Office for National Statistics

Economic Review, January 2014

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Abstract

This note draws together key economic stories from National Statistics produced over the latest month. This is in order to paint a coherent picture of the UK's economic performance using recent economic data.

Key Points

- Gross Domestic Product (GDP) grew at an unrevised rate of 0.8% in the third quarter of 2013. Growth was broadly based across the services, production and construction sectors, while the expenditure measure was supported by stronger household spending.
- Revisions have been introduced to expenditure estimates which raise the rate of GDP growth during 2012 and 2013. The UK economy is now 2.0% below its pre-downturn level of output, compared to 2.5% on previous estimates.
- The average number of hours per worker has returned to its pre-downturn peak. Combined with recent reductions in the unemployment rate, this points to a broad intensification in the use of labour in production.
- At the start of the New Year, this Review highlights several key features of the UK’s economic recovery, including labour productivity, investment, trade, regional house prices and real wages, in the light of information published during 2013.

Introduction

The third estimate of Gross Domestic Product (GDP) confirmed that the UK economy grew by 0.8% in the three months to September 2013. The Quarterly National Accounts also introduced revisions to recent quarters, raising growth rates in 2012 and 2013 which mean that the economy is now estimated to be 2.0% below its pre-downturn peak, compared with previous estimates of 2.5%. This edition of the Economic Review unpacks these changes and highlights the recent contribution of households to the economic recovery.

The January edition of the Economic Review also considers recent developments in the UK’s labour market. Average hours per worker returned to their pre-downturn peak in the third quarter of 2013 which, combined with recent falls in the unemployment rate, points to a broad intensification of the use of labour in the production process in recent months.

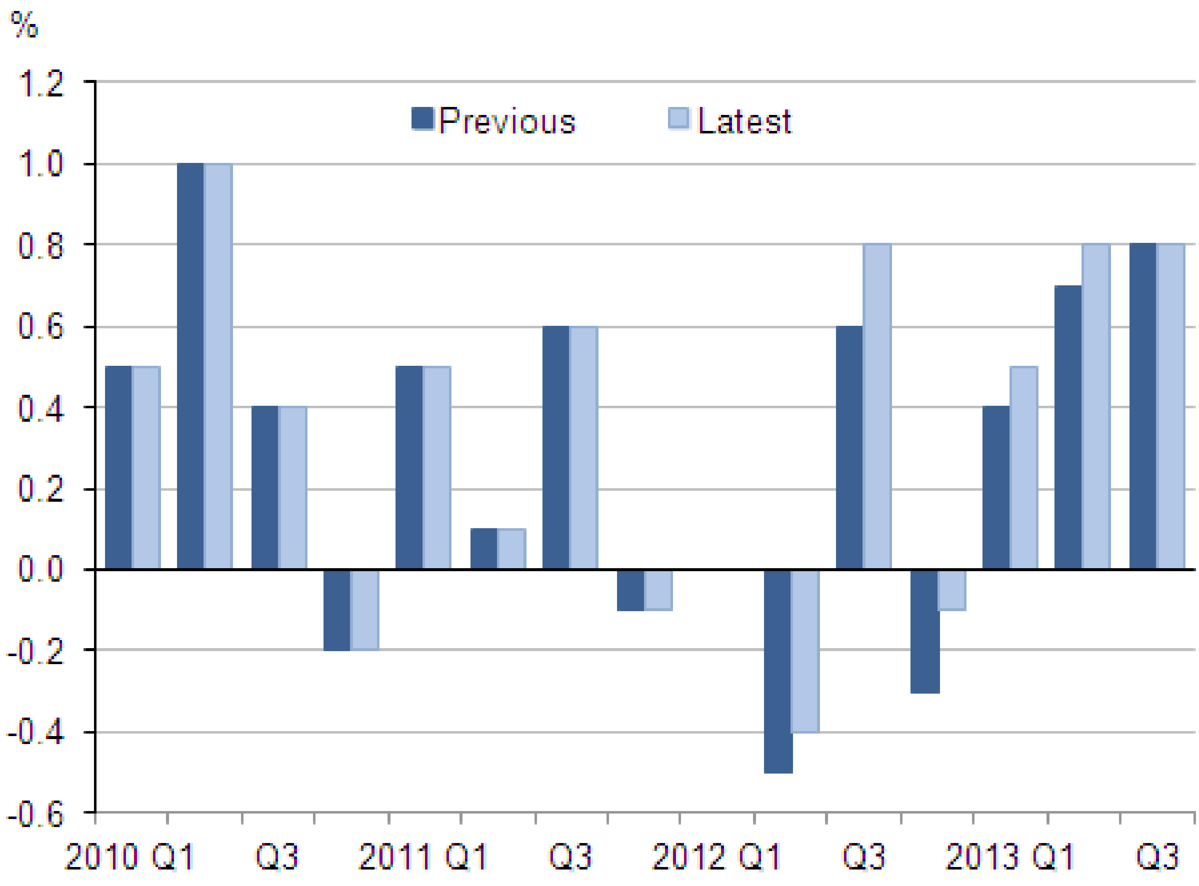
The final section of the Economic Review considers how our understanding of the UK economy has changed during 2013. It sets out five key characteristics of the UK's economic recovery which have only been partially explained by data and analysis published during the last twelve months, and which have implications for the economy's development in the New Year.

The Quarterly National Accounts

The third estimate of Gross Domestic Product (GDP) confirmed that the UK economy grew by 0.8% in the three months to September 2013. Output grew in each of the services (0.8% quarter on quarter), construction (2.6%) and production industries (0.6%), within which manufacturing (0.8%) also made a positive contribution. Stronger capital formation and continued growth in household spending supported the expenditure measure of GDP, while higher imports and lower exports reversed two consecutive quarters of positive net trade contributions to GDP.

The Quarterly National Accounts also introduced revisions arising from new data which suggest that GDP growth during 2012 was marginally stronger than formerly estimated and that the recovery during 2013 has been more marked than previously thought. GDP growth during 2012 as a whole was revised upwards from 0.1% to 0.3%, with stronger growth concentrated in the third 'Olympic' quarter in particular. GDP growth in each of the first two quarters of 2013 has been revised upwards by 0.1 percentage points, taking cumulative GDP growth in the first three quarters of 2013 from 1.8% to 2.1%. Revisions to the quarterly growth rates of GDP are shown in Figure 1.

Figure 1: Quarterly GDP growth rates, constant prices, seasonally adjusted



Source: Office for National Statistics

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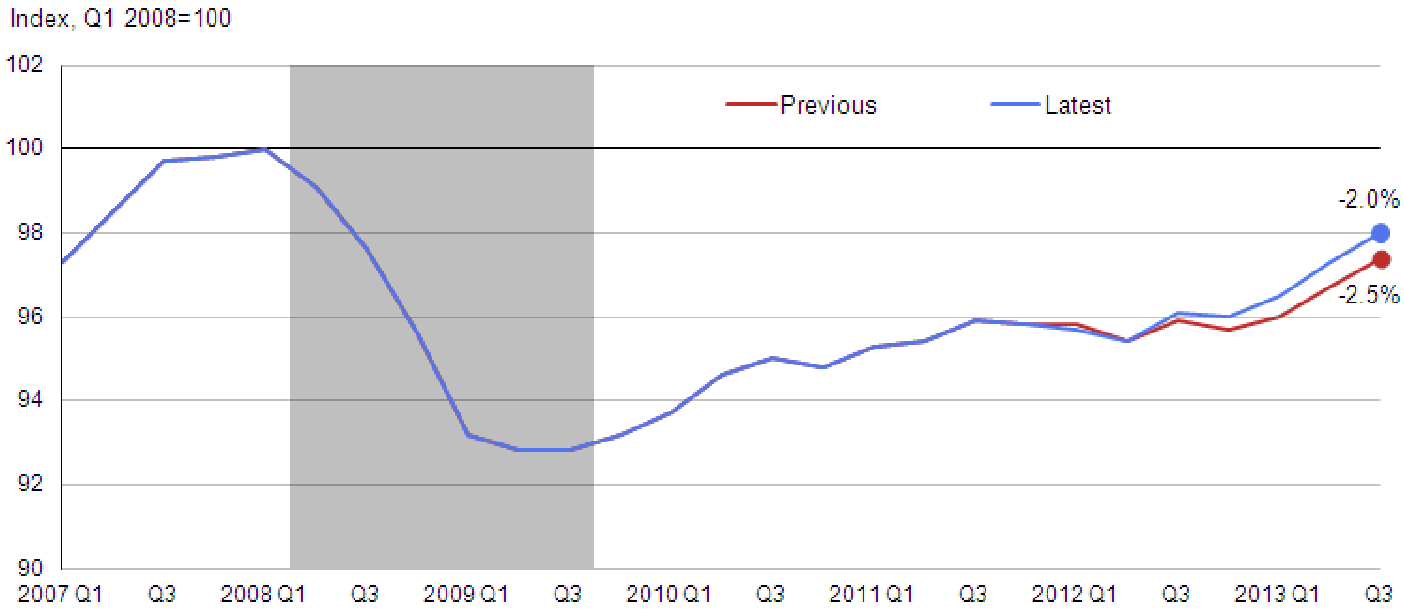
The aggregate impact of these revisions is to increase the estimated size of the UK economy. The level of GDP in Q3 2013 is now 0.5 percentage points higher than previously estimated, taking the economy closer to the pre-downturn level of output. Figure 2 shows the path of UK output relative to the level in Q1 2008. This figure shows that the economy is now around 2.0% smaller than the pre-downturn peak, compared with 2.5% smaller at the time of the second estimate of GDP.

