



# Economy Monitoring

Monthly Update  
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Environment, Planning and Economy

<b>Summary</b>	<b>2</b>
<b>A Introduction</b>	<b>3</b>
1. Commentary – do we know what is happening in the economy?	3
<b>B Cornwall</b>	<b>4</b>
2. Labour Market Analysis	4
3. Employment news	7
4. Economic survey Q4 2009 - Chamber of Commerce.	8
5. Housing	8
<b>C South West</b>	<b>9</b>
6. Overview	9
<b>D United Kingdom</b>	<b>10</b>
7. Quarterly Economic Indicators	10
8. Output	10
9. Labour Market Analysis	14
10. Housing	16
11. Retail, inflation and prices	17
12. Consumer confidence	20
13. Finance	20
<b>E International perspective</b>	<b>23</b>
14. Data	23
15. Reports and reviews	25

## Summary

- More positive signs on the economic front emerged as the UK left recession in Q4 and the labour market appeared more buoyant than expected. However, concerns still arise over the strength of recovery and what happens to government spending.

### Cornwall

- The **jobseeker total rose by 447**, in line with seasonal expectations, and well below the dramatic rise of a year ago. Vacancy figures rose compared to the previous year. **House prices continue to rise.**
- Chamber of Commerce survey figures suggest **businesses are more confident** than for the UK as a whole.

### SW

- The SW Purchasing Managers Index showed that on the output front, growth continued but at the slowest rate for six months. Jobs continued to be cut, though at least marked since May 2008. [The index is based on monthly survey data].

### UK

- As expected the preliminary **Q4 GDP figures rose**, though only by 0.1%, production and services output rose between October and November. New **Construction** orders rose compared to the previous quarter.
- Across the UK, both **unemployment and the claimant count fell.**
- **House prices across England and Wales continued to rise.** Gross mortgage lending rose in December, and was also up on December 2008 levels.
- **Retail sales rose by volume (2.1%) and value (3.6%)** in December compared to December 2008.
- **CPI Inflation rose**, from 1.9% in November to 2.9% in December.
- **Consumer confidence levels fell back** in December.
- Net lending to both businesses and individuals rose in November while consumer credit **fell**, though credit card lending **rose**.

### International

- Industrial production in the EU **rose** though unemployment continued upwards. Global trade volume and industrial production **increased** in November compared to October, though production is still 5% below the March 2008 peak.

## **A Introduction**

This report sets out a number of indicators which show what is happening in the economy, relating to claimant count, unemployment, house prices and repossessions. Some of these relate to Cornwall, some to the South West, while others indicate what is happening across the UK and on an international basis. Not all indicators/reports are issued monthly; hence updates will vary in coverage. Each update will only include new data though quarterly summaries will be shown where appropriate. The usual health warning with data should be borne in mind.

### **1. Commentary – do we know what is happening in the economy?**

The last three years have seen some dramatic events in the economy, with boom, recession and now finally tentative steps towards recovery. Such events inevitably result in much speculation about what happened and why and whether it can be prevented in the future. Much of the early analysis focused on the role of the subprime market in the United States [a market for borrowers who did not meet the underwriting requirements of mainstream lenders and hence high risk]. However, the OECD has suggested that the US would have probably had a downturn without this particular event. In one sense it is understandable that commentators fix upon a specific event as the cause, though often there are a number of factors which influence the onset of a recession. Galbraith in his analysis of the Great Depression in the US, for example identified a number of elements which led to the depression as distinct from the Wall Street Crash.

More recent analysis has suggested there were a number of underlying factors which increased the chance of a global recession, some common to a number of countries others of a more unique nature. There has been a growing awareness of the role played by the expansion of credit and creation of asset bubbles in the recent recession, which inevitably lead to instability in the system. Although similarities exist between one recession and another, particularly in relation to those which are a consequence of financial shocks, there are often differences arising from the evolving nature of the economic system and economic interrelationships. The ingenuity of the financial sector in devising new approaches to funding illustrates how matters evolve, sometimes with negative consequences. Such complexities can make analysis more problematical and render the search for appropriate policy options more difficult.

The recent work by McKinsey, referred to later in this report, adds to our understanding of what has happened and what options policy makers need to consider whether in terms of general economic policy, how to assist the recovery and the prevention of future crises. Here it is apparent that a combination of factors created conditions of instability – new ways of creation of credit by banks and other financial institutions, an over

dependence on financial services, increasing use of credit by households for example. Increased government borrowing in this context could therefore be regarded as a means to stabilise the economy rather than a cause of the instability. What the McKinsey report implies is that an understanding of the various types and nature of debt and their causes is necessary to create a durable framework for future policy. This supports comments from the IMF for example, that reducing government debt has to be considered in a wider economic context.

## **B Cornwall**

### **2. Labour Market Analysis**

#### **Claimant count**

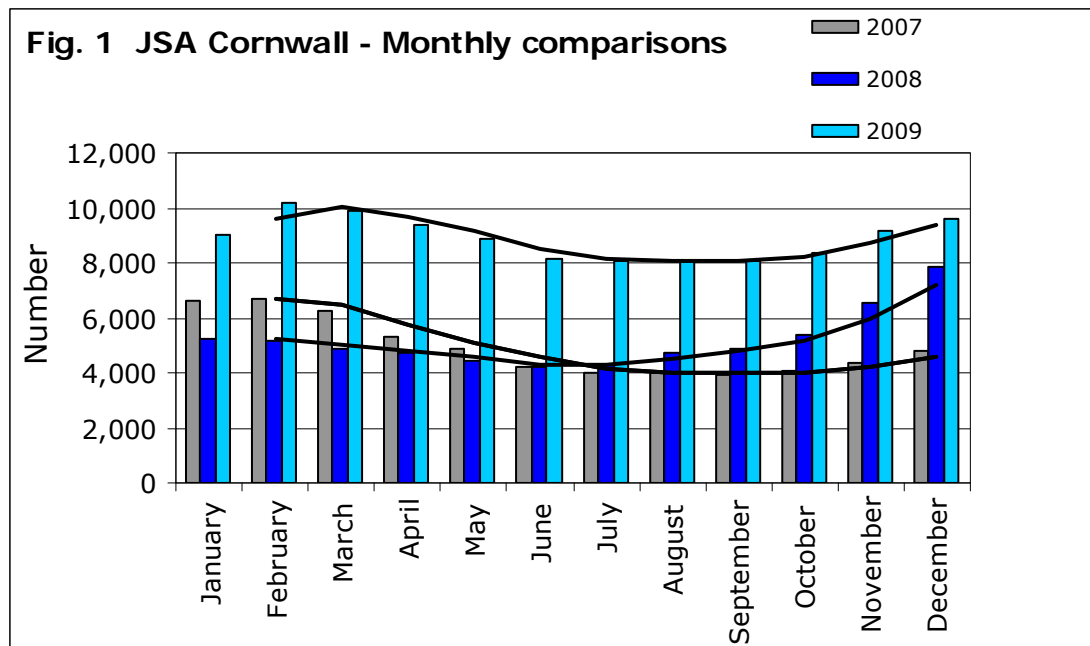
The latest claimant count data for December 2009 was released on 20 January 2010. The figures relate to those claiming Jobseekers Allowance.

[This figure is considered to underestimate the actual numbers unemployed, as it does not include people who are actively seeking work but not claiming Jobseekers Allowance, who are however included in the unemployment figures which are taken as a more accurate representation of the situation.. NB Not seasonally adjusted. Figures for Cornwall cover the unitary area only].

