25 April 2012

Office for National Statistics

Economic Review, April 2012

Author Name(s): **Malindi Myers, Office for National Statistics**

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

GDP contracted by 0.2 per cent in the first quarter of 2012, the second successive period of negative economic growth. The fall in real GDP was driven primarily by weakness in the construction sector, where output is estimated to have fallen by 3 per cent between the two latest quarters. But the dominant services sector of the economy grew only slowly while industrial production fell slightly.

The economy has shown no growth over the past year and has recovered less than half the output lost during the recession in 2008 and 2009.

The labour market showed some signs of improvement with a small rise in employment in the latest period and a slight drop in unemployment. However the rise in employment was entirely among part time workers, with a drop in the number of people employed full time.

Growth in retail sales volumes picked up in March but this was boosted by purchases of fuel at the end of the month, as well as the effect of unseasonably warm weather.

Real earnings continue to decline as a result of the combination of a further decline in average earnings growth and a slight pick-up in consumer price inflation.

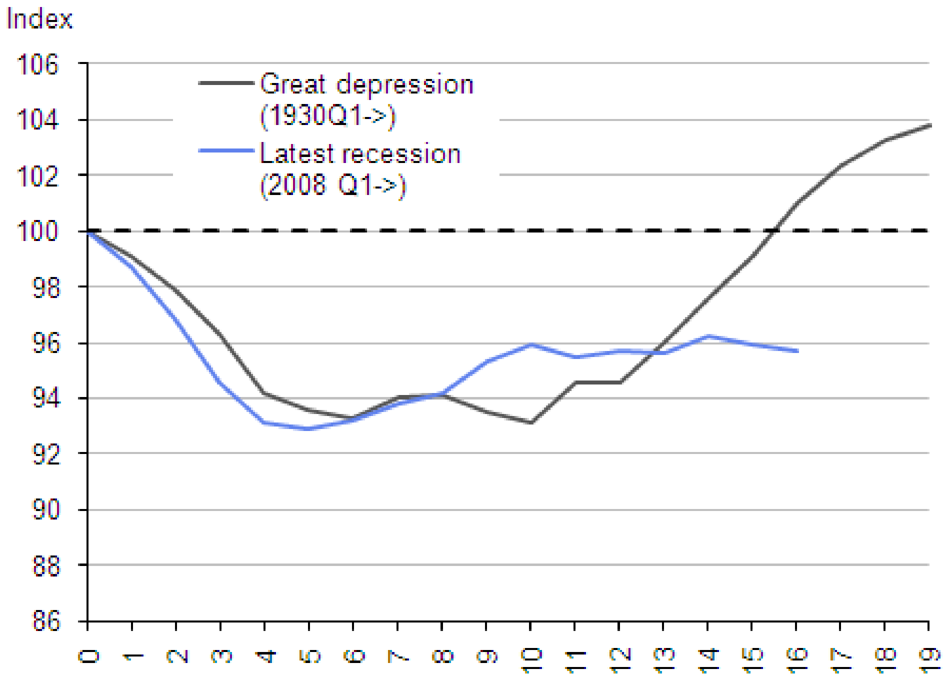
GDP contracts in the first quarter of 2012

UK real GDP fell by 0.2 per cent between the final quarter of 2011 and the first quarter of 2012, the second successive quarter of contraction. Over the past year the economy has therefore not grown at all, and total output is now 0.2 per cent lower than it was six quarters ago, in the third quarter of 2010. While GDP fell by 7.1 per cent from peak to trough during the recession in 2008 and 2009, it has subsequently recovered less than half that loss, and output is still 4.3 per cent below its pre-recession peak.

If the declining output of the North Sea oil and gas sector is excluded, then non-oil and gas GVA declined by 0.1 per cent in the latest quarter and is 0.2 per cent higher than in the first quarter of 2011.

Growth over the past eighteen months has been uneven, with four of the last six quarters showing negative growth. The stuttering nature of growth following the recession means that the economy is weaker relative to its pre-recession peak than at the corresponding stage of the depression in the early 1930s. It is also well below where it would have been if it had followed the path of either of the recessions in the early 1980s and early 1990s (Figure 1).

Figure 1: Decline and recovery in GDP levels during the latest recession and the 1930s depression (Pre recession peak = 100)



Source: Office for National Statistics

Notes:

1. Data for the 1930's recession is taken from Mitchell J, Solomou S and Weale M (2011) 'Monthly GDP estimates for inter-war Britain', National Institute of Economic and Social Research

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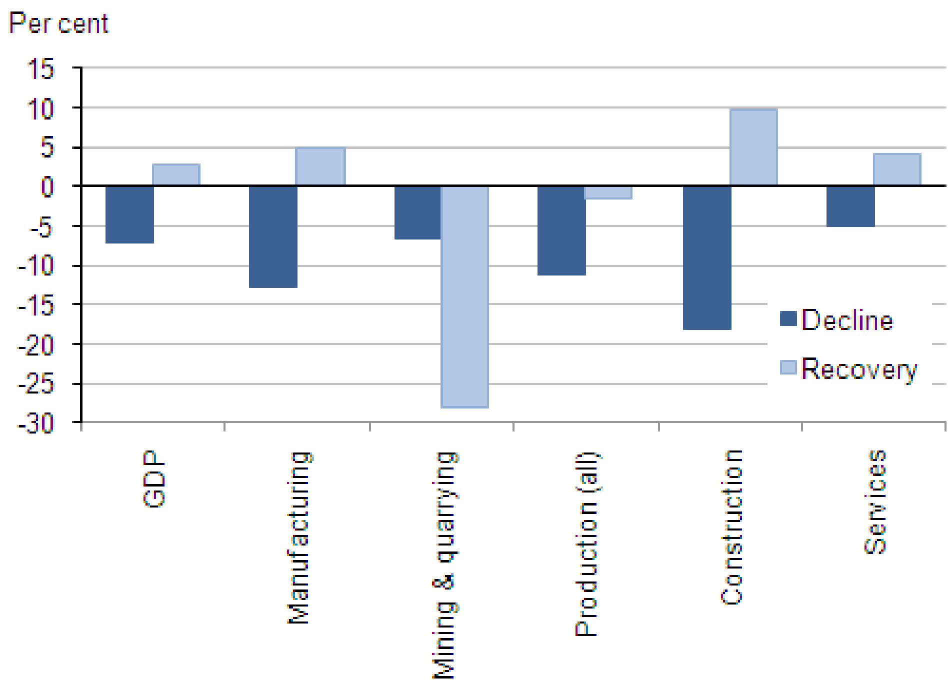
The modest scale of the recovery has been due to a number of factors. Oil and gas extraction has been in decline for several years, and as a result the mining and quarrying sector has deducted an average of -0.1 percentage points from GDP in recent quarters. Although the manufacturing sector showed signs of a resilient recovery until the middle of 2011, it has since contracted by 0.9 per cent. Meanwhile the services sector – which accounts for three quarters of whole economy output – has been growing only modestly (Figure 2).

