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ECONOMIC PROGRESS REPORT, OCTOBER ISSUE

The public sector borrowing requirement (PSBR) is an important indicator of how government policies are affecting the rest of the economy and in particular financial markets and the money supply. As part of its strategy to reduce inflation and monetary growth, the Government is planning for a substantial reduction over the medium-term in the PSBR as a percentage of the gross domestic product.

The leading article in the October issue of 'Economic Progress Report' describes the PSBR, shows how it has grown and how its composition and financing have changed since 1963, and describes its relationship to the money supply. It is based on an article recently published in 'Economic Trends' by the Central Statistical Office.

A short feature on page 3 explains why the PSBR in the current financial year is more than usually 'front-end loaded' - ie. it is being concentrated in the early part of the year.

Other material in this issue includes Developments in economic policy, a centre-page feature listing Government economic measures in the period March to September 1980 (pages 4 and 5), and the Treasury's latest Monthly economic assessment (pages 7 and 8).

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01-233-3415

156/80

Economic Progress Report

Published by the Treasury

No. 126 October 1980

Public sector borrowing requirement

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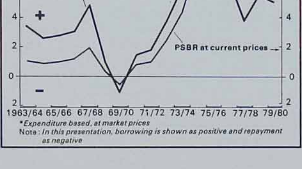
This article first describes the PSBR, then shows how it has grown and how its composition and financing have changed since 1963, and finally describes its relationship to the money supply. It is based on an article recently published by the Central Statistical Office*.

Public sector borrowing

The PSBR indicates the extent to which the public sector borrows from other sectors of the economy and overseas to finance the balance of expenditure and receipts arising from its various activities. The public sector comprises central government, local authorities and public corporations. The borrowing requirement of the whole public sector is important because government financial control extends over the whole sector, both through the public expenditure programmes and, on the financing side, through the central government's borrowing to meet not only its own needs but also a large part of those of the rest of the public sector. In return for access to funds through the central government, the rest of the public sector makes any temporary surpluses available to reduce the sector's overall borrowing requirement by investing them in public sector debt rather than in other assets. The PSBR is not affected by any switching by local authorities and public corporations between borrowing from central government and from the market, for example, when borrowing in foreign currency from banks or overseas has been encouraged by central government for balance of payments purposes through the exchange cover scheme. The more limited central government borrowing requirement (CGBR) is also an important figure for the Treasury and the Bank of England, since the central government borrows in somewhat different markets from local authorities and public corporations, and their borrowing does not have the same impact on the banking system as that of the central government.

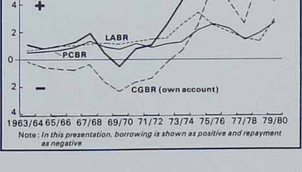
The PSBR is one of several balances struck in the national accounting system. For the public sector, as for other sectors, national accounts classify transactions into current, capital and financial accounts. Table 1 sets out a summary current, capital and financial account for the public sector in 1979-80 and shows the points at which the main balances are struck, with the borrowing requirement at an intermediate stage in the financial account. Items above the borrowing requirement line

*See 'Measuring the public sector borrowing requirement' in *Economic Trends*, August 1980, which gives a detailed explanation of how the PSBR and its sub-sector components are compiled and published.



*Expenditure based, at market prices

Note: *In this presentation, borrowing is shown as positive and repayment as negative*



Note: *In this presentation, borrowing is shown as positive and repayment as negative*

Table 1

COMPONENTS OF THE PUBLIC SECTOR: OUTLINE CURRENT, CAPITAL AND FINANCIAL ACCOUNTS 1979/80[1,2]

£ million

	General government				
	Central government	Local authorities	Total	Public corporations	Public sector
Current account					
Current saving	−398	1,213	815	4,031	4,846
Capital account					
Net capital transfers	−890	11	−879	568	−311
Gross domestic fixed capital formation	−1,537	−3,738	−5,275	−5,755	−11,030
Increase in book value of stocks and work in progress	−130	–	−130	−596	−726
Net acquisition of financial assets	−2,955	−2,514	−5,469	−1,752	−7,221
Financial accounts					
Lending to the private sector	24	−413	−389	90	−299
Purchases of company securities	310	–	310	−371	−61
Lending overseas	357	–	357	−101	256
Net trade credit	–	–	–	749	749
Receipts from unfunded pension schemes	247	–	247	–	247
Other identified financial assets	776	22	798	−633	165
Accruals adjustment	−2,314	157	−2,157	155	−2,002
Unidentified items	−705	−195	−900	−898	−1,798
Borrowing requirement (on own account)	**−4,260**	**−2,943**	**−7,203**	**−2,761**	**−9,964**
Central government direct lending to:					
Local authorities	−817	817	–	–	–
Public corporations	−3,151	–	−3,151	3,151	–
Other transactions in:					
Central government debt	8,228[3]	−10	8,218	−98	8,120
Local authority debt	–	2,122	2,122	130	2,252
Public corporation debt	–	14	14	−422	−408

