

## “Stat Attack” on the UK Economy in 2007

Between 1997 and 2007 the annual average changes for various key indicators is as follows:

- **CPI inflation** has averaged 1.6% pa (i.e. below the 2% inflation target) – but in 2006 and 2007, it averaged 2.3%, the highest rate of inflation since 1996. The UK now has one of the highest inflation rates among leading countries – the Bank of England has forecast that it rise towards 3.7% and possibly higher in the coming year. Note too the much higher figure for RPI inflation.
- The **trade deficit in goods** average has been £48bn (the deficit was £88bn in 2007 – a record)
- **Trade surplus** (services) average has been £21bn (the surplus was £39bn in 2007) – a record
- **GNP is larger than GDP** – because net investment income from external assets was positive in 2008
- **Consumer spending** ↑ 3.3% pa over the last decade – faster than the LR average of 3% - but the pace of increase has been slower in each of the last three years. Consumption was held up in 2007 through a combination of high house prices, record high employment and relatively low interest rates – but the prospects for 2008 are much weaker – consumption is being hit by the surge in food and utility prices; a decline in real incomes, higher mortgage costs, a recession in housing and a sharp decline in consumer confidence.
- **Real disposable income** ↑ 2.5% pa over the decade – so consumer spending has risen faster than income – the result being a fall in the household savings ratio (see below) – but this is likely to change in 2008-09 as consumers rein back spending and rebalance towards higher savings.
- **Consumer credit** ↑ 13.5% pa over the last ten years – an indication of the scale of the borrowing boom. But in 2006, that rate of growth slowed down to just 7% as the borrowing binge came to an end – and the growth of credit has slowed still further in 2007 and into 2008.
- The **household savings ratio** has averaged 5.5% of disposable income – about half the rate in the early 1990s – but it dipped to just 2.9% in 2007 the lowest rate of saving for a generation. This is a very low rate of saving and, potentially, raises problems for the economy in the years ahead especially if households suffer the effects of a recession brought about by the credit crunch.
- **Real GDP (real national output)** ↑ 2.8% pa from 1997-2007 – one of the fastest rates of growth in the European Union and the UK has now enjoyed over 16 years of continuous growth. Growth was around trend levels in 2006 and 2007 but the economy is expected to weaken this year and 2009 might be the weakest growth in nearly twenty years. Can the UK avoid a recession?
- **Productivity** ↑ 2.0% pa – steady growth, but productivity has risen faster in the USA
- **Capital investment** ↑ 4.9% pa between 1997-2007 and capital spending has risen faster than this in each of the last two years. As a result, investment measured as a share of GDP has risen from 16.1% in 2003 to just over 18% in 2007. This is welcome news for the supply-side of the economy. But we would expect to see a slowdown in capital spending (a negative accelerator effect at work) as the real economy weakens this year. Company profits have remained very high considering the pressures of rising costs from oil, gas and many other commodities.
- **House prices** in the UK have ↑ by 11% pa over the period 1997-2007 – much faster than inflation and incomes – so house prices have become more expensive in real terms and relative to incomes. As you will be aware, 2007 and the first half of 2008 has proved to be a turning point for the housing sector. Prices are now falling quite quickly in most parts of the country and there has been a sudden and large drop in mortgage availability. A significant house price correction is now underway; nobody is confident just how large this will be.
- **Manufacturing output** ↑ 0.5% pa since 1997 and manufacturing industry now contributes only 14% of national output compared to 21% when Labour came to power in 1997.
- **Service sector output** ↑ 3.5% pa – and their share of the economy continues to grow. Over ¾ of our national output now comes from the service sector.
- **Oil prices** averaged over \$75 per barrel in 2007, compared to a ten year average of just \$35 per barrel and in the first half of 2008, prices have spiked to reach over \$128 per barrel. There are some commentators including Goldman Sachs (and OPEC spokespeople) who have claimed that the price of a barrel of crude oil might well spike over \$200 in the next year or two.

