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ECONOMIC POLICY

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TREASURY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 31 January, are sidelined.

M. M. Deyes

M M DEYES

12A

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7 February 1983

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policy must continue to combine firmness and flexibility. Right for Government to have adjusted money supply and PSBR objectives in light of changed circumstances. But also right that medium-term direction of policy is maintained.

2. Benefits from control of public spending?

[1983 Public Expenditure White Paper Cmnd 8789 published 1 February.]

Public spending is under firm control and well within levels set in earlier plans. Good progress being made towards objective of reducing public spending as proportion of national output. Annual rate of increase in cash spending slowed down. Demonstrates determination to release to private sector resources which would otherwise have been consumed by the public sector. (For fuller coverage see Section K).

3. Expected 1982-83 outturn undershoot means fiscal policy tighter than intended to the detriment of employment and output?

PEWP 1983 figures for spending in 1982-83 need to be interpreted with care and, in any case, are only part of fiscal picture. Likely that some undershoot of PSBR in 1982-83 but inflation also lower than expected at time of last Budget. Cannot conclude that fiscal policy has been tighter than intended. (See also ^{A13} on Budget Outlook.)

4. Economic assumptions in 1983 PEWP - revised forecasts?

[For planning purposes assumes RPI increase of 5 per cent November 1982 - November 1983, unemployment (on new basis) in GB (excluding school leavers, averaging 2.7 million in 1982-83, 3 million in 1982-83, 3 million in 1983-84.)

Some economic assumptions have to be made for planning purposes, notably about social security, unemployment etc. These are not forecasts or predictions and in any case are unchanged from those of the Autumn Statement. (See also C10 and K13 and 17.)

5. Current indicators suggest recovery over/Activity flat?

Delayed but not over. GDP over 1 per cent higher than trough in Spring 1981; industrial output some 2 per cent higher. Flatness of output during 1982 partly reflected external developments: volume of world trade fell substantially, contrary to expectation at time of 1982 Budget. But rapid progress on inflation and improvements in productivity and competitiveness are encouraging; further modest recovery in output expected in 1983.

6. Shortage of demand?

Government cannot fine-tune either money or real GDP. Domestic demand in real terms has risen by nearly 4 per cent since spring 1981. Problem is lack of external demand and UK's depressed share of home and foreign markets (reflecting weak competitiveness), though exports held up extremely well last year in face of downturn in world economy. Improvements in supply performance needed as much as increased demand. Otherwise a boost to demand may be largely wasted, even in the short term.

7. Where will growth come from?

Already seeing benefits of lower inflation and interest rates reflected in higher consumer spending and recovery of investment in housing and many parts of private industry. Recovery in world economy will assist UK growth, as will continued effort to control inflation and contain costs.

8. Fall in exchange rate/rise in interest rates/show Government strategy off course?

No. UK monetary and financial condition remain sound. Government spending and borrowing on target - as is monetary growth. Inflation is falling. Underlying industrial performance also improving eg productivity, competitiveness. UK running substantial current account surplus. Foreign currency debts almost halved since took office. Movement in sterling needs to be considered in context of strength of other currencies eg \$.

9. Exchange rate slide will improve external competitiveness?

Will only have lasting benefit if wage settlements continue to be contained at more moderate, and realistic levels. Keeping firm control of labour costs is the key to improving our competitive position. Past experience (eg 1967-72 and 1973-76) illustrates all too clearly how easy it is for immediate benefits of devaluation to be eroded through higher price and wage inflation.

10. Cost competitiveness still 20 per cent lower than 1975 - a typical year for the 1970's?

[Both CBI (Sir T Beckett) and NEDO (in paper to February NEDC) have suggested that we will need to return eventually to competitiveness levels of mid-1970s.]

No reason to believe that 1975 - or any other particular year - represents a 'typical' level of competitiveness to which we should be trying to return. Important structural changes in UK economy since then; a competitiveness level which was 'reasonable' in mid 1970s may be inappropriate now.

11. Nevertheless, still need further substantial competitiveness/improvement?

Of course, better competitiveness is desirable. Lasting improvements depend on better productivity growth, lower wage inflation. Have made start - productivity performance as good as any of competitors over last two years. Now need to match this with equally competitive performance on earnings.

12. Outlook for inflation?

Remain confident of achieving 5 per cent RPI inflation early this year. As for rest of year, path may be a little bumpier than thought at time of Autumn Statement, but must not exaggerate possible effect of exchange rate depreciation. (See also D 4-7).

13. Implications of possible oil price fall for Government revenues/UK economy?

A modest and gradual fall in oil prices would bring both gains and losses for the UK, but the overall effect would be beneficial. It reduces world inflation and boosts activity - we share in those benefits. However in no one's interest for price to fall too far or too fast. (See also F6, G17, S2.)

13. Outlook for Budget

[Some commentators have interpreted 1983 PEWP as revealing extra £½ billion available to 'give away'. Chancellor's reference at TCSC 31 January to scope in 'some countries' for rise in domestic activity interpreted as hint of reflationary Budget.]

Cannot comment on speculation that fiscal adjustment is bigger than illustrative £1 billion figure included in the Autumn Statement. Reduction in public expenditure planning total should not be taken in isolation as indicating any particular change in that figure. Fact that PSBR may be undershooting this year - and outcome still very uncertain - does not carry any necessary implications for next year's figure. Many factors enter the equation - including the path of output, inflation and interest rates. Budget decisions have yet to be taken. (See also Section H.)

14. Government should do more for industry?

Have already done a good deal but, clearly, pressures on industry need to be taken into account. However, pressures too on persons for example, representations have been made about poverty and unemployment traps. Chancellor will be considering fiscal position over coming weeks, against background of recent developments in the economy and further outlook.

15. What about CBI Budget representations?

[CBI proposals published 26 January 'Costs are Crucial', include in £4 billion programme abolition of NIS, lower business rates, extra capital expenditure, lower energy costs and

indexation of personal taxes (but not specific duties); CBI say this is possible within £9 billion PSBR.]

Chancellor will study and fully consider CBI views. All representations play a useful part in putting together a Budget. Views of national organisations like CBI are particularly important. But cannot anticipate Budget decisions.

16. TUC Budget representations?

[£10 billion Budget package in TUC Economic Review 1983 published 2 February, presented as first stage in five year programme of expansion linked to national and company level planning and accompanied by exchange controls, selective import controls and NEA.]

Of course Chancellor will study TUC views. All representations play a useful part in putting together a Budget, and views of national organisations like the TUC are particularly important. But cannot be expected to agree with TUC criticisms of general thrust of Government policy. (See also C3, G11-12 and K14.)

17. Labour Party programme

[Unclear from recent statements eg Foot 22 January, Shore in 22 and 23 January broadcasts, exactly how far Labour leadership sticking to 'Programme for Recovery'; nevertheless clear that still espouse substantial depreciation and substantial reflation, plus (Foot speech) 'planned trade'].

Defects of Labour programme remain. Blow to confidence; wage restraint assumed without specific mechanism to achieve; 'planned trade' proposals equally vague. Claimed validation by running programme through Treasury model does not make results definitive.

18. Alliance programme a more credible alternative?

['Working together for Britain' published 20 January reiterates measures urged in earlier policy statements - designed to create over $\frac{1}{2}$ million jobs at net PSBR cost of £3-4 billion].

Contains some proposals which are sensible and not too far removed from Government thinking. But largely stands or falls on success of measures to control pay and prices. Suggestions for income policy wrap old ideas in new clothes. Pays lipservice to financial prudence but vague on how this would work in practice. Claimed impact of measures in SDP statements has looked extremely optimistic.

19. Chancellor's views on achieving world economic recovery

See T10.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent GDP figures

[GDP (average) unchanged between Q2 and Q3 1982, but GDP (output - which is better short term indicator - rose slightly for second successive quarter (with construction output 3 per cent up on previous quarter) to level about 1 per cent higher than in 1981 Q2. Evidence of declining trend in manufacturing during 1982. Underlying level of industrial output in three months to November 2 per cent above 1981 Q2 trough - virtually all extra North Sea oil output; manufacturing output 1 per cent below 1981 Q2.]

Output levels, particularly in manufacturing, remain disappointing - partly due to depressed world economic activity - but consumer goods holding up well, reflecting higher consumer expenditure. Expected higher world output and lower effective exchange rate should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide sounder base for expansion in medium term.

IF PRESSED on UK economy having suffered worst collapse of any major industrialised country since 1979

[On Treasury estimates, between 1979 and 1982 UK GDP fell by just over 4 per cent; US fell $\frac{1}{2}$ per cent and Canada 2 per cent. In Germany GDP has been roughly constant and in Japan, France and Italy it rose].

UK GDP grew relatively slowly throughout post-war period. But our performance during 1982 was better than many of our competitors, and we expect to do similarly this year.

IF PRESSED on index of manufacturing production in November (86.8, 1975 = 100) returning to 1967 levels (87.8 in 1967 Q1):

Such long term comparisons inappropriate without recognising changing sectoral composition of output. As consumers' preferences change and balance of comparative advantage alters, so will pattern of output. GDP is almost 26 per cent above its level in 1967.

2. Prospect for UK economy

[Industry Act Forecast Tables summarised in Commentary at end of Brief (Z7). NB New forecast will accompany Budget 15 March; undue emphasis should not be given to precise numbers in IAF.]

Industry Act forecast published with Autumn Statement November 1982 now a little dated, but prospect for 1982 remains one of modest recovery. New forecast based on most recent developments and statistics will be published on 15 March with Budget.

Outside forecasts: many pre-Budget forecasts now pending. (NB OECD Economic Survey of UK 1982 to be published Friday 11 February).

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments?

[Quarterly Trends Survey published 1 February inevitably linked by commentators with Budget representations - see A15 - shows mixed results: some encouraging. Positive points: sharp turn round on optimism questions (partly for seasonal reasons); ~~output~~ ^{industries increasing} of consumer goods; investment intentions less negative; very moderate increases in costs and prices. Defensive: ^{overall} ~~industries~~ increasing demand and output unlikely to increase in next four months; destocking continues; further ~~overall~~ falls in employment projected.]

Latest ^{Survey's} Survey results improved - particularly as regards optimism - compared previous recent/ and although manufacturing output remains depressed, activity in consumer goods industries showing encouraging increase. CBI stresses that substantial productivity improvements and continued progress on price inflation are signs of longer term improvement in UK manufacturing industry.

5. CBI views on Budget/exchange rate?

See A 13 and 15.

6. New orders figures and short-term indicators depressing?

[See Commentary - Z6 - for latest indicators.]

Some encouraging signs but figures still manifesting depressed economic activity which itself partly reflects flatness in world trade.

7. Construction industry forecasts show prospects of modest recovery?

[Joint Forecasting Committee of industry's 'Little Noddy' published 6-monthly forecast on 15 December. Prospect is for modest recovery in three years to 1984 - although output not restored].

Construction industry's problems remain difficult, but forecast moderately encouraging and recovery in housing investment in 1983 (some 16-17 per cent) very encouraging. Improved outlook for construction reflects success of policies reducing inflation and interest rates.

8. Fall in investment?

[For latest statistics see Commentary - Z3.]

1982 Q3 figures reflect some modest recovery after disappointing second quarter. [IF PRESSED]: latest DOI investment intentions survey suggesting 3 per cent fall in manufacturing investment between 1982 and 1983 is undoubtedly disappointing; outlook for total private fixed investment more encouraging. (See B7 above).]

9. Stock levels a threat to recovery?

[For latest statistics see Commentary - Z3.]

Quarterly stocks movements tend to be erratic; Q3 de-stocking may partly reflect adjustment to involuntary stockbuilding in 1982 H1. (This view possibly supported by December Trends Inquiry). Not too much weight should be placed on single quarter's data. GDP (output) figures (see B1 above) are a better guide to recent movements in activity.

10. Government contribution to improving competitiveness?

Government role is to create right environment: firm fiscal and monetary framework allowing for lower inflation and interest rates, supply side policies, NIS cut helps reduce business costs. Up to industry to secure ever higher levels of productivity and not fritter away benefits of Government policy in excessive wage increases.

11. Productivity growth falling off?

[Growth in output per head in manufacturing slowed down sharply during 1982; 2½ per cent in year to November. However, productivity still around 13 per cent higher than at end 1980. TUC Economic Review sceptical.]

Manufacturing productivity gains in last two years impressive - much bigger than might have been expected on past experience. Slow down 1982 probably inevitable as best opportunities for plant closures and improved efficiency are taken first. Recent experience still better than average post-war experience.

12. CSO's index of leading cyclical indicators?

Longer leading index fell in December after nine months of increase, reflecting rise in interest rates and decline in share prices. Fall in longer leader only based on one month's figures. Series not particularly smooth anyway, and decline based entirely on recent financial developments. No firm conclusions can be reached.

14. Outside forecasts

[GDP profile in recent major assessments and in IAF:]

	Per cent change							
	Phillips & Drew (Feb)	Simon & Coates (Jan)	LBS (Dec)	OECD (Dec)	CBI (Nov)	St James (Nov)	NIESR (Nov)	IAF (Nov)
1982 on 1981	+½	+½	+¼	+½	+½	+½	+¼	+½
1983 on 1982	+1½	+2	+2	+1	+1¼	+2	+1	1½
1984 on 1983	1¼	-	+2	-	-	+3½	+1	-]

Nearly all major outside forecasts see prospect of lower inflation and continued modest recovery. [NB Many 'pre-Budget' forecasts now pending.]

C LABOUR MARKET

1. Unemployment figures (new basis)/ other labour market indicators?

[Only modest changes now expected in 'headline' total till May. Influx of school leavers will not influence headline total until September/October. Overtime and total hours worked flat in 1982. Short-time increased substantially in October/November: expected to fall away in December.

	1981 Q4	1982 Q1	Q2	Q3	Q4	1983 Jan
'Total' unemployment (millions)	2.77	2.86	2.80*	2.94*	3.07	3.23(13.8%)
-UK adult sa unemployment (millions)	2.61	2.68	2.74	2.84	2.91	2.98(12.8%)
Increase in period (000's)	+32*	+23*	+28	+31	+27	+33
Vacancies (000's)	104	112	107	111	115	118

*After allowing for over 60's transferring off count

**Differences between consecutive three monthly moving averages

***Only about one-third of vacancies are notified officially. Probably total between 275 and 325 thousand].

Figures are tragic and worrying. But January increase not entirely unexpected (increase of same order as last year). Trend still upwards - as admitted - but no evidence of further worsening in rate of increase.

2. Unemployment still rising despite Government's policies?

Excessive wage increases - unjustified by either output levels or productivity improvements - have priced people out of jobs. Deepseated problems will take long time to check and reverse. Underlying signs of strength in economy and trade performance in 1982, higher productivity, greater competitiveness; essential to build on these.

3. Wage cuts not route to increasing employment?

[TUC Economic Review paras 3.1-6].

On the contrary. More modest wage increases - not necessarily wage cuts - along with improved productivity provide only route to lasting improvements in competitiveness and to recapture of lost markets.

4. Latest information on earnings/pay settlements?

See Section D.

5. Shorter work-time?

[Supported by TUC - referred to again in 1983 Economic Review.]

If reductions in working time are to reduce unemployment, there must also be a corresponding reduction in incomes. If weekly pay remains constant while hours are reduced, unit labour costs are forced up, competitiveness worsens, and output and employment suffer.

6. Government fiddling the statistics?

No. New basis cheaper, more accurate, cuts out wasteful procedures. Trend similar to previous series.

7. Unemployment in UK higher than in other countries?

[On standardised definitions in 1982 Q3 UK unemployment was 12.5 per cent (new series) compared with 8.3 per cent OECD rate - over double for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was much more in US (25 per cent) and Germany (33 per cent), Holland (37 per cent) and Canada (55 per cent) or than in UK (12 per cent).

8. True level of UK unemployment really much higher?

[TUC Economic Review 1983 claims 'true' figure over 4 million; Labour Research Department say 5 million The Times 6 December; SDP say 5½ million Guardian 7 January.]

Gross exaggerations, relying heavily on claimed one million fall in labour force between 1979 and 1982. Not supported by 1981 Labour Force Survey (see C10 below). Estimates also often include those benefiting from special employment measures who are not unemployed. Furthermore, as much as 10 to 20 per cent of official count may not be seriously seeking employment. Claimant figures are best available measure of trend.

9. Unemployment figures in 1983 PEWP

[Assumed unemployment (on claimants basis) for social security projections (GB, excluding school leavers) average 2.74 million in 1982-83 and 3.02 million thereafter. Figures consistent with those given (on 'registration' basis) in Autumn Statement].

Not a forecast. Assumptions on employment are in effect same as in Government Actuary's last report. Only change is definitional, ie from registration to claimant basis. Redefined figures consistent with Autumn Statement unemployment assumptions.

10. New employment figures significantly affect figures of GDP, manufacturing productivity etc?

[Employed labour force mid-1981 on new data about 800,000 higher than previous estimates, of which 550,000 additional employees in employment 250,000 additional self-employed. (Detailed figures not yet available on self-employed.) Mainly concentrated outside manufacturing sector.]

GDP effect probably quite small. Impact on measured productivity - output per head - greater eg manufacturing productivity in 1981 revised down by about one per cent. But will not significantly affect exceptional manufacturing productivity growth over last two years.

11. Cost of unemployment/Effect on PSBR?

Changes in unemployment affect public finances according to underlying circumstances, e.g changes in world trade, UK competitiveness, relative UK earnings etc. Not sensible to talk as if 'cost of unemployment' a single figure. Unemployment and supplementary benefit to people counted as unemployed currently expected to total £5 billion in 1982-83; comparable figures for uncollected taxes and national insurance contributions cannot be given. No basis available to estimate the level of earnings and tax receipts if all unemployed were working.

12. Government concerned over unemployment?

Of course; so pursuing balanced fiscal and monetary policies to curb inflation and improve conditions for enterprise - thus ensuring sustainable increase in employment. Nevertheless, substantially increased spending to alleviate impact on especially vulnerable groups. Pay settlements exert crucial factor influence on unemployment (See also Section D).

13. Extent of help?

Planned Government spending on special employment and training measures £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) and £2 billion in 1983-84. Latter includes £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) new Job Splitting Subsidy to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

14. Employment continuing to fall?

[Decline in total employment 2.2 million (9½ per cent) from mid 1979 to 1982 Q3. In 1982 quarterly decline increased - Q1 103,000, Q2 188,000, Q3 205,000 - but series of questionable reliability. Manufacturing employment fell ~~22,000~~ ^{73,000} in three months to November compared ~~22,000~~ ^{73,000} in previous three. [Sir T Beckett reported (FT 4 February) as expecting fall of 80-90 thousand more jobs in manufacturing over next four months].

Sustainable recovery and improved job prospects requires curbed inflation, greater competitiveness and lower interest rates. Substantial provision (£1½ billion) made available in current year to assist most vulnerable groups (see C13 above).

15. Recent productivity gains inimical to higher employment/lower unemployment?

This may be true in the short run. But in the longer term, as experience in Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

PRICES AND EARNINGS

[NB RPI for January to be published 11 February.]

PRICES

1. Inflation rate

[Year on year RPI increase 5.4 per cent in December, compared 6.3 per cent in November].

Year on year rate of inflation again fell sharply in December to 5.4 per cent - lowest level for 13 years (compared 5.1 per cent in March 1970). Price level actually slightly (0.2 per cent) lower in December than November.

2. Fall in inflation due only to reduction in mortgage rate?

True that falling mortgage interest rates have helped to reduce inflation, but only account for small part of fall. Only 1.3 percentage points of fall in rate of inflation from 12.0 per cent in January 1982, when mortgage rates at peak, to 5.4 per cent in December, resulted from fall in mortgage rates over that period.

3. Comparison with previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.1 per cent.]

When previous Government left office (May 1979), year-on-year rate of inflation was 10.3 per cent and rising (May 1978 figure was 7.7 per cent). Now (December 1982) 5.4 per cent and falling. We will be first Government for quarter-century to achieve lower average rate of inflation during its term of office than previous Administration.

4. Effect of recent fall in sterling on rate of inflation over next 18 months?

[Chancellor discussed in 19 January Debate speech.]

Remain confident of achieving 5 per cent RPI inflation soon. For rest of year, path may be a bit more bumpy than expected at time of Autumn Statement. But must not exaggerate possible effect of exchange rate depreciation. Exchange rate only one factor amongst many that affect inflation, although admittedly an adverse one. Government continuing to pursue sound money policies. New forecasts, taking account of all relevant factors, will be published with the Budget.

5. Ready reckoner for effect of depreciation on inflation?

[LBS assess sterling fall will add 2 per cent to inflation in 1983, 3½ per cent in 1984 The Times 17 Jan].

Not possible to give precise 'ready reckoner' for effect of exchange rate changes on price level. Suggestion of 2-3 per cent effect of recent depreciation on prices after 12-18 months much too pessimistic. Offsetting factors include weak commodity prices (including oil),

likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

6. No further decline in inflation this year?

[IAF with Autumn Statement: 5 per cent in 1983 Q4.]

Progress in recent months has been faster than was forecast; and may in consequence be rather slower in the months ahead. But we shall continue to experience the benefits of sound financial policies.

[IF PRESSED on Autumn Statement IAF: Unwise to speculate at this stage: new forecast will be published with Budget, taking account all relevant factors, both helpful (eg weak commodity prices) and less helpful (lower exchange rate).]

7. Future years?

[1983 PEWP published 1 February assumes price increases of 5 per cent in 12 months to November 1984 and 4 per cent in 12 months to November 1985.]

1983 PEWP does not contain forecasts of prices but working assumptions needed for social security programme. What actually happens will depend not least on financial policies pursued by Government which are designed to bring down inflation.

8. Inflation still not as low as competitors?

[December figures UK inflation 5.4 per cent compared 3.9 per cent in US, 4.6 per cent in West Germany, 9.7 per cent in France, 16.3 per cent in Italy and 1.8 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

9. Performance on inflation compared with main competitors no better than under previous Government?

[Jack Straw interview LBC radio 19 January.]

No. Since May 1979 annual average rate of inflation in major other Western economies no lower than during period of last Government (February 1974 to May 1979 8.5 per cent; May 1979 to December 1982 8.8 per cent). But in UK average rate of inflation under present Government well below level under previous (February 1974 to May 1979 15.4 per cent, May 1979 to December 1982 12.1 per cent).

10. TPI shows pay rises need to be $\frac{1}{2}$ per cent higher than RPI to maintain living standards?

[TPI increase 12 months to December 5.8 per cent, compared RPI increase of 5.4 per cent].

Gap between RPI and TPI (now 0.4 percentage points) widened in July 1982 when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of change - except for minority who have spell of unemployment during year.

11. Nationalised industry prices

[Increase in nationalised industry prices, water charges and London Transport Fares over 12 months to December 14.3 per cent compared RPI increase of 5.4 per cent.].

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 also played important part. Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices and RPI now about 9 per cent, compared 14 per cent in January 1981; over half of present differential explained by LT fares and 1981 winter electricity rebate. NI prices expected to rise broadly in line with inflation in 1983-84. This substantial improvement is sustainable as long as the industries contain their current costs (particularly pay) in same way private sector companies have to do.

PAY

12. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

13. Settlements still over 6 per cent?

[CBI figures published 19 January suggest manufacturing settlements averaging 6.2 per cent so far in pay round.]

CBI data bank of manufacturing settlements showed average of about 6 per cent in round up to end of last year. Since then, National Engineering Agreement has been ratified at 4.8 per cent, so manufacturing settlements have probably come down further now. But of course most settlements in the economy generally have yet to be concluded; important that these settlements should be kept as low as possible.

14. A 3½ per cent pay policy?

The 3½ per cent pay figure [announced 1 October for calculating the pay element in public expenditure cash plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it decision on offer to be made in any individual case. Higher or lower settlements are not ruled out. Each will be considered on merits.

15. Government exhortations on pay imply aiming to cut living standards?

[Real earnings have shown little variation over past two years; though November level was actually about 1¼ per cent higher than November 1981.]

Low pay increases do not necessarily mean reduction in living standards. But whether they do or not, they are essential if we are to create competitive and profitable productive sector, and thus secure conditions for sustained improvement in living standards.

16. Average earnings index

[Year on year growth 8.3 per cent in November compared with 7.3 per cent in October. However, underlying increase slightly lower than in October at about 8½ per cent.]

Fact that average earnings index is ahead of RPI casts doubt on wilder claims about falling living standards. Further moderation in settlements is needed if we are to maintain jobs and get inflation down.

17. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to idea that an incomes policy can be made to work on permanent basis. They always succumb to distortions they create.

18. Pay increase for nationalised industries' boards this year?

No general level of increases for board members this year. Proposals for each board being considered individually on merits, in light of circumstances. When relatively large increases have been approved by Ministers responsible (in consultation with Chancellor) it is because these have been justified by such factors as need to recruit people of ability, inadequate differentials with senior staff and performance of industry. Because board pay held back in previous years, many salaries are now seriously out of line with market rates.

19. Performance-related pay for nationalised industry board members?

An attractive concept. Practicalities and implications are being studied jointly with representatives of Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

20. Index-linked pensions and Scott report?

Government announced in Debate 22 October that favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

21. Public sector pensions to be adjusted to take account of overshoot?

[Compare Section M re State Pensions uprating overshoot.]

Public service pensions increases are linked, by legislation, to increase in the additional, earnings-related, component of the State retirement pension. November 1982 increase was therefore also 2.7 percentage points over the increase in the RPI. There will therefore need to be an adjustment to next November's increase. Decisions have yet to be taken on what that increase will be.

E MONETARY AND FINANCIAL POLICY

1. Monetary growth on target?

[NB. Provisional monetary aggregates (for banking January) to be published 8 February. Banking December figures summarised below:

	per cent s.a.		
	M1	£M3	PSL2
December increase	0.9	0.6	0.5]

Growth rates of all three aggregates within target range - M1 and £M3 at almost 11 per cent and PSL2 about 9 per cent.

2. Why have interest rates gone up?

[Barclays, Lloyds and Natwest increased their base rates by 1 per cent (to 11 per cent) on 11 January and Midland theirs by $\frac{1}{4}$ per cent (to 11 per cent) on 12 January. Still down by 5 points since peak in October 1981. Long term interest rates also reduced significantly over past year.]

Structure of interest rates in domestic money markets was dislodged by fall in sterling. Interest rates in domestic money markets rose sharply in early January but have steadied. Bank base rate increases and increase in Bank of England's dealing rates reflected this. Government remain determined to maintain sound monetary conditions and to continue progress towards lower inflation. To have resisted the rise could have been interpreted as a weakening of the Government's resolve.

3. Rise in interest rates will stifle recovery (as in autumn 1981)?

Does not follow. The fall in the exchange rate, though adverse for inflation (but see also D4-5), will ease pressure on companies. (See also A8).

4. Did Government engineer rise in interest rates?

As is evident from sequence of events, the rise in interest rates stems from market developments, including developments in currency markets.

5. Prospects for resuming falls in interest rates?

Interest rates have to adjust to play their part in maintaining sound monetary conditions. Route to lower interest rates is ultimately through lower inflation.

6. PM'S remarks on interest rates at lunch with Committee of London Clearing Bankers 2 February

PM was reiterating what Chancellor said in House (19 January) and PM said in speech to Glasgow Chamber of Commerce (28 January): that there is no reason for further rise in interest rates now. She also said that banks' increasing costs must not obstruct any interest rate reductions consistent with sound monetary conditions.

7. Will slide in sterling affect monetary conditions?

Level of sterling is one of the factors taken into account in judging monetary conditions. Recent fall in exchange rate may reflect market uncertainty about monetary conditions, though this is scarcely justified, given the reassuring position on the PSBR and monetary aggregates. Rise in interest rates will reassure markets that monetary conditions required for continued control of inflation will be maintained.

8. Will mortgage rate now rise?

[Mortgage rates have fallen 5 percentage points from peak in March 1982. Latest cut, to 10 per cent, came into effect for all home buyers on 1 December. Bank base rates have risen 1 per cent since then.]

That is a question for the building societies. Their liquidity position is very strong at present; they do not need to be rushed into adjusting their rates.

9. Treasury view of Spalding report on building societies

[Published 26 January.]

Studying it with interest.

10. Bank lending growing too fast?

[Bank lending starting to decrease slowly. Increased by (seasonally adjusted) £2 billion in September, average for October and November [because of STC distortion] £1.5 billion, and £0.8 billion in December.]

December figure lowest for last year. Bank lending to companies has steadied; lending to persons has fallen off from its high level last summer.

F EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[Since October, sterling has fallen 12 per cent in effective terms, 11 per cent against the dollar, 12 per cent against the D-Mark, 21 per cent against the yen. Sterling's low against dollar was \$1.5105 on 2 February in New York.

	October average	11 Jan low points	4 Feb noon	% change Oct -4 Feb
\$/£	1.6977	1.5635	1.5170	-10.6
DM/£	4.2932	3.6757	3.7622	-12.4
Y/\$	460.12	357.96	364.16	20.9
£ effective	92.5	80.6	81.0	-12.4

Markets have been volatile since end-October, largely reflecting fluctuations in market perceptions of the course of US interest rates. Thus, the recent recovery of the US dollar has gone some way to reverse what had been seen as a general re-alignment of currencies, with long-expected rise in D mark and yen. Oil price weakness and uncertainties have also unsettled the markets, particularly for sterling. Irresponsible Opposition policy statements also had an effect].

Government has no target for exchange rate. Nor do recent events suggest conditions exist in which pursuing a target would be a viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible. Government not indifferent to UK exchange rate, which is important for economy. It is one of factors taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Impact of fall in sterling on inflation?

Will no doubt be some modest impact on inflation from recent fall. But probably less or slower to come through than many commentators suggest. Importers into UK have had healthy profit margins. They absorbed much of effect of sterling's fall in 1981 and they may remain reluctant to raise prices in today's market conditions. Food on green £ prices reflect 'green pound' (which is fixed separately) and has been unchanged (see Note below). Commodity prices (including oil prices - one of reasons for sterling's fall) are weak - and tend to be set in dollars, where fall in sterling has been least. And, of course, some of the fall could prove to be temporary.

Report in FT 18 January suggesting 'green £' changed? - not the case. What has happened is that fall in sterling has eliminated gap between market rate and green £.

3. Should not Government welcome fall in pound?

A lower exchange rate means higher costs to industry and the consumer: no-one should welcome that. Of course, recent fall in pound may bring some relief to British firms that

are facing difficult competitive pressures in home and overseas markets, particularly from Europe and the Far East - but they must contain their costs rigorously in order to retain that benefit. We cannot solve our basic problems of competitiveness by depreciation, and no-one should doubt our determination to adhere to our counter-inflation policies. Sound money remains at heart of Government's economic strategy.

4. Government reaction to further fall in rate?

No sound reason for rate to fall. Underlying financial position is strong

- Government spending and borrowing are under control and on target;
- Government deficit, as percentage of GDP, is one of smallest in industrial countries;
- substantial current account surplus - larger in 1982 than the £3½ billion forecast only last November;
- inflation falling, and fell faster over last year than in any other major country;
- monetary growth within targets, and signs are it will stay there. [See also Section E].

5. Improve UK competitiveness directly by encouraging exchange rate down further?

Substantial fall in exchange rate as advocated by Opposition, would give only very temporary gains of competitiveness for UK industry. Would raise costs of imports directly and, by alleviating competitive pressures, permit general increase in prices of domestically produced goods. This would have repercussions for wage bargaining and hence trigger a general rise in costs, undermining initial competitiveness gains. We in UK have seen striking examples of this process: improvement in competitiveness following 1967 devaluation had largely been eroded by 1972; furthermore, although exchange rate fell by 25 per cent between 1973 and 1976, competitiveness was on balance unchanged.

6. Will lower oil prices mean further fall in sterling?

Recent slide in value of sterling in part reflects expectations that oil prices were about to fall; to this extent reduction has already been taken account of in the exchange markets.

7. Why was underlying reserve loss lower in January than in December?

There is no arithmetical relationship between intervention and exchange rate changes. [FOR USE IF NECESSARY: For variety of reasons (end-year markets, run-up to first OPEC meeting where outcome particularly uncertain), market conditions in December were particularly unsettled.]

8. Progress in reduction of overseas debt?

Total official external debt now stands at around \$12 billion, compared \$22 billion when Government took office. Our remaining debt is now smaller in relation to our imports than at any time since Second World War.

9. Situation has been made worse by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations).

10. Join EMS exchange rate mechanism (ERM)?

Recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

G BALANCE OF PAYMENTS

[NB January trade figures to be published 24 February.]

1. Trade figures and current account

[1982 current account surplus of £4.6 billion. Oil trade in substantial surplus (£4.6 billion); non-oil trade remains in (£2.4 billion) deficit. Invisibles in healthy (£2.5 billion) surplus. IAF shows zero current account balance in 1983, but this does not allow for £600 million EC refund payment deferred into 1983. Q4 balance of payments performance may justify more optimism about 1983 current account - best estimate £½ - 1 billion surplus].

£0.9 billion current account surplus for December brought total for 1982 to £4.6 billion. (compared £6 billion in 1981). Achieved without £0.6 billion EC refund which will now come in 1983. That should boost next year's current account from the zero balance forecast in the IAF to £½ - 1 billion surplus. The late 1982 figures reflect mainly the continuing improvement in our oil trade. Non-oil exports have also been holding up well at a time when world trade has probably declined. Similarly, imports remained flat despite a surge in retail spending in last three months.

2. Trade in manufactures in deficit last year ?

When exports and imports put on comparable basis [ie both valued on balance of payments basis], we recorded a surplus on trade in manufactures of approaching £2½ billion in 1982. [NOT FOR USE: Figures underlying IAF suggest that trade in manufactures may go into deficit this year].

3. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. Export levels were low last summer, particularly in August, but have since recovered. Underlying level of non-oil exports has probably not changed over past year. This is a good performance when, because of world recession, world trade has probably fallen (1982 first year-on-year fall since 1975).

4. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

5. Import trends

There has been little change in underlying level of manufacturing imports since end-1981. Manufacturing output fell back a little in 1982, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

6. Competitiveness?

10 - 11
See A ~~H-13~~.

7. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Jaguar cars are a striking example of improvements in performance that British industry is capable of. Jaguar's drive for higher quality secured them an increase in overseas sales last year of 56 per cent over 1981.

8. Buy British?

See P13.

9. Protectionism?

We are concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Pressing for positive European Community action to remedy this. But wish to make clear, as Chancellor has said that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

10. Export subsidies?

In UK's interest to support multilateral efforts to limit use of subsidised credits which distort normal patterns of commercial trading. Until these efforts succeed, it is our policy to provide the necessary level of support for UK exporters - though there will of course always be scope for questioning amount of subsidy worth paying to win a particular contract.

11. Selective import controls would assist economic reconstruction?

[TUC 1983 Economic Review calls for import controls on sectors and products that will play key role in economic reconstruction or be subject to serious problems of adjustment to new market conditions.]

No. UK Government are looking for expansion of world trade not contraction. Protectionism only reduces competition, which raises prices and limits choice for consumers.

12. Wouldn't import controls help reduce unemployment?

Protectionist measures only lead to retaliation by other countries. UK economy particularly vulnerable; one third of our output is exported. We cannot afford to have other countries putting up barriers against our trade and services.

3. So what can be done to safeguard British producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

14. Japan

Welcome the tariff reductions announced end-December. Small step in right direction. Fully support EC measures to step up action under GATT aimed at putting further pressure on Japanese to open up their domestic market.

15. GATT meeting

Glad to see that GATT meeting reaffirmed need to resist growing protectionist pressures. GATT declaration represented realistic commitment on behalf of signatories to the open trading system in present difficult economic climate.

16. Services

Work in the GATT on services is a major new departure and one of particular interest to UK. Field is wide but UK will contribute constructively with view to making early progress.

17. Textiles

This GATT study relates to the longer term and as such is not unreasonable. In no way affects present Multilateral Fibres Agreement and latest bilateral agreements which will run until 1986.

18. Effect of lower oil prices on UK trade?

Oil only relatively modest proportion of UK overseas trade. Benefits from boost to world trade will offset relatively small trade balance impact.

19. Q3 Balance of Payments and capital account

[Q3 invisibles surplus of £0.6 billion. Outflow of investment and other capital transactions of £0.3 billion. Private sector direct investment abroad fell to £0.8 billion and private sector portfolio investment abroad down £0.2 billion from Q2 to £1.0 billion.]

Invisibles account continues to be in healthy surplus - £1½ million cumulative surplus on invisibles in first three quarters of 1982.

20. Continuing capital outflow shows folly of abolishing exchange controls?

[Article by F Williams in The Times 31 January: 'Why Peter Shore misses the target on foreign funds'.]

Wrong to talk about money flowing out of the country. Those who wish to invest abroad have to buy foreign currency and find someone else who wishes to invest in Britain to purchase sterling in return. The nation's net capital outflow or inflow - as a matter of arithmetic - matches the current account balance. Just as countries with deficits have to borrow abroad, those with surpluses acquire net overseas assets.

21. Portfolio outflow higher than last year?

[Q3 Balance of Payments figures published 8 December showed continuing outflow of UK overseas portfolio investment. Guardian on 9 December described this as rising trend.]

True that there is little sign yet of end to expected period of stock adjustment following ending of exchange controls. But misleading to say portfolio investment abroad is rising.

Figures are as follows:

			£ billion
1981	Q1	-	1.3
	Q2	-	1.0
	Q3	-	0.7
	Q4	-	1.1
			average - 1.0
1982	Q1	-	1.6
	Q2	-	1.3
	Q3	-	1.3

Q3 figure is smaller than in Q2 or Q1, and about the average for last year.

22. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. Government has succeeded in reducing PSBR as percentage of GDP; further reduction is projected. Inflation has fallen fast - expected to fall further (see D1). Base rates have risen but still well below (5 per cent) peak in 1981. Benefits seen in recovery of debenture market. [IF PRESSED: Would like to see rates lower still, so long as not likely to endanger progress on inflation.]

2. Government planning balanced Budget?

[Chancellor questioned in Guardian interview 17 December about reports that Professor Walters at FT bankers' conference advocated balanced Budget over run of years.]

Government aims to reduce PSBR as share of money GDP over medium term. Illustrative profile in 1982 MTF5 shows figure of 2 per cent in 1984-85. Nothing has been said about later years.

3. Recent rises in interest rates make nonsense of Government's claim that PSBR matters?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - however PSBR over run of years implies lower interest rates - still holds true.

4. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

5. PSBR in December quarter

[PSBR in December quarter £3.1 billion (£2.5 billion seasonally adjusted). PSBR April-December £7.6 billion (£5.3 billion seasonally adjusted.)]

Wrong to prorate £5.3 billion to arrive at likely PSBR for 1982-83. On balance however December quarter figures indicate PSBR likely to undershoot IAF figure of £9 billion.

6. PSBR likely to be £8 billion in 1982-83 compared £9 billion in IAF?

[F Williams article The Times 21 January].

It is possible. But must remember that margins of error in any precise forecast substantial.

7. What would undershoot be if Government had not taken recent measures?

[CONFIDENTIAL NOT FOR USE: At time measures taken they were thought likely to 'boost' PSBR by around £1½ billion in 1982-83 - an estimate itself liable to quite a large margin of error.]

Rather strange question. Given the uncertainty over PSBR outturn this year it is impossible to answer.

8. EC refunds - implications for PSBR in 1982-83?

No reason at present to suggest EC refunds due to UK will not be paid over by end March 1983.

[CONFIDENTIAL NOT FOR USE: EC Commission has recently opened a new account with the Paymaster General into which has deposited funds equivalent to our refunds entitlement. These deposits are classified as miscellaneous capital receipts, and so PSBR has already been reduced. In unlikely event EC withdrew the deposits before end March, PSBR would be increased. (See also Section N.)]

9. Government intentions for 1983-84 PSBR?

[Autumn Statement PSBR for 1983-84 assumed to be £8 billion - 2¼ per cent of GDP; 1982 MTFs was £8½ billion. Press speculation that £2 billion available for tax cuts.].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before. (See also A16).

10. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

11. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's.]

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because borrowing has adverse effects on interest rates and inflation. But a higher tax burden does not necessarily mean that people are worse off, because gross earnings have risen faster than prices since 1978-79. On average, all types of household in work at all earnings levels are better off in 1982-83 than in 1978-79. [NB: individuals may have done better or worse than average.]

2. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children have also benefited from generous increases in benefits such as FIS.

3. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to EC levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ¼p in the basic rate.

4. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden is about average for OECD countries [provisional 1981 data from OECD's Revenue Statistics 1965-81]. Similarly, UK taxes on personal income and UK employees' social security contributions are about average for EC countries and lower than USA [1980 provisional OECD data].

5. Too few tax officials on evasion work?

Not prepared to abandon our manpower targets (see L1). Within these, we do redeploy staff as appropriate. Inland Revenue has deployed 400 extra staff to counter tax evasion and 'the black economy'.

6. Cuts in taxation in 1983 Budget?

Must wait until Budget Day. Cannot comment now on size of PSBR, fiscal adjustment or individual tax changes. (See also A13 and 15).
-16
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7. Future of married man's personal allowance?

[Labour Party commitment to phase out in favour of increased CB etc; SDP proposals to abolish as part of proposals in document 'Attacking Poverty'.]

Government launched debate with 1980 Green Paper on Taxation of Husband and Wife. Green Paper set out number of different options; these being considered in light of very wide range of views received. Abolition would affect many millions of taxpayers, and by itself, leave a basic rate taxpayer £5 a week worse off. For some people it would worsen poverty and unemployment traps.

8. SDP plan to abolish poverty trap?

SDP scheme costs £5 billion - even on their own estimates - and still leaves marginal tax rates for people in poverty trap of 80-85 per cent. It extends trap both up and down the income scale. Ten times as many people would have marginal rates increased as would have them reduced. Claims to have eliminated trap are based on artificially restricted definitions. Their proposals would leave some people on below average earnings worse off.

9. Government unconcerned about poverty and unemployment traps

Government is concerned about poverty and unemployment traps, in context of incentives as a whole. Traps arise from attempts of successive Governments to alleviate poverty while keeping costs in bounds. Alternatives are to give less support for poor and unemployed or to let costs rip. Necessary step in right direction is to reduce burden of income tax by restraining public expenditure; long-term solution is increased real earnings resulting from sustained improvement in productivity and economic performance: both are goals of Government policy.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE WHITE PAPER 1983 (Cmnd 8289)

[1983 PEWP published 1 February shows total spending held within previous plans:-

	1983-84	1984-85	£ billion 1985-86
PEWP 1982 adjusted for 1982			
Budget changes	120.7	127.6	
Figures in Autumn Statement November 1982	120.1		
PEWP 1983	119.6	126.4	132.3]

Press coverage has queried whether control of spending real or apparent eg 'Done with Mirrors' S Times 6 February.]

1. Ratio of public spending to GDP this year and next?

[Ratio rose from 43 per cent in 1980-81 to 44½ per cent in 1981-82 - though still below level of 1974-75 and 1975-76 (46 per cent in both years).]

Using expected outturn of expenditure, and Industry Act Forecasts of GDP, 1982-83 ratio expected to be 44 per cent, falling to 43½ per cent in 1983-84. Demonstrates progress towards Government objective of reducing ratio. Rising trend has been reversed.

2. Further ahead?

Too early to predict ratio in future years. Wait for Budget forecasts. Certainly Government's aim to bring the ratio down further.

3. Cost terms figures for 1983-84 show fall in plans compared with 1982-83?

Planning total for 1983-84 expressed in cost terms shows reduction of about ¼ per cent compared with 1982-83 plans expressed in cost terms (calculated using current GDP deflators). (NB. In Table 1.14 of the White Paper the planning total expressed in cost terms for 1983-84 shows an increase over 1982-83 of some ¼ per cent. But this comparison must be treated with caution because it compares plans in 1983-84 with outturn in 1982-83. This caveat applies to the individual programmes as well as to the planning total.)

4. Why no cost terms figures beyond 1983-84?

Cost terms figures in Table 1.14 go only as far as 1983-84 because it is only for that forward year that a forecast of the GDP deflator is available.

5. Comparison of planning totals in cost terms with Autumn Statement?

Changes to planning total expressed in cost terms compared with Autumn Statement (Table 2.2) almost entirely due to changes in cash figures, including substitution of estimated outturn for plans for 1982-83. (Also small revision to GDP deflator for 1980-81.)

6. Comparison of planning totals in cost terms with 1982 Budget?

1983-84 planning total expressed in cost terms in Table 1.14 of 1983 PEWP is some £1.5 billion more than the corresponding figure at the time of the 1982 Budget (£104.4 billion, base year 1981-82), because downward revision of cash plans for 1983-84 has been more than offset by reduction in expected inflation in 1982-83 and 1983-84 since 1982 Budget. This does not mean that expenditure plans for 1983-84 have increased. Plans are in cash and have been revised downwards. Cost terms figures are merely derived arithmetically from the cash figures. Thus comparison tells more about revision in the deflator than about revision of cash plans. In simple terms, it means that if you reduce the rate of inflation, one of the benefits is that you can buy more with the cash made available.

7. Real rise in spending in 1983-84 compared with last year's Budget plans as a result of falling inflation?

If 1983 PEWP plans for 1983-84 compared with Budget plans using same deflators for both (ie GDP deflators published in last Industry Act Forecast), 1983 PEWP plans show fall of nearly £1 billion in cost terms compared with Budget plans. (Trying to compare them using different deflator forecasts tells more about revision in deflator than about revision in cash plans).

8. Should not all programmes have been revised downwards, given fall in inflation?

One of main aims of cash planning is to require programme managers to plan to achieve optimum service levels within cash constraints. Price changes in general have to be absorbed. Automatic downward adjustment to programmes when inflation falls would inevitably mean automatic upward adjustment if inflation were to rise. This would destroy the object of cash planning. In the Survey, all programmes were reviewed individually. Prospects for inflation were one factor taken into account, and cash plans for 1983-84 were reduced by £1.1 billion.

9. Shortfall

1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. At this stage, this can only be broad order of magnitude rather than detailed estimate. Considerably smaller than 1982-83 estimated shortfall on outturn of some £1½ billion, reflecting both smaller Contingency Reserve and Government's plans to combat capital

underspending. Shortfall for later years not directly estimated, but allowed for in 'provisional reserves'.

10. 'Provisional reserves'

Government's aim is to show realistic planning totals for all years. This means, when planning in cash, making some allowance for future changes. 'Provisional reserves' are designed to provide Contingency Reserves for future years, and to allow for possible shortfall and possible further programme changes.

11. Contingency Reserve of £1½ billion for 1983-84 too small? (as suggested by TCSC)

Contingency Reserve 1983-84 is set at £1.5 billion compared with £2.4 billion in 1982-83 and £274 billion in 1981-82. In retrospect clear that size of the Reserve was set too high in both those two years. There was substantial spare capacity in 1981-82 and is likely to be spare capacity again in 1982-83. Size of Reserve will be reviewed at time of Budget before set finally as control total for the year.

12. Pay

As announced 1 October 1982, plans include sufficient cash in 1983-84 to provide for average increases in wages and salaries bills to 3½ per cent, from due settlement dates for armed forces, the civil service and certain other groups. Provision made for health service is consistent with settlements now reached covering both this year and next.

13. Other prices

Public expenditure now planned in cash. With exception of social security and the provision for pay for 1983-84 there are no explicit price assumptions underlying the plans. Of course, in determining the cash plans Ministers have had in mind a broad view, consistent with their general strategy, about the future course of prices. But it is not in general necessary for these to be formulated in precisely quantified terms, nor has it been.

14. Declining share of capital expenditure?

[TUC Economic Review proposes £29½ billion public sector investment over 5 years.]

Immediate problem is not to make more funds available but to get local authorities and nationalised industries to spend capital provision available to them. Capital expenditure in 1983-84 now planned to be some 12 per cent higher than estimated outturn for 1982-83 (put at about £10 billion). Prime Minister wrote to local authorities and nationalised industries in November explaining Government's concern at present level of underspending, and changes are being made in the capital allocation procedures for local authorities to combat underspending in future.

15. CBI representations about public expenditure? (FT Report 27 Jan)

Both Government and CBI are seeking a close and effective control over public expenditure. CBI not now proposing any net increase in the total of public expenditure - rather, a small net reduction - but are proposing, in their Budget representations, changes in allocation of public expenditure. These, like all other Budget representations, will be taken into account by Chancellor in preparing Budget.

16. Recent fall in the exchange rate

There have been some changes in exchange rates since plans finalised. But these are price changes of a kind which cash planning is intended to absorb and are only one of the factors - which may operate in either direction - faced by programme managers. Presumption is therefore that plans will stand, subject always to possibility of review in cases of particular difficulty.

17. Economic assumptions unrealistic/out-of-date/horrifying?

Specific economic assumptions are given for certain programmes only eg social security. Following usual convention (eg used by previous Government) these assumptions are not forecasts or predictions. They are illustrative working assumptions used to calculate the cash plans during this planning cycle. For example, if developments in world economy favourable and conditions at home - particularly continued reduction in pay settlements - permit, assumed level of unemployment could turn out to be too high.

18. Size of the fiscal adjustment?

1983 PEWP sets out expenditure plans, expanding on earlier Autumn Statement. Beyond that cannot go at present. Expenditure plans shown in the White Paper should not be taken in isolation as indicating any particular change in the fiscal adjustment from that shown in the Autumn Statement. New Industry Act Forecast will be published at time of Budget, taking account of latest known position on public expenditure and all other relevant information, including decisions on size of PSBR, and many other changes - including to exchange rate and oil prices - which have occurred since the Autumn.

19. What about public spending in the longer term?

1983 PEWP only covers next three years. Risk that present trends projected to end of this decade could lead to significant increase in public expenditure, not the reduction which the Government wants.

ST JOHN STEVAS BILL

20. Government attitude to St John Stevas Bill?

(Second reading 28 January)

We recognised in our White Paper on the Role of the Comptroller and Auditor General (Cmnd 8323 of July 1981) the desirability of legislation on this subject. House will now have opportunity to modernise the 1866 and 1921 Acts, and that is welcome. However, there are strong arguments against the proposal in the Bill to give C & AG access to books of nationalised industries. The industries should be set clear financial targets and then be subject to minimum of interference. Bill is a move in opposite direction. All of these issues should be considered by the House.

21. Why did not Government introduce legislation?

This is a subject on which it is very desirable to proceed by consensus. Unfortunately that has not been the position. Hope wide measure of agreement will emerge during course of Bill's passage through House.

LOCAL GOVERNMENT

22. LA capital underspending in 1982-83

Following underspend of £ $\frac{3}{4}$ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1 $\frac{1}{2}$ billion (GB figures). Some steps in hand to reduce the underspend: PM wrote last autumn to local authority associations; local authorities can apply for extra allocations (about £200 million issued so far), and can spend without limit on improvement grants; extra £150 million made available to Housing Corporation.

23. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

24. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83; (gross) housing spending up £350 million (13 per cent); urban programme (including Urban Development Grant) up by £70 million (to £350 million). Local authorities will be allowed to spend above allocations on improvement grants.

25. LA current overspending in 1982-83

Budget returns from LAs in Great Britain indicate that overspend of over £1 billion on current expenditure relevant for rate support in prospect. In response, rate support grant cut by £308 million in England, £27 million in Scotland, and £5 million in Wales.

26. RSG settlements 1983-84

Realistic and generous: expenditure provision effectively 10 per cent higher than in last settlement and grant 3 per cent higher than 1982-83 settlement - provided authorities do not overspend. [For details refer to Statements by Secretaries of State for Environment, Wales and Scotland on 16 December.]

27. Grant penalties 1983-84

Hope won't be necessary to have any. But authorities were warned in July 1982 of expenditure guidance now issued and have had ample time to adjust 1983-84 budgets to avoid incurring grant penalties.

28. Rate increases in 1983-84?

On average there should be no need for rate increases in 1983-84. If authorities spend in line with expenditure targets any increases should be low; some councils have already announced intention to reduce rates. Where rate increases are high because of overspending it will be LA's own fault.

29. Service cuts?

Up to local authorities to decide how to keep to the provision in the RSG settlement. If they choose to allow irresponsible pay settlements, services may have to suffer unnecessarily.

30. Higher council house rents?

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. If that figure confirmed, will be possible to provide for real increase in capital investment in housing in 1983-84.

31. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc. (See also P3.)

FALKLANDS EXPENDITURE

32. Falklands defence costs?

Latest assessment of costs of operation, of replacing equipment lost during conflict, and of garrison, is about £700-£800 million in 1982-83. Provision has been made for £624 million in 1983-84. £684 million in 1984-85 and £552 million in 1985-86. Total Falklands costs of £3 billion reported last month in Press [Guardian report 13 December] are broadly consistent with latest estimate of costs.

33. How will the defence costs be met?

Extra defence costs will be met by additions to defence budget on top of provision for NATO 3 per cent a year real growth target. Block defence cash limit for 1982-83 increased by £371 million so far on account of operations in South Atlantic (Hansard 9 November 1982 Col W108). This increase has been met from the Contingency Reserve. It has not therefore affected the Public Expenditure planning total.

34. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). About £10 million now expected to be spent in 1982-83. A further £5 million may be spent on rehabilitation in 1983-84. Ministers have agreed on a package of measures for long term development of the Islands tentatively estimated to cost in all £31 million over next 6 years.

35. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £2 million has so far been paid out, but this is no guide to what the final total might be. Costs in 1982-83 will be absorbed within FCO programme.

L CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10½ per cent to 655,000 (at 1 October 1982). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Government seeking cut of 60,000 through privatisation?

[Guardian report 28 January: 'Pressure to cut 60,000'.]

Government is reviewing need for staff in Departments over period 1984-88. This is normal good management practice. No decisions have been taken. Figure of 60,000 quoted in The Guardian is completely fictitious.

3. Civil service efficiency?

[TCSC published 17 January memorandum by Council of Civil Service Unions commenting on Government's reply (Cmnd 8616) to TCSC's report 'Efficiency and Effectiveness in the Civil Service').

Main theme of Council's memorandum is that drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. Great savings already made with little effect on provision of services.

4. Civil service pay negotiations in 1983?

Government have told civil service unions that there will be room for genuine negotiations and that they intend to conduct those negotiations with the view of reaching an agreed settlement. In answer to unions' question about availability and terms of arbitration, Government have said that it is too soon to answer; they were looking for a negotiated settlement.

5. Contents of unions' claim?

Unions' claim for 1983 has been received; proposal is:

- (a) flat rate increase of £12 per week for all non-industrial Civil Servants on National Salaries up to and including £6264 pa;
- (b) above this level, 'substantial' percentage increases, providing, in particular, 10 per cent on salaries up to £9758 pa.

Additionally, the unions propose minimum wage for all staff aged 18 or over of £85 per week, and reduction in the working week to 35 hours net. The Government have acknowledged receipt of the claim, and said they will arrange first discussion of it when unions' supporting evidence is to hand.

6. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Unions have now confirmed their willingness to enter into joint discussion - first procedural meeting was held 22 January.

7. Scott Report/Public sector pensions?

See D 20-21.

N EUROPEAN COMMUNITY

1. UK budget settlement for 1982

[European Parliament on 16 December rejected draft supplementary and amending budget established by Council of Ministers on 8 November to make the necessary budgetary provision for our refund payments. This action obstructed implementation of settlement reached by Foreign Ministers 26 October, providing for basic gross refund of around £630 million (about £480 million net) by end-December.]

Council of Ministers established a new draft supplementary budget for 1983 on 1 February. European Parliament is expected to give this a first reading this week. We hope Parliament will adopt new supplementary budget in time for our refunds to be paid over before end-March.

[BACKGROUND NOT FOR USE: In order to meet its undertaking not to let Parliament's actions in December place us in a worse position than under October agreement, Commission have opened a new account with the Paymaster General (EEC No.3 Account) into which they have deposited funds equivalent to our refunds entitlement. We get interest benefit from these funds. The EEC No.1 account has been temporarily run down, but we are pressing Commission to bring balance up to 1982 average].

2. Refunds for 1983 and later

On 17 November Commission produced its proposals for dealing with UK budget problem in 1983 and later. Commission communication does not suggest what size our refunds - or our net contribution after refunds - should be. We think it provides a suitable framework for discussion of problem within the Community and hope that progress will now be made quickly. PM has said this will have to be discussed at next European Council in March if solution not found by then. On 7 February, Chancellor gave Press Conference in Brussels at which emphasised importance of finding lasting, fair and comprehensive solution to problem of budgetary imbalances. He offered some ideas to show possibilities.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

We very much hope the issue of our Budget contributions can be satisfactorily settled without need for recourse to such a step.

5. Commission Green Paper on 'own resources' system

Commission Green Paper on 'own resources' was published 7 February. We will study this carefully. Our opposition to an increase in the 1 per cent VAT ceiling is well known.

6. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

7. Costs of CAP to UK consumers

The Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

8. European Monetary System exchange rate mechanism

See F10.

P **INDUSTRY**

1. Latest statistics of output and investment?

See Section B and commentary at end of Brief.

2. High interest rates damaging for industry and investment?

Banks' base rates still 5 percentage points lower than October 1981. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year.

3. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

4. Energy prices?

See R6-8.

5. Government believes levels of industrial support are far too high? Intend to trim?

[Observer 9 January alleged that secret Whitehall paper, questioning value of export credits, had sparked off major interdepartmental row.]

Public spending is too high generally, and industry support no exception. This is not to say that industrial support is not useful in a period of transition; but must aim at deploying a declining total more flexibly, focussing help where really needed and on industries and technologies of tomorrow. (See also G10).

6. Government review of regional policy?

Officials of the Departments concerned have been reviewing the effectiveness of the main instruments of regional policy. Now for Government to consider whether to commission further work in particular areas that would be necessary to prepare for any changes. Have not yet reached conclusions on any aspect. Too soon to say when will reach conclusions.

7. What kind of industrial base and pattern of employment is Government aiming for?

Size and shape of industry and employment will not be determined directly by Government and cannot be forecast with any accuracy. Clearly, much of traditional industrial base and

traditional sources of employment will remain important, but new businesses are coming alone too. Important thing is to provide right incentives for business and for costs to be kept under firm control. Government does not, contrary to some reports, underrate importance of traditional manufacturing industry.

8. Companies' financial position?

[NB company sector borrowing in 1982 Q3 includes large element of unidentified transactions (-£1 billion)]

	£bn					
	1979 Year	1980 Year	1981 H1	H2	1982 H1	Q3
Net borrowing requirement (+)/repayments (-)	+6.1	+6.5	-1.7	+6.2	+6.0	+1.9
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.3	+0.7	-1.1	+0.8]

Financial position of industrial and commercial companies (excluding North Sea) improved in 1981, relative to 1979 and 1980; encouraging figure for Q3 financial surplus - though this may principally reflect a further round of improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in borrowing requirement second half 1981 due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for first three quarters 1982 suggest companies' borrowing requirements remain high, but much less so than in 1979 or 1980.

9. ICCs liquidity ratios in 1982 Q3?

[D. Industry's survey of 200 large companies (published 3 December in British Business) shows a further significant deterioration in liquidity in 1982 Q3. Also shows £1 billion reduction in total current assets since 1982 Q1 whereas national accounts show total identified liquid assets of all ICCs increasing this year].

True that DOI figures - which relate only to very large companies - show some deterioration in liquidity. But no evidence of widespread concern about liquidity: companies are still able to meet their financing needs through bank borrowing.

10. Profits/rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 17 per cent 1982 Q3 compared 1981 Q3 but increase was from a very low base. ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.)

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance

by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

11. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

12. Future of cashless pay/Truck Acts?

Discussion at NEDC 5 January demonstrated CBI and TUC support for major shift to cashless pay. Government considering carefully arguments both for and against repeal of Trucks Acts, as means of accelerating progress.

13. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price or quality - otherwise would only render firms incapable of competing internationally. But should give British products - and ourselves - a full and fair chance.

14. NEDC meeting - Lord Cockfield attack on NEDO chief for trade performance paper

[At NEDC meeting 2 February, Lord Cockfield described paper by NEDO on international issues as muddled, inaccurate, prejudiced and ill-informed.]

Lord Cockfield did criticise a paper discussed at last week's NEDC meeting - on the grounds that it was too critical about Britain's trade performance and failed to recognise what the Government have been doing through GATT to increase opportunities for UK exporters. NEDO paper was very wide-ranging, and it has been agreed that Chancellor, Mr Murray, Sir Terence Beckett and Mr Chandler should get together to consider how further work on issues raised in it should proceed.

15. Government help for small firms

Last Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment

limit under Business Start-Up Scheme to £20,000 a year. These measures designed to encourage start-ups and existing firms.

16. Response to Loan Guarantee Scheme?

[Nearly 7,900 guarantees already issued - about half to new businesses. Total lending under scheme over £260 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. Department of Industry has been called to honour only about 160 guarantees out of nearly 7,900 so far issued. Future of scheme under review.

17. Enterprise zones

Response to first eleven zones has been encouraging; many new firms have been set up and others expanded. (But too early to assess overall success). Proposed sites for nine new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one for Wales have also been announced. One more for Wales under consideration.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. EFLs for 1982-83

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. British Telecom expected to undershoot its EFL substantially, BSC to overshoot substantially.

2. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 were announced in Autumn Statement; EFLs revised to allow for NIS reductions were announced 23 December. No further revisions included in 1983 PEWP. Overall external finance in line with previous plans. £2.6 billion being made available to nationalised industries in 1983-84. Overall, external finance in line with previous plans. £2.6 billion being made available to nationalised industries in 1983-84.

3. Government attitude to Mr St John Stevas' Bill on Parliamentary control of expenditure?

See K7-8

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. Rolling programme of Monopolies and Mergers Commission investigations has been set up. Introduction of market forces provides the greatest incentive to efficiency.

NATIONALISED INDUSTRY PAY AND PRICES

5. Nationalised industries' prices

[Increase in nationalised industry prices, water charges and London Transport fares over 12 months to December 1982 14.3 per cent, compared with RPI 5.4 per cent.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices (including water charges and London Transport fares) and RPI now currently about 9 per cent, compared with 14 per cent in January 1981; over half of present differential explained by LT fares and last winter's electricity rebate. NI prices expected to rise broadly in line with inflation in 1983-84. This substantial

improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

6. UK industrial energy prices above those of European counterparts?

[At NEDC on 8 December CBI complained that energy-intensive industries pay 20 to 40 per cent more for energy than European competitors.]

Vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. But on average, electricity prices will not increase in 1983 (see 8 below). Measures worth over £300 million in energy cost savings have been introduced in last two Budgets to help industry. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating industry. But Energy and Industry Secretaries have indicated willingness to have further discussions with industry about electricity prices.

7. Freeze on industrial gas prices?

[BGC announcement that freeze on renewal prices for contract gas would be extended to first nine months of this year].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

8. Electricity prices?

As announced by the Secretaries of State (for Energy and for Scotland) on 12 November, electricity prices (domestic and industrial) will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

9. Nationalised industry boards' pay?

See D 18-19.

INVESTMENT

10. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Wasteful to provide funds for public sector projects with lower returns than those in private sector. Unfortunately, pre-tax rate of return on

nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

11. Finance more nationalised industry investment by cutting current spending?

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million in current year; and each 1 per cent off total costs saves £330 million in current year.

12. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statistical definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must by definition form part of public sector borrowing requirement.

13. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

14. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in 1981-82 and look like doing similarly in 1982-83 (by about £700 million - excluding BNOC). Even so, actual investment this year expected increase about 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PRIVATISATION

15. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £550 million. Full details of this year's receipts will be published after end of financial year. Sale of Britoil completed and will amount to about £625 million, paid partly in 1982-83 and partly in 1983-84. Wytch Farm disposal is still proceeding [IF PRESSED: but is unlikely to be completed this financial year.] For sale ~~to~~ ABP see R19.

16. What further sales expected?

Sale of British Gas Corporation's major offshore oil assets expected in 1983-84. Government have announced plans to transfer British Telecom and British Airways to the private sector in due course.

17. What sales included in special asset sale targets for future years?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive. changes from 1982 PEWP reflect decisions on privatisation since last targets published, and make allowance for additional disposals likely to arise from continuing scrutiny of potential candidates for privatisation.

18. Marketing of public assets - Amersham and Britoil failures in different ways?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded; about 75 per cent of Britoil shares left with subunderwriters and large discount when first traded].

No. These companies successfully privatised. Pricing an issue not easy especially when company's shares have not previously been traded. In addition, cannot accurately anticipate movements in market after price fixing but while offer still open.

19. Associated British Ports 'giveaway' like Amersham?

NB Comment, except factual, to be avoided during offer period - until 11 February.

On 2 February announced offer for sale of 19.6 million ordinary shares of Associated British Ports Holdings plc at 112p per share; application list to open and close on 9 February.

20. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil); preference in allocation of shares (B Ae, C & W, Amersham, Britoil, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, Britoil, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company. Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSBR projections, partly because of higher production, partly higher oil prices. P&D as reported in The Times 4 January assess Government revenue will peak in 1983-84. Aberdeen University computer runs see sharp falls The Times 31 January.]

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSBR because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels. In general, higher estimates by others are based on combination of higher expected future production and prices and lower expected future capital expenditure.

2. Impact of lower oil prices on UK?

Lower oil price, on balance, good for UK. Large disruptive movements in any direction are in no one's interest. But modest and gradual fall would reduce inflation and boost growth - both good for us. Trade balance effect relatively modest, and fall in \$/£ rate since autumn enough to offset effect on revenues of a significant fall in oil prices.

3. Will UK Government reduce North Sea oil prices?

North Sea oil prices are for BNOG to decide on. BNOG is a pricetaker, not price maker. It follows the market, it does not lead it.

4. Government to relax North Sea fiscal regime?

Oil companies have argued for substantial reductions in taxation. No decisions have been taken. But fact-finding discussions have been taking place with UKOOA and individual companies since the summer to try to close the gap between Government's and companies' assessment of North Sea taxable capacity. These discussions will soon be concluded.

5. Onerous tax system damaging future field developments?

[Energy Select Committee report published 27 January on depletion policy claims North Sea tax regime inhibiting development. Recommends overhaul of tax regime].

Will obviously study report carefully. But remember that other adverse factors - falling oil prices earlier this year; high development costs - much more important than tax. Detailed study has shown that, under current tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that this structure will provide more secure and stable tax regime. A completely new regime would not necessarily

be more stable. Certainly disruptive in short term. Aberdeen University study shows UK taxation on marginal fields to be one of world's 'more lenient'.

6. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

7. Benefits of North Sea should be used to strengthen economy?

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1982-83.

8. Are we really any better off for North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

9. 'Precipitous drop' in North Sea output after 1985?

[Phillips & Drew forecast of oil output almost halving between 1985 and 1990 - FT 4 January.]

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline - though not as steeply as P&D expect. Cannot be complacent about effects of falling North Sea output. Best thing we can do is pursue our present economic policies so that economy in better shape when output begins to decline.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. World recovery under way?

[Article The Times 3 February quotes number of examples in Europe and US where leading indicators have begun to turn around, suggesting world on brink of recovery.]

Welcome early but still tentative signs that are beginning to emerge of the recovery in prospect. Now that inflation and interest rates have been brought down, forecasts point to recovery in output for the industrial countries of around 1-2 per cent this year. Progress on inflation should ensure recovery is soundly based and sustainable.

2. Prospects for US economy?

[US GNP fell $\frac{1}{2}$ per cent in 1982 Q4, bringing fall for 1982 as whole to 1.8 per cent. This was largest annual fall in post-war period. Administration expects growth of 1.4 per cent in 1983.]

Fall in US GNP was disappointing although not unexpected, as OECD had earlier forecast decline of similar magnitude in 1982. Most forecasters expect gradual recovery in 1983, helped by falls in inflation and interest rates.

3. US Budget

[US Administration forecasts budget deficits ranging from \$20⁷ billion in current FY to \$300 billion in FY 1988 if no action taken. Administration has proposed package of measures aimed at reducing deficit, including freeze on Federal expenditure, structural reform of social security system and \$45 billion cuts in defence expenditure. These would reduce budget deficit to \$189 billion in FY 1984 and \$117 billion in FY 1988.]

Share Administration's concern over potential size of budget deficit. Glad to see Administration's proposals to reduce public sector deficit over medium term. In line with UK's fiscal policy as set out in MTFS. Vital for world recovery that Administration and Congress can agree quickly on firm measures to reduce deficit if US interest rates are not to rise again, as economy recovers.

4. US monetary policy

[At end of last year Federal Reserve suspended M1 target and raised M2 target to 9 $\frac{1}{2}$ per cent, at annual rate, over last few months of 1982. (Original M2 target, set in February, was for growth within 6-9 per cent range; M2 growth in Sep-Dec 1982 exceeded range but was broadly in line with revised target). Targets for 1983 not yet announced: expected in February. Administration's economic report suggest Federal Reserve should pay closer attention to growth of total spending in economy rather than narrow money targets.]

Welcome Federal Reserve's flexible approach but stress that Reserve Chairman, Mr Volcker, has made clear that reduction of inflation remains priority and that monetary targets have not been abandoned. Mr Volcker also stressed that Budget deficits must be reduced if interest rates are not to rise again as economy recovers.

5. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 8.9 to 3.9 per cent), UK (12.0 to 5.4 per cent), Japan (3.6 to 2.3 per cent), Italy (17.9 to 16.3 per cent), Canada (12.1 to 9.3 per cent) France (14.0 to 9.7 per cent), Germany (6.3 to 4.6 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation together with falls in interest rates offer better prospects for recovery this year.

6. World financial crisis 'over'?

[Mr Leigh Pemberton reported (FT 30 December) as saying international financial crisis is over, but it is still a very serious situation which will take several years to solve. Mr ⁸Caer (Zurich^{en} banker) reported in Guardian 4 February as saying crisis not over and may not yet have reached climax.]

Most major debtors now undertaking adjustment programmes - often with IMF assistance. They may of course remain convalescent for some time, but we now have the measure of the problem. There have also been moves to improve banking supervision, and banks themselves are improving their information flows.

7. Enlarged GAB

[G10 Ministers met in Paris on 18 January to discuss, inter alia, what role an enlarged GAB (General Arrangement to Borrow) might play in augmenting IMF resources.]

G10 Ministers have agreed, subject to necessary legislative approval, that GAB should be increased from \$76 billion to \$196 billion. Participants' shares in GAB have been adjusted to reflect better their size and role in the world economy. UK share will be 10 per cent. Switzerland is to become a full member. At times when balance of payments position could threaten stability of international monetary system, GAB will be available not only for participants but for any IMF member that agrees a conditional programme with the Fund.

8. Increase in IMF Quotas

IMF has particularly important role in present circumstances in providing finance to countries while they go through necessary adjustments. Essential that IMF has adequate resources. UK has suggested increase of at least 50 per cent in IMF quotas and has played constructive part in building present international consensus on need for progress on Quota Review.

9. IMF Interim Committee?

[Interim Committee meeting in Washinton⁹ 10-11 February. Chancellor, as Chairman, proposed meeting be brought forward from late April, because of importance attached to international community increasing IMF resources, and progress already made in discussions between members.]

There are of course differences in opinion between members of Interim Committee about how IMF resources should be increased, and a lot of note widespread recognition of need to reach agreement. *← hard bargaining remains to be done. But good to*

10. Chancellor's thoughts on strategy for world economic recovery

As told TCSC 31 January, sees four major elements: major countries need to continue collectively to pursue prudent monetary and fiscal policies; within overall framework of prudent policies, countries need to ensure that balance of their individual policies is right; need for adjustment by major debtors; need to avoid protectionism.

~~forward from late April to 10-11 February. We hope that an early and satisfactory agreement can be reached.~~

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS
7 FEBRUARY 1983

Summary comment

The effective exchange rate has fallen by about 12 per cent since October and interest rates have risen 2 points since end November. However, the direction and the consistency of policy are unchanged. GDP remains flat and manufacturing activity is below 1982 trough levels. RPI inflation fell to 5½ per cent in December and 5 per cent is confidently expected in the next few months. This year, a modest rise is expected in both GDP and in manufacturing output.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent last year unfulfilled. A modest recovery in world trade is expected this year.

- . world commodity prices are at their lowest level in real terms for thirty years;
- . oil prices are weak and likely to remain so for the near future;
- . consumer price inflation (OECD major 7) 5½ per cent in December ranging from 16 per cent in Italy to 4½ per cent in Germany and 2½ per cent in Japan;
- . average world 3-month interest rates 9½ per cent at 31 January a fall of 4½ points between January 1983 and October 1981; US 3 month rate stood at 8.75 per cent on 31 January;
- . world trade volume (weighted by UK markets) fell by some 2-3 per cent in 1982;
- . total industrial production for the OECD Major 7 fell 5½ per cent in the twelve months to November; in the US it fell by 6 per cent in the 12 months to December;
- . unemployment (OECD total) 8.7 per cent in October compared with 6.7 per cent for average 1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remarked in stronger surplus during 1982 than forecast in IAF. Both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil

ade but the volume of exports held up well in 1982 and are unlikely to fall below their 1981 levels.

. OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries.

. import volume rose sharply as activity recovered in 1981 and import penetration rose too; in 1982 non-oil import volumes showed little change on 1981 H2.

. the effective exchange rate closed at 81.0 on 4 February. Pound now below both 87-93 range occupied for the last year and May 1979 level (86.3).

Financial Developments

.Monetary aggregates within target range for 1982-83, M1 and £M3 towards top of range, PSL2 towards bottom;

.most banks raised base rates by 1 point on 11 January (to reach 11 per cent) following similar increase on 26/29 November; short term interest rates down 5½ points since October 1981; base-rates down about 5 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £10½ billion in 9 months to December.

.PSBR: £5.3 billion in 9 months to December; Industry Act Forecast of £9 billion in 1982-83 now at upper end of range of likely outcomes.

.Underlying fall in the reserves during January was \$359 million.

Inflation

.retail price inflation, 5.4 per cent in year to December. Prospect of 5 per cent in next few months.

.TPI increase in 12 months to December was 5.8 per cent;

Wholesale price inflation: input prices up 9.1 per cent in year to January compared with 8.0 per cent in December following higher oil prices due to sterling depreciation against the dollar; output prices up 7.4 per cent in year to January. (Lowest increase since July 1978.)

GDP and industrial production

.GDP(O) rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Construction output in 1982 Q3 was 3 per cent up on previous quarter and 2 per cent higher than in 1981 Q3. Underlying level of industrial production also remains broadly flat but is 2 per cent above spring 1981 trough almost entirely due to increased oil and gas production; the underlying level of manufacturing output is slightly below its trough level and there are clear indications of a declining trend during 1982.

Demand Components

consumer spending held up well during the recent recession and has continued to strengthen since 1982 H1. Some fall in RPDI (see below personal sector) offset by lower savings ratio. Retail sales rose 2 per cent in December on previous month and in 1982 as a whole were 2½ per cent up on 1981, partly reflecting abolition of HP controls. Consumers' expenditure in Q4 1982 (provisional) 1½ per cent up on previous quarter (this is being reflected in the relative buoyancy of the consumer goods industries) and, in 1982 as a whole was 1 per cent above its 1981 level.

gross fixed investment recovered slightly in 1982 Q3 from a disappointing second quarter and in the first three quarters of 1982 was 3 per cent up on same period in 1981, but 8½ per cent below its average 1979 level. Manufacturing investment has been weak but is responsible for only 30 per cent of total investment by manufacturing, distributive and service industries.

destocking of £37 million (at 1975 prices) occurred in 1982 Q3. Stocks are volatile and one quarter's figures should not be over emphasised;

government consumption is virtually flat. In 1982 Q3 it was 1½ per cent up on the preceding quarter and on its level in the same period last year;

non-oil exports held up well in 1982 against a 3 per cent fall in world trading activity;

imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising but non-oil import volumes this year have shown little change since 1981 H2.

Productivity and Competitiveness

manufacturing productivity continues to rise - at 2½ per cent in year to Q3 1982. Productivity now 13 per cent up on end 1980;

manufacturers' unit wage/salary costs up less than 6½ per cent in 3 months to November 1982 on a year earlier;

Cost competitiveness has improved some 20 per cent since early 1981, but remains around 10 per cent worse than in May 1979 (whole of this deterioration is attributable to excessive wage costs).

Company Sector

ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the third quarter by 4¾ per cent; and in first 3 quarters of 1982 were 11½ per cent up on their average 1981 level;

non-North Sea profits fell 4¼ per cent in Q3 1982 on previous quarter but in first three quarters of 1982 were 13¾ per cent up on their average 1981 level;

gross profits of North Sea oil companies in the first 3 quarters of 1982 were 8 per cent up on their average 1981 level;

ICCs financial surplus was £0.5 billion in six months to September 1982 following deficit of £0.3 billion in previous six. Over same period net borrowing requirement fell from £9.1 billion to £4.0 billion.

working days lost through industrial stoppages estimated at 85,000 in December, lowest monthly figure for last two years. Total for whole of 1982 (7.9 million) well below average of 12 million for last ten years.

insolvencies: provisional totals for 1982 are 5,707 bankruptcies and 12,039 company liquidations, increases of 11 per cent and 40 per cent on 1981.

Personal Sector

wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

underlying rate of increase in average earnings in year to November 1982 was about 8½ per cent, lowest rate of increase since November 1977;

CBI reports that pay settlements in manufacturing industry averaged 6.1 per cent in 1982 Q4 compared with 6.8 per cent in the third quarter. Bulk of settlements will occur in 1983 H1;

real earnings broadly flat in last 12 months but RPDI in the third quarter is about 2¼ per cent lower than the average for 1981.

Labour Market

UK employees in employment fell 2.2 million (9¼ per cent) between 1979 Q2 and 1982 Q3 (almost two-thirds concentrated in manufacturing); between 1981 Q3 and 1982 Q3 employment fell by 702,000; manufacturing employment fell a further 73,000 (1¼ per cent) between 3 months to November 1982 and preceding 3 months;

total employees in employment fell more in the third quarter of 1982 (205,000) than in the previous quarter (188,000);

total registered unemployment rose by 128,000 to 3.22 million (13.8 per cent on the new basis) in January; two thirds of the increase is estimated to be seasonal;

UK adult unemployment rose by 35,000 to 2.98 million (12.8 per cent) in January; the underlying rate of increase remains broadly steady at about 30,000. Notified vacancies increased by 4,000 to 122,000 in January but volume of vacancies remain at very low levels;

notified redundancies fell by 11,000 in December to 62,500;

other labour market indicators hours lost through short time working has increased steadily since July 1982 to the levels prevailing in 1981 Q4 and 1982 Q1. Hours of overtime worked remain broadly flat.

Forward Indicators

.car production (seasonally adjusted) rose to 76,000 in December from 66,000 in November while commercial vehicle production fell from 24,200 to 22,700 (sa); new car registrations (not seasonally adjusted) in 1982 were about 5½ per cent up on 1981; in January 1983 was the best January on record.

New commercial vehicle registrations rose 6 per cent between 1981 and 1982.

.steel production (seasonally adjusted) fell in December and in 1982 Q4 the weekly rate of production fell 10 per cent and was 32 per cent down on same period in 1981;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, rose 8 per cent in 3 months to November, and were up 6 per cent on a year earlier. Engineering orders rose about 1¼ per cent in three months to October compared with previous three months;

.Latest DOI investment intentions survey suggests a 3 per cent fall in manufacturing investment between 1982 and 1983 but other components of investment (distribution and services) are more encouraging;

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts have been broadly flat in the last nine months but in 1982 as a whole were about 27 per cent up on 1981. Total completions in 1982 Q4 recovered slightly from their level in the middle of 1982 but in the year as a whole were about 14 per cent down on 1981;

.a sharp seasonal rise in unemployment occurs in January thereafter headline total should remain flat till May;

.CSO's index of longer leading indicators fell in December after 9 months of increase reflecting the rise in interest rates and the decline in share prices.

CBI's January (Quarterly) Trends Survey was much improved on recent surveys, the strongly reduced negative balance on the business optimism questions being particularly encouraging though the Survey confirms that manufacturing output and orders remain depressed, some

parts of manufacturing (particularly consumer goods industries) seem more buoyant. The CBI themselves stress that improved productivity and continued progress in reducing cost and price inflation are "signs of longer term improvement in the state of UK manufacturing industry." CBI November forecast projects GDP(O) growth at $1\frac{1}{4}$ per cent next year with manufacturing investment contracting. Also assumes £2½ billion fiscal adjustment in 1983/84 whereas IAF suggests £1 billion.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be $\frac{1}{2}$ -1 per cent - about $\frac{1}{2}$ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around $1\frac{1}{2}$ per cent, assuming some recovery in world economy, with inflation/interest rates falling at least for some time this year.

Industry Act Forecast

NB. November IAF will be superseded by Budget Forecast (on March 15); latter will take full account of economic developments since November Forecast was prepared. Undue emphasis on precise figures in November IAF no longer appropriate.

.Treasury forecast published November 8th assumes a modest (2 per cent) world recovery in 1983. Forecast includes a £1 billion fiscal adjustment in 1983-84 within a fiscal/monetary stance broadly in line with 1982 MTFS. Between 1982 and 1983 GDP grows by $1\frac{1}{2}$ per cent. Principal demand increases are from consumers expenditure and capital investment. Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983. Government Actuary assumes unemployment (old basis) averages 2.9 million (GB, ex school leaver) in 1982-83 and 3.2 million in 1983-84. On new basis figures could be up to 200,000 lower.

Key Statistics Week-Ending Friday 11 February

Mon 7 : Wholesale prices (Jan)
: Retail sales (Dec - final);
: Credit business (Dec)
: Housing starts and completions (Dec)

Tues 8 : Monetary aggregates (Jan - prov)

Wed 9 : CGBR (Dec)

Thurs 10 : Vehicle production (Jan - prov)

Fri 11 : Retail price index (Jan)
: Tax and price index (Jan)
: Building Societies figures (Jan)
: Steel production (Jan)

Economic Outlook

● 1982 – 1986

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Forecast Summary

We expect the recent fall in the pound to halt the decline in manufacturing industry and help generate a modest upturn this year. Total output is expected to be 1¼ per cent higher than in 1982 while consumer price inflation falls to under 6 per cent year on year.

The situation in world and UK financial markets has changed significantly since the middle of last year: the oil price has weakened and sterling has fallen with it; interest rates worldwide are some 3 points lower and US rates have fallen by almost twice as much; the dollar is down from its 1982 peak and the US monetary authorities have indicated that they will pursue more accommodating policies. It could be as much as 6 months before we see a reaction to these changes in the real economy, but the prospects for world recovery in 1983, especially the second half of the year, now seem assured. We expect world GNP to rise by 2¼ per cent in the course of the year, with world industrial production rising about twice as fast.

Although the latest industrial news in the UK is bad, with stocks being run down and output falling, the conditions for revival are in place. The recovery of profits, already evident in the third quarter, will be sustained this year by the recent fall in the exchange rate and the financial position of companies has been further improved by the liquidation of stocks which occurred at the end of last year. If, as we expect, the recent surge in demand is sustained in the second half of the year by a moderately expansionary Budget, producers will not go on running down stocks as they have in recent months. The improvement in company liquidity and a narrowing gap between borrowing costs and expected inflation will, as output begins to rise, encourage some modest restocking by the end of the year.

If output recovery is led (rather as in 1981) by a stock turnround, the essential underpinning is the forecast growth of consumption. Consumers' expenditure was 3 per cent above mid-year levels by the end of 1982. We expect it to hold that level in the first half of this year, and then grow again in the second half, helped by the Budget. We do not expect the recent sharp fall in the savings ratio, financed by bank borrowing, to continue. The growth of consumption in 1983 reflects real income growth.

A high proportion of the extra demand is met by

imports, which are forecast to rise by nearly 6 per cent during the year despite the fall in the pound. Export growth is considerably below this – the world recovery is sluggish at first and the recent improvement in competitiveness is slow to take effect. Net trade thus has a strong negative influence on demand. Since we also expect the terms of trade to be worse following sterling's depreciation, a sharp deterioration in the current account is in prospect. Nevertheless, given the size of the surplus at end-1982 we do not expect an external deficit to emerge this year.

The recovery of output in 1983 takes place against a background of falling inflation. In 1982 public spending and borrowing was below target and the monetary aggregates were under control. Inflation worldwide was falling and in the UK retail prices rose nearly 3 per cent less than officially forecast at the time of the Budget. Partly as a consequence, wage settlements at the start of the 1982-3 wage round have been moderate and this, together with continued labour-shedding, will exert downward pressure on prices in the first half of the year. Our inflation forecast for 1983 has thus been revised downwards despite the fall in the exchange rate.

In later years we expect inflation to accelerate – 1983 is the low point in the present inflation cycle – as the recovery gathers pace and the effects of the depreciation feed through. In the medium term our forecast, based on a continuation of present policies, is that the financial background remains tight. The increase in taxes and social security contributions over the life of the government, the slow past and projected growth of public spending volumes, and the recent favourable movements in public sector wage relativities are such that the government can afford to cut income tax rates and still reduce the share of public borrowing in GDP. Hence we expect monetary growth in single figures despite last year's fall in interest rates and a mildly expansionary Budget. Given this fiscal and monetary background we do not expect sterling to be far below present levels by 1986, even though sudden changes of sentiment in the election period may cause substantial short term movements.

Our forecast of a broadly stable exchange rate means that UK inflation in the medium term is closely linked to world inflation. At present worldwide destocking is exerting downward pressure on prices, especially of oil and other raw materials. We expect the real oil price to fall until the end of next year, and we are also forecasting that a weaker dollar will help contain costs. Against this favourable background we expect

UK inflation to remain below 8 per cent over the period.

The savings ratio tends to follow the inflation rate, and although we expect some short term rise in the ratio from the low fourth quarter level, in the medium term it settles down at around 9½ per cent. Changes in the savings ratio – especially large in recent years – are thus not an important influence on consumption from now on. Output is sustained by steady growth of real incomes and consumption at about 2 per cent per annum, helped by repeated cuts in the standard rate of income tax and the gradual abolition of the National Insurance Surcharge. The delayed effects of the recent fall in sterling also boost output slightly in later years, as net trade makes a small positive contribution to aggregate demand. This sustains output growth once the initial impetus from the stock turnround peters out.

Our medium term forecasts of steady recovery and, by the standards of the 1970s, low inflation, are based on the assumption (not a forecast) that the present government is returned at the next election. We assume that it persists with its strategy of reducing public borrowing and keeping a tight rein on monetary growth. We have examined an alternative, more reflationary, strategy coupled with restrictions on imports and wages. This would produce a higher rate of growth of output in the short term, but would, even on fairly optimistic assumptions about the reaction of wages and of financial markets, mean a return to double digit inflation in the medium term. On less optimistic assumptions about the exchange rate and wage behaviour, inflation rises to 17 per cent and output, though initially higher than in our central forecast, is significantly lower by the end of the period.

	1982	1983	1984	1985	1986
GDP (output measure, per cent change)	0.5	1.8	2.0	2.0	1.6
Inflation (consumer prices)	8.0	5.8	7.0	7.5	7.8
<i>Components of Demand (per cent change)</i>					
Consumers expenditure	1.1	2.3	1.5	2.3	2.2
Private fixed investment (excluding dwellings)	2.5	3.3	4.0	1.5	0.1
Public consumption	1.7	0.9	0.6	0.6	0.6
Exports	0.1	1.7	1.5	2.4	1.8
Imports	4.1	4.6	2.0	1.8	1.3
<i>Financial Background</i>					
Public sector borrowing requirement (£bn, fin. yrs)	7.4	9.2	8.4	7.4	6.4
Money supply sterling M3 (per cent change)	10.8	10.5	9.5	10.1	9.6
Exchange rate (trade weighted index, 1975 = 100)	91	81	80	79	77
Wages and salaries per employee (per cent change)	8.8	7.3	7.6	9.5	9.5
Average earnings in manufacturing (per cent change)	11.0	8.1	7.2	8.3	8.0
Wholly unemployed (UK, millions, new definition)	2.8	3.1	3.2	3.1	3.1
Balance of payments (£bn)	4.2	1.5	0.0	-0.1	-0.3

Planning Feature

The Forecast in Detail

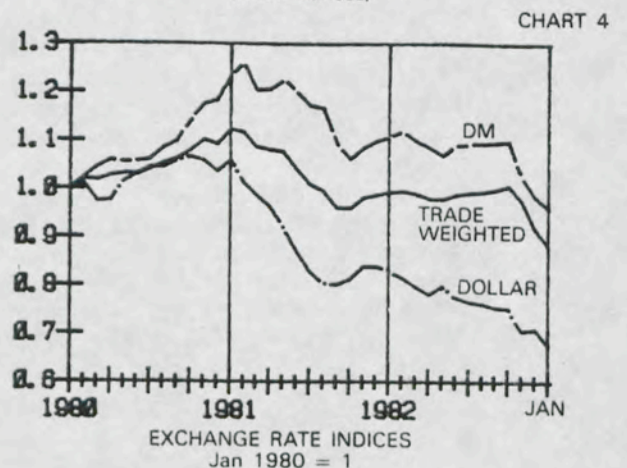
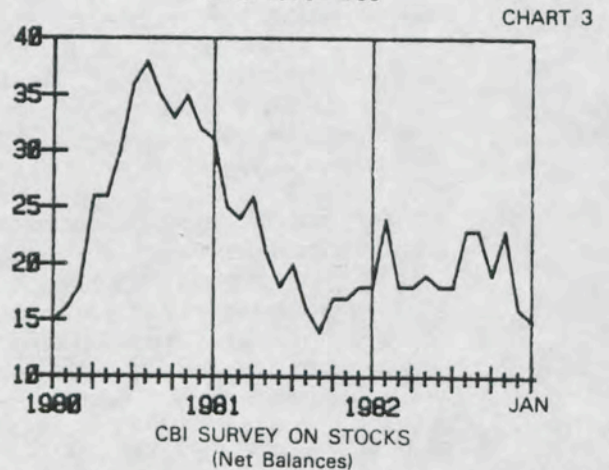
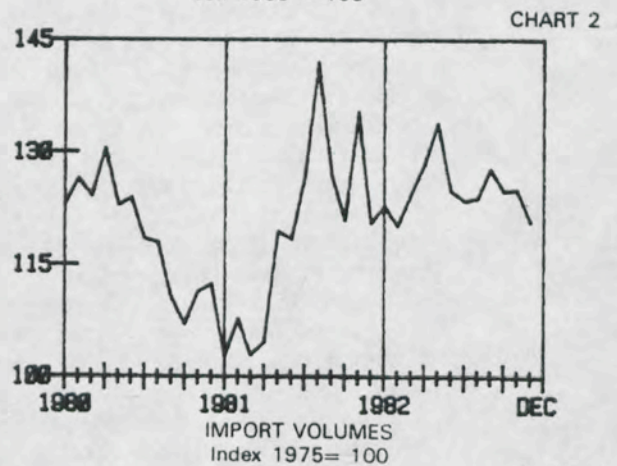
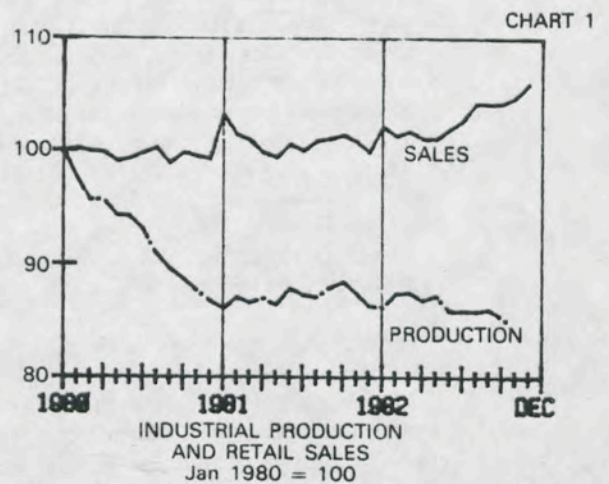
(1) Recent Developments

The latest economic statistics continue to show buoyant retail sales – up 4 per cent since June. Yet the rise in demand is not being satisfied by current UK production (Chart 1). Manufacturing output is down by 3 per cent in November compared with a year earlier, while the latest CBI survey gives no indication that the down trend was reversed in December or January. One possible explanation – that the demand is being met by imports – has not so far been borne out by the trade statistics. Imports have been falling as Chart 2 shows.

