Dorset LEP - Monthly Economic Commentary – July 2023

Moors Economics Limited – July 2023

This short paper highlights some key economic developments over the past 1-2 months – both nationally and relevant to the local Dorset and Bournemouth, Christchurch and Poole (BCP) economy.

1. Context – national and international trends

The latest Gross Domestic Product (GDP – a measurement of total value of goods and services produced in the UK economy) figures released by the Office of National Statistics (ONS) shows that the economy had a slight bounce back from the fall seen in March. Monthly GDP grew by 0.2% in April, following a fall of 0.3% in March (which has had no revisions). Each of the broad sectors had contrasting trends, when compared to previous month's performance. For example, the service sector grew by 0.3% in April, after falling by 0.5% in March. However, production fell by 0.3% in April, following strong growth of 0.7% in March. Similarly, construction fell by 0.6% in April, following growth of 0.2% in March.

However, looking over a slightly longer timeframe, the service sector only grew by 0.1% in the three months to April, while production and construction grew by 0.2% and 1.6% respectively. The below chart shows that the contribution of the broad sectors to overall growth (or what growth there is) has fluctuated wildly, particularly the service sector. Overall, output in the UK economy in April 23 was only 0.5% higher than the previous year, illustrating the weak growth trend that persists.

As well as weakness in the UK economy, there is weakness in neighbouring economies. The eurozone fell into recession this winter. The economy of the 20-nation bloc contracted by 0.1% in the first 3 months of 2023. As in other regions, the eurozone has been hit by rising food and energy prices that have weighed on household spending – itself falling by 0.3% in the first quarter of 2023, following a 1% fall at the end of 2022.

Chart 1: Monthly UK GDP (2019=100)

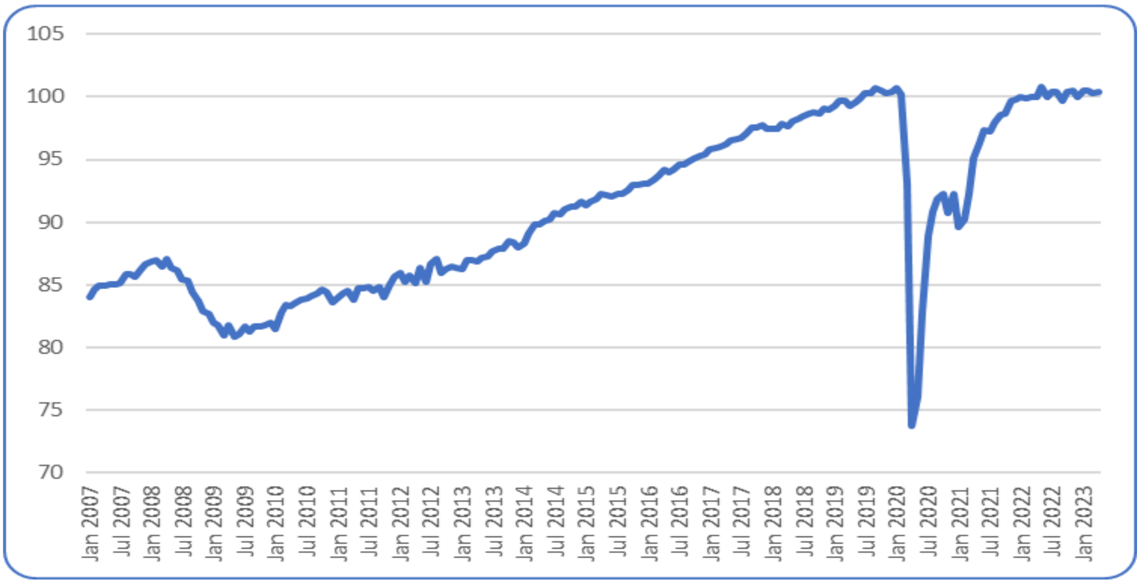
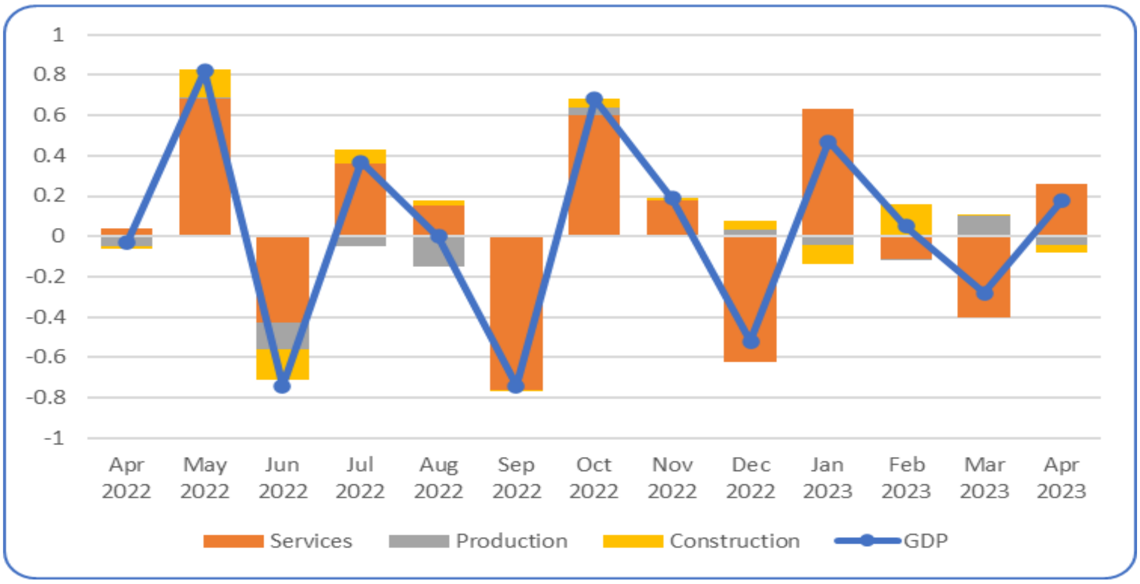


