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MEDIUM TERM PROSPECTS AND THE FISCAL ADJUSTMENT

In my minute to you of 24th October I set out some preliminary results on medium-term prospects and compared these with the projections of outside forecasters. I warned that the prospects for the "fiscal adjustment" had deteriorated and promised a further report taking account of the public expenditure and other fiscal policy decisions. The attached note fulfils this undertaking. It is based upon the Industry Act forecast extended over the period to 1984. It will need to be updated in the New Year in line with the new forecast and little weight should be attached to specific numbers at this stage. Ideally we would have waited until the new forecast was available and presented this paper on that basis. Unfortunately that would delay an examination of these issues, even in general terms, until too far into January. We have therefore judged it right to put this note to you now although not with the intention of eliciting decisions but rather to invite you to take note of some of the potential problems that may arise. There could be significant changes to the numbers by the time we incorporate the current forecast and further work is needed in examining the government accounts. However in general the attached paper exposes the kind of problems we are likely to face in approaching the presentation of the medium term outlook.

2. The first issue is to examine the extent to which the outlook has changed since the MTFs. The principal difference is that the current recession seems to be deeper than forecast at Budget time and the level of output could be lower than expected in the MTFs throughout the period. Partly for this reason, and partly because

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of considerably higher public expenditure in cost terms the "fiscal adjustment" is likely to be smaller and later than implied in the MTF's projections. Indeed in 1981-82 some increase in personal taxes is implied to achieve a PSBR consistent with the assumed monetary target.

3. Two cases are presented in the note. Both start from the recently published Industry Act forecast. The first shows, against the background of subdued world trade and the massive loss of competitiveness, very little growth of output after the recession. The second is a more optimistic one, which by assuming better external trade performance, a stronger domestic economy and lower inflation produces growth over the years 1980-83 that averages the 1% assumed in the MTF's. But because the recession is deeper in the first of those years, the growth has to be correspondingly stronger in the last two years. The Industry Act forecast of a fall of 1½ per cent in GDP in 1981 would simply a rise in GDP of about 4½ per cent for the two years 1982 and 1983 taken together. This would imply that recovery from the recession would be about as steep as the downswing. This is certainly possible, but it is probably unwise to regard it as a central forecast at this stage. Since we shall have to justify any figure for growth in the later years - whether a 'forecast' or an 'assumption' - to the Treasury Committee and others we need to look very carefully at the plausibility of the figures. The two cases taken together here broadly span the range of current outside forecasts on the medium term - if one excludes the extremes of Liverpool on the up side and Cambridge on the down side.

4. One can regard the present note as illustrating four choices for presentation: these are:-

- (i) Case I
- (ii) Case II
- (iii) A middle case somewhere between the two
- (iv) A range of projections encompassing both Case I and Case II

The first of these, giving Case I alone, is obviously unattractive. It shows little growth in the later years, continuing rising

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unemployment and no scope whatever for tax reductions. Case II is clearly more attractive and implies tax cuts in 1983-84 (though not 1982-83) of much the same order as the MTFIS projections. But for the reasons given above it may not be easy to give this case sufficient credibility for it to stand on its own at the moment given the large fall in output through 1980 and its implications for the annual growth in 1981. An attempt is made in the attached note to indicate some of the reasons why it may not be unrealistic to assume a fairly vigorous recovery from the recession as world output recovers, inflation is reduced and the loss of competitiveness is partly reversed; we will need to discuss among ourselves how credible we regard them. One obvious relevant point, which we can only take into account nearer the time, will be what other forecasters are predicting for those years at the time. My view at this stage is that we should be looking for an outcome that is more towards the Case II presented here but that it would be unwise at this stage to go completely that far.