The total for Cornwall is now 9,615. The last time Cornwall's December figure was higher than this was in 2000 when it equalled 9,756. Since November numbers in Cornwall have increased by 447 (4.9%). Within the SW, 11 of the 16 County/Unitary areas saw a decline in numbers from the previous month, with the other 5 showing an increase. The largest falls in percentage terms were Plymouth (-8.5%), Swindon (-6.9%) and Wiltshire (-5.4%). Cornwall saw the largest increase of 4.9%, followed by Somerset with 3.0%. The UK showed a decrease of 0.2%, with a fall of 1.7% across the SW.

Since December 2008 the number of claimants in Cornwall has risen by 1,756 or 22%. This compares to an increase of 36% across the UK and 35% across the South West. Only three areas in the SW had a lower increase – Devon and Torbay and Isles of Scilly. Figure 1 illustrates the number of claimants on a monthly basis for 2007, 2008 and 2009.

Looking at Fig. 1, illustrates some interesting differences between each year. Whereas the 2007 trendline shows a gentle rise from the summer, the 2008 increase is quite dramatic, with 2009 falling between the two.



The claimant count rates for December, were Cornwall 3.1%, GB 4.1% and SW 2.9% respectively. Between December 2008 and December 2009, Cornwall's rate increase, from 2.5% to 3.1% equals a rise of 24%. This is the third lowest rise for authorities across the SW. The highest rate increase, of 57.1% was recorded in Swindon.

An increase in numbers between November and December in Cornwall is not unusual, this has occurred for all of the ten years from 2000 to 2009. The average increase has been 460, so this year's rise of 447 lies below this and is well below last year's figure of 1,310. An increase in the number of claimants is also common at this time of year for most SW authorities and for the UK. Only four SW authorities tend to see falls for this period, though this year the figure was higher at 11.

### **In-flows and off-flows**

The recent Chartered Institute of Personnel and Development (CIPD) report highlights the importance of looking at data other than the headline claimant count figures. Using the inflow and outflow figures shows the changes that have occurred with people moving on to and off the claimant count. Across Britain during the April 2008 to November 2009 period inflows of 6,115,460 with outflows of 5,368,560. This gives a rate of outflows to inflows of 87.8%. The rate for the South West is 87.5% and for Cornwall 90.3%. Looking at counties and Unitaries across Britain shows that Cornwall is joint 33<sup>rd</sup> out of 206 authorities and the top one for SW authorities. In this regard, Cornwall is quite successful compared to other areas.

## Vacancies

The latest vacancies data was released on 20<sup>th</sup> January 2010. There were 2,393 notified vacancies in Cornwall in December. This represents a decrease of 207 since November (8%). This is in below the percentage decreases across Britain (29.9%) and SW England (25.3%). With the exception of Swindon all SW authorities saw a decline. Looking at the data, decreases in vacancy numbers between November and December occurred in four of the past six years. The fall this year is lower than for last year. Compared to December 2008, vacancies are up by 61.3%, compared to a rise of 17.6% for the SW and 10.6% for GB. Across the SW eleven Unitaries/counties saw a rise in vacancies, five with falls, the largest percentage fall was in Torbay (-22.3%).

[Survey data for the UK suggests that of all external vacancies, only a minority, 40% are advertised through Jobcentres].

The vacancy to claimant count ratio, which shows the number of vacancies per claimant, is a crude measure of how buoyant the jobs market is. A ratio below 1.0 indicates there are fewer vacancies than claimants. Currently Cornwall is performing better than GB but is below the SW with a ratio of 0.25, (SW 0.27, and Britain 0.17) – Table 1. The November 2009 figures are all below the figures for November 2008.

<b>Table 1: Vacancy to claimant ratio comparisons</b>									
	Great Britain			South West			Cornwall		
Date	Claimant	Vacancies	Ratio	Claimant	Vacancies	Ratio	Claimant	Vacancies	Ratio
Dec-08	1,516,907	237,386	0.16	66,710	20,021	0.30	7,859	1,484	0.19
Nov-09	1,516,907	374,380	0.25	91,599	31,587	0.34	9,168	2,600	0.28
Dec-09	1,513,921	262,546	0.17	90,035	23,953	0.27	9,615	2,393	0.25
Change 08 09	-2,986	25,160	0	23,325	3,932	-0.03	1,756	909	0.06

[NB. (1) Notified vacancies for the month covers the inflow of newly notified vacancies to Jobcentre Plus].

(2) Changes to Jobcentre Plus vacancy handling procedures have lead to a major discontinuity in the vacancy statistic pre and post May 2006

## Labour market overview

Labour market figures for Cornwall from the Annual Population Survey are available up to June 2009. [Figures cover a year and are produced quarterly]. The latest figures show that compared to the previous period – year ending March 2009, the number of working age, economically active and employed rose. Part-time workers increased while full-time workers decreased. The number of unemployed remained stable. Compared to a year previously, employment fell, largely due to a fall in part-time jobs. Unemployment rose as did the number of economically inactive.

Looking at Jobseekers Allowance figures for December show that both the numbers and rate have increased compared to December 2008.

<b>Table 2: Labour market indicators</b>						
		Period			Comparisons (change)	
Activity		(A) Jul 07 - Jun 08	(B) Apr 08 - Mar 09	(C) Jul 08-Jun 09	Previous qtr (B)	Year ago (A)
Working age	No	309200	310300	310500	200	1300
Economic activity	No	243600	242200	243700	1500	100
	Rate	78.8	78.1	78.5	0.4	-0.3
Employment	No	230400	226200	227700	1500	-2700
	Rate	74.5	72.9	73.3	0.4	-1.2
Full-time	No	163400	165700	165200	-500	1800
Part-time	No	67000	60500	62100	1600	-4900
Unemployment	No	13200	16000	16000	0	2800
	Rate	5.4	6.6	6.6	0	1.2
Economically inactive		65600	68100	66900	-1200	1300
	Rate	21.2	21.9	21.5	-0.4	0.3
Activity		Period			Comparisons (change)	
		Dec-08	Nov-09	Dec-09	Previous month	Year ago
Claimant count	No	7859	9168	9,615	447	1,756
Claimant count	Rate	2.5	3	3.1	0.1	0.6
Vacancies	No	1484	2600	2,393	-207	909
Per 100 employee jobs	Rate	0.8	1.3	1.2	-0.1	0.4

[NB Vacancy rate based on employee jobs data from the ABI, all 2008 figures].

All data derived from NOMIS - claimant count and jobcentre vacancies.

### 3. Employment news

On the employment front, new retail jobs have been created with 50 at Poundland (St. Austell/Newquay, 15-20 at Peacocks in Newquay and 17 at Pets at Home in Liskeard. A new fish and chip restaurant in Falmouth (Rick Stein) is opening in March. Losses include 80 at Highgrove homes (Truro), also with redundancies in Redruth (6) and Falmouth (14), while jobs are under threat at care centres in Penzance (14) and St. Ives (9), with 11 potential losses at WS Stevenson in Newlyn.

Sources: Various news reports

#### 4. Economic survey Q4 2009 - Chamber of Commerce.

Figures from Cornwall "suggest that many local businesses are more confident than the national picture". Figures set out below.

