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PART A

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PART A

MEDIUM TERM FINANCIAL STRATEGY 1984

DDS 25 years NAZ/3 25/08/94

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PART A

NFA59

CONFIDENTIAL

From: J WILLIAMS
Date: 20 January 1984

NOTE FOR THE RECORD

cc Sir T Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Battishill

TIMETABLE FOR FORECAST/MTFS

At the meeting of Second Permanent Secretaries this morning, and in subsequent discussions, the following arrangements for processing the forecast and MTFS were agreed:

(i) The pre-Budget forecast would be circulated on Monday 30 January. On Friday if possible.

(ii) It would be taken by PCC as scheduled on Tuesday 31 January.

(iii) It would then be considered immediately afterwards at the 31 January overview meeting. 11.30

(iv) Sir Terence Burns would prepare a note for both PCC and the overview meeting on the monetary and PSBR ranges to be included in the MTFS. Short note on the numbers

(v) This note would tie in with HF's more technical note on monetary targets. Mr Cassell will try to submit this to Sir Peter Middleton also on 30 January.

This Week End

Part II of FSBR

Forecast – PSBR

3 page reminding + last PSBR + ~~paper that should be~~ on all figures – Forecast

P/Ct.

MTFS – PSBR and Monetary Ranges

(i) Curr PSBR
(ii) Chevening
(iii) [illegible] – Options

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2. This timetable would prepare the Chancellor for his discussion with the Prime Minister on 1 February about the Budget and the 9 February Economic Cabinet. It was also agreed that the Chancellor should be shown by 27 January first drafts of the economic paper for the 9 February Cabinet and drafts of the two public expenditure papers. The objective is for these papers to be in the final form by 1 February

JW.

J WILLIAMS

BUDGET BOX

BUDGET SECRET

COPY NO 1 OF 5 COPIES

From: SIR PETER MIDDLETON
Date: 27 January 1984

SIR T BURNS

cc Chancellor

ALAN WALTERS

I spoke to Alan Walters yesterday. He will not be seeing the PM before he returns to the US - but she has asked him to leave her a note of his ideas on the Budget.

2. I took him through the general lines of our thinking, but said nothing at all about the LTPE exercise.

3. He was more than happy with the general thrust of what we have in mind:

(i) He agrees with the approach to broad and narrow money - though the fact that I had to go into this at some length shows that the FT story by Sam Brittan is going to prove quite a presentational hurdle.

(ii) He is strongly in favour of extending the MTFS period to 5 years.

(iii) As one might imagine from his previous comments he wants to get to zero inflation over the MFTS period. I talked around this with him and he

657/1

agreed that what he really meant was monetary and fiscal conditions by the end of the period pointing to zero inflation after a lag. However, as always in dealing with him on this subject - I avoided talking about the precise time scale in which price stability would be achieved.

(iv) Following this line of reasoning he was strongly in favour of a big fall in the PSBR in the first year - to at least 2½% of GDP in 1984-85, and if possible to as low as £7 billion. He arrived at this by taking into account asset sales, the general strength of the economy, fears about what might happen in the US (not very specific), some concern about inflation prospects plus the need to make a big push at the start of the Parliament. He would definitely want to go this low if it could be achieved without raising taxes and would even contemplate some tax increase.

(v) Thereafter, he wanted to see the PSBR fall preferably to around 1% of GDP by the end of the period.

(vi) He envisaged the range for broad money to come down from 6-10% in 1984-85 by 1% stages each year.

(vii) He was strongly of the opinion that the range for narrow money should start at 2 - 6 as consistent with the present inflation rate and come down by ½% stages. We spent a bit of time chatting about this and explaining the case for a higher starting point, but I suspect that a figure of this sort will appear in his recommendations to the PM.

(viii) He said that if he did not think that the deficit would come down at least to the MTFS proportion of GDP in the Budget he would want to argue for a small immediate increase in interest rates - but given that this was what we were thinking of he was quite content with the present stance of policy. (I suspect on this that Eddie George had tried to recruit him before he came to see me).

4. I said nothing to him about the content of the forecast - but his instinct was that the PSBR in 1984-85 and 1986 would turn out better than in the Autumn forecast, so he thought it would be relatively pointless to reduce the 1984-85 PSBR below £86 billion and stick to a neutral Budget.

5. We then reverted to the package of measures. He greatly liked the Capital Allowances/Stock Relief/CT option - he has no enthusiasm for NIS except as a political ploy, the importance of which he recognises. He also liked PAS (and said that the PM would also be in favour though based on her earlier enthusiasm for the idea). Once again however he saw this in a PSBR reducing light. I tried the argument that some of it could be used for abolishing NIS - because we should be bringing forward a measure the Government should have to do next year anyway. He agreed that this would be logical, but he still did not like it; he was rather worried that this option might look too politically attractive!

6. It goes without saying that he was in favour of stamp duty relief, share options, LAPR (on new contracts only he thought) and CTT. He also liked the idea of extending the VAT base to provide some revenue, without commenting on the particular measures involved.

7. Of course, he would like the credit license duty to cover the whole field including mortgages. But he saw the problem with this. He wondered whether we could get away with a lower rate across the board. And he did think that building society gilts might provide a basis for arguing that there was a certain even handedness between tax provisions affecting the banks and the building societies.

8. All in all pretty satisfactory. Alan Walters usually adopts a hawkish line at this point, and that is not at all unhelpful to us. He was more than happy with the general thrust and structure of our ideas. He was not totally hooked on his numbers. Moreover, he will not be back again before 28 February when he is coming to seem me as soon as he arrives for an update on the position.

PEM

P E MIDDLETON

Budget 1984
Medium Term
Financial Strategy

84 Budget.

cl
Part A.

Chief Economic Adviser to the Treasury

MTFS etc

- Timetable (20/1)
- PEM on Alan Walters (27/1)
- PSBR path (FO3) (6/2)
- C/E MTFS (6/2)
- C/E PSBR path (7/2)
- C/E MTFS (13/2)
- C/E PSBR P/E (13/2)
- FC→FEAG 13/2
- PBM MTFS 20/2
- C/E Forecast 21/2
- C/E MTFS 21/2
- PBM P/E 21/2
- FC MTFS 23/2
- C/E 5 yr MTFS (24/2)
- C/E PSBR (28/2)
- Riley MTFS 28/2
- Minutes MTFS 29/2
- Riley Presentation of MTFS

A59

FROM: T BURNS
DATE: 27 January 1984

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
PCC
Sir L Airey
Mr Fraser
Mr Monck
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Lankester
Mrs Lomax
Mr Riley
Mr Sedgwick

Mr Ridley
Mr Lord
Mr Portillo

THE MTFS: PSBR AND MONETARY RANGES

I attach a note which discusses PSBR and Monetary Ranges for this year's MTFS.

T BURNS

MTFS: MONEY RANGES AND PSBR

Overall Stance

1. It has already been agreed that the MTFS should assume money GDP growth falling to 5-6 per cent by 1988-89. We do not yet have a forecast for the last two years consistent with these assumptions. The focus here is on the first three years, especially next year, though some general points can be made about the later years. The early years will need looking at again when we have a full forecast, to check that they are consistent with an acceptable five year profile.

2. There is much to be said for erring on the low side in setting the PSBR and monetary targets for next year, if the pledge to reduce inflation to zero is to look credible in current circumstances. Money GDP is likely to grow by about 8 per cent in 1984-85, much the same as in 1983-84. Latest indicators suggest real output may be growing more strongly than most outside forecasters are expecting. We do not expect inflation to rise, but the CBI Survey results on prices and costs will be seen as bad news. Recent monetary figures have caused unease in the City. The Bank think markets will be disappointed by a final inflation assumption as high as 3 per cent, which makes it particularly important to avoid giving the impression that policy is being relaxed now.

Money Ranges

3. There will be two target ranges, one for broad and one for narrow money. Monetary ranges indicated in last year's FSBR, suggested in the Chevening, paper and assumed in the latest forecasts, are shown in the attached tables, together with central forecasts for the next three years.

4. For next year, the choice of target range for broad money - £M3 (and PSL2) - is between the 6-10 per cent range suggested in the 1982 and 1983 Red Books, and extending this year's 7-11 per cent for another year. There is a presumption in favour of 6-10 per cent.

This is what the markets and outside commentators are expecting. A higher figure will be seen as an easing in policy, unless we can come up with a very good story. This may not be easy. Possible arguments in favour of a higher target are:-

(i) Velocity has fallen more than we expected a year ago and may continue to do so. The pattern of financial intermediation is probably still changing in ways that inflate £M3 and PSL2. Against this the consumer boom has helped the case of those who argue that the growth in private sector credit is boosting demand.

(ii) Despite high broad money growth, inflation has continued to come down more rapidly than most people expected, and no-one forecasts a dramatic upturn. This is a variant of (i). But high liquidity may make us vulnerable to inflationary shocks, even if it does not immediately fuel inflation.

(iii) A higher range would be needed to allow for the persistent tendency for PSL2 to grow faster than £M3. The latest forecast puts PSL2 growth at the top of a 6-10 per cent range next year. But we have lived with PSL2 1-2 per cent above this year's target. If PSL2 is our main excuse, it could look as if we are upgrading it.

(iv) With money growth likely to be at or above the top of this year's range, the deceleration implied by a 6-10 per cent target might be too sharp. But this argument will not convince those who worry that policy is currently too lax. And recent briefing has emphasised that growth has been running at annual rates of less than 10 per cent over the past six months.

5. There are two <u>internal</u> arguments for a higher range:-

(i) for a given PSBR, a higher money range implies a lower funding requirement. Other things being equal, there might be less pressure on interest rates, and less need to over fund. But interest rates reflect inflationary expectations too, and if 7-11 per cent was badly received, funding could be more, not less difficult.

(ii) the higher starting point could allow us to reduce the ranges by 1 per cent a year over the MTFS period without arriving at very low figures for 1988-89. But if we want to avoid going down in $\frac{1}{2}$ per cent steps there may have to be a standstill somewhere. A high figure for next year means that the standstill is at the very beginning of the period - arguably the worst place of all. A standstill at the end implies that policy has reached some steady state. The best place for a pause would be in the middle of the period.

6. The Bank strongly favour 6-10 per cent. It is not unrealistic if the PSBR is held at £8 bn or lower. And 1 per cent would buy very little extra room for manoeuvre in exchange for the presentational damage.

7. The target for <u>narrow money</u> will apply to M0 (and M2); both newcomers to the MTFS. There is little past information on M2 so the main focus has to be on M0. Few outside commentators have taken a view on the appropriate M0 range. Suggestions cluster around 4-8 per cent and 3-7 per cent. M0 growth has fluctuated between 5 and 8 per cent over the current target period, a large increase on recent years, probably in response to lower interest rates. Treasury and Bank forecasts suggest growth of about 6-6$\frac{1}{2}$ per cent next year. So both 4-8 per cent and 3-7 per cent are possible choices (assuming we retain a 4 point range).

8. The case for the higher range is that:-

(i) there should be a better chance of keeping both M0 and M2 within it (M2 has grown slightly faster than M0 over its short life.)

(ii) it will be easier to construct a smoothly declining profile for the later years (though we may still need a standstill somewhere if we are to avoid going below 0-4 per cent in the fifth year).

9. Both ranges imply a lower growth in velocity than in the past. The EPR article on measuring narrow money commented on "the marked upward trend in velocity, which goes back many years ..... the trend has been relatively stable, though with some slight tendency to accelerate", attributing it to financial innovation which is "likely to result in continuing economies in cash usage". (Velocity has risen by about 4 per cent a year on average over the past twenty years, perhaps 6 per cent a year over the past five: these figures were not quoted in the EPR article.) Reasons for expecting a slowdown in velocity are:-

(i) the relatively fast increase in velocity since 1979 reflects in part the tight policies needed to reduce inflation. As the effects of these policies come through and interest rates fall, there should be a period when velocity grows slowly relative to trend. This is part of the process of adjusting to lower rates of inflation, and is already under way.

(ii) the demand for non-interest bearing assets is likely to be permanently higher relative to income at lower sustained levels of inflation and interest rates.

The lower the range, the less there is to explain.

10. The balance of argument points to 4-8 per cent, although the Bank have argued that if we choose a 7-11 per cent range for broad money, there would be a presentational case for choosing 3-7 per cent for narrow money.

Fiscal Policy

11. The fiscal prospect in the Winter Forecast is set out in tables 4 and 5. The PSBR path is fixed by assumption, but the path of the fiscal adjustment depends on the rest of the forecast, including the forecast of GDP growth. The figures for 1987-88 and 1988-89 have not yet been finalised.

12. The broad picture is that a small positive fiscal adjustment (£½-1 billion) seems to be compatible with an £8 billion PSBR in 1984-85, with the prospect of further tax cuts in 1985-86 (£3½ bn on the assumption of a ¼ per cent PSBR reduction). Thereafter, with North Sea revenues expected to decline, there may be little further scope for cutting taxes,

13. The arguments for a substantial fall in the PSBR in 1984-85, as assumed in the forecast, are as follows:

(i) no progress has been made in the last 2 years in bringing the PSBR down as a share of GDP. Allowing for increased asset sales, there has actually been an increase. The PSFD has also increased as a share of GDP - see Table 5.

(ii) Real interest rates are currently high, probably some way above their longer term values.

(iii) A lower PSBR will make it easier to meet the broad money target, especially if bank lending rises rapidly.

(iv) The market might be disappointed with a figure greater than the £8 billion assumed in the Autumn Statement.

14. There are other arguments which point to a sharp reduction in 1984-85, followed by a flatter profile in the later years:

(i) oil revenues are forecast to have a similar profile to that assumed at Chevening, although over the next three years they are expected to be lower - and declining in nominal terms - see Table 6. Reducing the PSBR after 1984-85 will be made more difficult by this profile of oil revenues, and this argues for making substantial progress in 1984-85 itself.

(ii) The profile of asset sales, with a significant step up in 1984-85 followed by a flat path thereafter, points to an early reduction.

15. The 1984-85 fiscal adjustment is now positive, and so it is possible to achieve a PSBR lower than the £8 billion in the forecast without raising taxes. Moreover it would be perverse to raise taxes this year, since there appears to be scope for significant tax cuts in the next year. But it is important to remember that fiscal adjustment in the second year of the MTFS typically tends to be revised down in subsequent forecasts. And the profile for oil revenues suggests aiming for a low PSBR figure in 1985-86 also.

16. The balance of argument points to a budget which is broadly neutral in PSBR terms. On the basis of the forecast, this would mean not making use of the available fiscal adjustment, and accepting a PSBR below £8 billion. If the PSBR forecast were revised upwards, I would still want to aim for a broadly neutral budget and accept what that implied for the PSBR, provided it did not mean going above about £8½ billion.

17 If, however, the proposal to abolish the PAS system for VAT on imports goes ahead, this would need to be taken into account because:

- the resulting increase in revenue is once-for-all, with no significant effect after 1984-85;

- it may have relatively little effect on money because of offsetting increases in bank borrowing and other sources of finance such as trade credit. A given broad money target would require heavier funding unless the PSBR were also lower.

18. This suggests that only part of any increase in revenue from abolishing PAS should be given away in the form of reductions in other taxes. Other aspects of the composition of the budget package will need to be taken into account in setting the final PSBR number.

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ANNEX

Table 1: BROAD MONEY

			1983-4	1984-5	1985-6	1986-7	
1983 FSBR TARGET			7-11	6-10	5-9		
CHEVENING PAPER				6-10	6-10	5-9	7 6 5
FORECAST	ASSUMED RANGES			7-11	6-10	5-9	
	FORECASTS	£M3	11	8.8*	8.4*	7.6*	
		PSL2	12.9	9.7	9.4	8.5	

* New definition of PSBR and £M3 (excluding public sector deposits)

Table 2: NARROW MONEY (MO)

		1983-4	1984-5	1985-6	1986-7	
CHEVENING PAPER			4-8	3-7	2-6	
FORECAST	ASSUMED RANGES		4-8	3-7	2-6	1-5 0-4
	FORECASTS FOR MO	7.0	6.6	5.9	4.3	

Table 3: INTEREST RATES - FORECAST

	1983-4	1984-5	1985-6	1986-7
SHORT RATES	$9\frac{3}{4}$	$8\frac{3}{4}$	$7\frac{3}{4}$	$7\frac{1}{4}$
LONG RATES	$10\frac{1}{2}$	$9\frac{1}{4}$	$8\frac{3}{4}$	$8\frac{1}{4}$

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ANNEX

TABLE 4: PSBR £BN (% of GDP)

	1983-4	1984-5	1985-6	1986-7	1987-8	1988-9
1983 FSBR TARGET	8(2¾)	8(2½)	7(2)			
of which fiscal adjustment		[½]	[4]			
CHEVENING PAPER	10(3¼)	8½(2½)	7(2)	6½(1¾)	6½(1¾)	6(1½)
FORECAST	10.5(3.5) 2.9	8.0(2.4)	7.8(2¼)	7.4(2)	6.8(1¾)	6.1(1½)
of which fiscal adjustment		[1.1]	[4.9]	[6.8]		
		2.01	2.1	2.05	1.90	1.86

TABLE 5: PSFD £BN (% of GDP)

	1983-4	1984-5	1985-6	1986-7	1987-8	1988-9
CHEVENING PAPER	10(3¼)	8¾(2½)	7½(2¼)	7(2)	6½(1¾)	6(1½)
FORECAST	11.5(3¾)	8.4(2½)	8.6(2½)	8.2(2.2)	7.1(1.8)	6.4(1.6)

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ANNEX

TABLE 6: OIL REVENUES, £BN (% of GDP)

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
CHEVENING PAPER	2.4(1.2)	3.9(1.7)	6.5(2.5)	7.8(2.8)	9.0(3.0)	9.9(3.0)	9.7(2.8)	10.1(2.8)	9.2(2.4)	9.7(2.4)
FORECAST	2.4(1.2)	3.9(1.7)	6.5(2.5)	7.8(2.8)	8.8(2.9)	10.0(3.0)	9.5(2.7)	9.4(2.5)	9.3(2.4)	9.2(2.2)
						·45	·15	−·05	−·15	−·36

TABLE 7: SPECIAL ASSET SALES, £BN

	1982-83	1983-84	1984-85	1985-86	1986-87
1983 FSBR/PEWP	0.6	0.8	1.5	0.5	
FORECAST/1984 PEWP	0.6	1.2	1.9	2.0	2.0

MTFS

1. "MEDIUM TERM FINANCIAL STRATEGY: THE CO-ORDINATION OF FISCAL AND MONETARY POLICIES", CHOURAQUI AND PRICE, OECD WORKING PAPER NO.9, July 1983

2. "PUBLIC SECTOR DEFICITS: PROBLEMS AND POLICY IMPLICATIONS", PRICE AND CHOURAQUI, OECD ECONOMIC OUTLOOK, OCCASIONAL STUDIES, June 1983

The two papers have the same authors and cover similar ground. However, there are some differences (including a switch of senior authors between the two) and this note will be mainly addressed to the first paper which contains a little more material, although I will refer to the differences where relevant.

2. The paper is in two halves. The first describes the fiscal and monetary policy stance since Opec II and analyses the current policy setting. Although both monetary and fiscal matters are discussed the emphasis is very much on the latter. This pattern continues into the second half of the paper which is concerned with the implementation and co-ordination of monetary and fiscal policies.

I. Monetary and Fiscal Stance 1970-80

3. The historical discussion reports the familiar picture of macro-economic policy stance within the OECD since 1970. Chouraqui and Price (CP) use a rather interesting set of charts to illustrate this (attached) which show OECD-wide measures of fiscal and monetary policy. We might perhaps consider using these pictures in our own presentation.

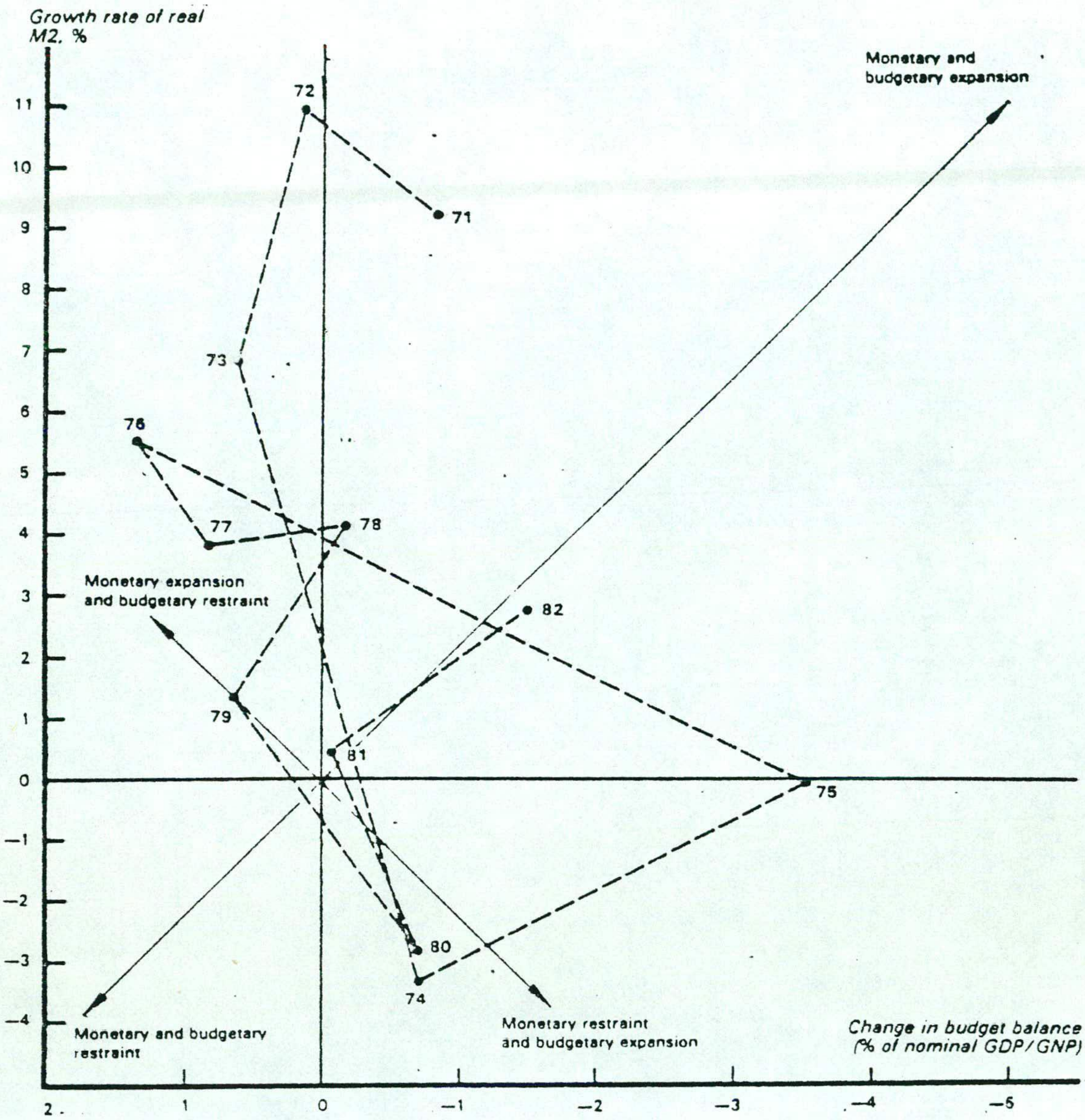
4. Monetary stance is defined in terms of real interest rates and real money growth. Fiscal stance is measured in terms of the actual and cyclically adjusted budget balances. Traditionally the OECD have considered changes in budget deficits to be the relevant indicators of fiscal stance but this paper looks at both levels and changes.

5. Real interest rates are a fairly uncontroversial indicator of monetary stance but measurement is difficult. The OECD papers give little detail on their method of calculation but it looks like they have used annualised rates of consumer price inflation. The indicator is therefore an ex post measure. Moreover, since the nominal interest

CHART 1

FISCAL-MONETARY POLICY MIX IN THE OECD AREA

A. — REAL MONEY SUPPLY, REAL INTEREST RATES AND GENERAL GOVERNMENT BUDGET BALANCES: AGGREGATE FOR THE MAJOR SEVEN COUNTRIES 1971-1982



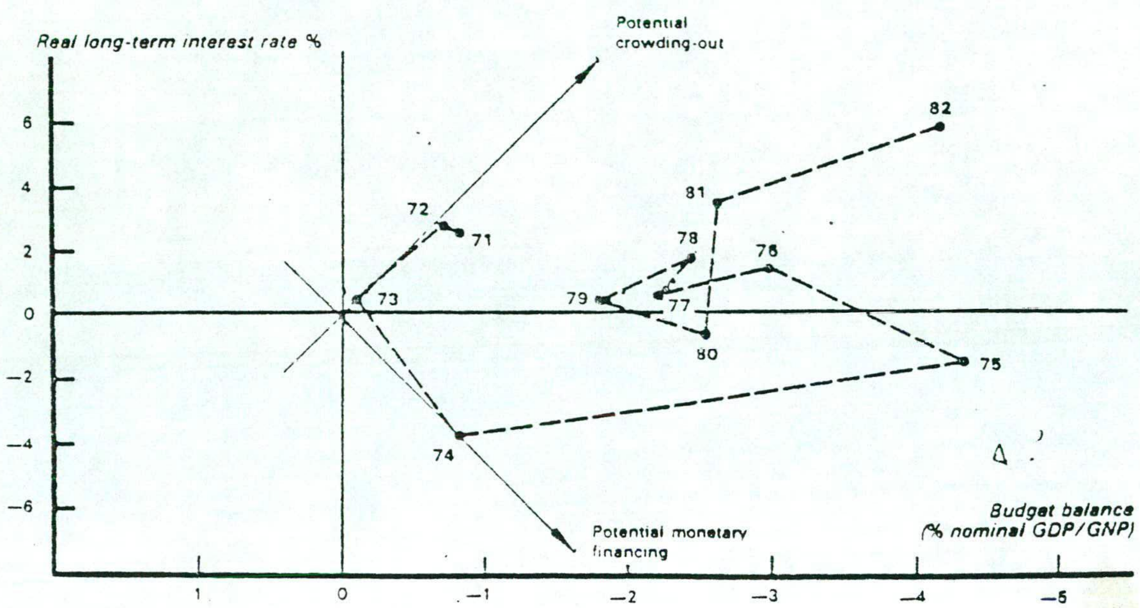
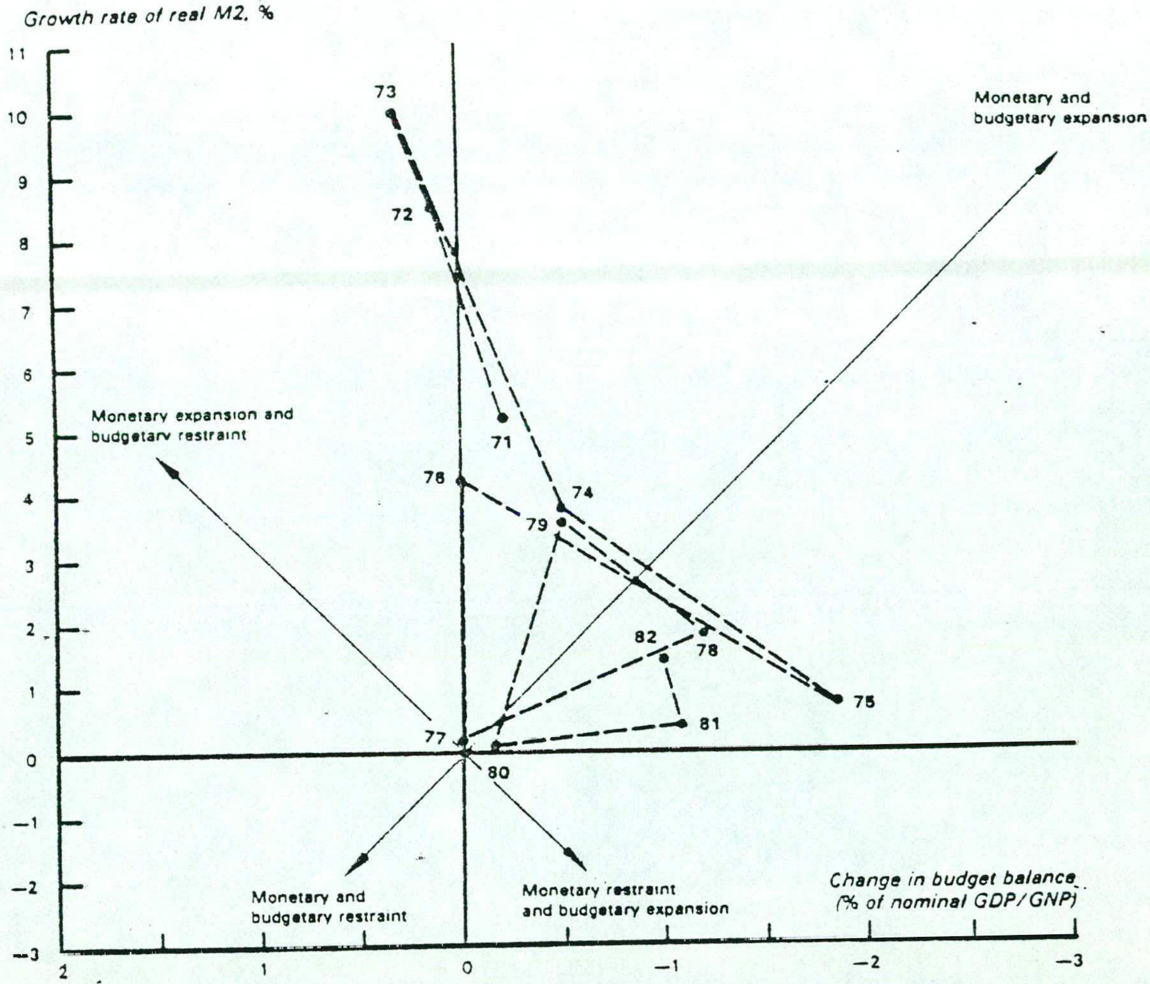


CHART 1 (continued)

FISCAL-MONETARY POLICY MIX IN THE OECD AREA

B. — REAL MONEY SUPPLY, REAL INTEREST RATES AND GENERAL GOVERNMENT BUDGET BALANCES: AGGREGATE FOR SELECTED SMALLER COUNTRIES 1971-1982



