TUC Economic Quarterly

Number 5 October 2014

This quarterly TUC report provides an analysis of UK economic and labour market developments over recent months, and includes a spotlight feature on pay and earnings.

Summary

- In common with many other countries, there has been a significant revival in UK economic activity from the second half of 2012.
- Revisions to the National Accounts now show this revival a little stronger than previously thought.
- Domestic demand appears to be the key factor in expansion.
- Trade is weak, and there are growing fears of global slowdown.
- Household and corporate savings have been reduced over the past years, and deleveraging may have stalled.
- Public sector deficit reduction has slowed, as tax revenues falter.
- The labour market is expanding rapidly, with the unemployment rate of 6.2 per cent at a six year low, though underemployment continues to play a significant role.
- Furthermore, earnings growth continues to weaken with official figures at historic lows.

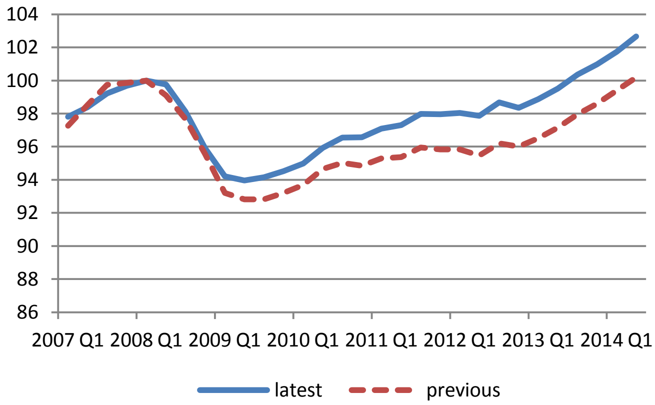
Economy

Economic growth

In 2014 Q2 growth was 0.9 per cent compared with the previous quarter, and 3.2 per cent compared with the same quarter a year ago; this was the highest since 2006 Q3.

With the latest quarterly dataset, the ONS made significant changes to the National Accounts that in part followed from adopting new international standards (European System of Accounts, ESA 2010 in turn based on the United Nations, System of National Accounts, SNA 2008). These led to upward revisions to the level of nominal or cash GDP throughout history, averaging £53 billion (or 4 per cent of GDP), which is now estimated at £1,713 billion for 2013. Real GDP has also been revised; growth is now stronger since the crisis, a little slower before the crisis, and the recession reduced slightly in severity. The latest profile for real GDP is shown below: the pre-crisis peak is restored earlier than previously estimated (in 2013 Q3 rather than in the current quarter), with the economy now estimated at 2.2 per cent above this point (previously 0.2 per cent).

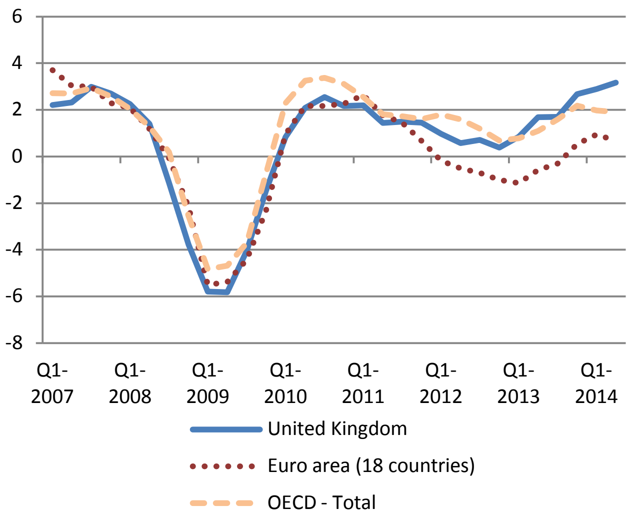
Index of real GDP, 2008 Q1 = 100



This revival in growth is common to most OECD countries; the chart below shows the UK against the OECD and euro area (EA) groupings. The decisive factors in this revival appear to have been monetary action in the second half of 2012, following Mario Draghi's promise to "do whatever it takes"; these included the European Central Bank's outright monetary transactions (from August), and the third round of the US Federal Reserve's quantitative easing in September (some called it 'QE infinity'); in the UK there was funding for lending and various schemes aimed at the housing market. In addition there was some relaxation of austerity to various degrees across the globe.