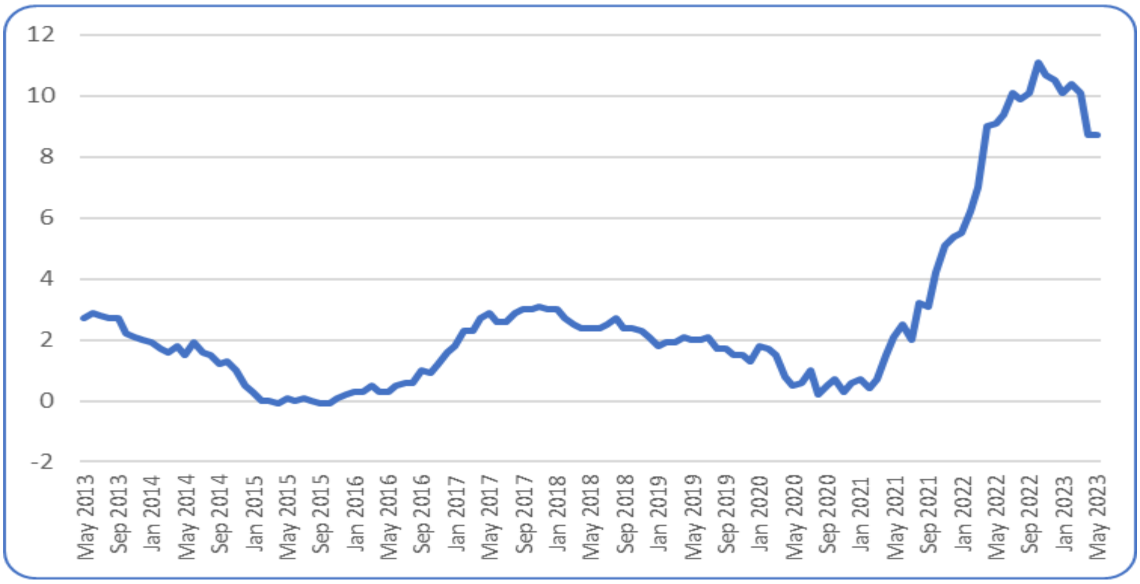
Chart 2: Contributions to monthly GDP growth (percentage points)

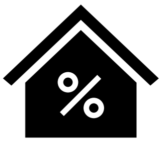


The latest inflation data for May 23 showed that price increases remain stubbornly high. The Consumer Price Index (CPI – a measurement of price increases over the last month compared to the previous 12 months) to May was 8.7%, unchanged from April. Food inflation remained particularly high, remaining at 18.4% in the 12 months to May 2023, although slightly lower than the 19.1% seen in April. Inflation in relation to restaurants and hotels also remains above 10% - highlighting the increasing cost of eating out for many.

However, there are some indications from food retailers that there are early signs of food inflation easing slightly. Both Sainsbury's and Tesco's have recently feel that evidence indicates that food prices are not rising as fast as they were, and that wholesale prices have fallen in recent months for some goods (although that has in turn led to questions about whether these have been passed onto lower prices charged to consumers by the supermarkets). Both major supermarkets feel that food inflation may have peaked, but prices are likely to remain high. Prices remain high for essentials such as rice and potatoes, as weather issues and locked-in increases in the price of labour and energy continue to bite. Some of the supermarkets and other food retailers also cited increased regulations relating to food imports which are also having an adverse impact on prices.