[1] Consistent with *Financial Statistics*, July 1980.
[2] *Sign convention*: In this presentation, inflows are treated as positive, outflows as negative. Over the whole account, total inflow equals total outflow. The balances (net acquisition of financial assets and own account borrowing requirement) are struck by adding downwards. They therefore equal the total of the remaining inflows and outflows below them, but with opposite sign.
[3] The CGBR, i.e. the central government's borrowing to finance its own account borrowing requirement (−4,260) and also its on-lending to local authorities and public corporations (−817 and −3,151).

(approaching it from the current and capital account) are regarded as determining the size of the borrowing requirement, and items below as financing it, accommodating to its otherwise determined size.

The borrowing requirements shown in Table 1 are those *on own account*. For local authorities and public corporations these are indeed their borrowing requirements (LABR and PCBR respectively) but the CGBR and the general government (ie central government *plus* local authorities) borrowing requirement (GGBR) are in fact defined as including borrowing to finance direct on-lending to other parts of the public sector. The GGBR thus includes direct on-lending to public corporations and the CGBR includes direct on-lending to local authorities and public corporations. For local authorities and public corporations, the totals of the items below the borrowing requirement line other than their direct borrowing from central government are termed their *contributions* to the PSBR. There are therefore two ways of looking at the components of the consolidated PSBR and these are shown in Table 2.

Changes in the PSBR since 1963

The charts show the growth of the PSBR and changes in its composition and sources of finance since 1963, the earliest year for which data are available on current definitions.

Chart 1 compares the PSBR at current prices with the PSBR as a percentage of gross domestic product (GDP). In money terms the PSBR fluctuated relatively little from 1963-64 to 1971-72 (though it was negative, ie a net repayment, in 1969-70) but then rose sharply until 1975-76; it fluctuated after that but remained higher than at any time in the previous ten years. The PSBR as a percentage of GDP is in many ways a more useful measure of the changes over time, not least because it makes some allowance for inflation. It fluctuated rather more widely than the PSBR in money terms in the earlier years, and rather less in the later years, but it still showed a pronounced rise from 1971-72 to 1975-76, when it reached nearly 10 per cent of GDP; and although it fell after 1975-76, it remained generally above the levels of before 1972-73.

Table 2

COMPONENTS OF THE PSBR, 1979/80

More usually	*£ million*	*Alternatively*	*£ million*
CGBR	8,228	CG own account borrowing requirement	4,260
LA contribution	2,126	LABR	2,943
GGBR	10,354		
PC contribution	−390	PCBR	2,761
PSBR	9,964	PSBR	9,964

THE UNEVEN PATH OF THE PSBR

The forecast of the public sector borrowing requirement (PSBR) for the current financial year, published in the *Financial Statement and Budget Report* at the time of the Budget on 26 March, was £8½ billion.

The PSBR for the April-June quarter was £4.8 billion. This first quarter figure is, however, no guide to the likely outcome for the financial year as a whole. There are a number of irregular factors that are particularly important in the current financial year which result in borrowing being more than usually 'front-end loaded' – ie it is being concentrated in the early part of the year. These irregular factors include:

(i) the change in timing of receipts of petroleum revenue tax. This tax is now payable in September and March. Over £1 billion was received on 1 September and the effect of this will be reflected in the PSBR figures for the second quarter of the financial year.

(ii) Defence expenditure was unusually high in the first quarter and is now being reined back.

(iii) Most of the receipts from the special sales of assets are expected towards the end of the financial year.

(iv) Refunds arising from the 30 May agreement on the UK contribution to the European Community Budget will also occur towards the end of the financial year.

Some of these and other special factors also made last year's PSBR 'front-end loaded'. The high PSBR so far is similar to last year's pattern, when the PSBR was high in the first three quarters of the financial year and was substantially negative in the final quarter. The table below shows the quarterly figures of the PSBR and its components during the last two financial years and in the first quarter of the current year.