Figure 2: UK output relative to the pre-downturn peak, constant prices, seasonally adjusted



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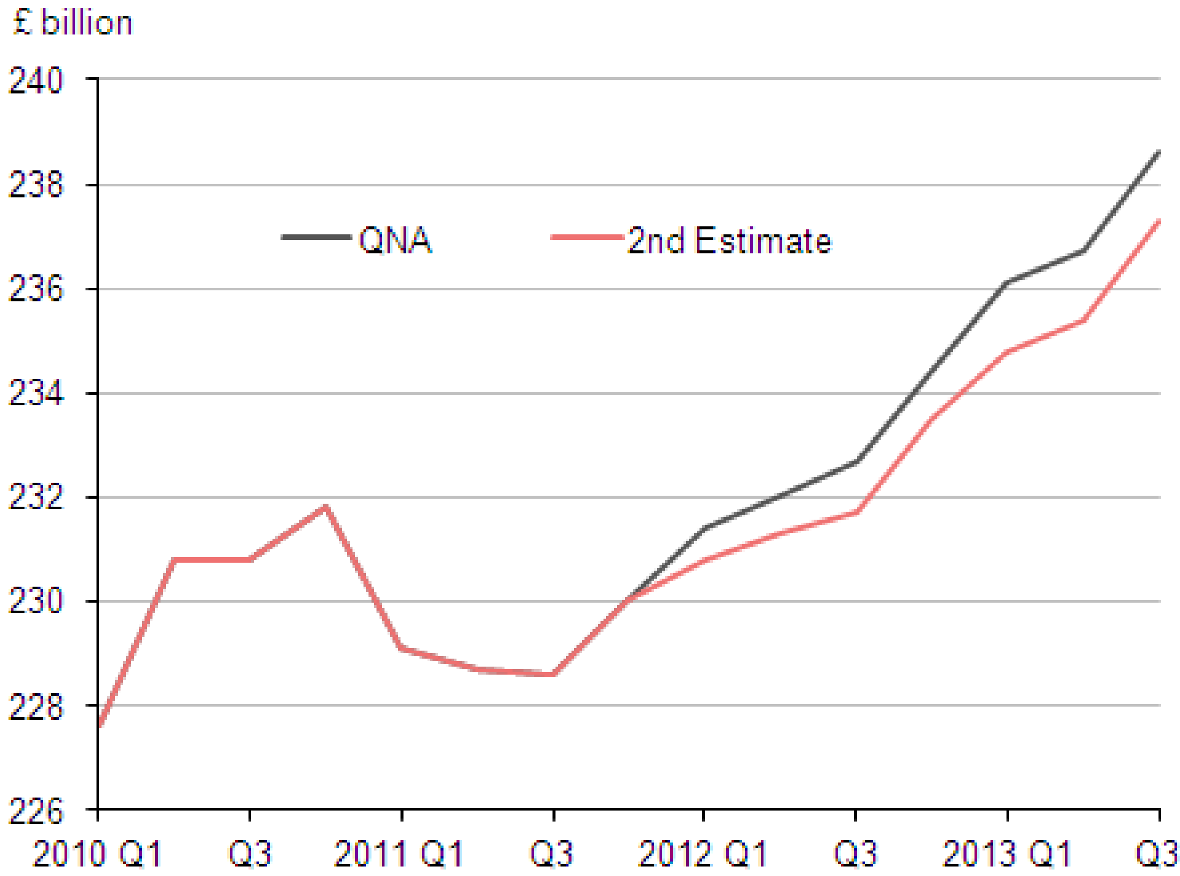
While growth during 2013 has been revised upwards, much of this revision is as a consequence of faster than previously estimated expenditure growth during 2012. Within the expenditure measure of GDP, this is partly attributable to new estimates of household final consumption expenditure (Figure 3). These suggest that the volume of household consumption grew more strongly than previously estimated as inflation started to abate during 2012. Household final consumption expenditure is now estimated to have grown by 1.5% during 2012, 0.3 percentage points higher than the previous estimate.

Figure 3: Revisions to Household Final Consumption Expenditure, constant prices, seasonally adjusted



Source: Office for National Statistics

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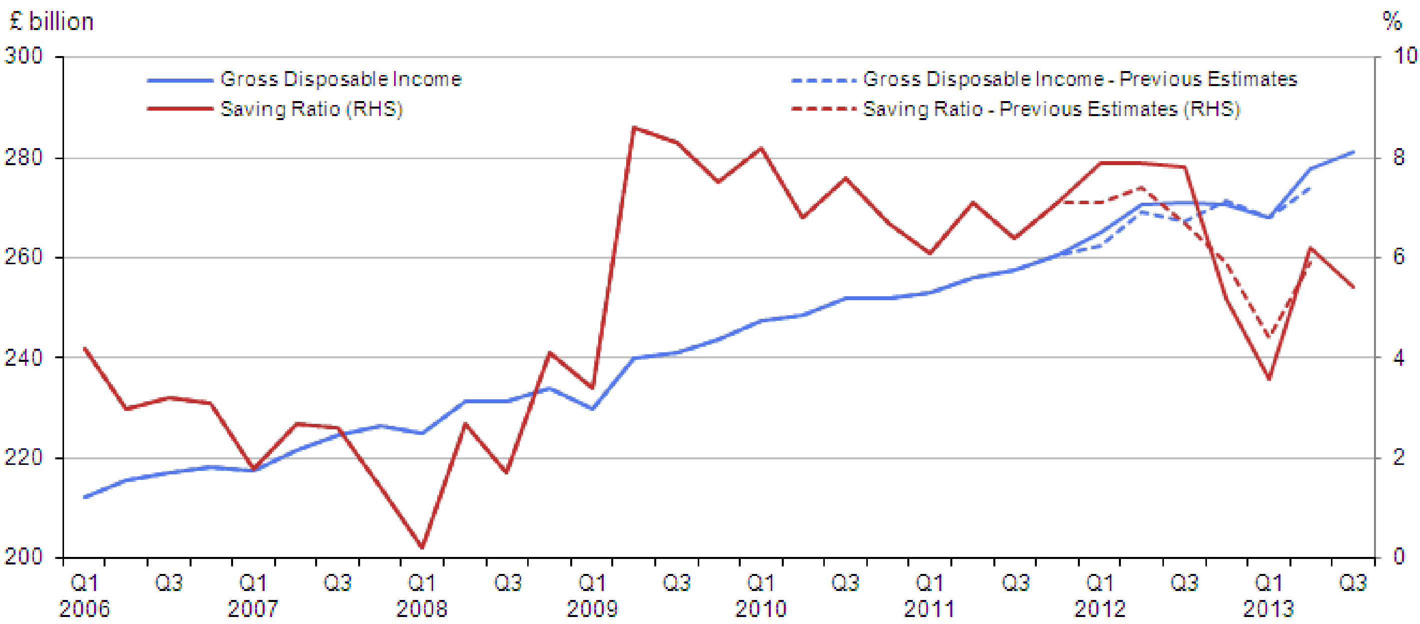
The revisions to household expenditure are a consequence of newly available data from the Living Costs and Food Survey and other financial surveys, and reflect a balance of upwards and downwards revisions to spending on different goods and services. Upwards revisions came from higher spending on Housing and Food & Drink than previously estimated, as well as a large positive contribution from spending on Miscellaneous Goods & Services – which includes Insurance, Financial Services, Personal Effects and Personal Care. Downwards pressure came from lower than previously estimated spending on Transport.

