Economic Review - October 2011

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Abstract

This note provides some wider economic analysis to support the Statistical Bulletin relating to the latest GDP release and other major economic releases during the latest month. By drawing on the wider array of economic releases surrounding the GDP release, for example the labour market, trade, retail sales and inflation releases, this note attempts to provide a more comprehensive picture of how the economy has performed in the latest quarter and, where relevant, the latest month.

Summary

- The latest month's economic releases present a picture of continuing weakness in economic growth, with no immediate relief from current high rates of inflation.
- GDP is estimated to have grown by 0.5 per cent in the third quarter of 2011. GDP has increased by 0.5 per cent over the latest year, a significant slowdown from the 2.6 per cent growth in the preceding twelve months.
- Output of the production sector has weakened during much of 2011, a reversal of the significant growth seen during the second half of 2010, with negative year-on-year growth in five of the six months between March and August. Manufacturing output fared better, but has nevertheless weakened slightly in the last few months.
- Services output is estimated to have risen by 0.7 per cent between the second and third quarters of 2011, and is 1.2 per cent higher than a year earlier. Construction output fell between the two latest quarters, and output was down 4 per cent in the year to August.
- Real household disposable income growth has been weak in 2010 and into 2011, but ticked up in the second quarter to 1.2 per cent. The savings ratio had been moderating during 2009 and 2010 but picked up in the second quarter to 7.4 per cent.
- The labour market weakened in the June-August period compared with the previous three months. The level of employment fell by 178,000, mainly driven by fewer people in part-time employment, while the rate of unemployment rose from 7.7 per cent to 8.1 per cent, a rate not seen since mid-1996. Younger age groups accounted for the bulk of the latest rise in unemployment.
- The trade deficit fell from £8.2 billion to 7.8 billion in August as underlying export volume growth exceeded that of imports. Excluding oil and erratic items, export and import volumes have both returned in August towards levels seen in the first quarter of 2011 when net overseas trade made a positive contribution to GDP growth.

- The trend in retail sales volumes over the past year remains broadly flat despite a slight increase in September. The value of sales was 5.4 per cent higher than a year earlier, demonstrating the impact of rising food price inflation.
- Price inflation continues to erode spending power, as consumer price inflation increased to 5.2 per cent in September, up from 4.5 per cent in August, in particular due to large rises in gas and electricity prices.
- Public sector net borrowing (excluding the temporary effects of financial interventions) was £63.5 billion between April and September 2011, £7.5 billion lower than in the same period in 2010.

GDP growth in 2011Q3

GDP is estimated to have grown by 0.5 per cent in the third quarter of 2011. GDP has increased by 0.5 per cent over the latest year, a significant slowdown from the 2.6 per cent growth in the preceding twelve months.

Growth in the third quarter was led by the services sector which accounts for just over 76 per cent of total GDP. Services contributed the whole of the 0.5 per cent increase in GDP in the quarter, with a small positive contribution from the production industries being offset by a contraction in construction output.

Over the past year, GDP growth has been wholly dependent on growth in the services sector, which in total contributed 0.9 points to GDP growth over the year. Construction reduced GDP growth over the year by 0.3 percentage points, and production industries by another 0.1 points. Within the latter manufacturing was a positive contributor to growth but mining and quarrying reduced GDP growth by 0.4 percentage points.

Contributions to Quarterly GDP growth by sector

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Output of the production industries

Output of the production sector has weakened considerably during much of 2011, a turnaround from the significant growth seen during the second half of 2010, and year-on-year growth has been negative – or in June zero - in each of the six months between March and August. This reflects particularly the double digit percentage falls seen in the output of the mining & quarrying and of the oil & gas extraction sectors during this period.

Manufacturing output has held up rather better, with positive year-on-year growth of just under 3 per cent in the latest six months. This was well down on the growth of more than 5 per cent seen during the period July 2010 to February 2011, but the latter period is perhaps flattered by the weak baseline for comparison when the manufacturing sector was still in, or just emerging from, recession.

However the level of manufacturing output has fallen slightly in recent months, and in August was about the same as its average level in the second quarter of 2011. Output remains around 7 per cent below its pre-recession peak in the first quarter of 2008.

Production and manufacturing sector growth

(change on month a year ago)

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Construction output

The construction sector has continued to weaken in recent months, with total output down by 4 per cent year-on-year in August. However the gradual slowing in year-on-year growth rates during 2011 in part reflects the comparison with a period of robust construction activity in the summer of 2010.