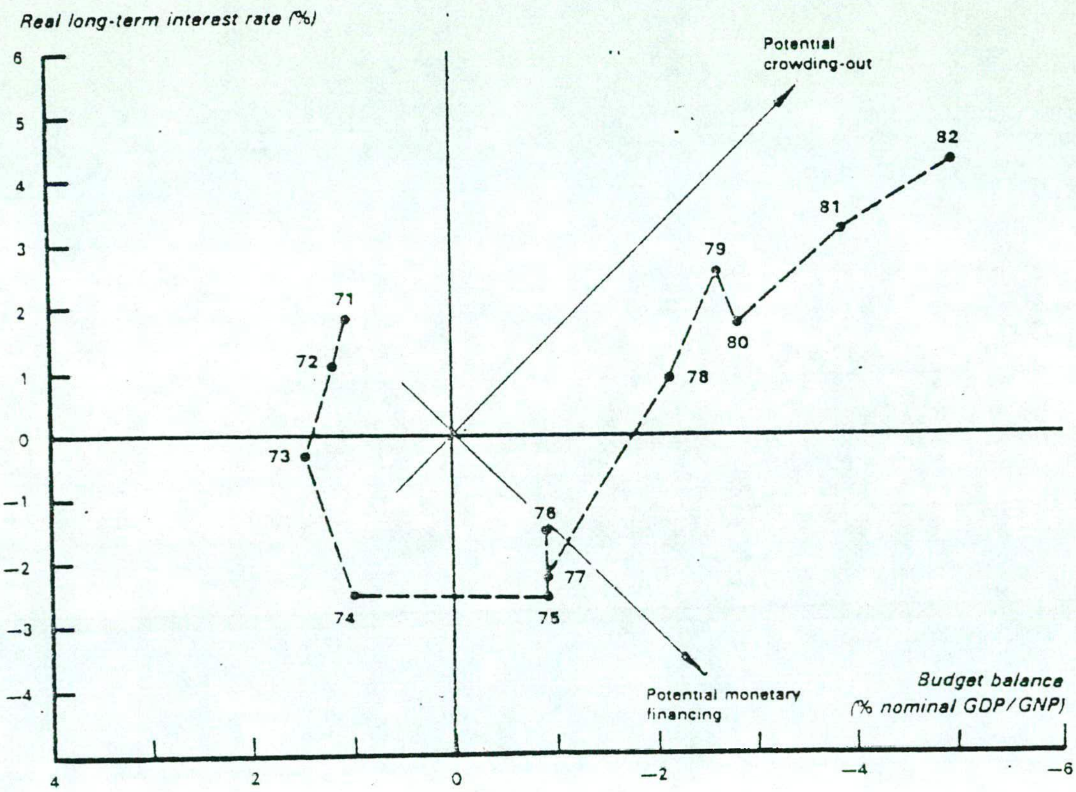
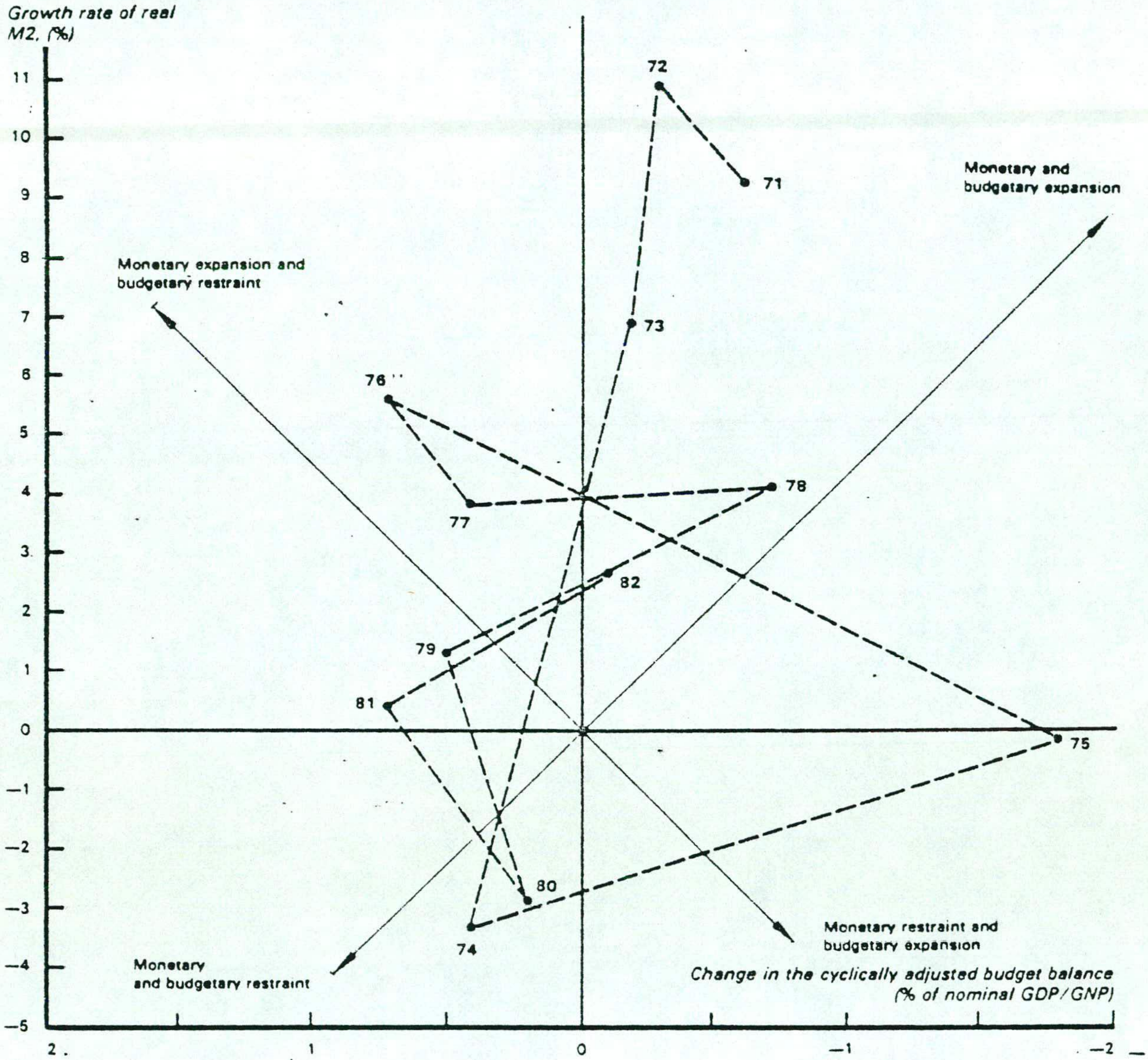
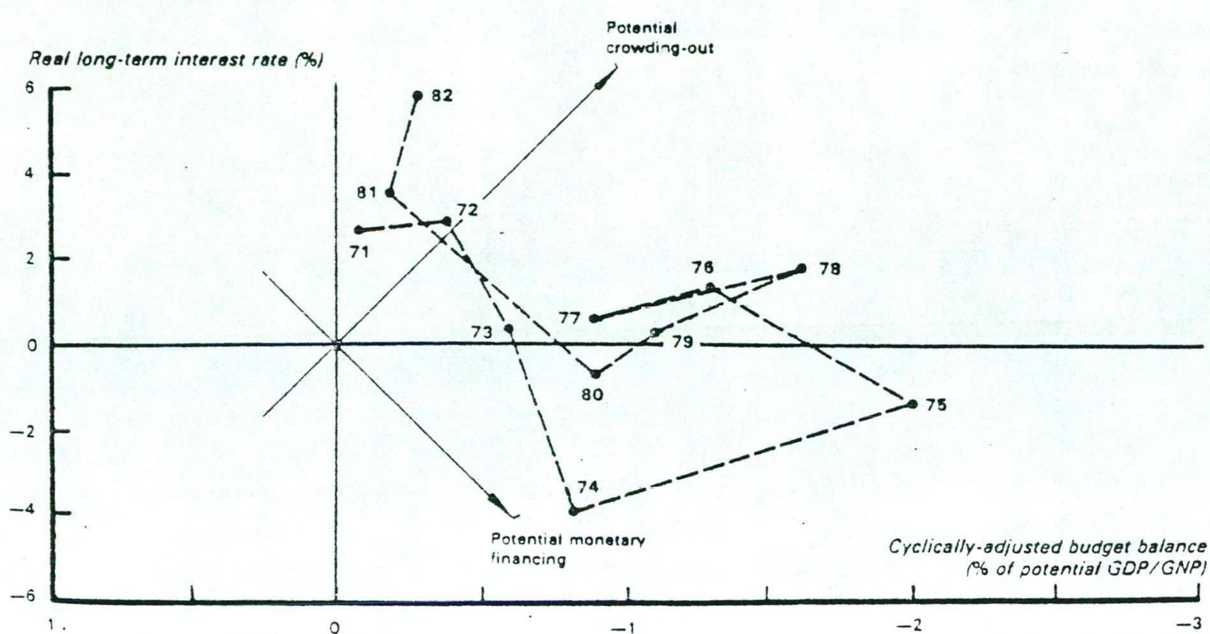


CHART 1 (continued)

FISCAL-MONETARY POLICY MIX IN THE OECD AREA

C. — REAL MONEY SUPPLY, REAL INTEREST RATES AND CYCLICALLY-ADJUSTED BUDGET BALANCES: AGGREGATE FOR THE MAJOR SEVEN COUNTRIES 1971-1982





rate used refers to long-dated assets (20 year gilts for the UK) there is an obvious inconsistency. This is likely to be particularly important for the UK where there have been sharp swings in the level of short term interest rates relative to long rates. The other indicator of monetary stance - real money growth - has fewer measurement problems but does suffer from problems if velocity is trended or real growth is significant. In a sense the deviation of the level of velocity from trend might be a superior measure.

6. The question of whether to measure fiscal stance in terms of levels or changes is a difficult one. At a WP1 meeting earlier this year Poole argued that fiscal stance had very temporary effects on aggregate demand and, therefore, changes in the deficit from year to year were the appropriate indicator. We would probably argue that the level of the deficit was more appropriate and, at least for the purposes of measuring the pressure from fiscal policy on financial markets, tend to play down the significance of year to year fluctuations. The question of whether the deficit should be cyclically adjusted is a familiar one and the arguments will not be repeated here. It is interesting, though, that CP give equal weight to both the actual and cyclically-adjusted deficit but the second paper - which has Price as the senior author - emphasises the cyclically adjusted measure. The inflation-adjusted budget deficit is discussed in the Price and Chouraqui paper but not in CP. This perhaps reflects the fact that countries other than the UK attach little importance to this measure.

7. The authors draw the following conclusions from their measures.

(a) From 1971-72 there was a heavy monetary expansion assisted by some fiscal expansion. The Price and Chouraqui paper emphasises the fiscal expansion rather more. Certainly real money growth was very rapid in these years. But real interest rates were around 2% on the OECD-wide measure.

(b) 1973-74 saw a massive fiscal contraction with a rather less severe fiscal contraction. In fact the monetary contraction occurred entirely in 1974. In 1973 real money grew 7% according to the OECD figure. Moreover, real interest rates fell sharply in 1974, to nearly -4% (fiscal policy was, if anything, mildly expansionary in 1974 compared with 1973). The contradictory signals between the two monetary indicators presumably reflects the effects of a large inflationary shock which reduced both real money and <u>ex post</u> real interest rates.

(c) 1975 witnessed a massive fiscal expansion however measured: a rise of 1.8% of GNP in the total OECD fiscal deficit cyclically-adjusted, and 3.3% unadjusted. Real money growth was precisely zero but real interest rates remained negative.

(d) from 1976 to 1979 CP suggest that fiscal policy contracted overall in the OECD, but not in the smaller countries. This conclusion is based on changes in the budget deficit. The level of the actual fiscal deficit stayed high in these years. The stance of monetary policy is not described (although the widespread tendency to adopt monetary targets was noted) but their two indicators give clear signals: real interest rates were close to zero and real money growth was positive.

(e) CP suggest that policies of fine-tuning had been discredited by 1977-78. Inflation remained a problem but stagnating output led to pressures for reflation. According to CP, countries felt that they could resolve this dilemma by pursuing tight monetary policy enhanced by monetary targets whilst relaxing fiscal policy to boost output. The second oil shock meant that this growth failed to materialise and, in 1980, OECD countries found themselves with recession, inflation and wide budget deficits.

<u>Merits of the CP Method of Analysis</u>

8. Any attempt to generalise the policy stance across many countries over a decade or so will inevitably be superficial. But the scattergrams given in the paper provide a useful illustration of general trends. Of course, their value is limited to the usefulness of the indicators that the authors choose to present and their measures do have drawbacks. Their measure of real interest rates is flawed and we would, I think, have preferred the inflation-adjusted PSBR to be

included as a measure of fiscal stance (it may well have given a quite different impression, particularly during the mid -70s when it may have indicated a contraction in fiscal stance). Some of the scattergrams look like tangled spiders' webs but others, such as the one depicting real interest rates and budget balances for the smaller OECD countries are striking and probably give a much clearer impression than would a table of figures.

II. Recent Policy Stance

9. With swollen budget deficits, uncomfortably high inflation and a major recession, OECD countries faced some difficult policy choices as they entered the 1980s. Generally speaking they have chosen to restrict fiscal policy. CP list a range of considerations that influenced this decision.

(i) "Inflation first" - countries such as the UK and Australia with high past inflation rates saw fiscal restriction as a prior requirement for balanced medium term growth in money and output.

(ii) Budget consolidation - high and rising budget deficits in Japan and Germany were seen to be keeping up interest rates, damaging private investment and creating a potential source of inflationary pressure.

(iii) Debt service burden - this featured in most small countries particularly those with large external debts and more generally in any country with low inflation. The burden of servicing existing debt was felt to be severe and damaging to the economy both in the short term and long term. Scandinavia, Ireland, Belgium and the Netherlands are included as examples of countries where this view was held.

10. Supply side considerations were also becoming more popular but these are not discussed by CP in their historical analysis. Indeed the US approach to fiscal policy - self-sustaining tax cuts as a means of generating increased productivity - does not fit into any of these categories. The US and France seem to have been the only

two countries in this period who, if not actively attempting to raise the fiscal deficit, were pursuing policies that would inevitably have that effect. CP might have examined these two countries' performance relative to other OECD countries and attempted to draw conclusions about the effects of different policy mixes on economies.

Lessons of the 1970-82 Experience

11. The authors principal conclusion from this period is that attempts to cut budget deficits by fiscal contration may fail. *Ex ante* restriction may translate into a bigger deficit *ex post* as a recession is induced and the automatic stabilisers raise welfare spending and reduce taxes. CP believe this process explains the combination of discretionary fiscal tightening and burgeoning budget deficits in 1979 and 1980.

12. Simulations on the Treasury model do not suggest that the offsets to budget cuts are sufficient to generate a perverse response by the PSBR. Such an effect is a theoretical possibility, however. In a simple Keynesian model, the formal condition (which is not considered in either paper) is that the product of the multiplier and the marginal tax (and transfer) rate exceed unity*.

13. The Price and Chouraqui paper gives a table of multipliers for the US, Japan, France, UK and Canada**. These are graded in terms of the effects after 8 quarters and average around 2, those with non-accommodating monetary policy being below this whilst accommodating monetary policy leads to generally higher but more variable estimates. With marginal rates of tax net of transfers probably in the range of 0.4-0.5 this would indeed support the view that *ex ante fiscal contractions would have very limited leverage on budget*

* Define the PSBR as G - T and suppose G is exogenous and $T = LUMP + \alpha Y$ where α is the marginal tax and transfer rate.

Now, if $k = dY/dG$ is the multiplier,

$$\frac{d(PSBR)}{dG} = 1 - \frac{dT}{dY}\cdot\frac{dY}{dG} = 1 - \alpha k$$

** See following page for footnote.

deficits, particularly if several countries tightened policy simultaneously.

14. However, once lags and other effects are taken into account the leverage is probably greater. The lower taxes and additional transfer payments typically occur some time after government expenditure (and hence income) have fallen. This delay may not be important if the deficit is defined on an accruals basis but it is relevant for cash-based definitions such as the PSBR. Debt interest effects also raise the leverage - particularly if nominal interest rates fall in response to lower government expenditure. Estimates from the Treasury model suggest that more than half of a given <u>ex ante</u> fiscal contraction feeds through to the PSBR in the first two years, though obviously this figure varies according to type of contraction and policy assumptions made.

15. CP's argument that <u>ex ante</u> contractions do not reduce <u>ex post</u> fiscal deficits is more convincing when they consider a monetary and fiscal contraction together. In this case nominal and real interest rates are likely to rise, tending to increase the budget deficit and strengthening the tendency of the built-in stabilisers to offset the effect on the deficit of the <u>ex ante</u> fiscal cut. Simulations based on last year's model suggest that a 2% rise in short term interest rates combined with a £1 billion cut in public expenditure would leave the PSBR broadly unchanged in the first two years.

16. CP are obviously worried that the widespread attempts at "budget consolidation" risk plunging the OECD into a deflationary spiral. But even if their thesis were correct and cutting budget programmes were an ineffective way to cut the budget deficit there are other forces that could operate to prevent a deflationary spiral. Chief amongst these is inflation. Recession and fiscal restriction exert downward pressure on prices. Lower inflation eases the stringency of a monetary policy expressed in terms of fixed money

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** Detective work by Mr Ritchie reveals that the source for the UK numbers is Colin Mowl's October 1980 Working Paper. I am surprised that more recent figures were not used. Apparently these would be higher and therefore more in line with the figures quoted for other countries.

supply growth targets and thereby promotes recovery. It also lowers interest rates which cuts the debt interest budget. But it also diminishes the need for fiscal restriction since a desire to lower inflation is often part of the motivation behind a move to fiscal stringency.

17. Although the authors mention the problems associated with setting fiscal policy with reference to the actual budget deficit, they do not come out in favour of the cyclically adjusted measure. Or, at least, substantial arguments against such a strategy are given, but since the paper gives arguments for and against so many strategies it is hard to tell where CP sympathies actually lie. Many of the difficulties with cyclically adjusted measures of fiscal policies that are mentioned reflect points made by Mr Cassell at WP1. The fact that such measures are normally graded in terms of high employment or peak output levels of demand than are unlikely to be sustainable - and therefore invariably indicate a more restrictive fiscal stance than the actual deficit is noted. It is also pointed out that the tax and transfer systems were not designed to be automatic stabilisers and cannot be expected to deliver to correct degree of fiscal response. CP also pick up a point made by Poole at WP1 that built-in stabilisers may, by distorting markets close the gap between actual and potential output not by raising the former but by pulling in the latter. Yet this is not really a point about cyclical policy, it relates to the effect of fiscal policy on trend output.

18. Surprisingly the authors omit the argument about forecast budget deficits advanced by ~~many~~ many delegates at the WP1 meeting on structural budget deficits. This relates to the question of whether a budgetary position is sustainable. The OECD had been arguing that the structural budget deficit was the appropriate indicator of the sustainability of fiscal policy: the actual deficit could be wide providing it disappeared when the economy recovered, but if a structural deficit emerged action to trim the budget would be necessary. Most delegates suggested that cyclical adjustment focused too narrowly on one influence on the deficit and to assess whether current fiscal policy was infeasible it was necessary to project the deficit over a run of years taking account of all relevant influences including demographic

and other factors.

19. It was noted in both papers that pursuing a policy of holding the cyclically-adjusted budget deficit constant over time was acceptable <u>in principle</u> provided that the markets discounted fluctuations in the actual budget deficit due to the cycle and the economy was broadly in equilibrium. <u>In practice</u> these conditions were never met. This point was not accepted in the Price and Chouraqui paper but there is a footnote with the following quotable quote from Samuelson: "An automatic mechanism is set up by discretion, is abandoned by discretion and is interfered with by discretion." In this sense governments choose the response of the budget deficit to the cycle (presumably this applied only to fluctuations that are foreseen). On this argument all movements in budget deficits are discretionary.

20. The policy dilemma facing OECD governments has remained, however. The recession points to expanding fiscal policy but high deficits are seen as a barrier in themselves to economic recovery. Moreover, CP argue that even if "budget consolidation" is <u>necessary</u> for longer run growth it may not be <u>sufficient.</u> There are arguments for pursuing a sustained deficit. CP put the case for this in terms of "excess private savings" without discussing how they are to be determined. There is a limited discussion of how a portfolio demand by the private sector for public sector debt would justify a continuous public sector deficit (along the lines of some of our recent thinking in this area) but this is not developed.

21. The US policy position is discussed separately and CP note that it could be described as either:

(a) expansionary fiscal policy conflicting with given monetary objectives, or

(b) restrictive monetary stance conflicting with given fiscal position.

(a) points to restraining fiscal policy and is the position taken by many non-US OECD members, but (b) - which would suggest easing monetary policy - may also be valid according to CP and they repeat the problem of simultaneous monetary and fiscal contractions being potentially self-defeating. This argument justifies the fascinating conclusion that "monetary and fiscal policy may offer policy-makers nearer one instrument than two".

III. Macroeconomic Policy and Economic Performance: Some Statistical Evidence

22. CP display scattergrams (attached) of some measures of policy stance against indicators of economic performance for various OECD countries averaged over the last ten years. It is difficult to know what to make of the results. In many cases where a significant correlation is obtained the results look sensitive to the inclusion of an outlier such as Japan. The footnote to chart 5c, which shows correlation of 0.39, describes this as "excluding Japan, Italy, and Spain, significant at 20%"-hardly suggesting a clear relationship.

23. Perhaps the most interesting results are those which suggest no relationship eg chart 2A which plots growth against inflation (this is consistent with Chris Melliss'work), chart 5A, growth against the change in government spending, chart 5B, growth against change in government employment and charts 4C and B which relate budget indicators to unemployment and growth. This all suggests that simple cross-section evidence gives little support to the idea that particular policies towards inflation or the budget have systematic affects on growth and unemployment. One apparently striking result is worth mentioning: a positive time series relationship between average OECD nominal long term interest rates and the share of the general government in total net private savings (ie net of capital consumption). Clearly this warrants further study but I suspect it reflects the effect of higher interest rates on the budget deficit rather than a link running the other way.*

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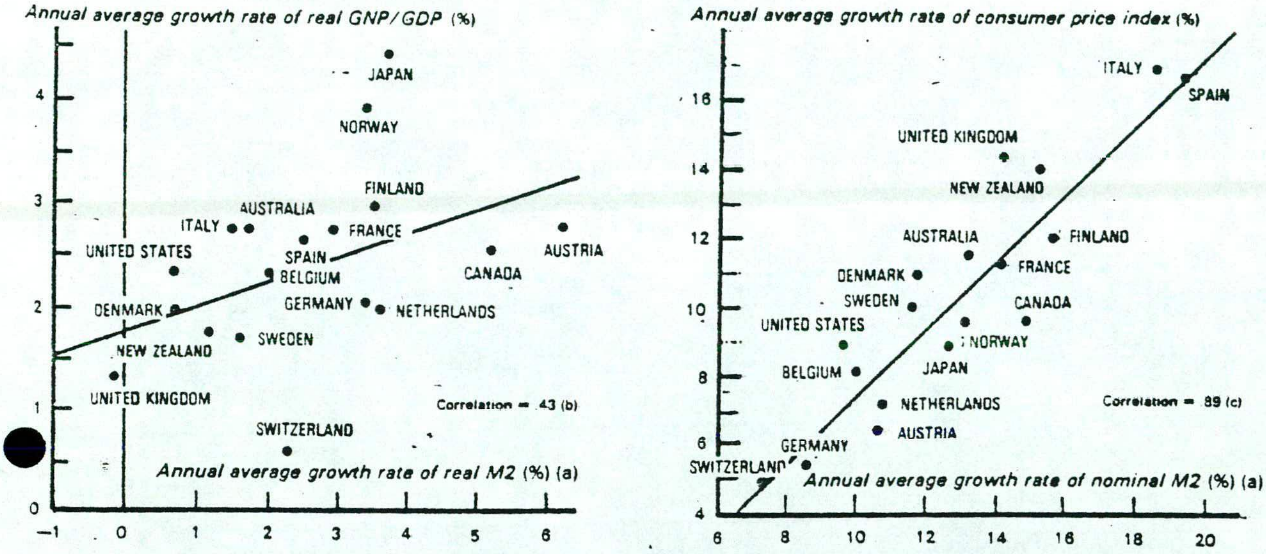
* The public sector is a net debtor, the private sector a net creditor. A rise in nominal interest rates will tend to expand the budget deficit and private savings. Since budget deficits tend to be smaller than private savings, an equal absolute increase in both raises the ratio of the former to the latter.

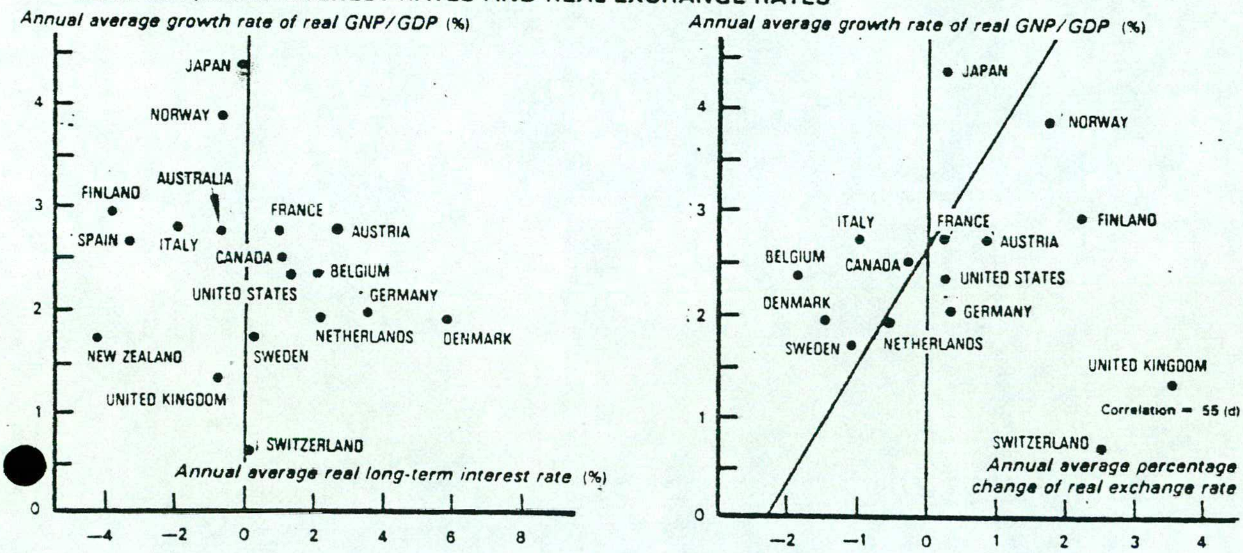
CHART 3

ECONOMIC PERFORMANCE AND INDICATORS OF MONETARY STANCE IN SELECTED OECD COUNTRIES 1973-1982

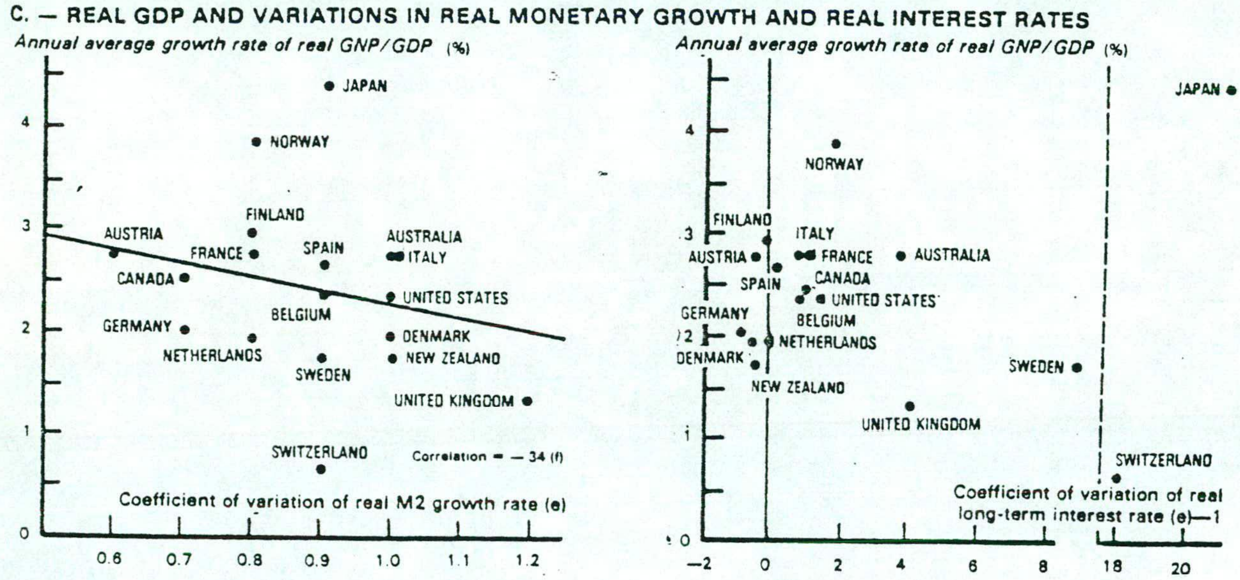
A. — REAL GDP, INFLATION AND MONETARY GROWTH



B. — REAL GDP, REAL INTEREST RATES AND REAL EXCHANGE RATES



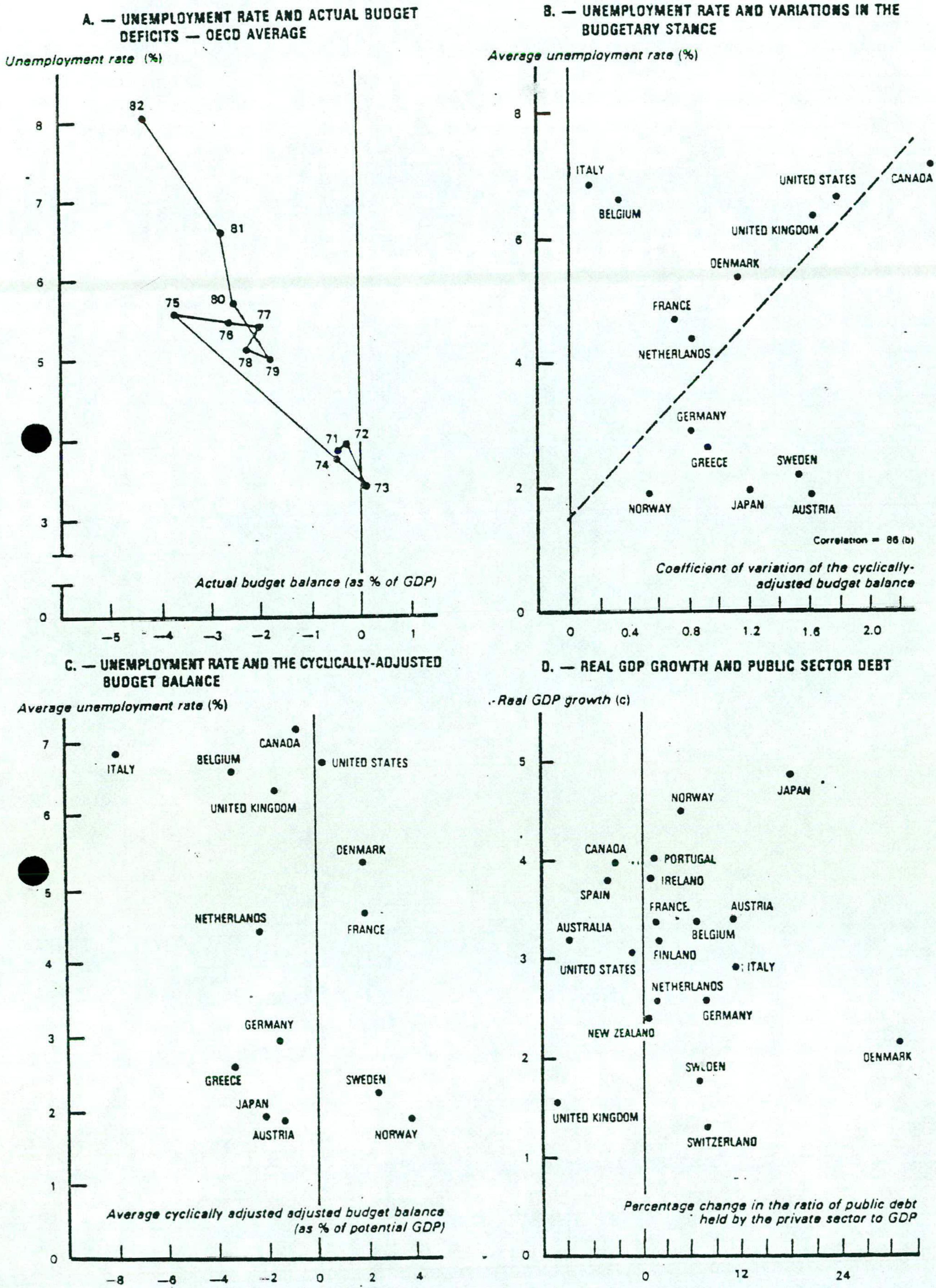
C. — REAL GDP AND VARIATIONS IN REAL MONETARY GROWTH AND REAL INTEREST RATES



(a) M3 for Germany and £M3 for United Kingdom. (b) Significant at 10%. (c) Significant at 1%. (d) Excluding United Kingdom and Switzerland, significant at 5%. (e) Coefficient of variation = standard deviation/mean. (f) Excluding Japan, United Kingdom and Switzerland, significant at 20%.

CHART 4

ECONOMIC PERFORMANCE AND BUDGETARY INDICATORS IN SELECTED OECD COUNTRIES 1971-1982 (a)

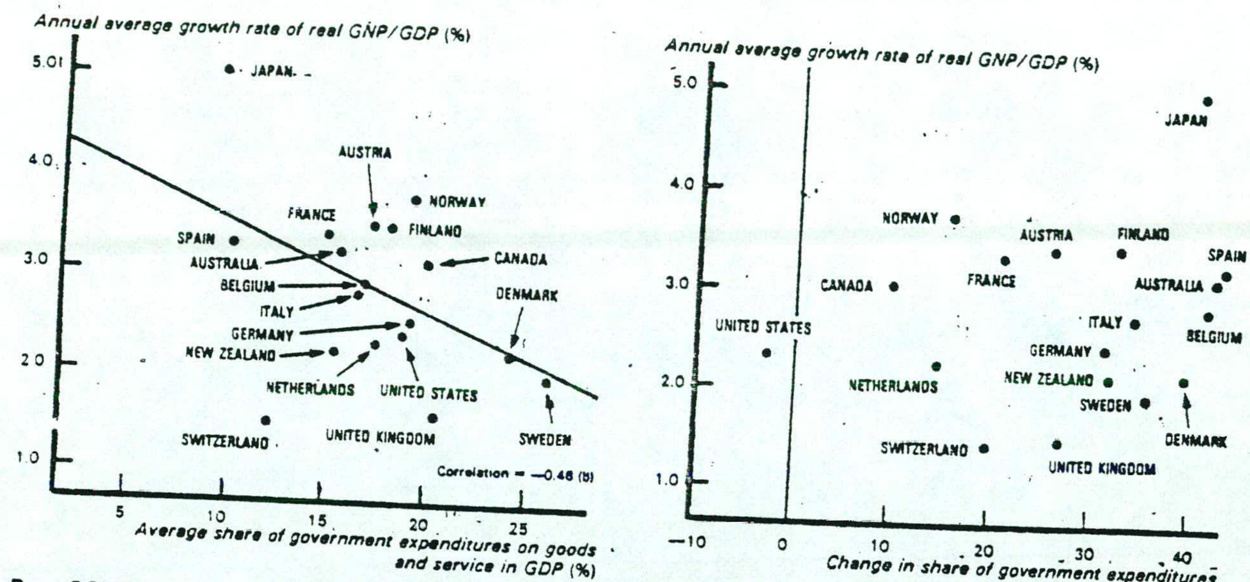


(a) See Annex 1. (b) Excluding Japan, Italy, Austria, Belgium and Sweden, significant at 5%. (c) Average annual real GNP/GDP growth rate.

