Office for National Statistics

Article

Quarterly economic commentary: July to September 2018

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

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1 . Summary

- Real UK gross domestic product (GDP) is estimated to have increased by an unrevised 0.6% in Quarter 3 (July to Sept) 2018, while real GDP growth in 2017 has been revised up from 1.7% to 1.8%.

- Households, corporations and government all continue to be net borrowers in Quarter 3 2018, borrowing or running down their savings to finance their spending and investment, financed by the rest of the world being a net lender to the UK.

- The current account deficit widened to 4.9% in the latest quarter, financed primarily by a net inflow of portfolio investment, mainly reflecting equity investment, while there has been a divestment of the net acquisition of financial assets and the net incurrence of financial liabilities in each of the last two quarters.

- There have been increasing signs that the tightness in the labour market is now showing up in higher nominal wage growth, as regular pay increased by 3.3% in the year to the three months to October, the fastest increase since late 2008.

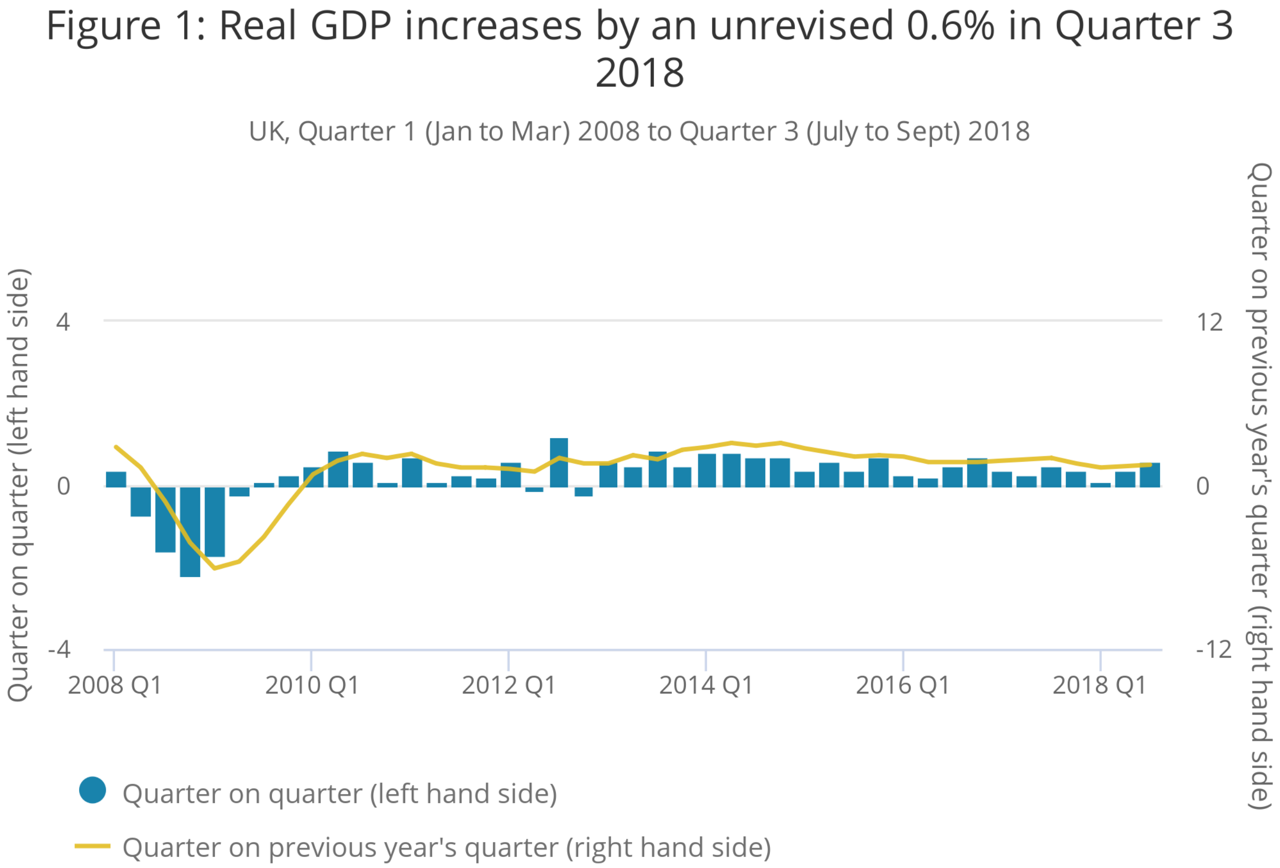
- The Consumer Prices Index including owner occupiers' housing costs (CPIH) increased by 2.2% in the year to November 2018, while the Consumer Prices Index (CPI) growth eased slightly to 2.3%, largely reflecting a large fall in petrol prices.

2 . Gross domestic product (GDP)

UK gross domestic product (GDP) is estimated to have increased by 0.6% in Quarter 3 (July to Sept) 2018, unrevised from the first quarterly estimate of GDP. In comparison with the same quarter a year ago, the UK economy has grown by an unrevised 1.5%. This is a slight pickup from previous quarters in the year, although the overall picture remains one of relatively subdued growth (Figure 1). 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.

Figure 1: Real GDP increases by an unrevised 0.6% in Quarter 3 2018

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 3 (July to Sept) 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).

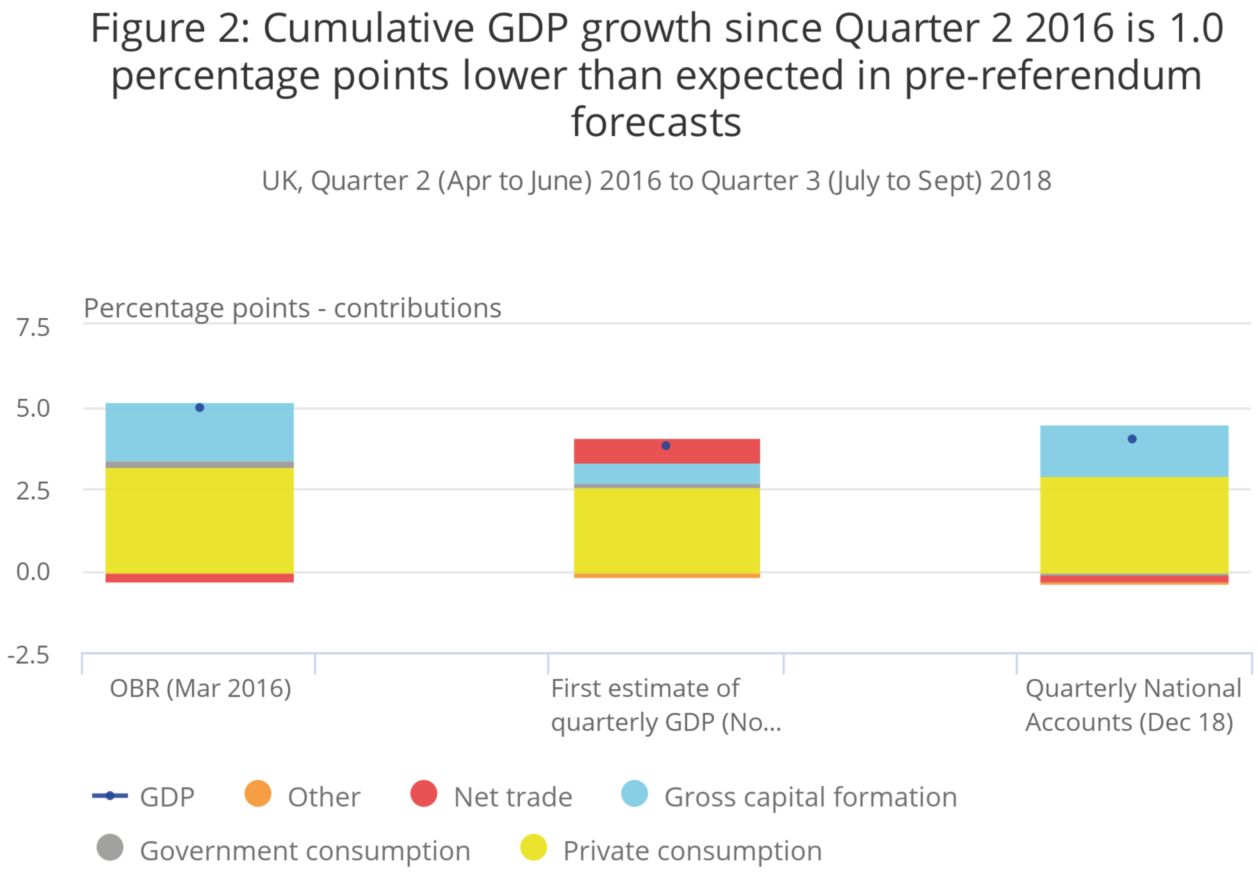
The headline picture is in line with previous estimates, showing that there has been some gain in momentum through the year. It reinforces the view that there was a temporary slowdown in the first quarter of the year, in which real GDP grew by an unrevised 0.1%, reflecting to some extent the effects of the adverse weather conditions. The pickup in the last two quarters partly reflects the increase in food and drink sales over the summer months, as consumers took advantage of the warmer weather and the World Cup.

Real GDP growth in 2017 has been revised up from 1.7% to 1.8%. The UK and Germany are the only G7 economies to have not experienced a pickup in growth in 2017. This is against a backdrop of a strengthening global economy last year. Having been one of the fastest growing G7 economies in 2016, the UK experienced GDP growth that was faster than only Italy in 2017.

Figure 2 shows the expenditure contributions to cumulative GDP growth from Quarter 2 (Apr to June) 2016, comparing today's estimates with the pre-referendum forecasts produced by the Office for Budget Responsibility (OBR) in March 2016. It also shows the picture that was published in the previous vintage of GDP. Cumulative GDP growth over this period has been largely unrevised, with the latest estimates showing that the economy has increased by 4.0% since Quarter 2 2016, compared to 3.8% in the previous estimate. This compares to the 5.0% that was forecast in March 2016 by the OBR, which was conditioned on a vote to remain in the European Union, with household consumption and gross capital formation being notably weaker than forecast. However, it is important to note that the outlook produced at the time would have been subject to forecast errors, with subsequent unforeseen developments in the UK and global economy. It also illustrates that there has been less external rebalancing than previously estimated. There have been a number of improvements incorporated into the latest estimates of trade flows, which explains why net trade is now estimated to have subtracted 0.2 percentage points to GDP growth over this period. This is in contrast to the positive contribution of 0.8 percentage points recorded in the previous estimate.

Figure 2: Cumulative GDP growth since Quarter 2 2016 is 1.0 percentage points lower than expected in pre-referendum forecasts

UK, Quarter 2 (Apr to June) 2016 to Quarter 3 (July to Sept) 2018



Source: Office for National Statistics and Office for Budget Responsibility

Notes:

1. "Other" captures the statistical discrepancy.

