Office for National Statistics

Article

Quarterly economic commentary: October to December 2022

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

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Release date:
31 March 2023

Next release:
30 June 2023

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1 . Main points

- UK gross domestic product (GDP) increased by 0.1% in Quarter 4 (Oct to Dec) 2022, leaving the economy 0.6% larger than a year earlier, as higher inflation and a tightening in financial conditions have weighed on the economy in recent quarters.

- There was a narrowing in the UK current account deficit in Quarter 4 2022 to 0.4% of GDP, reflecting an improvement in net investment income; there were large disinvestments of other investments held by UK and foreign investors.

- The unemployment rate of 3.7% is close to the historical lows recorded in the mid-1970s, while broader measures of labour market availability are close to their lows, although the three-month change in vacancies has now declined for eight consecutive months.

- There was an increase in the 12-month rate of Consumer Prices Index (CPI) inflation to 10.4% in February 2023, having fallen for the previous three months; core inflation remains elevated pointing to underlying inflationary pressures.

2 . National accounts

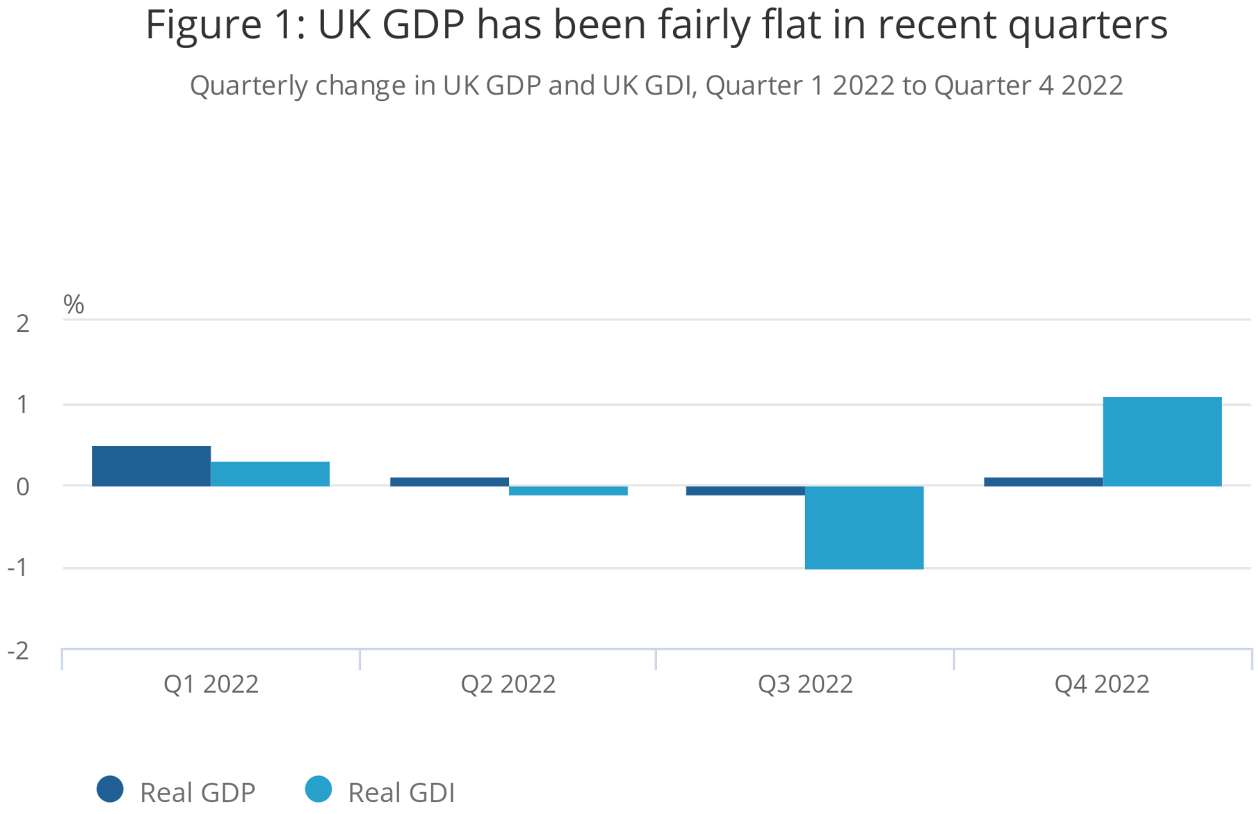
Higher inflation and a tightening in financial conditions have weighed on the UK economy in recent quarters (Figure 1). Gross domestic product (GDP) increased by 0.1% in Quarter 4 (Oct to Dec) 2022, leaving the economy only 0.6% larger than a year earlier. There was a 0.3% rebound in GDP in January 2023, following a 0.5% contraction in December 2022.