5. A second major problem is that even with the higher output in Case II the prospects for the "fiscal adjustment" have deteriorated. This can be seen by reworking the MTFIS figures to show how the main totals have diverged from our expectations at the time of the last Budget. Table V of the attached note indicates the size of some of the divergences. As will be seen, the biggest arise in the present year and in 1981-82. They reflect to some extent changes in policy - for instance public expenditure plans in the next white paper will show considerable increases compared with Cmnd 7841, by no means all of which can be attributed to the recession. I attach considerable importance to a detailed explanation of changes to the PSBR forecast that clearly relates these to policy changes and to the other principal causal factors. It is also important to relate these changes to the planning totals we present in survey prices in Public Expenditure white paper. All this, however, is a major exercise that cannot be undertaken until the forecasts currently being prepared are completed early next month. But we will certainly have to be ready with a full explanation in next year's FSBR.

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6. Although it is not necessary yet to decide the precise form that the medium term material might take at budget time, it is likely that we will wish to provide something on the medium term. Medium term projections of revenue, expenditure and borrowing in fact pre-date the MTFS - they were carried in the last public expenditure white papers of the Labour government - and given the interest the Armstrong Committee has shown in these it would be difficult to discontinue them now, whether or not the full MTFS framework is repeated.

CONCLUSION

7. The attached note on the medium-term prospect is intended to show Ministers how things have changed since the MTFS. It will need to be updated in the New Year in line with changes to the short-term forecast, and little weight should be placed on the specific numbers. However, the broad picture presented exposes the sort of problems that we are likely to face in approaching the presentation of the medium-term prospect in the Budget.

8. These problems arise mainly because it may be difficult to give reasonable credibility to a repetition of the 1% growth assumption used last March and because the projections of the PSBR (and within it, in particular, public expenditure in cost terms) are substantially less favourable than those presented last March. Though the figures are likely to change quite a bit between now and Budget time, there seems little likelihood that these particular problems will go away, and as part of the general background to preparation for the Budget the attached note is intended to give some broad indication of them.



(TERRY BURNS)

16th December, 1980.

MEDIUM TERM PROSPECTS AND THE FISCAL ADJUSTMENT

This note briefly summarises the economic prospect in the medium term, compares this with outside forecasts, assesses the size of the 'fiscal adjustment', and compares the latest estimates of this with those in the published MTFs.

2. Any medium term projections are subject to a wide margin of error that increases the further ahead they go. The projections in this note are a relatively simple extension to later years of the Industry Act forecast. They take account of the effects on the main economic aggregates of (i) the changes agreed by Cabinet to public expenditure programmes in 1982-83 and 1983-84 and (ii) the effects in the later years of the announced policy changes on National Insurance and to the North Sea fiscal regime. The projections therefore give estimates of the effects of these policy decisions on public sector borrowing and the 'fiscal adjustment'. The forecast currently being prepared, which will be ready in January, will present a more detailed assessment of the implications both of these policy decisions and of recent information on the behaviour of the economy.

3. There are two cases reported in this note.

Case I, with low growth, extends the recent Industry Act forecast over the period to 1984. Inflation continues to fall, but there is little growth in 1982 or 1983.

Case II covers the same period. This sticks to the Industry Act for 1981 but assumes that there is higher growth than in Case I in subsequent years.

Both cases assume the same world environment in which world trade in manufactures (weighted by UK market shares) rises on average by $5\frac{1}{2}$ per cent per annum in the period after 1980. Over the same period the real \pounds price of oil rises on average by $2\frac{1}{2}$ per cent per annum.

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POLICY ASSUMPTIONS

Money Supply

After 1980-81 £M3 grows at the centre of the ranges set out in the MTFS.

Public Expenditure

Exogenous public expenditure is as in Cmnd 7841 as modified by savings on the EC contribution and the changes recently announced by the Chancellor for 1981-82 and agreed by Cabinet for later years. Endogenous public expenditure (social security payments, debt interest etc.) is consistent with policy decisions (on rates of benefit etc.) and with its economic determinants - unemployment, inflation, interest rates - as set out in the various projections in this note. In other words endogenous expenditure has been allowed to increase to take account of the differences between the economic assumptions here and the PES assumptions.

