

Article

# Quarterly economic commentary: April to June 2018

Economic commentary for the latest Quarterly National Accounts, prices and labour market indicators.

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Release date:  
28 September 2018

Next release:  
21 December 2018

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# 1 . Summary

- Real UK gross domestic product (GDP) is estimated to have increased by an unrevised 0.4% in Quarter 2 (Apr to June) 2018, although the incorporation of more comprehensive VAT turnover data has painted a weaker picture for construction output in Quarter 1 (Jan to Mar) 2018 leading to a downward revision of UK GDP growth to 0.1% from 0.2%.
- Households continue to be net borrowers in Quarter 2 2018, the seventh consecutive quarter in which households have had to borrow or run down their savings to finance their spending and investment, while the households' saving ratio remains low by historical standards at 3.9%.
- The current account deficit widened to 3.9% in Quarter 2 2018, although much of this reflects volatile movements in erratic goods (including non-monetary gold and aircraft), financed by net inflows of portfolio and direct investment.
- Compared to the same three months a year ago, nominal regular pay increased by 2.9% in the three months to July, while the unemployment rate fell to 4.0% over this period and the number of people in employment continued to pick up, albeit at its slowest pace since September 2017.
- The 12-month growth rate of the Consumer Prices Index including owner occupiers' housing costs (CPIH) increased slightly to 2.4% in the year to August, although this was driven predominantly by volatile components in the CPIH basket, such as recreation and culture and clothing and footwear and is not necessarily a sign of broader inflationary pressure.

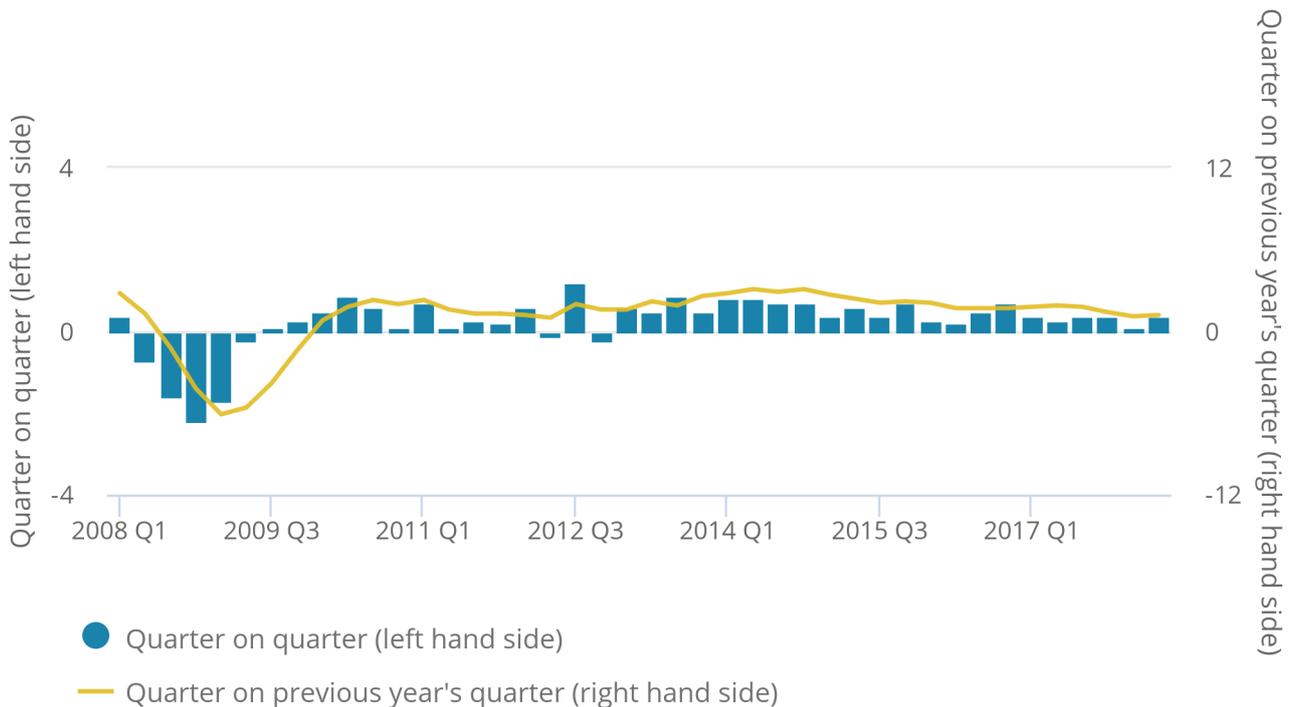
## 2 . Gross domestic product

UK Gross Domestic Product (GDP) increased by an unrevised 0.4% in Quarter 2 (Apr to June) 2018. This follows a soft patch earlier in the year, where the UK economy grew by a revised 0.1% in Quarter 1 (Jan to Mar) 2018 (Figure 1). This was driven by updated construction estimates, which is largely derived from the incorporation of Value Added Tax (VAT) turnover, where administrative information from approximately 85,000 businesses has now replaced data for 2,400 survey returns in the construction industry. Compared to the same quarter a year ago, the UK economy increased by 1.2% – revised down slightly from the previously published 1.3%. There is an underlying trend of slowing real GDP growth, as the UK economy grew by 0.5% in the first half of 2018 compared with the second half of 2017. This marks the weakest six-monthly growth since the second half of 2011. [More timely figures](#) are available on the UK economy, but these have not incorporated the revisions in the latest Quarterly National Accounts, so this is not covered here.

In the year to Quarter 2 2018, the implied GDP deflator increased by a revised 2.0%, up from the previous estimate of 1.7%. This was driven by an upward revision to the general government consumption deflator. This reflected updates to current price data for healthcare expenditure in Quarter 2 2017, resulting in a lower base. In contrast, volumes were largely unaffected as the output of healthcare consumed by patients are recorded directly, rather than the nominal figures being adjusted for price changes. Quarterly growth in the general government consumption deflator remains unrevised.