As the below chart indicates this has all been 'enjoyed' more fulsomely by those countries not in the EA, though even in the EA the threat of returning to full-blown recession was averted, at least for the time being. The expansion has meant the UK joins (of the OECD) Australia, Hungary, Ireland, Korea New Zealand and Australia with annual growth rates of over 3 per cent. Nonetheless, the threat of withdrawal of stimulus hangs heavy in the air, not least for emerging markets.

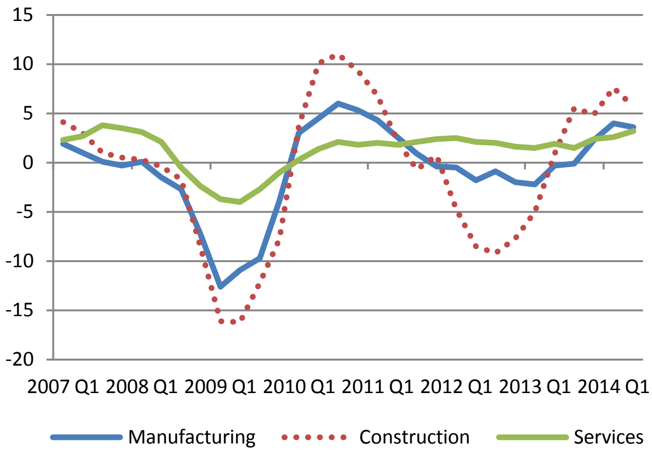
Real GDP growth, quarter on a year ago



Output

The restoration of the pre-crisis peak follows from the expansion of the service sector, which is now 6½ per cent above its previous peak; manufacturing (-4½ per cent) and construction (-9 per cent) still remain a way below their respective recent highs. That said, the chart shows that since 2013 all three main industry groupings have been growing steadily in a manner not seen since before the crisis.

Industry groupings, four quarter output growth



Within the service sector, growth is dominated by three of the eleven published industrial aggregates: wholesale and retail trade (5.0 per cent), scientific, administration and support (9.2 per cent, the category that includes all business services and professional support categories) and other services (7.0 per cent). The growth in the middle category in particular may be related to the outsourcing of public services.

One point to watch might be a slight weakening of output growth in both manufacturing and construction between the first and second quarters, with quarterly growth in manufacturing slowing to 0.5 per cent from 1.5 per cent, and in construction to 0.7 from 1.8 per cent. This slowdown has been echoed by private sector sources, with the manufacturing PMI at a seventeen month low. Construction declined quite sharply between July and August (-3.9 per cent). Whie these figures are volatile, it is striking that all areas of new work fell (housing, infrastructure, private commercial and private industrial).

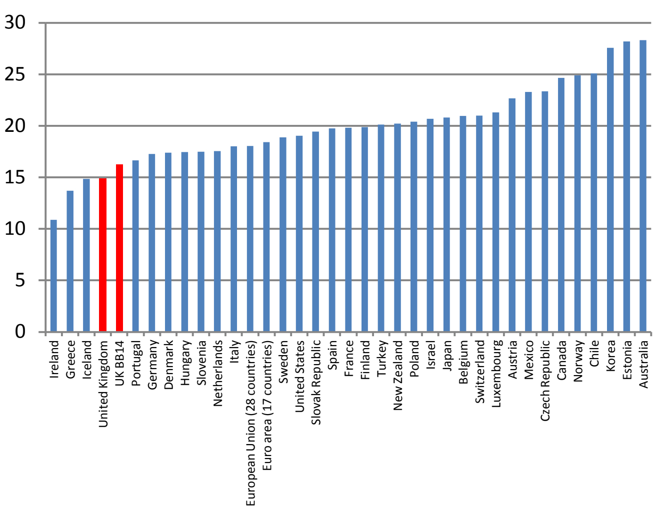
Demand

Latest figures show fairly balanced contributions to quarterly growth from each of households, government and investment (both business and dwellings). Household demand was up 0.6 per cent on the quarter and 2.1 per cent on a year ago; government demand up 1.0 per cent on the quarter and 1.2 per cent on a year ago; gross fixed capital investment (GFCF) up 1.3 per cent on the quarter and 9.1 per cent on a year ago.

