Economics

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Introduction

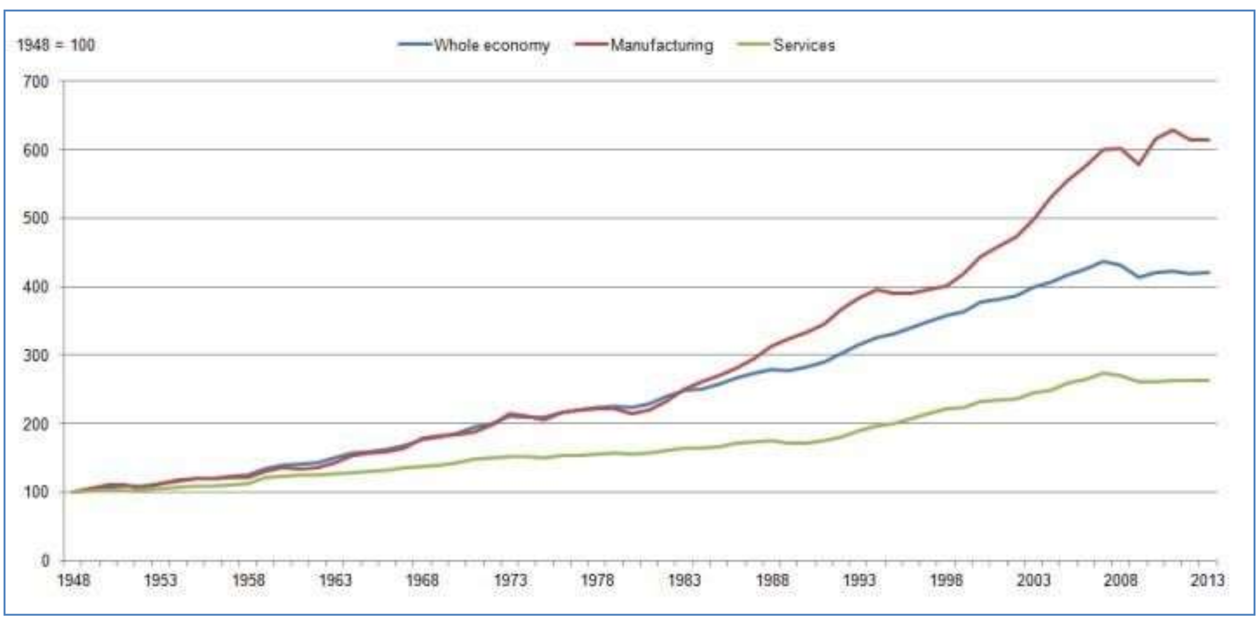
UK economy has always experienced ups and down situation however it has effectively managed to improve its GDP and output level over the past many years. The UK economy includes variety of sectors like other economies. Similar to other developed economies, there has been a remarkable shift in the structure of the UK economy from traditional to new approach. This paper has explained evolution of output, inflation, interest rates and government spending over the years in the UK. In addition, impacts of financial crisis 2007-09 on these indicators of economy were also discussed.

Evolution of major financial indicators in the UK

Output Level

A significant shift from manufacturing to services has made the economy to grow rapidly with the pace of globalization and technological advances (BIS, 2012). Significant changes in manufacturing, experiencing low-wage competition and technology adaptation have resulted in fall in global prices of product but in services it went up. Since 1978, there has been a significant fall in workforce of about 60% in manufacturing sector, however total output has increased over the time. According to ONS (Office for National Statistics), UK jobs in manufacturing in 2012 is just 8% as compared to 25 % in 1978. Though share of manufacturing sector has fallen to 10 % only in 2013 from 36% in 1948, but total output or production level has grown continuously by 2.8% (ONS, 2014). It is almost double from the growth in service sector which provides maximum employment in the UK (Michael and Banks, 2014).

Figure 1: Labor Productivity 1948-2013



Source: Office for National Statistics, 2014

Development of Inflation over years

For any economy, inflation is very important indicator of economic growth as it represents changes or stability in the price of goods or services. Inflation directly gets affected with central bank's decisions towards monetary policies, fiscal policies or any other policies. For any central bank, it is important to keep the inflation rate closer to the rate targeting for stability. In order to calculate inflation, Consumer Prices Index (CPI) is used by central banks considering the prices of specific items where consumer spending are higher on energy, food and clothing etc (World Bank, 2013).