The upward revisions to household consumption were supported by revisions to household incomes during 2012. Figure 4 shows revisions to the path of total households' gross disposable income (GDI) and the saving ratio since 2006. GDI – the sum of all gross disposable income across UK households – was revised upwards during 2012 and has grown relatively strongly during the second and third quarters of 2013. Much of this increase is attributable to higher than previously estimated Mixed Income and Distributed Income of Corporations during 2013 which raised the income of households. Income from Wages & Salaries is largely unrevised over this time period.

Figure 4: Households' Gross Disposable Income, constant price, seasonally adjusted, Saving Ratio (%)



Source: Office for National Statistics

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Figure 4 also indicates that the balance of higher income and higher expenditure during 2012 resulted in upwards revisions to the saving ratio, reflecting larger upward revisions to income than spending. Compared with previous estimates, the household saving ratio was 0.8, 0.5 and 1.1 percentage points higher in each of the first three quarters of 2012, before falling more sharply at the beginning of 2013. These revisions suggest that rather than continuing to reduce their saving smoothly from the peak rate in Q2 2009, households raised their rate of saving slightly in 2012, before reducing it in 2013. Note that the profile of the saving ratio in the first two quarters of 2013 is distorted by changes to the timing of bonus payments, but the average ratio in the first three quarters of around 5.1% is well below the 7.2% figure seen in 2012. The timing of this fall in the saving ratio corresponds to the acceleration of GDP growth and the strengthening of the economic recovery during 2013.

Notes

1. New data have become available from a range of administrative and survey sources, including the Monthly Business Survey, the Living Cost and Food Survey, the Quarterly Capital Expenditure Inquiry and the Quarterly Stocks Inquiry. More information on why GDP is revised

is available ([Explaining economic statistics - Quarterly GDP revisions]) and summarised in an infographic ([Explaining economic statistics - Understanding GDP and how it is measured]).

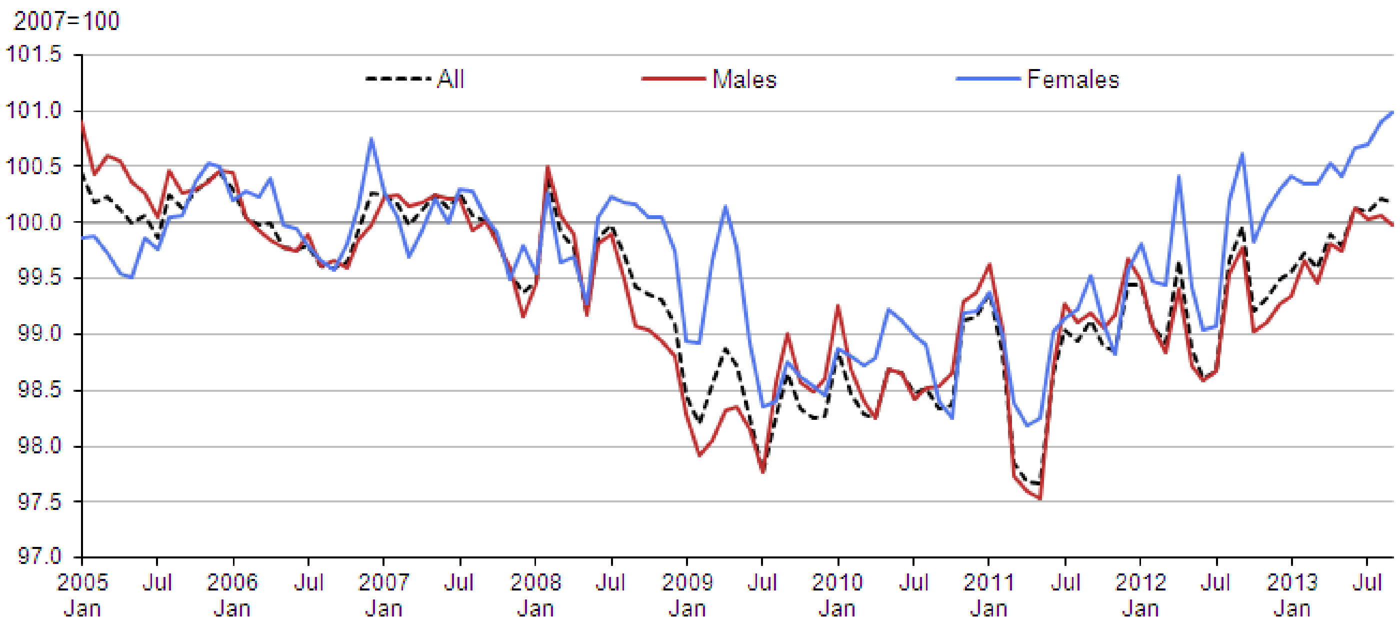
2. See Economic Review - September 2013 for an analysis of bonus payments during Q2 2013

Labour Market

The strength of output growth during 2013 also appears to have had an impact on the labour market. The unemployment rate among those aged 16 and over has fallen from 7.8% in the three months to June, to 7.6% in the three months to September and to 7.4% in the three months to October. Among women, the unemployment rate in the three months to October was 6.9%, 0.4 percentage points lower than the same period a year ago, while among men, the unemployment rate has fallen from 8.3% to 7.7% over the same period. The Claimant Count rate of unemployment has also been on a downwards trajectory, falling for the sixth consecutive month in November to 3.8%: the lowest level since January 2009.

Alongside this relatively sharp fall in the rate of unemployment, the average number of hours worked per worker has also recovered to its pre-downturn level, pointing to a broad intensification in the use of labour in production. Figure 5 shows the average number of hours worked by male, female and all workers, indexed to their respective levels in 2007. While the average number of hours worked has been declining over the past two decades, average hours worked has recovered from around 31.5 hours per week in Q3 2009 to around 32.1 hours per week in Q3 2013. However, while average hours for males have risen slightly more slowly than the average for all workers over this period, average hours for females have increased sharply from a lower base: rising from 26.2 to 26.8 hours per week. This latter increase amounts to each female worker completing an extra week of work per year compared with mid-2009.

Figure 5: Average hours per worker



Source: Office for National Statistics

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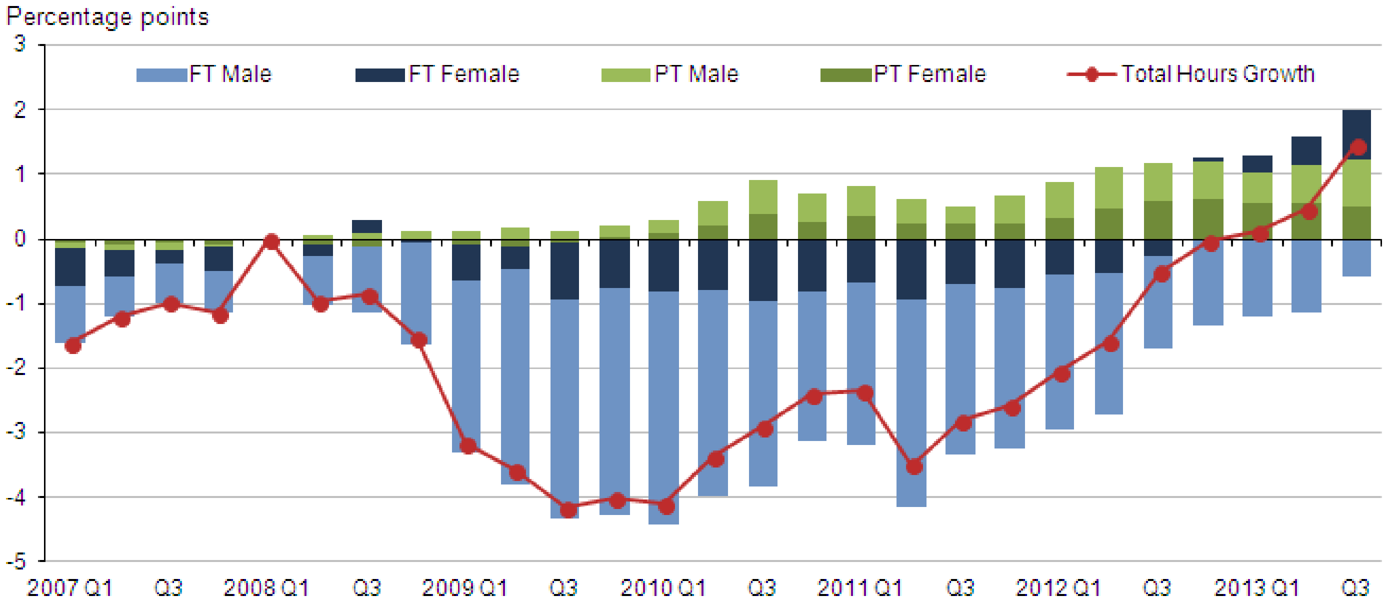
While average hours per worker have returned to their pre-downturn level, the total number of hours worked was 1.5% above the pre-downturn peak in Q3 2013, largely as a consequence of the rising level of employment. Figure 6 shows contributions to the growth in total hours worked relative to Q1 2008 from full-time and part-time employment among males and females. It suggests that much of the fall in total hours worked during the economic downturn arose as a consequence of lower male and female full-time hours. Between Q1 2008 and Q1 2010, the total number of hours declined by 4.1% which was more than accounted for by the fall in male and female full-time hours. Between 2010 and 2012, the growth of part-time hours among both men and women supported moderate growth in the total number of hours worked. However, while aggregate female full-time hours rose above their pre-downturn peak at the end of 2012, male full-time hours remain below their level in Q1 2008: The share of all hours worked accounted for by full-time work fell from around 86.5% at the end of 2010, to around 85.5% in 2012.