From the middle of last year industry once again started to run down stocks, and the conjunction of falling output and rising consumption suggests that inventories are still being reduced. One reason for this is that the financial position of companies, after improving steadily in 1981, deteriorated sharply in the first half of 1982, following the steep rise in interest rates in the autumn of 1981 and the subsequent strength of the exchange rate. When put under similar pressure (from similar causes) in 1980 companies reacted by running down stocks at a rapid rate. They reacted in the same way in the second half of last year – the CBI survey (Chart 3) shows an increase (recently reversed) in the number of firms who regard stocks as more than adequate.

Another perspective on these developments is provided by the financial statistics, which show a marked change in the pattern of bank advances in the later months of 1982. Bank lending to persons remains buoyant, but new bank lending to manufacturing industry has fallen sharply. Instead of companies borrowing from the banks to finance their holdings of stocks, consumers have been borrowing in order to buy. Their purchases have been supplied out of stock, and companies have used the cash thus generated to reduce their own borrowing.

The conjunction of strong consumption and weak output reflects the financial background – strong exchange rate, high interest rates – prevailing in the first half of last year. However, from Budget time onwards the authorities, having maintained a fairly tight fiscal stance, were encouraging interest rates to fall. For a while UK interest rates came down more rapidly than elsewhere, but the balance of payments was in large surplus and the pound remained strong. From the summer onwards US interest rates fell sharply, enabling UK interest rates to come down further without threatening the stability of the exchange rate. However, in November fears of a serious weakening in the oil price surfaced. Additionally, domestic demand in the UK was rising more rapidly than elsewhere. The Chancellor's Autumn Statement implied a balance of payments deficit by the end of 1983. The pound fell sharply on the foreign exchanges and has been weak ever since (Chart 4).



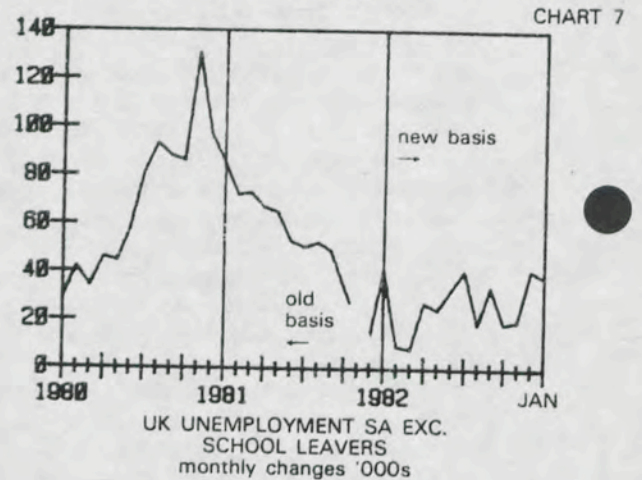
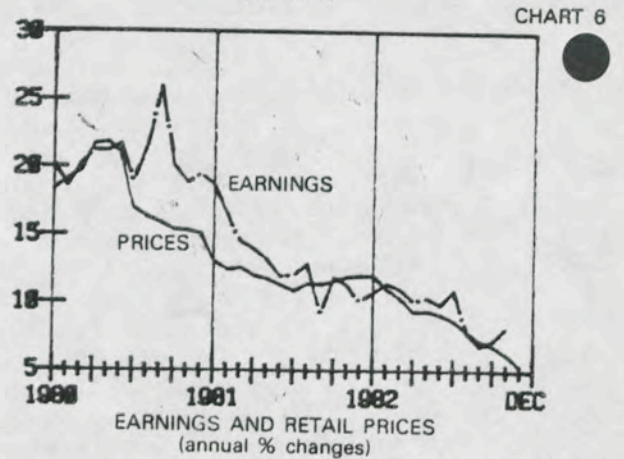
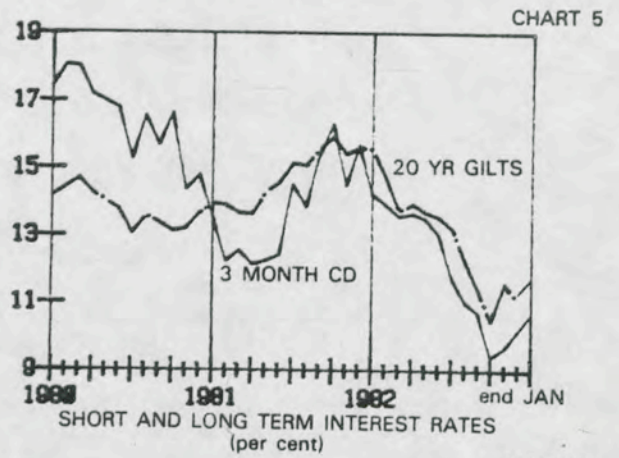
The fall in sterling has brought the year-long decline in UK interest rates to a halt (Chart 5). The outflow of capital from the sterling money markets and security markets has meant increased selling of sterling-denominated paper, driving the price down and the yield up. Selling typically starts in the money markets (e.g. of sterling CDs), but arbitrage quickly transmits the upward pressure on interest rates to other security markets. Thus market forces have tended to push up interest rates across the board, whether or not the authorities have sought such a rise to protect the pound.

The upturn in interest rates has come at a time when purely domestic considerations would point to stable or falling rates. Public borrowing may undershoot even the downward-revised 1982-3 estimate of £9bn published in the Autumn Statement. Gilt sales continue to exceed immediate funding requirements. Bank lending to the private sector as a whole is still buoyant but the improved financial position of companies has reduced the upward pressure on the money supply, and the growth of the money stock is within target.

The tight fiscal and monetary stance of the past two years is now also being reflected in a convincing fall in the inflation rate (Chart 6). The 6-monthly rate of increase in retail prices, excluding seasonal food, fell from a peak of nearly 10 per cent in April and has been under 5 per cent since October. The 'headline' retail price index has performed even more spectacularly, with the annual rate falling to 5.4 per cent in December. However, the fall in the exchange rate has already started to push up prices at the wholesale level.

Monthly movements in earnings are much more difficult to interpret, since they are affected by the timing of individual wage settlements. However, the statistics show that a sharp drop in the annual rate of increase, from over 10 to around 7 per cent, occurred in August, and evidence from the CBI databank as well as press reports of recent settlements all tend to support the view that a "going rate" for wage increases is now around 7 per cent in the private sector, and distinctly less in the public sector.

These figures imply that the costs of employing people are (despite the cuts in the National Insurance Surcharge) still tending to rise faster than the price of their output. Employers are still seeking productivity gains and with output flat this is being achieved by releasing labour whenever possible. The sharp rise in unemployment in December-January (Chart 7) indicates that business confidence remained at a low ebb throughout the autumn of 1982, despite a sharp increase in profits in the third quarter. The fall in the exchange rate means that the improvement in profitability should be sustained next year. But the consequent threat of a rise in interest rates is acting as a brake on expansion. Although the financial conditions which were responsible for the weak performance of output in 1982 have changed decisively for the better, producers are not yet persuaded that the upturn in demand is more than a temporary response to the abolition of hire purchase controls and lower interest rates. They are probably



looking to the Budget of 15 March for confirmation that demand is likely to remain on its present expansionary path.

LS

(2) Assumptions – Central Forecast

We continue to make our best guesses about likely policy developments rather than assuming 'unchanged' policies. In the central forecast we assume that the broad thrust of policy is unchanged, i.e. we have made the technical assumption that the present government is returned in the next General Election. But, because an election must be held within the next 15 months, we also consider the medium-term prospects under alternative economic policies. (For details see p. 19.) In the central forecast, therefore, we assume that policy will continue to be guided – though not completely determined – by an extended Medium-Term Financial Strategy (MTFS). For 1983-4 the MTFS requires the PSBR to be 2¼ per cent of GDP at market prices. Given official inflation and output forecasts, the Chancellor is therefore aiming for a 1983-4 PSBR of £8bn (Autumn Statement, p. 13). In the central forecast, however, we have assumed that the Budget of 15 March will give greater weight to the political objectives of cutting income tax and maintaining the attack on inflation, even if this implies slippage from the MTFS targets. Specifically we have assumed that the standard rate of income tax will be cut by 1p, that personal tax allowances will be raised by 12 per cent and that indirect taxes will be raised by only half the amount required for full revalorisation. This amounts to a total tax giveaway (compared with unchanged policy) of £1½ bn and results in a PSBR of just over £9bn, 3.1 per cent of GDP at market prices.

The Fiscal and Monetary Framework

We forecast that the PSBR will be £7½bn in 1982-3, somewhat below the official projection of £9bn contained in the Autumn Statement, which was itself revised down from the (March 1982) Budget forecast of £9½bn. Thereafter, given our Budget and election assumptions, the PSBR rises to £9-9¼bn in 1983-4 before declining again in 1984-5 and later years. By 1986-7, the continuation of present policies implies a PSBR of 1¼ per cent of GDP at market prices. But even so our forecasts lie above the MTFS projections – at present the MTFS only goes as far as 1984-5 – and this is because we assume further cuts in income tax and the national insurance surcharge in the medium term. Given our forecasts of the likely growth of public expenditure and the rise in North Sea oil taxation these cuts are consistent with the PSBR declining as a share of GDP, but from the higher base level of 1983-4.

The downward trend of interest rates has been interrupted by the weakness of sterling, even though fiscal and monetary policy remain fairly tight. The Chancellor has announced that he does not intend to raise interest rates again to defend the pound. We interpret this to mean that interest rates will be guided principally by domestic monetary conditions. Since monetary growth is currently inside the MTFS

guidelines we forecast that there will be further cuts in interest rates during 1983. Thereafter we expect economic recovery, together with the relaxation of fiscal policy, to increase the demand for credit more rapidly than the supply of savings and this will lead to higher interest rates in 1984. This combination of fiscal policy and interest rates is forecast to keep the growth of the money supply (£M3) in the 9-11 per cent range over the next four years.

Table 1
Summary of Fiscal and Monetary Assumptions

Financial years:	82-3	83-4	84-5	85-6	86-7
PSBR					
£bn	7.4	9.2	8.4	7.4	6.4
% of GDP at market prices	2.7	3.1	2.6	2.1	1.7
Short-term interest rates	11.1	9.3	10.8	11.6	11.6
Percentage growth in money supply during financial years	11.2	8.7	10.4	9.7	9.3

In Table 2 we summarise the effects on the PSBR of the main tax changes that we have built into the forecast. This table compares the PSBR in our central forecast with the PSBR that we would have forecast had we assumed Rooker-Wise (5.4 per cent) indexation of income tax allowances on March 15 as well as in all future years; similarly, full revalorisation of indirect taxes in all Budgets, no cuts in the rate of income tax and no further cuts in the national insurance surcharge.

In the first, second and third lines of Table 2, we

Table 2
Effects of assumed income tax and NIS cuts on the PSBR (£bn)

Financial years:	83-4	84-5	85-6	86-7
Cumulative (ex post) effect of cuts in income tax and NIS rates on:				
Income tax	-1.5	-2.3	-3.1	-5.0
National Insurance Surcharge (NIS)	-	-0.6	-2.1	-2.3
Total income tax plus NIS	-1.5	-2.9	-5.2	-7.3
Cumulative net effect on other government receipts and expenditure	+0.3	+0.8	+1.3	+1.9
Total net effect on PSBR	1.2	2.1	3.9	5.4
add PSBR without policy changes	8.0	6.3	3.5	1.0
gives PSBR forecast from Table 1 (which is after allowing for tax changes)	9.2	8.4	7.4	6.4

measure the 'ex-post' effects on income tax and National Insurance Surcharge revenue of the assumed cuts in these taxes. These 'ex post' effects are generally less than the 'ex ante' effects (sometimes called 'exchequer costs'). This is because 'ex post' effects allow for the impact on tax revenue of rises in income and demand that occur as a result. The fourth line shows the net effect of increases in other government revenue, and decreases in government expenditure, caused by the cuts in income tax and National Insurance Surcharge. All effects are cumulative.

Table 3 shows that in the central forecast, which includes the cuts in income tax and National Insurance Surcharge, the PSBR as a percentage of GDP is rather above the MTFS guidelines in the 1983-4 and 1984-5 financial years. However our estimates on 'unchanged policies' show a PSBR very close to the MTFS guidelines. This suggests that, given our government expenditure assumptions, the 1983 Budget will have to be broadly 'neutral' in its effect on tax revenue to achieve the MTFS guideline for the PSBR as a percentage of GDP.

Corresponding to the PSBR projections Table 3 also shows that we expect monetary growth (£M3) to stay within the target range in 1983-4 but to move above the range as output picks up in 1984-5. On unchanged policies, however, monetary growth remains just within the target range in 1983-4 and 1984-5.

Table 4 brings together the main elements of public expenditure and compares our forecast with the new Public Expenditure White Paper (Cmnd 8789). It shows that for 1982-3 we still expect total public expenditure to undershoot the downward revised target. This undershooting is not, however, maintained in the future. We

Table 3
Government MTFS and LBS forecast compared

Financial years:	82-3	83-4	84-5	85-6	86-7
<i>PSBR as percentage of GDP at market prices:</i>					
Official guideline (MTFS)	3½	2¾	2	n/a	n/a
LBS estimate					
without policy changes	2.7	2.7	2.0	1.0	0.3
with policy changes	2.7	3.1	2.6	2.1	1.7
<i>Percentage growth of money supply during financial years:</i>					
Official guideline (MTFS)	8-12	7-11	6-10	n/a	n/a
LBS estimate					
without policy changes	11.2	8.1	9.3	8.0	6.6
with policy changes	11.2	8.6	10.4	9.8	9.3

n/a = not available

expect expenditure to increase by about 8 per cent in cash terms in 1983-4 and this takes expenditure a little above the official plans. In 1984-5 and 1985-6 the gap widens further. This is because we expect inflation to pick up again in these years without, we assume, any corresponding offset to the volume of public expenditure.

Table 4
Government expenditure
(£bn cash)

Financial years:	82-3	83-4	84-5	85-6	86-7
<i>Government plans (Cmnd 8789)</i>					
1. Planning Total (includes contingency reserve)	113.0	119.6	126.4	132.3	n/a
less effect from:					
2. Special sales of assets					
gives:	-0.6	-0.75	-1.5	-0.5	n/a
3. Planning Total (exc. asset sales)	113.6	120.3	127.9	132.8	n/a
<i>LBS forecasts:</i>					
4. Planning Total (exc. asset sales)	112.4	121.3	131.1	142.2	154.0
<i>Difference between Government and LBS</i>					
5. Line 4 minus line 3	-1.2	1.0	3.2	9.4	n/a

n/a = not available

Tax and Public Expenditure Assumptions in Detail

A. Taxes

(1) *Personal income tax.* We have assumed that the Budget of March 15 will increase personal tax allowances and bands by 12 per cent, compared with the statutory obligation (Rooker-Wise) of 5.4 per cent. The 6.6 per cent additional increase, when added to the 2 per cent supplement in the 1982 Budget, means that over half of the 1981 Budget shortfall – there was no increase in personal tax allowances when normal indexation requirements would have meant an increase of 15.1 per cent – will have been made good. We assume that subsequent Budgets will only implement the statutory increase. As a result allowances are increased by 6 per cent, 7½ per cent and 7¾ per cent in each of the financial years 1984-5 to 1986-7, respectively.

The standard rate of income tax has not been changed since 1979-80. We assume cuts as follows:

Standard rate of income tax %	
1983-4	29
1984-5	28
1985-6	27
1986-7	25

(2) *Corporation tax* (excluding North Sea oil-related receipts). We assume no change in the rate of corporation tax. Receipts of this tax depend on past profits and on a complex system of allowances. We expect only a small rise in the coming financial year and larger increases after that.

(3) *Indirect taxes* (VAT and specific duties). We assume no change in the 15 per cent rate of VAT. We are, however, departing from our usual assumption of complete revalorisation of specific duties. This is because the recent deceleration in retail prices means that the inflation rate is likely to start rising again in the run up to the next election. We believe the Chancellor will seek ways of stemming this rise, and we assume that he will put up duty rates by only half the amount needed for full revalorisation. In future years we assume full revalorisation of all duties. However, expenditure on dutied goods – cigarettes, spirits, etc. – has tended to fall as a share of total spending and the ratio of indirect taxes to current price consumption is therefore forecast to fall slightly over the next four years.

(4) *National Insurance Contributions* (including the surcharge). We assume no change in National Insurance contributions from the rates announced in the Autumn Statement and which come into effect in April. The National Insurance Surcharge (which is treated as an indirect tax in the national income accounts) was reduced in the 1982 Budget from 3½ per cent to 2½ per cent. But because the earliest practicable date at which the cut could be implemented was 2 August 1982, the Chancellor announced a further ½ per cent reduction for the period of August 1982 to April 1983.

Additionally, in the Autumn Statement, the Chancellor announced that the 2 per cent rate would apply retrospectively to the whole of 1982-3 and that employers in the private sector (as with earlier cuts in the NIS the public sector has not been able to benefit because its cash limits have been cut by an amount equivalent to the NIS reduction) would obtain this benefit by reduced payments in January-March 1983. In the present forecast we have treated this additional rebate – estimated by the government at £350m – as a financial transaction which increases the PSBR (but not the public sector's financial deficit). We are also assuming that the NIS rate, set at 1½ per cent for 1983-4, will not be further changed over the next 12 months, that it will be cut to 1 per cent in 1984-5 and eliminated completely in 1985-6.

(5) *Local authority rates* are assumed to rise about 7¼ per cent on average – though some authorities will require much higher rate increases – in the coming financial year and in line with the public consumption deflator in later years.

(6) *Taxes on North Sea oil* (royalties, PRT and corporation tax on oil companies). In the 1982 Budget the Chancellor announced the abolition of the Supplementary Petroleum Duty, an increase in the rate of PRT from 70 to 75 per cent and arrangements for advancing (and smoothing the flow of) PRT payments. Although the revised arrangements imply a net reduction in PRT and SPD payments (because Advance PRT is offsettable against PRT whereas SPD was not), we expect that the total tax take as a per cent of North Sea oil profits will rise over the years to 1986-7. In that year we expect total North Sea taxes of over £15 billion compared to about £8¼ billion in the current financial year.

B. Government expenditure

(1) *Government consumption* volume is assumed to rise about ½ per cent p.a. from 1983 onwards. Within the total, procurement expenditure (on goods and services produced by the private sector, including defence equipment) rises by about 1½ per cent p.a. while employment falls further.

(2) *Public investment* in total fell 18 per cent in 1981, the largest of a long sequence of annual declines. However, this partly reflects council house sales. In 1982 the fall was probably about 4 per cent. We are projecting some growth in investment from now on. Initially housing will be the main beneficiary, subsequently the nationalised industries. Over the four years 1983-6 as a whole we are projecting that total public investment will rise by about 2½ per cent p.a. on average.

(3) *Pensions* were increased by 11 per cent in November – 9 per cent was the government's Budget forecast of retail price inflation over the 12 months to November

and 2 per cent was the 1981 shortfall. Because inflation in the year to November was, however, only 6.3 per cent, pensions and other grants received a 2.7 per cent unintended addition. We have assumed that the government will not pursue its original plan of recovering some of this increase in future years, so that pensions

and other grants will be increased in line with inflation throughout the forecast period.

(4) *UK contributions to the EEC budget* are assumed to remain broadly unchanged in real terms from the 1982-3 outturn.

(3) The Outlook for 1983

World Background

World output fell sharply in 1982, especially in the manufacturing sector. We expect a steady rise during 1983, but for the year as a whole output will not be significantly higher than in 1982. The disappointing performance of the world economy last year had its origins in the sharp rise in US interest rates in 1981, of which the main consequences were a strong dollar and a high level of world interest rates, as inflation-conscious governments tried to stop their currencies from depreciating. Higher interest rates and a strong dollar exacerbated the financing problems of developing countries, and led them to cut back their imports. The strong dollar put up the cost of oil and added to the problems of the manufacturing sector, especially in Europe and Japan. High interest rates weakened demand for interest-sensitive items such as inventories, consumer durables and capital equipment. These negative influences outweighed, in 1982, the positive effects on output of the rapid fall in world inflation, which meant that the real money stock was some 3-4 per cent higher than a year earlier throughout the year.

Table 5

Annual change (per cent)	1981	1982	1983
World industrial production	0.9	-4.5	0.1
World manufacturing prices	10.3	7.0	5.3
World consumer prices	10.6	8.1	6.7
Oil prices (\$)	10.0	-4.2	-11.3
Non-oil commodity prices	4.2	0.9	-2.5

Our forecast of recovery this year assumes that monetary growth will continue at an annual rate of 9½ per cent while producer price inflation bottoms out at just under 5 per cent. More crucially it depends on our assumption that the dollar will resume its fall from the peak level of 126 on the trade-weighted index, falling below 110 at the end of the year. A lower dollar, and weaker dollar oil prices, are forecast to stimulate recovery in the manufacturing sector. In addition we expect the sharp fall in US interest rates since last summer to result in a significantly lower average level of world interest rates in 1983 than in 1982. We expect this to stimulate growth in the second half of the year. If these assumptions prove correct we would expect world industrial production to grow by 3 per cent in the course of this year, with world GNP rising by 2 per cent.

Borrowing Requirement and Money Supply

The substantial reduction in the public sector deficit which occurred in 1981-2 following the tight 1981 Budget shows every sign of being maintained in 1982-3.

Revenue continued to rise fairly rapidly even though economic growth was lower than officially forecast at the time of the Budget and inflation fell faster than expected. Consumption in general, consumer durables and retail sales in particular, have a higher tax content than other components of demand, and their buoyancy in the second half of last year helped to sustain revenue despite the weak output performance. The lower pound has also boosted the sterling value of UK oil revenues, and the government's share thereof. Borrowing has also been reduced by inflation in the public sector falling more rapidly than elsewhere. This mainly reflects lower public sector wage settlements but it is also due to lower procurement prices. The cash limit system appears to have helped curb the normal tendency for public sector prices to run ahead of those in the private sector, and the weakness of demand, particularly in the capital goods sector, has also been an important factor.

Table 6

Financial year totals	1981-2	1982-3	1983-4
Public sector deficit £bn	-6.0	-5.1	-7.0
Borrowing requirement £bn	8.7	7.4	9.2
% of GDP (at market prices)	3.5	2.7	3.1
Change in money stock (£M3)			
during financial year: £bn	9.5	8.9	7.7
%	13.6	11.2	8.7

In the 1983-4 financial year the growth of the tax base is expected to pick up as economic recovery resumes. The improvement in the financial position of public corporations is expected to continue, and revenue from National Insurance contributions also rises substantially in real terms following the 1983 increase in the rate. At the same time the cost of servicing public sector debt is forecast to fall as the current decline in interest rates is sustained. However, these favourable factors are more than offset by the tax cuts that we assume will be enacted in the 1983 Budget (see p.6) and by the sharp rise in the real value of current grants following the 11 per cent uprating in November 1982. Oil revenue is also expected to be less buoyant, reflecting our assumption of lower oil prices, a weaker dollar and some loss of revenue during the changeover to the new tax system.

A higher public sector deficit in 1983-4 is mirrored in a higher borrowing requirement (we do not expect any significant change in the financial items) but we nevertheless expect the recent slowdown in the rate of monetary growth to continue. The improvement in the financial position of companies, who have used the recent buoyancy of consumer demand to liquidate stocks, has reduced company borrowing from the banks. We also expect personal borrowing to moderate when real incomes are boosted by tax cuts. More moderate growth of bank lending is expected to result in slower monetary growth during the financial year 1983-4 than in 1982-3.

Exchange Rates, Competitiveness and Terms of Trade

The 10 per cent fall in sterling's trade-weighted index that has occurred since November has brought the real exchange rate close to its sustainable long-run equilibrium level. We expect a further small decline this year, but this will take place mainly against the continental currencies and the yen. Our assumption of a fall in the dollar's trade-weighted rate implies a small rise in the pound against the dollar.

Table 7

Annual change (per cent)	1981	1982	1983
Effective exchange rate	-1.2	-4.7	-10.8
Wholesale prices: world	10.3	7.0	5.3
UK	10.6	8.6	7.5
Competitiveness			
- means more competitive	-0.9	-3.2	-8.9
Terms of trade in manufacturing	3.3	-0.4	-3.4

Although UK inflation at the retail level is now close to the world average, UK producer prices are still rising more rapidly than overseas competitors. Even so the recent fall in the pound will mean a substantial improvement in competitiveness in 1983. UK costs are still historically high relative to competitors', but this handicap is probably justified by North Sea oil and we expect only a small further improvement in competitiveness this year.

Given that demand is now stronger in the UK than overseas, we expect the fall in sterling to be more fully reflected in import prices than in export prices, so that the UK's terms of trade in 1983 will be worse than the exceptionally favourable 1982 level. This implies that the squeeze on importers' profit margins, which cushioned import prices from the full effect of the 1981 fall in sterling, will continue, but at a much slower pace; while UK exporters, competing on depressed overseas markets, will take advantage of the fall in sterling to lower their (foreign currency) prices.

Earnings, Prices and Profits

A sharp drop in the annual rate of increase of manufacturing earnings occurred in the third quarter of 1982, reflecting the fact that the bunching of private settlements at and after the end of the 1981 pay round did not recur in 1982. The drop was sharper and occurred sooner in the public sector, and public sector wages are now coming rapidly back into line with those in the private sector, unwinding the effects of the Clegg settlements.

We expect increases in basic wages to remain moderate in all sectors of the economy this year. The pay round began against a background of sharply falling inflation, with the government implementing cash limits and a public sector pay guideline of 3½ per cent. Settlements so far have been moderate, with private sector pay offers somewhat higher than those made in the public sector.

Given our forecast of a continued rise in output this year, and given that earnings in the private sector tend to rise faster than basic wage rates as economic activity picks up, we expect private sector wages to rise nearly 2 per cent faster than public sector wages during 1983.

Table 8

Annual change (per cent)	1981	1982	1983
Wages and salaries per head			
Manufacturing	13.2	11.0	8.1
General government	14.3	6.6	6.4
Whole economy	11.9	8.8	7.3
Unit labour costs in manufacturing	9.5	4.9	4.3
Manufacturing output prices	10.6	8.6	7.5
Company profits			
Net of stock appreciation	2.9	11.2	19.9
Excluding North Sea oil	-12.8	9.8	31.0

Since the fall in the exchange rate came at a time when the pattern of wage settlements was already well established, we expect it to have little effect on wages in the present round. However, a lower exchange rate will both put up manufacturing input prices and make it easier for producers to raise their output prices. We do not therefore expect any significant further deceleration of wholesale prices this year. The combination of a lower rate of increase of unit costs (helped by decelerating wages and rising output) and a stable rate of price increases implies substantially higher profits in 1983, especially in the manufacturing sector. Some of this increase is already visible in the profits data for 1982, which shows a sharp rise in the third quarter.

Consumption

The continued fall in employment in 1982 was a major factor in holding the growth of total personal income some 2 per cent below the rate of growth of wages per head. Since consumer prices grew in line with wages, real disposable income fell by just over 2 per cent. Despite this fall, however, consumption rose by nearly 3 per cent during the year, with virtually all of the rise coming in the second half. The rise in consumption was sustained entirely by a sharp fall in the personal savings ratio and financed by a rapid increase in personal borrowing. It followed the abolition of hire purchase controls in July and coincided with steadily falling interest rates.

In 1983 we expect total personal incomes once again to be eroded by falling employment. However, this will be offset by cuts in personal income tax and by a further decline in inflation (helped, we assume, by non-indexation of some specific duties) below the rate of

Table 9

Annual change (per cent)	1981	1982	1983
Total personal income	9.5	6.6	6.5
Income tax	12.4	9.5	2.3
Disposable income	8.6	5.6	6.8
Consumer prices	10.9	8.0	5.8
Real disposable income	-2.1	-2.2	1.0
Consumer spending	0.4	1.1	2.3
Savings ratio as % of disposable income (levels)	13.4	10.5	9.3

wage increases. As a consequence real disposable income is expected to be about 1 per cent higher this year than in 1982. We do not expect the savings ratio to remain at the exceptionally low level estimated for the fourth quarter of last year, but even allowing for some rise the *average* rate of saving in 1983 will be about 1 per cent lower than in 1982. The combination of higher real disposable income and lower saving will bring about an increase of about 2 per cent in personal consumption.

The recent upswing in consumer spending has been concentrated on durable goods, sales of which in the third quarter of 1982 were 12 per cent higher than a year earlier. We estimate an even greater annual increase in the fourth quarter. Some of this represents a bringing forward of consumption following the abolition of hire purchase controls rather than a permanent increase and we expect expenditure on durables to fall back in the course of this year. Even so the 1983 average is likely to be over 5 per cent higher than 1982, a rise of well over 10 per cent over two years.

Table 10

Annual change (per cent)	1981	1982	1983
Personal consumption	0.4	1.1	2.3
durables	2.9	7.3	6.5
non-durables	0.2	0.5	1.9
Public consumption	0.0	1.7	0.9
procurement	-0.4	3.9	3.1
employment	0.2	0.4	-0.4

Public consumption continues to rise steadily in volume terms although public sector employment remains flat (it has not risen significantly since 1975). The combination of a cash limits system for controlling public expenditure and a falling rate of inflation has meant that public sector procurement rose sharply by recent standards in 1982. We expect a similar pattern in 1983, with public employment and relative wages both falling thus making room for an increase in public procurement spending within the available cash limits.

Investment

Total investment in the third quarter of 1982 proved surprisingly strong. Given the recent tendency of the public sector to underspend on capital projects, we have assumed that most of the third quarter increase in investment took place in the private sector. Even if, as we expect, investment falls back in the fourth quarter, it now looks as though investment in 1982 was rather higher than predicted by the intentions survey. In 1983 we expect business investment to go on rising as confidence is revived by the recent improvement in competitiveness and the recovery of profits (which is forecast to continue next year). We also expect the substantial flow of funds into the building societies in 1982 to result in a sharp increase in private residential investment in 1983. Over the two years to mid-1982 public investment was cut by over a quarter, but the recent data suggest that public capital spending has been stabilised. We expect it to rise in 1983, partly because capital goods prices are now increasing very slowly, so that some volume increase is possible within the cash limits, and partly because we expect some relaxation of the controls on public spending in order to help the recovery along.

Table 11

Annual change (per cent)	1981	1982	1983
Private fixed investment	-3.8	4.8	3.6
of which			
non-housing (incl. oil)	-2.2	4.1	2.5
housing	-15.5	10.7	12.0
Public fixed investment	-17.6	-3.8	2.8
of which			
housing	-35.2	6.9	1.6
non-housing			
general government	-21.5	-32.2	-3.0
nationalised industries	-8.6	4.2	4.6
Total investment	-8.2	2.5	3.3
Stockbuilding (£bn 1975 prices)	-1.9	-0.9	0.0

The conjunction of rapidly rising consumption, falling UK industrial production and stable imports meant renewed destocking in the second half of 1982 – we estimate that the rundown of stocks was faster in the fourth quarter than in the third. Destocking followed a deterioration in the financial position of companies in the first half of 1982 which was linked to high interest rates and a strong exchange rate. We estimate that company finances improved in the second half of the year (following the rise in profits in the third quarter and helped by destocking itself). The improvement will be sustained this year by the fall in the exchange rate and lower interest rates, and we expect a general revival of business confidence in 1983. Accordingly we expect destocking to come to an end in the second half of the year, but we forecast only modest rebuilding of stocks.

The Balance of Payments

The weakness of world demand hit UK exports in the second half of 1982, leaving them some 2½ per cent below year-earlier levels. However, imports were also weak, and the UK terms of trade improved. Consequently the balance of payments surplus rose, and we now estimate a substantially higher surplus in the second half of 1982 than in the first half. We expect the balance of payments to deteriorate quite rapidly in the course of this year, although we still expect a substantial surplus for 1983 as a whole.

Table 12

Annual change (per cent)	1981	1982	1983
Exports	-2.2	-0.1	1.7
Imports	-0.3	4.1	4.6
Terms of trade	4.5	1.0	-2.1
Current balance of payments (£bn)	6.1	4.2	1.5

Although the recent fall in the pound is expected to cause a gradual acceleration in exports this year, we expect a faster rise in imports as destocking comes to an end (a similar pattern to that seen in 1981). However an equally important reason for the deterioration in the balance of payments is the immediate worsening in the terms of trade which we expect in the first half of this year as a consequence of sterling's fall. We do not expect the impact of a weaker pound to be as completely cushioned by a squeeze on importers' excess profit margins as happened in 1981, since importers' profits are now close to normal levels.

The Components of Demand

Table 13 summarises the main demand changes which determine the shape of the forecast. In 1982 there was a significant recovery of domestic demand (worth about 1½ per cent of GDP). Destocking was also substantially less than in 1981, adding a further 1 per cent to demand. (The year-on-year picture is very different from the changes during the year: destocking was concentrated in the second half of 1982 and was a strong negative influence on output at that time.) However, the deterioration in net trade was a negative influence on demand worth nearly 1½ per cent of GDP, so that total expenditure rose by only 1 per cent. The discrepancy between output and expenditure widened again, leaving output growing more slowly still, by only ½ per cent. In 1983 we expect a further significant increase (over 2 per cent) in domestic final demand, plus a further boost of nearly 1 per cent from the end of destocking. A substantial proportion of the extra demand will be met from imports, and we expect the deterioration in net trade to be worth more than 1 per cent of GDP. However in 1983 we are assuming that output and expen-

diture measures will move in line, and this means that output is expected to be nearly 2 per cent higher this year than in 1982.

Table 13

£bn 1975 prices	1981	1982	1983
Domestic demand at factor cost	102.8	104.3	106.4
Stockbuilding	-1.9	-0.9	-0.0
Net trade	-1.7	-3.1	-4.2
GDP (expenditure measure)	99.3	100.3	102.1
Output/expenditure adjustment	0.7	1.2	1.2
GDP (output measure)	98.6	99.1	100.9

Output, Productivity and Employment

Although total UK output continued to advance in 1982, the rate of increase was very slow, especially in comparison with the growth of final demand (suggesting the problems lie on the supply side). Moreover the trend of industrial production, when oil is excluded, was flat or downwards, while manufacturing production fell gently throughout the year and rather more sharply in the fourth quarter. The weakness of manufacturing production – a high proportion of which is exported – is partly due to the sharp fall in manufacturing exports, a consequence of weak world demand and an uncompetitive exchange rate. It also reflects renewed destocking in the second half of last year – the rise in demand was met out of stocks rather than by new production.

Our forecast for 1983 of a recovery in world trade and a steady rise of manufacturing exports, taken in conjunction with our forecast of a substantial turnaround in stockbuilding, together imply a recovery in manufacturing production this year – we expect a rise of over 3 per cent through the year. Even so the rise in manufacturing output and industrial production forecast for 1983 is small compared with past recoveries, and reflects our view that a substantial proportion of the fall in manufacturing output relative to GDP that has taken place since 1979 is permanent.

Table 14

Annual change (per cent)	1981	1982	1983
GDP	-2.5	0.5	1.8
GDP excluding oil	-2.9	-0.1	1.6
Employment	-4.1	-2.7	-1.4
Manufacturing output	-6.2	-1.2	0.5
Manufacturing employment	-9.8	-5.3	-3.5
Working population	-0.6	-1.3	-0.0
Unemployment (millions)			
(UK s.a. excl. school leavers)	2.5	2.8	3.1

The present recession has been characterised by an unusually rapid response of employment to changes in output, and the sharp increases in unemployment in December and January suggest that the weakness of industrial and manufacturing production continued to the end of the year. We estimate that employment fell by nearly 3 per cent in 1982 with, as has been the case throughout the recession, the fall concentrated mainly in manufacturing. However, as output begins to rise more rapidly this year we expect the fall in employment to come to an end. Even so the average level of manufacturing employment in 1983 will be some 3½ per cent less than in 1982. The loss of jobs in the rest of the private sector will be much smaller, and we expect government employment to be virtually stable at 5 million, 0.2 per cent below last year. Because the population of working age is still rising fairly rapidly (it has risen ½ per cent per annum in recent years and this will continue in 1983) the fall in employment produces a more than proportionate rise in unemployment.

The Company Sector Deficit

Table 15

Company sector (£bn)	1981	1982	1983
Profits net of stock appreciation	23.3	25.9	31.0
Savings (after tax, dividends, interest & stock appreciation)	16.2	18.4	23.8
Stockbuilding	-3.4	-2.1	-0.3
Investment	20.7	20.8	22.7
Financial surplus	-1.0	-0.0	1.8

In the first half of last year the financial position of companies was weakened by high interest rates and a strong exchange rate. In the third quarter, however, a sharp increase in profits occurred and we estimate that the advance will continue, though more slowly, in the fourth quarter. With non-trading income also up, but dividend and interest payments lower than in the first half of the year, we estimate a substantial increase in company savings. Company investment declined between the first and second quarters of 1982 and we estimate that the decline continued in the second half of the year. At the same time there is strong evidence to suggest that stocks were being run down again at a much more rapid rate. These estimates imply a substantial improvement in the financial position of companies, with a surplus emerging in the second half of the year which mirrors almost exactly the deficit in the first half. We expect this surplus to be maintained in 1983 even though destocking is forecast to come to an end in the course of the year. This reflects a sharp rise in profits at the beginning of the year (helped by the fall in the value of the pound) while the main items of company expenditure (dividends, interest, taxes and investment)

rise more moderately during the year. The reduction in the National Insurance Surcharge is a further factor behind the improvement.

Sector Flows

The surge in personal consumption in the second half of 1982 and the associated rundown of stocks resulted in a sharp deterioration in the financial position of the personal sector, the main counterpart of the improvement in the position of the company sector. We now estimate that for 1982 as a whole the surplus of the personal sector fell substantially (compared with 1981), thereby enabling all the other sectors to reduce their deficits.

Table 16

Sector flows (£bn)	1981	1982	1983
Companies	-1.0	-0.3	1.8
Persons	16.4	11.1	7.9
Public sector	-7.3	-5.2	-7.0
Overseas sector	-6.1	-4.2	-1.5

Although we assume that the sharp reduction in the personal savings ratio will be partially reversed in 1983, the average for the year is still substantially lower than in 1982. Since we forecast that the recent surge in investment in the personal sector (mainly by small unincorporated businesses) will continue this year (though more slowly), we expect a further large reduction in the surplus of the personal sector. We also expect an increase in the public sector deficit as a consequence of our assumed tax cuts. The counterpart of the public sector deficit and smaller personal sector surplus is a further reduction in the deficit of the overseas sector (i.e. fiscal expansion and more consumption leads to a smaller balance of payments surplus). However this still leaves room for a further improvement in the financial position of companies.

North Sea oil

The dollar price of North Sea oil, which was at one time substantially above world average levels (reflecting the premium commanded by North Sea oil because of its quality, its proximity to markets and the stability of supply) fell in 1982 as world prices came down and the UK premium over world prices was eroded. We expect a further fall in 1983, but no dramatic collapse: as world recovery gets under way later in the year we expect oil prices to start rising again. We are also forecasting that the dollar will resume its fall later this year, which will make it easier for producers to put up the dollar price of their product without affecting demand.

Despite the current weakness of world oil demand, and the consequent softness of the price, we expect UK

Table 17

	1981	1982	1983
North Sea output (m. tonnes)	89	102	110
Price:			
\$/barrel	36	33	31
exchange rate \$/£	2.03	1.74	1.62
Value of North Sea oil production (£bn)	12.3	14.9	16.2
Contribution to public sector revenues (financial years, £bn)	6.9	8.3	8.9

oil production to go on rising. The oil sector, which in 1982 accounted for 6½ per cent of UK output at current prices, will continue to grow far more rapidly than the rest of the economy. But volume growth in 1983 of 7½ per cent is about half the rate of increase in 1982, and the period of rapid build up of oil production is now coming to an end. The increases in the North Sea contribution to the balance of payments and to tax revenues, which have been swollen in the current financial year by the fall in the pound against the dollar, will also be less rapid in 1983-4 partly because of the weaker oil price, but more importantly because of our forecast that the pound will stop falling. The sterling value of oil revenues was boosted by 14½ per cent in 1982 by exchange rate movements. In 1983 the boost will be only 6½ per cent.

(4) Focus: Employment and the Measurement of Output

GEOFFREY DICKS

The first results from the 1981 employment census are now available. They show that previous estimates of employment, based on the 1978 census and subsequent returns from a sample of firms included in that census, have seriously underestimated the true level of employment. This is because information on firms either going out of business or starting in business is not available and has to be forecast on the basis of past trends. Over the last four years these trends have not been reliable, in particular far more new firms have started up in the service industries than was thought likely at a time of falling output. Thus in the distributive trades employment is now known to have been stable between 1978 and 1981, whereas earlier estimates suggested a fall of 150,000. Similarly in insurance and banking and miscellaneous services little change was originally suggested, and increases of 128,000 and 169,000 respectively have emerged from the census data. As a result total employment in September 1981 is now estimated at 21.1 million, a fall of 1.1 million from June 1978 but an increase of 538,000 on the previous quarterly estimates. Of this 466,000 is in the service

sector and half of this latter consists of part-time females. Table 1 shows the revisions to the UK employment series, Table 2 the industries where the changes have been concentrated.

Table 1 shows how the Department of Employment has revised up its estimates of total UK employment over the last five years. The revisions get relatively larger over the period: thus at mid-year employment has been revised up by 0.8 per cent in 1979, 1.6 per cent in 1980 and 2.4 per cent in 1981. By the time of the 1981 census (September) the revision is 2.7 per cent and it is instructive to note that the subsequent figures do not suggest any further widening of this gap. (This will have to wait for the next census!)

Table 2 shows a similar picture for those industries which are most affected by the new data. At June of last year the initial estimates of employment are now shown to have underestimated employment by as much as 7½ per cent for miscellaneous services and insurance, banking, finance and business services. Together with distributive trades and professional and scientific services these industries account for 473,000 extra jobs out of a Great Britain total of 546,000.

The effect on output

We have already shown in *Economic Outlook* (October 1982, p. 16, Table 20) how revisions to GDP (output

Table 1
Employees in employment, UK, seasonally adjusted

		NEW millions	OLD	CHANGE	
				'000s	%
1978	March	22.7	22.7	15	0.1
	June	22.8	22.7	20	0.1
	September	22.8	22.8	61	0.3
	December	23.0	22.9	103	0.5
1979	March	23.0	22.9	144	0.6
	June	23.1	22.9	186	0.8
	September	23.1	22.9	227	1.0
	December	23.1	22.8	269	1.2
1980	March	23.0	22.7	310	1.4
	June	22.8	22.5	352	1.6
	September	22.5	22.1	393	1.8
	December	22.2	21.8	435	2.0
1981	March	21.9	21.5	476	2.2
	June	21.7	21.2	518	2.4
	September	21.5	21.0	559	2.7
	December	21.3	20.8	554	2.7
1982	March	21.2	20.7	555	2.7
	June	21.0	20.5	546	2.7

Source: NEW: *Employment Gazette*, December 1982, table 1.1
OLD: *Employment Gazette*, November 1982, table 1.1

Table 2
Employees in employment, G.B.: Principal changes by Industry

SIC	Industry	June:		1979		1980		1981		1982	
		000s	%	000s	%	000s	%	000s	%	level millions	
III-XIX	Manufacturing	16	0.2	32	0.5	48	0.8	45	0.8	5.6	
XXIII	Distributive trades	44	1.6	87	3.2	131	5.1	139	5.5	2.7	
XXIV	Insurance, banking etc.	27	2.2	54	4.4	82	6.8	89	7.3	1.3	
XXV	Professional and scientific services	35	1.0	49	1.4	65	1.8	69	1.9	3.7	
XXVI	Misc. services	55	2.3	110	4.5	165	7.0	176	7.6	2.5	
	GREAT BRITAIN	186	0.8	352	1.6	517	2.5	546	2.7	20.6	

Source: *Employment Gazette*, Table 1.2, changes between November and December 1982

measure) have been, in recent years, invariably upwards. Table 3 repeats and updates this information.

Table 3
Data revisions for GDP(O) 1980-82

		%
1980	1	1.3
	2	1.0
	3	0.4
	4	0.7
1981	1	0.7
	2	0.1
	3	-
	4	-0.1
1982	1	-
	2	0.1

Note: figures refer to percentage difference between the first and most recent estimate.

These revisions reflect the incidence of new information, received by the CSO, most of which occurs outside the industries covered by the index of industrial production. No revisions to GDP have been officially calculated since the latest employment census.

Although employment has been revised upwards by a significant amount (and further upward revisions are likely to be announced in the self-employed category), it is clear that output will not be revised by anything like the same extent.

In the first place the output estimate of GDP is not generally calculated from employment data. The principal exception to this is in the public sector, where no independent measure of output exists, and here the employment data is little revised. In general output is estimated from physical quantities, e.g. by counting the number of cars, etc., produced by industry. Obvious difficulties of measurement exist particularly in the

service sector and here the CSO relies on various proxy measures. For example the output of the banking sector is related to the number of cheques cleared, the output of insurance companies to the number of policies issued, that of accountants is derived from figures for VAT and so on. An important counter-example is advertising, where the measurement of output is related to employment but for most sectors the GDP(O) measure is independent of employment. In these sectors revisions to employment data will have no effect on output.

However, we are in a period of rapid change, when the numbers both of bankruptcies and of new firms are at record levels. There are many new and rapidly growing kinds of economic activity (e.g. in the data processing industry and its offshoots) for which adequate physical measures of output do not exist. Under these circumstances it may well be the case that employment is a better guide to output than the current proxy measures which are based on an outdated structure of supply. Employment itself will understate output in service sector industries which are able to achieve large, computer-based increases in productivity.

Some support is given to this view by the fact, shown in Table 4, that of the three measures of GDP, output (O) expenditure (E), and income (Y), it is the output measure which, since 1979, has shown both the lowest level of GDP and also the largest fall in activity. This by itself casts doubt on the accuracy of GDP(O). The discovery that employment was 2-3 per cent higher than previously thought raises further questions about the accuracy of the output measure, and suggests that GDP(O) may have overstated the depth of the recession.

To illustrate the order of magnitude of the measurement error we have calculated, in Table 5, what the revision to the employment data would mean under certain assumptions about productivity and also on the assumption that the output of the newly-discovered employees has not already been taken into account.

We know that a large number of the newly discovered employees are part-time women (334,000 out of 538,000 for Great Britain as a whole). We also know that most of the jobs are in the service sector where productivity is usually lower than in manufacturing. In Table 5 we

Table 4
GDP, various measures

	1979		1980		1981	
	level	%	level	%	level	%
Output measure	110.3	2.1	107.1	-2.9	104.5	-2.5
Expenditure measure	109.9	1.4	107.6	-2.1	105.2	-2.2
Income measure	111.7	1.8	109.3	-2.1	106.5	-2.6
Average estimate	110.7	1.8	108.0	-2.5	105.4	-2.4

Table 5
Outline calculations of revisions to GDP (output)

1. GDP (output)	110.3	107.1	104.5
2. % revision to June employment data	0.8	1.6	2.4
3. Implied output if productivity of new found employees is equal to national average	111.1	108.7	106.9
4. Adjustment to take account of below average productivity of additional employees	-0.3	-0.8	-1.1
5. Estimated level of output	110.8	107.9	105.8
6. GDP (% changes)			
output measure, CSO estimate	2.1	-2.9	-2.5
output measure, derived estimate	2.6	-2.6	-2.0
expenditure measure	1.4	-2.1	-2.2

show what the revisions to employment could imply for output if the productivity of newly discovered workers was equal to the average productivity in their sector. The result would be to narrow the gap between the output and expenditure measure of GDP. Even so there are still substantial discrepancies between the two measures, and as long as the output measure continues to rely on counting physical units which may no longer reflect the true pattern of output in the service sector, these discrepancies will remain. The discovery of extra employees will not, for some time to come, be reflected in official statistics on output.

Conclusions

The output measure of GDP is generally thought to provide the best guide to short-run movements in total output in the economy. For this reason we present

forecasts of GDP(O) in *Economic Outlook*, though it has to be recognised that our system forecasts the expenditure measure. We move to forecasts of GDP(O) from GDP(E) via an adjustment about which we know very little and which we are clearly unable to forecast.

However, the revisions to the employment data, which we have described here, cast doubt upon the accuracy of GDP(O) which has been out of line with the other measures of GDP. This casts doubt on the belief that GDP(O) is the better short-term guide to movements in output. Additionally the concentration of revisions to the employment data on the service sector suggests that it is this element of output which GDP(O) fails to estimate in the short term. Equivalently it can be concluded that the weight of industrial production (GDP(O)) is overstated. Thus over the last few years of deep industrial recession, total activity has been far less depressed than industry, and may also have been less depressed than the early estimates suggested.

Medium term prospects for the UK economy

GILES KEATING

Prospects for the economy several years ahead are even more uncertain than projections of the near future. Government policy is currently particularly uncertain given that a general election is due to occur in the next 15 months. This article presents three 'alternative scenarios', one based on Conservative Party policies, the others on the spirit of Labour Party policies.

*The first case described is our central forecast. It is a continuation of current Conservative Party policies. The second and third cases are based on our interpretation of Labour Party policies. These policies are assumed to involve widespread use of government intervention, planning, wage and import controls. Monetary targets are relaxed or abandoned. We consider two possible outcomes of such policies. Under one outcome the policies are relatively successful in boosting output and employment without greatly raising inflation. Under the other outcome, output is lower than on current policies and inflation much higher.**

Summary of main results

The main results, summarised in Table 1, are:

Output and employment

On current policies total output grows nearly 2 per cent per annum between 1983 and 1986, with unemployment fairly stable. In the 'successful planning' case, output growth averages 2½ to 3 per cent per annum with un-

* Our simulations of Labour Party policies are not directly comparable with those prepared by the Rt. Hon. Peter Shore MP and others. This is because our projections are based on more up-to-date information about unemployment, the exchange rate and other indicators; and because the policies are assumed to be implemented from a later date.

employment falling to about 2¼ million (UK, excluding school leavers) by the end of 1986. Under 'less successful planning', output grows only about 1½ per cent per annum and unemployment rises slightly.

Inflation

On current policies this rises to about 7½ per cent in 1984, 1985 and 1986. Under 'successful planning', it increases to between 11 and 12 per cent by 1986. 'Less successful planning' gives a rising rate of inflation reaching 17 per cent in 1986.

Exchange rate and interest rates

Under current policies we expect the effective exchange rate to decline only slightly. Bank base rates of 10½ to 11½ per cent are forecast from next year. We expect similar figures for the exchange rate and for interest rates under 'successful planning'. This reflects accommodating monetary policy and import controls. In the 'less successful planning' case we predict marked falls in the exchange rate and higher interest rates. These high interest rates prevent larger exchange rate falls. Both 'planning' cases assume exchange controls. Because of large, almost uncontrollable 'Euro-sterling' holdings and because of avoidance, we expect these controls to have a major impact for only about six months.

Margins of uncertainty

The 'current policies' case is a central prediction of the likely effects of existing policies. By contrast, the 'successful planning' and 'less successful planning' cases represent optimistic and pessimistic projections. The most likely effects of a 'planned economy' policy probably lie between these two projections. The *Briefing Paper* presents various measures of uncertainty attached to our central forecast. These measures are *conditional* on the policy assumptions. The present article illustrates some likely outcomes on alternative policy assumptions. Each of these outcomes is itself subject to error margins similar to those given in the *Briefing Paper* for the

Table 1
Summary of medium-term prospects on alternative policies

	'Current policies' continue	Planning: 'successful'	Planning: 'less successful'
GDP growth, annual average between 1983 and 1986 (%)	1.9	2.7	1.5
Unemployment, level end 1986 UK excl. school leavers, thousands	3150	2810	3220
Inflation, end 1986 (12 month RPI increase, %)	7.7	11.8	16.9
Effective exchange rate, end 1986 (1975 = 100)	78	78	66
UK Bank base rates, end 1986, %	12	12	17

central forecast. When forecasting uncertainty is added to policy uncertainty, the range of possible outcomes becomes extremely wide. Even so, some outcomes are more likely than others and the present exercise, which explores the more probable cases, is helpful for contingency planning.

Main assumptions

Trade performance, investment, wage bargaining and other behaviour follow past relationships in the 'current policies' case. Under 'successful planning' these past relationships are altered by controls and 'planning agreements'. For any given level of competitiveness these reduce *import penetration*. Export market share is boosted by agreements with other nations. For the 'less successful planning' case, *import penetration* is reduced but export market share falls due to retaliatory import controls. In both 'planning' cases, wages and prices are pushed upwards by the relaxation of pressure from com-

peting imports. This upward influence is partially offset by the *downward effect on wages and prices* of agreements and controls, particularly under 'successful planning'. The adjustments used in the three cases are described in the box on page 26.

Current policies imply broad adherence to the Medium-Term Financial Strategy (Tables 2 and 3). This covers the period to 1984/5. Beyond then, we assume monetary growth of about 9 per cent per annum while the nominal PSBR falls further. The 'successful planning' and 'less successful planning' cases both assume higher government spending compared to present policies in 1983/4 and 1984/5. The 'successful planning' case also includes a modest additional tax cut and further spending increases. The government in the 'planning' cases is assumed to dislike very large exchange rate falls. To prevent such falls in the 'less successful planning' case, interest rates are raised and there is some reversal after 1984/5 of earlier government spending increases.

World output is expected to grow 2 per cent per

Table 2
Fiscal Policy

£bn	'Current policies' continue	Planning: 'successful'	Planning: 'less successful'
Public expending 'planning total' (includes spent contingency reserve, excludes debt interest, excludes effect of asset sales)			
1983/4: at current prices	121.3	121.9	122.3
<i>in volume terms</i>			
(1975 prices)	49.4	49.7	49.7
1986/7: at current prices	154.0	173.8	194.1
<i>in volume terms</i>			
(1975 prices)	50.0	52.2	51.2
Receipts from taxes on income and expenditure and National Insurance			
1983/4: at current prices	111.7	112.0	112.5
<i>Income tax basic rate (%)</i>	29	29	29
1986/7: at current prices	143.9	156.6	178.8
<i>Income tax basic rate (%)</i>	25	24	25
<i>Note: Apart from income tax basic rate, tax rates are the same under all three policies</i>			
Other net public sector receipts at current prices (includes debt interest)			
1983/4	0.4	0.4	0.7
1986/7	3.7	2.4	3.0
PSBR			
1983/4: at current prices	9.2	9.5	9.1
<i>as % of GDP</i>	3.9	3.8	3.7
1986/7: at current prices	6.4	14.8	12.3
<i>as % of GDP</i>	2.0	4.0	3.1

Table 3
Monetary and exchange rate policy

	'Current policies' continue	Planning: 'successful'	Planning: 'less successful'
Sterling M3 percentage growth during:			
1984/5	10.4	11.3	11.1
1985/6	9.7	12.0	10.4
1986/7	9.3	13.7	10.8
UK bank base rates, average for years:			
1984/5	10.8	10.8	11.7
1985/6	11.6	11.6	15.9
1986/7	11.6	11.6	16.7
Sterling effective exchange rate (1975 = 100) end of year:			
1984/5	79	79	66
1985/6	79	79	66
1986/7	78	78	66

annum between 1983 and 1986 (Table 4). Inflation is forecast to remain at around 6 to 8 per cent per annum. Oil and commodity prices increase by less than this until the end of 1984, after which they are forecast to rise somewhat more rapidly. (See the January 1983 Forecast Release.) These projections apply to our 'current policies', 'less successful planning' and 'successful planning' cases.

Table 4
World Economic Trends

Annual average percentage growth	1972 to 1983	1983 to 1986
World GNP	2.4	2.0
World exports of manufactures	4.4	4.7
World consumer prices	9.6	7.0
Dollar price of marker world oil	36.5	8.5
World non-oil commodity price	9.6	4.1

'World' consumer and commodity prices are in SDRs

UK productivity (manufacturing output per person employed) grows about 1½ per cent per annum on current policies. It is forecast to rise faster under 'successful planning' because of a cyclical boost from higher output. Under 'less successful planning', lower output depresses productivity growth. For all three cases, the population of working age is forecast to rise about 200,000 over the year to early 1984 and by 120,000 per annum from then to the end of the forecast period.

North Sea oil output is expected to grow slowly, roughly in line with the centre of the government's projections. Government revenue from the North Sea is expected to reach about £15 billion per annum in 1986/7 (except under 'less successful planning' where the figure is somewhat higher because sterling falls more).

The following pages contain details of our medium-term projections. The central case (current policies) is described first. This is followed by the 'successful planning' and 'less successful planning' cases.

The results in detail

Current policies

The first of the three cases assumes broad continuation of current policies. This is our central forecast. It is shown in full detail on ~~pages 6-9~~. Main results are also shown in the summary tables in this article.

There are several key elements in the 'current policies' forecast to 1986. First, wage costs in manufacturing do not rise rapidly enough to offset the beneficial effects of the recent devaluation. Nor do they rise slowly enough to give further significant gains in competitiveness. As a result cost competitiveness is far better than in 1980 and 1981, returning more or less to its historical average level. This allows non-oil corporate real profitability to rise well above the depressed figures recorded in 1980 and 1981, but much of the benefit from restored competitiveness also goes to persons. Real profitability therefore remains well below the average for the 1970s. The projected path for competitiveness prevents further sharp rises in import penetration. However, the UK share of world export markets falls somewhat.

Our projections for manufacturing unit labour costs and for profitability, together with a fairly stable exchange rate and slowly rising world prices, generate our forecast for inflation. This is predicted to be about 7½ per cent in 1984, 1985 and 1986 (measured as twelve-monthly Retail Price Index increases).

The second key element in the forecast is the projected pattern of demand. Company spending on fixed investment and stocks recovers only mildly from the depressed levels of the 1980 to 1982 period. This reflects companies' continuing low real profits. It is also due to their desire to avoid borrowing at fairly high interest rates. Depressed expectations for demand are also a significant influence.

This weak recovery in company spending is combined with slow growth in net exports partly due to previously weak competitiveness. Government spending is permitted to rise only very slowly. Our forecast suggests that only one main component of demand makes a

substantial contribution to demand growth after 1984. This is consumers' expenditure, which rises on average 2 per cent per annum over that period. The result is GDP growth averaging just under 2 per cent per annum over that period.

The third key element in the forecast is the financing of the rise in consumer spending. The counterpart to our forecast of a limited recovery in real profitability is that scope exists for some rise in real personal incomes. This is taken largely as a boost to take-home pay of those already with jobs. Employment rises only slightly between 1983 and 1986. Total personal sector real take-home incomes rise about 2 per cent per annum over this period. This is broadly in line with the predicted rise in real consumer spending.

These forecasts of personal income and spending imply that the savings ratio remains around 9 to 10 per cent. This is well below the figure recorded from 1979 to 1981, close to the level estimated for the end of last year and well above 1960s levels. We expect this savings ratio to reflect continued rapid personal sector bank borrowing. This occurs despite our forecast that monetary growth (sterling M3) declines to about 9 per cent by 1986-7. This is possible because of our projection of a falling nominal PSBR and of a cautious approach to bank borrowing by companies.

The final key element concerns the consistency of this money stock forecast with our projections for the exchange rate and for interest rates. We are predicting a difference of 1 to 2½ per cent between UK and 'world' short term interest rates from 1983 to 1986. This is slightly above the assumed ½ to 1 per cent per annum depreciation of sterling. This means that implied expectations of currency market operators are not far wrong. We predict that UK money stock grows about ½ to 1 per cent above 'world' money stock. This is broadly consistent with our exchange rate forecast, allowing for similar growth in real output in the UK and abroad. The derivation of our money stock forecast, given interest rates and sectoral spending and income decisions, was explained above. Our forecasts of monetary growth, exchange rate and interest rates are consistent with one

Table 5
Components of GDP

Annual average percentage growth	1972 to 1983	1983 to 1986		
		'Current policies'	'Successful planning'	'Less successful planning'
Gross Domestic Product: Output measure	0.8	1.9	2.7	1.5
Consumers' expenditure	1.5	2.0	2.8	1.4
Total fixed investment	0.1	1.9	2.0	-1.9
General government consumption	1.8	0.6	2.6	1.0
Exports of goods and services	3.3	1.9	1.4	1.6
Imports of goods and services	2.8	1.7	1.7	-0.6

another and with our projections of incomes and expenditure. They are, however, subject to very great uncertainty.

'Successful planning' case

The policy assumptions for the 'successful planning' case differ substantially from those used for our 'current policies' forecast. Higher government spending and modest extra tax cuts are assumed. Accommodating monetary policy, plus import controls and investment-boosting 'planning agreements' are also assumed. A very important assumption is that an agreement with trades unions reduces wage rises below what they would otherwise be. We expect higher government demand and relaxation of import competition to have a substantial upward influence on average earnings. The assumed agreement with the trades unions partially offsets this upward effect.

Under 'successful planning', we predict that manufacturing unit labour cost competitiveness changes little next year and worsens 4 per cent in both 1985 and 1986. This reflects our assumption that the exchange rate is the same as in our 'current policies' forecast, together with our forecast of somewhat higher earnings and a slightly better productivity performance due to higher output.

This fairly modest loss of competitiveness under 'successful planning' means that there is only a small tendency for the export market share to fall relative to current policies. This tendency is marginally reduced by our assumption of reciprocal agreements with nations pursuing similar policies. Import penetration into the UK is restricted. The effect is to cause a marginal worsening in our forecast of net export growth under 'successful planning' compared to 'current policies'.

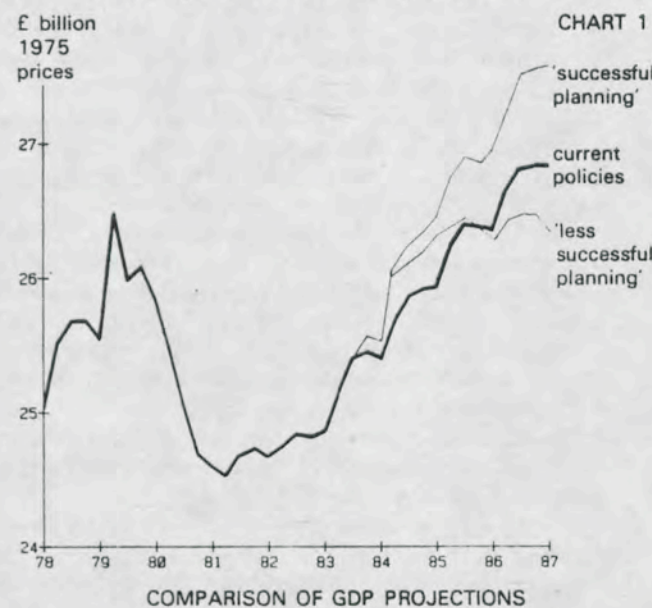
The loss of competitiveness, although small, tends to reduce profits. This tendency is only partially offset by the effect of higher output. Real corporate profitability is therefore significantly lower under 'successful planning' than under 'current policies'. This effect is particularly marked towards the end of our forecast period. In 1985 and 1986 companies' finances are also adversely affected by the need to build up stocks (to meet increased demand) and to invest more (to fulfil 'planning agreements'). The result is that in 1985 and 1986 we expect company borrowing needs to be rising sharply under 'successful planning'. These needs might be met through conventional bank borrowing or through government-organised loans. Either way, it seems unlikely that companies would be willing to sustain this borrowing growth much beyond 1986, unless real profitability started to rise markedly.

Inflation under 'successful planning' is expected to rise slowly, reaching 11 to 12 per cent by 1986. This is faster than our projection under current policies, mainly reflecting higher manufacturing labour costs.

The pattern of demand forecast under 'successful planning' relies on consumer spending and government consumption as its faster-growing elements. Each grows

on average 2½ to 3 per cent per annum between 1983 and 1986. Fixed investment and stockbuilding provide a smaller contribution to demand growth. Net exports have no effect, or a small negative impact, in the years from 1983 to 1986. The main contrasts with our 'current policies' projections are the higher government spending and the faster consumer spending growth. The latter largely reflects the boosts to real personal incomes caused by higher wage rises and somewhat higher employment. The higher wage rises are forecast to worsen the external trade balance only marginally, because of import controls and reciprocal trade agreements.

These forecasts for components of demand give GDP growth of 2½ to 3 per cent average between 1983 and 1986. This is sufficient to reduce unemployment by about 350,000 from present levels, to about 2.8 million (UK, excluding school leavers) by end-1986.



The monetary growth expected under 'successful planning' is about 11½ to 13½ per cent per annum from early 1984 onwards. Broadly, this reflects a rising PSBR (reaching almost £15 billion in 1986/7) and increasing company borrowing demands, partially financed by a large and growing personal sector surplus. This forecast monetary growth is markedly higher than the 9½ to 10½ per cent per annum projected under current policies. Despite this difference, we have assumed a similar exchange rate path (very slow depreciation) and short-term interest rates (10½ to 11½ per cent) under the two different policies.

This forecast assumes that exchange controls have a significant effect on the exchange rate for only a limited period. The projection therefore does not rely on the 'fixing' of the exchange rate by the government. Instead it assumes that the projections for monetary growth, interest rates and exchange rates are more or less consistent with the present level of control of financial markets. This in turn requires that over the forecast

period foreign exchange markets give more attention to wage settlements and competitiveness (which are roughly consistent with the assumed exchange rate) than they give to money stock growth and the PSBR (which suggest a faster depreciation than is assumed).

This assumption about the behaviour of financial markets is highly uncertain and crucial to the forecast. Therefore our third view of the medium term, 'less successful' planning, uses a somewhat different assumption about financial market reactions. It also assumes less success in holding down average earnings.

'Less Successful Planning'

The 'less successful planning' case assumes that from end 1983 the government begins to pursue a strategy of higher public spending, exchange and import controls and wage and planning agreements. In contrast to the 'successful planning' case, the foreign exchange markets are assumed to react by initially marking sterling down about 5 per cent. Then in Autumn 1984, as the initial impact of exchange controls wears off and as the assumed failure of wage agreements becomes apparent, the markets are assumed to try to reduce sterling's rate again, this time much more sharply. The government is assumed to acquiesce in some depreciation but to want to prevent a fall much greater than 15 per cent below early 1983 levels. As a result, the government is assumed to stabilise the effective rate at around 66 (1975 = 100) by raising short-term interest rates sharply and reversing some of its earlier increases in public spending. Tables 3 and 4 show that public spending volume by 1986 is higher than on current policies but lower than under 'successful planning'. Short-term interest rates reach about 16½ per cent.

The key differences between the 'less successful planning' case and the 'successful planning' case thus arise from the assumed behaviour of four groups. First, trades union and employers agree to significantly higher wage settlements under 'less successful planning'. Second the financial markets believe that the government's policies imply a marked depreciation of sterling. Third, other countries react to UK import controls with retaliation, in contrast to the 'successful planning' case. Fourth, the government reacts to these other groups' actions by partially reversing its own policy.

The combination of the exchange rate movements and rapidly rising average earnings causes cost competitiveness to improve during 1984 and then to worsen. By 1986, cost competitiveness has returned to the same level as under 'successful planning', somewhat worse than on 'current policies'. This improved competitiveness, although temporary, has a significant beneficial effect on the trade balance especially in 1985. This beneficial effect is boosted by our forecast of a lower level of domestic demand (explained below), which depresses imports. Retaliation by other nations against UK import controls marginally offsets these other effects. The overall impact gives our projection of

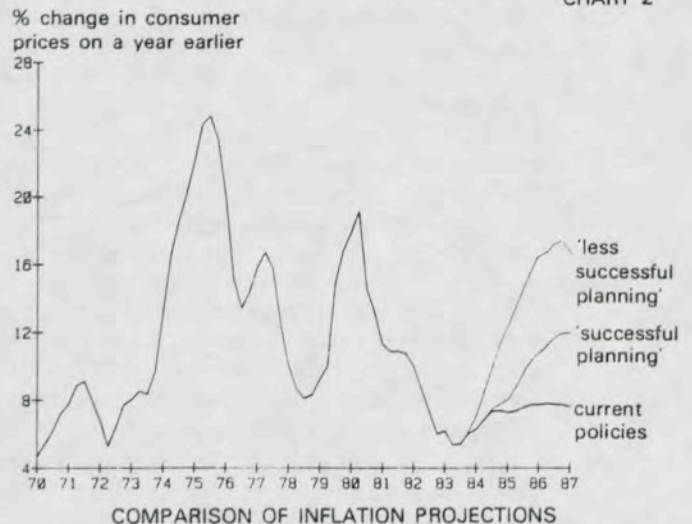
about 2 per cent per annum net export growth from 1983 to 1986. This is stronger than forecast under either 'current policies' or 'successful planning'.

Rapidly growing wages and weak output combine to give a forecast of falling real corporate profitability throughout most of the period to 1986. This means that corporate borrowing rises rapidly, despite cutbacks in fixed investment and stocks. Very low (probably negative) real profitability and high borrowing suggest a dangerous position for the corporate sector by 1986.

The falling exchange rate and rapid wage increases combine to give growing inflation. Inflation is forecast to reach almost 17 per cent by 1986: it would be even higher if profitability were not expected to fall. The substantial pay increases permit those with jobs to have rising real incomes over the forecast period, despite high inflation. The upward effect of this on total personal incomes is only marginally offset by falls in employment. The resulting rise in personal incomes is the counterpart to the falls in real company profitability. Because of high and rising inflation, the savings ratio rises throughout the period from 1983 to 1986. This gives our consumer spending growth forecast of about 1½ per cent per annum over this period. In 1984, this is expected to be combined with marked rises in government spending and some increase in fixed investment, stocks and net exports. As a result, GDP increases rapidly in 1984, by 2½ per cent to 3 per cent, and unemployment falls. In 1985 and 1986 this pattern changes. Consumer spending and net exports continue to grow at about 1½ per cent per annum each. However, government and company spending stop rising or fall back. GDP rises by only ¼ per cent on average in 1985 and 1986. Unemployment rises sharply, by some 200,000 in each of those years.

It is assumed that neither public borrowing nor money stock are of direct concern to the government in this 'less successful planning' case. However these items are assumed to be of concern to the financial markets. The government acts to prevent a larger fall in the

CHART 2



exchange rate by raising interest rates and cutting public spending. In addition to preventing further exchange rate falls, these measures have the 'side-effect' of restraining both public borrowing and monetary growth. We expect a PSBR of £12¼ billion in 1986/7 under this case, with sterling M3 growing 10½ to 11 per cent in that year (see Tables 2 and 3). This rate of monetary growth broadly reflects very high company borrowing needs and the PSBR noted above financed by a very large personal sector surplus.

Monetary growth so far below the rate of nominal output increases is not sustainable. With the company sector under the severe financial strains noted above, a sharp fall in the rate of wage increases is likely, probably accompanied by large cutbacks in output and employment. These developments are not projected to occur within our forecast period.

Conclusion

We have reviewed three possible types of medium term development: a continuation of present policies; a 'successful' application of planning; and a less successful application of planning. The last of these boosts inflation without reducing unemployment and sets up severe pressures on the company sector which cannot be regarded as sustainable. The 'successful planning' case provides some limited success in reducing unemployment without greatly fuelling inflation, but is based on fairly optimistic assumptions about financial and labour market reaction to government policy. The first case, continuation of current policies, holds inflation down, sets up no great strain on any sector's financial position and relies only on central guesses about financial and labour market behaviour. However, it indicates no reduction in the current rate of unemployment.

North Sea Oil

After previous optimistic predictions of North Sea oil output levels, current official estimates are now cautious. Government forecasts for 1982 suggested a range of 90-105 m. tonnes. The outturn is likely to be about 102 m. tonnes, at the top of this range. In 1983, as more fields come on line, we expect output to be 110 m. tonnes. This is in the upper half of the official band. By 1986 we expect production of 118 m. tonnes, at the mid-point of official estimates.

Whilst we predict that North Sea oil production will remain fairly buoyant, it is likely that its price will remain weak. We expect it to continue to move broadly in line with the OPEC marker price. Past levels for North Sea and OPEC prices have been respectively, in 1979 21 and 18; 1980 34 and 32; and in 1981 36 and 35 (all in dollars per barrel).

The current weakness in the oil market reflects attempts by OPEC to maintain prices without further production cuts, despite weak world demand. Although OPEC may eventually make some formal or informal agreement to cut production, we do not expect any strong recovery in demand for oil. World output (OECD Gross National Product) is expected to grow by less than 2 per cent per annum over the forecast period. Given this background we expect the North Sea oil price to change little in 1983 and 1984, thereafter rising to 41 dollars/barrel by 1986.

These movements are broadly in line with the expected change in other world commodity prices.

One of the major factors influencing North Sea oil revenues is the dollar/sterling exchange rate. Since North Sea oil is (currently) priced in dollars, a depreciation in sterling increases government tax receipts. To underline the importance of currency movements, we illustrate below the impact on North Sea oil revenues of a depreciation in the exchange rate

by 10 per cent. The percentage of North Sea revenues accruing to the Treasury has increased from 28 per cent in 1979 to 51 per cent in 1981. For the forecast period this rate will rise further, given the present tax structure. We assume that it will be over 60 per cent by 1986.

10 per cent Depreciation in the Sterling-Dollar Exchange Rate

<i>Changes from the base forecast</i>	1983	1984	1985	1986
Profits from N.S. oil (£bn)	1.4	1.5	1.7	2.0
Total N.S. tax receipts (£bn)	0.8	1.0	1.2	1.5
Consumer Price Index (Annual %)	1.2	2.7	2.7	2.6
GDP (% increase)	0.4	0.4	0.1	0.1

Our forecasts for oil revenues and tax receipts on these assumptions are given below. (The figures apply to the 'current policies' and 'successful planning' cases. Government revenues are somewhat higher in the 'less successful planning' case because sterling is lower):

	1983	1984	1985	1986
Price of North Sea Oil (dollars/barrel)	31	34	37	41
Exchange rate \$/£	1.6	1.7	1.7	1.7
Production (m.tonnes)	110	114	118	122
Value of North Sea Oil Production (£bn)	13.1	14.0	15.7	18.6
Contribution to public sector revenues (financial years, £bn)	8.9	10.2	12.7	15.1

List of adjustments and fixes used in the simulations			
Variable description and model code	'successful planning'	'less successful planning'	Reason for altering variable
Effective exchange rate (EER)	Fixed at 'current policies' rate	Exogenously made to fall to 66 (1975 = 100)	Explained fully in text
Average earnings in manufacturing (AEM)	Adjustment starting at 0.2% rising to 1½%	Adjustment starting at ¼%, rising to 2%	Reflects impact on wage bargaining of reduced import competition, partially offset by agreement with unions
General Government consumption (G)	Raised £40m (at 1975 prices) in 1983Q4, rising to £400m per quarter by end-1986	Raised £100m (at 1975 prices) in 1983Q4 rising to £200m during 1984 then falling back to £100m	Government fiscal policy instrument
Total import volume (M)	Fixed at 'current policies' level	Prevented from rising above 'current policies' level	Reflects controls on import volumes
Manufactured goods export volume (XGM)	Growth rate adjusted up ½% per quarter from 1984Q4	Growth rate adjusted down ½% per quarter from 1984Q4	Reflects reciprocal trade agreements, or retaliation
Personal income tax payments (TJYP)	Adjusted down £250m (current prices) per quarter 1985Q1, £500m per quarter from 1986Q4	No adjustment from 'current policies'	Reflects cut in basic income tax rate
Private non-residential fixed investment (INPOX)	Adjusted up £100m (1975 prices) from 1986Q1	No adjustment from 'current policies'	Reflects 'planning agreements' between government and industry
UK Treasury Bill rate (RS)	No adjustment from 'current policies'	Adjustment of 1½ points per quarter from 1984Q4	Fully explained in text
Consumer spending volume (C)	No adjustment from 'current policies'	Adjusted down by £40m (at 1975 prices) from 1984Q4 – rising slightly	Reflects redistributive effect of interest rate changes
Manufacturing employment (EEMF)	No adjustment from 'current policies'	Adjusted down 10 thousand per quarter from 1985Q1	Reflects impact of severe financial squeeze on company behaviour
<p>Note: The effect of 'adjustments' is fully or partially cumulative in some cases. See LBS Model Manual. All adjustments mentioned are relative to the 'current policies' main forecast. The adjustments used in the main forecast are printed in Tables 14-17, pp. 81 to 84.</p>			

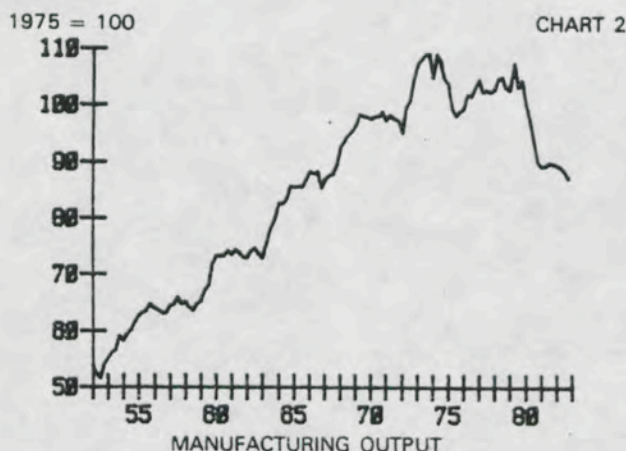
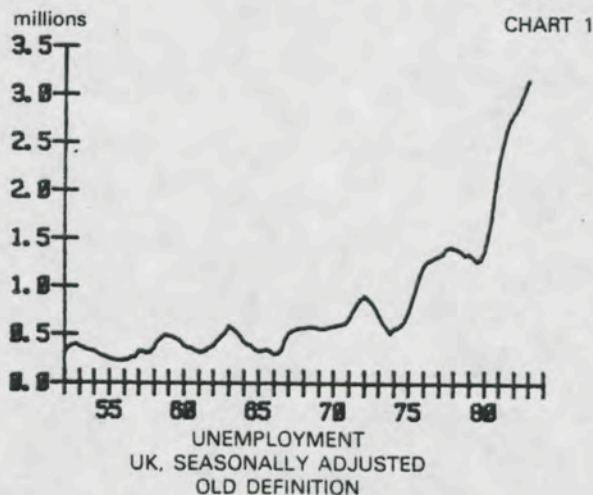
Economic Viewpoint

The Economy: Returning to Balance?

ALAN BUDD and GEOFFREY DICKS

In October 1981 in "An Economy Out of Balance" we examined the state of the economy following the severe shocks of 1979 and 1980. We warned that adjustments in some markets, particularly for goods and labour, might be "painfully slow". In this Viewpoint we bring that study up to date. We argue that the recent fall in the exchange rate has helped to correct some of those imbalances and that there should now be the basis for a recovery of output and a check to the rise in unemployment.

In our previous article we started by suggesting that "with manufacturing output 20 per cent below its mid-1979 level and unemployment at a post-war record and still rising, it is clear that the economy is severely out of balance". Charts 1 and 2 show that there appears to have been little or no progress in restoring that balance in the past 15 months. At the time, we expected



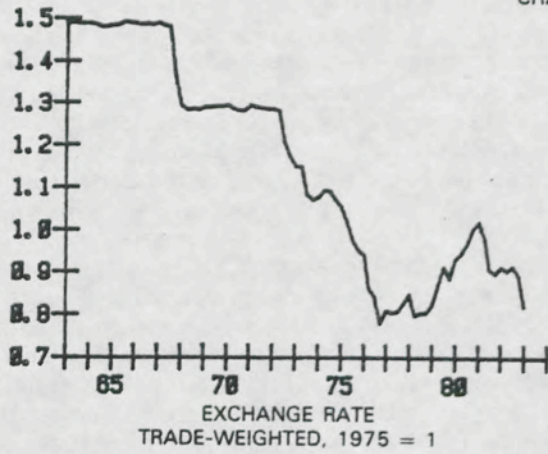
manufacturing output to fall by a further 1 per cent during 1982 but it now looks as if the fall will be about 3 per cent. Unemployment has also risen more rapidly than we expected. One rather gloomy conclusion that could be drawn is that the labour and goods markets are in fact in balance and that there has been a permanent rise in unemployment and a permanent fall in the underlying level of manufacturing output. We believe that that is too pessimistic; we shall suggest that those markets have been affected by a particularly unfavourable combination of costs and prices and that for most of 1982 there was little further adjustment. We interpret that as a sign of how slowly they adjust rather than as a sign that they were in equilibrium. Since October of last year there has been a further significant adjustment through the fall in the exchange rate. We shall consider, as before, the current state of the markets for foreign currency, for domestic money, for goods and services and for labour.

The Exchange Rate

After its fall during the summer of 1981, the effective exchange rate remained remarkably stable until near the end of 1982. As Charts 4 and 5 show, during this period the exchange rate was high, by comparison with previous trends, in relation to the money supply and in relation to UK prices. In the past we have particularly emphasised the role of the money supply in determining movements in the exchange rate. The idea is that the exchange rate anticipates future movements in relative prices. If, in the long run, competitive forces ensure that our prices move roughly in line with those of our competitors, when measured in a common currency, then a relative rise in the UK money supply will cause the exchange rate to fall. The rise in the money supply will raise prices in sterling and the fall in the exchange rate will keep our prices, in a common currency, in line with those of our competitors.

From the beginning of 1979 to the beginning of 1981 there was little sign of these processes operating. Although the money supply grew rapidly the exchange rate actually rose; far from the movement in the exchange rate bringing our prices into line with those of our competitors it actually exaggerated the loss of competitiveness caused by the rapid rise in UK costs. The fall in the exchange rate in the middle of 1981 removed part of the imbalance and the most recent fall has gone a considerable way to restoring the exchange rate to the levels that would be expected from underlying relationships. Further evidence that the fall in the exchange rate has now brought UK prices into line with those in the rest of the world is provided by Chart 6. It shows the relationship between import prices and world prices of manufactured goods (each measured in the same currency). Although the UK is an open economy and only represents a small part of the total world market, during 1979 and 1980, the UK was a "price-setter" rather than a "price-taker" in its own domestic

CHART 3



of this development is that *further* falls in the exchange rate are likely to lead to a proportionate rise in import prices.)

CHART 6

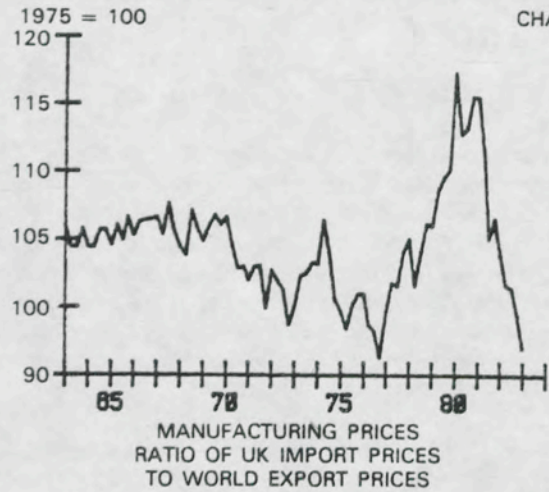
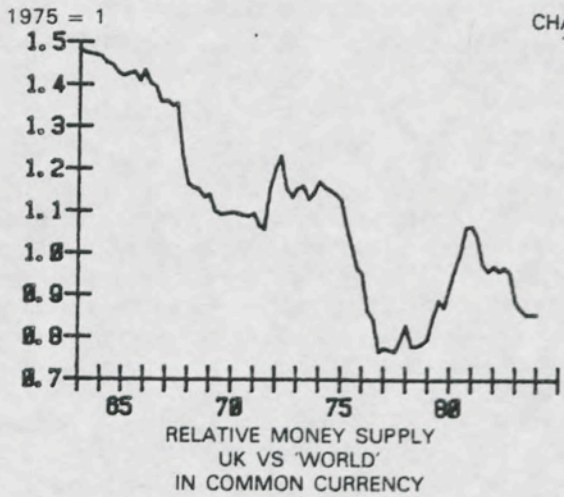


CHART 4



It is difficult to quantify the relative importance of a number of possible causes of the recent fall in the rate. Political uncertainty appears to have played a part but more concretely there has been the fall in oil prices, with further falls expected, and a relative decline in UK interest rates (Charts 7 and 8).

CHART 7

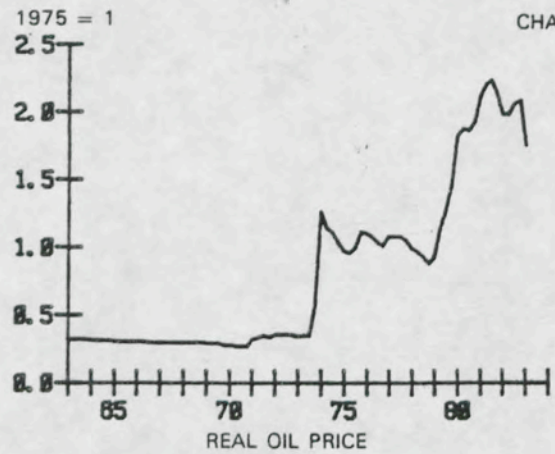


CHART 5

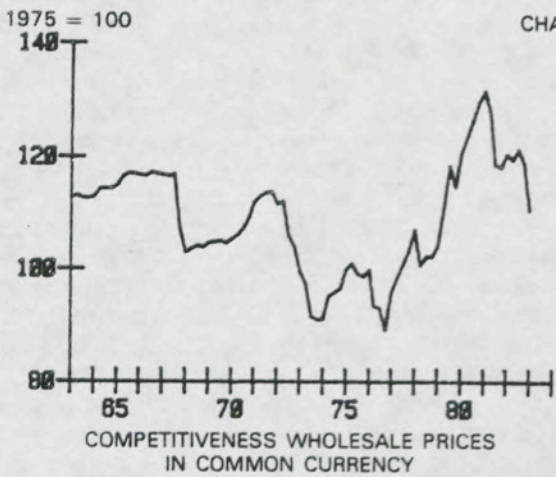
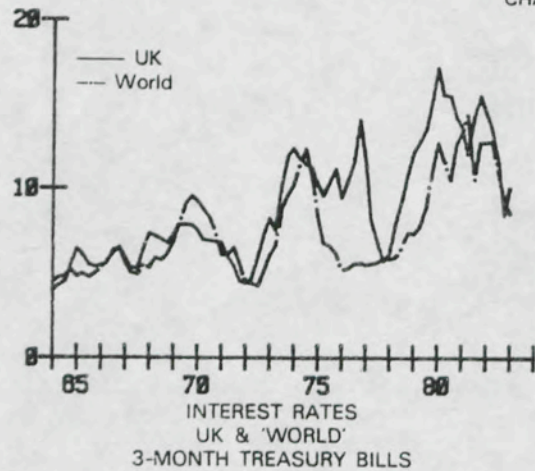


CHART 8



market. Foreign manufacturers sold their goods in the UK at UK prices rather than at world prices and thereby made large profit margins rather than seeking a large volume of sales by holding their prices lower. (Had they done the latter they might have feared that the UK would extend protection.) As the exchange rate has fallen, foreign suppliers have cut their prices in foreign currency terms and import prices have now come back into line with world prices. (One important implication

Although the fall in the exchange rate has largely restored our relative prices to their expected levels, there is still some discrepancy, compared with past trends, between the exchange rate and the quantity of money in the UK. This discrepancy matches the discrepancy between the money supply and prices, which reflects conditions in the market for money. We consider it next.

Money

The growth of the money supply (sterling M3) is currently being held within the upper limit of the range of 8-12 per cent set at the last Budget. If the outturn is about 11 per cent for the current financial year, the cumulative growth of the money supply over the three years of the MTFS (since April 1980) will have been about 60 per cent. Over the same period nominal GDP has risen by about 30 per cent and private expenditure, in current prices, has risen by about 25 per cent. Those developments appear to raise serious doubts about the basis of the government's strategy of reducing the growth of the money supply in order to reduce the growth of nominal income and inflation.

the calculations of monetary growth and expenditure growth mentioned above – the first quarter of 1980 – was untypical. The growth of the money supply was being artificially held down by the operation of the corset and people were being forced to hold other forms of financial asset. Part of the fall in the velocity of circulation since then has been due to the unwinding of that effect. However, the Treasury has hitherto based its choice of monetary targets on the assumption that there is an underlying rise in the velocity of circulation – i.e. a fall in the ratio of the money supply to nominal GDP – through time. Roughly speaking, past trends suggest that nominal GDP rises between 1 and 2 per cent a year faster than the money supply. On that basis the current ratio of 2.1 (money stock/quarterly private sector nominal GDP) may be compared with an expected trend value of 2.0. If that calculation were correct it would suggest that the current level of the money supply is sufficient to finance an additional 3 per cent of private expenditure.