Figure 2: Inflation rate in the UK

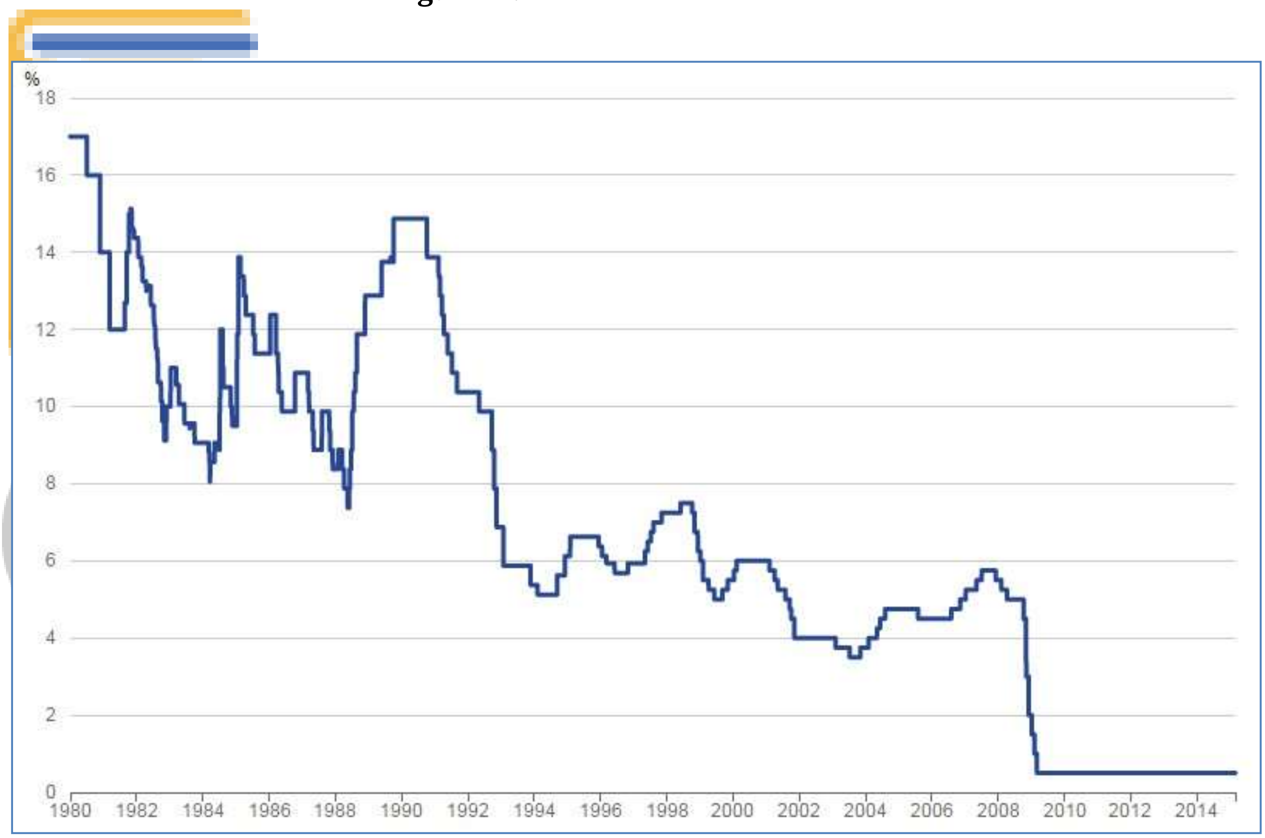
Source: Consumer Price Inflation, ONS, 2015

From the figure above by ONS, it can be easily seen that inflation has reached to 0.3% in the UK in January 2015 which is lowest over the last 50 years. Over the past 10 years, it was the first time inflation has reached such a low percentage below to 1%. During 2003-2008, inflation has reached to 3% and further to highest level of over 5 % in 2008 and 2011 (ONS, 2015).

Interest Rates by bank of England

Interest rates have vital role in development and economic expansion of a country. Direct investment in various industries or sectors largely depends on interest rates as it helps investors to get ease in their investment using finances from banks. Interest rates are also a price controller within the economy as in order to improve economic condition, inflation and money supply, central banks take strong decisions to lower down interest rates. In the UK, Bank of England sets out interest rates seeing conditions of the economy.

