Number 8 February 2016

This quarterly TUC report provides an analysis of UK economic and labour market developments over recent months.

Summary

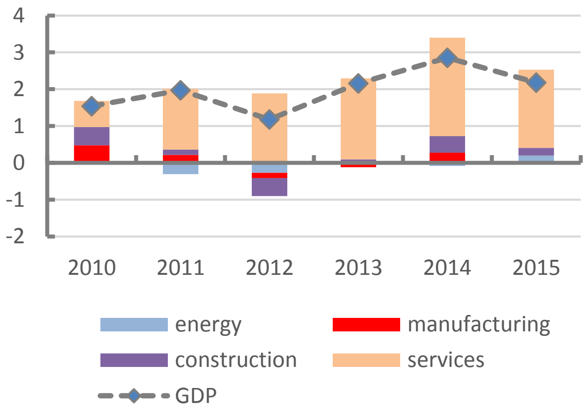
The growth rate of the UK economy slowed in 2015, following a more rapid expansion in 2014. This slowdown was common to a number of countries. In the UK there are still material gains in employment but any revival in earnings growth appears to have been short-lived. The headline rate of inflation has fallen to zero per cent, the lowest since 1931.

This quarterly looks at the factors driving this shift in growth, the response of the labour market and public finances and considerations related to the fall in prices. A spotlight feature looks at the impact of public sector job cuts on labour market figures.

GDP growth and global backdrop

The preliminary estimate showed GDP growth at 0.5 per cent in 2015Q4, up from 0.4 per cent in Q3. This continues a run of slightly weaker figures through the year relative to 2014. The four quarter growth rate is now 1.9 per cent – the lowest since 2013Q1. For 2015 as a whole growth is estimated at 2.2 per cent, down from 2.9 per cent in 2014.

GDP calendar year growth and contributions by industry (percentage points)



This slowdown is common to the majority of advanced economies, but the UK has also started again to lose ground against others. In 2015Q3 (the latest quarter for which comparable data is available) UK growth ranked about halfway up the OECD country league table; in 2014Q1 it was around a quarter from the top.

However, the weakness is most severe in emerging market economies, which have been hit hardest by falls in oil and other commodity prices. But events also follow the withdrawal of economic stimulus, both globally given the ending of quantitative easing (QE) in the US, and the more localised ending of the 2014 pre-election government spending boost in the UK. On the other hand EU economies have performed marginally better, as the European Central Bank took up the reigns for QE and the scale of EU government spending cuts has been moderated.

2016 opened to significant and still ongoing financial turmoil, with a collapse in the stock exchange and slowing growth in China, distress in the economies of other emerging markets, falling commodity prices, growing indebtedness, disinflation (a sustained decrease in the rate of inflation), the Federal Reserve's December tightening of policy and, most recently, pertinent questions about the solvency of some global investment banks.

In an address on 7 January the Chancellor warned: "Last year was the worst for global growth since the crash and this year opens with a dangerous cocktail of new threats. For Britain, the only antidote to that is confronting complacency and sticking to the course we've charted". The TUC shares many of the Chancellor's concerns about the nature of the recovery, but continues to disagree with his proposed course of action.

Industry breakdown

The above chart shows contributions to growth from the main industrial sectors, and the associated intensifying imbalances. While manufacturing made a positive contribution in 2014, the output of the sector fell a little (by -0.2 per cent) in 2015. Construction also slowed quite significantly. More generally the chart shows how the service sector has accounted for the vast share of economic growth in every year after 2010.

These trends intensified over 2015. In Q4 the service sector accounted for all the UK's quarterly growth, and within the service sector nearly all quarterly growth was accounted for by distribution, hotels and business services industries (notably 'office administration and other business support', hinting at the potential role of outsourcing). For broad industry groupings, quarterly and annual growth rates are shown in the table below.