The turnaround in investment (which includes plant and machinery, transport, residential and commercial buildings as well as government investment) is one of the bigger stories in the newly revised National Accounts. Previously investment was understood only recently to have revived; on the latest figures recovery has been underway since 2009, ahead of the current government taking office. Investment now contributes around a third to the overall recovery in GDP on an annual basis between 2009 and 2013, a similar share to household consumption. Previously investment did not contribute at all over that period, and consumption accounted for over half of the recovery.

It should be noted, however, that as a share of GDP, the UK investment performance remains well short of other countries (the chart shows 2012 figures, given availability of figures for other countries, but the UK share does not change significantly into 2013, to 16.4 per cent from 16.2 per cent in 2012).

2012 GFCF as a share of GDP, current prices



Trade data continue to disappoint, with little gain in exports over the past three years. In 2014 Q2 exports fell by -0.4 per cent, the same as in the previous quarter. These falls are set against even weaker imports, which fell by -0.3 in the latest quarter, following a fall of -2.0 per cent in the previous. Overall, net trade has made only a limited contribution to GDP over recent quarters. Monthly figures show further weakening into the third quarter. At face value, this recent deterioration has been more to do with non-EU countries, though the figures are very volatile. On an annual and underlying basis, there is a decline of -2.5 per cent to both EU and non-EU coutries. As we go to press, alarm is growing again about the condition of the EA economy, following in particular various weak results for Germany.

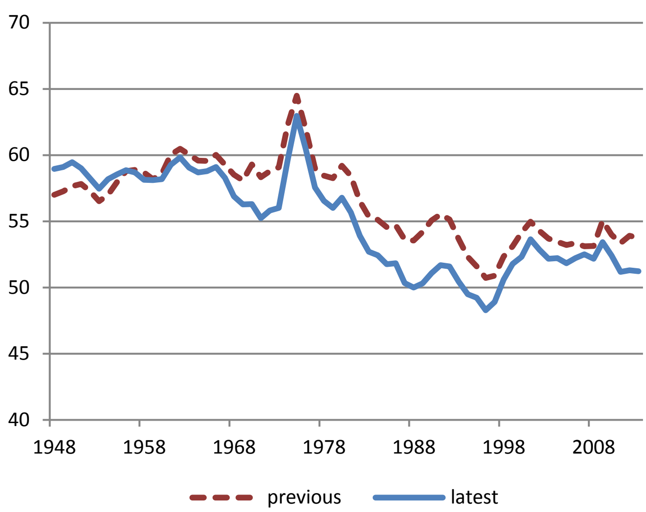
Incomes, saving and debt

Households

While gains in GDP led to some employment gains, they have not been reflected in pay packets and household incomes.

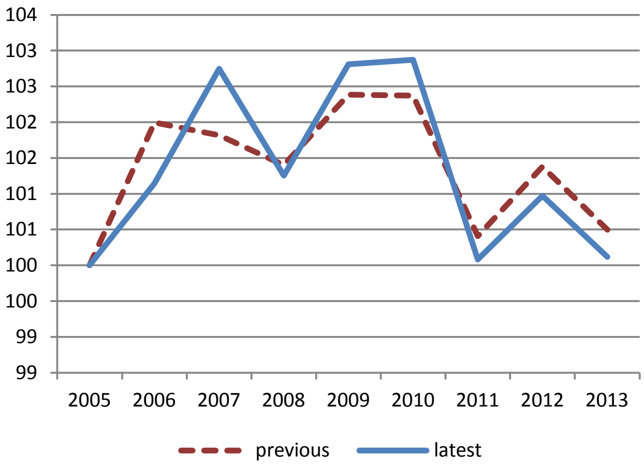
Over the past year, compensation of employees has increased by only 1.4 per cent, while total profits are up 10.7 per cent. Moreover, the national accounts revisions show virtually all of the gain in GDP accruing to firms. The labour share, measured as compensation of employees as a share of GDP (in cash terms), is reduced fairly uniformly across the whole span of the data, with 2013 revised down to 51.2 per cent from the previous estimate of 53.7 per cent (shown on the chart below). The decline from the recent peak in 2009 to 2013 is sharper at -2.2 percentage points on the new figures, compared to -1.3 percentage points on the previous figures.

