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PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and
other Departments in Whitehall

TREASURY WEEKLY ECONOMIC BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 1 March, are sidelined. Briefing for the Budget Statement and White Paper on Public Expenditure will be circulated separately.

M M Deyes

M M DEYES

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R I G ALLEN

7 March 1982

EB Division
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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 and promotion of enterprise and initiative. Reduction of inflation requires maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Relative importance given to inflation and unemployment?

Government is concerned about both. These are complementary not competitive objectives; unemployment will not be reduced by relaxing struggle against inflation.

3. What did 2 December 1981 announcements imply about overall policy stance?

Did not imply any change in broad direction of policy. Helpful to bring together various announcements due in the autumn. But only part of the picture. Need to be seen in context of forthcoming Budget.

4. Budget objectives

We intend to use the Budget to sustain and maintain the progress now evident. We shall continue with policies designed to reduce inflation and to create the conditions for sustainable growth.

5. PM's remarks about Chancellor's 'limited room for manoeuvre'?

[Speech for Engineering Employers' Federation 23 February.]

PM stressed in remarks to EEF that not seeking to pre-empt rhF's Budget speech. But was trying to inject a note of realism.

6. Implications of falling oil prices?

See R2.

7. Scope for tax cuts? Stimulation of economy?

Chancellor considers all representations. Cannot anticipate Budget judgement but no question of abandoning our strategy; cannot throw away gains already made. Will need to assess appropriate fiscal stance in light of circumstances, including monetary prospects and outlook for inflation.

8. Armstrong report - TCSC comment

[Report from TCSC expected in the Spring]

Welcome interest shown by Treasury Select Committee in Armstrong report. Very important implications for conduct of Government bodies and for Parliamentary procedure. Shall look forward to Committee's report.

9. Government has failed to accommodate recession?

On the contrary. Have been flexible within the limits of prudence over the levels of public spending and borrowing. But experience shows that attempts to 'buy' jobs only temporarily beneficial. Repercussions weaken economy and worsen job prospects in longer run.

10. Failure to control monetary growth?

Despite likely overshoot of £M3 target this year, monetary conditions have been moderately restrictive, as intended. Total money spending has grown at an annual rate of 10 per cent during 1980 and 1981, broadly consistent with original MFS guidelines.

11. Lower interest rates ?

Must proceed cautiously if not to jeopardise progress on inflation through either a weakening exchange rate or excessive monetary growth. But despite difficult conditions abroad, bank base rates have come down by 2½ per cent since September, and market rates have fallen generally.

12. Expectations for UK economy in 1982 disappointing?

[New forecasts recently published by NIESR, LBS, P&D, Liverpool Group.]

Published forecasts show usual wide range of views. Government will publish new forecast with Budget on 9 March.

(i) Signs of recovery

- Total output (GDP) rose in both 3Q and 4Q 1981. Level in 4Q some 1 per cent above 2Q.
- Short time working in manufacturing fell in 1981 to below 1/4 its January peak;
- 1981 figures show volume of engineering and construction orders up about 17 and 9 per cent respectively on 2H 1980.
- Private sector housing starts in 1981 up by 37 per cent on 2H 1980.
- Most recent major independent forecasts assess low point in activity reached in 1H 1981; prospect of some recovery in 1982.

(ii) Earnings and settlements. Increases halved in 1980-81 pay round. Public sector in line. There is a good deal of evidence that average settlements in private sector are running lower than in the 1980-81 round. [CBI pay data bank for manufacturing settlements suggests average is now around 7 per cent compared with 9 per cent in previous round.]

(iii) Productivity. Output per head in manufacturing rose 10 per cent during 1981. Investment in plant and machinery holding up well.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs over last year - just 2½ per cent in year to 4Q 1981.

(v) Competitiveness. Improved by over 10 per cent during 1981, reflecting pay moderation combined with exchange rate fall.

(vi) Profits: Non North Sea industrial and commercial companies gross trading profits (net of stock appreciation) rose some 13 per cent in 3Q.

(vii) Exports holding up well; non-oil export volumes in 4 months to December up 3½ per cent on 1980. 1981 figures (incomplete) show engineering export orders up 20 per cent on 2H 1980.

(viii) Unemployment. Rate of increase in unemployment since mid 1981 about half that in 1H and 1/3 that in 4Q 1980. Vacancies improving since mid 1981. Short-time working in manufacturing reduced by over 1/3 during 1981 and overtime working has increased.

(ix) Special employment measures. Total provision on Job Release Scheme, Temporary Short-Time Working Compensation and Community Enterprise Programme in 1982-83 now planned to reach over £520 million, with additional £61 million for young worker scheme (starting January 1982). Spending on Youth Opportunities Programme to rise to £700 million in 1982-83. 280,000 unemployed school-leavers last year found places on YOP by Christmas.

(x) Training. Over next 3 years £4 billion to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 1983 represents major step towards comprehensive provision for young people.

(xi) Industrial relations. Number of strikes in 1980 and 1981 less than in any year since 1941 and number of working days lost only a third of average of last ten years.

(xii) Retail prices. Inflation almost halved since peak in spring 1980 (21.9 per cent). 12 monthly increase in January of 12.0 per cent. [NB Progress affected by lower exchange rate.]

(xiii) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 350. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover about 250,000 employees.

(xiv) Loan Guarantee Scheme. Over 2300 guarantees issued so far on loans totalling over £80 million. Over half of loans going to new businesses.

(xv) Enterprise Zones. 10 out of 11 zones already in operation. Last one (Isle of Dogs) expected to start in April.

