Office for National Statistics

Article

Quarterly economic commentary: October to December 2019

Economic commentary for the latest quarterly national accounts, prices and labour market indicators.

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Table of contents

1. Main points
2. Gross domestic product
3. Sector and financial accounts
4. Balance of payments
5. Labour market
6. Prices
7. Conclusions

1 . Main points

- Real UK gross domestic product (GDP) was flat in Quarter 4 (Oct to Dec) 2019; there was much volatility throughout the last year, in part reflecting changes in the timing of activity related to the UK's original planned exit dates from the EU, although the underlying picture is one in which there was a slowing in the UK economy.

- There was a sharp reduction in the net borrowing requirements for corporations, which were a net lender in Quarter 4 2019 of 0.3% of GDP, but much of this reflected movements in non-monetary gold between the UK and the rest of the world; the net lending of households stood at 0.4% of GDP, while the net borrowing of the government was 2.0% of GDP.

- In Quarter 4 2019, the current account deficit narrowed to 1.0% of GDP – the narrowest it has been since Quarter 2 (Apr to June) 2011 – reflecting an improvement in the UK's trade performance, but much of this reflected volatile movements in non-monetary gold; this was financed by the UK reducing its external assets in Quarter 4 2019, particularly in other investment.

- The employment rate increased to a joint record high of 76.5%, caused by a record quarterly increase in full-time employment; the unemployment rate stood at 3.9% in this three-month period, while regular nominal pay increased by 3.1% in the year to three months to January 2020.

- The Consumer Prices Index including owner occupiers' housing costs (CPIH) inflation rate was 1.7% in February; the rate of inflation slowed in the latter half of the last year, mainly reflecting a lower contribution from electricity, gas and other fuels in response to the lowering of the price cap for some domestic gas and electricity customers, but its contribution increased again in January 2020 as the price reductions from a year earlier unwound.

2 . Gross domestic product

UK gross domestic product (GDP) was flat in Quarter 4 (Oct to Dec) 2019. The quarterly path was particularly volatile throughout the last year, in part reflecting changes in the timing of activity related to the UK's original planned exit dates from the EU. However, looking through this volatility, the underlying picture is one in which there has been a slowing in the UK economy, which is likely to be reflecting domestic and global uncertainties (Figure 1). The 1.4% increase in UK GDP in 2019 is one of the slowest rates since the financial crisis.

More timely estimates show that the UK economy was flat in the three months to January 2020, [1] reflecting the recent underlying slowing in the services industry and falls in output of the production industry over this three-month period. Services output was flat, while production output fell by 1.0%; this was partially offset by a 1.4% increase in construction output.

Figure 1: Looking through the recent volatility, there was an underlying slowing in the UK economy

UK, Quarter 1 (Jan to Mar) 2015 to Quarter 4 (Oct to Dec) 2019

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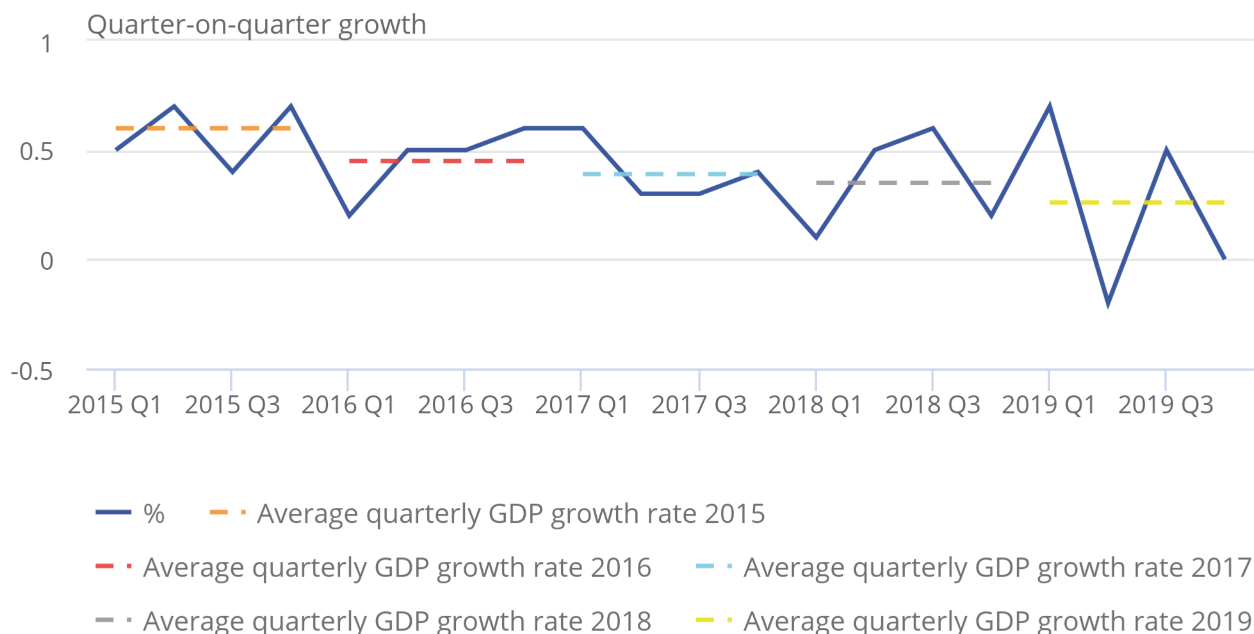

Source: Office for National Statistics – GDP quarterly national accounts, UK: October to December 2019

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).

