution from vehicle insurance. RPIX inflation – the all items RPI excluding mortgage interest payments – was 3.2 per cent in November, up from 3.1 per cent in October.

Independent forecasts

December 2007

UK forecasts

The tables below supplement the Economic Review by providing a forward-looking view of the UK economy. The tables shows the average and range of independent forecasts for 2007 and 2008 and are extracted from HM Treasury's Forecasts for the UK Economy.

2007

	Average	Lowest	Highest
GDP growth (per cent)	*3.0*	*2.5*	*3.3*
Inflation rate (Q4, per cent)			
CPI	*2.0*	*1.2*	*2.3*
RPI	*4.0*	*3.5*	*4.4*
Claimant unemployment (Q4, million)	0.85	0.81	1.10
Current account (£ billion)	–43.5	–53.2	–38.0
Public Sector Net Borrowing (2007–08, £ billion)	36.6	30.5	40.9

2008

	Average	Lowest	Highest
GDP growth (per cent)	*1.9*	*–0.1*	*3.0*
Inflation rate (Q4, per cent)			
CPI	*2.1*	*1.4*	*3.2*
RPI	*2.5*	*1.5*	*3.8*
Claimant unemployment (Q4, million)	0.92	0.74	1.23
Current account (£ billion)	–45.8	–59.1	–33.0
Public Sector Net Borrowing (2008–09, £ billion)	37.0	22.8	50.9`

Notes

Forecast for the UK economy gives more detailed forecasts, and is published monthly by HM Treasury. It is available on the Treasury's website at: www.hm-treasury.gov.uk/economic_data_and_tools/data_index.cfm

Selected world forecasts

The tables below supplement the Economic Review by providing a forward-looking view of the world economy. The tables show forecasts for a range of economic indicators taken from Economic Outlook (preliminary edition), published by OECD (Organisation for Economic Co-operation and Development).

2007

	US	Japan	Euro area	Total OECD
Real GDP growth (per cent)	*2.2*	*1.9*	*2.6*	*2.7*
Consumer price (percentage change from previous year)	*2.8*	*–0.0*	*2.1*	*4.5*
Unemployment rate (per cent of the labour force)	*4.6*	*3.8*	*6.8*	*5.4*
Current account (as a percentage of GDP)	*–5.6*	*4.7*	*0.2*	*–1.4*
Fiscal balance (as a percentage of GDP)	*–2.8*	*–3.4*	*–0.7*	*–1.6*

2008

	US	Japan	Euro area	Total OECD
Real GDP growth (per cent)	*2.0*	*1.6*	*1.9*	*2.3*
Consumer price (percentage change from previous year)	*2.7*	*0.3*	*2.5*	*4.2*
Unemployment rate (per cent of the labour force)	*5.0*	*3.7*	*6.4*	*5.4*
Current account (as a percentage of GDP)	*–5.4*	*4.8*	*–0.1*	*–1.4*
Fiscal balance (as a percentage of GDP)	*–3.4*	*–3.8*	*–0.7*	*–2.0*

Notes

The OECD *Economic Outlook* is published bi-annually. Further information about this publication can be found at www.oecd.org/eco/Economic_Outlook