(xvi) Examples of export successes reported in the Press include: £160 million ^{construction of} contract for two new colleges in the largest ever such contract between Britain and Nigeria (Mitchell Cotts Group); approved tender for veterinary vaccines to Kampuchea (Hoechst UK); supply of 1000 special gearboxes to Istanbul within five weeks of order (Turner-Spicer Transmissions); travelling hoists with exceptionally low headroom (550mm) for use in Danish oil and gas exploration platform in North Sea (Tonnes Force); a profiled metal cladding system for a power station in The Gambia (Ash and Lacy Steel); and glazing for the new Financial Complex in Port of Spain - the biggest ever such gained by a UK glass processor (Clark and Eaton with Pilkingtons). New British-designed, managed and partly funded, domestic water supply project in Jordan was opened by King Hussein on 18 February.

(xvii) UK preferred location: US electronics industry survey reports UK most preferred location for establishing new plants.

(xviii) Overseas debt repayments. Official external debt reduced from over \$22 billion, when Government took office, to \$13.3 billion at end-1981.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Current position and prospects?

[Preliminary GDP (output) estimate for Q4 1981 up $\frac{1}{4}$ per cent on Q3 reflecting higher North Sea output and higher gas and electricity demand partially offset by fall in manufacturing and construction output. Little change elsewhere.]

Recovery confirmed by second successive quarterly rise in total output. Output in Q4 1 per cent up on Q2 - the earlier low point.

IF ASKED about relationship to Government forecasts - improvement in H2 consistent with December IAF - NB new assessment in FSBR.

IF PRESSED on apparent weakening of recovery (based on November/December industrial output) - see 2 below.

2. Recent manufacturing production figures show resumed decline?

[Manufacturing output in November and December down some 2 per cent in each month with December figure reaching new low point.]

November and December figures affected by car disputes and exceptionally severe weather. Even so, index for Q4 as a whole much the same as in Q3, and about 2-3 per cent higher than in H1 (cyclical low point).

3. Other evidence of improvement in economy?

Engineering and construction orders and private sector housing starts all well up during 1981 on H2 1980. Productivity (output per head) in manufacturing rising strongly - up 10 per cent in Q3 1981 from Q4 1980. January cyclical indicators continue to confirm recovery under way. (Coincident indicator has been rising consistently since May; earlier weakening in longer leading indicator partly reversed, with improvements during November to January. (Labour market indicators - see C1.)

4. Latest CBI Enquiry?

February's enquiry shows a further improvement in order books and a rise in the net balance of firms (from 1 to 3 per cent) expecting to increase output over the next four months.

5. Government assessment of prospects

[Industry Act forecast (2 December) assessed recovery to have begun. End to destocking. Consumers' expenditure and Government expenditure flat.]

	Increase in 1982 per cent
GDP	1
Manufacturing output	4
Exports	2½
Investment	2½

NB New assessment will be contained in FSBR to be published with Budget]

Industry Act forecast sees prospect of some recovery. (Last two Government assessments of economy were broadly correct.) Exports and investment up. Resumption of decline in inflation. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

6. Outside forecasts

[GDP profile in recently released major forecasts:

	<u>NIESR</u>	<u>LBS</u>	<u>CBI</u>	<u>Phillips & Drew</u>	<u>OECD</u>	<u>IAF</u>
	(Feb)	(Feb)	(Nov)	(Mar)	(Dec)	(Dec)
Per cent change 1982 on 1981	+1½	+1½	+1	+1¼	+¼	+1]

Most recent major independent forecasts assess that low point in activity was reached in first half of 1981, with prospect of some recovery in 1982. As always, a range, with Cambridge forecasts being the more pessimistic.

7. High interest rates will abort recovery? Business confidence weakened?

Understand concern over interest rates, but it is absolutely essential to contain inflation. Inflation is inimical to sustainable recovery. Interest rates only one of factors affecting industry. Other costs, particularly labour costs, more important for improved profitability and competitiveness.

C LABOUR

1. Unemployment continues to rise?

[February total count was 3,045,000 (12.6 per cent) down by 26,000 on January. Seasonally adjusted excluding school leavers figure was 2,836,000 (11.7 per cent), a rise of just 7,000 on January.]

Figures so far this year distorted by severe weather. Average monthly increase in January and February together about 30,000 (after allowance for over 60's transferring to long term Supplementary Benefit). Compared with 40,000 a month in H2 1981 this suggests a further slowing down in rate of increase (but figures have been affected for almost half a year by series of distortions - bad weather, civil service strike).

2. Vacancies?

Whilst down very marginally in February, both stock and flow figures show definite improvement since mid 1981.

3. Employment continues to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Q3 figures indicate decline of 150,000 compared with 300,000 per quarter in H1 1981. Manufacturing employment declined by 34,000 a month in Q4, a little more than Q3.]

Third quarter decline in total employment half that in H1 1981. Manufacturing employment statistics suggest that lower rate of decrease was maintained in fourth quarter.

4. Government forecasts for unemployment

[Government Actuary's Report published 2 December uses working assumption of an average level of 2.6 million unemployed in Great Britain (excluding school leavers) in 1981-82 and 2.9 million in 1982-83. (222,000 school leavers and adult students in 1981-82, 225,000 in 1982-83).]

Like previous administrations Government does not publish forecasts of unemployment, though some Government publications, eg Government Actuary's Report, contain working assumptions. Government is concerned about unemployment. Scale of special employment measures (SEMs) adequate evidence of this. Prospects depend on further progress on productivity and competitiveness. [See 5 below for independent forecasts.]

IF PRESSED GA figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - eg lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

5. Independent forecasts?

[Consensus is for medium term rise in "narrow definition" unemployment, reaching about 3 million in Q4 1982.]

History shows unemployment forecasts to be very uncertain (this is a major reason why Government does not publish one). Reflected in wider range especially for beyond 1982.

6. Unemployment higher than in other countries?

[OECD standardised data show UK H2 1981 at 11 per cent compared with OECD average of 7½ per cent.]

