Article

Quarterly economic commentary: October to December 2021

Economic commentary for the latest quarterly national accounts, prices and labour market indicators.

Contact:
Sumit Dey-Chowdhury
economic.advice@ons.gov.uk
+44 207 592 8622

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1 . Main points

- The UK economy expanded by 1.3% in Quarter 4 (Oct to Dec) 2021, while there was a bounce back in January 2022 following the contraction in December that reflected the effects of the Omicron variant.

- There was a narrowing in the current account deficit in Quarter 4 2021, as the UK ran a surplus on its net investment income for the first time since 2011.

- There has been a further tightening in the labour market as it continues to recover from the coronavirus (COVID-19) pandemic, as vacancies in all industries are now above their pre-coronavirus pandemic levels.

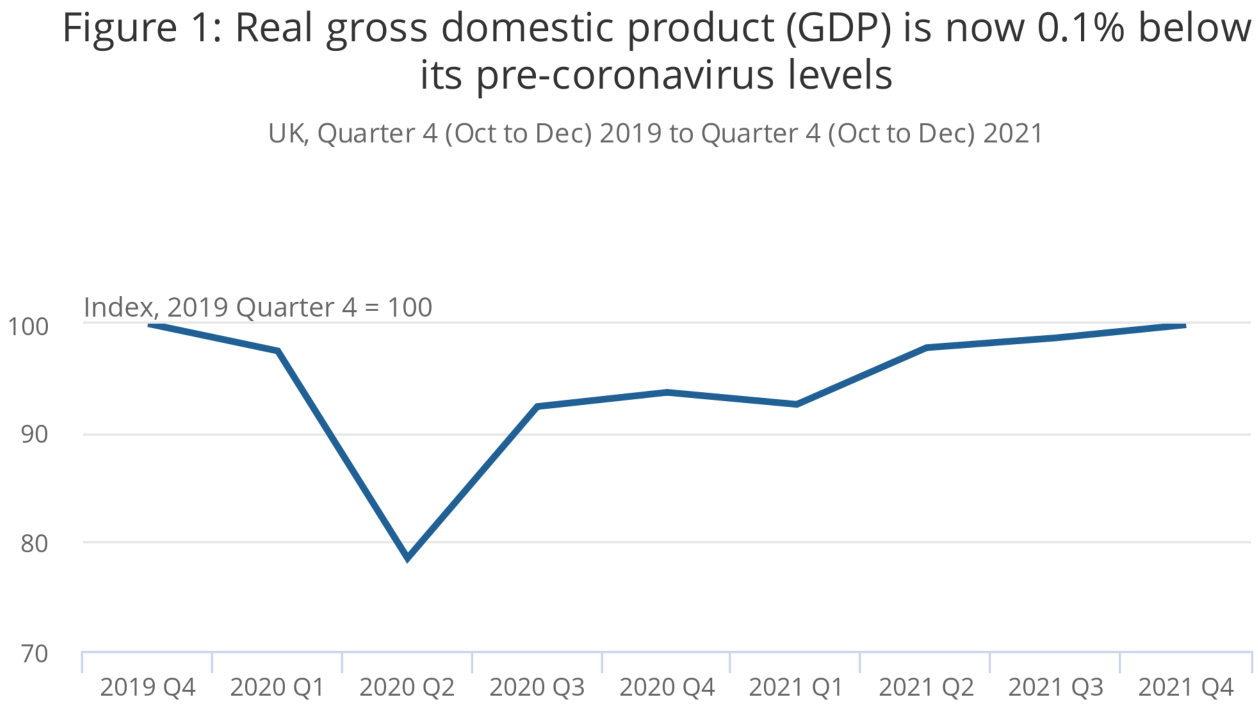
- The annual rate of consumer price inflation has risen to its highest rate since March 1992, reflecting domestic and global price pressures.

2 . National accounts

The UK economy expanded by 1.3% in Quarter 4 (Oct to Dec) 2021, leaving gross domestic product (GDP) 0.1% below its pre-coronavirus (COVID-19) pandemic level (Figure 1). A rise in the number of GP visits at the start of the quarter, a large pickup in COVID-19 testing and tracing activities, and the extension of the vaccination programme helps to explain some of the quarterly increase in GDP.

