

# UK Monthly Economic Update

7<sup>th</sup> May 2009

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## Monetary Policy Committee (MPC) keeps the Bank Rate unchanged at 0.5%

Comment from Stephen Boyle, Head of RBS Group Economics:

*"Despite the biggest stimulus in UK history, the recession continues to deepen. But don't panic, the policies put in place will work eventually. The Bank of England has now decided to expand its asset purchase scheme rather than stay its hand. Given the lag between action and effect, this can't have been an easy call."*

## The economy slumps more than expected

**The first three months of 2009 were the worst for the UK economy in three decades.** Output fell at its fastest rate since 1979 in Q1, as the speed of recession accelerated to -1.9% q/q. Most investors expected a moderation, or at least a levelling off, in the pace of the recession, but this did not come to pass. This decline brings the cumulative output loss over the past nine months to 4.1%, surpassing the peak-to-trough contraction of the 1990s and approaching the 6% decline seen in the early 1980s.

**Whilst a poor performance for the economy was expected, the drivers of the downturn came as a surprise.** This recession was forecast to be led by a retrenchment in consumer spending and financial services. In fact, it was investment and manufacturing that declined the most. The full GDP breakdown will be released later this month, but early figures show manufacturing slipped 6.1% on the quarter while the service sector only tripped up a little, falling just 1.1%. And it's quite likely consumer spending surpassed dismal expectations: a strong outturn from retail sales suggests that at least one aspect of spending has not fully succumbed to the recession.

## Retail spending continues to confound expectations – but for how much longer?

**Napoleon said the UK is a nation of shopkeepers.** True or not, it certainly seems that we are a nation of shoppers. Although the country has been in recession for nine months, retail spending continues to grow, bucking the economy's downward momentum. Sales volumes for the three months to March (adjusted for price changes) were up 1% on the previous three months, the strongest q/q performance in a year. But that doesn't tell the full story: compared to the same period last year, total expenditure in the UK fell 4% but consumer spending in retail outlets increased by almost 2% (chart 1). Retailers took a larger share of every pound spent.

**Developments in the job market can help us understand this phenomenon.** The unemployment rate has increased sharply but that's not the whole story. The inflow into unemployment has been driven by more people looking for work (who weren't looking previously), not just by more people being made unemployed (chart 2). The number of people in work has fallen 274K from its peak in May last year, while the ranks of the unemployed have expanded by almost half a million. This is unusual - in a recession, as workers lose their jobs, many leave the labour market (often because a partner is still employed or to pursue other opportunities like further education). This time around the opposite has happened - as the recession deepens, more people have entered the labour market. The increase in unemployment has thus had limited impact on retail spending because, statistically speaking, nearly half of the newly unemployed were not working beforehand, and most people who had jobs before still have them.

**Neither retail spending nor employment can hold out indefinitely.** Because labour market indicators lag wider economic conditions, the substantial contraction the economy has experienced over the last six months is only starting to be felt. In Q1 employers tried to retain workers, reducing costs by reducing working hours or making jobs part-time. But firms themselves are struggling to hang on: insolvencies increased almost 60% on the year, reaching their highest level since the end of the 1990's recession. With external demand still weak, the severity of the recession will push more businesses into bankruptcy, reducing job prospects. Cracks are also showing in the retail market: overall spending has held up but discretionary spending and big ticket purchases are already in decline (chart 3). New car registrations have been falling for 12 months and spending at non-food stores for two.

**As households continue to repair their balance sheets, wages and income will come under pressure from a deteriorating labour market.** Retail spending will increasingly feel the pinch as households increase savings and reduce consumption.

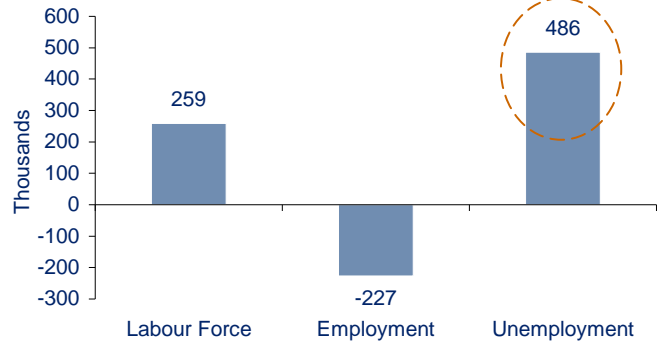
**Chart 1: Retail spending resilient as GDP tumbles**

(% Y/Y)  
Source: Thomson Datastream



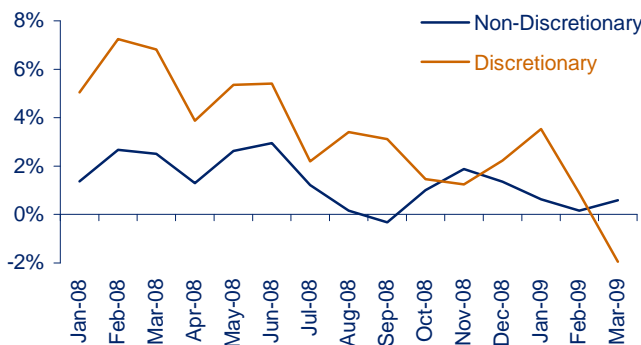
**Chart 2: Unemployment rising faster employment is falling**

Change since January 2008  
Source: Thomson Datastream



**Chart 3: Retail spending on discretionary items falling**

(% Y/Y)  
Source: Thomson Datastream



**Interest rate facts & figures**

Source: Bank of England, RBS Group

	Bank of England	RBS Group
<b>Current rate</b>	0.5%	0.5%
<b>Since</b>	5 <sup>th</sup> Mar 09	5 <sup>th</sup> Mar 09
<b>Month ago</b>	0.50%	0.50%
<b>Year ago</b>	5.00%	5.00%

Minutes of May MPC meeting released: 20<sup>th</sup> May 2009  
Next MPC announcement: 4<sup>th</sup> June 2009  
Next Inflation Report published: 13<sup>th</sup> May 2009

**Following the decision, The Royal Bank of Scotland, National Westminster Bank plc and Ulster Bank Ltd. kept their Base Rate unchanged at 0.5%**

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
	2.7	3.9
2009	-0.1	3.0
	-1.3	1.6
	-2.4	-0.2
	-1.8	-0.6
2010	0.8	0.5
	1.5	0.5
	1.7	1.0
	1.8	1.0

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