PUBLIC SECTOR BORROWING*

£ million

	Central government (own account)	Local authorities	Public corporations	Total public sector
Quarters				
1978 2nd qtr	2,066	83	68	2,217
3rd qtr	1,567	221	509	2,297
4th qtr	2,419	86	713	3,218
1979 1st qtr	−86	900	651	1,465
2nd qtr	2,684	270	391	3,345
3rd qtr	1,845	645	1,335	3,825
4th qtr	2,117	472	1,340	3,929
1980 1st qtr	−2,416	1,556	−339	−1,199
2nd qtr	3,275	600	1,035	4,910
Financial years				
1978-79	5,966	1,290	1,941	9,197
1979-80	4,230	2,943	2,727	9,990

*Not seasonally adjusted, consistent with *Financial Statistics*, September 1980.

Chart 2 shows that, compared with central government own account borrowing, the LABR and the PCBR have been relatively steady since 1963-64 though both fluctuated more after 1972-73 than in the earlier years. Central government own-account borrowing, in contrast, varied widely over the whole period. It was negative from 1963-64 to 1972-73 and positive since then, with fluctuations superimposed on this underlying shift. The PSBR has generally varied in step with the large changes in the central government component.

The PSBR is financed in three main ways; by sales of debt to the public outside the banking system (for example, gilts, national savings, local authority stocks and bonds); by external transactions (ie transactions with residents of other countries) which include not only government borrowing but also changes in the official reserves; and by borrowing from the banking system. Chart 3 shows changes in the sources of finance for the PSBR by lending sector. The main features are the increasing importance from about 1970-71 of borrowing from the non-bank private sector (mainly 'other financial institutions' and persons) and the pronounced net repayments to overseas in 1969-70 to 1971-72 and again in 1977-78, when there were sharp increases in the official reserves.

continued on page 6

READERS' ENQUIRIES

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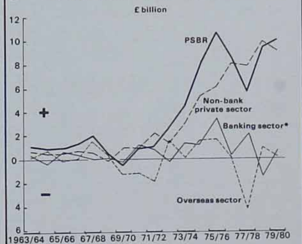
3 SOURCES OF FINANCE FOR THE PSBR



*Includes foreign currency borrowing from banks
Note: *In this presentation, both borrowing and its financing are shown as positive, repayment and its counterparts as negative*