Figure 6: Contributions to the growth in total hours: Percentage points relative to Q1 2008



Source: Office for National Statistics

Notes:

1. FT refers to full-time
2. PT refer to part-time

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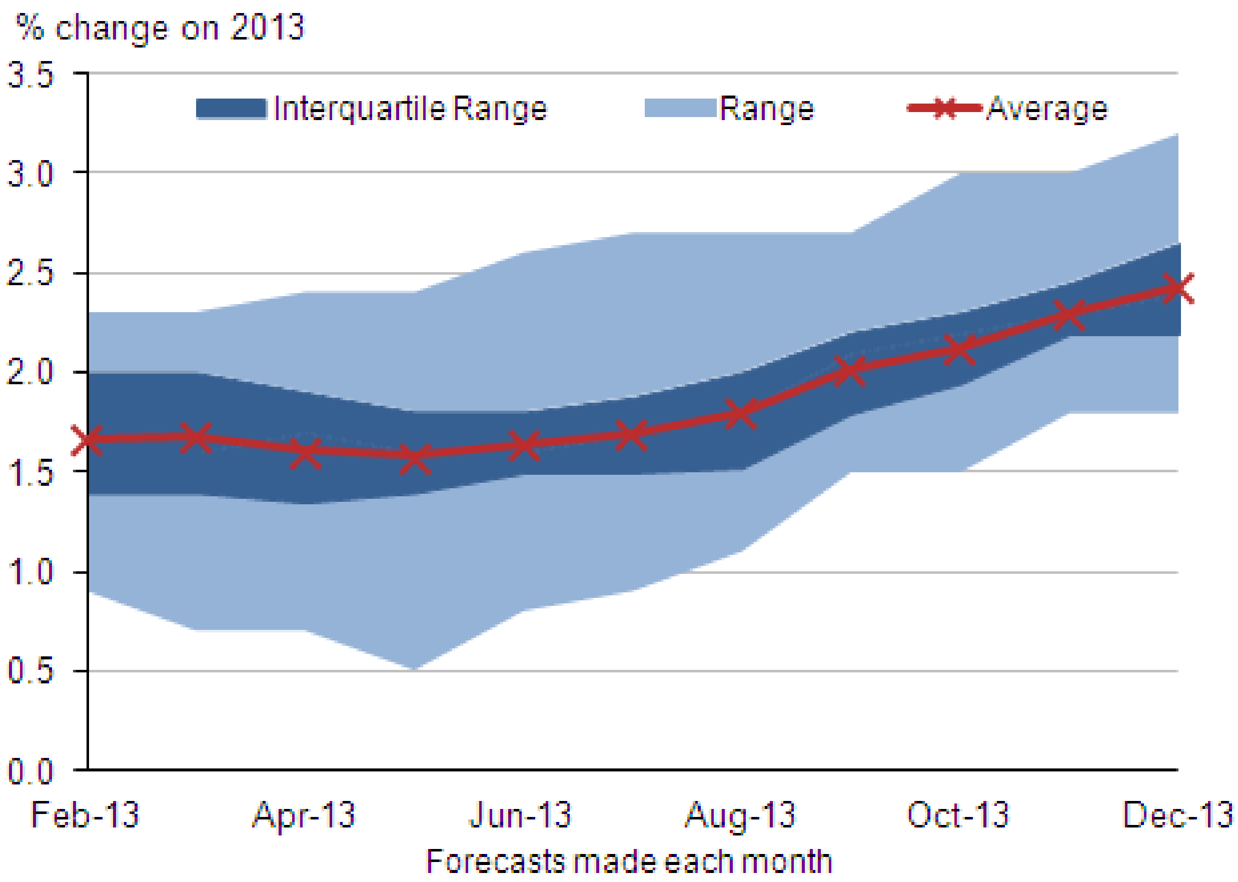
Taken together, the fall in the unemployment rate and the rise in the average number of hours worked per week suggest a strengthening of labour market conditions, with an increase in both the number of workers and the intensity of their employment. However, as Figure 6 shows, much of the growth in total hours worked since Q1 2008 has been in part-time employment: Male full-time hours remain below the pre-downturn peak.

The nature of the economic recovery

While our understanding of economic developments during 2013 will continue to evolve into the New Year, the start of 2014 offers an opportunity to review what has been learned about the economy during the past twelve months. As the Bank of England has highlighted, an economic recovery now appears to be underway. Following a period of relatively flat output growth, the economy was growing at its fastest pace in three years in Q3 2013. Unemployment has continued to fall and annual inflation – which averaged 2.6% between January and November 2013 – was more stable during 2013 than any twelve month period since 2003.

The emergence of a strengthening economic recovery during 2013 has also had a substantial impact on growth expectations for 2014. Figure 7 shows the average, inter-quartile range and spread of external forecasts for GDP growth in 2014, made between February and December 2013. It shows that independent forecasters have become increasingly optimistic as the year progressed. The average full-year GDP growth forecast fell from around 1.7% in February 2013, to around 1.6% in May 2013, but has since risen to 2.4% following stronger-than-anticipated economic developments towards the end of 2013.

Figure 7: Independent forecasts of UK GDP growth in 2014: % change on 2013



Source: Treasury (Her Majestys)

