

# Economic Review, September 2015

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## Abstract

The main economic stories from National Statistics produced over the latest month, painting a coherent picture of the UK economic performance using recent economic data.

## Main points

- The second estimate of Gross Domestic Product (GDP) indicated that the UK economy grew by 0.7% in the second quarter of 2015, the tenth successive quarter of output growth. The first information on expenditure components showed continued growth in household spending as well as a strong increase in export growth.
- This recent rise in exports notwithstanding, net trade made a small and erratic contribution to GDP growth during the recovery as a whole. Exports and imports grew at broadly similar rates over this period.
- The fall in Consumer Price Inflation (CPI) below 1% in recent months is concentrated in relatively import intensive products. Growth in the GDP deflator - a broad measure of inflation across the economy - has also declined since 2014. Since the downturn growth in the GDP deflator has been lower than growth in consumer prices – explained in part by low capital goods inflation in 2010 and 2011.
- While unemployment remained low in Q2 2015, hiring from the unemployed remained strong compared with pre-downturn trends. Firms are increasingly hiring from those already employed, signalling potential tightness in the labour market.
- Key uncertainties around the extent of spare capacity in the labour market include whether the shift to more flexible work patterns is involuntary - therefore suggesting underemployment - or a step-change which is unlikely to be reversed.
- A concentration of low paid work in particular industries is one factor which may determine the effect that the National Living Wage will have on the labour market.

## Introduction

The second estimate of Q2 2015 Gross Domestic Product (GDP) indicated that the UK economy grew by 0.7%, unrevised from the preliminary estimate. This marked the tenth successive quarter of output growth, with all major industry groups contributing positively. Following this period of growth, the UK economy is now estimated to be 5.2% larger than in Q1 2008.

The largest contribution to quarter on same quarter a year earlier GDP growth came from private consumption, while the contributions of fixed investment and government consumption remained relatively stable. Net trade has made a small and erratic contribution to GDP growth during the recovery as a whole as a result of growth in both exports and imports. This Review finds that growth in goods exports, especially those in finished manufactures, have been as important to export growth as services exports. In addition, it highlights the recent divergence in export growth between EU and non-EU countries over recent years, and the important role of a small number of countries.

While GDP growth has been strong, Consumer Price Inflation (CPI) has fallen in recent quarters. Analysis in this Review indicates that this fall was mainly due to relatively import intensive goods, such as new cars and other household durable goods. Comparing CPI to the GDP deflator - which captures the weighted movement in the prices of the goods and services which are included in GDP – suggests that low capital goods inflation partly offset higher consumption inflation during 2010 and 2011. The result is that domestic inflation pressures may therefore have been lower than implied by the CPI until recently.

The unemployment rate in Q2 2015 stood at 5.6%, up slightly from 5.5% in the previous quarter. This Review examines broader indicators of slack in the labour market to ask whether the headline rate is stabilising. Hiring from unemployment remains fairly high but is increasingly giving way to employers hiring from other firms. However, changes to the labour market since the downturn make it difficult to conclude whether this trend may result in inflationary wage pressure. Several of these changes are examined, with a focus on the wage floor in the UK and the distribution of low paid work across industries.

## GDP

The second estimate of Gross Domestic Product (GDP) indicated that the UK economy grew by 0.7% in the second quarter of 2015, unrevised from the preliminary estimate. Following output growth of 0.4% in the first quarter of 2015, the pace of GDP growth increased slightly between April and June, returning to the average quarterly growth rate since the end of 2012, and continuing a run of ten quarters of continuous GDP growth. On an annual basis, however, growth has slowed slightly. Comparing the current quarter with the same period a year earlier, output growth slowed from 3.4% in Q4 2014 to 2.9% in Q1 2015, and to 2.6% in the Q2 2015.

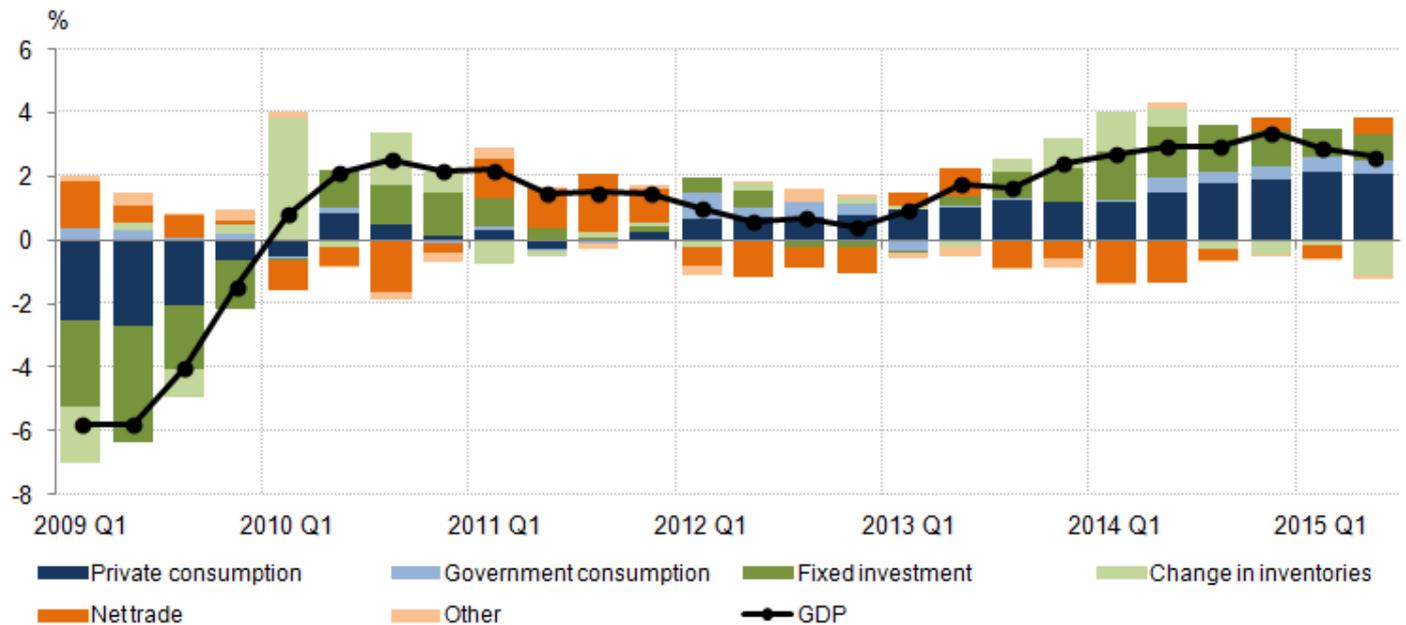
The increase in quarterly GDP growth in Q2 2015 reflected stronger output growth in all three major industry groups, although services made the largest contribution to growth. Production output grew by 0.7% in the second quarter of 2015, reflecting growth of 6.1% in mining & quarrying output. Manufacturing, by contrast, experienced a slight contraction, with output falling by 0.3% in the three months to June. Construction output grew by 0.2% over the same period – mainly as a result of a 3.9% rise in the construction of new private housing – largely offsetting a small fall in construction output in the previous quarter. Aggregate services output growth also strengthened in the three months to June 2015: rising from 0.4% in Q1 2015 to 0.7% in Q2 2015, reflecting a stronger performance in the business services and finance industries in particular.

The second estimate of GDP contained the first information on the expenditure components of GDP in Q2 2015 (Figure 1). Following recent trends, the largest contributor to quarter on same quarter a year earlier GDP growth was private consumption, which added 2.1 percentage points to GDP

growth over this period. The contributions of fixed investment – which had waned in recent quarters – and government consumption remained relatively stable, adding 0.8 and 0.4 percentage points to aggregate expenditure over this period. An 8.1% increase in exports – the strongest growth since Q1 2011 – more than offset growth in imports to result in a net trade contribution of 0.5 percentage points in the second quarter.

### Figure 1: Contributions to growth in the expenditure measure of GDP

Quarter on same quarter a year ago, chained volume measure, seasonally adjusted



Source: Office for National Statistics

#### Notes:

1. 'Other' includes the statistical discrepancy. 'Private consumption' equates to household consumption and 'Non-profit institutions serving households' consumption.

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## Exports

This recent rise in exports notwithstanding, net trade made a small and variable contribution to GDP growth during the recovery as a whole. Following a [marked depreciation of Sterling in 2008 and 2009](#), net trade made a positive contribution to output growth in both these years, but bounced between expansion and contraction over the following five years. Stronger growth of exports than

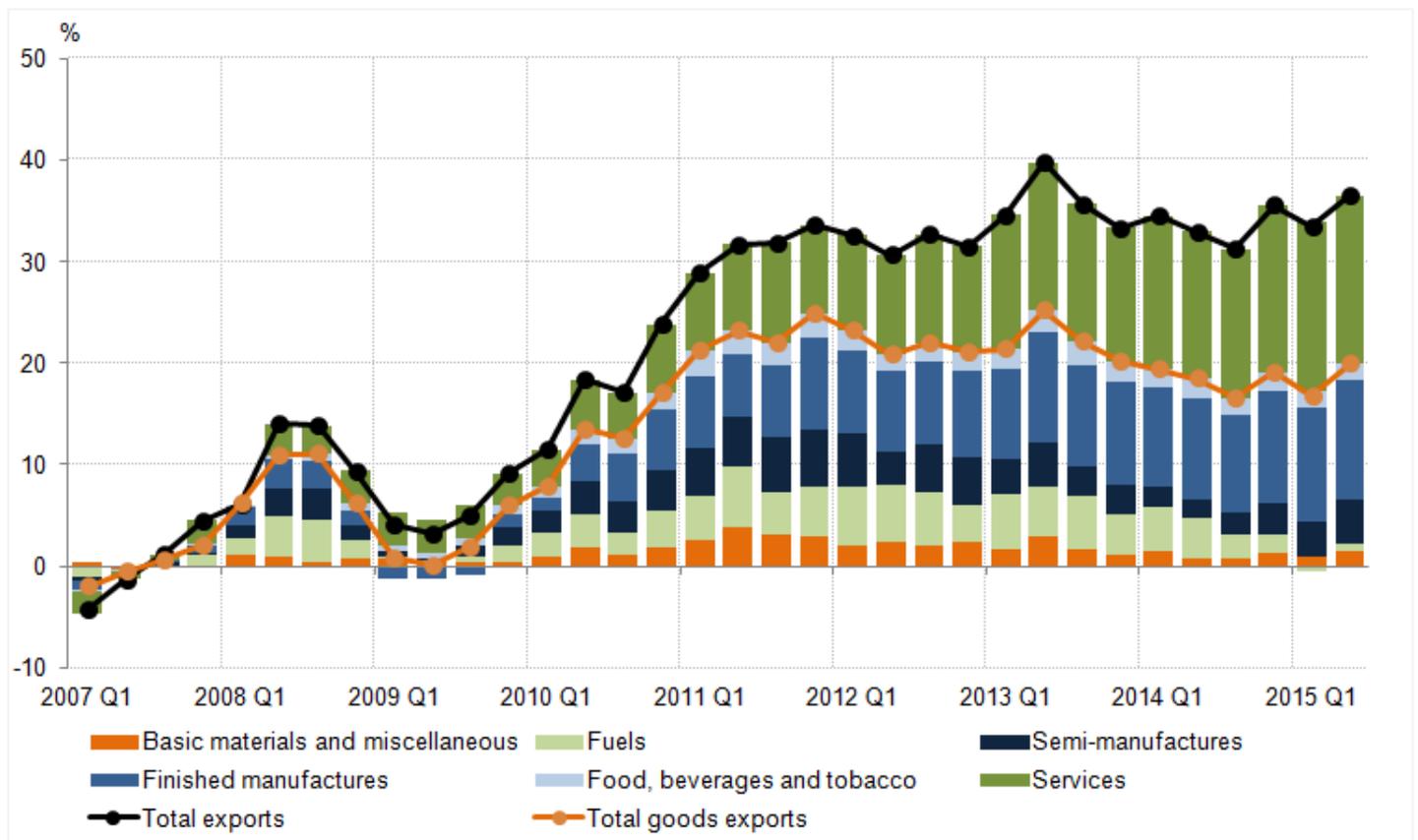
of imports generated a positive contribution to GDP for net trade of 1.4 percentage points in 2011, before lapsing to -0.8, 0.0 and -0.6 percentage points in 2012, 2013 and 2014 respectively.