Taxes

Specific indirect taxes and the allowances and higher bands for personal taxes are raised in each budget from 1981 in line with the increase in the RPI in the previous calendar year. The projections assume the existence of the additional North Sea tax (at a rate of 20 per cent) and some changes to the PRT reliefs (as assumed in scheme C1 of the Inland Revenue note to the Chancellor of November 4). The projections take account of changes to the yield of North Sea taxes caused by changes in the exchange rate. (This is, however, best done with the Inland Revenue's detailed model of North Sea taxes, the results of which will be incorporated in the January forecast. The calculations here give only a broad idea of the likely changes to North Sea revenues as a result of exchange rate fluctuations.)

PSBR

The PSBR (as a per cent of GDP) is constrained to produce, on the best judgement we can make the assumed monetary growth at broadly acceptable interest rates. For the purposes of

these projections the PSBR has been assumed to be £9b in 1981-82, or $3\frac{3}{4}$ per cent of GDP at market prices. It falls to $1\frac{1}{2}$ per cent of GDP in 1983-84, as assumed in the MTF5. This path for the PSBR has been achieved by adjustments to personal taxes. For 1981 any differences from the Industry Act forecast are the result of the effects of the higher taxes necessary to achieve the assumed PSBR ratio.

The Exchange Rate

The exchange rate is assumed to float without intervention. This implies a path in which the effective exchange rate stays at a high level in 1981 but then declines.

Earnings

After the Industry Act period earnings in the private sector and nationalised industries are determined by unemployment and lagged prices. Public service earnings are assumed to rise in line with those in the rest of the economy.

THE MEDIUM TERM PROSPECT

4. It is useful to view the projections in the context of the recorded long run performance of the UK economy. The Table below compares the main features of the projections in the UK and world economies with experience in earlier years.

	World trade in manufactures (UK shares)	World GNP	UK GDP	World Industrial Output	UK manufacturing Output	£M3	PSBR	RPI
	% pa	% pa	% pa	% pa	% pa	% pa	% GDP	% pa
1964-73	10.1	4.9	3.0	6.0	4.0	9.5	2.6	5.9
1973-79	5.1	2.8	1.2	2.3	-0.7	12.1	6.7	15.6
1979-84	5½	3	(i) (ii) -½ +½	2.4	(i) (iii) -4 -3	9	3	(i) (ii) 12 11

(i) Case I

(ii) Case II

5. Table I presents a case that subject to assumed changes in fiscal policy extends the recent short term forecast to 1984-85. For the financial years 1981-82 to 1983-84 the fiscal action to achieve the desired PSBR ratio means that personal taxes have to be higher in each year than would be implied by full indexation of bands and allowances.

6. After falling in 1981 GDP does not change significantly in 1982 and 1983, and rises slightly in 1984. Between 1980 and 1983 GDP falls by an average of $\frac{1}{4}$ per cent a year compared with the rise of one per cent assumed for the MTF5. Effectively the initial fall in output is greater and the recovery is postponed until 1984. The projected growth of GDP is well below that of potential output, which is in the range $1\frac{1}{2}$ - 2 per cent per annum, and unemployment rises throughout the period to 3 million by 1983.

7. Prices and earnings decelerate sharply between 1980 and 1982, and at a slightly reduced rate thereafter. After 1980 the pressures to reduce the rate of growth of earnings, through high unemployment and the financial pressures on companies, are likely to be greater than those on prices, which will be raised by the falling exchange rate. The result is that real take home pay is projected to fall substantially between 1980 and 1984. The counterpart to the fall in real take home pay is some easing of the pressure on companies. This is one of the key judgements in these projections.

8. Labour cost competitiveness has been deteriorating since 1977 and this process continues in 1981. Some improvement is implied after 1982, bringing it back to about the same level as in 1980. If the exchange rate were to be higher than expected the outlook for inflation would improve, but at the expense of company finances and output.

9. The main factors that produce the poor prospect for GDP are the relatively slow growth in the world economy, the effects of the loss of competitiveness, and the gradual tightening of fiscal and monetary policy that is necessary to reduce inflation. One consequence of these is the low level of profitability that companies face.