## **Notable points from the UK economy in 2007-08**

1. The Bank of England has warned that it expects to miss the inflation target (CPI > 3%) several times over the next two years. How great are the risks to inflation? Is there a case for modifying the target? How much will unemployment have to fall to bring inflation back into target range? These are undoubtedly difficult days for the central bank – perhaps the most testing since they were given operational independence in May 1997
2. A record trade deficit in goods (£88bn) and a huge current account deficit (£53bn) suggest that Britain's balance of payments deficits are becoming dangerously high. Sooner or later there has to be a macroeconomic adjustment that moves the British economy away from consumption and debt towards saving and exports. That adjustment seems to have started. An economic slowdown and the sharp depreciation in the value of sterling against the Euro will help to lower the trade deficit and give a competitive boost to the UK export sector.
3. The government ran another large budget deficit and the accumulated national debt rose above £500bn for the first time. Public sector debt will surge even higher because of the nationalisation of the Northern Rock in November 2007.
4. The UK was the top recipient of foreign direct investment in the world economy – largely because of the boom in takeovers and mergers, but also because of relatively high interest rates and the strong UK property and bond markets
5. The pound reached \$2 for the first time since 1991 although it has since slipped back a little – the key currency development in the last 12 months has been the depreciation of sterling against the Euro
6. The UK economy generated a real GDP of £1.2 trillion pounds – but it was overtaken by China and slipped to 5<sup>th</sup> place in the rankings of largest economy
7. Consumer spending as a share of GDP reached an historic high of 66% - but the consumer boom now looks to be well and truly over.

## **Strengths and weaknesses of the UK economy**

### **Strengths**

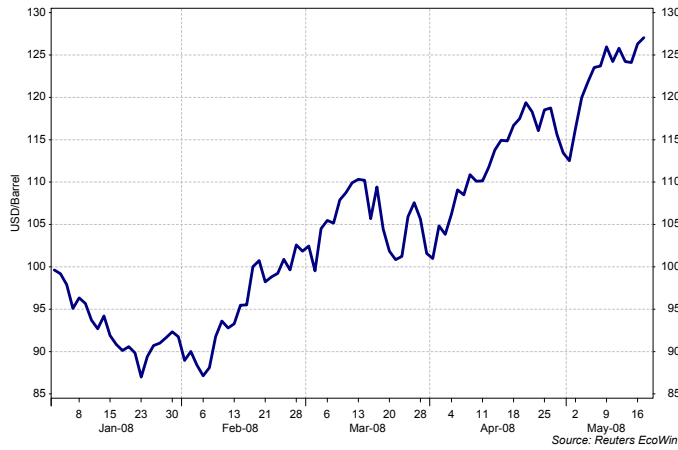
1. Economic growth still reasonably strong given the weakness in the USA
2. Unemployment still falling, employment still rising (highest ever in 2008)
3. Strong performance in financial services and creative services
4. Manufacturing sector decline halted (New Model built on high value industrial output)
5. CPI generally within target range despite inflationary pressures in 2008

### **Weaknesses**

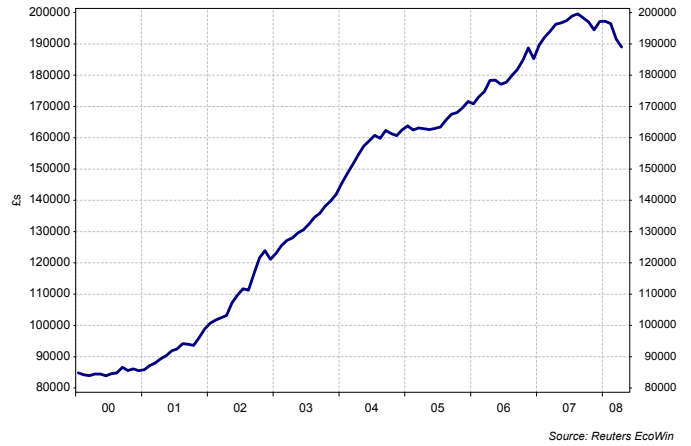
1. Serious inflationary pressures (see RPI); lagged impact on real growth rate?
2. Evidence of growing food and fuel poverty
3. Housing market on brink of slump/collapse
4. Credit Crunch....the fall out continues
5. Monetary Policy increasingly impotent given external world events
6. The government's own 'self-imposed' fiscal rules are now under serious pressure – Darling's £3bn tax giveaway – the end of his fiscal credibility / worries over rising government debt and the increasing burden of taxation on people and businesses

