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FROM: H P EVANS
DATE: 30 January 1986

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Prime Minister 2

I suggest paragraphs 1-33 and, particularly the thorough discussion of employment prospects in paragraphs 112-120. There is a forecast assuming $18 oil on the back.

DHS
10/2

TREASURY ECONOMIC FORECAST

I attach a copy of our report on the internal forecast. While we base the main case on an oil price of around $20 a barrel, we look at the possible consequences of a $15 oil price.

2. Miss Peirson's report on Public Sector Finances is being circulated separately. It provides chapter and verse for our view that the lower oil revenues in the main case remain consistent with a sizeable, but reduced, fiscal adjustment in 1986.

3. With oil and financial markets so volatile, there is a somewhat greater than usual risk of changes to the forecast when we carry out the usual updating exercise next month for final decisions in the Budget and for the FSBR.

HPE

H P EVANS

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TREASURY ECONOMIC FORECAST

JANUARY 1986 REPORT

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TREASURY ECONOMIC FORECAST: JANUARY 1986

Report by EA

Introduction

This is the report on the internal January exercise. Detailed reports are being circulated as follows:

Public finances, Miss Peirson (PSF).

Oil production and revenues, Mr Hacche (EA2).

Financial forecast, Mr Mowl (EA2).

World economic prospects, Mr Matthews (EF2).

2. In general, we follow the policy framework of the last MTFS. The forecast covers the next two years, in summary pages 2-15, and in detail pages 21-59. Pages 16 to 20 outline the consequences of yet lower oil prices.

3. The **world economy** is now in a period of moderate growth and low inflation. The steep fall in oil prices in recent weeks will bring benefits to consumers in the form of lower inflation and higher growth of real incomes.

SUMMARY

4. The forecast makes broadly the same assumptions as the MTFS: that monetary and fiscal policy together will be set so as to bring about a decline in the growth of nominal GDP.

5. From 1986-87 onwards, the PSBR is as in the MTFS, although the composition (especially higher asset sales and lower oil revenues) has changed. This suggests that fiscal policy is a little easier than in the MTFS. To compensate for this and for the tendency of money GDP growth to be a little faster, monetary policy has to be somewhat ~~higher~~ tighter than was implied by the projections underlying the MTFS.

6. Indeed monetary policy is already tighter. The exchange rate is higher, and interest rates are very high, in real terms, in relation to other countries and relative to the MTFS.

Oil prices

7. The main uncertainty in this forecast is the level of oil prices and the consequences of the recent fall in prices for the world economy and the UK. Ever since 1982, successive forecasts allowed for falls in real oil prices as a consequence of the growing imbalance between supply and demand - but these falls did not begin until 1985.

8. We have assumed that North Sea prices average $20 for the rest of this year and in 1987, 25 per cent below last year. A bigger fall is likely if OPEC does not reduce its output. Even if the price does average $20 for 1986, there are liable to be sharp fluctuations: one possibility is that prices will fall further before recovering later in the year.

Exchange rates and interest rates

9. This forecast was completed against the market background of a falling pound and upward pressures on interest rates. Thus far the exchange rate has fallen no more than would be expected given the fall in oil prices. Fears of further oil price falls, and some uncertainty over policy, may explain the current market pressures. The situation is, however, different from a year ago, when there was only a modest fall in oil prices in relation to the fall in the exchange rate, and a larger rise in UK interest rates. Last year these factors led to a sharp recovery in the exchange rate, though with some delay.

10. We assume that the exchange rate fall attributable to oil prices (using a ratio of about 1:4) is accommodated with only a moderate rise in interest rates - because the net effect on inflation is probably small. We also assume that, whatever the immediate fluctuations, the lure of high UK rates will serve to steady the exchange rate once the uncertainties over oil prices and over policies are reduced.

	Exchange rates		North Sea Oil price		Short-term Interest rates, per cent		
	Effective index	$/£	$	£	UK	UK-world differential	UK "real"
1984 Q4	75	1.22	28½	23½	10	1	5½
1985 Q4	80	1.44	29	20	11½	3½	7
1986 January 29	74	1.39	18½	13½	13	5	9½
1986 Q4	75	1.44	20	14	11½	4½	7½
1987 Q4	73	1.48	21½	14½	10¾	4½	6½

The financial forecast

11. MO growth has slowed down this financial year, probably in response to higher interest rates. The growth of MO remains around 4 per cent in 1986-87 and 1987-88 as the growth of personal incomes stays high and interest rates decline slowly. We judge that rapid growth in £M3 is consistent with low inflation: there is every reason to expect further falls in velocity. A chart on page 59 shows that in successive versions of the MTFS (the same is true in internal forecasts) there has been a pronounced tendency to over-forecast £M3

velocity. (Forecasts of money GDP have been much more accurate than forecasts of £M3.) The scale of financial liberalisation, and probably somefall in the price of financial services, is continuing to encourage both companies and persons to hold more financial assets and liabilities. The forecast is summarised and compared with the MTFS in the following table:

Monetary Policy Targets and Indicators

(per cent changes on a year earlier for M0 and £M3)

	Sterling Index		M0		£M3		UK short Interest Rates	
	Forecast	MTFS	Forecast	MTFS range	Forecast	MTFS range	Forecast	MTFS
1984-85	76	76	5½	4-8	9½	6-10	11	11
1985-86	79	74	4½	3-7	13	5-9	12¼	12
1986-87	75	74	3½	2-6	13	4-8	11¾	10
1987-88	73	72	3½	1-5	12	3-7	10¾	9

Inflation

12. Inflation, as measured by the RPI, is now set to fall quickly. Even with a rise in mortgage rates, the RPI should be a little below 4 per cent in the second quarter, on the assumption that indirect taxes are indexed in the budget. By the fourth quarter the RPI rate may be about 4 per cent: the slight deterioration compared with the Autumn Statement reflecting adverse movements in the mortgage rate and local rates. The broader measure of inflation, the GDP deflator, is expected to rise by 5½ per cent in 1985-86, and 4 per cent in 1986-87: both figures would be 1-1½ per cent higher without the steep decline in sterling oil prices. Most measures of inflation are not expected to change much in 1987: lower increases in wages and profits should offset the faster growth of import prices.

Income and spending

13 Rising output and falling commodity prices should provide companies (except those in the North Sea) and households with substantial rises in real incomes; we expect real incomes of industrial and commercial companies to rise a further 7 per cent in 1986, while persons' real incomes, after tax, may rise by about 5½ per cent. This includes ½ per cent from the assumed fiscal adjustment.

14. Judgments about private sector spending also take into account the high level of interest rates and the availability of finance. The forecast gives greater weight to the high level of interest rates than to the availability of finance. Even so, private sector spending is likely to rise strongly this year, and, though perhaps more slowly, in 1987.

Constant prices, per cent changes on a year earlier

	level in 1984 £ bn	1985	1986	1987
Company sector spending	27	4	4	3½
Personal sector spending	152	2½	4	4
Government spending on goods and services	62	1	½	0
Total domestic demand	241	2	3½	3

Activity

15. Both 1984 and 1985 saw strong rises in **exports**: for manufactures export growth was probably 1-2 percentage points above the growth in world trade. We have assumed that this good performance will not be repeated: even so, export growth in 1986-87 may not be much short of that in world markets. In the home market too 1985 was a good year for domestic manufacturers, with only a slow rise in import penetration.

16. The fastest period of (underlying) growth in the economy was probably in the second half of 1984 and first half of 1985: some 4 per cent at an annual rate. There was some slowing down in the course of 1985: our forecast, which seems consistent with the January CBI Trends survey, suggests that underlying growth will be around 2½ per cent in 1986 and 1987.

Per cent changes on a year earlier

	1985	1986	1987
Domestic demand	2	3½	3
Exports (non-oil)	6	3	3
Imports (non-oil)	4	5½	4
GDP: non-oil output	3½(3)	3 (2½)	2½
GDP: total output	3½(3)	3 (2½)	2

Figures in brackets are after adjustment for the effects of the coal strike

Unemployment

17. The continuing rise in activity is probably still creating new jobs, though the statistics are not adequate to measure the scale of increase with any accuracy. Unemployment has risen only a little in the past nine months. The increasing effect of special employment measures (this forecast assumes extra spending out of the reserve of £150 million net in 1986-87), the re-structuring of National Insurance Contributions, and the slow down in the growth of the labour force may well make for a slow fall in unemployment. But at the aggregate level, there is no sign of any downward adjustment of real wage growth in the UK.

Current account of the balance of payments

18. The current account has been in sizeable surplus for some years now, and we expect another substantial surplus to be earned in 1986, despite the decline in oil prices. The deficit on manufactures may increase, with the surplus on invisibles growing. 1987 may see a smaller surplus, partly because of a smaller contribution from oil.

Nominal income: the policy framework and the impact of falling oil prices

19. The forecast is for the growth of money GDP to slow down, though by rather less, mainly in 1987-88, than in the MTFS:

	per cent			
	1984-85	1985-86	1986-87	1987-88
MTFS	6¾	8½	6½	5¾
January forecast	7(8½)	9(7½)	6½(6½)	7

Figures in brackets are adjusted for the estimated effects of the coal strike. Growth in nominal GDP this year is turning out very close to that in the MTFS.

The composition of money GDP growth in the forecast is as follows:

	per cent			
January forecast	1984-85	1985-86	1986-87	1987-88
GDP Deflators total	4½	5½(5)	4 (4½)	4½(3½)
non-oil	3½	7	5½	4½
oil	+ 15	- 18	- 28	+ 1
output (strike adjusted)	3½	2½(2½)	2½(2)	2 (2)
Nominal GDP (strike adjusted : total	8½	7½(7)	6½(6½)	6½(5¾)
non-oil	7½	9	8½	7½

Figures in brackets are from the 1985 MTFS

20. Even though oil output represents only 5-6 per cent of total GDP, the big price falls mean that its contributions to changes in nominal GDP are significant. The bottom line shows that there is a declining trend in non-oil nominal incomes in both of the forecast years. This mainly reflects the trend in prices: the fall in oil and other commodity prices working their way through to wages and profits. The fall in nominal GDP brought about by lower oil prices is at least partly offset by a faster rise in output in the non-oil sector.

Risks and uncertainties

21. Errors from past forecasts are reminders of the scope for error:

	Forecast	Average error from past forecasts
GDP growth 1985 to 1986	3	1
Balance of payments on current account, £billion, 1986	4	2½
RPI: per cent increase to fourth quarter, 1986	4	1*
Fiscal adjustment 1986-87, £ billion	2	2½**

* Average error calculated from budget forecasts since 1979

** Average error calculated from PSBR errors in budget forecasts (since 1981)

The fiscal prospect

22. On **Public expenditure**, (full details are set out in Miss Peirson's note) we start with the plans in the 1986 PEWP, though for years after 1986-87 the plans look increasingly unrealistic in some key areas. We attempt to forecast whether the Reserves will be over or under spent, and by how much. For 1986-87, we make the following crucial assumptions:

(i) There will be no major policy changes increasing expenditure. But the pressures on programmes are nearly always upwards.

(ii) There will be no major unexpected calls on the Reserve - such as a coal strike.

(iii) Economic developments will be as in our main forecasts.

23. The new style Reserve covers all spending over and above programmes. By calculating the difference between outturn and programme plans for the year immediately ahead we see the size of reserve that was actually needed in recent years:

	£ billion					
	1981-82	1982-83	1983-84	1984-85	1985-86 Forecast	1986-87 Forecast
Reserve needed	1.5	1.4	2.2	6.1 (3.5)	4.7 (3.6)	4½
Allowance in Budget forecast	1.6	2.4	- 0.1	2.8	5.0 (4.5)	4½*

Figures in brackets exclude the costs of the coal strike.

* 1986 PEWP

24. The increasing difficulties of public expenditure control are reflected in the top line. For 1986-87, it is sensible to make a comparison with the strike adjusted figures for earlier years. Except for 1983-84, the allowance made in the FSBR for the year ahead was about right, if the coal strike effects are excluded.

25. Our central estimate of the **Reserve** required is £4½ billion in 1986-87. It is a coincidence that this is the same figure as in the PEWP.

26. For later years the Reserves have usually been seriously inadequate: the same is likely to be true of current plans, by perhaps £2½ billion in 1987-88 and perhaps double that in 1988-89. The increase in the Reserve (from £4½ billion in 1986-87 to £6¼ billion in 1987-88 to £8 billion in 1988-89) is barely enough to cover the likely increases needed for local authorities alone, and there will be other claims (such as social security) increasing over the period.

27. **Revenues** are buoyant, except for oil revenues which are forecast to fall from £11½ billion this financial year to £8 billion in 1986-87 and £6½ billion in 1987-88. This is based on a North Sea price of $20 a barrel.

The table below analyses the forecasts of central government revenues from taxes and National Insurance contributions.

CG revenues (excluding oil taxes) from taxes and NICs, as proportion of nominal income (less oil), per cent

		1983-84	1984-85	1985-86	1986-87**	1987-88**
(1)	Actual/forecast	33.4	33.3*	32.8	33.2	34.0
(2)	Line (1) adjusted to remove effects of changes in tax rates and allowances in 1984 and 1985 Budgets	33.4	33.3*	33.4	33.7	34.4

* adjusted for effects of coal strike (because the net effect on revenues was small)

** before fiscal adjustment

28. The rise of more than one percentage point between 1984-85 and 1987-88 in the adjusted proportion mainly reflects the effect of real fiscal drag on personal income tax (worth about £¾ billion). Receipts from corporation tax rise rapidly because of the lagged reaction of onshore company taxes to the rapid rises in profits in earlier years. A further factor is the forecast shift in the distribution of income from 1985-86 in favour of employment incomes and away from onshore company profits (reversing the shift seen up till then). This will tend to raise taxes for given total nominal incomes because the average tax rate on employment income is higher than on company income.

29. Since the 1985 MTFS, the forecasts have changed as follows:

£ billion	1985-86		1986-87	
	MTFS	Jan 86	MTFS	Jan 86
Oil revenues	13½	11½	11½	8
Non-oil revenues	136½	138	147½	150
Total	150	149½	159	158

30. The increase in non-oil revenues in both years reflects mainly a 2 per cent increase in the level of non-oil nominal income, as well as some increase in the yield for given incomes and expenditure. With no change in the planning total for 1986-87 (higher asset sales offsetting higher programme expenditure), the scope for fiscal adjustment has been reduced by the fall in oil revenues -but by much less in absolute terms because of the extra revenues elsewhere, some of which are already evident in 1985-86.

