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ECONOMIC PROSPECTS FOR 1989

The Industry Act (1975) requires the Government to publish economic forecasts twice a year. This forecast reviews economic developments so far this year and outlines the prospects for 1989. The main details of the forecast were given to the House of Commons this afternoon by the Chancellor of the Exchequer.

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ECONOMIC PROSPECTS FOR 1989

Summary

GDP is forecast to grow by 3 per cent in 1989, following growth of 4½ per cent this year. Inflation is expected to peak in mid-1989, and fall back by the end of the year.

Assumptions

2. The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. It assumes that both North Sea oil prices and sterling remain close to their recent levels. The public sector debt repayment (PSDR) is expected to be about £10 billion in the current financial year, equivalent to 2 per cent of GDP. The forecast assumes a similar PSDR in 1989-90 to that in 1988-89; the actual PSDR for that year will, as usual, be set in the Budget.

World economy

3. GNP in the major industrialised countries has grown faster than expected and is forecast to rise by 4 per cent in 1988; growth is forecast to slow down slightly, to 3 per cent, in 1989. World trade in manufactures has also picked up strongly and should grow by 8½ per cent in 1988. Inflation in the major industrialised countries is expected to remain low.

Demand and activity

4. The economy has grown strongly over the past year, though major inconsistencies in the official statistics (discussed in the annex) make it difficult to assess the precise extent of growth. The average measure of GDP, which may understate the true position, is forecast to grow by about 4½ per cent in 1988, with manufacturing output rising by 7 per cent. Non-oil export volumes have recovered strongly after falling in early 1988. Domestic demand has risen sharply over the past year as investment has boomed and consumers' expenditure has continued to grow rapidly. It is expected to moderate in 1989.

UK trade
and current
account

5. The UK current account is forecast to be in deficit by £13 billion in 1988. This is considerably larger than forecast at Budget time, due mainly to stronger growth in both investment and consumption. The current account deficit should show a slight reduction during 1989.

Inflation

6. Retail price inflation is expected to be 6½ per cent in the fourth quarter of 1988. It is likely to rise further in the first half of 1989 before falling to 5 per cent in the fourth quarter of 1989. Manufacturing unit labour costs have risen slowly over the past year, since productivity has continued to grow at a very fast rate.

Labour
market

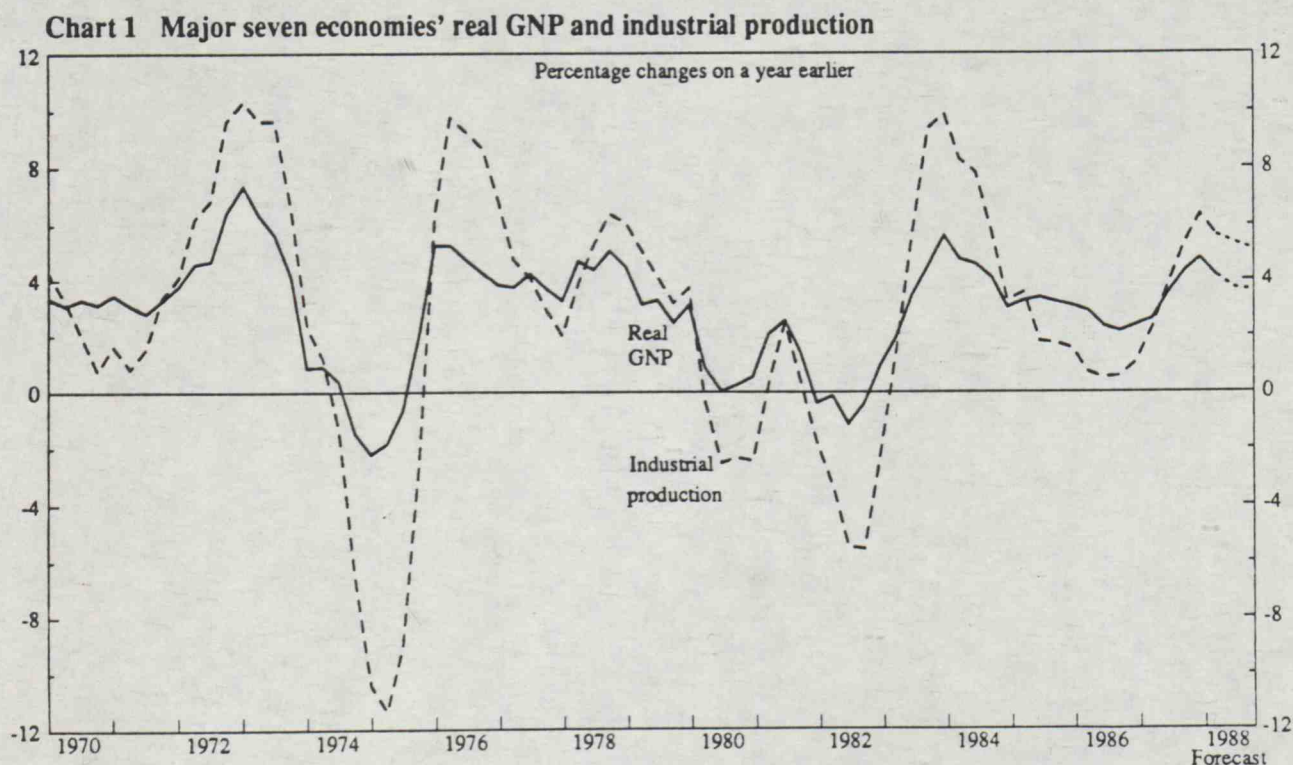
7. Employment has increased rapidly over the past year. Unemployment fell by half a million in the year to September. It should continue to fall over the next year, though probably at a slower rate than recently.

World economy

Recent
developments

8. Since the recession in 1982 the major seven OECD countries have experienced six years of steady growth, with real GNP growing at an average rate of 3½ per cent a year and the unemployment rate falling by 2½ per cent.

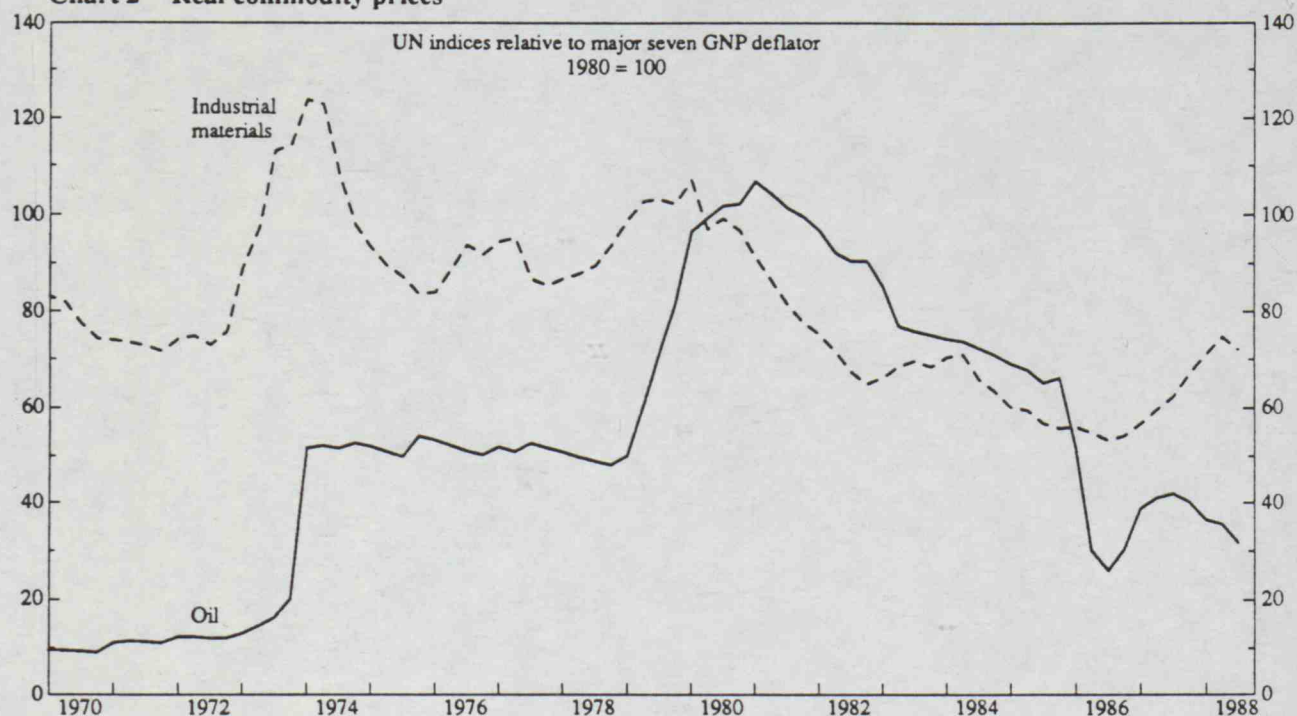
9. Growth in these countries is estimated to have increased to over 4 per cent over the past year. Exports have grown strongly, especially to those developing countries which benefited from the rise in real commodity prices in 1987 and the first half of 1988. Greater exchange rate stability following the Louvre accord and rising capacity utilisation have strengthened business confidence and contributed to a resurgence of investment.



10. In contrast to 1984, when the strength of activity in the major seven mainly reflected developments in the United States, the latest spurt in activity has been experienced in all these countries. This is reflected in the pick up in total trade and in world trade in manufactures, both of which are rising at around 9 per cent a year. All the major countries are currently experiencing an investment boom.

11. Although non-oil commodity prices rose by nearly 20 per cent in real terms over the last year, oil prices fell by rather more. The net effect on aggregate costs in industrial countries is likely to be small. Consumer price inflation in the major seven countries has remained around 3 per cent.