Compensation of employees, % of GDP



The most comprehensive measure of household incomes is real household disposable income per head, which adjusts the national-accounts measure of disposable income for inflation and increases in the population. (HM Treasury have previously suggested in *Autumn Statement* 2013 para. 1.29 that RHHDI provides a 'complete picture' of living standards.) Annual figures are shown below. On the basis of the latest figures, household incomes in 2013 were little different to their level in 2005. Looking over time, incomes are now estimated as down 2.7 per cent down on the peak in 2010; previously the fall was 1.8 per cent on the peak in 2009.

Real household disposable income per capita, index 2005=100



(Note that on a quarterly basis, the figures rebound into 2014 Q2, but there seems to be a serious seasonal factor here, with the past four years showing a strong rise into Q2, related to bonus payment and tax changes. Annual figures are likely to provide a more stable guide to underlying trends.)

The saving ratio

Another important area of revisions in the National Accounts are those affecting the saving ratio following major changes to the treatment of pensions. These were well trailed in advance, and result from a change in the way earnings from pension funds are allocated to the household sector as flows of income. They result in a significant upward revision to the saving ratio of between 2 and 5 percentage points between 1997 and 2013.

One way to view the change is that the revised figures reflect the position as if any deficits on pension funds were closed, with the liability ultimately on companies to make promises good (liabilities on the company balance sheet have therefore increased by £700 billion). Obviously there is no guarantee that they can make good, so the implied increased strength of household finances might be interpreted with caution. Note also that the changes do not impact on household income (as opposed to saving), which is based on *disposable* income and includes pension payments/benefits rather than pension contributions. It is therefore difficult to see any immediate macroeconomic implications. The Bank of England have already anticipated this, arguing in the August *Inflation Report*: "the increase in household saving ratio does not contain any significant information on the outlook for household consumption".

But outside the impact of changes to methodology, the new profile still shows saving falling, from 11.0 per cent in 2010 to 6.4 per cent in 2013; previously the decline was from 7.3 per cent in 2010 to 5.2 per cent in 2013. The National Accounts also include a additional and broader measure: net lending / borrowing. This is analogous to looking at government or corporate finances after capital spending, and measures household finances net of fixed investiment in housing. These figures show net lending falling negative (ie to borrowing) in 2013 for the first time on an annual basis since 2008, and remained negative in the first two quarters of 2014. In this way the relationship between consumption and income is approaching (but still some way from) the position in the run up to the crisis. From the perspective of debt, broadly, deleveraging – measured as reductions in household liabilities (mortgages, credit, pay-day lending etc) as a share of income –has stalled, suggesting that rising personal debt is at least partly responsible for driving consumption growth.

Corporate finances

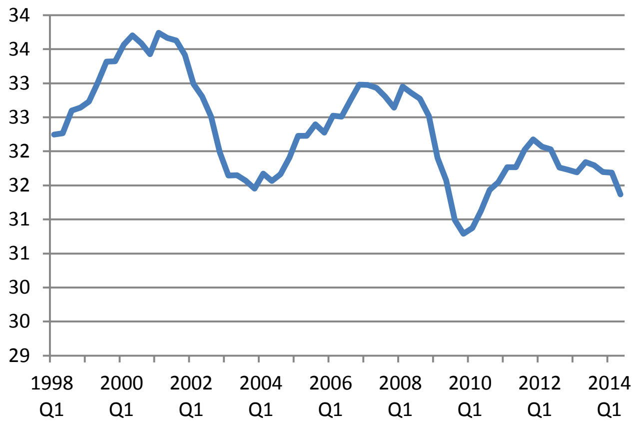
As above, firms have seen strong profit growth over the past two years; in addition the level of profits has been revised up. The combination of these upward changes set against increases to capital investment has meant a changed profile for the corporate surplus, which was revised up over the period 2008 to 2012 by on average around £10 billion a year. But the figure for 2013 was revised down by £8 billion. The corporate surplus now declines from the recent peak of £69 billion in 2011 to £15 billion in 2013, and to only £642 million in 2014 Q2. There is some interest here in the implications for firms being able to afford increases in wages. First, the figures are aggregates, and will astratct from some firms being in positive and others in negative positions. Moreover the very prolonged duration of the surplus (13 years) means that companies have built up very significant cash reserves (over £500 billion). But also from a *macro*economic view, the figures are a constraint only insofar as any increased wages do not lead to higher demand. With higher demand, firms' revenues would increase to meet higher wage payments.

