Office for National Statistics

Article

Quarterly economic commentary: January to March 2019

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

Contact:
Sumit Dey-Chowdhury
Sumit.Dey-Chowdhury@ons.gov.uk
+44 (0)207 592 8622

Release date:
28 June 2019

Next release:
30 September 2019

Table of contents

1 . Main points

- Real UK gross domestic product (GDP) increased by 0.5% in Quarter 1 (Jan to Mar) 2019, while more timely estimates show that there has been a notable weakening in recent months, as output fell by 0.1% in March and by 0.4% in April – though this is likely to be reflecting some temporary factors, which may unwind over the coming months.

- Households, corporations and government continued to be net borrowers in Quarter 1 2019, borrowing or running down their savings to finance their spending and investment, financed by the rest of the world being a net lender to the UK.

- The current account deficit widened to 5.6% of GDP in the first quarter of 2019, the highest it has been since the third quarter of 2016 and one of the largest on record, though this reflects to a large extent the large increase of imports of unspecified goods which includes non-monetary gold (NMG).

- The employment rate remained at a record high of 76.1% in the three months to April 2019, with the unemployment rate hitting a multi-decade low of 3.8%, while the number of vacancies has eased a little in early 2019.

- The 12-month Consumer Prices Index including owner occupiers' housing costs (CPIH) rate of inflation was 1.9% in May 2019, as the contributions of those components that have an import content of at least 40% was at its lowest rate since January 2017.

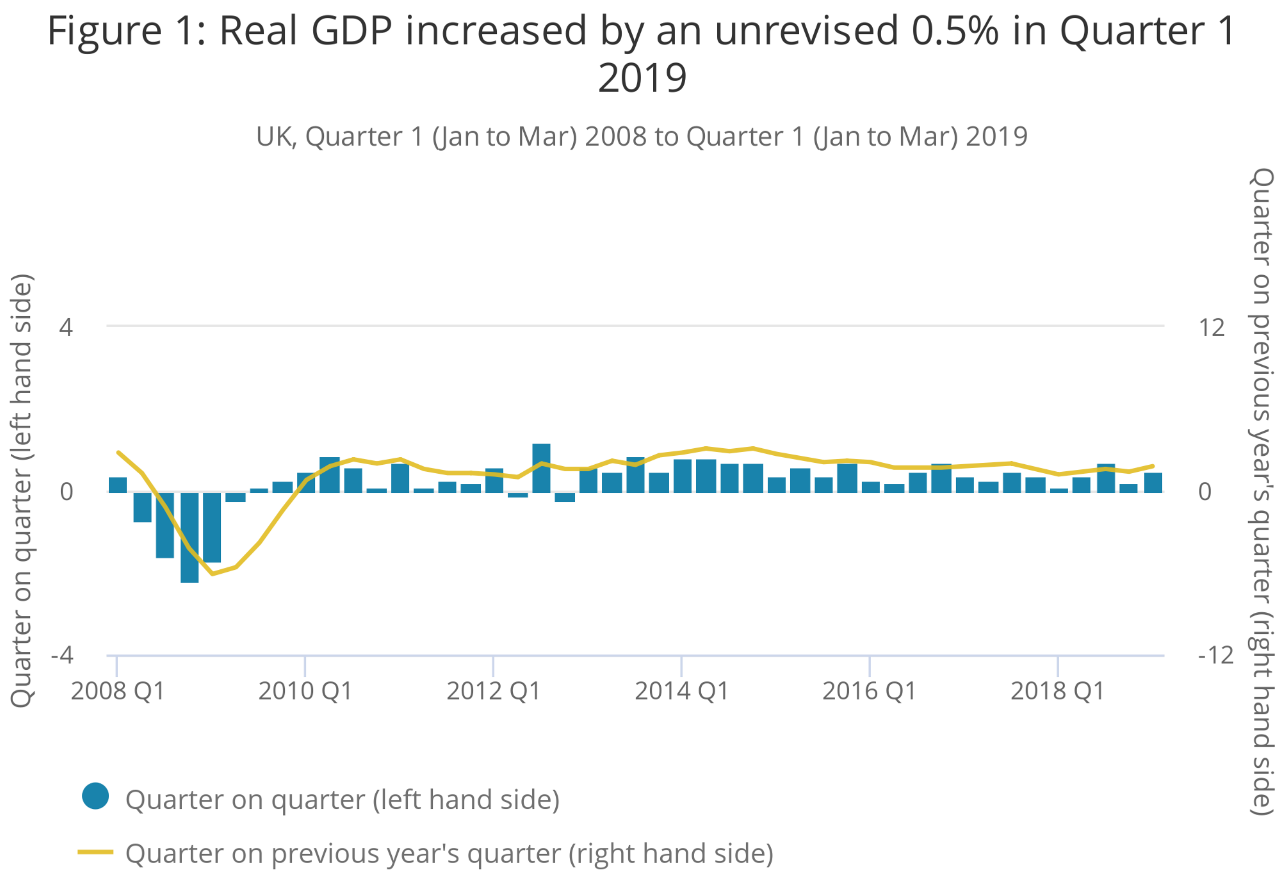
2 . Gross domestic product

UK gross domestic product (GDP) increased by 0.5% in Quarter 1 (Jan to Mar) 2019, following a slowing in growth in the previous quarter. In comparison with the same quarter a year ago, UK GDP increased by 1.8%, its fastest rate since Quarter 3 (July to Sept) 2017 (Figure 1). The pickup in the first quarter is in part due to the profile of the monthly path of late, where a relatively weak December 2018 has fed through to the quarterly figure. More timely estimates show that there has been a notable weakening in recent months, as output fell by 0.1% in March and by 0.4% in April – the latter marking the weakest monthly figure since March 2016. This is likely to be reflecting some temporary factors, which may unwind over the coming months.

There was a sharp 24% fall in car production in April, as it was reported that a number of car manufacturers had brought forward their annual shutdowns as part of the contingency planning ahead of the UK's original exit date from the European Union at the end of March 2019. Furthermore, the effects of the boost to stockpiling that took place in the first quarter of the year may have waned in April.

Figure 1: Real GDP increased by an unrevised 0.5% in Quarter 1 2019

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: January to March 2018

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).

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 comprise GDP. In the year to Quarter 1 2019, the GDP deflator increased by 1.6%, continuing the easing that has been seen in recent quarters. This weakness in the implied import deflator for goods in Quarter 1 has been driven by falls in the price of fuel imports – including gas and electricity, and crude and refined oil – due to a fall in oil prices in Quarter 1 2019. Nominal GDP increased by 0.9% in Quarter 1 2019.

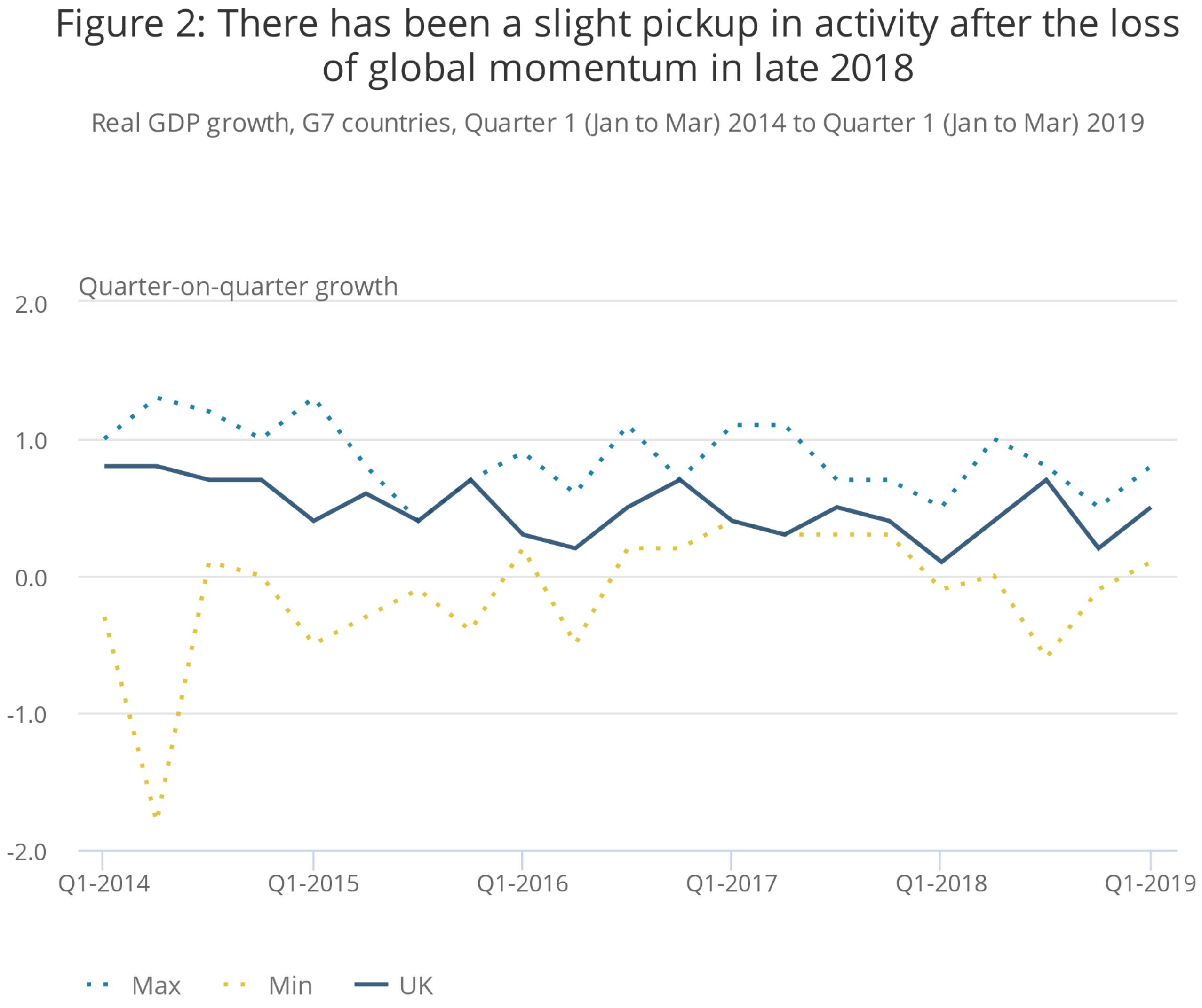
Figure 2 shows how the UK economy has performed compared with other G7 countries in recent years, which plots the range of real GDP growth across these advanced economies. Following a period through 2017 and the first half of 2018 in which the UK was towards the bottom of these international comparisons, there has been an improvement in the UK's relative performance. This reflects to some extent that that there had been a loss of global momentum in late 2018, as Italy had entered a technical recession, while Germany had only narrowly avoided one.