Chart 2 Real commodity prices



Forecast

12. Table 1 shows the forecasts for world trade, activity and inflation in the major seven countries. Real GNP is expected to grow a little less strongly in 1989 than in 1988, with some slow-down in consumer spending.

Table 1 World economy

	Percentage changes on previous year		
	Forecasts		
	1987	1988	1989
Major seven countries ¹ :			
Real GNP	3½	4	3
Real domestic demand	3½	4	3
Industrial production	3	5½	4½
Consumer prices	3	3	4
World trade, at constant prices			
Total imports	5	9	6½
Trade in manufactures	5½	8½	7½

1 US, Japan, Germany, France, UK, Italy and Canada

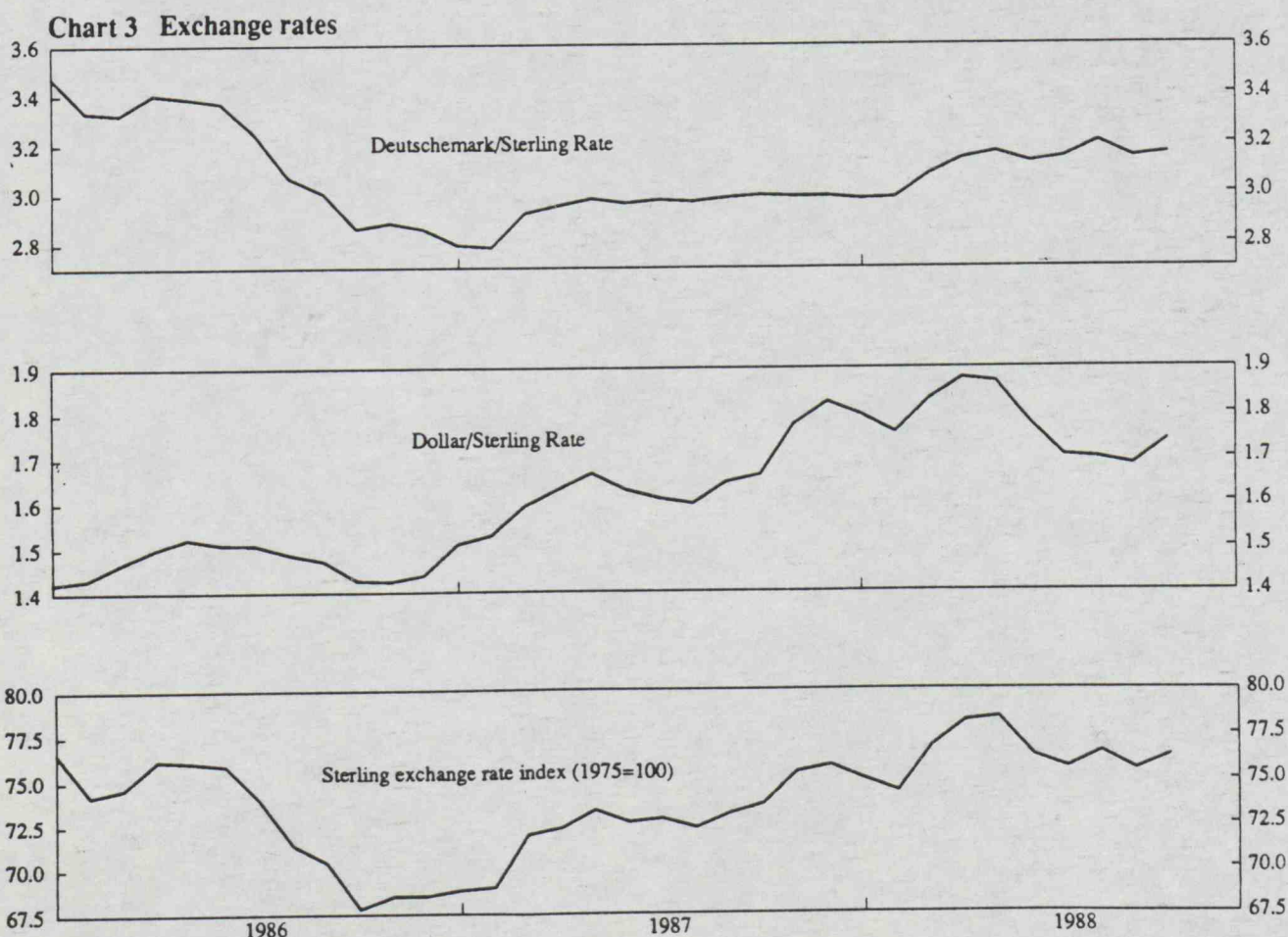
13. Growth in world trade may also slow a little in 1989, but will probably still remain high since the imports of some developing countries are expected to remain buoyant.

14. Spot prices of non-oil commodities have weakened recently, but the continued strength of industrial activity makes a further fall doubtful. There is likely to be a modest rise in consumer price inflation in 1989.

Trade and the balance of payments

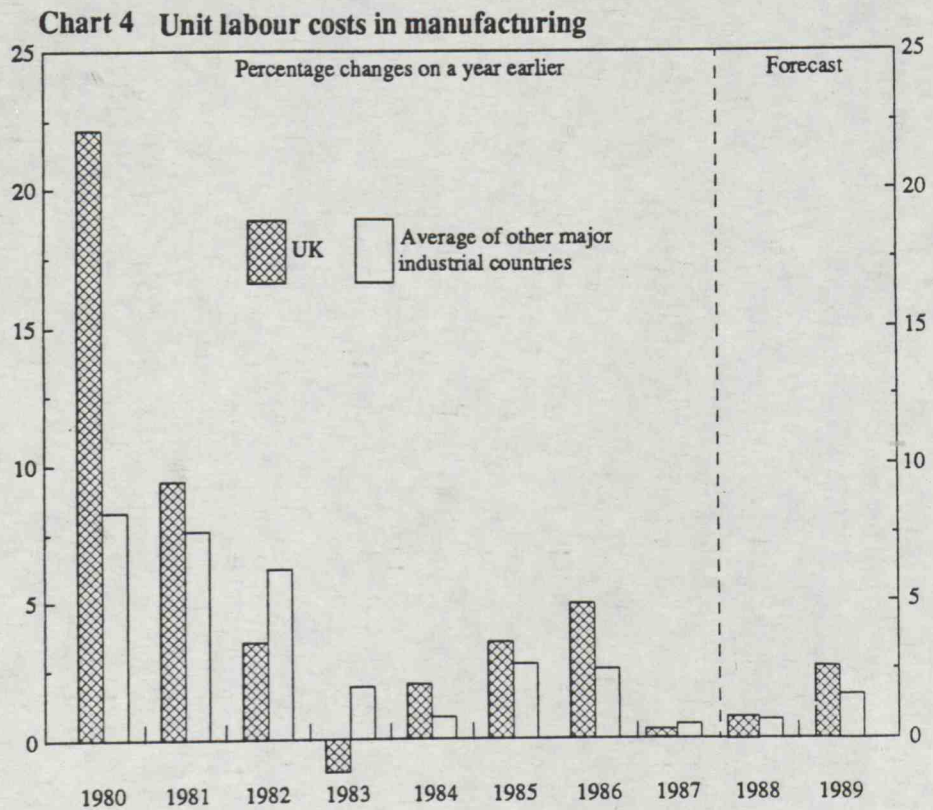
Exchange rates

15. Exchange rates between the major currencies have been fairly stable over the past eight months. The dollar/Deutschemark rate is close to its level at the time of the Louvre accord. The forecast assumes that sterling remains close to recent levels.



Relative
costs and
prices

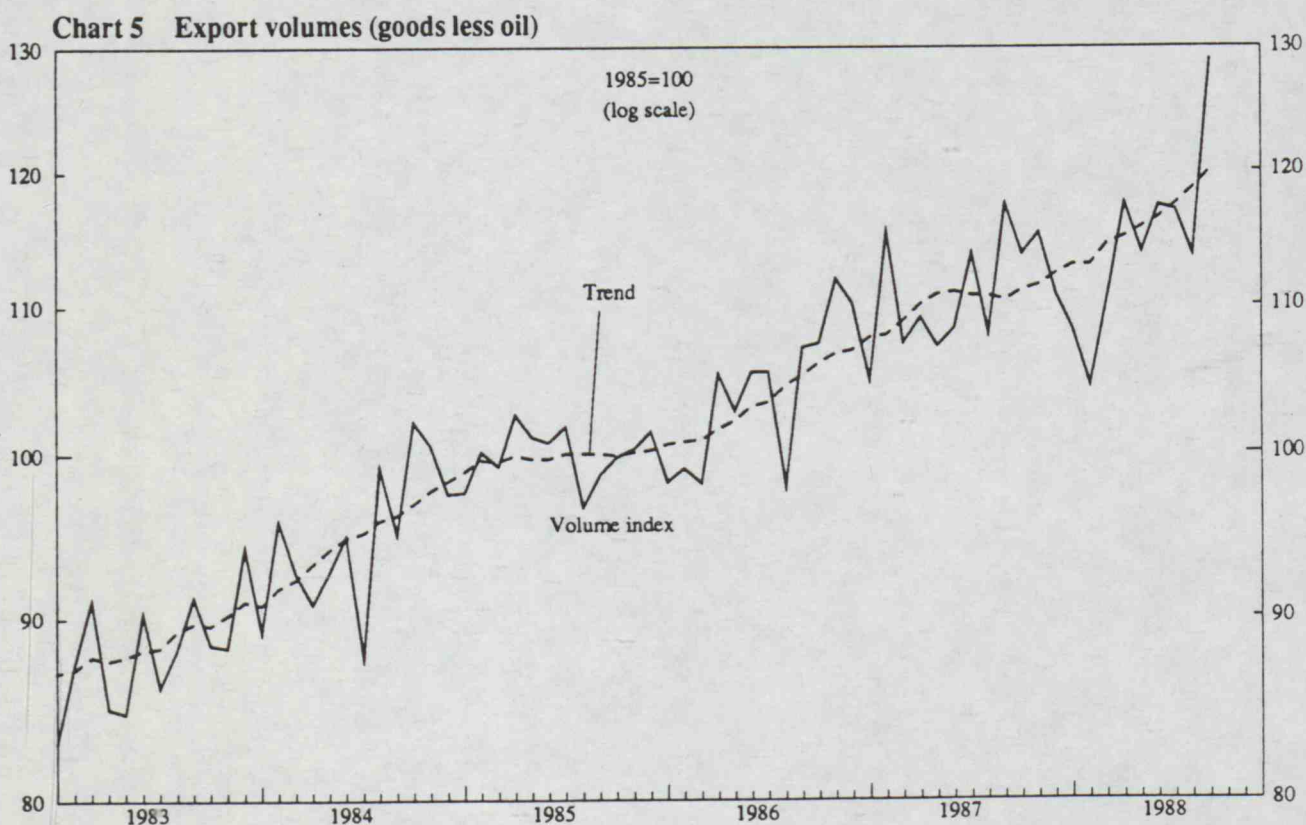
16. Manufacturing unit labour costs in the UK have risen only slightly over the past year. Most of the large gain in labour cost competitiveness in 1986 has been maintained.



