Office for National Statistics

Article

Quarterly economic commentary: July to September 2019

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

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1 . Main points

- Real UK gross domestic product (GDP) increased by 0.4% in Quarter 3 (July to Sept) 2019, following increased levels of volatility in the first half of the year that largely reflect changes in the timing of activity related to the UK's original planned exit date from the European Union in late March.

- In Quarter 3 2019, households primarily financed the lower levels of net lending in the latest three months by reducing the amount of currency and deposits placed with financial institutions, while the reduction in the net borrowing of private non-financial corporations (PNFCs) reflected a fall in gross capital formation.

- The current account deficit narrowed to 2.8% of GDP in Quarter 3 2019, its lowest share of GDP since early 2012, while the UK's net borrowing was financed by an increase in its liabilities to the rest of the world, specifically in debt investment.

- The employment rate stood at a record high of 76.2% in the three months to October 2019 and the unemployment rate at a multi-decade low of 3.8%, although the number of vacancies has now fallen for 10 consecutive months.

- The 12-month growth rate of the Consumer Prices Index including owner occupiers' housing costs (CPIH) remains at 1.5% in November 2019, marking the lowest rate of inflation since late 2016, as much of the recent easing has reflected the lowering of the price cap for some domestic gas and electricity customers by the Office of Gas and Electricity Markets.

2 . Gross domestic product

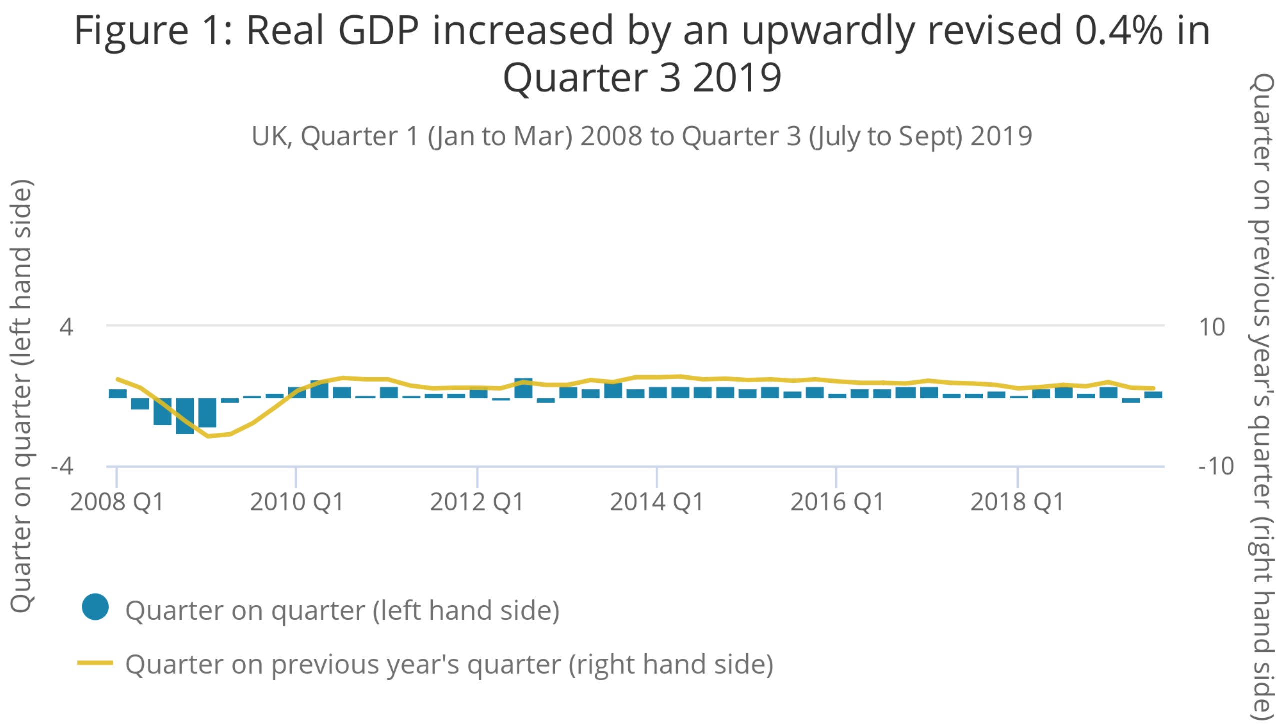
Following increased levels of volatility in the first half of the year that largely reflected changes in the timing of activity related to the UK's original planned exit date from the European Union in late March, real UK gross domestic product (GDP) increased by 0.4% in the third quarter (July to Sept) of 2019.

Looking through these temporary factors that underpin this volatility, there are signs that there is an underlying slowing in the UK economy, which is likely to be reflecting the high levels of domestic and global uncertainties. Quarterly GDP growth has been 0.3% on average this year, continuing the slowing that has been experienced over the previous five years. Compared with the same quarter a year ago, the UK economy increased by 1.1% - the joint weakest figure since mid-2012.

More timely estimates show that the UK economy was flat in the three months to October 2019 [1], reflecting the recent underlying slowing in the services industry and falls in output of the production and construction industries over this three-month period. Services output increased by 0.2%, whilst production output fell by 0.7% and construction output fell by 0.3%.

Figure 1: Real GDP increased by an upwardly revised 0.4% in Quarter 3 2019

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 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. Real GDP figures are volume estimates that are adjusted for the effects of inflation over time.

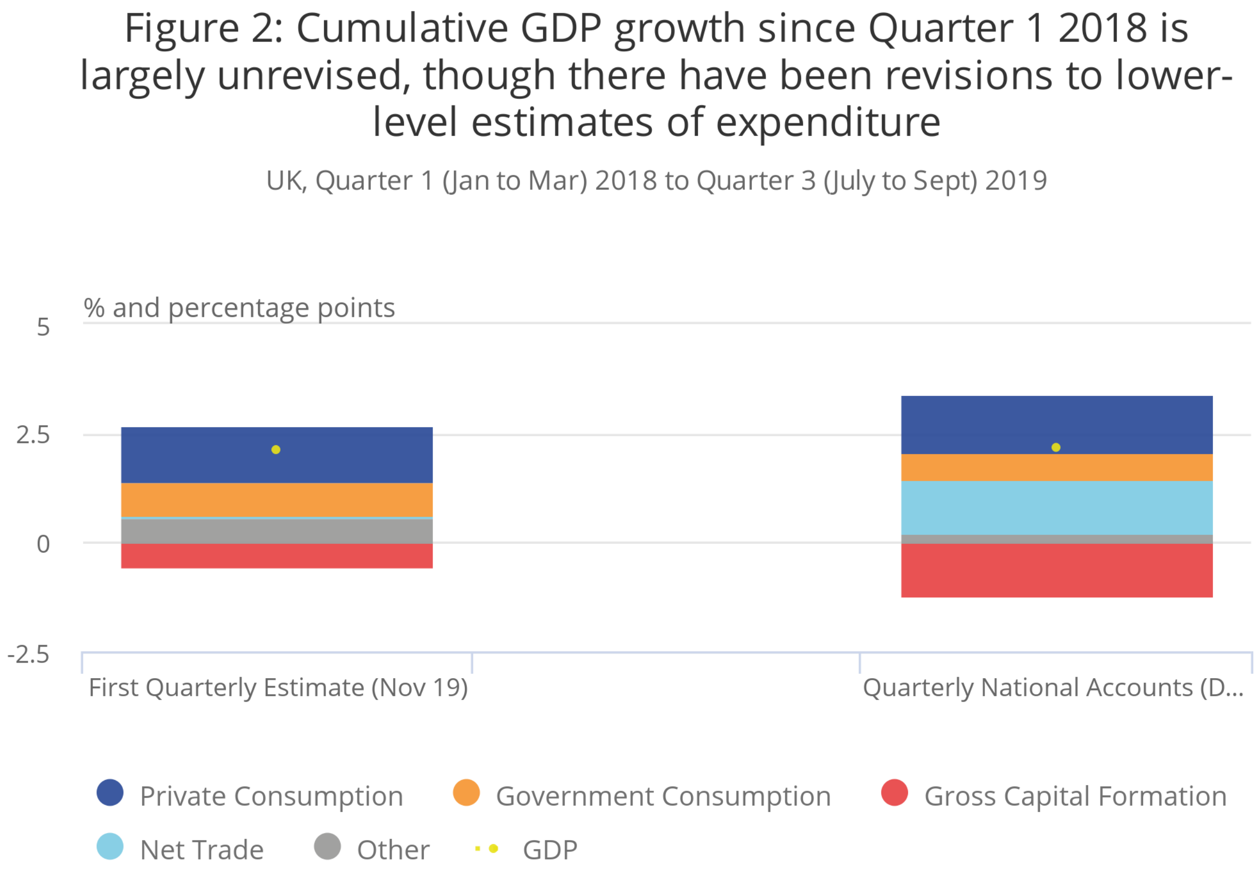
3. In line with the National Accounts Revisions Policy, all quarters from Quarter 1 (Jan to Mar) 2018 onwards are open for revision.