Figure 2: Losses and gains in economic output of key sectors during the recession (2008 Q1 - 2009 Q2) and recovery (2009 Q2 - 2012 Q1; per cent)



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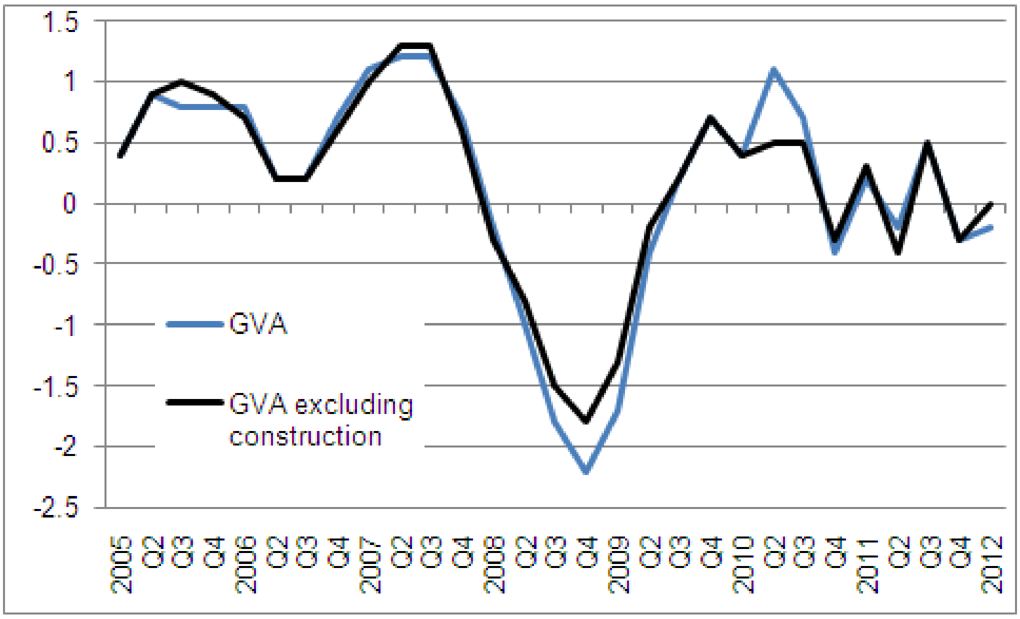
The construction sector has accounted for a much greater share of the volatility of GDP growth than its 7.6 per cent share of total output would suggest. For example, over the last six quarters, the average absolute contribution of construction output to quarterly GDP growth has been about one third of the corresponding figure for total GDP. And during that period as a whole, the weakness in construction has accounted for more than half the drop in GDP. In the latest quarter alone, the construction sector explained the entire 0.2 per cent fall in GDP. Figure 3 shows the impact of the construction sector on GDP growth.

Figure 3: GDP growth, including and excluding construction activity (per cent)



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Production industries

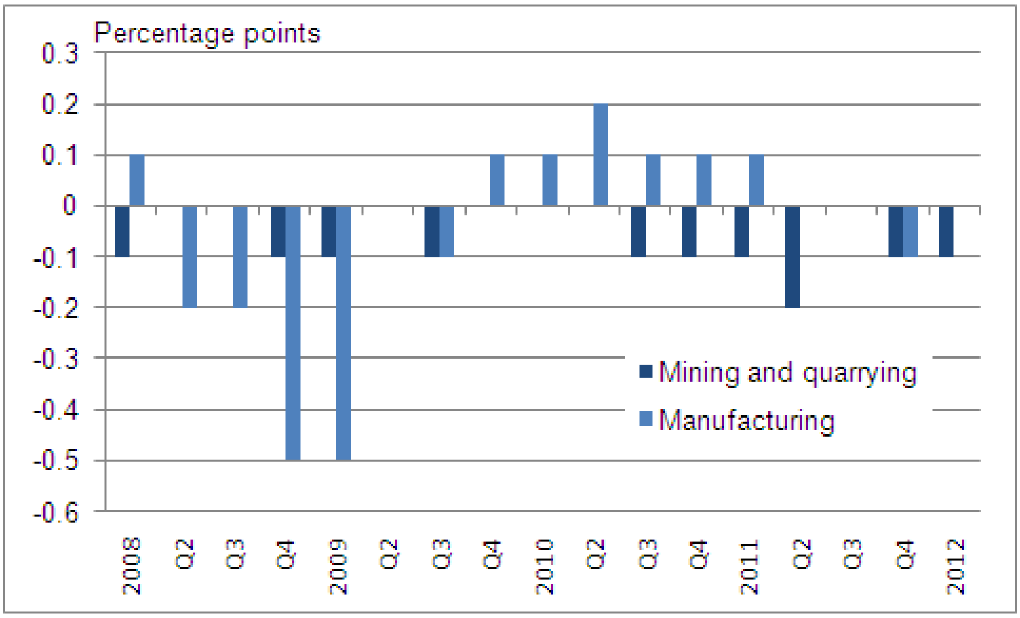
Output in the production sector increased in February compared to January (0.4 per cent) but was lower than the level of output a year ago. The positive growth between January and February contrasts with the weak performance during much of 2011, and production in January and February was on average more than 3 per cent lower than in the same months of 2011. The rise in output in the production sector as a whole in February reflects the fact that the mining and quarrying and the electricity, gas and steam distribution sectors both grew on a month on month basis for the first time since August 2011.

