

## Economic commentary

*This commentary describes the main features of the economy at home and abroad as background to financial developments, and gives a more detailed account of points made in the General assessment.*

- *Abroad, low activity has contributed to exceptional weakness in commodity prices. Nominal interest rates have fallen.*
- *In the United Kingdom, output has also remained low. Inflation has declined.*

*Later sections deal with financial developments in the United Kingdom. The rise in bank lending to companies showed some sign of slackening in the summer. Lending to the personal sector, however, continued to grow rapidly, with mortgage lending the main area of expansion; nevertheless, the housing market remained subdued. Monetary growth was contained within the target range; interest rates have fallen substantially.*

### The world economy

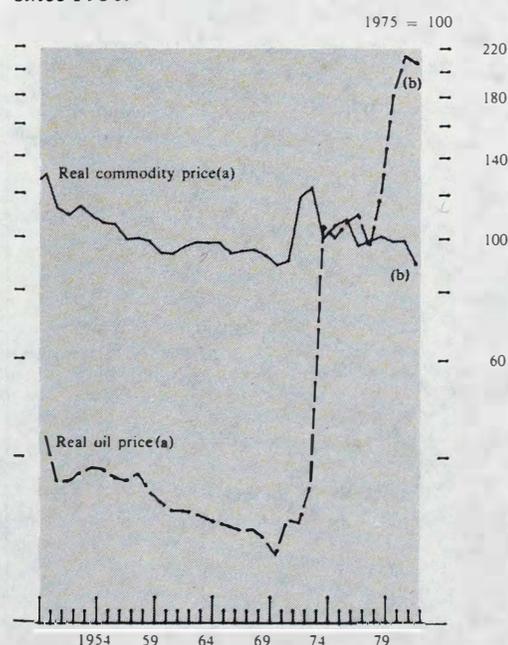
For the last two years, GDP in the major industrial countries has been growing very slowly, with falls in output in some quarters. Spare capacity has increased and unemployment rates are now post-war records everywhere except Japan. The US economy was among the first to weaken and has experienced two phases of falling activity, in 1980 and again since the latter part of 1981. Among the other countries, Japan has continued to grow (albeit slowly by its own standards), whereas the European economies have been weak.

In the six major overseas countries taken together, total output grew by barely 1% between the final quarter of 1979 and the first quarter of this year. All the growth came from foreign trade (notably trade with oil-exporting countries). Domestic demand was unchanged, with business spending and housing investment weak; narrow profit margins and high nominal and real interest rates were factors. As in the United Kingdom, company liquidations became more numerous.

The Assessment notes that forecasts have proved optimistic. Nevertheless, most continue to suggest a recovery of demand in industrial countries in the latter part of this year, led by consumer spending and stocks. Recent declines in interest rates (themselves partly stemming from a realisation of the depth of the recession) should contribute to demand. Indeed, GNP rose somewhat in the United States in the second quarter after six months of sharp decline (and may have grown further in the third quarter). Tax cuts and increases in social security benefits introduced in July should help to sustain consumer spending. In Japan, also, GNP grew quite strongly in the second quarter, reflecting an unexpected recovery in consumer demand. In continental Europe, however, activity was depressed and hopes of early recovery appear to have evaporated. This is particularly true of West Germany, where industrial orders have fallen sharply and private forecasts for this year and next have been heavily revised down.

The prolonged weakness of demand in most countries has had a significant effect on commodity prices, which, in relation to the

### Commodity prices are the lowest in real terms since 1950.



(a) Deflated by the price of manufactured goods in world trade. Commodity prices are represented by the UN index; the oil price is a representative Saudi crude until 1975 and an average price thereafter.

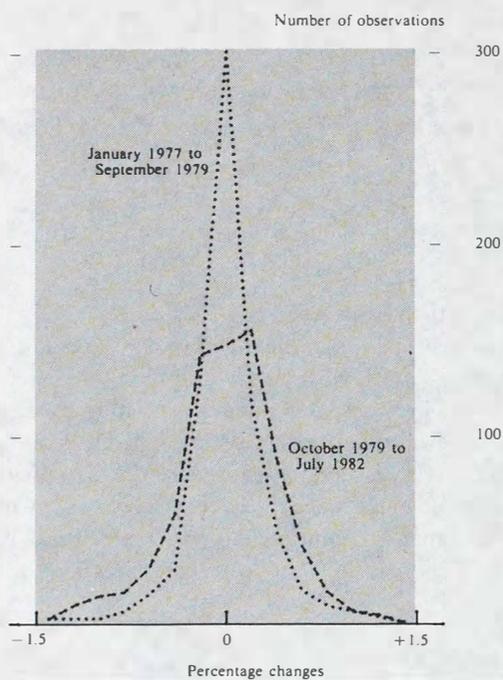
(b) First half year.

## Variability of exchange rates

In recent years exchange rates have become increasingly volatile, even when comparisons are confined to the last ten years of generalised floating. Increased variability is evident both in day-to-day fluctuations in rates and in movements over long periods.

Chart 1 shows the relative frequency of daily movements of particular sizes in sterling's effective rate; larger changes have become more frequent. The same is true of weekly movements.

**Chart 1**  
Frequency of daily movements in the sterling effective exchange rate



Other currencies have experienced an even greater increase in variability; indeed, in the last year sterling has been more stable than other major currencies in effective terms. (These conclusions hold for rates against the US dollar as well as for effective rates.)