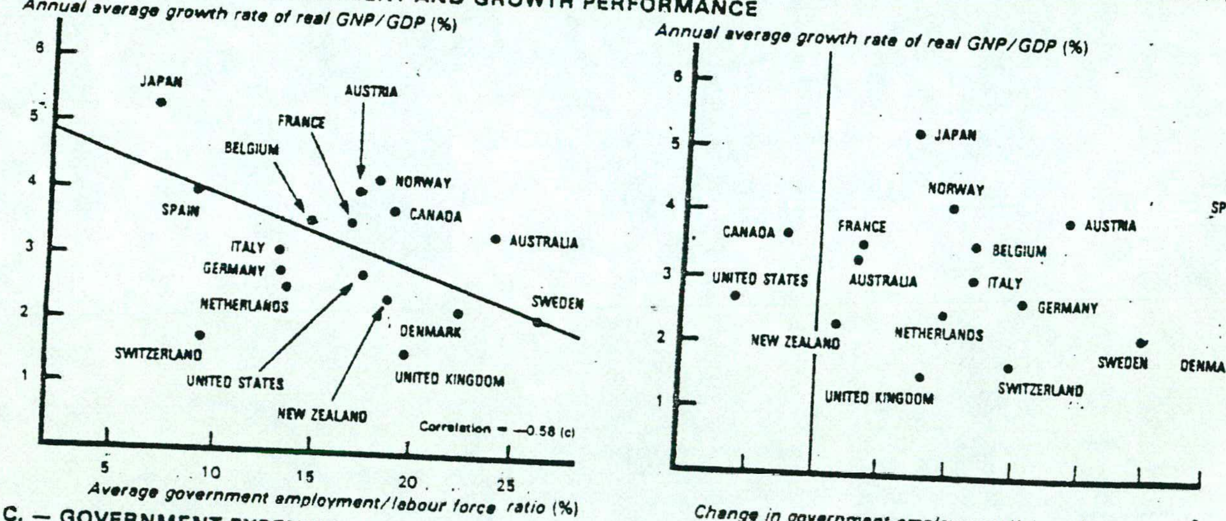
CHART 5

ECONOMIC PERFORMANCE AND THE EXPANSION OF THE GOVERNMENT SECTOR IN SELECTED OECD COUNTRIES, 1970-1982 (a)

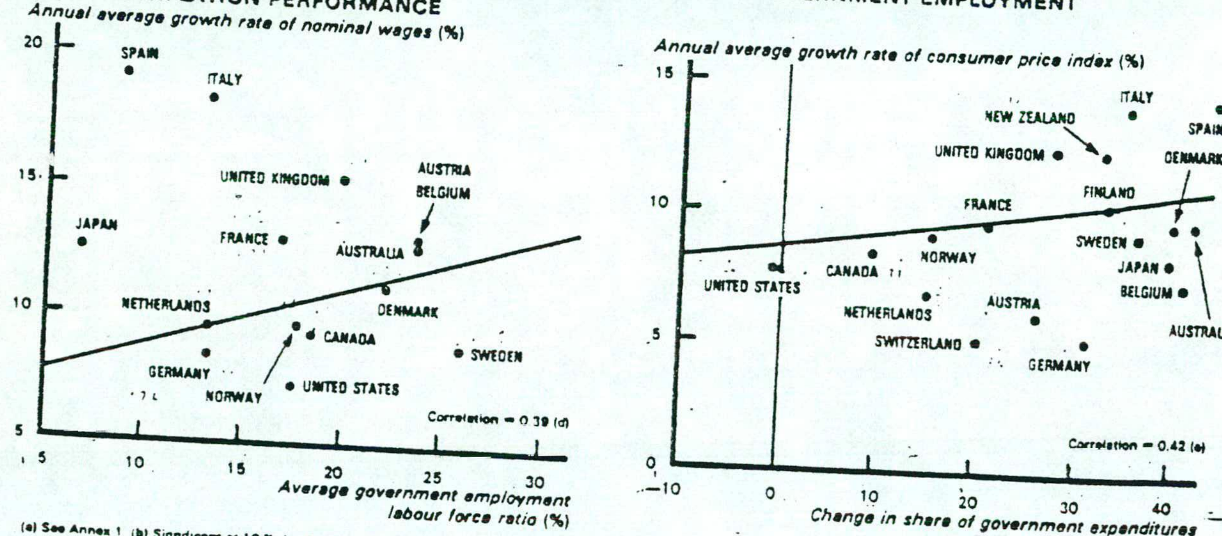
A. — GOVERNMENT EXPENDITURES ON GOODS AND SERVICES AND GROWTH PERFORMANCE



B. — GOVERNMENT EMPLOYMENT AND GROWTH PERFORMANCE



C. — GOVERNMENT EXPENDITURES ON GOODS AND SERVICES, GOVERNMENT EMPLOYMENT AND INFLATION PERFORMANCE

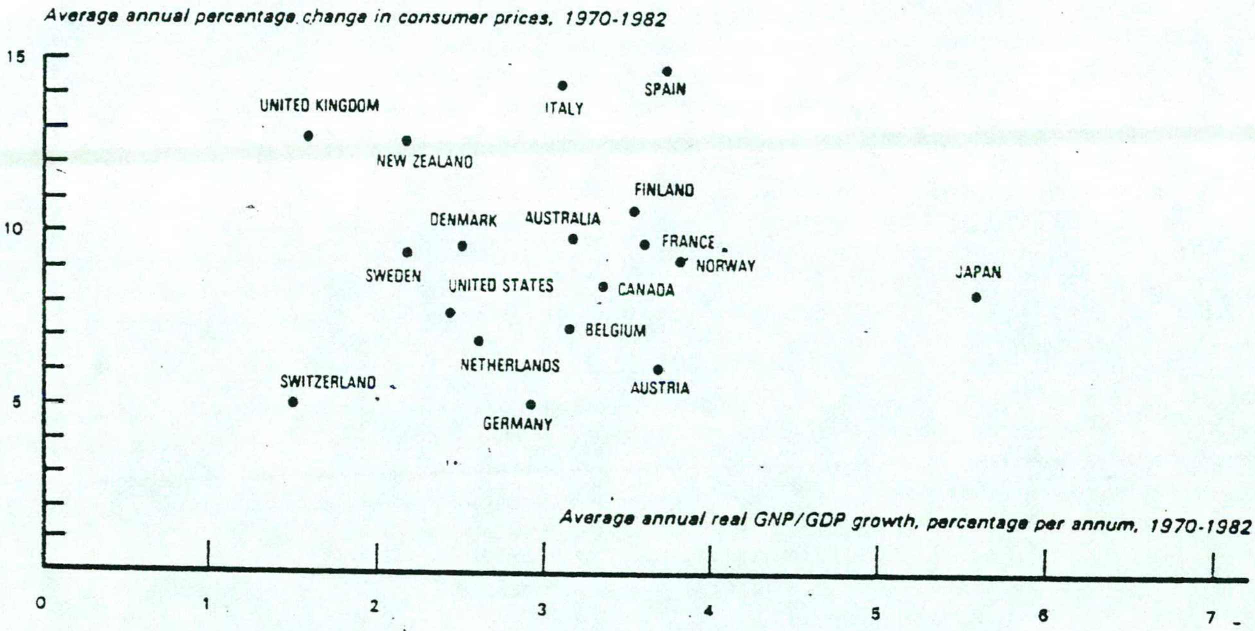


(a) See Annex 1. (b) Significant at 10 %. (c) Excluding Switzerland, significant at 5 %. (d) Excluding Japan, Italy and Spain, significant at 20 %. (e) Excluding Germany, Austria and Switzerland, significant at 20 %.

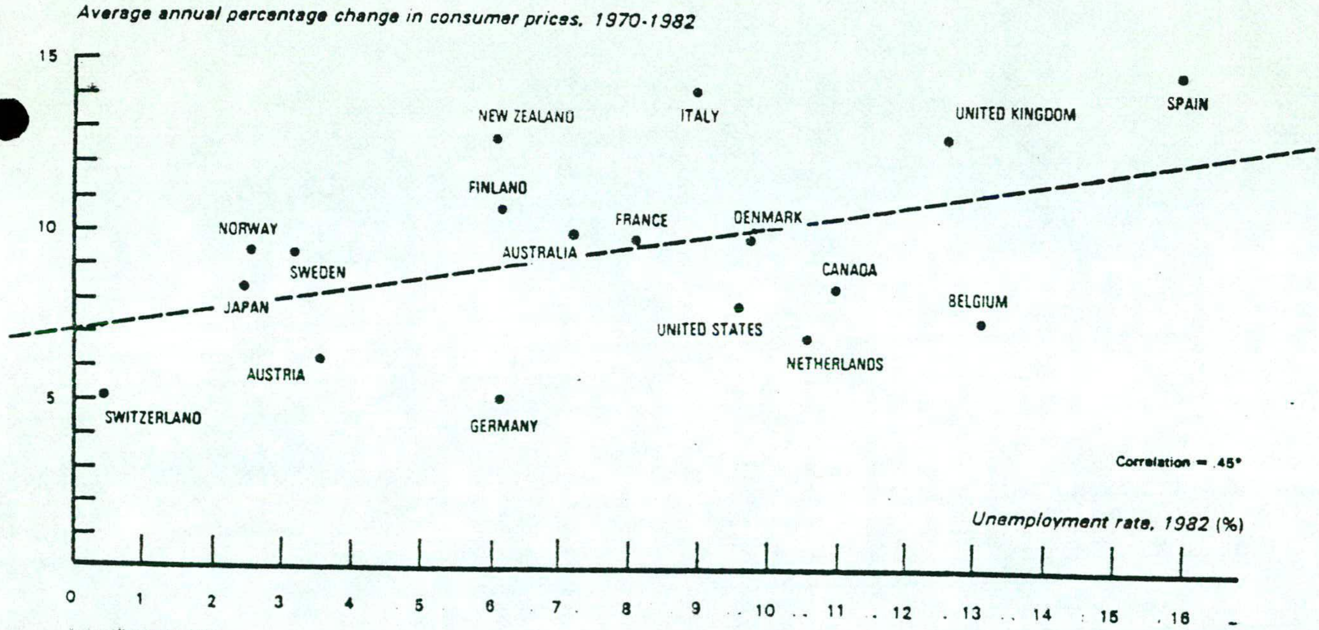
CHART 2

INFLATION, GROWTH AND UNEMPLOYMENT PERFORMANCE IN SELECTED OECD COUNTRIES

A. - REAL GDP GROWTH AND INFLATION



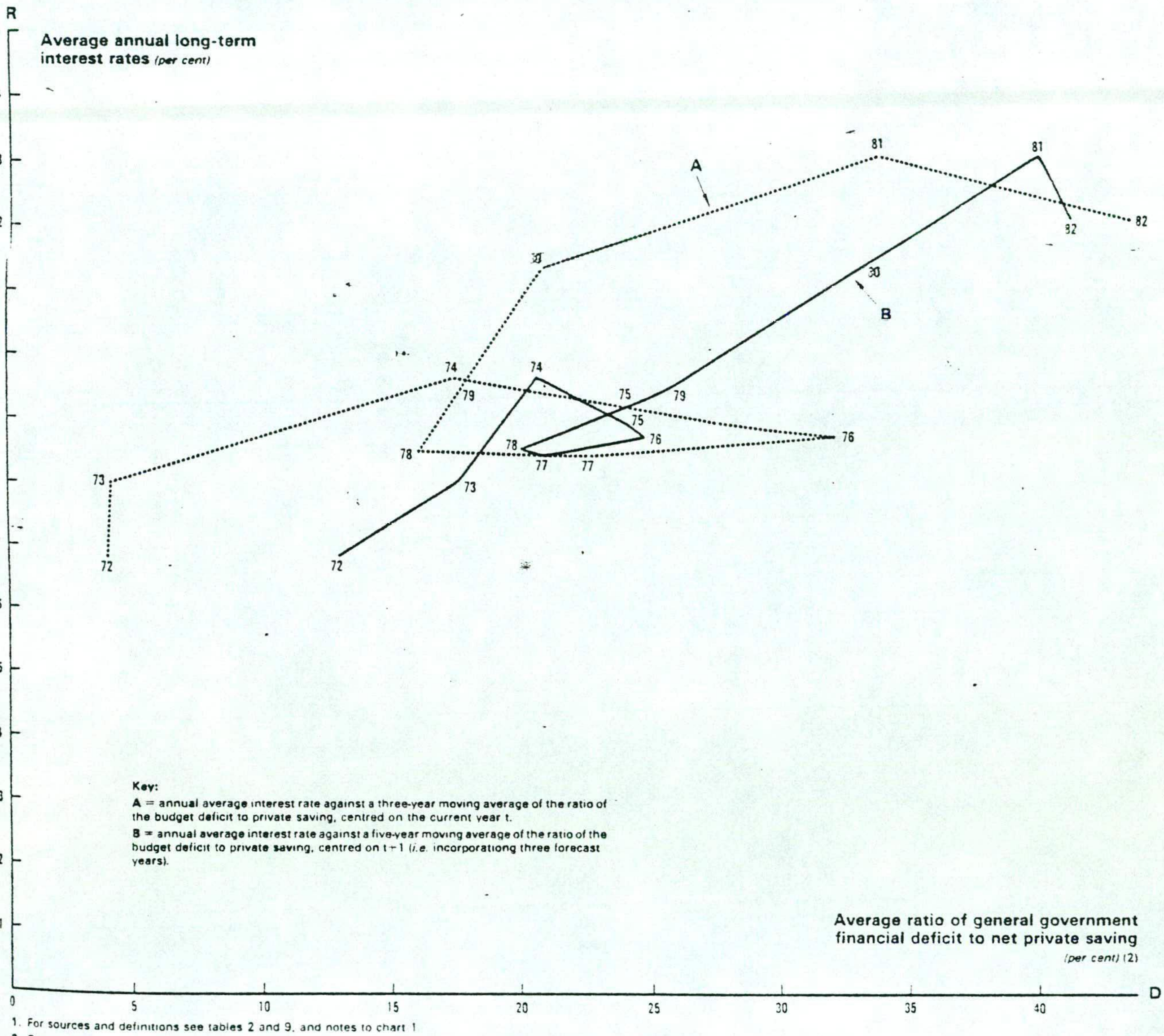
B. — UNEMPLOYMENT RATE AND INFLATION



* significant at 10%

CHART 2

LONG-TERM INTEREST RATES AND THE PROJECTED SHARE OF PRIVATE SAVINGS TO BE TAKEN UP BY THE GENERAL GOVERNMENT IN THE SEVEN MAJOR OECD COUNTRIES, 1972-82 (1)



1. For sources and definitions see tables 2 and 9, and notes to chart 1.

2. Regressions with a dummy equal to 1 in 1975 and 1976 yielded the following results:

A: dr/dD = 0.14 (t = 4.60) R2 = 0.73 R = 0.85

B: dr/dD = 0.20 (t = 11.20) R2 = 0.94 R = 0.97

IV Public Expenditure and Debt Trends

24. CP describe experience in the OCED area since 1970. Overall the share of general government expenditure in GNP in the OECD has risen from 32½% to 40% over the period 1970-1982. The greatest increase was in Sweden (24 percentage points) the slowest was in the US (3%). The extent to which the US profile reflected the cut in defence spending following the Vietnam War is not discussed. But OECD public investment has fallen from 17% to 11% of total public spending between 1970 and 1982, whilst general government net savings are now negative compared with 3% of GNP in 1970. Many countries such as Germany are more concerned with eliminating negative government savings than the size of the fiscal deficit <u>per se</u> and even more see a rising public sector debt/GNP ratio as the prime fiscal impediment to growth. Only in the UK, US, Spain and Australia did the debt:income ratio fall during the period 1971-1980. External debt within the OECD has risen from 3.1% of GNP in 1975 to 6.5% in 1980 and a small number of countries accounted for a disproportionately large share of this increase. Alone amongst OECD countries, the UK reduced its external debts over this period. The rising level of public sector indebtedness together with the rise in interest rates has led to a doubling of debt service costs (as a % of GNP) in the OECD since 1970.

25. I was surprised that CP do not make more of the role of nominal interest rates relative to the growth in nominal income. As a matter of simple arithmetic a continuous budget deficit on public sector current expenditure cannot be sustained if nominal interest rates exceed the nominal growth rate. When the big fiscal expensions took place in the mid-1970s nominal interest rates were well below the nominal growth rate and financing budget deficits was relatively easy. In the 1980s the position is reversed causing severe problems for those countries whose budget deficits were excessive particularly countries where unexpectedly low growth and high unemployment had swollen the deficit.

CP do mention the role of the real rate of return on public investment and there are occasional vague references to the level of interest rates and the sustainability of budget deficits, but these arguments are not developed.

A66

FROM: C MELLISS
DATE: 2nd February 1984

Budget folder

MR ODLING-SMEE

cc Sir T Burns
Mr Riley
Mr Mackinnon

OUTSIDE FORECASTS OVER THE MEDIUM TERM

I attach a table, summarising outside forecasts of output and inflation (CED), prepared by Mr Mackinnon.

I have added a final column excluding the Liverpool forecasts.

On output the internal forecast looks quite pessimistic over the last 3 years compared with the average of outside forecasters - it is lower than any of them.

On inflation the internal forecast, perhaps consistently with its view on output, has a significantly lower inflation path than any of the outside forecasters except Liverpool. The continuing deceleration which will be shown in the MTFS is quite at odds with the message from the outside forecasts.

The gap between the internal forecast and the average of outside forecasts is significantly larger than it was this time last year, as the following figures show:-

	GDP		Inflation	
	Average	HMT	Average	HMT
1983	1.7	2.1	6.4	6.8
1984	2.0	2.4	7.2	7.2
1985	1.7	1.9	7.9	7.4

39/2

The outside forecasters recent record on inflation has not been very impressive - so we are probably justified in discounting their views in casting the MTFS numbers.

C L Melliss

C MELLISS

OUTSIDE FORECASTS

MEDIUM TERM PROJECTIONS OF OUTPUT AND INFLATION

Calendar years % change	LBS	NIESR	P & D	S & C	Henley	CE	Lpool	BOE	Average	Average excl L/pool	Sum 49
Output											
1984	2.4	2.0	2.4[a]	1.8	2.4[b]	2.1	3.7[b]	2.6	2.4	2.2	3.2
1985	2.4	1.0	1.2[a]	1.6	1.4[b]	1.4	3.0[b]	1.4	1.7	1.5	2.5
1986	1.7	–	1.0[a]	0.9	1.2[b]	1.2	4.3[b]	–	1.7	1.2	1.5
1987	1.1	–	1.5[a]	1.0	1.5[b]	1.5	4.4[b]	–	1.8	1.3	1.0
1988	–	–	1.2[a]	–	1.7[b]	1.3	–	–	1.4	1.4	0.7

Notes:
a. average measure
b. expenditure measure

Inflation (consumer expenditure deflator)	LBS	NIESR	P & D	S & C	Henley	CE	Lpool	BOE	Average	Average excl L/pool	Sum 49
1984	5.9	5.9	5.8	5.9*	6.0	6.3	3.3	5.8	5.6	5.9	4.9
1985	6.3	6.6	5.3	5.4*	6.5	6.3	1.2	6.1	5.5	6.1	3.9
1986	6.9	–	4.2	5.1*	7.4	5.8	0.7	–	5.0	5.9	3.9
1987	7.5	–	5.0	5.7*	8.1	8.0	0.7	–	5.9	6.9	4.2
1988	–	–	6.1	–	9.2	7.5	–	–	7.6	7.6	4.0

Note:
*retail prices

Sources:
London Business School (Economic Outlook) – October 1983
National Institute Economic Review – November 1983
Phillips and Drew (Economic Forecasts) – January 1984
Simon and Coates (Economic Analyst) – January 1984
Henley Centre (Framework Forecasts) – January 1984
Cambridge Econometrics (Forecast Report) – January 1984
Liverpool MacroEconomic Research Group – December 1983
Bank of England – Winter 1983 Domestic Forecast

Timetable: Next couple of weeks

Credibility over presentation

Gained by sticking to it as closely as possible

- M1; XR; Numbers -

Broad [illegible]

CONFIDENTIAL

FROM: T BURNS
DATE: 3 FEBRUARY 1983

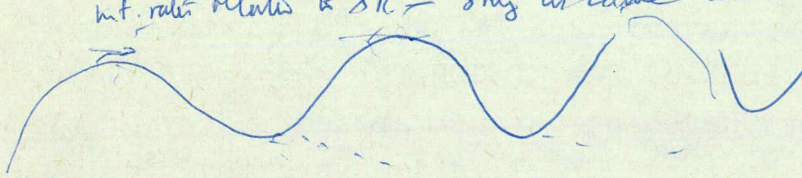
CHANCELLOR

cc. Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (R)
Minister of State (C)
PCC
Mr Cassell
Mrs Lomax
Mr Odling-Smee
Mr Monck
Mr Evans
Mr Sedgwick
Mr Shields
Mr Riley
Mr Ridley
Mr French
Mr Harris

* Not too far on M1. Stick to AMS words.

Don't want to say £M3 at lower end. But [illegible]

* XR should be kept. Helpful if acknowledge that int. rates related to XR - Stay as came down.



THE MEDIUM TERM FINANCIAL STRATEGY

1. I attach a paper by MP reviewing the main issues involved in updating the MTFS.

2. The first question is whether the Government will want to re-affirm its commitment to reducing inflation, given the low level from which we start and the generally flat or slightly rising profile for inflation shown in the latest internal forecast. We assume that the answer to this is yes; and that the text and figures in the MTFS will need to be broadly consistent with this aim. We also assume that you will want, as last year, to show a growth in output at least in line with productive potential.

3. Given this objective we need to have decisions on the choice of monetary guidelines, PSBR ratios and the illustrative assumptions for inflation and output. Work on the MTFS projections can then get under way.

Monetary Guidelines

4. On monetary guidelines my inclination is to go for the higher of the two runs of figures shown in the paper (table 2). These are the same as published in the last MTFS with the extra year added showing a further one point deceleration. I am eager to avoid being seen to accommodate monetary policy to a lower inflation rate. The maintenance of a given nominal framework as inflation falls is the most persuasive argument for why recovery will emerge. The higher range also enables us to say that we are expecting M1 to grow at or above the top of the range while £M3 is expected to be in the lower part of the range.

PSBR

5. I would prefer to stay with variant A for the PSBR path (table 5 of the paper). This shows a PSBR of $2\frac{3}{4}$% of GDP for 1983-84 falling to 2% of GDP by 1985-86. In the Chevening paper I argued in favour of publishing a PSBR of £8 billion for 1983-84; a downward revision would not be easy to justify given that output is now a little lower than expected at the time of the last Budget. Such a profile will also give an extra bit of flexibility for 1984-85 and 1985-86.

6. If you choose £$7\frac{1}{2}$ billion for the 1983-84 PSBR then we have little option other than to choose variant B for the later years.

Economic Assumptions

7. For the economic assumptions I see little difficulty in projecting a growth rate of $2\frac{1}{2}$% per annum.

8. The profile for inflation is more difficult. Undoubtedly there is a very large margin of error surrounding the assumption for 1985-86, but it is unwise to push optimism too far, given:

i. the most recent forecast

ii. the extent to which the recent inflation decline has a number of temporary factors associated with it

iii. the prospects for world prices as world output recovers

iv. the various external forecasts.

I am inclined to opt for the alternative assumption A in table 9. It does not show much further progress on inflation but it does show a continuation of low inflation whilst pointing in the right direction.

9. In broad terms there will be two conflicting influences on inflation over the next two-three years both in the UK and the world as a whole:

i. a low <u>level</u> of output; continuing excess capacity, will exercise downward pressure on inflation

ii. an improved <u>growth</u> of output; putting some upward pressure on inflation if the very low real level of commodity prices recovers (and maybe also profit margins).

It is difficult to judge the balance of these factors. Most commentators are putting a lot of weight on (ii). This may be pessimistic but there are risks of credibility in departing too far from the consensus.

<u>Other Aspects</u>

10. Whichever option is chosen, we need to look again at what is said (or implied) about:

i. the exchange rate

ii. M1 and, more generally, the status of the different aggregates.

Ministers have already seen a paper by M1 by Mr Monck, and that discussion is not repeated in this paper. Discussions about the monetary ranges could have implications for the status of the different aggregates. On the exchange rate, we suggest sticking as closely as possible to the formula used last year.

<u>Next Steps</u>

11. We hope to discuss this paper with you next week and in the mean-time hold separate discussions with the Bank and Alan Walters.

TB

~~T BURNS~~

MEDIUM TERM FINANCIAL STRATEGY

1. This note raises the main issues involved in presenting the MTFS and extending the monetary guidelines and fiscal projections to 1985-86. They relate to:

(1) what is said about the broad objectives of policy;

(2) the financial framework: the monetary targets for 1983-84 and the guidelines for the later years; what is said about other financial indicators, including the exchange rate; and the PSBR assumption for the later years;

(3) the assumptions needed to construct the economic projections underlying the revenue and expenditure tables.

The monetary guidelines will need to be discussed in more detail with the Bank. But it is useful to take a preliminary look at all the main issues at the same time, to ensure broad consistency between different elements of the MTFS. The final section of the paper outlines two main options.

Objectives

2. The MTFS has always opened with a general statement of the Government's medium term objectives. In 1980-81 and 1981-82 this read:

"The Government's objectives for the medium term are to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment."

Last year was a bit more explicit (as some commentators noted):

"The Government's objective is to continue reducing the rate of inflation, thereby promoting a sustainable growth of output and employment."

going on to add:

"The Government's policies are directed at achieving a rate of inflation that is well into single figures."

This objective has never been qualified though we have increasingly acknowledged that the financial policies needed to achieve it are, to some extent, contingent on world events and UK productivity performance. Nor has it been quantified, though last year we published illustrative assumptions about the inflation rate, as background to the fiscal projections.

3. The rise in the GDP deflator in 1981-82 was over 11%; in 1982-83 it is likely to be around 7% (slightly lower than the 7½% forecast this time last year). We think that present policies are unlikely to be consistent with a further significant or lasting reduction in the inflation rate, at least over the period covered by the MTFS; our best guess (inevitably uncertain) is that it will be broadly flat, possibly showing some tendency to rise as the economy recovers.

4. The Chevening discussions implied that Ministers are ultimately aiming for a further reduction in the inflation rate (a view reflected in some recent Ministerial speeches), but felt that a fuller discussion of the medium term strategy needed to achieve this should wait until after the election. This could create problems. Given the low level from which we start, a clear statement that the Government is aiming for a further reduction in inflation may look (and be) inconsistent with monetary guidelines and other assumptions similar to those we used last year.

5. It is, of course, helpful to emphasise the progress that has already been made. But we assume that Ministers will want to reaffirm the commitment to reducing inflation and to support this by signalling some further movement in **this** direction over the **period** of the MTFS. If this is correct, the opening sentences might be redrafted on the following lines:

"Government policies have achieved a rate of inflation that is well into single figures. The objective ~~for~~ over the medium term is to continue reducing inflation, and to promote a sustainable growth in output and employment."

The rest of this paper considers how we could make the text and figures in the MTFS consistent with a modest further fall in the inflation rate over the next three years.

The 1982 MTFS

6. The monetary ranges for broad and narrow money, the PSBR assumptions, and the illustrative figures for inflation and real and money GDP shown in last year's MTFS are summarised in Table 1; the estimated outturn for 1982-83 is in brackets.

TABLE 1. Guidelines and Economic Assumptions 1982 FSBR

% change on a year earlier	1982-83		1983-84	1984-85
Money	8-12		7-11	6-10
M1		(12½)		
£M3		(11¼)		
PSL2		(9¼)		
PSBR £bn	9½	(7.9)	8½	6½
as % GDP	3½	(2.9)	2¾	2
Prices (GDP deflator)	7½	(7)	7	6½
Real GDP	1¾	(¾)	← 2½	→
Money GDP	9.8	(8)	9.6	9.4

7. With monetary growth at the centre of the range, these figures implied little change in velocity over the period, and a significant growth in real money balances, consistent with the expected recovery in output. The FSBR also said that the ranges had been constructed on the assumption of "no major changes in the exchange rate from year to year". The exchange rate is now over 10% lower than it was in the first quarter of 1982. However, the outturn for 1982-83 may not be too different from that envisaged in last year's MTFS (though the time path has, not surprisingly, been more uneven) : an estimated outturn for the effective rate of 88, compared with a forecast of 87½.

Monetary Guidelines

8. Money GDP may have grown by 1½-2 per cent less than we expected last year. But this has not been reflected in the monetary figures. With the growth in both M1 and £M3 probably at the top of the target range, there has been a fall in velocity on both measures of money. Relative to consumer prices, at least, the growth in real money balances has also been stronger than we expected last year.

9. If we want to show a declining path for inflation, and we stick to the same monetary ranges as suggested last year, we shall need to explain the significance of these developments and explain why unchanged money figures are now thought to be consistent with a lower rate of inflation in the medium term. Some commentators will argue that the failure to reduce monetary growth in the face of unexpectedly low inflation and output has had the effect of automatically easing monetary pressures. In time this will lead to a faster growth in output and a rebound in inflation. Without a change in monetary growth in nominal terms, there is no reason to look for a lower rate of inflation in the medium term. The more we imply that we are looking for a better outcome on inflation, consistent with the same recovery in real output, the more difficult it will be to rebut these arguments.

10. One approach is to argue that we have changed out view about the impact of structural changes on velocity, and now think that last year's monetary ranges may be consistent with a better medium term outcome on inflation. We have good reason for expecting a fall in M1 velocity as interest rates and inflation come down. This was foreshadowed in last year's MTFS and underlined in the Autumn Statement. We admitted that the scale and timing of this shift was uncertain. Mr Monck's paper on "Monetary Targets in 1983-84 : M1" discusses various ways in which we might seek to get this message across - either by repeating last year's form of words, adding to them, or adopting a (more or less formal) separate range for narrow money.

11. It may be more difficult to sustain the argument that the velocity of £M3 is likely to remain lower than we were expecting last year, and could even fall further without lasting damage to inflation. As

Mr Burns' paper for Chevening noted, some of our explanations for the fall in £M3 velocity in recent years imply some move in the opposite direction in the future, for example as real interest rates fall. The timing and scale are, of course, very difficult to judge. But there are problems in pleading too much ignorance. The more often we point to unpredictable structural shifts in velocity, the more we risk discrediting the whole MTFS approach with its emphasis on a stable financial framework centred on monetary targets.

12. It is worth considering the case for moving down the monetary ranges, at least as they apply to broad money. This would be a way of reinforcing expectations of a lasting move to lower inflation. We do not need to imply that we think there is a very close relationship between monetary growth over the next few years and the rate of inflation over the same period. But if we take the view that inflation is likely to stabilise, or even fall further - in reponse to past policy, or world events - the stance of policy may look excessively easy if we do stick to last year's guidelines - with possible implications for the rate of inflation in the longer term.

13. There are, however, a number of arguments against such a move, at this time :-

(i) it might be interpreted as a deliberate attempt to tighten policy - in effect, to chase the rate of inflation down - which would put the recovery in jeopardy;

(ii) it might involve tacitly conceding a degree of primacy for £M3. The arguments for looking for lower monetary growth apply mainly to the broad aggregates. Last year the monetary ranges applied equally to both broad and narrow measures of money;

(iii) by drawing attention to the money figures, the change might be taken as a move away from the more flexible approach to policy developed over the past year.

Any change would, in logic, have to apply to 1983-84. It would be difficult to justify simply changing 1984-85, particularly as we have always argued that the ranges for the later years are purely illustrative, not targets.

14. Table 2 shows two possible sets of figures. Variant A repeats last year's guidelines for 1983-84 and 1984-85 and allows a further 1% deceleration in the range for 1985-86. Variant B shows ranges which are 1% points lower in each year. One way of reinforcing the credibility of variant A would be to stress that the ranges apply equally to both broad and narrow measures of money, and say that there are reasons for looking for a growth in £M3 towards the bottom of the range, just as there are reasons for expecting M1 to grow at or above the top, at least for a time. In describing variant B, we would need to say that we are expecting M1 to grow above the range. The choice between these variants would not necessarily amount to much in practice; a 1% difference is small in relation to the width of the range, and the precision with which we can control these aggregates. But the mere act of moving down the ranges could be presentationally significant.

BMG 'No'

Table 2: Alternative Monetary Ranges for 1983-84 to 1985-86

	1983-84	1984-85	1985-86
Variant A[1]	7-11	6-10	5-9
Variant B[2]	6-10	5-9	4-8

[1] Broad and narrow money

[2] Mainly broad (at least by implication)

The Exchange Rate

15. In principle, there could be a case for revising down the monetary ranges in response to the fall in the exchange rate. If the forecast is broadly right, however, it may not be very strong, particularly for the later years. In practice, last year's assumption of "no major fall" encompassed exchange rate levels not all that different from those shown in the latest forecasts:

Table 3 : Exchange Rate Forecasts

	1982 MTFS	Winter 1983
1982-83	87.4	88.1
1983-84	83.7	80.0
1984-85	81.8	79.7

16. We shall need to say something about the role of the exchange rate. Commentators will read significance into any departure from last year's formula, and **that** may be a good reason for adhering to it fairly closely (though in fewer words). Last year we said:

> "The behaviour of the exchange rate can help in the interpretation of monetary conditions, particularly when the different aggregates are ~~known~~ to be distorted. The exchange rate is a route through which changes in the money supply affect inflation. It can also be an important influence on financial conditions. External or domestic developments that change the relationship between the domestic money supply and the exchange rate may therefore disturb the link between money and prices, at least for a time. Such changes cannot be readily taken into account in setting monetary targets But they are a reason why the Government considers it appropriate to look at the exchange rate in monitoring conditions and in taking decisions about policy." Para 2.8.