Comparing Q2 2015 with the same period six years earlier – the trough of the economic downturn – net trade has been a drag on GDP growth of 0.4 percentage points. This reflects exports growing by a similar proportion to imports over this time: the volume of exports grew by 24.7% between Q2 2009 and Q2 2015 while imports grew by 24.6%. However, as the UK ran a trade deficit in Q2 2009 this resulted in the volume of imports increasing by more than exports in absolute terms, causing a slight drag on GDP growth.

In comparison to output growth since the downturn – which has been concentrated in the services industries – growth in exports has been more evenly split between goods and services. Figure 2 shows contributions to the cumulative growth of nominal exports relative to 2007, and indicates that goods and fuels exports accounted for the majority of export growth between 2007 and 2011 – [partly reflecting changes in oil prices](#). Over the same period services exports grew at a slower pace in value terms. This likely reflects the importance of financial services to the UK's exports of services, and the slow recovery of this industry over this period. More recently, lower oil prices have played a role in markedly reducing the value of the UK's exports of fuels and other goods. As a result, goods and services account for fairly even fractions of total nominal exports growth. While the value of UK exports had increased by 36.5% in Q2 2015 compared to 2007, growth in goods exports contributed 19.9 percentage points compared with a slightly more modest 16.6 percentage point contribution from services.

**Figure 2: Contributions to the growth of UK exports compared to the average quarterly level of exports in 2007**

Current prices, percentage points, seasonally adjusted



Source: Office for National Statistics

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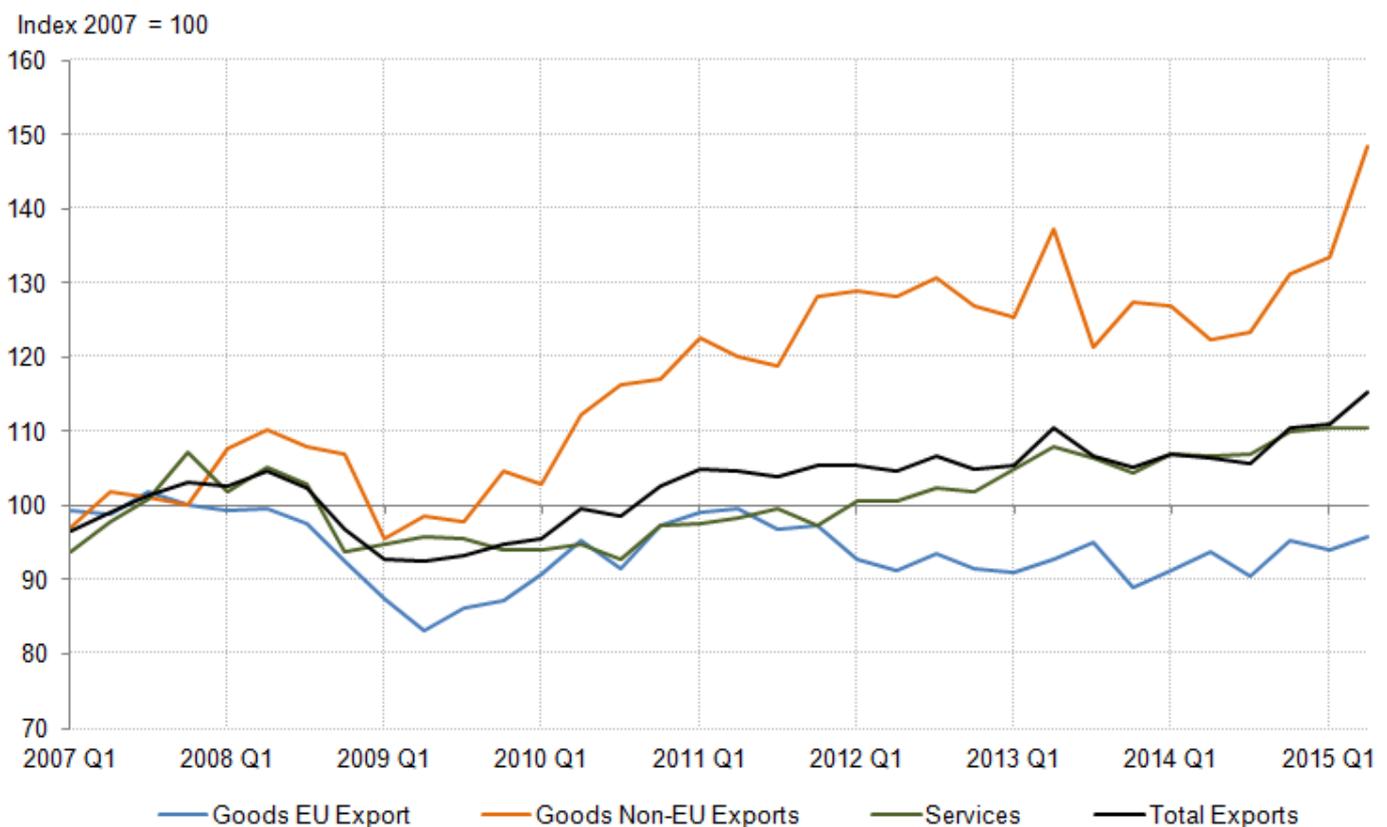
Within the goods exports category, fuels, basic materials and 'food, beverages and tobacco' products all played an important role in supporting exports growth in 2010 and 2011, but have waned between 2012 and 2015. These have been replaced by growth of semi-manufactures and finished manufactures, possibly reflecting differences in the performance of the UK's export markets. Information on [nominal export turnover reported by manufacturing companies](#) suggests this growth has been driven by higher motor vehicle exports as well as 'air, spacecraft & related' products. Comparing the average nominal export turnover level for these products in 2007 with the most recent period, motor vehicle exports rose by £4.0 billion (96%) to £8.1 billion, while 'air, spacecraft & related' exports rose £1.9 billion (85%) to £4.1 billion.

The geographical composition of the UK's export markets has been subject to increased attention in recent years. This is partly a consequence of the markedly different growth rates in emerging and advanced economies, but is also a result of debate over the UK's relationship with the European Union (EU). In levels terms, the values of UK exports of goods to the EU and non-EU countries

are now broadly similar: in 2014 these were £147 billion and £145 billion respectively. However, in recent years UK goods exports to non-EU countries have grown at a much faster rate than UK goods exports to the EU. Figure 3 shows the volume of goods exports to both markets, indexed to their levels in 2007. Since 2007 the volume of goods exports to non-EU countries rose by 48.5%, while the volume of exports to EU countries fell by 4.1%. In part, this reflects the relative strength of these markets during the downturn. Exports of goods to EU countries were more affected by the economic downturn, falling by 16.4% between the UK economy's peak and trough, compared to a fall of 8.3% to non-EU nations. It also reflects the relative economic performances of the UK's trading partners since then, with much weaker (stronger) demand growth in the EU (non-EU) markets.

### Figure 3: Exports of goods to EU and non-EU countries, total services exports, and total exports

Chained volume measure, 2007=100, seasonally adjusted



Source: Office for National Statistics

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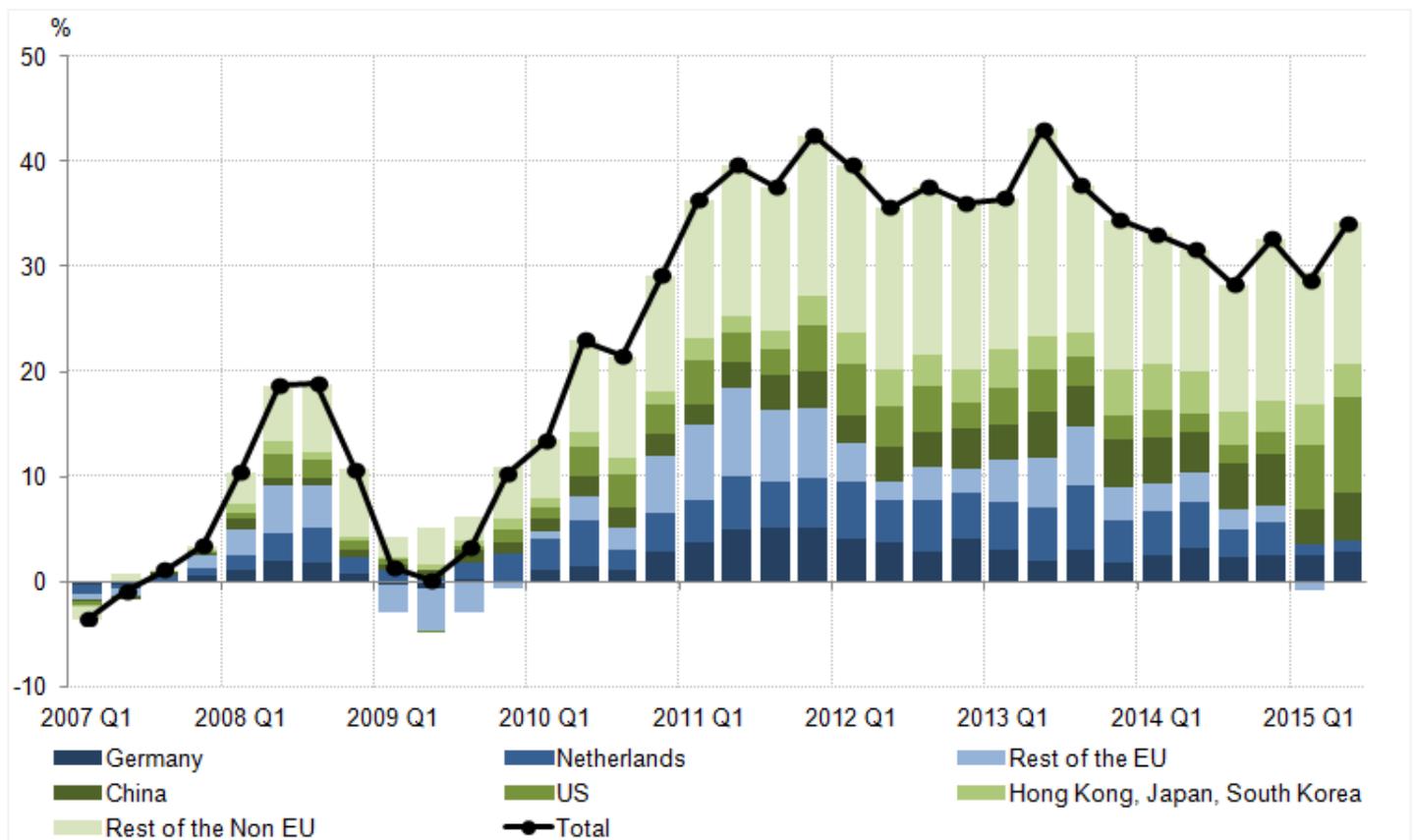
More detailed data on the value of UK goods exports to specific countries also shows the importance of non-EU markets for recent export growth, and highlights the important role of a relatively small number of countries. Figure 4 shows the cumulative contribution to current price

