Number 4 June 2014

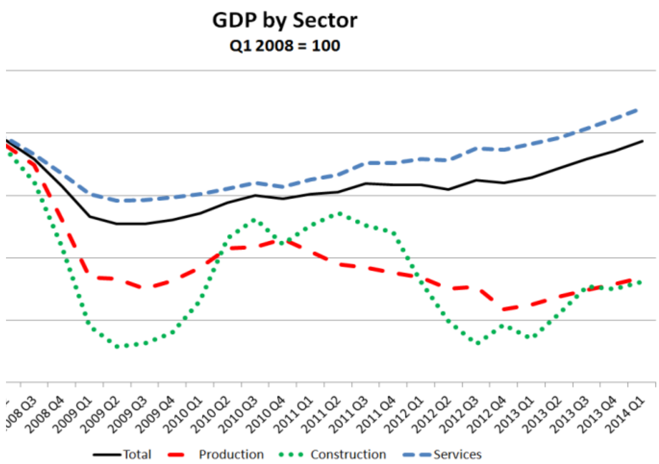
This quarterly TUC report provides an analysis of UK economic and labour market developments over recent months, and includes an extended feature on self-employment.

Summary

- GDP growth has been strong since the start of 2013.
- But GDP per capita is less impressive.
- And returning to the pre-recession peak is taking a long time.
- It is too early to raise interest rates to halt inflation.
- Employment continues to grow. This is in part due to very marked increases in self-employment.
- Average earnings continue to lag inflation.

Economy

GDP grew by 0.8 per cent in the first quarter of 2014; this was the fifth successive quarter of growth and GDP is now 3.1 per cent higher than in Q1 2013. Overall, GDP is now 0.6 per cent below its pre-recession peak and gross value added in services has already surpassed that mark. Construction and production, by contrast, still have some way to go, though it must be borne in mind that these sectors contribute much less to total GDP than services.



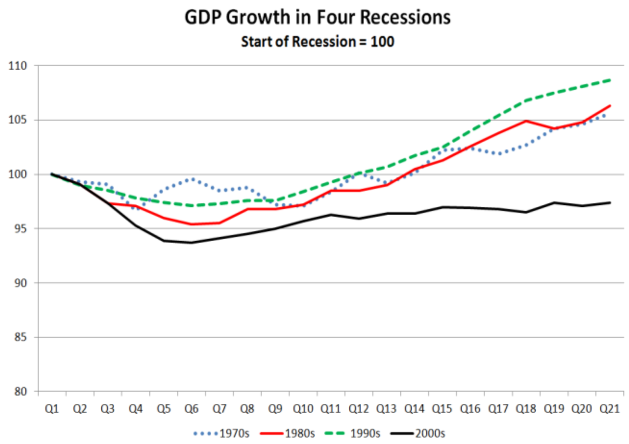
In the most recent quarter, construction and production (mainly manufacturing) grew, but the recovery over the past two years has overwhelmingly been a services phenomenon:

GDP and output by broad industrial grouping, UK, % change on previous quarter

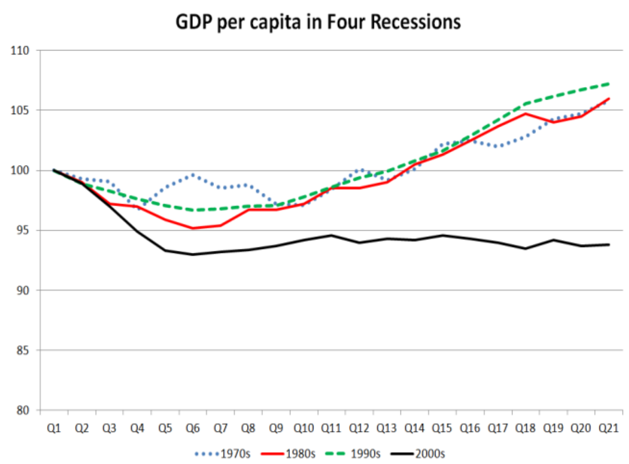
	GDP	Agric	Production	Construction	Services
2012					
Q1	0.0	-1.7	-0.4	-4.4	0.3
Q2	-0.4	-2.2	-1.0	-3.6	-0.1
Q3	0.8	-0.3	0.2	-2.1	1.0
Q4	-0.2	-0.2	-2.1	1.9	-0.1
2013					
Q1	0.4	-4.8	0.4	-1.3	0.5
Q2	0.8	2.0	0.7	2.3	0.5
Q3	0.8	0.4	0.6	2.6	0.7
Q4	0.7	0.2	0.5	-0.2	0.8
2014					
Q1	0.8	-0.7	0.8	0.3	0.9
Q1 12 – Q1 14	**3.7**	**-7.3**	**-0.3**	**-4.5**	**4.5**