The latest [World Economic Outlook](#) produced by the International Monetary Fund (IMF) cites “an increase in trade tensions and tariff hikes between the United States and China, a decline in business confidence, a tightening of financial conditions, and higher policy uncertainty across many economies” for the weakening towards the end of last year. More recent figures show there has been an uptick in other G7 economies in early 2019, although some of this may have been anticipated, as there were some temporary factors that had weighed on activity in late 2018. This includes the disruptions to German car production following the introduction of new emission standards.

While the US economy expanded by 0.8% in Quarter 1, some of this was driven by relatively volatile components such as lower imports and higher stockbuilding. There is also evidence of a weakening in global trade and investment in early 2019, which in part may be a reflection of the continued trade tensions impacting on confidence levels and uncertainty, helping explain why the IMF concludes that the “balance of risks to the outlook remains on the downside”.

Figure 2: There has been a slight pickup in activity after the loss of global momentum in late 2018

Real GDP growth, G7 countries, Quarter 1 (Jan to Mar) 2014 to Quarter 1 (Jan to Mar) 2019



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

Notes:

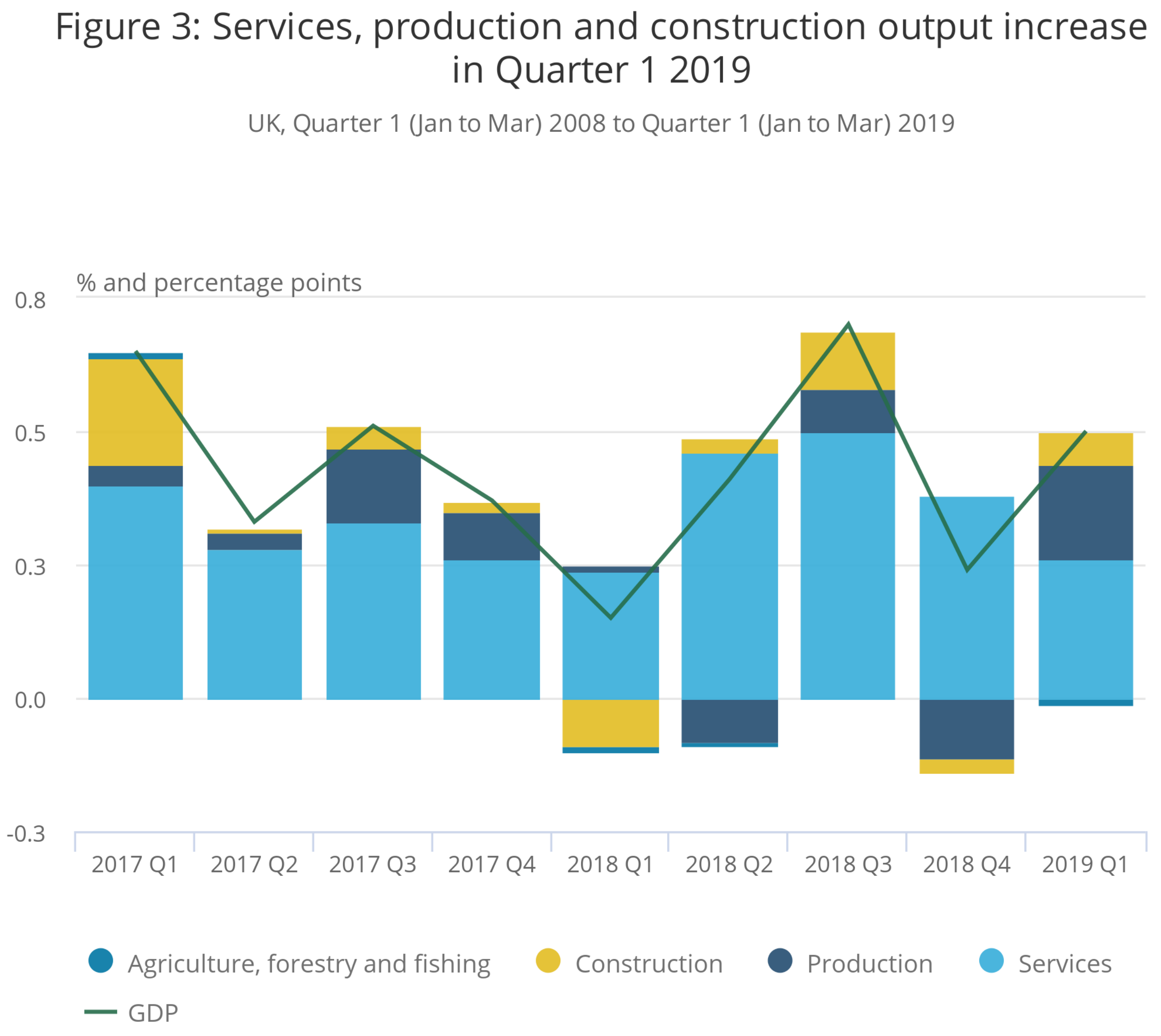
1. All OECD figures correct as of 25 June 2019.

Output

Services output increased by 0.4% in Quarter 1 2019, a slight easing from the previous quarter. The increase was mainly driven by wholesale retail and motor trade (Figure 3), reflecting a pickup in Retail Sales. However, the Bank of England's Agents' Summary Survey (PDF, 805KB) paints a weaker picture for the first three months of the year, attributing the weakening demand to the relatively subdued UK housing market in addition to the recent political uncertainty. The latest Services Purchasing Managers' Index PMIs (PDF, 176KB) reports a slight pickup in May, reflecting an intake of new work and a slight improvement in business conditions, although there was evidence that uncertainty had held back client demand, while the latest evidence by the Confederation of British Industry (CBI) reported a decline in business conditions in the three months to May.

Figure 3: Services, production and construction output increase in Quarter 1 2019

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: January to March 2018

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).

Production output increased by 1.1% in Quarter 1 2019, driven by a marked increase in manufacturing output of 1.9% – its strongest rate since Quarter 3 1999. There has been much interest in the extent to which stockbuilding has been impacting upon the UK economy in the year so far, where businesses increase their holdings of intermediate and/or finished goods, typically in response to unexpected shocks to demand – such as concerns that there may be disruptions at the UK border. The strong pickup in overall manufacturing is consistent with an increase in activity ahead of the UK's originally intended departure date from the European Union and relates to the timing of deliveries from manufacturing businesses to their customers.

It is difficult to unpick how much of the increase in manufacturing output in Quarter 1 2019 might reflect the increase of domestic output produced by UK manufacturers in response to the stockpiling demands by UK and/or foreign manufacturers. There has been external survey evidence that points to a sharp uptick in businesses increasing their inventories of stocks. For instance, the Bank of England's Agents' Summary shows that "around half of all respondents had been building inventories as part of their contingency planning for Brexit", while almost one-third of respondents to the latest Decision Maker's Panel Survey reported an increase in stock levels. This pickup in manufacturing was also captured in the UK Manufacturing PMI for March 2019, which recorded a 13-month high in manufacturing activity due to "companies stepping up production to build-up inventories in advance of Brexit and to also meet rising inflows of new work". The May CBI Industrial Trends Survey reported stocks of finished goods were at their highest balance since the recession.

More recent evidence from a range of external business surveys after the original exit date from the European Union suggests that stockpiling has been easing of late. For instance, the latest UK Manufacturing PMIs (PDF, 147KB) fell to a near three-year low in May, where there was "a sharp easing in the rate of increase in finished goods stocks and pre-production inventories drop for the first time in ten months". This chimes with the June CBI Industrial Trends Survey, which reported that stock adequacy had returned to more normal levels, after the sharp increase in May.