Case II

10. There are a number of ways in which growth could be higher over the period as a whole. Among these are:

(i) The effects on trade volumes of the loss of competitiveness could be less than assumed.

(ii) The effects of the loss of competitiveness on the output of traded goods could be offset by increases in other categories of output that become (relatively) more profitable. Any long run or structural rise in the real exchange rate - for instance as a result of the existence of North Sea oil and changes in its price - will in the long run change the structure of aggregate output. The share of traditional traded goods will be lower and the share of non-traded goods higher than would otherwise have been the case. It is commonly assumed that the contraction in the share of output of traded goods will take place first so that total output falls. Resources will then move to the non-traded sector as profitability &/or wages are higher. There is, however, no reason why the rise in the share of non-traded goods in total cannot occur at the same time as the contraction in output of traded goods. The projections in Case I assume a very slow adjustment of output of non-traded goods, but there is little direct evidence on the timing of this adjustment.

(iii) The decline in inflation and nominal interest rates could influence company sector behaviour, so that, in ways imperfectly understood, they produce and invest more than expected in Case I.

Even if output falls to the extent expected in 1980 and 1981 there are reasons why the subsequent upturn could be greater than in Case I. There are explanations particularly relevant to cyclical movements in output rather than average growth over the whole period, though factors (i)-(iii) above could also contribute to cyclical fluctuations.

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(iv) The process by which stockbuilding and investment rise again after cyclical falls could be stronger than expected. (This would be the counterpart of the greater than expected fall in stocks so far.)

(v) The response to any easing of pressure on profit margins could be stronger than assumed in Case I. It is instructive to analyse directly the factors that determine output, rather than indirectly through the factors that determine individual categories of expenditure (net exports, stockbuilding etc.). It is possible that profitability is a dominant influence on the output decision of companies even in the short run. One possible interpretation of the present fall in output is that firms whose profit margins have been squeezed have chosen to reduce output. (It is worth noting that the reduction in profit margins has occurred widely in the economy and has not been confined to those sectors that produce traded goods and are sensitive to the recent loss of competitiveness.) An implication of this interpretation of recent events is that if profit margins recover output would rise quite sharply. Both Case I and Case II assume some further squeeze on profit margins in the immediate future. If earnings were then to decelerate sharply firms could then rebuild margins and increase output.

Case II (in Table II) can be interpreted as assuming some combination of (i)-(v). Private domestic expenditure and net trade have been adjusted, by roughly equal amounts, to produce the higher growth.

11. Case II assumes that prices and earnings decelerate more quickly. There is an ex ante reduction in the rate of inflation of 1 and 2 per cent respectively in 1982 and 1983. 75 per cent of this comes about through lower earnings and the rest through a direct adjustment to produces. The lower earnings and lower exchange rate (as a result of lower interest rates) produce a much greater improvement in competitiveness than in Case I.

12. Average growth in GDP over the period 1980-83 is 1 per cent. This is the same as in the MTFs, though there is a greater fall in output at the beginning of the period and a stronger recovery thereafter.

COMPARISON WITH OUTSIDE FORECASTS

13. Table III compares the projections set out in this note with those of outside forecasters. There are two extreme cases - the Cambridge Economic Policy Group, with an annual average fall in GDP of nearly 3 per cent between 1979 and 1983, and Minford with an annual average rise of nearly 2 per cent. On present evidence it looks as if both will be very wrong about 1980.

14. If cases I and II are compared with the other groups it is clear that Case I is markedly more pessimistic than all except Cambridge Econometrics. Even Case II has less growth than the LBS and NIESR, which despite considerable differences of view on how the economy works have the same growth between 1979 and 1983. A caveat is in order here. Most of the outside forecasters published quite recently. In some cases, however, the analysis was carried out much earlier. (This is particularly true of the National Institute's work.) If the outside forecasters were to redo their work it is possible that their growth rates would be between Case I and II.

15. There is a quite astonishing degree of unanimity on the prospects for inflation in spite of both wide differences of view on how the economy works and large errors in past forecasts. This coincidence of views in no guarantee of the accuracy of predictions.