Very short-term movements in exchange rates comprise three elements: changes in the same direction which accumulate and emerge as a trend; administered changes—for example changes in parity in the European Monetary System (EMS)—which are reflected in market rates; and random movements. A simple measure of variability, such as the standard deviation, will be affected by a change in trend in the exchange rate. This source of variability can be removed by measuring fluctuations around the trend. A statistical measure of this random variability—the root mean squared deviation of weekly percentage changes from a 53-week moving average trend—increased from 0.77 between January 1977 and September 1979 to 1.12 between October 1979 and February 1982.

There is also some evidence that fluctuations in the US dollar have been a source of increased variability in effective rates. If the dollar is excluded from the calculation, the increase in the variability of sterling's effective exchange rate between the two periods is somewhat lessened. (This is a purely arithmetic exercise which may not identify all variability stemming from this source: for instance, movements in the dollar may at times

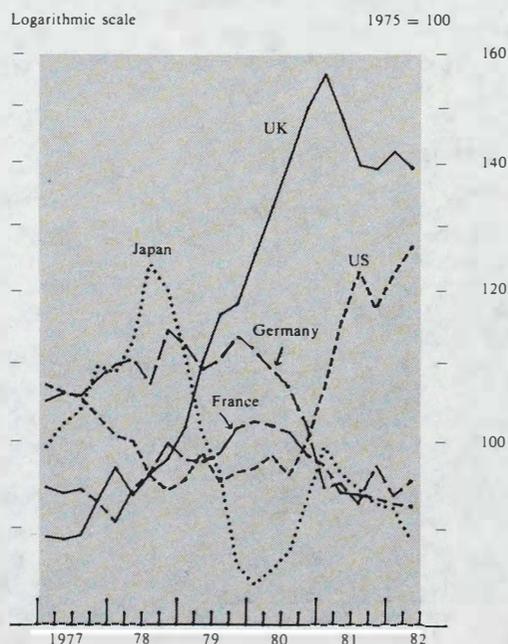
have increased exchange rate variability between participants of the EMS.)

This increase in short-term variability may have caused the widening of the margins between buying and selling rates quoted by banks. Until 1972, sterling, like most other currencies, remained within a narrow band around a declared parity against the US dollar, and margins of two points (eg 2.4000–2.4002) were normal. Now the margin is usually between 5 and 10 points even at quiet times, and margins of 20 points are commonly quoted when exchange rates are moving rapidly. Forward transactions, through which the risk of movements in exchange rates can, in principle, be covered, have also become more expensive. As a result, the cost of carrying out international business has somewhat increased.

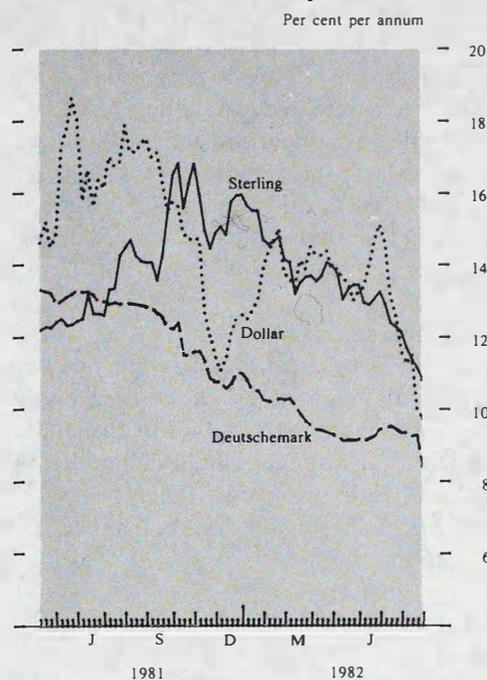
In the longer term, changes in exchange rates should reflect changes in domestic costs and prices in the countries concerned, and also structural developments affecting the pattern of trade, saving and investment—the exploitation of North Sea oil and gas is an example. The appropriate response to structural change is often hard to assess, but exchange rates have not in recent years even approximately offset changes in domestic costs in different countries, and have even at times gone against them. Consequently, 'real' exchange rates—nominal rates adjusted for changes in industrial labour costs in different countries—have changed very markedly (Chart 2). A 'real' appreciation not justified by the other factors mentioned which lasts for some time drives business out of exporting or competing with imports into production for the sheltered home market (or out of employment altogether); when it is reversed, resources tend to move back again; the cost is the dislocation caused.

Although undue variability in exchange rates may be undesirable, measures to prevent or reduce it—exchange controls, or the acceptance of domestic monetary conditions which would not otherwise have been chosen—are themselves costly.

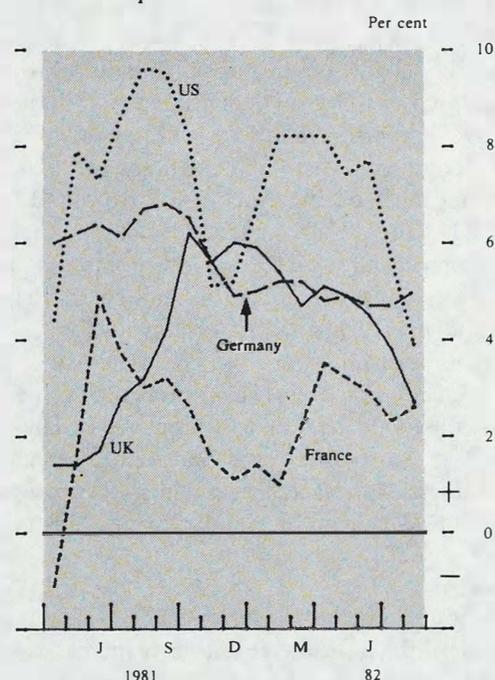
**Chart 2**  
Real exchange rates<sup>(a)</sup>



(a) Exchange rates adjusted for changes in normalised unit labour costs.

