

# Latest economic data releases

June 2012

## Background

June has been a month of conflicting messages with regards to the health of the economy. Whilst the released data – much of which we comment on below – has shown some signs for encouragement, sentiment on macro conditions remain more gloomy. This was best exhibited by Mervyn King's (Governor of the Bank of England) latest comments on the extent of the Eurozone crisis, its on-going impact on UK trading conditions and his view that the financial crisis has still some way to unwind. Consumer sentiment remains sluggish in the medium-term.

We therefore offer our interpretation of what the data is telling us in this context, and specifically what the implications may be for the South West.

## Inflation

It is important to understand that inflationary measurements are one tool that we hold to interpret the strength of demand inherent in the economy. When demand is relatively high in comparison to supply then inflation has a tendency to rise, whilst the opposite is also true – sluggish demand will often see inflation fall. It is the reason why one focus of monetary policy is upon managing inflation through the joint 'throttles' of interest rates and money supply.

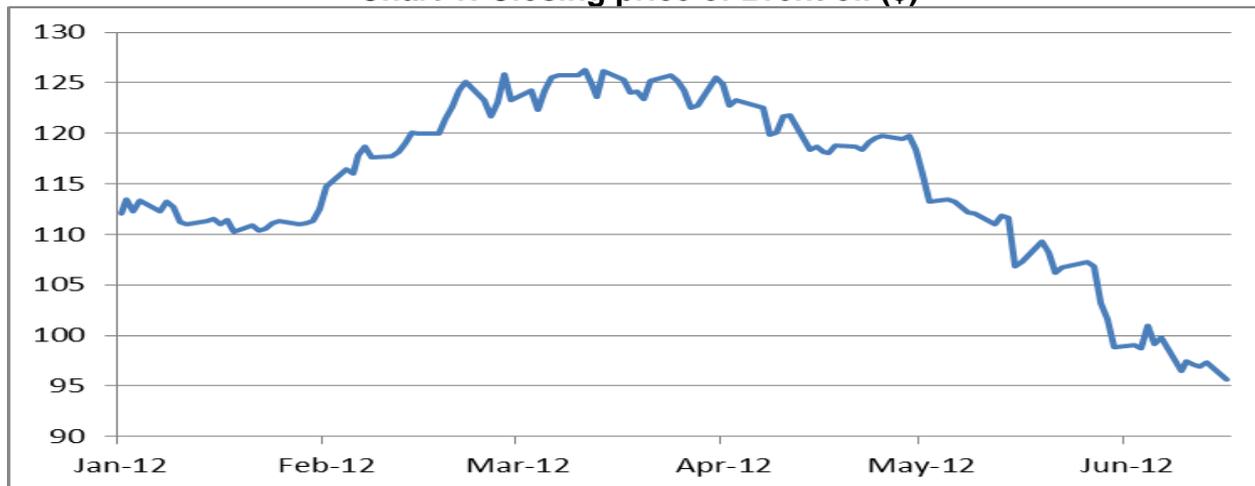
To that end, it was interesting to see that most of the media focus was upon the benefits to individuals and consumers rather than the macro picture. An easing of the inflation rate means that our purchasing power increases, and from that perspective it is certainly welcomed. However, from a macro perspective it may also indicate that demand conditions are relatively benign. It is for that reason why there was some commentary on the prospect of a further cut in interest rate and the prospect of 'Quantitative Easing 3'.

We have commented previously that much of the inflationary pressure experienced over the past 18 months has been driven by global conditions rather than the strength of domestic demand. In particular, high commodity prices for products such as oil and metals have kept input prices high and fed through to the price for final products. Given that the measures of inflation – Retail Price Index (RPI) & Consumer Price Index (CPI) – capture price changes in the products and services that consumers purchase, then the transmission effect that begins from rising input prices is ultimately shown in the RPI/CPI measures.

