



H M Treasury
Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270 4360

Sir Peter Middleton KCB
Permanent Secretary

SECRET

Paul Gray Esq
10 Downing Street
LONDON
SW1

28 January 1988

Dear Paul,

... I enclose a copy of the main report on the Winter 1988 Treasury Economic Forecast.

A copy is also going to Brian Griffiths.

*Yours ever,
Simon*

S D H SARGENT
Private Secretary

TREASURY ECONOMIC FORECASTING EXERCISE

WINTER 1988 REPORT

	<u>Contents</u>	<u>Page</u>
1.	Summary	1
2.	The World Economy	6
3.	Trade and the Balance of Payments	8
4.	Domestic Demand and Activity	13
5.	Prices and Earnings	19
6.	Employment, Unemployment and Productivity	25
7.	Financial Conditions	26
8.	Public Finances	30
Annex I	Comparison with outside forecasts	
Annex II	Net acquisition of financial assets by sector: historical data	

TREASURY ECONOMIC FORECASTING EXERCISE

(1) SUMMARY

The forecast covers the period to the end of 1989 (1989-90 for public finances). Table 1 summarises the results.

(i) Main resultsThe World economy

2 After some hesitation in the second half of 1986 and early 1987 growth in the world economy picked up more strongly than expected in the third quarter of 1987 (particularly in North America and Japan). Major 7 GNP probably rose by just under 3 per cent in 1987, while industrial production in October was 5 per cent higher than a year earlier.

3 Activity is likely to remain strong in the first half of 1988 with only modest effects from the collapse in equity prices and the subsequent disturbances in foreign exchange markets. The US authorities continue to give priority to avoiding recession rather than stabilising the dollar. There are likely to be further falls in the dollar during 1988 until adverse effects lead to tighter monetary policy. The underlying balance of payments problem is unlikely to be solved until further fiscal action is taken. Weakening of activity in the US during 1988 will contribute to moderation in the growth of Major 7 GNP. This may be a little lower than in 1987, at just over 2½ per cent in 1988 and just under 2 per cent in 1989.

4 Growth of world trade in manufactures, which may have been about 5 per cent in 1987, is forecast to rise to 6 per cent in 1988 before falling to 4 per cent in 1989. Continuing strong activity in the early part of 1988 is likely to lead to a further rise in real commodity prices in 1988. The average North Sea oil price is forecast to be \$17 in 1988 and to rise slightly in 1989.

UK Activity

5 Last year GDP and domestic demand grew significantly faster in the UK than in the rest of the Major 7. The CSO may revise up the current estimates for growth of domestic demand (3¼ per cent higher than a year earlier in the first three quarters of 1987) and GDP (5 per cent up over the same period.)

6 Growth in consumers' expenditure should be lower in 1988, though at 4½ per cent it will still be buoyant. It will be boosted by the assumed

TABLE 1 : SUMMARY OF FORECAST

	FSBR 1987	OCTOBER INTERNAL 1987	AUTUMN STATEMENT 1987	WINTER 1988
A THE WORLD ECONOMY				
1. <u>GNP (MAJOR 7 EXCLUDING UK)</u> (per cent change on a year earlier)				
1986	2.6	2.7	2 [®]	2.7
1987	2.6	2.5	2½	2.8
1988	3.0	2.6	2	2.6
1989	2.9	2.4		1.9
2. <u>DOMESTIC DEMAND (MAJOR 7 EXCLUDING UK)</u> (per cent change on a year earlier)				
1986	3.8	3.8	3 [®]	3.7
1987	3.0	2.6	2 [®]	3.0
1988	3.2	2.6	2	2.8
1989	3.0	2.5		1.8
3. <u>WORLD TRADE IN MANUFACTURES</u> (per cent change on a year earlier)				
1986		1.9	2	2.0
1987		3.8	3 [®]	5.3
1988		4.9	4	6.0
1989		4.8		4.2
B UK ACTIVITY AND DEMAND				
4. <u>GDP VOLUME (non-North Sea in brackets)</u> (per cent change on a year earlier)				
1986	2.6(2.7)	3.1(3.2)	3(3)	3.0(3.1)
1987	3.0(3.1)	4.1(4.5)	4(4½)	4.3(4.7)
1988	2.4(2.9)	3.0(3.5)	2½(3)	3.1(3.6)
1989	2.4(2.9)	2.4(2.8)		2.4(2.7)
5. <u>VOLUME OF DOMESTIC DEMAND</u> (per cent change on a year earlier)				
1986	3.2	3.8	4	3.8
1987	3.5	3.9	4	3.9
1988	2.4	4.1	3½	4.3
1989	2.2	2.9		2.6
6. <u>UNEMPLOYMENT (UK S.A. EXCLUDING SCHOOL LEAVERS million)</u>				
1986 Q4	3.14	3.14	3.14	3.14
1987 Q4	2.88	2.74	2.73	2.66
1988 Q4	3.01	2.52	2.71	2.41
1989 Q4	2.94	2.54		2.34
C INFLATION AND MONEY GDP				
7. <u>MONEY GDP (MARKET PRICES)</u> (per cent change on a year earlier)				
1986-87	6.1	6.6	6.6	6.7
1987-88	7.5	8.9	8½	9.9
1988-89	6.4	8.5	7½	7.6
1989-90	6.1	7.8		7.0

	<u>FSBR</u> <u>1987</u>	<u>OCTOBER</u> <u>INTERNAL</u> <u>1987</u>	<u>AUTUMN</u> <u>STATEMENT</u> <u>1987</u>	<u>WINTER</u> <u>1988</u>
8. <u>RPI (excluding mortgage interest payments in brackets)</u> <u>(per cent change on a year earlier)</u>				
1986 Q4	3.4(3.4)	3.4(3.4)	3.4(3.4)	3.4(3.4)
1987 Q4	3.9(3.4)	3.9(3.7)	4(3.6)	4.1(4.0)
1988 Q4	3.3(3.0)	5.3(4.6)	4½(4.4)	4.0(3.8)
1989 Q4	3.3(3.2)	4.3(3.9)		4.4(4.2)
9. <u>GDP market price deflator</u> <u>(per cent change on a year earlier)</u>				
1986-87	3.2	3.0	3.0	3.2
1987-88	4.4	4.6	4½	5.0
1988-89	4.0	5.4	4½	4.8
1989-90	3.6	5.2		4.6
D <u>PUBLIC FINANCES</u>				
10. <u>PSBR - £ billion</u>				
1986-87	4.1	3.5	3.4	3.4
1987-88	3.9	-1.2	1.0	-2.8
1988-89	4.4	-5.0		-3.4
1989-90	4.9	-5.4		-3.7
11. <u>PSBR - % OF GDP</u>				
1986-87	1.1	0.9	1	0.9
1987-88	1.0	-0.3	¾	-0.7
1988-89	1.0	-1.1		-0.8
1989-90	1.0	-1.1		-0.8
12. <u>ANNUAL FISCAL ADJUSTMENT - £ billion</u>				
1988-89	3.2*	13.6*		12.0*
1989-90	1.5*	2.8*		2.9*
allocated to				
(a) reducing personal taxes				
1988-89	3.2	4.1**		4.0
1989-90	1.7	2.0		2.4
(b) reducing PSBR				
1988-89	0.0	9.5		8.0
1989-90	-0.2	0.8		0.5

*Assuming PSBR ratio of 1 per cent as in 1987 MTFs.

**This was one third of the fiscal adjustment remaining after the higher (by £1b.) than previously assumed level of privatisation receipts had been used to reduce the PSBR.

E MONETARY CONDITIONS

13. <u>SHORT TERM INTEREST RATES</u> <u>(per cent))</u>				
1986 Q4	11.2	11.2	11.2	11.2
1987 Q4	10.3	10.5	9.5	9.2
1988 Q4	10.1	11.0	9.5	9.5
1989 Q4	9.7	11.0		9.5

SECRET

	<u>FSBR</u> <u>1987</u>	<u>OCTOBER</u> <u>INTERNAL</u> <u>1987</u>	<u>AUTUMN</u> <u>STATEMENT</u> <u>1987</u>	<u>WINTER</u> <u>1988</u>
14. <u>MO</u> (per cent change on a year earlier)				
1986-87	4.3	4.3	4.3	4.3
1987-88	4.0	5.1	4.9	5.1
1988-89	3.4	4.4	4.3	5.0
1989-90	3.0	3.4		3.0
15. <u>STERLING INDEX</u> (1975=100)				
1986	72.8	72.8	72.8	72.8
1987	70.3	72.0	72.0	72.6
1988	69.3	72.5	72.5	77.1
1989	67.3	72.5		76.5
16. <u>£/DM EXCHANGE RATE</u>				
1986	3.19	3.19	3.19	3.19
1987	2.78	2.95	2.95	2.94
1988	2.67	2.94	2.94	2.96
1989	2.52	2.87	2.87	2.88
17. <u>RELATIVE UNIT LABOUR</u> <u>COSTS</u> (1980=100)				
1986	77.6	77.3	77.3	78.0
1987	74.0	74.8	75.1	75.5
1988	73.5	76.7	75.4	79.8
1989	70.1	76.9		80.5
<u>F TRADE AND CURRENT ACCOUNT</u>				
18. <u>VOLUME OF NON-OIL EXPORTS OF</u> <u>GOODS</u> (per cent change on a year earlier)				
1986	4.2	4.2	4	4.0
1987	5.2	6.2	7	7.2
1988	4.0	2.6	3½	5.2
1989	4.9	3.3		4.3
19. <u>VOLUME OF NON-OIL IMPORTS OF</u> <u>GOODS</u> (per cent change on a year earlier)				
1986	5.6	5.6	5½	5.7
1987	8.0	8.1	8	8.2
1988	1.7	4.7	5	6.9
1989	3.1	2.9		3.3
20. <u>CURRENT BALANCE</u> <u>£ billion</u>				
1986	-1.1	-1.0	-1.0	-0.9
1987	-2.7	-2.4	-2½	-2.5
1988	-1.7	-4.3	-3½	-4.6
1989	-0.4	-5.6		-5.3

large tax cut in the 1988 budget and, for a time, by lower short term interest rates. The fall in equity prices should do no more than offset the effects of the rise during the first part of 1987. Business confidence seems largely unimpaired by the stock market crash, and investment growth should pick up in 1988 and 1989. Total domestic demand is therefore expected to grow more strongly in 1988 than in 1987. But the decline in net exports that began during 1987 will probably continue. As a result GDP growth is likely to fall from 4½ in 1987 to about 3 per cent in 1988 and 2½ per cent in 1989. Growth in 1988 and 1989 taken together would be close to the post 1981 average.

The balance of payments

7 Despite the strong growth of demand the current account deficit seems to have widened only modestly, from £1b. in 1986 to £2½b. in 1987 - as forecast in the FSB and Autumn Statement. A larger deficit on trade in manufactures and increased transfers abroad more than account for this worsening. During 1987 the competitiveness gains achieved in 1986 were partly eroded. If the dollar falls as forecast and sterling by assumption falls only slightly against the DM, the sterling index will rise further. This is likely to contribute to a further worsening of competitiveness, with adverse effects on non-oil trade in 1988 and 1989. Falling North Sea production and lower oil prices will reduce the surplus on oil trade by £1½b. in 1988 and £½b. in 1989. These developments taken together could increase the current account deficit to £4½b. in 1988 (a monthly rate of just under £400m.), or 1 per cent of GDP. Continuing current account deficits and a reduction in the sterling value of the UK's dollar assets imply that the UK's net stock of foreign assets, which probably fell to about £90b. at the end of 1987, will fall further to about £80b.

8 The growing current account deficit coupled with continued net direct investment outflows by companies and further portfolio investment abroad by financial institutions implies the need for substantial offsetting capital inflows. The forecast is that UK companies and banks will be able to attract much of the necessary finance at the projected interest rates, but sterling may eventually come under some downward pressure against non dollar currencies. It is assumed the sterling/DM rate does not fall much below 2.90. The sterling index, after rising during 1988, is projected to ease as the dollar rebounds during 1989.

Inflation and money GDP

9 The prospects for RPI inflation in the short term will depend critically on fluctuations in the exchange rate and the mortgage interest rate. The sterling index is now higher than assumed at the time of the

Autumn Statement and expected to be rising through 1988). The forecast is for RPI inflation in 1988Q4 of a little over 4 per cent - below the 4½ per cent in the Autumn Statement.