**Figure 1: Real GDP growth picks up to 0.4% in Quarter 2 (Apr to June) 2018, following growth of 0.1% in Quarter 1 (Jan to Mar)**

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**Source: Office for National Statistics**

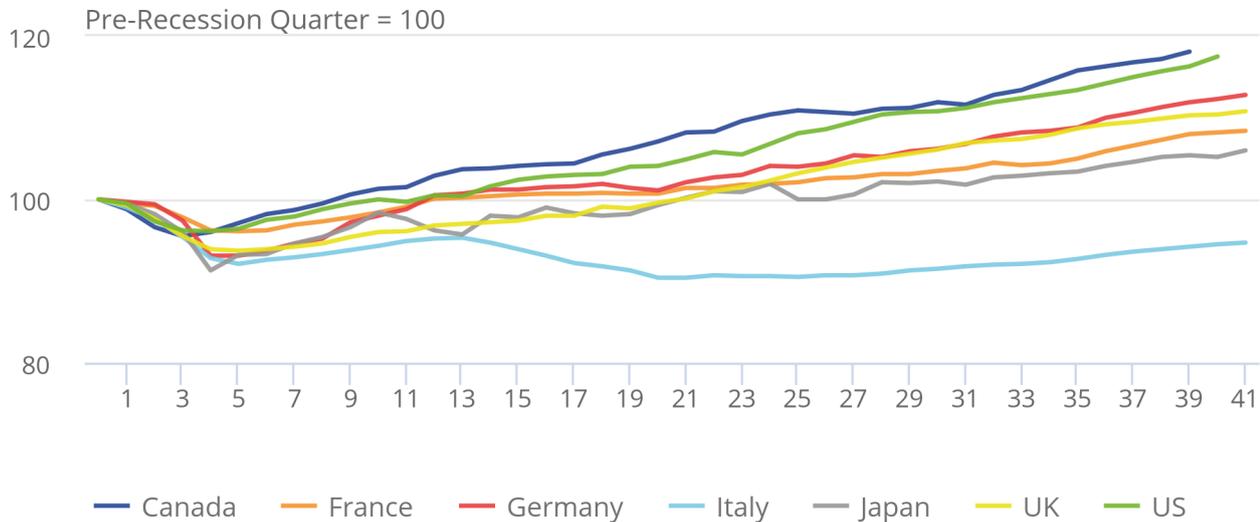
**Notes:**

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept), and Q4 refers to Quarter 4 (Oct to Dec).

The collapse of Lehman Brothers in September 2008 is widely considered to mark the start of the global financial crisis. Figure 2 shows the profile of the UK economy over the last 10 years, compared with the other G7 countries. The UK economy went into recession in Quarter 2 2008, with GDP falling by 0.7%, leading to a peak-to-trough fall of 6.3%, as output fell for five consecutive quarters through 2008 and 2009. It took over five years for the UK economy to recover to its pre-crisis levels and the latest estimates show that it is now 10.8% above that peak. Figure 2 highlights the global nature of the crisis, but also how the path of each recovery compares. Italy, Japan and Germany all experienced larger peak-to-trough falls in GDP, although the UK took the joint-longest to recover its pre-crisis levels of GDP along with Japan. Italy is excluded from this comparison, as it the only G7 economy to have not recovered to the size of its economy before the financial crisis.

**Figure 2: The evolution of the G7 economies since the Global Financial Crisis**

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Source: Office for National Statistics and Organisation for Economic Co-operation and Development

## Output

Construction output fell by a revised 1.6% in Quarter 1 2018, marking its weakest quarterly growth since mid-2012. It was previously highlighted that the adverse weather conditions earlier in the year had some impact on the construction industry. The incorporation of more comprehensive administrative estimates from VAT returns supports this view, with output falling by more than previously estimated. Latest figures show that there was a bounce back in construction output in Quarter 2 2018, which increased by 0.8%. There was evidence from business surveys that favourable weather in June had helped boost construction activity. For example, the latest Bank of England Agents' Summary of Business Conditions noted that recent dry weather had helped businesses "catch up on progress lost due to adverse weather-related disruption earlier in the year". The Construction Purchasing Managers' Index (PMI) for April 2018 also highlighted a recovery in construction activity following a snow-disrupted Quarter 1 2018, particularly for housebuilding but also in the commercial building and civil engineering sectors.

Manufacturing output fell by 0.7% in Quarter 2 2018 and has now fallen for two consecutive quarters, largely reflecting an easing in manufacturing export growth. The Bank of England Agents' Summary of Business Conditions reported that manufacturing export volumes growth eased in Quarter 2 2018, but "remained firm and outpaced growth for the domestic market". The latest [Bank of England Agents' Summary of Business Conditions](#) reports that domestic output growth is reported to have eased slightly into Quarter 3 2018 but that it remains above trend. The headline Manufacturing PMI for August reported its lowest figure in over two years, with a marked slowdown in export orders. The latest Confederation of British Industry (CBI) Industrial Trends Survey reports that manufacturing growth slipped in September to a four-month low, but remains above its historical rates.

Growth in the services industries increased by a revised 0.6% in Quarter 2 2018, following relatively subdued growth of 0.3% in Quarter 1 2018. The quarterly revision was primarily driven by accommodation and food services, reflecting the incorporation of VAT turnover data up to Quarter 1 2018. This revised up the level of growth in March and impacted on growth in subsequent periods. Retail trade was one of the areas identified as being affected by the adverse weather earlier in the year, with volumes falling by 0.3% in Quarter 1 2018. This was driven by a sharp decline in petrol sales, partly offset by a boost to online retail spending. The retail industry bounced back in Quarter 2 2018, with output rising by 2.0%, driven by buoyant food and drink sales as consumers took advantage of the warm weather and World Cup celebrations. This is in line with external surveys such as the British Retail Consortium's Retail Sales Monitor which attributed the boost in demand for items such as beer, barbecues and summer clothing to these two factors, as well as the two Bank Holidays and the Royal Wedding.

## Expenditure

Household consumption was relatively subdued in 2017, as households faced an inflationary squeeze on incomes following the fall in the exchange rate. Household consumption growth slowed to 0.4% in Quarter 2 2018, reflecting a slowing in housing expenditure. This was in part due to a fall in energy use following the adverse weather earlier in the year. Growth was revised up to 0.5% in Quarter 1 2018, primarily due to the incorporation of additional survey data and changes to the forecasting method for health insurance. More timely figures available on retail sales shows that these have continued to strengthen, increasing by 2.0% in the three months to August. Much of the pick up earlier in the summer may have been attributed to the heatwave and the World Cup, though the continued momentum through to August provides some evidence of a broader pick up.

