PO-CH/NL/0143
PART C

Chex Lawson

PART C

SECRET

(Circulate under cover and notify REGISTRY of movement)

PO -CH /NL/0143

PART C

RPI)

Begins: ~~17/6/86~~ 22/4/86

Ends: ~~22/8/86~~ (CONTINUED)

3/6/86

DD: 25 years

5/9/95

CHANCELLOR'S 1986 PAPERS ON ECONOMIC STATISTICS, TRADE FIGURES AND THE RETAIL PRICE INDEX (RPI)

PO -CH /NL/0143

PART C

CHANCELLOR OF THE EXCHEQUER

Ch,

You wanted to discuss the March trade figures with Terry this afternoon.

RL.

23/4

156/6

SECRET AND PERSONAL
until 11.30 am on Friday 25 April 1986
then CONFIDENTIAL

No comments on Sizzy. But Discuss with Sir T Burns @ breakfast. M.

FROM: J E FLITTON
DATE: 22 APRIL 1986

1. MR KELLY
2. CHANCELLOR

cc as attached list

The size of the deficit is disturbing, even allowing for the erraticism of monthly figures.

C/ A day earlier than usual to give you plenty of time to scrutinize draft briefing for IDT. Pl indicate any suggestions. Ro 22/4

MARCH TRADE FIGURES

The March trade figures will be released on Friday 25 April. The current account was in deficit by £538 million (c.f. £262 million surplus in February).

Ce Discount & get no much further Rh 22/4

PS. Copy of DTI press notice below also for your approval. OK?

Summary

2. Visibles were in large deficit by £1,138 million, the largest deficit since monthly records began in 1963. This was partly offset by an estimated invisibles surplus of £600 million. Export volumes are falling; import volumes show little change in recent months.

Main points

3. (i) The March visible trade deficit is £800 million higher than in February. This is made up of a £300 million lower oil surplus and a £500 million higher non-oil deficit;

(ii) the underlying level of non-oil export volume has been falling since the middle of 1985 (see chart). Volume (excluding erratics) fell 3 per cent between the latest two quarters to stand 3 per cent above Q1 1985;

(iii) the underlying level of non-oil import volume increased through most of 1985 but appears to have changed little in the last few months;

(iv) the March <u>oil trade surplus</u> of £397 million is £300 million below the February figure. It reflects both lower export volume and the substantial fall in oil prices. However, the surplus of £2.1 billion in Q1 as a whole was well above that of the previous two quarters;

(v) the <u>manufacturing trade</u> deficit of nearly £800 million in March is substantially above recent levels and is probably erratic;

(vi) the <u>invisibles</u> surplus continues to be projected at a healthy £600 million.

<u>Comparison with forecast</u>

4. The visible deficit in 1986Q1 was £1 billion higher than the FSBR forecast. The difference comes entirely from the non oil balance where the main factor is the low level of manufactured exports - 6 per cent below forecast. Import volumes for manufactures are also lower than forecast (3 per cent), but import prices have risen more than forecast (1½ per cent), leaving values much as expected.

The oil balance in the first quarter was as forecast but prices were lower and net export volumes higher than expected.

<u>Trade Prices</u>

5. Import prices for manufactures rose 1½ per cent in March and prices of fuel imports fell 13 per cent. Other import prices were broadly unchanged. All import prices are still below levels a year ago. Non-fuel export prices rose in March. The non-oil terms of trade have worsened this year but in March were still 1½ per cent above 1985 as a whole.

SECRET AND PERSONAL
until 11.30 am on Friday 25 April 1986
then UNCLASSIFIED

Trade prices in March % changes

	Food		Basics		Manufactures		Fuel	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
On previous month	2.0	0.0	0.5	-0.5	1.0	1.5	-15.0	-13.0
On year earlier	3.0	-6.0	-13.0	-20.0	3.0	-1.5	-48.0	-42.0

Effect on markets

6. The markets are expecting a current account surplus of £250 million (and a trade deficit of £350 million). This is nearly £800 million too optimistic. It is difficult to judge the effect on markets of the poor figures but they will certainly not be helpful.

Press briefing

7. I should be grateful for clearance of the attached press briefing.

John Flitton

J E FLITTON
EF1

156/11

SECRET AND PERSONAL
until 11.30 am on Friday 25 April 1986
then UNCLASSIFIED

DRAFT BRIEFING FOR IDT

Positive

1. Despite March deficit, still substantial surplus of £0.9 billion on current account in Q1. Too much should not be read into one month's figures, which can be erratic.

2. Invisibles surplus estimated at £2.2 billion in Q1.

Defensive

1. **Record current account deficit**

[March deficits on current account, visible trade, manufactures and non-oil trade all records.]

Too much significance should not be read into one month's figures, which can be erratic. 1986 current account forecast in Budget to be in surplus by £3½ billion for the year as a whole.

2. **Export volumes**

[Export volume excluding oil and erratics down 6 per cent since February 1985 peak.]

Some fall from the early 1985 peak was to be expected. But grew by 5½ per cent in 1985, above growth in world trade, and expected to grow by further 6 per cent ~~in~~ over 1986 as a whole.

3. **Import volumes**

Excluding oil and erratics, volume fell 1 per cent in Q1 to stand 3 per cent above a year ago. Underlying trend shows little change in last few months.

SECRET AND PERSONAL
until 11.30 am on Friday 25 April 1986
then UNCLASSIFIED

4. **Manufacturing trade deficit**

Should not read too much into one month's figures. 1985 deficit of £3 billion improvement of over £0.9 billion on 1984 and FSBR forecasts unchanged deficit for 1986. Erratic monthly movements ~~against~~ apart, manufacturing trade deficit more than outweighed by substantial surplus on oil (despite fall in prices) and invisibles. UK exporters increased share of world trade 1981-85 in volume terms. UK manufacturing output (up 4 per cent in 1984 and 3 per cent in 1985) and share of world trade in manufactures (broadly stable since 1981 after years of decline) more important indicators of industrial performance than trade balance.

5. **Lower oil prices**

Bound to affect current balance. But substantial oil surplus of £5 billion still expected in 1986.

6. **Realism of FSBR forecast in light of lower oil prices**

[Current account surplus of £3½ billion forecast for 1986 after £3 billion surplus in 1985.]

Forecast already allows for effect of lower oil prices on visible balance partially offset by the lower profits earned by foreign oil companies operating in North Sea. Comparison with 1985 distorted by coal strike and timing of receipt of rebate on 1984 EC contribution.

TABLE 1: CURRENT ACCOUNT

£ billion

	1985	Q4 1985	1986 Q1	Jan	Feb	Mar	1986 year to date
Oil	+8.2	+1.9	+2.1	+1.0	+0.7	+0.4	+2.1
Non-oil	-10.2	-2.1	-3.4	-0.9	-1.0	-1.5	-3.4
Total visible trade	-2.1	-0.2	-1.3	+0.1	-0.3	-1.1	-1.3
o/w trade in manufactures (BOP basis)	-3.0	-0.6	-1.4	0.3	-0.4	-0.8	-1.4
Invisibles	+5.0	+1.1	+2.2*	+1.0*	+0.6*	+0.6*	+2.2*
Current Account	+3.0	+0.9	+0.9	+1.1	+0.3	-0.5	+0.9

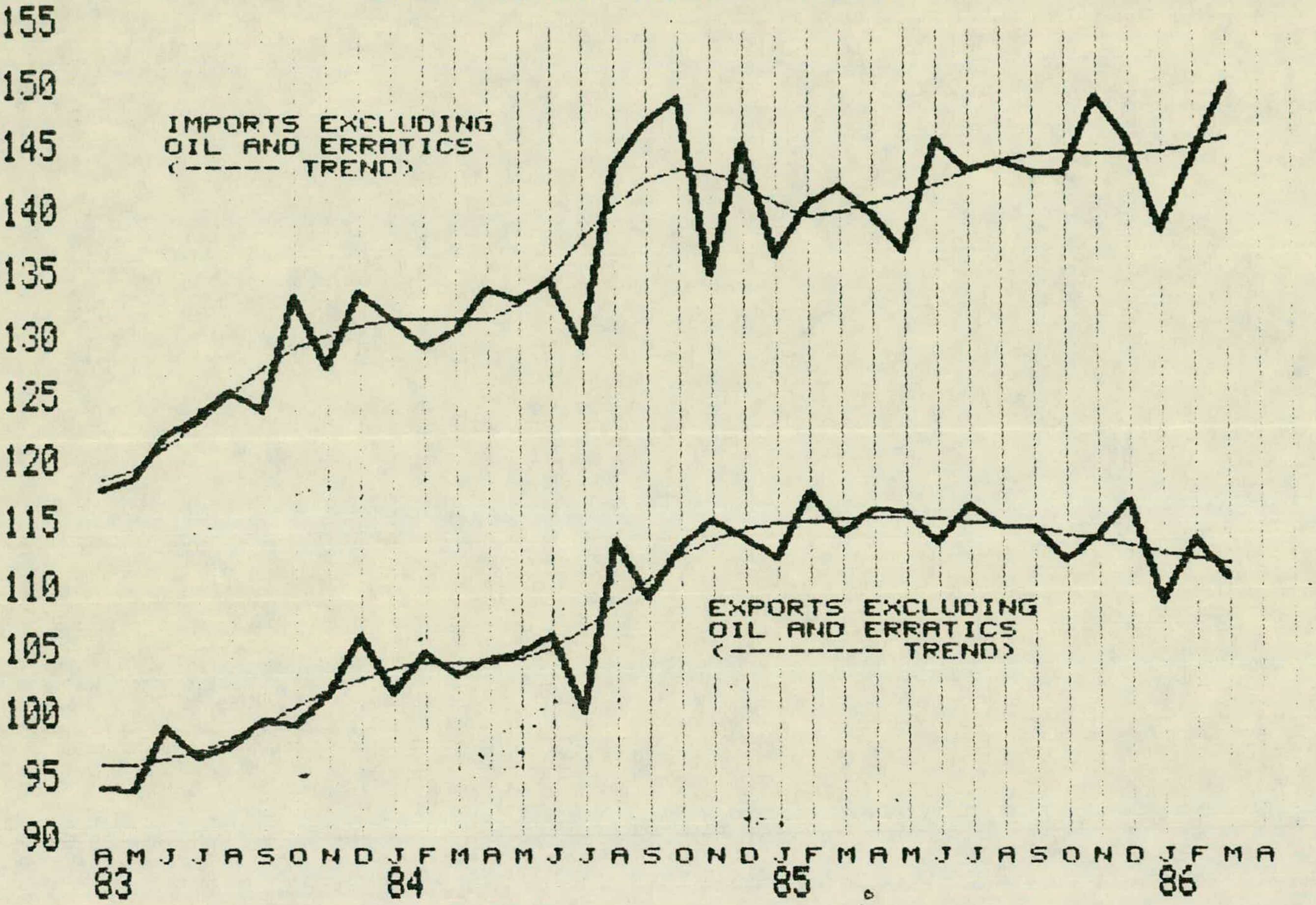
*projection

TABLE 2: EXPORTS AND IMPORTS (percentage change)

	1986 Mar on Feb	Q1 1986 on Q4 1985	Q1 1986 on Q1 1985
i. Exports			
Total value	-7½	-4½	-9½
Total volume (BOP basis)	-6½	-1½	-1
Total volume excl oil and erratics (BOP basis)	-2½	-3	-3
Manufactures volume (excl erratics) OTS basis	-2	-4	-4
Fuels (Volume)	-20	+10	+2½
ii. Imports			
Total value	+5½	+1½	-8½
Total volume (BOP basis)	+4½	-1½	-1
Total volume exc oil and erratics (BOP basis)	+4	-1	+3
Manufactures volume (excl erratics) OTS basis	+3½	-1½	+1½
Fuels (Volume)	-6	-16	-33

SECRET AND PERSONAL UNTIL RELEASE OF PRESS NOTICE AT 11.30AM 25.4.86

VOLUME INDICES



ON A BALANCE OF PAYMENTS BASIS 1980=100 SEASONALLY ADJUSTED

TRADE FIGURES FOR APRIL 1986

Advance Circulation

Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Lavelle
Mr Cassell
Mr H P Evans
Mr Fitchew

Mr C Kelly
Miss O'Mara
Mr Culpin
Mr S Robson
Mr Mowl
Mr Segal
Mr Barrell

Mr Gill - Bank
Mr Norgrove - No 10
Miss Deuchers - DTI

Circulation after 11.30 am on Friday 25th April

Financial Secretary
Minister of State
Mr Butler
Mr Byatt
Mr Lankester (Washington)
Mr Sedgwick
Mr Odling-Smee
Mr Melliss
Mr Riley

Mr P Patterson
Mr Matthews (EF)
Mr Shaw
Mr C Pickering
Mr Lord
Mr Davies
Miss Roche - NO 10

46/15

Ch/ We've been waiting for J O-S to come back on R Sosa's? point. I only show you at this stage in case Terry asks what's going on. (I haven't had a chance to speak to him today) RL 23/4

FROM: ROBERT CULPIN

DATE: 23 APRIL 1986

Please thank RB for his letter, with suggestions. Wk 1 [illegible] N

MRS LOMAX

WORKING PAPER ON FEEDBACK RULES

I am not going to lose sleep over this, because only 4 people will read it. But I should like minor drafting changes to neuter it further.

2. As drafted, it could be taken to say this:

a. if you believe the Treasury Model, we can devise simple rules to tell you how to vary interest rates to keep money GDP on track - so you don't need all this nonsense about discretion;

b. if people expect the future to be like the past - and this is described as the "conventional mode" - monetary conditions are useless: they are no better a guide than targeting money GDP directly, even if you allow for the fact that it takes ages to measure money GDP. Monetary conditions are only some use if you believe in the full glories of rational expectations.

Look, for example, at paragraphs 47-49 or paragraph 68.

3. This doesn't sound like the Lombard Speech we know and love.

4. The problem is almost entirely one of drafting. The answer to b, for example, is that the exchange rate and the monetary aggregates tell you something so long as they reflect expectations which are not entirely an extrapolation of the past. It is just that the working paper doesn't say so.

5. I have had a private word with Mr Odling-Smee. He thinks we could strengthen the disclaimers in paragraph 68 and/or paragraph 49.

For reasons of tact, it would help if he could draft something and clear it with the author. He will do that. I will then come back to you.

5. I also noticed a couple of other minor drafting points. Paragraphs 9 and 11 call money GDP an intermediate target - correctly in context, but perhaps a bit confusingly in relation to our normal terminology. And with your passion for cost push heresies, you might want to submit paragraph 30 to the thought police - though I assume it only tells you that an increase in earnings raises the price level, not the rate of inflation.

RC

ROBERT CULPIN

RR7.78

pmp

FROM: MRS R LOMAX

DATE: 24 April 1986

SIR P MIDDLETON

cc Sir T Burns
Mr Odling-Smee
Mr Culpin

TREASURY WORKING PAPER ON FEEDBACK RULES AND CONSISTENT EXPECTATIONS

The Chancellor was grateful for your minute of 17 April. He is content to go ahead and publish, as you recommend, provided it is done in an ultra-low key way.

2. He thinks it might be wise for Mr Culpin to look at the drafting, for any possible pitfalls, before we release it.

RL

RACHEL LOMAX

RR7.76

pwp

FROM: MRS R LOMAX
DATE: 24 April 1986

MR CULPIN

WORKING PAPER ON FEEDBACK RULES

The Chancellor has seen your minute to me of 23 April. He has asked me to thank you for your helpful suggestions, with which he concurs.

RL

RACHEL LOMAX

46/44

FROM: ROBERT CULPIN

DATE: 25 APRIL 1986

MRS LOMAX

cc Sir P Middleton
Sir T Burns
Mr Odling-Smee

WORKING PAPER ON FEEDBACK RULES

This is just to record that, following your note of 24 April, I have agreed minor drafting changes with Mr Odling-Smee and Mr Westaway. The Working Paper will now be published, without publicity, whenever sufficient copies have been produced.

RC

ROBERT CULPIN

CONFIDENTIAL

FROM: SIR T BURNS
DATE: 25 April 1986

CHANCELLOR

cc Sir P Middleton
Mr Cassell
Mr Kemp
Mr Evans
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Culpin
Mr S Davies
Mr S Brooks

RPI LESS MORTGAGE MORTGAGE INTEREST PAYMENTS

We have been giving some thought to the possibility of placing increased emphasis upon the RPI less mortgage interest payments. The sharp reduction in mortgage rates coming into effect this summer means that the inflation rate to be published in mid-year will be very low. Later this year or sometime next year we are likely to see some unwinding of this pattern unless there are continuing falls in the mortgage rate. It may be useful later this year to point out that this is a reflection of the contribution of mortgage rates and does not signify a change of trend. It will be more effective if we begin by drawing attention to this when the actual inflation rate is below the adjusted rate.

2. I attach a chart, which shows the extent to which the RPI excluding mortgage payments has been much more stable than the RPI itself.

3. Mr Evans has informally approached Paul Dworkin of the Department of Employment about the possibility of adding to the press notice a column or two for the RPI less mortgage interest payments.

4. As we expected, he took the view that this was a uniquely bad time: the RPI Advisory Committee was in the process of coming to the conclusion that there were good reasons why mortgage interest payments should remain in the RPI. For the DE to revise the press notice in order to give greater emphasis to the RPI less mortgage interest payments in the course of the Committee's deliberations would look very bad.

5. We can expect DE to repeat this line if we were to make a more formal approach.

6. I also raised the matter informally with Jack Hibbert of the CSO and he was more receptive to the idea. He saw some merit in providing this extra information, and approved of the idea of introducing it when it was to our disadvantage. He offered to speak to Paul Dworkin.

7. Even if DE refuse to go along with our proposal we could still publicise the RPI less mortgage interest payments by

(i) an ~~RPI~~ EPR box, containing a few figures and a simple chart, or

(ii) an EPR article on measures of inflation in general (RPI, RPI less mortgage interest payments, wholesale prices etc) and

(iii) regular briefings on movements in the RPI less mortgage interest payments.

8. My preference would be for (i) rather than (ii). It would undoubtedly be better if an EPR presentation followed an introduction of this series in DE's monthly press notice. But if necessary we could do it ourselves. My own feeling is that it does make sense to get this measure onto the record, possibly as part of a general exposition of problems of measuring inflation - which were always likely to come into prominence once inflation was brought to low levels.

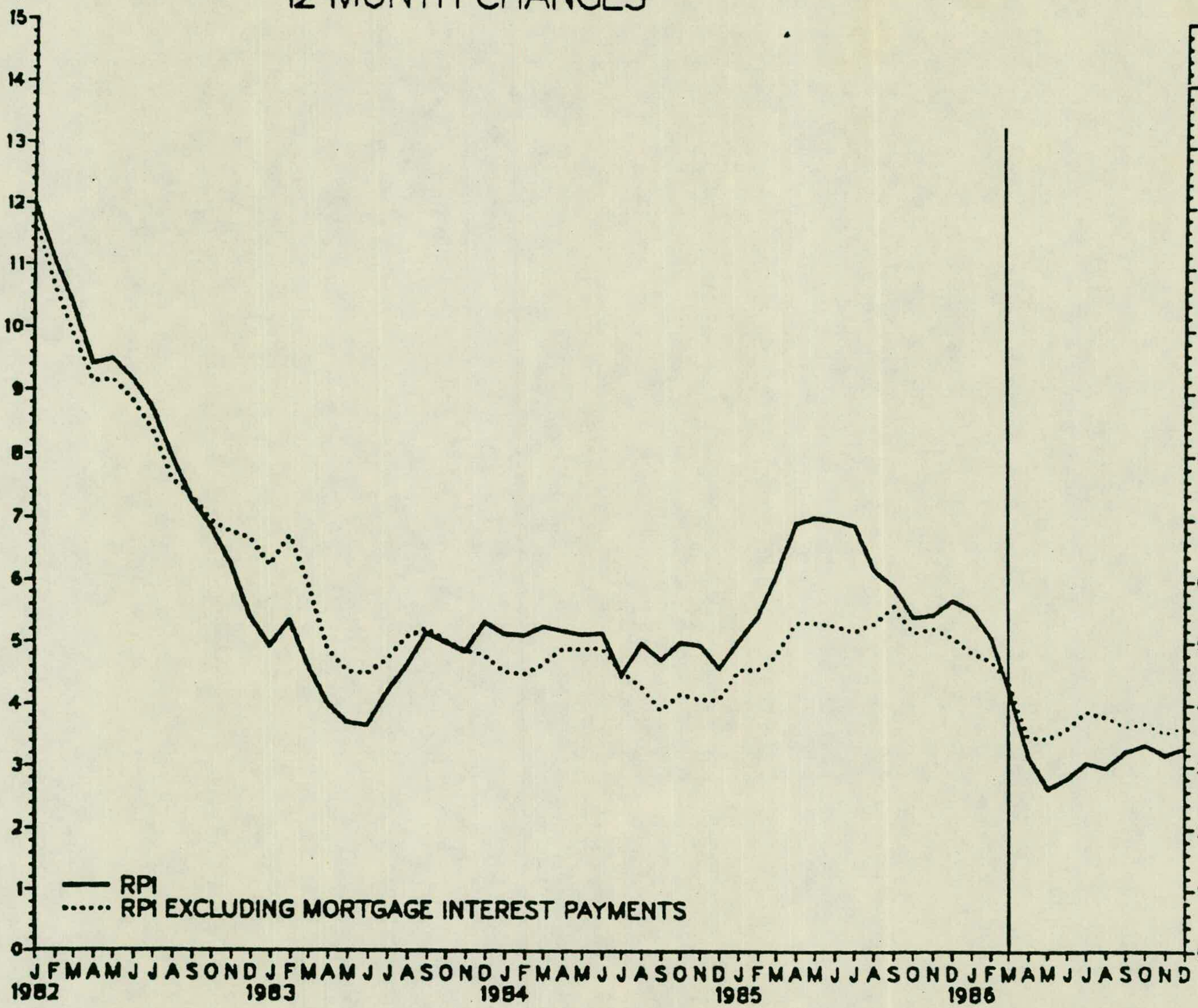
9. Past experience suggests that we are unlikely to hit the headlines with any other measure of inflation, particularly if it is below the official figure. Even so I see it as important to the informed commentator.

10. If you are interested in getting DE to expand their press notice I will ask Mr Evans to pursue it further with both DE and the CSO. It would be worth your sounding out Lord Young at an early stage to persuade him of the wisdom of such a move. (The next RPI, for April, is published on May 16). Perhaps the best argument is that an expansion of the material in the monthly press notice could cover, not just this adjusted version of the RPI, but other adjustments as well.

T BURNS

ENC

RPI AND RPI EXCLUDING MORTGAGE INTEREST PAYMENTS
12 MONTH CHANGES



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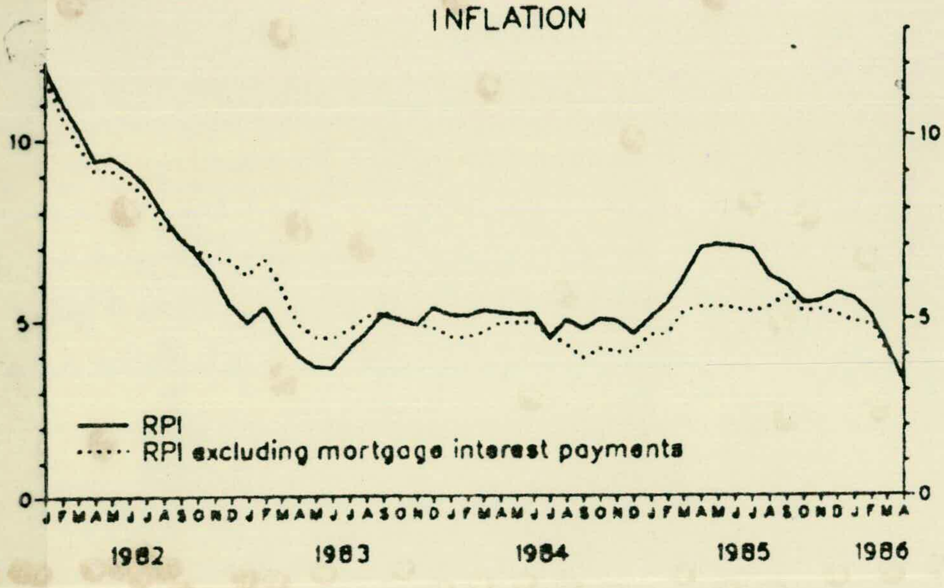


Inflation

as measured by the 12 month percentage change in

	RPI	RPI excluding mortgage interest payments
1985		
March	6.1	5.2
June	7.0	5.3
December	5.7	5.1
1986		
March	4.2	4.0
April	[3.2]	[3.5]

There was a steep fall in inflation from 1980 to 1983, followed by a period of no major change up until early 1986. Latest figures and most forecasts (including the Government forecast published in the FSBR) show a substantial decline in inflation in 1986.

2. The Retail Prices Index is the most commonly used measure of inflation and is shown in the chart. Unlike other measures, the RPI has, since 1975, included the mortgage interest rate, as an indicator of the cost of owner-occupied housing. The all-items RPI is thus sensitive to changes in interest rates which are subject to substantial short term fluctuations (a fall of 1 point in the mortgage rate reduces the all-items RPI by nearly ½ per cent). The chart also shows the RPI excluding mortgage interest payments. This is a less volatile series, which moves similarly to the RPI over the longer term.

3. Mortgage interest rates have fallen from 12¾ per cent in March to 12 per cent from 1 April, and a further reduction will affect the June index. In the chart the effects of the increases in mortgage rates in February and April 1985 on the RPI stand out clearly. At the present time the two series are not very different, but with further mortgage rate cuts in the pipeline, the all-time RPI is likely to run below the RPI excluding mortgage interest payments over the next few months.

CHANCELLOR OF THE EXCHEQUER

Please add

Miss O' Mara

to copy list

I agree with the general approach. Whatever happens we shd do 7(iii). It wd also be sensible for HMSL? to have a word with [illegible] (para 6); & I will have a word with L.Y. [illegible] I am bound, however, while [illegible] adjustments you are suggesting @ X; subject to that, I cannot see the point of [illegible] quite clear what is [illegible] by 7(i): where wd this [illegible] appear? Finally, I agree that 7(ii) should [illegible] until we know what we shall [illegible] but we will want to do it then. NL.

CONFIDENTIAL

FROM: SIR T BURNS
DATE: 25 April 1986

CHANCELLOR

Ch/ You might ask Robert for his views on this. I'd be surprised if the DE approach came to anything, but it's worth a try - preferably via J. Hibbert. But I think we should do 7(ii); 7(i) might be a follow up to 7(ii) rather than an alternative. Of course, this would mean a bit less boasting by everyone this summer, which may be tough when it comes to the point. RL 25/4.

cc Sir P Middleton
Mr Cassell
Mr Kemp
Mr Evans
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Culpin
Mr S Davies
Mr S Brooks

RPI LESS MORTGAGE MORTGAGE INTEREST PAYMENTS

We have been giving some thought to the possibility of placing increased emphasis upon the RPI less mortgage interest payments. The sharp reduction in mortgage rates coming into effect this summer means that the inflation rate to be published in mid-year will be very low. Later this year or sometime next year we are likely to see some unwinding of this pattern unless there are continuing falls in the mortgage rate. It may be useful later this year to point out that this is a reflection of the contribution of mortgage rates and does not signify a change of trend. It will be more effective if we begin by drawing attention to this when the actual inflation rate is below the adjusted rate.

PPS. What is the lowest RPI ex MR figure so far & when? (It looks to me like 4% in Sept '84).

2. I attach a chart, which shows the extent to which the RPI excluding mortgage payments has been much more stable than the RPI itself.

PS. On 2nd thoughts, before going ahead on this, I wd like Mr Butler's views on whether he sees any snags with this (what I have in mind is the [illegible] for [illegible] upratings! We do not want the 1987 upratings to be on the basis of the RPI ex MR, on the grounds that pensioners don't have mortgages). NL.

3. Mr Evans has informally approached Paul Dworkin of the Department of Employment about the possibility of adding to the press notice a column or two for the RPI less mortgage interest payments.

4. As we expected, he took the view that this was a uniquely bad time: the RPI Advisory Committee was in the process of coming to the conclusion that there were good reasons why mortgage interest payments should remain in the RPI. For the DE to revise the press notice in order to give greater emphasis to the RPI less mortgage interest payments in the course of the Committee's deliberations would look very bad.

5. We can expect DE to repeat this line if we were to make a more formal approach.

6. I also raised the matter informally with Jack Hibbert of the CSO and he was more receptive to the idea. He saw some merit in providing this extra information, and approved of the idea of introducing it when it was to our disadvantage. He offered to speak to Paul Dworkin.

7. Even if DE refuse to go along with our proposal we could still publicise the RPI less mortgage interest payments by

(i) an RPI box, containing a few figures and a simple chart, or

(ii) an EPR article on measures of inflation in general (RPI, RPI less mortgage interest payments, wholesale prices etc) and

(iii) regular briefings on movements in the RPI less mortgage interest payments.

8. My preference would be for (i) rather than (ii). It would undoubtedly be better if an EPR presentation followed an introduction of this series in DE's monthly press notice. But if necessary we could do it ourselves. My own feeling is that it does make sense to get this measure onto the record, possibly as part of a general exposition of problems of measuring inflation - which were always likely to come into prominence once inflation was brought to low levels.

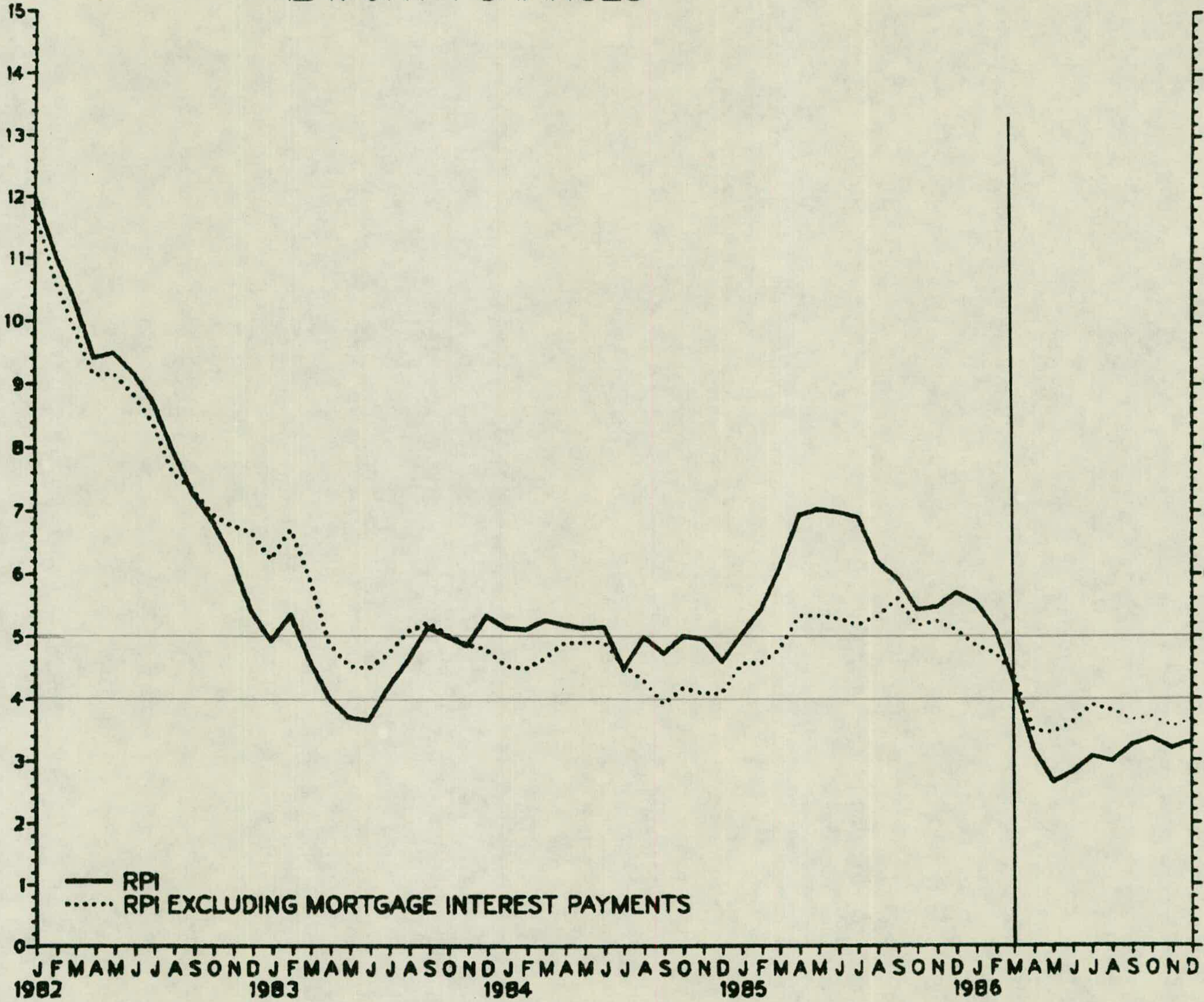
9. Past experience suggests that we are unlikely to hit the headlines with any other measure of inflation, particularly if it is below the official figure. Even so I see it as important to the informed commentator.

10. If you are interested in getting DE to expand their press notice I will ask Mr Evans to pursue it further with both DE and the CSO. It would be worth your sounding out Lord Young at an early stage to persuade him of the wisdom of such a move. (The next RPI, for April, is published on May 16). Perhaps the best argument is that an expansion of the material in the monthly press notice could cover, not just this adjusted version of the RPI, but other adjustments as well.

T BURNS

ENC

RPI AND RPI EXCLUDING MORTGAGE INTEREST PAYMENTS
12 MONTH CHANGES



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D: 25-4-86 M: JYOTI.TABCONV

Ms/46

CONFIDENTIAL

Rachel,
I'm afraid this did not come out of BF until today. Cathy seems to think that not great harm has been done. Hopefully it will not happen again. ... CJE
would have done to see Ld Young.

- part

FROM: MRS R LOMAX
DATE: 28 April 1986

1 ~~Cathy one for you~~ in future.
2 ~~Debbie~~ - write to Terry
3 bf 1/5 with answer to qn para 4(i) & FERB's views.

SIR T BURNS

cc Sir P Middleton
Mr F E R Butler
Mr Cassell
Mr Kemp
Mr Evans
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Culpin
Miss O'Mara

RPI LESS MORTGAGE INTEREST PAYMENTS

The Chancellor agrees with the general approach in your minute of 25 April. But before going nap on any of this, he would like Mr Butler's views on whether he sees serious risks for public expenditure. What the Chancellor has in mind is the risk for social security upratings: clearly we do not want the 1987 uprating to be on the basis of the RPI excluding mortgage interest payments, on the grounds that pensioners do not have mortgages.

2. Subject to Mr Butler's comments, the Chancellor thinks that, whatever happens, we should give regular briefings on movements in the RPI less mortgage interest payments. He thinks it might also be sensible for Jack Hibbert to have a word with Paul Dworkin, and for him to sound out Lord Young. But he is not clear what "other adjustments" to the RPI you are referring to in your final paragraph. On the face of it, he cannot see the point of confusing the issue by introducing them.

3. The Chancellor agrees that we should defer an EPR article on measures of inflation until we know where we stand with Department of Employment. But he thinks we will want to do it then. However, he is not entirely clear what you mean by "an RPI box". He has asked where this would appear.

4. The Chancellor would also be grateful if you would let him know the lowest figure so far for the RPI excluding mortgage interest payments: at a quick glance, it looks rather like 4 per cent in September 1984.

RL.

RACHEL LOMAX

12/2

Pgs pl

FROM: ANNA LEMESSANY

DATE: 29 April 1986

PPS

cc Sir P Middleton
Mr Cassell
Mr Kemp
Mr Evans
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Culpin
Mr S Davies
Mr S Brooks

RPI LESS MORTGAGE INTEREST PAYMENTS - CORRIGENDUM

There is an error in the minute from Sir Terence Burns circulated on 25 April 1986. In paragraph 7, subheading (i) should read ´an EPR box´ and not an RPI box.

Anna Lemessany.

ANNA LEMESSANY

Private Secretary

RPI

Thanks. 1 will write to N. Fowler re X - safer now a word. Suggest to Rob, 'all clear to go ahead'. 2. I agree with RE's para 2 below.

FROM: F. E. R. BUTLER
29th April, 1986.

CHANCELLOR OF THE EXCHEQUER

c.c. Chief Secretary
Sir Peter Middleton
Sir T. Burns
Mr. Anson
Mr. Cassell
Mr. Kemp
Mr. Evans
Mr. Odling-Smee
Mr. Peretz
Mr. Scholar
Mr. Sedgwick
Mr. Culpin
Miss O'Mara
Mr. Gray
Mr. M. Williams
Miss Noble

Ch/ Worth a word with Fowler if we want to make a big splash - or seem to be getting anywhere with DEm (see X in para 3). The dangers are a bit less with an EPR article.
See Robert's thoughts below. Also that the mysterious "RPI box" was a misprint for "EPR box".
Content to interpret this as green light? or sound out DHSS first?
RL 30/4

RPI LESS MORTGAGE INTEREST PAYMENTS

X You asked whether I saw serious risks for public expenditure arising from the proposal in Sir T. Burns' minute of 28th April.

2. Such risks could arise in two ways - either through proposals for the adoption of such an index (if it were higher than the RPI) for uprating of benefits, as mentioned in Mrs. Lomax's minute, or less directly through giving Departments ammunition for arguing for a higher provision in the Survey.

3. On the uprating of benefits the legislation provides for benefits to be uprated by not less the movement in the general level of prices. This is a deliberately imprecise formula to allow the Secretary of State to use the measure which is most appropriate to the particular benefit. In practice, most benefits have been uprated by the r.p.i., and DHSS Ministers have said publicly that they do not envisage making any change. But there are pressures from the lobbies to use other indices when they are more advantageous - eg the pensioners' price index - and the publication of this new index could attract some pressure for its use when it would produce higher upratings. I believe that this pressure could be resisted on the same grounds as other such pressures have been resisted, especially since the use of r.p.i. has now become well-established. But it would

be a wise precaution to check in advance of publication that DHSS Ministers share this view and would commit themselves to resisting any pressures which arose.

4. As regards our general discussions with Departments, the GDP deflator these days plays a bigger role than the r.p.i. In pursuing their own interests, Departments will always be inclined to pray in aid whatever index best helps their case, and the more indices there are, the more they will tend to switch attention to whichever will give them the highest increase. But for programme expenditure they are more likely to base their argument on a specific index relating to their expenditure, and I would not expect them to be inclined or able to make much use of series formed by the RPI less mortgage interest payments.

F.E.R.B.

F. E. R. BUTLER

46/54

FROM: ROBERT CULPIN
DATE: 30 APRIL 1986

CHANCELLOR

cc CST
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Kemp
Mr Evans
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Miss O'Mara
Mr Pickford

RPI LESS MORTGAGE INTEREST PAYMENTS

If we are going to publicise more actively the RPI less mortgage interest payments - and I agree that we should - it is worth bearing in mind that:

a. you drew specific attention to it in your most recent evidence to the TCSC, and

b. Mr Wainwright asked you for precisely the chart which Sir Terence Burns has just supplied.

Transcript attached.

2. I suggest that:-

just about!

i. in any discussion with Lord Young or his officials, we might as well use the point that we have been asked to publish the information in question; and

?

ii. if we then go ahead, write what? it could (just) be worth writing to the TCSC first. Saying what?

No | We could draw their attention to an EPR article, when published; maybe – though I doubt it – do the same with the DE press notice, if expanded.
But writing in advance seems to invite them to provide views/possible trouble.

Inform them 24 hours in advance. N.

ROBERT CULPIN

EXTRACTS FROM MINUTES OF EVIDENCE TAKEN BEFORE THE TREASURY AND CIVIL SERVICE COMMITTEE

25 MARCH 1986

171. The trouble with the track record is for almost three years, now perhaps ended, inflation has been going up rather than down and has certainly not moved in correspondence with money GDP.

(Mr *Lawson.*) I do not accept that for a moment.

172. It is in the Red Book chart 2.1.

(Mr *Lawson.*) The RPI is not the most accurate reflection in any event because of the curiosity of the mortgage rate being in the RPI (which is not the case in most other major countries, Canada is the only one that has it), which creates a distorting effect.

179. Would it not be fair minded and more helpful to the House of Commons Committee if you gave us a diagram of the rate of inflation as you think it ought to be compiled?