As services account for more than three quarters of the economy, the growth of services output completely outweighs the other industries. In the most recent quarter, 0.7 points of our recent 0.8 percentage point growth is the effect of services.

Compared to previous recessions, this recovery is still very protracted. The recoveries from the 1970s, 1980s and 1990s recessions took GDP past its pre-recession peak in around three years.



Furthermore, much GDP growth is simply a matter of a growing population. Real GDP per capita has hardly grown at all since 2009 and on this measure the contrast with previous recessions is even more marked.



Finally, when UK GDP per capita is compared with other major industrialised democracies, our performance is average, not remarkable. If we compare changes between 2008 and 2014 in GDP per capita, the UK has nowhere near done as well as the genuinely impressive performances of the USA, Canada and Germany:

GDP per capita, per centage change, 2008 - 2014

Country	Change
USA	13.81
Germany	7.87
Canada	7.26
Japan	0.73
UK	**-0.68**
France	-1.45
Italy	-8.37

$US, current prices, source: IMF *World Economic Outlook* database

In its most recent *World Economic Outlook*, the International Monetary Fund forecast that the UK would have the fastest growing economy in the G7 in 2014. In January they had forecast 2014 growth at 2.4 per cent, this forecast was raised to 2.9 per cent and 2.5 per cent in 2015. However, the IMF also suggested that UK growth was unbalanced, with too little investment and exports very weak.

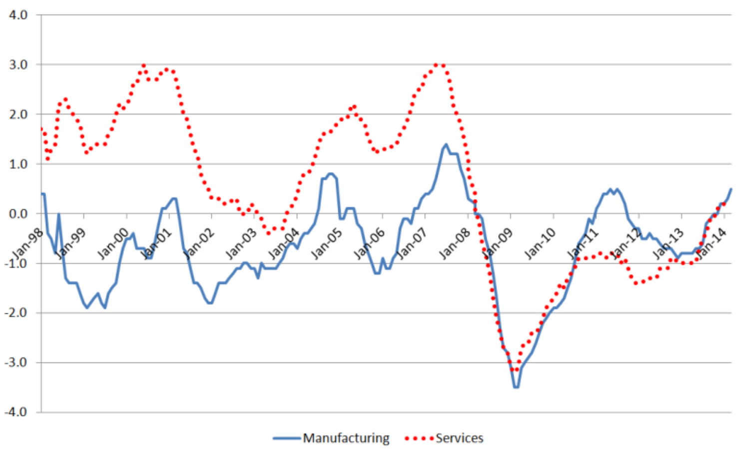
The OECD’s Composite Leading Indicators (not so much forecasts, as measures designed to show when economies may be at a turning point) showed growth at about trend levels in most developed countries (with a “positive change in momentum” in the Euro area) and in the UK above trend but “tentatively losing momentum”, with a slight downturn after nearly two years of accelerating growth.

A key question is whether the current rate of growth is sustainable. The Office for Budget Responsibility, in their most recent *Economic and Fiscal Outlook*, revised up their forecast for growth in 2014, from 2.4 to 2.7 per cent, but they hardly changed the forecast for 2015 (raising it by just 0.1 point) and left forecasts for 2016 and 2017 unchanged. In the Bank of England’s latest *Inflation Report*, GDP growth is expected to peak at about 3.5 per cent and then slow down in the second half of 2014 before stabilising at 2.5 to 3.0 per cent through to mid-2017. The OBR explicitly links this to their judgement that the output gap (the gap between the level of demand and the economy’s capacity to meet that demand) is smaller than they believed last year.