Figure 1: Real gross domestic product (GDP) is now 0.1% below its pre-coronavirus levels

UK, Quarter 4 (Oct to Dec) 2019 to Quarter 4 (Oct to Dec) 2021



Source: Office for National Statistics – GDP Quarterly National Accounts

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

2. Index is referenced to Quarter 4 (Oct to Dec) 2019.

Following the monthly contraction in December, there was a bounce back in January 2022 as GDP increased by 0.8%. This rebound reflected a pickup in consumer-facing service industries, implying only a limited effect of the Omicron variant, while the increase in the Test and Trace programme and GP appointments led to an increase in health output.

Modelling by the OECD shows that recent geopolitical developments in Ukraine are expected to lead to higher consumer price inflation and reduce global output this year. The recent increase in energy and commodity prices will feed into domestic and global inflationary pressures, even though the UK has limited direct linkages to trade with Russia and trade with Ukraine. These countries export commodities that are important intermediate inputs and recent evidence from the Bank of England highlights how businesses expect this to exacerbate shortages of some tradable goods.

Household savings have increased over the pandemic, given the larger impact on consumption than on income. In Quarter 4 2021, there was a further fall in the household saving ratio to 6.8% (Figure 2). There was a further rise in household consumption in the latest quarter, particularly in transport, net tourism, and clothing and footwear. There was a slight decline in real household disposable income in Quarter 4 2021, reflecting the effects of higher inflation. The Office for Budget Responsibility's Economic and fiscal outlook now forecasts the increase in consumer price inflation to lead to the largest decline in living standards on record. Given the expected intensifying on the squeeze on living standards, a larger drawdown of these built-up savings is now expected.

Figure 2: Households have reduced their flow of savings in recent quarters

Households' saving ratio, Quarter 1 (Jan to Mar) 2000 to Quarter4(Oct to Dec) 2021

Source: Office for National Statistics – Quarterly Sector Accounts

Householdshave recently reduced the rate in which deposits have been made with UK banks and building societies, which had reached record highs earlier in the coronavirus pandemic. However, there was an increase in Quarter 4 2021.There has been a further increase in these household deposits in January 2022. These are lower than the average net inflows of monthly deposits over the previous 12 months, although these are still higher than prior to the pandemic.

Private non-financial corporations (PNFCs) increased their net lending in the final quarter of 2021, primarily reflecting a fall in dividend payments to shareholders. There was an increase in businesses investment inQuarter4 2021.There is evidence that investment intentions continue to be strong, reflecting an increase in demand and a tight labour market. However, there were signs that rising input costs would be a constraint on their capital expenditure.

Public sector net borrowing (PSNB) was £13.1 billion in February 2022. This lower borrowing compared with a year ago reflects higher tax revenues, particularly Value Added Tax (VAT) and Pay-As-You-Earn Income Tax. This includes the effect of higher nominal spending and the tightening in the labour market. There was a fall in furlough subsidy payments on the year. However, there was a further rise in interest payments as increases in inflation fed through into higher debt payments on index-linked UK government bonds. The latest Office for Budget Responsibility forecasts show an improved PSNB outlook for the next five years, though PSNB is higher in the financial year 2022 to 2023 reflecting the direct and indirect effects of higher inflation.