The implied GDP deflator represents the broadest measure of inflation in the domestic economy, reflecting changes in the price of all goods and services that comprise GDP. In the year to Quarter 3 2018, the implied GDP deflator increased by a revised 2.1%. Growth in the government consumption deflator picked up to 3.4% over the year, the strongest rate since Quarter 3 2009. This was driven by increases to nominal estimates of government expenditure, primarily due to final outturns for local government replacing budgetary data in the financial year 2017 to 2018 and changes in the way Value Added Tax (VAT) returns are processed. The revision to the GDP implied deflator in Quarter 3 stems predominantly from an upward revision to the household consumption deflator, partially offset by downwards revision to the exports deflator.

Output

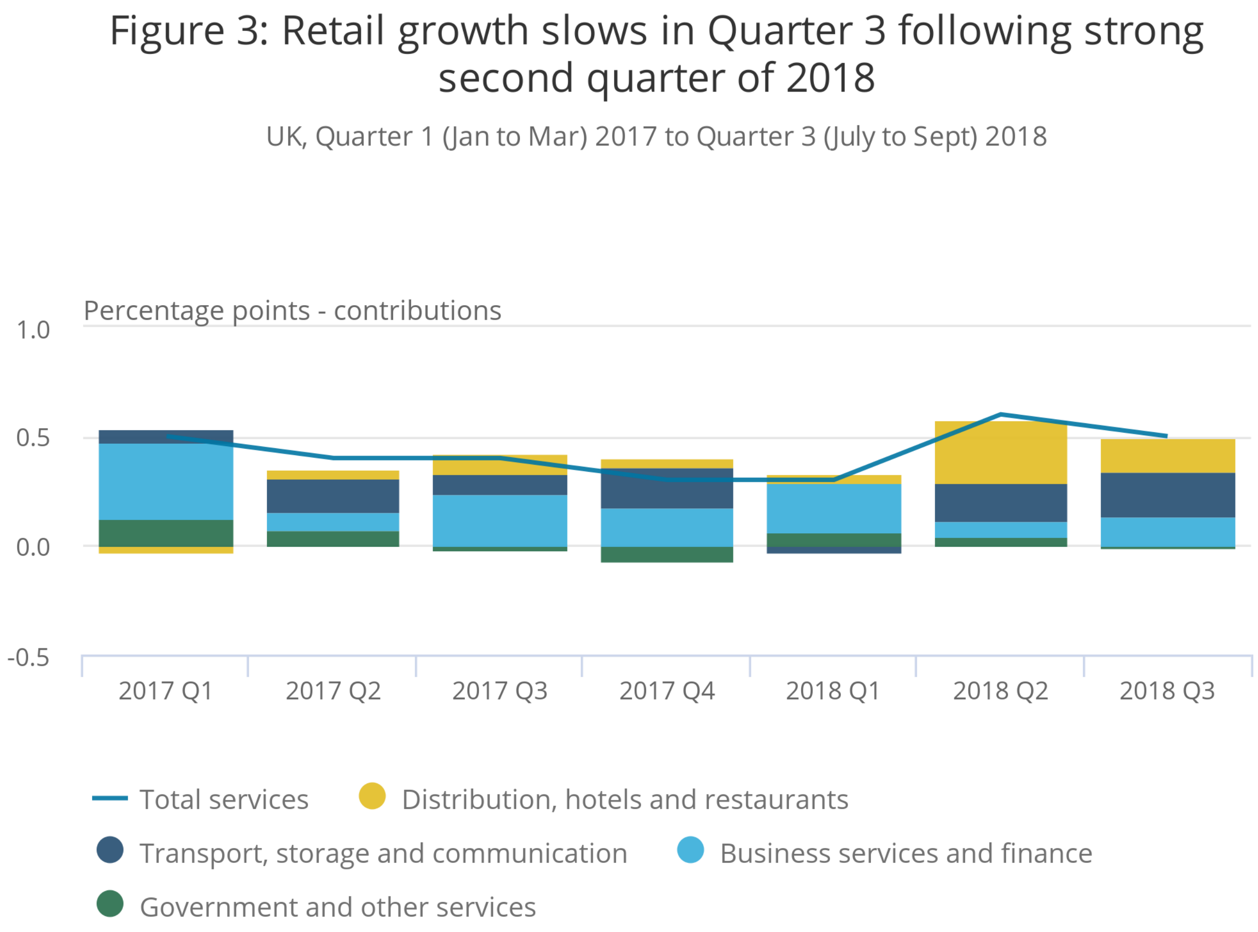
The output measure of gross domestic product (GDP) increased by an unrevised 0.6% in Quarter 3 2018. Despite some revisions to the main components of output, the recent narrative remains largely unchanged. Following a strong summer, in part driven by buoyant food and drink sales as consumers took advantage of the warmer weather and the World Cup, services output growth eased slightly to 0.5% in Quarter 3. This was revised up from 0.4% in the first estimate. Construction output growth picked up in Quarter 3, following a weak start to the year that was affected by the heavy snowfall, increasing by an upwardly revised 2.3%. Manufacturing output fell in the first two quarters of the year but rose by a revised 0.4% in the latest quarter.

Growth in services output in Quarter 3 2018 has been revised up slightly to 0.5%, a slight easing from the unrevised 0.6% growth recorded in Quarter 2 2018, where activity was relatively strong in the summer months. This largely reflected a pickup in retail trade, driven by buoyant food and drink sales as consumers took advantage of the warmer weather and the World Cup. Following growth of 1.7% in Quarter 2, growth in wholesale and retail trade slowed to 1.0% in Quarter 3 2018 (Figure 3). This slowdown in growth is corroborated by external evidence, including by the Confederation of British Industry (CBI) who noted “retail sales have cooled as the summer boost to the sector fades”. It also points towards subdued growth going forward as “firms grapple with weak household income growth and structural changes posed by digital disruption”. The latest insights from the British Retail Consortium (BRC) also imply a further slowdown in sales.

Figure 3 also shows the largest positive contribution to service sector growth came from transport, storage and communication, which increased 1.5% in Quarter 3 2018. This is in part due to the computer programming industry, which continues to perform particularly well. Elsewhere, there has also been a pickup in growth in business services and finance sector, driven by growth in the accounting and auditing industries. However, external evidence from Bank of England Agents Summary note that business services activity has eased somewhat in Quarter 3 2018, with their contacts citing that “there was tighter cost control due to heightened uncertainty ahead of Brexit”, while the latest CBI Services Sector Survey reports a slight fall in business service volumes in the more recent three-month period to November. The outlook for services appears subdued, with the latest Services Purchasing Managers’ Index (PMI) (PDF, 152KB) falling to its lowest level in November since immediately after the EU referendum. Respondents cited uncertainty weighing on business and consumer spending, while new orders continued its recent slowing trend. Survey evidence from the CBI paint a similar picture, particularly in consumer services, as sentiment deteriorated at its fastest pace for two years in the most recent three-month period.

Figure 3: Retail growth slows in Quarter 3 following strong second quarter of 2018

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 3 (July to Sept) 2018



Source: Office for National Statistics

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Output growth of the construction industry in Quarter 3 2018 is slightly stronger than first estimated, revised up from 2.1% to 2.3%, and remains the fastest quarterly rise since the first quarter of 2017. The increase in the value of construction work in Quarter 3 2018 in part still reflects a recovery following the relatively weak start to 2018, in which construction output fell by an unrevised 1.6% as the weather affected first three months of the year, corroborated by business surveys at the time. Previous analysis in the First quarterly estimate of GDP showed that the Quarter 3 2018 construction growth was driven by particularly pronounced monthly movements, including weaker base growth in April 2018 and stronger growth in September 2018. The updated monthly figures that are consistent with today's figures will be available in the Construction output in Great Britain: November 2018 publication, released on 11 January 2019.

Production output is now estimated to have increased by 0.6% in Quarter 3, following a fall of 0.7% in the previous quarter. There remains a bounce back in production output in Quarter 3 2018, in part reflecting the effects of the weather on energy supply in the first half of the year. Output increased across all four main production sectors, driven by manufacturing, where output increased by a revised 0.4% in Quarter 3. This was the first quarterly rise in 2018, following two consecutive quarters of contraction at the start of the year. This pickup is somewhat at odds with external survey evidence at the time, which had commented on an easing in domestic and export manufacturing output in Quarter 3 2018. The latest Manufacturing Purchasing Managers' Index (PMI) picked up slightly in November, although activity remains subdued with the reading among the weakest recorded over the past couple of years. The external picture appears to be easing, with "reduced client interest from overseas and ongoing Brexit uncertainties" highlighted. Survey evidence from the The Manufacturers' Organisation appears to point to a softer outlook for the manufacturing industry, highlighting a weakness in export orders, with respondents citing "Brexit uncertainty, weaker global growth and the impact of protectionist policies".

The recovery in manufacturing output reflects a pickup across a number of industries following a weak Quarter 2. This was driven partly by manufacturing of transport equipment, specifically motor vehicle production, which grew 1.1% in Quarter 3 2018. However, compared with the same quarter a year ago, production of transport equipment fell by 1.0% in Quarter 3 2018. This longer-term weakness in car production in part reflects softer growth in domestic demand, at a time when household real incomes have been squeezed. The weakness in car production is broadly consistent with the latest data from the Society of Motor Manufacturers and Traders (SMMT), which noted a 16.8% fall in UK car manufacturing in September 2018 compared with the same period in 2017. The SMMT attributed the slowdown to a "turbulent first three quarters as global trade tensions, model changes and uncertainty over diesel and Brexit were exacerbated by testing backlogs due to new emissions regulations".