The Treasury's view, in setting the monetary targets for the Medium-Term Financial Strategy, appears to be that there has been a permanent shift in the demand for money, i.e. a permanent fall in the velocity of circulation. We have on several occasions suggested reasons

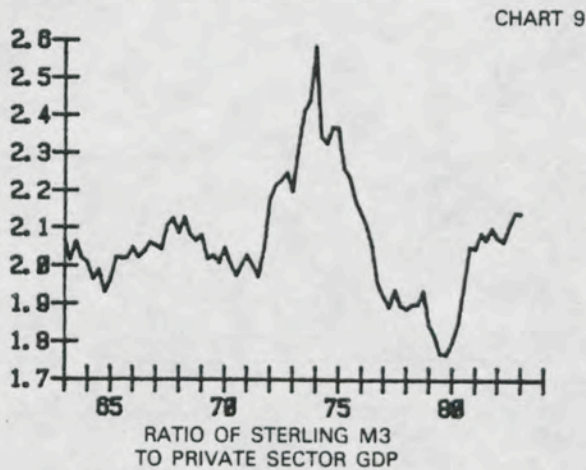


CHART 9

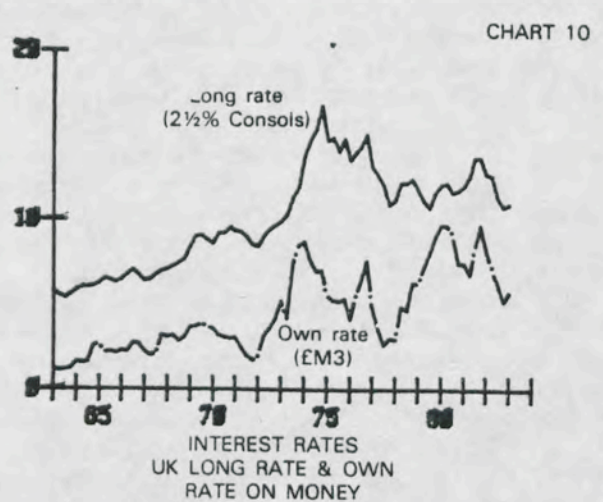


CHART 10

Chart 9 shows the ratio of sterling M3 to private sector expenditure. There was a much larger rise in the ratio at the time of the monetary explosion of 1972-3 but that was followed by a return to more normal levels. That adjustment came about almost entirely through a rise in prices. A crucial question is whether there will be a similar reaction (though on a smaller scale) from the current position. To use more familiar terms, we have seen a significant fall in the velocity of circulation of money and the question is whether it will rise again to its former rate. If it does, there is the further question of how the rise in nominal expenditure will be shared between price rises and increases in real expenditure. (Finally there is the question of how much of any increase in real expenditure will be met from domestic output and how much will be spent on foreign goods.)

The first point to be made is that the starting point for

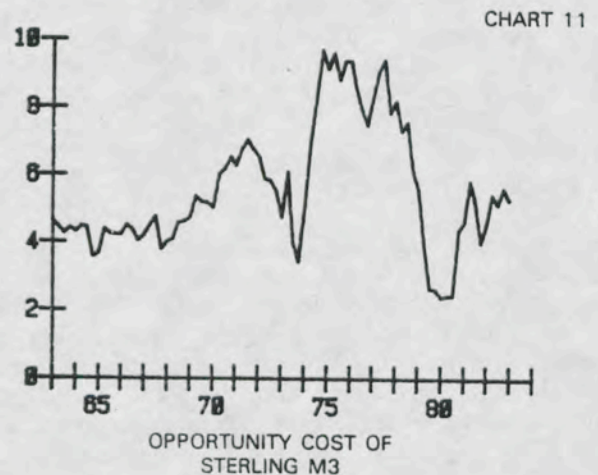


CHART 11

for a *temporary* fall in velocity. The most important explanation was the rise in the relative return on money balances, compared with other financial assets. Chart 10 shows the movements in the average return on money balances and the return on 2½ per cent consols; Chart 11 shows the difference between the two series. For much of 1980 the gap between the two rates was exceptionally small. Money therefore became an attractive asset and the demand for money balances rose relative to expenditure. However the gap between the two returns has opened up since the end of 1980 and one would expect on those grounds to see some rise in velocity. Chart 9 does not suggest that this has yet happened. It is, however, possible that there has been a permanent shift towards money. For much of the post-war period, the UK has been exceptional in experiencing a rising velocity of circulation in terms of broad definitions of the money supply. This may be because cartel arrangements among the clearing banks and rising inflation have generated very low or negative real returns on time deposits. In more recent years competition has become far more intense and we may be reaching the end of the era in which the public is prepared to lend funds to the banks at low interest rates. Thus there will be less incentive to economise on money balances.

We have implicitly accepted arguments of this type in our forecasts and we are forecasting little further change in the velocity of circulation. However, we cannot be completely sure that the money market is in balance. There is still the possibility of a rapid growth of expenditure if velocity returns to its previous trend level. In the short run much of the response would be felt on output but in the longer term our forecasts of inflation could prove far too optimistic. For the moment we are assuming that the market for money, like the market for currency, is back in balance.

If we extend our discussion to the wider question of balance in financial markets as a whole, we have in the past emphasised the strains that can be placed on the market by an excessively large PSBR in relation to money supply targets. The rapid reduction in the ratio of the PSBR to GDP (from nearly 6 per cent in 1980/81 to less than 3 per cent in the current financial year) has greatly eased the financing problem. Private sector pressures on the money supply (from bank borrowing) have been stronger than expected and may account for the persistence of high real interest rates; but the current broad fiscal/monetary policy mix is about right.

Goods and Services

We argued in the previous *Economic Viewpoint* that disequilibrium in the market for money had affected the market for goods and services during 1980. The high return on money had raised the demand for money, and people tried to switch from expenditure into money, thereby reducing the level of demand and output. Also the exceptionally high level of the real exchange rate had the conventional effect of increasing imports and

harming exports. The accompanying high rates of interest affected investment and stockbuilding.

We do not believe that the arguments relating to money markets or to the high exchange rate apply with the force they did. In each case there has been a significant change, although the fall in the exchange rate has been too recent for it to have had any effect on the market for goods and services so far. Real interest rates have, however, remained high. We believe that this helps to explain the further reduction in stock levels in the second half of last year.

A further possible source of imbalance in the economy is through a weakness of world demand. We argued in October 1981 that, at that stage, the world recession could only have been a minor factor compared with domestic developments. Charts 12 and 13 suggest that the position has changed markedly. Chart 12 compares industrial production in the UK and the world and Chart 13 shows developments in GDP. Chart 12 should be the more significant in terms of causation. The main effect of world demand on our economy comes through exports of goods which will tend, in turn, to depend on world industrial production. In the past, as Chart 12 shows, movements in UK industrial produc-

CHART 12

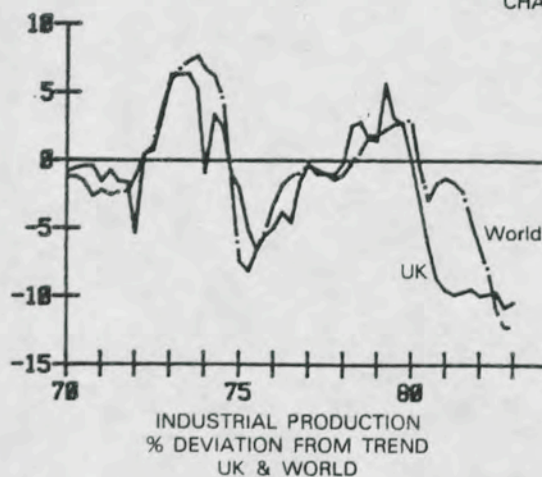
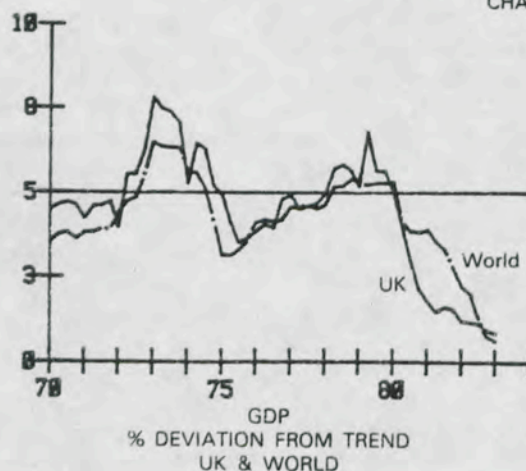


CHART 13



tion have closely matched movements in world industrial production when each is measured in terms of deviations from a trend. During 1980 and 1981 the UK economy, quite exceptionally, experienced a recession which was far deeper than the world recession.

Since 1981, however, there has been a considerable improvement in the relative position of the UK and the world recession is, if anything, now deeper than that of the UK. This can be seen for both industrial production and for GDP. (The relative position of manufacturing output is rather worse.) One can say that other economies have been suffering similar problems of imbalance as they have pursued counter-inflationary policies. (It is not possible, by definition, for all countries to have an over-valued currency but, as discussed in January's *Forecast Release*, the US has certainly suffered from the rise in its real exchange rate and the strong dollar imposed inflationary problems on other industrial economies.) Charts 12 and 13 suggest that the UK will now benefit from the expected recovery in world output in 1983 and 1984.

Finally, the government's policy of reducing the PSBR has had the short-term effect of cutting domestic demand. Although we are expecting the downward trend in the ratio of the PSBR to GDP to continue, this is consistent, thanks to North Sea oil, with a reduced burden of tax on the personal sector and the non-oil companies, and there is scope for a steady increase in domestic demand.

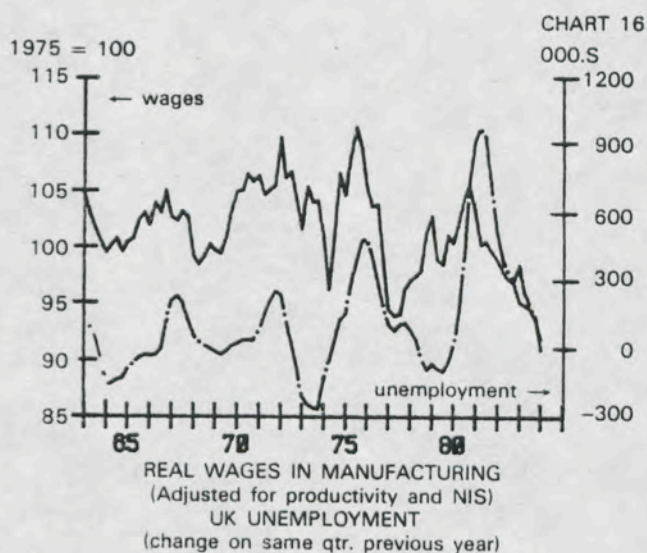
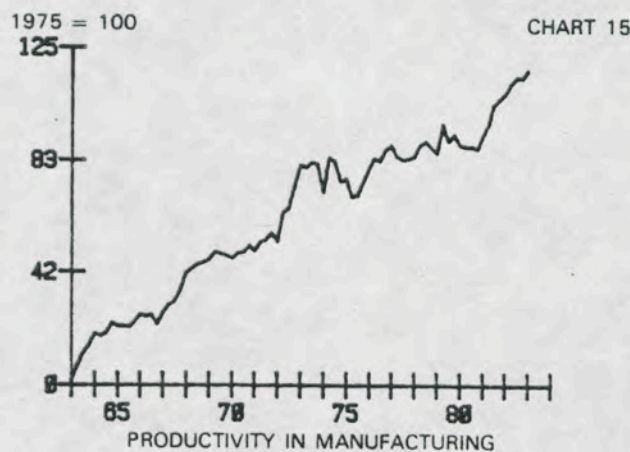
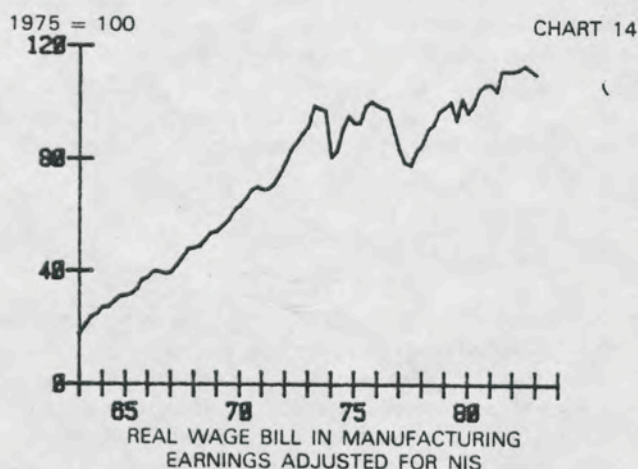
Labour

It is the labour market which is taking longest to come into balance. Throughout this recession, and in spite of the rapid rise in unemployment, average earnings in manufacturing have risen faster than producer prices. In terms of decisions about employment it is the marginal cost of labour that matters and it may be that the marginal cost, i.e. the cost of employing an extra worker, has risen rather less rapidly than average earnings since the latter includes increases in working hours. However, it is discouraging that the recession has had so little effect on pay levels. (The rate of nominal increases in pay has fallen but the rate of inflation has fallen even more rapidly.)

Although the recession has had little effect on average earnings it appears to have had a marked impact on labour costs. The rate of increase of unit labour costs in manufacturing during 1980 was 22 per cent; during 1981 it was 10 per cent and during 1982 it was probably about 5 per cent. At the risk of over-simplification one can say that productivity increases together with reductions in the national insurance surcharge have brought about the reductions in costs that were needed, given the rise in wages.

Charts 14 to 16 show what has happened. Chart 14 shows the movements in the ratio of wages to prices and Chart 15 shows productivity. Chart 16 shows that when the exceptional increases of productivity in recent years

are taken into account the ratio falls significantly. The chart makes allowance for movements in other input prices and therefore provides a reasonable guide to the average profit margin in manufacturing. In the past, as Chart 16 shows, the level of the ratio has roughly matched the change in unemployment. A high ratio has been associated with rapid increases in unemployment



and a low ratio has been associated with stable or falling unemployment. We emphasised before that we cannot necessarily deduce a causal relationship between the two. A recession caused by external factors – a world recession for example – will tend to increase unemployment and raise the ratio of labour costs to prices because productivity falls. Also the recent rise in productivity has itself been brought about by a fall in employment rather than by a rise in output so that the increase in unemployment has necessarily accompanied the rise in productivity and the fall in the ratio. We can, however, suggest that if the ratio is held at its current level as a result of wages rising at about the same rate of prices, there are reasonable prospects for an end to the rise in unemployment.

Back in Balance?

In October 1981 we particularly emphasised two points at which the economy seemed to be out of balance. The first was the exchange rate and the second was wages. The two were connected since both wages and prices had been slow to adjust to the rise in the exchange rate since the beginning of 1979. At that time we forecast that the effective exchange rate would fall steadily during 1982 and would reach a level of 79 by the first quarter of 1983.

In the event the exchange rate stayed much higher than we expected until the end of 1982. However, cost competitiveness improved about as much as we expected because productivity rose much more rapidly than we expected. The most recent fall in the exchange rate goes a long way to restoring balance in terms of our competitiveness and we have seen a significant shift in the relationship between wage costs and prices.

These developments suggest that we can now hope to see some restoration of balance in the markets for goods and for labour. On our calculations, the growth of output in 1982 (as measured by the expenditure estimate of GDP) was equal to the growth of final expenditure (consumption plus exports plus investment). In other words there was no net drain on the growth of output from destocking or imports. That is by strong contrast with the position in recent years, particularly in 1980 when final expenditure was unchanged but output fell by 2 per cent.

We are forecasting that final expenditure will grow by about 1.9 per cent in 1983 and that output will grow slightly less rapidly. There is a good chance that with the economy back in balance we shall see a rise in the proportion of expenditure which is met out of domestic production and that the growth of output will be more rapid than our forecasts suggest.

Briefing Paper

Forecasting uncertainty; How accurate can we be?

R. J. CORKER

This Briefing Paper is the second in our series of three papers concerning aspects of forecasting and model building. In last October's Economic Outlook we discussed the structure of econometric models and how they are used, in conjunction with our judgement, to produce macroeconomic forecasts. It was stressed in that paper that the equations we use in our economic models cannot describe economic behaviour precisely. There are unpredictable, random elements, which affect actual outcomes – in other words our equations are stochastic. In this paper we investigate the stochastic nature of the equations and the model more closely and we describe ways of quantifying the uncertainty of our published forecasts. We publish, for the first time, projected error bands about our central forecast. To a large extent we are attempting to answer the question, "How accurate can we be?". The related question "How accurate have we been?" will form the basis of the third article, to be published in June. The paper is divided into three parts. Part I is mainly expository; Part II describes our methodology and Part III presents the empirical results.

I SOURCES OF FORECAST ERROR

Before we discuss how we might quantify forecast uncertainty, it is instructive to catalogue the sources of error in a macroeconomic forecast produced by a large-scale computer model. (A brief summary of the key features of econometric models as described in the October 1982 *Briefing Paper* can be found opposite. The reader who is familiar with the operation of economic models should turn to Part II, where we discuss our methodology or to Part III where we present our empirical results.)

In considering the possible sources of errors in our forecasts it is convenient to distinguish between model and non-model errors.

Model errors

Model-generated forecast errors derive from two sources; equation misspecification and the stochastic nature of the model. Taking the first of these, errors in specification relate to our having an incorrect model. In other words our equations are an incorrect description of economic behaviour. For example, we may include explanatory variables which are irrelevant or exclude variables which have an important influence on the economic activity in question. We may have the right variables but expressed in the wrong form. Also we may

wrongly specify the dynamics of economic behaviour. The search for correct behavioural relationships requires that we have the correct economic theory and that the theory is correctly expressed and estimated. This is not a simple problem. All models of the UK economy are inevitably misspecified to some extent and will remain so despite continued research efforts.

The misspecification errors are perhaps the most

In the October 1982 *Briefing Paper* we described the main features of an econometric model. We may briefly summarise these as follows:

An econometric model is made up of a set of mathematical equations. These equations represent relationships between macroeconomic quantities – e.g. inflation, total consumption, the money supply, etc. – and are of three types. The most important – and contentious – equations are those described as "behavioural" and which express our theoretical perception of how the economy behaves. Identities and technical relationships (the other types of equation) have less contentious origins.

A forecast is just a mathematical solution for the future values of economic quantities that is consistent with all the behavioural equations, technical relationships and identities in the model. The solution procedure is somewhat complicated since the equations are *simultaneous*. We need to know the forecast value of one variable before we can forecast another, but the forecast of the first variable again depends on the forecast of a third variable which may depend on the first and so on. A computer algorithm is needed to find the consistent solution path.

The model is also *dynamic* with current values of economic variables depending on past values of either themselves or other variables. Such a feature means that our model does not exhibit instant adjustment; for example, the price level will only respond to a change in the money supply gradually and after a delay.

Finally there is an important distinction between variables which we denote as *endogenous* and those designated as *exogenous*. Both types of variable will be found in behavioural equations helping to forecast other variables but the forecast of the exogenous variables is determined by a process outside the model structure. For example we decide at an early stage of the forecast the projected volume of government spending for the next five years. Hence there is no equation in the model to determine government spending, but government spending is used to forecast other variables such as government employment and the PSBR which are endogenous. The move to cash limits and the planning of public expenditure in cash terms means that we do have to reconsider our initial projections in the light of our forecasts of the public sector wage bill and the authorities' planning total.

serious kind since it is not possible to quantify their likely magnitude in advance. For this reason statements about forecast uncertainty are conditional on the absence of specification error. Stochastic errors arise because the equations in our model cannot be exact descriptions of economic activity and are necessarily simplifications of what we know to be more complex processes. We know that our equations do not precisely fit past observations and we do not expect them to predict outcomes precisely in the future. But any statement about the magnitude of the errors is based on the assumption that the equation is an unbiased representation of reality.

We can illustrate these sources of model error by referring again to the equation for consumption of non-durables which we described in the previous *Briefing Paper*. (See below). The equation will almost certainly be misspecified. For example, there is no mention of the personal sector's wealth, or the level of unemployment, although both probably affect consumers' behaviour. Also we have only one measure of income whereas consumption will depend on how income is distributed between different groups of people. The term ϵ_t records our recognition that this is a stochastic equation. Our statistical techniques provide an estimate of the distribution (or pattern) of the stochastic errors.

Over the estimation period the average value of these errors is zero but, as we described in the previous *Briefing Paper*, we sometimes project non-zero error terms, which we call "constant adjustments".* It should

* For the present forecast, tables of constant adjustments can be found on pages 81-4

be noted that these projections do not necessarily mean that we know precisely what the future value of the error term will be, rather we have some view of what its expected or average value will be in future periods. Thus for all our forecasts using behavioural equations there will be stochastic errors in the future and these contribute to the uncertainty of the forecast.

The fact that we choose non-zero values for some of the residual terms in the future implies something about the *prior certainty* we possess about the actual outcomes. We only impose the non-zero constant adjustment because we are more confident that this will improve the accuracy of the forecast. This confidence hinges on the forecaster's access to external information such as industrial surveys, monthly data, etc., which are not reflected in the equations of the model. Therefore, although we can measure the distribution of stochastic errors in the past, this distribution may not be an accurate representation of *our view* of the pattern of errors in the future. By drawing on our external information and judgement, we believe that for the short period of, say, up to four quarters into the future, the pattern of random errors will be more tightly clustered around our chosen constant adjustment than they have been in the past. So departures from the constant adjustment are *less likely to be as large* as the model equation suggests. Obviously as we forecast further into the future our confidence in external information diminishes and our expected distribution of future residuals is then best described by historical outcomes. Statements about the certainty we have in our forecast should reflect this judgemental confidence.

The consumption equation in the LBS model

$$\begin{aligned} \Delta \ln \text{CND}_t = & -0.0045 - 0.470 \Delta \ln \text{CND}_{t-1} - 0.344 \Delta \ln \text{CND}_{t-2} \\ & + 0.208 \Delta \ln \text{YD}/_t + 0.151 \Delta_2 \ln \text{YD}/_{t-2} - 0.096 \ln \text{CND}_{t-3} \\ & \quad \quad \quad \text{YD}/_{t-4} \\ & - 0.201 \Delta \ln \text{PC}_t - 0.213 (\Delta \ln \text{PC}_{t-1} - \Delta \ln \text{PC}_{t-2}) \\ & - 0.166 \Delta \ln \text{PC}_{t-3} + \epsilon_t \end{aligned}$$

Key

CND = Non-durable consumption (1975 prices)

YD/ = Real disposable income

PC = Consumption price deflator

ln = Natural logarithm of variable

subscript t = Time period (in quarter years)

Δ = difference of variable, e.g. $\Delta \ln \text{CND}_t = \ln \text{CND}_t - \ln \text{CND}_{t-1}$

Δ_2 = two-period difference, e.g. $\Delta_2 \ln \text{YD}/_t = \ln \text{YD}/_t - \ln \text{YD}/_{t-2}$

ϵ_t = (random) error term

For a description of this equation, see *Economic Outlook*, October 1982, p. 28.

Finally, the parameters or coefficients, such as the numbers -0.470 and -0.344 are also subject to uncertainty. Statistical techniques generate the expected value of these parameters but we cannot be certain, even if the equation is correctly specified, that these numbers are correct. Uncertainty about the values of parameters provides another possible source of model error.

Non-model errors

Non-model errors can occur even if the model is correctly specified and is not subject to stochastic errors in estimated equations. One important source is errors in the published data. Largely this is a problem of scale. The official statisticians collect vast numbers of returns from firms, shops, banks etc., which they aggregate into single observations. This process will involve considerable measurement error and it would be impossible to calculate exactly the true value of GDP, for example, for a country as large as the UK (even if a satisfactory, unambiguous definition could be agreed upon). By itself, this means that our estimation of model equations are based on data that only approximate the true values of economic outturns.

A more serious problem, however, is that the data are often revised by the official statisticians, particularly when series are *seasonally adjusted*. Seasonal adjustment is a process of smoothing raw data to remove an underlying or systematic seasonal pattern. For example the level of unemployment is usually seasonally adjusted to take account of such factors as the end of the school year or holiday-related jobs. The techniques of seasonal adjustment are frequently updated and so, perhaps as long as 12-18 months after the first publication, official estimates are revised. The consequence is that the latest data we have are largely provisional. Since our equations are dynamic this means that these recent values are used to predict future values for other variables. Hence there is a possibility that forecast errors are made because we start with wrong historical values.

A second non-model error source is in our prediction of the likely paths of exogenous variables. These, it will be recalled, are not generated by the model but must be predicted independently beforehand. In our model most policy variables such as tax rates and the level of public expenditure are forecast exogenously.

Errors in exogenous variable forecasts can be broken down into two components in much the same way that model forecast errors have in the previous section. In one sense there is a stochastic component: government spending, world interest rates etc., can only be forecast to within a certain tolerance. It is possible, as we see later, to allow for this source of error when evaluating overall forecast uncertainty.

A second component, which is usually unquantifiable, is the probability that our underlying assumptions break down. To take an example, we know there will be a general election in the near future. The outcome of this election will determine the course of the economy in the

short and medium term. It is much more difficult to allow for the possibility of fundamental changes of policy using the statistical techniques we are applying here. Thus our statements about uncertainty are dependent on the policy assumptions which are set out on pp. 6 to 10.

Just as we impose non-zero constant adjustments in which we have more confidence than historical estimation of behavioural equations might otherwise suggest, generally we are more confident about our immediate exogenous variable forecasts than our projections for the medium or longer term. For example, over the next twelve months we could view large random departures from our expected forecast for current government spending to be less likely than in subsequent periods. So for exogenous variables we also have a prior view of the distribution of the future stochastic components which may well differ from some historically measured pattern of deviations from past trends. Again we attempt to reflect these prior views in the measurement of future forecast certainty to which we now turn.

II QUANTIFYING FUTURE UNCERTAINTY

From the preceding discussion we have suggested that there are ways of quantifying at least part of a forecast's uncertainty. In this section we describe one way of doing this. Firstly, though, we describe a summary measure which is used to capture the size of uncertainty. This is usually referred to as the *standard error*.

Suppose we take all our forecasts made in the past and compare them with actual outcomes. The difference between actuals and predictions are then measurable forecasting errors. If our model is unbiased, on average those errors are zero although in certain cases they may be of substantial size. The standard error is calculated by squaring all these errors, adding all the squared errors together, dividing the sum by the number of forecasts and then taking the square root (see below).

Constructing the forecast standard error

Let A_t = actual value of the variable in period t
 $P_{i,t}$ = i^{th} predicted value of the variables in period t
 n = the number of predictions
 s_t = the standard error at time t

Then,

$$s_t = \sqrt{\frac{\sum_{i=1}^n (P_{i,t} - A_t)^2}{n}}$$

As described in the text, each $P_{i,t}$ is generated by stochastic simulation to produce an artificial sample of predictions consistent with the idea that each forecast has an unpredictable random component. A_t is chosen to be the base forecast value since actual values are obviously unknown in the future.

The advantage of this seemingly complicated measure is that it has certain statistical properties that we can use to our advantage in the following way. If we can predict the size of the standard error for each variable in the future, then, by making some not too onerous mathematical assumptions*, we can make probability statements about the certainty of the forecast. In particular if the assumptions we make about the quality of our model and about government policy are correct then there is only a one-in-twenty chance that the actual outcome will lie outside a band ± 2 standard errors either side of the central forecast. The forecast uncertainty can therefore be quantified if we can in some way measure future standard errors of variables.

Stochastic simulations

Our aim in this paper is to quantify *some* elements of the uncertainty and future errors of our forecasts. We shall particularly concentrate on the errors that arise from the stochastic nature of the behavioural equations and from the uncertainty of our forecasts of exogenous variables. Even though this is a limited exercise it is an extremely complex one. Our model is highly interdependent. Therefore errors in one part of the forecast will generate errors in another part of the forecast. For example, errors in forecasting real personal disposable income (which is itself generated by several separate equations) will cause errors in forecasting consumption even if the equation for consumption is exactly correct. Our forecast for GDP depends on the interaction between a large number of behavioural equations and exogenous forecasts. It is virtually impossible to calculate the standard error of the forecast of GDP or of the other key variables in our forecast analytically. Instead we use the technique of *stochastic simulations*.

Stochastic simulations are produced by programming the computer to generate a large number of forecasts. Each forecast uses the estimated structure of the model but in each case where stochastic errors can occur it chooses random numbers according to the rules (or probability distributions) which we estimate generated the errors observed in the past. (As we explain in the next section, in some cases we alter the probability distributions for the future.) In the equation for non-durable consumption, for example, stochastic errors can arise in each of the coefficients on the right hand side or through the residual term, ϵ_t . There will also be an equation elsewhere in the model for the consumer price index which will in turn have its own stochastic elements – in particular a residual term and a dependence on exogenously determined tax rates. In the past we have observed, or at least can estimate, the size of the standard error of all these sources. For example, the standard error of the residual of non-durable consumption is 0.6 per cent of its average value in the past and that for consumer prices is 0.4 per cent. So the random

numbers chosen are scaled by these standard errors. The scaling is such that 68 per cent of the random numbers for the non-durable consumption residuals lie within a range ± 0.6 per cent of the base forecast value (i.e. the chosen value of any future constant adjustment) and 95 per cent will lie in the band ± 1.2 per cent either side of the base forecast in each future period. The stochastic simulations of the model will provide a range of forecasts for all the endogenous variables in the model. We can then estimate the standard error of these forecasts and use them as a measure (in the limited sense already emphasised) of the uncertainty of our forecasts.

We have only found it practicable to generate stochastic simulations based on two sources of random error: the residual error in estimated equations and the error in forecasting exogenous variables. We have not included the errors that can be generated from the stochastic nature of the estimates of the parameters or coefficients of the equations.

Allowance for judgement

A further possibility is to take account of the judgemental skill of the forecaster when we evaluate forecast uncertainty (see Corker, Ellis and Holly, "Uncertainty and Forecasting Precision", CEF Discussion Paper No. 98). One of the conclusions of the first *Briefing Paper* in this series was that a forecaster's judgement is a legitimate addition to the forecasting procedure. The forecaster typically has some additional information which he wishes to incorporate in the forecast through imposing a constant adjustment. In some cases this means that the forecaster will be less uncertain about the future than perhaps the stochastic experiments suggest – at least for, say, six to twelve months into the future. To capture this feature we have thus devised a scheme for rescaling the measured standard errors of constant adjustments and exogenous variables in the immediate future when we conduct stochastic simulations on the model.

For constant adjustments imposed in the immediate future our prior view is that sizeable deviations from these values are less likely than in the more distant future. We therefore scale down the standard errors of constant adjustments in the short run relative to those in the longer run. Similarly we allow the standard errors of exogenous forecasts to grow with time once again to reflect our prior views.

Hence the forecast standard error bands we publish in this edition of *Economic Outlook* take into account three factors: the stochastic nature of model equations, the stochastic nature of exogenous variable forecasts and the certainty content of forecasters' judgement. The quantification of the latter is somewhat subjective, but we believe that the results give a better estimate of the true margin of error than if we simply ignore the problem.

* Namely stationarity, normality and linearity.

Interpretation of the standard error bands

We emphasise that the standard errors we present are *conditional* measures of uncertainty. They are conditional on

- a) A correctly specified model.
- b) The policy assumptions which have been used.
- c) No fundamental change in the structure of the economy.

A way of extending the scope of the uncertainty measures to overcome condition (b) would be to produce an alternative forecast based on an alternative set of assumptions about economic policy*. The forecast standard errors would then be recomputed for this second 'scenario'. The alternative forecast would thus have associated confidence bands. For the *conditional* standard errors presented there is a 95 per cent chance that the actual outcome will lie within ± 2 standard errors of the central forecast. There is a 68 per cent probability that the outcome will lie in a ± 1 standard error band.

III UNCERTAINTY AND THE CURRENT FORECAST

In Table 1 we present the results of the stochastic experiments which quantify the uncertainty of the forecast contained in this *Economic Outlook*. We concentrate on just a few key variables, reporting annual totals or averages for the next three years.

Considering all the variables together we observe certain common features. The standard errors all become larger the further into the future we are forecasting. Intuitively this is what we would expect. The confidence we have in our 1983 forecast is higher than that for 1984 and 1985. Increasing standard error bands with time is not, however, a feature we would observe for all variables indefinitely. A mathematical property of our model ensures that for many variables the forecast standard errors eventually settle down to constants. By 1985 several variables have reached this upper limit – the public sector borrowing requirement being a notable exception. For example this limit would appear to be about 1.5 percentage points for the growth rate of GDP, slightly lower for consumption and about 3 per cent for fixed investment. As we have repeatedly stressed, this interpretation is conditional on our having the correct model and there being *no fundamental shocks* to world events or domestic economic policy. If indeed we do have the correct model and domestic and world economic institutions do not change fundamentally in character then there seems no reason why forecast uncertainty should increase simply with the passage of time. It is because we do give increasing weight to the possibility of *political and structural change* that subjectively we are increasingly less confident about outcomes the further into the future we look. Thus our

intuitive assessment of uncertainty is not entirely consistent with the measure presented here. The former includes diminishing confidence in the continued economic status quo whereas the latter is conditional on the continuation of the status quo. In this sense the standard errors presented here represent the minimum irreducible amount of precision that can be attached to our forecasts.

The general reasons why we find increasing standard errors at least for the next three years are two-fold. Firstly the model, as explained earlier, is dynamic. For this reason the uncertainty in one period feeds through to the next with a cumulative effect. Secondly the possession of additional non-model information allows us to be more certain about the near future than the model by itself might otherwise suggest. As explained, this is the reason why we impose constant adjustments to amend the pure model forecast. In our stochastic experiments we have allowed for this improved confidence in the way we have scaled the standard errors of residuals and exogenous variables. This auxiliary information extends into 1983 for many variables.

It should be recognised that, in February 1983, we only know the full 1982 outcomes for a limited number of variables (interest rates and exchange rates are obvious examples). Indeed many of the last available data (mostly for 1982 Q3) are provisional and could well be revised. For example we know from the 1981 Labour Force Survey that estimates of employment have been revised upwards by 800,000. This implies that the CSO will also be revising upwards the level of output (see Focus, p. 16). So our forecast of standard errors reflects the uncertainty about the past.

Much of our non-model information relates to this so-called "ragged-edge" data period. For example we often have up-to-date data on retail sales which is a useful indicator of consumers' expenditure or we have the latest total unemployment figure but no disaggregated figures for employment in different sectors. Or we may possess two months' data for the most recent quarter for certain variables. We can use all such information to make more accurate estimates of the unknown recent past. Even so, our assessment of 1982 is uncertain and this uncertainty carries forward to 1983 and subsequent years.

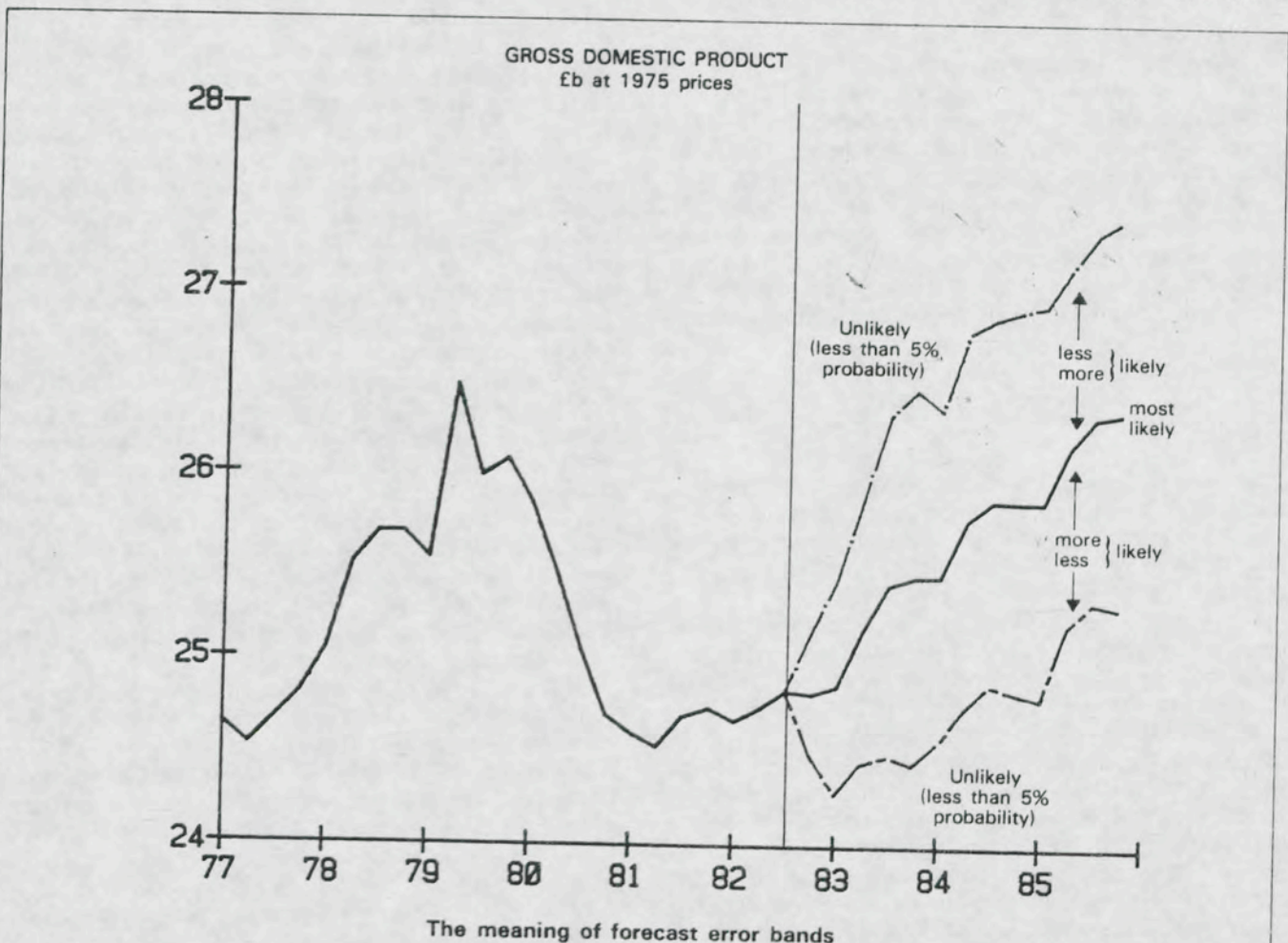
We now turn to a discussion of the standard errors of particular variables. The components of demand which are reported are consumption, fixed investment, exports and imports which, together with stockbuilding and government expenditure (not reported), constitute expenditure on GDP at market prices. The standard errors for the annual growth rate of GDP increase each year to a maximum of approximately 1.5 per cent, implying for the *level* of GDP the band shown in Chart 1. On the basis of current information we are forecasting a growth of 1.8 per cent in GDP in 1983. But because of the uncertainty attached to forecasting there is a 95 per cent chance that the growth in GDP will lie in a range from -0.6 per cent to 4.2 per cent. So although our forecast for GDP in 1983 implies that there will

* As we do in the section on the medium term (p.19).

probably be positive growth, there is a distinct possibility that growth could be negative.

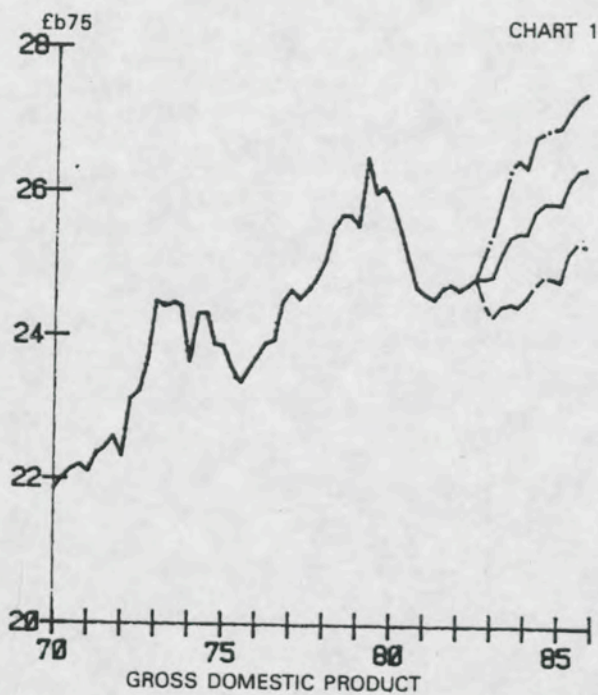
It is very important at this stage to emphasize that it is *not equally* as likely that GDP will fall in 1983 as it will rise. Conditional on the model and the information we have at present the *most likely* outcome is what we have forecast. The further we move away from the mid-range of the band shown in Chart 1 overleaf, the *less likely* the outcome (see below).

Looking at the components one notices that exports, imports and investment are all more difficult to forecast accurately (i.e. have larger standard errors) than GDP whereas consumption can be predicted with more precision. The reason for this is largely that the consumption function is a well researched area of economics and consumption decisions tend to be reasonably predictable stable relationships. Export, import and investment decisions are more difficult to



The above chart reproduces on a larger scale the forecast and standard error bands for Gross Domestic Product shown in Chart 1. Data was available at the time the forecast was completed, up to the third quarter of 1982. Beyond this period, the chart forks three ways. The central line is our published forecast. This is our best estimate of the future evolution of GDP, i.e. the path we think GDP is *most likely* to follow if our underlying assumptions are correct. We regard outcomes away from the central path as progressively less likely, although still a possibility. The two broken lines (± 2 standard errors) mark a boundary outside which we consider outcomes to be unlikely. There is only a one-in-twenty chance that outcomes will lie in these regions. Clearly the ± 2 standard error boundary

is a subjective choice. Less cautious people might consider that a one-in-ten or one-in-five chance is sufficiently small to demark unlikely outcomes. In these cases the upper and lower bounds would be much closer to the central forecast. It should be stressed that in the 'less likely' region, the possibility of outcomes away from the central forecast does not diminish proportionally with the size of such deviations. If the broken lines are viewed as contours on a map then further lines could be drawn symmetrically about the central forecast. Such lines, if each represented a ten per cent decrease in probability, would be clustered much more densely around the central forecast than in outlying regions.



capture mathematically and also tend to be more volatile data series.

The next three variables in Table 1 are all price variables. The first of these, average annual consumer price inflation (Chart 2), has a steadily growing standard error over the next three years. Our expected outcome for consumer price inflation in 1983 is thus the centre of the range 4.2 per cent to 7.4 per cent. By 1985 the range is 3.3 per cent to 11.7 per cent which although larger than that for 1983 still seems narrow when one considers the erratic movements of prices over the last decade. The narrowness of the range is, however, largely a consequence of our 'consistent policy' assumptions. A new government committed to reflation or even a U-turn by the current government could well force the actual outcome through the top of the forecast range.

The reported precision of average earnings in manufacturing is similar quantitatively to that for price inflation. The same qualitative remarks about the continuation of anti-inflation policy also apply to this variable.

The third price variable reported is the trade-weighted exchange rate - the price of sterling. The standard error, as a proportion of the forecast value, is fairly large, (e.g. two standard errors in 1985 is 18 per cent of the expected value and implies a range 0.65 to 0.93). The exchange rate has proved notoriously difficult to forecast in the past largely because the speed of adjustment in exchange markets can be extremely fast and is dependent on fairly unpredictable speculative expectations. The 'fundamental' determinants of a long-run equilibrium exchange rate may be reasonably certain, but large sustained movements away from equilibrium are quite common. Most forecasters would, therefore, view even

Table 1
Forecast Standard Errors

GDP and Demand Components at 1975 prices
(annual % changes)

	1983	1984	1985
GDP (output measure)			
forecast	1.8	2.0	2.0
standard error	1.2	1.3	1.5
Consumers' expenditure			
forecast	2.3	1.5	2.3
standard error	0.8	1.1	1.3
Fixed Investment			
forecast	3.3	4.0	1.5
standard error	2.4	2.8	3.2
Exports			
forecast	1.7	1.5	2.4
standard error	1.5	2.0	2.3
Imports			
forecast	4.6	2.0	1.8
standard error	1.5	2.2	2.6

Earnings, Prices, Money & Exchange Rate

Consumer prices (index 1975 = 100) annual % change			
forecast	5.8	7.0	7.5
standard error	0.8	1.8	2.1
Average earnings in manufacturing			
forecast	8.1	7.2	8.3
standard error	0.7	1.4	2.1
Sterling exchange rate trade weighted, index 1975 = 1.0			
forecast	0.81	0.80	0.79
standard error	0.04	0.06	0.07
Money Supply (£M3) end year 4-qr change			
forecast	9.6	10.0	9.8
standard error	2.1	2.6	2.9

Key Balances

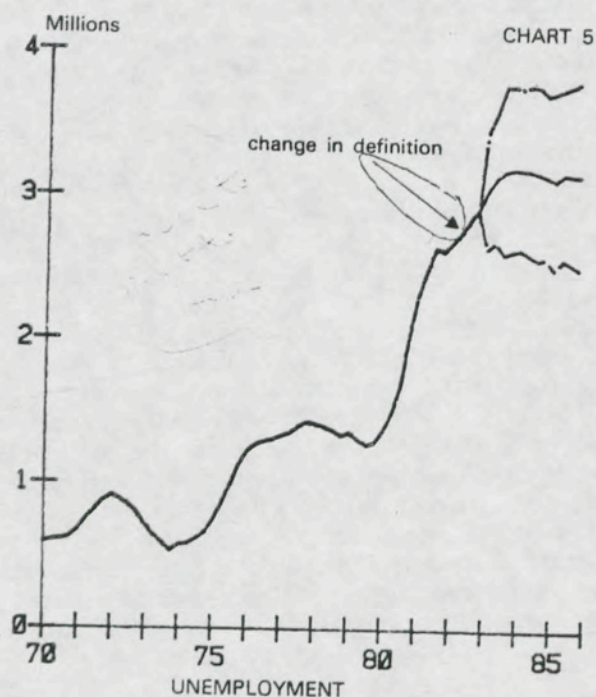
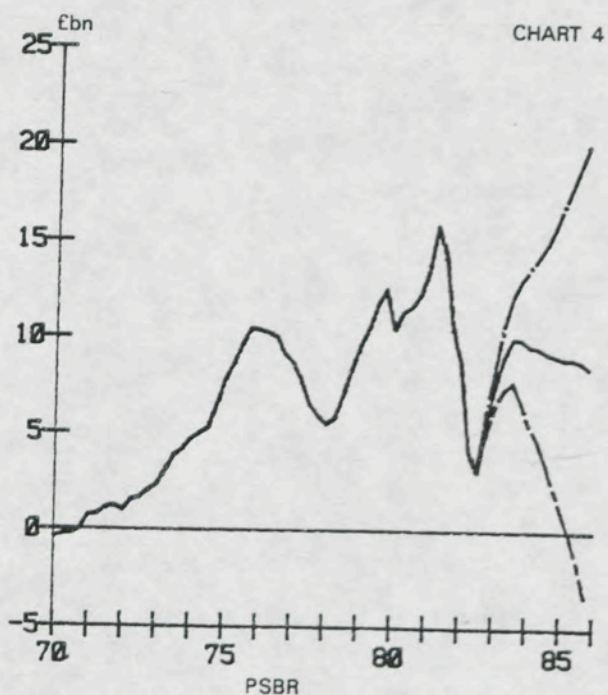
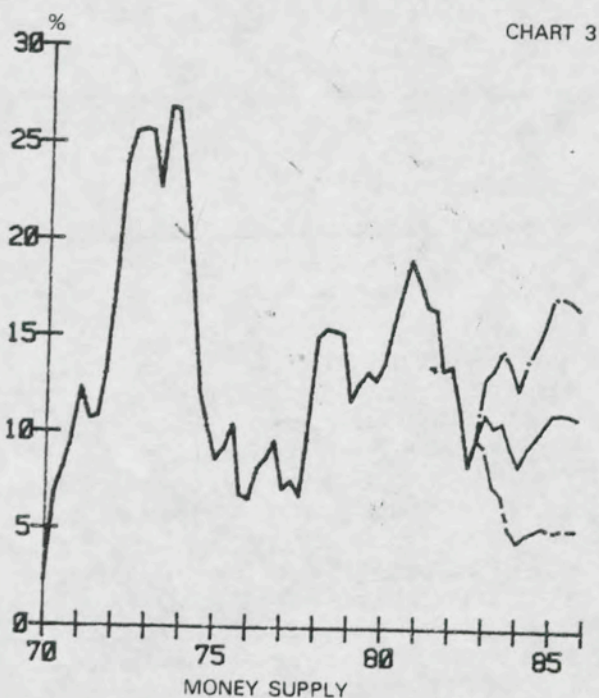
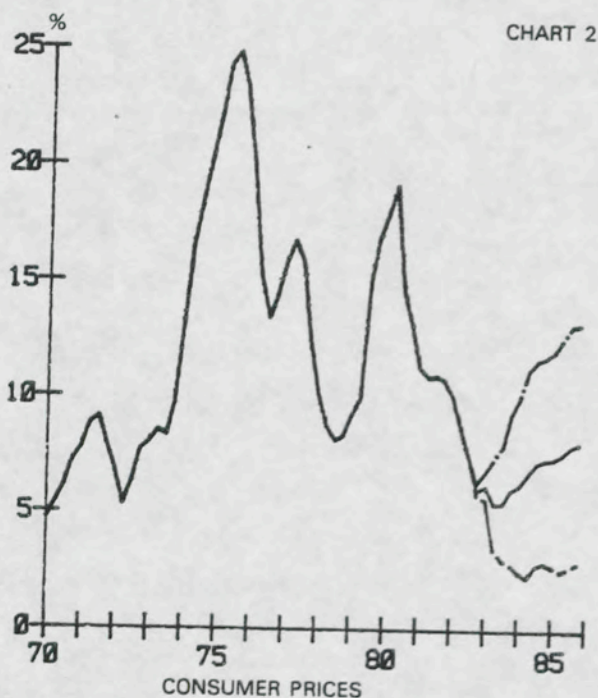
Public Sector Borrowing Requirement £ billion, financial years			
forecast	9.2	8.4	7.4
standard error	1.6	3.4	5.9
Balance of Payments £ billion			
forecast	1.5	0.0	-0.1
standard error	1.4	3.3	5.1
UK unemployment, excl. school leavers millions			
forecast	3.14	3.17	3.13
standard error	0.18	0.22	0.25

the reported uncertainty band as uncomfortably narrow. More than any other variable the exchange rate depends on market perceptions of the government's policy stance, and the narrowness of our error bands (as for prices and wages, but to a far greater degree) is conditional on the policy assumptions.

The next variable on the table shows the precision with which we can predict money supply growth (Chart 3). It also gives some indication of the ease with which the money supply can be controlled. Target bands much tighter than the ± 2 standard error

range reported here would seem to us fairly ambitious.

This point is reinforced when we look at the precision of our forecasts of the public sector borrowing requirement (Chart 4) which by 1985 ranges (± 2 standard errors) from -£4.4bn to £19.2bn. This is largely because the PSBR is calculated at the end of a long chain of economic transactions and is particularly sensitive, as a balance, to small changes in both government revenue and spending. This lack of precision underlies the difficulty in forecasting the room for manoeuvre of the Chancellor in the next



Budget.

The same is true for the forecast of the current account of the balance of payments. Although the net balance is forecast to be only a small number, small changes in any of the components – exports, imports, volume and prices – can cause large changes in the outcome. This is reflected in the relatively large standard errors.

The final variable in the table is UK unemployment (Chart 5) which has a surprisingly low standard error given the size of movements in the unemployment rate over the last few years. Our reported bands say that our model predicts almost certainly no significant change in unemployment from the 3 million level over the next three years.

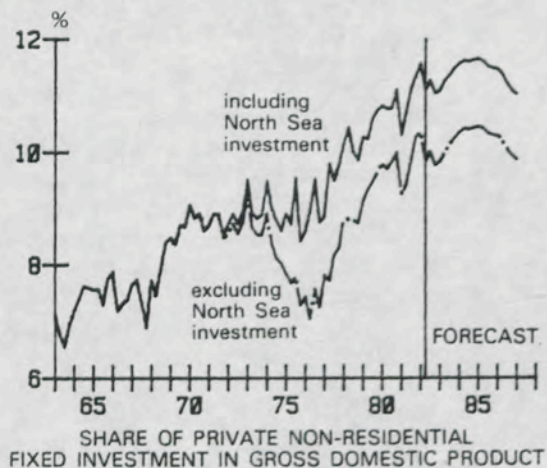
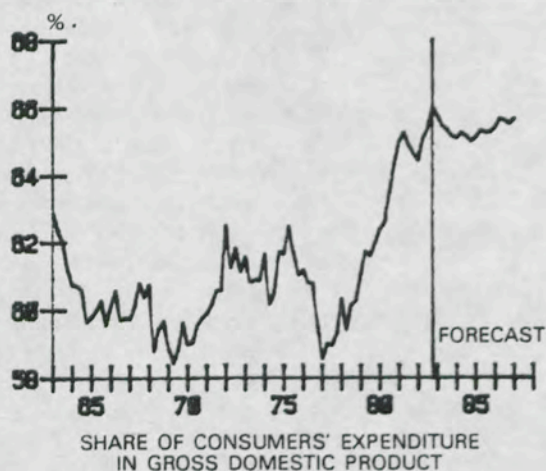
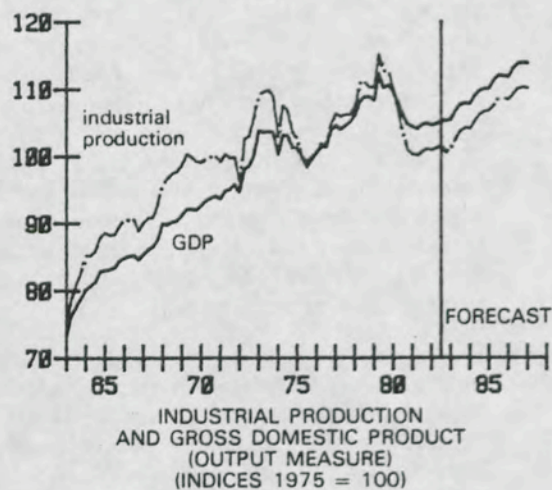
It is clear from Charts 1-5 that the uncertainty we attach to our current forecast is qualitatively very

different for different variables. For some variables our estimated precision is fairly uniform over the forecast period (e.g. Chart 5) whereas for others uncertainty grows quite rapidly (e.g. Chart 4 and to a lesser extent Chart 2). The explanations we have offered in the text are partly technical and partly economic. In particular our chosen measure of uncertainty relies heavily on unchanged economic policy. If indeed policy is as we assume then the standard errors presented here are a reasonable assessment of how accurate we can be as economic forecasters. However our simulations of the medium term outlook under different policy assumptions (see p.19) illustrate how great is the influence of policy on economic prospects. When "policy uncertainty" is taken into account the margins of error attached to our forecast are far greater than shown in Charts 1-5.

UK Sector Analysis

1. The Allocation of Resources

(see Appendix table 1)



All shares in this section are expressed as a percentage of GDP at market prices and are in volume terms (1975 prices).

Figure 1 The output measure of GDP rose by nearly $\frac{1}{2}$ per cent between the second and third quarters of 1982. This was despite a $\frac{1}{2}$ per cent fall in the expenditure measure in the same period. In the fourth quarter we estimate that the fall in expenditure was more than fully recovered but that output overall was little affected. For the forecast period we are assuming that output and expenditure will move in line. They rise only slightly in the current quarter, more quickly in the rest of the year. This translates into output growth of $2\frac{1}{2}$ per cent during 1983 and produces 1.8 per cent for the year as a whole. The recovery continues in 1984-6 during which GDP grows by nearly 2 per cent p.a. Industrial production in the latest month (November) was at the lowest level of the year. From this low base we expect industrial output to grow marginally more rapidly than total output. But even so it has not attained previous peaks by the end of the forecast period.

Figure 2 1982 ended with consumers' expenditure rising rapidly – by $2\frac{1}{4}$ per cent in the second half of the year alone – and thereby surpassing the previous peak (1979Q2 when spending was boosted by the pre-announced rise in VAT). As a share of GDP, consumers' expenditure is also at an all-time high, having raised its share by eight percentage points in the last five years. In 1983 we expect the growth of consumption to mark time in the first half of the year as some re-building of savings takes place. But in the second half of the year, helped by income tax reductions, consumer spending resumes its upward path. Over the forecast period its share of GDP is expected to be consolidated at around current levels.

Figure 3 Private non-residential fixed investment has also been increasing its share of total resources over the last five years (by about three percentage points) – only in 1981 did this category of investment record a fall and this was, we estimate, more than recovered last year. This is despite the weakness of manufacturing investment and reflects the comparative strength of investment within the personal and service sectors (where the growth of leasing has been an additional factor). In 1983 we expect the recent recovery in profits to produce a $2\frac{1}{4}$ per cent increase – a little more than the intentions surveys suggest – and a further $5\frac{1}{2}$ per cent in 1984. Some slowdown is forecast in 1985-6, as the recovery in profits tails off.

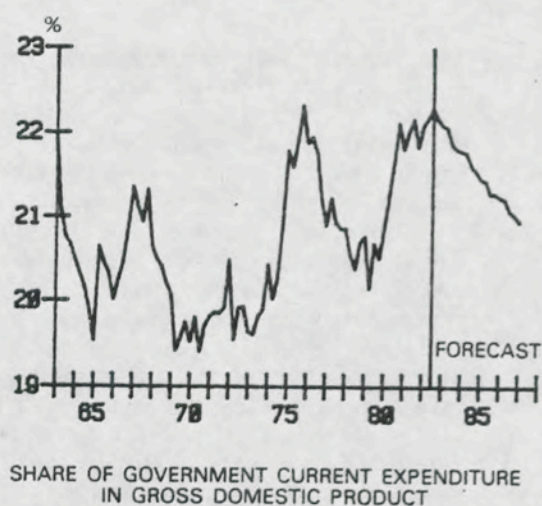


Figure 4 General government current consumption has also been growing more rapidly than GDP in the last few years, so that its share is back at previous peak levels. Within the total, however, the major categories of spending have moved rather differently – under the present government defence and the national health service have grown, education is unchanged and only the “other” category has actually shrunk. Over the forecast period we are projecting growth of public consumption of about ½ per cent p.a., rather less than either GDP or the historical trend. Within the total we expect some increase in the share of procurement (spending on goods and services produced outside the general government sector), little or no change in employment.

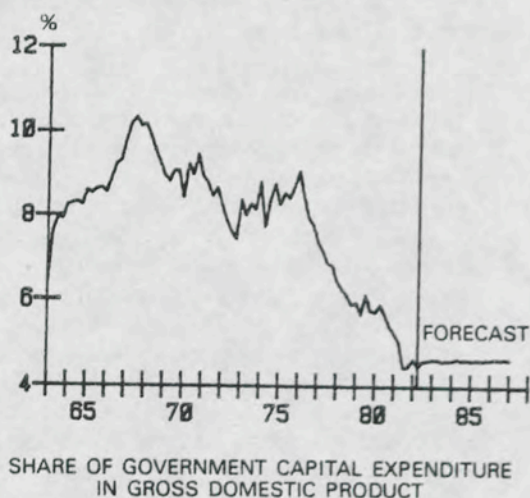


Figure 5 Recent trends in public sector fixed investment have been obscured by large increases in council house sales (which are measured as ‘negative’ public investment). However, even allowing for this effect public fixed investment as a proportion of GDP has fallen to very low levels by historical standards. The latest data (1982Q2) show that the decline in investment in the nationalised industries came to an end in the middle of 1981 but that it is still continuing in the rest of the public sector. We are forecasting a general revival in public investment which we assume will rise at about 2 per cent p.a. from now on. This is more or less in line with GDP which leaves the share stable at the recent, low level. Within the total general government investment is forecast to grow at about 2 per cent p.a., public corporation investment a little faster.

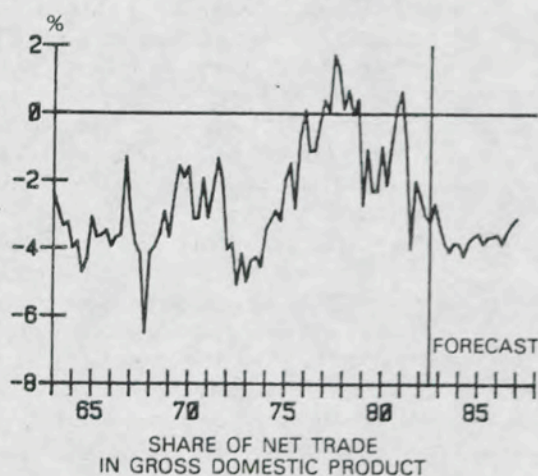


Figure 6 From the beginning of 1981 until the middle of 1982, erratic movements aside, imports grew more rapidly (or fell less rapidly) than exports. More recently, however, this trend has been reversed and at the end of last year exports were showing remarkable resilience in the face of a depressed world economy, while imports were falling, as UK industry continued its rapid destocking. Nevertheless we estimate that import volumes were 4 per cent higher in 1982 than a year earlier, whereas exports were unchanged. We expect this sort of gap to remain in 1983, with imports rising as destocking slows down. In 1984-6, however, exports should be benefiting from buoyant world demand and the recent improvement in competitiveness, so that by the end of the forecast period we expect a small positive contribution to GDP from net trade.

2. Prices, Costs and Earnings*

(see Appendix tables 2 and 3)

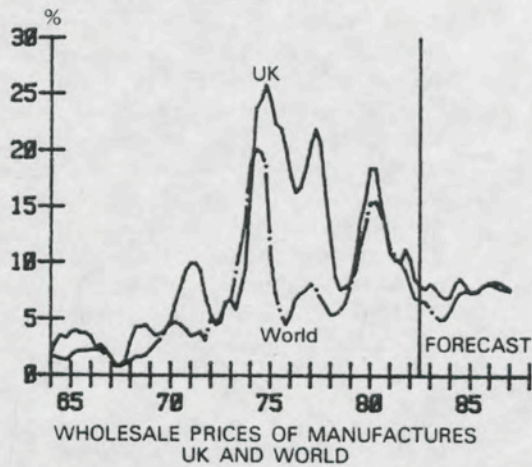


Figure 7 Over the 3½ years since the OPEC II oil price explosion, UK wholesale price inflation has moved broadly in line with (though somewhat above) world inflation. In the forecast period we expect world inflation to continue falling throughout 1983 and thereafter to rise to around 7-8 per cent. Initially we do not expect UK inflation to match the fall in world inflation, remaining 2-3 percentage points above the world rate – a consequence of the recent fall in the exchange rate. However we are not forecasting any substantial further falls in the pound, and in the later years of the forecast period UK and world inflation rates are forecast to come in line.

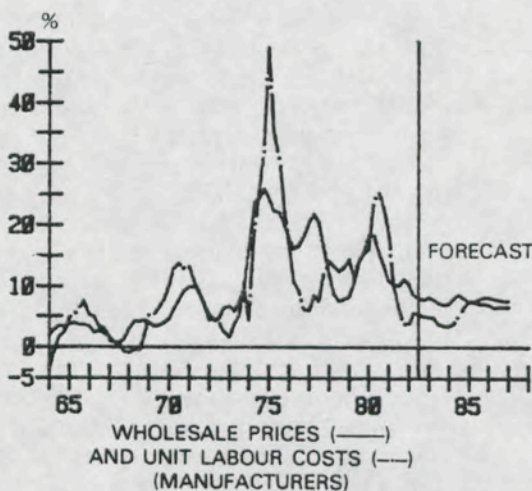


Figure 8 The profitability of UK manufacturing industry depends on the relative growth rates of manufacturing output prices and unit labour costs. Profits were severely squeezed after the second oil price shock as unit labour costs rose much more rapidly than prices. The response of industry was to cut costs (by negotiating lower wage settlements and by securing productivity improvements from a 20 per cent smaller labour force) so that by the end of 1981 unit labour costs in manufacturing were rising at a rate of under 4 per cent. The gap between output prices and unit costs narrowed during 1982 to about 2-3 per cent. We forecast that this difference will be maintained in 1983 and 1984 but that it will be eroded thereafter.

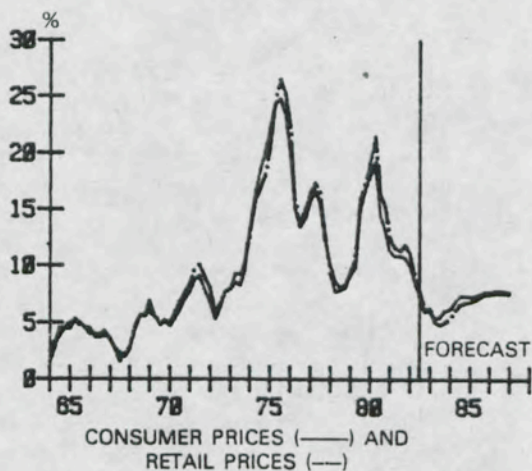


Figure 9 The chart shows the implied deflator for consumers' expenditure (CPI) and the retail price index (RPI). The two indices generally move very closely in line, but diverge noticeably when interest rates are changing rapidly. This represents a difference of treatment of mortgage payments as a result of which the inflation rate as measured by the RPI is likely to be below that of the CPI when interest rates are falling. Consumer price inflation is likely to continue falling for another six months and should reach a low of 5½ per cent this year. For retail prices a low of under 5 per cent may be achieved. By the end of 1983 we expect both measures to be moving upwards again, settling in the 6-8 per cent range in the upswing of the next cycle.

*All data in this section except Figure 11 are annual percentage changes.

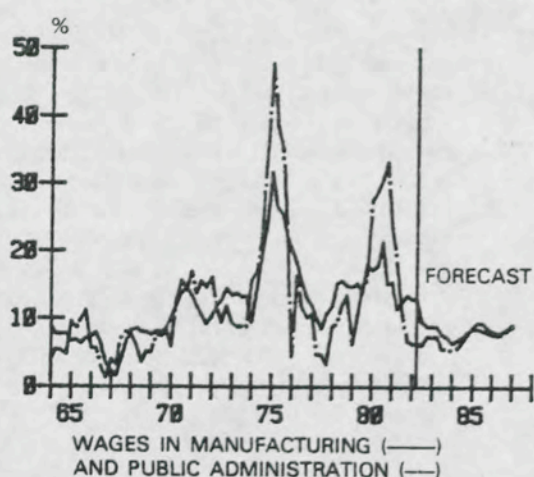


Figure 10 Although public and private wages tend to move in line over the medium term, there are periods of acute divergence. In the two inflationary surges of 1974-5 and 1979-80, for example, public sector wages rose far more rapidly than manufacturing – partly in order to ‘catch up’ with rates prevailing in the private sector. In the last pay round the reverse was true – wage rates moved more or less in line but less short-time and more overtime working in manufacturing pushed industrial earnings ahead. This is expected to persist in the current round although the discrepancy between the two sectors is expected to diminish. Towards the end of 1984 public and private sector wages are forecast to move in line.

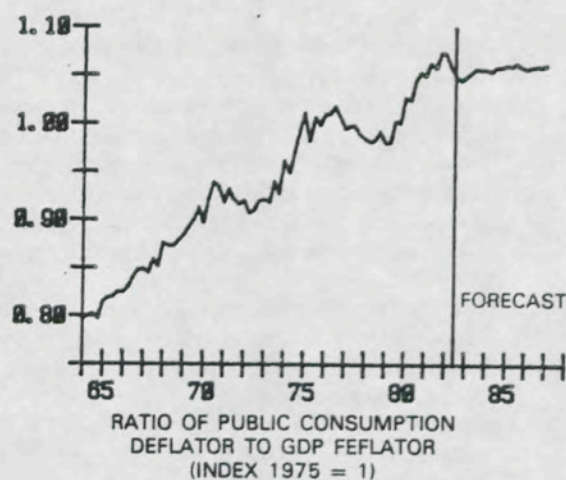


Figure 11 In the past twenty years the price of government consumption has tended to rise steadily relative to the GDP deflator. This ‘relative price effect’ (RPE) occurs because wage increases in the private sector are offset by productivity gains whereas in the public sector, where there is no independent measure of output, productivity gains are by convention non-existent. In general it is only possible to reverse the RPE by incomes policies which, in the UK experience, have been applied more firmly or for longer in the public sector. But, as in 1980 after the public sector catch-up following the Clegg awards, the process is usually reversed and a very strong RPE emerges. In the forecast we expect the operation of cash limits to exert downward pressure on public sector wages and, until the mid-1980s, keep the public consumption deflator in line with that for total GDP.

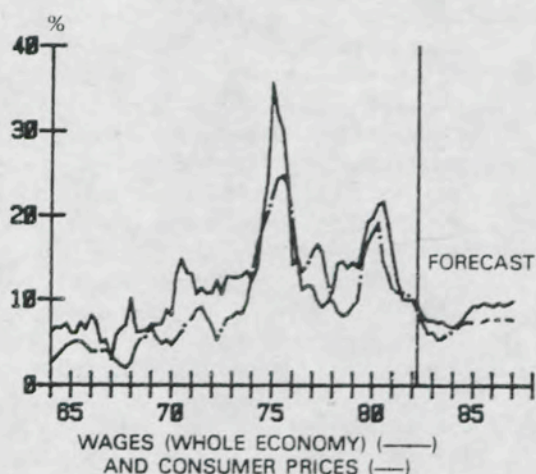


Figure 12 The gap between wage and price inflation measures the increase in real earnings for those in work. These rise in line with labour productivity in the medium term; within the cycle real wages tend to fall under the operation of an incomes policy or with high and rising unemployment (the level of real wages is also a determinant of the level of unemployment). Despite the depth of the current recession, however, real earnings have continued to rise in the last few years – although the rate of increase is below that of the 1970s. In the forecast we expect a level of unemployment approaching 3¼ million to hold back real earnings growth to around one per cent per annum.

3. Employment and Unemployment

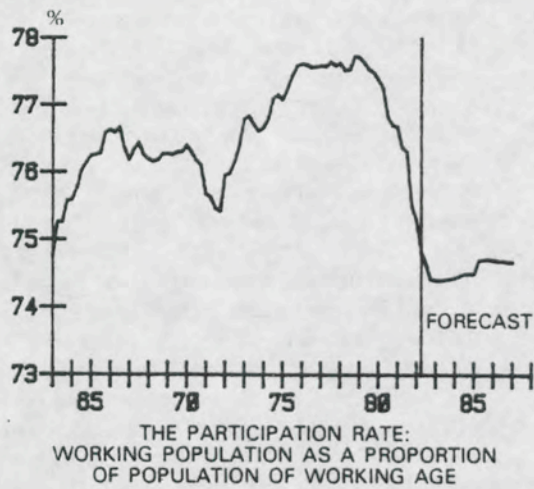


Figure 13 The participation rate shows the proportion of the population of working age who are working or registered as seeking work. Revisions to employment data show that the steep fall in the ratio since 1979 has not been as pronounced as previously shown. In the later years of the forecast we expect unemployment to stop rising and, reflecting revised employment data and forecasts, we expect the participation rate to settle at around 74-75 per cent.

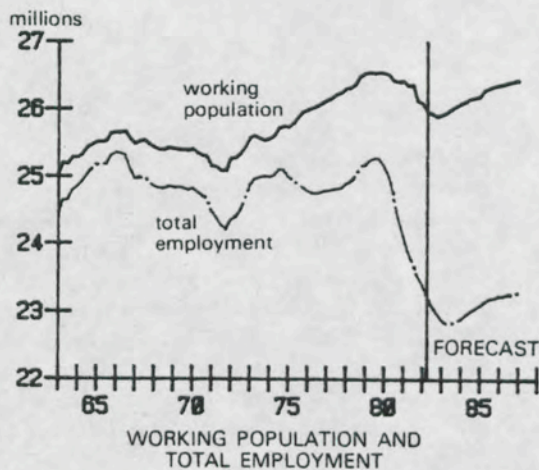


Figure 14 Following the 1981 Labour Force Survey the figures for total employment have been revised upwards by some 800,000. The "discovered workers" were found mainly in the "other employment" sector shown in Figure 18. The figures for the working population have also been revised upwards in line. The population of working age is forecast to grow by about 600,000 over the forecast period, the working population by around 400,000 and the employed labour force by only 75,000. The employed labour force has fallen rapidly since its cyclical peak in the third quarter of 1979. Even by the end of the forecast, total employment is expected to be over 2 million below its highest 1979 level.



Figure 15 The Department of Employment has recently changed its method of calculating the total number of unemployed. The new definition uses the more accurate computer count of those receiving benefits instead of the manual count of those registering as unemployed. As a result the November 1982 figure on the new measure was lower by some 190,000 than on the old basis. This introduces a break on the chart in the fourth quarter of 1981 (as marked). The figures do not include school leavers of whom about 300,000 are currently unemployed. In the forecast we expect unemployment to peak on the new measure at about 3.2 million at the beginning of 1984, thereafter retaining a fairly flat profile around the 3.1 million mark.

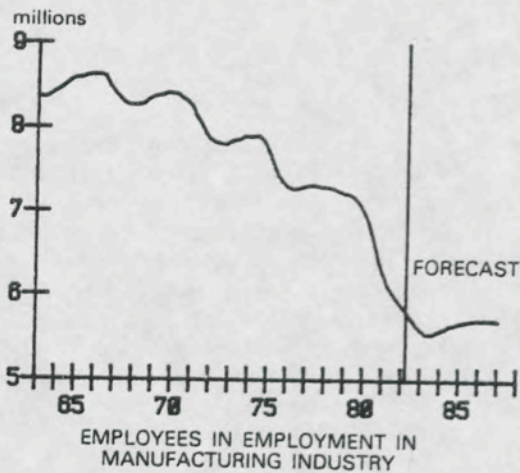


Figure 16 The rise in unemployment is largely associated with the collapse of employment in manufacturing, although employment has fallen in all three main sectors of the economy. Manufacturing employment has been declining since the mid 1960s. Typically, after each cyclical downturn less than half the loss of manufacturing employment has been regained during the subsequent recovery. The falls in both manufacturing output and employment have been unusually dramatic in the current cycle (manufacturing output has fallen more than in the 1930s and manufacturing employment has fallen 21 per cent during the government's period of office). We expect the decline to be arrested by the middle of this year as prospects for the manufacturing sector improve following the recent fall in the exchange rate. Thereafter manufacturing employment grows at approximately 1 per cent per annum to a level of 5.7 million by 1985.

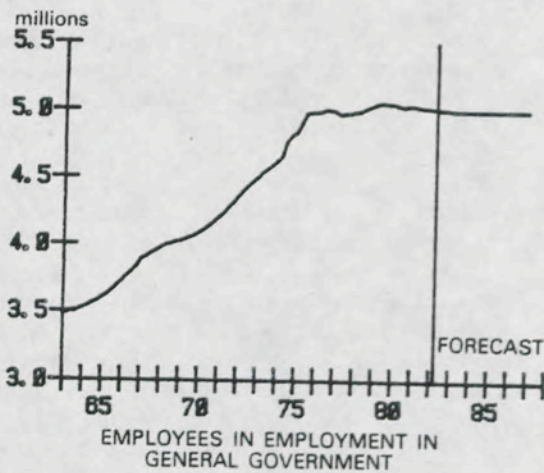


Figure 17 General government includes central government and local authorities but excludes public corporations. In the 1960s and 1970s general government employment expanded rapidly - particularly in local authorities and the National Health Service. This trend was broken following the 1976 sterling crisis. Subsequently government employment was broadly stable until the present recession during which it has fallen by about 1 per cent. Over the forecast period we expect general government employment to remain broadly flat.

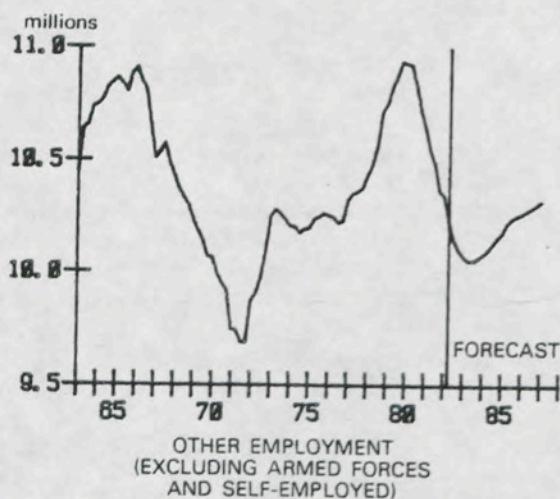


Figure 18 The category 'other employment' now covers almost one half of total civilian employment against 28 per cent in manufacturing and 24 per cent in general government. It includes employment in the service sector, public utilities, construction, agriculture and North Sea oil. The proportion of female and part-time workers in this sector is high and labour released elsewhere in the country has often been absorbed into it. Employment in this category has fallen 7¼ per cent from its 1979 peak. We expect a further 1 per cent fall in 1983 and growth thereafter of about 1 per cent p.a.

4. The shares of national income: wages and profits

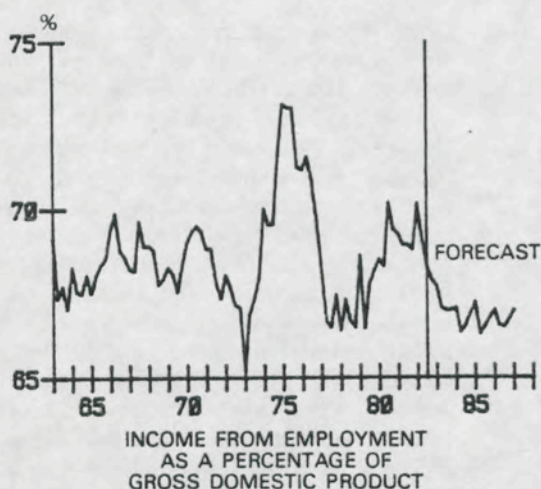


Figure 19 The share of employment incomes in GDP moves counter-cyclically, tending to be high when economic activity is depressed and low when demand is buoyant. The wage share peaked in late 1980/early 1981. It has since declined significantly. This decline is expected to continue during the recovery phase of the current cycle, mirroring the pattern observed from the mid-1970s onwards. Important influences are the more modest rate of wage increases and falling employment. This means that part of the expected recovery in output helps corporate profits. North Sea activities also boost profits and depress the wage share over the forecast period.

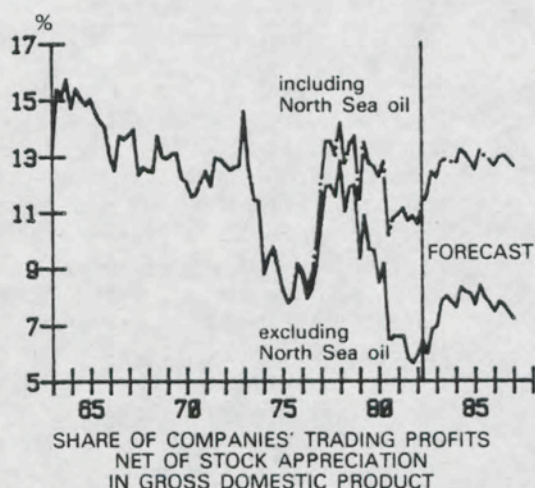


Figure 20 The share of profits in GDP is largely the obverse of the share of wages and salaries (incomes from rent and self-employment tend to be stable at about 16-17 per cent of GDP). When the share of employment incomes increased during 1980 the profits share fell sharply. The share of profits (excluding stock appreciation and profits earned in the North Sea) has recovered somewhat to around 6 per cent and is projected to rise further - to a level approaching 8 per cent - over the next eighteen months. This rise would leave the share of non-oil profits at a low level by historical standards. For non-oil companies the peak share of profits is likely to be achieved in the course of 1985. By the end of the forecast period about 40 per cent of profits earned in the UK are expected to come from the North Sea.

The Shares of National Income

Annual percentage changes	1982	1983	1984	1985	1986
Income from employment	5.5	5.5	8.2	10.4	9.9
Company profits (exc. stock appreciation)	11.2	19.9	11.3	9.8	9.8
Company profits (exc. stocks & North Sea oil)	9.8	31.0	14.3	9.1	4.8
Public sector profits	16.5	20.5	13.0	12.0	10.0
Rent & self-employment income	7.0	8.1	8.8	10.3	9.4
Gross domestic product (current prices)	7.1	7.7	8.9	10.3	9.8
Deflator for GDP	6.9	6.2	6.8	8.2	8.2
Share of profits (levels %)	11.5	12.7	13.0	12.9	12.9

5. Real Incomes, Savings and Consumption

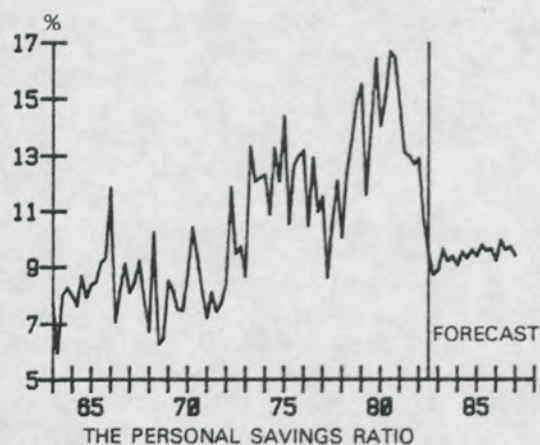


Figure 21 Consumption patterns tend to change rather slowly in response to changes in real incomes. Hence when real incomes rise (as in 1977-80) the savings ratio goes up. The fall in the savings ratio since 1980 partly reflects the squeeze on real incomes. It is also linked to the fall in the rate of inflation and to the fall in interest rates. The rapid fall in the rate of inflation in 1982, and the continued squeeze on real incomes produced a further sharp fall in net personal savings, which was achieved mainly by a large increase in borrowing. We estimate that the savings ratio fell below 9 per cent in the fourth quarter of 1982, but we expect some rebound this year when real incomes are boosted by the Budget measures. Over the forecast period as a whole, when real income growth is a fairly steady 1½-2 per cent and inflation stays in the 6-7 per cent range, we expect the savings ratio to remain close to 9 per cent.

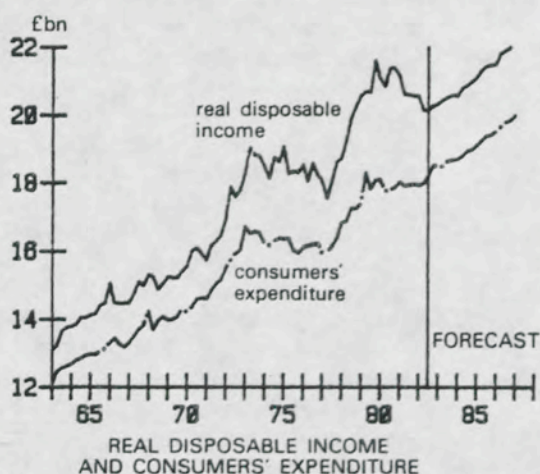


Figure 22 Real disposable incomes have fallen over the past two years by over 5 per cent – broadly in line with the fall in total employment. The real income of those in work is little changed. Over the forecast period we expect real incomes to start rising again, as the rate of inflation falls below the rate of increase in wages and the decline in employment slows to a halt. The pick up is modest in 1983 – despite the assumed cuts in personal taxation and the less-than-complete revalorisation of specific duties – mainly because the fall in employment is still substantial. But in later years the growth of real disposable income accelerates, as employment stops falling, and consumers' expenditure rises in ~~time~~

Personal Disposable Income: Key Elements

Annual percentage changes	1982	1983	1984	1985	1986
Wages and salaries	5.6	5.5	8.2	10.4	9.9
Current grants	14.2	10.5	8.5	7.5	7.8
Other personal income	4.9	6.9	9.1	10.6	9.8
Total personal income	6.6	6.5	8.4	10.0	9.6
UK tax on income – personal sector	9.5	2.3	6.0	8.4	5.7
Disposable income	5.6	6.8	8.7	10.2	10.1
Deflator for consumption	8.0	5.8	7.0	7.5	7.8
Real disposable income	-2.2	1.0	1.6	2.5	2.2
Consumption	1.1	2.3	1.5	2.3	2.2
Personal savings ratio (levels)	10.5	9.3	9.4	9.6	9.6

6. The Fiscal Structure

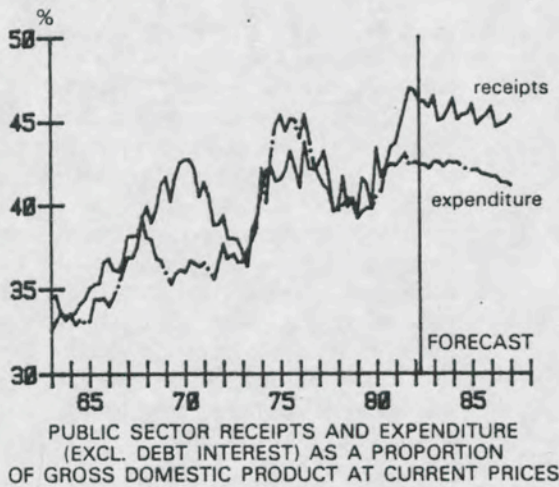


Figure 23 During the life of the present government the public sector deficit has been reduced despite a major recession which has tended to lower receipts and increase expenditure. Figure 23 shows that this reduction has been brought about mainly by an increase in taxes. Over the forecast period we expect a reduction in tax rates, so that total revenue falls slightly as a share of GDP even though it would normally tend to rise during a recovery period. The share of public expenditure also falls, mainly because it grows slightly less rapidly than GDP in volume terms.

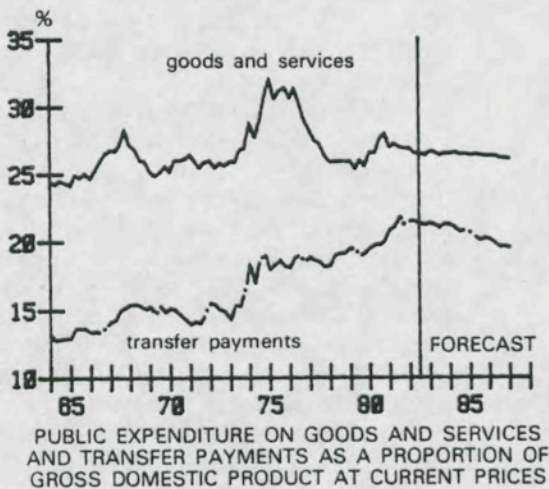


Figure 24 Although the 1980-82 recession has been as severe as that of 1974-5, the share in GDP of public expenditure on goods and services (which tends to go up in recessions) has not risen nearly as sharply. This mainly reflects the repeated cuts in public investment, which has fallen sharply as a share of GDP (see Figure 5). Public consumption has been relatively unscathed. Transfer payments (pensions, unemployment pay, debt interest and subsidies) have taken a steadily increasing share of GDP over the years. They have risen particularly rapidly during the present recession, reflecting the sharp increase in the number of unemployed, and the high interest payments on public sector debt. Over the forecast period we expect public expenditure on goods and services to rise, but less rapidly than GDP. Transfer payments fall significantly as a share of GDP because unemployment stops rising while interest payments and subsidies are stable or falling in real terms.

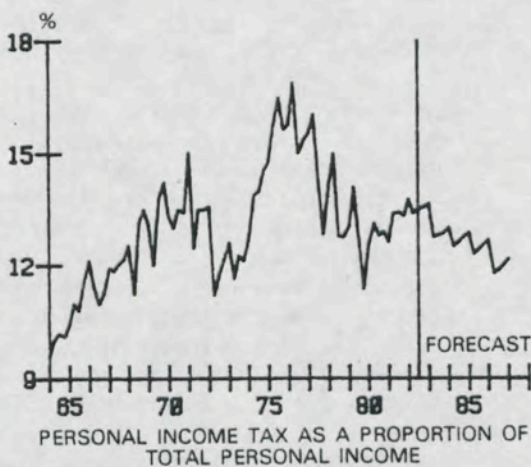


Figure 25 Taxes on income, expressed as a share of total personal income (employment income, rent dividends and interest, self-employment incomes and grants) fell steadily in the late 1970s, culminating with the substantial cuts in tax rates implemented in the first Conservative Budget. Over the past two years the personal tax burden has risen again, most notably because of the decision not to implement the Rooker-Wise increase in personal allowances in 1981. We assume that some of this fall in the real value of personal income tax allowance will be made good in the coming Budget and that in later years allowances will be indexed in line with inflation. We also assume that there will be repeated cuts in the basic rate of income tax, bringing it down to 25 per cent by 1986-7. As a consequence the personal tax burden falls from 1983 onwards.

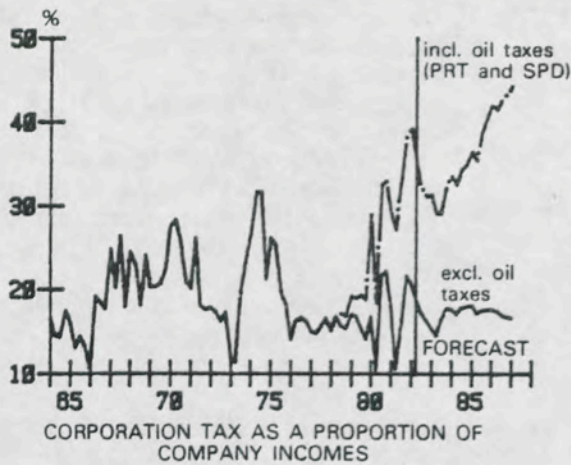


Figure 26 Corporate tax is paid in arrears, so that in recession years the company sector pays a high proportion of its current income in taxes which reflect the profits earned before the recession. This explains the peaks in the corporate tax burden in 1970 and 1974-5. In the present recession profits have moved erratically, recovering in 1981, falling back in the first half of 1982 and recovering sharply in the second half, and their movements are reflected in the corporate tax ratio. The recent fall in the tax burden of the non-oil corporate sector is expected to continue this year as profits go on rising. In later years, however, we are forecasting a steady increase in the tax burden on oil companies as an increasing proportion of oil revenue is taxed at the marginal PRT rate.

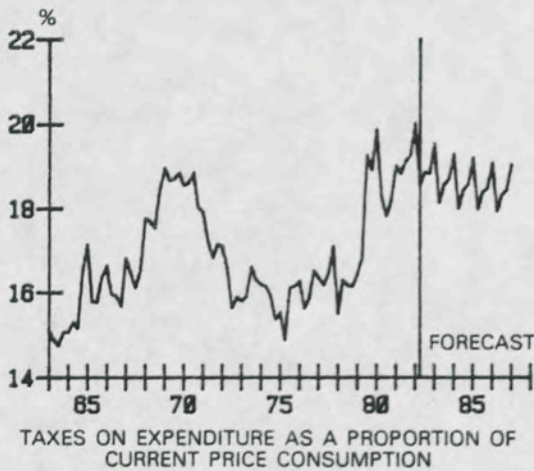


Figure 27 Taxes on consumers' expenditure (VAT plus specific duties) rose sharply as a proportion of consumers' expenditure following the increase in the VAT rate from 8 to 15 per cent in 1979. The ratio has moved erratically over the past two years as consumers have adjusted their patterns of expenditure to the new tax regime. Over the forecast period we assume a constant VAT rate. We have however departed from our usual assumption that specific duties are uprated in line with inflation: for 1983 we assume only partial uprating (see Assumptions, p. for details) and this implies a fall in the percentage of personal consumption that is taken in tax. In later years we assume that full indexation occurs at Budget time (which produces a pronounced seasonal pattern in the ratio). Because the income elasticity of goods bearing specific duties is less than unity there is a fall in the percentage of consumer spending taken in tax over the forecast period.