31. The 1985-86 PSBR which we revised up to £8 billion in the Autumn Statement we have now revised down to £7 billion: that estimate is likely to change further in the run-up to the Budget.

32. Our best estimate of the annual fiscal adjustments, with a PSBR at £7½ billion, are £2 billion for 1986-87 and £4 billion in 1987-88. There have been major changes to asset sales and to oil revenues in particular:

Asset sales, £ billion

	1985-86	1986-87	1987-88
MTFS	2½	2¼	2¼
PEWP/January forecast	2½	4¾	4¾

Oil revenues, £ billion

	1985-86	1986-87	1987-88
MTFS	13½	11½	9½
January forecast	11½	8	6½

33. The PSBR is one measure of the fiscal position. The **public sector financial deficit** - the net acquisitions of financial assets by the public sector - excludes from the PSBR financial transactions such as asset sales and net lending. In contrast to the PSBR, the financial deficit has increased in recent years.

	£ billion	
	PSBR	**Financial deficit**
Average: 1980-81 to 1982-83	10	9
Average: 1983-84 to 1985-86	9	12
1986-87	7½	11½
1987-88	7	11½

SUMMARY TABLE AND COMPARISON WITH THE FSBR AND AUTUMN STATEMENT

	FSBR/MTFS MARCH 1985	AUTUMN STATEMENT NOVEMBER 1985	JANUARY 1986
1. World GNP (major 6)			
(% change on year earlier)			
1984	4½	4½	4½
1985	3½	3	2½
1986	3	3	3
1987	3½	-	3
2. Effective Exchange Rate			
(1975=100)			
1984 Q4	75	75	75
1985 Q4	74	81	80
1986 Q4	74	81	75
1987 Q4	72	-	73
3. Oil prices, $ North Sea spot			
1984	29½	29½	29½
1985	27	27½	27½
1986	26	25	20½
1987	26½	-	20½
4. Nominal GDP (mp)			
(% change on year earlier)			
1984-85	6¾	7	7
1985-86	8½	9	9
1986-87	6½	7	6½
1987-88	5¾	-	6½

	FSBR/MTFS MARCH 1985	AUTUMN STATEMENT NOVEMBER 1985	JANUARY 1986
5. GDP Volume (% change on year earlier)			
1984	2½	2½	2½
1985	3½	3½	3½
1986	2	3	3
1987	2	-	2
6. RPI (% change on year earlier)			
1985 Q4	5	5½	5½
1986 Q4	3¾	3¾	4
1987 Q4	3	-	4¼
7. Unemployment (UK s a excluding school leavers, millions)			
1985 Q4	3.1	3.18	3.17
1986 Q4	3.0	3.2	3.10
1987 Q4	3.0	-	3.10
8. Current Balance (£ billion)			
1984	0	1	1
1985	3	3	3½
1986	2½	4	4
1987	1½	-	1½
9. PSBR, £ billion (% of GDP in brackets)			
1984-85	10½(3¼)	10 (3)	10 (3)
1985-86	7 (2)	8 (2¼)	7 (2)
1986-87	7½(2)	7½(2)	7½(2)
1987-88	7 (1¾)	-	7 (1¾)

	FSBR/MTFS MARCH 1985	AUTUMN STATEMENT NOVEMBER 1985	JANUARY 1986
10. Fiscal Adjustment (annual not cumulative)			
1986-87	3½	[3]	2
1987-88	3	-	4
11. Interest Rates Short-term (per cent)			
1985 Q4	11½	11½	11¾
1986 Q4	10	10¼	11½
1987 Q4	9¼	-	10¾
12. Money Supply £M3 (% change)			
1984-85	9½	9½	9½
1985-86	8½	13½	13
1986-87	7½	12	13
1987-88	6½	-	12
13. Money Supply M0 (% change)			
1984-85	4¾	5½	5½
1985-86	4½	4½	4½
1986-87	4½	4	3½
1987-88	5½	-	3½

OIL PRICE VARIANT

34. The main forecast assumes that world oil prices in 1986 and 1987 remain at about $20 per barrel, close to the current spot level. There is great uncertainty over this, and as a variant we have investigated the effect on the world and UK economies of assuming that there is further fall in the price of oil of $5 (25 per cent) at the beginning of the second quarter of 1986. Oil prices are then assumed to remain about $5 per barrel lower than in the base throughout the forecast period.

Effects on World Economy

35. The fall in oil prices will tend to reduce inflation, boost consumer spending and reduce government expenditure in the oil importing countries. The ultimate effect on world economy will depend crucially on the policy reactions of governments in both the industrialised and oil-exporting countries. In the former it is assumed that governments in the major seven countries keep monetary growth rates unchanged by lowering interest rates; and that countries with historically high budget deficits (US, France, Italy and Canada) allow the operation of automatic stabilisers to reduce their deficits in relation to nominal GDP, while deficits in Japan, Germany and the UK remain broadly unaffected by the lower oil price. The net effect is to reduce nominal GDP in the major 7 countries by up to 0.8 per cent, policy not being sufficiently expansionary to offset the effects of the fall in oil prices on the price level. The oil exporting countries, some of whom face severe balance of payments difficulties even in the base case, are assumed to cut imports and invisible payments (eg. payments to expatriate workers) by as much as possible to avoid exhausting their reserves of useable overseas assets too quickly.

36. Largely because we have no clear idea of the precise consequences, the variant makes no allowance for major changes in economic behaviour. Such a sharp fall in oil prices could pose problems for the banking system, eg. from the increased likelihood of default on debt repayments by an oil-dependent countries such as Nigeria or Mexico, or from failures of banks in the US which are heavily exposed in the energy sector. We have not attempted to make specific allowances for these risks.

37. Within this policy framework and under these assumptions, real GDP in the major seven countries could be 1¼ per cent higher after two years, and world import volumes perhaps 1¾ per cent higher in part due to greater world oil trade. The price level in the major 7 is forecast to fall by about 1 per cent after about a year. This effect increases to about 2 per cent after 2 years, but then stabilises because of higher world activity.

Effects on UK Economy

38. In the face of lower oil prices we have assumed that the PSBR ratio is unchanged, and that lower oil revenues lead to a smaller fiscal adjustment. This contrasts with the assumption in the Powell/Horton Working Paper where the PSBR was allowed to rise. We have assumed no change in interest rates. This is consistent with little effect on monetary growth.

39. The forecast variant is shown in levels terms in the table on page 19 and as differences in the table on page 20.

40. Unlike other OECD countries, whose balance of payments benefit, lower oil prices lead to a deterioration in the UK current account. Furthermore, if the lower oil price is expected to persist, the value of North Sea oil reserves, and future export earnings, are reduced. In the forecast variant the sterling effective rate falls by nearly 4 per cent in 1986, slightly less in 1987. This is less than our previous relationship - a 10 per cent fall in oil prices leading by itself to a 3 per cent fall in the effective rate - might suggest. This is because the effect on the exchange rate depends on the absolute (not the percentage) fall in oil prices: and a 25 per cent fall starting from $20 per barrel would have about two thirds the effect of a 25 per cent fall starting from $30 per barrel.

41. The fall in the exchange rate and some rise in UK exports in line with higher world activity is not sufficient to prevent a deterioration in the current account of about £1 bn in 1987. This compares with the fall in the value of oil exports of £2¾ bn in the same year. By 1987 it seems likely that North Sea production would be adversely affected, and a small allowance for this has been made of 4½m tonnes (4%).

42. The variant suggests that there would be virtually no change in GDP. However UK real incomes (measured by Real National Disposable Income) fall by nearly one half of 1 per cent compared with the forecast. Within unchanged GDP there is:

- higher non-oil net exports because of higher world trade, and an improvement in competitiveness,

- a small rise in fixed non-North Sea investment and stockbuilding caused by higher private non-oil output,

- lower consumers' expenditure, mainly because the smaller fiscal adjustment reduces real personal disposable income.

43. Unlike other industrialized countries which clearly benefit, UK inflation, as measured by the RPI, is virtually unchanged as a result of lower world oil prices in 1986 and 1987. This is because higher import prices and wage costs offset the effect of lower sterling oil prices. The GDP deflator, which excludes the effect of higher import prices and in which oil prices have about a 5 per cent weight, is lower than in the main forecast, by about ½ per cent, and consequently Money GDP is also lower in the first year, by about the same.

44. The assumed fall in the dollar price of oil of about 25 per cent leads to a reduction in sterling oil prices of about 23 per cent. This, coupled with lower production, reduces North Sea Revenues by £1¼ bn and £2¼ bn in 1986-87 and 1987-88 respectively, and gives levels of North Sea revenues of £6¼ bn and £4 bn in the two years. The fall in revenue is proportionately larger than the fall in prices because, in broad terms, taxes are levied on the surplus over operating costs.

45. The variant suggests that the fiscal adjustment would be £1½ bn and £2 bn lower than in the forecast in 1986-87 and 1987-88. The main changes in the public sector accounts are set out below:

£bn	Fiscal Adjustment	Income Taxes ex FA	North Sea Taxes	Total Receipts	Total Expenditure
1986-87	-1.4	0.2	-1.6	0	0
1987-88	-2.0	0.4	-2.3	-0.2	-0.2

SUMMARY TABLE JANUARY 1986 FORECAST

		MAIN FORECAST	LOWER OIL PRICES
1.	World GNP (major 7 excluding UK) % change on year earlier)		
	1986	3	3½
	1987	3	3½
2.	Effective Exchange Rate (1975 = 100)		
	1986 Q4	75	72
	1987 Q4	73	70
3.	Oil prices, $ Brent spot		
	1986 Q4	20	15
	1987 Q4	21½	16½
4.	Nominal GDP (mp) (% change on year earlier)		
	1986-87	6.7	6.2
	1987-88	6.8	6.7
5.	GDP Volume (% change on year earlier)		
	1986	2.7	2.8
	1987	1.7	1.8
6.	RPI (% change on year earlier)		
	1986 Q4	4.1	4.0
	1987 Q4	4.3	4.2
7.	Current Balance (£ billion)		
	1986	4¼	3¾
	1987	1½	½
8.	Fiscal Adjustment (annual not cumulative) £bn		
	1986-87	2¼	¾
	1987-88	4¼	2¼

LOWER OIL PRICE VARIANT

% change from base

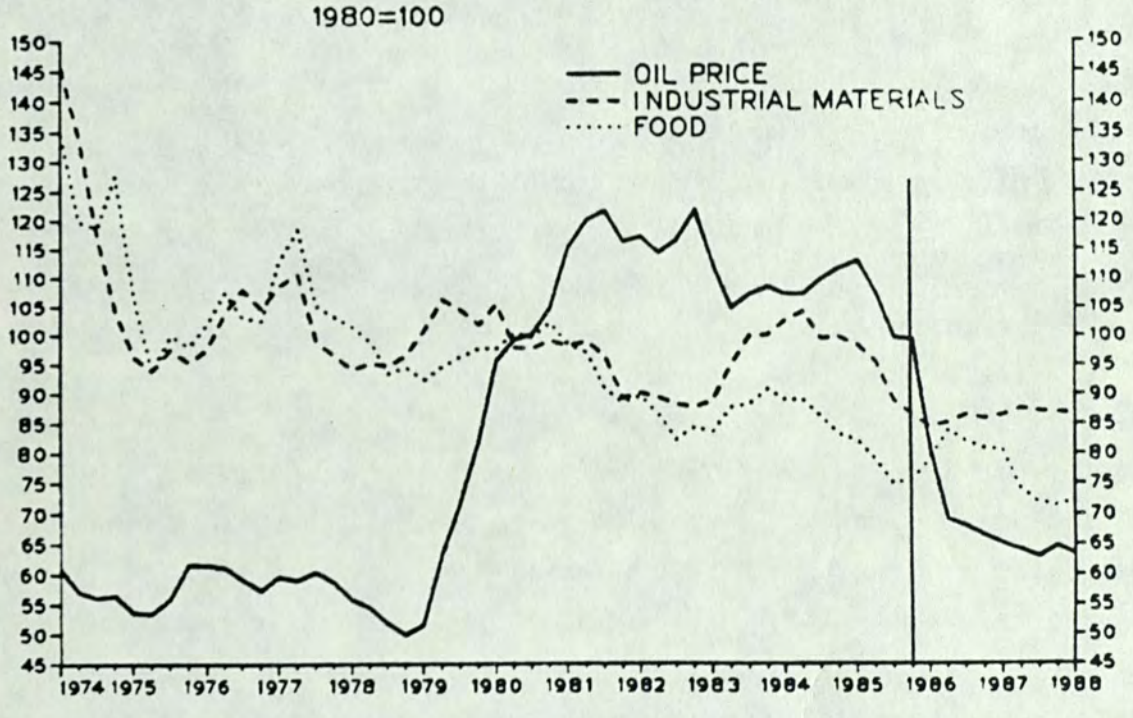
Year	Major 7 excl. UK GDP	Major 7 excl. UK Consumer Price Index	Real GDP	RPI	Nominal GDP	Real National Disposable Income	£ Effective exchange rate
1986-87	+0.6	-1.1	+0.1	-0.1	-0.5	-0.3	-3.8
1987-88	+1.1	-2.2	+0.1	-0.1	-0.6	-0.4	-3.7
1988-89	+1.3	-2.3	0	+0.1	-0.2	-0.2	-3.2
1989-90	+1.2	-2.0	0	+0.1	0	-0.2	-2.8

Year	Labour cost competitiveness	Earnings	Employees in employment (000s)	North Sea Revenues (£bn)	Fiscal Adjustment (£bn)	World Trade in manufactures (UK weighted)
1986-87	-3.8	+0.2	+10	-1.6	-1.4	+0.7
1987-88	-2.9	+0.3	+70	-2.2	-2.0	+1.5
1988-89	-2.9	+0.6	+70	-2.1	-1.6	+1.5
1989-90	-3.2	+1.0	+10	-1.9	-1.2	+1.4

THE WORLD ECONOMY

46 For some time we have been forecasting falls in **world oil prices**, but not big or fast enough. For this forecast we have assumed that world prices are $20 a barrel in 1986. This is not very different from the current (January 28) spot and forward price for West Texas Intermediate. The implications of a bigger fall were examined earlier in this report. For 1987 we have assumed no change in the dollar oil price, but a continuing fall in the dollar, and hence in the real oil price. Real oil prices are now close to their pre 1979 levels. With a few exceptions like coffee, other **world commodity markets** provide evidence of plentiful supplies relative to demand. Prices are likely to remain weak.