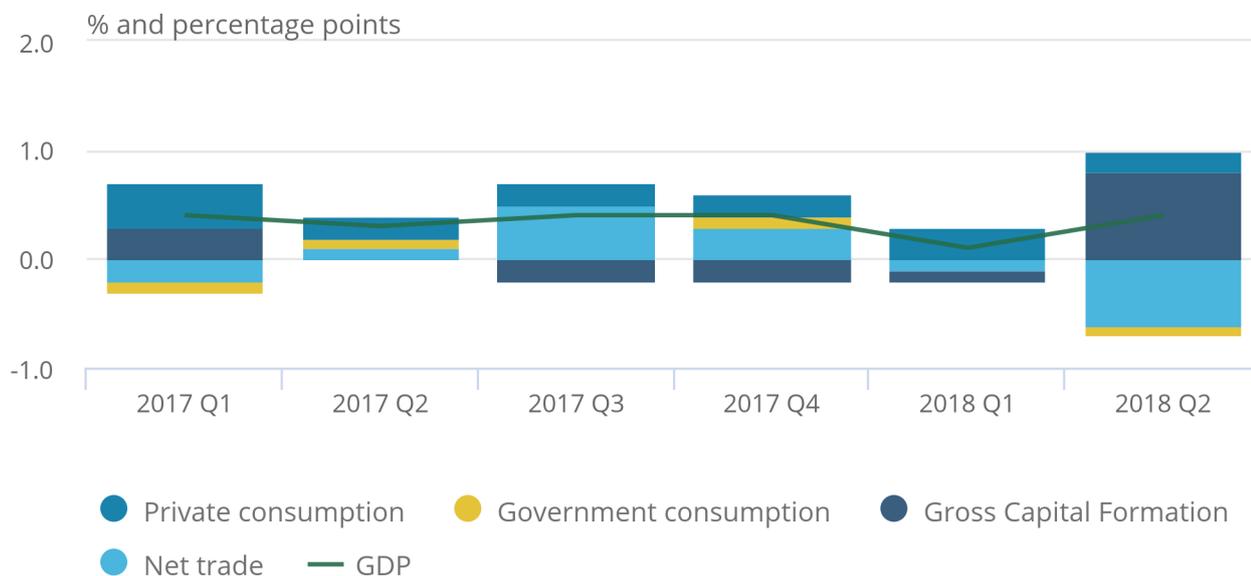
Gross fixed capital formation is estimated to have fallen by 0.5% in Quarter 2 2018, revised down from a rise of 0.8%. Business investment fell by a revised 0.7% in Quarter 2 2018 and has now fallen in each quarter of the year so far. This revision was driven by the receipt of additional survey data, that brought the response rate into line with that which is typically observed for the Quarterly National Accounts. This marks the fourth consecutive slowing of business investment growth. While external surveys suggest that this recent weakness may at least in part reflect uncertainty around Brexit, investment intentions appear to remain modestly positive. Private dwelling investment was revised up in Quarter 2 2018 to a rise of 2.4%, while general government investment was revised down to 1.3%. This reflected updated figures from central government and local authorities. Gross capital formation – which also includes changes in inventories and net investment of valuables – was the largest contribution to GDP growth. However, this is largely due to a sharp rise in non-monetary gold (NMG), which is recorded within the UK National Accounts as a change to valuables. An equivalent but offsetting impact is recorded within trade in goods and services, such that the impact of NMG on headline GDP is neutral (Figure 3). The increase in gross capital formation also reflects the application of an alignment adjustment to changes in inventories.

General government consumption fell by 0.4% in Quarter 2 2018, primarily reflecting a decrease in other consumption by central government (which includes items such as public administration and water and waste management services). Growth in government consumption has been revised since the previous estimate of a rise of 0.4%, driven by the receipt of additional monthly outturn data.

Net trade made a negative contribution of 0.6 percentage points to GDP growth in Quarter 2 2018, though some of this reflects the aforementioned movements in NMG. There have been revisions to the quarterly growth profile for both exports and imports throughout 2017 and 2018, which primarily reflect updated estimates from HMRC and the International Trade In Services (ITIS) survey. Total export volumes are now estimated to have fallen by 2.2% in Quarter 2 2018. The fall in goods exports was due to machinery and transport equipment (mainly cars), which fell by 5.0% – the sharpest quarterly fall since Quarter 2 2011 – and is consistent with the fall in manufacturing output.

**Figure 3: Household consumption eases slightly in Quarter 2 (Apr to June) 2018, while there are downward revisions in total investment**

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Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept), and Q4 refers to Quarter 4 (Oct to Dec).
2. Private consumption is the sum of household consumption and non-profit institutions serving households (NPISH) consumption.

## Income

Nominal GDP grew by 0.8% in Quarter 2 2018, revised up from 0.7%. This was driven by upward revisions to both Compensation of Employees (CoE) and Gross Operating Surplus (GOS), and was partly offset by a downward revision to other income. Growth in CoE was revised up despite a downward revision to the level of CoE in Quarter 2 2018. This is because there was a larger downward revision to its levels in Quarter 1 2018. This reflected downward revisions to employers' social contributions mostly offset by upward revisions to wages and salaries. This resulted in an upward revision to growth in Quarter 2 2018. CoE growth is now estimated to have slowed to 0.7% in Quarter 2 2018, marking the second consecutive slowing in quarterly CoE growth.