There has been some recent volatility in the monthly path, particularly in the transport and storage, health, and education industries. This reflected the timing of industrial action over these months and the unseasonal fall in school attendance levels in December 2022.

Recent findings explain how the UK has experienced its largest negative terms-of-trade impact in around 50 years , reflecting how the UK has been an importer of higher energy and commodity prices over the last year. That said, there has been an improvement in real gross domestic income in Quarter 4 2022, reflecting lower natural gas prices feeding into a fall in import prices from recent highs.

Figure 1: UK GDP has been fairly flat in recent quarters

Quarterly change in UK GDP and UK GDI, Quarter 1 2022 to Quarter 4 2022



Source: GDP quarterly national accounts from the Office for National Statistics

Notes:

1. Real GDI is a measure that adjusts real GDP to reflect changes in purchasing power that arise from movements in the terms of trade, which capture the ratio of export prices to import prices.

2. In the year to Quarter 4 2022, the 0.6% increase in real GDP was larger than that in real GDI (0.3%), implying a negative welfare effect over this period.

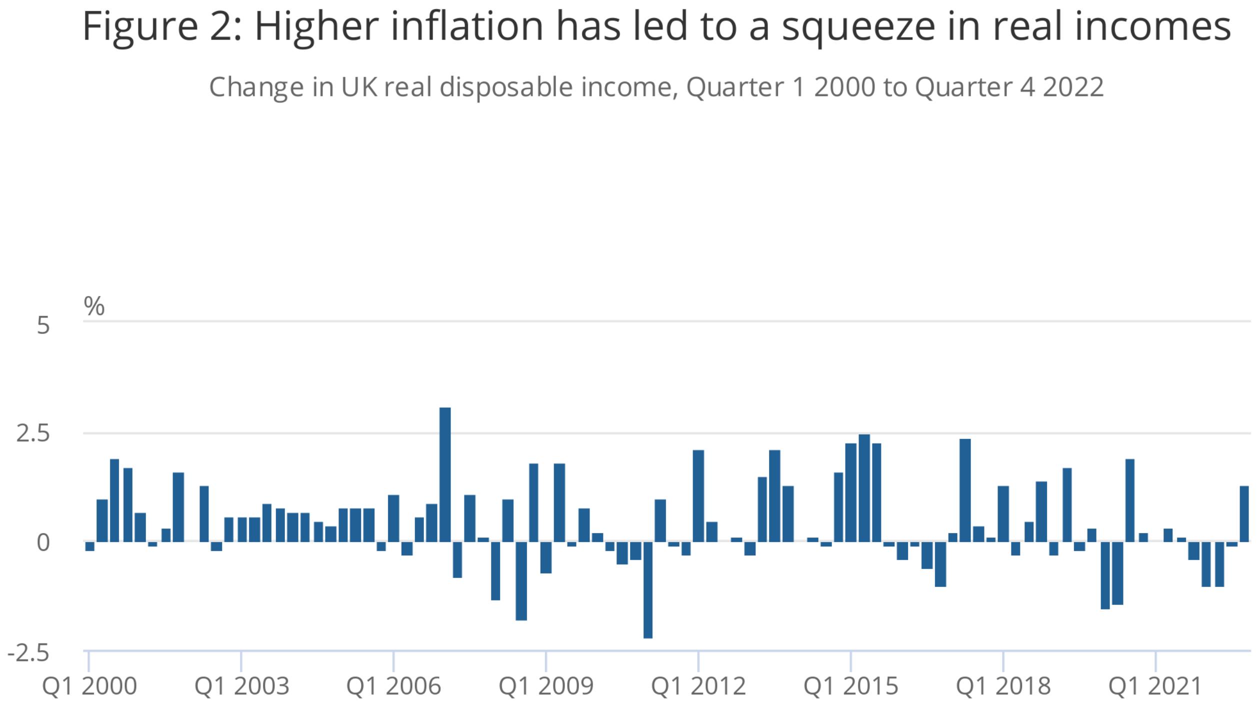
Survey findings show that the cost-of-living crisis is having an impact on consumption behaviour, where households are spending less on essentials and non-essentials. One uncertainty is the extent to which any "forced" savings built up over the coronavirus (COVID-19) pandemic will be run down this year in response to the real income squeeze.