REAL COMMODITY PRICES *



* IN RELATION TO PRICES OF MANUFACTURES

47. These big falls will stimulate oil demand and reduce supply from non-OPEC countries. But these effects build up only slowly (we have not yet seen the full effect of the 1979-80 price rises); and the present level of output in OPEC is likely to remain a long way below potential for some years. Hence any major strengthening of prices seems unlikely before the early 1990s.

48. Falling commodity prices provide a favourable background for industrial countries, enabling inflation to fall without squeezing profit margins or reducing real wages.

Per cent changes on a year earlier

	1983	1984	1985	1986	1987
World GNP (major 7)	2½	4½	2½	3	3
Consumer prices (major 7)	4½	4½	4	3	3
World imports: total	3	9	3	5	4

49. In the **United States** the slowdown in economic growth has been accompanied by lower interest rates. Short rates are now around 8 per cent, tax-deductible for business and consumers, and no longer look high in relation to an inflation rate of 3 per cent or so. The dollar has fallen (in effective terms) by over 20 per cent since its peak in February 1985, but the potential effect on inflation is being partly offset by lower importers' margins and the fall in oil prices. For 1986 as a whole, US import prices may be no more than 4 per cent higher than in 1985.

50. If confidence in financial markets does not break, the US should be able to continue with some growth and low inflation for a time. But the speed of adjustment to the deficits looks very slow indeed. The external deficit, in particular, is unlikely to decline much - even with some further dollar depreciation - until domestic demand growth in the US is appreciably slower than in other OECD countries. This could come about either through a speeding up of domestic demand growth elsewhere, and there is an element of this in our forecast for Japan and Europe, or by a further slowing down in the US. A US recession could be induced by tighter policies if a faster adjustment to the deficits is required. Domestic demand growth in the US and other countries is summarized in the following table:

Domestic demand at constant prices
per cent changes on a year earlier, at annual rates

	US	Japan	Europe	UK
1982-84	7	2½	1½	3½
1984-87	3	4	2½	3

51. With some further appreciation of the yen and DM, and with falls in commodity prices, we expect falling interest rates and broadly stable prices in **Japan** and **Germany** for the two or three years. In terms of both deutschmarks and yen, world oil prices are currently roughly half their level of eighteen months ago. But with some further tightening of fiscal policy in Japan, the expansion of domestic demand may not fully compensate for a slower growth of Japanese exports, leaving GDP growth in the 3-4 per cent range, compared with the 4-5 per cent of recent years. The potential for faster growth is greater in Europe and we expect the 2 per cent growth rates of the last two years to be succeeded by growth nearer to 3 per cent in 1986 and 1987.

52. Most **developing countries** will benefit from continued expansion in OECD, and from the big fall in oil prices, even though their own export prices may be weak. Oil exporters face the prospect of further large cuts in imports, as well as running down their reserves. Heavily indebted oil producers such as Mexico and Nigeria are likely to face particular difficulties and to seek greater debt relief from their creditors.

EXCHANGE RATES AND COMPETITIVENESS

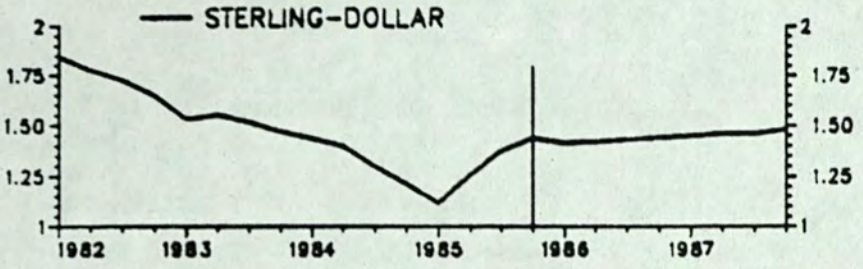
53. Forecasts made a year ago underestimated the level of sterling in 1985. One factor was an initial underestimate of the interest differential in favour of sterling (see table), which averaged 4 points, compared with less than 1 in the two previous years; another was a larger than expected fall in the dollar. But for most of the explanation we have to resort to the tendency of financial markets to overshoot in the short run. In the present forecast we have made some allowance for this, but have taken the assumed improvement in sentiment partly in the form of a fall in interest rates from their current level and partly a small rise in sterling.

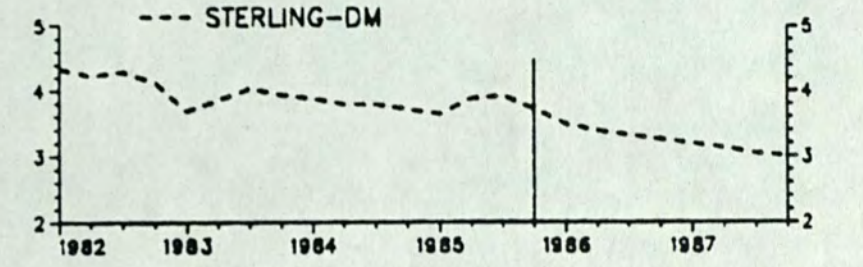
	Forecasts for 1985 made in:				
	January 1985	**Budget 1985**	**Autumn Statement 1985**	**1985 Outturn**	**Current Forecast for 1986**
Sterling Index	72	73	78½	78¼	75½
Short term Interest rates	11½	12½	12¼	12¼	12¼
Interest differential	2¾	3½	4	4	5
Oil prices:					
$	26½	27	27	27	20½
Real*	101	109	103	105	71
Dollar effective	142	148	141	141	122

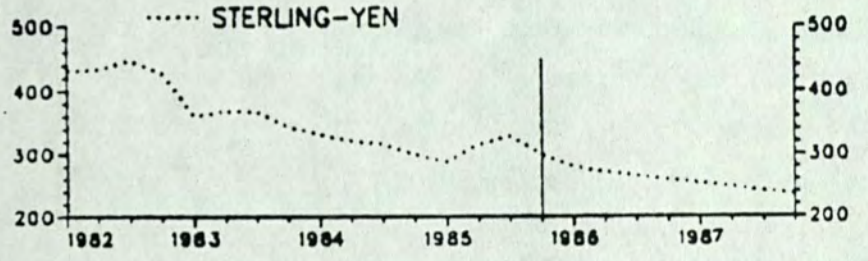
* 1980=100

54. Recent market expectations, as implied by the interest differential reflected in the forward rate, have been for sterling to depreciate about 5 per cent over the next year. The forecast has a slower fall because we assume a revised market assessment if oil prices stabilise as forecast, the dollar continues to weaken and the economic indicators (inflation, current account) are favourable. UK short rates in 1986 are forecast to be 5 per cent above the average of the major 6.

BILATERAL RATES FOR STERLING

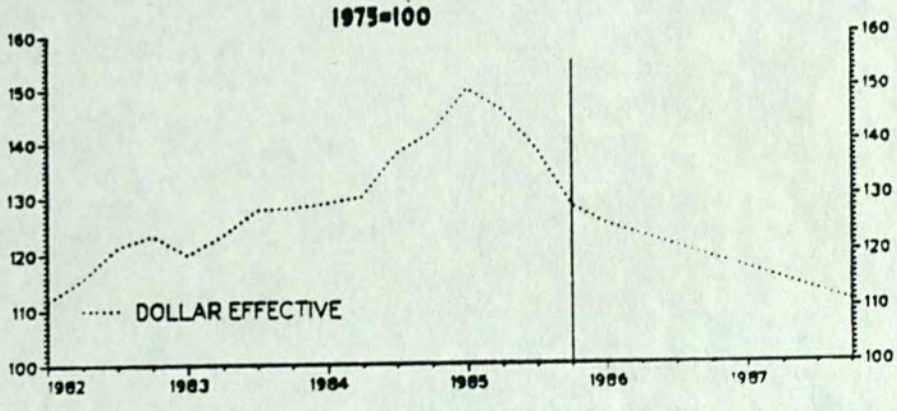


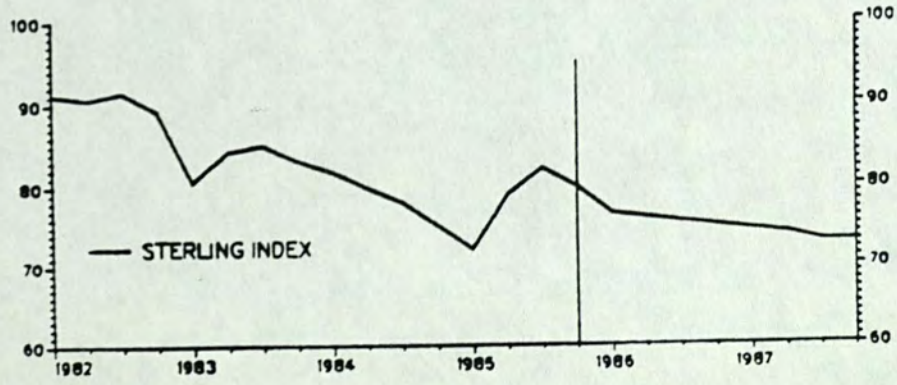




STERLING AND DOLLAR EXCHANGE RATES

1975=100





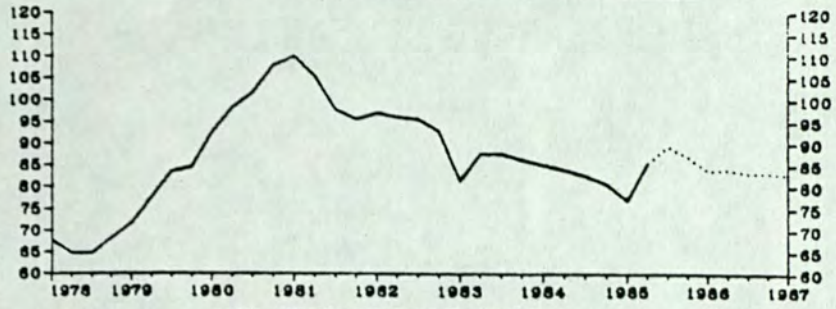
55. With the effective exchange rate at the bottom end of, or slightly below, the 75-85 range of the last four years, there should be a slight improvement in UK manufacturing competitiveness.

Price and Cost Competitiveness 1980=100

	Effective Rate	Relative export prices	Relative Unit Labour Costs
1983	83½	90	85½
1984	78½	88½	83
1985	78	92	85
1986	75½	91	83½
1987	73½	90½	82

56. While all the measures show an improvement in cost and price competitiveness since 1980, the last few years - and the next two years on our forecast - exhibit little change. This is despite a falling trend in the exchange rate, and reflects the tendency of labour costs in the UK to rise more than in our main competitors. The fluctuations in measured competitiveness in recent years (which are mirrored in the CBI balances - see next chart) are not likely to be contributing much to the UK's trade performance.

RELATIVE ACTUAL UNIT LABOUR COSTS



RELATIVE EXPORT PRICES

PROPORTION OF RESPONDENTS IN C.B.I. SURVEY CITING PRICES (COMPARED WITH OVERSEAS COMPETITORS) TO BE A CONSTRAINT ON EXPORT ORDERS

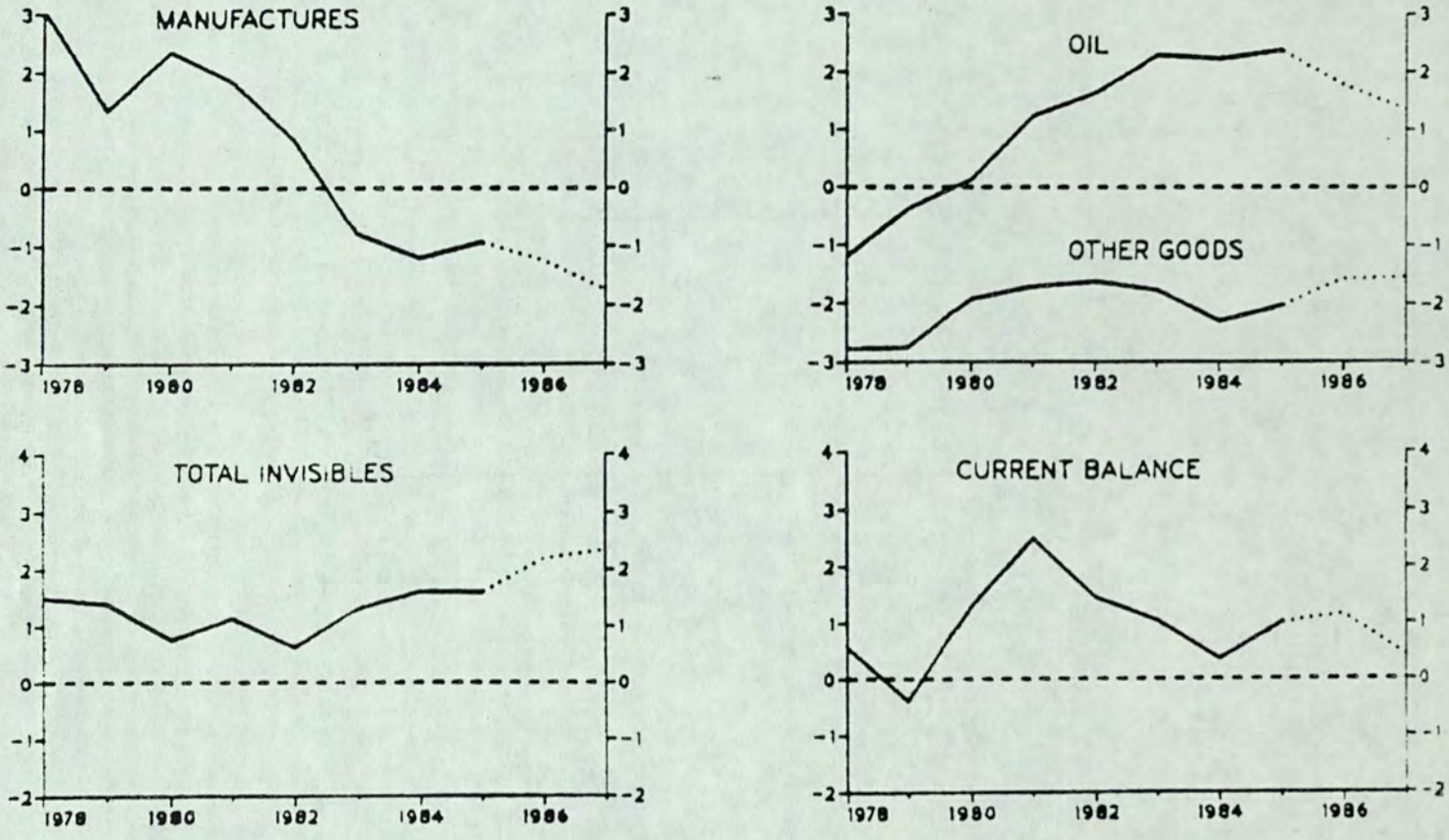
Trade and the balance of payments

57. The UK is expected to continue to run a substantial balance of payments surplus in 1986, as it has done since 1980. The contribution of manufacturing has tended to fall since 1979, more than offset by rising surpluses elsewhere. The chart below sets out recent trends and prospects.