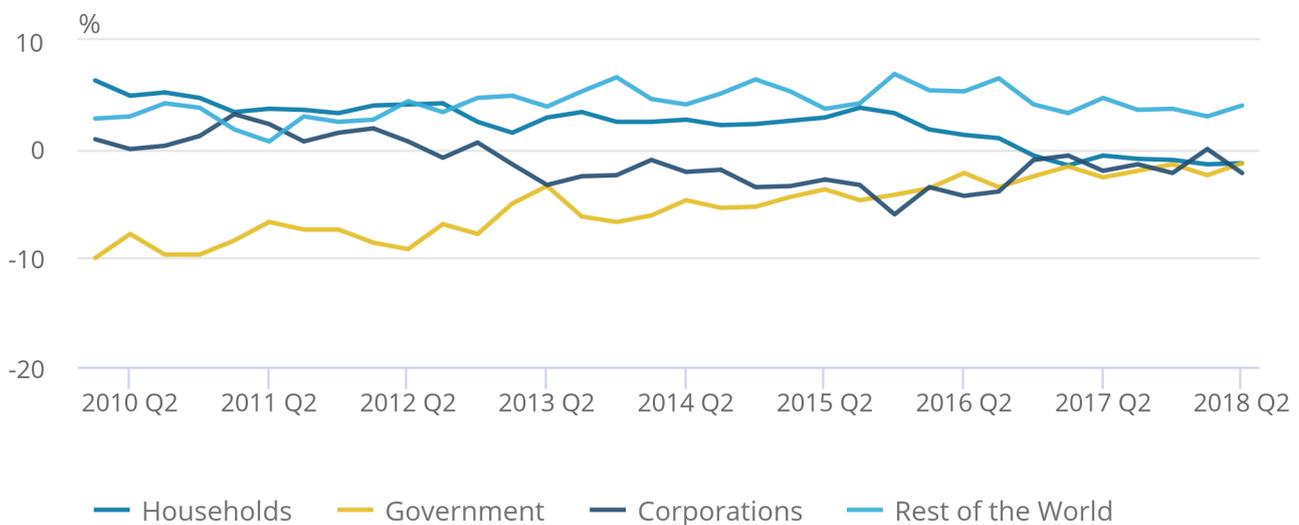
Other income growth also slowed, but contributed positively to growth, in Quarter 2 2018. Meanwhile, GOS contributed negatively to nominal GDP growth for the first time since Quarter 2 2017. However, this largely reflects the application of an alignment adjustment in the calculation of profits for private non-financial corporations.

### 3 . Sector and financial accounts

Figure 4 shows the net lending or borrowing positions of households, corporations, government and the rest of the world. These must sum to zero, as total borrowing must be matched by total lending. The rest of the world continues to be a net lender to the UK, with each of these domestic sectors being net borrowers in Quarter 2 (Apr to June) 2018. The net borrowing position of households in Quarter 2 2018 was equivalent to 1.3% of gross domestic product (GDP) for households, 2.2% for corporations and 1.3% for government.

**Figure 4: Households, corporations and government are all net borrowers in Quarter 2 (Apr to June) 2018**

Figure 4: Households, corporations and government are all net borrowers in Quarter 2 (Apr to June) 2018



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept), and Q4 refers to Quarter 4 (Oct to Dec).
2. Corporations is the sum of PNFCs and financial corporations, and Households include household and NPISH.

Households have traditionally been a net lender, but recent trends highlight how households have increasingly become net borrowers. This is the seventh consecutive quarter in which households have had to borrow or run down their savings to finance their spending and investment, which remains unprecedented. This is also reflected in the households' saving ratio, which has been on a downward trend in recent years reaching a record low of 4.2% in 2017. The latest figures show a saving ratio of 3.9% in Quarter 2 2018, marginally up on the previous quarter. This was mainly due to growth in accumulation of pension entitlements and wages and salaries outpacing growth in household consumption. There were also downward revisions to the saving ratio in Quarter 1 (Jan to Mar) 2018, from 4.1% to 3.6% – the second lowest on record (Figure 5) – reflecting both downward revisions to pensions accumulations and upward revisions to household consumption expenditure. More timely figures show that consumer credit growth remains elevated, although the latest Bank of England figures show a slowing to 8.5% in the year to July, reflecting a fall in both credit card and other types of lending (including personal loans, overdrafts and car finance). This is the slowest rate since November 2015, although these figures can be a little volatile.

Real household disposable income (RHDI) increased by 0.4% in Quarter 2 2018. This was a slowing from the upwardly revised 0.7% in Quarter 1 2018, which was mainly due to upward revisions to wages and salaries. This reflected updated public sector estimates and alignment to comparable labour market data. The effect of inflation on RHDI was less marked in Quarter 2 2018, as the impact of the fall in exchange rate became less pronounced on the rate of price changes compared to a year earlier. However, this was more than offset by a slowdown in wages and salaries and net social benefits and contributions.

**Figure 5: The households' saving ratio remains low by historical standards**

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Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept), and Q4 refers to Quarter 4 (Oct to Dec).

There was a sharp increase in the net borrowing of corporations in Quarter 2 2018, which increased from 0.1% to 2.2% of gross domestic product (GDP), reflecting increased net borrowing by private non-financial corporations (PNFC) and financial corporations. The increase in PNFC net borrowing largely reflects a pick up in inventories, following a sharp fall in Quarter 1 2018. The net borrowing increase for financial corporations was due to a net drop in distributed income.

