Economic commentary

In major overseas countries, *recent announcements of budgetary and monetary plans suggest little change from the anti-inflationary stance adopted over recent years. These policies have helped reduce average inflation to rates not seen for over a decade (although the downward movement may now be losing momentum).*

Inflation continues to vary between countries, and similarly there has been a diverse pattern of economic recovery. Where inflation has been brought down to low levels economic growth has generally been resumed, but where inflation remains a considerable problem (as in some parts of Europe) the recession has not yet clearly come to an end.

In the United Kingdom *latest indications are that the recovery in activity which began some three years ago is continuing at a moderate pace, with few signs of a re-emergence of inflationary pressure. Until recently, the output response from domestic industry has been rather slow, but it may now be quickening somewhat. The rapid rise in output per head also seems to be continuing, especially in manufacturing. Partly for that reason, the trend in unemployment has not improved as much as might have been expected.*

Faster growth in demand at home than abroad worsened the balance of trade (apart from oil) last year, but this situation may now be changing. Exports, having been rather sluggish in the previous twelve months, contributed most to demand in the fourth quarter. Even so, the recovery continues to rely quite heavily on consumer spending, much of it financed by borrowing. The pattern of recovery so far has brought a marked improvement in the financial position of industrial companies. Borrowing by the public sector increased for a time last year, but its subsequent deceleration and the large funding programme helped moderate the growth in the monetary aggregates over the last six months.

Monetary and credit targets and projections

Percentage changes at an annual rate

	1983(a)		1984(a)
	Target	Outturn	Target
United States			
M_1	5 – 9	7.2	4 – 8
M_2	7 –10	8.3	6 – 9
M_3	6½– 9½	9.7	6 – 9
Domestic non-financial sector's debt	8½–11½(b)	10.5	8 –11(b)
Germany			
Central bank money	4 – 7	7	4 – 6
France			
M_2	9	9.7(c)	5½– 6½(d)
Italy			
Total domestic credit expansion	18.4	20.6	17.4(e)
Switzerland			
Adjusted monetary base	3	3.6	3
Japan			
M_2 plus CDs	7(f)	7.2(f)	7(g)
United Kingdom			
Sterling M_3		9.7(h)	6 –10
M_1	7–11	11.1(h)	..
PSL_2		12.6(h)	..
MO	..	6.3	4 – 8

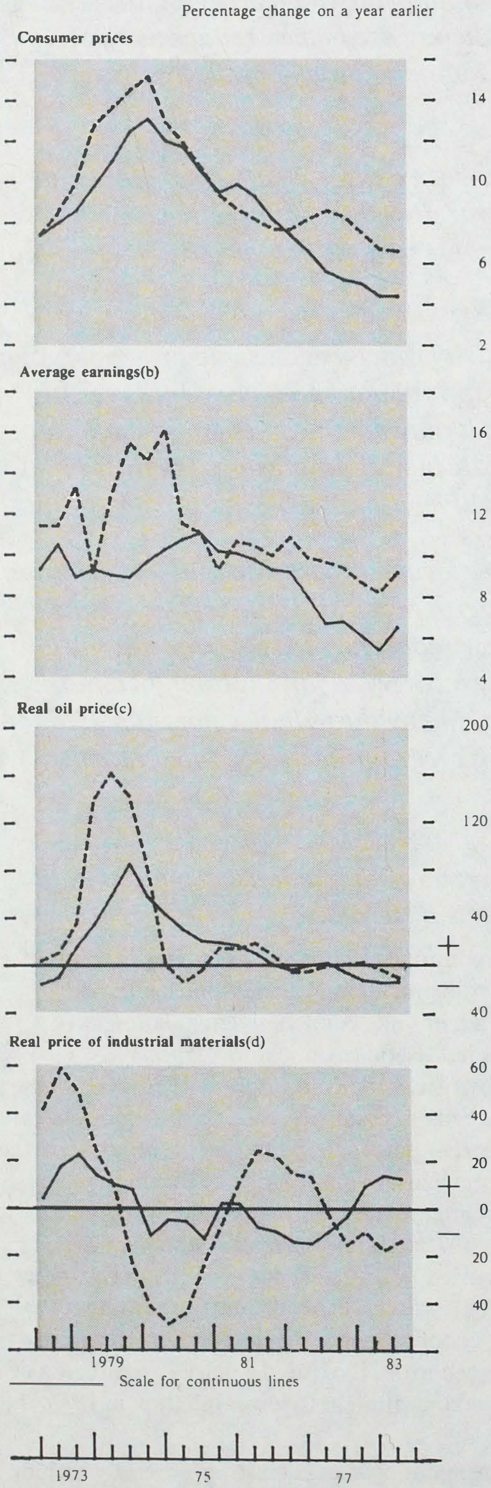
(a) Target periods differ between countries; periods closest to the calendar year are shown.
(b) Monitoring range.
(c) Year to November.
(d) Resident M_2.
(e) Projection for 1984 based on PSBR target.
(f) 1983 Q4.
(g) 1984 Q1.
(h) Outturn for first 12 months of target period.

The world economy: *monetary and fiscal policies in the major countries remain restrictive*

Most major countries continue to set monetary policy in terms of the growth of monetary aggregates of various kinds, although financial innovation and, in some countries, deregulation have made some aggregates less useful as indicators of monetary conditions. Monetary targets and projections for 1983 were on the whole realised. In many major countries, monetary expansion was far more rapid in the earlier part of the year than in the latter; in the United States the early expansion in M_1 led to a rebasing and widening of the target range; and in Germany, rapid growth in central bank money up to the March European Monetary System realignment had to be offset by much slower growth later to meet the target for the year as a whole. In most countries the targets have been tightened, but only slightly, for the coming year; in France, however, the authorities have used a marked tightening of the target to signal their commitment to lower inflation in 1984.

The budget plans of the major overseas countries generally include smaller fiscal deficits this year. The US Federal deficit is officially expected to fall from a record $195 billion (6.0% of GNP) in the financial year which ended last September to a projected $184 billion (5.2% of GNP) in the current financial year and to $180 billion (4.6% of GNP) in financial year 1985. The Canadian Budget for the year beginning in April 1984 envisages a lower

Prices in the major economies[(a)] since 1973



(a) Canada, France, Germany, Italy, Japan, United Kingdom and United States; GNP weights.

(b) Manufacturing.

(c) Ratio of average OPEC price to world export price of manufactures.

(d) Ratio of 'Economist' index to world export price of manufactures.

deficit, also reversing the pattern of recent years. Japan and Germany have medium-term budget strategies intended to reduce budget deficits in relation to GNP by restraining public expenditure in particular. External pressures and continuing concern over inflation have also induced the French authorities to maintain tight fiscal policies, aimed at holding the central government deficit in the current year to 3% of GDP, while in Italy the authorities intend to reduce public borrowing as a percentage of GDP.

Additional perspective on the stance of fiscal policy can be gained if changes in the size of the budget deficit are considered in the light of economic activity, and of the 'inflation tax' levied on holders of public sector debt. For example, it is estimated that the strength of the recovery in the United States would, in itself, have reduced the budget deficit last year as compared with the previous year. The direct impact of other changes in Federal revenue and expenditures might be regarded as expansionary in 1982 and 1983, although the size of actual and prospective deficits will also have held interest rates in the United States higher than they otherwise would have been so that the total effect on activity is less clear. This year, the whole of the projected reduction in the Federal deficit can be ascribed to the further growth of the economy. In the other major overseas economies, little of the prospective fall in German and Japanese deficits can be ascribed to cyclical factors, while the continued weakness of activity in France and Italy would in itself tend to increase the size of their deficits. In France and Italy, however, inflation and thus the 'inflation tax', may be lower this year than last. Elsewhere there may be little change, in marked contrast to 1981 and 1982 when rapidly falling inflation meant that the erosion of the real value of public sector debt in private hands slowed down and fiscal policy became, on that account, less contractionary. Taking account of cyclical factors and inflation, fiscal policy in the major overseas countries is likely to provide modest restraint on growth this year, as in 1983.