10 The return of GDP growth to more normal levels will probably lead to somewhat lower recorded (though not underlying) productivity growth. This in turn will lead to faster growth in labour costs than recent exceptionally favourable rates. The impact of this on prices will probably be offset by some squeeze on profit margins as a result of less buoyant domestic activity and increased competition from foreign producers as sterling rises. Most measures of inflation are likely to be fairly stable between 4 and 5 per cent in the period until end 1989.

11 Money GDP growth during 1987-88 appears to be turning out well above the forecasts in the FSBR (7½ per cent) and the Autumn Statement (8½ per cent). Figures for the GDP deflator in the first half of the year have been revised up and with real growth of 4 per cent or more money GDP growth could be 10 per cent. Over the forecast period money GDP growth falls, though the path will still be above that in the 1987 MTFs; the reduction in growth reflects lower growth in real GDP.

Public finances

12 The performance of public finances continues to be astonishingly strong. The PSBR in 1987-88 is now forecast to be in surplus by nearly £3b., compared with a forecast surplus of £1b. expected in the internal October forecast. Receipts have continued to run above earlier profiles, with VAT, corporation tax in particular, and more recently income tax contributing significantly to the overshoot. Central government expenditure (on a cash basis) is well below the levels expected at budget time. 1987-88 is likely to be the first year since 1982-83 in which public expenditure undershoots the planning total in the previous PEWP. (Expenditure in 1987-88 could also undershoot the total in the 1988 PEWP.)

13 This strength of public finances should continue during 1988-89, though not quite on the scale expected in the October forecast because a downward revision to the forecast for receipts more than offsets one for expenditure. With profits in 1987 having once again grown very strongly, and forecast economic growth in 1988 revised up, CT receipts in 1988-89 and 1989-90 should be higher than previously expected. But lower oil prices have reduced forecast North Sea revenues by £1b. in each year; the stock market crash will reduce receipts of Stamp Duty (by £¾b. in 1988-89) and, with increasing effect over the forecast period, capital taxes (by £¾ in 1989-90).

14 Although public expenditure is likely to undershoot plans in 1987-88 the forecast is for a small overshoot of the existing plans in 1988-89 and a rather larger one in 1989-90. These forecast overshoots are, however, more modest than in some earlier forecasts, mainly because lower inflation in 1988 and lower unemployment throughout have led to lower forecasts for social security spending (by £1½b. in 1989-90 compared with the October estimate). The forecast does allow for increases in public sector pay that are some way above those consistent with the plans, and has central government procurement (the main constituents of which are health and defence) rising significantly more in real terms than the current plans envisage.

15 Adopting the convention used in October the forecast arbitrarily allocates one third of any fiscal adjustment in 1988-89 to cuts in personal taxes and two thirds to reducing the PSBR (taking the 1987 MTFS assumption of a PSBR of 1 per cent of GDP as the starting point). This convention yields a slightly lower PSBR surplus of £3½b., ¾ per cent of GDP, than in the October (internal) forecast and an assumed tax cut in the 1988 budget of £4 billion. (The October forecast had higher privatisation receipts - of £6b. - than the £5b. now assumed. The assumed extra receipts were allowed to increase the PSBR surplus.) There is scope for a tax cut in the 1989 budget of £2½b. if the PSBR is held at a surplus of ¾ per cent of GDP.

16 The ex post fiscal stance - as measured by the general government deficit, the only comparable measure for G7 countries - is already tighter in the UK than on average in the rest of the G7, and becomes relatively tighter over the forecast period. No other G7 economy is likely on present plans to have a lower general government deficit as a share of GDP in 1988 and 1989.

TABLE 2 : GENERAL GOVERNMENT FISCAL DEFICITS AS A SHARE OF GDP (per cent)

	1979-85	1985	1986	1987	1988	1989
UK	3.1	2.8	2.6	1.5	0.8	0.6
G7 (less UK)	3.2	3.1	3.1	2.6	2.8	2.5

(ii) Risks

The world economy

17 The behaviour of the dollar together with its effects on the world

economy are particular uncertainties in the forecast. The WEP has made no specific allowance for adverse effects from uncertainties associated with exchange rates and equity markets on world trade and activity. Nevertheless it is difficult to see how effects could be anything but adverse.

18. If the dollar fell less than assumed, it would - with sterling linked to the DM - ease the upward pressures on the sterling index and mitigate both the forecast loss of competitiveness and downward pressure on inflation.

The personal sector

19 Considerable uncertainty surrounds the past and likely future behaviour of the personal sector. The latest CSO figures show the saving ratio down to 5 per cent by 1987 Q3, and the sector's net acquisitions of financial assets negative for the last year. The forecast shows (small) personal sector deficits in 1988 and 1989 even though the saving ratio rises - particularly in 1988 following the large assumed tax cut.

20 A number of factors may have contributed to the large fall in saving and the emergence of a personal sector deficit. The strong rise in asset values throughout the 1980s has boosted financial wealth. Contribution holidays for companies' pension funds are one result of this, but it may also have led to some discretionary dissaving by households. A higher rate of equity withdrawal by owner occupiers may have followed the rapid growth of house prices. This implies that it is the private sector's management of its finances, not overloose macro policies, that is producing strong consumption growth, the current account deficit and the associated reduction in net foreign assets.

21 There are large risks either way to the forecast. The recent low saving and personal sector deficit may be reversed. On its own this would produce lower consumers' expenditure growth, a better current account, and a higher path for net overseas assets. On the other hand it is possible that the very low level of saving could persist, which would lead to a continued rapid growth of consumers' expenditure, a greater worsening of the current account, and a larger rundown in net foreign assets.

Public finances

22 One of the main uncertainties is the extent to which the amazing strength of public finances will survive a return of growth to a more normal rate. In particular the growth of profits is likely to revert to a rate close to the growth of money GDP following very high growth for a

number of years. But this forecast shows stronger GDP growth than earlier exercises, and there is not too dramatic a reduction in the growth of profits and, subsequently, corporation tax. A less favourable prospect for growth could would produce a lower fiscal adjustment for the 1988 and 1989 budgets.

(2) THE WORLD ECONOMY

23 Output in the major 7 grew faster in 1987 than was previously expected, particularly in North America and Japan (and the UK). Exports of the major 7 as a whole, which were broadly unchanged in 1986, picked up, while import growth slowed. Consequently business investment and industrial production grew strongly.

24 There are few indications yet of the extent to which October's stock market collapse will affect activity. In the US and Japan the recent strong growth of industrial production was maintained in November, and the unemployment rate in the US fell to its lowest level since 1979. The forecast assumes equity prices remain broadly at current levels. The October collapse is expected to have only modest effects on confidence and activity, except in the US, where significant wealth effects on consumers' expenditure are likely.

TABLE 3 : G7 (EXCLUDING UK) GROWTH AND INFLATION

Percentage changes on a year earlier	1986	1987	1988	1989
Real GNP	2.7	2.8(3.0)	2.6(2.6)	1.9(2.7)
Domestic demand	3.7	3.0(3.1)	2.8(2.7)	1.8(2.7)
Industrial production	1.0	3.0	4.5	2.9
Consumer prices	1.8	2.5	3.4	3.9

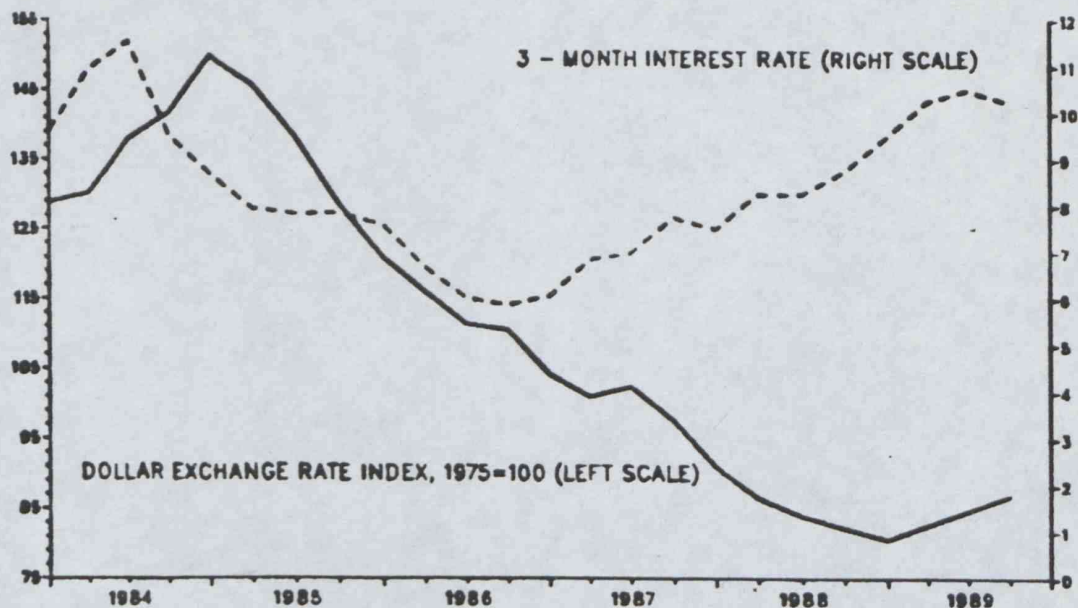
Note: Figures in brackets are IMF Staff's December estimates for G7 including UK.

25 Prospects for world activity, inflation, and trade will depend crucially on policy responses to the turbulence in stockmarkets and currency markets. Fiscal policy plans for 1988 suggest that the average budget deficit of G7 countries will be about the same proportion of GNP as in 1987 (Table 2). There may be a small rise in the federal deficit in the US, little change in the Japanese government's budget deficit, but some widening of the budget deficit in Germany.

26 It is harder to assess prospects for interest rates and exchange rates. The forecast assumes that official foreign exchange market intervention will not be maintained at the high levels seen in 1987 and early 1988, and that private flows will therefore have to be attracted to finance the continuing large US current account deficits. This will probably involve some combination of higher US interest rates and a still lower dollar. Given the reluctance of the US authorities to raise interest rates in a Presidential election year, a substantial further weakening of the dollar seems probable over the next twelve months or so. In 1989 a tightening of monetary policy followed by more determined action to reduce the federal deficit point to a sharp slowdown in US domestic demand and some recovery in the dollar.

27 This exchange rate profile is obviously subject to considerable uncertainty on both the timing and extent of further dollar depreciation, but until there is a credible US commitment to stabilise the dollar and concrete signs of a falling current account deficit periodic downward pressure on the dollar looks inevitable.

CHART A : US EXCHANGE RATE AND SHORT RATES



28 Non-oil commodity prices rose strongly in real terms during 1987. The forecast is for a further rise in real prices of industrial materials during 1988, as world industrial production strengthens further, though food prices will probably remain weak. Prospects for oil prices depend on OPEC's ability to restrict production. The forecast is that the oil price (North Sea average) will be around \$17 per barrel in 1988, but the margin

of error around this could be +/- \$5 per barrel. (A separate note considers the implications of a lower world oil price.)

29 Consumer price inflation in countries with appreciating exchange rates, particularly Japan and Germany, is forecast to remain low. The depreciation of the dollar and falling margin of unused resources have so far had only a modest effect on inflation in the US, but inflation there could be running at around 6 per cent by the end of 1988.

30 Total world imports of goods are estimated to have grown by over 4 per cent in 1987, when, as expected, trade in manufactures picked up strongly and grew significantly faster than total trade. In 1988 trade in manufactures is again expected to be buoyant - it could grow by as much as 6 per cent - as imports by Asian NICs continue to expand, and cutbacks in OPEC's imports are reduced. But in 1989, the projected slowdown in world activity is expected to be accompanied by slower growth in world trade.