Industry growth in 2015, per cent

	Q on previous Q				Q on same Q in 2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Manufacturing	-	-0.6	-0.4	-	1.2	0.1	-0.9	-1
Construction	2.1	0.3	-1.9	-0.1	6.4	5.3	1	0.3
Services	0.3	0.5	0.6	0.7	3	2.5	2.4	2.2
GDP	0.4	0.5	0.4	0.5	2.5	2.3	2.1	1.9

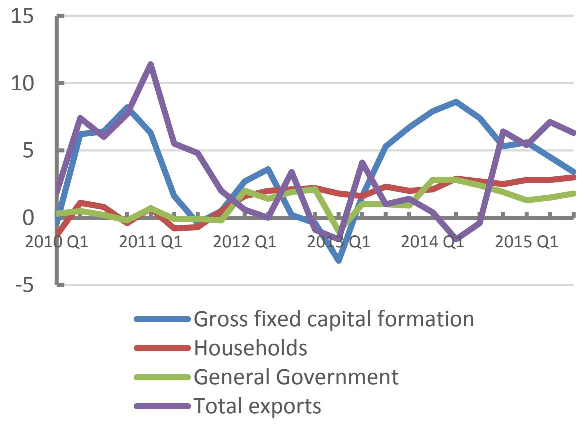
Manufacturing was technically in recession through the middle of the year. Construction moved into recession in the second half of the year (just), with increases in housebuilding stalled.

Expenditure and demand

The expenditure measure of GDP captures the final expenditure on goods and services by each sector of the economy (households, firms, government and the rest of the world). Over the past year the position has been increasingly distorted by 'noflation'. The overall GDP deflator that measures prices across the whole economy is now at only 0.1 per cent, echoing the figures for consumer inflation (below).

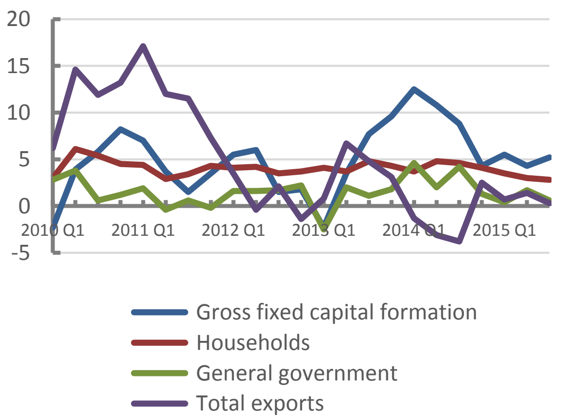
When examined in the usual volume terms (i.e. with the effects of price removed), the suggestion is that the weakening in growth is because the pace of investment has slowed, despite household expenditure picking up pace slightly and a surge in export growth. (Note that these figures extend only to the third quarter of 2015 at the moment.)

Demand volumes: four quarter growth (percentage points)



But in value terms (i.e. cash figures, not adjusted for inflation), the story is different. The slowdown in investment growth has been arrested, but on the other hand consumer demand growth is gently but steadily weakening and there has been no surge in exports. Government demand is also clearly weaker than it was a year ago, echoing the now withdrawn surge in spending.

Demand values: four quarter growth (percentage points)



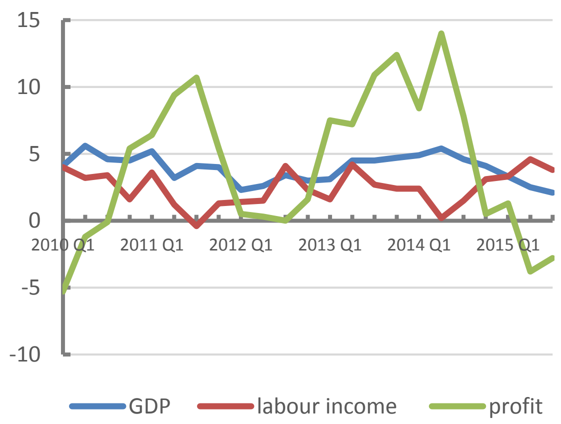
So the rate of increase in spending across certain parts of the economy might not be as robust as the expenditure components at face value suggest: expenditure volumes are rising as a result of low inflation, but conversely the cash values of spending are growing less strongly.