goods exports from EU countries (blue bars) and non-EU countries (green bars). Although UK direct exports to Germany and the Netherlands have increased, other notable EU economies including Ireland, Italy and Spain account for a smaller value of UK goods exports than they did in 2007.

Consequently, direct exports to the 'rest of the EU'<sup>1</sup> made a small downward contribution of 0.2 percentage points to the value of goods export growth during the period between 2007 and 2015 Q2, despite this set of countries typically accounting for nearly a third of the UK's total goods exports in value terms.

#### Figure 4: Contributions to the growth of UK goods exports compared to the average quarterly level of goods exports in 2007

Current prices, percentage points, seasonally adjusted



Source: Office for National Statistics

#### Notes:

- 'Rest of the EU' is defined as total goods exports to the EU less goods exports to Germany and the Netherlands. 'Rest of the non-EU' is defined as total goods exports to non-EU countries less goods exports to the US, China, Hong Kong, Japan, and South Korea.

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In contrast, exports to a range of non-EU countries have been expanding relatively rapidly. Current price exports to the US – our largest single trading partner – accounted for just over a quarter of growth, while exports to China, Hong Kong, Japan and South Korea accounted for just under a quarter. The bloc of non-EU countries excluding the above accounted for the remainder of growth, rising by 61% over the period from £12.2 billion per quarter to £19.6 billion per quarter. Information from the ONS Pink Book 2014 suggests that the Gulf Arabian countries and some parts of Africa such as Nigeria are driving this growth, along with Brazil and India.

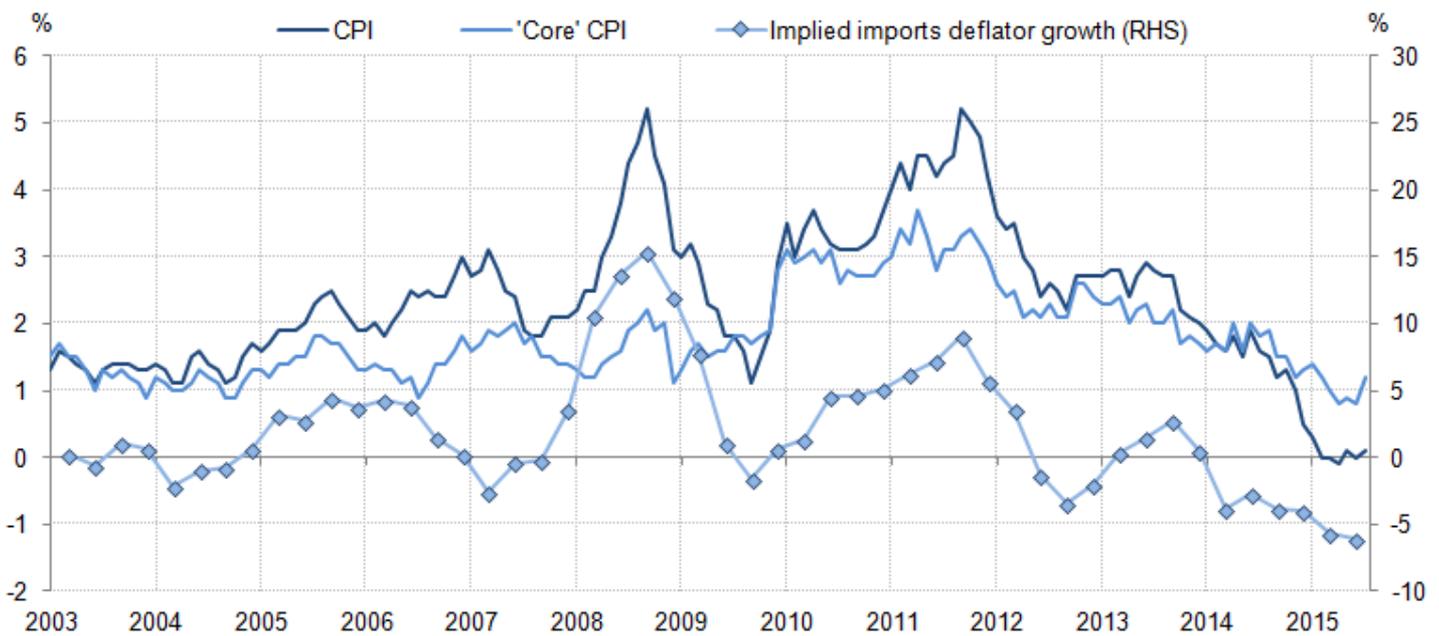
Developments in these trade patterns partly depend on the relative strength of each country's market in addition to a slowdown in world trade growth relative to GDP growth since the downturn. EU GDP growth was stable at 0.4% in the most recent quarter, while the IMF forecast world output growth to be only slightly slower in 2015 (3.3%) compared to growth in the previous year (3.4%). However, other factors such as the 5.0% appreciation in the Sterling exchange rate between Q2 2014 and Q2 2015 may also be important.

## Notes

1. EU countries excluding Germany and the Netherlands.

## Price pressure

Despite the relative strength of recent economic growth and sharp falls in the unemployment rate, which may both indicate that spare capacity in the UK economy is diminishing, price pressure has remained historically weak. The Consumer Prices Index (CPI) rose in July by 0.1% compared to a year earlier, only slightly above the joint record low of -0.1% reached in April (Figure 5). Core inflation – which excludes the prices of products that are relatively volatile, such as energy, food, alcohol, and tobacco – increased from 0.8% to 1.2%, largely as a consequence of smaller price falls for clothing in 2015 than in the same period a year earlier. Import prices – which have been falling on average since mid-2014 – continued to decline in Q2 2015.

**Figure 5: Headline and core inflation, and implied imports price inflation, %**

Source: Office for National Statistics

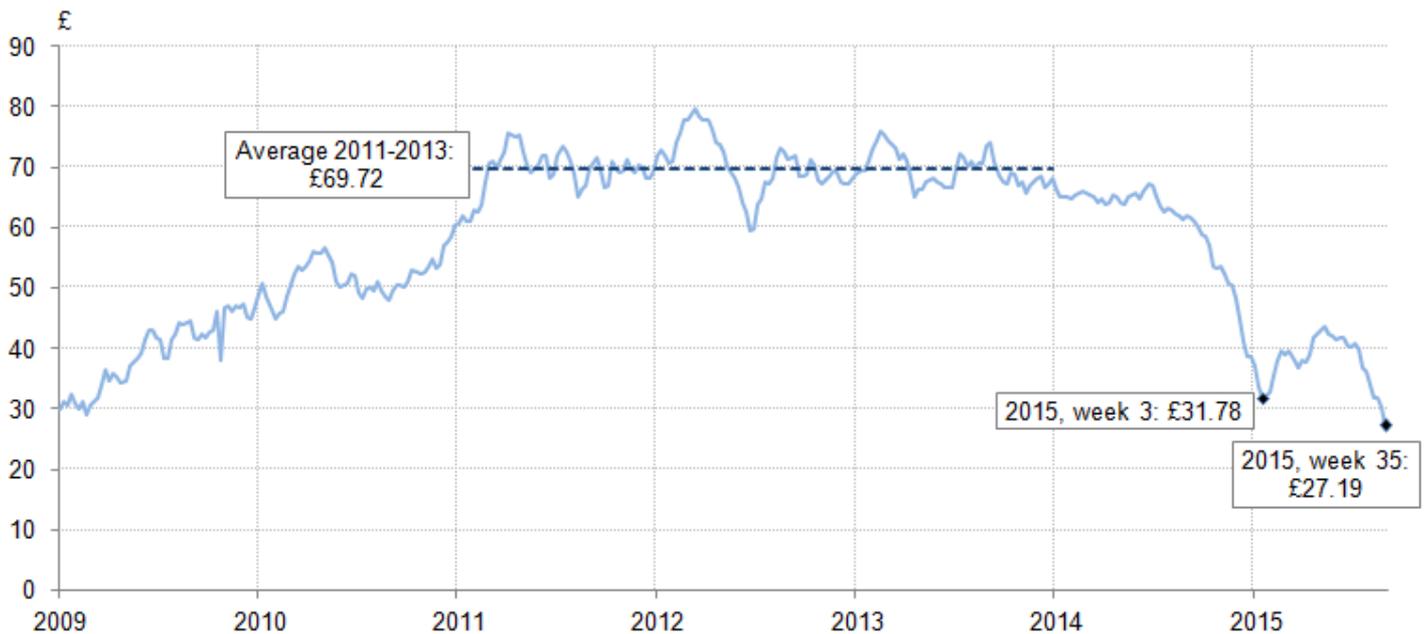
#### Notes:

1. The measure of import price inflation used here is growth in the implied imports deflator. This equates to nominal imports divided by the volume of imports. The implied import deflator series is quarterly - the final month of each quarter is used as the reference date.