There was an uptick in the saving ratio to 9.3% in Quarter 4 2022, including the effects of the Energy Bills Support Scheme where a £400 payment was provided to consumers. This is spread over a period of six months beginning on 1 October 2022. The higher level of the saving ratio of late also reflects changes in the net equity that households have in pension funds. Movements in the price and yield of UK government bonds have fed through to the income earned on these pension funds.

Higher inflation continues to bite on real disposable incomes. This had declined for four consecutive quarters before a 1.3% increase in Quarter 4 2022, which included the effects of the Energy Bills Support Scheme on gross disposable income (Figure 2). There was a slight rebound in the volume of household consumption expenditure in Quarter 4 2022, which slowed through the second half of last year.

Figure 2: Higher inflation has led to a squeeze in real incomes

Change in UK real disposable income, Quarter 1 2000 to Quarter 4 2022



Source: Quarterly sector accounts from the Office for National Statistics

More timely figures show that there has been a fall in net mortgage lending to individuals in January 2023, as gross repayments increased. Net mortgage approvals fell for the fifth consecutive month. There was an increase in the interest rate paid on newly drawn mortgages and the stock of mortgages in January.

Private non-financial corporations (PNFCs) became net lenders in Quarter 4 2022, as there was an increase in their profits, though this primarily reflected higher returns in the oil and gas industry. There was also a fall in capital expenditure in the final quarter, which remains below its pre-coronavirus levels.

There is some evidence that investment intentions have improved, reflecting slightly lower uncertainty about the economy and how high labour and non-labour costs are incentivising more automation to improve efficiency. There was an increase in net repayments of loans by businesses in January 2023, while there was an increase in cost of new borrowing by PNFCs. Tighter financial conditions might have an impact upon investment.

There was an increase in public sector net borrowing excluding public sector banks (PSNB ex) in February 2023 to £16.7 billion. This higher borrowing on the year primarily reflected higher spending on energy support schemes, including the Energy Price Guarantee (EPG) for households and the Energy Bill Relief Scheme (EBRS) for businesses.

This was partially offset by lower spending on interest payable on public sector net debt (PSND) on the year. Many of these debt payments are index-linked. There was a fall in the Retail Prices Index compared with a year ago, which feeds through into lower interest payable on the year. This was the first year-on-year fall since April 2021. Receipts were higher on the year, particularly in Pay As You Earn Income Tax and Corporation Tax receipts, which included additional revenues from the energy profits levy.