17. It is the rapid increase in domestic demand that explains most of the deterioration in the current account. Recent CBI surveys suggest that some industries have been facing capacity constraints, so it is likely that part of the unexpected domestic demand has been satisfied by imports. Some potential exports may also have been diverted to the domestic market.

Trade volumes
(goods other
than oil)

18. After erratically low figures in early 1988, the volume of UK manufactured exports has since risen as world trade has continued to expand. In the third quarter of 1988 the volume of exports of manufactures was $7\frac{1}{2}$ per cent higher than a year earlier. Manufactured export volumes are forecast to rise by over 8 per cent in 1989, close to the projected growth of world trade.



19. Chart 6 shows how after decades of decline, the UK's volume share of world trade in manufactures has changed little since 1981.

Chart 6 Share of UK exports in total world trade in manufactures

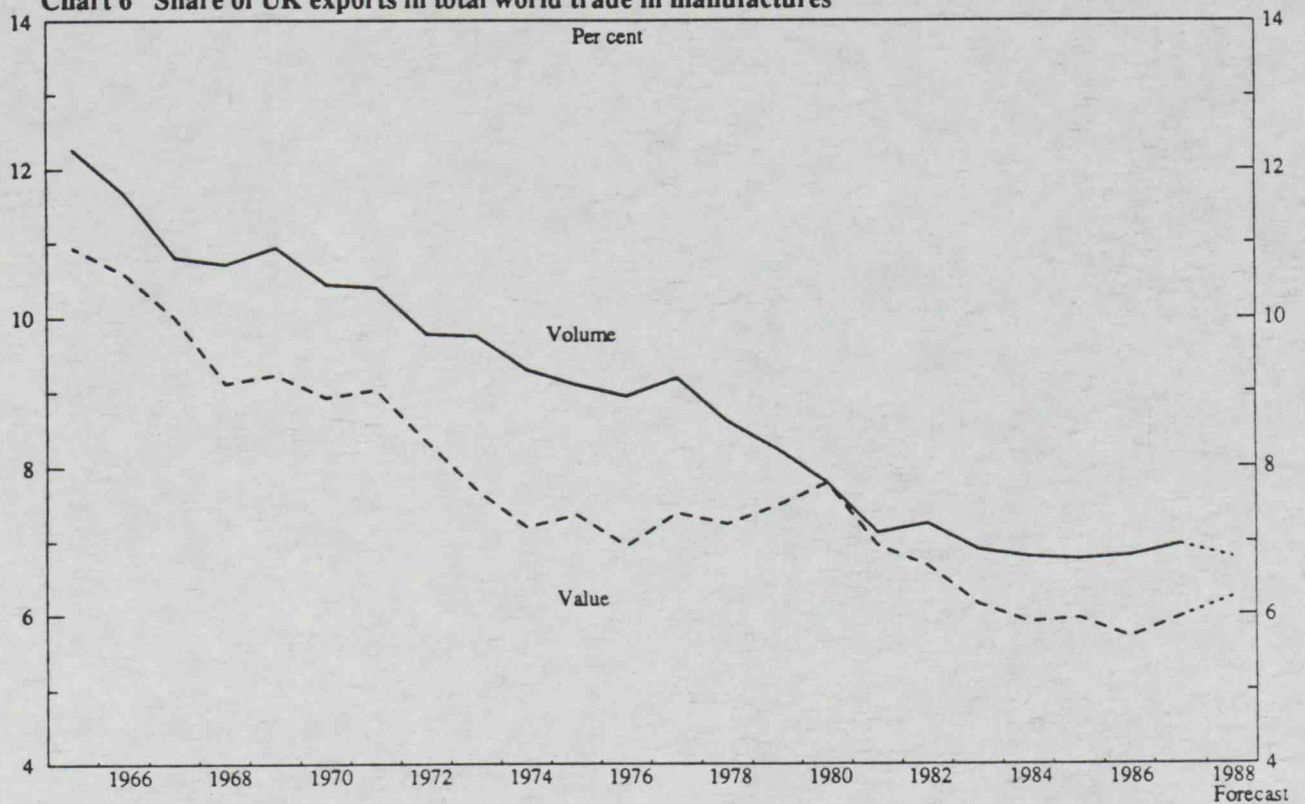
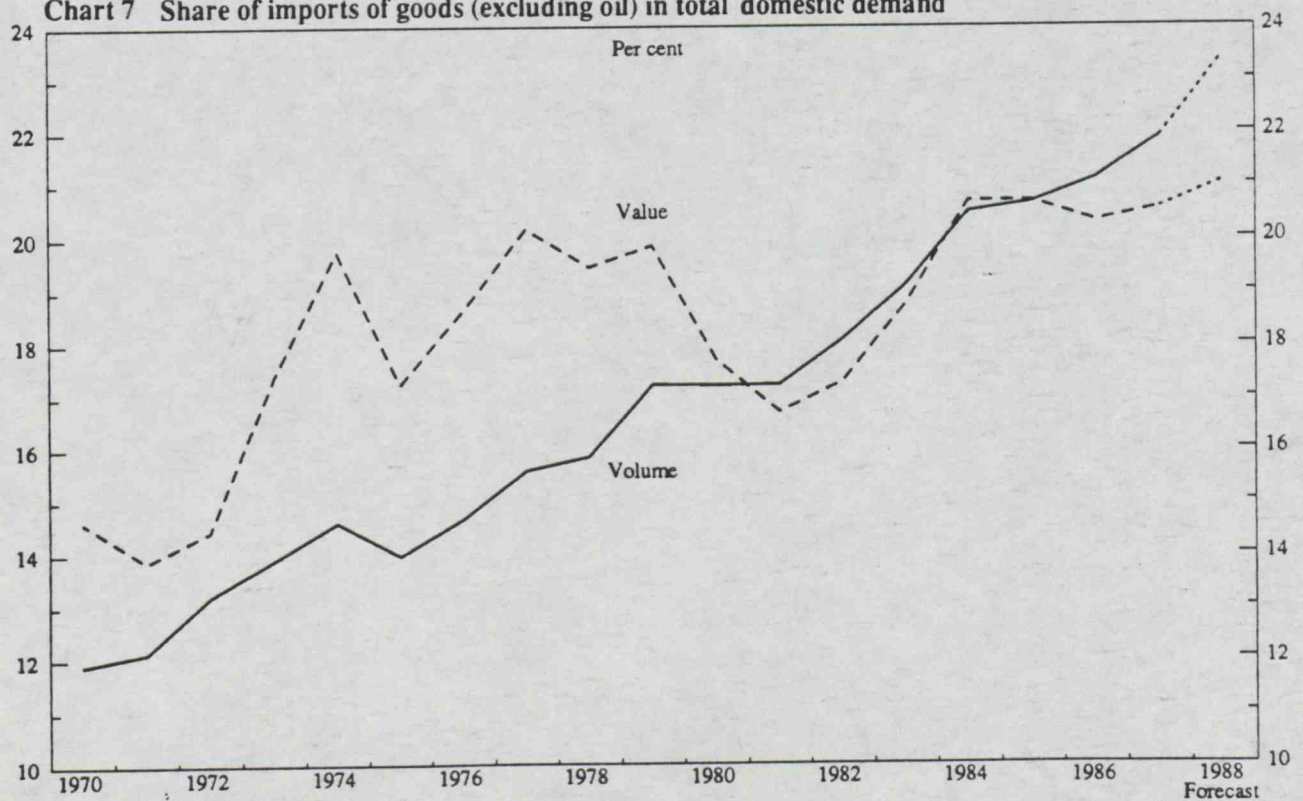


Chart 7 Share of imports of goods (excluding oil) in total domestic demand



20. Non-oil imports have risen very rapidly this year reflecting the strength of domestic demand and capacity shortages in some industries. Non-oil imports are expected to grow by 13½ per cent in 1988. But import growth should slow significantly in 1989, to 5 per cent, as domestic demand decelerates and as extra capacity becomes available following the investment boom.