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Much of this weakness in inflation is accounted for by recent negative movements in the price of oil, [the appreciation of Sterling](#) and [increased competition among retailers](#). The price of Brent crude fell markedly from around £70 per barrel on average between 2011 and 2013, to around £32 per barrel at the start of 2015 (Figure 6). This fall – which helped to reduce household energy and transport costs in particular – stabilised through 2015, and appeared set to start to fall out of annual comparisons of price inflation in coming months. However, as Figure 6 shows, fears over the outlook for the Chinese economy have contributed to further falls in the oil price in recent weeks. Having recovered to around £40 per barrel, the price of oil fell back to around £27 per barrel during August, its lowest level in more than 6 years.

**Figure 6: Brent Crude Oil Price: £/barrel****Notes:**

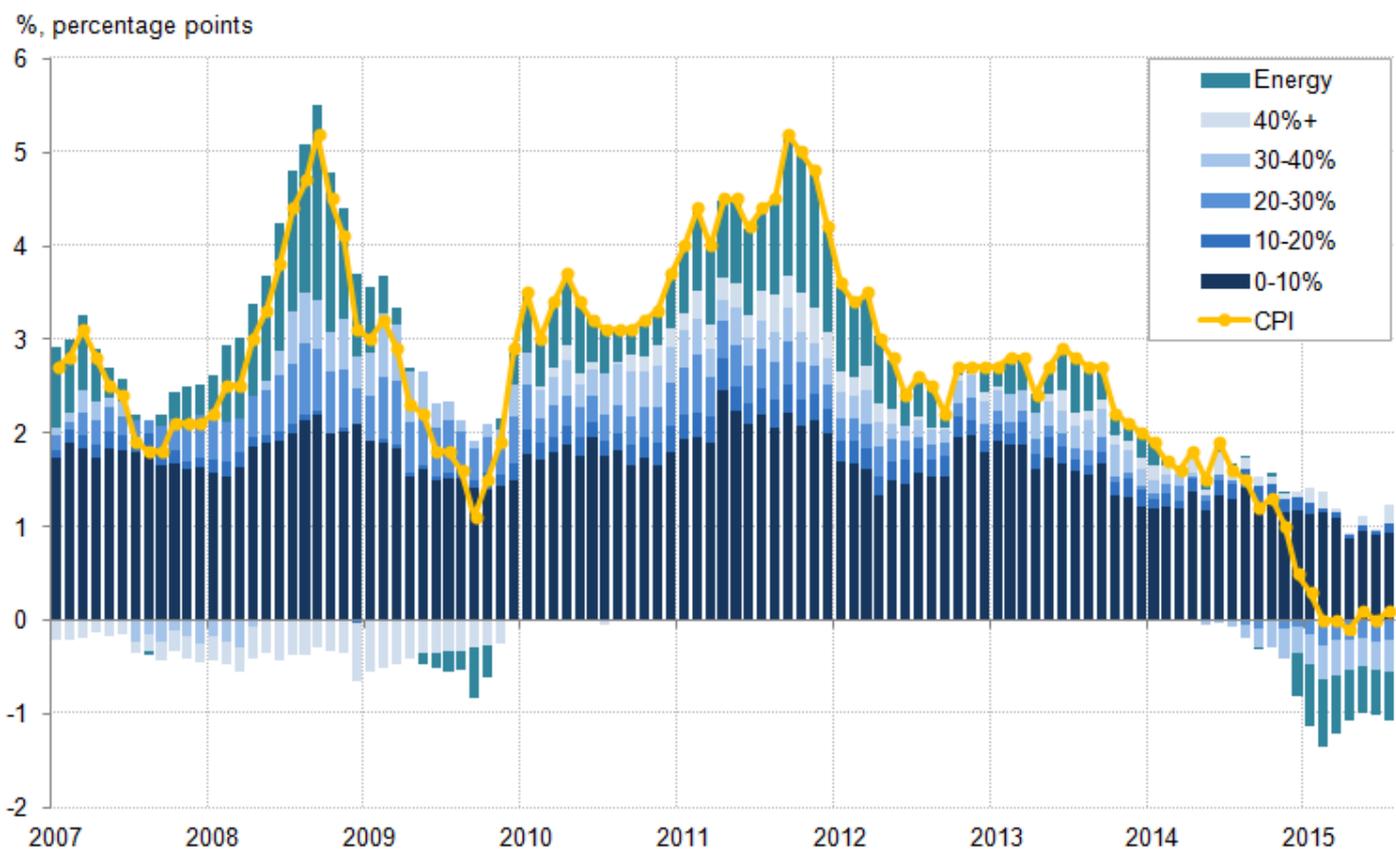
1. Source: Financial Times

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Alongside these movements in the oil price, changes in the value of Sterling also appear to have played an important role in dampening price pressure in recent months. Figure 7 shows contributions to the movement in the headline inflation rate by products of differing direct import intensities and by energy. Products purchased by households which are largely domestically produced – including many services such as transport and water supply services, catering and accommodation services – have made a fairly consistent contribution to the annual CPI inflation in recent months, moderating slightly from an average annual contribution of 1.3 percentage points in July 2014 to 0.9 percentage points in July 2015. By contrast, products with a higher direct import intensity – which are sourced abroad to a greater degree, including new cars and other household durable goods – have pulled down on the CPI in recent months. These trends are consistent with movements in the exchange rate: Sterling appreciated markedly against the Euro in recent months, helping to ease the rate of import price inflation.

**Figure 7: Contributions to the CPI by import intensity of production, % and percentage points**

Source: Office for National Statistics

#### Notes:

1. This chart groups the 85 class-level components of the CPI into six categories, depending on their estimated import intensity in household consumption. This is calculated using data on imports by households in the Input-Output Tables 2010 converted to a Classification of Individual Consumption According to Purpose (COICOP) basis. Class-level components are therefore grouped according to whether they are supplied to households solely by domestic producers (0% imported category) or the fraction of their consumption by households that was supplied by imports in 2010 (0-10%, 10-20%, 20-30%, 30-40%, 40%+). Energy goods – including gas, electricity, liquid and solid fuels and fuels and lubricants – are grouped together separately. The methodology is consistent with that used in the February 2015 Economic Review.

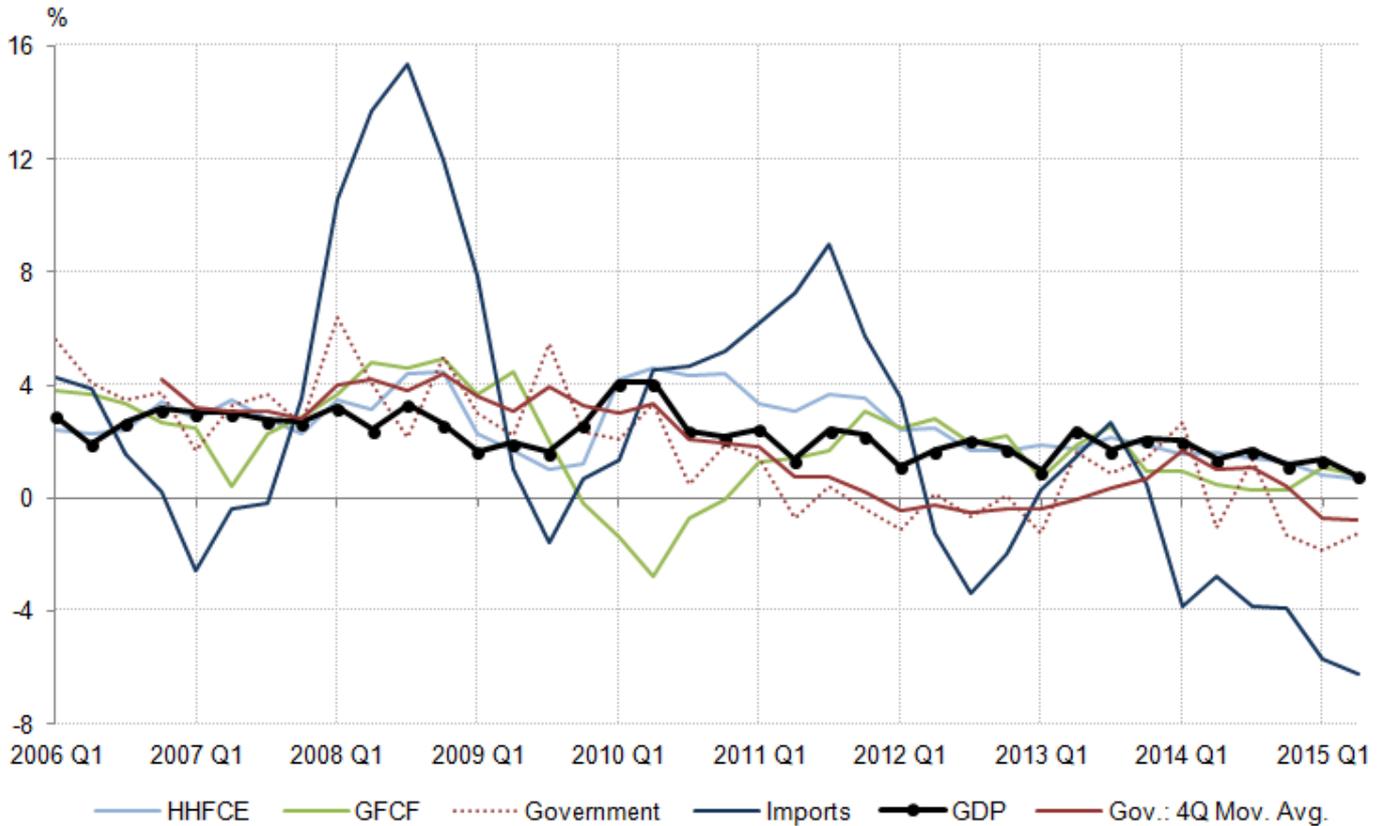
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The GDP deflator – which captures the weighted movement in the prices of the goods and services which are included in GDP – has also weakened slightly since the end of 2013, partly reflecting the decline in consumer price inflation (Figure 8). The GDP implied deflator can be thought of as a broad measure of inflation that reflects price movements for household spending, investment, government spending, and trade components. Importantly the GDP implied deflator is a weighted average of these price effects, reflecting changes in prices and the composition of expenditure GDP in any two periods. It is therefore more broadly defined than the more familiar measure of consumer price

inflation, which captures changes in a single component of GDP – Household Final Consumption Expenditure – albeit the largest at more than 60% of total GDP.

**Figure 8: Quarter-on-previous-year change of the implied deflators for GDP, household consumption, government consumption, fixed investment and imports: %**



Source: Office for National Statistics

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The four-quarter growth of the GDP deflator has slowed from 2.1% in Q4 2013 to 1.2% in Q4 2014, to just 0.8% in Q2 2015, capturing both the weakness of consumer price inflation (as measured by the household final consumption implied deflator), falling import prices (as captured by the imports implied deflator) and the weakness of implied price growth for government services in recent quarters<sup>1</sup>. The prices of capital goods – as captured by the Gross Fixed Capital Formation (GFCF) implied deflator – have grown at a broadly similar rate as private consumption in recent years. However, this represents a recovery from the marked divergence between the two series during 2010 and 2011. Following the downturn, both the GFCF implied deflator and the GDP deflator fell markedly compared with the private consumption price inflation. This divergence – which partly reflects the impact of the large depreciation of Sterling in 2008 and 2009 feeding into traded goods and services prices – implies that the weighted price growth of the average UK product fell relative to the rate of consumer price inflation over this period.