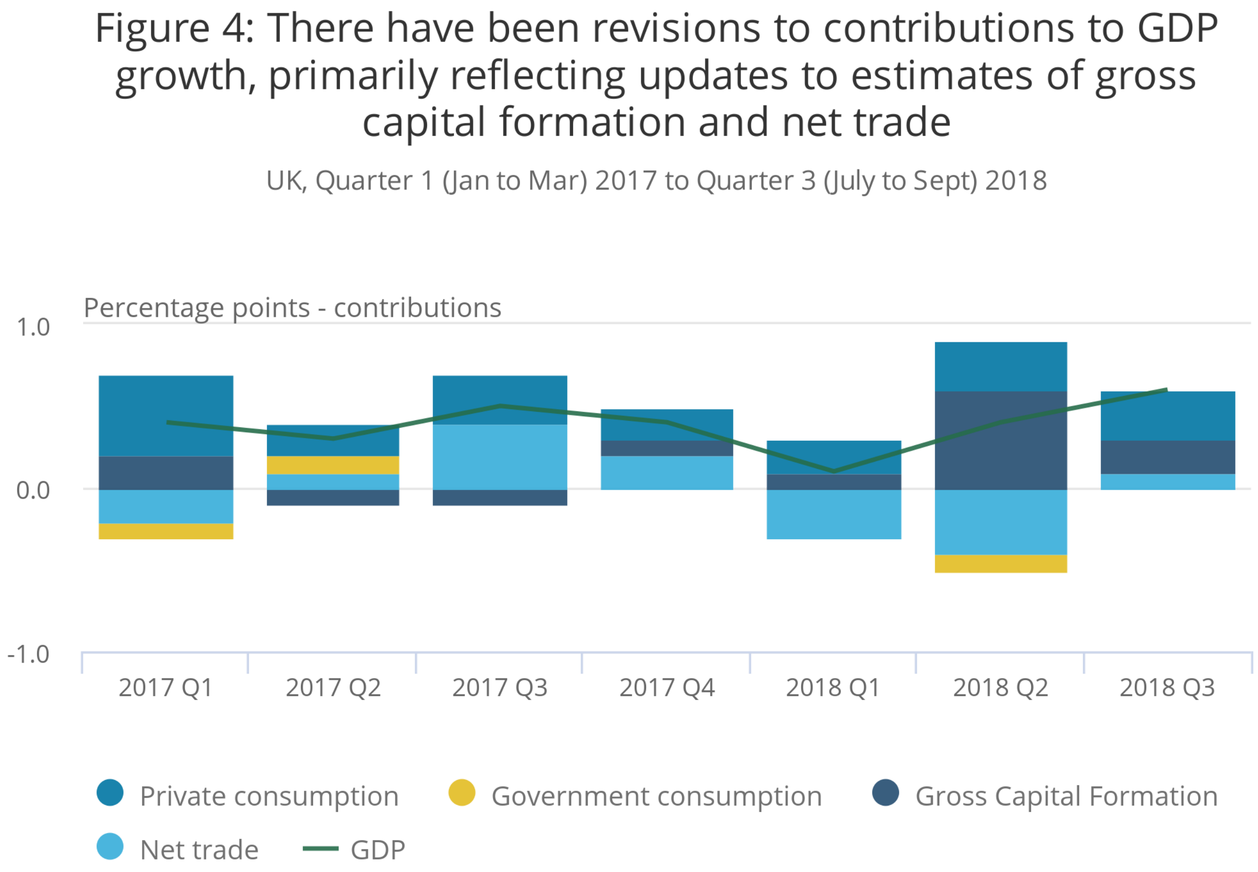
Meanwhile, output in the energy supply sector rose by 1.4% in Quarter 3, revised down 0.5 percentage points. Energy supply production had been heavily affected by weather conditions in the first half of 2018, with production boosted by the cold weather in Quarter 1 (Jan to Mar), followed by some element of fall back and unusually warm temperatures in Quarter 2.

Expenditure

The expenditure measure of gross domestic product (GDP) increased by 0.6% in Quarter 3 2018. Gross capital formation, net trade and household consumption all contributed positively to growth in Quarter 3 2018, while the contribution of government consumption was flat (Figure 4). However, there are some notable revisions to the composition of GDP growth in the latest quarter, specifically offsetting revisions to gross capital formation and net trade. This reflects updated estimates of non-monetary gold (NMG), as well as improvements to nominal and real estimates of trade flows and a shift in the alignment adjustment. As earlier analysis showed, the cumulative effect of revisions to net trade since Quarter 1 2017 has led to there being less external rebalancing since the referendum than previously estimated.

Figure 4: There have been revisions to contributions to GDP growth, primarily reflecting updates to estimates of gross capital formation and net trade

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 3 (July to Sept) 2018



Source: Office for National Statistics

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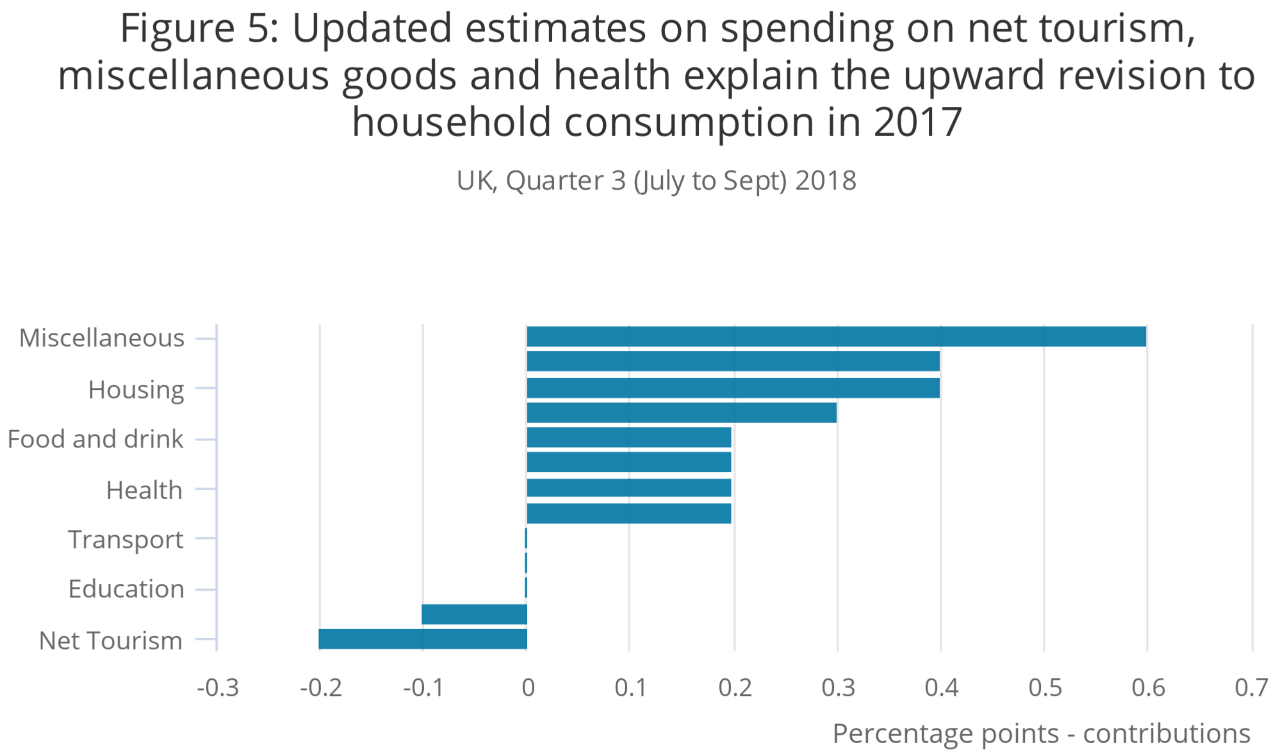
Private consumption increased by an unrevised 0.5% in Quarter 3 2018. One of the main drivers for the increase was the increase in spending on miscellaneous goods, particularly other financial services. There was a notably sharp drop in household spending on transport, which fell by 1.4%. This mainly reflects a fall in spending on motor cars and is consistent with the weak figures seen in motor trades services output. External evidence has also pointed to a number of demand and supply factors affecting the industry over the last year. The outlook for households appears to be subdued with the latest GfK Consumer Confidence Index falling to its lowest level in almost a year in November, reporting increased concerns over household finances, the general economy and purchase intentions.

Household consumption growth in 2017 is now estimated to be 2.2%, an upward revision from 1.9%. This reflects updates to spending on net tourism, miscellaneous goods and health. Household spending includes all expenditure made by households that are resident in the UK, irrespective of where the spending takes place. However, to include all domestic expenditure, it is necessary to add spending by non-residents that happens in the UK, and subtract spending by UK residents that happens outside of the UK. The latest estimates show that there was more spending on net tourism in 2017 – that is, foreign residents are estimated to have spent more in the UK in 2017 relative to the amount spent by UK residents abroad. Whilst there has been an upward revision in 2017, this still reflects a notable slowing from 3.2% growth in the previous year, as the impact of the sterling depreciation led to a squeeze in the purchasing power of households. This has been most evident in the slowing in spending on clothing and footwear, communication and miscellaneous goods.

There was a sharp rise in retail sales in November 2018, with the volume of goods bought increasing by 1.4% on the month, following two months in which there has been a fall in the volumes sold. The monthly growth captures some of the shift in consumer spending to earlier in the year, partly due to Black Friday promotions. Retailers have reported that these promotions are likely to have been a factor in the strong figures reported in November 2018, with sales in household goods stores increasing by 5.3%. This was the largest increase since late 2013. In the three months to November 2018, retail sales increased by 0.4%.

Figure 5: Updated estimates on spending on net tourism, miscellaneous goods and health explain the upward revision to household consumption in 2017