- 63% of businesses report **UK Sales** have remained the same or increased in the last quarter (62% for Q3).
- 58% of businesses report **UK Orders** have remained constant or increased over the last quarter (51% for Q3).
- 82% of businesses had maintained or increased the **size of their workforce** since the last Quarterly Economic Survey; up from 78% in quarter 3. The same percentage (82%) expects to maintain or grow their workforce over the next quarter.
- 80% of businesses intend to maintain or increase planned **investment in training**; up from 74% in Q3.
- 64% intend to maintain or increase current levels of **investment in plant and equipment**; up from 61% in Q3.
- 82% of businesses expect their **turnover** to remain the same or to increase over the next 12 months; up from 73% for Q3.
- 78% expect to maintain or increase the **profitability** of their business over the next 12 months; up from 62% for Q3.
- Businesses appear under less pressure to raise prices. Business reporting pressures linked to **raw materials** fell from 38% in Q3 to 22% for Q4. Pressures to raise prices because of **finance costs** dropped from 23% in Q3 to 16% for Q4.

Source: Cornwall Chamber of Commerce and Industry, 12 January 2010.

#### 5. Housing

House prices across Cornwall rose in December compared to November, up by £1,214. This is the seventh month of increases. Trends in Cornwall are broadly consistent with England and Wales data, where prices continue to increase. Compared to December 2008 prices in Cornwall are down by 1.8%, whereas for England and Wales there was an increase of 2.5%. Figure 2 below shows annual changes for counties in England and Wales. Since the peak of April 2008, average prices in Cornwall have fallen by 11.5%, (from £209,608 down to £185,475); the comparative figure for England and Wales is 11.1%. Overall figures do not of course provide a complete picture whether in terms of the different types of housing available, housing need and employment.

Source: Land Registry. House Price Index, 29 January 2010.

## C South West

### 6. Overview

#### **South West output increased in December, but at slowest rate for six months. (Purchasing Managers Index)**

“South West PMI data signalled further expansion of business activity within the region during December. Increased private sector output has now been recorded for eight consecutive months, but the latest rise was slower than the UK average and the weakest since June. Output growth was supported by higher levels of new business and an associated improvement in clients’ willingness to spend. Companies indicated that pricing power was still relatively weak, with output charges falling slightly while input costs rose at a robust pace in December.

Private sector output growth in the South West slowed for the second successive month in December. Nonetheless, the rate of expansion remained solid and was driven by increased business activity in both the manufacturing and service sectors. Higher levels of incoming new business were the main factor leading to increased output in December. New order growth has been recorded in seven of the past eight months, although the rate of expansion was only moderate in December and less marked than the UK average.

Outstanding business at South West companies fell further in December, which survey respondents generally linked to spare capacity and relatively weak underlying demand. However, the latest reduction in backlogs was only marginal and the slowest in the current twenty-eight month period of decline. Some manufacturing firms noted that delays from suppliers had placed upward pressure on volumes of unfinished work. Job shedding was recorded again in December, largely reflecting ongoing adjustments to spare capacity and efforts by firms to reduce costs. This extended the current period of declining staffing levels to twenty-one months, but the latest fall was the least marked since May 2008.

Input cost inflation was the highest for fourteen months in December and remained stronger than the UK average. The manufacturing and service sectors both recorded increased cost burdens, which some panel members attributed to higher fuel prices. December data indicated a slight fall in prices charged by South West firms, which they generally linked to efforts to stimulate sales. There were also a number of reports that strong competition continued restrict operating margins in the region”.

“PMIs are based on monthly surveys of carefully selected companies which provide an advance indication of what is really happening in the private sector economy by tracking variables such as output, new orders, employment and prices across both manufacturing and service sectors. The PMI surveys are based on fact, not opinion”.

Source: Markit, South West PMI, 11 January 2010.

## D United Kingdom

### 7. Quarterly Economic Indicators

The table below summarises the main quarterly economic indicators.

Table 3: Latest Economic Indicators		
Activity	Period	% change on a year earlier
GDP *1	09 Q4	+0.1
Service sector output	3m to Nov	+0.1
Industrial production	3m to Nov	-8.4
Manufacturing output	3m to Nov	0.0
Households' consumption	09 Q3	0.0
Whole economy investment	09 Q3	2.2

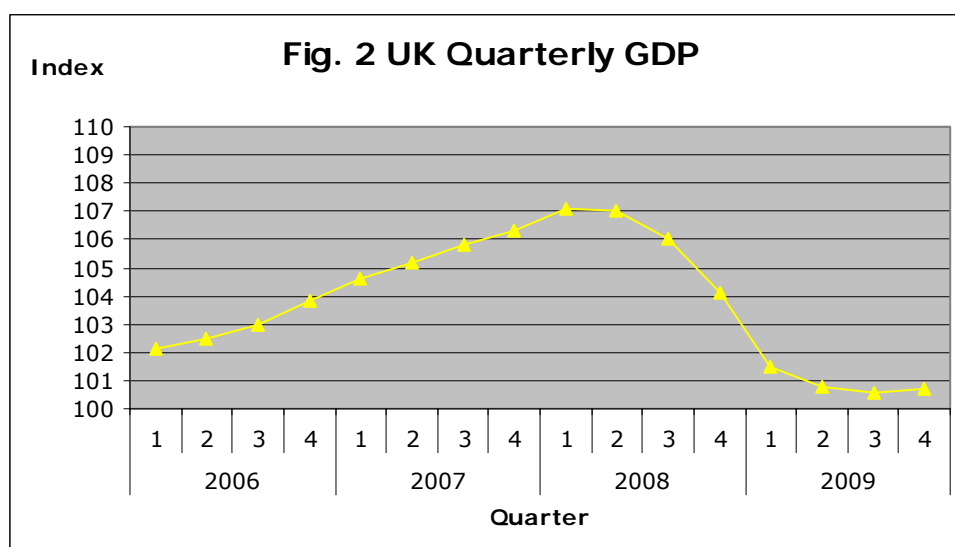
Source: HMT – Pocket databank - Latest Economic Indicators.

### 8. Output

#### Gross domestic product, preliminary estimate 4th Quarter 2009

“The chained volume measure of gross domestic product (GDP) increased 0.1 per cent in the fourth quarter of 2009. The increase in output was due mainly to increases in distribution, hotels and restaurants and government and other services. Output of the service industries increased 0.1 per cent. Output in the production industries increased 0.1 per cent. GDP decreased 3.2 per cent between 2009 Q4 and 2008 Q4. Chained volume measure Index (2005 =100)”.

Figure two shows the quarterly GDP data for the UK. The peak is clearly shown in Q1 2008 with the nadir reached in Q3 2009.



Source: ONS, Gross Domestic Product – 4th quarter 2009, Statistical Bulletin, 26 January 2010.

## Estimates of monthly GDP, biggest contraction since 1921

“Our monthly estimates of GDP suggest that output grew by 0.3 per cent in the three months ending in December, following on from a growth of 0.2 per cent in the three months ending in November. These data show that GDP fell by 4.8 per cent in 2009. This is a bigger fall than in any year of the great depression and is Britain’s biggest contraction since 1921. As the graph below shows, the broader picture of the depression is that output fell sharply for twelve months until March and has not changed very much since then, although evidence of a recovery is starting to emerge”.

Source: National Institute of Economic and Social Research, estimates of monthly GDP, 13 January, 2010.

## Index of Production, November shows 6.0% annual fall

Year on year, overall production output in November 2009 was 6.0 per cent lower than in November 2008. Output in the mining and quarrying sector decreased by 6.5 per cent in November 2009 compared to the same month a year ago with a 4.1 per cent decrease in oil and gas extraction. Over the same period, output of the energy supply industries fell by 10.6 per cent with decreases in electricity and gas supply output being offset by an increase in water supply output.