In contrast, manufacturing output fell in February. Although the manufacturing sector recovered well following the recession in 2008 and 2009, it returned to contraction in June 2011, since when output has fallen by just under 2 per cent. This partly reflects the weakness of the global economy, especially the euro zone. Exports of manufactured goods, which rose strongly during 2009 and 2010, have subsequently flattened off. The weakness in February stemmed mainly from weakness in output of capital goods and intermediate goods.

Weakness in the manufacturing sector was offset by growth in the utilities and water and waste sectors. Despite the improvement in the mining and quarrying sector in February, this sector pulled down the estimated growth of the production sector as a whole in the first quarter of 2012.

Manufacturing and mining & quarrying have both contributed negatively to GDP growth in each of the last three quarters – the first time they have combined in this way since the middle of 2009 (Figure 4).

Figure 4: Contributions to GDP growth from mining and quarrying sector and from manufacturing (percentage points)



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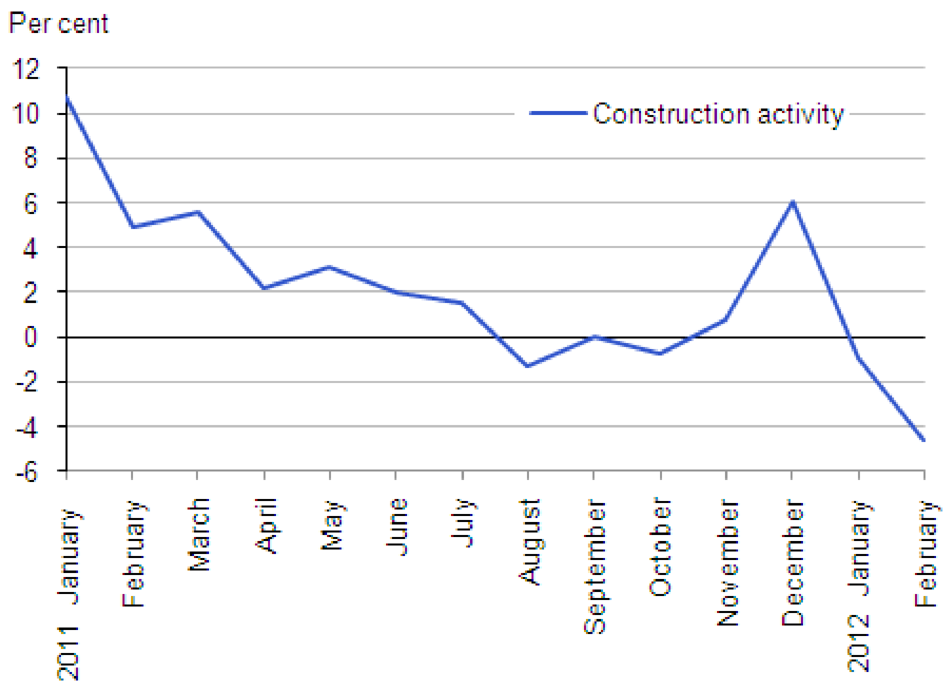
Construction output

Although construction output picked up between January and February, by 6.1 per cent (not seasonally adjusted), the level in January and February is lower than in December 2010 and January 2011, when particularly bad weather may have reduced activity rates.

This monthly series is not seasonally adjusted, but comparing activity in one month relative to the same month of the previous year reduces the impact of regular seasonal variations. On this basis, output in February 2012 was 4.6 per cent lower than in February 2011, the lowest year-on-year growth rate since January 2011. This may in part reflect the impact of the squeeze on public sector capital spending (Figure 5).

Figure 5: Growth of construction activity (Non-seasonally adjusted, month on month a year ago, percentage change)