Nominal GDP growth has continued to slow of late, easing to 0.7% in Quarter 3 2019. The implied GDP deflator represents the broadest measure of inflation in the domestic economy, reflecting changes in the price of all goods and services that make up GDP. It slowed in the year to Quarter 3, increasing by an unrevised 2.0%, primarily reflecting a slowing in the growth of prices of household consumption.

Cumulative GDP growth has largely been unrevised over the period open to revision, although there have been some offsetting revisions to lower-level estimates of expenditure – most notably to gross capital formation and net trade (Figure 2). There has been more external rebalancing than previously estimated. The revised estimates continue to show a weaker contribution of private consumption over this period, which in part reflects the effect of a squeeze in purchasing power from higher import inflation. It may also reflect the effects of heightened levels of uncertainty, which also continue to have led to weaker levels of gross capital fixed formation than might have been expected given the broader business conditions.

Figure 2: Cumulative GDP growth since Quarter 1 2018 is largely unrevised, though there have been revisions to lower-level estimates of expenditure

UK, Quarter 1 (Jan to Mar) 2018 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 2019

Notes:

1. ‘Other’ captures the statistical discrepancy.

International

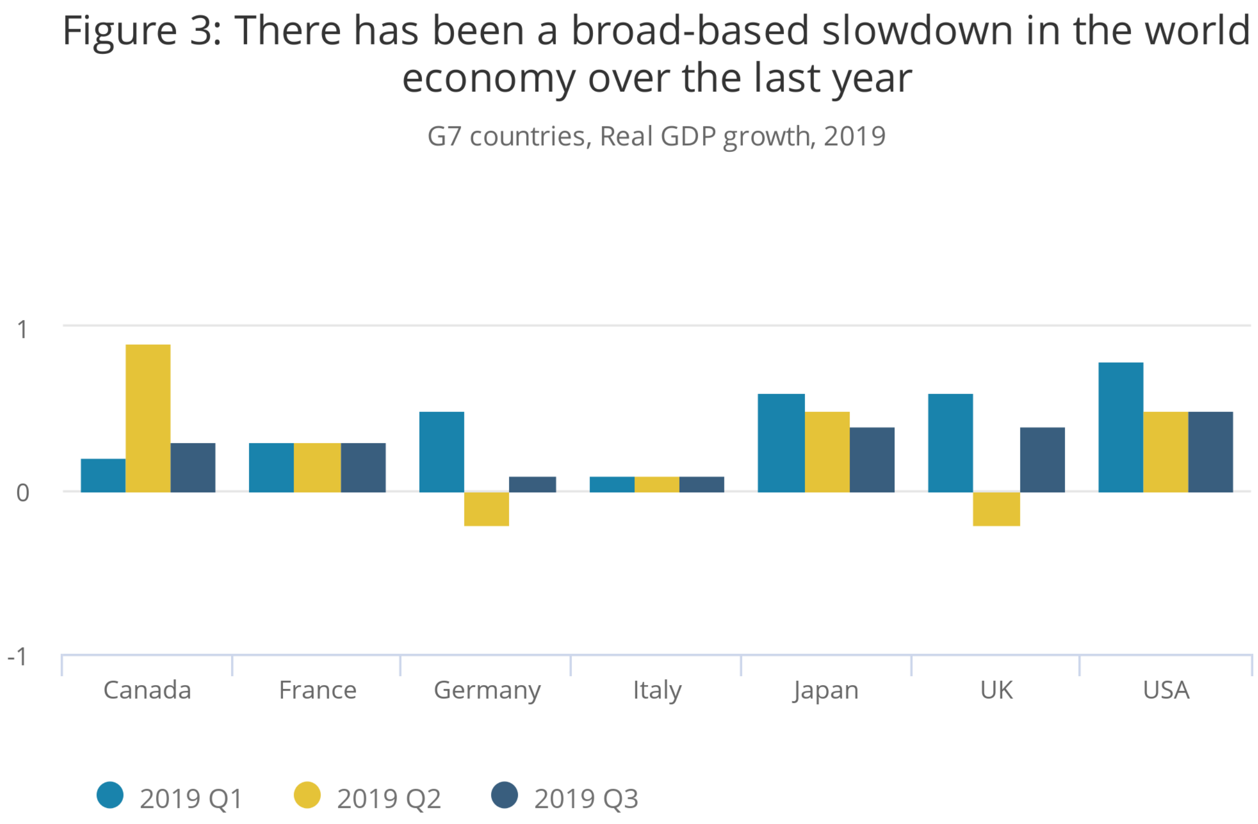
The world economy has experienced a broad-based slowdown over the year, in part because of the direct and indirect effects of the increase in trade protectionism. In its latest [World Economic Outlook](), the International Monetary Fund (IMF) forecasts global GDP to increase by 3.0% this year - its slowest rate of expansion since the global financial crisis - as "rising trade and geopolitical tensions have increased uncertainty about the future of the global trading system and international cooperation more generally" have weighed on confidence, investment and trade.

Those views are also broadly in line with those of the Organisation for Economic Co-operation and Development, who cite that there are "increasing signs that the cyclical downturn is becoming entrenched" as it [forecasts that the global outlook is set to remain subdued]().

Figure 3 shows how the UK economy has performed compared with other G7 countries through 2019 so far. The performance of these European economies this year has been subdued in the context of recent years, as France, Germany and Italy have each experienced relatively slower GDP growth this year. This is likely to reflect to some extent the direct effects of policy uncertainty that have weighed on global industrial production and trade flows, while the indirect effects on business confidence may have adversely impacted upon investment spending.

Figure 3: There has been a broad-based slowdown in the world economy over the last year

G7 countries, Real GDP growth, 2019



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

Notes:

1. All OECD figures correct as of 13 December 2019.

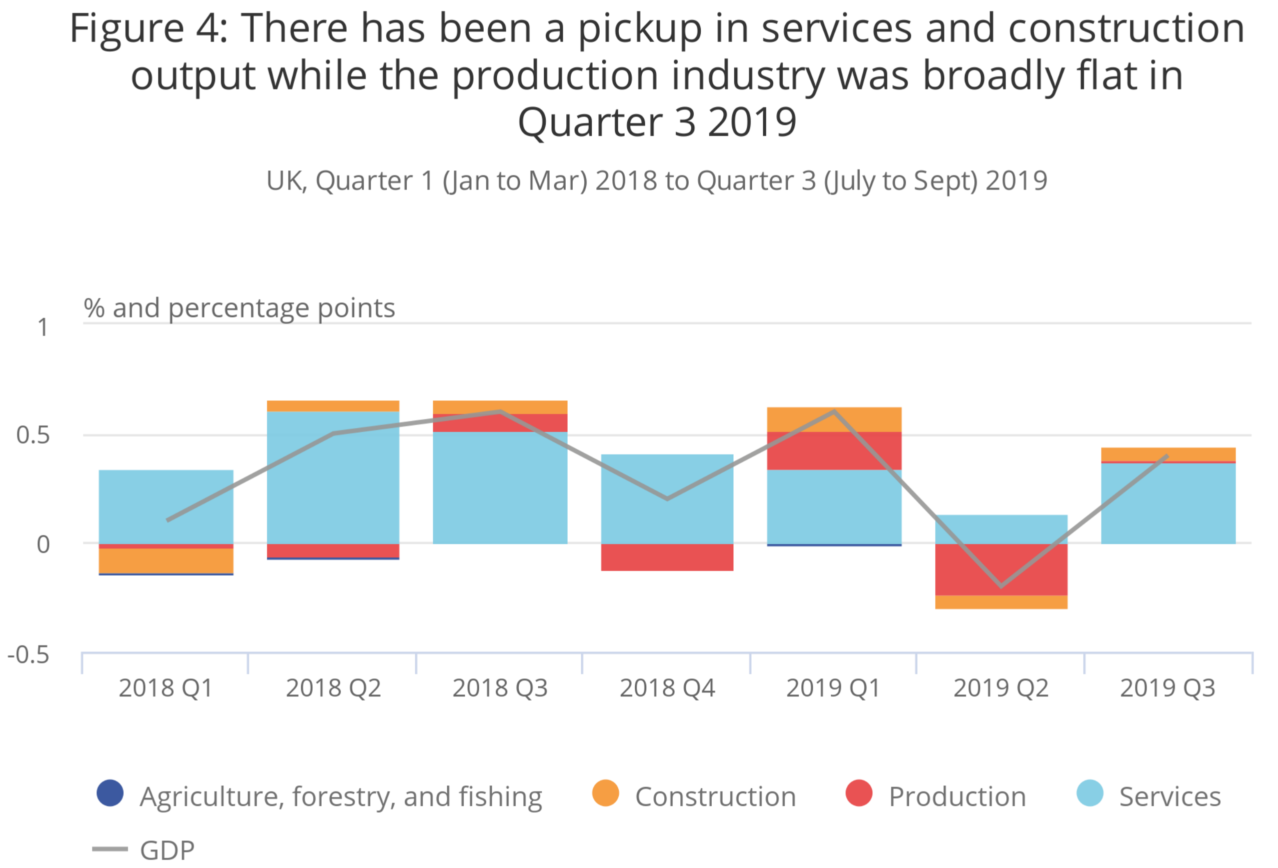
Output

The slowdown over the last year has been most evident in the services industry. However, following the weakest quarterly figure in three years in the previous quarter, there was a 0.5% pickup in Quarter 3 2019. There was a 0.1% increase in production output in the latest quarter, whilst construction output experienced a pickup following a weak Quarter 2 (Apr to June) 2019 (Figure 4).

