

The UK economy

Overview

Once again there has been a weakening of the world economy in the first quarter of this year. The UK however has done relatively well although growth is down slightly. The economy is forecast to return to trend growth in 2004. Inflation is not a significant threat to the economy and some commentators are more concerned with deflation. The Bank of England wisely left interest rates at 3.75 per cent allowing them room for further manoeuvre if the economy and in particular manufacturing does not recover sufficiently in the latter half of 2003. The UK labour market continues to perform well with a steadily rising employment rate and low unemployment. The government has stood by the Treasury assessment on the Euro stating that the time is not right with two of the five tests yet to be satisfied.

UK real GDP growth is forecast to be 1.9 per cent in 2003 and 2.3 per cent in 2004. Consumption and government spending will remain important components of demand and investment is forecast to recover in 2004. As previously forecast unemployment is expected to remain at low levels with steady employment growth during the year. Full recovery is forecast for 2004 and the outlook for the UK economy is good.

Outlook

Table 1 contains the consensus forecasts for the main UK economic indicators taken from a monthly survey by HM Treasury of City and other independent forecasters. UK GDP growth is forecast to be 1.9 per cent in 2003 and 2.3 per cent in 2004, which is similar to the last quarter. There is a slight downward revision to the GDP forecast, inflation remains on target and this has been helped by the small decline in oil prices and the slowing of growth in the housing market. As in the previous QEC unemployment is forecast to remain at very low levels and for the first time this year the new medium-term consensus forecasts from HM Treasury demonstrate that forecasters believe that claimant count will remain below one million over the period of the forecast. Employment growth is slow but steady, which is an encouraging sign for the economy. The current account is expected to remain in deficit by about one per cent of GDP in the short-run. There is conflicting data over the current budget with the Treasury projecting a deficit of £11.7 billion for 2002 returning to surplus by 2006. Other organisations are less optimistic and do not assume that tax revenues will be so strong resulting in a larger deficit in 2006-07. This means that the PSNB is likely to be closer to 3.0 per cent of GDP (£42 billion) in the medium-term as opposed to the Treasury estimate of 1.7 per cent of GDP (£22 billion) in 2006-07.

Table 1: Independent forecasts of the UK economy

	2002	2003	2004	2005
Real GDP growth (%)	1.6	1.9	2.3	2.2
Inflation rate (RPIX %)	2.6	2.5	2.2	2.2
Unemployment (claimant count, million)	0.95	0.94	0.96	0.98
Employment growth (%)	0.2	0.1	0.2	0.3
Current account (£ billion)	-16.0	-17.4	-18.4	-19.6
PSNB (£ billion)	20.7	28.5	31.1	31.7

Source: National Statistics and "Forecasts for the UK economy", HM Treasury, May 2003.

UK macroeconomic trends

Output growth

GDP grew by 0.2 per cent in the first quarter of 2003 compared to a 0.4 per cent rise in the previous quarter. Growth in the same period last year was only 0.1 per cent. Over the year to the first quarter 2003 GDP growth was 2.2 per cent at market prices. GVA at basic prices increased by 2.0 per cent over the same period.

During the first quarter sectoral output declined in most sectors of the economy with the exception of services. The largest fall was in electricity, gas and water supply where output declined by 3.5 per cent on a quarterly basis but grew by 0.4 per cent on an annual basis. This was the only non-service sector to register positive annual growth. The decline in manufacturing was only 0.1 per cent for 2003 Q1 on 2002 Q4 and this may be a further sign that manufacturing is beginning to recover. Construction still demonstrates strong annual growth of 7.1 per cent with growth of 2.1 per cent over the quarter. Service sector growth was 2.6 per cent on an annual basis but only 0.3 per cent during the quarter. The strongest performers in UK services are transport, communications and storage services growing at 2.9 per cent over the year (0.4 per cent for the last quarter) and business and financial services increasing at 2.9 per cent on an annual basis compared to 0.3 per cent on a quarterly basis. Distribution, hotels and catering output increased by 2.7 per cent over the year (but only by 0.2 per cent over the quarter). Clearly services are still driving growth in the UK economy and this will have knock-on effects for employment and income.