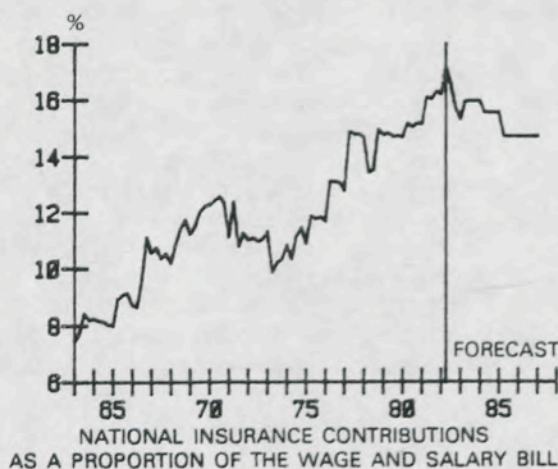


Figure 28 Because the National Insurance fund is largely self-financing, increases in pensions and (especially recently) increases in the number of unemployed, have required an increase in contribution rates. The percentage of wages and salaries paid in National Insurance contributions (including the Surcharge) has thus risen steadily over the years and rose further in 1982 (despite the Budget reduction in the Surcharge) when contribution rates went up again. We expect another increase in the ratio when National Insurance contributions go up again in April, but in later years we expect no further change (because the National Insurance fund stays in balance at present rates when unemployment stops rising). We are, however, assuming the abolition of the National Insurance Surcharge in two stages, and it is this which brings down the ratio in 1984 and 1985.

7. Sector Flows and Monetary Behaviour

(see Appendix tables 5, 6 and 7)

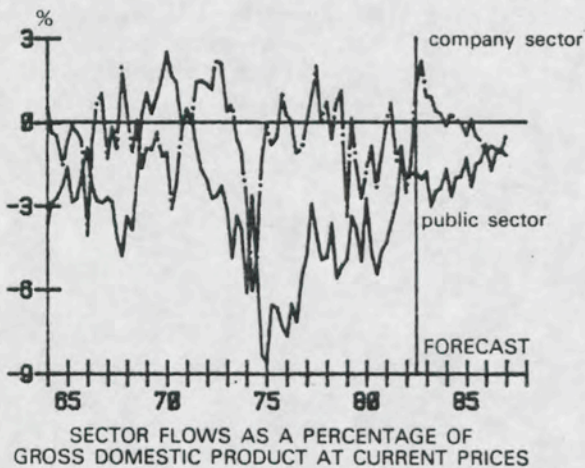


Figure 29 An important feature of the recent UK recession has been the effort made by the public and corporate sectors to improve their financial positions. The government has raised taxes while companies have cut back expenditure. The resulting fall in demand partly frustrates their attempt by reducing profits and tax receipts and boosting social security payments. Despite this industrial and commercial companies (ICCs) switched from a deficit of £1.4bn in 1980 to a £1.0bn surplus in 1981. The public sector's deficit fell £2½bn in the same period. In the forecast period we expect the ICCs to be in surplus until 1985 and in balance thereafter. For the public sector we expect little further reduction in its deficit over the next eighteen months because we are assuming that taxes will be cut in the 1983 and 1984 Budgets. From late 1984 we expect some decline in the public sector deficit as demand boosts tax receipts.

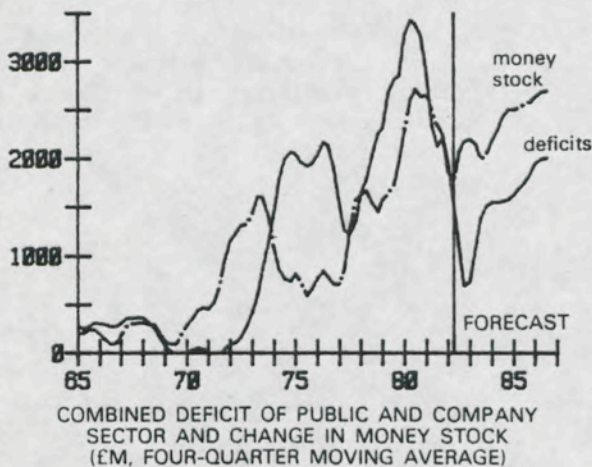


Figure 30 To the extent that deficits in the public and company sectors are financed through the banks, they have a direct influence on monetary growth. The chart compares the combined deficit of the two sectors with the change in the money stock (both variables are shown as 4-quarter moving averages). The largest discrepancy between the combined deficit and money growth is between 1974 and 1977, when personal sector bank borrowing was particularly depressed. Over the forecast period we expect monetary growth to exceed the combined deficit. This partly reflects fairly rapid growth of personal borrowing to finance consumption.

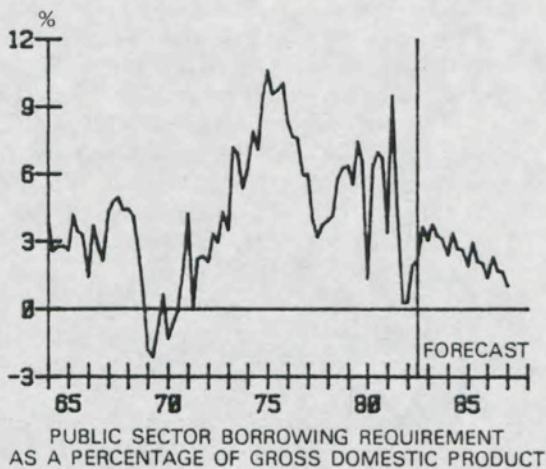


Figure 31 The PSBR is expected to fall as a proportion of GDP throughout our forecast period. This reflects our assumption of public spending growth slower than GDP and of only very modest tax cuts. The projected PSBR is slightly above the figures in the Medium-Term Financial Strategy.

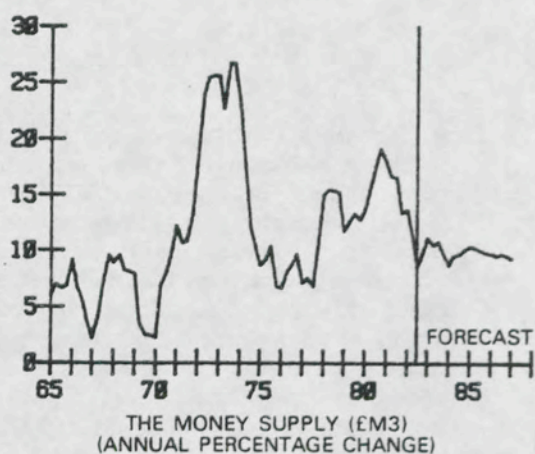


Figure 32 We expect growth in sterling M3 to be within the government's 8 to 12 per cent range for the current target period. In later years, growth slows further - to about 9½ per cent in 1986. This reflects a lower demand for finance from the public sector, stable real company loan demand until 1984 with some rise thereafter, and continued fairly rapid personal bank borrowing.

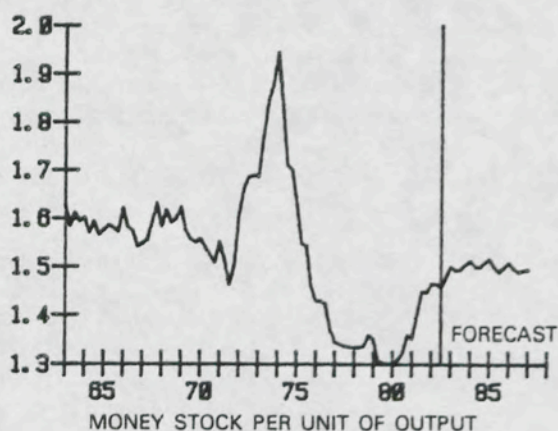


Figure 33 The stock of money (£M3) per unit of output (GDP at market prices) has risen nearly 10 per cent over the past two years. This fall in the velocity of circulation reflects declining inflation and continued recession at a time of fairly rapid monetary growth. We do not expect further substantial falls in velocity. Instead we expect it to stabilise around current levels.

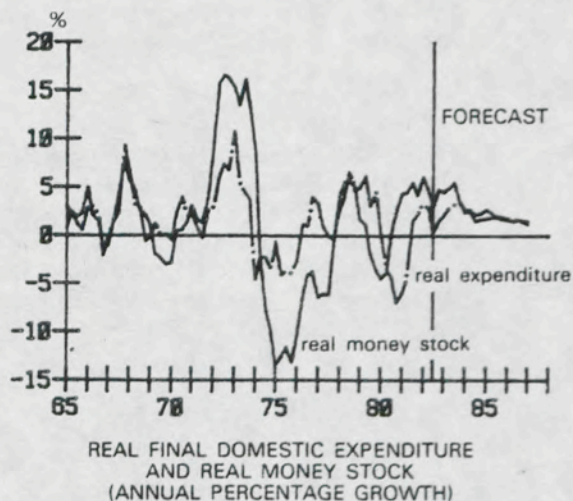


Figure 34 Changes in real final expenditure tend to be less volatile than previous changes in the real money stock. The relationship can also be disturbed by sharp changes in interest rates. Thus two years of high real interest rates and a high rate of return on money itself have reduced the expenditure response to the rapid monetary growth of 1980-1. But interest rates have now fallen and the distortions should begin to unwind. In the forecast period the real money supply should re-establish itself as a robust leading indicator of final expenditure.

8. The Company Sector

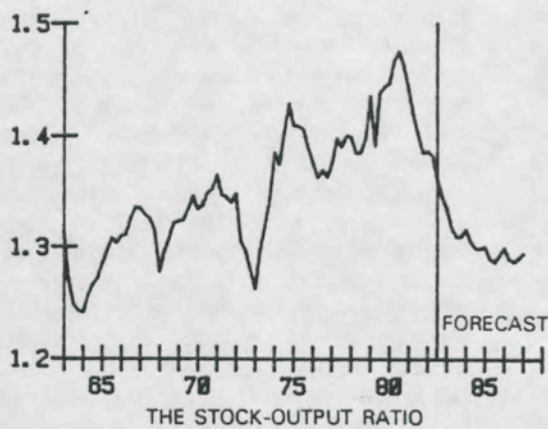


Figure 35 The chart shows the ratio of stocks to quarterly GDP. The ratio tends to rise in recessions and fall during recovery periods. This ratio fell relatively little during the weak recovery of 1978-9. This was probably partly due to frustrated expectations of a stronger recovery and partly due to tax relief on stockholdings. The ratio rose at first in the 1980 recession. Massive destocking has subsequently brought it down. We expect some further fall over the forecast period to around the levels recorded in the 1960s and early 1970s. The lower share of manufacturing output in GDP and improved stock-keeping methods suggest that further falls from present levels are still possible.

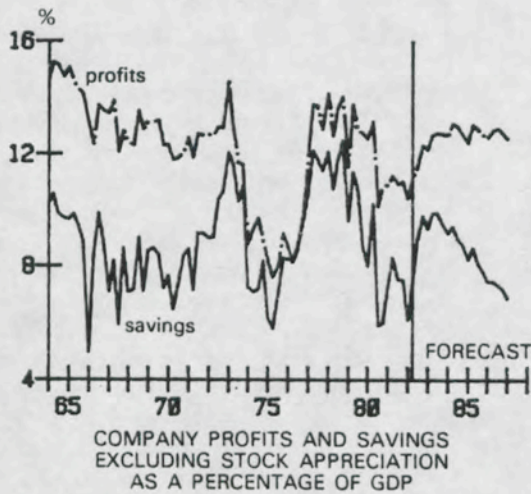


Figure 36 Company savings are equal to company profits plus other corporate income less expenditure on dividends, interest and taxes. The chart shows that profits are the main determinant of savings (both are measured net of stock appreciation) but the downward trend is less evident in savings than in profits. However savings and profits are subject to large cyclical swings. Both have fallen in the present recession. Both are currently recovering as economic activity picks up. However, the chart shows that savings (as a proportion of GDP) are expected to fall after 1984 despite stable profits. This mainly reflects higher tax, interest and dividend payments.

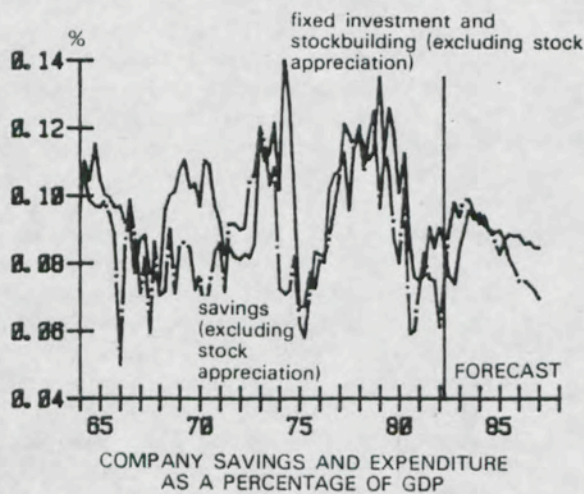


Figure 37 Companies' savings and their capital expenditure have moved fairly closely together over the historical period shown. In 1983 and 1984 we expect the rise in savings to be reflected in a rise in investment, an end to destocking and some modest stockbuilding. From 1985 company savings fall as a percentage of GDP. We expect the growth of expenditure on fixed investment to continue, financed by increased borrowing.

9. The Balance of Payments — export and import volumes

(see Appendix tables 8, 9 and 10)

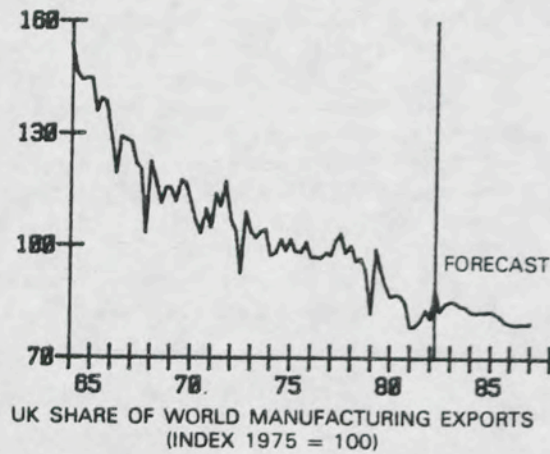


Figure 38 UK manufacturing exports ended 1982 reasonably strongly, and the 1982 average was unchanged on the previous year. This was at a time when, we estimate, total world trade in manufactures contracted by about 5 per cent. Relative to the historical trend of a declining share of trade UK manufactures did exceptionally well last year, especially as the fall in the exchange rate only occurred at the end of the year. The improvement in competitiveness notwithstanding, we do not expect this performance to be maintained during the world recovery — UK manufacturers have historically performed relatively well during world downturns, relatively badly in recovery periods. Over the next four years we expect world trade growth of 3½ per cent p.a. and UK export growth of 2 per cent p.a.

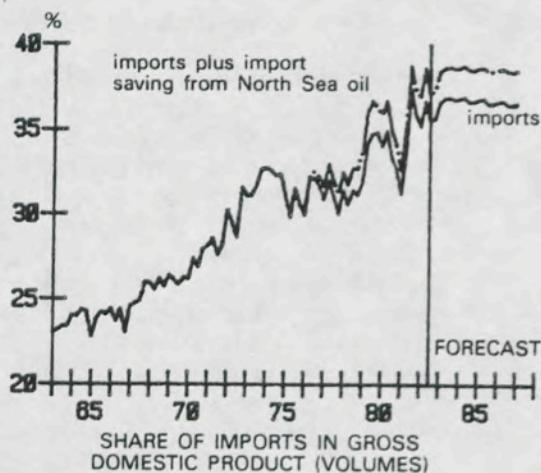


Figure 39 The share of imports in GDP grew steadily in the 1960s and early 1970s. Some stability accompanied the weakness of sterling in the mid 1970s but, with UK output falling more sharply than the rest of the world during the current recession, the import share has risen further. Over the last six months, however, the economy has begun to recover while import volumes have been falling. We expect the most recent trend in imports to be reversed in early 1983 as the renewed bout of destocking comes to an end. By the end of the year imports and GDP should be rising at about the same rate, so that no further increase in the import share is recorded in the latter part of the forecast period.

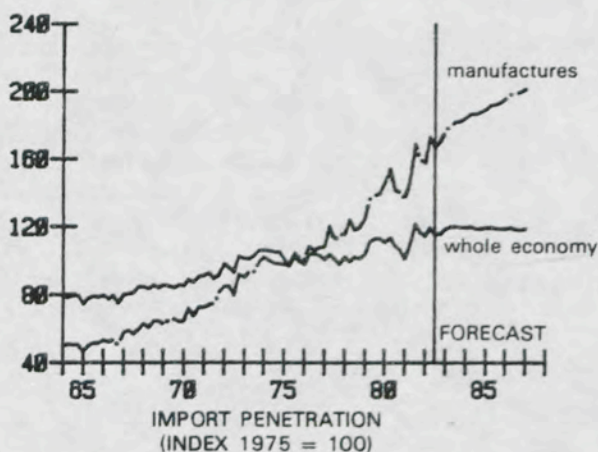


Figure 40 The chart shows, in index form, the ratio of total imports to total output and also the ratio of imports of manufactures to manufacturing output. Over the last twenty years there has been an upward trend in total import penetration. The more pronounced trend in manufactures shows that import penetration is largely a manufacturing phenomenon. Import penetration was reversed in the 1980 recession but this was a temporary pause linked to the rundown of stocks. As destocking came to an end and output started to recover, import penetration rose again and for manufacturing reached new peaks. From now on we expect the upward trend to be resumed in manufacturing although this will be offset for the economy as a whole by North Sea oil. As shown above we expect little change in the degree of import penetration overall.

10. The Balance of Payments — the terms of trade

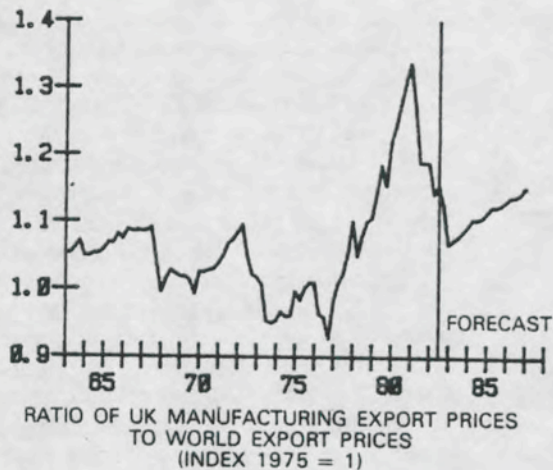


Figure 41 The chart shows UK competitiveness as measured by the ratio of UK export prices to competitors' prices. After the exchange rate appreciation over the period 1977-81, and the rapid rise in domestic costs, UK export prices were well out of line on international markets, and the subsequent fall in the exchange rate has been taken as an opportunity to improve price competitiveness. We forecast that the recent fall in the exchange rate will produce a further improvement but the equilibrium level of relative prices is now, because of oil, higher (less competitive) than in the past. In the medium term we expect UK export prices to rise faster than competitors, implying a deterioration in export price competitiveness despite a small fall in the exchange rate.

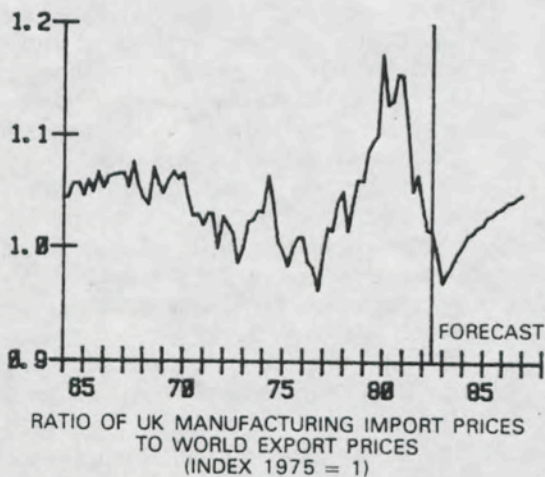


Figure 42 The price of UK manufacturing imports is closely linked to the average world price of manufacturing exports. However, there is some tendency for those exporting to the UK to reduce their prices in foreign currency terms when sterling falls (in order to match the lower prices of domestic suppliers) and to put up their prices when sterling rises (taking advantage of the easier competitive position to boost their profits). This pattern was evident in sterling's appreciation in 1979-80 and its fall in 1981. We expect the recent fall to have a similar effect, but not to the same extent, as importers' profit margins are now lower. Over the forecast period we expect the ratio to rise as margins are rebuilt.

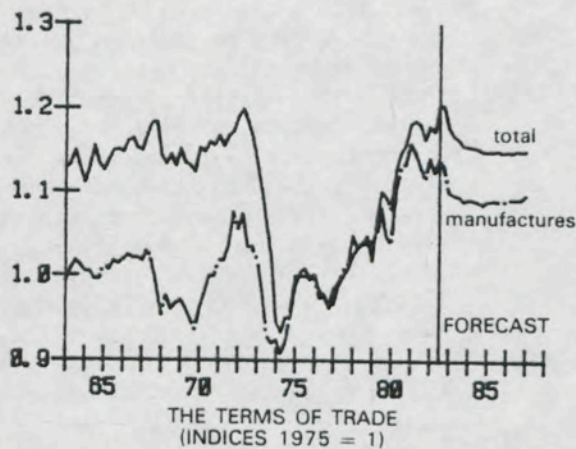


Figure 43 The terms of trade in manufactures, which is the ratio of the two preceding charts, depends in the short term on the effect of exchange rate movements on the relative profit margins of exporters and importers. A rise in the exchange rate has historically tended to squeeze importers' profit margins more than exporters' and resulted in an improvement in the terms of trade. A fall in the exchange rate similarly has tended to worsen the terms of trade. This happened when the exchange rate fell in 1981 and we expect it to happen again following the recent fall. However, the expected deterioration still leaves the terms of trade (manufacturing and total) much better than in any previous post-war cycle, an improvement which is explained by the move to self-sufficiency in oil.

11. The Balance of Payments — exchange rate and competitiveness

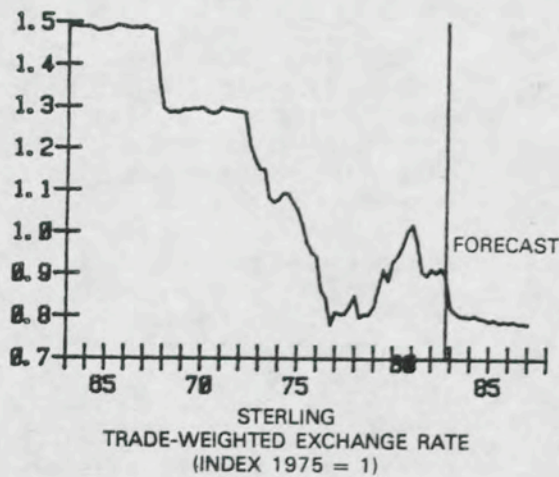


Figure 44 The 15-month stability of the exchange rate came to an end last November – in the three months from the end of October to the end of January sterling fell 12-13 per cent against the basket of currencies, 8-9 per cent against the US dollar. Factors underlying the recent weakness include weaker oil prices, lower UK interest rates and projections of a current account deficit by the end of 1983. As a result of the depreciation, however, UK competitiveness is no longer out of line and domestic fiscal and monetary policy remain reasonably tight. On the assumption of no change in policy and erratic short-term movements apart, we expect sterling to be more or less stable at its current level over the next four years.

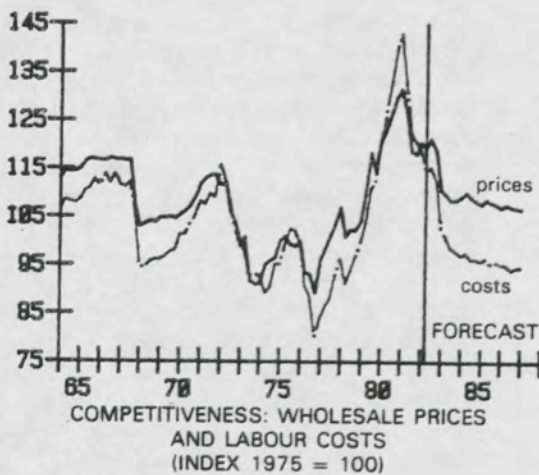


Figure 45 The recent depreciation of sterling has boosted the competitiveness of UK industry just as it did in 1981. As a result both sterling and competitiveness are back at about the levels which the government inherited in May 1979. On the cost side the improvement has been supplemented by the reduction in the national insurance surcharge. From now on we expect UK costs and prices to move in line with those in other countries so that competitiveness is little changed over the forecast period. Some improvement on the price side follows the modest sterling fall which we project; on the cost side our assumption of a reduction and then the abolition of the NIS provides further gains.

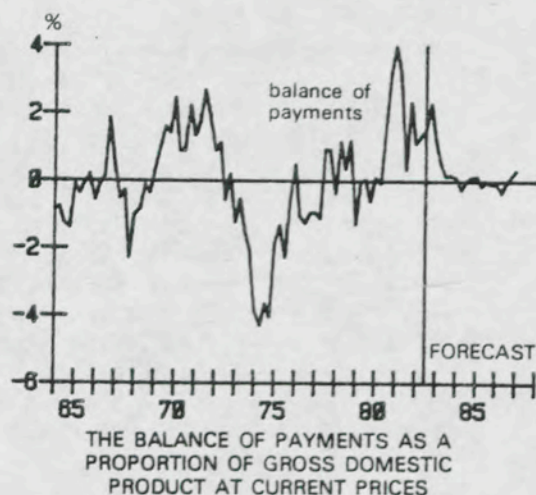


Figure 46 The chart shows the current account as a percentage of GDP. From 1975 to 1981 there was a fundamental improvement in the current account, initially due to North Sea oil revenues and subsequently to the reduction of imports in conjunction with the 1980-2 stock rundown. More recently exports have been at record levels while imports have been falling so that the current account surplus for 1982 passed £4½bn. In 1983 the combination of J-curve effects following the fall in sterling, the boost to imports from the end of destocking and the relative weakness of our main European trading partners is expected to eliminate the surplus. Thereafter we expect modest deficits in 1984-5 and a return to surplus by the end of 1986.

APPENDIX: Sector Analysis Tables

The allocation of resources

Table 1

Annual percentage changes	1982	1983	1984	1985	1986
Consumption	1.1	2.3	1.5	2.3	2.2
Government current consumption	1.7	0.9	0.6	0.6	0.6
Public investment	-3.8	2.8	2.0	2.2	2.1
Private residential investment	10.7	12.0	4.7	-2.3	0.2
Private non-residential investment	4.1	2.5	4.8	1.7	-0.7
Change in stocks as % of GDP	1.0	0.8	0.4	0.1	0.1
Domestic expenditure	1.8	2.6	1.9	2.0	1.6
Exports	-0.1	1.7	1.5	2.4	1.8
Imports	4.1	4.6	2.0	1.8	1.3
Factor cost adjustment	1.9	3.3	1.6	2.7	2.6
Gross domestic product	0.5	1.8	2.0	2.0	1.6

Prices, costs and earnings

Table 2

Annual percentage changes	1982	1983	1984	1985	1986
World price of exports of manufactures	7.0	5.3	6.8	7.7	8.2
Effective exchange rate	-4.7	-10.8	-1.2	-1.1	-0.5
UK export price of manufactures	7.6	11.1	10.8	10.6	10.3
Wholesale price index - manufacturing	8.6	7.5	8.0	7.7	7.9
Productivity in manufacturing industry	5.1	3.1	2.2	-8	1.1
Average earnings in manufacturing	11.0	8.1	7.2	8.3	8.0

Table 3

Annual percentage changes	1982	1983	1984	1985	1986
Income from employment	5.5	5.5	8.2	10.4	9.9
Gross Domestic Product	0.5	1.8	2.0	2.0	1.6
Wage cost per unit output (Exc. North Sea Oil)	5.5	3.9	6.2	8.3	8.3
Deflator for GDP	6.9	6.2	6.8	8.2	8.2
Terms of trade	1.0	-2.1	-1.1	-0.3	0.0
UK import prices	6.7	13.0	10.8	10.3	10.8
Tax rate on final expenditure	10.8	-0.3	5.0	3.9	5.8
Consumer prices	8.0	5.8	7.0	7.5	7.8

Investment and stockbuilding

Table 4

Annual percentage changes	1982	1983	1984	1985	1986
Private non-residential investment (including oil)	4.1	2.5	4.8	1.7	-0.7
(excluding oil)	3.6	2.8	5.4	1.9	-0.8
Housing investment (total)	9.2	8.0	3.7	-0.8	0.8
Ratio of company fixed investment to GDP (current prices - annual ave.)	9.3	9.0	9.1	8.6	8.4
Stock level (quarterly average £b)	33.9	33.2	33.6	33.9	34.4
Gross domestic product (quarterly average £b)	24.8	25.2	25.7	26.2	26.7
Stock-output ratio	1.37	1.32	1.30	1.29	1.29
Stockbuilding (annual total £m)	-859	-44	333	441	509

The borrowing requirement and monetary behaviour

Table 5

Quarterly average	1982	1983	1984	1985	1986
Real money balances (£b)	36.6	38.2	39.1	40.0	40.6
Money supply/income ratio	1.47	1.50	1.50	1.50	1.50
Real domestic expenditure (£b)	28.6	29.5	30.1	30.7	31.1
Percentage change					
Real money balances	4.6	4.6	2.4	2.2	1.6
Real domestic expenditure	1.9	2.9	2.1	1.9	1.6
Nominal money supply (end year, £b)	86	94	104	114	125
Borrowing requirement as % GDP at market prices (fiscal year)	2.7	3.1	2.6	2.1	1.7

Table 6

Annual percentage changes	1982	1983	1984	1985	1986
Nominal GDP – expenditure estimate	8.0	8.1	9.0	10.4	9.9
Public sector current receipts					
Income taxes – total receipts	11.8	3.4	9.5	10.7	8.8
Expenditure taxes – total receipts	9.5	2.6	6.5	6.9	8.5
National Health and Insurance contributions	13.4	11.0	9.4	10.4	9.9
Public sector – current expenditure					
Current spending – goods and services	8.2	6.8	7.8	9.3	8.7
Subsidies	-12.0	-0.4	5.6	8.2	8.2
Debt interest	7.4	1.4	4.0	4.3	3.7
Current grants	14.3	9.3	8.5	7.5	7.8
Public sector capital formation	1.3	9.3	10.8	10.0	10.0
Level (fiscal year)					
Acquisition of financial assets (£b)	-5.1	-7.0	-6.2	-5.2	-4.2
Borrowing requirement (£b)	7.4	9.2	8.4	7.4	6.4

Table 7

Level as a % of nominal GDP at market prices Net acquisition of financial assets by:	1982	1983	1984	1985	1986
Government	-1.9	-2.4	-2.1	-1.6	-1.2
Companies	-0.1	0.6	0.1	-0.4	-1.0
Persons	4.1	2.7	2.4	2.3	2.4
Overseas	-1.5	-0.5	0.0	0.0	0.1

The balance of payments

Table 8

Annual percentage changes	1982	1983	1984	1985	1986
UK export prices	7.8	10.6	9.6	10.0	10.8
UK import prices	6.7	13.0	10.8	10.3	10.8
Terms of trade	1.0	-2.1	-1.1	-0.3	0.0
World export prices in sterling	16.1	18.8	8.1	8.8	8.7
Value index of exports of manufactures	7.6	11.1	10.8	10.6	10.3
Value index of imports of manufactures	7.9	15.0	11.3	10.6	10.1

Table 9

Annual percentage changes	1982	1983	1984	1985	1986
World industrial production	-4.5	0.1	3.9	3.2	3.0
World trade	-4.9	0.1	5.2	4.5	4.5
Exports – goods and services	-0.1	1.7	1.5	2.4	1.8
Domestic expenditure	1.8	2.6	1.9	2.0	1.6
Imports – goods and services	4.1	4.6	2.0	1.8	1.3
Oil savings as a % of imports (level, current prices)	22.2	20.3	19.3	18.9	19.6

Table 10

Annual percentage changes	1982	1983	1984	1985	1986
Exports of goods	0.2	2.2	2.4	3.2	2.1
Imports of goods	5.4	5.5	2.4	1.9	1.4
Terms of trade (goods only)	2.0	-1.5	-0.6	0.3	0.6
Annual total £m					
Visible trade balance	1663	-1085	-1571	-583	542
Balance of services	4010	3591	2998	2529	2131
Net property incomes and transfers	-1472	-1055	-1458	-2042	-2931
Current balance of payments	4202	1452	-31	-96	-257

Forecast Tables

This section comprises seventeen tables containing forecast data for over 150 economic time series, together with constant adjustments for 50 variables.

Please note that:

- (i) Growth rates in the quarterly section of the table are the percentage change over the same quarter in the previous year.
- (ii) The date shown in the line marked DATA under the annual totals (e.g. 8104) indicates the latest quarter for which data is available at the time of going to press.

Table 1: Expenditure on the Gross Domestic Product and other key indicators.

- (i) $GDP = GDPE - ADJ$
- (ii) $GDPE = C + IF + II + G + X - M - FCA$

Table 2: Prices and costs.

Table 3: Personal income and consumption.

- (i) $YJ = YWS + YFP + YEC + YJG + YJO$
- (ii) The identity for disposable income is built up such that:
 $YWS + YFP + YEC + YJG + YJO - EJTA - ENIH - TJYP = YD$
 NB EJTA = personal transfers abroad (net) and taxes paid. This variable is not shown in the table.
- (iii) Real disposable income is disposable income (YD) deflated by the consumption deflator (PC)

Table 4: Fixed investment and stockbuilding.

- (i) Series in the table run across such that:
 $IF = IFP + IFG$; $IFP = INP + IHP$; $IFG = IGG + IPCOR$; $IGG = INGG + IHG$
 $INP = INPOX + INSO$
- (ii) Included are stockbuilding, the stock level and a stock output ratio which is average annual stock level as a ratio of the quarterly average level of GDP.

Table 5: Public sector — flow of funds.

- (i) The current surplus identity reads across such that:
 $SGA = TYA + TEA + ENIH + YGTP + YGRA - Gf - EDDBA - ESAB - EGGA$
- (ii) The net acquisition of financial assets $FG = SGA + FTKG - IDGf$

Table 6: Balance of payments.

- (i) The balances are built up such that:
 $BALV = XG.PXG - MG.PMG$
 $BALI = XS.PXS - MS.PMS + BYPA + BTAB$
 $BAL = BALV + BALI$

Table 7: Money supply and related items.

Table 8: Factor incomes in GDP and expenditure on GDP (current prices).

- (i) $GDPfE$ is the expenditure measure of GDP in current prices, it equals $PGDP \cdot GDPE$
- (ii) The current price of GDP identity is built up such that:
 $GDPfE = YEM + YCTP + YGTP + YRSE - YSA + RESEY = Cf + If + IIf + Gf + Xf - Mf - FCAf$
- (iii) The residual error, RESEY, the discrepancy between expenditure and income estimates of GDP, may differ from the residual error, RES2, shown on Table 12, when the latest data for the balance of payments current account used in the sector flows are not consistent with the latest published national accounts.

Table 9: Company sector — flow of funds.

- (i) $YCTP = YCT- + YSAC$
- (ii) $SC = YCTP + YCNT - ECDV - ECOI - ECTP$
- (iii) $SC- = SC - YSAC$
- (iv) $FC = SC - IFCf - IICf + FTKC$
 NB FTKC = capital transfers is not shown.

Table 10: Output, employment and unemployment.

- (i) $ET = EEMF + EEGG + EEBAAR + ESFOR$
 NB ESFOR = self-employed + forces is not shown.

Table 11: North Sea oil.

- (i) Variable YTPN includes the public sector's share of North Sea profits.

Table 12: Sector flows — net acquisition of financial assets.

- (i) FG, FP, FO and RES2 sum to zero.
- (ii) $FP = FC + FJ$
- (iii) RES2: see note (iii) to Table 8.

Table 13: World variables.

Tables 14-17: Constant adjustments.

Variables contained in the tables

Code	
ADJ	Expenditure estimate of GDP <i>minus</i> output estimate at 1975 prices
AEM	Average earnings in manufacturing 1975 = 100
BAL	Current balance of payments, £m, seasonally adjusted
BAL/	Current balance of payments as a % of GDP
BALI	Invisible balance, £m, seasonally adjusted
BALV	Trade balance, £m, seasonally adjusted
BTAB	Net private and government transfers abroad, £m, seasonally adjusted
BYPA	Net interest profits, and dividends payments abroad, £m, seasonally adjusted
C	Total consumers' expenditure, at 1975 prices, £m, seasonally adjusted
C£	Total consumers' expenditure, £m, seasonally adjusted
CD	Durable consumption, at 1975 prices, £m, seasonally adjusted
CND	Non-durable consumption, at 1975 prices, £m, seasonally adjusted
CPET	Petroleum consumption (primary fuel input basis) millions of tonnes
ECDV	Payments of dividends on ordinary shares, £m, seasonally adjusted
ECOI	Other dividends and interest payments, corporate sector, £m, seasonally adjusted
ECTP	Corporate payments of UK taxes on income, £m, seasonally adjusted
EDBA	Public sector debt interest payments, £m, seasonally adjusted
EEBAR	Other employment, thousands, seasonally adjusted
EEGG	Employees in employment, general government, thousands, seasonally adjusted
EEMF	Employees in employment, manufacturing, thousands, seasonally adjusted
EER	Sterling exchange rate index, trade-weighted, 1975 = 1
EGGA	Current grants from the public sector, £m, seasonally adjusted
ENIH	Employees' National Health and Insurance contributions, £m, seasonally adjusted
ENSA	Expenditure on invisible account of the balance of payments due to North Sea oil, £m
ESAB	Subsidies, £m, seasonally adjusted
ET	Employees in employment, total employment, UK, thousands, seasonally adjusted
FC	Net acquisition of financial assets by the company sector, £m, seasonally adjusted
FC/	Net acquisition of financial assets by the company sector as a % of GDP
FCA	Factor cost adjustment at 1975 prices, £m, seasonally adjusted
FCA£	Factor cost adjustment, £m, seasonally adjusted
FCOX	Net acquisition of financial assets by the non-North Sea company sector, £m, seasonally adjusted
FG	Net acquisition of financial assets by the public sector, £m, seasonally adjusted
FG/	Net acquisition of financial assets by the public sector as a % of GDP
FJ	Net acquisition of financial assets by the personal sector, £m, seasonally adjusted
FJ/	Net acquisition of financial assets by the personal sector as a % of GDP
FO	Net acquisition of financial assets by the overseas sector, £m, seasonally adjusted
FP	Net acquisition of financial assets by the private sector, £m, seasonally adjusted
FTKG	Net capital transfers public sector, £m, seasonally adjusted
G	Public authorities' current expenditure on goods and services at 1975 prices, £m, seasonally adjusted
G£	Public authorities' current expenditure on goods and services, £m, seasonally adjusted
GDP	Gross Domestic Product output based at 1975 prices, £m, seasonally adjusted
GDPE	Gross Domestic Product, expenditure based at 1975 prices, £m, seasonally adjusted
GDPOX	Gross Domestic Product output based at 1975 prices, £m, seasonally adjusted excluding North Sea oil
GDP£E	Gross Domestic Product, £m, seasonally adjusted, expenditure measure
IDG£	Gross domestic capital formation by the public sector, £m, seasonally adjusted
IF	Fixed investment at 1975 prices, £m, seasonally adjusted
IF£	Fixed investment, £m, seasonally adjusted
IFC£	Gross domestic fixed capital formation: company sector, £m, seasonally adjusted
IFG	Gross domestic fixed capital formation at 1975 prices, public sector, £m, seasonally adjusted
IFP	Gross domestic fixed capital formation at 1975 prices, private sector, £m, seasonally adjusted
IGG	Gross domestic fixed capital formation at 1975 prices, general government, £m, seasonally adjusted
IHG	Public dwellings investment at 1975 prices, £m, seasonally adjusted
IHP	Private dwellings investment at 1975 prices, £m, seasonally adjusted
II	Stockbuilding at 1975 prices, £m, seasonally adjusted
II£	Stockbuilding, £m, seasonally adjusted
IIC£	Value of the physical increase in stocks and work in progress: company sector, £m, seasonally adjusted
INGG	Gross domestic non-residential fixed capital formation at 1975 prices, general government, £m, seasonally adjusted
INP	Private non-dwellings fixed investment at 1975 prices, £m, seasonally adjusted
INPOX	Private non-dwellings fixed investment at 1975 prices, £m, seasonally adjusted excluding investment in North Sea oil
INSE	Private fixed investment in North Sea oil, £m, seasonally adjusted
INSO	Private fixed investment in North Sea oil at 1975 prices, £m, seasonally adjusted
IPW	World industrial production, 1975 = 100
KII	Stock level at 1975 prices, £m, seasonally adjusted
KII/	Stock-output ratio
KM3/	Money stock per unit of quarterly expenditure
KM3*	Real money stock
KM3£	Money stock, sterling M3, £m, end-quarter seasonally adjusted (old basis)
LUKA	Unemployed, excluding school leavers in UK, thousands, seasonally adjusted
M	Imports of goods and services at 1975 prices, £m, seasonally adjusted
M£	Imports of goods and services, £m, seasonally adjusted
MG	Imports of goods (f.o.b.) at 1975 prices, £m, seasonally adjusted

MG2	Imports of fuel (c.i.f.) at 1975 prices, £m, seasonally adjusted
MS	Imports of services at 1975 prices, £m, seasonally adjusted
MXO	Oil import savings at 1975 prices, £m, seasonally adjusted
NSO	Production of North Sea oil in millions of tonnes
OSWI	Index of average earnings, residual and tertiary sector, 1975 = 100
PC	Consumer prices index, 1975 = 1, seasonally adjusted
PCOMM	World non-oil commodity prices index, 1975 = 1
PEFD	Deflator for final domestic expenditure, 1975 = 1
PFL	Unit value index for imports of fuels, 1975 = 1
PG	Price index for government current expenditure on goods and services, 1975 = 1, seasonally adjusted
PGDP	Price index for the Gross Domestic Product, 1975 = 1, seasonally adjusted
PIF	Price index for fixed investment, 1975 = 1, seasonally adjusted
PIMI	Index of wholesale input prices, manufacturing, 1975 = 1
PIMO	Index of wholesale prices of manufacturing output, 1975 = 100
PM	Price index for imports 1975 = 1, seasonally adjusted
PMAN	Unit value index for manufactured imports, 1975 = 1
PMG	Price index for imports of goods, 1975 = 1, seasonally adjusted
PMS	Price index for imports of services, 1975 = 1, seasonally adjusted
POIL\$	\$ price of barrel of oil (average OPEC export price)
POIL*RI	Index of real oil price, 1975 = 1
POPWA*	Population of working age, UK, thousands
PRDM	Index of productivity in manufacturing industry, 1975 = 100
PROD	Index of industrial production, 1975 = 100, seasonally adjusted
PRODMF	Index of manufacturing production, 1975 = 100, seasonally adjusted
PSBR	Public sector borrowing requirement, £m, seasonally adjusted
PSWI	Index of average earnings, general government, 1975 = 100
PX	Price index for exports, 1975 = 1, seasonally adjusted
PXG	Price index for exports of goods, 1975 = 1, seasonally adjusted
PXGM	Unit value index for manufactured exports, 1975 = 1
PXS	Price index for exports of services, 1975 = 1, seasonally adjusted
PXWM	Unit value index for world exports of manufacturers in sterling, 1975 = 1
RESEY	Discrepancy between the expenditure and income estimates of Gross Domestic Product, £m, seasonally adjusted
RES2	Residual error in the sector financial accounts, £m, seasonally adjusted
RES2/	Residual error as % of GDP
RL	Interest rate on undated consols
RS	3-month Treasury Bill rate
SC	Corporate sector savings, £m, seasonally adjusted
SC-	Corporate sector savings net of stock appreciation, £m, seasonally adjusted
SGA	Balance undistributed income of the public sector, £m, seasonally adjusted
SJE/	Personal sector savings ratio (%)
TEA	Taxes on expenditure, £m, seasonally adjusted
TJYP	Payments of UK personal income tax, £m, seasonally adjusted
TPRT	Payments of Petroleum Revenue tax, £m (includes Supplementary Petroleum Duty)
TROY	Payments of royalties on North Sea oil, £m
TYA	Payments of income tax, £m, seasonally adjusted
ULCM	Unit labour cost in manufacturing industry, 1975 = 100
WCPI	Index of world consumer prices, 1975 = 100
WGNP	World gross national product index, 1975 = 100
WM3	World money supply, 1975 = 100
WM3/	World real money supply, 1975 = 100
WPOP	Working population, UK, thousands
WWPI	Index of world wholesale prices, 1975 = 100
X	Exports of goods and services at 1975 prices, £m, seasonally adjusted
X£	Exports of goods and services, £m, seasonally adjusted
XG	Exports of goods at 1975 prices, £m, seasonally adjusted
XG2	Index of volume of exports of fuels, 1975 = 100, seasonally adjusted
XGM	Index of exports of manufactures, 1975 = 100
XS	Exports of services at 1975 prices, seasonally adjusted
XWM	Index of world exports of manufactures, 1975 = 1
XXO	Exports of crude petroleum at 1975 prices, £m, seasonally adjusted
YCNT	Corporate gross non-trading profits, £m, seasonally adjusted
YCTP	Gross trading profits of companies, £m, seasonally adjusted
YCT-	Corporate gross trading profits net of stock appreciation, £m, seasonally adjusted
YC-N	Corporate gross trading profits net of stock appreciation and North Sea oil profits, £m, seasonally adjusted
YD	Personal disposable income, £m, seasonally adjusted
YD/	Personal disposable income at 1975 prices, £m, seasonally adjusted
YEC	Employers' contributions, £m, seasonally adjusted
YEM	Income from employment, £m, seasonally adjusted
YFP	Forces pay, £m, seasonally adjusted
YGRA	Public sector receipts of rent, interest and dividends, £m, seasonally adjusted
YGTP	Public sector trading profits, £m, seasonally adjusted
YJ	Total personal incomes, £m, seasonally adjusted
YJG	Current grants to the personal sector from the public sector, £m, seasonally adjusted
YJO	Other personal income, £m, seasonally adjusted

YNSV	Savings on the balance of payments current account due to production of North sea oil, £m
YRSE	Income from rent and self-employment (including imputed charge for consumption of non-trading capital), £m, seasonally adjusted
YSA	Stock appreciation, £m, seasonally adjusted
YSAC	Stock appreciation: company sector, £m, seasonally adjusted
YSE	Self-employment incomes, £m, seasonally adjusted
YTPN	Gross trading profits arising from North Sea oil, £m, (including the public sector's share of North Sea oil profits)
YWS	Wages and salaries, £m, seasonally adjusted (%)

TABLE 1 EXPENDITURE ON THE GROSS DOMESTIC PRODUCT & KEY INDICATORS														
	GDP:	ADJ	GDPE:	C	IF	II	G	X	M	FCA:	PROD	LUKA	EER	PC:
	:GROSS	:DIFFER-	GDP EXP-:	CONSUMER	FIXED	STOCK	GOVERN-	EXPORTS	IMPORTS	FACTOR	:INDEX OF	UK UNEM-	STERLING	DEFLATOR:
	:DOMESTIC	:ENCE EXP	ENDITURE:	EXPEND-	INVEST-	BUILDING	MENT	GOODS &	GOODS &	COST	:INDUST.	PLOYMENT	WEIGHTED	FOR
	:PRODUCT	:& OUTPUT	ESTIMATE:	ITURE	MENT		CONSUMP-	SERVICES	SERVICES	ADJUST-	:PROD-	(SA)	INDEX	CONSUMP-
	: :EST. GDP	:	:	:	:	:	TION			MENT	:UCTION			TION
	: £M 75	: £M75 A	£M75 A :	£M75 A	£M75 A	£M75 A	£M75 A	£M75 A	£M75 A	£M75 A :	75=100	'000 A	75=1	75=1
ANNUAL VALUES														
:1976:	96084	: 1709	97793 :	64707	20640	658	23178	29595	30234	10751 :	102.1	1272	.86	1.16 :
:1977:	98655	: 535	99190 :	64517	20139	1382	22951	31508	30562	10745 :	106.1	1377	.81	1.33 :
:1978:	101933	: 351	102284 :	68227	20845	1146	23438	32092	31754	11710 :	109.9	1376	.81	1.45 :
:1979:	104103	: -392	103711 :	71599	21039	1782	23866	32914	35326	12163 :	112.6	1302	.87	1.63 :
:1980:	101061	: 427	101488 :	71550	20443	-1555	24311	33057	34143	12175 :	105.3	1648	.96	1.90 :
:1981:	98561	: 702	99263 :	71871	18774	-1871	24302	32335	34042	12102 :	100.4	2509	.95	2.11 :
:1982:	99065	: 1195	100260 :	72667	19236	-859	24712	32290	35439	12329 :	100.9	2793	.91	2.27 :
:1983:	100888	: 1200	102088 :	74339	19866	-44	24940	32826	37078	12741 :	102.9	3135	.81	2.40 :
:1984:	102912	: 1200	104112 :	75453	20668	333	25100	33320	37805	12943 :	105.5	3166	.80	2.57 :
:1985:	104996	: 1200	106196 :	77174	20968	441	25260	34122	38467	13299 :	107.8	3131	.79	2.76 :
:1986:	106650	: 1200	107850 :	78846	20990	509	25420	34720	38980	13643 :	109.4	3143	.79	2.98 :
:DATA:	8203	8203	8203	8204	8203	8203	8203	8203	8203	8203	8203	8204	8204	8203 :
:81 1:	24599	: 561	25160 :	18040	4690	-642	6055	7853	7672	3160 :	100.2	2304	1.02	2.02 :
:81 2:	24528	: 262	24790 :	17926	4667	-694	6048	8029	8251	2936 :	100.0	2482	.98	2.09 :
:81 3:	24693	: -247	24446 :	17934	4663	-226	6127	8133	9241	2943 :	100.5	2641	.91	2.13 :
:81 4:	24740	: 127	24867 :	17971	4754	-309	6072	8320	8879	3063 :	101.0	2609	.90	2.18 :
:82 1:	24670	: 409	25079 :	17927	4902	-62	6147	8010	8687	3158 :	100.7	2679	.91	2.22 :
:82 2:	24740	: 349	25090 :	17998	4693	2	6132	8249	9076	2909 :	101.1	2743	.90	2.27 :
:82 3:	24835	: 136	24971 :	18242	4846	-371	6223	7925	8827	3066 :	101.5	2838	.91	2.29 :
:82 4:	24820	: 300	25120 :	18500	4795	-428	6210	8106	8849	3196 :	100.4	2913	.89	2.32 :
:83 1:	24863	: 300	25163 :	18523	4851	-203	6220	8175	9095	3306 :	101.2	3043	.82	2.36 :
:83 2:	25164	: 300	25464 :	18482	4933	-40	6230	8201	9271	3069 :	102.4	3131	.81	2.39 :
:83 3:	25408	: 300	25708 :	18659	5012	115	6240	8197	9361	3147 :	103.7	3177	.80	2.42 :
:83 4:	25454	: 300	25754 :	18675	5070	84	6250	8254	9352	3219 :	104.2	3191	.80	2.45 :
:84 1:	25411	: 300	25711 :	18715	5108	87	6260	8237	9349	3339 :	104.1	3188	.80	2.50 :
:84 2:	25698	: 300	25998 :	18807	5162	92	6270	8279	9487	3124 :	105.1	3182	.80	2.55 :
:84 3:	25874	: 300	26174 :	18941	5185	72	6280	8367	9475	3198 :	106.2	3157	.80	2.59 :
:84 4:	25929	: 300	26229 :	18990	5214	82	6290	8436	9493	3282 :	106.6	3135	.79	2.64 :

TABLE 1 EXPENDITURE ON THE GROSS DOMESTIC PRODUCT & KEY INDICATORS

	GDP:	ADJ	GDPE:	C	IF	II	G	X	M	FCA:	PROD	LUKA	EER	PC:
	:GROSS DOMESTIC PRODUCT	:DIFFERENCE & OUTPUT EST. GDP	GDP EXPENDITURE ESTIMATE	CONSUMER EXPENDITURE	FIXED INVESTMENT	STOCK BUILDING	GOVERNMENT CONSUMPTION	EXPORTS GOODS & SERVICES	IMPORTS GOODS & SERVICES	FACTOR COST ADJUSTMENT	INDEX OF INDUST. PRODUCTION	UK UNEMPLOYMENT (SA)	STERLING WEIGHTED INDEX	DEFLATOR FOR CONSUMPTION
	: £M 75	: £M75 A	£M75 A	: £M75 A	£M75 A	£M75 A	£M75 A	£M75 A	£M75 A	£M75 A	: 75=100	'000 A	75=1	75=1
	% CHANGES OVER PREVIOUS YEAR													
:1976:	1.9	--	3.7	: .1	1.1	--	1.0	8.8	4.2	3.2	: 2.1	--	-14.3	15.6
:1977:	2.7	--	1.4	: -.3	-2.4	--	-1.0	6.5	1.1	-.1	: 3.9	--	-5.2	15.2
:1978:	3.3	--	3.1	: 5.8	3.5	--	2.1	1.9	3.9	9.0	: 3.5	--	.4	8.8
:1979:	2.1	--	1.4	: 4.9	.9	--	1.8	2.6	11.2	3.9	: 2.5	--	7.1	12.8
:1980:	-2.9	--	-2.1	: -.1	-2.8	--	1.9	.4	-3.3	.1	: -6.5	--	10.1	16.1
:1981:	-2.5	--	-2.2	: .4	-8.2	--	-.0	-2.2	-.3	-.6	: -4.6	--	-1.2	10.9
:1982:	.5	--	1.0	: 1.1	2.5	--	1.7	-.1	4.1	1.9	: .5	--	-4.7	8.0
:1983:	1.8	--	1.8	: 2.3	3.3	--	.9	1.7	4.6	3.3	: 1.9	--	-10.8	5.8
:1984:	2.0	--	2.0	: 1.5	4.0	--	.6	1.5	2.0	1.6	: 2.6	--	-1.2	7.0
:1985:	2.0	--	2.0	: 2.3	1.5	--	.6	2.4	1.8	2.7	: 2.2	--	-1.1	7.5
:1986:	1.6	--	1.6	: 2.2	.1	--	.6	1.8	1.3	2.6	: 1.5	--	-.5	7.8
:DATA:	8203	8203	8203	8204	8203	8203	8203	8203	8203	8203	8203	8204	8204	8203
	% CHANGES OVER SAME PERIOD PREVIOUS YEAR													
:81 1:	-4.8	--	-2.2	: -.4	-11.4	--	-.1	-7.7	-12.8	-1.3	: -8.7	--	9.5	11.3
:81 2:	-3.7	--	-2.6	: 1.1	-9.6	--	.4	-3.5	-7.4	3.0	: -6.4	--	3.5	10.9
:81 3:	-1.4	--	-3.2	: .6	-7.4	--	.8	.2	10.5	-3.0	: -2.9	--	-6.3	10.9
:81 4:	.2	--	-.9	: .6	-4.0	--	-1.2	2.5	9.9	-.9	: .1	--	-10.5	10.8
:82 1:	.3	--	-.3	: -.6	4.5	--	1.5	2.0	13.2	-.1	: .5	--	-10.4	10.0
:82 2:	.9	--	1.2	: .4	.6	--	1.4	2.7	10.0	-.9	: 1.1	--	-7.7	8.7
:82 3:	.6	--	2.1	: 1.7	3.9	--	1.6	-2.6	-4.5	4.2	: 1.0	--	1.0	7.4
:82 4:	.3	--	1.0	: 2.9	.9	--	2.3	-2.6	-.3	4.4	: -.6	--	-.6	6.0
:83 1:	.8	--	.3	: 3.3	-1.1	--	1.2	2.1	4.7	4.7	: .5	--	-10.1	6.2
:83 2:	1.7	--	1.5	: 2.7	5.1	--	1.6	-.6	2.2	5.5	: 1.3	--	-10.3	5.4
:83 3:	2.3	--	3.0	: 2.3	3.4	--	.3	3.4	6.0	2.6	: 2.2	--	-12.6	5.4
:83 4:	2.6	--	2.5	: .9	5.8	--	.6	1.8	5.7	.7	: 3.8	--	-10.3	6.0
:84 1:	2.2	--	2.2	: 1.0	5.3	--	.6	.8	2.8	1.0	: 2.9	--	-2.5	6.3
:84 2:	2.1	--	2.1	: 1.8	4.6	--	.6	1.0	2.3	1.8	: 2.6	--	-.8	6.8
:84 3:	1.8	--	1.8	: 1.5	3.4	--	.6	2.1	1.2	1.6	: 2.4	--	-.6	7.4
:84 4:	1.9	--	1.8	: 1.7	2.8	--	.6	2.2	1.5	1.9	: 2.3	--	-.8	7.4

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TABLE 2 PRICES AND COSTS														
	PGDP:	PC	PIF	PG	PX	PM:	AEM	PRDM	ULCM	PXWM:	PIMI	PIMO	PXGM	PMAN:
	: DEFLATOR:	DEFLATOR	DEFLATOR	DEFLATOR	DEFLATOR	DEFLATOR:	AVERAGE	PRODUCT-	UNIT LAB	WORLD	: WHL/SALE	WHL/SALE	PRICE OF	PRICE OF:
	: - GROSS :	- GROSS	PUBLIC	- EXPORTS	- IMPORTS:	EARNINGS	IVITY IN	COST IN	EXPORT	: PR. INDEX	PR. INDEX	MANUFACT	MANUFACT:	
	: DOMESTIC:	DOMESTIC	CONSUMP-	GOODS &	GOODS &	: IN MANU-	MANUFAC-	MANUFAC-	MANUFACT:	MANUFACT	- URED	- URED		
	: PRODUCT :	FIX. CAP.	TION	SERVICES	SERVICES:	FACTUR'G	TURING	TURING	STERLING:	INPUT	OUTPUT	EXPORTS	IMPORTS :	
	: 75=1	: 75=1	75=1	75=1	75=1	: 75=100	75=100	75=100	75=1	: 75=1	75=100	75=1	75=1	
	ANNUAL VALUES													
: 1976:	1.14 :	1.16	1.14	1.15	1.20	1.22 :	117	105	111	1.25 :	1.27	117	1.20	1.23 :
: 1977:	1.28 :	1.33	1.28	1.27	1.38	1.39 :	129	106	120	1.39 :	1.46	141	1.42	1.42 :
: 1978:	1.43 :	1.45	1.43	1.41	1.49	1.43 :	147	107	136	1.45 :	1.45	153	1.57	1.51 :
: 1979:	1.62 :	1.63	1.64	1.61	1.66	1.54 :	170	109	155	1.49 :	1.68	172	1.71	1.62 :
: 1980:	1.92 :	1.90	1.93	1.99	1.91	1.70 :	200	107	189	1.51 :	2.01	200	1.91	1.74 :
: 1981:	2.13 :	2.11	2.10	2.26	2.10	1.78 :	227	113	207	1.65 :	2.28	221	2.05	1.81 :
: 1982:	2.28 :	2.27	2.17	2.41	2.26	1.90 :	252	119	217	1.92 :	2.43	240	2.21	1.95 :
: 1983:	2.42 :	2.40	2.28	2.55	2.50	2.14 :	272	123	227	2.28 :	2.63	258	2.45	2.24 :
: 1984:	2.58 :	2.57	2.42	2.73	2.74	2.38 :	292	125	237	2.46 :	2.83	279	2.72	2.49 :
: 1985:	2.80 :	2.76	2.60	2.96	3.01	2.62 :	316	126	255	2.68 :	3.12	300	3.00	2.76 :
: 1986:	3.02 :	2.98	2.82	3.20	3.34	2.91 :	341	128	272	2.91 :	3.52	324	3.31	3.03 :
: DATA:	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8204	8204	8203	8203 :
: 81 1:	2.06 :	2.02	2.07	2.17	2.01	1.70 :	216	109	206	1.48 :	2.14	212	1.98	1.71 :
: 81 2:	2.11 :	2.09	2.08	2.25	2.04	1.72 :	220	112	204	1.58 :	2.26	219	2.02	1.76 :
: 81 3:	2.17 :	2.13	2.12	2.29	2.14	1.82 :	233	115	208	1.75 :	2.36	224	2.08	1.84 :
: 81 4:	2.18 :	2.18	2.12	2.34	2.18	1.88 :	238	116	210	1.79 :	2.37	229	2.13	1.91 :
: 82 1:	2.21 :	2.22	2.15	2.37	2.21	1.88 :	244	117	213	1.84 :	2.38	234	2.18	1.91 :
: 82 2:	2.26 :	2.27	2.16	2.39	2.21	1.88 :	249	119	216	1.91 :	2.40	238	2.18	1.94 :
: 82 3:	2.30 :	2.29	2.17	2.41	2.28	1.89 :	255	120	219	1.92 :	2.45	242	2.22	1.95 :
: 82 4:	2.34 :	2.32	2.20	2.45	2.34	1.94 :	259	120	221	2.00 :	2.51	247	2.25	1.99 :
: 83 1:	2.38 :	2.36	2.24	2.49	2.43	2.06 :	265	121	224	2.21 :	2.60	253	2.35	2.14 :
: 83 2:	2.40 :	2.39	2.27	2.53	2.47	2.12 :	270	122	226	2.26 :	2.63	257	2.42	2.21 :
: 83 3:	2.43 :	2.42	2.29	2.56	2.52	2.17 :	274	123	228	2.31 :	2.61	260	2.49	2.27 :
: 83 4:	2.46 :	2.45	2.32	2.60	2.57	2.23 :	278	124	229	2.34 :	2.68	264	2.54	2.33 :
: 84 1:	2.51 :	2.50	2.36	2.65	2.66	2.30 :	283	125	231	2.39 :	2.77	271	2.62	2.40 :
: 84 2:	2.56 :	2.55	2.41	2.70	2.71	2.35 :	289	125	235	2.43 :	2.82	278	2.68	2.45 :
: 84 3:	2.61 :	2.59	2.45	2.76	2.77	2.41 :	295	126	239	2.49 :	2.84	282	2.75	2.53 :
: 84 4:	2.65 :	2.64	2.48	2.81	2.82	2.45 :	300	126	244	2.54 :	2.90	285	2.81	2.59 :

TABLE 2 PRICES AND COSTS

	PGDP:	PC	PIF	PG	PX	PM:	AEM	PRDM	ULCM	PXWM:	PIMI	PIMO	PXGM	PMAN:
	DEFLATOR: - GROSS DOMESTIC PRODUCT	DEFLATOR FOR CONSUMP- TION	DEFLATOR - GROSS DOMESTIC FIX.CAP.	DEFLATOR PUBLIC CONSUMP- TION	DEFLATOR -EXPORTS GOODS & SERVICES	DEFLATOR -IMPORTS GOODS & SERVICES	AVERAGE EARNINGS :IN MANU- FACTUR'G	PRODUCT- IVITY IN MANUFAC- TURING	UNIT LAB COST IN MANUFAC- TURING	WORLD EXPORT STERLING	:WHL/SALE :PR. INDEX :MANUFACT :INPUT	WHL/SALE PR. INDEX MANUFACT OUTPUT	PRICE OF MANUFACT -URED EXPORTS	PRICE OF MANUFACT -URED IMPORTS
	: 75=1	: 75=1	75=1	75=1	75=1	75=1	: 75=100	75=100	75=100	75=1	: 75=1	75=100	75=1	75=1
	: % CHANGES OVER PREVIOUS YEAR													
:1976:	14.1	15.6	14.2	15.4	19.6	21.8	16.6	5.1	10.6	24.5	27.0	17.3	20.0	22.7
:1977:	12.3	15.2	11.8	10.4	15.7	14.4	10.2	.7	8.6	11.7	14.7	19.8	18.1	15.5
:1978:	11.5	8.8	11.8	10.4	7.5	2.9	14.5	1.3	13.2	4.2	-7	9.1	10.9	6.7
:1979:	13.4	12.8	14.6	14.1	11.4	7.7	15.5	1.6	13.9	2.8	15.9	12.2	8.7	7.1
:1980:	18.5	16.1	17.9	24.0	15.4	9.8	17.9	-1.4	22.2	1.4	19.9	16.3	11.7	7.1
:1981:	11.1	10.9	8.7	13.5	9.7	5.0	13.2	5.2	9.5	9.2	13.6	10.6	7.5	4.0
:1982:	6.9	8.0	3.4	6.4	7.8	6.7	11.0	5.1	4.9	16.1	6.7	8.6	7.6	7.9
:1983:	6.2	5.8	5.1	5.9	10.6	13.0	8.1	3.1	4.3	18.8	8.0	7.5	11.1	15.0
:1984:	6.8	7.0	6.4	7.1	9.6	10.8	7.2	2.2	4.7	8.1	7.7	8.0	10.8	11.3
:1985:	8.2	7.5	7.4	8.6	10.0	10.3	8.3	.8	7.3	8.8	10.1	7.7	10.6	10.6
:1986:	8.2	7.8	8.1	8.0	10.8	10.8	8.0	1.1	6.7	8.7	13.0	7.9	10.3	10.1
:DATA:	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8204	8204	8203	8203
	: % CHANGES OVER SAME PERIOD PREVIOUS YEAR													
:81 1:	15.9	11.3	13.7	18.5	7.7	-1.6	15.4	1.7	18.9	-2.4	8.4	10.9	7.0	-3.9
:81 2:	12.0	10.9	9.3	16.1	7.1	1.7	11.5	4.0	10.3	3.8	12.2	10.3	6.3	2.3
:81 3:	9.8	10.9	7.5	11.0	11.6	8.3	12.6	6.9	6.3	15.2	16.8	10.1	7.2	7.0
:81 4:	7.3	10.8	4.8	9.5	12.2	11.7	13.4	8.3	3.7	20.4	16.7	11.2	9.2	11.0
:82 1:	7.0	10.0	3.6	9.3	9.8	10.2	12.8	6.9	3.5	24.1	11.4	10.4	10.1	11.7
:82 2:	6.8	8.7	3.7	6.6	8.0	9.1	13.0	6.2	5.7	20.7	6.3	8.6	7.9	10.2
:82 3:	6.1	7.4	2.3	5.3	6.4	4.3	9.6	4.4	5.4	9.8	3.8	8.0	6.7	6.0
:82 4:	7.7	6.0	4.0	4.8	7.1	3.4	8.9	3.3	5.1	11.7	5.7	7.7	5.6	4.2
:83 1:	7.7	6.2	4.4	5.3	9.9	10.0	8.8	3.5	4.9	20.1	9.2	8.2	8.0	12.1
:83 2:	6.5	5.4	5.1	5.7	12.0	12.6	8.8	2.9	5.0	18.2	9.5	7.8	11.0	13.8
:83 3:	5.6	5.4	5.5	6.3	10.6	14.7	7.6	2.6	3.8	20.0	6.5	7.2	12.2	16.6
:83 4:	4.9	6.0	5.3	6.1	10.1	14.6	7.2	3.6	3.5	17.0	6.8	6.9	13.0	17.2
:84 1:	5.6	6.3	5.4	6.2	9.4	11.5	6.5	2.9	3.4	8.5	6.4	7.0	11.3	12.1
:84 2:	6.6	6.8	6.1	6.8	9.7	10.9	6.9	2.7	4.0	7.5	7.5	8.1	10.7	11.2
:84 3:	7.4	7.4	6.9	7.6	9.8	10.8	7.3	2.1	5.0	8.0	8.7	8.6	10.5	11.1
:84 4:	7.7	7.4	7.1	8.0	9.6	10.2	8.1	1.4	6.5	8.4	8.3	8.1	10.6	11.0

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TABLE 3 PERSONAL INCOMES & CONSUMPTION														
	YJ:	YWS	YFP	YEC	YJG	YJO	YSE:	TJYP	ENIH:	YD	YD/	CND	CD	SJ£/:
	TOTAL PERSONAL INCOMES	WAGES AND SALARIES	FORCES PAY	EMPLOY- ERS CONTRIB- UTIONS	GRANTS TO PERSONAL SECTOR	OTHER PERSONAL INCOME	SELF- PLOYMENT INCOMES	EM:TAX ON INCOME :SECTOR	NATIONAL HEALTH & INSUR. CONTRIB.:	DISPOS- ABLE INCOME	REAL DISPOS- ABLE INCOME	NON DURABLE CONSUMP- TION	DURABLE CONSUMP- TION	SAVINGS RATIO
	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M75 A	£M75 A	£M75 A	%
ANNUAL VALUES														
:1976:	110769	66040	1474	10018	12765	20472	10084	17422	8426	84949	73453	59066	5641	11.9
:1977:	123957	73101	1506	11191	15108	23051	11292	18149	9462	96300	72282	59293	5224	10.7
:1978:	143103	83674	1645	12881	17903	27000	13368	19518	10107	113404	78225	62222	6005	12.7
:1979:	170261	98196	2020	14915	20979	34151	16222	21732	11531	136802	83629	64849	6750	14.4
:1980:	200851	116004	2436	17610	25493	39308	17581	25812	13944	160820	84740	65446	6104	15.6
:1981:	219890	124018	2708	20443	31251	41470	18569	29023	15945	174647	82991	65591	6280	13.4
:1982:	234476	130946	2943	21384	35689	43514	19852	31779	18086	184445	81156	65927	6740	10.5
:1983:	249796	138141	3105	22599	39434	46517	21767	32499	20073	197068	81966	67161	7177	9.3
:1984:	270827	149480	3360	24454	42801	50732	23702	34455	21964	214241	83280	68362	7091	9.4
:1985:	297870	165032	3709	26999	46008	56122	26196	37337	24250	236105	85381	69796	7378	9.6
:1986:	326346	181400	4077	29676	49580	61613	28611	39448	26655	260051	87264	71204	7642	9.6
:DATA:	8203	8202	8202	8203	8203	8203	8202	8203	8203	8203	8203	8203	8203	8203
:81 1:	53172	30267	656	4869	7320	10060	4513	6711	3693	42679	21176	16463	1577	14.8
:81 2:	54388	30628	654	5137	7686	10283	4558	7284	3987	43044	20628	16331	1595	13.1
:81 3:	55554	31315	680	5204	7981	10374	4729	7462	4058	43980	20606	16364	1570	13.0
:81 4:	56776	31808	718	5233	8264	10753	4769	7566	4207	44944	20581	16433	1538	12.7
:82 1:	57890	32239	728	5267	8603	11053	4837	7960	4243	45637	20579	16386	1541	12.9
:82 2:	58033	32538	723	5310	8770	10692	4879	7776	4556	45659	20138	16417	1581	10.6
:82 3:	58808	32859	740	5357	9056	10796	5047	7943	4614	46214	20164	16474	1768	9.5
:82 4:	59745	33310	752	5450	9260	10973	5089	8100	4673	46935	20274	16650	1850	8.8
:83 1:	60985	33735	762	5519	9516	11453	5351	8320	4732	47895	20333	16703	1821	8.9
:83 2:	61851	34210	760	5595	9749	11536	5390	7890	5027	48896	20462	16664	1818	9.7
:83 3:	62879	34806	784	5694	9956	11639	5463	8049	5114	49676	20557	16860	1799	9.2
:83 4:	64081	35390	799	5790	10212	11890	5563	8239	5200	50602	20613	16935	1740	9.4
:84 1:	65387	36041	814	5897	10415	12220	5703	8515	5296	51536	20584	16942	1772	9.1
:84 2:	66915	36865	819	6029	10622	12579	5895	8365	5417	53091	20793	17038	1769	9.6
:84 3:	68443	37807	851	6185	10795	12804	5997	8639	5555	54206	20890	17152	1789	9.3
:84 4:	70083	38767	875	6343	10969	13129	6106	8936	5696	55408	21013	17230	1760	9.6

TABLE 3 PERSONAL INCOMES & CONSUMPTION															
	YJ:	YWS	YFP	YEC	YJG	YJO	YSE:	TJYP	ENIH:	YD	YD/	CND	CD	SJE/:	
	TOTAL :PERSONAL :INCOMES	:WAGES :AND :SALARIES	FORCES :PAY	EMPLOY- :ERS :CONTRIB- :UTIONS	GRANTS :TO :PERSONAL :SECTOR	OTHER :PERSONAL :INCOME	SELF- :PLOYMENT :INCOMES	EM: :TAX ON :PERSONAL :SECTOR	NATIONAL :HEALTH :& :INSUR. :CONTRIB.:	:DISPOS- :ABLE :INCOME	REAL :DISPOS- :ABLE :INCOME	NON :DURABLE :CONSUMP- :TION	DURABLE :CONSUMP- :TION	SAVINGS :RATIO	
	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M A	£M75 A	£M75 A	£M75 A	%	
	% CHANGES OVER PREVIOUS YEAR														
:1976:	15.4	12.1	14.9	25.0	24.1	16.8	18.2	15.8	23.0	14.8	-0.8	-0.4	5.1	-5.9	
:1977:	11.9	10.7	2.2	11.7	18.4	12.6	12.0	4.2	12.3	13.4	-1.6	.4	-7.4	-9.9	
:1978:	15.4	14.5	9.2	15.1	18.5	17.1	18.4	7.5	6.8	17.8	8.2	4.9	15.0	18.8	
:1979:	19.0	17.4	22.8	15.8	17.2	26.5	21.3	11.3	14.1	20.6	6.9	4.2	12.4	12.9	
:1980:	18.0	18.1	20.6	18.1	21.5	15.1	8.4	18.8	20.9	17.6	1.3	.9	-9.6	8.3	
:1981:	9.5	6.9	11.2	16.1	22.6	5.5	5.6	12.4	14.4	8.6	-2.1	.2	2.9	-13.9	
:1982:	6.6	5.6	8.7	4.6	14.2	4.9	6.9	9.5	13.4	5.6	-2.2	.5	7.3	-22.0	
:1983:	6.5	5.5	5.5	5.7	10.5	6.9	9.6	2.3	11.0	6.8	1.0	1.9	6.5	-11.0	
:1984:	8.4	8.2	8.2	8.2	8.5	9.1	8.9	6.0	9.4	8.7	1.6	1.8	-1.2	1.0	
:1985:	10.0	10.4	10.4	10.4	7.5	10.6	10.5	8.4	10.4	10.2	2.5	2.1	4.1	2.3	
:1986:	9.6	9.9	9.9	9.9	7.8	9.8	9.2	5.7	9.9	10.1	2.2	2.0	3.6	.3	
:DATA:	8203	8202	8202	8203	8203	8203	8202	8203	8203	8203	8203	8203	8203	8203	
	% CHANGES OVER SAME PERIOD PREVIOUS YEAR														
:81 1:	12.1	10.4	11.2	19.0	22.5	7.7	5.6	13.0	14.8	11.8	.4	-.2	-3.2	5.3	
:81 2:	10.3	6.7	11.4	18.4	23.6	8.8	4.9	12.5	14.4	9.6	-1.1	.6	6.9	-12.9	
:81 3:	8.0	5.2	10.7	15.4	23.0	3.3	5.7	13.2	13.3	6.8	-3.7	.3	3.8	-22.3	
:81 4:	7.7	5.7	11.3	12.0	21.3	2.7	6.2	11.1	15.0	6.6	-3.8	.2	4.6	-22.9	
:82 1:	8.9	6.5	11.0	8.2	17.5	9.9	7.2	18.6	14.9	6.9	-2.8	-.5	-2.3	-13.0	
:82 2:	6.7	6.2	10.6	3.4	14.1	4.0	7.0	6.8	14.3	6.1	-2.4	.5	-.9	-18.9	
:82 3:	5.9	4.9	8.8	2.9	13.5	4.1	6.7	6.4	13.7	5.1	-2.1	.7	12.6	-26.5	
:82 4:	5.2	4.7	4.7	4.1	12.1	2.0	6.7	7.1	11.1	4.4	-1.5	1.3	20.3	-31.0	
:83 1:	5.3	4.6	4.6	4.8	10.6	3.6	10.6	4.5	11.5	4.9	-1.2	1.9	18.2	-30.9	
:83 2:	6.6	5.1	5.1	5.4	11.2	7.9	10.5	1.5	10.3	7.1	1.6	1.5	15.0	-9.0	
:83 3:	6.9	5.9	5.9	6.3	9.9	7.8	8.2	1.3	10.8	7.5	1.9	2.3	1.7	-3.2	
:83 4:	7.3	6.2	6.2	6.2	10.3	8.3	9.3	1.7	11.3	7.8	1.7	1.7	-6.0	7.4	
:84 1:	7.2	6.8	6.8	6.8	9.4	6.7	6.6	2.3	11.9	7.6	1.2	1.4	-2.7	2.0	
:84 2:	8.2	7.8	7.8	7.8	8.9	9.0	9.4	6.0	7.8	8.6	1.6	2.2	-2.7	-1.3	
:84 3:	8.8	8.6	8.6	8.6	8.4	10.0	9.8	7.3	8.6	9.1	1.6	1.7	-.5	1.1	
:84 4:	9.4	9.5	9.5	9.5	7.4	10.4	9.7	8.5	9.5	9.5	1.9	1.7	1.2	2.4	

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TABLE 4 FIXED INVESTMENT & STOCKBUILDING

	IF:	IFP	IFG:	INP	IHP:	IGG:	INGG	IHG:	IPCOR:	INPOX	INSO:	II	KII	KII/:
	:FIXED :INVEST- :MENT	:PRIVATE :FIXED :INVEST- :MENT	PUBLIC :FIXED :INVEST- :MENT	:PRIVATE :NON RES- :IDENTIAL :INVEST	PRIVATE :RESID- :ENTIAL :INVEST.	:INVEST- :MENT :GENERAL :GOVT	:GENERAL :GOVT :NONRESID :INVEST.	PUBLIC :RESID :INVEST- :MENT	:INVEST- :MENT BY :PUBLIC :CORP'NS	:PRIVATE :NON RES :INVEST. :EXC. OIL	INVEST- :MENT IN :NORTH :SEA OIL :	:STOCK- :BUILDING	STOCK :LEVEL	STOCK :OUTPUT :RATIO
	: £M75 A :	£M75 A	£M75 A :	£M75 A	£M75 A :	£M75 A :	£M75 A	£M75 A :	£M75	: £M75 A	£M75 A :	£M75 A	£ M 75	%
	ANNUAL VALUES													
:1976:	20640	11759	8881	9579	2180	4836	2752	2084	4045	7827	1752	658	32847	1.37
:1977:	20139	12419	7720	10380	2039	4018	2144	1874	3702	8767	1613	1382	34306	1.39
:1978:	20845	13815	7030	11488	2327	3557	1823	1734	3473	9988	1500	1146	35458	1.39
:1979:	21039	14186	6853	12169	2017	3414	1816	1598	3439	10939	1230	1782	37142	1.43
:1980:	20443	13997	6446	12305	1692	2982	1568	1414	3464	11140	1165	-1555	36959	1.46
:1981:	18774	13460	5314	12030	1430	2147	1231	916	3167	10742	1288	-1871	34762	1.41
:1982:	19236	14103	5113	12520	1583	1814	835	979	3299	11126	1391	-859	33891	1.37
:1983:	19866	14611	5255	12839	1772	1805	810	995	3450	11433	1400	-44	33231	1.32
:1984:	20668	15307	5361	13452	1854	1841	826	1015	3520	12048	1400	333	33554	1.30
:1985:	20968	15491	5477	13679	1812	1877	842	1035	3600	12277	1400	441	33918	1.29
:1986:	20990	15397	5593	13582	1815	1913	858	1055	3680	12179	1400	509	34424	1.29
:DATA:	8203	8202	8202	8202	8202	8202	8202	8202	8202	8202	8202	8203	8203	8203

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TABLE 4 FIXED INVESTMENT & STOCKBUILDING

	IF:	IFP	IFG:	INP	IHP:	IGG:	INGG	IHG:	IPCOR:	INPOX	INSO:	II	KII	KII/:
	:FIXED :INVEST- :MENT	:PRIVATE :FIXED :INVEST- :MENT	PUBLIC :FIXED :INVEST- :MENT	:PRIVATE :NON RES- :IDENTIAL :INVEST	PRIVATE :RESID- :ENTIAL :INVEST.	:INVEST- :MENT :GENERAL :GOVT	:GENERAL :GOVT :NONRESID :INVEST.	PUBLIC :RESID :INVEST- :MENT	:INVEST- :MENT BY :PUBLIC :CORP'NS	:PRIVATE :NON RES :INVEST. :EXC. OIL	INVEST- :MENT IN :NORTH :SEA OIL :	:STOCK- :BUILDING	STOCK :LEVEL	STOCK :OUTPUT :RATIO
	: £M75 A :	£M75 A	£M75 A :	£M75 A	£M75 A :	£M75 A :	£M75 A	£M75 A :	£M75	: £M75 A	£M75 A :	£M75 A	£ M 75	%
	% CHANGES OVER PREVIOUS YEAR													
:1976:	1.1	2.2	-3	2.8	-1	-3.0	-8.8	5.9	3.2	-2.4	34.2	--	-7	-2.5
:1977:	-2.4	5.6	-13.1	8.4	-6.5	-16.9	-22.1	-10.1	-8.5	12.0	-7.9	--	4.4	1.7
:1978:	3.5	11.2	-8.9	10.7	14.1	-11.5	-15.0	-7.5	-6.2	13.9	-7.0	--	3.4	.0
:1979:	.9	2.7	-2.5	5.9	-13.3	-4.0	-.4	-7.8	-1.0	9.5	-18.0	--	4.8	2.6
:1980:	-2.8	-1.3	-5.9	1.1	-16.1	-12.7	-13.7	-11.5	.7	1.8	-5.3	--	-5	2.5
:1981:	-8.2	-3.8	-17.6	-2.2	-15.5	-28.0	-21.5	-35.2	-8.6	-3.6	10.6	--	-5.9	-3.6
:1982:	2.5	4.8	-3.8	4.1	10.7	-15.5	-32.2	6.9	4.2	3.6	8.0	--	-2.5	-3.0
:1983:	3.3	3.6	2.8	2.5	12.0	-.5	-3.0	1.6	4.6	2.8	.7	--	-1.9	-3.7
:1984:	4.0	4.8	2.0	4.8	4.7	2.0	2.0	2.0	2.0	5.4	.0	--	1.0	-1.0
:1985:	1.5	1.2	2.2	1.7	-2.3	2.0	1.9	2.0	2.3	1.9	.0	--	1.1	-.9
:1986:	.1	-.6	2.1	-.7	.2	1.9	1.9	1.9	2.2	-.8	.0	--	1.5	-.1
:DATA:	8203	8202	8202	8202	8202	8202	8202	8202	8202	8202	8202	8203	8203	8203

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TABLE 5 PUBLIC SECTOR - FLOW OF FUNDS														
	PSBR	FG	FTKG:	SGA:	TYA	TEA	ENIH	YGTP	YGRA:	G£	EDBA	ESAB	EGGA:	IDG£:
	:PUB SECT NET ACQ.	NET	:CURRENT	:INCOME	EXPEND-	NATIONAL	PUBLIC	INCOME	:GOVT.	DEBT.	SUBSID-	CURRENT	:PUB.SECT:	
	:BORROW'G FIN ASST	CAPITAL	:SURPLUS	:TAX	ITURE	HEALTH	SECTOR	RENT &	:EXPEND.	INTEREST	IES	GRANTS	:CAPITAL	
	:REQUIRE- PUBLIC	TRANSFER:	PUBLIC	:RECEIPTS	TAX	& INSUR.	PROFITS	DIVIDEND:	G & S	PUBLIC	EXPEND-	:FORMAT-		
	:MENT SECTOR	PUB.SECT:	SECTOR	:	RECEIPTS	CONTRIB.		INTEREST:		EXPEND.	ITURE	:ION		
	: £M A	£M A	£M A	: £M A	: £M A	£M A	£M A	£M A	: £M A	£M A	£M A	£M A	: £M A	: £M A
	ANNUAL VALUES													
:76/7:	8722	-7621	-228	: 3320	: 19533	17093	8838	5014	4435	: 27397	6530	3530	14136	: 10713
:77/8:	5509	-6262	-368	: 3874	: 20562	21139	9760	5168	4882	: 30181	7092	3294	17105	: 9768
:78/9:	9636	-8211	-418	: 2496	: 23041	24452	10252	5789	5262	: 33899	8542	3826	20320	: 10289
:79/0:	10484	-7574	-289	: 4767	: 26289	33118	12041	5952	7090	: 40568	10455	4664	24033	: 12052
:80/1:	13558	-11076	-456	: 2516	: 31713	37860	14421	6648	9040	: 50461	12548	5637	28707	: 13136
:81/2:	8719	-6049	-235	: 6452	: 37478	44705	16495	8147	10359	: 56375	14447	5647	34249	: 12028
:82/3:	7408	-5116	-568	: 7845	: 40488	47311	18574	9655	10914	: 60420	14996	5126	38548	: 12462
:83/4:	9181	-6981	-703	: 7414	: 41968	49076	20637	11209	11675	: 64605	15310	5145	42091	: 13692
:84/5:	8449	-6249	-767	: 9699	: 46360	52475	22510	12612	12674	: 70004	15956	5525	45445	: 15181
:85/6:	7446	-5246	-836	: 12339	: 51439	55942	24830	14257	13919	: 76515	16632	5993	48902	: 16749
:DATA:	8204	8202	8202	8202	8202	8202	8203	8203	8202	8203	8202	8202	8202	8202

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TABLE 5 PUBLIC SECTOR - FLOW OF FUNDS														
	PSBR	FG	FTKG:	SGA:	TYA	TEA	ENIH	YGTP	YGRA:	G£	EDBA	ESAB	EGGA:	IDG£:
	:PUB SECT NET ACQ.	NET	:CURRENT	:INCOME	EXPEND-	NATIONAL	PUBLIC	INCOME	:GOVT.	DEBT.	SUBSID-	CURRENT	:PUB.SECT:	
	:BORROW'G FIN ASST	CAPITAL	:SURPLUS	:TAX	ITURE	HEALTH	SECTOR	RENT &	:EXPEND.	INTEREST	IES	GRANTS	:CAPITAL	
	:REQUIRE- PUBLIC	TRANSFER:	PUBLIC	:RECEIPTS	TAX	& INSUR.	PROFITS	DIVIDEND:	G & S	PUBLIC	EXPEND-	:FORMAT-		
	:MENT SECTOR	PUB.SECT:	SECTOR	:	RECEIPTS	CONTRIB.		INTEREST:		EXPEND.	ITURE	:ION		
	: £M A	£M A	£M A	: £M A	: £M A	£M A	£M A	£M A	: £M A	£M A	£M A	£M A	: £M A	: £M A
	% CHANGES OVER PREVIOUS YEAR													
:76/7:	--	--	--	: --	: 13.0	14.6	23.2	42.3	21.2	: 14.9	28.9	.7	21.7	: 3.6
:77/8:	--	--	--	: --	: 5.3	23.7	10.4	3.1	10.1	: 10.2	8.6	-6.7	21.0	: -8.8
:78/9:	--	--	--	: --	: 12.1	15.7	5.0	12.0	7.8	: 12.3	20.4	16.2	18.8	: 5.3
:79/0:	--	--	--	: --	: 14.1	35.4	17.5	2.8	34.7	: 19.7	22.4	21.9	18.3	: 17.1
:80/1:	--	--	--	: --	: 20.6	14.3	19.8	11.7	27.5	: 24.4	20.0	20.9	19.4	: 9.0
:81/2:	--	--	--	: --	: 18.2	18.1	14.4	22.5	14.6	: 11.7	15.1	.2	19.3	: -8.4
:82/3:	--	--	--	: --	: 8.0	5.8	12.6	18.5	5.4	: 7.2	3.8	-9.2	12.6	: 3.6
:83/4:	--	--	--	: --	: 3.7	3.7	11.1	16.1	7.0	: 6.9	2.1	.4	9.2	: 9.9
:84/5:	--	--	--	: --	: 10.5	6.9	9.1	12.5	8.6	: 8.4	4.2	7.4	8.0	: 10.9
:85/6:	--	--	--	: --	: 11.0	6.6	10.3	13.0	9.8	: 9.3	4.2	8.5	7.6	: 10.3
:DATA:	8204	8202	8202	8202	8202	8202	8203	8203	8202	8203	8202	8202	8202	8202