Total production output increased by 0.4 per cent between October and November. Mining and quarrying output increased by 5.9 per cent with an increase in oil and gas production output of 7.2 per cent. Energy supply output decreased by 3.5 per cent on the month with decreases in the electricity and water supply output being offset by an increase in the gas supply output.

All sectors in Table 4.

<b>Table 4: Sector Breakdown</b>		
<b>Sector – changes</b>	<b>Previous month</b>	<b>Same period a year ago</b>
Production	-0.4	-6.0
Manufacturing	0.0	-5.4
Mining and quarrying	5.9	-6.5
Electricity, gas and water supply		-10.6

Source: ONS Index of production, Statistical Bulletin and release, 13 January 2010.

## Index of Services - November 2009

“The seasonally adjusted Index of Services in November 2009 fell by 2.3 per cent compared with November 2008. ... Four of the five components of the services sector decreased in the most recent month on a year earlier.

The largest contribution to the decrease was business services and finance which fell by 4.4 per cent. The only component which increased was distribution. Output from the Service sector rose by 0.1 per cent between October and November. The largest contribution to the increase was government and other services which rose by 0.2 per cent". Sector details in Table 5 below.

<b>Table 5: Sector Breakdown</b>	
<b>Sector – changes November 2009 compared to November 2008</b>	<b>Change</b>
<u>Distribution</u> The largest contributions to the increase were retail which rose by 3.5 per cent and motor trades which rose by 7.7 per cent.	+2.1
<u>Hotels and restaurants</u> The largest contributions to the decrease were canteens and catering and bars	-5.8
<u>Transport, storage and communication</u> The largest contributions to the decrease were land transport which fell by 4.5 per cent, other transport services which fell by 5.3 per cent and post and telecommunications which fell by 1.7 per cent	-3.2
<u>Business services and finance</u> The largest contribution to the decrease was other business services which fell by 5.5 per cent.	-4.4
<u>Government and other services</u> The largest contribution to the decrease was recreation which fell by 8.9 per cent.	-0.7

Source: ONS Index of services, November 2009, Statistical Bulletin and Release, 26 January 2010.

### **New orders in the construction industry, November 2009**

"Orders in the three months to November 2009 rose by 1 per cent compared with the previous three month period. Orders in the 12 months to November 2009 fell by 14 per cent compared with the previous 12 months but orders in the three months to November 2009 rose by 4 per cent compared with the same period a year earlier. In the three months to November 2009, compared with the same period a year earlier, private housing orders rose by 23 per cent and public and housing association housing orders rose by 9 per cent. All orders figures quoted are seasonally adjusted and in constant (2005) prices".

What is clear here is the important role played by the public sector in boosting demand. Changes by sector in Table 6.

<b>Table 6: Changes by Sector</b>			
<b>Sector</b>	<b>3 months to November compared to previous quarter</b>	<b>Same quarter a year ago</b>	<b>Year to November compared to previous 12 months</b>
	<b>%</b>	<b>%</b>	<b>%</b>
Overall	+1	+4	-14
Private housing	+56	+23	-30
Public housing <sup>2</sup>	-30	+9	-6
Infrastructure	-28	+102	+54
Public non housing	0.0	+10	+9
Private commercial	+17	-34	-44
Private industrial	+18	-10	-38

<sup>2</sup> NB Results from this sector volatile.

Source: ONS, New orders in the construction industry, Statistical Bulletin, 14 January 2010.

### **New car registrations and vehicle production**

New car registrations rose in December by 38.9% to 150,936 units. Full year registrations down 6.4% to 1,994,999 units, the lowest level since 1995. Since its introduction, the scrappage scheme has accounted for over a fifth of all new car registrations and is estimated to represent 20.8% of the December market. "The December new car market was boosted by the Scrappage Incentive Scheme and consumers looking to avoid January's VAT increase," said Paul Everitt, SMMT chief executive. "The 2009 market of 1,994,999 new car registrations was significantly above early expectations and reflects the positive impact of the scheme, due to end in February.

"Another tough year awaits the UK motor industry in 2010, with new car registrations expected to be below 2009 levels and only limited recovery in the van and heavy commercial vehicle markets. Sustaining the progress made in the latter part of 2009 will require stronger demand from fleet and business buyers, alongside the greater availability and affordability of credit and finance," he continued.

Total vehicle production in December 2009 rose by over a half compared to December 2008; yearly figures fell by a third.

Full details in Table 7.

<b>Table 7: Vehicle Production</b>				
<b>Production</b>	<b>Dec 08</b>	<b>Dec 09</b>	<b>Change</b>	<b>% Change</b>
Total	60,113	92,587	+32,474	+54
	<b>YTD Dec 2008</b>	<b>YTD Dec 2009</b>	<b>Change</b>	<b>%</b>
Total	1,649,515	1,090,139	-559,376	-33.9

Source: Society of Motor Manufacturers and Traders Limited. 7 and 22 January 2010.

## 9. Labour Market Analysis

The main features were that the employment rate (Sept-Nov) at 72.4% was the lowest since the winter of 1996-97, the numbers employed continued to fall, due to falls in full-time employed offsetting increases in part-time work. "... the number of people in part-time employment increased by 99,000 to reach a record high of 7.71 million. There were 1.03 million employees and self-employed people working part-time because they could not find a full-time job. This is the highest figure since records for this series began in 1992 and it is up 46,000 on the quarter".

A rate of 7.8% for unemployment for the September to November 2009 period was recorded, numbers of unemployed fell by 7,000 over the quarter to reach 2.46 million, "the first quarterly fall in the number of unemployed people since the three months to May 2008. The number of people unemployed for more than 12 months increased by 29,000 over the quarter to reach 631,000, the highest figure since the three months to November 1997. The number of people claiming Jobseeker's Allowance (the claimant count) in December 2009 fell by 15,200 on the month to reach 1.61 million. This is the second consecutive monthly fall in the claimant count and the largest monthly fall since April 2007".

"The inactivity rate for September to November 2009 was 21.2 per cent, up 0.2 on the quarter but below the record high of 23.3 per cent recorded in 1983. The number of inactive people of working age increased by 79,000 to reach a record high of 8.05 million. This increase in inactivity is largely driven by the number of students not in the labour market which has increased by 81,000 on the quarter to reach 2.24 million, the highest since comparable records began in 1993".

All details in Table 8.

NB Claimant count figures for December are provisional and likely to be revised in the future.