UK, Quarter 3 (July to Sept) 2018



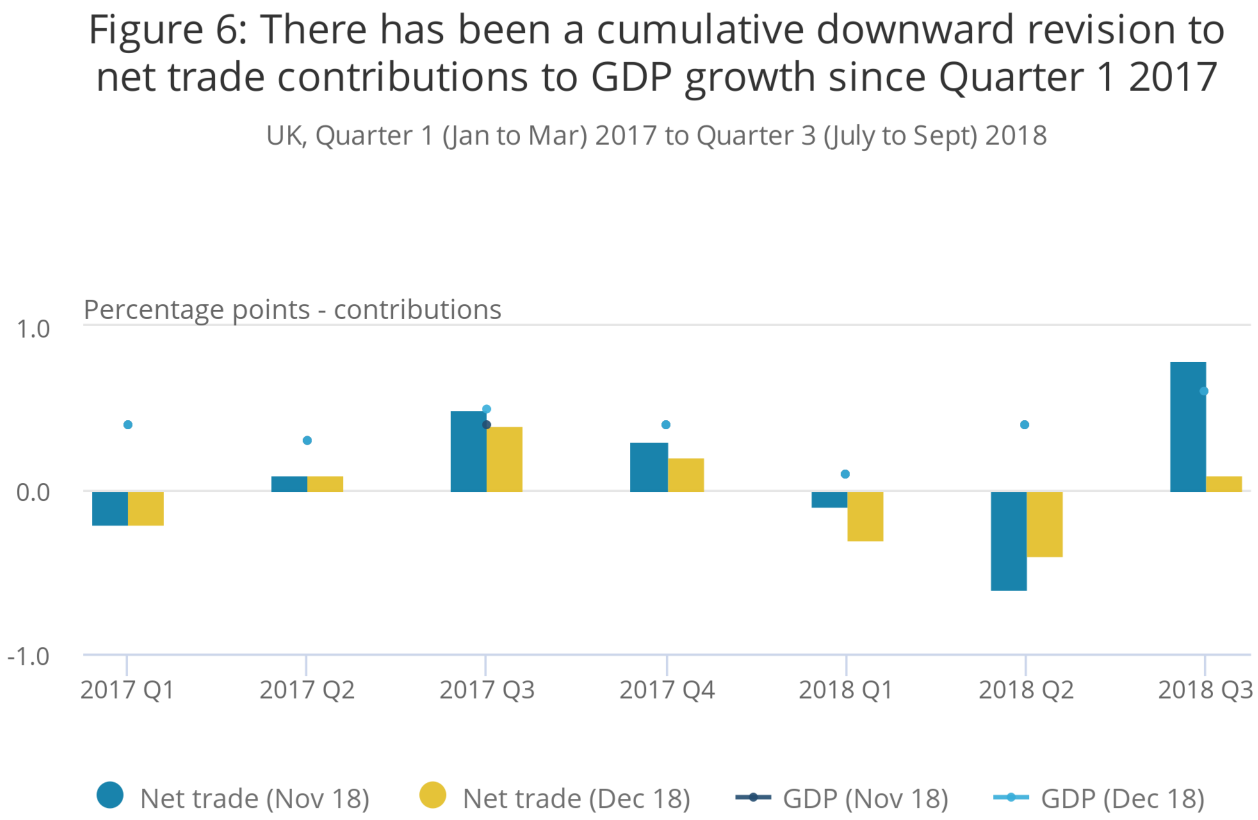
Source: Office for National Statistics

There have been some revisions to the lower-level expenditure estimates, most notably in net trade and gross capital formation. This includes revisions to the latest estimates of non-monetary gold (NMG), which is recorded within the National Accounts as a change to valuables and in trade in goods. Movements in NMG, which tend to be volatile, do not affect headline GDP as these are recorded as equivalent offsetting impacts but this is reflected in the composition of GDP growth. This has led to an upward revision in the contribution of gross capital formation (where changes to valuables are recorded) in Quarter 3 2018. Having previously subtracted 0.6 percentage points from GDP growth, the latest estimates now show that there was a positive contribution of 0.2 percentage points. The effect of NMG has been offset in an equivalent downward revision to the net trade contribution.

There have also been a number of improvements incorporated into the estimation of trade figures, reflecting nominal changes and improvements to a number of goods deflators, aimed at capturing more accurately the price movements of exports and imports. This has led to additional revisions feeding through into the volume estimates of exports and imports. Figure 6 shows the revisions to the net trade contributions to GDP growth since Quarter 1 2017, with the quarterly path of GDP growth largely unchanged. The cumulative effect over this period has been for net trade to have contributed less than previously estimated, most notably in the latest quarter in which net trade is now estimated to have contributed 0.1 percentage points to GDP growth in Quarter 3 2018. This is revised down from 0.8 percentage points and mainly reflects updated estimates of unspecified goods, which includes NMG.

Figure 6: There has been a cumulative downward revision to net trade contributions to GDP growth since Quarter 1 2017

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 3 (July to Sept) 2018



Source: Office for National Statistics

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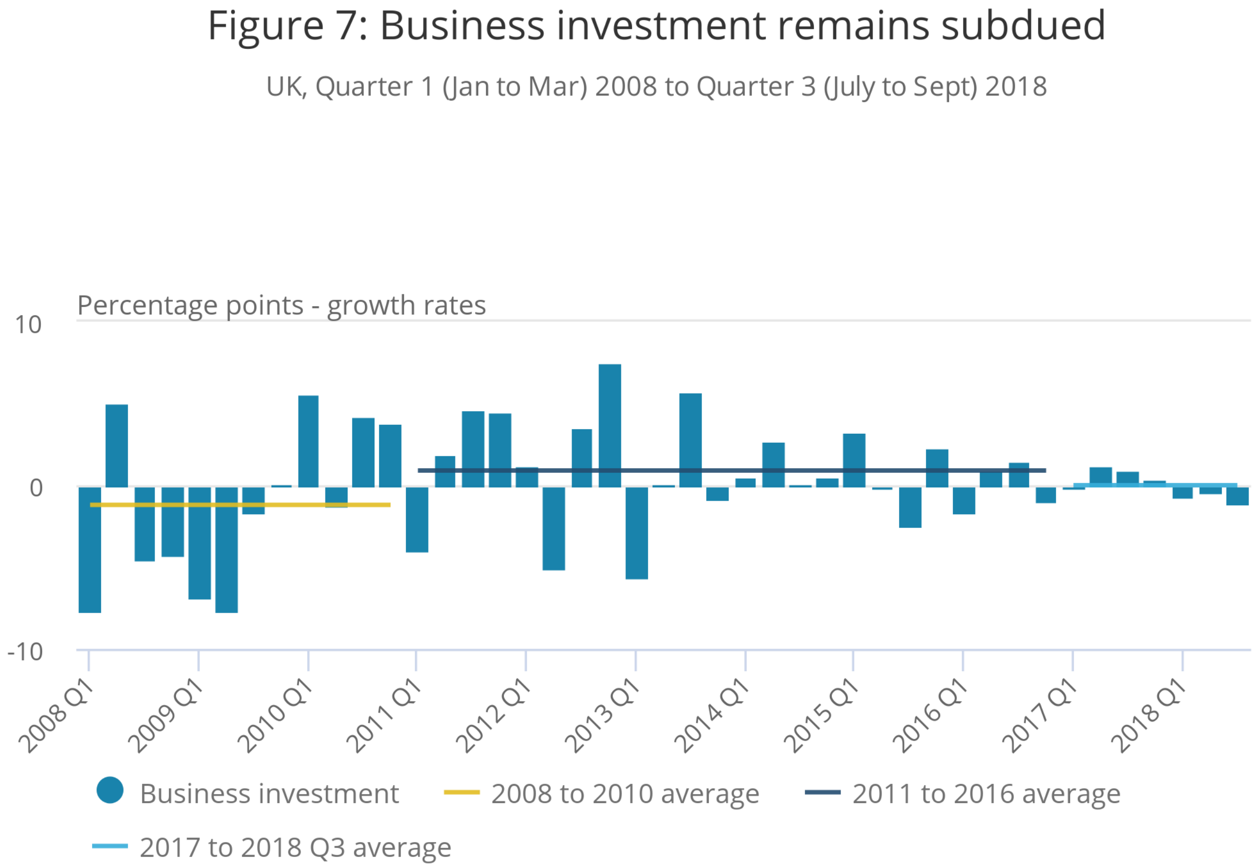
Business investment fell by 1.1% in the latest quarter. The latest estimates continue to show that business investment has now fallen for three consecutive quarters, which has not been seen since the global financial crisis (Figure 7). There have also been downward revisions to the quarterly path in 2017, giving a slightly weaker picture of capital expenditure. Business investment is now estimated to have increased by 1.5% in 2017, revised down from 1.8%. [Recent research](#) has found evidence that Brexit uncertainty has weighed on the economy so far, reducing the levels of investment and employment since the referendum. Firms have increasingly responded that Brexit is one of the main drivers of uncertainty, with the latest findings showing that almost 40% of businesses highlighting it as a factor. This figure has risen of late, pointing to the effects of uncertainty still being pronounced. This would also corroborate other survey evidence that points to uncertainty weighing on investment intentions. In a recent [CBI survey](#), 80% of businesses cited Brexit as having a negative impact on investment decisions, a marked increase from the 36% that was reported a year earlier. Intelligence from the Bank of England identifies Brexit uncertainty as the largest headwind to capital expenditure, in line with the most recent [Deloitte CFO Survey (PDF, 1.27MB)](#).

Figure 7: Business investment remains subdued

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 3 (July to Sept) 2018



Source: Office for National Statistics

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There is increasing attention on whether there has been an increase in stockpiling, as businesses prepare for the UK leaving the European Union in March 2019. Uncertainty remains high, while evidence from the Bank of England finds that the majority of businesses have not made any change to their business plan or are still in the process of implementing such changes. This could point to there being a response by businesses looking to stockpile, while it also reports that “companies expect to build stocks whatever the Brexit outcome” and that those who expect to increase inventories expect to raise holdings of raw materials and finished goods. Intelligence from the Bank’s Agents also provide some further evidence, citing that “demand for warehousing space has increased sharply while road haulage companies expect activity to be higher than usual in early 2019”. One factor is the expected increase in the stockpiling of imports. The latest Manufacturing Purchasing Mangers’ Index (PMI) also finds some evidence of stockpiling. Today’s estimates show an increase in inventories, although users should be aware that a number of adjustments have been applied to the change in inventories component in Quarter 3 2018 to help balance the different measurement approaches to GDP. The estimates should be considered accordingly.

There have been upward revisions to the quarterly path of government investment, with the latest estimates showing that it increased by 3.7% in 2017. Some of these revisions reflect that there has been a reallocation of capital expenditure that relates to the Mersey Gateway Project, with more accurate information now available as to when this activity took place. Although the expenditure on the entire project was reported by the Halton local authority in their accounts for the financial year ending March 2018, we have taken the decision to record this expenditure on an accruals basis across the construction period, which has led to revisions to the quarterly path.

There has been a notable downward revision to government consumption in Quarter 3 2018, which is now estimated to have fallen by 0.3%. This has been driven by updated financial outturn data for healthcare, military and central government public administration. This latest data also includes an improved recording of Value Added Tax (VAT) refunds, which have been taken on in the National Accounts to align with the Public Sector Finances. This is an estimate of the amount of VAT claimed back by local authorities and central government departments and it is included in final consumption expenditure to ensure that the sales of services consumed by government are recorded on an equivalent basis, whether they are provided by government or by the private sector. The recording of VAT refunds has been reviewed in collaboration with both HM Revenue and Customs (HMRC) and HM Treasury (HMT) and we have improved the recording of the VAT refunds associated with the National Health Service, Academies, the BBC and Police Commissioners. As such, these updates to VAT refunds have led to revisions to estimates of government consumption.

Income

Nominal gross domestic product (GDP) grew by 1.0% in Quarter 3 2018. There has been a notable upward revision of 0.3 percentage points to nominal GDP growth in 2017, which is now estimated to have increased by 4.1%.

Quarterly growth in nominal GDP has continued to be driven by growth in compensation of employees (CoE), which increased by 1.4% in Quarter 3 2018. This marks its fastest rise in over a year, reflecting an increase in both wages and salaries and in employers’ social contributions. This is reflected in the latest labour market data, which shows that nominal regular wage growth increased by 3.3% in the year to the three months to October 2018, the fastest rate of growth since late 2008. Gross operating surplus of corporations increased by 0.1% in Quarter 3, revised from the previous estimate of 1.4%.