World inflation—*tending to flatten out*

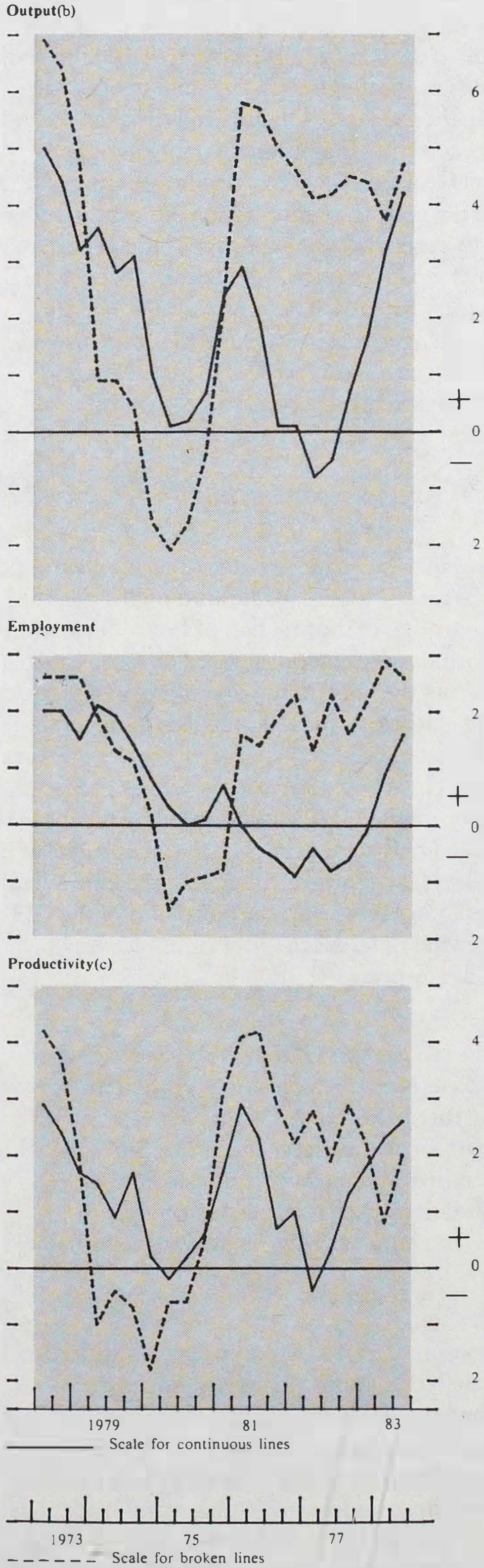
Consumer prices in the OECD area were, on average, 5.2% higher in 1983 than in the previous year, the lowest annual increase since 1972. However, inflation did not fall much during the year, and some short-term comparisons which were showing very low rates of increase a year ago have since moved back up towards 5% per annum. The inflation rates of individual countries remain dispersed, with some of the smaller OECD members still experiencing very high rates.

The deceleration in consumer prices has been better sustained after the second oil shock than after the first (see chart). This improvement has been associated with lower increases in wages, and although the more protracted recession has meant somewhat lower productivity gains until recently, profit margins have recovered more in the first phase of the current recovery than they did in 1975–76. Unit labour cost increases are now very low and further improvement may be hard to achieve. The deceleration in earnings may have come to an end, particularly where labour markets have tightened, and productivity gains may fade as more countries pass the initial stage of recovery.

Recent short-run movements in inflation probably owe most to commodity prices. Non-oil commodity prices, having reached an

Output, employment and productivity in the major economies[(a)] since 1973

Percentage change on a year earlier



(a) Canada, France, Germany, Italy, Japan, United Kingdom and United States; GNP weights.

(b) GNP.

(c) Output per man, whole economy.

unsustainably low level at the end of 1982, increased rapidly, but have since levelled off. When expressed in SDR terms, to minimise the influence of exchange rate movements, the Economist all-items index rose by some 26% over the first three quarters of 1983; in the fourth quarter, by contrast, it rose by less than 1% and by end-February it stood 2% below its end-1983 level. The earlier increases were thought to have reflected an unexpectedly rapid increase in demand, together with supply shortages in several markets (often associated with abnormal weather patterns). The prospect of more normal food supplies together with an increasing response of production to continuing, but only moderate, growth of industrial demand for commodities helps to explain the recent levelling off in prices, and might even indicate some fall in real prices this year. Such behaviour would be fairly characteristic of previous cycles (see chart on page 10).

Oil prices (in the increasingly important spot market) have recovered from the low point reached a year ago. The prospect this year is for some increase in demand for oil with the effects of higher world activity not entirely offset by the continuing impact of past oil price increases.

Recovery in industrial countries *is still uneven and muted*

Since the trough of the world recession in the final quarter of 1982, activity in the industrialised countries has picked up: in the year to the fourth quarter of 1983, GNP in the major seven industrial countries is estimated to have risen by around 4%. Growth has been most rapid in North America, but is also underway in Germany and Japan. Recovery has yet to be established in France and Italy, where inflationary pressures are still strong. Unemployment, having risen strongly from 1979 to 1982, has now fallen steeply in North America, but only flattened out in Europe.

Private consumption, which had been growing slowly throughout the recession, accelerated in the course of last year and made the biggest contribution to growth. Increases in consumption have reflected both rising real personal disposable incomes and falling saving ratios (fostered perhaps by lower inflation). In the United States, real disposable incomes have benefited directly from tax cuts and from a recovery in employment, while lower interest rates have encouraged borrowing for consumer durables and hence a fall in the saving ratio. In the major economies of continental Europe, by contrast, real personal disposable income has been more sluggish, but in Germany it rose by $1\frac{1}{4}\%$ in the course of 1983 (and consumption rose by $1\frac{1}{2}\%$).

The largest swings in demand have been in stockbuilding and fixed investment. Destocking had contributed to the depth of the recession at the end of 1982 but by the end of last year stocks were being rebuilt. Residential investment, having been hit by high nominal interest rates, recovered last year. In addition, business investment made an increasing contribution to GNP growth in the course of 1983. This is no doubt associated, especially in North America and Germany, with a revival in corporate profitability and with tax incentives, and may also reflect an improvement in business confidence induced by the sustained reduction in inflation. On the other hand, net external trade has continued to hold back growth in the major countries as a whole. Non-oil

Demand in the major overseas economies

Contributions to GNP growth in the year to 1983 Q4; percentage points

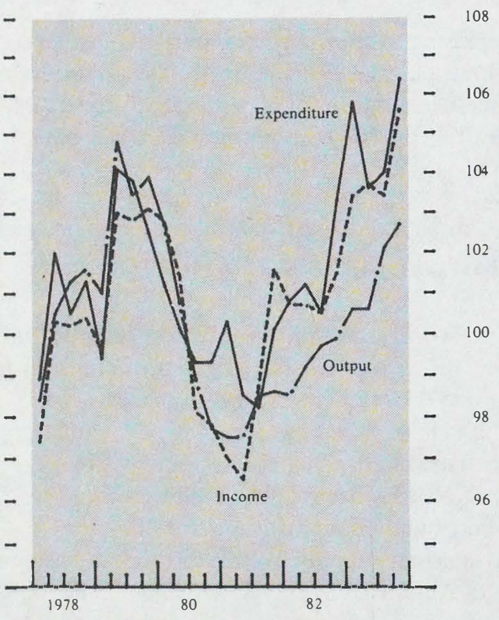
	North America	Japan	Germany	France	Italy(a)
Consumption	3.3	1.2	0.8	0.3	—
Government expenditure	−0.4	0.3	0.1	0.1	0.1
Fixed investment	2.4	0.3	1.0	−0.5	−0.8
Stockbuilding	2.0	—	2.0	0.1	—
Net external trade	−1.1	1.9	−0.7	0.6	1.2
GNP growth	**6.1**	**3.6**	**3.2**	**0.6**	**0.5**

(a) Partly estimated.

Measures of GDP *show different rates of growth in the United Kingdom.*

Seasonally adjusted

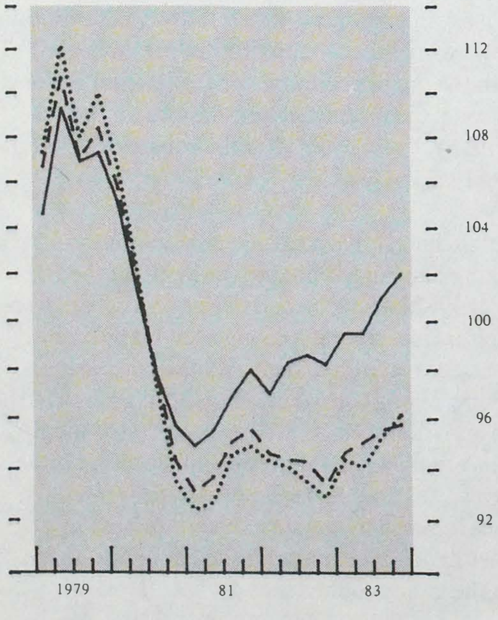
1980 = 100 (logarithmic scale)



North Sea oil and gas accounts for much of the recovery in **industrial production.**

.... Manufacturing
——— Production industries
— — Production industries, excluding oil and gas extraction

1980 = 100 (logarithmic scale)



developing countries have been reducing their real current account deficits in response to financing constraints, and oil exporting countries have cut imports following the fall in oil prices early in 1983.