If this is correct, the economy's ability to continue growing without inflation accelerating is more limited than previously believed. Some commentators have already argued that rising employment levels and some tenuous signs of wage recovery indicate that inflation is a real threat and have called for interest rate rises to "head off" the threat.

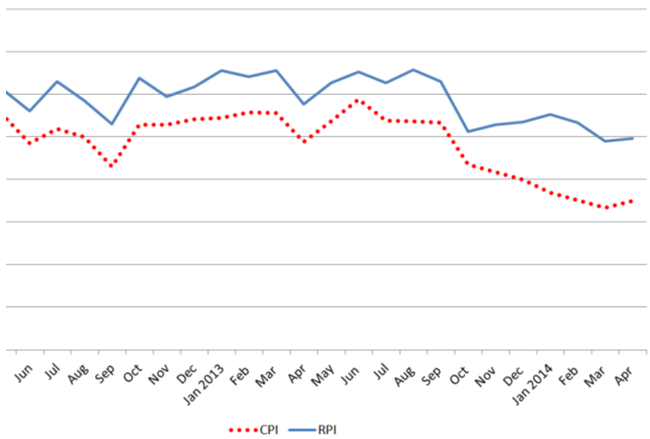
This is likely to be an over-reaction. Employment levels are high, but the working age population has risen too, making unemployment a better indicator of labour market slack. The number of unemployed people in the latest Labour Force Survey figures was 549,000 higher than the pre-recession peak. There are still 3.7 unemployed people for every job vacancy – a ratio half as high again as that which pertained before the election. And the level of underemployment suggests continuing under-use of resources, with 1.4 million people in part-time jobs who say their first choice would have been full-time – 700,000 higher than the typical pre-recession level. The results of the Bank of England's agents' monthly reports on whether businesses around the country believe capacity constraints are getting worse or better also indicate that we are a long way short of the problems experienced previously:

Capacity Constraints



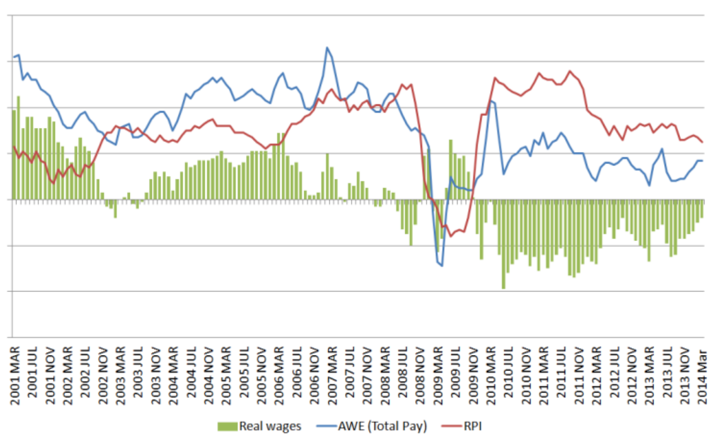
Most importantly, inflation does not show any sign of taking off. Whether we use the Retail Price Index (RPI, normally used in pay negotiations) or the Consumer Price Index (CPI, the government's preferred measure) inflation is low and lower than it was two years ago:

Inflation Over the Past Two Years



But despite low inflation the squeeze on living standards continues. Despite the brief press interest when the figures for average weekly earnings showed a rate of increase slightly higher than inflation as measured by the CPI, in the latest figures, earnings again fell below inflation on this measure and even further below inflation measured by the RPI. Earnings continue to fall in real terms, indicating that the main cause of the living standards crisis is low wage increases, not high inflation.