These revised estimates continue to show that there was a period of increased volatility in the first half of the year relating to the UK’s original planned exit date from the European Union, likely reflecting the effects of bringing forward activity in the first quarter of the year and the decline in car production owing to widespread car plant shutdowns in April. This has been most evident in the quarterly movements in manufacturing output, which increased by 2.4% in Quarter 1 (Jan to Mar) 2019, followed by a fall of 2.6% in Quarter 2.

Figure 4: There has been a pickup in services and construction output while the production industry was broadly flat in Quarter 3 2019

UK, Quarter 1 (Jan to Mar) 2018 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 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. Contribution to real GDP quarter-on-quarter growth. Components may not sum to total because of rounding.

Services output increased by an upwardly revised 0.5% in Quarter 3 2019, a pickup from the loss in momentum that has been evident over the previous year. However, compared with the same quarter in the previous year, it increased by 1.6% - the weakest figure since the first quarter of 2018.

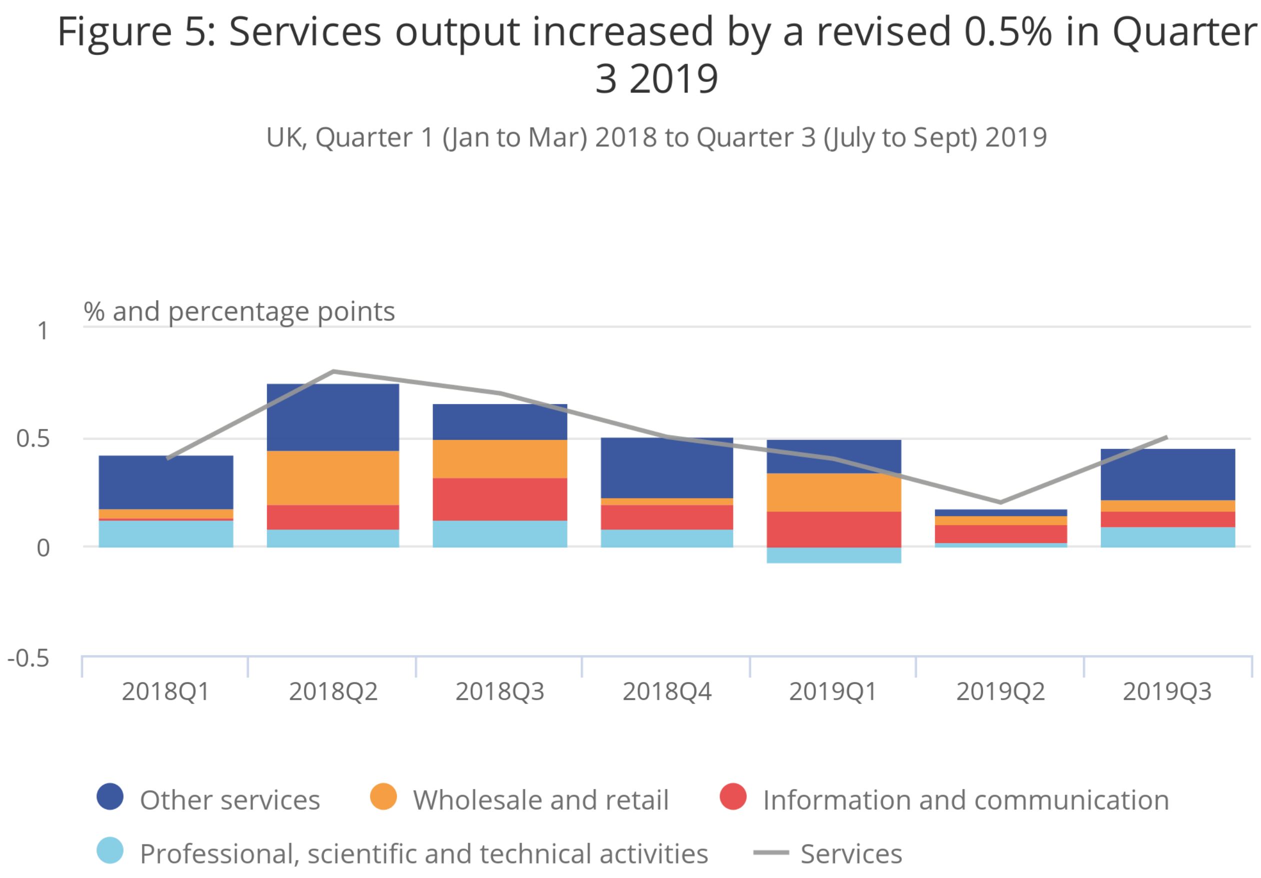
The easing has also been reported in the [Quarter 3 2019 Bank of England Agents' summary](), which recorded how business services continued to grow at a modest rate, with weaker demand for transaction-related services partially offset by strong demand for IT services. More recent information in the [Services Purchasing Managers' Index]() (PDF, 177KB) reports of there being a slight decline in output in November, although this was its sharpest fall since March. Respondents cited that uncertainty had led to "cautious business and consumer spending".

The quarterly increase has been driven by all four of the main services industries (Figure 5) with the most notable contribution coming from other services. This increase reflected a 0.8% increase in human health and social work activities alongside a 1.2% increase in financial and insurance activities, following five consecutive quarters of decline. Wholesale, retail and motor trades increased by 0.4% in Quarter 3 2019.

A range of external indicators appear to be signalling a recent decline in retail activity. However, it should be noted that there are different methodological factors that can affect comparability with official figures.

Figure 5: Services output increased by a revised 0.5% in Quarter 3 2019

UK, Quarter 1 (Jan to Mar) 2018 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 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. Contribution to quarter-on-quarter service sector growth. Components may not sum to total because of rounding.

The volatility throughout the first half of 2019 has been particularly pronounced in the manufacturing industry, that was consistent with activity being brought forward ahead of the UK's original intended European Union departure date. This was then followed by a slowdown in activity in Quarter 2 exacerbated by car plant shutdowns in April.

The subdued performance of the manufacturing industry in the three months to September 2019 has also been recorded by the recent CBI Industrial Trends Survey, which also noted that stock levels were above adequate, as uncertainty and the ongoing global manufacturing slowdown continued to have an adverse effect on manufacturers. The British Chambers of Commerce Quarterly Economic Survey also reported a deterioration in manufacturing activity, highlighting "diminishing cashflow, weakening global demand and disrupted supply chains". The latest Manufacturing Purchasing Manager's Index (PDF, 136KB) recorded a fall in output, new orders and employment in November, in part reflecting domestic and global conditions as respondents cited the "destocking at clients following the delay to Brexit and the ongoing uncertainty surrounding the political, economic and global trade situations".

Construction output increased by an upwardly revised 1.2% in Quarter 3 2019, following a 1.0% decline in Quarter 2. The latest Bank of England Agents' Summary of Business Conditions reported strength in residential construction, with the development of lower-priced properties remaining strong, supported by the Help to Buy schemes. More timely information from the Construction Purchasing Managers' Index (PDF, 167KB) recorded a fall in activity for the eighth consecutive month in November, citing that "domestic political uncertainty had led to indecision among clients" as there was a lack of new work to replace those contracts that had been completed.