Yes, but unemployment now rising more rapidly in most other OECD countries. German unemployment has risen ½ million since mid-1981, reaching its highest level (7½ per cent) since early post-war period, and compares with about 1 per cent in early 1970's. Seriousness of UK position reflects poor productivity and competitiveness in the past and inflationary excesses in the 1978-79 and 1979-80 pay rounds.

7. What is the cost to public funds to the current level of unemployment?

[Subject of oral PQs 11 February and of CST speech at Guisborough 5 February]

Payments of unemployment benefit and supplementary benefit to people registered as unemployed are expected to total about £4 billion in 1981-82. Comparable figures cannot be given for revenues which were not collected - such figures could only be hypothetical.

8. Cost of unemployment - Revised estimate?

[Intended article for EPR 'suppressed' - The Times 18 February.]

Work has been done to update the figures on the cost of unemployment which appeared in February 1981 edition of Economic Progress Report. But there are considerable problems and doubts about such calculations and it is not possible to consider publication until these doubts have been resolved.

9. Total cost of unemployment £13 billion?

Totals of this kind are by themselves meaningless. They imply a comparison with an economy with zero unemployment which is not feasible. A really major change in the level of unemployment would mean that taxes, benefits, wages, prices etc would be very different from the present. £13 billion is not a 'cost' which could be saved or spent elsewhere. We cannot wish unemployment away.

10. Why not employ unemployed people on public works etc?

We continue to examine the options. But schemes to provide jobs in the public sector tend to have a net Exchequer cost, unless the amount paid is relatively low.

11. Should spend more on reducing unemployment - especially for young people?

As announced last July and in 2 December statement , Government has increased spending on special employment and training measures. Plan to spend £1.5 million cash in 1982-83 - nearly 40 per cent more than in 1981-82. Much of this specifically on young people.

12. Need to bring system of industrial training up to date?

Agreed. White Paper on New Training Initiative set out action required in industry and education ,as well as lead from Government.

13. What has Government done to make labour market more flexible?

Have taken action on a number of points:

Training: extra spending on 16-17 year olds, plans to reform apprenticeship system (see C11 above).

Young workers: subsidy to employers to take on youngsters at lower wage rates - object to price young back into labour market.

Mobility: Housing Act 1980 provisions for short-term tenancy in private rented sector.

Industrial relations: steps already taken and further proposals just published to redress imbalance of power between employers and unions.

Employment Act 1980 measures to reduce costs of employment and rigidity in wage-setting practices.

D TAXATION

1. Burden of taxation

[Total taxation in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82].

This has inevitably increased during a time when national production has not been growing. But real personal disposable income is still higher than at any time in the period when the Labour Party was in Government.

2. Not worse than in other countries?

OECD report showed that Government's total 'take' (by way of taxation and national insurance contribution) as percentage of GDP is less than in many other industrial countries - UK eleventh in OECD rankings, behind most other EC countries, including France and W Germany. [NB: HMG's position is that national insurance contributions are not a tax]. Similar picture given in article in Economic Trends for December (which also uses OECD statistics).

3. What will be in this year's Budget?

The Hon. Member will have to contain himself for a few more minutes.

N.B. Briefing on the Budget will be circulated on 9 March.

E PUBLIC EXPENDITURE AND FINANCE

[The Chancellor announced 2 December 1981 main decisions for public spending 1982-83. Main increases are: local authority current expenditure (£1.3 billion), employment measures (£0.8 billion), defence (£0.5 billion) and finance for nationalised industries (£1.3 billion). Increases will be offset in part by general reduction in most cash-limited expenditure and by specific cuts - including increased prescription and other health service charges. Planning total for 1982-83 will be in region of £115 billion, against £110 billion for White Paper revalued.]

1. Further announcements?/Outturn in 1981-82?/Questions on later years?

Full details will be new in White Paper to be published Tuesday pm 9 March.

[Briefing on Public Expenditure White Paper Cmnd 8494 being circulated separately.]

2. Cash limits 1982-83 and public sector pay?

The Government last year concluded that provision for 1982-83 should be made on the basis of a 4 per cent pay factor overall. This remains its view. Some public servants may get more than 4 per cent, some may get less. But there is no automatic entitlement. Every settlement will have to be justified on a rigorous assessment of its merits. That position is unchanged. (See also J7-8)

3. Preferential treatment for Civil Service?

Mechanisms for dealing with expenditure on public service pay apply to the Civil Service as they do to others. We did give an undertaking to the Civil Service unions last year that if agreement could not be reached in this year's negotiations we would be prepared to go arbitration. The award would be subject if necessary, to override-with the approval of this House. We stand by that assurance in the terms it was made. An offer has now been made to the non-industrial civil servants (grades up to Principal) which averages 4.05 per cent. (See also J9-10)

4. Contingency reserve and pay

Existence of Contingency Reserve does not mean that excessive public service pay settlements will be financed. If a pay increase is justified and cannot be financed within cash limits or by savings elsewhere, access to Reserve is possible. This is a decision which Ministers would have to take at the appropriate time, bearing in mind other potential calls on the reserve. Government's view remains that 4 per cent is a reasonable overall provision within its expenditure planning.

5. Cut staff numbers in public services?

Numbers in public service have already fallen since we took office. Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for nearly 15 years. We are well on target to achieve our aim of having 102,000 fewer staff in post in April 1984 than when Government came into office; this will be smallest Civil Service since the war. Local authority manpower has been reduced by nearly 75,000 (over 4 per cent).

6. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46 per cent in both years). The large rise from 41 per cent in 1979-80 is partly because of the "relative price effect" and partly because the volume of expenditure rose at a time when real GDP has fallen. Good chance that ratio will fall in 1982-83.