The good news is that commodity prices have been easing of late. In particular, oil prices have fallen over the last six months as global demand conditions have weakened and some of the supply imbalances have worked through. The chart below shows that the price of Brent oil has fallen substantially since March. The effect of this, of course, is beginning to work through to the price of petrol on forecourts but also impacts on most manufactured goods such as plastics, chemicals etc.

Metals have also shown some weakness. For example, the price of traded copper fell 11% during May - extending its medium-term downward trend.

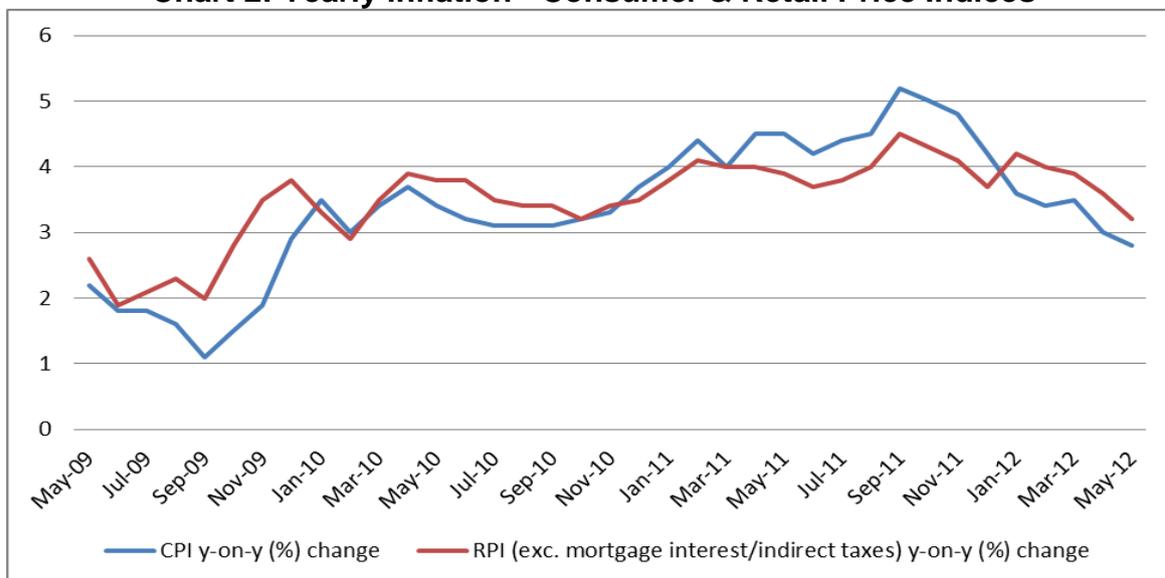
**Chart 1: Closing price of Brent oil (\$)**



The impact of falling input prices – combined with continuing dampened domestic demand – is that inflation continues to fall from the peak experienced in September 2011. The CPI measurement is now 2.8%, compared to its peak of 5.2%, and is at its lowest rate for two and a half years. In September 11 transport costs (including fuel) were rising by 8.9% per year. The annual change has now fallen to 1.7% - a significant adjustment driving the aggregate index.

Food price inflation also slowed considerably during May – the annual rate of change falling to 3.3% from 4.3% in April.

**Chart 2: Yearly inflation - Consumer & Retail Price Indices**



The fall in inflation now seen was broadly expected by the Bank of England (BoE) in 2011 as the commodity price bubble began to deflate. The BoE does expect inflation to continue to fall during the rest of 2012 – as spare capacity continues to weigh on prices - but recognises that beyond that timeframe the outlook is more uncertain.