<b>Table 8: Labour market indicators</b>				
<b>Activity</b>		<b>Period</b>	<b>Comparisons (change)</b>	
			<b>3M to Nov 09</b>	<b>3M to Aug 09</b>
Working age employment	Rate	72.4	-0.1	-1.7
In employment	No	28.92	-14,000	-451,000
Full-time employment	No	21.21	-113,000	
Part-time employment	No	7.71	+99,000	
Total hours worked	No	910.9 million	+6.2 million	
Average hours per week	No	31.5	+0.2	
Unemployment	Rate	7.8	0.0	+1.6
Unemployment	No	2.46	-7,000	+511,000
Working age inactivity	No	8.05 million	+79,000	+202,000
Working age inactivity	Rate	21.2	+0.2	+0.4
Redundant	No	182,000	-31,000	-46,000
Redundancy rate (per 1000 employees)	Rate	7.3	-1.2	-1.7
<b>Activity</b>		<b>Period</b>	<b>Comparisons</b>	
			<b>3 months to Oct</b>	<b>3 month to Nov on a year ago</b>
Average earnings (ex bonuses )	%		-0.1	+1.1
<b>Activity</b>		<b>Period</b>	<b>Comparisons</b>	
		<b>September</b>	<b>Previous Qtr</b>	<b>Year ago</b>
Workforce jobs	No	30.86	-127,000	-649,000
<b>Activity</b>		<b>Period</b>	<b>Comparisons</b>	
		<b>December</b>	<b>October</b>	<b>Year ago</b>
Claimant count	No	1.61 million	-15,200	+430,700
Claimant count	Rate	5.0	0.0	+1.3
<b>Activity</b>		<b>Period</b>	<b>Comparisons</b>	
		<b>3M to Dec 09</b>	<b>3M to Sept 09</b>	<b>Year ago</b>
Vacancies		448,000	+16,000	-80,000
Per 100 employee jobs	Rate	1.7	+0.1	-0.3

Source: Office for National Statistics, Labour Market Statistics January 2010, Statistical Bulletin, 20 January 2010.

### Recession has 'deep impact' on jobs

"The Chartered Institute of Personnel and Development (CIPD) say that 1.3 million people were made redundant during the recession. The study says that is double the fall in employment and equivalent to 4.4% of people in work before the downturn. It also says that two-thirds of people made redundant were paid 28% less when they managed to find another job. The report also highlights the difficulty of getting full-time employment. It says that there were 6.2 million fresh claims for jobseeker's allowance between April 2008 and November 2009. That is seven-and-a-half times the rise in the unemployment claimant count during the recession. The CIPD's economic adviser, John Philpott, said: "Although the scale of job loss in the recession is much less than originally feared... it is evident that

the direct experience of redundancy, repeat spells of unemployment and pay penalties has nonetheless been widespread." "This is likely to have a much greater impact on perceptions of job security and consumer confidence during the recovery than the simple 'unemployment situation is better than feared' story of the moment would suggest," he added. "Every job loss is a tragedy," said employment minister Jim Knight. "What the figures in this report highlight is that thousands of people have found work very quickly through jobcentres, with 70% of people leaving unemployment benefit within six months."

Source: BBC, Recession has 'deep impact' on jobs, 25 January 2010.

## 10. Housing

### House prices

House prices across England and Wales increased for the eighth month running. The average is now £161,783 compared to the low of £152,736 in April 2009. The high point was reached in January 2008 of £184,979.<sup>1</sup> "The number of sales per month has increased since last year, with an average of 58,000 transactions between July 2009 and October 2009, compared to an average of 46,655 in the same period a year before". Full details for England and Wales and Cornwall in Table 9.

**Table 9: House Prices, Land Registry**

Month	Cornwall		England and Wales	
	Index	Average Price (£)	Index	Average Price (£)
Dec-08	340.2	188,872	252.4	157,764
Jan-09	333.9	185,412	251.1	156,958
Feb-09	327	181,588	246.2	153,876
Mar-09	323	179,331	244.6	152,893
Apr-09	321.7	178,618	244.4	152,736
May-09	316.5	175,734	244.5	152,819
Jun-09	317.6	176,357	245.2	153,234
Jul-09	318.2	176,706	250.4	156,501
Aug-09	320.4	177,880	251.2	157,000
Sep-09	325.8	180,894	253.9	158,716
Oct-09	329.5	182,978	256.4	160,274
Nov-09	331.8	184,261	258.5	161,580
Dec-09	334	185,475	258.8	161,783

Source: Land Registry. House Price Index, 29 January 2010. [Index Jan 1995 = 100].

<sup>1</sup> Figures are revised with each new release; hence figures often differ from those in previous editions of EMMU. The survey measures the change in prices of completed sales rather than mortgage data and hence is seen as a more accurate measure.

## **Mortgages and lending**

### **Gross mortgage lending up 14% in December**

"Gross mortgage lending reached an estimated £13.7 billion in December, a 14% rise from £12.1 billion in November and up 3% on December 2008, according to the Council of Mortgage Lenders. This is the first time the annual monthly comparison has been in positive territory since October 2007. However, other than in 2008, this is still the lowest figure for December since 2001 (£13.4 billion). Lending totalled £39.1 billion in the fourth quarter, up slightly from £39 billion in the previous quarter but down by 14% on the last three months of 2008. There is typically a 6% fall between the third and fourth quarter. For 2009 as a whole, lending totalled £143.7 billion, slightly above our annual forecast of £141 billion. However, this is down 43% from £253 billion in 2008 and the lowest annual total since 2000 (£119.8 billion)".

Source: Council of Mortgage Lenders, 21 January 2010.

### **CML – Market Commentary**

"The start of the New Year brings some reason for optimism. 2010 will almost certainly be a better year than 2009. The UK likely emerged from recession towards the end of last year, while housing and mortgage markets are certainly in better shape than twelve months ago. However, there remains little prospect of a rapid improvement in the coming months. Like much of Europe, the UK economy is expected to pick up only gradually, particularly over the early part of the year. The election will keep UK's fiscal position out there as a key issue, but with little serious action to curtail deficit this year. We remain vulnerable to further shocks and changes in market conditions. The end of the stamp duty holiday could be one such example. Following a stronger than anticipated end to last year, driven by house purchase activity, mortgage lending may see a larger than usual seasonal drop-off in the coming months. Various headwinds will slow the improvement further out, and we anticipate a rather quiet year ahead. But low interest rates, an improving economic backdrop and wider access to credit should underpin the market".

Source: Council of Mortgage Lenders, 21 January 2010.

## **11. Retail, inflation and prices**

### **Retail Sales, Modest underlying growth**

"Year on year, the volume of retail sales in December 2009 was 2.1 per cent higher than in December 2008. Predominantly food stores increased by 2.8 per cent compared to the same period a year ago. Predominantly non-food stores increased by 0.7 per cent.

Sales volume in the three months October to December increased by 0.7 per cent when compared to the previous three months. Three-monthly growth increased by 0.4 per cent for predominantly food stores while predominantly non-food stores increased by 0.5 per cent.

Total sales volume in the three months to December was 2.7 per cent higher than the same period a year ago. Sales volume for predominantly food stores increased by 1.8 per cent. Predominantly non-food stores increased by 2.5 per cent.

Between November and December, total sales volume increased by 0.3 per cent. Predominantly food stores increased by 0.3 per cent while predominantly non-food stores increased by 0.1 per cent.

The seasonally adjusted value of retail sales for December 2009 was 3.6 per cent higher than in December 2008 and the three months to December 2009 was 3.0 per cent higher than the same period a year earlier”.

Source: ONS, Retail Sales, Release, 22 January 2010.

**CPI annual inflation – the Government’s target measure – was 2.9 per cent in December, up from 1.9 per cent in November.**

“The increase in the CPI annual rate of 1.0 per cent between November and December 2009 is the largest ever increase in the annual rate between two months. This record increase is due to a number of exceptional events that took place in December 2008: the reduction in the standard rate of Value Added Tax (VAT) to 15 per cent from 17.5 per cent; sharp falls in the price of oil; pre-Christmas sales as a result of the economic downturn.

These exceptional events led to the CPI falling by 0.4 per cent between November and December 2008 (a record fall between these two months). The CPI increase between November and December 2009 of 0.6 per cent is far more typical (the CPI increased by 0.6 per cent between November and December in both 2006 and 2007). These exceptional events also affected the change in the RPI annual rate.

