Office for National Statistics

Article

Monthly economic commentary: July 2017

Provides analysis of the latest estimate of GDP and economic commentary for prices, short-term indicators and labour market indicators to complement theme day economic commentary.

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1 . Main points

- The preliminary estimate of gross domestic product (GDP) indicated that the UK economy grew by 0.3% in Quarter 2 (Apr to June) 2017, following growth of 0.2% in the previous quarter.
- UK economic growth in Quarter 2 2017 was driven by the services sector, while production and construction acted as a drag.
- The core Consumer Prices Index including owner occupiers' housing costs (CPIH), which excludes energy, tobacco, food and alcoholic drinks, has been rising in recent months, although it fell back 0.1 percentage points in June.
- The employment rate reached a record high of 74.9% in the 3 months to May 2017, supported by growth in full-time, part-time and self-employed employment.
- Real wages including bonuses (total pay) fell by 0.7% in the 3 months to May 2017 compared with a year earlier – the most since August 2014.

2 . Statistician's comment

Commenting on today's GDP figures, ONS Head of National Accounts Darren Morgan said:

"The economy has experienced a notable slowdown in the first half of this year.

"While services such as retail, and film production and distribution showed some improvement in the second quarter, a weaker performance from construction and manufacturing pulled down overall growth."

3 . Summary

Growth in the UK economy has slowed during the first half of 2017, but activity remains 9.0% above its pre-downturn peak. Growth in Quarter 2 (Apr to June) 2017 was driven by the services sector, particularly the distribution, hotels and catering sector, while production and construction acted as a drag.

Growth in overall and core[1] consumer prices including owner occupiers' housing costs (CPIH) fell back slightly in June, but real wages, including bonuses fell by 0.7% in the 3 months to May compared with a year earlier – the biggest fall since August 2014.

More detailed theme day economic commentary is available for:

- Short-term indicators
- Prices
- Labour market

Notes for: Summary

1. Core CPIH excludes energy, tobacco, food and alcoholic drinks.

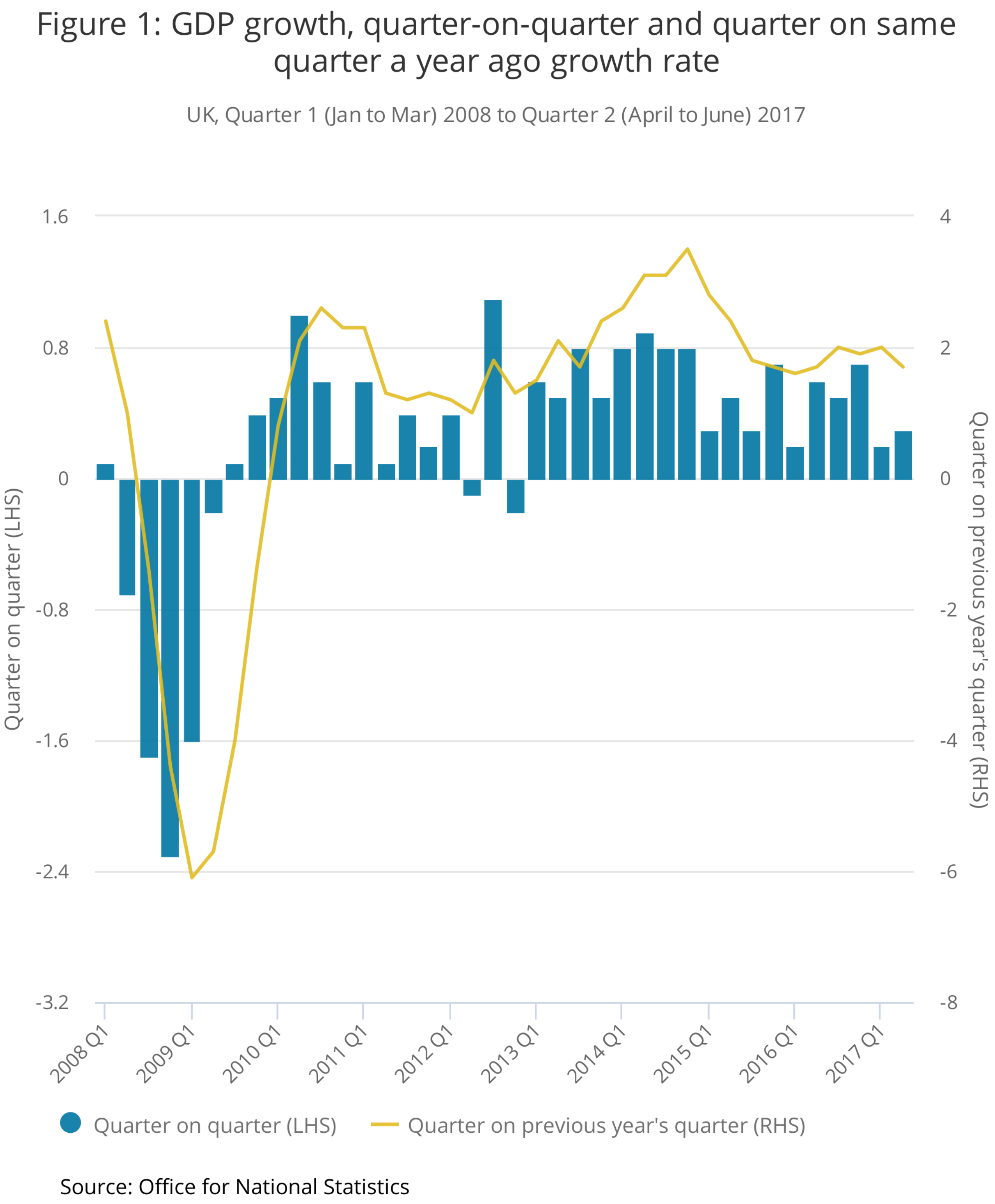
4 . The preliminary estimate of GDP shows that the UK economy grew by 0.3% in Quarter 2 2017, following growth of 0.2% in the previous quarter

Today's gross domestic product (GDP) release contains new information regarding UK economic growth in Quarter 2 (Apr to June) 2017. Within this release is an early indication of output growth in production, construction and services in June. In addition, data on services output in May have been published.

Figure 1 shows that the preliminary estimate of GDP indicated that the UK economy grew by 0.3% in Quarter 2 2017, following growth of 0.2% in the previous quarter and by 1.7% compared with a year ago. This is below the 5-year compound average growth rate of 2.2%. Today's release also provides a complete year of data since the UK EU membership referendum.