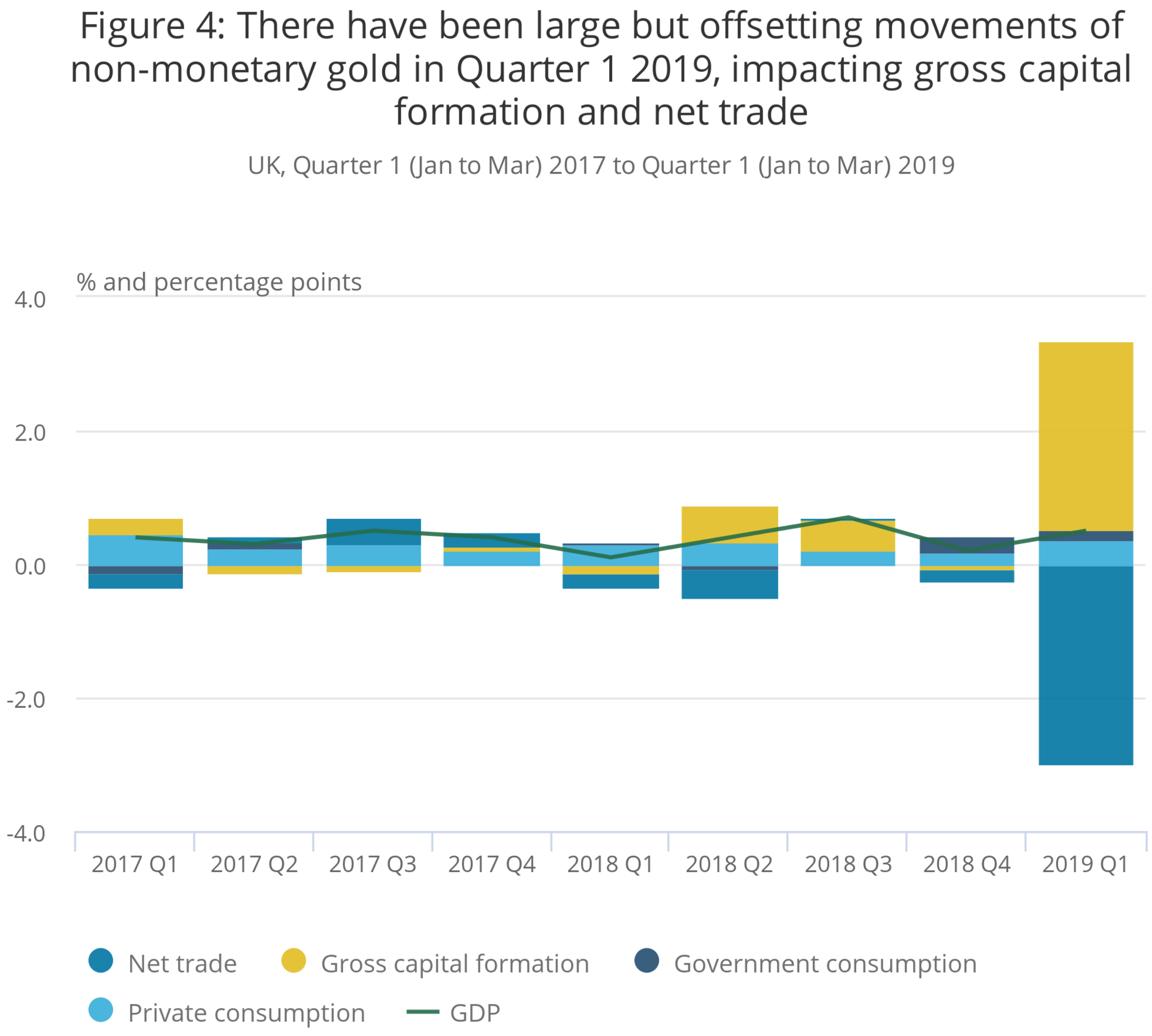
Construction output grew 1.4% in the first quarter of the year, following from a weak end to last year when construction fell 0.5% in Quarter 4 2018. The latest Bank of England's Agents' Summary Survey (PDF, 805KB) notes how "heightened caution around business investment has resulted in some commercial developments being paused or delayed". The latest Construction PMI surveys point to a fall in activity in May, as respondents had "to hold back on major spending decisions in response to Brexit uncertainty and concerns about the economic outlook" while reporting a fall in business optimism.

Expenditure

Private consumption, government consumption and gross capital formation (GCF) contributed positively to growth, while net trade subtracted from GDP growth in the first quarter of 2019. However, the underlying picture has been distorted as there have been some notable movements in imports of unspecified goods in the first quarter of 2019. These unspecified goods include non-monetary gold (NMG) and account for the large but offsetting impacts to gross capital formation and net trade. Whilst there is no effect on headline GDP growth, these movements impact the contributions to GDP growth (Figure 4).

Figure 4: There have been large but offsetting movements of non-monetary gold in Quarter 1 2019, impacting gross capital formation and net trade

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: January to March 2018

Notes:

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

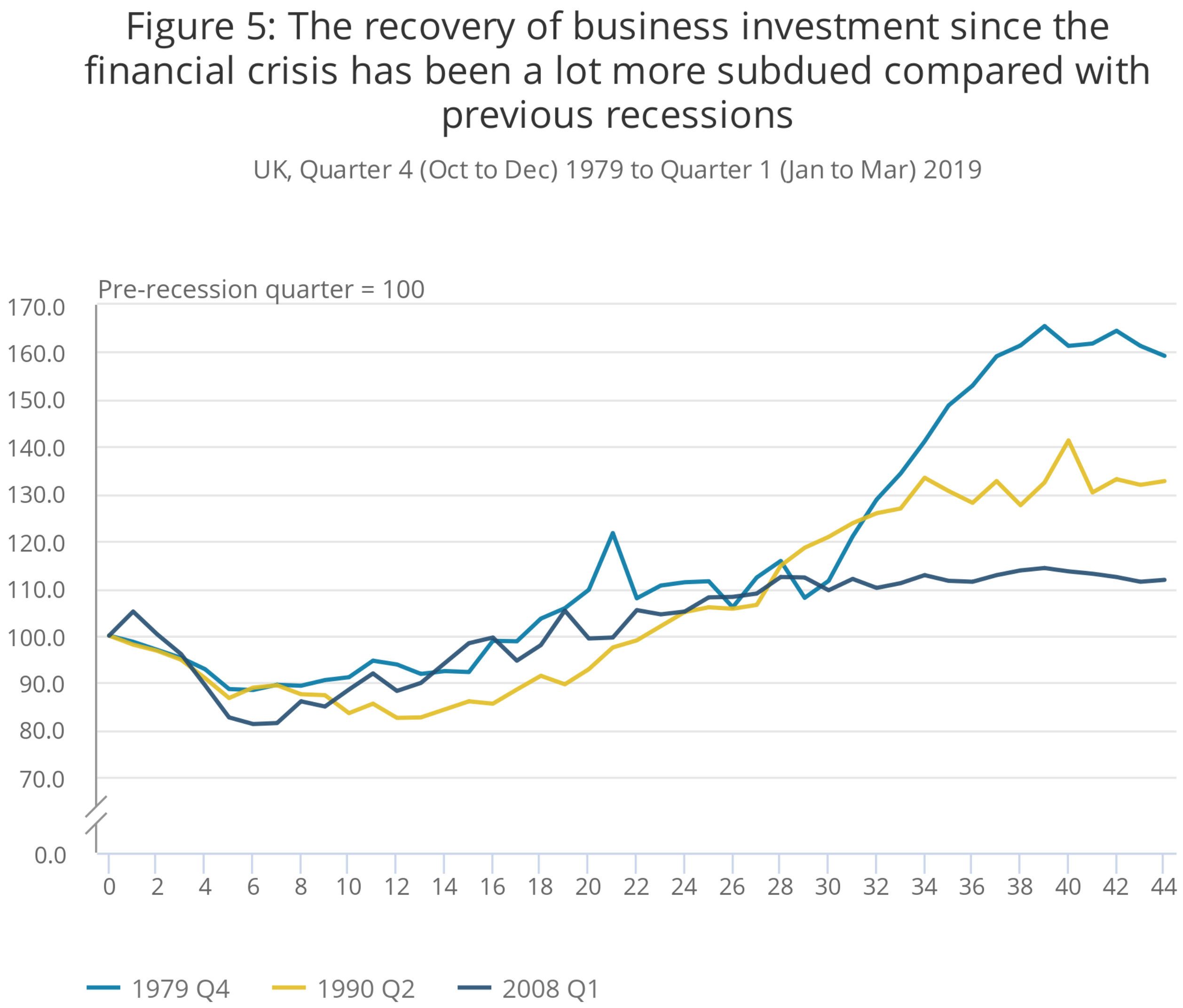
2. Components may not sum to total gross domestic product due to rounding and loss of additivity in data prior to open period. The statistical discrepancy is also not displayed.