The public finances

While the household and corporate financial (positive) surpluses have shrunk, the government's (negative) deficit has been somewhat reduced. According to the Public Sector Finances release, the current budget deficit fell to £73 billion in 2013/14 from £104 billion in 2009/10. Into the latest year, however, the pace of this improvement has slowed. In the financial year to date (April to August 2014), the current deficit was -£36.4 billion, down only marginally on -£36.6 billion over the same period last year.

In their assessment of these figures the OBR stress the shortfall in receipts compared to forecast, in particular a fall in income tax and National Insurance Contributions receipts when they had expected rises; these are attributed to unexpectedly weak earnings growth.[1] The chart shows total taxes and NICs as a share of GDP falling steadily in recent years and approaching the previous low point around the end of the recession. This is atypical behaviour for an expansion and shows the living standards crisis has impacts far beyond households.

Taxes and NICs as a % share of nominal GDP, four quarter moving average



Inflation

In spite of the revival in growth, inflation remains comfortably below target. The July figure of 1.5 per cent matches the four-and-a-half-year low seen in May, and means CPI inflation has been below its target of 2 per cent for eight months in a row - the longest such run since 2005. These figures as well as earnings figures (below) indicate an absence of inflationary pressures in the economy.

The national accounts revisions seem neutral for assessments of the output gap, with output gains matched by a corresponding increase in productivity and hence trend, so that the output gap remains unchanged. Moreover the increasingly restored balance between investment and consumption suggests better conditions for non-inflationary growth.

Calls for rate rises in the midst of a living standards and earnings crisis seem premature, to say the least. A rate rise would serve mainly to force higher mortgage costs on households that are suffering the seventh year of falling real earnings, so that rises in incomes have fallen short of rises in costs. This may push some households into crisis, and would require others to further retrench risking choking off any

1 http://budgetresponsibility.org.uk/wordpress/docs/Sep-2014-PSF-commentary.pdf

recovery. For the coprporate sector, unlike a wage rise, a rate rise increases increases costs in the face of likey reduced demand and revenues.

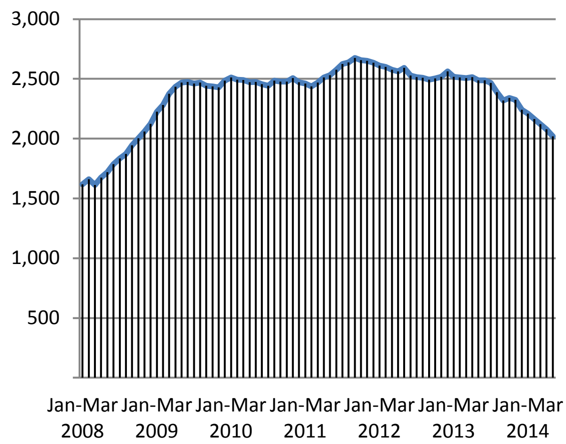
Labour market

The latest labour market statistics continue to show increases in employment and falls in unemployment. This, however, is set against record level lows in earnings growth.

The most recent figures cover May to July 2014 and are mainly compared with the February to April figures. There was a fall in unemployment of 146,000 to 2.02m, a rise in employment of 74,000 to 30.61m; and inactivity rose by 114,000 to 8.93m. This is the largest rise in inactivity for 5 years.

Over the last year employment has grown by 774,000 while in the previous year employment grew by 275,000. However, the most recent period has seen the slowest quarterly employment increase for a year. The rate of employment growth is 0.2 per cent compared to a quarterly rate of around 1 per cent at the start of the year. The unemployment level fell by 468,000 over the year, and now stands just above two million (chart). The unemployment rate fell sharply to 6.2 per cent, from 6.6 per cent.