3 . Balance of payments

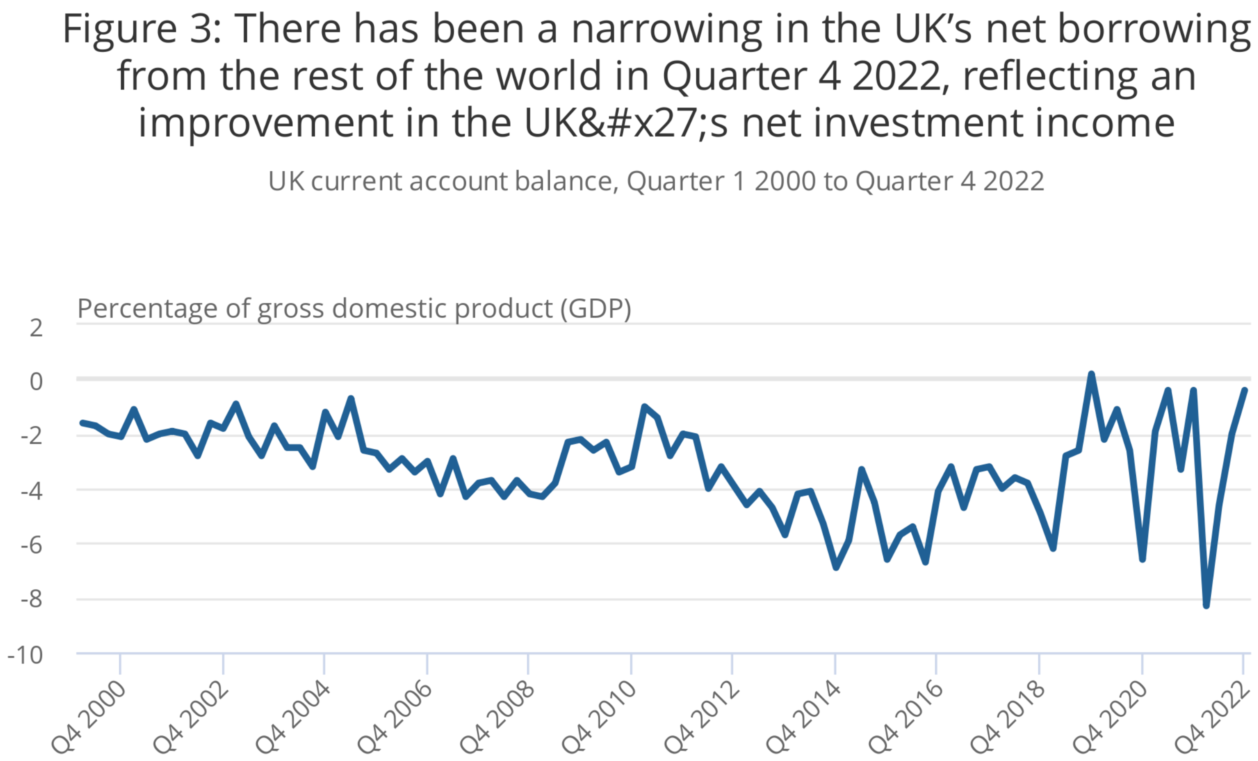
There has been sharp narrowing in how much the UK has been borrowing from the rest of the world (Figure 3). In Quarter 4 (Oct to Dec) 2022, the UK had a current account deficit of 0.4% of gross domestic product (GDP), including volatile movements in non-monetary gold and an improvement in net investment income.

Higher energy prices in response to the conflict in Ukraine increased the value of oil and other fuels imports, which were not more than offset by lower volumes for these products. This led to a widening of the underlying goods trade deficit through much of 2022. However, in Quarter 4 2022, there was an improvement in the net goods trade position for other fuels, given the lower levels of natural gas prices towards the end of 2022. The Organisation for Economic Co-operation and Development highlight there was a [decline in global trade in late 2022].

In Quarter 4 2022, the UK recorded a surplus on its net investment income. There was an increase in net income on other investment, reflecting higher interest rates. Cross-border income flows have also been affected by the energy crisis. Movements in oil and gas prices over the last year have been reflected in changes in the returns on the holdings of assets in the oil and gas industry. In Quarter 4 2022, the UK paid out less more income on foreign direct investment in the UK oil and gas industry.

Figure 3: There has been a narrowing in the UK’s net borrowing from the rest of the world in Quarter 4 2022, reflecting an improvement in the UK's net investment income

UK current account balance, Quarter 1 2000 to Quarter 4 2022



Source: Balance of paymentsfrom the Office for National Statistics

Internationalfinancial flows tend to be volatile, particularly in the most mobile forms of capital. In Quarter 4, there were large disinvestments of these types of other investments held by UK and foreign investors. This might have reflected some of the heightened levels of economic uncertainty late last year.There have been large movements in financial markets recently. These include the recent failure of Silicon Valley Bank and the purchase of Credit Suisse and concerns about wider potential contagion effects.