Real Pay Increases



Labour market

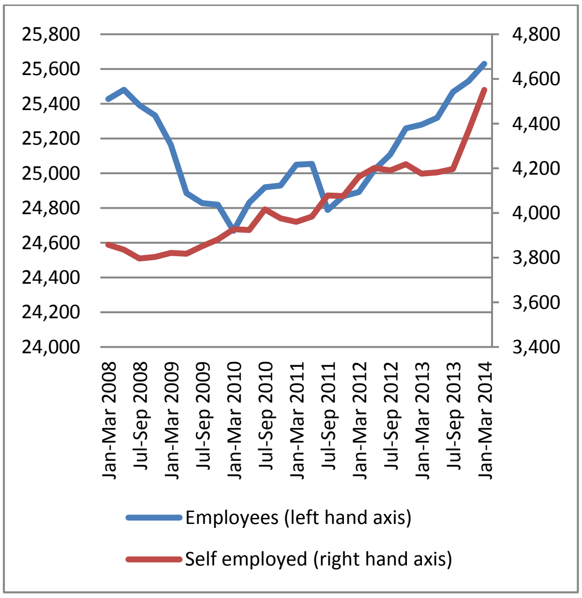
The latest labour market statistics show that the improvements in the labour market that began a year and half ago are continuing. The unemployment rate is at 6.8 per cent and the unemployment level fell by 133,000 to reach 2.21 million. This is the lowest since early 2009. Employment grew by another 283,000 and the employment rate is also recovering; it currently stands at 72.7 per cent, close to the pre-recession level of 73 per cent. Vacancies are also just below their pre-recession level, there are 628,000 job vacancies compared to 696,000 in 2008.

Beyond these headline figures are concerns are that: the rise in employment has been in insecure low-paying self-employment work; there is still a huge living standards gap to make up; and that it is still premature to say that a labour market recovery has taken place. The Bank of England in its recent *Inflation Report* also acknowledged that 'significant slack remains in the labour market.'[1]

Self-employment

The most recent labour market statistics show that of the 283,000 increase in employment, 183,000 is in self-employment and 99,000 is in employee jobs (of which 33,000 are in temporary work). The rise in employment has continued to be driven by self-employment, which is extraordinary as self-employment is a relatively small part of UK jobs market. Although just one in seven workers are self-employed, over half of all jobs growth over the year has been in this type of work.

Employee v self-employment numbers 2008-2014

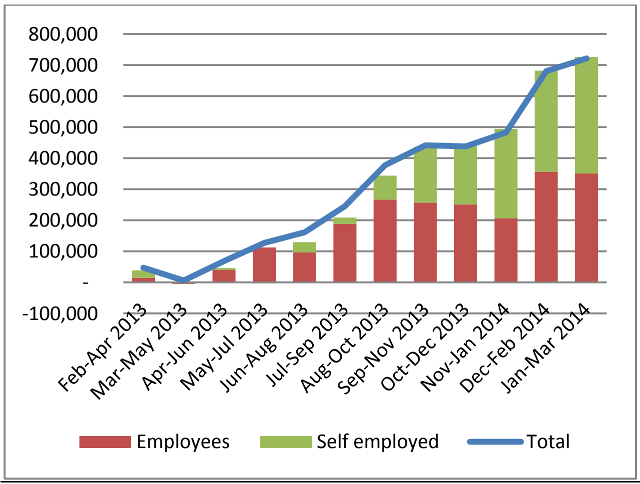


While the number of employees has only just reached pre-recession levels, the story with self-employment has been very different. The growth in self-employment is both a recent phenomenon and a continuation of a longer term trend. Numbers have been rising since the early 2000's; in early 2001 there were 3.28m self-employed, by the end of 2007 this had reached 3.82m. After the downturn, however, self-employment accelerated to reach its current level of 4.56m.

There have been several phases in the rise in self-employment since the onset of the recession. At the beginning of the downturn self-employment fell on a small scale, followed by an increase towards the end of 2009. Over the same period employee jobs declined dramatically, with self-employment cushioning overall employment falls. From mid-2011 while self-employment continued to increase it played a less important role in job creation as the number of employee jobs began to rise faster than the self-employed. But the latest twist is that over the last year, while employment increased by 722,000, the number of employees increased by 351,000 a (one per cent rise) and the number of self-employed has increased far more sharply by 375,000 (a nine per cent rise).