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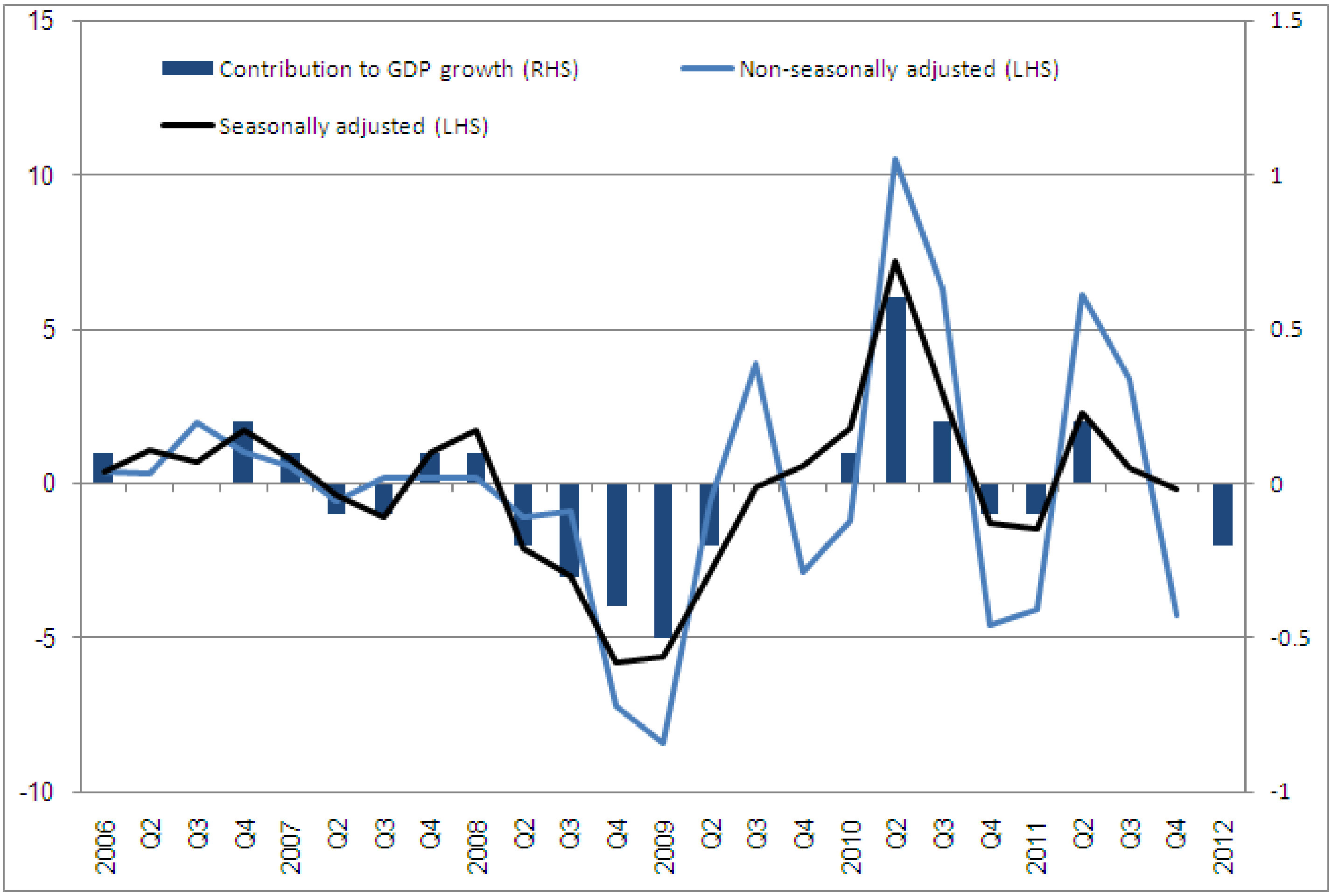
Although the construction sector only accounts for 7.6 per cent of the whole economy, its volatility is such that it has had a significant impact on quarterly GDP growth rates in several recent quarters. Both new work and repair and maintenance work have contributed to this volatility.

Recent re-assessment of seasonal adjustment factors has identified a seasonal break in one of the component series of construction output in early 2010. This is apparent in Figure 6 which shows both seasonally adjusted and non-seasonally adjusted quarterly growth rates.

Figure 6: Growth of construction activity and its contribution to GDP growth (quarter on quarter, percentage growth and percentage point contributions)



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Services sector

Services sector growth eased in February, on a year-on-year basis, from 1.6 per cent in January to 0.8 per cent in February. This is the weakest such growth since April 2011, and only the fourth time it has dipped below 1 per cent during the last two years.

The weakening of the services sector growth was broadly based, with three of the four main sub-sectors - distribution, hotels & restaurants, transport, storage & communications, and business services & finance - declining between January and February, and government and other services being flat, on a month on month basis. Compared to a year ago, growth of the same three sub-sectors declined in February by at least a percentage point. Government and other services was the only sector to maintain growth similar to the previous month.

The services sector is estimated to have returned to modest growth in the first quarter of 2012, with growth of 0.1 per cent following a contraction of similar magnitude in the fourth quarter of 2011. This is weaker than the average quarterly growth rate in 2011 of 0.4 per cent.

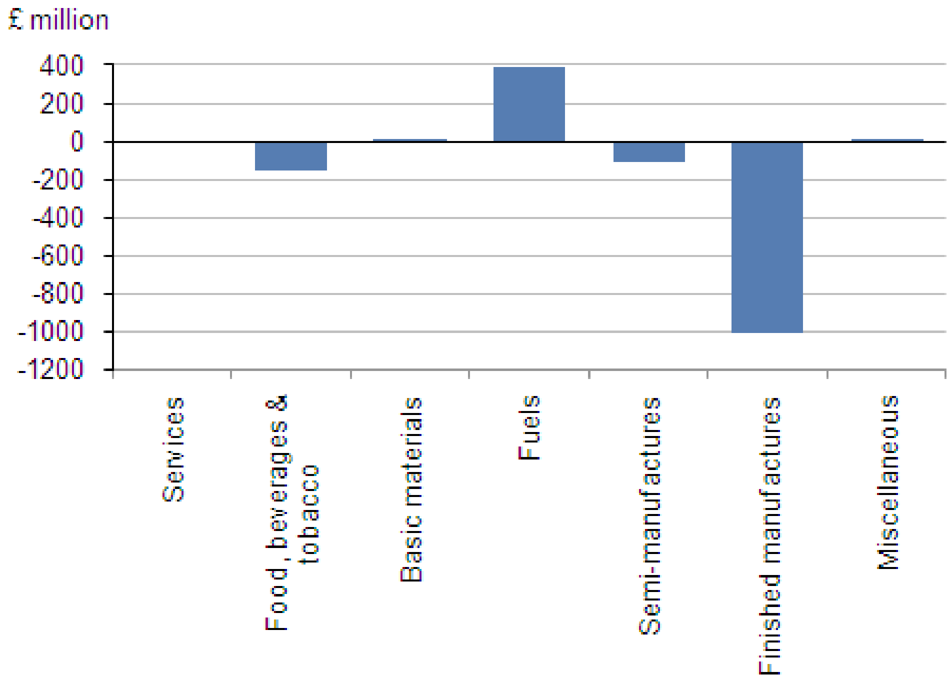
Transport & storage and government & other services drove the growth in services sector output in the first quarter of 2012, but this was offset by a fall in growth in the business services & finance sector.