Chart 3: Consumer Price Inflation (% annual increase)





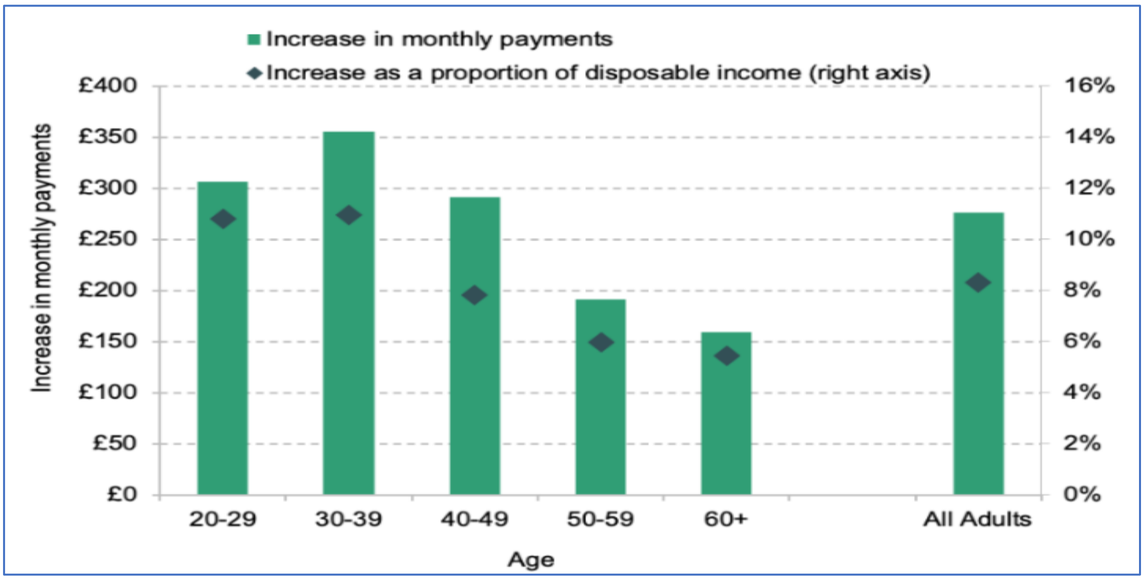
The persistent high inflation has led to further increases in the bank base rate announced by the Bank of England. The recent announcement at the end of June of a further 0.5% rise in the base rate (noting that it was a 7-2 vote on the bank's Monetary Policy Committee), now means it stands at 5% - its highest level in 15 years. The base rate has now been increased 13 times since December 2021. This – combined with market expectations that further rises will still occur – means that the interest rates on mortgages have reached levels similar to those seen during the mini 'financial crisis' last November.

A typical five-year fixed mortgage deal now has an interest rate of more than 6%. The average two-year fixed deal is now 6.47%. Mortgage lenders have been increasing rates and withdrawing deals recently. It is estimated that more than 400,000 people will see their existing fixed deals end between July and September.

Separate analysis by the Resolution Foundation estimates that total annual mortgage repayments could rise by up to £15.8bn by 2026, and by £2,900 for the average household re-mortgaging next year. They estimate that the increase of a typical cost of mortgage repayments will increase by 3% of typical household income this year – even bigger than the 2.4% increase in 1989 when interest rates also increased quickly (although a lower proportion of households now have a mortgage compared to in the late 1980s).

Further analysis undertaken by the Institute of Fiscal Studies has drawn out the implications of the higher mortgage costs on household living standards and disposable income. In March 2022, households with a mortgage were spending an average of £670 per month on mortgage payments, £230 of which was on interest payments. The IFS estimates that – following the latest rate increases - on average those in mortgage-holding households will pay almost £280 more each month, with 30-39-year olds paying almost £360 more. This will be a significant hit to mortgagors' disposable incomes (i.e. incomes after mortgage payments) at a time that families are already under strain – on average disposable incomes will fall by 8.3%, with those aged 30-39 again seeing the biggest hit (almost 11%). For some the rise will be substantially larger: almost 1.4 million – 690,000 of whom are under 40 – will see their

Chart 4: Average increase in mortgage payments amongst adults in mortgage-holding households, by age