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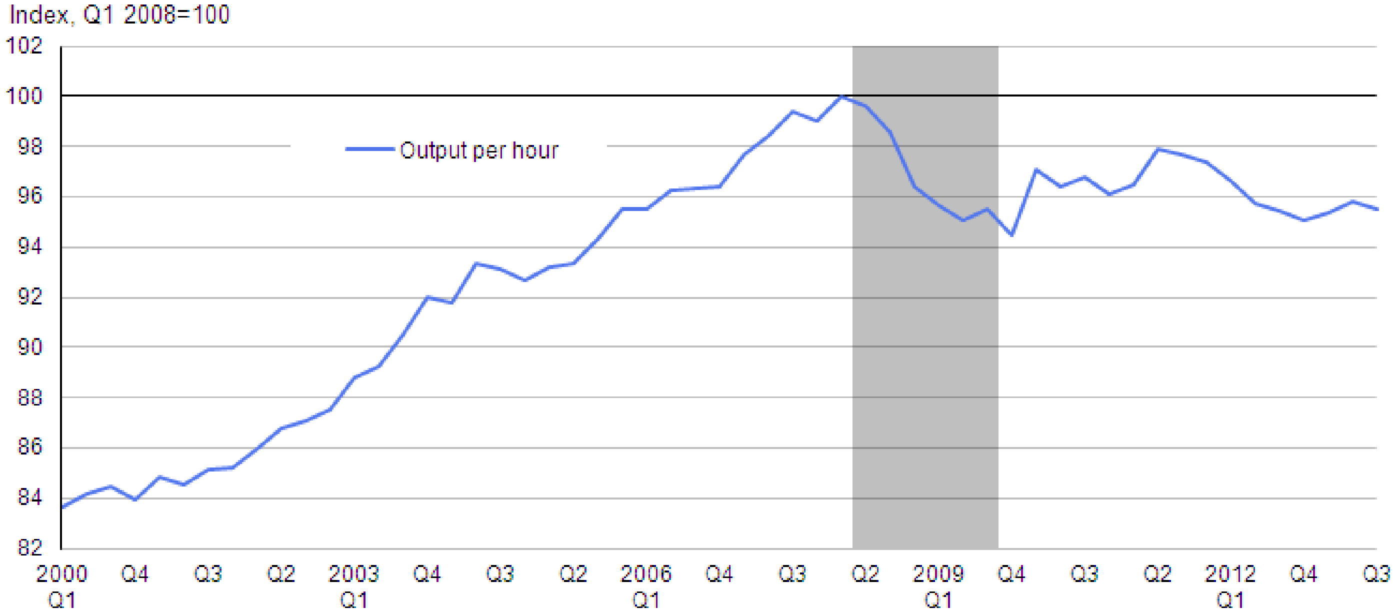
While expectations of economic growth during 2014 have gradually risen over the past twelve months, uncertainty remains about several aspects of the UK economy's performance during 2013 and how these features will develop in the future. Some of these characteristics are common to previous cycles, while others appear to be peculiar to the slowdown and subsequent recovery since 2008. The information which has been published and the analysis which has been undertaken during 2013 has helped economists to understand some of these trends, but there remains substantial uncertainty about how others will evolve in the New Year and how they will affect the UK economy as a whole. This section briefly considers five characteristics of the recent economic recovery.

1. Labour Productivity & Wages

Perhaps the defining characteristic of the economic downturn which started in 2008 is the weakness of labour productivity. Figure 8 shows the path of output per hour since 2000, and indicates that while labour productivity recovered from its initial fall between Q1 2010 and Q2 2011, it fell again during 2012 as continued labour market strength combined with stagnant output growth. In 2013, output per hour has broadly stabilised as a consequence of the revival of output growth. However, in Q3 2013 output per hour was just 0.1% higher than a year earlier and 4.9% lower than the level in Q1 2008.

Figure 8: Output per Hour, constant prices, seasonally adjusted



Source: Office for National Statistics

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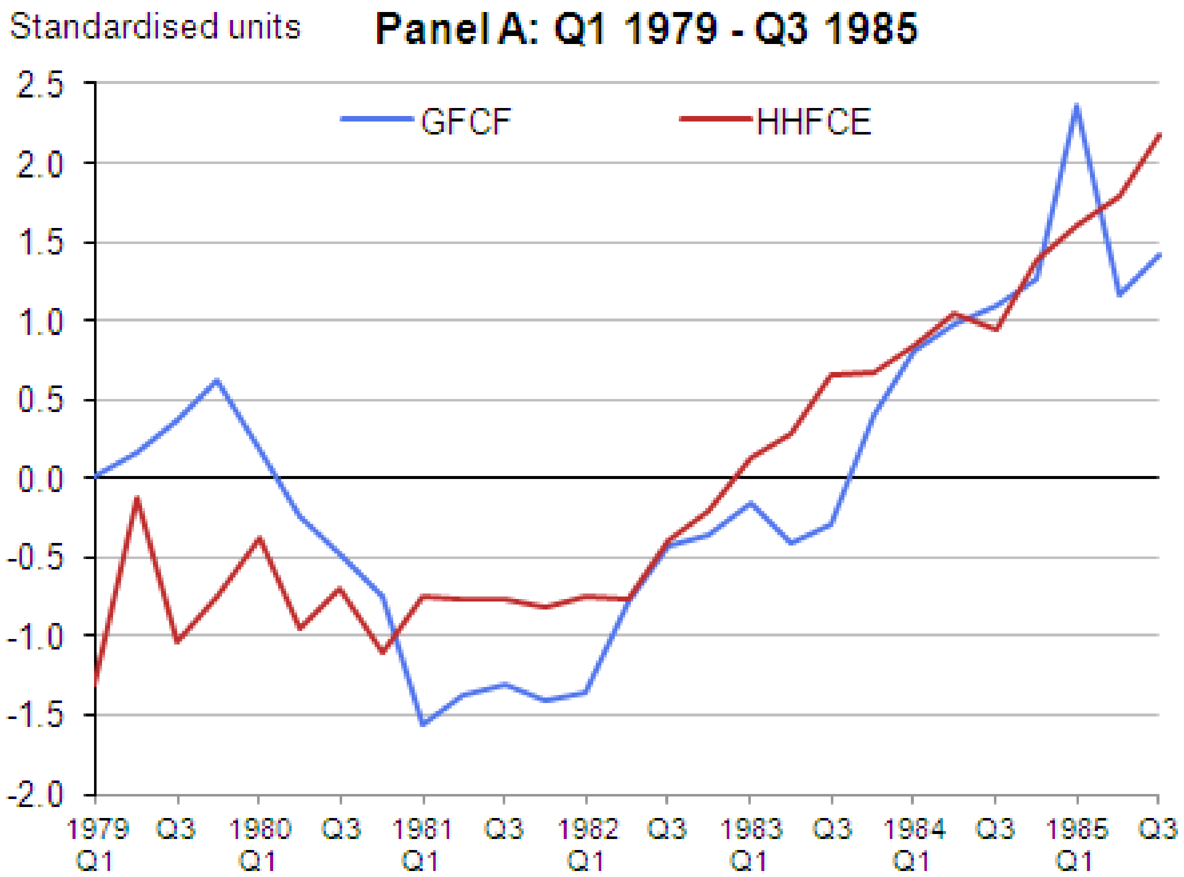
This poor productivity performance raises questions about how rapidly the acceleration of output growth will affect both conditions in the labour market and broader inflationary pressure. If the fall in productivity is permanent, then it is likely to have implications for the degree of spare capacity in the UK economy. If the fall is temporary and is reversed as economic growth accelerates, then the economy has scope for faster growth without increasing inflation. In either case, the recent fall in productivity is likely to be one of the primary contributors to the reduction in real wages experienced since the onset of the economic downturn.

2. Investment

Secondly, while an economic recovery is underway, it continues to be led by growing household expenditure rather than by a recovery of investment or a stronger net trade position. Conventional wisdom indicates that consumer spending often provides the main impetus for growth during the early stages of recovery. Once this rise in demand is established, firms begin to invest in new plant, machinery and buildings, providing further support for the economy. Figure 9 casts some light on these dynamics, showing the paths of investment and household expenditure during the three most recent economic downturns in standardised unit terms. During the downturns in the early 1980s and 1990s there is some evidence that the turning point for household consumption occurs prior to that of investment. However, in the most recent downturn, the economy is yet to convert steady growth in household spending into stronger investment (note that in the early stages of the recovery, both investment and household consumption were affected by policy initiatives to strengthen demand, such as the bringing forward of public sector investment and measures such as the car scrappage scheme).

Figure 9A: Gross Fixed Capital Formation and Household Final Consumption Expenditure, standardised units in multiple downturns, constant price, seasonally adjusted



Source: Office for National Statistics

Notes:

1. GFCF refers to Gross Fixed Capital Formation
2. HHFCE refers to Household Final Consumption Expenditure
3. Standardised units reflect the number of standard deviations a specific value is above or below the series average. It is calculated by taking the specific observation, subtracting the average for a given period and dividing by the standard deviation for the same period.