17. The statement that the monetary ranges "have been constructed on the assumption that there are no major changes in the exchange rate from year to year" (para.2.16) is likely to be as true this year as last - though given recent experience commentators may find that difficult to accept. We have, however, admitted to the Select Committee that "no major change" can cover movements of **up to** 10%, and we can emphasise the difference between year to year changes and shorter term volatility.

The PSBR Assumption

18. The PSBR for 1983-84 has provisionally been set at £8 billion, equal to 2¾% of GDP, the ratio suggested in last year's MTFS and the Autumn Statement. Last year we showed a further decline to 2% in 1984-85. The forecast assumes that this ratio is held in 1985-86. Given the forecast for money GDP,this implies the following, rather uneven, path for the nominal PSBR:

Table 4: The PSBR Path: Winter 1983 forecast

	1981-82	1982-83	1983-84	1984-85	1985-86
PSBR £bn	8.7	7.9	8.0	6.5	7.1
as % GDP	3.4	2.9	2.7	2.0	2.0

19. The MTFS has always emphasised the importance of consistent fiscal and monetary policies; we have argued that a progressive deceleration in monetary growth requires a trend decline in the PSBR ratio, to avoid undue pressure on real interest rates. Despite considerable success on the fiscal front in the last couple of years, real interest rates **have not fallen,** and, in the forecasters judgment, are likely to remain near present levels over the next few years. If reducing real interest rates is a priority, there may be a case for looking for a sharper decline in the PSBR ratio over the MTFS period than the latest forecasts assume. This case would be all the stronger if we go for a faster deceleration in monetary growth, consistent with some further decline in inflation.

20. On the other hand, if we stick to 2% for 1984-85 (and, a fortiori if we take a lower figure) there may be no room for a positive fiscal adjustment next year, once account is taken of this year's fiscal changes (**assuming that this year's PSBR is set at 2¾%**). An increase in the PSBR ratio to **2½%** (equivalent to **about £8 billion**) would give us an extra £1½ billion to play with on the fiscal adjustment. It may be difficult to find convincing excuses for this change. But, given that it is small, and that most outside commentators now regard fiscal policy as excessively tight, there should be no great presentational problem. If we then chose a ratio of 2% in 1985-86 we would be showing a gradual decline in the PSBR both in nominal terms and relative to GDP over the whole MTFS period (though the **precise numbers for the** nominal PSBR will depend on the assumed path for money GDP, which could be significantly different from the present forecast).

21. Alternatively, we could reconcile a 2% PSBR ratio for 1984-85 with a small positive fiscal adjustment in that year, if we aimed a little lower in 1983-84, for example, by setting the PSBR ratio at 2½ per cent (about £7½ billion) rather than the 2¾ per cent (£8 bn) now in mind. This would have the effect of sharing the fiscal adjustment between the two years. We can also help to create more room for tax cuts in 1984-85 by avoiding measures in the 1983 Budget which have a sharply increasing effect on revenue over time (eg some of the company tax options fall into this category).

22. The long term objective for the PSBR has a bearing on the choice of figures for 1985-86. What this objective should be depends both on the underlying growth in the economy and the objective for inflation. Even if we are aiming for stable prices, it is not clear that we should be looking for a balanced budget in the long term. The PSBR ratio averaged around 2½-2¾ per cent during the 1950's and 1960's. A rather lower PSBR ratio would probably be consistent with the same average rate of inflation now, to allow for a lower ratio of debt to GDP and a slightly slower underlying rate of growth in real output. Rough calculations on the lines suggested in Mr Burns' paper suggest a longer term objective for the PSBR ratio of between 1½-2 per cent - and less than this if we want to improve on the 50's/60's inflation performance.

23. Table 5 suggests two possible paths for the PSBR, both consistent with a fairly smooth decline relative to GDP (and no actual rise in the nominal PSBR). The figures for the later years are purely illustrative; we can and have revised them significantly when we come to take decisions about fiscal policy. But they play an important part in shaping expectations. While the lower path would no doubt be attacked by some as excessively deflationary, it is little more than a straight line extrapolation of last year's MTFS. We could not justify an expectation of lower inflation over the next few years by pointing to a tighter fiscal policy. But the lower figures might look more consistent with lower monetary figures, and continued optimism about the prospects for reducing real interest rates.

Table 5: Alternative PSBR Paths

	1983-84	1984-85	1985-86 CST
Variant A:			
£ bn	8	7 8	6 7
as % GDP	2¼	2½ ¼	2 1¾
Variant B:			
£ bn	7½	6½	5
as % GDP	2½	2	1½

The Economic Assumptions

24. Last year we published assumptions (shown in table 1) for:

(1) the general rate of inflation (GDP market price deflator) in each year;

(2) the <u>average</u> rate of growth of output over 1983-84 and 1984-85;

(3) Money GDP, in each year.

The text also described, in vague terms, the oil price assumption underlying the projection of North Sea oil tax revenues. We normally face close questioning from the Select Committee on such things as unemployment, productive potential and the pattern of growth (though we avoid giving figures, especially for unemployment).

25. We shall have to provide at least as much information this year. The published FSBR forecasts will include the first half of 1984, updating and extending those already shown in the Autumn Statement. Taking this as our starting point, we shall need to revise the assumptions for 1984-85, and choose numbers for 1985-86. (The question of what to say about oil prices will need careful consideration nearer the time).

26. In choosing assumptions in the past we have always been rather more optimistic than internal forecasts while aiming to produce a defensible, realistic and internally consistent picture. This has sometimes, in some respects, produced better medium-term forecasts. On output, the only assumption we have volunteered from the outset, we have been somewhat too optimistic in the MTFS, while the internal forecasts have been somewhat too pessimistic. On inflation (and on money GDP) the MTFS projections of 1980 and 1981 were more accurate than internal forecasts (though this would not of course be apparent to an outsider). In some other areas - such as unemployment - the MTFS has been rather less accurate than the internal forecasts.

27. As well as the internal forecasts, we have usually given some weight to:

(1) what outside forecasters are saying;

(2) economic assumptions published by the Government in other contexts, eg public expenditure;

(3) the need to present a picture broadly consistent with the Government's general medium term objectives, and, in particular, the monetary guidelines.

The Internal Forecast

28. Table 6 compares the latest internal pre-Budget forecast with the figures for GDP and inflation underlying the 1982 MTFS:

Table 6 : Treasury Forecasts

	1982-83	1983-84	1984-85	1985-86
Output				
1982 MTFS	1.7	2.6	2.6	n.a.
1983 Pre-Budget	0.8	2.8	2.2	1.7
Inflation (GDP deflator)				
1982 MTFS	7.8	6.9 (7)*	6.7 (6½)*	n.a.
1983 Pre-Budget	7.1	5.6	6.9	7.1
Money GDP (at market prices)				
1982 MTFS £ bn	280	307	336	n.a.
% change	9.8	9.6	9.4	n.a.
1983 Pre-Budget				
£bn	274	298	326	355
% change	7.9	8.7	9.3	8.9

* figures in brackets show rounding used for publication

29. In the terms used in the MTFS these forecasts suggest:

(i) an average rate of growth of real GDP in the last two years of 2%;

(ii) an inflation rate of 7% in both 1984-85 and 1985-86 (1½% points above the forecast for 1983-84, though this may be revised before publication in the FSBR);

(iii) growth in money GDP close to 9% in each of the last two years (growth in 1984-85 similar to that shown last year, though the level is 3% lower).

All these figures are subject to revision between now and March, to take account of new information and Budget decisions. If the PSBR is held to the £8 bn assumed in the forecast, however, these revisions may be relatively minor. This general profile of inflation and output has been a feature of all recent forecasts.

Outside Forecasts

30. Table 7 summarises six of the outside forecasts completed within the last three months. Only Phillips and Drew take account of last month's fall in the exchange rate, and all assume a significantly higher rate than the latest internal forecasts. The interpretation of unchanged policies varies - the National Institute allow no fiscal adjustment, while the EIU assume a significant relaxation in fiscal and monetary policies relative to the MTFS.

Table 7: Outside Forecasts

Calendar years % change	LBS	EIU	P&D	CE	NI	BANK	Average	HMT
Output								
1983	2.0	2.0	1.8	1.8	1.0	1.4	1.7	2.1
1984	2.0	3.4	2.9*	1.9	1.0	0.8	2.0	2.4
1985	1.7	2.2	n.a.	2.0	1.5	1.2	1.7	1.9
Inflation (consumer expenditure deflator)								
1983	6.7	6.3	6.7	6.3	5.1	7.3	6.4	6.8
1984	9.2	6.3	7.0*	8.0	5.6	7.4	7.2	7.2
1985	9.3	8.3	n.a.	9.4	[5.2ø]	7.4	7.9	7.4

* 1st half only

ø RPI

31. On output, the Treasury forecast is above the average of outside forecasts, and only the EIU is as buoyant overall - no doubt partly a reflection of the lower exchange rate we are assuming. On inflation, almost all the forecasters are expecting somefurther deceleration in inflation in 1983, followed by a modest upturn in 1984 and 1985. (The National Institute - with a very tight fiscal policy, and the exchange rate constant at 92 - is a possible exception, though fully comparable figures are not available for 1985). The Treasury inflation forecast - despite a lower exchange rate - is close to the average of the outside forecasts, and more optimistic than most for 1985.

Public Expenditure

32. In contrast to last year, when there were published cash factors, the Public Expenditure Survey is not based on explicit assumptions about inflation. The published MTFS assumptions about the GDP deflator will, however, enable commentators to convert the cash figures in the White Paper into cost terms and to draw conclusions about the growth of public expenditure in "real" terms. In choosing inflation assumptions therefore we have to keep an eye on what they imply for the real growth in public expenditure. The lower the inflation assumption, the higher the implied figures for public expenditure in cost terms, and vice versa.

33. The new public expenditure White Paper contains cost terms figures for 1983-84, using the forecast for the GDP price deflator published in the Autumn Statement (5%). This implies a real growth in public expenditure between 1982-83 and 1983-84 of ¾%. We will probably volunteer a new cost terms table, covering the later years of the survey, after the Budget. That would also reflect any revisions to our inflation forecast for 1983-84.

34. Table 8 compares the implied movement in public expenditure in cost terms using the White Paper cash totals and the latest internal forecasts for the GDP price deflator with the cost terms figures as they appeared last year. The new White Paper cost figures for 1983-84 are also shown.

Table 8: Public Expenditure

	1982-83	1983-84	1984-85	1985-86
1982 White Paper/MTFS				
Cash totals £bn	114.7	120.7	127.6	n.a.
(% change)		(5.2)	(5.7)	
GDP price deflator 1981-82=100	107.8	115.3	123.0	n.a.
(% change)	(7.8)	(6.9)	(6.7)	
"Cost terms" £bn*	106.4	104.7	103.8	n.a.
(% change)	(1.3)	(-2.5)	(-0.8)	
1983/PEWP and 1983 forecast inflation				
Cash totals £bn	113	119.6	126.4	132.3
(% change)	(7.7)	(5.8)	(5.7)	(4.7)
GDP price deflator 1981-82=100	107.1	113.1	120.9	129.5
(% change)	(7.1)	(5.6)	(6.9)	(7.1)
"Cost terms" £bn*	105.5	105.7	104.5	102.2
(% change)	(0.8)	(0.2)	(-1.1)	(-2.2)
1983 PEWP (and A.S. inflation forecast)				
GDP price deflator	107.5	112.8		
(% change)	7½	5	n.a.	n.a.
Cost terms £bn	105.1	105.9	n.a.	n.a.
(% change)	(0.4)	(0.8)		

* i.e. cash totals adjusted for movements in GDP price deflator since 1981-82.

35. Since the White Paper figures do not embody a specifically quantified view of future inflation, it is difficult to say whether they are compatible with any particular profile of inflation that might underlie the expenditure totals in the MTFS. But the published inflation assumptions will affect the implied real content of the published cash totals and the implied ratio of public expenditure to GDP. An inflation assumption that was well below the levels in the forecast would make the present cash plans look more generous in terms of volume, and this could prompt the sort of criticism of lax control recently expressed by the

Select Committee. Similarly, because the lower inflation assumption would reduce the level of nominal GDP in future years, the published cash plans would represent a higher ratio of GDP than is implied in the forecast. These presentational problems could become problems of substance if an unrealistically low inflation assumption led departments to make their own dispositions on that assumption: the real content if their plans would be higher than could be sustained within the cash totals if inflation fell only as forecast and this would make the cash totals harder to hold in those later years. While these problems should be manageable provided the inflation assumptions are not too far below those in the latest forecast they clearly would become greater as the assumptions depart further from the forecast.

36. The MTFS inflation assumptions will directly influence the base line for 1986-87 in the new Survey. On past form, the baseline might be constructed by assuming some further deceleration in the general rate of inflation and possibly allowing for some additional squeeze in volumes. The figures currently in mind are 3 or 3½%. Either might look unduly severe if we adopted an inflation assumption of say 5 or 5½% for 1985-86; but would look reasonably consistent with 4 or 4½%.

37. There is no obvious tension between the PES assumptions about unemployment (which will be published in the White Paper) and the latest forecasts. Both show unemployment, on the new definition (GB, narrow) flat at around 3m. This is broadly consistent with the 2% average growth in output in the forecast over the last two years, and what we have previously said about productive potential (an underlying growth of around 2-2½% over the next few years).

Alternative Assumptions

38. There is some room for departing from the internal forecasts on both inflation and output; but, in the light of the outside forecasts, it might be difficult to defend both a signficantly more buoyant path for output and a much lower path for inflation. Very low inflation figures could have unwelcome implications for the real growth - and possibly the control - of public expenditure over the next few years,

and point to an unrealistically low baseline for 1986-87 in the new Survey. A low path for inflation may also look inconsistent with last year's monetary guidelines, at least insofar as they relate to broad money.

39. Table 9 compares the forecast with two alternative assumptions about inflation. Both alternatives are coupled with 2½% growth in real output - (slightly above the forecast).

Variant A shows a fairly flat path for inflation. The 1983-84 inflation rate is rounded up to 6%, and there is some token deceleration thereafter. Given the margins of error, this is a defensible, if rather favourable, interpretation of the current internal forecast. On this assumption about inflation, the cash totals in the White Paper would imply no growth in public expenditure in cost terms.

Variant B illustrates a more ambitious path for inflation. This would have obvious political advantages, but it would look distinctly optimistic in relation to 2½% growth and the outside forecasts. We can, in principle, reconcile low inflation and high output in a number of ways, for example by assuming a very slow growth in costs, reflecting some combination of low earnings or high productivity growth, but outsiders are unlikely to find the picture very convincing. This inflation assumption could cause practical and presentational problems on public expenditure; it implies continuing growth in cost terms, given the White Paper cash totals, and could point to an unrealistically low base line for 1985-86 in the new Survey.

Table 9: Alternative Economic Assumptions

	Internal Forecast	Alternative Assumptions	
		A	B
Inflation (GDP deflator) 4 2/3 7			
1983-84	5.6	6	5½
1984-85	6.9	5½	5
1985-86	7.1	5	4
Real output			
1983-84	2¾	2¾	2¾
1984-85) average 1985-86)	2	2½	2½
Money GDP			
1983-84	8¾	9	8½
1984-85) average 1985-86)	9	8	7
Public expenditure in 1981-82			
Cost terms £ bn (% change)			
1983-84	105.7 (0.2)	105.4(-)	105.8 (0.3)
1984-85	104.5(-1.1)	105.5(-)	106.6 (0.8)
1985-86	102.2(-2.2)	105.2(-0.3)	107.3 (0.7)

40. The choice of economic assumptions interacts with the decisions that are needed on the monetary guidelines and the PSBR path:

(i) retaining the same monetary ranges as in last year's MTFS (and allowing a further 1% reduction in 1985-86) would imply some shift in velocity, and a faster growth in real balances relative to last year, even on the higher of the two inflation assumptions (variant A). The combination of a still lower growth in money GDP with last year's guidelines would imply a continuing fall in velocity over the time period of the MTFS. It might be difficult to convince people that this was consistent with the assumed reduction in inflation, or with a continuation of the fall beyond the end of the MTFS period;

(ii) lower monetary ranges would help to get round some of the problems involved in choosing the lower inflation assumption (variant B). A change would be presented as being consistent with better inflation prospects than were envisaged last year. It might, however, be interpreted as a deliberate tightening in stance and, on this view, the assumption of 2½% real growth would look less credible. Since the lower ranges would be more relevant to broad money, they would also imply a degree of primacy for £M3;

(iii) the choice between the two PSBR variants is fairly fine. But the lower path (falling to 1½% in 1985-86) would look more consistent with a clearer signal on inflation, and lower monetary ranges.

41. We see no particular problems with the higher inflation assumption (variant A). It can be defended as a reasonable interpretation of what the present policy might deliver. It would be more difficult to present variant B in this light. Even if changes to the financial framework helped to make a better inflation outlook more credible, there could be awkward questions about the prospects for recovery.

MP1 Division
2 February 1983

A59

CONFIDENTIAL

From: J ODLING-SMEE

6th February 1984

CHANCELLOR OF THE EXCHEQUER

cc Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Battishill
Mr Riley
Mr Melliss
Mr Ridley

THE PSBR PATH

I attach a table setting out our current estimates of the PSBR and the fiscal adjustment. It is based on the following policy assumptions:

(a) Public Expenditure. The PEWP planning totals to 1986-87, then flat in cost terms to 1988-89.

(b) Tax.

(i) The major changes proposed for the 1984 Budget are included; in the case of Corporation Tax it is assumed that the rate is reduced to 45% and held there and the FYAs are reduced to the first stage (75% for P and M, 50% for IBA) only.

(ii) LA rates are assumed to rise in line with nominal GDP

(iii) NI contribution rates are held constant.

(c) Monetary Policy. Interest rates and gilt sales are such as to keep the monetary aggregates within their target ranges.

2. The calculations are very rough at this stage. The process of aligning the forecast for the first few years with the medium-term economic assumptions and incorporating the effects of the proposed Budget changes will not be completed for some time, partly because of the large number of small Budget items that have to be taken into account. The attached numbers are based on various approximations some of which may prove to be incorrect.

JOS

J ODLING-SMEE

403
2.

There is an error on this table

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	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
GDP growth (%)	3.0	3.1	2.3	2	2	2
PSBR						
Before fiscal adjustment (£bn)	10.5	6.9	3.9	1.2	-0.8	-1.2
After fiscal adjustment (£bn)	10.5	7.4	7.0	7.4	6.9	7.2
(% of GDP)	$3\frac{1}{2}$	$2\frac{1}{4}$	2	2	$1\frac{3}{4}$	$1\frac{3}{4}$
FA (cumulative) (£bn)	0	0.5	3.1	6.2	7.7	8.4
(% of GDP)	0	~~$1\frac{3}{4}$~~ 1/4	1	$1\frac{3}{4}$	2	2
FA (year-to-year change) (£bn)	0	0.5	2.6	3.1	1.5	0.7
Other Items						
Oil Revenues (£bn)	8.8	10.0	9.5	9.4	9.3	9.2
(% of GDP)	2.9	3.0	2.7	2.5	2.4	2.2

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FROM: J O KERR
DATE: 6 February 1984

Sir T Burns

cc Economic Secretary
Sir P Middleton
Mr Bailey
Mr Cassell
Mr Battishill
Mr Evans
Mr Lankester
Mr Odling-Smee
Mr Ridley
Mr Scholar
Mrs Lomax
Mr Riley
Mr Sedgwick
Mr Norgrove

MEDIUM TERM FINANCIAL STRATEGY

The Chancellor was grateful for your minute of 3 February, covering a draft of the early section of the 1984 MTFS. I ... attach a revised version, in which his proposed changes are underlined.

2. In para 5, he is sure that it will be important to bring out very clearly the deceleration in monetary growth during the year, comparing the most recent six months with the previous six months. He does not understand the proposed reference to asset prices.

3. In shortening the last two sentences of para 7, he has in mind that the last clause in your version of the paragraph would need some explanation, if it were in fact reinstated.

4. He notes that the last sentence of para 8, as drafted, suggests that high interest rates lead to <u>faster</u> growth of broad money! He agrees that there should be a chart of £M3 and MO growth. If it also covers PSL2 and M2, they should rate only very faint dotted lines!

5. The explanation - para 10 - of the move to separate target

1039/2

ranges for broad and narrow money needs, in the Chancellor's view, to be expanded to point out that they are differently affected by developments in financial markets.

6. The Chancellor would be inclined to omit the square bracketted phrase in para 11.

7. He is inclined to think that the last sentence of para 13 deserves further attention.

8. Apart from thinking it best that the 1983-84 PSBR figure in table 2.3 and para 14 should be the same, the Chancellor's main point on para 14 is that we ought to go for round numbers, avoiding a spurious impression of great accuracy in forecasting the outturn!

JOK.

J O KERR

3.65

A59

CONFIDENTIAL

FROM: J O KERR

DATE: 7 February 1984

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Lankester
Mr Ridley

Speak to JOS

MR ODLING-SMEE

MTFS: THE PSBR PATH

The Chancellor was grateful for your minute yesterday setting out current estimates of the PSBR and the fiscal adjustment through the MTFS period. He notes that the numbers may still change a bit.

2. The Chancellor prefers the year-to-year basis for the fiscal adjustment, rather than the cumulative presentation.

3. There might, in the Chancellor's view, be advantage in showing all the Treasury Ministers before too long how the PSBR and money numbers for the MTFS are shaping up. He has asked whether it would be feasible to put round a short paper by the end of this week, for discussion at next weeks "overview" meeting. Could you let me know?

JOK.

J O KERR

14/2

CONFIDENTIAL

A59

SECRET

From: J ODLING-SMEE
10th February 1984

CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir Peter Middleton
Sir Lawrence Airey
Mr Fraser
Sir Terence Burns
Mr Littler
Mr Bailey
Mr Cassell
Mr Monck
Mr Battishill
Mr Evans
Mr Monger
Mr Lankester
Mr Ridley
Mr Hall
Mr Lord
Mr Portillo

THE MTFS: PSBR AND MONETARY RANGES

Sir Terence Burns' paper of 27th January set out some numbers for the PSBR path and the monetary ranges over the MTFS period. It was discussed briefly at the overview meeting on 31st January.

2. It was agreed that the 1984-85 targets for broad and narrow money should be 6-10 and 4-8 respectively. Although final decisions were not taken, it was provisionally agreed that the target ranges should be reduced by one percentage point a year.

3. You asked for further advice on the PSBR path. At the overview meeting on 7th February you indicated that you would like to show a PSBR of £7.5 billion ($2\frac{1}{4}$% of GDP) in 1984-85, and to plan for £7 billion. The purpose of this note is to consider what the PSBR path might be beyond that. The main arguments in Sir Terence Burns' paper (paragraphs 11-18), especially those relating to the PSBR in 1984-85, are not repeated here.

2/2/2

4. Since Sir Terence Burns' paper was written we have been extending the short-term forecast to 1988-89 on the basis of assumptions about medium-term economic developments. In doing so we are taking account of the proposed measures in the 1984 Budget. It is necessary to ensure that the forecast we make for the five years of the MTFS period is consistent with what is being assumed in the LTPE exercise, since the two will be published at the same time. All this work is not yet complete, and anyway the forecasters will be looking again at the forecast for the first two or three years. Nevertheless, I think that the broad picture that we now have is sufficiently firm to indicate the likely order of magnitude of the fiscal adjustment associated with any particular PSBR path.

Economic Assumptions

5. It has already been agreed that the MTFS should assume money GDP growth falling to 5-6% by 1988-89. Output is assumed to grow at an average rate of 2¼% a year from 1983-84 to 1988-89, as in the LTPE calculations. Inflation is assumed to fall gradually to just above 3% in 1988-89. This is in line with the further decline to zero in 1993-94. The annual growth rates are shown in the attached table.

Policy Assumptions

6. The public expenditure planning total is assumed to be as in the PEWP to 1986-87, and then flat in cost terms to 1988-89. Debt interest is estimated separately according to movements in interest rates and debt outstanding.

7. The changes proposed for the 1984 Budget are included. In the case of Corporation Tax it is assumed that capital allowances are reduced to the first stage (75% FYA for plant and machinery and 50% for industrial buildings) and the CT rate to 45%. Both allowances and the rate are held at these levels for the rest of the period. It is assumed that stock relief is abolished. Should it be decided to announce in the Budget the whole progression to lower allowances and CT rate, this assumption will have to be changed.

8. Local authority rates are assumed to rise broadly in line with nominal GDP. National Insurance contribution rates are held constant, with revalorisation of the earnings limits.

9. Interest rates and gilt sales are such as to keep the monetary aggregates within the target ranges mentioned in paragraph 2.

The PSBR and Fiscal Adjustment

10. The numbers in the attached table are presented on the assumption that the PSBR will decline gradually from $2\frac{1}{4}$% of GDP in 1984-85 to $1\frac{3}{4}$% of GDP in 1988-89. Some fall in the PSBR ratio would be consistent with the declining path for monetary growth. On the other hand the profile of asset sales and oil revenue together points to aiming for a large reduction in the PSBR early in the period, especially in 1984-85, followed by a flatter path thereafter.

11. At zero inflation and the low rates of monetary growth that go with it a still lower PSBR would be required. The LTPE exercise therefore assumes a PSBR of 1% of GDP in 1993-94. Some movement towards that level during the MTFS period is necessary if the LTPE assumption is to remain unchanged and evidently the two exercises have to be consistent.

12. Given constant public expenditure in cost terms and the assumed PSBR path, our calculations suggest that there is a significant positive fiscal adjustment available over the MTFS period. It is spread out fairly evenly, with scope for tax cuts (or expenditure increases) of about £2 billion in the 1985, 1987 and 1988 Budgets and of over £4 billion in 1986. This cumulates to a total of £12 billion or 3% of GDP by the end of the MTFS period.

13. The positive fiscal adjustment occurs despite the decline in oil revenues (by $\frac{3}{4}$ percentage point of GDP from 1984-85 to 1988-89) and the PSBR (by $\frac{1}{2}$ percentage point). Real growth of $2\frac{1}{4}$% a year on average from 1983-84 provides buoyant revenues. Meanwhile by assumption the public expenditure planning total does not grow at all in cost terms and debt interest also falls relative to GDP, mainly because of the fall in inflation and nominal interest rates. Experience suggests that in practice

SECRET

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
Economic Assumptions						
Real GDP growth	3	3	2¼	2	2	2
Inflation	5	4¾	4¼	4	3½	~~3¼~~ 3
Money GDP growth	8¼	8	6¾	6	5½	5¼
PSBR and Fiscal Adjustment						
PSBR before fiscal adjustment (£bn)	0	6.9	3.9	-0.5	-3.3	-5.1
PSBR after fiscal adjustment (£bn)	10.5	7.4	7.0	7.4	6.8	7.2
(% of GDP)	3½	2¼	2	2	1¾	1¾
FA (year-to-year change) (£bn)	0	0.5	2.6	4.8	2.2	2.2
			3	3	3	3
Memorandum Items						
Oil Revenues (£bn)	8.8	10.0	9.2	9.2	9.2	9.3
(% of GDP)	3	3	2½	2½	2¼	2¼
FA (cumulative) (£bn)	0	0.5	3.1	7.9	10.1	12.3
(% of GDP)	0	¼	1	2	2½	3

Riley version in blue folder, attached

A59.

CONFIDENTIAL

FROM: J O KERR

DATE: 13 February 1984

MR RILEY

cc Sir P Middleton
Sir T Burns
Mr Bailey
Mr Cassell
Mr Battishill
Mr Evans
Mr Lankester
Mr Odling-Smee
Mr Ridley
Mr Scholar
Mr Sedgwick
Mrs Lomax

MTFS

The Chancellor was grateful for your 10 February revised draft of the early sections of the MTFS. I attach a further version incorporating his amendments (side-lined).

2. You will see that the last two sentences of paragraph 13 are now in square brackets. This is because the Chancellor believes that they are still much too convoluted and obscure. He points out that we have been in the habit of explaining the <u>direct</u> link between lower inflation and lower private savings (as individuals no longer need to protect themselves against wealth erosion) without any need to argue via public sector debt.

3. The Chancellor thinks that this section of the MTFS ought to end with one further paragraph, summarising and rounding it off. He wonders whether Sir P Middleton shares this view; and, if so, whether he would like to propose a suitable paragraph.

J O KERR

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BUDGET CONFIDENTIAL

A59.

CH/EX REF. NO. B(84)91

FROM: J O KERR

DATE: 13 February 1984

cc PS/Chief Secretary
PS/Financial Secretary
Sir T Burns
Mr Bailey
Mr Cassell
Mr Battishill
Mr Scholar
Mr Norgrove

SIR P MIDDLETON

FSBR: PUBLIC EXPENDITURE

You will have seen - Mr Norgrove's minute of 10 February - the mock-up of a posssible public expenditure section for the FSBR. The Chancellor recalls that you previously saw attractions in including such a section: he would be grateful if you could let him know what you know think.

2. His own reaction is that he would still like there to be a public expenditure section in the FSBR, but that the mock-up text is not quite what was envisaged. I suspect that his concern is that it reads like a series of footnotes to the PEWP: whereas the original idea was to draw out, and highlight, the main messages in the PEWP. Given the decision that the MTFS section of the FSBR will set out assumptions about public expenditure for two additional years beyond the span of the PEWP, it would seem desirable that the nature of these assumptions should also be spelt out in the public expenditure section. And, given the decision to publish - with a bit of luck simultaneously - an LTPE Green Paper, it would seem appropriate that the FSBR should contain a paragraph or two about it, and the rewards/penalties if the PEWP pattern of no increase in real terms is/is not carried forward into the longer-term.

3. The Chancellor would be grateful for your further advice, and any comments from GE.

J O KERR

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A59

SECRET

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-233 5627

cc Sir P Middleton
Sir T Burns
Mr Lankester
Mr Sedgwick
Mr Lomax

F. Cassell
Deputy Secretary

13 February 1984

E A J George Esq
Bank of England
Threadneedle Street
LONDON EC2R 8AH

Dear Eddie,

MTFS NUMBERS

I told you when we met last week how our thinking was progressing on the numbers for the new MTFS, and that the Chancellor had decided not to pursue any of the technical changes we recently looked at for presenting the monetary ranges in this year's Red Book (though we would like to change the announcement of the monthly figures to give less emphasis to the latest month and more to the movement over the last 3 or 6 months).

The numbers we are looking at for the MTFS are:-

Ranges for Monetary Growth

Percentage change during year		1984-85	1985-86	1986-87	1987-88	1988-89
Narrow Money - MO (and M2)		4- 8	3-7	2-6	1-5	0-4
Broad Money - £M3 (and PSL2)		6-10	5-9	4-8	3-7	2-6
PSBR	£bn	7.4	7.0	7.4	6.8	7.2
	% of GDP	$2\frac{1}{4}$	2	2	$1\frac{3}{4}$	$1\frac{3}{4}$
Real GDP growth	%	3	$2\frac{1}{4}$	2	2	2
Inflation	%	$4\frac{3}{4}$	$4\frac{1}{4}$	4	$3\frac{1}{2}$	$3\frac{1}{4}$
Money GDP growth	%	8	$6\frac{3}{4}$	6	$5\frac{1}{2}$	$5\frac{1}{4}$

Caveat

SECRET

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Obviously, at this stage these numbers are provisional, but it would be useful to have your general reaction. Perhaps we might discuss them at the end of Peter Middleton's meeting tomorrow.

F CASSELL

A59

CONFIDENTIAL

From: SIR PETER MIDDLETON
Date: 20 February 1984

SIR T BURNS

cc Mr Bailey
Mr Cassell
Mr Battishill
Mr H Evans
Mr Odling-Smee
Mr Lankester
Mr Sedgwick
Mr Scholar
Mrs Lomax
Mr Stibbard
Mr Riley
Mr Melliss
Mr Ridley

MEDIUM TERM FINANCIAL STRATEGY

I still do not like paragraph 12 in the latest draft. First, it will be misunderstood, not least by the Bank. Second, I do not think it is true as drafted. Whether we operated at the long or the short end of the interest rate spectrum, the presumption will normally be that if action is taken we are willing to contemplate an increase in the average level of interest rates. Referring to short term interest rates and funding as distinctive policy measures, with the possible inference that funding is not quite interest rates at all, is misleading. And I doubt whether the last sentence makes things better; it seems to emphasise the distinction before dismissing it as a practical matter. See the first draft of the Budget Speech if you do not believe me.

2. All we need to make clear is the equal weight which is to be given to broad and narrow in interest rate decisions. This is adequately covered in paragraph 11, so paragraph 12 also appears to be redundant.

uu/2

3. One further point, which also struck me as a result of reading the Budget Speech. The reference in paragraph 5 to "... conditions have not been too lax" sounds unduly defensive. Can we give it a more positive ring?