Private consumption increased by 0.6% in the first three months of 2019, above the average quarterly growth of 0.4% in 2017 and 2018. Whilst there has been an easing in consumer credit growth of late, the continued resilience of the labour market has fed through to a pickup in incomes. External evidence points towards a subdued outlook in consumer demand. The Quarter 1 Bank of England Agents' Summary of Business Conditions states that "uncertainty about Brexit and the wider economy weighed on spending" in Quarter 1 2019, as its more recent survey evidence highlights weaker demand for household goods in part due to the softer housing market. Consumer confidence remained below its long-run average in March 2019, although more recent figures report a slight improvement in May, including an uptick in the confidence in personal finances. More timely figures show that retail sales volumes increased by 1.6% in the three months to May. That in part reflects the weakness in late 2018, although month-on-month volumes fell in April and May.

Following four consecutive quarters of decline throughout 2018, there was a modest pickup of 0.4% in business investment in the first quarter of 2019. Given the strength in the labour market and financial market conditions, as well as the experience of previous recoveries, the underlying weakness in business investment is likely to reflect that heightened uncertainty about the future trading relationship with the European Union is weighing on investment intentions (Figure 4). This is shown in a range of external surveys, such as the latest Bank of England Agents' Summary of Business Conditions, which finds that investment intentions fell to their lowest since January 2010. The latest Decision Maker Panel Survey finds that 57% of businesses reported that Brexit was in their top source three sources of uncertainty, where "concerns about supply chains and customs were the most commonly cited". This chimes with the latest Deloitte Chief Financial Officers (CFO) Survey which states that "more than half of CFOs continue to rate current levels of uncertainty as high or very high".

Figure 5: The recovery of business investment since the financial crisis has been a lot more subdued compared with previous recessions

UK, Quarter 4 (Oct to Dec) 1979 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: January to March 2019

There has been much interest in the extent to which stockbuilding has been taking place in the UK, which would be recorded under changes in inventories. The underlying data show a substantial increase of £6.6 billion in stocks being held by UK companies in the most recent quarter. The latest [Decision Maker Panel Survey] finds that uncertainty has played a role in the increase in stocks held by businesses, as those respondents that reported “Brexit was an important source of uncertainty for their business were much more likely to have increased stocks than firms who saw Brexit uncertainty as less important”.

Government consumption is estimated to have increased by 0.8% in Quarter 1 2019, following an increase of 1.3% in the previous quarter. Government investment increased by 5.2% due to increases across a number of central government departments.

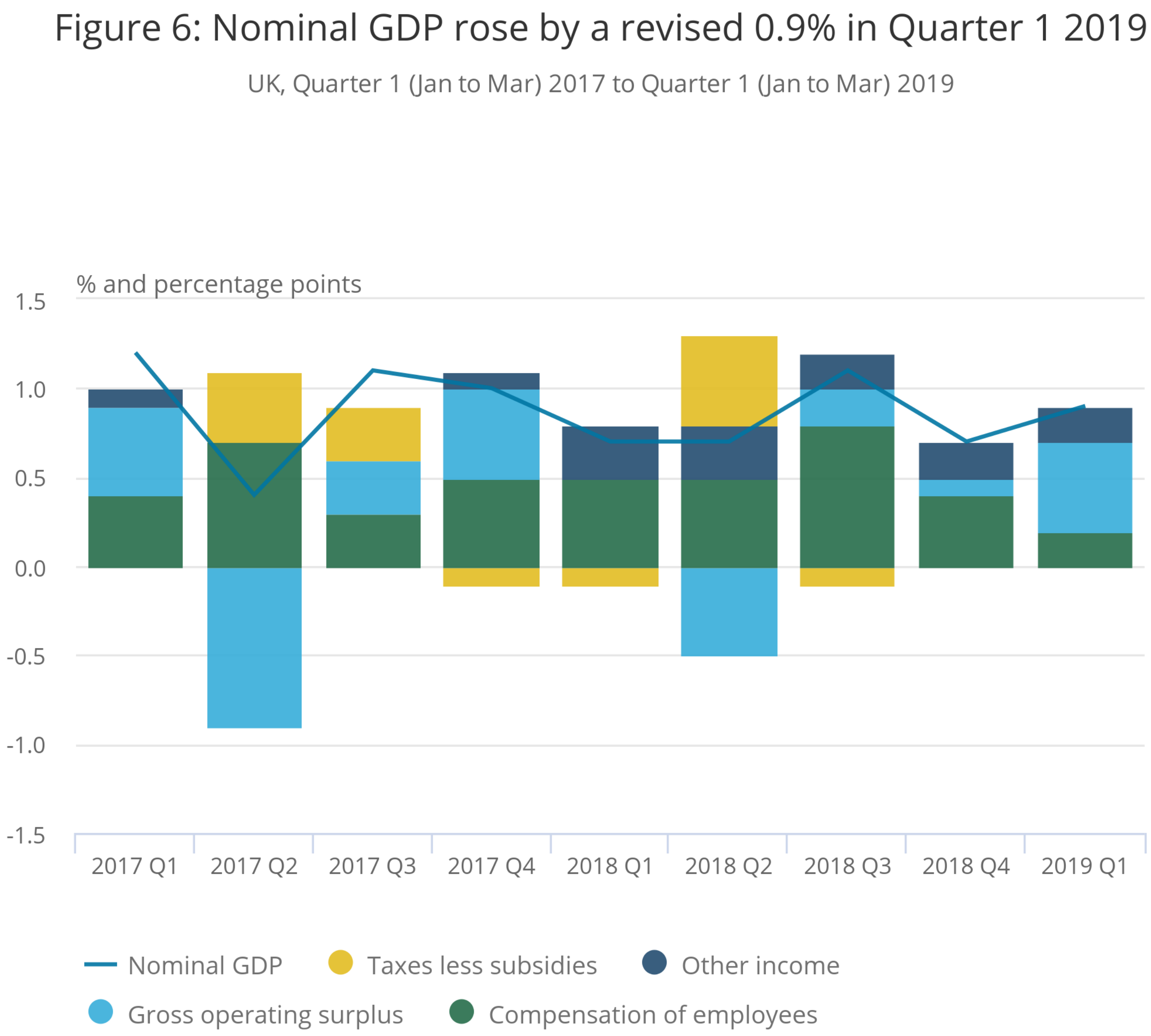
The UK trade deficit widened to 3.7% of nominal GDP in Quarter 1 2019, although this is largely a reflection of the sizeable increase of imports of unspecified goods, which includes NMG. Excluding unspecified goods, the trade deficit was at 1.7% of nominal GDP. It is also possible that concerns around disruptions at the UK border may have impacted the gross trade flows recorded in the early months of the year. For instance, there was an increase in imports of medicinal and pharmaceutical products in Quarter 1, which would be consistent with an increase in activity ahead of the UK's originally intended departure date from the European Union.

Income

Nominal gross domestic product (GDP) increased in Quarter 1 (Jan to Mar) 2019, rising by 0.9% (Figure 5). There was a slowing in wages and salaries, as end of financial year bonus payments were weaker than originally expected, while employers' social contributions increased by 1.7% in the first quarter of the year. Gross operating surplus of corporations has increased by 2.6%, while other income increased by 1.0%, slowing slightly from the growth rates recorded in 2018.

Figure 6: Nominal GDP rose by a revised 0.9% in Quarter 1 2019

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics – GDP Quarterly National Accounts, UK: January to March 2018

Notes:

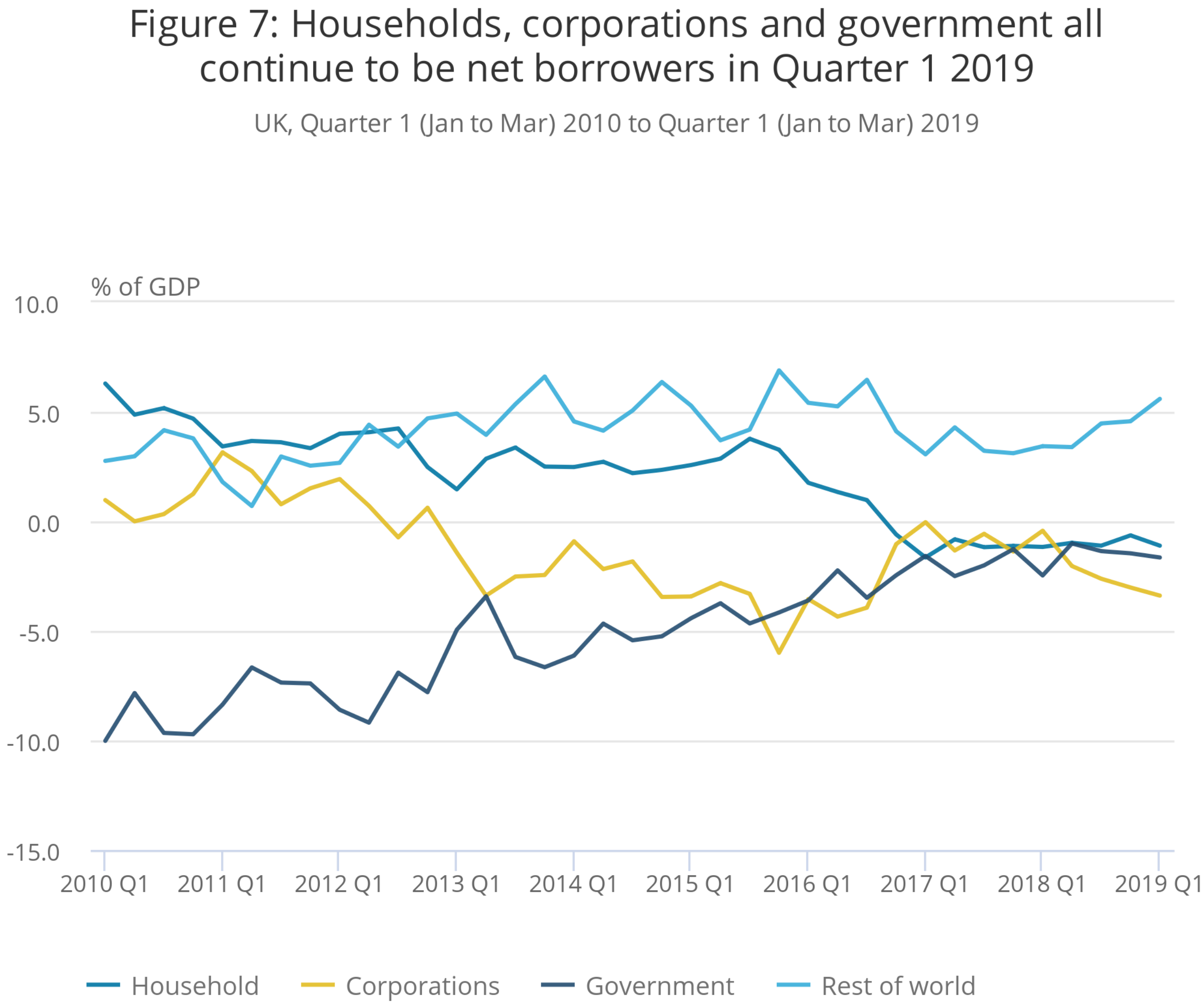
1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept), and Q4 refers to Quarter 4 (Oct to Dec).