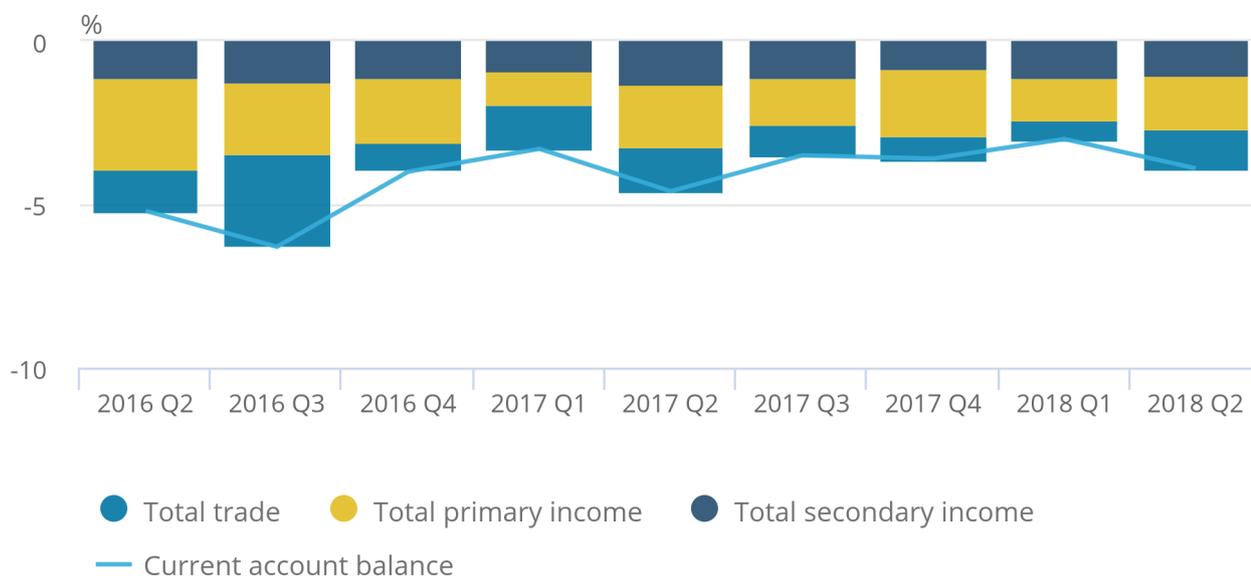
General government was a net borrower in Quarter 2 2018 of 1.3% of GDP, the narrowest it has been since before the crisis. The latest figures on Public Sector Finances show that public sector net borrowing (PSNB) was £6.8 billion in August, which was £2.4 billion up on a year ago. This reflected higher spending than a year ago, particularly departmental spending. PSNB stands at £17.8bn in the financial year to August, which is £7.8bn lower than the same time last year and the lowest since financial year 2002 to 2003. This is in part driven by the increase in PAYE income tax, National Insurance Contributions and Value Added Tax receipts, reflecting the stronger growth in employment and the recent pick up in consumer spending. As at the end of August, public sector net debt (PSND) was 84.3% of GDP.

## **4 . Balance of Payments**

To finance the overall net borrowing positions of households, corporations and government, the UK is running a current account deficit. Revised figures show that the rest of the world has been lending less to the UK in recent quarters than previously estimated, driven by improvements to net flows of trade and investment income (Figure 6). The current account deficit now stands at 3.7% of gross domestic product (GDP) in 2017, revised from 3.9%. This is a marked narrowing from its historical high of 5.2% in 2016, which may reflect the effects of the sterling depreciation and the pick up in global economy in 2017. This improvement continued into Quarter 1 (Jan to Mar) 2018, with the current account deficit reaching 3.0% – the narrowest it has been since Quarter 3 (July to Sept) 2011. There was a widening in the latest quarter, with the current account deficit reaching 3.9%. Much of this widening reflected movements in the trade balance – particularly movements in erratic goods (including non-monetary gold and aircraft) which can be particularly volatile and not be a true indication of the underlying trend.

**Figure 6: A widening in the current account deficit in the latest quarter, although much of this reflects volatile movements in erratic goods**

Figure 6: A widening in the current account deficit in the latest quarter, although much of this reflects volatile movements in erratic goods



Source: Office for National Statistics

Notes:

1. Components may not sum to current account balance due to rounding.
2. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (April to June), Q3 refers to Quarter 3 (July to Sept), Q4 refers to Quarter 4 (Oct to Dec).

As the rest of the world is a net lender to the UK, this borrowing must be financed by net financial inflows. In Quarter 2 2018, the UK's net borrowing was financed by a £114.3 billion net inflow of portfolio investment, reflecting similar levels of debt and equity flows, and a £11.3 billion net inflow of direct investment. However, financial flows in and out of the UK tend to be volatile, with the latest figures showing that there was a divestment of the net acquisition of financial assets and the net incurrence of financial liabilities in Quarter 2 2018. Table 1 provides some historical context to the size and direction of these financial flows, showing that the divestment that took place in Quarter 2 (Apr to June) 2018 is in contrast to those flows observed in 2013 to 2017. The size of these quarterly flows in the first half of 2018 are also markedly larger, though quarterly flows are volatile. There was an outflow of foreign investment in the UK of £115.3 billion in Quarter 2 2018, which was driven by flows of other investment which tend to be the most mobile form of capital. In contrast, there were gross inflows of direct and portfolio investment. Similarly, there was a divestment of UK investment in the rest of the world of £129.7 billion, made up of £66.2 billion of other investment and £66.0 billion of portfolio investment.

**Table 1: Divestment of gross financial inflows and outflows in Quarter 2 (Apr to June) 2018**

<b>Average Quarterly Flows (£bn)</b>	<b>2003 to 2007</b>	<b>2008 to 2012</b>	<b>2013 to 2017</b>	<b>Quarter 1 ( Jan to Mar) 2018</b>	<b>Quarter 2 (Apr to June) 2018</b>
Net Acquisition of Financial Assets	169.5	-37.1	4.3	119.1	-129.7
Net Incurrence of Financial Liabilities	180.2	-22.5	26.6	122.5	-115.3
Net Inflows	10.7	14.6	22.3	3.4	14.4

Source: Office for National Statistics

Despite incurring an increase in flows of net liabilities in Quarter 2 2018, there has been a slight improvement in the UK's net international investment position. The UK recorded a net liability position of £247.6 billion (11.9% of annual GDP) at the end of Quarter 2 2018, an improvement from 13.2% at the end of the previous quarter.

## 5 . Labour market

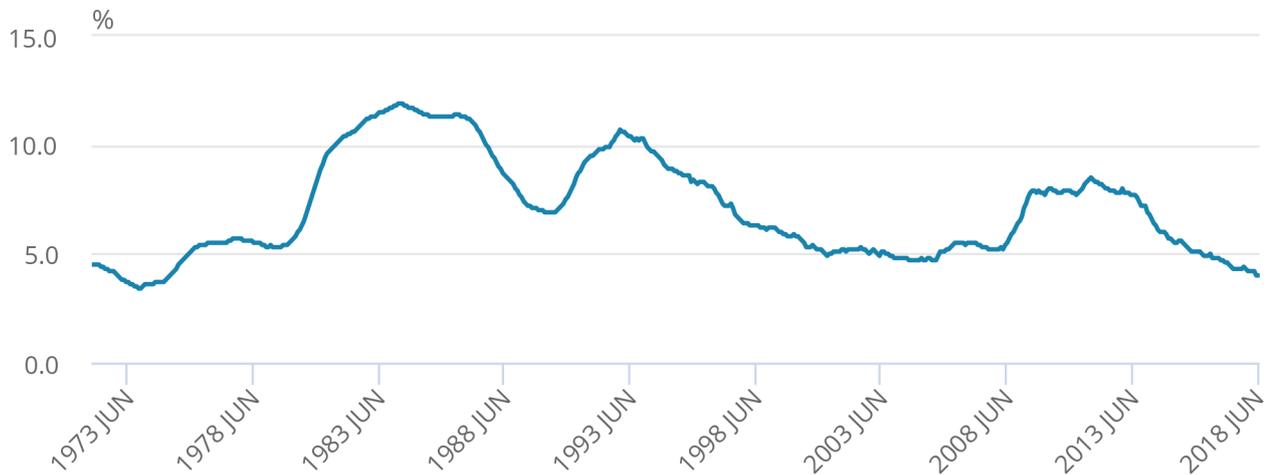
In the three months to July, the unemployment rate fell to 4.0%, as the number of unemployed people fell by 55,000 on the quarter (Figure 7). The unemployment rate was last lower in early 1975, highlighting the tightening in the labour market. The number of people in employment in the UK continued to pick up over these three months, albeit at its slowest pace since September 2017. The headline employment rate was slightly down at 75.5% in the latest quarter.