P E MIDDLETON

BUDGET SECRET

A59

Ch/Ex Ref No B(84)211

FROM: J O KERR
DATE: 21 February 1984

Mr Evans

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Littler
Mr Cassell
Mr Kemp
Mr Monck
Mr Battishill
Mr Lankester
Mr Odling-Smee
Mr Ridley
Mr Folger
Mr Shields
Mr Norgrove
Mr Hall

ECONOMIC FORECAST: FSBR DRAFT

The Chancellor has seen the draft attached to your minute of 20 February. He now awaits the revised numbers promised for the end of this week.

2. He has one major query on the proposed text. The first sentence of para 37 states that:-

> "The extent of the rise in borrowing in this cycle was made possible by the removal of direct controls on financial institutions".

He would be grateful for a submission discussing this point, and explaining how it could be substantiated.

4. The following are his minor comments on the text:-

a. para 8. Is it really true that output in Europe "is showing only patchy signs of recovery"?

b. para 9. The text should state how many of the "major economies" have been considered in connection with the inflation performance which it describes.

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c. para 22. For "on account of" read "given the ....".

d. para 30. The chart of real unit labour costs is encouraging, and would appear to justify an extra sentence saying when such costs were last as low. The Chancellor would in any case like to know the answer.

e. para 32, last sentence. Delete "the net direct effect of which is expected to be a small rise in prices".

f. para 35. The last sentence, on the savings ratio, refers to chart 7: but chart 7 doesn't show the ratio. Shouldn't it?

g. para 38. The marginal note suggests that chart 8 should not show interest payments: the Chancellor agrees.

h. para 40. Chart 9. The Chancellor does not recognise the figures in Chart 9, and wonders whether a profits chart would not be simpler and better.

i. para 42. The last sentence, referring to the effect on investment in 1984-5 of the proposed Corporation Tax changes, will be read with keen interest. The Chancellor would like to see the figuring underlying it. He also thinks it important that the text should make clear that the effect discussed is a net one, with some investment brought forward, some - but not much - cancelled, and the net result a plus in 1984-5.

j. para 47. It is unsatisfactory that we appear to have to rely on September figures on the labour market. When will the December figures be available?

JOK.

J O KERR

CONFIDENTIAL

A59

FROM: J O KERR
DATE: 21 February 1984

Mr Riley

cc Sir P Middleton
Sir T Burns
Mr Bailey
Mr Cassell
Mr Battishill
Mr Evans
Mr Odling-Smee
Mr Lankester
Mr Sedgwick
Mr Scholar
Mrs Lomax
Mr Stibbard
Mr Melliss
Mr Ridley

MEDIUM TERM FINANCIAL STRATEGY

The Chancellor has seen the new version of the MTFS which you submitted on 17 February.

2. On the first twelve paragraphs, he has only the following new suggestions:-

a. para 4, sentence 2. The reference should surely be to <u>most/many</u> "other major industrial countries".

b. para 5. Before Table 2.1. A chart of interest rates should be included.

c. para 8, sentence 1. It would be best to drop the reference to the last three months, and stick to only the last twelve and six.

3. In the new paras 13-23, he has made a number of suggestions, side-lined in the attached clean text. But you should also know that

a. he is not entirely happy about the argument in the last two sentences of para 13.

b. he does not think that paras 15 and 16 work very well, in their present form.

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c. he sees a problem with the second sentence of para 17, which could be construed as undesirably postponing price stability.

d. he will focus in detail on paras 2.4, 2.5, and 2.6 when the numbers are available. But he will not wish the fiscal adjustment line in 2.6 to be shown cumulatively. The line in the table ought, in his view, to be a year-to-year line: the cumulative figures should be in the footnote.

e. he has dropped the last part of para 22, since it duplicates material in para 18.

f. he is not entirely happy with para 23, as now drafted.

J O KERR

FISCAL POLICY

13. In the three last years, fiscal policy has been significantly tighter than in 1979-80 and 1980-81. The PSBR has averaged [less than 3½ per cent] of money GDP, compared with over 5 per cent in the earlier years, and this tightening is confirmed by the reduction in the public sector financial deficit. [Because of the reduction in inflation, erosion of the real value of existing public sector debt has become much less rapid. This has meant lower saving by the private sector, and so a lower nominal PSBR, relative to GDP, has been consistent with recovery in the real economy.]

Table 2.3: Public Sector Finances

% of GDP	Average 1979-81	1981-82	1982-83	1983-84
PSBR	5.2	3.4	3.3	3.5 (estimated)

14. The PSBR in 1983-84 is now forecast at about £10 billion, equivalent to [3½ per cent] of GDP. This is broadly as forecast in the Autumn Statement, but, despite the measures announced in July, about £2 billion higher than was expected at the time of the 1983 Budget. Local Authority borrowing seems to have been running much higher than expected, and Central Government expenditure, particularly on non-cash-limited programmes, has exceeded last year's forecasts.

The PSBR path

15. Government policies have been directed to achieving a progressive reduction in public sector borrowing over the medium term. Fiscal restraint is essential to the achievement of lower inflation and interest rates. [The PSBR is still above the level that would be consistent with price stability and acceptable interest rates, taking into account the composition of public sector receipts and expenditure.] [rewrite required]

[16. The appropriate path of the PSBR from year to year reflects many considerations, including the cyclical position of the economy and the growth of private sector credit. The profile of public sector asset sales is an important aspect of the composition of the PSBR which has also been taken into account, since they are unlikely to make a large contribution to reducing interest rates. The establishment of a high level of asset sales over the next five years points to a significant downward shift in the PSBR path. The pattern of North Sea oil revenues is also relevant: the likelihood that they may be close to their peak in 1984-85 is a further reason for seeking to make rapid progress this year in reducing the PSBR.] [rewrite required]

PSBR projections

17. The PSBR for 1984-85 is forecast to be [£7½ billion], equivalent to [2¼ per cent] of GDP, slightly below the figure assumed a year ago and in the Autumn Statement. The fiscal projections summarised in table 2.6 show further small reductions in the PSBR as a proportion of GDP in subsequent years, to [1¾ per cent] in 1987-88 and 1988-89, [with the prospect of further reductions consistent with a move to price stability.] [?omit] The figures after 1984-85 are illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time. But the illustrative profile should be compatible with falling inflation and monetary growth, and ~~at the same time~~ declining interest rates in both nominal and real terms.

Assumptions

18. For the period to 1986-87, the fiscal projections in tables 2.4-2.6 are based on the public expenditure plans shown in the Public Expenditure White Paper (Cmnd 9143), updated where necessary to take account of Budget measures and estimating changes. Further details for 1983-84 and 1984-85 are given in Part 5. For 1987-88 and 1988-89, no public expenditure decisions have yet been taken and the projections assume that the public expenditure planning total remains unchanged in real terms. Asset sales in 1987-88 and 1988-89 are assumed to remain at the levels in the White Paper for the previous three years. Real output is assumed to grow by 2¼ per cent a year on average over the five years. The general rate of inflation, as measured by the GDP deflator, which was [5] per cent in 1983-84, is assumed to fall to [4½ per cent] in 1984-85, and to 3 per cent by 1988-89. These assumptions imply growth of money GDP falling from [ ] per cent in 1983-84 to 5 per cent by the end of the period.

PUBLIC EXPENDITURE

19. Table 2.4 shows the relationship between the planning total for public expenditure and general government expenditure in national accounts terms (the definition of public expenditure lying behind the general government borrowing requirement).

[Table 2.4: General Government Expenditure]

REVENUE

20. The growth of Govenrment revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as policy decisions. Revenue is projected on the conventional assumption of constant tax rates and indexed allowances and thresholds at the proposed 1984-85 levels. No change is assumed in National Insurance contribution rates. Projections of North Sea tax revenues assume that oil prices do not change much from current levels for the next two years and then rise broadly in line with world inflation.

21. On these assumptions, general government receipts are projected to rise by [about 35] per cent between 1983-84 and 1988-89, [broadly in line with the growth in total money GDP]. Government revenue from the North Sea is expected to fall in real terms after 1984-85 as North Sea output falls, but this is more than offset by rising revenues from the growing non-North Sea economy.

[Table 2.5: General Government Receipts]

PUBLIC SECTOR BORROWING

22. The projections of Government receipts and expenditure are brought together in table 2.6 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment, conventionally assumed to take the form of lower personal taxes, depends critically on the estimates of revenue and expenditure. These are subject to major uncertainties about, for example, the tax yield for an assumed set of tax rates or the behaviour of oil prices.

[Table 2.6: Public Sector Borrowing (1)]

CONCLUSIONS

23. The projections shown in tables 2.4-2.6 are no more than illustrative of one particular evolution of the economy. If the domestic and world economies develop in a different way, the projections for public finances could be substantially affected. The actual path for the PSBR cannot be predicted with precision from year to year. However the underlying trend matters much more than the inevitable short-term fluctuations. The policy response to such fluctuations would depend on their nature, but the intention would be to hold firmly to the

strategy, by maintaining financial conditions consistent with a continued trend to lower inflation. The key to sustained recovery lies in reducing the growth of costs and increasing the returns to investment and enterprise. Within the financial framework set out here, there will be room for a satisfactory growth in output without damaging the outlook for inflation.

24. Progress in reducing inflation over the medium term will be influenced to some extent by events outside our own control. But the pre-eminent determinant will continue to be the financial discipline imposed by the Government's monetary and fiscal policies. There will inevitably be short-term fluctuations around the underlying trend. But, subject to that, the Government's policies will continue to be firmly directed towards achieving a progressive reduction in the rate of inflation, with the ultimate objective of stable prices.

A59

CONFIDENTIAL

From: SIR PETER MIDDLETON
Date: 21 February 1984

CHANCELLOR

cc Sir T Burns
Mr Bailey
Mr Anson
Mr Cassell
Mr Battishill
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Riley
Mr Stibbard

FSBR:PUBLIC EXPENDITURE

You asked for my views on the treatment of Public Expenditure in the FSBR. I have discussed this with Mr Bailey and Mr Scholar.

2. First, I am sure that we must have a reference to LTPE in the FSBR to establish the link with the MTFS. I had contemplated quite a substantial section at the end of the MTFS section and Mr Scholar provided the attached draft. But having looked at it, I think a rather different treatment would be best. All references to 17 February draft of the MTFS:

(a) expand paragraph 19 which is very thin with the attached draft paragraphs;

(b) delete completely the concluding sections of the MTFS (paragraphs 23-24) and add the following draft paragraphs;

(c) do not use the charts in the FSBR - they seem out of tone with the document and are in the Green Paper.

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3. This seems to me to both end the MTFS on the right note and put the Green Paper in its proper context - as a forward shadow of the MTFS.

4. As far as the proposed Section 5 is concerned, there are divided views. The material set out in Mr Norgrove's minute of 10 February all goes in the FSBR. We might score a few Brownie points by bringing it all together. But it is not essential to do so.

5. What we all believe you should do is include the material, on public expenditure programmes up to 1986-87 in 1982-83 cost terms which were published in a PQ last year at Budget time (copy attached) This could either be done in Section 5 if we have one or in one of the tables at the end of the FSBR. It needs to be separated from the MTFS section so that we avoid any impression of planning on a precise price profile for individual years.

EM

P E MIDDLETON

TAKE IN AFTER PARAGRAPH 19

19a. Last month's Public Expenditure White Paper (Cmnd 9143) set out in detail the government's plans on the level and make-up of public spending to 1986-87. On the assumptions on inflation in paragraph 18 above, these plans means that public expenditure should remain broadly level in real terms for the next three years.

19b. This stability is projected forward for a further two years, with the assumption that public expenditure in 1987-88 and 1988-89 will remain at its 1986-87 level in real terms. If the decisions which have still to be taken on the public expenditure totals for these years follow the assumed path, this should lead to a continuing fall in the share of the national product taken by public spending.

23. The projections of expenditure, revenue and borrowing in tables 24 and 26 are illustrative, and could be different in particular years if the domestic and world economies developed in a markedly different way. But whatever the response to short term fluctuations, the trend will be maintained, bringing with it continued progress to lower inflation.

~~The longer term~~

24. To achieve the ultimate objective of stable prices with lower interest rates, the declining trend in public borrowing will, moreover, need to be maintained beyond the MTFS period. And to bring about progressive reductions in taxation at the same time, expenditure has to remain under tight control.

25. Precise figures beyond 1988-89 are of course even more difficult to produce than for the MTFS period. But the Green Paper on Expenditure and Taxation which is published today provides an illustrative framework for a further five years showing projections of public spending totals alongside the implications for taxation.

26. The Green Paper shows what is possible if the long established upward trends witnessed in the past are reversed - and public expenditure either remains level in real terms up to 1993-94 or grows at no more than an average 1% in real terms after 1988-89. These are not decisions. But (only) if this degree of control over expenditure is maintained it will be possible to continue to reduce the burden of tax on both companies and persons.

Public Expenditure

Mr. Beaumont-Dark asked the Chancellor of the Exchequer if he will revise and extend table 1.14., public expenditure in cost terms by programme, in volume 1 of Cmnd. 8789, "The Government's Expenditure Plans 1983-84 to 1985-86", using the gross domestic product deflator assumptions given in the "Financial Statement and Budget Report", and taking account of Budget measures and other changes as they affect the public expenditure planning totals for 1982-83 and 1983-84.

Mr. Brittan: The table following shows cost terms figures resulting from inflating or deflating the cash outturn for past years and the cash provision for future years to a base of average 1981-82 prices, using the deflator for gross domestic product at market prices. For future years the general inflation assumptions used are as given in paragraph 2.16 of the Financial Statement and Budget Report, that is the GDP deflator averages 7 per cent. in 1982-83, 5½ per cent. in 1983-84 and 1984-85 and 5 per cent. in 1985-86.

The programme detail shown in the table is based on the cash figures given in table 1.7 of Cmnd. 8789. A line at the bottom of the table shows the planning totals for 1982-83 and 1983-84 including the effects of Budget measures and other changes since Cmnd. 8789 was published.

Public Expenditure in cost terms by programme

£ million base year 1981-82

	·5904	·6526	·7640	·9035	1·0000	1·07	1·12885	1·1909367	1·2504
	1977-78	*1978-79*	*1979-80*	*1980-81*	*1981-82*	*1982-83*	*1983-84*	*1984-85*	*1985-86*
Defence	11,553	11,486	12,077	12,374	12,606	13,468	14,162	14,520	14,660
Overseas aid and other overseas services									
Overseas aid	1,015	1,108	1,031	983	960	896	936	920	900
Net payments to EC institutions	918	1,151	1,098	245	153	542	337	380	420
Other overseas services	722	579	594	570	573	620	653	650	640
Agriculture, fisheries, food and forestry	1,467	1,246	1,318	1,491	1,3~~37~~ 29	1,667	1,554	1,390	1,380
Industry, energy, trade and employment	3,782	4,652	3,771	4,439	5,319	5,471	4,980	4,610	4,330
Transport	3,845	3,750	3,882	3,825	3,898	4,056	3,811	3,800	3,750
Housing	5,789	5,473	5,908	4,933	3,137	2,410	2,473	2,510	2,490
Other environmental services	3,311	3,458	3,537	3,576	3,244	3,208	3,157	3,090	3,040
Law, order and protective services	3,034	3,120	3,376	3,505	3,774	4,004	4,060	4,050	4,030
Education and science	11,922	11,883	11,709	12,065	11,828	11,802	11,126	10,840	10,670
Arts and libraries	506	521	529	528	520	541	499	490	480
Health and personal social services	11,081	11,378	11,648	12,576	12,751	12,971	12,941	12,910	12,850
Social security	23,572	25,187	25,415	25,963	28,510	30,349	30,468	30,180	30,310
Other public services	1,545	1,485	1,517	1,593	1,556	1,561	1,484	1,460	1,460
Common services	1,297	1,307	1,321	1,216	1,453	1,544	883	910	950
Scotland	5,478	5,644	5,821	5,893	5,772	5,853	5,655	5,530	5,430
Wales	2,166	2,263	2,343	2,356	2,243	2,223	2,239	2,190	2,180
Northern Ireland	3,076	3,275	3,209	3,215	3,218	3,335	3,372	3,380	3,370
Government lending to nationalised industries	−347	1,080	2,541	2,459	1,457	1,274	986	1,050	750
Local authority current expenditure not allocated to programmes (England)	—	—	—	—	—	—	801	390	200
Adjustments									
Public corporations' net overseas and market borrowing	1,384	679	−630	−683	260	−1,014	−259	−370	−530
Special sales of assets	−928	—	−1,308	−394	79	−500	−650	−1,250	−400
Contingency reserve	—	—	—	—	—	250	1,300	—	—
Provisional reserve	—	—	—	—	—	—	—	2,500	2,400
General allowance for shortfall	—	—	—	—	—	−900	−1,100	—	—
Planning Total*†	96,187	100,726	100,706	102,728	104,684	105,614	105,920	106,110	105,770
Planning Total—rounded*	96,200	100,700	100,700	102,700	104,700	105,600	105,900	106,100	105,800
Planning total including Budget measures and other changes	—	—	—	—	—	105,100	105,700	—	—

MR SCHOLAR'S DRAFT

BUDGET SECRET

1. Public expenditure has risen in recent decades in real terms and as a share of GDP. Charts 1 and 2 below indicate the course of this growth-:

2. As a consequence, and in parallel, the burden of taxation has also grown over this period, as Chart 3 shows.

It is the government's intention to arrest these long-established upward trends. Last month's Public Expenditure White Paper (Cmnd 9143) set out in detail the government's plans on the level and make-up of public spending to 1986-87. On the assumptions on inflation in paragraphs X-Y above, these plans mean that public expenditure should remain broadly level in real terms for the next three years.

4. The financial strategy set out in paragraphs X-Y above projects forward this stability for a further two years, to 1988-89, with the assumption that public expenditure in 1987-88 and 1988-89 will remain at its 1986-87 level in real terms. Such public expenditure totals, four and five years hence, will naturally be subject to review in successive years. But the extended period of stability in public spending foreshadowed in the medium term financial strategy should, as the economy grows, lead to further falls in the share of the national product taken by public spending; and should provide scope for reductions in the level of public borrowing and in the burden of taxation.

5. The government are today publishing a Green Paper on expenditure and taxation in the longer term which provides an illustrative framework within which public spending for a further five years, up to 1993-94, may be considered, together with the implications for the burden of taxation. The illustrations in the Green Paper are of public expenditure remaining level in real terms throughout the period up to 1993-94; or growing at no more than an average 1% in real terms a year after 1988-89.

6. The Green Paper is a discussion document, and records no decisions about future public expenditure totals, or about taxation. But it concludes that the pressures for ever higher public spending will be intense over the next ten years, just as they have been in the past twenty; and that it will be possible to make worthwhile reductions in the tax burden by 1993-94 only if firm control over public expenditure is maintained.

A 59

FROM: F CASSELL
23 February 1984

SIR T BURNS

cc - Sir P Middleton
Mr Odling-Smee
Mrs Lomax
Mr Riley

MEDIUM TERM FINANCIAL STRATEGY

I showed the Bank the draft of the monetary section of the MTFS (as sent forward under Mr Riley's submission of 17 February).

They are quite happy with it with the exception - not surprisingly - of paragraph 12.

Eddie George has suggested an alternative version, which would begin at the top of page 5:

> "... interpretation. Assessment of monetary conditions and judgements about interest rates would take account equally of both narrow and broad money, as well as other available evidence, including the exchange rate. The ranges shown in table 2.2 have again been constructed on the assumption that there is no major change in the exchange rate from year to year. The broader aggregates might have particular relevance for decisions about fiscal and funding policy, though this kind of distinction cannot be carried far: in the real world the different aspects of policy are necessarily interrelated."

I think this is an improvement. The problem with paragraph 12 is that it was drafted very closely on the Mansion House speech, in the light of the Chancellor's instructions after Samuel Brittan's article inspired by the Bank. Significantly this paragraph seems to emerge unscathed from every version that goes to the Chancellor. I think that this revised version would

553/2

also meet some of Sir P Middleton's unhappiness about paragraph 12. If you are all agreed on it, perhaps the best thing would be to minute the Chancellor specifically about this proposed change since it does touch on such a sensitive spot.

For the rest, the Bank had only minor drafting suggestions.

They thought that the material in paragraphs 3 and 4 might be slightly regrouped. The last sentence of paragraph 3 fitting better into the supply side arguments in paragraph 4. (I don't attach much weight to this.)

The second footnote under table 2.1 should refer to building society deposits in December 1983 and January 1984.

Paragraph 8 might better begin:

> "In the year to mid-February £M3 grew by [$10\frac{3}{4}$] per cent; its growth rates over the last 12, 6 and 3 months were ..."

Paragraph 10.a., last line above the table:

> "A progressive further decline in inflation"

Paragraph 11, end of first line, add:

> "In interpreting its behaviour the authorities..."

I hope we can get the Chancellor's approval of changes of this sort quickly, so that we can send an agreed version to the Bank of England ahead of next week's two meetings between the Chancellor and the Governor.

F CASSELL

Ps. This was dictated before our further discussion with Sir Peter Middleton this morning about M2. I will pursue the points raised there with the Bank.

CH/EX REF NO B(84)305

FROM: J O KERR

DATE: 24 February 1984

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell

MR HALL

FIVE YEAR MTFS?

The Chancellor has seen your further minute about the de Zoete & Bevan circular of 9 February, and has minuted as follows:-

> "Evidently a leak: I am very concerned about this. Budget security - and this goes for all Budget documents - is essential".

J O KERR

CONFIDENTIAL

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FROM: J O KERR
DATE: 28 February 1984

Mr Battishill

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Littler
Mr Cassell
Mr Evans
Mr Odling-Smee
Mr Monger
Mr Ridley
Mr Scholar
Mr Hall
Mr Riley
Mr Stibbard
Mr Collinson
Mr Norgrove
Mr Martin

FSBR

The Chancellor has seen Mr Norgrove's minute of 27 February. His answers to the questions in its para 11 are as follows:-

desk

a. /Should Part I be amalgamated with Part IV?/
On balance, he would prefer to stick to the format of FSBR 1983, though it would be helpful if Part I could be confined to a single page.

b. /Should Part V go ahead?/
Yes.

2. In addition, the Chancellor suggests that Part III should include a breakdown of forecast Q4 1984 inflation on the lines of the 1982 and 1983 breakdowns given in Table 3.3. Given the press comment on the PEWP, he thinks it important to scotch the belief that there is likely to be a large increase in nationalised industry prices.

JOK.

6/4/2

J O KERR

covering BUDGET SECRET

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CHANCELLOR

A See para 12 (slightly)

FROM: C J RILEY
DATE: 28 February 1984

cc Economic Secretary
Sir Peter Middleton
Sir Terry Burns
Mr Cassell
Mr Lankester
Mr Odling-Smee
Mrs Lomax
PS/Governor)
Mr George) B/England
Mr Flemming)
Mr Goodhart)

MEDIUM TERM FINANCIAL STRATEGY

I attach a revised version of the MTFS, taking on board the changes agreed at your meeting yesterday. It is due to be discussed at your meeting with the Governor tomorrow afternoon. The section on monetary conditions, which is now based on the first guess at the February money figures, is likely to need changing when the provisional figures are available.

CJR

C J RILEY

Bank

1 [B] Happy with monetary section. See no trouble in operating within this framework.

2 [B] Prefer safety margin on PSBR.
Better if didn't have to strive to get down to it. (Never have to say it was central).
7¼ looks more precise

3 Know of LTPE but not yet seen it.

4 Budget measures. One change. Decided to drop Consumer credit licence duty.

[B] Amalgamation + original. V. important step forward.
Uncertainty re impact of company tax package.
Don't yet have estimate of cost saving. If large impact would affect PSBR, resource allocation; BoP.
Not case for holding back. Personally don't think will be large - hope manageable.

[C] No precedent. Made own estimate + taken into account in arithmetic. What think is that paying bills in advance. Only way of avoiding is immediate effect - would be too disruptive. Must live with uncertainty

[B] Risk on monetary side. Nervous. On top of underlying increase. Incentive to providers of leases.
Could have implications for stem

[C] Have to accept that, but give impression of worry or uncertainty. Take into account

[B] Nat Savings target - higher target might put pressure on short rates.
Lower need to sell gilts should help. Portfolio overseas stockholding might also help.

(C) That should also be helped by larger contingency reserve.

(B) Feel rather without credit duty will provide measure in consumer debt ratio. Hope possibility for change in structural instruments next year.

(C) Happy to look again next year. Logic; revenue; but marginal. Not likely to have significant effect.

(B) Accept - but margin about 1%?

(C) No way will be on mortgages.

1072a/2

DRAFT 28.2.84

MEDIUM TERM FINANCIAL STRATEGY

Objectives

1. Inflation has come down to levels not experienced in the UK since the 1960s. There has been a steady recovery in output for almost three years. The aim over the medium term is to continue reducing inflation and to build on recent improvements in the performance of the economy. The Government therefore intends to continue with present policies. The medium-term financial strategy sets out the framework within which policy operates.

The Financial Framework

2. Firm financial policies are the essence of the strategy. This entails control of monetary growth and public sector borrowing. In order to reduce inflation further, the Government intends to continue reducing rates of monetary growth. The paths appropriate for different measures of money depend on the nature of the measures and the structural influences on them, as well as the behaviour of other financial indicators. Fiscal policy is designed to be consistent with the monetary framework and the Government's objectives for inflation. A congruence of monetary and fiscal policy is necessary to ensure balance in the economy, particularly between investment and consumption and between sectors which are more or less exposed to international competition. Falling monetary growth and inflation require a further reduction in the PSBR as a share of GDP, to permit interest rates to fall in nominal and real terms.

3. Lower cost and price inflation within a given financial framework makes room for faster growth of output and employment. The reduction in inflation achieved so far has been an important factor in the strong growth of output the UK is now experiencing, ahead of other European countries. The continuing low rate of inflation indicated by the MTFS will also provide the macroeconomic environment for a sustained improvement in the supply side of the economy, towards which the Government's micro-economic policies are directed.

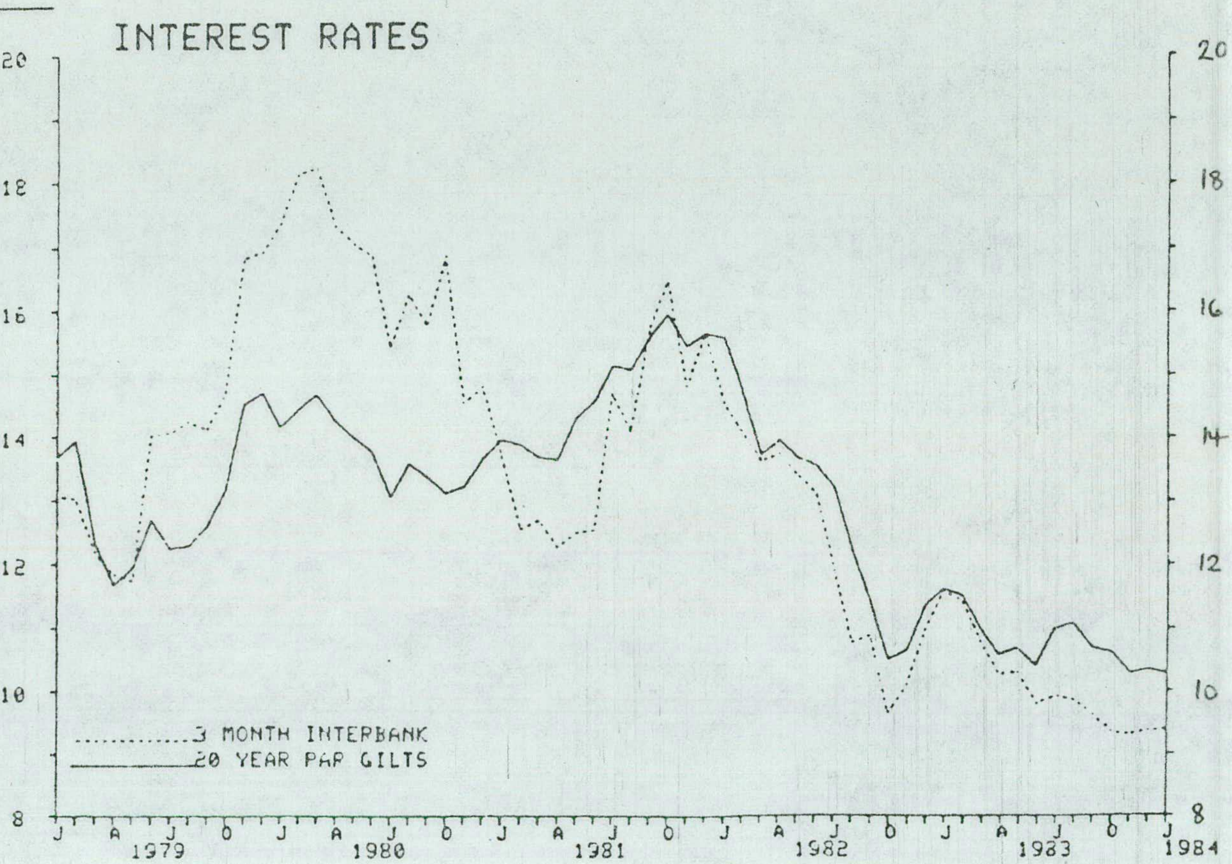
4. Further improvements in productivity and moderation in pay will lead to higher levels of output and employment. In spite of recent improvements, there is still a substantial gap between the level of productivity in the UK and that in most other major industrial countries. The Government will continue to encourage enterprise, efficiency and flexibility by increasing incentives, promoting competition, improving the working of markets, and pressing ahead with privatisation.

RECENT FINANCIAL CONDITIONS

Monetary conditions in 1983-84

5. Monetary conditions have been broadly consistent with the objectives indicated last year. Of the three target aggregates, both £M3 and M1 grew within the 7-11 per cent range in the year to mid-February. Although the growth of PSL2 was somewhat above the top end, since the summer its growth too has been within the target range. Other evidence, including the behaviour of narrower measures of money, also supports the view that conditions have been satisfactory. The effective exchange rate has remained broadly flat. Nominal short and long term interest rates have continued to fall from their peak in 1980-81, after a short interruption at the end of 1982; but with inflation lower too, real rates remain high by past standards.

CHART 2.1



Notes: 3 MONTH INTERBANK LAST FRIDAY OF MONTH
20 YEAR PAR GILTS AVERAGE OF WEDNESDAYS

Table 2.1: Monetary Growth in 1983-84

	Percentage change during year					
	M0[1]	M1	M2[2]	£M3[3]	PSL1	PSL2
February 1983-February 1984	$6^1{}_4$	11	9	10	$10^1{}_4$	$12^3{}_4$

1. Weekly averaged series
2. Excluding the reclassification of building society deposits in December 1983 and January 1984, the growth of M2 over the year was [$7^1{}_2$] per cent.
3. Old definition: including public sector deposits.

Narrow Money

6. M1 grew by [11%] over the year to mid February, [close to the top of the target range]. But the increasing share of interest bearing deposits within the total has complicated interpretation, and made M1 an increasingly inadequate measure of transactions balances.

7. Other measures of narrow money have continued to grow more slowly. M0, and its principal component, notes and coin, rose by [$6^1{}_4$ per cent] over the year to mid February; M2 and the non-interest bearing component of M1 grew rather faster. There was some acceleration in all these aggregates over the winter of 1982-83, but since then the growth rates have eased back slightly.