DEVELOPMENTS IN ECONOMIC POLICY

Date	INDUSTRY	EMPLOYMENT, INCOMES, PRICES	HOME FINANCE	OVERSEAS FINANCE
3.3.80		*Youth Opportunities Programme* expansion for 80-81 announced by Manpower Services Commission.		
20.3.80			Green Paper on *Monetary Control* published.	
26.3.80 Budget	Scheme to allow income tax relief on certain losses on equity investments in small companies; ending of certain close company restrictions; extension of relief for interest on borrowings to invest in close companies; reduction in 'small companies' rate of corporation tax to 40% and 100% capital allowances for construction of small industrial buildings. *Enterprise Zones* scheme announced. *Stock relief:* one year deferral of certain recovery charges. Changes in allowances for expenditure on certain kinds of *leasing*. *PRT* raised from 60 to 70%, and payments *advanced*.	*Pensions* to be raised in November to £43.45 (married), £27.15 (single). £10 *Christmas bonus* for pensioners and others. *Family Income Supplement* to be improved. *Short-term benefits* and *invalidity benefit* to be raised in November by 5% less than forecast prices rise. *Earnings Related Supplement* to be reduced from January 81 and abolished January 82. *Child Benefit* to be raised in November to £4.75, lone parent's premium to £3. *Mobility allowance* to be raised to £14.50 in November. *Supplementary benefit to strikers' families* to be reduced, and taxed in due course.	*Medium-term financial strategy* published, charting reduction in monetary growth to around 6 per cent by 83-84. *Monetary policy:* target for sterling M3 growth of 7-11 per cent (annual rate) for mid-February 80 to mid-April 81. *Income Tax:* increased personal allowances, abolition of 25% lower rate, raising of higher rate thresholds, indexation of higher rate bands and investment income surcharge from 81-82, reduction of relief on insurance premiums to 15% from April 81. *CTT:* threshold doubled to £50,000. *Indirect taxes:* excise duties raised.	
31.3.80			*National Heritage Act* received Royal Assent.	
1.4.80		*National Insurance Contributions* increased. *Prescription charge* rose to 70p.	National Debt Office and Public Works Loan Board merged to form *National Investment and Loans Office*.	
2.4.80		Green Paper *Income during Initial Sickness — a New Strategy*.		
3.4.80	*Competition Act* received Royal Assent.		*Education (No 2) Act* received Royal Assent.	
29.4.80				Ending of mandatory foreign currency financing of *export credit contracts* involving finance of £5m or more.
1.5.80	*British Aerospace Act* received Royal Assent.			
13.5.80			*Civil service staff cuts* to 630,000 by April 84 announced.	
14.5.80				Agreement on increases from 1 July in international minimum interest rates for officially-supported medium and long-term *export credits* (½% for poorer countries, ¾% for others).
23.5.80		*Social Security (No 1) Act* received Royal Assent.		
30.5.80				EC Foreign Affairs Council agreed on reduced *UK net contribution to EC Budget*. The Agricultural Council agreed on 5% *farm price* increases and new arrangements for *sheepmeat*.
13.6.80		*Local authorities* in England and Wales requested to review 80-81 budgets so as to cut real expenditure to 2% below 78-79 expenditure.		
18.6.80			End of *Supplementary Special Deposits Scheme* ('corset').	
19.6.80	Statement of plans for *gas-gathering pipeline* in North Sea.			
19.6.80	Measures announced to help *areas hit by steel industry cuts*.			
27.6.80				Agreement announced on *debt settlement with Zimbabwe*.
30.6.80	*Industry Act, Transport Act*, received Royal Assent.			
1.7.80	Announcement that Government to provide £42.5m to *Harland and Wolff* in 80-81, review structure and management policy, etc.			
3.7.80			*MLR* cut from 17% to 16%.	
7.7.80		PM announced salary increases (less than proposed in Top Salaries Review Board's report) for *senior public servants, ministers and MPs*.		
14.7.80	Announcement of intention to inject private capital into *British Rail subsidiaries*.			Announcement that *HMG $1.5bn Eurodollar loan* to be prepaid during 1980.
16.7.80	*Post Office:* proposal to relax postal monopoly announced.			
17.7.80		Social Security (No 2) Act *received Royal Assent*.	Announcement of committee set up to review enforcement powers of *Inland Revenue* and *Customs*.	
21.7.80	*Post Office:* proposal to relax telecommunications monopoly announced.			
21.7.80	*Electricity supply:* Intention to end monopoly announced.			
21.7.80	Announcement of intention to legislate to allow introduction of private capital into *British Transport Docks Board*.			
23.7.80	*Oil depletion policy:* some production to be deferred from 80s.		Announcement of intention to reorganise *NHS* administration, including abolition of Area Health Authorities in England.	
29.7.80	Announcement of names of 7 *Enterprise Zones;* and £25m for Inmos micro-chip factory in South Wales.			
1.8.80		Employment Act received Royal Assent.	*Finance Act* received Royal Assent.	
4.8.80	Announcement of more flexible financial control of *nationalised industries*.	Announcement that *Clegg Comparability Commission* to be abolished, *Review Bodies* to be retained.		
7.8.80	*National Freight Corporation:* decision announced to incorporate as the National Freight Company on 1 October, as first step towards privatisation as soon as possible.		Announcement that *local authorities* in England and Wales expected to plan for volume of current expenditure in 81-82 2% below targets set for 80-81.	
8.8.80	*Coal Industry Act* received Royal Assent.	*Health Services Act* received Royal Assent.	*Housing Act* received Royal Assent.	
2.9.80				Announcement of final repayment on 1977 *IMF* standby.
9.9.80			*National Savings:* Announcement that new index-linked certificate to be issued to holders of 60 or over; limits on monthly payments on index-linked SAYE to be raised.	
18.9.80			Announcement that revised budgets of local authorities in England and Wales for 80-81 still 2.6% above level requested. Proposals to reduce grant by £200m in consequence.	