The number of unemployed people per vacancy is an alternative indicator of slack in the labour market, as it is a measure of the difficulty with which employers would be able to fill jobs. If there are relatively few unemployed people to the number of vacancies available, it would point to there being a tight labour market. The latest figures show vacancies reaching a record high of 833,000 in the three months to July, while the number of unemployed people fell further over the same period, providing some evidence of a further tightening in the labour market. The unemployment-to-vacancies ratio is now lower than its pre-downturn level.

The latest Bank of England Agents' summary of business conditions provides further evidence that the labour market is tightening with recruitment difficulties remaining elevated. Labour market tightness was cited by respondents in the construction, haulage and information technology industries.

**Figure 7: Unemployment rate falls to 4.0% in the three months to July, the lowest rate it has been since early 1975**

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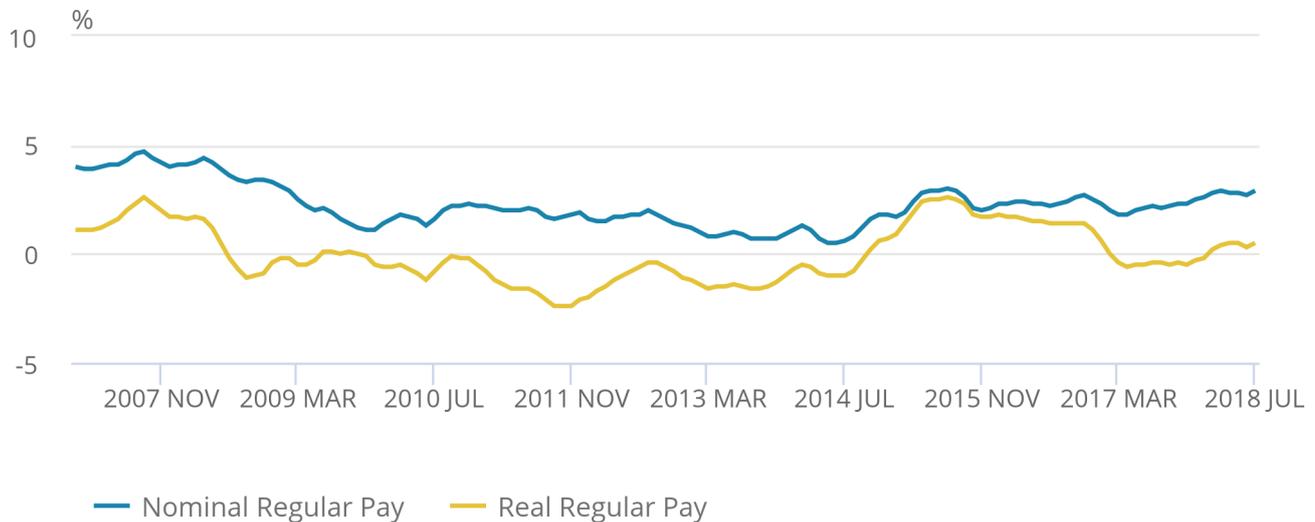
**Source: Office for National Statistics**

Despite the apparent tightness that has been observed in the labour market of late, there has been a wage puzzle in the UK labour market as this tightness has not so far shown up in a sustained increase in wage inflation. There has been much debate as to why this might be the case, with some observing that there is more slack in the labour market than the headline unemployment rate would imply. For example, it may be that underemployment is a more appropriate indicator, which captures involuntary part-time employment – that is, those individuals who would like to work more hours, and so reflect more slack in the labour market. In recent years, this has been higher than the unemployment rate, although this additional slack has fallen. Another explanation is that the natural rate of unemployment may be lower than it has historically been, reflecting structural shifts in the labour market affecting the relationship between unemployment and wages. Another often cited explanation has been the weakness in UK labour productivity over the last 10 years.

The latest figures show that there are some tentative signs that the tightness in the labour market may be showing up in the pick up in earnings. Compared to the same quarter a year ago, nominal regular pay increased by 2.9% in the three months to July. That said, when adjusted by the Consumer Prices Index including owner occupiers' housing costs (CPIH) to consider the effects of price changes, it translates to real regular pay growth of only 0.5% (Figure 8). While this is the sixth consecutive month of real increases, Figure 8 shows the squeeze in real pay experienced of late, because of the increase in inflation that has largely been driven by the sterling depreciation that followed the EU Referendum. Total pay for the whole economy, which includes bonus payments, increased to 2.5% in the three months to July. Real total pay grew by 0.2% on a Consumer Prices Index including owner occupiers' housing costs (CPIH) basis over the same period. The latest Recruitment and Employment Confederation Report on Jobs highlights that the high demand for labour, alongside the continued low availability of labour, has led to recruitment agencies reporting an increase in permanent starting salaries across all regions in August. However, it concludes that it is unclear if this reported increase is exerting strong upward pressure on overall wage growth.