Figure 3 : Interest Rates in the UK



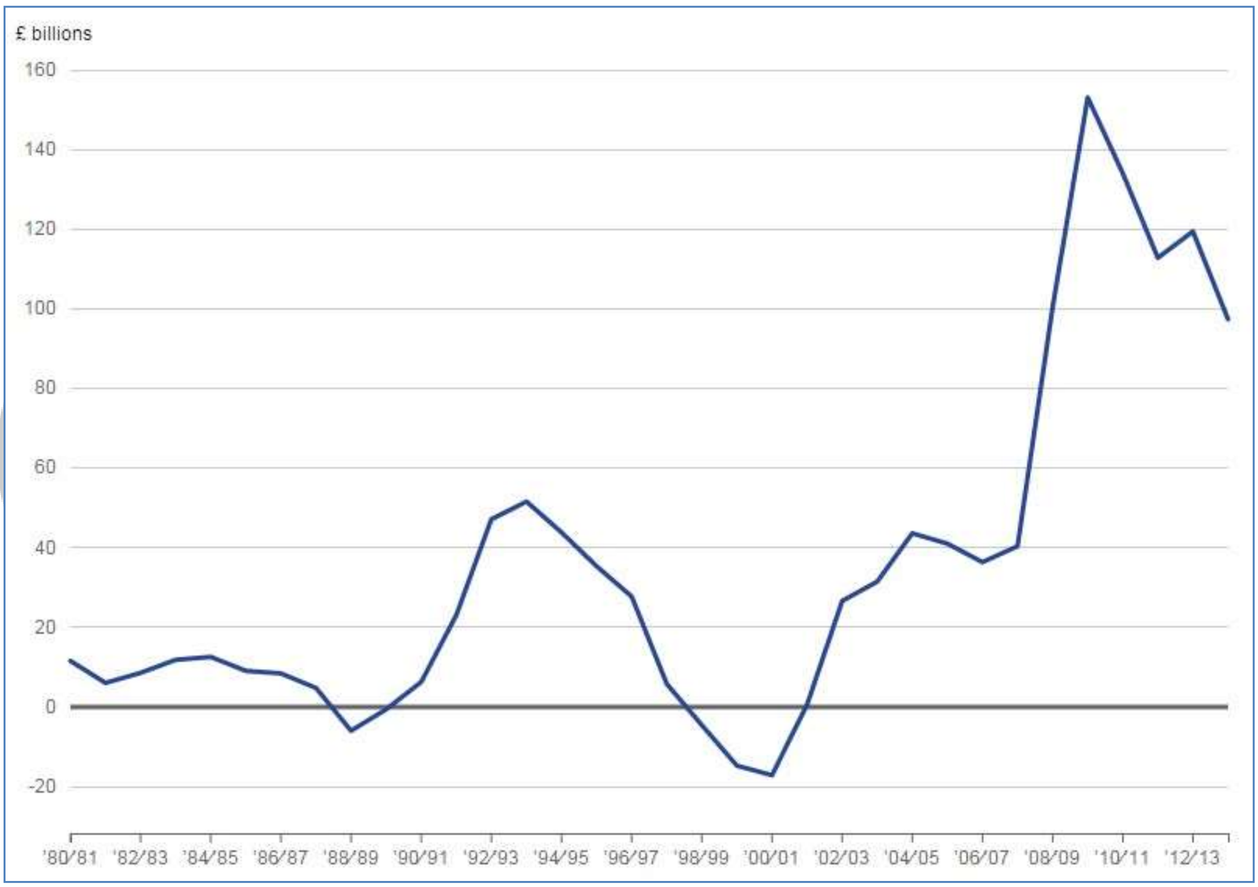
Source: Bank of England Interest Rates, ONS, 2015

From the figure above by ONS, it can evident that interest rates were ranging from 6 % to 5% during 1993 to 2008. However, since March 2009, bank interest rate has been 0.5% which is very low as compared to all time historical trends (ONS, 2015). Low interest rate was aimed to improvise investment in the economy and boost up consumer spending by reducing cost of borrowing.

Government Spending in the UK

Overall financial position of the economy is notified by the government income and its spending. Balance of both determines whether the economy is in surplus situation or experiencing deficit. In the UK, government has spent larger than what it has earned (Marks and Sweet, 2013),. Since, 1980, government income is less than expenditure that has resulted in UK deficit continually.

Figure 4: Fiscal Deficit in the UK



Source: Public Sector Finances, January 2015, ONS

Using data from the ONS, it is clear to state that financial crisis of 2007-08 has hit the economy largely as its deficit has reached to £153 billion in 2009 end as compared to 40 billion pound in 2007 end (ONS, 2015). UK government expenditure was all time higher to control financial crisis, stock market downfall, bailouts to business for their survival, manage employment and other financial problems. For the year ending 2014, government expenditure was £97.3 billion higher than government receipts.

Impact of Major Economic Downturn 2007-08 in UK indicators

Impact on output level

Recent global financial crisis of 2007-09 has hit UK market drastically. Overall productivity or output level declined in both service sectors as well as manufacturing sector. Prices of goods & products and services were shooting up and it was resulting to low income spending in the market. Therefore, production level was very down as an impact of this crisis.

Impact on Inflation

Inflation has reached to its highest level of 5.2% in 2009 that was higher than the target rate of 2% set by Bank of England. Price of consumer durable goods, food, etc went up. Housing market, real estate sector, employment all were majorly hit by the financial crisis. These sever results led to increase in consumer price index level (ONS, 2015).

Impact on Interest Rates

Financial crisis has resulted to increase in the prices, low money supply in the market, decreasing consumer spending and shut down of businesses. In order to control such situation, bank of England had to lower down its interest rates that reached to historical level of 0.5%. Lowering down of interest rate was aimed to increase financing, borrowing from the market, support business, control inflation, provide backup to employment and control increasing prices.

Conclusion

Eventually, UK economy has recovered its set back from the major hit of financial crisis in 200709. Taking strong measures of financial controls, Bank of England and government have made significant efforts to control financial position. Low interest rates have opened the way for international market players to establish their manufacturing unit or support existing units by receiving loans at lower rates. Increasing investments in technology in manufacturing or services sectors have significantly supported to increase output level to 2.8% today. Only concern for the government is to increase income source as deficit has been higher over the past five years as a result of financial crisis.

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