**Short-term interest rates have fallen . . .**

. . . but remain positive in real terms.<sup>(a)</sup>



(a) Three-month money market rates deflated by change in prices over the year starting two quarters before the current period.

prices of manufactured goods, are at their lowest since 1950 (see the chart on page 333). 'Real' oil prices have also decreased somewhat this year. At the same time, rises in wages and earnings have slowed down in most industrial countries. Taken as a whole, cost pressures in the major countries have eased, and price inflation has tended to come down.

**Interest rates fall . . .**

Movements in US interest rates have been the focus of attention in financial markets. A strict monetary policy in the United States, heavy borrowing by the Federal Government, and expectations of economic recovery, contributed to an uneven rise in interest rates for all terms in the first half of the year. In July and August, however, rates fell precipitously. Factors were that the Federal Reserve appeared ready to accept somewhat faster growth in money supply as a response to uncertainty and greater demand for liquidity; that Congress approved tax increases and spending cuts to take effect over three years; and that prospects for the US economy looked bleaker. The decline in market rates was accompanied by successive reductions in the discount rate to 10%. Since late August, however, market rates have edged up again.

The fall in US rates was reflected in the United Kingdom and Germany. The retreat of sterling interest rates from their peak last autumn had continued in the first half of the year despite the rise in US rates and the strength of the dollar. Indeed, after January sterling money market rates were predominantly below dollar rates, having earlier been well above them. The fall in sterling rates quickened in the summer, and administered rates were reduced in a number of other centres as circumstances—notably the exchange market—allowed. On the whole, UK rates have fallen more this year than rates elsewhere, though from a higher starting point.

The tendency for inflation to decline has nevertheless left real interest rates substantially positive.

**Payments positions evening out . . .**

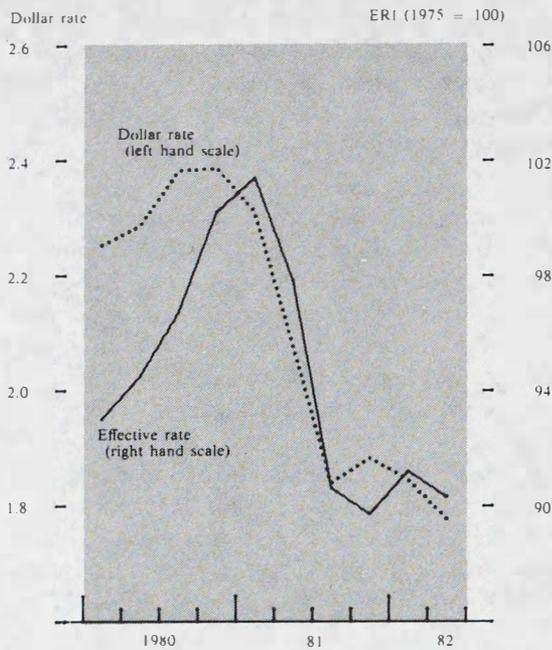
Meanwhile, there has been a marked change in the payments position of different groups of countries. World recession and energy saving have virtually eliminated the combined surplus of OPEC countries, from \$70 billion last year. The major OECD countries taken together moved into surplus. Within this group, the United Kingdom's current account surplus fell from some \$13 billion last year to about \$3 billion in the first half of 1982, whereas the position of other major countries improved. The deficit of the small industrial countries fell a little. The current accounts of the non-oil developing countries appear to be improving, despite the fall in their export receipts, although their financing problems remain severe—see the tables on page 355.<sup>(1)</sup>

**The UK economy****The exchange rate remains steady . . .**

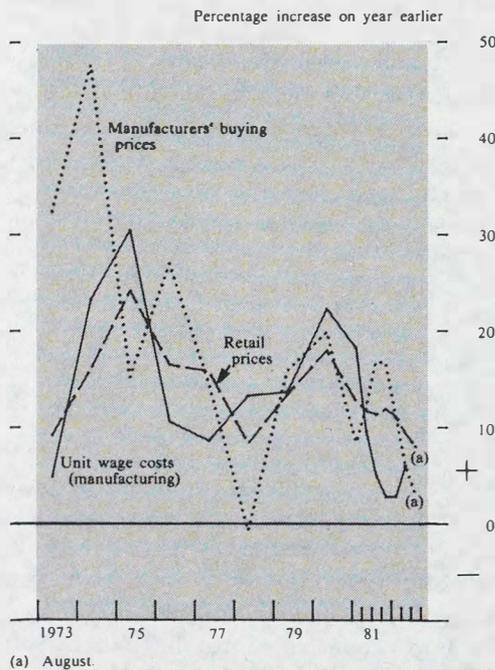
Sterling has now been steady in effective terms for the last year, having declined by about 10% in the previous twelve months. In fact, it declined against the dollar by 5½% between the average for the fourth quarter of last year and the second quarter of 1982 (and in late September was 9½% below the average level in the fourth quarter), but in effective terms it moved for the most part narrowly

(1) Discrepancies between the current account positions of various groups of countries are discussed on page 356.