# Chart Room

**West Texas Intermediate Crude Oil**  
US dollars per barrel, one month futures price, NYMEX

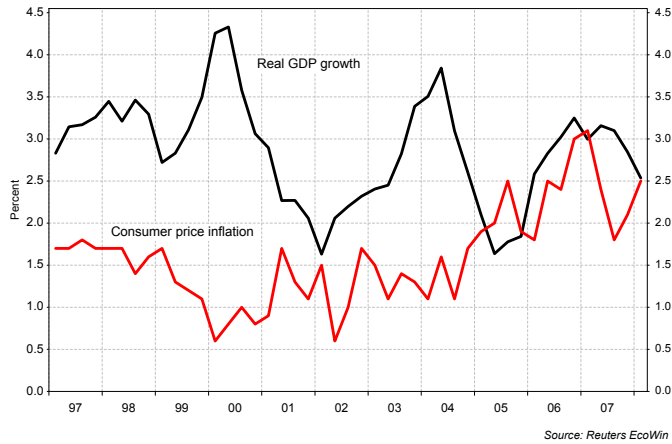


**Average house prices in the UK**  
average prices per month, £s, source: Halifax plc



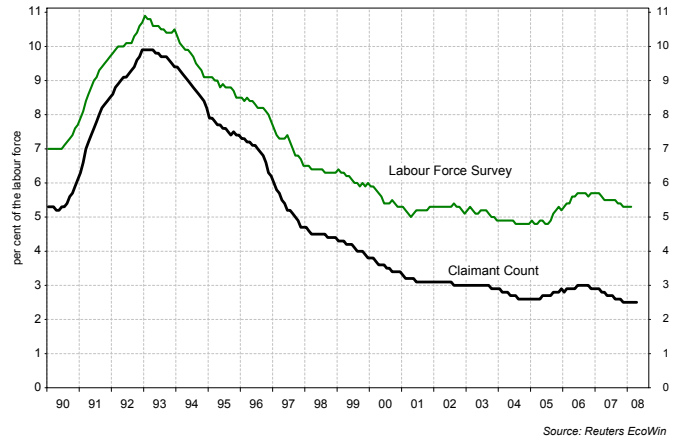
**Economic Growth and Inflation**

UK Real GDP Growth and Consumer Price Inflation, annual percentage change



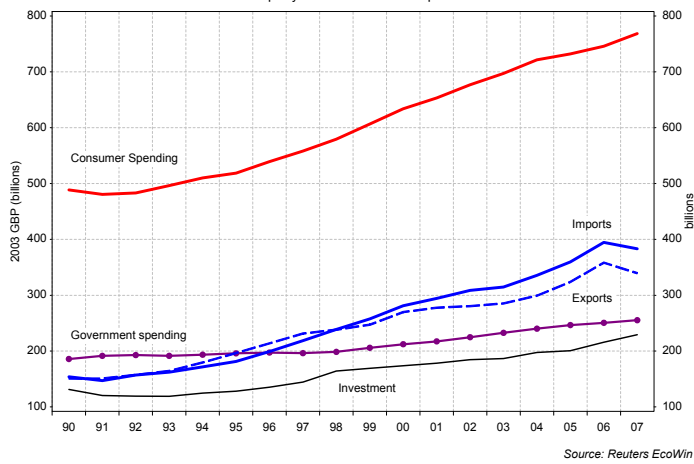
**Unemployment in the UK Economy**

people aged 16-59 (women) / 64 (men), seasonally adjusted



**The Components of Aggregate Demand**

£bn per year at constant 2003 prices



**Retail Price and Consumer Price Inflation in the UK**

Annual percentage change in the retail price index and CPI