Expenditure

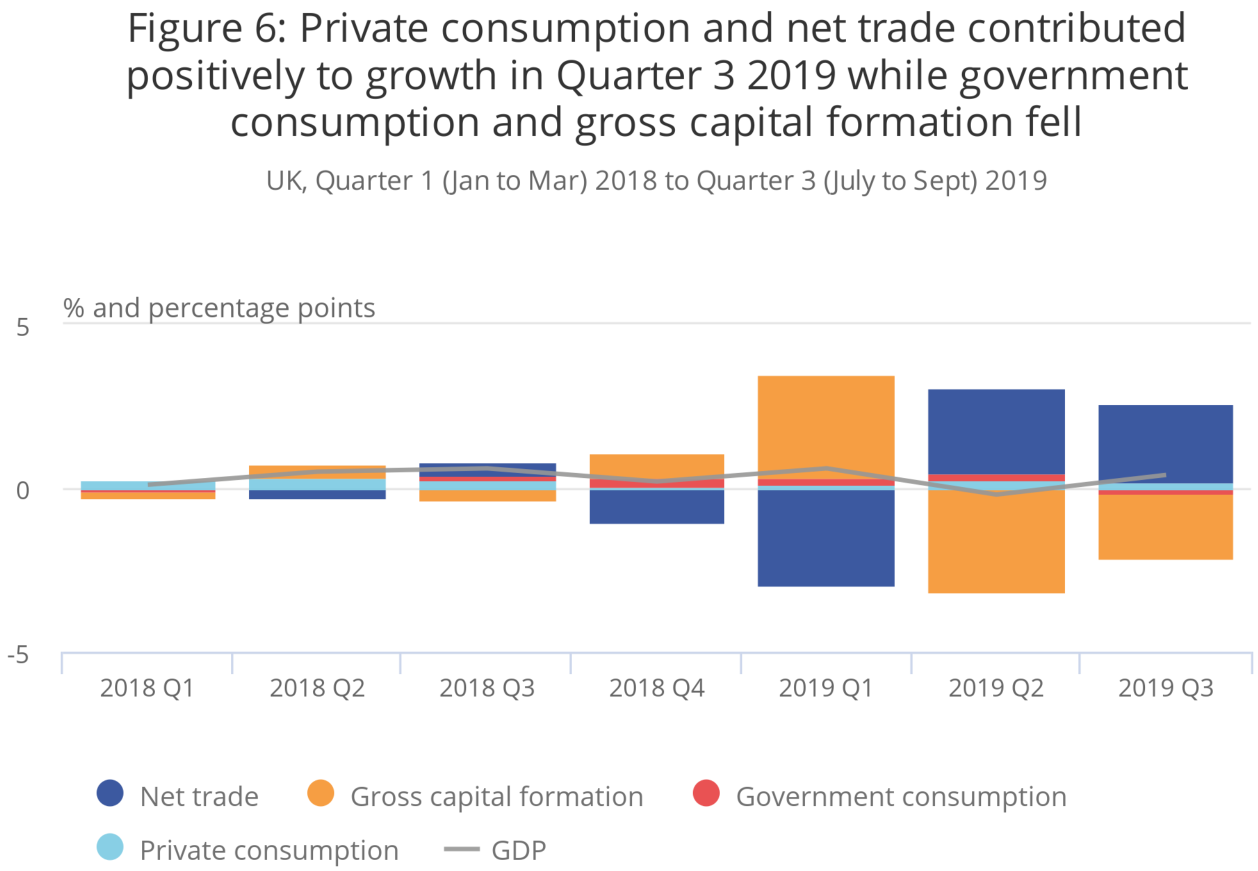
Private consumption and net trade contributed positively to growth in Quarter 3 2019, while there were falls in government consumption and gross capital formation (Figure 6). The 0.3% increase in household consumption in the third quarter, in line with its recent trend, was mainly driven by higher spending on transport, restaurants and miscellaneous goods and services.

The latest Bank of England Agents' Summary of Business Conditions notes the weakness in retail sales in Quarter 3 compared with a year ago, citing "base effects from strong sales a year ago when there was a boost from warm weather and the football World Cup".

Whilst the latest figures from the British Retail Consortium point to a fall in retail sales in the year to November, these figures have been impacted by the timing of "Black Friday" this year. Once this has been adjusted for, there is some evidence that there has been a pickup in activity compared with recent months. The latest GfK Consumer Confidence Index continues to show relatively low levels of confidence, as consumers appear to be in a "wait-and-see mode" because of ongoing uncertainty.

Figure 6: Private consumption and net trade contributed positively to growth in Quarter 3 2019 while government consumption and gross capital formation fell

UK, Quarter 1 (Jan to Mar) 2018 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 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. Contribution to real GDP quarter-on-quarter growth. Contributions may not sum to total because of rounding, whilst the statistical discrepancy is also not displayed.

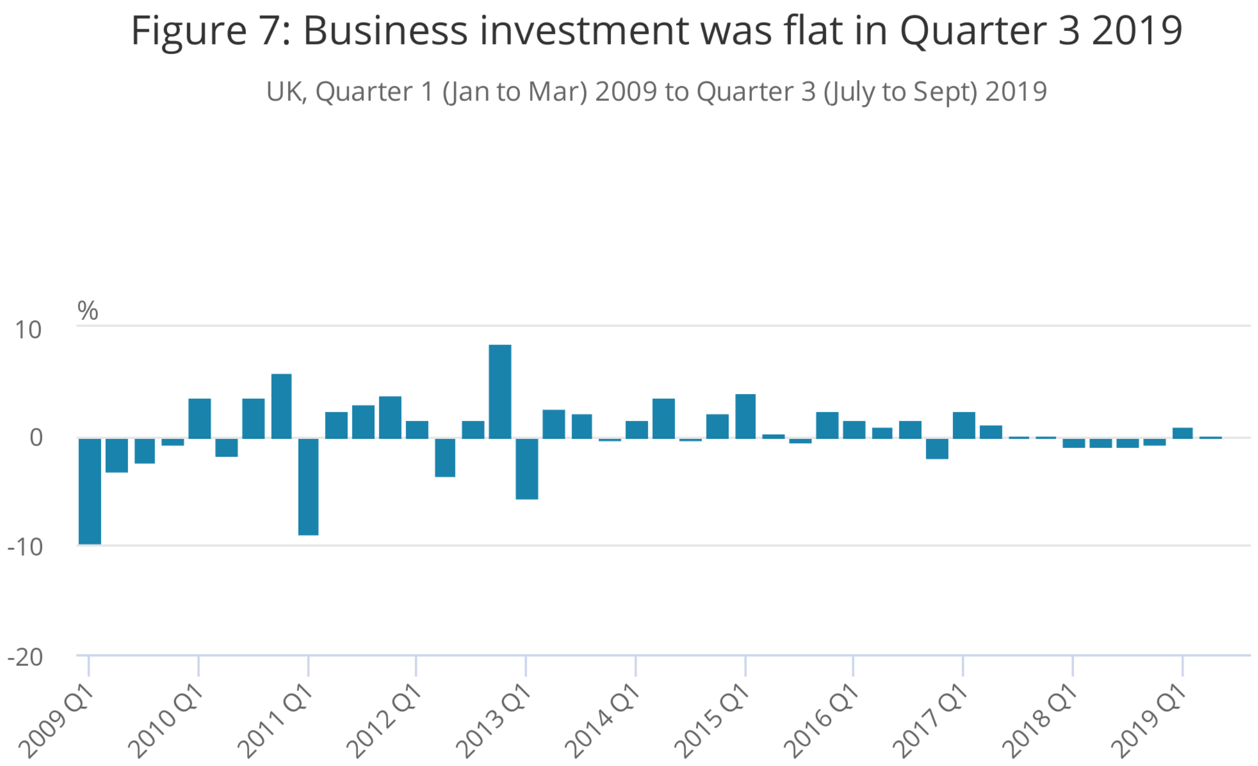
Recent analysis finds evidence that uncertainty has become "more persistent and entrenched" (PDF, 224KB), impacting upon private consumption and capital spending - and that the effects are larger once the persistence of uncertainty is also considered. There is more incentive for businesses to hold back on capital expenditure if any uncertainty is expected to last for a short period of time - and that "persistent rolling uncertainty is likely to be especially damaging".

Uncertainty is likely to explain why investment has continued to be so subdued of late, as business investment has largely been flat or falling for much of the last two years (Figure 7). This is at a time in the economic cycle when a more marked pickup in expenditure would be expected, whilst domestic uncertainty may explain why capital spending in the UK has been weaker than in other advanced economies.

The latest Bank of England Agents' Summary of Business Conditions reports that investment intentions remained at a nine-year low in the third quarter as "Brexit uncertainty continued to dampen companies' appetite to invest". Recent analysis by the National Institute of Economic and Social Research finds that business investment is about 15% lower than expected (PDF, 399KB), given the underlying financial conditions facing businesses.

Figure 7: Business investment was flat in Quarter 3 2019

UK, Quarter 1 (Jan to Mar) 2009 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 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. Business investment refers to quarter-on-quarter growth in volume estimates of business investment.

Movements in inventories earlier in the year support the narrative of the stockpiling and subsequent unwinding of stocks. Excluding alignment adjustment, stocks held by UK companies increased in the first quarter of 2019 as stocks were built up and subsequently fell as stocks were run down. This is corroborated by external evidence, such as the Bank of England's Agents' Summary, which showed that "around half of all respondents had been building inventories as part of their contingency planning for Brexit" in Quarter 1 2019. Similarly, the Markit UK Manufacturing PMI (PDF, 148KB) for June 2019 reported that "the impact of firms unwinding stockpiles built before the original Brexit date continued to reverberate through the sector and exacerbate weak demand."