Figure 1: GDP growth, quarter-on-quarter and quarter on same quarter a year ago growth rate

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 2 (April to June) 2017



Source: Office for National Statistics

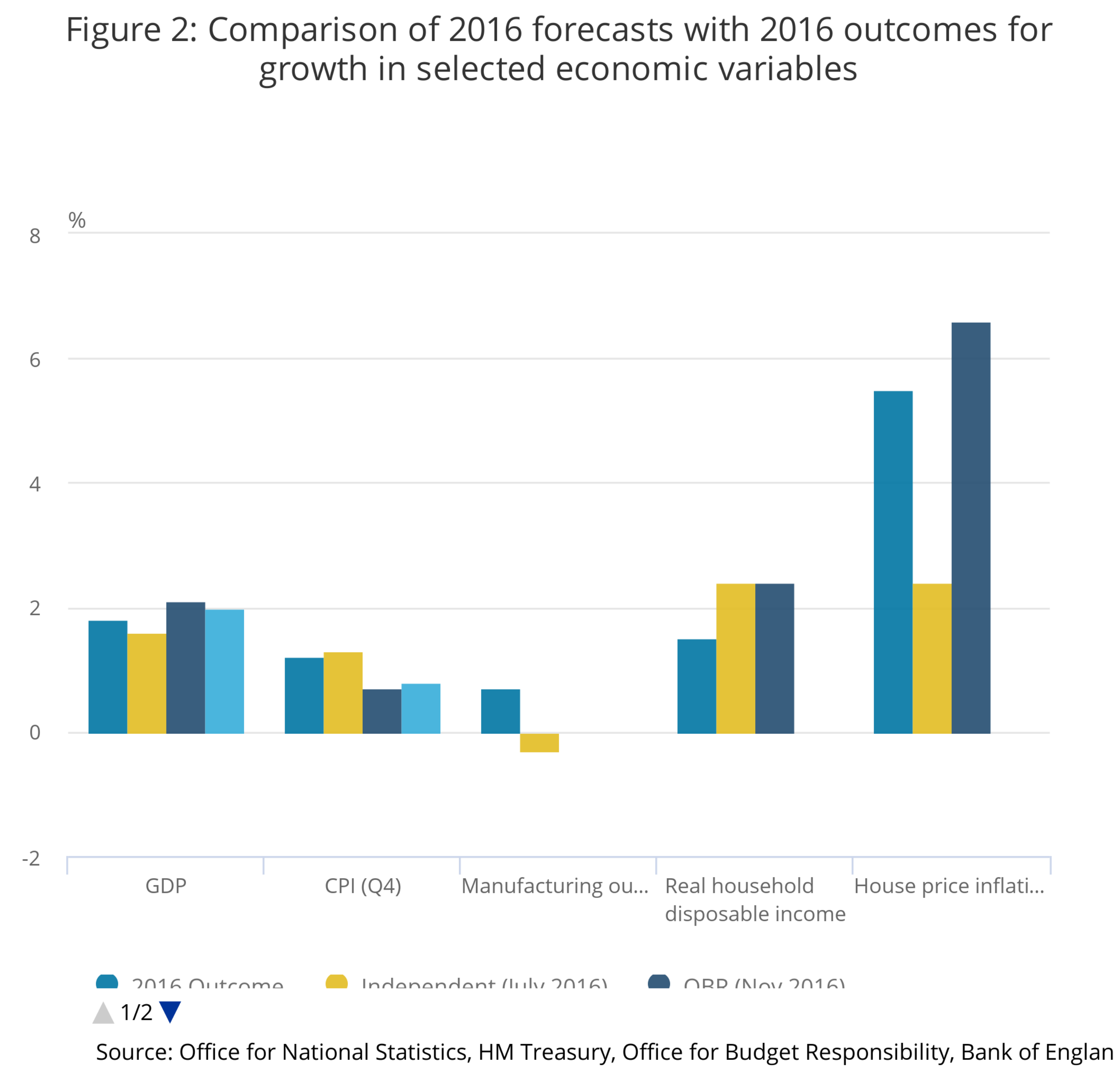
Notes:

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)
   Q4 refers to Quarter 4 (Oct to Dec)

5 . Economic growth and manufacturing output in 2016 was not as weak as some independent forecasters expected

Figure 2 shows forecasts by the Bank of England (BoE), the Office for Budget Responsibility (OBR) and independent forecasters compared with the 2016 outcome for a number of economic variables. Each forecast refers to the first published figure following the EU referendum vote – July 2016 for independent forecasts, August 2016 for the BoE and November 2016 for the OBR.

Figure 2: Comparison of 2016 forecasts with 2016 outcomes for growth in selected economic variables



Source: Office for National Statistics, HM Treasury, Office for Budget Responsibility, Bank of England

Notes:

1. Not all forecasters release public forecasts for each of the economic variables.

The UK economy grew by 1.8% in 2016 – slightly stronger than the 1.6% growth predicted by independent forecasters in July 2016, but weaker than the forecasts of the BoE and OBR. Manufacturing activity also outperformed independent forecasters' expectations with output growing by 0.7% in 2016 compared with an expected contraction of 0.3%. However, growth in real household disposable income was slower than expected by independent forecasters and the OBR.

With today's release of preliminary estimates for Quarter 2 (Apr to June) 2017 gross domestic product (GDP) and manufacturing output, it is also possible to track progress against OBR, independent and BoE forecasts for the whole of 2017 against both Quarter 1 (Jan to Mar) and Quarter 2 2017 outcomes.

In 2016, the average independent forecast and BoE predicted that calendar year GDP growth for 2017 would be 0.8%, while the OBR forecast predicted annual growth of 1.4%. Without revisions to Quarter 1 and Quarter 2 2017 data and assuming equal quarterly growth in Quarters 3 (July to Sept) and 4 (Oct to Dec), GDP would need to contract by an average of 0.7% in each of the remaining 2 quarters in order to hit the annual GDP growth predicted by independent forecasts and the BoE. GDP would have to grow by a quarterly average of 0.1% to hit the OBR forecast – both considerably weaker than the average quarterly GDP growth rate of 0.5% over the past 5 years. It should be noted that these trajectories are not necessarily the quarterly growth path that would be implied by the original 2017 forecasts.

For manufacturing, the average independent forecast in July 2016 predicted that output would contract by 0.2% in 2017. Without other revisions, manufacturing output would need to contract by an average of 1.5% in each of the remaining 2 quarters of 2017 in order to reach this forecast – a rate not seen since Quarter 4 2012 when output fell by 1.7%. Consecutive falls of over 1% in manufacturing output have not been seen since the 2008 crisis.