(Mr *Lawson.*) There is, I believe, a company in the City of London called Phillips & Drew who regularly publish the rate of inflation, the RPI, with mortgage rate knocked out of it and you can see that for yourself if you wish to and see a much smoother path.

180. Not many of my constituents are clients of Phillips & Drew, or any other City stockbrokers. My last question, because time is going on fast, is really to ask you to raise the curtain, at least for the benefit of the House of Commons, on this speech you are to make as late as the middle of April?

(Mr *Lawson.*) I cannot, I have not written it yet!

psp.

A23/1

COPY NO 86

MONTHLY ECONOMIC BRIEF

Prepared by the CSO on 1 May 1986

There was a sharp rise in seasonally adjusted unemployment in the month to March partly explicable by cold weather. While the March figure was probably erratically high, developments over the latest few months now point to a resumption of an upward trend. Revised estimates of the employed labour force show a rise of 276,000 in 1985 compared with 391,000 in 1984, suggesting a rather less buoyant rate of increase.

The annual rate of inflation fell sharply in March from 5.1 to 4.2 per cent. A further fall to around three and a quarter per cent is likely in April as increases in prices generally will be partially offset by the effect of lower oil prices and reductions in mortgage interest rates. This should result in a movement in the RPI between March and April of about half that recorded a year ago when mortgage rates increased. Producer input prices continue to fall from their peak level of around a year ago but there is no indication at present of any further decline in output price inflation.

Bank base rates currently stand at $10\frac{1}{2}$ per cent. They were reduced in two stages during the month by 1 per cent overall. World interest rates fell generally. There was a substantial strengthening of sterling against most major currencies in the first part of April. Following a further weakening of the dollar, sterling rose sharply, touching a high of $1.5590 on 28 April, its highest level since June 1983.

A PSBR of £3.0 billion in March brought the cumulative total for the financial year 1985-86 to £5.9 billion compared with £10.2 billion in the previous financial year. The undershoot of £0.9 billion on the FSBR forecast can mainly be attributed to higher than expected Central Government receipts, with non-oil revenues even more buoyant than expected.

Limited information about developments in the economy in the first quarter suggests growth of around $\frac{1}{2}$ per cent on the previous quarter. The underlying level of activity is now seen to be growing by between $\frac{1}{2}$ and $2\frac{1}{2}$ per cent per annum.

Visible trade is estimated to have been in deficit by £1138 million in March, following a deficit of £338 million in February. The underlying level of non-oil export volume has fallen in recent months while the underlying level of non-oil import volume, which has increased since the beginning of 1985, appears to have changed little over the past few months.

RECENT RATES OF CHANGE AND ASSESSMENT OF CURRENT TREND FOR SOME KEY ECONOMIC INDICATORS

In the following notes, the figures for current trend represent our best assessment of the current underlying rate of increase after making allowance for temporary distorting factors such as strikes, unseasonal weather effects, etc. The figures show how the series are moving currently and may be different from the comparisons over the latest published twelve months.

GDP (average measure) in the fourth quarter of 1985 was 3 per cent higher than in the same period a year ago or $1\frac{1}{2}$ per cent after discounting the effects of the coal strike. This figure does not take account of past experience which shows that revisions to growth rates for the initial published estimates of GDP were on average upwards though not uniformly so. The assessment of current underlying trend for the first quarter of 1986 is that the rate of increase lies in the range $\frac{1}{2}$–$2\frac{1}{2}$ per cent per annum.

Industrial production in the three months to February was $3\frac{1}{2}$ per cent higher than in the same period a year ago, but unchanged after allowing for the effects of the coal strike and other disputes, notably in the motor vehicles industry. On the same basis, respective figures for manufacturing were 1 and $\frac{1}{2}$ per cent. The assessment of underlying trend for industrial production is that the rate of increase currently lies in the range -1 to +1 per cent per annum. The trend in manufacturing output is also in the range -1 to +1 per cent per annum.

Retail prices rose by a little over 4 per cent in the twelve months to March 1986. A less variable indicator of the underlying movements in retail price inflation can be obtained by monitoring developments in about 70 per cent of the RPI, mainly covering private sector prices and excluding mortgage rates, local authority rates, seasonal food, nationalised industry prices and petrol. This series rose by $4\frac{1}{2}$ per cent in the twelve months to March 1986. (Not published).

Producer input prices declined in seasonally adjusted terms in each of the months from March last year to March this year. Some further decline is expected in April, bringing the index more than 11 per cent below its peak in February last year.

Average earnings (underlying) in the twelve months to February rose by $7\frac{1}{2}$ per cent. The current trend is estimated to be in the range $7\frac{1}{2}$–8 per cent per annum.

Unit wage costs in manufacturing in the three months to February rose by 7 per cent compared with the same period a year ago. The current underlying trend is estimated to be in the range 7–9 per cent per annum.

Unemployment (excluding school leavers) in the twelve months to March has been rising on average by 9 thousand per month and by 12 thousand per month in the latest six months. Discounting the effects of employment and training measures as far as possible, the current underlying trend appears to be an increase in the region of 15 thousand per month.

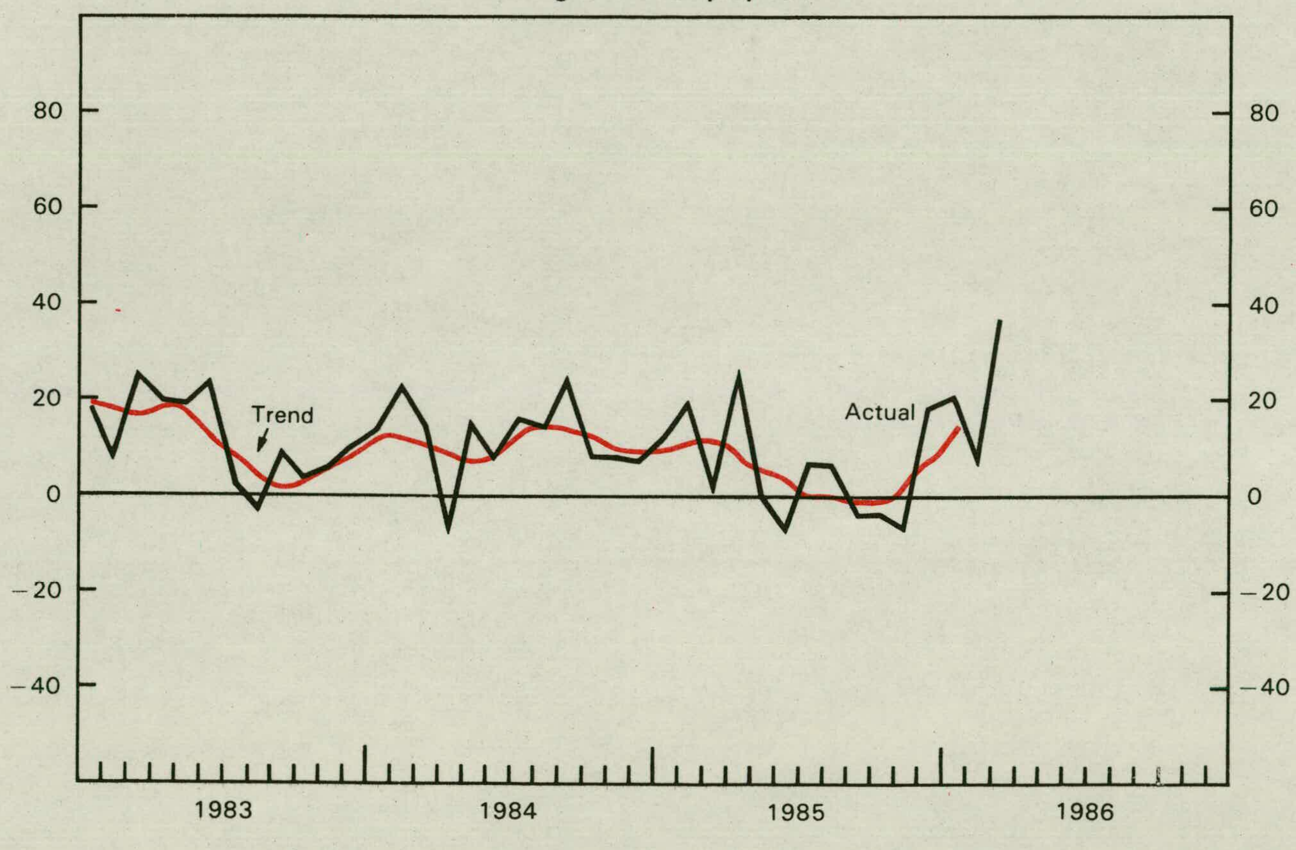
Movements over the latest published 12 months include any revisions that may have occurred since last publication (in general any such differences only occur in the GDP series).

CHART 1

Changes in output and expenditure

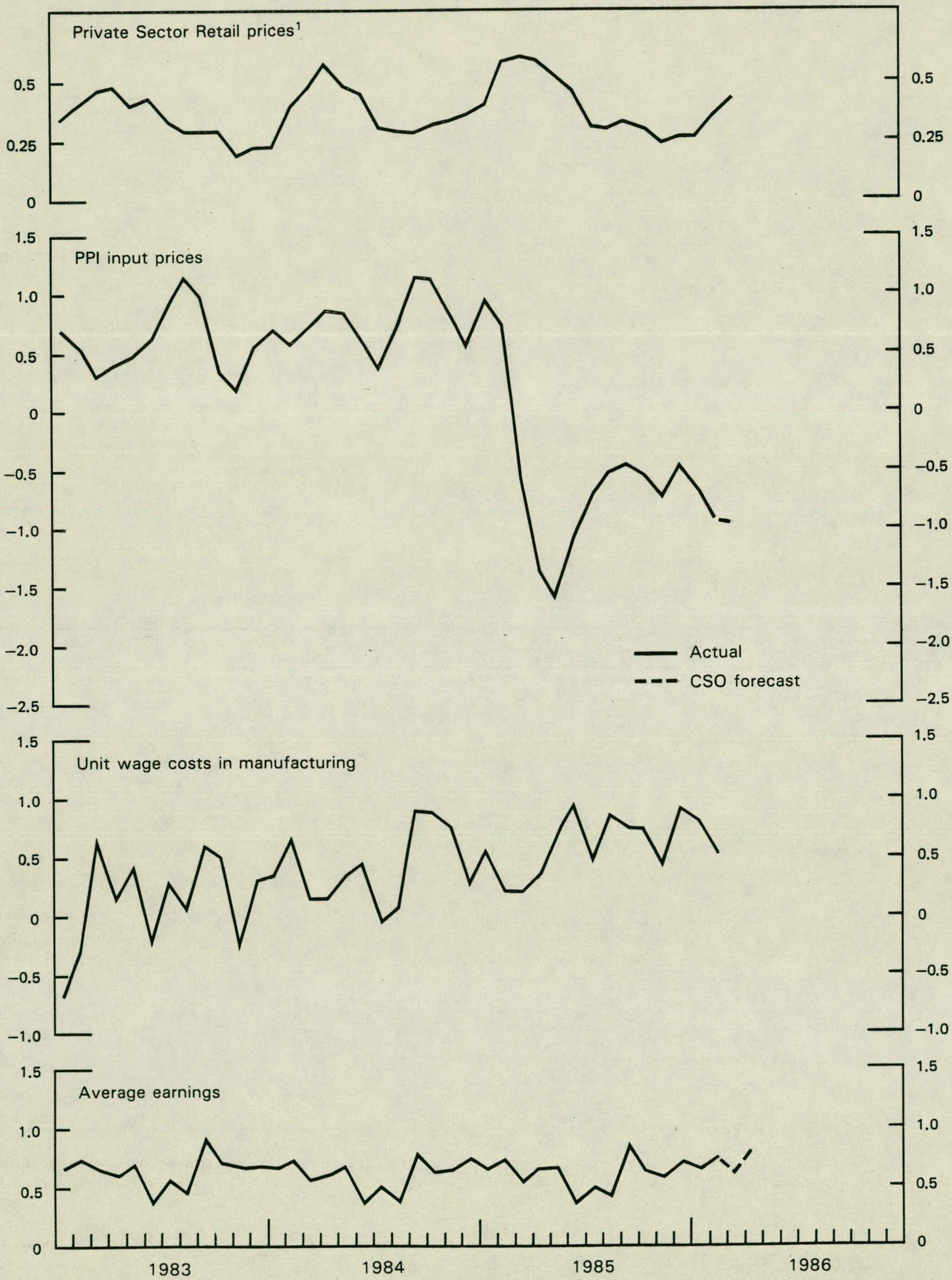
CHART 2

Changes in unemployment



Rate of increase in average earnings, unit wage cost in manufacturing PPI input prices and Private sector retail prices

Month to month percentage changes, smoothed and adjusted for distorting factors where appropriate



1. Excludes seasonal food, mortgage interest, rent, rates and water charges, motor vehicle licences, products produced by Nationalised industries and petrol.

CHART 4

Movements in underlying average earnings and the tax and price index comparisons with 12 months previously

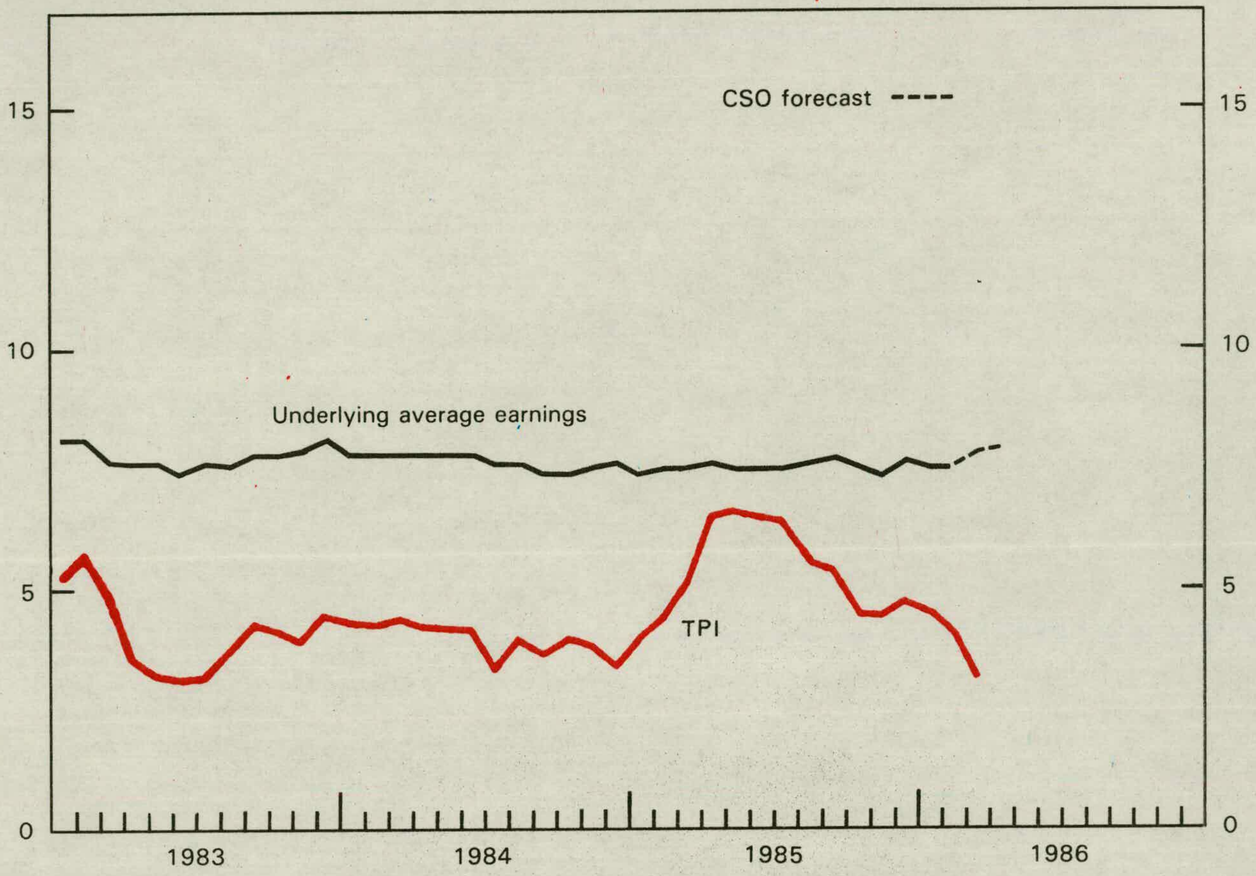


CHART 5

Interest rates

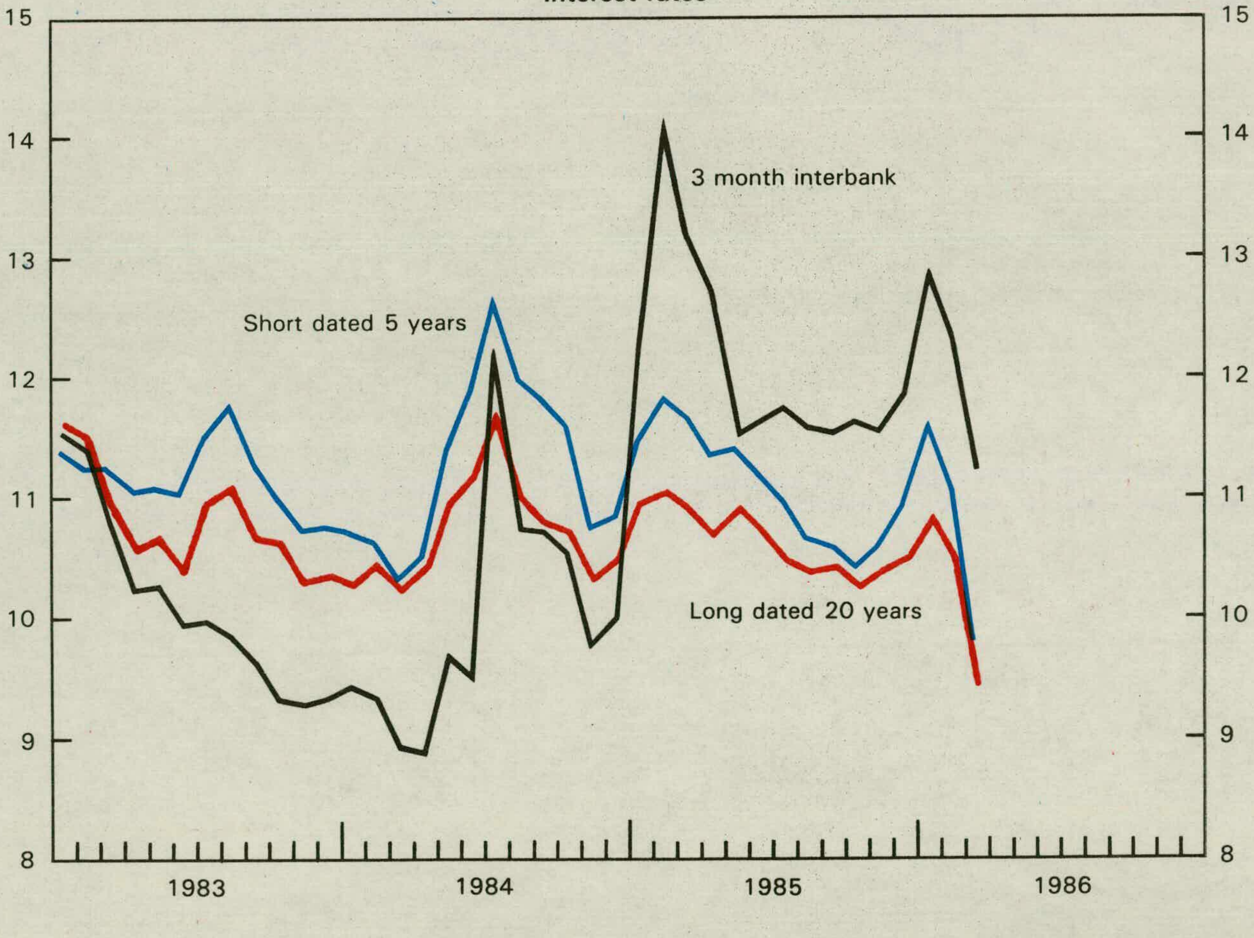
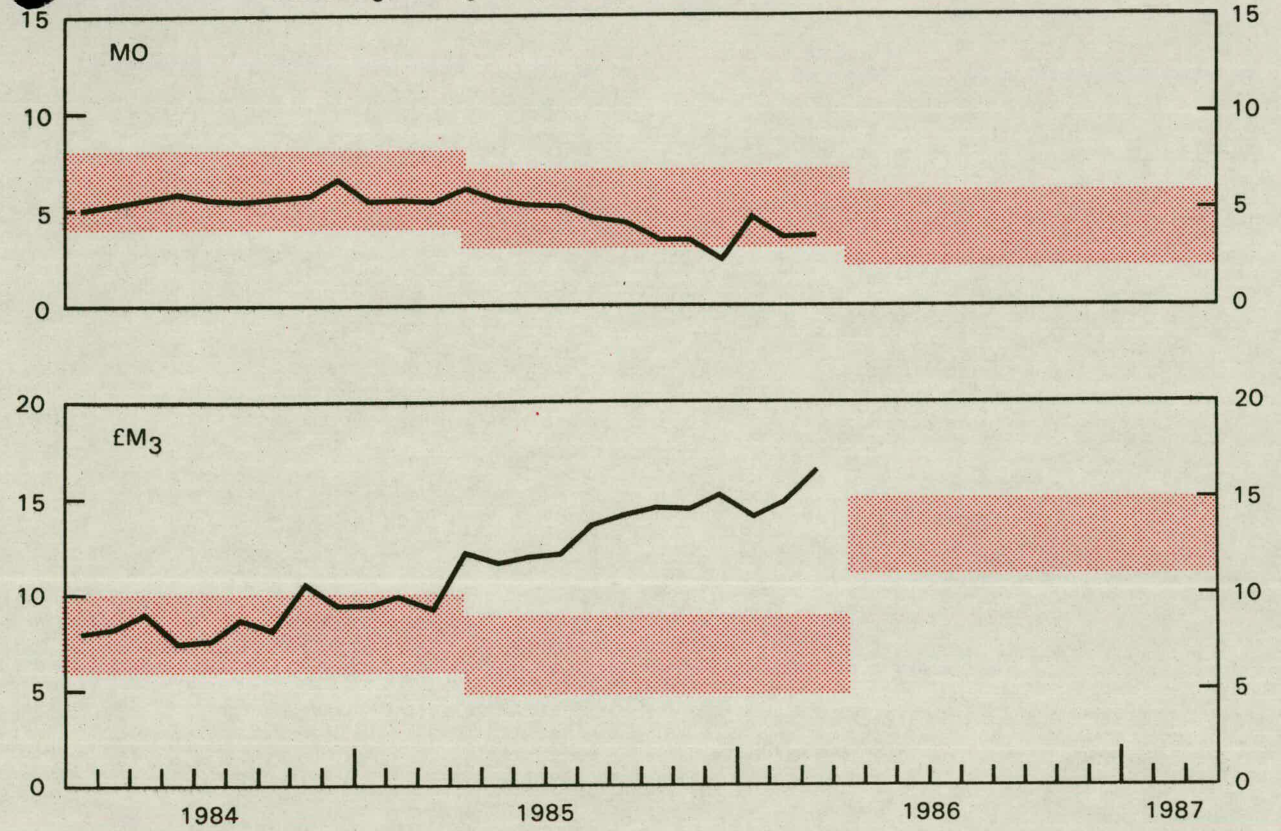


CHART 6

Monetary aggregates

Percentage change on previous 12 months (seasonally adjusted)

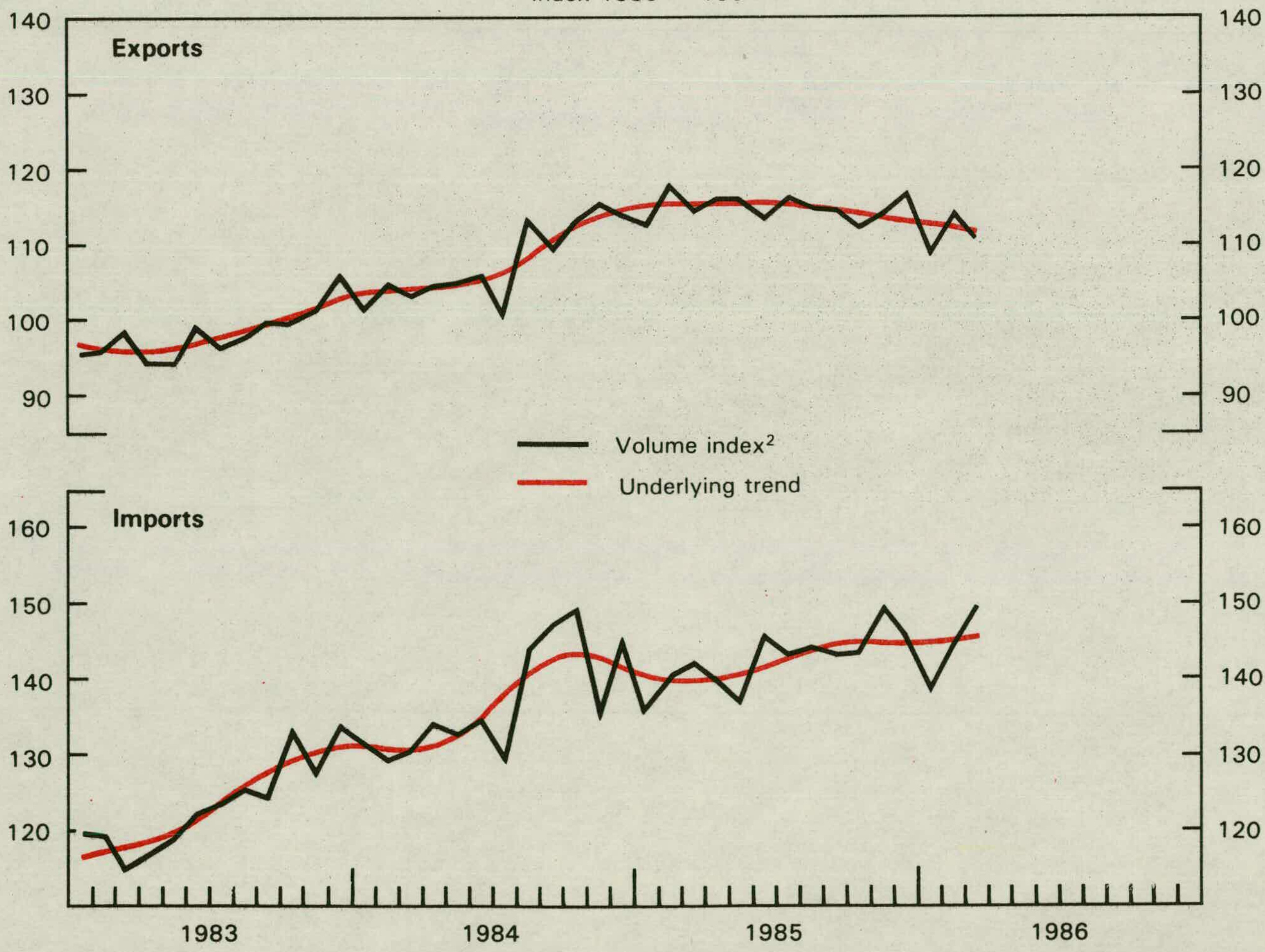


Shaded areas represent announced target ranges

CHART 7

Exports and Imports (excluding oil and erratics[1]

Index 1980 = 100



1. Ships, North Sea Installations, Aircraft, Precious Stones and Silver
2. Seasonally adjusted data, Balance of Payments basis

RR3.9

Ch/ We might have a quick word about this in the margins of the 5pm Priorities meeting.

FROM: MRS R LOMAX
DATE: 1 May 1986

SIR P MIDDLETON RL 1/5

cc PS/Chief Secretary
Mr F E R Butler
Sir T Burns

ECONOMIC PRESENTATION TO CABINET: 6 JUNE

Sometime ago it was suggested that it might be a helpful lead in to the public expenditure round if Sir Terence Burns gave a scene setting talk to Cabinet outlining the economic prospect and drawing some morals - implicit or explicit - about the importance of containing public expenditure. This meeting was pencilled in for 6 June. No.10 now want to know if they can go firm on the arrangements.

2. I should be grateful for advice. You may want to discuss with the Chancellor either this evening, or when you see him again tomorrow.

RL.

RACHEL LOMAX

~~Strict Support~~

LR2.7

p8

FROM: MRS R LOMAX
DATE: 2 May 1986

SIR T BURNS

cc PS/Chief Secretary
Sir P Middleton
Mr F E R Butler

ECONOMIC PRESENTATION TO CABINET: 6 JUNE

Following discussion between the Chancellor, Chief Secretary, Sir Peter Middleton and Mr Butler last night, I have told No 10 to cancel the Cabinet meeting they had pencilled in for 6 June. The general view at the Chancellor's meeting was that there was very little to be gained from making a presentation to Cabinet, and a risk that it would stir things up unnecessarily.

2. The Chancellor hopes you will not be too disappointed!

RL.

RACHEL LOMAX

28-3281

CONFIDENTIAL

FROM: H P EVANS

DATE: 2 May 1986

Ch

Something for you to discuss with Robert on the plane.

You may want to talk to Lord Young before writing

RL 2/5

CHANCELLOR

cc: Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Kemp
Mr Peretz
Mr Scholar
Mr Davies
Miss O'Mara
Mr Culpin
Miss Noble
Mr Brooks

I broadly agree with this advice. I have amended the letter to Ld Y (& the EPR box text), but it needs further amendment to deal with X. I will try & have a word with Ld Y @ Xday. I will also need to write to N. Fowler ~~[illegible]~~ as soon as I have dealt with Ld Y. NL.

Good, but when?

RPI LESS MORTGAGE INTEREST PAYMENTS

Jack Hibbert and I have spoken further to DE. They will be more sympathetic to an expansion of the Press Notice later this year in the context of changes recommended by the RPI Advisory Committee. X It is likely to suggest including in the Press Notice the RPI less housing as one of a number of extra series to be published. This series is usually very close to the RPI less mortgage interest payments.) As Sir Terence Burns said in his minute of 25 April, DE are likely to resist quite strongly any immediate change in the Press Notice.

Publicity

2. As an alternative to expanding the Press Notice, publicity will come from Treasury press briefing. EA1 will expand its monthly note on the RPI (which is circulated internally a day before publication) to include relevant material.

3. An article in the EPR could cover various measures of inflation (RPI, RPI less mortgage interest payments, GDP deflator, producer prices etc). The message would be that the RPI ~~excluding~~ including mortgage interest payments is more volatile than the other measures.

4. Alternatively we could include a box in the EPR. I attach a draft, which includes references to the April RPI (to be published

on May 16). This says rather little (it could say even less), but the chart is the best argument. I prefer this option as getting over the message simply: we could follow it up with a longer article later in the year. The next EPR is scheduled to appear on June 11.

Consultation with DE

5. Assuming you wish to go ahead with an EPR box, I attach a draft letter for you to send to Lord Young. Alternatively, you could speak to him along the same lines.

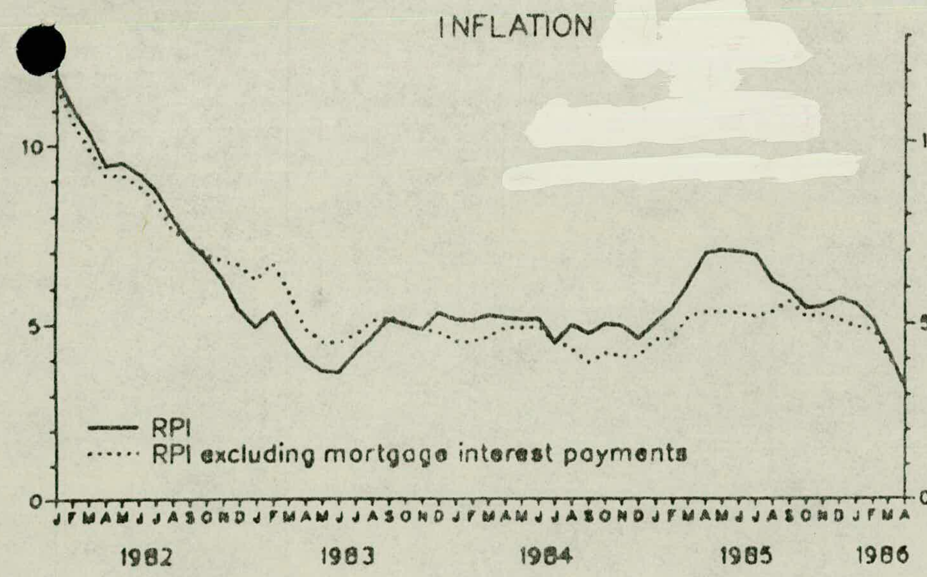
6. It will be suggested either by Lord Young or the press that the Treasury's desire to exclude mortgage interest payments from the RPI reflects our inability to get the Advisory Committee to agree to take this element out of the RPI - and our unwillingness to accept that verdict. This is not a conclusion we need resist. There are good reasons for paying attention to this particular version of the index.

7. Finally, you asked what was the lowest figure so far for the RPI excluding mortgage interest payments: since 1975, when this element was first included in the RPI, the lowest figure was 3.9% for September 1984.

HPE

H P EVANS

25-3281



Inflation

as measured by the 12 month percentage change in

	RPI	RPI excluding mortgage interest payments
1985		
March	6.1	5.2
June	7.0	5.3
December	5.7	5.1
1986		
March	4.2	4.0
April	[3.2]	[3.5]

There was a steep fall in inflation from 1980 to 1983, followed by a period of no major change up until early 1986. Latest figures and most forecasts (including the Government forecast published in the FSBR) show a substantial decline in inflation in 1986.

2. The Retail Prices Index is the most commonly used measure of inflation and is shown in the chart. Unlike other measures, the RPI has, since 1975, included ~~includes~~ the mortgage interest rate, as an indicator of the cost of owner-occupied housing. The all-items RPI is thus sensitive to changes in interest rates which are subject to substantial short term fluctuations (a fall of 1 point in the mortgage rate reduces the all-items RPI by nearly ½ percent). The chart also shows the RPI excluding mortgage interest payments. This is a less volatile series, which moves similarly to the RPI over the longer term.

3. Mortgage interest rates have fallen from 12¾ percent in March to 12 percent from 1 April, and a further ~~cut~~ reduction will affect the June index. In the chart the effects of the increases in mortgage rates in February and April 1985 on the RPI stand out clearly. At the present ~~In April~~ time the two series are now very different, but with ~~1986 both series were very similar at about [3-3½] percent. With~~ further mortgage rate cuts in the pipeline, the all-items RPI is likely to ~~show smaller increases~~ run below the RPI excluding mortgage interest payments over the next few months.

33-3281

Pl. type

~~DRAFT~~ LETTER TO LORD YOUNG

~~As we are all well aware,~~ The inflation rate is coming down rapidly and we should see some very low figures in the next few months. These rates will not be fully sustainable and I wanted to tell you of some modest presentational steps I am taking.

Part of the fall in the rate of inflation as measured by the RPI reflects the influence of falling mortgage rates. This clearly ~~is a temporary influence~~ cannot go on forever, and when interest rates stop falling, we shall accordingly lose this benefit from the RPI. Commentators will then claim that inflation is rising again.

Movements in interest rates make for short-term volatility in the RPI. That is a fact of life, but a less volatile inflation series can be obtained by omitting mortgage interest payments from the RPI. I have been asked by the Treasury and Civil Service Select Committee ~~TCSC~~ to publish this series.

The attached draft is scheduled to appear in the next issue of the Economic Progress Report, due out on June 11. The chart shows clearly that the RPI excluding mortgage interest payments is less volatile, and so a better indicator of (the underlying ~~rate of~~ trend of) inflation. Both series will be used in Treasury briefing.

None of this need cast any doubt on the primacy of the RPI itself, nor on its method of construction. But it meets a need for a less volatile series and it fulfils a request by the TCSC.

In due course, it may be sensible to include this or similar measures of inflation in your monthly press notice. Indeed, I gather that this may be one of the recommendations of the RPI Advisory Committee but the Committee is not due to report until next month, and I see advantage in drawing attention to less volatile measures of inflation now, while the RPI with and without the mortgage component are not very different.

[Copy to J Hibbert, CSO]

NIGEL LAWSON

RR3.12

CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 1 May 1986

MR F E R BUTLER

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Cassell
Mr Kemp
Mr Evans
Mr Scholar
Mr Culpin
Miss O'Mara
Miss Noble

RPI LESS MORTGAGE INTEREST PAYMENTS

The Chancellor was grateful for your minute of 29 April. He agrees that it would be wise to clear our lines with DHSS Ministers as you suggest - though he thinks it would be safer to write than talk. He would be grateful if Miss Noble would provide an appropriate draft, when the time comes.

2. The Chancellor has also seen Mr Culpin's minute on the same subject of 30 April. He agrees that, in any discussion with Lord Young or his officials, we might as well use the point that we have been asked by the TCSC to publish information about the RPI less mortgage interest payments. If we then go ahead and publish an EPR article or box, we might then inform the TCSC 24 hours in advance.

3. Subject to clearing our lines with Mr Fowler, the Chancellor is content to go ahead as indicated in my minute of 28 April.

RL

RACHEL LOMAX

PWP

CONFIDENTIAL

until 11.30 a.m. 12 May then

UNCLASSIFIED

FROM: PAUL DAVIS

DATE: 9 MAY 1986

1. MR S J ~~DAVIES~~ SJD

2. CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Monck
Mr H P Evans
Mr R Culpin
Miss O'Mara
Mr Pickford
Mr S Brooks
Mr Hacche
Mr Pickering
Mr Vernon
Ms Turk
Mr Cropper
Mr Ross Goobey
Mr Tyrie

* Worth ... (perhaps).
2. Lower output price fig
Since when?

Since 1974 when series started.

Ext 3434

PRODUCER PRICES FOR APRIL

The Producer Price Indices for April will be published at 11.30 a.m. on Monday 12 May. The annual rate of increase in output prices has fallen again, and the level of input prices continues to decline.

2. **Producer Prices**

(percentage change over a year earlier)

	Output Prices All	**Output Prices** All excluding FDT*	**Input Prices** All (not seasonally adjusted)	**Input Prices** All (seasonally adjusted)	**Input Prices** All excluding FDT*
1985 Q2	5.6	6.4	3.4	3.4	6.8
Q3	5.6	6.5	- 0.7	- 0.7	- 1.2
Q4	5.1	5.9	- 5.4	- 5.4	- 5.1
1986 Q1	5.0	5.0	- 9.1	- 9.3	-11.6
March	4.9	4.7	-10.9	-10.9	-14.6
April	4.5	4.4	- 9.0	- 8.8	-11.8

* Excluding the food, drink and tobacco industries.

3. Prices of materials and fuel purchased by manufacturing industry fell by 0.5 per cent (seasonally adjusted) between March and April. The index has now fallen for 14 months in succession. The overall fall in the year to April 1986 was 8.8 per cent.

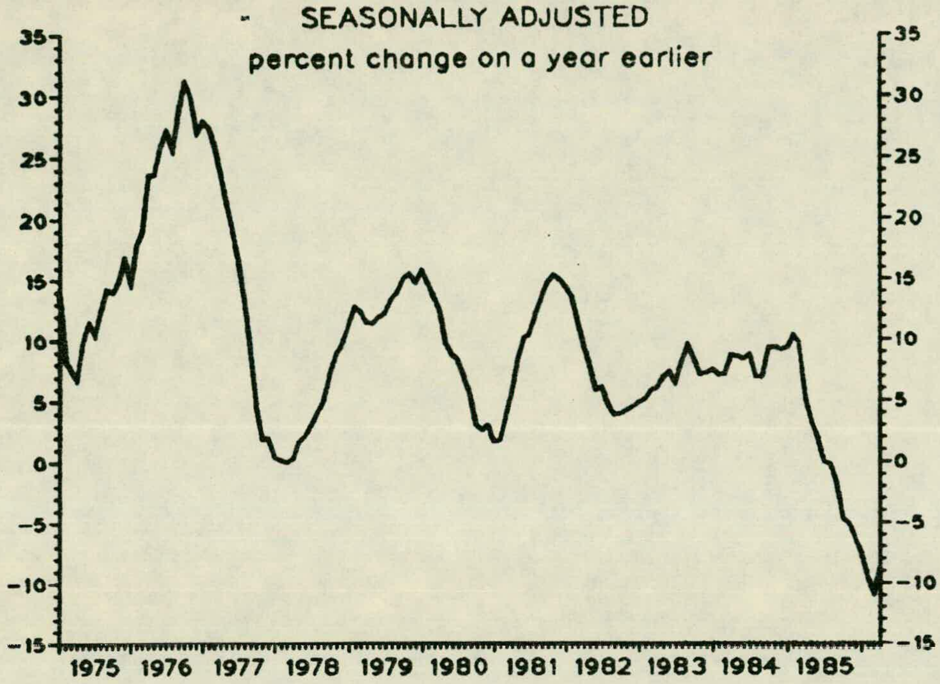
4. In the year to April, producer output prices rose by 4.5 per cent, compared with an increase of 4.9 per cent in the year to March. Between March and April, the index rose by 0.8 per cent. Of this rise less than a ½ percentage point was accounted for by the increase in tobacco duties announced in the Budget. Excluding the food, drink and tobacco industries, output prices rose by 4.4 per cent in the year to April (4.7 per cent in the year to March).