International

The latest World Economic Outlook cites trade policy uncertainty and geopolitical tensions as factors weighing on the global economy in the second half of last year, particularly on manufacturing output and trade. Figure 2 shows how the G7 countries performed through last year. Three countries – France, Italy and Japan – experienced a contraction in Quarter 4 2019, while GDP was flat in Germany and the UK. The most striking figure is the 1.8% fall recorded in Japan in Quarter 4 2019; this is its largest contraction in over five years, and it is likely to partly reflect the increase in consumption tax last autumn.

However, these latest forecasts by the International Monetary Fund (IMF) do not incorporate any effects from the coronavirus (COVID-19) pandemic. The latest Interim Economic Outlook models a scenario where there are broader contagion effects through the global economy, in which there is a slowing in global GDP growth to 1.5% this year and a 3.8% fall in global trade. This is based on the effects not only of reducing the demand for goods and services but also impacting on the ability of businesses to supply those goods and services, incorporating “a significant hit to confidence, heighted uncertainty and (voluntary) restraints on travel and commercial and sporting events all likely to depress spending”.

The latest independent forecasts for the UK economy show that there is an expectation of a pronounced effect in Quarter 2 (Apr to June) 2020, with the new consensus for a quarterly fall in GDP of 0.3%. The latest Flash Purchasing Managers' Index (PMI) provides some further insight into the possible effects, highlighting that in March the "monthly decline in output across manufacturing and services exceeded that seen even at the height of the global financial crisis".

Figure 2: Three G7 countries experienced a contraction in GDP in Quarter 4 2019

G7 countries, real GDP growth, 2019

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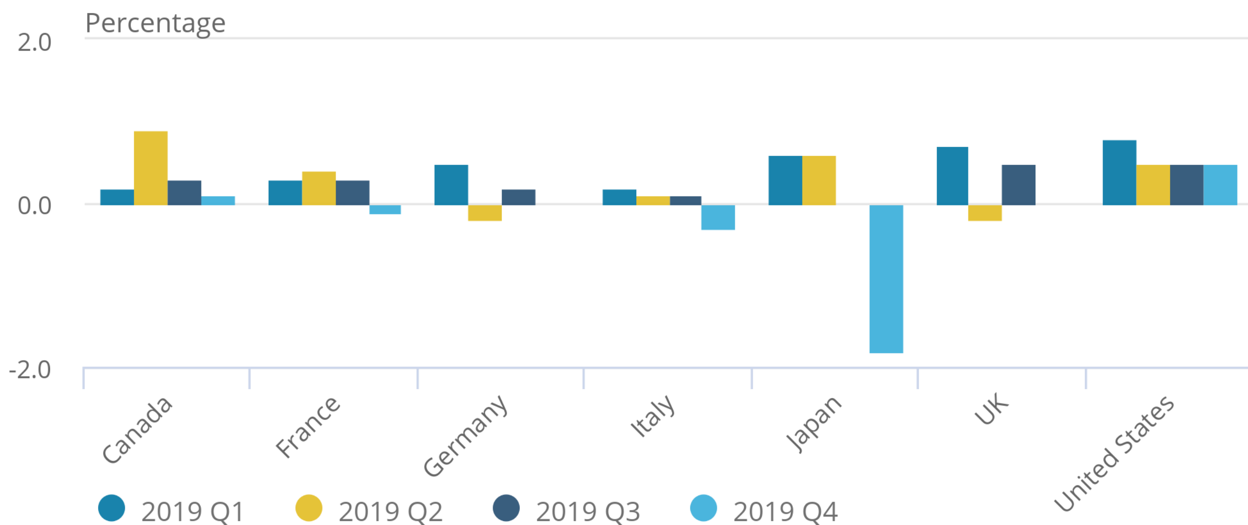

Source: Office for National Statistics, Organisation for Economic Co-operation and Development

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. All Organisation for Economic Co-operation and Development (OECD) figures correct as of 23 March 2020.

Output

The recent volatility was most pronounced in the production industry, specifically in manufacturing (Figure 3). This was consistent with activity being brought forward ahead of the UK's original intended EU departure date, followed by a slowdown in activity that was exacerbated by partial car plant shutdowns in April 2019. Similar impacts were seen ahead of the second intended EU departure date in October 2019, although to a lesser extent. The Bank of England Agents' summary of business conditions noted how "stockbuilding activity ahead of the October Brexit deadline was lower than it was ahead of the March deadline".