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TABLE 6 BALANCE OF PAYMENTS														
	BAL:	BALV	XG	PXG	MG	PMG:	BALI	XS	PXS	MS	PMS	BYPA	BTAB	XGM:
	:CURRENT	:VISIBLE	EXPORTS	DEFLATOR	IMPORTS	DEFLATOR:	INVISI-	EXPORTS	DEFLATOR	IMPORTS	DEFLATOR	INTEREST	PRIVATE	EXPORT
	:BALANCE	:TRADE	OF	FOR	OF	FOR	:BLE	OF	FOR	OF	FOR	PROFITS	& GOVT.	VOLUME
	:OF	:BALANCE	GOODS	EXPORTS	GOODS	IMPORTS	:TRADE	SERVICES	EXPORTS	SERVICES	IMPORTS	& DIVS	TRANSFER	MANUFAC-
	:PAYMENTS:		GOODS	GOODS	GOODS	GOODS	:BALANCE	SERVICES	SERVICES	SERVICES	SERVICES	ABROAD	ABROAD	TURES
	: £M	: £M	£M75	75=1	£M75	75=1	: £M	£M75	75=1	£M75	75=1	£M	£M	75=100
	A	A	A		A		A	A		A		A	A	
	ANNUAL VALUES													
:1976:	-875	-3929	21236	1.18	23980	1.21	3054	8359	1.22	6254	1.25	1365	-760	109
:1977:	-22	-2284	22887	1.39	24419	1.39	2262	8621	1.37	6143	1.40	118	-1115	118
:1978:	1018	-1573	23486	1.49	25559	1.43	2591	8606	1.47	6195	1.44	615	-1746	119
:1979:	-853	-3458	24288	1.67	28474	1.55	2605	8626	1.62	6852	1.53	892	-1745	118
:1980:	2865	1185	24733	1.92	26994	1.71	1680	8324	1.89	7149	1.64	-273	-2107	118
:1981:	6122	2979	24515	2.08	26991	1.78	3143	7820	2.14	7051	1.79	1011	-1981	112
:1982:	4202	1663	24555	2.24	28451	1.88	2539	7734	2.31	6988	1.98	660	-2132	112
:1983:	1452	-1085	25097	2.49	30019	2.12	2536	7730	2.53	7060	2.26	832	-1886	112
:1984:	-31	-1571	25703	2.73	30724	2.34	1540	7617	2.77	7081	2.56	560	-2018	115
:1985:	-96	-583	26517	3.00	31319	2.56	487	7604	3.05	7147	2.89	127	-2169	119
:1986:	-257	542	27082	3.33	31764	2.82	-799	7638	3.38	7216	3.28	-593	-2338	121
:DATA:	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203
:81 1:	2417	1677	5886	2.00	5915	1.71	740	1967	2.05	1757	1.69	207	-535	107
:81 2:	2003	1132	6074	2.02	6470	1.72	871	1955	2.13	1781	1.74	381	-565	110
:81 3:	205	-320	6186	2.13	7484	1.81	525	1947	2.18	1757	1.86	170	-635	112
:81 4:	1497	490	6369	2.18	7122	1.88	1007	1951	2.21	1757	1.88	253	-246	117
:82 1:	733	323	6041	2.20	6941	1.87	410	1969	2.25	1746	1.91	-185	-494	112
:82 2:	887	125	6316	2.18	7314	1.86	762	1933	2.31	1762	1.96	408	-651	116
:82 3:	1005	401	6007	2.28	7088	1.87	604	1918	2.31	1739	1.98	164	-533	108
:82 4:	1577	814	6191	2.33	7108	1.92	763	1915	2.36	1741	2.06	273	-454	110
:83 1:	844	81	6218	2.42	7339	2.04	763	1957	2.45	1755	2.16	216	-462	111
:83 2:	373	-276	6265	2.46	7504	2.09	649	1936	2.50	1766	2.22	207	-469	112
:83 3:	101	-485	6275	2.52	7590	2.14	586	1922	2.55	1771	2.29	212	-474	112
:83 4:	133	-405	6338	2.56	7585	2.20	538	1916	2.60	1767	2.35	197	-482	113
:84 1:	72	-418	6334	2.65	7588	2.27	490	1904	2.68	1761	2.45	186	-491	113
:84 2:	-196	-585	6381	2.70	7714	2.31	389	1899	2.74	1774	2.52	156	-501	114
:84 3:	11	-340	6460	2.76	7703	2.36	351	1907	2.80	1772	2.59	113	-509	115
:84 4:	82	-229	6529	2.81	7719	2.41	311	1907	2.85	1774	2.66	105	-517	117

TABLE 6 BALANCE OF PAYMENTS

	BAL:	BALV	XG	PXG	MG	PMG:	BALI	XS	PXS	MS	PMS	BYPA	BTAB	XGM:
	CURRENT	VISIBLE	EXPORTS	DEFLATOR	IMPORTS	DEFLATOR:	INVISI-	EXPORTS	DEFLATOR	IMPORTS	DEFLATOR	INTEREST	PRIVATE	EXPORT
	BALANCE	TRADE	OF	FOR	OF	FOR	BLE	OF	FOR	OF	FOR	PROFITS	& GOVT.	VOLUME
	OF	BALANCE	GOODS	EXPORTS	GOODS	IMPORTS	TRADE	SERVICES	EXPORTS	SERVICES	IMPORTS	& DIVS	TRANSFER	MANUFAC-
	PAYMENTS:		GOODS	GOODS	GOODS	GOODS	BALANCE	SERVICES	SERVICES	SERVICES	SERVICES	ABROAD	ABROAD	TURES
	£M A	£M A	£M75 A	75=1	£M75 A	75=1	£M A	£M75 A	75=1	£M75 A	75=1	£M A	£M A	75=100
	% CHANGES OVER PREVIOUS YEAR													
:1976:	--	--	9.9	18.5	5.8	21.2	--	6.3	22.3	-1.5	24.5	--	--	9.0
:1977:	--	--	7.8	17.0	1.8	15.0	--	3.1	12.3	-1.8	12.4	--	--	8.0
:1978:	--	--	2.6	7.7	4.7	2.8	--	-2	7.1	.8	3.2	--	--	1.1
:1979:	--	--	3.4	12.0	11.4	8.1	--	.2	9.8	10.6	5.9	--	--	-8
:1980:	--	--	1.8	14.6	-5.2	10.5	--	-3.5	17.2	4.3	7.1	--	--	-4
:1981:	--	--	-9	8.6	-0	3.8	--	-6.1	13.1	-1.4	9.5	--	--	-5.1
:1982:	--	--	.2	7.9	5.4	5.7	--	-1.1	7.6	-9	10.4	--	--	.0
:1983:	--	--	2.2	11.0	5.5	12.8	--	-1	9.5	1.0	14.1	--	--	.5
:1984:	--	--	2.4	9.6	2.4	10.3	--	-1.5	9.6	.3	13.2	--	--	2.5
:1985:	--	--	3.2	10.0	1.9	9.7	--	-2	10.0	.9	13.0	--	--	3.2
:1986:	--	--	2.1	10.8	1.4	10.2	--	.4	10.8	1.0	13.6	--	--	1.8
:DATA:	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203
	% CHANGES OVER SAME PERIOD PREVIOUS YEAR													
:81 1:	--	--	-7.6	7.0	-15.5	-2.7	--	-8.1	9.9	-2.1	3.2	--	--	-11.6
:81 2:	--	--	-2.3	5.1	-9.1	.5	--	-6.9	13.1	-.7	6.6	--	--	-7.6
:81 3:	--	--	2.5	9.9	14.1	7.1	--	-6.3	16.8	-2.3	13.2	--	--	-2.6
:81 4:	--	--	4.3	12.2	12.8	10.8	--	-2.8	12.5	-.4	15.0	--	--	1.7
:82 1:	--	--	2.6	9.9	17.3	9.4	--	.1	9.6	-.6	13.2	--	--	4.7
:82 2:	--	--	4.0	7.9	13.0	8.3	--	-1.1	8.5	-1.1	12.6	--	--	5.5
:82 3:	--	--	-2.9	6.7	-5.3	3.7	--	-1.5	5.6	-1.0	6.8	--	--	-3.6
:82 4:	--	--	-2.8	7.1	-.2	2.0	--	-1.9	7.0	-.9	9.2	--	--	-6.0
:83 1:	--	--	2.9	10.1	5.7	9.3	--	-.6	9.3	.6	13.2	--	--	-.6
:83 2:	--	--	-8	13.2	2.6	12.4	--	.1	8.2	.3	13.1	--	--	-3.5
:83 3:	--	--	4.5	10.6	7.1	14.6	--	.2	10.6	1.8	15.4	--	--	3.6
:83 4:	--	--	2.4	10.1	6.7	14.7	--	.1	10.1	1.5	14.5	--	--	2.9
:84 1:	--	--	1.9	9.4	3.4	11.1	--	-2.7	9.4	.3	13.4	--	--	1.6
:84 2:	--	--	1.8	9.7	2.8	10.4	--	-1.9	9.7	.4	13.4	--	--	1.9
:84 3:	--	--	2.9	9.8	1.5	10.1	--	-.8	9.8	.0	13.3	--	--	3.1
:84 4:	--	--	3.0	9.6	1.8	9.6	--	-.4	9.6	.4	12.9	--	--	3.3

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TABLE 7 MONEY SUPPLY & RELATED ITEMS							
	PSBR	KM3E	PEFD	KM3*	KM3/	RS	RL:
	: PUB SECT MONEY	DEFLATOR	REAL	MONEY	TREASURY	INTEREST:	
	: BORROW'G STOCK,	- FINAL	MONEY	STOCK/	BILL	RATE	
	: REQUIR- STERLING	EXPEND	STOCK	OUTPUT	RATE	UNDATED	
	: MENT M3	-ITURE				CONSOLS	
	: EM A	EM A	75=1	EM75A	%	%	%
	ANNUAL VALUES						
:1976:	9175	39360	1.15	34126	1.41	11.3	14.2
:1977:	5993	42498	1.31	32435	1.34	8.0	12.2
:1978:	8358	48980	1.44	34107	1.34	8.5	12.0
:1979:	12608	55170	1.63	33867	1.31	13.4	11.3
:1980:	12215	64330	1.93	33383	1.32	15.6	11.9
:1981:	10580	74623	2.13	34939	1.41	13.9	13.0
:1982:	5455	82647	2.26	36553	1.47	12.0	11.9
:1983:	9508	91325	2.39	38228	1.50	9.0	10.6
:1984:	8678	99987	2.55	39147	1.50	9.9	10.6
:1985:	7763	110042	2.75	39994	1.50	11.0	10.8
:1986:	6631	120613	2.97	40630	1.50	11.2	10.7
:DATA:	8204	8203	8203	8203	8203	8203	8203
:81 1:	2047	70250	2.06	34171	1.35	13.6	12.0
:81 2:	5859	73310	2.12	34544	1.40	12.0	12.6
:81 3:	2522	76600	2.17	35368	1.45	14.3	13.7
:81 4:	152	78330	2.20	35671	1.45	15.5	13.7
:82 1:	186	79800	2.20	36245	1.46	14.5	12.8
:82 2:	1282	81720	2.26	36218	1.46	13.5	12.6
:82 3:	1472	83068	2.29	36356	1.46	11.5	11.4
:82 4:	2515	86000	2.30	37392	1.48	8.4	10.8
:83 1:	2139	88700	2.34	37870	1.50	10.0	11.0
:83 2:	2695	90297	2.38	38021	1.49	9.0	10.6
:83 3:	2371	92070	2.40	38351	1.49	8.5	10.4
:83 4:	2303	94233	2.44	38671	1.50	8.5	10.3
:84 1:	1812	96380	2.49	38786	1.51	9.0	10.4
:84 2:	2617	98901	2.53	39029	1.50	9.7	10.5
:84 3:	2116	101016	2.58	39199	1.50	10.2	10.7
:84 4:	2132	103652	2.62	39573	1.51	10.6	10.7

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TABLE 7 MONEY SUPPLY & RELATED ITEMS							
	PSBR	KM3E	PEFD	KM3*	KM3/	RS	RL:
	: PUB SECT MONEY	DEFLATOR	REAL	MONEY	TREASURY	INTEREST:	
	: BORROW'G STOCK,	- FINAL	MONEY	STOCK/	BILL	RATE	
	: REQUIR- STERLING	EXPEND	STOCK	OUTPUT	RATE	UNDATED	
	: MENT M3	-ITURE				CONSOLS	
	: EM A	EM A	75=1	EM75A	%	%	%
	% CHANGES OVER PREVIOUS YEAR						
:1976:	--	8.3	15.4	-6.3	-8.5	--	--
:1977:	--	8.0	13.5	-5.0	-5.2	--	--
:1978:	--	15.3	9.6	5.2	.2	--	--
:1979:	--	12.6	13.5	-7	-1.9	--	--
:1980:	--	16.6	18.1	-1.4	.5	--	--
:1981:	--	16.0	10.9	4.7	6.8	--	--
:1982:	--	10.8	5.9	4.6	3.8	--	--
:1983:	--	10.5	5.6	4.6	2.2	--	--
:1984:	--	9.5	6.9	2.4	.5	--	--
:1985:	--	10.1	7.7	2.2	-3	--	--
:1986:	--	9.6	7.9	1.6	-3	--	--
:DATA:	8204	8203	8203	8203	8203	8203	8203
:81 1:	--	17.9	13.0	4.4	4.0	--	--
:81 2:	--	16.6	11.6	4.5	6.9	--	--
:81 3:	--	16.4	10.4	5.5	9.5	--	--
:81 4:	--	13.4	8.8	4.2	6.5	--	--
:82 1:	--	13.6	7.1	6.1	8.3	--	--
:82 2:	--	11.5	6.3	4.8	4.6	--	--
:82 3:	--	8.4	5.5	2.8	.6	--	--
:82 4:	--	9.8	4.8	4.8	2.1	--	--
:83 1:	--	11.2	6.4	4.5	2.5	--	--
:83 2:	--	10.5	5.3	5.0	2.0	--	--
:83 3:	--	10.8	5.0	5.5	2.6	--	--
:83 4:	--	9.6	5.9	3.4	1.8	--	--
:84 1:	--	8.7	6.1	2.4	.7	--	--
:84 2:	--	9.5	6.7	2.7	.5	--	--
:84 3:	--	9.7	7.4	2.2	.3	--	--
:84 4:	--	10.0	7.5	2.3	.3	--	--

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TABLE 8 FACTOR INCOMES IN GDP & EXPENDITURE ON GDP (CURRENT PRICES)

	GDP£:	YEM	YCTP	YGTP	YRSE	YSA	RESEY:	C£	IF£	II£	G£	X£	M£	FCA£:
	:GDP CURR:TOTAL	GROSS	PUBLIC	RENT & STOCK	RESIDUAL:CONSUMER	FIXED	INVEST-	PUBLIC	EXPORTS	IMPORTS	FACTOR			
	:PRICES :INCOME	TRADING	SECTOR	SELF EM- APPRECI-	ERROR	EXPEND-	MENT IN	CONSUMP-				COST		
	:EXPEND. :FROM EM-	PROFITS	PROFITS	PLOYMENT ATION		ITURE	STOCKS	TION				ADJUST-		
	:MEASURE :PLOYMENT				INCOME				MENT					
	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A
ANNUAL VALUES														
:1976:	111566	77532	15218	4654	18577	6472	2057	74850	23556	881	26739	35436	36916	13071
:1977:	127050	85798	20521	5283	20986	4908	-630	85948	25727	1881	29244	43582	42607	16968
:1978:	146079	98200	23257	5596	24378	4247	-1105	98867	29743	1601	32984	47726	45546	19597
:1979:	167937	115131	28983	5780	29213	9190	-1980	117071	34469	2995	38324	54625	54616	26018
:1980:	194538	136050	27708	6464	33082	6456	-2310	135738	39411	-2706	48424	63158	57913	31574
:1981:	211411	147169	27553	7793	36200	5692	-1931	151286	39377	-4160	54942	67822	60730	37126
:1982:	228280	155273	28421	9083	38722	3031	-176	165198	41713	-1855	59468	72949	67275	41929
:1983:	246773	163845	35444	10948	41854	5860	500	178733	45276	-83	63537	82053	79547	43197
:1984:	268899	177294	39410	12367	45548	6431	699	194099	50111	828	68514	91309	89882	46071
:1985:	296856	195740	43731	13849	50258	7668	954	213408	54607	1197	74901	102840	100894	49188
:1986:	326251	215153	47880	15236	54997	8261	1230	234962	59092	1496	81439	116008	113334	53403
:DATA:	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203

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TABLE 8 FACTOR INCOMES IN GDP & EXPENDITURE ON GDP (CURRENT PRICES)

	GDP£:	YEM	YCTP	YGTP	YRSE	YSA	RESEY:	C£	IF£	II£	G£	X£	M£	FCA£:
	:GDP CURR:TOTAL	GROSS	PUBLIC	RENT & STOCK	RESIDUAL:CONSUMER	FIXED	INVEST-	PUBLIC	EXPORTS	IMPORTS	FACTOR			
	:PRICES :INCOME	TRADING	SECTOR	SELF EM- APPRECI-	ERROR	EXPEND-	MENT IN	CONSUMP-				COST		
	:EXPEND. :FROM EM-	PROFITS	PROFITS	PLOYMENT ATION		ITURE	STOCKS	TION				ADJUST-		
	:MEASURE :PLOYMENT				INCOME				MENT					
	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A	£ M A
% CHANGES OVER PREVIOUS YEAR														
:1976:	18.3	13.7	25.4	42.9	17.9	20.3	434.3	15.8	15.4	-161.4	16.5	30.3	27.2	25.3
:1977:	13.9	10.7	34.8	13.5	13.0	-24.2	-130.6	14.8	9.2	113.5	9.4	23.0	15.4	29.8
:1978:	15.0	14.5	13.3	5.9	16.2	-13.5	75.4	15.0	15.6	-14.9	12.8	9.5	6.9	15.5
:1979:	15.0	17.2	24.6	3.3	19.8	116.4	79.2	18.4	15.9	87.1	16.2	14.5	19.9	32.8
:1980:	15.8	18.2	-4.4	11.8	13.2	-29.7	-16.7	15.9	14.3	-190.4	26.4	15.6	6.0	21.4
:1981:	8.7	8.2	-6	20.6	9.4	-11.8	-16.4	11.5	-1	53.7	13.5	7.4	4.9	17.6
:1982:	8.0	5.5	3.1	16.5	7.0	-46.8	-90.9	9.2	5.9	-55.4	8.2	7.6	10.8	12.9
:1983:	8.1	5.5	24.7	20.5	8.1	93.4	-384.2	8.2	8.5	-95.6	6.8	12.5	18.2	3.0
:1984:	9.0	8.2	11.2	13.0	8.8	9.7	39.7	8.6	10.7	-1103.3	7.8	11.3	13.0	6.7
:1985:	10.4	10.4	11.0	12.0	10.3	19.2	36.6	9.9	9.0	44.6	9.3	12.6	12.3	6.8
:1986:	9.9	9.9	9.5	10.0	9.4	7.7	28.8	10.1	-8.2	25.0	8.7	12.8	12.3	8.6
:DATA:	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203	8203

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TABLE 9 COMPANY SECTOR - FLOW OF FUNDS

	YCTP:	YCT-	YSAC:	YCNT	ECDV	ECOI	ECTP:	SC	SC-	IFCE	IICE:	FC	FCOX	YC-N:
:GROSS	:PROFITS	COMPANY	:NON-	DIVIDEND	EXPENDI-	COMPANY	:SAVINGS	SAVINGS	COMPANY	COMPANY	:FINANC'L	FC EXC.	COMPANY	
:TRADING	:NET OF	STOCK	:TRADING	ORDINARY	TURE ON	PAYMENTS:		NET OF	FIXED	VALUE OF:	DEFICIT	OIL COM-	PROFITS	
:PROFITS	:STOCK	APPRECI-	:PROFITS	SHARES	INTEREST	TAXES ON:		STOCK	INVEST-	STK&WRK	:COMPANY	PANIES	(-NSO)	
	:APPREC'N	ATION			ETC	INCOME		APPREC'N	MENT	IN PROG	:SECTOR			
: £M A	: £M A	£M A	: £M A	£M A	£M A	£M A	: £M A	£M A	£M A	£M A	: £M A	£M A	£M A	£M A
: ANNUAL VALUES														
:1976:	15218	: 9864	5354	: 9116	1840	5218	2189	: 15087	9733	10006	353	: -561	1114	9342
:1977:	20521	: 16619	3902	: 8956	2211	5655	3092	: 18519	14617	12079	1588	: 1058	1935	14700
:1978:	23257	: 19904	3353	: 9809	2682	5893	3904	: 20587	17234	15335	1339	: 859	2261	17580
:1979:	28983	: 21421	7562	: 13554	4273	8928	4828	: 24508	16946	18024	2660	: -3624	-3131	16808
:1980:	27708	: 22630	5078	: 16475	4302	13796	6427	: 19658	14580	20737	-2486	: -3522	-2965	15047
:1981:	27553	: 23281	4272	: 20126	4658	13836	8283	: 20450	16178	20700	-3418	: -1030	-423	13115
:1982:	28421	: 25880	2541	: 24200	5967	15324	10340	: 20989	18448	20796	-2144	: -309	-1609	14407
:1983:	35444	: 31029	4488	: 26674	7409	14896	11475	: 28338	23850	22682	-268	: 1819	278	18869
:1984:	39410	: 34539	4925	: 28707	8771	16193	13841	: 29312	24387	24371	187	: 250	-844	21559
:1985:	43731	: 37915	5871	: 30914	9940	18367	16062	: 30275	24403	25708	493	: -1333	-1944	23515
:1986:	47880	: 41629	6325	: 32399	11028	20483	18395	: 30373	24048	27395	742	: -3615	-4396	24654
:DATA:	8203	8203	8203	8202	8202	8202	8202	8202	8202	8202	8202	8202	8104	8104

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TABLE 9 COMPANY SECTOR - FLOW OF FUNDS

	YCTP:	YCT-	YSAC:	YCNT	ECDV	ECOI	ECTP:	SC	SC-	IFCE	IICE:	FC	FCOX	YC-N:
:GROSS	:PROFITS	COMPANY	:NON-	DIVIDEND	EXPENDI-	COMPANY	:SAVINGS	SAVINGS	COMPANY	COMPANY	:FINANC'L	FC EXC.	COMPANY	
:TRADING	:NET OF	STOCK	:TRADING	ORDINARY	TURE ON	PAYMENTS:		NET OF	FIXED	VALUE OF:	DEFICIT	OIL COM-	PROFITS	
:PROFITS	:STOCK	APPRECI-	:PROFITS	SHARES	INTEREST	TAXES ON:		STOCK	INVEST-	STK&WRK	:COMPANY	PANIES	(-NSO)	
	:APPREC'N	ATION			ETC	INCOME		APPREC'N	MENT	IN PROG	:SECTOR			
: £M A	: £M A	£M A	: £M A	£M A	£M A	£M A	: £M A	£M A	£M A	£M A	: £M A	£M A	£M A	£M A
: % CHANGES OVER PREVIOUS YEAR														
:1976:	25.4	: 26.2	--	: 25.9	19.1	10.4	-3.8	: 39.4	49.6	18.8	--	: --	--	19.9
:1977:	34.8	: 68.5	--	: -1.8	20.2	8.4	41.3	: 22.7	50.2	20.7	--	: --	--	57.4
:1978:	13.3	: 19.8	--	: 9.5	21.3	4.2	26.3	: 11.2	17.9	27.0	--	: --	--	19.6
:1979:	24.6	: 7.6	--	: 38.2	59.3	51.5	23.7	: 19.0	-1.7	17.5	--	: --	--	-4.4
:1980:	-4.4	: 5.6	--	: 21.6	.7	54.5	33.1	: -19.8	-14.0	15.1	--	: --	--	-10.5
:1981:	-.6	: 2.9	--	: 22.2	8.3	.3	28.9	: 4.0	11.0	-.2	--	: --	--	-12.8
:1982:	3.1	: 11.2	--	: 20.2	28.1	10.8	24.8	: 2.6	14.0	.5	--	: --	--	9.8
:1983:	24.7	: 19.9	--	: 10.2	24.2	-2.8	11.0	: 35.0	29.3	9.1	--	: --	--	31.0
:1984:	11.2	: 11.3	--	: 7.6	18.4	8.7	20.6	: 3.4	2.3	7.4	--	: --	--	14.3
:1985:	11.0	: 9.8	--	: 7.7	13.3	13.4	16.0	: 3.3	.1	5.5	--	: --	--	9.1
:1986:	9.5	: 9.8	--	: 4.8	10.9	11.5	14.5	: .3	-1.5	6.6	--	: --	--	4.8
:DATA:	8203	8203	8203	8202	8202	8202	8202	8202	8202	8202	8202	8202	8104	8104

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TABLE 10 OUTPUT, EMPLOYMENT AND UNEMPLOYMENT														
	GDP	GDPOX	PROD	PRODMF:	POPWA*	WPOP:	EEMF	EEGG	EEBAR:	ET	LUKA:	AEM	PSWI	OSWI:
	:GROSS	GDP EXCL	INDUST-	MANUFAC-	POPULA-	WORKING	:MANUF'G	GEN.GOV'T	OTHER	:TOTAL	UK UNEM-	:AVERAGE	PUBLIC	OTHER
	:DOMESTIC	NORTH	RIAL	TURING	:TION OF	POPULA-	:EMPLOYEE	EMPLOYEE	EMPLOY-	:EMPLOY-	PLOYMENT:	EARNINGS	SECTOR	WAGES &
	:PRODUCT	SEA OIL	PRODUC-	PRODUC-	:WORKING	TION	:IN EM-	IN EM-	MENT	:MENT	(SA)	:IN MANU-	WAGES &	SALARIES:
	:(OUTPUT)		TION	TION	:AGE		:PLOYMENT	PLOYMENT			:FACTOR'G	SALARIES		
	: £M 75	£M75 A			: '000S	'000	: '000 A	'000 A	'000 A	: '000 A	'000 A	: 75=100	75=100	75=100
ANNUAL VALUES														
1976:	96084	95601	102.1	101.5	: 33572	26046	: 7284	4997	10237	: 24774	1272	: 117	111	112
1977:	98655	97102	106.1	102.9	: 33765	26201	: 7307	4981	10354	: 24824	1377	: 129	117	125
1978:	101933	99735	109.9	103.9	: 33996	26381	: 7272	5008	10550	: 25005	1376	: 147	130	142
1979:	104103	100922	112.6	104.4	: 34217	26550	: 7174	5052	10849	: 25248	1302	: 170	145	167
1980:	101061	97711	105.3	95.4	: 34366	26474	: 6750	5039	10854	: 24826	1648	: 200	189	199
1981:	98561	94840	100.4	89.4	: 34544	26326	: 6092	5028	10507	: 23816	2509	: 227	216	219
1982:	99065	94783	100.9	88.4	: 34728	25976	: 5767	5012	10203	: 23183	2793	: 252	230	239
1983:	100888	96310	102.9	88.8	: 34924	25986	: 5567	4999	10060	: 22851	3135	: 272	245	256
1984:	102912	98160	105.5	90.7	: 35107	26146	: 5632	4997	10117	: 22980	3166	: 292	261	277
1985:	104996	100073	107.8	92.7	: 35227	26300	: 5703	4997	10223	: 23169	3131	: 316	284	305
1986:	106650	101563	109.4	94.1	: 35347	26400	: 5720	4999	10282	: 23257	3143	: 341	307	339
DATA:	8203	8203	8203	8203	8202	8202	8202	8202	8202	8202	8204	8203	8202	8202

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TABLE 10 OUTPUT, EMPLOYMENT AND UNEMPLOYMENT														
	GDP	GDPOX	PROD	PRODMF:	POPWA*	WPOP:	EEMF	EEGG	EEBAR:	ET	LUKA:	AEM	PSWI	OSWI:
	:GROSS	GDP EXCL	INDUST-	MANUFAC-	POPULA-	WORKING	:MANUF'G	GEN.GOV'T	OTHER	:TOTAL	UK UNEM-	:AVERAGE	PUBLIC	OTHER
	:DOMESTIC	NORTH	RIAL	TURING	:TION OF	POPULA-	:EMPLOYEE	EMPLOYEE	EMPLOY-	:EMPLOY-	PLOYMENT:	EARNINGS	SECTOR	WAGES &
	:PRODUCT	SEA OIL	PRODUC-	PRODUC-	:WORKING	TION	:IN EM-	IN EM-	MENT	:MENT	(SA)	:IN MANU-	WAGES &	SALARIES:
	:(OUTPUT)		TION	TION	:AGE		:PLOYMENT	PLOYMENT			:FACTOR'G	SALARIES		
	: £M 75	£M75 A			: '000S	'000	: '000 A	'000 A	'000 A	: '000 A	'000 A	: 75=100	75=100	75=100
% CHANGES OVER PREVIOUS YEAR														
1976:	1.9	1.4	2.1	1.5	: .5	.8	: -3.2	1.4	-.0	: -.6	--	: 16.6	10.6	11.6
1977:	2.7	1.6	3.9	1.5	: .6	.6	: .3	-.3	1.1	: .2	--	: 10.2	5.7	11.7
1978:	3.3	2.7	3.5	.9	: .7	.7	: -.5	.6	1.9	: .7	--	: 14.5	10.9	13.8
1979:	2.1	1.2	2.5	.5	: .6	.6	: -1.3	.9	2.8	: 1.0	--	: 15.5	11.8	18.0
1980:	-2.9	-3.2	-6.5	-8.7	: .4	-.3	: -5.9	-.3	.0	: -1.7	--	: 17.9	30.3	18.7
1981:	-2.5	-2.9	-4.6	-6.2	: .5	-.6	: -9.8	-.2	-3.2	: -4.1	--	: 13.2	14.3	10.5
1982:	.5	-.1	.5	-1.2	: .5	-1.3	: -5.3	-.3	-2.9	: -2.7	--	: 11.0	6.6	8.7
1983:	1.8	1.6	1.9	.5	: .6	.0	: -3.5	-.3	-1.4	: -1.4	--	: 8.1	6.4	7.3
1984:	2.0	1.9	2.6	2.2	: .5	.6	: 1.2	-.0	.6	: .6	--	: 7.2	6.4	8.2
1985:	2.0	1.9	2.2	2.2	: .3	.6	: 1.3	.0	1.0	: .8	--	: 8.3	9.1	10.2
1986:	1.6	1.5	1.5	1.5	: .3	.4	: .3	.0	.6	: .4	--	: 8.0	8.0	10.9
DATA:	8203	8203	8203	8203	8202	8202	8202	8202	8202	8202	8204	8203	8202	8202

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TABLE 11 NORTH SEA OIL													
	NSO	YTPN	TPRT	TROY	YNSV	ENSA	INSE	PFL	MG2	XXO	MXO	CPET	
	NORTH SEA OIL PRODUCTION	PROFITS FROM NORTH SEA OIL	TAX FROM PETROL REVENUE	NORTH SEA OIL ROYAL- TIES	DIRECT EFFECT ON VIS. ACCOUNT	EXPEND- ITURE ON INVIS. ACCOUNT	FIXED CAPITAL FORMAT'N N.S.OIL	UNIT VAL INDEX IMPORTS OF FUEL	IMPORTS OF FUELS	EXPORTS OF OIL	OIL IMPORT SAVINGS	PETROL CONSUMP- TION	
	£M TON	£M A	£M A	£M	£M	£M A	£M A	75=1	£M75 A	£M75	£M	£M75 A	
ANNUAL VALUES													
:1976:	12	526	0	44	651	188	2004	1.31	4328	142	341	77	
:1977:	37	1950	0	193	2302	550	2062	1.47	3780	609	945	80	
:1978:	53	2356	183	284	2898	744	2135	1.38	3472	895	1303	82	
:1979:	76	4838	826	473	5720	1368	2015	1.75	3309	1332	1849	82	
:1980:	80	8036	2399	977	9037	2215	2247	2.48	2787	1676	1673	71	
:1981:	89	10990	4009	1299	12308	2351	2702	3.17	2279	2340	1380	65	
:1982:	102	12403	4867	1680	14919	2448	3016	3.58	2161	2504	1750	68	
:1983:	110	13147	5419	1820	16176	2519	3190	3.89	2141	2747	1831	70	
:1984:	114	14032	6624	1956	17388	2676	3394	4.07	2206	2847	1898	72	
:1985:	118	15568	8557	2151	19119	2967	3646	4.42	2231	2947	1965	74	
:1986:	122	18352	10936	2504	22256	3498	3942	5.05	2204	3047	2031	74	
:DATA:	8203	8203	8202	8201	8202	8203	8202	8203	8203	8203	8203	8203	

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TABLE 11 NORTH SEA OIL													
	NSO	YTPN	TPRT	TROY	YNSV	ENSA	INSE	PFL	MG2	XXO	MXO	CPET	
	NORTH SEA OIL PRODUCTION	PROFITS FROM NORTH SEA OIL	TAX FROM PETROL REVENUE	NORTH SEA OIL ROYAL- TIES	DIRECT EFFECT ON VIS. ACCOUNT	EXPEND- ITURE ON INVIS. ACCOUNT	FIXED CAPITAL FORMAT'N N.S.OIL	UNIT VAL INDEX IMPORTS OF FUEL	IMPORTS OF FUELS	EXPORTS OF OIL	OIL IMPORT SAVINGS	PETROL CONSUMP- TION	
	£M TON	£M A	£M A	£M	£M	£M A	£M A	75=1	£M75 A	£M75	£M	£M75 A	
% CHANGES OVER PREVIOUS YEAR													
:1976:	936.2	2007.5	.0	388.8	1153.1	94.2	52.9	31.0	.4	--	--	-4.1	
:1977:	221.6	271.1	675.0	338.6	253.7	192.6	2.9	12.6	-12.7	--	--	4.1	
:1978:	41.5	20.8	£££££££	47.2	25.9	35.3	3.6	-6.1	-8.2	--	--	2.2	
:1979:	44.7	105.4	351.3	66.5	97.4	83.9	-5.6	26.0	-4.7	--	--	-4.4	
:1980:	5.3	66.1	190.4	106.6	58.0	61.9	11.5	42.3	-15.8	--	--	-12.6	
:1981:	11.1	36.8	67.1	33.0	36.2	6.1	20.2	27.8	-18.2	--	--	-8.7	
:1982:	14.3	12.9	21.4	29.3	21.2	4.1	11.6	12.8	-5.2	--	--	3.7	
:1983:	7.6	6.0	11.3	8.3	8.4	2.9	5.8	8.7	-9	--	--	3.8	
:1984:	3.6	6.7	22.2	7.5	7.5	6.2	6.4	4.7	3.0	--	--	2.6	
:1985:	3.5	11.0	29.2	10.0	10.0	10.9	7.4	8.6	1.1	--	--	2.1	
:1986:	3.4	17.9	27.8	16.4	16.4	17.9	8.1	14.3	-1.2	--	--	.8	
:DATA:	8203	8203	8202	8201	8202	8203	8202	8203	8203	8203	8203	8203	

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TABLE 12 SECTOR FLOWS-NET AQ FIN ASSETS											
	FG	FP:	FC	FJ:	FO	RES2:	FG/	FC/	FJ/	BAL/	RES2/:
	FINANC'L NET ACQ.:	NET ACQ.	NET ACQ.	NET ACQ.	RESIDUAL:	FG AS	FC AS	FJ AS	BAL AS	RES2 AS	
	ASSETS	FIN ASST:	FIN ASST	FIN ASST:	FIN ASST	ERROR	SHARE OF	SHARE OF	SHARE OF	SHARE OF	
	PUBLIC	PRIVATE	COMPANY	PERSONAL:	OVERSEAS		GDP	GDP	GDP	GDP	
	SECTOR	SECTOR	SECTOR	SECTOR	SECTOR						
	£M A	£M A	£M A	£M A	£M A	£M A	% SA	% SA	% SA	% SA	%
	ANNUAL VALUES										
:1976:	-8312	5380	-561	5941	857	2057	-6.7	-.4	4.8	-.7	1.7
:1977:	-5948	6556	1058	5498	17	-630	-4.1	.7	3.8	-.1	-.5
:1978:	-7950	10073	859	9214	-1018	-1105	-4.8	.5	5.5	.6	-.6
:1979:	-8280	9407	-3624	13031	853	-1980	-4.3	-1.9	6.7	-.5	-1.0
:1980:	-9936	15111	-3522	18633	-2865	-2310	-4.4	-1.6	8.2	1.2	-1.0
:1981:	-7322	15375	-1030	16405	-6122	-1931	-3.0	-.4	6.6	2.5	-.8
:1982:	-5210	10753	-309	11062	-4202	-1341	-1.9	-.1	4.1	1.5	-.5
:1983:	-6958	9726	1819	7908	-1452	-1317	-2.4	.6	2.7	.5	-.5
:1984:	-6478	7697	250	7447	31	-1250	-2.1	.1	2.4	-.0	-.4
:1985:	-5563	6663	-1333	7997	96	-1196	-1.6	-.4	2.3	-.0	-.3
:1986:	-4431	5452	-3615	9066	257	-1278	-1.2	-1.0	2.4	-.1	-.3
:DATA:	8202	8202	8202	8202	8202	8203	8202	8202	8202	8203	8203

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TABLE 13 WORLD										
	WGNP	IPW	XWM	WM3	WWPI	WCPI	POIL\$	PCOMM	POIL*RI	WM3/
	WORLD	WORLD	WORLD	WORLD	WORLD	WORLD	\$ PRICE	NON-OIL	INDEX OF	WORLD
	GROSS	INDUST-	EXPORTS	MONEY	WHOLE-	CONSUMER	OF	COMMOD-	REAL OIL	REAL
	NATIONAL	RIAL	OF MANU-	STOCK	SALE	PRICES	BARREL	ITY	PRICE	MONEY
	PRODUCT	PROD'N	FACTURES		PRICES		OF OIL	PRICES		SUPPLY
	75=100	75=100	75=1	75=100	75=100	75=100	\$/B	75=1	75=1	75=100
ANNUAL VALUES										
1976:	105	108	1.12	108	107	109	11	1.11	1.05	101
1977:	109	113	1.18	122	115	118	13	1.23	1.07	107
1978:	114	117	1.23	138	121	128	13	1.16	.93	114
1979:	118	123	1.30	155	134	140	18	1.30	1.19	116
1980:	119	123	1.37	172	154	158	32	1.48	1.86	112
1981:	121	124	1.39	193	169	175	35	1.55	2.17	114
1982:	120	118	1.33	214	181	189	34	1.56	2.03	118
1983:	121	119	1.33	234	191	202	30	1.52	1.61	122
1984:	124	123	1.40	255	204	215	32	1.55	1.49	125
1985:	126	127	1.46	279	220	230	34	1.61	1.44	127
1986:	129	131	1.52	304	238	247	38	1.71	1.48	128
DATA:	8202	8203	8202	8202	8202	8203	8203	8203	8203	8202

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TABLE 13 WORLD										
	WGNP	IPW	XWM	WM3	WWPI	WCPI	POIL\$	PCOMM	POIL*RI	WM3/
	WORLD	WORLD	WORLD	WORLD	WORLD	WORLD	\$ PRICE	NON-OIL	INDEX OF	WORLD
	GROSS	INDUST-	EXPORTS	MONEY	WHOLE-	CONSUMER	OF	COMMOD-	REAL OIL	REAL
	NATIONAL	RIAL	OF MANU-	STOCK	SALE	PRICES	BARREL	ITY	PRICE	MONEY
	PRODUCT	PROD'N	FACTURES		PRICES		OF OIL	PRICES		SUPPLY
	75=100	75=100	75=1	75=100	75=100	75=100	\$/B	75=1	75=1	75=100
% CHANGES OVER PREVIOUS YEAR										
1976:	5.0	8.5	12.1	13.3	6.8	8.7	5.2	11.5	4.4	6.1
1977:	4.0	3.8	4.8	12.8	7.3	8.9	10.7	10.9	1.7	5.1
1978:	4.3	4.1	4.9	13.1	5.8	7.9	.2	-6.0	-12.4	6.9
1979:	3.5	5.0	5.1	12.4	10.6	9.8	45.1	12.5	26.9	1.7
1980:	1.2	-.1	5.4	10.7	14.6	12.9	74.0	13.9	57.3	-3.5
1981:	1.3	.9	2.2	12.2	10.3	10.6	10.0	4.2	16.5	1.7
1982:	-.7	-4.5	-4.9	10.9	7.0	8.1	-4.2	.9	-6.7	3.6
1983:	.8	.1	.1	9.5	5.3	6.7	-11.3	-2.5	-20.4	4.0
1984:	2.2	3.9	5.2	9.2	6.8	6.6	6.7	2.0	-7.6	2.2
1985:	1.9	3.2	4.5	9.1	7.7	7.1	7.3	4.0	-3.3	1.3
1986:	1.9	3.0	4.5	9.2	8.2	7.3	11.5	6.3	3.0	.9
DATA:	8202	8203	8202	8202	8202	8203	8203	8203	8203	8202

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TABLE 14 SUMMARY TABLE OF CONSTANT ADJUSTMENTS

	AEM	CND	EEBAR	EEMF	EER	II	INPOX	KM3E	M	PC	PIMO	PMAN	PXGM	XGM:
	75=100	£M75 A	'000 S	'000 S	75=1	£M75 A	£M75 A	£M	£M75 A	75=1	75=100	75=1	75=1	75=100
:80 1:	-1.40	-186	102	10	.0657	-300	-4	1044	-90	-.0185	1.81	.0931	.0189	-2.83
:80 2:	1.06	-107	110	-26	-.0047	114	-139	1374	71	-.0121	-.72	-.0578	.0054	-1.64
:80 3:	1.07	-209	40	-59	.0443	-404	-85	748	-526	-.0262	.22	.0087	.0000	.10
:80 4:	-2.57	-226	31	-56	.0739	-596	28	1279	-606	-.0176	-1.36	.0288	-.0026	1.40
:81 1:	1.74	-24	23	-6	.1033	-591	-251	-83	-894	-.0269	.49	.0115	.0057	-2.88
:81 2:	.50	-146	-38	-16	-.0191	-846	-65	157	10	-.0112	-.81	-.0214	.0054	-2.95
:81 3:	4.68	-13	0	24	.0059	-491	13	2252	689	-.0149	.03	-.0533	-.0262	-.11
:81 4:	-.21	-109	-100	-14	.0222	-522	100	788	-17	-.0157	.52	.0181	-.0068	1.57
:82 1:	.51	-119	21	-31	.0533	-357	34	-353	-363	-.0230	.66	-.0347	-.0226	.09
:82 2:	.74	-71	-105	-28	.0210	-295	-201	-46	-25	-.0056	2.05	-.0486	-.0670	3.10
:82 3:	.81	-5	-50	-30	.0464	-656	-35	-1137	-321	-.0214	.61	-.0358	-.0349	-2.49
:82 4:	-1.11	-10	-50	-30	-.0186	-650	-100	29	-100	-.0278	1.08	-.0474	-.0489	2.60
:83 1:	.00	0	-50	-20	-.0376	-425	-100	2210	0	-.0100	2.75	-.0200	-.0400	.00
:83 2:	.00	-150	-50	-10	.0049	-425	-100	0	0	-.0100	1.00	-.0200	-.0400	.00
:83 3:	.00	-50	-50	0	.0235	-350	-100	0	0	-.0100	1.00	-.0200	-.0400	2.00
:83 4:	.00	-50	-50	0	.0170	-350	-100	0	0	-.0100	1.00	-.0200	-.0400	4.00
:84 1:	.00	-50	-50	0	.0100	-350	-100	0	0	-.0100	1.00	-.0200	-.0400	4.00
:84 2:	-1.00	-50	-50	0	.0100	-350	-150	0	0	-.0100	1.00	-.0200	-.0400	2.00
:84 3:	-1.00	-50	-50	0	.0100	-350	-150	0	0	-.0100	1.00	-.0200	-.0400	.00
:84 4:	-1.00	-50	-50	0	.0100	-350	-150	0	0	-.0100	1.00	-.0200	-.0400	.00
:85 1:	-1.00	-50	-50	0	.0100	-350	-150	0	0	-.0100	1.00	-.0200	-.0400	.00
:85 2:	-3.00	-50	-50	0	.0100	-350	-200	-500	0	-.0100	1.00	-.0200	-.0400	.00
:85 3:	-3.00	-50	-50	0	.0100	-350	-200	-500	0	-.0100	1.00	-.0200	-.0400	.00
:85 4:	-3.00	-50	-50	0	.0100	-350	-200	-500	0	-.0100	1.00	-.0200	-.0400	-2.00
:86 1:	-3.00	-50	-50	0	.0100	-350	-200	-500	0	-.0100	1.00	-.0200	-.0400	-4.00
:86 2:	-3.00	-50	-50	0	.0100	-350	-250	-1000	0	-.0100	1.00	-.0200	-.0400	-4.00
:86 3:	-3.00	-50	-50	0	.0100	-350	-250	-1000	0	-.0100	1.00	-.0200	-.0400	-4.00
:86 4:	-3.00	-50	-50	0	.0100	-350	-250	-1000	0	-.0100	1.00	-.0200	-.0400	-4.00
:87 1:	-3.00	-50	-50	0	.0100	-350	-250	-1000	0	-.0100	1.00	-.0200	-.0400	-4.00

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TABLE 15 CONSTANT ADJUSTMENTS IN ALPHABETICAL ORDER

	BYPA	CD	ECDV	ECOI	ECTP	EDBA	EEGG	ENIH	ENSA	FCA	IHP	IPW	MG2	OSWI
	£M	£M75 A	£M	£M	£M	£M	'000 S	£M	£M	£M75 A	£M75 A	75=1	£M75 A	75=100
:80 1:	1	-3	-123	532	22	321	-46	-7	42	86	-76	2.3083	117	-5.05
:80 2:	107	-107	-178	541	99	44	18	-4	85	-179	-36	-2.1918	47	-1.96
:80 3:	201	-162	25	588	52	-67	-32	-37	-102	104	-10	-.7485	-8	-6.75
:80 4:	342	-207	-376	935	1	281	-56	-1	-108	81	-35	3.8381	-33	-5.75
:81 1:	419	-125	-25	539	90	-171	60	13	-123	-18	9	2.2887	-68	-11.00
:81 2:	483	-65	121	642	38	-53	36	-9	-192	38	-44	.6810	-70	-8.78
:81 3:	296	-103	-125	644	56	130	-54	-28	-119	-118	13	-.5519	32	-10.51
:81 4:	764	-97	-498	727	70	114	28	57	197	-56	-10	-2.0912	5	-9.98
:82 1:	270	-109	-7	599	-139	133	-41	37	60	24	34	-1.4048	57	-12.80
:82 2:	836	-22	53	780	-78	28	-5	21	-63	-38	-13	-3.2843	56	-13.18
:82 3:	661	-34	0	800	0	-100	-70	34	-143	46	7	-4.8570	-65	-15.91
:82 4:	800	148	134	800	0	-100	-20	30	-100	0	0	-2.9633	0	-18.10
:83 1:	800	0	0	800	0	-100	-20	30	0	0	0	-1.2517	0	-19.00
:83 2:	800	0	0	800	-200	-100	-20	0	0	50	0	-1.3978	0	-19.00
:83 3:	800	0	0	800	-200	0	-20	0	0	0	0	-.4312	0	-19.00
:83 4:	800	0	0	800	-200	0	-20	0	0	0	0	-.0941	0	-19.00
:84 1:	800	0	0	800	-200	0	-20	0	0	0	0	-1.0000	0	-19.00
:84 2:	800	0	0	800	-300	0	-20	0	0	0	0	-1.0000	0	-19.00
:84 3:	800	0	0	800	-300	0	-20	0	0	0	0	-1.0000	0	-19.00
:84 4:	800	0	0	800	-300	0	-20	0	0	0	0	.0000	0	-19.00
:85 1:	800	0	0	800	-300	0	-20	0	0	0	0	.0000	0	-19.00
:85 2:	800	0	0	800	-400	0	-20	0	0	0	0	.0000	0	-19.00
:85 3:	800	0	0	800	-400	0	-20	0	0	0	0	.0000	0	-19.00
:85 4:	800	0	0	800	-400	0	-20	0	0	0	0	.0000	0	-19.00
:86 1:	800	0	0	800	-400	0	-20	0	0	0	0	.0000	0	-19.00
:86 2:	800	0	0	800	-500	0	-20	0	0	0	0	.0000	0	-19.00
:86 3:	800	0	0	800	-500	0	-20	0	0	0	0	.0000	0	-19.00
:86 4:	800	0	0	800	-500	0	-20	0	0	0	0	.0000	0	-19.00
:87 1:	800	0	0	800	-500	0	-20	0	0	0	0	.0000	0	-19.00

TABLE 16 CONSTANT ADJUSTMENTS IN ALPHABETICAL ORDER (CONT)

	PCOMM	PFL	PIF	PIMI	PMG	PMS	PROD	PRODMF	PSWI	PXS	RL	RS	TEA	TJYP
	75=1	75=1	75=1	75=1	75=1	75=1	75=100	75=100	75=100	75=1	%	%	£M	£M
:80 1:	-.0484	-.1057	.0091	.0340	.0334	-.1047	.01	-2.65	-.86	-.0404	-.1	.6	171	454
:80 2:	.0182	-.0641	-.0059	-.0116	-.0278	-.0948	.20	-1.08	-2.80	-.0327	.1	-1.5	-935	690
:80 3:	.0576	-.0737	.0007	-.0031	-.0182	-.0700	-.07	-1.19	8.85	-.0330	-.4	1.5	-759	-275
:80 4:	.0359	.0110	-.0047	-.0090	.0078	-.1723	.01	-1.73	1.05	.0928	.3	-1.9	-384	31
:81 1:	-.0764	.0059	.0027	.0090	.0081	-.1361	.69	.22	2.84	.0272	.8	-.6	-720	-31
:81 2:	.0044	.0128	-.0570	-.0064	-.0455	-.1309	.55	.39	.85	.0602	1.2	-2.4	-64	442
:81 3:	.0178	-.0681	-.0150	-.0881	-.0030	-.0624	.32	-.00	4.52	-.0657	1.1	4.1	320	16
:81 4:	.0028	.0868	-.0574	-.0822	.0067	-.1113	.62	-1.10	-7.67	-.0202	-.7	-.7	250	-120
:82 1:	.0525	.0035	-.0257	-.0490	-.0081	-.1248	.60	.53	-4.45	.0154	-.3	-1.5	197	184
:82 2:	.0726	-.1868	-.0415	.0065	-.0190	-.1236	.47	-.43	-3.26	.0858	.3	-.8	-15	266
:82 3:	.0979	-.0031	-.0345	.0137	-.0103	-.1036	.28	.17	1.76	-.1078	-.7	-.9	0	97
:82 4:	.0300	.1801	-.0262	-.0774	.0000	-.1000	.12	-1.25	-1.93	.0000	.0	-1.8	0	0
:83 1:	.0300	.1515	-.0200	-.0941	.0000	-.1000	.50	.00	-3.00	.0000	.0	2.6	0	0
:83 2:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	-1.6	0	0
:83 3:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	-.1	0	0
:83 4:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	-.1	0	0
:84 1:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:84 2:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:84 3:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:84 4:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:85 1:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:85 2:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:85 3:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:85 4:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:86 1:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:86 2:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:86 3:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:86 4:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0
:87 1:	.0300	.0000	-.0200	.0000	.0000	-.1000	.50	.00	-3.00	.0000	.0	.0	0	0

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TABLE 17 CONSTANT ADJUSTMENTS IN ALPHABETICAL ORDER (CONT)

	TROY	WCPI	WGNP	WM3	WPOP	WWPI	XG2	XWM	XS	YEC	YFP	YGTP	YSA	YSE
	£M	75=1	75=1	75=100	'000 S	75=1	75=100	75=1	£M75	£M	£M	£M	£M	£M
:80 1:	13	2.3251	2.6482	.65	26	1.9390	8.84	.0483	17	-388	52	-1135	-25	-87
:80 2:	-33	3.0739	1.6301	-.34	53	-.4648	-3.36	.0230	-91	-350	-16	-995	-8	-97
:80 3:	9	1.9594	2.7975	1.05	-37	-.2197	-11.36	.0067	-76	-353	-2	-530	-3	108
:80 4:	-27	2.6474	2.3458	.17	4	.7310	-50.36	.0286	-54	-249	16	-297	2	-82
:81 1:	-17	2.5584	2.9697	.68	40	1.6386	11.30	.0159	-62	-79	5	-416	1	-29
:81 2:	-28	2.8725	1.9977	2.21	-69	.3285	8.95	.0356	-110	132	28	-447	0	-62
:81 3:	-23	3.5183	2.3572	2.40	3	-.4037	-9.71	.0238	-136	85	34	-422	-5	85
:81 4:	-17	3.0504	1.9148	2.72	-254	1.0051	-29.69	.0440	-75	29	37	-290	-3	-34
:82 1:	1	2.2460	1.8576	1.31	-24	.7913	1.55	.0318	-26	-8	29	-37	-1	52
:82 2:	0	3.0611	2.3056	.72	-136	.5165	15.06	-.0342	-82	-12	28	36	-2	-67
:82 3:	0	3.2768	1.9172	-.56	-36	.2873	-10.59	.0000	-44	-19	26	-276	0	87
:82 4:	0	3.0000	1.5000	-.63	-74	.5000	30.09	.0000	-40	0	0	-300	0	0
:83 1:	0	3.0000	1.5000	-.50	0	.5000	.00	.0000	-40	0	0	-300	0	0
:83 2:	0	3.0000	1.5000	-.50	0	.5000	.00	.0000	-40	0	0	-250	0	0
:83 3:	0	3.0000	1.5000	-.50	0	.5000	.00	.0000	-40	0	0	-250	0	0
:83 4:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:84 1:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:84 2:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:84 3:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:84 4:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:85 1:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:85 2:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:85 3:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:85 4:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:86 1:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:86 2:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:86 3:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:86 4:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0
:87 1:	0	3.0000	1.5000	-.50	0	.0000	.00	.0000	-40	0	0	-250	0	0

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	72	The implications of rational expectations for the forecasting and the simulation of econometric models	Holly Beenstock
	73	Capital formation in a small open economy	Beenstock Willcocks
	74	Poverty, taxation and the welfare state	Beenstock
	75	An aggregative model of the UK labour market	Beenstock Warburton
	76	The causes of slower growth in the world economy	Beenstock Willcocks
	77	Rational expectations and the government budget constraint in a monetary model of inflation	Beenstock
	78	The empirical relationship between the money stock and the price level in the UK: a test of causality	Holly Longbottom
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	81	Finance and international direct investment in the United Kingdom	Beenstock
	82	The role of expectations in the determination of the maturity structure of the supply of bonds	Holly
	83	UK imports and the international trading order	Beenstock Warburton
	84	An anticipated optimal policy in a perfect foresight model	Holly
	85	An aggregative monetary model of the world economy	Beenstock Dicks
	86	Monetary policy expectations and real exchange rate dynamics	Beenstock Budd Warburton
	87	Economic management and aggregate supply	Ball
1981	88	An integrated analysis of the effective exchange rate for sterling	Warburton Beenstock
	89	Debt management, interest rates and the money supply in the United Kingdom	Beenstock Willcocks
	90	Does monetarism fit the UK facts?	Budd Holly Longbottom Smith
	91	Monetary policy and exchange rate policy in the Netherlands	Budd Warburton

	92	Open-loop optimal policies in rational expectations models	Holly Zarrop
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	100	User manual for SOMA	Holly
	101	Short term models and long term problems	Budd Holly
	102	Forecasting, expectations and information	Holly
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PRIME MINISTER

Economic Strategy
(C(83) 5)

BACKGROUND

FLAG A

In C(83) 5, the Chancellor of the Exchequer seeks the views of his colleagues on the size of the Public Sector Borrowing Requirement (PSBR) in 1983-84; and on how any reductions in taxation that he may be able to make in his Budget should be allocated between measures to reduce income tax, measures to assist companies, and measures to reduce prices.

2. Although the Chancellor of the Exchequer will take the views of his colleagues into account in preparing his Budget, he will not wish to be bound by them. He will also want to avoid any commitment to further collective discussion during the run-up to the Budget on 15th March, though he will be willing to discuss particular points bilaterally with individual Ministers.

3. The main features of the economic background are that inflation has fallen much faster than expected a year ago: the latest annual figure is 5.4 per cent, compared with a forecast of about 10 per cent before the 1982 Budget. Interest rates are significantly lower. Output is forecast to grow in 1983 by about 2 per cent. But the exchange rate has depreciated significantly; and later in the year this will produce, at least temporarily, an increase in inflation. Unemployment is likely to continue to grow, but at a much slower rate than in 1982. The key figures are set out in Annex 1 to C(83) 5.

The Level of the PSBR in 1983-84

4. The Chancellor of the Exchequer may not want to be too specific about the figures at the Cabinet meeting. As you know, the present forecasts indicate a PSBR in 1983-84 of about £6 billion if tax changes are confined to revalorisation. The medium term financial strategy implies a PSBR of about $2\frac{3}{4}$ per cent of Gross Domestic Product, or some £8 billion; and this would be in line with the indications given at the time of the 1982 Budget. On

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this basis, there is room for a fiscal adjustment of about £2 billion. The Chancellor of the Exchequer says (paragraph 9 of C(83) 5) that his preliminary view is that it would be a mistake to publish a forecast 1983-84 PSBR above £8 billion. There are indeed arguments for greater caution, which he may wish to deploy:

- (a) The markets are volatile. It would be dangerous to risk losing confidence and provoking a further substantial decline in the exchange rate.
- (b) Inflation is likely to rise again temporarily in the not too distant future. It will be important to do nothing which might add to inflationary pressures and, in particular, to try to keep interest rates down.
- (c) Although there are obvious political attractions in a larger fiscal adjustment, one of the Government's strongest points is its consistency of purpose and prudent management.

5. A further point that must be borne in mind is the effect of any fiscal adjustment on the PSBR in 1984-85. It would be dangerous to pre-empt now too much of the room for manoeuvre in that year. Moreover, the Financial Statement and Budget Report this year will have to include an estimate of the size of the fiscal adjustment in 1984-85: the Government would be strongly criticised if that estimate was unexpectedly low.

6. Clearly all these arguments will apply with greater force to any suggestion that the PSBR should be higher than £8 billion.

The Fiscal Options

7. To the extent that the scope for relaxation is used to reduce taxes, should the reductions mainly benefit persons or companies? Should they be concentrated on direct taxation, or used to affect prices through reduced indirect taxation? Are there individual measures which are particularly attractive or unattractive?

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Persons or Companies?

8. Pound-for-Pound, reductions in personal and company taxation have broadly similar economic effects. Reductions in personal taxation may help companies through increased demand or lower wage claims; reductions in company taxation may help people by increasing employment opportunities.

9. The main points which the Cabinet will wish to consider are as follows:

- (a) Recent fiscal measures - particularly the successive reductions in the National Insurance Surcharge (NIS) and last year's loading of the increase in National Insurance Contributions on to employees - have benefited companies rather than persons.
- (b) The depreciation in the exchange rate will help more companies than it damages; the resulting higher inflation will hit persons.
- (c) The Government is exposed to criticism (as Table 2 in Annex 3 to C(83) 5 brings out) for not having done more to reduce the burden of personal taxation.
- (d) On the other hand, company profits are still very low (Table 4 in Annex 3), and the industrial base fragile: the recent revisions in the estimated numbers of people in employment have thrown doubt on previous estimates of gains in productivity over the past few years.

FLAG B

Direct or Indirect Taxation?

10. The main arguments affecting the choice between direct and indirect taxation are as follows:

- (a) In favour of reductions in indirect taxation is the fact that inflation is likely to turn upwards, at least temporarily. A reduction in indirect taxation would at least partly offset the effect of this on the Retail Price Index (RPI).
- (b) But even a reduction of 0.5 per cent in the RPI would cost some £600 million a year. To achieve a sufficiently large reduction to avoid any upsurge in inflation could use up the whole of the room for fiscal adjustment.


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- (c) It would look odd to devote substantial sums to reducing the real burden of taxation on drink or tobacco, though the case for containing the rise in other forms of indirect taxation may be stronger.
- (d) The Government is committed to shifting the burden of taxation away from direct taxation.

Particular Measures

11. There is a very wide range of possible changes which could be mentioned in the Cabinet's discussion. There is a useful ready reckoner of revenue effects in Annex 4 to C(83) 5. The particular pressures most likely to be discussed are the following:

Income Tax: Basic Rate or Allowances?

The arguments in C(83) 5 seem to point to increasing income tax allowances and thresholds. It may be suggested that it would be better to reduce the basic rate. But to reduce the basic rate by only 1p would cost nearly £1 billion in a full year. The same money would permit an increase in allowances (or allowances and thresholds) of 5 to 6 per cent.

NIS


From April 1983 the rate of NIS will be 1½ per cent.

If there is to be a further reduction, the choice may lie between ½ per cent and 1½ per cent (ie abolition): the reduction of 1 per cent would leave the rate at a derisory ½ per cent. Abolition would cost £1.2 billion in a full year.

Corporation Tax

The main rate of corporation tax is 52 per cent. A 2 per cent reduction would cost £230 million in a full year. It might have useful psychological significance, but, because of the generous allowances available, the incidence of corporation tax is very uneven. Reductions in it are not a way of helping the generality of companies.

FLAG C



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Petrol Tax

Particularly in the light of Parliamentary difficulties last year, some of your colleagues may suggest that petrol tax should not be fully revalorised. Halving the increase needed for revalorisation would cost about £100 million.

Public Expenditure

12. It may be suggested that part of the fiscal adjustment should be used to increase public expenditure. I understand that the Chancellor of the Exchequer is discussing various packages with the Ministers directly concerned. The costs of these packages are modest and can probably be found from the Contingency Reserve (ie within the Government's overall spending plans). But more ambitious suggestions may be put forward: for example, for a large programme of public works. If so, you will wish the Cabinet to consider the following:

- (a) The Government has gained a good deal of credit for not increasing its spending plans for 1983-84 between expenditure reviews. Does it want to put that credit at risk?
- (b) If there is to be no increase in public expenditure overall, major new programmes would require off-setting savings. Are those savings available?
- (c) Programmes of public works take a long time to mount. If one could be mounted now (and there are no definite proposals in view), could it take effect quickly enough to be useful?

13. One possible complication is on the social security front. The Ministerial Group on Social Security Issues (MISC 88) is recommending to the Cabinet that the November 1983 uprating of social security benefits should be adjusted downwards by 2 per cent to take partial account of the 2.7 per cent overshoot in the November 1982 uprating. I understand that this is already broadly allowed for in the Chancellor's calculations. But the Cabinet will not consider the recommendations from MISC 88 until

SECRET



SECRET

17th February; and if the decision then were to be in favour of a significantly smaller adjustment, the Budget calculations could be affected. There is however no need to discuss this unless one of your colleagues raises the point.

HANDLING

14. After the Chancellor of the Exchequer has introduced his memorandum, each member of the Cabinet is likely to want to speak. The main questions are:

- (i) What should the PSBR be for 1983-84?
- (ii) How should any fiscal adjustment be distributed as between persons and companies and as between direct and indirect taxation?
- (iii) Should any significant part of the adjustment be devoted to additional public expenditure?

In practice, it will be difficult to keep these issues separate; and you will probably find it convenient to go round the table seeking the views of each of your colleagues on the whole range.

15. You will probably wish to ask the Secretary of State for Industry to speak early in the discussion, so that the Cabinet can take account of his views on the needs of industry. The Secretary of State for Employment may have views on the likely effects on different tax options on wage bargaining. The Lord President of the Council and the Chief Whip can advise on back-bench opinion. The Chief Secretary, Treasury will be able to deal with any public expenditure points.

16. Before you sum up, you may wish to ask the Chancellor of the Exchequer to give his general reactions to the discussion.

CONCLUSIONS

17. In summing up, you will wish to reflect the balance of views on the size of the PSBR in 1983-84 and on the options for allocating any fiscal adjustment. You will wish to make clear that the Chancellor of the Exchequer is not committed by the discussion to particular changes in his Budget and you will want to avoid any commitment to further general discussion by the Cabinet, apart from the traditional meeting immediately preceding the Budget.



SECRET

18. You might then record conclusions which:
- (i) Invite the Chancellor of the Exchequer either to take account of the views expressed in discussion in his further work in the Budget or, if there is widespread pressure for a stronger formulation, to be broadly guided by your summing up.
 - (ii) Invite any Minister who has particular points on possible tax changes to discuss them directly with the Chancellor of the Exchequer or, in the case of public expenditure points, with the Chief Secretary.

RIA

Robert Armstrong

2nd February 1983



Prime Minister (2) CE JV
MS 4/2

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

1 February 1983

D C R Heyhoe Esq
Private Secretary to the Lord President

Dear David,

In view of the continuing interest in the impact of lower oil prices on the UK and world economy, the Chancellor has asked me to circulate the attached short unclassified brief.

Copies of this letter go to Michael Scholar at No 10, Murdo Maclean at No 12, and to the Private Secretaries of all members of Cabinet.

Yours ever,
John Kerr
JO KERR

Effect of Oil Price Changes on UK and world economy

1. A lower world oil price is on balance good for the UK. Large disruptive movements in any direction in no-one's interest: disrupt the world economy. If the price falls too low, future sharp rise may become inevitable. But a modest/gradual fall on balance good for the UK. Reduces inflation in the world, and raises growth, both of which are helpful to our industries - and offset relatively modest direct impact on the trade balance. Oil accounts for relatively small proportion of UK economy (4-4½ per cent of GNP) and overseas trade (net oil exports are 10 per cent of non-oil exports), even tax revenue (6 per cent).
2. Improves output. Oil importing countries have better balance of payments, lower inflation, and can therefore look for some increase in growth. British exporters gain from higher world output and trade.
3. Reduces inflation. Direct benefit for inflation enhanced for countries that are oil importers, to the extent that their currencies rise; partially offset for us to the extent that sterling falls.
4. Impact on PSBR. Lower North Sea revenues - if North Sea prices follow world prices - would initially add to PSBR. But for this purpose the sterling price of North Sea oil counts, not the dollar price. Fall in £/\$ rate since Autumn is enough to offset effect on revenues of significant fall in oil price.
5. Effect on Exchange Rate. Not surprising that changes in world price of oil affect currencies. Impact of a fall on UK modestly helpful (see above). Bigger benefits for other major currency countries (Germany and Japan in particular) that are large net importers of oil. So raises the value of their currencies against sterling. Part of the recent fall in sterling

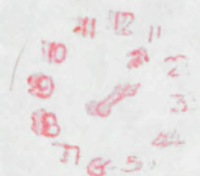
reflects expectations that oil price would fall, so if fall does occur it may already be discounted - at least partly - in exchange markets. No domestic reasons for sterling to fall: underlying UK monetary and financial conditions remain sound.

6. Effect on UK current account is not large, Because net oil exports are only a relatively modest part of our overseas trade, any fall in £/\$ exchange rate raises their sterling value. Current account would have been in very substantial surplus last year even had oil prices been 10 or 20 per cent lower. [Taking the direct impact only - and forgetting any effect on exchange rate or the benefits to UK exports from better world growth - with a 10 per cent lower oil price the current account surplus last year would have been around £ $\frac{1}{2}$ billion lower than the £4 $\frac{1}{2}$ billion actually secured.]

7. No reason to think a modest fall in oil prices will necessarily worsen international banking problems. Most developing countries benefit from lower oil prices. Indeed, their problems were caused by the 1979/80 rise in oil prices. Brazil's problems, for example, would be eased by a fall in oil prices. Mexico's and Nigeria's would be increased in the short run, and possibly this could have an adverse short term effect on banking confidence. In longer term all debtor countries, including Mexico, benefit to the extent that lower oil prices bring lower inflation, lower nominal interest rates and better growth in world trade.

8. Why are petrol prices at the pump rising, not falling? Average world oil prices (in \$) have, so far, hardly fallen since the Autumn. But sterling has fallen by around 10 per cent against the dollar. So the sterling cost of crude oil has risen in recent months. Profit margins on oil refining and marketing were already very low. So attempts by oil companies to restore profitability, together with increase in sterling cost of oil, may mean rising petrol prices in the short term. A fall in world oil prices would help offset this.

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PPS/CHANCELLOR

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copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/EST
PS/MST(C)
PS/MST(R)
PS/Home Secretary
PS/Lord Chancellor
PS/Foreign Secretary
PS/Secretary of State for Education and
Science
PS/Lord President of the Council
PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Environment
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Trade
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments
and other Departments in Whitehall

TREASURY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 24 January, are sidelined.

M M Deyes

M M DEYES

12A

R I G ALLEN

31 January 1983

EB Division
H M Treasury
01-233-5503

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A **GENERAL ECONOMIC STRATEGY**

✓NB 1983 Public Expenditure White Paper being published 1 February.✓

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policy must continue to combine firmness and flexibility. Right for Government to have adjusted money supply and PSBR objectives in light of changed circumstances. But also right that medium-term direction of policy is maintained.

2. Recovery over/Activity flat?

Delayed but not over. GDP over 1 per cent higher than trough in Spring 1981; industrial output some 2 per cent higher. Flatness of output during 1982 partly reflected external developments: volume of world trade fell substantially, contrary to expectation at time of 1982 Budget. But rapid progress on inflation and improvements in productivity and competitiveness are encouraging; further modest recovery in output expected in 1983.

3. Policy far too tight, given world recession? Shortage of demand?

Government cannot fine-tune either money or real GDP. Domestic demand in real terms has risen by nearly 4 per cent since spring 1981. Problem is lack of external demand and UK's depressed share of home and foreign markets (reflecting weak competitiveness), though exports held up extremely well last year in face of downturn in world economy. Improvements in supply performance needed as much as increased demand. Otherwise a boost to demand may be largely wasted, even in the short term.

4. Where will growth come from?

Already seeing benefits of lower inflation and interest rates reflected in higher consumer spending and recovery of investment in housing and many parts of private industry. Recovery in world economy will assist UK growth, as will continued effort to control inflation and contain costs.

5. Rise in interest rates will kill hopes for recovery - as in autumn 1981?

Does not follow: rise in interest rates only one element in picture, and interest rates still 5 points below October 1981 level. Recent figures for PSBR, money supply, etc confirm that strategy is on course.

6. Outlook for inflation?

Remain confident of achieving 5 per cent RPI inflation early this year. As for rest of year, path may be a little bumpier than thought at time of Autumn Statement, but must not exaggerate possible effect of exchange rate depreciation. (See also D 3-4).

7. Are we to undertake from Chancellors' speech of 19 January that Government now has a target/ceiling for interest rates, regardless of exchange rate developments?

No. UK monetary and financial conditions remain sound - inflation is falling, monetary growth and PSBR are on target, balance of payments current account has remained in surplus. So stand by Chancellor's statement (in Economic Debate 19 January) that 'there is no doubt that there is no reason for a further rise in interest rates now'.

8. Fall in exchange rate underlines poor state of UK economy?

Underlying economy is in good shape. Government spending and borrowing on target - as is monetary growth. Inflation is falling. UK running substantial current account surplus. Foreign currency debts almost halved since took office. Movement in sterling needs to be considered in context of strength of other currencies eg \$.

9. Exchange rate slide will improve external competitiveness?

Will only have lasting benefit if wage settlements continue to be contained at more moderate, and realistic levels. Keeping firm control of labour costs is the key to improving our competitive position. Past experience (eg 1967-72 and 1973-76) illustrates all too clearly how easy it is for immediate benefits of devaluation to be eroded through higher price and wage inflation.

10. CBI suggestion that cost competitiveness still 20 per cent lower than 1975?

[Sir Terence Beckett: 26 January.]

Wrong to make simplistic comparisons with 1975 (or indeed any other period). Important test of competitiveness is whether domestic producers can achieve reasonable share of home and world markets. Indications for 1982 are encouraging: import penetration stopped rising and there was some increase in our share of export markets.

11. Does PM agree with CBI Budget representations?

[CBI proposals published 26 January 'Costs are Crucial', include in £4 billion programme abolition of NIS, lower business rates, extra capital expenditure, lower energy costs and indexation of personal taxes (but not specific duties); CBI say this is possible within £9 billion PSBR.]

Chancellor will study and fully consider CBI views. All representations play a useful part in

putting together a Budget. Views of national organisations like CBI are particularly important. But cannot anticipate Budget decisions.

12. Government should do more for industry?

Have already done a good deal but, clearly, pressures on industry need to be taken into account. However, pressures too on persons. Poverty and unemployment traps matter for concern. Chancellor will be considering fiscal position over coming weeks, and scope and need for fiscal changes.

13. Outlook for Budget

Cannot comment on speculation that fiscal adjustment is bigger than illustrative £1 billion figure included in the Autumn Statement. Fact that PSBR may be undershooting this year - and outcome still very uncertain - does not carry any necessary implications for next year's figure. Many factors enter the equation - including the path of output, inflation and interest rates, and - of course - new public expenditure figures to be published 1 February. So nothing can be said at this stage. (See also H).

14. Implications of possible oil price fall for Government revenues/UK economy?

A modest and gradual fall in oil prices would bring both gains and losses for the UK, but the overall effect would be beneficial. However in no one's interest for price to fall too far or too fast. (See also D4, F6, S2.)

15. Labour Party programme

[Unclear from recent statements eg Foot 22 January, Shore in 22 and 23 January broadcasts, exactly how far Labour leadership sticking to 'Programme for Recovery'; nevertheless clear that still espouse substantial depreciation and substantial reflation, plus (Foot speech) 'planned trade'].

Defects of Labour programme remain. Blow to confidence; wage restraint assumed without specific mechanism to achieve; 'planned trade' proposals equally vague. Claimed validation by running programme through Treasury model does not make results definitive.

16. Alliance programme a more credible alternative?

['Working together for Britain' published 20 January reiterates measures urged in earlier policy statements - designed to create over $\frac{1}{2}$ million jobs at net PSBR cost of £3-4 billion].

Contains some proposals which are sensible and not too far removed from Government thinking. But largely stands or falls on success of measures to control pay and prices. Suggestions for income policy wrap old ideas in new clothes. Pays lipservice to financial prudence but vague on how this would work in practice. Claimed impact of measures in SDP statements has looked extremely optimistic.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent GDP figures

[GDP on the average measure was unchanged between Q2 and Q3 of 1982, but GDP (output - which is a better indicator of short term movements - rose slightly for second successive quarter (with construction output 3 per cent up on previous quarter) to level about 1 per cent higher than in 1981 Q2. Industrial production in November 1½ per cent down on October; 1 per cent decline in manufacturing. Now clear evidence of declining trend in manufacturing during 1982. Underlying level of industrial output in three months to November 2 per cent above 1981 Q2 trough - virtually all reflecting higher North Sea oil output; manufacturing output 1 per cent lower than in 1981 Q2.]

Level of output particularly in manufacturing remains disappointing - partly due to depressed world economic activity - but consumer goods holding up well, reflecting higher consumer expenditure. Expected higher world output and lower effective exchange rate should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide a sounder base for expansion in the medium term.

IF PRESSED on UK economy having suffered worst collapse of any major industrialised country since 1979

[On Treasury estimates, between 1979 and 1982 UK GDP fell by just over 4 per cent; US fell ½ per cent and Canada 2 per cent. In Germany GDP has been roughly constant and in Japan, France and Italy it rose].

UK GDP has grown slowly relatively to most other major Western economies throughout the post-war period. But our relative performance during 1982 was better than many of our competitors, and we expect to do similarly this year.

IF PRESSED on index of manufacturing production in November (86.8, 1975 = 100) returning to 1967 levels (87.8 in 1967 Q1):

Inappropriate to make such long term comparisons without recognising that sectoral composition of output is changing. As consumers' preferences change and balance of comparative advantage alters, so will configuration of economy. GDP is almost 26 per cent above its level in 1967.

2. Prospect for UK economy

[Industry Act Forecast Tables summarised in Commentary at end of Brief. NB New forecast will accompany Budget 15 March; undue emphasis should not be given to precise numbers in IAF.]

World background still unfavourable, but modest (around 2 per cent) recovery generally forecast for 1983.

Industry Act forecast published with Autumn Statement assumed fiscal/monetary policy broadly as 1982 MTFs. PSBR in 1982-83 £9 billion (likely to undershoot), ^{£ 8 billion in 1983-84, with assumed £1bn fiscal adjustment 83 Budget, IAF} ~~1983-84~~ expected: modest recovery in GDP and manufacturing output; consumer expenditure main stimulus to domestic demand; recovery in capital investment; falling balance of payments current account surplus; 5 per cent RPI inflation early in 1983.

Outside forecasts generally in agreement but assume larger fiscal adjustment (around £2 billion) and weak recovery in capital investment. Most expect:- modest recovery in GDP (around 1½ per cent); further falls in inflation in H1 (but less optimistic on inflation than IAF); only slight moderation in average earnings in 1982-83 pay round; adult (seasonally adjusted) unemployment (new basis) rising throughout to around £3.1 million - further weakening of balance of payments current account. Impact of sterling depreciation in 1983: prospects for output and balance of payments improved; outlook for inflation only slightly less favourable.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments?

Next CBI Industrial Trends Survey being published Tuesday 1 February; separate briefing being provided.

5. New orders figures and short-term indicators depressing?

[New construction orders rose 8 per cent in three months to November compared previous three - 6 per cent up on year earlier. In three months to November total housing starts up 8 per cent on preceding three, and 24 per cent on same period in 1981. Volume of new orders in engineering industries rose about 1½ per cent in three months to October compared previous three. Car production rose to 76000 in December, but 2½ per cent down in last six months compared previous six. New vehicle registrations (not seasonally adjusted) in 1982 about 5½ per cent up on 1981. Weekly rate of steel production fell in December and in 1982 Q4 was 32 per cent lower than 1981 Q4.]

Some encouraging signs but figures still manifesting depressed economic activity which itself partly reflects flatness in world trade.

6. Construction industry forecasts show prospects of modest recovery?

[Joint Forecasting Committee of Building and Civil Engineering Economic Development Committees (EDCs) published 6-monthly forecast on 15 December. Overall prospect is for modest recovery in three years to 1984 - although overall growth rate fails to restore output to 1970's levels].

Construction industry's problems remain difficult, but forecast moderately encouraging and recovery in housing investment in 1983 (some 16-17 per cent) very encouraging. Improved outlook for construction reflects success of policies reducing inflation and interest rates.

7. Fall in investment and reduction in stocks?

[Capital expenditure by manufacturing, distributive and service industries in 1982 Q3 3 per cent higher than Q2 but 2 per cent down in latest six months compared previous six. Investment in manufacturing (including leased assets) in 1982 Q3 unchanged from previous quarter but 4½ per cent lower in latest six months than previous six. CBI October survey shows, for second successive survey, decline in investment intentions. IAF projects 3 per cent growth in fixed investment in 1982, 5 per cent in 1983.]

Figures reflect some modest recovery after disappointing second quarter. [IF PRESSED: latest DOI investment intentions survey suggests 3 per cent fall in manufacturing investment between 1982 and 1983. This is undoubtedly disappointing, but manufacturing is only one component in total private fixed investment, outlook for which is more encouraging. (See B6 above).]

8. Stock levels a threat to recovery?

[In 1982 Q3 manufacturers' and distributors' stocks fell unexpectedly sharply by around £420 million (1975 prices). Apart from 1980 Q4 and 1981 Q2, fall was larger than any quarter in current recession.]

Quarterly movements in stocks tend to be erratic; Q3 de-stocking may partly reflect adjustment to involuntary stockbuilding in 1982 H1. (This view possibly supported by December Trends Inquiry). Not too much weight should be placed on single quarter's data. GDP (output) figures (see B1 above) are a better guide to recent movements in activity.

9. Competitiveness not improved this year?

Cost competitiveness has improved about 20 per cent since 1981 Q1 and taking into account recent exchange rate movements, is about 10 per cent worse than when Government took office; though exchange rate lower than in May 1979. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one. Lower exchange rate makes it all the more important for companies to maintain close control over their costs. (See also section F).

10. Government contribution to improving competitiveness?

Government role is to create right environment: firm fiscal and monetary framework allowing for lower inflation and interest rates, supply side policies, NIS cut helps reduce business costs. Up to industry to secure ever higher levels of productivity and not fritter away benefits of Government policy in excessive wage increases.

11. Productivity growth falling off?

[Growth in output per head in manufacturing slowed down sharply during 1982; 2½ per cent in November (compared same period a year earlier). However, productivity still around 13 per cent higher than at end 1980.]

Manufacturing productivity gains in last two years much bigger than might have been expected on past experience. Slowing down during 1982 probably inevitable as best opportunities for plant closures and improved efficiency are taken up first. Recent experience still better than average post-war experience.

12. CSO's index of leading cyclical indicators?

Longer leading index fell in December after nine months of increase, reflecting rise in interest rates and decline in share prices. Fall in longer leader only based on one months figures. Series not particularly smooth anyway, and decline based entirely on recent financial developments. No firm conclusions can be reached.

13. Outside forecasts

[GDP profile in recent major assessments and in IAF:

	Per cent change							
	Simon & Coates (Jan)	Phillips & Drew (Jan)	LBS (Dec)	OECD (Dec)	CBI (Nov)	St James (Nov)	NIESR (Nov)	IAF (Nov)
1982 on 1981	+½	+½	+¼	+½	+½	+½	+¼	+½
1983 on 1982	+2	+1¾	+2	+1	+1¼	+2	+1	1½
1984 on 1983	-	-	+2	-	-	+3½	+1	-]

Nearly all major outside forecasts see prospect of lower inflation and continued modest recovery.

C LABOUR MARKET

[NB Unemployment figures for January to be published Thursday 3 February].

1. Recent unemployment figures (on new and old basis) and other labour market indicators?

[Recent unemployment/vacancy figures shown in Table below on both old and new basis. Because of seasonal factors, sharp rise in 'headline total' expected in January, thereafter flat till May. Other labour market indicators: hours lost through shorttime working have increased steadily since July 1982 returning to 1981 Q4 and 1982 Q1 levels; overtime remains flat.

	1981				1982				Dec
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
'Total' unemployment (millions)	-	-	-	2.77	2.86	2.80*	2.94*	3.07	3.10 (13.3%)
(on old basis)	2.46	2.59	2.93	2.96	3.04	3.01	3.28	n.a	n.a
UK adult sa unemployment (millions)	-	-	-	2.61	2.68	2.74	2.84	2.91	2.95 (12.7%)
(on old basis)	2.28	2.48	2.64	2.75	2.82	2.88	2.98	n.a	n.a
increase in period (000's)**				+32*	+23*	+28	+31	+27	+27
(on old basis)	+77	+62	+51	+26	+18	+30	+42	n.a	n.a
Vacancies (000's)	98	89	96	104	112	107	111.0	115	118

*After allowing for over-60's transferring off register

**differences between consecutive three monthly moving averages]

Rise in underlying rate of increase in December figures probably reflects in part the modified signing-on procedures operated at Benefit Offices over Christmas. Underlying increase in unemployment broadly flat in 1982 but doubtless unemployment will continue to rise for some time until benefits of lower inflation, greater wage moderation and improved competitiveness eventually begin to filter through.

2. Unemployment still rising despite Government's policies?

Excessive wage increases - unjustified by either output levels or productivity improvements - have eroded cost competitiveness and priced people out of jobs. Deepseated problems, which have taken long time to build up, will also take long time to check and reverse.

3. Latest information on earnings/pay settlements?

See Section D.

4. Devaluation way to improve competitiveness and hence employment prospects?

See F5.

5. Government fiddling the statistics?

No. New basis is cheaper, more accurate and cuts out wasteful procedures. New basis using voluntary registration also reveals similar trend to previous series.

6. What categories of unemployed affected by changes?

Severely disabled now included. Non-claimants registering at Job Centres, and far more people who find jobs before day of count, now removed. Non-claimants are principally married women paying reduced national insurance contributions and some may previously have been self-employed. Non-claimants number 110-150 thousand in most months of the year.

7. Will adjustment between 'old' and 'new' way of counting always be as great as $\frac{1}{4}$ million?

Generally, difference between old and new counts would have been between 170 and 190 thousand. October difference was exceptionally large because many (about 100,000 people) still on register at Job Centres had in fact already found jobs.

8. Does new system affect GAD assumptions for 1982-83 and 1983-84?

Scale of the assumed increase will not be significantly affected, but the assumed GB levels of 2.9 million in 1982-83 and 3.2 million in 1983-84 (excluding school leavers) could be some 200,000 lower ie 2.7 million and 3.0 million. Number of claimants eligible will, of course be unaffected.

9. Unemployment in UK higher than in other countries?

[On standardised definitions in 1982 Q3 UK unemployment was 12.5 per cent (new series) compared with 8.3 per cent OECD rate - over double for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - increase in latest three months on previous three in number unemployed (on national definitions - not strictly comparable) was much more in US and Germany (up 8.7 per cent) Canada (8.0 per cent) or Holland (7.5 per cent), than in UK (2.8 per cent).

10. True level of UK unemployment really much higher?

[TUC say 'true' figure just under 4 $\frac{1}{2}$ million The Times 11 November, Labour Research Department say 5 million The Times 6 December; SDP say 5 $\frac{1}{4}$ million Guardian 7 January.]

Gross exaggerations, relying heavily on claimed one million fall in labour force between 1979 and 1982. This is not supported by 1981 Labour Force Survey (see C12 below).

Estimates also often include those benefiting from special employment measures who are not unemployed. Furthermore, as much as 10 to 20 per cent of official count may not be seriously seeking employment. Claimant figures are best available measure of trend.

11. True level of vacancies?

Official notified vacancies (118,000 in December) reflect only about one third of total openings for job seekers.

12. New employment figures significantly affect figures of GDP, manufacturing productivity etc?

[Employed labour force mid-1981 on new data about 800,000 higher than previous estimates, comprised of extra 550,000 employees in employment (found by 1981 Census of Employment), plus extra 250,000 self-employed (from 1981 Labour Force Survey). Extra employees mainly concentrated outside manufacturing sector. On new data, manufacturing sector accounts for whole of fall in employment to mid-1981.]

Effect on GDP probably quite small - manufacturing productivity revised down by about one per cent in both 1981 and 1982; whole economy productivity figures revised down more substantially in 1981 and 1982 but still suggest recovery in productivity since end-1980.

13. Cost of unemployment/Effect on PSBR?

Effects of changes in unemployment on the public finances likely to vary widely according to underlying circumstances, for example changes in world trade, UK competitiveness, level of UK earnings and so on. Not therefore sensible to talk about 'cost of unemployment' as though there were a single figure. Payments of unemployment benefit and supplementary benefit to people registered as unemployed are currently expected to total about £5 billion in 1982-83. Comparable figures for total of taxes and national insurance contributions not collected cannot be given. There is no basis for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

14. What is Government's own forecast of unemployment?

[Government Actuary was instructed to assume that number of unemployed in Great Britain, excluding school leavers etc, would average 2.9 million in 1982-83 and 3.2 million in 1983-84, (or just under 3.4 million including school leavers). Assumption for 1982-83 same as in 1982 PEWP but for 1983-84 300,000 higher than in 1982 PEWP.]

GA's assumptions are not predictions or forecasts. [IF PRESSED they provide reasonable assessment of prospect but any forecast of unemployment must be highly conditional.]

15. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups. Most crucial factor in influencing unemployment is level of pay settlements (See also Section D).

16. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures and £2 billion in 1983-84. Within the latter, £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) the new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) the new Job Splitting Subsidy to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

17. Employment continuing to fall?

[Total employment declined 2.0 million (8½ per cent) between mid 1979 and Q2 1982. Decline of 103,000 in 1982 Q1 increased to 188,000 in 1982 Q2. Manufacturing employment fell by 21,000 between September and October last year to 5,550,000 (compared 5,896,000 in September 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C1⁶ above).

18. Recent productivity gains inimical to higher employment/lower unemployment?

This may be true in the short run. But in the longer term, as experience in Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[Year on year RPI increase 5.4 per cent in December, compared 6.3 per cent in November].

Year on year rate of inflation again fell sharply in December to 5.4 per cent - lowest level for 13 years (compared 5.1 per cent in March 1970). Price level actually slightly (0.2 per cent) lower in December than November.

2. Fall in inflation due only to reduction in mortgage rate?

True that falling mortgage interest rates have helped to reduce inflation, but only account for small part of fall. Only 1.3 percentage points of fall in rate of inflation from 12.0 per cent in January 1982, when mortgage rates at peak, to 5.4 per cent in December, resulted from fall in mortgage rates over that period.

3. Comparison with previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.1 per cent.]

When previous Government left office (May 1979), year-on-year rate of inflation was 10.3 per cent and rising (May 1978 figure was 7.7 per cent). Now (December 1982) 5.4 per cent and falling. We will be first Government for quarter-century to achieve lower average rate of inflation during its term of office than previous Administration.

4. Effect of recent fall in sterling on rate of inflation over next 18 months?

[Chancellor discussed in 19 January Debate speech.]

Remain confident of achieving 5 per cent RPI inflation soon. For rest of year, path may be a bit more bumpy than expected at time of Autumn Statement. But must not exaggerate possible effect of exchange rate depreciation. Exchange rate only one factor amongst many that affect inflation, although admittedly an adverse one. Government continuing to pursue sound money policies. New forecasts, taking account of all relevant factors, will be published with the Budget.

5. Ready reckoner for effect of depreciation or inflation?

[LBS assess sterling fall will add 2 per cent to inflation in 1983, 3½ per cent in 1984 The Times 17 Jan].

Not possible to give precise 'ready reckoner' for effect of exchange rate changes on price level. Suggestion of 2-3 per cent effect of recent depreciation on prices after 12-18 months much too pessimistic. Offsetting factors include weak commodity prices (including oil),

likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

6. No further decline in inflation?

[IAF with Autumn Statement: 5 per cent in 1983 Q4.]

Progress in recent months has been faster than was forecast; and may in consequence be rather slower in the months ahead. But we shall continue to experience the benefits of sound financial policies.

[IF PRESSED on Autumn Statement IAF: Unwise to speculate at this stage: new forecast will be published with Budget, taking account all relevant factors, both helpful (eg weak commodity prices) and less helpful (lower exchange rate)].

7. Inflation still not as low as competitors?

[December figures UK inflation 5.4 per cent compared 3.9 per cent in US, 4.6 per cent in West Germany, 9.7 per cent in France, 16.3 per cent in Italy and 1.8 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

8. TPI shows pay rises need to be $\frac{1}{2}$ per cent higher than RPI to maintain living standards?

[TPI increase 12 months to December 5.8 per cent, compared RPI increase of 5.4 per cent].

Gap between RPI and TPI (now 0.4 percentage points) widened in July 1982 when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of change - except for minority who have spell of unemployment during year.

9. Nationalised industry prices

[Increase in nationalised industry prices, water charges and London Transport Fares over 12 months to December 14.3 per cent compared RPI increase of 5.4 per cent].

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 also played important part. Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices and RPI now about 9 per cent, compared 14 per cent in January 1981; over half of present differential explained by LT fares and 1981 winter electricity rebate. Signs are that the gap will continue to narrow. Sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also R6-8.)

PAY

10. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

11. Level of pay settlements?

[CBI figures published 19 January suggest manufacturing settlements averaging 6.2 per cent so far in pay round.]

CBI data bank of manufacturing settlements showed average of about 6 per cent in the round up to the end of last year. Since then, National Engineering Agreement has been ratified at 4.8 per cent, so manufacturing settlements have probably come down further now. But of course most settlements in the economy generally have yet to be concluded; it is important that these settlements should be kept as low as possible.

12. A 3½ per cent pay policy?

The 3½ per cent pay figure [announced 1 October for calculating the pay element in public expenditure cash plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it decision on offer to be made in any individual case. Higher or lower settlements are not ruled out. Each will be considered on merits.

13. Government exhortations on pay imply aiming to cut living standards?

[Real earnings have shown little variation over past two years; though November level was actually about 1¼ per cent higher than November 1981.]

Low pay increases do not necessarily mean reduction in living standards. But whether they do or not, they are essential if we are to create competitive and profitable productive sector, and thus secure conditions for sustained improvement in living standards.

14. Average earnings index

[Year on year growth 8.3 per cent in November compared with 7.3 per cent in October. However, underlying increase slightly lower than in October at about 8½ per cent.]

Fact that average earnings index is ahead of RPI casts doubt on wilder claims about falling living standards. Further moderation in settlements is needed if we are to maintain jobs and get inflation down.

15. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to idea that an incomes policy can be made to work on permanent basis. They always succumb to distortions they create.