5. I attach two charts showing the movements in producer input and output prices from January 1975.

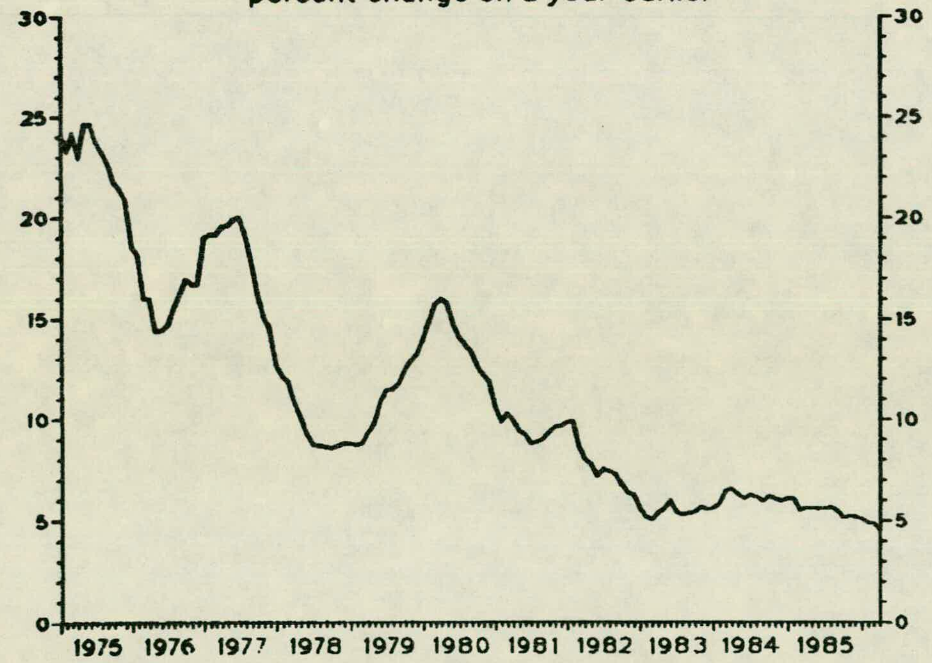
PAUL DAVIS
EA1 Division
x 3434

n1pd-pdpr

MATERIALS AND FUEL PURCHASED BY MANUFACTURING INDUSTRY
- SEASONALLY ADJUSTED
percent change on a year earlier



PRODUCER OUTPUT PRICES
percent change on a year earlier



CHANCELLOR OF THE EXCHEQUER

Ch.

You'd want to chew this one with Terry. He was away last week - it's been difficult to fit him in this week (though we could just manage it on Thursday, unless you're busy with speeches) But I'll see he's booked up for next week.

Discussed with T.B. m.

RL. 13/5

PX

CONFIDENTIAL

FROM: S J DAVIES
DATE: 9 MAY 1986

1. SIR TERENCE BURNS
2. CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Geoffrey Littler
Mr F E R Butler
Mr Byatt
Mr F Cassell
Mr E P Kemp
Mr N Monck
Mr H P Evans
Mr Fitchew
Mr J Odling-Smee
Mr Peretz
Mr M Scholar
Mr P Sedgwick
Mr A Turnbull
Mr R Culpin
Mr Matthews
Mr Mowl
Miss O'Mara
Mr Riley
Mr P Allum
Mr Cropper
Mr Ross Goobey
Mr Tyrie.

The economy seems to be flatter than we expected and the CBI Survey was a little disappointing. A similar pattern of sluggish output is evident in other major countries. We continue to expect that lower oil prices will improve world output but it could be some months before we see the effect in the statistics - that was the experience when oil prices rose sharply.

Inflation is turning out a little lower than expected - because of the mortgage rate effect - and the effects of lower oil prices are already evident.

This adds up to a difficult background for interest rate decisions.

TB
13 May 86

RECENT ECONOMIC STATISTICS AND THE FSBR FORECAST

We have had two months' trade, industrial output, and price statistics, and one month's labour market statistics since the Budget forecast was completed. As in other OECD countries the recent indicators of economic activity have generally been disappointing, while short-term inflation prospects have, if anything, improved since the time of the Budget. I attach a note, compiled by Peter Allum, which compares the recent statistics with what we had been expecting at the time we finalised the Budget forecast.

2. Primarily because of earlier and larger reductions in the mortgage rate than we had allowed for in the forecast, the RPI is now likely to turn out a little lower than in the Budget forecast, particularly over the summer months. Other measures of inflation are, as far as we can see, in line with the forecast.

Could you say this in public

n1bsd-tbch

3. On the basis of the limited outturn data so far available, final demand seems to have turned out significantly lower than we had expected in the first quarter of 1986, with non-oil exports a particular source of disappointment. This weakness in demand has been reflected in disappointing figures for non-oil industrial output. And the weakness is also evident in labour market data: the recent deterioration in the trend in unemployment, some fall back in overtime working, and probably also an increase in the rate of loss of jobs in manufacturing industry. A couple of months ago we had been expecting the first quarter to show GDP growth of around 1 per cent over the previous quarter. Currently it looks more likely to turn about below $\frac{1}{2}$ per cent; and the preliminary figure for the output measure of GDP, to be published in just over a week's time is likely to suggest a pretty sluggish economic performance.

4. The fact that other OECD countries have been recording falling or static industrial output so far in 1986 and the behaviour of UK exports both suggest that world economic developments have a lot to do with the recent weakness in the UK: it may well be that demand from the world outside the OECD area is currently even more depressed than forecast. In the UK, consumer demand also appears hardly to be responding at all as yet to the pick up in real income growth: it is the saving ratio rather than consumer spending that has been rising.

5. We expect that domestic demand will respond to higher real incomes before long - both in the UK and in other industrial countries. But even if by the second half of the year spending has picked up as anticipated, the worse than expected start to the year could drag average growth for the year down below the forecast (with perhaps a stronger outturn in 1987).

6. Given the CSO's tendency to revise data upwards we need to be wary about reading a lot into a couple of months' preliminary statistics. But it is significant that the recent official statistics on output seem consistent with the relatively gloomy results from recent CBI surveys. Although the April CBI survey appeared to show some improvement over the results recorded during the winter months, the improvements were less than are usual at this time of year. The CSO's seasonally adjusted versions of the CBI's results show no improvement:

Balance of responses to CBI Quarterly Surveys

(seasonally adjusted by CSO: not published).

		Business Optimism	Change in new orders in past 4 months	Volume of Output past 4 months	Volume of Output next 4 months
1985	January	3	14	15	21
	April	3	14	15	21
	July	6	11	18	16
	October	5	19	14	19
1986	January	- 2	- 1	8	6
	April	- 8	- 10	- 6	7

The one encouraging indication from these figures is the large gap between the balance expecting output to recover over the next 4 months and the balance reporting a fall in output over the previous 4 months: companies are expecting the immediate future to see some sort of turnround from the immediate past.

7. The prolongation of the period of sluggish growth, which has now continued for four quarters, raises the possibility that the first half of 1985 will be seen in retrospect as marking a cyclical turning point, in terms of the CSO's cyclical analysis. The upswing that began in the second quarter of 1981 may have come to an end, and a cyclical downswing started, in the first half of 1985. There certainly was a sharp slowdown in GDP growth around this point. Having grown by $3\frac{1}{2}$ per cent in strike adjusted terms in the year to the first quarter of 1985, GDP has probably grown by under $1\frac{1}{2}$ per cent in strike adjusted terms in the year to the first quarter of 1986. This interpretation would vindicate the message given by the longer leading cyclical indicator which turned down during the first half of 1984.

8. However it is also possible - in the light both of our own forecast and of the more recent upward movements in the CSO's leading indicators - that the period mid 1985 to mid 1986 will be seen in retrospect as a pause within a longer upswing. It would require only a short burst of growth at the rate seen in 1984 to bring this about; all one can say at present is that it is still too early to pronounce finally on whether 1985 marked a cyclical turning point.

n1sd-tbch

S J DAVIES

g.32 **CONFIDENTIAL**

FROM: **MISS G M NOBLE**

pwf

DATE: **12 MAY 1986**

CHANCELLOR OF THE EXCHEQUER

Hold for advice from Perm + CST.

cc
Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Cassell
Mr Kemp
Mr Peretz
Mr Scholar
Mr Watson
Mr Evans
Miss O"Mara
Mr Culpin
Mr Brooks

RPI LESS MORTGAGE INTEREST PAYMENTS

i.e. 40% of all non NI benefits.

I attach a draft letter to Mr Fowler, as requested. DHSS, as you know, already use the RPI less housing for uprating supplementary benefit and so I think it is worth covering the relationship between that index and RPI less mortgage interest.

Why not put them RPI less housing

G M Noble

G M NOBLE

Pl. type

DRAFT LETTER FROM: CHANCELLOR OF THE EXCHEQUER

TO: SECRETARY OF STATE FOR HEALTH AND SOCIAL SECURITY

RPI LESS MORTGAGE INTEREST PAYMENTS

~~As you are well aware,~~ The RPI is coming down rapidly and we should see some very low figures in the next few months. Part of the reduction is due to the influence of falling mortgage rates. This is a temporary influence and when interest rates stop falling we shall lose the benefit from the RPI. That is a fact of life, but commentators will then claim that inflation is rising again.

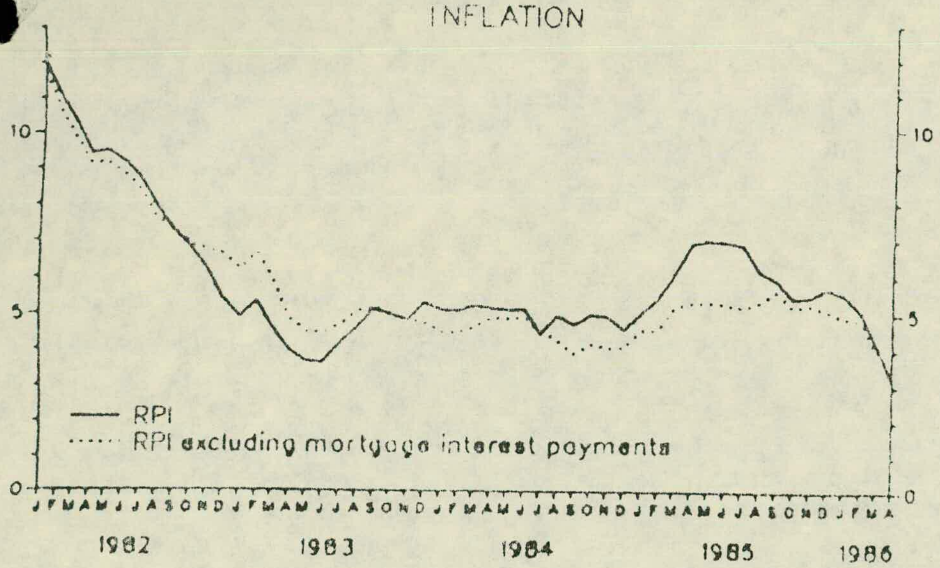
2. To prepare the ground for this, presentationally, I want to start getting over the message about how sensitive the RPI is to short term movements in interest rates. I propose to do this by including the attached article in the next issue of the June Economic Progress Report due out on 11 June. The main feature is a chart when shows how much of the volatility in the RPI is due to mortgage interest. The article will also meet a request from the TCSC to publish figures for the RPI excluding mortgage interests.

3. None of this should cast any doubt about the primacy of the RPI itself, or of your use of the RPI less housing, but I

thought you would welcome advance warning. As you will see from the attached chart, although RPI less housing excludes rather more than mortgage interest payments, the two move very closely.

NIGEL LAWSON

Inflation



as measured by the 12 month percentage change in

	RPI	RPI excluding mortgage interest payments
1985		
March	6.1	5.2
June	7.0	5.3
December	5.7	5.1
1986		
March	4.2	4.0
April	[3.2]	[3.5]

There was a steep fall in inflation from 1980 to 1983, followed by a period of no major change up until early 1986. Latest figures and most forecasts (including the Government forecast published in the FSBR) show a substantial decline in inflation in 1986.

2. The Retail Prices Index is the most commonly used measure of inflation and is shown in the chart. Unlike other measures, the RPI includes the mortgage interest rate, as an indicator of the cost of owner-occupied housing. The all-items RPI is sensitive to changes in interest rates which are subject to substantial short term fluctuations (a fall of 1 point in the mortgage rate reduces the all-items RPI by nearly ½ percent). The chart also shows the RPI excluding mortgage interest payments. This is a less volatile series, which moves similarly to the RPI over the longer term.

3. Mortgage interest rates have fallen from 12¾ percent in March to 12 percent from 1 April, and a further cut will affect the June index. In the chart the effects of the increases in mortgage rates in February and April 1985 on the RPI stand out clearly. In April 1986 both series were very similar at about [3-3½] percent. With further mortgage rate cuts in the pipeline, the all-items RPI is likely to show smaller increases over the next few months.

CONFIDENTIAL

From: SIR PETER MIDDLETON

Date: 13 May 1986

CHANCELLOR

cc Sir T Burns
Mr Cassell
Mr Peretz
Mr Scholar
Mr Kemp
Mr Watson
Mr Evans
Miss Noble
Mr Culpin

RPI LESS MORTGAGE INTEREST PAYMENTS

used for uprating supp ben - see below

I had not quite realised that we have an established series on RPI less housing. Before we send the letter to Mr Fowler, would it not be as well to see if this series suited us just as well as RPI less mortgage interest payments. The chart seems to show it has almost identical characteristics. It would avoid the risks involved in creating another series.

KF Murphy
(private secretary)

pp P E MIDDLETON

RC2.32

cc Mr Matthews
Mr Hacche
Mr Dolphin
PWP

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 May 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David,

UK RELATIVE ECONOMIC PERFORMANCE

... I attach the information you asked me for on the telephone yesterday on the UK's performance compared to other Summit countries between 1979 and 1981 and now.

Yours ever,

Cathy

CATHY RYDING
Assistant Private Secretary

69/037

FROM: A M DOLPHIN
DATE: 13 May 1986

MS RYDING

cc: Mr Matthews
Mr Hacche

UK RELATIVE ECONOMIC PERFORMANCE

You asked how the UK's current economic performance compares with the other Summit countries and how it compared in 1979 and 1981. I attach some tables showing information on growth, employment/unemployment, inflation and current balances.

These tables show:

(i) Real GDP growth in the UK in 1985 was higher than in the US and higher than in each of the major European countries. In 1979 and 1981 the UK had the lowest growth rate (except for the US in 1979 where growth was marginally lower) among the Summit countries.

(ii) The UK's relative performance on employment growth has improved since 1979 but growth in the UK remains lower than in the other six Summit countries overall.

(iii) Unemployment (as a percentage of the labour force) is now higher in the UK than in any other Summit country, as it was in 1981, but not in 1979 when the US, France, Italy and Canada all had higher unemployment.

(iv) Italy was the only Summit country with higher inflation than the UK over the twelve months to March 1986.

(v) Unit labour costs in the UK grew faster than in the other Summit countries in 1985 and in 1979, but in 1981 UK growth was below the average for these countries.

A.M. Dolphin

A M DOLPHIN

1. Growth of GNP/GDP (per cent)

	1979	1981	1985
United States	2.5	1.9	2.2
Japan	5.3	3.7	4.6
Germany	4.0	-	2.4
France	3.3	0.5	1.1
Italy	4.9	0.2	2.2
Canada	3.2	3.3	4.5
Major six (excluding UK)	3.5	1.9	2.6
United Kingdom	2.6	-1.5	3.3
Major Seven	3.4	1.6	2.7

2. Growth in employment (per cent)

	1979	1981	1985
United States	2.9	1.1	2.0
Japan	1.3	0.8	0.8
Germany	1.8	-0.6	0.8
France	-	-0.6	-0.3
Italy	1.0	0.3	0.5
Canada	4.1	2.8	2.8
Major six (excluding UK)	2.2	0.7	1.4
United Kingdom	1.1	-3.9	1.1
Major Seven	2.1	0.3	1.4

3. Unemployment (per cent of labour force)

	1979	1981	1985	March 1986
United States	5.9	7.6	7.2	7.1
Japan	2.1	2.2	2.7	2.7
Germany	3.3	4.9	8.2	9.2
France	6.2	7.7	10.8	10.3
Italy	7.7	8.4	10.6	11.2
Canada	7.4	7.5	10.5	9.6
Major six (excluding UK)	5.0	6.2	7.1	7.2
United Kingdom	5.4	9.5	13.1	13.0
Major Seven	5.0	6.5	7.6	7.7

4. Consumer price inflation (per cent)

	1979	1981	1985	March 1986
United States	11.3	10.4	3.5	2.3
Japan	3.6	4.9	2.1	1.1
Germany	4.1	6.3	2.2	0.1
France	10.8	13.4	5.8	3.0
Italy	14.8	18.7	9.2	7.3
Canada	9.1	12.5	4.0	4.1
Major six (excluding UK)	8.8	9.7	3.6	2.1
United Kingdom	13.4	11.9	6.1	4.2
Major Seven	9.2	9.9	3.8	2.3

5. Growth in unit labour costs in manufacturing (per cent)

	1979	1981	1985
United States	10.6	7.3	1.6
Japan	-2.1	1.8	0.1
Germany	2.4	5.1	-0.1
France	9.3	11.9	1.4
Italy	9.7	19.0	4.4
Canada	7.8	13.8	2.3
Major six (excluding UK)	6.8	7.6	1.3
United Kingdom	17.3	6.8	5.4
Major Seven	7.7	7.5	1.6

6. Current balances (US $ billions)

	1979	1981	1985
United States	-1	6	-118
Japan	-9	5	50
Germany	-6	-6	13
France	5	-5	-
Italy	6	-8	-4
Canada	-4	-5	-2
Major six (excluding UK)	-9	-12	-60
United Kingdom	-2	13	4
Major Seven	-11	1	-56

I agree ~~the~~ 100% with Mr Evans. ~~The~~ Using the Ex housing series would be positively counterproductive. It has to be Ex Mortgage Interest. See latest note and folder below for further vivid illustration. N.

CONFIDENTIAL

FROM: H P EVANS
DATE: 14 MAY 1986

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr F Cassell
Mr Peretz
Mr M Scholar
Mr E P Kemp
Mr Watson
Miss Noble
Mr R Culpin
Mr S J Davies

Can't win! must go on the offensive. N.

Ch/ CST is looking at these papers again tonight, & may well prefer RPI less housing, on PEX grounds. We need to get him sorted out by him at the latest – and hence to avoid the question of consulting Fowler. Providing you have cleared your lines with CST, you may want to hold him in the margins of Cabinet. We can follow up with a letter – I don't know the existing draft will do (see below); but CST needs to be ved anyhow. RL. 14/5

RPI LESS MORTGAGE INTEREST PAYMENTS

PS. On the draft of Young's letter, do you want to include the extra para (assuming we do go for RPI less MIR)

Sir Peter Middleton's minute asked whether the RPI less housing would suit us just as well as the RPI less mortgage interest payments. The RPI less housing is published quarterly by DE and thus using it would avoid creating a new series. Moreover, DE would probably be less concerned about our giving prominence to these figures. However there are some significant disadvantages to concentrating on the RPI less housing.

already used for uprating supp ben

2. The main one is that, if we want to demonstrate the impact of fluctuations in mortgage interest rates on inflation as measured by the all items RPI, we can only do this clearly by showing the RPI with and without mortgage interest payments. We may know that the charts for the RPI less housing and the RPI less mortgage interest payments look very similar; but those who have not seen our charts will not necessarily accept that the different movements in RPI and RPI less housing primarily reflect mortgage interest rate changes.

Simply met by producing this chart, & thereafter focusing on RPI less housing.

3. While we may expect some sympathy for the idea of using the RPI less mortgage interest payments as a less volatile indicator of inflation, we may experience less sympathy and more cynicism over using the RPI less housing. We would not want to argue that the cost of shelter should not in principle be given a weight in our measure of inflation; and in view of the tendency of Local Authority rates in particular to rise much faster than retail prices generally, we may arouse suspicions about our motives in using a measure of inflation which excludes them. It should be much easier to defend the use of a measure of inflation that excludes just mortgage interest payments: you have already referred to it in public, in evidence to the TCSC.

Fair point; but owner occupiers represent the majority of households. An index that totally excludes housing costs is deficient too.

4. At all events it would be more difficult to claim, as in the currently proposed letter to Lord Young, that the RPI <u>less housing</u> was a "better indicator of underlying tends in inflation" than the all items index.

5. On the other hand there is clearly force in the argument that it would be preferable not to introduce a new price index if we can avoid it. If we do start quoting figures for the RPI excluding mortgage interest payments commentators may relate this to the forthcoming RPIAC recommendations. There may be renewed speculation about the recommendations of the RPIAC and unfavourable comments on the Treasury's view versus the majority of the Committee. But that will surface at some stage in the next few months in any case.

6. The RPIAC will probably recommend that the DE should publish figures for the RPI less housing, rather than the RPI less mortgage interest payments, in their monthly press notice. DE will not necessarily feel bound to follow the RPIAC's advice on the contents of their press notice, and the change will not come until the autumn at the earliest. But while such a recommendation, and its implementation, would be positively helpful if we had already started to give prominence to the RPI less housing, it would be less helpful if we had chosen to give prominence to the RPI less mortgage interest payments.

7. The letter to Lord Young and the EPR box, as amended by you, are attached. If you decide to go for the RPI less housing, changes to these and to the letter to Mr Fowler will of course be necessary. If you prefer the RPI less mortgage interest payments, you may like to refer to the possible alternative of using the RPI less housing in an additional paragraph, as follows:

"I have considered whether the use of the index for the RPI less housing, which is already published, would do, allowing us to avoid the publication of a new price series. I have concluded, however, that there would be serious difficulties about using this as a measure of trends in inflation, as there seem no good reasons for excluding the other elements of housing costs from such a measure."

8. A separate note is coming to you on the April RPI, to be published on Friday this week. It will include references to both the RPI less housing and the RPI less mortgage interest payments. For use by IDT and others we need to decide which series to use in briefing on Friday.

HPE

H P EVANS

n2hp-ch-rpi

RC2.34

PWP

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

14 May 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David,

UK'S RELATIVE ECONOMIC PERFORMANCE

... Further to my letter of 13 May, I attach the additional information you requested.

Yours ever,

Cathy

CATHY RYDING
Assistant Private Secretary

69/043

FROM: A M DOLPHIN
DATE: 14 May 1986

MS RYDING

cc: Mr Hacche

UK'S RELATIVE ECONOMIC PERFORMANCE

You reported that No 10 had asked for some further information following your letter of 13 May. This is contained in the attached tables.

2. In 1979 the UK's productivity growth was second lowest among the Summit countries (growth was lower in the United States), but in 1985 UK productivity growth was exceeded only in Germany and France.

3. Similarly, in 1979 the UK's GDP growth only exceeded growth in the United States among the Summit countries, whereas in 1985 the UK had risen to third place in the league table behind Japan and Canada.

A.M. Dolphin

A M DOLPHIN

PRODUCTIVITY GROWTH* (AVERAGE ANNUAL CHANGE, PER CENT)

	1979-1985	1981-1985
United States	3.1	4.1
Japan	3.1	3.7
Germany	3.0	3.7
France	4.3	5.2
United Kingdom	4.0	4.8
Italy	4.3	3.8
Canada	3.2	4.8

* Output per manhour in manufacturing

REAL GDP GROWTH (AVERAGE ANNUAL CHANGE, PER CENT)

	1979-1985	1981-1985
United States	1.9	2.4
Japan	4.0	4.0
Germany	1.2	1.5
France	1.1	1.3
United Kingdom	1.1	2.7
Italy	1.3	1.0
Canada	2.1	2.0

8:2

PERSONAL AND CONFIDENTIAL
until 11.30am Thursday 15 May
then UNCLASSIFIED

FROM: S D KING
DATE: 14 MAY 1986

1. **~~MISS~~ O'MARA**

2. **CHANCELLOR OF THE EXCHEQUER**

These figures bear out the message in Mr Davies' note of 9 May on developments since the Budget forecast. Press comment will no doubt focus on the quarterly fall in manufacturing output. We shall therefore want to stress that the future for manufacturing looks rather brighter in the light of the oil price fall. The CBI's latest survey supports this view.

MOT 14/5

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Burgner
Mr H P Evans
Mr Scholar
Mr Shaw
Mr Culpin
Mr S Davies
Mr Pickford
Mr Hacche
Mr Naisbitt
Mr Pickering
Mr Dyer (+1 for No 10)
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Stirling - CSO
Mr Kingaby - CSO
Mr Lang - CSO
HB/02

INDEX OF OUTPUT OF THE PRODUCTION INDUSTRIES - MARCH 1986

This will be published at 11.30am on Thursday, 15 May.

2. The index of production in the first quarter of 1986 rose by ½ per cent from the level of the previous quarter: manufacturing output fell by 1 per cent. The divergence can be accounted for by strong growth of 4½ per cent in "energy and water supply". "Other energy" was particularly strong, mainly because electricity and gas were boosted by the poor weather conditions experienced in the first quarter. In comparison with a year earlier, production rose by 2½ per cent and manufacturing output fell by 1 per cent.

3. Between February and March the index of production, manufacturing output, and output of the energy and water supply industries were broadly unchanged.

4. **Recent movements**

percentage changes	1985 on 1984	1986Q1 on 1985Q4	1986Q1 on 1985Q1	March on February
Index of Production	+ 4½	+½	+ 2½	0
within which:				
Manufacturing	+3	- 1	- 1	0
Energy and Water	+9	+ 4½	+ 10	0
adjusted for coal strike:				
Index of Production	+2½	½	- ½	+0
Manufacturing output	+2½	-1	-1	+0

5. Recent index numbers for manufacturing, and consequently production in total have been revised downwards on receipt of later and more complete information. On the basis of these estimates manufacturing output has shown some decline since 1985Q2, and CSO's assessment is that the trend in manufacturing output is now downward in underlying terms. Production as a whole declined from 1985Q1 but in 1986Q1 the fall in manufacturing output was more than offset by a large increase in energy and water supply. However, in underlying terms, production in 1986Q1 is down ½ per cent on 1985Q1.

6. Despite these downward revisions CSO will continue to make bias adjustments upward to recent estimates of manufacturing output that are broadly upward. Historical experience suggests that such adjustments are still warranted.

7. Manufacturing output in the latest quarter was 10½ per cent above its 1981Q1 trough but was 9 per cent below 1979Q2 peak. The index of production was 2 per cent above its average 1979 level, although still slightly below the peak recorded in 1979Q2.

Other industrial detail

8. A good increase in output in 1986Q1 compared with a year earlier was recorded by mechanical engineering [+6½ per cent]. Falls over the same period were recorded by electrical and instrument engineering [-8 per cent] and chemicals [-4 per cent] - two industries which had, until recently, shown good year on year growth - and by metals [- 3 per cent].

Assessment

9. Manufacturing output rose strongly in 1984 and 1985 as a whole but has declined since 1985Q2. CSO believe the underlying trend is now downwards.

10. Press comment will probably be unfavourable, emphasising the decline in manufacturing since 1985Q2.

11. Manufacturing output grew by 3 per cent in 1985, the fourth year of uninterrupted growth - the longest such period since 1970. But this point should be deployed carefully, given the decline over the last 12 months.

Lines to take

12. Possible lines for IDT to take are:

13. Positive:-

(i) Manufacturing output expected to grow by 3 per cent this year, following 3 per cent growth in 1985 and 4 per cent growth in 1984.

(ii) Manufacturing output has now grown for four successive years - longest period of uninterrupted growth since 1970 - and a fifth year of growth is forecast.

(iii) Manufacturing profitability in 1984 best since 1973. Exports up 6 per cent in 1985 to beat 1984's all time and expected to rise by further 6 per cent in 1986. No previous five year period in which manufacturing has been so successful in holding its market share and keeping pace with world output. Manufacturing industry expected to be major beneficiary of fall in oil price.

Defensive:-

(iv) Manufacturing output trend downward. Expected to be temporary - as supported by CBI's April Trends Survey. FSBR forecasts growth of 3 per cent in 1986 as a whole - making five successive years of growth.

(v) Downward revisions to manufacturing output show bias adjustment unjustified

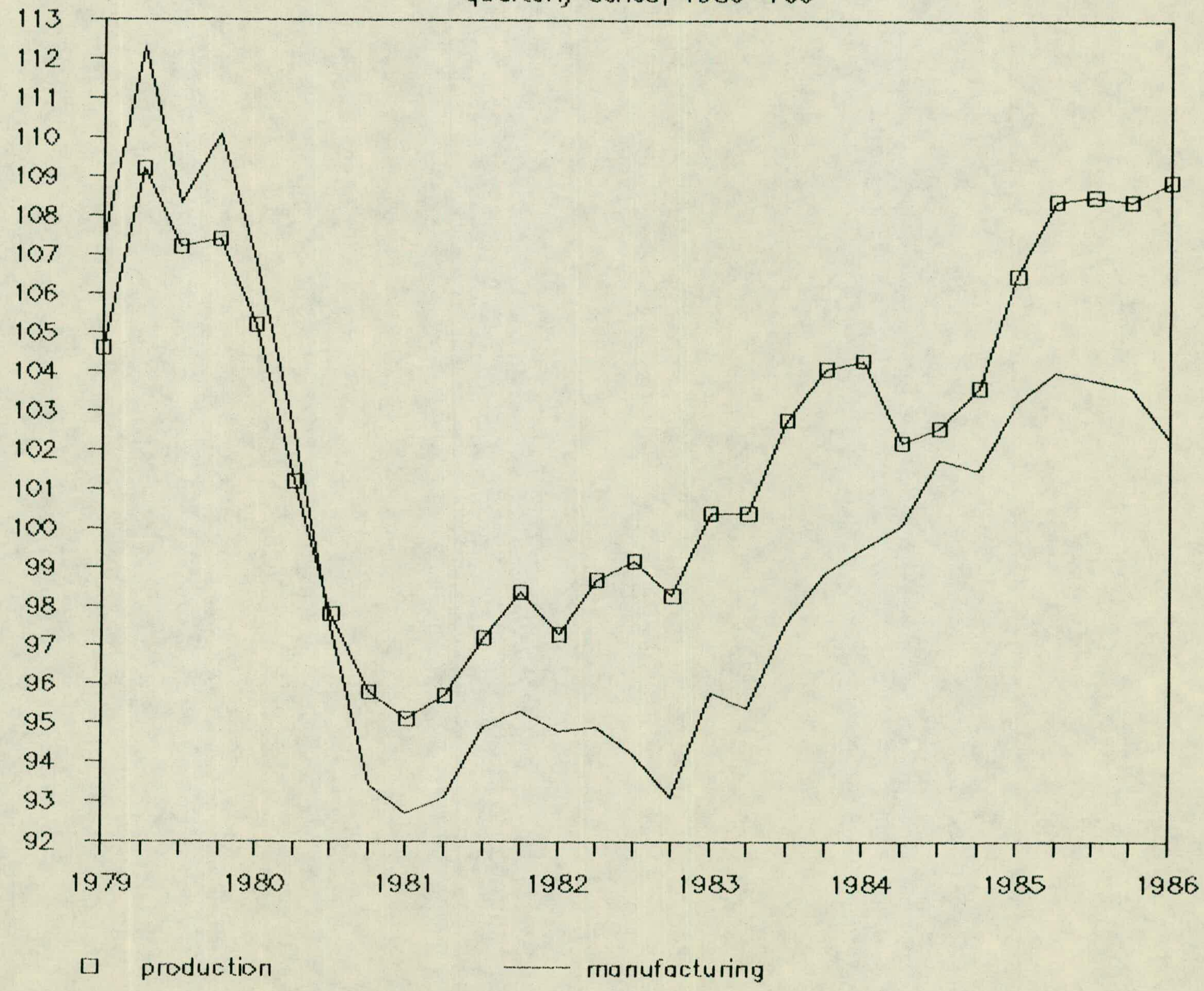
No. Historical experience shows initial estimates of manufacturing output have been underestimated on average. Therefore bias adjustments completely justified.

Steph King

S D KING

OUTPUT OF THE PRODUCTION INDUSTRIES

quarterly series, 1980=100



PWP

CHANCELLOR OF THE EXCHEQUER

Thanks –

C/ We understand from Peter Lilley that a recent Report of the Birmingham Chamber of Industry and Commerce was mentioned yesterday evening & you said you wanted to see it. We think this must be it. The first two pages are for Birmingham and the next two for the West Midlands as a whole.

CR

15/5.

PS The main characteristic of these numbers seems to be that the percentage of firms expecting the situation to improve or continue unchanged is significantly higher than the proportion expecting it to deteriorate.

No. of Respondents 72*
(97 in December)
*excludes Sandwell companies which are now analysed separately.

BIRMINGHAM CHAMBER OF INDUSTRY AND COMMERCE

RESULTS OF MARCH 1986 QUARTERLY ECONOMIC SURVEY BY PERCENTAGE

	1986 Mar.	1985 Dec.	Sept.	June	Mar.
QUESTION 1. DELIVERIES AND ORDERS					
a) Home deliveries compared with 3 months ago are up	32%	39%	37%	37%	39%
same	43%	43%	45%	41%	36%
down	25%	18%	18%	22%	25%
Home orders compared with 3 months ago are up	31%	40%	40%	32%	35%
same	35%	32%	33%	39%	37%
down	34%	28%	27%	29%	28%
b) Export deliveries compared with 3 months ago are up	26%	25%	17%	23%	29%
same	48%	51%	47%	58%	54%
down	26%	24%	36%	19%	17%
Export orders compared with 3 months ago are up	28%	24%	18%	24%	25%
same	48%	43%	40%	43%	51%
down	24%	33%	42%	33%	24%
QUESTION 2. PRODUCTION					
At the moment the percentage of firms working					
at full capacity is	24%	31%	21%	13%	15%
at 80-100% capacity is	34%	31%	35%	38%	39%
at 60-80% capacity is	38%	37%	37%	43%	38%
at less than 60% capacity is	4%	1%	7%	6%	8%
QUESTION 3. STOCKS					
a) During the last 3 months stock levels have increased	29%	29%	19%	32%	37%
remained the same	50%	47%	52%	48%	43%
decreased	21%	24%	29%	20%	20%
b) During the next 3 months stock levels will increase	17%	28%	17%	14%	15%
remain the same	67%	53%	66%	62%	55%
decrease	16%	14%	17%	24%	30%
QUESTION 4. CASHFLOW					
Compared with 3 months ago the situation is improved	19%	27%	25%	25%	23%
same	60%	50%	53%	53%	55%
worse	21%	23%	22%	22%	22%
QUESTION 5. LABOUR					
a) During the last 3 months the percentage of firms who have					
increased their workforce is	27%	24%	30%	18%	20%
kept their workforce constant is	59%	54%	50%	63%	59%
reduced their workforce is	14%	22%	20%	19%	21%
b) During the next 3 months the workforce will probably					
increase	17%	20%	16%	16%	21%
remain constant	71%	62%	72%	68%	63%
decrease	12%	18%	12%	16%	16%
c) Of those firms who have recruited during the last 3 months, the percentage experiencing difficulty in finding:-					
i) skilled manual workers is	50%	28%	30%	26%	26%
ii) other manual workers is	8%	5%	10%	9%	9%

QUESTION 6. INVESTMENT

	1986 Mar.	1985 Dec.	Sept.	June	Mar.
a) Investment plans for plant and machinery during the next 12 months have been					
revised upwards	23%	28%	24%	15%	15%
unchanged	73%	66%	75%	82%	80%
revised downwards	4%	6%	1%	3%	5%
b) Investment plans for building work have been					
revised upwards	14%	10%	8%	6%	8%
unchanged	83%	87%	92%	91%	86%
revised downwards	3%	3%	0%	3%	6%

QUESTION 7. EXCHANGE RATES

	1986 Mar.	1985 Dec.	Sept.	June	Mar.
a) Changes in exchange rates over the past 3 months have affected future profitability as follows:-					
improve	28%	NA	NA	NA	NA
remain the same	55%	NA	NA	NA	NA
worsen	17%	NA	NA	NA	NA
b) The relative importance to business profitability of lower interest rates against changes in the exchange rate is:-					
more important	40%	NA	NA	NA	NA
equal importance	35%	NA	NA	NA	NA
less important	25%	NA	NA	NA	NA

QUESTION 8. CONFIDENCE

	1986 Mar.	1985 Dec.	Sept.	June	Mar.
a) Firms confident turnover will improve	62%	57%	50%	42%	50%
remain the same	34%	32%	39%	50%	36%
worsen	4%	11%	11%	8%	14%
b) Firms confident profitability will improve	54%	48%	45%	36%	33%
remain the same	35%	33%	39%	44%	47%
worsen	11%	19%	16%	20%	20%

QUESTION 9. BUSINESS FACTORS*

Firms were asked to indicate 4 factors most likely to improve their prospects. The following shows the order of importance placed on the factors listed:

	1986 Mar.	1985 Dec.	Sept.	June	Mar.
Lower Interest Rates	74%	1	1	1	1
Reduction of Local Authority Rating	61%	2	2	2	2
Higher Productivity	49%	3	3	4	3
Reduction of Tax Burden on Companies	44%	4	6	7	4
Reduction in Competition from Imports	32%	6	7	6	7
Lower Rate of Inflation	31%	7	4	3	5
Lower Pay Settlements	26%	NA	NA	NA	NA
Reduction in Public Utility Charges	25%	NA	NA	NA	NA
Reduction of Personal Taxation	18%	8	8	8	8
Improved Cash Availability	14%	NA	NA	NA	NA
Removal of Foreign Trade Barriers	13%	NA	NA	NA	NA
Better Industrial Relations Climate	3%	9	9	9	9

**The Business Factors question has changed and it is not therefore possible to show comparative percentages for previous quarters. Accordingly where the factors have remained the same, the previous ranking on a scale 1 to 10 is shown.*

ECO/2/A/SB/SJ
7th April 1986

[illegible] MIDLANDS REGIONAL GROUP OF CHAMBERS OF COMMERCE

No. of Respondents: 487
(403 in December)

RESULTS OF MARCH 1986 QUARTERLY ECONOMIC SURVEY BY PERCENTAGE

QUESTION 1. DELIVERIES		1986 Mar.	1986 Dec.	Sept.	June	Mar.
a) Home deliveries compared with 3 months ago are	up	36%	47%	34%	40%	43%
	same	44%	38%	50%	43%	37%
	down	20%	15%	16%	17%	20%
Home orders compared with 3 months ago are	up	38%	42%	34%	40%	43%
	same	36%	33%	42%	40%	34%
	down	26%	25%	24%	20%	23%
b) Export deliveries compared with 3 months ago are	up	28%	32%	26%	31%	37%
	same	54%	48%	51%	51%	50%
	down	18%	20%	23%	18%	13%
Export orders compared with 3 months ago are	up	29%	27%	25%	32%	37%
	same	52%	44%	45%	42%	45%
	down	19%	29%	30%	26%	18%

QUESTION 2. PRODUCTION

At the moment the percentage of firms working

at full capacity is	27%	33%	29%	25%	25%
at 80-100% capacity is	43%	38%	39%	43%	39%
at 60-80% capacity is	25%	25%	27%	26%	31%
at less than 60% capacity is	5%	4%	5%	6%	5%

QUESTION 3. STOCKS

a) During the last 3 months stock levels have	increased	33%	31%	29%	34%	31%
	remained the same	45%	49%	47%	44%	49%
	decreased	22%	20%	24%	22%	20%
b) During the next 3 months stock levels will	increase	18%	19%	21%	18%	17%
	remain the same	60%	59%	60%	55%	59%
	decrease	22%	22%	19%	27%	24%

QUESTION 4. CASHFLOW

Compared with 3 months ago the situation is	improved	24%	26%	27%	25%	25%
	same	52%	51%	48%	54%	52%
	worse	24%	23%	25%	21%	23%

QUESTION 5. LABOUR

a) During the last 3 months the percentage of firms who have

increased their workforce is	25%	34%	31%	31%	28%
kept their workforce constant is	59%	52%	53%	53%	54%
reduced their workforce is	16%	14%	16%	16%	18%

b) During the next 3 months the workforce will probably

increase	17%	24%	20%	23%	22%
remain constant	72%	62%	70%	68%	66%
decrease	11%	14%	10%	9%	12%

c) Of those firms who have recruited during the last 3 months, the percentage experiencing difficulty in finding:-

i) skilled manual workers is	50%	45%	42%	43%	44%
ii) other manual workers is	14%	9%	16%	13%	15%

QUESTION 6. INVESTMENT	1986 Mar.	1985 Dec.	Sept.	June	Mar.
a) Investment plans for plant and machinery during the next 12 months have been					
revised upwards	28%	30%	24%	23%	23%
unchanged	68%	67%	68%	74%	74%
revised downwards	4%	3%	8%	3%	3%
b) Investment plans for building work have been					
revised upwards	12%	10%	10%	11%	10%
unchanged	85%	87%	86%	86%	85%
revised downwards	3%	3%	4%	3%	5%

QUESTION 7. EXCHANGE RATES

a) Changes in exchange rates over the past 3 months have affected future profitability as follows:-

improve	24%	NA	NA	NA	NA
remain the same	54%	NA	NA	NA	NA
worsen	22%	NA	NA	NA	NA

b) The relative importance to business profitability of lower interest rates against changes in the exchange rate is:-

more important	47%	NA	NA	NA	NA
equal importance	31%	NA	NA	NA	NA
less important	22%	NA	NA	NA	NA

QUESTION 8. CONFIDENCE

a) Firms confident turnover will	improve	57%	58%	48%	51%	58%
	remain the same	37%	33%	41%	43%	34%
	worsen	6%	9%	11%	6%	8%
b) Firms confident profitability will	improve	46%	46%	41%	40%	42%
	remain the same	40%	39%	41%	43%	40%
	worsen	14%	15%	18%	17%	18%

QUESTION 9. BUSINESS FACTORS*

Firms were asked to indicate 4 factors most likely to improve their prospects. The following shows the order of importance placed on the factors listed:

Lower Interest Rates	67%	1	1	1	1
Reduction of Local Authority Rating	51%	3	3	2	2
Higher Productivity	43%	2	2	3	3
Reduction of Tax Burden on Companies	36%	4	5	4	4
Lower Rate of Inflation	29%	6	6	6	6
Improved Cash Availability	27%	NA	NA	NA	NA
Reduction in Competition from Imports	24%	7	7	7	7
Lower Pay Settlements	20%	NA	NA	NA	NA
Reduction in Public Utility Charges	19%	NA	NA	NA	NA
Reduction of Personal Taxation	13%	8	8	8	8
Removal of Foreign Trade Barriers	11%	NA	NA	NA	NA
Better Industrial Relations Climate	2%	9	9	9	9

**The Business Factors question has changed and it is not therefore possible to show comparative percentages for previous quarters. Accordingly where the factors have remained the same, the previous ranking on a scale 1 to 10 is shown.*

ECO/2/A/SB/SJ
7th April 1986

28-2846

moena — please thank
CR16/5

FROM: H P EVANS
DATE: 15 May 1986

CHANCELLOR

Thanks

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Mr Butler
Sir Terence Burns
Mr Kemp
Mr Peretz
Mr Scholar
Mr Culpin
Mr Davies
Ms O'Mara
Mr Pickering
Dr Rowlatt
Mr Cropper
Mr Ross Goobey
Mr Tyrie

IFS REPORT ON THE RPI

The IFS yesterday published a report on aspects of the RPI. There are a number of articles in this morning's press picking up the IFS criticisms.