Manufacturing output fell for the third consecutive quarter, contracting by 1.1% in Quarter 4 2019. Some of the underlying weakness is likely to reflect the weaker global economy, as trade tensions have weighed on manufacturing and trade in particular. More timely information has pointed to a pickup in manufacturing output, in part reflecting the reduced political uncertainty in the UK. However, the UK Manufacturing PMI cited evidence of supply chain disruptions in February 2020, as there were “sizeable raw material delivery delays, rising input costs and increased pressure on stocks of purchases”.

The underlying slowing in the UK economy reflects the recent trend in the services industries. Services output increased by a subdued 0.2% in Quarter 4 2019, reflecting a broad-based slowing. The Bank of England Agents’ summary of business conditions recorded a weakening in business services activity as political uncertainty weighed on activity. The latest Services PMI cited a greater willingness to spend in early 2020, although there was evidence of “a negative impact on sales from the coronavirus outbreak, particularly to clients in overseas markets”.

Figure 3: There was an underlying slowing in services output, while volatility throughout the year was particularly pronounced in the production industry

UK, Quarter 1 (Jan to Mar) 2018 to Quarter 4 (Oct to Dec) 2019

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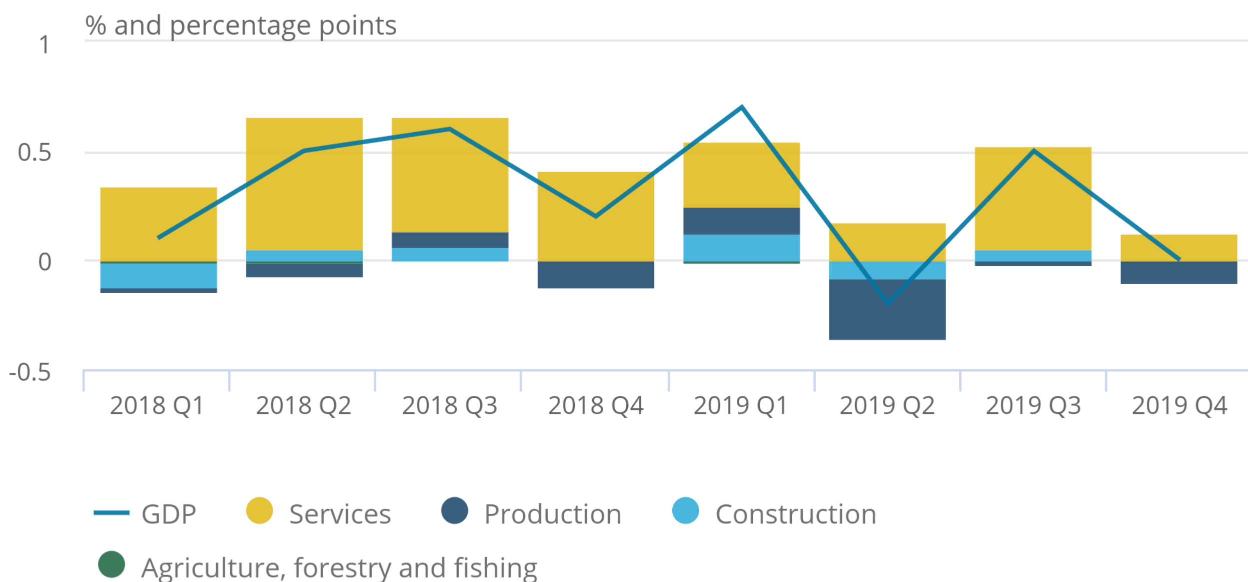


Source: Office for National Statistics – GDP quarterly national accounts, UK: October to December 2019

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. Chart shows contribution to real gross domestic product (GDP) quarter-on-quarter growth.
3. Components contributions may not sum to total because of rounding