PUBLIC FINANCE AND THE FISCAL ADJUSTMENT

16. Table IV compares the current projections of the PSBR ratio and the fiscal adjustment and interest rates with those that underlay the published MTFS.

17. Although the scope for tax cuts depends critically on the prospects for output there is no unique relationship between them. The relationship can be altered by policy decisions, if these result in different tax rates or public expenditure. In addition it can vary for reasons unrelated to policy. For given GDP and tax rates the tax yield will depend on the composition of income, expenditure and output. For instance if the proportion of consumers' expenditure in total expenditure is high the yield of expenditure taxes will be higher. In addition for taxes with a long accruals-payments lag the tax yield in a particular year will to some extent depend on determinants in earlier years.

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18. The assumed PSBR ratios imply a negative fiscal adjustment in 1981-82, ie higher personal taxes than would be the case with full indexation of current allowances and bands. In Case I there is a negative fiscal adjustment, though of diminishing size, until 1983-84. In Case II there is a positive fiscal adjustment by 1983-84. There have been a number of policy changes since the MTF5 that influence the fiscal adjustment. In particular the volume of public expenditure is higher than assumed at the time of the budget. Even in the absence of the policy changes which influence the fiscal adjustment its profile in Case II would have been different over the period from that in the MTF5. Although Case II has the same average growth rate as assumed in the MTF5 the increased amplitude of the cycle - with a greater initial fall in output followed by a more pronounced upswing - delays the period when taxes can be cut.

19. Table V compares total government revenues, expenditure, and borrowing at 1978-79 prices (ie in cost terms) with those in the MTF5 (ie it is directly comparable with Table 9 in the FSBR). The striking features of this table are

- (a) public expenditure in cost terms rises by over 3 per cent between 1979-80 and 1980-81 and then declines by a small amount in 1981-82 and by rather more in the following year.
- (b) public expenditure in cost terms is on average just over $4\frac{1}{2}$ per cent higher than shown in the FSBR in the financial years 1980-81 to 1983-84.

In 1980-81 and 1981-82 the higher expenditure is in part offset by higher revenue some of which is the result of the announced policy changes.

20. The figures in Table V are consistent with the Industry Act forecast up to 1981-82 and are an extension of it to later years. The estimates of revenue and expenditure are liable to change as the forecast currently being prepared makes a detailed assessment of recent events and policy decisions. Nevertheless the broad picture of considerably higher expenditure and higher borrowing (or lower fiscal adjustment) than in the MTF5 is unlikely to alter.

TABLE I:

CASE I LOWER GROWTH

ACTIVITY	1978	1979	1980	1981	1982	1983	1984	Annual Average 1979-1981	Annual Average 1981-1984
<u>GROSS DOMESTIC PRODUCT</u>	3.1	1.3	-2.9	-1 $\frac{1}{2}$	$\frac{1}{4}$	$\frac{1}{4}$	1	-2 $\frac{1}{4}$	$\frac{1}{2}$
<u>MANUFACTURING OUTPUT</u>	0.4	0.0	-9.6	-4	-2 $\frac{3}{4}$	-2 $\frac{3}{4}$	-1 $\frac{1}{4}$	-6 $\frac{3}{4}$	-2
<u>UNEMPLOYMENT (%)</u>	5.6	5.3	6.8	9 $\frac{3}{4}$	11 $\frac{1}{4}$	12	13	7 $\frac{1}{4}$	11 $\frac{1}{2}$
<u>PRICES AND COSTS</u>									
<u>AVERAGE EARNINGS</u>	14.3	16.3	22.6	13 $\frac{3}{4}$	9	8 $\frac{1}{4}$	7	18 $\frac{1}{4}$	8
<u>RETAIL PRICES</u>	8.3	13.4	18.0	11 $\frac{3}{4}$	10 $\frac{1}{4}$	10 $\frac{1}{2}$	9	15	10
<u>REAL TAKE HOME PAY</u>	6.8	3.6	1.1	0	-2 $\frac{1}{4}$	-2	0	$\frac{1}{2}$	-1 $\frac{1}{4}$
<u>BALANCE OF PAYMENTS</u>									
<u>EFFECTIVE EXCHANGE RATE</u>	63	67.8	75.0	76 $\frac{1}{2}$	74 $\frac{1}{4}$	70	66 $\frac{1}{2}$	73	71 $\frac{3}{4}$
<u>LABOUR COST COMPETITIVENESS</u>	93.5	10.8	136.2	145	145 $\frac{3}{4}$	139 $\frac{3}{4}$	134 $\frac{1}{4}$	130 $\frac{3}{4}$	141 $\frac{1}{4}$
<u>CURRENT BALANCE (£B)</u>	0.6	-1.9	2.2	2 $\frac{3}{4}$	$\frac{1}{4}$	$\frac{1}{4}$	2 $\frac{1}{2}$	1	1 $\frac{1}{2}$
<u>PSBR AND FINANCIAL FORECAST (FINANCIAL YEARS)</u>									
<u>PSBR (£B)*</u>	9.2	9.9	11.2	9	7 $\frac{1}{2}$	4 $\frac{1}{2}$	2 $\frac{1}{2}$	10	6
<u>PSBR AS % OF GDP</u>	5.5	5.1	5.1	3 $\frac{3}{4}$	2 $\frac{3}{4}$	1 $\frac{1}{2}$	$\frac{3}{4}$	4 $\frac{3}{4}$	2 $\frac{1}{4}$
<u>EM3 (% CHANGE THROUGH YEAR)</u>	12.1	13.1	16.6	8 $\frac{1}{2}$	7	6	6	12 $\frac{1}{2}$	6 $\frac{1}{4}$
<u>L.A. 3-MONTH INTEREST RATE</u>	10.7	14.9	16.3	13	11	9 $\frac{1}{2}$	9	14 $\frac{1}{2}$	10
<u>20 YEAR GILT RATE</u>	12.9	13.3	13.4	12	11	10	10	12 $\frac{1}{2}$	10 $\frac{1}{2}$

* NB There is a fiscal adjustment for the years 1981-82 to 1984-85 (see Table III).