2. In general our line eg in first order PQS should be that all these matters are being considered by the RPI Advisory Committee, expected to report to The Secretary of State for Employment later this year - perhaps in July. The main arguments are covered in the attached briefing note. Most of the IFS recommendations have not found favour with the Advisory Committee.

3. There is an oral PQ from Mr Andrew McKay, due to be answered by you, this afternoon, and the IFS report could well come up in this context.

HPE

H P EVANS

IFS REPORT : THE RPI AND THE COST OF LIVING

Factual

1. Report published May 14 by Institute for Fiscal Studies, commissioned by Chartered Association of Certified Accountants.

2. Main topics of report : measurement of owner-occupiers' housing costs; differences in the inflation experience of different types of households; measurement of quality changes; weighting system.

3. Report covers some aspects of the construction of RPI. These aspects, and on any others, being considered by RPI Advisory Committee. Report expected later this year.

Positive

1. Welcome informed analysis of RPI.

2. Report recognizes that no single index can be fully suited to the many uses of the RPI.

3. Report recognizes widespread use of index, by private sector and government, and need for continuity in methods of constructing index.

4. In general, differences between the RPI and the other measures in IFS report are small, or very small: some of the IFS proposals would reduce index; other would increase it.

Defensive

1. IFS claim that RPI disguises differences in the inflation experience of households because, according to their calculations, a price index for the poorest ten per cent of households rose by 17 per cent more than that for the highest ten per cent between 1974 and 1982. But always recognized that RPI cannot apply equally to all groups; households inevitably affected in different ways by price changes. Example

quoted by IFS should be seen in context of rise in total index from 100 in 1974 to 320 in 1982. DE publish special indices for low-income pensioner households; these deviate only slightly from the general index.

2. IFS claim that RPI ignores capital gains in estimating housing costs using mortgage interest payments. True, but IFS report rightly recognizes great difficulties in measuring costs of owner-occupied housing. This is widely seen as the most difficult conceptual problem in RPI; little agreement, in UK or elsewhere, on best solution. Of major countries, only Canada, other than UK, uses mortgage interest payments. IFS solution is to treat capital gains on housing as an offset to mortgage interest. This implies that the faster those prices rise, the slower the RPI should rise!

3. IFS report claims RPI overstates inflation because it fails to take account of quality changes. Again, very difficult to measure. But RPI does make some allowance. This issue, and approach recommended by IFS, is being examined by RPI Advisory Committee.

4. IFS report also claims RPI overstates inflation because of use of out of date expenditure patterns in constructing weights. RPI Advisory Committee examining this, but proposed solution involves projections of expenditure patterns. This raises problems of accuracy and of need for revisions if projections prove faulty.

5. IFS report claims RPI inadequate as a cost of living index. But RPI (despite its origins many years ago) is an index of price changes and not a cost of living index. A price index will fall only if prices fall; a cost of living index will fall, even if all prices are unchanged, if consumers shift their pattern of spending eg away from Harrods and towards Tesco.

EXTRACT FROM THE LONDON STANDARD, WED' 14 MAY

A note on this, pse.
M.

'THE RPI's GOT IT WRONG'

THE Government's inflation measure—the retail retail price index — calculates inflation wrongly, according to an independent report published today, and it has a major effect on public spending — with every 1% change in the RPI costing about £500 million a year in such items as pensions uprating and other social security changes, says the report from the Institute of Fiscal Studies.

Commissioned by the Chartered Association of Certified Accountants, it points out that he RPI is based on out-of-date spending patterns, different income groups have differing cost of living changes, house price gains are ignored, and the quality of the goods in the calculation is improving all the time.

Mr Robert Markless, executive administrator at the IFS said: "Inflation is the centrepiece of Government policy. But its main economic target is to keep down a figure which is not precise enough."

Inflation in 1978 would have been 9·1% rather than 9·9% had the RPI taken into account the fact that people switch from expensive to cheaper goods in 1983 it would have been 4·8% rather than 4·9%.

Cx

letter to welcome?

RL 19/5

Ok as amended. The chart is not quite up to date. Is this deliberate?

FROM: G N NOBLE
DATE: 15 MAY 1986

AW. 19/5

I have slightly amended the draft letter. FERB 18.5

1. MR F E R BUTLER

2. CHANCELLOR

cc PS/CST

RPI LESS MORTGAGE INTEREST PAYMENTS: LETTER TO MR FOWLER

I attach a revised draft letter to Mr Fowler.

2. My own feeling is that the EPR article is unlikely to cause us any problems, because it merely states that the RPI is volatile because of mortgage interest and demonstrates the effect. But what could cause difficulty is the description of the new index as "a better indicator of underlying trends in inflation". The significant word in that is, of course, "underlying" but it is all too easy for outside commentators - especially those on the social security side - to miss the subtlety. I think it would be helpful if the point could be made without using those words.

3. The draft letter does not ask for an explicit assurance from Mr Fowler before the EPR article is published. I think that will only raise suspicions and recent experience suggests there is little hope of Mr Fowler dealing with the matter quickly, so it could hold up the article.

Year ah!

G N NOBLE

PA type

~~DRAFT~~ LETTER FROM CHANCELLOR OF THE EXCHEQUER TO SECRETARY OF STATE FOR HEALTH AND SOCIAL SECURITY

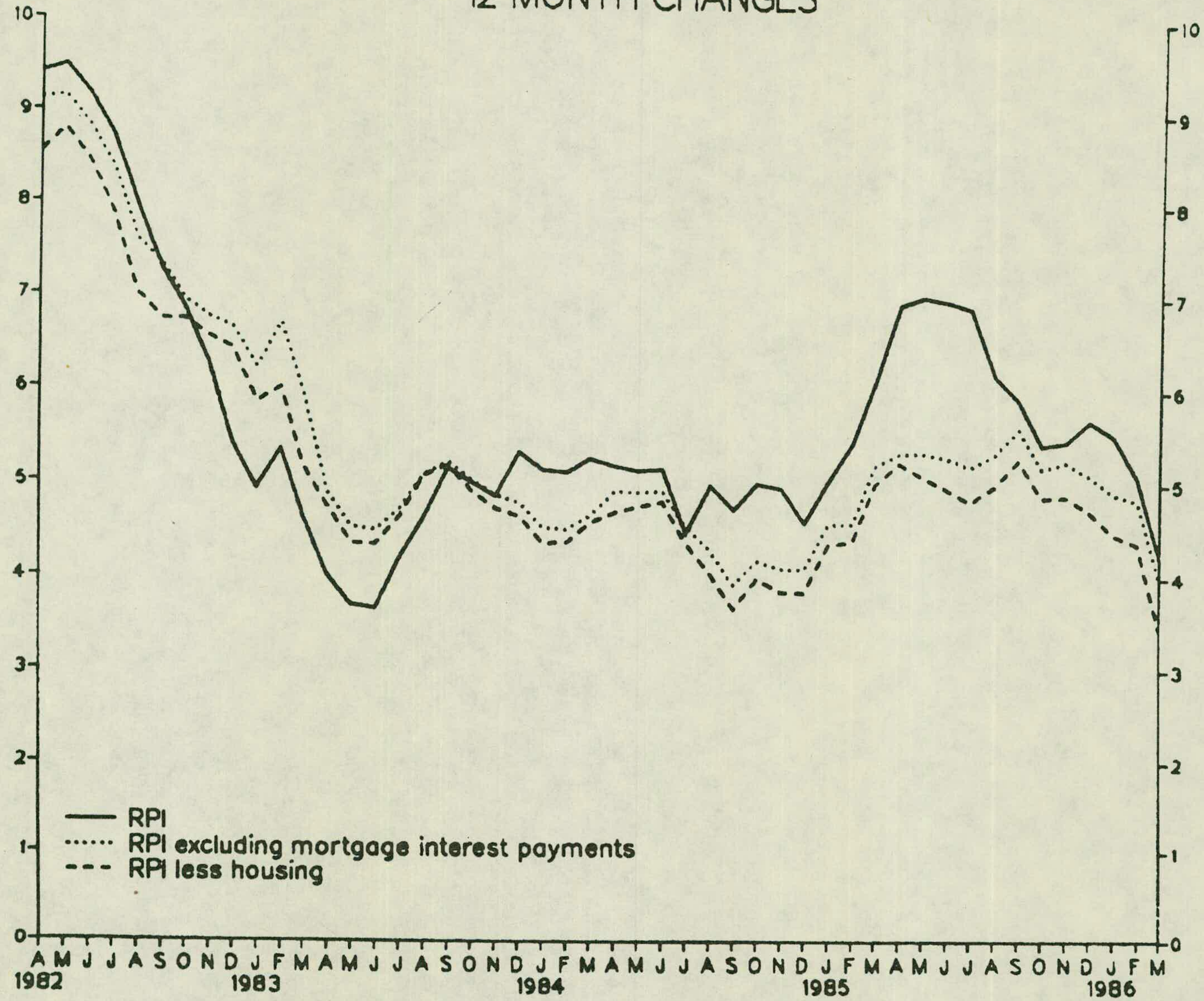
RIP LESS MORTGAGE INTEREST PAYMENTS

As you are well aware, the RPI ~~is coming~~ has come down rapidly and we should see some very low figures in the next few months. Part of the reduction is due to the influence of falling mortgage rates. This is a temporary influence and when interest rates stop falling we shall lose the benefit from the RPI. Commentators ~~will~~ may then claim ~~we have lost our grip on inflation.~~ that inflation is rising again.

To head off these arguments, (which would be politically inopportune,) I want to start getting over the message that the RPI is highly sensitive to short term movements in interest rates and that the underlying trend in inflation is still downwards. I propose to do this by including a short article in the next issue of the Economic Progress Report, due out on 11 June, which will show the recent values of the RPI excluding mortgage interest. The article will also meet a request from the ~~TCSC~~ Treasury and Civil Service Select Committee to publish this series.

There is clearly some risk that ~~commentators will argue that~~ since this index will show a higher rate of inflation for the next few months ~~it should be~~ the opportunity will be taken to argue that it should be used instead of the RPI for next April's uprating. ~~this different index should be used for uprating benefits. You should have no difficulty resisting such arguments.~~ As the attached chart shows, the series (not surprisingly) moves very ~~closely to~~ much in line with the RPI less housing, which you already use for supplementary benefit upratings, and you have a well established line about using the full RPI for other benefits. For public expenditure reasons, it is essential to hold to this line. ~~However, if you see any difficulty in all this,~~ If you think that publication of this article will cause you any real difficulty in doing so, could you let me know within the next week.

RPI AND RPI LESS MORTGAGE INTEREST 12 MONTH CHANGES



G: JYOTI.DISRPI/XM2
M: JYOTI.TABCONV

D: 9-5-86

LR2.38 **PERSONAL & CONFIDENTIAL**

pwp

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

16 May 1986

Professor Geoffrey Walter Maynard
Chase Manhattan Ltd
PO Box 16
Woolgate House
LONDON EC2P 2HD

Dear Geoffrey

I have decided that it would be a good idea to set up an informal group of economists which could meet with me at regular intervals. There would be no papers and no formal agenda. The existence of the group would not be disclosed and what we say would be completely confidential. I would propose to open a discussion on matters of current interest. And I would hope that anyone in the group would raise issues which he thought important.

I very much hope that you will agree to join the group and come to an initial discussion at No 11 in the next few weeks. Terry Burns will of course also be a member of the group, but there would be no other Treasury officials present. My office will be getting in touch to fix a time.

Yours ever
Nigel

NIGEL LAWSON

FROM: APS/Minister of State

DATE: 19 May 1986

MR S J DAVIES

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary

RECENT ECONOMIC STATISTICS AND THE FSBR FORECAST

The Minister of State has seen your minute of 9 May and would welcome a brief word of explanation (unless there is an appropriate reference elsewhere in the papers to which he could be pointed by way of explanation) of the last sentence of paragraph 7:

> "This interpretation would vindicate the message given by the longer leading cyclical indicator which turned down during the first half of 1984".

We will be in touch to arrange.

E Frankis

MISS E C FRANKIS
Assistant Private Secretary

CONFIDENTIAL

RECENT INDICATORS AND THE FSBR FORECAST

This note summarises information available from the latest economic indicators, and compares this with the forecast underlying the FSBR. Section 1 provides a brief summary of recent developments in oil prices and financial markets. Following this, section 2 discusses recent developments in demand and output. Section 3 covers the labour market, while section 4 considers inflation, containing some indication of how recent developments are likely to influence the profile of inflation during the current year.

I. Oil Prices and Financial Developments since the Budget

Oil Prices

1. North Sea prices averaged around $16 a barrel in the month before the Budget. On Budget day itself prices were somewhat lower than this, at around $14½ a barrel. The Budget arithmetic was based on the assumption that oil prices, both North Sea and world would average $15 per barrel for the rest of 1986 and throughout 1987.

2. Since the Budget North Sea prices have averaged $12½ a barrel, and world prices $12 a barrel though prices last week were a little higher than this. The $15 assumption related to the average for 1986-87 as a whole, and it was to be expected that prices would fluctuate around the average. It is therefore much too early to say whether the $15 assumption will be appropriate. Futures prices for North American crude, which is quite heavily traded compared to the thin trading of forward Brent, have generally been within $1 of spot prices and are currently only a few cents below spot prices.

Interest Rates and Exchange Rates

3. Nominal interest rates have fallen throughout the industrialised world. Long as well as short rates have fallen indicating that the main influence has been the downward revision of inflation expectations following the fall in oil prices, and perhaps also reflect perceptions of an improved outlook

in the US. The fall in overseas rates has been greater than expected for the USA and Japan but much as expected for Europe. UK interest rates have shared in the general trend but the fall has been greater than expected, both absolutely and relative to overseas rates. Interbank and 20 year gilts rates are now 1½ points and 1 point respectively below the Budget Forecast for 1986Q2. Experience has shown however that sentiment can quickly change and it is too early to say whether these sort of differences will persist for the whole year. Much depends on what happens to actual and expected oil prices. In the absence of a move back above $20 a barrel it seems likely that much of the improvement to inflation expectations will persist.

4. The Budget forecast assumed a sterling effective rate of about 73½ for the rest of 1986 similar to the average rate in February. The rate recovered from a low point of 72.5 in the first week of March to 74.3 on Budget day and has subsequently been in the range 75-76½. Sterling has been stronger than expected against both the $ and the DM though much as expected against the Yen. This underprediction has occurred despite lower than assumed oil prices and a lower than expected interest differential, possibly reflecting the Budget's good reception, a reassessment of the effects of oil prices falls, goods news on the PSBR and on inflation, and a slightly weaker than expected dollar. (The underprediction of the $/£ rate has been slightly greater than that of the DM/£ rate).

Monetary Aggregates

5. Provisional money supply figures for banking April were published on 6 May. MO rose by 0.3 per cent in this month, giving a year on year increase of 3.2 per cent, within the lower half of the 1986-87 target range. £M3 is provisionally estimated to have risen by 3.1 per cent in banking April, with its annual rate of growth of 16.6 per cent above the upper end of the 1986-87 target range of 11-15 per cent.

6. The large increase in £M3 can be partly attributed to a marked increase in bank lending to companies, probably related to increased investment expenditure prior to the phasing out of capital allowances.

PSBR

7. The cumulative PSBR for 1985-86 was £5.9 bn, lower than the forecast of £6.8 bn made at the time of the Budget. This difference is largely accounted for by a higher than forecast outturn for central government receipts, with the increase spread across many areas such as receipts of composite rate income tax from building societies, receipts from the second-call on BT shares, and tobacco duties.

II DEMAND AND OUTPUT

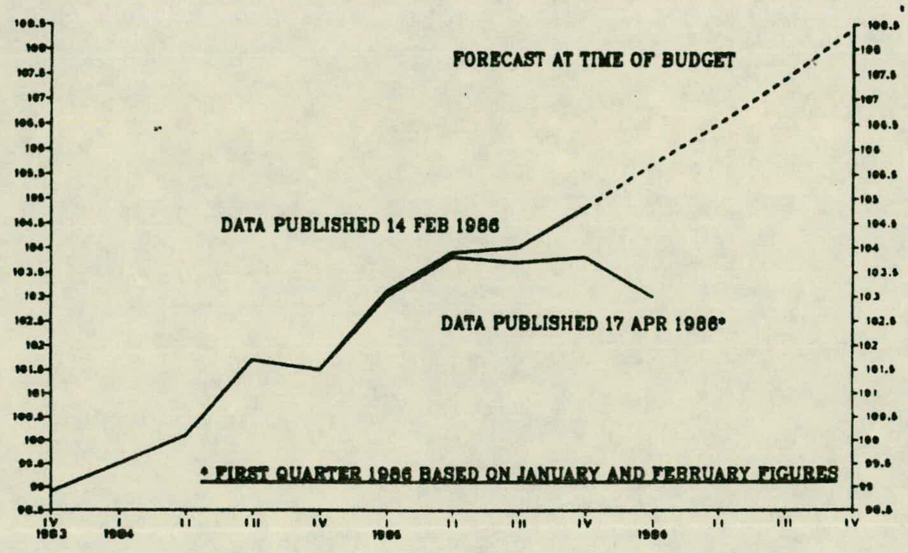
8. The FSBR forecast showed a $9\frac{1}{2}$ per cent increase in money GDP during 1985-86, followed by growth of $6\frac{3}{4}$ per cent in 1986-87. Data is not yet available for the first quarter of 1986, but CSO projections suggest that the forecast for 1985-86 will prove close to the outturn.

9. The FSBR forecast of 3 per cent growth in both real gross domestic product and manufacturing output between 1985 and 1986 is consistent with an underlying rate of increase in output of around $\frac{3}{4}$ of one per cent per quarter. At the time of the Budget it seemed likely that growth in the first quarter would exceed this rate, reflecting a peak in North Sea oil production, and a surge in investment expenditure prior to the final reduction in capital allowances. Recent indicators suggest that growth during the first quarter of 1986 may prove to be less than anticipated. This evidence is summarised below.

Output of the Production Industries

10. The FSBR forecast for manufacturing output was based on data, published in mid February, for the period to December 1985. This showed output to have increased by $\frac{3}{4}$ per cent in the fourth quarter of 1985. More recent information, covering the months of January and February of 1986, show no growth in manufacturing output in the three months to February, and include downward revisions to the data for 1985, particularly for the fourth quarter. These developments are summarised in the chart below.

INDEX OF MANUFACTURING OUTPUT

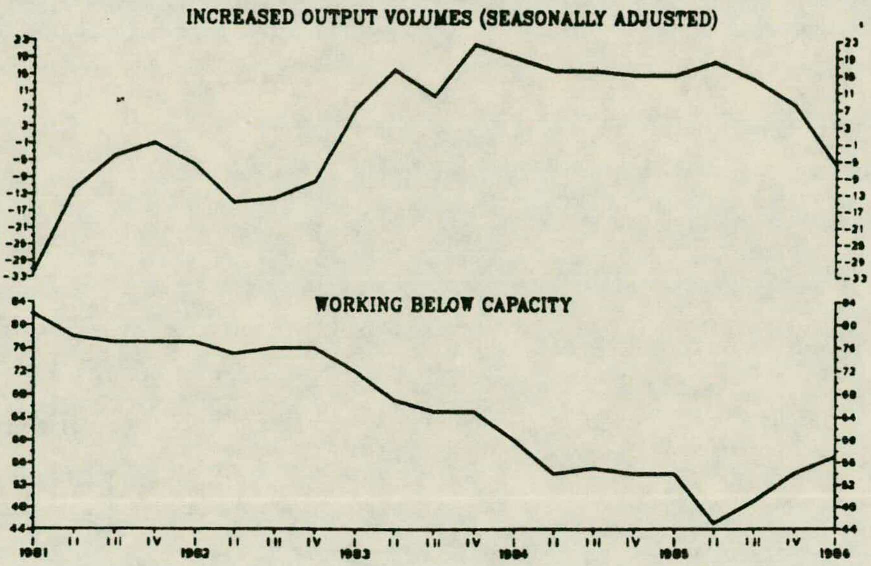


11. Assessment of recent trends in manufacturing output is difficult given the record of upward revisions to initial CSO estimates of manufacturing output. While the CSO now add bias adjustments to the output index, it is too early to know whether the adjustments are adequate. The CSO assess the current underlying trend in manufacturing output to be between -1 and +1 per cent per annum.

CBI Quarterly Industrial Trends Survey - April 1986

12. The latest CBI industrial trends survey was published on 29 April. Analysis of the survey results support the published production statistics in suggesting a slow-down in manufacturing output growth over the last few quarters. The chart below shows the balance of firms reporting as working below full capacity and the balance of firms reporting increased volumes of output. The latter series has been cyclically adjusted by the CSO who have detected a degree of seasonality in the published figures. Both series show less optimistic responses since mid-1985.

PERCENTAGE BALANCE OF CBI RESPONDENTS REPORTING:



13. CBI survey responses on output growth show some correlation with the published index of manufacturing output. Based on past experience of the relationship between these two indicators, the April survey results can be seen as consistent with little change, or even a small fall in manufacturing output between the fourth quarter of 1985 and first quarter of 1986.

14. The CBI survey also reports output expectations for the quarter ahead. While the response on this question is usually similar to that given in response to the question on output growth in the current quarter, that in the April survey is considerably more optimistic, providing some evidence that manufacturers expect an upturn in demand during the second quarater.

Expenditure components

(a) Consumers' expenditure

15. The FSBR forecast projected a 4 per cent increase in consumers' expenditure during 1986, which, with a 5 per cent increase forecast for disposable incomes, was consistent with a small rise in the savings ratio. Provisional figures for consumers' expenditure in the first quarter are now available. These show consumers' expenditure, both on durables and

non-durables, broadly unchanged since the fourth quarter of 1985. Given projections of strong growth in disposable incomes in the first quarter, this represents a sharp increase in the saving ratio following a year in which it has been broadly flat.

16. The apparent flatness of consumer spending may well be misleading since revisions to consumers' expenditure data are often substantial. Furthermore, there appears to be a problem with CSO's seasonal adjustments: consumer's spending is recorded as having fallen in the first quarter of four out of five years since 1981; but is only recorded as having fallen in one other quarter over this period.

17. The retail sales index, shown below, suggests that growth in consumers' expenditure may have flattened off somewhat in late 1985/early 1986, but also shows a rebound in spending in March.

Retail sales index
(volumes, seasonally adjusted)

1984	July	115.9	1985	January	117.0
	August	117.5		February	117.2
	September	115.6		March	119.4
	October	115.0			
	November	117.4			
	December	117.3			

18. On balance the recent data does not cause us to believe that the FSBR forecast of a 4 per cent increase in consumer spending will turn out to be over-optimistic; particularly as inflation and interest rates have fallen more than forecast.

(b) Investment and Stockbuilding

19. At the time of the FSBR the first quarter of 1986 was expected to show a strong increase in investment expenditure prior to the final reduction in capital allowances. As yet we have no firm evidence of the scale of increase in spending; first quarter national accounts figures for investment and

stockbuilding are not published until 22 May, and indicators that are available give conflicting accounts of first quarter developments.

20. The first quarter increase in investment expenditure seen in 1985 was associated with a marked increase in bank lending to companies. As paragraph 5 notes, this feature is again seen in figures for lending to companies for the first quarter of 1986. However, the investment surge in 1985 was also associated with increased capital imports and increased domestic production of capital goods, features which the table below shows are not as yet apparent in the data for the first quarter of 1986.

(Percentage Increase on Previous Quarter)

	Production industries output*	**of which capital goods***	**import of goods**	**of which capital goods**
1985Q1	1.8	2.9	- 1.4	7.0
1986Q1	- 0.5	- 0.2	- 1.1	- 8.9

21. The FSBR forecast projected small increases in private investment in dwellings throughout 1986 and the first half of 1987. Figures for private housebuilding starts and completions were published on 2 May. These are consistent with the forecast, showing a broadly flat picture for completions while starts bounced back to levels seen in the second half of 1985 following a poor February figure that was accounted for by bad weather.

(c) Trade in Goods

22. March figures for trade in goods were published on 25 April. Non-oil import and export volumes fell in the first quarter to levels well below those forecast, possibly reflecting weaker than expected economic activity both at home and overseas. Imports were 2 per cent lower than forecast and exports 5 per cent. In national accounts terms lower net trade in goods reduced the quarterly rate of increase of GDP by around ½ percentage point relative to the FSBR forecast.

---

* December to February

23. Non-oil trade prices rose more than expected in the first quarter, possibly because the weakness in the exchange rate came through quicker than expected. If this interpretation is correct our forecast of import prices for the end of 1986 would not need changing. The degree of underprediction was greater in the case of import prices, with the effect that the non-oil terms of trade were worse than forecast. This, together with lower net volumes, produced a non-oil visible deficit £1 billion higher than forecast. Most of this difference was in manufactures where the first quarter deficit was £1 billion compared with the FSBR forecast of £3 billion for 1986 as a whole. The surplus on oil trade of £2 billion was in line with the forecast.

III. LABOUR MARKET

24. The table below shows recent outturns for UK adult unemployment and compares these to figures forecast at the time of the FSBR.

UK Adult Unemployed (000's, seasonally adjusted)

Quarter	Outturn	Forecast
1985 Q1	3088	
Q2	3119	
Q3	3124	
Q4	3122	
1986 Q1	3171	3155
Q2		3131
Q3		3116
Q4		3080
1987 Q1		3041
Q2		3015

25. As a result of the very poor March figure,the outturn for UK adult unemployment in the first quarter of 1986 was around 15,000 higher than forecast. On the basis of the latest figures the Department of Employment assess the current underlying trend in unemployment to be upwards at around 10,000 a month (excluding the effect of SEMs this figure increases to around 15,000 a month). The table above shows that the FSBR forecast allowed for an improvement in the trend, with a decline in adult unemployment during 1986.

26. Revisions to figures for the employed labour force for the period up to the fourth quarter of 1985 have been published since the Budget. These show a 117,000 increase in employment in the fourth quarter of 1985, and an increase of 311,000 in 1985 as a whole, compared with a figure of around 230,000 in the forecast underlying the Budget. However, figures for manufacturing employment in the first quarter of 1986 have proved lower than forecast. The fall of 20,000 in GB manufacturing employment in February was the largest since September 1983 and may reflect a slowdown in manufacturing output growth.

27. Recent figures for manufacturing overtime working, shown in the table below, also suggest some recent weakness.

Hours of Overtime Worked

(manufacturing sector, millions, seas adj.)

1984	Q1	11.2	1985	Q1	11.9
	Q2	11.6		Q2	11.6
	Q3	11.6		Q3	12.2
	Q4	11.8		Q4	12.1
			1986	Q1	11.7

IV INFLATION

Earnings and Unit Labour Costs

28. Recent information on settlements and earnings is in line with the judgements underlying the FSBR forecast. However growth in unit labour costs has been higher than we expected: the provisional outturn for unit wage costs in the manufacturing sector in the three months ending February 1986 shows a rise of 6.8 per cent on a year earlier, compared with a rise of 6 per cent in 1985.

Import Prices and Oil Prices

29. We over-estimated the prices of imported basic materials by about ⅔ per cent in the first quarter and under-estimated the prices of imported finished manufactures by about 2¼ per cent. The sterling price of crude oil is turning out lower than assumed. The April figure at £9.39 per barrel was £1 below the forecast for the second quarter.

Producer Prices

30 Our forecast for producer input and output prices in 1986Q1 were correct. Figures for April (published on 12 May) are also in line with our forecast.

Retail Prices

31. Petrol prices have fallen since the Budget, and may now be some 7p lower than forecast for May. (The world oil price is, as noted earlier, below the FSBR assumption.) Each 2p per gallon is worth about 0.05 per cent off the RPI.

32. In the housing sector we forecast on the basis that mortgage rates would fall from 12¾ per cent in March to 11¾ per cent in 1986Q4. In the event, these rates fell to 12 per cent from the 1 April and a further fall of at least one per cent is due on 1 June. If mortgage rates stay at 11 per cent to the end of the year, this would reduce our forecast of RPI inflation by about a third of a per cent.

33. It seems likely that the measure of Local Authority rate increases relevant for RPI purposes will be somewhat below what we had expected in March. The latest view (which is by no means final) is that a figure in the range 13-14 per cent is most likely compared with our forecast of 17 per cent. If this turns out to be the case our RPI forecast is on this account rather less than 0.1 per cent too high for 1986Q4.

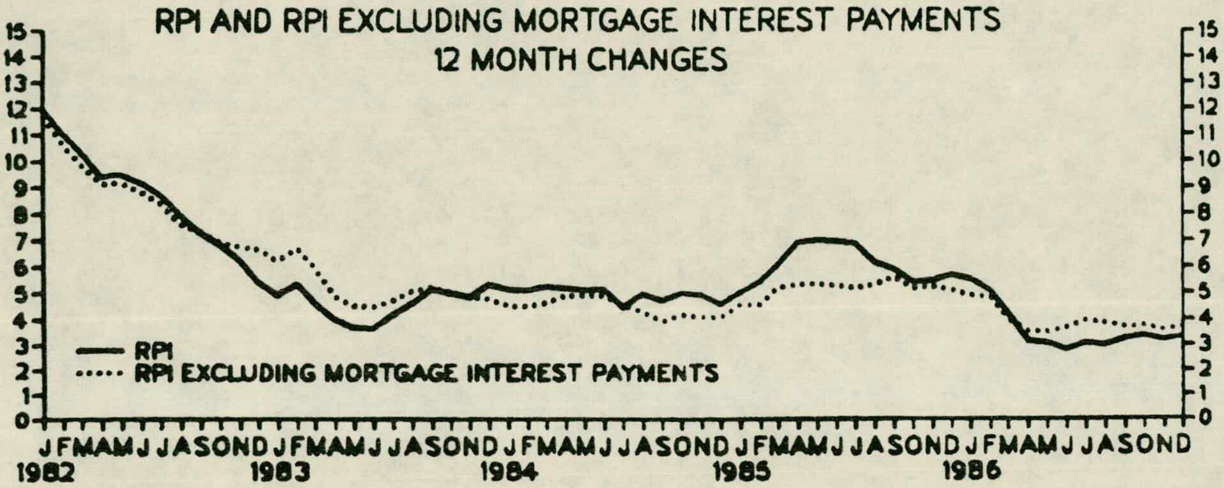
34. Nationalised Industry prices seem likely to turn out lower than forecast. We had forecast only a small rise in domestic gas prices of 2 per cent, similar to the outturn (1.8 per cent). For electricity prices where domestic price rises of a little less than five per cent have been announced (in line with the forecast) it now seems likely that there will be some reductions later in the year. We might now reduce our forecast for the rise in Nationalised Industry prices to 1986 Q4 from 4 per cent in the FSBR to 2 per cent, worth about 0.15 per cent off the RPI in 1986 Q4.

35. For the categories so far mentioned, recent developments have all been more favourable than forecast, and taken together could reduce the RPI by over ½ per cent in 1986 Q4. Changes in food prices are turning out much as expected. The remainder of the retail prices index - accounting for about half of the index - is more likely to turn out above than below the FSBR forecast. The revisions to the employment figures since 1984 mean that wage costs for industry as a whole have been growing somewhat faster than previously thought. And so far import prices are higher than forecast on balance, although this difference may well not persist.

36. We do not think that the balance of changes yet warrants a revision to our forecast for 1986Q4 but we would certainly think now that inflation is more likely to turn out below 3½ per cent than above it.

37. Mainly because of the larger and earlier cuts in the mortgage interest rates than assumed in the FSBR forecast, the inflation rate will be lower than we had expected over the next few months. At the time of the FSBR we expected it to fall only a little below 3½ per cent between April and June. It now seems likely to be near 3¼ per cent in April, and to be at or below 3 per cent in May and June. Thereafter it is likely to rise marginally (as we enter the period when the monthly changes in inflation were exceptionally low the previous year).

38. The chart below shows our latest projections for the RPI and the RPI excluding mortgage interest rates.



45:2

CONFIDENTIAL
until 11.30am Wednesday 21 May
then RESTRICTED

Meena - thanks please.

FROM: S D KING
DATE: 20 May 1986

1. ~~MISS~~ O'MARA
2. CHANCELLOR OF THE EXCHEQUER

Thanks to higher oil & gas extraction, the figures still show some growth. But this will not stop press stories suggesting the recovery has come to an end

MOM 20/5

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Burgner
Mr H P Evans
Mr Shaw
Mr Culpin
Mr S Davies
Mr Pickford
Mr Allum
Mr Hacche
Mr Pickering
Mr Dyer (+1 for No.10)
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Stirling - CSO
Mr Clary - CSO
Mr Lang - CSO
HB/02

GDP (OUTPUT MEASURE) IN FIRST QUARTER 1986

The CSO will publish the preliminary estimate for GDP(O) on 21 May. An advance copy of the press notice is attached.

First Quarter Figures

2. GDP(O) is estimated to have risen by almost ½ per cent between the fourth quarter of 1985 and the first quarter of 1986. This follows an increase of ¾ per cent in the fourth quarter of 1985.

3. The contributions of changes in the individual components of GDP(O) are tabled below.

Industry	Contributions to percentage change in GDP(O) 1986Q1 on 1985Q4
1. Agriculture, forestry and fishing	-
2. Construction	-0.2**
3. Services	+0.2
4. Industrial production of which:	+0.2
5. Oil and gas extraction	+0.3
6. Other energy and water supply	+0.2
7. Manufacturing	-0.3
GDP(O)*	+0.4*

* Sum of rows 1-4 (NB divergence due to rounding)
**Not for use

4. The positive contribution of production growth to GDP growth was due to growth in oil and gas extraction and energy and water supply (due partly to bad weather) - offset only partly by a fall in manufacturing.

5. The main contribution to growth in the service industries came from the category termed 'other services' - which includes subdivisions such as banking, public administration, defence, education and health. Distribution output as a whole was flat; though an increase in retail sales was recorded, falls were recorded elsewhere - eg. wholesaling, motortrades.

6. [NOT FOR USE: very preliminary information suggests that construction output fell by 2½ per cent in 1986Q1. However, this is really no more than a best guess by DOE, and in the past these guesses have more often than not shown downward bias.]

Assessment

7. Despite widespread claims that the recovery is now over, growth seems to have continued in the first quarter of 1986 after a rise of ¾ per cent in 1985Q4, albeit at a slower rate. However, media comment may focus on the observation that in strike adjusted terms overall growth since 1985Q1 has been slowing down, and that the series for GDP excluding oil and gas extraction (available on request to the Press) shows no change between 1985Q4 and 1986Q1.

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then RESTRICTED

Lines to take

7. Positive

(a) GDP(O) up almost ½ per cent between third and fourth quarter of 1985

(b) Preliminary estimate of GDP(O) suggests 2½ per cent growth between 1985Q1 and 1986Q1.

Defensive

(c) Output stagnant since beginning of last year. Output risen by 2½ per cent in year to 1986Q1, and up ½ per cent in 1986Q1 on previous quarter.

(d) GDP(O) less oil and gas extraction flat in 1986Q1/ At this rate, can expect growth of less than 2 per cent for 1986 as a whole. Quarterly series erratic. CBI April Trends Survey suggests firmer growth in second quarter than in first. And fall in oil price should bring benefits in latter half of year.

S D KING

PRESS
AND
INFORMATION SERVICE

CSO

CENTRAL STATISTICAL OFFICE

GREAT GEORGE STREET
LONDON
SW1P 3AQ

PRESS CALLS ONLY 01-233 7489
(AFTER 1800 HRS 01-233 3000)
OTHER ENQUIRIES 01-233 6135/6193

CSO(86)51
21 May 1986

GROSS DOMESTIC PRODUCT (OUTPUT-BASED) - FIRST QUARTER 1986

Preliminary estimates suggest that output of the whole economy grew by almost ½ per cent between the fourth quarter of 1985 and the first quarter of 1986. Energy and water supply increased by 4½ per cent but manufacturing output fell by 1 per cent. Output of the service industries as a whole increased by about ½ per cent. Distribution output (which includes the motor trades) was little changed from its level in the second half of 1985.

The preliminary output-based estimate of gross domestic product (GDP) in the first quarter is 111.5 (seasonally adjusted at constant prices, with 1980=100), some 2½ per cent above its level of a year earlier (1½ per cent after adjusting for the effect of the coal strike upon the earlier period).

As can be seen from the Table, the expenditure, income and output measures of GDP (and by implication the average measure) can move irregularly for particular quarters, and differently to each other.