TABLE 4 : THE VOLUME OF WORLD TRADE IN GOODS

Percentage changes on a year earlier	1986	1987	1988	1989
Total world imports of which:	5.0	4.2	4.8	3.5
- Major seven	9.1	5.4	5.2	2.8
- OPEC	-19.1	-7.1	-4.2	-2.0
- Non-OPEC developing countries	1.2	3.4	5.6	6.2
Total world imports of manufactures	2.0	5.3	6.0	4.2

(3) TRADE AND THE BALANCE OF PAYMENTS

31 The latest estimate of the current account deficit for 1987 is close to the £2½ billion forecast in both the FSBR and the Autumn Statement. The widening in the deficit from the £1 billion recorded in 1986 reflected an increased deficit on manufactured trade and a reduced surplus on invisibles. The current account deficit seems likely to widen further to about £4½ billion in 1988 as sterling's strength continues to reverse the competitiveness gains of 1986, domestic spending grows rapidly and the oil surplus declines.

TABLE 5 : UK CURRENT ACCOUNT (£bn)

	Visible trade balances			Net invisibles			Current balance
	Manufactures	Oil	Other	Services	IPD	Transfers	
1986	-5.3	4.1	-7.2	5.1	4.6	-2.2	-0.9
1987	-6.7	4.2	-6.9	5.4	5.0	-3.5	-2.5
1988	-8.1	2.7	-6.0	5.3	5.0	-3.4	-4.6
1989	-8.3	2.1	-6.0	5.2	5.7	-4.0	-5.3

Non-oil visible trade

32 The deficit on trade in manufactures is forecast to increase from £6½ billion in 1987 to £8 billion in 1988. The UK's domestic demand growth and the effects of deteriorating competitiveness are likely to cause import volumes to continue to grow more quickly than exports. Sterling's appreciation, coupled with domestic unit labour costs rising a little faster than abroad, is forecast to reverse all but about 4 per cent of the competitiveness gains since 1985. The pound's strength, however, may initially improve the terms of trade and help to offset at least partly the deterioration in trade volumes.

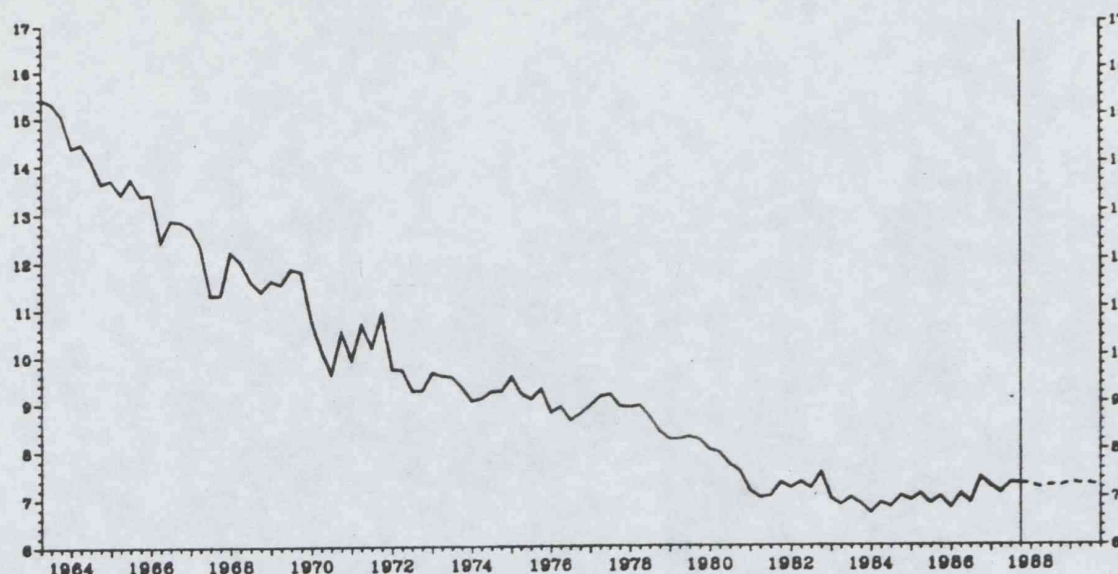
33 The deficit in manufactures should level off from the end of 1988 as slower UK demand growth brings the rise in imports more closely into line with export growth during 1989. The level of the deficit in 1989, however, may still be rather higher than in 1988 reflecting the projected deterioration in the course of the current year.

34 The volume of manufactured exports rose strongly during 1987 as the lagged benefits of improved competitiveness helped UK producers gain an increased share of world trade. Exports are forecast to rise more modestly during 1988 and 1989 as a result of recent lost competitiveness and - in 1989 - slower world trade growth.

TABLE 6 : TRADE VOLUMES
(per cent changes on previous year)

	Exports				Imports			
	Manufactures	Oil	Other	Total	Manufactures	Oil	Other	Total
1986	2.9	1.9	9.1	3.6	5.4	16.1	7.4	6.5
1987	8.1	-1.4	2.9	5.6	9.4	-4.0	4.1	7.1
1988	6.0	-3.1	2.6	3.7	9.9	12.1	0.1	7.3
1989	4.7	-5.9	2.5	2.7	4.3	4.3	-0.2	3.3

CHART B : SHARE OF UK EXPORTS IN TOTAL WORLD TRADE IN MANUFACTURES
(per cent)



35 The volume of manufactured imports recovered sharply in the course of 1987 following the unexpected recorded fall in the early part of the year. The rise in imports has reflected probably both the strong rise in domestic demand as well as latterly the effects of lost competitiveness. Imports are forecast to rise less rapidly during 1988 with a further slowdown during 1989 as domestic demand growth eases.

TABLE 7 : STERLING AND THE TERMS OF TRADE
(per cent changes on previous year)

	Exchange rate index	Non-oil export prices	Non-oil import prices	Non-oil terms of trade	Oil export prices	Total terms of trade
1986	-6.9	0.2	0.9	-0.7	-50.1	-5.4
1987	-0.3	3.2	2.1	1.2	4.1	1.4
1988	6.2	-0.1	-1.9	1.8	-21.8	1.4
1989	-0.8	2.4	2.6	-0.1	-1.9	0.5

36 The deficit on trade in non-manufactures fell slightly in 1987 as an improvement in the terms of trade more than offset the fact that import volumes rose faster than exports. The deficit is forecast to fall further in 1988. The terms of trade are projected to show a further improvement while export volumes grow modestly but import volumes grow less rapidly as the recent surge in domestic stockbuilding ends.

Oil trade

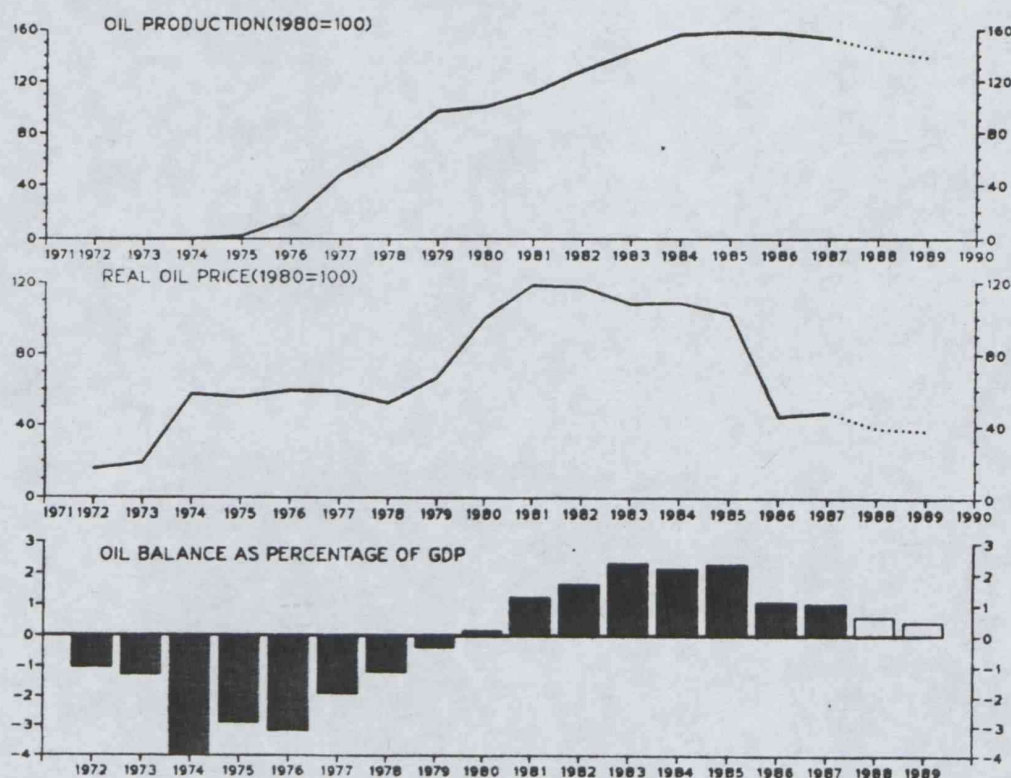
37 The strengthening of world oil prices in 1987 and a reduction in domestic demand for oil more than offset the rather more rapid than expected decline in North Sea output so that the oil trade surplus rose slightly. The surplus, however, is forecast to decline steeply in 1988 with a further fall in 1989 as sterling oil prices weaken, domestic demand for oil rises, and North Sea oil output falls.

TABLE 8 : NORTH SEA OIL

	Average North Sea oil price		N Sea output	Oil trade balance	N Sea* taxes
	\$/barrel	£/barrel	mm tonnes	£ bn	£bn
1986	14.3	9.7	126.9	4.1	4.8
1987	17.8	10.9	123.4	4.2	4.6
1988	17.0	8.4	115.7	2.7	3.5
1989	17.4	8.5	111.4	2.1	3.4

* financial year totals

CHART C : OIL OUTPUT, PRICES AND TRADE

Invisibles

38 The surplus on invisibles, which rose strongly in 1986, seems likely - on the evidence so far available - to have fallen slightly in 1987, mainly as a result of an increase in net transfers to the EC. The

surplus on services increased modestly as a result of rising earnings from financial services which more than offset a worsening performance on travel, civil aviation, and sea transport. Net earnings from interest, profits and dividends rose slightly less than earlier expected as the pound's appreciation reduced the sterling value of overseas earnings.

39 The value of the UK's net overseas assets was reduced last year by sterling's appreciation, the fall in world equity prices and by the current account deficit. The latest estimate is that net overseas assets fell from £111 billion at end-1986 to £87 billion at end 1987.

TABLE 9 : THE INVISIBLES BALANCE
(£ billion)

	Services	N Sea IPD	Other IPD	EC transfers	Other transfers	Total invisibles	Estimated net over- seas assets (end-year)
1986	5.1	-1.6	6.2	-0.7	-1.5	7.5	111
1987	5.4	-1.7	6.8	-1.8	-1.7	6.9	87
1988	5.3	-0.9	5.8	-1.5	-2.0	6.8	78
1989	5.2	-0.5	6.2	-2.0	-2.0	6.9	81

40 The invisibles surplus is forecast to remain flat in 1988 and 1989. The UK's rapid growth and the loss of competitiveness seem likely to work against any early improvement in the services surplus. Payments of interest, profits and dividends abroad by North Sea companies should decline as output falls. The surplus on other net IPD earnings, however, seems likely to fall largely as a result of the pound's forecast appreciation. This reduces further the sterling value of earnings although yields are expected to rise in the wake of the global fall in equity prices. Net transfers abroad are forecast to remain substantial, with transfers to the EC assumed at this stage still to move in line with the working of the Fontainebleau abatement system - although details could change in the light of any new EC agreement on Community expenditure.

41 The current account deficit and sterling's strength are expected to contribute to a further decline in the value of net overseas assets during 1988 to about £80b. The recovery of the dollar in 1989, however, is expected to increase the value of the UK's overseas assets and offset the continued drain from the current deficit so that the net asset position may show little further change.