Overall, the evidence that the recovery overseas is broadening out is still limited. If the estimates for the fourth quarter are correct, output in the major economies of continental Europe will have picked up by only $1\frac{3}{4}\%$ in the first year of recovery—a muted rise compared with previous cyclical upturns. The smaller OECD countries have also experienced only limited growth so far. With policy in the industrial countries if anything tending to tighten overall, and net external trade unlikely to provide a stimulus for the industrial countries as a whole, the continuation of the present recovery will depend to a great extent on business confidence, and corporate spending on fixed investment, stocks and labour. Some slowdown in North American growth seems likely; and faster growth in Europe. Even if average growth rates fall from now on, the pattern of growth may be no less favourable for UK exports, given the importance of markets in Europe.

The UK economy: *the recovery in output and demand is broadening . . .*

Estimates for the fourth quarter suggest that the output measure of GDP grew at an annual rate of some 2%, continuing the pace of recovery seen since the trough in the first half of 1981. The output measure again rose more slowly than those based on expenditure and on income, continuing the uncertainty about the precise scale of the recovery. Recent statistical work has tended to suggest not only that the output measure, GDP(O), has been a better measure of short-term movements in activity but also that it has been a better predictor of 'compromise GDP', as indicated by the mean of the three measures when finally revised.(1) The initial estimate of GDP(O) has nevertheless tended to underestimate the final average level by a small margin ($\frac{1}{2}\%$). However, the behaviour of the GDP measures may be somewhat different in the current recovery, which is unusual in some respects.

A significant part of the recovery in GDP, notably in the earlier stages, can be attributed to North Sea oil and gas production, now some 32% higher than three years ago. This accounts for about a quarter of output growth since the first half of 1981. Since the North Sea sector has comparatively few employees, and productivity in other industries has improved strongly, the prolonged rise in GDP has only recently begun to be reflected in a levelling out of employment.

There are signs that non-oil output may now be gathering pace. The annual rate of growth of manufacturing output between the three months to January and the preceding three months was over 5%. Surveys of manufacturing conducted by the Confederation of British Industry (CBI) in January and February suggested a widespread improvement in business confidence. There was a significant increase in the number of firms reporting better order books, and evidence that some recovery in output may now be occurring at the heavier end of industry.

(1) See 'The three measures of GDP' by Andrew Britton and David Savage, *National Institute Economic Review*, February 1984.

The UK economic recovery—some comparisons

The present economic upturn began in the first half of 1981. This note compares the contributions made by the different components of demand to recovery in the first $2\frac{1}{2}$ years of this and three preceding cycles. Cyclical troughs have been chosen on the basis of the output estimate of GDP, generally regarded as the best available measure of short-term movements in output; the base periods chosen accord fairly closely with the troughs suggested by CSO composite indicators (see footnote to the chart).

The rise in GDP has been slower in the present upturn than in its predecessors (Table 1). (The upturn starting at the end of 1971 was already past its peak after $2\frac{1}{2}$ years.) Two features stand out. First, the rise in total domestic demand in the current upturn has not been slow. Second, there has been a substantial worsening in real net exports, in contrast even with this stage of the strong domestic recovery in the early 1970s.

Table 1
Contributions to GDP growth

Contributions to the percentage change in GDP

	Recoveries(a)			
	1966–1969	1971–1974	1975–1978	1981–1983
Consumer spending	4.1	4.4	3.7	4.5
Government spending	–0.4	1.8	0.3	1.3
Fixed investment	2.2	0.2	0.8	2.0
Stockbuilding	0.8	3.2	2.3	2.6
Domestic demand	**6.7**	**9.6**	**7.1**	**10.3**
Exports	4.4	5.7	4.8	1.3
Imports (increase –)	–3.9	–5.3	–2.3	– 4.7
Net exports	*+0.5*	*+0.4*	*+2.5*	*– 3.4*
Factor cost adjustment (increase –)	–0.6	–0.9	–1.9	– 1.2
GDP (E)(b)	**6.9**	**9.0**	**8.0**	**5.8**
GDP (O)	**8.5**	**8.2**	**7.5**	**5.1**
Memoranda:				
GDP (O), excluding North Sea activity	*8.5*	*8.2*	*4.7*	*3.7*
Net exports, excluding oil	..	*+0.4*	*+0.1*	*– 4.9*

(a) The figures in the table relate to the contributions to GDP growth over a $2\frac{1}{2}$ year period, starting in the half-years listed in the footnote to the chart.

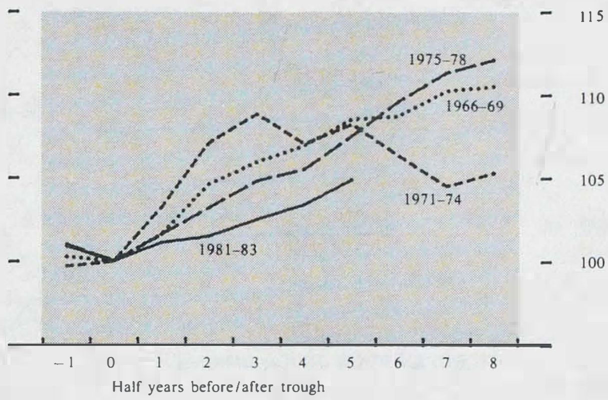
(b) At factor cost. Prior to 1978, expenditure components do not sum to GDP (E) owing to the method of rebasing to 1980 prices.

The individual contributions to the rise in domestic demand are roughly in line with previous experience. In respect of consumption, however, the underlying forces have been strikingly different on this occasion. Almost the whole of the recent rise in consumer spending has been associated with a fall in the saving ratio, with real personal disposable income as conventionally measured growing only slightly (see also page 15).

Fixed investment has contributed to domestic demand, as has stockbuilding (though without the large additions to stocks seen in earlier cycles). About one-third of the growth in fixed investment since early 1981 has been in the form of dwellings, mainly in the private sector. Private industrial investment has grown steadily; within this, manufacturing investment has fallen substantially, while capital expenditure by distribution and services industries has been remarkably buoyant.

Recent recoveries compared

Indices, cyclical trough = 100(a)



(a) Based on output estimate of GDP. The cyclical troughs were as follows:

Recovery	Trough chosen (half years)	Composite indicator trough
1966–69	1966 Q4–1967 Q1	Mar. 1967
1971–74	1971 Q4–1972 Q1	Feb. 1972
1975–78	1975 Q3–Q4	Aug. 1975
1981–83	1981 Q1–Q2	May 1981

Exports of goods and services have risen only slowly over the past $2\frac{1}{2}$ years. Cost competitiveness will undoubtedly have been a factor, although it has improved considerably since 1981. In addition, UK export markets were little better than flat over the period. Earlier upturns coincided with more favourable competitiveness and export market growth. Lack of competitiveness will also have contributed to the rise in imports of goods and services, equivalent to about half the rise in domestic demand: the volume of non-oil imports has risen by about one-quarter, imports of manufactured goods rising by over 30 per cent.

As both exports and imports have benefited from North Sea oil, the deterioration in the rest of UK trade has been even more marked. GDP excluding output from the North Sea sector has risen by less than 4 per cent since the first half of 1981; and with imports meeting such a large proportion of UK demand for manufactures, output in the manufacturing sector has risen by little more than $3\frac{1}{2}$ per cent over the same period.

Table 2
Real incomes and consumer spending

Percentage change

	Recoveries(a)			
	1966–1969	1971–1974	1975–1978	1981–1983
Real personal disposable income	5.0	11.4	3.2	1.3
Consumer spending	6.2	6.4	5.5	6.4

(a) Periods are as described in the footnote to the chart.

Contributions to the change in GDP

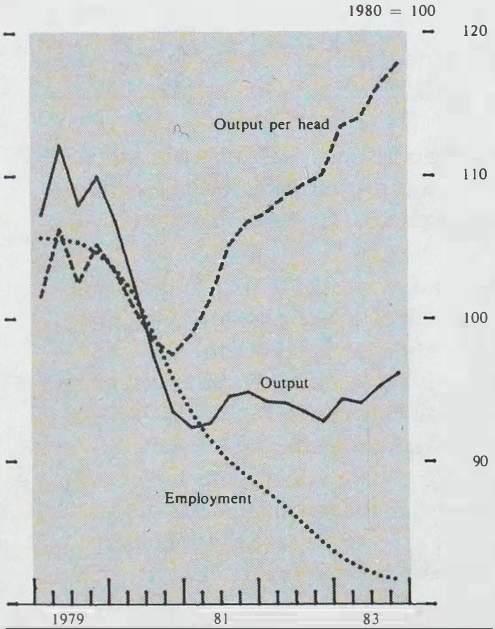
Percentage change on previous quarter

	1983			
	Q1	Q2	Q3	Q4(a)
Consumer spending	−0.1	+1.1	+0.8	+0.3
Government consumption	+0.5	−0.4	+0.3	+0.3
Fixed investment	+0.7	−0.6	+0.3	+0.3
Stockbuilding	+2.5	−1.2	−0.1	+0.8
Exports	—	−0.2	+0.6	+2.0
Total final expenditure	+3.7	−1.4	+0.7	+3.7
Imports	−0.9	−0.5	−0.2	−1.4
Factor cost adjustment	−0.2	−0.2	−0.1	—
GDP(E)	**+2.6**	**−2.0**	**+0.4**	**+2.3**
Memo item				
GDP(O)	*+0.6*	*+0.1*	*+1.5*	*+0.5*

(a) Provisional.