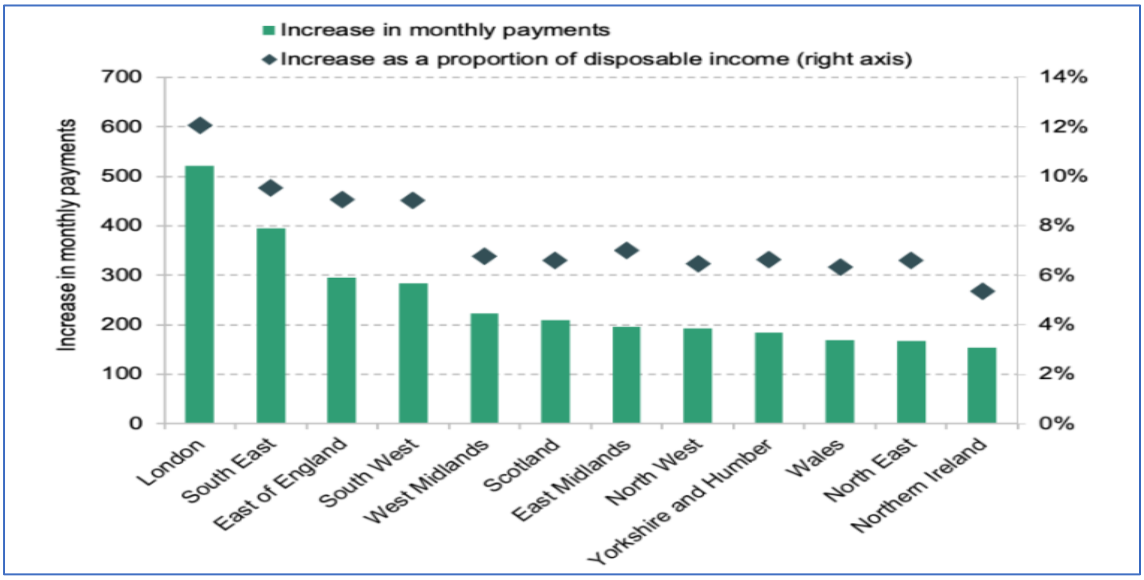


Source: Institute of Fiscal Studies

As well as differences by age, there are also differences between the regions, with average rises amongst mortgagors ranging from just over £150 in Northern Ireland to £390 per month in the South East and £520 in London. Falls in disposable income will be roughly 6-7% in much of the North of England, Midlands, Scotland and Wales, but will reach 9.4% in the South East of England and 12% in London. For the South West, the typical increase in monthly payments for mortgage holders equates to c£280 – equivalent to a 9.5% increase as a proportion of disposable income.

Overall, 60% of those with a mortgage (roughly 19% of adults) are set to spend more than a fifth of their incomes on mortgage payments. This is a substantial increase. In March 2022, only 36% of mortgage holders were in this position (around 12% of adults at that time.

Chart 5: Average increase in mortgage payments amongst adults in mortgage-holding households, by region

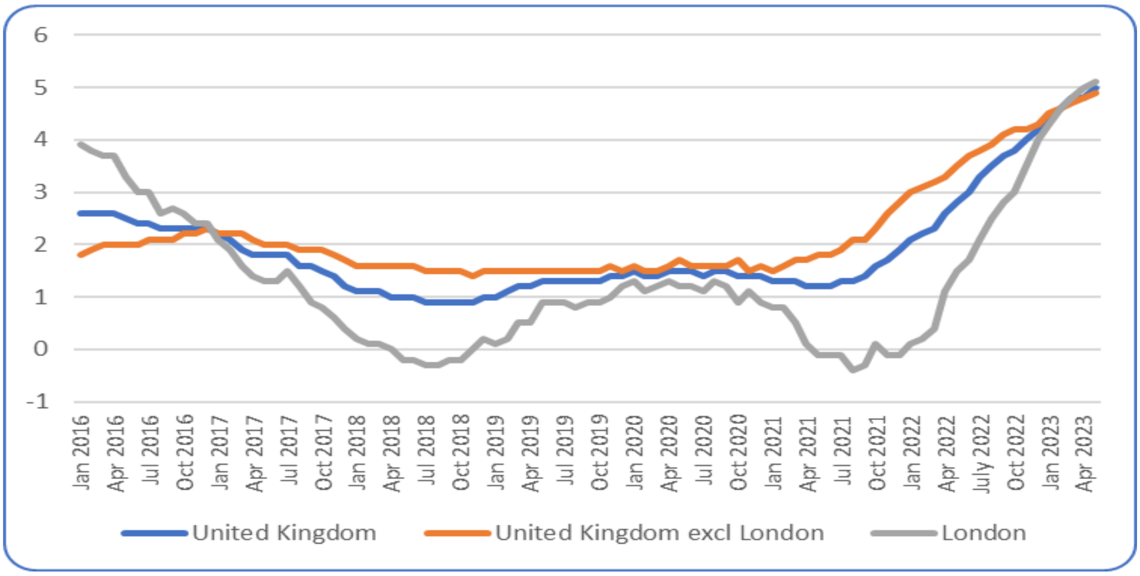


Source: Institute of Fiscal Studies

Alongside the significant increases in monthly payments for mortgage holders, there is also pressure on rents. Local housing allowances, which govern the maximum amount of support low income private renters can get for their rent, has been frozen in cash terms since 2020. However, at the same time, rents for new and existing lets have increased by more than a fifth on average over that time.

Overall, rental levels are increasing quickly. [Annual rental prices across the UK rose by 5% in May, the highest rate for the 7 years since this data began to be collected.] In the South West, the annual increase was slightly lower – at 4.6%.