Given intensifying global fragilities, it is not obvious where any strengthening in demand and hence growth into the future will come from.

Spending and incomes

Likewise nominal GDP growth has slowed far more abruptly than GDP in volume terms. Again these figures are available only to the end of the third quarter of 2015, but show four quarter growth of 2.1 per cent, the same as growth on the real measure, and hence inflation according to the GDP deflator is at zero per cent. Nominal GDP growth has only been slower on two occassions since the Second World War; through the recent financial crisis and a one-off occasion in 1958.

Income growth, quarter on a year ago (percentage points)

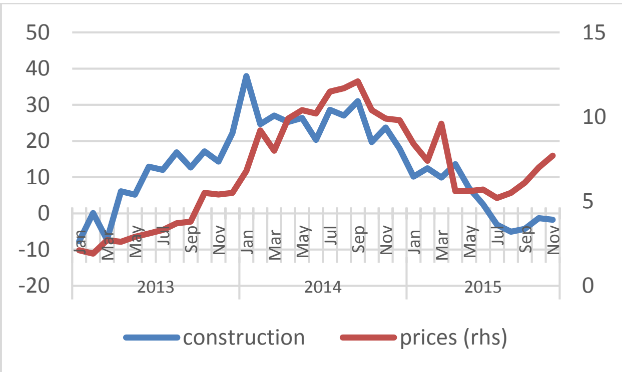


Given firms earn revenues in cash, this is likely to suggest emerging pressures on corporate profits and household incomes. In the latest quarter these are most apparent in the corporate sector. While total spending on wages and salaries and employers' contributions to pension schemes rose by 3.8 per cent on the year to the third quarter, profits fell -2.8 per cent. If nominal GDP growth continues to slow, it is hard to see how this stronger growth in the pace of labour incomes (whether through pay, hours or employment) can continue (discussed below).

Housing market

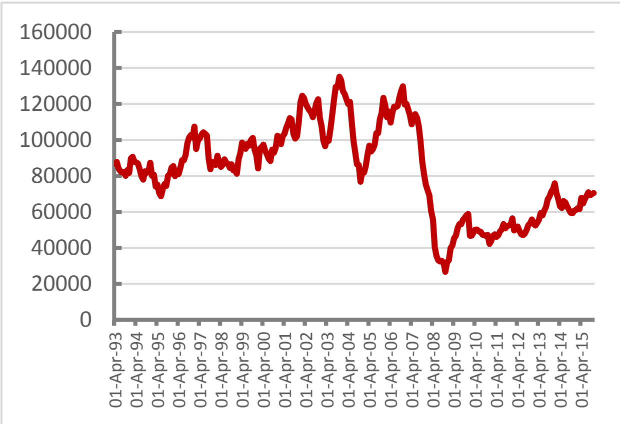
The one area where prices have been holding up is in the housing market, this comes as demand seems to be increasing but supply has stalled. Annual house price inflation had peaked at 12.1 per cent in September 2014 and slowed into 2015, but in recent months the figures are up again, from a low point of 5.2 per cent in July to 7.7 per cent in November. On supply, housing construction has slowed sharply from recent peak annual growth rates of around 25 per cent over 2014 to the latest figures which are around zero per cent – the chart below compares the growth rate for construction of houses with house price inflation.

House prices and construction output, growth on a year ago (percentage points)



On demand, mortgage approvals for house purchases are increasing again. Approvals slowed after a recent peak in January 2014, but started picking up again at the end of the same year. In the year to November 2015, approvals were up by 21 per cent. In their February *Inflation Report*, The Bank of England stress that "much of this growth can be attributed to the buy-to-let sector. In the year to 2015 Q34, the stock of buy-to-let lending [i.e. cash] rose by 10%, compared to just 0.4% for lending to owner-occupiers".