Trade

The trade deficit widened in each of January and February, reversing the significant narrowing between November and December, such that the trade deficit at the end of February is back to the level it was at in November. The deterioration in the trade balance was largely due to a worsening goods deficit, but was reinforced by a very slight narrowing of the services surplus. The deficit on the balance of trade in oil narrowed sharply, falling by a third between January and February. The relatively mild weather through the winter months may have reduced fuel imports. Although the prolonged slowing in North Sea oil and gas extraction continued to reduce the value of oil exports, their value was boosted by a sharp rise in the average price per tonne

The worsening of the trade in goods deficit was driven by manufactures and semi manufactures, partly reflecting the weak economic and financial situation in Europe. Imports of semi-manufactures declined too, but imports of finished manufactures (volume terms) increased (Figure 7).

Figure 7: Contributions to the widening of the trade deficit in February 2012 (£ million)



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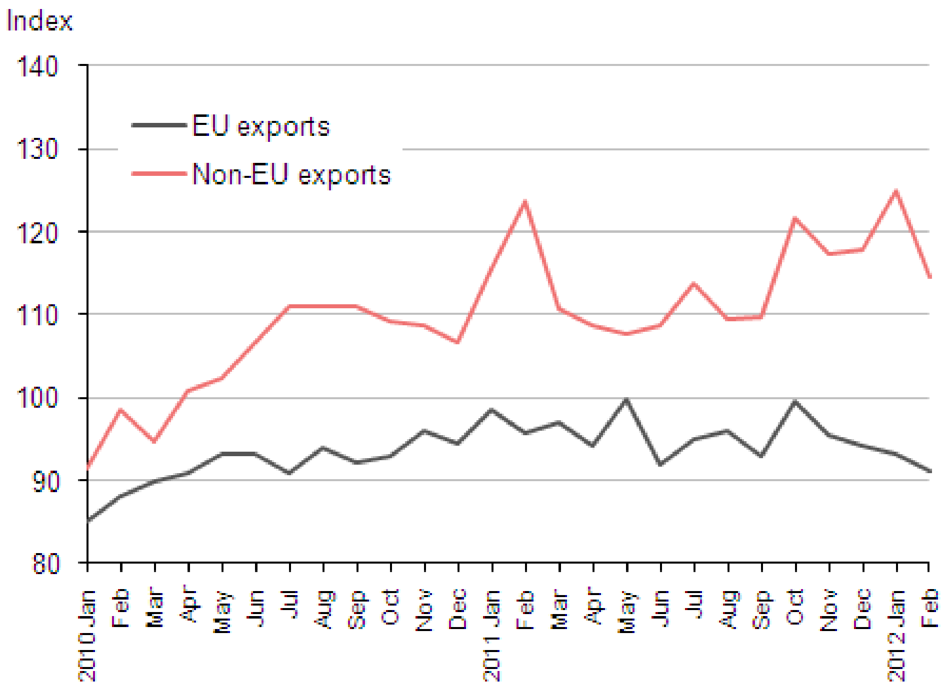
The deficit with the EU on trade in goods improved (+£0.4 billion) between January and February, whilst the goods deficit with non-EU trading partners deteriorated markedly (-£1.3 billion). The improvement in the deficit with the EU was due to a lower volume of imports from the EU, whilst the worsening in the trade deficit with non-EU economies was due to a sharp fall in exports, down 8.2 per cent in the month if oil and erratic items are excluded. Cars (-16 per cent), capital goods (-9 per cent) and food, beverages and tobacco (-7 per cent) saw the biggest falls in total export volumes (Figure 8).

Figure 8: Export levels to EU and non-EU (Index 2008=100)



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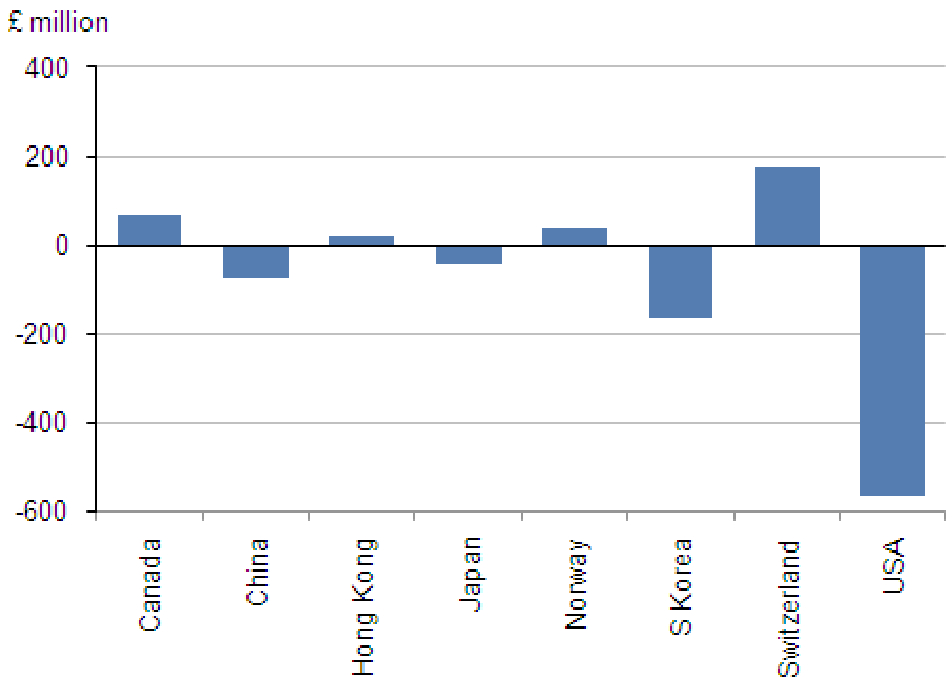
The weakness of exports to the non-EU was led by a sharp fall in exports to the US, of more than £0.5 billion. Even though the US is the UK's largest single country export destination, accounting for 15 per cent of total UK goods exports and 32 per cent of exports to all non-EU countries, this still amounts to a substantial 15 per cent fall between the two latest months (Figure 9).