In August, the repair & maintenance sector fared relatively well, falling by proportionately less year-on-year than new work. New housing construction has been edging up despite the weakness of the housing market, and was up 3.3 per cent in the latest three months on a year earlier. Construction of new infrastructure has been especially strong in recent months, and rose nearly 11 per cent over the same period.

Construction output is estimated to have contracted by 0.6 per cent in the third quarter of 2011, having a very slight downward effect on GDP growth in the period.

Services sector output

The services sector grew by 1.2 per cent in the year to August, unchanged from growth in the year to July and broadly in line with average year-on-year growth rates seen so far during 2011.

Growth in August was led by transport, storage and communication sector, consistent with the 3.4 per cent year-on-year growth seen in this category. Growth in the output of government and other services has slowed slightly over the year. Average year-on-year growth during the first half of 2011 was 1.6 per cent. Because it contributes 29 per cent of total services output, government and other services accounted for 0.5 points of total services sector growth on average during this period. However in the last two months, year-on-year growth has averaged 1.3 per cent, implying a contribution to services growth of 0.4 per cent.

Sector accounts

The sector accounts, that were published on the 25th October, provided a more detailed picture of the economic position facing households, notably on household disposable income growth and the saving ratio.

Growth of real household disposable income (RHDI) was 1.2 per cent in the second quarter of 2011, but that followed growth of -1.7 per cent in the first quarter of 2011 and -1.3 per cent in the fourth quarter of 2010. Growth of RHDI for 2010 as a whole was just 0.1 per cent, though this was an upward revision from the previously published data. Growth of households' disposable income has been generally subdued in the last few years, rising by 0.6 per cent a year on average between

2007 and 2010, compared to annual average growth of 1.4 per cent between 2004 and 2007, and an average growth rate of more than 3 per cent between 1989 and 2003.

Real household disposable income growth

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The general weakness of RHDID growth in recent years reflects modest wage growth, particularly compared to high inflation which has eroded the spending power of household incomes. Real wage growth has been negative for much of the last three years, and inflation has been nearly twice the rate of earnings growth since mid-2009. However, in some years households' gross disposable incomes have been supported by lower interest payments on debt, notably mortgage interest payments, as well as lower tax and higher benefit payments relating to the automatic fiscal stabilisers. A note providing more detail on the impact of the recession on households can be found here: http://www.ons.gov.uk/ons/dcp171766_240249.pdf

The saving ratio, which provides something of a gauge of the sentiment of households regarding their financial position and outlook of economic conditions, ticked up in the second quarter of 2011, to 7.4 per cent from 5.9 per cent in the first quarter. The saving ratio rose sharply between 2008 and 2009 - from 0.9 per cent in early 2008 to 9.4 per cent in the second quarter of 2009 - but came down steadily to 5.9 per cent in the first quarter of 2011. This picture of an elevated saving ratio between 2008 and 2011 compares with an average saving ratio of just over 3 per cent between 2005 and 2007.

The saving ratio, previously and most recently published

June and October 2011

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The Current Account deficit improved dramatically in Q2 2011, the deficit fell to £2.0billion from £4.1billion in Q1 despite the total trade deficit increasing to £6.8billion in Q2 from £5.8billion in Q1. There was a geographic disparity in how UK trade performed. When considering the current account with only EU countries there was an improvement in the deficit of £8.8billion compared to the deficit of £13.4billion in the previous quarter. Within this section of the current account the improvement was driven by a strengthening in goods and services exports which in turn improved the UK's trade deficit with EU nations.

Labour market

The labour market weakened in the June-August period compared with the previous three months.

The level of employment fell by 178,000, mainly driven by fewer people in part-time employment, and the employment rate dropped by 0.3 percentage points to 70.4 per cent. The drop in the number of part-time workers was the biggest quarterly fall since comparable records began in 1992, led by those that did not want a full-time job. The share of part-time workers that wanted but could not find a full-time job therefore rose from 16.1 per cent to 16.6 per cent, compared with less than 10 per cent immediately prior to the recession.

The rate of unemployment rose from 7.7 per cent to 8.1 per cent, a rate not seen since mid-1996.

The brunt of rising unemployment is being borne by younger age groups. Almost two-thirds of the rise in unemployment between the two latest three-month periods was among 16-24 year olds. The unemployment rate for 18-24 year olds was 19.1 per cent in the June-August period, up sharply from 17.4 per cent in March-May. While aggregate unemployment has risen from just over 5 per cent at the start of the recession to its current level of 8.1 per cent, the rate of unemployment among 18-24 year olds saw a much greater increase from 12 per cent to 19 per cent.