The graph shows us in more detail at what has been happening in the last year; there is a sharp rise in self-employment particularly over the last six months.

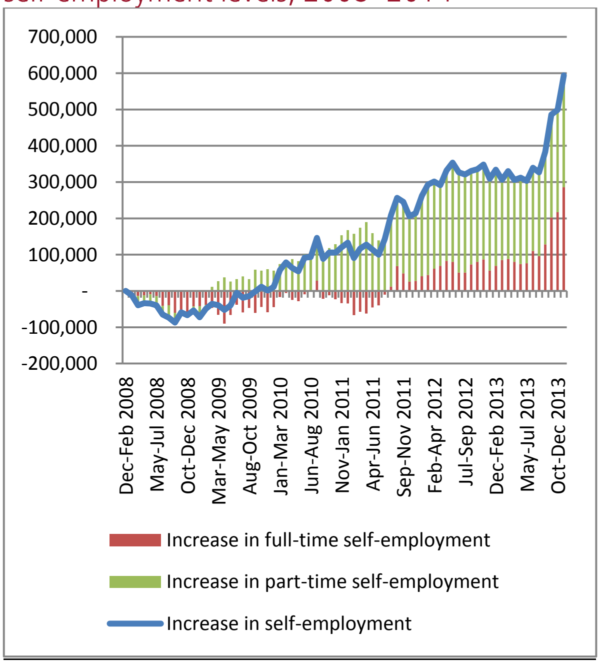
Change in employee and self-employed 2013-2014



Previous TUC analysis of self-employment has shown that self-employed workers often earn less, are more likely to be underemployed and have less job security than employees. What is more, since early 2008, 53 percent of the increase in self-employment has been in part-time self-employment.

This could be down to choice, with women trying to fit work in around care commitments or the older population choosing to do so by easing themselves into retirement. However, it could be that the self-employed have moved into part-time work due to the limited availability of full-time work. Evidence for this includes the fact that, since early 2008, there has been a 5% increase in part time employees compared to a 39% increase in part time self-employment.

Change in full-time and part-time self-employment levels, 2008- 2014



Analysis by the Resolution Foundation[2] also shows that currently the self-employed are slightly more likely to be underemployed than employees, which is a reversal of the pre-2005 picture when this group were highly over-employed compared to employees.

Recent Resolution Foundation[3] research also found that earnings from self-employment fell by a fifth between 2006 and 2010, while official figures published by Parliament[4] found that the average annual income from self-employment is less than £10,000 for women. Recent figures from Citizens Advice[5] also suggested that self-employed workers are as likely to have debt problems as unemployed people.

When being self-employed allows those who have always wanted to be their own boss to start their own business, or when it means that workers with a great business idea are able to realise it (and take on the risks associated with it), then self-employment can be a fantastic opportunity. But the TUC's concern is that some people have been forced into self-employment as they have no alternative.

Recent TUC analysis also shows that the number of people starting their own businesses has fallen in recent years, in spite of rising self-employment. The biggest growth areas of self-employment since mid-2010 have been people working for themselves (up 232,000), freelancing (up 69,000) or sub-contracting (up 67,000).

In contrast, the number of self-employed people who either run a business, or are a partner or sole director in one (positions usually associated with entrepreneurship) has actually fallen by 52,000. These figures show that rising self-employment is part of a wider shift towards insecure employment, rather than as a result of a growing number of people starting up new companies.

Some self-employment is of course a good thing, but debate and discussion around the nature of the current rise in self-employment looks set to continue for some time to come.

Involuntary temporary and part-time work also remain significant; since 2008 they have risen by 66% and 103% respectively. And new analysis by the ONS of zero-hour contracts shows the scale of insecure work. There are 1.4m such contracts - or 2.7 million if the 1.3 million contracts where people are reported as doing no work over the two week time period used for analysis are included.

