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Prime Minister ^②

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Dear Robin,

MS

The Prime Minister will wish to be aware of the economic assumptions Treasury Ministers have in mind for use in the report of the Government Actuary (GA) on the social security benefits updating order (to be published around the end of June), and in the Public Expenditure Survey.

The main assumptions are summarised as follows:

MAIN ECONOMIC ASSUMPTIONS

	Unemployment (million)	Prices (per cent rise to May)	Average Earnings (per cent rise year on year)
1985-86	<u>3.0</u>	6½	<u>7½ (7)*</u>
1986-87	2.9	4½	6
1987-88	2.85	3½	5
1988-89	2.8	3	4½

*Figure in brackets is for underlying earnings growth, ie adjusted for the effect of the coal strike.

The only assumptions to be published at this stage will be those for unemployment and earnings for 1985-86. They will be contained in the GA's report, and are underlined in the above table. For prices, the report will be based on the actual May RPI figure to be published in June.

For unemployment, the figure that it is proposed to publish is an average 3.0 million unemployed (GB narrow definition, ie excluding school leavers) in 1985-86. This is the same as the assumption published in the GA's November 1984 report. The Treasury's economic forecast completed just before

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the Budget had figures for unemployment of 2.97 million in 1984-85 and 2.98 million in 1985-86. The figure quoted by the Government Actuary is normally rounded to the nearest 0.1 million or, occasionally, to the nearest 0.05 million. On either convention, the Treasury forecast for 1985-86 rounds to 3.0 million.

In the past the unemployment assumptions have normally shown a flat path for unemployment in later years; following this tradition, the assumption would be for unemployment to stay at 3 million in later years. The assumptions that Treasury Ministers are now proposing to issue allow for a decline in unemployment in the years after 1985-86. For 1986-87 and 1987-88 this decline in unemployment reflects the expenditure measures announced in the Budget (YTS and the Community Programme). This means that the public expenditure projections in the PES will take credit for the effect that these measures will have on social security expenditure, as the FSBP forecast of public expenditure did.

Figures for unemployment in the years after 1985/86 are not published at this time of year and the unemployment assumptions will be reconsidered in October before publication. We will, of course, keep the Prime Minister in touch with the proposals that Treasury Ministers then have.

For earnings, it is proposed to give the Government Actuary a figure of $7\frac{3}{4}$ per cent growth in 1985-86. This is affected by the return of earnings in the coal industry to a more normal level, following the end of the coal strike. The Government Actuary will be asked to give prominence, as he did in his November 1984 report, to the underlying figure for average earnings growth (ie excluding strike effects), which would be 7 per cent in 1985-86.

The figure for earnings growth in 1984-85 that he will publish will be $6\frac{1}{2}$ per cent (estimated outturn), equivalent to an underlying $7\frac{1}{4}$ per cent. Thus his figures will show a small decline in underlying earnings growth between 1984-85 and 1985-86. This means a slight change from the November 1984 report when the Government Actuary gave a figure of $7\frac{1}{2}$ per cent underlying growth in 1984-85, followed by 7 per cent in 1985-86.

*Yours ever
Rachel.*

RACHEL LOMAX