16. Pay increase for nationalised industries' boards this year?

No general level of increases for board members this year. Proposals for each board being considered individually on merits, in light of circumstances. When relatively large increases have been approved by Ministers responsible (in consultation with Chancellor) it is because these have been justified by such factors as need to recruit people of ability, inadequate differentials with senior staff and performance of industry. Because board pay held back in previous years, many salaries are now seriously out of line with market rates.

17. Performance-related pay for nationalised industry board members?

An attractive concept. Practicalities and implications are being studied jointly with representatives of Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

18. Index-linked pensions and Scott report?

Government announced in Debate 22 October that favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

E MONETARY AND FINANCIAL POLICY

1. Monetary growth on target?

[Money and banking figures published 13 January summarised below:

	M1	£M3	per cent s.a. PSL2
December increase	0.9	0.6	0.5]

Growth rates of all three aggregates within target range - M1 and £M3 at almost 11 per cent and PSL2 about 9 per cent.

2. Why have interest rates gone up?

[Barclays, Lloyds and Natwest increased their base rates by 1 per cent (to 11 per cent) on 11 January and Midland theirs by $\frac{3}{4}$ per cent (to 11 per cent) on 12 January. Still down by 5 points since peak in October 1981. Long term interest rates also reduced significantly over past year.]

Structure of interest rates in domestic money markets was dislodged by fall in sterling. Interest rates in domestic money markets rose sharply in early January but have steadied. Bank base rate increases and increase in Bank of England's dealing rates reflected this. Government remain determined to maintain sound monetary conditions and to continue progress towards lower inflation. To have resisted the rise could have been interpreted as a weakening of the Government's resolve.

3. Rise in interest rates will stifle recovery (as in autumn 1981)?

Does not necessarily follow. The fall in the exchange rate, though adverse for inflation, (but see also D4-5), will ease pressure on companies. (See also A7).

4. Did Government engineer rise in interest rates?

As is evident from sequence of events, the rise in interest rates stems from market developments, including developments in currency markets.

5. Will interest rates rise further?

[Interest rate 'ruled out as means of defending sterling' claimed in Guardian 20 January.]

Stand by what Chancellor said in Debate 19 January; 'there is no reason for further rise in interest rates now; if the exchange rate were to fall further, such a fall could well be only temporary'. Government remain determined to maintain sound monetary conditions.

6. Prospects for resuming falls in interest rates?

Interest rates have to adjust to play their part in maintaining sound monetary conditions. Route to lower interest rates is ultimately through lower inflation.

7. Will slide in sterling affect monetary conditions?

Level of sterling is one of the factors taken into account in judging monetary conditions. Recent fall in exchange rate may reflect market uncertainty about monetary conditions, though this is scarcely justified, given the reassuring position on the PSBR and monetary aggregates. Rise in interest rates will reassure markets that monetary conditions required for continued control of inflation will be maintained.

8. Will mortgage rate now rise?

[Mortgage rates have fallen 5 percentage points from peak in March 1982. Latest cut, to 10 per cent, came into effect for all home buyers on 1 December. Bank base rates have risen 1 per cent since then.]

That is a question for the building societies. Their liquidity position is very strong at present; they do not need to be rushed into adjusting their rates.

9. Treasury view of Spalding report on building societies

[Published 26 January.]

Studying it with interest.

10. Bank lending growing too fast?

[Bank lending starting to decrease slowly. Increased by (seasonally adjusted) £2 billion in September, average for October and November [because of STC distortion] £1.5 billion, and £0.8 billion in December.]

December figure lowest for last year. (NB Might have been distorted by short banking month.) Bank lending to companies has steadied; lending to persons has fallen off from its high level last summer.

F EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[Since October, sterling has fallen 12 per cent in effective terms, 10 per cent against the dollar, 13 per cent against the D-Mark, 21 per cent against the yen.

	October average	11 Jan low points	31 Jan 10.15 am	% change Oct -31 Jan
\$/£	1.6977	1.5635	1.5330	-9.7
DM/£	4.2932	3.6757	3.7505	-2.6
Y/\$	460.12	357.96	365.16	20.6
£ effective	92.5	80.6	81.1	-12.3

Markets have been volatile since end-October, largely reflecting fluctuations in market perceptions of the course of US interest rates. Thus, the recent recovery of the US dollar has gone some way to reverse what had been seen as a general re-alignment of currencies, with long-expected rise in D mark and yen. Oil price weakness and uncertainties have also unsettled the markets, particularly for sterling. Irresponsible Opposition policy statements also had an effect].

Government has no target for exchange rate. Nor do recent events suggest conditions exist in which pursuing a target would be a viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible. Government not indifferent to UK exchange rate, which is important for economy. It is one of factors taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Impact of fall in sterling on inflation?

Will no doubt be some modest impact on inflation from recent fall. But probably less or slower to come through than many commentators suggest. Importers into UK have had healthy profit margins. They absorbed much of effect of sterling's fall in 1981 and they may remain reluctant to raise prices in today's market conditions. Food on green £ prices reflect 'green pound' (which is fixed separately) and has been unchanged (see Note below). Commodity prices (including oil prices - one of reasons for sterling's fall) are weak - and tend to be set in dollars, where fall in sterling has been least. And, of course, some of the fall could prove to be temporary.

Report in FT 18 January suggesting 'green £' changed - not the case. What has happened is that fall in sterling has eliminated gap between market rate and green £.

3. Should not Government welcome fall in pound?

A lower exchange rate means higher costs to industry and the consumer: no-one should welcome that. Of course, recent fall in pound may bring some relief to British firms that are facing difficult competitive pressures in home and overseas markets, particularly from

Europe and the Far East - but they must contain their costs rigorously in order to retain that benefit. We cannot solve our basic problems of competitiveness by depreciation, and no-one should doubt our determination to adhere to our counter-inflation policies. Sound money remains at heart of Government's economic strategy.

4. Government reaction to further fall in rate?

No sound reason for rate to fall. Underlying financial position is strong

- Government spending and borrowing are under control and on target;
- Government deficit, as percentage of GDP, is one of smallest in industrial countries;
- substantial current account surplus - larger in 1982 than the £3½ billion forecast only last November;
- inflation falling, and fell faster over last year than in any other major country;
- monetary growth within targets, and signs are it will stay there. [See also Section E].

5. Improve UK competitiveness directly by encouraging exchange rate down further?

Substantial fall in exchange rate as advocated by Opposition, would give only very temporary gains of competitiveness for UK industry. Would raise costs of imports directly and, by alleviating competitive pressures, permit general increase in prices of domestically produced goods. This would have repercussions for wage bargaining and hence trigger a general rise in costs, undermining initial competitiveness gains. We in UK have seen striking examples of this process: improvement in competitiveness following 1967 devaluation had largely been eroded by 1972; furthermore, although exchange rate fell by 25 per cent between 1973 and 1976, competitiveness was on balance unchanged.

6. Will lower oil prices mean further fall in sterling?

Recent slide in value of sterling in part reflects expectations that oil prices were about to fall; to this extent reduction has already been taken account of in the exchange markets.

7. Why did Bank of England intervene so heavily in December?

Foreign exchange markets have recently been unsettled generally, with sharp movements in major currencies and uncertainties about price of oil. In these circumstances not surprising that Bank had to intervene on larger scale than normal to slow underlying rapid movements and to ensure that sensible two way trading could take place.

8. Are the reserves too low?

Against background of Government's policies (not only towards exchange rate), Government do not regard present level of net or gross reserves as worryingly low. (Level of gross reserves rather lower than it was in mid-1979, although on any measure greatly exceeds that reached in 1976). Misleading to look at gross reserves. Real change since 1979 is reduction achieved in overseas debts run up by last Government - cut from \$22 billion in May 1979 to little over \$12 billion today.

9. Situation has been made worse by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations).

10. Join EMS exchange rate mechanism (ERM)?

Recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

G BALANCE OF PAYMENTS

[NB January trade figures to be published 24 February.]

1. Trade figures and current account

[1982 current account surplus of £4.6 billion. Oil trade in substantial surplus (£4.6 billion); non-oil trade remains in (£2.4 billion) deficit. Invisibles in healthy (£2.5 billion) surplus. IAF shows zero current account balance in 1983, but this does not allow for £600 million EC refund payment deferred into 1983. Q4 balance of payments performance may justify more optimism about 1983 current account - best estimate £½ - 1 billion surplus].

£0.9 billion current account surplus for December brought total for 1982 to £4.6 billion. (compared £6 billion in 1981). Achieved without £0.6 billion EC refund which will now come in 1983. That should boost next year's current account from the zero balance forecast in the IAF to £½ - 1 billion surplus. The late 1982 figures reflect mainly the continuing improvement in our oil trade. Non-oil exports have also been holding up better than expected at a time when world trade has probably declined. Similarly, imports remained flat despite a surge in retail spending in last three months.

2. Trade in manufactures in deficit last year?

When exports and imports put on comparable basis [ie both valued on balance of payments basis], we recorded a surplus on trade in manufactures of over £2 billion in first 11 months of 1982. [NOT FOR USE: Figures underlying IAF suggest that trade in manufactures may go into deficit this year].

3. Heading for poorer net trade balances in manufactures? Need to improve competitiveness to avoid this?

Agree desirability of lasting improvement in competitiveness of UK manufacturing industry. Depends on better productivity growth, lower wage inflation. Have made start - productivity performance as good as any of competitors over last two years. If could match this with equally competitive performance on earnings, would be well on way to lasting improvement in competitiveness.

4. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports from September onwards from the erratically low August level but underlying level of non-oil exports, after weakening in mid-1982, seems to have recovered in recent months to level of last spring at a time when, due to world recession world trade has probably fallen (1982 first year-on-year fall since 1975).

5. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Jaguar cars are a striking example of improvements in performance that British industry is capable of. Jaguar's drive for higher quality secured them an increase in overseas sales last year of 56 per cent over 1981.

6. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

7. Import trends

There has been little change in underlying level of manufacturing imports since end-1981. Manufacturing output fell back a little in 1982, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

8. Protectionism?

[Mr Foot's Glasgow speech 22 January.]

We are concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Pressing for positive European Community action to remedy this. But wish to make clear, as Chancellor said last year [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

9. Japan

Welcome the tariff reductions announced end-December. Small step in right direction. Fully support EC measures to step up action under GATT aimed at putting further pressure on Japanese to open up their domestic market.

10. GATT meeting

Glad to see that GATT meeting reaffirmed need to resist growing protectionist pressures. GATT declaration represented realistic commitment on behalf of signatories to the open trading system in present difficult economic climate.

11. Services

Work in the GATT on services is a major new departure and one of particular interest to UK. Field is wide but UK will contribute constructively with view to making early progress.

12. Textiles

This GATT study relates to the longer term and as such is not unreasonable. In no way affects present Multilateral Fibres Agreement and latest bilateral agreements which will run until 1986.

13. Q3 Balance of Payments and capital account

[Q3 invisibles surplus of £0.6 billion. Outflow of investment and other capital transactions of £0.3 billion. Private sector direct investment abroad fell to £0.8 billion and private sector portfolio investment abroad down £0.2 billion from Q2 to £1.0 billion.]

Invisibles account continues to be in healthy surplus - £1¼ million cumulative surplus on invisibles in first three quarters of 1982.

14. Continuing capital outflow shows folly of abolishing exchange controls?

[Article by F Williams in The Times 31 January: 'Why Peter Shore misses the target on foreign funds'.]

Wrong to talk about money flowing out of the country. Those who wish to invest abroad have to buy foreign currency and find someone else who wishes to invest in Britain to purchase sterling in return. The nation's net capital outflow or inflow - as a matter of arithmetic - matches the current account balance. Just as countries with deficits have to borrow abroad, those with surpluses acquire net overseas assets.

15. Portfolio outflow higher than last year?

[Q3 Balance of Payments figures published 8 December showed continuing outflow of UK overseas portfolio investment. Guardian on 9 December described this as rising trend.]

True that there is little sign yet of end to expected period of stock adjustment following ending of exchange controls. But misleading to say portfolio investment abroad is rising. Figures are as follows:

				£ billion
1981	Q1	-	1.3	average - 1.0
	Q2	-	1.0	
	Q3	-	0.7	
	Q4	-	1.1	
1982	Q1	-	1.6	
	Q2	-	1.3	
	Q3	-	1.3	

Q3 figure is smaller than in Q2 or Q1, and about the average for last year.

16. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports

and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. Government has succeeded in reducing PSBR as percentage of GDP; further reduction is projected. Inflation has fallen fast - expected to fall further (see D1). Base rates have risen but still well below (5 per cent) peak in 1981. Benefits seen in recovery of debenture market. [IF PRESSED: Would like to see rates lower still, so long as not likely to endanger progress on inflation.]

2. Government planning balanced Budget?

[Chancellor questioned in Guardian interview 17 December about reports that Professor Walters at FT bankers' conference advocated balanced Budget over run of years.]

Government aims to reduce PSBR as share of money GDP over medium term. Illustrative profile in 1982 MTF5 shows figure of 2 per cent in 1984-85. Nothing has been said about later years.

3. Relationship between public sector borrowing and interest rates not as direct as this government claims?

Links between interest rates and the PSBR are not simple or instantaneous, nor do we claim them to be. But that is not to say that the relationships is not important. This Government's firm control of borrowing is certainly one of the factors responsible for the recent falls in short term interest rates, compared with last autumn 1981.

4. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

5. PSBR in December quarter

[PSBR in December quarter £3.1 billion (£2.5 billion seasonally adjusted). PSBR April-December £7.6 billion (£5.3 billion seasonally adjusted.)]

Wrong to prorate £5.3 billion to arrive at likely PSBR for 1982-83. On balance however December quarter figures indicate PSBR likely to undershoot IAF figure of £9 billion.

6. PSBR likely to be £8 billion in 1982-83 compared £9 billion in IAF?

[F Williams article The Times 21 January].

It is possible. But must remember that margins of error in any precise forecast substantial.

7. What would undershoot be if Government had not taken recent measures?

[CONFIDENTIAL NOT FOR USE: At time measures taken they were thought likely to 'boost' PSBR by around £1½ billion in 1982-83 - an estimate itself liable to quite a large margin of error.]

Rather strange question. Given the uncertainty over PSBR outturn this year it is impossible to answer.

8. EC refunds - implications for PSBR in 1982-83?

No reason at present to suggest EC refunds due to UK will not be paid over by end March 1983.

[CONFIDENTIAL NOT FOR USE: EC Commission has recently opened a new account with the Paymaster General into which has deposited funds equivalent to our refunds entitlement. These deposits are classified as miscellaneous capital receipts, and so PSBR has already been reduced. In unlikely event EC withdrew the deposits before end March, PSBR would be increased. (See also Section N.)]

9. Government intentions for 1983-84 PSBR?

[Autumn Statement PSBR for 1983-84 assumed to be £8 billion - 2½ per cent of GDP; 1982 MTFS was £8½ billion].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before. (See also A14³).

10. Recent rises in interest rates make nonsense of Government's claim that PSBR matters?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - however PSBR over run of years implies lower interest rates - still holds true.

11. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

12. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's.]

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¼ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because borrowing has adverse effects on interest rates and inflation. But a higher tax burden does not necessarily mean that people are worse off, because gross earnings have risen faster than prices since 1978-79. On average, all types of household in work at all earnings levels are better off in 1982-83 than in 1978-79. [NB: individuals may have done better or worse than average.]

2. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children have also benefited from generous increases in benefits such as FIS.

3. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to EC levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ¼p in the basic rate.

4. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden is about average for OECD countries [provisional 1981 data from OECD's Revenue Statistics 1965-81]. Similarly, UK taxes on personal income and UK employees' social security contributions are about average for EC countries and lower than USA [1980 provisional OECD data].

5. Too few tax officials on evasion work?

Not prepared to abandon our manpower targets (see L1). Within these, we do redeploy staff as appropriate. Inland Revenue has deployed 400 extra staff to counter tax avoidance and 'the black economy'.

6. Cuts in taxation in 1983 Budget?

Decisions for 1983 Budget, both on PSBR and particular tax changes, have not yet been made.

7. Future of married man's personal allowance?

[Labour Party commitment to phase out in favour of increased CB etc; SDP proposals to abolish as part of proposals in document 'Attacking Poverty'.]

Government launched debate with 1980 Green Paper on Taxation of Husband and Wife. Green Paper set out number of different options; these being considered in light of very wide range of views received. Abolition would affect many millions of taxpayers, and by itself, leave a basic rate taxpayer £5 a week worse off. For some people it would worsen poverty and unemployment traps.

8. SDP plan to abolish poverty trap?

SDP scheme costs £5 billion - even on their own estimates - and still leaves marginal tax rates for people in poverty trap of 80-85 per cent. It extends trap both up and down the income scale. Ten times as many people would have marginal rates increased as would have them reduced. Claims to have eliminated trap are based on artificially restricted definitions. Their proposals would leave some people on below average earnings worse off.

9. Government unconcerned about poverty and unemployment traps

Government is concerned about poverty and unemployment traps, in context of incentives as a whole. Traps arise from attempts of successive Governments to alleviate poverty while keeping costs in bounds. Alternatives are to give less support for poor and unemployed or to let costs rip. Necessary step in right direction is to reduce burden of income tax by restraining public expenditure; long-term solution is increased real earnings resulting from sustained improvement in productivity and economic performance: both are goals of Government policy.

K PUBLIC EXPENDITURE AND FINANCE

[1983 Public Expenditure White Paper will be published 3.30pm Tuesday 1 February. Briefing will be circulated separately, and should be substituted by recipients for any relevant items below. Next issue of this document will be amended in light of 1983 PEWP and relevant briefing].

PUBLIC EXPENDITURE REVIEW AND AUTUMN STATEMENT 1982

[Total spending of £120.1 billion in revised plans for 1983-84 announced 8 November 1982. Compares with total of £120.7 billion in 1983-84 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 being published in 1983 Public Expenditure White Paper. Plans now announced were firm. Precise figures may have changed slightly between November and 1983 White Paper in light of more detailed calculations. Contingency Reserve will be reviewed before White Paper finalised.]

1. How do revised plans for 1983-84 compare with those previously announced?

Outcome of annual review of public expenditure plans was to hold planning total within previously announced plans. First time this has happened since 1977.

2. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

3. Contingency Reserve 1982-83 and 1983-84?

Containment of additional expenditure within Contingency Reserve helps to keep public expenditure as a whole within planning total determined by Government. Provisional setting of Reserve at £1500 million in 1983-84, compared with £2500 million in 1981-82 and £2400 million in 1982-83, reflects fact that amounts provided in those years now appear to have been unnecessarily large. [Used up in 1981-82: about £1145 million; charged to date in 1982-83: about £1290 million.]

4. Shouldn't all programmes have been reduced with fall in inflation?

No. Under cash planning, presumption is that planning totals will be maintained, unless any major change invalidates the main assumptions on which they were based. (Level of services then what can be obtained with cash available after making every effort to reduce costs.) Inflation in 1983-84 put at about 5 per cent higher than in 1982-83; this compares with 6 per cent implicit factor used when old 'volume' series was converted to cash. We took view this reduction not great enough to justify wholesale adjustment.

5. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But lower inflation and interest rates make it possible to accommodate such changes without major cuts in services.

6. What about years following 1983-84? How do figures compare with Budget time?

Figures for these years will be published in next Public Expenditure White Paper, early in 1983. Planning total for 1984-85 will be within total announced at Budget time. [NB No figure for 1985-86 announced yet].

PUBLIC EXPENDITURE - GENERAL

7. Government attitude to St John Stevas Bill?

(Second reading 28 January)

We recognised in our White Paper on the Role of the Comptroller and Auditor General (Cmnd 8323 of July 1981) the desirability of legislation on this subject. House will now have opportunity to modernise the 1866 and 1921 Acts, and that is welcome. However, there are strong arguments against the proposal in the Bill to give C & AG access to books of nationalised industries. The industries should be set clear financial targets and then be subject to minimum of interference. Bill is a move in opposite direction. All of these issues should be considered by the House.

8. Why did not Government introduce legislation?

This is a subject on which it is very desirable to proceed by consensus. Unfortunately that has not been the position. Hope wide measure of agreement will emerge during course of Bill's passage through House.

9. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gave figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

10. Capital spending in public sector?

Government policy is that provision made for capital expenditure, both in central government and local authorities, should be fully spent, subject to normal prudential margin. (Of course always necessary to take account of implications for future current running

costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also K14-16 and R12-16).

11. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

12. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

13. Public services pay in 1983-84/3½ per cent pay assumption?

Government attach great importance to realistic wage settlements in next round, in both public and private sectors. 3½ per cent assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in 1983-84 public expenditure plans for those groups for which Government directly responsible, other than NHS. (It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.)

LOCAL GOVERNMENT

14. LA capital underspending in 1982-83

Following underspend of £¼ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: PM wrote last autumn to local authority associations; local authorities can apply for extra allocations (about £200 million issued so far), and can spend without limit on improvement grants; extra £150 million made available to Housing Corporation.

15. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to

afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

16. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83; (gross) housing spending up £350 million (13 per cent); urban programme (including Urban Development Grant) up by £70 million (to £350 million). Local authorities will be allowed to spend above allocations on improvement grants.

17. LA current overspending in 1982-83

Budget returns from LAs in Great Britain indicate that overspend of over £1 billion on current expenditure relevant for rate support in prospect. In response, rate support grant cut by £308 million in England, £27 million in Scotland, and £5 million in Wales.

18. RSG settlements 1983-84

Realistic and generous: expenditure provision effectively 10 per cent higher than in last settlement and grant 3 per cent higher than 1982-83 settlement - provided authorities do not overspend. [For details refer to Statements by Secretaries of State for Environment, Wales and Scotland on 16 December.]

19. Grant penalties 1983-84

Hope won't be necessary to have any. But authorities were warned in July 1982 of expenditure guidance now issued and have had ample time to adjust 1983-84 budgets to avoid incurring grant penalties.

20. Rate increases in 1983-84?

On average there should be no need for rate increases in 1983-84. If authorities spend in line with expenditure targets any increases should be low; some councils have already announced intention to reduce rates. Where rate increases are high because of overspending it will be LA's own fault.

21. Service cuts?

Up to local authorities to decide how to keep to the provision in the RSG settlement. If they choose to allow irresponsible pay settlements, services may have to suffer unnecessarily.

22. Higher council house rents?

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment

Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. If that figure confirmed, will be possible to provide for real increase in capital investment in housing in 1983-84.

23. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc. (See also P5.)

FALKLANDS EXPENDITURE

24. Falklands defence costs?

Latest assessment of costs of operation, of replacing equipment lost during conflict, and of garrison, is about £700-£800 million in 1982-83. Provision has been made for £624 million in 1983-84. Provision made for subsequent years will be announced in 1983 Public Expenditure White Paper. [CONFIDENTIAL until PEWP published 3.30 pm Tuesday 1 February: Provision in 1984-85 £684 million; 1985-86 £552 million]. Total Falklands costs of £3 billion reported last month in Press [Guardian report 13 December] are broadly consistent with latest estimate of costs.

25. How will the defence costs be met?

Extra defence costs will be met by additions to defence budget on top of provision for NATO 3 per cent a year real growth target. Block defence cash limit for 1982-83 increased by £371 million so far on account of operations in South Atlantic (Hansard 9 November 1982 Col W108). This increase has been met from the Contingency Reserve. It has not therefore affected the Public Expenditure planning total.

26. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). About £10 million now expected to be spent in 1982-83. A further £5 million may be spent on rehabilitation in 1983-84. Ministers have agreed on a package of measures for long term development of the Islands tentatively estimated to cost in all £31 million over next 6 years.

27. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £2 million has so far been paid out, but this is no guide to what the final total might be. Costs in 1982-83 will be absorbed within FCO programme.

L CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10½ per cent to 655,000 (at 1 October 1982). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Government seeking cut of 60,000 through privatisation?

[Guardian report 28 January: 'Pressure to cut 60,000'.]

Government is reviewing need for staff in Departments over period 1984-88. This is normal good management practice. No decisions have been taken. Figure of 60,000 quoted in The Guardian is completely fictitious.

3. Civil service efficiency?

[TCSC published 17 January memorandum by Council of Civil Service Unions commenting on Government's reply (Cmnd 8616) to TCSC's report 'Efficiency and Effectiveness in the Civil Service').

Main theme of Council's memorandum is that drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. Great savings already made with little effect on provision of services.

4. Civil service pay negotiations in 1983?

Government have told civil service unions that there will be room for genuine negotiations and that they intend to conduct those negotiations with the view of reaching an agreed settlement. In answer to unions' question about availability and terms of arbitration, Government have said that it is too soon to answer; they were looking for a negotiated settlement.

5. Contents of unions' claim?

Unions' claim for 1983 has been received; proposal is:

- (a) flat rate increase of £12 per week for all non-industrial Civil Servants on National Salaries up to and including £6264 pa;
- (b) above this level, 'substantial' percentage increases, providing, in particular, 10 per cent on salaries up to £9758 pa.

Additionally, the unions propose minimum wage for all staff aged 18 or over of £85 per week, and reduction in the working week to 35 hours net. The Government have acknowledged receipt of the claim, and said they will arrange first discussion of it when unions' supporting evidence is to hand.

6. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Unions have now confirmed their willingness to enter into joint discussion - first procedural meeting was held 22 January.

7. Scott Report/Public sector pensions?

See D 18.

M SOCIAL SECURITY

[Benefits uprated by 11 per cent 22 November 1982 which included 9 per cent to take account of inflation. RPI increase in 12 months to November was 6.3 per cent, hence 9 per cent was 2.7 percentage points more than needed to preserve value of benefits. Announced in Autumn Statement that November 1983 uprating would be adjusted to have regard to this over-provision for inflation. Chief Secretary made clear to Social Services Committee on 15 December, however, that saving would be £180 million in 1983-84 - less than would be achieved by full recovery of overshoot. Social Services Committee Report on Autumn Statement published 29 January recommends that, given £180 million saving, adjustment should be 1.7 per cent, achieving that saving and no more. Better alternative would be to reduce required saving to £100 million with adjustment of 1.5 per cent, using excess savings to improve benefits.]

1. Pensions should not be adjusted next November?

Pensioners better off this year by extent of overshoot. Only question how much of this real increase continues beyond November 1983. No decisions on precise rise in pensions can be taken until nearer Budget time - Government will then have to take account of priorities inside and outside social security programme. But it will not go back on its pledge to maintain real value of pensions over lifetime of this Parliament.

2. Public expenditure saving?

Full recovery of overshoot would save about £250 million in 1983-84; about £800 million in a full year. But social security programme has been reduced by £180 million in 1983-84 by £500 million in 1984-85 and £600 million in 1985-86. This reflects Government's judgment of appropriate level of expenditure. Exact level of November 1983 uprating will be settled at Budget time, when Government will, as usual, take wide range of factors into account.

3. Improvements in benefits?

[Ie, using difference between planned adjustment and full savings from recovery of overshoot.]

There is constant pressure from both sides of House for whole variety of improvements. Government will have to determine priorities, eg between change in individual benefits and adjustment in next uprating. Decisions will, as usual, be taken at Budget time.

4. Retirement age?

[Social Services Committee Report published 24 November: principal recommendation a more flexible State retirement scheme with 'fulcrum' pension age of 63 for both men and women. Net long-term cost of Committee's proposals is £500 million at current benefit levels; equivalent to about 0.25 per cent on both employers' and employees' NICs. Required contribution for occupational pension schemes would need to increase by 15-20 per cent - about 2-3 per cent extra on payrolls].

Government welcomes this Report and the political consensus the Committee achieved. Report deals with important issues which Committee recognises as not for this Parliament. Their emphasis on equality and flexibility absolutely right.

5. Restore abatement of unemployment benefit?

[Amongst recommendations of Social Services Committee Report on Autumn Statement, published 29 January.]

Social Services Secretary made Government position clear in debate on 22 November. Government do not regard abatement of unemployment benefit as permanent measure; are considering question of its restoration in light of available resources and other decisions on uprating of benefits which will be taken as usual in context of uprating statement to be made at Budget time.

6. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit on contributions). To raise remainder would require, for example, rise in employee's NIC from current 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

7. SDP proposals?

See J8.

N EUROPEAN COMMUNITY

1. UK budget settlement

[European Parliament on 16 December rejected draft supplementary and amending budget established by Council of Ministers on 8 November to make the necessary budgetary provision for our refund payments. This action obstructed implementation of settlement reached by Foreign Ministers 26 October, providing for basic gross refund of around £630 million (about £480 million net) by end-December.]

The Commission presented new budgetary proposals on 19 January. These were considered by the Foreign Affairs and Budget Councils on 24 and 26 January. It was agreed that the Presidency would discuss them informally with the Parliament's Budgets Committee and, subject to satisfactory outcome, ^{from these discussions} the Council will establish a draft supplementary budget some time this week. This should allow the Parliament to give a first reading during its plenary session beginning 7 February, and, we hope, to adopt the new supplementary budget in time for our refunds to be paid over before end-March.

[BACKGROUND NOT FOR USE: In order to meet its undertaking not to let the Parliament's actions in December place it in a worse position than under the December agreement, the Commission have open^{ed} a new account with the Paymaster General (EEC No.3 Account) into which they have deposited funds equivalent to our refunds entitlement. We get the interest benefit from these funds. The EEC No.1 account has been temporarily run down, but Commission is expected shortly to bring the balance up to the 1982 average].

2. Refunds for 1983 and later

On 17 November the Commission produced its proposals for dealing with UK budget problem in 1983 and later. Commission communication does not suggest what size of our refunds - or our net contribution after refunds - should be. We think it provides a suitable framework for discussion of problem within the Community and hope that progress will now be made quickly. PM has said this will have to be discussed at next European Council in March if solution not found by then.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

We very much hope the issue of our Budget contributions can be satisfactorily settled without need for recourse to such a step.

5. Commission Green Paper on 'own resources' system

Commission Green Paper on 'own resources' is expected soon. We will study this carefully. Our opposition to an increase in the 1 per cent VAT ceiling is well known.

6. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

7. Costs of CAP to UK consumers

The Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

8. European Monetary System exchange rate mechanism.

See F9.

P **INDUSTRY**

[NB Next meeting of NEDC Wednesday 2 February].

1. Latest statistics of output and investment?

See Section B.

2. Effect of NIC and NIS changes announced last November on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance Surcharge for 1983-84, cutting rate to 1½ per cent; also, half of reduction in rate next financial year brought forward into current one. Effect will be as if private sector had paid at 2 per cent rather than 2½ per cent (rate announced in 1982 Budget) during 1982-83. Small increase in employer's NIC as from April 1983 also announced 8 November.]

Special reduction in NIS worth about £350 million to private sector employers in 1982-83, announced NIC and NIS changes taken together will benefit them by over £400 million in 1983-84. Constitute substantial reduction in costs faced by private sector commerce and industry.

3. How does this compare with burden as at May 1979?

Private employers will pay around £1 billion less in 1983-84 than they would have done under rate of NIS and employers' NIC inherited from previous Administration.

4. High interest rates damaging for industry and investment?

Banks' base rates still 5 percentage points lower than October 1981. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year.

5. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

6. Energy prices?

See R7-9.

7. Government believes levels of industrial support are far too high? Intend to trim?

[Observer 9 January alleged that secret Whitehall paper, questioning value of export credits, had sparked off major interdepartmental row.]

Public spending is too high generally, and industry support no exception. This is not to say that industrial support is not useful in a period of transition; but must aim at deploying a declining total more flexibly, focussing help where really needed and on industries and technologies of tomorrow.

8. Government review of regional policy?

[Civil servants' report being studied by Ministers says FT 28 January].

Officials of the Departments concerned have been reviewing the effectiveness of the main instruments of regional policy. Now for Government to consider whether to commission further work in particular areas that would be necessary to prepare for any changes. Have not yet reached conclusions on any aspect. Too soon to say when will reach conclusions.

9. What kind of industrial base and pattern of employment is Government aiming for?

Recent weak performance of the manufacturing sector in part reflects unexpected fall in world trading activity in 1982. But also reflects UK's competitive weakness and the need for long overdue and fundamental structural adjustments. Improved competitiveness, through further improvements in productivity and greater wage moderation, only way to enable UK manufactures to gain a lasting advantage from the coming, modest, upturn in world trade.

10. Companies' financial position?

[NB company sector borrowing in 1982 Q3 includes large element of unidentified transactions (-£1 billion)]

	£bn					
	1979	1980	1981		1982	
	Year	Year	H1	H2	H1	Q3
Net borrowing requirement						
(+)/repayments (-)	+6.1	+6.5	-1.7	+6.2	+6.0	+1.9
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.3	+0.7	-1.1	+0.8]

Financial position of industrial and commercial companies (excluding North Sea) improved in 1981, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in borrowing requirement second half 1981 due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for first three quarters 1982 suggest companies' borrowing requirements remain high, but much less so than in 1979 or 1980.

11. ICCs liquidity ratios in 1982 Q3?

[D. Industry's survey of 200 large companies (published 3 December in British Business) shows a further significant deterioration in liquidity in 1982 Q3. Also shows £1 billion reduction in total current assets since 1982 Q1 whereas national accounts show total identified liquid assets of all ICCs increasing this year].

Liquidity ratios (total current assets divided by total current liabilities) not necessarily most fruitful method of interpreting liquidity position. Companies are not short of liquidity at the moment. Liquidity behaviour of largest companies may simply reflect relative ease with which they can meet cash flow pressures with bank over-draft facilities which may not be so readily available to smaller companies.

12. Profits/rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 17 per cent 1982 Q3 compared 1981 Q3 but increase was from a very low base. ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.)

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

13. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

14. Future of cashless pay/Truck Acts?

Discussion at NEDC 5 January demonstrated CBI and TUC support for major shift to cashless pay. Government considering carefully arguments both for and against repeal of Trucks Acts, as means of accelerating progress.

15. Buying British

Many British products have always been competitive. New competitive ones coming onto market. Should not buy British regardless of price or quality - that would only render firms incapable of competing internationally - but should give British products - and ourselves - a full and fair chance.

16. Government help for small firms

Last Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. These measures designed to encourage start-ups and existing firms.

17. Response to Loan Guarantee Scheme?

[Nearly 7,900 guarantees already issued - about half to new businesses. Total lending under scheme over £260 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. Department of Industry has been called to honour only about 160 guarantees out of nearly 7,900 so far issued. Future of scheme under review.

18. Enterprise zones

Response to first eleven zones has been encouraging; many new firms have been set up and others expanded. (But too early to assess overall success). Proposed sites for nine new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one for Wales have also been announced. One more for Wales under consideration.

R PUBLIC OWNERSHIP AND PRIVATISATION

[NB: 1983 PEWP references below are CONFIDENTIAL until 3.30 pm Tuesday 1 February.]

NATIONALISED INDUSTRIES - GENERAL

1. EFLs for 1982-83

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. British Telecom expected to undershoot its EFL substantially, BSC also.

2. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 were announced in Autumn Statement; EFLs revised to allow for NIS reductions were announced 23 December. No further revisions included in 1983 PEWP. Overall external finance in line with previous plans. £2.6 billion being made available to nationalised industries in 1983-84. Overall, external finance in line with previous plans. £2.6 billion being made available to nationalised industries in 1983-84.

3. Government attitude to Mr St John Stevas' Bill on Parliamentary control of expenditure?

See K7-8

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. Rolling programme of Monopolies and Mergers Commission investigations has been set up. Introduction of market forces provides the greatest incentive to efficiency.

NATIONALISED INDUSTRY PAY AND PRICES

5. Nationalised industries' prices

[Increase in nationalised industry prices, water charges and London Transport fares over 12 months to December 1982 14.3 per cent, compared with RPI 5.4 per cent.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices (including water charges and London Transport fares) and RPI now currently about 9 per cent, compared with 14 per cent in January 1981;

over half of present differential explained by LT fares and last winter's electricity rebate. Signs are that gap will continue to narrow. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

6. UK industrial energy prices above those of European counterparts?

[At NEDC on 8 December CBI complained that energy-intensive industries pay 20 to 40 per cent more for energy than European competitors.]

Vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. But on average, electricity prices will not increase in 1983 (see 9 below). Measures worth over £300 million in energy cost savings have been introduced in last two Budgets to help industry. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating industry. But Energy and Industry Secretaries have indicated willingness to have further discussions with industry about electricity prices.

7. Freeze on industrial gas prices?

[BGC announcement that freeze on renewal prices for contract gas would be extended to first nine months of this year].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

8. Electricity prices?

As announced by the Secretaries of State (for Energy and for Scotland) on 12 November, electricity prices (domestic and industrial) will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

9. Nationalised industry boards' pay?

See D 16-17.

INVESTMENT

10. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Wasteful to provide funds for public sector projects with lower returns than those in private sector. Unfortunately, pre-tax rate of return on

nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

11. Finance more nationalised industry investment by cutting current spending?

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million in current year; and each 1 per cent off total costs saves £330 million in current year.

12. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statistical definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must by definition form part of public sector borrowing requirement.

13. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

14. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in 1981-82 and look like doing similarly in 1982-83 (by about £700 million - excluding BNOC). Even so, actual investment this year expected increase about 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PRIVATISATION

15. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £550 million. Full details of this year's receipts will be published after end of financial year. Sale of Britoil completed and will amount to take £625 million, paid partly in 1982-83 and partly in 1983-84. ⁴Witch Farm disposal is still proceeding [IF PRESSED: but is unlikely to be completed this financial year.]

16. What further sales expected?

Sale of British Gas Corporation's major offshore oil assets expected in 1983-84. Government have announced plans to transfer British Telecom and British Airways to the private sector in due course.

17. What sales included in special asset sale targets for future years?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive. changes from 1982 PEWP reflect decisions on privatisation since last targets published, and make allowance for additional disposals likely to arise from continuing scrutiny of potential candidates for privatisation.

18. Marketing of public assets - Amersham and Britoil failures in different ways?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded; about 75 per cent of Britoil shares left with subunderwriters and large discount when first traded].

No. These companies successfully privatised. Pricing an issue not easy especially when company's shares have not previously been traded. In addition, cannot accurately anticipate movements in market after price fixing but while offer still open.

19. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil); preference in allocation of shares (B Ae, C & W, Amersham, Britoil, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, Britoil, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company. Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSNR projections, partly because of higher production, partly higher oil prices. P&D as reported in The Times 4 January assess Government revenue will peak in 1983-84. Aberdeen University computer runs see sharp falls The Times 31 January.]

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSNR because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels. In general, higher estimates by others are based on combination of higher expected future production and prices and lower expected future capital expenditure.

2. Impact of lower oil prices on UK?

Lower oil price, on balance, good for UK. Large disruptive movements in any direction are in no one's interest. But modest and gradual fall would reduce inflation and boost growth - both good for us. Trade balance effect relatively modest, and fall in \$/£ rate since autumn enough to offset effect on revenues of a significant fall in oil prices.

3. Will UK Government reduce North Sea oil prices?

North Sea oil prices are for BNOG to decide on. BNOG is a pricetaker, not price maker. It follows the market, it does not lead it.

4. Government to relax North Sea fiscal regime?

Oil companies have argued for substantial reductions in taxation. No decisions have been taken. But fact-finding discussions have been taking place with UKOGA and individual companies since the summer to try to close the gap between Government's and companies' assessment of North Sea taxable capacity. These discussions will soon be concluded.

5. Onerous tax system damaging future field developments?

[Energy Select Committee report published 27 January on depletion policy claims North Sea tax regime inhibiting development. Recommends overhaul of tax regime].

Will obviously study report carefully. But remember that other adverse factors - falling oil prices earlier this year; high development costs - much more important than tax. Detailed study has shown that, under current tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that this structure will provide more secure and stable tax regime. A completely new regime would not necessarily

be more stable. Certainly disruptive in short term. Aberdeen University study shows UK taxation on marginal fields to be one of world's 'more lenient'.

6. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

7. Benefits of North Sea should be used to strengthen economy?

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1982-83.

8. Are we really any better off for North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

9. 'Precipitous drop' in North Sea output after 1985?

[Phillips & Drew forecast of oil output almost halving between 1985 and 1990 - FT 4 January.]

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline - though not as steeply as P&D expect. Cannot be complacent about effects of falling North Sea output. Best thing we can do is pursue our present economic policies so that economy in better shape when output begins to decline.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

[US Administration publishing detailed budget proposals and forecasts Monday 31 January.]

1. OECD Economic Outlook December 1982?

[OECD Economic Outlook forecast OECD growth of $1\frac{1}{2}$ per cent in 1983 (minus $\frac{1}{2}$ per cent in 1982) and inflation to fall to $6\frac{3}{4}$ per cent ($7\frac{1}{2}$ per cent in 1982). OECD believes it is Governments' responsibility to minimise risks to world recovery from growing protectionism and financial instability.]

OECD suggests modest recovery and falling inflation this year. Broadly in line with IAF. OECD recognises that Governments have, rightly, been reluctant to change basic thrust of policies, which have achieved hard-won gains on inflation, when inflationary expectations can easily be rekindled.

2. Prospects for US economy?

[US GNP fell $\frac{1}{2}$ per cent in 1982 Q4, bringing fall for 1982 as whole to 1.8 per cent. This largest annual fall in post-war period. Press reports (eg Wall Street Journal 6 January) suggest US Administration expects growth of $1\frac{1}{2}$ per cent in 1983.]

Important keep figures in perspective; although disappointing they were not unexpected as OECD had earlier forecast decline of similar magnitude in 1982. Most forecasters expect gradual recovery in 1983, helped by falls in inflation and interest rates. OECD predict for example growth of 2 per cent in 1983. US Administration's next forecast due to be published end January.

3. President Reagan's State of Union Address:

[US Administration forecasts budget deficits ranging from \$231 billion in FY 1984 to \$300 billion in FY 1988 if no action taken. Administration has proposed package of measures to reduce deficit, including freeze on Federal expenditure, structural reform of social security system and \$45 billion cuts in defence expenditure. These would reduce budget deficit to \$177-189 billion in FY 1984 and \$90-117 billion in FY 1988 (depending on growth rate) if implemented. Further details expected in budget due to be published 31 January.]

Glad to see Administration's strategy of reducing public sector deficit over medium term. In line with UK's fiscal policy as set out in MTFs. Important for world recovery that US deficit be reduced so that US interest rates not forced up again, as economy recovers. So hope that Administration and Congress can agree quickly on measures to reduce deficit.

4. US monetary policy

[At end of last year Federal Reserve suspended M1 target and raised M2 target to $9\frac{1}{2}$ per cent, at annual rate, over last few months of 1982. (Original M2 target, set in February, was for growth within 6-9 per cent range; M2 growth in Sep-Dec 1982 exceeded range but was broadly in line with revised target). Targets for 1983 not yet announced: expected in February.]

Welcome Federal Reserve's flexible approach but stress that Reserve Chairman, Mr Volcker, has made clear that reduction of inflation remains priority and that monetary targets have not been abandoned. Mr Volcker also stressed that Budget deficits must be reduced if interest rates are to continue to fall.

5. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 9.6 to 4.6 per cent), UK (12.0 to 5.4 per cent), Japan (3.6 to 2.3 per cent), Italy (17.9 to 16.3 per cent), Canada (12.2 to 9.8 per cent) France (14.0 to 9.7 per cent), Germany (6.3 to 4.6 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation together with falls in interest rates offer better prospects for recovery this year.

6. World financial crisis 'over'?

[Mr Leigh Pemberton reported (FT 30 December) as saying international financial crisis is over, but it is still a very serious situation which will take several years to solve.]

Most major debtors now undertaking adjustment programmes - often with IMF assistance. They may of course remain convalescent for some time, but we now have the measure of the problem. There have also been moves to improve banking supervision, and banks themselves are improving their information flows.

7. Enlarged GAB

[G10 Ministers met in Paris on 18 January to discuss, inter alia, what role an enlarged GAB (General Arrangement to Borrow) might play in augmenting IMF resources.]

G10 Ministers have agreed, subject to necessary legislative approval, that GAB should be increased from \$76 billion to \$196 billion. Participants' shares in GAB have been adjusted to reflect better their size and role in the world economy. UK share will be 10 per cent. Switzerland is to become a full member. At times when balance of payments position could threaten stability of international monetary system, GAB will be available not only for participants but for any IMF member that agrees a conditional programme with the Fund.

8. Increase in IMF Quotas

IMF has particularly important role in present circumstances in providing finance to countries while they go through necessary adjustments. Essential that IMF has adequate resources. UK has suggested increase of at least 50 per cent in IMF quotas and has played constructive part in building present international consensus on need for progress on Quota Review.

9. IMF Interim Committee - Next Meeting?

In view of the progress made in discussions so far on increasing IMF quotas and the priority attached to strengthening the Fund's resources, the Chancellor as newly elected Chairman of the Interim Committee, has proposed next meeting of the Committee should be brought forward from late April to 10-11 February. We hope that an early and satisfactory agreement can be reached.

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS
31 JANUARY 1983

Summary comment

The effective exchange rate has fallen by about 12 per cent since mid November and interest rates have risen 2 points since end November. However, the direction and the consistency of policy are unchanged. GDP remains flat and manufacturing activity is below 1982 trough levels. RPI inflation fell to 5½ per cent in December and 5 per cent is confidently expected in the next few months. This year, a modest rise is expected in both GDP and in manufacturing output.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent last year unfulfilled. A modest recovery in world trade is expected this year.

- world commodity prices are at their lowest level in real terms for thirty years;
- oil prices are weak and likely to remain so for the near future;
- consumer price inflation (OECD major 7) 5½ per cent in December ranging from 16 per cent in Italy to 4½ per cent in Germany and 2½ per cent in Japan;
- average world 3-month interest rates 9¼ per cent at 24 January a fall of 4½ points between December 1982 and October 1981; US 3 month rate stood at 8.5 per cent on 24 January; real interest rates remain clearly positive;
- world trade volume has been more or less flat since the middle of last year;
- total industrial production for the OECD Major 7 fell 5½ per cent in the twelve months to November; in the US it fell by 6 per cent in the 12 months to December;
- unemployment (OECD total) 8.7 per cent in October compared with 6.7 per cent for average 1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remarked in stronger surplus during 1982 than forecast in IAF. Both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil

trade but the volume of exports held up well in 1982 and are unlikely to fall below their 1981 levels.

- . OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries.
- . import volume rose sharply as activity recovered in 1981 and import penetration rose too; in 1982 non-oil import volumes showed little change on 1981 H2.
- . the effective exchange rate was at 80.9 on January 28. Pound now below both 87-93 range occupied for the last year and May 1979 level (86.3).

Financial Developments

.Monetary aggregates within target range for 1982-83, M1 and £M3 towards top of range, PSL2 towards bottom;

.most banks raised base rates by 1 point on 11 January (to reach 11 per cent) following similar increase on 26/29 November; short term interest rates down 5½ points since October 1981; base-rates down about 5 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £10½ billion in 9 months to December.

.PSBR: £5.3 billion in 9 months to December; Industry 'Act Forecast of £9 billion in 1982-83 now at upper end of range of likely outcomes.

.After taking account of foreign currency borrowing and repayments, there was an underlying fall in the reserves during December of \$856 million.

Inflation

.retail price inflation, 5.4 per cent in year to December. IAF forecasts further falls with prospect of 5 per cent by spring 1983.

.TPI increase in 12 months to December was 5.8 per cent;

.Wholesale price inflation input prices up 7½ per cent in year to December compared with 6½ per cent in November following higher oil prices due to sterling depreciation against the dollar; output prices up 8 per cent in year to December.

GDP and industrial production

.GDP(O) rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Construction output in 1982 Q3 was 3 per cent up on previous quarter and 2 per cent higher than in 1981 Q3. Underlying level of industrial production also remains broadly flat but is 2 per cent above spring 1981 trough almost entirely due to increased oil and gas production; the underlying level of manufacturing output is slightly below its trough level and there are clear indications of a declining trend during 1982.

Demand Components

.consumer spending held up well during the recent recession and has continued to strengthen since 1982 H1. Some fall in RPDI (see below personal sector) offset by lower savings ratio. Retail sales rose substantially in December and in 1982 Q4 were 4½ per cent up on same period in 1981, partly reflecting abolition of HP controls. Consumers' expenditure in Q4 1982 (provisional) 1½ per cent up on previous quarter (this is being reflected in the relative buoyancy of the consumer goods industries) and, in 1982 as a whole was 1 per cent above its 1981 level.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak but is responsible for only 30 per cent of total investment by manufacturing, distributive and service industries.

.destocking of £410 million (at 1975 prices) occurred in 1982 Q3. But in the CBI's December Survey, number of respondents with "more than adequate" stocks was lowest this year. Stocks are volatile and one quarter's figures should not be over emphasised;

.government consumption is virtually flat. In 1982 Q3 it was 1½ per cent up on the preceding quarter and on its level in the same period last year;

.non-oil exports held up well in 1982 against a 3 per cent fall in world trading activity;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising but non-oil import volumes this year have shown little change since 1981 H2.

Productivity and Competitiveness

.manufacturing productivity continues to rise - at $2\frac{1}{4}$ per cent in year to Q3 1982. Productivity now 13 per cent up on end 1980;

.manufacturers' unit wage/salary costs up less than $6\frac{1}{2}$ per cent in 3 months to November 1982 on a year earlier;

.Cost competitiveness has improved some 20 per cent since early 1981, but remains around 10 per cent worse than in May 1979 (whole of this deterioration is attributable to excessive wage costs).

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the third quarter by $4\frac{3}{4}$ per cent; and in first 3 quarters of 1982 were $11\frac{1}{2}$ per cent up on their average 1981 level;

.non-North Sea profits fell $4\frac{1}{4}$ per cent in Q3 1982 on previous quarter but in first three quarters of 1982 were $13\frac{3}{4}$ per cent up on their average 1981 level;

.gross profits of North Sea oil companies in the first 3 quarters of 1982 were 8 per cent up on their average 1981 level;

.ICCs financial surplus was £0.5 billion in six months to September 1982 following deficit of £0.3 billion in previous six. Over same period net borrowing requirement fell from £9.1 billion to £4.0 billion.

.working days lost through industrial stoppages estimated at 85,000 in December, lowest monthly figure for last two years. Total for whole of 1982 (7.9 million) well below average of 12 million for last ten years.

.insolvencies: provisional totals for 1982 are 5,707 bankruptcies and 12,039 company liquidations, increases of 11 per cent and 40 per cent on 1981.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to November 1982 was about 8½ per cent, lowest rate of increase since November 1977;

.CBI reports that pay settlements in manufacturing industry averaged 6.1 per cent in 1982 Q4 compared with 6.8 per cent in the third quarter. Bulk of settlements will occur in 1983 H1;

.real earnings broadly flat in last 12 months but RPDI in the third quarter is about 2¾ per cent lower than the average for 1981.

Labour Market

.UK employees in employment fell 2.2 million (9¾ per cent) between 1979 Q2 and 1982 Q3 (almost two-thirds concentrated in manufacturing); between 1981 Q3 and 1982 Q3 employment fell by 702,000; manufacturing employment fell a further 73,000 (1¼ per cent) between 3 months to November 1982 and preceding 3 months;

.total employees in employment fell more in the third quarter of 1982 (205,000) than in the previous quarter (188,000);

.total registered unemployment rose by 34,000 to 3.10 million (13.3 per cent on the new basis) in December;

.UK adult unemployment rose by 41,000 to 2.95 million (12.7 per cent) in December; the increase is higher than in recent months but this may reflect modified signing on procedures over Christmas; nevertheless the underlying increase in Q4 1982 was only 27,000 compared with 31,000 in Q3 1982 and 28,000 in Q2 1982;

.notified vacancies increased by 3,000 to 118,000 in December but one month's figures should be treated with caution and volume of vacancies remain at very low levels;

.notified redundancies fell by 11,000 in December to 62,500;

.other labour market indicators hours lost through short time working has increased steadily since July 1982 to the levels prevailing in 1981 Q4 and 1982 Q1. Hours of overtime worked remain broadly flat.

Forward Indicators

.car production (seasonally adjusted) rose to 76,000 in December from 66,000 in November while commercial vehicle production fell from 24,200 to 22,700 (sa); new vehicle registrations (not seasonally adjusted) in 1982 were about 5½ per cent up on 1981;

.steel production (seasonally adjusted) fell in December and in 1982 Q4 the weekly rate of production fell 10 per cent and was 32 per cent down on same period in 1981;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, rose 8 per cent in 3 months to November, and were up 6 per cent on a year earlier. Engineering orders rose about 1¼ per cent in three months to October compared with previous three months;

.Latest DOI investment intentions survey suggests a 3 per cent fall in manufacturing investment between 1982 and 1983 but other components of investment (distribution and services) are more encouraging;

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 38,500 a quarter in 1980 to 53,100 in 1982 Q1, fell back in the spring, but in 3 months to November, increased 8 per cent on previous 3 months and were 24 per cent up on same period in 1981. After previously drifting downwards, total completions were fairly flat during 1982 Q2 and Q3 but in 3 months to November were 7 per cent up on previous 3 months;

.a sharp seasonal rise in unemployment occurs in January thereafter headline total should remain flat till May;

.CSO's index of longer leading indicators fell in December after 9 months of increase reflecting the rise in interest rates and the decline in share prices.

CBI's October (Quarterly) Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand. December Trends Enquiry suggests previous trends broadly continuing but export order recovered from November's deterioration. CBI November forecast projects GDP(O) growth at $1\frac{1}{2}$ per cent next year with manufacturing investment contracting. Also assumes $\pounds 2\frac{1}{2}$ billion fiscal adjustment in 1983/84 whereas IAF suggests $\pounds 1$ billion.

Outside forecasts

Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be $\frac{1}{2}$ -1 per cent - about $\frac{1}{2}$ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around $1\frac{1}{2}$ per cent, assuming some recovery in world economy, with inflation/interest rates falling at least for some time into next year.

Industry Act Forecast

NB. November IAF will be superceded by Budget Forecast (on March 15); latter will take full account of economic developments since November Forecast was prepared. Undue emphasis on precise figures in November IAF no longer appropriate.

Treasury forecast published November 8th assumes a modest (2 per cent) world recovery in 1983. Forecast includes a $\pounds 1$ billion fiscal adjustment in 1983-84 within a fiscal/monetary stance broadly in line with 1982 MTFS. Between 1982 and 1983 GDP grows by $1\frac{1}{2}$ per cent. Principal demand increases are from consumers expenditure and capital investment. Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983. Government Actuary assumes unemployment (old basis) averages 2.9 million (GB, ex school leaver) in 1982-83 and 3.2 million in 1983-84. On new basis figures could be up to 200,000 lower.

Key Statistics Week-Ending Friday 4 February

- Tues 1 : CBI Industrial Trends Survey (Jan)
: Overseas travel and tourism (November)
- Wed 2 : UK official reserves (Jan)
: capital issues and redemptions (during the month of January)
: Advance energy statistics (Dec)
- Thurs 3 : Unemployment (Jan - prov)
: Unfilled vacancies (Jan - prov)

(i) Activity. GDP has recovered by 1½ per cent since spring 1981. Industrial output in the 3-months to November was 2 per cent above its trough in the second quarter of 1981 (largely oil and gas). IAF (published with Autumn Statement) and most recent major independent forecasts see prospect of modest recovery next year.

(ii) Demand: Consumers' expenditure in the fourth quarter was 1½ per cent up on the preceding quarter and in 1982 as a whole, 1 per cent higher than in 1981. Retail sales rose 1 per cent and 2½ per cent on similar comparisons.

(iii) PSBR: government borrowing now amongst lowest in industrialised world.

(iv) Public expenditure planning total for 1983-84 now a little below total published at Budget time.

- first time since 1977 that a Government has not increased its spending plans in course of Survey

- planning total for next year represents a fall in public expenditure as a proportion of GDP compared with plans for this year (44 per cent next year, 45 per cent this year).

(v) Inflation. Increase in RPI over the 12 months to December was 5.4 per cent; the rate of inflation has now fallen for seven consecutive months and is the lowest since March 1970. Remain confident of achieving 5 per cent this spring. Although inflation prospects for rest of year now not quite so encouraging, still good. Manufacturers' output prices up 8 per cent in year to December.

(vi) Costs.

- Increase in average earnings halved in 1980-81 pay round; further moderation in 1981-82 round, to around 9 per cent.

- On OECD estimates, UK productivity (whole economy) in 1982 rose faster than that of our major competitors.

- Manufacturers' unit wage and salary costs up about 6½ per cent in 3 months to November 1982 over same period last year.

cessive CBI surveys shows lowest degree of unit cost pressures for 15 years.

(vii) Manufacturing productivity. Output per head has risen about 13 per cent since end 1980. Output per head and output per hour now about 6 and 8 per cent higher than previous cyclical peak in 1H 1979.

(viii) Competitiveness. Cost competitiveness (manufacturing) improved by about 20 per cent since early 1981.

(ix) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, excluding North Sea) up 13½ per cent in first 3 quarters of 1982 on average 1981 level. [NB recovery in profits from very low base: pre-tax real rate of return of ICC's (excluding North Sea) only 3 per cent in 1981.]

(x) Controls: HP controls abolished in summer, adds to a long list of other controls already abolished (pay, dividends, prices, exchange controls, office development permits, industrial development certificates).

(xi) Enterprise zones: further 13 zones announced in 1982 bringing total to 24.

(xii) Housing starts (total) - up 24 per cent in 3 months to November compared with same period 1981. [NB But broadly flat during 1982.] New construction orders up 6% on same comparison.

(xiii) Total new construction work: in third quarter of 1982 was 6 per cent higher than in the previous quarter and 7 per cent higher than the same period a year earlier while total construction output was 3 per cent and 2 per cent up on similar comparisons.

(xiv) Special employment measures. Total planned provision for special employment schemes £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983); total planned provision for 1983-84 £2 billion.

(xv) Overseas debt repayments. Official external debt reduced from over \$22 billion in May 1979 to less than \$12½ billion at end-December 1982.

(xvi) On target to achieve smallest Civil Service since War by 1984 (630,000).

Record no 7 changes in over-employment

PPS/CHANCELLOR

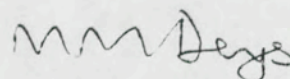
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Mr Salveson (for transmission to No.10)
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 PS/Secretary of State for Energy
 PS/Secretary of State for Transport
 PS/Chancellor of the Duchy of Lancaster
 PS/Secretary of State for Employment
 PS/Paymaster General
 and officials in HMT, Revenue Departments
 and other Departments in Whitehall

TREASURY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 17 January, are
 sidelined.



M M DEYES

12A

R I G ALLEN

24 January 1983

EB Division
 H M Treasury
 01-233-5503

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policy must continue to combine firmness and flexibility. Right for Government to have adjusted money supply and PSBR objectives in light of changed circumstances. But also right that medium-term direction of policy is maintained.

2. Recovery over/Activity flat?

Delayed but not over. GDP some 1 per cent higher than trough in Spring 1981; industrial output some 2 per cent higher. Flatness of output during 1982 partly reflected external developments: volume of world trade fell substantially, contrary to expectation at time of 1982 Budget. But rapid progress on inflation and improvements in productivity and competitiveness are encouraging; further modest recovery expected in 1983.

3. Policy far too tight, given world recession? ^{Shortage} ~~Storage~~ of demand?

Government cannot fine-tune either money or real GDP. Domestic demand in real terms has risen by nearly 4 per cent since spring 1981. Problem is lack of external demand and UK's depressed share of home and foreign markets (reflecting weak competitiveness), though exports held up extremely well last year in face of downturn in world economy. Improvements in supply performance needed as much as increased demand. Otherwise a boost to demand may be largely wasted, even in the short term.

4. Where will growth come from?

Already seeing benefits of lower inflation and interest rates reflected in higher consumer spending and recovery of investment in housing and many parts of private industry. Recovery in world economy will assist UK growth, as will continued effort to control inflation and contain costs.

5. Higher interest rates will kill hopes for recovery - as in autumn 1981?

[Barclays, Lloyds and Natwest put up base rates 1 percentage point to 11 per cent on 11 January and Midland on 12 January. Mr Shore in 19 January broadcast claimed that high real interest rates would strangle recovery].

Does not follow: rise in interest rates only one element in picture, and interest rates still 5 points below October 1981 level. Fall in exchange rate will ease pressure on companies. And if not eroded by higher pay settlements could contribute to improved competitiveness.

6. Outlook for inflation?

Remain confident of achieving 5 per cent RPI inflation early this year. As far rest of year, path may be a little bumpier than thought at time of Autumn Statement, but must not exaggerate possible effect of exchange rate depreciation. (See also D 3-4).

7. Government attitude to interest rate rises?

As has been stated on many occasions, level of sterling only one factor taken into account in judging monetary conditions and in determining Government attitude to interest rates. If recent fall in exchange rate partly reflects market uncertainty about monetary conditions (despite reassuring position on PSBR and monetary aggregate), then rise in interest rates will reassure markets that monetary conditions required for continued control of inflation will be maintained. [See also Section E].

8. Recent developments demonstrate policy being steered by exchange rate?

Should be clearer than ever that Government has no target for exchange rate. Little in recent events to suggest it would be viable policy to adopt such a target. As one of world's major currencies, sterling bound to be influenced by events that have origins abroad - such as reappraisal of relative value of other countries' currencies and expectations about international price of oil. [See also Section F].

9. Why is sterling so weak?

Never possible to be certain of all factors affecting exchange rates. But the dollar seems to have recovered on changed perceptions about the course of US interest rates, partially reversing the long-expected rise in value of yen and D mark. There is still some continuing concern about oil price prospects. Reported Opposition views about exchange rate may have been another factor.

10. Exchange rate slide will improve external competitiveness?

Will only have lasting benefit if wage settlements continue to be contained at more moderate, and realistic levels. Keeping firm control of labour costs is the key to improving our competitive position. Past experience (eg 1967-72 and 1973-76) illustrates all too clearly how easy it is for immediate benefits of devaluation to be eroded through higher price and wage inflation.

11. Government should do more for industry?

[CBI expected publish Budget recommendations 26 January].

Measures announced in Autumn Statement (notably NIS reduction) themselves have benefits for industry particularly in helping keep down costs. Other announcements made at around

same time - on energy prices ending of regional development grant deferment, local authority capital spending initiative, more sites chosen for enterprise zones also helpful. And keep in mind wider benefits of lower inflation and interest rates and benefits of 1982 Budget measures still coming through.

12. Government believes levels of industrial support are far too high? Intend to trim?

[Observer 9 January alleged that secret Whitehall paper questioning value of export credits had sparked off major interdepartmental row.]

Public spending is too high generally, and industry support no exception. This is not to say that industrial support is not useful in a period of transition; but must aim at deploying a declining total more flexibly, focussing help where really needed and on industries and technologies of tomorrow.

13. What kind of industrial base and pattern of employment is Government aiming for?

Size and shape of industry and employment will not be determined directly by Government and cannot be forecast with any accuracy. Clearly, much of traditional industrial base and traditional sources of employment will remain important, but new businesses are coming along too. Important thing is to provide right incentives for business and for costs to be kept under firm control. Contrary to some reports, Government does not belittle importance of traditional manufacturing industry.

14. Outlook for Budget

Cannot comment on speculation that "fiscal adjustment" is bigger than illustrative £1 billion figure included in the Autumn Statement. Fact that PSBR may be undershooting this year - and outcome still very uncertain - does not carry any necessary implications for next year's figure. Many factors enter the equation - including the path of output, inflation and interest rates, and - of course - new public expenditure figures shortly to be published. So nothing can be said at this stage. (See also H⁸).

15. Labour Party programme

[Unclear from recent statements eg Foot 22 January, Shore in weekend broadcasts, exactly how far Labour leadership sticking to 'Programme for recovery' nevertheless clear that espouse substantial depreciation, substantial reflation, plus (Foot speech) 'planned trade'].

Defects of Labour programme remain. Blow to confidence; wage restraint assumed without specific mechanism to achieve; planned trade proposals equally vague. Claimed validation by running programme through Treasury model does not make definitive. And Mr Shore seems to have revised ^{his} views on what should go in.

16. Treasury model - technical advice

See B15.

17. Alliance programme a more credible alternative?

['Working together for Britain' published 20 January reiterates measures urged in earlier policy statements - designed to create over $\frac{1}{2}$ million jobs at net PSBR cost of £3-4 billion].

Contains some proposals which are sensible and not too far removed from Government thinking. But largely stands or falls on success of measures to ^{control} ~~effect~~ pay and prices. Suggestions for income policy wrap old ideas in new clothes. Pays lipservice to financial prudence but vague on how this would work in practice. Claimed impact of measures in SDP statements has looked extremely optimistic.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Prospects for UK economy

[Industry Act Forecast Tables summarised in Commentary at end of Brief. NB New forecast will accompany Budget 15 March; undue emphasis should not be given to precise numbers in IAF.

Main points from Industry Act forecast and other recent forecasts:-

- Although recovery in 1982 has been hesitant, partly reflecting depressed world activity, it should gather pace in 1983: about 1½ per cent growth of GDP 1983 on 1982. All outside forecasts (some rather dated) expect recovery to continue in 1983; consensus is for year-on-year growth around 1½ per cent.
- RPI inflation has come down much faster than expected (now 5.4 per cent annual rate to December) and expected to be 5 per cent early this year.
- Wage settlements are expected to decline further over current pay round. [No forecast given in IAF but GAD Report assumes 6½ per cent earnings growth between 1982-83 and 1983-84, against 9 per cent in previous year.] Productivity growth still fast (level of output per head in manufacturing now around 13 per cent above end-1980).
- Consumers' expenditure continues to recover and is provisionally estimated to be 1½ per cent up in 1982 Q4 on previous quarter and, in 1982 as whole, 1 per cent higher than 1981. Forecast is for 2½ per cent increase between 1982 and 1983.
- Current account of balance of payments likely to be around £4½ billion in 1982 - well in excess of figure in IAF. Some deterioration expected in 1983]

Prospect is for modest recovery during 1983 and lower inflation - 5 per cent RPI inflation in next few months. Further forecast taking full account of world and UK economic developments since November will be published at Budget time.

2. Recent GDP figures

[GDP on the average measure was unchanged between Q2 and Q3 of 1982, but GDP (output - which is a better indicator of short term movements - rose slightly for second successive quarter (with construction output 3 per cent up on previous quarter) to level about 1 per cent higher than in 1981 Q2. Industrial production in November 1½ per cent down on October; 1 per cent decline in manufacturing. Now clear evidence of declining trend in manufacturing during 1982. Underlying level of industrial output in three months to November 2 per cent above 1981 Q2 trough - virtually all reflecting higher North Sea oil output; manufacturing output 1 per cent lower than in 1981 Q2.]

Level of output particularly in manufacturing remains disappointing - partly due to depressed world economic activity - but consumer goods holding up well, reflecting higher consumer expenditure. Expected higher world output and lower effective exchange rate should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide a sounder base for expansion in the medium term.

[INDEXED on index of manufacturing production in November (86.8, 1975 = 100) returning to 1967 levels (87.8 in 1967 Q1):

Inappropriate to make such long term comparisons without recognising that sectoral composition of output is changing. As consumers' preferences change and balance of comparative advantage alters, so will configuration of economy. GDP is almost 26 per cent above its level in 1967.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments/Business confidence collapsed?

[CBI October Quarterly Survey showed less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). CBI December Enquiry shows previous trends broadly continuing but orders in consumer goods industries are 'least weak' while export orders books have recovered somewhat after November deterioration.]

Results of recent CBI reports still disappointing. Deterioration in optimism, and weakness of immediate outlook (next four months), probably reflect in part very depressed level of activity, at home and overseas, during last year. But CBI not entirely gloomy - favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. December Enquiry reveals some recovery in export orders. As witnessed by surveys from Times Business Forum in October and November, great majority of businessmen support Government's basic economic strategy and are optimistic about prospects for company growth/profits over next two years. Decisions announced 8 November aimed to reduce business and industry's costs and should boost confidence.

5. New orders figures and short-term indicators depressing?

[New construction orders rose 8 per cent in three months to November compared previous three - 6 per cent up on year earlier. In three months to November total housing starts up 8 per cent on preceding three, and 24 per cent on same period in 1981. Volume of new orders in engineering industries fell 5 per cent in three months to September compared previous three. Car production rose to 73000 in December, but 6½ per cent down in 1982 Q4 compared 1981 Q4. New vehicle registrations (not seasonally adjusted) rose 13 per cent in 1982 Q4. Weekly rate of steel production fell in December and - 1982 Q4 was 32 per cent lower than 1981 Q4.]

Some encouraging signs but figures still manifesting depressed economic activity which itself partly reflects flatness in world trade.

6. Construction industry forecasts show prospects of modest recovery?

[Joint Forecasting Committee of Building and Civil Engineering Economic Development Committees (ECDs) published 6-monthly forecast on 15 December. Overall prospect is for

modest recovery in three years to 1984 - although overall growth rate fails to restore output to 1970's levels].

Construction industry's problems remain difficult, but forecast moderately encouraging and recovery in housing investment in 1983 (some 16-17 per cent) very encouraging. Improved outlook for construction reflects success of policies reducing inflation and interest rates.

7. Fall in investment and reduction in stocks?

[Capital expenditure by manufacturing, distributive and service industries in 1982 Q3 3 per cent higher than Q2 but 2 per cent down in latest six months compared previous six. Investment in manufacturing (including leased assets) in 1982 Q3 unchanged from previous quarter but 4½ per cent lower in latest six months than previous six. CBI October survey shows, for second successive survey, decline in investment intentions. IAF projects 3 per cent growth in fixed investment in 1982, 5 per cent in 1983.]

Figures reflect some modest recovery after disappointing second quarter. [IF PRESSED: latest DOI investment intentions survey suggests 3 per cent fall in manufacturing investment between 1982 and 1983. This is undoubtedly disappointing, but manufacturing is only one component in total private fixed investment, outlook for which is more encouraging. (See B6 above).]

8. Stock levels a threat to recovery?

[In 1982 Q3 manufacturers' and distributors' stocks fell unexpectedly sharply by around £420 million (1975 prices). Apart from 1980 Q4 and 1981 Q2, fall was larger than any quarter in current recession.]

Quarterly movements in stocks tend to be erratic; Q3 de-stocking may partly reflect adjustment to involuntary stockbuilding in 1982 H1. (This view possibly supported by December Trends Inquiry). Not too much weight should be placed on single quarter's data. GDP (output) figures (see B2 above) are a better guide to recent movements in activity.

9. Competitiveness not improved this year?

Cost competitiveness has improved about 20 per cent since 1981 Q1 and taking into account recent exchange rate movements, is about 10 per cent worse than when Government took office; though exchange rate lower than in May 1979. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one. Lower exchange rate makes it all the more important for companies to maintain close control over their costs. (See also section F).

10. Government contribution to improving competitiveness?

Government role is to create right environment: firm fiscal and monetary framework allowing for lower inflation and interest rates, supply side policies, NIS cut helps reduce

business costs. Up to industry to secure ever higher levels of productivity and not fritter away benefits of Government policy in excessive wage increases.

11. Productivity growth falling off?

[On revised statistics, incorporating discovery of previously unidentified employees in employment (See C¹³), growth in output per head in manufacturing slowed down sharply during 1982; Q1 9 per cent, Q2 7 per cent, Q3 4 per cent, in three months to November 2½ per cent (compared same period a year earlier). However, productivity still almost 14 per cent higher than at end 1980.]

Manufacturing productivity gains in last two years much bigger than might have been expected on past experience. Slowing down during 1982 probably inevitable as best opportunities for plant closures and improved efficiency are taken up first. Recent experience still better than average post-war experience.

12. CSO's index of leading cyclical indicators?

Longer leading index fell in December after nine months of increase, reflecting rise in interest rates and decline in share prices. Fall in longer leader only based on one months figures. Series not particularly smooth anyway, and decline based entirely on recent financial developments. No firm conclusions can be reached.

13. Outside forecasts

[GDP profile in recent major assessments and in IAF:

	Per cent change							
	Simon & Coates (Jan)	Phillips & Drew (Jan)	LBS (Dec)	OECD (Dec)	CBI (Nov)	St James (Nov)	NIESR (Nov)	IAF (Nov)
1982 on 1981	+½	+½	+½	+½	+½	+½	+½	+½
1983 on 1982	+2	+1½	+2	+1	+1½	+2	+1	1½
1984 on 1983	-	-	+2	-	-	+3½	+1	-]

Nearly all major outside forecasts see prospect of continued recovery and lower inflation. (Most now need updating to take fuller account of most recently available statistics and economic developments since 1982 Q3.)

14. Treasury Economic Model

[Series of questions from Mr Austin Mitchell MP (Hansard 23 December cols W647-8) concerning detailed technical aspects of the model are typical of recent interest.]

Treasury Ministers do not comment on the detailed operation of the model, which is a matter for the professional judgement of Treasury economists. Treasury economists do not provide a professional consultancy service for MPs, though do offer technical guidance to the outside bureaux through which it is available to researchers.

C LABOUR MARKET

1. Recent unemployment figures (on new and old basis) and other labour market indicators?

[Recent unemployment/vacancy figures shown in Table below on both old and new basis. Because of seasonal factors, sharp rise in 'headline total' expected in January, thereafter flat till May. Other labour market indicators: hours lost through shorttime working have increased steadily since July 1982 returning to 1981 Q4 and 1982 Q1 levels; overtime remains flat.

	1981				1982				Dec
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
'Total' unemployment (millions)	-	-	-	2.77	2.86	2.80*	2.94*	3.07	3.10 (13.3%)
(on old basis)	2.46	2.59	2.93	2.96	3.04	3.01	3.28	n.a	n.a
UK adult sa unemployment (millions)	-	-	-	2.61	2.68	2.74	2.84	2.91	2.95 (12.7%)
(on old basis)	2.28	2.48	2.64	2.75	2.82	2.88	2.98	n.a	n.a
increase in period (000's)**				+32*	+23*	+28	+31	+27	+27
(on old basis)	+77	+62	+51	+26	+18	+30	+42	n.a	n.a
Vacancies (000's)	98	89	96	104	112	107	111.0	115	118

*After allowing for over-60's transferring off register

**differences between consecutive three monthly moving averages

Rise in underlying rate of increase in December figures probably reflects in part the modified signing-on procedures operated at Benefit Offices over Christmas. Underlying increase in unemployment broadly flat in 1982 but doubtless unemployment will continue to rise for some time until benefits of lower inflation, greater wage moderation and improved competitiveness eventually begin to filter through.

2. Unemployment still rising despite Government's policies?

Excessive wage increases - unjustified by either output levels or productivity improvements - have eroded cost competitiveness and priced people out of jobs. Deepseated problems, which have taken long time to build up, will also take long time to check and reverse.

3. Latest information on earnings/pay settlements?

See Section D.

4. Devaluation way to improve competitiveness and hence employment prospects?

See F5.

5. Government fiddling the statistics?

No. New basis is cheaper, more accurate and cuts out wasteful procedures. New basis using voluntary registration also reveals similar trend to previous series.

6. What categories of unemployed affected by changes?

Severely disabled now included. Non-claimants registering at Job Centres, and far more people who find jobs before day of count, now removed. Non-claimants are principally married women paying reduced national insurance contributions and some may previously have been self-employed. Non-claimants number 110-150 thousand in most months of the year.

7. Will adjustment between 'old' and 'new' way of counting always be as great as ¼ million?

Generally, difference between old and new counts would have been between 170 and 190 thousand. October difference was exceptionally large because many (about 100,000 people) still on register at Job Centres had in fact already found jobs.

8. Does new system affect GAD assumptions for 1982-83 and 1983-84?

Scale of the assumed increase will not be significantly affected, but the assumed GB levels of 2.9 million in 1982-83 and 3.2 million in 1983-84 (excluding school leavers) could be some 200,000 lower ie 2.7 million and 3.0 million. Number of claimants eligible will, of course be unaffected.

9. Unemployment in UK higher than in other countries?

[On standardised definitions in 1982 Q3 UK unemployment was 12.5 per cent (new series) compared with 8.3 per cent OECD rate - over double for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - increase in latest three months on previous three in number unemployed (on national definitions - not strictly comparable) was much more in US and Germany (up 8.7 per cent) Canada (8.0 per cent) or Holland (7.5 per cent), than in UK (2.8 per cent).

10. True level of UK unemployment really much higher?

[TUC say 'true' figure just under 4½ million The Times 11 November, Labour Research Department say 5 million The Times 6 December; SDP say 5½ million Guardian 7 January.]

Gross exaggerations, relying heavily on claimed one million fall in labour force between 1979 and 1982. This is not supported by 1981 Labour Force Survey (see C12 below). Estimates also often include those benefiting from special employment measures who are

not unemployed. Furthermore, as much as 10 to 20 per cent of official count may not be seriously seeking employment. Claimant figures are best available measure of trend.

11. True level of vacancies?

Official notified vacancies (118,000 in December) reflect only about one third of total openings for job seekers.

12. New employment figures significantly affect figures of GDP, manufacturing productivity etc?

[Employed labour force mid-1981 on new data about 800,000 higher than previous estimates, comprised of extra 550,000 employees in employment (found by 1981 Census of Employment), plus extra 250,000 self-employed (from 1981 Labour Force Survey). Extra employees mainly concentrated outside manufacturing sector. On new data, manufacturing sector accounts for whole of fall in employment to mid-1981.]

Effect on GDP probably quite small - manufacturing productivity revised down by about one per cent in both 1981 and 1982; whole economy productivity figures revised down more substantially in 1981 and 1982 but still suggest recovery in productivity since end-1980.

13. Cost of unemployment/Effect on PSBR?

Effects of changes in unemployment on the public finances likely to vary widely according to underlying circumstances, for example changes in world trade, UK competitiveness, level of UK earnings and so on. Not therefore sensible to talk about 'cost of unemployment' as though there were a single figure. Payments of unemployment benefit and supplementary benefit to people registered as unemployed are currently expected to total about £5 billion in 1982-83. Comparable figures for total of taxes and national insurance contributions not collected cannot be given. There is no basis for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

14. What is Government's own forecast of unemployment?

[Government Actuary was instructed to assume that number of unemployed in Great Britain, excluding school leavers etc, would average 2.9 million in 1982-83 and 3.2 million in 1983-84, (or just under 3.4 million including school leavers). Assumption for 1982-83 same as in 1982 PEWP but for 1983-84 300,000 higher than in 1982 PEWP.]

GA's assumptions are not predictions or forecasts. [IF PRESSED they provide reasonable assessment of prospect but any forecast of unemployment must be highly conditional.]

15. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable

increase in employment. Nevertheless has substantially increased spending on schemes to allate impact on especially vulnerable groups. Most crucial factor in influencing unemployment is level of pay settlements (See also Section D).

16. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures and £2 billion in 1983-84. Within the latter, £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) the new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) the new Job Splitting Subsidy (open on 1 January) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

17. Employment continuing to fall?

[Total employment declined 2.0 million (8¼ per cent) between mid 1979 and Q2 1982. Decline of 103,000 in 1982 Q1 increased to 188,000 in 1982 Q2. Manufacturing employment fell by 21,000 between September and October last year to 5,550,000 (compared 5,896,000 in September 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C1⁶ above).

18. Recent productivity gains inimical to higher employment/lower unemployment?

This may be true in the short run. But in the longer term, as experience in Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[Year on year RPI increase 5.4 per cent in December, compared 6.3 per cent in November].

Year on year rate of inflation again fell sharply in December to 5.4 per cent - lowest level for 13 years (compared 5.1 per cent in March 1970). Price level actually slightly (0.2 per cent) lower in December than November.

2. Fall in inflation due only to reduction in mortgage rate?

True that falling mortgage interest rates have helped to reduce inflation, but only account for small part of fall. Only 1.3 percentage points of fall in rate of inflation from 12.0 per cent in January 1982, when mortgage rates at peak, to 5.4 per cent in December, resulted from fall in mortgage rates over that period.

3. Comparison with previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.1 per cent.]

When previous Government left office (May 1979), year-on-year rate of inflation was 10.3 per cent and rising (May 1978 figure was 7.7 per cent). Now (December 1982) 5.4 per cent and falling. We will be first Government for quarter-century to achieve lower average rate of inflation during its term of office than previous Administration.

4. Effect of recent fall in sterling on rate of inflation over next 18 months?

[Chancellor discussed in 19 January Debate speech.]

Remain confident of achieving 5 per cent RPI inflation soon. For rest of year, path may be a bit bumpy. But must not exaggerate possible effect of exchange rate depreciation. Exchange rate only one factor amongst many that affect inflation, although admittedly an adverse one. Government continuing to pursue sound money policies. New forecasts, taking account of all relevant factors, will be published with the Budget.

5. Ready reckoner for effect of depreciation on inflation?

[LBS assess sterling fall will add 2 per cent to inflation in 1983, 3½ per cent 1984 Times 17 Jan].

Not possible to give precise 'ready reckoner' for effect of exchange rate changes on price level. Suggestion of 2-3 per cent effect of recent depreciation on prices after 12-18 months much too pessimistic. Offsetting factors include weak commodity prices (including oil), likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

6. No further decline in inflation?

[IAE: 5 per cent in 1983 Q4.]

Progress in recent months has been faster than was forecast; and may in consequence be rather slower in the months ahead. But we shall continue to experience the benefits of sound financial policies.

7. Inflation still not as low as competitors?

[November figures UK inflation 6.3 per cent compared 4.6 per cent in US, 4.7 per cent in West Germany, 9.4 per cent in France, 16.9 in Italy and 2.3 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

8. TPI shows pay rises need to be $\frac{1}{2}$ per cent higher than RPI to maintain living standards?

[TPI increase 12 months to December 5.8 per cent, compared RPI increase of 5.4 per cent].

Gap between RPI and TPI (now 0.4 percentage points) widened in July 1982 when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of change - except for minority who have spell of unemployment during year.

9. Nationalised industry prices

[Increase in nationalised industry prices, water charges and London Transport Fares over 12 months to December 14.3 per cent compared RPI increase of 5.4 per cent.].

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 also played important part. Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices and RPI now about 9 per cent, compared 14 per cent in January 1981; over half of present differential explained by LT fares and 1981 winter electricity rebate. Signs are that the gap will continue to narrow. Sustained improvement only possible if industries succeed in holding down current costs, particularly pay.

PAY

10. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

11. Level of pay settlements?

[CBI figures published 19 January suggest manufacturing settlements averaging 6.2 per cent so far in pay round.]

Average has been in single figures, and moving downwards, in each of past two years. Only a minority of bargaining groups have settled so far in this pay round, but I believe we are seeing still lower settlements. In everyone's interest that pay settlements should come down, and come down sharply.

12. A 3½ per cent pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in public expenditure cash plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it decision on offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each will be considered on merits.

13. Government exhortations on pay imply aiming to cut living standards?

[Real earnings have shown little variation over past two years; in 1982 Q3 were only 0.2 per cent lower than in 1981 Q3.]

Low pay increases do not necessarily mean reduction in living standards. But whether they do or not, they are essential if we are to create competitive and profitable productive sector, and thus secure conditions for sustained improvement in living standards.

14. Average earnings index

[Year on year growth 8.3 per cent in November compared with 7.3 per cent in October. However, underlying increase slightly lower than in October at about 8½ per cent.]

Fact that average earnings index is ahead of RPI casts doubt on wilder claims about falling living standards. Further moderation in settlements is needed if we are to maintain jobs and get inflation down.

15. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to idea that incomes policy can be made to work on permanent basis. They always succumb to distortions they create.

16. Pay increase for nationalised industries' boards this year?

No general level of increases for board members this year. Proposals for each board being considered individually on merits, in light of circumstances. When relatively large increases have been approved by Ministers responsible (in consultation with Chancellor) it is because these have been justified by such factors as need to recruit people of ability, inadequate

differentials with senior staff and performance of industry. Because board pay held back in previous years, many salaries are now seriously out of line with market rates.

17. Performance-related pay for nationalised industry board members?

An attractive concept. Practicalities and implications are being studied jointly with representatives of Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

18. Index-linked pensions and Scott report?

Government announced in Debate 22 October that favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

E MONETARY AND FINANCIAL POLICY

1. Monetary growth on target?

[Money and banking figures published 13 January summarised below:

	per cent s.a.		
	M1	£M3	PSL2
December increase	0.9	0.6	0.5]

Growth rates of all three aggregates within target range - M1 and £M3 at almost 11 per cent and PSL2 about 9 per cent.

2. Why have interest rates gone up?

[Barclays, Lloyds and Natwest increased their base rates by 1 per cent (to 11 per cent) on 11 January and Midland theirs by $\frac{3}{4}$ per cent (to 11 per cent) on 12 January. Still down by 5 points since peak in October 1981. Long term interest rates also reduced significantly over past year.]

Structure of interest rates in domestic money markets was dislodged by fall in sterling. Interest rates in domestic money markets rose sharply in early January but have steadied. Bank base rate increases and increase in Bank of England's dealing rates reflected this. Government remain determined to maintain sound monetary conditions and to continue progress towards lower inflation.

3. Rise in interest rates will stifle recovery (as in autumn 1981)?

Does not necessarily follow. The fall in the exchange rate, though adverse for inflation, (but see also D4-5), will ease pressure on companies. (See also A6).

4. Did Government engineer rise in interest rates?

As is evident from sequence of events, the rise in interest rates stems from market developments, including developments in currency markets.

5. Will interest rates rise further?

[Interest rate 'ruled out as means of defending sterling' claimed in Guardian 20 January.]

What Chancellor said in Debate 19 January was that there is no reason for further rise in interest rates now; if the exchange rate were to fall further, such a fall could well be only temporary. Government remain determined to maintain sound monetary conditions.

6. Prospects for resuming falls in interest rates?

Government does not make predictions about interest rates. Interest rates have to adjust to play their part in maintaining sound monetary conditions. Route to lower interest rates is ultimately through lower inflation.

7. Will slide in sterling affect monetary conditions?

Level of sterling is one of the factors taken into account in judging monetary conditions. Recent fall in exchange rate may reflect market uncertainty about monetary conditions, though this is scarcely justified, given the reassuring position on the PSBR and monetary aggregates. Rise in interest rates will reassure markets that monetary conditions required for continued control of inflation will be maintained.

8. Will mortgage rate now rise?

[Mortgage rates have fallen 5 percentage points from peak in March 1982. Latest cut, to 10 per cent, came into effect for all home buyers on 1 December.]

That is a question for the building societies. Their liquidity position is very strong at present; they do not need to be rushed into adjusting their rates.

9. Bank lending growing too fast?

[Bank lending starting to decrease slowly. Increased by (seasonally adjusted) £2 billion in September, average for October and November [because of STC distortion] £1.5 billion, and £0.8 billion in December.]

December figure lowest for last year. (NB Might have been distorted by short banking month.) Bank lending to companies has steadied; lending to persons has fallen off from its high level last summer.

F EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[Since October, sterling has fallen 11 per cent in effective terms, 9 per cent against the dollar, 11 per cent against the D-Mark, 19 per cent against the yen.

	October average	11 Jan low points	24 Jan 10.15 am	% change Oct -24 Jan
\$/£	1.6977	1.5635	1.5470	-8.9
DM/£	4.2932	3.6757	3.8273	-10.9
Y/\$	460.12	357.96	373.52	-18.8
£ effective	92.5	80.6	82.3	-11.0

Markets have been volatile since end-October, largely reflecting fluctuations in market perceptions of the course of US interest rates. Thus, the recent recovery of the US dollar has gone some way to reverse what had been seen as a general re-alignment of currencies, with long-expected rise in D mark and yen (reflecting underlying strength of Germany and Japanese economies and their improving trade balances); partly from weakness and uncertainty about oil prices (lower price helps other countries and their currencies - has little impact on UK). Irresponsible Opposition policy statements also had an effect].

Government has no target for exchange rate. Nor do recent events suggest conditions exist in which pursuing a target would be a viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible. Government not indifferent to UK exchange rate, which is important for the economy. It is one of factors taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Should not Government welcome fall in pound?

A lower exchange rate means higher costs to industry and the consumer: no-one should welcome that. Of course, recent fall in pound may bring some relief to British firms that are facing difficult competitive pressures in home and overseas markets, particularly from Europe and the Far East - but they must contain their costs rigorously in order to retain that benefit. We cannot solve our basic problems of competitiveness by depreciation, and no-one should doubt our determination to adhere to our counter-inflation policies. Sound money remains at the heart of the Government's economic strategy.

3. Impact of fall in sterling on inflation?

Will no doubt be some modest impact on inflation from recent fall. But probably less or slower to come through than many commentators suggest. Importers into UK have had healthy profit margins. They absorbed much of the effect of sterling's fall in 1981 and they may remain reluctant to raise prices in today's market conditions. Food prices reflect the 'green pound' (which is fixed separately) and has been unchanged - see Note below. Commodity prices (including oil prices - one of reasons for sterling's fall) are weak - and

to be set in dollars, where fall in sterling has been least. And, of course, some of the fall could prove to be temporary.

Note Report in FT 18 January suggesting green £ changed - not the case. What has happened is that fall in sterling has eliminated gap between market rate and green £.

4. Government reaction to further fall in the rate?

No sound reason for the rate to fall. The underlying financial position is strong

- Government spending and borrowing are under control and on target;
- the Government deficit, as a percentage of GDP, is one of the smallest in the industrial countries;
- we continue to run a substantial current account surplus, larger in 1982 than the £3½ billion forecast only last November;
- inflation is falling, and fell faster over the last year than in any other major country;
- monetary growth is within the targets, and the signs are it will stay there. [See also Section E].

5. Improve UK competitiveness directly by encouraging exchange rate down further?

Substantial fall in exchange rate as advocated by Opposition, would give only very temporary gains of competitiveness for UK industry. Would raise costs of imports directly and, by alleviating competitive pressures, permit general increase in prices of domestically produced goods. This would have repercussions for wage bargaining and hence trigger a general rise in costs, undermining initial competitiveness gains. We in the UK have seen striking examples of this process: improvement in competitiveness following 1967 devaluation had largely been eroded by 1972; furthermore, although the exchange rate fell by 25 per cent between 1973 and 1976, competitiveness was on balance unchanged.

6. Why did Bank of England intervene so heavily in December?

[Letter from Jack Straw MP 6 January].

Foreign exchange markets have recently been unsettled generally, with sharp movements in major currencies and uncertainties about the price of oil. In these circumstances not surprising that Bank had to intervene on a larger scale than normal to slow underlying rapid movements and to ensure that sensible two way trading could take place.

7. Are the reserves too low?

[Letter from Jack Straw MP 6 January].

Against the background of the Government's policies not only towards the exchange rate, Government do not regard the present level of the net or gross reserves as worryingly low. (Level of gross reserves rather lower than it was in mid-1979, although on any measure greatly exceeds that reached in 1976). Misleading to look at gross reserves. Real change since 1979 is the reduction achieved in the overseas debts run up by the last Government - cut from \$22 billion in May 1979 to a little over \$12 billion today.