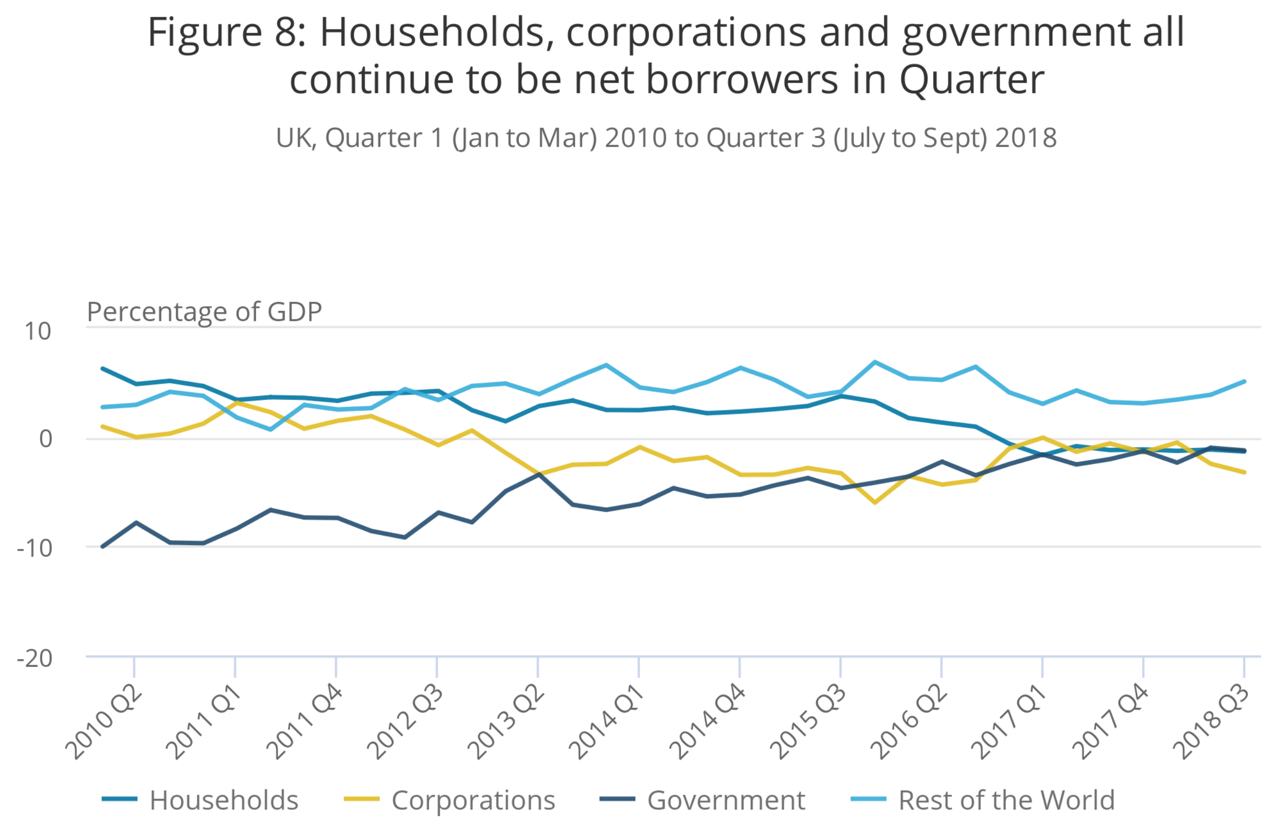
There have been upward revisions to the level of taxes on products and production in today’s estimates, which is due to the incorporation of the Apprenticeship Levy, the Immigration Skills Charge and the Soft Drinks Industry Levy. There has also been an improvement in the recording of VAT refunds, which led to revisions to government consumption in the expenditure measure of GDP.

3 . Sector and financial accounts

Figure 8 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. If investment exceeds saving for a sector, then it is a net borrower. The latest figures show that each of the domestic sectors in the UK is running a deficit in Quarter 3 (July to Sept), with the net borrowing position equivalent to 1.3% of gross domestic product (GDP) for households (including non-profit institutions serving households), 3.2% for corporations and 1.2% for government. The rest of the world continues to be a net lender to the UK to finance these net borrowing positions, with a widening current account deficit in Quarter 3 financing the increased net borrowing of corporations in particular.

Figure 8: Households, corporations and government all continue to be net borrowers in Quarter

UK, Quarter 1 (Jan to Mar) 2010 to Quarter 3 (July to Sept) 2018



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Households have traditionally been a net lender, but recent trends highlight how households have increasingly become net borrowers. This is the eighth consecutive quarter in which households have had to borrow or run down their savings to finance their spending and investment, an unprecedented run. Whilst early estimates can be prone to revision, the underlying downward trend provides a clear reflection that households have recently saved less to support spending growth in the face of the squeeze in real incomes. Household net borrowing increased further in Quarter 3, increasing from 1.1% to 1.3%. Whilst there was an increase in wages and salaries in the latest quarter, this was largely offset by an equivalent increase in consumption expenditure. However, there was also an increase in taxes on income and wealth that helps explain why net borrowing increased in the quarter.

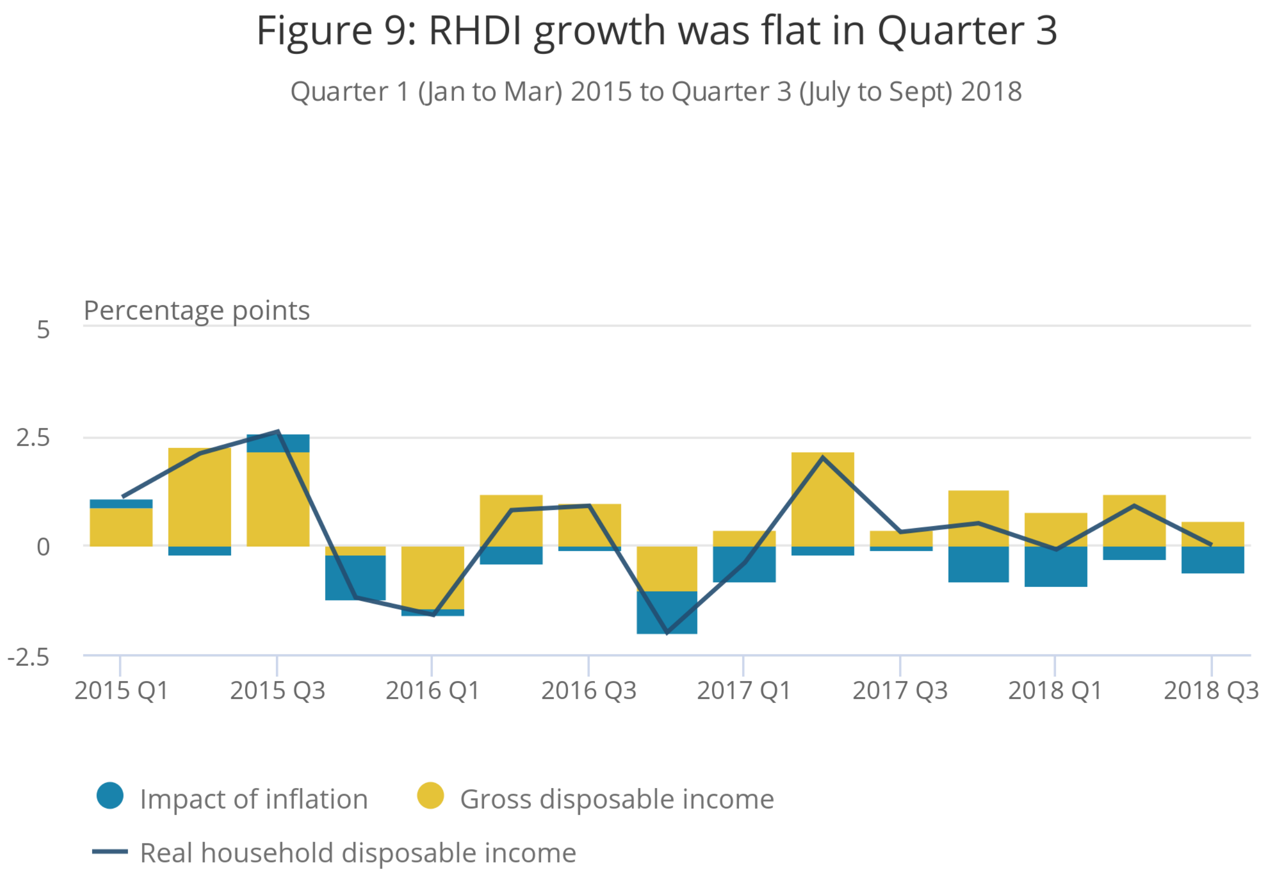
These recent trends have also been reflected in the households’ saving ratio, which has been on a downward trend in recent years. Having peaked at 10.7% in 2009 following the effects of the financial crisis as households rebuilt their financial positions, the saving ratio has trended downwards, and has been particularly pronounced in the last couple of years. The latest estimates show that this reached a record low of 3.9% in 2017, revised from the previous estimate of 4.2%, principally reflecting updated estimates of higher consumption expenditure. The latest figures show the households’ saving ratio fell further in Quarter 3 2018, reaching 3.8% – its joint-third lowest on record.

More timely figures from the Bank of England show that consumer credit growth continued to slow, easing to 7.5% in the year October. Although these figures can be somewhat volatile, there is an underlying trend of a slowing in consumer borrowing, with the October figure being the slowest growth rate since May 2015 and below the peak of 10.9% that was recorded in November 2016.

Real household disposable income (RHDI) growth was flat in Quarter 3, continuing the recent underlying subdued trend, which reflects to a large extent the increase in the price of consumption in the last couple of years (Figure 9). This in turn reflects the increase in imported inflation, following the exchange rate deprecation around the time of the EU referendum, and its pass through to consumer prices. There has been an upward revision to RHDI in 2017, from a fall of 0.1% to an increase of 0.5%. This follows a fall of 0.2% in RHDI in the previous year.

Figure 9: RHDI growth was flat in Quarter 3

Quarter 1 (Jan to Mar) 2015 to Quarter 3 (July to Sept) 2018



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There was a sharp increase in the net borrowing of corporations in Quarter 3 2018, which increased from 2.4% to 3.2% of GDP, reflecting increased net borrowing by private non-financial corporations (PNFC). Given that Brexit uncertainty is likely to have weighed on investment, it might have been expected that PNFCs would have seen a fall in their net borrowing. However, there was a fall in reinvested earnings on foreign direct investment (FDI) in the latest quarter. Foreign investors who hold FDI in the UK receive a return on that investment, but these income payments can be reinvested back into that UK business. In Quarter 3, there was a fall in this income, which increased the net borrowing requirements of PNFCs to finance their expenditure. Businesses can raise money by borrowing from banks or from financial markets. Figures from the Bank of England shows that the amount outstanding of businesses' borrowing increased by £5.8 billion in October, following a fall of £1.9 billion in September.