Mortgage approvals, number



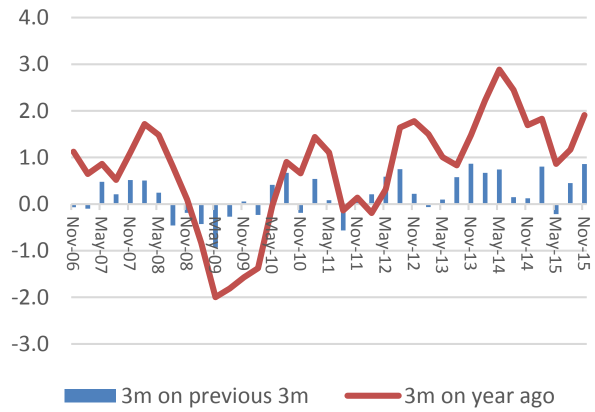
However, as a consequence of hefty annual price growth, price levels are now far out of reach for a growing number of people and mortgage approvals are way below levels seen ahead of the financial crisis.

The labour market

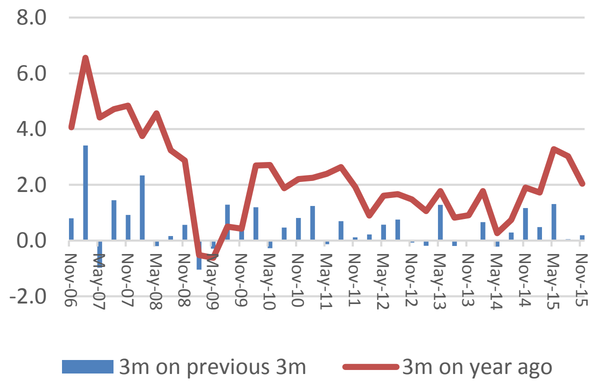
Since economic growth accelerated in 2013, the labour market has been characterised by strong growth in employment set against weak growth in wages.

The latest figures show employment growth strengthening to 0.9 per cent on the quarter and 1.9 per cent compared with a year ago (see chart below, based on three-monthly periods up to September–November 2015). While some slowdown was evident over the second half of 2014 and into 2015, jobs growth has since picked up again.

Employment growth, per cent



Average weekly earnings growth, per cent



As a result of this sustained expansion of jobs, the employment rate has risen to 74.0 per cent, the highest on records that extend back to 1970. At 5.1 per cent, the unemployment rate is the lowest it has been for over ten years – since August-October 2005 when it was 4.9 per cent.

But in general terms, employment gains have come at the expense of earnings. Annual average weekly earnings growth averaged a little over four per cent ahead of the crisis; since the crisis there has been an exceptionally prolonged period of very low earnings growth (as shown in the following chart). Finally, over the end of 2014 and start of 2015 there were some gains, but this only resulted in annual growth of 3.3 per cent, which has seemingly proved very short-lived. In the latest quarter, annual growth has slowed abruptly to 2.0 per cent and the two most recent quarterly growth figures of 0.0 and 0.2 per cent respectively are indicative of likely further weakness ahead.

The recent revival in earnings growth together with ongoing low inflation outcomes have meant that there are finally material gains in real earnings (after a seven year decline). But the danger has always been that low inflation outcomes will feedback to wage settlements; this now appears to be the reality. The Bank of England observe "the period of low inflation may have weighed on wage settlements" (*Inflation Report*, February 2016, p. 40). Moreover, employment and earnings growth on the year together crudely approximates to annual growth in total wages and salaries of four per cent (corresponding broadly to labour income on the 'Income growth' chart); as noted above, this is much higher than nominal GDP growth, which potentially also suggests downward pressures on future labour income, and hence wages and/or jobs.

Public finances

The performance of the public finances since the coalition government took office has broadly followed macroeconomic outcomes. In the early years, growth and labour income fell short of expectations, revenues disappointed and the improvement in public finances fell greatly short of plans. The stronger economy in 2014 meant higher government revenues, but in 2015 revenues weakened again. Revenue growth in the year to 2014Q4 was 7.6 per cent; this slowed to 1.3 per cent in the year to 2015Q4.