Oil trade

21. The oil trade surplus is expected to fall by over £1½ billion in 1988 to around £2½ billion. This is the result of lower sterling oil prices, a decline in production (mainly due to the Piper Alpha disaster), and increased domestic demand for oil. Oil production is likely to fall again in 1989. Declining production and a further rise in domestic demand for oil imply another fall of about £½ billion in the oil surplus in 1989.

Trade prices and the terms of trade

22. The terms of trade have improved somewhat over the past year, with the higher exchange rate more than offsetting the effects of falling oil prices. The terms of trade are assumed to remain broadly unchanged during the rest of 1988 and in 1989.

Table 2 Visible trade

	Percentage changes on previous year					
	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade ¹	Export volume	Import volume	Terms of trade ¹
1987	5	7	1	6½	8	1
1988 Partly forecast	2	12½	1½	5	13½	2
1989 Forecast	7	5	1	8½	5	1

¹ The ratio of UK export average values to import average values.

Invisibles and overseas assets

23. The surplus on invisibles in 1988 is likely to be around £2 billion lower than in 1987. This is largely due to a fall in the balance on services. UK tourists

have been spending more abroad and the surplus on financial services has come down due to lower insurance premiums net of claims.

24. Net earnings from interest, profits and dividends are expected to be unchanged from last year. The deficit on transfers is also expected to be unchanged in 1988 with lower payments to the European Community offset by higher bilateral aid.

25. The invisibles surplus should rise a little in 1989 in part because payments abroad by North Sea companies continue to fall.

26. During 1987 the value of the stock of UK net overseas assets fell by £24 billion, to £90 billion, largely due to the fall in the sterling value of UK assets in North America following the fall in the US dollar.

Current account 27. The current account is estimated to have been in deficit by just under £10 billion in the first 9 months of 1988 (though the large positive balancing item suggests that this may overstate the actual deficit). The forecast for the year as a whole is for a deficit of £13 billion (about $2\frac{3}{4}$ per cent of GDP).

28. The forecast for 1989 is for a slightly smaller current account deficit. The expected slowdown in domestic demand growth will benefit non-oil trade, but this will be partly offset by the smaller oil surplus.

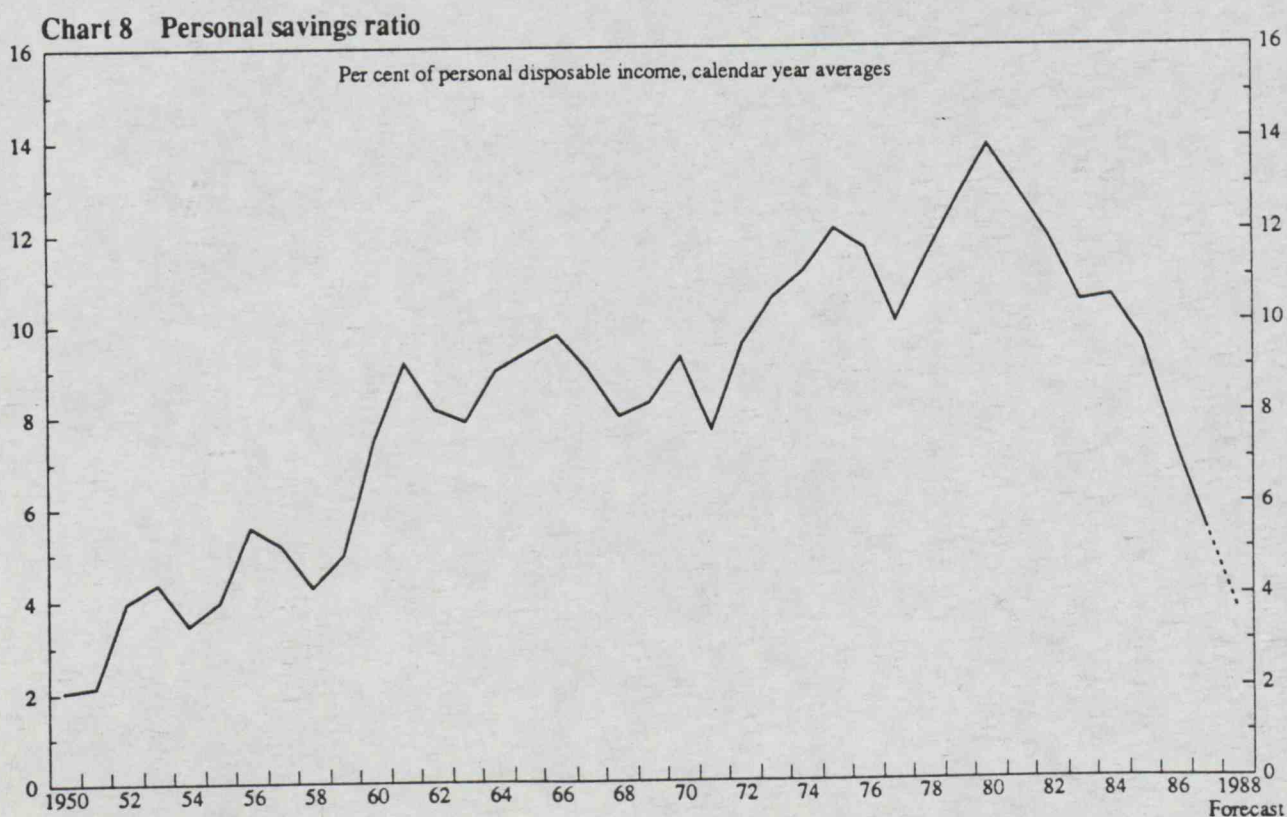
Table 3 Current account

	£ billion				
	Manufactures	Other	Oil	Invis- ibles	Current balance
1987	- 7½	-7	4	7½	- 2½
1988 Partly forecast	-13	-8	2½	5½	-13
1989 Forecast	-11½	-7½	2	6	-11

Demand and activity

Personal sector expenditure 29. Consumer spending is estimated to have risen by $5\frac{1}{2}$ per cent in 1986 and by 5 per cent in 1987. This is considerably faster than the growth in real personal disposable income, and the recorded savings ratio fell from an estimated $9\frac{1}{2}$ per cent in 1985 to $5\frac{1}{2}$ per cent in 1987. In 1988 consumer spending is likely to increase by about $5\frac{1}{2}$ per cent, a similar rate to that in 1986 and 1987. The savings ratio is likely to fall to about $3\frac{1}{2}$ per cent.

30. Several factors may explain the substantial fall in the savings ratio since 1980. Most important has been greater confidence in the future, with people having lower inflation expectations and greater wealth, especially following the large rise in house prices. In addition, employers' contributions to pension funds have been falling in recent years as companies have reacted to the surpluses that many funds have been running; this scores in the official statistics as lower personal saving.

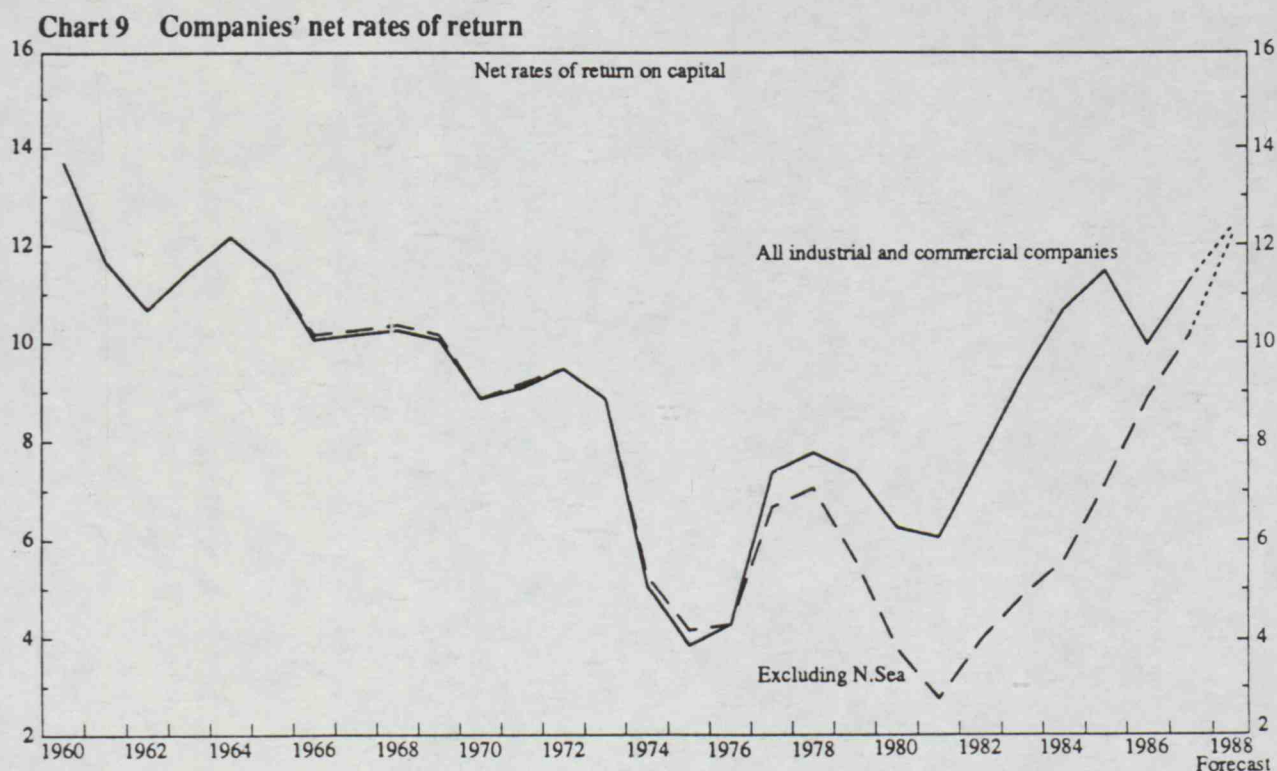


31. The fall in the savings ratio has been associated with an increase in borrowing - particularly mortgage borrowing - following the ending of mortgage rationing and other restrictions. But householders will not wish to go on accumulating debt at the same rate as recently: levels of borrowing are already high relative to income. Moreover, households are now, for the first time, substantial net payers of interest, and higher interest rates are therefore particularly likely to reduce consumer spending. This should be reinforced by a slow-down in the growth of house prices and hence of housing wealth. Consumer spending is expected to rise by 3½ per cent in 1989 with a deceleration through the year. The savings ratio should recover slowly during 1989.