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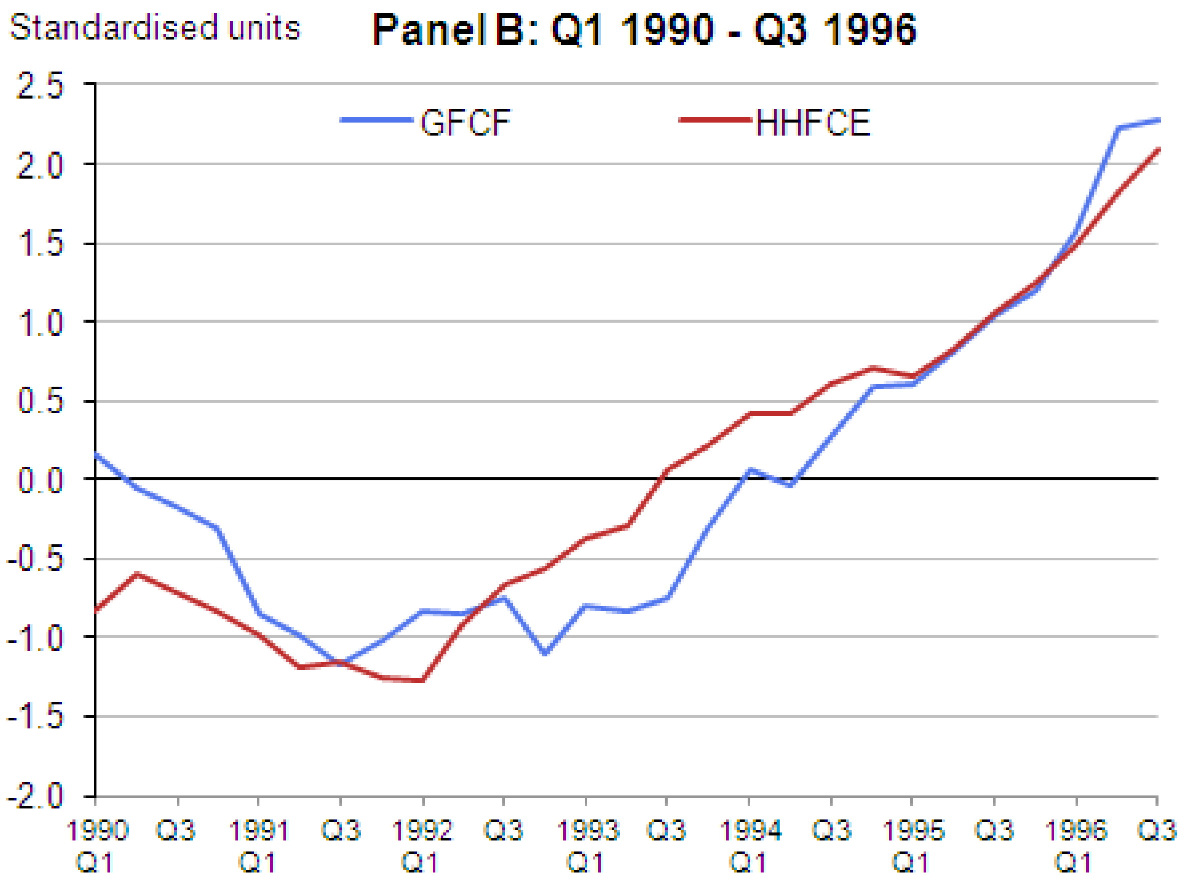
Figure 9B: Gross Fixed Capital Formation and Household Final Consumption Expenditure, standardised units in multiple downturns, constant price, seasonally adjusted



Source: Office for National Statistics

Notes:

1. GFCF refers to Gross Fixed Capital Formation
2. HHFCE refers to Household Final Consumption Expenditure
3. Standardised units reflect the number of standard deviations a specific value is above or below the series average. It is calculated by taking the specific observation, subtracting the average for a given period and dividing by the standard deviation for the same period.

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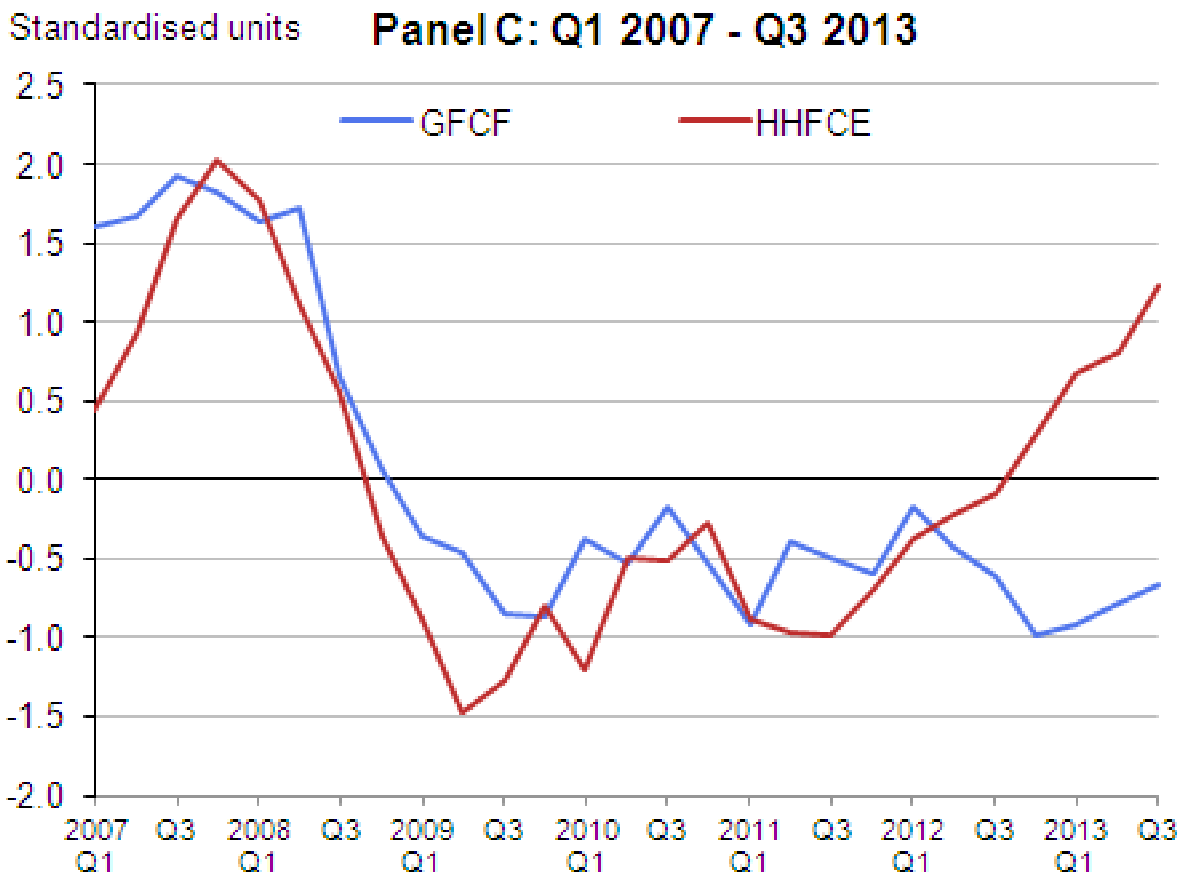
Figure 9C: Gross Fixed Capital Formation and Household Final Consumption Expenditure, standardised units in multiple downturns, constant price, seasonally adjusted



Source: Office for National Statistics

Notes:

1. GFCF refers to Gross Fixed Capital Formation
2. HHFCE refers to Household Final Consumption Expenditure
3. Standardised units reflect the number of standard deviations a specific value is above or below the series average. It is calculated by taking the specific observation, subtracting the average for a given period and dividing by the standard deviation for the same period.