58. Over the forecast period the oil surpluses fall with oil prices. The deficit in manufacturing was steady in 1984 and 1985, reflecting a combination of good growth in world trade, a strong trade performance - in terms of market share - by the UK, and in 1985 improving terms of trade.

59. We assume that trade performance will continue to be strong by the standards of the past 10-15 years, but not to the same extent as in 1984-85.

TRADE BALANCES AS SHARE OF GDP



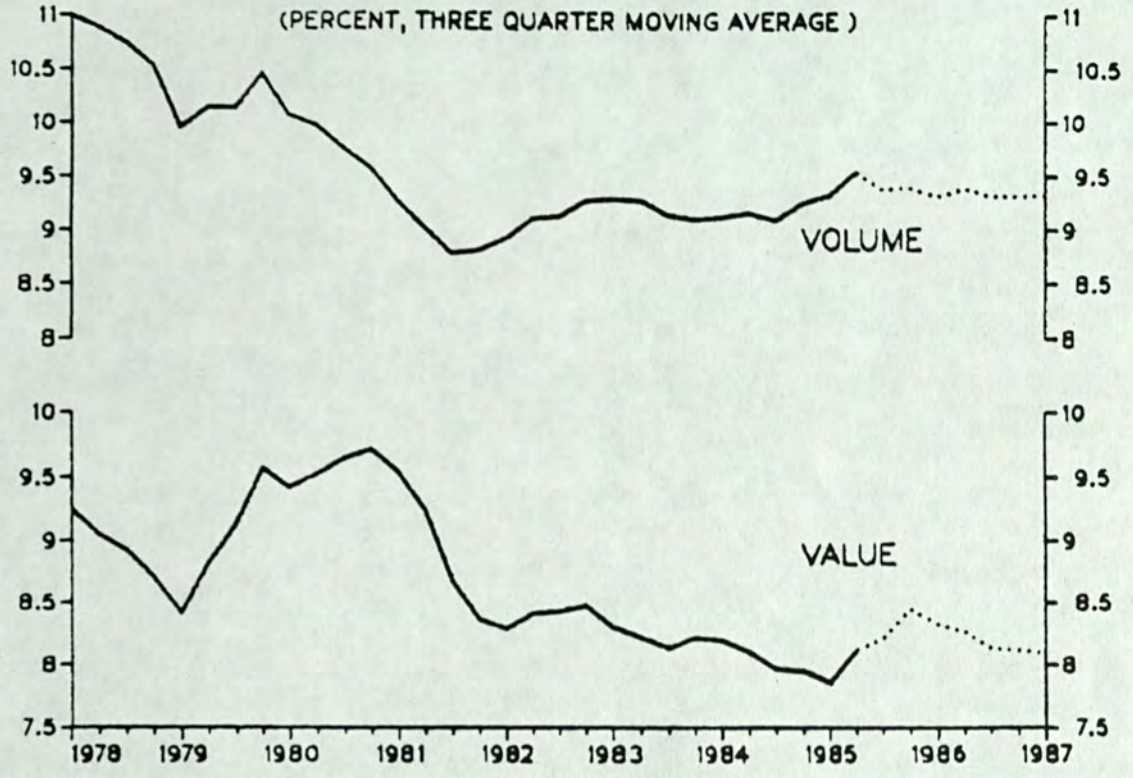
60. The improvement in the balance on other goods (food, drink and tobacco and basic materials) is largely the result of the 9 per cent improvement in the terms of trade that has recently taken place.

Trade in Manufactures

61. Short term movements in manufactured goods trade, which account for 70 per cent of total trade, are dominated by world trade and domestic demand.

62. Exports were higher than forecast in both 1984 and 1985 and exporters improved their share of world trade in volume terms - this is unusual in a period of substantial growth in world trade. The chart below shows the UK share of world trade in both volume and value terms.

SHARE OF U.K EXPORTS IN MAIN MANUFACTURING COUNTRIES EXPORTS OF MANUFACTURES



63. Recent information on exports suggest that we have once again experienced an increase in the last quarter of the year - although DTI statisticians claim that the seasonal adjustment is not at fault.

64. The forecast of exports is for slower growth of 3-3½ per cent in 1986 and 1987, partly because of some slowdown in world trade in 1987, but also because we have allowed for only part of the recent good performance to be repeated. Even so, any fall in the UK share of world trade is likely to be very modest.

65. In the last three years, the growth in demand has been shared by importers and domestic producers, with importers continuing to increase their share. We expect domestic demand for manufactures to grow a little more slowly in 1986 and 1987, partly because growth in the economy is less investment and more consumption orientated. Nevertheless with consumer durables spending rising strongly, especially in 1986, import growth is likely to be substantial: we put it at 8 per cent in 1986, 6 per cent in 1987.

Trade in Manufactures

per cent changes (except for last line), annual averages

	1974-1982	1982-1985	1985-1987
Volumes			
World trade	3	4½	4
UK exports	1	5	3½
Domestic demand	- 2	5½	3
UK imports	6	10	7
Terms of trade	+ 2	0	1
Balance of trade in manufactures level, as per cent of GDP	2½	- 1	- 1½

Invisibles

66. The balance of trade in **services** has more than doubled since 1982, and recent revisions by the CSO confirm that 1985 was an exceptionally good year for services - partly because the strengthening of the pound in the spring led to an improvement in the terms of trade without much effect on volumes. Any further improvement in the services balance in 1986 and 1987 is liable to be small. The balance on transfers was low in 1985 because most of the EC rebate for 1984 was deferred into 1986. Net payments to the EEC are expected to remain low in 1987.

67. Earnings from **Interest, Profits and Dividends** have been rising strongly in recent years as the stock of overseas assets has risen. There was a setback in 1985 because UK interest rates and other rates of return rose relative to those overseas, and because of BP's 0.6 billion write-off on Sohio. In 1986 and beyond, oil debits will fall, reflecting lower profits in the North Sea, and the non-oil balance, though still held down by high UK rates, should resume their rise as the stock of overseas assets rises. The invisible balance and its main components are set out in the following table.

Invisibles balances £ billion

	1984	1985	1986	1987
Services	4	6½	6½	6½
IPD	3½	3	4½	5½
Transfers	- 2½	- 3½	- 2½	- 3
Total	5	5½	8	9

The sterling value of the total stock of overseas assets has benefitted from rising stock markets but has been reduced by the rise in the sterling/dollar rate (a high proportion of our overseas assets are denominated in dollars). The table below gives past and forecast levels of our stocks of overseas assets. Of the rise estimated at £77 billion between 1979 and 1985, the cumulative current balance accounts for £20 billion, the remainder is accounted for by revaluations, including currency and stock market changes.

Net overseas assets

End year	£ billion	per cent of GDP
1979	12	6
1984	76	24
1985	90	26
1986	99	26
1987	105	26

68. The current account surplus is set out in the following table, with some of the special factors which distort the trends:

£ billion

	Current account						
	1981	1982	1983	1984	1985	1986	1987
Actual/forecast	6	4	3	1	3½	4	1½
i)coal strike effects	-	-	-	2½	1½	-	-
ii) Shift of EC rebate	-	-	-	-	½	- ½	-
iii) Sohio write-off	-	-	-		½	-	-
Current balance allowing for i) and ii) and iii)	6	4	3	3½	6	3½	1½
Memo Net oil exports less NS IPD debits (this item is adjusted for the coal strike)	1	2	4	6½	6½	4½	3½

69. Once again, despite some allowance for upward revisions of early estimates, the current account for 1985 is turning out a little better than in the forecasts. Except for oil, there now appears to be little tendency for the UK current account to deteriorate, when the UK and the world economy are growing at similar rates. The sharp deterioration between 1981 and 1983 reflected mainly the faster growth of domestic demand in the UK: 7 per cent, as against 2½ per cent in the major 6.

INFLATION

Producer Prices

70. As recent data and responses to the CBI survey show, manufacturers' ability to raise their prices remain very limited, mainly as a result of falling prices of competing manufacture imports. Even with little change in the growth of wage costs, the increase in total costs including imported materials and fuels may be no more than 3 per cent from now on. The main influences on producer prices are set out in the table below:

Manufactures
per cent changes on a year earlier
(annual averages)

	Unit Labour costs	Import costs	Total costs	Prices of imported manufactures	Domestic output prices
1984	1½	10	4½	7½	5½
1985	4	4	4	6½	6½
1986	4½	- 7½	1	4	4
1987	4½	2	3½	6½	4

71. The table shows costs again rising faster than more slowly than domestic output price so that margins rise in 1986.

RETAIL PRICES

72. **Nationalised Industry** prices in 1986 are being set early in the year, and provide for increases close to (a backward looking estimate of) the inflation rate. In consequence the growth of nationalised industry prices for the rest of 1986 looks high in relation to prices in general. By 1987, however, nationalised industry prices should rise at a slower rate than prices in general. We have allowed for the effects of lower oil prices on coal, gas and electricity, though more on industrial than domestic prices. **Petrol prices** are forecast to fall to 175p a gallon by the end of 1986.

Retail Prices Index, per cent changes on a year earlier

	Food	Housing	Nationalised industries	Petrol	Other	Total
Weights	19	15	8	5	53	100
1984 Q4	3.3	10.6	4.2	3.2	4.1	4.8
1985 Q4	3.2	9.3	5.4	1.6	5.5	5.5
1986 Q2	2½	8	5	- 10	4	3¾
1986 Q4*	3	9	5	- 10	4	4
1987 Q2*	3½	3	2½	- 7	5	4
1987 Q4	3½	5	3	- 2	5	4½

* Forecasts for these periods are normally published in the FSBR, but without the split between petrol and other.

73. **Housing** prices will be affected by a sharp increase forecast for local authority rates in April; and by movements in the mortgage rate: we have assumed a rise of 1 per cent in March, which is reversed in August. Details of the housing index are set out in the next table:

Housing prices in the RPI, percentage change on a year earlier

	Mortgage Interest payments	LA rates	Other (rents, insurance, repairs etc)	Total
Weights	32	25	43	100
1985Q4	12	9	7	9
1986Q2	9	12	5	8
1986Q4	12	13	4	9
1987Q2	- 3	9	4	3

74. RPI inflation slows to under 4 per cent over the next few months as the big increases in early 1985 drop out of the annual comparisons. The monthly figures may look as follows:

RPI

per cent changes on a year earlier

December 1985	(published)	5.7
January 1986		5.6
February		5.0
March		4.6
April *		3.9
May		3.8
Q3		4
Q4		4

This assumes specific indirect tax rates are raised by 5.7 per cent in the budget, in line with December outturn. The consequence for the level of the total index is ½ per cent, which is allowed for in these figures. If there were no rise in the mortgage rate, then the figures for March to May would be lower by 0.4 per cent.

75. By Q4 1986 the inflation rate is put at 4 per cent, ¼ per cent higher than the forecast in the Autumn Statement; the effects of lower oil prices have been more than offset by a lower exchange rate, a higher mortgage rate, and a higher forecast of local authority rates.

76. In 1987, there may not be much change in the inflation rate, as the growth of unit wage costs slows, but there is less gain on commodity and oil prices.

GDP Deflator

77. This measures the price of UK "value added". It is not affected directly by import prices nor by mortgage rates, and so tends to be more stable than the RPI (though subject to revision, usually upwards). Its main components are wages and profits per unit of output.

78. The MTFS profile showed only a very muted rise in 1985-86 and a slow fall thereafter. Our latest assessment is very similar.

GDP deflator, per cent change on a year earlier

	1984-85	1985-86	1986-87	1987-88
MTFS	4½	5	4½	3½
January forecast: total	4½	5½	4	4½
: total less oil	3½	7	5½	4½

79. The GDP deflator measures domestically generated inflation. It is affected by world prices only when world prices affect domestic profits, earnings, or other domestic incomes. Neither the rise in non-oil import prices during 1984-85 nor their subsequent fall has had the impact on the GDP deflator that it has had on other price indices. In 1985-86 and 1986-87 the fall in world oil prices pushes down North Sea prices and profits: the deflator for non-oil GDP rises by about 1½ points a year more than the whole economy GDP deflator.

Pay

80. Earnings growth in the private sector has been broadly constant at an annual rate of 7½-9 per cent since late 1982. Price inflation has fluctuated around an average of 5 per cent. Each of the last three pay rounds has led to a substantial increase, some 3 per cent a year on average, in real earnings before tax. This was a little higher than anticipated by wage bargainers, because of the tendency for price forecasts to be pessimistic except in 1985. There has been little or no tendency for the high level of unemployment to restrict the growth of wages. The ability of employers to pay, as substantial productivity gains have been made, has increased over this period.