### Sterling exchange rates fell in 1981, but the effective rate has been steady for a year.



### Inflation is considerably reduced.



in the range 90-92, strengthening slightly over the period.<sup>(1)</sup> Sterling has proved steady despite the fact that interest differentials were tending to move against the United Kingdom, the current account was worsening (at least in relation to the position of other major countries) and oil prices were steady or falling. Declining inflation and the prospect that firm monetary and fiscal policies would continue to be applied were probably factors. The steadiness of sterling has influenced UK prices and industrial competitiveness, with consequences for external trade and domestic activity.

### Inflation continues to decline . . .

The fall in the exchange rate last year will still be adding modestly to cost and price increases, although most of the effect will have come through.<sup>(2)</sup> (It is the change in the effective rate that appears to be more significant here than the change in the dollar rate, despite the widespread practice of invoicing in dollars, because dollar prices, especially prices of commodities, are not independent of the strength of that currency.)

The recent firmness of sterling, together with the weakness of commodity prices, has contributed to very moderate increases—3% in the year to August—in the prices which industry pays for raw materials and fuel. Labour costs, the other main component in manufacturing industry's costs, increased by about 6% in the year to the second quarter. The slight speeding up in labour costs from last year reflects somewhat slower growth in productivity in the first half of 1982. Wage settlements in the 1981/82 pay round averaged around 7%, compared with about 9% in the previous year, and did not change much during the course of the round. (Information compiled by the CBI shows that 90% of settlements were in the 4%–10% range, and suggests that low profits and the difficulty of raising prices in highly competitive markets are the main factors holding down settlements.) After allowing for temporary factors, average earnings rose by 9¼% in the year to July; the gradual implementation of this year's more modest pay settlements continues to reduce the year-on-year increase. These increases in industrial costs are much lower than in most recent years. In 1980, for example, manufacturers' buying prices rose by 20%, and unit wage and salary costs in manufacturing industry rose by 22%.

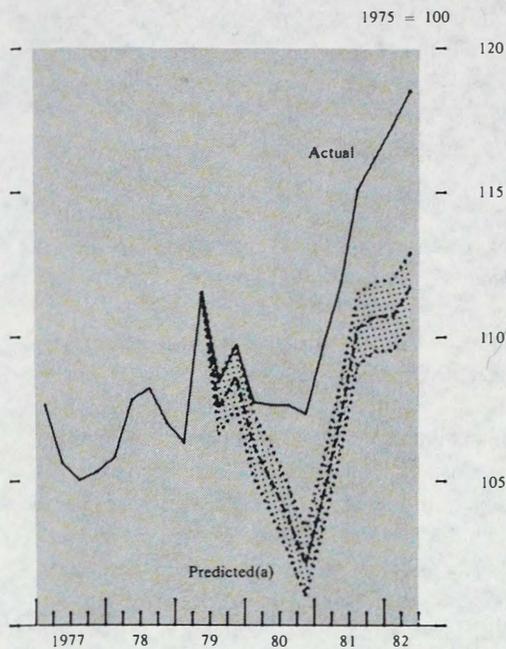
The growth of unit labour costs in other sectors has slowed but by less than in manufacturing industry. Profits have increased substantially though from a very low level. Consequently, the increase in the GDP deflator—a comprehensive measure of home costs including profits, trading surpluses of public corporations and all wages and salaries—at 7% in the year to the second quarter, was larger than the rise in industrial labour costs.

Slower growth in industrial costs, the cut in mortgage interest rates in April, and lower increases in indirect taxes and council rents and rates, have contributed to a substantial fall in retail price inflation. The year-on-year increase, which at the turn of the year was 12%, fell to 8% in August, with the benefit of the lower mortgage rates (reduced from 1 September) still to come. The prospect of further reduction in the year-on-year increase is good.

(1) The behaviour of sterling and other leading currencies is discussed in more detail on page 363.

(2) It appears that a 10% decline in the rate might, in the absence of any response in wages, add about 2% to consumer prices after a year, with some further effect still to come. See 'Sterling and inflation', September 1981 *Bulletin*, page 365.

**Productivity in manufacturing industry is better than expected.**



(a) The shaded area represents the (95% confidence) band of likely outcomes in the absence of structural change.

**Productivity growth continues unusually fast . . .**

Productivity has continued to increase in recent quarters; and though the rise now seems to be less rapid than it was last year, it is still significantly faster than on average in the past. The level of productivity thus continues to be higher than would have been predicted from earlier experience—by a margin of perhaps 5%–6% in the middle of this year (see chart).

In the past, the course of productivity has been affected in a fairly regular way by the economic cycle. Thus in the early stages of a recession, employment is not normally reduced in proportion to output, so that productivity as usually calculated rises less than usual or may fall: firms tend to keep labour on their books against an expected recovery in output. This adds a temporary element to costs, but an element that seems not to get passed on in prices—no doubt in part because demand in these circumstances is specially weak. Thus profits fluctuate greatly over the course of the cycle. The practice of pricing on the basis of 'normal' costs means that profits benefit disproportionately when productivity rises abnormally fast. This may explain why profits have recently shown so marked a recovery from the very low level reached early last year (page 340).

Of various alternative measures of international competitiveness, the best seems to be that based on labour costs per unit of output in manufacturing industry in this country compared with those in our main competitors (page 371). Such a measure is affected by the same considerations that apply when interpreting productivity changes: if there is an abnormal element of labour costs in a recession that does not get passed on in prices, it should be discounted in a measure of competitiveness. That is why the IMF present a measure of cost competitiveness in a 'normalised' form—estimated from 'potential' not actual productivity growth. But such a trend in productivity is particularly difficult to estimate in conditions like the present. If the recent fast growth of productivity represents a break in the 'trend', the normalisation procedure will be slow to pick it up. Estimates of competitiveness may therefore somewhat underestimate what has really occurred in the last year or so.