Taken together, while growth in GDP and manufacturing output have both slowed, it appears that activity might not be as weak as some expected in the immediate aftermath of the EU referendum vote.

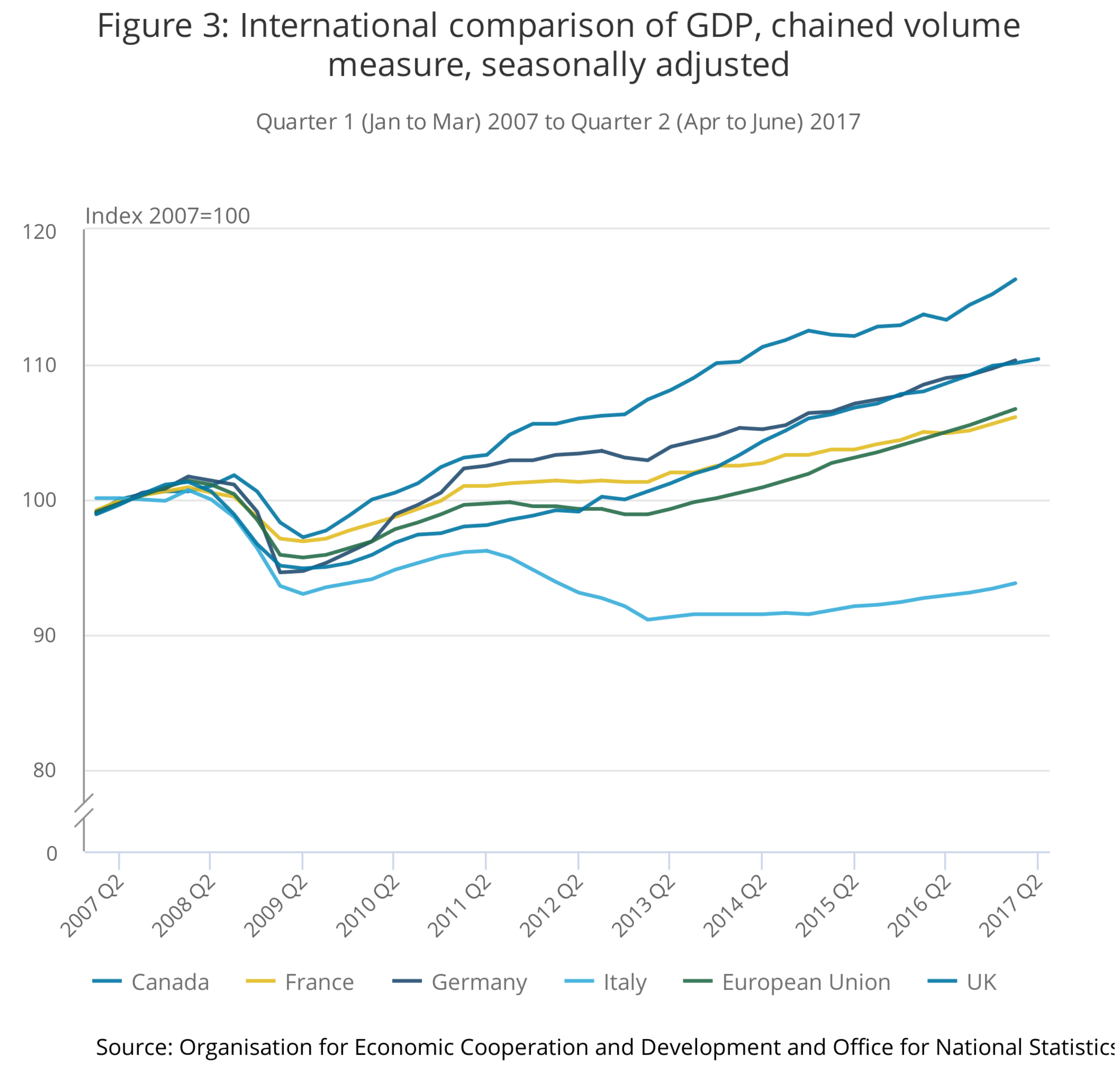
6 . The UK economy continued to grow at rates comparable with other major economies

Figure 3 shows the performance of the UK economy compared with selected G7 economies, as well as the European Union. The chart shows that the UK economy has performed strongly compared with the European Union as a whole since mid-2012, following a very similar path to that of the German economy from the end of 2014. On the other hand, the chart shows that the growth rate of the French economy has been broadly slower than the UK since the start of 2011.

All the economies shown have surpassed their pre-downturn peak with the exception of Italy, which is still 6.8% lower than in Quarter 1 (Jan to Mar) 2008. Over the same period, Canada is the strongest performing economy shown, with total growth of 15.5%. The latest figures show that as of Quarter 2 (Apr to June) 2017, gross domestic product (GDP) in the UK is 9.0% above its pre-downturn peak.

Figure 3: International comparison of GDP, chained volume measure, seasonally adjusted

Quarter 1 (Jan to Mar) 2007 to Quarter 2 (Apr to June) 2017



Source: Organisation for Economic Cooperation and Development and Office for National Statistics

Notes:

1. Data for Canada and EU countries are only available up to Quarter 1 2017.

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

7 . UK economic growth in Quarter 2 2017 was driven by the services sector, while production and construction acted as a drag