3 . Sector and financial accounts

Figure 7 shows the net lending or borrowing positions of households (including non-profit institutions serving households), corporations, government and the rest of the world. These must sum to zero, as total borrowing must be matched by total lending. Recent trends have shown households, corporations and government have had to borrow or run down their savings to finance their spending and investment. This has continued into the first quarter of 2019 – net borrowing is equivalent to 1.1% of gross domestic product (GDP) for households (including non-profit institutions serving households), 3.4% for corporations and 1.7% for government. As such, the rest of the world continues to be a net lender to the UK to finance that domestic saving is less than investment.

Figure 7: Households, corporations and government all continue to be net borrowers in Quarter 1 2019

UK, Quarter 1 (Jan to Mar) 2010 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics – Quarterly Sector Accounts, UK: January to March 2019

Households have traditionally been a net lender, although in recent times that has not been the case, as households have now been net borrowers stretching back to late 2016. Whilst early estimates can be prone to revision, the underlying downward trend provides a clear reflection that households have recently saved less to support their spending. Household net borrowing was 1.1% in Quarter 1 (Jan to Mar) 2019 (including non-profit institutions serving households), primarily reflecting an increase in final consumption expenditure, while there was also increased spending by households on investment, inventories and valuables. This more than offset the increase in compensation of employees (CoE) and net property income. The increase in wages and salaries was relatively subdued, in part reflecting weaker-than-expected end of financial year bonus payments in March. The flows to finance this net borrowing can be volatile, but households primarily financed their net borrowing in the first three months of the year by reducing the amount they deposited with banks and building societies.

This has also been reflected in the households' saving ratio. Having peaked at 10.7% in 2009 following the effects of the financial crisis as households rebuilt their financial positions, the saving ratio has trended downwards in recent years. This has been particularly pronounced of late. In Quarter 1, there was a slight fall in the saving ratio to 4.1%, which remains low by historical standards. More timely figures from the Bank of England show that consumer credit growth continued to slow, easing to 5.9% in the year to April. Although these figures can be somewhat volatile, there is an underlying trend of a slowing in consumer borrowing, where consumer credit growth reached its peak of 10.9% in November 2016. It is now at its weakest rate since June 2014.

There was an increase in the net borrowing of corporations in Quarter 1 2019 to 3.4%. Private non-financial corporations (PNFC) reduced their net borrowing, from 2.0% to 1.5%, primarily reflecting an increase in gross operating surplus and reduced spending on investment which fell for the third consecutive quarter. This might reflect to some extent the range of external surveys that provide evidence that uncertainty has weighed on capital spending. Given the volatile nature of financial flows, quarterly movements in how borrowing is financed are not necessarily an indication of underlying trends. That said, there was a record fall in currency and deposits held by PNFCs of £50.0 billion, as PNFCs shifted to holding other types of assets, including debt securities. In contrast, financial corporations markedly increased their net borrowing in Quarter 1, from 1.0% to 1.8%, mainly driven by an increase in spending on gross capital formation. These figures should be treated with some caution, as this reflect the notable movements in imports of unspecified goods in the first quarter of 2019, which include non-monetary gold (NMG). This has been reflected in a record high in the acquisition less disposal of valuables by financial corporations.

General government was a net borrower in Quarter 1 2019 of 1.7% of GDP. In the latest Economic and Fiscal Outlook (PDF, 3.69MB) published in March of this year, public sector net borrowing (PSNB) is forecast to be 1.1% of GDP this financial year, reflecting higher income tax receipts and lower debt interest spending, due to lower market expectations of future interest rates. Whilst the updated forecasts provide additional headroom against the fiscal mandate, it was noted that the forthcoming changes in the accounting treatment of student loans could increase the structural budget deficit by around 0.5% of GDP in the financial year ending (FYE) 2021, which would "absorb almost half the government's current headroom of 1.2% of GDP against the fiscal mandate". Further analysis provides revised estimates of the effect of improved accounting of student loans, showing that it would add £10.6 billion to PSNB in the latest financial year.

The latest figures show that PSNB was £5.1 billion in May, while borrowing in the first two months of the financial year was £11.9 billion – higher than a year ago. Central government receipts were 3.5% higher in May, but this was more than offset by a 4.2% increase in spending by central government. A higher settlement for the National Health Service and higher net investment helps explain why spending has been higher in the financial year-to-date compared to this time last year. The Office for Budget Responsibility (PDF, 151KB) now expects a small rise in borrowing in FYE 2020, in part reflecting "slower growth in receipts reflecting the Budget 2018 announcements on the income tax personal allowance and higher rate threshold, the temporary rise in the annual investment allowance to £1 million, and slower growth in the main nominal tax bases in 2019". Net debt was 82.9% of GDP as of the end of May 2019.