COPY No. 7

PERSONAL AND CONFIDENTIAL until release of Press Notice at 1130 p.m. on 21.5.86 and thereafter unclassified

GROSS DOMESTIC PRODUCT AT CONSTANT FACTOR COST

Seasonally adjusted

1980=100

		Average estimate	Based on: Expenditure data	Based on: Income data(1)	Based on: Output data
1980		100.0	100.0	100.0	100.0
1981		98.6	98.9	98.5	98.3
1982		100.4	100.1	101.0	100.1
1983		103.7	103.8	104.3	103.1
1984		106.4	105.5	107.4	106.4
1985		109.9	109.0	110.6	110.0
1982	1	99.8	100.0	100.3	99.2
	2	100.3	99.7	101.3	100.0
	3	100.3	99.2	101.3	100.5
	4	101.1	101.4	101.2	100.8
1983	1	102.9	103.6	103.2	101.8
	2	102.8	102.3	104.0	102.1
	3	104.3	104.3	104.7	103.8
	4	105.0	104.8	105.2	104.9
1984	1	105.8	105.6	106.3	105.6
	2	105.4	104.6	105.9	105.6
	3	106.8	105.3	108.4	106.7
	4	107.7	106.5	109.0	107.6
1985	1	108.5	107.8	109.0	108.8
	2	110.3	109.2	111.6	110.0
	3	110.1	109.0	111.0	110.2
	4	110.7	110.1	110.9	111.1
1986	1	..	..	..	111.5 (2)

(1) Income data deflated by the implied index of total home costs derived from expenditure data.

(2) Preliminary estimate.

NOTES TO EDITORS

1. The preliminary estimate of the output based measure of gross domestic product is derived from the provisional estimate of the index of output of the production industries for the first quarter, published on 15 May, together with partial information for the rest of the economy. Any revisions to quarterly data, together with estimates of GDP based on expenditure and income data, will be released by Press Notice on 20 June. Series consistent with today's Press Notice are available on request for output of the whole economy other than extraction of mineral oil and natural gas, and for output of the service sector as a whole.

2. As the table shows, the estimates of GDP based on expenditure, income and output data may move differently in the short term. The output based measure is usually considered to be the most reliable measure of short term movements.

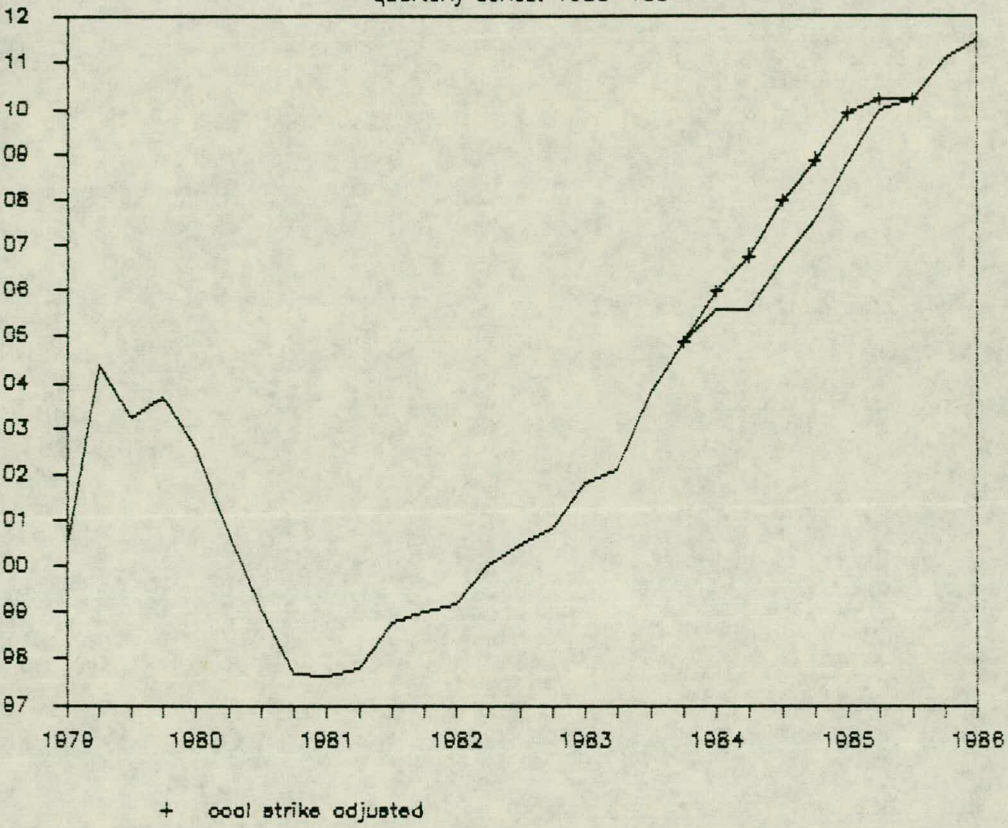
3. The 1980-based GDP(O) series was introduced in September 1983. Since then, the revision in the month following publication to the preliminary estimate of change in GDP(O) between the two most recent quarters has tended to be upwards. The mean revision to the estimate of change is +0.2 but for any particular quarter the actual revision can fall within quite a wide range of this average; since rebasing, revisions have varied from -0.2 to +0.4. The average is based on only ten quarters and could itself change considerably as more quarters' data become available.

4. All GDP estimates are liable to revision over a much longer period, as firmer and more complete data become available. An article published in the July 1985 issue of Economic Trends reports the results of an investigation into the pattern of these long-term revisions. It should be noted that the article does not include revisions made in the month following the initial publication of GDP(O), which are discussed in the previous paragraph. While some assessment is made in the article of figures for the three separate measures of GDP, the focus of the analysis is in respect of the average estimate. GDP Press Notices containing new data for this measure now give ranges within which (based on past evidence) the finally revised figures are likely to lie, but related information is not published in respect of the individual measures.

5. The series and weights used to compile the 1980-based GDP(O) series are described in an Occasional Paper. The effects of rebasing on all the measures of GDP were described in an article in December 1983 Economic Trends. Occasional papers (price £2.50 each) and off-prints of Economic Trends articles (price £1.20 each) are available from the Central Statistical Office.

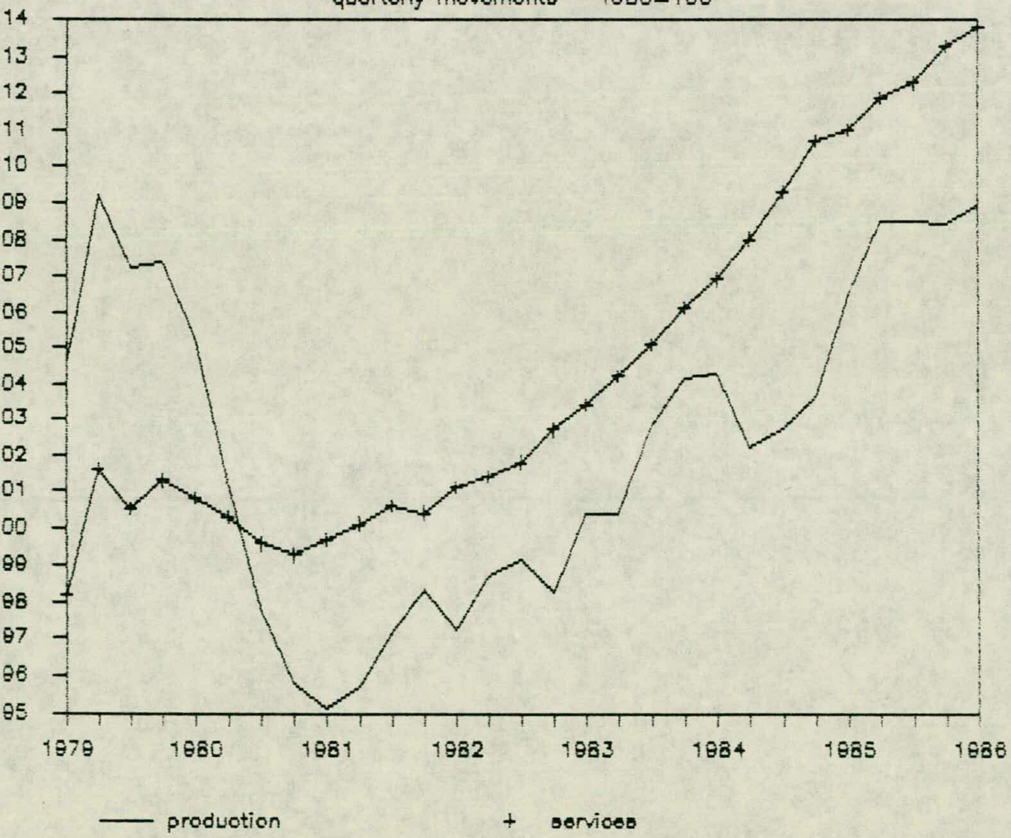
GDP (OUTPUT)

quarterly series: 1980=100

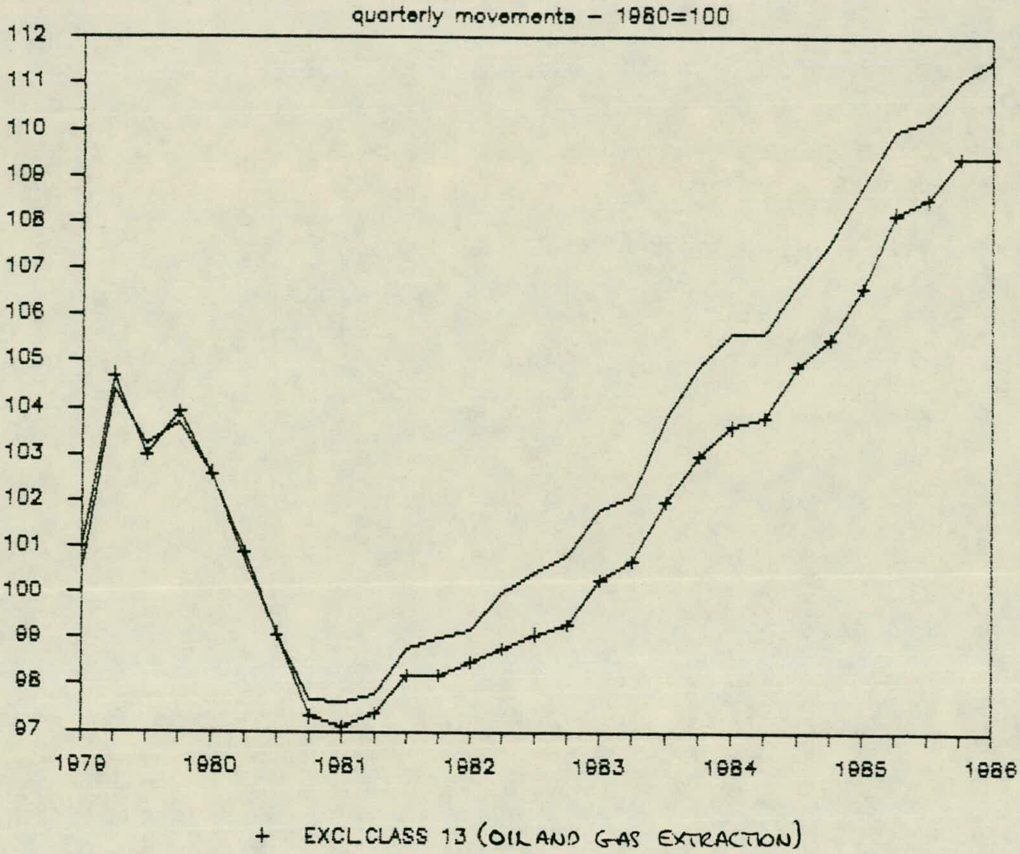


OUTPUT OF PRODUCTION & SERVICE SECTORS

quarterly movements – 1980=100



GDP(OUTPUT)


quarterly movements - 1980=100
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1982
1983
1984
1985
1986
+ EXCL CLASS 13 (OIL AND GAS EXTRACTION)

10-3282

pwsp

FROM: H P EVANS

DATE: 21 May 1986

MR CULPIN

cc: PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Butler
Mr Byatt
Mr Kemp
Mr Odling-Smee
Mr Scholar
Mr Davies
Miss O'Mara
Mr Brooks
Mr Cropper

"NEW LIGHT ON PRICE RISES"

An article by Robin Marris (Birkbeck College) in today's FT attempts to throw new light on price rises in recent years by classifying components of the retail prices index into three main categories: energy items, public items, and private items. A copy of the article, with a correction to one of the figures, is attached.

2. The article tries to suggest that the Government's anti inflationary policies have been offset in part or in whole by above average increases in many items controlled or influenced by the Government. There is a distinctly odd selection of items in the RPI listed as publicly determined. Paragraph 5 below comments on the treatment of mortgage interest payments, and drink.

3. But the main objection to the article is the implicit assumption running through it that inflation is the result of a very large number of factors operating independently and which can be identified by scrutinising the details of the RPI. Such scrutiny is very necessary for some purposes; we do it ourselves;

and it is essential in order to understand and interpret the RPI figures in recent months and the outlook over the short term. Movements in items like seasonal food prices, mortgage interest rates, indirect taxes can play a large part in month to month movements in the all items index.

4. But over the medium term the overall inflation rate is dominated by the consequences of financial policies, both here and abroad. Within periods of four years above average increases in for example local rates or tobacco duties have their primary effect on relative prices, and not on the overall price level.

5. Among the points that can be made on the details of the table:

Robert has his own paper on MIP + RPI.

(1) Mortgage interest payments reflect, in addition to mortgage interest rates, past house price inflation, which has usually been above inflation in general. This point has been forgotten in the very confused paragraph dealing with interest rates. So has the extent of market influences on mortgage rates.

(2) The drink/tobacco element in the table is treated as a publicly administered price on the grounds that tax is such a large part of the final price. In the case of beer, which accounts for over half the total drink component, the specific duty element accounts for a little over a quarter of the VAT exclusive price. This makes it ridiculous to count beer as a publicly administered price.

6. As to the perpetuation of inflationary expectations, referred to in the final paragraphs, that clearly depends on the general inflation rate. There is no reason to single out the public sector. In any event, over pessimistic expectations of future inflation may not have much implication for the course of actual inflation, although they will raise the costs of achieving a particular reduction in inflation.

C. Longran

pp H P EVANS

New light on price rises

By Robin Marris

TWO statistics dominate economic reporting: the level of unemployment and the inflation rate. Most of us, with varying clarity, understand the connection between them—that fear of renewed inflation is the obstacle to expanding real demand and reducing unemployment. But what lies behind the Retail Price Index, which thus governs our economic destinies? We know it is an average of price changes among many commodities. Are there persistent leaders? Can we identify a "competitive" sector of the economy (eg, the "grey economy") where prices, being more influenced by the balance of demand and supply, are less influenced by cost-push?

In pursuit of such questions I decided to try to make use of the more detailed data available in the Department of Employment Gazette and other official publications. What I found was not, in Byron's words, "that which I sought"; but, I believe, equally interesting.

My first discovery was that if a distinctive "competitive" sector exists in the British economy today, an outsider cannot observe it. Government statisticians revise the RPI to incorporate a range of different types of "price-regimes" (from supermarket to barrow-boy), but the way the index is *categorised* forestalls the kind of dismemberment I needed. Not unreasonably, the index's categories relate to kinds of consumer need, not kinds of markets.

So instead I calculated annual inflation rates for each of the 150 published categories back to 1978. Then I arranged them in inflationary order. I found that in place of a contrast between "competitive" prices and "administered" prices there seemed to be a marked distinction between the behaviour of *publicly-administered prices*, on the one hand, and what for what of a better adjective may be called "private" prices on the other.

In the former group I include any items whose prices are dominated in one way or another by the acts and policies of nationalised industries, of central or local government, or of central or local government-employees. The excise on alcoholic beverages, for example, is so high that the price of a pint of beer is almost as much a government-set price as is council house rent. Similarly, although mortgage interest rates represent the price of a service rendered by private lenders to house-buyers through the intermediary of the building society, this apparent "market" price is in practice dominated by general money rates, which are in turn dominated by central government monetary policy. Thus the main RPI items included in the "public" category are rents (which in the RPI are mainly council rents), mortgage interest payments, rates, car and TV licences, phones, rail fares, and drink and tobacco.

The RPI item for mortgage interest reflects the *rate of increase* of nominal interest rates. The excess of the item's inflation rate over the national average inflation rate is thus a measure of the growth of *real* interest rates. This growth, as can be seen by comparing the mortgage interest row with the "all items" row has been sharp throughout the period.)

Defining "public" prices in this way does not mean treating the government as monolithic. The present central government, while keeping up interest rates and indirect taxes, which are public prices, at the same time exhorts local government to restrain the rates, which are also public prices.

The distinguishing feature of the prices included in my "public" category is not that they are all set in one way but rather that the forces setting them are not the market forces of supply and demand.

Subject to a qualification, the *private sector* was then defined as "all other." The qualification is energy. Because the 1978-82 inflation, both in the UK and worldwide, was triggered by the doubling of crude oil prices so-called second oil shock (re- between 1978 and 1980), I created a separate sector of energy items including not only oil, but also coal, gas, electricity and petrol. Corresponding nationalised industries were therefore not included in the "public" sector.

The private sector was further divided (see table) into services and goods, and the latter were subdivided into food, clothing, cars, and "other." (Behind all this lies data gathered by the Department of Employment relating to about 20 items of services, 90 foodstuffs, a dozen clothing items and maybe a score of "other" goods.)

The results are, I think, quite striking. Both in 1978-82, when inflation was rampant, and in the subsequent period, when it was stable (and also in 1985 itself), the public items persistently led. The proverbial man from Mars, studying the table alone, would reach the simple conclusion that our inflation was largely *caused* by our Government!

This is rather hard on a Government which believes its policies to be anti-inflationary. The interest rate is high to protect the exchange rate. The exchange rate is protected to restrain domestic prices, and so on.

Keynesians and "wets" (the two are not synonymous—one can be a very dry Keynesian as Keynes himself, were he alive today, almost certainly would be) argue that the exchange rate and interest rates are too high and domestic demand too low to permit the rise in exports and domestic output needed to reduce unemployment. Sophisticated Government supporters retort that if the Government lowered taxes and nominal interest rates, while letting the nominal exchange rate slide, domestic inflation would accelerate to such an extent that neither interest rates nor the real exchange rate would, in the event, decline so there would be, *ex post facto*, no expansion of real demand. Instead of economic recovery, there would be accelerating inflation and general chaos. The only salvation, according to this view, is to soldier on until inflationary expectations have been finally ground out of our society.

But what I think my table shows is that this "sophisticated-Thatcherist" argument itself contains a Catch 22. The policy, by creating a state of affairs where "public" inflation, responsible for over a quarter of the weight of the Retail Prices Index, is always ahead of private inflation, is itself a significant factor in the perpetuation of inflationary expectations: to a considerable extent, the reason why earnings, both of public and private employees, push inexorably upwards, is the general belief that inflation is permanent. And a major cause of that belief is the apparently permanent inflation of "public" prices.

This doleful conclusion does not win back the argument for the "wets." It puts the ball back in their court. She who wishes to escape Catch 22 must change the rules. A familiar scheme of rule changes in the Great Inflation Game is known as "prices and incomes policies". The problem then departs from the sphere of economics and becomes entirely political. The "wets" who follow this route may end up, according to history, locked in mortal combat with the unions, out of office or dry.

ANATOMY OF UK INFLATION

Average inflation rate, 1978 to 1986*

	Per cent weight 1985-86	Per cent per year 1978-82	1982-86	1985-86
Energy items	11.5	17.8	5.2	2.6
Mortgage interest	4.6	30.2	6.4	18.4
Rent/rates	7.6	19.5	7.6	8.9
Drink/tobacco	11.2	14.5	7.6	6.8
Post/phone	~~18.0~~ 1·8	15.8	3.0	5.0
Other†	1.5	10.2	9.3	9.4
All "public" items	26.7	17.4	7.4	9.4
"Private" services‡	13.2	14.1	5.7	6.7
Food	19.0	10.8	3.6	3.2
Clothing	7.5	6.1	2.1	3.6
Cars§	5.5	10.0	2.2	2.2
Other goods	16.6	10.3	5.1	5.1
All "private" goods	48.6	9.8	3.7	3.8
All "private" items	61.8	10.7	4.1	4.4
All items in RPI	100.0	13.1	5.1	5.5
Imported goods		7.4	5.6	−3.6

* Based on Retail Prices Index in January each year. † Rail fares, car, radio and TV licences. ‡ Includes car maintenance and insurance, restaurant meals. § Comparable models: purchase prices, new and second-hand.

The author is Professor of Economics at Birkbeck College, London University.

SEAADG/SE   John Flitton. 8085   (Flitton.)

SECRET AND PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 28 MAY 1986 AT 11.30 AM

PWP

To:
MINISTER FOR TRADE

Copy No 3 (23)

From:
PETER STIBBARD
US/S2
Room V/258 215 4872

21 May 1986

1. Where are the year to date (Jan-April) figs? - Tables in Annex.
2. Is this the first non-oil surplus? (i.e. col A - col B +ve) M.

OVERSEAS TRADE FIGURES FOR APRIL

THE CURRENT ACCOUNT

In April, exports were valued at £6038 million and imports at £6229 million so that visible trade, seasonally adjusted on a balance of payments basis, showed a deficit of £191 million compared with a record deficit of £1211 million in March.

The Central Statistical Office project a surplus of £600 million for invisibles in April so that the current account is provisionally estimated to have been in surplus of £409 million compared with a deficit in March of £611 million.

Table 1: CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES (Table 2 of Press Notice)

This includes invisibles

Seasonally adjusted
Balance of payments basis

£ million

	Current Account Balance	Visible Trade Balances Total	Oil	Non-oil	Invisibles Balance
1984	+ 880	-4391	+6937	-11328	+5270
1985	+2952	-2068	+8163	-10231	+5020
1985 Nov-Jan	+1742A	- 77	+2126	-2203	+1819A
1986 Feb-Apr	+ 55A	-1745	+1344	-3089	+1800A
1986 Feb	+ 256A	- 344	+ 678	-1021	+ 600A
Mar	- 611A	-1211	+ 330	-1541	+ 600A
Apr	+ 409A	- 191	+ 337	- 527	+ 600A
	A		B	NO	

A = Projection

In the three months ended April, there was a deficit on visible trade of £1.7 billion - a surplus on trade in oil of £1.3 billion offset by a deficit of £3.1 billion on non-oil trade. Between the three months ended January and the latest three months the deficit on visible trade increased by £1.7 billion - the surplus on oil was reduced by £0.8 billion while the deficit on non-oil trade increased by £0.9 billion.

SECRET AND PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 28 MAY 1986 AT 11.30 AM

EXPORTS

The value of exports in April was £315 million (5½ per cent) higher than in March. Exports of oil fell by £30 million but exports of the erratic items rose by £296 million and accounted for most of the overall increase. Excluding oil and the erratic items, exports increased by £49 million (1 per cent) in April.

In the three months ended April, export volume was ½ per cent lower than in the previous three months and 1 per cent lower than a year earlier. The volume of exports excluding oil and the erratic items fell by ½ per cent in the latest three months. The gradual decline in the underlying level of non-oil export volume - which began in the middle of last year - appears to have continued so far in 1986. Recent volume movements in broad commodity categories are shown in the following table:-

Table 2: EXPORT VOLUME INDEX NUMBERS: 1980 = 100 (Tables 4, 5 and 9 of Press Notice)

Seasonally adjusted

	BOP BASIS		OTS BASIS			
	Total Trade	Total exc oil and erratics	Basic Materials	Fuels	Manufactures exc erratics: Semis	Manufactures exc erratics: Finished
1984	112.5	107.6	106.3	160.2	112.1	103.8
1985	118.6	115.0	107.0	170.9	118.9	113.7
1985 Nov-Jan	118.9	113.4	112	177	117	113
1986 Feb-Apr	118.5	112.8	111	175	117	110
1986 Feb	120.7	114.2	112	192	121	110
Mar	112.7	110.8	112	154	113	110
Apr	122.2	113.4	108	177	118	112

By value, exports fell by 5½ per cent in the latest three months. Exports to Western Europe fell by 6 per cent overall with exports to the EC countries down 5½ per cent. Exports to North America fell by 10 per cent in the latest three months but exports to the other developed countries were up 6½ per cent. Exports to the developing countries also increased.

IMPORTS

The value of imports in April was £705 million (10 per cent) lower than the exceptionally high level of imports in March. Imports of erractic items fell by £85 million and imports of oil by £37 million. Excluding oil and the erratic items, imports fell by 9½ per cent in April.

In the three months ended April, import volume was ½ per cent higher than in the previous three months but 1½ per cent lower than a year earlier. Excluding oil and the erratic items, the volume of imports fell by ½ per cent between the three months ended April and the latest three months to a level 2½ per cent higher than a year ago. The underlying level of non-oil import volume appears to have changed little in recent months. Recent volume movements in broad commodity categories are shown in the following table:-

Table 3: IMPORT VOLUME INDEX NUMBERS: 1980 = 100 (Tables 4 and 13 of Press Notice)

Seasonally adjusted

	BOP BASIS		OTS BASIS			
	Total Trade	Total exc oil and erratics	Basic Materials	Fuels	Manufactures exc erratics: Semis	Manufactures exc erratics: Finished
1984	121.9	137.0	101.7	86.5	137.2	153.0
1985	125.7	142.6	102.2	85.0	143.9	161.5
1985 Nov-Jan	125.9	144.7	103	77	147	166
1986 Feb-Apr	126.6	144.2	107	76	148	158
1986 Feb	125.8	144.4	114	71	148	159
Mar	132.2	149.8	106	75	155	163
Apr	121.9	138.4	101	80	142	151

By value, imports increased by 3½ per cent in the latest three months. Imports from the developed countries grew by 3½ per cent with imports from Western Europe up 5 per cent and imports from North America and the other developed countries down 1 per cent. Within the total for Western Europe imports from the European Community countries rose by 2½ per cent and those from the rest of Western Europe by 13 per cent. The latter increase largely reflects higher imports of precious stones from Switzerland.

TRADE IN MANUFACTURES

Estimates of trade in manufactures on a balance of payments basis for April will be published in the next Monthly Review of External Trade Statistics. On present estimates the deficit on trade in manufactures increased by £0.4 billion between the three months ended January and the latest three months and totals £1.3 billion in the first four months of 1986.

SECRET AND PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 28 MAY 1986 AT 11.30 AM

Table 4: TRADE IN MANUFACTURES (SITC 5-8) (Table 16 of Press Notice, quarterly data only)

£ million
Seasonally adjusted
Balance of payments basis

	Exports	Imports	Balance
1984	46590	50469	- 3879
1985	52296	55313	- 3017
1985 Nov-Jan	12961	13633	- 672
1986 Feb-Apr	13196	14277	- 1081
1986 Feb	4329	4725	- 396
Mar	4275	5050	- 775
Apr	4592	4503	+ 89

PUBLICATION

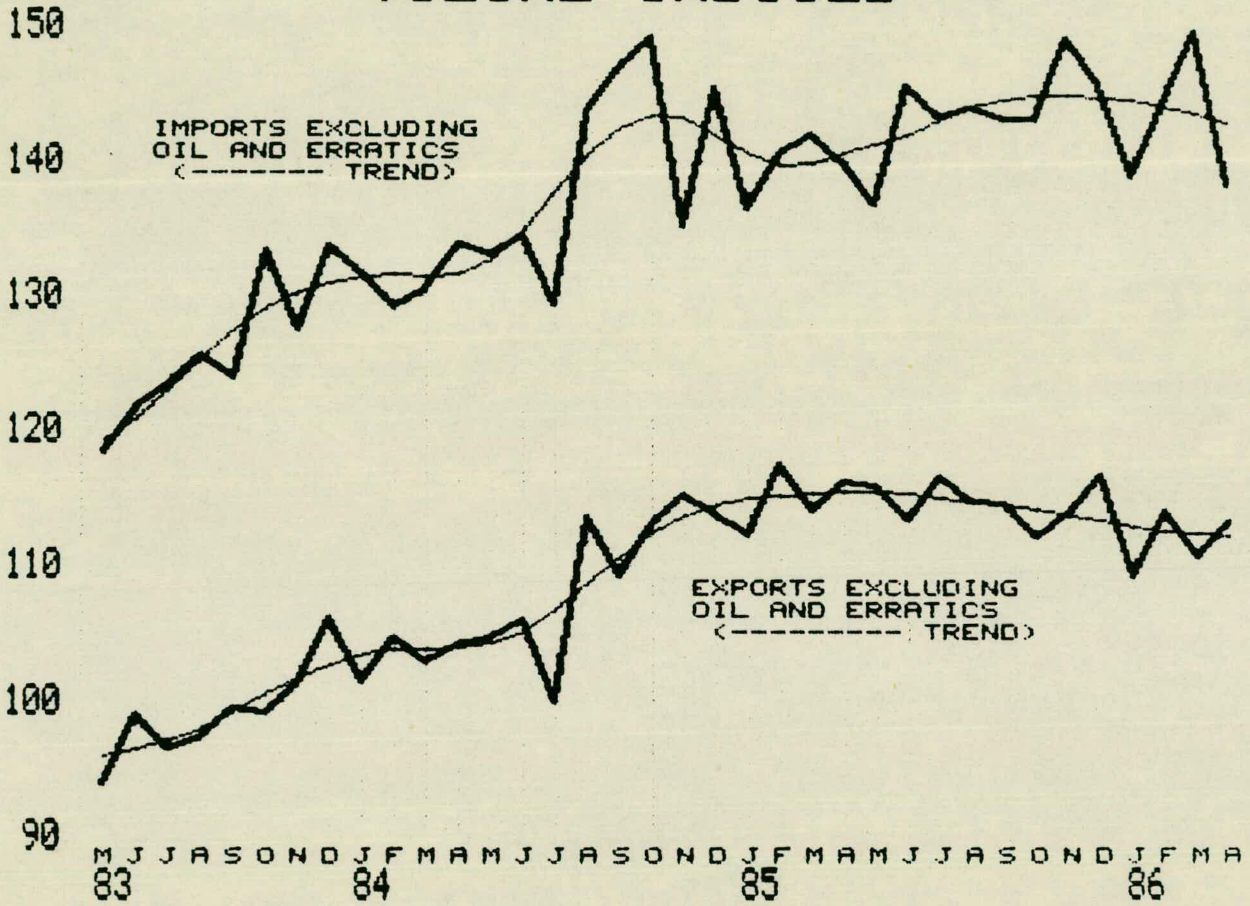
The release of the press notice containing the April figures is scheduled for Wednesday 28 April at 11.30am.

Peter Stibbard

P J STIBBARD

SECRET AND PERSONAL UNTIL RELEASE OF PRESS NOTICE AT 11.30AM 23.5.86

VOLUME INDICES



ON A BALANCE OF PAYMENTS BASIS 1980=100 SEASONALLY ADJUSTED

INTERNAL NOTE

CIRCULATION LIST

Copy No	1	Minister for Trade
	2	Prime Minister
	3	Chancellor of the Exchequer
	4	Secretary of State for Trade and Industry
	5	Sir Robert Armstrong (Cabinet Office)
	6	Sir Brian Hayes (Dept of Trade and Industry)
	7	Sir Peter Middleton (HM Treasury)
	8	Governor of the Bank of England
	9	Chairman of the Board of HM Customs and Excise
	10	Mr J Hibbert (CSO)
	11	Mr Finlinson (HM Customs and Excise)
	12	Mr A Croxford (CSO)
	13	Mr P Walker (HM Treasury)
	14	Mr Barrell (HM Treasury)
	15	Mr A McIntyre (CSO)
	16	Dr P Rice (Dept of Energy)
	17	Mr H H Liesner)
	18	Mr P Stibbard)
	19	Mr W E Boyd)
	20	Mr E J Wright) Dept of Trade and Industry
	21	Mr A R Hewer)
	22	Ms F Deuchars)
	23	Mr D B Packer)

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UNCLASSIFIED

FROM: COLIN MOWL
DATE: 21 May 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Byatt
Mr Cassell
Mr Monck
Mr Kemp
Mr Evans
Mr Fitchew
Mr Odling-Smee
Mr Sedgwick
Mr Peretz
Mr Scholar
Mr Turnbull
Mr Culpin
Mr Melliss
Mr S J Davies
Miss O'Mara
Miss Peirson
Mr Riley
Mr Pickford
Mr Ross Goobey
Mr Norgrove - No.10

Meena
thanks please

NATIONAL INSTITUTE ECONOMIC REVIEW: MAY 1986

The May National Institute Economic Review, which includes the National Institute's latest forecasts for the UK and world economies, is to be released at 9 o'clock this evening. The Review also contains special articles on the effects of lower oil prices on the UK economy and LDCs, and on vocational training in Britain and France.

<u>The Forecast</u>

2. The forecast, based a sterling index of 75 and an average oil price of $15-16 a barrel, contains few surprises. The forecast of GDP growth is little changed from the February Review, although less is now expected to be accounted for by manufacturing. The forecast of inflation has however been revised down.

3. The Institute's forecast is summarised, and compared with the FSBR, in the attached table. The main features are:

- an assessment that the cyclical recovery in the UK lost its momentum early last year.

- GDP growth of nearly 2 per cent in 1986 and 1¾ per cent in 1987.

- a small decline in adult unemployment, largely attributed to special measures, to 2.92 million (seasonally adjusted) by the end of 1987.

- RPI inflation of 2¾ per cent at the end of 1986 and 3½ per cent at the end of 1987.

- a zero current account balance in 1986 and a £2 billion deficit in 1987.

- a PSBR in 1986-87 in line with Treasury projections but £9½ billion forecast for 1987-88 with a zero fiscal adjustment.

4. We do not disagree with the Institute's assessment that recent data show a slowing in the rate of growth of economic activity over the past year. This appears to be partly the result of a sluggish world economy. The Institute claims credit for having predicted this a year ago, but other forecasts made at the same time, including last year's FSBR, also anticipated some slowing in the pace of expansion in the year to the first quarter or first half of 1986. In contrast to most other forecasters however the Institute's projections of slow growth go back earlier than last year and it is not surprising, given this persistent pessimism, that it has eventually been proved right, for one relatively short period at least. More relevant to the assessment of the Institute's current forecast of relatively slow growth for the future is its track record over a longer period and this is one of unjustified pessimism.

5. The Institute's projections of most components of final expenditure are lower than those in the FSBR. Its lower forecast of consumer spending appears to be mainly the result of less buoyant personal income. Its lower fixed investment forecast is partly because lower oil prices are assumed to have a much quicker effect on North Sea investment than assumed in Treasury forecasts and partly because the Treasury forecast assumes that rising profits will produce higher non-oil investment than indicated by the last DTI intentions survey. The Treasury forecast is more in line with the latest CBI intentions survey for manufacturing.

6. The Institute's belief that the rise in the exchange rate in the middle of last year is still restraining exports is one reason why it has only ¾ per cent export volume growth in 1986, compared with 5 per cent in the FSBR. Even though export volumes in the first quarter were lower than assumed in the FSBR, the Institute forecast still looks pessimistic. The Institute is also relatively pessimistic on the invisible balance - it does not believe that there will be any net benefit on invisibles from lower oil prices.

7. The Institute has reduced its forecast of inflation since February and at 2¾ per cent for the end of 1986 is slightly lower than the FSBR. (This appears to partly reflect a further fall in mortgage rates beyond the reductions already announced for June.) Average earnings growth in the current round is expected to be similar to that in the last round, but lower inflation this year is expected to reduce wage inflation by 1-2 percentage points in the next round.

8. The Institute is forecasting a PSBR of £9½ billion for 1987-88 with a zero fiscal adjustment, compared with £7 billion in the MTFS with a £2 billion tax reduction. Relatively cautious revenue projections (partly low output growth) and public expenditure well above the PEWP are the main reasons for the difference.

NIESR's Appraisal

9. The Institute does not appear to have devoted much thought to its appraisal. The main points are as follows:

- there has been the slowdown in growth discussed in paragraph 4.

- the flagging world economy will draw some stimulus from the fall in oil prices.

- the Budget, estimated to have added ¼ per cent to GDP by end 1987, should have been more expansionary.

- high UK interest rates are preventing sterling from adjusting fully to lower oil prices, thus damaging the prospects for exports and investment.

Effects of lower oil prices

10. The analysis of the effects of lower oil prices on the UK economy is discussed in the attached note by MP2. As explained there it is in some ways an unusual piece of work but the end-results are broadly consistent with other studies. Lower oil prices produce higher GDP and little change in inflation in the UK.

Line to take

11. On the slowdown in growth over the past year:

- concede that this may have occurred but note that (i) it partly reflected world conditions (ii) output continued to rise, albeit more slowly (ii) the pace of expansion is bound to be uneven (iv) the prospects are good.

12. On the forecast

- note the projected low level of inflation, a forecast broadly in line with the FSBR.

- note that the relatively low GDP growth forecast is consistent with the Institute's well known pessimism, which has usually not been justified.

13. On the appraisal:

- note that short-term interest rates have fallen 2 points in recent months and that the sterling index is 6 per cent lower than the second half of last year, mainly reflecting the fall in oil prices.

14. On the effects of lower oil prices:

- NIESR analysis that lower oil prices are slightly beneficial for UK output and broadly neutral on inflation is not inconsistent with Treasury results.

Colin Mowl

COLIN MOWL

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SUMMARY AND COMPARISON OF FORECASTS

Constant prices % change on year earlier		NIESR	FSBR*
Gross Domestic Product	1986	1.9**	3
	1987	1.7**	2½
Manufacturing output	1986	0.7	3
	1987	1.8	2½
Consumers' expenditure	1986	3.1	4
	1987	3.0	4
Total fixed investment	1986	0.1	5
	1987	0.7	0
General government consumption	1986	1.1	1
	1987	1.0	½
Stockbuilding (contribution to GDP)	1986	0.3	0
	1987	0.4	½
Exports	1986	0.7	5
	1987	2.4	3
Imports	1986	2.3	6
	1987	4.7	5
Current account (£bn)	1986	0.1	3½
	1987	-2.2	1½
World Trade (% change)	1986	4½	5½
	1987	5½	5½
PSBR (£bn)	1986-87	6.7	7
(fiscal adjustment in brackets)	1987-88	9.6 (0)	7 (2)
RPI (% change)	1986 Q4	2.8	3½
	1987 Q4	3.5	3½(Q2)
Unemployment	1986 Q4	3.06	-
(millions seasonally adjusted)	1987 Q4	2.92	-

* FSBR figures for 1987 are for first half
** Output measure

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OIL PRICES AND THE ECONOMY

1. The Review contains a note which presents simulations in the National Institute model of the 40% fall in the world price of oil from a $25 base. The effects on the world economy are based on a scaling up of the results in Horton Powell working paper. There are two alternative monetary policy assumptions for the UK - fixed real interest rates and fixed nominal exchange rates. In both cases the PSBR is assumed to vary. These assumptions contrast with those used in the recent Treasury exercise where the PSBR/GDP ratio was assumed to be fixed by fiscal adjustment on personal incomes (it was, however, assumed to vary in the Horton Powell) and monetary growth was assumed unchanged at base values. The National Institute's assumptions probably give rise to larger short run output effects compared with the alternative of a fixed PSBR.

2. An important, and unusual, feature in the NIESR simulations is that the oil price reduction is assumed to be correctly anticipated one year in advance; the actual fall in the oil price occurs at the start of year 2 of the simulation while the exchange rate depreciates at the beginning of year 1. This assumption leads to a smaller fall in the exchange rate than if it had been unanticipated, and a rise in inflation in the first year. However it is the form of the exchange rate equation and other model properties, rather than rational expectations - which can be assumed whether the fall in oil prices is anticipated or not, which probably account for the comparatively small depreciation in the National Institute's work. The assumption that the oil price fall was fully anticipated seems extreme and unrealistic. The average effective exchange rate in 1985 was the same as in 1984 and the weakness in the exchange rate at the beginning of 1985 was probably mainly caused by uncertainties over domestic monetary and fiscal policy, although uncertainty over oil prices may have added to this.

3. The results of the assessment is that GDP rises gradually compared to the base, by between ¼ and ½ per cent in year 2 according to the monetary policy assumption, rising to about 1 per cent in year 5. The price level is little changed under fixed real interest rates, but falls slightly on average under an exchange rate target.