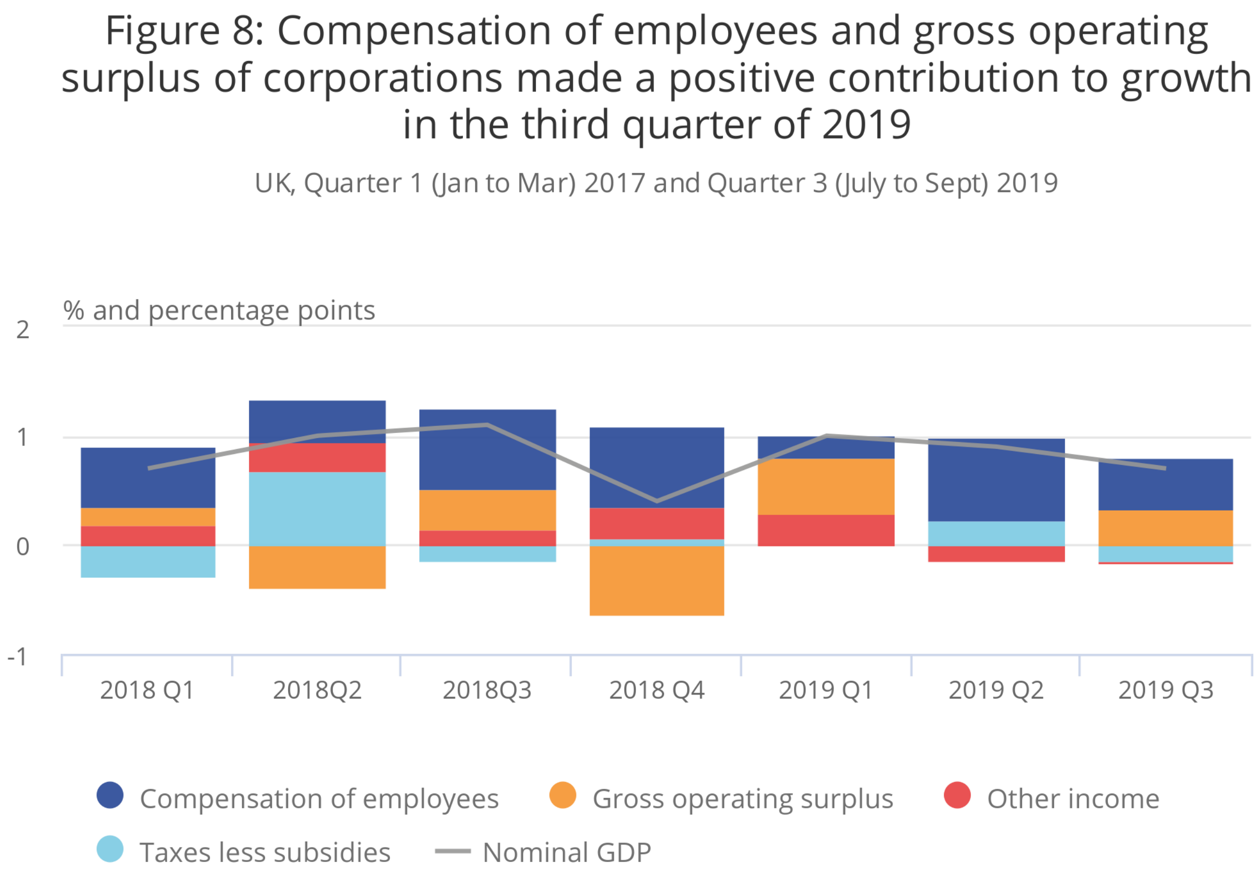
Trade flows have been volatile in the first half of 2019, in part reflecting the effects of movements of "unspecified goods" - which include non-monetary gold. These large movements in gross trade flows have continued into the third quarter, with the UK trade deficit narrowing to 0.1% of nominal GDP - the lowest trade deficit as a proportion of the size of the economy since Quarter 4 (Oct to Dec) 1997. Whilst there are indicators that show that recent trade policy uncertainty has weighed on global trade flows, the revised figures for the UK show that there has been more external rebalancing over 2018 and 2019 than previously estimated.

Income

Nominal gross domestic product (GDP) increased by 0.7% in Quarter 3 (July to Sept) 2019, driven by compensation of employees (CoE) and gross operating surplus (GOS) of corporations (Figure 8). There have been downward revisions to mixed income throughout all the quarters open for revision - more information on these revisions can be found in the review of households' mixed income estimates - which fell by a revised 0.3% in Quarter 3 2019.

Figure 8: Compensation of employees and gross operating surplus of corporations made a positive contribution to growth in the third quarter of 2019

UK, Quarter 1 (Jan to Mar) 2017 and Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: July to September 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. Contribution to nominal GDP quarter-on-quarter growth. Contributions may not sum to total because of rounding.

For private non-financial corporations (PNFCs), GOS increased by 1.7% in the third quarter. The latest Quarterly Economic Survey from the British Chambers of Commerce (BCC) reports that "indicators for business confidence in turnover and profitability among manufacturers dropped to an eight-year low" whilst the balance of service firms confident in turnover and profitability improvements sector also fell in the quarter. For financial corporations, GOS increased by a revised 4.2% in Quarter 3 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 published on 20 December 2019. Fully consistent figures will be published on 13 January 2020.

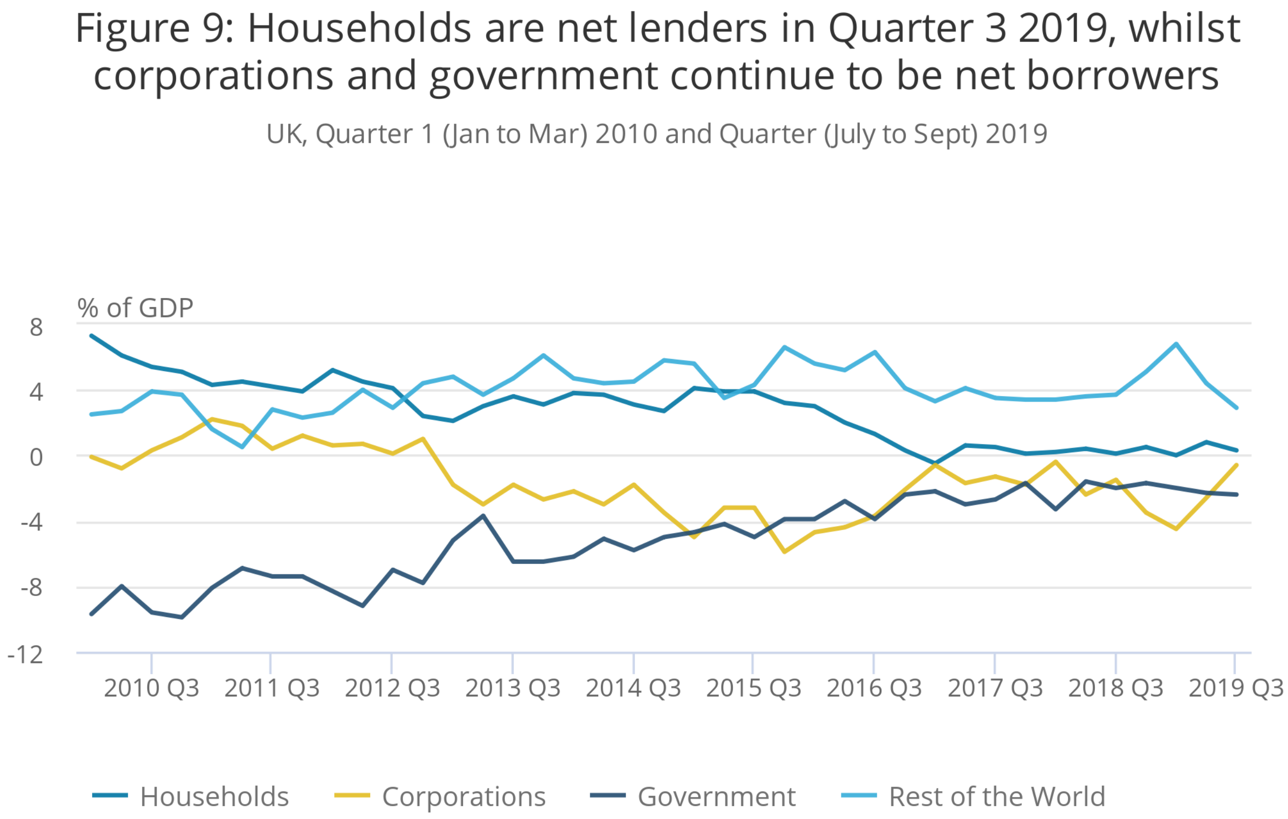
3 . Sector and financial accounts

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 quarter.