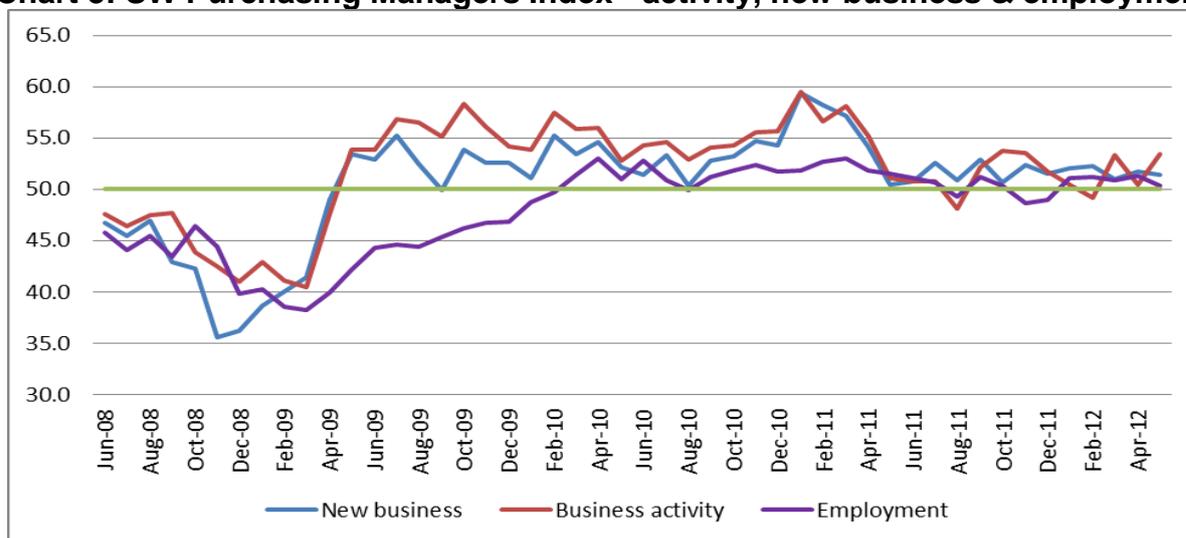
Therefore, these latest inflation figures do provide a useful indication demand conditions both home and abroad. Lower commodity prices show a slight ‘cooling of the engine’ in the emerging economies, underpinning what was already a relatively subdued environment in the UK. The impact on price growth is of course welcome. The hope is that it provides stimulus to consumer spending throughout the latter part of 2012. It was welcomed that the latest monthly retail sales figures for May rebounded from the very weak figures for April.

### Purchasing Managers Index (PMI)

The latest data continues the story of tentative sentiment from businesses. The May PMI survey shows that output has expanded, but only marginally so. Positively, the indications are that output has risen at its strongest rate since November 11 and the hope is that this may signal the end of the moribund economic period experienced from December 11 through to April 12. As seen in the official GDP estimates for Q4 2011 and Q1 2012, this period will be notable for extremely difficult trading conditions.

If the PMI does act as a leading indicator<sup>1</sup> then the figures for April and May do suggest that the Q2 2012 GDP figures will see a return to marginally positive output growth. In general, the UK series has tended to be slightly more positive than the South West on the measurements for new business, employment intentions and activity (although for the latter the SW was stronger in May).

**Chart 3: SW Purchasing Managers Index - activity, new business & employment**



The latest survey results also suggest that manufacturing activity has picked up. Again, this is to be welcomed, as manufacturing has particularly struggled in the past 6-8 months after its mini-revival during 2010 and the early part of 2011.

<sup>1</sup> Previous research has found a correlation between the PMI index and GDP

In many ways it is expected that the employment intentions remain relatively weak. We expect that business activity and new business would need to be sustained in positive territory to create enough confidence for hiring to take place. The chart above shows that between April 09 and April 10 business activity and new business was consistently above 55 (readings above 50 signal an increase or improvement). It was only after this period that the employment measurement rose above 50 – signalling an expansion in hiring. As expected, employment lags confidence as businesses react. As such, on the basis that business activity has not yet been sustained at sufficient levels, we would not yet expect significant hiring to take place in the near-term.