General government was a net borrower in Quarter 3 2018, of 1.2% of GDP, which is one of the narrowest it has been since before the crisis. In the latest Office for Budget Responsibility (OBR) Economic and Fiscal Outlook (PDF, 2.45MB), the five-year outlook for the public finances appears to look largely unchanged. Public sector net borrowing (PSNB) is now forecast to reach 0.9% of GDP in 2022 to 2023, in line with the previous forecast. That said, "this masks a significant improvement in the underlying pace of deficit reduction". Borrowing has fallen at a faster pace in the first half of 2018 to 2019 than had been previously expected, reflected in PSNB being revised £11.6 billion lower in this financial year in the absence of any policy change. However, the discretionary fiscal loosening announced in the 2018 Autumn Budget has the effect of offsetting this improvement, leaving the deficit largely unchanged over the forecast horizon. PSNB is now expected to reach 0.8% in 2023 to 2024, which would be its lowest level since 2001 to 2002.

The outturns for PSNB in 2018 to 2019 so far have tended to be better-than-expected, which help explain the above forecast revisions. PSNB recorded its lowest borrowing figure in November 2018 for 14 years of £7.2 billion, which is an improvement of £0.9 billion from a year earlier. Relative to the same period last year, central government receipts were 3.8% higher, mainly reflecting receipts from Value Added Tax, Income Tax and National Insurance contributions. PSNB is estimated to be £32.8 billion in the first eight months of financial year ending 2019 , compared with £46.4 billion at the same time in the previous financial year, the lowest year-to-date for 16 years.

In December, it was announced that there would be a change in the treatment of student loans in the public sector finances and the National Accounts. Unlike typical loans, student loan repayments are contingent on borrowers' income and there are conditions in which these student loan obligations may be cancelled. As such, some have considered it to be a "fiscal illusion (PDF, 607KB)" that student loans are currently recorded as conventional loans, as significant loan cancellations are not reflected in the public sector finances. The revision to the accounting treatment will better reflect the economic reality – the amounts that are expected to be repaid will be treated as a financial asset, while the amounts that are not expected to be repaid will now be treated as a government expenditure. These changes in the accounting treatment are expected to be reflected in the public finances in September 2019, with the Office for Budget Responsibility (PDF, 2.45MB) estimating the impact to worsen public sector net borrowing by £12.3 billion in the financial year 2018 to 2019.

In its latest Fiscal Monitor, the International Monetary Fund (IMF) provides cross-country comparisons of public sector balance sheets. This provides a more comprehensive picture of the public assets (for example, public infrastructure) that are owned and the non-debt liabilities (for example, pension liabilities) that are owed by government, encompassing more than financial ones that are held. The IMF reports that "including the assets, liabilities, and operations of financial and non-financial public corporations in the balance sheet shows the full scale of wealth under the government's control". The report finds that the UK has a negative net worth that as a per cent of GDP is above only Portugal in its sample of 31 countries. This reflects to some extent how the UK's balance sheet has responded to the global financial crisis over the last 10 years. There was a marked increase in the UK government's holding of assets and liabilities in 2008, following the nationalisation of Northern Rock, Royal Bank of Scotland and Lloyds, which were reclassified into the public sector as part of the bailing out of these financial institutions.

4 . Balance of payments

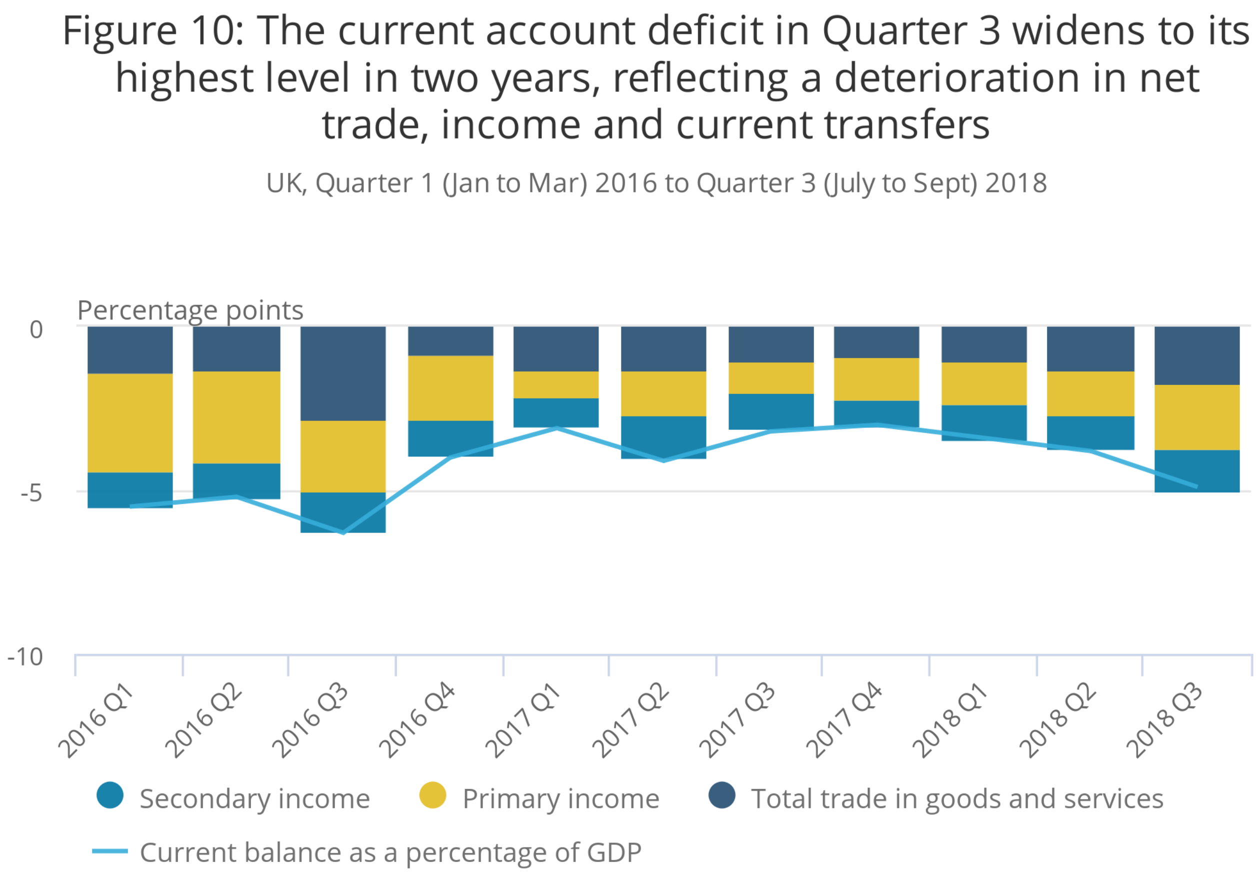
To finance the overall net borrowing positions of the UK, the UK is required to run a current account deficit. In recent years, this has widened to levels that are high by historical and international standards, reaching 5.2% of gross domestic product (GDP) in 2016. However, there was a narrowing in 2017 that is likely to reflect the effects of a pickup in the global economy and the effect of a fall in the exchange rate.

Whilst quarterly income flows can be volatile, today's figures show that there has been a marked widening in how much the UK is borrowing from the rest of the world in Quarter 3 (July to Sept) 2018, from a revised 3.8% in Quarter 2 (Apr to June) to 4.9% in Quarter 3 (Figure 10). This movement in the latest quarter reflects a deterioration in the net flows of trade, investment income and current transfers. The widening in net investment income reflects a fall in net income on holdings of foreign direct investment (FDI), in which the UK earned less on its external assets than it paid out on its external liabilities, which is typically not the case for the UK.

Despite the widening in Quarter 3, the revised figures included in today's estimates largely point to an improved external position, in which the UK is less reliant on external financing than previously estimated. The current account deficit in 2017 has been revised from 3.7% to 3.3%. This is the narrowest annual figure since 2011, as it is now estimated that the UK has received more investment income on its holding of FDI abroad than previously estimated in 2017. However, there has been a notable downward revision in Quarter 1 (Jan to Mar) 2018 to net trade, which has led to a wider current account deficit than recorded in the previous vintage. This reflects the aforementioned improvements to how trade flows have been measured.

Figure 10: The current account deficit in Quarter 3 widens to its highest level in two years, reflecting a deterioration in net trade, income and current transfers

UK, Quarter 1 (Jan to Mar) 2016 to Quarter 3 (July to Sept) 2018



Source: Office for National Statistics

Notes:

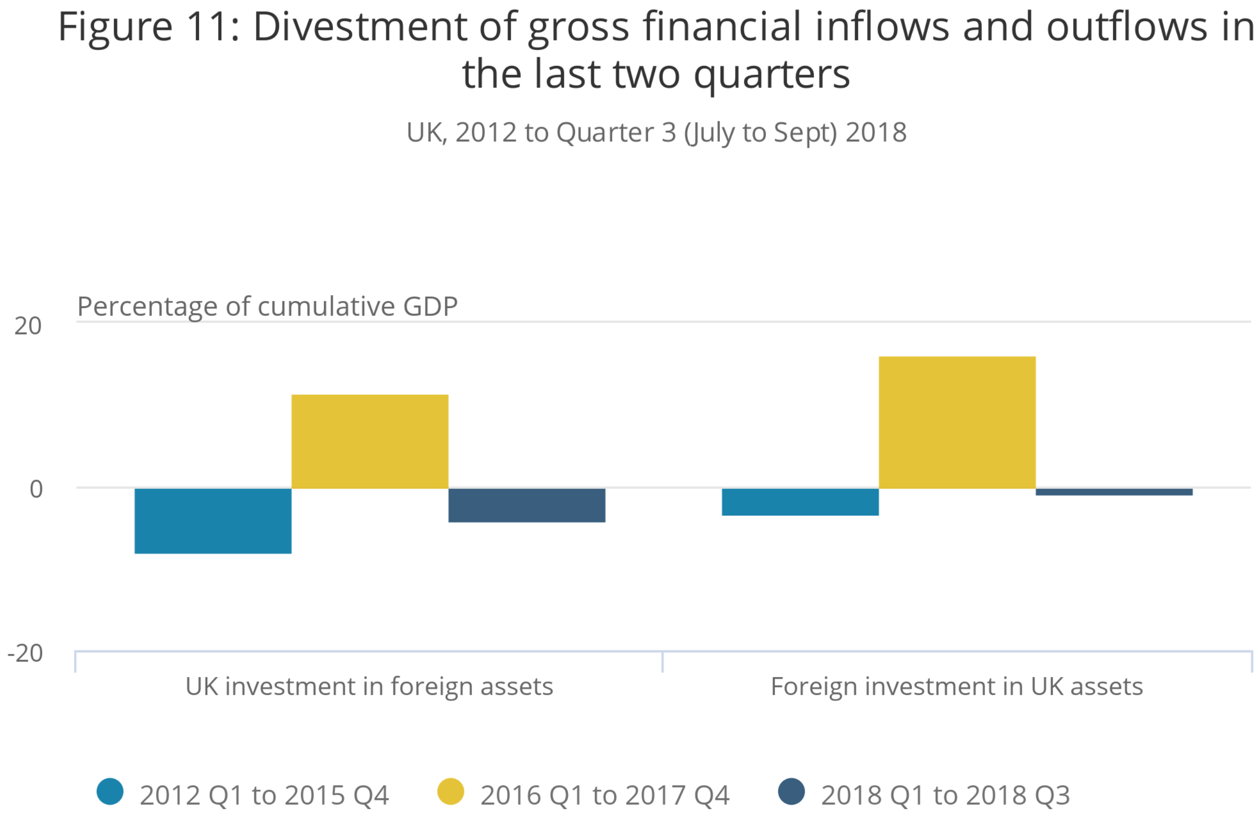
1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept), and Q4 refers to Quarter 4 (Oct to Dec).