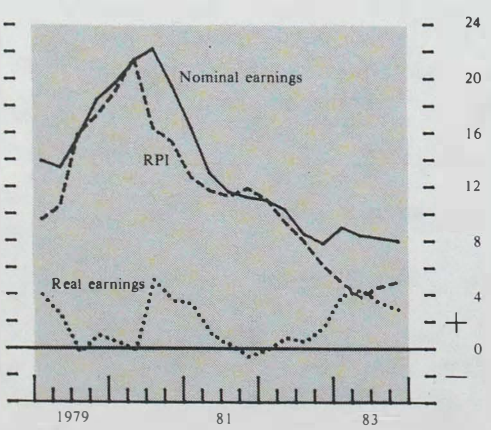
With **productivity in manufacturing** *rising rapidly, growth in* **output** *has been insufficient to reverse the fall in* **employment**.

1980 = 100



Real earnings[(a)] *continue to rise.*

Percentage change on previous year



(a) Whole economy.

Although improving, the situation remains unsatisfactory, with almost one-third of firms reporting order books below normal.

Unlike previous stages of the recovery, much of the increase in demand in the fourth quarter was due to exports. Stockbuilding and industrial fixed investment were stronger than in the previous six months, but personal consumption was less of an expansionary element than previously. More recently, retail sales were down sharply in January but (on provisional figures) recovered some of this fall in February; in the latest three months sales were up just over 4% on the same period last year.

A comparison of the present recovery with similar phases in the past two decades (see page 13) shows that the present upswing in output has been comparatively slow; exports have contributed much less than in previous upswings, while imports have met a sizeable part of the rise in domestic demand. This cycle is, however, different from previous ones in that recovery this time came earlier here than overseas and owes less than in the past to stimulative policies.

. . . but **unemployment** *still seems to be rising*

Total employment may have increased slightly during the course of last year but the improvement in the labour market has been more modest than appeared some months ago; the fall in manufacturing employment may have slowed. In the second half of last year, adult unemployment (seasonally adjusted) showed little net movement month by month, but the underlying picture was obscured by the impact of special employment measures and changes in coverage. Selective employment and training measures may have reduced the increase in the 'headline' unemployment total (unadjusted, including school-leavers) by around 140,000 between June and October; but many of these were school-leavers joining the Youth Training Scheme. The rise in the (seasonally adjusted) total, excluding school-leavers, in January and February, at nearly 30,000 per month, is similar to the trend up to last spring but part of the increase may reflect the volatility of the statistics. And the strong rise in vacancies seen earlier last year has fallen away, although this reflects in part the influence of the Community Programme.

Real earnings *growth continues but productivity gains are containing wage costs. . .*

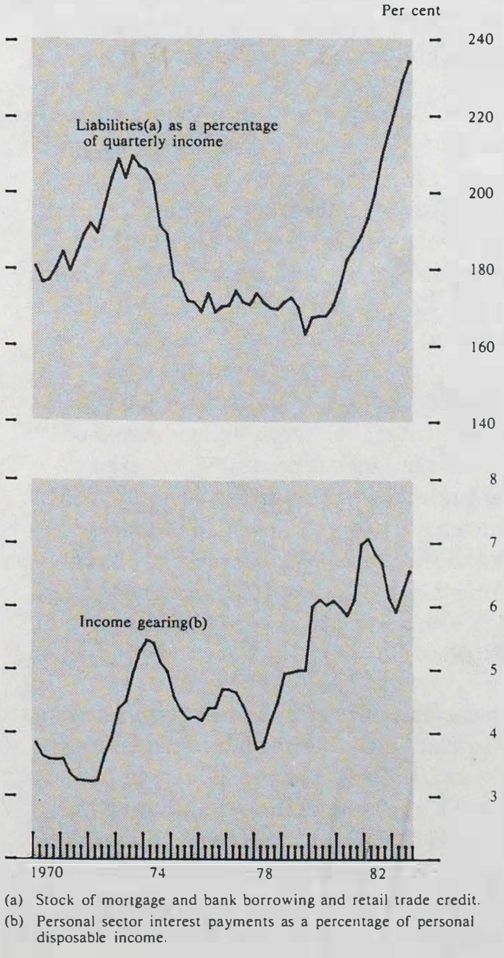
Pay settlements in the current round are averaging 5%–6%, much the same as last year, although it is too early yet to be sure about the trend. In January, average earnings in the whole economy (adjusted for back pay, etc) were up 7¾% on a year earlier, the same rate as in the previous five months, and still well ahead of inflation. For some while now the rise in manufacturing earnings (9½%) has been faster than in total earnings reflecting, it appears, a combination of more overtime and bonus payments related to output. During 1983, productivity gains in the economy at large were sufficient to contain the growth in unit wage costs. For manufacturing industry the picture has been striking; in the year to the fourth quarter of 1983, output per head was up 7% and unit wage costs rose by about 2¾%. This period also saw a significant improvement in profit margins. With input prices, notably of imported goods, picking up towards the end of the year, margins may have narrowed a little in the fourth quarter, although perhaps not in the export sector.

Personal income and saving

	Conventionally measured	Adjusted for inflation losses(a)	Adjusted for inflation losses, and *less* net contributions to life and pension funds
Real disposable income, *1980=100*			
1979	98.6	100.5	100.5
1980	100.0	100.0	100.0
1981	97.5	97.6	97.5
1982 H1	97.4	99.2	99.9
H2	96.7	99.2	99.8
1983 Q1	96.5	99.2	98.8
Q2	97.9	101.4	102.4
Q3	98.8	102.8	104.3
Saving ratio(b)			
1979	12.8	7.5	−1.7
1980	14.5	7.5	−1.7
1981	12.1	5.0	−4.6
1982 H1	11.9	6.5	−2.3
H2	9.2	4.2	−4.7
1983 Q1	8.4	3.6	−6.4
Q2	8.2	4.1	−4.4
Q3	7.9	4.3	−3.8

(a) See the December 1983 *Bulletin*, page 467.
(b) As a percentage of income similarly adjusted.

High personal sector **income gearing** *reflects the* **ratio of debt to income.**



(a) Stock of mortgage and bank borrowing and retail trade credit.
(b) Personal sector interest payments as a percentage of personal disposable income.

. . .*and progress against* **inflation** *has been sustained*

The recent rate of increase of both retail and producer prices has continued steadily, with little sign of acceleration. The increase in the twelve-month measure of retail price inflation, from a low point of $3\frac{3}{4}\%$ in mid-1983 to about 5% by the end of the year, was more a reflection of price movements a year earlier than of recent developments. Budget changes (see page 21) will add 0.7% to the retail price index (a little more than in 1983) but this will be partially offset by the impact of the 1 percentage point reduction in building society mortgage rates following the Budget.

The personal sector *continues to spend and borrow heavily*

Fairly strong growth of consumers' expenditure continued throughout 1983. Only recently has real personal disposable income (RPDI)—as conventionally measured—recovered a little: until mid-1983, the growth of consumer spending was accompanied by a large fall in the saving ratio, encouraged by falling inflation.