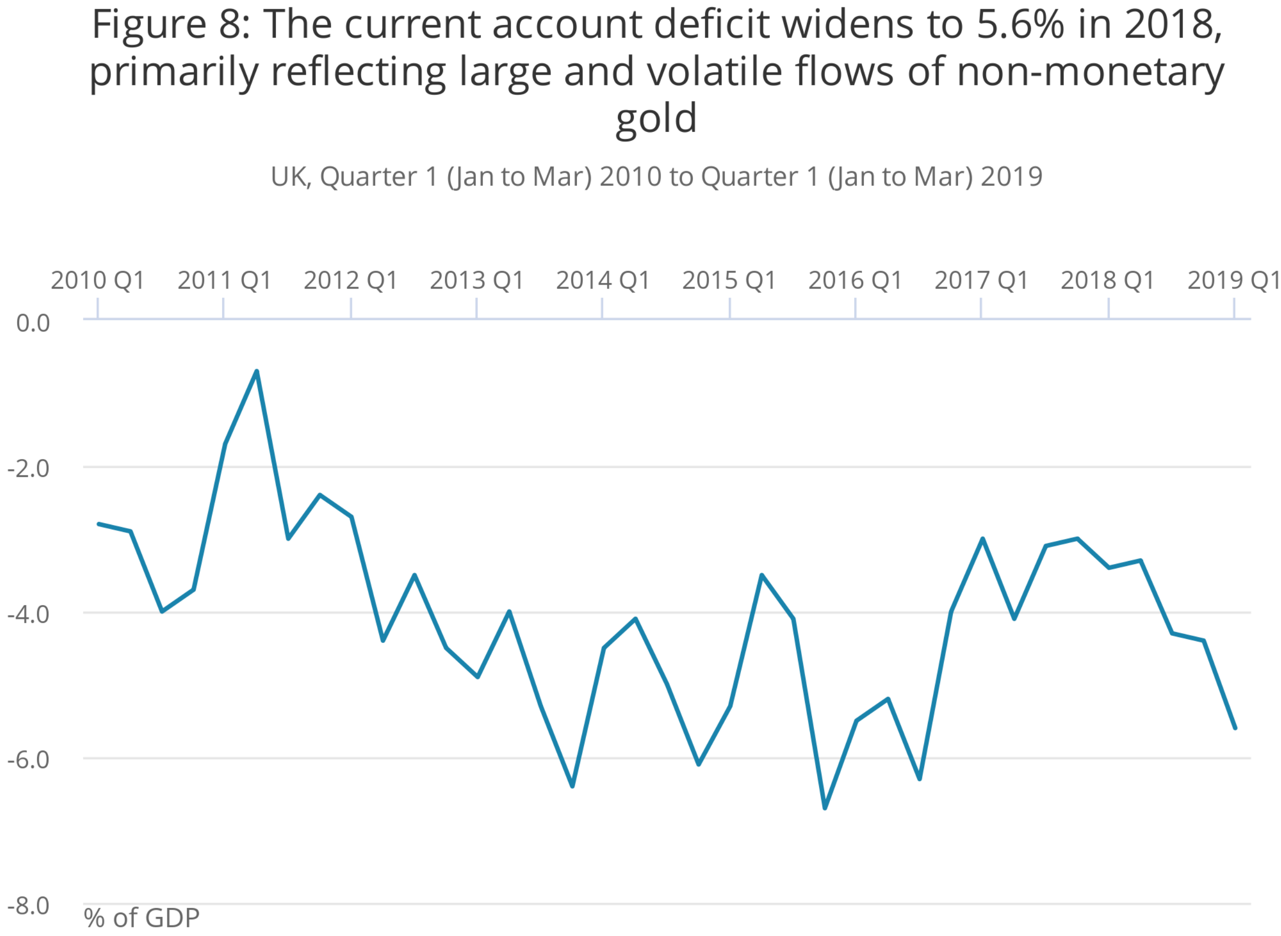
4 . Balance of Payments

The UK current account deficit captures the extent to which it is borrowing from the rest of the world, so that it can finance these overall net borrowing positions of households, corporations and government. In recent years, this has widened to levels that are high by historical and international standards, raising concerns around whether the UK can rely on record high levels of external financing to help fund its domestic expenditure. These concerns have been further heightened by the uncertainty over the future of the UK's trading arrangements. In periods of increased uncertainty, foreign investors may be less willing to lend to the UK, and if this were to happen this could potentially lead to a "sharp fall in sterling, bringing about a more abrupt demand-led narrowing of the current account deficit" (see Office for Budget Responsibility, 2019 (PDF, 3.69MB) for more information).

In Quarter 1 2019, the UK current account deficit widened to 5.6% of GDP, although early estimates can be prone to revision (Figure 8). This is the highest it has been since the third quarter of 2016 and one of the largest on record. That said, this primarily reflects the large increase of imports of unspecified goods, including non-monetary gold (NMG), as opposed to a marked decline in the UK's net investment income. The flows of such unspecified goods have driven the widening of the total trade deficit from 1.8% to 3.7% of GDP in the quarter, but as these can be particularly large and volatile, it is not a true reflection of the underlying external position. Furthermore, there is some evidence that gross flows of trade in Quarter 1 may have reflected an 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 further improvement in net investment income in Quarter 1, continuing the underlying trend over the last three years. This reflected higher net income of foreign direct investment (FDI), as there was a fall in earnings paid out to foreign investors holding FDI in the UK.

Figure 8: The current account deficit widens to 5.6% in 2018, primarily reflecting large and volatile flows of non-monetary gold

UK, Quarter 1 (Jan to Mar) 2010 to Quarter 1 (Jan to Mar) 2019



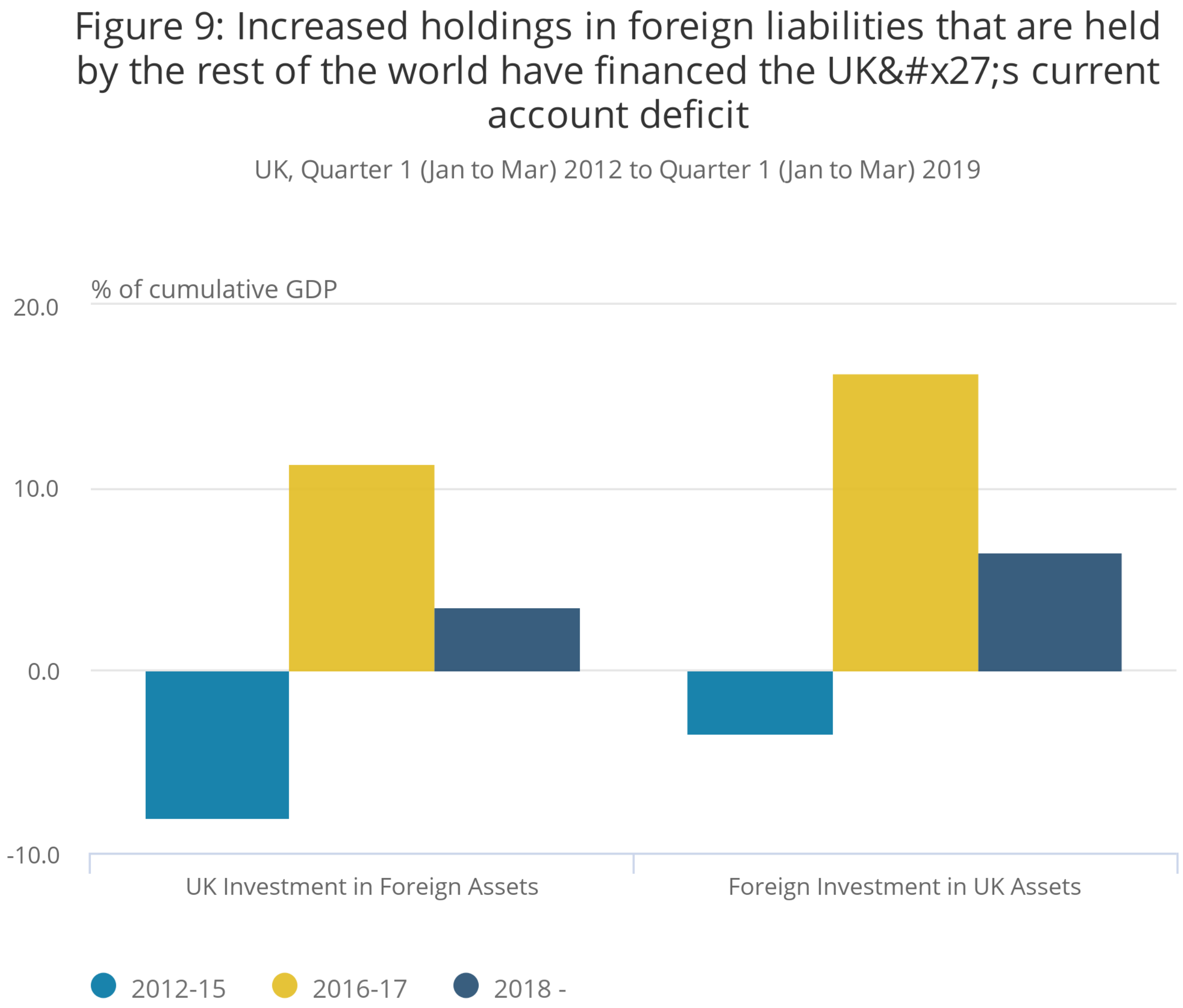
Source: Office for National Statistics – Balance of Payments, UK: January to March 2019

As the rest of the world is a net lender to the UK, this borrowing must be financed by net financial inflows. This can be achieved by the UK increasing liabilities to the rest of the world and/or disinvesting in previously-owned foreign assets. Figure 9 shows how the UK's current account deficit has been financed in recent years, providing some historical context around the size 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 were 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, 6.76MB) highlights this reliance on external financing as a risk to financial stability. It notes that "sharp falls in foreign investor appetite for UK assets could lead to falls in UK asset prices and a tightening in domestic credit conditions", while citing that there has been mixed evidence about investor appetite for UK assets since the EU Referendum.

However, financial flows in and out of the UK tend to be particularly volatile. This has been evident through 2018 and into the first quarter of this year, where there have been pronounced swings in the flows of capital between the UK and the rest of the world, which are not shown in Figure 9. In Quarter 1 2019, there was a divestment of the net acquisition of financial assets, specifically in other investment. This comprises mainly of short-term loans and deposits – which tend to be the most mobile form of capital – reversing the picture of the previous quarter. There was also a marked reduction in the net inflow of foreign investment into the UK, reflecting a divestment of FDI and a reduction in the net inflow of other investment. FDI tends to be less mobile in nature, reflected to some extent in that this was the first divestment of FDI since early 2015. This reflected UK subsidiaries paying off loans to their foreign parents, with little merger and acquisition activity in the first quarter.

Figure 9: 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 1 (Jan to Mar) 2019



Source: Office for National Statistics – Balance of Payments, UK: January to March 2019

In its latest assessment, the [Office for Budget Responsibility (PDF, 3.69MB)] notes that that UK’s net liability position is “modest” as a share of GDP, reducing the risk of the UK running a large current account deficit. This increased from 6.7% of annualised GDP at the end of the previous quarter to 9.1% at the end of Quarter 1 2019, although this remains relatively modest by historical standards.