Because imports are subtracted from GDP, growth in import prices contribute negatively to the GDP deflator. The GDP deflator can therefore be regarded as a measure of domestically generated inflation. This means that during periods when import prices were strong (e.g. 2008 and 2010 to 2011), GDP deflator growth is generally weaker than consumer price inflation.

The growth rate of the imports implied deflator can be partly explained by the relative currency changes throughout the period, as well as by movements in oil and other commodity prices. Assuming a fixed price paid in local currency, the depreciation of the sterling from 2008 to 2011 would have increased the price paid, shown by positive growth of the price deflator for this period. An opposite argument can be used to explain the fall in prices observed in 2014, given the appreciation of the sterling.

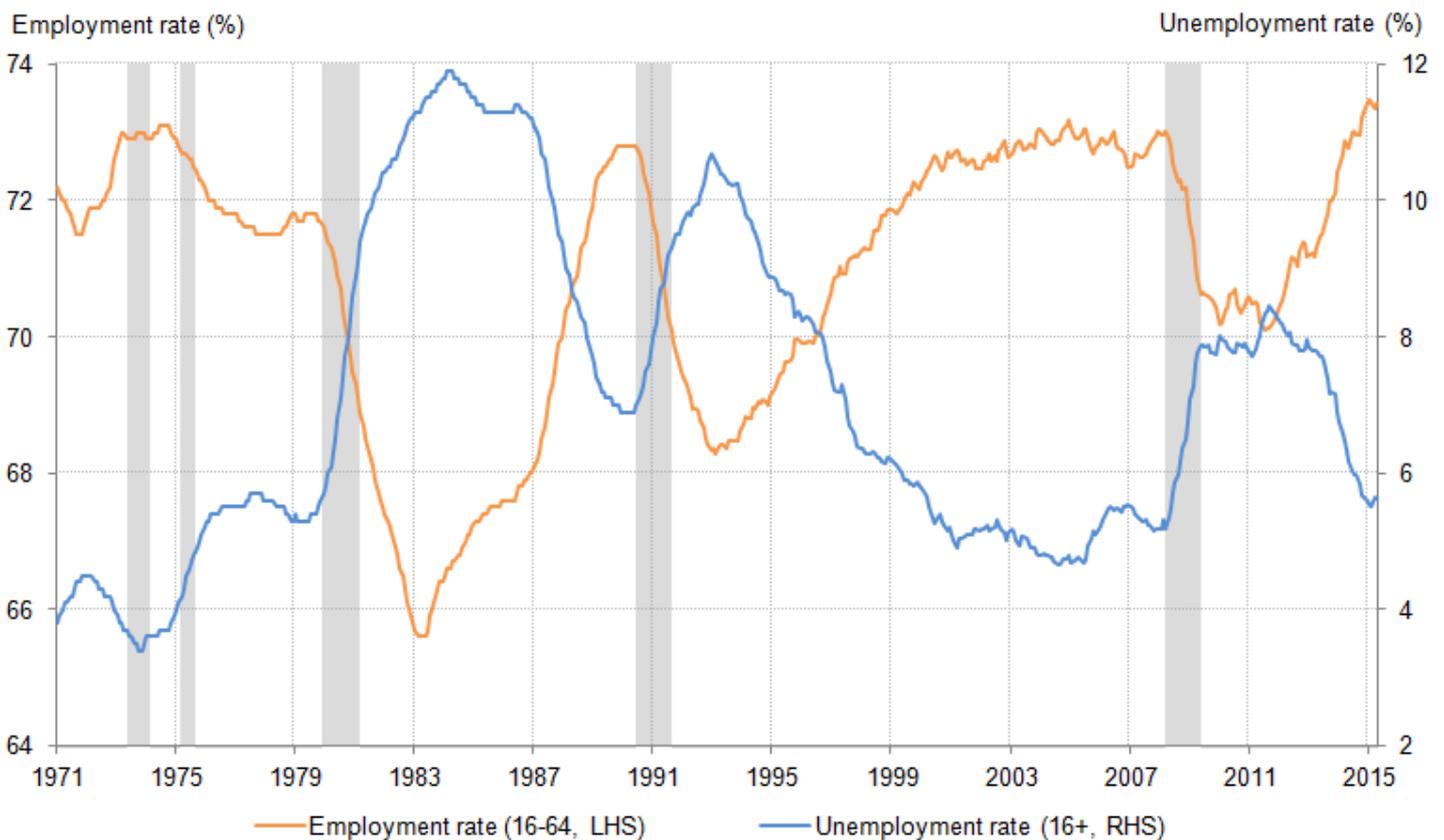
## Notes

1. Within the expenditure components shown in Figure 8 the implied government deflator is a more complex concept, since it combines price indices used for deflating one-third of government services, and implied deflators for the remaining two-thirds. The latter are derived from the ratio of current-price expenditure and directly-measured volumes expressed in constant-price terms. This is due to the nature of some public services in the UK being provided free at the point of delivery, which means there are no direct measures of the prices for these services. Since 2010, the government implied deflator has remained fairly steady and turned negative in recent quarters, after a prolonged period of positive growth prior to the economic downturn. This is partly reflective of the increase in output coinciding with reductions in the growth of current price government expenditure.

## Unemployment

The strength of the UK's labour market is one of the defining characteristics of the [economic downturn and the subsequent recovery](#). While both output and employment fell sharply in 2008 and 2009, employment fell considerably less and has since recovered much more quickly. Partly as a result, the rise in the unemployment rate from around 5.1% on average between 2002 and 2007 to 8.5% in the three months to November 2011 has almost been entirely reversed. The unemployment rate was 5.6% in the three months to June 2015.

Figure 9 shows the UK's employment and unemployment rates between 1971 and 2015, and highlights periods of economic contraction in the 1970s, early 1980s, early 1990s and in 2008. Comparing these previous episodes with the most recent downturn, it suggests that the fall in employment and corresponding growth in unemployment was broadly similar in 2008 to that in previous downturns. However, it is the strength of employment during the latest recovery that is particularly notable and much faster than following the economic downturn in 1991 in particular. The UK's employment rate in the three months to June 2015 was 73.4% - the highest recorded rate over this 40 year period – while the unemployment rate stood at 5.6%, which was just 0.5 percentage points higher than the 2002-2007 average.

**Figure 9: Employment rate (ages 16 to 64) and the unemployment rate (16+), %**

Source: Office for National Statistics

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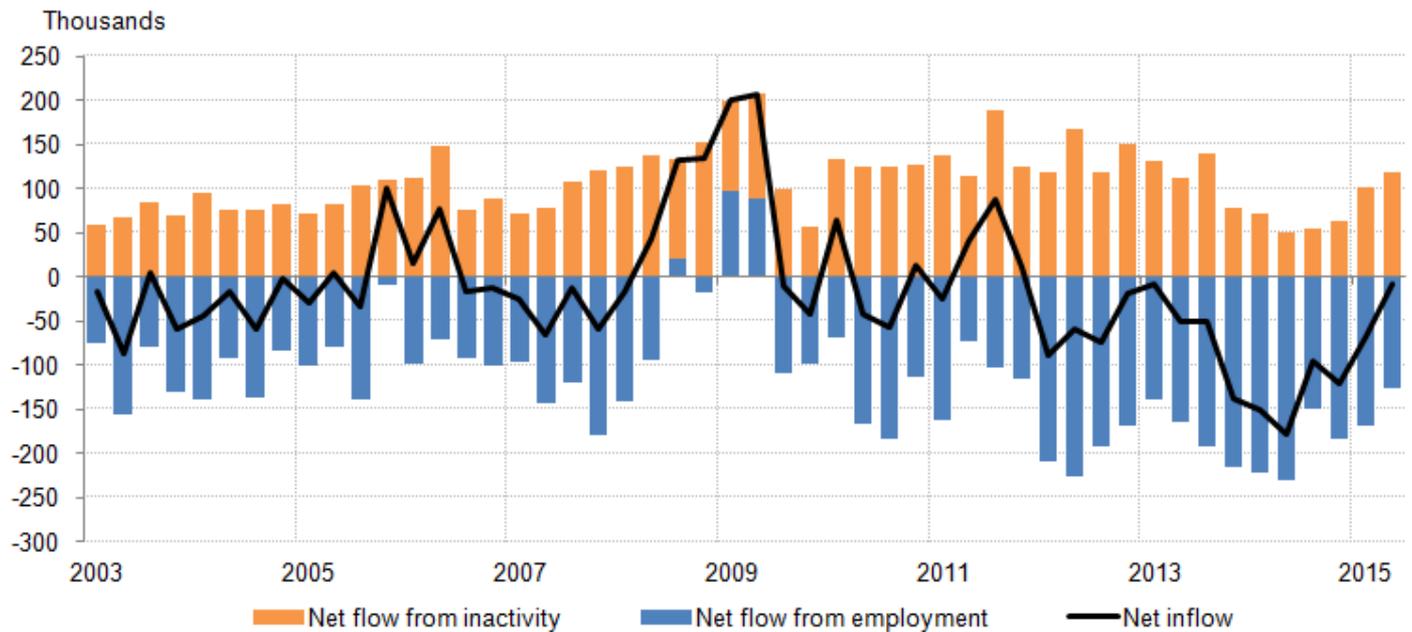
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However, following several quarters in which the unemployment rate has fallen quite sharply, the rate of decline appears to have levelled off in the first half of 2015, prompting some commentators to argue that spare capacity in the labour market is limited and that the UK is close to 'full employment'. This is particularly significant, as with fewer potential recruits available from the unemployed, firms may quickly find that lower unemployment feeds into skill shortages and then to higher wages, which in turn could feed through to inflationary pressures. This recent stabilisation of the unemployment rate is examined in more detail in Figure 10, which shows the net flows into unemployment from employment and inactivity.