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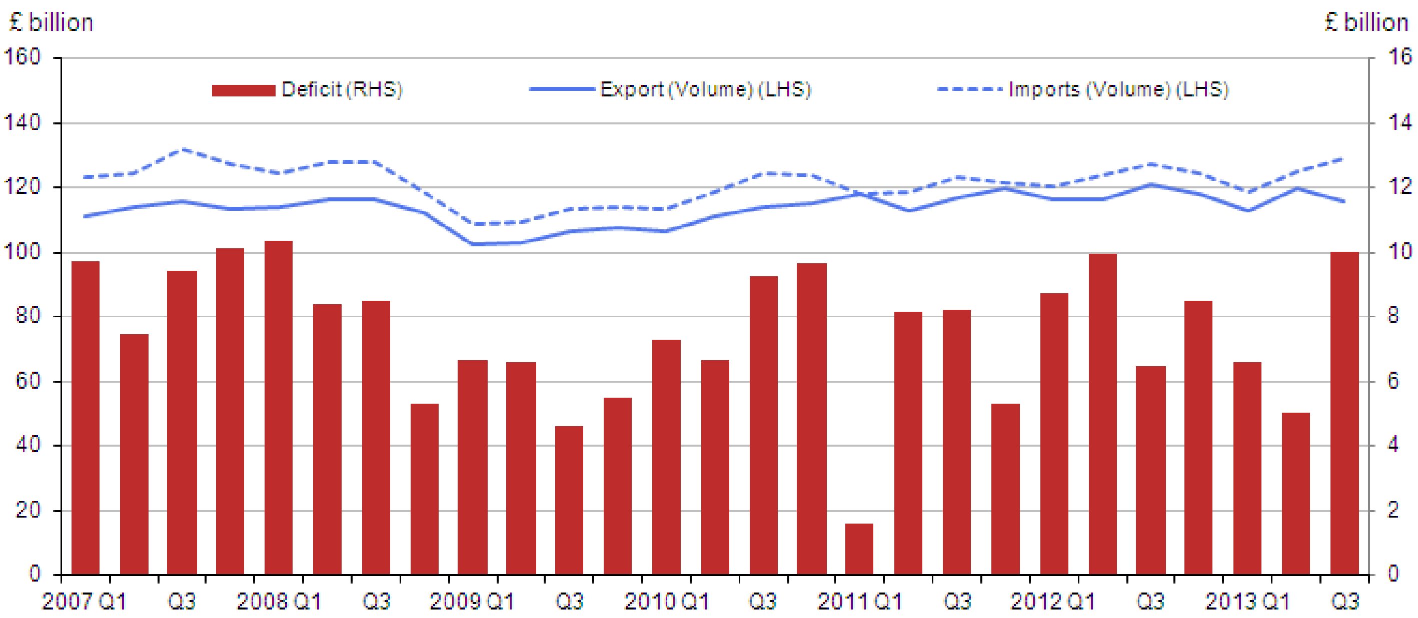
Although total investment has risen slowly during the first three quarters of 2013, it is still around 0.7% lower than a year earlier, and remains someway below both its level in Q1 2008 and its pre-downturn peak in 2007. Figure 9 suggests that the fairly close relationship in movements of investment and household consumption observed in previous downturns has not been as strong during recent quarters in particular.

3. Trade

Despite an economic recovery in the United States and a gradual improvement of conditions in the Euro-area, the UK's trade performance changed relatively little during 2013. Exports were held back by continued weakness in European economies, while imports rose in reflection of strengthening domestic demand. The volumes of UK imports and exports grew at broadly similar rates between Q4 2012 and Q3 2013 (Figure 10), although they diverged sharply in the final quarter as imports rose and exports fell. Net trade made only a modest contribution to growth during the first three quarters of 2013, following a significant negative contribution in 2012.

Figure 10: Volume of UK Goods and Services Exports, Imports, £ billion, constant prices, seasonally adjusted, Value of UK Trade Deficit, current price, seasonally adjusted



Source: Office for National Statistics

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The weakness of trade and its modest contribution to overall GDP growth in recent quarters is underlined by the balance of trade and the current account deficit in the Balance of Payments. Figure 10 shows that the UK's balance of trade was around -£10 billion in Q3 2010: the third largest deficit on record. This was exacerbated by a sharp deterioration in UK earnings on overseas investments, and as a result the current account of the Balance of Payments reached a deficit of more than £20 billion in Q3 2013, equivalent to more than 5% of GDP and the largest quarterly deficit on record on this basis.

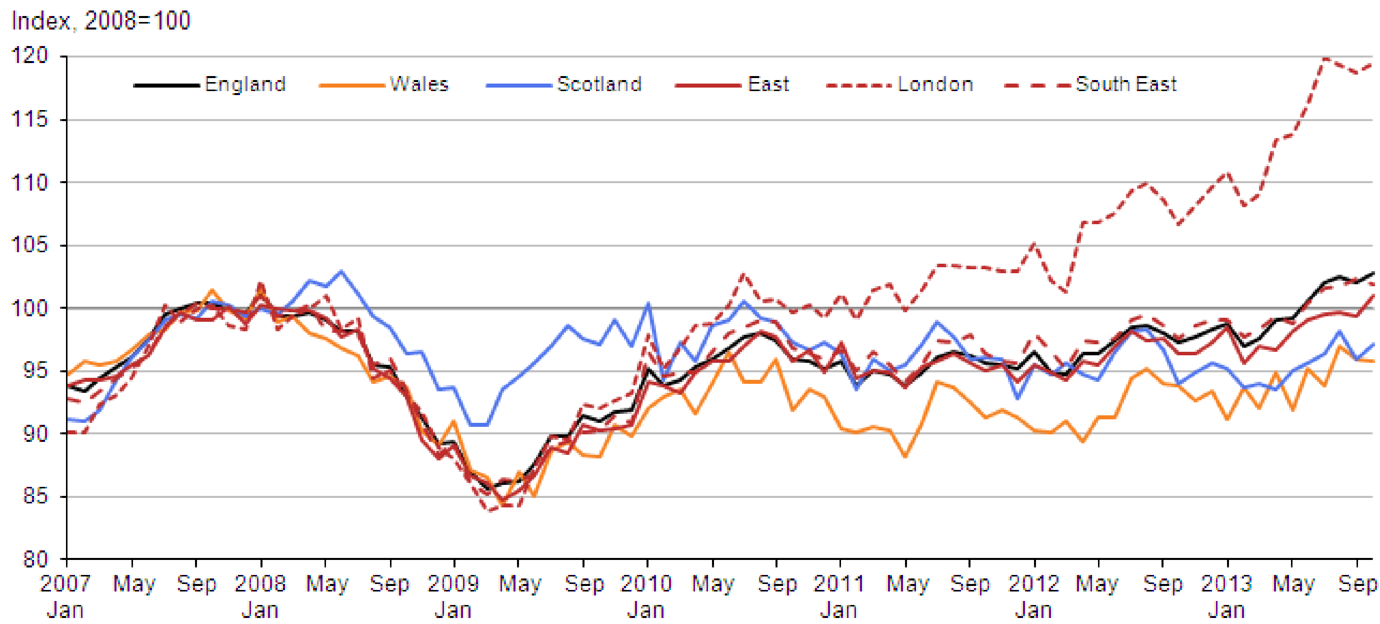
4. Housing

A central feature of the economic recovery which has taken hold in the UK during 2013 is a boost in housing market activity. Average UK house prices increased by 5.5% during the year to October 2013, substantially above the average for the year to October 2012 (1.4%) and the year to October

2011 (-0.5%). Data from the Bank of England also suggest that the volume of housing market transactions has started to rise. In November 2013, the number of mortgage approvals for house purchases was 32.6% higher than a year earlier, and the cumulative annual total was the highest since mid-2008.

Figure 11 shows average house prices for selected regions and countries of Great Britain. While all the regions have experienced house price increases in recent months, prices in London have risen much faster than elsewhere. In October, the average London house price was 12.0% higher than a year earlier, compared with 2.0% in Wales, 1.3% in the North West and 0.8% in Yorkshire & Humber. Only London, the East of England and the South East had risen above their pre-downturn levels in October 2013.

Figure 11: Average UK house price by region



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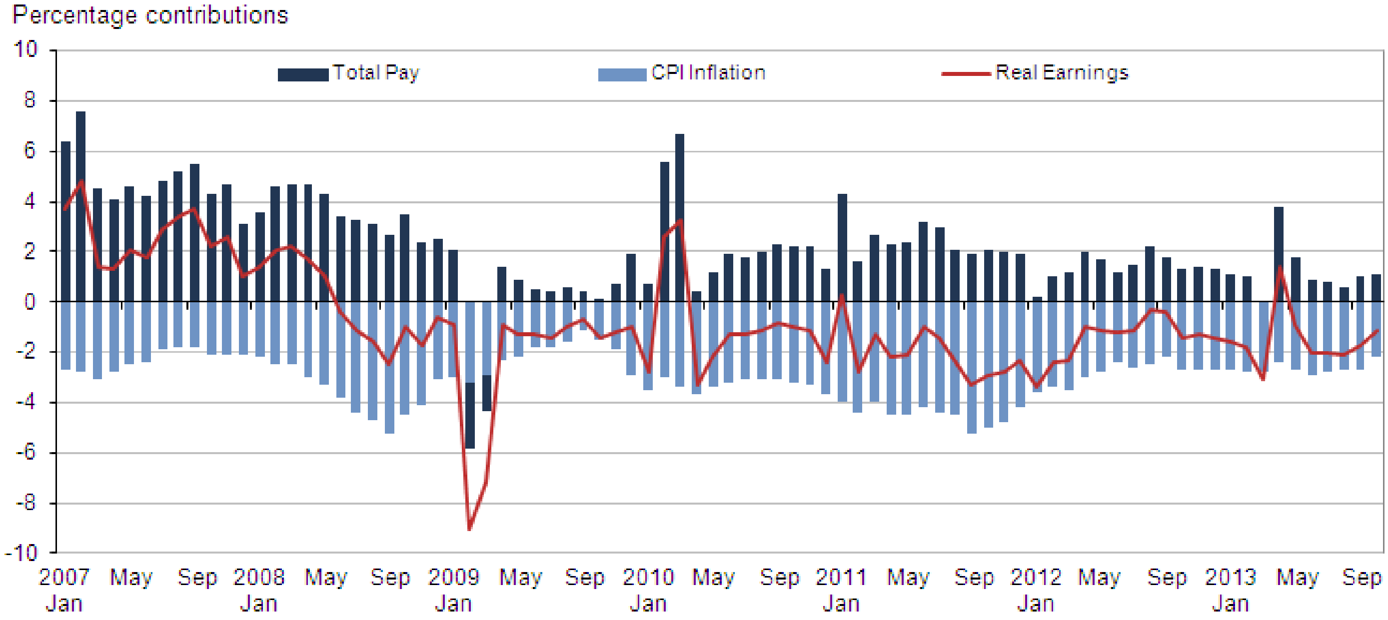
5. Real Wages and Real Households' Disposable Income per head