8. Situation has been made worse by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All the experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations).

9. Join~~ing~~ EMS exchange rate mechanism (ERM)?

Recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally ^rfaded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM not a policy: it carries ^{an} ~~an~~ obligation to take policy action to try to defend a particular rate.

G BALANCE OF PAYMENTS

[November trade figures to be published 27 January.]

1. Trade figures and current account

[November trade figures showed trade account in slight surplus though non-oil trade remaining in deficit; Q3 balance of payments figures shows invisibles surplus of £200 million a month in Q3 after £260 million a month in Q2. Cumulative current account surplus of £3.8 billion in eleven months to November. IAF shows zero current account balance in 1983.]

Current account remains in substantial surplus, albeit reduced from 1981 levels - current account surplus for 1981 was £6 billion.

2. Trade in manufactures in deficit last year ?

When exports and imports put on comparable basis [ie both valued on balance of payments basis], we recorded a surplus on trade in manufactures of over £2 billion in first 11 months of 1982. [NOT FOR USE: Figures underlying IAF suggest that trade in manufactures may go into deficit this year].

3. Heading for poorer net trade balances in manufactures? Need to improve competitiveness to avoid this?

Agree desirability of lasting improvement in competitiveness of UK manufacturing industry. Depends on better productivity growth, lower wage inflation. Have made start - productivity performance as good as any of competitors over last two years. If could match this with equally competitive performance on earnings, would be well on way to lasting improvement in competitiveness.

4. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports from September onwards from the erratically low August level but underlying level of non-oil exports, after weakening in mid-1982, seems to have recovered in recent months to level of last spring at a time when, due to world recession world trade has probably fallen (1982 first year-on-year fall since 1975).

5. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Jaguar cars are a striking example of improvements in performance that British industry is capable of. Jaguar's drive for higher quality secured them an increase in overseas sales last year of 56 per cent over 1981.

6. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

7. Import trends

There has been little change in underlying level of manufacturing imports since end-1981. Manufacturing output fell back a little in 1982, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

8. Protectionism?

[Mr Foot's Glasgow speech 22 January.]

We are concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Pressing for positive European Community action to remedy this. But wish to make clear, as Chancellor said last year [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

9. Japan

Welcome the tariff reductions announced end-December. Small step in right direction. Fully support EC measures to step up action under GATT aimed at putting further pressure on Japanese to open up their domestic market.

10. GATT meeting

Glad to see that GATT meeting reaffirmed need to resist growing protectionist pressures. GATT declaration represented realistic commitment on behalf of signatories to the open trading system in present difficult economic climate.

11. Services

Work in the GATT on services is a major new departure and one of particular interest to UK. Field is wide but UK will contribute constructively with view to making early progress.

12. Textiles

This GATT study relates to the longer term and as such is not unreasonable. In no way affects present Multilateral Fibres Agreement and latest bilateral agreements which will run until 1986.

13. Q3 Balance of Payments and capital account

[Q3 invisibles surplus of £0.6 billion. Outflow of investment and other capital transactions of £0.3 billion. Private sector direct investment abroad fell to £0.8 billion and private sector portfolio investment abroad down £0.2 billion from Q2 to £1.0 billion.]

Invisibles account continues to be in healthy surplus - £1½ million cumulative surplus ^{on} ~~the~~ invisibles in first three quarters of 1982.

14. Continuing capital outflow shows folly of abolishing exchange controls?

Wrong to talk about money flowing out of the country. Those who wish to invest abroad have to buy foreign currency and find someone else who wishes to invest in Britain to purchase sterling in return. The nation's net capital outflow or inflow - as a matter of arithmetic - matches the current account balance. Just as countries with deficits have to borrow abroad, those with surpluses acquire net overseas assets.

15. Portfolio outflow higher than last year?

[Q3 Balance of Payments figures published 8 December showed continuing outflow of UK overseas portfolio investment. Guardian on 9 December described this as rising trend.]

True that there is little sign yet of end to expected period of stock adjustment following ending of exchange controls. But misleading to say portfolio investment abroad is rising. Figures are as follows:

		£ billion	
1981	Q1	-	1.3
	Q2	-	1.0
	Q3	-	0.7
	Q4	-	1.1
			average - 1.0
1982	Q1	-	1.6
	Q2	-	1.3
	Q3	-	1.0

Q3 figure is smaller than in Q2 or Q1, and about the average for last year.

16. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. Government has succeeded in reducing PSBR as percentage of GDP; further reduction is projected. Inflation has fallen fast - expected to fall further (see D1). Base rates have risen but still well below (5 per cent) peak in 1981. Benefits seen in recovery of debenture market. [IF PRESSED: Would like to see rates lower still, so long as not likely to endanger progress on inflation.]

2. Government planning balanced Budget?

[Chancellor questioned in Guardian interview 17 December about reports that Professor Walters at FT bankers' conference advocated balanced Budget over run of years.]

Government aims to reduce PSBR as share of money GDP over medium term. Illustrative profile in 1982 MTF5 shows figure of 2 per cent in 1984-85. Nothing has been said about later years.

3. Relationship between public sector borrowing and interest rates not as direct as this government claims?

Links between interest rates and the PSBR are not simple or instantaneous, nor do we claim them to be. But that is not to say that the relationships is not important. This Government's firm control of borrowing is certainly one of the factors responsible for the recent falls in short term interest rates, compared with last autumn 1981.

4. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

5. PSBR in December quarter

[PSBR in December quarter £3.1 billion (£2.5 billion seasonally adjusted). PSBR April-December £7.6 billion (£5.3 billion seasonally adjusted.)]

Wrong to prorate £5.3 billion to arrive at likely PSBR for 1982-83. On balance however December quarter figures indicate PSBR likely to undershoot IAF figure of £9 billion.

6. PSBR likely to be £8 billion in 1982-83 compared £9 billion in IAF?

[F. Williams article The Times 21 January].

It is possible. But must remember that margins of error in any precise forecast substantial.

7. What would undershoot be if Government had not taken recent measures?

[CONFIDENTIAL NOT FOR USE: At time measures taken they were thought likely to 'boost' PSBR by around £1½ billion in 1982-83 - an estimate itself liable to quite a large margin of error.]

Rather strange question. Given the uncertainty over PSBR outturn this year it is impossible to answer.

8. Government intentions for 1983-84 PSBR?

[Autumn Statement PSBR for 1983-84 assumed to be £8 billion - 2¼ per cent of GDP; 1982 MTFS was £8½ billion].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before. (See also A14).

9. Recent rises in interest rates make nonsense of Government's claim that PSBR matters?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - however PSBR over run of years implies lower interest rates - still holds true.

10. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

11. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's.]

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because borrowing has adverse effects on interest rates and inflation. But a higher tax burden does not necessarily mean that people are worse off, because gross earnings have risen faster than prices since 1978-79. On average, all types of household in work at all earnings levels are better off in 1982-83 than in 1978-79. [NB: individuals may have done better or worse than average.]

2. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children have also benefited from generous increases in benefits such as FIS.

3. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to EC levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under ¼p in the basic rate.

4. British tax burden high by international standards?

[Times 13 January article highlights data published in December Economic Trends].

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [provisional 1981 data from OECD's Revenue Statistics 1965-81]. Similarly, UK taxes on personal income and UK employees' social security contributions about average for EC countries and lower than USA [1980 provisional OECD data].

5. Too few tax officials on evasion work?

Not prepared to abandon our manpower targets (see L1). Within these, we do redeploy staff as appropriate. Inland Revenue has deployed 400 extra staff to counter tax avoidance and 'the black economy'.

6. Cuts in taxation in 1983 Budget?

Decisions for 1983 Budget, both on PSBR and particular tax changes, have not yet been made.

7. Future of married man's personal allowance?

[Labour Party commitment to phase out in favour of increased CB etc; SDP proposals to abolish as part of proposals in document 'Attacking Poverty'.]

Government launched debate with 1980 Green Paper on Taxation of Husband and Wife. Green Paper set out number of different options; these being considered in light of very wide range of views received. Abolition would affect many millions of taxpayers, and by itself, leave a basic rate taxpayer £5 a week worse off. For some people it would worsen poverty and unemployment traps.

8. SDP plan to abolish poverty trap?

SDP scheme costs £5 billion - even on their own estimates - and still leaves marginal tax rates for people in poverty trap of 80-85 per cent. It extends trap both up and down the income scale. Ten times as many people would have marginal rates increased as would have them reduced. Claims to have eliminated trap are based on artificially restricted definitions. Their proposals would leave some people on below average earnings worse off.

9. Government unconcerned about poverty and unemployment traps

Government is concerned about poverty and unemployment traps, in context of incentives as a whole. Traps arise from attempts of successive Governments to alleviate poverty while keeping costs in bounds. Alternatives are to give less support for poor and unemployed or to let costs rip. Necessary step in right direction is to reduce burden of income tax by restraining public expenditure; long-term solution is increased real earnings resulting from sustained improvement in productivity and economic performance: both are goals of Government policy.

K PUBLIC EXPENDITURE AND FINANCE

[Total spending of £120.1 billion in revised plans for 1983-84 announced 8 November. Compares with total of £120.7 billion in 1983-84 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 will be published in next Public Expenditure White Paper in late January/early February 1983. Plans now announced are firm. Precise figures may change slightly between now and White Paper in light of more detailed calculations. Contingency Reserve will also be reviewed before White Paper finalised.]

PUBLIC EXPENDITURE REVIEW AND AUTUMN STATEMENT

1. How do revised plans for 1983-84 compare with those previously announced?

Outcome of annual review of public expenditure plans was to hold planning total within previously announced plans. First time this has happened since 1977.

2. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

3. Contingency Reserve 1982-83 and 1983-84?

Containment of additional expenditure within Contingency Reserve helps to keep public expenditure as a whole within planning total determined by Government. Provisional setting of Reserve at £1500 million in 1983-84, compared with £2500 million in 1981-82 and £2400 in 1982-83, reflects fact that amounts provided in those years now appear to have been unnecessarily large. [Used up in 1981-82: about £1145 million; charged to date in 1982-83: about £1290 million.]

4. Shouldn't all programmes have been reduced with fall in inflation?

No. Under cash planning, presumption is that planning totals will be maintained, unless any major change invalidates the main assumptions on which they were based. (Level of services then what can be obtained with cash available after making every effort to reduce costs.) Inflation in 1983-84 put at about 5 per cent higher than in 1982-83; this compares with 6 per cent implicit factor used when old 'volume' series was converted to cash. We took view this reduction not great enough to justify wholesale adjustment.

5. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But lower inflation and interest rates make it possible to accommodate such changes without major cuts in services.

6. What about years following 1983-84? How do figures compare with Budget time?

Figures for these years will be published in next Public Expenditure White Paper, early in 1983. Planning total for 1984-85 will be within total announced at Budget time. [NB No figure for 1985-86 announced yet].

PUBLIC EXPENDITURE - GENERAL

7. Will Government support St John Stevas Bill?

(Second reading 28 January)

We recognised in our White Paper on the Role of the Comptroller and Auditor General (Cmnd 8323 of July 1981) the desirability of legislation on this subject. House will now have opportunity to modernise the 1866 and 1921 Acts, and that is welcome. However, there are strong arguments against the proposal in the Bill to give C & AG access to books of nationalised industries. The industries should be set clear financial targets and then be subject to minimum of interference. Bill is a move in opposite direction. All of these issues should be considered by the House.

8. Why did not Government introduce legislation?

This is a subject on which it is very desirable to proceed by ^S consensus. Unfortunately that has not been the position. Hope wide measure of agreement will emerge during course of Bill's passage through House.

9. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gave figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

10. Capital spending in public sector?

Government policy is that provision made for capital expenditure, both in central government and local authorities, should be fully spent, subject to normal prudential margin. (Of course always necessary to take account of implications for future current running costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also ~~K17-19~~ and ~~R17-15~~).
14-16 12-16

11. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service

pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

12. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

13. Public services pay in 1983-84/3½ per cent pay assumption?

Government attach great importance to realistic wage settlements in next round, in both public and private sectors. 3½ per cent assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in 1983-84 public expenditure plans for those groups for which Government directly responsible, other than NHS. (It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.)

LOCAL GOVERNMENT

14. LA capital underspending in 1982-83

Following underspend of £¼ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: PM wrote last autumn to local authority associations; local authorities can apply for extra allocations (about £200 million issued so far), and can spend without limit on improvement grants; extra £150 million made available to Housing Corporation.

15. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

16. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83; (gross) housing spending up £350 million (13 per cent); urban programme (including

Urban Development Grant) up by £70 million (to £350 million). Local authorities will be allowed to spend above allocations on improvement grants.

17. LA current overspending in 1982-83

Budget returns from LAs in Great Britain indicate that overspend of over £1 billion on current expenditure relevant for rate support in prospect. In response, rate support grant to be cut by £308 million in England, £27 million in Scotland, and £5 million in Wales.

18. RSG settlements 1983-84

Realistic and generous: expenditure provision effectively 10 per cent higher than in last settlement and grant 3 per cent higher than 1982-83 settlement - provided authorities do not overspend. [For details refer to Statements by Secretaries of State for Environment, Wales and Scotland on 16 December.]

19. Grant penalties 1983-84

Hope won't be necessary to have any. But authorities were warned in July 1982 of expenditure guidance now issued and have had ample time to adjust 1983-84 budgets to avoid incurring grant penalties.

20. Rate increases in 1983-84?

On average there should be no need for rate increases in 1983-84. If authorities spend in line with expenditure targets any increases should be low; some councils could even reduce rates. Where rate increases are high because of overspending it will be LA's own fault.

21. Service cuts?

Up to local authorities to decide how to keep to the provision in the RSG settlement. If they choose to allow irresponsible pay settlements, services may have to suffer unnecessarily.

22. Higher council house rents?

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. If that figure confirmed, will be possible to provide for real increase in capital investment in housing in 1983-84.

23. Green Paper on Domestic Rating System: Government response?

Currently considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc. (See also P^S.)

FALKLANDS EXPENDITURE

24. Falklands defence costs?

Latest assessment of costs of operation, of replacing equipment lost during conflict, and of garrison, is about £700-£800 million in 1982-83. Provision has been made for £624 million in 1983-84. Provision made for subsequent years will be announced in 1983 Public Expenditure White Paper. Total Falklands costs of £3 billion reported recently in Press [Guardian report 13 December] are broadly consistent with latest estimate of costs.

25. How will the defence costs be met?

Extra defence costs will be met by additions to defence budget on top of provision for NATO 3 per cent a year real growth target. Block defence cash limit for 1982-83 increased by £371 million so far on account of operations in South Atlantic (Hansard 9 November 1982 Col W108). This increase has been met from the Contingency Reserve. It has not therefore affected the Public Expenditure planning total.

26. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). About £10 million now expected to be spent in 1982-83 of which about £½ million will be found from Aid Programme and balance from Contingency Reserve. A further £5 million may be spent on rehabilitation in 1983-84. Ministers have agreed on a package of measures for long term development of the Islands tentatively estimated to cost in all £31 million over next 6 years (announced by Foreign Secretary 8 December).

27. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1½ million has so far been paid out, but this is no guide to what the final total might be. Costs in 1982-83 will be absorbed within FCO programme.

L CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10½ per cent to 655,000 (at 1 October 1982). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service efficiency?

[TCSC published 17 January memorandum by Council of Civil Service Unions commenting on Government's reply (Cmnd 8616) to TCSC's report 'Efficiency and Effectiveness in the Civil Service').

Main theme of Council's memorandum is that drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. Great savings already made with little effect on provision of services.

3. Civil service pay negotiations in 1983?

Government have told civil service unions that there will be room for genuine negotiations and that they intend to conduct those negotiations with the view of reaching an agreed settlement. In answer to unions' question about availability and terms of arbitration, Government have said that it is too soon to answer; they were looking for a negotiated settlement.

4. Contents of unions' claim?

Unions' claim for 1983 has been received; proposal is:

- (a) flat rate increase of £12 per week for all non-industrial Civil Servants on National Salaries up to and including £6264 pa;
- (b) above this level, 'substantial' percentage increases, providing, in particular, 10 per cent on salaries up to £9758 pa.

Additionally, the unions propose minimum wage for all staff aged 18 or over of £85 per week, and reduction in the working week to 35 hours net. The Government have acknowledged receipt of the claim, and said they will arrange first discussion of it when unions' supporting evidence is to hand.

5. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Unions have now confirmed their willingness to enter into joint discussion.

6. Scott Report/Public sector pensions?

See D 18.

M SOCIAL SECURITY

[Benefits uprated by 11 per cent 22 November 1982 which included 9 per cent to take account of inflation. RPI increase in 12 months to November announced 17 December was 6.3 per cent, hence 9 per cent 2.7 percentage points too high. Announced in Autumn Statement that November 1983 uprating would be adjusted to have regard to over-provision for inflation. Chief Secretary made clear to Social Services Committee on 15 December that saving would be £180 million in 1983-84 - less than would be achieved by full recovery of overshoot].

1. Pensions should not be adjusted next November?

Pensioners better off this year by extent of overshoot. Only question how much of this real increase continues beyond November 1983. No decisions on precise rise in pensions can be taken until nearer Budget time - Government will have to take account of priorities inside and outside social security programme. But it will not go back on its pledge to maintain real value of pensions over lifetime of this Parliament.

2. Level of overshoot?

Allowance of 9 per cent made for inflation between November 1981 and November 1982 in November 1982 uprating based on forecast at Budget time 1982. Actual RPI increase (published 17 December) for 12 months to November 1982 was 6.3 per cent; hence overshoot is 2.7 percentage points. Reflects Government success in reducing inflation.

3. Public expenditure saving?

Full recovery of overshoot would save about £250 million in 1983-84; more in a full year. But social security programme has been reduced by £180 million in 1983-84. This reflects Government's judgement of appropriate level of expenditure. Exact level of November 1983 uprating will be settled at Budget time, when Government will, as usual, take wide range of factors into account.

4. Improvements in benefits?

[Ie, using difference between reduction of £180 million and full saving of £250 million if overshoot fully recovered.]

There is constant pressure from both sides of House for whole variety of improvements. Government will have to determine priorities, eg between change in individual benefits and adjustment in next uprating. Decisions will, as usual, be taken at Budget time.

5. Uprate pension by pensioners' price index?

[Two PPI's for one and two person households; both exclude housing costs. Both indices have moved less than full RPI which is used to uprate pensions and other benefits between 1978 Q4 and 1982 Q3. Differential between PPIs and RPI including or excluding housing costs fluctuates over time, but is never very large.]

Pensioner's price index is not necessarily representative of pattern of pensioners' spending, and is constructed on limited information from a very small sample of pensioners. We consider RPI to be best measure of general level of prices, and appropriate for uprating of pensions. In any case, pensioners would not have done any better had we used the PPI to uprate pensions since we came into office.

6. Retirement age?

[Social Services Committee Report published 24 November: principal recommendation a more flexible State retirement scheme with 'fulcrum' pension age of 63 for both men and women. Net long-term cost of Committee's proposals is £500 million at current benefit levels; equivalent to about $\frac{1}{4}$ per cent on employers' and employees' NICs. Required contribution for occupational pension schemes would need to increase by 15-20 per cent - about 2-3 per cent extra on payrolls].

Government welcomes this Report and the political consensus the Committee achieved. Report deals with important issues which Committee recognises as not for this Parliament. Their emphasis on equality and flexibility absolutely right.

7. Restore abatement of unemployment benefit?

Social Services Secretary made Government position clear in debate on 22 November. Government do not regard abatement of unemployment benefit as permanent measure; are considering question of its restoration in light of available resources and other decisions on uprating of benefits which will be taken as usual in context of uprating statement to be made at Budget time.

8. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from current 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

9. SDP proposals?

See J8-9.

N EUROPEAN COMMUNITY

1. UK budget settlement

[European Parliament on 16 December rejected draft supplementary and amending budget established by Council of Ministers on 8 November to make the necessary budgetary provision for our refund payments. This action obstructed implementation of settlement reached by Foreign Ministers 26 October, providing for basic gross refund of around £630 million (about £480 million net) by end-December.]

European Council now considering new budgetary proposals presented by Commission on 19 January. It is hoped a new draft supplementary budget for 1983 will be considered by the Parliament in week beginning 7 February and adopted in time to allow our refunds to be paid over before end-March.

[CONFIDENTIAL NOT FOR USE: As a first step, Commission has opened a new account with the Paymaster General (EEC No.3 Account) into which they have deposited funds equivalent to our refunds entitlement. We get the interest benefit from these funds. The EEC No.1 account has been temporarily run down, but Commission is expected shortly to bring the balance up to the 1982 average].

2. Refunds for 1983 and later

On 17 November the Commission produced its proposals for dealing with UK budget problem in 1983 and later. Commission communication does not suggest what size of our refunds - or our net contribution after refunds - should be. We think it provides a suitable framework for discussion of problem within the Community and hope that progress will now be made quickly. PM has said this will have to be discussed at next European Council in March if solution not found by then.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

We very much hope the issue of our Budget contributions can be satisfactorily settled without need for recourse to such a step.

5. Commission Green Paper on 'own resources' system

Commission Green Paper on 'own resources' is expected by end-January. We will study this carefully. Our opposition to an increase in the 1 per cent VAT ceiling is well known.

6. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

7. Costs of CAP to UK consumers

The Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

8. European Monetary System exchange rate mechanism

See F9.

P INDUSTRY**1. Latest statistics of output and investment?**

See Section B.

2. Effect of NIC and NIS changes announced in Autumn Statement on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance surcharge for 1983-84, cutting rate to 1½ per cent; also, half of 1 percentage point reduction in rate next financial year will be brought forward into current one. Effect will be as if private sector had paid at 2 per cent rather than 2½ per cent (rate announced in 1982 Budget) during 1982-83. Small increase in employer's NIC as from April 1983 also announced on 8 November.]

Special reduction in NIS is worth about £350 million to private sector employers in 1982-83, and announced NIC and NIS changes taken together will benefit them by over £400 million in 1983-83. Constitute a substantial reduction in costs faced by private sector commerce and industry.

4. How does this compare with burden as at May 1979?

Private employers will pay around £1 billion less in 1983-84 than they would have done under rate of NIS and employers' NIC inherited from previous Administration.

4. High interest rates damaging for industry and investment?

Banks' base rates still 5 percentage points lower than October 1981. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year.

5. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

6. Energy prices?

See R7-9.

7. Companies' financial position?

[NB company sector borrowing in 1982 Q3 includes large element of unidentified transactions (-£1 billion)]

	1979	1980	1981	1982		1982
		Year	H1	H2	H1	Q3
Net borrowing requirement (+)/repayments (-)	+6.1	+6.5	-1.7	+6.2	+6.0	+1.9
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.3	+0.7	+1.1	-0.8]

Financial position of industrial and commercial companies (excluding North Sea) improved in 1981, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in borrowing requirement second half 1981 ~~financial position~~ due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for first three quarters 1982 suggest companies' borrowing requirements remain high, but much less so than in 1979 or 1980.

8. ICCs liquidity ratios in 1982 Q3?

[D. Industry's survey of 200 large companies (published 3 December in British Business) shows a further significant deterioration in liquidity in 1982 Q3. Also shows £1 billion reduction in total current assets since 1982 Q1 whereas national accounts show total identified liquid assets of all ICCs increasing this year].

Liquidity ratios (total current assets divided by total current liabilities) not necessarily most fruitful method of interpreting liquidity position. Companies are not short of liquidity at the moment. Liquidity behaviour of largest companies may simply reflect relative ease with which they can meet cash flow pressures with bank over-draft facilities which may not be so readily available to smaller companies.

9. Profits/rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 17 per cent 1982 Q3 compared 1981 Q3 but increase was from a very low base. ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.)]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

10. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

11. Future of cashless pay/Truck Acts?

Discussion at NEDC 5 January demonstrated CBI and TUC support ^{for} ~~from~~ major shift to cashless pay. Government considering carefully arguments both for and against repeal of Trucks Acts as means of accelerating progress.

12. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

13. Response to Loan Guarantee Scheme?

[Nearly 7,400 guarantees already issued - about half to new businesses. Total lending under scheme over £245 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. Department of Industry has been called to honour only about 160 guarantees out of nearly 7,400 so far issued. Future of scheme under review.

14. Enterprise zones

Response to first eleven zones has been encouraging; many new firms have been set up and others expanded. (But too early to assess overall success). Proposed sites for nine new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one for Wales have also been announced. One more for Wales under consideration. (Total (13 or 14 in all) slightly more than 'eleven' new zones referred to by Chancellor 27 July; this reflects number and quality of applications received from local authorities).

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. EFLs for 1982-83

Nationalised industries' total external financing limits for 1982-83 were increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession.

2. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 were announced in Autumn Statement. Overall, external finance in line with previous plans. £2.7 billion being made available to nationalised industries in 1983-84.

3. Why is benefit of reductions in National Insurance Surcharge being restricted to private sector?

[Reductions in nationalised industry external financing limits, to offset effect of NIS reduction, were published in a Written Answer on 22 December.]

Purpose of reduction is to stimulate private sector industry and commerce by reducing cost of employing labour. By restricting reduction to private sector, it was possible to give higher level of assistance than would otherwise have been possible. If public sector had benefited, amount going to private sector would have been only two-thirds of what we propose. We believe the money will be spent more productively in private sector than it would in public sector.

4. Government attitude to Mr St John Stevas' Bill on Parliamentary control of expenditure?

See K7-8

5. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. Rolling programme of Monopolies and Mergers Commission investigations has been set up. Introduction of market forces provides the greatest incentive to efficiency.

NATIONALISED INDUSTRY PAY AND PRICES

6. Nationalised industries' prices

[Increase in nationalised industry prices, water charges and London Transport fares over 12 months to December 1982 14.3 per cent, compared with RPI 5.4 per cent.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Differential between NI prices (including water charges and London Transport fares) and RPI now currently about 9 per cent, compared with 14 per cent in January 1981; over half of present differential explained by LT fares and last winter's electricity rebate. Signs are that gap will continue to narrow. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

7. UK industrial energy prices above those of European counterparts?

[At NEDC on 8 December CBI complained that energy-intensive industries pay 20 to 40 per cent more for energy than European competitors.]

Vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. But on average, electricity prices will not increase in 1983 (see 9 below). Measures worth over £300 million in energy cost savings have been introduced in last two Budgets to help industry. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating industry. But Energy and Industry Secretaries have indicated willingness to have further discussions with industry about electricity prices.

8. Freeze on industrial gas prices?

[BGC announcement that freeze on renewal prices for contract gas would be extended to first nine months of this year].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

9. Electricity prices?

As announced by the Secretaries of State (for Energy and for Scotland) on 12 November, electricity prices (domestic and industrial) will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

10. British Telecom's deferred tariff increase

[BT again deferred its tariff increase until at least July 1st this year. Charges last raised Nov 1981. From April 1st a low user rebate scheme is to be introduced].

We welcome BT's decision to defer its tariff increase again. This will mean that BT have not raised prices for at least 20 months. We are also pleased with the rebate scheme, which should benefit those who do not use their telephone a great deal.

11. Nationalised industry boards' pay?

See D 18-19.

INVESTMENT

12. Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Wasteful to provide funds for public sector projects with lower returns than those in private sector. Unfortunately, pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus 1/4 per cent, compared with 3 per cent for industrial and commercial companies.

13. Finance more nationalised industry investment by cutting current spending?

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million in current year; and each 1 per cent off total costs saves £330 million in current year.

14. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statistical definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must by definition form part of public sector borrowing requirement.

15. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

16. Investment plans unlikely to be attained?

[PM has stressed to chairman of NI Chairmen's Group importance of maintaining NI investment programme: £900 million underspend 1981-82, £500 million expected underspend 1982-83.]

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. At time of 1982 Budget NI planned investment for 1982-83 26 per cent higher than estimated outturn 1981-82. Some signs plans may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. PM has made it clear that industries should make full and proper use of their allocation.

PRIVATISATION

17. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £494 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOG oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of minus £79 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor has said (Cambridge 3 July 1982), 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

18. What further sales expected?

Special sales of assets in 1982-83 forecast at around £550 million and expected to increase in subsequent years. Sale of Britoil has been completed and will amount to about £625 million, paid partly in 1982-83 and partly in 1983-84. Programme for 1983-84 involves, primarily, sale of British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom -but not before next Election.

19. Marketing of public assets unsuccessful - Amersham and Britoil failures in different ways?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded; about 75 per cent of Britoil shares left with subunderwriters and large discount when first traded].

No. These companies successfully privatised. Pricing an issue not easy especially when company's shares have not previously been traded. In addition, cannot accurately anticipate movements in market after price fixing but while offer still open.

20. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil); preference in allocation of shares (B Ae, C & W, Amersham, Britoil, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, Britoil, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company. Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSNR projections, partly because of higher production, partly higher oil prices. P&D as reported in The Times 4 January assess Government revenue will peak in 1983-84.].

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSNR because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels. In general, higher estimates by others are based on combination of higher expected future production and prices and lower expected future capital expenditure.

2. Impact of lower oil prices on UK?

[Article in The Times 21 January suggested fall to \$25 a barrel would have severe short term effects on tax revenues, balance of payments and exchange rates. Similarly gloomy report S Times 23 January.].

Impossible to say what will happen to oil prices. Good chance that they will not fall. Even if they do, not obvious that they will fall very far or very fast. Impact on world economy and on UK will depend on number of factors. But, despite falling North Sea tax revenues, UK could benefit from lower prices. Inflation might be lower and activity higher than would otherwise have been the case. Not easy to find strong relationship between oil prices and exchange rate. So effect on exchange rate unlikely to be as dramatic as The Times article suggests.

3. Government to relax North Sea fiscal regime?

Oil companies have argued for substantial reductions in taxation. No decisions have been taken. But fact-finding discussions have been taking place with UKOOA and individual companies since the summer to try to close the gap between Government's and companies' assessment of North Sea taxable capacity. These discussions will soon be concluded.

4. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive.

That present structure will provide more secure and stable tax regime. Aberdeen University study shows UK taxation on marginal fields to be one of world's 'more lenient'.

5. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

6. Benefits of North Sea should be used to strengthen economy?

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1982-83.

7. Are we really any better off for North Sea oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

8. 'Precipitous drop' in North Sea output after 1985?

[Phillips & Drew forecast of oil output almost halving between 1985 and 1990 - FT 4 January.]

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline - though not as steeply as P&D expect. Cannot be complacent about effects of falling North Sea output. Best thing we can do is pursue our present economic policies so that economy in better shape when output begins to decline.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. OECD Economic Outlook December 1982?

[OECD Economic Outlook forecast OECD growth of $1\frac{1}{2}$ per cent in 1983 (minus $\frac{1}{2}$ per cent in 1982) and inflation to fall to $6\frac{1}{4}$ per cent ($7\frac{1}{2}$ per cent in 1982). OECD believes it is Governments' responsibility to minimise risks to world recovery from growing protectionism and financial instability.]

OECD suggests modest recovery and falling inflation this year. Broadly in line with IAF. OECD recognises that Governments have, rightly, been reluctant to change basic thrust of policies, which have achieved hard-won gains on inflation, when inflationary expectations can easily be rekindled.

2. Prospects for US economy?

[US GNP fell $\frac{1}{2}$ per cent in 1982 Q4, bringing fall for 1982 as whole to 1.8 per cent. This largest annual fall in post-war period. Press reports (eg Wall Street Journal 6 January) suggest US Administration expects growth of $1\frac{1}{2}$ per cent in 1983.]

Important keep figures in perspective; although disappointing they were not unexpected as OECD had earlier forecast decline of similar magnitude in 1982. Most forecasters expect gradual recovery in 1983, helped by falls in inflation and interest rates. OECD predict for example growth of 2 per cent in 1983. US Administration's next forecast due to be published end January.

3. US budget deficit?

[Press reports suggest US Administration expect budget deficit from between \$150-200 billion in FY 83 to \$ 200 billion in FY 84 and about \$ 300 billion in FY 88. Reports suggest President Reagan will propose three year package of contingency tax increases of \$135 billion to take effect if deficits from October 1985 are expected to exceed \$100 billion].

US economy has made important progress in changing inflationary expectations and reducing inflation and interest rates. Important however that US acts to reduce budget deficits if inflation and interest rates are not to rise again as recovery gains momentum. Better to tackle public expenditure than ^{raise} ~~rise~~ taxes. Budget plans are to be published end January.

4. US monetary policy

[At end of last year Federal Reserve suspended M1 target and raised M2 target to $9\frac{1}{2}$ per cent, at annual rate, over last few months of 1982. (Original M2 target, set in February, was for growth within 6-9 per cent range; M2 growth in Sep-Dec 1982 exceeded range but was broadly in line with revised target). Targets for 1983 not yet announced: expected in February.]

Welcome Federal Reserve's flexible approach but stress that Reserve Chairman, Mr Volcker, has made clear (in evidence to Congress) that reduction of inflation remains priority and that monetary targets have not been abandoned.

5. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 9.6 to 4.6 per cent), UK (12.0 to 5.4 per cent), Japan (3.6 to 2.3 per cent), Italy (17.9 to 16.3 per cent), Canada (12.2 to 9.8 per cent) France (14.0 to 9.7 per cent), Germany (6.3 to 4.6 per cent).]

Inflation has fallen in all major countries in the past year and now averages 6 per cent. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

6. World financial crisis 'over'?

[Mr Leigh Pemberton reported (FT 30 December) as saying international financial crisis is over, but it is still a very serious situation which will take several years to solve.]

Most major debtors now undertaking adjustment programmes - often with IMF assistance. They may of course remain convalescent for some time, but we now have the measure of the problem. There have also been moves to improve banking supervision, and banks themselves are improving their information flows.

7. Enlarged GAB

[G10 Ministers met in Paris on 18 January to discuss, inter alia, what role an enlarged GAB (General Arrangement to Borrow) might play in augmenting IMF resources.]

G10 Ministers have agreed, subject to necessary legislative approval, that GAB should be increased from \$76 billion to \$196 billion. Participants' shares in GAB have been adjusted to reflect better their size and role in the world economy. UK share will be 10 per cent. Switzerland is to become a full member. At times when balance of payments position could threaten stability of international monetary system, GAB will be available not only for participants but for any IMF member that agrees a conditional programme with the Fund.

8. Increase in IMF Quotas

IMF has particularly important role in present circumstances in providing finance to countries while they go through necessary adjustments. Essential that IMF has adequate resources. UK has suggested increase of at least 50 per cent in IMF quotas and has played constructive part in building present international consensus on need for progress on Quota Review.

9. IMF Interim Committee - Next Meeting?

In view of the progress made in discussions so far on increasing IMF quotas and the priority attached to strengthening the Fund's resources, the Chancellor as newly elected Chairman of the Interim Committee, has proposed next meeting of the Committee should be brought

forward from late April to 10-11 February. We hope that an early and satisfactory agreement can be reached.

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS

24 JANUARY 1983

Summary comment

The effective exchange rate has fallen by about 12 per cent since mid November and interest rates have risen 2 points since end November. However, the direction and the consistency of policy are unchanged. GDP remains flat and manufacturing activity is below 1982 trough levels. RPI inflation falls to 5½ per cent in December and 5 per cent is confidently expected in the next few months. This year, a modest rise is expected in both GDP and in manufacturing output.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent last year unfulfilled. A modest recovery in world trade is expected this year.

- . world commodity prices are at their lowest level in real terms for thirty years;
- . oil prices are weak and likely to remain so for the near future;
- . consumer price inflation (OECD major 7) under 6 per cent in November ranging from 16 per cent in Italy to 4½ per cent in Germany and 3 per cent in Japan;
- . average world 3-month interest rates 9½ per cent at 3 January a fall of 4½ points between December 1982 and October 1981; US 3 month rate stood at 8.5 per cent on 3 January; real interest rates remain clearly positive;
- . world trade volume has been more or less flat since the middle of last year;
- . total industrial production for the OECD Major 7 fell 6 per cent in the twelve months to Oct; in the US it fell by 7½ per cent in the 12 months to November;
- . unemployment (OECD total) 8.7 per cent in October compared with 6.7 per cent in 1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remarked in stronger surplus during 1982 than forecast in IAF. Both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil

trade but the volume of exports held up well in 1982 and are unlikely to fall below their 1981 level.

. OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries.

. import volume rose sharply as activity recovered in 1981 and import penetration rose too; in 1982 non-oil import volumes showed little change on 1981 H2.

. the effective exchange rate was at 82.4 on January 21. Pound now below both 87-93 range occupied for the last year and May 1979 level (86.3).

Financial Developments

.Monetary aggregates within target range for 1982-83, M1 and £M3 towards top of range, PSL2 towards bottom;

.most banks raised base rates by 1 point on 11 January (to reach 11 per cent) following similar increase on 26/29 November; short term interest rates down 5½ points since October 1981; base-rates down about 5 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £10½ billion in 9 months to December.

.PSBR: £5.3 billion in 9 months to December; Industry Act Forecast of £9 billion in 1982-83 now at upper end of range of likely outcomes.

.After taking account of foreign currency borrowing and repayments, there was an underlying fall in the reserves during December of \$856 million.

Inflation

.retail price inflation, 5.4 per cent in year to December. IAF forecasts further falls with prospect of 5 per cent by spring 1983.

.TPI increase in 12 months to December was 5.8 per cent;

.Wholesale price inflation input prices up $7\frac{1}{2}$ per cent in year to December compared with $6\frac{1}{4}$ per cent in November following higher oil prices due to sterling depreciation against the dollar; output prices up 8 per cent in year to December.

GDP and industrial production

.GDP(O) rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Construction output in 1982 Q3 was 3 per cent up on previous quarter and 2 per cent higher than in 1981 Q3. Underlying level of industrial production also remains broadly flat but is 2 per cent above spring 1981 trough almost entirely due to increased oil and gas production; the underlying level of manufacturing output is slightly below its trough level and there are clear indications of a declining trend during 1982.

Demand Components

.consumer spending held up well during the recent recession and has continued to strengthen since 1982 H1. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales rose substantially in December and in 1982 Q4 were $4\frac{1}{2}$ per cent up on same period in 1981, partly reflecting abolition of HP controls. Consumers' expenditure in Q4 1982 (provisional) $1\frac{1}{2}$ per cent up on previous quarter (this is being reflected in the relative buoyancy of the consumer goods industries) and, in 1982 as a whole was 1 per cent above its 1981 level.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak but is responsible for only 30 per cent of total investment by manufacturing, distributive and service industries.

.destocking of £410 million (at 1975 prices) occurred in 1982 Q3. But in the CBI's December Survey, number of respondents with "more than adequate" stocks was lowest this year. Stocks are volatile and one quarter's figures should not be over emphasised;

.government consumption is virtually flat. In 1982 Q3 it was $1\frac{1}{2}$ per cent up on the preceding quarter and on its level in the same period last year;

.non-oil exports held up well in 1982 against a 3 per cent fall in world trading activity;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising but non-oil import volumes this year have shown little change since 1981 H2.

Productivity and Competitiveness

.manufacturing productivity continues to rise - at 2½ per cent in year to Q3 1982. Productivity now 13 per cent up on end 1980;

.manufacturers' unit wage/salary costs up less than 6½ per cent in 3 months to November 1982 on a year earlier;

.Cost competitiveness has improved some 20 per cent since early 1981, but remains around 10 per cent worse than in May 1979 (whole of this deterioration is attributable to excessive wage costs).

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the third quarter by 4½ per cent; and in first 3 quarters of 1982 were 11½ per cent up on their average 1981 level;

.non-North Sea profits fell 4½ per cent in Q3 1982 on previous quarter but in first three quarters of 1982 were 13½ per cent up on their average 1981 level;

.gross profits of North Sea oil companies in the first 3 quarters of 1982 were 8 per cent up on their average 1981 level;

.ICCs financial surplus was £0.5 billion in six months to September 1982 following deficit of £0.3 billion in previous six. Over same period net borrowing requirement fell from £9.1 billion to £4.0 billion.

.working days lost through industrial stoppages estimated at 211,000 in November, lowest monthly figure since December 1981.

.insolvencies: provisional totals for 1982 are 5,707 bankruptcies and 12,039 company liquidations, increases of 11 per cent and 40 per cent on 1981.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings in year to November 1982 was about 8½ per cent, lowest rate of increase since November 1977;

.CBI reports that pay settlements in manufacturing industry averaged 6.1 per cent in 1982 Q4 compared with 6.8 per cent in the third quarter. Bulk of settlements will occur in 1983 H1;

.real earnings broadly flat in last 12 months but RPDI in the third quarter is about 2½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.0 million (8¾ per cent) between 1979 Q2 and 1982 Q2 (over two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 645,000; manufacturing employment fell a further 93,000 (1¾ per cent) between Q3 and Q2 1982;

.total employment fell more in the second quarter of 1982 (188 thousand) than in the previous quarter (103,000);

.total registered unemployment rose by 34,000 to 3.10 million (13.3 per cent on the new basis) in December;

.UK adult unemployment rose by 41,000 to 2.95 million (12.7 per cent) in December; the increase is higher than in recent months but this may reflect modified signing on procedures over Christmas; nevertheless the underlying increase in Q4 1982 was only 27,000 compared with 31,000 in Q3 1982 and 28,000 in Q2 1982;

.notified vacancies increased by 3,000 to 118,000 in December but one month's figures should be treated with caution and volume of vacancies remain at very low levels;

.other labour market indicators hours lost through short time working has increased steadily since July 1982 to the levels prevailing in 1981 Q4 and 1982 Q1. Hours of overtime worked remain flat.

Forward Indicators

.car production (seasonally adjusted) rose to 73,000 in December from 66,000 in November while commercial vehicle production fell from 25,000 to 22,900 (sa); new vehicle registrations (not seasonally adjusted) increased by 13½ per cent in 3 months to December on same period in 1981;

.steel production (seasonally adjusted) fell in December and in 1982 Q4 the weekly rate of production fell 10 per cent and was 32 per cent down on same period in 1981;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, rose 8 per cent in 3 months to November, and were up 6 per cent on a year earlier. Engineering orders also disappointing with a 5 per cent fall in the latest 3 months.

.Latest DOI investment intentions survey suggests a 3 per cent fall in manufacturing investment between 1982 and 1983 but other components of investment (distribution and services) are more encouraging;

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 38,500 a quarter in 1980 to 53,100 in 1982 Q1, fell back in the spring, but in 3 months to November, increased 8 per cent on previous 3 months and were 24 per cent up on same period in 1981. After previously drifting downwards, total completions were fairly flat during 1982 Q2 and Q3 but in 3 months to November were 7 per cent up on previous 3 months;

.a sharp seasonal rise in unemployment occurs in January thereafter headline total should remain flat till May;

.CSO's index of longer leading indicators fell in December after 9 months of increase reflecting the rise in interest rates and the decline in share prices.

CBI's October (Quarterly) Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand. December Trends Enquiry suggests previous trends broadly continuing but export order recovered from November's deterioration. CBI November forecast projects GDP(O) growth at $1\frac{1}{2}$ per cent next year with manufacturing investment contracting. Also assumes £2½ billion fiscal adjustment in 1983/84 whereas IAF suggests £1 billion.

Outside forecasts

Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be $\frac{1}{2}$ -1 per cent - about $\frac{1}{2}$ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around $1\frac{1}{2}$ per cent, assuming some recovery in world economy, with inflation/interest rates falling at least for some time into next year.

Industry Act Forecast

NB. November IAF will be superceded by Budget Forecast (on March 15); latter will take full account of economic developments since November Forecast was prepared. Undue emphasis on precise figures in November IAF no longer appropriate.

Treasury forecast published November 8th assumes a modest (2 per cent) world recovery in 1983. Forecast includes a £1 billion fiscal adjustment in 1983-84 within a fiscal/monetary stance broadly in line with 1982 MTFs. Between 1982 and 1983 GDP grows by $1\frac{1}{2}$ per cent. Principal demand increases are from consumers expenditure and capital investment. Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983. Government Actuary assumes unemployment (old basis) averages 2.9 million (GB, ex school leaver) in 1982-83 and 3.2 million in 1983-84. On new basis figures could be up to 200,000 lower.

Key Statistics Week-Ending Friday 28 January

Tues 25 : New vehicle registrations (Dec)
Thurs 27 : Employment (Nov)
: Industrial stoppages (Nov)
: Overtime and short-time (Dec)
Fri 28 : Sales and orders in engineering industries (Oct)
: car production (Dec - final)

Info
has seen p/3



●
Michael.

for your information. Jell.
Alan has one too. 28/11

of the
Chancellor of the Exchequer's
Private Secretary

Treasury Chambers,
Parliament Street,
S.W.1.

JANUARY 1983 FORECAST

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Annex: comparisons of forecasts

Tables from the printout:

1. General Summary
2. Financial Summary
3. Demand and output
4. Personal consumption
5. Exchange rates and competitiveness
6. Balance of payments
7. Retail prices
8. Public sector borrowing
9. Money supply

Introduction and summary

1. This paper reports on the latest internal Treasury forecast. Based on the same policy assumptions as the forecast in the Autumn Statement, the forecast takes account of latest information, including the fall in sterling in recent weeks. The forecast covers the period to the financial year 1985-86.
2. The text of the report and its charts highlight the main issues and uncertainties. A summary of the forecast is given in the table on pages 5 and 6, and detailed comparisons with earlier Treasury forecasts and with the latest outside forecasts are provided in the Annex. A selection of tables from the printout is attached: as always the numbers should not be interpreted too literally.
3. The assumption, spelt out in Section II, is that present policies will be continued beyond the election. Since we attribute some of the fall in sterling to the possibility of a marked change in policy after the election, we are inclined to forecast a little strengthening of the rate in 1984. In essence, we have brought forward the fall that successive forecasts have incorporated. We could of course be seriously wrong - in either direction. Section III of the report reports our judgment that the recent fall in the rate will allow a substantial competitiveness gain, as wage settlements respond only slowly to a recovery in profits and to some pick up in the rate of RPI inflation.
4. Section IV sets out the prospect for the world economy. The recovery, postponed for a time, is expected to begin this year and to be stronger by 1984. While there are obviously downside risks, there are also a number of commentators stressing the possibility that US growth will be higher than the Administration's "deliberately cautious" estimate of $1\frac{1}{2}$ per cent in 1983. The risks of a sharp rise in commodity prices do not look all that high, especially as real oil prices look set to fall.
5. Section V shows the way in which UK exports have held up in 1982 despite very difficult trading conditions. With the UK forecast to grow rather faster than most other industrialised

countries, there is a tendency for the current account surplus to shrink, though by 1984 the benefits of better competitiveness are being felt.

6. Section VI shows the extent to which the forecast of inflation has gone up: unless the exchange rate regains most of its recent fall - and we do not assume this - then it seems likely that the inflation rate in 1983 will be higher than earlier envisaged. We think that the addition to the inflation rate will not be quite as large as a straight application of the Treasury ready reckoner would suggest (mainly because of lower oil prices) - and clearly less than the recent calculations of the Bank of England or the London Business School. Beyond 1983, maintenance of existing policies - PSBR at 2 per cent of GDP and 6-10 per cent growth of monetary aggregates - is perhaps compatible with inflation staying in the range 6-8 per cent, though we are very unsure of this.

7. Section VII sets out the prospects for the individual components of domestic demand. Continuing growth in personal consumption - helped by the fiscal adjustment - combined with a turnaround in stockbuilding and some investment growth in both private and public sectors to raise domestic demand by over 3 per cent in 1983. The latest statistics - retail sales sharply up in December, manufacturing output down in November - indicate the difficulties of assessing the impact of rising demand on domestic output, but we do expect a recovery, even including manufacturing, once the present stock rundown is over.

8. Section VIII suggests that despite the recovery in output and profitability, unemployment is expected to rise a little further. The discovery of $\frac{3}{4}$ million extra people in the labour force in mid 1981 complicates the analysis but does not change significantly the prospects for unemployment.

9. Section IX looks in some detail at public expenditure and the PSBR. Even with the control totals set, the forecast requires judgment about shortfall, use of the contingency reserve, spending by local authorities and so on. In total, these

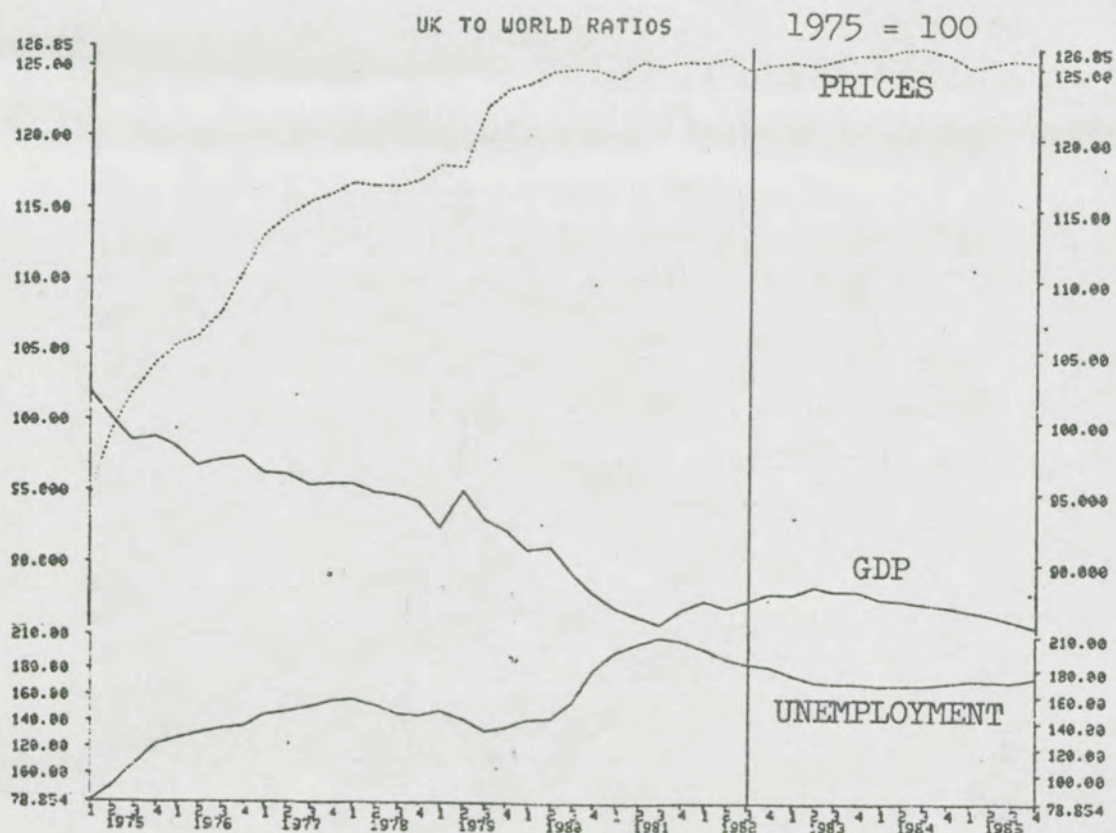
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judgments suggest somewhat higher shortfall than the forthcoming White Paper. Forecasts of expenditure, taken with forecasts of revenue, suggest scope for a fiscal adjustment - by convention taken all on personal income tax - of about £2 billion in 1983-84. It should be noted that additions to public expenditure, if contemplated in the run-up to the budget, are liable to reduce the fiscal adjustment even if the extra money is found from the contingency reserve - because we assume that not all the reserve will be spent.

10. Section X relates the forecast of sectoral flows - the financial surpluses and deficits - to the rest of the forecast. The financial position of the company sector now looks better as a consequence of the fall in the exchange rate and the judgment that the gain in competitiveness will last.

11. Section XI suggests that - if we are right about pressure on sterling easing - there may be scope for interest rates to come down a little, either this year or next, consistently with keeping most but not all measures of monetary growth within the 7-11 per cent range for 1983-84. M1 is likely to rise above the top end of the range; but £M3 should rise more slowly if we are right in judging that the growth of bank lending will slow down.

12. One way of looking at the prospect for the UK is to compare ourselves with other countries. The chart below shows the ratio (UK to world) for prices, GDP and unemployment. The period up to



about 1981 shows that the UK grew more slowly, unemployment rose more, and prices rose faster. Since 1981 there has been a marked change, part of which reflects the timing of recession: in the UK this was steeper and earlier than elsewhere. Over the forecast period as a whole UK performance, in this relative sense, is better than in recent years.

13. The report points to particular areas of uncertainty. The timing and speed of the recovery in other countries remains very uncertain. At home there is some concern that the growth in liquidity could fuel more expenditure (in real or nominal terms), and that the supply response to rising demand could be limited. But we have made some allowances for these effects already.

14. The main forecast incorporates a fiscal adjustment in 1983-84 of some £2 billion. We have also looked at the consequences of assuming a zero adjustment ie assuming that tax changes in the budget are limited to simple revalorisation. With the same assumptions about monetary policy, the lower PSBR allows interest rates to be lower, with the exchange rate also down - though the size of these changes is very uncertain.

15. The direct effect of this alternative assumption is on consumers: their real incomes are reduced by over 1 per cent, which leads partly to lower spending, partly to lower saving. The cut in interest rates and exchange rates provides some offset to the lower spending by consumers. In total, by the first half of 1984, output could be $\frac{1}{4}$ per cent lower and prices $\frac{1}{4}$ per cent lower. In later years, more of the impact would be felt on inflation and less on output. The gain on interest rates could be between 1 and 2 per cent - on the assumption that there is the same growth in (the average of) monetary aggregates.

16. These are no more than broad orders of magnitude - and make no attempt to allow for the reactions in financial markets to the announcement of a significantly lower PSBR than is currently expected.

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SUMMARY TABLE AND COMPARISON OF FORECASTS

	FSBR/MTFS MARCH 1982	AUTUMN STATEMENT NOVEMBER 1982	INTERNAL FORECAST JANUARY 1983
<u>World Trade in Manufactures</u> (% change on year earlier)			
1981	4	4½	3½
1982	4	-2	-3
1983	4½	2½	1½
1984	5½	6	7
<u>GDP Volume</u> (% change on year earlier)			
1981	-2.0	-2½	-2½
1982	1.4	½	½
1983	2.4	1½	2
1984	2.8	2½	2½
<u>Manufacturing Output</u> (% change on year earlier)			
1981	-6½	-6½	-6½
1982	3	0	-½
1983	2	0	0
1984	2	1½	2
<u>Unemployment</u> (UK sa excl school leavers, millions, <u>new</u> definition)			
1981 Q4	2.6	2.6	2.6
1982 Q4	2.8	2.9	2.9
1983 Q4	2.8	3.2	3.0
1984 Q4	2.8	3.3	3.1
<u>RPI</u> (% change on year earlier)			
1981 Q4	12	12	12
1982 Q4	9	6	6
1983 Q4	7	5	6½
1984 Q4	6	7	7
<u>Effective Exchange Rate</u>			
1975 = 100			
1981	95	95	95
1982	88½	91	90½
1983	84½	89½	80
1984	82	84½	80

Current Balance
(£b)

1981	8½	6	6
1982	4	3½	4½
1983	3	0	1
1984	3	0	2

Nominal GDP (mp)
(% change on year earlier)

1981	10	9½	9½
1982	10½	9	8½
1983	9	7	8
1984	10	9	9½

PSBR and fiscal adjustment
(£b)

1981-82	10½	9	9
1982-83	9½	9	8
1983-84	8½ (½)	8 (1)	8 (2)
1984-85	6½ (2)	6½ (1½)	6½ (2)

Interest Rates
Short-term

per cent

1981-82	14	14	14
1982-83	13½	10½	11
1983-84	12	8	10
1984-85	10	9	9

Money Supply £M3
(% change on year earlier)

1982 Q1	14½	13½	13½
1983 Q1	11	12	11½
1984 Q1	9	8½	9½
1985 Q1	7	7	8

M1
(% change on year earlier)

1982 Q1	9	7	7
1983 Q1	11	11	12½
1984 Q1	13	13	13½
1985 Q1	13	10	11½

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Policy assumptions

17. In general, we have maintained the same policy assumptions as in the forecast published in the Autumn Statement:

(i) Short-term interest rates are assumed to be set so that, as far as possible, the monetary aggregates (a simple average of broad and narrow) will stay within the MTFs ranges, while taking account of other factors, including the level of the exchange rate, affecting monetary conditions.

(ii) Public Expenditure control totals are as in the forthcoming White Paper. The expenditure forecasts here differ from the White Paper on account of different economic assumptions, different judgments about shortfall etc. A detailed reconciliation is given in Section IX.

(iii) Direct and indirect taxes are assumed to be revalorised by $5\frac{1}{2}$ per cent (the rise in the RPI between December 1981 and December 1982) in the 1983 Budget.

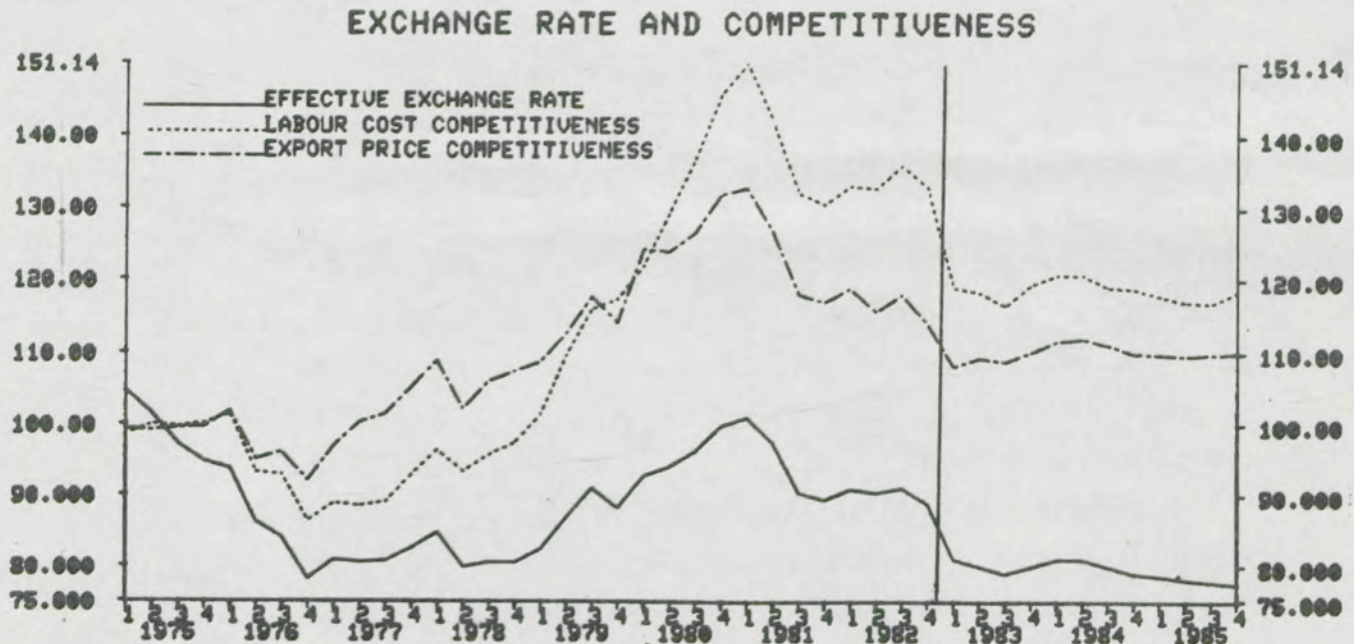
(iv) The PSBR in 1983-84 is constrained to £8 billion, and thereafter to 2 per cent of GDP, by means of a fiscal adjustment, taken by convention on personal income tax. This means that the forecast already takes credit for a 1983 budget in which, on top of revalorisation, there is a reduction in personal income tax of some £2 billion. A variant of the forecast with no fiscal adjustment in 1983-84 is discussed on page 4. Note that the fiscal adjustment is defined in terms of its effect on the PSBR: thus the fiscal adjustment estimated at about £2 billion in both 1983-84 and 1984-85 provides scope for cuts in income tax worth (in terms of income tax revenue) around £2 billion in 1983-84 and £2½ billion in 1984-85, the difference in the second year reflecting the usual feedbacks to the Exchequer from activity, interest payments etc.

Exchange rate

18. In common with many outside forecasters we have been expecting a decline in sterling for some time, partly because we did not regard as sustainable the levels of competitiveness prevailing in 1981 and 1982 - the need for some improvement has been common ground - but more because we did not see the adjustment coming about solely through productivity and wage changes.

19. We treat part of the recent fall as a reflection of election fears. Our assumption of unchanged policies after the next election - ie the re-election of the present Government - suggests to us that perhaps after a further period of (by recent standards, mild) weakness for much of 1983, the exchange rate may strengthen after the election, with a level in 1984 of perhaps around 80. Reduced pressures on the rate for the rest of 1983 may allow a small fall in interest rates.

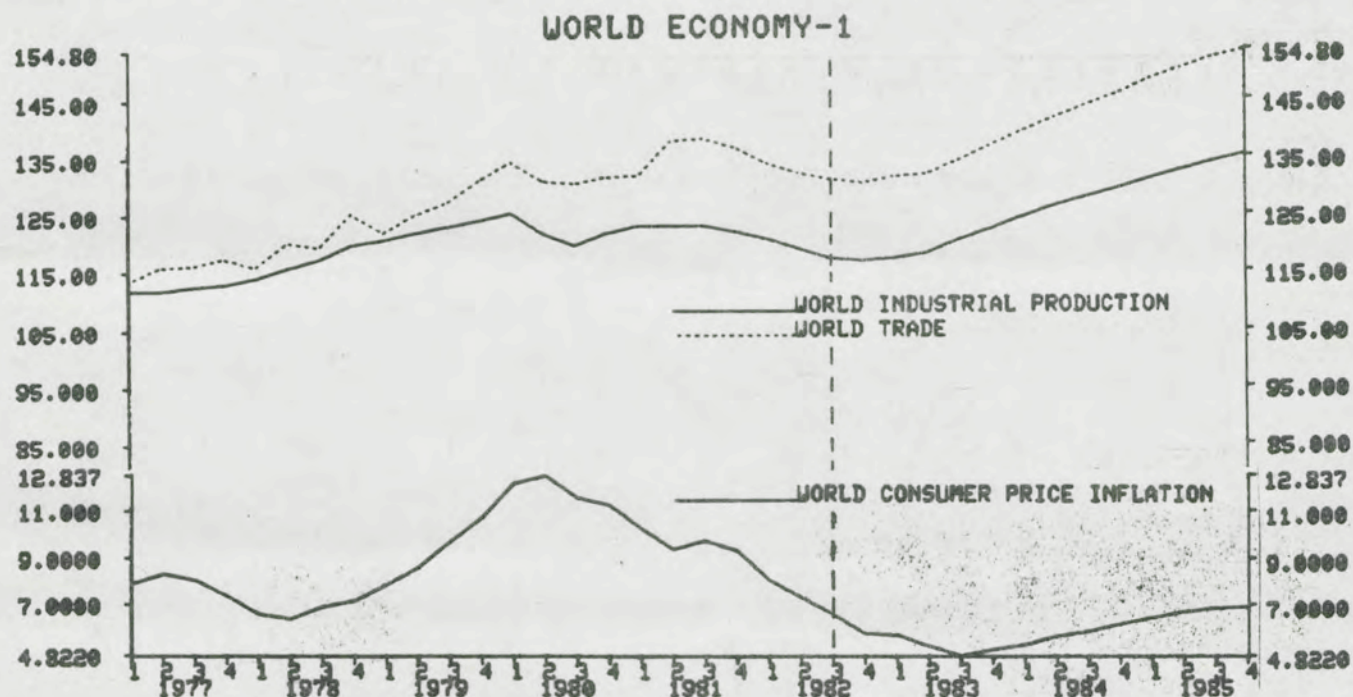
20. Now that the rate has fallen, the prospects for competitiveness and for the current account are improved, though we still see the current account in only small surplus. The chances of a substantial further fall are thus probably reduced. The chart below shows the view on the exchange rate and on competitiveness embodied in the forecast.



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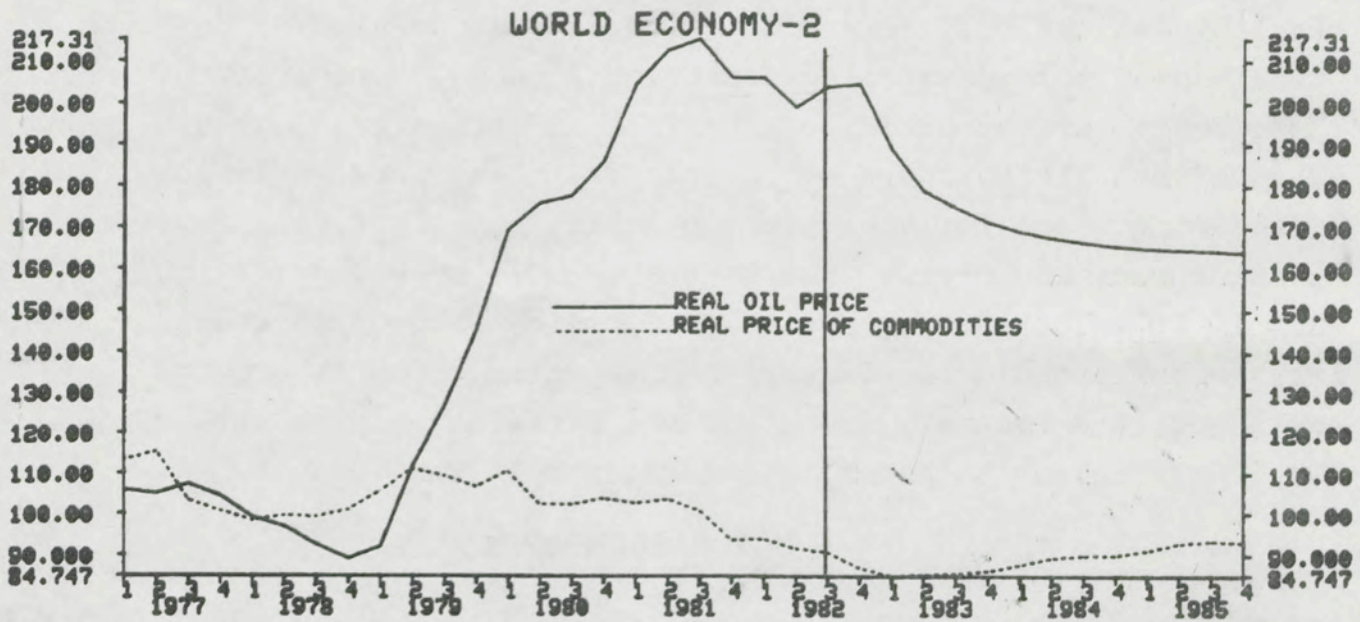
The world economy

21. A paper for Chevening described recent developments and future prospects for the world economy; the Report on World Economic Prospects is being circulated about now. The forecasts continue to point to a moderate recovery as a result of easier monetary policies (notably in the US), lower inflation and a lessening of the debt problems of some developing countries. Hopes of recovery have been postponed: but the extent of the fall in inflation and the extent of the adjustments that are being made in the current recession provide increasing scope for a pick up in activity. The timing nevertheless remains very uncertain. The recovery could be delayed further - but if it is, then, particularly if policy becomes more expansionary, the recovery could be sharper than expected. On the central forecast, the recovery in output and profitability is not likely to be sufficient to begin to reduce unemployment.



22. We have allowed for the recent weakness in oil demand - likely to recover only very slowly - to be reflected in a 7 per cent (\$2) cut in the average dollar oil price in the next few months, with larger falls in real oil prices as the dollar continues to decline. (We shall review this judgment nearer to the budget). By comparison with the forecast in the Autumn Statement, recovery comes a little later; and oil prices are a little lower. As the world economy

recovers, so too, in a muted way, do commodity prices with the major exception of oil. Hence the upturn in inflation, worldwide, is very limited.



23. The table below summarises the main elements of the forecast:

per cent changes per annum

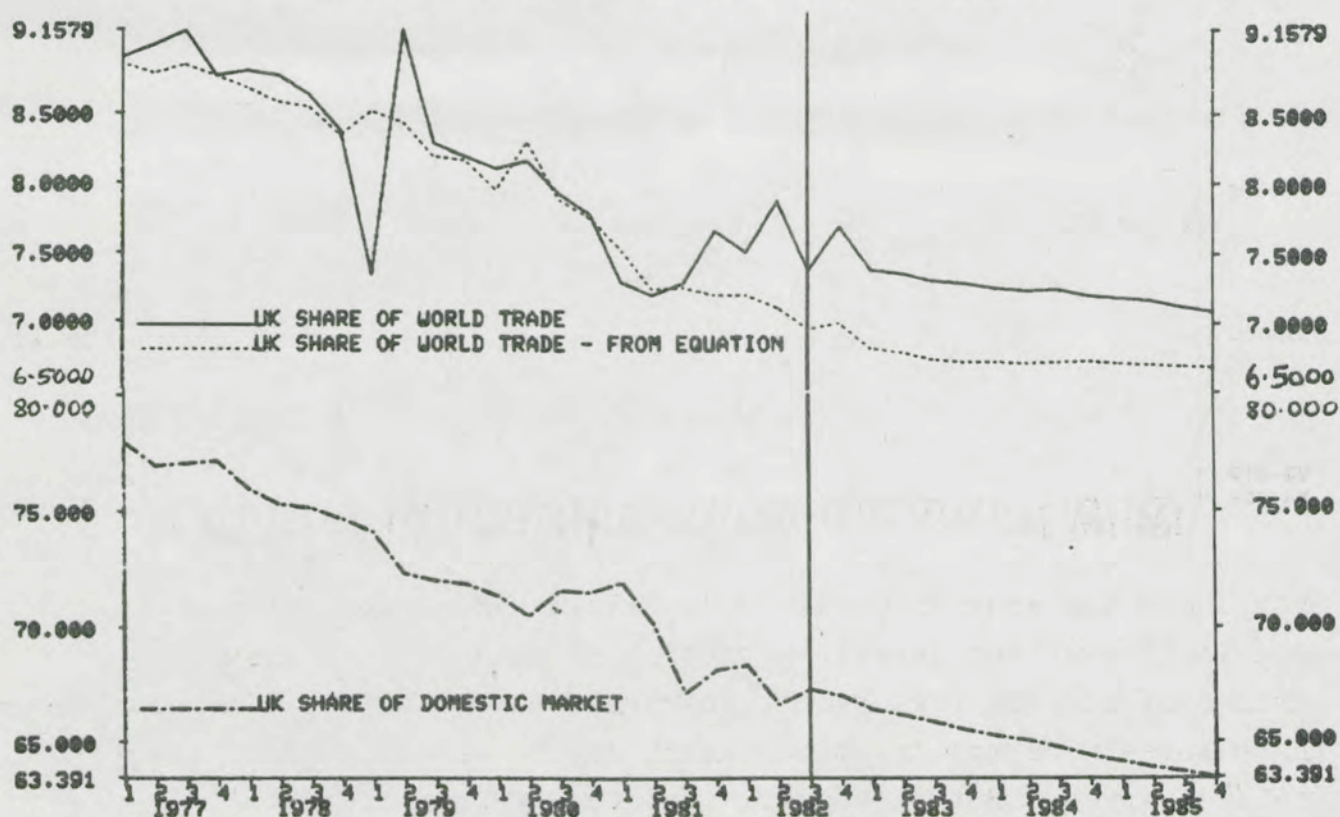
	1973-80	1981	1982	1983	1984	1985
GDP (major 6)	2½	1½	-1	1½	3½	3½
World trade in manufactures (UK weighted)	5½	3½	-3	1½	7	6
Imports into less developed countries (volume, including OPEC)	7½	9	-5½	-½	8	7½
Consumer prices (major 6)	9½	10	7	5½	6	7
Real oil prices	26½	18½	-3	-12½	-6½	-1½

UK Trade

24. UK exports rose in October and November, but monthly figures have been very erratic and the forward indicators are gloomy. The chart below shows that UK export volumes have done better than expected since the middle of 1981, perhaps in part because of the greater than expected gain in export price competitiveness and perhaps because spare capacity in UK manufacturing has encouraged higher production, at least for export, on low profit margins. To the extent that recent performance implies that adverse competitiveness had less effect in 1981 and 1982, or reflected low demand, then the recent improvement in performance may be partially reversed. On the other hand, recent behaviour may herald better performance in the future with continued aggressive pricing behaviour. We have given slightly more weight to the former, and the forecast allows most but not all of the higher level of exports to continue over the forecast period, and the recent gains in competitiveness are forecast nearly to halt the decline in the UK share of trade in manufactures.

25. Better competitiveness and a better performance in the second half of 1982 implies that UK exports will be higher by the end of 1983 than forecast in the Autumn Statement, despite a lower level of world trade. But the upward trend in import penetration must be expected to continue, though it should be damped by the lower exchange rate.

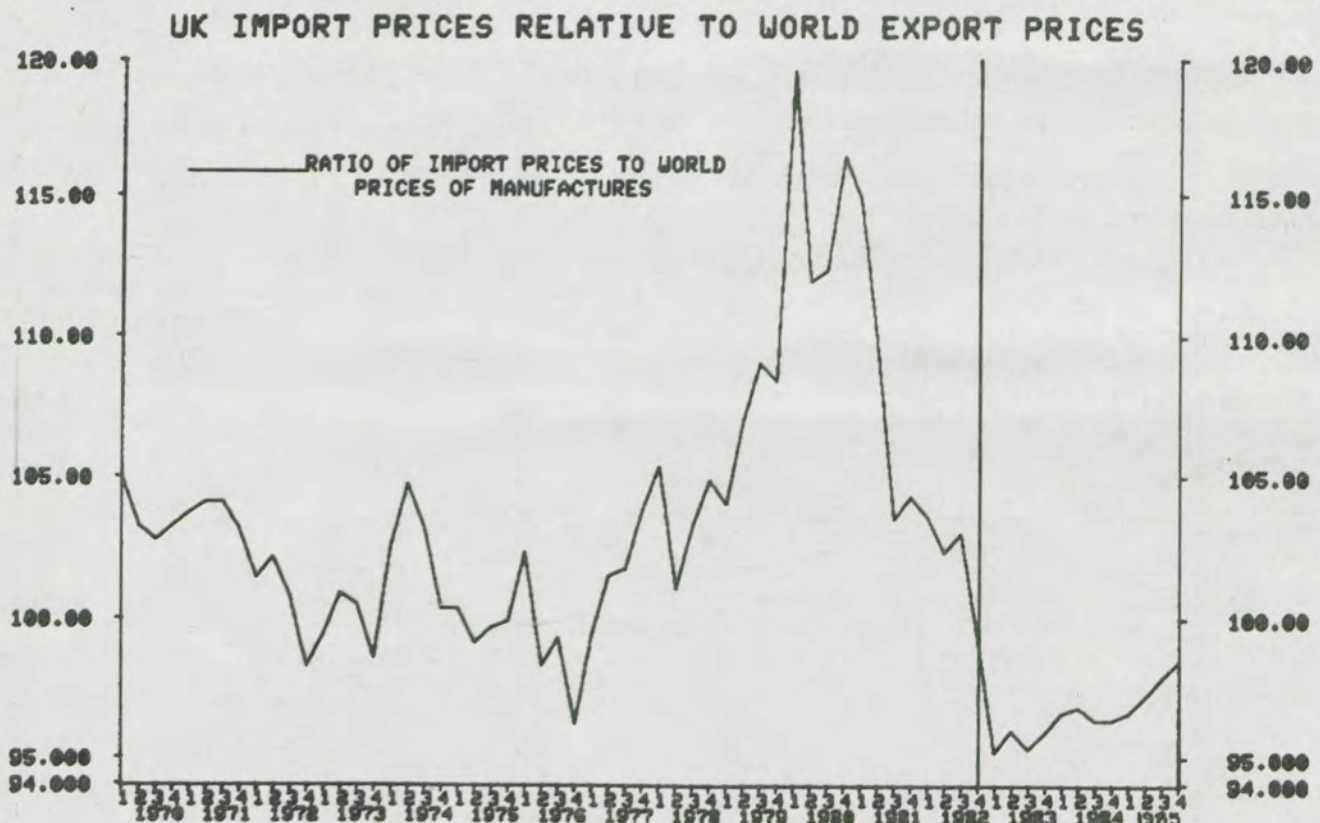
TRADE PERFORMANCE IN MANUFACTURES



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26. An important issue - especially for inflation and the balance of payments - is the extent to which the lower exchange rate will affect prices charged in the UK by foreign suppliers. Analysis of the sixties and seventies shows that importers normally price their goods giving some weight to prices charged by domestic producers (the converse proposition about the pricing policy of UK producers, though clearly true in some areas such as steel and chemicals, has proved less easy to establish). Thus when the exchange rate increases as it did up to early 1981, importers raised their prices by enough to give them high profits but by less than domestic producers. (UK exporters appear to do the same in overseas markets).

27. The fall in the exchange rate since early 1981 has been accompanied by a smaller than expected rise in import prices (and in our export prices). An important question in relation to the recent fall in the rate is how much further importers will cut their margins after the recent fall in the exchange rate. The chart below relates the prices charged by the UK's foreign suppliers to prices charged in other markets.



28. There are many difficulties in making these comparisons, especially over the correct weighting of manufactures and semi-manufactures. The very recent sharp movements may owe something to the swings in commodity prices which may be weighted differently in the two series. But it appears that foreign suppliers are not now charging significantly higher prices in the UK than elsewhere; that

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the scope for a further major reduction in importers' profit margins is limited; and that the recent fall in sterling is likely to be more fully reflected in prices than was the 1981 fall in sterling. In relation to domestic prices, however, import prices are likely to remain relatively high (the index of import price competitiveness, which averaged close to 100 in the 1970s, is forecast at or near 120 for the forecast period).

29. Since the Autumn Statement forecast was published, the current account of the balance of payments has been stronger than expected, despite the delay to the EC refund (in the forecast, this is assumed to benefit the current account in the first quarter of 1983; whereas most of the benefit to the PSBR was gained in the final quarter of 1982; as a result of differing accounting treatments).

30. Whereas we expect the volume of imports to resume its rise in 1983 as domestic demand continues to grow, the volume of exports is liable to fall back for a quarter or two, in line with recent survey evidence, and reflecting our judgment that the Q4 level was above trend and as the world economy picks up only slowly. With UK demand rising faster than that of most other countries the visible balance is forecast to move into deficit in 1983, before stabilising thereafter as the full effects of the gain in competitiveness come through. On invisibles, there continues to be a prospect of a rising net benefit from IPD flows as we continue to have current account surpluses (and hence net capital outflows) and as world activity and profitability pick up; and the services account is likely to benefit from both the upturn and the gain in competitiveness.

£bn	1981	1982	1983	1984
Visible balance	3	1½	-2½	-3
Invisibles	3	2½	3½	5
Current account	6	4	1	2

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Inflation

31. At the time of the budget, inflation was expected to come down: using the RPI measure it has come down faster than expected; on other measures it is close to the forecast rate.

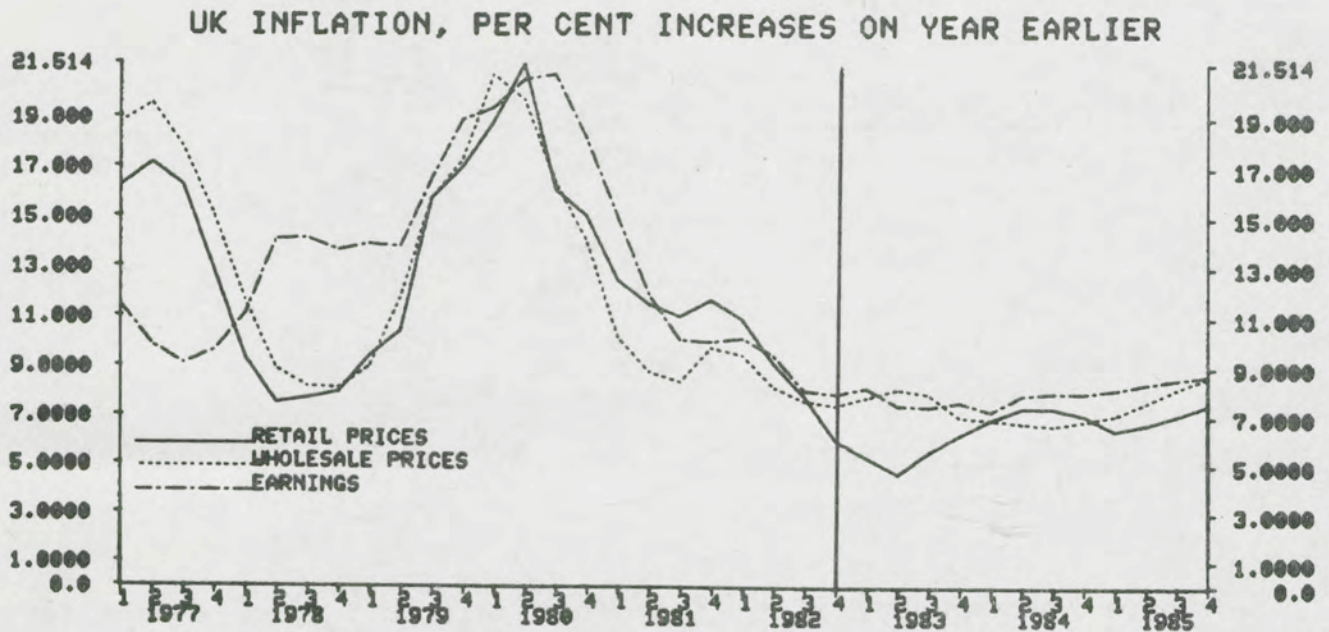
Annual rates of inflation, per cent

	Fourth quarter 1981	Forecast at budget time	Fourth quarter 1982 Provisional Estimate of outturn
1) RPI	12	9	6 $\frac{1}{4}$
2) RPI excluding food, housing & NIs	10 $\frac{1}{2}$	7	6
3) Wholesale prices (excluding food, drink & tobacco)	10	7	7 $\frac{1}{2}$
4) GDP deflator	10	7	[7 $\frac{1}{2}$]

32. The RPI was affected by several factors not typical of prices in general - in particular big falls in seasonal food prices and in interest rates. While commodity prices, world wide, were generally lower than expected, and the exchange rate, for most of the year, higher than expected, oil prices have been higher. The December RPI was 5 $\frac{1}{2}$ per cent up on a year earlier; a further decline, perhaps to 5 per cent, is expected in January.

33. The general rate of inflation - as measured by wholesale prices of manufactures or by expenditure prices in total - is probably now in the 6-7 per cent range, well above the estimated rise of about 3 per cent in labour costs between the fourth quarters of 1981 and 1982 (this includes the first reduction in NIS), and the rise of only 2 per cent or so in import prices.

34. Although the forecast is very uncertain, we do not expect any major change in the general inflation rate over the forecast period. In 1983, lower oil prices and slower growth in wage costs (helped by reductions in NIS) may broadly offset the effects of the recent fall in the exchange rate and allow some further rebuilding of profit margins. In 1984, although there may not be much further change in the exchange rate there is liable to be some recovery in commodity prices, and at home there could be a slightly faster growth in costs.



35. These movements in the general rate of inflation will probably continue to be exaggerated by the retail prices index. On the basis of a budget which allows for revalorisation of the specific duties, the rate could be at 5 per cent or below in April, May and June. But, as comparison is made with the corresponding months in 1982 - some of which were favourably affected by falls in the mortgage rate and seasonal food prices - and as the effects of the recent fall in the exchange rate are felt, the RPI annual rate is likely to rise again, reaching perhaps $6\frac{1}{2}$ per cent by the fourth quarter of 1983.*

36. The slowdown in earnings growth has lagged behind the fall in the rate of price inflation. The current pay round could yield an outcome on earnings of around 7 per cent (with settlements in the $5-5\frac{1}{2}$ range). For the next, 1983-84, round we have tentatively forecast earnings growth of 8 per cent, as the inflation rate (measured by the RPI) moves up and there is a clear improvement in profitability and competitiveness, and so a relaxation in the financial constraints on the company sector.

*As table 7 at the back makes clear the prices charged by nationalised industries are forecast to rise a little more slowly than other retail prices from now on.

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<u>Pay rounds</u> (to Q3)	<u>Settlements</u> (whole economy, underlying)	<u>Average earnings</u> (underlying)	<u>Public services settlements</u> (underlying)	<u>Cash provision for pay</u> (for following financial year)
1980-81	8½	11	8	6
1981-82	7	9	6½	4
1982-83	5-5½	7	5	3½
1983-84	6-6½	8	6	n a

37. There are a number of risks to this forecast. One is that for 1983 we have underestimated the speed and extent of the feed through from the exchange rate fall. Beyond then, worries have been expressed by a number of forecasters about the risks of a more rapid upturn in inflation in response to the better financial position of companies and the possibility of higher spending by the private sector following the rebuilding of its real stocks of financial wealth over the last two years. An opposite risk is that we have, as before, underestimated the downward pressures on inflation in a world where the UK is still less competitive than for almost all the 1970s, and where a substantial margin of spare capacity at home and abroad continues to limit profits.

38. Real average take-home pay has been squeezed in the 1980-81 and 1981-82 pay rounds by about 3 per cent and 1 per cent respectively. The earnings forecast is consistent with an increase in real take-home pay of 3-4 per cent in the current round following by a small further increase in 1983-84, both helped by the assumed fiscal adjustments.

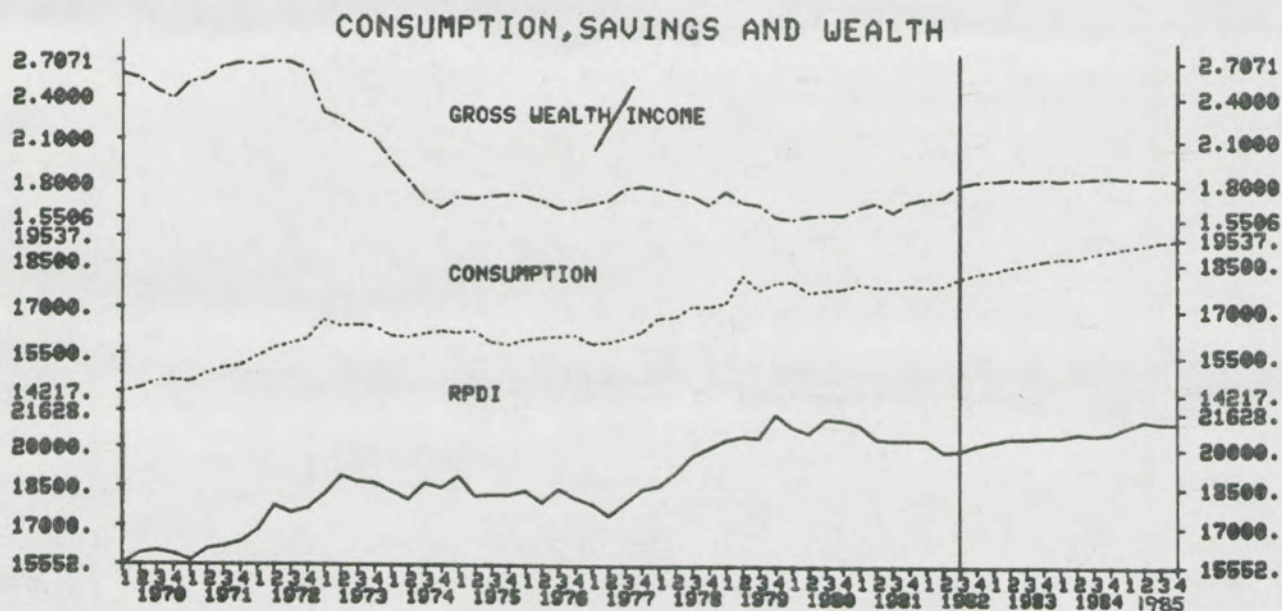
39. Looked at from the employers' side, labour costs are increasing only slowly at the moment, helped by cuts in NIS. After a rise of 2 per cent forecast for 1983, we expect a considerably faster rise, perhaps about 6 per cent, in 1984 as the growth in productivity slows down, there are no further cuts in NIS (by assumption) and the growth of money earnings edges up.

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Domestic demand and output

40. Consumer demand is clearly rising quite strongly now, with expenditure on both durables and non-durables well up on a year ago. Much of the increase has come in durables and reflects the abolition of HP controls in July and, perhaps, the continuing high level of bank borrowing and the fall in interest rates in the second half of 1982. Moreover, real personal incomes probably stopped falling in mid 1982 and have since been rising.

41. The chart below shows that the fall in real incomes since the peak in 1980 has been accompanied by little change in consumer spending until recently: as the rate of inflation came down and as the stock of bank borrowing built up, consumers were prepared to save less. From 15½ per cent in 1980 the savings ratio has fallen in recent quarters to below 10 per cent.

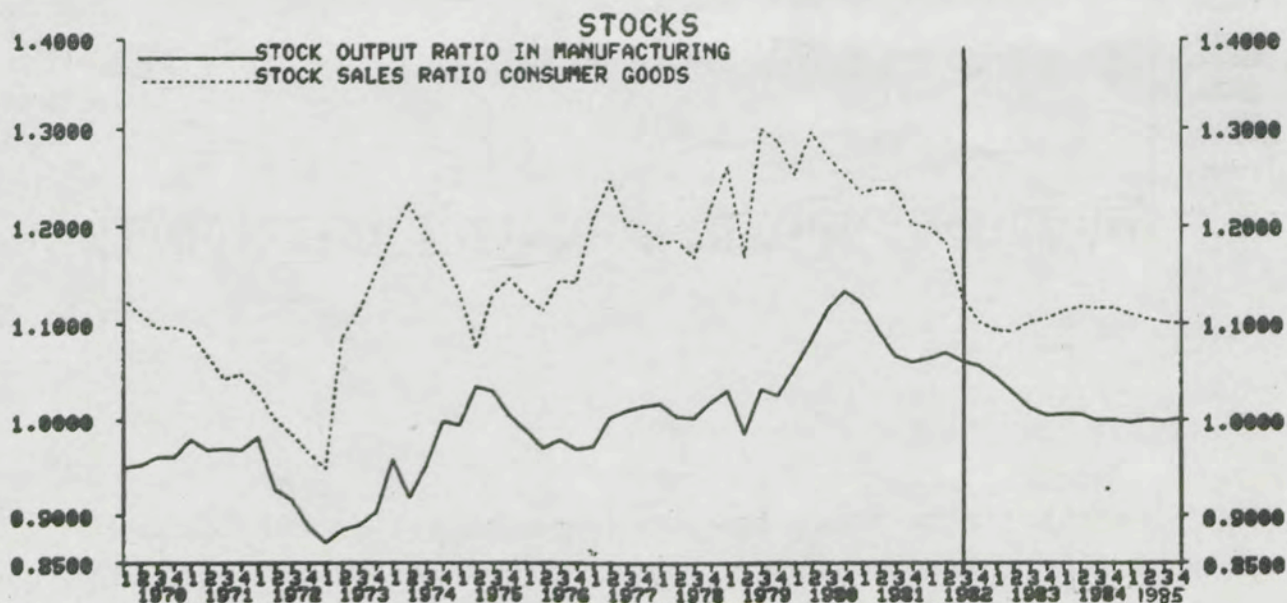


42. The chart also shows how the personal sector has begun to rebuild its financial wealth: the ratio of wealth to income has been

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rising over the last year or two, and is forecast to rise further over the next year, before levelling off. Lower interest rates (which increase the value of fixed-interest securities and equities) and high borrowing more than offset the fall in the flow of savings. It is still very uncertain how far consumers wish to go in rebuilding their stocks of wealth: we have assumed that they have learnt to live with the position since 1974, and do not wish to return to the much higher stocks (in relation to income) of the late 1960s and early 1970s. If this is correct then consumers will be content to save a lower proportion of their income than in recent years: at about 9 per cent, the forecast savings ratio is close to the average for the period 1965-1972, compared to 13 per cent in the period 1973-1981.