(4) DOMESTIC DEMAND AND ACTIVITY

Personal Income and Expenditure

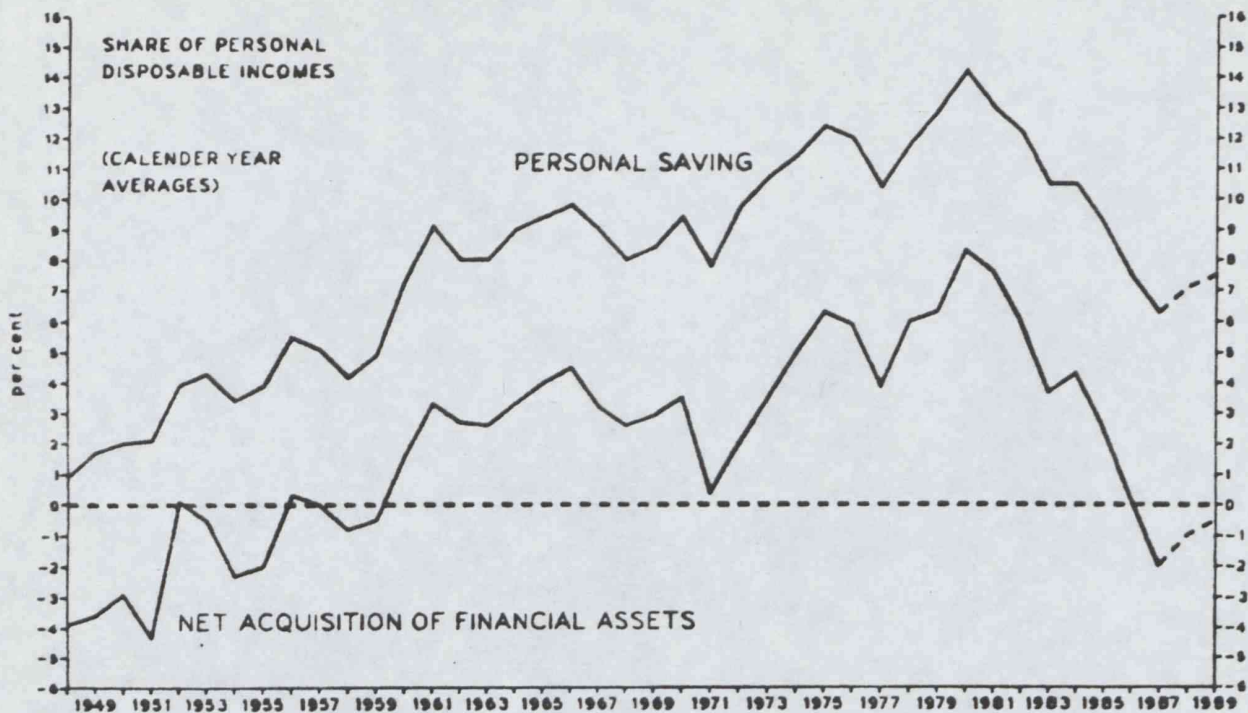
42 Consumers' expenditure is now estimated to have risen by 6 per cent in 1986 and by 5½ per cent in the year to 1987Q3. Retail trade figures fell back slightly in December, but remain well above outturns prior to October. New car registrations in November were below peak September levels, but still 9 per cent higher than a year earlier. Given the gap between the expenditure and output measures of GDP in 1987, present estimates of consumers' expenditure probably understate the strength of spending in 1987.

43 The personal sector saving ratio has fallen by over half since 1980. The first estimate for 1987Q3 suggests that it could now be as low as 5 per cent, a level not experienced since the 1950s. If consumers' expenditure is subsequently revised up (and personal sector incomes are not revised up proportionately), the savings ratio in 1986 and 1987 could turn out even lower. Possible explanations for this fall are:

- (i) Lower inflation - there is now less need to save to maintain real financial wealth.
- (ii) Recent increases in house prices may also have enabled greater spending, relative to income, through mortgage equity withdrawal.
- (iii) Employers' pension contributions (part of measured personal income) have fallen over the past two years as firms have taken contribution holidays. Employers' pension contributions are unlikely to be perceived as "effective" income and probably do not influence personal spending. Their decline is more likely to show up as a fall in the saving ratio.

Whatever the reasons, the saving ratio has fallen over the last three years, whilst real incomes have risen substantially. This contrasts with historical behaviour; the saving ratio normally rises when income grows above trend, and falls when income grows below trend.

CHART D: PERSONAL SAVING AND NET ACQUISITION OF FINANCIAL ASSETS



44. Because consumer spending reacts to movements in net financial wealth with a lag the fall in stock prices since mid-October will probably do no more than offset the rise in consumer spending due in 1988 from the rise in wealth through 1986 and 1987. But an assumed reduction in personal taxes in the 1988 Budget should ensure another strong increase in consumption (4½ per cent) in 1988. Moreover, the recent fall in interest rates (which is assumed to be largely reversed through 1988) should also boost consumer spending in the short term. Total consumer spending growth could slow to about 3 per cent in 1989, as growth in real personal disposable income slows following a much smaller tax cut assumed for the 1989 Budget.

45. Prospects for private dwellings investment in 1988 are subject to two opposing influences; strong growth in real incomes and the fall in net financial wealth post stockmarket crash. On balance, private dwellings investment is likely to grow more slowly in 1988 and 1989 - about 3½ per cent in both years - than in 1986 and 1987 (10 and 6 per cent respectively). This is more closely in line with RPDPI growth than over the last two years.

46 Continued fast growth in house prices in 1988 (10-11 per cent, slowing to 5-6 per cent in 1989), rising investment in dwellings and only

small increases in the saving ratio mean that the personal sector's net acquisitions of financial assets will be in persistent (though diminishing) deficit throughout 1987-89. This, too, is unprecedented since the 1950s.

TABLE 10: PERSONAL INCOME, EXPENDITURE AND SAVING

	<u>Real personal disposable income</u>	<u>Real consumers' expenditure</u>	<u>Persons' net acquisition of financial assets</u>	<u>Personal saving ratio</u>
	(Percent changes on previous year)		(£ bn)	(per cent)
1985	2.3	3.9	6.0	9.2
1986	4.0	6.0	0.5	7.5
1987	3.5	5.1	- 5.5	6.1
1988	5.5	4.5	- 3.3	7.0
1989	3.4	2.9	- 2.0	7.4

Company Income and Expenditure

47. Business investment was erratic in the first three quarters of 1987. But, according to the latest DTI Investment Intentions Survey, manufacturing investment (including leasing) should be 6 per cent higher in 1987 than in 1986, when it actually fell by over 5 per cent. Investment by the construction, distribution and selected service (including financial) industries is also expected to rise by 6 per cent in 1987, after falling 1 per cent in 1986.

48. The forecast assumes little impact on investment from the stock market crash and is based largely on the December DTI Intentions Survey. Taken on its own, the fall in equity prices would have increased the cost of capital. But this effect will have been more than offset by the subsequent fall in interest rates. The stock market crash could, of course, also inhibit investment through a break in business confidence. But the limited evidence available from CBI enquiries suggests that confidence has not been significantly impaired, though there is anecdotal evidence of an increase in uncertainty. All in all, investment growth is likely to be fairly buoyant over the next two years, both in the manufacturing and in non-oil non-manufacturing sectors. Investment growth in the latter will be boosted by work on the Channel Tunnel.

SECRET

TABLE 11:

GROSS DOMESTIC FIXED CAPITAL FORMATION
(percentage changes on previous year)

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Business	- 3	4½	8½	4
of which				
North Sea	-14½	-25	5½	- 6½
Manufacturing	- 5½	6½	11	4½
Other business	- 1	6½	8	4½
Private dwellings	6½	5	2½	3
General government	5½	- 3	3½	½
TOTAL	0	3½	6½	3½

49. Stockbuilding increased sharply in 1987Q3, partly due to special factors. Over the forecast period, we assume that the long-run decline in stock-output and stock-sales ratios continues, though at a slower rate than in the past. As a result, stockbuilding is £¼-lb. (1980 prices) in both 1988 and 1989.

50. Non-North Sea industrial and commercial companies' profits net of stock appreciation (as currently recorded and abstracting from the effects of the re-allocation of some public corporations - particularly BGC - to the private sector) were 14 per cent higher in 1987 than in 1986 (Table 13). Profits growth may slow slightly in 1988 and by rather more in 1989 as a result of moderating output growth and the squeeze on margins following the rise in the exchange rate. Despite the slowdown in the growth of profits and the rise in company sector spending, there should be no financial or liquidity constraints. ICCs' net acquisition of financial assets falls, but remains in clear surplus.

TABLE 12 : THE FINANCIAL POSITION OF INDUSTRIAL AND COMMERCIAL COMPANIES

(per cent)	Profits as a share of money GDP		Rate of return on assets, non- oil ICCs
	<u>Total</u>	<u>Non-oil</u>	
1973-85 average	12.0	9.0	5½
1986	15	12½	9
1987	16½	13¾	10½
1988	16	14¾	11
1989	15	13½	10½

- 51 Non-North Sea ICCs' profits growth is expected to slow down. Thus net income (approximately the Corporation Tax base) grows more slowly - the deceleration is accentuated in 1988 by rising interest rates.

TABLE 13: PROFITS OF INDUSTRIAL AND FINANCIAL COMPANIES
(percentage changes on previous year)

	Non-North Sea Industrial and Commercial Companies*		Financial Companies	
	Gross Trading Profits**	Net Income	Net Income	
1986	22 (22)	26	22	
1987	17 (14)	25½	24	
1988	10½	7	8½	
1989	1½	- 1½	11	

* Figures in brackets show growth of profits adjusted to exclude the effect of newly privatised companies being included in the sector.

** Net of stock appreciation.

Sectoral surpluses and deficits

52 The recent and prospective pattern of financial surpluses/deficits is unusual relative to the experience since 1950, notwithstanding the large residual error in 1987, which causes serious problems of interpretation. The most striking feature is the sharp decline in personal sector net acquisitions over the three years 1984-86; according to latest estimates it was probably in deficit in 1987. The forecast foresees further (though declining) personal sector deficits. The overseas sector reflects the forecast pattern of persistent current account deficits. Neither of these features is necessarily disturbing; the stock of personal sector financial assets has risen markedly in recent years, as has the stock of overseas assets. There is, therefore, scope for some rundown.

TABLE 14: SECTORAL NET ACQUISITIONS OF FINANCIAL ASSETS
(fbillion: (-) deficit/(+)surplus)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Persons	9.4	6.0	0.5	- 5.5	- 3.3	- 2.0
Companies:						
N. Sea	2.8	0.8	- 2.7	1.1	0.0	0.6
Non-N.Sea ICCs	4.5	6.0	8.5	9.0	5.4	2.0
Financial	0.6	1.1	4.4	6.0	3.3	4.6
Public sector	-12.9	-10.1	- 8.8	- 4.9	- 2.6	- 2.1
Overseas*	- 1.4	- 2.9	0.9	2.5	4.6	5.3
Residual Error	2.8	0.8	2.7	7.3	8.0	8.6

* The current account, with reversed sign, plus capital transfers.

Aggregate Demand and Output

53 The three GDP measures - Expenditure, Income, and Output - now show similar estimates of growth, of about $5\frac{1}{4}$ per cent, in the year to 1987Q3. Even so, the separate measures could depict markedly different growth rates for 1987 as a whole. GDP(O) is likely to show about 5 per cent growth, GDP(I) $4\frac{1}{2}$ per cent and GDP(E) about $3\frac{1}{2}$ per cent. Together these suggest GDP(A) growth of $4\frac{1}{4}$ per cent, though it is clearly difficult to assess the strength of the growth in 1987 with any precision. The output measure is normally the most reliable indicator of short term movements, and this confirms very rapid growth. There must be a strong expectation that 1987 expenditure will, at some stage, be revised up. Growth in the average measure of GDP could reach $4\frac{1}{2}$ per cent, perhaps more.

54 GDP growth is expected to moderate in 1988, to about 3 per cent ($3\frac{1}{2}$ per cent excluding oil). The slowdown is largely due to weaker net exports. Domestic demand growth is likely to be higher in 1988 than so far recorded for 1987. It is expected to fall in 1989, particularly if tax cuts in the 1989 Budget are much more modest than in 1988. As a result, growth of GDP is likely to fall further in 1989, to $2\frac{1}{2}$ per cent ($2\frac{3}{4}$ per cent excluding oil).

TABLE 15 : EXPENDITURE AND OUTPUT
(percentage changes on previous year)

	1986	1987	1988	1989
Domestic demand	3.8	3.9	4.3	2.6
Exports of goods and services	3.1	5.7	3.1	2.4
Import of goods and services	6.2	6.9	6.6	3.2
Compromise adjustment	0.3	1.0	0.1	0.0
GDP(A)	3.0	4.3	3.1	2.4
Non-oil GDP	3.1	4.7	3.6	2.7
Manufacturing	0.8	5.8	4.7	3.0

(5) PRICES AND EARNINGS

55. RPI inflation in 1987Q4 was 4.1 per cent, very close to the 4 per cent predicted in the FSBR and the 1987 Autumn Statement, though higher than the 3½ per cent in the 1986 Autumn Statement. Producer price inflation in 1987Q4 turned out slightly higher than expected.

