UK economy flatlines in third quarter

November 2023

The UK economy grew by 0.2% in September, building off a 0.1% expansion in August as rising output in services and construction boosted overall activity. But a poor start to the quarter saw GDP flat through Q3, following mildly positive growth in the first half of the year. The latest labour market data, though limited in scope (see below), points to a continued softening, with vacancies falling and signs that wage pressures may have peaked. But overall the labour market remains fairly resilient, with employment firm and unemployment steady. The Monetary Policy Committee (MPC) held rates at 5.25% at their last meeting at the beginning of November and markets are pricing for rates to remain unchanged again in December.

Stagnation nation

A broad-based rise in activity across the services sector resulted in GDP growing 0.2% in September, with output increasing in 8 out of 14 services sub-sectors. This was accompanied by an increase in construction output, which grew 0.4% on the back of an increase in repair and maintenance as good weather in September helped boost output, according to the ONS. Production output stagnated, however, capping off a weak quarter, as manufacturing (+0.1%) failed to recover from a 0.7% fall in August. Overall, GDP was flat during the third quarter, as the slight expansion of output during August and September failed to offset a decline of 0.6% in July.

The expenditure breakdown of the national accounts highlights broad-based pressures currently weighing on activity. The stagnation of GDP reflected a deterioration in household spending (-0.4% quarter on quarter), government consumption (-0.5%) and investment (-2%) with only net trade (0.4%) making a positive contribution to GDP as the trade deficit narrowed. Other developed economies showed similar trends, suggesting higher interest rates are beginning to feed through the global economy. Like the UK, Canada and Italy saw no growth through the third quarter, while Germany saw a small contraction (-0.1%) as Japan saw a steeper fall (-0.5%) while France grew only slightly (0.1%). However, the US economy remained more resilient, with a broad-based jump in consumer spending driving growth of 1.2% in the third quarter.

As we noted last month, ONS have been struggling with declining response rates to their Labour Force Survey and until March next year will be publishing a limited labour market dataset as they transition to a new methodology. The latest “experimental” statistics show little change in labour market conditions in the three months to September, with employment, unemployment and inactivity rates all broadly unchanged at 75.7%, 4.2% and 20.9%, respectively. Meanwhile, vacancies (one of the few consistent and comparable datasets that have been published) fell for the 16th consecutive rolling quarter to 957,000 in the quarter to October, down from a record high 1.3 million in the quarter to May 2022. Despite the long-running trend of falling vacancies, they remain 16% above pre-pandemic levels.

The latest earnings statistics for the three months to September show that year-on-year wage growth has eased marginally but remains near record highs. Regular pay (excluding bonuses) rose 7.7% over the year to July-September, decelerating slightly from 7.8% in the year to April-June. The slight slowing of wage growth comes despite the fastest rise in public sector pay on record (7.3%) as pay-uplifts for doctors and teachers on 1st September (backdated to April for some) boosted the overall figure. Private sector wage growth moderated to 7.8%, from 8.2% in the three months to June. Taking inflation into account, real regular pay rose 1.3% in the three months to September (when adjusting for CPIH) or 1.0% (using our preferred CPI measure).

While wage growth remains high, signs that pay pressures are easing suggest the Bank is unlikely to shift from leaving rates unchanged at the next meeting of the MPC in December, particularly as other measures of pay growth suggest that salary pressures are softening. This includes CBI surveys, which suggest wage growth to ease over the next year (with manufacturing wage growth expected to slow from 5.6% in the 12 months to October 2023 to 4.7% in the 12 months to October 2024). While we've probably reached the end of the tightening cycle now, the Bank of England estimates that over half the impact has yet to be felt. As more households come off fixed-rate mortgages, rising interest bills will weigh on disposable income and limit the scope for a recovery in consumer spending.

The near-term outlook is poor, given sticky inflation, the lagged impact of higher interest rates, and business investment facing headwinds from weak demand, high-cost pressures and ongoing labour shortages. The weakness of activity is now feeding through to a softening labour market. However, unemployment is expected to remain relatively low and with wage growth now outpacing inflation UK households are seeing the beginnings of a recovery in their purchasing power. This should help prevent any significant downturn in the economy.