The rise in the overall unemployment rate from 7.9 per cent to 8.1 per cent marks a breaking out from the very narrow range of 7.7-8.0 per cent seen throughout the previous two years.

Annual average earnings growth fell for both total pay (2.8 per cent in the three months to August) and regular pay i.e. excluding bonus payments (1.8 per cent) compared with the previous three month period. There is currently a fairly even distribution of regular pay growth between public (2.0 per cent excluding publicly-owned financial services institutions) and private sector (1.8 per cent).

However within the private sector, regular pay growth ranges from 4.1 per cent in the finance and business services sector to 1.2 per cent in manufacturing and 0.8 per cent in wholesaling, retailing, hotels and restaurants.

Productivity

Productivity growth on an output per worker basis was flat in the second quarter of 2011 compared to the previous quarter and negative compared to the same quarter a year earlier (-0.2 per cent).

However output per hour increased between the first and second quarter, both compared to the previous quarter (up 1.3 per cent) and compared to the same quarter a year ago (1.4 per cent).

In part, this may reflect the effect of the additional public holiday for the royal wedding on 29th April 2011. While some sectors of the economy would have been closed for the day, thereby reducing total hours worked, the impact on employment might be expected to be much smaller. However this may not be the whole story. The latest labour market data suggest that total hours worked increased slightly in the June-August period, but restoring only part of the drop seen in the March-May period.

Productivity growth for the whole economy

percentage change, quarter on quarter

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Trade

The deficit on the trade in goods fell to £7.8 billion in August. The fall in the deficit reflects a rise of £0.2 billion in exports of goods and a fall of £0.2 billion in imports of goods. The volume of goods exports (excluding oil and erratics) rose by 1.3 per cent in the month, faster than the 0.3 per cent increase in import volumes on the same basis. Both export and import volumes in August returned to close to their levels in the first quarter of 2011 when trade made a substantial positive contribution to GDP growth.

The surplus on trade in services was unchanged at £5.9 billion in August with imports and exports both rising slowly in the month.

Retail sales

The volume of retail sales grew in September by 0.6 per cent when compared to both the previous month and the same month the previous year, demonstrating the broadly flat trend in retail sales volumes over the past twelve months. Inflation in the retail sector remains high, and the value of retail sales has increased by 5.4 per cent from the level in September 2010. In the first nine months of 2011, average year-on-year growth in retail sales values has exceeded volume growth by 4.4 percentage points.

Consumer price inflation

High rates of consumer price inflation continue to erode the real value of households' spending power. Annual consumer price inflation increased to 5.2 per cent in September, up from 4.5 per cent in August, and equalling the rate in September 2008 which has never been exceeded. Retail price inflation rose from 5.2 per cent to 5.6 per cent in September, the highest annual RPI inflation rate since 1991.

Higher gas and electricity prices were by far the largest single contributor to the rise in the annual rate of price inflation, up by 13.0 per cent and 7.5 per cent respectively between August and September when they were broadly unchanged on a year ago. Petrol and diesel prices fell between the two months, but by less than in the same period of 2010, thereby also pushing up the annual inflation rate.

Transport contributed 1.4 percentage points to the 5.2 per cent annual inflation rate in September, the largest contribution of any sub-component. This reflects substantial increases in the cost of fuel and lubricants over the past twelve months, up by 17.8 per cent, and air transport fares, up 17.6 per cent. A decrease of 2.1 per cent in air transport fares between August and September was less than the seasonal fall in the same period of 2010.

Producer price inflation

Producer price inflation remained elevated throughout September. Manufacturers' input prices rose 1.7 per cent between August and September, compared with a rise of 0.6 per cent in the same period of 2010. The rise was driven by increases in the prices of crude oil and other imported parts and equipment; crude oil prices rose 42.8 per cent in the year to September. Output prices rose at a slower rate, increasing 0.3 per cent between August and September.

Public sector finances

In the period April to September 2011, public sector net borrowing (excluding the temporary effects of financial interventions) was £63.5 billion, £7.5 billion lower than in the same period in 2010. Half of this was due to reductions in capital expenditure, and the improvement in the current budget deficit over the same period was therefore only £3.4 billion.

The Office for Budget Responsibility's Economic and Fiscal Outlook of March 2011 forecast that growth of total government receipts in 2011-12 as a whole would outstrip that of government current expenditure. However the OBR's full year forecast of receipts growth of 6.9 per cent is somewhat ahead of the latest outturn figures, which show receipts growing by only 4.9 per cent in the first half of the financial year.