Table 3

PSBR, STERLING M3, AND THE BANKING SECTOR BALANCE SHEET

PSBR		Banking sector: net increase in: Total assets	Total liabilities		Sterling M3
Sterling borrowing from banks	a	Sterling lending to public sector	Sterling deposits of UK residents	d	UK residents' sterling bank deposits
–	b	Sterling lending to non-bank private sector	Sterling deposits of overseas residents		–
–		Sterling lending to overseas residents	Foreign currency deposits	e	–
		Foreign currency lending:	Net non-deposit liabilities		
Foreign currency borrowing from banks	c	Public sector			–
–		Other			–
Borrowing from the non-bank private sector:					
Notes and coin					Increase in notes and coin in circulation
Other					–
Borrowing from overseas and other foreign currency borrowing					–
Total PSBR					Total increase in sterling M3

The PSBR's link with money supply

The relationship, in accounting terms, between the PSBR and sterling M3, the measure of the money supply to which the government's target relates, can be seen by arranging the balance sheet of the banking system and details of public sector financing as in Table 3†.

In Table 3 the balance-sheet relationship determines that:

$$a + b + c = d + e$$

In purely accounting terms, it can be seen from the table that public sector borrowing from banks (a) represents an increase in the banking sector's total assets which will in turn generally tend to be reflected in changes in UK residents' sterling bank deposits (d), the major component of sterling M3. This accounting relationship does not, however, carry any implications for economic behaviour. In particular, when the PSBR, or any other individual item in the relationship, changes this may well be accompanied by changes in other items so that the effect on the money supply is not one for one. For instance, an increase in the PSBR may be accompanied by an increase in private sector financial wealth leading possibly to more purchases of public sector debt by the non-banks and perhaps to lower bank lending to the private sector, and these will influence the net effect on sterling M3. The relationship between the PSBR and sterling M3 will also depend critically on the level and structure of interest rates and hence on the monetary policy being pursued.

†More detailed descriptions, including the accounting link with domestic credit expansion (DCE), are given in, for example, the article 'Monetary policy and the economy' in the July 1980 issue of *Economic Progress Report*, an article 'DCE and the money supply – a statistical note' in the March 1977 issue of the *Bank of England Quarterly Bulletin*, and the 1980 edition of *Financial Statistics Explanatory Handbook*.

National income

The 1980 edition of the annual 'Blue Book' – ***National Income and Expenditure*** **– was recently published by the Central Statistical Office (HMSO, price £10.50). It contains statistics of national income, expenditure and output for the years 1969 to 1979. In addition, the main summary tables go back to 1958 on a consistent basis.**

The *gross national product* (the total income of all UK residents) amounted to £164 billion in 1979, compared with £145 billion in 1978. The average per head of the population was about £2,930. *Gross domestic product at factor cost* (the total value of goods and services produced in the UK excluding taxes on expenditure) rose by 14 per cent between 1978 and 1979. After allowing for the effects of inflation, the real increase in GDP (at 1975 prices), shown by the average of the three measures (income, expenditure and output), was 1½ per cent, lower than the rise of 3 per cent in the previous year. Excluding North Sea oil and gas, the increase was only ½ per cent.

Total personal income (income from employment and self-employment, investment incomes and government grants) increased 17 per cent before tax between 1978 and 1979. As a result of the cuts in personal taxation in 1979, *personal disposable income* rose by rather more than this, by 18½ per cent. *Saving* in 1979 was 14 per cent of disposable income, about 2 per cent higher than the average of the previous three years.

After allowing for the effects of price changes, *real personal disposable income* rose by 6 per cent. This increase follows the even larger increase, of 8 per cent, recorded for the previous year. This is only the second case since 1945 of a rise of 14 per cent or more over two years, the previous occasion being between 1971 and 1973.

In 1979, total *consumers' expenditure* amounted to about £115 billion – £2,050 per head of the population. Over the ten-year period 1969-79, the share of expenditure on food, clothing and footwear and tobacco fell, while that on housing, alcoholic drink, buying and running motor vehicles all rose.

Profits of industrial and commercial companies, excluding North Sea oil companies and after deducting stock appreciation, showed little change in 1979, while income from employment rose 17 per cent. North Sea oil and gas companies doubled their profits, net of stock appreciation, between 1978 and 1979, and their share of industrial and commercial companies' profits rose from 12 per cent to 22 per cent.

Monthly Economic Assessment

Prepared by the Treasury on the basis of data available up to 26 September 1980*

- Recent months have seen smaller price increases, which have progressively lowered the year-on-year level of price inflation.
- The volume of exports continues to be flat. There was a surplus on visible trade in August for the third consecutive month.
- Output fell sharply in the second quarter. Unemployment continued to rise rapidly in September.
- Partly because of the unwinding of distortions caused by the 'corset', money supply has been growing above the target range.