32. The housing market has been particularly buoyant over the past year, though the fall in building society mortgage commitments in August and September suggests that the pressure of demand is easing. Nonetheless, private sector investment in dwellings and improvements is likely to increase substantially in 1988 as a whole. It is likely to rise much more slowly in 1989.

Company
incomes and
expenditure

33. The net rate of return of non-North Sea industrial and commercial companies (ICCs) rose for the sixth successive year in 1987, back to levels not seen for almost twenty years. The net rate of return of manufacturing companies rose to just over 9 per cent in 1987, again the highest level for almost twenty years. With continued strong profit growth likely in 1988 net rates of return are expected to improve further.



34. Developments so far in 1988 confirm the investment boom predicted by recent CBI surveys and DTI Investment Intentions Surveys. Business investment is expected to rise a little faster in 1988 than the June DTI Intentions Survey suggested. Manufacturing investment, including leased assets, is likely to rise by 18 per cent and total non-oil business investment by over 13 per cent. Further growth in business investment is likely in 1989. Recorded stockbuilding is expected to continue on only a moderate scale in 1988 and 1989.

Table 4 Gross domestic fixed capital formation

	£billion at 1985 prices 1987	Percentage changes on previous year		
		1987	Forecasts	
			1988	1989
Business ¹	41.1	6½	13½	7½
of which: non-oil business	39.2	8½	13½	7
manufacturing	10.1	5	18	10
Private dwellings ²	15.2	7	13	2½
General government	8.1	- ½	½	2½
Total fixed investment	64.2	5½	12	5½

1 Includes investment by public corporations.

2 Includes purchase less sales of land by persons, companies and public corporations, other than purchases of council houses.

Prospects for demand and activity 35. Growth of the average measure of GDP is forecast to be around 4½ per cent in 1988. It could turn out to be even higher if, as seems likely, the expenditure measure is subsequently revised up. With the forecast slow-down in domestic demand, GDP is expected to rise more slowly in 1989.

36. North Sea output fell by some 3 per cent between the first half of 1987 and the first half of 1988, and is expected to decline further in the second half of 1988. In 1989 declining output in the North Sea may reduce GDP growth by ½ percentage point. Manufacturing output is forecast to rise faster than total non-North Sea GDP in both 1988 and 1989.

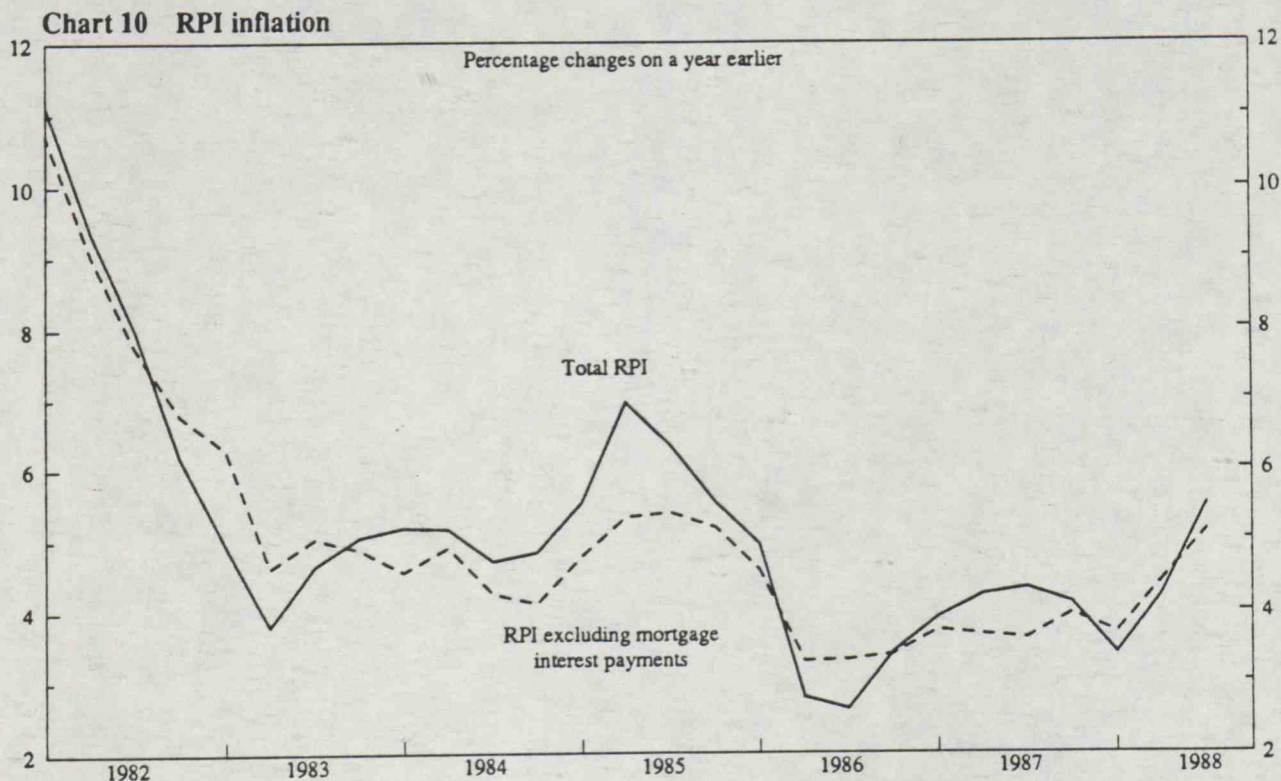
Table 5 Domestic demand and GDP

	Percentage changes on a year earlier		
	1987	Forecasts	
		1988	1989
Domestic demand	4½	6	3
Exports of goods and services ¹	5½(6½)	1½(4)	5½(6½)
Imports of goods and services ¹	7½(8)	12(13)	4½(5)
Gross Domestic Product ^{1,2}	4(4½)	4½(5)	3(3½)
Manufacturing Output	6	7	4½

1 Non-oil shown in brackets. 2 Average measure.

Inflation

37. The annual rate of RPI inflation has risen since early 1988, in part as a result of the rise in mortgage interest rates. Chart 10 shows that, excluding mortgage interest payments, the increase has been less pronounced, though it has risen from the low levels of 1986 and 1987 which were associated with the oil price fall.



38. RPI inflation is likely to average $6\frac{1}{2}$ per cent in the fourth quarter of 1988; excluding mortgage interest payments the figure is expected to be 5 per cent. Producer price inflation has also edged up during 1988. Though higher than expected at Budget time, the underlying rate of increase in prices has been lower than in periods of fast demand and output growth in the 1970s.

39. The underlying increase in average earnings has risen from $8\frac{1}{2}$ per cent at the start of the year to $9\frac{1}{2}$ per cent in August 1988. Pay settlements have edged up as labour markets have tightened, but high overtime payments and performance related bonuses have also played an important part.

40. Despite high earnings increases, growth in manufacturing unit labour costs has been kept down by the rapid growth in productivity. Unit labour costs in manufacturing are expected to rise by just under 1 per cent in 1988.

Prospects

41. The low growth in costs over the last two years has not been fully reflected in producer output prices. With fast growth in demand, UK manufacturing industry has increased profit margins substantially. The projected slow-down in demand and activity may mean that profit margins will show less growth in 1989, and that unit labour costs will grow more rapidly (because of a likely cyclical slow-down in productivity growth). Producer output price inflation may be only a little less in 1989 than in 1988.

Table 6 Costs in manufacturing

	Percentage changes on previous year			
	Unit labour costs	Cost of materials and fuel	Estimated total unit costs ²	Output prices ¹
1986	5	-10½	2¼	4
1987	¾	5	1½	4¼
1988 Partly forecast	¾	4	1¼	4¾
1989 Forecast	2½	1½	3¼	4½

1 Producer prices excluding food, drink and tobacco industries.

2 Including costs of bought-in services.

42. Retail price inflation could rise further during the first half of 1989 before moderating to 5 per cent by the fourth quarter. The fluctuations in the RPI are chiefly the result of past changes in mortgage rates; excluding mortgage interest payments, the inflation path is likely to be much smoother.

Table 7 Retail prices index

	Percentage changes on a year earlier			
	Weight in 1988	1987 Q4	Forecasts	
			1988 Q4	1989 Q4
Food	16½	3½	3½	3½
Nationalised industries	5½	2½	7½	6½
Housing	15½	7	16½	7
Other	63	3½	4½	4½
Total	100	4	6½	5

43. The GDP deflator, which measures the price of domestic value added (principally unit labour costs and profits per unit of output), is forecast to rise by 6½ per cent in 1988-89 and by 5 per cent in 1989-90.

Productivity and the labour market

44. The workforce in employment in Great Britain has continued to rise strongly over the last year: in the twelve months to June 1988 it is estimated to have risen by 440,000 thousand. Since 1983 there has been an increase of over 2 million in the workforce in employment.