LOCAL GOVERNMENT

7. Spending plans for 1982-83? Too tough? Too weak?

In order to set local authorities reasonable and realistic targets, we have increased the plans by £1.35 billion. But substantial economies will still be required as plans only allow about 2 per cent more cash spending than latest budgets for this year.

8. Cut in RSG percentage will mean large rate increases?

Not at all. If local authorities budget to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend. [NB. FSBP published 9 March to quote 12 per cent rise in rate income-taking account of information on actual rate increases.]

9. Will the Government limit rates as suggested by the CBI?

We certainly share the CBI's concern about the harmful effect of high rates on business. The problem with limiting rates is that, unless local authorities cut their spending, it has to be paid for by domestic ratepayers or the taxpayer generally. However, we will be considering this further in the context of the longer term future of the domestic rating system. Meanwhile the Government's continuing pressure on local authorities to reduce expenditure should help all ratepayers.

10. Control of local authority spending?

We will maintain pressure to reduce spending through rate support grant system and otherwise. Provision in Local Government Finance (No.2) Bill to ban supplementary rates will oblige local authorities to budget responsibly at start of year and prevent a repetition of the irresponsible increases in spending planned by some authorities this year. In Scotland, we are seeking power to oblige excessive spenders to reduce their rate demands.

11. Green Paper on Domestic Rating System: rules out change?

No, it reaffirms our long-standing commitment to reform which we want as quickly as circumstances allow. The issues are complex and highly important to domestic ratepayers. The Green Paper sets out the requirements of any alternative source of revenue and describes the advantages and disadvantages of the alternatives in order to present the best basis for consultation.

F SOCIAL SECURITY

1. November 1982 uprating?

The forecast movement in prices to be used for this uprating and the rates for certain benefits will be given by the Chancellor of the Exchequer in his Budget statement. Further information will be given by the Secretary of State for Social Services on Wednesday 10 March.

2. Restoration of shortfall?

We have already made clear that the 2% shortfall will be made good for the State retirement pension and other long-term benefits. The Chancellor of the Exchequer will make clear our decision on the restoration of the shortfall for unemployment and other short-term benefits in his Budget statement.

3. Restoration of 5 per cent abatement of unemployment benefit?

[Unemployment and some short-term benefit rates were abated by 5 per cent in November 1980 in lieu of taxation. Unemployment benefit (but not other abated benefits) comes into tax from April/July 1982. Ministers have said they will announce their decision on whether to restore abatement before benefit comes into tax.]

Await Budget statement.

4. People no longer better off when unemployed

[Report by Institute of Fiscal Studies looked at position of short-term unemployed after abolition of earnings related supplement and 5 per cent abatement of UB made in November 1980. Reported that gap between in and out of work incomes had widened, concluded that UB and supplementary benefit should be increased in real terms.]

We have taken measures such as the abolition of earnings-related supplement and the taxation of short term benefits which serve to

improve financial incentives to work. In a minority of cases, however, the gap between incomes in and out of work is still narrow. We shall continue to promote measures to encourage effort and improve the balance in incomes in and out of work.

5. Death grant - increase to realistic level?

We recognise that the present death grant of £30 is of only marginal benefit, and have been looking at ways in which it could be improved. I hope there will be an announcement on this soon.

6. Supplementary Benefit - uprate by RPI less housing cost component?

It is our intention to uprate the scale rates of Supplementary Benefits by the forecast movement in the RPI with a broadly based adjustment for the likely relative movement of housing costs [Note: we do not wish to make public a forecast of the housing index.]

Housing costs are not met from the scale rates of supplementary benefit, recipients of this benefit receive separate provision for housing, normally representing 100% of their costs. It is quite reasonable, therefore, to exclude housing costs from the scale rates.

7. National Insurance - contracting out?

3 March

[DHSS announced on Wednesday that the rebate on national insurance contributions for "contracting out" employment was to be reduced from 7% to 6½% from April 1983 and that changes were to be made to the terms for "buying back" into the State scheme.]

The rebate recognises that occupational pension schemes provide benefits which the Government would otherwise have to provide. The Government Actuary now considers that pension funds should find it easier to finance those obligations - hence the reduction in the rebate. The change will narrow the margin between contracted in and contracted out contribution rates, but not necessarily increase the actual contracted out rates of payment, this will depend on the decisions taken on contribution rates for 1983-84.

We do not think the changes will cause many private sector schemes to move back into the State scheme. The "buy back" terms are to be changed gradually - so there should be no sudden rush to "buy back".

G PUBLIC SECTOR BORROWING

1. PSBR in 1981-82

[Industry Act forecast showed PSBR in 1981-82 on target for Budget estimate of £10½ billion; PSBR in April - December published 4 February was £10½ billion]

Await Financial Statement and Budget Report for latest estimate .

2. Effect of civil service dispute on CGBR?/Revenue?

[CGBR April-January published 9 February, was £8 billion.]

Effect of dispute (concluded July 1981) was to add around £2¼-2½ billion to the CGBR in April 1981-January 1982, of which £½ billion is the cost of extra net interest payments.

3. Will the Government be able to collect all delayed revenue this financial year?

Some revenue is expected to be outstanding at the end of March.

4. Recession means that PSBR should be higher, not lower?

In my rhF's 1981 Budget statement he explained that this year's PSBR would be larger on account of the recession. But experience shows that attempts to buy jobs with reflation simply fuel inflation and quickly have to be reversed. Our policies are designed to cut inflation and secure a sustainable improvement in output and employment.

5. PSBR in 1982-83 ?

Await Budget Speech and PSBR .

H MONETARY AND FINANCIAL POLICY

1. Lower interest rates?

[Bank base rates were reduced by $\frac{1}{2}$ per cent to 13 $\frac{1}{2}$ per cent with effect from 25 February. Have come down 2 $\frac{1}{2}$ per cent from peak of 16 per cent in the autumn. Market rates generally fell back during last week of February and early March.]