Factors influencing private sector earnings, pay rounds

	1982-83	1983-84	1984-85	1985-86	1986-87
Inflation, per cent					
(i) At start of round, Q3	8	4½	4½	6½	(4)
(ii) Outcome on inflation, Q3	4½	4½	6½	(4)	(4)
Unemployment level at start of round, per cent	11	12	12½	12¾	(12½)
Profit share, per cent (non-North Sea ICCs)	8¾	10	12	(12¾)	(12½)
Earnings growth per cent change on a year earlier	8¼	7¾	8½	(8)	(6¾)

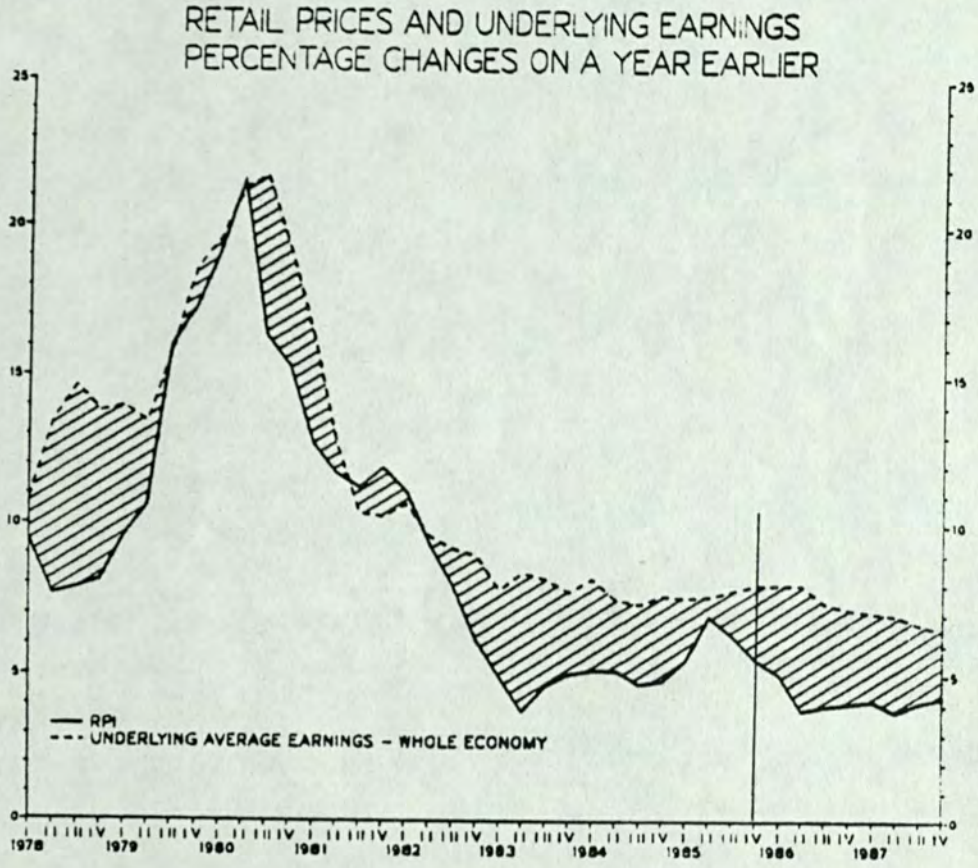
Figures in brackets are forecast; pay rounds run approximately from September to August

81. With both employers' and employees' real incomes rising strongly, wage bargains have been concluded with little difficulty. Short-term fluctuations in price inflation - often not fully anticipated - have had little impact on wage settlements and earnings growth. But a clear and sustained shift in the rate of inflation is likely to be reflected in wage settlements, though not immediately.

82. Current pay settlements are much as forecast: we expect earnings growth in the pay round as a whole to be about 8 per cent in the private sector. By the spring, inflation is likely to be down to below 4 per cent, and any pick-up later in the year likely to be small. By mid year, the average employee may have seen his take home pay up by some 6 per cent in real terms. (This includes a contribution of 1 per cent from the fiscal adjustment of £2 billion in the 1986 budget, assumed to be wholly in the form of income tax cuts).

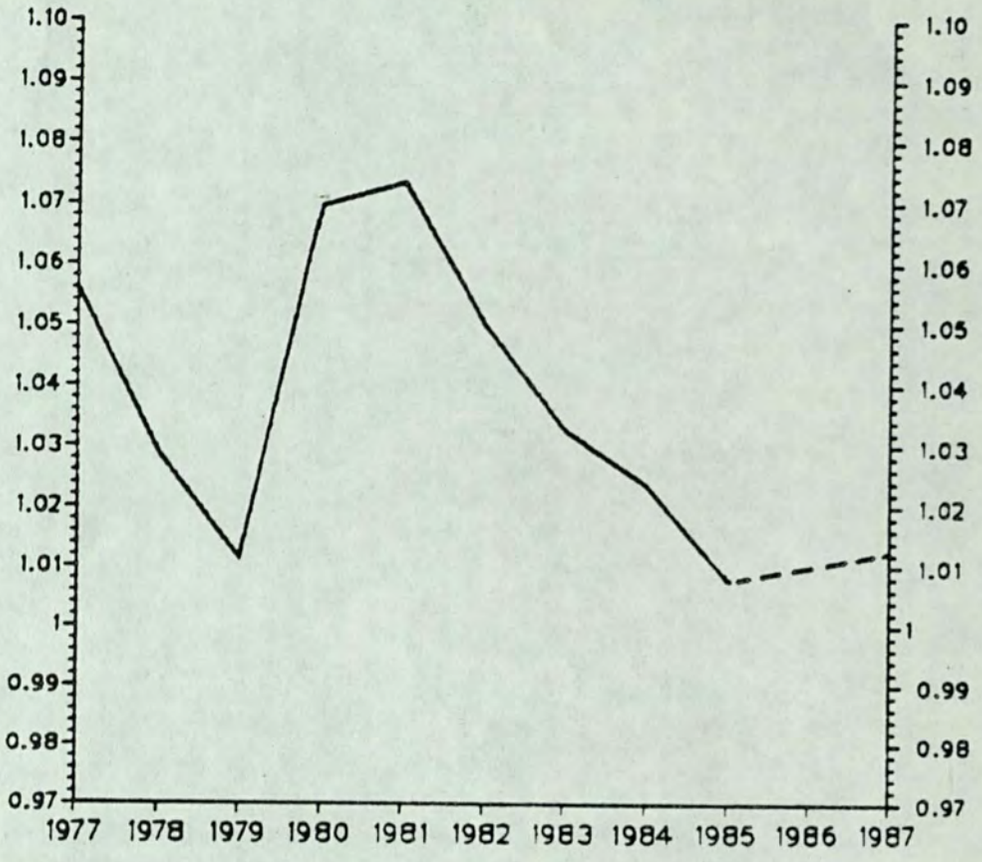
83. At mid 1986, employers will continue to see their ability to raise prices as limited: without lower wage settlements, profit shares and rates of return would be liable to decline. Taking into account both employers' and employees' position - and tending to give rather more weight to the former, though it is not crucial to the outcome - we think that earnings growth in the private sector may slow to 7 per cent or below in the course of 1987. Even this - with the help of another large fiscal adjustment in the 1987 budget -could deliver another 4-5 per cent growth in real take-home pay.

84. The overall picture for earnings growth and price inflation is shown in the next chart:



85. Public service pay presents more difficulties to both pay bargainers and forecasters. We interpret the offers made to local authority manuals, teachers and civil servants as evidence that pay will no longer rise more slowly in the public services than in the rest of the economy. We have assumed that from now on, earnings in the public services will in general rise at the same rate as earnings elsewhere: this will often mean higher settlements in the public services because of lower drift. The teachers we treat as an exception: as well as getting a late settlement of their 1985 pay claim (too late to be paid in financial year 1985-86) they get the extra £1¼ billion spread over 4 years. The resulting ratio of public service to whole economy earnings is shown in the chart below:

RELATIVE EARNINGS IN PUBLIC SERVICES
TO WHOLE ECONOMY EARNINGS (UNDERLYING)
(JAN 1980=1)



Labour costs

86. The table below shows the composition of unit labour costs (recent fluctuations in the monthly statistics for unit wage costs, around an average of some 5 per cent, are probably of little significance):

Private sector, per cent changes on a year earlier

	Earnings (underlying)	Taxes on labour and employers' contributions	Total labour costs	Productivity	Unit Labour costs
1983	8½	4	8	5	3
1984	8	- 2½	6½	3	3½
1985	8	0	7	2½	4½
1986	8	3	7½	2½	5
1987	7	4	6½	2	4½

NIS reductions, and reductions in employers' contribution to pension funds, account for low figures in the second column.

COMPANY INCOME AND SPENDING

87. 1985 saw a further recovery in the profitability of industrial and commercial companies taken as a whole. However, the fall in sterling oil prices - and the flattening out of North Sea output - meant that North Sea companies' profits went into reverse after the first quarter of the year; while non-North Sea profits benefited from the lower price of oil and other inputs. North Sea profits may fall by about a third in 1986; but non-North Sea profits should again rise as the economy continues to expand and costs grow slowly.

Industrial and Commercial Companies' Profits (per cent)

	As a Share of Total Income		Rate of return on assets, non-North Sea
	Oil	Non-oil*	
1973-1983 average	2.5	10.3	5.3
1984	6.9	11.2	6½
1985	6.2	12.2	8
1986	3.9	12.7	8½
1987	3.3	12.1	8

* Net of stock appreciation; adjusted for privatisation.

88. Data revisions are reducing the size of the discrepancy in the company sector accounts for 1984 and the first half of 1985. The financial accounts now give a rather healthier picture for the position of ICCs than previously - one that is much more consistent with the buoyancy of ICCs profits. The financial accounts are also now more consistent with the results of surveys which suggest quite a comfortable liquidity postion. Our forecast suggests that ICCs liquidity should remain at around present levels in relation to sales over the next two years.

Business Investment

89. Business investment now appears to have fallen back rather more sharply after the first quarter of 1985 than we had thought at the time of the Autumn Statement. For 1985 as a whole we now expect that manufacturing investment will rise by about 6 per cent (including assets leased from finance lessors), and non-manufacturing investment by a similar amount.

90. These rates of investment imply that the ratios of capital to output have continued to fall in both manufacturing and non-manufacturing over the last year. Although manufacturing output is only about 4 per cent below its 1979 average, manufacturing investment is still almost 20 per cent below its 1979 level. As measured by the CSO, the gross capital stock in manufacturing is rising at around ½ per cent a year; although the true growth rate may be a little higher than this (perhaps up to 1½ per cent) if there has, in the past, been substantial - but unrecorded - premature scrapping of the capital stock.

91. Despite the 3 per cent rise in manufacturing output over the past year, the number of firms quoting capacity as a potential constraint on output is the same as a year ago. While some industries such as textiles have been reporting capacity constraints approaching 1973 levels, overall the proportion is well below levels experienced in 1973 and at cyclical peaks during the 1960s.

92. The level of capacity utilisation and the much improved rate of profit now being earned on the existing capital stock both point to a further rise in investment during 1986. But the latest DTI Intentions Survey again suggests weak business investment this year. Part of the explanation for this weakness may be that investment has been brought forward into 1985 to forestall the reduction in capital allowances due in April 1986; but it is likely that most of the investment brought forward will occur in the first quarter of 1986, so that the total for investment in the calendar year is unlikely to be greatly affected by forestalling. Possibly high interest rates are part of the explanation, though with the stock market strong throughout 1985, the cost of equity finance has not risen as much as real interest rates.

93. In the forecast we have written up the DTI Intentions Survey figures for both 1986 and 1987: the forecast for 1986 is not much changed from the Autumn Statement.

	Percentage Increase by Volume in		
	1985	1986	1987
Manufacturing* (£6.4 billion in 1984)			
DTI Survey	6	- 2	0
HMT Forecast	6	0	3
Non-manufacturing** (£14.4 billion in 1984)			
DTI Survey	6	2	3
HMT Forecast	6	4	4

* Including leased assets

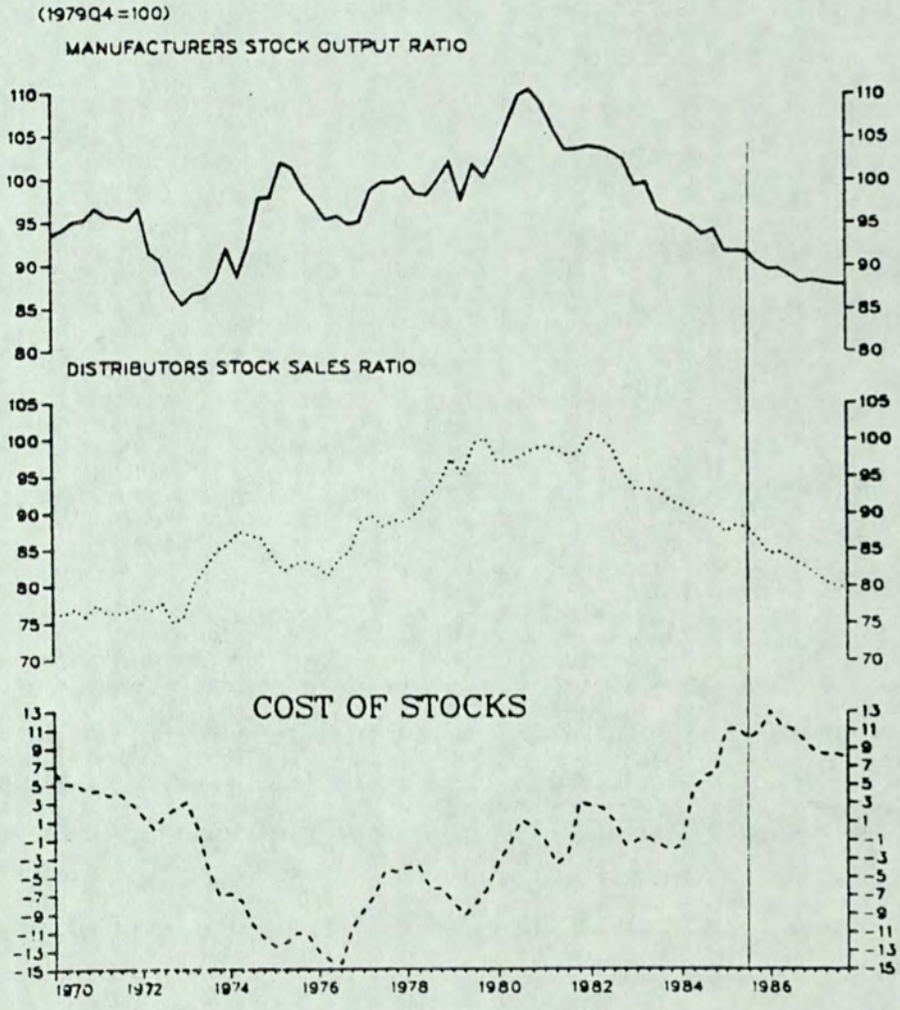
** Adjusted for privatisation and excluding assets leased to manufacturers.

Stockbuilding

94. There seems to have been little overall change to the level of stocks held by manufacturers and distributors during the course of 1985: manufacturers' stocks are currently some £5 bn (14 per cent) lower in real terms than they were at the end of 1979. We interpret much of the rise in stock output ratios during the latter part of the 1970's and much of the subsequent reversal as attributable to changes in the cost of financing holdings of stocks - see next chart.