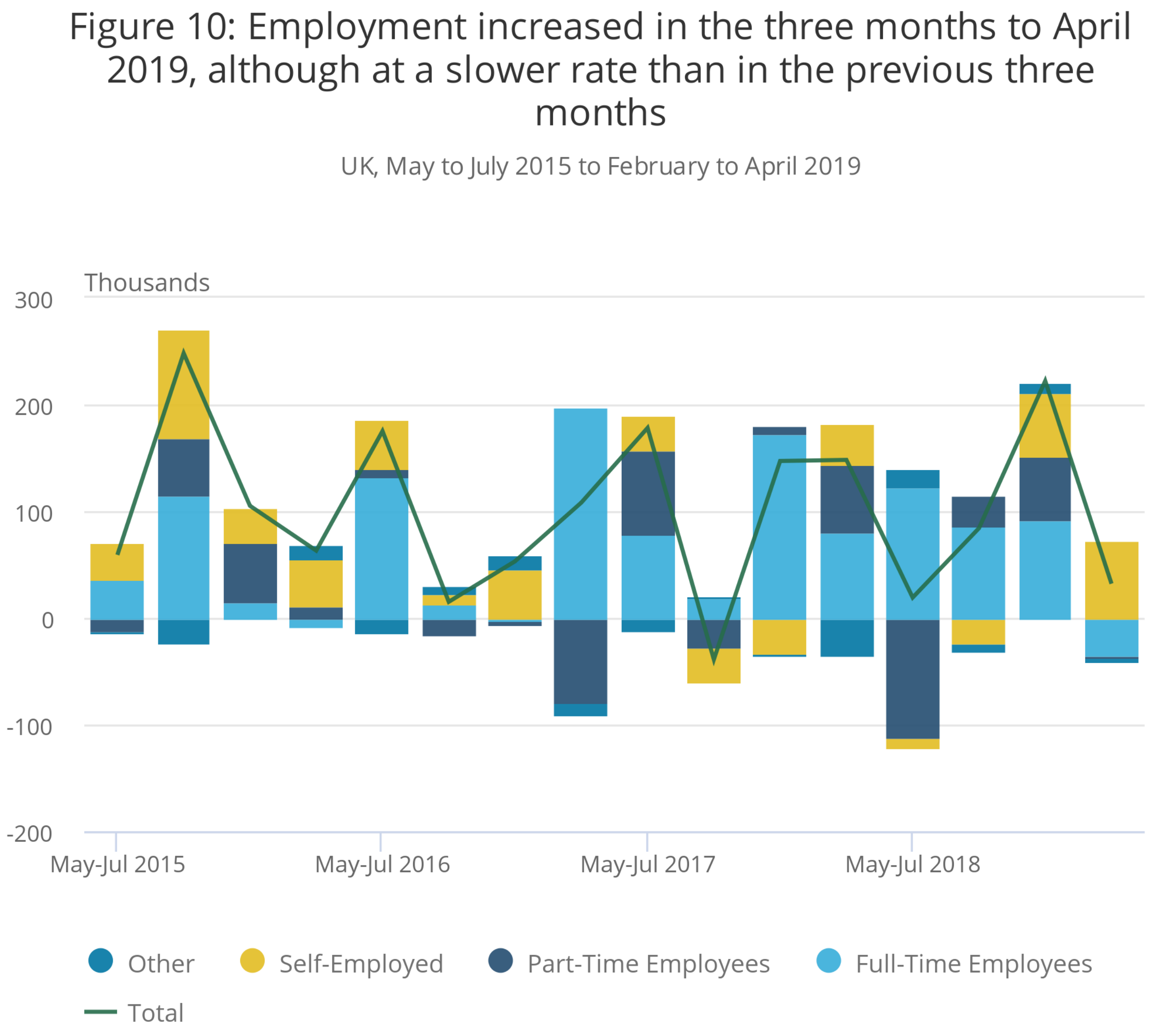
5 . Labour market

Despite gross domestic product (GDP) falling sharply by 0.4% in April, in part reflecting temporary factors such as the unwinding of the build-up of stocks by businesses earlier in the year and earlier-than-usual shutdowns by car manufacturers in April, the UK labour market is still showing signs of resilience. Employment increased by 32,000 from the three months to January to the three months to April, which was driven by a rise in the number of self-employed. That said, the number of employees fell by 38,000 over this period – the first fall after a sustained period of increases (Figure 10).

The employment rate remained at a record high 76.1%, while the number of unemployed people fell by 34,000 over this three-month period as the unemployment rate hit 3.8% – its lowest figure since January 1975. It is now slightly below some estimates of the natural rate of unemployment, such as the latest estimate by the [Bank of England](), indicating a tight labour market.

Figure 10: Employment increased in the three months to April 2019, although at a slower rate than in the previous three months

UK, May to July 2015 to February to April 2019



Source: Office for National Statistics – Labour Market, UK: June 2019

When there is limited spare capacity in the labour market, employers are expected to offer higher wages as they compete over a smaller pool of available resource in the labour market. While still below its pre-crisis rates, this tightness is now showing up in higher nominal wage growth, as regular pay increased by 3.4% in the year to the three months to April. This marked the ninth consecutive rolling three-month period in which it has exceeded 3%, which is the longest such sustained period since early 2009. The latest analysis by the [National Institute of Economic and Social Research (PDF, 357KB)]() estimates that regular nominal pay growth will stabilise at 3.5% in Quarter 2 of this year. Real regular wage growth increased by 1.5% over the same period.

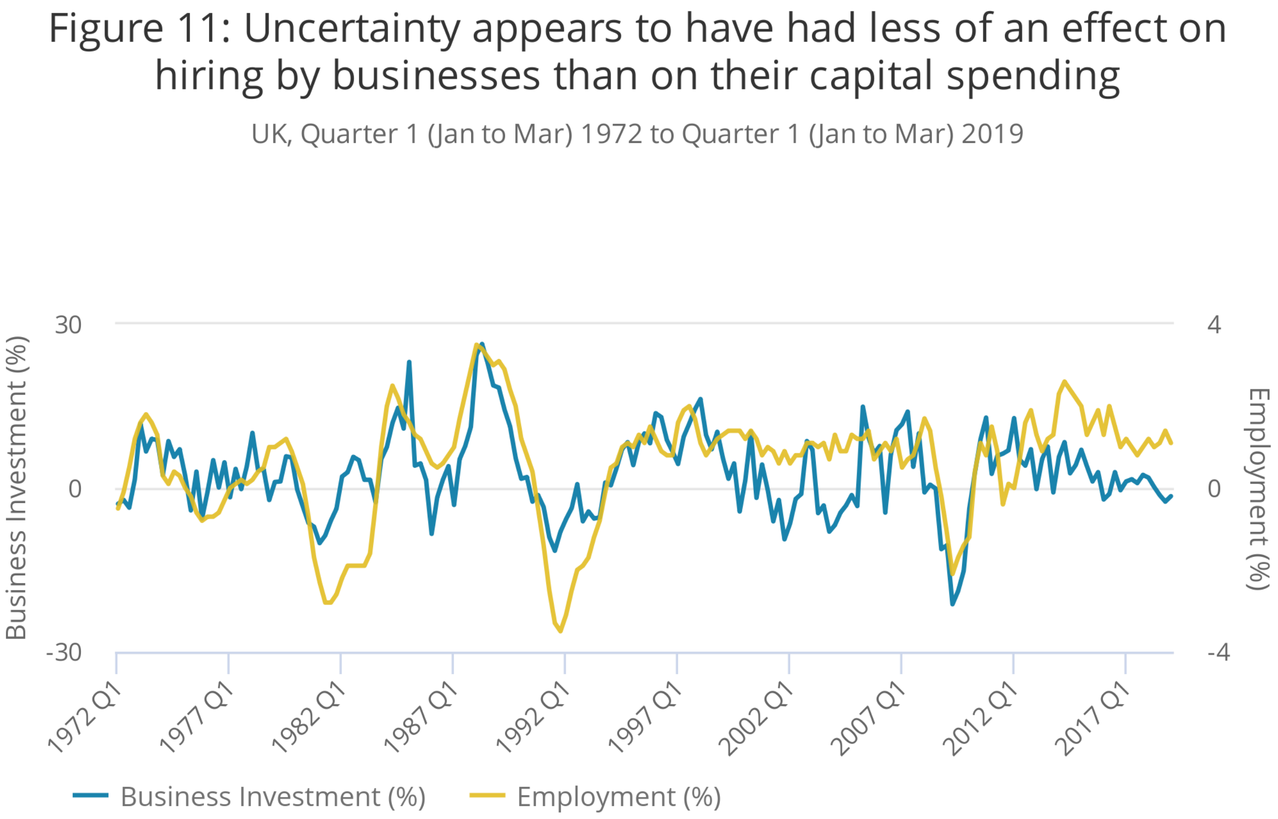
Vacancies provide an alternative measure of the difficulty with which employers would be able to fill jobs. If there are relatively few unemployed people to the number of vacancies available, it would imply a tight labour market. The unemployment-to-vacancies ratio remains low by historical standards, although the number of vacancies has eased a little in early 2019 with a slight uptick in this ratio over the latest three-month period as the number of vacancies fell from its all-time high earlier this year of 861,000 to 837,000.

The evidence from external surveys is a little more mixed. For example, the latest Report on Jobs by the Recruitment and Employment Confederation (REC) finds evidence reports subdued hiring trends, as the number of permanent staff appointments falling in May – the fourth fall in five months, with a sharper fall than the previous month – as anecdotal evidence identified that this had been dampened by uncertainty. It also reported that vacancy growth in May had remained subdued. That said, it also reported that “ongoing Brexit-related uncertainty and generally tight labour market conditions” were weighing on labour supply in May. The Agents’ Summary of Business Conditions for Quarter 1 paint a similar picture, reporting a weakening in employment intentions reflecting “caution due to slower output growth and Brexit uncertainty”. It also reported that there had also been an increase in recruitment difficulties, citing labour shortages – particularly in particular in the information technology, professional services, engineering and haulage industries.