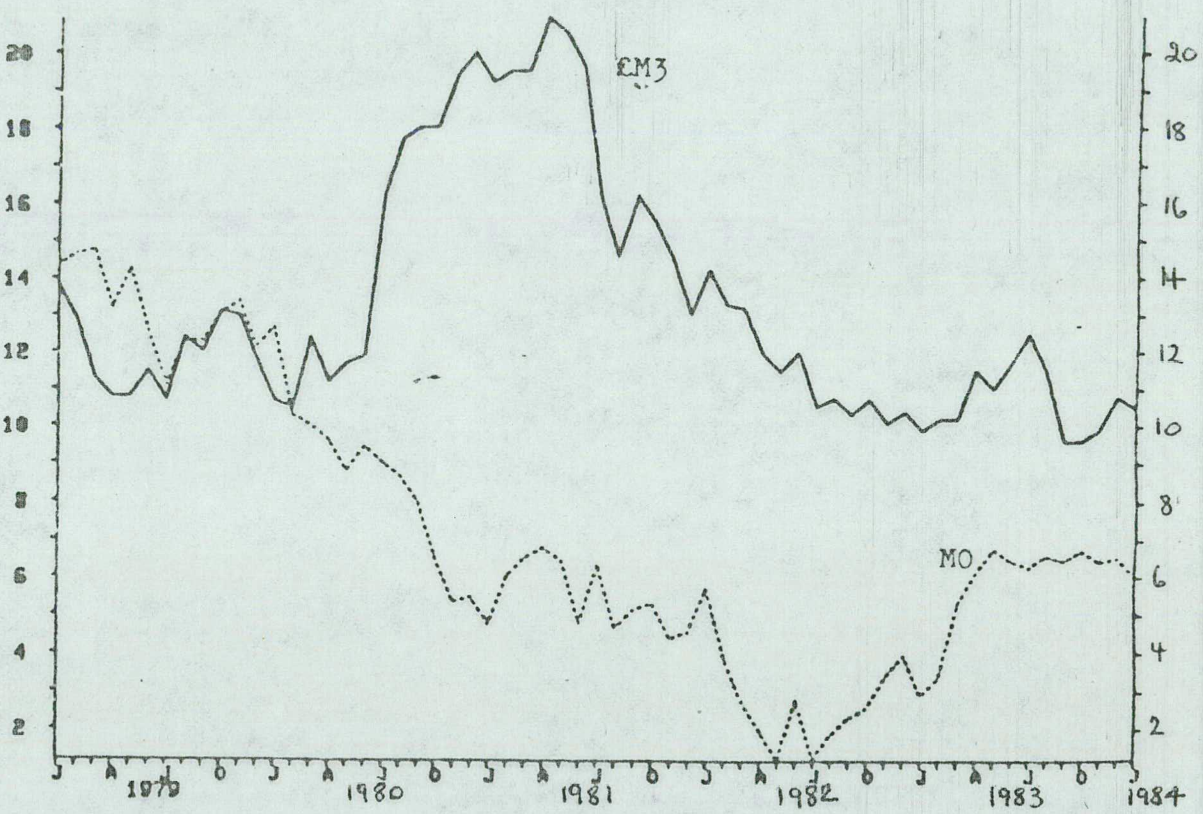
Broad Money

8. In the year to mid February £M3 grew by [10] per cent, well within the target range. The growth rate rose sharply in the early months of the target period, but slackened again from the summer onwards. The main expansionary influence during the Spring was the public sector's demand for credit; bank lending to companies grew very slowly, reflecting a marked improvement in their financial position. More recently, there has been an increase in lending by banks to the private sector, offset by a contraction of their lending to the public sector. PSL2 has grown rather faster than £M3, by [123_4%], as

highly competitive rates enabled building societies to attract record inflows in the second half of the year.

CHART 2.2

MONETARY GROWTH
PERCENTAGE CHANGE ON YEAR EARLIER



Notes: (1) Based on banking months (MO is based on weekly data averaged over the banking month)

(2) £M3 has been adjusted to take account of the introduction of the new monetary sector in November 1981 in place of the former banking sector.

(3) Old definition of £M3: including public sector deposits.

MONETARY POLICY

Money ranges

9. The Government will continue to pay attention to both broad and narrow measures of money. As explained above, the behaviour of M1, the measure of narrow money hitherto used for target purposes, is becoming increasingly difficult to interpret. Other measures of narrow money, such as M0, are likely to be more satisfactory indicators of financial conditions. M2 should eventually be a better guide than M1, but it will need interpreting with particular care for some time since it is a relatively new aggregate and its recorded growth has recently been distorted by changes in the terms of building society accounts.

10. Past experience suggests that, over time , narrower monetary aggregates tend to grow more slowly than the broad aggregates. In the last two years, differences in the behaviour of M1 and the broad aggregates were not expected to be very large, which is why they were encompassed within the same target range. But in general, separate target ranges for broad and narrow money are more appropriate, particularly as the period of the MTFS is extended.

11. As in previous versions of the MTFS the monetary ranges give a broad indication of the objectives of monetary policy for a number of years. But the ranges for 1984-85 are targets. The target for broad money is 6-10 per cent, the range indicated in last year's Financial Statement. The target for narrow money in 1984-85 will be 4-8 per cent. As in previous years, the targets apply to the annual rate of growth over the 14 months beginning in mid-February 1984. Illustrative ranges for the following four years are also shown in table 2.2. Targets for the later years will be decided nearer the time, taking account of any changes in the financial structure that may alter the economic significance of different aggregates. The aim will be to maintain monetary conditions consistent with a continuing downward trend in inflation.

Table 2.2 Ranges for Monetary Growth

percentage change during year

	1984-85	1985-86	1986-87	1987-88	1988-89
Narrow money - M0[1]	4-8	3-7	2-6	1-5	0-4
Broad money - £M3[2]	6-10	5-9	4-8	3-7	2-6

1 Weekly averaged series.

2 New definition: excluding public sector deposits.

12. The target for broad money remains £M3. In interpreting its behaviour the authorities will continue to take account of other indicators of broad money, in particular PSL2. The target for narrow money applies to M0. In interpreting its behaviour attention will also be paid to other indicators of narrow money and in particular M2, though as noted above this aggregate will need careful assessment. Both PSL2 and M2 include building society liabilities, which are an important element in monetary conditions. These liabilities have in the past grown [slightly] more rapidly than the equivalent liabilities of the monetary sector.

13. Broad and narrow money will have equal status in the assessment of monetary conditions and interest rates. As in the past, the authorities will take into account all the available evidence, including the exchange rate.

FISCAL POLICY

14. In the last three years, fiscal policy has been significantly tighter than in 1979-80 and 1980-81. The PSBR has averaged [less than 3½%] of money GDP, compared with over 5% in the earlier years. This has been consistent with recovery in the real economy because of the reduction in inflation and interest rates. Expenditure by both companies and households has risen in response to lower inflation and interest rates. In the case of households there has been an associated fall in the savings ratio.

% of GDP	Average 1979-81	1981-82	1982-83	1983-84
PSBR	5.2	3.4	3.3	[3.3] (estimated)

15. The PSBR in 1983-84 is now forecast at [about £10 billion], equivalent to [$3\frac{1}{4}$%] of GDP. This is broadly as forecast in the Autumn Statement, but [nearly £2 billion] higher than expected at the time of the 1983 Budget. Local Authority borrowing seems to have been running much higher than expected, and Central Government expenditure, particularly on non-cash-limited programmes, has exceeded last year's forecasts.

The PSBR path

16. Government policies have been directed to achieving a progressive reduction in public sector borrowing over the medium term. Fiscal restraint is essential to the achievement of lower inflation and interest rates. A further reduction in the PSBR over the medium term is required to be consistent with the monetary targets at acceptable interest rates.

17. The appropriate path of the PSBR from year to year reflects many considerations, including the cyclical position of the economy. The composition of public sector receipts and expenditure also has to be taken into account. The profile of public sector asset sales is an important aspect of this, since they are unlikely to make a large contribution to reducing interest rates. The higher level of asset sales over the next five years than in recent years points to an initial downward shift in the PSBR path. The pattern of North Sea oil revenues is also relevant: the likelihood that they may be close to their peak in 1984-85 is a further reason for seeking to make rapid progress this year in reducing the PSBR.

PSBR projections

18. The PSBR for 1984-85 is forecast to be [£$7\frac{1}{2}$ billion], equivalent to [$2\frac{1}{4}$%] of GDP, slightly below the figure assumed a year ago and repeated in the Autumn Statement. The fiscal projections summarised in table 2.6 show further small reductions in the PSBR as a proportion of GDP in subsequent years, to [$1\frac{3}{4}$%] in 1987-88 and 1988-89. The figures after 1984-85 are

illustrative, and decisions about the appropriate PSBR in particular years will be taken nearer the time. But the illustrative profile should be compatible with falling inflation and monetary growth, and interest rates declining in both nominal and real terms.

Assumptions

19. For the period to 1986-87, the fiscal projections in tables 2.4-2.6 are based on the public expenditure plans shown in the Public Expenditure White Paper (Cmnd 9143), updated where necessary to take account of Budget measures and estimating changes. Further details for 1983-84 and 1984-85 are given in Part 5. For 1987-88 and 1988-89, no public expenditure decisions have yet been taken and the projections assume that the public expenditure planning total remains unchanged in real terms. Asset sales in 1987-88 and 1988-89 are assumed to remain at the levels in the White Paper for the previous three years. Real output is assumed to grow by $2\frac{1}{4}$% a year on average over the five years. The general rate of inflation, as measured by the GDP deflator, which was [5]% in 1983-84, is assumed to fall to [$4\frac{1}{2}$%] in 1984-85, and to 3% by 1988-89. It is assumed that there is no major change in the exchange rate from year to year. These assumptions imply growth of money GDP falling from 8% in 1983-84 to 5% by the end of the period.

PUBLIC EXPENDITURE

20. Table 2.4 shows the relationship between the planning total for public expenditure and general government expenditure in national accounts terms (the definition of public expenditure lying behind the general government borrowing requirement).

21. Last month's Public Expenditure White Paper (Cmnd 9143) set out in detail the government's plans on the level and make-up of public spending to 1986-87. On the assumptions on inflation in paragraph 18 above, these plans mean that public expenditure should remain broadly level in real terms for the next three years.

22. This stability is projected forward for a further two years, with the assumption that public expenditure in 1987-88 and 1988-89 will remain at its 1986-87 level in real terms. If the decisions which have still to be taken on the public expenditure totals for these years follow the assumed path, this should lead to a continuing fall in the share of the national product taken by public spending.

Table 2.4: General Government Expenditure

£billion,cash

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
Public expenditure planning total(1)	113.7	120½	126½	132	136½	141½	146
Interest payments (2)	14.5	15	15½	15½	15½	15½	16
Other adjustments (3)	4.5	3½	4½	4½	5½	5½	5½
General government expenditure in national accounts terms	132.4	138½	146½	152	158	162	167
of which special sales of assets (net)(4)	0.5	1	2	2	2	2	2

(1) See Cmnd 9143 table 1.1 for 1982-83 to 1986-87. Assumed to be constant in cost terms from 1986-87 to 1988-89.

(2) For 1982-83 see table 2.4, Financial Statistics. For 1983-84 and 1984-85 see table [6.5]

(3) See table [5.3] for details. The main adjustment is to convert the definition of expenditure onto a national accounts basis.

(4) See Cmnd 9143 table 1.2 for 1982-83 to 1986-87. Assumed to be constant in cash terms from 1986-87 to 1988-89.

Totals may not add due to rounding

REVENUE

23. The growth of Government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as policy decisions. Revenue is projected on the conventional assumption of constant tax rates and indexed allowances and thresholds at the proposed 1984-85 levels except where the budget contains specific proposals for the later

years. [All changes proposed in the budget are taken into account.] No change is assumed in National Insurance contribution rates. Projections of North Sea tax revenues assume that oil prices do not change much from current levels for the next two years and then rise broadly in line with world inflation.

24. On these assumptions, general government receipts are projected to rise by [about 36] per cent between 1983-84 and 1988-89, [a little higher than the growth in total money GDP]. Government revenue from the North Sea is expected to fall in real terms after 1984-85 as North Sea output falls, but this is more than offset by rising revenues from the growing non-North Sea economy.

Table 2.5: General Government Receipts

£billion, cash

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-8
Taxes on incomes, expenditure and capital		96½	104	111	118½	126½	133
National Insurance and other contributions		21½	23	24½	26	27½	29
Interest and other receipts		11	10½	10½	11	11	11½
Accruals adjustment		-	+ 1	- ½	- ½	- ½	½
Total	122.1	128½	138½	146	155	164½	173½
of which North Sea tax(1)		9	10	9½	9½	9½	9

(1) Royalties, Petroleum Revenue Tax (including advance payments) and Corporation Tax from North Sea oil and gas production (before Advance Corporation tax set off

Totals may not add due to rounding.

PUBLIC SECTOR BORROWING

25. The projections of Government receipts and expenditure are brought together in table 2.6 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment depends critically on the estimates of revenues and expenditure.

These are subject to major uncertainties about, for example, the tax yield for an assumed set of tax rates and the behaviour of oil prices—and of course for the last two years the level of expenditure has yet to be agreed.

Table 2.6: Public Sector Borrowing(1)

£billion, cash

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
General government expenditure	138½	146½	152	158	162	167
General government receipts	128½	138½	146	155	164½	173½
Fiscal adjustments from previous years(2)	-	-	-	1½	5	9½
Annual fiscal adjustment(2)	-	-	1½	3½	4½	3½
GGBR	10	8	7½	8	7	7
Public Corporations market and overseas borrowing	- ½	- 1	- ½	- 1	-	-
PSBR(3)	10	7½	7	7	7	7
as % of GDP	3¼	2¼	2	2	1¾	1¾
Money GDP at market prices	302	326	348	369	390	410

(1) Further details for 1983-84 and 1984-85 are provided in table [6].

(2) Means lower taxes or higher expenditure than assumed in lines 1 and 2.

(3) From 1984-85 onwards, the definition of the PSBR and its components exclude changes in public sector deposits and certain other short term assets of a similar nature.

Totals may not add due to rounding.

COMPARISON WITH THE 1983 REVENUE AND EXPENDITURE PROJECTIONS

26. Table 2.7 shows changes in the fiscal projections since the 1983 FSBR.

Table 2.7 Revenues and Expenditure: Comparison with 1983 projections

	1983-84	1984-85	1985-86
General Government Expenditure	1	1½	1
General Government Receipts	-	1½	2
Implied cumulative Fiscal Adjustment	-	- ½	- 2½
GGBR	1	- ½	- ½
PSBR	1	- 1	-
Change in PSBR ratio (%)	½	- ¼	-

Changes in assumptions

27. The level of nominal GDP in 1983-84 is estimated to have been about 2 per cent higher than expected a year ago. This reflects mainly a higher level of output, due chiefly to upward revisions to past data. The increase in the GDP deflator was slightly lower than expected. Growth of money GDP in 1984-85 and 1985-86 is now projected to be a little lower than assumed last year, reflecting lower inflation. This year's budget measures have the effect of reducing the fiscal adjustment in 1985-86. The projected PSBR is [¼]% lower as a proportion of GDP in 1984-85, and unchanged in 1985-86.

Changes in receipts and expenditures

28. The factors affecting the outturn for 1983-84 are discussed in part 5. The higher level of expenditure in 1983-84, compared to a year ago is the result both of a higher planning total - the result of overspending by central government and local authorities, especially, offset by underspending on Nationalised Industries EFL's and unspent Contingency Reserve - and higher debt interest payments resulting both from higher than expected borrowing and estimating revisions. In 1984-85 and 1985-86 the planning totals, set out in Cmnd 9413, are virtually unchanged. However, in both

years debt interest payments are expected to be somewhat higher, and this is reflected in higher General Government expenditure. The projection of general government receipts takes account of the Budget measures. In 1984-85 tax receipts are expected to be about [£1½ billion] higher. This is the result of the budget measures, esimating changes and North Sea revenues, which are now projected [£2 billion] higher as a result of higher production and sterling oil prices. The projection of tax receipts in 1985-86 is about [£2 billion] lower than a year ago, due mainly to the budget measures.

CONCLUSIONS

29 The projections of expenditure,revenue and borrowing in tables 2.4-2.6 are ilustrative, and could be different in particular years if the domestic and world economies developed in a markedly different way. Bur whatever the response to short term fluctuations, the trend will be maintained, bringing with it continued progress to lower inflation.

30.. To achieve the ultimate objective of stable prices with lower interest rates, the declining trend in monetary growth and public borrowing will need to be maintained beyond the MTFS period. And to bring about progressive reductions in taxation at the same time, expenditure has to remain under tight control.

31. The Green Paper on Expenditure and Taxation which is published today provides an illustrative framework for a further five years showing projections of public spending totals alongside the implications for taxation.

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BUDGET SECRET

CH/EX REF NO B(84)377

NOTE OF A DISCUSSION OF THE DRAFT 1984 MTFS AND PROPOSED BUDGET MEASURES BETWEEN THE CHANCELLOR AND THE GOVERNOR AT THE TREASURY AT 2.30 PM ON 29 FEBRUARY 1984

Present:

Chancellor	Governor	Mr Lankester
Economic Secretary	Deputy Governor	Mrs Lomax
Sir P Middleton	Mr George	Mr Riley
Sir T Burns	Mr Goodhart	Mr Kerr
Mr Cassell	Mr Fleming	

I MTFS

The meeting considered the latest (28 February) draft of the 1984 MTFS.

2. The Governor confirmed that the Bank were content with the text. In particular, the section on monetary policy, and specifically table 2.2 and paragraphs 12 and 13, which had been much discussed, was now entirely acceptable to the Bank.

3. The Chancellor drew attention to the projected PSBR path, with a sharp step change down in 1984-85, followed by a gradual decline thereafter. He had not yet taken a final decision on the precise figure for the 1984-85 PSBR: the choice lay between £7.5b and £7.25b. The Governor said that the Bank would be very content with £7.5b: £7.25b would be even better. Mr George added that the market expectation was for £8b, or perhaps marginally below £8b. To come out at £7.5b or £7.25b would be well received, particularly if it was felt that the figure was perhaps a little above the central forecast. It was noted that the markets should spot that the position on the Reserve was very different, and much more comfortable, than the one which had obtained at the start of the present financial year, when the figure for assumed shortfall on public expenditure actually exceeded the figure shown for the Reserve.

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4. The Chancellor mentioned the plan to publish on Budget Day a Green Paper on long term taxation and public expenditure. It was agreed that the Bank should be shown a copy of the latest draft.

II BUDGET MEASURES

5. The Governor said that the Bank welcomed the proposed measures as imaginative and useful. There were uncertainties about the effects of the CT rate/capital allowances package during the transitional period, but the proposed reform was valuable, and he was sure that it should go ahead.

6. It was noted that there would certainly be some advancement of investment as a result of the announcements in respect of capital allowances; but that there might be rather more advancement of bill-paying. The risks of a surge in bank lending to the company sector were considered, and it was noted that circumstances could arise in which short term interest rates might have to be higher, as a result of the effects of the package on the financial sector, than they might otherwise be. But it was agreed that this price would be worth paying.

7. The Chancellor mentioned that he had decided to drop for Budget '84 the proposed consumer credit duty. The effects on the company sector of the change in leasing, the introduction of the composite rate, the change to LAPR, and the changed treatment of building society gilts would cumulatively be considerable, and he had concluded that it would be a mistake to throw in CCD as well at this stage. Mr George hoped that CCD was not shelved for all time: it would have had some value as an instrument of monetary control. It was noted that CCD, if not extended to building society mortgages qualifying for mortgage interest relief would be a fairly minor instrument, and

that the political difficulties of extending it to such mortgage business might well be insuperable. But it was agreed that the proposal for a CCD covering the same scope as the last variant considered in this Budget should be considered again for Budget '85.

8. The Deputy Governor expressed concern about the proposal to raise the national savings target from £3 billion to £3.5 billion. This would be bound to bring additional upward pressure on short term interest rates. It was suggested that it would be difficult to raise the target next year, in view of assurances given to the banks in connection with the composite rate. So no increase in 1984 might mean no increase for two years. Moreover funding through national savings had over the last six months been running at an annual rate of some £3.5b. It was however noted that both the banks and the building societies would complain if the target were raised this year. They would also monitor funding performance through national savings, and would complain if it appeared that a £3b target were likely to be overshot. The Deputy Governor however thought that the most sensitive time, in relation to both banks and building societies, was the present. Once the banks had accepted that they were going to have to face all the administrative difficulties of the composite rate, and had made a start on re-programming their computers, they would be less likely to complain loudly. The Governor too thought that an overshoot of a £3 billion target would bring fewer and less strident protests than the announcement now of a £3.5 billion target. The Chancellor said that he was disposed to agree, but would think further about the issue.

9. On the composite rate, the Chancellor noted that the banks had broken the confidentiality of the consultative process. It would be very helpful if the Governor could make it known that any further public campaign on this issue would be bound to reduce the likelihood that the authorities would again conduct such confidential consultations.

10. The question of the foreign emoluments deduction was raised, and it was suggested that complaints from the foreign banking community in London could be disarmed by transitional phasing arrangements. The Chancellor said that he had considered the point since the Governor had first raised it with him. He was however advised that the concession sought would affect a wide range of individuals, including second generation immigrants who continued to benefit from the current arrangements by preserving a notional domicile abroad. Moreover, it would be politically difficult to ~~appear~~ to include in the Budget what would appear as a further concession to a wealthy section of the community. He had concluded that the Inland Revenue proposal should stand.

11. The Governor and the Chancellor noted with satisfaction that contacts and co-operation between the Bank and the Treasury in the run-up to the Budget had been particularly close and effective.

JOHN KERR
1 March 1984

Distribution:

PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Battishill
Mr Lankester
Mrs Lomax
Mr Riley

PS/Governor) Bank of
PS/Deputy Governor) England

CH/EX REF. NO. B(84) 389.

FROM: J O KERR

DATE: 2 MARCH 1984

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Monger
Mr Odling-Smee
Mr Riley
Mr Folger
Mr Norgrove
Mr Ridley
PS/IR
PS/C&E

MR BATTISHILL

FSBR: TREATMENT OF 1985-86 FIGURES

The Chancellor has given further thought to your minute of 29 February, in the light of your helpful supplementary advice yesterday. On reflection, he does not think that the possible 1985-86 column for table 1.1 of the FSBR is worth having. He is accordingly prepared to settle for your original proposal that the total 1985-86 effect of the Budget should be mentioned in the FSBR only in a single sentence in the text.

2. As for the form of table 1.1, the Chancellor would be content with something along the lines of the version you submitted yesterday, dropping the 1985-86 column, provided that stamp duty is shown as a separate line.

JOK.

J O KERR

1. SIR PETER MIDDLETON
2. CHANCELLOR

copies attached for

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State

cc Sir Terence Burns
Mr Bailey
Mr Cassell
Mr Monck
Mr Evans
Mr Battishill
Mr Odling-Smee
Mr Lankester
Mr Scholar
Mr Folger
Mr M Hall
Mrs Lomax
Mr S Davies
Mr A Ridley
Mr Portillo
Mr Lord

PRESENTATION OF THE MTFS

I attach some notes on the presentation of the MTFS. In terms of the headings listed in Mr Kerr's minute of 14 February, they cover "key items" and "pitfalls". The notes are in the style of briefing, mainly in order to keep the length down, and the aim will be to ensure consistency with the relevant section of the Budget briefing.

CJR

C J RILEY

KEY THEMES

(a) General

(i) Inflation has come down to levels not experienced in the UK since the 1960s, and there has been a steady recovery in output. The aim is to continue reducing inflation and to build on recent improvements in the economy by continuing with present policies.

(ii) This means continuing to reduce rates of monetary growth, and further reductons in the PSBR as a share of GDP.

(iii) The MTFS imposes an essential financial discipline on the Government, and provides the framework for achieving consistency between monetary and fiscal policies.

(iv) It indicates to the private sector the financial environment it faces, and thereby improves confidence and encourages favourable expectations about the future.

(v) The MTFS now sets out the government's intentions over a longer period than previously - 5 years, the whole life of this Parliament.

(vi) The paths for the PSBR and monetary growth should be consistent with interest rates falling in nominal and real terms.

(vii) Lower cost and price inflation within a given financial framework makes room for faster growth of output and employment.

(b) Monetary Targets

(vi) The target range for broad money is as set out in last year's MTFS: it still applies to £M3, with other indicators of broad money, particularly PSL2, taken into account in interpreting its behaviour.

(vii) For narrow money the focus of attention shifts to M0 because the narrow aggregate used hitherto - M1 - is becoming increasingly distorted and difficult to interpret. The target range for M0 is lower than for broad money because past experience suggests it tends to grow more slowly. In interpreting its behaviour, other indicators of narrow money, in particular M2, will also be taken into account.

(viii) Broad and narrow money will have equal status in the assessment of monetary conditions and interest rates, but as in the past, the authorities will continue to take into account all the available evidence including the exchange rate.

(c) PSBR path

(ix) The PSBR is reduced significantly in 1984-85, to a lower level than in last year's MTFS, and thereafter falls gradually as a share of GDP.

(x) The higher level of asset sales over the next five years than in the recent past, and the likelihood that revenues from the North Sea will be near their peak, are both reasons for making rapid progress in reducing the PSBR.

PITFALLS

Defensive material should include the folowing:

(a) General Stance and Objectives of Policy

(i) Fiscal policy has been expansionary - that explains the recovery in the economy. No, the recovery mainly reflects lower inflation and lower interest rates. The worst of the recession occurred in 1980 when the PSBR was at its largest and inflation at its peak; the recovery started in 1981 when - on any definition - fiscal policy was more contractionary, but when inflation had fallen sharply.

(ii) Reduction in PSBR too great, and will kill off the recovery. Prospects favourable for the coming year. Reduction in PSBR will help to secure lower interest rates, which will sustain the recovery. The PSBR reduction in 1981-82 did not prevent the economy from moving steadily out of recession.

(iii) Is the PSBR reduction in 1984-85 sufficient, given higher asset sales, once-for-all effect of change to VAT on imports, and high North Sea revenues? The PSBR forecast is £7 billion, £1 billion lower than in last year's MTFS. It is £3 billion lower than 1983-84, 1% of GDP, which is a big step down and demonstrates clearly the government's commitment to firm fiscal policies.

(iv) Fall in inflation due to world conditions/other countries have made more substantial progress. Many other countries have been applying the sorts of policies to deal with inflation that we have ourselves adopted, and these policies have met with widespread success in reducing inflation. Since inflationary expectations were more firmly entrenched in Britain than in many other countries (eg US, Germany, Japan) our achievement has been especially impressive. Those countries which have not given so much priority to the problem of inflation now have significantly faster inflation than we do.

(v) What has happened to the ultimate objective of zero inflation? That remains the ultimate objective and the MTFS path makes substantial progress towards it. Growth in GDP deflator down from 5% in 1983-84 to 3% by the end of the period. If we do better than that there will be room for more output growth.

(vi) Why price stability? Restoration of stability to value of money reduces uncertainty and allows people to make more rational calculations about the future. Efficiency of the economy improved.

(vii) Why incur costs of reducing inflation further when we can easily live with 5%? Costs very limited if prices and wages adjust quickly and must be compared with benefits. Inflation at 5% is quite high enough to create uncertainty and reduce efficiency of the economy. It was considered much too high in 1950s and 1960s.

(viii) 3 per cent inflation assumption for 1988-89 hardly any better than the $3\frac{1}{2}$ per cent inflation rate achieved temporarily in 1983. Assumption relates to GDP deflator which rose by more than 5 per cent in 1983, so significant further progress is assumed.

(ix) When will price stability be achieved? That depends on many factors, including world inflation and behaviour in the domestic economy. It could be more quickly than we have assumed - between 1988-89 and 1993-94 - but right to make a cautious assumption.

(x) GDP growth too optimistic. $2\frac{1}{4}$% is well below rate achieved in 1950s and 1960s (2.9% from 1951 to 1973). It is near centre of range achieved in peacetime periods from 1850s onwards. Plenty of scope for catching up with productivity levels of other countries. There is also room for growth above underlying trend rate.

(xi) Assumed GDP growth is not adequate, and shows that the stance of policy is too tight. Assumption is $2\frac{1}{4}$% per year, about the average of the post-War period and well above the figure achieved over the last decade. Furthermore, unlike in the last decade, the contribution of the North Sea to GDP growth may be negative as oil production gradually declines.

(xii) GDP growth insufficient to bring down unemployment. Provided that pay settlements are reasonable and efficiency continues to improve, there is every chance that unemployment will fall within the MTFS period. Also, the Budget measures - eg the abolition of NIS - will encourage additional employment.

(xiii) What is the Government doing about unemployment? By reducing inflation and providing a stable financial environment, the Government is creating the best conditions for sustainable growth of output and employment. Against this background, unemoyment will come down most rapidly if the labour market, especially real wages, adjusts quickly.

(xiv) MTFS a fiction after 1986-87 because there are no public expenditure plans. The MTFS is primarily about the overall stance of policy rather than the precise details. The PSBR figures for 1987-88 and 1988-89 represent the Government's broad intentions, given the assumptions about developments in the economy. The fiscal adjustments in those years could in principle be used to finance lower taxes or higher expenditure.

(xv) Consistent with Green Paper on Public Expenditure and Taxation into the 1990's? The Green Paper takes the MTFS as its starting point, and makes projections for the later years which are consistent with it.

(b) Monetary Targets

(i) Changing the target monetary aggregates shows government does not have a clear idea of which aggregates affect the economy in which ways? Not a question of government changing its mind about how different aggregates affect the economy, it is the changing character of M1 - increasing interest bearing component - which makes it difficult to interpret and hence less suitable as a narrow target aggregate.

(ii) Why two targets? Encapsulating both broad and narrow money in one target range has been possible in the last two years only because the growth of M1 and the broad aggregates were not expected to be very different. But growth of M0 is expected to be lower than growth of the broad aggregates, given the trend in its velocity, and so separate targets are appropriate. There is nothing unusual in this. For example, the United States has for many hears had a higher target for broad money than for narrow money.

(iii) MTFS getting too complicated to affect private sector behaviour? Setting out two target ranges instead of one is hardly a major complication; most helpful if government sets out in the MTFS the basis on which it actually intends to operate monetary policy.

(iv) Why not focus directly on money GDP? Much more sensible given changes in the financial system and the different behaviour of different aggregates. It never has been the case that the authorities focus exclusively on one measure of money. Have always stressed the importrance of paying attention to other indicators, and have been ready to change the specification of the targets in the MTFS - eg the introduction of M1 in 1982 and M0 this year. Other potential target variables, such as the exchange rate, would also pose difficulties in practice. Money GDP is quite unsuitable as an operational target, not least because information on it tends to be significantly delayed and subject to revision.

(v) MO quite unsuitable as a target. Insensitive to short-term interest rates and liable to be distorted by financial innovation (as shown by BEQB article in December 1982). Econometric evidence never conclusive, but more recent work by Treasury suggests that there has been some interest sensitivity and that it is possible to take account of financial innovation in assessing behaviour of MO. MO is best available proxy for transaction balances. MTFS stresses need to assess its behaviour in light of other indicators of narrow money, eg M2.

(vi) Why the reduction in narrow money target to 4-8%? Means a tightening of monetary policy/higher interest rates on the way? The reduction in the target reflects the different trend change in velocity of the aggregate being targetted, not a tightening of policy.

(vii) MO ranges too high given past trends in velocity. No, because declining interest rates will cause temporarily faster MO growth.

(viii) What happens if narrow and broad money give conflicting indications? Assessment of monetary conditions and interest rates based on both. But, as in the past, authorities will take into account all available evidence, including the exchange rate.

(ix) Role of exchange rate? Response to exchange rate movements depends on overall assessment of domestic monetary conditions. Exchange rate will continue to be one of the financial indicators taken into account in interpreting monetary conditions.

(x) Monetary ranges set on the assumption of "no major change in the exchange rate from year to year." What does no major change mean?

(c) PSBR Path

(i) Why the big reduction in the PSBR in 1984-85?

- the PSBR was higher than intended originally in 1983-84 and interest rates remain fairly high.
- asset sales are higher in 1984-85, and we have takenthe profile of asset sales into account in setting the PSBR path.
- change to VAT on imports only has a once-for-all effect.
- although the projection of North Sea taxes is very uncertain, they are likely to be near their peak in 1984-85. It will therefore be less easy to reduce the PSBR in subsequent years, making it more important to reduce it now.

(ii) What do you mean by "take account of asset sales in setting PSBR"? Asset sales have relatively little impact on interest rates than most other ways of reducing public expenditure or the PSBR. So if asset sales rise, it may be appropriate to have a lower PSBR so as to maintain downward pressure on interest rates.

(iii) Is the PSBR reduction in 1984-85 sufficient to bring interest rates down? That will depend on other factors, such as overseas interest rates. But clearly it makes a very considerable contribution.

(iv) No need to reduce PSBR. PSBR/interest rate link discredited. Link is not close in the short term, but in the long run it is not in doubt. The last three years, in which the PSBR has been much lower than in 1979-80-81, have seen a significant fall in both short and long term interest rates. The contrast with the US, with its high and rising deficit and high (long term) interest rates, is striking.

(v) PSBR profile does not show much decline: not very ambitions attempt to control borrowing? Necessary to make early progress in reducing the PSBR because of the rise in asset sales, the profile of North Sea taxes. The profile is consistent with the assumptions about inflation. Figures of course for later years are only illustrative, and can be changed nearer the time.

(vi) Odd relationship between projections of PSBR and monetary ranges. Cash figures for PSBR shows big fall next year then almost no further fall, while monetary ranges fall steadily. The paths are consistent: the PSBR declines further as per cent of GDP.

(vii) Does zero inflation mean should aim for a balanced Budget? As long as the economy is growing and the public sector is increasing its productive physical assets, it is appropriate to borrow. Also, from point of view of financial markets, people will be prepared to increase net holdings of Government debt at acceptable interest rates when their real incomes are growing and Government is acquiring productive assets.

(viii) PSBR inappropriate measure of fiscal policy: Public Sector or General Government Financial Deficit are better measures. No single statistic such as the PSBR can totally describe fiscal conditions: hence, we take its composition into account (eg the effect of asset sales). The main factors which affect the difference between the PSFD and the PSBR have been taken into consideration in setting the PSBR path. But GGFD certainly not an adequate measure; it is unaffected by changes in the profitability of nationalised industries, which clearly do affect the economy.

(ix) PSBR should be defined so not affected by asset sales? Present treatment is symmetrical because when assets purchased they add to the PSBR. Have taken account of profile of asset sales in setting the PSBR path: this is one reason for the size of the fall in the PSBR between 1983-84 and 1984-85.

(x) Real PSBR?