4. The National Institute compare the results of simulations of a 10% fall in oil price on their model with those obtained by the Treasury (Horton Powell Working Paper) and a 25% fall on the LBS model (table below). The assessments are not comparable - the policy assumptions differ while recent internal Treasury results have been more optimistic - but it is interesting to note that only the LBS expect a significant reduction in inflation, and then only in the first two years of the simulation period. In our view, which seems to be shared by the National Institute, the main price equation on the LBS model has too large a weight on oil prices. Also, the three simulations each suggest an increase in GDP as a result of the fall in oil prices, albeit with the affects, in both the Treasury and NIESR cases, being very small.

Oil Prices and the Economy

Table NIESR, HMT and LBS simulations of the oil price change

	GDP (%)	Inflation[a] (RPI)[b] (% pts)	Exchange rate[a] (%)	North Sea oil revenue (£bn)	PSBR (£bn)	Short-term interest rate (% pts)
NIESR: 10% fall						
Year 1	0.04	0.23	−0.72	0.03	0.04	0.1
2	0.10	−0.02	−0.71	−0.44	0.38	0.2
3	0.15	−0.08	−0.79	−1.28	1.23	−0.1
4	0.20	0.01	−0.64	−1.19	0.92	−0.04
5	0.22	0.18	−0.63	−1.25	0.88	0.03
HMT: 10% fall						
Year 1	0.1	−0.1	−2.2	−0.7	0.7	0.3
2	0.2	0.2	−1.7	−1.1	1.1	0.4
3	0.1	0.1	−1.5	−1.2	1.0	0.4
4	0.0	0.0	−1.5	−1.1	1.1	0.4
5	0.0	−0.1	−1.2	−1.1	1.3	0.4
LBS: 25% fall						
Year 1	0.44	−0.94	−6.47	−1.56	1.286	–
2	1.21	−0.2	−5.89	−2.14	1.27	–
3	1.28	0.8	−4.60	−2.01	0.518	–
4	0.94	1.03	−3.96	−1.96	0.187	–
5	0.6	0.94	−4.33	−1.86	0.08	–

(a) Fourth quarter.
(b) Figures for NIESR are CPI.
Note: In its run, the LBS assumes given interest rates and gilt sales. The dates of these simulations could be crucial to the size of the North Sea oil tax revenue effect.

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PMP.

DEPARTMENTS OF INDUSTRY AND TRADE
– COMMON SERVICES
1 Victoria Street London SW1H 0ET
Telephone Direct Line 01-215 4887
Switchboard 01-215 7877

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~~I phoned to say C was content~~
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Mrs R Lomax
Principal Private Secretary
Chancellor of the Exchequer
H M Treasury
Parliament Street
LONDON
SW1P 3AG

22 May 1986

I am attaching a copy of the draft Press Notice on the Current Account of the United Kingdom Balance of Payments in April. The draft was agreed earlier today at the usual interdepartmental meeting.

Publication is set for Wednesday 28 May at 11.30 am and I should be grateful if you would arrange for the Notice to be cleared by 12.00 noon Tuesday 27 May and to inform me accordingly.

A copy of this letter and draft Press Notice is being sent to Sir Peter Middleton and Mr Walker, H M Treasury.

Yours sincerely

W. E. Boyd

W E BOYD

COVERING SECRET AND PERSONAL

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REVISED DRAFT.

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on 28/5/86 at 11.30 am

COPY 3.
No. (14)

THE CURRENT ACCOUNT OF THE UNITED KINGDOM
BALANCE OF PAYMENTS

OK

APRIL 1986

The current account for April is estimated to have been in surplus by £409 million compared with a deficit of £611 million in March. In April, exports were valued at £6038 million and imports at £6229 million so that trade in goods was in deficit by £191 million.

The balance on invisibles in April is projected to be in surplus by £600 million, a large surplus on the transactions of the private sector and public corporations being partly offset by a deficit on Government transactions.

FEBRUARY TO APRIL 1986

In the three months ended April, the current account showed a surplus of £0.1 billion compared with a surplus of £1.7 billion in the previous three months. There was a deficit on visible trade of £1.7 billion in the latest three months compared with a deficit of £0.1 billion in the previous three months. The surplus on invisibles is projected at £1.8 billion.

CURRENT ACCOUNT

TABLE 1 £ million, Seasonally adjusted

		Current Balance	Visible Trade: Balance	Visible Trade: Exports fob	Visible Trade: Imports fob	Invisibles Balance b
1984		+ 880	- 4391	70367	74758	+ 5270
1985		+ 2952	- 2068	78072	80140	+ 5020
1985	Q1	- 374	- 1266	20070	21336	+ 892
	Q2	+ 1333	- 124	20237	20361	+ 1457
	Q3	+ 1072	- 453	18748	19201	+ 1525
	Q4	+ 921	- 225	19018	19242	+ 1146
1986	Q1	+ 800 a	- 1400	18204	19604	+ 2200 a
1985	Nov	+ 112	- 214	6301	6515	+ 326
	Dec	+ 475	- 18	6387	6405	+ 493
1986	Jan	+ 1155 a	+ 155	6289	6135	+ 1000 a
	Feb	+ 256 a	- 344	6192	6535	+ 600 a
	Mar	- 611 a	- 1211	5723	6934	+ 600 a
	Apr	+ 409 a	- 191	6038	6229	+ 600 a
Nov-Jan	1986	+ 1742 a	- 77	18977	19054	+ 1819 a
Feb-Apr	1986	+ 55 a	- 1745	17953	19698	+ 1800 a
Jan-Apr	1986	+ 1209 a	- 1591	24242	25833	+ 2800 a

a Invisibles for January to April 1986 are projections and subject to revision as information becomes available. VAT abatements received from the E.C in January have been included in the projection for that month .

b Monthly figures are one-third of the appropriate calendar quarter's estimate or projection, except for VAT abatements received from the European Community which are allocated to the month they are known to have been received. Information relating to credits and debits can be found in Table 3.

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VISIBLE TRADE IN APRIL 1986

There was a deficit on visible trade in April of £191 million compared with a deficit of £1211 million in March. The surplus on oil was virtually unchanged at £337 million while the deficit on non-oil trade was reduced by £1013 million to £527 million.

At £6038 million, exports in April were £315 million (5½ per cent) higher than in March. Exports of the erratic items rose by £296 million and therefore accounted for most of the overall increase. Exports of oil fell by £30 million between the two months. Excluding oil and the erratic items exports increased by £49 million (1 per cent).

Total imports were valued at £6229 million in April which was £705 million (10 per cent) lower than the exceptionally high level of imports in March. Imports of the erratic items fell by £85 million and imports of oil by £37 million. Excluding oil and the erratic items, imports fell by 9½ per cent in April.

RECENT TRENDS

Visible balance

In the three months ended April, there was a deficit on visible trade of £1.7 billion - a deficit of £3.1 billion on non-oil trade partly offset by a surplus on trade in oil of £1.3 billion. In the three months ended January visible trade was in broad balance. Between then and the latest three months the deficit on non-oil trade increased by £0.9 billion and the surplus on oil was reduced by £0.8 billion.

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Exports

Exports amounted to £18.0 billion in the latest three months, £1.0 billion (5½ per cent) less than in the three months ended January. Export of oil fell by £1.3 billion while exports of the erratic items rose by £0.2 billion. Excluding oil and the erratic items exports increased by £0.1 billion (½ per cent) in the latest three months.

By volume, exports were ½ per cent lower in the latest three months compared with the three months ended January and 1 per cent lower than a year earlier. The volume of exports excluding oil and the erratic items also fell by ½ per cent in the latest three months and was 3 per cent down on the same period a year ago. The gradual decline in the underlying level of non-oil export volume - which began in the middle of last year - appears to have continued so far in 1986.

Imports

Total imports were valued at £19.7 billion in the latest three months, £0.6 billion higher (3½ per cent) than in the previous three months. Imports of the erratic items increased by £0.3 billion while imports of oil fell by £0.5 billion. Excluding oil and the erratic items, imports rose by £0.8 billion (5 per cent).

In the three months ended April, total import volume was ½ per cent higher than in the previous three months and 1½ per cent lower than a year earlier. Excluding oil and the erratic items, the volume of imports fell by ½ per cent in the latest three months to a level

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2½ per cent higher than a year earlier. Figures of non-oil import volume have fluctuated considerably in recent months but the underlying level appears to have changed little since last summer.

Terms of trade and unit values

The terms of trade index fell by 1 per cent in the latest three months as the export unit value index fell by 2½ per cent and the import unit value index was reduced by 1½ per cent. Compared with the same period a year ago, the export unit value index has fallen by 7 per cent and the import unit value index by 11 per cent. As a result the terms of trade index is now about 5 per cent higher than a year ago.

Export unit values for fuels fell by 31 per cent in the latest three months while the unit value index for non-oil exports increased by 2 per cent. Within the total for non-oil exports, unit values for basic materials were marginally down in the latest three months but the other broad sectors all recorded increases of between 1½ per cent and 4 per cent.

Import unit values for fuels were reduced by 25 per cent in the latest three months while those for non-oil imports rose by 3 per cent. Import unit values for basic materials were unchanged in the latest three months, those for food beverages and tobacco were up 2 per cent and those for manufactures were up 3½ per cent.

Analysis by area

By value, exports to the developed countries fell by 6½ per cent in the latest three months. Exports to North America were 10 per cent lower than in the three months ended January and exports to the European Community countries were down 5½ per cent. Exports to the other developed countries, however, rose by 6½ per cent and deliveries to the developing countries also increased.

Imports from the developed countries grew by 3½ per cent in the latest three months - higher arrivals from Western Europe (up 5 per cent) offsetting lower imports from North America and the other developed countries (both down 1 per cent). Within the total for Western Europe, arrivals from the European Community countries rose by 2½ per cent. Imports from the developing countries fell by 3½ per cent in the latest three months.

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NOTES TO EDITORS

1 REVISIONS

Data for the first quarter of 1986 have been revised due to later information becoming available.

2 STANDARD NOTES

The standard notes describe the differences between the Balance of Payments (BOP) and the Overseas Trade Statistics (OTS) bases of compilation. Copies can be obtained from the address below.

3 AREA (tables 11 and 15)

Low value consignments ie items of an individual value less than £475, are not analysed by country. Area figures in tables 11 and 15 are therefore deficient to the extent of these consignments.

In addition the data by area are seasonally adjusted independently leading to further differences between the sum of areas and figures for total trade.

4 MONTHLY REVIEW OF EXTERNAL TRADE STATISTICS

The Monthly Review supplements the information contained in this Press Notice. It gives longer historical runs of data and contains charts, tables on the UK Balance of Payments, UK exports and imports on an Overseas Trade Statistics basis, and certain international comparisons. The Monthly Review is available from the Department of Trade and Industry at the address given below for an annual subscription of £36 or £3 per copy.

The 1986 Annual Supplement, (price £4 per copy), giving longer historic runs of data, has recently been issued. Copies are available from the address below.

Enquiries about the Standard Notes, and the Monthly Review, should be addressed to S2A, Room 255, Department of Trade and Industry, 1 Victoria Street, London SW1H OET, Telephone: 01-215 4895.

INDEX OF TABLES

UKBAAB

Table 2

CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES
(Balance of Payments basis)

£ million seasonally adjusted

	Current Balance	Visible Trade					Invisible Balance b
		Exports fob	Imports fob	Visible Balance	of which Oil	of which Non-Oil	
1984	+ 880	70367	74758	- 4391	+ 6937	- 11328	+ 5270
1985	+ 2952	78072	80140	- 2068	+ 8163	- 10231	+ 5020
1985 Q1	- 374	20070	21336	- 1266	+ 1958	- 3225	+ 892
Q2	+ 1333	20237	20361	- 124	+ 2411	- 2535	+ 1457
Q3	+ 1072	18748	19201	- 453	+ 1900	- 2353	+ 1525
Q4	+ 921	19018	19242	- 225	+ 1893	- 2117	+ 1146
1986 Q1	+ 800 a	18204	19604	- 1400	+ 1994	- 3394	+ 2200 a
1985 August	+ 342	6105	6272	- 167	+ 653	- 820	+ 509
Sept	+ 421	6242	6328	- 87	+ 662	- 749	+ 508
Oct	+ 334	6329	6323	+ 7	+ 754	- 747	+ 327
Nov	+ 112	6301	6515	- 214	+ 649	- 862	+ 326
Dec	+ 475	6387	6405	- 18	+ 491	- 508	+ 493
1986 Jan	+ 1155 a	6289	6135	+ 155	+ 987	- 832	+ 1000 a
Feb	+ 256 a	6192	6535	- 344	+ 678	- 1021	+ 600 a
Mar	- 611 a	5723	6934	- 1211	+ 330	- 1541	+ 600 a
Apr	+ 409 a	6038	6229	- 191	+ 337	- 527	+ 600 a
Feb-Apr 1985	- 198	20410	21693	- 1282	+ 1856	- 3138	+ 1084
Nov-Jan 1986	+ 1742 a	18977	19054	- 77	+ 2126	- 2203	+ 1819 a
Feb-Apr 1986	+ 55 a	17953	19698	- 1745	+ 1344	- 3089	+ 1800 a
% Change							
Latest 3 months on - previous 3 months		- 5½	+ 3½				
Same 3 months one year ago		- 12	- 9				

a Invisibles for January to April 1986 are projections and subject to revision as more information becomes available. VAT abatements received from the EC in January have been included in the projections for that month.

b Monthly figures are one-third of the appropriate quarters estimate or projection except for VAT abatements received from the Community which are allocated to the month they are known to have been received.

Table 3

INVISIBLES

£ million seasonally adjusted

	All Sectors						Private Sector and Public Corporations[d]		
	Credits	Debits	Balance	of which Services	of which Interest Profits Dividends	of which Transfers	Credits	Debits	Balance
1983	65225	61226	+ 3999	+ 3671	+ 2468	- 2140	60614	52374	+ 8240
1984	76491	71221	+ 5270	+ 4225	+ 3342	- 2297	71603	61623	+ 9980
1985	80027	75007	+ 5020	+ 6291	+ 2294	- 3565	75512	64138	+ 11374
1984 Q1	17533	16488	+ 1045	+ 1041	+ 529	- 525	16286	14134	+ 2152
Q2	17921	16824	+ 1097	+ 983	+ 862	- 748	16904	14448	+ 2456
Q3	19483	18178	+ 1305	+ 1145	+ 891	- 731	18497	15832	+ 2665
Q4	21554	19731	+ 1823	+ 1056	+ 1060	- 293	19916	17209	+ 2707
1985 Q1	21394	20502	+ 892	+ 1220	+ 712	- 1040	20214	17591	+ 2623
Q2	20163	18706	+ 1457	+ 1662	+ 501	- 706	19152	16306	+ 2846
Q3	19356	17831	+ 1525	+ 1729	+ 715	- 919	18175	14976	+ 3199
Q4	19114	17968	+ 1146	+ 1680	+ 366	- 900	17971	15265	+ 2706

d ie excluding general Government transactions and all transfers.

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EXPORT AND IMPORT UNIT VALUE AND VOLUME INDEX NUMBERS

Table 4

(Balance of Payments basis)

Indices 1980 = 100

	Unit Value (Not seasonally adjusted)			Volume (seasonally adjusted)	
	Exports	Imports	Terms of Trade[e]	Exports	Imports
1984	136.0	139.7	97.4	112.5	121.9
1985	143.5	145.2	98.8	118.6	125.7
1985 Q1	146.4	152.3	96.1	118.6	126.6
Q2	145.5	148.8	97.8	120.5	124.8
Q3	141.7	141.4	100.2	116.3	124.1
Q4	140.5	138.3	101.6	118.9	127.4
1986 Q1	139.0	137.6	101.0	117.4	126.1
Aug	141.4	140.3	100.8	114.4	122.7
Sept	141.4	140.5	100.6	116.7	123.6
Oct	140.5	139.1	101.0	118.8	125.0
Nov	140.4	137.6	102.1	118.5	129.6
Dec	140.5	138.2	101.7	119.4	127.8
1986 Jan	140.7	138.3	101.7	118.7	120.3
Feb	138.7	137.8	100.7	120.7	125.8
Mar	137.5	136.6	100.7	112.7	132.2
Apr	135.3	133.0	101.7	122.2	121.9
Feb-Apr 1985	147.5	153.3	96.2	119.9	128.4
Nov-Jan 1986	140.6	138.0	101.9	118.9	125.9
Feb-Apr 1986	137.2	135.8	101.0	118.5	126.6
% Change					
Latest 3 months on - previous 3 months	- 2½	- 1½	- 1	- ½	+ ½
- same 3 months one year ago	- 7	- 11	+ 5	- 1	- 1½

e Export unit value index as a percentage of the import unit value index.

VALUE AND VOLUME OF EXPORTS AND IMPORTS EXCLUDING THE MORE ERRATIC ITEMS[f]

Table 5

(Balance of Payments basis)

seasonally adjusted

	Value £ million fob		Volume Index 1980 = 100	
	Exports	Imports	Exports	Imports
1984	65746	71197	115.4	128.8
1985	73765	76598	123.0	133.4
1985 Q1	19171	20233	124.3	133.2
Q2	18948	19326	124.1	131.4
Q3	17835	18439	121.5	132.4
Q4	17811	18599	122.2	136.5
1986 Q1	17146	18656	121.5	133.2
1985 Aug	5928	6132	121.5	132.8
Sept	5899	6081	121.4	131.9
Oct	5921	6073	122.1	133.2
Nov	5898	6293	121.8	138.7
Dec	5993	6234	122.9	137.6
1986 Jan	5926	5877	123.0	127.6
Feb	5839	6229	125.2	133.2
Mar	5381	6550	116.5	138.8
Apr	5400	5929	121.2	129.0
Feb-Apr 1985	19342	20462	124.7	134.4
Nov-Jan 1986	17816	18403	122.5	134.6
Feb-Apr 1986	16620	18708	121.0	133.7
% Change				
Latest 3 months on - previous 3 months	- 6½	+ 1½	- 1½	- ½
- same 3 months one year ago	- 14	- 8½	- 3	- ½

f These are defined as ships, North Sea installations, aircraft, precious stones, and silver.

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TRADE IN OIL[9]
(Balance of Payments basis)

seasonally adjusted

	Balance of Trade in oil	Exports of Oil					Imports of Oil				
		Total	Crude Oil [SITC (REV 2) 333.0]			Rest of Division 33	Total	Crude Oil [SITC (REV 2) 333.0]			Rest of Division 33
	£ million fob	£ million fob	£ million fob	million tonnes	Avg value per tonne £ fob	£ million fob	£ million fob	£ million fob	million tonnes	Avg value per tonne £ fob	£ million fob
1984	+ 6937	14852	12173	75.9	160.4	2679	7915	3751	25.0	150.1	4163
1985	+ 8163	16050	12921	79.0	163.5	3128	7887	4155	26.1	159.0	3732
1985 Q1	+ 1958	4721	3923	21.5	182.3	798	2763	1211	6.9	176.5	1552
Q2	+ 2411	4336	3499	20.1	174.0	837	1925	1078	6.5	165.6	847
Q3	+ 1900	3410	2599	17.5	148.4	810	1509	816	5.6	145.4	694
Q4	+ 1893	3583	2900	19.9	145.9	683	1690	1050	7.2	146.9	640
1986 Q1	+ 1994	3117	2520	22.8	110.7	597	1123	678	6.2	108.7	445
1985 Aug	+ 653	1143	852	5.8	148.2	290	490	275	1.9	141.6	215
Sept	+ 662	1143	939	6.5	145.6	204	481	271	1.9	144.1	210
Oct	+ 754	1277	1050	7.2	145.8	227	523	291	2.0	143.9	233
Nov	+ 649	1180	974	6.7	145.8	207	532	327	2.2	150.6	205
Dec	+ 491	1126	876	6.0	146.1	249	635	433	3.0	146.2	202
1986 Jan	+ 987	1378	1133	8.2	138.6	244	391	246	1.8	136.0	144
Feb	+ 678	1048	859	8.2	104.4	189	370	227	2.2	101.4	143
Mar	+ 330	692	528	6.4	83.1	164	362	204	2.2	93.7	158
Apr	+ 337	662	450	6.8	66.5	212	325	153	2.2	69.7	172
Feb-Apr 85	+ 1856	4606	3850	20.9	184.7	755	2750	1423	8.0	177.2	1327
Nov-Jan 86	+ 2126	3683	2984	20.9	143.0	700	1557	1006	6.9	144.9	551
Feb-Apr 86	+ 1344	2401	1836	21.3	86.1	565	1057	585	6.6	88.3	473
% Change											
Latest 3 months on - previous 3 months		- 35	- 38	+ 2½	- 40	- 19	- 32	- 42	- 4½	- 39	- 14
- same 3 months one year ago		- 48	- 52	+ 2½	- 53	- 25	- 62	- 59	- 18	- 50	- 64

9 Trade in petroleum and petroleum products. These figures differ from those published by the Department of Energy which are on a time of shipment basis (see paragraph 7 of the standard notes).

SECRET and personal until release of press notice on 28 [illegible] at 11.30 a.m.

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Table 7

TRADE IN GOODS OTHER THAN OIL
(Balance of Payments basis)

	Total								Excluding Erratics[f]			
	Value, £ million, fob (seasonally adjusted)			Unit value index 1980 = 100 (not seasonally adjusted)			Volume index 1980 = 100 (seasonally adjusted)		Value, £ million fob (seasonally adjusted)		Volume index 1980 = 100 (seasonally adjusted)	
	Balance of non oil trade	Exports	Imports	Exports	Imports	Terms of Trade[e]	Exports	Imports	Exports	Imports	Exports	Imports
1984	- 11328	55515	66843	133.5	136.2	98.0	105.1	128.2	50894	63282	107.6	137.0
1985	- 10231	62022	72253	141.8	141.9	99.9	110.6	132.9	57715	68711	115.0	142.6
1985 Q1	- 3225	15349	18573	142.2	147.1	96.7	109.2	131.6	14450	17470	114.8	139.8
Q2	- 2535	15901	18436	142.8	144.7	98.7	112.1	132.4	14612	17401	115.3	140.9
Q3	- 2353	15338	17691	141.6	139.3	101.7	110.0	132.9	14425	16930	115.4	143.6
Q4	- 2117	15435	17552	140.6	136.5	103.0	111.3	134.7	14229	16909	114.4	146.1
1986 Q1	- 3394	15087	18481	143.0	140.0	102.1	107.6	135.1	14029	17533	111.4	144.4
1985 Aug	- 820	4962	5783	141.6	138.5	102.2	107.3	131.4	4786	5642	114.9	144.1
Sept	- 749	5099	5847	141.5	138.5	102.2	109.9	132.5	4756	5599	114.8	143.2
Oct	- 747	5052	5799	140.7	137.3	102.4	109.4	132.7	4644	5550	112.3	143.2
Nov	- 862	5121	5983	140.6	135.8	103.5	111.1	137.8	4717	5761	114.1	149.3
Dec	- 508	5262	5770	140.6	136.3	103.2	113.5	133.6	4867	5599	116.9	145.7
1986 Jan	- 832	4912	5744	141.8	137.4	103.2	105.6	129.4	4549	5487	109.3	139.0
Feb	- 1021	5144	6165	143.0	140.6	101.7	110.1	134.7	4791	5859	114.2	144.4
Mar	- 1541	5032	6572	144.2	141.9	101.6	107.0	141.7	4690	6188	110.8	149.8
Apr	- 527	5376	5904	143.9	140.3	102.6	115.2	129.3	4739	5604	113.4	138.4
Feb-Apr 85	- 3138	15805	18943	143.2	148.0	96.7	111.3	133.3	14737	17712	116.1	140.9
Nov-Jan 86	- 2203	15294	17497	141.0	136.5	103.3	110.1	133.6	14133	16846	113.4	144.7
Feb-Apr 86	- 3089	15552	18641	143.7	140.9	101.9	110.8	135.0	14219	17651	112.8	144.2
% Change												
Latest 3 months on												
- previous 3 months		+ 1½	+ 6½	+ 2	+ 3	- 1½	+ ½	+ 1	+ ½	+ 5	- ½	- ½
- same 3 months one year ago		- 1½	- 1½	+ ½	- 5	+ 5½	- ½	+ 1	- 3½	- ½	- 3	+ 2½

[f] These are defined as ships, North Sea installations, aircraft, precious stones, and silver.

[e] Export unit value index as a percentage of the import unit value index.

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EXPORTS BY COMMODITY
(Overseas Trade Statistics basis)

Table 8

£ million, fob, seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
1984	70488	4693	1989	15308	46703	42169	16333	8217	8116	25835	1050	4673	11199	8912
1985	78331	4970	2145	16712	52514	48482	18449	9411	9038	30033	1343	5257	13493	9940
1985 Q1	20148	1192	579	4892	13035	12181	4692	2384	2307	7489	338	1292	3330	2529
Q2	20258	1284	529	4513	13436	12248	4704	2402	2303	7544	340	1304	3350	2550
Q3	18828	1300	531	3600	12879	12020	4532	2285	2246	7489	336	1342	3394	2416
Q4	19097	1193	506	3708	13164	12033	4522	2340	2182	7512	329	1319	3418	2445
1986 Q1	18257	1206	511	3297	12766	11807	4418	2293	2125	7389	293	1297	3346	2452
1986 Feb	6205	436	173	1106	4340	4021	1547	817	730	2474	104	445	1124	802
Mar	5755	400	165	739	4281	3968	1457	740	717	2511	88	438	1149	836
Apr	6028	419	159	703	4577	4003	1497	788	709	2506	127	459	1082	838
Nov-Jan	19040	1151	518	3839	13014	11941	4442	2317	2125	7499	321	1316	3401	2461
Feb-Apr	17989	1254	496	2548	13198	11992	4502	2346	2156	7491	319	1342	3355	2475
Percentage Change	- 5½	+ 9	- 4	- 34	+ 1½	+ ½	+ 1½	+ 1	+ 1½	—	- 1	+ 2	- 1½	+ ½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

EXPORTS BY COMMODITY: VOLUME INDICES
(Overseas Trade Statistics basis)

Table 9

INDICES 1980 = 100, seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	69	31	136	735	658	252	112	141	406	18	71	170	147
1984	112.8	117.2	106.3	160.2	104.4	107.0	112.1	124.3	102.3	103.8	82.4	107.8	105.4	102.6
1985	119.3	119.1	107.0	170.9	110.8	115.7	118.9	133.3	107.5	113.7	99.4	111.6	121.4	107.6
1985 Q1	119.4	118	110	180	110	116	120	134	109	113	99	109	120	110
Q2	121.0	122	102	176	112	116	120	133	109	114	100	111	120	109
Q3	117.1	123	110	161	109	115	117	130	107	114	102	114	123	105
Q4	119.7	114	106	168	112	116	119	136	105	114	97	112	123	106
1986 Q1	118.0	117	113	184	107	111	115	131	102	109	88	108	117	103
1986 Feb	121.2	129	112	192	109	114	121	140	105	110	93	112	118	101
Mar	113.7	113	112	154	107	111	113	124	104	110	79	108	119	104
Apr	122.3	118	108	177	115	114	118	137	103	112	108	115	115	107
Nov-Jan	119.5	110	112	177	111	115	117	134	103	113	95	111	122	107
Feb-Apr	119.1	120	111	175	110	113	117	134	104	110	93	112	117	104
Percentage Change	- ½	+ 9	- 1	- 1½	-	- 1½	+ ½	- ½	+ 1	- 2½	- 1½	+ ½	- 4	- 2½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

SECRET and personal until release of press notice on 28 MAY 86 at 11.30 a.m.

EXPORTS BY COMMODITY: UNIT VALUE INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 not seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0–9	0+1	2+4	3	5–8	5–8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	69	31	136	735	658	252	112	141	406	18	71	170	147
1984	136.0	128	131	152	135	133	127	130	125	137	157	135	140	132
1985	143.4	134	140	155	143	142	135	139	132	147	162	147	150	141
1985 Q1	146.3	132	146	173	143	141	135	139	132	145	161	146	148	139
Q2	145.4	134	146	163	144	143	136	141	133	147	162	147	150	142
Q3	141.6	134	136	142	143	143	135	140	132	147	162	148	151	141
Q4	140.4	134	130	140	142	142	134	137	131	148	163	149	151	141
1986 Q1	138.9	136	128	114	145	145	137	142	133	150	166	153	153	144
1986 Feb	138.6	136	128	112	145	145	137	141	133	150	164	153	152	144
Mar	137.4	138	129	95	146	147	138	144	133	152	170	156	155	145
Apr	135.2	140	127	80	146	147	137	143	133	152	174	156	155	145
Nov-Jan	140.5	135	129	138	143	143	135	138	131	148	164	150	151	142
Feb-Apr	137.1	138	128	96	145	146	137	143	133	152	169	155	154	145
Percentage Change	- 2½	+ 2½	- ½	- 31	+ 2	+ 2	+ 2	+ 3	+ 1½	+ 2½	+ 3½	+ 4	+ 1½	+ 2

[h] These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

[j] Based on the United Nations Broad Economic Categories end-use classification.

Table 11

EXPORTS BY AREA
(Overseas Trade Statistics basis)

£ million, fob, seasonally adjusted

	Total[K]	Developed Countries: Total	European Community	Rest of W Europe	North America Total	North America USA	Other	Developing Countries: Total	Oil exporting countries	Other	Centrally planned economies
1984	70488	55364	33127	7132	11416	10159	3688	13356	5806	7550	1630
1985	78331	62722	38200	7420	13310	11499	3792	13880	5957	7924	1587
1985 Q1	20148	15940	9992	1779	3179	2817	990	3758	1682	2077	389
Q2	20258	16210	9537	2034	3667	3189	972	3606	1510	2096	420
Q3	18828	15203	9312	1790	3182	2715	919	3314	1408	1906	386
Q4	19097	15369	9359	1817	3282	2778	910	3202	1357	1845	392
1986 Q1	18257	14652	8689	1779	3254	2784	930	3241	1405	1837	442
1986 Feb	6205	5053	2971	608	1120	968	354	1036	432	604	174
Mar	5755	4575	2748	561	961	831	304	1106	486	620	125
Apr	6028	4619	2833	520	973	857	293	1172	566	606	144
Nov-Jan	19040	15202	9065	1850	3393	2867	894	3263	1418	1845	428
Feb-Apr	17989	14246	8552	1689	3054	2656	951	3314	1484	1830	442
Percentage Change	- 5½	- 6½	- 5½	- 8½	- 10	- 7½	+ 6½	+ 1½	+ 4½	- 1	+ 3½

K See paragraph 3 of Notes to Editors.

SECRET and personal until release of press notice on 28 [illegible] 86 at 11.30 a.m.

IMPORTS BY COMMODITY

Table 12

(Overseas Trade Statistics basis)

£ million cif seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
1984	78967	8933	5418	10334	53011	49708	17930	6322	11608	31778	3670	8346	10218	9543
1985	84790	9274	5389	10517	58288	54953	19619	6903	12716	35334	4165	8887	11623	10659
1985 Q1	22565	2354	1468	3546	14844	13806	4817	1674	3143	8989	1014	2243	2975	2757
Q2	21548	2352	1366	2656	14848	13842	4920	1792	3128	8922	1116	2219	2928	2659
Q3	20321	2311	1312	2138	14250	13508	4913	1729	3184	8595	988	2189	2838	2581
Q4	20356	2256	1243	2178	14346	13798	4970	1708	3262	8829	1047	2237	2882	2662
1986 Q1	20670	2507	1225	1725	14839	14002	5024	1809	3215	8978	1152	2281	2881	2665
Feb	6912	809	437	576	4964	4683	1671	599	1073	3011	368	772	967	905
Mar	7270	907	414	563	5255	4943	1773	627	1146	3170	435	795	1011	929
Apr	6617	770	390	542	4750	4461	1615	582	1033	2846	326	775	932	813
Nov-Jan	20151	2251	1183	2041	14327	13752	4916	1744	3172	8837	1083	2244	2872	2637
Feb-Apr	20800	2486	1242	1681	14969	14087	5060	1808	3252	9027	1128	2342	2910	2647
Percentage Change	+ 3	+ 10	+ 5	- 18	+ 4½	+ 2½	+ 3	+ 3½	+ 2½	+ 2	+ 4	+ 4½	+ 1½	+ ½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

IMPORTS BY COMMODITY: VOLUME INDICES

Table 13

(Overseas Trade Statistics basis)

INDICES 1980 = 100 seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	124	81	138	626	543	217	63	154	326	42	94	96	94
1984	120.2	112.3	101.7	86.5	134.1	146.7	137.2	164.5	125.9	153.0	119.9	139.6	161.4	172.9
1985	124.3	113.6	102.2	85.0	140.7	154.5	143.9	176.2	130.6	161.5	127.9	139.6	172.8	187.2
1985 Q1	125.1	111	102	102	139	151	139	168	126	159	123	135	171	189
Q2	123.3	112	98	82	141	153	142	180	126	160	139	137	170	184
Q3	122.8	116	103	75	140	154	147	180	133	159	125	139	171	184
Q4	126.0	115	106	81	143	160	149	177	137	167	124	147	180	192
1986 Q1	124.5	126	105	71	141	155	148	183	133	159	130	145	171	175
1986 Feb	124.6	123	114	71	141	154	148	183	133	159	125	147	171	175
Mar	129.8	136	106	75	146	160	155	190	141	163	143	148	176	177
Apr	121.2	115	101	80	135	148	142	176	128	151	107	148	166	162
Nov-Jan	124.4	114	103	77	142	158	147	179	134	166	127	148	178	188
Feb-Apr	125.2	125	107	76	141	154	148	183	134	158	125	148	171	171
Percentage Change	+ ½	+ 9	+ 4	- 1	- 1	- 3	+ 1	+ 2	+ ½	- 5	- 2	- ½	- 4	- 9

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

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IMPORTS BY COMMODITY: UNIT VALUE INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 not seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver(PS): Total	Chemicals	Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Passenger Motor Cars	Other Consumer	Intermediate	Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	124	81	138	626	543	217	63	154	326	42	94	96	94
1984	138.0	132	133	168	134	133	126	134	123	137	144	135	145	129
1985	143.1	137	130	172	141	141	133	139	130	146	152	147	155	134
1985 Q1	150.3	142	143	191	146	144	135	143	132	150	154	151	158	138
Q2	146.7	141	136	181	143	143	135	141	133	148	150	147	159	136
Q3	139.2	135	124	161	139	139	131	137	128	144	149	145	154	131
Q4	136.3	132	116	155	137	138	130	137	127	143	156	143	148	131
1986 Q1	135.6	134	116	132	140	142	132	141	129	148	165	145	152	138
1986 Feb	135.9	135	116	131	141	142	133	141	129	149	166	145	153	140
Mar	134.7	135	116	113	143	144	133	142	130	151	171	148	155	142
Apr	131.5	134	115	101	141	143	132	141	129	149	169	146	154	140
Nov-Jan	136.0	132	115	154	137	138	130	138	127	143	158	142	148	132
Feb-Apr	134.0	135	116	115	142	143	133	141	129	150	168	146	154	141
Percentage Change	- 1½	+ 2	-	- 25	+ 3½	+ 4	+ 2	+ 2½	+ 2	+ 5	+ 6½	+ 3	+ 4	+ 6½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

IMPORTS BY AREA

Table 15

(Overseas Trade Statistics basis)

£ million cif seasonally adjusted

	Total K	Developed Countries: Total	European Community	Rest of W Europe	North America Total	USA	Other	Developing Countries: Total	Oil exporting countries	Other	Centrally planned economies
1984	78967	65279	37408	11184	11067	9368	5620	11514	2934	8579	2043
1985	84790	71520	41413	12025	11703	9920	6379	11233	2782	8451	1894
1985 Q1	22565	18709	10596	2940	3600	3074	1573	3296	812	2484	558
Q2	21548	17957	10271	3060	3044	2602	1582	2984	851	2133	441
Q3	20321	17293	10096	3083	2546	2166	1569	2499	499	2000	485
Q4	20356	17561	10451	2942	2512	2078	1655	2454	620	1834	410
1986 Q1	20670	17868	10695	3121	2395	2007	1657	2422	504	1918	424
1986 Feb	6912	5968	3512	1078	774	650	604	770	155	615	134
Mar	7270	6364	3809	1146	848	716	562	840	145	695	147
Apr	6617	5555	3337	934	815	681	470	823	148	675	152
Nov-Jan	20151	17311	10402	2787	2467	2063	1655	2525	705	1819	405
Feb-Apr	20800	17888	10658	3158	2437	2047	1635	2432	447	1985	434
Percentage Change	+ 3	+ 3½	+ 2½	+ 13	- 1	- ½	- 1	- 3½	- 37	+ 9	+ 7

K See paragraph 3 Notes to Editors.

SECRET and personal until release of press notice on 28 MAY 86 at 11.30 a.m.

COMMODITY ANALYSIS OF VISIBLE TRADE
(Balance of Payments basis)

£ million, seasonally adjusted

SITC (R2)	Food Beverages and Tobacco 0 + 1			Basic Materials 2 + 4			Fuels 3		
	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance
1984	4672	8196	- 3524	2014	4864	- 2850	15308	9917	+ 5391
1985	4936	8481	- 3545	2161	4789	- 2628	16712	10094	+ 6618
1984 Q2	1175	2037	- 862	493	1174	- 681	3520	2355	+ 1165
Q3	1142	2073	- 932	519	1192	- 673	3840	2507	+ 1333
Q4	1218	2126	- 908	563	1349	- 786	4180	3297	+ 883
1985 Q1	1186	2155	- 969	585	1315	- 731	4892	3387	+ 1505
Q2	1276	2153	- 877	533	1226	- 693	4513	2548	+ 1965
Q3	1290	2122	- 832	534	1162	- 628	3600	2067	+ 1533
Q4	1185	2052	- 867	509	1086	- 577	3708	2092	+ 1616
1986 Q1	1198	2332	- 1134	515	1086	- 571	3271	1631	+ 1639

SITC (R2)	Semi-Manufactures 5 + 6			Finished Manufactures 7 + 8			Total Manufactures 5 - 8		
	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance
1984	18266	18410	- 144	28324	32059	- 3735	46590	50469	- 3879
1985	20042	19978	+ 65	32254	35335	- 3081	52296	55313	- 3017
1984 Q2	4502	4439	+ 62	6717	7775	- 1058	11218	12214	- 996
Q3	4558	4684	- 127	7126	8336	- 1210	11684	13021	- 1337
Q4	4960	4890	+ 69	7797	8771	- 974	12757	13662	- 905
1985 Q1	5017	4836	+ 182	7946	9263	- 1316	12963	14098	- 1135
Q2	5201	5050	+ 151	8223	9025	- 803	13423	14075	- 652
Q3	4852	5126	- 274	7960	8361	- 402	12812	13487	- 675
Q4	4973	4967	+ 5	8125	8686	- 560	13098	13653	- 555
1986 Q1	4847	5282	- 435	7894	8883	- 990	12741	14165	- 1424

Monthly data at this level of detail are published in the Monthly Review of External Trade Statistics.

Ms/26

RMP

FROM: MRS M HENSON
DATE: 22 May 1986

MR MOWL

NATIONAL INSTITUTE ECONOMIC REVIEW:
MAY 1986

The Chancellor has seen and was grateful for your minute of 21 May.

Meena Henson
MEENA HENSON

FROM: S BROOKS

DATE: 29 May 1986

1. ~~MR~~ EVANS

2. CHANCELLOR

Paragraph 3 below suggests that the need to go ahead with this box in the next EPR is less pressing. I agree, but I see no strong reason for holding it up.

HPE.
29/5

cc: Economic Secretary
Sir P Middleton
Sir T Burns
Mr Kemp
Mr Peretz
Mr Scholar
Mr Watson
Mr Culpin
Miss Noble
Mr Davies
Miss O'Mara
Mr Walton

I agree that this should go ahead. But what approach is [illegible] for [illegible] & Young? N.

RPI EXCLUDING MORTGAGE INTEREST PAYMENTS: EPR BOX

I have revised the draft for the June EPR box in the light of the April RPI figures and comments received. A copy of the new version is attached.

2. It looks increasingly likely that we shall see some very low RPI inflation figures in the second half of this year, helped of course by cuts in mortgage rates. At some stage we shall lose this benefit: when that happens, there will be a tendency for the annual RPI increase to go up. This is a major reason for looking at the RPI less mortgage interest payments.