Monetary developments

Money supply on the broad definition, sterling M3 (notes and coin in circulation plus UK residents' sterling bank deposits) increased by £1.8 billion (2.9 per cent) in the banking month of August. Like last month, this month's figures were distorted by the ending of the supplementary special deposit scheme (the 'corset'). This makes it difficult to assess the underlying rate of growth, but the best estimate at present is that in both the banking months of July and August it was 1-2 per cent.

The large central government borrowing requirement of just over £2 billion was a major contribution to the increase in the money supply. Net purchases of central government debt by the non-bank private sector, at about £1.2 billion, were also large and offset a substantial part of the borrowing requirement. Bank lending in sterling to the private sector in the banking month of August amounted to £860 million.

Extensions to index-linked National Savings schemes were announced on 9 September. These are intended to offset the declining contribution of National Savings to financing the PSBR over the last year and a half compared with the levels achieved in the previous two and a half years. The changes are expected to raise an additional £1½ billion towards financing the PSBR during the remainder of the financial year, and will ease the pressure on the gilt-edged market and hence on long-term interest rates.

Interest rates in the UK fell somewhat during September but remained broadly stable in the USA and Europe. The interest differential in favour of the UK thus remained substantial. The 3-month inter-bank rate has fallen about 1 per cent since the beginning of the month to around 15¾ per cent on 23 September, while the one-year rate fell slightly more over the same period to $13\frac{7}{8}$ per cent. The **gilts market** has been generally firm during September on continued expectations of a reduction in MLR, with yields falling about 1 per cent at the short end (5 years) and by around ½ per cent at the long end (20 years) by 23 September. A new stock (£1,300 million Exchequer 12 per cent 1998 'A') was announced on 12 September.

Gross domestic product

The output measure of **GDP**, usually considered to be the best indicator of short-term movements, fell by about 2 per cent between the first and second quarters of 1980, reflecting the widespread fall in private domestic demand.

On the expenditure measure, GDP showed a decline during the second quarter of 2½ per cent at constant market prices. Consumption was down in the second quarter, reflecting the pre-Budget boost to sales in the first quarter. Gross domestic fixed capital formation declined slightly, but within the aggregate figures public sector investment increased. Public expenditure on goods and services was broadly unchanged. The reduction in the level of stocks continued during the second quarter. During 1980 the volume of exports of goods (excluding erratic items) has been maintaining a broadly flat profile; but import volume (excluding erratic items) was down 4 per cent during the first half of 1980 compared with the second half of 1979.

Company sector

Industrial production fell by 2 per cent in the three months to July compared with the previous three months (February-April); manufacturing output fell by nearly 2½ per cent in the same period. Within manufacturing nearly all sectors have recorded falls in output, most notably chemicals (down by 8 per cent). Taking the first seven months of the year together, which to some extent eliminates the impact of industrial disputes in 1980, industrial production for this period was some 4 per cent, and manufacturing output some 5½ per cent, lower than the average level in 1979. Output of the construction industry fell by about 4½ per cent during the second quarter. Output of North Sea oil and gas so far during 1980 has remained at much the same level since the second quarter of 1979.

Employment in the index-of-production industries fell by 87,000 between June and July. The fall in employment has been concentrated in manufacturing industry. In the first seven months of 1980 manufacturing employment has declined by 4 per cent compared with the average for 1979. Productivity in manufacturing is thus holding up in the face of declining output, and indicates that firms are shedding labour rapidly in order to alleviate their financial pressures. This rapid fall is responsible for the sharp rise in unemployment.

The number of people in the UK registered as **unemployed** rose to 1,784,000 (excluding school-leavers) at the September count, a rise of 88,000 in the month. The average monthly increase in the third quarter was 83,000 compared with 41,000 in the second quarter. The number of **school-leavers**† registered as unemployed fell by 57,000 during the month. Notified unfilled vacancies were 113,000 in September, a fall of 8,000 since August.

Manufacturer's raw material costs have risen more slowly in recent months but labour costs have continued to rise rapidly. **Prices of materials and fuels**† purchased by manufacturing industry fell by ¼ per cent between July and August. The year-on-year increase in the index fell – for the fifth consecutive month – to 19 per cent in August. In the six months to August the index rose by 3¾ per cent at an annual rate, compared to an annual rate of more than 35 per cent over the previous six months. This recent rapid deceleration in costs of materials and fuels reflects the appreciation of sterling and the easing of commodity price pressures, especially on oil.

