

United Kingdom

How unemployment could (technically) fall to 7.0% within the next few months

- Given the steep falls in one-month jobless data, the UK's unemployment rate could fall to 7.0% within the next few months
- Policymakers will need to communicate how this is likely to change their stance on interest rates

The rate of unemployment in the UK dropped more than expected in the three months to October, down to 7.4%, catching many analysts by surprise. The data raise the possibility of the jobless rate reaching the Bank of England's policy threshold of 7.0% far earlier than the Bank of England is expecting.

First though, here's a recap into how the jobless rate is calculated:

The Office for National Statistics calculates the rate of unemployment through a survey of households. However, it's not the same sample of households that is polled each month. Instead, the ONS uses three 'cohorts' of households on a rotating basis. Each cohort contains around 15,000 households. The ONS then uses the rolling three-month average of the three cohorts to produce the latest unemployment rate. However, also note that each cohort of 15,000 changes slightly every month, as one fifth of the respondents gets replaced with new people.

The monthly data from the ONS are shown opposite (and can be accessed fully [here](#)).

Last month we noted that cohort A's unemployment rate needed to drop from 7.7% to at least 7.2% in order to bring the headline rate down to 7.4%. We considered this to look infeasible, but cohort A's rate of unemployment in fact dropped right down to 7.0%. This 0.7 percentage point drop is in fact the largest ever seen since data were first available right back to 1992.

Perhaps we should have been more confident in forecasting such a steep fall. After all, surveys have been signalling the steepest rates of job creation since the late 1990s in recent months. It is therefore worth noting that if cohort B shows a similar 0.7% drop in its unemployment rate, the headline unemployment rate

Single-month unemployment data

	Household Survey 'Cohort'	Single Month Rate	Published average of latest 3 months
Jan-12	A	8.2	8.3
Feb-12	B	8.3	8.3
Mar-12	C	8.1	8.2
Apr-12	A	8.0	8.1
May-12	B	8.1	8.1
Jun-12	C	7.9	8.0
Jul-12	A	8.2	8.1
Aug-12	B	7.6	7.9
Sep-12	C	7.7	7.8
Oct-12	A	8.0	7.8
Nov-12	B	7.5	7.7
Dec-12	C	7.8	7.8
Jan-13	A	8.1	7.8
Feb-13	B	8.0	7.9
Mar-13	C	7.4	7.8
Apr-13	A	8.0	7.8
May-13	B	8.0	7.8
Jun-13	C	7.4	7.8
Jul-13	A	7.7	7.7
Aug-13	B	8.0	7.7
Sep-13	C	7.1	7.6
Oct-13	A	7.0	7.4

Source: Office for National Statistics.

Survey data on employment



Source: Markit (KPMG/REC Report on Jobs).

would be pushed down to 7.1%. While the prospect of a repeat of such a steep drop requires a large degree of optimism, it certainly means that, technically speaking, a 7.0% unemployment rate by the end of the year is looking feasible all of a sudden.

Bank of England caught out

We should at this point remember that the 7.0% unemployment rate is very much merely a condition that would need to be met before the Bank would even start considering raising interest rates. However, the Bank has clearly been caught out, looking far too pessimistic on the strength of the recovery. Its latest forecasts, published only a month ago, indicated that it did not expect the jobless rate to fall below 7.0% until late-2014. Early-2014 would now not look overly optimistic.

This raises a challenge for the Bank of England in respect to its forward guidance, which seeks to reassure businesses, households and the markets that interest rates will stay at historical lows until the economic recovery is robust and well established. With recent forecasts already looking out-of-date, the Bank will need to communicate what the faster than anticipated improvement in its chosen bellwether of the health of the economy means for interest rates.

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