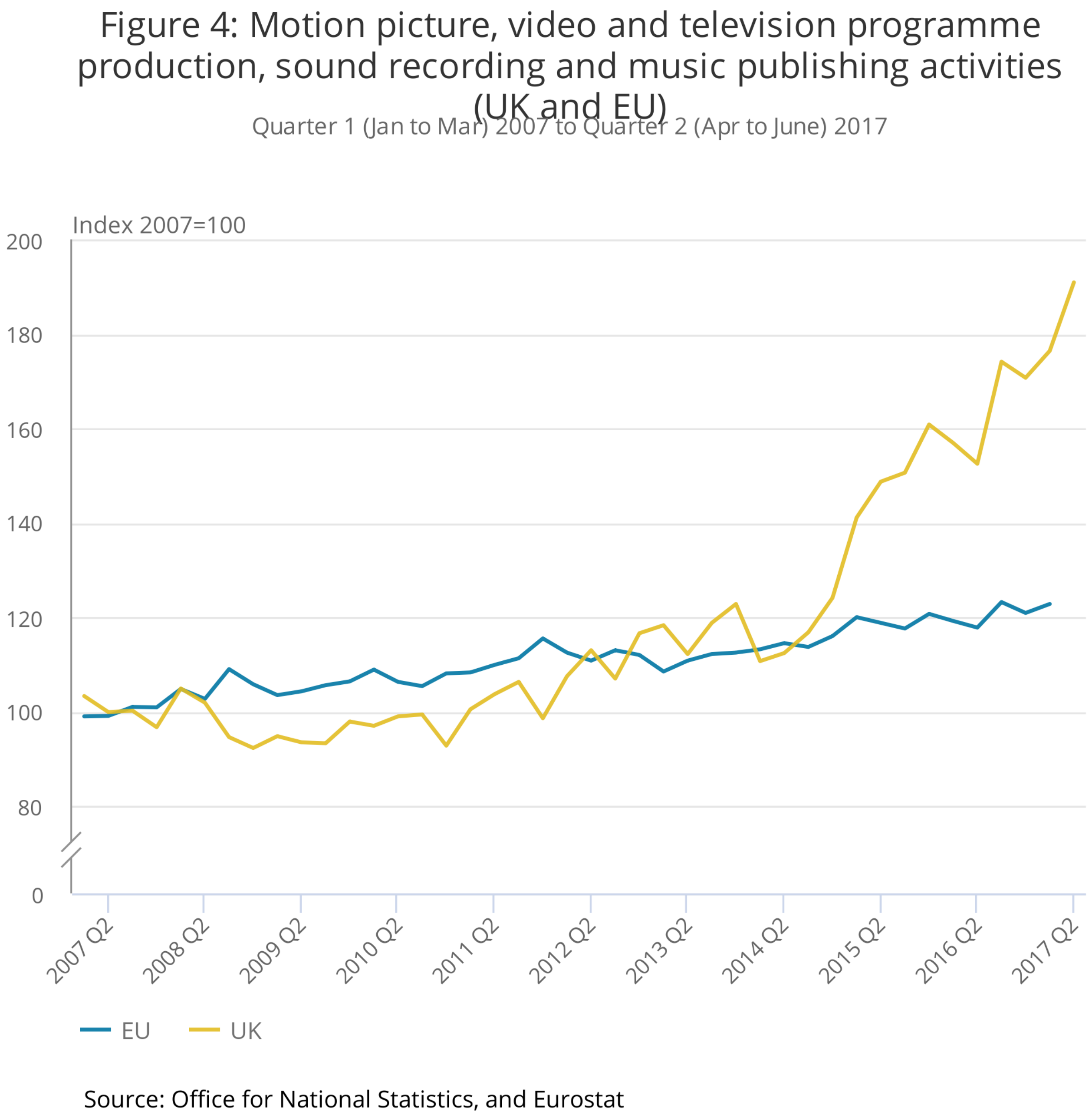
Looking at the monthly path, May 2017 saw a 0.2% monthly increase in total services output following a rise of 0.1% in April 2017. Driving the growth was the business services and finance sector, which saw a 0.6% increase – contributing 0.2 percentage points towards total services growth. This is the largest monthly growth in the sector since April 2016, which also saw growth of 0.6%. Transport, storage and communication also made a positive contribution to growth in May (0.1 percentage points) while the distribution, hotels and restaurants, and government and other services sectors both remained virtually flat.

Looking over the longer-term, total services output increased by 2.3% in Quarter 2 (Apr to June) 2017 compared with a year earlier. The largest contributor towards this growth was again the business services and finance sector, which saw a 2.0% increase and contributed 0.8 percentage points. However, there has also been particular strength in the motion picture industry within the transport, storage and communication sector.

Figure 4 shows that growth in UK motion picture and publishing activities has significantly outpaced that in EU countries since early 2014. UK motion picture activities have grown by 72.4% since Quarter 1 (Jan to Mar) 2014, compared with only 8.5% across the EU. This may be partly attributable to the introduction of tax credits for certain television and film productions, making the UK a more attractive prospect for production companies.

Figure 4: Motion picture, video and television programme production, sound recording and music publishing activities (UK and EU)

Quarter 1 (Jan to Mar) 2007 to Quarter 2 (Apr to June) 2017



Source: Office for National Statistics, and Eurostat

Notes:

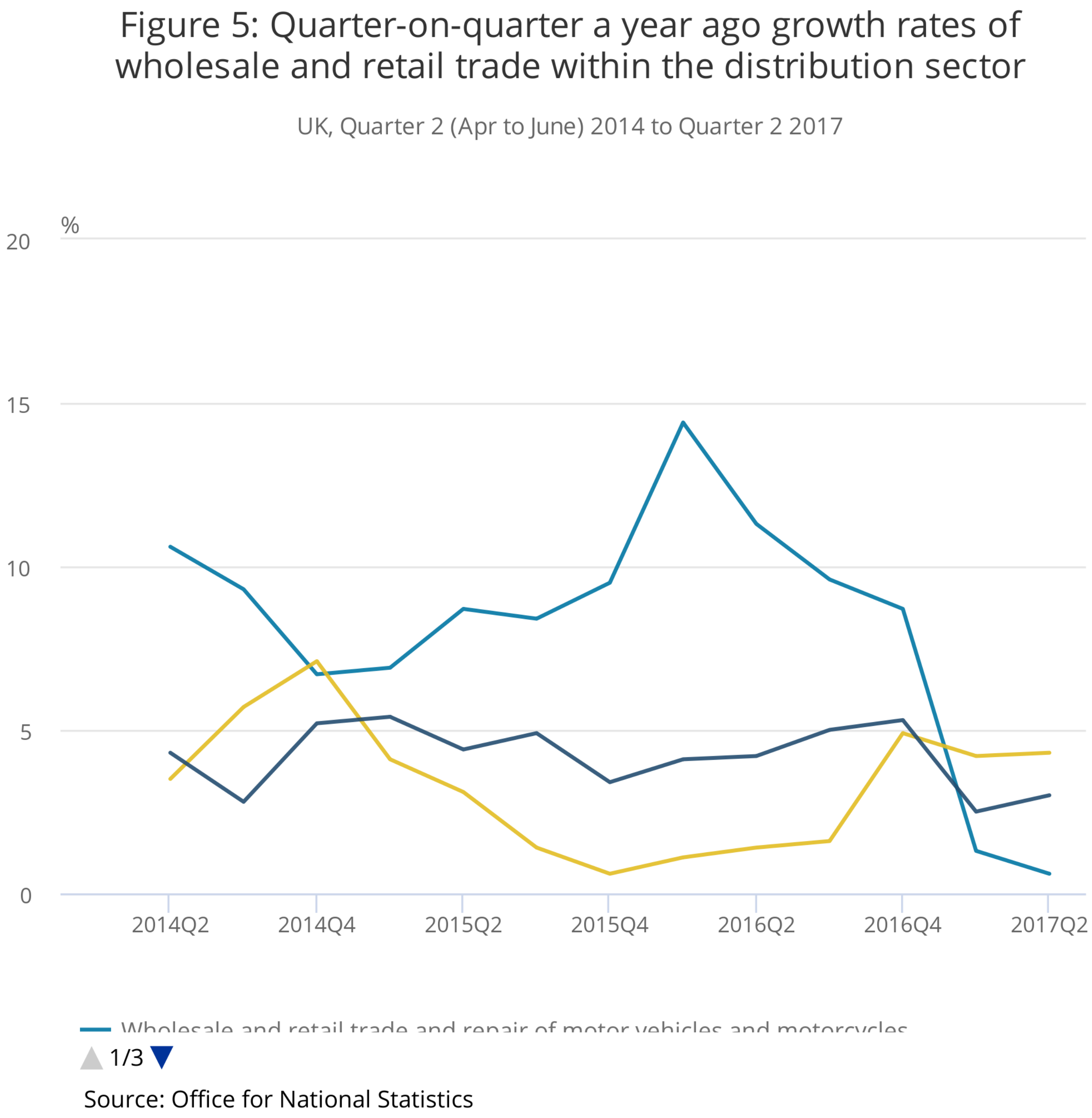
1. Data for EU countries are only available up to Quarter 1 2017.