Prices for manufacturers' home sales† (wholesale prices) rose by only ½ per cent between July and August and the year-on-year increase in the index fell for the fourth consecutive month to 15¼ per cent. In the six months to August the annual rate of increase was 10 per cent. Since the beginning of this year wholesale prices have shown progressively smaller increases each month. In recent months there has almost certainly been a decline in profitability. To some extent this reflects manufacturers' attempts to maintain sales against strong competitive pressures.

Gross domestic fixed capital formation in total declined by 2 per cent in the second quarter. Within the total, the public sector element rose slightly (despite a reduction in public service and dwellings investment) because of a higher level of investment by public corporations.

Manufacturing investment was down 5 per cent in the second quarter whilst distribution and service investment was up by 3 per cent. The latter includes financial companies which lease some of the fixed assets that they own to manufacturing industry. Manufacturing, distribution and services capital formation in total remained unchanged during the second quarter, and fell by 1 per cent between the second half of 1979 and the first half of this year.

The fall in sales combined with financial pressures induced wholesalers and retailers to continue to reduce **stocks** in the second quarter. Manufacturers reduced stocks only slightly although the pattern so far

*Unless otherwise stated, all statistics quoted in this assessment are seasonally adjusted.

† Not seasonally adjusted.

this year has been distorted by the effects of the steel strike. In the first half of 1980 manufacturers, wholesalers and retailers in total reduced their stocks by £900 million (at 1975 prices), a sharp turnaround from the £350 million increase in stocks in the latter half of 1979. Even so, stock levels were still higher in relation to sales and production at the middle of the year than at the end of 1974, and indications from the CBI industrial trends survey are that stocks are still above desired levels.

Personal sector

Average earnings of employees in Great Britain are estimated provisionally to have risen by 18.8 per cent in the year to July 1980. However, this number was artificially depressed by the presence of large amounts of back pay in July 1979. The underlying increase in earnings in the year to July 1980 is estimated at 21½ per cent. Earnings are being depressed by reductions in overtime and widespread short-time working.

The tax and price index* (TPI) rose by 18.5 per cent over the same period. (In the year to August the TPI rose by 17.8 per cent.)

The earnings and TPI statistics indicate that the underlying level of real take-home pay for an individual paying the basic tax rate has increased by about 2 to 3 per cent in the year to July 1980.

Retail prices* rose by 0.2 per cent in August reflecting small price increases in most sectors and a substantial fall in the prices of seasonal foods. In the year to August the index rose by 16.3 per cent, compared with 16.9 per cent in July, and a peak annual rate of 21.9 per cent in May.

Consumers' expenditure in the second quarter fell by 2½ per cent from the high pre-Budget buying level of the first quarter. In the first half year as a whole, however, it was about 1½ per cent higher than in the latter half of 1979, and the savings ratio declined by about 1 percentage point to 14 per cent. The volume of retail sales fell by almost 2 per cent between the first and second quarters. The July and provisional August figures suggest that retail sales are about 1 per cent below the monthly average of the second quarter.

External trade and payments

The volume of **exports of goods** (excluding erratic items) in August confirms the broadly flat underlying monthly level so far this year. Exports of manufactures (excluding erratic items) have changed little, though this conceals some falls in exports of semi-manufactures, offset by a slightly more buoyant performance by some categories of finished goods. The flat volume of exports suggests that the benefit of a continuing increase in world trade has been offset by the effects of declining competitiveness. The volume of **imports of goods** (excluding erratic items) increased by 4 per cent during August but this represents a recovery from an erratically low July level. The volume of imports fell some 4 per cent between the second half of 1979 and the first half of 1980. This fall has been widely spread. There have been lower imports of fuels, and food, drink and tobacco imports have been lower, but have recently shown signs of recovery. Imports of basic materials are below their high level in the latter part of 1979, reflecting reductions in manufacturing output and stocks of materials. Imports of finished manufactures have also declined.

