chex.jp/kg1/7

n.b.P.M.
BHP
13/9

Treasury Chambers, Parliament Street, SW1P 3AG
071-270 3000

13 September 1990

Barry Potter Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1A 2AA

Dear Barry

Q2 BALANCE OF PAYMENTS

I understand that the Chancellor spoke to the Prime Minister about yesterday's balance of payments figures - and in particular the revision to invisibles - yesterday. The Chancellor therefore ... thought you might be interested to see today's press comment on the figures, which I enclose.

Yours

Kate

MISS K GASELTINE
Assistant Private Secretary

Thursday, September 13, 1990

The Guardian

Trade gap is wider than thought

Larry Elliott
Economics Correspondent

10

THE smallest quarterly invisible trade surplus for 23 years left Britain's trade even deeper in the red in the first half of 1990 than originally feared, it emerged yesterday.

Figures from the Central Statistical Office showed that the current account deficit in the three months to June stood at £4.9 billion compared with an original forecast of £4.1 billion.

Officials had been projecting a surplus for the second quarter of £900 million on invisible trade, which includes travel, banking, EC payments and interest, profits and dividends. They said yesterday preliminary figures put the surplus at £57 million, a drop from the £1.8 billion surplus recorded in the first quarter. The small surplus on invisibles was the lowest since the £55 million in the second quarter of 1967, and made only a tiny dent in the £5 billion shortfall on visible trade in the three months to June.

An upward revision to the invisibles surplus in the first quarter meant the current account deficit was reduced by £155 million to £4.6 billion, but the shortfall for the first six months of 1990 was 9.5 billion against the earlier estimate of £8.8 billion.

Yesterday's figures are subject to further revision and contain an enormous £8 billion balancing item, but the office is now certain to downgrade its forecast for invisibles in the third quarter when the August trade figures are released later this month. This will make it even more likely that the deficit for 1990 will exceed the £15 billion forecast in the Budget.

The office said the surplus on services was nearly £400 million down on the first quarter, reflecting a reduction in earnings from travel and sea transport. A second factor was a swelling of the deficit on transfers from £900 million to £1.3 billion as a result of lower receipts from the EC's agricultural and regional development funds.

The cost of attracting "hot money" from overseas to finance the huge visible trade deficit left the surplus on interest, profits and dividends at £400 million in the second quarter.

FINANCIAL TIMES

Worsening deficit reopens statistics row

10

By Peter Marsh, Economics Staff

BRITAIN'S surplus on invisible trade between April and June all but vanished, according to government figures yesterday.

The new figures indicate that the UK's current-account deficit is significantly worse than thought. They have reopened the debate about the quality of government statistics. Mr John Major, the Chancellor, has said he wishes to improve their quality.

The figures put the deficit on current account for the second quarter of 1990 at £4.94bn, in contrast with last month's government estimate of £4.10bn.

Mr Richard Caborn, Labour MP for Sheffield Central and one of his party's spokesmen on trade, said the announcement showed that the UK was heading for a £20bn current-account deficit for the year. He said the Government's economic policies were in disarray.

The main detailed change in the new figures is a revised estimate on invisible trade, which includes services, interest payments by banks and inter-government transfers.

Traditionally, Britain has a strong surplus on invisibles. In previous years this has helped to reduce the large deficit on trade in manufactured goods.

According to the Central Statistical Office (CSO) yesterday, Britain had a surplus of £57m on invisibles in the second quarter of 1990. That contrasts with the office's estimate last month for that period of £900m. In July, the surplus for the quarter had been put at £600m.

Yesterday's discussion about the correct figures for the current-account balance is part of a long-running argument about whether government statistics are giving an accurate picture of fluctuations in the economy.

In May Mr Major announced improvements in the collection and analysis of statistics by the CSO, which are due to show an effect next year.

Mr John Shepperd, an economist at Warburg Securities, the investment bank, said the CSO's changes were "perverse" and "misleading."

The British Invisible Exports Council, a private-sector body representing banks and other financial institutions, said the revisions made the numbers "virtually useless."

According to yesterday's figures, the UK had a surplus of £952m in the second quarter in the balance of trade in services and a £422m surplus from interest, profits and dividends. These were almost entirely offset by net transfers out of the country of £1.32bn.

6

STANDARD

10 — WEDNESDAY, 12 SEPTEMB

Inflation rate 'may be wrong'

10

MPs warned today that the Retail Price Index may be unreliable, **writes David Shaw.**

Misleading figures lead to distortions of share prices and wage rates, says the Tory-controlled Public Accounts Committee.

Millions of people could also be short-changed on pensions and state benefits. The MPs say that even an error of 0.1 per cent can cost or save the Government around £75 million a year in state payouts.

But, with the inflation rate set to pass 10 per cent on Friday, the Central Statistical Office and Department of Employment insist it remains a reliable and "extremely robust indicator".

The MPs say they "note" the assurances, but say every effort must be made to ensure the accuracy of the figures.