**Figure 8: Signs of a pick up in nominal regular pay as the labour market continues to tighten**

Figure 8: Signs of a pick up in nominal regular pay as the labour market continues to tighten

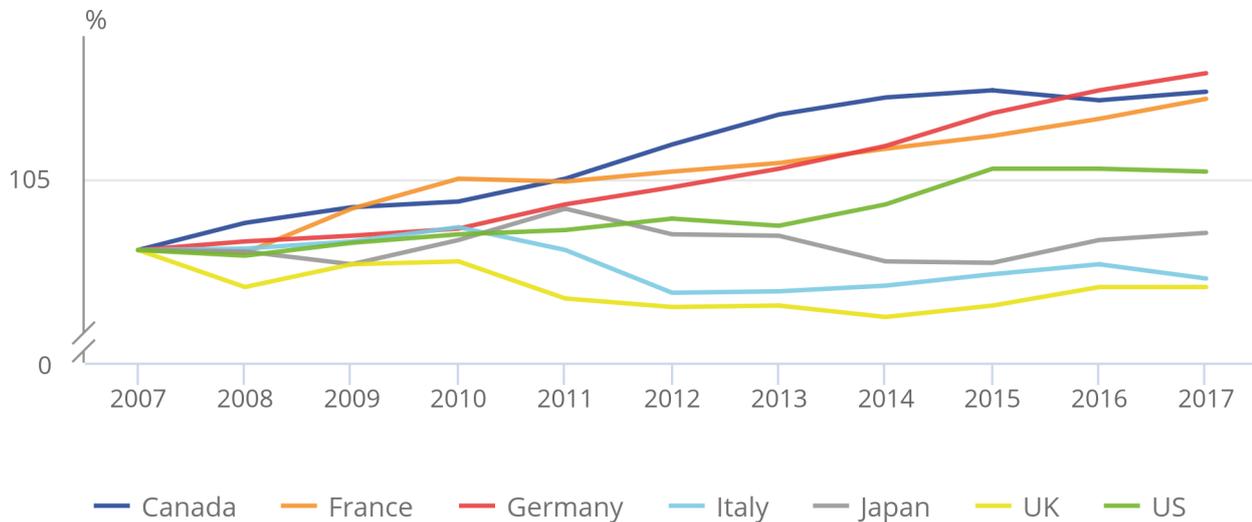


**Source: Office for National Statistics**

One of the core themes of the 2018 Employment Outlook by the Organisation for Economic Co-operation and Development (OECD) is how real wage growth is below its pre-crisis trends for many OECD countries. Figure 9 highlights how the UK has experienced the weakest wage growth of all G7 countries over the last decade, with average real wages in the UK falling by 0.3% per year on average over the last 10 years. Italy is the only other G7 economy to have seen a contraction in average real wage growth over this period. In contrast, Germany, Canada and France all experienced average real wage growth of at least 1% per year.

**Figure 9: Average UK real wages are still below their pre-downturn levels**

Figure 9: Average UK real wages are still below their pre-downturn levels



Source: Office for National Statistics and Organisation for Economic Co-operation and Development

## 6 . Prices

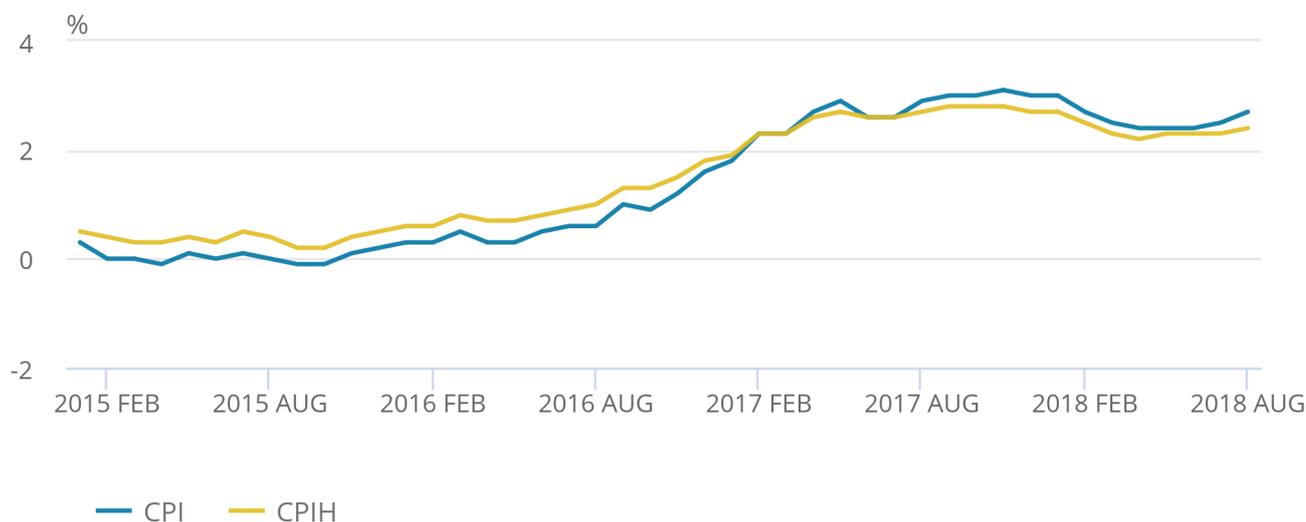
### Consumer Price Inflation

Following the outcome of the EU Referendum, there was a sharp fall in the exchange rate. This led to an increase in inflation, as the sterling value of goods and services in imported final and intermediate demand rose, which have been reflected in consumer prices. The 12-month growth rate of the Consumer Prices Index including owner occupiers' housing costs (CPIH) peaked at 2.8% in September to November 2017, but has since been largely followed by flat and falling inflation. This is because the effects of the sterling depreciation are now reflected in the price level of a year ago. That is, while the level of prices is still higher, the rate at which consumer prices are increasing has eased. As such, the 12-month growth rate of CPIH has fallen to 2.2% to 2.3% in recent months.

Contrary to market expectations reported by Bloomberg, CPIH growth increased slightly to 2.4% in the year to August, up from 2.3% a month earlier. Similarly, CPI growth was higher than consensus expectations, increasing to 2.7% over the same period (Figure 10). This could be seen as being consistent with the absorption of slack in the economy. However, it is important to note that the increase in August was driven predominantly by volatile components in the CPIH basket, so these effects may prove to be temporary and not necessarily be a reflection of underlying inflationary pressures.