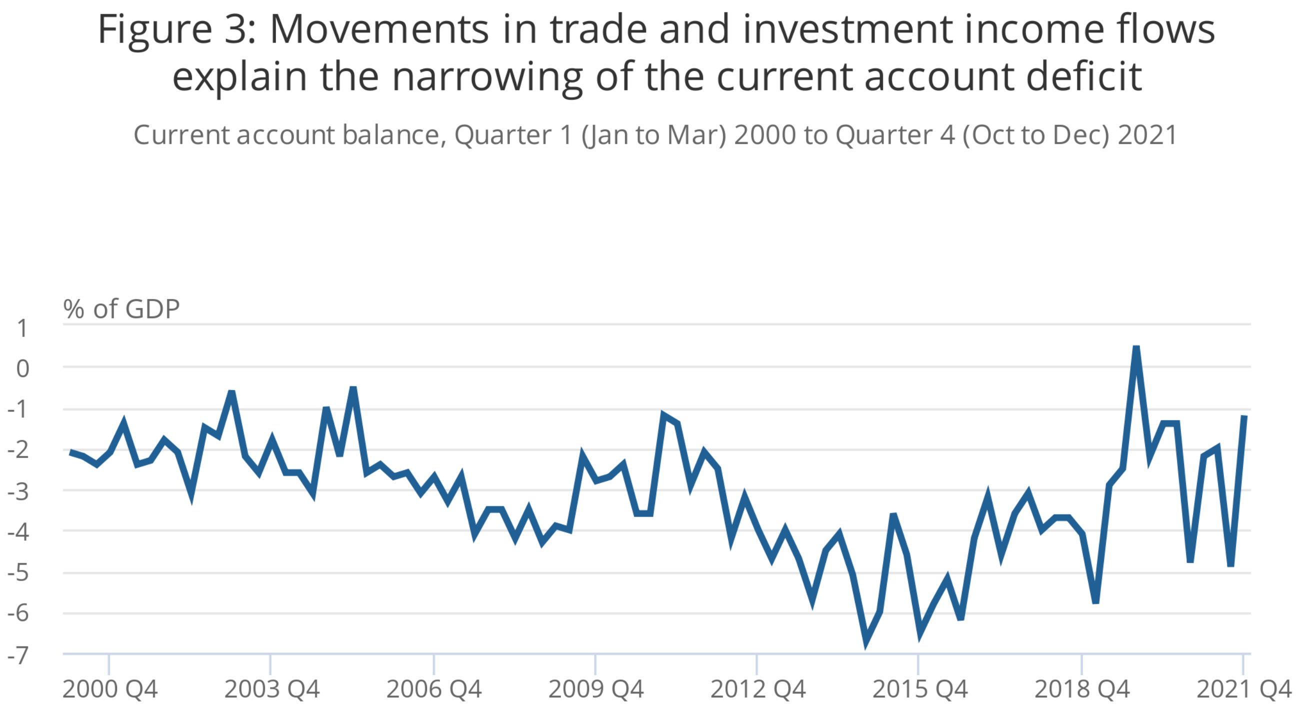
3 . Balance of payments

The current account deficit narrowed to 1.2% of gross domestic product (GDP) in Quarter 4 (Oct to Dec) 2021, reflecting movements in trade flows and investment income (Figure 3). This in part reflected volatile trade of non-monetary gold. The increases in the prices of oil and other fuels in late 2021 have been reflected in the value of these gross trade flows. As the UK is a net importer of these products, this has led to a widening in the trade deficit in other fuels.

The conflict in Ukraine is likely to have indirect effects through supply chains and there is some evidence that businesses have highlighted the impact upon the availability of raw materials and components from the region. The UK ran a surplus on its net investment income in Quarter 4 2021 for the first time since the early 2010s. UK investors received more income on their holdings on foreign direct investment, reflecting higher returns in the oil industry.

Figure 3: Movements in trade and investment income flows explain the narrowing of the current account deficit

Current account balance, Quarter 1 (Jan to Mar) 2000 to Quarter 4 (Oct to Dec) 2021



Source: Office for National Statistics – Balance of Payments

International financial flows tend to be volatile. The UK's net borrowing from the rest of the world has primarily been financed by foreign investors increasing their holdings of portfolio investment in the UK in the latest quarter. This is particularly in debt securities as there was an increase in the issuance of UK government bonds to non-resident investors. UK investors also disinvested holdings of debt and equity investment held in the rest of the world.