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Further details

- **GDP expanded by 0.2% in September**, primarily driven by growth in the services sector. Construction output also rose, but output from the production sectors was flat. This follows 0.1% growth in August (revised down from 0.2%) and a steep 0.6% contraction in July.
  - **Services output rose** by 0.2% in September, following 0.3% in August (revised down from 0.4%). Activity rose in 8 out of 14 sub-sectors. Activity in consumer-facing services fell by 0.2% and remains 4.9% below its pre-COVID level in February 2020.
  - **Construction output also grew** (0.4%), with a 2.1% increase in repair and maintenance offsetting a 0.8% fall in new work. This rise puts an end to two consecutive months of falling construction output.
  - **Production output stagnated** in September, following falls of 0.5% in August (upwardly revised from -0.7%) and 1.1% in July. Manufacturing was broadly stable (0.1%), following a fall of 0.7% in August, driven by the manufacture of electronics (+0.20pp), and of machinery and equipment (+0.19pp).
  - The ONS pointed to anecdotal evidence that industrial action in the health sector (junior and senior doctors), higher education, rail and some parts of the bus network had all impacted activity. An unseasonably warm September helped boost construction, dairy output, hospitality, rental & leasing, and sports activities.

- **Despite the expansion in activity in September, the UK economy flatlined during the third quarter as a whole,** following growth of 0.2% in the second quarter.
    - **Household spending** fell 0.4%, following a 0.5% increase in the previous quarter.
    - **Government consumption** fell by 0.5%, following 2.5% growth in Q2, reflecting declines in spending on health (-1.4%) and education (-0.3%), most likely due to industrial action.
    - Gross fixed **investment** also fell (-2%), reflecting lower investment in transport equipment, other machinery & equipment, and dwellings. Business investment fell by 4.1% through the quarter following two consecutive quarters of strong growth (4% and 4.1% in Q1 and Q2, respectively).
    - The fall in business investment wasn't entirely surprising, however, given the temporary boost in previous quarters from the end of the super-deduction (in April) and large purchases of aircraft in Q2. Following significant revisions made in September, business investment stands 4% above its pre-pandemic (Q4 2019) level.
    - **Net trade** made a positive contribution to quarterly GDP (0.4%) with the trade deficit narrowing to 0.7% of nominal GDP from 1.5% in Q2. Export volumes increased (0.5%) driven by increasing services exports (notably other business services (which includes distribution services of energy, placement personnel, publishing and real estate), services between affiliated enterprises, and management consulting) while import volumes fell (reflecting a fall in the import of goods, mainly machinery and transport equipment).
- **Recent CBI business surveys suggest that UK private sector activity fell slightly in the quarter to October,** with output/business volumes expected to be flat over the next three months.

Experimental data shows unemployment and inactivity unchanged over the summer

- The ONS is transitioning to a new methodology in the publication of its labour market surveys, so detailed estimates of employment, unemployment and inactivity are unavailable. This is primarily because response rates to the ONS' surveys have been steadily falling in recent years. Between now and Spring 2024, the ONS will only be publishing *experimental* estimates of labour market data. The numbers below represent these new estimates.
- The employment rate stood at 75.7% in the three months to September, unchanged from the previous quarter with numbers employed rising by 38,000 to 31.56 million (the highest number since the three months to March 2020).
- The unemployment rate was broadly unchanged through the quarter and stood at 4.2% (1.42 million).
- The inactivity rate was also unchanged and stood at 20.9% (8.72 million).
- The jobs market continued a recent downtrend with the number of vacancies falling for the 16th consecutive rolling-quarter to 957,000 (though vacancies are still 16% above pre-pandemic levels).

Early signs that wage growth has peaked despite public sector wages rising at a record pace

- Nominal regular pay (excl. bonuses) rose by 7.7% over the year to July-September 2023, decelerating slightly from the 7.8% figure in the three months to June, though remaining at the third fastest rate since records began in January-March 2001.
    - Nominal regular pay growth stood at 7.8% in the private sector, slowing from 8.2% in the three months to June. Nominal pay growth accelerated in the public sector as pay-uplifts to doctors and teachers boosted growth to 7.3%, the highest figure since records began.
    - Finance & business services saw the fastest wage growth by sector (9.4%, the highest since records began), followed by manufacturing (7.7%), wholesaling, retailing, hotels & restaurants (6.5%), and construction (5.8%)
- Adjusting for CPIH inflation, real regular pay across the economy rose by 1.3% in the year to July-September, following growth of 0.1% in the April-June period. Whereas adjusting for CPI (our preferred measure of inflation) real regular pay rose 1.0% in the three months to September.