A review of the 40-year-old system is now being carried out by the Central Statistical Office following criticism that:

- In many areas of the country only half the required prices are being collected;
- Staff in unemployment offices, who are supposed to spend part of their day gathering the prices, do not do so on their managers' orders;
- The "basket of goods" measured may not properly reflect shopping by average households;
- Housing and holiday costs need to be better reflected in the figures.

Thursday, September 13, 1990

The Guardian

MPs' report calls for revamped RPI to make it more accurate

Larry Elliott
Economics Correspondent

10

THE monthly inflation figures should provide a more realistic measure of the cost of housing, the House of Commons Public Accounts Committee recommended in a report published yesterday.

With the release of figures on Friday set to show the annual inflation rate rising over 10 per cent, the PAC said the Retail Prices Index needed to be revamped to make it more accurate and reliable.

The all-party committee said it was glad to see that the Central Statistical Office was examining a number of shortcomings and difficulties in the construction of the RPI, and was looking for "early solutions" to the problems.

It noted that the CSO believed the RPI was "an extremely robust" means of measuring inflation, and gave limited support to the campaign to remove mortgages from the Index.

The Government claims that mortgage interest payments have exaggerated the surge in inflation, and the PAC concluded that housing was a difficult issue which ought to be re-examined by the CSO.

Unemployment Benefit Offices are used to collect the prices of the basket of goods and services which make up the RPI, with the components determined by the annual Family Expenditure Survey.

The PAC said it was "unacceptable" that there should be a shortfall of nearly 50 per cent in the number of local prices collected by UBOs. It was also "particularly important" that the CSO ensure that the expenditure profile for the RPI basket of goods properly reflected the pattern of spending in UK households.

The report was also critical of the computer error which led to the understatement of the RPI by 0.1 percentage point in 1986 and 1987, which led to people receiving lower benefits than they were entitled to.

DAILY Mirror

TORIES FAIL AT SUMS

BLUNDERS in the Government's inflation index and in the balance of payments were attacked yesterday.

MPs said the retail price index was unreliable and could be holding back pensions. The trade gap for April, May and June was revealed to be a deficit of £4.9 billion against estimates of £4.1 billion.

THE TIMES

Fatal flaws

27

Whitehall's number-crunchers came in for severe criticism on two fronts yesterday. Second quarter current account data made a £900 million surplus on invisibles almost disappear as if by magic, prompting an angry response from the City. The Commons public accounts committee meanwhile made a frontal assault on the unloved retail price index. Almost universally recognised as a flawed measure of inflation for its inclusion of that highly moveable feast, mortgage interest payments, the RPI took another battering.

The CSO's collection methods were called inefficient and MPs wanted urgent improvement to ensure that it accurately reflected real changes in the cost of goods, services and housing. This is all hard to dispute.

Singled out for criticism was the failure of the RPI to differentiate between inflation for the average citizen and that affecting the pensioner. This is not new ground. But, given the gap that has emerged between the mortgage-free pensioner and the wage-earning home-buyer during the present period of high interest rates, it is worth fresh scrutiny. The chancellor has made it clear that he understands all this. His political sense will, however, tell him not to dismantle the RPI before the next election. Having suffered the pain of seeing it climb close to and probably above 10 per cent, he would be a fool not to try to reap the electoral benefit when the exaggerated descent comes through.

As to the disappearing invisibles, the British Invisible Exports Council, voice of the private sector services industry, was aghast.

How could the CSO transform an estimated surplus of £900 million only 20 days earlier into a meagre £57 million. Roger Nightingale, one of the City's long-standing CSO watchers considers the current account data to be the best of a bad bunch. Even then, he dismisses the series as "hardly worth the paper they are written on". The chancellor's increasing reliance on judgement when setting policy would appear a necessity rather than a option.

5

'ily Telegraph
Thursday, September 13, 1990

Earnings from invisibles fade

26

By Anne Segall

THE contribution of the service sector to Britain's balance of payments shrunk almost to zero in the second quarter of the year, as the weakness of the dollar hit tourism and high interest rates pushed up the cost of attracting foreign capital to Britain.

There was also a sharp decline in the amount earned abroad by British companies, particularly in the oil sector, while transfers to the EEC rose sharply. According to the Central Statistical Office, the net contribution of the service sector was £57m, down from £1·188 billion in the first quarter.

At their peak, invisible earnings were running at more than £600m a month and even though they have been shrinking, a contribution of £100m a month was expected this year by the Chancellor, John Major.

The invisibles slump has destroyed hopes of a sharp improvement in Britain's current account position this year. The CSO now puts the second quarter deficit at £4·94 billion instead of £4·1 billion, as originally thought. And in six months, the gap has reached £9·6 billion, up from £9·2 billion in the same period a year ago.

At the time of the Budget, Mr Major forecast a narrowing of the current account deficit for the year to £15 billion but City economists yesterday expected the gap to be about £17 billion, representing a negligible improvement on the record deficit of £19·1 billion last year.