4 . Labour market

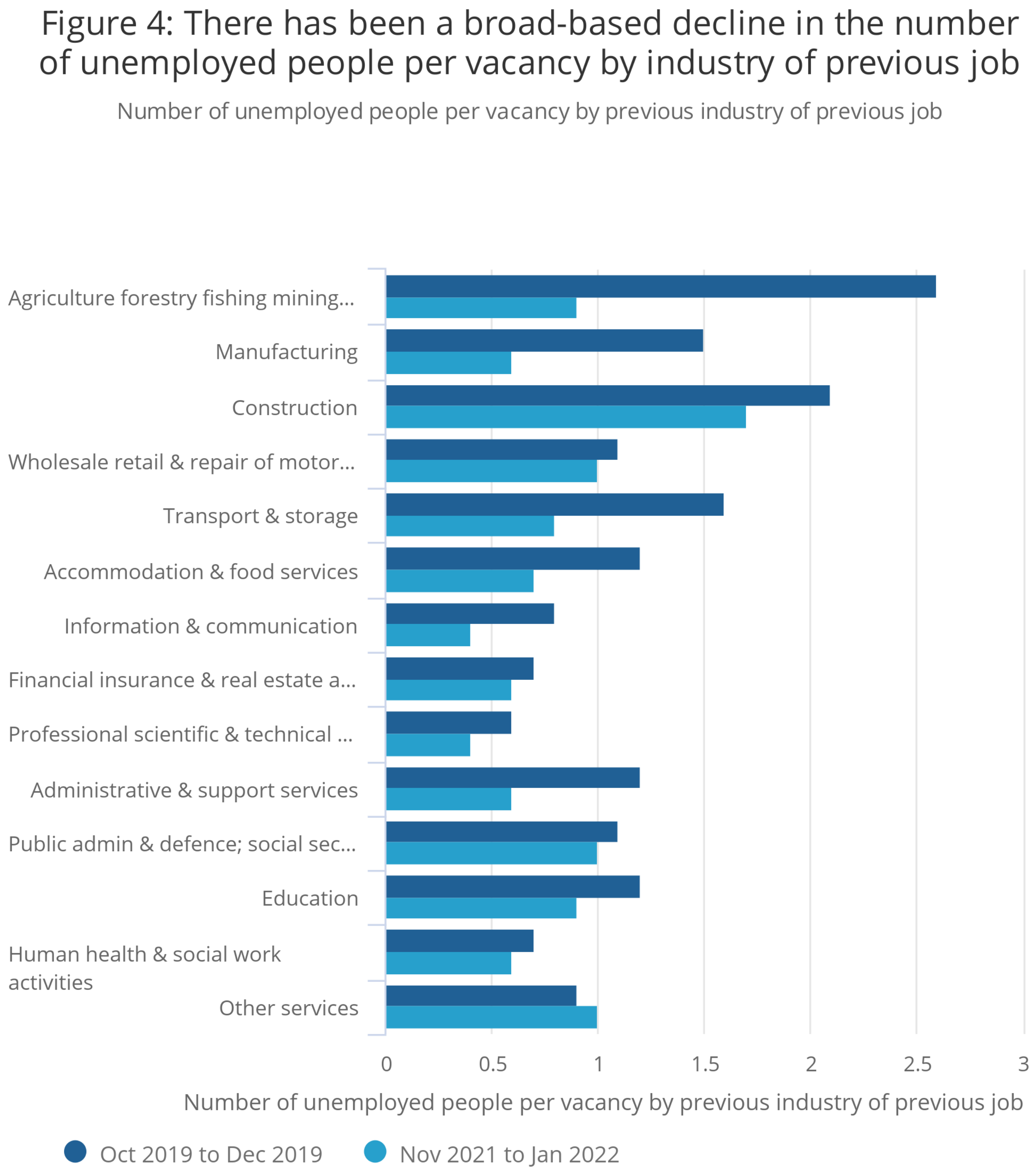
There has been a further tightening in the labour market as it continues to recover from the coronavirus (COVID-19) pandemic. The unemployment rate is now where it was prior to the pandemic (3.9%), while early estimates show that the strong increase in the number of employees on payroll continues in February 2022, although these first estimates tend to be revised down. The redundancy rate has decreased to a record low following the end of the Coronavirus Job Retention Scheme (CJRS).