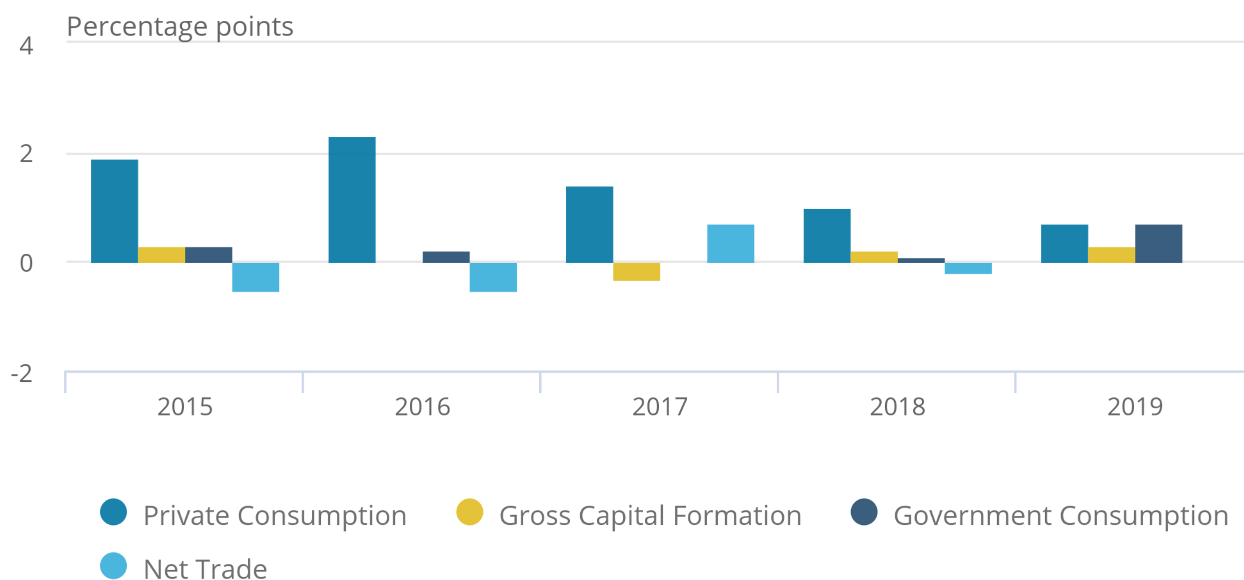
Expenditure

The loss of underlying momentum in the UK economy is largely explained by an easing in private consumption (Figure 4). This not only likely reflects the initial squeeze in purchasing power, following the increase in import inflation after the fall in the exchange rate, but also the heightened levels of uncertainty that may have led to an increase in precautionary saving. Given the "option value of waiting", uncertainty is also likely to have led to the postponement or cancellation of capital spending. Businesses have continued to hold back on investment of late, particularly at this point in the economic cycle where a pickup might have been expected.

These trends have been apparent towards the end of the year, as household consumption was flat in Quarter 4 2019 while business investment fell by 0.5%. There was a slight increase in the GfK Consumer Confidence figures in recent months, although any impact of the COVID-19 outbreak on consumer behaviour, confidence and spending patterns are not reflected so far. For instance, the latest CBI Distributive Trades Survey reports that "while households are stockpiling groceries in response to the spread of the coronavirus and the introduction of social distancing, they are putting off purchases of non-essential items" while retail sales volumes are expected to fall sharply in the year to April. The latest Decision Maker Panel reports that the proportion of businesses that are reporting "Brexit as one of their top three current sources of uncertainty remained broadly unchanged in February", following a fall since the UK general election. However, these uncertainties are now expected to take longer to be resolved, while any potential COVID-19 effects have not yet been reflected.

Figure 4: The contribution of private consumption to annual GDP growth has eased in recent years

UK, 2015 to 2019



Source: Office for National Statistics – GDP quarterly national accounts, UK: October to December 2019

Notes:

1. Private consumption comprises of final consumption expenditure by households and non-profit institutions serving households.

2. Chart shows contribution to real GDP year-on-year growth.

3. Components contributions may not sum to total due to rounding. The statistical discrepancy is also not displayed.

Government consumption has contributed much of the increase in GDP in 2019. This was caused by central government spending in areas such as health, education and defence, in part reflecting the Spending Round 2019 . Trade flows were particularly volatile through 2019, largely reflecting movements in non-monetary gold and stockpiling by UK and European businesses. The monthly figures imply that some activity was being brought forward in preparation for the UK's intended departure date from the EU on 31 October 2019, albeit less pronounced than earlier in the year. There was an increase of £2.4 billion [2] in stocks being held by UK companies in Quarter 4 2019.

Income

Growth of nominal GDP slowed to 0.1% in Quarter 4 2019, which is the weakest figure since Quarter 2 2011. Compensation of employees (CoE) increased by 0.6% in Quarter 4 2019, caused by wages and salaries; this represents an easing from Quarter 3 (July to Sept) 2019. Gross operating surplus (GOS) of corporations fell by 1.3% in Quarter 4 2019, following an increase of 3.5% in Quarter 3 2019. The latest information on profit warnings cites “political uncertainty, rising geopolitical tensions and a global economic slowdown”, as warnings increased in 2019. Over a fifth of profit warnings cited domestic or geopolitical uncertainty in Quarter 4 2019.

Notes for: Gross domestic product

1. The latest official estimates of monthly GDP do not reflect the revisions that have been incorporated as part of the latest quarterly national accounts released 31 March 2020. Fully consistent figures will be released 9 April 2020.

2. Alignment and balancing adjustments are typically applied to the inventories component to help balance the different approaches to GDP. These adjustments have been removed in this figure.