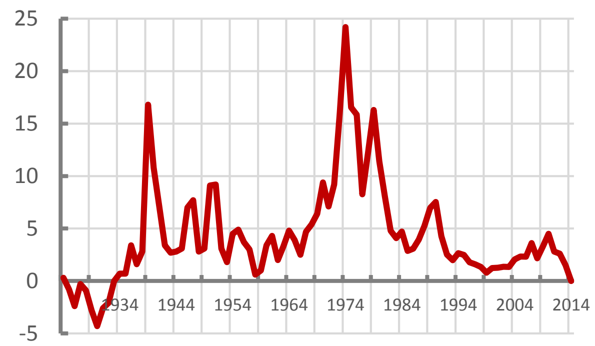
This slowdown means that once more the public finances are falling against recently revised plans for the current financial year. Over the year as a whole the government expected borrowing to reduce to £73.5bn in 2015-16 from £94.7bn in 2014–15, an improvement of 22 per cent. Outturn figures show that in the year to date (April–December) borrowing was £74.2bn down from £85.2bn in the same period last year, an improvement of only 11 per cent. Following the release of these figures, the Office for Budget Responsibility issued a projection: "A simple extrapolation of the year-on-year percentage fall in the deficit would imply full-year borrowing of around £78 billion, a fall of only £11 billion and around £9 billion above forecast".

Inflation

While the most recent CPI inflation figures have been just positive, 2015 was characterised by exceptionally low inflation outcomes. Headline CPI inflation rose to 0.2 per cent in December, from 0.1 per cent in November; core inflation (excluding energy, fuel, food, alcohol and tobacco) also rose to 1.4 per cent from 1.2 per cent. However both measures were heavily distorted by a sharp increase in air fares, a notoriously erratic component that accounted for almost the whole monthly increase for both measures, and will inevitably reverse next month.

The bigger picture is that inflation for the calendar year 2015 has come in at zero per cent. This is the lowest figure since 1931 – at the height of the great depression (on the basis of Bank of England historic data). Across the globe, the story is little different.

CPI inflation, calendar years



Each month the Treasury keep track of forecasts produced by City and other economists. In March 2015 (after the first zero monthly figure for annual CPI inflation), their record shows the average forecast for inflation at the end of the year (specifically Q4 2015) was 0.9 per cent (across the City) and 0.8 per cent (for independent forecasters). The latest ONS figures showed Q4 inflation at 0.1 per cent.

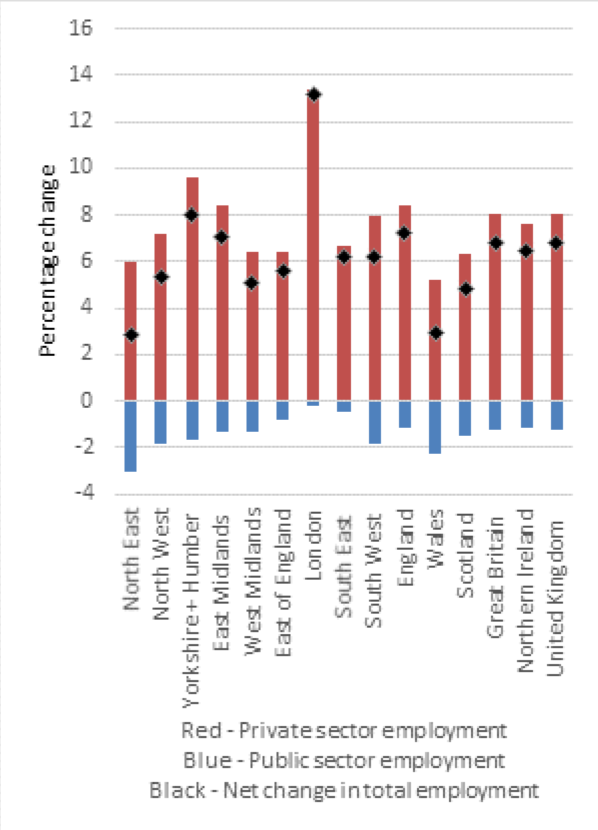
But even now the extent of these pressures is clear, opinions about the implications still differ. There is still a tendency to blame mainly external forces, and avoid the conclusion that low inflation reflects a high level of spare capacity.