The rate of economic inactivity continues to be above its pre-coronavirus pandemic level. A new trend arising since the start of the pandemic has been the increase in economic inactivity for those aged 50 years and over, which has been the main driver of recent increases in the economic inactivity rate. Our recent analysis shows that it reflects mainly retirement but also the pandemic, health and lifestyle changes.

The number of job vacancies has risen to a new record high in the period December 2021 to February 2022. Vacancies in all industries are now above their pre-coronavirus pandemic levels. The unemployment-to-vacancy ratio is at a record low. Figure 4 shows that this tightening in the labour market is reflected in most industries. Businesses continue to experience worker shortages. Recent business insights showed that 13% of businesses reported experiencing a shortage of workers in early March 2022, particularly in accommodation and food service activities industry.

Figure 4: There has been a broad-based decline in the number of unemployed people per vacancy by industry of previous job

Number of unemployed people per vacancy by previous industry of previous job



Source: Office for National Statistics – Labour Market Overview

Nominal regular earnings have continued to increase in the latest three months. Evidence from the Report on Jobs survey highlights how "intense competition for workers in February" has led to further steep increases in rates of starting pay. The Bank of England's Monetary Policy Report shows that pay settlements are expected to pick up sharply this year, in part reflecting the tight labour market and higher inflation. However, real regular earnings fell on the year highlighting the squeeze of higher inflation.