Of course we want to see lower rates. But we must proceed cautiously if we are not to let up in the fight against inflation. Despite difficult conditions abroad, interest rates have fallen.

2. Will high US rates push up our rates?

High US rates are certainly an adverse development and in September were one of the key factors in driving our rates up. Recently, however, with the pound remaining stable in world markets, our rates have been able to ease somewhat, without creating inflationary dangers. The position of the pound has no doubt been helped by better prospects for the wage round and the good trade figures. Nevertheless, it remains true that domestic policy cannot ignore the difficult international background.

3. What is the Government doing about it?

As my rhF the Chancellor stated in his speech to the House of 28 January, we support the anti-inflationary stand of the US authorities. But we have made clear on many occasions our concern about the balance of fiscal and monetary policy and its implications for interest rates.

4. If US rates are determining ours, why all the concern about the PSBR?

We do not claim that US rates are sole influence on our own and that there is nothing we can do to offset our own rates. Just as we are urging a balance between fiscal and monetary policy in the US, so we must achieve that ourselves.

5. Should not European governments jointly exert pressure on US?

Other European governments have made their views known in the same way we have.

6. Interest rates levels choking the recovery?

Agree that high interest rates pose problems for industry. But companies' financial position generally much stronger than a year ago. No purpose served by allowing higher inflation, whether due to falling exchange rate or credit-financed consumer spending.

7. Two tier system of interest rates?

Not practicable in highly sophisticated financial market like UK's. Very difficult to prevent money borrowed at lower rate being on-lent at higher. A lower rate for specified borrowers would require extra Government subsidy which would push up borrowing or require cross-subsidisation by the banks. In either case the level of interest rates to other borrowers would be increased.

8. Will there be an overshoot of money supply target?

[£M3 increased by 1.7 per cent in banking January, bringing annualised rate of growth over target period to 15.7 per cent. M1 grew by 1.8 per cent in January and at a rate of 10.0 per cent over target period. PSL2 grew by 1.1 per cent in January and at a rate of 12.4 per cent over target period. Position remains seriously distorted by effect of Civil Service strike.]

Growth in £M3 over target period will be above top end of target range, even allowing for effects of Civil Service strike. Too early to say by how much. Interpretation of figures very difficult because of Civil Service strike distortions. Some good features in monetary picture: 1981-82 PSBR should be close to forecast; funding programme is on track. But bank lending disturbingly high, despite level of interest rates.

9. When will the strike distortions be eliminated?

Distortion will continue for some months yet. The distortion to the CGBR was reduced by about £½ billion in (calendar) January. In ten months ending January the effect of the strike was to add around £2½-2¾ billion to the CGBR.

J PRICES AND EARNINGS

1. Inflation has increased under this Government?

Considerable progress has been made in bringing down inflation from a peak of 21.9 per cent in May 1980 to 12.0 per cent in January.

2. When will single figure inflation be achieved?

[Year-on year rate of inflation unchanged in January at 12 per cent, compared with lowest recent level of 10.9 per cent in July 1981.]

Progress in reducing inflation has been hindered by fall in exchange rate, and by higher mortgage interest rates. Industry Act forecast is for year-on-year rate of inflation of 10 per cent by Q4 1982. We expect downward trend to continue thereafter. [IF PRESSED: Precise timing of further progress is of course uncertain. Could be before the end of the year, could be early next year.]

3. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. The rate of nationalised industry price rises is now coming more closely into line with the RPI. [See P11-12.]

4. TPI

The fact that the TPI has been increasing faster than the RPI (roughly 3½ per cent faster over the year to January) reflects the measures which have been taken to restrain Government borrowing, which is essential if inflation is to be controlled.

5. Current level of pay settlements ?

In economy generally, settlements in last pay round averaged 8-9 per cent. Negotiators seem to be settling up to about a third lower in this round than they did in previous. And almost all settlements seem to be in single figures.

6. Private sector pay - the CBI's 7 per cent?

[CBI figures published 17 February suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

Settlements have been lower in recent months, reflecting an increasing sense of realism about pay. But the need is for continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

7. Public sector pay

Government's approach to pay in the public services must take account of what the taxpayer can afford. Pay negotiations in the nationalised industries and local authorities are a matter for the parties concerned, as are the financial consequences of any settlements reached.

8. 4 per cent cash factor unrealistic/unfair?

Real incomes had risen to unsustainable level and public service pay increased relative to private sector since 1979. 4 per cent is broad measure of what Government thinks reasonable and can be afforded as general allowance in fixing programmes from which public service pay bill has to be met.

9. Application to the Civil Service?

There have been two negotiating meetings with the non-industrial civil service trade unions. Government has reaffirmed its undertakings to negotiate without a predetermined cash limit and its willingness to go to arbitration in the event of disagreement. This is subject to reserving the right to ask the House of Commons to set aside the arbitration award if necessary on grounds of overriding national policy. The unions have said that the offer is unacceptable and have asked to proceed immediately to arbitration.

10. Difference between Government's offer and the union claim?

In framing its offer the Government has placed much more emphasis on market considerations and management objectives than on comparability and the cost of living. The unions' emphasis is on the latter two aspects.

11. Average earnings index

[Fall in year on year growth from 11.3 per cent in November to 9.9 per cent in December may attract attention, though (unpublished) underlying increase, broadly unchanged at, just over 11 per cent]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to December straddles two pay rounds - not useful indicator of recent trends.

12. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

13. Government aiming to cut living standards?

[Latest (revised) RPD I figures suggest no further fall between Q2 and Q3 1981.]