After allowance for movements in the effective exchange rate and the rise in earnings in manufacturing industry here and abroad, the United Kingdom's international cost competitiveness improved during the course of last year, in round terms, by between 10% (using the IMF's customary cyclical adjustment) and 15% (if full credit is taken for the unexpected growth in productivity); there was probably little change in the first half of this year, when sterling was steady and wage inflation abroad came down. But these developments must be seen against the loss of 50% or more in industrial cost competitiveness between 1978 and late 1980.

**Exports lose share, import penetration increases . . .**

Both exports and imports of goods (excluding oil and the usual erratic items) grew rapidly in volume between early last year, when they were exceptionally low, and the second quarter of 1982. From the first quarter of 1980, exports fell by 3% while imports increased by 11%. In this period, world trade grew by perhaps 5% and domestic spending (plus exports) fell by 2%. Thus UK exports lost share in world markets and imports took a larger share in domestic sales. The ratio of the volume of exports to the volume of imports

## Fixed investment

Gross fixed investment in the first half of this year was higher than last year, although somewhat below the rate in 1979 and 1980 (and, indeed, 1975). The overall figures conceal some very large changes in composition. The decline in housebuilding has quickened since 1979; indeed, investment in housing has recently been barely half as much as it was a decade ago. Non-housing investment by central and local government has also fallen substantially; and non-housing investment by public corporations has diminished since the mid-1970s. Shipping investment has declined considerably in the last decade; investment in North Sea oil and gas has greatly increased, although it is well below the peak of 1976.

### Fixed investment

£ billions, 1975 prices

	1972	1975	1979	1980	1981	1982	
						Q1(a)	Q2(a)
Industrial(b)	7.4	7.4	10.0	9.9	9.4	9.6	9.2
of which, <i>manufacturing(c)</i>	3.4	3.7	4.4	4.2	3.6	3.4	3.3
Housing	4.3	4.1	3.6	3.1	2.3	2.5	..
Government excluding housing	3.7	3.3	2.0	1.7	1.3	1.0	..
Other(d)	4.4	5.6	5.4	5.7	5.8	6.5	..
<b>Total</b>	<b>19.8</b>	<b>20.4</b>	<b>21.0</b>	<b>20.4</b>	<b>18.8</b>	<b>19.6</b>	<b>19.0</b>

(a) Seasonally adjusted at an annual rate.

(b) Mostly private investment, in manufacturing, distribution and services.

(c) Since 1975, including leased assets.

(d) A residual, including most investment by nationalised industries, North Sea investment, and shipping.

Industrial investment has been unexpectedly strong in the current recession. In the first half of this year, it was less than 6% below the peak year of 1979, and well above the rate of a decade ago. Compositional changes have occurred within this category. Fixed investment in manufacturing industry has not grown on balance in the last decade even if leased assets are included. Investment by distributive and service industries, on the other hand, excluding shipping and assets leased to manufacturers, has grown sharply and now accounts for two-thirds of industrial investment. Within industrial investment as a whole, building work has declined; almost all the growth has been in plant and machinery.

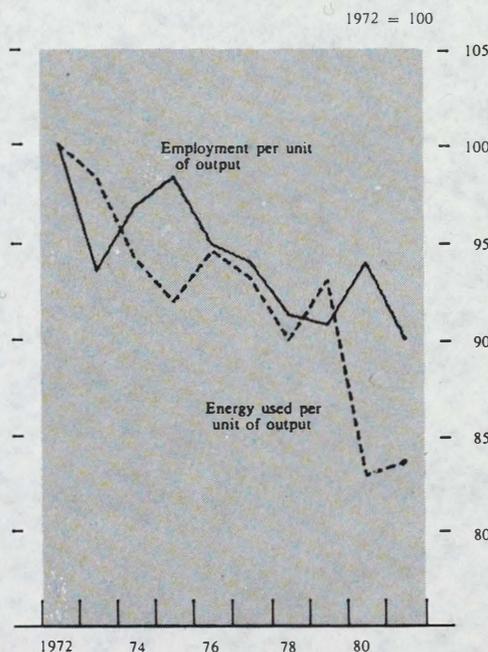
The level of industrial investment—even in manufacturing—in the present recession cannot be explained by the easily quantifiable influences used in econometric work. Industrial output, which in the past has been a strong influence on investment, has fallen sharply since 1979, and surveys of business opinion have not suggested expectations of a recovery. It does not seem likely, therefore, that industrialists have been investing to meet an expected expansion of demand—although the aggregate figures may conceal changes in the composition of demand which has given rise to new investment. The estimated real rate of return on existing assets, while rising in the last year or so, remains low by earlier standards—4%,

compared with around 5% in 1975 (the worst year in the last recession) and about 10% a decade ago.<sup>(1)</sup> The real cost of financing investment—by borrowing, raising equity, or running down financial assets—or of leasing assets has probably been higher than this for most companies.