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

While the distribution, hotels and restaurants sector grew by 3.7% in Quarter 2 2017 compared with Quarter 2 2016, its quarter-on-quarter a year ago growth rate has slowed since a peak of 6.0% in Quarter 4 (Oct to Dec) 2016. This slowdown is partly attributable to a decline in the wholesale and retail trade and repair of motor vehicles and motorcycles, which has seen growth fall from 14.4% in Quarter 1 2016 to 0.6% in Quarter 2 2017 (Figure 5). Growth in retail trade services has also slowed, from 5.3% in Quarter 4 2016 to 3.0% in Quarter 2 2017. This is consistent with retail trade figures released earlier this month for June 2017.

Figure 5: Quarter-on-quarter a year ago growth rates of wholesale and retail trade within the distribution sector

UK, Quarter 2 (Apr to June) 2014 to Quarter 2 2017



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar)
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   Q3 refers to Quarter 3 (July to Sept)
   Q4 refers to Quarter 4 (Oct to Dec)

Despite a depreciation in the sterling exchange rate, which may be expected to encourage overseas travellers to the UK, growth in accommodation services has also been slowing. On a quarter-on-quarter a year ago basis, growth has fallen from 5.6% in Quarter 4 2016 to 1.8% in Quarter 2 2017, with the sector recording its first contraction in Quarter 1 2017 (negative 0.7%) since Quarter 4 2012. Meanwhile, growth in food and beverage service activities has been steadily increasing since Quarter 3 (July to Sept) 2015, recording 8.3% growth in Quarter 2 2017 on a quarter on quarter a year ago basis. This followed growth of 9.0% in Quarter 1 2017, a rate not seen since Quarter 4 2001.

However, the latest [IHS Markit's UK Business Outlook] report released earlier this month suggests that optimism within the hotels and restaurants sector is low for the next 12 months, which is largely attributed to both subdued domestic consumer demand and rising inflation (particularly food prices).

In contrast to the services sector, production and construction both acted as a drag on the economy in Quarter 2 2017. These sectors combined reduced gross domestic product (GDP) growth by around 1 percentage point. The main contributor to the 0.4% fall in production output was manufacturing, which fell by 0.5%. This fall was driven predominantly by a fall in production of motor vehicles, as well as other manufacturing.

Despite the fall, output of motor vehicles is still historically high, following strong growth in the industry since the economic downturn. Conversely, other transport equipment, which includes trains, ships and aircraft, as well as military vehicles, grew relatively strongly in Quarter 2 2017 compared with Quarter 1, contributing 0.1 percentage points to manufacturing growth, compared with negative 0.6 percentage points from motor vehicles.

Production also fell by 0.4% compared with Quarter 2 2016, with the largest negative contribution coming from the energy production sector, which could be attributed to warmer than average temperatures in the first 3 months of 2017. Manufacturing grew 0.3% compared with Quarter 2 2016, with textiles, wearing apparel and leather products; machinery and equipment; and chemicals and chemical products among the larger contributors.

The preliminary estimate of construction suggests that total output volumes fell by 0.9% in Quarter 2 2017 compared with the previous quarter. For the preliminary estimate, figures for June are largely forecast so a breakdown of the components of construction is not available (official figures for June will be published on 10 August 2017). The previously published monthly path for construction in Quarter 2 2017 showed declines of 1.1% and 1.2% in April and May respectively.