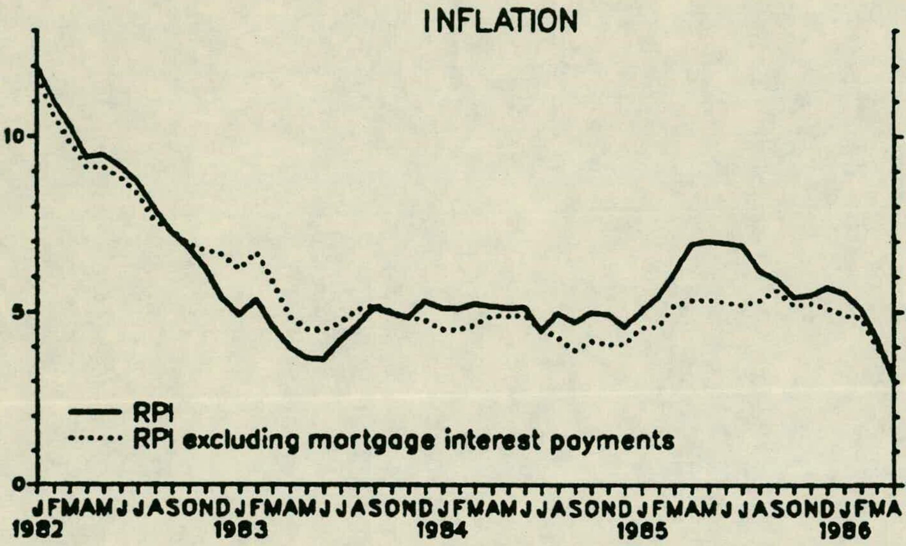
3. The timing of these movements is of course very uncertain. But it could well be 1987, even perhaps late in the year, before the annual RPI figures rise significantly on this count. Any effect this year now looks like being much more muted.

4. Comments please by close on Monday, 2 June.

S Brooks

S BROOKS
EA1
x 7946

ASSESSING CHANGES IN RPI INFLATION



Inflation

as measured by the 12 month percentage change in

	RPI	RPI excluding mortgage interest payments
1985		
March	6.1	5.2
June	7.0	5.3
December	5.7	5.1
1986		
March	4.2	4.0
April	3.0	3.4

There was a steep fall in inflation from 1980 to 1983, followed by a period of no major change up until early 1986. Latest figures and most forecasts (including the Government forecast published in the FSBR) show a substantial decline in inflation in 1986.

2. The Retail Price Index is the most commonly used measure of inflation and is shown in the chart. Unlike other measures, the RPI includes the mortgage interest rate, as an indicator of the cost of owner-occupied housing. The all-items RPI is sensitive to changes in interest rates which are subject to substantial short term fluctuations. A fall of one point in the mortgage interest rate from a level of 11 percent reduces the cost of mortgage interest payments by more than 9 percent. This will reduce the RPI by nearly $^1{}_2$ percent, with almost all the effect coming through in the month of the interest rate change. The impact of such changes on the twelve month rate of increase of the RPI can make the assessment of current trends in inflation more difficult. The chart also shows the RPI excluding mortgage interest payments. This is a less volatile series, which moves similarly to the RPI over the longer term.

3. Mortgage rates increased by one percentage point in February 1985 and by a further one percentage point in April. After remaining at 14 percent for the summer, a cut of $1^{1}4$, effective for most borrowers, in September took the rate down to $12^{3}4$ percent where it remained until the spring of 1986. A reduction of $^{3}4$ percent became generally effective on 1 April and a further cut [of 1 percent] will affect the June index. In the chart the effects of the increases in mortgage rates in February and April 1985 on the RPI stand out clearly. RPI inflation peaked at 7 percent in May and June, while the twelve month rate of increase of the RPI excluding mortgage interest payments only reached 5.3 percent in these months. By April 1986 both series showed a major fall in inflation, compared with 1985. With the mortgage rate cut in June, the twelve month rate of increase of the all-items RPI over the next few months is likely to remain below the change in the index excluding mortgage interest payments.

CONFIDENTIAL

A[illegible]1 COPY NO 86

pmp

MONTHLY ECONOMIC BRIEF

Prepared by the CSO on 30 May 1986

The published preliminary output-based measure of GDP for the first quarter of 1986 is consistent with a picture of a mild slowdown in the underlying rate of growth in economic activity, which perhaps started in the first part of 1985. Manufacturing output appears to have fallen back a little since the second quarter of 1985.

The latest unemployment figures show a continuing upward trend, despite the continuing favourable impact of employment and training measures.

The annual rate of retail price inflation fell from 4.2 to 3.0 per cent per annum in April - the lowest rate since January 1968. Further moderate falls in the annual rate of inflation are expected in the next two months. Petrol prices are expected to have fallen between April and May. Most borrowers will face lower mortgage interest rates in June. With average earnings rising by 7½ per cent in the year to March on an underlying basis, considerably more quickly than productivity, the picture for unit wage costs is not encouraging. For the whole economy, unit wage costs in the first quarter are likely to have been about 6 per cent higher than a year ago; for manufacturing the increase over the same period is 8 per cent.

The PSBR in April was £0.9 billion, slightly lower than outside commentators had expected.

The current account in recent months has been affected by the decline in oil prices. However the strength of invisibles has been sufficient to keep the underlying position in surplus. Visible trade was in deficit by £191 million in April, following a deficit of £1,211 million in March. The gradual decline in the underlying level of non-oil export volume, which began in the middle of last year, appears to have continued so far in 1986. Figures of non-oil import volume have fluctuated considerably in recent months but the underlying level appears to have changed little since last summer.

Base rates fell by a further ½ per cent to 10 per cent in the second half of May. During the first two weeks of the month, share prices continued to fall from earlier highs. More recently, there has been some recovery but as the month closed there continued to be marked fluctuations.

CONFIDENTIAL

RECENT RATES OF CHANGE AND ASSESSMENT OF CURRENT TREND FOR SOME KEY ECONOMIC INDICATORS

In the following notes, the figures for current trend represent our best assessment of the current underlying rate of increase after making allowance for temporary distorting factors such as strikes, unseasonal weather effects, etc. The figures show how the series are moving currently and may be different from the comparisons over the latest published twelve months.

GDP (average measure) in the fourth quarter of 1985 was 3 per cent higher than in the same period a year ago or $1\frac{1}{2}$ per cent after discounting the effects of the coal strike. This figure does not take account of past experience which shows that revisions to growth rates for the initial published estimates of GDP were on average upwards though not uniformly so. The assessment of current underlying trend for the first quarter of 1986 is that the rate of increase lies in the range $\frac{1}{2}$–$1\frac{1}{2}$ per cent per annum.

Industrial production in the first quarter was $2\frac{1}{2}$ per cent higher than in the same period a year ago, but $\frac{1}{2}$ per cent lower after allowing for the effects of the coal strike and other disputes, notably in the motor vehicles industry. On the same basis, respective figures for manufacturing were -1 per cent in both cases. The assessment of underlying trend for industrial production is that the rate of increase currently lies in the range 0 to -2 per cent per annum. The trend in manufacturing output is in the range -1 to -3 per cent per annum.

Retail prices rose by 3 per cent in the twelve months to April 1986. It is only possible to provide a useful indicator of trend for about 70 per cent of the RPI, mainly covering private sector prices and excluding mortgage rates, local authority rates, seasonal food, nationalised industry prices and petrol. The current trend for this series is about 4 per cent per annum. In the twelve months to April 1986 this series rose by just under 4 per cent (not published).

Producer input prices declined in seasonally adjusted terms in each of the months from March last year to April this year. Some further small decline is expected in May, bringing the index to about 12 per cent below its peak in February last year.

Average earnings (underlying) in the twelve months to March rose by $7\frac{1}{2}$ per cent. The current trend is estimated to be in the range $7\frac{1}{2}$–8 per cent per annum.

Unit wage costs in manufacturing in the three months to March rose by $8\frac{1}{2}$ per cent compared with the same period a year ago. With productivity falling at present, the current underlying trend is estimated to be in the range 8-10 per cent per annum.

Unemployment (excluding school leavers) in the twelve months to April has been rising on average by 7 thousand per month and by 14 thousand per month in the latest six months. Discounting the effects of employment and training measures as far as possible, the current underlying trend appears to be an increase in the region of 15-20 thousand per month.

Movements over the latest published 12 months include any revisions that may have occurred since last publication (in general any such differences only occur in the GDP series).

CHART 1

Changes in output and expenditure

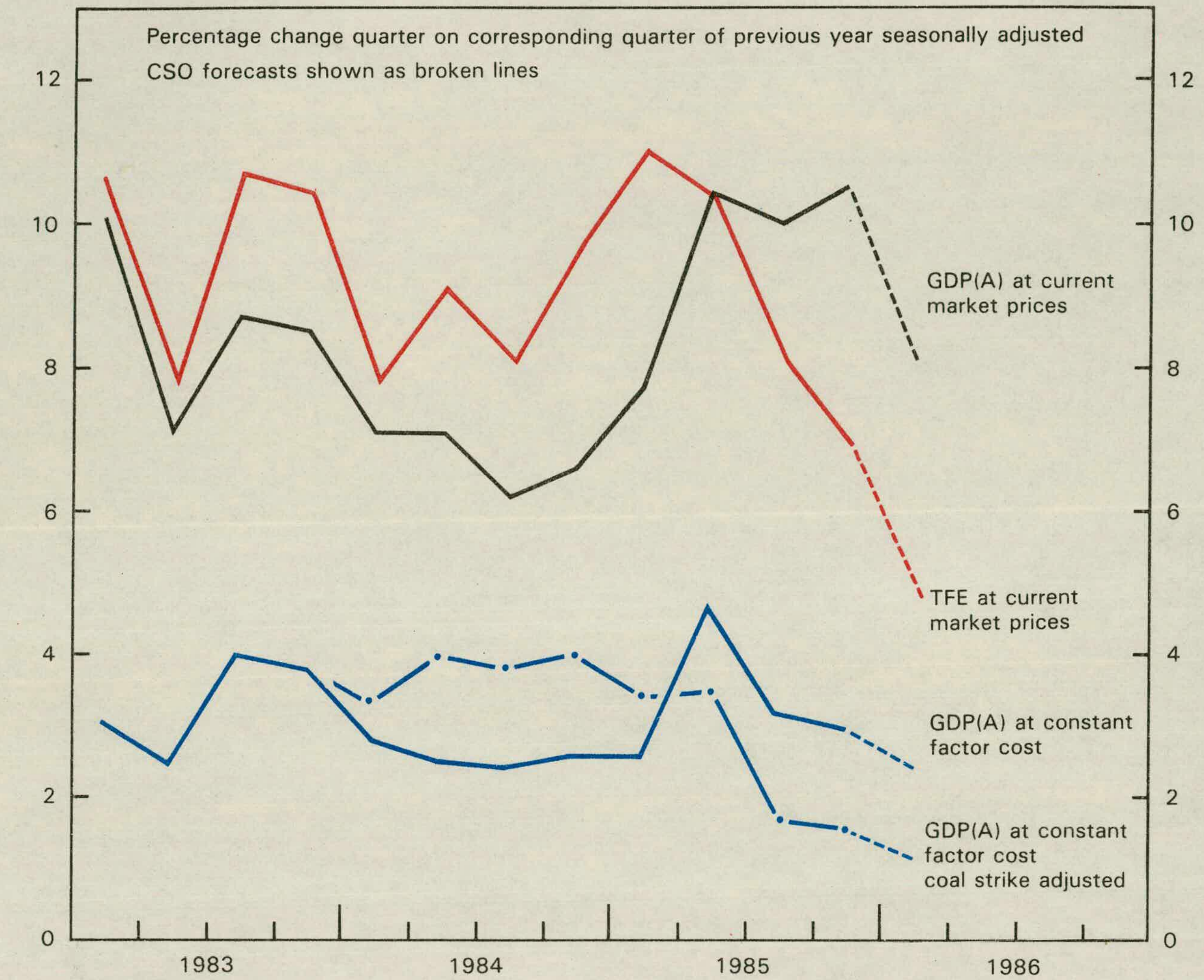
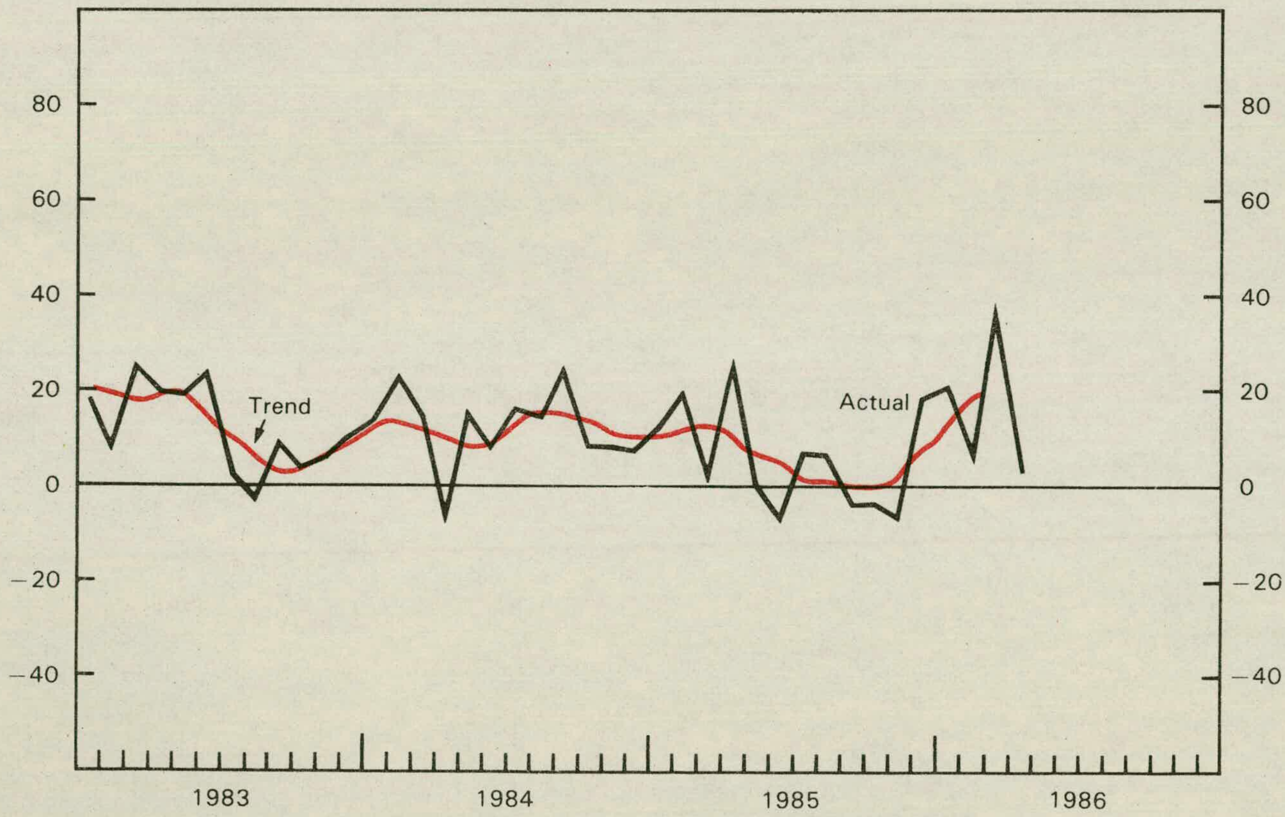


CHART 2

Changes in unemployment



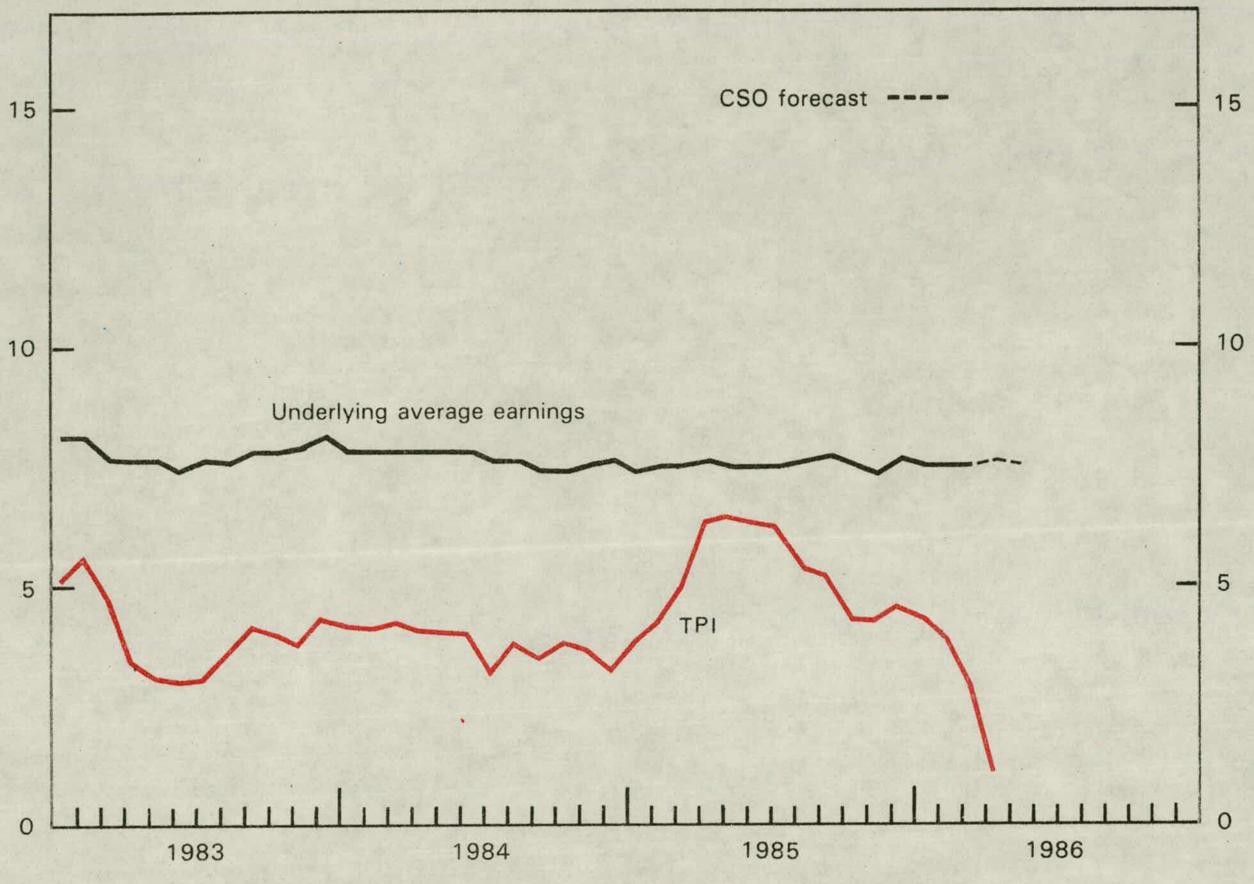
Rate of increase in average earnings, unit wage cost in manufacturing PPI input prices and Private sector retail prices

Month to month percentage changes, smoothed and adjusted for distorting factors where appropriate

1. Excludes seasonal food, mortgage interest, rent, rates and water charges, motor vehicle licences, products produced by Nationalised industries and petrol.

CHART 4

Movements in underlying average earnings and the tax and price index comparisons with 12 months previously



Interest rates

CHART 5

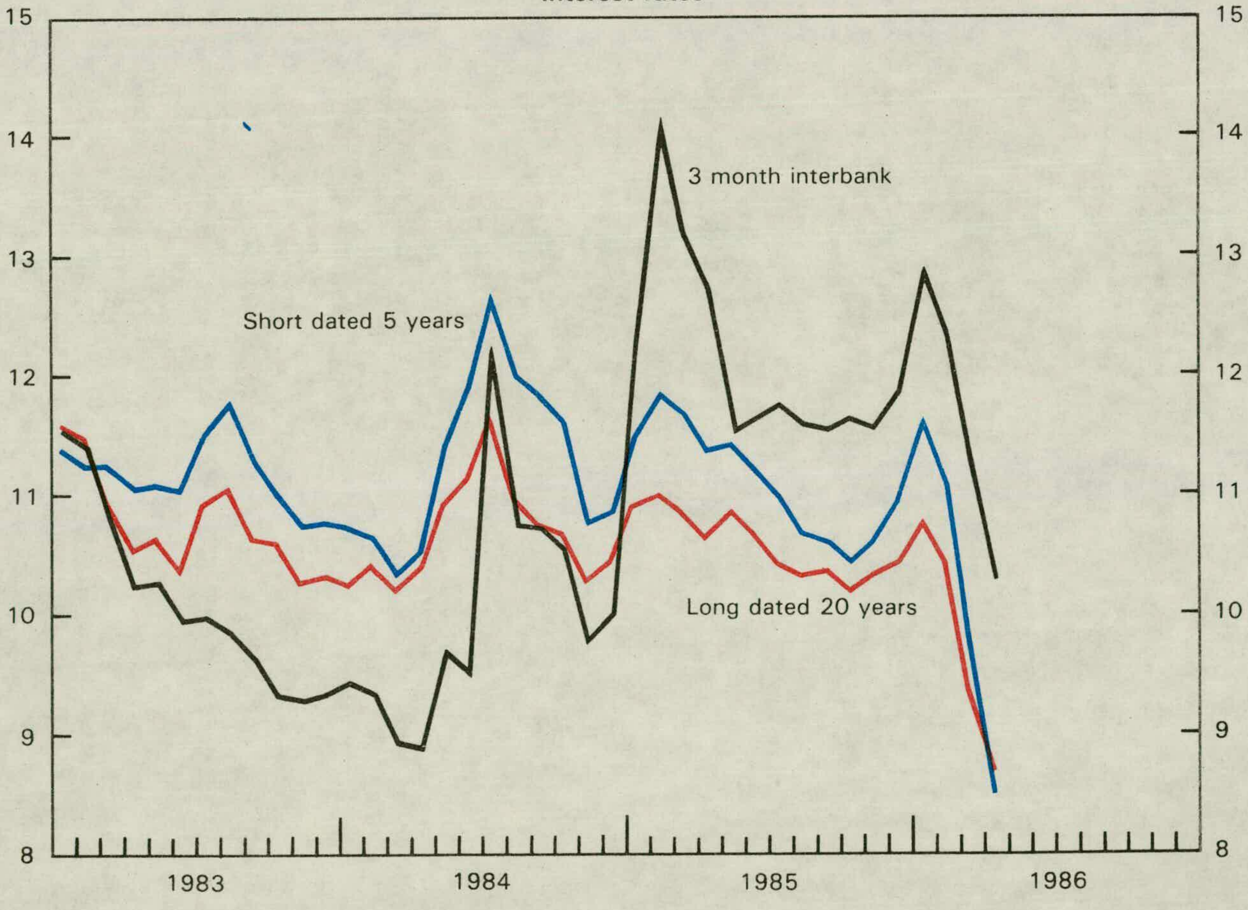
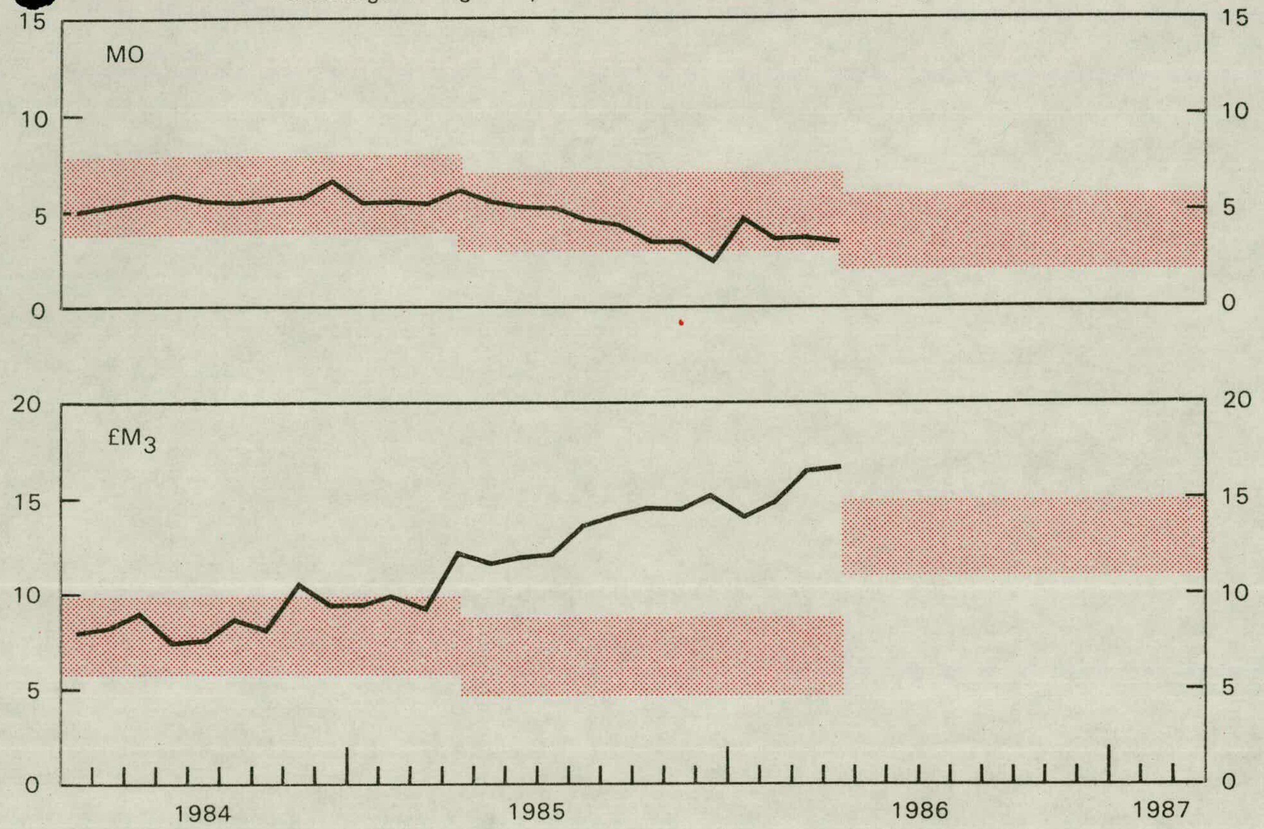


CHART 6

Monetary aggregates

Percentage change on previous 12 months (seasonally adjusted)

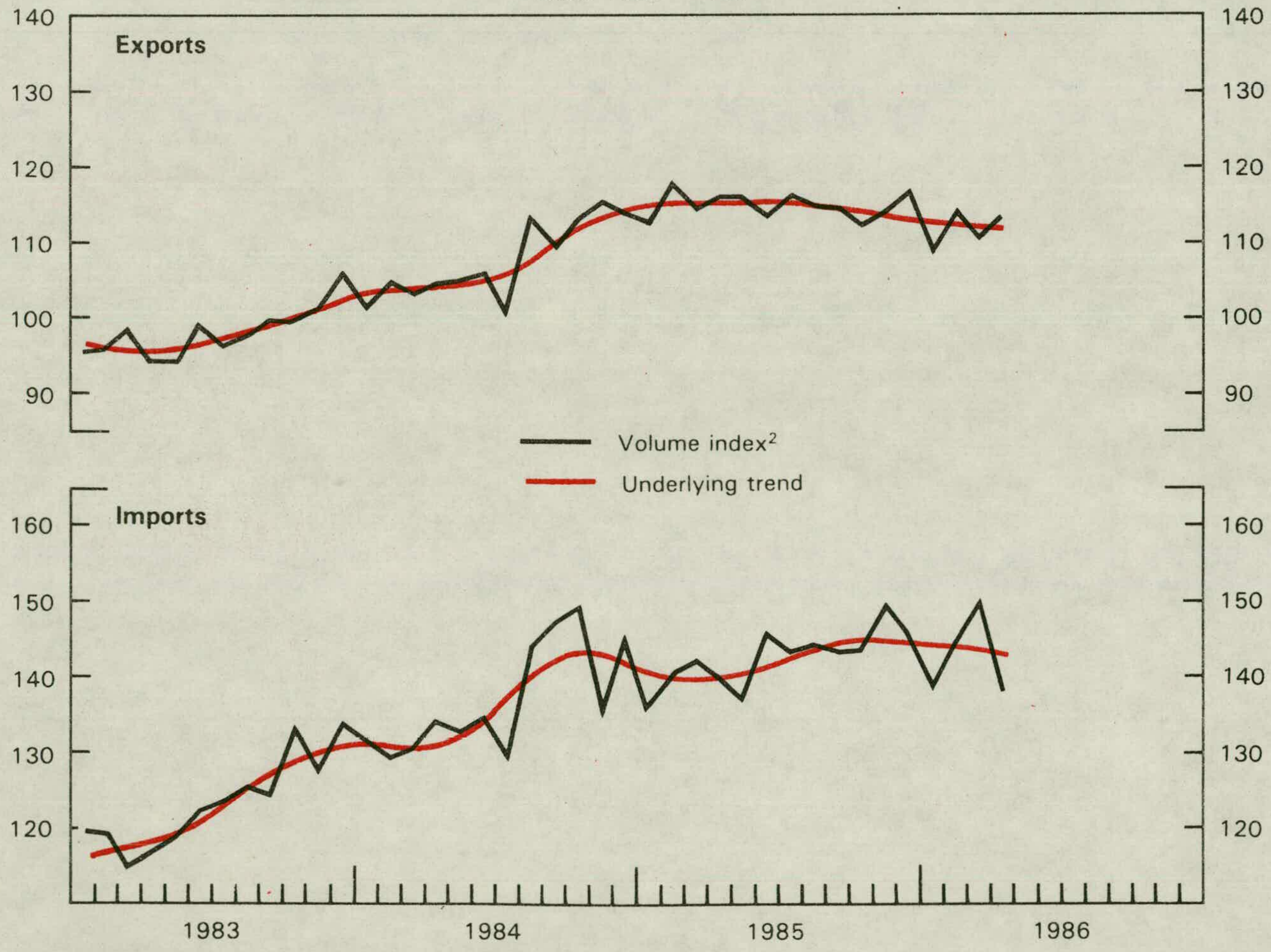


Shaded areas represent announced target ranges

CHART 7

Exports and Imports (excluding oil and erratics[1])

Index 1980 = 100



1. Ships, North Sea Installations, Aircraft, Precious Stones and Silver
2. Seasonally adjusted data, Balance of Payments basis

8/3069

CONFIDENTIAL

FROM: DAVID PERETZ
June 1986

ECONOMIC SECRETARY

cc Chancellor
Chief Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Evans
Mr Sedgwick
Mr Culpin
Mr Walsh
Miss O'Mara
Mr Mathews
Mr Richardson
Ms Goodman
Mr Ross Goobey
Mr Hosker T.Sol
Mr Lewis T.Sol

CHANGES TO THE RPI: IMPLICATIONS FOR INDEX LINKED GILTS AND SAVINGS CERTIFICATES

I should report some exchanges we have been having with Treasury Solicitor's Department, the Bank of England and Department of Employment about the forthcoming RPI Advisory Committee Report and the Government decisions that will subsequently be required; and the possible implications for sales of index linked gilts and National Savings Certificates.

has arrived

2. The draft RPIAC Report has just been circulated, and Mr Evans will be letting the Chancellor have a separate note on that, and the main recommendations. This minute is only about the possible implications for sales of index linked debt, and the implications of that for the handling of the RPIAC Report and the timetable to take decisions on it - about which, I understand, the Secretary of State for Employment will shortly be writing to the Chancellor.

attached

3. I should preface what follows by saying that there is as I understand it no reason to think that the proposed changes to the RPI could be held to be significantly to the detriment of holders of index linked gilts or National Savings Certificates, so there should not be any problem. But even so we should, I think, do everything we reasonably can to make sure that our position is as secure, legally, as it can be.

Potential Problems

4. There are two slightly different kinds of problems that a change to the constitution of the RPI could cause in the context of index linked securities.

5. The first relates to the clause in the prospectus for index linked gilts issued in the past that provides for premature redemption if a change is made to the coverage or basic calculation of the RPI which in the opinion of the Bank of England is a fundamental change "materially detrimental" to the interests of holders of indexed securities. There are currently nearly £10 billion of indexed gilts on the market at nominal value alone; indexed, they are worth more than £12 billion. Since without exception they stand below their (indexed) par value, if the clause were triggered we could expect to have to redeem the entire amount. Even if we were able to replace them by issuing an equivalent quantity of new IGs, there would be a very considerable loss to HMG represented by the difference between the face value of the securities and the market value prior to early redemption. We could hardly contemplate a change to the RPI that would cause this clause to be triggered.

6. For this reason we arranged for the Bank of England to be represented on the RPIAC, to keep a close watch on changes that could trigger the redemption clause. Nevertheless, once the Advisory Committee Report is published and Government decisions made, the Bank of England will need to go through a formal process of assessing its conclusions - not least against the possibility that they could be subject to legal challenge. It seems prudent that they should go through roughly the same process immediately - now that we have the draft RPIAC report - with a view to reassuring themselves and us that there is no problem as quickly as possible. This assessment is now taking place, and we will report the results as soon as possible. I am firmly assured by all involved, including the DOE statisticians, that the changes proposed are not of a kind likely to cause a problem in this respect.

7. The second problem applies to sales of index linked gilts and National Savings Certificates during the period prior to announcement of Government decisions on the RPI Advisory Committee's proposals. Here there is a risk of legal challenge from individuals who have bought IGs or index linked savings certificates during a period when the Government as seller knew of an adverse forthcoming change in the RPI which it had not disclosed to the purchaser. Obviously if our conclusion and that of the Bank of England is that the proposed changes should not be materially detrimental to the interest of holders of such securities, so that the IG redemption clause is not triggered, this is less of a problem. But we are advised that the problem would not go away entirely. A challenge on whether or not the redemption clause should have been triggered would have to show that the Bank of England's view as reached at the time that the changes would not be materially detrimental to the interest of holders was reasonably held. No doubt a court's view on that would be coloured by what had happened in fact, but the Bank would at the end of the day only have to show that they had acted reasonably. However, in the case of sales made during a period before announcement it might be sufficient for a litigant to establish, after the event that the change had in fact been against his interests.

8. The legal advice on this, therefore, (and we have taken Counsel's opinion) is that we could take two further steps to try to protect our position:-

(i) We should try to keep the period between receipt in Government of the RPIAC Report and its publication and announcement of Government decisions on it, as short as possible; and

(ii) we should try to secure as much publicity as we can at the time the report of the Advisory Committee is completed for the fact that it has been completed and submitted to the Government, and some indication of its significance; and that decisions on it would be announced shortly.

9. Department of Employment can I think broadly go along with this, which in fact fits in with their timetable reasonably well though they are naturally reluctant to say much if anything about the report's significance before it is published, other than to repeat the RPIAC's terms of reference. Assuming the RPI Advisory Committee adopts a final report soon after their meeting on 12 June, Department of Employment would:-

(a) make a prompt announcement (probably in the last week of June) by way of a Written PQ, and press release, when the Report is submitted; and

(b) aim to publish the Report within two or three weeks, together with the Government's decisions, which will not be taken until immediately before publication.

10. This all seems rather complicated. The only safe alternative, as I see it, would be to remove index linked securities from sale altogether during the period before we can announce conclusions on the RPIAC Report. It would, of course, be easy enough not to issue any new IGs. But we would have to explain why we were withdrawing index linked savings certificates from sale; and why the Bank was avoiding making any sales of IGs in the secondary market. That, it seems to me, would draw attention to the potential problem in a highly unsatisfactory way. Another option would be to insert forthwith a health warning in the prospectuses for IG's and index linked certificates. But again this would draw attention to the problem. Moreover it would not solve the problem of the Bank's sales of existing IG's in the secondary market.

Conclusion

11. As I say, Lord Young should be writing to the Chancellor shortly setting out the proposed timetable, and we have reached an agreement with Department of Employment which I hope goes as far to protect our position against the latter kind of problem

as we reasonably can. As to the Bank of England's assessment of the implications of the proposed changes for the indexed gilt redemption clause, I will of course report their conclusions as soon as we have them. Meanwhile Mr Evans will be letting the Chancellor have a note in the next few days summarising the proposals in the draft report.

DLCP

D L C PERETZ

PS I see that Lord Young has now written to the Chancellor as expected, setting out his approach. Assuming you and the Chancellor are content with the above, and subject to any detailed points Mr Hosker may have, it may be possible simply to reply to his letter saying we are content.

Ch/ Even though this isn't for publication you'll want to read Terry's comments especially on fiscal policy.

The Fischer paper is variable (& there are points I would expect Ch. to pick up) But you'll be interested in the lines but on EMS (which Terry has rightly ignored)

FROM: SIR T BURNS

DATE: 3 June 1986

MRS LOMAX

cc Sir P Middleton

Thanks. I hesitate to comment, since these are Terry's own comments. But I have made some suggestions on paras 19, 20 & 22 (where I wd prefer to see the passages in [ ] deleted). Regrettably, these comments [illegible] the same diff. between TB & myself over the fiscal/monetary mix, tho' it [illegible] v. great in practice. I have retained the Fischer paper for future study. N.

CONFERENCE ON THE BRITISH ECONOMY

RL 4/6

Recently I attended a conference on the British Economy organised by Layard and Dornbusch. I was the discussant of a paper on monetary policy by Stanley Fischer of MIT. The paper is not very polished at this stage and clearly needs further work although its conclusions are, in the main, broadly acceptable.

2. I attach a copy of the paper and the comments I made at the conference. I have been asked to send a written copy of my comments to Fischer as author to help his revision of the paper.

3. My comments will not be published but I would be grateful if the Chancellor could glance at them (and maybe the paper) before I send them off. There is some scope for editing if necessary.

TB
2

T BURNS

ENCS

COMMENTS ON "BRITISH MONETARY POLICY" BY STANLEY FISCHER

I would like to respond to some of Fischer's more challenging remarks although not necessarily in the same order. The topics I will comment on are

- the role of nominal GDP in the operation of monetary policy

- the role of monetary aggregates

- the role of the exchange rate in monetary policy

- the issue of the mix between monetary and fiscal policy.

Obviously this is not a comprehensive list: to some extent I have tried to avoid those areas that Charles Goodhart has tackled.

The role of nominal GDP

2. I begin with the role of nominal GDP. We have found it increasingly useful as a device for setting out medium term objectives. I therefore agree with the broad conclusions reached by Fischer. There is not much scope for using it as a short-term objective when deciding the setting of policy instruments but it is useful as a medium-term framework.

3. It enables government to set out the policy framework towards which it will be directing fiscal policy and money supply growth.

4. One important advantage is that it enables government to step back a little from the output/inflation trade-off by limiting its direct responsibility to setting the nominal framework within which the private sector operates. The

precise split of nominal GDP between output and inflation is then seen principally as a matter for the private sector although it is acknowledged that macro-measures can influence their behaviour. It follows that the faster is the adjustment of wages and prices to the nominal framework the better will be the growth of output. The framework also enables government to argue that there need be no fear of slower earnings growth leading to a downward spiral of nominal demand.

5. When considering a profile for money supply growth or the level of government debt outstanding it is necessary anyway to make a judgement about the underlying growth of output. That is also wrapped up within the money GDP framework.

6. In setting out a path for money GDP growth it is important not to attempt to be too rigid. Obviously the appropriate path has to be changed if there is any reassessment of the medium term growth of productive potential - although I stress that it is the medium term that counts and not simply year to year output fluctuations. And sometimes it is necessary to make some adjustments if the starting point changes - this often happens simply because of extensive revisions to GDP data. And it would be wrong to hope to exactly offset all short-run shocks to output and inflation leaving nominal GDP unchanged.

7. The first MTFS did not spell out the money GDP assumptions implicit in the arithmetic. Prices and output were shown separately in the second MTFS and money GDP explicitly since 1982.

8. Looking back we can compare the profile of estimated money GDP with the figure that was implicit in the assumptions that were made for the early versions of the MTFS. The broad conclusion is that the outturn has been reasonably close to the assumptions. Nominal GDP growth averaged over 15 per cent per annum in the years 1973 to

1980. It has been brought down to an average of 7 to 8 per cent over the past two years if account is taken of the coal strike. There was some tendency for the nominal GDP growth to decline faster than expected in the early stages but taken as a whole it can be said that the outturn has been much as anticipated when the original MTFS numbers were put together. This is worth bearing in mind when discussing monetary policy.

Monetary Aggregates

9. My second set of comments are directed towards the role of monetary aggregates.

10. In early versions of the MTFS £M3 had a prominent position. It was inherited from the seventies; had anticipated the growth of inflation in the mid-70s; and seemed to provide a useful framework for integrating monetary and fiscal policy.