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

14. Incomes Policy

[Attention may be drawn to Prof. Meade's proposal in his book "Stagflation Vol I" (published 21 January) for an incomes policy, based on consensus about growth of aggregate national income, and featuring arbitration on employment - effect criteria; or to Prof. Layard's ideas for wage inflation tax (picked up by SDP).]

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

15. Index-linked pensions and the Scott Report?

The Government is considering the whole question in the light of the Scott Report. Our aim is to ensure that pensions to public servants are fair to taxpayers, as well as to employees, pensioners and their dependents.

K BALANCE OF PAYMENTS

1. Balance of payments December 1981

[December trade figures published 25 January]

December current account is estimated to have been £498 million in surplus, compared with £218 million in November. Most of the improvement was due to increased surplus on oil and erratic goods. Although both exports and imports fell back from the high November levels, these figures confirm the underlying recovery in UK trade.

2. Trends in exports

Non-oil exports were 3½ per cent higher in volume terms than in 1980. Exports of intermediate and capital finished manufactured goods are now higher in both value and volume terms than in 1979 and 1980 despite loss of competitiveness. DoI survey of engineering industry suggests export deliveries will continue to rise in 1982, as does CBI Industrial Trends Survey.

3. Oil exports and erratics

Surplus on oil exports rose by £188 million to £402 million. Trade in erratics (precious stones, aircraft, ships, North Sea installations) improved by £86 million. This reflects recent trend towards surplus in ships and aircraft, consistent with UK manufacturers' general success in exporting finished capital goods.

4. Trends in imports

December import figures are in line with the average for the previous 3 months. The recovery in imports is across the board, including basic materials and manufactures used by UK industry. This supports the view that destocking is coming to an end and the economy picking up.

5. Trends in invisibles

Surplus on all invisibles is projected to be around £500 million in Q4 1981.

6. TUC proposal for an import deposit scheme?

This would raise prices in the shops, increase costs for domestic manufacturers, run counter to our international obligations and probably lead to retaliation against successful British exporters.

L EXCHANGE RATE AND THE RESERVES

1. Sterling still too high?

[Since last September, sterling has remained broadly stable and is currently over 12 per cent below its effective rate peak early last year. Recent 'lows' have been \$1.77 on 14 September, DM4.07 on 20 October. 'Highs' were \$1.97 on 30 November, DM4.407 on 9 February. Rates at noon on 4 March were \$1.8255; DM4.32 and an effective rate of 90.96. Reserves at end February stood at \$23.4 billion, compared with \$23.2 billion at end January.]

Our policy is to allow the rate to be determined primarily by the balance of market forces. The effective exchange rate is only slightly higher than when the Government took office. Manipulating the rate is no answer to problems in the real economy.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Concerted intervention to reduce the value of the dollar?

All the experience in recent years is that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: the matter for real concern is the US fiscal/interest rate mix, a problem all countries are familiar with.

4. Does the Government have an exchange rate target?

No. As my rhF the Chancellor has made clear on many occasions, it is very difficult to make judgments about the 'right' level for the exchange rate or to resist strong market trends. That continues to be the Government's view. However, the Government is not indifferent to exchange market developments: account is taken of the level and movement in the exchange rate when taking decisions on interest rates.

5. Sterling should join the EMS?

[See M8-9]

6. Exchange rate and competitiveness?

I welcome the improvement in UK cost competitiveness of over 10 per cent in 1981. This has been partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors.

7. Debt repayments

We have made substantial progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to \$14 billion by the end of 1981. This has been more than achieved - external debt is now around \$13½ billion, compared with over \$22 billion when the Government took office.

M EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

On 25 January, Foreign Ministers had a lengthy discussion on the four key issues in the negotiations over the Mandate. It was not possible to reach agreement. The main issue preventing agreement was the view of a number of other Member States that refunds to the UK should be arbitrarily and automatically reduced over time, regardless of the scale of the problem. That was quite unacceptable to the UK. There was also disagreement about the duration of the new refunds arrangement. Foreign Ministers will consider these problems again at their meeting in March, on the basis of proposals from the Presidents of the Council and Commission.

2. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May 1980.

3. Lower Commission estimates of net contributions in respect of 1980 and 1981?

The most recent Commission estimates suggest that our net contributions in respect of 1980 and 1981 will be significantly lower than expected at the time of the 30 May Agreement. That is very satisfactory. For we remain one of the less prosperous Member States. The problem of 1982 and later years remains to be solved.

4. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that the minimum net refunds payable under the 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

5. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

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

My rhF, 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.

EUROPEAN MONETARY SYSTEM

8. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

9. When will the conditions be right?

Sterling is an international financial currency and is also particularly affected by oil market factors. These mark sterling out from other Community currencies, and add to the difficulty of the decision on the timing of sterling's participation. The balance of advantages, risks and disadvantages is constantly changing, so that the question of participation remains complex.

N INDUSTRY

1. Prospects for industry - recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 $\frac{1}{2}$ per cent upon Q3 and some 2 per cent up on H1. New forecast will be published with Budget on 9 March.

2. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) other than North Sea activities net of stock appreciation were around £4.3 billion in Q3 1981. Borrowing requirement of ICCs has improved over year to Q3 1981, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 4 December) shows further marked improvement in third quarter (particularly in manufacturing) bringing liquidity ratio back to 1979 Q3 level. NB figures difficult to interpret, however, particularly because of uncertain impact of CS dispute].

Figures mildly encouraging. Company financial position is in any case confused by effects of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

3. High interest rates damaging for industry and investment?

[Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.]

Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFs. (See brief H).

4. Mr Chandler's call for a new industrial policy

[In speech Thursday 25 February, DG of NEDO called on both sides of industry to bury their differences and formulate a new long-term industrial policy]

I agree with Mr Chandler's remarks about the complex set of causes underlying Britain's problems, and about the need for action to improve the country's long term lack of competitiveness. But not within the power of Government to bring about all the changes required. Improvements in work practices, for example, and restraint in wage and price increases depend above all on the approach of the two sides of industry.