43. Spending by companies faltered in the second half of 1982 as the boom in consumption gave manufacturers and distributors an opportunity to run off some apparently unwanted stocks. At least, that is our interpretation: there is no sign as yet of rising consumer demand being reflected in domestic production of manufactures, nor even in higher imports. The fall in stocks in the second half of 1982 helps to make the stock/output ratio look less above normal, though the apparent upward trend in the series in the 1970s makes that a difficult judgment.



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44. Indications from the investment intentions survey suggest that industrial investment will rise again in 1983 and 1984, probably reflecting the expected growth in the economy and helped by the fall in nominal (though not real) interest rates in 1982. Within the total manufacturing investment could level out in the course of 1983.

45. A major question is how to interpret the large rebound in the liquidity and financial position of companies since early 1980. Already they have fully reversed the reduction in the gross liquidity ratio sustained in 1979-80 as inflation rose, and this may suggest scope for either reduced borrowing, or increased spending, over the forecast period. A sharper rebound of company spending than is in the forecast, with less of a deceleration in borrowing, is certainly possible, but our view is that companies will remain fairly cautious given the experience of the last few years, the continuing level of real interest rates and the competitive disadvantages still faced by many companies.

46. The prospects for domestic demand are summarised in the table below:

per cent increases on a year earlier	1981	1982	1983	1984	1985
Personal consumption	$\frac{1}{2}$	1	3	2	2
Change in Stockbuilding (as per cent of level of GDP)	0	1	1	$\frac{1}{2}$	0
Fixed investment (public and private)	-8	3	$3\frac{1}{2}$	4	$3\frac{1}{2}$
Public consumption	0	1	$\frac{1}{2}$	1	$\frac{1}{2}$
Total domestic demand	$-1\frac{1}{2}$	$2\frac{1}{2}$	$3\frac{1}{2}$	$2\frac{1}{2}$	2

47. With better competitiveness and profitability, the prospects for meeting a good part of this demand from higher production at home have increased - despite recent low figures for manufacturing output. By 1984 higher output for export is forecast to be making a significant contribution.

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	1981	1982	1983	1984	1985
Exports of goods and services	-2	0	0	5	4½
Imports of goods and services	0	4	3½	5½	4
Gross Domestic Output	-2½	½	2	2½	2
Manufacturing output	-6½	-½	0	2	1½

48. There are various risks. On the demand side the increase in company spending could be greater (see paragraph 45 above). Alternatively the increase in personal consumption could be slower, perhaps reflecting a greater desire to save; and with the world economy as forecast, this could lead to slower growth of UK demand and output for a time, before picking up more strongly in 1984. On the supply side, the response to higher demand could be stronger on imports, particularly for manufactures where we have tended to overestimate the level of output in recent forecasts.

Employment and unemployment

49. The discovery by DE that the working population in mid 1981 was ¾ million more than first thought has implications for:

(i) productivity. Mainly outside manufacturing, the latest estimates no longer suggest any above average productivity gains (but those in manufacturing are confirmed, as is the contrast between the broad sectors).

(ii) activity rates. The drop in the labour force suggested by previous estimates is now no longer apparent. Hence the number who lost their jobs over the period 1979-81 matches quite closely the increase in unemployment.

50. The recovery in the economy over the forecast period, together with the improved profitability and financial position of companies, suggest that the fall in employment could now be over, though there will probably be some further falls in manufacturing. The labour force is probably rising: while it is clear that the population of working age is continuing to rise by some 200,000 a year, the trend in activity rates is much less clear - we have assumed little change. On this forecast, unemployment is a little more likely to rise than to fall.

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Public expenditure and the PSBR

51. Our starting point is the planning total in the forthcoming White Paper. This compares with earlier estimates of public expenditure as follows:

	Planning Total, £ billion, cash			
	1981-82	1982-83	1983-84	1984-85
1981 PEWP	104½	110	113½	-
1982 PEWP	105½	114½	120	127½
1982 Autumn Statement	105	114½	120	-
1983 PEWP	104½	113	119½	126½
1983 JANUARY FORECAST	104½	112½	118½	125½

52. The reduction in the expected rate of inflation after the 1982 PEWP led to an upward revision in the future level of public expenditure when measured in cost terms - compare the first and second lines of the table below

	Planning Totals			
	Cost terms, 1981-82 prices, £ billion			
	1981-82	1982-83	1983-84	1984-85
1982 PEWP	105½	106½	104½	104
1983 PEWP	104½	105	106	105
JANUARY 1983 FORECAST	104½	105	105	104

53. The forecast updates the economic assumptions and shortfall judgments used in the PEWP.

54. The table below shows how the judgments made in the forecast lead to a forecast level of cash public expenditure in total that is a little lower than in the PEWP in both 1982-83 and 1983-84. In other words, the net allowance for shortfall is higher in the forecast. The table identifies the main areas where shortfall is expected: in 1983-84, apart from the usual tendency for the operation of cash limit ceilings to lead to underspending, the nationalised industries are the main element:

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	£ billion, cash	
	1982-83	1983-84
1. Public Expenditure Planning Total as in 1983 White Paper	113	119½
2. Net shortfall allowance in 1983 White Paper	-1	-1¼
3. Public expenditure plans (including CR) <u>before</u> shortfall	114	120¾
4. Shortfall in forecast	-1¾	-2¼
of which		
i) nationalised industries	-¼	-1¼ (of which ¾ from the contingency reserve)
ii) local authorities (current <u>and</u> capital)	-½	0
iii) Central government cash limits	-1	-1
5. Planning total in forecast (= 3 + 4 + other adjustments)	112¼	118½

55. Lines 1 and 3 in this table include the £1½ billion contingency reserve ^{in 1983-84.} In constructing the forecast we have assumed that half of this is allocated to nationalised industries, half to other areas of public expenditure. The latter we assume to be fully spent. But the nationalised industries, their surpluses benefiting from rising demand rather than big rises in prices, should be able to finance their investment - as always likely to be well below **plans** - with much the same level of external finance as in the current year, leaving them undershooting their EFLs and not requiring their allocation of the contingency reserve (the sum of these two being the £1¼ billion in line 4 i)). In 1982-83 ^{set at budget time} the industries are underspending their EFLs/by perhaps £½ billion; whereas at budget time, their share of the £2¼ billion contingency reserve amounted to £900 million, none of which (net) seems likely to be needed nor allocated to other contingencies, despite the policy changes last November.

56. This forecast does not allow for the effects of extra expenditure measures which might be announced in the budget or later: even if these were financed out of the contingency reserve -

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leaving the public expenditure control totals intact - they could well, depending on their size, reduce the amount of shortfall in the forecast and so reduce the scope for fiscal adjustment.

57. Other points to note include:

- i) The forecast allows for continued overspending on current, and underspending on capital, by local authorities, as usual on the basis of unchanged policies.
- ii) The forecast allows for an uprating of social security benefits in November 1983 in line with the forecast rise in prices (6½ per cent) less £180 million in 1983-84 allowed for recovery of overshoot.
- iii) In the later years of the forecast, particularly 1985-86, the inflation rate is above what was in mind when the public expenditure figures were constructed. As usual, we have assumed that this will result in a squeeze on volumes but only up to a maximum of 2 per cent, beyond which cash expenditure is assumed to increase.

PSBR

58. Between April and December 1982, the PSBR amounted to £7½ billion. It is usual for borrowing to be small, sometimes negative, in the final quarter of the financial year but this year various measures announced in November - worth about £1 billion though there was some effect before the end of 1982 - make it likely that the total for the financial year 1982-83 will rise to around £8 billion, consistent with the seasonally adjusted outturn of £5.3 billion (annual rate £7 billion) to end December. Our projections take into account detailed work on the central Government accounts by Accounts Division.

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59. Prospects for 1983-84 and 1984-85 are summarised in the table below, set out in a format similar to table 1.8 in the Autumn Statement:

£billion (per cent change)	1982-83	1983-84	1984-85
General Government expenditure	129½(+ 8½)	136½(+ 5½)	145½(+ 6½)
General Government receipts (on the basis of revalorisation only)	120½(+ 9)	130(+ 8)	140½(+ 8½)
Implied fiscal adjustment* (+ implies tax cuts)	-	+2	+2
General Government Borrowing Requirement	9	8½	7
PSBR: £billion	8	8	6½
as % of GDP	3	2¾	2
Money GDP	274 (+ 8)	298 (+ 8½)	326(+ 9½)

60. The projected rise in the public expenditure planning total, under 6 per cent, is less than the rise in money GDP, with hardly any increase at all in debt interest payments (not part of the planning total). Public sector revenues, before fiscal adjustment but after revalorisation, are expected to rise at much the same rate as money GDP.

61. Important influences on the movement of receipts between 1982-83 and 1983-84 include:

- i) the lower rate of NIS;
- ii) the full year revenue effects of taxing unemployment benefit;
- iii) the increase in National Insurance contribution rates;
- iv) the switch in receipts from the duty on spirits out of 1982-83 into 1983-84;
- v) the 20 per cent rise forecast for corporation tax receipts in response to the increase in profits in 1982.

* effect on the PSBR

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Customs and Excise expect to recover in 1983-84 a further £1½ billion of tax receipts delayed by the Civil Service dispute, a similar amount to that estimated for 1982-83.

62. Oil revenues in sterling are forecast to be a little higher in 1983-84 than forecast at the time of the Autumn Statement, with the lower level of sterling more than offsetting a lower world oil price. Forecasts of oil revenues, described much more fully in a separate note by Mr Powell, are as follows:

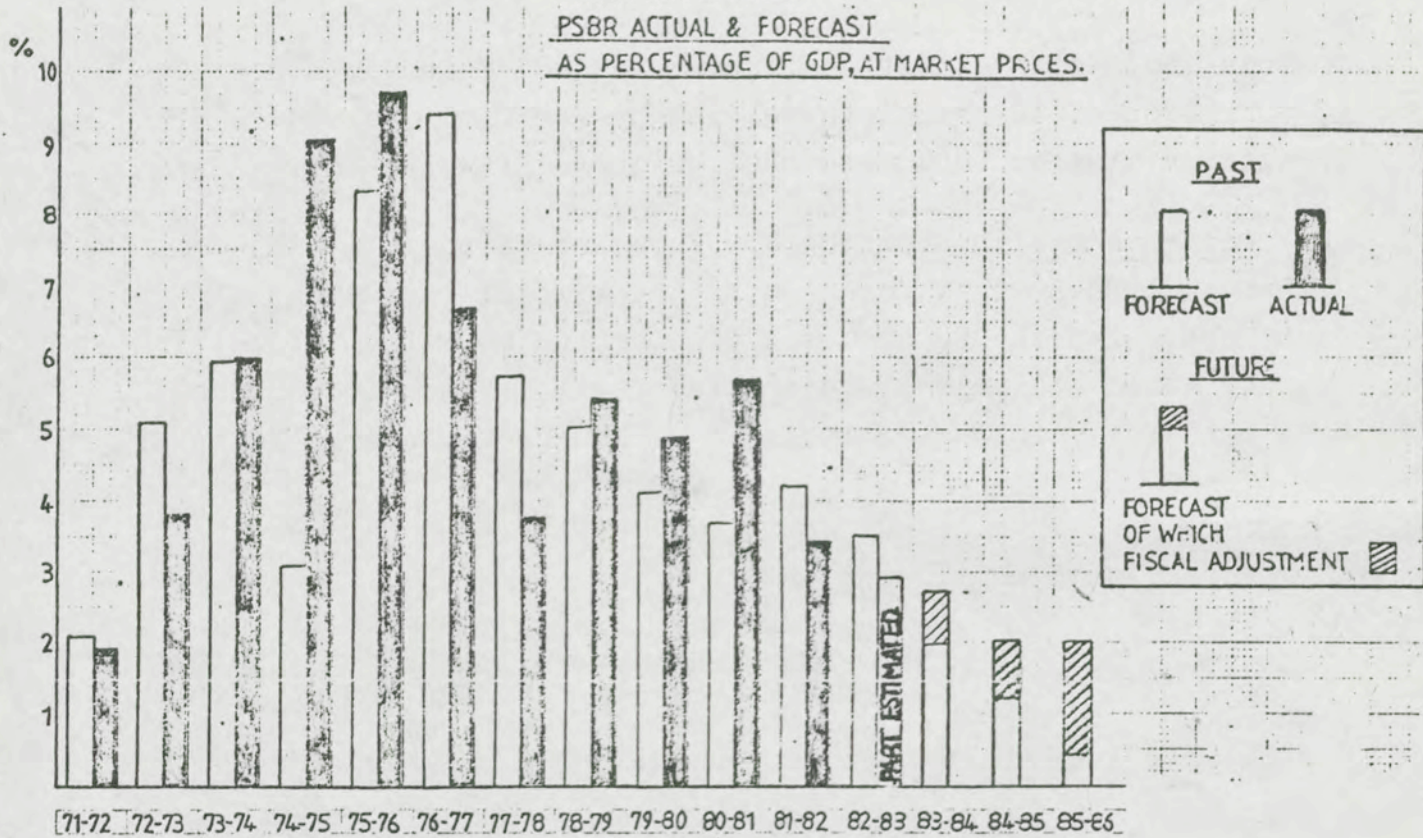
	£ billion		
	FSBR/MTFS MARCH 1982	AUTUMN STATEMENT NOVEMBER 1982	JANUARY 1983
1982-83	6	7	7½
1983-84	6	7½	8
1984-85	8	-	8½

63. Users of forecasts should be aware of the substantial margins of error surrounding our assessments of the PSBR and fiscal adjustment. The average margin of error on the PSBR, based on forecasts over the last fifteen years, is about 1½ per cent of GDP. In the forecast published with the Budget this will probably be shown as £4½ billion. The chart below shows errors on forecasts made at budget time: in the past, the PSBR turned out substantially higher than forecast in 1974-75 and 1980-81, when the economy moved sharply into recession and when public sector wages rose rapidly. Conversely the PSBR turned out under forecast in 1976-77 and 1977-78 (and to a much lesser extent 1981-82 and 1982-83), periods of some cyclical recovery in the economy. Methods of forecasting the PSBR now attempt to give more weight to these cyclical factors.

64. Given the margins of error, an outturn within £2-3 billion of the forecast (as in 1981-82 and, we expect, 1982-83) must be accounted satisfactory: either a good or a lucky forecast.

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PSBR ACTUAL & FORECAST
AS PERCENTAGE OF GDP, AT MARKET PRICES.



65. Fiscal policy is often defined in terms of its effect on the flow of public sector revenues and expenditures; but changes in the stock of public sector debt may also have effects on, for example, decisions to spend. Such changes reflect not only borrowing in each year but also the change in the rate of inflation (and in some versions, reductions in the market value of public sector debt as interest rates change). The effect of inflation on the stock of public sector debt outstanding is often known as the inflation tax.

66. The table below shows the actual PSBR as a percentage of GDP, and one definition of the "real" PSBR defined as the actual PSBR less the inflation tax:

	percentage of GDP					
	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
PSBR	5	5½	3½	3	2¾	2
Inflation tax (using RPI)	7¼	4	3½	2¾	2½	2¼
"Real" PSBR	-2¼	1½	0	¼	¼	-¼

In this table a positive "real" PSBR indicates that policy is less restrictive than a negative "real" PSBR.

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Flows of funds

67. The flows of savings and investment in the economy have important implications for the stocks of assets held by each sector and for the desire to borrow from banks and hence for the monetary aggregates.

68. Throughout the 1970s the personal sector ran a financial surplus, and the public sector a deficit, with companies generally close to balance. These patterns are reflected in the sectoral balance sheets: in terms of financial assets, the personal sector has long been a net creditor, the public sector a net debtor. Part at least of the explanation for this pattern of sectoral flows lies in the incidence of inflation: the higher it is, the more savings are required (by the personal sector) simply to maintain the real value of stocks of financial assets; and conversely (for the public sector) the larger the deficit can be without increasing the real value of financial liabilities. The table below shows the fall in the personal sector financial surplus that has already taken place up to 1982.

Financial surplus/deficits, per cent of GDP

	1973-1979 average	1980	1981	1982	1983	1984
Personal sector	5	8	6½	4	3½	3
Company sector	-½	-1½	-½	-½	½	0
of which industrial & commercial companies (excluding North Sea)	½	-1	½	0	½	½
Public sector	-5	-4½	-3	-2	-3	-2
Overseas sector (the reverse of the current account)	½	-1½	-2½	-1½	-½	-½

69. These figures tell us what the various sectors actually did; but not necessarily what the sectors wanted to do - and since one sector's deficit is another's surplus (by definition) there can be a significant difference between the two. Note that the forecasts for 1983 and 1984 already take account of a fiscal adjustment whose direct impact on the personal sector's disposable income is about 1 per cent in 1984 (and about ¾ per cent of GDP).

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70. The 1980 recession can be regarded, in large part, as an attempt by industrial and commercial companies to reduce the large financial deficit in prospect as a result of the rise in interest rates and the big loss in competitiveness (which would tend to increase the surplus of the personal and overseas sector). Quick and large scale action - destocking and laying off labour - left the public sector deficit increased and the overseas sector in deficit in 1980.

71. Over the forecast period, the gain in competitiveness should enable industrial and commercial companies to stay in modest surplus while the personal sector's surplus is reduced - though as the chart on page 17 makes clear, this should be consistent with the maintenance of a roughly constant wealth/income ratio for the personal sector as a whole. The margins of error surrounding forecasts (and best estimates) of sector financial balances are very wide. But the general message is that financial pressures on companies are likely to ease significantly, with the attendant risk that there will be less incentive to limit cost increases; while the personal sector is likely to run smaller surpluses than has been typical of recent years. To a very considerable extent, the imbalances so evident in 1980 are being corrected.

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Interest rates and monetary aggregates*

72. The monetary forecast has been constructed on essentially the same assumptions as the autumn forecasts. Short-term interest rates are set so as to ensure that average monetary growth lies within the MTFs range

per cent

<u>1983-84</u>	<u>1984-85 and future years</u>
7-11	6-10

The weights attached to individual aggregates are as before:

per cent

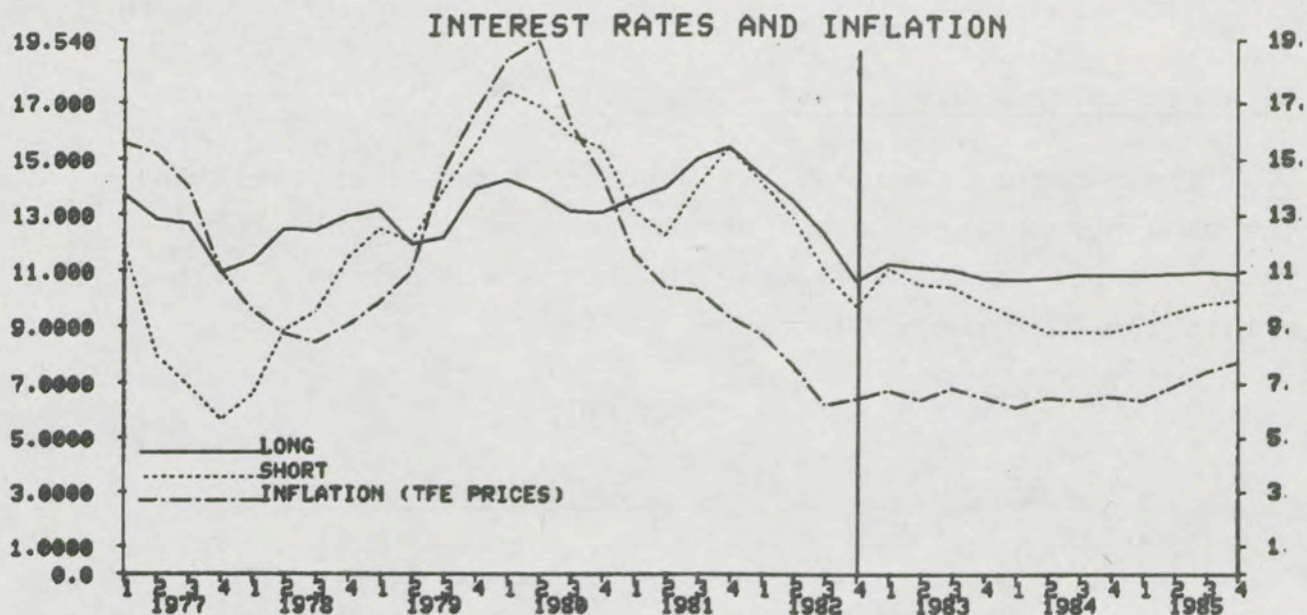
MO	10
M1	40
£M3	25
PSL2	25

In addition the path of interest rates is assumed to be set so as to avoid sharp changes in the exchange rate; and funding policy assumes that overfunding is avoided.

73. The path of interest rates is set out below:

	World basket (short rates)	3-month interbank	UK long rates	UK inflation through the year (The deflator for total final expenditure)
	per cent			
1981-82	14	14	15	9
1982-83	11	11½	12	7
1983-84	8½	10	11	6½
1984-85	8½	9	11	6½
1985-86	8½	10	11	8

*This section of the forecast is prepared jointly with the Bank of England.



74. With interest rates in other countries expected to come down a little further, and with low UK inflation, we see UK interest rates in the near future as being a little more likely to fall than to rise. The uncertainties likely to remain in financial markets suggest that a major fall in interest rates is not very likely in the run up to the general election. With inflation remaining low in 1984, lower nominal and real rates would seem possible then.

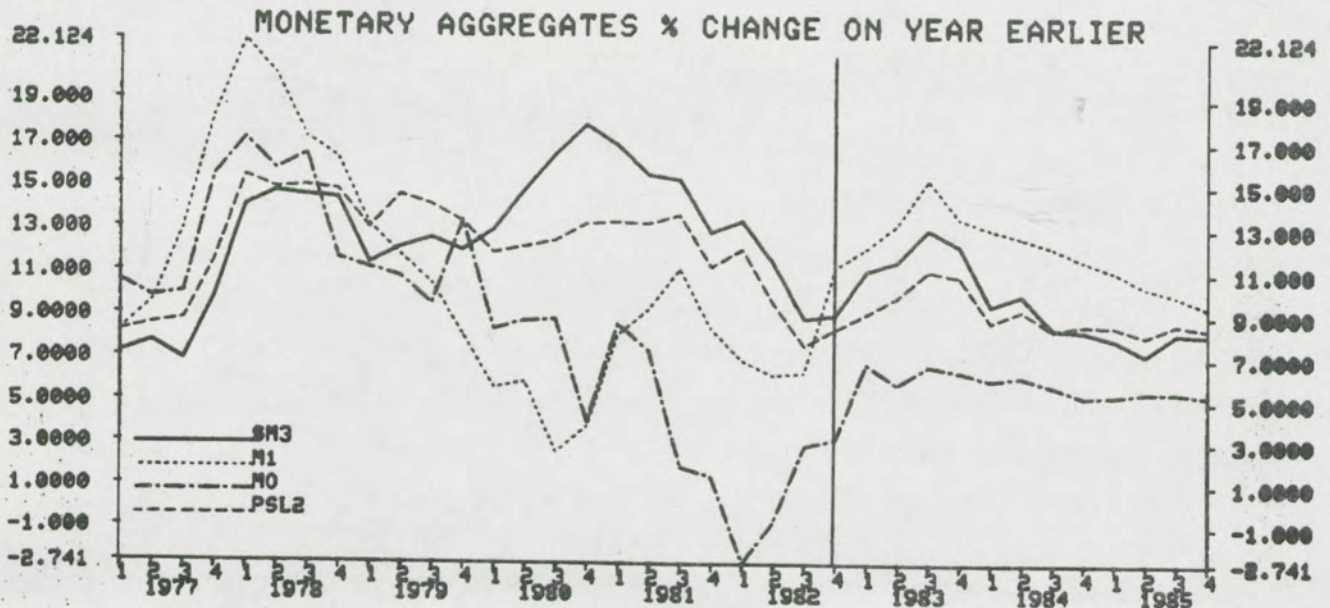
75. The pattern of financial balances in the forecast should favour a fall in broad monetary growth. The growth of company borrowing should fall further as companies move into financial surplus, while the decline in the personal surplus is more likely to be reflected in slower growth of bank and building society deposits. It is likely that the growth rate of personal bank borrowing will fall from the present exceptionally high level relative to income, though past experience leads us to be cautious about this judgment.

76. For neither sector do we expect the build-up of wealth and liquidity ratios to continue at recent rapid rates. Total bank lending is expected to decelerate in each of the next two years, as also is the private sector's overall financial surplus - the counterpart of a weaker current account (and a lower PSBR in 1984-85). With progressively slower growth of gross financial wealth in the next two years, the deceleration of £M3 in the last year should continue.

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77. The chart below shows the past and forecast growth of the main monetary aggregates (we do not have sufficient data on M2 to enable any analysis or forecasting to be possible):



78. At the time of the Autumn Statement, it was thought likely that the growth of both £M3 and M1 in the current financial year would be around the top of the target range of 8-12 per cent. The latest monthly forecast suggests that this is still likely, with M1 - more responsive to the large cuts in interest rates since late 1981 - growing perhaps rather faster than £M3. In 1983-84, we expect to see continued substantial growth of M1, perhaps over 13 per cent, as the response to the lower level of interest rates is continued. Growth in £M3 should be rather slower than for M1.

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79. The table below shows the growth of the two main monetary aggregates and of the weighted average described in paragraph 72 above.

	M1	£M3	Weighted average of M0, M1, £M3, PSLR2 per cent per annum	MTFS range
1981-82	7	13½	9	-
1982-83	12½	11½	10½	8-12
1983-84	13½	9½	10½	7-11
1984-85	11½	8	9½	6-10
1985-86	9	8	8	[6-10]

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ANNEX: COMPARISON OF FORECASTS

Treasury Forecasts

Table A below compares the current Treasury Forecast with the last two Budget Forecasts, the internal October Forecast and the one published in the Autumn Statement.

2. Previous comparisons have revealed successive downward revisions to the output and inflation forecasts, partly due to a progressively more pessimistic view of the prospects for a recovery in the world economy. On this occasion however, despite a further postponement of the world recovery shown by the world trade in manufactures figures in the table, the forecasts of UK output and inflation are now higher than those made last autumn. The main reasons for faster output growth in 1983 compared with what was previously expected are a somewhat bigger increase in personal consumption, a larger turnround in stockbuilding between 1982 and 1983 due to more de-stocking in the second half of 1982, and a larger contribution from net trade. The last factor owes much to improved competitiveness following the recent fall in the exchange rate. The fall in the rate is probably the most important new piece of information in this forecast and is responsible for the upward revision to the inflation forecast.

Outside Forecasts

3. Table 3 compares the current Treasury forecast with three outside forecasts and a "consensus" obtained by averaging all the major outside forecasts. While some of the outside forecasts envisaged a fall in sterling through 1983 none expected the size of fall which has already occurred. It is likely therefore that there will be upward revisions to both the rate of inflation and the growth of output in 1983. The latest Treasury forecast does indeed have faster output growth in 1983 than the consensus, but the inflation forecasts are similar. This suggests that the Treasury has a more optimistic view of the other influences on inflation, probably on commodity (including oil) prices, and import prices more generally.

4. The Bank of England forecast quoted is the "lower exchange rate" variant of their December forecast, in which an effective rate of 82 throughout 1983 was assumed. The difference between the Treasury and Bank forecasts of output are fairly minor, but the Bank are forecasting faster inflation at the end of 1983 probably because they are forecasting higher oil prices, higher importers' margins, and higher earnings.

5. There is little difference between Treasury and outside forecasts of the PSBR in 1982-83 though not all the outsiders will have taken full account of the Autumn Statement. Forecasts of the 1983-84 PSBR depend partly on what is assumed about the Budget. Most of the major forecasters with the exception of NIESR assume some fiscal adjustment over and above revalorisation. Only the LBS come up with a PSBR significantly in excess of the Autumn Statement's £8 billion.

COMPARISON OF TREASURY FORECASTS

TABLE A

	1981 FSBR/MTFS	1982 FSBR/MTFS	OCTOBER 1982	AUTUMN STATEMENT	JANUARY 1983
<u>Money Supply £M³*</u>					
(% Change on year earlier)					
1982 Q1	8.0	14.5 (15.5)	13.4	13.4	13.7
1983 Q1	7.0	11.1 (11.6)	11.9	12.2	11.3
1984 Q1	6.0	8.9 (9.2)	8.2	8.4	9.7
1985 Q1	6.0	7.0 (7.3)	6.4	6.8	8.1
<u>PSPR</u>					
(£b and % of money GDP)					
1981-82	10.6 (4.3)	10.6 (4.2)	8.8 (3.5)	8.8 (3.5)	8.7 (3.4)
1982-83	8.9 (3.3)	9.5 (3.4)	8.0 (2.9)	9.0 (3.3)	7.9 (2.9)
1983-84	6.0 (2.0)	8.4 (2.8)	8.5 (2.9)	8.1 (2.8)	8.0 (2.7)
1984-85	3.3 (1.0)	6.7 (2.0)	6.5 (2.0)	6.5 (2.0)	6.5 (2.0)
<u>Nominal GDP (mp)</u>					
(% Change on year earlier)					
1981	10.2	10.1	9.7	9.7	9.7
1982	10.1	10.6	8.6	8.9	8.5
1983	9.8	9.2	7.8	6.9	8.0
1984	9.8	9.9	9.1	8.9	9.6
<u>RPI</u>					
(% Change on year earlier)					
1981 Q4	10.2	11.9	11.9	11.9	11.9
1982 Q4	7.5	9.0	6.2	6.1	6.2
1983 Q4	7.4	7.1	5.6	4.7	6.4
1984 Q4	7.0	6.0	6.9	7.0	7.2
<u>Interest Rates</u>					
A Short Term					
1981-82	12.2	14.2	14.2	14.2	14.2
1982-83	11.5	13.5	10.7	10.4	11.4
1983-84	9.9	11.9	8.8	8.0	10.2
1984-85	9.0	10.2	9.4	8.9	9.1
B Long Term					
1981-82	13.3	15.0	14.9	14.9	14.9
1982-83	12.9	14.0	11.8	11.4	12.1
1983-84	11.3	12.6	10.3	9.6	11.1
1984-85	10.7	11.4	11.1	10.5	11.0
<u>World Trade in Manufactures</u>					
<u>UK Weighted</u>					
% Change on year earlier					
1981	3.0	4.1	4.5	4.3	3.3
1982	6.4	4.0	- 0.7	- 2.0	- 3.1
1983	7.3	4.6	3.2	2.7	1.3
1984	6.8	5.5	5.6	5.9	6.8
<u>UK Exports of Goods and Services</u>					
(% change on year earlier)					
1981	- 5.3	- 1.5	- 1.9	- 1.9	- 2.2
1982	- 0.4	3.3	- 0.8	- 0.9	- 0.1
1983	3.4	3.7	1.2	0.2	- 0.1
1984	4.8	4.4	4.2	4.9	5.2

The 1981 FSBR/MTFS was based on the old monetary sector.

	1981 FSBR/MTFS	1982 FSBR/MTFS	OCTOBER 1982	AUTUMN STATEMENT	JANUARY 1983
<u>Average Earnings</u> (private cyclically adjusted - % change on year earlier)					
1981 Q3	9.8	13.6	11.4	11.2	9.9
1982 Q3	6.9	9.0	9.7	9.7	10.0
1983 Q3	6.0	8.3	7.2	6.9	7.0
1984 Q3	5.4	7.4	8.5	8.2	8.0
<u>Effective Exchange Rate</u> 1975 = 100					
1981	101.2	94.9	94.9	94.9	94.9
1982	100.4	88.5	90.9	91.3	90.6
1983	98.9	84.6	87.6	89.5	80.0
1984	96.7	81.9	83.4	84.6	80.3
<u>Labour Costs Competitiveness</u> (Ratio of UK to competitors costs 1975 = 100)					
1981 Q4	151.3	139.3	134.4	134.4	131.3
1982 Q4	150.8	136.2	138.4	139.2	133.8
1983 Q4	145.7	130.3	131.1	130.6	120.0
1984 Q4	145.2	129.8	123.6	123.3	119.6
<u>Current Balance</u> (£b)					
1981	2.8	8.3	6.0	6.0	6.1
1982	- 0.8	4.2	3.0	3.7	4.2
1983	- 1.4	2.9	0.6	0.2	1.3
1984	- 0.4	3.3	- 0.6	- 0.3	2.1
<u>Manufacturing Output</u> (% Change on year earlier)					
1981	- 6.6	- 6.4	- 6.3	- 6.4	- 6.4
1982	1.5	3.2	0.2	0.0	- 0.7
1983	0.9	2.2	1.0	0.2	0.1
1984	1.2	1.9	1.5	1.6	2.2
<u>GDP Volume (fc)</u> (% Change on year earlier)					
1981	- 2.0	- 2.0	- 2.4	- 2.4	- 2.4
1982	1.2	1.4	0.7	0.7	0.7
1983	2.3	2.4	1.6	1.3	2.1
1984	2.2	2.8	2.6	2.5	2.4
<u>Unemployment*</u> (UK sa excl school leavers - millions)					
1981 Q4	2.7	2.8	2.8	2.8	2.8
1982 Q4	2.9	3.0	3.1	3.1	3.1
1983 Q4	2.8	3.0	3.4	3.4	3.2
1984 Q4	2.8	3.0	3.4	3.4	3.3
<u>I & C Companies' Financial</u> <u>Surplus/Deficit</u>					
1981	- 0.9	1.4	1.8	1.8	2.0
1982	- 4.7	0.2	- 0.2	- 0.8	1.0
1983	- 2.4	- 1.8	0.4	1.6	2.5
1984	- 0.9	- 0.9	- 0.9	0.5	2.4

*Old Basis

Comparisons with Outside Forecasts

	Phillips & Drew January 1982	NIESR November 1982	LBS November 1982	Consensus Forecast	Bank of England December 1982 ¹	Treasury January 1983
1. £M3 % Change on year earlier						
1983 Q1	10.0	12.3	11.1	10.4	N.A.	11.3
1984 Q1	10.0	11.5	11.5	10.0	N.A.	9.7
2. £M1 % change over year earlier						
1983 Q1	12.5	12.0	-	12.0	N.A.	12.4
1984 Q1	8.5	12.5	-	10.2	N.A.	13.3
3. Interest rates, short- term % (Treasury bill rate)						
1982 Q4	9.3	NA	9.5	9.7	9.6	9.5
1983 Q4	8.7	NA	9.0	9.2	10.0	9.7
4. PSBR £bn (of which in brackets 1982-3 fiscal adjustment)	8.5	8.0	8.0	7.7	8.5	7.9
1983-4	8.5(2.0)	7.9(0)	9.7(1.5)	7.9(N.A)	7.9(2.2)	8.0(2.0)
5. Exchange rate 1975 = 100						
1982 Q4	89.6	91.5	91.0	90.5	89.2	89.2
1983 Q4	89.4	92.0	87.0	88.5	82.0	80.0
6. Current Account £bn						
1982	3.4	4.2	2.5	3.0	3.9	4.2
1983	0.4	5.3	1.5	1.1	0.6	1.3
7. Average earnings % change on year earlier						
1982	9.5	9.8	11.3	9.6	9.8	9.1
1983	7.8	8.2	8.0	7.6	8.2	7.8
8. RPI(CPI) % change on year earlier						
1982 Q4	6.3	(7.9)	(7.5)	6.7(7.3)	6.2	6.2
1983 Q4	6.0	(5.1)	(6.7)	6.3(5.9)	<u>7.8</u>	6.4

¹ Lower Exchange Rate Variant

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	Phillips & Drew January 1982	NIESR November 1982	LBS November 1982	Consensus Forecast	Bank of England December 1982 ⁴	Treasury January 1983
9. RPDI % change on year earlier						
1982	- 1.9	- 1.8	- 2.1	- 1.4	- 1.9	- 2.1
1983	1.0	1.1	0.9	1.3	0.6	1.7
10. Import Volume goods and services %						
1982	3.7	3.8	3.7	4.4	4.6	4.1
1983	3.1	3.1	3.8	4.7	5.8	3.7
11. Export Volume goods and services %						
1982	- 0.6	- 0.1	- 0.9	- 0.5	- 0.5	- 0.1
1983	0.8	1.8	3.5	1.4	0.4	- 0.1
12. GDP Volume, % change on year earlier						
1982	0.5	0.3	0.3	0.4	0.4	0.7
1983	1.8	1.0	2.0	1.6	1.9	2.1
13. Unemployment million, Q ⁴						
1982	2.9 ^a	3.1	3.1	3.1	3.1	3.1
1983	3.1 ^a	3.2	3.2	3.2	3.2	3.2

'Consensus' includes: National Institute (Nov)
London Business School (Nov)
Phillips & Drew (Jan)
OECD (Dec)
St James (Nov)
Cambridge Econometrics (Dec)
Cambridge Economic Policy Group (April)
Liverpool (Dec)
CBI (Nov)

though results are not reported for some variables by some forecasters.

^a New Basis

TABLE 1: SUMMARY

	1	2	3	4	5	6	7	8	9	10	11	12	13
	GDP AT CONSTANT PRICES 1975=100	UK UNEMP NARROW ADJ(1)	CYC.PRIV EARNINGS % CHANGE OVER PREV.YR.	RPI % CHANGE OVER PREV. YEAR	PSBR(2)	PSBR(2) /NOMINAL GDP	CURRENT BALANCE	ICC'S NAFA	PERSONAL NAFA	EFFECTIVE EXCHANGE RATE	INTEREST RATES 3-MONTH INTER BANK	INTEREST RATES 20-YEAR GILTS	EM3 % CHANGE OVER PREV. YEAR
1981	105.4	2539	12.2	11.9	10841	4.36	6121	2032	16317	94.87	13.92	14.71	15.3
1982	106.1	2935	9.9	8.6	5190	1.93	4193	976	10942	90.59	12.15	12.92	10.9
1983	108.4	3143	7.5	5.6	9155	3.14	1253	2515	9910	80.00	10.64	11.22	12.2
1984	111.0	3237	7.9	7.3	6632	2.08	2070	2357	8772	80.25	9.12	10.97	9.2
1985	113.1	3334	8.7	7.1	7523	2.17	1166	1242	9411	78.00	9.77	11.09	8.1
1981/82	105.4	2673	10.8	11.5	8706	3.43	4437	868	15222	92.31	14.18	14.92	14.5
1982/83	106.2	3009	9.3	7.2	7925	2.89	4056	2833	9851	88.05	11.36	12.12	10.3
1983/84	109.2	3158	7.4	6.0	8029	2.69	1050	2062	9548	80.00	10.20	11.07	11.8
1984/85	111.6	3270	8.1	7.2	6509	2.00	2015	2048	8804	79.65	9.07	11.02	8.9
1985/86	113.5	3354	8.9	7.4	7104	2.00	814	583	9482	77.60	10.00	11.10	8.1
1981 QTR 1	105.8	2281	16.5	12.7	2100	3.50	2417	351	4740	101.40	13.33	13.78	17.2
QTR 2	105.1	2482	12.1	11.7	6124	9.98	2002	959	4132	97.80	12.47	14.18	15.8
QTR 3	104.8	2641	9.9	11.2	2507	3.99	205	216	3713	90.60	14.22	15.20	15.5
QTR 4	105.8	2751	10.7	11.9	110	0.17	1497	506	3732	89.70	15.65	15.67	13.1
1982 QTR 1	106.0	2817	10.6	11.1	-35	-0.05	733	-813	3645	91.14	14.38	14.64	13.7
QTR 2	105.9	2877	10.0	9.4	1188	1.78	887	-263	2691	90.60	13.12	13.73	11.7
QTR 3	106.1	2990	10.0	8.0	1616	2.38	1005	787	2161	91.41	11.19	12.49	9.1
QTR 4	106.3	3056	9.0	6.2	2421	3.50	1568	1265	2445	89.20	9.90	10.83	9.3
1983 QTR 1	106.6	3114	8.3	5.5	2700	3.84	596	1044	2554	81.00	11.25	11.43	11.3
QTR 2	108.0	3134	7.7	4.7	1798	2.51	195	445	2622	80.00	10.70	11.29	11.8
QTR 3	109.0	3156	7.0	5.7	2263	3.08	216	467	2441	79.00	10.60	11.23	13.3
QTR 4	109.9	3169	7.2	6.4	2394	3.17	246	559	2293	80.00	10.00	10.91	12.5
1984 QTR 1	110.1	3172	7.5	7.1	1574	2.04	393	591	2192	81.00	9.50	10.87	9.7
QTR 2	110.8	3230	7.7	7.5	1957	2.48	592	516	2592	81.00	9.00	10.92	10.2
QTR 3	111.3	3260	8.0	7.5	1662	2.06	650	823	2074	80.00	9.00	11.03	8.7
QTR 4	111.9	3286	8.2	7.2	1439	1.75	435	427	1914	79.00	9.00	11.06	8.5
1985 QTR 1	112.5	3305	8.4	6.6	1451	1.73	338	282	2224	78.60	9.30	11.06	8.1
QTR 2	113.0	3317	8.6	6.8	2326	2.71	309	413	2794	78.20	9.70	11.10	7.4
QTR 3	113.4	3336	8.8	7.2	1924	2.19	269	384	2299	77.80	10.00	11.12	8.4
QTR 4	113.6	3378	8.9	7.7	1822	2.03	250	163	2094	77.40	10.10	11.09	8.3
1986 QTR 1	113.8	3384	9.1	7.9	1032	1.13	-14	-377	2295	77.00	10.20	11.07	8.4

(1) 'NARROW' EXCLUDES SCHOOL LEAVERS

(2) FINANCIAL YEAR SEASONALLY ADJUSTED

TABLE 2: PRIVATE SECTOR FINANCIAL SUMMARY

PERCENTAGE CHANGES ON PREVIOUS YEAR (EXCEPT COL. 14)

	1	2	3	4	5		7	8		9	10	11	12		13	14	15
	TFE	REAL	REAL	NOMINAL	PRIVATE SECTOR			PRIVATE SECTOR				BANK	PRIVATE SECTOR		HOLDINGS		REAL
	DEFLATOR	TFE	GDP	GDPM	FINANCIAL WEALTH			FINANCIAL WEALTH				LENDING	OF GILTS		AS A %		MONEY
					EXCLUDING	GROSS DOMESTIC		INCLUDING	GROSS DOMESTIC		TO	EXCL.	INCL.	OF GROSS		SUPPLY	
					REVALUATIONS		REVALUATIONS	REVALUATIONS			PRIVATE	REVALS.	REVALS.	WEALTH			
					NET		NET				SECTOR						
1981	10.68	-1.62	-2.43	9.73	22.19	21.11	17.37	18.92	19.65	15.31	16.53	14.72	8.89	23.48		5.91	
1982	7.30	1.75	0.66	8.49	2.92	11.96	10.49	10.31	15.29	15.28	28.45	8.81	23.31	25.11		1.52	
1983	6.68	2.54	2.15	8.00	10.01	12.09	12.48	13.32	13.46	14.40	18.58	8.06	13.77	25.18		2.59	
1984	6.47	3.08	2.45	9.61	7.93	9.09	8.52	10.15	10.05	9.88	13.09	7.17	11.01	25.40		-0.46	
1985	7.24	2.45	1.91	8.86	7.12	8.36	7.70	6.80	8.22	7.51	11.15	6.29	5.74	24.82		-1.64	
1981/82	9.94	0.18	-1.39	9.38	18.49	20.04	15.93	14.02	18.02	13.21	18.57	12.82	5.32	23.12		3.94	
1982/83	6.83	1.38	0.76	7.92	3.53	11.28	10.73	12.66	15.39	16.59	27.02	8.46	26.09	25.26		1.86	
1983/84	6.52	3.21	2.83	8.72	9.59	11.21	11.44	12.23	12.29	12.94	16.99	8.10	12.66	25.35		1.67	
1984/85	6.53	2.80	2.17	9.28	7.63	8.77	8.10	9.00	9.36	8.93	12.21	6.64	8.99	25.26		-0.60	
1985/86	7.64	2.21	1.66	8.93	6.97	8.34	7.73	6.61	8.19	7.52	11.14	6.34	5.74	24.69		-1.71	
1981 QTR 1	11.78	-4.55	-3.98	10.78	22.44	20.16	18.25	26.72	22.09	20.90	18.23	16.98	24.61	25.84		4.81	
QTR 2	10.55	-3.30	-3.50	9.44	22.75	22.21	19.11	20.17	21.01	17.48	12.75	15.87	11.26	23.94		4.74	
QTR 3	10.63	-0.02	-1.90	9.60	25.89	21.44	15.26	18.02	17.82	10.32	14.69	12.73	-1.04	22.09		4.44	
QTR 4	9.54	1.54	-0.24	9.15	17.70	20.64	16.87	12.08	18.04	13.31	20.29	13.30	3.11	22.27		3.24	
1982 QTR 1	8.87	2.64	0.16	9.33	7.62	15.88	12.47	6.89	15.54	12.00	25.68	9.39	8.07	24.17		4.41	
QTR 2	7.91	3.05	0.74	8.73	2.26	9.24	5.93	4.26	10.16	7.23	31.39	6.23	10.08	23.92		3.50	
QTR 3	6.15	0.80	1.26	7.96	-1.44	12.18	13.67	12.38	18.56	22.95	30.74	10.80	39.66	26.02		2.74	
QTR 4	6.51	0.57	0.49	8.01	3.25	10.54	9.88	17.47	16.79	18.80	26.21	8.84	36.88	26.10		2.59	
1983 QTR 1	6.87	1.13	0.55	7.03	10.05	13.14	13.46	16.40	15.90	17.39	21.15	7.98	19.39	24.90		4.15	
QTR 2	6.31	1.94	1.99	7.46	10.69	14.51	16.06	17.93	17.67	20.62	20.82	10.40	23.62	25.13		5.14	
QTR 3	6.90	3.12	2.70	8.39	10.30	10.45	10.21	10.39	10.49	10.27	17.09	6.16	6.31	25.04		5.97	
QTR 4	6.58	3.98	3.34	9.06	8.98	10.27	10.20	9.41	10.46	10.46	15.79	7.68	8.41	25.62		5.55	
1984 QTR 1	6.23	3.80	3.29	9.89	8.37	9.60	9.28	11.82	11.10	11.40	14.76	8.15	14.18	25.58		3.25	
QTR 2	6.56	2.98	2.55	10.02	8.09	9.44	8.99	10.85	10.65	10.69	13.82	7.24	12.06	25.45		3.40	
QTR 3	6.49	3.04	2.17	9.67	7.83	8.96	8.33	9.93	9.88	9.62	12.61	7.74	11.41	25.39		2.03	
QTR 4	6.60	2.52	1.80	8.89	7.41	8.34	7.51	8.15	8.66	7.96	11.35	5.56	6.83	25.18		1.80	
1985 QTR 1	6.48	2.65	2.18	8.62	7.20	8.33	7.57	7.24	8.35	7.59	11.22	6.01	6.08	25.05		1.55	
QTR 2	7.00	2.63	2.03	8.75	7.16	8.27	7.57	6.65	8.05	7.26	10.92	6.56	5.69	24.90		0.38	
QTR 3	7.55	2.40	1.82	8.94	7.12	8.42	7.83	6.68	8.23	7.56	11.36	6.10	5.34	24.71		0.78	
QTR 4	7.89	2.12	1.60	9.12	6.99	8.40	7.83	6.64	8.25	7.62	11.11	6.47	5.88	24.63		0.41	
1986 QTR 1	8.11	1.68	1.20	8.90	6.59	8.27	7.69	6.48	8.22	7.62	11.17	6.23	6.03	24.54		0.25	

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TABLE 3: INDUSTRY ACT FORECAST TABLE 2 (% CHANGE ON ONE YEAR EARLIER)

CONSTANT PRICE FORECASTS OF EXPENDITURE, IMPORTS AND GROSS DOMESTIC PRODUCT
\$ MILLION AT 1975 PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13
	CONSUMERS' EXPEND	GENERAL GOVERNMENT EXPEND ON GOODS & SERVICES	FIXED INVEST	TOTAL	OTHER FIXED INVEST	EXPRPTS OF GOODS AND SERVICES	CHANGE IN STOCKS	TOTAL FINAL EXPEND	LESS IMPRPTS OF GDS AND SERVICES	LESS ADJUST TO FACTOR COSTS	GDP AT FACTOR COST (EXPEND MEASRE)	PLUS STAT ADJUST	GDP AT FACTOR COST
1981	0.4	-0.0	-28.0	-3.1	-4.8	-2.2		-1.6	-0.3	-0.6	-2.2		-2.4
1982	1.0	1.1	-18.1	-0.5	5.9	-0.1		1.8	4.1	1.1	1.0		0.7
1983	2.9	0.7	11.7	1.5	2.5	-0.1		2.5	3.7	2.8	2.1		2.1
1984	1.8	1.1	26.1	2.9	1.9	5.2		3.1	5.5	2.6	2.3		2.4
1985	2.1	0.6	9.3	1.4	2.6	4.3		2.5	4.1	2.6	1.8		1.9
1981 FIRST HALF	0.3	0.2	-23.1	-2.5	-8.3	-5.6		-3.9	-10.1	0.7	-2.4		-3.7
1981 SECOND HALF	0.6	-0.2	-33.4	-3.7	-1.1	1.3		0.8	10.2	-1.9	-2.0		-1.1
1982 FIRST HALF	-0.1	1.3	-28.5	-1.4	7.3	2.4		2.8	11.6	-0.5	0.5		0.4
1982 SECOND HALF	2.0	0.8	-4.8	0.4	4.6	-2.5		0.7	-2.4	2.6	1.6		0.9
1983 FIRST HALF	3.3	0.5	8.3	1.0	2.7	-1.8		1.5	1.9	2.9	1.2		1.3
1983 SECOND HALF	2.5	1.0	14.9	1.9	2.2	1.5		3.6	5.5	2.8	3.0		3.0
1984 FIRST HALF	1.9	1.3	30.7	3.4	1.2	4.9		3.4	5.9	2.7	2.6		2.9
1984 SECOND HALF	1.7	0.8	22.0	2.5	2.5	5.5		2.8	5.0	2.6	2.0		2.0
1985 FIRST HALF	2.1	0.6	9.8	1.4	3.4	4.8		2.6	4.5	2.8	1.9		2.1
1985 SECOND HALF	2.1	0.6	8.8	1.3	1.7	3.8		2.3	3.7	2.5	1.7		1.7

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TABLE 4: CONSUMERS EXPENDITURE

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
	REAL	CONSMR	EXP.	REAL	SAVINGS	CONSMR	- - -	- % CHANGES ON	PREVIOUS	YEAR OF -	- - -	WEALTH-	-INT" T	RATES-	
	TOTAL	DUR-	NONDUR	PERSNL	RATIO	PRICE	TOTAL	CONSUMPTION-	PERSNL	CONSMR	RPDI	INCOME	REAL 1	NOMI-	
		ABLES	ABLES	DISP.		INDEX		ABLES	ABLES	DISP.	PRICES	RATIO		NAL	
				INC.					INC.					(3 MTH)	
1981	71871	6274	65597	82991	13.40	210.5	0.4	2.8	0.2	8.6	10.9	-2.1	4.85	3.0	13.9
1982	72557	6640	65917	81267	10.72	227.7	1.0	5.8	0.5	5.9	8.2	-2.1	5.10	4.0	12.1
1983	74646	6974	67670	82650	9.69	242.6	2.9	5.0	2.7	8.4	6.6	1.7	5.13	4.1	10.6
1984	76023	7144	68878	83271	8.70	260.2	1.8	2.4	1.8	8.0	7.2	0.7	5.04	1.9	9.1
1985	77626	7269	70356	85122	8.81	278.4	2.1	1.7	2.1	9.3	7.0	2.2	4.92	2.8	9.8
1981/82	71758	6244	65514	82394	12.91	215.6	0.4	3.3	0.1	7.4	10.6	-2.9	4.88	3.6	14.2
1982/83	73113	6816	66296	81247	10.01	231.5	1.9	9.2	1.2	5.9	7.4	-1.4	5.15	4.0	11.4
1983/84	75073	7030	68042	82841	9.38	246.7	2.7	3.1	2.6	8.6	6.5	2.0	5.11	3.7	10.2
1984/85	76389	7172	69215	83668	8.70	264.4	1.8	2.0	1.7	8.3	7.2	1.0	5.02	1.9	9.1
1985/86	78034	7319	70716	85513	8.75	283.4	2.2	2.0	2.2	9.6	7.2	2.2	4.88	2.8	10.0
1981 QTR 1	18040	1571	16469	21176	14.81	201.5	-0.4	-3.6	-0.1	11.8	11.3	0.4	4.85	2.0	13.3
QTR 2	17926	1595	16331	20628	13.10	208.7	1.1	6.9	0.6	9.6	10.9	-1.1	5.03	1.6	12.5
QTR 3	17934	1570	16364	20606	12.97	213.4	0.6	3.8	0.3	6.8	10.9	-3.7	4.66	3.3	14.2
QTR 4	17971	1538	16433	20581	12.68	218.4	0.6	4.6	0.2	6.6	10.8	-3.8	4.89	4.9	15.6
1982 QTR 1	17927	1541	16386	20579	12.89	221.8	-0.6	-1.9	-0.5	6.9	10.0	-2.8	4.97	4.3	14.4
QTR 2	17998	1581	16417	20138	10.63	226.7	0.4	-0.9	0.5	6.1	8.7	-2.4	4.98	4.5	13.1
QTR 3	18242	1768	16474	20164	9.53	229.2	1.7	12.6	0.7	5.1	7.4	-2.1	5.26	3.8	11.2
QTR 4	18390	1750	16640	20386	9.79	233.0	2.3	13.8	1.3	5.7	6.7	-0.9	5.20	3.2	9.9
1983 QTR 1	18483	1717	16765	20559	10.10	237.2	3.1	11.4	2.3	6.8	6.9	-0.1	5.14	4.3	11.2
QTR 2	18614	1736	16877	20702	10.09	240.3	3.4	9.8	2.8	9.0	6.0	2.8	5.15	4.7	10.7
QTR 3	18704	1766	16938	20677	9.54	244.4	2.5	-0.1	2.8	9.3	6.6	2.5	5.13	4.0	10.6
QTR 4	18845	1755	17090	20712	9.02	248.7	2.5	0.3	2.7	8.5	6.8	1.6	5.10	3.2	10.0
1984 QTR 1	18910	1773	17137	20750	8.87	253.2	2.3	3.3	2.2	7.8	6.8	0.9	5.05	2.7	9.5
QTR 2	18908	1794	17113	20859	9.35	258.4	1.6	3.4	1.4	8.3	7.5	0.8	5.02	1.5	9.0
QTR 3	19058	1791	17267	20808	8.41	262.7	1.9	1.4	1.9	8.2	7.5	0.6	5.05	1.5	9.0
QTR 4	19147	1786	17361	20854	8.18	266.6	1.6	1.8	1.6	7.9	7.2	0.7	5.05	1.8	9.0
1985 QTR 1	19276	1801	17474	21147	8.85	269.7	1.9	1.6	2.0	8.6	6.5	1.9	4.98	2.8	9.3
QTR 2	19348	1821	17527	21382	9.51	275.9	2.3	1.5	2.4	9.4	6.8	2.5	4.89	2.9	9.7
QTR 3	19465	1822	17643	21304	8.63	281.3	2.1	1.7	2.2	9.6	7.1	2.4	4.91	2.9	10.0
QTR 4	19537	1825	17712	21289	8.23	286.4	2.0	2.2	2.0	9.7	7.4	2.1	4.90	2.7	10.1
1986 QTR 1	19684	1851	17834	21538	8.61	290.1	2.1	2.7	2.1	9.5	7.6	1.8	4.83	2.6	10.2

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FOOTNOTE 1 COL 14 = COL 15 - COL 11

TABLE 5: EXCHANGE RATES AND COMPETITIVENESS

	1 . . . E X C H A N G E R A T E S . . .			2 -----COMPETITIVENESS OF MANUFACTURES-----				
	3 EFFECTIVE EXCH. RATE	4 EXPORT WTD EXCH. RATE	5 DOLLAR/£ EXCH. RATE	6 RELATIVE EXPORT PRICES	7 RELATIVE WHSALE PRICES	8 RELATIVE N.UNIT LAB.COSTS	9 IMPORT PRICE COMPET	10 RELATIVE PROFBLTY EXPORTS
1981	94.87	92.823	2.025	124.41	132.19	139.60	123.13	91.32
1982	90.59	89.742	1.751	117.31	129.67	134.57	121.96	90.37
1983	80.00	78.947	1.605	109.65	118.45	119.00	116.24	92.76
1984	80.25	77.569	1.724	111.77	120.33	120.56	117.09	93.17
1985	78.00	74.179	1.758	110.32	117.85	118.20	115.78	93.56
1981 QTR 1	101.40	99.155	2.310	133.61	140.92	151.14	125.40	91.30
QTR 2	97.80	95.424	2.069	127.63	134.90	143.03	124.89	91.09
QTR 3	90.60	89.002	1.838	118.74	126.30	132.90	122.58	91.55
QTR 4	89.70	87.714	1.884	117.68	126.65	131.33	119.67	91.33
1982 QTR 1	91.14	89.590	1.847	119.55	130.05	134.01	122.84	91.26
QTR 2	90.60	88.961	1.780	116.30	129.12	133.65	120.96	90.39
QTR 3	91.41	90.305	1.728	118.68	131.23	136.82	121.51	90.34
QTR 4	89.20	90.113	1.649	114.69	128.27	133.80	122.53	89.51
1983 QTR 1	81.00	80.526	1.596	108.69	119.30	119.77	117.73	91.10
QTR 2	80.00	79.090	1.595	109.90	118.26	119.01	116.04	92.84
QTR 3	79.00	77.725	1.599	109.28	117.30	117.21	115.17	93.52
QTR 4	80.00	78.448	1.632	110.71	118.93	120.01	116.00	93.60
1984 QTR 1	81.00	79.044	1.679	112.30	121.77	121.50	117.94	92.93
QTR 2	81.00	78.523	1.721	112.62	121.62	121.48	117.59	92.96
QTR 3	80.00	77.030	1.744	111.62	119.83	119.68	116.78	93.26
QTR 4	79.00	75.679	1.753	110.55	118.09	119.57	116.03	93.51
1985 QTR 1	78.60	74.905	1.775	110.40	118.37	118.46	116.70	93.16
QTR 2	78.20	74.420	1.764	110.18	117.76	117.71	116.03	93.33
QTR 3	77.80	73.936	1.753	110.26	117.59	117.59	115.21	93.73
QTR 4	77.40	73.455	1.742	110.44	117.69	119.05	115.18	94.02
1986 QTR 1	77.00	72.975	1.731	110.83	118.51	118.57	115.09	94.06

JANUARY FORECAST

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TABLE 6: BALANCE OF PAYMENTS

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

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
	EXPORT	IMPORT	VISIB	EXPORT	IMPORT	BAL	TRANSFERS		BAL	IPD	IPD	BAL	INVIS	CURRENT	CURRENT
	GOODS	GOODS	BAL	SERV	SERV	SERV	CRED	DEB	TRANSF	CREDIT	DEBIT	IPD	BAL	BALANCE	BALANCE
															DOLLRS (1)
1981	51071	48092	2979	16751	12638	4113	2501	4483	-1982	10089	9078	1011	3142	6121	12398
1982	55095	53398	1697	17733	13798	3935	3124	5221	-2097	10327	9669	658	2496	4193	7344
1983	59775	61931	-2156	19118	15451	3667	3675	5661	-1986	12058	10329	1728	3409	1253	2010
1984	65602	68837	-3235	21637	16910	4727	3596	5806	-2210	13487	10699	2788	5305	2070	3568
1985	73254	78813	-5559	24521	18843	5678	3800	6325	-2525	15752	12179	3572	6725	1166	2050
1981 QTR 1	11769	10092	1677	4031	2963	1068	585	1120	-535	2224	2017	207	740	2417	5584
QTR 2	12253	11121	1132	4160	3105	1055	496	1062	-566	2353	1972	381	870	2002	4142
QTR 3	13191	13511	-320	4252	3262	990	603	1238	-635	2557	2387	170	525	205	376
QTR 4	13858	13368	490	4308	3308	1000	817	1063	-246	2955	2702	253	1007	1497	2820
1982 QTR 1	13279	12956	323	4422	3333	1089	790	1284	-494	2229	2414	-185	410	733	1353
QTR 2	13745	13620	125	4465	3460	1005	661	1312	-651	2771	2363	408	762	887	1579
QTR 3	13666	13265	401	4423	3450	973	790	1323	-533	2645	2481	164	604	1005	1737
QTR 4	14405	13557	848	4423	3555	868	883	1302	-419	2682	2411	271	720	1568	2585
1983 QTR 1	14452	14566	-114	4545	3730	815	844	1305	-461	2883	2527	356	710	596	950
QTR 2	14748	15327	-579	4704	3823	881	868	1345	-477	2948	2578	370	774	195	310
QTR 3	15119	15814	-695	4874	3917	957	880	1454	-574	3087	2559	528	911	216	345
QTR 4	15456	16224	-768	4995	3981	1014	1083	1557	-474	3140	2665	474	1014	246	401
1984 QTR 1	15829	16577	-748	5129	4069	1060	861	1440	-579	3248	2588	660	1141	393	658
QTR 2	16185	16855	-670	5343	4174	1169	895	1460	-565	3298	2640	658	1262	592	1019
QTR 3	16595	17412	-817	5496	4283	1213	907	1393	-486	3405	2665	740	1467	650	1133
QTR 4	16993	17993	-1000	5669	4384	1285	933	1513	-580	3536	2806	730	1435	435	762
1985 QTR 1	17539	18714	-1175	5853	4510	1343	913	1532	-619	3708	2919	789	1513	338	600
QTR 2	18035	19396	-1361	6042	4654	1388	947	1564	-617	3879	2980	899	1670	309	545
QTR 3	18593	20071	-1478	6228	4787	1441	959	1604	-645	4019	3067	951	1747	269	471
QTR 4	19087	20632	-1545	6398	4892	1506	981	1625	-644	4146	3213	933	1795	250	434
1986 QTR 1	19564	21369	-1805	6521	5014	1507	1053	1650	-597	4268	3387	881	1791	-14	-23

(1) N.B. COLUMN 11 IN U.S. DOLLAR MILLIONS

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TABLE 7: RETAIL PRICES INDEX AND CONSUMERS EXPENDITURE DEFLATOR

RECORDED AND FORECAST

WEIGHTS (1)	1 RETAIL PRICES INDEX JANUARY 1974=100					6 PERCENTAGE CHANGES OVER LAST YEAR FOR RETAIL PRICE INDEX AND COMPONENTS					11 CONS. EXPD. DEFLATOR (SEAS. ADJ.) INDEX 1975=100		12 P-C CH ON PREV. YEAR
	FOOD 216	HOUSING 128	NAT. IND. 73	OTHER 585	TOTAL 1000	FOOD	HOUSING	NAT. IND.	OTHER	TOTAL			
1981	277.5	318.2	368.3	286.4	295.0	8.5	18.1	19.5	10.5	11.9	210.5	10.9	
1982	299.4	358.2	418.6	306.5	320.4	7.9	12.6	13.6	7.0	8.6	227.7	8.2	
1983	311.4	365.8	449.3	327.1	338.2	4.0	2.1	7.4	6.7	5.6	242.6	6.6	
1984	328.3	394.9	474.3	353.8	363.0	5.4	7.9	5.5	8.2	7.3	260.2	7.2	
1985	351.4	424.2	504.5	379.1	388.8	7.0	7.4	6.4	7.1	7.1	278.4	7.0	
1981 QTR 1	268.7	285.2	352.5	274.0	280.4	8.6	18.3	25.7	11.1	12.7	201.5	11.3	
QTR 2	277.0	319.9	364.7	285.0	294.0	8.2	17.5	21.9	10.0	11.7	208.7	10.9	
QTR 3	278.8	324.0	376.3	290.7	299.1	7.5	16.3	19.2	10.2	11.2	213.4	10.9	
QTR 4	285.6	343.7	379.8	295.9	306.5	9.6	20.3	12.5	10.6	11.9	218.4	10.8	
1982 QTR 1	297.7	346.7	391.4	298.1	311.6	10.8	21.6	11.0	8.8	11.1	221.8	10.0	
QTR 2	304.1	365.0	417.7	305.4	321.5	9.8	14.1	14.5	7.1	9.4	226.7	8.7	
QTR 3	297.0	364.6	428.8	309.3	323.0	6.5	12.5	14.0	6.4	8.0	229.2	7.4	
QTR 4	298.9	356.7	436.3	313.5	325.4	4.7	3.8	14.9	5.9	6.2	233.0	6.7	
1983 QTR 1	305.8	349.0	444.1	317.1	328.6	2.7	0.7	13.5	6.4	5.5	237.2	6.9	
QTR 2	311.5	367.9	446.8	324.5	336.8	2.4	0.8	7.0	6.3	4.7	240.3	6.0	
QTR 3	312.6	371.4	450.7	330.6	341.3	5.3	1.9	5.1	6.9	5.7	244.4	6.6	
QTR 4	315.8	374.9	455.8	336.5	346.3	5.7	5.1	4.5	7.3	6.4	248.7	6.8	
1984 QTR 1	322.4	378.5	464.5	341.6	351.8	5.4	8.4	4.6	7.7	7.1	253.2	6.8	
QTR 2	328.1	397.5	471.1	352.0	362.0	5.3	8.0	5.4	8.5	7.5	258.4	7.5	
QTR 3	329.4	400.3	477.5	358.5	367.0	5.4	7.8	6.0	8.5	7.5	262.7	7.5	
QTR 4	333.3	403.2	483.9	363.1	371.3	5.5	7.5	6.2	7.9	7.2	266.6	7.2	
1985 QTR 1	341.5	406.2	492.5	364.7	375.0	5.9	7.3	6.0	6.8	6.6	269.7	6.5	
QTR 2	349.5	426.6	500.2	376.4	386.8	6.5	7.3	6.2	6.9	6.8	275.9	6.8	
QTR 3	353.9	430.1	508.4	384.5	393.5	7.4	7.4	6.5	7.2	7.2	281.3	7.1	
QTR 4	360.6	433.8	516.7	390.8	399.7	8.2	7.6	6.8	7.6	7.7	286.4	7.4	
1986 QTR 1	370.4	439.6	526.6	393.0	404.6	8.5	8.2	6.9	7.8	7.9	290.1	7.6	

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(1) THESE WEIGHTS ARE APPLICABLE TO INDICES BASED ON JANUARY 1974 = 100

JANUARY FORECAST

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TABLE 8: PUBLIC SECTOR -CURRENT AND CAPITAL ACCOUNTS - PART C

	1	2	3	4	5	6	7
	PSBR	- OF WHICH:-	- OF WHICH:-	-	- OF WHICH:-	-	-
		CG COMP	LA COMP	PC COMP	CG OWN AC BORR	LA TOT BORR	PC TOT BORR
1981	10841	10216	1249	-624	9935	583	323
1982	5190	7777	-1949	-638	3851	-565	1905
1983	9155	12237	-2588	-493	8270	-499	1386
1984	6632	8674	-1592	-450	5504	208	920
1985	7523	8805	-881	-400	5565	919	1040
1981/82	8706	7518	1020	168	6325	-115	2497
1982/83	7925	11800	-2700	-1175	7200	-499	1225
1983/84	8029	10753	-2023	-700	7053	-22	1000
1984/85	6509	8380	-1470	-400	5361	230	919
1985/86	7104	8718	-1213	-400	5158	687	1260
1981 QTR 1	2100	2262	36	-198	2706	277	-882
QTR 2	6124	5349	631	144	5179	366	579
QTR 3	2507	2683	296	-472	2290	-66	284
QTR 4	110	-77	286	-98	-239	7	343
1982 QTR 1	-35	-435	-193	594	-903	-421	1291
QTR 2	1188	1313	212	-337	1403	116	-330
QTR 3	1616	2444	-628	-200	771	10	835
QTR 4	2421	4456	-1340	-695	2581	-269	110
1983 QTR 1	2700	3587	-944	57	2445	-355	611
QTR 2	1798	2573	-574	-200	1768	-73	105
QTR 3	2263	3003	-540	-200	1978	-39	325
QTR 4	2394	3074	-530	-150	2079	-29	345
1984 QTR 1	1574	2103	-379	-150	1228	121	225
QTR 2	1957	2486	-429	-100	1692	21	244
QTR 3	1662	2174	-412	-100	1399	38	225
QTR 4	1439	1911	-372	-100	1186	28	226
1985 QTR 1	1451	1809	-257	-100	1085	143	224
QTR 2	2326	2656	-231	-100	1928	219	178
QTR 3	1924	2212	-187	-100	1381	263	281
QTR 4	1822	2128	-206	-100	1170	294	357
1986 QTR 1	1032	1722	-589	-100	678	-88	444

ALL VARIABLES ARE FINANCIAL YEAR SEASONALLY ADJUSTED

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TABLE 9: MONEY SUPPLY COUNTERPARTS TABLE

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4				5	6	7	8	9	10	11	12	13	14
	SALES OF PUB. SECTOR DEBT TO NON BANKS								BANK LENDING PRIV. SECTOR	DOM COUNTER -PARTS	NET EXTE- RNALS	NON- DEP LIABS	RES.	INCR. IN £M3	% CHG £M3		
	PSBR	GILTS	NATSAV	T+LA BILLS	LA DEPOSITS	CTDS	OTHER										
1981	10581	7658	4003	38	-492	-94	-209	11115	10792	190	1575	506	9913	3.13			
1982	4922	6906	3654	43	-782	968	-333	18625	13091	-2171	2409	-575	7936	2.24			
1983	9166	5972	2494	-41	-943	218	1	14056	15521	-1750	2575	498	11694	2.96			
1984	6646	4413	1823	-32	-300	-135	0	11701	12578	-1474	2125	-14	8965	2.06			
1985	7523	5488	1822	18	-132	414	0	12753	12666	-1349	1800	0	9517	2.02			
1981/82	8695	6570	4048	62	-144	401	-45	14864	12667	-1077	1472	468	10586	3.24			
1982/83	7686	5973	2793	200	-1500	710	-94	16145	15749	-2788	2930	-81	9950	2.74			
1983/84	8029	6108	2498	-68	-600	-27	2	13632	13748	-1762	2500	1	9487	2.33			
1984/85	6509	4836	1640	-11	-200	131	-1	11891	12005	-1369	1900	-1	8735	1.97			
1985/86	7104	5251	1841	28	-107	261	0	13166	12996	-1463	1800	1	9734	2.03			
1981 QTR 1	2047	2681	1439	-181	-123	-70	-403	2062	766	1384	282	-172	1696	2.24			
QTR 2	5859	2098	1273	-130	1	-124	400	800	3141	-101	466	445	3019	3.90			
QTR 3	2523	905	572	163	-41	-141	-371	3068	4504	-692	618	-96	3098	3.85			
QTR 4	152	1974	719	186	-329	241	165	5185	2381	-401	209	329	2100	2.51			
1982 QTR 1	161	1593	1484	-157	225	425	-239	5811	2641	117	179	-210	2369	2.77			
QTR 2	1016	1054	418	-114	-72	-91	-65	3343	3229	-1436	398	437	1832	2.08			
QTR 3	1459	3159	631	376	-442	589	-29	5310	2485	-427	782	-11	1265	1.41			
QTR 4	2286	1100	1121	-62	-493	45	0	4161	4736	-425	1050	-791	2470	2.71			
1983 QTR 1	2925	660	623	0	-493	167	0	3331	5299	-500	700	284	4383	4.68			
QTR 2	1731	1685	630	-11	-150	-18	0	3589	3184	-171	625	67	2455	2.51			
QTR 3	2172	1150	615	-20	-150	116	1	3419	3879	-549	625	92	2797	2.79			
QTR 4	2338	2477	626	-10	-150	-47	0	3717	3159	-530	625	55	2059	2.00			
1984 QTR 1	1788	796	627	-27	-150	-78	1	2907	3526	-512	625	-213	2176	2.07			
QTR 2	1907	1132	382	1	-50	-83	-1	3216	3742	-91	500	49	3200	2.98			
QTR 3	1562	1636	446	-4	-50	-92	1	2693	2318	-419	500	100	1499	1.35			
QTR 4	1389	849	368	-2	-50	118	-1	2885	2992	-452	500	50	2090	1.86			
1985 QTR 1	1651	1219	444	-6	-50	188	0	3097	2953	-407	400	-200	1946	1.70			
QTR 2	2276	1700	502	7	-32	161	0	3245	3183	-71	500	50	2662	2.29			
QTR 3	1824	1297	455	8	-25	35	0	3486	3540	-440	500	101	2701	2.27			
QTR 4	1772	1272	421	9	-25	30	0	2925	2990	-431	400	49	2208	1.82			
1986 QTR 1	1232	982	463	4	-25	35	0	3510	3283	-521	400	-199	2163	1.75			

COL 1 CALENDAR YEAR SEASONALLY ADJUSTED
 COL 2 COMPRISES GILTS, LONG TERM LA DEBT AND PC DEBT
 COL 4 COMPRISES TREASURY BILLS, LA TEMPORARY DEBT AND OTHER CG DEBT
 COL 9 = COL1-COL2-COL3-COL4-COL5-COL6-COL7+COL8

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ECON POL.

Prime Minister²



MS 21/1

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Michael Scholar Esq
Private Secretary
10 Downing Street
LONDON
SW1

MS

21 January 1983

Dear Michael

... I am enclosing a copy of the latest Pay Brief.

Copies also go to the Private Secretaries to Members of E, E(PSP) and E(EA).

Yours Sincerely

Felicity Everiss

MS F M EVERISS
Private Secretary

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PAY BRIEF: POSITION IN MID-JANUARY

SETTLEMENTS

1981/82 PAY ROUND

1 In the National Health Service, 2-year agreements have now been reached for all of the major groups, including Nurses and Midwives (1 April - 482,600) averaging 12.3% from 23 August 1982, Ancillaries (1 April - 211,800) and Ambulancemen (1 April - 18,100) averaging 6% from 1 April 1982 with a further 4½% from 1 April 1983.

2 After taking account of delayed settlements the revised cumulative average level of settlements in the 1981/82 pay round for the whole economy is just under 7%. The average in the public sector is just under 7% (trading just under 7½% and services just over 6½%) and in the private sector is 7% (manufacturing just under 6½% and non-manufacturing just over 7½%).

1982/83 PAY ROUND

3 Since the December pay brief 105 settlements covering 1,212,000 employees have been recorded. In the private sector (96 settlements covering 267,000 employees) the weighted average level of settlements in the last month is just under 6%. The average in the public sector (9 settlements covering 945,000 employees) is just over 4½%. Important settlements in the private sector are Vauxhall Motors (15,600) at 8.7%, Multiple Baking Production (20,000) at 7.0% and Philips Industries staff (15,000) at 5.2%. The principal settlements in the public sector are NHS nurses and midwives (482,600) and NHS ancillaries (211,800) at 4.5% and Coalmining staff (47,000) at 6.5%.

4 The 4.8% increase in national minimum rates for workers in Engineering (1 November - 1,500,000) has been ratified by both parties. (The National Engineering Agreement is excluded from the average settlement figures as pay, in general, is set by domestic agreements negotiated throughout the year.)

5 The cumulative average level of settlements for the whole economy this round (299 settlements covering 2,788,000 employees) is 5½%. Just over 20% of employees about whom the Department expects to receive information have reached settlements.

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6 In the private sector the cumulative average is 5½% (288 settlements covering 1,517,000 employees). The average for manufacturing is just under 5½% and for non-manufacturing is 5½%. On average, settlements are about 1% below those agreed in the same period last year. About 9/10 of settlements and of employees are in a 4% to 8% range, with about ½ of settlements and 4/5 of employees at 5% to 6%.

7 In the public sector (11 settlements covering 1,271,000) the cumulative average is 5½%. The average in the public trading sector is 6½% (Coalmining) and in the services sector is just under 5½%.

8 Coverage: The limitations of the Department's coverage of settlements were explained in the September pay brief (para 14).

9 The only Wages Council agreement since December is for Retail non-Food (512,800) at 8%. Twelve Wages Councils covering 1,835,600 employees have either made or decided to make orders to come into effect during the current pay round. The weighted average increase in representative minimum rates is just under 6%, with manufacturing at just over 5% and non-manufacturing about 6%. If these are added to settlements for this round, using rates as a proxy for earnings and DE estimates for the numbers of workers affected, the cumulative average for the private sector is a little higher at just over 5½%, with manufacturing unchanged at just under 5½% but non-manufacturing slightly higher at just over 5½%.

NEGOTIATIONS

10 In the PUBLIC SECTOR, ASLEF rejection of the British Rail offer of £5 per shift (unconsolidated) additional responsibility payment for driver - only operation on the Bedford/St Pancras line is holding up an increase of 6% from 6 September 1982 for British Rail clerical and conciliation grades (19 April 1982 - 136,000), recommended by the Railways Staffs National Tribunal. ASLEF are referring the offer to arbitration. For the 1982/83 pay round, United Kingdom Atomic Energy Authority manuals (1 October - 4,760) are considering an improved offer of about 3¼% on average earnings. The claim is for a substantial increase.

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A meeting has been arranged for 3 February. Water Service manuals (7 December - 29,400) have rejected a 4% offer and balloted in favour of strike action - due to begin on 24 January. The claim is for a substantial increase (about 15%) to bring them into line with the upper quartile of manual earnings generally, also a 1 hour reduction in the working week and a further 1 week holiday. The Employers have referred the case unilaterally to ACAS. ACAS is holding informal talks with both parties. Unions for Gas Supply manuals (16 January - 41,600) are considering an offer of just under 4% on earnings. The claim is for a substantial increase, reduction in hours, extra holidays and other benefits - estimated by the unions to be worth 13% overall on average earnings. A meeting has been arranged for 21 January. Electricity Supply manuals (20 March - 90,000) have submitted a claim for a substantial increase, reduction in hours, earlier retirement and other benefits. An offer is expected to be made on 3 February. A claim for a 9.5% increase has been submitted for British Steel employees (1 January - 103,700). The Chairman of BSC has stated that the industry cannot afford a national increase but there may be scope for local productivity bargaining. The TUC Public Services Committee has agreed to present claims with 'common core' elements of at least 8% for public service groups, against a government cash provision of 3½% for settlements. Unions representing Local Authority manuals (4 November - 1,022,930) are to consult members on a 4½% offer and are expected to reply by 11 February. Civil Service (1 April - 500,000) unions have submitted a claim for a substantial increase with a flat rate increase of £12 per week on salaries up to £6,264 per annum, a minimum wage of £85 (18 and over) and a 35 hour week. Teachers E&W (1 April - 452,000) have submitted a claim for a substantial increase, permanent pay determination machinery within the Burham framework and other benefits.

11 In the PRIVATE SECTOR, claims have been presented for increases of at least 8% for London Clearing Banks Staff (1 April - 170,000). Management are expected to reply on 4 February. Unions representing Newspaper Publishers Association, printworkers (1 January - 33,000) are expected to put an improved offer of 4% on earnings to ballots of their members with recommendations to accept. A 5% offer to Guardian Royal Exchange staff (1 January - 8,700) has been rejected and a failure to agree has been recorded. Negotiations are continuing. The claim is for increases of 10% - 15% and 1 extra day holiday.

/In the Heating

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In the Heating and Ventilating Industry (1 February - 32,500) unions are consulting their Executive Committees on an offer of about 6%. The claim is for parity with the electrical and plumbing craft rate of £3 per hour - an increase of 17½% - plus extra holidays. A meeting has been arranged for 24 January. Negotiations in Road Haulage (1 January - 60,000) are continuing in 15 of the 21 areas on offers ranging from 0% to 5%. Four areas have already accepted increases of 3.3% to 5.8%. Industrial action is still being threatened in Scotland, South Wales and Metropolitan and South East. The claim is for £100 per week basic rate, a 35 hour week and 5 weeks holiday - estimated to cost about 40% overall. Most of the oil companies have now made offers to Oil Tanker Drivers (1 November - 7,500). Shop stewards at 3 major oil companies - Texaco, Shell and BP - have voted against putting offers of 6.4% to 7.0% on rates to ballots of members. The companies are not prepared to re-negotiate the offers. The claim is for a 14.5% increase. Petrofina (300) have accepted 7% on earnings and Total (300) 7.05% on rates.

PRICES AND EARNINGS

PRICES

12 In December the year on year increase in retail prices was 5.4% compared with 6.3% in November.

EARNINGS

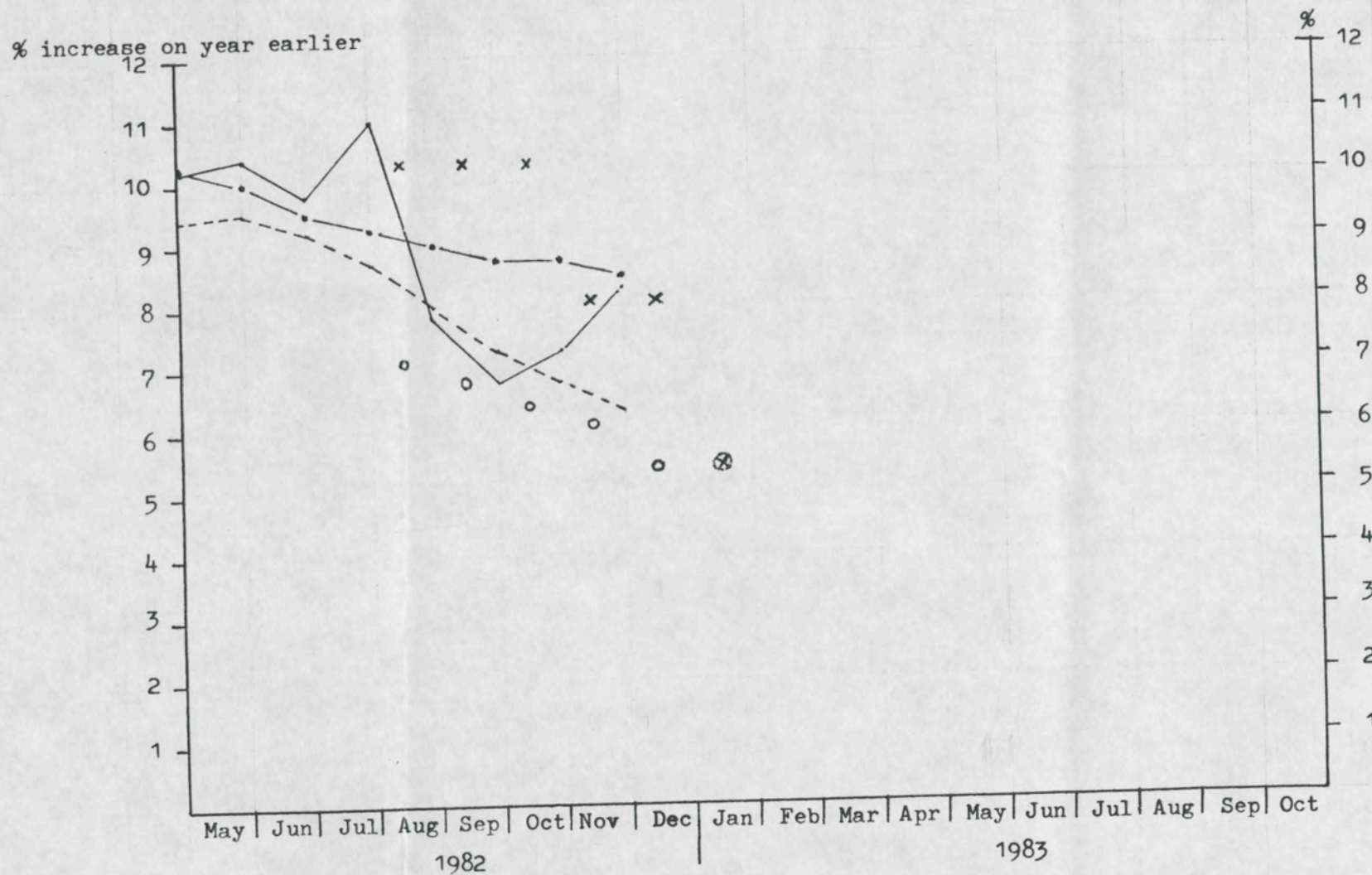
13 In November the year on year increase in average earnings for the whole economy was 8.3% compared with 7.3% in October. The November increase was affected by a number of temporary factors, notably back-pay in local government and the variation in the timing of annual settlements, the net effect being to slightly depress the actual increase. The underlying increase in November was 8½%; this continues the downward trend in the underlying increase which was 8¾% in October, having fallen steadily from 11% in January 1982.

REAL DISPOSABLE INCOME

14 Real disposable income - taking account of the changes in earnings, prices and taxes - of a married man on average adult male earnings with a non-working wife and two children under 11 (with no other tax liabilities or allowances and not contracted out of the State Pension Scheme) remained at the same level in the 3 month period ending November 1982 as in the corresponding period last year.

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TRENDS IN EARNINGS AND PRICES



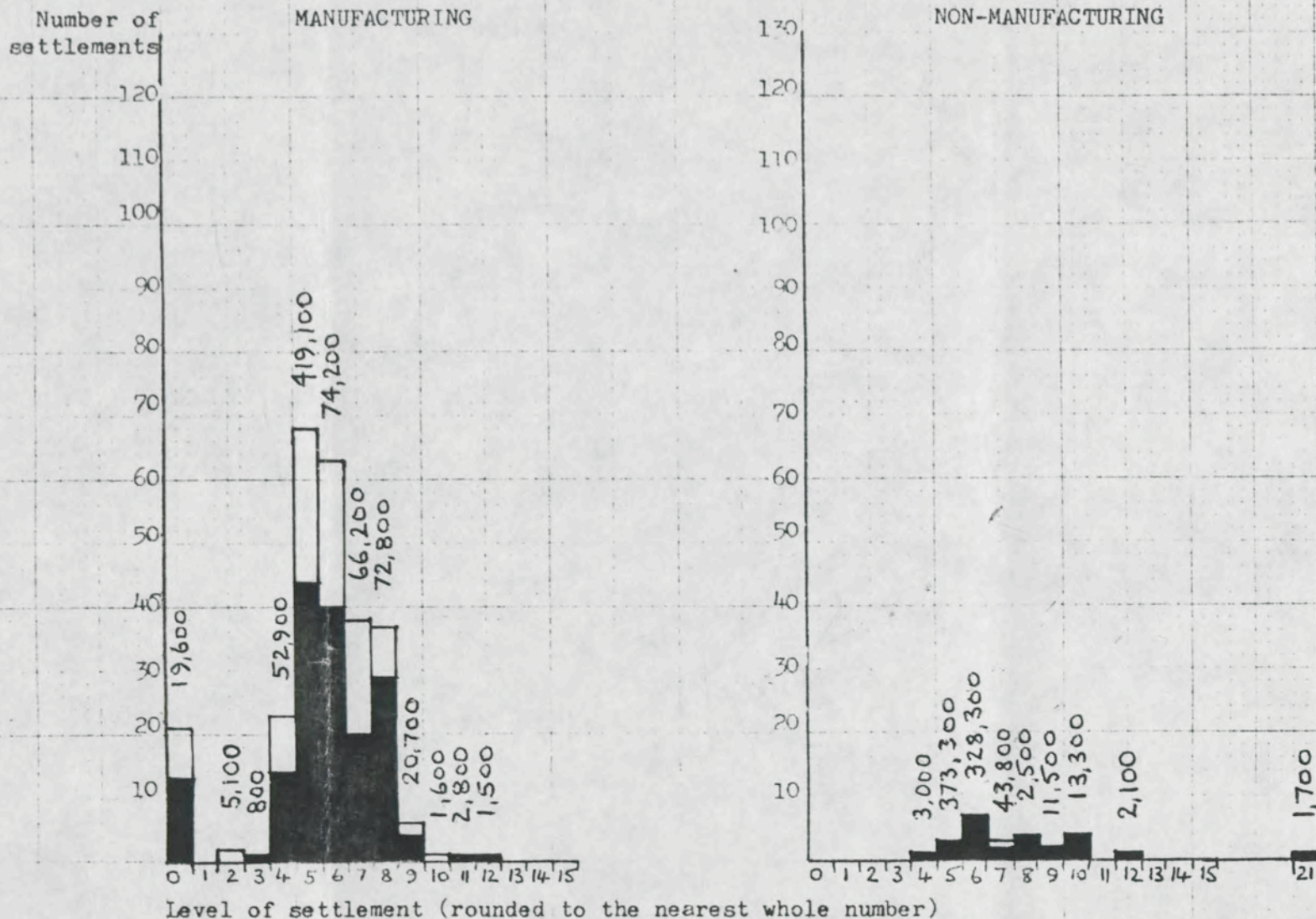
----- Retail Price Index
 _____ Average Earnings Index
 •—• Underlying rate of increase in earnings
 x Cumulative Average Increase in Earnings
 Public Sector Settlements
 o Private Sector Settlements

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DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1982

APPENDIX 2

KEY SETTLEMENTS UP TO THE LAST PAY BRIEF
 SETTLEMENTS SINCE THE LAST PAY BRIEF



NOTE - THE NUMBER OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

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PART 20 ends:-

HM/T to O/R 18/1

Note: Part 20 destroyed
at review

PART 21 begins:-

Employment to MCS + alt
21/1

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