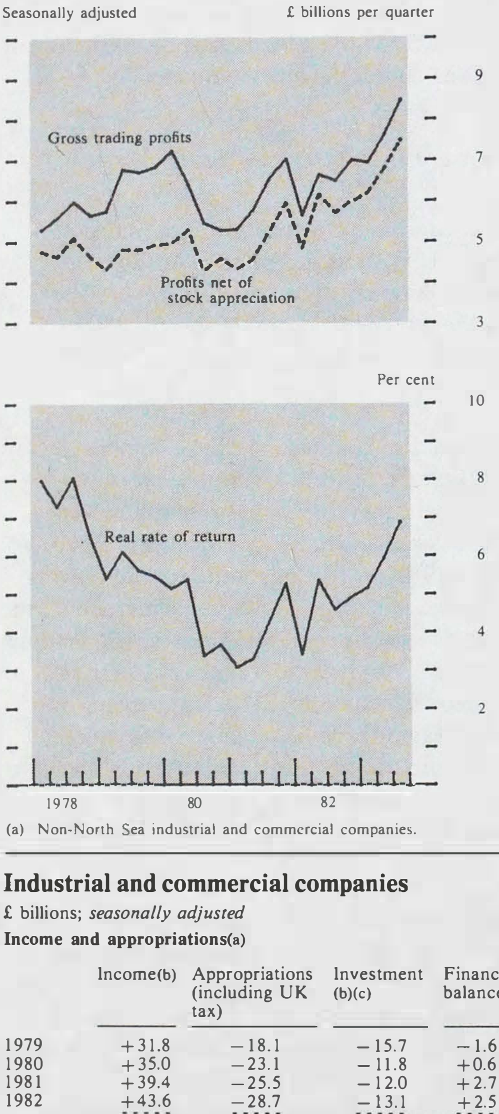
Some insight into what has been happening can be obtained by subtracting from RPDI (and thus from saving) the erosion in the real value of net liquid assets; this erosion has recently become smaller as inflation has slowed down. RPDI adjusted in this way has risen quite fast since 1981, and the fall in the adjusted saving ratio has been much less than in the conventionally measured ratio. If a further adjustment is made, by removing the net contributions to life assurance and pension funds to yield a measure closer to (inflation-adjusted) personal income available for spending or discretionary saving, the saving ratio has changed little since 1981.[1] These adjusted figures imply that people are now spending more of their incomes because, with lower inflation, they do not need to save as much as before to maintain the real value of their net liquid assets.

The fall in the saving ratio in the last three years has been accompanied by higher borrowing rather than lower holdings of financial assets. The bulk of the increase has been in the form of mortgage borrowing, three-quarters of which is from building societies. The flow of net borrowing from societies rose by about 40% from £8.1 billion in 1982, to over £11 billion in 1983. Reflecting this, the ratio of personal sector (gross) liabilities, including mortgages, to income is now above its peak of the early 1970s; and Bank estimates suggest that the proportion of personal sector disposable income spent on (gross) interest payments remains historically high, at $6\frac{1}{2}\%$, even though interest rates are now well below their 1980 peak. From the end of 1980 to the third quarter of last year, personal sector indebtedness rose by nearly £50 billion, about £35 billion of which was recorded as borrowing for house purchase, the remainder being extra consumer credit and other personal sector borrowing. Personal holdings of (gross) liquid assets have also grown substantially, by more than £45 billion, over this period. More than half of this increase was in building society deposits.

The large increase in personal indebtedness since 1980 may be attributable in part to the fall in the cost of servicing debt associated with the reduction in interest rates since the autumn of

(1) On this measure the saving ratio is negative; ie if contributions to life assurance and pension funds are left out, the personal sector is dissaving.

Profits *and* **real profitability** *have improved considerably.*[a]



(a) Non-North Sea industrial and commercial companies.

Industrial and commercial companies

£ billions; *seasonally adjusted*

Income and appropriations(a)

	Income(b)	Appropriations (including UK tax)	Investment (b)(c)	Financial balance
1979	+31.8	−18.1	−15.7	−1.6
1980	+35.0	−23.1	−11.8	+0.6
1981	+39.4	−25.5	−12.0	+2.7
1982	+43.6	−28.7	−13.1	+2.5
1983 Q1	+12.3	− 7.7	− 3.8	+1.1
Q2	+12.3	− 7.8	− 3.5	+1.1
Q3	+13.8	− 7.7	− 3.6	+2.6

Financial transactions (inflows +)

	Financial balance	Identified financial trans-actions(d)	Balancing item	**Net borrowing require-ment**	*of which bank borrowing* (e)
	1	*2*	*3*	*columns 1+2+3*	
1979	−1.6	−2.2	−1.5	**−5.3**	*4.0*
1980	+0.6	−4.7	−1.6	**−5.7**	*6.3*
1981	+2.7	−4.7	−0.7	**−2.7**	*5.7*
1982	+2.5	−6.0	−3.2	**−6.7**	*6.8*
1983 Q1	+1.1	−0.6	−1.3	**−0.8**	*−0.7*
Q2	+1.1	−1.4	−0.2	**−0.5**	*0.3*
Q3	+2.6	−2.0	−2.9	**−2.3**	*1.6*

(a) Some items are omitted from the table.
(b) Net of stock appreciation; before depreciation.
(c) Fixed capital and stocks.
(d) Trade credit etc, investment abroad and in UK company securities.
(e) Includes Bank of England transactions in commercial bills.

1981, but a more important influence has probably been the much enhanced availability of credit (at existing interest rates). The relaxation of controls affecting lending institutions, beginning with the ending of the supplementary special deposits scheme in mid-1980, was an important factor. Also important has been greater competition among building societies and banks, in mortgage lending and in the attraction of deposits, from which the personal sector has benefited considerably. Banks and building societies have improved the range of liquid assets offered and reduced the (post-tax) margin between borrowing and lending rates faced by persons. In this process, rationing of credit to individual borrowers has become less prevalent and individuals now have more opportunity to adjust their borrowing and liquid asset holdings to desired levels.

The increased supply of mortgage credit has helped recovery in the still depressed housebuilding sector. Private housing starts rose by nearly 20% in 1983 to reach their highest level for ten years. House prices, adjusted to exclude effects of changes in the mix of houses sold, continue to rise at an annual rate of 10%–12%, with no acceleration apparent.

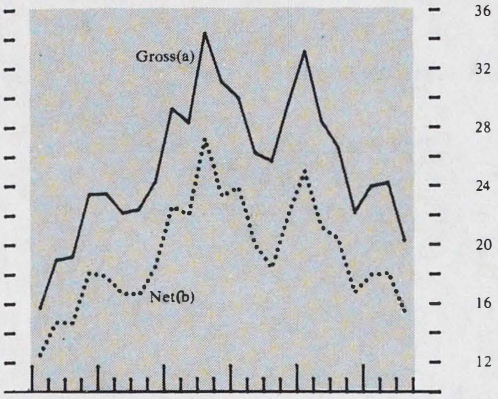
Company sector finances *have improved further*

The profits of industrial and commercial companies are estimated to have risen quite strongly in the third quarter of last year. The real pre-tax rate of return to non-North Sea companies was then close to 7%, more than double its level in early 1981. This recovery still leaves profitability below the levels of the late 1970s, and far short of the rates that were common before 1973. Margins may have narrowed a little in the fourth quarter, but profits will have benefited from the slightly faster pace of industrial activity.

Company appropriations rose only slowly, even in nominal terms, over the first three quarters of 1983. After growing strongly until early 1982, when they were high in relation to profits, dividend payments did not respond to the further rise in profits. Interest payments were held in check by lower interest rates last year, and company income gearing, in both gross and net terms, has fallen very sharply since early 1982 (see chart on page 17). With UK taxes and profits due abroad also rising slowly, companies' undistributed income has increased rapidly—to just over £15 billion (excluding stock appreciation) in the first three quarters of 1983, nearly 50% higher than in the corresponding period of 1982. At the same time, capital spending has been subdued, even in nominal terms, at least until the fourth quarter when provisional figures suggest that the recovery foreshadowed in CBI and Department of Trade and Industry (DTI) surveys may have begun. Manufacturing investment rose by over 4½% in the quarter, and there was a turn-round from destocking to stockbuilding by manufacturers and distributors.

These developments have allowed a substantial improvement in the financial position of companies. On the available figures, their financial surplus was over £6 billion at an annual rate in the first three quarters of 1983, a substantial turn-round from the £1½ billion deficit in 1979. The financial counterparts to the estimated company sector surplus are difficult to identify precisely. If account is taken of company borrowing from banks and elsewhere, together with known placements of funds at home and abroad, there is a large unidentified residual—£6 billion at an

Companies' **income gearing** *has fallen back.*



(a) Gross interest payments as a percentage of income net of stock appreciation, tax payments and profits due abroad.
(b) Net interest payments as a percentage of non-interest income net of stock appreciation, tax payments and profits due abroad.