With the balance on **invisibles** in August projected to be £75 million, the **current account** was £138 million in surplus. The large favourable balances in July, on both oil and non-oil trade (mainly reflecting trade in erratic items) were reduced in August by around £100 million each. In the eight months to August the visible deficit was about £600 million. The current account is estimated to be in a small overall surplus so far this year after allowing for the surplus on invisible trade. This compares with the forecast published in the *Financial Statement and Budget Report* at the time of the March Budget of a £1½ billion current account deficit in the first half of 1980. The current account has benefitted not only from the favourable volume balance of imports and exports but also from improvements in the terms of trade. Export prices have risen by 2½ per cent over the three months to August, whilst import prices have declined by ½ per cent on account of sterling's strength and weakening commodity prices.

The sterling exchange rate* in the month to 26 September was broadly stable, showing a marginal decline of 0.3 per cent against the US dollar and of 0.1 per cent in effective terms. On 26 September it closed at £1 = $2.3945 and 76.1 effective (21 December 1971 = 100). Overseas investment in British gilts and holdings of sterling banking and money market liabilities increased by over £1½ billion* during the second quarter following an increase of £¾ billion* in the first quarter of 1980. At the end of August the UK's official reserves stood at $28.3 billion*, the same level as at the end of July.

†Not seasonally adjusted.

Economic indicators[1] (seasonally adjusted)

PUBLISHED MONTHLY (months or monthly averages)	Unit	1979	1979 3rd qtr	1979 4th qtr	1980 1st qtr	1980 2nd qtr	1980 June	1980 July	1980 Aug	
1. Industrial production	1975=100	112.6	112.6	112.4	110.4	106.6	107.1	106.4	–	1
2. Unemployment (excl. school-leavers)	000s	1,303.4	1,266.8	1,286.7	1,377.8	1,492.3	1,535.1	1,606.0	1,695.4[5]	2
3. " " "	% of all employees	5.4	5.2	5.3	5.7	6.2	6.4	6.6	7.0[5]	3
4. Retail sales (volume)[2]	1976=100	101.5	99.0	101.0	102.4	100.6	100.7	99.0	100.5	4
5. Exports f.o.b.[3]	£m	3,391	3,547	3,672	3,975	3,844	3,690	4,032	3,958	5
6. Imports f.o.b.[3]	£m	3,674	3,711	3,934	4,186	4,038	3,967	3,771	3,895	6
7. Balance of payments current balance	£m	–155	+2	–213	–54	–29	+80	+311	+75	7
8. £'s effective exchange rate (average for month)[4]	21.12.71=100	67.8	71.0	68.8	72.1	73.3	73.7	74.6	75.5	8
9. Official reserves[4] (end of period)	$m	22,719	22,751	22,719	26,963	28,172	28,172	28,272	28,291[6]	9
10. Money supply: Sterling M3 (end of period)	£m	55,750	54,180	55,750	56,860	58,720	58,720	61,670	63,480	10
11. Retail prices[4]	Jan 1974=100	223.5	231.3	237.6	248.8	263.2	265.7	267.9	268.5	11
12. Tax and price index[4]	Jan 1978=100	113.2	115.0	118.7	125.2	132.2	133.6	134.9	135.3	12
13. Average earnings (older series)[2]	Jan 1974=100	247.8	250.5	265.5	276.0	289.9	298.0	299.7	–	13
14. Average earnings (whole economy)[2]	Jan 1976=100	150.9	153.9	161.7	168.7	178.1	182.3	182.7	–	14

PUBLISHED QUARTERLY	Unit	1979	1979 1st qtr	1979 2nd qtr	1979 3rd qtr	1979 4th qtr	1980 1st qtr .	1980 2nd qtr	
1. Output (gdp) at constant factor cost	1975=100	110.2	108.6	112.1	109.8	110.4	109.4	107.4	1
2. Manufacturing industry's fixed capital expenditure	£m 1975 prices	3,872	964	962	969	977	948	902	2
3. Consumers' expenditure	£m 1975 prices	70,816	17,406	18,242	17,417	17,751	18,072	17,634	3
4. Balance of payments, current balance	£m	–1,863	–965	–264	+5	–639	–162	–68	4
5. Balance of payments on invisible account	£m	+1,541	+637	+261	+497	+146	+470	+233	5

1. Many of the most recent figures are provisional and may be subject to revision. 2. Excluding Northern Ireland. 3. Balance-of-payments basis. 4. Not seasonally adjusted. 5. Figures for September were 1,783,500 (7.4 per cent of all employees). 6. Figure for September was $27,637 million.

Printed in England for Her Majesty's Stationery Office by Colibri Press Ltd., London E8. Dd 8016752 130M 9/80