SMALL FIRMS

5. Government help for small firms

Over 75 measures taken which help important small firms sector: in particular the Business Start-Up Scheme, the pilot Loan Guarantee Scheme, the Venture Capital Scheme, and reduction in the burden of small firms' corporation tax.

6. Response to Loan Guarantee Scheme?

Scheme operating successfully. We have already issued more than 2700 guarantees - well over half to new businesses. Total lending under scheme is just under £100 million. Ten new banks were admitted to the Scheme in November 1981: a total of twenty-seven financial institutions are now participating.

ENTERPRISE ZONES

7. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation early in April 1982.

8. Response from private sector?

Response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

P NATIONALISED INDUSTRIES

EXTERNAL FINANCING LIMITS

1. EFLs for 1982-83?

Despite constraints on public expenditure as a whole, Government recognised problems faced by the industries in period of recession and increased provision for 1982-83 by £1.3 billion cash. This larger than increase in any individual Departmental programme.

2. Pay assumptions?

Government ^{has} not set uniform pay assumption for the industries. But their own assumptions have been discussed, and external financing limits set on assumption reasonable settlements would be reached. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

3. Government simply forcing financing burden onto consumer, ie through higher prices?

Some further price rises assumed in reaching decision on EFLs as in previous years. Should be possible to avoid large real increases experienced in 1980-81; but requires continuing effort to keep down current costs, particularly pay.

4. Government still cutting back the industries savagely?

Not so. The industries made very large original bids for additional external finance in 1982-83, totalling about £2.5 billion, in their medium-term financial plans presented to Government in summer 1981. This would have brought their total external finance to around £4 billion. Agreed increase of £1.3 billion was roughly halfway between the industries' original bids and the White Paper figure.

INVESTMENT

5. Current year?

Last Public Expenditure White Paper showed nationalised industry planned investment 15 per cent higher in real terms this year than a year ago. Although now expect final figure to be lower than this the industries will still be investing well over £6 billion. Quantity of investment frustrated by tight EFLs is less than often implied. TSSC report last August estimated in range of £250-500 million this financial year.

6. Future years?

Investment approvals will be published in forthcoming Public Expenditure White Paper, as in previous years.

7. Take nationalised industry investment out of PSBR?

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

8. Private finance for NI investment?

We have indicated our willingness to consider new financing proposals, most recently in the context of the review carried out by the NEDC Working Party. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself reduce PSBR, nor does it lessen burden on financial markets.

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

Yes. In particular, moderate pay settlements are essential. Ability to finance new investment in nationalised industries is bound to diminish if excessive pay settlements are agreed. Each 1 per cent off wage costs would save about £140 million per annum; and each 1 per cent off total costs saves £330 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

10. Nationalised industries' prices

Nationalised industries' price rises have been due in part to ending of previous Government's policy of artificial and distortionary price restraint. But since middle of 1980-81, gap between NI price increases and RPI has started to narrow sharply. Artificial price restraint would result in unacceptable increased burden on taxpayer and distortion of market forces.

[CAUTION: gap between NI and 'all items' RPI could widen again in near future. Factors include LT fare and domestic gas prices increases in spring, winter electricity discount scheme ending, dropping out of RPI of last year's double revalorisation of excise duties.]

[IF PRESSED on domestic gas price increases: These prices will still be below economic levels.]

11. Will HMG take action over electricity price rises to large users?

The review by the Electricity Council of the CEGB's Bulk Supply Tariff has now been produced and considered by Ministers. Await my rhF's Budget Statement.

12. Will HMG take action over industrial gas prices?

HMG is well aware of industry's concern about further increases in gas contract prices. Await my rhF's Budget Statement.

PRIVATISATION

13. Government simply selling valuable national assets to achieve PSBR target?

Of course the cash is welcome, but benefits run wider than that. Not only will the main financial benefit be that future borrowing of these undertakings will be outside the PSBR and no longer burden the taxpayer, but the organisations concerned will be made responsive to market forces and thus have greater incentives to improve efficiency.

14. Does the Government have more privatisation plans to announce?

Legislation already passed to enable public to hold equity stake in British Airways, British Transport Dock Board, subsidiaries of British Rail; and to dispose of some of British Telecom's peripheral activities. Oil and Gas (Enterprise) Bill published 17 December will permit public to invest in BNOC's upstream business and certain parts of BGC's activities, in particular oil production. The Government have now sold its entire shareholding in the National Freight Company and Amersham International. We shall be announcing further measures in due course.

15. Special disposals programme just a subsidy for speculators?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices where shares first traded]

Not in Government's interest to see shares underpriced, but also risks in pitching price too high. Getting balance right not easy - especially where company's shares have not previously been traded. [IF PRESSED: Government concerned to learn from experience: well aware of the criticisms that have been made.]

16. How will Government handle sale of Britoil in light of Amersham experience and falling world oil prices?

No detailed decisions have yet been made as to the manner of the sale.

17. Will HMG postpone sale of Britoil after recent oil price falls?

HMG hopes that the sale of shares will take place before the end of this year. HMG is determined to ensure that taxpayer benefits to the fullest extent from the sale. We would not go ahead unless satisfied that the price obtainable for the shares represents fair value to the taxpayer.

R NORTH SEA AND UK ECONOMY

1. Will HMG reduce price of North Sea oil further in face of weak market?

[BNOG have agreed \$4 a barrel reduction - equivalent to 11 per cent reduction in \$ price of Forties oil - now at \$31. Effect on sterling price - and hence Government revenues - could be smaller if the exchange rate falls as a direct result of the fall in \$ oil prices.]