The table below shows the change in the composition of the workforce from 2008-2014; it shows that full-time employee jobs have still not quite reached their pre-recession levels despite rising employment levels.

Composition of workforce, 2008-2014

	Jan-Mar 08 (000s)	Dec-Feb 14 (000s)	Change (000s)	Change (%)
Employees	25,428	25,630	202	0.8
Self- employed	3,858	4,551	693	18.0
Total part-time	7,522	8,177	655	8.7
Employees full-time	18,991	18,901	-90	-0.5
Employees part-time	6,437	6,729	292	4.5
Self-employed full-time	2,930	3,259	329	11.2
Self-employed part-time	928	1,292	364	39.2
Involuntary Temporary Work	359	594	235	65.5
Involuntary Part-time	701	1,421	720	102.7

Regional/nation variations

In this quarter, the employment rate increased in all areas with the exception of the South East and Wales. The unemployment rate fell in all areas with the exception of the North East.

Employment – rates and levels by region/nation

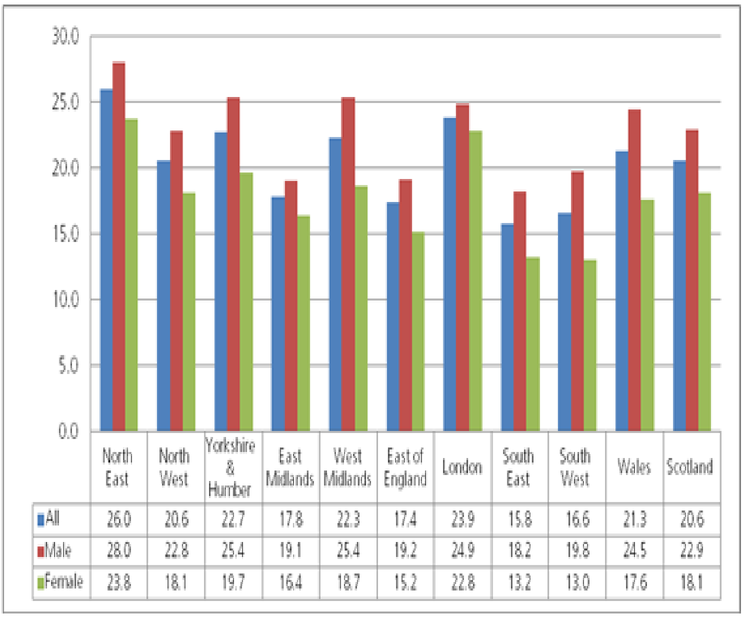
	Jan March 2014		Change over quarter	
	Aged 16+	Aged 16-64	Aged 16+	Aged 16-64
Region/Nation	Level	Rate (%)	Level	Rate (%)
North East	1,204	69.2	30	1.7
North West	3,204	69.8	58	1.2
Yorkshire & Humber	2,554	71.5	13	0.3
East Midlands	2,181	73.0	15	0.5
West Midlands	2,502	70.1	16	0.9
East of England	2,987	76.3	27	0.6
London	4,040	71.8	39	0.6
South East	4,364	76.2	2	-0.4
South West	2,630	76.0	71	1.4
Wales	1,369	70.0	-18	-0.8
Scotland	2,585	73.5	29	0.7
Northern Ireland	810	67.8	2	0.2
United Kingdom	30,430	72.7	283	0.6

Unemployment rates and levels by region/nation

	Jan March 2014		Change over quarter	
	Aged 16+	Aged 16+	Aged 16+	Aged 16+
	Level	Rate (%)	Level	Rate (%)
North East	135	10.1	5	0.1
North West	266	7.7	-11	-0.4
Yorkshire & Humber	230	8.3	-10	-0.4
East Midlands	155	6.6	-6	-0.3
West Midlands	213	7.8	-13	-0.5
East of England	171	5.4	-9	-0.3
London	334	7.6	-17	-0.4
South East	228	5	-6	-0.1
South West	136	4.9	-41	-1.6
Wales	100	6.8	-5	-0.3
Scotland	178	6.4	-18	-0.7
Northern Ireland	63	7.2	-1	-0.1
United Kingdom	2,209	6.8	-133	-0.4

While there has been a fall in youth unemployment of 48,000, the national youth unemployment level conceals significant regional differences. The latest available data by region show that in the North East the youth unemployment rate stands at 26% and male youth unemployment is a staggering 28%.