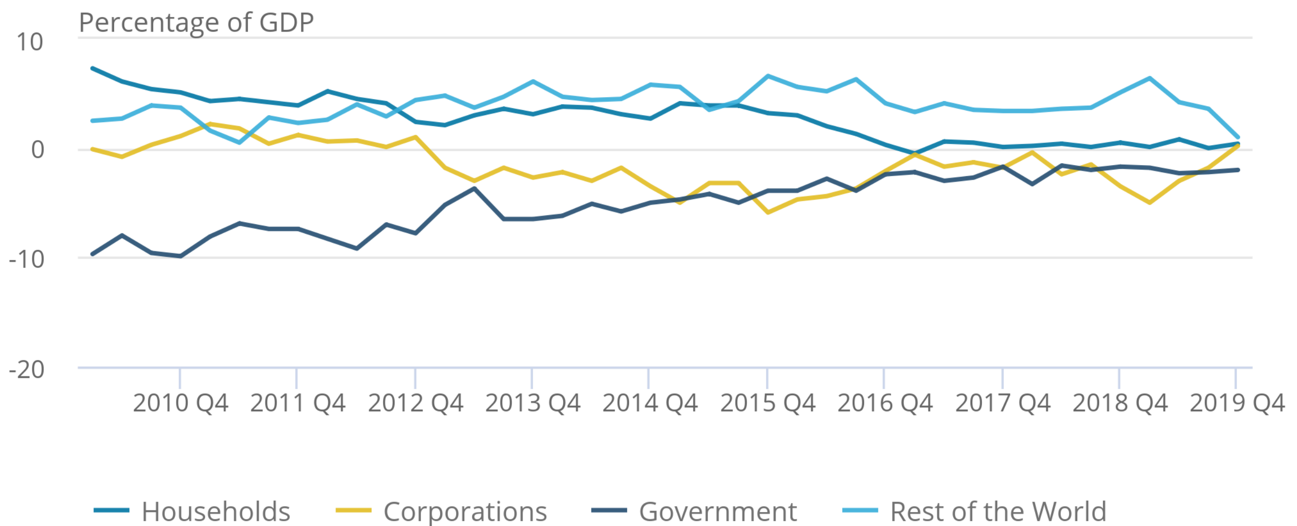
3 . Sector and financial accounts

The paths of sectoral income and expenditure determine whether households, [1] corporations, the government and the rest of the world are net lenders or borrowers. As total borrowing must be matched by total lending, these financial positions must sum to zero in any period.

Figure 5 shows that while the rest of the world was a net lender to the UK in Quarter 4 (Oct to Dec) 2019, it was at its lowest level since Quarter 2 (Apr to June) 2011. This reduction in the reliance on external financing was reflected by a sharp reduction in the net borrowing requirements for corporations, which were a net lender in Quarter 4 2019 of 0.3% of gross domestic product (GDP). This was the first time that corporations were a net lender since late 2012. The net lending of households stood at 0.4% of GDP, while the net borrowing of the government was 2.0% of GDP in Quarter 4 2019.

Figure 5: There was a sharp reduction in net borrowing by corporations in Quarter 4 2019, while the UK's reliance on external financing was at its lowest since 2011

UK, Quarter 1 (Jan to Mar) 2010 and Quarter 4 (Oct to Dec) 2019



Source: Office for National Statistics – Quarterly sector accounts, UK: October to December 2019

Notes:

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

Corporations were a net lender of 0.3% of GDP in Quarter 4 2019, having been a net borrower of 1.9% of GDP in Quarter 3 (July to Sept) 2019. This large movement reflected the improved financial position of financial corporations, as there was a large fall in gross capital formation in Quarter 4 2019. This was largely caused by volatile movements in non-monetary gold between the UK and the rest of the world in Quarter 4 2019. Financial flows are typically volatile, which was the case in Quarter 4 2019. The improved financial position reflected a large increase in the issuance of equity and investment fund shares and in currency and deposits by financial corporations, partially offset by reductions in the holdings of loans and debt securities.

There was a slight increase in the net borrowing of private non-financial corporations (PNFCs), which stood at 0.4% of GDP in Quarter 4 2019. This reflected a fall in gross operating surplus (GOS), partially offset by a fall in gross capital formation. This reflected the large exports flows of non-monetary gold, while the heightened levels of uncertainty through last year also weighed on capital spending by PNFCs. This was financed by a reduction in the holdings of finance in the other accounts and in the holdings of loans, partially offset by an increase held as currency and deposits.

There was a slight increase in the net lending by households, which was 0.4% of GDP in Quarter 4 2019. This primarily reflected a fall in taxes on income and wealth and a rise in compensation of employees (CoE) and social contributions. This also helps explain the rise in the saving ratio to 6.2% in Quarter 4 2019. While the saving ratio was still relatively low by historical standards, it picked up a little. Recent analysis has "some of the saving rate increase to be due to precautionary motives" in response to increased levels of uncertainty. The corresponding financial flows can be volatile, but households primarily financed the higher levels of net lending in Quarter 4 2019 by increasing the amount of finance held in other accounts and currency and deposits placed with financial institutions.