11. However it is difficult to disagree with Fischer that over the past six years £M3 has not been a good indicator of monetary policy. Having grown less rapidly on average than money GDP during the 70s it has grown persistently faster than money GDP in the 1980s.

12. Fischer mentions the effect of the ending of the corset but there is probably more to it than that. One significant feature was the move from a period of negative real interest rates to one of positive real interest rates. Given that £M3 is largely interest-bearing deposits we would give this some weight. Secondly the abolition of the corset has coincided with substantial technical innovations in world money markets. The combination of a more competitive financial system and technical progress seems to have reduced the costs of financial intermediation. This may be an important reason for the large growth of financial wealth in the UK over this period. A further piece of evidence is the rapid growth of liquidity held by financial institutions.

13. My interpretation is that over the past ten years narrow money has provided better information about monetary conditions. However assessing the behaviour of narrow money has not been straightforward either.

- M1 used to be the main narrow money indicator. But this has been distorted by the rapid growth of interest bearing M1.

- Non-interest bearing M1 is an obvious replacement. But this turns out to be highly sensitive to interest rate movements because of the thin dividing line with interest bearing M1. As a result it varies a great deal around its 2 to 3 year trend.

- MO has moved reasonably closely in line with a smoothed NIB M1 and in my judgement has been the most useful monetary indicator over the past 10 years. It suffers two drawbacks; because it is so narrow it has a credi~~t~~ability problem; and because it is so closely related to transactions it cannot hope to provide a long leading indication for movements in money GDP. Even so it has been a crucial comfort in many periods when otherwise there would have been pressure to tighten monetary conditions because of a rapid growth of liquidity. Such a tightening turned out to be unnecessary.

14. Fischer raises the question of monetary base control. Over the past seven years there has been occasional interest in some form of MBC. It has had its powerful Influential advocates. It might have been possible to move more systematically towards targeting the base and leaving interest rates to be determined in the market. No doubt this would not have been done in a rigid manner regardless of the movement of short-term rates but some step in this direction might have been possible. But I have not been persuaded that we could negotiate the transition without risk when a change to MBC

would significantly increase the demand for bankers' balances. At the moment these are trivial and it would not have been possible to more than guess at the appropriate targets during that transition period.

Exchange rate

15. The third of my topics is the role of the exchange rate.

16. I agree with Fischer about the pervasive nature of the effects of the exchange rate. In an open economy like the UK I doubt if it is possible to conduct monetary policy without an eye to the exchange rate. But I think Fischer overdoes it. Our estimates suggest there are powerful effects from interest rates independent of the exchange rate; particularly on stock-building and housing but also on consumer and company spending generally. I would not want to go as far as him in weighing exchange rate movements relative to interest rate changes.

17. Exchange rate movements have consistently played a significant role in the operation of monetary policy even though that role may have changed slightly from time to time. the failure to raise interest rates in September 1980 despite a substantial overshoot of the monetary target was largely taken because of conflicting evidence from the exchange rate. Similarly the 2 points reduction of interest rates in November 1980 and March 1981. And an examination of interest rate changes since then will highlight a number of occasions when the exchange rate had a clear role - particularly when it was falling sharply.

18. But this role has never been in the form of an unpublished target. There has been a bias against excessive exchange rate fluctuations and some presumption that exchange rate changes in part reflect monetary conditions unless there is clear evidence to the contrary. But this is a far cry from an unpublished target range.

If F thinks we have an i.r. target (wh. we do not) what does he think it is?

19. Similarly I do not agree with Fischer's characterisation of UK monetary policy as being dominated by interest rate targets. Again there is a bias against excessive interest rate volatility but that is a different matter. He only provides one piece of evidence: comparative interest rate volatility in the UK and US. I hesitate to suggest that this comparison may owe more to developments in the United States.

20. One of the puzzles raised by the paper is that Fischer seems to be suggesting targets for a wide range of variables - money supply, interest rates and exchange rates; and medium-term nominal GNP. In part this may entail a different interpretation of the word target. What he may have in mind is something rather similar to the way in which policy has been conducted in recent years. Money GDP assumptions are the medium-term strategic objective. Money supply targets are the central focus for delivering those objectives but the numbers need recalibrating in the light of emerging information about velocity movements. Exchange rate changes provide further information particularly if the money supply figures give conflicting signals; and there is tendency to avoid exchange rate changes developing a momentum of their own. But it has been accepted that some of the pressure has should to be borne by money supply and exchange rate variation rather ~~for~~ than it all ~~to be~~ being passed on to interest rates.

Fiscal/Monetary Policy Mix

21. My biggest disagreement with Fischer is in relation to the last of my points; the issue of the fiscal/monetary policy mix.

22. I should begin by emphasising that we have never imagined a rigid relationship between fiscal policy and monetary policy. But we have argued that for any given growth of nominal GDP the bigger the fiscal deficit the higher interest rates need to be. And in recent years this has pointed to a higher exchange rate. Therefore unless you

believe that changes in the mix have a significant sustained impact on the split of nominal GDP between output and inflation (implicitly rejecting the unchanged nominal GDP framework) it is necessary to make an explicit choice about the pressure that fiscal policy should place upon monetary policy.

23. There have been two reasons for attempting to buttress monetary policy with an appropriate fiscal policy:

- the first has been to avoid interest rates taking all of the pressure of disinflationary policy with its implications for the exchange rate, the balance of payments and the accumulation of overseas assets;

- the second has been to avoid explicitly the risk of anti-inflationary policy looking unsustainable by asking too much of interest rates. This has pointed to maintaining a 'safe' stance for fiscal policy with room for manoeuvre in the event of a worse than expected outturn.

24. Whilst on this subject I would add that this paper, as well as the Begg paper, mis-states the position about the conduct of fiscal policy in the face of cyclical changes. The 1981 MTFS stated:

"Because the level of activity in the economy is below that assumed in last year's projections, the path for the PSBR shown in these projections is rather higher than that shown last year".

It is also clear from the figures presented in the paper that the PSBR figures have been revised upwards.

25. But it is not clear to me that there is any presumption that the fiscal stabilisers that happen to be the product of the tax and benefit system should be left to operate unimpeded when pursuing a disinflationary policy. That must

depend upon the implications for interest rates and the extent of the pressure they would have to bear.

26. An implicit issue that flows through this paper - and that by David Begg - is the effect of a change in the fiscal/monetary mix. There seems to be a presumption of significant gains to output and inflation from an easier fiscal policy combined with tight monetary policy. This is not the result we get. If policy is operated so that nominal GDP is broadly unchanged we compute some short-term gain but it is small and is not sustained. And it brings with it a current account deterioration and a loss of net overseas financial assets.

27. Alternatively if there is an explicit decision to increase the growth of nominal GDP there is, in principle, a choice between easier fiscal or monetary policy. In the short run fiscal policy probably has a larger impact, but according to Treasury calculations the difference is not great.

28. It follows that the case for any change in the fixed monetary mix depends upon the initial conditions. If at the outset real interest rates are high and there is a need to protect the external position then a shift towards easier monetary and tighter fiscal policy is likely to be preferred. On the other hand if real interest rates are low and the country is in chronic current account surplus the ~~revenue~~ reverse will be more appropriate.

29. It follows from this that the argument that the UK needs a fiscal stimulus at this stage is unsubstantiated. Faced with lower oil prices and the loss of net export revenue it is not clear to me why there should be an emphasis on fiscal expansion. If we can maintain the profile for the growth of money GDP without this fiscal expansion it will clearly be better from the point of view of long-term balance of payments effects.

30. I would add in passing that I find odd the argument that EMS would make way for easier fiscal policy. Surely the main effect of EMS membership, if it was credible, would be to bring down UK interest rates relative to those in Europe. Faced with that it would be perverse to also ease fiscal policy which could only make it more difficult to sustain EMS membership.

T BURNS
3 June 1986

1498/29

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prop.

FROM: P M WALKER
DATE: 3 June 1986

1. MR KELLY
2. ECONOMIC SECRETARY

cc Chancellor*
Sir P Middleton
Sir G Littler*
Sir T Burns*
Mr Evans*
Mr Fitchew
Mr Culpin
Ms O'Mara
Mr Mowl
Mr Barrell*
Mr Segal
Mr Owen
Mr Ross Goobey

Mr Croxford - CSO

BALANCE OF PAYMENTS FIGURES: FIRST QUARTER 1986

The invisible and capital account figures for 1986 Q1 will be published at 11.30 am on Thursday 5 June. A copy of the CSO press notice is attached (top copy and asterisked copy recipients only). Summary tables are at annex 1.

2. The figures are not very newsworthy. But the Q1 current account has been revised <u>down</u> to £0.5 billion, from the projected £0.8 billion in the April trade figures press notice. On the other hand, the 1984 current account surplus has been revised <u>up</u> from £0.9 billion to £1.6 billion, and that for 1985 has been revised from £3.0 billion to £3.8 billion.

Revisions

3. The revisions to the 1984 and 1985 current account stem mainly from the 1984 enquiry into direct investment, which for the first time was addressed to oil companies in the same format as non-oil companies. This produced improvements to both data and methodology for 1984 onwards. It also, however, created a discontinuity, as the oil companies were not prepared to provide data on the new basis for years before 1984.

4. Although the new system for oil companies will take a year or so to settle down, the revision of oil company figures at this stage should help reduce the size of future revisions when the Pink Book is prepared.

Current account (table B of press notice)

5. The reduction in the surplus for Q1 is due to invisibles now being estimated at £1.9 billion, against a projected £2.2 billion. Visibles were in deficit by £1.4 billion.

Services (table C)

6. Most noticeable was the return of the travel balance to deficit, after six quarters in surplus. This probably reflects the combination of a relatively strong pound and American tourists new-found caution. It is too early to say whether the deficit is likely to persist.

Interest, profits and dividends (IPD) (table D)

7. The Q1 figures show a recovery from 1985 Q4, which suffered from the £0.6 billion write-off by BP of losses on its Sohio subisidary, but were still below the surplus being recorded in the middle of last year.

Transfers (table E)

8. The £0.2 billion deficit in Q1, an improvement of £0.5 billion on the previous quarter, was due mainly to the delayed receipt of the lump sum VAT abatement relating to the 1984 budget.

Investment and other capital transactions (table G)

9. Preliminary figures show a small net outflow of £255 million in Q1, after a £3 billion inflow in 1985 Q4. The Q4 figure was mainly due to the inflow on UK banks' foreign currency transactions of over £5 billion: Q1 saw a return to a more normal £0.9 billion.

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Inward and Outward investment (table I)

10. Overseas investment in the UK and UK private investment overseas both rose. The rise in overseas investment in the UK was mainly due to direct investment, by both oil and non-oil companies. The latter included the £0.3 billion purchase of Cornhill insurance by Allianz of West Germany. The rise in UK investment overseas was entirely due to a rise in portfolio investment. Insurance companies, pension funds and investment trusts all increased their overseas investments.

Press notice and briefing

11. I should be grateful for clearance of the attached press notice and briefing.

P M WALKER

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Annex 1

SUMMARY OF THE BALANCE OF PAYMENTS*

£ billion

		(1) Current balance	(2) Visible balance	(3) Invisible balance	(4) Identified investment and other capital transactions
1983		3.2	- 0.8	4.0	- 5.1
1984		1.6	- 4.4	6.0	- 7.2
1985		3.8	- 2.1	5.8	- 3.2
1985	Q1	- 0.1	- 1.3	1.2	- 2.3
	Q2	1.6	- 0.1	1.9	0.5
	Q3	1.5	- 0.5	1.9	- 4.4
	Q4	0.8	- 0.2	1.0	3.0
1986	Q1	0.5	- 1.4	1.9	- 0.3

*Seasonally adjusted, except for column 4

[(1) = (2) + (3), but may not add up due to rounding].

Invisibles**

£ billion

		(1) Services	(2) IPD	(3) Transfers	(4) Balance (total)	(5) Balance (private sector and public corporations)
1983		3.7	2.5	- 2.1	4.0	8.2
1984		4.2	4.0	- 2.3	6.0	10.7
1985		6.2	3.1	- 3.5	5.8	12.2
1985	Q1	1.2	1.0	- 1.0	1.2	2.9
	Q2	1.7	0.7	- 0.7	1.7	3.1
	Q3	1.8	1.1	- 0.9	1.9	3.6
	Q4	1.5	0.3	- 0.9	1.0	2.6
1986	Q1	1.3	0.8	- 0.2	1.9	2.9

**Seasonally adjusted

[(4) = (1) + (2) + (3), but may not add up due to rounding].

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PRESS BRIEFING FOR IDT

Positive

1. Substantial upward revisions in 1984 and 1985 current account surpluses.

2. Recovery in interest, profits and dividends after fall in 1985 Q4.

Defensive

1. **Downward revision to 1986 Q1 current account from figure given in April trade figures?**

   Trade figures based on projected invisibles surplus. This is first estimate; further revisions likely in future as more data becomes available.

2. **Revision means Budget forecast of £3.5 billion surplus for 1986 too high?**

   Too early to say on basis of only one quarter, much of the data for which is preliminary and can be subject to extensive revision.

3. **Large portfolio outflows support exchange controls, as proposed by Labour?**

   No. These outflows have contributed to the build-up of our net overseas assets. These assets were almost £90 billion at end-1985, second only to Japan, and generated interest, profits and dividends of over £3 billion in 1985.

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CSO(86)54

5 June 1986

UNITED KINGDOM BALANCE OF PAYMENTS: PRELIMINARY FIGURES

FOR THE FIRST QUARTER OF 1986

Preliminary estimates indicate that the UK current account (seasonally adjusted) was in surplus by £0.5 billion in the first quarter of 1986 (Table A).

There was a deficit on visible trade of £1.4 billion and a surplus on invisible transactions of £1.9 billion (Table A).

The preliminary estimates for the first quarter put the net credit on services at £1.3 billion and net investment earnings (ie interest, profits and dividends) at £0.8 billion (Tables C and D). Net transfer payments overseas are put at £0.2 billion (Table E). It must be stressed that figures for invisible transactions, particularly for the most recent quarters, are liable to substantial revisions as later information becomes available.

The estimated surplus on services in the first quarter was a little below the high level of the previous three quarters (Table C).

The preliminary estimate of the surplus on interest, profits and dividends indicates a recovery from the low level estimated for the preceding quarter. The fourth quarter figure for 1985 had been reduced by a £0.6 billion charge against BP's share of the profits of its US subsidiary Sohio. First quarter earnings by oil companies were moderated by falling oil prices (Table D).

Enquiries: Balance of payments figures: Central Statistical Office 01-233 7489
Economic policy aspects : HM Treasury 01-233 3415

The deficit on transfers fell from £0.9 billion in the fourth quarter of 1985 to £0.2 billion in the first quarter of 1986. This reflects in part receipt in January 1986 of the balance of the lump sum VAT abatement arising from the UK's excessive net contribution to the 1984 Community budget (Table E).

Although figures for investment and other capital transactions are not yet complete (they exclude the series for UK non-bank private sector transactions with banks overseas) they show an outflow of £0.3 billion in the first quarter compared with an inflow of £3.0 billion in the preceding quarter (Table G).

UK banks' foreign currency borrowing and lending abroad resulted in a net inflow of £0.9 billion in the quarter. This was a more typical quarterly figure following the exceptional outflow and inflow recorded in the last two quarters respectively of 1985 (Table G).

There were large increases over the preceding quarter in both UK banks sterling borrowing and lending (excluding UK export credit); for lending this ended the run of net repayment to banks which occured in the previous three quarters. Sterling borrowing (including liabilities to overseas monetary authorities) and lending combined resulted in a net inflow of £2.1 billion in the first quarter compared with an outflow of £0.2 billion in the preceding quarter (Table G).

There was an outflow of £0.7 billion in the first quarter under "other" borrowing or lending overseas. This compared with an inflow of £0.9 billion in the fourth quarter of 1985, reflecting transactions by UK non-bank financial institutions (Table G).

Overseas investment in the UK in the first quarter, at £3.0 billion, recovered sharply from the low fourth quarter figure. Investment by overseas oil companies increased from £0.1 to £0.7 billion while other overseas direct investment, which included the acquisition of Cornhill by Allianz (£0.3 billion), amounted to £1.4 billion compared with net disinvestment of £0.1 in the preceding quarter (Table I).

UK private investment overseas also increased between the quarters, from £4.4 to £5.6 billion. Direct investment, which included the British Telecom acquisition of Mitel (£0.2 billion), was lower and portfolio investment by UK banks was sharply down. Portfolio investment by other UK residents, provisionally estimated as £3.8 billion, was, however, the highest quarterly figure recorded (Table I).

Revisions

The revisions since the last Press Notice to the estimates of direct investment, both earnings (interest, profits and dividends) and transactions stem mainly from the results of the 1984 enquiry into direct investment (to be published in "British business" on June 6) which included revisions to data reported by oil and non-oil companies. For the first time the inquiry was addressed to oil companies in the same format as for non-oil companies and financial institutions. This has resulted in some improvement in methodology and additional data for 1984 and later periods producing some discontinuities in series.

The revisions to direct investment earnings have had the net effect of increasing the estimated current account surplus by £0.7 billion in 1984. For 1985 the revisions, together with minor revisions to other series, have increased the current account surplus by £0.8 billion. Revisions to transactions have reduced net capital outflows under direct investment by £0.2 billion in 1983 and £0.1 billion in 1985 and increased the outflow in 1984 by £1.5 billion.

TABLE A

SUMMARY BALANCE OF PAYMENTS

£ million

	1983	1984	1985	1984				1985				1986
				1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr
							Seasonally adjusted					
Visible trade (balance)	-835	-4391	-2068	-65	-1240	-1463	-1623	-1266	-124	-453	-225	-1400
Invisibles (balance):												
Services	3671	4225	6233	1041	983	1145	1056	1230	1711	1755	1537	1301
Interest, profits and dividends	2467	4025	3120	725	818	1146	1336	1015	699	1083	323	832
Transfers	-2140	-2297	-3522	-525	-748	-731	-293	-1037	-699	-913	-873	-205
Total	3998	5953	5831	1241	1053	1560	2099	1208	1711	1925	987	1928
Current balance	3163	1562	3763	1176	-187	97	476	-58	1587	1472	762	528
							Not seasonally adjusted					
Current balance	3163	1562	3763	699	-722	115	1470	-686	1069	1522	1858	159
Investment and other capital transactions	-5071	-7184	-3207	-926	-1692	-1735	-2831	-2335	455	-4365	3038	-255
Official financing:												
Official reserves (drawings on,+: additions to,-)	607	908	-1758	77	857	279	-305	90	-607	-49	-1192	-580
Other official financing	213	408	959	113	-189	64	420	184	169	81	525	227
Balancing item	1088	4306	243	37	1746	1277	1246	2747	-1086	2811	-4229	449

A

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CURRENT ACCOUNT
Seasonally adjusted

TABLE B

£ million

	1983	1984	1985	1984				1985				1986
				1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr
Credits												
Exports of goods												
Oil	12501	14852	16050	3625	3421	3740	4066	4721	4336	3410	3583	3117
Other	48275	55515	62022	13048	13439	13909	15119	15349	15901	15338	15434	15087
Total	60776	70367	78072	16673	16860	17649	19185	20070	20237	18748	19017	18204
Invisibles	65225	77192	81074	17805	17963	19735	21689	21914	20466	19639	19055	19081
Total	126001	147559	159146	34478	34823	37384	40874	41984	40703	38387	38072	37285
Debits												
Imports of goods												
Oil	5525	7915	7887	1341	1890	1971	2713	2763	1925	1509	1690	1123
Other	56086	66843	72253	15397	16210	17141	18095	18573	18436	17692	17552	18481
Total	61611	74758	80140	16738	18100	19112	20808	21336	20361	19201	19242	19604
Invisibles	61227	71239	75243	16564	16910	18175	19590	20706	18755	17714	18068	17153
Total	122838	145997	155383	33302	35010	37287	40398	42042	39116	36915	37310	36757
Balances												
Visible trade												
Oil	6976	6937	8163	2284	1531	1769	1353	1958	2411	1901	1893	1994
Other	-7811	-11328	-10231	-2349	-2771	-3232	-2976	-3224	-2535	-2354	-2118	-3394
Total	-835	-4391	-2068	-65	-1240	-1463	-1623	-1266	-124	-453	-225	-1400
Invisibles	3998	5953	5831	1241	1053	1560	2099	1208	1711	1925	987	1928
of which: Private sector and public corporations: services and I.P.D.	8239	10663	12230	2342	2418	2910	2993	2922	3116	3590	2602	2923
Current balance	3163	1562	3763	1176	-187	97	476	-58	1587	1472	762	528

B

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Table C

SERVICES
Seasonally adjusted

£ million

	1983	1984	1985	1984 1st qtr	1984 2nd qtr	1984 3rd qtr	1984 4th qtr	1985 1st qtr	1985 2nd qtr	1985 3rd qtr	1985 4th qtr	1986 1st qtr
Credits												
Private sector and public corporations												
Sea transport	3054	3273	3551	777	803	848	845	888	913	872	878	796
Civil aviation	2665	2931	3212	697	738	735	761	806	856	781	769	784
Travel	4003	4614	5451	1079	1115	1195	1225	1347	1375	1412	1317	1340
Financial and other services	9419	10707	12359	2661	2626	2619	2801	3013	3055	3026	3265	3133
Total	19141	21525	24573	5214	5282	5397	5632	6054	6199	6091	6229	6053
General government	473	474	490	127	86	124	137	140	103	120	127	161
Total credits	19614	21999	25063	5341	5368	5521	5769	6194	6302	6211	6356	6214
Debits												
Private sector and public corporations												
Sea transport	4067	4386	4628	1078	1056	1043	1209	1260	1172	1065	1131	1054
Civil aviation	2354	2683	2839	624	637	687	735	721	679	679	760	775
Travel	4090	4664	4877	1109	1196	1147	1212	1266	1140	1162	1309	1396
Financial and other services	3909	4446	4729	1092	1102	1100	1152	1280	1185	1082	1182	1181
Total	14420	16179	17073	3903	3991	3977	4308	4527	4176	3988	4382	4406
General government	1523	1595	1757	397	394	399	405	437	415	468	437	507
Total debits	15943	17774	18830	4300	4385	4376	4713	4964	4591	4456	4819	4913
Balance												
Private sector and public corporations												
Sea transport	-1013	-1113	-1077	-301	-253	-195	-364	-372	-259	-193	-253	-258
Civil aviation	311	248	373	73	101	48	26	85	177	102	9	9
Travel	-87	-50	574	-30	-81	48	13	81	235	250	8	-56
Financial and other services	5510	6261	7630	1569	1524	1519	1649	1733	1870	1944	2083	1952
Total	4721	5346	7500	1311	1291	1420	1324	1527	2023	2103	1847	1647
General government	-1050	-1121	-1267	-270	-308	-275	-268	-297	-312	-348	-310	-346
Total	3671	4225	6233	1041	983	1145	1056	1230	1711	1755	1537	1301

C

CONFIDENTIAL UNTIL PUBLICATION

Table D

INTEREST, PROFITS AND DIVIDENDS
Seasonally adjusted

£ million

	1983	1984	1985	1984 1st qtr	1984 2nd qtr	1984 3rd qtr	1984 4th qtr	1985 1st qtr	1985 2nd qtr	1985 3rd qtr	1985 4th qtr	1986 1st qtr
Credits												
Earnings on –												
Direct investment	6265	7800	8018	1998	1650	2186	1966	2429	2111	2024	1454	1769
Portfolio investment	2590	3560	5080	723	783	935	1119	1361	1256	1234	1229	1428
Export credit	835	949	1129	233	233	235	248	289	284	291	265	270
External foreign currency lending by UK banks	28936	34551	32724	7566	8060	8946	9979	9283	8317	7487	7637	7241
External sterling lending by UK banks	1299	1719	2694	355	424	467	473	622	653	723	696	607
Bank deposits and lending overseas	1463	2078	2340	441	487	551	599	662	591	554	533	501
Other assets	701	728	689	172	202	169	185	183	164	165	177	185
Total credits	42089	51385	52674	11488	11839	13489	14569	14829	13376	12478	11991	12001
of which:												
Private sector and public corporations	41473	50779	52118	11344	11664	13352	14419	14680	13241	12349	11848	11847
General government	616	606	556	144	175	137	150	149	135	129	143	154
Debits												
Earnings on –												
Direct investment												
Non-oil companies	2418	2936	3330	709	756	683	788	859	968	635	868	761
Oil companies and miscellaneous	2958	3519	4170	1149	833	719	818	1441	923	753	1053	705
Total	5376	6455	7500	1858	1589	1402	1606	2300	1891	1388	1921	1466
Portfolio investment	928	1052	1288	240	263	274	275	268	315	329	376	402
External foreign currency borrowing by UK banks	28785	34548	34148	7445	7898	9278	9927	9664	8849	7892	7743	7563
External sterling liabilities	2423	2726	4114	627	629	712	758	885	1003	1184	1042	1107
Borrowing from banks etc., overseas (1)	1290	1636	1570	375	402	439	420	426	393	372	379	387
Other liabilities	820	943	934	218	240	238	247	271	226	230	207	244
Total debits	39622	47360	49554	10763	11021	12343	13233	13814	12677	11395	11668	11169
of which:												
Private sector and public corporations	37955	45462	47388	10313	10537	11862	12750	13285	12148	10862	11093	10571
General government	1667	1898	2166	450	484	481	483	529	529	533	575	598
Balance												
Total balance	2467	4025	3120	725	818	1146	1336	1015	699	1083	323	832
of which:												
Private sector and public corporations	3518	5317	4730	1031	1127	1490	1669	1395	1093	1487	755	1276
General government	-1051	-1292	-1610	-306	-309	-344	-333	-380	-394	-404	-432	-444

1. Excluding loans to HMG and under the public sector exchange cover scheme which are included under other liabilities.

D

CONFIDENTIAL UNTIL PUBLICATION

Table E

TRANSFERS
Seasonally adjusted

£ million

	1983	1984	1985	1984 1st qtr	1984 2nd qtr	1984 3rd qtr	1984 4th qtr	1985 1st qtr	1985 2nd qtr	1985 3rd qtr	1985 4th qtr	1986 1st qtr
Credits												
Private	1301	1438	1577	347	356	363	372	380	392	400	405	410
General government receipts from EC institutions:												
Budget refunds	807	528	61	-	-	-	528	61	-	-	-	-
Other	1414	1842	1699	629	400	362	451	450	396	550	303	456
Total	2221	2370	1760	629	400	362	979	511	396	550	303	456
Total credits	3522	3808	3337	976	756	725	1351	891	788	950	708	866
Debits												
Private	1485	1603	1736	390	388	396	429	424	427	441	444	458
General government												
Bilateral aid	530	560	573	140	131	142	147	162	129	150	132	118
Payments to EC institutions (1)	2994	3216	3789	782	787	751	896	1137	721	1090	841	279
Other	653	726	761	189	198	167	172	205	210	182	164	216
Total	4177	4502	5123	1111	1116	1060	1215	1504	1060	1422	1137	613
Total debits	5662	6105	6859	1501	1504	1456	1644	1928	1487	1863	1581	1071
Balance												
Private	-184	-165	-159	-43	-32	-33	-57	-44	-35	-41	-39	-48
General government	-1956	-2132	-3363	-482	-716	-698	-236	-993	-664	-872	-834	-157
Total balance	-2140	-2297	-3522	-525	-748	-731	-293	-1037	-699	-913	-873	-205
of which: with EC institutions (2)	-773	-846	-2029	-153	-387	-389	83	-626	-325	-540	-538	177

1. The figures from the fourth quarter of 1985 onwards are net of VAT abatements. £166 million of the abatement in respect of the UK's net contribution to the 1984 European Community Budget was received in December 1985, and £439 million in January 1986. Also included in the first quarter of 1986 is a VAT abatement of £218 million in respect of the UK's net contribution to the 1985 Community Budget.
2. This series does not have the same coverage as that shown in Table 3.3 of 'The Government Expenditure Plans 1986-1987 to 1988-1989' (Cmnd 9702-11). For an explanation of the differences, see section 12 of the 1985 edition of the CSO Pink Book.

E

CONFIDENTIAL UNTIL PUBLICATION

VOLUME, UNIT VALUE AND IMPLIED PRICE INDICES(1)

Table F

1980=100

	1983	1984	1985	1984 1st qtr	1984 2nd qtr	1984 3rd qtr	1984 4th qtr	1985 1st qtr	1985 2nd qtr	1985 3rd qtr	1985 4th qtr	1986 1st qtr
							Seasonally adjusted					
Volume indices												
Exports of goods	103.8	112.5	118.6	109.5	109.1	112.6	118.7	118.6	120.5	116.3	118.9	117.4
Exports of non-oil goods	97.2	105.1	110.6	102.0	102.7	104.3	111.5	109.2	112.1	110.0	111.3	107.6
Exports of services	96.8	100.2	109.2	99.0	99.5	101.1	101.3	105.9	111.7	110.2	109.2	105.5
Exports of goods and services	102.0	109.4	116.3	106.9	106.7	109.7	114.4	115.5	118.3	114.8	116.5	114.4
Imports of goods	109.7	121.9	125.7	113.9	120.2	123.3	130.1	126.6	124.8	124.1	127.4	126.1
Imports of non-oil goods	116.4	128.2	132.9	122.1	126.1	130.2	134.4	131.6	132.4	132.9	134.7	135.1
Imports of services	99.6	101.9	105.1	103.0	102.5	98.6	103.5	105.0	103.2	102.9	109.1	110.7
Imports of goods and services	107.6	117.8	121.6	111.7	116.6	118.3	124.8	122.3	120.4	119.8	123.7	123.0
							Not seasonally adjusted					
Unit value indices												
Exports of goods	125.7	136.0	143.5	131.4	134.3	137.1	141.3	146.4	145.5	141.7	140.5	139.0
Exports of non-oil goods	123.6	133.5	141.8	129.0	131.7	135.2	138.1	142.2	142.8	141.6	140.6	143.0
Imports of goods	127.5	139.7	145.2	133.9	137.6	141.4	145.8	152.3	148.8	141.4	138.3	137.6
Imports of non-oil goods	124.3	136.2	141.9	130.7	134.6	137.9	141.6	147.1	144.7	139.3	136.5	140.0
Terms of trade(2):												
All goods	98.6	97.4	98.8	98.2	97.5	96.9	96.9	96.1	97.8	100.2	101.6	101.0
Non-oil goods	99.4	98.0	99.9	98.7	97.9	98.0	97.6	96.7	98.7	101.7	103.0	102.1
Implied price indices												
Exports of services	129.1	139.9	146.2	137.0	138.7	138.4	145.5	149.5	144.9	143.2	148.1	148.9
Imports of services	137.3	149.6	153.8	145.7	146.2	148.9	158.0	165.5	152.4	146.6	153.5	155.1

1. The methods employed to produce these series are described on page 26 of the 1985 edition of the CSO Pink Book.
2. Export unit value index as a percentage of the import unit value index.

CONFIDENTIAL UNTIL PUBLICATION

Table G

INVESTMENT AND OTHER CAPITAL TRANSACTIONS(1)
Not seasonally adjusted

£ million

	1983	1984	1985	1984				1985				1986
				1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr
Overseas investment in:- UK public sector												
British government stocks(2)	714	781	1438	243	-44	240	342	508	637	452	-159	212
Other	-14	-458	-58	-8	-447	-2	-1	-9	-11	-37	-1	-8
UK private sector	4383	1270	6279	1456	-2668	1601	881	2529	1419	1278	1053	2809
UK private investment overseas	-11413	-14841	-21797	-5291	-818	-4168	-4564	-8152	-4534	-4709	-4402	-5574
Official long-term capital	-380	-327	-310	-171	-11	-8	-137	-88	-48	-45	-129	-85
Import credit(3)	12	172	-13	15	53	39	65	149	-93	-16	-53	4
Export credit(3)	-1552	-673	-194	-297	-190	-61	-125	-35	-104	1	-56	56
Foreign currency borrowing or lending abroad by UK banks	1413	9075	4453	2642	2657	1673	2103	1577	957	-3436	5355	940
Exchange reserves in sterling												
British government stocks(4)	227	188	1482	103	107	-36	14	208	640	-75	709	-164
Banking and money market liabilities(4)	785	1089	95	311	63	256	459	-389	-354	589	249	566
Other banking and money market liabilities in sterling	3167	5160	4089	1332	1853	1508	467	4792	-142	222	-783	3403
External sterling lending by UK banks(5)	-1339	-4718	-1663	-1413	-1104	-1115	-1086	-2912	408	476	365	-1838
UK non-bank private sector transactions with banks overseas(6)	-1444	-2061	-871	8	-163	-1233	-673	-442	457	-1000	114	..
Other borrowing or lending overseas	890	-1265	3832	210	-818	-561	-96	-112	1115	1950	879	-686
Other transactions	-519	-576	31	-65	-163	131	-479	41	108	-15	-103	110
Total investment and other capital transactions	-5071	-7184	-3207	-926	-1692	-1735	-2831	-2335	455	-4365	3038	-255

1. Assets: increase-/decrease+. Liabilities: increase+/decrease-. Excluding official financing
2. Investment by non-residents other than overseas monetary authorities
3. Excluding trade credit between 'related' firms.
4. Transactions of overseas monetary authorities only
5. Excluding credit for UK exports
6. Deposits with and borrowing from banks in the reporting area covered by the BIS: not available for the most recent quarter

CONFIDENTIAL UNTIL PUBLICATION

OFFICIAL FINANCING(1)
Not seasonally adjusted

Table H

[illegible]lion

	1983	1984	1985	1984				1985				1986
				1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr
Official financing transactions(2)												
Net transactions with:												
IMF	-36	-	-	-	-	-	-	-	-	-	-	-
Foreign currency borrowing:												
By HM Government(3)	-	273	405	-	79	194	-	145	-177	-3	440	-36
under the public sector exchange cover scheme	249	135	554	113	-268	-130	420	39	346	84	85	263
Official reserves(drawings on,+: additions to,-)	607	908	-1758	77	857	279	-305	90	-607	-49	-1192	-580
Total official financing	820	1316	-799	190	668	343	115	274	-438	32	-667	-353
Official financing liabilities & official reserves (End of period levels)(4)												
Borrowing from:												
IMF	-	-	-	-	-	-	-	-	-	-	-	-
Other foreign currency borrowing:												
By HM Government	241	613	2187	243	339	573	613	722	512	473	2187	2130
under the public sector exchange cover scheme	5397	6749	5681	5441	5508	5893	6749	6130	6078	5746	5681	6206
Total official financing liabilities	5638	7362	7868	5684	5847	6466	7362	6852	6590	6219	7868	8336
Official reserves	12271	13553	10753	11619	11432	12319	13553	10998	10913	10075	10753	12686

1. For definition see section 10 of the 1985 edition of the CSO Pink Book.
2. Valued in sterling at market-related rates of exchange.
3. Drawings on (+) repayments of (-) euro-dollar facilities arranged with UK clearing banks, a $350 million bond issue in New York and overseas residents' investment in the $2500 million issue of floating rate notes. Also includes assignments to HMG of other public sector debt involving equal and offsetting reductions in foreign currency liabilities taken out under the public sector exchange cover scheme.
4. Gold holdings, Special Drawing Rights and non-dollar currencies have been revalued at March of each year since 1979.
Before revaluation, the level of official reserves was £12298 million at end-March 1984, £12715 million at end-March 1985 and £10991 million at end-March 1986. The level of total official financing liabilities, before revaluation, was £5800 million at end-March 1984, £7098 million at end-March 1985 and £7939 million at end-March 1986.

H

CONFIDENTIAL UNTIL PUBLICATION

INWARD AND OUTWARD INVESTMENT(1)
Not seasonally adjusted

Table I

£ million

	1983	1984	1985	1984				1985				1986
				1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr	2nd qtr	3rd qtr	4th qtr	1st qtr
Overseas investment in UK												
Direct investment												
Non-oil companies												
Unremitted profits(2)	1085	1389	1861	509	505	372	3	628	663	424	146	539
Other	1030	807	-131	250	-168	444	281	136	-247	239	-259	840
Oil companies and miscellaneous	1323	-1771	1494	607	-3140	610	152	1265	-47	95	181	705
Total	3438	425	3224	1366	-2803	1426	436	2029	369	758	68	2084
Portfolio investment in:												
UK company securities	945	845	3055	90	135	175	445	500	1050	520	985	725
UK public sector	700	323	1380	235	-491	238	341	499	626	415	-160	204
Total	1645	1168	4435	325	-356	413	786	999	1676	935	825	929
Total	5083	1593	7659	1691	-3159	1839	1222	3028	2045	1693	893	3013
UK private investment overseas												
Direct investment(3)												
Unremitted profits(2)	..	-4825	-4796	-1339	-968	-1460	-1058	-1614	-1403	-1282	-497	-863
Other	..	-1146	-1721	-392	370	-378	-746	-1418	689	-317	-675	319
Total	-5253	-5971	-6517	-1731	-598	-1838	-1804	-3032	-714	-1599	-1172	-544
Portfolio investment by:												
UK Banks	-2404	-7187	-8715	-2133	-650	-1741	-2663	-1870	-2020	-1950	-2875	-1200
Other financial institutions(4)	-3522	-1618	-4668	-1218	275	-719	44	-2674	-1499	-654	159	} -3830
Other	-234	-65	-1897	-209	155	130	-141	-576	-301	-506	-514	
Total	-6160	-8870	-15280	-3560	-220	-2330	-2760	-5120	-3820	-3110	-3230	-5030
Total	-11413	-14841	-21797	-5291	-818	-4168	-4564	-8152	-4534	-4709	-4402	-5574

1. Net of disinvestment. Assets: increase-/decrease+.Liabilities: increase+/decrease-.
2. Excluding unremitted profits of branches.
3. Includes investment by a number of public corporations.
4. Includes security dealers from 1984.

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I

MRS LOMAX

FROM: SIR T BURNS

DATE: 3 JUNE 1986

Ch

A summary of CG's comments on the Fischer paper. You have Terry's comments from Lorangue.

RL 5/6

Thanks

MR ODLING-SMEE

CONFERENCE ON THE BRITISH ECONOMY

I attach a copy of the remarks that I made to the Sussex Conference about Stanley Fischer's paper "British Monetary Policy".

2. Charles Goodhart was the other discussant and was rather more critical of the paper than I was. He made the following points:

- Fischer attributed too much strategic significance to the Bank of England relative to the Treasury. He should refer to speeches by Nigel Lawson, both as Financial Secretary to the Treasury and Chancellor of the Exchequer; and various editions of the Medium-Term Financial Strategy. Basically Fischer exaggerated the role of the Bank in the operation of monetary policy.

- Fischer's description of the role of interest rates was wrong. There was concern about volatility of interest rates but he gave the wrong impression in suggesting that the Bank had interest rates targets. There was no period of open loop fixed interest rate targets although there had been one or more periods when there was an effective ceiling in place.

- Fischer was wrong about the Bank's handling of the gilt-edged market. The Bank's approach reflected the extent to which the long end of the British market was dominated by a couple of under-capitalised jobbers.

- The advantage of the £M3 target was that it forced the authorities to think about the balance of fiscal and monetary policy; something that the US had failed to do.

- Fischer's remarks about the cyclical adjustment of the FSBR were wrong. The original MTFS did allow for the possibility of some cyclical variation in the PSBR as it was anticipated that this would coincide with an offsetting cyclical variation of bank lending. What had complicated the position in 1981-82 was that the downturn in activity had not brought with it a lower growth of bank lending.

- The problem with £M3 was not inherent in interest-bearing aggregates but simply reflected the fact that its velocity pattern had changed in recent years.

- He fundamentally disagreed with the remarks Fischer made about monetary base control. Clearly the quantity of money and interest rates were related but he did not see that a change of system would change the initial conditions. In other words there was no reason to believe that it would change behaviour if the Bank moved to control the quantity and leave interest rates to be determined by the markets rather than controlling interest rates and leaving the money supply to be determined. The practical difference would be that with MBC violent changes in interest rates would likely occur. The only way that the demand and supply for money could be brought into balance quickly would be by sharp changes to the level of income. This in turn could lead to more volatile monetary growth. As far as he was concerned the chain of causation would run as follows; interest rates - money GDP - MO. This was a recipe for volatile interest rates.

3. The discussion was relatively heated but no very important points of substance emerged.

(Sgd) **T BURNS**

ENC