Figure 9: Change in export levels to the major non-EU trade partners (£ million, value terms)



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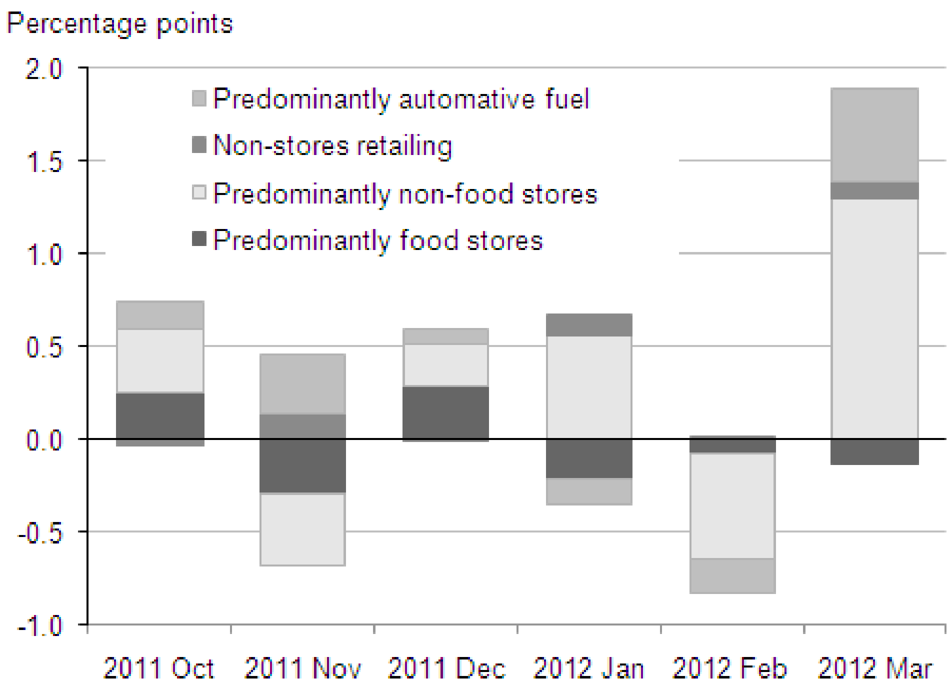
Retail sales

The volume and value of retail sales both grew by 1.8 per cent between February and March, which for both series is one of the strongest month-on-month growth rates since early 2011.

Growth in sales volumes was broadly based - with predominantly food stores the only sub-sector to see a month on month decline. Strong growth was experienced in predominantly automotive fuel sales which grew by 4.9 per cent between January and February, partly driven by strong purchases of fuel in late March in response to the threat of a strike by tanker drivers. Despite this, the overall impact of predominantly automotive fuel on total retail sales was limited – all retailing excluding automotive fuel for March was 1.5 per cent – only 0.3 percentage points lower than the headline figure.

Strong growth in sales by predominantly non-food stores, up 3.0 per cent, contributed 1.3 percentage points to the 1.8 per cent growth in total retail sales volumes between February and March. The ‘other’ category in non-food stores drove this sub-sector’s growth, and this may have been influenced by the unseasonably warm weather in March (Figure 10).

Figure 10: Sector contributions to the volume of retail sales (month on month, percentage points)



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Labour market

In the three months to February, employment increased by 53,000 compared with the previous three month period, and the level of unemployment went down by 35,000. On the face of it, the deterioration of the labour market in recent months therefore appears to have eased somewhat.

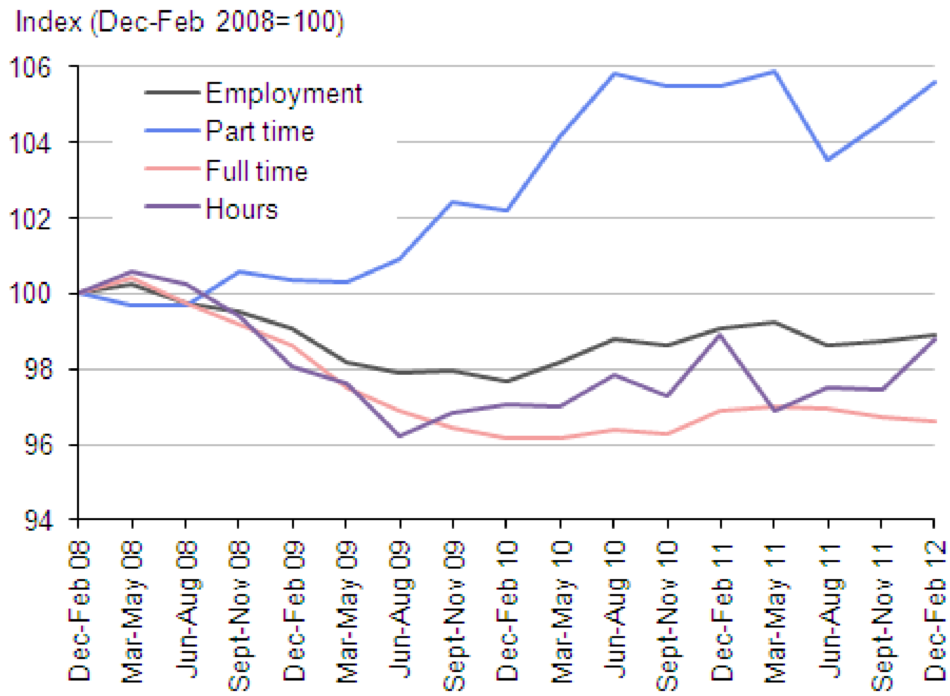
However, the more detailed employment and unemployment data indicates a more mixed picture.