UK current account
£ billions; *seasonally adjusted*

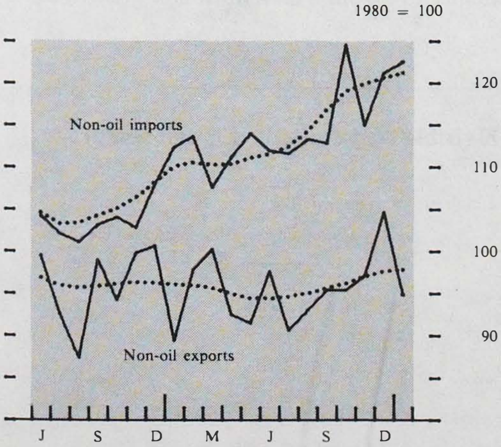
	1981 Year	1982 Year	1983 Year	Q3	Q4
Visible balance	+3.7	+2.4	−0.5	−0.2	—
of which:					
Oil	*+3.1*	*+4.6*	*+7.0*	*+1.5*	*+2.1*
Manufactures	*+4.8*	*+2.5*	*−2.1*	*−0.5*	*−0.6*
Other(a)	*−4.3*	*−4.7*	*−5.4*	*−1.3*	*−1.5*
Net invisibles	+3.6	+3.2	+2.5	+0.9	+0.3
of which:					
Services	*+4.2*	*+3.9*	*+4.4*	*+1.0*	*+1.0*
IPD	*+1.3*	*+1.4*	*+0.5*	*+0.3*	*+0.1*
Transfers	*−2.0*	*−2.1*	*−2.3*	*−0.4*	*−0.8*
Current balance	**+7.3**	**+5.6**	**+2.0**	**+0.7**	**+0.3**

(a) Food, drink and tobacco; basic materials; non-oil fuels; miscellaneous items.

Exports *have shown an underlying improvement recently;* **imports** *remain very high.*

At 1980 prices, including erratic items

.... Estimated trends



annual rate in the first three quarters of 1983. It is unclear how far this reflects overestimation of company incomes or underestimation of their spending or appropriations, or errors in measuring their acquisition of financial assets. Errors of this magnitude highlight the statistical problems that pervade the company sector accounts.

Notwithstanding these problems, company balance sheets have clearly strengthened in aggregate over the past two years. Identified financial transactions point both to a sizeable buildup in their liquid assets and to a sustained improvement in their net liquidity, confirmed independently by DTI and CBI surveys. Companies' bank borrowing was low in the early part of 1983, but has risen somewhat since. This upturn is not easy to explain in relation to their easier financial position; it may represent borrowing by businesses that have yet to benefit from improving economic conditions, and preparations by others for higher capital spending if the recovery lasts. Some support for this latter view may be drawn from the parallel, and even more marked, rise in companies' bank deposits in the second half of last year, more particularly in the fourth quarter.

The current account *surplus has been eroded by faster recovery at home*

The current account surplus, at £2 billion in 1983, was down by £3½ billion from the previous year. This deterioration reflects the earlier recovery here compared with most of our trading partners; and competitiveness, despite substantial improvement in the last three years, is still less favourable than it was before the large adverse movement at the end of the 1970s.

On visible trade, the surplus of nearly £2½ billion in 1982 became a deficit of £½ billion in 1983. The balance of trade in non-oil goods deteriorated by even more, reflecting primarily a sizable (£4½ billion) worsening in net trade in manufactures over the year. The UK's traditional surplus on manufacturing trade disappeared, following a long deterioration. The growing non-oil deficit was partly offset by a strongly-expanding oil surplus.

The surplus on invisibles is estimated to have fallen last year by some £¾ billion to £2½ billion. Net investment earnings fell by nearly £1 billion, to £½ billion, as a general recovery in domestic profits was also reflected in higher earnings on foreigners' direct investment (both oil and non-oil) in the United Kingdom; these grew more rapidly than UK income from investment abroad. There was, however, a small improvement in the services balance despite the UK's unfavourable cyclical position relative to other countries. Higher net earnings from travel and financial services more than offset a reduction in net shipping receipts as the UK share of the world fleet further declined. Net transfer payments abroad rose £0.2 billion to £2.3 billion. (Trade in services is discussed on page 34.)

A lower current account surplus had been widely predicted for last year; the outturn, particularly on trade account, was less unfavourable than expected. The volume of manufactured exports (excluding erratic items) increased 9% in the fourth quarter and there was a sharp increase in oil exports. Exports fell back sharply in January, but the underlying level in recent months represents a clear improvement from mid-1983.

The geographical distribution of UK visible trade[1]

Recent years have seen a decline in the United Kingdom's share in world trade. In 1970, for example, UK exports accounted for 7% of the value of total world imports, a share which had fallen to 5% by 1982. In volume terms, the decline in share was even greater, UK export prices having risen faster than world prices over the period. Although UK imports have risen considerably faster than GDP, they too have shrunk in relation to world trade.

Substantial changes have occurred in the shares of UK trade in goods with the main overseas blocs of countries. Most strikingly, the European Community (EC) has become a much more important trading partner. In 1963, the EC took some 28% of UK exports; by 1983 this had risen to 44%, with an increase of eleven percentage points since the United Kingdom became a member in 1973, even though the current EC members' share in total world imports has fallen. The share of UK exports in our partners' total imports has risen from 6% to 8% since 1970 (Table 1). The United Kingdom has also become a more important export market for the EC, taking 9% of the exports of other EC countries, against 6% in 1970.

Table 1
UK exports as a percentage of total imports by each bloc

	1970	1982
European Community	6	8
Non-EC developed countries	7	5
of which:		
United States	*6*	*6*
Japan	*2*	*1*
OPEC	10	7
Centrally planned economies	6	3
Non-OPEC developing countries	6	4

Source: IMF, *Direction of Trade Statistics*.

Matching these changes, the non-OPEC developing countries and (since the early seventies) the non-EC developed countries now take a smaller share of UK exports, while we have imported a lot less from OPEC since North Sea oil came on stream.

Trade shares have generally evolved smoothly, although the value of imports from OPEC rose sharply in 1974 with oil prices. As the oil exporters spent some of their extra income, they became more important as an export market, and have to some extent remained so.

These developments are partly associated with the pronounced change in the commodity composition of our visible trade described in the December *Bulletin*. The rising share of EC markets in UK exports shown in Table 2 mostly reflects exports of oil (and food). Although a larger proportion of UK exports of manufactures now go to the EC, the growth is less pronounced than that in the other two categories. And the growth in the value of the UK's manufactured imports from other EC countries has been striking: between 1970 and 1983 such imports grew by a factor of 15, twice as rapidly as the rise in our manufactured exports to the other EC countries.

Table 2
Composition of UK visible exports
Percentages

		Exports to:							
		EC–10		Other developed		Rest of world		Total	
Commodity composition		1973	1983	1973	1983	1973	1983	1973	1983
Manufactures	1973	26		32		25		84	
	1983		25		22		19		66
Oil	1973	2		1		—		3	
	1983		13		7		—		21
Other	1973	5		4		3		13	
	1983		6		4		4		13
Total	1973	33		38		29		100	
	1983		44		33		23		100

Source: *Overseas Trade Statistics of the United Kingdom*.

The United Kingdom has lost market share mainly in countries which buy little of our oil. In these instances, in particular, the loss in market share is associated chiefly with performance in manufactured goods (Table 2). Exports of manufactured goods to non-EC countries accounted for only 41% of UK exports in 1983, compared with 57% ten years earlier.

With UK market shares unevenly spread between economic blocs, the distribution of growth in overseas markets may have an important bearing on total export demand. Thus in the last year or so GDP in North America and Japan has risen much more rapidly than in the major European countries; this is reflected in rather larger increases in exports to those markets in 1983. However, North America and Japan together took only 17% of UK visible exports: UK exports and output would thus benefit more from a resumption of growth in Europe.

Table 3
Changes in UK visible trade with the EC and rest of the world

Value in 1983 as a multiple of value in 1970

	Total trade	Manufactures	Food, drink and tobacco	Oil
Trading partner				
European Community:				
UK exports	11.0	7.7	13.8	93.2
UK imports	12.2	15.3	6.9	8.1
Rest of the world:				
UK exports	6.0	5.1	6.1	51.2
UK imports	5.4	7.1	2.5	5.8

Source: *Overseas Trade Statistics of the United Kingdom*.

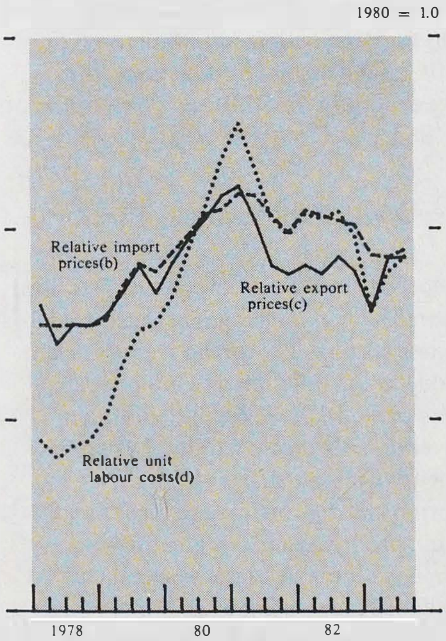
(1) This note complements one describing the commodity composition of UK trade in the December 1983 *Bulletin*, page 464. It relates only to the reported destination of exports and source of imports.