Finally, one of the most striking economic developments during the downturn has been the weakness of real wage growth (Figure 12). Continuing the trend from 2012, annual earnings growth exceeded inflation in just one of the twelve months to October 2013. Since June 2008, earnings growth has exceeded inflation in just four months. With annual earnings growth remaining around 1% throughout 2013, the fall in inflation to 2.1% in November moderated, but did not eliminate the scale of the squeeze on real pay.

Figure 12: Contributions to annual growth in real earnings



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This weakness in real earnings has also had an impact on real households' disposable income (RHDI). Although total RHDI has grown as a consequence of the increasing level of employment, on a per capita basis the weakness of real incomes has limited households' ability to support the economy through higher spending. In Q3 2013, RHDI per capita was 0.3% lower than the same period a year earlier, 2.3% lower than its peak in Q2 2009 and at broadly the level first achieved in late 2005.

Notes

1. See Economic Review - December 2013 for an analysis of the relationship between output per worker and labour costs per worker.

2. For an in-depth analysis of the UK's trade performance since 2007, see this ONS article: 'Explanations beyond exchange rates - trends in the UK since 2007'

Reference Tables

Table 1: UK demand side indicators

Change on previous period, volume series

	CDID[7]	2012	2013 Q2	2013 Q3	2013 Aug	2013 Sep	2013 Oct	2013 Nov
GDP[1]	ABMI	0.3	0.8	0.8				
Index of Services								
All Services[1]	S2KU	1.3	0.6	0.8	0.4	0.2	0.1	
Business Services & Finance[1]	KI7L	2.1	0.7	1.2	0.6	0.1	0.3	
Government & Other[1]	KI7T	1.2	0.0	0.4	0.3	0.4	0.4	
Distribution, Hotels & Rest. [1]	S2MV	0.9	1.8	1.1	0.4	0.3	-0.6	
Transport, Stor. & Comms. [1]	KI7B	0.0	0.0	-0.2	-0.1	0.0	-0.1	
Index of Production								
All Production[1]	K222	-2.5	0.8	0.6	-1.1	0.9	0.4	
Manufacturing[1]	K22A	-1.7	0.8	0.8	-1.2	1.2	0.4	
Mining & Quarrying[1]	K224	-9.8	2.2	0.6	-0.9	1.0	-1.1	
Construction[1]	L2N8	-7.5	2.6	2.6	0.3	-0.5	2.2	

Retail Sales Index									
All Retailing[1]	J5EK	1.1	1.0	1.3		-1.0	0.7	-0.9	0.3
All Retailing, excl.Fuel[1]	J467	1.4	0.9	1.5		-1.1	0.9	-0.7	0.4
Predom. Food Stores[1]	EAPT	0.0	-0.5	1.5		-2.6	-0.5	0.0	0.2
Predom. Non-Food Stores[1]	EAPV	1.7	1.9	1.0		0.0	2.7	-1.5	0.5
Non-Store Retailing[1]	J5DZ	9.7	3.3	3.9		1.9	-1.5	0.2	0.4
Trade									
Balance[2,3]	IKBJ	-33.6	-5.0	-10.0		-2.2	-2.6	-2.6	
Exports[4]	IKBH	0.3	2.5	-3.2		0.4	-0.7	-1.4	
Imports[4]	IKBI	2.3	1.2	0.7		-0.1	0.3	-1.4	
Public Sector Finances									
PNSB-ex[5]	J5II	-25.1	13.2	-1.0		-1.5	-1.3	0.8	1.0
PNSB-ex, ex RM & APF[6,]	L65P	2.9	-3.2	-0.4		-1.5	-1.3	0.8	1.0
PNSD-ex as a % GDP	HF6X	74.7	75.0	76.5		75.1	76.5	76.0	76.6

Table source: Office for National Statistics

Table notes:

1. Percentage change on previous period, seasonally adjusted, CVM
2. Levels, seasonally adjusted, CP
3. Expressed in £ billion
4. Percentage change on previous period, seasonally adjusted, CP
5. Public Sector net borrowing, excluding the impact of financial interventions. Level change on previous period a year ago, not seasonally adjusted
6. Public Sector net borrowing, excluding the impact of financial interventions, the Royal Mail Pension Plan and transfers from the Bank of England Asset Purchase Facility. Level change on previous period a year ago, not seasonally adjusted, CP, Financial Year
7. Where applicable, CDIDs refer to the index series on which the growth rates are based.

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Table 2: UK supply side indicators

	CDID	2012	2013	2013		2013	2013	2013	2013
			Q2	Q3		Aug	Sep	Oct	Nov
Labour Market									
Employment Rate[1, 2]	*LF24*	71.1	71.5	71.8		71.7	71.8	72.0	
Unemployment Rate[1, 3]	*MGSX*	7.9	7.8	7.6		7.7	7.6	7.4	
Inactivity Rate[1, 4]	*LF2S*	22.6	22.3	22.2		22.2	22.2	22.1	
Claimant Count Rate[7]	*BCJE*	4.7	4.5	4.2		4.2	4.0	3.9	3.8
Total Weekly Earnings[6]	*KAB9*	£469	£478	£475		£475	£475	£476	
CPI									
All-item CPI[5]	*D7BT*	2.8	2.7	2.7		2.7	2.7	2.2	2.1
Transport[5]	*D7C2*	2.3	0.9	1.3		1.2	1.1	-0.3	0.2
Recreation & Culture[5]	*D7C4*	0.2	1.4	0.8		0.9	0.9	0.7	1.1
Utilities[5]	*D7BX*	5.0	4.3	4.3		4.2	4.2	4.1	3.4
Food & Non-alcoh. Bev. [5]	*D7BU*	3.2	4.2	4.1		4.1	4.3	3.9	2.8
PPI									
Input[8]	*K646*	1.3	1.5	2.5		1.8	1.0	0.0	-1.0
Output[8]	*JVZ7*	2.1	1.3	1.4		1.5	1.2	0.8	0.8

HPI[8]	*WMPQ*	1.7	2.9	3.6		3.7	3.8	5.5

Table source: Office for National Statistics

Table notes:

1. Monthly data shows a three month rolling average (e.g. The figure for October is for the three months ending in October)
2. Headline employment figure is the number of people aged 16-64 in employment divided by the total population 16-64
3. Headline unemployment figure is the number of unemployed people (aged 16+) divided by the economically active population (aged 16+)
4. Headline inactivity figure is the number of economically active people aged 16 to 64 divided by the 16-64 population
5. Percentage change on previous period a year ago, seasonally adjusted
6. Estimates of total pay include bonuses but exclude arrears of pay (£)
7. Calculated by JSA claimants divided by claimant count plus workforce jobs
8. Percentage change on previous period a year ago, non-seasonally adjusted

Download table

XLS XLS format
(33 Kb)

Background notes

1. Details of the policy governing the release of new data are available by visiting www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html or from the Media Relations Office email: media.relations@ons.gsi.gov.uk

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