Table 8 Changes in Employment

	Thousands, GB seasonally adjusted					
	Employees in employment		Self- employed	HM forces	Work related government training programmes	Workforce in employment
	Male	Female				
June 1985 to June 1986	-68	+152	+ 16	-4	+50	+145
June 1986 to June 1987	- 6	+242	+234	-3	+85	+552
June 1987 to June 1988	+60	+222	+124 ¹	-3	+35	+438

¹ Figures for self-employment over the last year are a projection based on self-employment growth over the previous six years.

45. Productivity has been growing strongly, with manufacturing productivity now estimated to have risen by $4\frac{1}{2}$ per cent a year on average since 1979. Underlying growth in labour productivity in manufacturing industry now appears to be higher than the rate experienced in the 1960s. Output per head in the non-manufacturing sector has risen by about $1\frac{1}{4}$ per cent a year since 1979, and by about $2\frac{1}{2}$ per cent a year since 1983.

Table 9 Output per head of the employed labour force

	Annual average, percentage changes		
	1964-73	1973-79	1979-88 ²
Manufacturing	$3\frac{1}{4}$	$\frac{3}{4}$	$4\frac{1}{2}$
Non-manufacturing ¹	3	$\frac{1}{2}$	$1\frac{3}{4}$
Whole economy	$2\frac{3}{4}$	1	$2\frac{1}{4}$
Non-North Sea economy	$2\frac{3}{4}$	$\frac{1}{2}$	2

1 Excludes public services and North Sea oil and gas extraction.

2 Includes estimate for 1988.

Unemployment

46. By September 1988, seasonally adjusted adult unemployment in the UK had fallen for 26 successive months, by some 940,000 in total. The fall in unemployment over the past year is mainly attributable to the strong growth of output and employment. A further, though slower, fall in unemployment is likely over the year ahead. The main threat to achieving this would be excessive pay settlements.

Financial developments

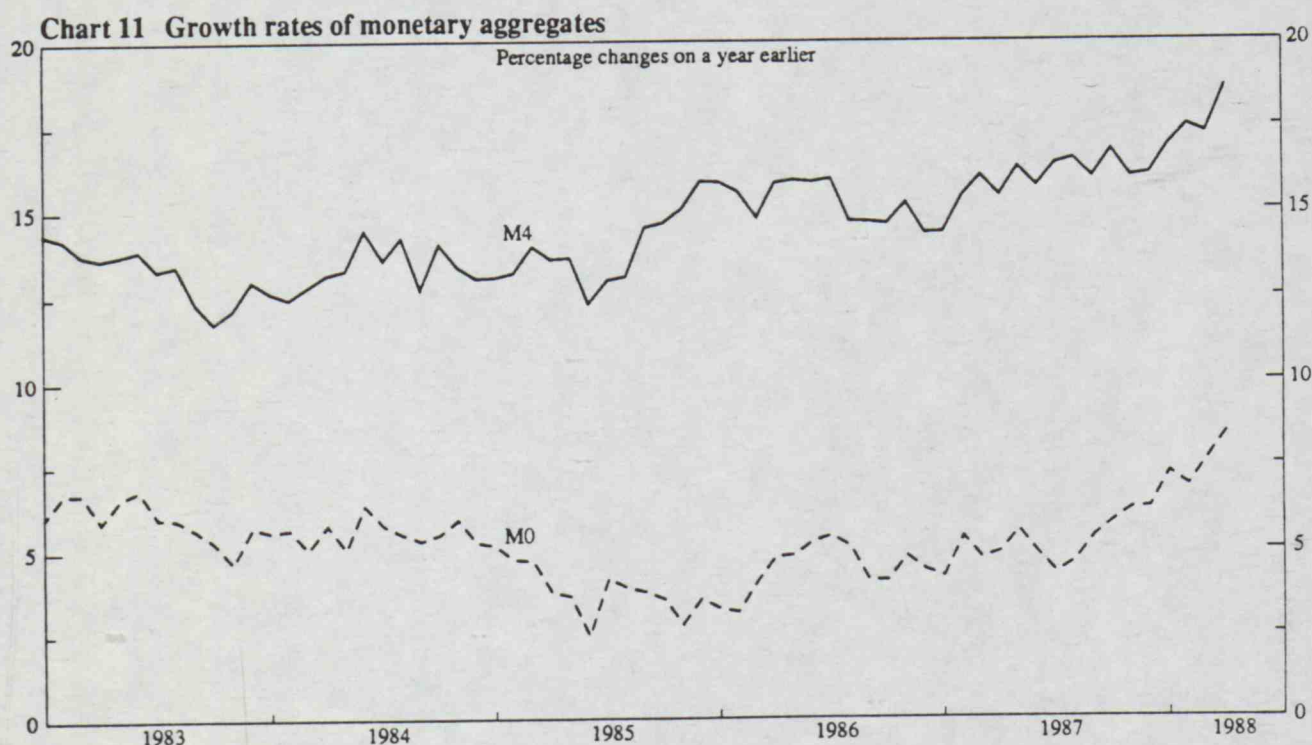
47. Over the past year, with the exception of a short-lived upsurge in April and May, the sterling index has varied by less than 3 per cent from its present level. In the nine months to September, the reserves increased by an underlying \$5 billion, net of official borrowing.

Narrow money

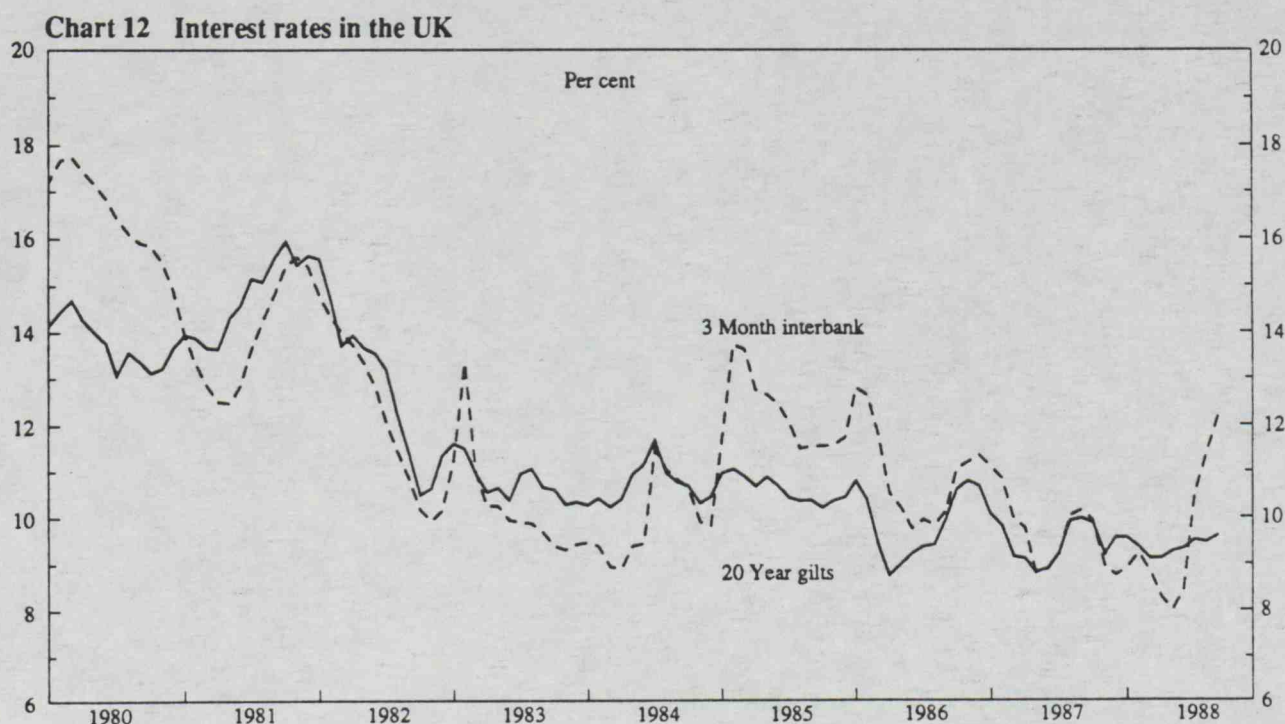
48. The year on year growth of M0 has remained above the top of its 1-5 per cent target range. Increases in interest rates since the summer are expected to slow the growth of M0 considerably over the next six months, although it may not return within its target range by the end of the financial year.

Broad money

49. Broad money has continued to grow rapidly. There has been a marked increase in personal and financial sector deposits, as the stock market crash led to a move away from new investment in equities and unit trusts. Financial innovation and liberalisation continue to contribute to the growth of broad money.



50. Chart 12 shows the recent path of interest rates. Monetary conditions have tightened considerably during this year.



Fiscal developments

51. Tables 10 to 12 show both the Budget projections and latest forecasts for general government expenditure and receipts and the public sector debt repayment. The PSDR in 1987-88 was £3½ billion, slightly higher than estimated in the 1988 FSBR.

52. In the first half of 1988-89 there was debt repayment of just over £3½ billion, compared with public sector borrowing of about £2 billion in the first half of 1987-88. The revised forecast for 1988-89 as a whole is a PSDR of £10 billion, £6½ billion higher than forecast in the FSBR. This is due in roughly equal amounts to higher than expected receipts and lower than expected

expenditure. The revisions on the receipts side largely reflect the higher than expected growth of money GDP.

Table 10 General government expenditure

	£ billion		
	1987-88 Outturn	1988-89 Budget forecast	Latest forecast
Public expenditure planning total	145.7	156.8	153.6
Interest payments	17.5	17.5	17.7
Other adjustments	8.2	8.6	9.6
General government expenditure	171.5	182.9	180.9
of which			
Privatisation proceeds	- 5.2	- 5.0	- 6.0

53. Gross debt interest payments in 1988-89 are a little higher than forecast at Budget time because of higher interest rates and inflation (which raises the cost of servicing indexed debt). Higher than expected debt repayment reduces interest payments, but most of this effect will be in future years. The upward revision to the forecast of other adjustments largely reflects a change in the composition of public corporations' net financing which increases general government expenditure, but does not affect the PSDR.