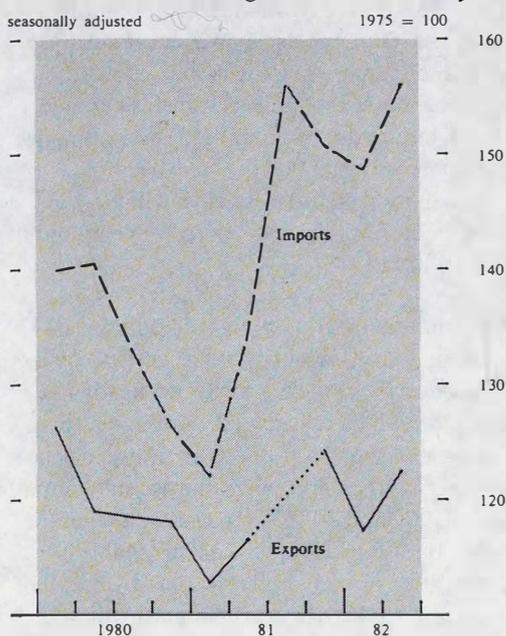
So a comparison of the return on existing investment and the cost of financing new investment would not suggest an inducement to increase the capital stock with equipment similar to that in place. But there are good reasons for supposing that the average profitability of existing assets does not reflect the incentive to invest. Large increases in the price of fuel, and to a lesser extent in labour costs, probably mean that the return on new equipment is considerably higher than that on old equipment installed when fuel and labour were relatively cheap. Reductions in the amount of fuel and labour used per unit of output in industry no doubt to some extent reflect the replacement of older assets. Moreover, technology—especially in electronics—has advanced rapidly in recent years. Reports, supported by CBI surveys, that firms are investing to increase efficiency rather than to produce more, are consistent with these explanations.

The Department of Industry survey published in May indicated a 2% increase in industrial investment in 1982; this would require the rate of investment to rise in the second half. The survey suggested further growth in industrial investment in 1983, in which manufacturing industry would share. By contrast, the CBI's survey in July appeared to indicate a decline in manufacturing investment in the coming year.

### Industrial output, employment and energy use



(1) A sample of company accounts on a current cost basis suggests rather higher real pre-tax profitability for the latest years than estimates based on national income sources—see the article on page 376. Company accounts use different assumptions and methods of calculation, which would also affect estimates of the real cost of capital, however, and need not imply a greater inducement to invest.

Trade volumes<sup>(a)</sup> have grown less than last year

(a) Excluding oil and the usual erratic items.

For other balance of payments items see page 335

(excluding oil and the usual erratic items; 1975 = 100) fell from 90 in the first quarter of 1980 to 79 in the second quarter of 1982; the move into surplus on visible trade was accounted for by trade in oil and (in a statistical sense) unusually strong terms of trade.

Recently, however, imports have tended to level off, with the total volume of imports (excluding oil and the usual erratic items) down  $1\frac{3}{4}\%$  between the fourth quarter of 1981 and the three months June-August, and imports of manufactured goods up only  $1\frac{1}{4}\%$ . The slower growth of imports of manufactured goods in recent months may be partly attributable to the improvement in cost competitiveness in the course of last year. Exports of manufactured goods, by contrast, fell by  $8\frac{1}{2}\%$  between the fourth quarter of last year and the latest three months. If, as is possible, the introduction of new documentation procedures caused exports to be overstated late last year, the figures may exaggerate the decline, but some fall would have been expected from the earlier loss of competitiveness (which appears to take longer to affect exports of manufactured goods than imports) and developments in world markets. Recent monthly trade figures have been erratic, but, broadly speaking, the course of imports and exports is explicable in terms of competitiveness (calculated using the IMF normalisation procedure), world and domestic markets, and established trends—suggesting that any improvement in competitiveness arising from unexpected growth in productivity has not so far affected trade.

## Activity flattens out after some recovery . . .

Trade flows have influenced (as well as reflected) the development of the economy. For this purpose trade in goods and services as a whole counts.

Although all the measures show GDP higher in the first half of this year than in the early or middle part of last year, they vary in the timing and extent of changes. Thus the expenditure measure shows a later trough last year and a more rapid recovery from it than the output measure. Moreover, whereas output flattened out last autumn, spending appears to have risen into the early part of this year before levelling off. The periods shown in the table are chosen to indicate broad movements in output and expenditure (expressed as annualized rates of change, except in the last line where actual changes are shown).

## Contributions to the change in GDP

Percentages; annual rate (except last row)

	1979 (average) – mid-1981 (a)	mid-1981 (a) – 1982 H1
Consumers' expenditure	—	-0.1
Government current expenditure on goods and services	+0.3	+0.4
Gross fixed investment	-1.2	+0.9
Exports (goods and services)	-0.2	+0.1
Total (final expenditure excluding stockbuilding)	-1.1	+1.3
Stockbuilding	-1.8	+2.5
Imports (goods and services) (increase -)	+0.1	-0.7
Adjustment to factor cost (increase -)	+0.2	-0.3
GDP measures:		
Expenditure	-2.5	+2.8
Output	-2.7	+0.5
Average(b)	-2.5	+1.4
Average not annualised	-5.0	+1.1

(a) Average of second and third quarter figures.

(b) Average of expenditure, output and income measures.

The underlying course of demand is best seen from final expenditure, excluding stock changes. The total has changed rather little in the recession, the main feature being a decline in non-industrial fixed investment. Altogether, final expenditure has contracted, and then recovered, at an annual rate of barely 1%. More striking have been the changes in stocks. To the extent that final spending is satisfied by reducing stocks, domestic output or imports are lower than would otherwise have been the case. The large reductions in stocks up to the middle of last year tended to reduce output substantially, except in so far as they fell on imports. By the same token, the virtual end to destocking has tended to raise output, except to the extent that more imports were drawn in.

The number of jobs declined further in the first half of the year. Most of the decline continued to be in industry. Registered unemployment (adults, seasonally adjusted) has risen more rapidly since the spring; in September, more than 3 million ( $12\frac{3}{4}\%$  of the workforce) were unemployed.