- The increase in employment levels was due to a rise in part time employment of 80,000, with full time employment dropping by 27,000.
- The decline in unemployment was entirely among men (43,000), whilst unemployment for women increased by 8,000.
- The decline in the unemployment level was for those in shorter periods of unemployment, up to twelve months, whilst the longer term unemployed increased further. This is not surprising, since those in shorter periods of unemployment experience less skill loss and retain more confidence, but for those in long term unemployment the individual and social costs can be much higher, and unemployment can become entrenched.

- The claimant count went up slightly in March, but the recent downward trend in inflows to the count continued.
- Average weekly earnings growth declined further to 1.1 per cent, with regular pay growth remaining unchanged at 1.6 per cent as annual growth in bonus payments was negative for the second month in a row.

Although the increase in employment levels was driven by a rise in part time employment, total weekly hours worked increased. Average weekly hours worked by full-time workers rose from 37.0 to 37.4 between the two latest three month periods, returning close to the level of a year earlier. Compared with the December 2007 to February 2008 period, before the start of the 2008-2009 recession, average hours worked have changed relatively little, and the divergence between total hours worked and employment that appeared during the recession appears to be narrowing (Figure 11).

Developments in key labour market indicators (Dec-Feb 2008 = 100)



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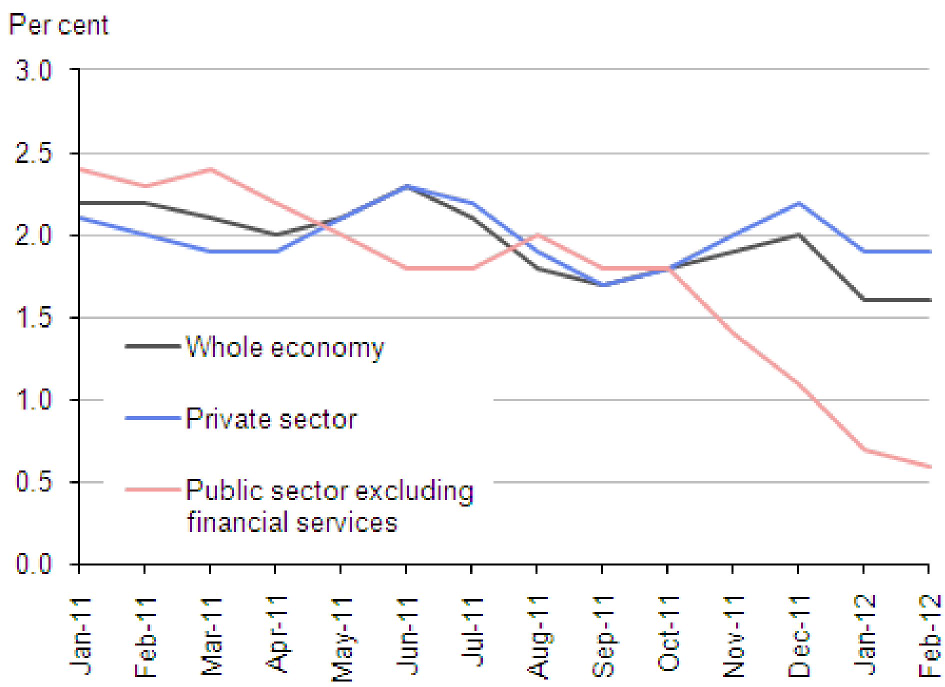
Earnings growth for the whole economy has been supported in recent months by the relative strength of total wage growth in the financial and business services sector. However, in the three months to February, total wage growth in this sector was flat due to year-on-year falls in bonus payments.

Annual growth in total pay (including bonuses) in the three months to February was 1.2 per cent in the private sector compared with 0.6 per cent in the public sector (excluding financial services). Public sector pay growth has been declining as the period of pay restraint (with a pay freeze for many workers) exerts an increasing influence. The average level of earnings in the public sector (excluding financial services) remains above that for private sector workers, reflecting the different composition of workers in each area (Figure 12).

Figure 12: Wage growth (percentage change for three month average compared to the same three months a year ago)



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Public sector finances

Public sector net borrowing for the financial year 2011-12 was £126.0 billion, nearly £11 billion lower than in the previous financial year, and in line with the latest forecasts made by the Office for Budget Responsibility (OBR) in their economic forecast – however forecasts of total current receipts and total expenditure differed slightly.

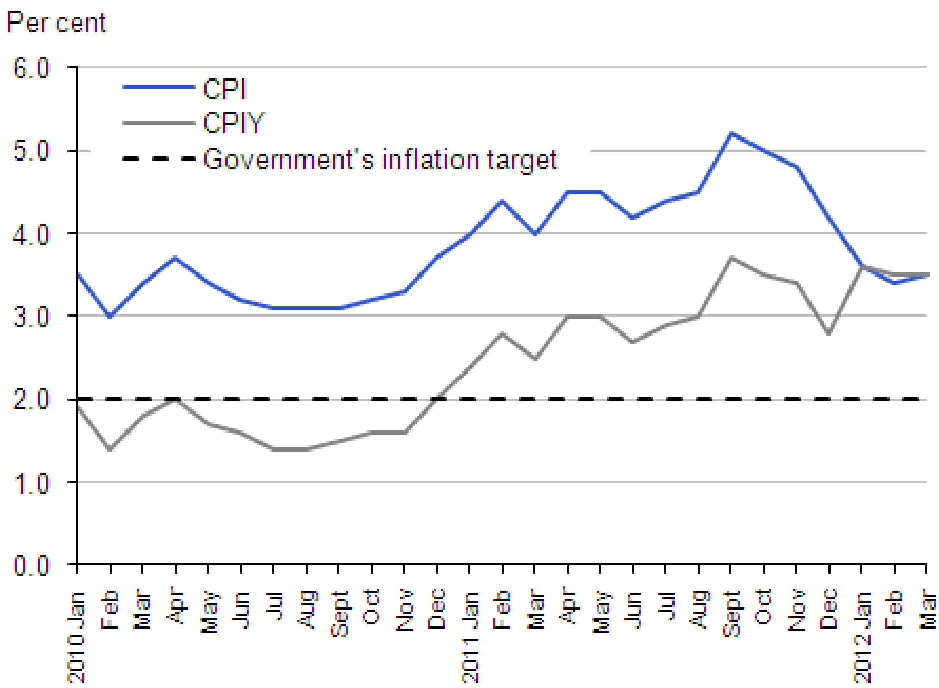
Total current receipts for the financial year as a whole were £531.3 billion, £1.4 billion lower than the £532.7 billion forecast by OBR. This was mainly driven by lower than expected returns from taxes on production and taxes on income and wealth. However, this was counterbalanced by lower than expected expenditure – total expenditure for the financial year 2011/12 was £617.0 billion – £1.8 billion lower than expected by the OBR. Figures should be interpreted with some caution, as revisions are expected as the data for 2011/12 settles.