Prices of UK oil are set by commercial negotiation. BNOG is largely a third party trader, and must find prices which satisfy both suppliers and customers.

2. Impact of falling oil prices on Government revenues and Government strategy?

[PM warned in 23 February speech that limited room for manoeuvre in Budget.]

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Economic Secretary to Treasury has estimated that each \$1 off the price reduces revenue, other things being equal, £300 million in full year. (New forecasts of Government revenues will be published at Budget time). But note that falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation.

3. What will HMG do about oil taxation revenues?

Await my rhF's Budget.

4. Will HMG change North Sea fiscal regime in line with proposals received?

I commend the oil industry's representatives and others who have made suggestions for the hard work they have put in. We have looked at the suggestions with an open mind. Await my rhF's Budget statement.

5. Does HMG accept C&AG's criticisms of the North Sea fiscal regime?

A full review of the fiscal regime is in progress. We shall take the C&AG's observations into account.

6. North Sea oil depletion policy?

Secretary of State for Energy announced in June last year that the Government would review the possibility of oil production cuts in 1982. We shall give the industry proper notice of our intentions.

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

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 a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Only one-twentieth of total general government receipts in 1981-82.

8. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels. Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

9. North Sea revenues should be channelled into a special fund to finance new investment, particularly in energy?

North Sea revenues are already committed. Setting up a special Fund would make no difference. More money would not magically become available. So the money for this Fund would have to come from somewhere else. This would mean higher taxes or lower public expenditure, if public sector borrowing is not to rise. If borrowing did rise, then so would interest rates. Not obvious that net effect would be good for investment.

S WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Governments will have no choice but to reverse policies now unemployment has risen to post-war record levels in many Western countries?

[Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and probably exceeded 2 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since 1935.]

No indication of a widespread departure from consensus achieved last year (eg Ottawa Summit, IMF Interim Committee) about need for prudent fiscal and monetary policies to bring down inflation.

2. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries fell to 9.4 per cent in December. Underlying rates falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980 to around 9.4 per cent in December 1981. Further decline expected 1982.

3. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

4. Other countries giving priority to reducing unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

5. Other governments not following such stern policies as UK?

[Most major countries (US, Japan, Germany, Italy, Netherlands, Belgium, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Belgian government has used its special powers to freeze prices temporarily and severely curtail wage increases for rest of 1982.]

Most governments persevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

6. UK is alone in Europe. Even Germany announced investment/employment scheme last week?

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

7. Prospects for UK economy worse than for other countries?

No. Treasury and most independent forecasts expect UK growth this year of about 1 per cent. This is broadly in line with the OECD's forecast for our major industrial competitors. Unemployment is expected to rise in all major countries except Japan. UK inflation (GNP deflators) likely to be around the OECD average and below that in France, Italy and Canada.

8. Even US using fiscal deficit to stimulate economy?

True US deficit is larger than anticipated. It is planned to fall but present level carries risk of prolonging period of high interest rates which could delay a European recovery. We strongly support the determination of the US authorities to combat inflation. But we believe fiscal and monetary policies must work together to that goal.

9. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer and have fallen in the last few weeks.

10. Prospects for international interest rates?

Always difficult to forecast interest rates with certainty, but firm and balanced policies should over a period bring lasting reduction in both inflation and interest rates.

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, St James) assess fall in output ended in H1 1981, with some recovery thereafter (in range 1-1½ per cent for 1982). ITEM and OECD are more pessimistic; seeing further falls of output into 1982. Year-on-year inflation is forecast by most groups to fall further to a range of 9-10½ per cent in 1982 Q4. Most groups see little possibility of further substantial reductions in 1983; inflation forecast to remain around 10 per cent in 1983. The industry Act forecast, of a 1 per cent rise in output in 1982, and 10 per cent inflation in Q4 1982 is broadly in line with this consensus. Unemployment (UK adult seasonally adjusted) forecast to reach around 3 million by end 1982, with some groups (P&D, LBS, Simon & Coates) expecting stabilisation in 1982, other expecting some further rise.

GDP output estimate rose in both Q3 and Q4 1981. Level in Q4 some 1 per cent above Q2. In Q4 1981 industrial output rose ½ per cent while manufacturing output was little different from the previous quarter.

Consumers' expenditure rose 1½ per cent in Q4 1981: the overall level in 1981 was only very slightly higher than 1980. Retail sales rose sharply in January 1982 but the average level in the 3 months to January fell by ½ per cent. The volume of visible exports in Q4 1981 was 5½ per cent higher than in Q4 1980. The volume of visible imports rose 14 per cent on the same comparison. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £20 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the last two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,836,000 (11.7 per cent) at February count, up 7,000 on January. Vacancies were 113,500 in February.

Wholesale input prices (fuel and materials) rose ½ per cent in February; however the year-on-year increase fell to 12 per cent. Wholesale output prices rose ¾ per cent in February and are 10½ per cent above a year ago. Year-on-year RPI increase remained at 12.0 per cent in January. Year-on-year increase in average earnings was 9.9 per cent in December. RPDI was flat in Q3 1981 following falls in the previous two quarters and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio rose 1 per cent to 14½ per cent in Q3 1981.

• • • PSBR £9.7 bn in the first three quarters of 1981/82 and CGBR (unadjusted) £8.0 bn in ten months to January 1982; but both distorted upwards by the civil service dispute. Underlying PSBR believed in line with Budget forecast (£10½ bn).

Sterling M3 increased by 1.7 per cent in banking January.

Visible trade showed average monthly surplus of £190 million in the 4 months to December 1981 compared with an average monthly surplus of £525 million in the first two months of 1981. Invisibles surplus in 1981 estimated at £2.8 billion. Reserves at end-February \$23.4 billion. At the close 4 March the sterling exchange rate weakened to \$1.828 : the effective rate was 91.0.