**Figure 10: The 12-month growth rate of CPIH increased to 2.4% in the year to August, driven by higher theatre admission prices, transport fares and clothing and footwear**

Figure 10: The 12-month growth rate of CPIH increased to 2.4% in the year to August, driven by higher theatre admission prices, transport fares and clothing and footwear



Source: Office for National Statistics

Recreation and culture pushed up CPIH, with prices increasing by 3.6% in the year to August. This is its highest rate since January 2010, with the price of theatre admissions and computer games pushing the rate up between July and August. These games are heavily dependent on the composition of bestseller charts, often resulting in large overall price changes from month to month. The price increases in clothing and footwear were driven by the introduction of new autumn ranges, particularly those in women’s and children’s clothing. These prices typically increase between July and August following the summer sales but the price increase was larger this year, which may have been influenced by the proportion of items on sale this year.

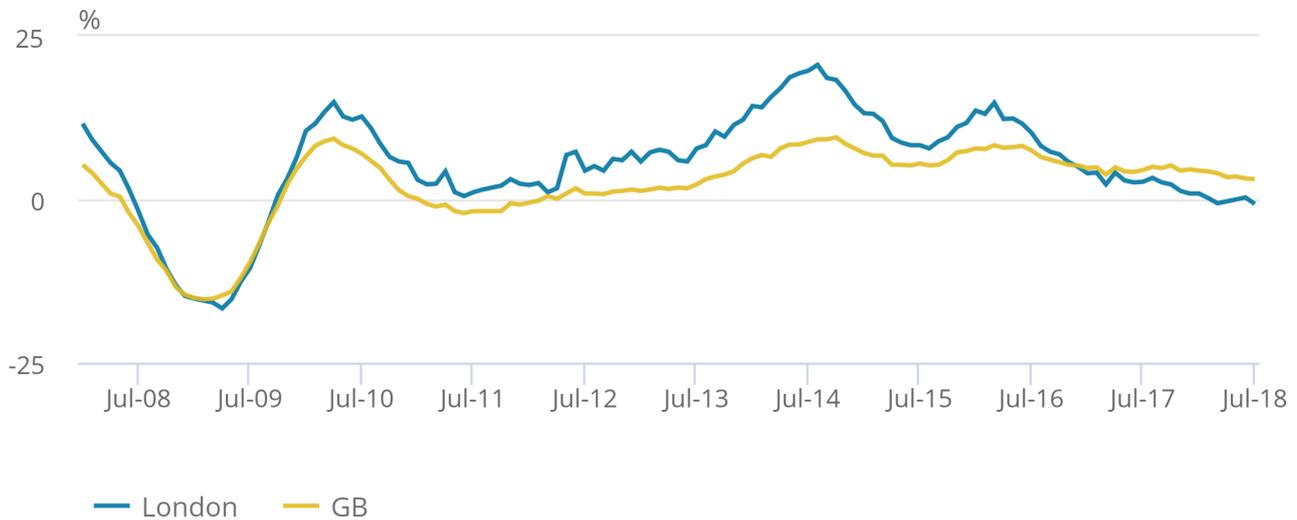
Research undertaken by the National Institute of Economic and Social Research (NIESR) would corroborate this view that the increase in consumer price inflation is not a reflection of wider underlying inflationary pressures. Analysing the prices of over 135,000 products that are included in the inflation basket shows that the increase in inflation was driven by “relatively large increases in a small number of items”, as opposed to widespread price increases. As such, NIESR conclude that the pick up in inflation is unlikely to persist.

## House Price Inflation

Recent analysis points to a cooling in the UK housing market, as house price inflation has been on a broadly downward trend since June 2016. Average UK house prices increased by 3.1% in the year to July, recording its lowest annual figure in almost five years. This has largely been consistent with other price market indices, such as the Halifax and Nationwide, who are reporting relatively subdued annual house price inflation of late. Figure 11 highlights how this has been particularly marked in London, where prices fell by 0.7% in the year to July. This is its lowest rate since September 2009 and is the third time in the last five months in which London house prices have fallen. Rental prices in London have also fallen of late, consistent with the latest survey evidence, in which the Royal Institution of Chartered Surveyors (RICS) reports that sentiment remains downbeat in London.

**Figure 11: House price growth in London declines at its fastest rate since September 2009**

Figure 11: House price growth in London declines at its fastest rate since September 2009



Source: HM Land Registry, Office for National Statistics

The latest Inflation Report offers insights as to why there may be idiosyncratic factors that explain this weakness in London demand, highlighting that it might have been “disproportionately affected by regulatory and tax changes since 2014”. This includes the introduction of a higher Stamp Duty rate on additional residential properties, which might be making the London buy-to-let market less attractive to potential investors. It is also possible that other factors at play such as Brexit uncertainty and the fall in net EU migration may be having a relatively larger effect on housing activity in London.

## 7 . Conclusions

Following a soft patch earlier in the year, the latest estimates show that UK economy grew by 0.4% in Quarter 2 (Apr to June) 2018. Recent figures point to subdued real gross domestic product (GDP) growth, as the UK economy grew by 0.5% in the first half of 2018 compared with the second half of 2017, marking the weakest six-monthly growth since the second half of 2011.

The rest of the world continues to be a net lender to the UK, with each of households, corporations and government being net borrowers. Recent trends highlight how households have increasingly become net borrowers of late, while the households' saving ratio remains low by historical standards. The net borrowing of general government is the narrowest it has been since before the financial crisis. Despite the widening in current account deficit in the latest quarter, this appears to have reflected volatile movements in erratic goods, with the underlying trend appearing to reflect a narrowing from the historical highs recorded in 2016.

There is some evidence of a tighter labour market, as the unemployment rate fell to 4.0% in the quarter – the lowest it has been since early 1975. There are tentative signs that this is showing up in a pick up in nominal earnings, although real pay remains muted. Contrary to market expectations, Consumer Prices Index including owner occupiers' housing costs (CPIH) growth increased slightly in the year to August. This could be seen as being consistent with the absorption of slack in the economy, but it is more likely that the increase was driven predominantly by volatile components in the CPIH basket – specifically recreation and culture and clothing and footwear. These effects may prove to be temporary and not necessarily be a reflection of underlying inflationary pressures.