The resilience in the UK labour market is in sharp contrast to the latest figures of business investment, which remains subdued, especially in the context of comparable points in previous UK recoveries. There is a wide range of survey evidence that points to the effects of heightened uncertainty weighing on capital spending, which fell in every quarter of 2018. However, employment growth has been relatively much stronger over this period. This pattern is typically not the case as Figure 11 shows how there is a tendency hiring and capital spending tend to follow each quite closely. Recent analysis (PDF, 581KB) highlights that one factor might be that firms may be more likely to substitute labour for capital in such periods of heightened uncertainty, if it is the case that hiring would be easier to reverse. Capital expenditure on the other hand tends to be more expensive to reverse or are irreversible. Citing responses to the latest Decision Makers Panel (DMP) Survey, the latest Inflation Report highlights that such substitution may not be the main factor, but rather that more those companies whose production is more labour-intensive have been growing relatively quicker than those that have more capital-intensive production processes.

Figure 11: Uncertainty appears to have had less of an effect on hiring by businesses than on their capital spending

UK, Quarter 1 (Jan to Mar) 1972 to Quarter 1 (Jan to Mar) 2019



Source: Office for National Statistics

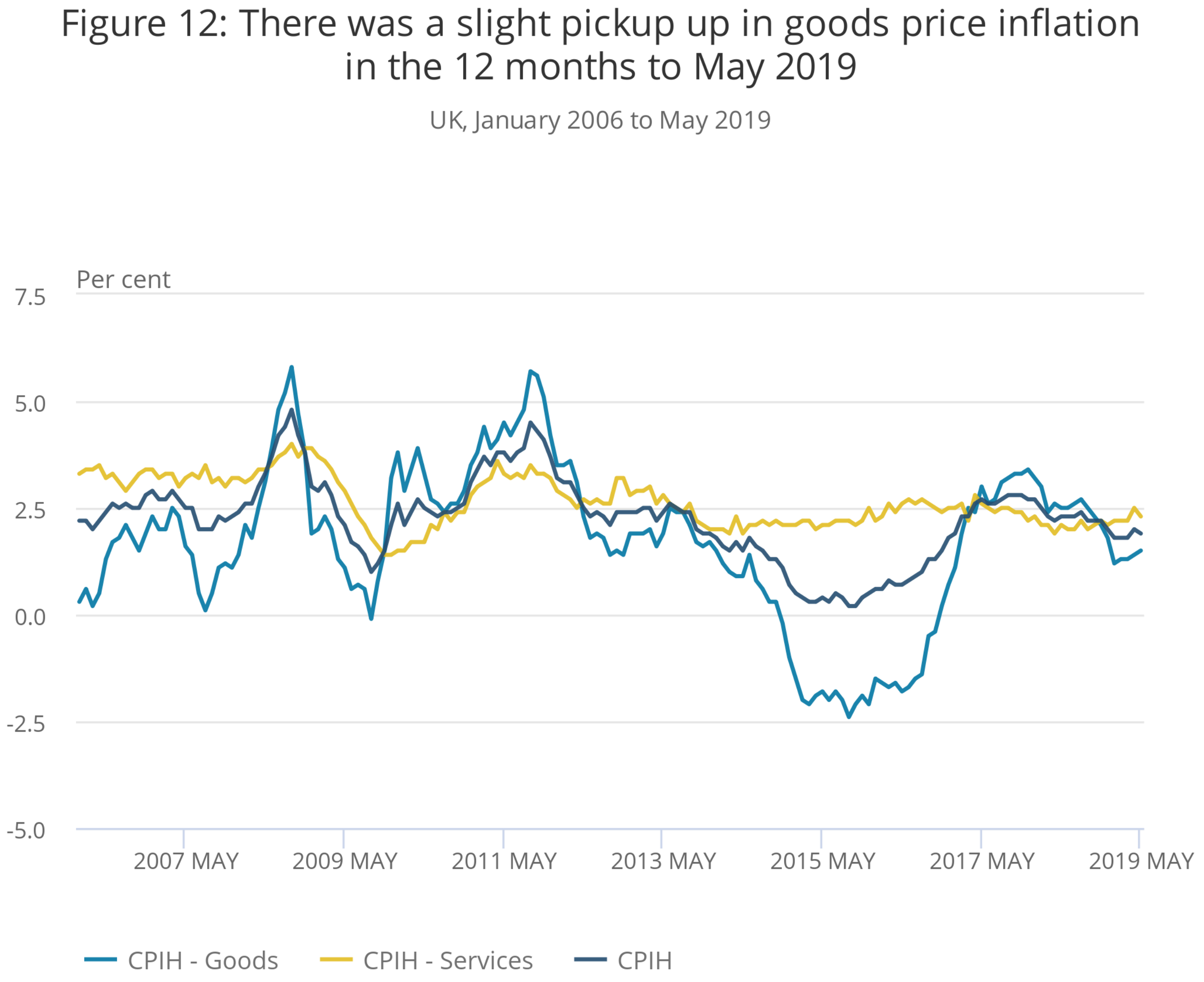
6 . Prices

The latest figures show that there was a slight easing in the 12-month Consumer Prices Index including owner occupiers' housing costs (CPIH) inflation rate to 1.9% in May. This was largely driven by a 3.8% fall in the price of transport services between April and May, particularly those that relate to air fares, compared with a 2.0% rise over this same period a year ago. Much of this fall was driven by the timing of Easter and the associated school holidays this year. Annual CPI inflation was also slightly lower in May at 2.0%. Analysis by the National Institute of Economic and Social Research shows that the easing in CPI inflation was driven by "a few volatile goods and services such as air fares" and that its estimate of underlying inflation, which excludes the higher and lowest price changes, increased by 0.3 percentage points in the year to May.

CPIH goods price inflation ticked up slightly to 1.5% on the year to May. Despite the pickup in recent months, in part reflecting the notable rise in energy prices, Figure 12 shows that goods price inflation is still relatively subdued compared to the increases that were experienced through much of 2017 and 2018. This likely reflects the fading effects of import inflation, as goods tend to be imported much more than services, and whose sterling value in imported final and intermediate goods initially increased following the fall in the exchange rate after the outcome of the referendum on membership of the EU. However, these effects are now reflected in the price level of a year ago. Analysis of annual CPIH inflation by import intensity shows that the contributions of those components that have an import content of at least 40% was at its lowest rate since January 2017. CPIH services price inflation which tends to be considered a proxy for domestic inflationary pressure, eased to 2.3% over the same 12-month period. This is slightly below the rate experienced over the previous 12 months.

Figure 12: There was a slight pickup up in goods price inflation in the 12 months to May 2019

UK, January 2006 to May 2019



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

7 . Conclusions

The latest estimates show that growth of the UK economy picked up to 0.5% in the first quarter of the year, following a slowing in the previous quarter. More timely estimates show that there has been a notable weakening in recent months, as output fell by 0.1% in March and by 0.4% in April. This is likely to be reflecting some temporary factors, which may unwind over the coming months. It was reported that a number of car manufacturers had brought forward their annual shutdowns as part of the contingency planning ahead of the UK's original exit date from the European Union at the end of March 2019, while the effects of the boost to stockpiling that took place in the first quarter of the year may have waned in April.

The rest of the world continues to be a net lender to the UK, with each of households, corporations and government being net borrowers. Recent trends highlight how households have become net borrowers, which increased to 1.1% in Quarter 1 (Jan to Mar) 2019, while the household saving ratio remains low by historical standards. Private non-financial corporations (PNFC) reduced their net borrowing, primarily reflecting an increase in gross operating surplus and reduced spending on investment which might reflect to some extent the range of external surveys that provide evidence that uncertainty has weighed on capital spending. The current account deficit was 5.6% of gross domestic product (GDP) in Quarter 1 2019, though much of the widening in the quarter reflects volatile movements in non-monetary gold (NMG). Financial flows in and out of the UK tend to be particularly volatile, which has been particularly evident through 2018 and into the first quarter of this year. In Quarter 1 2019, there was a divestment of the net acquisition of financial assets, specifically in other investment.

There are no clear signs of uncertainty weighing on the labour market, as the tightness can be seen in a range of labour market indicators. Employment increased by 32,000 from the three months to January to the three months to April, as the employment rate remained at a record high 76.1%, while the unemployment rate hit 3.8% – its lowest figure since January 1975. The unemployment-to-vacancies ratio remains low by historical standards, although the number of vacancies has eased a little in early 2019 with a slight uptick in this ratio over the latest three-month period. Regular pay increased by 3.4% in the year to the three months to April. This marked the ninth consecutive rolling three-month period in which it has exceeded 3%, which is the longest such sustained period since early 2009.

The 12-month Consumer Prices Index including owner occupiers’ housing costs (CPIH) inflation rate to 1.9% in May. This was largely driven by a 3.8% fall in the price of transport services between April and May, particularly those that relate to air fares. Much of this fall was driven by the timing of Easter and the associated school holidays this year. The contributions of those components that have an import content of at least 40% was at its lowest rate since January 2017, consistent with the fading effects of import inflation. CPIH services price inflation which tends to be considered a proxy for domestic inflationary pressure, eased to 2.3% over the same 12-month period.