As the rest of the world is a net lender to the UK, this borrowing must be financed by net financial inflows. Figure 11 shows how the UK's current account deficit has been financed of late. Between 2012 and 2015, the UK's external borrowing was overall being financed by UK investors selling more of their external assets than foreign investors were selling their UK assets. This overall financing position then reversed between 2016 and 2017, resulting in a large volume of foreign inflows – that is, an increase in the accumulation of financial liabilities. However, that position has changed in 2018, where in each of the last two quarters, the overall net position has been UK investors selling their foreign assets rather than increasing their net holdings of foreign liabilities. The latest Financial Stability Report (PDF, 6.04MB) highlights this reliance on external financing as a risk to financial stability, noting that "sharp falls in foreign investor appetite for UK assets could lead to falls in UK asset prices and a tightening in domestic credit conditions".

Although financial flows in and out of the UK tend to be volatile, the latest figures show that there has been a divestment of the net acquisition of financial assets and the net incurrence of financial liabilities in each of the last two quarters. Although some caution is advised given the inherent volatility in these flows, this is the first time that there have been consecutive quarters of divestment in almost three years. In Quarter 3 2018, the UK's external borrowing was financed by a £51.5 billion net inflow of portfolio investment, mainly reflecting equity flows. There was a divestment of UK foreign liabilities in the UK of £43.1 billion in the last quarter, which was driven by large flows of other investment which tend to be the most mobile form of capital – the same pattern in the previous quarter. In contrast, there were gross inflows of direct investment, but this was more than offset by divestment of UK other and portfolio investment in the rest of the world.

Figure 11: Divestment of gross financial inflows and outflows in the last two quarters

UK, 2012 to Quarter 3 (July to Sept) 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).

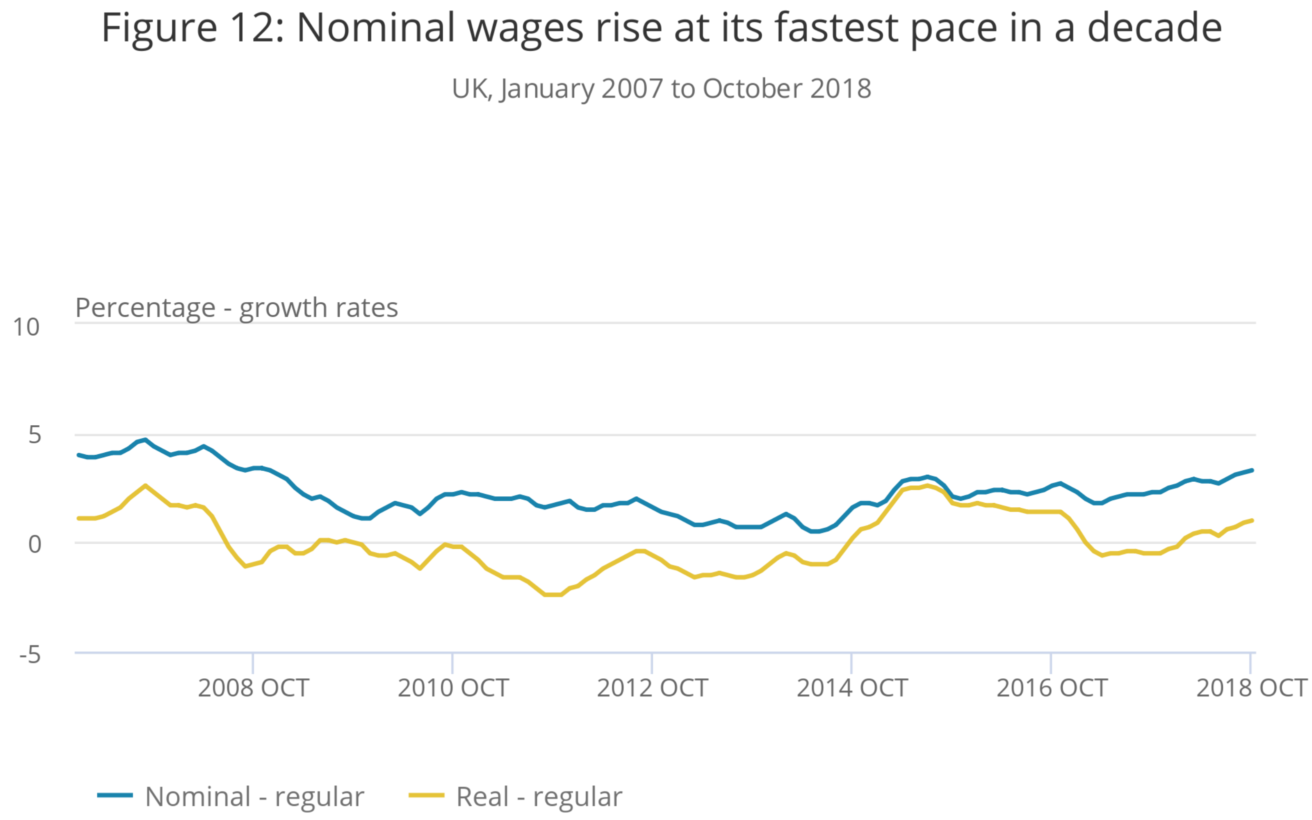
Despite incurring an increase in flows of net liabilities in Quarter 3 2018, there has been an improvement in the UK's net international investment position. The UK recorded a net liability position of £113.7 billion (5.4% of annualised GDP) at the end of the last quarter, an improvement from a revised 10.0% at the end of the previous quarter. This reflects revaluation effects, which capture the changes in the valuation of external assets and liabilities but when there is no change in the underlying stock. These can reflect changes in the exchange rate and /or equity prices.

5 . Labour market

There have been increasing signs that the tightness in the labour market is now showing up in higher nominal wage growth. In recent months, annual nominal regular wage growth has been in excess of 3%, which is the first time that this has happened since the effects of financial crisis took hold a decade ago. In the year to the three months to October, regular pay increased by 3.3% – the fastest increase since November 2008 – continuing the upward trend that has been seen over the last couple of years (Figure 12). Real regular wage growth increased by 1.0% over the same period, the fastest rate since the end of 2016, when inflation was subdued.

Figure 12: Nominal wages rise at its fastest pace in a decade

UK, January 2007 to October 2018



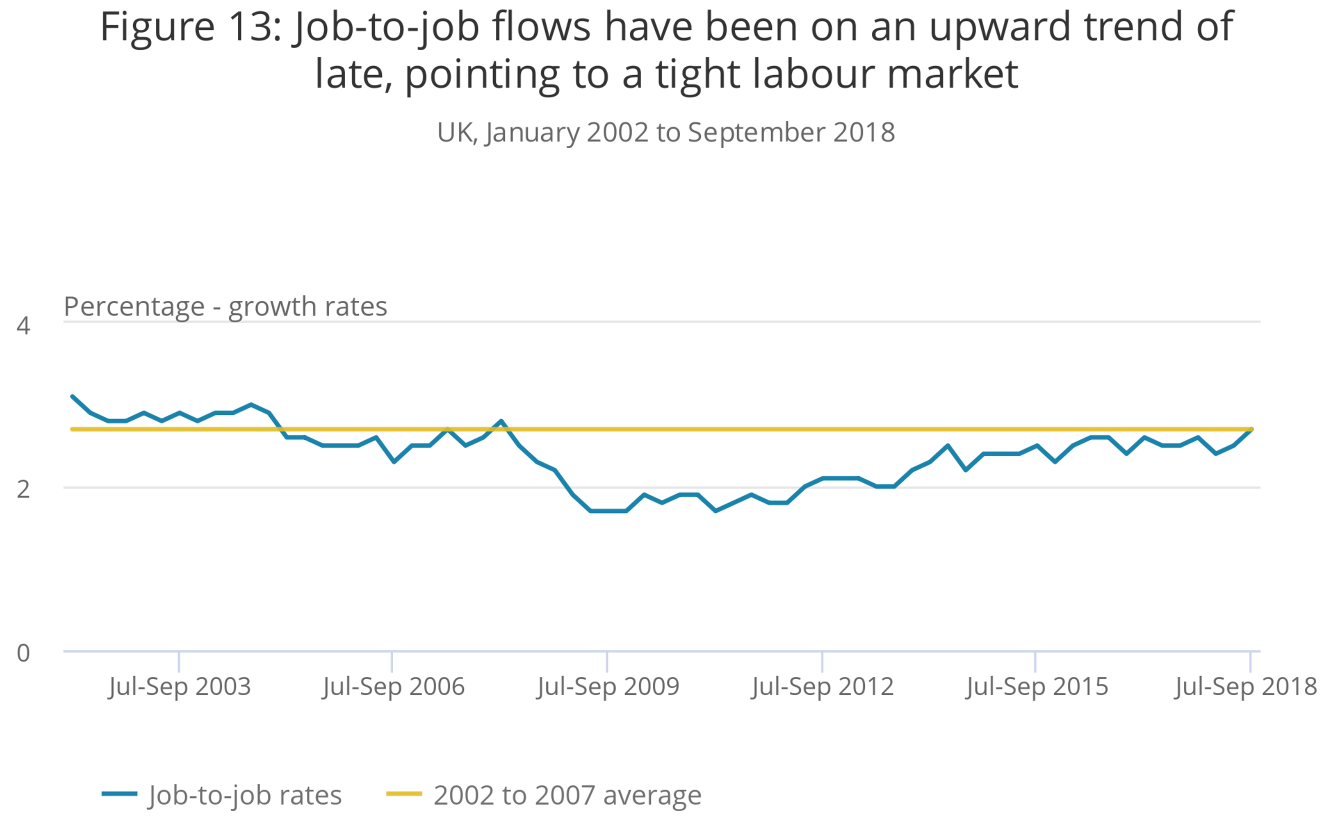
Source: Office for National Statistics

When there is limited spare capacity in the economy, employers are expected to offer higher wages as they compete over a smaller pool of available resource in the labour market. The tightness in the labour market today can be seen in a range of labour market indicators. The employment rate stood at 75.7% in the three months to October, the joint highest rate since records began in 1971, driven by an increase in full-time employment. The number of people in employment increased by 396,000 in the year to October 2018, with full-time employment increasing by 428,000 over the year, while there was a fall in part-time employment of 32,000 over the same period. The unemployment rate was 4.1%, which is low by historical standards, with the number of people unemployed falling by 49,000 over the last year.