Apart from sporadic stimulus measures, governments across the globe have retrenched ever since the worse of the financial crisis was apparently over. But these actions have had a bigger macroeconomic impact than expected; consequent low rates of growth have meant a sustained underutilisation of resources that is likely to be cumulative in its impact. In parallel, financial fragilities have not been resolved, and even the UK public debt has continued to rise. In the TUC's view policy makers risk outright deflation if they do not do more to fully utilise the UK's economic potential. Further retrenchment in the face of economic fragility would be the worst possible option.

Spotlight feature - regional public sector employment

The TUC has commented before on how London has disproportionately benefitted from employment growth; this spotlight feature discusses how the position has been exacerbated by public sector job cuts.

Public and private sector contributions to employment growth, 2010-2015



The graph above shows how the percentage gain over 2010-15 in total employment in each region/ nation is allocated between private sector gains and public sector job losses. The tables below show actual headcounts and percentage changes for each sector.

Since 2010, public sector employment across the UK has fallen by 373,000 (seven per cent). Every region/nation has lost public sector jobs over the past five years, but some have been especially hard hit. Very broadly, those regions with the weaker gains in private sector employment have seen the larger falls in public sector employment. Most obviously, private sector gains contributed least in the North East and Wales, and in the same regions public sector losses had the largest negative impact. (Note that the chart shows contributions, which take into account the relative importance in each region of public and private sector jobs to the total, and therefore does not match with the percentage changes in employment levels in the tables below).

In terms of the actual percentage change in public sector jobs, the regions with above average job losses were the North East, North West, Yorkshire and the Humberside, East Midlands and South West. These are four of the five regions with the lowest GDP per head. Outside London and the South East, Northern Ireland shielded public sector job cuts most effectively.

In contrast, London has only seen a one per cent fall in public sector employment while achieving a 16 per cent rise in private sector employment, significantly more than any other area.

Change in public sector employment since 2010 – excluding effects of major reclassifications

Data in thousands not seasonally adjusted	2010 Sep	2015 Sep	change since 2010	% change since 2010
North East	262	228	-34	-13
North West	645	585	-60	-9
Yorkshire/Humber	493	455	-38	-8
East Midlands	357	330	-27	-8
West Midlands	470	437	-33	-7
East of England	423	402	-21	-5
London	708	698	-10	-1
South East	635	615	-20	-3
South West	478	431	-47	-10
England	4,470	4,181	-289	-6
Wales	321	291	-30	-9
Scotland	568	531	-37	-7
Great Britain	5,359	5,003	-356	-7
Northern Ireland	214	205	-9	-4
United Kingdom	5,598	5,225	-373	-7

(Comparisons have been done from Sept 2010 – to Sept 2015 as data is not seasonally adjusted)

Change in private sector employment since 2010 excluding effects of major reclassifications

Data in thousands not seasonally adjusted	2010 Sep	2015 Sep	change since 2010	% change since 2010
North East	847	913	66	8
North West	2,561	2,793	232	9
Yorkshire/ Humber	1,841	2,066	225	12
East Midlands	1,644	1,812	168	10
West Midlands	2,006	2,164	158	8
East of England	2,160	2,326	166	8
London	3,614	4,192	578	16
South East	3,344	3,611	267	8
South West	2,081	2,286	205	10
England	20,098	22,162	2,064	10
Wales	999	1,068	69	7
Scotland	1,922	2,079	157	8
Great Britain	23,018	25,309	2,291	10
Northern Ireland	543	601	58	11
United Kingdom	23,792	26,169	2,377	10

(Comparisons have been done from Sept 2010 – to Sept 2015 as data is not seasonally adjusted)

*Note both sets of figures exclude major reclassifications and hence are not distorted by this. As in the past few years, further education and sixth form colleges and Royal Mail have moved from being classified as in the public to the private sector, while Network Rail, Bradford and Bingley and RBS moved in the opposite direction; Lloyds and Northern Rock moved in and then back out again.