**Profits rise but companies borrow more . . .**

The cost of materials and labour used by manufacturing industry has, as noted, been rising less. Other costs, such as local authority rates, may have continued to increase quite fast, and interest payments—treated in the national accounts as transfer payments, not as part of value added, but no doubt thought of by companies paying them as no different from other costs—have been burdensome.<sup>(1)</sup> (Recent reductions in interest rates will have considerably eased companies' position, each percentage point fall contributing about £300 million.)

Although the growth in manufacturers' selling prices has also slowed down (to 7 $\frac{3}{4}$ % in the year to August), it has done so by less than the growth in costs—and the same is probably true for ICCs as a whole. So profit margins will have widened. Moreover, there will have been some increase in the volume of sales since early last year. Altogether, profits net of stock appreciation rose substantially between the first halves of 1981 and 1982, only a small part of the increase coming from North Sea operations. Real profitability (excluding North Sea operations) recovered to 4% in the first half of this year, compared to some 3% a year earlier. The growth in profits appears to have been absorbed, however, by higher taxes and interest payments (and to a lesser extent increases in other appropriations).

Estimates of ICCs' capital spending in the first half of this year are not yet available. Industrial investment (as defined in the box opposite) appears to have increased by more than £ $\frac{1}{2}$  billion at current prices from the first half of 1981, and manufacturers and distributors added somewhat to their stocks—whereas a year earlier they had reduced them by about £1 $\frac{1}{2}$  billion. Nevertheless, stocks (especially manufacturers' stocks of finished goods) remained rather high in relation to production and sales, despite the enormous reductions which had occurred up to mid-1981. CBI surveys indicate that further reductions in manufacturers' stocks are likely; real interest rates, improved methods of stock control, and expectations about production and sales are factors influencing the desired level.

Taken with a small reduction in ICCs' undistributed income, these estimates for capital expenditure indicate a deterioration in companies' financial balance. Figures for their financial transactions in the first half of 1982 are not yet complete (and errors and omissions have been very large in some previous periods), but companies borrowed heavily from the banks especially in the first quarter when delayed tax payments were made; there was some sign of an underlying slackening in the rate of borrowing in the second quarter.

Profits have increased since early last year, but in real terms—divided by the GDP deflator—and excluding North Sea operations they were not much higher early this year than in 1975, at the worst of the last recession, although companies have shed much more labour than in the mid-1970s. Fixed investment by contrast has been better maintained. The move from large financial deficit in 1979 to approximate balance is similar to that which occurred between 1974 and 1976, but company liquidations—of

**Income and appropriations of industrial and commercial companies**

£ billions; seasonally adjusted

	1979	1980	1981		1982
			H1	H2	H1
Annual rates					
Total income (net of stock appreciation) of which, gross trading profits, excluding North Sea operations	31.9	34.9	35.7	41.0	41.0
	18.7	18.8	17.7	19.4	21.6
Interest payments	- 5.7	- 7.8	- 7.4	- 8.5	- 8.9
Other appropriations	- 12.5	- 15.5	- 16.1	- 19.0	- 20.3
Undistributed income (= saving)	13.7	11.6	12.2	13.5	11.8

**Selected financial transactions of industrial and commercial companies**

£ billions, annual rate; seasonally adjusted

	1979	1980	1981		1982	
			H1	H2	Q1	Q2
Acquisition (—) of liquid and other financial assets	- 0.8	- 4.2	- 5.8	- 5.6	- 3.6	..
Bank borrowing	4.9	7.2	0.2	13.9	14.7	4.1
Other borrowing	2.0	3.2	3.0	2.7	2.5	..
.. not available.						

(1) For most companies, however, rates and net interest payments are quite small in relation to labour costs, amounting to under £9 $\frac{1}{2}$  billion in 1981 for all ICCs—a wider group than manufacturing—compared with wages, salaries and employers' national insurance contributions of nearly £76 billion. As a group, ICCs probably paid about as much for fuel and materials as for labour.

See the box on page 338

### Personal income, spending and saving at 1975 prices

Percentage changes, annual rate, seasonally adjusted

	1975-77	1977-80	1980 (average)- 1982 H1(a)
Wages, salaries, forces' pay	-3.5	+ 3.7	- 3.1
Employers' national insurance contributions	+2.4	+ 3.4	+ 2.2
Social security benefits	+5.0	+ 6.8	+ 9.0
Other income	-0.6	+ 6.2	- 3.8
Taxes on personal income and employees' national insurance contributions (increase -)	+2.6	- 0.3	- 2.7
<b>Real personal disposable income</b>	<b>-1.2</b>	<b>+ 5.5</b>	<b>- 2.0</b>
Consumer spending	-0.1	+ 3.5	-
Saving	-8.8	+19.4	-13.1

(a) Including estimates for 1982 Q2.

### Personal sector saving, capital spending and financial transactions

£ billions; 1975 prices

	1979	1980	1981	1982	
				Q1	Q2(a)
Saving	11.8	13.2	11.1	2.9	2.3
Capital spending	4.2	3.5	3.4	1.0	1.0
Acquisition of financial assets	15.1	14.2	13.5	3.7	..
Borrowing	6.7	5.8	6.8	1.7	2.0(b)

### Personal sector borrowing

£ billions; 1975 prices

	1979	1980	1981	1982	
				Q1	Q2
Loans for house purchase	4.0	3.9	4.5	1.1	1.4(b)
of which:					
from banks	0.4	0.3	1.1	0.4	0.6
from building societies	3.2	3.0	2.9	0.6	0.9
Other loans	2.7	1.9	2.3	0.6	0.6(c)
of which:					
bank loans to persons and households	0.6	0.6	0.9	0.2	0.2
bank loans to unincorporated businesses	0.9	1.0	0.9	0.3	0.4
Total	6.7	5.8	6.8	1.7	2.0(b)

.. not available.