54. The forecast for general government receipts has been revised up by over £3½ billion since the Budget, most of which is accounted for by higher taxes and national insurance contributions. VAT and income tax are expected to be £1 billion and £½ billion higher respectively than in the Budget forecast. Other significant increases come from national insurance contributions and stamp duty, each of which are £½ billion higher. The higher stamp duty mainly reflects the buoyancy of the housing market earlier this year.

55. Total interest and dividend receipts are forecast to be £½ billion higher in 1988-89 than in 1987-88. Within this, dividends are about £¼ billion lower due to the sale of the government's remaining shares in British Petroleum, and interest receipts £¼ billion higher. General government receipts in total are now forecast to increase by 8½ per cent in 1988-89, much the same rate of increase as in 1987-88.

Table 11 General government receipts

	£ billion		
	1987-88	1988-89	
	Outturn	Budget forecast	Latest forecast
Taxes on income, expenditure and capital	132.7	141.2	143.8
National insurance and other contributions	29.1	31.6	32.2
Interest and dividends	6.0	5.6	6.4
Other receipts	5.8	6.5	6.3
Total receipts	173.6	184.9	188.6
of which			
North Sea revenues	4.7	3.3	3.3

56. Table 12 shows the Budget and latest forecasts for the PSDR. The forecast is still subject to a wide margin of error: the average error on PSDR forecasts for the current financial year made in the autumn is ½ per cent of GDP, or nearly £3 billion. On the basis of this forecast, the budget surplus in 1988-89 will be larger as a proportion of money GDP than in any year since the beginning of the 1950s, the earliest date for which figures on this basis are available.

Table 12 Public sector debt repayment

	£ billion		
	1987-88 Outturn	1988-89 Budget forecast	Latest forecast
General government expenditure	171.5	182.9	180.9
General government receipts	173.6	184.9	188.6
General government debt repayment	2.0	2.0	7.8
Public corporations' market and overseas debt repayment	1.6	1.2	2.0
PSDR	3.6	3.2	9.8
PSDR as per cent of GDP	$\frac{3}{4}$	$\frac{3}{4}$	2
PSDR excluding privatisation proceeds as per cent of GDP	$-\frac{1}{4}$	$-\frac{1}{2}$	$\frac{3}{4}$

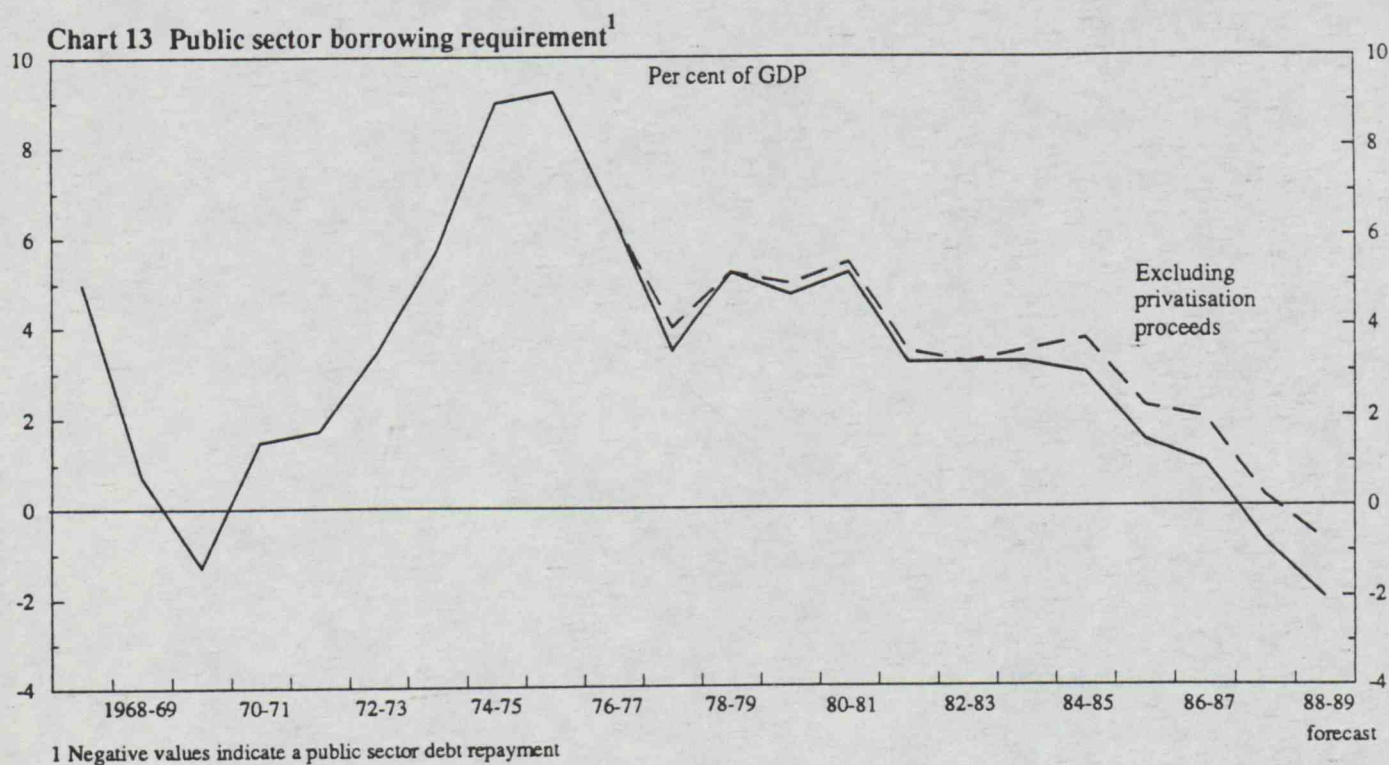


Table 13: Economic prospects: summary

Percentage changes on previous year unless otherwise stated

	1987	Forecast		Average errors from past ¹ forecasts
		1988	1989	
GDP and domestic demand at constant prices				
Domestic demand	4½	6	3	1
of which:				
Consumers' expenditure	5	5½	3½	1½
General government consumption	1	½	- ½	¾
Fixed investment	5½	12	5½	2½
Change in stockbuilding (as a percentage of GDP)	0	0	0	¾
Exports of goods and services	5½	1½	5½	2½
Imports of goods and services	7½	12	4½	2½
Gross domestic product	4	4½	3	¾
Manufacturing output	6	7	4½	2
 Balance of payments current account (£ billion)	 - 2½	 -13	 -11	 4½
Inflation				
Retail price index (Q4 on Q4)	4	6½	5	1½
GDP deflator at market prices (financial year)	5½	6½	5	1½
 Money GDP at market prices (financial year) £ billion	 10 424	 11 471	 8 508	 1½
 PSDR (financial year) £ billion as a percent of GDP	 3½ ¾	 10 2		 3 ½

¹ The errors relate to the average differences (on either side of the central figure) between Autumn Industry Act forecasts and outturn over the last ten years and apply to the forecasts for 1989, except for the PSDR where they apply to the forecasts for 1988-89.

TABLE 14 GROSS DOMESTIC PRODUCT AND ITS COMPONENTS

£billion at 1985 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less imports of goods and services	Less adjustment to factor cost	Plus statistical adjustment	GDP at factor cost (average measure)	GDP index (average measure) 1985=100
1984	207.9	74.0	58.1	97.1	1.1	438.1	96.7	48.7	0.8	293.5	96.3
1985	215.3	74.0	60.3	102.8	0.6	452.9	99.2	49.5	0.5	304.7	100.0
1986	226.8	75.4	60.8	106.6	0.6	470.3	105.6	51.8	1.1	314.0	103.0
1987	238.5	76.0	64.2	112.5	0.6	491.8	113.3	54.5	3.1	327.1	107.4
1988	251.9	76.4	72.0	114.4	1.0	515.8	126.8	56.7	8.9	341.2	112.0
1989	261.1	75.9	76.0	120.8	0.6	534.4	132.8	59.4	9.9	352.1	115.6
1987H1	117.0	37.8	31.2	55.5	-0.2	241.4	53.9	26.7	0.9	161.6	106.1
H2	121.4	38.3	32.9	57.1	0.7	250.4	59.4	27.8	2.3	165.5	108.6
1988H1	124.2	38.0	34.2	56.0	0.5	253.0	60.9	27.8	4.1	168.5	110.6
H2	127.8	38.4	37.8	58.3	0.5	262.8	65.9	29.0	4.8	172.7	113.4
1989H1	129.8	37.9	37.9	59.8	0.3	265.7	65.9	29.5	4.9	175.2	115.0
H2	131.3	38.1	38.1	60.9	0.3	268.7	66.9	29.9	5.0	176.9	116.1

Per cent changes 2

1986 to 1987	5	1	5½	5½	0	4½	7½	5	½	4	4
1987 to 1988	5½	½	12	1½	0	5	12	4	2	4½	4½
1988 to 1989	3½	- ½	5½	5½	0	3½	4½	4½	½	3	3