- a useful indicator of fiscal conditions. But not sensible to set nomnal PSBR to achieve targets for real PSBR, (could involve raising nominal PSBR if inflation rises, effectively accomodating higher inflation).
- lower inflation has meant some easing in fiscal conditions in 1983-84; real PSBR has risen slightly, compared with 1982-83, (one way in which lower inflation helps to raise real demand, within given nominal framework).

(xi) Cyclically adjusted PSBR?

- no single correct way of calculating cyclical adjustment (not enough just to take out direct "cost of unemployment" - cyclical adjustment to PSBR depend on precisely what is assumed about monetary policy and how the cyclical change is achieved.
- even if it could be calculated, there is no reason why it should be held constant/take a particular value.
- acid test is pressure on interest rates. Actual not hypothetical PSBR that has to be financed (and affects spending)

- objective is to secure trend reduction in PSBR relative to GDP: the cyclical position is taken into account (eg 1981), but not via a mechanical cyclical adjustment.

(xii) Changes in public sector balance sheets (published by IFS) show fiscal policy is expansionary. Short run changes in these data can be highly volatile - substantially affected by revaluations and not a good guide to fiscal conditions. Flow variables such as the PSBR more relevant to setting fiscal policy in the short term.

(xiii) Fall in public sector net worth is worrying? IFS figures are a very incomplete measure of the public sector's net worth, and certainly exaggerate the present situation. The forecast decline in the PSBR will anyway reduce the fall in public sector net worth.

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COPY NO 2

ECONOMIC PROSPECTS TO EARLY 1986, AND ECONOMIC ASSUMPTIONS IN THE MTFS AND GREEN PAPER ON PUBLIC EXPENDITURE AND TAXATION

The March 1984 Financial Statement and Budget Report contained an economic forecast to mid-1985 and an extension of the Medium Term Financial Strategy to financial year 1988-89. In addition the Green Paper on Public Expenditure and Taxation into the 1990s discussed growth in the long term and suggested some plausible assumptions. The attached tables and note give further details of these forecasts, and assumptions and of the effects of the Budget. They are for the personal use of the recipient only.

EA/MP Groups
HM Treasury

4 APRIL 1984

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Mr G Midgley
Mr J Thorp

ECONOMIC PROSPECTS TO EARLY 1986

The short-term forecast described in Part 3 of the FSBR does not differ markedly from the internal Winter Forecast circulated by Mr Evans on 13 February. There is little to add therefore to what was said there and in the FSBR itself. The paragraphs below compare the FSBR forecast with earlier ones, discuss briefly those aspects of the economic prospects not covered in the FSBR and summarise data changes since the Winter Forecast. The attached tables give more detail than was published.

Comparison with Previous Forecasts

2. Table 1 summarises the FSBR and earlier forecasts. Our assessment of the prospects for growth and inflation in 1984, both at home and overseas, have changed very little since the Autumn Statement. Indeed the latest forecast of UK GDP growth is not much different from that given in last year's FSBR. The only significant change since the Winter Forecast is a higher forecast of manufacturing output. This is partly due to upward revisions to recent data.

More on the FSBR Forecasts

3. As can be seen from Table 1 unemployment (seasonally adjusted excluding school leavers) may remain around 3 million. Employment, on the other hand is expected to continue increasing. Employment in total might increase by about 300,000 between the fourth quarters of 1983 and 1985, following an estimated 60,000 increase in 1983. Within this total employment is forecast to fall in general government and manufacturing, and to rise elsewhere.

4. Our assessment of the financial prospects has changed little since January. The nominal effective exchange rate is assumed to average 83 over the next two years, implying a small appreciation from the current level. This seems consistent with current forward rates and the prospects for the current account. The pound may appreciate against the dollar but depreciate against the DM and Yen. Banks' base rates fell soon after the Budget and our view is that, within the monetary policy framework, there is scope for a similar fall later in the year. This view

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Table 1

SUMMARY AND COMPARISON OF FORECASTS

	FSBR/MTFS MARCH 1983	AUTUMN STATEMENT	WINTER 1984	FSBR/MTFS MARCH 1984
World Trade in Manufactures				
(% change on year earlier)				
1982	- 3½	- 3	- 3	- 3
1983	1	- ½	1	1
1984	6½	5½	4½	5
1985	6½	6½	5	4½
GDP Volume				
(% change on year earlier)				
1981	- 2½	- 1½	- 1½	- 1½
1982	½	2	2	2
1983	2	3	3	3
1984	2½	3	3	3
1985	2½		2½	2½
Manufacturing Output				
(% change on year earlier)				
1981	- 6½	- 6½	- 6½	- 6½
1982	- ½	½	0	0
1983	2	1½	1	1½
1984	2½	3	2½	3½
1985	2	1½	1½	2
Unemployment				
(UK sa excluding school leavers, millions, new definition)				
1982 Q1	2.7	2.7	2.7	2.7
1983 Q1	3.0	3.0	3.0	3.0
1984 Q1	2.9	2.9	2.9	3.0
1985 Q1	3.0	2.9	2.8	3.0
1986 Q1	3.0	2.8	2.8	3.0

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	FSBR/MTFS MARCH 1983	AUTUMN STATEMENT	WINTER 1984	FSBR/MTFS MARCH 1984
RPI				
(% change on year earlier)				
1981 Q4	12	12	12	12
1982 Q4	6	6	6	6
1983 Q4	6	5	5	5
1984 Q4	5½	4½	4½	4½
1985 Q4	5		4	4
Effective Exchange Rate				
1975 = 100				
1981	95	95	95	95
1982	91	91	91	91
1983	81	83	83	83
1984	82	84	83	83
1985	81	83	83	83
Current Balance				
(£ billion)				
1981	6	6½	6½	7½
1982	4	5½	5½	5½
1983	1½	½	2	2
1984	1½	0	1½	2
1985	- ½	1	½	½
Nominal GDP (mp)				
(% change on year earlier)				
1981	9½	9½	9½	10
1982	9	9½	9½	9½
1983	7½	8½	8½	8½
1984	8½	8	8½	8
1985	8	7½	7	7

is very much conditional on stability in the exchange rate and further downward revisions to inflationary expectations as the market's view of inflation comes more into line with that of the official forecast. Similar reasoning points to a further fall in nominal interest rates in 1985-86, when 3 month inter-bank rate could be below 8 per cent on average, compared with 9 per cent currently.

Data

5. In most instances the data used to construct the Budget forecast were in agreement with the latest published figures - ie those of the January 1984 "Economic Trends". There were some exceptions to this however. In particular:-

(i) Revisions to the trade figures were taken on board, and the past data was consistent with DTI's Press Notice on the January trade figures and CSO's Press Notice, Balance of Payments in the fourth quarter and year 1983. These revisions involved the reclassification of certain transactions in gold to the capital account, which lead to an upward revision to current account surpluses since 1980, and a downward revision to exports of goods and services in 1983*, mainly for exports of manufactures. In addition the definition of erratic items was changed to exclude silver bullion.

(ii) Revisions to current price, average GDP at market prices were incorporated. The figures used were close to those published in the March Press Notice.

6. In other instances where the model data do not correspond exactly to the January "Economic Trends" figures it is because provisional CSO revisions were incorporated. This was particularly useful where provisional 1983 Q4 data were available. It was not possible of course to achieve full consistency with the GDP Press Notice published on the 20th March, 1984 as the figures were not finalised in time to incorporate them fully in the Budget forecast.

* The 1982 figures were also revised down in the Press Notice on the February Trade figures.

THE ECONOMIC EFFECTS OF THE BUDGET MEASURES

7. Estimates of the economic effects of the Budget first require a view to be taken as to how the economy might have developed without the Budget measures, in order to have a base from which to assess the impact of the Budget changes. This base should represent 'unchanged policies', but this is not an unambiguous concept. For public expenditure, 'unchanged policies' for a long time was interpreted as sticking to public expenditure plans in volume terms, but the switch to planning in cash terms has necessitated some rethinking. It is now standard practice to assume a cash limit squeeze will operate, if actual inflation exceeds the rates assumed in the cash plans. On the tax side, the conventional interpretation of 'unchanged policies' has been no changes in tax rates and allowances/reliefs, except for statutory indexation of income tax allowances and revalorisation of specific duties.

8. It can be argued, however, that this conventional definition of 'unchanged policies' is at variance with the approach in the MTFS, where broad guidelines are laid down for a number of years for the overall fiscal stance (as measured by the PSBR). In MTFS terms, 'unchanged policies' thus means no change in the fiscal stance. On this view, unless the Budget is 'PSBR-neutral' on the conventional arithmetic for all years covered by the MTFS, unchanged tax rates and allowances/reliefs will not constitute a no policy change alternative with which the Budget measures can be legitimately compared.

9. On the conventional arithmetic, the Budget package is PSBR-neutral for 1984-85, but not for 1985-86 and subsequent years. For 1985-86, the Budget measures imply an increase in the PSBR of something under £2 billion. The abolition of postponed accounting for VAT on imports, which will yield once-for-all additional revenue of £1.2 billion in 1984-85, is important in producing PSBR-neutrality for the first year.

10. An analysis of the economic effects of the tax changes in the Budget compared with no changes in tax rates has been made. For 1984-85 at least this would give similar results to an analysis based on no change in fiscal stance. The Budget package is mildly reflactionary, but the Treasury model suggests that the overall boost to output will be small (only around + 0.1 per cent in each of the first two years). The level of the RPI will be increased by around ⅓ per cent by the extension of VAT to take-away food and the real increase in tobacco duty, but there should be no impact on the underlying inflation rate.

11. The company tax changes may well have major economic consequences in the long-run, with the tax bite on taxable profits substantially reduced, but subsidies now available on certain kinds of investment also much reduced, and employment costs down, both relative to capital and in absolute terms (through NIS abolition). It is, however, very difficult to offer any quantitative estimates of the long-run effects of all these changes. For the short-run, we estimate the corporation tax rate reductions, the changes in capital allowances and stock relief, and the abolition of NIS are together likely to add - on the conventional arithmetic - around £$\frac{1}{2}$ billion to the PSBR for 1984-85, and £1 billion for 1985-86. The main short-run effect on activity is likely to be the impact of forestalling (bringing forward investment to take advantage of capital allowances before they are entirely phased out) on fixed investment. Because of forestalling, total fixed investment may be over one per cent higher in 1984-85 as a result of the company tax changes alone, and $\frac{1}{2}$ per cent in 1985-86. These estimates are of course subject to a wide margin of error. With most of this additional investment being plant and machinery, the import content is likely to be relatively high, and there could be a substantial adverse impact on the current account. The abolition of stock relief is likely to have a negative impact on stockbuilding in 1984-85 - perhaps around £200 million at 1980 prices - as stock levels are adjusted for the change in tax regime. All these effects and those of the other Budget measures are of course incorporated in the post-Budget forecast summarised in the first section of this note.

PROJECTIONS FROM 1985-86 TO 1988-89 AND BEYOND

12. The MTFS period has been extended to 1988-89, and the Green Paper on the longer term (Cmnd 9189) makes assumptions about the growth of GDP through to 1993-94.

13. The assumed rate of growth of GDP is $2\frac{1}{4}$ per cent over the five years from 1983-84. Growth is forecast to be $2\frac{3}{4}$ per cent up on a year earlier in the second half of 1985. Thereafter it is assumed to grow at 2 per cent a year to the end of 1988-89. Production in the North Sea sector is forecast to decline from the end of 1985-86, falling at an annual rate of about 8 per cent - around the centre of the Department of Energy's forecast range. The growth of GDP excluding the North Sea is therefore about $\frac{1}{2}$ per cent a year faster than for total GDP in the three years 1985-86 to 1988-89. The growth of consumers' expenditure averages 3 per cent a year from 1985-86, and provides, arithmetically, the chief contribution to GDP looked at in terms of expenditure growth. Private fixed investment also provides a positive contribution to GDP growth.

14. The forecast rise in the GDP deflator in 1985-86 is assumed to be $4\frac{1}{4}$ per cent, declining to 4 per cent in 1986-87 and by $\frac{1}{2}$ per cent in each of the two subsequent years. There is little change in the exchange rate and real world oil prices, and a rise in the world price of commodities of around 5 per cent a year. Private sector earnings are assumed to decelerate by $1\frac{1}{2}$ per cent in the 1986 pay round and by a further 1 per cent in both the 1987 and 1988 rounds by which time the rate of growth of private earnings is projected to be about 4 per cent. Whole economy real earnings net of tax continue to grow quite briskly over the MTFS period, averaging about 3 per cent a year between 1985 and 1988.

15. For the work on the Green Paper two alternative assumptions for GDP over the period 1988-89 to 1993-94 have been used; that GDP grows annually by 2 per cent and $1\frac{1}{2}$ per cent, with corresponding figures of $2\frac{1}{4}$ and $1\frac{3}{4}$ per cent for GDP excluding North Sea production. The growth of productive potential may slow in this second period as the projected growth in the labour force virtually ceases and production in the North Sea continues to decline. Further discussion of these growth assumptions is given in Annex 3 of the Green Paper.

16. A major purpose of the projections of GDP beyond 1985-86 is to provide the framework for analysing public sector expenditures and receipts. This analysis can be helped by bringing together the key aggregates on expenditure, receipts and borrowing. This is done in tables 12-15 .

17. The figures for net debt interest relate to general government, and are on a national accounts basis. Other net receipts includes on the expenditure side the national accounts adjustments and certain public corporations' capital expenditure and on the receipts side accruals adjustments and other general government receipts, which is mainly rent, dividend and trading income. (See Table A5, footnote 5, of the Green Paper).

18. An important working assumption behind these figures is that inflation falls to zero by 1993-94. Nominal interest rates are assumed to fall in line with this reduction in inflation. As a consequence of this and the assumed reduction in the PSBR as a per cent of GDP there is a fall in net debt interest payments by general government which broadly matches the reduction in the PSBR between 1988-89 and 1993-94.

1984 BUDGET FORCAST

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TABLE 1 SUMMARY OF EXPENDITURE

£ MILLION AT 1980 PRICES,SEASONALLY ADJUSTED

	1 CONS EXPDT	2 PUBLIC AUTH CONS	3 FIXED INV	4 FINAL DOMEST DEMAND	5 STOCK BUILD -ING	6 TOTAL DOMEST DEMAND	7 EXPORTS GOODS+ SERVICES	8 TOTAL FINAL EXPDT	9 IMPORTS GOODS+ SERVICES	10 FACTOR COST ADJT	11 GDP(E) AT FACTR COST	12 COMPR ADJT	13 GDP(COMP) AT FACTR COST	14 GDP INDEX 1980=100
1980	137324	48419	39241	224984	-3236	221748	63202	284950	57429	30854	196667	887	197554	100.0
1981	137559	48329	35557	221445	-2655	218790	61932	280722	55462	30023	195237	-445	194792	98.6
1982	139422	48942	37646	226010	-1000	225010	62838	287848	57564	30927	199357	-766	198591	100.5
1983	144752	50152	39338	234242	620	234862	63190	298052	60433	32079	205540	-1368	204172	103.3
1984	149518	50054	41883	241455	1493	242948	66334	309282	64766	33048	211468	-999	210469	106.5
1985	154160	50199	43230	247589	1605	249194	68909	318103	67893	34014	216196	-402	215794	109.2
1980 QTR 1	34911	12074	10238	57223	-501	56722	16561	73283	15557	7964	49762	713	50475	102.2
QTR 2	34128	12006	9989	56123	-135	55988	15832	71820	14956	7626	49238	496	49734	100.7
QTR 3	34134	12100	9645	55879	-1201	54678	15351	70029	13635	7544	48850	-54	48796	98.8
QTR 4	34151	12239	9369	55759	-1399	54360	15458	69818	13281	7720	48817	-268	48549	98.3
1981 QTR 1	34423	12084	8983	55490	-1010	54480	15170	69650	12802	7543	49305	-754	48551	98.3
QTR 2	34380	11954	8803	55137	-1329	53808	15279	69087	13378	7430	48279	-225	48054	97.3
QTR 3	34329	12245	8813	55387	-182	55205	15659	70864	14807	7598	48459	296	48755	98.7
QTR 4	34427	12046	8958	55431	-134	55297	15824	71121	14475	7452	49194	238	49432	100.1
1982 QTR 1	34216	12171	9375	55762	56	55818	15716	71534	14357	7655	49522	-134	49388	100.0
QTR 2	34606	12175	9149	55930	240	56170	15986	72156	14793	7702	49661	-124	49537	100.3
QTR 3	35012	12183	9535	56730	-612	56118	15285	71403	14187	7771	49445	42	49487	100.2
QTR 4	35588	12413	9587	57588	-684	56904	15851	72755	14227	7799	50729	-550	50179	101.6
1983 QTR 1	35448	12662	9892	58002	595	58597	15778	74375	14679	7889	51807	-838	50969	103.2
QTR 2	36106	12493	9641	58240	-45	58195	15657	73852	14945	7980	50927	-254	50673	102.6
QTR 3	36517	12486	9768	58771	-130	58641	15374	74015	15051	8070	50894	25	50919	103.1
QTR 4	36681	12511	10037	59229	200	59429	16381	75810	15758	8140	51912	-301	51611	104.5
1984 QTR 1	36776	12526	10377	59679	346	60025	16308	76333	15840	8158	52335	-350	51985	105.3
QTR 2	37290	12504	10339	60133	352	60485	16519	77004	16074	8233	52697	-250	52447	106.2
QTR 3	37510	12483	10552	60545	388	60933	16655	77588	16341	8282	52965	-200	52765	106.8
QTR 4	37942	12541	10615	61098	407	61505	16851	78356	16510	8375	53471	-199	53272	107.9
1985 QTR 1	37861	12529	10800	61190	390	61580	16954	78534	16714	8377	53443	-200	53243	107.8
QTR 2	38202	12582	10809	61593	420	62013	17127	79140	16857	8445	53838	-200	53638	108.6
QTR 3	38808	12527	10761	62096	400	62496	17344	79840	17063	8548	54229	-1	54228	109.8
QTR 4	39289	12561	10860	62710	395	63105	17482	80587	17257	8644	54686	-1	54685	110.7
1986 QTR 1	39016	12531	10845	62392	206	62598	17567	80165	17260	8598	54307	1	54308	110.0

COL 4=COLS 1+2+3; COL 6=COLS 4+5

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TABLE 2 FIXED INVESTMENT

AT 1980 PRICES,£ MILLION SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12
	-BUILDINGS,PLANT AND MACHINERY AND VEHICLES-						PRIV. DWELLS	PRIV. LAND	TOTAL PRIV.	TOTAL PUBLIC (1)	TOTAL FIXED INV. (1)	TOTAL LEASING
	MANUF(EXCL. LEASING) PRIV.	PUBLIC	TOTAL	PRIV. SHIPPING & AIR TRANS.	PRIV. NORTH SEA	OTHER PRIV. NON MAN.						
1980	6146	299	6445	0	2158	12446	3820	2492	27062	12179	39241	830
1981	4665	200	4865	0	2332	12334	3154	2790	25275	10284	35557	899
1982	4263	194	4457	0	2297	13424	3384	4186	27554	10092	37646	1014
1983	4153	154	4307	0	1883	14188	4125	3805	28154	11183	39338	796
1984	4728	160	4888	0	2350	15430	4369	3607	30484	11400	41883	918
1985	5293	160	5453	0	2224	16269	4570	3590	31946	11285	43230	976
1980 QTR 1	1669	76	1745	0	556	3099	1046	712	7082	3156	10238	199
QTR 2	1611	79	1690	0	548	3039	985	645	6828	3161	9989	209
QTR 3	1522	71	1593	0	481	3083	955	575	6616	3029	9645	203
QTR 4	1344	73	1417	0	573	3225	834	560	6536	2833	9369	219
1981 QTR 1	1245	65	1310	0	541	3091	832	499	6208	2775	8983	212
QTR 2	1177	45	1222	0	640	2941	759	587	6104	2700	8803	210
QTR 3	1131	41	1172	0	606	3095	780	813	6425	2389	8813	228
QTR 4	1112	49	1161	0	545	3207	783	891	6538	2420	8958	249
1982 QTR 1	1066	71	1137	0	588	3381	825	1003	6863	2512	9375	246
QTR 2	1072	35	1107	0	587	3172	826	1060	6717	2432	9149	266
QTR 3	1045	46	1091	0	584	3455	825	1075	6984	2551	9535	274
QTR 4	1080	42	1122	0	538	3416	908	1048	6990	2597	9587	228
1983 QTR 1	993	48	1041	0	568	3428	968	1061	7018	2874	9892	215
QTR 2	1051	31	1082	0	517	3409	1060	930	6967	2674	9641	182
QTR 3	1031	39	1070	0	373	3595	1016	930	6945	2822	9768	195
QTR 4	1078	36	1114	0	425	3756	1081	884	7224	2813	10037	204
1984 QTR 1	1115	40	1155	0	500	3791	1103	885	7394	2984	10377	217
QTR 2	1140	40	1180	0	640	3796	1066	910	7552	2787	10339	207
QTR 3	1210	40	1250	0	635	3902	1090	905	7742	2810	10552	247
QTR 4	1263	40	1303	0	575	3941	1110	907	7796	2819	10615	247
1985 QTR 1	1323	40	1363	0	566	4067	1119	904	7979	2822	10800	256
QTR 2	1323	40	1363	0	556	4083	1132	892	7986	2823	10809	231
QTR 3	1309	40	1349	0	556	4030	1151	896	7942	2819	10761	240
QTR 4	1338	40	1378	0	546	4089	1168	898	8039	2821	10860	249
1986 QTR 1	1304	40	1344	0	551	4107	1176	894	8032	2813	10845	252

(1) PUBLIC SECTOR INVESTMENT IS FINANCIAL YEAR SEASONALLY ADJUSTED.CONSEQUENTLY COL 11 WHICH IS CALENDER YEAR SEASONALLY ADJUSTED,IS NOT PRECISELY EQUAL TO THE SUM OF COLS 9 AND 10

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TABLE 3 CONSUMERS EXPENDITURE

	1 REAL TOTAL	2 CONSMR DUR-ABLES	3 EXP. NONDUR -ABLES	4 REAL PERSNL DISP. INC.	5 SAVINGS RATIO	6 CONSMR PRICE INDEX	7 % CHANGES ON PREVIOUS YEAR OF: CONSUMPTION TOTAL	8 CONSUMPTION DUR-ABLES	9 CONSUMPTION NONDUR -ABLES	10 PERSNL DISP. INC.	11 CONSMR PRICES	12 RPDI	13 WEALTH-INCOME RATIO	14 INT"T RATES REAL 1	15 INT"T RATES NOMI-NAL (3 MTH)
1981	137559	13415	124144	156903	12.33	111.1	.2	3.0	-.1	8.5	11.1	-2.4	5.08	2.8	13.9
1982	139422	14483	124902	157009	11.20	120.3	1.4	8.0	.6	8.3	8.3	.1	5.24	4.0	12.3
1983	144752	16889	127928	159971	9.51	126.6	3.8	16.6	2.4	7.2	5.2	1.9	5.99	4.9	10.1
1984	149518	18341	131176	163838	8.74	132.6	3.3	8.6	2.5	7.3	4.7	2.4	5.98	4.2	8.9
1985	154160	18262	135898	169551	9.08	137.5	3.1	-.4	3.6	7.4	3.8	3.5	5.93	4.2	8.0
1981/82	137352	13379	123967	156360	12.16	113.9	.4	4.5	-.1	7.9	10.7	-2.6	5.08	3.4	14.2
1982/83	140654	15253	125353	157171	10.51	122.1	2.4	14.0	1.1	7.8	7.2	.5	5.46	4.2	11.5
1983/84	146080	17346	128816	160874	9.20	128.1	3.9	13.7	2.8	7.4	4.9	2.4	6.00	4.7	9.7
1984/85	150603	18324	132279	164742	8.58	134.0	3.1	5.6	2.7	7.1	4.6	2.4	5.98	4.0	8.7
1985/86	155315	18333	136981	170804	9.07	138.9	3.1	.1	3.6	7.5	3.7	3.7	5.90	4.2	7.8
1981 QTR 1	34423	3309	31114	39926	13.78	106.4	-1.4	-6.3	-.9	11.3	11.8	-.5	5.06	1.6	13.3
QTR 2	34380	3428	30952	38933	11.69	110.1	.7	6.7	.1	8.5	10.9	-2.2	5.23	1.6	12.5
QTR 3	34329	3352	30977	38863	11.67	112.8	.6	5.8	.0	6.6	10.9	-3.9	5.01	3.3	14.2
QTR 4	34427	3326	31101	39181	12.13	115.2	.8	7.1	.2	7.7	10.8	-2.9	5.02	4.8	15.6
1982 QTR 1	34216	3273	30937	39383	13.12	117.4	-.6	-1.1	-.6	8.8	10.3	-1.4	5.07	4.0	14.4
QTR 2	34606	3437	31157	39215	11.75	119.9	.7	.3	.7	9.6	8.9	.7	5.00	4.5	13.4
QTR 3	35012	3698	31306	38948	10.11	121.3	2.0	10.3	1.1	7.7	7.5	.[illegible]	5.25	3.9	11.5
QTR 4	35588	4075	31502	39463	9.82	122.6	3.4	22.5	1.3	7.1	6.4	.7	5.65	3.5	9.9
1983 QTR 1	35448	4043	31388	39545	10.36	124.6	3.6	23.5	1.5	6.6	6.2	.4	5.93	4.9	11.1
QTR 2	36106	4075	32018	39700	9.05	125.7	4.3	18.6	2.8	6.2	4.9	1.2	6.05	5.3	10.1
QTR 3	36517	4304	32193	40098	8.93	127.2	4.3	16.4	2.8	8.0	4.9	3.0	5.99	4.9	9.8
QTR 4	36681	4467	32329	40628	9.72	128.6	3.1	9.6	2.6	8.0	4.9	3.0	5.98	4.4	9.4
1984 QTR 1	36776	4500	32276	40448	9.08	130.9	3.7	11.3	2.8	7.4	5.0	2.3	5.98	4.3	9.3
QTR 2	37290	4700	32590	41053	9.17	131.9	3.3	15.3	1.8	8.5	4.9	3.4	5.96	4.1	9.0
QTR 3	37510	4589	32920	41040	8.60	133.2	2.7	6.6	2.3	7.2	4.7	2.3	5.98	4.1	8.8
QTR 4	37942	4552	33390	41297	8.12	134.2	3.4	1.9	3.3	6.0	4.3	1.6	6.01	4.3	8.6
1985 QTR 1	37861	4483	33379	41352	8.44	136.8	3.0	-.4	3.4	6.9	4.5	2.2	5.98	3.7	8.2
QTR 2	38202	4518	33684	42200	9.47	137.2	2.4	-3.9	3.4	6.9	4.0	2.8	5.93	4.0	8.0
QTR 3	38808	4613	34195	42853	9.44	137.7	3.5	.5	3.9	7.9	3.4	4.4	5.89	4.5	7.8
QTR 4	39289	4648	34640	43146	8.94	138.4	3.5	2.1	3.7	7.8	3.2	4.5	5.91	4.6	7.7
1986 QTR 1	39016	4554	34462	42605	8.42	142.4	3.0	1.6	3.2	7.2	4.1	3.0	5.89	3.6	7.6

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TABLE 4 RETAIL PRICES INDEX AND ITS COMPONENTS

INDEX NUMBERS BASED ON JANUARY 1979=100

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
	INDEX LEVELS					-ONE QUARTER PERCENTAGE CHANGES-					-FOUR QUARTER PERCENTAGE CHANGES-				
	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL SUM	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL
WEIGHTS(1)	219	128	73	581											
1980	255.8	269.4	308.3	259.3	263.7	2.4	6.4	6.5	2.9	3.6	12.1	29.0	25.2	16.8	18.0
1981	277.5	318.2	368.3	286.4	295.0	2.3	4.8	2.9	2.5	2.8	8.5	18.1	19.5	10.5	11.9
1982	299.3	358.2	418.6	306.5	320.4	1.1	.9	3.5	1.5	1.5	7.9	12.6	13.6	7.0	8.6
1983	308.8	367.0	441.0	323.6	335.1	1.5	1.7	.3	1.2	1.2	3.2	2.5	5.4	5.6	4.6
1984	323.4	397.2	452.4	337.8	351.3	.7	1.6	.8	1.1	1.1	4.7	8.2	2.6	4.4	4.8
1985	333.5	415.1	467.2	351.7	364.9	.8	.8	.7	.9	.9	3.1	4.5	3.3	4.1	3.9
1980 QTR 1	247.5	241.0	280.4	246.7	248.8	4.3	9.1	6.7	3.6	4.7	13.1	25.8	19.2	20.0	19.1
QTR 2	255.9	272.3	299.3	259.1	263.2	3.4	13.0	6.7	5.0	5.8	13.6	31.1	26.1	22.0	21.5
QTR 3	259.3	278.7	315.7	263.9	268.9	1.3	2.4	5.5	1.9	2.2	11.8	29.4	26.5	13.8	16.4
QTR 4	260.7	285.8	337.7	267.5	273.9	.5	2.5	7.0	1.4	1.9	9.9	29.4	28.5	12.3	15.3
1981 QTR 1	268.7	285.2	352.5	274.0	280.4	3.1	-.2	4.4	2.4	2.4	8.6	18.3	25.7	11.1	12.7
QTR 2	277.0	319.9	364.7	285.0	294.0	3.1	12.2	3.5	4.0	4.9	8.2	17.5	21.9	10.0	11.7
QTR 3	278.8	324.0	376.3	290.7	299.1	.6	1.3	3.2	2.0	1.7	7.5	16.3	19.2	10.2	11.2
QTR 4	285.6	343.7	379.8	295.9	306.5	2.4	6.1	.9	1.8	2.5	9.6	20.3	12.5	10.6	11.9
1982 QTR 1	297.7	346.7	391.4	298.0	311.6	4.2	.9	3.1	.7	1.7	10.8	21.6	11.0	8.8	11.1
QTR 2	304.1	365.0	417.7	305.5	321.5	2.1	5.3	6.7	2.5	3.2	9.8	14.1	14.5	7.2	9.4
QTR 3	297.0	364.6	428.8	309.1	323.0	-2.3	-.1	2.7	1.2	.5	6.5	12.5	14.0	6.3	8.0
QTR 4	298.5	356.7	436.4	313.5	325.4	.5	-2.2	1.8	1.4	.7	4.5	3.8	14.9	5.9	6.2
1983 QTR 1	302.1	348.9	442.6	316.0	327.0	1.2	-2.2	1.4	.8	.5	1.5	.6	13.1	6.0	4.9
QTR 2	306.3	363.6	440.5	322.9	333.7	1.4	4.2	-.5	2.2	2.0	.7	-.4	5.5	5.7	3.8
QTR 3	310.4	375.1	438.5	326.5	338.0	1.3	3.2	-.5	1.1	1.3	4.5	2.9	2.3	5.6	4.6
QTR 4	316.4	380.6	442.3	329.1	341.8	1.9	1.5	.9	.8	1.1	6.0	6.7	1.4	5.0	5.0
1984 QTR 1	321.1	383.8	447.7	329.9	344.1	1.5	.8	1.2	.2	.7	6.3	10.0	1.2	4.4	5.2
QTR 2	324.7	397.9	451.1	336.9	351.0	1.1	3.7	.8	2.1	2.0	6.0	9.4	2.4	4.3	5.2
QTR 3	322.9	401.3	454.1	340.9	353.6	-.6	.9	.7	1.2	.7	4.0	7.0	3.6	4.4	4.6
QTR 4	324.9	405.9	456.7	343.7	356.5	.6	1.1	.6	.8	.8	2.7	6.6	3.3	4.4	4.3
1985 QTR 1	330.5	406.3	464.2	345.7	359.5	1.7	.1	1.6	.6	.8	2.9	5.9	3.7	4.8	4.5
QTR 2	335.7	419.4	468.8	350.7	365.5	1.6	3.2	1.0	1.4	1.7	3.4	5.4	3.9	4.1	4.1
QTR 3	332.8	415.0	466.6	353.6	365.9	-.9	-1.0	-.5	.8	.1	3.1	3.4	2.7	3.7	3.5
QTR 4	335.1	419.6	469.3	355.6	368.9	.7	1.1	.6	.8	.8	3.1	3.4	2.8	3.8	3.5
1986 QTR 1	338.0	422.9	480.9	363.9	375.0	.9	.8	2.5	2.0	1.7	2.3	4.1	3.6	5.3	4.3

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(1) THESE WEIGHTS ARE APPLICABLE TO INDICES BASED ON JANUARY 1974 = 100 AND DO NOT NECESSARILY SUM TO 1000