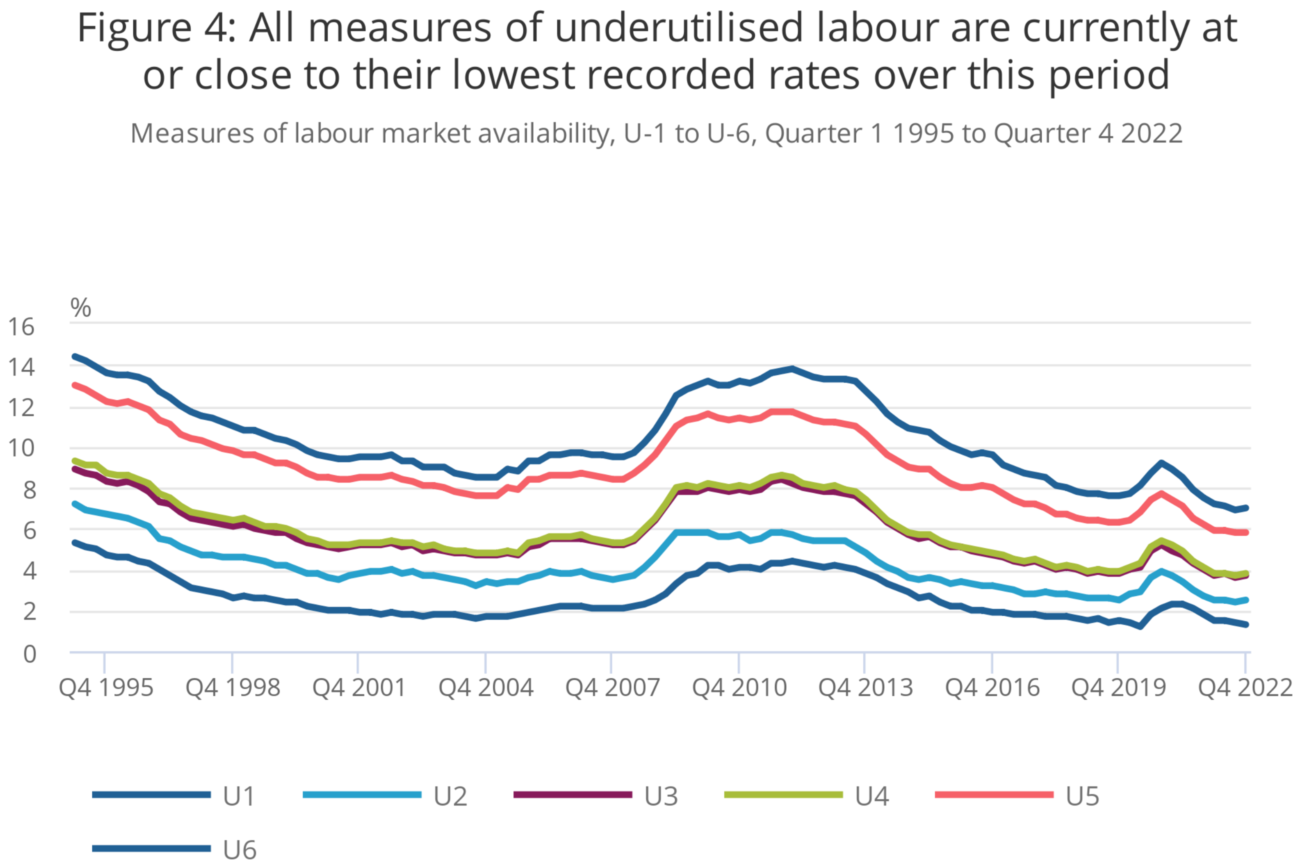
4 . Labour market

The labour market remains tight by historical standards. The unemployment rate of 3.7% is close to the historical lows recorded in the mid-1970s, while broader measures of labour market availability have similarly not picked up of late (Figure 4) implying there is relatively little spare capacity in the labour market.

Recruitment difficulties picked up in early February 2023, likely reflecting the high vacancies-to-unemployment ratio. However, the three-month change in vacancies has now declined for eight consecutive months, pointing to a cooling in labour demand, while there is some evidence that uncertainty is leading to businesses hiring fewer permanent staff.

Figure 4: All measures of underutilised labour are currently at or close to their lowest recorded rates over this period

Measures of labour market availability, U-1 to U-6, Quarter 1 1995 to Quarter 4 2022



Source: Labour market overview from the Office for National Statistics

Notes:

1. Narrower measures (U-1 and U-2) reflect the implications of unemployment may be harder for some than others, such as those who are long-term unemployed and those who were previously employed rather than a new entrant to the labour market.