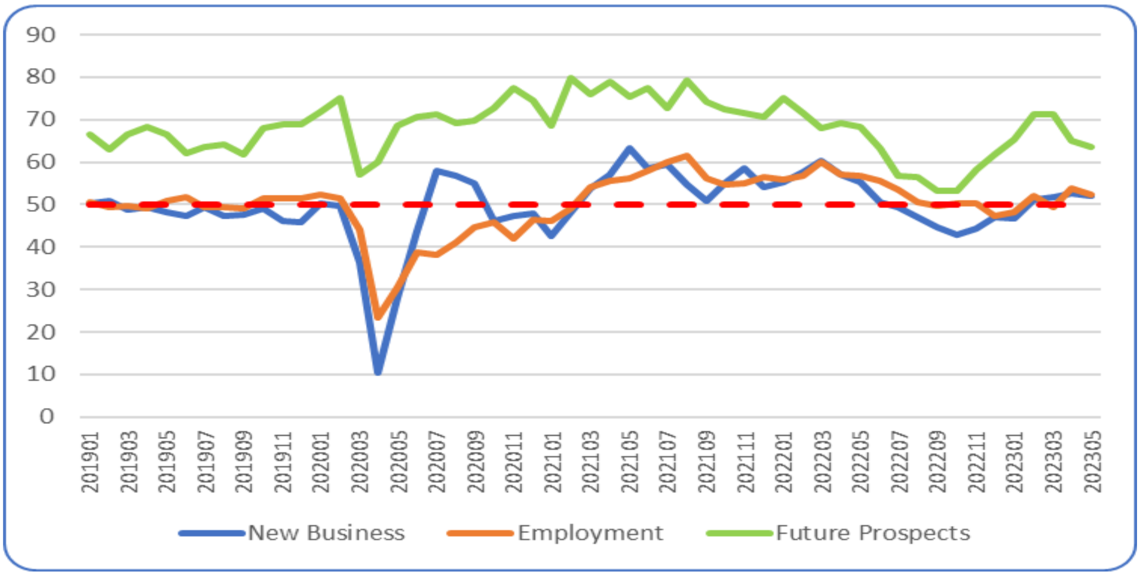
Chart 6: Index of private housing rental prices percentage change over 12 months, UK and London



The regional South West Purchasing Managers Index (PMI) produced by S&P Global on behalf of NatWest is a seasonally adjusted index that measures the month-on-month change in sentiment from a panel of businesses. The indices on several measures vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease.

The latest data suggests South West businesses are broadly neutral in sentiment in terms of employment and the level of new business, but still hold a positive view in terms of future prospects, although less positive than a couple of months ago. Referring back to the earlier commentary around inflation, two-thirds of businesses still expect to continue to need to charge customers higher prices, and this is as a consequence of the higher input costs they are facing themselves – including labour.

Chart 7: NatWest Purchasing Managers Index – South West – May 23 (>50 increasing confidence, <50 decreasing confidence)



The latest monthly residential market survey undertaken by the Royal Institute of Chartered Surveyors (RICs) indicates that paints a picture of sentiment which is a little less downbeat, evidenced in indicators on demand and sales returning their least negative readings in over a year. However, it also recognised that the recent interest rate rises may place renewed pressure on sales market in the months ahead.

Turning to house prices, a net balance of -30% of respondents cited a further fall in national prices during May. Looking ahead, the national house price expectations series (for the coming twelve months) now sits in broadly neutral territory, posting a net balance of just -3%. However, this appears slightly more benign than the view of some lenders. For example, Halifax recently estimated that house prices are falling at their fastest rate in 12 years. However, it is important to note that this rate of annual decline reflects somewhat of historically high prices in 2022 – annual growth peaked at 12.5% in June 2022, boosted by the temporary cut in Stamp Duty.

Interestingly, new instructions were reported to have risen by a net balance of +14% of survey participants during May. Consequently, this breaks a run of thirteen successive negative monthly readings beforehand and marks the strongest reading for the new listings metric since March 2021. Alongside this, average stock levels on estate agents books have picked up slightly in recent months.