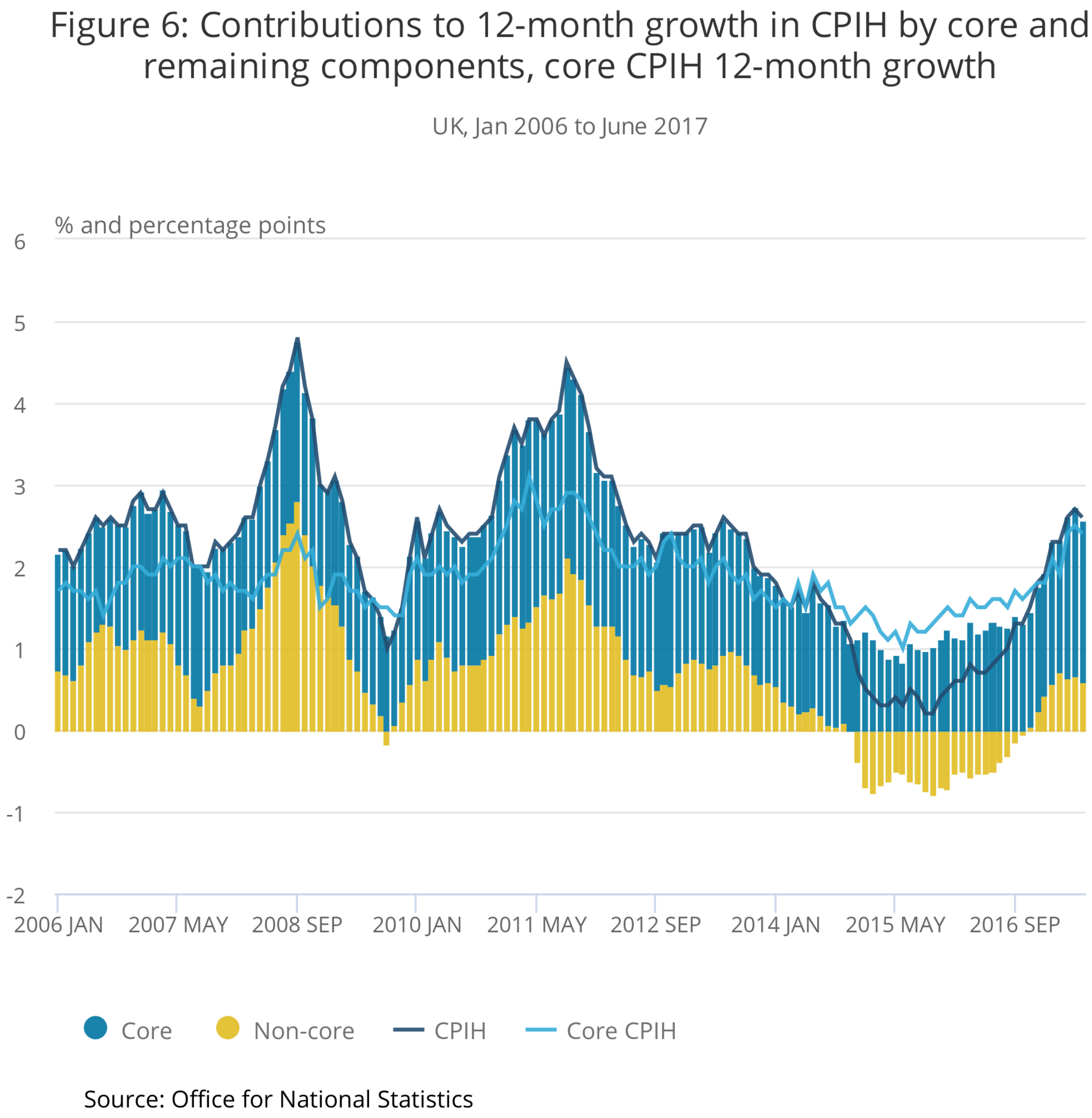
8 . Core CPIH has been rising in recent months, although it fell back 0.1 percentage points in June

When looking at inflation, it can also be useful to look at "core inflation" which excludes the volatile components energy, tobacco, and food and alcoholic beverages. Figure 6 shows contributions to Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month growth by the aggregated components of core and non-core CPIH along with inflation rates for headline CPIH and core CPIH. It is clear from the figure that non-core components of CPIH tend to drive rises and falls in the overall rate of CPIH.

Since September 2015 when CPIH dropped to 0.2%, its lowest rate since the series began in 2006, this measure of inflation has gradually increased, reaching 2.7% in May 2017 before falling slightly to 2.6% in June. Over the same period core CPIH increased from 1.2% to 2.5% in May, dipping slightly to 2.4% in June. Non-core components, particularly energy, have contributed positively to CPIH since November 2016.

Figure 6: Contributions to 12-month growth in CPIH by core and remaining components, core CPIH 12-month growth

UK, Jan 2006 to June 2017



Source: Office for National Statistics

Looking at the components of non-core CPIH, over the past few months food and non-alcoholic beverages, and energy have started to contribute positively to inflation, reversing previous trends. For example, from July 2014 to January 2017, food and non-alcoholic beverages always contributed negatively to CPIH reflecting strong price competition amongst food stores in the UK. From December 2014 to September 2016, energy always contributed negatively to CPIH reflecting falls in the oil price over this period.

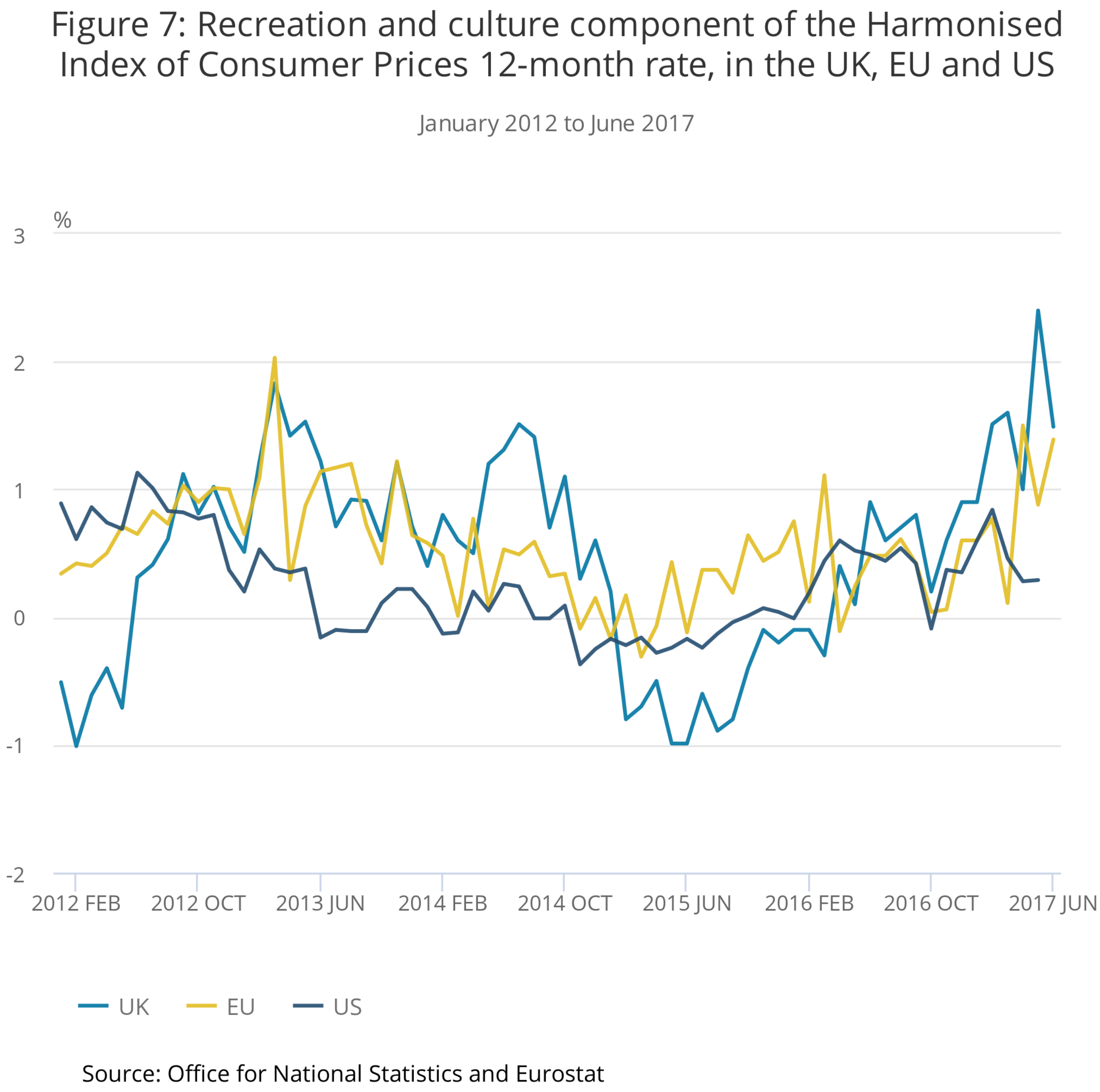
Core inflation has also been broadly increasing since August 2016. [UK consumer price inflation: May 2017](#) points out that rising prices for recreational and cultural goods was the largest contributor to the increase in the CPIH 12-month inflation rate between April and May 2017, particularly the component games, toys and hobbies. Price movements for games in this category are highly dependent on bestseller charts and tend to fluctuate from month to month. For example, the overall price rise from April to May was followed by a fall between May and June.