2. Broader measures (U-4, U-5, and U-6) reflect that official unemployment figures may understate the full extent of labour availability. For example, by excluding inactive persons who want a job and those in employment but working fewer hours than desired.

The participation puzzle helps explain some of this tightness in the labour market, as there are still 488,000 more people who are economically inactive than before the coronavirus (COVID-19) pandemic, particularly those aged 50 to 64 years. Early retirement and sickness are likely to explain some of this lower participation in the labour market. That said, labour force participation has increased over the last three months. Furthermore, there was a record high net flow out of economic inactivity in Quarter 4 (Oct to Dec) 2022, driven by people moving into employment.

Labour market tightness and inflation expectations are putting pressure on pay, although there are some tentative indications that wage inflation might have peaked. There was a slight easing in regular nominal earnings, which increased by 6.5% in the three months to January 2023, although this is still one of the highest rates on record.

Expected pay settlements for the coming year are around 6%, although these are a little lower in the second half of this year. The real income squeeze helps explain some of the higher prevalence of labour disputes in recent months. In January 2023, there were 220,000 working days lost, down from 822,000 in December 2022, where rail, postal and health strikes took place.

5 . Prices

There was an increase in the 12-month rate of Consumer Prices Index (CPI) inflation to 10.4% in February 2023, having fallen for the previous three months. This re-acceleration in consumer prices reflected higher prices for food, which has increased by 18.3% over the last year, in part reflecting the effects of vegetable shortages.

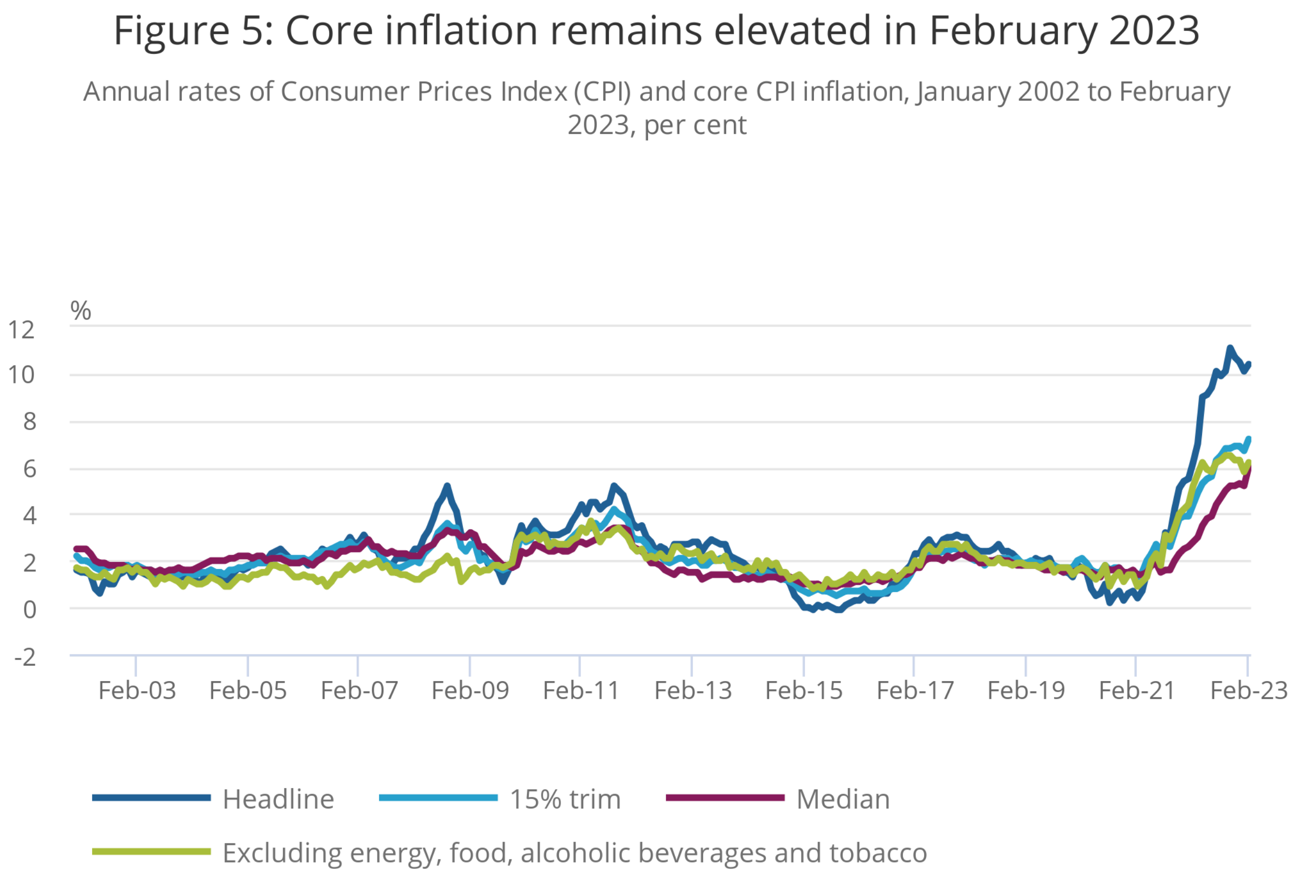
Clothing prices also increased on the year, while there were also price recoveries for alcoholic beverages in pubs in February, which had been discounted in the previous month. There was a sharp increase in services inflation to 6.6% in February, up from 6.0%, which is often considered a better proxy of domestic price pressures.