Unemployment levels 2008 – 2014



Inactivity rose by 114,000, so some of the fall in unemployment appears to reflect movements in to economic inactivity and away from the labour market rather than into employment. There has been a 70,000 increase in inactivity due to being a student, and a 33,000 increase in inactivity due to long tern sickness. Although this is the highest rise in inactivity for five years, it does follow the rate falling to a historic low at the start of the year.

It is too early to say whether this is a new trend or just a blip, but the unemployment rate at 6.2 per cent still remains above the pre-recession level of 5.2 percent. There are still 400,000 more unemployed people than before the crisis.

Youth unemployment fell by 106,000 over the quarter, and by 213,000 over the year. These are the largest quarterly and annual falls in youth unemployment since comparable records began in 1992. However, youth unemployment was rising before the current downturn started, and youth unemployment levels still remain concerning at 747,000. What is more a third of 18-24 year olds have been unemployed for over a year, this is just over 10 percentage points higher than pre–recession levels.

Composition of employment

In contrast with recent quarters almost all new jobs were part-time. Of the 74,000 rise in employment this quarter, 68,000 has been in part-time work. This part-time growth has been driven by women, as the number of men working part-time has fallen.

While the majority of the increase in employment this quarter was also in employee jobs (88 percent), over the year employee jobs have risen by 1.7 percent compared to 8.8 per cent in self-employment. The extraordinary rise in self-employment since early 2008 has been reported widely; almost one worker in seven now is self-employed.

We have also reported that the current composition of the workforce is very different to pre-recession levels. The table below provides us with an update, this shows that full-time employee jobs have only just reached their pre-recession levels despite rising employment levels. Involuntary part-time and temporary work still remain high.

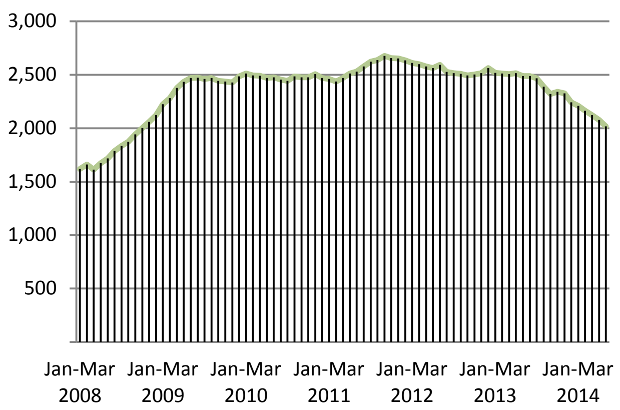
Composition of workforce – 2008- 2014

	Jan-Mar 2008	April - June 2014	Change in numbers	% change
	(000's)	(000's)	(000's)	%
Employees	25,428	25,816	388	1.50%
Self employed	3,858	4,541	683	17.70%
Total working full – time	21,988	22,376	388	1.76%
Total working part-time	7,522	8,233	711	9.50%
Employees full-time	18,991	19,056	65	0.30%
Employees part-time	6,437	6,760	323	5.00%
Self-employed full-time	2,930	3,238	308	10.50%
Self-employed part-time	928	1,303	375	40.40%
Involuntary temporary	359	612	253	70.50%
Involuntary part- time	701	1,333	632	90.20%

Underemployment

There have been recent falls in-involuntary part-time work however this still accounts for too high a share of employment. In early 2008 the proportion of people working part-time who could not find full-time work was 9.5 per cent; this peaked at 18.5 percent in mid 2013 and currently stands at 16.5 percent.