Figure 7 shows the 12-month inflation rate of the recreation and culture component of the Harmonised Index of Consumer Prices (HICP) – which includes games, toys and hobbies – for the UK, the EU as a whole and US between January 2012 and June 2017. The HICP is equivalent to the Consumer Prices Index (CPI) in the UK – not including owner occupiers' housing costs – and allows for international comparisons to be made on a consistent basis. Over this period, the volatility of HICP inflation for these goods was apparent in each of the UK, EU and US.

Although the growth rate has risen in both the UK and EU as a whole since January 2017, there is no consistent relationship between price movements in the three areas over the whole period shown. HICP inflation in the UK for recreational and cultural goods in May was the highest rate it has been over the period since January 2012 at 2.4%. This fell sharply to 1.5% in the 12 months to June 2017, but in the EU as a whole, the rate increased from 0.9% to 1.4% over the same 2 months.

Figure 7: Recreation and culture component of the Harmonised Index of Consumer Prices 12-month rate, in the UK, EU and US

January 2012 to June 2017



Source: Office for National Statistics and Eurostat

Notes:

1. Core components of CPIH exclude energy, tobacco, and food and alcoholic beverages.

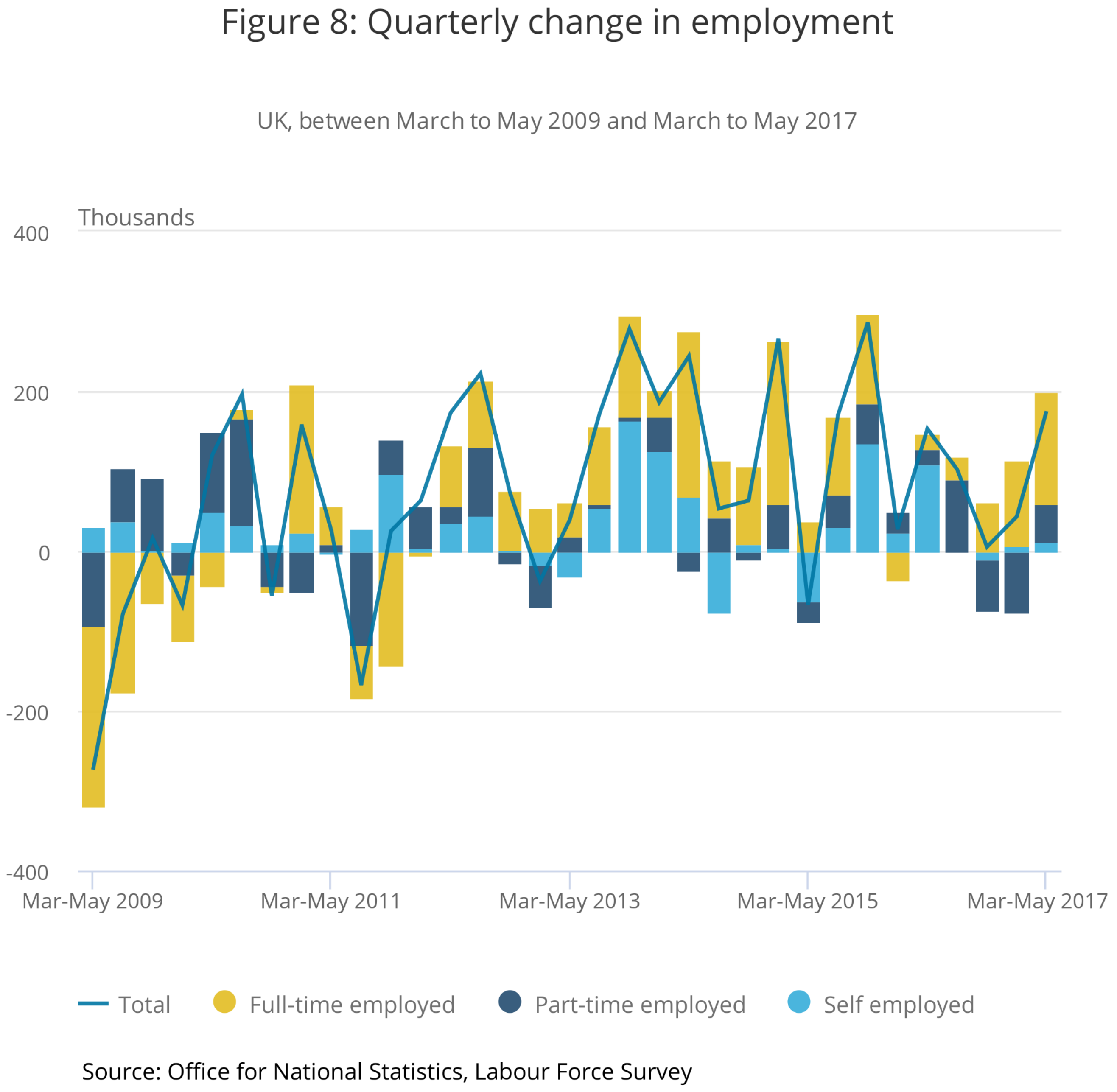
2. The core CPIH 12-month growth rate does not equal the contribution to growth for CPIH from the core components due to the different weights of the two series. Core CPIH growth does however follow the same direction as the contribution to growth series.