TABLE II

CASE II HIGHER GROWTH

	1978	1979	1980	1981	1982	1983	1984	Annual Average 1979-1981	Annual Average 1981-1984
<u>ACTIVITY</u>									
GROSS DOMESTIC PRODUCT	3.1	1.3	-2.9	-1 $\frac{1}{2}$	+1 $\frac{1}{2}$	3	2 $\frac{1}{2}$	-2 $\frac{1}{4}$	2 $\frac{1}{4}$
MANUFACTURING OUTPUT	0.4	0.0	-9.3	-4	- $\frac{1}{2}$	3 $\frac{3}{4}$	- $\frac{1}{2}$	-6 $\frac{3}{4}$	0
UNEMPLOYMENT (%)	5.6	5.3	6.8	10 $\frac{3}{4}$	11	10 $\frac{3}{4}$	10 $\frac{3}{4}$	8 $\frac{3}{4}$	10 $\frac{3}{4}$
<u>PRICES AND COSTS</u>									
AVERAGE EARNINGS	14.3	16.3	22.6	13 $\frac{3}{4}$	8	6	4 $\frac{1}{4}$	18 $\frac{1}{4}$	6
RETAIL PRICES	8.3	13.4	18.0	11 $\frac{3}{4}$	9 $\frac{3}{4}$	8 $\frac{3}{4}$	7 $\frac{1}{2}$	14 $\frac{3}{4}$	8 $\frac{3}{4}$
REAL TAKE HOME PAY	6.8	3.6	1.1	$\frac{1}{4}$	-1 $\frac{1}{2}$	$\frac{1}{2}$	1 $\frac{1}{4}$	$\frac{3}{4}$	0
<u>BALANCE OF PAYMENTS</u>									
EFFECTIVE EXCHANGE RATE	63.0	67.8	75.0	76 $\frac{1}{2}$	74 $\frac{1}{2}$	68 $\frac{3}{4}$	62 $\frac{1}{4}$	75 $\frac{3}{4}$	68 $\frac{1}{2}$
LABOUR COST COMPETITIVENESS	93.5	110.8	136.2	145	144 $\frac{3}{4}$	133 $\frac{1}{4}$	118 $\frac{1}{2}$	140 $\frac{1}{2}$	132 $\frac{1}{4}$
CURRENT BALANCE	0.6	-1.9	2.2	2 $\frac{3}{4}$	$\frac{1}{4}$	-2 $\frac{3}{4}$	-5 $\frac{1}{2}$	2 $\frac{1}{2}$	-2 $\frac{3}{4}$
<u>PSBR AND FINANCIAL FORECAST (FINANCIAL YEARS)</u>									
PSBR (£B) *	9.2	9.9	11.2	9 $\frac{1}{4}$	7 $\frac{1}{2}$	4 $\frac{1}{2}$	2 $\frac{1}{2}$	10 $\frac{1}{4}$	4 $\frac{3}{4}$
PSBR AS % OF GDP		5.1	5.1	3 $\frac{3}{4}$	2 $\frac{3}{4}$	1 $\frac{1}{2}$	1 $\frac{3}{4}$	4 $\frac{1}{2}$	1 $\frac{3}{4}$
EM3 (% CHANGE THROUGH YEAR)	12.1	13.1	16.6	8 $\frac{1}{2}$	7	6	6	12 $\frac{1}{2}$	6 $\frac{1}{4}$
L.A. 3-MONTH INTEREST RATE	10.7	14.9	16.3	13	10 $\frac{1}{2}$	8 $\frac{1}{2}$	8	14 $\frac{1}{2}$	9
20 YEAR GILT RATE	12.9	13.3	13.4	12	10 $\frac{1}{2}$	9 $\frac{1}{2}$	9	12 $\frac{1}{2}$	9 $\frac{1}{2}$

*NB There is a fiscal adjustment for the years 1981-82 to 1984-85 (see Table III).

TABLE III

MEDIUM TERM PROJECTIONS BY OUTSIDE FORECASTERS

	1980	1981	1982	1983	Average 1979-83
<u>Rate of growth of GDP</u> (% per annum)					
P/D	-3.2	-1.8			
CEISS	-3.7	-1.7	0.1	1.9	-0.9
LBS	-2.5	-0.6	2.4	1.9	0.3
(a) NIESR	-2.6(*)	-0.4(-0.8*)	1.2(0.8*)	0.3	0.4
Minford	(b)	1.4	3.3	2.7	
CEPG	-6.1	-3.6	-1.3	-0.3	-2.8
ITEM	-2.9	-4.0	-2.0		
EIU	-2.5	-1.8	2.2	2.5	0.1
HMT i.	-3	-1½	0	0	-1
ii.	-3	-1½	1½	3	0
<u>Narrow unemployment</u> (fourth quarter, UK, seasonally adjusted, millions)					
P/D	1.9	2.3			
CEISS	2.0	2.5(c)	2.7(c)	3.1(c)	2.6
(d) LBS	1.8	2.1	2.2	2.2(c)	2.1
(d) NIESR	1.9(*)	2.3(2.3*)	2.6(2.7*)	3.0	2.5
Minford		2.1	1.9	1.8	
(c) CEPG	1.9	2.6	3.2	3.6	2.8
ITEM	1.9	2.6	3.0		
EIU	1.8	2.3	2.5	2.4	2.3
HMT i.	2	2½	2½	3	2½
ii.	2	2½	2½	2½	2½
<u>Consumer Price Inflation</u> (% per annum)					
P/D	15.9	11.8			
CEISS	17.7	11.7	12.9	8.6	12.7
LBS	16.9	12.0	8.5	6.5	10.9
NIESR	15.0(*)	11.9(e)(11.2*)	10.6(e)(8.6*)	8.8(e)	11.6
Minford		8.1	4.1	8.1	
CEPG	19.1	12.6	16.9	9.8	14.6
ITEM	16.2	14.5	12.2		
EIU	18.1	15.4	12.1	9.5	13.7
HMT i.	15½	11	10	10	11½
ii.	15½	11	9½	8½	11