Vacancies also remain high by historical levels, rising to a high of 848,000 over the three months to November. Vacancies provide 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 (or equivalently if the number of vacancies in relation to the size of the labour force is high), it would point to there being a tight labour market. The unemployment-to-vacancies ratio is now lower than the level before the financial crisis. Labour market flows provide another indicator of spare capacity in the labour market, as employees are less likely to move between jobs when there are high levels of slack. This is because it is likely that there will be less hiring by employers taking place in such times, or there is less job security. The latest figures show that there has been a continued increase in the flows of job-to-jobs moves, which has continued to be on an upward trend (Figure 13).

Figure 13: Job-to-job flows have been on an upward trend of late, pointing to a tight labour market

UK, January 2002 to September 2018



Source: Office for National Statistics

This has been corroborated by the latest Report on Jobs by the [Recruitment and Employment Confederation] (REC), which provides further signs that that the tightness in the labour market has led to rises in pay for both permanent and temporary staff. Pay for temporary staff increased at its fastest rate since July 2007, with the demand for labour driving a sharp increase in starting salaries. However, while staff placements continued to rise, it eased to a four-month low in November. Vacancy growth remains high by historical standards, though it eased to its slowest rate in over two years. While there was a fall in those businesses in the service industry that was looking to recruit, the [British Chambers of Commerce (PDF, 534KB)] also reports that almost three-quarters of businesses that did look to recruit experienced recruitment difficulties. The latest Inflation Report includes an update on business conditions from the Bank of England Agents. It shows that while there was a softening in employment intentions, employment was expected to continue to rise and that recruitment difficulties were expected to worsen, particularly in IT and construction.

The Annual Survey of Hours and Earnings provides a much richer insight into the distribution of earnings in the UK. Median hourly earnings among full time employees increased by 2.7% in the year to April 2018, while those in the top income decile experienced an increase of 3.4%. Earnings increased by 3.8% for those in the bottom decile. The introduction of the National Living Wage in April 2016 helps explain why the proportion of all jobs that are considered “low-paid” – that is, those jobs in which that employee is paid below two-thirds of the median pay figure – is the lowest on record.

The latest figures show that the median gender pay gap for full-time employees stood at a record low of 8.6% in April 2018, a fall from 9.1% in the previous year. For all employees, the gender pay gap fell to 17.9%. This higher figure reflects there being a higher proportion of females working in lower-paid, part-time jobs. Analysis of how the gender pay gap has changed over time and by age cohort shows that the difference in earnings between men and women has been on a downward trend over the last 20 years. This has been particularly marked for younger workers, where the gender pay gap in 2018 is 1.9% for those aged 18 to 21 years old, 1.3% for those aged 22 to 29 years and 0.8% for those aged 30 to 39 years. While there has also been a narrowing for the older cohorts, the gap in 2018 is much higher for those aged 40 to 59 years. It may be that this reflects that some of this cohort includes those females who have taken time out of the labour market to raise families. It can also be seen that the one cohort where the gender pay gap has increased in recent years is those aged 60 years or more.

6 . Prices

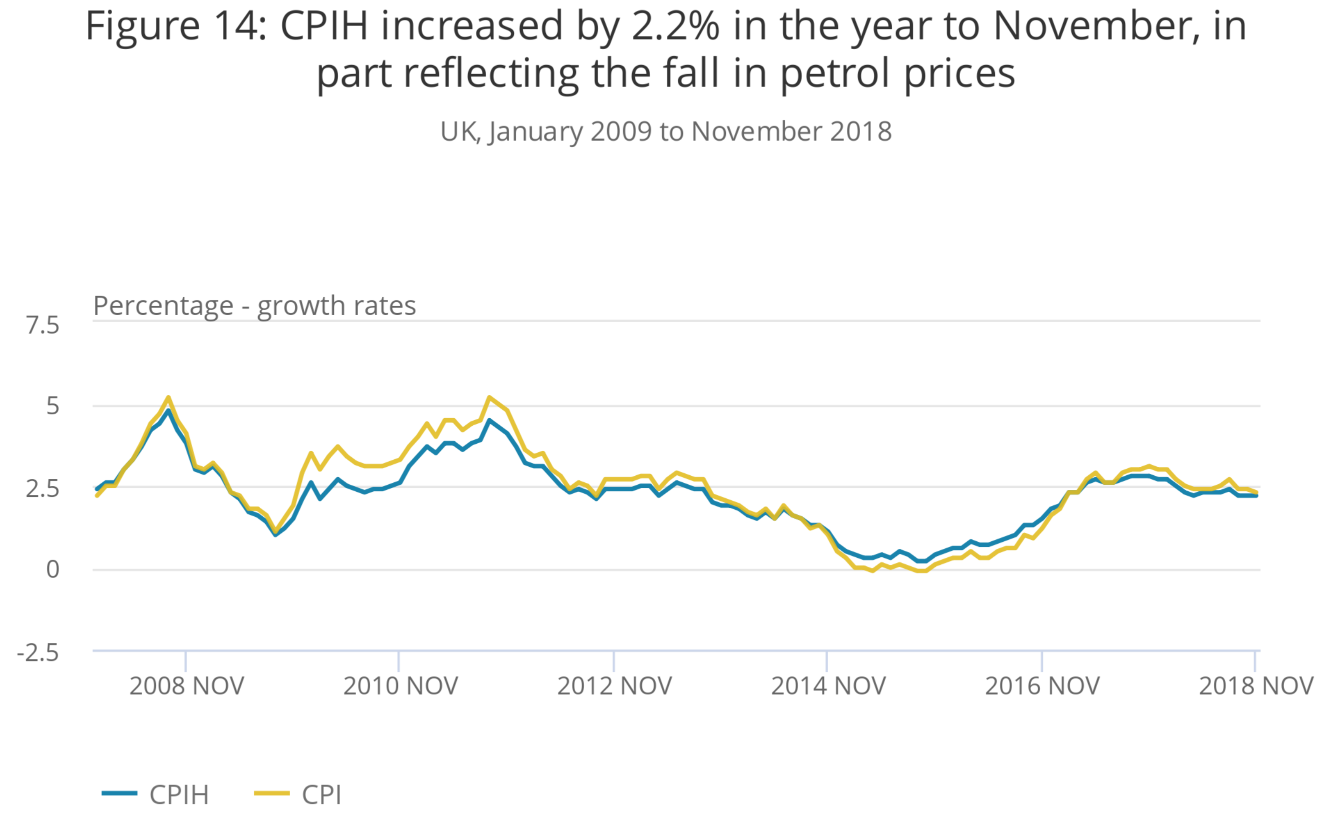
Following the outcome of the EU referendum, there was a sharp fall in the exchange rate. This led to an increase in inflation, as the sterling value of goods and services in imported final and intermediate demand rose and this has been reflected in consumer prices. The 12-month growth rate of the Consumer Prices Index including owner occupiers’ housing costs (CPIH) peaked at 2.8% in September to November 2017, but has since eased back. This is partly 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.

CPIH increased by 2.2% in the year to November, unchanged from a month earlier (Figure 14). Over the same period, CPI growth was 2.3%, which was down from the 2.4% annual change in October. This is the lowest annual rate of CPI since March 2017 – when it was also 2.3% – and reflects a large fall in petrol prices of 2.6 pence per litre between October and November 2018, compared with a rise of 1.8 pence per litre over the same period a year ago. There has been a fall in the crude oil price of late, reflecting demand and supply factors. This is reflected in the producer price index for crude oil, which shows a monthly fall of 11.8% in November.

Recreation and culture also contributed to the easing in consumer price inflation, where the main downward effects came from games, toys and hobbies (particularly computer games including downloads), and cultural services (principally admission fees to live music events). Price movements for both computer games and live music events can often be relatively large depending on the composition of bestseller charts and the bands that are touring at the time of price collection, often resulting in large overall price changes from month to month. This was partially offset by an upward contribution from alcoholic beverages and tobacco, where an increase in duty on tobacco at the Autumn Budget pushed up prices.

Figure 14: CPIH increased by 2.2% in the year to November, in part reflecting the fall in petrol prices

UK, January 2009 to November 2018



Source: Office for National Statistics

7 . Conclusions

The latest estimates show that UK economy grew by 0.6% in Quarter 3 (July to Sept) 2018, with some gain in momentum through the year. There was a temporary slowdown in the first quarter of the year, reflecting to some extent the effects of the adverse weather conditions. The pickup in the last two quarters partly reflects the increase in food and drink sales over the summer months, as consumers took advantage of the warmer weather and the World Cup. However, there is an underlying trend of subdued real gross domestic product (GDP) growth, reinforced by how the UK economy has compared with other G7 countries of late.

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. The households' saving ratio remains low by historical standards, while real household disposable income growth was flat in the latest quarter. There was a fall in reinvested earnings on foreign direct investment (FDI), which increased the net borrowing requirements of private non-financial corporations to finance their expenditure. The current account deficit widened in Quarter 3, while there has been a reversal of late in financial flows in and out of the UK, as the UK's external borrowing has overall been financed by UK investors selling more of their external assets than foreign investors were selling their UK assets.

The tightness in the labour market today can be seen in a range of labour market indicators and there have been increasing signs that this is now showing up in higher nominal wage growth. In the year to the three months to October, regular pay increased by 3.3% – the fastest increase since November 2008 – continuing the upward trend that has been seen over the last couple of years. Consumer Prices Index including owner occupiers' housing costs (CPIH) increased by 2.2% in the year to November, while Consumer Prices Index (CPI) growth recorded its lowest annual rate since March 2017. This reflects a large fall in petrol prices, as a result of the recent fall in the price of crude oil, reflecting demand and supply factors.