## Figure 10: Contributions to net inflows to unemployment, from inactivity and employment

Seasonally adjusted, ages 16 to 64, Q1 2003 to Q2 2015



Source: Office for National Statistics

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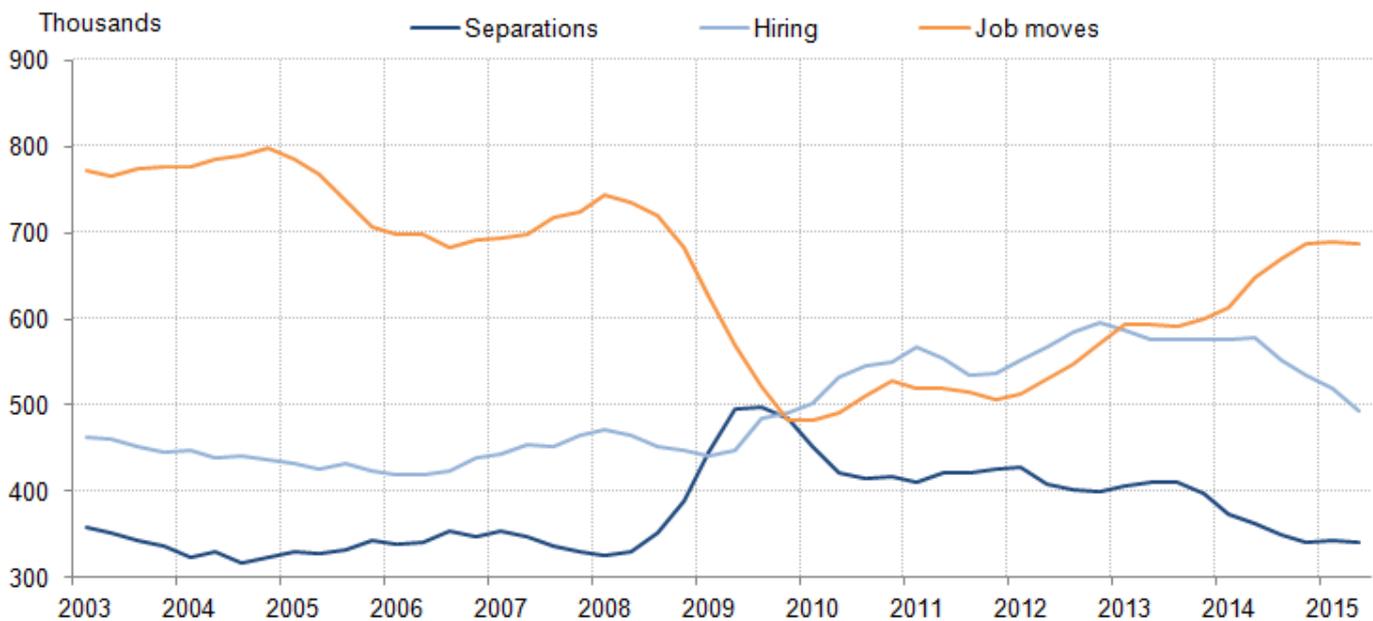
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Net inflows into unemployment turned negative from 2012 onwards, as the flow of people from unemployment into employment picked up while the labour market recovered. However, they have approached zero again in Q2 2015 as the unemployment rate stabilised. Despite net hiring - the net outflow from unemployment to employment – weakening slightly in recent quarters, it has remained relatively strong by historical standards in Q2 2015. Meanwhile, net inflows from inactivity rose, driven both by more inactive people joining the labour market to start looking for work and fewer unemployed people leaving. This supports [previous work](#) which suggested that a key determinant of the remaining slack in the UK labour market is the employability of those moving between inactivity and unemployment. If the inactive are now more attached to the labour market than they were previously, they may act as a greater source of spare capacity than in previous downturns.

While the rising net flow from inactivity to unemployment suggests that there remains headroom in the labour market for further employment growth, a number of indicators suggest that conditions have tightened sharply over the past year. Average weekly earnings grew by 2.4% on the year in the three months to June, and [growth in private sector pay was strong compared to recent standards](#). Workforce flows data on job-to-job moves may also suggest some further tightness, shown in Figure 11. The chart shows the number of people each quarter who move from employment to unemployment (separations), unemployment to employment (hiring), and job moves (within employment).

**Figure 11: Separations (flow from employment to unemployment), hiring (flow from unemployment to employment), and job-to-job moves, four quarter moving average, Ages 16 to 64, thousands**



Source: Office for National Statistics

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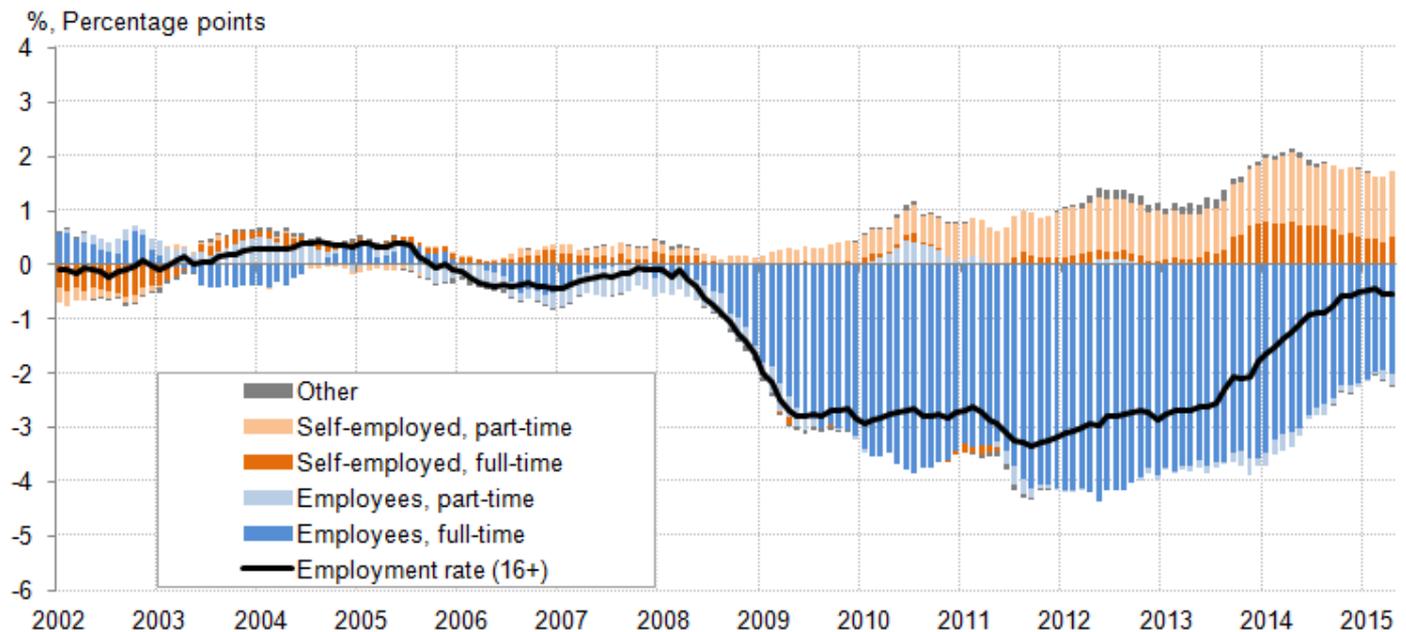
The trends evident in these flows data point to a substantial degree of normalisation and tightening in the labour market in recent periods. Following the economic downturn in 2008, hiring and job-to-job moves fell while separations rose, as some employers sought to reduce labour costs or went out of business. As the labour market began to recover in 2012, hiring and job moves rose simultaneously. This suggests that employers looking to recruit during this period could find the skills they were seeking among either the unemployed or the currently employed. Both series levelled off during 2013. However, since 2014 hiring from the pool of unemployed has fallen while the number of job-to-job moves has increased further. This may suggest that employers are finding it [increasingly difficult to hire skilled workers from the unemployed](#).

Should this trend be sustained there are potential implications for wage pressures, as firms increasingly seek new employees from the stock of those already in employment. Absent an increase in labour supply from older workers delaying retirement or increased net immigration (for example) this increase in job-moves can be associated with [greater pressure on wage inflation](#).

Judging the degree of spare capacity in the UK economy is complicated by the marked shift in the composition of employment between the start of the economic downturn and the most recent data. Figure 12 summarises some of these changes. It indicates that relative to the pre-downturn period 2002-2007, aggregate employment is composed of proportionately more self-employed workers – both full time and part time – and a considerably smaller fraction that are full time employees.

Compared to this long run average, self employed workers added 1.7 percentage points to the employment rate in Q2 2015. Partially offsetting this effect, the lower fraction of employment accounted for by employees made a lower contribution to the aggregate employment rate over the same period.

**Figure 12: Contributions to the change in the 16+ employment rate, relative to the average rate between 2002 and 2007, percentage points**



Source: Office for National Statistics

**Notes:**

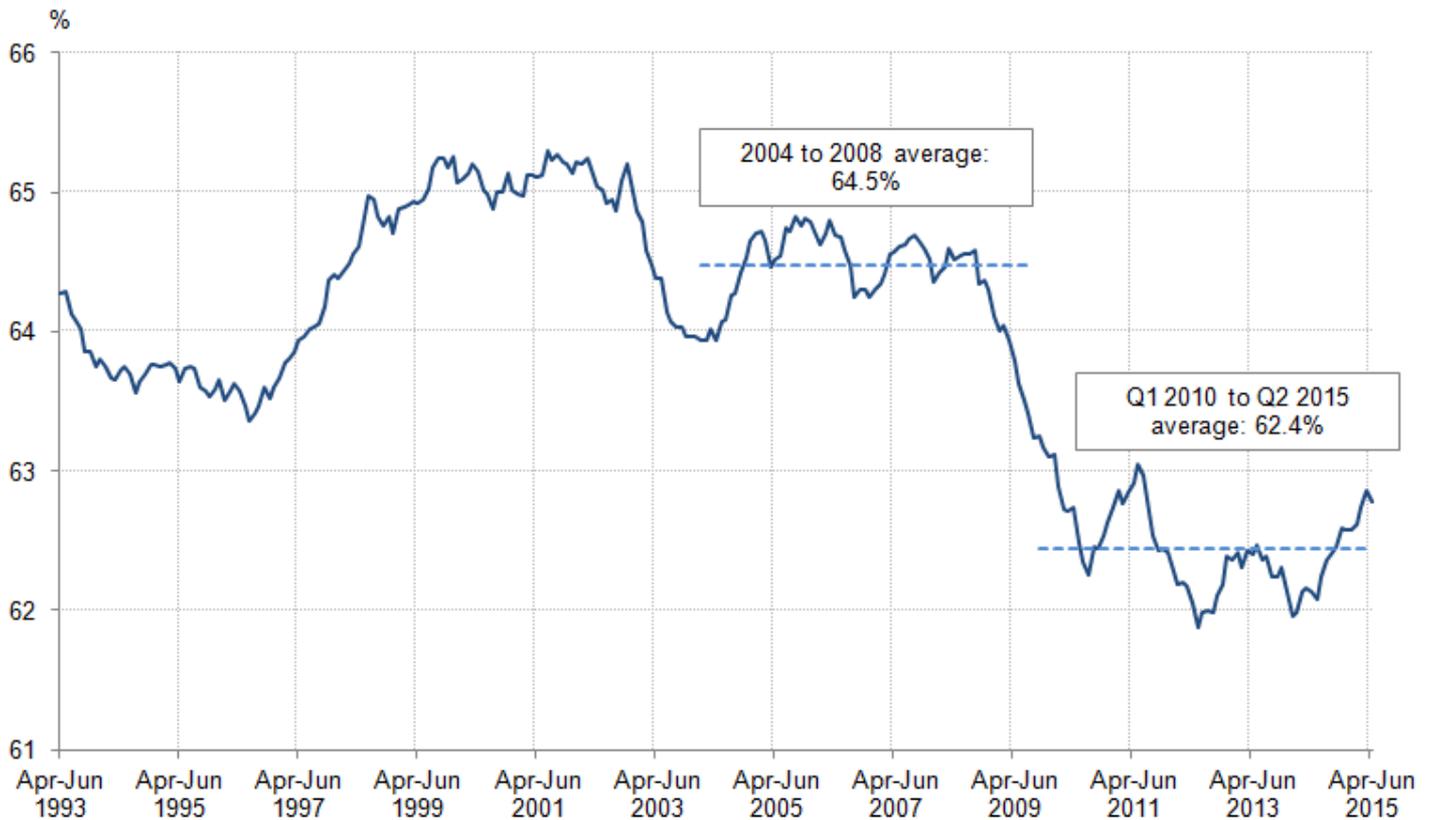
1. 'Other' includes unpaid family workers and government supported training & employment programmes