Producer Prices

56 Producer prices (excluding the food, drink and tobacco industries) rose by 4½ per cent in the year to 1987Q4. The increase was mainly accounted for by rising margins and import costs, especially fuel prices, which recovered from the exceptionally low levels of 1986. Unit labour costs in manufacturing are also estimated to have increased, but only by ¼ per cent. Earnings rose by 8½ per cent through 1987, but were largely offset by a 6½ per cent increase in labour productivity and a 1½ per cent reduction in other labour costs (the result of pension contribution holidays).

57 Productivity growth is likely to slow through 1988, as activity growth moves closer to trend; unit labour costs in manufacturing are expected to rise by 4½ per cent in the year to 1988Q4. The cost of inputs, on the other hand, is expected to fall by about 3½ per cent through 1988, as a result of the rise in the effective exchange rate and resumed weakness in oil prices. Producers are expected to take some advantage of the fall in material input prices (as they did in 1986) to raise domestic margins through the year. But the increase in margins through 1988 is less than half the rate of 1987; producers are constrained by foreign competition and the slowdown in output growth. Producer price inflation (excluding food, drink and tobacco) is expected to be around 3½ per cent by end 1988. It may fall further, to about 3½ per cent by end-1989. The main reasons

for the fall are continued competitive pressures and a further slowdown in growth (both of which lead to a fall in profit margins).

TABLE 16:

COSTS AND PRICES IN MANUFACTURING
(percentage changes on previous year)

	<u>Unit labour costs</u>	<u>Cost of materials and fuels</u>	<u>Estimated total costs</u>	<u>Domestic producer output prices*</u>
1986 Q4	0.3	-5.6	-0.3	3.9
1987 Q4	0.2	6.2	1.3	4.8
1988 Q4	4.2	-3.8	2.0	3.8
1989 Q4	3.9	6.0	4.4	3.6

* excluding food, drink and tobacco.

Retail Prices

58 RPI inflation is expected to fall to 3½ per cent by mid-1988, as a result of lower mortgage rates introduced at the end of 1987. But it should pick up to around 4 per cent by end-1988, with notably sharp increases in domestic rates and some nationalised industry prices.

TABLE 17:

COMPONENTS OF THE RETAIL PRICE INDEX
(Percentage changes on previous year)

	<u>1986Q4</u>	<u>1987Q4</u>	<u>1988Q4</u>	<u>1989Q4</u>
Food prices	3.2	3.3	1.6	3.5
NI prices	3.6	2.3	6.6	5.5
Housing prices	7.1	7.0	8.2	8.2
Other prices	2.6	3.8	3.4	3.6
- of which				
petrol	- 12.6	1.3	-0.2	3.7
other items	3.9	4.0	3.6	3.6
All items RPI	3.4	4.1	4.0	4.4
RPI excluding mortgage interest payments	3.4	4.0	3.8	4.2

59 Table 18 sets out the detailed changes in nationalised industry prices charged to domestic consumers over the year to 1987Q4 and 1988Q4, and table 19 gives real price increases over a run of financial years.

TABLE 18 : NOMINAL NATIONALISED INDUSTRY PRICE INCREASES FOR CONSUMERS

(per cent)	Year to 1987 Q4	Year to 1988 Q4
Post	3.0	2.8
Rail	5.7	7.1
Electricity	- 0.4	8.2
Coal and coke	0.0	1.5
Bus	6.7	5.4
Water	6.9	7.3

TABLE 19 : REAL NATIONALISED INDUSTRY PRICE INCREASES
(percent changes on previous financial year; weighted average
for consumers and industry)

	Average 1983-84 to 1985-86	1986-7	1987-8	1988-9	1989-90
British coal	0.9	- 3.5	- 4.3	- 3.2	- 2.4
Electricity	- 3.1	- 2.0	- 3.7	3.6	1.3
BSC	- 1.4	- 2.0	- 3.0	- 1.9	- 2.4
Post Office	- 3.0	- 2.1	- 0.4	- 1.6	- 0.2
Water	1.9	4.5	2.3	3.3	2.0
LRT	- 6.1	2.2	2.1	4.6	2.8
British Rail	- 3.1	2.7	1.5	1.5	- 0.6

60 Increased nationalised industry prices will, by themselves, raise RPI inflation in 1988Q4 by a little more than $\frac{1}{4}$ per cent compared with inflation in 1987Q4. Other influences underlying the RPI inflation outlook to 1988(4) are:

- (i) The formula relating gas prices to oil prices and the RPI should give about a $3\frac{1}{2}$ per cent rise in domestic prices this year, following a $4\frac{1}{2}$ per cent fall in 1987 (the difference is worth about 0.2 per cent on total RPI inflation).
- (ii) A $12\frac{1}{4}$ per cent rise in average domestic local authority rate poundage (see para 87) this year compared with $7\frac{3}{4}$ per cent last year (the difference is worth 0.2 per cent on inflation).
- (iii) Mortgage interest payments add 0.1 per cent to inflation in 1988Q4. (Mortgage interest rates are lower at end-1988 than end-1987. However, the rising level of mortgage debt more than offsets this.)

61 All the above factors put upward pressure on inflation in the year to

1988Q4. They are largely offset, however, by a slowdown in inflation in other private sector prices. They rose 4 per cent over the past year; they would have risen by about 4½ per cent but for the non-indexation of duties in the 1987 Budget. The slowdown in 1988 is mainly accounted for by low import costs. It slows further in 1989, largely because of a squeeze on profit margins.

62. The table below sets out the monthly RPI inflation path for 1988. Inflation is likely to rise after March, as post Budget increases in specific duties and rates and electricity price increases show up in the index. However, this is offset by movements in the mortgage interest payments components, and weak gas and food prices.

TABLE 20: MONTHLY PATH OF RPI INFLATION (annual percentage changes)

		<u>All items RPI</u>	<u>RPI excluding mortgage interest payments</u>			<u>All items RPI</u>	<u>RPI excluding mortgage interest payments</u>	
1987	August	4.4	3.7	1988	April	3.3	3.8	
	September	4.2	3.5		May	3.7	3.9	
	October	4.5	3.9		June	3.7	3.8	
	November	4.1	4.0		July	3.8	4.0	
	December	3.7	4.0		August	4.0	4.1	
		- - - - -	- - - - -			September	3.9	4.1
1988	January	3.6	3.9			October	4.0	3.8
	February	3.4	3.7			November	3.8	3.7
	March	3.3	3.6			December	4.2	3.8

The GDP deflator

63. Recent revisions to the data have pushed up the market price GDP deflator in the first half of 1987. Latest estimates suggest a rise of 4.8 per cent in the year to 1987Q3. It now looks as if the FSBR and Autumn Statement projections for GDP price inflation in the current financial year (4½ and 4¼ per cent respectively) are on the low side; the outturn could be about 5 per cent. The market price GDP deflator moderates in 1988-89, primarily due to weak oil prices: the non-oil deflator picks up in 1988-89, before slowing thereafter as activity growth moderates. (The contrast between the rise in inflation measured by the non-oil GDP deflator and the small fall in retail and producer price inflation through 1988 reflects the differential effects on these measures of the projected slowdown in import prices: as occurred in 1986, this will tend to depress producer and retail prices but not the GDP deflator.)

TABLE 21: THE DEFLATOR FOR GDP AT MARKET PRICES
(percentage change on previous year)

	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>
MTFS				
Total	3	4½	4	3½
non-oil	6	4¼	3¾	3¼
Winter forecast				
Total	3½	5	4¾	4½
non-oil	6	4¼	5	4½

Earnings

64. The 1986-1987 pay round is now complete, though information on settlements is still coming in. But it seems that private sector settlements averaged 5¼ per cent, about ½ per cent lower than the previous round. In the manufacturing sector settlements were, on average, a full 1 per cent lower. But settlements were clearly on an upward trend through the year to August 1987 and this upward trend seems to have continued. The current pay round has barely begun and the number of settlements is small, but it seems most unlikely the settlements will turn out at less than 6 per cent (their average at the end of the previous round). That is the forecast for 1987-88. A similar figure is projected for 1988-89.

65. Overtime in manufacturing increased steadily through 1987. By November it was at record levels, contributing some ¾ per cent to the 8 per cent growth in private sector earnings over the year. The projected slowdown in activity should moderate the rise in settlements and reduce overtime payments (as overtime working falls back).

TABLE 22: PRIVATE SECTOR SETTLEMENTS AND EARNINGS
(Contributions to changes between third quarters of successive years)

	<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>
Settlements	5¼	6	6
Drift	2¼	2¼	2¼
Overtime	½	- ¼	- ½
Increase in average earnings	8	8	7¾

66. In the year to August 1987 local authority earnings grew rather more slowly than the private sector. Over the year to August 1988 they are more likely to grow faster. Teachers were paid 7½ per cent from October and will receive a further 1 per cent in April from restructuring. We assume teachers settle in their next pay round in line with RPI inflation. Local authority manuals have already settled on a 10½ per cent increase. Other local authority workers face varied prospects. Overall, local authority earnings are likely to rise by 10¼ per cent in the 1987-88 pay round (compared to about 8 per cent in the private sector), and 8½ per cent in

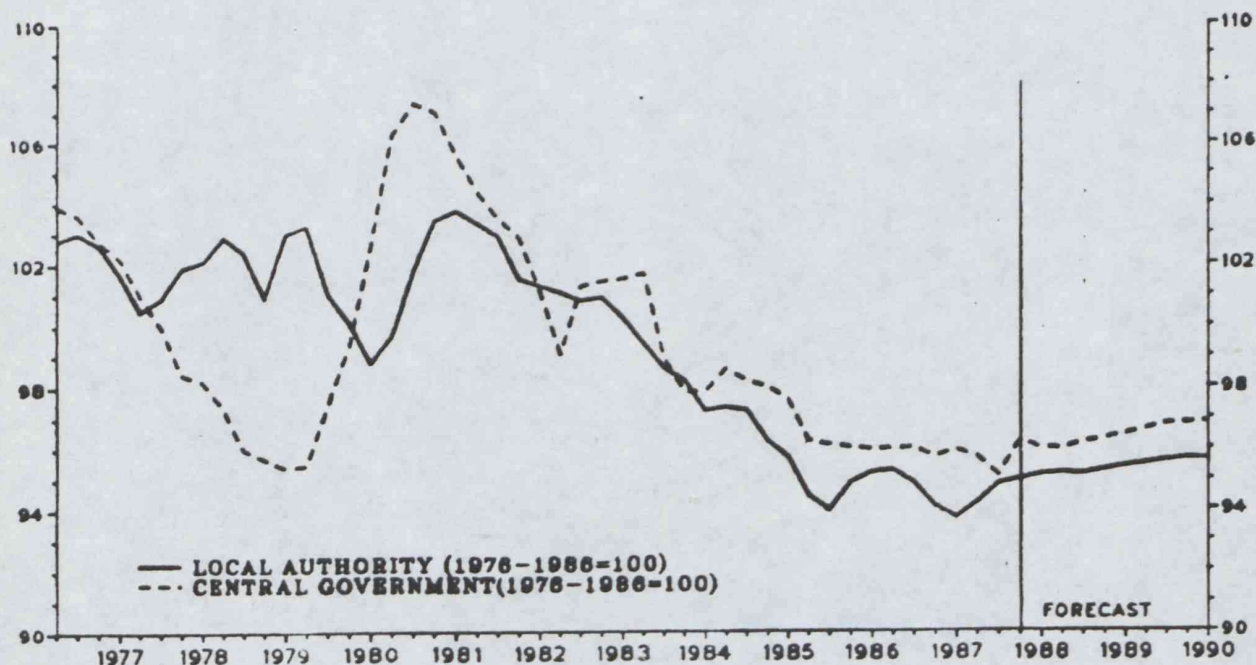
the following round. They come broadly into line with private sector settlements thereafter.

