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PRIME MINISTER
ECONOMIC INDICATORS

The economic position can usefully be considered under six headings:

- international background
- UK monetary stance
- demand
- output
- inflation
- balance of payments.

International background

Before the recent increase in oil prices, world economic growth had already begun to falter. G7 growth was projected at around 2½ per cent this year and next. Interest rates are generally high in real terms in order to squeeze out the resurgence of inflation, eg in both US and (by local standards) Germany.

The oil price increase will have two short-term effects. The boost to oil prices will increase inflation; and, for given domestic monetary stance, they will reduce the room for output growth and hence world trade prospects. In short, international prospects are for higher short-term inflation and weaker output growth.

UK Monetary stance

All monetary indicators are now showing some deceleration in growth. MO is currently increasing at a rate of 5.5% - a rapid deceleration from the 7.3% growth in May. MO is projected to show a 4.8% increase in August, that is within the target range. Thereafter it is expected to grow at between 5 and 6% per annum over the rest of this calendar year.

Unless velocity has suddenly increased, as a coincident indicator, the MO data suggest a slow-down in economic activity within the UK.

This picture is confirmed by the broad monetary indicators. M4 growth and MW4 have both slackened. Other indicators such as M4 lending and building society deposits suggest a general weakening. Business demand for new loans has also dropped - although the stock of outstanding debt is very nearly as high as in 1980-81.

The rise in the exchange rate means a further tightening of the monetary stance. The nominal exchange rate is higher than a year ago; and given the much greater growth in domestic costs (eg the 7% rise in unit labour costs in the UK against zero in Germany), the appreciation in real terms must be putting immense pressure on export margins and on domestic producers facing import competition.

Demand

There is evidence of much slower growth in retail demand - retail sales fell by 2½% in June and were broadly steady in July. Export demand has also started to weaken; the CBI forward order book provides evidence of poor prospects; export volumes fell this month; and world trade prospects must have deteriorated as a result of the oil price increase.

Output

The latest evidence still shows some buoyancy in the economy: the GDP (0) figures for the second quarter showed considerable resilience as have recent manufacturing output figures. But the forward indicators of output from the CBI suggest deteriorating prospects.

Inflation

Although the RPI year on year increases have been fairly steady in recent months, oil price increases are likely to push the annual rate to above 10% in the next month or so. But a turn around is still expected before Christmas. And it is progress in

bringing down wage settlements that will determine how quickly inflation falls - and how far output is damaged and unemployment rises. There is no indication of any deceleration in wage settlements as yet.

Balance of Payments

Import levels are showing evidence of near stagnation: this suggests that activity in the economy is slowing down. The bad news is that export figures are also showing the first indications of some weakening. Little improvement can reasonably be expected at a time of a high real exchange rate and deteriorating world trade prospects.

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