The largest upward pressures ... Transport - within this division the largest upward effect came from fuels and lubricants where prices rose by 0.2 per cent between November and December this year compared with a fall of 6.2 per cent a year ago. ... Within transport there was also large upward pressure from the purchase of new cars where prices rose slightly this year but fell a year ago. The 2.1 per cent decrease between November and December 2008 was the third largest monthly fall in the price of new cars on record and was largely due to the reduction in the VAT rate in December 2008 to 15 per cent from 17.5 per cent.

In the year to December 2009, RPI annual inflation was 2.4 per cent, up from 0.3 per cent in November. The last time there was an increase in the 12-month rate greater than 2.1 per cent between two months was in June and July 1979 when the rate increased from 11.4 per cent to 15.6 per cent.

The exceptional events that took place in December 2008 that help explain the change in the CPI annual rate in December 2009 also apply to the change in the RPI annual rate. In addition to these exceptional events there was also significant upward pressure to the change in the RPI annual rate

from housing. Within housing the main upward effect came from mortgage interest payments which rose this year but fell significantly a year ago when most lenders passed on the one and a half point decrease in the Bank rate. ... RPIX inflation – the all items RPI excluding mortgage interest payments – was 3.8 per cent in December, up from 2.7 per cent in November.

As an internationally comparable measure of inflation, the CPI shows that the UK inflation rate in November was above the provisional figure for the European Union. The UK rate was 1.9 per cent whereas the EU's as a whole was 1.0 per cent".

Source: ONS, News Release, 19 January 2010.

#### **Consumer Price Index and the Retail Price Index**

"The consumer prices index (CPI) is the main United Kingdom domestic measure of consumer price inflation for macroeconomic purposes. It forms the basis for the Government's inflation target that the Bank of England's Monetary Policy Committee (MPC) is required to achieve. The retail prices index (RPI) is the most long-standing general purpose measure of inflation in the United Kingdom and is available from June 1947. It is used for a variety of purposes by both government and external users including the indexation of various incomes and prices and the uprating of pensions, benefits and index-linked gilts.

The CPI excludes a number of RPI series mainly relating to housing costs (for example, council tax), and in particular to owner occupiers' housing costs (including mortgage interest payments, house depreciation and buildings insurance). In addition, the CPI excludes the annual road fund licence and, from 2006, TV licences ...and Trades Union subscriptions which by convention are not part of household expenditure. The CPI includes series for university accommodation fees, foreign students' university tuition fees, and unit trust and stockbrokers' charges, none of which are included in the RPI".

Source: ONS, Statistical Bulletin, 13th October 2009.

#### **Producer prices, December 2009**

"The output price index for home sales of manufactured products rose 3.5 per cent in the year to December, compared with a rise of 2.9 per cent in the year to November. The index rose 0.5 per cent between November and December, mainly reflecting price rises in other manufactured products, transport equipment, food and electrical products. The output price index excluding excise duties rose 3.2 per cent in the year to December. The index rose 0.6 per cent between November and December. The output price index excluding food, beverages, tobacco and petroleum rose 2.6 per cent in the year to December. The index rose 0.7 per cent between November and December".

Source: ONS, Producer Prices, Statistical Bulletin, December 2009, 8 January 2010.

## 12. Consumer confidence

### Confidence falls back in December

- Consumer confidence recorded a five point decrease in December to 69 – its biggest fall since November 2008.
- The Expectations Index dropped eight points to 101 in December.
- The Present Situation Index remained unchanged in December while the Spending Index fell by one point.
- The proportion of consumers who think the economic situation will be better in six months' time now stands at 34%, compared to 41% in November.
- The proportion of people who think there will be many or some jobs available in six months' time dropped from 27% to 25% in December, but ended the year 10 percentage points higher than in January.
- Over a third of consumers believe now to be a good time to make a major purchase, while 38% believe it to be a bad time – up four percentage points in December.

“The five point fall in confidence in December suggests that an element of caution may have begun to creep back into the minds of consumers over the Christmas period. This comes at the end of a positive year for the index, which gained some upwards momentum in 2009 to help claw its way up from the record low seen in January. The main driver behind this revival is likely to have been a renewed hope for the future economic situation and a belief that the worst of the recession is over. However, the looming VAT hike and other tax changes announced in the Pre-Budget Report may have impacted on confidence in December, forcing people to review their expectations for the future. Although it is still early days, these lower expectations may foreshadow a more sluggish consumer outlook in 2010 as stimulus measures are withdrawn.”

[**Present Situation Index** reflects sentiment about the current economic and employment situation. **Spending Index** reflects sentiment about spending on household goods and major purchases.]

Source: Nationwide Consumer Confidence Index in partnership with TNS, 6 January 2010.

## 13. Finance

### Public sector finances December 2009

“The main statistics released show, that in December **2009**: the **public sector current budget** was in **deficit** by **£11.5** billion; this is a **£0.4 billion higher deficit** than in December 2008, when there was a **deficit** of **£11.1** billion; **public sector net borrowing** was **£15.7** billion; this is **£1.9 billion higher** net borrowing than in December 2008, when net borrowing was **£13.8** billion;

the **public sector net cash requirement** was **£23.6** billion, a **£2.0** billion **higher** net cash requirement than in December 2008, when there was a net cash requirement of **£21.6** billion.

At the end of December 2009 **public sector net debt** was **£870.0** billion (equivalent to **61.7** per cent of GDP). This compares to **£733.9** billion (**51.7** per cent) as at the end of December 2008.

Public sector net borrowing (excluding financial interventions) was £50.3 billion in the third quarter of 2009-10, up from £32.1 billion in the third quarter of 2008-09.

Public sector net debt (excluding financial interventions) at the end of December 2009 was £740.6 billion (52.5 per cent of GDP) up from £596.9 billion (42.1 per cent of GDP) a year earlier.

#### **Financial year to date (April 2009 – December 2009):**

Monthly data can be volatile, so it can be misleading to read too much into one month's data. The following paragraphs give information on the financial year to date and comparisons with the corresponding period of the previous financial year.

**In financial year 2009/10:** the **public sector current budget** was in deficit by **£93.4** billion; this is a **£47.1** billion **higher** deficit than in the same period of 2008/09, when there was a deficit of **£46.3** billion; **public sector net borrowing** was **£119.9** billion. This was a **£56.3** billion **higher** net borrowing than in the same period of 2008/09, when there was net borrowing of **£63.6** billion;

the **public sector net cash requirement** (see table PSF7) was **£120.5** billion; **£69.1** billion **higher** net cash requirement when compared with the same period of 2008/09 when there was a net cash requirement of **£51.4** billion;

**public sector net borrowing excluding financial interventions** was **£127.9** billion. This was a **£57.8** billion **higher** net borrowing than in the same period of 2008/09, when there was net borrowing of **£70.1** billion".

Source: ONS and Treasury, Public sector finances, Statistical Bulletin, 11 January 2010.

#### **Bank of England, Trends in Lending, January 2009**

"The flow of net lending to UK businesses rose in November, though remained subdued. The effective rate on new lending increased in November, though in the Credit Conditions Survey lenders reported a reduction in spreads and fees during 2009 Q4 overall — the first such declines recorded in this survey since 2007 Q2. Some business contacts reported a marginal improvement in the availability of credit during the second half of 2009, with conditions reported to have eased more for larger companies than their smaller counterparts. The major UK lenders reported that loan demand continued to be weak.