Domestic activity and non-oil visible imports

At constant prices; 1980 = 100

	1982		1983	
	H1	H2	H1	H2
Total domestic expenditure	101	101	104	106
of which:				
Consumer spending	*100*	*103*	*104*	*107*
Investment	*94*	*97*	*97*	*100*
Manufacturing production	94	93	94	96
Non-oil imports of goods	111	108	117	125
of which:				
Consumer goods	*115*	*111*	*120*	*131*
Food, drink and tobacco	*111*	*105*	*107*	*109*
Capital goods	*119*	*126*	*137*	*147*
Intermediate goods	*111*	*109*	*117*	*124*

Some of the loss of **competitiveness**[(a)] *in 1978–81 has since been recovered.*



(a) A reduction represents an improvement in UK competitiveness.
(b) Import prices in relation to manufacturers' domestic selling prices.
(c) Ratio of foreign manufacturers' prices to export prices of UK manufactured goods.
(d) Ratio of unit labour costs in UK manufacturing industry to the same abroad.

Imports continued to respond sharply to the increase in domestic demand last year, and on a broader front than might have been expected from the composition of demand. As in the previous year, consumers' expenditure—up nearly 4%—was the strongest element in domestic demand. But the 15¾% increase in non-oil import volume through the year (comparing second halves of 1982 and 1983) was fairly evenly spread between goods meeting final consumer demand and those satisfying industrial demand—capital goods and intermediate inputs like steel and chemicals. The sustained growth of imported industrial inputs in the face of sluggish domestic production implies a particularly sharp rise in import penetration in these goods. Excluding erratic items, non-oil imports were not much changed in January.

The growth in merchandise exports towards the end of last year probably owes something to the faster world recovery. But despite the recent pickup, non-oil exports probably grew less than world markets as a whole between 1982 and 1983. This may be partly because, so far, the world recovery has been concentrated in markets which do not absorb a large proportion of UK exports: North America and Japan together account for only about 17%. Clearly, from the UK's point of view, a broader recovery in overseas activity would be desirable. Recent trends in the direction of UK trade are described on page 18.

Some of the loss in (non-oil) market share at home and abroad may also be due to lagged effects of the large fall in competitiveness in 1978-80. Part of the loss has since been reversed. This has brought some improvement in UK exporters' profitability as labour costs have fallen in relation to those abroad; and lower export prices in relation to competitors' prices. Similar improvements have made home-produced goods more competitive in relation to imports. But it will take some time for these changes to work through fully to trade flows.

Public sector: *borrowing slightly above target, but budgeted to fall*

The public sector borrowing requirement (PSBR) for 1983/84, which had been projected at £8.2 billion (2¾% of forecast GDP) at the time of the March 1983 Budget, is now estimated at £10 billion (3¼% of GDP), unchanged from the forecast in the Autumn Statement. Even at this late stage of the financial year, this figure is still uncertain. The difference between the original projection and the outturn now expected is well within the average error of forecasts made at Budget time. It is mainly accounted for by much higher than expected local authority borrowing, while central government spending, particularly on non-cash-limited programmes, has exceeded last year's forecasts. Government receipts were a little larger than forecast, mainly because of the unexpectedly strong performance of North Sea revenue in the past six months.

In his Budget on 13 March, the Chancellor of the Exchequer forecast a PSBR of £7¼ billion for 1984/85 (2¼% of GDP). This represents a continuation of the steady reduction in the ratio of the PSBR to GDP laid down in the Medium-Term Financial Strategy (MTFS). The implications of the Budget for total revenue in 1984/85 are fairly small, beyond what would be needed to compensate for the effects of inflation on tax allowances etc in the past twelve months; but a number of changes are proposed which

Public expenditure planning totals in the 1984 White Paper[a]

	1983/84	1984/85	1985/86	1986/87
£ billions	120.3	126.2	131.6	136.2
Percentage increase on previous year	*6.1*	*4.9*	*4.3*	*3.5*

(a) Including changes made in the Budget.

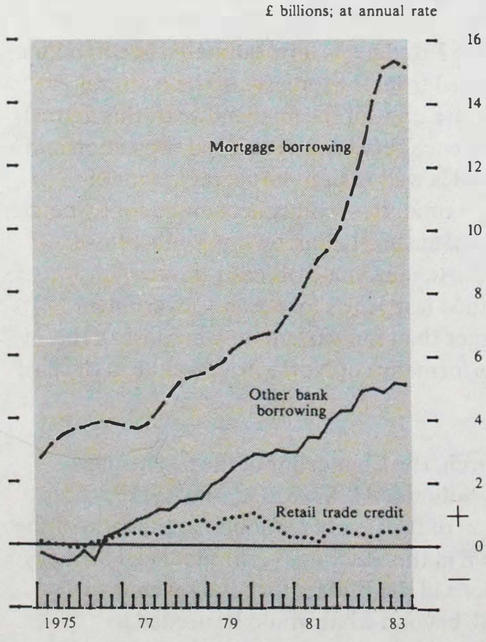
Sector financial positions: summary

£ billions

	1981 Year	1982 Year	1983 H1(a)	1983 Q3(a)
Financial surplus +/deficit −				
Personal sector	+13.7	+10.4	+ 6.8	+ 6.3
Industrial and commercial companies	+ 2.7	+ 2.5	+ 4.5	+10.5
Financial companies and institutions	− 0.7	+ 0.2	+ 0.6	− 0.7
Public sector	− 8.3	− 7.3	−10.1	−11.3
of which:				
Central government	*− 7.0*	*− 6.7*	*− 8.3*	*−10.6*
Local authorities	*+ 0.1*	*+ 1.1*	*− 0.9*	*− 0.7*
Public corporations	*− 1.5*	*− 1.7*	*− 0.9*	*− 0.1*
Overseas sector	− 7.3	− 5.6	− 2.1	− 2.6
Residual error	− 0.1	− 0.2	+ 0.3	− 2.2

(a) Seasonally adjusted, at an annual rate.

The flow of **personal sector borrowing,** *chiefly on mortgage, has expanded rapidly.*



would improve the neutrality of the tax system with respect to different categories of saving and investment. (Budget measures are summarised on page 21.)

The government's latest plans for public expenditure (defined to include asset sales as negative expenditure) were published in a recent White Paper (Cmnd 9143, February 1984), and have since been marginally revised to incorporate Budget changes. Public expenditure is projected to show only moderate growth in current price terms over the next few years, with annual percentage increases declining from 5% in 1984/85 to 3½% in 1986/87. On the assumptions for inflation underlying the MTFS, these plans imply that the volume of expenditure should be broadly flat for the coming three years. Although no detailed expenditure projections have been made beyond this period the MTFS also assumes that the planning total will remain unchanged in real terms until 1988/89. Taking these plans together with assumptions on government receipts and other public sector transactions, the MTFS implies a progressive decline in the PSBR as a proportion of nominal GDP, to 1¾% by 1988/89.

Intermediation *has been boosted by changes in sector finances*

Developments in the real economy in the past two years, described earlier, have been accompanied by major changes in the financial positions of the main economic sectors. The public sector's deficit has increased. The large reduction in inflation and interest rates, and the increased availability of credit, have permitted a major reduction in saving (as conventionally measured) by the personal sector. Financial and competitive pressures have brought rationalisation, improved productivity, spending cutbacks and destocking by companies, and produced a major and growing financial surplus in the company sector. And the external current account surplus has been reduced (equivalent to an improvement in the financial position of the overseas sector); this has come about because the recovery of demand, led largely by personal consumption and a considerable slowdown in destocking, has increased imports without a corresponding rise in export demand. The improvement during 1983 in the combined financial positions of the company and overseas sectors was financed about equally by the personal sector and the public sector, which each showed a deterioration of some £3–4 billion on 1982.

These shifts in financial balances have been accompanied by a general increase in the scale of financial intermediation, particularly in the second half of 1983. Some companies appear to have stepped up their borrowing while others were in healthy financial surplus; and the personal sector maintained its borrowing at a high level but continued to add to its deposits with building societies. Increased intermediation may have stemmed from the narrowing of interest margins between lending and borrowing rates, a greater supply of credit at existing interest rates, and increased demands for liquid assets in the private sector either to restore holdings that had been depleted in real terms, or to prepare for increased capital spending as the recovery broadens. Greater disparities in financial positions within the corporate sector may also have been a factor tending to make for greater intermediation.