Figure 9 shows that the rest of the world continues to be a net lender to the UK, as domestic saving is less than domestic investment, although this is at its lowest level since early 2012. The net lending of households stood at 0.3% of gross domestic product (GDP), while there was a marked reduction in the net borrowing for corporations to 0.6% in the latest quarter. The net borrowing of government was 2.4% of GDP in Quarter 3 (July to Sept) 2019.

Figure 9: Households are net lenders in Quarter 3 2019, whilst corporations and government continue to be net borrowers

UK, Quarter 1 (Jan to Mar) 2010 and Quarter (July to Sept) 2019



Source: Office for National Statistics – Quarterly Sector Accounts, UK: July to September 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), Q4 refers to Quarter 4 (Oct to Dec).

2. There have been revisions from Quarter 1 2018, which include incorporating the latest annual benchmarks of Foreign Direct Investment and Financial Inquiry Surveys. It also includes recent improvements to how mixed income is estimated.

The decrease in household net lending in Quarter 3 2019 primarily reflected an increase in final consumption expenditure, a rise in taxes on income and wealth, and a fall in net capital transfers. The corresponding financial flows can be volatile, but households primarily financed the lower levels of net lending in the latest three months by reducing the amount of currency and deposits placed with financial institutions. Other than the fall in net capital transfers, this also helps explain the fall in the saving ratio from 6.0% to 5.4% in the latest quarter.

Household indebtedness stands at 126.6% as of the end of Quarter 3 2019, whilst the latest [Financial Stability Report](#) (PDF, 7.58MB) finds that a low proportion of households are considered very highly indebted and that debt-servicing costs remain low.

General government was a net borrower in Quarter 3 2019 of 2.4% of GDP. In the latest Economic and Fiscal Outlook (PDF, 3.68MB) published in March of this year, public sector net borrowing (PSNB) is forecast to be 1.1% of GDP this financial year. That said, the changes in the accounting treatment of student loans are not reflected in those forecasts. The Office for Budget Responsibility has produced a restated forecast (PDF, 2.92MB), which has taken on subsequent classification and other statistical changes that have been implemented - including the effects of this new treatment of student loans. The effect has been to raise PSNB by around £20 billion a year.

The latest figures show that PSNB in the financial year-to-date is £50.9 billion, which is £5.1 billion higher than the same period a year ago. Public sector net debt (PSND) stands just above £1.8 trillion at the end of November 2019[2].

There was a marked reduction in the net borrowing of corporations from 2.6% in Quarter 2 (Apr to June) 2019 to 0.6% in the latest quarter, reflecting the improved financial positions of private non-financial corporations (PNFCs) and financial corporations.

The reduction in the net borrowing of PNFCs reflected a fall in gross capital formation. There is evidence that uncertainty has continued to weigh on capital expenditure, whilst stockpiling that was taking place in the first quarter of the year in the lead up to the UK's original planned exit date from the European Union in late March seems to have been run down in Quarter 3. Given the volatile nature of financial flows, movements in how borrowing is financed are not necessarily an indication of underlying trends. That said, the fall in borrowing was primarily financed by a reduction in the holdings of loans and finance held in equity and investment funds. The reduction in net borrowing by financial corporations largely reflected an increase in net property income, caused by an increase in reinvested earnings received on foreign direct investment and a fall in the payments of dividends. This was mainly financed by an increase in loans issued by financial corporations.

Notes for Sector and financial accounts

1. Households includes non-profit institutions serving households.
2. These public sector finances figures exclude public sector banks.

4 . Balance of payments

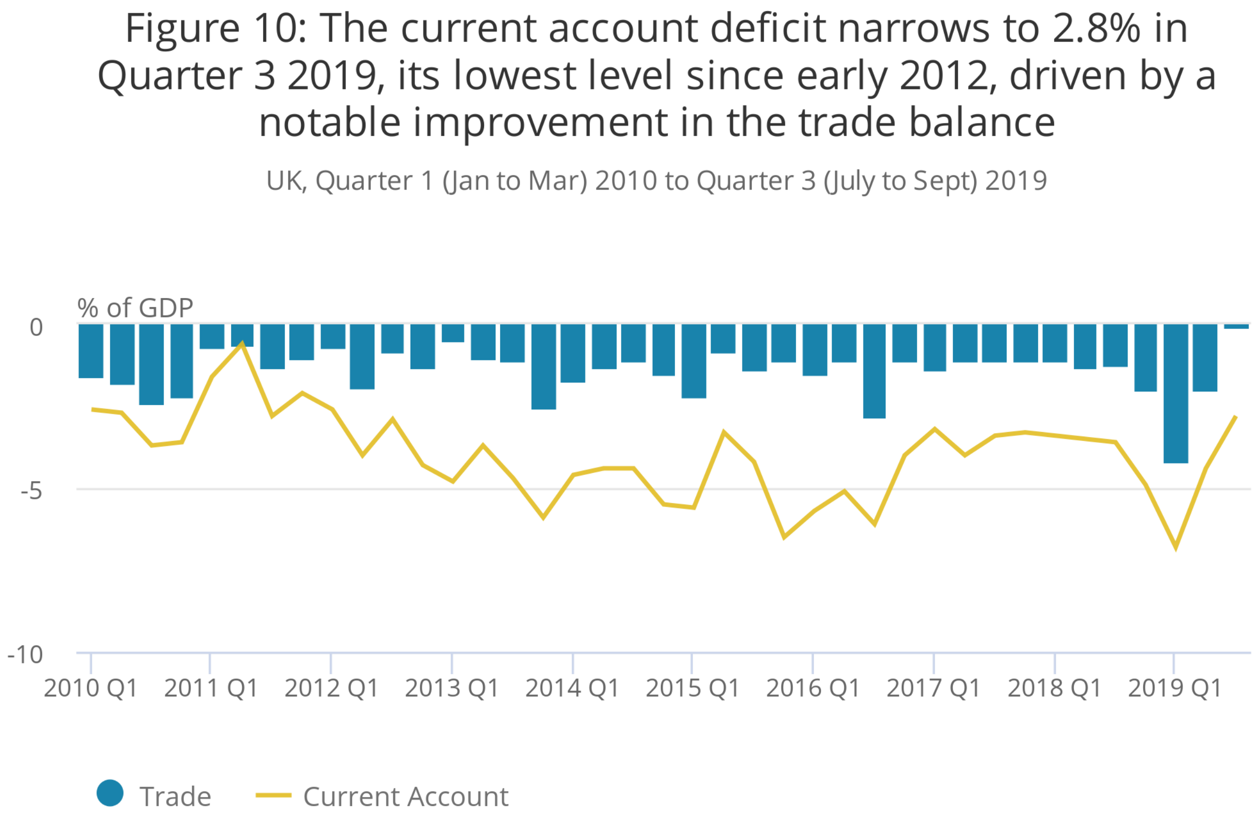
The UK current account deficit captures the extent to which it is borrowing from the rest of the world. Reflecting the low levels of domestic saving to finance domestic investment, overseas investors have historically been net lenders to the UK. This has raised concerns around whether its reliance on external financing is sustainable, given that the UK current account deficit has in recent years widened to levels that are high by historical and international standards. These concerns have been further 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.

There have been some volatile movements in gross trade flows through 2019, in part reflecting the large increase of trade in unspecified goods, including non-monetary gold (NMG), and the likely increase in stockpiling by UK and European businesses in anticipation of the UK's original exit date from the European Union at the end of March 2019.

There has been a marked narrowing in the current account deficit in Quarter 3 (July to Sept) 2019, reaching 2.8% of nominal gross domestic product (GDP) - its lowest level relative to the size of the economy since Quarter 1 (Jan to Mar) 2012. Figure 10 shows that this has been driven by an improvement in the UK's trade deficit, which narrowed to 0.1%, reflecting a notable increase in net exports of finished manufactured goods and semi-manufactured goods. Recent trends show that the UK has paid out more to foreign investors holding investment in the UK than domestic investors receive on their external investments. In Quarter 3 2019, there was an increase in the earnings paid out on foreign direct investment in the UK.