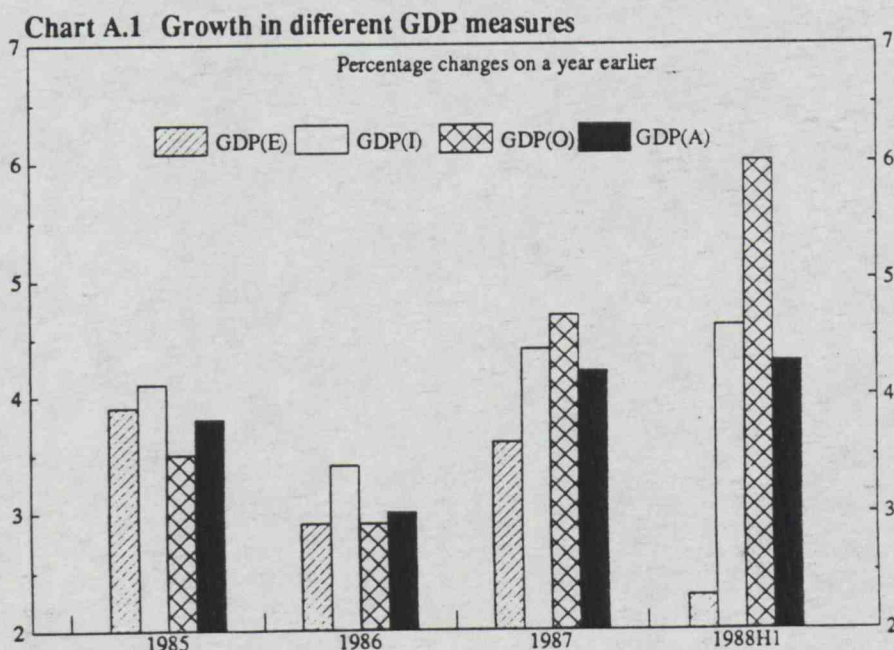
¹ The GDP figures are averages of constant price output, expenditure and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to the nearest half per cent. Figures for 1988H2 and beyond are forecasts. In the year to 1988H1, the expenditure measure grew by 2½ per cent compared with 4½ per cent growth for the income measure and 6 per cent for the output measure. It is likely that the expenditure measure and, consequently, the average measure both understate recent growth.

² Changes as a percentage of GDP for stockbuilding and statistical adjustment

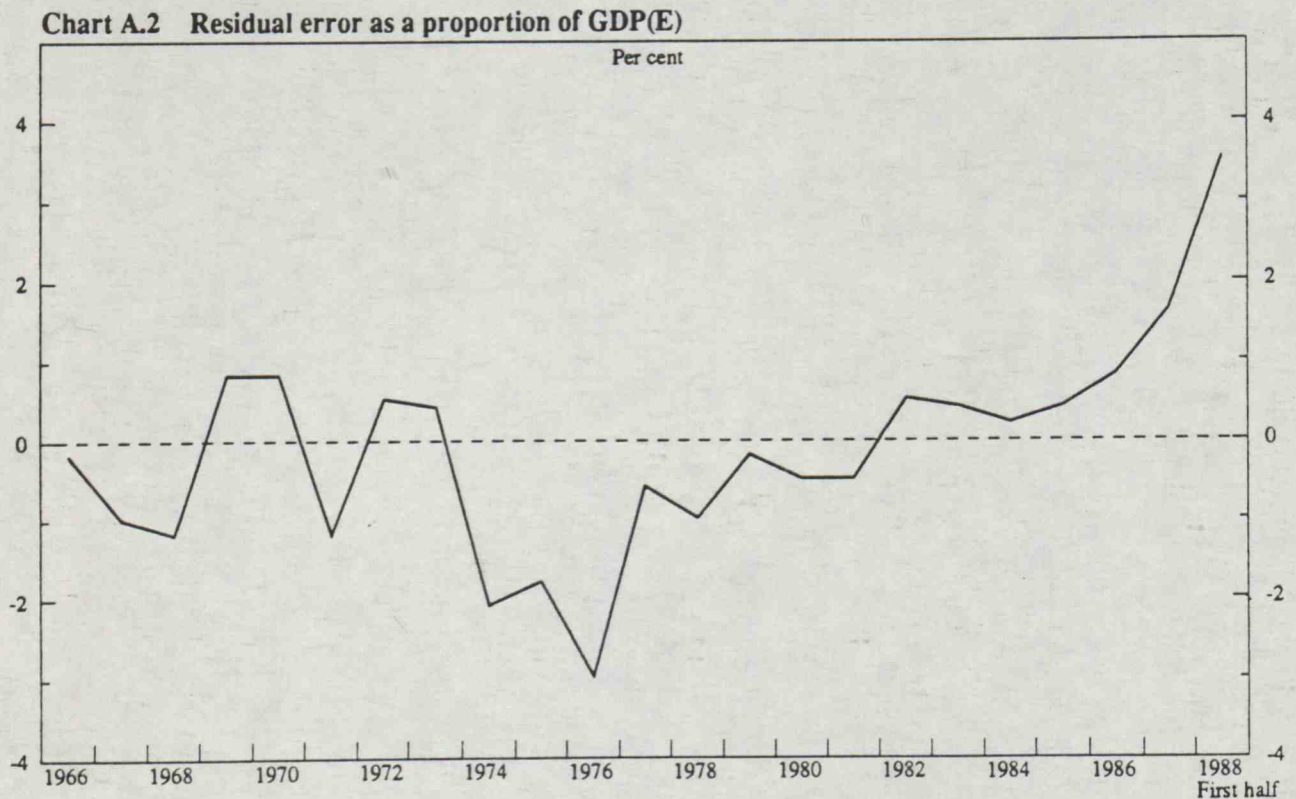
National and sectoral accounts

A.1. It is difficult to assess how strongly the UK economy has grown over the past two years because of the considerable disparity between the growth rates of the various measures of real GDP. The disparity was particularly marked for the first half of 1988. Chart A.1 illustrates the differences between the separate measures since 1985.

A.2. The output estimate of GDP, which is generally considered the most reliable short-term indicator, grew by 6 per cent in the year to the first half of 1988. The income measure has also shown strong growth. By contrast, the expenditure estimate of GDP grew by only 2½ per cent over the same period. It seems likely that growth in aggregate expenditure has been under-recorded over the past two years, and maybe over a longer period.

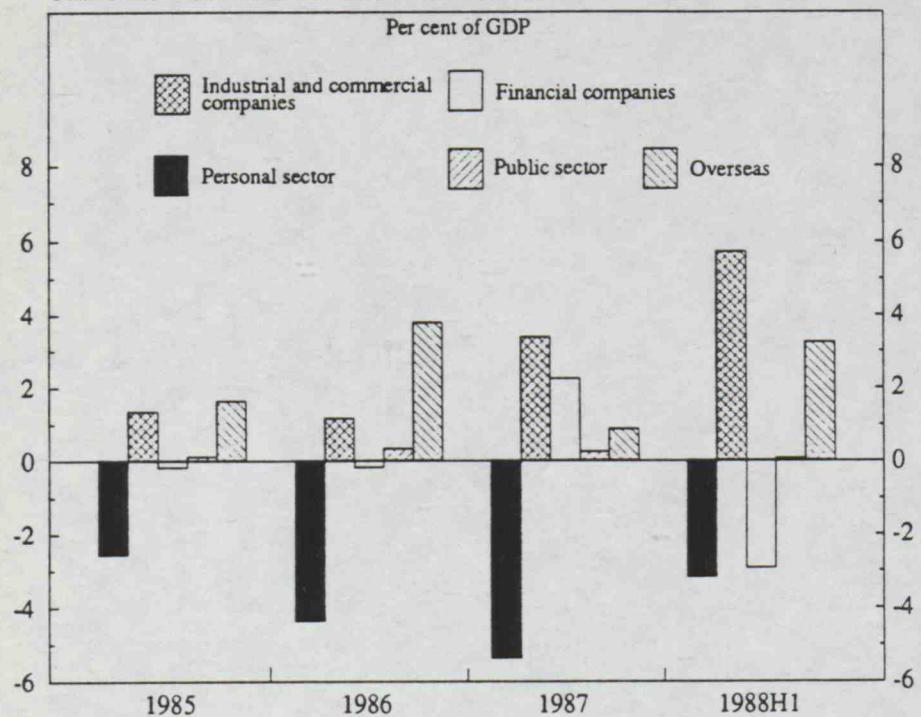


A.3. There are related problems with the current price national accounts figures, reflected in a rising residual error (the difference between the current price income and expenditure measures of GDP), especially in the first half of 1988.



A.4. At the same time large balancing items have emerged in the sectoral financial accounts. Sectoral balancing items are the differences between net acquisitions of financial assets as measured from financial data and as measured from national income and expenditure data. The sum of the balancing items is equal to the difference between the income and expenditure measures of GDP.

Chart A.3 Sectoral unidentified transactions



A.5. There is little information on the nature or size of the errors in the income and expenditure or the financial accounts that give rise to these large balancing items.

A.6. In 1987, the balancing item for the personal sector was equal to about 8 per cent of personal disposable income. This indicates that the personal sector may have acquired far more financial assets than the national income and expenditure estimates imply. It is also consistent with some under-recording of personal sector income and, hence, savings.

A.7. The large overseas balancing item in the first half of 1988 (about £7 billion) indicates that there were either unrecorded net credits on the current account or unrecorded net capital inflows or, most likely, both. To the extent that it reflects unrecorded net credits (ie net visible exports or invisibles) the true current account deficit would be lower than the recorded figure.

A.8. The balancing item for the industrial and commercial companies sector may imply some under-recording of spending on investment and stocks or unrecorded trade credit extended to other sectors. If net exports and company sector capital spending were higher than the recorded figures indicate, that would go some way to correct the sluggish behaviour of the recorded expenditure measure of GDP relative to the other measures.

A.9. The forecast for 1989 makes some allowance for a further rise in the average estimate of GDP, relative to the expenditure measure, though much less than in 1988.