a:\economy.vlb

PRIME MINISTER

THE ECONOMY

If you have the opportunity over the weekend, it is worth glancing through the attached article (flag A) in the Bank of England's quarterly bulletin. I have highlighted the main points. It is is an excellent account of the current state of the economy.

In particular, I would draw your attention to the sidelined paragraph. The depth of all recessions depends upon the need for, and the speed of, adjustment in the corporate sector. As the article points out, the large corporate sector deficit and the high net income gearing of companies suggest an overall fragility in the company sector. A sharp reduction in activity to remove the fragility would lead to a sharper and deeper recession.

Also at flag B is the latest CSO figures on stock building. Normally I would not trouble you with this indicator: but stock building over the next few months may be a useful lead indicator of the depth and length of the recession although the figures are difficult to interpret. The main points are as follows:

- The stock building figures are consistent with the Treasury's central forecast (which is, as you know, less optimistic than the published Autumn statement).

- The rise in retailers' stocks in 1990 Q3 is almost certainly involuntary.

- Wholesalers have begun to de-stock.

- But manufacturers, like retailers, have been caught out by the suddenness of the downturn and are involved in involuntary stocking.

This involuntary stocking at this stage by retailers and manufacturers indicates a need for a sharper de-stocking (and hence lower output) in the months ahead to bring stock and output levels to the right levels for lower domestic and overseas demand.

BHP

BARRY H POTTER

16 November 1990