Youth unemployment by regions/nations Jan 2013- Dec 2013

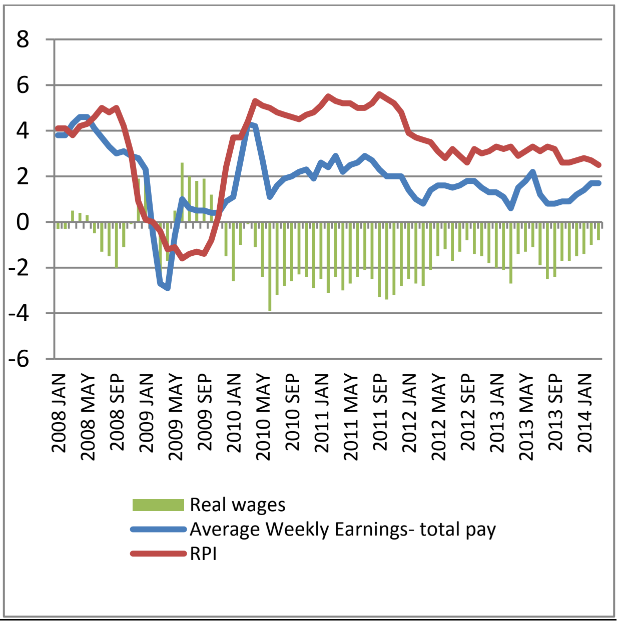


Pay

Pay is another area of substantial concern. Is the wage squeeze really over? Definitely not if we measure inflation by the Retail Prices Index (RPI), which is far more commonly used than the Consumer Prices Index (CPI)in pay bargaining; by this measure real pay is still falling.

While CPI inflation (which excludes housing costs) has fallen to 1.8 per cent, RPI inflation is currently at 2.5 per cent. Although mortgage rates may be low, house prices are rising sharply and in many areas rents are rising too, with particularly substantial rises in London. Particularly in this context it is questionable whether a measure which excludes the cost of housing can really be considered an accurate means to assess living standards.

Average Weekly Earnings, RPI and Real Wages 2008 -2014



But even using the CPI measure (the government's preferred measure), earnings growth only returned briefly when using the 'total pay' measure of 1.7 per cent (which includes bonuses). If 'regular pay' is used, a more appropriate series given that most people do not receive bonuses, earnings are only rising by 1.3 per cent. A real earnings squeeze is still very much in place.

In addition, public sector workers are largely subject to a 1 per cent pay cap, most social security benefits (including tax credits for working families) are capped at 1 per cent, and the growing number of self-employed (whose earnings are likely to be lower than average) are not even included in these wages figures.

Real earnings are at best stagnating and still falling for many. It will be years before living standards even return to where they were in 2008. The Office for Budget Responsibility (OBR) has estimated that real incomes will not return to their 2009-10 levels until 2018 at the earliest.

Notes

[1] The Bank of England Inflation report is available at www.bankofengland.co.uk/publications/Pages/inflationreport/2014/ir1402.aspx

[2] The Resolution Foundation report that includes this analysis is available at www.resolutionfoundation.org/publications/just-job-or-working-compromise-changing-nature-sel/

[3] The Resolution Foundation report that includes data on earnings from self-employment, is available at www.resolutionfoundation.org/publications/state-living-standards

[4] The House of Commons figures on income from self-employment are available in column 758W at http://www.publications.parliament.uk/pa/cm201314/cmhansrd/chan130.pdf

[5] The Citizens Advice figures are available at www.citizensadvice.org.uk/index/pressoffice/press_index/press_20140319.htm