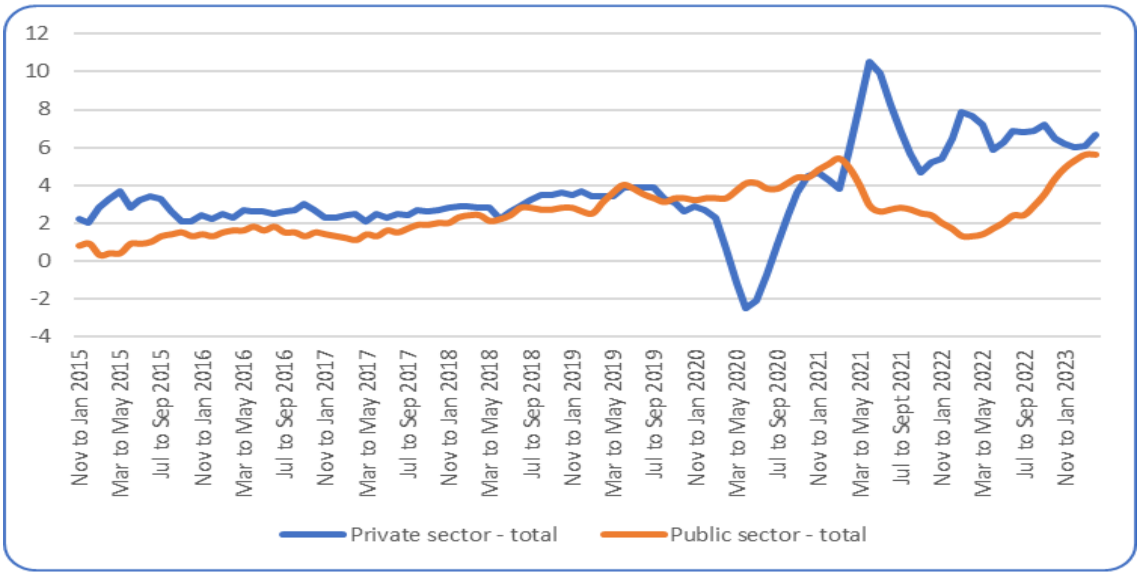
Some commentators attribute some of the resilience of the housing market in the face of higher interest rates with two factors: first, the UK still has a growing population, with net migration exceeding 600,000 in 2021. Second, most homebuyers have yet to feel the pain of the higher interest rates because they remain on fixed-rate mortgages (estimated to be around 85% of mortgage holders – although many of these will need to find new deals shortly in a market of higher rates and fewer deals).

2. Pay – the impact of inflation and a smaller workforce

The latest ONS estimates suggests that that the annual growth rate of average weekly earnings, including bonuses, was 6.5 per cent in the three months to April, while pay growth excluding bonuses was 7.2 per cent - representing the largest growth rate in regular pay recorded outside of the pandemic period. The disparity in public and private-sector wage growth has risen for the first time in six months, with private sector regular pay growing by 7.6 per cent while regular pay in the public sector grew by 5.6 per cent.

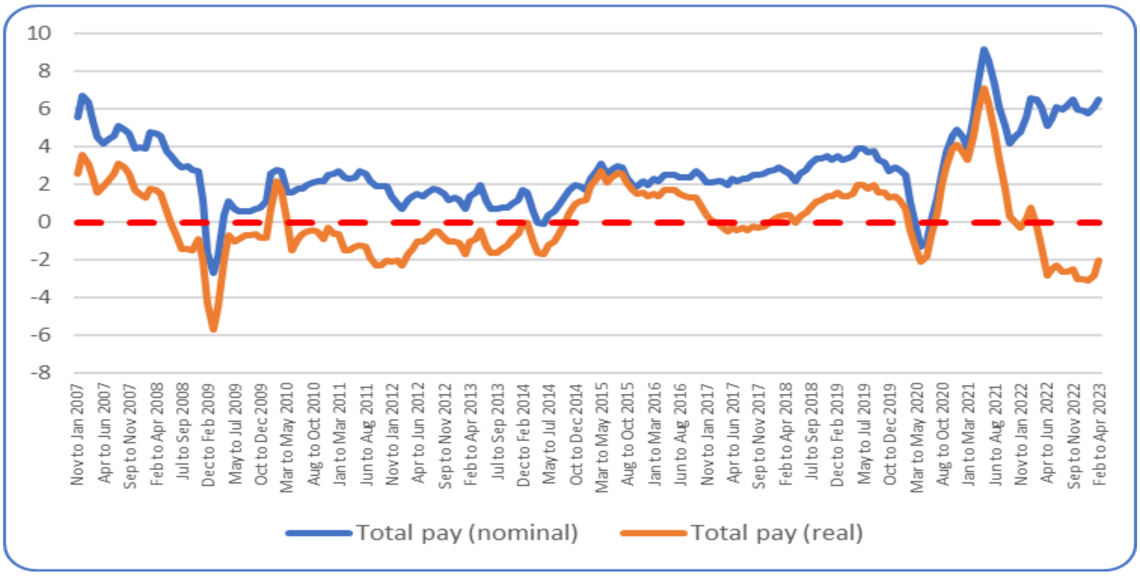
In general, the upward pressure on nominal pay growth can be explained (at least in part) by the shrinking workforce over the past couple of years – although there are signs that this is now reversing (see later comment). The overall picture still remains of a relatively tight labour market.

Chart 8: Average weekly earnings annual growth rate for total pay (including bonuses)



Growth in employees' average total pay (including bonuses) was 6.5% and growth in regular pay (excluding bonuses) was 7.2% in February to April 2023. For regular pay this is the largest growth rate seen outside of the coronavirus pandemic. However, growth in total and regular pay fell in real terms (adjusted for inflation) on the year in February to April 2023, by 2.0% for total pay and 1.3% for regular pay.