The banking system has shared to a rather uneven extent in the expansion of intermediation through the past year or so. While the

The Budget

The Budget is broadly revenue-neutral in 1984/85, with a net effect approximately equivalent to that of indexing allowances and duties in line with inflation. But revenues receive a non-recurring boost of £1.2 billion from the prompter collection of VAT on imports, starting in October. In a full year (when this and other timing effects have worked through) revenues would be lower by £1.7 billion (compared with an indexed base). The PSBR is forecast to fall from an estimated £10 billion ($3\frac{1}{4}$% of GDP) in 1983/84 to £$7\frac{1}{4}$ billion ($2\frac{1}{4}$% of GDP) in 1984/85.

Budget measures: direct effects on public sector transactions—change from indexed base[(a)]

£ millions at current prices; + indicates an increase in revenue

	Effect in 1984/85	Effect in a full year
Income tax allowances and thresholds	− 940	−1,470
Corporation tax rates, stock relief and capital allowances	− 280	− 250
Other income tax and other direct taxes	+ 190	+ 450
Stamp duties	− 450	− 460
National insurance surcharge	− 335	− 865
Value added tax	+ 375	+ 650
Excise duties	+ 200	+ 215
VAT: withdrawal of postponed accounting for imports	+1,200	—
Total	**− 40**	**−1,730**

(a) Effects compared with the case in which tax allowances and thresholds, specific duties etc are raised in line with inflation, and no other changes are made.

The main proposals

Several of the budget proposals directly affect **business taxation**. The last 1% of the national insurance surcharge will be removed in October; a progressive reduction in corporation tax, to 35% for profits earned after March 1986, will be accompanied by a phased elimination of first-year capital allowances; stock relief is ended forthwith. These and other changes (some affecting North Sea companies) are estimated to cause businesses to pay £500 million more tax in 1984/85 (mainly because of the change affecting VAT on imports) but to save them £1.4 billion in 1985/86.

Most **personal tax** allowances and thresholds rise in line with inflation (5.3% in the year to December 1983), but the basic allowances increase by $12\frac{1}{2}$%. Most **excise duties** are increased broadly in line with inflation, though by differing amounts (and the duty on wine is reduced in accordance with a judgment in the European Court). The base of **value added tax** is widened. As a direct effect, these changes in taxes on spending are estimated to raise retail prices by 0.7% (a slightly larger direct effect than in last year's Budget).

Various measures are proposed to remove anomalies in the treatment of **savings** and to promote the efficient working of **securities markets.** Life assurance premium relief is withdrawn on new contracts. The investment income surcharge is abolished and stamp duty is reduced to 1%. Most corporate fixed-interest securities are exempted from capital gains tax if held for more than twelve months. The composite rate treatment of interest from building societies will be extended to banks next year.

The Medium-Term Financial Strategy

The new target ranges for monetary growth are expressed in terms of narrow money (MO), for which the target in 1984–85 is 4%–8%, and broad money (sterling M_3), for which the target is 6%–10%: the targets are lowered in the illustrative ranges for the following four years. Attention will also be paid to other monetary indicators, particularly M_2 and PSL_2, and other available evidence, including the exchange rate, in interpreting monetary conditions. The PSBR is projected at about £7 billion for the next five years, falling from $2\frac{1}{4}$% of GDP in 1984/85 to $1\frac{3}{4}$% in 1988/89. Public expenditure, roughly constant in real terms, also falls as a proportion of GDP, in accordance with plans for 1984/85 to 1986/87 recently published in the Public Expenditure White Paper (Cmnd 9143).

Ranges for monetary growth[(a)]

Percentage change over target period at annual rate

	1984–85	1985–86	1986–87	1987–88	1988–89
Narrow money, MO	4–8	3–7	2–6	1–5	0–4
Broad money, sterling M_3	6–10	5–9	4–8	3–7	2–6

(a) Changes in the way the aggregates will be measured are described in a note on page 78.

Economic prospects

The rate of inflation is forecast to fall to $4\frac{1}{2}$% by the end of this year and to 4% by the middle of 1985. GDP is forecast to grow by 3% this year but more slowly in the first half of 1985: investment, stockbuilding and exports (helped by a revival of overseas markets) take over some of the earlier impetus from consumer spending. The current account is expected to stay in small surplus over the period to mid-1985; the effective exchange rate is assumed to remain broadly unchanged.

Projected contributions to the change in GDP[(a)]

Percentage change at an annual rate; *seasonally adjusted*

	1983 H2–1984 H1	1984 H1–1984 H2	1984 H2–1985 H1
Consumer spending	$+1\frac{3}{4}$	$+2\frac{3}{4}$	$+1\frac{1}{4}$
General government consumption	—	—	$+\frac{1}{4}$
Fixed investment	$+1\frac{3}{4}$	$+\frac{3}{4}$	+1
Stockbuilding	$+1\frac{1}{4}$	—	$+\frac{1}{4}$
Exports	+2	$+1\frac{1}{2}$	$+1\frac{1}{2}$
Imports (increase −)	$-2\frac{1}{4}$	$-1\frac{3}{4}$	$-1\frac{1}{2}$
GDP	**+4**	**$+3\frac{1}{2}$**	**$+2\frac{1}{4}$**

Source: *Financial Statement and Budget Report 1984–85.*

(a) Average measure at 1980 factor cost. Adjustments needed to derive the average measure at factor cost from the expenditure figures are omitted from the table.

Borrowing by domestic sectors[a]

£ billions

	1981	1982	1983		
	Year	Year	H1(b)	Q3(b)	Q4(b)
Personal sector					
Financial surplus +/deficit −	13.7	10.4	6.8	6.3	..
Total borrowing	14.5	19.4	19.8	20.8	..
of which:					
From banks	*6.3*	*10.1*	*8.5*	*9.3*	*8.1*
From building societies	*6.3*	*8.1*	*11.5*	*9.7*	*11.4*
Industrial and commercial companies					
Financial surplus +/deficit −	2.7	2.5	4.5	10.5	..
Total borrowing	9.7	9.9	5.8	12.1	..
of which, from banks(c)	*5.7*	*6.8*	*− 0.9*	*6.5*	*3.8*
Public sector					
Financial surplus +/deficit −	− 8.3	− 7.3	−10.1	−11.3	..
Total borrowing	10.7	5.4	13.1	10.4	10.0
of which, from banks	*− 0.3*	*− 2.2*	*− 2.0*	*− 3.3*	*− 0.5*
Memo item					
Total bank lending to UK domestic sectors(c)	*13.7*	*17.3*	*8.7*	*16.4*	*15.2*

.. not available.

(a) New borrowing net of repayments, in sterling and foreign currencies.
(b) Seasonally adjusted, at an annual rate.
(c) Includes Issue Department transactions in commercial bills.

personal sector maintained a very high rate of borrowing and asset accumulation, it relied rather more heavily on intermediation through building societies than through banks, compared with previous years. Industrial and commercial companies actually repaid debt to the banking system in the first part of 1983, before resuming borrowing on almost the previous scale in the second half of the year. Although the public sector borrowing requirement was higher in 1983 than 1982, it was still largely covered by debt sales outside the banking system—mostly to the personal sector, either directly through national savings or indirectly via sales of gilts to financial institutions outside the monetary sector. The counterpart of these various developments was an overall rate of bank lending to the UK private sector in 1983 somewhat lower in nominal terms than in 1982, but as high in the last three quarters of 1983 as in the same period of 1982.

While increased intermediation between private sector borrowers and lenders was thus an important source of growth of both sterling M_3 and broad liquidity (PSL_2) in 1983, the expansionary impetus from this source came much more in the second half of the year. The slowdown in the rate of growth of sterling M_3 in the second half of 1983 (see Table A on page 24) largely reflected the course of the public sector's contribution to the change in money stock (that is, intermediation between the private and public sectors). This is seen in the varying relationship between debt sales and the borrowing requirement through the year (see Table C on page 25).

At 12.3%, the pace of broad liquidity (PSL_2) growth between mid-February 1983 and mid- February 1984 was faster than that of sterling M_3 (9.7%), and PSL_2 tended to accelerate more sharply than sterling M_3 around the turn of the year. In part, this divergence may be attributed to the greater competitiveness of building societies in attracting personal sector deposits. The divergence also reflects in part the composition of debt sales: certain national savings instruments are included in PSL_2, and purchases of gilts by building societies may have been financed by building society liabilities also included in PSL_2. Another part reflects a rundown of bank deposits held by building societies in order to meet the demand for mortgages; such deposits are included in sterling M_3 but not in PSL_2. Monetary developments are described more fully in the following article.