Figure 10: The current account deficit narrows to 2.8% in Quarter 3 2019, its lowest level since early 2012, driven by a notable improvement in the trade balance

UK, Quarter 1 (Jan to Mar) 2010 to Quarter 3 (July to Sept) 2019



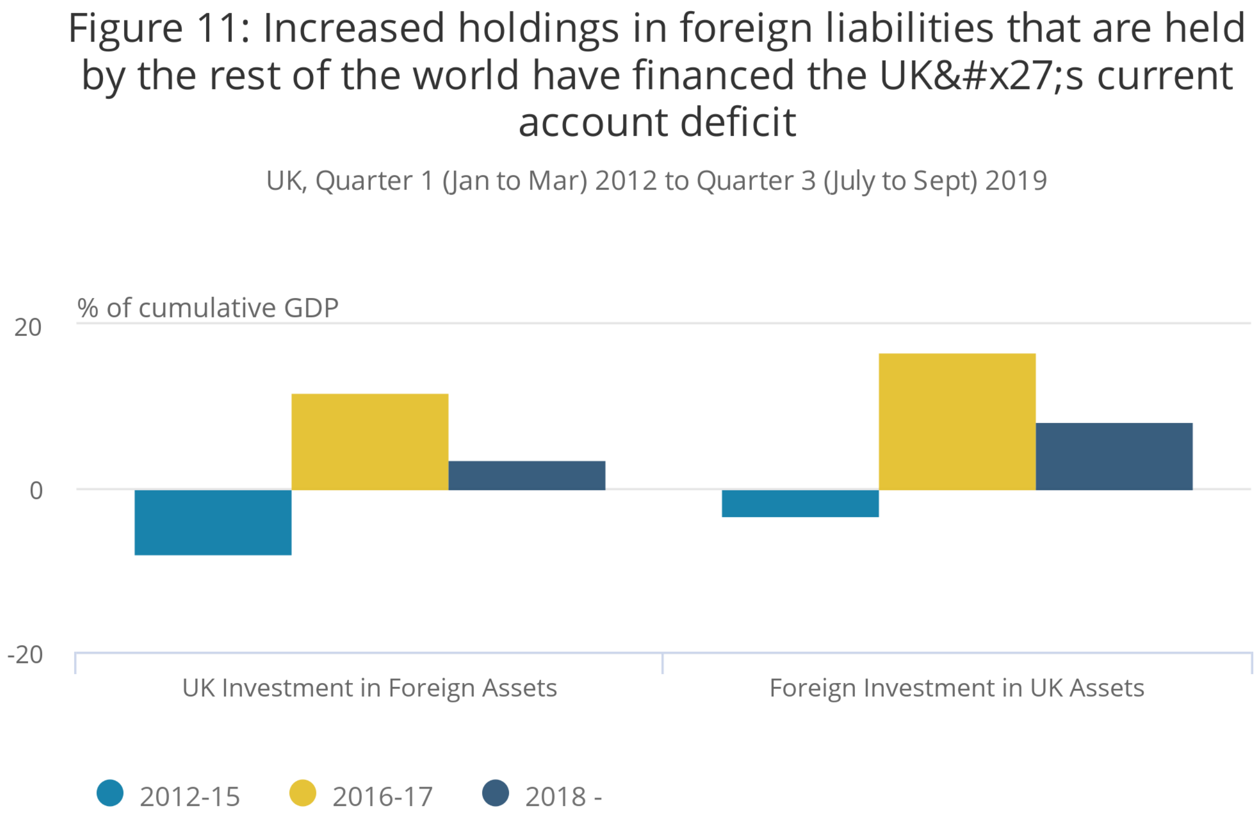
Source: Office for National Statistics – Balance of Payments, UK: July to September 2019

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. Figure 11 shows how the UK's current account deficit has been financed in recent years, which shows how the pattern of financing has changed over time – in particular, the gross size of these capital flows and the net direction of these flows.

Between 2012 and 2015, the UK's external borrowing was overall being financed by UK investors selling more of their external assets than foreign investors selling their UK assets. This overall financing position has since reversed, resulting in a large volume of foreign capital inflows – that is, an increase in the accumulation of financial liabilities to finance the current account deficit. The latest [Financial Stability Report (PDF 7.58MB)] 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".

Figure 11: Increased holdings in foreign liabilities that are held by the rest of the world have financed the UK's current account deficit

UK, Quarter 1 (Jan to Mar) 2012 to Quarter 3 (July to Sept) 2019



Source: Office for National Statistics – Balance of Payments, UK: July to September 2019

In recent quarters, there have been large swings in the flows of capital between the UK and the rest of the world, reflecting the volatile nature of financial flows into and out of the UK. In Quarter 3 2019, the UK increased its liabilities to the rest of the world, specifically in debt investment.

Other investment tends to be the most mobile form of capital, comprising mainly of loans and deposits. Movements in these capital flows have been 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. There have been further withdrawals of other investment in the latest two quarters.

It has been the case that there have typically been net inflows of direct and portfolio investment into the UK from foreign investors. This position had reversed in the first quarter of the year, which may have reflected a shift in the appetite of foreign investors, given the original deadline for the UK's withdrawal from the European Union. This may also explain why there have been net inflows of these types of investment in the latest two quarters. There has also been a pronounced shift in other investment in the UK in Quarter 3, as there was a large net inflow of this more mobile form of capital.

The Office for Budget Responsibility notes that that the UK's net liability position is modest as a share of GDP (PDF, 3.69MB). A relatively strong external balance sheet would help how the UK is able to finance its borrowing from the rest of the world. Whilst the UK holds a large gross stock of external liabilities, it also holds a similar stock of external assets, largely reflecting the open nature of the UK economy. As of the end of Quarter 3 2019, the net liability position stood at 19.0% of annualised GDP.

5 . Labour market

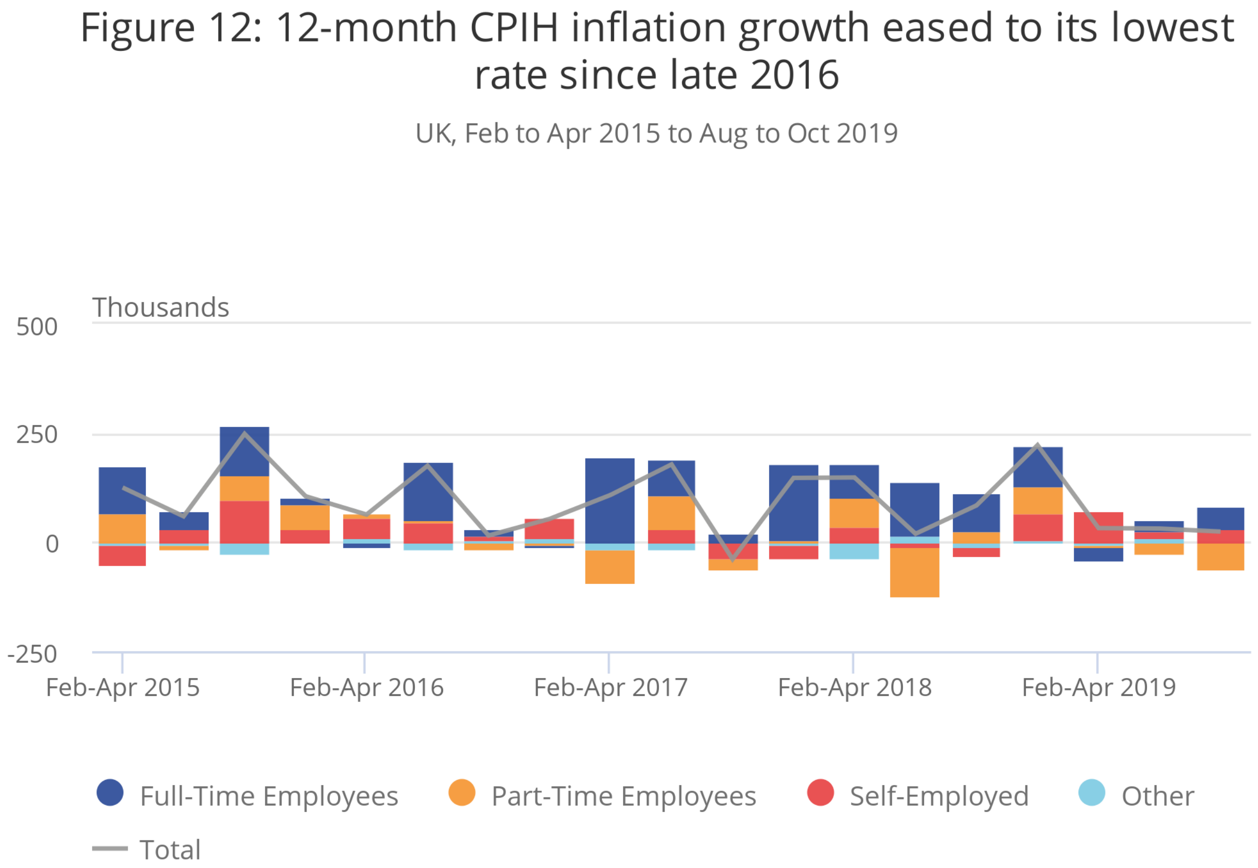
The latest headline figures for the three months to October 2019 appear to show a labour market that remains tight. The employment rate stands at a record-high 76.2% and the unemployment rate at a multi-decade low of 3.8%. This is now slightly below some estimates of the natural rate of unemployment (PDF, 6.2MB) .

Employers are expected to offer higher wages in a tight labour market, as they compete over a smaller pool of available resource and there were signs that this tightness was now showing up in higher nominal wage growth. However, there has been a slowing in rate of growth of total pay, which stood at 3.2% in the year to three months to October 2019, although this easing was largely related to the profile of bonus payments, which had been particularly strong this time last year. Regular pay increased by 3.5% over the same period, a slight easing from recent months.