Chart 9: Real average weekly earnings single-month growth rates (%)

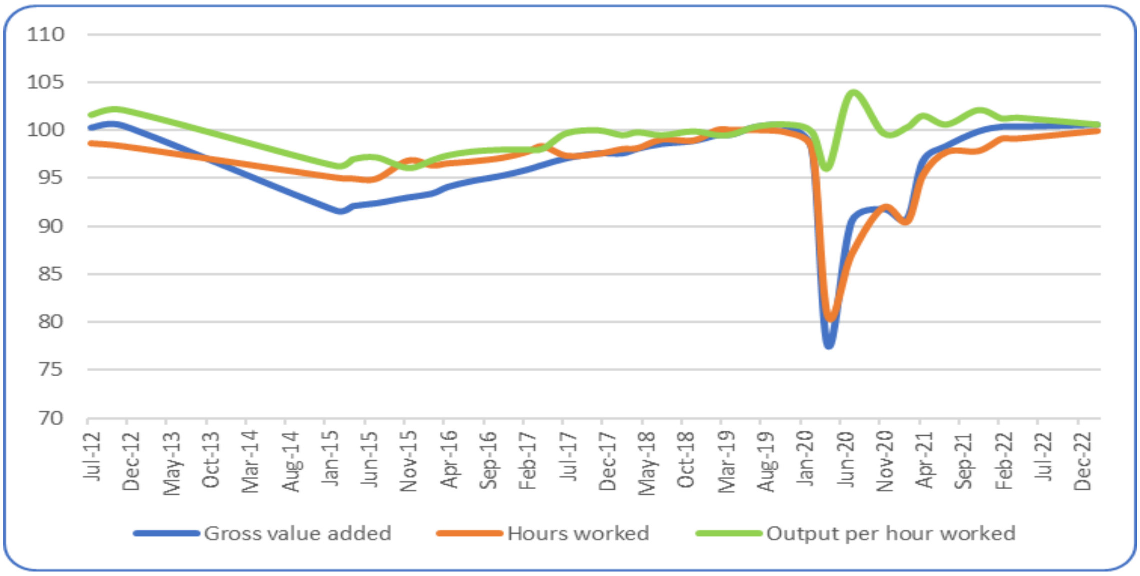


3. The continuing productivity conundrum

The ONS's preliminary estimate of UK output per hour worked was 0.6 per cent lower than the first quarter of 2022, representing the weakest annual growth in this estimate of productivity since 2013, excluding the pandemic period (noting that these flash estimates can be quite volatile). This was driven by a quarterly increase in the GVA (0.1%), and a bigger increase in the number of hours worked (1.6%).

In Quarter 1 2023, preliminary estimates of UK output per worker were 0.9% lower than the same quarter a year ago, and it remained unchanged compared with the period immediately before the coronavirus pandemic.

Chart 10: Output per hour worked, gross value added, hours worked (2019=100)



4. UK Labour Market Trends

The number of people in employment across the UK increased to a record high in the latest quarter with increases in both the number of employees and self-employed workers. The timelier estimate of payrolled employees for May 2023 shows a monthly increase, up 23,000 on the revised April 2023 figures, to 30m (although should be treated as provisional).

The unemployment rate for February to April 2023 increased by 0.1 percentage points on the quarter to 3.8%. The increase in unemployment was driven by people unemployed for up to 12 months.

Average hours worked have now returned to levels similar to those seen before the pandemic and increased in the last quarter. This increase was driven by women, who reached a record high average hours worked.

The economic inactivity rate decreased by 0.4 percentage points on the quarter, to 21.0% in February to April 2023. Looking at economic inactivity by reason, the quarterly decrease was largely driven by those inactive for other reasons and those looking after family or home. Meanwhile, those inactive because of long-term sickness increased to a record high.

In March to May 2023, the estimated number of vacancies fell by 79,000 on the quarter to 1,051,000. Vacancies fell on the quarter for the 11th consecutive period and reflect uncertainty across industries, as organisations continue to cite economic pressures as a factor in holding back on recruitment.