95. High real interest rates, and the abolition of stock relief in the 1984 Budget mean that the cost of holding stocks is now much higher than at any time in the last ten years. The implication is that stock output ratios are likely to continue to fall; and this receives further support from recent Surveys. A positive balance of both distributors and manufacturers still say that their stock levels are too high; and replies to the CBI's January Trends Survey indicate that manufacturers are expecting to reduce stocks from current levels.

AGGREGATE STOCK RATIOS



PERSONAL INCOME AND SPENDING

96. For some time now we have been forecasting an exceptionally large rise in personal disposable income in 1986, and with it the re-emergence of consumer spending as the main area of growth in demand. This pick up in consumption has already started and is now evident in the figures for 1985; the CSO's preliminary estimates of consumers' expenditure for the fourth quarter (which we expect will be revised up a little) show 3 per cent growth in total consumers' expenditure between the second halves of 1984 and 1985, compared with 1½ per cent in 1984; and a 9 per cent rise in spending on durable goods over the same period.

97. The rise in spending so far has been rather larger than might have been expected given the recorded change in personal disposable income: the personal savings ratio may have fallen by about a point between the second half of 1984 and the second half of 1985. There seems to have been an improvement in consumer confidence over this period: perhaps the outcome of the coal strike has had something to do with this.

98. We now expect real personal disposable incomes of persons to rise by about 5½ per cent in 1986, and by about 3½ per cent in 1987: this compares with rises of just under 2½ per cent a year in the three years to 1985. The main contributions to the much higher growth rates in real incomes come from:

(i) a fall in consumer price inflation, which may average a little under 4 per cent in 1986, compared with 5 per cent in the previous three years;

(ii) the slight pick up in wage settlement rates during the 1984-85 pay round, higher public sector settlements during the present pay round, and a large chunk of back pay for teachers, which together mean that growth in average earnings is about ¾ per cent higher in 1986 than in 1985;

(iii) the forecast fiscal adjustment of £2 bn in 1986 and £4 bn in 1987 which adds about ½ per cent to disposable income growth in 1986, and 1½ per cent in 1987;

(iv) employment growth of about 1 per cent a year over the next two years, helped by the 1985 Budget measures, and by an assumed further employment package in the 1986 Budget.

These are partly offset by:

(v) a reduction in employers' pension fund contributions in response to the present large (£10-12 bn according to GAD estimates) actuarial surpluses of pension funds.

99. We do not expect consumers' expenditure quite to keep pace with the growth of personal income in 1986. The saving ratio normally rises during periods of fast personal income growth; and as durables spending seems during 1985 to have anticipated the pick up in incomes growth due for 1986, it may grow correspondingly less this year. Our forecast also allows for some impact of the current high level of interest rates on consumer spending. On the other hand the fall in inflation in 1986, and the reduction in employers' pension fund payments - which will depress measured income but probably not expenditure - will tend to reduce the personal saving ratio.

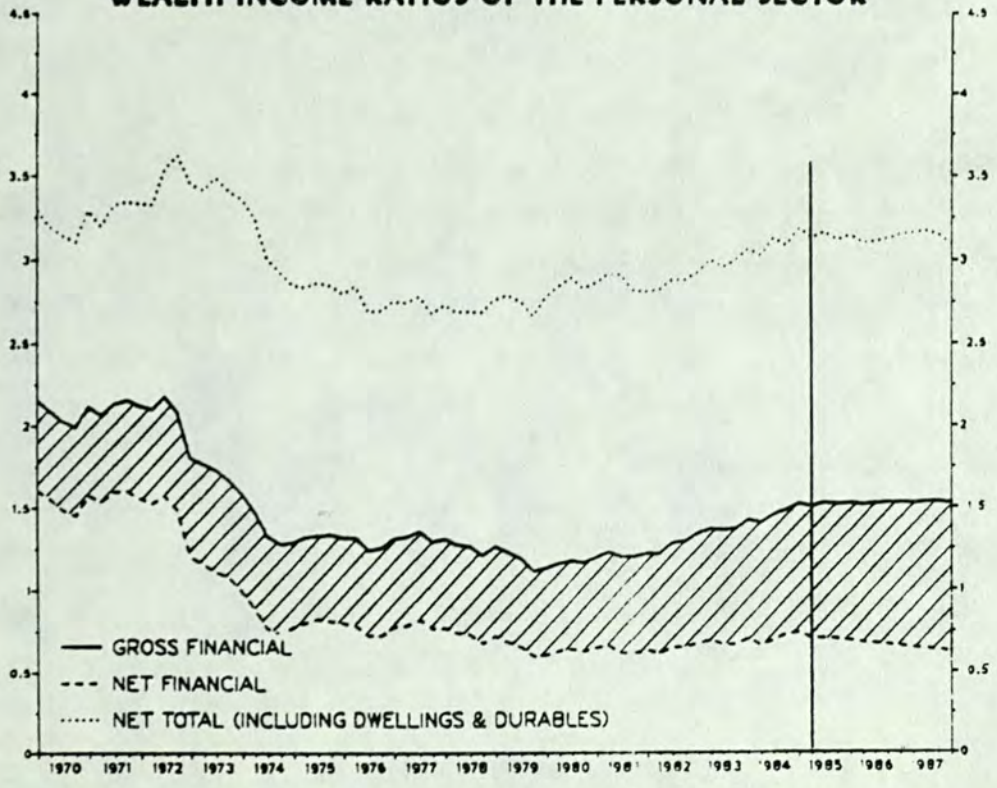
100. On balance we now expect consumers' expenditure to rise by about 4 per cent in 1986; and by a similar amount in 1987. The personal saving ratio is forecast to rise by a bit over one point in 1986, and to fall back a little in 1987.

101. We also expect persons' investment in housing to pick up in 1986. Private housing starts have been on an upward trend throughout 1985, although housing completions and investment in new dwellings have fallen. This rise in housing starts was not expected at the beginning of 1985; and the two increases in mortgage interest rates in the first four months might have been expected to lead to a still less favourable outturn. But the housing market managed to cope with these interest rates increases - the freer availability of mortgages clearly helped - and in the more prosperous parts of the country house prices have been rising fast enough to stimulate housebuilders to increased activity.

102.We expect therefore to see both completions and investment in new dwellings picking up again by the middle of 1986. Investment in improvements, now recognised as about half of total housing investment, was low between mid-1984 and early 1985 following the extension of VAT and the reduced availability of improvement grants. It recovered in the third quarter of 1985 and we expect it to continue rising roughly in line with growth in personal incomes.

103. The slowdown in inflation, the strength of the stock market, and (more recently) of house prices has meant that although the personal saving ratio has fallen from about 15 per cent in 1980 to around 12 per cent on average in the last three years, net personal wealth has been rising in relation to income. At first sight it may seem surprising, in view of the high level of interest rates, that the increase in the value of physical assets (included in the top line of the Chart) has been greater than the rise in net financial assets. But this is a consequence of asset revaluations and the programme of council house sales which have reduced persons' net financial wealth but not their total wealth (including dwellings). Persons' net financial wealth (which includes the net worth of life assurance and pension funds) is forecast to fall a little in relation to income in 1986 and 1987, as pension funds reduce their current actuarial surpluses. The forecast high level of durables purchases and housing investment is reflected in a gradual rise in the ratio of total net personal wealth to incomes.

WEALTH INCOME RATIOS OF THE PERSONAL SECTOR



Income and spending: the private sector in total

104.We expect a combination of rapid growth in real incomes and very high interest rates to keep saving high in 1986 (except of course for companies with North Sea interests). By 1987, companies will be finding it more difficult to raise profits. We assume that the rate of return falls a little in 1987: wage increases come down only moderately and productivity growth slows a little; while price increases continue to be restrained by very low inflation in the world. Calls on company incomes are likely to increase, with another large rise in the tax bill, reflecting profit growth in 1985 and 1986, and spending on capital assets rising further. In consequence the financial surplus of companies is forecast to fall in 1987, from the high levels of 1985 and 1986:

Financial surpluses £ billion

	1984	1985	1986	1987
Personal sector	12	12	15	15
Companies: i) North Sea	3	1	- 3	- 1
ii) Other	5	10	10	5
Total private sector	20	22	22	19

(Financial deficits are being run by the public sector, and by the overseas sector - corresponding to the surplus on the current account of the balance of payments.)

105.In successive forecasts we have been expecting the rate of profit to level off, but companies, by securing faster productivity growth and in other ways, have achieved further increases in profitability. The two most obvious routes to lower costs are higher productivity and lower (real) wage settlements: our forecasts have tended to be low on both productivity and real wage increases.

DEMAND AND ACTIVITY (SUMMARY)

106. The prospects for domestic demand (at constant prices) are summarised in the table below:

	per cent changes on a year earlier				
	1983	1984	1985	1986	1987
Personal Consumption	4	1½	2½	4	4
Public Consumption	2	1½	0	½	0
Total Investment	4½	8	2	4	1½
Change in stockbuilding (as per cent of level of GDP)	1	- ½	0	0	0
Total Domestic Demand	4½	2½	2	3½	3

107. The balance of trade made a substantial contribution to growth in 1985, because of the strong performance by UK manufacturers in both overseas and domestic markets. Domestic demand growth takes up the running this year and next.

108. The table below tries to split the growth of output into the contributions of domestic demand, external demand and trade performance. The numbers are only very approximate:

Contributions to growth of (non-oil) output, per cent

	1984	1985	1986	1987
Domestic demand less normal import content	1¾	¾	2	2
External demand	1½	1	¾	¾
Trade performance	- ¼	1¼	- ¼	0
Other	- ¼	- ¼	0	- ¼
GDP less oil and adjusted for coal strike	3¼	2¾	2½	2½

109. A positive figure for "Trade performance" measures the extent to which (a) exports gained share of the overseas market and (b) importers' share of the domestic market rose more slowly than usual. The 1¼ per cent figure for 1985 combines a strong export performance with a slower than expected rise in import penetration.

110. The estimated effects of the coal strike and of North Sea oil and gas production on total GDP can be seen in the following table:

	1980 = 100, and per cent changes on a year earlier				
	1983	1984	1985	1986	1987
GDP Average Measure	103.7	106.1	109.9	112.9	115.2
	(3.3)	(2.3)	(3.6)	(2.8)	(2.0)
Contribution of North Sea production to GDP changes	+ 0.4	0.2	0	- 0.1	- 0.5
Effects of coal strike	0	- 1.2	0.8	0.4	0
GDP less contribuiton of both oil and coal strike	2.9	3.2	2.8	2.4	2.5

111. The growth of oil production has accounted on average for half a per cent a year of the growth of GDP between 1980 and 1984. Oil production is now forecast to peak in 1986 and fall 5 per cent in 1987.

PRODUCTIVITY, EMPLOYMENT AND UNEMPLOYMENT

112. Recent CSO revisions to the figures for manufacturing output in 1985 (including the introduction of a bias adjustment to figures for the most recent six months) mean that we now see less of a slowdown in productivity growth over the last year. Output per head in manufacturing in 1985 probably rose by about 3½ per cent (on the published definition which includes an allowance for growth in self-employment in manufacturing): this is very close to the average growth rate in manufacturing productivity since 1979.

113. Although continuing high growth in real wages and low materials prices will encourage substitution away from labour over the next few years, we expect somewhat lower manufacturing productivity growth in 1986 and 1987, reflecting the gradual slowdown in output growth.

114. Outside manufacturing, productivity growth is affected by a number of special factors. The continuing shift towards part-time work is reducing growth in output per head by about ¾ per cent a year. The effect of the 1985 Budget measures (SEMS and NIC restructuring) and a further SEMS package assumed for the 1986 Budget reduce productivity growth by around ½ per cent a year on average in 1986 and 1987. On the other hand, the collapse of the coal strike and the outcome of the British Rail guards dispute mean that the way is open for substantial long overdue productivity gains in some nationalised industries. Exceptional productivity improvements in the two industries named (and also in the post office) are assumed to add almost ½ per cent a year to non-manufacturing productivity growth on average in 1986 and 1987.

Productivity Growth

	Manufacturing		Non-manufacturing*		
	Trend	Actual	Trend per full-time worker	Trend per head	Actual output per head
1973-79	1.6	0.7	1.6	1.0	0.5
1979-84	3.3	4.0	1.9	0.9	1.0**
1984-87	3.5	3.3	2.3	1.5	1.3**

* Private sector and nationalised industries (excluding steel). (These productivity estimates differ from published figures in attributing all self employment growth to non-manufacturing. They thus tend to overstate productivity growth in manufacturing a little, and understate productivity growth in non-manufacturing.)

** Adjusted for coal strike.

115. The implications for employment are set out in the table below. The last reasonably firm estimate for employment is for the second quarter of 1984.

	Employment, 000s, changes		
	1981 Q2 - 1985 Q2 (Annual average)	1985 Q2 - 1986 Q2	1986 Q2 - 1987 Q2
Employees	- 165	+ 75	+ 145
Self-employed	+ 125	+ 125	+ 125
Total employment	- 40	+ 200	+ 270
of which: full-time	- 245	+ 10	+ 15
part-time	+ 205	+ 190	+ 260
Full-time equivalent	- 145	+ 105	+ 145

116. Our projections for labour supply growth start off from the projections published in the July 1985 Employment Gazette. As compared with the Department of Employment's figures, we have allowed for rather higher female activity rates; and a continuing fall in activity rates for men near to retirement age.