General government was a net borrower in Quarter 3 2019 of 2.4% of GDP. The latest figures show that public sector net borrowing (PSNB) in the financial year-to-date (April 2019 to February 2020) was £44.0 billion; this was £4.2 billion higher than the same period a year ago. Public sector net debt (PSND) stood at 79.1% of GDP at the end of February 2020, lower than the 80.2% a year earlier.

In the latest Economic and fiscal outlook, PSNB is forecast to be £47.4bn this financial year. However, the Office for Budget Responsibility (OBR) has subsequently explained that these forecasts are "unlikely to be particularly informative about the full-year picture". This reflects that the impact of the coronavirus (COVID-19) on the UK economy appeared to be modest at the time of the forecast. However, it is expected that the recent policies undertaken by the government and the Bank of England will increase public sector borrowing and debt, while any disruption to economic activity will also have an adverse impact. As such, according to the OBR, it remains uncertain "how big an impact [this] will have in what is now the final month of this financial year".

Notes for: Sector and financial accounts

1. Households includes non-profit institutions serving households (NPISH).

4 . Balance of payments

The UK current account deficit captures the extent to which it is borrowing from the rest of the world. Historically, overseas investors have been net lenders to the UK, and this external financing has widened to levels that are high by historical and international standards in recent years. This had raised concerns around whether this was sustainable, which had become heightened by the uncertainty over the future of the UK's trading arrangements, particularly if there is a fall in the confidence of foreign investors and/or there is a shift in the global risk environment.

Figure 6 shows that there was a marked narrowing in the current account deficit over the last year. In Quarter 4 (Oct to Dec) 2019, it stood at 1.0% of gross domestic product (GDP) – the narrowest it has been since Quarter 2 (Apr to June) 2011 – reflecting an improvement in the UK's trade performance. That said, some of this improvement reflected trade in non-monetary gold, which can be particularly volatile. Trade flows were also impacted by the effects of stockpiling by businesses that took place in 2019, in anticipation of the UK's proposed exit dates from the EU at the end of March and October 2019.

Figure 6: The current account deficit was at its narrowest since early 2011 in Quarter 4 2019

UK, Quarter 1 (Jan to Mar) 2010 and Quarter 4 (Oct to Dec) 2019

Source: Office for National Statistics – Balance of payments, UK: October to December 2019

Notes:

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

A current account deficit must be financed by net financial inflows. This can be achieved by increasing external liabilities to the rest of the world and/or disinvesting in previously owned external assets. In recent years, the overall financing position has reflected an increase in the accumulation of financial liabilities to finance the net borrowing from the rest of the world. The latest Financial Stability Report highlights that this reliance on net foreign capital inflows leaves “the UK vulnerable to a reduction in international investor appetite for UK assets, which could lead to a tightening in credit conditions for UK households and businesses”. That said, in 2019 the UK financed its net borrowing by disinvesting in its external assets.

There were large swings in the financial flows between the UK and the rest of the world of late, reflecting the volatile nature of financial flows into and out of the UK. It is possible that these financial flows were also impacted by a shift in the appetite of foreign investors, given the earlier deadlines for the UK’s withdrawal from the EU.

In Quarter 4 2019, the UK reduced its liabilities to the rest of the world, primarily in other investment. This tends to be the most mobile form of capital, comprising mainly of loans and deposits. This was more than offset by the UK reducing its external assets in Quarter 4 2019 to help finance its net borrowing position, particularly other investment. Movements in these capital flows were particularly pronounced of late, and the Bank of England highlights that the relatively large share of other investment in the UK’s net inflows could leave the UK more vulnerable to a shift in investor confidence.

5 . Labour market

The latest headline figures for the three months to January 2020 show a labour market that remains tight. However, given that there were only two reported cases of the coronavirus (COVID-19) in the UK by the end of January, any adverse impacts on the UK labour market from the global pandemic are not expected to have been picked up in the figures so far.

Employment growth had slowed through 2019, likely reflecting the underlying loss in momentum in the domestic and global economy as well as the lower levels of spare capacity in the labour market. That said, those in employment rose by 184,000 in Quarter 4 (Oct to Dec) 2019, as the employment rate increased to a joint record high 76.5%, caused by a record quarterly increase in full-time employment. The unemployment rate stood at 3.9% in the three-month period, which remains low by historical standards. This is now slightly below the latest estimates of the natural rate of unemployment by the Office for Budget Responsibility (OBR) and the Bank of England.

Given that employers compete over a smaller pool of available resource in a tight labour market, it would be expected that higher wages are offered in a tight labour market in order to recruit and retain employees with the necessary skills. While there was a pickup in the underlying trend for nominal wage growth, there was a slowing over the previous six months (Figure 7). Regular nominal pay increased by 3.1% in the year to three months to January 2020. However, the latest views of the National Institute of Economic and Social Research show a weaker outlook for wage growth this year, reflecting “the impact of the coronavirus outbreak in the United Kingdom and in many other countries around the world”.