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An increase in flexible working patterns, such as self-employment, represents a particular challenge when trying to judge the extent of slack in the labour market. If these self-employed workers would prefer full-time employment – indicating 'underemployment' in the labour market - there may be more slack in the labour market than headline figures suggest. However, an increase in flexible work may reflect a shift in preferred working patterns and the degree of slack may be correspondingly reduced, in which case further improvements in the labour market may put [upwards pressure on wages](#). Figure 13 highlights the possibility of this shift in working patterns by examining the proportion of those employed who are full-time employees. Between 2004 and 2008, 64.5% of those employed had a full-time job as an employee. Since the downturn, there appears to have been a downward step-change, with the portion staying near 62.4% since Q1 2010.

**Figure 13: Proportion of those employed who are full-time employees, 16+, %, three-months to June 1993 to the three-months June 2015**



Source: Office for National Statistics

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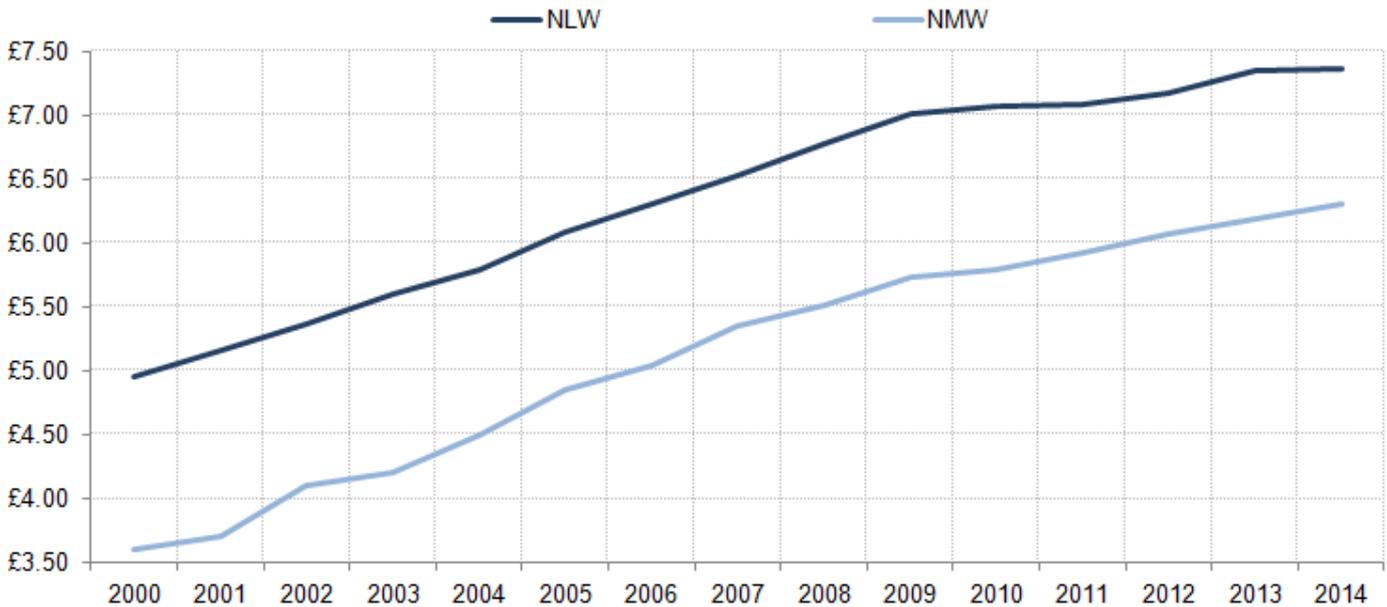
## National Living Wage

While changes in labour market conditions are central in determining the level and growth of wages, policy also has an important role to play. The National Living Wage (NLW) was announced in the 8th July Budget, with the aspiration that it should provide a higher wage floor in the labour market, lifting the earnings of the low paid. It will apply to non-apprentices aged 25 and above from April 2016. In contrast to the National Minimum Wage (NMW) – which is set by the Low Pay Commission the intention is for the NLW to be pegged at 60% of median hourly earnings for those aged 25 and over by April 2020<sup>1</sup>. As a consequence, it is likely to both raise earnings for employees and costs for employers.

The design of the NLW – in particular its link to the earnings of a reference group – permits an examination of the level it would have taken over the last few years and how it would have evolved in comparison with the adult NMW. This is shown in Figure 14, which compares the adult NMW

and a counterfactual NLW – 60% of median earnings for over-25s between 2000 and 2014. In April 2014, the NLW counterfactual was £7.36 while the NMW was £6.31, 86% of the NLW.

**Figure 14: The National Minimum Wage (NMW) and a counterfactual National Living Wage (NLW), April 2000 to April 2014**



Source: Office for National Statistics

**Notes:**

1. Each year corresponds to earnings data and the National Minimum Wage in April.

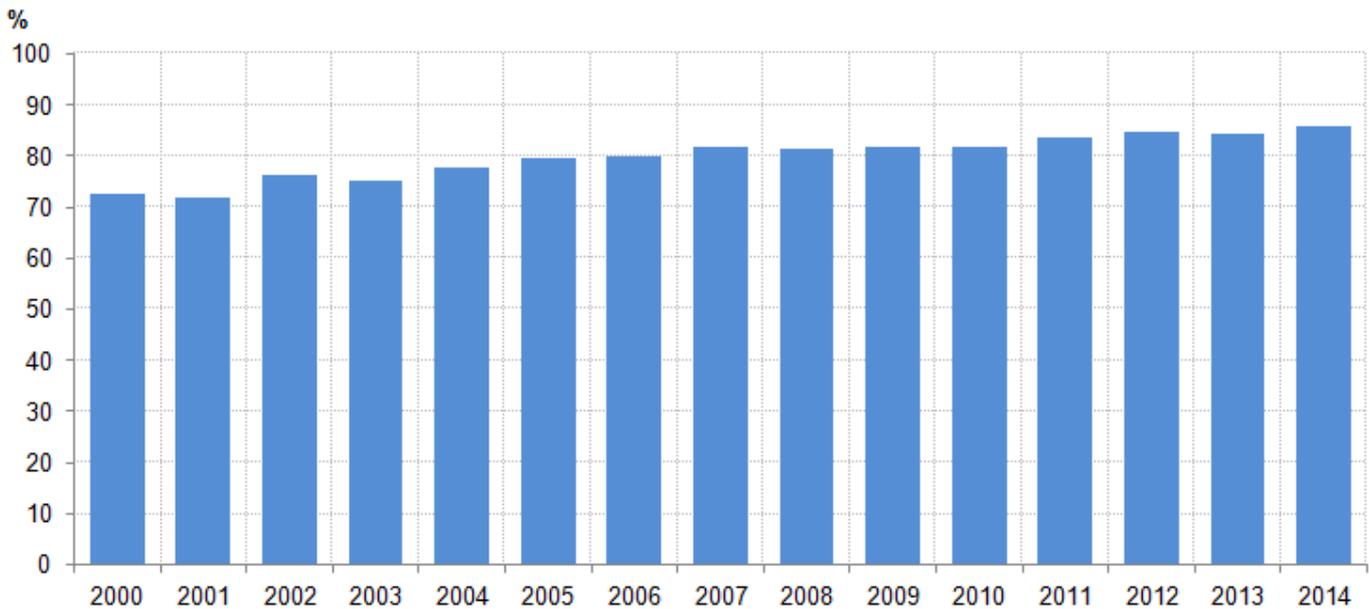
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Over this period as a whole, the NMW has generally increased at a rate faster than median earnings, resulting in the percentage difference between the NMW and the NLW counterfactual falling over time. Figure 15 shows that in 2001 the NMW was 72% of the proposed reference level of the NLW - however, by 2014 this gap had closed to 86%.

**Figure 15: The adult National Minimum Wage (NMW) as a percentage of the counterfactual National Living Wage (NLW), April 2000 to April 2014**