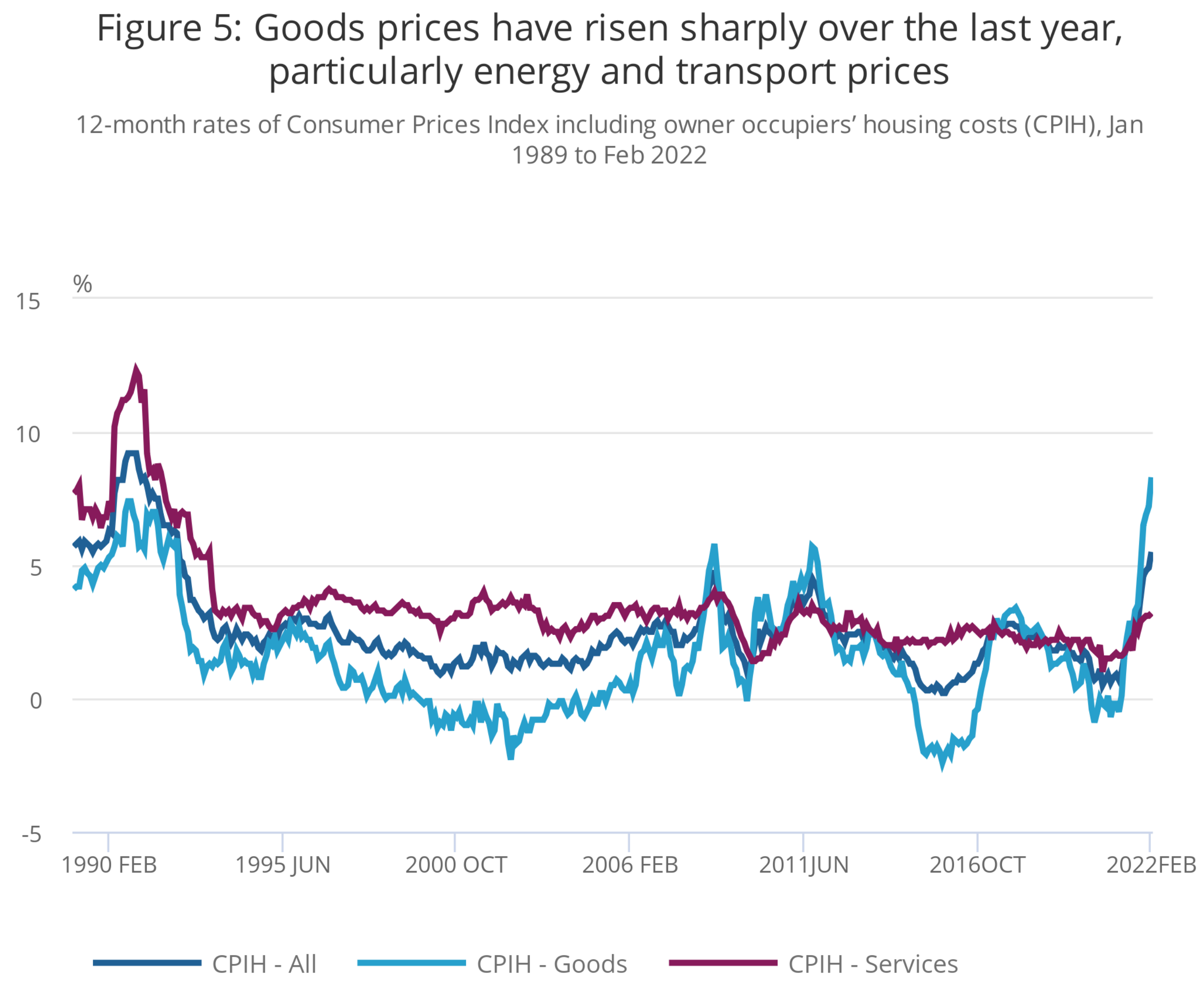
5 . Prices

The Consumer Prices Index including owner occupiers' housing costs (CPIH) [note 1] 12-month rate hit 5.5% in February 2022, its highest rate since March 1992 (Figure 5). Underlying inflation has also picked up further over the year. The producer price inflation (PPI) for output prices rose 10.1% on the year to February 2022, while input prices increased by 14.7% over the same period. Our latest business insights show that nearly half of businesses reported an increase in the prices of materials, goods or services bought in the last month in March 2022.

The main drivers of inflation in recent months have been energy and transport. Food also put upward pressure on prices. Increased demand for goods as the global economy has re-opened after the early days of the coronavirus (COVID-19) pandemic has led to some supply shortages. Energy, motor fuels, and food are particularly affected by global market conditions, including geopolitical instability. The conflict in Ukraine pushed gas and oil prices to their highest levels in more than a decade and is expected to lead to further increases in CPIH later this year. The Office for Budget Responsibility's Economic and fiscal outlook now forecasts a peak of inflation in the final quarter of this year.

Figure 5: Goods prices have risen sharply over the last year, particularly energy and transport prices

12-month rates of Consumer Prices Index including owner occupiers’ housing costs (CPIH), Jan 1989 to Feb 2022



Source: Office for National Statistics – Consumer Price Inflation

Consumer energy prices move in line with movements in the Office of Gas and Electricity Markets (Ofgem) energy price cap, which will rise further in April. These are intended to reflect movements in the wholesale markets for gas and electricity which have seen considerable price increases since mid-2021, reflecting domestic and international pressures.

1. The treatment of the Council Tax rebate in England will be as a payable tax credit, and so will be out of scope of the CPIH.

6 . Related links

Coronavirus (COVID-19)
Web page | Updated as and when data are available
Our latest data and analysis on the impact of coronavirus (COVID-19) on the UK economy and population. This is the hub for all coronavirus-related publications, including the fortnightly Business Insights and Conditions Survey (BICS).

GDP quarterly national accounts, UK: October to December 2021
Bulletin | Released 31 March 2022
Revised quarterly estimate of gross domestic product (GDP) for the UK. Uses additional data to provide a more precise indication of economic growth than the first estimate.

Balance of payments, UK: October to December 2021
Bulletin | Released 31 March 2022
A measure of cross-border transactions between the UK and rest of the world. Includes trade, income, capital transfers and foreign assets and liabilities.

Public sector finances, UK: February 2022
Bulletin | Released 22 March 2022
How the relationship between UK public sector monthly income and expenditure leads to changes in deficit and debt.

Labour market overview, UK: March 2022
Bulletin | Released 15 March 2022
Estimates of employment, unemployment, economic inactivity and other employment-related statistics for the UK.

Consumer price inflation, UK: February 2022
Bulletin | Released 23 March 2022
Price indices, percentage changes and weights for the different measures of consumer price inflation.