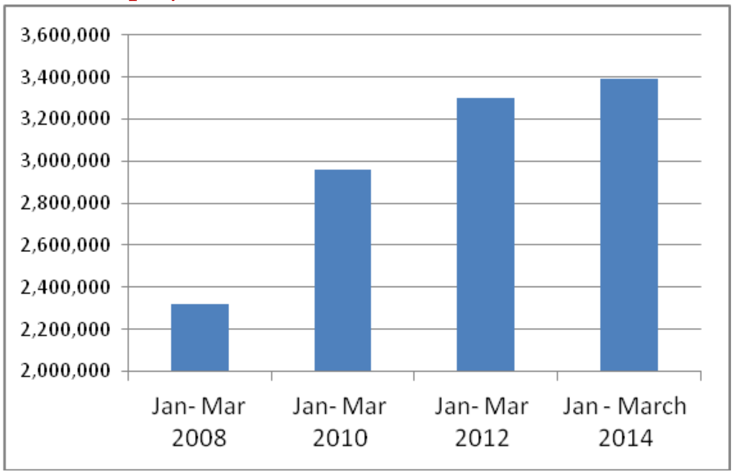
Involuntary part– time work 2008-2014



TUC analysis of the Labour Force Survey shows that across the UK the number of people who count as under-employed – people working part-time because they can't get a full-time job, or wanting more hours in their current job, has increased for both employees and the self-employed.

The analysis shows that while unemployment has fallen by over 400,000 since early 2012, under-employment has risen by 93,000. And at 3.4 million the current level of under-employment is over a million higher (46 per cent) than it was before the recession.

Underemployment levels 2008-2014



While there has been a small recent fall in involuntarily part-time work (people working part-time because they can't get a full-time job), the analysis revealed that a rise in the numbers who want more hours in their existing jobs means that under-employment is still increasing. Continual real wage falls mean that more people than ever are looking for extra hours to make ends meet.

Regions/nations

In this quarter, the employment rate increased in most areas, the exceptions being the North East, Yorkshire and Humber, Wales and Northern Ireland. The unemployment rate also fell in most areas, the exceptions being the North East, South West and Wales. The unemployment rate remains the highest in the North East at 9.9 percent, this is 3.7 percentage points higher than the national average, and 2.6 percentage points higher than Yorkshire and Humber which has the second highest rate of unemployment.

Employment/unemployment in the UK's regions /nations, May to July 2014

	Employment		Unemployment	
Data in 000's for level	Aged 16+	Aged 16-64	Aged 16+	Aged 16+
	Level	Rate (%)	Level	Rate (%)
North East	1,195	68.8	132	9.9
North West	3,222	70	239	6.9
Yorkshire/ Humber	2,561	71.6	203	7.3
East Midlands	2,206	73.8	130	5.6
West Midlands	2,518	70.3	194	7.1
East of England	2,991	76.7	155	4.9
London	4,101	72.6	303	6.9
South East	4,416	76.7	204	4.4
South West	2,621	76.2	137	5
England	25,832	73.3	1,697	6.2
Wales	1,347	68.8	96	6.7
Scotland	2,623	73.9	168	6
Northern Ireland	808	68	57	6.6
United Kingdom	30,609	73	2,019	6.2

Change on quarter (change since February to April 2014)

	Employment		Unemployment	
Data in 000's for level	Aged 16+	Aged 16-64	Aged 16+	Aged 16+
	Level	Rate (%)	Level	Rate (%)
North East	-11	-0.8	1	0.1
North West	10	0	-27	-0.7
Yorkshire/Humber	-12	-0.4	-25	-0.8
East Midlands	1	0	-12	-0.5
West Midlands	13	0.1	-9	-0.3
East of England	15	0.8	-13	-0.4
London	24	0.3	-25	-0.6
South East	42	0.3	-16	-0.4
South West	-13	0.1	1	0.1
England	69	0.1	-126	-0.4
Wales	-26	-1.3	0	0.1
Scotland	45	0.5	-15	-0.6
Northern Ireland	-14	-0.1	-4	-0.3
United Kingdom	74	0.1	-146	-0.4

Productivity

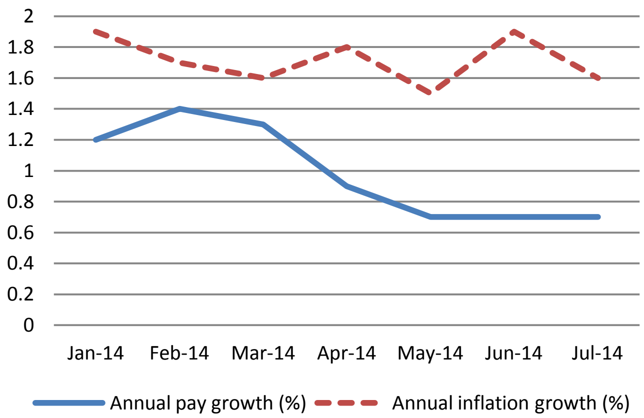
As has been widely discussed, employment gains still outstrip output growth so that productivity growth remains subdued. On the basis of the latest figures output per hour was unchanged in 2014Q2 compared with the previous quarter and -0.3 per cent lower than a year ago. Nonethless in level terms the early stages of the recovery was accompanied by gains in productivity; these stalled in the middle of 2012. Moreover the position is more mixed by industry, for example manufacturing productivity is growing by an annual rate of nearly 4.0 per cent. These trends will be discussed in more detail in the next bulletin.