67. Central government earnings grew more slowly ($7\frac{1}{4}$ per cent) than the private sector in the 1986-87 pay round, though nurses and some other health workers fared notably better. Health workers are likely to do better than the private sector over the forecast period. The rest of central government will continue to face slower earnings growth than the private sector, though for central government earnings as a whole, we project about $8\frac{1}{4}$ and $8\frac{1}{4}$ per cent for the 1987-88 and 1988-89 pay rounds.

TABLE 23: PUBLIC AND PRIVATE SECTOR UNDERLYING AVERAGE EARNINGS
(percentage changes over years to August)

	<u>Central Government</u>	<u>Local authorities</u>	<u>Private sector</u>
1986-87	$7\frac{1}{4}$	$7\frac{1}{2}$	8
1987-88	$8\frac{3}{4}$	$10\frac{1}{4}$	8
1988-89	$8\frac{1}{4}$	$8\frac{1}{2}$	$7\frac{3}{4}$

CHART E: RATIO OF LOCAL AUTHORITY AND CENTRAL GOVERNMENT EARNINGS TO PRIVATE SECTOR EARNINGS (FOUR QUARTER MOVING AVERAGE).



Labour Costs

68. Manufacturer's unit labour costs are likely to rise more quickly over the next two years, compared to 1987. Earnings growth picks up in the next year, and productivity growth falls back to more normal rates as output growth declines.

TABLE 24: LABOUR COSTS INCREASES IN MANUFACTURING
(percentage increases on previous year)

	<u>UK</u>	<u>Major 7 (less UK)</u>
1986	3.9	2.3
1987	- 0.2	1.3
1988	1.8	0.5
1989	3.8	1.7

(6) EMPLOYMENT, UNEMPLOYMENT AND PRODUCTIVITY

69. Preliminary estimates suggest that employment rose sharply in the first three quarters of 1987, by about 320,000. The fall in seasonally adjusted, adult unemployment that began in August 1986 also gathered pace through 1987; in the eight months to December it fell by an average 50,000 per month, compared to an average monthly decline of 24,000 in the previous eight months. These developments reflect recent strong growth in output and the influence of government measures.

TABLE 25: CHANGES IN UK ADULT UNEMPLOYMENT
(seasonally adjusted, 000's, Q2 to Q2)

	Unemployment	Effects of employment and training measures, restart and availability testing	Underlying unemployment
1984-1985	146	- 5	151
1985-1986	88	- 64	152
1986-1987	-238	- 165	- 73
1987-1988	-498	- 95	- 403
1988-1989	- 87	- 48	- 39

70 The recent and prospective growth of output suggests that employment will continue to rise through 1988 and 1989 and adult unemployment could

fall to 2.41m in 1988Q4 and to 2.34m in 1989Q4. The labour supply is expected to grow by 300,000 over the two years to 1989Q4 and the working population by 170,000.

71. Manufacturing productivity rose 7.2 per cent in the three months to November 1987 compared with the same period a year earlier. Productivity in the private non-manufacturing sector rose by 3½ per cent in the year to 1987Q3. Some of the increase in productivity was due to the cyclical strength in output and increased overtime working (manufacturing overtime per head reached record levels in October and November 1987). But there also seems to have been an increase in trend productivity growth and we expect this to be sustained over the future. Actual productivity, on the other hand, slows down in 1988 and 1989 with the deceleration in activity.

TABLE 27: LABOUR PRODUCTIVITY GROWTH
(per cent per annum)

	<u>1965-73</u>	<u>1974-79</u>	<u>1980-86</u>	Forecast <u>1987-89</u>
Manufacturing	3¾	¾	3¾	5¼
Private non-manufacturing	3	½	1½	2
Non-North Sea	2¾	½	1¾	2½
Whole Economy	2¾	1	2	2

72 The implications of trend productivity growth projections (and those for labour supply) for productive potential are shown below.

TABLE 28 : PRODUCTIVE POTENTIAL GROWTH
(per cent per annum)

	<u>Trend non-North Sea productivity growth</u>	<u>Labour supply</u>	<u>Non-North Sea productive potential</u>	<u>Contribu- tion of North Sea</u>	<u>Whole economy productivity potential</u>
1974-79	¾	½	1½	½	1¾
1980-86	1¾	½	2¾	¼	2½
1987-89	2½	¾	3½	- ½	3

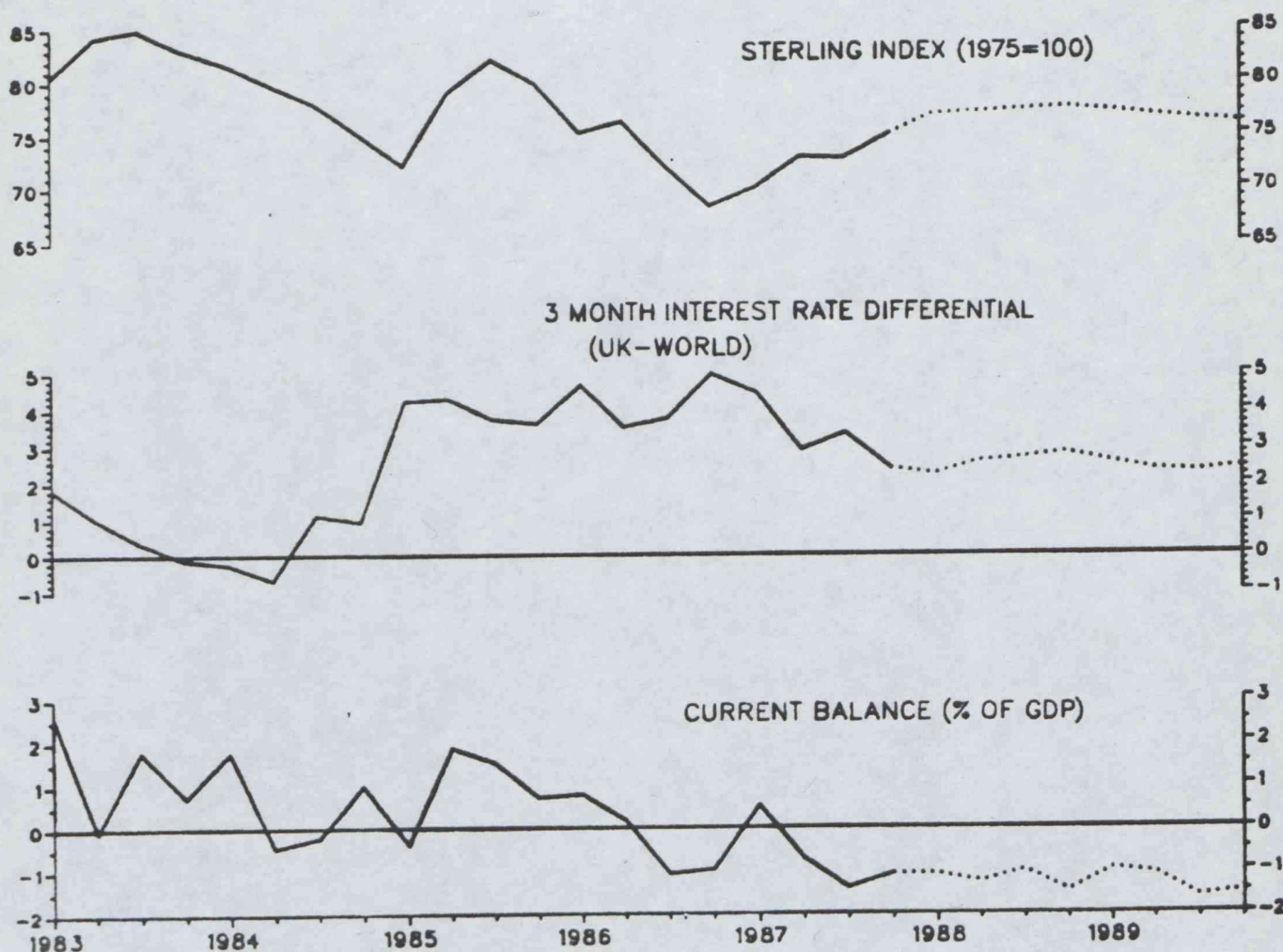
(7) FINANCIAL CONDITIONS

73 The further projected sharp fall during 1988 in the dollar's exchange rate index would on its own put upward pressure on sterling and other non-

dollar currencies. Other major countries are assumed to lower interest rates, but the growing UK current deficit and worsening competitiveness may put downward pressure on sterling relative to non-dollar currencies with corresponding upward pressure on domestic interest rates.

74 The forecast therefore assumes that base rates rise to 9 per cent in the second quarter of 1988 and 9½ per cent by the fourth quarter. This widens the differential against average world interest rates. About \$4 billion of the recent intervention is also assumed to be unwound in the latter half of 1988.

CHART F : STERLING AND THE CURRENT BALANCE



SECRET

TABLE 27 : EXCHANGE RATES AND COMPETITIVENESS
(average year rates)

	US dollar index	Sterling index	\$/£	DM/£	Relative unit labour costs (1980=100)
1984	134.6	78.6	1.34	3.79	82.9
1985	140.7	78.2	1.30	3.78	85.0
1986	114.7	72.8	1.47	3.19	78.0
1987	101.3	72.6	1.64	2.94	75.5
20 January	94.0	74.8	1.79	2.98	78.9*
1988	85.5	77.1	2.01	2.96	79.8
1989	83.8	76.5	2.05	2.88	80.5

* 1988(Q1) estimate.

75 In 1989 the expected rebound in the dollar and the UK's current account deficit bring about a gradual easing in the sterling index.

TABLE 28 : INTEREST RATES

	3-month US interest rates	3-month world rates	3-month sterling LIBOR	Mortgage rate
1987-88	7.3	6.5	9.2	11.0
20 January 1988	7.0	6.3	8.9	10.3
1988-89	8.7	6.7	9.5	10.5
1989-90	10.2	7.1	9.5	10.8

76 Among the domestic factors pointing to upward pressure on interest rates are brisk M0 growth, a continued strong rise in credit demand and money GDP continuing to overshoot the target growth rates in the 1987 MTFS. The growth in M0 has recently been below the rapid surge seen last summer, but it is still buoyed by rising consumer spending and the fall in interest rates in late-1987. It is possible that M0 will exceed its year-on-year target range in the months ahead. The projected rise in interest rates and slower growth of consumer spending are forecast to bring M0 growth back within target in the latter half of 1988.

TABLE 29 : MONETARY AGGREGATES AND CREDIT
(per cent change on a year earlier)

	Money GDP*	M0*	M3	M4	Lending by banks and building societies
1987-88	9.9 (7½)	5.1 (2-6)	20.4	15.3	18.8
December 1987	-	4.3	22.9	16.3	18.9
1988-89	7.6 (6½)	5.0 (1-5)	16.8	14.7	18.0
1989-90	7.0 (6)	3.1 (1-5)	12.2	12.4	15.1

* 1987 MTFS targets in brackets

77 Lending by banks and building societies which rose by 19 per cent in the year to December, is forecast to rise by a further 18 per cent in 1988-89 before slowing in 1989-90. Lending to persons is forecast to continue to grow strongly in the period ahead for both housing and other purposes, but is projected to rise less rapidly next year in reaction to rising ratios of debt and interest payments to income. Lending to companies seems likely to accelerate in 1988-89 as the weakness of the equity market encourages firms to turn to banks to finance a continued high rate of stockbuilding as well as their growing investment. The projected rise in private sector borrowing from all sources could well more than offset the decline in the public sector's needs and contribute to upward pressure on interest rates, particularly against a background where private savings are forecast to rise only slowly.

78 The forecast for M3 and M4 depends on the influences on different sectors - although uncertainties about the return on equities may generally encourage the non-bank private sector to increase the share of liquid assets in their total financial wealth. The growth of persons' liquid assets, however, is likely to be less rapid than in the past as a result of their low projected savings. Industrial and commercial companies which have built a strong liquidity position, are expected to invest increasingly in real assets reflecting the improved rates of return. Financial institutions' holdings of liquid assets are also expected to grow less rapidly than in the past reflecting their less buoyant inflows and wealth. M3 is forecast to rise by 17 per cent in 1988-89 and 12 per cent in 1989-90 while M4 rises by 15 per cent and 12 per cent.