Consumer prices

Annual consumer price inflation (CPI) ticked up by 0.1 percentage points to 3.5 per cent in March. This follows five months of decline when the rate fell from 5.2 per cent in September 2011 to 3.4 per cent in February. Although inflation on this basis has fallen significantly in recent months, the latest rate of 3.5 per cent is still well above the official target rate of 2 per cent. Perhaps more significantly in terms of the impact on economic activity, it is above the annual rate of earnings growth of 1.1 per cent in the latest period.

Although the headline inflation rate has been coming down over the last few months, this is in part due to the 2.5 percentage point rise in the rate of VAT in January 2011 rate which has now fallen out of the calculations. Inflation excluding indirect taxes – as measured by CPIY - has remained relatively high, and has fallen only slightly from its peak of 3.7 per cent in September. This suggests that the impact of the VAT increase has been the main influence on inflation figures since last autumn, and that otherwise there has been little downward trend in inflation (Figure 13).

Figure 13: Inflation, inflation excluding indirect taxes and the Government's inflation target (percentage change month on month a year ago)



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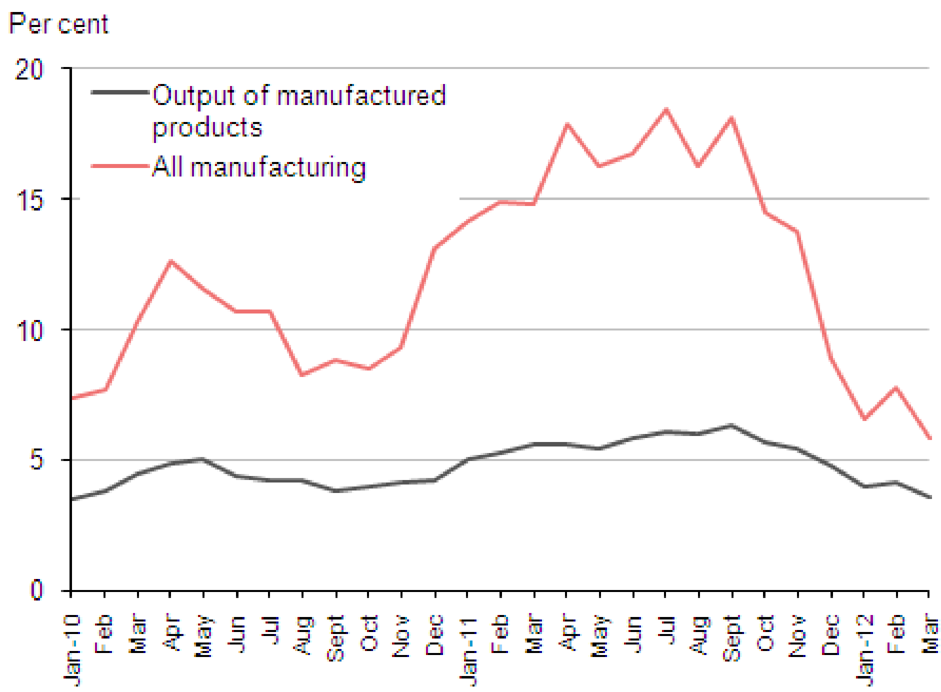
Producer prices

Annual producer price inflation for both output and input prices (manufacturing sector) has come down significantly since September 2011, and both are now at rates comparable with those of late 2009. Input price growth was 5.8 per cent in March, having come down from 18.1 per cent in

September, and output price growth was 3.6 per cent compared with 6.3 per cent in September. However input price inflation remains higher than output prices, with a negative impact on manufacturers' margins (Figure 14).

Figure 14: Input and output price growth (percentage change, month on month a year ago)



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The main drivers of output price growth in March were tobacco and alcohol, other manufactured products, food products and petroleum products. Other categories also made positive contributions, but these four categories made up 2.7 percentage points of the 3.6 per cent rise in March. Input price growth was dominated by increases in crude oil, which contributed 3.7 percentage points of the 5.8 per cent growth.

These drivers of producer price growth overlap to some extent with the drivers of the CPI inflation rate, but there are also notable differences. Food and beverages and transport made sizeable contributions to the 12-month CPI inflation rate, but housing and household services made the biggest contribution to CPI inflation. Whilst petroleum products and crude oil made significant contributions to producer output and input price growth respectively, the transport component in the CPI, which is influenced by petroleum and oil prices, made a sizeable but less significant contribution to CPI inflation (0.53 percentage points towards a headline rate of 3.5 per cent).

Background notes

1. You can follow ONS on Twitter and Facebook and watch our videos at YouTube.

2. 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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