The flow of net mortgage lending rose in November, though remained well below the average flow in 2008. Gross lending for house purchase increased in December, according to data from the major UK lenders, which was said partly to reflect some homebuyers bringing forward purchases before the

end of stamp duty relief. Mortgage approvals by the major UK lenders slowed in December, having risen in previous months. Mortgage credit availability was reported by lenders to have improved in 2009 Q4, particularly for borrowers with loan to value ratios above 75%, and secured lending spreads were expected to narrow in 2010 Q1. Demand for mortgages for house purchase was reported to have risen further.

The total flow of net consumer credit and the twelve-month growth rate of the stock of lending remained negative in November. Spreads between effective interest rates on consumer credit and Bank Rate and Libor remained significantly wider than a year earlier. Availability of consumer credit was reported by lenders to have tightened further. And although consumers' expectations for unemployment have fallen, consumer credit demand was expected to remain subdued". [Libor - London Inter-Bank Offered Rate. The rate at which international banks lend to each other].

Source: Bank of England, Trends in Lending, January 2010.

### **Lending to individuals: November 2009**

"**Total net lending to individuals** rose by £1.1 billion in November. The twelve-month growth rate remained at 0.7%. The three-month annualised growth rate was 0.6%, unchanged from a revised 0.6% for October. Within the total, **net lending secured on dwellings** increased by £1.5 billion, higher than the October increase of £1.1 billion and the previous six-month average of £0.7 billion. The twelve-month growth rate was 0.9%, unchanged from a revised 0.9% for October. The three-month annualised growth rate increased 0.1 percentage points to 1.2%.

Within total secured lending, secured lending by banks (excluding the effects of securitisations) increased by £4.3 billion, above both the October increase (£3.3 billion) and the previous six-month average of £2.8 billion. The **number of loan approvals for house purchase** (60,518) was higher than the October figure (57,718) and the previous six-month average; approvals for **remortgaging** (24,897) were slightly higher than in October but remained below the previous six-month average. The number of loans approved for **other purposes** (28,131) was lower than both the October figure and the previous six-month average. **Consumer credit** fell by a net £0.4 billion, weaker than the previous six-month average of a £0.2 billion fall. **Credit card lending** increased by £0.2 billion but **other loans and advances** fell by £0.6 billion. The annual growth rate of consumer credit continued to fall, to -0.5%; the three-month annualised growth rate remained at -2.2%".

Source: Bank of England, Statistical Release, Lending to individuals, 4 January 2010.

## **E International perspective**

### **14. Data**

#### **Euro area and EU27 unemployment up.**

The euro area (EA16) seasonally-adjusted unemployment rate was 10.0% in November 2009, compared with 9.9% in October. It was 8.0% in November 2008. The EU27 unemployment rate was 9.5% in November 2009, compared with 9.4% in October. It was 7.5% in November 2008. For the euro area this is the highest rate since August 1998 and for the EU27 since the start of the series (January 2000).

Among the Member States, the lowest unemployment rates were recorded in the Netherlands (3.9%) and Austria (5.5%), and the highest rates in Latvia (22.3%) and Spain (19.4%).

Compared with a year ago, all Member States recorded an increase in their unemployment rate. The smallest increases were observed in Germany (7.1% to 7.6%), Luxemburg (5.2% to 6.0%) and Malta (6.2% to 7.0%). The highest increases were registered in Latvia (10.2% to 22.3%), Estonia (6.5% to 15.2% between the third quarters of 2008 and 2009) and Lithuania (6.4% to 14.6% between the third quarters of 2008 and 2009).

In November 2009, the youth unemployment rate (under-25s) was 21.0% in the euro area and 21.4% in the EU27. In November 2008 it was 16.6% in both zones. The lowest rate was observed in the Netherlands (7.5%), and the highest rates in Spain (43.8%) and Latvia (36.3% in the third quarter of 2009). In November 2009, the unemployment rate was 10.0% in the USA and 5.2% in Japan.

Source: Eurostat News Release, 5/2010 - 8 January 2010

#### **Industrial production up.**

In November 2009 compared with October 2009, seasonally adjusted industrial production<sup>1</sup> grew by 1.0% in the euro area (EA16) and by 0.9% in the EU27. In October<sup>3</sup> production fell by 0.3% and 0.7% respectively. In November 2009 compared with November 2008, industrial production declined by 7.1% in the euro area and by 6.4% in the EU27.

Source: Eurostat News Release, 7/2010 - 14 January 2010.

#### **Construction output down.**

In the construction sector, seasonally adjusted production decreased by 1.1% in the euro area (EA16) and by 0.6% in the EU27 in November 2009, compared with the previous month. In October<sup>3</sup>, production fell by 0.4% and 0.3% respectively. Compared with November 2008, output in November 2009 dropped by 8.0% in the euro area and by 6.7% in the EU27.

Source: Eurostat News Release, 1/2010 - 19 January 2010.

## **Living conditions in 2008, 17% of EU27 population at risk of poverty**

"In 2008, 17% of the population in the EU27 were at risk of poverty. This means that their income after social transfers was below the poverty threshold<sup>1</sup>. Since 2005, the at-risk-of-poverty rate in the EU27 has been nearly stable, varying between 16% and 17%. The highest at-risk-of-poverty rates in 2008 were found in Latvia (26%), Romania (23%), Bulgaria (21%), Greece, Spain and Lithuania (all 20%), and the lowest in the Czech Republic (9%), the Netherlands and Slovakia (both 11%), Denmark, Hungary, Austria, Slovenia and Sweden (all 12%). It should be noted that the at-risk-of-poverty rate is a relative measure of poverty, and that the poverty threshold varies greatly between Member States.

In 20 of the 27 Member States, child at-risk-of-poverty rates were higher than for the total population. In 2008, the at-risk-of-poverty rate for those aged up to 17 years was 20% in the EU27. The highest rates were recorded in Romania (33%), Bulgaria (26%), Italy and Latvia (both 25%), and the lowest in Denmark (9%), Slovenia and Finland (both 12%). Elderly people also face a higher risk of poverty than the total population. In 2008, the at-risk-of-poverty rate for those aged 65 years and over was 19% in the EU27. The highest rates were observed in Latvia (51%), Cyprus (49%), Estonia (39%) and Bulgaria (34%), and the lowest in Hungary (4%), Luxembourg (5%) and the Czech Republic (7%). Being employed significantly reduces the risk of poverty. In 2008, the at-risk-of-poverty rate for those in employment was 8% on average in the EU27, ranging from 4% in the Czech Republic to 17% in Romania. Highest rate of material deprivation in Bulgaria, Romania, Hungary and Latvia".

Source: Eurostat News Release, 10/2010 - 18 January 2010

## **OECD composite leading indicators continue to signal a recovery**

"OECD composite leading indicators (CLIs) for November 2009 provide stronger signals of recovery than in last month's assessment. Troughs in the underlying reference series – the index of industrial production – for all major seven countries, except Canada and the United Kingdom, are also visible, and the CLIs for all major seven countries have moved above their long-term trend, implying an expansionary outlook relative to trend. The outlook for major non member economies also continues to point to a recovery".

Source: OECD, Paris, 8 January 2010 OECD Composite Leading Indicators News Release.