Source: Office for National Statistics

**Notes:**

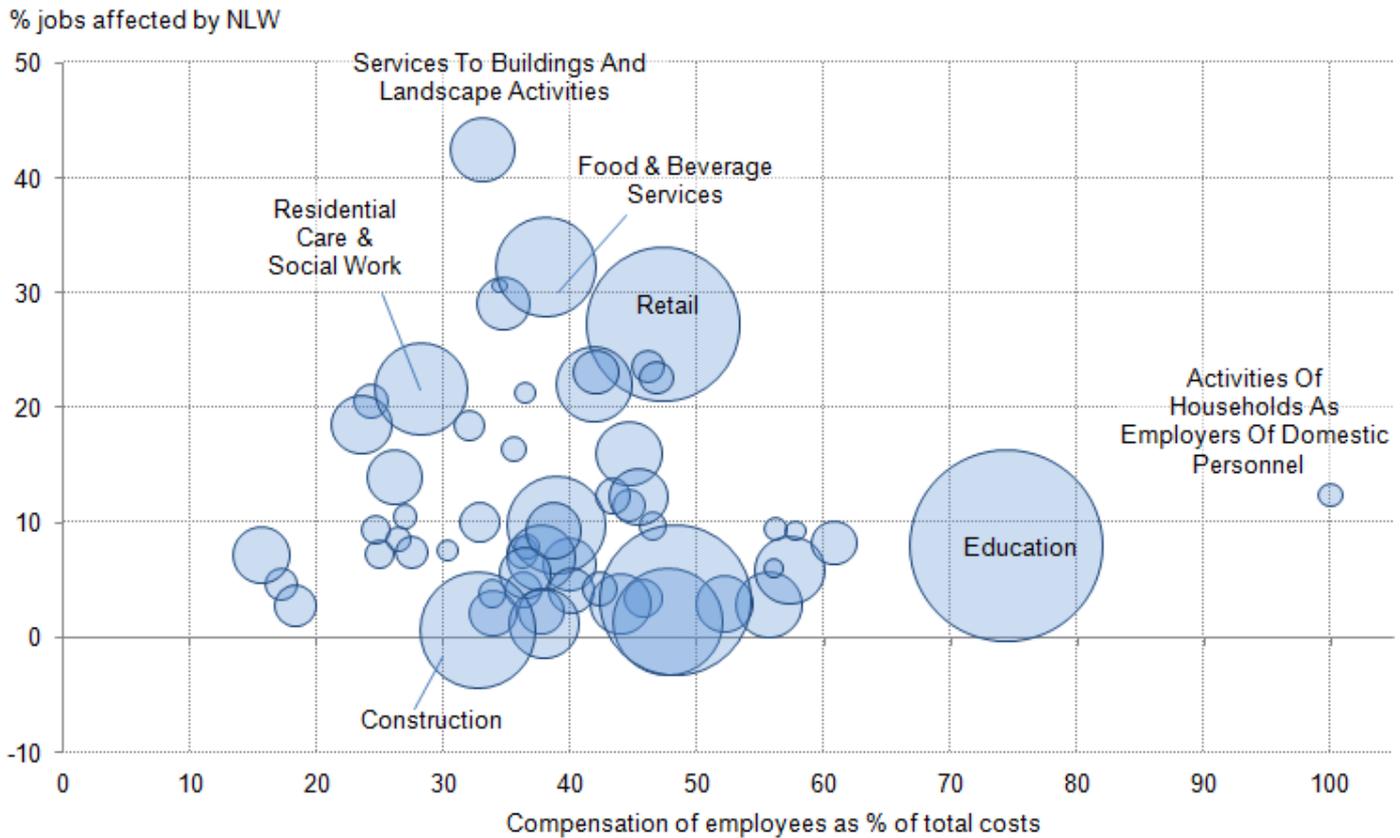
1. Each year corresponds to earnings data and the National Minimum Wage in April.

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As the prevalence of low-paid work differs across industries, the NLW is likely to have a greater impact on some industries than others. All else being equal, industries which are relatively labour intensive and those which have a large fraction of employees on low earnings will be more affected by the proposed change. Figure 16 examines employment in the UK from this perspective, plotting the fraction of jobs in each industry which paid below the reference level of the proposed NLW against the fraction of industry costs accounted for by compensation of employees. The first of these measures indicates the impact of the NLW on labour costs for a particular industry, while the second indicates how important labour costs are in determining total costs. The higher either (or both) of these measures are, the bigger the potential impact of the NLW on costs in that industry – and the more likely that firms will look to change their labour demand or output prices to offset these cost impacts. The size of each bubble is based on the number of jobs in each industry.

**Figure 16: Compensation of employees as a percentage of total costs and percentage of jobs 'affected' by the National Living Wage (NLW) by industry, 2014**



Source: Office for National Statistics

**Notes:**

1. Some industries are excluded due to disclosure issues. Jobs 'affected' by NLW are defined as non-apprentice jobs performed by over-25s where hourly earnings are less than 60% of whole economy median hourly earnings for over-25s.

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As Figure 16 demonstrates, fewer than 10% of jobs will be directly affected by the NLW in most industries. Additionally, those industries where labour costs are a large portion of total costs – such as Education – tend to have a low portion of jobs affected by the NLW. However, some industries such as Retail, Food & Beverage Services and Residential Care & Social Work – have a high portion of jobs affected by the NLW while labour costs form a reasonable portion of total costs. This indicates that the impact of the NLW may be concentrated among a few particular industries, rather than spread more widely across industries. This asymmetric effect across industries is likely to be an additional determinant of where the headline labour market figures settle in the medium term.

## Notes

1. The Low Pay Commission has been tasked with recommending the path for the NLW to take in reaching this peg. Throughout this discussion references to the NLW refer to this pegged system.

## Reference Tables

**Table 1: UK Demand side indicators**

	2013	2014	2014	2015	2015	2015	2015	2015	2015
			Q4	Q1	Q2	Apr	May	Jun	Jul
<b>GDP<sup>1</sup></b>	1.7	3.0	0.8	0.4	0.7	:	:	:	:
<b>Index of Services</b>									
All Services <sup>1</sup>	1.9	3.0	0.9	0.4	0.7	0.2	0.2	0.5	:
Business Services & Finance <sup>1</sup>	2.5	3.8	1.4	0.1	0.8	-0.1	0.4	0.7	:
Government & Other <sup>1</sup>	0.3	1.1	0.0	0.3	0.2	0.0	0.1	0.1	:
Distribution, Hotels & Rest. <sup>1</sup>	3.5	4.8	1.4	1.1	1.0	0.7	-0.2	0.6	:
Transport, Stor. & Comms. <sup>1</sup>	1.4	2.7	1.0	0.7	1.2	0.9	0.6	1.0	:
<b>Index of Production</b>									
All Production <sup>1</sup>	-0.5	1.7	0.4	0.2	0.7	0.2	0.3	-0.4	:
Manufacturing <sup>1-0.7</sup>		3.1	0.4	0.1	-0.3	-0.4	-0.6	0.2	:
Mining & Quarrying <sup>1</sup>	-2.5	-0.3	1.5	-0.5	6.1	3.4	4.6	-3.8	:
<b>Construction<sup>1</sup></b>	1.4	9.5	0.2	-0.2	0.2	0.0	-1.0	0.9	:

	2013	2014	2014	2015	2015	2015	2015	2015	2015
			Q4	Q1	Q2	Apr	May	Jun	Jul
<b>Retail Sales Index</b>									
All Retailing <sup>1</sup>	1.5	4.0	2.4	0.8	0.7	0.7	0.3	-0.1	0.1
All Retailing, excl. Fuel <sup>1</sup>	2.0	4.4	2.3	0.5	0.9	0.5	0.4	-0.3	0.4
Predom. Food Stores <sup>1</sup>	-0.1	0.8	1.5	0.2	0.1	-0.7	1.3	-0.4	-0.2
Predom. Non-Food Stores <sup>1</sup>	1.8	6.6	2.6	0.1	1.4	1.6	-0.3	-0.7	0.7
Non-Store Retailing <sup>1</sup>	17.8	12.1	5.3	4.1	2.7	0.5	0.1	3.4	1.4
<b>Trade</b>									
Balance <sup>2,3</sup>	-33.7	-35.2	-6.9	-7.5	-4.8	-2.3	-0.9	-1.6	:
Exports <sup>4</sup>	3.0	-1.7	3.3	-1.6	2.3	1.5	1.5	-0.6	:
Imports <sup>4</sup>	2.7	-1.3	0.0	-1.1	0.2	-0.4	-1.8	1.1	:
<b>Public Sector Finances</b>									
PSNB-ex <sup>3,5</sup>	-24.1	-6.0	-3.6	-7.1	-5.9	-2.3	-2.8	-0.8	-1.4
PSND-ex as a % GDP	79.3	81.6	81.6	80.7	81.4	80.5	80.8	81.4	80.8

**Table source:** Office for National Statistics

**Table notes:**

1. Percentage change on previous period, seasonally adjusted, CVM
2. Levels, seasonally adjusted, CP
3. Expressed in £ billion
4. Percentage change on previous period, seasonally adjusted, CP
5. Public Sector net borrowing, excluding public sector banks. Level change on previous period a year ago, not seasonally adjusted

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**Table 2: UK Supply side indicators**

	2013	2014	2014	2015	2015	2014	2015	2015	2015
			Q4	Q1	Q2	Apr	May	Jun	Jul
<b>Labour Market</b>									
Employment Rate <sup>1, 2</sup>	71.5	72.9	73.2	73.5	73.4	73.3	73.4	:	:
Unemployment Rate <sup>1, 3</sup>	7.6	6.2	5.7	5.5	5.6	5.6	5.6	:	:
Inactivity Rate <sup>1, 4</sup>	22.4	22.2	22.3	22.1	22.1	22.2	22.1	:	:
Claimant Count Rate <sup>7</sup>	4.2	3.0	2.6	2.4	2.3	2.3	2.3	2.3	2.3
Total Weekly Earnings <sup>6</sup>	£475	£480	£486	£488	£491	£492	£492	£488	:
<b>CPI</b>									
All-item CPI <sup>5</sup>	2.6	1.5	0.9	0.1	0.0	-0.1	0.1	0.0	0.1
Transport <sup>5</sup>	1.0	0.3	-0.4	-2.5	-2.1	-2.8	-1.5	-1.8	-1.9
Recreation & Culture <sup>5</sup>	1.1	0.9	0.6	-0.4	-0.8	-0.4	-1.0	-1.0	-0.6
Utilities <sup>5</sup>	4.1	3.0	2.5	0.9	0.4	0.5	0.4	0.4	0.4
Food & Non-alcoh. Bev. <sup>5</sup>	3.8	-0.2	-1.6	-2.9	-2.3	-2.8	-1.8	-2.2	-2.7
<b>PPI</b>									
Input <sup>8</sup>	1.2	-6.6	-9.4	-13.5	-12.2	-11.1	-12.4	-13.1	-12.4
Output <sup>8</sup>	1.3	0.0	-0.8	-1.7	-1.7	-1.7	-1.6	-1.6	-1.6

	2013	2014	2014	2015	2015	2014	2015	2015	2015
			Q4	Q1	Q2	Apr	May	Jun	Jul
<b>HPI<sup>8</sup></b>	3.5	10.0	10.0	8.5	5.6	5.6	5.6	5.7	:

**Table source:** Office for National Statistics

**Table notes:**

1. Monthly data shows a three month rolling average (e.g. The figure for February is for the three months Jan - Mar)
2. Headline employment figure is the number of people aged 16-64 in employment divided by the total population 16-64
3. Headline unemployment figure is the number of unemployed people (aged 16+) divided by the economically active population (aged 16+)
4. Headline inactivity figure is the number of economically active people aged 16 to 64 divided by the 16 to 64 population
5. Percentage change on previous period a year ago, seasonally adjusted
6. Estimates of total pay include bonuses but exclude arrears of pay (£)
7. Calculated by JSA claimants divided by claimant count plus workforce jobs
8. Percentage change on previous period a year ago, non-seasonally adjusted

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**Background notes**

1. Details of the policy governing the release of new data are available by visiting [www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html](http://www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html) or from the Media Relations Office email: [media.relations@ons.gsi.gov.uk](mailto:media.relations@ons.gsi.gov.uk)

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