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TABLE 5 OUTPUT BY SECTOR

AT 1980 PRICES SEASONALLY ADJUSTED
INDICES: 1980=100

	1	2	3	4	5	6	7	8	9	10	11	12
							% CHANGES ON PREVIOUS YEAR					
				PRIVATE & TRADING PUBLIC						PRIVATE & TRADING PUBLIC		
	WHOLE ECON -OMY	EXCL N.SEA OIL	PUBLIC NON-TRADING	MANU -FAC	N.S.OIL + GAS 1981=100	OTHER	WHOLE ECON -OMY	EXCL N.SEA OIL	PUBLIC NON-TRADING	MANU -FAC	N.S.OIL + GAS 1981=100	OTHER
1980	100.0	100.0	100.0	100.3	90.5	100.0	-3.2	-3.4	1.2	-8.6	1.2	-1.3
1981	98.0	97.4	100.4	93.9	100.0	98.9	-2.0	-2.6	.4	-6.4	10.5	-1.1
1982	99.3	98.1	99.6	93.9	113.9	101.0	1.3	.7	-.8	.1	13.9	2.1
1983	101.4	99.7	99.8	95.3	124.7	103.8	2.1	1.7	.2	1.5	9.5	2.8
1984	104.4	102.4	100.2	98.7	132.2	107.1	2.9	2.7	.4	3.6	6.0	3.1
1985	107.0	105.2	100.0	100.8	132.8	111.0	2.5	2.7	-.2	2.1	.5	3.7
1980 QTR1	102.7	102.8	99.8	107.0	90.8	101.3	1.6	1.2	2.3	-.5	11.9	2.5
QTR2	100.7	100.9	99.8	102.6	87.5	100.6	-3.9	-4.0	.9	-8.8	-2.9	-1.9
QTR3	98.9	99.0	100.3	97.7	88.2	99.3	-4.3	-4.1	.7	-9.8	-8.1	-2.6
QTR4	97.7	97.3	100.2	93.7	95.5	98.8	-6.0	-6.5	.9	-15.0	5.6	-3.0
1981 QTR1	97.5	97.0	100.6	92.7	97.6	98.8	-5.1	-5.7	.9	-13.4	7.5	-2.5
QTR2	97.5	97.0	100.4	92.9	98.1	98.1	-3.1	-3.8	.6	-9.5	12.0	-2.4
QTR3	98.5	98.0	100.6	94.8	99.7	98.8	-.4	-1.0	.3	-2.9	13.0	-.5
QTR4	98.6	97.8	100.1	95.1	104.6	99.8	.9	.4	-.1	1.5	9.5	1.0
1982 QTR1	98.5	97.8	100.2	94.5	103.4	100.2	1.0	.8	-.4	2.0	5.9	1.4
QTR2	99.2	97.9	99.5	94.3	114.4	100.4	1.7	.9	-.9	1.6	16.6	2.3
QTR3	99.7	98.3	99.5	93.8	117.5	100.9	1.3	.4	-1.0	-1.1	17.8	2.1
QTR4	99.9	98.4	99.4	93.1	120.1	102.4	1.3	.6	-.7	-2.1	14.8	2.6
1983 QTR1	100.7	99.1	99.6	94.5	121.0	103.8	2.2	1.4	-.6	.0	17.0	3.6
QTR2	100.7	99.3	99.6	94.4	118.7	103.6	1.6	1.4	.1	.1	3.8	3.1
QTR3	101.9	100.1	99.9	95.9	126.4	103.6	2.2	1.8	.3	2.3	7.6	2.7
QTR4	102.4	100.3	100.2	96.4	132.6	104.4	2.5	2.0	.8	3.6	10.4	2.0
1984 QTR1	103.1	101.1	100.4	98.0	132.6	105.0	2.4	2.0	.8	3.7	9.6	1.1
QTR2	104.1	102.1	100.2	98.4	131.2	106.7	3.3	2.8	.7	4.2	10.5	3.0
QTR3	104.7	102.8	100.2	98.9	132.2	107.5	2.7	2.6	.3	3.1	4.6	3.8
QTR4	105.7	103.8	100.1	99.5	132.8	109.1	3.2	3.4	-.1	3.2	.1	4.5
1985 QTR1	105.6	103.7	100.0	99.9	132.8	108.8	2.4	2.6	-.4	1.9	.1	3.7
QTR2	106.4	104.6	100.1	100.6	132.5	110.0	2.3	2.4	-.1	2.1	1.0	3.1
QTR3	107.6	105.8	100.0	101.2	133.0	111.9	2.8	2.9	-.2	2.2	.6	4.0
QTR4	108.5	106.7	99.9	101.7	133.0	113.3	2.7	2.8	-.2	2.1	.2	3.9
1986 QTR1	107.7	106.1	99.6	101.1	129.1	112.6	2.0	2.3	-.4	1.2	-2.8	3.5

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TABLE 6 PRODUCTIVITY BY SECTOR

AT 1980 PRICES SEASONALLY ADJUSTED
INDICES: 1980=100

	1	2	3	4	5	6	7	8	9	10	11	12
							% CHANGES ON PREVIOUS YEAR					
				PRIVATE & TRADING PUBLIC						PRIVATE & TRADING PUBLIC		
	WHOLE ECON -OMY	EXCL N.SEA OIL	PUBLIC NON-TRADING	MANU -FAC	N.S.OIL + GAS 1981=100	OTHER	WHOLE ECON -OMY	EXCL N.SEA OIL	PUBLIC NON-TRADING	MANU -FAC	N.S.OIL + GAS 1981=100	OTHER
1980	100.0	100.5	100.0	100.3	98.7	100.0	-2.5	-2.7	1.5	-3.5	-12.8	-2.9
1981	101.4	101.3	100.9	103.5	101.5	100.3	1.4	.8	.9	3.2	2.8	.3
1982	104.6	103.9	100.7	109.6	106.1	102.9	3.2	2.5	-.2	5.9	4.5	2.6
1983	107.6	106.3	101.1	116.6	112.4	104.8	2.8	2.3	.4	6.4	5.9	1.8
1984	110.1	108.6	102.6	122.6	117.8	105.9	2.4	2.2	1.5	5.1	4.9	1.1
1985	112.1	110.8	103.4	125.9	118.4	107.9	1.8	2.0	.7	2.7	.5	1.8
1980 QTR1	101.7	102.3	99.6	103.3	100.7	101.4	1.0	.6	2.1	1.8	-15.3	.0
QTR2	100.1	100.8	99.7	100.9	96.0	100.4	-3.9	-4.0	1.2	-5.1	-19.5	-4.0
QTR3	99.1	99.7	100.3	98.8	95.7	99.1	-3.3	-3.1	1.3	-3.7	-17.3	-4.2
QTR4	99.0	99.1	100.3	97.8	102.5	99.1	-3.8	-4.3	1.4	-7.0	1.2	-3.4
1981 QTR1	99.8	99.8	100.9	99.3	102.6	99.6	-1.9	-2.5	1.2	-3.9	2.0	-1.8
QTR2	100.8	100.7	100.9	101.8	101.6	99.5	.6	-.1	1.1	.9	5.8	-.9
QTR3	102.3	102.3	101.1	105.7	99.7	100.4	3.2	2.6	.8	7.1	4.2	1.3
QTR4	102.9	102.6	100.7	107.4	102.1	101.6	3.9	3.5	.4	9.8	-.4	2.6
1982 QTR1	103.1	102.9	101.0	108.1	98.6	102.0	3.4	3.1	.1	9.0	-3.9	2.4
QTR2	104.2	103.4	100.5	109.2	106.6	102.3	3.5	2.7	-.4	7.3	5.0	2.8
QTR3	105.3	104.4	100.8	110.2	109.5	102.8	2.9	2.0	-.4	4.2	9.8	2.4
QTR4	105.9	104.8	100.6	111.0	109.4	104.5	2.9	2.2	-.1	3.3	7.2	2.8
1983 QTR1	106.9	105.8	100.8	114.4	110.3	105.6	3.7	2.9	-.2	5.8	11.8	3.5
QTR2	107.0	106.0	100.6	115.3	108.2	105.0	2.6	2.5	.2	5.5	1.5	2.6
QTR3	108.0	106.7	101.1	117.9	112.7	104.3	2.6	2.2	.3	7.0	3.0	1.5
QTR4	108.3	106.6	101.9	119.1	118.2	104.3	2.2	1.8	1.3	7.3	8.0	-.2
1984 QTR1	109.1	107.5	102.4	121.5	118.2	104.6	2.0	1.5	1.6	6.2	7.2	-1.0
QTR2	109.9	108.5	102.5	122.2	116.9	105.8	2.7	2.3	1.9	6.0	8.1	.8
QTR3	110.4	108.9	102.7	123.0	117.8	106.2	2.2	2.0	1.6	4.3	4.6	1.8
QTR4	111.2	109.7	102.9	123.8	118.3	107.2	2.7	2.9	1.0	4.0	.1	2.8
1985 QTR1	111.0	109.5	103.1	124.5	118.4	106.5	1.7	1.9	.7	2.5	.1	1.8
QTR2	111.6	110.2	103.3	125.4	118.1	107.2	1.5	1.6	.7	2.6	1.0	1.2
QTR3	112.6	111.3	103.5	126.4	118.5	108.5	2.1	2.2	.7	2.8	.6	2.2
QTR4	113.3	112.0	103.6	127.3	118.5	109.3	1.9	2.1	.7	2.8	.2	2.0
1986 QTR1	112.5	111.3	103.8	127.1	115.1	108.1	1.3	1.6	.7	2.1	-2.8	1.6

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TABLE 7 EXCHANGE RATES AND COMPETITIVENESS

	1	2	3	4	5	6	7	8
	. . . E X C H A N G E	R A T E S . . .		-----COMPETITIVENESS OF MANUFACTURES-----				
	EFFECTIVE EXCH.RATE	EXPORT WTD EXCH.RATE	DOLLAR/£ . EXCH.RATE.	.RELATIVE EXPORT PRICES	RELATIVE WHSALE PRICES	RELATIVE N.UNIT LAB.COSTS	IMPORT PRICE COMPET	RELATIVE PROFBLTY EXPORTS
1980	96.10	94.288	2.327	100.02	99.92	100.02	99.95	100.03
1981	94.87	94.705	2.027	98.50	98.41	107.72	100.20	99.32
1982	90.59	91.032	1.750	93.57	94.93	104.35	97.44	100.19
1983	83.25	83.291	1.518	90.34	87.76	97.13	93.15	102.78
1984	83.22	83.331	1.502	91.71	88.82	98.54	94.62	103.18
1985	83.50	82.149	1.612	92.01	89.72	96.96	94.64	103.00
1980 QTR 1	93.00	91.234	2.254	95.71	95.19	90.60	96.87	100.73
QTR 2	94.50	92.868	2.286	99.31	97.95	96.90	99.73	100.87
QTR 3	96.70	94.593	2.382	100.70	101.39	102.90	101.03	99.97
QTR 4	100.20	98.457	2.387	104.34	105.16	109.70	102.18	98.55
1981 QTR 1	101.40	100.783	2.309	105.56	105.68	115.10	102.98	98.44
QTR 2	97.80	97.604	2.077	101.19	101.18	109.60	102.14	98.38
QTR 3	90.60	91.076	1.839	93.81	93.85	103.80	99.75	99.69
QTR 4	89.70	89.356	1.883	93.45	92.93	102.40	95.93	100.79
1982 QTR 1	91.14	91.280	1.845	94.39	95.57	104.40	98.74	100.30
QTR 2	90.60	90.751	1.779	92.54	95.20	104.68	97.42	99.59
QTR 3	91.41	92.494	1.728	95.12	96.26	105.41	97.22	100.43
QTR 4	89.20	89.603	1.649	92.21	92.70	102.91	96.37	100.43
1983 QTR 1	80.60	80.197	1.532	85.92	84.49	92.16	92.43	102.28
QTR 2	84.30	83.882	1.553	91.59	88.97	98.42	92.27	102.74
QTR 3	85.00	85.451	1.517	93.29	90.05	99.43	93.91	103.20
QTR 4	83.10	83.635	1.470	90.56	87.52	98.52	93.97	102.92
1984 QTR 1	82.40	83.169	1.439	90.52	87.38	98.19	94.04	103.22
QTR 2	83.50	83.772	1.500	92.12	88.98	99.36	94.81	103.35
QTR 3	83.50	83.388	1.523	92.15	89.34	98.37	94.97	103.12
QTR 4	83.50	82.995	1.548	92.06	89.56	98.24	94.65	103.05
1985 QTR 1	83.50	82.651	1.573	91.99	89.70	96.38	94.72	102.90
QTR 2	83.50	82.282	1.598	92.32	89.51	97.33	94.50	103.45
QTR 3	83.50	81.952	1.624	91.97	89.74	97.05	94.70	102.97
QTR 4	83.50	81.711	1.652	91.76	89.94	97.09	94.63	102.70
1986 QTR 1	83.20	81.046	1.673	91.99	89.55	94.47	94.47	103.36

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TABLE 8 BALANCE OF PAYMENTS

AT CURRENT PRICES, SEASONALLY ADJUSTED
RECORDED AND FORECAST £ MILLION *

	1 EXPORT GOODS	2 IMPORT GOODS	3 VISIB BAL	4 NON-OIL VISIBLE BALANCE	5 EXPORT SERV	6 IMPORT SERV	7 BAL SERV	8 TRANSFERS CRED	9 TRANSFERS DEB	10 BAL TRANSF	11 IPD CREDIT	12 IPD DEBIT	13 BAL IPD	14 INVIS BAL	15 CURRENT BALANCE
1980	47422	45908	1514	1199	15787	11520	4267	1778	3858	-2080	8397	8448	-51	2136	3650
1981	50976	47325	3651	538	16871	12622	4249	2585	4551	-1966	10274	8936	1338	3621	7272
1982	55566	53181	2385	-2164	17602	13728	3874	3151	5261	-2110	10989	9587	1402	3165	5551
1983	60658	61158	-500	-7498	19030	14641	4389	3241	5561	-2320	11366	10886	480	2549	2049
1984	66617	68904	-2287	-10099	21086	16255	4831	3778	5938	-2160	13911	12117	1794	4465	2178
1985	69714	74835	-5121	-12378	23893	17669	6224	3868	6481	-2613	15326	13116	2211	5822	701
1980 QTR 1	11998	12402	-404	-310	3977	2876	1101	452	914	-462	2164	2220	-56	583	179
QTR 2	11916	12162	-246	-212	3964	2897	1067	415	1010	-595	2198	2324	-126	346	100
QTR 3	11694	10805	889	709	3906	2891	1015	436	1015	-579	1909	1893	16	452	1341
QTR 4	11814	10539	1275	1012	3940	2856	1084	475	919	-444	2126	2011	115	755	2030
1981 QTR 1	11868	10054	1814	1029	4035	2906	1129	631	1135	-504	2272	2013	259	884	2698
QTR 2	12289	10956	1333	421	4166	3086	1080	553	1080	-527	2359	1949	410	963	2296
QTR 3	13157	13067	90	-640	4311	3297	1014	624	1261	-637	2650	2328	322	699	789
QTR 4	13662	13248	414	-272	4359	3333	1026	777	1075	-298	2993	2646	347	1075	1489
1982 QTR 1	13520	13048	472	-249	4409	3313	1096	794	1284	-490	2386	2357	29	635	1107
QTR 2	13878	13667	211	-681	4480	3428	1052	687	1308	-621	2776	2391	385	816	1027
QTR 3	13688	13100	588	-695	4284	3477	807	796	1352	-556	2805	2407	398	649	1237
QTR 4	14480	13366	1114	-539	4429	3510	919	874	1317	-443	3022	2432	590	1066	2180
1983 QTR 1	14819	14616	203	-1598	4709	3588	1121	806	1327	-521	2716	2425	291	891	1094
QTR 2	14752	15212	-460	-2016	4818	3545	1273	781	1459	-678	2625	2797	-172	423	-37
QTR 3	14862	15110	-248	-1769	4679	3720	959	914	1271	-357	2993	2694	299	901	653
QTR 4	16225	16220	5	-2115	4824	3788	1036	740	1504	-764	3032	2970	62	334	339
1984 QTR 1	16363	16613	-250	-2294	4991	3934	1057	1497	1508	-11	3187	2868	319	1365	1115
QTR 2	16626	17045	-419	-2381	5161	4017	1144	721	1486	-765	3480	2912	568	947	528
QTR 3	16723	17481	-758	-2681	5360	4108	1252	750	1440	-690	3552	3093	459	1021	263
QTR 4	16905	17765	-860	-2743	5574	4196	1378	810	1504	-694	3692	3244	448	1132	272
1985 QTR 1	17076	18183	-1107	-2967	5704	4279	1425	959	1534	-575	3642	3192	451	1301	194
QTR 2	17326	18492	-1166	-2991	5933	4392	1541	963	1601	-638	3773	3282	491	1394	228
QTR 3	17577	18900	-1323	-3129	6041	4455	1586	970	1710	-740	3912	3264	648	1494	171
QTR 4	17735	19260	-1525	-3291	6215	4543	1672	976	1636	-660	3999	3378	621	1633	108
1986 QTR 1	18060	19495	-1435	-3094	6387	4625	1762	1834	1649	185	4092	3363	729	2676	1241

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TABLE 9 BALANCE OF RESOURCES

AT 1980 PRICES,£ MILLION

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
										--EXCLUDING ALL FUEL--			IN THE ABSENCE OF N. S. OIL(1)		
	EXPORTS OF GOODS	IMPORTS OF GOODS	VISIBLE BALANCE	EXPORTS SERV.S	IMPORTS SERV.S	BALANCE SERV.S	TOTAL EXPORT	TOTAL IMPORT	BALANCE RESOURCE	EXPORT GOODS	IMPORT GOODS	VISIBLE BALANCE	EXPORT GOODS	IMPORT GOODS	VISIBLE BALANCE
1980	47415	45909	1506	15787	11520	4267	63202	57429	5773	40984	39473	1511	45895	47361	-1466
1981	47054	44132	2922	14878	11330	3548	61932	55462	6470	39306	38874	432	44983	45407	-424
1982	48301	46217	2084	14537	11347	3190	62838	57564	5274	39735	41422	-1687	45926	47662	-1736
1983	48519	49403	-884	14671	11030	3641	63190	60433	2757	39004	45102	-6098	45822	50931	-5109
1984	51039	53230	-2191	15296	11536	3760	66334	64766	1568	40867	48855	-7988	48132	54747	-6615
1985	52529	56097	-3568	16381	11797	4584	68909	67893	1016	42605	51752	-9147	49727	57706	-7979
1980 QTR 1	12488	12653	-165	4073	2904	1169	16561	15557	1004	10831	10875	-44	12110	13028	-918
QTR 2	11864	12061	-197	3968	2895	1073	15832	14956	876	10303	10370	-67	11517	12433	-916
QTR 3	11444	10759	685	3907	2876	1031	15351	13635	1716	9885	9228	657	11073	11105	-32
QTR 4	11619	10436	1183	3839	2845	994	15458	13281	2177	9965	8999	966	11193	10793	400
1981 QTR 1	11440	10006	1434	3730	2796	934	15170	12802	2368	9484	8736	748	10928	10313	615
QTR 2	11589	10551	1038	3690	2827	863	15279	13378	1901	9680	9350	330	11089	10861	228
QTR 3	11935	11967	-32	3724	2840	884	15659	14807	852	9952	10541	-589	11383	12256	-873
QTR 4	12090	11608	482	3734	2867	867	15824	14475	1349	10190	10245	-55	11582	11976	-394
1982 QTR 1	11957	11524	433	3759	2833	926	15716	14357	1359	10061	10214	-153	11441	11885	-444
QTR 2	12270	11938	332	3716	2855	861	15986	14793	1193	10166	10678	-512	11703	12328	-625
QTR 3	11767	11336	431	3518	2851	667	15285	14187	1098	9498	10135	-637	11117	11661	-544
QTR 4	12307	11419	888	3544	2808	736	15851	14227	1624	10010	10394	-384	11665	11787	-122
1983 QTR 1	12126	11995	131	3652	2684	968	15778	14679	1099	9797	10997	-1200	11480	12363	-883
QTR 2	11893	12231	-338	3764	2714	1050	15657	14945	712	9588	11119	-1531	11247	12574	-1327
QTR 3	11765	12237	-472	3609	2814	795	15374	15051	323	9505	11122	-1617	11127	12670	-1543
QTR 4	12735	12940	-205	3646	2818	828	16381	15758	623	10114	11863	-1749	11967	13323	-1356
1984 QTR 1	12608	12978	-370	3700	2863	837	16308	15840	468	10028	11876	-1848	11866	13344	-1478
QTR 2	12740	13196	-456	3780	2878	902	16519	16074	445	10206	12093	-1887	12014	13571	-1557
QTR 3	12795	13449	-654	3860	2892	968	16655	16341	314	10266	12367	-2101	12075	13836	-1761
QTR 4	12896	13607	-711	3956	2903	1053	16851	16510	341	10367	12517	-2150	12176	13994	-1818
1985 QTR 1	12959	13798	-839	3996	2917	1079	16954	16714	240	10457	12700	-2243	12250	14196	-1946
QTR 2	13059	13906	-847	4069	2951	1118	17127	16857	270	10573	12816	-2243	12356	14306	-1950
QTR 3	13220	14109	-889	4124	2955	1169	17344	17063	281	10747	13038	-2291	12522	14512	-1990
QTR 4	13291	14284	-993	4192	2974	1218	17482	17257	225	10828	13197	-2369	12597	14691	-2094
1986 QTR 1	13323	14278	-955	4244	2983	1261	17567	17260	307	10946	13180	-2234	12661	14682	-2021

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TABLE 10 FACTOR INCOMES - SHARES

PERCENTAGE OF TOTAL DOMESTIC INCOME NET OF STOCK APPRECIATION

	1 WAGES & SALARIES	2 NI & OTHER CONTRI-BUTIONS	3 TOTAL INCOME FROM EMPLMT	4 INCOME FROM SELF EMPLMT	5 ..NET COMPANY NON-OIL	6 PROFITS.. OIL	7 PUBLIC CORP ETC NET-SUR-PLUSES	8 RENT	9 TOTAL DOMST. INCOME (1)
1980	59.6	8.9	68.5	8.2	8.5	4.1	2.9	7.8	100.0
1981	58.9	9.3	68.2	8.2	7.2	5.1	3.4	8.0	100.0
1982	57.9	8.8	66.7	8.4	7.7	5.4	3.7	8.0	100.0
1983	56.4	8.6	64.9	8.4	9.0	6.1	3.7	7.8	100.0
1984	55.8	8.6	64.4	8.4	9.9	6.0	3.7	7.7	100.0
1985	56.2	8.6	64.8	8.4	10.2	5.4	3.5	7.7	100.0
1980 QTR 1	58.9	8.6	67.5	8.0	9.6	4.2	3.0	7.7	100.0
QTR 2	59.2	8.9	68.1	8.1	9.8	3.8	2.6	7.6	100.0
QTR 3	60.4	9.1	69.6	8.4	7.4	3.9	2.9	7.9	100.0
QTR 4	59.7	9.1	68.8	8.3	7.4	4.3	3.2	8.0	100.0
1981 QTR 1	59.8	9.3	69.1	8.3	6.4	4.9	3.1	8.2	100.0
QTR 2	59.4	9.4	68.8	8.2	6.5	5.0	3.5	8.1	100.0
QTR 3	58.5	9.3	67.8	8.2	7.3	5.1	3.5	8.0	100.0
QTR 4	57.9	9.2	67.1	8.1	8.3	5.3	3.3	7.9	100.0
1982 QTR 1	59.2	9.2	68.4	8.4	6.4	4.9	3.8	8.1	100.0
QTR 2	57.9	8.9	66.7	8.4	8.6	4.9	3.5	7.9	100.0
QTR 3	57.5	8.7	66.2	8.5	7.7	5.8	3.8	8.0	100.0
QTR 4	57.2	8.4	65.6	8.5	8.1	6.2	3.6	8.0	100.0
1983 QTR 1	57.0	8.4	65.5	8.4	8.2	6.2	3.8	7.9	100.0
QTR 2	56.9	8.6	65.5	8.4	8.9	5.3	4.0	7.9	100.0
QTR 3	56.0	8.5	64.5	8.3	9.5	6.3	3.6	7.8	100.0
QTR 4	55.6	8.7	64.3	8.4	9.5	6.6	3.6	7.6	100.0
1984 QTR 1	55.8	8.6	64.4	8.4	9.5	6.4	3.7	7.6	100.0
QTR 2	55.9	8.6	64.5	8.4	9.7	6.0	3.7	7.7	100.0
QTR 3	55.8	8.6	64.3	8.4	10.1	5.9	3.6	7.8	100.0
QTR 4	55.7	8.6	64.3	8.4	10.3	5.7	3.6	7.6	100.0
1985 QTR 1	55.9	8.6	64.5	8.4	10.1	5.7	3.7	7.7	100.0
QTR 2	56.2	8.7	64.8	8.4	10.1	5.4	3.6	7.7	100.0
QTR 3	56.3	8.6	64.9	8.4	10.3	5.3	3.4	7.7	100.0
QTR 4	56.3	8.7	64.9	8.3	10.4	5.2	3.4	7.7	100.0
1986 QTR 1	56.7	8.8	65.5	8.3	9.6	5.2	3.6	7.8	100.0

(1) NET OF STOCK APPRECIATION

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TABLE 11 SUMMARY ANALYSIS BY SECTOR - NET ACQUISITIONS OF FINANCIAL ASSETS

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11
	.........PRIVATE SECTOR........				.......PUBLIC SECTOR.......				OVERSEAS SECTOR	RESIDUAL ERROR	
	PERSONS	IND + COMM'L COMP'S	FINANC'L COMPS	TOTAL	PUBLIC CORPNS	CENTRAL GOV'T	LOCAL AUTHS	TOTAL	(1)	(2)	NAF
1981	13740	2663	-653	15750	-1456	-7000	120	-8336	-7272	4	138
1982	10409	2469	185	13063	-1694	-6731	1119	-7306	-5551	-586	793
1983	6826	6360	632	13818	-616	-9850	-722	-11188	-2049	75	467
1984	6727	5056	746	12529	-216	-7699	-1201	-9116	-2178	1100	135
1985	8121	1996	213	10330	5	-7585	-315	-7895	-701	800	934
1981/82	13296	1511	-1021	13786	-1276	-5614	701	-6189	-5681	1741	175
1982/83	8830	4098	812	13740	-1581	-7835	464	-8952	-5538	-1940	1152
1983/84	6630	6969	838	14437	-477	-9268	-908	-10653	-2070	1457	257
1984/85	6467	4045	393	10905	57	-8364	-551	-8858	-1257	900	-110
1985/86	8353	1101	199	9653	13	-6263	-342	-6592	-1748	800	518
1981 QTR 1	4011	630	-57	4584	-613	-2155	-501	-3269	-2698	-1365	-18
QTR 2	3295	889	-229	3955	-332	-1528	-41	-1901	-2296	-194	-47
QTR 3	3043	781	-254	3570	-234	-2101	85	-2250	-789	505	26
QTR 4	3391	363	-113	3641	-277	-1216	577	-916	-1489	1059	177
1982 QTR 1	3567	-522	-425	2620	-433	-769	80	-1122	-1107	372	19
QTR 2	2867	81	46	2994	-448	-1751	430	-1769	-1027	66	132
QTR 3	2170	1011	158	3339	-273	-2013	557	-1729	-1237	125	248
QTR 4	1805	1899	406	4110	-540	-2198	52	-2686	-2180	-1150	394
1983 QTR 1	1988	1107	202	3297	-320	-1873	-575	-2768	-1094	-981	378
QTR 2	1417	1135	97	2649	-126	-2274	131	-2269	37	206	211
QTR 3	1566	2629	-182	4013	-24	-2644	-163	-2831	-653	350	178
QTR 4	1855	1489	515	3859	-146	-3059	-115	-3320	-339	500	-300
1984 QTR 1	1792	1716	408	3916	-181	-1291	-761	-2233	-1115	400	168
QTR 2	1925	1149	252	3326	-8	-2352	-171	-2531	-528	300	-33
QTR 3	1633	1074	19	2726	-39	-2065	-157	-2261	-263	200	2
QTR 4	1377	1117	67	2561	12	-1991	-112	-2091	-272	200	-2
1985 QTR 1	1532	705	55	2292	92	-1956	-111	-1975	-194	200	-77
QTR 2	2282	362	61	2705	21	-2101	-23	-2103	-228	200	174
QTR 3	2272	497	53	2822	-73	-1921	-70	-2064	-171	200	387
QTR 4	2035	432	44	2511	-35	-1607	-111	-1753	-108	200	450
1986 QTR 1	1764	-190	41	1615	100	-634	-138	-672	-1241	200	-493

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TABLE 12

LONG TERM SUMMARY TABLE

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
GDP compromise (i)	-4.0	.0	2.3	2.5	3.2	2.4	2.0	2.0	2.0
GDP at factor cost less North Sea (i)	-5.1	-.9	.8	1.8	2.9	2.6	2.6	2.5	2.6
Nom GDP at market prices £bn	234.1	257.0	281.6	304.1	328.0	350.2	371.4	392.3	412.8
£bn 1982-83 prices	275.2	274.8	281.6	289.2	298.2	305.7	312.2	318.8	325.4
GDP at market prices less North Sea £bn	224.7	244.7	268.9	287.6	311.5	334.2	355.6	376.4	397.2
Summary Public Account									
£bn cash									
PEWP Planning Total	92.7	104.7	113.4	120.3	126.4	132.1	138.7	141.4	145.7
Nat Debt Interest (N Accounts basis)	7.9	9.4	9.2	10.1	10.6	10.4	10.7	10.7	10.7
North Sea Tax	4.1	6.5	7.8	8.9	10.2	9.6	9.4	9.4	9.2
Non North Sea Tax	82.0	95.2	103.2	109.1	117.2	126.7	136.4	144.5	151.6
Fiscal Adjustment	.0	.0	.0	.0	.0	1.9	6.8	10.0	13.3
Non North Sea Tax (ii)	82.0	95.2	103.2	109.1	117.2	124.8	129.6	134.5	138.3
Other	1.4	3.6	2.4	2.4	2.3	1.1	1.4	1.4	1.6
PSBR	13.2	8.8	9.2	10.0	7.2	7.0	7.0	6.8	7.2

(i) % change on a year earlier
(ii) after fiscal adjustment

TABLE 13

LONG TERM SUMMARY TABLE

£bn 1982-83 prices	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
PEWP Planning Total	109.0	111.9	113.4	114.4	114.9	115.3	114.9	114.9	11[illegible].9
Nat Debt Interest (N Accounts basis)	9.3	10.0	9.2	9.6	9.6	9.1	9.0	8.7	8.4
North Sea Tax	4.8	6.9	7.8	8.5	9.3	8.4	7.9	7.6	7.3
Non North Sea Tax	96.4	101.8	103.2	103.7	106.6	110.6	114.6	117.4	119.5
Fiscal Adjustment	.0	.0	.0	.0	.0	1.7	5.7	8.1	10.5
Non North Sea Tax (ii)	96.4	101.8	103.2	103.7	106.6	108.9	108.9	109.3	109.0
Other	1.6	3.8	2.4	2.3	2.1	1.0	1.2	1.1	1.3
PSBR	15.5	9.4	9.2	9.5	6.5	6.1	5.9	5.5	5.7
% of Nom GDP									
PEWP Planning Total	39.6	40.7	40.3	39.6	38.5	37.7	36.8	36.0	35.3
Nat Debt Interest (N Accounts basis)	3.4	3.6	3.3	3.3	3.2	3.0	2.9	2.7	2.5
North Sea Tax	1.8	2.5	2.8	2.9	3.1	2.7	2.5	2.4	2.2
Non North Sea Tax	35.0	37.0	36.7	35.9	35.7	36.2	36.7	36.8	36.7
Fiscal Adjustment	.0	.0	.0	.0	.0	.5	1.8	2.6	3.2
Non North Sea Tax (ii)	35.0	37.0	36.7	35.9	35.7	35.6	34.9	34.3	33.5
Other	.6	1.4	.9	.8	.7	.3	.4	.3	.4
PSBR	5.6	3.4	3.3	3.3	2.2	2.0	1.9	1.7	1.8

(ii) after fiscal adjustment

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TABLE 14

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SUMMARY OF EXPENDITURE AND RECEIPTS

£bn, 1982-83 prices	1989-90	1990-91	1991-92	1992-93	1993-94
Growth of GDP (MP)	2.0	2.0	2.0	2.0	2.0
Growth of Non-North Sea GDP (FC)	2.2	2.3	2.4	2.2	2.2
GDP level (£bn 1982-83 prices)	330.3	336.9	343.6	350.5	357.5
Public Expenditure Planning Total	115.6	116.8	118.0	119.1	120.3
Net Debt Interest	8.1	7.7	7.2	6.6	6.0
North Sea Tax	7.0	6.6	6.2	5.9	5.6
Non North Sea Tax (1)	111.1	112.3	113.6	114.7	115.8
Other (Net)	1.0	1.1	1.2	1.4	1.3
PSBR	4.6	4.4	4.1	3.9	3.6

(1) After fiscal adjustment

TABLE 15

SUMMARY OF EXPENDITURE AND RECEIPTS

	1989-90	1990-91	1991-92	1992-93	1993-94
As % GDP Market Prices					
Public Expenditure Planning Total	35.0	34.7	34.3	34.0	33.7
Net Debt Interest	2.4	2.3	2.1	1.9	1.7
North Sea Tax	2.1	2.0	1.8	1.7	1.6
Non North Sea Tax (1)	33.6	33.3	33.1	32.7	32.4
Other (Net)	.3	.3	.4	.4	.4
PSBR	1.4	1.3	1.2	1.1	1.0
Non North Sea Tax burden	34.9	34.5	34.1	33.6	33.3
Total Tax burden	35.8	35.3	34.9	34.4	34.0

(1) After fiscal adjustment