79 The PSBR is assumed to be fully funded outside banks and building societies, but the move to a negative borrowing requirement leads to net

SECRET

gilt repayments of £8 billion in 1988-89 and £9 billion in 1989-90 - even on the assumption that receipts from National Savings are reduced to £1 billion a year. Gross gilt sales fall from £13 billion in the current financial year to £1½ billion in 1988-89 and £½ billion in 1989-90.

TABLE 30: PSBR AND FUNDING
(£ billion)

	PSBR	Gilt sales to nbnbsps*	Nat Savs	Reserves	Other -seas financet	Other debt to nbnbsps	Over-fund+	Net gilt sales to banks and b.socs	Gross gilt sales to all sectors
1985-86	5.7	3.6	2.1	-2.4	4.3	-1.6	0.3	-0.7	11.7
1986-87	3.4	4.6	3.4	-3.8	5.3	-1.8	4.3	-1.2	14.6
1987-88	-2.8	2.3	1.8	-10.3	5.4	-2.8	-0.8	-1.8	13.1
1988-89	-3.4	-7.1	1.0	3.0	-0.1	-0.2	0.0	-0.5	1.7
1989-90	-3.7	-7.9	1.0	3.5	-0.1	-0.2	0.0	-0.5	0.6

* non-bank non-building society private sector

† includes foreign currency finance

+ overfund on M4 definition

80 The bulk of the financing of the UK's current account deficit together with the projected continued net outflows of direct and portfolio investment is forecast to be achieved through the banking system. (The forecast assumes modest gilt sales by non-residents.) Banks' net external liabilities are projected to increase by £6-7 billion a year.

TABLE 31 : NET EXTERNAL CAPITAL FLOWS
(£ billion)

	Direct invest -ment	Other private non bank	Banks' foreign currency	Banks' sterling	General Gov't	Official reserves	Balancing item	Current balance
1986	-6.0	-7.7	3.0	-0.4	3.0	-2.9	11.9	-0.9
1987	-10.2	7.8	6.0	4.0	5.2	-11.8	1.5	-2.5
1988	-7.5	3.0	5.2	1.6	-0.6	2.0	1.0	-4.6
1989	-7.9	2.7	4.6	1.9	-1.0	4.0	1.0	-5.3

(8) PUBLIC FINANCES

81 Table 32 compares the forecast with the FSBR and internal October forecast. The projections in the FSBR and Autumn Statement were not the forecasters' central estimate of the outturn.

TABLE 32 : PUBLIC SECTOR EXPENDITURE, REVENUE, AND BORROWING
(£ billion)

	FSBR	1987-88		FSBR	1988-89		FSBR	1989-90	
		Oct Fore- cast*	Winter Fore- cast		Oct Fore- cast*	Winter Fore- cast		Oct Fore- cast*	Winter Fore- cast
General Government Expenditure	173½	172½	172	180½	184	183½	188½	196½	194½
General Government receipts	169	173	173½	178	192	189½	187	206	204
Assumed cuts in personal taxes (cumulative)				3	4	4	5	6	6½
GGBR	4½	-½	-2	5½	-3½	-2½	6	-4	-3
Public corporations' overseas and market borrowing	-1	-½	-1	-1	-1½	-1	-1	-1½	-½
PSBR	4	-1	-3	4	-5	-3½	5	-5½	-3½
(per cent of GDP)	(1)	(-¼)	(-¾)	(+1)	(-1)	(-¾)	(1)	(-1)	(-¾)
brackets)									

* The internal forecast, not the Autumn Statement

(a) 1987-88

82 The PSBR for 1987-88 is now forecast to be a surplus of nearly £3b. The average absolute error on Winter forecasts made in the last 10 years is around 0.3 per cent of GDP (£1½b.). Five of the last six Winter forecasts, and each of the last four, have overpredicted the outturn.

83 The latest forecast represents an undershoot on the FSBR forecast of £6½b., and a reduction of £1½b. from the October internal forecast. Three-quarters of the predicted undershoot of the FSBR forecast is accounted for by higher general government receipts and the remaining one-quarter accounted for mainly by lower general government expenditure. Public corporations' market and overseas borrowing is little different from the FSBR. Table 33 shows the main revisions. Well over four-fifths of the downward revision to the forecast since the Budget has been on central government own account borrowing, with much smaller contributions from lower public corporations' and local authorities' borrowing.

SECRET

TABLE 33 : CONTRIBUTION TO THE CHANGE IN THE 1987
PSBR FORECAST SINCE OCTOBER AND THE FSBR

	<u>£ billion</u> <u>Changes since</u>	
	<u>FSBR</u>	<u>October</u>
<u>Higher General Government Receipts</u>		
- higher North Sea revenues from a higher North Sea oil price;	- $\frac{3}{4}$	-
- higher non-North Sea corporation tax reflecting higher profits in 1986 than recorded at Budget time (and also higher than currently recorded) and higher dividend payments (generating ACT) in 1987;	-1 $\frac{3}{4}$	- $\frac{1}{2}$
- higher income tax and national insurance contributions mainly reflecting higher money incomes;	-1 $\frac{1}{2}$	- $\frac{1}{4}$
- higher stamp duty than in FSBR, but slightly lower than in October, reflecting stock market gyrations;	- $\frac{1}{4}$	+ $\frac{1}{4}$
- higher VAT, in line with outturn to date, mainly reflecting higher than expected consumer spending;	- $\frac{3}{4}$	- $\frac{1}{4}$
- lower ECGD trading surplus due to delays in refinancing;	+ $\frac{1}{4}$	+ $\frac{1}{2}$
- higher other receipts, including, compared with October capital taxes and interest and dividends;	- $\frac{1}{4}$	- $\frac{3}{4}$
Total	-5	-1
<u>Lower General Government Expenditure</u>		
- a lower public expenditure planning total	-1 $\frac{3}{4}$	- $\frac{1}{2}$
- lower debt interest from lower interest rates	- $\frac{1}{2}$	- $\frac{1}{4}$
- changes to other adjustments	+ $\frac{3}{4}$	+ $\frac{1}{4}$
Total	-1 $\frac{1}{2}$	- $\frac{1}{2}$
<u>PC market and other borrowing</u>	- $\frac{1}{4}$	- $\frac{1}{4}$
TOTAL CHANGE IN PSBR FORECAST	-6 $\frac{3}{4}$	-1 $\frac{1}{2}$

(b) Public expenditure

84 There has been a small downward revision since October to the forecast of the planning total outturn in 1987-88. The outturn is now expected to undershoot the 1987 PEWP by about £1 $\frac{1}{4}$ b. The assumed privatisation proceeds

in 1988-89 and 1989-90 are lower than in October but the forecasts of the rest of the planning total have been revised down. Nevertheless they imply that the new plans - ie those in the 1988 PEWP - will be overspent, by about £1b. in the first and £2½b. in the second year. The forecast of these years takes account of the differences between the economic assumptions used in the PEWP and of the economic prospects in the forecast, together with other pressures on programmes which past experience suggests are likely. For example in the case of 1989-90 the forecast is trying to anticipate not only any changes in plans agreed in the next Survey, but also any eventual over or underspend on the finally agreed planning total.

85 Table 34 sets out forecast increases in actual programme spending compared with successive PEWPs in terms of economic rather than departmental categories. The forecast for 1987-88 is compared with the 1987 PEWP and those for 1988-89 and 1989-90 with the 1988 PEWP.

TABLE 34 : FORECAST ADDITIONS TO EXPENDITURE PLANS

	£ billion					
	1987-88		1988-89		1989-90	
	PEWP 1987	Forecast Claims on Reserve	PEWP 1988	Forecast Claims on Reserve	PEWP 1988	Forecast Claims on Reserve
<u>Allocated to programmes</u>						
1. Social Security (including HB)	44.7	0.2	46.9	0.6	49.5	1.0
2. LA current (excluding HB)	32.5	1.0	34.9	1.9	36.0	3.9
3. CG pay	24.8	0.5	26.8	0.8	27.8	2.1
4. CG procurement	24.6	-0.1	25.5	0.7	26.8	1.3
5. LA capital	4.3	-0.6	4.0	-0.2	4.0	0.1
6. EC	0.9	0.8	0.8	0.4	1.5	0.2
7. Nationalised industries	0.7	-0.3	0.7	-0.2*	0.0	0.5*
8. Other	17.8	0.2	18.8	0.6	19.6	0.8
9. Total programmes	150.1	1.7	158.3	4.6	165.1	9.8
10. Privatisation proceeds	-5.0	0.0	-5.0	0.0	-5.0	0.0
11. <u>Expenditure met from existing reserve</u>						
(i) allocated to programme baseline	0.0	1.7	0.0	3.5	0.0	7.0
(ii) unallocated	3.5	0.0	3.5	0.0	7.0	0.0
12. <u>Underspend (-)</u> <u>Addition to</u> <u>Reserve(+)</u>	0.0	-1.8	0.0	1.1	0.0	2.8
13. PLANNING TOTAL	148.6	-1.8	156.8	1.1	167.1	2.8

* includes EFL offsets to assumed privatisation of the Giro (-£60m.) in 1988-89 and BSC (+£150m.) in 1989-90

86 The forecast of social security expenditure is lower than in October mainly because of lower forecast unemployment and, in 1989-90, because the uprating is now forecast to be 4 per cent (based on forecast inflation to September 1988) and not 5½ per cent. The forecast still assumes continued underlying growth in social security spending - defined as the growth after allowing for the effects of changes in unemployment, upratings, policy changes, demographic factors etc - but at lower levels than the rather faster level which appears to have prevailed this year.

Underlying growth in social security expenditure - %

<u>1986-87</u>	<u>1987-88</u>	<u>1988-89</u>	<u>1989-90</u>
3.2	4.3	3.5	2.5

87 The forecast of local authority current spending, most of which is pay, assumes that numbers employed will rise at around 1½ per cent a year and that earnings increases will be above those in the private sector. This, together with the RSG settlements for 1988-89 and the assumption that authorities will build up balances in advance of the Community Charge, implies average rate poundage increases of about 11 per cent (12 per cent on domestic property) in 1988-89.

88 The forecast of central government pay assumes little change in numbers employed and earnings increases above those in the private sector. The forecast of central government procurement assumes growth in real terms much the same as the rate of the past two years.

89 Local authority gross capital spending and receipts are forecast to be flat in real terms. This is thought to be consistent with a LABR of a little over £1 billion a year compared with a revised forecast of just under £1b. for 1987-88 and an outturn of £½b. in 1986-87.

90 Nationalised industries (NI) in aggregate may undershoot their EFLs in 1988-89 mainly because they may find it difficult to achieve the planned sharp rise in capital spending, but also because the Post Office's external financing requirement is reduced by the assumed privatisation of the Giro. By contrast 1989-90 may see an EFL overshoot because the profit projections underlying the PEWP look optimistic given the slow down in economic growth envisaged in the forecast. The forecast also assumes the loss of BSC's negative EFL in that year as a result of privatisation. Neither this nor the effect of the privatisation of the Giro is allowed for in the PEWP EFL.

91 The forecast of debt interest payments has also been revised down since October as a result of a lower forecast of interest rates. In addition the forecast of GGE has been reduced since October (by £1b. in 1989-90) as a result of an assumed switch in the composition of NIs' external finance away from general government finance towards market and other borrowing. This switch, which follows the 1988 PEWP, has no effect on the PSBR or the fiscal adjustment even though it reduces GGE. The downward revision to GGE in 1989-90 is smaller in real than in cash terms because of a lower forecast of the GDP deflator.

SECRET

TABLE 35 PAST AND CURRENT FORECASTS
OF GGE EXCLUDING PRIVATISATION PROCEEDS

Forecast	1987-88		1988-89		£ billion 1989-90	
	Current Prices	Real Terms*	Current Prices	Real Terms*	Current Prices	Real Terms*
Jan 1986	176	169	186	169	-	-
PEWP 1986	174	168	179	168	-	-
Jan 1987	179	171	190	173	202	175
PEWP 1987	179	172	185	172	193	174
Oct 1987	178	170	190	172	203	175
PEWP 1980	178	170	188	173	198	176
Jan 1988	177	169	188	171	200	173

* 1986-87 prices

92 The ratio of GGE (excluding privatisation proceeds) to money GDP starts in 1987-88 below the level in the 1988 PEWP, and is forecast to stay below the PEWP path, falling in each successive year, but only slightly in 1989-90.