Figure 7: There was a slight easing in nominal pay growth in recent months

UK, January 2007 to January 2020

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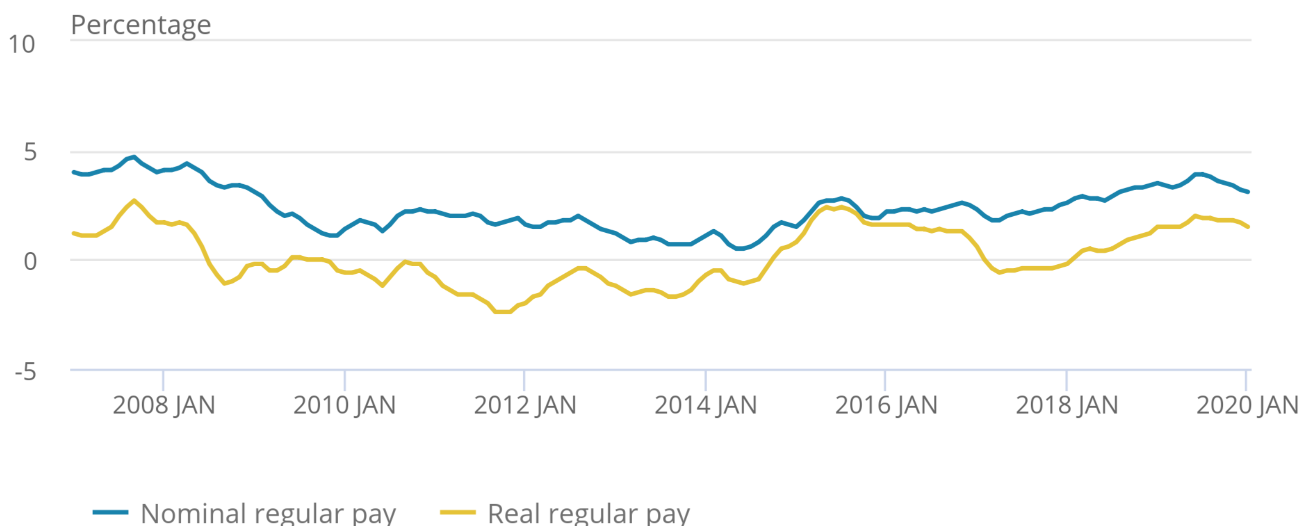


Source: Office for National Statistics – Labour market overview, UK: March 2020

Vacancies provide an alternative 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 imply a tight labour market. The unemployment-to-vacancies ratio remained low by historical standards, although the number of vacancies had continued to ease through the year. Despite rising in the three months to February 2020, the number of vacancies (817,000) was 3.6% lower than a year earlier. This might indicate that there was an easing in the demand for labour in response to higher levels of domestic and global uncertainty.

Permanent placement fell through much of last year, in part reflecting the heightened levels of uncertainty. However, the latest report on jobs by The Recruitment and Employment Confederation (REC) found that permanent placements increased for the third consecutive month in February and at their fastest pace in over a year. This was attributed to “sustained improvement in market confidence following last year's General Election”, with this increase in competition for labour leading to a rise in the starting pay for permanent staff. It also found that the candidate supply fell, albeit at its weakest rate since mid-2013. The REC cited that “improved confidence among workers and upcoming changes to IR35 legislation” may have explained the slower decline in labour supply.