Recent analysis shows that almost all 87 CPI classes have been recording a pickup in price on the year. Core inflation is often a better indicator of the underlying rate of inflation. Figure 5 shows that the official core inflation, which removes the price movements of energy, food, alcoholic beverages and tobacco, increased to 6.2%. Our new trimmed-mean measure of core inflation removes those goods and services that record the most volatile price changes at any point in time. This also indicates that there are broader inflationary pressures in the economy, picking up in February (7.2%).

Survey findings show that one-year ahead inflation expectations have fallen of late (3.9%), while five-year ahead inflation expectations are now at 3.0%. There is also evidence of a softening in firms' expected one-year ahead price inflation in the three months to February 2023.

Figure 5: Core inflation remains elevated in February 2023

Annual rates of Consumer Prices Index (CPI) and core CPI inflation, January 2002 to February 2023, per cent



Source: Consumer price Inflation from the Office for National Statistics

Notes:

1. The official core CPI inflation measure excludes energy, food, alcoholic beverages, and tobacco.

2. The alternative trimmed mean core inflation measure removes the top 15% and bottom 15% of the distribution of CPI item price changes in every month.

Output producer price inflation has fallen for the seventh consecutive month, having peaked in July 2022. Crude oil and petroleum products have had the largest effect in bringing down producer price inflation, although almost all components are still seeing prices rise on the year, with food products making the largest positive contribution to factory gate prices.

6 . Related links

[GDP quarterly national accounts, UK: October to December 2022]
Bulletin | Released 31 March 2023
Revised quarterly estimate of gross domestic product (GDP) for the UK. Uses additional data to provide a more precise indication of economic growth than the first estimate.

[Balance of payments, UK: October to December 2022]
Bulletin | Released 31 March 2023
A measure of cross-border transactions between the UK and rest of the world. Includes trade, income, capital transfers and foreign assets and liabilities.

[Public sector finances, UK: February 2023]
Bulletin | Released 21 March 2023
How the relationship between UK public sector monthly income and expenditure leads to changes in deficit and debt.

[Labour market overview, UK: March 2023]
Bulletin | Released 14 March 2023
Estimates of employment, unemployment, economic inactivity, and other employment-related statistics for the UK.

[Consumer price inflation, UK: February 2023]
Bulletin | Released 22 March 2023
Price indices, percentage changes and weights for the different measures of consumer price inflation.

[Business insights and impact on the UK economy: 23 March 2023]
Bulletin | Released 23 March 2023
The impact of challenges facing the economy and other events on UK businesses. Based on responses from the voluntary fortnightly business survey (BICS) to deliver real-time information to help assess issues affecting UK businesses and economy, including financial performance, workforce, trade, and business resilience.

7 . Cite this article

Office for National Statistics (ONS), released 31 March 2023, ONS website, article, [Quarterly economic commentary: October to December 2022]