If you have any feedback on this article or would like to share any insights into the trading conditions currently facing your business, please contact us at either of the email addresses below:

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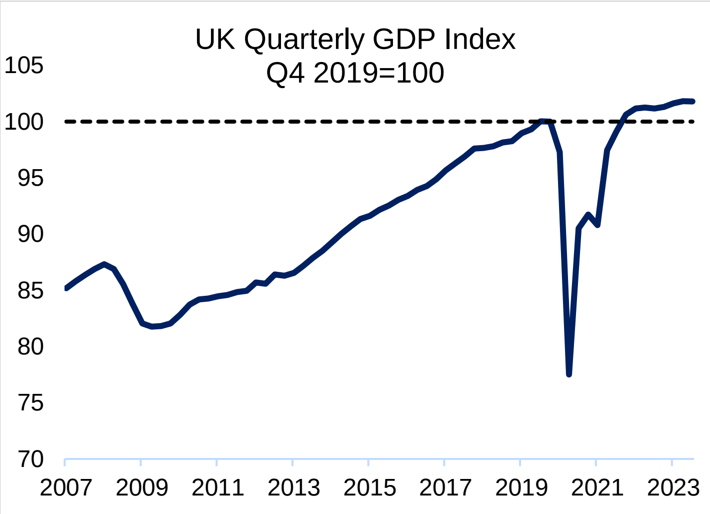
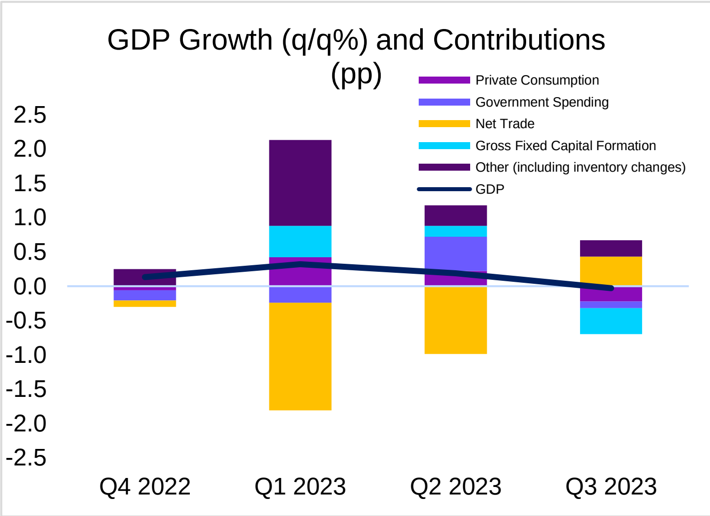
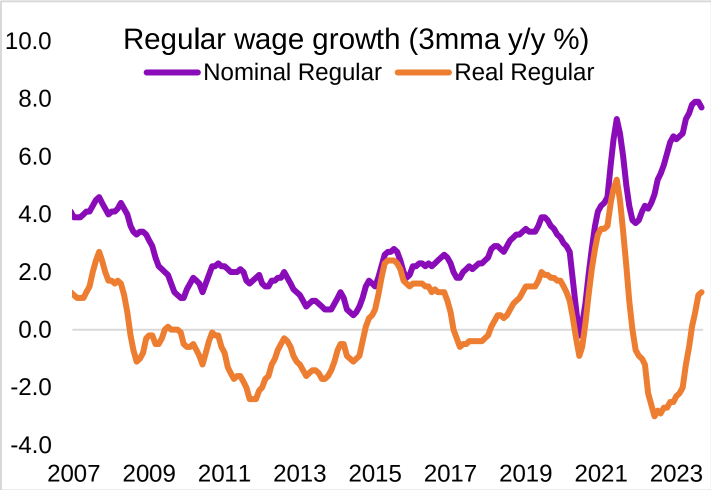
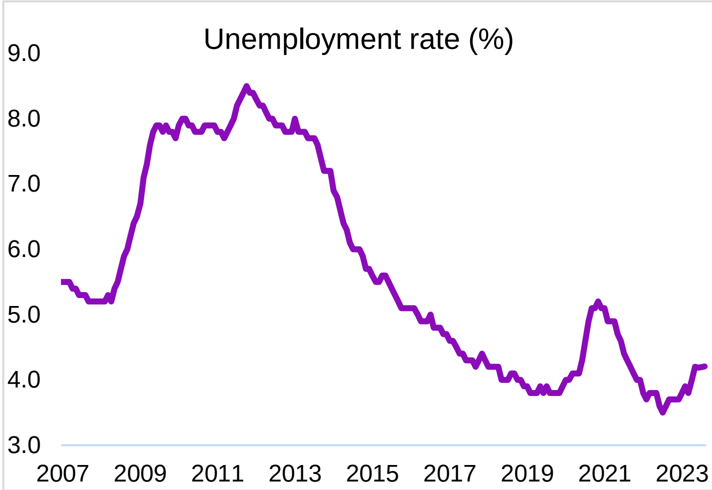





Regular wage growth (3mma y/y %)
Nominal Regular
Real Regular
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
2007
2009
2011
2013
2015
2017
2019
2021
2023


Unemployment rate (%)
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2007
2009
2011
2013
2015
2017
2019
2021
2023