TABLE 36 : RATIO OF GGE EXCLUDING PRIVATISATION PROCEEDS TO MONEY GDP

	per cent				
	1985-86	1986-87	1987-88	1988-89	1989-90
1988 PEWP	44½	44	42½	42	41¾
January Forecast	44½	44	41¾	41¼	41

(d) General government receipts

93 The forecast of general government receipts has been revised up for 1987-88 since October, continuing the pattern of revisions in earlier forecasts (see table 37). But the forecasts for 1988-89 and 1989-90 have been revised down. An upward revision of some £1¼b. a year to the forecast of non-North Sea corporation tax receipts has been more than offset by downward revisions to North Sea Revenues, stamp duties and capital taxes. Stamp duty is lower because of lower stock market prices and turnover. Lower stock market prices are also responsible for the downward revision to capital taxes, but because of assessment and payment lags this effect does have a significant impact on the numbers until 1989-90.

SECRET

TABLE 37: COMPARISON OF FORECASTS OF GENERAL GOVERNMENT RECEIPTS (PRE-FISCAL ADJUSTMENT FOR 1988-89 AND 1989-90)*

Forecast:	1987-88		1988-89		£ billion 1989-90	
	Cash	Real Terms	Cash	Real Terms	Cash	Real Terms
January 1986	166	159	178	162	188	164
FSBR 1986	162	156	171	160	179	162
January 1987	169	162	184	168	197	171
FSBR 1987	169	162	178	164	187	167
October 1987	173	165	192	174	207	178
January 1988	174	165	190	172	204	177

* Forecasts made before the 1987 and 1986 Budgets have been adjusted to be consistent with current tax rates and allowances. Real terms figures are at 1986-87 prices.

94 Table 38 shows non-oil taxes and national insurance contributions (NICs) as a percentage of non-oil money GDP ie the non-oil tax burden. It is now forecast to rise by nearly $\frac{1}{2}$ percentage point in 1987-88, the same as the rise in 1986-87. Before allowing for the assumed tax cuts a larger rise of about one point is forecast for 1988-89, but, with the tax cuts themselves equivalent to one percent of GDP, the tax burden is forecast to be flat after fiscal adjustment. A smaller rise in the non-oil tax burden, before fiscal adjustment, is forecast for 1989-90, but the effect of the assumed fiscal adjustment is to keep the tax burden broadly flat.

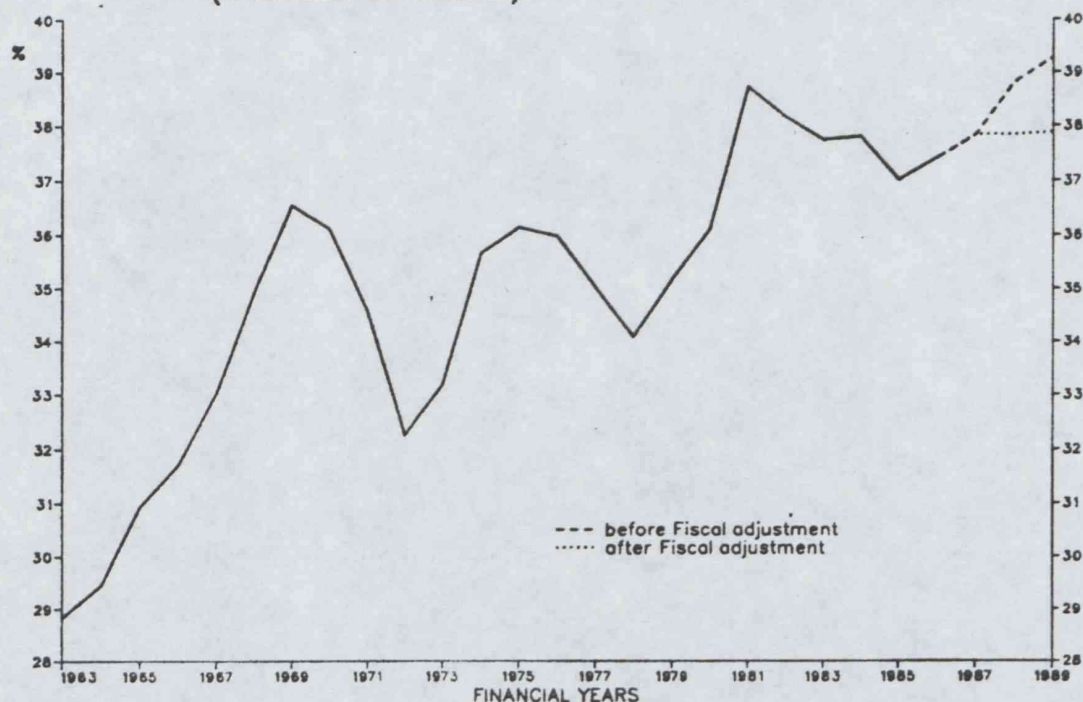
TABLE 38: NON-OIL TAXES AND NICs AS A PERCENTAGE OF NON-OIL GDP

	1985-86	1986-87	1987-88	1988-89	1989-90
FSBR					
(a) pre-fiscal adjustment	37.2	37.3	37.8	37.9	37.7
(b) post fiscal adjustment	37.2	37.3	37.8	37.1	36.6
October Forecast					
(a) pre-fiscal adjustment	37.0	37.5	38.0	39.1	39.4
(b) post-fiscal adjustment	37.0	37.5	38.0	38.0	38.0
Winter Forecast					
(a) pre-fiscal adjustment	37.0	37.4	37.8	38.8	39.3
(b) post-fiscal adjustment	37.0	37.4	37.8	37.8	37.9

95 The non-oil tax burden is forecast to rise in 1988-89 before fiscal adjustment because of the forecast rapid growth in non-oil corporation tax (CT), real fiscal drag on income tax, and because local authority rates increases are expected to be in double figures. Non-oil CT (including ACT) is now forecast to increase by a third in 1987-88 and the buoyancy of

profits in 1987 should lead to another large increase (over 25 per cent according to this forecast) in 1988-89. However a marked fall in profit growth in 1988 is forecast to lead to a very modest increase in non-oil CT receipts in 1989-90, perhaps of the order of 5 per cent. The rapid rise in asset values up to October 1987 is expected to generate increases in capital taxes of around 20 per cent in 1987-88 and 1988-89 but the recent fall in share prices could lead to a levelling off of capital tax receipts thereafter.

CHART G : NON-OIL TAXES AND NICs AS A % OF NON-OIL GDP
(FINANCIAL YEARS)



SECRET

ANNEX I : COMPARISON WITH OUTSIDE FORECASTS

	WINTER FORECAST	AVERAGE OF OUTSIDE FORECASTS (JANUARY)
A. ACTIVITY		
1. <u>GDP VOLUME</u> (per cent change on year earlier)		
1987	4.3	
1988	3.1	2.4
2. <u>UNEMPLOYMENT</u> (UK, sa, excluding school leavers in millions)		
1987Q4	2.66	
1988Q4	2.41	2.66
B. INFLATION		
3. <u>RPI</u> (per cent change on year earlier)		
1987Q4	4.1	
1988Q4	4.0	4.0
C. PUBLIC FINANCES		
4. <u>PSBR</u> (£ billion)		
1987-88	-2.8	
1988-89	-3.4	1.9
D. MONETARY CONDITIONS		
5. <u>SHORT TERM INTEREST RATES</u> (per cent)		
1987Q4	9.2	
1988Q4	9.5	8.8
6. <u>STERLING INDEX</u> (1975=100)		
1987Q4	74.9	
1988Q4	77.4	73.6
E. CURRENT ACCOUNT		
7. <u>CURRENT BALANCE</u> (£ billion)		
1987	-2.5	
1988	-4.6	-3.5

SECRET

ANNEX II : NET ACQUISITION OF FINANCIAL ASSETS BY SECTOR
(AS PERCENTAGE OF GDP)

Calendar Years	Personal (1)	ICC (2)	Financial (3)	Total Private Sector (4)	Public (5)	Overseas (6)	Residual Error (7)
1948	-2.8	1.8	0.3	-0.7	2.2	-1.4	-0.2
1949	-2.6	2.1	0.3	-0.1	2.4	-1.2	-1.1
1950	-2.1	3.1	0.3	1.3	2.6	-3.3	-0.6
1951	-3.2	2.5	0.3	-0.4	-1.6	2.2	-0.2
1952	0.1	4.0	0.5	4.6	-3.4	-1.0	-0.1
1952	-0.4	3.7	0.3	3.7	-4.1	-0.8	1.2
1954	-1.6	3.6	0.4	2.3	-2.4	-0.6	0.7
1955	-1.4	2.1	0.4	1.1	-2.0	0.8	0.1
1956	0.2	2.0	0.3	2.6	-2.6	-1.0	1.0
1957	0.0	1.5	0.4	1.9	-2.4	-1.0	1.5
1958	-0.6	2.1	0.3	1.8	-1.9	-1.6	1.7
1959	-0.3	1.8	0.2	1.6	-2.2	-0.7	-1.3
1960	1.1	0.9	0.2	2.3	-2.7	0.9	-0.4
1961	2.3	-0.2	0.2	2.4	-2.6	-0.2	0.5
1962	2.0	0.0	0.2	2.1	-1.8	-0.5	0.2
1963	1.9	1.4	-0.2	3.0	-2.6	-0.4	0.0

Financial Years	ICCs							
	North Sea	Other						
1963/64	1.8	0.0	1.8	-0.3	3.3	-3.1	0.0	-0.2
1964/65	2.4	0.0	-0.6	-0.3	1.6	-2.2	0.9	-0.2
1965/66	3.5	-0.1	-0.6	-0.3	2.4	-2.0	0.3	-0.8
1966/67	2.5	-0.1	1.0	-0.6	2.7	-2.6	-0.5	0.4
1967/68	1.8	-0.2	1.4	-0.6	2.4	-3.7	1.0	0.2
1968/69	1.2	-0.1	0.6	-0.9	0.8	-1.0	0.2	-0.1
1969/70	1.4	-0.1	1.0	-1.3	1.0	1.5	-1.5	-0.9
1970/71	2.1	-0.1	0.5	-0.9	1.6	0.8	-1.3	-1.1
1971/72	0.2	-0.2	2.4	-0.5	1.9	-1.1	-1.7	1.0
1972/73	1.3	-0.2	2.6	-0.5	3.2	-2.8	0.3	-0.7
1973/74	3.2	-0.5	0.6	-0.5	2.8	-4.6	2.1	-0.2
1974/75	4.3	-1.0	-0.8	-0.6	1.8	-6.2	3.5	0.9
1975/76	4.2	-1.4	2.1	-0.5	4.3	-7.1	0.9	1.9
1976/77	3.5	-1.2	0.9	-0.1	3.1	-5.9	1.1	1.8
1977/78	2.5	-0.9	2.0	-0.1	3.5	-4.4	0.0	1.0
1978/79	4.7	-0.6	0.8	-0.3	4.7	-4.8	-0.3	0.4
1979/80	4.1	0.0	-0.1	-0.3	3.8	-3.9	0.1	0.0
1980/81	6.4	0.0	0.4	-0.3	6.4	-4.9	-2.6	1.1
1981/82	4.7	-0.1	0.3	-0.2	4.8	-1.9	-2.5	-0.3
1982/83	3.3	0.2	1.9	0.2	5.6	-3.1	-1.6	-1.0
1983/84	2.8	0.6	1.6	0.5	5.4	-3.7	-0.9	-0.8
1984/85	2.6	0.7	1.5	0.1	4.9	-4.2	0.0	-0.8
1985/86	1.5	-0.2	2.0	0.6	3.8	-2.3	-1.0	-0.4
1986/87	-0.2	-0.1	1.9	1.4	3.0	-2.4	0.3	-0.9
Forecast								
1987/88	-1.7	0.2	2.2	1.1	1.9	-0.7	0.9	-2.1
1988/89	-0.6	0.0	0.9	0.8	1.2	-0.5	1.0	-1.8
1989/90	-0.4	0.1	0.3	1.0	1.0	-0.4	1.2	-1.8

NB Columns 1 + 2 + 3 = 4

Columns 4 + 5 + 6 + 7 = 0