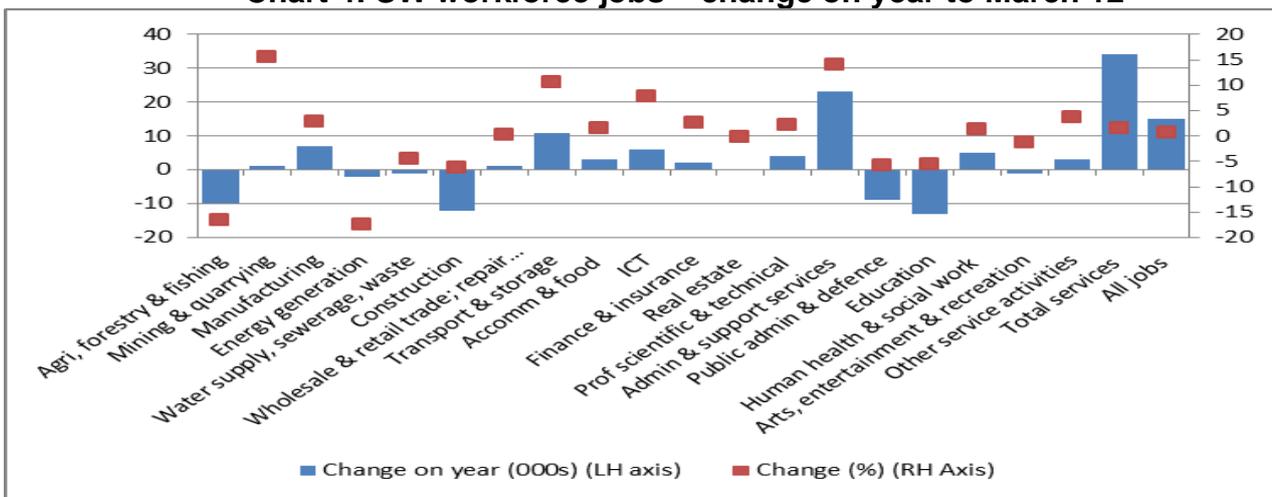
### Workforce Jobs

The latest quarterly release of regional workforce jobs data also provides interesting insight into the strength labour demand in differing parts of the economy in the region. The chart below shows that, as expected, those areas that are predominantly public sector such as public administration & defence (-6%) and education (-5.5%) have suffered falls in numbers employed over the year to March 2012. This highlights the impact of the public expenditure cuts.

The difficulties faced by construction over the last 4 years continue to be seen in its employment numbers. There has been large-scale job shedding in the industry since the recession significantly affected conditions and numbers continue to decline (annually down 6.3%). Construction employment is very much cyclical and in the long-term the numbers employed rose strongly through the decade preceding the recession. In one sense, it could be argued that what has happened since is a return to more sustainable levels of employment.

There has been a small increase in numbers (7,000) employed in manufacturing which again is to be welcomed. However, an annual increase of 2.8% is not significant enough to enact the large-scale rebalancing that remains an economic objective for many.

**Chart 4: SW workforce jobs – change on year to March 12**



## Conclusion

Data released during June has been mildly encouraging. Certainly it suggests the difficulties that were particularly marked in the early part of 2012 may have eased somewhat. It is our view that this will be demonstrated in the initial estimate of Q2 2012 GDP to be released in July.

On the other hand, as yet nor does it indicate any strong expansionary movement and – at the risk of being repetitive – it remains a picture of an economy tentatively treading water. The consensus is that there are more difficulties to be worked through in the Eurozone before that uncertainty decreases. The fact that yields for Spanish & Italian bonds remain historically high certainly shows that the financial markets believe the structural problems have yet to be resolved. Whilst these problems persist, the longer-term economic future remains uncertain.

As stated in previous Data Alerts, we do feel that there will be a short-term stimulus provided by the Jubilee and the Olympics, and consumer spending will be higher in the summer than it has been for some period. We have already seen early indications of that in the May retail sales figures and the latest PMI survey appears to back that up.

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## Contacts

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