Previous analysis highlighted that there is a tendency for hiring and capital spending to follow each quite closely but that has not been the case of late. This may reflect that firms may be more likely to substitute labour for capital in periods of elevated uncertainty, particularly if it is the case that it is easier and/or less costly to reverse hiring decisions. That said, employment increased by 24,000 from the three months to July 2019 to the three months to October, as the rate of change has eased of late (Figure 12). This may mean it is harder for businesses to recruit, given the tightness in the labour market, or it may reflect a slowing in underlying GDP growth and the heightened levels of uncertainty impacting upon the labour market.

Figure 12: 12-month CPIH inflation growth eased to its lowest rate since late 2016

UK, Feb to Apr 2015 to Aug to Oct 2019



Source: Office for National Statistics – Labour market overview, UK: December 2019

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 remains low by historical standards, although the number of vacancies has continued to ease through the year. It has now fallen for 10 consecutive months, standing at 794,000 in the three months to November 2019. This is 7.8% lower than its all-time high from earlier this year, which might be pointing towards there being an easing in the demand for labour in response to higher levels of domestic and global uncertainty.

The evidence from external surveys also provides some evidence that the labour market may no longer be tightening. The latest Report on Jobs by the Recruitment and Employment Confederation (REC) finds that the number of permanent staff appointments fell for the ninth consecutive month in November 2019, although at a weaker rate than in recent months. This slowing in hiring activity was attributed to "heightened uncertainty around the outlook".

There was evidence that this economic and political uncertainty was weighing on demand and supply - the latest figures showed the slowest increase in overall vacancies since October 2009, whilst candidate numbers fell at the quickest rate for five months as there were signs that people had become "reluctant to seek new roles due to uncertainty".

The Manufacturing Purchasing Managers' Index (PDF, 136KB) shows that employment fell for the eighth consecutive month in November 2019, falling at its steepest rate since September 2012, citing "cost reduction efforts, efficiencies, Brexit uncertainty, redundancies, natural wastage and staff restructuring". The labour market appears to be stabilising in the latest Services Purchasing Managers' Index (PDF, 177KB), despite respondents highlighting that uncertainty had been weighing on demand.

6 . Prices

The 12-month growth rate of the Consumer Prices Index including owner occupiers' housing costs (CPIH) was 1.5% in November 2019, unchanged from the previous month, and is at its lowest rate in three years (Figure 13). Much of the recent easing in the growth of CPIH has reflected 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 for the six-month period in effect from October 2019.

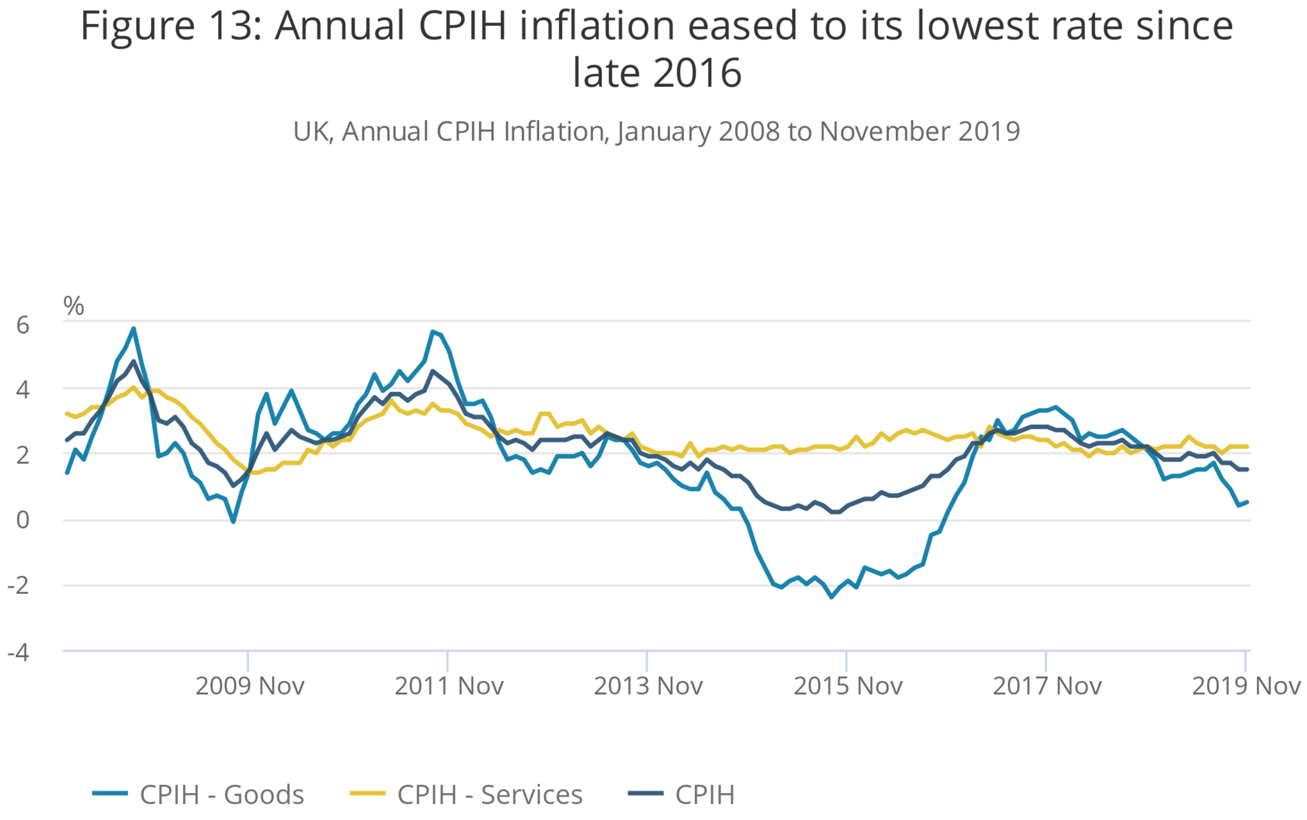
The CPIH inflation rate reflects domestic and external cost pressures. As the sterling value of imported final and intermediate goods increased following the large fall in the exchange rate in 2016, there was a marked increase in annual CPIH goods inflation through late 2016 and 2017, which has fallen back since early 2018, reaching 0.5% in November 2019.

Annual CPIH services price inflation, which is more of a proxy for domestic cost pressures, remains unchanged at 2.2% in November 2019. The latest Monetary Policy Report (PDF, 6.02MB) cites survey evidence that consumer services firms have found it harder to pass higher costs onto consumer prices, instead absorbing them into their profit margins. This might explain why the CPIH figures are a little weaker than labour cost indicators.

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. 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.

Figure 13: Annual CPIH inflation eased to its lowest rate since late 2016

UK, Annual CPIH Inflation, January 2008 to November 2019



Source: Office for National Statistics - Consumer Price Inflation, UK: November 2019

7 . Conclusions

UK gross domestic product (GDP) increased by 0.4% in Quarter 3 (July to Sept) 2019. This follows increased levels of volatility in the first half of the year, which largely reflect changes in the timing of activity related to the UK's original planned exit date from the European Union in late March. Looking through these temporary factors, there are signs that there is an underlying slowing in the UK economy, which is likely to be reflecting the high levels of domestic and global uncertainties.

In Quarter 3 2019, households were net lenders equivalent of 0.3% of gross domestic product (GDP), while net borrowing was 0.6% for corporations and 2.4% for the government. Households primarily financed the lower levels of net lending in the latest three months by reducing the amount of currency and deposits placed with financial institutions. The reduction in the net borrowing of private non-financial corporations (PNFCs) reflected a fall in gross capital formation. There is evidence that uncertainty has continued to weigh on capital expenditure, whilst stockpiling that was taking place in the first quarter of the year in the lead up to the UK's original planned exit date from the European Union in late March seems to have been run down.

The current account deficit narrowed to 2.8% of GDP in Quarter 3 2019, its lowest level since 2012. The narrowing reflected a notable increase in net exports of finished manufactured goods and semi-manufactured goods. Financial flows in and out of the UK tend to be particularly volatile, which has been particularly evident in recent times. In Quarter 3 2019, the UK increased its liabilities to the rest of the world, specifically in debt investment.

The labour market appears to remain tight. In the three months to October 2019, the employment rate stood at a record high 76.2%, while the unemployment rate hit 3.8%. While the unemployment-to-vacancies ratio remains low by historical standards, the number of vacancies has now fallen for 10 consecutive months. Regular pay increased by 3.5% in the year to the three months to October, a slight easing from recent months.

The 12-month growth rate of the Consumer Prices Index including owner occupiers' housing costs (CPIH) was 1.5% in November 2019, unchanged from the previous month and is at its lowest rate in three years. Much of the recent easing in CPIH has reflected a lower contribution from electricity, gas and other fuels in response to the lowering of the price cap by the Office of Gas and Electricity Markets for some domestic gas and electricity customers for the six-month period in effect from October 2019.