P/D	Phillips & Drew, November 1980
CEISS	Cambridge Econometrics Industrial Subscription Service, November 1980
LBS	London Business School, October 1980
NIESR	National Institute for Economic and Social Research, November 1980.
Minford	Liverpool Model, (date unknown, from the Financial Times 3 December 1980)
ITEM	Independent Treasury Economic Modellers Club, September 1980.
EIU	Economic Intelligence Unit, Aug. 1980
CEPG	Cambridge Economic Policy Group
HMT	Her Majesty's Treasury.

(a) The medium term forecast starts in 1981 and overlaps the short term forecast. Both are quoted where possible as they are substantially different. The short term is denoted(*).

(b) No figure given for 1980 although previous forecast was for zero growth.

(c) Yearly average.

(d) GB figures.

(e) Percentage change Q4 on Q4.

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TABLE IV

PSBR AND FISCAL ADJUSTMENT

	(1)	(2)	(3)
	MTFS	LOWER GROWTH (CASE I)	HIGHER GROWTH (CASE II)
PSBR/GDP ratio			
1980-81	$3\frac{3}{4}$	5	5
1981-82	3	$3\frac{3}{4}$	$3\frac{3}{4}$
1982-83	$2\frac{1}{4}$	$2\frac{3}{4}$	$2\frac{3}{4}$
1983-84	$1\frac{1}{2}$	$1\frac{1}{2}$	$1\frac{1}{2}$
1984-85	*	$\frac{5}{4}$	$\frac{5}{4}$
FISCAL ADJUSTMENT (1978-79 PRICES) £b.			
1980-81	0	0	0
1981-82	0	-1	-1
1982-83	$2\frac{3}{4}$	-1	$-\frac{1}{4}$
1983-84	$3\frac{1}{4}$	$-\frac{3}{4}$	2
1984-85	*	1	$5\frac{1}{4}$
THE BASIC RATE OF INCOME TAX (Pence per £)			
1980-81	30	30	30
1981-82	30	32(/)	32(/)
1982-83	25(/)	32(/)	31(/)
1983-84	24(/)	31(/)	26(/)
1984-85	*	28(/)	20(/)
SHORT TERM INTEREST RATES			
1980-81	14	$16\frac{1}{4}$	$16\frac{1}{4}$
1981-82	$9\frac{1}{4}$	13	13
1982-83	9	11	$10\frac{1}{2}$
1983-84	$8\frac{1}{2}$	$9\frac{1}{2}$	$8\frac{1}{2}$
1984-85	*	9	8

(/) These figures are the basic rates implied if the fiscal adjustment took the form solely of changes in the basic rate.

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TABLE V

PUBLIC SECTOR BORROWING

£ billion @ 1978-79 prices

		1979-80	1980-81	1981-82	1982-83	1983-84
Total General Government Expenditure	(i) MTFS	74½	74½	73	71	70½
	(ii) Case 1	75½	78	77	75	72½
	(iii) Case 2	75½	78	77	75	72½
	Receipts					
	(i) MTFS	66	67½	67½	69½	71
	(ii) Case 1	66½	69	69½	69½	69½
	(iii) Case 2	66½	69	69½	70	72
Fiscal Adjustment	(i) MTFS	-	-	-	2½	3½
	(ii) Case 1	-	-	-1	-1	-½
	(iii) Case 2	-	-	-1	-0	2
General Government Borrowing Requirement	(i) MTFS	8½	7	5½	4	3
	(ii) Case 1	9	9	6½	4½	2½
	(iii) Case 2	9	9	6½	5	2½
Public Sector Borrowing Requirement	(i) MTFS	8	6	5	3½	2½
	(ii) Case 1	8½	8	6	4½	2½
	(iii) Case 2	8½	8	6	4½	2½