(a) Estimates

(b) Banks and building societies only.

(c) Banks only.

which there were as many in the first half of this year as in the whole of 1975 or 1976—indicate the pressures to which many have been subject.

#### As real incomes have fallen, persons have borrowed more<sup>(1)</sup> . . .

Changes in the various components of real personal disposable income (RPDI) and spending in recent periods are shown in the table. RPDI grew by over 5% a year between 1977 and 1980. Consumer spending grew more slowly, so personal savings increased very fast. Since 1980, RPDI has contracted. Rapid growth in government grants (mainly unemployment and other social security benefits) has approximately offset the decline in wages and other sources of personal income, but the burden of taxes on personal income and employees' national insurance contributions has grown. (For those in work average earnings have risen somewhat faster than retail prices though usually more slowly than the tax and prices index). With consumer spending virtually unchanged, saving at 1975 prices has fallen.<sup>(2)</sup>

Less saving has taken the form of increased borrowing (at constant prices) and the acquisition of fewer financial assets.

Most personal borrowing (excluding unincorporated businesses) has been in the form of mortgages. Such borrowing rose sharply in real terms last year and continued to be strong in the first half of 1982. Within the total the banks' share has grown rapidly, from one-tenth in 1979 to some one-third in the first half of this year. The incursion by the banks into the housing market and more competitive behaviour by the building societies have undoubtedly made housing finance more readily available. The article on page 390 discusses the market in housing finance. Chart 9 on page 395 suggests that approximately half of recent new mortgage lending has gone to finance additions to the privately-owned housing stock, including some allowance for house improvements; the rest represents increased lending against housing already in private hands and must, in the aggregate, be used either to acquire financial assets, to repay debt in other forms, or to add to spending on other goods and services (some of it no doubt associated with moving house). When the stock of mortgages grew rapidly in the early and late 1970s, a boom in house prices followed. House prices are currently steady and building activity is subdued. Static real incomes and declining expectations about inflation contrast with conditions in the 1970s. This suggests that the recent growth in housing finance in part represents an extra demand for finance, met by a readier supply, which is not necessarily associated with growing demand for housing.

Lower inflation will reduce the amount of saving needed to maintain the real value of monetary assets—although the effect may be weakened by lower net interest receipts. On balance consumer spending is likely to be somewhat stronger than it would otherwise have been. The recent abolition of hire purchase restrictions should also help, although the effect is likely to be small. (Sales of new cars were a record in August, but this may have been mainly a response to the new registration letter. Retail sales in August were 1½% above the rate in the first half of the year).

(1) 'Persons' includes unincorporated businesses, unless stated otherwise.

(2) The June *Bulletin* (page 189) suggested that the rate of inflation, by affecting the real value of monetary assets, influences saving behaviour. A declining rate of inflation in the latest period will have reduced the amount of saving needed to maintain the real value of monetary assets.

**Sterling lending, public sector transactions and money supply<sup>(a)</sup>**£ billions, *seasonally adjusted*

	1979	1980	1981		1982
			H1	H2	H1
			<i>Annual rates</i>		
Sterling lending to the private sector	8.6	10.0	5.7	16.5	18.4
PSBR	12.6	12.2	14.7	6.5	1.4
Funding (-)(b)	-10.9	-9.5	-13.1	-9.0	-8.4
Sterling M <sub>3</sub>	6.6	10.9	8.4	10.1	7.5

(a) External and foreign currency transactions and changes in the banks' net non-deposit liabilities are omitted from the table.

(b) Sales of public sector debt to the non-bank private sector.

**Bank lending, public finance and money supply**

Various factors have influenced the pattern of sector financing in recent years. Freed from quantitative controls, the banks have competed more keenly for business. High and variable nominal interest rates and an uncertain outlook for inflation appear to have discouraged business from seeking finance in the capital market (although there are some recent indications of revival).

Consequently, bank lending in sterling to the private sector has been the main counterpart to monetary growth in recent years, having grown at a rate in excess of the targets set for the increase in sterling M<sub>3</sub> (approximately £6 billion in the 1979/80 target period, and £10 billion in the current 1982/83 period). The growth of money supply has been contained in part by matching (or at times more than matching) the PSBR by sales of public sector debt to the non-bank private sector, achieved by a drive to increase national savings as well as by heavy sales of gilt-edged securities.

In the first half of this year, bank lending in sterling to the private sector rose by over £9 billion.<sup>(1)</sup> The PSBR was lower than expected partly because of delayed receipts of tax, and over £4 billion of public sector debt was sold to the non-bank private sector, mostly in the first quarter. (The table on page 330, which covers periods of three banking months, shows that overfunding was negligible in the three months to mid-August.) Altogether, the growth in sterling M<sub>3</sub> in the first half of this year was less than in previous periods. M<sub>1</sub>, comprising a narrower set of assets than sterling M<sub>3</sub>, grew more slowly than the wider measure but accelerated during the period as interest rates fell. PSL<sub>2</sub>, a broader range of private sector assets, grew rather more slowly than sterling M<sub>3</sub>. The growth of the monetary aggregates was broadly in line with nominal national income.

(1) Including commercial bills acquired by the Issue Department of the Bank.