Pay

The squeeze in real wages continues. Total pay in July (including bonuses) increased by 0.6 percent, up from the recent distorted low of 0.1 per cent in June (effects caused by behaviour in response to the tax change last year).

Regular pay in July (which excludes bonuses) is at all time low of 0.7 percent for the third month in a row. Even the Government's preferred measure of CPI inflation at 1.5 this is still more than double the latest earnings figures. RPI inflation which takes into account housing costs is at 2.4 per cent, over three times more than wage growth.

Annual CPI inflation versus pay growth (regular pay) since start of year



A few months ago there were premature claims that earnings were catching up with inflation.

But the real earnings squeeze is still very much in place.

In his speech to the TUC in September, the Governor of Bank of England confirmed that real wages had fallen by around a tenth since the onset of the crisis, unprecedented since the early 1920s. The latter came in the wake of austerity after the First World War, and while similar in magnitude it lasted only two years; now in its seventh year, the current real wage squeeze has no historical precedent.

Spotlight feature – pay and earnings

A new report for the TUC looks at the difference between the figures for average weekly earnings and pay settlements and in the process shines a light on the cost of living crisis and the changing labour market.

Every month, the Office for National Statistics publishes a Statistical Bulletin[2] for the UK Labour Market and one of the key elements is a set of tables for Average Weekly Earnings (AWE) – for regular pay, bonus pay and total pay. If we look at the rate at which AWE has grown, we can see a collapse after the recession:

Average weekly earnings : percentage change year on year
(Total pay, whole economy, three month average)

In fact, average earnings have been growing at a lower rate than inflation – falling in real terms for more than four years. But, at the same time, pay settlements – annual pay increases - have been roughly keeping pace with inflation. The pay deals reported by organisations like Incomes Data Services and Labour Research have been averaging between two and three per cent for over a year.

The TUC commissioned Incomes Data Services to look into this puzzle, and published their report, *Earnings and Settlements* [3]in September.

2 http://www.ons.gov.uk/ons/dcp171778_372372.pdf
3 http://www.tuc.org.uk/sites/default/files Earnings_and_Settlements.pdf

The key to the solution, IDS found, is "compositional change". AWE is worked out by adding up the wages bill for 9,000 organisations and dividing this figure by the number of employees. This means that the average is not only influenced by organisations' pay settlements, but by other factors that affect pay like shifts in the number of hours people are working. Even more importantly, if the economy's mix of higher and lower paying occupations and industries shifts, AWE will reflect that too.

The most important result from the IDS study is that, since 2008, there has been a shift from higher to lower-paying sectors.

A second factor has been the shift from full-time to part-time work, often in the same lower-paying industries. This change has particularly affected young workers in industries like retail.

The IDS findings suggest that a number of union concerns in recent months are indeed linked: the living standards crisis, underemployment and the economy's shift to reliance on lower-paid low-productivity jobs.

Over the last five years, the number of jobs in the two lowest paying industries – food and beverage services and services to building and landscaping activities grew by around a quarter, a net increase of 277,000 jobs. Average weekly pay in these sectors is £224 and £265 respectively. Meanwhile, employment in financial services – the UK's highest paying industry, with an average weekly wage of £873.70 fell by 20 per cent, or 139,000 jobs.

TUC analysis has shown that, over the last two years, while unemployment has fallen, underemployment has risen, by 93,000. Underemployment, falling earnings and the shift to lower productivity industries are all happening at the same time as workers are increasingly worried about insecurity and casualisation. *Earnings and Settlements* helps us to understanding some very important changes in today's labour market.