## **World trade and production momentum continues upwards**

### World trade volume

"Based on preliminary data the world trade volume expanded by 1.1% in November from the previous month, following an increase of 1.4% in October (revised upward from 0.8%). World import volumes increased by 2.6% in November whereas world export volumes declined by 0.3%. This discrepancy is fully reflected in (partly estimated) diverging price trends. Import volumes of emerging countries continued to expand strongly, by 5%

on average. In the advanced economies as a whole, import volumes increased marginally in November, after having declined slightly in October. In Japan the rebound was marked, October having posted a very weak figure. European imports decreased however. In November, trade was still 12% below the peak level reached in April 2008, as the world economy is recovering from the unprecedented decline that occurred in November 2008 - January 2009. It was however 10% above the trough reached in May 2009. Monthly trade figures are volatile and focus on 'momentum' is therefore preferable. Momentum remains remarkably strong. In the three months up to November, world trade was up by 5,7% from the preceding three months, the highest figure in our series, which start in 1991.

#### World trade prices

In the three months up to November, dollar prices of world trade were up by 4.0% from the preceding three months. This is the sixth consecutive month of positive price momentum, which contrasts sharply with the deep declines that occurred towards the end of 2008. Dollar prices of traded manufactures continued to increase in November, momentum being 3.1%, the highest figure since July 2008.

#### World industrial production

On the basis of preliminary data, world industrial production continued to advance strongly in November, growing by 1.2% relative to the previous month, following a rise of 0.5% in October. All major regions shared in the increase, growth being particularly high in Japan. In November, world industrial production was still 5% below the peak level reached in March 2008. It was however up by 2% on the year. Since the trough in March 2009 it has risen steadily by an accumulated 8%. In the three months up to November world industrial production was up by 2.4% from the preceding three months. Industrial production in Japan and the emerging economies in Asia has recovered strongly, following massive declines in the beginning of this year".

Source: CPB Netherlands Bureau for Economic Policy Analysis, World trade monitor: November 2009, 26 January 2010.

## **15. Reports and reviews**

### **European Central Bank, Monthly Bulletin January.**

The ECB notes that with a 0.4% quarter on quarter increase in GDP economic activity in the euro area continued to expand. The upward movement was attributed to the turn in the inventory cycle, a recovery in exports together with the significant macroeconomic stimulus and the various measures implemented to support the financial system. However, the ECB reiterates comments in earlier reports about the temporary nature of some of these and the negative impact due to balance sheet adjustment. It is also considered that "low capacity utilisation rates are likely to dampen investment, and unemployment in the euro area is expected to increase somewhat further, thereby lowering consumption growth". Consequently, the euro areas growth is expected to be moderate and uneven, in line with previous comments. The report notes the "negative annual growth of bank

loans to the private sector” though loans to households are now positive. Loans to enterprises generally lag behind changes in output and while continuing uncertainty will depress demand for bank financing for some time.

The ECB states that it “will continue its enhanced credit support to the banking system, while taking into account the ongoing improvement in financial market conditions and avoiding distortions associated with maintaining non-standard measures for too long. The Governing Council will also continue to implement the gradual phasing-out of the extraordinary liquidity measures that are not needed to the same extent as in the past”.

Commenting on the issue of high government borrowing, the ECB states that these “carry the risk of triggering rapid changes in market sentiment, leading to less favourable medium and long-term market interest rates. This, in turn, would dampen private investment and thereby weaken the foundations for sustained growth”. They also refer to the impact high levels of public deficit and debt would have on monetary policy the Stability and Growth Pact. They therefore indicate that “... governments ... decide and implement in a timely fashion ambitious fiscal exit and consolidation strategies based on realistic growth assumptions, with a strong focus on expenditure reforms”.

Source: European Central Bank, Monthly Bulletin, January 2010.

### **Debt and deleveraging: the global credit bubble and its economic consequences**

This report sets the scene to the recession and its aftermath. It points out that “enabled by the globalization of banking and a period of unusually low interest rates and risk spreads, debt grew rapidly after 2000 in most mature economies.” The effect was that a number of economies – UK, Spain, South Korea and France had debt levels in relation to GDP which were higher than the United States. However, rather than look at total debt, there is a need to look at individual sectors – household, non-financial institutions (commercial real estate etc), government and financial institutions. It is suggested that there is no simple relationship between total debt to GDP levels and either the “sustainability of debt or the likely speed or extend of deleveraging”. Some countries in the past have undergone severe deleveraging despite low debt to GDP levels while other countries have maintained high debt levels for some time.

Table 10 shows total debt in relation to GDP (final column) and the contribution of each component to total debt. The figures indicate that while the UK experienced the largest rise in total debt relative to GDP between 2000 and 2008, government debt as a proportion of the total is relatively low accounting for 13.7%, compared to 20.7% in the US and 25.3% in Germany.

**Table 10: Sectoral composition of debt**

	Government	Non financial institutions	Households	Financial institutions	In relation to GDP
Country	%	%	%	%	%
Japan	41.0	20.9	14.6	23.5	459
UK	13.7	30.0	26.6	29.7	380
Spain	13.7	39.7	24.8	21.9	342
South Korea	8.5	34.7	24.2	32.6	331
Switzerland	11.8	23.9	37.6	26.8	313
France	23.7	35.7	14.3	26.3	308
Italy	33.8	27.1	13.4	25.8	298
US	20.7	26.9	33.1	19.3	290
Germany	25.3	24.2	22.7	27.8	274
Canada	24.5	22.0	34.3	19.2	245
China	20.3	60.8	7.6	11.4	159
Brazil	46.5	21.1	9.2	23.2	142
India	51.2	32.6	7.8	8.5	129
Russia	7.0	56.3	14.1	22.5	71

Each country was affected by a unique set of influences. Small countries such as Iceland and Ireland that set out to establish themselves as financial centres experienced significant credit booms between 2000 and 2008 fuelled by debt. In Iceland the debt to GDP ratio rose to 1,189% while for Ireland the figure was over 700%. The report highlights the role played by real estate in the growth of leveraging. "Rising real estate prices were both a cause and a consequence of increased borrowing: as property prices rose, buyers borrowed more to purchase them, thereby pushing prices up even more". By 2007 residential mortgage lending equalled 81% of GDP in the UK, 73% in the US. Despite mortgage lending being lower in Western Europe, it still accounted for the majority of growth in lending. The report suggests that the housing bubble may have been more significant than thought requiring closer monitoring of the sectors leveraging in the future. Rising house prices also masked household leverage, as "asset price appreciation can mask large and potentially unsustainable increases in leverage".

The data indicates that although overall the corporate sector had either stable or declining levels of leverage, two areas - the commercial estate sector, where high levels of leveraging are generally common, and companies which had been bought through leveraged buyouts. The report highlights the relationship between real estate booms and banking crises.

Reference has already been made to the financial sector where borrowing grew faster than GDP in most countries, particularly the UK and Spain.

The report suggests that deleveraging may be more difficult for economies now due to the global nature of the crisis and the increase in debt arising from the role played by governments in maintaining their economies. Another potential cause for concern relates to countries where a higher proportion of government debt is financed by foreign rather than domestic savings. If foreign savers consider that the economy is insecure, they may seek to withdraw savings hence pushing up interest rates and reducing economic growth. In policy terms, the report concludes that there is no simple means to prevent future credit bubbles, instead relying on a range of measures to fine tune the financial system. These could include better monitoring of what is happening, changes to banks in terms of monitoring risk and capital ratios, and policy changes to reduce lending for real estate and to limit household debt.

Source: McKinsey and Company, 2010.

**Please note text in quotation marks is a direct quote from the source.**

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Economic Development

31 January 2010

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