Labour Supply, 000s, changes

	1983 Q2 - 1985 Q2 (Annual average)	1985 Q2 - 1986 Q2	1986 Q2 - 1987 Q2
Males	90	45	35
Females	340	115	140
Total	430	160	175
(of which population effect)	160	120	110

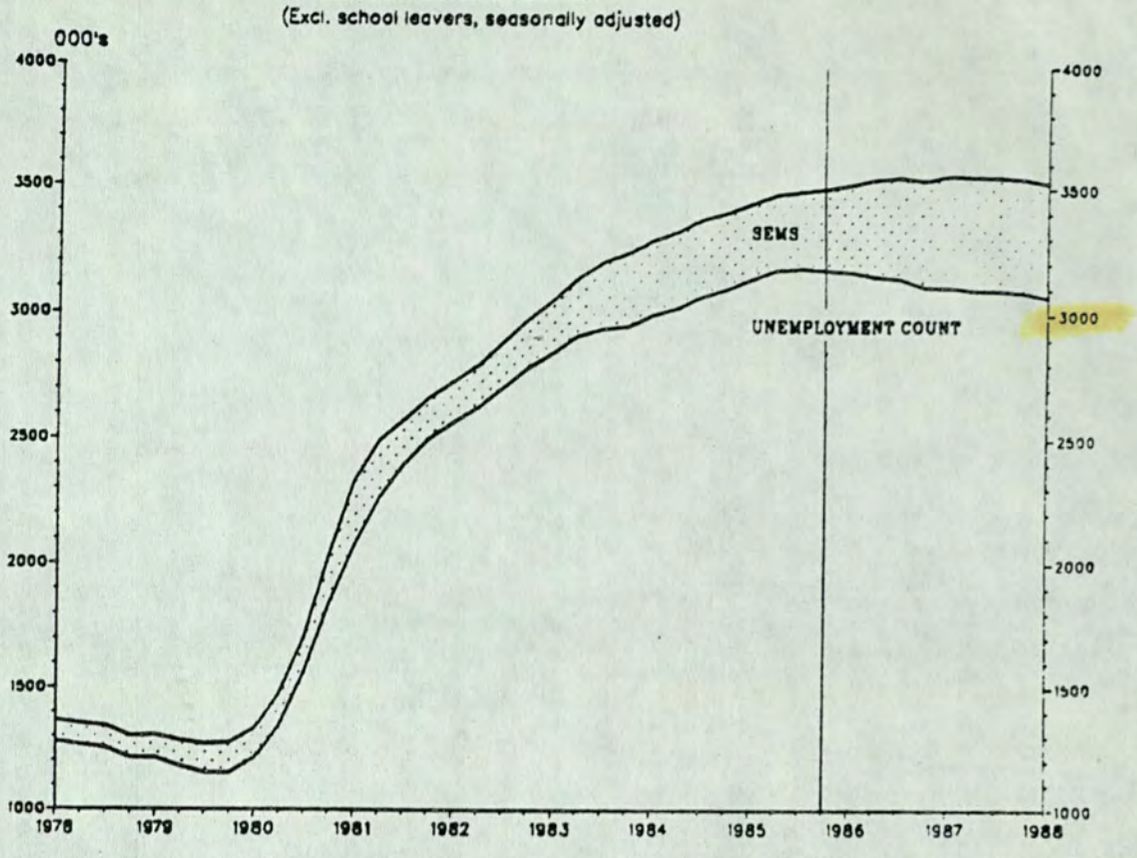
117. The trend in unemployment changed markedly for the better between the second and fourth quarters of 1985. We had been expecting some improvement during the course of the year, but the extent of the improvement (and the deterioration in the most recent months) was not expected and is at present not easy to explain. Maybe when the 1985 LFS arrives it will help to clarify the reasons for the improvement.

118. The latest employment statistics show a 120,000 smaller increase in the employed labour force in the first three quarters of 1985 than in the corresponding period of 1984. There was a 14,000 bigger fall over the more recent period in the number of employees in the production industries, (manufacturing, energy and water supply): industries where the employees are mainly full-time male workers with a high propensity to register as unemployed. The unemployment figures do show a rise in inflows onto the register in 1985; but this has been more than offset since the spring by a larger rise in outflows off the register. It is possible that this evidence of increased inflows and outflows means that the downward bias in the employment statistics - which reflects a failure of the statistics to keep pace with changes in the labour market - will have increased recently.

119. Our forecast does not make much allowance for a continuation of the unexplained part of the improvement in unemployment trend. Nevertheless we do expect unemployment to fall over the next two years as a result of lower growth in labour supply and the effects of the 1985 Budget measures. We have also allowed for a further package of employment measures in the 1986 Budget, which reduce (adult) unemployment by 60,000 by the first quarter of 1987. The chart shows the actual path of unemployment in the forecast, and also the growing impact of SEMS on the count.

UK UNEMPLOYMENT

(Excl. school leavers, seasonally adjusted)



120. As in previous forecasts we assume in constructing our unemployment forecast that:

(i) changes in the number of manufacturing employees feed one for one into claimant unemployment;

(ii) changes in part-time female employment have little effect on the number of claimant unemployed. Thus, taking account of the relative importance of this type of employment outside manufacturing, claimant unemployment might fall by only about 40 for every 100 extra jobs in the private sector outside manufacturing and by 60 for every 100 extra jobs in the public sector;

(iii) additions to labour supply from higher female activity rates do not have much impact on claimant unemployment, because most women joining the labour force will not have the insurance records that enable them to claim benefit.

The forecast for unemployment is set out below.

	Changes		
	1981Q2-1985Q2 (Annual average)	1985Q2-1986Q2	1986Q2-1987Q2
Unemployment:			
Total including school leavers.	+ 230	- 35	- 95
Narrow definition excluding school leavers.	+ 230	- 25	- 55
Memo: SEMS effect on unemployment			
- Total	- 30	- 85(-15)	- 90(-45)*
- Adult	- 15	- 85(-15)	- 60(-45)*
SEMS effect on employment statistics.	0	85(15)	0 (50)*

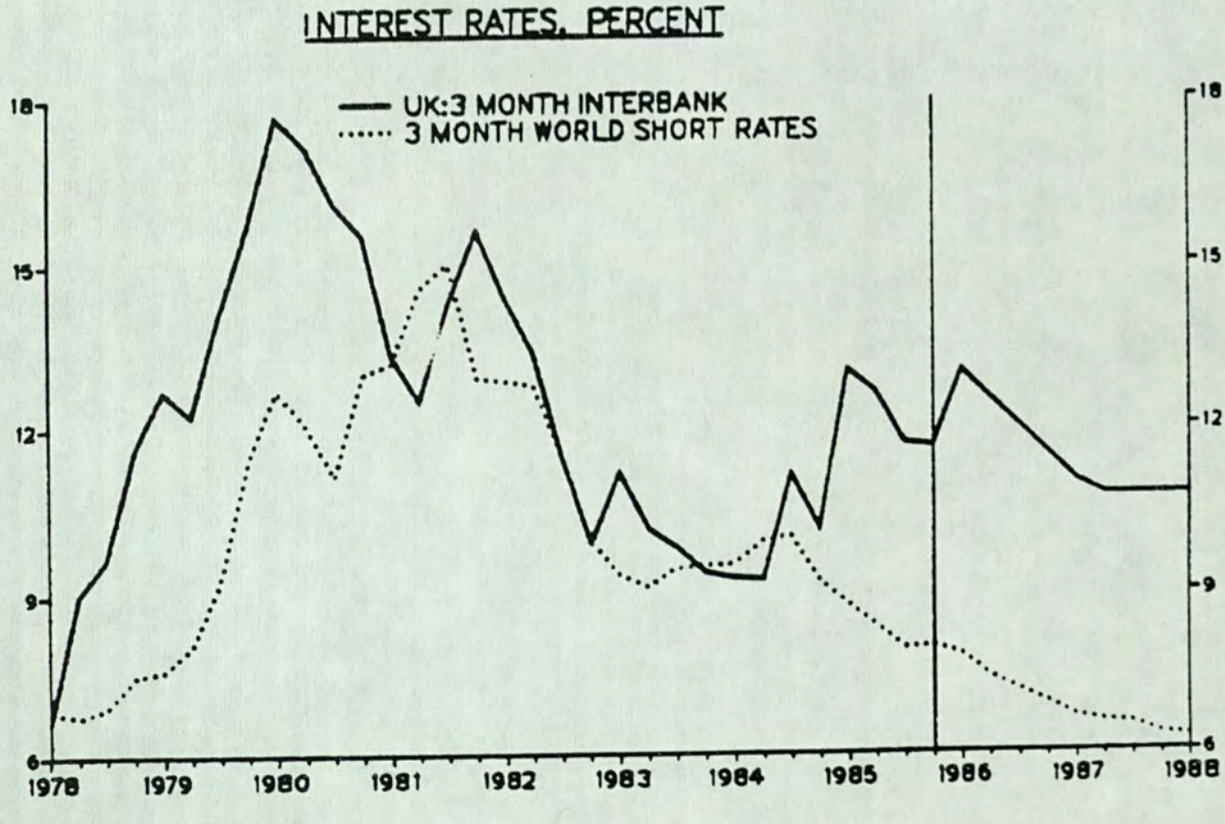
* Figures in parentheses show contribution of assumed 1986 SEMS package.

Financial forecast

121. As a result of the steep fall in oil prices and market pressures we have once again revised up our forecast of short-term interest rates. With overseas rates likely to fall at least outside the US (the recent fall in oil prices should help that process), we think that UK rates should be able to drift slowly downward once the immediate crisis is past. Even so sterling interest rates stay 4-5 per cent above the average of overseas rates through 1986 and 1987. Long rates, which have changed little in response to changes in money market rates, may not change much from current levels.

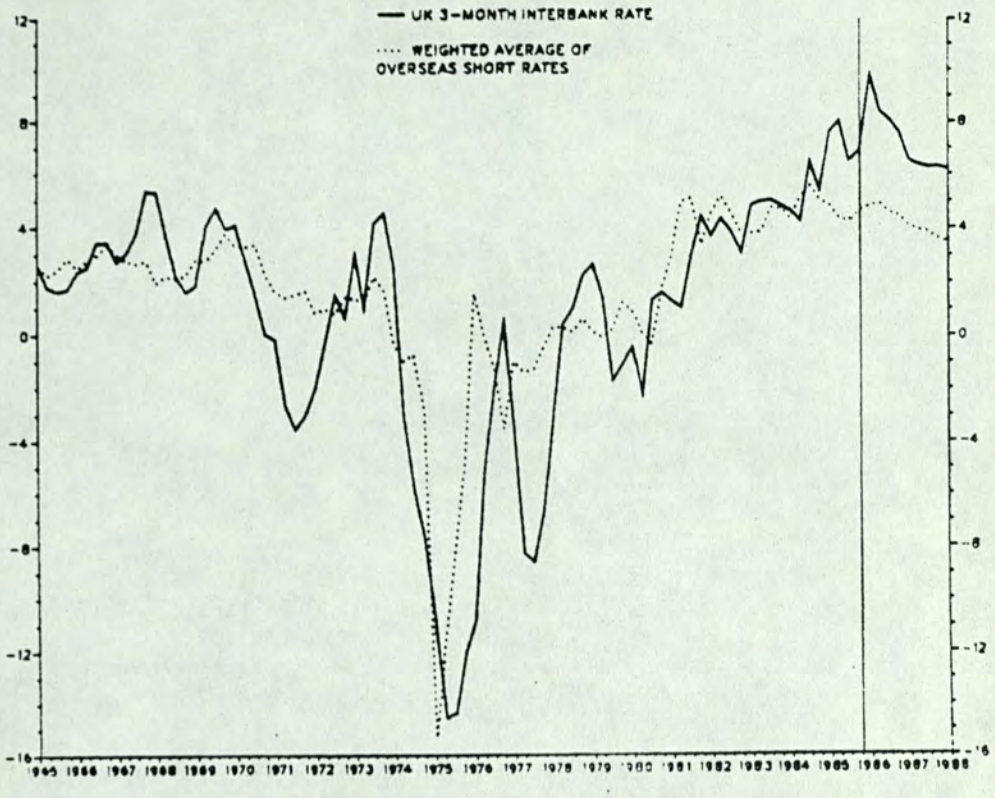
	World basket short rate	UK rates 3 month	mortgage rate*
1985 Q4	8	11½	12¾
1986 Q4	7	11½	12¾
1987 Q4	6½	11	12

* with a rise to 13¾ per cent assumed by March and a fall in Q3.



122. **Real rates** in the UK are higher than in most other countries:

REAL INTEREST RATES AT HOME AND ABROAD

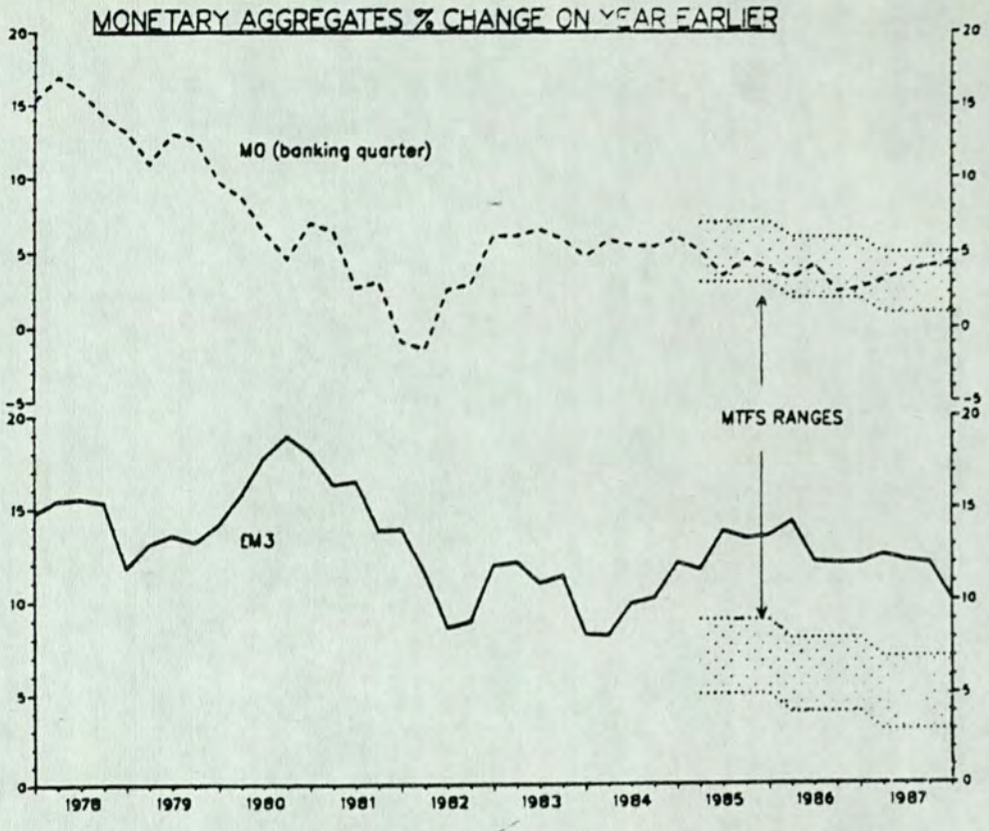


Monetary aggregates

123. The forecast is summarised and compared with the MTFS ranges in the following table and in the chart:

Average Percentage growth rates in financial years

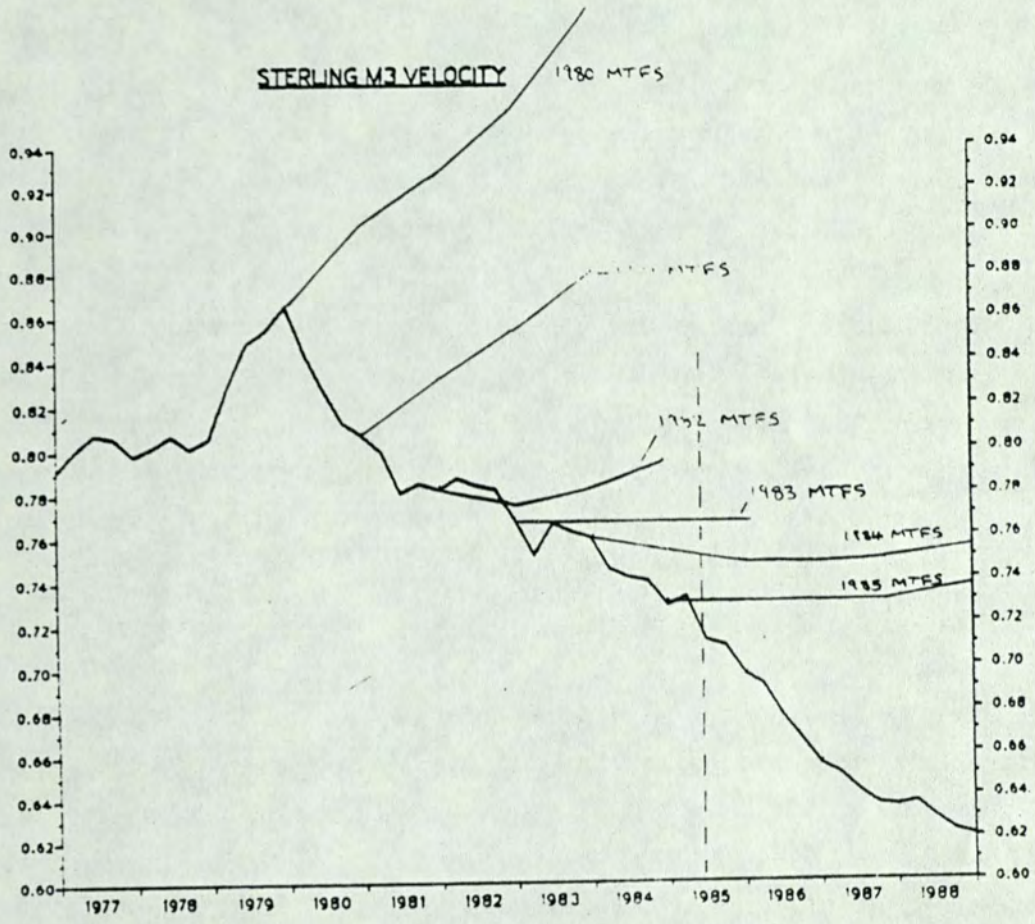
	MO		**£M3**		**PSL2A**
	MTFS range	**Outturn/Forecast**	**MTFS range**	**Outturn/Forecast**	**Outturn/ Forecast**
1984-85	(4-8)	5½	(6-10)	9½	13
1985-86	3-7	4½	5-9	13	12½
1986-87	2-6	3½	4-8	13	11½
1987-88	1-5	3½	3-7	12	11½



124. **M0 growth** has fallen by over one point over the past year, mainly in response to the rise in interest rates last winter, and is currently in the bottom half of its target range. The recent rise in interest rates will impart another downward impulse to M0, which will only be partly offset by buoyant personal incomes and expenditure. M0 growth could therefore stay in the 3-4 per cent range for most of the forecast period.

125. The forecast for **£M3 growth** - based on the assumption of no overfunding - assumes that the trends in velocity observed in recent years will continue: high real interest rates, financial liberalisation and the associated reduction in the margins between borrowing and lending for many customers all point to further rapid expansion in financial assets and liabilities. A range for £M3 in 1986-87, were it to be chosen purely on the basis of this central forecast, would be 11-15 per cent, 7 per cent above the range in the 1985 MTFS.

126. Early versions of the MTFS assumed a continuation of the rising velocity of the 1970s. More recent versions assumed that the growth of £M3 would be broadly in line with income - in fact, velocity has fallen almost continuously: see next chart.


STERLING M3 VELOCITY
1980 MTFS
1982 MTFS
1983 MTFS
1984 MTFS
1985 MTFS
0.94
0.92
0.90
0.88
0.86
0.84
0.82
0.80
0.78
0.76
0.74
0.72
0.70
0.68
0.66
0.64
0.62
0.60
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988

ANNEX: COMPARISON OF FORECASTS

Outside Forecasts

1. Table A compares the Treasury forecast with an average of outside forecasts. Both the Treasury and outside forecasters have revised up their GDP forecasts over the past year. The Treasury forecast is currently in the top half of the outside range for 1986, and is near the average for 1987.

2. The RPI inflation forecast is close to the outside average for both 1986 and 1987, whereas the earnings forecast is above the highest outside forecast (by the CBI) for 1986 before falling in line with the average for 1987. The implied higher real income growth in 1986, together with a higher fiscal adjustment to both 1986-87 and 1987-88 accounts for the higher Treasury forecast of private consumption.

3. The forecasts used are NIESR, LBS, Phillips & Drew, Simon & Coates, Henley, Cambridge, Oxford, Liverpool, CBI, OECD, CUBS and EC. Note that not all forecasts are used in working out the average - only those which are directly comparable.

4. Comparisons of oil prices and revenues are given in the separate report on oil, circulated by Mr Hacche.

Treasury Forecasts

5. Table B compares the internal January forecast with the last three Budget forecasts.

6. The outlook for GDP growth in 1986 is over half a per cent higher than in the last Budget forecast. This reflects higher oil production, and stronger growth of domestic demand, including fixed investment and government spending.

7. In contract to the FSBR forecast, which assumed a broadly constant exchange rate we now have a fall of around 6 per cent between 1985 and 1987, with lower real oil prices more than offsetting the effects of the projected fall in the dollar and higher domestic real interest rates.

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TABLE A - COMPARISON WITH OUTSIDE FORECASTS

	January Forecast	Outside Average	Outside range	
£M3 % change on year earlier				
1985-86	12.9	12.9	11.0(LBS)	15.5(Henley)
1986-87	12.8	11.6	9.7(LBS)	13.8(Henley)
1987-88	11.9	10.5	6.2(LBS)	13.3(Henley)
M0 % change on year earlier*				
1985-86	4.5	4.6	2.9(Henley)	5.75(NIESR)
1986-87	3.3	6.2	5.6(Henley)	7.1(LBS)
1987-88	3.6	2.7	1.3(LBS)	4.0(P&D)
PSBR £ bn				
1985-86	6.8	8.3	7.8(S&C)	9.3(Henley)
1986-87	7.6	8.6	7.5(LBS)	9.4(Henley)
1987-88	7.1	9.2	7.4(LBS)	11.1(Oxford)
Fiscal Adjustment (Annual)				
1986-87	2.2	1.6	0 (NIESR)	3.5(CBI)
1987-88	4.2	1.8	0 (NIESR)	3.8(S&C)
Exchange rate (1975 = 100)				
1986 Q4	75.0	76.5	73.1(Oxford)	80.3(NIESR)
1987 Q4	73.0	73.6	70.7(Oxford)	75.0(P&D, LBS)
Current account £ bn				
1985	3.6	3.2	1.3(L'pool)	4.25(OECD)
1986	4.3	2.6	1.1(CBI)	4.6(L'pool)
1987	1.6	-0.1	-4.2(Oxford)	4.5(L'pool)

	January Forecast	Outside Average	Outside range	
Consumption % change on year earlier				
1986	4.0	3.5	2.8(C'bridge)	4.2(S&C)
1987	3.9	2.7	1.8(NIESR, Henley)	3.7(LBS)
Import volume: goods and services % change				
1986	5.4	4.6	3.3(C'bridge)	6.6(CBI)
1987	4.1	4.6	2.7(NIESR)	8.1(Oxford)
Export volume: goods and services % change				
1986	3.6	2.6	0.5(Oxford)	4.3(CBI)
1987	1.7	2.3	1.4(C'bridge)	3.2(CBI)
GDP (output) volume % change				
1986	2.9	2.4	1.5(C'bridge)	3.7(CUBS)
1987	2.1	2.2	1.1(NIESR)	4.7(CUBS)
UK adult unemployment (millions)				
1986 Q4	3.1	3.10	3.03(S&C)	3.18(Henley)
1987 Q4	3.1	3.07	3.0(NIESR)	3.15(CBI)
RPI % change on year earlier				
1986 Q4	4.1	4.3	3.0(NIESR)	4.7(P&D)
1987 Q4	4.3	4.2	3.3(LBS)	5.0(P&D)
Average earnings % change on year earlier				
1986	8.7	7.7	6.6(L'pool)	8.3(CBI)
1987	6.8	6.8	4.6(L'pool)	7.5(S&C, P&D)

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TABLE B

COMPARISON OF TREASURY FORECASTS

	1983 MTFS/FSBR	1984 MTFS/FSBR	1985 MTFS/FSBR	January 1986 Forecast
Money Supply £M3				
(% change on year earlier)				
1984 Q1	9.0	9.5	8.1	9.8
1985 Q1	8.8	9.2	9.5	11.1
1986 Q1	7.5	8.2	8.0	13.4
1987 Q1	6.1	7.9	7.2	12.0
1988 Q1	-	6.0	6.2	11.0
PSBR				
£ billion (% of money GDP)				
1983-84	8.2(2.8)	10.0(3.3)	9.7(3.2)	9.7(3.2)
1984-85	8.9(2.5)	7.2(2.2)	10.5(3.2)	10.1(3.1)
1985-86	7.0(2.0)	7.0(2.0)	7.1(2.0)	6.8(1.9)
1986-87	6.4(1.8)	7.0(1.9)	7.5(2.0)	7.6(2.0)
1987-88	-	6.8(1.7)	7.0(1.8)	7.1(1.75)
Fiscal Adjustments (£ billion)*				
1983-84	-	-	-	-
1984-85	-0.4	-	-	-
1985-86	-3.8	-1.9	-	
1986-87	-8.8	-6.8	-3.7	-2.2
1987-88	-	-10.0	-6.8	-6.4
Nominal GDP (mp)				
(% change on year earlier)				
1983	7.5	8.6	8.4	8.5
1984	8.6	8.1	6.6	6.8
1985	7.9	6.9	8.5	8.8
1986	6.9	6.1	6.9	7.4
1987	-	5.7	6.1	6.5
RPI				
(% change on year earlier)				
1983 Q4	5.8	5.0	5.0	5.0
1984 Q4	5.4	4.3	4.8	4.8
1985 Q4	5.2	3.5	5.2	5.5
1986 Q4	5.1	4.5	3.8	4.1
1987 Q4	-	4.0	3.0	4.3

	1983 MTFS/FSBR	1984 MTFS/FSBR	1985 MTFS/FSBR	January 1986 Forecast
Current Balance (£ billion)				
1983	1.5	2.0	2.5	3.1
1984	1.5	2.2	0.1	1.1
1985	-0.6	0.7	2.9	3.6
1986	4.2	1.0	2.6	4.3
1987	-	-0.5	1.4	1.6
Manufacturing Output (% change on year earlier)				
1983	1.8	1.5	2.5	2.8
1984	2.4	3.6	3.4	3.8
1985	1.9	2.1	2.6	3.2
1986	0.9	1.4	2.0	2.4
1987	-	1.4	1.3	1.5
GDP Volume (% change on year earlier)				
1983	2.0	2.8	3.1	3.3
1984	2.7	3.1	2.5	2.3
1985	2.4	2.5	3.3	3.6
1986	1.9	2.0	2.2	2.8
1987	-	2.0	2.2	2.0
Interest Rates % (Short term)				
1983-84	9.6	9.7	9.7	9.7
1984-85	7.8	8.7	10.9	10.9
1985-86	7.4	7.8	11.9	12.2
1986-87	7.4	6.8	10.1	11.8
1987-88	-	6.1	9.3	10.8
World Trade in Manufactures, UK Weighted				
1983	1.0	1.3	1.4	0.8
1984	6.6	5.1	10.2	8.5
1985	5.7	4.5	5.5	4.2
1986	2.9	4.5	4.4	4.6
1987	-	3.8	4.5	3.5
UK Exports of Goods, Services (% change on year earlier)				
1983	0.9	0.6	1.4	2.6
1984	5.0	5.0	6.6	7.0
1985	4.9	3.9	6.4	6.6
1986	2.3	2.8	2.3	3.6
1987	-	2.8	2.7	1.7

	1983 MTFS/FSBR	1984 MTFS/FSBR	1985 MTFS/FSBR	January 1986 Forecast
Average Earnings				
(Private, not cyclically adj:- % change on year earlier)				
1983 Q3	7.3	8.3	8.7	9.3
1984 Q3	7.0	7.5	4.8	4.7
1985 Q3	6.5	7.3	9.3	10.0
1986 Q3	5.8	5.8	5.9	8.1
1987 Q3	-	4.8	4.7	6.8
Effective Exchange Rates				
(1975 = 100)				
1983	80.5	83.3	83.3	83.3
1984	81.8	83.2	78.6	78.6
1985	80.8	83.5	72.9	78.2
1986	79.6	82.8	74.0	75.8
1987	-	81.6	72.8	73.6
Unemployment				
(UK sa excl school leaver - million, new defn.)				
1983 Q4	2.9	2.9	2.9	2.9
1984 Q4	3.0	3.0	3.1	3.1
1985 Q4	3.1	3.0	3.1	3.2
1986 Q4	3.1	3.0	3.0	3.1
1987 Q4	-	3.0	3.0	3.1
I & C Companies Financial Surplus/Deficit, £ billion				
1983	0.7	6.4	6.9	5.1
1984	2.3	5.1	10.0	7.2
1985	1.8	2.0	8.7	8.5
1986	0.3	-0.3	4.1	5.5
1987	-	-0.9	5.5	4.1

* A negative sign indicates a reduction in taxes (see Fiscal Adjustments)

To be
Shredded.