Chart 11: Number of vacancies in the UK, seasonally adjusted (000s)

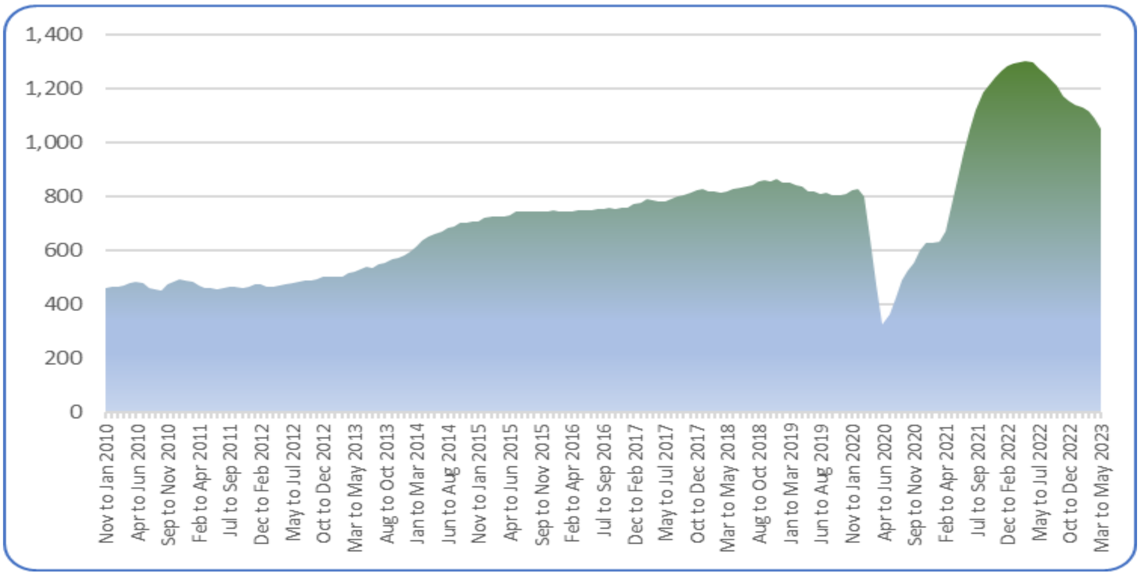
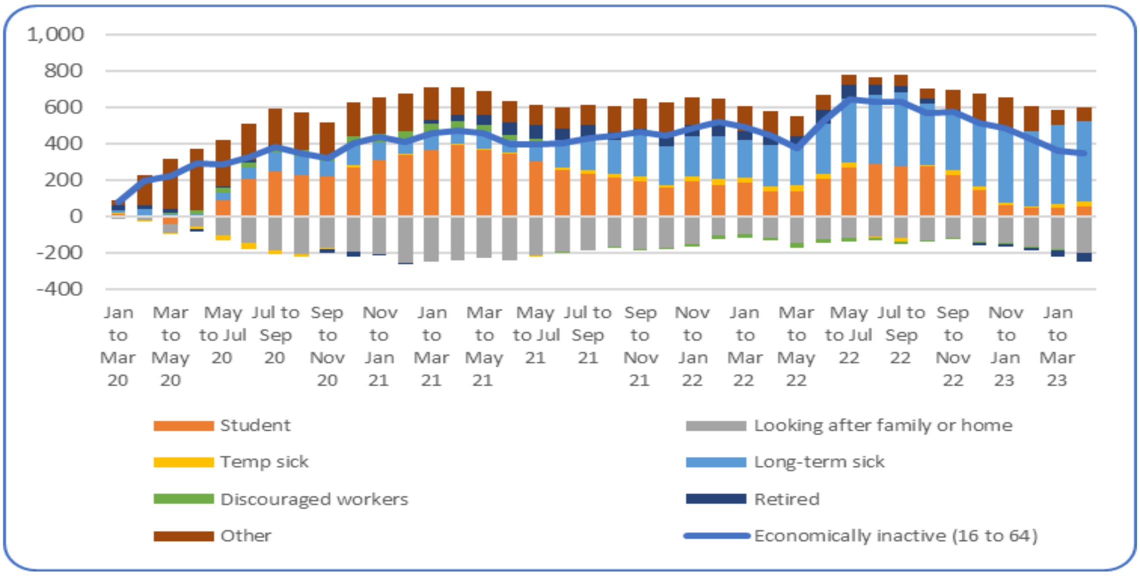


Chart 12: UK economic inactivity by reason, people aged 16 to 64 years (000s)



Increases in economic inactivity in the first year of the pandemic were largely driven by those aged 16 to 24 years, while more recent increases were driven by those aged 50 to 64 years. In the latest quarter there were decreases in the economic inactivity rates for all age groups, although not significant for the targeted 50-64 age group.

The increase in economic inactivity since the start of the coronavirus pandemic had been largely driven by those who were students and the long-term sick. The decrease in economic inactivity during the latest quarter (February to April 2023) was largely driven by those inactive for other reasons and those looking after family or home. Meanwhile, those inactive because of long-term sickness increased to a record high.

5. Local Labour Market Indicators (LMI)

Jan 2022 – Dec 2022				
	Employment rate (%) (aged 16-64)	**Unemployment rate (%) (aged 16-64)**	**Economic inactivity rate (%) (aged 16-64)**	**Claimant Count proportion (%)**
BCP Council area	77.7	4.1	18.9	3.4
Dorset Council area	76.7	1.6	22.0	2.4
Dorset LEP area	77.2	2.9	20.3	3.0
England	75.8	3.6	21.5	3.8