Components of demand

Consumption increased by 3.4 per cent on an annual basis in 2003 Q3 and by 0.4 per cent during the quarter. Government spending rose but only by 1.5 per cent on an annual basis and by 1.4 per cent for 2003 Q1 on 2002Q4. Investment grew by 1.0 per cent over the year but declined by 0.1 per cent on a quarterly basis. Inventories were in a similar

position in 2003 Q1 as they were in 2002 Q4. Exports declined by 0.8 per cent over the year but remained flat over the quarter. Imports however grew by 2.5 per cent over the year and by 0.7 per cent for 2003 Q1 on 2002 Q4. This will widen the trade gap.

The CBI distributive trades' survey of retailer sales balances has increased since April while the Nationwide house price index was unchanged in April. The Halifax house price index increased by only 0.4 per cent in April. The GfK consumer confidence headline balance rose to -5 in April from -10 in March. The BCC manufacturing sector optimism balance was largely unchanged but some surveys indicated a decline in future profitability e.g. the CBI Quarterly Industrial Trends survey. Overall there is mixed evidence in the surveys and this may be a further indication that manufacturing is poised to recover later this year and into next year. The Chartered Institute of Purchasing (CIPS) survey indicates, despite an increase in the orders balance overall the index remains below the crucial 50, the dividing line between an expansion and contraction of orders.

We are forecasting that the UK economy will perform well in the short-run but will not achieve the growth levels seen in some parts of the global economy. Low and stable inflation is more likely to assist growth rather than contribute to

deflation as some commentators suggest (although deflation is a possibility elsewhere in the global economy).

Inflation

The concerns expressed over inflation in the previous QEC have been avoided with a short Gulf War and a quick decline in oil prices. The oil price has not fallen as significantly as most commentators thought it would but it is expected to fall slightly further. The RPI increased to 181.2 in April from 179.9 in March. In the year to April all items in the RPI increased by 3.1 per cent (unchanged from March). RPIX increased from 178.7 to 180.0 or an increase of 3.0 per cent (again unchanged from March). The Bank of England will be switching its target from RPIX to harmonised index of consumer prices (HICP) (as stated in the Chancellors letter of 9th June). The HICP increased by 1.5 per cent over the past twelve months to 109.7 compared to an increase of 1.6 per cent in the last twelve-month period.

Interest rates have been kept at 3.75 per cent and this allows for the Bank of England to make a further cut (if appropriate) at a later date if the economy requires a further stimulus. If the rates are cut too early then we may find ourselves in a situation where policy is ineffective in addressing the problems of the economy. The US and Japan have very little room for policy adjustment having brought interest rates down to such a low level.



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The labour market

The UK labour market continues to perform well and this is demonstrated by the following:

- 7 the employment rate was unchanged at 74.6 per cent (27,900,000 in employment in Feb-Apr) 2003, a rise of 51,000 on the quarter or 242,000 over the year;
- 7 unemployment stood at 1,495,000 or 5.1 per cent on the ILO measure, a rise of 36,000 on the quarter but a decline of 11,000 over the year;
- 7 the economically active stood at 29,361,000 or 78.6 per cent, a rise of 87,000 on the quarter and by 231,000 over the year;
- 7 the claimant count was 950,800 (3.1 per cent) in May 2003 compared to 941,000 in the previous month. The rate remains unchanged however;
- 7 the number of workforce jobs in March 2003 was 29,602,000 and was up by 45,000 over the quarter and
- 7 employee jobs declined from 25,829,000 in December 2002 to 25,784,000 in March 2003 but self-employment and government training places increased over the same period.

Over the year agriculture and fishing (-36,000), energy and water (-12,000), manufacturing (-125,000) and finance and business services (-22,000) are the main sectors that have seen significant job losses. The main job gains were in public administration (157,000), distribution hotels and catering (66,000) and construction (53,000). Services expanded by 208,000 jobs whereas the total change in workforce jobs over the year was 88,000.

Full-time working declined from 20,730,000 in Nov-Jan to 20,662,000 in Feb-Apr. There was a rise in full-time working of 28,000 over the year however. Part-time working expanded by 120,000 over the quarter from 7,085,000 to 7,205,000 in Feb-Apr. The increase over the year is 214,000. Full-time employees are the only category to have a significant reduction in numbers working over both the quarter and the year.

Unemployment remains relatively low with the ILO rate increasing by 0.1 percentage points in the first quarter. Over the same period the male rate increased by 0.3 percentage points whereas the female rate declined by 0.1 percentage points. Unemployment over the year however fell significantly for all these groups.

The trend in the labour market is for a steady but slow rise in employment, stable and low unemployment and activity rates to continue to slowly increase.

Kenneth Low
13 June 2003

