

The UK economy

Overview

The situation in the world economy is slightly more promising since the last quarter although the short-run prospects for the Euro Area have worsened marginally. The US and the Far East drive growth and trade respectively. China in particular is experiencing strong growth. Japan has performed above expectations. Interest rates remain low and there are few significant inflationary worries. The UK labour market remains buoyant with a steadily rising employment rate and low unemployment.

UK real GDP growth is forecast to be 2.0 per cent in 2003, up from 1.7 per cent in the previous quarter. The forecast for 2004 is 2.6 per cent, again revised up from 2.3 per cent in the last quarter. Consumption and government spending remain the main components of demand but as the recovery sets in we expect investment to become more important. As previously forecast unemployment is expected to remain at low levels with steady employment growth during the year. The outlook for the UK economy is good.

Outlook

Table 1 contains the consensus forecasts for the main UK economic indicators taken from a monthly survey by HM Treasury of City and other independent forecasters. UK GDP growth is forecast to be 2.0 per cent in 2003 and 2.6 per cent in 2004. Inflation remains on target and the only cause for concern is the buoyant housing market and household debt. The Bank of England raised interest rates by 25 basis points to 3.75 per cent and undoubtedly these were two important factors in their decision. Unemployment is forecast to remain at very low levels although there has been an upward revision of unemployment in the medium term. Employment growth is

slow but steady and is relatively broad based. The forecast for 2003 is for relatively strong employment growth, which is driven by the service sector. The current account is expected to remain in deficit. PSNB is forecast to rise to £33.7 billion in the medium-term from £32.2 billion in 2002/03. This is a large revision to the £22.2 billion quoted earlier in the year by the Chancellor.

UK macroeconomic trends

Output growth

GDP (at constant 1995 prices) grew by 0.7 per cent in the third quarter of 2003 compared to a 0.6 per cent rise in the second quarter. GDP is now 2.0 per cent higher than it was at the same time last year. The OECD have warned however that despite the increased growth, which could mean that over the year growth could hit the bottom of the Chancellor's range of 2.0-2.5 per cent, taxes will have to rise to pay for the extra borrowing forecast by the Treasury.

GVA at basic prices increased in the third quarter by 0.7 per cent on a quarterly basis and by 1.9 per cent on an annual basis. Within GVA construction (6.7 per cent), business services and finance (3.0 per cent) and government services (2.5 per cent) were the best performing sectors for the third quarter of 2003 on the same quarter last year. Manufacturing declined by 0.4 per cent while mining and quarrying fell by 1.3 per cent and electricity, gas and water supply decreased by 2.0 per cent in the same period.

Components of demand

Consumption growth in the UK was 0.7 per cent for the third quarter (2.5 per cent on the same quarter last year) while government spending grew by 0.6 per cent in 2003 Q3 (4.3 per cent). Investment declined by 1.3 per cent (no change over the year). Exports increased marginally by 0.1 per cent in the third quarter but over the year this was a decline of 2.9 per cent. Imports rose by 1.0 per cent in the third quarter and contracted by 0.9 per cent on the same quarter last year.

Table 1: Independent forecasts of the UK economy

	2002	2003	2004	2005
Real GDP growth (%)	1.9	2.0	2.6	2.7
Inflation rate (RPIX %)	2.2	2.7	2.4	2.5
Unemployment (claimant count, million)	0.95	0.94	0.93	0.92
Employment growth (%)	0.2	0.5	0.2	0.2
Current account (£ billion)	-16.0	-23.5	-23.6	-30.1
PSNB (£ billion)	34.3	32.2	32.9	33.7

Source: National Statistics, National Institute Economic Review, 186, November 2003 and "Forecasts for the UK economy", HM Treasury, November 2003. Note: PSNB is given for financial years, e.g. 2002/03

Retail sales increased by 1.5 per cent on a volume basis, seasonally adjusted for the year up to October 2003. This is the highest sales have been since the index was re-based in the year 2000. House prices continue to rise and most data since October have been better than expected. This coupled with record consumer borrowing in September have pushed the MPC into increasing interest rates to 3.75 per cent in November. It is unlikely we will see any rate increases in the near future (highly unlikely in December and January) but clearly the Bank has signalled that interest rates are on the way up. There are few signs of any other inflationary pressures with average earnings, producer prices, consumer prices and the labour market still not exerting undue pressure.

Pre-Budget report

The highlight of the pre-budget report was the admission of Gordon Brown that 'we would have to borrow more despite forecasts suggesting that growth could hit the bottom of his range (2.0-2.5 per cent). The new Harmonised Index of Consumer Prices (HICP) target is 2.0 per cent but this will mean inflation will be effectively slightly higher than what it was under RPIX. This may mean that the Bank of England will raise rates in the early part of 2004. While the UK's share of debt is one of the lowest in the major economies there is a worrying trend developing – borrowing has increased again, this time up to £37 billion. There are concerns about the phrase 'over the cycle' and what the margin of surplus against debt will be. The Chancellor forecasts this to be £14 billion but other commentators believe it could be half of this. If in the next cycle, tax revenues are not as high as they have previously been then we can expect to have to pay more taxes to fund public

spending. Whether this is done by direct taxation or by 'stealth taxes' is a point for discussion. The other alternative to public spending cuts and this may be a favoured route as the Ministry of Defence consultation paper demonstrates a need for slimmed down flexible forces. The surely must also mean savings in the process.

The labour market

In the period July-September employment increased to 28,151,000, a rate of 74.6 per cent. ILO unemployment increased to 1,481,000 or 5.1 per cent for the same period. Claimant count for October 2003 fell to 926,900, a rate of 3.0 per cent. Average earning grew by 3.6 per cent for the period July-September 2003. The numbers who are economically active increased by 41,000 to 29,631,000 (a rate of 78.7 per cent) whereas the number who are inactive increased by 33,000 to 7,774,000 or 21.3 per cent. Claimant count decreased by 47,000 over the quarter and by 203,000 over the year. The level of claimant count is 29,695,000, a rate of 3.0 per cent in October 2003.

The number of workforce jobs was 26,695,000 in June 2003. This is an increase of 47,000 on a quarterly basis and an increase of 203,000 over the year. Within the workforce there was a gain of 9,000 employee jobs over the quarter. Self-employment has increased by 37,000 on the last quarter and by 200,000 on an annual basis. There has been a very small upward movement in the number of trainees to 101,000 from 100,000 in the last quarter.

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