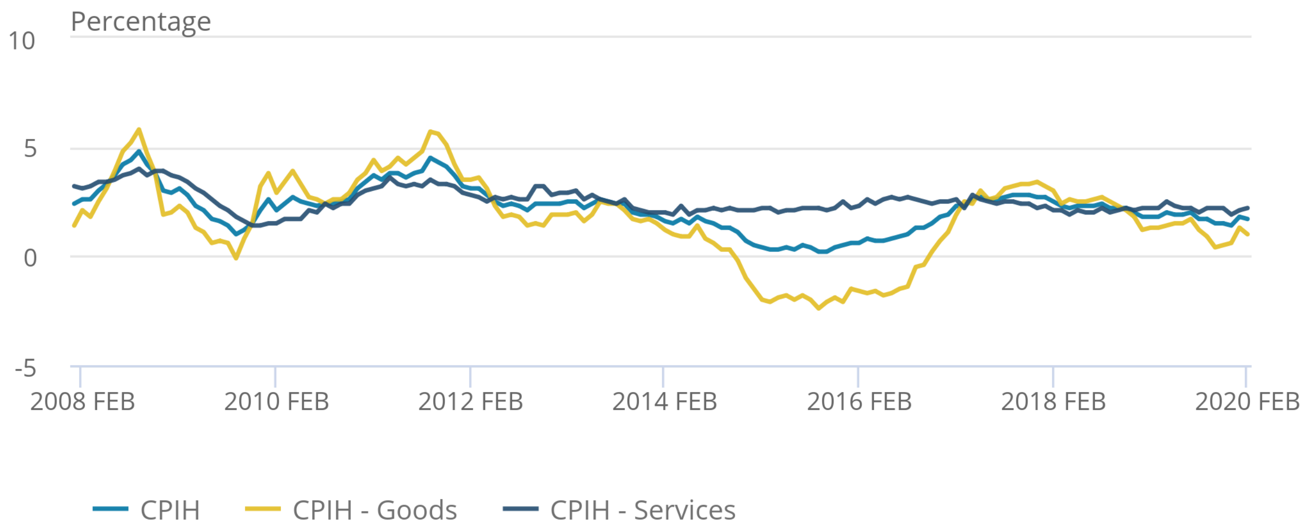
6 . Prices

After a pickup in January, there was a slight easing in the Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate in February to 1.7% (Figure 8). The contributions to change in the CPIH inflation rate were relatively small in this period, including downward price pressures from housing and household services and alcohol and tobacco. Analysis by the National Institute of Economic and Social Research found that its estimate of underlying inflation remained unchanged at 0.9% in February, consistent with its forecast of “headline CPI inflation rising to 2.1 per cent in the 12 months to February 2021”.

CPIH inflation has slowed in the latter half of the last year, mainly reflecting a lower contribution from electricity, gas and other fuels in response to the lowering of the price cap for some domestic gas and electricity customers by the Office of Gas and Electricity Markets (Ofgem) for the six-month period in effect from October 2019. However, its contribution increased again in January 2020 as the price reductions in January 2019 unwound. Any effects of the coronavirus (COVID-19) outbreak on the demand and supply of goods and services are not expected to have been picked up in these figures so far.

Figure 8: There was a slight easing in CPIH inflation in February to 1.7%

UK, Annual CPIH Inflation, January 2008 to February 2020



Source: Office for National Statistics - Consumer Price Inflation, UK: February 2020

There was a marked increase in annual CPIH goods inflation through late 2016 and 2017. This reflected the increase in the British pound value of imported final and intermediate goods following the fall in the exchange rate around the EU referendum in 2016. Having peaked at 3.4% in December 2017, the 12-month CPIH rate of goods inflation has since fallen back, reaching 0.4% in October 2019. It has picked up in subsequent months, standing at 1.0% in February. CPIH services price inflation is more of a proxy for domestic cost pressures, which fell from 2.8% in April 2017 to 2.2% in December 2017 and has remained around that level through to February 2020.

The overall inflation rate for those with an import content of at least 40% continues to be relatively muted compared with that experienced through 2017 and 2018, but it has increased a little in recent months. The contribution of those components that have a low import content of 0% to 10% does not appear to show a pickup in domestically generated inflation of late.

7 . Conclusions

Movements in UK gross domestic product (GDP) were particularly volatile throughout 2019, in part reflecting changes in the timing of activity related to the UK's original planned exit dates from the EU. However, looking through this volatility, the underlying picture is one in which there was a slowing in the UK economy, with UK GDP flat in Quarter 4 (Oct to Dec) 2019. Domestic and global uncertainties are likely explanations for the loss in momentum.

There was a sharp reduction in the reliance on external financing, which reflected the fall in the net borrowing requirements for corporations, which were a net lender in Quarter 4 2019 of 0.3% of GDP. There was a large fall in gross capital formation by financial corporations in Quarter 4 2019, largely caused by volatile movements in non-monetary gold between the UK and the rest of the world. There was a slight increase in the net lending by households, mirrored by a rise in the saving ratio to 6.2% in Quarter 4 2019. While the saving ratio was still relatively low by historical standards, it picked up a little recently, which might reflect precautionary motives in response to increased levels of uncertainty.

There was a marked narrowing in the UK's reliance on external financing over the last year, as the current account deficit reached 1.0% of GDP in Quarter 4 2019. This is the narrowest it has been since Quarter 2 (Apr to June) 2011, but much of this reflected volatile movements in the trade of non-monetary gold. Trade flows were also impacted by the effects of stockpiling by businesses that took place in 2019, in anticipation of the UK's proposed exit from the EU at the end of March and October 2019. This was financed by the UK reducing its external assets in Quarter 4 2019, particularly in other investment, which is typically the most mobile form of capital.

Although there was some slowing through 2019, employment rose by 184,000 in Quarter 4 2019. The employment rate increased to a joint record high 76.5%, while the unemployment rate stood at 3.9% in the three-month period. Regular nominal pay increased by 3.1% in the year to three months to January 2020, continuing the easing over the previous six months. Despite rising in the three months to February 2020, the number of vacancies (817,000) is 3.6% lower than a year earlier.

The Consumer Prices Index including owner occupiers' housing costs (CPIH) inflation slowed in the latter half of the last year, mainly reflecting a lower contribution from electricity, gas and other fuels. This was in response to the lowering of the price cap for some domestic gas and electricity customers by the Office of Gas and Electricity Markets (Ofgem) for the six-month period in effect from October 2019. However, its contribution increased again in January 2020 as the price reductions from a year earlier unwound. CPIH inflation was 1.7% in February.