9 . Employment reached a record high in the 3 months to May 2017 but real wages continue to fall

The number of people in work in the UK increased by 175,000 between December 2016 to February 2017 and March to May 2017 to 32.01 million, the largest increase since the 3 months to December 2015. This was supported by increases in the number of people working full-time (up 142,000), part-time (up 46,000), and the number of people in self-employment (up 13,000) (Figure 8). On the back of strong employment growth, the employment rate reached a new record high of 74.9% in the 3 months to May 2017.

Figure 8: Quarterly change in employment

UK, between March to May 2009 and March to May 2017



Source: Office for National Statistics, Labour Force Survey

Notes:

1. The contributions do not sum to the total change in employment as the change in unpaid family workers and government supported training and employment programmes are not shown.

Other indicators of labour market activity were relatively stable in the 3 months ending in May 2017. People worked, on average, 32.1 hours per week, less than for December 2016 to February 2017 but slightly more than for a year earlier. There were 774,000 job vacancies for April to June 2017. This was little changed compared with January to March 2017 but 29,000 more than for a year earlier. There were 2.6 job vacancies per 100 filled employee jobs for April to June 2017.

Unemployment

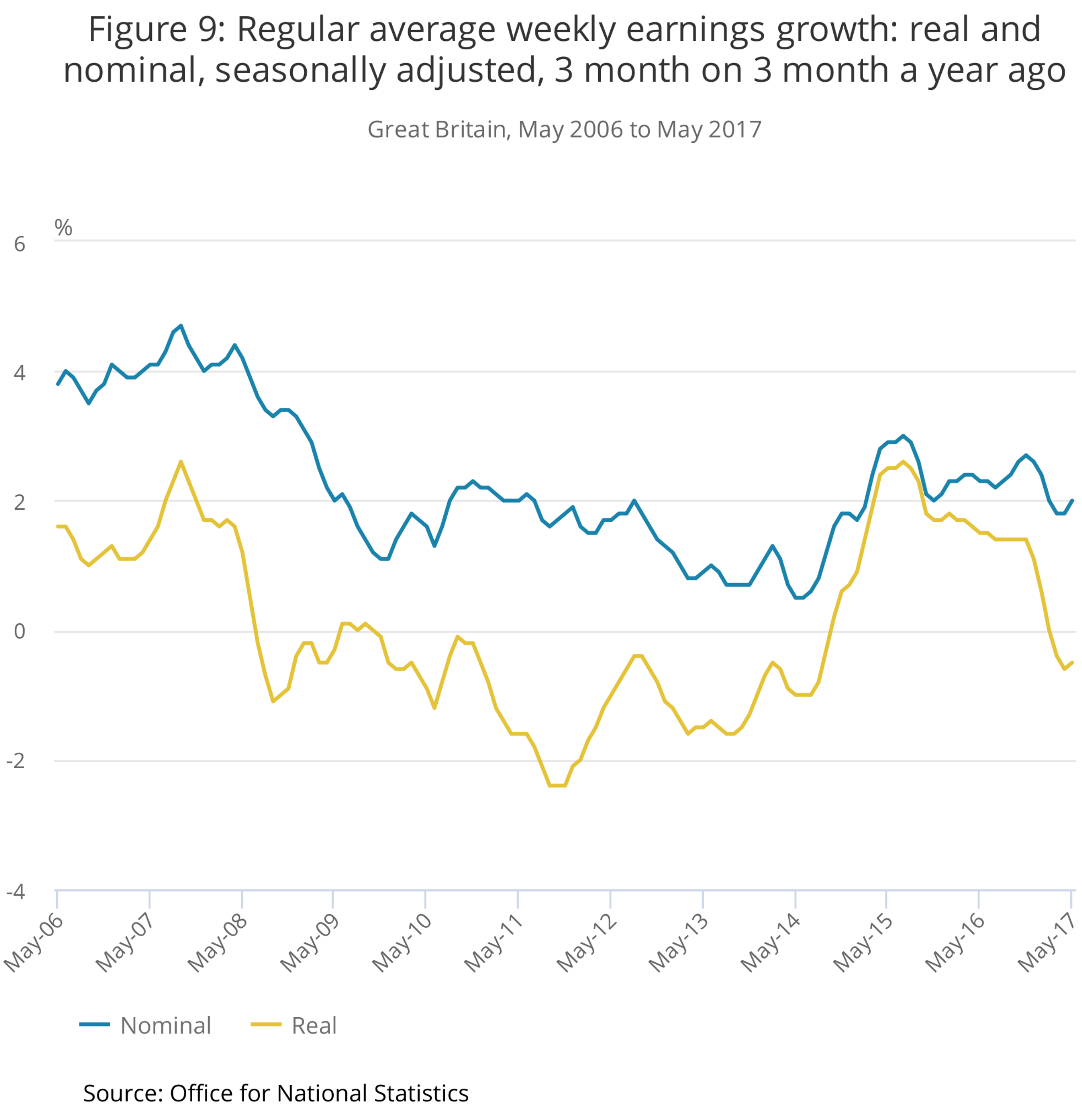
The unemployment rate declined to 4.5% in the 3 months ending in May 2017, the lowest since 1975. The fall in the unemployment rate compared with 3 months ago reflects the largest fall in the number of people who are unemployed (down 64,000) since the 3 months to November 2015. This is while the over 16s participation rate increased (from 63.4% to 63.6%) and the headline 16 to 64 economic activity rate increased to its equal highest on record (78.5%).

Real wages

In nominal terms, average weekly earnings for employees increased by 1.8% including bonuses and by 2.0% excluding bonuses in the 3 months to May 2017, compared with a year earlier. Real earnings declined despite historically low unemployment. Adjusted for inflation, average weekly earnings fell by 0.7% including bonuses and by 0.5% excluding bonuses, over the year. For total real pay (including bonuses) this is the largest 3-month average year-on-year decrease since the 3 months to August 2014. Figure 9 shows nominal and real weekly earnings growth for pay excluding bonuses (regular pay). Real wages for regular pay have been negative since February 2017 but fell at a slightly slower rate in the 3 months to May 2017 than the 3 months to April, compared with a year earlier.

Figure 9: Regular average weekly earnings growth: real and nominal, seasonally adjusted, 3 month on 3 month a year ago

Great Britain, May 2006 to May 2017



Source: Office for National Statistics

At the same time, labour productivity growth has been subdued. Earnings and other labour costs growth outpaced productivity growth, resulting in unit labour cost (ULC) growth of 2.1% in the year to Quarter 1 (Jan to Mar) 2017.