Richard Mason, executive director of the British Invisible Exports Council, said yesterday the dramatic reduction in estimates of second-quarter invisible earnings "cast serious doubt on the reliability of government statistics".

There was an £8 billion balancing item in the second quarter which represents unrecorded flows of cash into the country.

Government statisticians believe this is mostly capital, rather than payments for British goods and services.

7

THE TIMES Thursday, September 13, 1990

Trade deficit hit as invisibles plunge to £57m

By Colin Narbrough, Economics Correspondent

25

BRITAIN'S current account deficit widened to £4.94 billion in the second quarter, instead of narrowing to £4.1 billion as indicated by the initial monthly figures.

The figures make the government's forecast of an improvement in the trade balance this year look unachievable.

The deterioration was revealed in the quarterly trade figures covering April, May and June. The visible trade balance improved, but the current account decline was caused by a worsening in the invisibles balance, which comprises shipping, tourism, banking, insurance and government transfers. The surplus here dropped to £57 million from £1.19 billion in the first quarter. In the second quarter last year, the surplus was £1.93 billion.

The figures were bad news for John Major, the chancellor, as they made his forecast improvement in the current account deficit, to £15 billion this year from last year's £19.1 billion, appear unattainable. They also provoked an outcry in the City over the reliability of government statistics. They are already under fire in Westminster from the Commons public accounts committee, which attacked the retail price index as a distorted and inadequate measure of inflation.

John Mason, the British Invisible Exports Council executive director, said that less than three weeks ago, the CSO's Pink Book was showing a £900 million suplus on invisibles for the second quarter, now changed to £57 million. "What are we to believe?" he said, adding that the £8 billion balancing item the CSO uses to make the figures add up rendered any meaningful interpretation useless.

Mr Major earlier this year ordered a radical review of economic statistics that includes the trade figures, but it will be some time before results will be seen. Mr Mason called for urgent improvements and promised full BIEC co-operation.

The CSO's provisional seasonally adjusted figures gave a second-quarter deficit about £800 million larger than its projection last month. Then, the invisibles surplus was estimated at £900 million for the quarter.

The surplus on services dropped by £384 million, the surplus on interest payments and dividends by £364 million, and the transfers deficit widened by £383 million. Lower net earnings from sea transport and travel, reduced company earnings abroad and higher net payments by banks also contributed. Receipts from European Community funds were also lower.

Recent analysis of the tourism balance by Simon Briscoe, UK economist at Midland Montagu, draws the conclusion that there is little scope for an appreciable improvement for the next few years. Mr Briscoe estimates that the travel deficit will widen from £2.5 billion this year to £3.5 billion in 1995.

On visible trade, the figures showed a £5 billion second quarter deficit, down £800 million from the previous quarter and nearly £1.6 billion smaller than in the same quarter last year. This was, however, more than offset by the worsening of the invisibles picture and brought the current account deficit for the first half year to £9.56 billion.

● The Blue Book, published by the CSO yesterday, showed the economy growing at 2.1 per cent last year after 4.7 per cent in 1988, reflecting the impact of higher interest rates.

FINANCIAL TIMES

Economy's growth rate has halved since 1988

By Rachel Johnson

10

THE GROWTH rate of the UK economy has halved since 1988 while its inflation outlook has deteriorated, the Central Statistical Office reported yesterday.

In the Blue Book, its detailed annual portrait of the British economy, the CSO confirmed that gross domestic product in 1989 – the volume of goods and services produced in the UK – grew by 2 per cent, compared with a growth rate of 4.5 per cent in 1988.

The national accounts reveal that the output of the energy industries showed a sharp decline of 9.5 per cent in 1989, largely as a result of the Piper Alpha disaster, against a 4.4 per cent output decline in 1988.

The output of the manufacturing sector grew by 4.5 per cent in 1989 against 7.5 per cent in each of the previous two years.

The GDP deflator, the best guide to underlying price trends and domestically generated inflation, rose from 6.5 per cent to 7.5 per cent over the same period.

The effect on corporate profits of slower growth and higher inflation is contained in data indicating deteriorating trading conditions last year.

The gross trading profits for all companies and financial institutions fell marginally between 1988 and 1989 after 13 per cent growth between the previous two years.

The effect on investment was as marked. The volume of fixed investment was just 5 per cent higher in 1989 over the year before, compared with 15 per cent between 1987 and 1988.

For industrial and commercial companies, the financial deficit in 1989 totalled £24.6bn after a deficit of £10.4bn in 1988.

Exports of goods and services increased by 14 per cent at current prices last year, keeping abreast of a 14 per cent increase in imports. Net imports of goods and services increased from £15.2bn to £19.3bn in 1989.

With payments on the current account rising more than receipts, the UK's current account deficit grew from £15.2bn in 1988 to £19.1bn in 1989.

The CSO Blue Book 1990. HMSO, £13.

8