

# UK Monthly Economic Update

8<sup>th</sup> January 2009

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## Monetary Policy Committee (MPC) lowers the Bank Rate by 50bps to 1.50%

Comment from Stuart Porteous, Head of RBS Group Economics:

*"Few people – and certainly not the MPC – question the challenges the UK faces in 2009. As rates head towards zero, policymakers will be forced to embark on ever more unorthodox measures to get the economy moving again. Listen carefully and you can almost hear the printing presses being cranked up."*

Click [here](#) to read our report on the options available when interest rates get to zero and the new challenges they face.

## Unemployment is on the rise

**All indicators of the health of the labour market are sending the same sobering message.** The headline unemployment rate touched 6% in October last year. Although this is still some way below the UK's long-run average of 7.9%, it's the highest figure in almost ten years (Chart 1). In absolute terms, there were 1.9mn people officially looking for a job, close to half a million more than in the lows seen in 2004. Until recently, higher unemployment predominantly reflected a rise in people entering the job market, rather than employed workers losing their jobs. But this situation has changed for the worse. Employment has already fallen by almost 200k from its highs last year. And, judging from plummeting vacancies and depressed growth forecasts, further declines are almost guaranteed.

**Deteriorating job prospects have been quick on the heels of the downturn in wider economic growth.** Economic activity has so far declined by 0.6% from its cyclical peak, but the number of people unemployed has already risen by 13%. This contrasts with the experience of the early 1990s recession, when the economy shrank more than three times as much before unemployment responded in a similar magnitude. The beginning of the 1990s downturn was characterised by 'labour hoarding' – firms maintained levels of staff for a time in spite of weaker demand. Conceivably, it may be optimal to continue to pay salaries if there are hopes of a quick turnaround in the economy and costs of redundancy are high. However, the more sensitive relationship between GDP and unemployment that we are currently observing suggests that firms are less optimistic about a quick rebound in demand this time.

## The UK economy is undergoing a correction in sectoral imbalances

**The financial services and construction industries created the vast majority of new jobs in the last five years.** The UK economy generated an additional 1.3mn jobs over the 2003-07 period. But job growth was not spread evenly (Chart 2). The manufacturing industry shed 600k jobs, while finance, finance-related services and construction saw their employment levels shoot up by 1mn. The only other significant contributor to job growth was the public sector.

**The current recession will go hand in hand with further structural adjustments.** In future UK growth is likely to be less reliant on financial services and construction. This suggests that these two sectors will be hit disproportionately by upcoming cuts in employment. The rationale is straightforward. First, the UK property market remains in a difficult state. Residential and commercial property prices are already c.20% and c.30% below their peaks, respectively. And prices are widely expected to fall further. In response, construction of new houses has almost halved in the last twelve months with no imminent recovery in sight. Second, the UK is highly indebted, both by historic and international standards (Chart 3). In the current credit environment, this means that demand for new lending and associated services is coming under significant pressure.

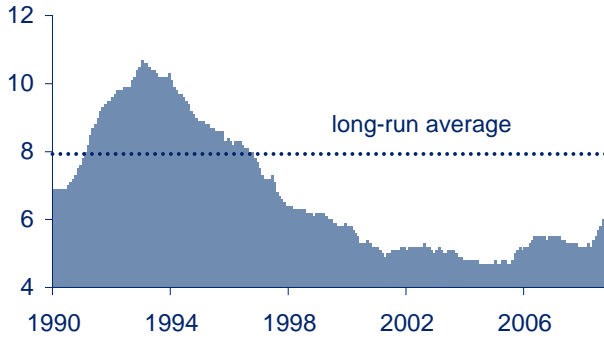
## A more flexible labour force reduces redundancy costs

**Falling unionisation rates and more part-time workers have increased labour market flexibility.** Close to 40% of all employees were union members in the early 1990s, while this figure fell below 28% in 2007, according to the latest Trade Union Membership report. Similarly, the number of people in part-time jobs has grown roughly twice as quickly as the full-time employed since the 1990s. It is less expensive to lay-off part-time workers – there are smaller redundancy packages and part-time employees tend to have less firm-specific expertise that is costly to re-acquire in an upswing. Declining redundancy costs could therefore help explain the swift tick-up in unemployment.

**Chart 1: unemployment on the rise, but still significantly below the long-run average**

(in %)

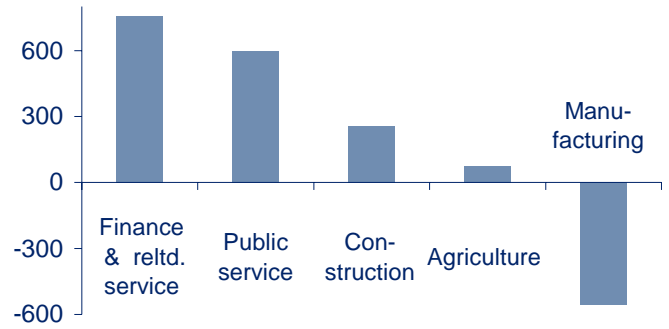
Source: Datastream



**Chart 2: change in number of jobs in selected industry sectors 2003-07**

(in thousands)

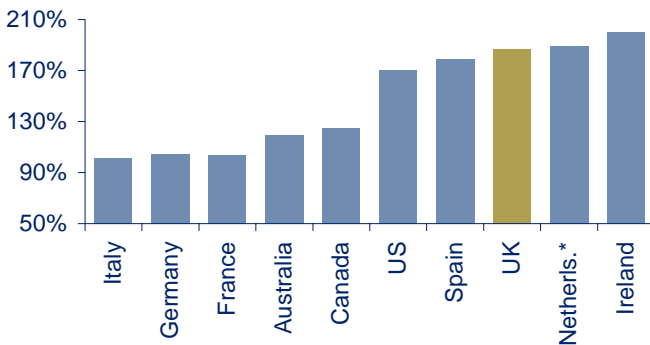
Source: Datastream



**Chart 3: the UK is highly leveraged (private credit/GDP, 2007)**

(in %)

Source: IMF, Federal Reserve; \*interest relief is given on mortgage debt



**Interest rate facts & figures**

Source: Bank of England, RBS Group

	Bank of England	RBS Group
<b>Current rate</b>	1.50%	1.50%
<b>Since</b>	8 <sup>th</sup> Jan 09	8 <sup>th</sup> Jan 09
<b>Month ago</b>	2.00%	2.00%
<b>Year ago</b>	5.50%	5.50%

Minutes of December MPC meeting released: 21<sup>st</sup> Jan 2009  
 Next MPC announcement: 5<sup>th</sup> February 2009  
 Next Inflation Report published: 11<sup>th</sup> February 2009

**Following the decision, The Royal Bank of Scotland, National Westminster Bank plc and Ulster Bank Ltd. lowered their Base Rate by 50bps to 1.50%**

All in %	Retail Price Index (includes mortgage payments)	Consumer Price Index
	RPI	CPI
2007	4.5	2.9
	4.4	2.6
	3.9	1.8
	4.2	2.1
2008	4.0	2.4
	4.4	3.4
	4.9	4.8
	2.8	4.0
2009	-0.3	2.5
	-1.7	1.3
	-3.0	0.2
	-2.3	0.4
2010	0.9	2.0
	2.5	2.4
	2.8	2.6
	3.5	2.7

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